



Rating Action: Moody's assigns first-time Baa2 issuer rating to Peninsula Clean Energy Authority, CA; outlook is stable

06 May 2019

New York, May 06, 2019 -- Moody's Investors Service today assigned a first-time Baa2 Issuer Rating to Peninsula Clean Energy Authority, CA (PCE), a California Community Choice Aggregator (CCA). The outlook is stable.

RATINGS RATIONALE

PCE's Baa2 Issuer Rating recognizes the economic strength of the service territory as a not-for-profit California CCA serving more than 285,000 customers throughout all communities in San Mateo County (Aaa stable). The rating considers the inherent strengths of the California CCA model which provides PCE with a captive and arguably sticky customer base capable of delivering reliable revenue and cash flow on a consistent basis. A strength of the California CCA model are the statutory provisions which enabled PCE to immediately become the default provider of generation services for San Mateo County customers of Pacific Gas and Electric Company (PG&E) upon inception. In PCE's case, all twenty of the cities in San Mateo County and the county voted affirmatively to join PCE, a credit positive.

The Baa2 rating considers the structure's established provisions for timely, full cost recovery through an independent rate setting authority; conservative management strategy centered exclusively around serving the electric needs of its San Mateo customers; actively involved board with a broad business background; ability to secure cost competitive renewable resources; and its demonstrated ability to generate internal free cash flow on a sustained basis; all credit positives. At the end of March 2019 PCE had unrestricted cash of about \$108 million, an increase of \$42 million from fiscal year end 2018 owing to steady monthly internal cash flow generation. It expects to have around \$125 million in cash at June 30, 2019, its fiscal year-end. PCE's ability to generate sustained free cash flow serves to mitigate the CCA's limited three-year operating history.

The rating further acknowledges the January 29th bankruptcy filing by PG&E, who acts as the billing and collection agent for northern California CCA's including PCE, along with the "first-day order" from the bankruptcy judge to maintain existing contractual and cash management arrangements between CCA's and PG&E. Under the CCA business model, PG&E includes charges for generation services provided by PCE on the monthly electricity bill that PG&E sends to its customers. Pursuant to Rule 23 of the California Public Utilities Commission (CPUC), once a PCE customer pays its utility bill, PG&E transfers collected CCA generation revenues to PCE on a daily basis. In return for PG&E providing billing and collection services, PCE and other CCAs each pay PG&E a fee, a process that has continued while PG&E operates under receivership. The PG&E bankruptcy court "first-day orders" included an acknowledgment that the cash flow collected by PG&E are revenues of the CCA. They are not a part of PG&E's estate and CCA revenues cannot have a lien placed against them by the debtor-in-possession lender.

The rating also recognizes the potential long-term market implications that will likely follow given PG&E's bankruptcy filing, including the current role that CCA's play in the state. While a variety of different proposals have been discussed concerning prospective roles for PG&E, CCA's, and other government entities in the state, our rating incorporates our understanding of the current framework for power procurement for CCA's operating in the state, particularly since we believe that the current framework is likely to remain unchanged until such time that PG&E emerges from bankruptcy, which we believe will be a several year process. In the meantime, the CCA model is a key element in the advancement of the state's objective to lower carbon emissions and transition to renewable energy sources. As a result both state and local policymakers as well as the CPUC are generally on the same page as to their support of and ultimate success of this model, an important consideration in our view. That said, the manner in which PG&E emerges from bankruptcy may change the role that CCAs play in the state, which could affect the direction of their credit profile prospectively.

In addition to these longer-term market considerations, PCE's credit profile faces nearer-term challenges, the most significant of which relates to their ability to manage power procurement risk which can be accompanied by uncertainties concerning resource production and load variability. PCE has sought to address these challenges by strengthening its power procurement capabilities, managing its long-term power procurement book by not overcontracting (net short position), executing on a strategy centered around building internal liquidity (expected to reach \$125 million at June 30, 2019) and supplementing it with external liquidity through a Barclays Bank line of credit, and focusing its efforts around the needs of its San Mateo County customers which helps to limit the volatility related to managing power procurement risk. Moreover, we note that the "opt-out" rate remains quite low (in the 2.5% range) indicating broad customer support for PCE. Prospective changes in load demand and the need for incremental renewable resources will depend upon the growth of the electric vehicles market and any resulting increase in energy demand.

Regarding power procurement risk, a particular challenge is the potential for CCAs, including PCE, to procure more energy under long term contracts than is needed to serve their customers' load requiring them to sell the more expensive excess energy into the wholesale power market at lower market prices. According to PCE's financial statements, PCE has entered into forward purchase commitments for delivery of renewable energy on an as-available basis that aggregates \$966 million at fiscal year-end 2018. In an extreme worst case scenario where there is a sudden decline in customer load, PCE could find itself in an under collected position should contracted power prices paid by PCE under these long-term arrangements exceed wholesale market prices for a sustained period. This scenario, for example, could emerge should a substantially higher than normal number of customers "opt-out" and return to PG&E for their generation product or through sustained technological advances which permanently limit customer load growth. As mentioned, to date, PCE has experienced an extremely low level of customers "opting-out" of around 2.5%. PCE has attempted to mitigate its power procurement risk as its current long-term contractual arrangements approximate 20-30% of its expected load with the remainder being satisfied by

medium-term, short-term, and market purchases across a very diverse list of energy suppliers with not one provider exceeding 15% of its load requirements. This broad approach around maintaining a net short position will continue even with PCE intending to increase its long-term resources under contract to 50% over the next several years as the CCA meets state-mandated renewable requirements and satisfies its own renewable supply objectives. In the end, PCE's ability to manage this risk is aided by a conservative approach to liquidity management, its strategy focused exclusively on serving the electric needs of San Mateo County, and by the fact that PCE's long-term commitments were executed within the last several years, providing them with the benefits of low cost renewable resources, giving PCE access to attractively priced long-term generation resources.

From a customer concentration standpoint, there is no customer dominance with about 40% of its revenues being provided by residential customers with the remainder coming principally from large and small commercial customers, some of whom have elected to opt for direct access. While revenues from the large commercial sector may be sensitive to economic cycles and could be exposed to incremental direct access risk, PCE's ability to maintain a net short position over the long run along with its plan to maintain strengthened liquidity helps to mitigate this risk. At year-end 2017 and 2018, PCE had over 100 and 158 days of liquidity, respectively. We anticipate days of liquidity to increase to approximately 250 days at year-end 2019, with the vast majority of such liquidity provided by internal cash on hand. PCE also has a timely local rate-setting process in which its board has authority to raise rates to grow annual revenues, if needed.

Based upon PCE's business plan, PCE's net position is forecast to continue to increase over the next several years. While a recent CPUC decision concerning the allocation of Power Cost Indifference Adjustment (PCIA) charges will result in a greater than expected portion of these charges being allocated to CCA customers, PCE's pricing strategy to offer its 50% renewable product at 5% below PG&E's bundled cost for generation remains unchanged and is expected to continue providing flexibility to increase its net position and cash balances while remaining price competitive to PG&E owing to the more competitive profile of its generating resources under short and long-term contracts.

Another important rating consideration is the California Joint Power Agency statute requirement (Title 1, Division 7, Chapter 5, Article 1 (Section 6500)) stating that PCE municipal members of the JPA must pay any of its remaining cost obligations to PCE if it decides to depart PCE and return to the investor-owned utility. While this provision has not been tested in the courts, participating members have been apprised of the ultimate risk prior to each of them obtaining their respective approvals to enter into the PCE participation agreement and join the CCA. Any municipal member of PCE that chooses to depart would have to give a one-year notice, fund its remaining obligations taken out on their behalf and receive a super-majority (67%) vote of approval from the PCE board making such a decision challenging if their departure were to adversely affect PCE.

RATING OUTLOOK

The stable outlook reflects expectations for a continuation of the current CCA model; PCE's ability to implement its core objective to provide clean energy options for customers in San Mateo county while growing its liquidity profile and maintaining independent board rate-setting as well as appropriately balancing energy purchase commitments relative to demand.

FACTORS THAT COULD LEAD TO AN UPGRADE

In light of the uncertainty that the PG&E bankruptcy is expected to have on the future of the California electric market place, limited near-term prospects exist for the rating to be upgraded. That said, the potential for a higher rating exists should:

- Trend of strengthening financial operations, including internal liquidity, continues
- Broader statutory acceptance of the CCA business model persists
- More favorable outcome concerning the PCIA allocation occurs in the CPUC Phase 2 decision process
- Narrowing or de-risking of power related remarketing risk

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Material decline in financial liquidity
- Power procurement market risk increases which results in sustained losses or customer under-collections
- An acceleration of customer opt-out rates
- State policy changes occur which weakens the CCA model from a credit perspective
- Failure to manage exposure to the loss of customer revenues due to "opt-outs" caused by competition from direct access
- Technological advances which permanently lowers the load profile leading to a weakening in the current procurement strategy

LEGAL SECURITY

Not Applicable

USE OF PROCEEDS

Not Applicable

PROFILE

Headquartered in Redwood City, CA, Peninsula Clean Energy Authority, CA (PCE) is a California Joint Powers Authority (JPA) formed in 2016 created after 20 communities in San Mateo County and the county unanimously executed the joint powers agreement to participate in clean energy aggregation. PCE provides electric service to more than 285,000 retail customers as a CCA under the CPUC Code Section 366.2.

METHODOLOGY

The principal methodology used in this rating was US Municipal Joint Action Agencies published in October 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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