



RATING ACTION COMMENTARY

Fitch Affirms Peninsula Clean Energy (CA)'s IDR at 'BBB+'; Outlook Stable

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Fitch Ratings - San Francisco - 16 Mar 2022: Fitch Ratings has affirmed the Issuer Default Rating (IDR) of Peninsula Clean Energy, CA (PCE) at 'BBB+'.

PCE has no direct debt outstanding.

The Rating Outlook is Stable.

SECURITY

The IDR reflects Fitch's assessment of PCE's vulnerability to default on its financial obligations.

ANALYTICAL CONCLUSION

The affirmation of the 'BBB+' rating is based on PCE's strong financial profile, which includes robust liquidity levels, despite weaker financial performance and the use of cash reserves in fiscal 2021. Days cash on hand (DCOH) declined to 256 at YE 2021 from 280 days at YE 2020 as a result of negative operating margins in 2021. Fitch's liquidity cushion ratio, measured by the combination of annual cash flow, unrestricted cash reserves and liquidity divided by operating expenditures, declined to 0.72x from 1.03x over the same period, but is still considered neutral to the rating.

The 'BBB+' IDR also reflects PCE's limited operational role as a Community Choice Aggregator (CCA) and the inherent credit weaknesses in the CCA business model, which include a non-captive customer base that can elect service from Pacific Gas and Electric Company (PG&E) and the resulting pressure to maintain competitive rates. Positively, the restricted scope of PCE's business, which is limited to the procurement of power, largely eliminates any material capex needs given current practices in securing power supply.

KEY RATING DRIVERS

Revenue Defensibility: 'Weaker'

The weaker revenue defensibility assessment primarily reflects a customer base that can opt out of service from PCE, and competitive pressure on PCE not to exceed PG&E's rates, given expected customer sensitivity to rates. Fitch does not believe these weaknesses are mitigated by PCE's independent authority to set and adjust rates or PCE's legal ability to impose an exit fee on departing customers. The assessment also reflects PCE's lack of control over the Power Cost Indifference Adjustment (PCIA) charged to its customers and established by the California Public Utility Commission (CPUC).

Operating Risk: 'Midrange'

PCE's operating risk is limited given its role as an energy-only provider. Power supply resources consist entirely of contracts with varying counterparties, geographic locations, terms and fuel types. The midrange assessment also incorporates the long-term financial risk associated with securing power supply for a potentially variable customer base, given state legislation that requires 65% of the state renewable portfolio standard (RPS) be secured under 10-year or longer contracts.

Financial Profile: 'Stronger'

PCE's financial profile is expected to remain stronger despite pricing pressure in fiscal 2021 that resulted in a drawdown of reserves to a still robust 256 days of operating reserves from 280 days in fiscal 2020. Issuer projections indicate a continued reduction of reserves through fiscal 2024, although a Board adopted liquidity policy requires maintaining a minimum working capital reserve of 180 days of operating expenses including purchased power.

Operating margin turned negative in in fiscal 2021 as a result of pricing constraints driven by lower PG&E generation rates and a higher PCIA. Quarterly results through Dec. 31,

2021 indicate similar negative margins for the first half of fiscal 2022. A PCIA rate decrease in 2022 coupled with a PG&E rate increase provides some additional pricing flexibility for PCE going forward.

Asymmetric Risk Additive Considerations

No material asymmetric risk factors affected the overall rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--High levels of cash reserves that provide meaningful protection against a potential multiyear customer opt-out trend, given PCE's long-term contractual commitments for energy purchase;

--Cessation of competition from alternative generation provider;

--Enhancements to customer opt-out provisions that limits or reduces long term customer departures.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Significant adverse change in the regulatory or competitive landscape within which PCE operates;

--An increase in PCE's leverage ratio above 0.0x on a sustained basis, or a trend in declining operating margins or reserve levels;

--Reversal to the pattern of declining renewable costs that erodes PCE's ability to compete with PG&E.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical

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<https://www.fitchratings.com/site/re/10111579>.

CREDIT PROFILE

PCE is a California joint-powers authority (JPA) created in 2016 for the purposes of implementing a CCA program. PCE's service area includes all of San Mateo County, CA. Within its service area, PCE provides generation-only services directly to all retail customers of PG&E, unless those customers opt out and elect PG&E as their provider. PG&E still delivers the energy to customers over PG&E transmission and distribution lines, and provides metering and billing services as PCE's collection agent.

The 20 cities located in the county and the county itself are required to remain part of the JPA or pay the costs incurred on their behalf prior to their departure. Any municipality seeking to leave the JPA must also provide six months' notice. While this requirement could act as a potential restriction on communities seeking to exit the JPA, it provides no constraint on whether residents of the member cities can opt out of service from PCE. In October of 2020, the Board approved the expansion to serve Los Banos, CA, located in Merced County. PCE service is expected to begin in April of 2022 and will add approximately 15,000 customers. Los Banos will be the first addition of a non-San Mateo County entity within PCE.

Revenue Defensibility

Default Generation Provider in San Mateo County

PCE is the default provider of power generation to all residents located in San Mateo County, as required by the 2002 California legislation enabling CCAs. The legally required default to PCE service is a strong credit feature. Customers are presumed to be price sensitive, but also relatively non-action oriented. Consumer behavior tends to strongly favor the default assignment when automatic enrollment occurs. Fitch views the default to PCE service and rates slightly below PG&E as supportive elements of demand and the final rating.

Customer Opt-Out Ability is Key Risk

Retail customers permanently retain the ability to opt out of service from PCE and revert to being an energy customer of PG&E at any time, potentially undermining the long-term stability of demand, and leading to Fitch's weaker assessment of revenue defensibility.

Customer opt-out rates have historically remained below 3.0%. Given PCE's electric supply rates are below those of PG&E, Fitch expects the opt-out rate to remain low.

CCAs are permitted to charge departing customers an exit fee, and PCE charges a \$5 administrative fee to residential customers and a \$25 fee to commercial customers that leave after the first year of service. The current administrative fee is minimal. Fitch expects any effort by PCE to impose a more sizable exit fee would be met with some level of political backlash. Fitch views the legal ability to implement an exit fee as insufficient on its own to provide financial protection against PCE's fixed costs in the event of a meaningful trend of customer departures.

Very Strong Service Area Characteristics

San Mateo County exhibits very strong service area characteristics, supporting ongoing demand. The county is located in the San Francisco Bay Area, equidistant from the cities of San Francisco to the north and San Jose to the south. The very strong service area characteristics suggest customers in the county may be less sensitive to price and more motivated by product differentiation offered by PCE compared with PG&E. The county's median household income was \$122,641 in 2019 (most recent data available), or 195% of the national average. Unemployment in the county has returned to a near pre-pandemic low of 2.8% as of December 2021.

PCE currently serves approximately 296,000 customers within San Mateo county, residing in 21 cities and unincorporated parts of the county. Residential customers account for around 44% of revenues. Customer concentration is not a concern, with the 10 largest customers accounting for only 9.94% of energy sales in fiscal 2021.

Product Differentiation

PCE offers two products to customers in support of its overall mission to provide 100% of power supplied renewable resources by 2025. PG&E began offering customers a 100% GHG free option but only 50% of PG&E's 2021 power supply was from renewable resources.

PCE's default product is ECOplus, which provides a power supply at or above 50% renewable and 100% GHG free. PCE also offers, at the customers' choice, ECO100, which provides a 100% renewable power supply. ECOplus is priced at a 5% discount to PG&E's comparable generation rate. ECO100 charges a \$0.01/kWh premium above the ECOplus rate, which results in a cost of approximately \$2.50 per month above PG&E's rates.

Local decision making and control, product differentiation, and cost savings provided the motivation for the cities and county to create and join PCE and define the agency's mission. However, it appears product differentiation is less of a motivation for individual customer decisions given the limited election by customers for PCE's greener alternative at a higher price. Fitch does not view PCE's product differentiation as sufficient to offset the risk of customers' opt-out flexibility; consumers are presumed to be price sensitive. PG&E and all California utilities are legally mandated to continue raising their GHG-free and renewable content over time, reducing PCE's current competitive advantage provided by its higher renewable content.

PG&E & Wildfire Risks

PG&E delivers the energy purchased from PCE to the retail customers over PG&E's transmission and distribution lines, and bills the retail customer on a combined bill in the role of PCE's billing agent. The flow of PCE revenues collected by PG&E was protected during the PG&E bankruptcy from January 2019 through June 2020. One of the first actions the bankruptcy court took during the initial days after the bankruptcy filing was to maintain the existing collection arrangements between PG&E and CCAs, including PCE. PG&E remits the funds daily to PCE.

PG&E engages in public safety power shutoffs (PSPS) to reduce its exposure to wildfires during certain weather conditions in high-risk areas. At times, the PSPS events affect PCE's sales because its customers receive power delivered via PG&E's transmission and distribution lines. PCE has no ability to deliver power to its customers during a PSPS. PG&E's notification timing has lengthened, which allows PCE to reduce the costs incurred to purchase and schedule energy deliveries via the California Independent System Operation (CAISO).

Wildfires have become more prevalent in California in recent years. PCE does not own or operate generation or transmission assets, which limits the liability risk of a catastrophic wildfire event that may be initiated by these types of assets and have exposed California utilities to extraordinary liability claims as a result of permissive inverse condemnation laws, regardless of whether the utilities lines or operations are determined to have caused or contributed to a damaging wildfire.

Independent Rate Setting, but Competition and PCIA Place Practical Constraints on Pricing

PCE has the independent ability to adjust rates to fully recover costs. The board of directors makes rate decisions that are not subject to external review. While all

participating cities and the county each have a representative on the PCE board, PCE is not considered a related entity of any one participating member or government entity. Fitch assumes that customers are rate sensitive over time due to the competitive pressure presented by PG&E as a potential alternate electricity provider and the lack of switching costs for customers. Together these aspects impose a practical limitation on rate setting.

In practice, PCE sets its rates for the ECOplus product at 5% less than PG&E cost of service for the comparable customer class. PCE adjusts its rates as often as practical after PG&E implements a rate change. This rate-setting philosophy is likely to remain in place unless PG&E exits the retail generation business or rates are lowered to a point that they do not recover PCE's full costs. In February 2022, the CPUC approved a new rate package from PG&E in the form of a generation rate increase for PG&E customers. The PCE board subsequently approved a resolution to implement a rate increase while maintaining the 5% discount to PG&E's bundled rates.

As long as PCE's rates remain competitive to those of PG&E, Fitch expects the vast majority of customers will decide not to opt out given the economic incentives to remain with PCE and the community support for the current product offerings. PCE's current rates offer future rate flexibility given the discount to PG&E's rates, but the net margin has been negatively impacted by the adherence to the 5% discount.

Power Cost Indifference Adjustment (PCIA)

PCE does not have ultimate control over one component of its rates, limiting its practical rate flexibility. Customers are charged a PCIA determined by the CPUC. PCE does not have direct recourse to alter the PCIA charged to its customers, but it elects to reduce the amount of its bill to each customer by the same amount of the PCIA charged to that customer to preserve the 5% rate differential to PG&E rates. If the CPUC raises the PCIA, this reduces PCE's revenues, and consequently operating margin.

The PCIA rate was triggered higher by approximately 44% in early 2021, but PCE projects the PCIA rate will decrease annually through 2025, from approximately .045 cents/kWh to .027 cents/kWh. Nevertheless, the PCIA is expected to be a volatile rate going forward that will continue to affect PCE revenues.

The PCIA is charged per kWh and is intended to reflect the difference in the cost of PG&E's portfolio developed to serve the departing customer, less the market value of the portfolio, leaving PG&E indifferent to the loss of that customer's generation load. PCIA charges increased over the past few years as market prices decreased, widening the gap between

PG&E's portfolio cost and the market value for that power. The PCIA will gradually become less relevant for PCE's customers as PG&E's legacy contracts mature over time.

Operating Risk

PCE's operational role is primarily limited to power supply procurement. The distribution, delivery and transmission of power, as well as billing and collections, remain obligations of PG&E. Cost drivers are well identified and power supply volatility is manageable given PCE's hedging practices. Capital needs are negligible because PCE does not own any generation; all power supply resources are contracted. Positively, this means PCE generally does not bear the development, construction, operating or system risks experienced by generation resource owners, integrated utilities or distribution utilities.

Operating Cost Flexibility

Operating costs consist of the cost of power, marketing, and general administration and operating expenses. PCE's cost of power is relatively stable within the budget year, as power supply is contracted at or above 90% for each upcoming 1-month period, primarily through fixed-price - or moderately escalating price - multiyear contracts. While the cost of power per MWh is generally known, the volumes necessary to serve load along with potential fluctuations in energy received under each contract, particularly for intermittent renewables, creates some uncertainty regarding the actual price at any point in time and increases the need to maintain adequate liquidity.

The risk of intermittent renewable supplies is partially mitigated by requirements for load-serving entities in California, such as PCE, to demonstrate a 15% reserve margin above its projected peak demand and the use of flexible capacity.

Resource Management

Robust power supplies are generally available with good transmission infrastructure in place. PCE's location within the California Independent System Operator, the prevalence of renewable generation in surrounding areas, the diversity of potential suppliers and the geographical dispersion of contracted resources position PCE well in terms of securing sufficient and adequately priced power to meet its needs.

Power supply is met by approximately 40 contracts with various suppliers incorporating multiple technologies and fuel types, including renewable, conventional and GHG free. Contracted resources are geographically diverse and vary in length and term of power

delivery, although all are located within California. No single contract accounts for over 27% of the total generation supply.

Balancing Potential for Load Declines with Long-Term Power Supply is Credit Risk

PCE's largest resource risk is balancing its contracted power supplies with a potentially variable demand, given lack of the exclusive right to provide generation service. PCE adopted a formal risk-management plan intended to limit the potential risk of being either short or long power supply in any particular year, or being vulnerable to unexpected price movement.

PCE's practices call for it to have between approximately 90% and 100% of its energy needs under fixed-price contracts during the upcoming year and successively lower amounts in each of the following years. PCE's policy is to be 100% hedged in each upcoming quarter, even those periods of the year that do not typically, but can, experience price variability. This was an enhancement the board implemented following an unusual pricing event in spring 2019. This strategy also benefited PCE during the late summer 2020 heat event that impacted California utilities.

PCE's hedging strategy mitigated the significant market price and usage spikes occurring over a multiple-day period in August, resulting in a net position increase of \$3.9 million in the first quarter of fiscal 2021. Total net position improved by \$11.1 million through the first two quarters of fiscal 2021.

Balancing supply and demand is further complicated by certain legislative mandates. Utilities, including CCAs, must secure at least 65% of the RPS-compliant power under contracts that extend 10 years or longer by 2021. PCE has procured approximately 73% of power supply under contracts of at least 10 years in length. While California's RPS compliance targets are below the actual renewable content of PCE's power supply (33% in 2020, compared with PCE's 51%), the long-lived nature of the contracts pose challenges to adjusting power supply costs if significant load departure occurs. PCE could withstand a pronounced customer departure rate over a multi-year period, but not likely an event that precipitated a widespread and abrupt departure of most of the customer base.

Limited Capital Needs

PCE's capital needs are limited and do not include plans to build self-owned generation. Fitch has not included any debt financing of capital needs in its analysis.

Financial Profile

PCE's stronger financial profile is supported by strong liquidity levels, but the assessment is less of a consideration in the final rating than the revenue defensibility and operating risk assessments. Fitch's leverage metric includes fixed obligations, such as debt and pension liabilities (of which PCE has neither) minus cash reserves, compared with cash flow. Given the absence of fixed obligations, Fitch's leverage calculation for PCE has historically been negative.

Strong liquidity supports PCE's financial profile and the final rating. PCE's most recent financial forecast for fiscals 2022-2026 was completed in June 2021 and accounted for the continued impacts of the coronavirus on demand and lower financial margins over the next five years. Liquidity is additionally enhanced by the availability of a \$12 million line of credit. Cash balances at the end of fiscal 2021 (June 30) totaled \$165 million, or 256 days' cash on hand. Including the line of credit, PCE's total days' liquidity was 275.

Unaudited interim results show unrestricted cash balances stable at \$165.8 million on Dec. 31, 2021. Management adopted a revised liquidity reserve policy in February 2021 that targets maintaining reserves at 180 days' cash. Fitch expects cash reserves to remain strong, in excess of the board policy.

Asymmetric Risk Additive Considerations

Governance and Management

PCE is governed by a 22-member Board of Directors. The board members are elected city council members or supervisors from each of the member cities and counties served by PCE. While they are not elected to the PCE board, the representatives have been elected to represent their respective communities.

Regulatory Risk

The legal and regulatory environment for CCAs continues to evolve. Fitch does not currently view the legal and regulatory regime as an asymmetric additive risk factor that affects the overall rating, but changes could present a rating risk in the future. Regulatory changes could result in either positive or negative changes to credit quality.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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ENTITY / DEBT ⇅	RATING ⇅	PRIOR ⇅
Peninsula Clean Energy (CA)	LT IDR BBB+ Rating Outlook Stable Affirmed	BBB+ Rating Outlook Stable
Peninsula Clean Energy (CA) /Issuer Default Rating - Electric/1 LT	LT BBB+ Rating Outlook Stable Affirmed	BBB+ Rating Outlook Stable

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[U.S. Public Power Rating Criteria \(pub. 09 Apr 2021\) \(including rating assumption sensitivity\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 01 Sep 2021\) \(including rating assumption sensitivity\)](#)

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Peninsula Clean Energy (CA)

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Utilities and Power US Public Finance North America United States
