Moody's
INVESTORS SERVICE

CREDIT OPINION
22 March 2017

Update

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RATINGS

Avista Corp.

Domicile	Spokane, Washington, United States
Long Term Rating	Baa1
Type	LT Issuer Rating
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Ryan Wobbrock 212-553-7104
Vice President
ryan.wobbrock@moodys.com

Jillian Cardona +1 212 553 4351
Associate Analyst
jillian.cardona@moodys.com

Jim Hempstead 212-553-4318
MD-Utilities
james.hempstead@moodys.com

AVISTA CORP.

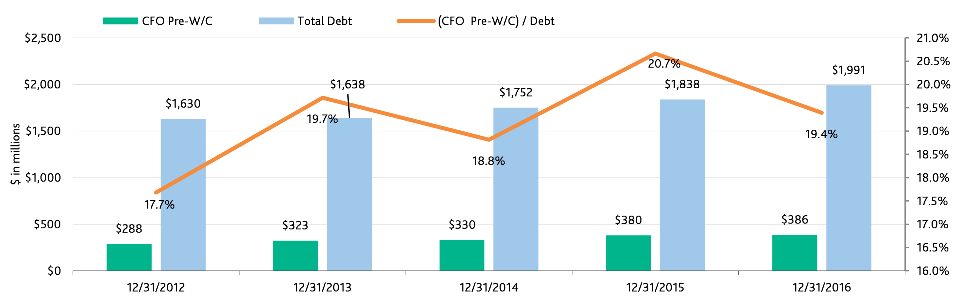
A Vertically Integrated Electric and Gas Utility

Summary Rating Rationale

Avista Coporation's (Avista, Baa1 Stable) Baa1 issuer rating reflects its primary business as a low-risk vertically integrated electric and gas utility with supportive cost recovery mechanisms, such as electric and gas revenue decoupling. Recent events in Washington, Avista's primary regulatory jurisdiction, create some uncertainty for the company going forward, but Avista's financial profile can provide cushion to offset any negative effects over the next 12-18 months.

Avista has some unregulated exposure in addition to its ownership of regulated utility Alaska Electric Light and Power (AEL&P, Baa3 Stable), which provide marginal operational and cash flow diversity, but remain neutral in terms of affecting the ratings of Avista.

Exhibit 1
Historical CFO Pre-WC, Total Debt and CFO Pre-WC to Debt



Source: Moody's Investors Service

Credit Strengths

» Low-risk utility with supportive cost recovery mechanisms

» Stable cash flow production

Credit Challenges

» Significant miscommunication, recently, between AVA and its key regulator

» Clean Air Rule in Washington could be costly

Rating Outlook

The stable outlook incorporates our view that despite a recent rate filing snafu in Washington, Avista's financial profile will maintain cash flow from operations pre-working capital (CFO pre-WC) CFO pre-WC to debt in the high-teens range and that it will continue to receive adequate cost recovery within its regulatory jurisdictions. The stable outlook also incorporates a view that unregulated operations will remain below 15% of consolidated earnings and cash flow.

Factors that Could Lead to an Upgrade

The ratings for Avista could be upgraded if the company were able to produce CFO pre-WC to debt above 21% on a sustained basis, without the benefits from one-time adjustments or temporary tax benefits.

Factors that Could Lead to a Downgrade

Avista's ratings could considered for downgrade with less supportive regulatory relationships over a sustained period of time and if CFO pre-WC to debt were to fall to 17% on a consistent basis. Also, if the contribution of Avista's unregulated business were to increase disproportionately to those of its regulated operations, it could be downgraded.

Key Indicators

Exhibit 2

KEY INDICATORS [1]

Avista Corp.

	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
CFO pre-WC + Interest / Interest	4.4x	5.0x	5.2x	5.7x	5.4x
CFO pre-WC / Debt	17.7%	19.7%	18.8%	20.7%	19.4%
CFO pre-WC – Dividends / Debt	13.5%	15.2%	14.3%	16.2%	15.0%
Debt / Capitalization	47.4%	46.7%	44.6%	44.8%	44.5%

[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™

Detailed Rating Considerations

SIGNIFICANT MISCOMMUNICATION WITH WASHINGTON REGULATORS

In Washington, there appears to be some form of miscommunication between Avista and the Washington Utilities and Transportation Commission (WUTC). This is evident given Avista's most recent rate filing being rejected by the WUTC in December 2016, which was followed by a WUTC denial for reconsideration of the December decision, in February 2017. This was a surprising outcome considering our view that the core competency of utility management is managing regulatory relationships and an outright denial by the regulator is unexpected.

Since the WUTC is Avista's most important regulator, overseeing roughly 60% of the company's revenue generation, we anticipate that the company will have a declining financial profile over the next 12-18 months while Avista engages the commission in preparation for another filing (expected during 2Q17). While this is a credit negative development, Avista currently has a strong enough financial profile to absorb this rate case delay without any ratings impact (see financial section, below). Moreover, we view this snafu as temporary, and expect that the company will continue to receive adequate and timely cost recovery of prudently incurred costs.

In the meantime, Avista's last general rate case order remain intact, including the electric and gas decoupling mechanisms, which we view as a significant credit positive. Decoupling enhances the timely recovery of fixed costs for the utility and provides for stable and predictable gross margin and cash flow in the face of declining use, in addition to attrition adjustments for ongoing rates. This has been beneficial to Avista since residential and commercial customer electric and gas use has declined over the past two years.

FINANCIAL PROFILE PROVIDES SOME CUSHION FOR RATE CASE DELAY

Avista's key financial metrics, such as cash flow from operations before the changes in working capital (CFO pre-WC) to debt, continue to be very stable at around 19%. This level is in-line with other Baa1 vertically integrated peers and should provide a degree of financial flexibility for the company to withstand the financial decline expected over the next 12-18 months.

For example, Avista estimates that the delay in obtaining a rate order will reduce its earnings per diluted share between $0.20 to $0.30 for 2017. We estimate that this would equate to between $13 million and $20 million of net income. This reduction of net income could reduce cash flow to debt metrics by up to 100 basis points, or around 18%, assuming no increase in debt. We would expect this trend to correct itself once an acceptable general rate case is filed with the WUTC and becomes approved. However, should cash flow to debt remains in the mid-teen's percent range (e.g., 16% or 17%) there could be negative ratings pressure for Avista.

We see a more significant risk with Avista's level of deferred taxes generated in 2016. The company benefitted from around $125 million of deferred tax increases that represented roughly 35% of CFO in 2016. We expect this level to decline significantly going forward, which could place additional pressure on financial metrics. For example, if deferred taxes reduced to around $75 million (the average level from 2012-2016) 2016 CFO pre-WC to debt would be 17%.

WASHINGTON'S CLEAN AIR RULE PROVIDES AN ASPECT OF UNCERTAINTY

In September 2016, the Washington State Department of Ecology adopted the Clean Air Rule (CAR) which establishes emission standards for green house gas (GHG) emissions from certain sources in the state, including power plants and natural gas distributors. The plan calls for a reduction of GHG emissions over time, at a pace of 1.7% annually until 2035; however, the base level has not been set by the Department of Ecology.

Exactly how, and at what cost, the rule might affect Avista's power plant generation and natural gas distribution is currently unclear. Under the rule, Avista can comply by simply reducing emissions or providing Emission Reduction Units (ERUs) - a cap and trade type mechanism within Washington state borders, which has yet to be administered.

We view the ability to reduce emissions from owned generation as more feasible than from natural gas deliveries - which are primarily based on customer needs and generally outside the control of the company - since the company only acts as a conduit for natural gas deliveries. Therefore, if Avista is held financially accountable for the emissions of roughly 117 Bcf of gas deliveries per year, rates and customer bills could rise with no added benefit of service - a credit negative.

The first compliance period ranges from 2017 to 2020, giving Avista time to incorporate a compliance strategy. We note that several parties, including Avista, filed a joint action in the US District Court for the Eastern District of Washington challenging the CAR; thus, a prolonged litigation period will likely ensue.

Liquidity Analysis

We expect Avista to maintain adequate liquidity in the next 12-18 months.

Avista's external liquidity source consists of a $400 million senior secured revolving credit facility, which expires in April 2021. As of 31 December 2016, there were $154 million of cash borrowings, leaving $246 million available 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.

Avista was in compliance with the facility's sole covenant of less than 65% capitalization, with a ratio of 52.9% as of 31 December 2016.

AEL&P has a $25 million line of credit which expires in November 2019 and requires a consolidated debt to capitalization covenant of 67.5%. As of 31 December 2016, there were no borrowings or letters of credit outstanding under the facility and AEL&P was in compliance with its covenant, with a ratio of 55.6%.

Avista's next material debt maturities occur in May and June 2018, when $7 million and an aggregate $255.5 million of senior debt are due, respectively.

Profile

Avista Corporation (Avista, Baa1 Stable) is primarily a regulated electric and gas utility servicing around 375,000 electric and 335,000 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; Baa3) which serves around 17,000 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 is under the purview of the Regulatory Commission of Alaska (RCA).

Rating Methodology and Scorecard Factors

Exhibit 3

Rating Factors				
Avista Corp.				
Regulated Electric and Gas Utilities Industry Grid [1][2]	**Current FY 12/31/2016**		**Moody's 12-18 Month Forward View As of Date Published [3]**	
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)	5.5x	A	4.6x - 4.9x	A
b) CFO pre-WC / Debt (3 Year Avg)	19.6%	Baa	17% - 19%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	15.2%	Baa	14% - 16%	Baa
d) Debt / Capitalization (3 Year Avg)	44.6%	A	41% - 43%	A
Rating:				
Grid-Indicated Rating Before Notching Adjustment		Baa1		Baa1
HoldCo Structural Subordination Notching	0	0	0	0
a) Indicated Rating from Grid		Baa1		Baa1
b) Actual Rating Assigned		(P)Baa1		(P)Baa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 12/31/2016.
[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.
Source: Moody's Financial Metrics™

Ratings

Exhibit 4

Category	Moody's Rating
AVISTA CORP.	
Outlook	Stable
Issuer Rating	Baa1
First Mortgage Bonds	A2
Senior Secured	A2
Senior Unsecured MTN	(P)Baa1
ALASKA ELECTRIC LIGHT AND POWER COMPANY(AELP)	
Outlook	Stable
Issuer Rating	Baa3
AVISTA CORP. CAPITAL II	
Outlook	Stable
BACKED Pref. Stock	Baa2

Source: Moody's Investors Service

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