FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Energy Northwest, WA Elec Rev Ref Bonds 'AA'; Affirms Bonneville IDR at 'AA-'

Mon 11 May, 2020 - 4:37 PM ET

Fitch Ratings - Austin - 11 May 2020: Fitch Ratings has assigned a 'AA' rating to the following electric revenue refunding bonds issued by Energy Northwest, WA, secured by payments from the Bonneville Power Administration (Bonneville):

--Up to $365 million Columbia Generating Station Electric Revenue Refunding Bonds, Series 2020-A and 2020-B (taxable).

--Up to $54 million Project 1 Electric Revenue Refunding Bonds, Series 2020-A and 2020-B (taxable).

The 2020 bonds are scheduled to price on May 20, 2020 via negotiation. Bond proceeds will refinance existing bonds as part of Bonneville's and Energy Northwest's regional debt cooperation program, potentially fund a portion of capex requirements at the Columbia Generating Station and pay costs of issuance.

At the same time, Fitch has affirmed the 'AA-' Issuer Default Rating (IDR) of the Bonneville Power Administration. The IDR reflects the credit quality of Bonneville's repayment of all its fixed obligations, including federal and nonfederal debt and lease obligations.

Fitch also affirmed the 'AA' debt ratings on the following nonfederal debt, which is secured on parity through payments from Bonneville:

--$794.3 million Energy Northwest (ENW) Project 1 revenue bonds.

--$3.14 billion ENW Columbia Generating Station revenue bonds.

--$912.7 million ENW Project 3 revenue bonds.

--$200.8 million Idaho Energy Resources Authority transmission facilities revenue bonds, series 2017.

--$899.2 million Port of Morrow transmission facilities revenue bonds, series 2012, 2014, 2015, 2016-1, 2016-2 and 2019.

--$68.5 million Lewis County Public Utility District (PUD) No. 1 Cowlitz Falls hydroelectric project revenue refunding bonds, series 2013.

The ratings on the nonfederal debt listed above and issued by Energy Northwest, Idaho Energy Resources Authority, Port of Morrow and Lewis County PUD No. 1 reflect Bonneville's unconditional obligation to pay debt service, as well as structural security features specific to the priority of these obligations ahead of Bonneville's federal debt (approximately $5.3 billion in U.S. Treasury debt and $1.6 billion in federal appropriations debt as of Sept. 30, 2019).

The Rating Outlook on all ratings is Stable.

SECURITY

Bonneville's payments to ENW for debt service on the bonds are unconditional and are made as an operating expense from the Bonneville Fund. All of Bonneville's revenues are required to be deposited in the Bonneville Fund, which is a separate fund within the U.S. Treasury. Expenditures from the Bonneville Fund do not require further federal appropriation. The nonfederal debt obligations are consolidated as obligations on Bonneville's financial statements and are paid prior to Bonneville's payments on its borrowings from the U.S. Treasury and federal appropriations debt.

Analytical Conclusion

The 'AA-' IDR on Bonneville reflects its very strong revenue defensibility and very low operating cost, which support the utility's financial profile assessment of very strong despite a leverage ratio over 10.0x in fiscal 2019 and a weaker liquidity profile.

The IDR incorporates steps taken by Bonneville and its customers since 2017 to implement a financial reserve policy (FRP) and include specific steps within the rate-setting process designed to build liquidity and maintain minimum reserves specific to each of the power and transmission business lines. While Fitch considered the funding timeline to reach the 60-day reserve target lengthy, estimated at 10 years, the reallocation of reserves between the two business lines in fiscal 2019 brought the power business line closer to the 60-day minimum, while the transmission business line was reduced but remained above the 60-day minimum.

The 'AA' ratings on the nonfederal debt obligations - distinct from Bonneville's 'AA-' IDR - further reflect Bonneville's unconditional obligation to make those payments ahead of its federal debt. Bonneville's federal obligations include the structural ability to defer debt repayments and interest due in the event Bonneville's revenues are insufficient following the payment of Bonneville's other obligations, including the nonfederal debt.

Coronavirus Impact

The coronavirus pandemic and related government containment measures worldwide create an uncertain environment for public power utilities in the near term. Specifically, Fitch is concerned that the widespread social distancing and stay-at-home measures will result in significant economic and financial pressures for communities and utilities throughout the country. While Bonneville's service territory is expansive and overall demand has been consistent with 2019 levels through March and April, further revenue disruptions could occur depending on the magnitude and duration of the related economic impacts.

Fitch's analysis considers a scenario that anticipates potentially more significant stress from the pandemic. Fitch's sensitized downside scenario factors a 9% decline in sales volumes in 2020, followed by a return to sales growth over the ensuing three years. This sensitized downside stress case has the potential to delay the expected decline in Bonneville's leverage ratio in the near term and may delay reserve accumulation. Even under this scenario, Bonneville's financial profile should remain supportive of the current 'AA-' IDR, although the potential extension of these results beyond the near term could result in negative rating pressure.

KEY RATING DRIVERS

Revenue Defensibility: 'aa': Geographic and Operational Revenue Diversity

Bonneville's revenue defensibility is very strong. Long-term power sales contracts with over 125 customers and Bonneville's dominant role as the regional transmission provider results in long-term revenue stability, notwithstanding some degree of renewal risk related to the power supply contracts.

Bonneville establishes its own rates, although rate flexibility is constrained by a lengthy and formal process. The purchaser credit quality of Bonneville's wholesale customers is strong and borders on very strong. The largest customers exhibit favorable service area characteristics and very strong financial profiles.

Operating Risk: 'aa': Hydroelectric Dominant Power Supply

Operating costs are very low, largely due to a predominantly hydroelectric generation fleet. Capital needs relate to reinvestment in the aging generation assets and transmission investment across the six-state service area.

Financial Profile: 'aa': Highly Leveraged but Adequate Financial Profile

Bonneville's financial profile is very strong, but its leverage ratio remains at the high end of the 'aa' category assessment. Transmission business lines are able to support slightly higher leverage than the power business line, resulting in Fitch's tolerance for leverage that trended slightly higher than the 'aa' threshold in prior years.

Given planned capital spending and debt issuance, Fitch expects Bonneville's leverage ratio to decline to the 9.0x-10.0x range over the next five years. The rating reflects consideration of stress scenarios related to either variable hydrology or economic disruption from the coronavirus pandemic that have the potential to keep leverage levels closer to 2019 levels in the near term. Combined liquidity is adequate but expected to increase as a result of the FRP.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations affect the final rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Consistently higher funding in rates to support pay-as-you-go capex that produces a materially lower leverage profile for Bonneville.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Declines in consolidated system liquidity or disruption to Bonneville's planned increase in power business reserve levels.

--Leverage trending consistently above 10.0x, although the Fitch Analytical Stress Test (FAST) model indicates overall leverage is expected to remain in the current range, with annual fluctuations expected due to hydrology.

--A potential dilution of revenue defensibility over the medium term that potentially reduces Bonneville's ability to support existing leverage at the current rating. The potential for dilution could occur from reductions in load served to Bonneville's power customer base or more permissive contract terms that might emerge during the contract-renewal process expected in the next few years.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

ENW owns and operates the Columbia Generating Station (CGS), the Packwood Lake Hydroelectric Project and the Nine Canyon Wind Project. ENW also has financial responsibility for Projects 1 and 3, its terminated nuclear projects. Bonneville is responsible for the repayment of ENW costs, including debt service, related to CGS and Projects 1 and 3 through the terms of net billing agreements. Currently, Bonneville pays CGS, Project 1 and 3 costs to ENW under a direct-pay agreement. The direct pay agreement permits ENW net billing participants (Bonneville's preference customers) to purchase power from and make payments directly to Bonneville without making net billing payments to ENW to receive bill credits from Bonneville as outlined under the net billing agreements. Given Bonneville's unconditional payment obligation for the debt, Bonneville and ENW have agreed to a regional debt cooperation program that optimizes debt across the two entities for the lowest overall cost and access to capital considerations.

Bonneville provides wholesale power to a population of more than 14 million in the Pacific Northwest through a resource portfolio consisting of low-cost hydropower and nuclear generation. Transmission services are provided to a similar six-state region but to a broader number of utilities. Bonneville is the largest of four federal power-marketing administrations within the U.S. Department of Energy. Bonneville's predominantly hydroelectric generation portfolio - 86% of total owned capacity - results in hydrology risk and a variable energy supply. Low market energy prices in the region place competitive pressure on Bonneville to keep rate increases as low as possible and drove Bonneville's net secondary revenues (short-term sales made outside its long-term contracts) lower over the past decade.

For more information, see "Bonneville Power Administration, Oregon" (http://www.fitchratings.com/site/re/10112908), published March 6, 2020, on www.fitchratings.com.

Financial Profile

Bonneville's leverage ratio, as measured by net-adjusted debt to adjusted funds available for debt service (FADS), declined to 9.9x in fiscal 2018 from 10.7x in fiscal 2015. Declining leverage, while slight, was driven by gradual declines in outstanding debt and relatively stable cash flow, or FADS. FADS declined in fiscal 2019 as a result of higher purchase-power costs related to below average water conditions and high market prices at times, increasing leverage to 11.4x. Total outstanding debt continued its gradual decline.

Bonneville's consolidated coverage of full obligations is typically modest, at around 1.0x, but fell below this level in the last four fiscal years, contributing to Fitch's weaker assessment of liquidity and coverage. This was due to repaying nonscheduled principal in advance as part of the regional cooperation debt strategy. Fitch's analysis of Bonneville's IDR focuses on the calculation of coverage for all obligations, including Bonneville's federal obligations, which can be deferred.

ENW's debt service coverage (DSC) increased as a result of the regional debt cooperation strategy. DSC, as calculated by Bonneville, is approximately 5.0x due to refunding and restructurings performed for all three ENW projects on principal payments.

Fitch Analytical Stress Test (FAST)

Fitch's FAST analysis indicates Bonneville's financial performance should be stable through the five-year base case and stress case, and it accounts for variability that can occur on Bonneville's hydroelectric system. The base case indicates leverage should decline very slightly over time. Fitch assumes 0% growth in total wholesale sales in the base case. The stress case includes large declines in total wholesale sales during the first two years of 9.1% and 3.5%, respectively, followed by a recovery to positive sales growth.

The standard stress case imposes a moderate stress based on Bonneville's historical movement in total sales, which can be large based on hydrological conditions, although the ultimate impact to revenues will be determined by wholesale market prices at the time. Leverage will be elevated, above 12.0x, in the initial two years but returns to between 9.0x and 10.0x in the final years of the five-year period. Additional assumptions in both the base and stress cases include Bonneville's planned amounts of capital spending, debt funding of all capital spending and rate increases in line with the financial reserve policy.

Fitch additionally considered a sensitized downside scenario in relation to the economic uncertainty resulting from the coronavirus pandemic. Demand decline was assumed at 9% in the first year, with a recovery to typical sales over the following three years. Results were similar to the stress case noted previously, although pressure on cash reserve levels could be more acute in the near term.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Bonneville Power Administration (OR)	LT IDR	AA-	Affirmed
• Bonneville Power Administration (OR) /Issuer Default Rating/1 LT	LT	AA-	Affirmed

ENTITY/DEBT	RATING		
• Bonneville	LT	AA	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub. 30 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Public Power - Fitch Analytical Stress Test Model, v1.1.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bonneville Power Administration (OR)	EU Endorsed
Energy Northwest (WA)	EU Endorsed
Idaho Energy Resources Authority (ID)	EU Endorsed
Lewis County Public Utility District No. 1 (WA)	EU Endorsed
Port of Morrow (OR)	EU Endorsed

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