Marin Clean Energy, California

Rating

Long-Term Issuer Default Rating[a] BBB+

[a]Upgraded from 'BBB' on Aug. 26, 2020.

Rating Outlook

Stable

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (March 2020)

Related Research

Fitch Upgrades Marin Clean Energy (CA)'s IDR to 'BBB+' from 'BBB'; Outlook Stable (August 2020)

California Wildfires, Blackouts Highlight Utility Operating Risk (August 2020)

Global Economic Outlook — June 2020 - Coronavirus Disruption Easing (June 2020)

Deficit Borrowing in Crisis Recovery Neutral to Negative for U.S. States & Locals (June 2020)

U.S. Public Finance and Infrastructure: Coronavirus Response So Far (April 2020)

USPF Changes Model Assumptions Due to Coronavirus (April 2020)

Fitch Ratings Updates 2020 Sector Outlooks to Reflect Coronavirus Impact (March 2020)

The Long-Term Issuer Default Rating [IDR]) upgrade to 'BBB+' is based on Marin Clean Energy's (MCE) stronger than expected financial performance in the past year, intent to retain larger cash reserve balances, and resolution of the rate and regulatory uncertainty during the Pacific Gas & Electric (PG&E) bankruptcy. MCE increased its rates in 2019 with the intent to bolster cash flow and cash reserves. Days cash on hand (DCOH) increased to 162 at YE20 from 80 days at YE19.

Fitch Ratings' liquidity cushion ratio, measured by the combination of annual cash flow, unrestricted cash reserves and available liquidity divided by operating expenditures, also nearly doubled, to 0.79x from 0.42x over the same period. The MCE board's revision in November 2019 to amend the reserve policy with higher target balances should continue the trend of healthy cash flow and increasing cash balances.

The 'BBB+' IDR also reflects MCE'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 PG&E, and the resulting pressure to maintain competitive rates. To date, MCE has successfully retained over 86% of the customers in its service area eligible to opt-out. Positively, the restricted scope of MCE's business, which is limited to the procurement of power, largely eliminates any material capex needs given current practices in securing power supply.

MCE's rating is further supported by a strong financial profile that reflects consistently improving liquidity levels over the past two years and helps mitigate risks associated with competitive pressures. However, MCE's strong leverage profile is less of a consideration in the rating given the absence of direct debt obligations.

Key Rating Drivers

Revenue Defensibility: **Weaker**: MCE's weaker revenue defensibility assessment reflects a customer base that can opt out at any time and at minimal cost. This results in competitive pressure on MCE. While the potential for customers to switch providers creates incentive for MCE to maintain rates in line with those of PG&E, MCE's rates have at times exceeded PG&E's. The risk of customer loss is not fully mitigated by MCE's independent authority to set and adjust rates, product differentiation or legal ability to impose an exit fee on departing customers. The assessment also reflects MCE's lack of control over the Power Cost Indifference Adjustment (PCIA) charged to its customers, established by the California Public Utilities Commission.

Operating Risk: Midrange: MCE's operating risk is limited given its narrow role as an energy-only provider. Power supply resources consist of over 350 energy and capacity purchase contracts with varying lengths of term and counterparties, and minimal capital needs. The midrange assessment also incorporates the long-term financial risk associated with right-sizing power supply for a potentially variable customer base, given the state requirement established by Senate Bill 350, which requires 65% of the state's required renewable portfolio standard (RPS) be secured under 10-year or longer contracts by 2021.

Financial Profile: Stronger: MCE's stronger financial profile reflects robust operating margins and liquidity levels that are expected to continue to increase over the next three years. Cash flow improved substantially in fiscal years 2019 and 2020 with the addition of Contra Costa County to the service area in 2019, in addition to an average 6.5% rate increase in fiscal 2020. Headwinds from the coronavirus and resulting impacts on the economy may result in a tightening of cash flow in fiscal 2021, but margins are expected to remain healthy and cash balances to increase.

Asymmetric Risk Additive Considerations: No material asymmetric risk factors affected the overall rating.

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Further upward movement is considered unlikely in the near term during the current recessionary environment.
- High levels of cash reserves that provide meaningful protection against a potential multiyear customer opt-out trend, given MCE's long-term contractual commitments for energy purchase.
- Cessation of competition from PG&E as the alternate energy provider.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- An increase in the leverage ratio above 0.0x on a sustained basis or a trend of declining operating margins or reserve levels.
- Significant adverse change in the regulatory or competitive landscape within which MCE operates.
- Reversal in the pattern of declining renewable costs that erodes MCE's ability to compete with PG&E.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
BBB+	Upgraded	Stable	8/26/20
BBB	Assigned	Stable	8/29/19

Credit Profile

MCE is a California joint powers authority (JPA) created on Dec. 19, 2008 for the purpose of implementing a CCA program. Since then, the JPA has grown from its initial eight members located within Marin County to include all of the following: Marin and Napa Counties (including all cities and towns), unincorporated Contra Costa County and Solano County, and the cities and towns of Benicia, Concord, Danville, El Cerrito, Lafayette, Martinez, Moraga, Oakley, Pinole, Pittsburg, Richmond, San Pablo, San Ramon and Walnut Creek.

MCE serves a four-county service area but continues to grow through the in-fill addition of part of the counties not previously served. The governing body of each city or county must vote to join the MCE JPA, and MCE's board of directors must also vote affirmatively to extend service to the new community. Unincorporated Solano County is the most recent expansion of MCE's service, with approximately 9,600 accounts moving to MCE as of April 1, 2020; one new board member was added. On April 1, 2021, MCE will add approximately 56,000 additional customers in the cities of Pleasant Hill and Vallejo. Additional cities within the service area may elect, and be approved, to join in the future.

MCE provides energy supply to non-captive retail customers who elect MCE as their energy provider instead of PG&E. PG&E still delivers the energy to MCE customers over PG&E transmission and distribution lines, and provides billing services as MCE's collection agent. PG&E remits the funds daily to MCE, and its role in this regard was well protected during the PG&E bankruptcy in 2019-2020.

Revenue Defensibility

Default Energy Supplier in Four-County Service Area

MCE is the default provider of energy supply for all retail customers within the member's service area, as required by the 2002 California legislation enabling the formation of CCAs. The legally required default to MCE service is a strong credit feature. Customers are presumed to be price sensitive, but also relatively non-action oriented. Customer behavior tends to strongly favor the default assignment when automatic enrollment occurs. Fitch reviews the default to MCE service, in combination with rate competitiveness with PG&E and a higher renewable content, as supportive elements to the final rating.

New members (i.e. counties, cities and towns) elect, by a vote of their City Council or County Board of Supervisors, to join MCE. Once part of the JPA, participating cities and counties are required under the agreement establishing MCE to remain part of MCE or pay the costs

incurred on their behalf prior to their departure. In addition, any municipality seeking to leave the JPA must provide one year's notice.

Customer Opt-Out Ability a Key Credit Risk

Retail customers permanently retain the ability to opt out of service from MCE 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. Customers who opt out of MCE within the initial 60 days of being enrolled as an MCE customer are able to opt back into MCE at any time. Customers who opt out of MCE after the initial 60-day period are required to remain a PG&E customer for one year prior to being eligible to opt back to MCE.

MCE reports that it serves approximately 86% of the customers within its service territory, implying that approximately 14% of the customer base has selected PG&E as their power provider. MCE's IRP notes that participation rates have improved over time, with the initial communities (2010-2011) at approximately 78% and the more recent communities (2016-2018) resulting in higher retention rates of 89%-91%. MCE was the state's first CCA and its initial years included a higher degree of community education and opposition from PG&E than subsequent CCA formations. Given MCE's rates that are competitive with those of PG&E, Fitch expects the opt-out rate will continue to decrease from the initial start-up years.

MCE is legally able to impose an exit fee on customers switching back to PG&E. At present, MCE does not charge customers an exit fee if they opt out within the first 60 days of service. If a customer opts out after 60 days of service, MCE charges a one-time $5 (residential) or $25 (commercial) administrative fee. This fee could be increased to either stem departures or capture the costs incurred to service departing load. While legally permissible, this mechanism has not been used extensively, and Fitch expects that any effort by MCE to sharply raise its exit fee could be met with some level of political backlash. Fitch views the legal ability to implement an exit fee as a potentially important tool, but insufficient on its own to protect against a meaningful trend of customer departures and raise MCE's overall demand characteristics.

Very Strong Service Area Characteristics

MCE's four county service area exhibits very strong service area characteristics, supporting ongoing electric demand and, potentially, a greater customer interest in the product differentiation offered by MCE compared to PG&E. Marin, Napa, Solano and Contra Costa Counties are located in the northern and eastern portions of the San Francisco Bay Area. Marin County, with the largest number of customers, exhibits median household income levels that are 183% of the national average and unemployment rates that are about 62% of the national average.

MCE's current customer count is approximately 475,000, following an approximately 80% increase in April 2018 (fiscal 2019) as service was expanded into Contra Costa County and another small increase in April 2020 with service into unincorporated Solano County. The customer base will continue increasing if additional communities elect to join. MCE's customers are viewed as non-concentrated. Demand growth is expected to track economic trends in the region due to MCE's position as the default electric provider in the service area.

Coronavirus Impacts on Demand

Electric sales to the existing customer base are generally expected to remain relatively flat on a per customer basis, given industry advancements in energy efficiency and conservation, although usage fluctuates with weather and economic conditions.

California's governor enacted a stay-at-home order in mid-March and, more recently, in July, announced the reclosure of certain venues across the state, such as in-person dining. Electrical demand from MCE's commercial class declined as a result, although residential usage increased. The overall impact to MCE's load in April was a 5% decline from forecast levels. As a result, MCE reduced its load forecast for the balance of fiscal 2021 (March 31 fiscal YE), although sales in May rebounded above both the new and original load forecasts. Revised expectations in fiscal 2021 remain strong and supportive of credit quality. Residential revenues that account for approximately 44% of total retail revenues should help buffer the net revenue impacts of demand declines precipitated by the coronavirus and related economic shock.

Product Differentiation

MCE offers customers three programs: 1) default 60% renewable "light green" option; 2) 100% renewable "deep green" option; and 3) 100% local solar option. The vast majority of customers (97.6%) participate in the light green program. MCE's light green product offered 60% renewable content and 90% greenhouse gas free power, compared to PG&E's renewable content in its base rate plan, reported at 39% in 2018 (most recent power content label available). MCE's integrated resource plan outlines the goal to increase the light green renewable content to 70% by 2030, subject to product availability and cost.

The higher renewable content of MCE's power supply appears to be the consideration that has garnered political and community support for MCE (and other CCAs). However, it appears less of a primary motivation for individual customer decisions given the limited election of the deep green option. Fitch does not view MCE's product differentiation as sufficient to offset the otherwise weaker demand characteristic. In addition, PG&E (along with other California IOUs) are legally mandated to continue raising their power supply's renewable content over time, reducing MCE's current competitive advantage in renewable content. However, MCE's targeted investment in renewable projects within the service area will likely continue to be a distinguishing factor with the potential to build customer loyalty.

PG&E Risks

PG&E delivers the energy purchased from MCE to retail customers over PG&E's transmission and distribution lines, and bills the retail customer on a combined bill in the role of MCE's billing agent. The flow of MCE 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 MCE. PG&E remits the funds daily to MCE.

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 MCE's sales because its customers receive power delivered via PG&E's transmission and distribution lines. MCE has no ability to deliver power to its customers during a PSPS. PG&E declared 12 PSPS in 2019, seven of which affected parts of the service are to varying degrees. The revenue impacts have been manageable to date and PG&E's notification timing has lengthened, which allows MCE to reduce the costs incurred to purchase and schedule energy deliveries via the California Independent System Operation (CAISO).

Independent Rate Setting but Competitive Pricing Constraints

MCE has 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 municipalities have a seat on the MCE board, MCE is not under the local authority of participating member city and town councils. 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, MCE sets its rates to be competitive with PG&E, which is sufficient to recover costs. In July 2019, MCE's board increased rates to capture the existing headroom between MCE and PG&E's rates, but preserving MCE's cost advantage at approximately 0.3% on average for each customer class. The result was an overall average rate increase of approximately 6.5% across all customer classes. The rate increases increased revenues in fiscal 2020, which increased MCE's operating margin and bolstered reserve levels.

In May 2020, PG&E raised rates, including the PCIA charge, which resulted in MCE's rates being 1.5% higher than those of PG&E, on average. The exception is for the new Solano County customers since their agreement included a rate match to PG&E through the first year (April 2021). MCE did not experience a notable number of new opt-out decisions after May 2020 as a result of its slightly higher rates. Additional rate changes by MCE or PG&E are not anticipated until 2021.

As long as MCE'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 MCE and the

community support for the current product offerings. MCE's current rates do not offer future rate flexibility but the net margin produced by the rates has been used to build reserves levels in 2019 and 2020 to a point that is supportive of the higher rating.

Power Cost Indifference Adjustment

MCE does not have ultimate control over one component of its rates, further limiting rate flexibility. MCE's customers are charged a PCIA that is determined by the California PUC. The 1.5% differential noted above between MCE and PG&E rates takes into account the PCIA charge paid by MCE customers to PG&E.

The PCIA is charged on a per kWh basis 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 energy load. The PCIA is adjusted at least annually and varies by the year that the customer joined the CCA. For example, a customer that began being served by MCE in 2015 would have the same “2015 vintage PCIA” charged to all other 2015 vintage customers.

PCIA charges have increased over the past few years as market prices have decreased, widening the gap between PG&E's portfolio cost and the market value for that power. Over time, the PCIA will gradually become less relevant for MCE customers as PG&E's legacy contracts mature. None of these contracts were altered by the PG&E bankruptcy.

Operating Risk

MCE'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 robust hedging practices. MCE does offer additional programmatic services such as energy storage programs for vulnerable customers and critical facilities and energy-efficiency programs funded by the California Public Utility Commission, but these are modest in scope and rely on received funding.

MCE's capex needs are negligible as MCE does not own any generation; all power supply resources are contracted. Positively, this means MCE generally does not bear the development, construction, operating or system risks experienced by generation resource owners, integrated utilities or distribution utilities. A change in MCE's operating risk profile through the development and/or ownership of generation resources could lead to a revision of the assessment.

Operating Cost Flexibility

Operating costs consist of the cost of power, marketing, and general administration and operating expenses. MCE's cost of power is largely known as power supply is contracted primarily through fixed price (or moderately escalating price) multiyear contracts. MCE's power procurement guidelines, as outlined by its 2019 integrated resource plan (IRP), target the procurement of between 70% and 100% of the current year power supply under fixed-price contracts, between 60% and 95% of power supply in the following year and up to 70% in the third year and beyond. The practice is designed to reduce exposure to market price risk and allow for annual rate setting.

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), create some uncertainty regarding the actual price at any point in time and increase 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 MCE, to demonstrate a 15% reserve margin above its projected peak demand and the use of flexible capacity.

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

MCE's power supply is currently met by over 350 energy, capacity and price hedging contracts with various suppliers incorporating multiple technologies and fuel types, including renewable, conventional and carbon free. Contracted resources are geographically diverse. MCE's energy

mix was 60% renewable in 2019, which is well above state mandates and the renewable content available in PG&E's power supply.

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

MCE's largest resource risk is balancing its power supply with a potentially variable customer base, given its lack of the exclusive right to provide energy supply. MCE has adopted a formal risk management plan that seeks to limit the potential risk of being either short or long power supply in any particular year. MCE's practice is to contract to fill short positions at years 1 to 5 to prevent significant pricing risks to emerge. MCE's practices call for it to have between approximately 90%-115% of its energy needs under a fixed-price contract during the current calendar year and successively lower amounts in each of the following four years.

Balancing supply and demand is further complicated by certain legislative mandates. CCAs must secure at least 65% of the RPS compliant power under contracts that extend 10 years or longer by 2021. While California's RPS compliance targets are well below the actual renewable content of MCE's power supply, the long-lived nature of the contracts poses challenges to adjusting power supply costs if significant load departure occurs. This risk is mitigated by MCE's demonstrated trend to date of maintaining customers through periods when PG&E rates were lower than MCE's and the ability to maintain the other 35% of supply from short-term contracts.

Financial Profile

MCE's leverage profile is supportive of the rating but less of a consideration than the revenue defensibility and liquidity profile assessments. Fitch's leverage metric includes fixed obligations, such as debt and pension liabilities (of which MCE has neither) minus cash reserves as compared to cash flow. Given the absence of fixed obligations, Fitch's net leverage calculation for MCE is negative.

Strong operating margins and liquidity levels are key supports of MCE's stronger financial profile assessment and the final rating. Service area growth (80% customer increase in fiscal 2019) in addition to rates and financial reserve policies adopted by the board resulted in notable improvement in the financial profile in fiscal years 2019 and 2020. Operating margin increased to 16% in fiscal 2020 from 3% in fiscal 2018.

The system's available cash balance at fiscal year-end 2018 was modest at approximately $34.4 million, or 63 days. Available cash increased to $155.1 million by YE20, including the newly created $10.5 million operating reserve fund. MCE established the operating reserve fund in November 2019 to allow for building a rate stabilization account. Although the revenues were deferred for accounting purposes in the 2020 audited financial statements, Fitch has included the $10.5 million in its calculations for liquidity and cash flow. Liquidity levels are enhanced by the use of lines of credit. MCE has a $40 million LOC with JPMorgan. When the LOC is included, Fitch's days liquidity calculation at YE20 was 204 DCOH.

Management amended its reserve policy in November 2019 to target building cash reserves to 240 DCOH, up from 140 DCOH previously. MCE's policy includes available LOCs, but does not include amounts set aside in the operating reserve fund. MCE expects to reach the new liquidity target by fiscal year-end 2023.

Asymmetric Risk Additive Considerations

Governance and Management

MCE is governed by a 29-member board of directors. The board members are elected City Council members or supervisors from each of the member cities and counties served by MCE. While they are not elected to the MCE board, the representatives have been elected to represent their respective communities. The board has appointed experienced, executive leadership to run daily operations of MCE. MCE has approximately 60 employees.

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.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Financial Summary

(Audited Fiscal Years Ended March 31)	2016	2017	2018	2019	2020
Net Adjusted Debt to Adjusted FADS (x)[a]	**(1.32)**	**(2.40)**	**(5.52)**	**(1.72)**	**(1.91)**
Net Adjusted Debt Calculation ($000)					
Total Short-Term Debt	—	—	—	—	—
Total Current Maturities of Long-Term Debt	—	—	—	—	—
Total Long-Term Debt	—	—	—	—	—
Total Debt	**—**	**—**	**—**	**—**	**—**
Total Unrestricted Cash	21,697	36,656	34,385	70,789	155,107
Adjusted FADS for Leverage Calculation ($000)					
Total Operating Revenue ($000)	151,665	181,166	205,753	362,292	416,119
Total Operating Expenses	135,257	166,111	199,967	322,343	348,717
Operating Income	**16,407**	**15,056**	**5,786**	**39,949**	**67,402**
+ Adjustment of Deferred Revenue	—	—	—	—	10,500
+ Depreciation and Amortization	77	93	114	189	260
+ Interest Income	12	105	325	944	2,958
Funds Available for Debt Service	**16,496**	**15,254**	**6,225**	**41,082**	**81,120**
Coverage of Full Obligations (x)	**14.00**	**—**	**—**	-	-
Funds Available for Debt Service	16,496	15,254	6,225	41,082	81,120
Full Obligations Calculation					
Cash Interest Paid	145	33	40	35	144
Prior Year Current Maturities	1,035	—	—	—	—
Total Annual Debt Service	**1,180**	**33**	**40**	**40**	**40**
Liquidity Cushion Calculation (x)	**0.34**	**0.43**	**0.33**	**0.42**	**0.79**
Unrestricted Cash (Days)	**59**	**81**	**63**	**80**	**162**
Operating Margin (%)	**11**	**8**	**3**	**11**	**16**
Liquidity Calculation					
+ Total Unrestricted Cash	21,697	36,656	34,385	70,789	155,107
+ Total Borrowing Capacity	15,000	20,000	25,000	25,000	40,000
- Amounts Unavailable	7,300	—	—	—	—
Cash Operating Expense Calculation					
Total Operating Expense	135,257	166,111	199,967	322,343	348,717
Depreciation and Amortization	77	93	114	189	260
Cash Operating Expenses	**135,181**	**166,018**	**199,853**	**322,154**	**348,457**

[a]Calculated as defined by Fitch's revenue master criteria.
Source: Fitch Ratings, Fitch Solutions, Lumesis, EIA, Marin Clean Energy (CA).

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