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Energy Northwest, Washington Bonneville Power Administration, Oregon; Wholesale Electric

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Energy Northwest, Washington Bonneville Power Administration, Oregon; Wholesale Electric

Credit Profile		
US$195.75 mil elec rev rfdg bnds (Bonneville Pwr Admin) (Project 3) ser 2016-A due 07/01/2028		
Long Term Rating	AA-/Stable	New
US$183.315 mil electric rev rfdg bnds (Bonneville Pwr Admin) (Project 1) ser 2016-A due 07/01/2028		
Long Term Rating	AA-/Stable	New
US$85.24 mil columbia generating station elec rev and rfdg bnds (Bonneville Pwr Admin) ser 2016-A due 07/01/2032		
Long Term Rating	AA-/Stable	New
US$38.7 mil columbia generating station elec rev and rfdg bnds (Bonneville Pwr Admin) ser 2016-B due 07/01/2028		
Long Term Rating	AA-/Stable	New
US$17.55 mil elec rev and rfdg bnds (Bonneville Pwr Admin) (Project 3) ser 2016-B due 07/01/2028		
Long Term Rating	AA-/Stable	New
US$11.33 mil elec rev rfdg bnds (Bonneville Pwr Admin) (Project 1) ser 2016-B due 07/01/2028		
Long Term Rating	AA-/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AA-' rating to six series of proposed Energy Northwest (ENW), Wash., bonds. Bonneville Power Administration (BPA), Ore., will pay the bonds' debt service as operating expenses of its electric system.

The bonds include:

- $183,315,000 Project 1 electric revenue refunding bonds, series 2016-A due 7/1/2028
- $85,240,000 Columbia Generating Station (CGS) electric revenue and refunding bonds, series 2016-A due 7/1/2032
- $195,750,000 Project 3 electric revenue refunding bonds, series 2016-A due 7/1/2028
- $11,330,000 Project 1 electric revenue refunding bonds, series 2016-B (taxable) due 7/1/2028
- $38,700,000 Columbia Generating Station electric revenue and refunding bonds, series 2016-B (taxable) due 7/1/2028
- $17,550,000 Project 3 electric revenue refunding bonds, series 2016-B (taxable) due 7/1/2028

At the same time, Standard & Poor's affirmed its 'AA-' ratings on existing parity and prior-lien ENW debt and additional nonfederal obligations that BPA pays as an operating expense of its electric system. The outlook is stable. Standard & Poor's also affirmed its 'aa-' stand-alone credit profile on BPA.

Although the series project 1 and 3 bonds are subordinate ENW obligations, the utility covenanted to close its prior liens. The $41 million of project 1 senior debt and the $123 million of project 3 senior debt represent less than 2.5% of the $7.5 billion of nonfederal debt that BPA supports. Furthermore, the utility projects that the project 1 2016A and B bonds will retire the remaining project 1 bonds senior lien bonds on July 1, 2016. In light of the imminent plans to extinguish project 1 prior lien bonds and the modest amount of project 3 bonds, we do not view the subordinate-lien position as an additional exposure. ENW has retired its prior-lien CGS debt. CGS is ENW's only completed and operating nuclear unit.

The incomplete nuclear units 1 and 3, have $1.9 billion of debt and the operating CGS nuclear unit has $3.4 billion.

ENW and BPA will use the bonds' proceeds to refund portions of ENW's existing debt. Bonneville has been using ENW refunding transactions to capture debt service savings and to defer portions of its ENW debt to free up funds to retire portions of higher interest federal appropriation debt on an accelerated basis and preserve Treasury borrowing capacity, which is subject to a cap.

At the end of fiscal 2015 (Sep. 30) Bonneville had $16.1 billion of debt obligations, consisting of $3.9 billion of federal appropriations, $4.7 billion of bonds issued to the U.S. Treasury, and $7.5 billion of nonfederal debt that Bonneville supports. BPA's financial statements include in its nonfederal debt $1.7 billion of lease obligations and $302 million of customer power prepayments. It pays nonfederal debt from net revenues before it services federal Treasury debt and appropriations.

Accelerating portions of high interest rate federal appropriations debt by using the cash flow that reamortizing ENW debt through refunding transactions frees up should reduce interest expense. As federal debt is retired, funds that would have been applied to its principal will then be available to further accelerate portions of BPA's Treasury debt, which is critical to funding BPA's capital program. The utility operates under a congressionally imposed $7.7 billion ceiling on its Treasury borrowings. Although as of the Sept. 30, 2015 fiscal year-end, $4.7 billion of Treasury bonds were outstanding, the utility's reports that capital spending needs could exhaust the remaining Treasury borrowing capacity by as soon as 2017. Despite the $680 million of debt extensions preceding the current transaction, Treasury debt has been rising. Fiscal 2015's $4.7 billion was 10% higher than 2014's.

BPA expects that reducing Treasury debt with the savings from ENW debt deferrals will alleviate its borrowing constraints and add years to its Treasury borrowing capacity. BPA labels its use of ENW debt extensions to reduce appropriations and Treasury debt, "Regional Cooperation Debt Refinancings." To further these plans, it expects $1.3 billion of additional transactions debt extensions beyond the $680 million of debt extensions since 2014.

In furtherance of BPA's Regional Cooperation debt extensions, BPA, ENW, and Wells Fargo Bank, N.A., embarked on a three-way arrangement to finance additional federal debt acceleration beyond the opportunities that traditional capital market refundings provide. To accomplish this, on Feb. 4, 2016, ENW entered into a $300 million loan agreement with Wells Fargo. The agreement matures on June 30, 2017. During the agreement's term, ENW will defer a portion of BPA's obligation to pay ENW's operating expenses and debt-related interest and BPA will apply the near-term savings to federal debt reduction.

BPA plans to maintain its power rates as though ENW didn't provide payment forbearance during the life of the Wells Fargo loan and will use the funds attributable to the avoided payments to retire about $280 million of federal appropriations debt with interest rates that are higher than those of the Wells Fargo loan and the takeout debt that ENW plans to issue to retire the Wells Fargo facility. ENW will use draws on the Wells Fargo facility to cover the forborne BPA operating and interest payments. BPA will likely use available funds to extinguish the Wells Fargo loan to ENW maturing in June 2017. Alternatively, ENW could issue refunding bonds and BPA would be responsible for servicing the ENW takeout debt.

The Wells Fargo loan will be parity debt with the ENW second-lien debt. We have reviewed the loan agreement's default events and believe that they do not add risk to ENW's capital market debt's bondholders. Moreover, the loan agreement bars Wells Fargo from accelerating the loan's repayment if ENW is not insolvent and the parity ENW debt is not subject to acceleration.

The 'AA-' ratings on ENW's debt and the other nonfederal debt that BPA supports reflect Bonneville's contractual obligations to support the debt and the application of our government-related entities (GRE) criteria. We believe that Bonneville's stand-alone credit profile is 'aa-' and there is a moderately high likelihood that the U.S. government would provide extraordinary support to it in financial distress. We base the latter view on our opinion of the strong link between the BPA and the federal government, as well as the important federal role the agency plays in the Pacific Northwest. However, after downgrading the U.S. to 'AA+' from 'AAA' in August 2011, we no longer view the U.S. government's sovereign credit profile as lifting the ratings of the nonfederal obligations that BPA supports above the utility's stand-alone credit profile.

The GRE rating reflects our view of:

- Bonneville's status as a federal agency;
- The ongoing financial support the federal government provides to the agency through long-term loans and credit lines;
- Legislation that allows BPA to defer repayments of federal obligations if in financial distress; and
- The utility's important contributions to the Pacific Northwest's economy, where it indirectly serves a population of about 12 million in eight states, provides low-cost power that is critical to the region's economic health, and operates key transmission resources.

Bonneville's stand-alone credit profile reflects our assessment of the following factors:

- The federal government provides ongoing support to BPA through loans and credit lines.
- Congress increased the agency's federal borrowing authority in 2009 to $7.70 billion, up $3.25 billion (or 73%). However, Bonneville projects that by 2017, it could consume the headroom between its $4.7 billion of U.S. Treasury borrowings and $7.7 billion as it proceeds with capital spending.
- Nonfederal bondholders benefit from the legislative mechanism that allows BPA to pay nonfederal debt as an operating expense ahead of federal debt service and to defer repaying federal obligations if it lacks the financial resources to meet all of its operating and debt obligations.
- The utility's financial performance includes a track record of at least 1.8x nonfederal accrual debt service coverage in fiscal years 2010-2015, tempered by accrual coverage of total obligations of 1.0x in 2011 and 2013, 0.9x in 2012, but 1.2x in 2014 and 1.3x in 2015.
- BPA exhibits robust liquidity with more than $1.3 billion of unrestricted cash in fiscal years 2013-2015, which tempers the sometimes substantial impacts of variable hydrology conditions on financial performance and mitigates credit risks inherent in biennial rate cases.
- An exceptionally broad and diverse service territory supports the revenue stream.
- The strong, efficient, and economical operations of the federal hydroelectric Columbia River Power System

translates into favorable wholesale power prices that foster strong demand for its output and ENW's nuclear production.
- Customers demonstrated their commitment to the agency's system by entering contracts with BPA that extend from 2008-2028. However, the contracts do not establish rates and the utility continues to rely on biennial rate proceedings.
- Tiered rates underlying the customer contracts help shield BPA from market volatility by assigning to customers the costs of their energy needs that exceed their allotments of capacity from the federal hydroelectric projects and CGS.

Standard & Poor's also incorporates the following factors in its assessment:

- Financial performance hinges on hydrology conditions that can impair surplus power sales revenues and require replacement power purchases that add to expenses. Although we believe robust liquidity provides a cushion that tempers the financial implications of weak hydrology, the liquidity cushion is vulnerable to hydrology conditions and power market volatility. For example, BPA projects that its financial reserves in fiscal 2016 are susceptible to a 35% decline relative to 2015 due to reduced water flows and weak market prices for surplus power sale. Plans to apply portions of its reserves to reducing federal debt will also erode financial reserves.
- Highly politicized and protracted biennial rate proceedings can delay rate relief and constrain the benefits of autonomous ratemaking authority and financial flexibility. Nevertheless, the utility established electric rates for municipal and cooperative customers during 2014-2015 that were 9% higher than the rates that went into effect in October 2013 and transmission rates were 11% higher. Rates for fiscal years 2016-2017 raised first-tier power rates on average by 7.1% to 3.4 cents per kWh and transmission rates by 4.4%. The most recent rate adjustments went into effect on a preliminary basis on Oct. 1, 2015 and became final on Feb. 2, 2016, after Federal Energy Regulatory Commission review.
- Bonneville and ENW project substantial capital needs that could add to both organizations' debt and consume BPA's Treasury borrowing authority. The utility reports it is exploring off-balance-sheet financing arrangements, including leases and energy prepayments by its customers, to address expectations that it could soon exhaust its federal borrowing capacity. BPA's capital spending program is important to maintaining the integrity of its generation fleet and managing forced outage incidents.
- The $7.7 billion federal debt limit includes $750 million carved out as a credit line, which leaves about $2.3 billion of capacity based on $4.7 billion of existing Treasury debt.
- The success of the Regional Cooperation debt refinancings and the ability to extend the tenor of BPA's capacity to borrow from Treasury hinge on the economics of refinancing opportunities for reamortizing nonfederal debt, the willingness of ENW to serve as a conduit issuer, and the potential for accelerating portions of Bonneville's federal appropriations and Treasury debt.
- The Regional Cooperation debt refinancings will strengthen non-federal debt service coverage in the near-term, but will likely erode debt service coverage in later years because BPA and ENW are deferring non-federal debt service.

Outlook

The stable outlook reflects our view that Bonneville's stand-alone credit profile can withstand a further downgrade on the U.S. Also, we believe the power rate increases covering the two fiscal years that began in October 2015 could help support debt service coverage and liquidity. At the same time, ENW's willingness to serve as a conduit to capital markets remains important to managing Treasury borrowing limits.

Upside scenario

We do not expect to raise the ratings in the next two years because of the size of the BPA and ENW capital programs and our view that improvements in non-federal debt service coverage ratios reflect the deferral of debt amortization to later years to address the Treasury's cap on BPA's borrowings

Downside scenario

If, during our two-year outlook horizon, Bonneville's robust liquidity cushion erodes meaningfully whether due to hydrology conditions, capital needs, or weak market for its surplus power, we could lower the stand-alone credit profile. Also, if BPA adds significant off-balance-sheet leverage obligations because of its statutory debt ceiling, it could lead to negative implications for the stand-alone credit profile and the 'AA-' rating.

Bonneville's Nonfederal Debt Obligations

BPA's nonfederal rated obligations include:

- $5.4 billion of ENW revenue and refunding bonds: $3.4 billion relates to the operating CGS and the balance is for the incomplete units 1 and 3;
- $82.0 million of Public Utility District No. 1 of Lewis County, Wash., Cowlitz Falls Project bonds;
- $119.6 million of Northwest Infrastructure Financing Corp. (Schultz-Wautoma project) bonds; and
- $16.0 million of Northern Wasco Public Utility District, Ore. (McNary Dam Project) bonds.

Through Northwest Infrastructure Financing, which developed transmission assets financed through lease arrangements, BPA also has borrowed $317 million on credit lines as of Sept. 30, 2015, down from $615.2 million of Sept. 30, 2014, and has committed to servicing $1.7 billion of capital leases.

Operations

Bonneville markets electricity generated at 31 federal hydroelectric projects, ENW's nonfederal nuclear CGS, and several nonfederal small power plants. It primarily markets these resources' output to the customers of 125 public power and electric cooperative utilities (84% of sales), federal agencies, direct service industries, and the residential and farm customers of six investor-owned utilities. BPA also operates an extensive transmission system that facilitates power marketing activities. Its transmission system represents about 75% of the Pacific Northwest's transmission capacity.

In fiscal 2015, federal hydroelectric projects supplied about 66% of the electricity that Bonneville sold, down from about 87% in 2013. The decline reflects changes in hydrology conditions. ENW's CGS supplied about 8% in 2015 and the balance came from other non-federal projects.

ENW debt financed two partially completed nuclear reactors and one completed reactor, CGS, a 1,150 megawatt reactor. Dividing nonfederal debt service by the kilowatt-hours (kWh) from nuclear capacity and other non-federal assets produces an average nonfederal assets debt service per kWh that was about 10x more expensive than the federal hydroelectric assets' debt service per kWh in 2013, but that ratio declined to 1.4x in 2015 because the Regional Cooperation debt reamortization has sharply reduced annual non-federal debt service requirements. The nuclear assets' debt is the leading component of non-federal obligations.

Capital Spending Forecast

Bonneville projects about $4.2 billion of 2016-2020 capital projects. In descending order, transmission projects, hydroelectric asset upkeep, energy efficiency projects, and fish and wildlife protection represent the largest segments of the capital program. We view investments in the hydroelectric assets as critical to cash flow, particularly because the generating assets have exhibited an above-average forced outage factor relative to the balance of the power industry. Power sales accounted for 71% of 2015's operating revenues, compared to transmission's 27%.

ENW projects about $555 million of 2016-2020 capital projects.

Related Criteria And Research

Related Criteria

- USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014
- USPF Criteria: Wholesale Utilities, May 24, 2005
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings Detail (As Of March 14, 2016)		
Energy Northwest, Washington		
Bonneville Pwr Admin, Oregon		
Energy Northwest elec rev rfdg bnds		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest proj 1 Columbia generating station & proj 3 elec rev rfdg bnds (Bonneville Pwr Admin)		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest proj 1, Columbia Generating Sta, & proj 3 elec rfdg		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed

Ratings Detail (As Of March 14, 2016) (cont.)		
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) elec rev rfdg bnds (Proj 1)		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) rev bnds (Nuclear Proj #2) ser 1975A dtd 03/01/75due 07/01/2012 (cusip# 939828LL1)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Columbia generating station elec rev bnds		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Columbia Generating sta elec (BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Columbia Generating Station elec rev & rfdg bnds (Bonneville Pwr Admin)		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Sub Lien		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (Nuclear Proj 1,2,3)		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (1,Columbia,3)		
Long Term Rating	AA-/Stable	Affirmed
Bonneville Pwr Admin elec rev rfdg (Colu)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (XL Capital Assurance Inc.)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
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)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Washington Pub Pwr Supp Sys (Nuclear Proj #3) (Bonneville Pwr Admin)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Northern Wasco Cnty Peoples Util Dist, Oregon		
Bonneville Pwr Admin, Oregon		
Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) rev rfdg bnds (Mcnary Dam Fishway Hydroelec Proj)		
Long Term Rating	AA-/Stable	Affirmed
Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) (McNary Dam Fishway Hydroelec Proj)		

Ratings Detail (As Of March 14, 2016) (cont.)		
Long Term Rating	AA-/Stable	Affirmed
Northwest Infrastructure Financing Corp., New York		
Bonneville Pwr Admin, Oregon		
Northwest Infrastructure Financing Corp. (Bonneville Pwr Admin) TRANs		
Long Term Rating	AA-/Stable	Affirmed

Many issues are enhanced by bond insurance.