

FITCH RATES PORT OF MORROW, OR'S TRANSMISSION REVS 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-14 June 2016: Fitch Ratings has assigned a 'AA' rating to the following bonds issued by the Port of Morrow, Oregon and secured by payments from the Bonneville Power Administration (Bonneville):

--Approximately \$120 million transmission facilities revenue bonds, series 2016-2 (taxable).

The bonds are scheduled to price on June 21, 2016, via negotiation. Bond proceeds will be used to purchase certain transmission assets and pay costs of issuance.

The Rating Outlook is Stable.

SECURITY

The Port of Morrow series 2016-2 bonds are payable from lease payments made to the Port of Morrow from Bonneville, which are an absolute and unconditional payment obligation. Bonneville's payments are made as an operating expense from the Bonneville Fund and are on parity with Energy Northwest's (ENW) outstanding revenue bonds, the Lewis County PUD hydroelectric project bonds and outstanding Port of Morrow bonds. These payments are paid prior to Bonneville's payments on borrowings from the U.S. Treasury (\$4.6 billion) and federal appropriations debt (\$3.9 billion).

KEY RATING DRIVERS

BONNEVILLE'S OBLIGATION SECURES BONDS: The rating on the Port of Morrow bonds reflects the credit quality of Bonneville and its absolute and unconditional obligation to make payments for debt service. Payments are made from the Bonneville Fund, which includes revenues from its power and transmission business lines.

COMPETITIVE REGIONAL SUPPLIER: Bonneville provides wholesale electricity to a population of more than 12 million in the Pacific Northwest region through a competitive resource portfolio consisting primarily of low-cost hydropower. Transmission services are provided to a similar six-state region but to a broader cast of utilities.

LOW-RISK POWER SALES CONTRACTS: Bonneville sells power through long-term, take-or-pay contracts that recover cost of service from 131 preference customers. The contract terms limit Bonneville's financial exposure to member load increases and lower-than-expected generation output. However, the contracts expire in 2028, and customers are not obligated to continue to purchase from Bonneville if new contracts are not signed.

CASH RESERVE VARIABILITY: Bonneville's cash reserves have been variable given market price fluctuations and changing hydrology conditions but strengthened in fiscals 2014 and 2015. Bonneville also has access to a \$750 million federal line of credit with the U.S. Treasury Department, which provides additional liquidity.

CAPTIAL NEEDS INCREASING LEVERAGE: Capital needs to fund aging generation infrastructure and new transmission investment in the region are sizable at \$4 billion through 2020. Bonneville's overall leverage is expected to rise as a result.

RATING SENSITIVITIES

WEAKENING OF RESERVES: Bonneville Power Administration's reserve levels exhibit variability. While they have strengthened in the past two years, reserve levels remain linked to seasonal hydrological conditions and power market prices received for excess energy sales. The maintenance of strong reserves, given the variation in revenues that can result from these two factors, is key to the ratings and a sustained and sizable reduction in reserves could result in downward rating pressure.

CREDIT PROFILE

The Port of Morrow (the port) is a port district located in Morrow County, Oregon. The port has the legal authority to own and issue bonds to fund transmission assets throughout the region. This right was validated by a court opinion sought by the Port in March 2012, prior to the first lease transaction executed with Bonneville. According to the terms of multiple lease agreements between the Port of Morrow and Bonneville, Bonneville makes unconditional lease payments directly to the trustee (the port has assigned the lease revenues to the trustee) that are equal to debt service on outstanding bonds, including the proposed series 2016-2 bonds. Bonneville retains operational control of the transmission assets.

Bonneville is the largest of the regional federal power marketing agencies within the Department of Energy. Bonneville accounts for approximately 33% of the electricity consumed and 75% of the transmission infrastructure in the region. The majority of Bonneville's revenues are provided by power operations. Transmission revenues accounted for approximately 26% of operating revenues in fiscals 2014 and 2015.

RATING NOT BASED ON DIRECT FEDERAL SUPPORT

The rating reflects the credit quality of Bonneville as a self-supporting entity. Bonneville's subordinate obligations to the U.S. Treasury offer a layer of structural support to the Port of Morrow, Lewis County PUD and ENW bonds (non-federal debt), in that Bonneville must defer payment to the Treasury if it has insufficient funds to meet its non-federal debt. This provision could provide payment flexibility, but Fitch's rating reflects the expected timely repayment on all Bonneville's obligations.

A linkage with the federal government exists in the form of governance by the DOE, appointment of the administrator, congressional approval on Bonneville's budget, and the banking and lending relationship with Treasury. However, Fitch's ratings reflect Bonneville's stand-alone credit quality and its ability to repay its obligations from ongoing revenues.

REGIONAL COOPERATION DEBT

Bonneville and ENW have agreed to a regional cooperation debt plan that extends the maturity of outstanding ENW debt (CGS and Projects 1&3) and uses the revenues made available from lower debt service costs on those projects to prepay higher interest rate debt to the U.S. Treasury. While this effectively accelerates payment of Bonneville's subordinate obligations by extending the ENW bond maturity, it makes available federal borrowing capacity and provides economic benefit to preference customers, who are the ultimate ratepayers that repay both types of debt.

SUFFICIENT POWER SUPPLIES; RELIANCE ON NET SECONDARY REVENUES

Bonneville is statutorily required to provide power to preference customers in the region. Bonneville currently makes power sales to preference customers under 20-year contracts that

became effective in fiscal 2012. The contracts limit Bonneville's role as a regional provider to the allocation of the existing federal system (predominantly hydro-electric generation but including CGS) at cost-based (Tier 1) rates, which include environmental costs related to the federal assets. Preference customers can request Bonneville to supply additional power needs above their Tier 1 allocation from the federal system, but the energy is provided at Bonneville's actual costs to secure the power.

For operational planning purposes, Bonneville uses an assumption of water conditions below the 30-year average, referred to as critical water. Bonneville estimates its available generation resources will provide 8,089 annual average megawatts (aMW; an annual average megawatt is equal to 8,760 megawatt-hours) of firm energy under low (or critical) water conditions in fiscal 2017. This represents the amount of firm energy (Tier 1) Bonneville plans to have available to divide among its preference customers, with an estimated demand in fiscal 2017 of 6,886 aMW. Bonneville's other power sales include small amounts to federal agencies in the region and direct service industrial customers. The remaining power produced is sold into the market.

For ratemaking and financial planning purposes, Bonneville considers the additional energy production available for sale under 'average' water conditions. The federal system is expected to provide 10,309 aMW in 2017, based on average water conditions. The production in excess of estimated demand is assumed to be sold at forward market prices with revenues used to supplement sales to preference customers. These wholesale sales, netted against market purchases made by Bonneville during certain months of the year to shape the output of the federal system, compose net secondary system revenues.

RESERVE VARIABILITY

Bonneville's sizable hydro-electric generation fleet requires market sales in some months and market purchase in other months to balance the load demands with actual output of the federal system. While Bonneville has reduced its financial reliance on net secondary revenues in recent years, there continues to be a degree of variability in net secondary revenues in the power business line. The risk of revenue variability is managed through cash reserves and ultimately, a cost recovery adjustment clause that can be enacted in Tier 1 rates, if needed.

Bonneville's reserves for risk, or unencumbered reserves, improved in fiscals 2014 and 2015, after five previous years of declines. At the end of fiscal 2015, Bonneville had \$845 million in unencumbered reserves. The balance of reserves between the power (\$395 million) and transmission (\$450 million) business lines had become more equitable as well. Management estimates included in the rate case approved for fiscals 2016 and 2017 indicate that reserves will stay in the same general range.

LARGE CAPITAL INVESTMENTS NEEDED

As with many utilities across the county, Bonneville faces the issue of aging infrastructure and delayed capital reinvestment. Capital needs over the next five years are estimated at \$4 billion, with around half of the spending (around \$2.2 billion) occurring in the transmission business line. These amounts do not include approximately \$600 million that ENW estimates will be needed at CGS through 2024. Capital needs are expected to continue to place upward pressure on Bonneville's rates. Bonneville raised its power rates 7.1% and transmission rates 4.4% on Oct. 1, 2015.

Bonneville and its customers face the challenge of funding upgrades and improvements to the valuable fleet of aging hydroelectric facilities. Although the assets are owned by the Bureau of Reclamation and U.S. Army Corps of Engineers, Bonneville makes the decisions regarding the pace and scope of capital reinvestment. Bonneville does not have authority to issue its own

debt and has a statutory debt limit with the U.S. Federal Treasury of \$7.7 billion (\$4.6 million outstanding at year-end fiscal 2015), making capital funding decisions complex. The Port of Morrow or similar lease financing structures provide financing for transmission assets while the regional cooperation debt strategy frees up ongoing treasury capacity as non-federal debt is extended.

For additional information, see Fitch's report, 'Energy Northwest, WA and Bonneville Power Administration, OR', dated March 17, 2016.

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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012

U.S. Public Power Rating Criteria (pub. 18 May 2015)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864007

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