MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Avista Corp. to Baa2, outlook stable

20 Dec 2018

Approximately $1.1 billion of securities affected

New York, December 20, 2018 -- Moody's Investors Service ("Moody's") today downgraded Avista Corp.'s (Avista) issuer rating to Baa2 from Baa1, its senior secured and first mortgage bond ratings to A3 from A the trust preferred securities rating at Avista Corp. Capital II to Baa3 from Baa2. The outlook for Avista is stable.

"Avista's cash flow is lower primarily due to tax reform, resulting in financial metrics in the mid-teens range stated Nana Hamilton, Analyst. "In addition, Moody's sees less predictability with the regulatory outcomes Washington and room for the company to better manage its relationship with the commission."

Downgrades:

..Issuer: Avista Corp.

.... Issuer Rating, Downgraded to Baa2 from Baa1

....Senior Secured First Mortgage Bonds, Downgraded to A3 from A2

....Underlying Senior Secured First Mortgage Bonds, Downgraded to A3 from A2

....Senior Secured Medium-Term Note Program, Downgraded to (P)A3 from (P)A2

....Senior Secured Regular Bond/Debenture, Downgraded to A3 from A2

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)Baa2 from (P)Baa1

..Issuer: Avista Corp. Capital II

....Pref. Stock, Downgraded to Baa3 from Baa2

Outlook Actions:

..Issuer: Avista Corp.

....Outlook, Changed To Stable From Negative

..Issuer: Avista Corp. Capital II

....Outlook, Changed To Stable From Negative

RATINGS RATIONALE

Pre-tax reform, deferred income taxes constituted a significant portion of Avista's operating cash flow. For example, in 2016, over a third of operating cash flow was associated with deferred taxes. Between 2013 to 2017, deferred taxes averaged about 26% of cash flow. With the lower tax rate and loss of bonus depreciation from tax reform, Avista's ratio of cash flow to debt over the next two years should be around 16%.

The Baa2 rating also looks at Avista's less predictable regulatory outcomes in Washington, where the company generates about 60% of its revenue. Although the state has some credit supportive mechanis such as revenue decoupling, the use of historic test years results in the need file general rate cases more frequently. In August 2018, rate base attrition adjustments, which are considered to be credit supportive, wer ruled by the Washington Court of Appeals as against the state's used and useful law. This legal decision was part of an ongoing review of Avista's 2015 Washington rate case.

Separately, in April 26, 2018, the Washington Utilities and Transportation Commission (WUTC) issued a f order in Avista's most recent electric and natural gas general rate cases filed on May 26, 2017. Although Avis had requested three-year electric and gas rate plans in its original filing, the WUTC's order provided for new rates effective May 1, 2018 for one year. In its order, the WUTC approved a net electric revenue increase of $10.8 million and a net natural gas revenue decrease of $2.1 million, both including the impacts from the tax cuts and jobs act (TCJA). Both electric and natural gas orders were based on a slightly below industry average ROEs of 9.5% and equity layers of 48.5%. In addition, the WUTC agreed to withhold $10.4 million the electric excess deferred federal income taxes that resulted from TCJA for the purpose of accelerating the depreciation schedule for Colstrip Units 3 and 4 to reflect a remaining useful life of those units through December 31, 2027.

Although Moody's considers the outcome of the rate case as neutral from a credit perspective, the compan relationship with the Washington commission has been more contentious than other peers'. For example, Avista's February 2016 rate filing was rejected by the WUTC in December 2016, and the company's requ reconsideration of the decision was rejected by the commission in February 2017.

On 5 December 2018, the WUTC rejected Hydro One Limited's (HOL) proposed acquisition of Avista, concluding that the proposed merger agreement is not in the best interest of Avista or its customers from a political and financial risk perspective. Avista and HOL have filed a petition for reconsideration of Washing decision and decisions from Idaho and Oregon on the acquisition are still pending.

Outlook

The stable outlook incorporates a view that Avista's financial profile will maintain a ratio of cash flow from operations pre-working capital (CFO pre-WC) to debt in the mid-teens range and assumes that the utility will receive adequate cost recovery within its regulatory jurisdictions. The stable outlook also incorporates a view that the proposed acquisition by HOL is unlikely to be completed and that unregulated operations will rema below 15% of consolidated earnings and cash flow.

What could change the rating -- Up

A rating upgrade could be considered with a demonstrated improvement in regulatory relationships or with CFO pre-WC to debt above 19% on a sustainable basis and CFO pre-WC less dividends to debt above 18% on a sustained basis.

What could change the rating -- Down

A downgrade could be considered if there was a sustained depreciation of regulatory relationships or if CFO pre-WC to debt deteriorated to below 14% on a consistent basis. A rating downgrade could also be considere if, in the event of a successful completion of the HOL acquisition, Avista is required to provide direct finan support of HOL's acquisition debt.

The principal methodology used in these ratings was Regulated Electric and Gas Utilities published in June 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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