

**Rating Action: Orkuveita Reykjavíkur**

**Moody's assigns Aa2 rating to Orkuveita Reykjavíkur (Iceland)**

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**First time rating**

London, 11 January 2007 -- Moodys Investors Service has today assigned a long-term senior unsecured issuer rating of Aa2 to Orkuveita Reykjavíkur ("Reykjavik Energy" or "RE"). The rating outlook is stable.

The Aa2 rating reflects Moody's Joint-Default Analysis for Government-Related Issuers and is driven by the strong credit quality of its owners -- in particular the City of Reykjavik (the City, which owns 93.5%) and its Icelandic municipal partners, the Town of Akranes (5.5%) and the Municipality of Borgabyggd (1%) -- and the high levels of support and dependence attributed to this multi-utility. These reflect the strategic importance of RE, which provides essential utility services to the City and surrounding areas, as well as the guarantee of collection provided by its owners.

RE's intrinsic strength is recognised in the Baseline Credit Assessment (BCA) of 11 (on a scale of 1 to 21, where 1 represents the lowest credit risk). RE has a low-moderate business risk for a utility, deriving over 70% of its revenues from the low-risk utility services that it provides. However, over time, higher-risk unregulated cash flows will assume greater importance as RE's strategy is to significantly increase its electricity-production capacity through a EUR1.5 billion, debt-funded investment programme. This will lead to a significant weakening of its financial profile until the new capacity is fully on stream in 2012.

The Aa2 rating factors the strong credit quality of the City, which is underpinned by the robust operating environment and the predictable and supportive institutional framework for Icelandic local governments. Stable financial operations with improving (albeit narrow) margins supported by solid, own sources of revenues also support the credit risk profile, as does the City's moderate and declining direct debt. However, Moody's credit quality assessment also incorporates the City's considerable exposure to debt guarantees provided to RE.

Moody's factors support towards the top end of the high category for RE. Under RE's governing act, the partners are responsible for all the liabilities of RE in proportion to their shareholding. This constitutes a "guarantee of collection". The liability of the partners gives the creditors a direct claim against the partners after the remedies against the borrower have been exhausted. Whilst this type of guarantee, which is common in Nordic countries, does not offer bondholders the same degree of protection as a standard guarantee given the potential for non-timely payment, there are strong incentives for timeliness, including penalty interest and costs of collection on overdue payments.

Under the current guarantee structure, the City of Reykjavik is only legally responsible for RE's liabilities in proportion to its pro-rata holding in RE. However, given its dominance in the shareholding (over 93%) and decision-making, Moody's believes it is most improbable that the City would not ensure timely repayment of RE's obligations. However, the rating is sensitive to support assumptions, and any dilution of shareholding that called into question the commitment of the City of Reykjavik towards extraordinary support for RE could exert negative pressure.

Dependence is considered high, reflecting the fact that the likely cause of a City default -- severe economic distress - would probably affect both City tax revenues and utility revenues, supporting a strong default correlation between the two entities.

The outlook is stable. The rating is unlikely to move upwards in the medium term as it would require a two-notch shift upwards in the company's BCA, assuming all the other rating inputs remained the same, to have a one-notch impact on the final rating. A shift upwards in the assessment of the City of Reykjavik would not impact the rating unless accompanied by a further move upwards in support factors.

Moody's believes that the company's BCA is comfortably positioned at its current level but the rating could move down if there was a significant and prolonged deterioration in the company's financial profile beyond expectations. A more negative credit assessment of the City or a reduction in support assumptions could also create downward rating pressure.

Orkuveita Reykjavíkur, based in and around Reykjavik, Iceland is the country's largest multi-utility, providing electricity, hot water heating, cold water and waste services to more than 50% of the Icelandic population.

The company focuses on generating environmentally friendly energy from geothermal sources. It is Iceland's second-largest electric utility after Landsvirkjun. Since 2005, the company has also been a fibre-optic service provider although this is expected to remain a relatively limited contributor to the business. As at FYE 2005, the company had revenues of EUR196 million.

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