STANDARD & POOR'S PUBLIC FINANCE

Publication date: 18-Feb-2004
Reprinted from RatingsDirect

Summary: Bonneville Pwr Admin, OR; Utility, Wholesale Electric

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Credit Profile

AFFIRMED	
Northern Wasco Cnty Peoples Util Dist, Oregon	
$30.245 mil. Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) (McNary Dam Fishway Hydroelec Proj)	AA-
Tacoma, Washington	
$17.660 mil. Tacoma (Bonneville Pwr Admin) rev rfdg util bnds (Conserv Sys Proj) ser 2003	AA-
Washington Pub Pwr Supp Sys, Washington	
$3.469,458 bil. Washington Pub Pwr Supp Sys (Bonneville Pwr Admin) (Nuclear Proj 1,2,3)	AA-
$82.250 mil. Washington Pub Pwr Supp Sys (Bonneville Pwr Admin) (Nuclear Proj 1-3) rfdg rev bnds ser 1997A dtd 09/01/1997 due 07/01/2004-2007 2018	AAA/AA-(SPUR)
$140.665 mil. Washington Pub Pwr Supp Sys (Bonneville Pwr Admin) (Nuclear Proj 1-3) rfdg rev bnds ser 1997A dtd 09/01/1997 due 07/01/2008-2017	AAA/AA-(SPUR)
$7.074 mil. Washington Pub Pwr Supp Sys (Nuclear Proj #3) rfdg rev bnds ser 93C dtd 9/23/93 due 7/1/2013 2014 2015 2017(CUSIP #939830RW7 RY3 RX5 RZ0)	AAA/AA-(SPUR)
Lewis Cnty, Washington	
$31.280 mil. Lewis Cnty rev rfdg bnds (Bonneville Pwr Admin) (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2007-2012	AAA/AA-(SPUR)
$104.650 mil. Lewis Cnty (Bonneville Pwr Admin) rev rfdg bnds (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2013-2024	AAA/AA-(SPUR)
Bonneville Pwr Admin, Oregon	
Energy Northwest, Oregon	
$2.380,680 bil. Energy Northwest (Bonneville Pwr Admin) Sub Lien	AA-
$208.755 mil. Energy Northwest Proj No. 3 rfdg elec rev bnds ser 2001-A dtd 03/22/2001 due 07/01/2001-2004 2010 2011 2017 2018	AAA/AA-(SPUR)
$157.260 mil. Energy Northwest columbia generating station rfdg elec rev bnds ser 2002-A dtd 02/25/2002 due 07/01/2017-2018	AAA/AA-(SPUR)
$177.105 mil. Energy Northwest proj #1 rfdg elec rev bnds (Bonneville Pwr Admin) ser 2002-A dtd 02/25/2002 due 07/01/2015-2017	AAA/AA-(SPUR)
$71.380 mil. Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin) (Project No. 1) ser 2002-A dtd 03/01/2002 due 07/01/2013-2014	AAA/AA-(SPUR)
$48.000 mil. Energy Northwest rfdg elec rev bnds (Columbia Gen Station) ser 2001-B dtd 05/09/2001 due 07/01/2018	AAA/AA-(SPUR)

$186.600 mil. Energy Northwest rfdg elec rev bnds (Columbia Generating Station) ser 2001-A dtd 03/22/2001 due 07/01/2013-2017	AAA/AA-(SPUR)
$23.600 mil. Energy Northwest rfdg elec rev bnds (Project No. 1) ser 2001-B dtd 05/09/2001 due 07/01/2017	AAA/AA-(SPUR)
$25.675 mil. Energy Northwest rfdg elec rev bnds (Project No. 3) ser 2001-B subseries B-3-1, B-3-2, B-3-3 dtd 05/09/2001 due 07/01/2018	AAA/AA-(SPUR)
Energy Northwest, Washington	
$18.100 mil. Energy Northwest (Bonneville Pwr Admin) columbia generating station rfdg elec rev bnds (Bonneville Pwr Admin) ser 2003 A dtd 04/10/2003 due 07/01/2010	AAA/AA-(SPUR)
$23.105 mil. Energy Northwest (Bonneville Pwr Admin) columbia generating station rfdg elec rev bnds ser 2003A dtd 04/10/2003 due 07/01/2010	AAA/AA-(SPUR)
$18.210 mil. Energy Northwest (Bonneville Pwr Admin) proj #1 rfdg elec rev bnds (taxable) ser 2003 B	AAA/AA-(SPUR)
$82.415 mil. Energy Northwest (Bonneville Pwr Admin) proj #3 rfdg elec rev bnds (Bonneville Pwr Admin) ser 2003 A dtd 04/10/2003 due 07/01/2012 2015	AAA/AA-(SPUR)
$70.000 mil. Energy Northwest (Bonneville Pwr Admin) proj #3 rfdg elec rev bnds ser 2003A dtd 04/10/2003 due 07/01/2011 2017	AAA/AA-(SPUR)
$200.485 mil. Energy Northwest (Bonneville Pwr Admin) rfdg elec rev bnds (Project No. 1) ser 2003C dtd 04/10/2003 due 07/01/2016-2017	AAA/AA-(SPUR)
$104.770 mil. Energy Northwest Proj No. 1 rfdg elec rev bnds ser 2001-A dtd 03/22/2001 due 07/01/2001-2002 2004 2007 2010-2013	AAA/AA-(SPUR)
$73.815 mil. Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin) (Columbia Generating Station) ser 2002-B dtd 04/17/2002 due 07/01/2018	AAA/AA-(SPUR)
$50.000 mil. Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin) (Columbia Generating Station) ser 2002-B dtd 04/17/2002 due 07/01/2018	AAA/AA-(SPUR)
$101.950 mil. Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin) (Proj No 1) ser 2002-B dtd 04/17/2002 due 07/01/2017	AAA/AA-(SPUR)
$50.000 mil. Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin) (Proj No 3) ser 2002-B dtd 04/17/2002 due 07/01/2016	AAA/AA-(SPUR)
$25.360 mil. Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin) (Proj No 3) ser 2002-B dtd 04/17/2002 due 07/01/2016	AAA/AA-(SPUR)
Conservation and Renewable Energy Sys, Washington	
$30.320 mil. Conservation and Renewable Energy Sys (Bonneville Pwr Admin) conserv prj rev rfdg bnds (Bonneville Pwr Admin) ser 2003 due 10/01/2014	AA-
Eugene, Oregon	
$58.326 mil. Eugene (Bonneville Pwr Admin) (Trojan Nuclear Proj)	AA-
OUTLOOK:	STABLE

Rationale

Standard & Poor's Ratings Services affirmed its 'AA-' rating on the debt of Energy Northwest (ENW) and certain other non-federal debt obligations (the rated obligations), which are secured by payments from the Bonneville Power Administration. The rating is not an issuer credit rating for Bonneville. The outlook was changed to stable from negative to reflect the cumulative affect of improved circumstances, including the increase in cash reserves to $511 million as of Sept. 30, 2003 from a low of $188 million as of Sept. 30, 2002, as well as the successful implementation of a 10.1% safety-net cost recovery adjustment clause (SN CRAC) starting Oct. 1, 2003 that is expected to generate about $125 million annually in additional revenues. The change in outlook also reflects the use of cash savings from the ENW debt optimization program to prepay treasury debt as intended, rather than towards meeting operating expenses.

Financial pressure on Bonneville resulting from unfavorable wholesale market conditions and higher than anticipated costs led to a deterioration of cash reserves to $188 million at the end of fiscal 2002 from $811 million at the end of fiscal 2000. Standard & Poor's revised the outlook on the rated obligations to negative from stable in March 2003 as a result of the significant customer resistance to an SN CRAC that would further increase rates in the economically struggling Northwest. Bonneville's customers demanded that the agency use the debt optimization savings generated at Energy Northwest to avoid rate increases instead of using the cash to prepay more expensive Treasury debt. Effecting such a proposal would have been tantamount to debt financing of operating expenses. While a number of utilities in the Northwest did exactly this in response to the western U.S. power crisis, such a practice would not have been reflective of a 'AA' category credit By demonstrating a willingness to raise rates in the face of significant political pressure by using debt optimization savings to prepay treasury debt, Bonneville avoided a downgrade of the rated obligations. Importantly, the SN CRAC is based on a formula that allows additional rate increases in fiscal 2005 and 2006 should it become necessary, subject to a cap of $290 million per year.

In fiscal 2003, Bonneville revised its forecast of surplus wholesale revenues to reflect more reasonable assumptions following the 2002 collapse of wholesale markets across the country. This has shaved over $650 million in revenues during fiscal 2004 through 2006. Also, the recent increase in gas prices, coupled with stronger-than-expected precipitation in the spring of 2003, strengthened wholesale revenues and contributed to bridging the projected revenue shortfall. These, along with the 11% financial based CRAC (FB CRAC) implemented in fiscal 2003 and over $500 million in cost reductions and deferrals through fiscal 2006 aided in the notable recovery of Bonneville's cash reserves to $511 million from $188 million.

The 'AA-' rating on the Energy Northwest debt reflects the following credit strengths:

- The $6.3 billion in Energy Northwest obligations are legally an operating expense of Bonneville, which makes the debt senior to approximately $7.3 billion in outstanding Treasury debt and federal obligations. This advantageous position offers bondholders the assurance of debt service coverage of at least 2.0x in every year as long as sufficient revenues are collected to meet all of Bonneville's debt obligations, including the Treasury debt. Even during the western U.S. power crisis, coverage of the rated obligations has consistently remained above 2.0x;
- Beginning on July 1 of each year, cash to pay each Bonneville wholesale power bill is sent directly to Energy Northwest from approximately 100 Energy Northwest participants to pay operating expenses and debt service on the Energy Northwest debt. Only after these obligations are met do participants send payments to Bonneville to fund the agency's operating and remaining

debt obligations;
- The presence of rate setting authority in Bonneville's existing contracts, including three separate cost recovery adjustment clauses (CRACs), and political support to use those CRAC mechanisms should allow Bonneville to maintain strong debt service coverage on the Energy Northwest debt as well as meet its scheduled Treasury repayments;
- Despite low hydrology and the high cost of replacement power, generation rates remain reasonable and competitive at approximately 3.2 cents-3.6 cents per kWh as of Oct. 1, 2003; and
- Successful implementation of the Slice product allocates 22% of the federal system to purchasers who are obligated to pay a percentage of the system costs in return for a percentage of system output, reducing Bonneville's exposure to low water flow; however, Bonneville retains full operational authority over the system. This benefit is mitigated by the increased operating and financial risk that it places on Bonneville's customers that select this product.

Rating concerns include:

- Continued political lobbying by customers to roll back the SN CRAC;
- Exposure to volatility in wholesale power markets with about $1.64 billion in secondary revenues over the fiscal 2004-2006 period; and
- Ongoing discussions about Bonneville's role in the regional power market beyond 2006, and uncertainty over the nature of its contracts with customers.

Although Standard & Poor's has revised Bonneville's outlook to stable in view of the positive developments in fiscal 2003, risks do remain to the rating given the significant dependence on wholesale revenues, which were about $1,640 million in fiscals 2004-2006. Bonneville uses a Monte Carlo simulation of over 3,000 games, involving variables such as stream flows, gas prices, power prices, weather, and other variables to arrive at a probability distribution of wholesale revenues and other statistics such as the reserve levels and treasury payment probability (TPP). At the present rating level, Standard & Poor's is satisfied with the current expected treasury default probability, which is better than the 80% level established in the SN CRAC rate case given that expectations for normal water this year and persistence of high gas prices has eliminated several potentially unfavorable wholesale scenarios for 2004.

Still, given that Bonneville's SN CRAC rates represent a "mean" revenue scenario and that the standard deviation of wholesale revenues remains high at about $100 million for fiscal 2004 and even higher for fiscals 2005 and 2006, there is always the possibility that Bonneville may have to implement further rate hikes, a politically difficult task, or run down its reserves again, which could jeopardize ratings. The alternative of cost cutting can only be viable to a certain extent given the magnitude of cost reductions already in place.

Wholesale market trends will thus continue to have a significant impact on Bonneville's ratings. Beyond fiscal 2006, the evolution of Bonneville's business and the nature of its contracts with customers will be key determinants of its credit profile. Bonneville's loads and resources are in balance for fiscal years 2004 through 2006. If Bonneville were to have no power sales to direct service industries (DSIs) after 2006 and meet its IOU residential exchange obligations (which enable residential and farm customers of IOUs to share in the benefits of the federally funded hydro system) through monetary benefits rather than supplying power physically, Bonneville will only have a small firm power deficit beginning in 2007. An increase in the percentage of the system sold to customers as the Slice product will further reduce risk to Bonneville by transferring hydro risk to these customers. The ongoing regional dialogue addressing Bonneville's role in meeting regional loads in the future will determine how much business risk Bonneville assumes.

Liquidity.

The expected reserve level at the end of fiscal 2006, based on the scenarios run for the SN CRAC, is about $440 million, a level of liquidity that is sufficient at the current rating level. Bonneville has a two-year, $250 million Treasury note liquidity facility that is usually reserved for exceptionally cold weather and emergencies. Debt optimization funds from ENW could potentially be used to offset operating costs in an emergency rather than to pre-pay treasury debt. Bonneville may also discuss with the U.S. Treasury reclaiming past prepayments on debt that is still not due under the maturity schedule. Finally, Bonneville can also reschedule its "scheduled" payments on the Treasury debt that is not yet due in the event of a crisis. However, such a course of action is highly unlikely and is considered a last resort.

Outlook

The stable outlook reflects greater confidence in current wholesale revenue projections and expectations that management would adjust the SN CRAC as formulaically required over the next two years. However, Bonneville's rating still remains vulnerable to adverse wholesale market or water flow conditions.

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Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280.

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