AVISTA CORP.
RESPONSE TO REQUEST FOR INFORMATION

JURISDICTION:	WASHINGTON	DATE PREPARED:	10/08/2015
CASE NO:	UE-150204 & UG-150205	WITNESS:	Kelly Norwood
REQUESTER:	Bench	RESPONDER:	Kelly Norwood
TYPE:	Bench Request	DEPT:	State & Federal Regulation
REQUEST NO.:	Bench Request No. 5	TELEPHONE:	(509) 495-4267
		EMAIL:	kelly.norwood@avistacorp.com

REQUEST:

Bench Request No. 5:

Please provide copies of the most recent S&P and Moody's Ratings Reports that address regulatory treatment, as well as a copy of the most recent Regulatory Research Associates (RRA) State Regulatory Evaluation.

RESPONSE:

Please see Bench_DR_05, Attachments for the following documents:

Bench_DR_05, Attachment A – Regulatory Research Associates (RRA) State Regulatory Evaluations, July 31, 2015

Bench_DR_05, Attachment B – Standard & Poor's – Ratings Direct, May 19, 2015
Bench_DR_05, Attachment C – Standard & Poor's – Ratings Direct, May 9, 2014

Bench_DR_05, Attachment D – Moody's – Credit Opinion, March 11, 2015
Bench_DR_05, Attachment E – Moody's – Issuer Comment, August 21, 2014

Regulatory Research Associates
REGULATORY FOCUS

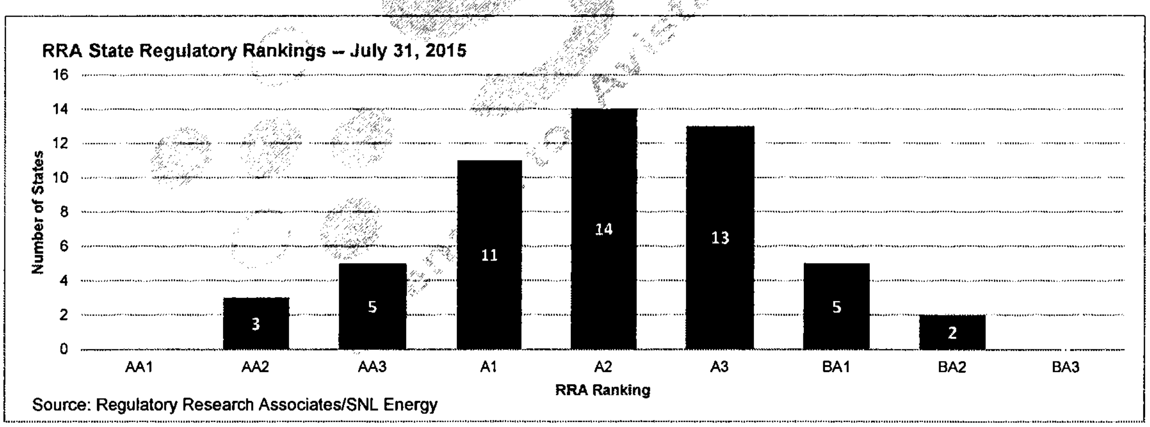
July 31, 2015

STATE REGULATORY EVALUATIONS
~ Including an Overview of RRA's ranking process ~

As part of RRA's research effort, we evaluate the regulatory climates of the jurisdictions within the 50 states and the District of Columbia (a total of 53 jurisdictions) on an ongoing basis. The evaluations are assigned from an investor perspective and indicate the relative regulatory risk associated with the ownership of securities issued by each jurisdiction's electric and gas utilities. Each evaluation is based upon our consideration of the numerous factors affecting the regulatory process in the state, and is changed as major events occur that cause us to modify our view of the regulatory risk accruing to the ownership of utility securities in that individual jurisdiction.

We also review our evaluations when we update our Commission Profiles, and when we publish this quarterly comparative evaluations report. The majority of factors that we consider are discussed in Focus Notes articles, Commission Profiles, or Final Reports. We also consider information obtained from contacts with commission, company, and government personnel in the course of our research. The final evaluation reflects our assessment of the probable level and quality of the earnings to be realized by the state's utilities as a result of regulatory, legislative, and court actions.

RRA maintains three principal rating categories, Above Average, Average, and Below Average, with Above Average indicating a relatively more-constructive, lower-risk regulatory environment from an investor viewpoint, and Below Average indicating a less-constructive, higher-risk regulatory climate from an investor viewpoint. Within the three principal rating categories, the numbers 1, 2, and 3 indicate relative position. The designation 1 indicates a stronger (more constructive) rating; 2, a mid-range rating; and, 3, a weaker (less constructive) rating. We endeavor to maintain about an equal number of ratings above the average and below the average. The graph below depicts the current distribution of our rankings. (***A more detailed explanation of our ratings process can be found in the Appendix that begins on page 3.***)



RRA's previous "State Regulatory Evaluations" report was published on April 10, 2015, and we have made no rating changes since that report. However, even though we are not adjusting our Average/3 rating of Arkansas regulation at this time, we view recently enacted legislation establishing a formula rate plan (FRP) paradigm that includes a revenue-sharing mechanism as a constructive step (see the RRA Article dated 3/31/15). Certain other recent developments indicate that a wait-and-see approach is appropriate. In addition, we had previously observed that the New Mexico regulatory environment was showing signs of improvement; however, the Commission recently issued two orders that essentially prohibit the use of fully forecasted test years in base rate proceedings, despite enabling legislation. These decisions have been appealed to the state Supreme Court, and the appeals are ongoing. Although we view these developments as negative from an investor perspective, we are not amending our Below Average/1 ranking of New Mexico regulation at this time.

Above Average

1

2

Alabama
Virginia
Wisconsin

3

Florida
Georgia
Indiana
Iowa
Mississippi

Average

1

California
Colorado
Hawaii
Kentucky
Louisiana—PSC
Louisiana—NOCC
Michigan
North Carolina
North Dakota
South Carolina
Tennessee

2

Alaska
Idaho
Kansas
Maine
Minnesota
Missouri
Nebraska
Nevada
New York
Ohio
Oklahoma
Utah
Washington
Wyoming

3

Arizona
Arkansas
Delaware
District of Columbia
Massachusetts
New Hampshire
New Jersey
Oregon
Pennsylvania
Rhode Island
South Dakota
Texas RRC
Vermont

Below Average

1

Illinois
Montana
New Mexico
Texas PUC
West Virginia

2

Connecticut
Maryland

3

ALPHABETICAL LISTING

Alabama - AA/2
Alaska – A/2
Arizona - A/3
Arkansas –A/3
California – A/1
Colorado - A/1
Connecticut – BA/2
Delaware - A/3
Dist. of Col. - A/3
Florida – AA/3
Georgia – AA/3
Hawaii - A/1
Idaho - A/2
Illinois - BA/1
Indiana - AA/3
Iowa - AA/3
Kansas – A/2
Kentucky - A/1
Louisiana – A/1
Maine - A/2
Maryland – BA/2
Massachusetts – A/3
Michigan - A/1
Minnesota - A/2
Mississippi - AA/3
Missouri - A/2
Montana - BA/1
Nebraska – A/2
Nevada – A/2
New Hampshire – A/3
New Jersey - A/3
New Mexico - BA/1
New York – A/2
North Carolina - A/1
North Dakota - A/1
Ohio - A/2
Oklahoma - A/2
Oregon - A/3
Pennsylvania - A/3
Rhode Island - A/3
South Carolina - A/1
South Dakota - A/3
Tennessee - A/1
Texas PUC - BA/1
Texas RRC – A/3
Utah - A/2
Vermont - A/3
Virginia - AA/2
Washington - A/2
West Virginia – BA/1
Wisconsin - AA/2
Wyoming - A/2

Appendix: Explanation of RRA ratings process

As noted above, RRA maintains three principal rating categories, Above Average, Average, and Below Average, with Above Average indicating a relatively more constructive, lower-risk regulatory environment from an investor viewpoint, and Below Average indicating a less constructive, higher-risk regulatory climate. Within the three principal rating categories, the numbers 1, 2, and 3 indicate relative position. The designation 1 indicates a stronger (more constructive) rating; 2, a mid-range rating; and, 3, a weaker (less constructive) rating within each higher-level category. Hence, if you were to assign numeric values to each of the nine resulting categories, with a "1" being the most constructive from an investor viewpoint and a "9" being the least constructive from an investor viewpoint, then Above Average/1 would be a "1" and Below Average/3 would be a "9."

The rankings are subjective and are intended to be comparative in nature. Consequently, we do not use a mathematical model to determine each state's ranking. However, we endeavor to maintain a "normal distribution" with an approximately equal number of rankings above and below the average. The variables that RRA considers in determining each state's ranking are largely the broad issues addressed in our State Regulatory Reviews/Commission Profiles and those that arise in the context of rate cases and are discussed in RRA Rate Case Final Reports. Keep in mind that the rankings reflect not only the decisions rendered by the state regulatory commission, but also take into account the impact of the actions taken by the governor, the legislature, the courts, and the consumer advocacy groups. The summaries below are intended to provide an overview of these variables and how each can impact a given regulatory environment.

Commissioner Selection Process/Membership--RRA looks at how commissioners are selected in each state. All else being equal, RRA attributes a greater level of investor risk to states in which commissioners are elected rather than appointed. Generally, energy regulatory issues are less politicized when they are not subject to debate in the context of an election. Realistically, a commissioner candidate who indicates sympathy for utilities and appears to be amenable to rate increases is not likely to be popular with the voting public. Of course, in recent years there have been some notable instances in which energy issues in appointed-commission states have become gubernatorial/senatorial election issues, with detrimental consequences for the utilities (e.g., Illinois, Florida, and Maryland, all of which were downgraded by RRA when increased politicization of the regulatory process became apparent.)

In addition, RRA looks at the commissioners themselves and their backgrounds. Experience in economics and finance and/or energy issues is generally seen as a positive sign. Previous employment by the commission or a consumer advocacy group is sometimes viewed as a negative indicator. In some instances, new commissioners have very little experience or exposure to utility issues, and in some respects, these individuals represent the highest level of risk, simply because there is no way to foresee what they will do or how long it will take them to "get up to speed."

Commission Staff/Consumer Interest--Most commissions have a staff that participates in rate proceedings. In some instances the Staff has a responsibility to represent the consumer interest and in others the Staff's statutory role is less defined. In addition, there may or may not be: additional state-level organizations that are charged with representing the interests of a certain class or classes of customers; private consortia that represent certain customer groups; and/or, large-volume customers that intervene directly in rate cases. Generally speaking, the greater the number of consumer intervenors, the greater the level of uncertainty for investors. The level of risk for investors also depends on the caliber and influence (political and otherwise) of the intervening parties and the level of contentiousness in the rate case process. RRA's opinion on these issues is largely based on past experience and observations.

Rate Case Timing/Interim Procedures--For each state commission, RRA considers whether there is a set time frame within which a rate case must be decided, the length of any such statutory time frame, the degree to which the commission adheres to that time frame, and whether interim increases are permitted. Generally speaking, we view a set time frame as preferable, as it provides a degree of certainty as to when any new revenue may begin to be collected. In addition, shorter time frames for a decision generally reduce the likelihood that the actual conditions during the first year the new rates will be in effect will vary markedly from the test period utilized (a discussion of test periods is provided below) to set new rates. In addition, the ability to implement all or a portion of a proposed rate increase on an interim basis prior to a final decision in a rate case is viewed as constructive.

Return on Equity--Return on equity (ROE) is perhaps the single most litigated issue in any rate case. There are two aspects RRA considers when evaluating an individual rate case and the overall regulatory environment: (1) how the authorized ROE compares to the average of returns authorized for energy utilities nationwide over the 12 months, or so, immediately preceding the decision; and, (2) whether the company has been accorded a reasonable opportunity to earn the authorized return in the first year of the new rates. (It is important to note that even if a utility is accorded a "reasonable opportunity" to earn its authorized ROE, there is no guarantee that the utility will do so.)

With regard to the first criteria, RRA looks at the ROEs historically authorized for utilities in a given state and compares them to utility industry averages (the benchmark statistics are available in *RRA's Major Rate Case Decisions Quarterly Updates*). Intuitively, authorized ROEs that meet or exceed the prevailing averages at the time established are viewed as more constructive than those that fall short of these averages.

With regard to the second consideration, in the context of a rate case, a utility may be authorized a relatively high ROE, but factors, e.g., capital structure changes, the age or "staleness" of the test period, rate base and expense disallowances, the manner in which the commission chooses to calculate test year revenue, and other adjustments, may render it unlikely that the company will earn the authorized return on a financial basis. Hence, the overall decision may be negative from an investor viewpoint, even though the authorized ROE is equal to or above the average. (RRA's *Rate Case Final Reports* provide a detailed analysis of each fully-litigated commission decision.)

<u>Rate Base and Test Period</u>--As noted above, a commission's policies regarding rate base and test year can impact the ability of a utility to earn its authorized ROE. These policies are often outlined in state statutes and the commission usually does not have much latitude with respect to these overall policies. With regard to rate base, commissions employ either a year-end or average valuation (some also use a date-certain). In general, assuming rate bases are rising, i.e., new investment is outpacing depreciation, a year-end valuation is preferable from an investor viewpoint. Again this relates to how well the parameters used to set rates reflect actual conditions that will exist during the rate-effective period; hence, the more recent the valuation, the more likely it is to approximate the actual level of rate base being employed to serve customers once the new rates are placed into effect. Some commissions permit post-test-year adjustments to rate base for "known and measurable" items, and, in general, this practice is beneficial to the utilities.

Another key consideration is whether state law and/or the commission generally permits the inclusion in rate base of construction work in progress (CWIP), i.e., assets that are not yet, but ultimately will be, operational in serving customers. Generally, investors view inclusion of CWIP in rate base for a cash return as constructive, since it helps to maintain cash flow metrics during a large construction phase. Alternatively, the utilities accrue allowance for funds used during construction (AFUDC), which is essentially booking a return on the construction investment as a regulatory asset that is recoverable from ratepayers once the project in question becomes operational. While this method bolsters earnings, it does not augment cash flow.

With regard to test periods, there are a number of different practices employed, with the extremes being fully-forecasted (most constructive) on the one hand and fully historical (least constructive) on the other. Some states utilize a combination of the two, in which a utility is permitted to file a rate case that is based on data that is fully or partially forecast at the time of filing, and is later updated to reflect actual data that becomes known during the course of the proceeding.

<u>Accounting</u>--RRA looks at whether a state commission has permitted unique or innovative accounting practices designed to bolster earnings. Such treatment may be approved in response to extraordinary events such as storms, or for volatile expenses such as pension costs. Generally, such treatment involves deferral of expenditures that exceed the level of such costs reflected in base rates. In some instances the commission may approve an accounting adjustment to temporarily bolster certain financial metrics during the construction of new generation capacity. From time-to-time commissions have approved frameworks under which companies were permitted to, at their own discretion, adjust depreciation in order to mitigate under-earnings or eliminate an over-earnings situation without reducing rates. These types of practices are generally considered to be constructive from an investor viewpoint.

<u>Alternative Regulation</u>--Generally, RRA views as constructive the adoption of alternative regulation plans that: allow a company or companies to retain a portion of cost savings (e.g. fuel, purchased power, pension, etc.) versus benchmark levels; permit a company to retain for shareholders a portion of off-system sales revenues; or, provide a company an enhanced ROE for achieving operational performance and/or customer service metrics or for investing in certain types of projects (e.g., demand-side management programs, renewable resources, new traditional plant investment). The use of ROE-based earnings sharing plans is, for the most part, considered to be constructive, but it depends upon the level of the ROE benchmarks specified in the plan, and whether there is symmetrical sharing of earnings outside the specified range.

<u>Court Actions</u>--This aspect of state regulation is particularly difficult to evaluate. Common sense would dictate that a court action that overturns restrictive commission rulings is a positive. However, the tendency for commission rulings to come before the courts, and for extensive litigation as appeals go through several layers of court review, may add an untenable degree of uncertainty to the regulatory process. Also, similar to commissioners, RRA looks at whether judges are appointed or elected.

Legislation--While *RRA's Commission Profiles* provide statistics regarding the make-up of each state legislature, RRA has not found there to be any specific correlation between the quality of energy legislation enacted and which political party controls the legislature. Of course, in a situation where the governor and legislature are of the same political party, generally speaking, it is easier for the governor to implement key policy initiatives, which may or may not be focused on energy issues. Key considerations with respect to legislation include: how prescriptive newly enacted laws are; whether the bill is clear or ambiguous and open to varied interpretations; whether it balances ratepayer and shareholder interests rather than merely "protecting" the consumer; and, whether the legislation takes a long-term view or is it a "knee-jerk" reaction to a specific set of circumstances.

Corporate Governance--This term generally refers to a commission's ability to intervene in a utility's financial decision-making process through required pre-approval of all securities issuances, limitations on leverage in utility capital structures, dividend payout limitations, ring-fencing, and authority over mergers (discussed below). Corporate governance may also include oversight of affiliate transactions. In general, RRA views a modest level of corporate governance provisions to be the norm, and in some circumstances these provisions (such as ring-fencing) have protected utility investors as well as ratepayers. However, a degree of oversight that would allow the commission to "micromanage" the utility's operations and limit the company's financial flexibility would be viewed as restrictive.

Merger Activity--In cases where the state commission has authority over mergers, RRA reviews the conditions, if any, placed on the commission's approval of these transactions, specifically: whether the company will be permitted to retain a portion of any merger-related cost savings; if guaranteed rate reductions or credits were required; whether certain assets were required to be divested; and, whether the commission placed stringent limitations on capital structure and/or dividend policy.

Electric Regulatory Reform/Industry Restructuring--RRA generally does not view a state's decision to implement retail competition as either positive or negative from an investor viewpoint. However, for those states that have implemented retail competition, RRA considers: whether up-front guaranteed rate reductions were required; how stranded costs were quantified and whether the utilities were accorded a reasonable opportunity to recover stranded costs; the length of the transition period and whether utilities were at risk for power price fluctuations associated with their default service responsibilities during the transition period; how default service is procured following the end of the transition period; and, how any price volatility issues that arose as the transition period expired were addressed.

Gas Regulatory Reform/Industry Restructuring--Retail competition for gas supply is more widespread than is electric retail competition, and the transition was far less contentious, as the magnitude of potential stranded asset costs was much smaller. Similar to the electric retail competition, RRA generally does not view a state's decision to implement retail competition for gas service as either positive or negative from an investor viewpoint. RRA primarily considers the manner in which stranded costs were addressed and how default service obligation-related costs are recovered.

Securitization--Securitization refers to the issuance of bonds backed by a specific existing revenue stream that has been "guaranteed" by regulators. State commissions have used securitization to allow utilities to recover demand-side management costs, electric-restructuring-related stranded costs, environmental compliance costs, and storm costs. RRA views the use of this mechanism as generally constructive from an investor viewpoint, as it virtually eliminates the recovery risk for the utility.

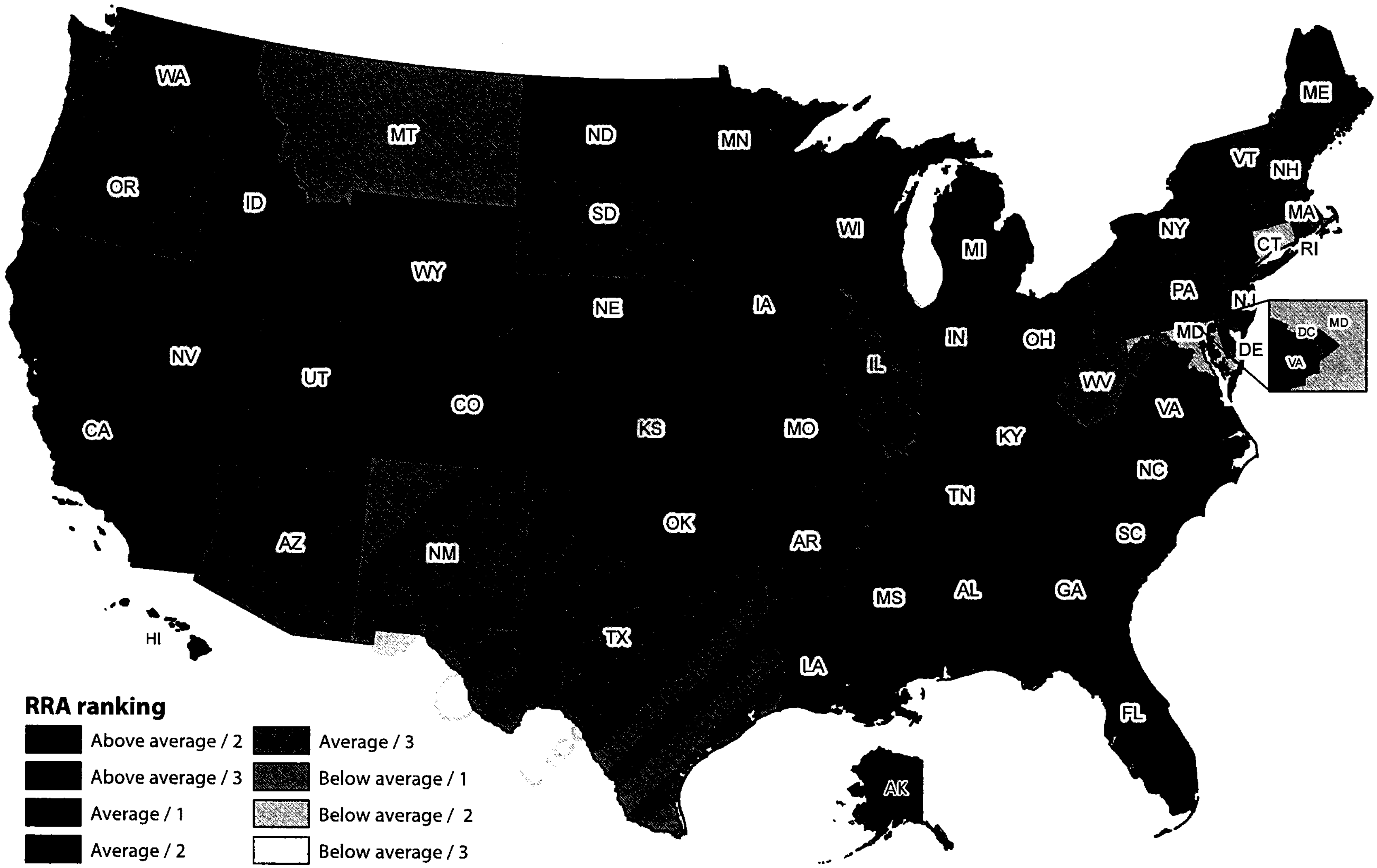
Adjustment Clauses--For many years adjustment clauses have been widely utilized to allow utilities to recover fuel and purchased power costs outside a general rate case, as these costs are generally subject to a high degree of variability. In some instances a base amount is reflected in base rates, with the clause used to reflect variations from the base level, and in others, the entire annual fuel/purchased power cost amount is reflected in the clause. More recently, the types of costs recovered through these mechanisms has been expanded in some jurisdictions to include such items as pension and healthcare costs, demand-side management program costs, FERC-approved transmission costs, and new generation plant investment. Generally, RRA views the use of these types of mechanisms as constructive, but also looks at the frequency with which the adjustments occur, whether there is a true-up mechanism, and whether adjustments are forward-looking in nature. Other mechanisms that RRA views as constructive are weather normalization clauses that are designed to remove the impact of weather on a utility's revenue and decoupling mechanisms that may remove not only the impact of weather, but also the earnings impacts of customer participation in energy efficiency programs. Generally, an adjustment mechanism would be viewed as less constructive if there are provisions that limit the utility's ability to fully implement revenue requirement changes under certain circumstances, e.g., if the utility is earning in excess of its authorized return.

Integrated Resource Planning--RRA generally considers the existence of a resource planning process as constructive from an investor viewpoint, as it may provide the utility at least some measure of protection from hindsight prudence reviews of its resource acquisition decisions. In some cases, the process may also provide for pre-approval of the ratemaking parameters and/or a specific cost for the new facility. RRA views these types of provisions as constructive, as the utility can make more informed decisions as to whether it will proceed with a proposed project.

Renewable Energy/Emissions Requirements--As with retail competition, RRA does not take a stand as to whether the existence of renewable portfolio standards or an emissions reduction mandate is positive or negative from an investor viewpoint. However, RRA considers whether there is a defined pre-approval and/or cost-recovery mechanism for investments in projects designed to comply with these standards. RRA also reviews whether there is a mechanism (e.g., a percent rate increase cap) that ensures that meeting the standards does not impede the utility's ability to pursue other investments and/or recover increased costs related to other facets of its business. RRA also looks at whether incentives, such as an enhanced ROE, are available for these types of projects.

Rate Structure--RRA looks at whether there are economic development or load-retention rate structures in place, and if so, how any associated revenue shortfall is recovered. RRA also looks at whether there have been steps taken over recent years to reduce/eliminate inter-class rate subsidies, i.e., equalize rates of return across customer classes. In addition, RRA considers whether the commission has adopted or moved towards a straight-fixed-variable rate design, under which a greater portion (or all) of a company's fixed costs are recovered through the monthly customer charge, thus according the utility greater certainty of recovering its fixed costs.

RRA state regulatory rankings



Source: SNL Energy/RRA
As of July 31, 2015
Texas PUC is Below Average/1 and the Texas RRC is Average/3

SNLFinancial

STANDARD & POOR'S RATINGS SERVICES
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RatingsDirect®

Summary:
Avista Corp.

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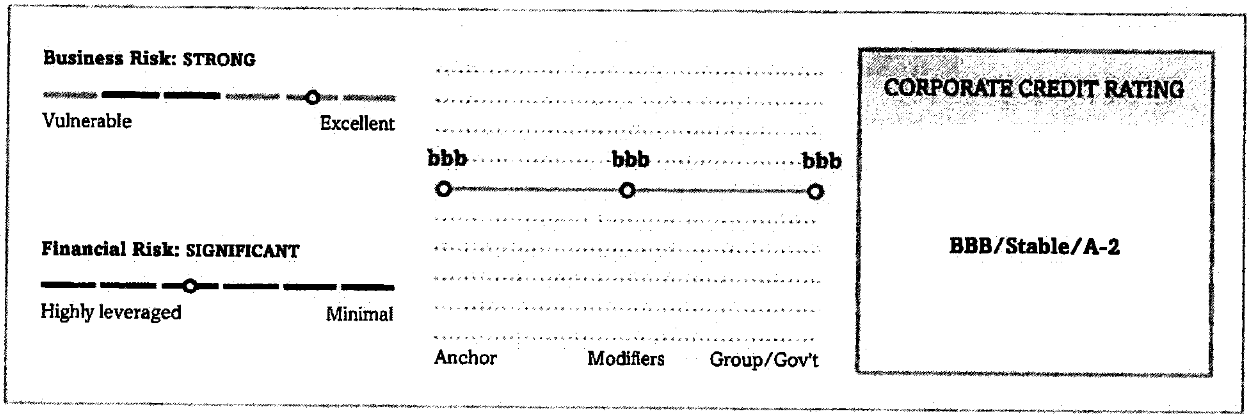
Summary:

Avista Corp.



Rationale

Business Risk: Strong	Financial Risk: Significant
• Regulated vertically integrated electric and natural gas distribution utility. • Geographic and operational diversity but largely Washington focus. • Higher hydroelectric power use. • Regulatory mechanisms provide cash flow stability when purchasing power during low water periods.	• Elevated capital spending over the next few years. • Negatively discretionary cash flow after dividends. • Consistent access to capital markets to fund capital spending. • A "strong" liquidity position that provides the utility a cushion due to its hydroelectric power use.

Outlook: Stable

The stable outlook on Avista Corp. reflects our expectation over the next two years that the company will continue to effectively manage regulatory risks, fund capital spending in a manner that does not meaningfully increase leverage, preserve adequate liquidity, and maintain comparable financial performance. Under our base-case scenario we expect funds from operations (FFO) to total debt to average about 16%.

Downside scenario

We could lower the rating in the next two years if business risk were to materially rise or credit measures diminish such that FFO to debt would be consistently below 13%. This could occur as a result of greater borrowing or increased rate lag, a large deferral, or adverse regulatory decisions.

Upside scenario

In the next two years, we do not currently contemplate an upgrade given the company's current business mix and its focus on regulated operations. Credit quality could strengthen if cash flow measures considerably improve, specifically FFO to debt of more than 23% on a sustained basis. In addition, we would expect debt to EBITDA of less than 3.5x. The company can accomplish this by paying down debt with higher internally generated cash flow, increased equity issuances, or asset dispositions.

Standard & Poor's Base-Case Scenario

Assumptions

- Average capital spending of $360 million in 2015 and declining to $350 million for 2016.
- Dividends of roughly $85 million per year over the forecasted period.
- Regular recovery of electric and gas rates through respective surcharges.
- Average operation and maintenance expenses consistent with historical levels.
- Negative discretionary cash flow indicating external funding needs.

Key Metrics

	2014A	2015E	2016E
FFO/total debt (%)	20.8	14.2-15.5	15.7-16.5
Debt/EBITDA (x)	4.5	4.2-4.6	3.8-4.2
OCF/total debt (%)	24	17-18.5	17-18.5

Note: Standard & Poor's adjusted figures. A--Actual. E--Estimate. FFO--Funds from operations. OCF--Operating cash flow.

Business Risk: Strong

In our assessment, Avista's business risk profile is "strong" based on what we consider the utility's "satisfactory" competitive position, "very low" industry risk of the regulated utility industry, and "very low" country risk of the U.S. where the company operates. The company's competitive position incorporates its vertically integrated electric and natural gas distribution utility operations in Washington and Idaho, electric operations in Alaska, and gas distribution in Oregon. Although the company operates in four states, it has fewer than 400,000 electric and about 330,000 natural gas customers with no meaningful industrial concentration. When needed, the utility requests through the regulatory process to recover costs. Since the utility has hydroelectric power exposure, recovery mechanisms are important to mitigate the need to purchase power for customers when the hydro power is unavailable. The company has some flexibility in implementing incremental rate changes through its energy recovery mechanism in Washington and the power cost adjustment in Idaho, but the recovery of excess power costs in Washington is more restrictive with minimum thresholds and deferral bands. Purchased gas adjustments for gas distribution units in all three gas jurisdictions, along with hedging, mitigate gas supply risk. We view these as important in averting large cost adjustment requests and support the business risk profile.

Financial Risk: Significant

We base our financial risk profile assessment of "significant" on the medial volatility financial ratio benchmarks. Our assessment takes into consideration the mostly steady cash flows from the utility business. Our base case indicates that capital spending along with dividend payments will lead to negative discretionary cash flow over the next few years. External funding will be needed to cover the deficit since internally generated cash flow is insufficient. Our base-case scenario suggests mostly steady key credit measures for the next several years, including FFO to debt from about 14% to 16%. Our base case indicates that the supplemental ratio of operating cash flow to debt is expected to range from about 17% to about 18.5%, bolstering the "significant" financial risk profile assessment.

Liquidity: Strong

Avista has "strong" liquidity as our criteria define the term. We believe the company's liquidity sources are likely to cover its uses by more than 1.5x over the next 12 months and remain above 1x over the subsequent 12 months. We expect the company to meet cash outflows even with a 30% decline in EBITDA.

Principal Liquidity Sources	Principal Liquidity Uses
• We estimate FFO of about $280 million in 2015 and $310 million in 2016. • Revolving credit facility of $425 million in 2015 and 2016.	• Capital spending of about $360 million in 2015 and $350 million in 2016. • Dividends of roughly $85 million per year in 2015 and 2016.

Other Credit Considerations

Other modifiers have no impact on the rating outcome.

Group Influence

Avista is subject to the group rating methodology criteria. We view Avista as the parent that is also the driver of the group credit profile. As a result, Avista's group and stand-alone credit profiles are the same at 'bbb'.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/A-2

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Group credit profile:** bbb

Recovery Analysis

- Avista's first mortgage bonds benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral coverage of more than 1.5x supports a recovery rating of '1+' and an issue rating two notches above the issuer credit rating.

Issue Ratings

- We rate the preferred stock two notches below the issuer credit rating to reflect the discretionary nature of the dividend and the deeply subordinated claim if a bankruptcy occurs.

- The short-term rating on Avista is 'A-2' based on the issuer credit rating and our assessment of its liquidity as at least adequate.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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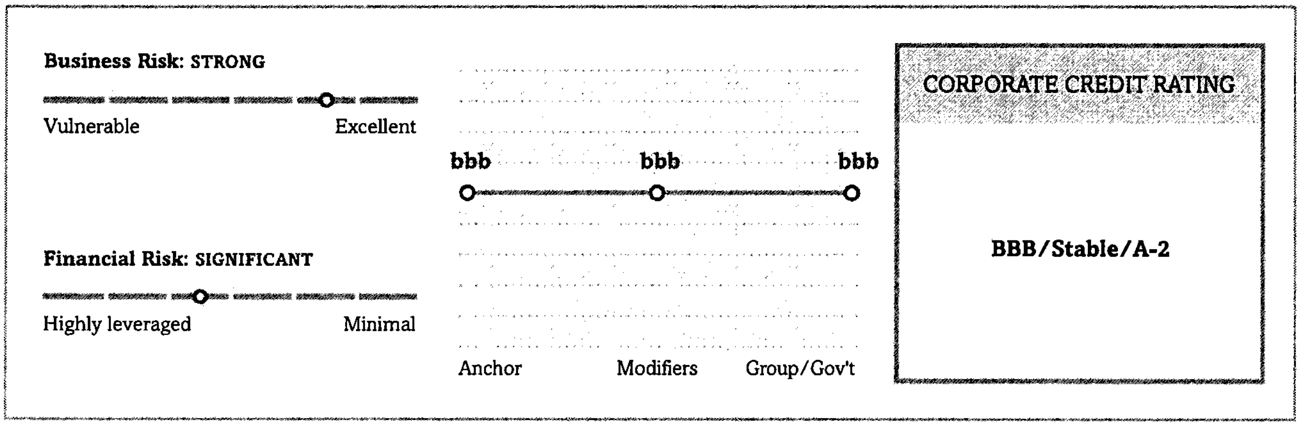
Summary:

Avista Corp.



Rationale

Business Risk: Strong	Financial Risk: Significant
• Primarily a regulated electric and natural gas distribution utility • Geographic and operational diversity, and customer diversity • Heavily dependent on hydroelectric power, regulatory mechanisms provide cash flow stability when purchasing power during low water periods	• Sufficient cash flow measures to maintain a "significant" financial risk profile • Capital spending slowing, which could strengthen cash flow measures • Regulatory decisions continue to support the company's cash flow measures • "Strong" liquidity position supports replacement power purchases when hydroelectric generation declines

Outlook: Stable

The stable outlook reflects our expectation that the company will continue to effectively manage regulatory risks, fund capital spending in a manner that does not meaningfully increase leverage, preserve adequate liquidity, and maintain comparable financial performance. Under our base case scenario we expect funds from operations (FFO) to total debt of 16%.

Downside scenario

We could lower the rating if business risk would materially rise or credit measures diminished such that FFO to debt would be consistently below 13%. Causes could include greater borrowing or increased rate lag, a large deferral, or adverse regulatory decisions.

Upside scenario

We could raise the rating if the business risk greatly improves or financial measures strengthen to levels including FFO to debt over 23%.

Standard & Poor's Base-Case Scenario

Assumptions

- Low-single-digit EBITDA growth
- Capital spending of about $250 million per year
- Negative discretionary cash flow, results in external funding

Key Metrics

	2013A	2014E	2015E
FFO to debt (%)	16.7	15-17	16-18
CFO to debt (%)	15.6	14-15.5	14.7-16.1
Debt/EBITDA (x)	4.0	4-5	4-5

A--Actual. E--Estimated. FFO--Funds from operations. CFO--Cash flow from operations.

Business Risk: Strong

Our assessment of Avista's business risk profile is "strong", as defined in our criteria, based on what we consider the utility's "satisfactory" competitive position, "very low" industry risk of the regulated utility industry, and "very low" country risk of the U.S. The company's competitive position incorporates its vertically-integrated electric and natural gas distribution utility operations in Washington and Idaho, and gas distribution in Oregon. The utility has had mixed results through the regulatory process but has filed when needed to recover costs. Since the utility has hydroelectric power exposure, recovery mechanisms are important to mitigate the need to purchase power for customers when the hydro power is unavailable. The company has some flexibility in implementing incremental rate changes through its energy recovery mechanism in Washington and the power cost adjustment in Idaho, but the recovery of excess power costs in Washington is incomplete due to minimum thresholds and deferral bands.

Purchased gas adjustments for gas distribution units in all three jurisdictions, along with hedging, mitigate gas supply risk. We view these as important in averting large cost adjustment requests and help support the rating. The company is acquiring Alaska Energy & Resources Co., which is the parent of Alaska Electric Light & Power Co., a Juneau, Ala.-based electric utility for $174 million. Ecova Inc., an energy cost-management business, is the only significant nonutility business that remains within Avista Corp. Although the business does not require significant capital investments since it is a service business, the expansion of this business, along with its attendant volatility, could weaken the business risk profile.

Financial Risk: Significant

Based on the medial volatility financial ratio benchmarks, our assessment of Avista's financial risk profile is "significant". Our base case indicates that capital spending along with dividend payments will lead to negative discretionary cash flow over the next few years. External funding will be needed to cover the deficit since internally generated cash flow is insufficient. Our base case forecast suggests mostly steady key credit measures for the next several years. Debt leverage could grow modestly, with debt to EBITDA between 4x and 4.5x. For the 12 months ended Dec. 31, 2013, FFO to debt was 16.7%, cash flow from operations (CFO) to debt was 15.6%, and debt to EBITDA was 4x. Our baseline forecast for the next few years includes FFO to debt between 15% and 18% and CFO to debt between 14% and 16%. If completed, the acquisition of Alaska Energy and Resources is unlikely to result in material deterioration to the Avista's financial risk profile.

Liquidity: Strong

Avista has "strong" liquidity as our criteria define the term. We believe the company's liquidity sources are likely to cover its uses by more than 1.5x over the next 12 months and remain above 1x over the subsequent 12 months. We expect the company to meet cash outflows even with a 30% decline in EBITDA.

Principal Liquidity Sources	Principal Liquidity Uses
• FFO of about $250 million in 2014 and about $265 million in 2015 • Credit facility availability of about $450 million in 2014 and about $450 million in 2015	• Dividends of $80 million in 2014 and $85 million in 2015 • Capital spending of $260 million in 2014 and $250 million in 2015

Other Modifiers

Other modifiers have no impact on the rating outcome.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/A-2

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Financial policy:** Neutral (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Group credit profile:** bbb

Recovery Analysis

- We assign recovery ratings to first-mortgage bonds (FMBs) issued by U.S. utilities, which can result in issue ratings being notched above an issuer credit rating (ICR) on a utility depending on the rating category and the extent of the collateral coverage. The FMBs issued by U.S. utilities are a form of "secured utility bond" (SUB) that qualify for a recovery rating as defined in our criteria.
- The recovery methodology is supported by the ample historical record of 100% recovery for secured bondholders in utility bankruptcies in the U.S. and our view that the factors that enhanced those recoveries (limited size of the creditor class and the durable value of utility rate-based assets during and after a reorganization given the essential service provided and the high replacement cost) will persist in the future.
- Under our SUB criteria, we calculate a ratio of our estimate of the value of the collateral pledged to bondholders relative to the amount of FMBs outstanding. FMB ratings can exceed a CCR on a utility by up to one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories depending on the calculated ratio.
- Avista's FMBs benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral coverage of more than 1.5x supports a recovery rating of '1+' and an issue rating

two notches above the ICR, or 'A-'.

Related Criteria And Research

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Commercial Paper, April 15, 2008
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

MOODY'S
INVESTORS SERVICE

Credit Opinion: Avista Corp.

Global Credit Research - 11 Mar 2015

Spokane, Washington, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa1
First Mortgage Bonds	A2
Senior Secured	A2
Senior Unsecured MTN	(P)Baa1
Avista Corp. Capital II	
Outlook	Stable
BACKED Pref. Stock	Baa2

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Key Indicators

[1]**Avista Corp.**

	12/31/2014	12/31/2013	12/31/2012	12/31/2011
CFO pre-WC + Interest / Interest	5.2x	4.8x	4.4x	4.8x
CFO pre-WC / Debt	18.8%	19.4%	17.4%	19.1%
CFO pre-WC - Dividends / Debt	14.3%	15.0%	13.3%	15.1%
Debt / Capitalization	44.4%	46.9%	47.7%	47.5%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Low-risk utility in supportive regulatory jurisdictions

Core utility business in Washington provides stable cash flow

Elevated capex, dividend payout and share buybacks are credit negatives

Corporate Profile

Avista Corp. is primarily a regulated electric and gas utility servicing around 367,000 electric and 326,000 gas customers in Washington, Idaho and Oregon. Avista also owns Alaska Energy and Resources Company (AERC;

not rated), parent of Alaska Electric Light and Power Company (AEL&P; not rated) which serves around 16,000 electric customers in Juneau, Alaska.

Avista's utility operations are primarily regulated by the Washington Utilities and Transportation Commission (WUTC), Idaho Public Utilities Commission (IPUC) and the Oregon Public Utility Commission (OPUC). AEL&P's rates are regulated by the Regulatory Commission of Alaska (RCA).

SUMMARY RATING RATIONALE

Avista's Baa1 issuer rating reflects its primary business as a low-risk vertically integrated electric and gas utility in supportive regulatory jurisdictions. The rating also incorporates a steady financial profile that should remain as such with a newly implemented decoupling mechanism in Washington, and a business risk profile that has been enhanced by the 2014 sale of its unregulated energy management services subsidiary in mid-2014. The addition of a small utility in Alaska has added marginal regulatory, operational and cash flow diversity, but remains ratings neutral for the company.

Avista has initiated, and partly executed, a share repurchase program and increasing dividend during a time of heightened capital expenditures, which tempers some of the positive ratings trends. Furthermore, management team has identified areas of intended growth which could be unregulated in nature, but we view this as more long-term and is not incorporated in the Baa1 rating.

DETAILED RATING CONSIDERATIONS

SUPPORTIVE REGULATION PROVIDES RATINGS BALLAST

The primary credit driver for Avista is the degree of regulatory support and cost recovery allowed by its regulatory authorities, and particularly via the WUTC, which regulates roughly 60% of the company's revenue. In December 2014, the WUTC authorized approximately $12.3 million of electric, and $8.5 million gas, revenue increases, effective January 1, 2015. More importantly, the WUTC rate order allowed Avista to implement a revenue decoupling mechanism for both electric and gas customers. The mechanism will be in place for five years, but reviewed after three years and will include an earnings test and demand reduction targets for determining collections/rebates. Avista's annual decoupling charges will be capped at 3% of rates, with unrecovered balances carried forward to future years. We view the implementation of full electric and gas decoupling mechanisms as a significant credit positive for the company, since it will enhance the recovery of fixed costs for the utility and provide for stable and predictable gross margin and cash flow over the next several years. While the company's cash flow has been very stable, historically, the decoupling mechanism should help to reduce some regulatory lag.

While we've seen improvement in the Washington jurisdiction, we note that Avista's recent all-party (and OPUC staff approved) settlement in Oregon was rejected by the OPUC. Avista had filed for over $9.1 million of revenue increases in Oregon, in which the OPUC took exception to three areas: early adoption of a customer credit related to pipe replacement expenditures; rate allocation between customers; and an accounting mechanism which could defer margin based on actual-to-stipulated customer count (i.e., "customer count tracking mechanism"). While we maintain our view that the Oregon regulatory framework is ultimately supportive, the rejection of an all-party settlement is rare and adds an element of unpredictability to the ultimate decision and rate structure of the case. Oregon rates typically provide roughly 10% of Avista's annual revenue, so while it is a credit negative from a predictability standpoint, it is not a material ratings driver. We note that the company and settling parties issued a new stipulation, to address the OPUC concerns, on March 6th.

Idaho, Avista's third primary regulatory jurisdiction, is viewed as the most supportive of Avista's state regulatory environments. The IPUC allows for a wide variety of interim rate making mechanisms (trackers) and has a track record of credit supportive rate decisions. This allows for a high degree of predictability to roughly 25% of Avista's consolidated revenue.

FINANCIAL METRICS COULD BE PRESSURED AMIDST SHARE BUYBACKS, HIGH CAPEX AND INCREASING DIVIDEND

Avista's key financial metrics, such as cash flow from operations before the changes in working capital (CFO pre-WC) to debt, have been very stable over the past five years, at around 17%. The company consistently produces around $275 million of CFO pre-WC, which excludes the impact of one-time cash flow benefits from tax accounting allowances (the most significant benefit occurring in 2014, where both capital repairs and bonus depreciation boosted CFO through deferred taxes). This compares to roughly $1.6 billion of debt, on average over the past five years.

The primary challenges to Avista's financial metrics will come via a heightened capital spend and high dividend payout. The company's capital expenditures have been on a steady rise since 2010 ($205 million) and is expected to peak at $390 million this year (including $15 million at AEL&P), while maintaining a relatively high $365 million in both 2016 and 2017. Financing these expenditures will require additional debt issuances, especially in light of a share buyback program (approximately 2.5 million shares were repurchased in 2014 for nearly $80 million; the company also has board authorization to repurchase 800,000 more through 1Q15) and an increasing dividend, targeted at a growth of 4% to 5% annually. We note that the company is expecting to keep the dividend within its earnings growth rate, but at a negative free cash flow level of $180 million in 2015, Avista is financing the dividend through debt - a credit negative.

Our expectations for Avista to produce $275 million of CFO, have $390 million in capital expenditures and over $80 million of expected dividends, will leave the company with a significant free cash flow deficit (i.e., about $195 million) in the coming months. The company will make use of the cash flow generated from tax benefits to help fund these expenditures, which may lessen the debt financing required (we expect Avista to capitalize operations in-line with its WUTC allowed capital structure of 47% / 53% equity / debt). Absent the one-time tax boosts to CFO, and considering higher debt levels, Avista could produce at or near 15% CFO pre-WC to debt, which is more reflective of a Baa2 vertically integrated electric and gas utility.

Avista's greatest capital requirements are primarily related to bolstering its transmission and distribution assets, as well as upgrading its hydroelectric generation facilities. The nature of these investments is more basic when compared to many other integrated utilities across the nation who are in the midst of constructing new generation facilities or making significant environmental upgrades. Avista's long power supply position is beneficial to its credit profile as the company is not currently required to make investments in higher-cost, higher-risk assets, like many of its regional peers.

APPETITE FOR GROWTH MAY INTRODUCE GREATER RISK OVER THE LONG-TERM

Avista's business risk profile improved in 2014, through the sale of Avista's primary unregulated business (Ecova, not rated) and through the acquisition of rate regulated utility assets in Alaska. We view both developments as credit positive since it increased the overall contribution and diversity of regulated cash flow to consolidated operations. However, we view both as ratings neutral given the small size of each subsidiary. Furthermore, the addition of AERC offers no real synergies to speak of, along with a new regulatory relationship to maintain, which requires a share of management attention.

As described above, the nature of Avista's capital plan is viewed positively, since it is focused on basic system improvements; however, we continue to caution that should the "plain vanilla" type investment profile cause management to look for growth opportunities in non-traditional areas, this could have the potential to raise the risk profile of Avista's investments, which could overshadow the regulated bias of M&A activity in 2014.

Along these lines, we note that management has identified and drawn attention to creating new growth platforms through a non-utility subsidiary, Salix, Inc. (not rated), a subsidiary of Avista Capital, Incl. (not rated, a wholly-owned subsidiary of Avista). Salix was formed to explore opportunities to extend natural gas use beyond traditional pipeline supplied markets, via expansion of liquefied natural gas (LNG) services throughout the region. Avista's strategy is premised on the low-price and abundant supply of natural gas, which could give LNG an economic advantage over other competing fuels.

We view Salix much in the same way we did the development of Ecova, from its nascent stages in the mid-to-late 2000's. We expect that management will take small, measured approaches to the development of its unregulated business, with Salix's overall contribution to the consolidated entity remaining around 10% - 15% of earnings and cash flow. Should Salix grow to be a larger portion of earnings and cash flow, or exhibit more business risk (e.g., as a commodity-based business, unlike the operations of Ecova), we would view this as negative to Avista's credit profile. Currently, Salix and Avista's plans to explore LNG delivery throughout the Pacific Northwest is not impacting the company's ratings.

Liquidity

Avista's external liquidity source consists of a $400 million senior secured revolving credit facility, which expires in April 2019. As of December 31, 2014, there were $105 million of cash borrowings and nearly $33 million in letters of credit outstanding, leaving $262 million of available liquidity under the line of credit. Since Avista currently has unsecured investment grade ratings from two nationally recognized rating agencies, the company has the option to request the banks to relinquish the existing First Mortgage Bond collateral position, but it has chosen not to do so for economic reasons. Despite the collateral staying in place at Avista's discretion, the secured nature of the credit facilities somewhat constrains Avista's liquidity flexibility, in our opinion, since the typical investment grade issuer (having an unsecured facility) can use collateral as an option to improve bank credit access during periods of unforeseen liquidity stress.

The facility has a $100 million accordion feature and is subject to grid pricing. The $400 million facility does not contain any material adverse change language for borrowings but does so to access the $100 million accordion feature. The facility also includes a debt to capitalization covenant not to exceed 65%. As of December 2014, the company had sufficient headroom available under the debt to capitalization covenant.

AEL&P has a $25 million line of credit which expires in November 2019 and has a consolidated debt to capitalization covenant of 67.5%. As of December 31, 2014, the full amount was available for borrowing and AEL&P was in compliance with its covenant.

Avista's next material debt maturities occur in August 2016 when $90 million of first mortgage bonds is due. AERC's next maturity is in 2019 when its $15 million term loan is scheduled to expire.

Rating Outlook

The stable outlook incorporates our view that Avista's financial profile will maintain CFO pre-WC to debt in the high-teens range and that it will ultimately continue to receive supportive cost recovery from its regulators. The stable outlook also incorporates a view that unregulated operations will remain below 15% of consolidated earnings and cash flow, and that the company's financial policy will maintain a relatively even mix of debt and equity in its capital structure.

What Could Change the Rating - Up

The ratings for Avista could be upgraded if the company were able to produce CFO pre-WC to debt above 20% on a sustainable basis, without the benefits from one-time tax policy adjustments.

What Could Change the Rating - Down

Avista's ratings could be negatively impacted if the level of regulatory support wanes, if the contribution of its unregulated business were to increase disproportionately to those of its regulated operations, or if CFO pre-WC to debt were to fall to 15% for a sustainable period.

Rating Factors

Avista Corp.

Regulated Electric and Gas Utilities Industry Grid [1][2]	**Current LTM 12/31/2014**		**[3]Moody's 12-18 Month Forward ViewAs of Date Published**	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	A	A	A	A
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Baa	Baa	Baa	Baa
b) Sufficiency of Rates and Returns	Baa	Baa	Baa	Baa
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	A	A	A	A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	4.8x	A	4.5x - 4.9x	A
b) CFO pre-WC / Debt (3 Year Avg)	18.6%	Baa	15% - 19%	Baa

c) CFO pre-WC - Dividends / Debt (3 Year Avg)	14.2%	Baa	11% - 15%	Baa
d) Debt / Capitalization (3 Year Avg)	46.4%	Baa	45% - 50%	Baa
Rating:				
Grid-Indicated Rating Before Notching Adjustment		Baa1		Baa1
HoldCo Structural Subordination Notching	n/a	n/a		n/a
a) Indicated Rating from Grid		Baa1		Baa1
b) Actual Rating Assigned		Baa1		Baa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2014; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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ISSUER COMMENT

Avista's Rate Case Settlement Is Credit Positive

From Credit Outlook

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On Monday, Avista Corp. (Baa1 stable) announced an all-parties settlement in the company's electric and natural gas general rate case filings. The settlement, if approved by the Washington Utilities and Transportation Commission (WUTC), is credit positive for Avista because it allows the company to implement electric and natural gas revenue decoupling mechanisms, which enhance the stability of gross margins, and apply rate increases to customer bills starting on 1 January 2015.

The revenue decoupling mechanisms, recommended for a five-year period, will also improve the predictability of Avista's gross margins by establishing a target margin for the company to achieve through utility rates. Additionally, it will allow the company to recover any margin shortfall (owing to declining sales volume and subject to an earnings test) through a surcharge in the following year, up to a 3% annual rate adjustment. The net electric increase of roughly 2.4% and natural gas revenue hike of approximately 5.5% are credit positive because they will help the company offset rising costs and maintain cash flow/debt of around 20% over the next two years.

The rate settlement, if approved, would also indicate improved regulatory support for Avista since traditional rate making in Washington has made limited use of special cost recovery mechanisms and has incorporated the use of historical test years (i.e., setting future rates to recover historical cost levels). The historical regulatory treatment frequently resulted in Avista having revenue levels that lagged real-time cost recovery and resulted in the company achieving returns on equity (ROE) below those allowed by the WUTC. For example, Avista was often allowed ROE of around 10%, but would only be able to achieve an actual ROE of 7%-8% because of cost inflation.

Avista's current settlement includes a rate design that makes forward-looking cost, demand and revenue assumptions, which will improve the company's ability achieve higher ROE levels, with the certainty that divergences between expected and actual margins will be addressed in the following year.

What is Moody's Credit Outlook?

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Report Number: 174656

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