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Ratings

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Summary:

Marin Clean Energy, California; Retail Electric

Primary Credit Analyst:
Alexandra Rozgonyi, Englewood + 1 (303) 721 4824; alexandra.rozgonyi@spglobal.com

Secondary Contact:
Doug Snider, Englewood + 1 (303) 721 4709; doug.snider@spglobal.com

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Credit Highlights

- S&P Global Ratings' issuer credit rating (ICR) on Marin Clean Energy (MCE), Calif. is 'A'.
- The outlook is stable.

Security

The ICR represents our view of MCE's capacity and willingness to meet its financial commitments as they come due and does not apply to any specific financial obligation. MCE has no debt outstanding, nor does it plan to issue any debt in the near term.

Credit overview

The ICR reflects MCE's predominantly residential customer base with well above-average incomes across Contra Costa, Marin, Napa, and Solano counties. The rating also reflects the community choice aggregator's (CCA) robust liquidity balances and an overwhelmingly carbon-free energy portfolio, already meeting California's Renewable Portfolio Standards (RPS). Tempering these strengths are retail rates that have been higher than Pacific Gas & Electric (PG&E) over the previous six months (in 2024), which could constrain future rate-making flexibility. PG&E's rates were 40% greater than the state average in 2023 based on the Energy Information Administration. Management indicated MCE's rates for 2025 will be below PG&E's after the latter's expected rate increase, although, in our opinion, these rates are still elevated. Further limiting the rating are projections of increasing power supply costs (due to new contracts and high renewable certificate [REC] prices) that could additionally pressure management to add rate increases. Additional risks include the ease with which customers can transition back to the incumbent utility, a power portfolio with largely unrated or low-rated counterparties, potential delays for new storage projects, rising REC costs, high resource adequacy (RA) prices, and exposure to volatile market prices via short- and medium-term purchases and contracts.

The rating further reflects our view of the following factors:

- Management's commitment to cost-of-service based rate setting;
- Fuel mix that consists largely of renewable and noncarbon-emitting resources, including 94 short- and intermediate-term energy contracts and hedges 64 long-term purchased power agreements (PPAs), and 43 capacity contracts;
- Rise in liquidity and fixed-charge coverage (FCC) to 291 days of operating expenses and 1.7x FCC in fiscal 2024, both of which we consider robust; and

- No debt outstanding and no plans to issue debt in the near term.

Partially offsetting the above strengths, in our view, are the following factors:

- Projected decline in FCC in fiscal years 2025 to 2028 to just above 1.0x prior to rebounding due to elevated purchased power costs and management's forecast which does not include rate increases; and
- Exposure to wildfires through California's strict liability standard and inverse condemnation is limited, given the absence of ownership of transmission and distribution (T&D) assets. However, we note that the CCA has indirect exposure to wildfires, and the associated costs, which affect PG&E T&D assets needed to serve MCE's customers.

Environmental, social, and governance

Environmental physical risks including drought conditions that can limit hydro supply, which is about 48% of MCE's power supply in 2023, and this can necessitate the purchase more volatile short-term or spot market purchases. We believe MCE faces limited environmental risks related to California's RPS goals. It has exceeded these targets ten years before their compliance date. MCE's "light green" power mix is 59.6% eligible renewable (solar 33.3%, wind 15.5%, eligible hydro 7.7%, geothermal 1%, and biomass 2.2%). Noneligible renewables include large hydro at 40.1%, nuclear 0.2%, and unspecified power 0.1%. However, as a practical matter, the intermittency of renewable resources might frustrate the CCA from achieving California's ambitious greenhouse gas emission goals in the absence of advances in long-duration storage technology. We also note MCE could face indirect exposure to wildfires from events caused by PG&E's T&D assets.

We believe MCE has elevated exposure to social capital factors. Its residential customers pay rates that are slightly higher than PG&E residential rates in 2024, and we note that PG&E's rates are elevated (140% of California's average retail system rate in 2023), which could weigh on financial flexibility. However, this is mitigated somewhat by well above-average effective buying incomes across MCE's territory and a low delinquency rate. We continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion. Along with the rate of inflation, as measured by the Consumer Price Index (CPI), that has persisted above 2% for longer than anticipated, Bureau of Labor Statistics data shows that electricity price inflation continued to outpace the broader CPI by 100 basis points (bps) to more than 200 bps during March-October 2024. The increases in delinquency rates and debt balances among household, credit card, and auto loan debt, along with household savings rates that are tracking below pre-pandemic levels, compound the financial pressures electricity consumers face as utilities invest in the hardening of existing assets to withstand more frequent and severe climate events while also investing in emissions reductions. Potentially exacerbating issues of energy affordability are S&P Global Economics' forecast of weakening GDP, and the uncertainty surrounding whether and when the president-elect will implement economic initiatives proposed as a candidate, including imposing tariffs. The potential for the president-elect's proposals to add to inflation and weaken GDP growth might add to the economic headwinds facing utility customers, which can negatively influence capacity to make timely utility bill payments. (See "Economic Outlook U.S. Q1 2025: Steady Growth, Significant Policy Uncertainty," published Nov. 26, 2024, on RatingsDirect).

Finally, we view the utility's governance factors as credit supportive, as they include proactive risk management and robust joint powers agency (JPA) member agreements that limit both the ability and incentive for member departure. MCE maintains and updates as needed a reserve, investment, risk management, and debt management policy (if MCE

ever decides to enter into debt obligations). However, the potential for retail customer opt-out is beyond management's control and tempers our view of the CCA's governance factors somewhat.

Outlook

The stable outlook reflects the significant increase in liquidity in fiscal 2024, which we believe provides sufficient cushion in combination with counterparty collateral posting requirements that will reduce (but not eliminate) counterparty and customer migration risks. The outlook further reflects our anticipation that exceptionally strong incomes across the service territory will continue to mitigate high rates, customer retention rates will remain stable, and the resource portfolio will continue to limit the utility's exposure to increasingly stringent emissions regulations and competitive and potentially volatile wholesale markets.

Downside scenario

We could lower the rating if the cost of future power, energy storage, and/or significant counterparty nonperformance weaken financial metrics. We could also do so if MCE experiences customer opt-outs that leave it with meaningful surplus energy purchase commitments whose cost must be recovered through either liquidation into competitive wholesale markets or rate increases.

Upside scenario

Based on management's projections of higher operating costs which could weaken coverage and the barriers to rate increases that management might face following 2023's 20% rate increase, we do not anticipate raising the rating within our outlook horizon.

Credit Opinion

Enterprise profile

MCE is a JPA originally formed in 2008 (with retail service beginning in 2010) to procure retail electric power on behalf of about 580,000 accounts serving more than 1 million people across 37 member communities in four San Francisco Bay Area counties. The customer base increased by about 20% from 2020 to 2023 but stabilized in 2024. MCE is expecting to start serving a new member city, Hercules, in 2025, which will add about 10,000 customers (estimated 1.98% voting share). There are no other new planned expansions. MCE derives the majority of its retail revenue from residential customers (about 49.3% in fiscal 2024), which we believe provides the CCA with revenue stability and we believe MCE's large size provides economies of scale.

PG&E, on behalf of MCE, performs monthly retail electric meter readings, bills MCE's customers, collects customer payments, and conveys over its T&D systems the electricity MCE procures. PG&E segregates and remits to MCE the revenue it collects for MCE; we understand this revenue is insulated from an investor-owned utility (IOU) bankruptcy.

Retail electricity customers who migrated to MCE at the introduction of service in their area may return to their respective incumbent IOU on 60 days' notice. MCE does not impose fees on departing customers. We consider the relative ease with which customers can return to their previous electric utility a potential risk to MCE's revenue stream. While MCE's opt-out rate is elevated relative to that of other rated CCAs at about 14%, we note that a significant

portion of these departures occurred closer to MCE's inception as the first CCA in California.

Representatives of MCE's member jurisdictions make up the CCA's board. The board sets the retail rates for the power it procures. In addition to MCE's energy charges, the major components of the customer bills that PG&E prepares also include charges for energy delivery, administrative expenses, and the power charge indifference adjustment (PCIA). The PCIA is a legislatively created vehicle. It provides for the IOUs' recovery of those portions of pre-existing generation investments and energy procurement costs that market sales of energy surpluses created by customer migrations to CCAs do not financially support. The PCIA shields IOUs' non-CCA customers from the cost shifting that might otherwise occur due to the migration of retail customers to CCAs. The PCIA varies by customer class, but decreased by about 90% since 2021 to 2023 and then increased modestly in 2024, which somewhat enhanced MCE's rate-making flexibility. MCE raised rates in January 2023, and the average retail generation rate increased by approximately 20%, which was somewhat offset by the reduction in the PCIA. Moreover, no further rate increases are planned at this time.

MCE sets its rates based on its cost of service. This model has resulted in MCE net rates (including the PCIA charge) exceeding those of PG&E for certain periods in the past, including 2024. Importantly, customer opt-outs have not increased markedly during these periods. To mitigate opt-outs, about two years ago, management implemented its own customer relations management department, which it believes is another reason why opt-outs have not spiked at times when MCE's rates are above those of PG&E. Nevertheless, given that electric rates are still significantly above the state's average, we believe long-term rate-raising flexibility could be pressured.

MCE's power portfolio consists of largely noncarbon-emitting resources, in our view, with more than 201 power purchase and RA contracts in place. However, there is some concentration in large hydro, eligible hydro, and solar making up 81% of energy. Given the large hydro concentration, drought conditions and demand can reduce supply, affecting the need to purchase additional contracts or spot market purchases. This happened in 2024 as the hydro supply was limited, mainly due to higher demand for carbon-free energy. In our view, high RA, REC prices, volatile energy costs, and short-term recontracting risk could result in MCE raising rates, weakening competitiveness or financial metrics. Additionally, although there is significant diversity among counterparties, there is still risk associated with the low-rated or unrated counterparties. However, we note MCE has a risk management policy around limiting counterparty exposure and it holds $100 million from counterparties as credit/performance support.

To mitigate the effects of price spikes and market volatility, MCE continues to add hedge contracts and targets to keep spot market purchases during a year between 5%-10%. MCE was in full compliance with RA requirements in 2024 and is adding storage capacity and long-term PPAs to continue to meet them. Nevertheless, given supply-chain constraints and delays in the interconnection, we believe some of these new storage projects could be delayed.

Financial profile

MCE does not have any debt; however, S&P Global Ratings calculates FCC to reflect its view that MCE is funding its contracted power suppliers' recovery of investments in generation capacity. When calculating FCC, our proxy for suppliers' recovery of capital investment from their purchasers reduces operating expenses and imputes debt service by a matching amount. Applying that adjustment, we calculated FCC that rose to 1.7x in fiscal 2024 from 1.07x in fiscal 2022 largely due to the combination of the sizable generation rate increase and decline in PCIA. The net bill

impact on MCE customers was muted due to a decline in the PCIA netting out to about a 10% rate increase. Based on our calculations of management-provided projections, we expect FCC to decline from currently robust metrics to around 1.0x in fiscal 2026 prior to rebounding to 1.2x, which we consider adequate. The projected decline is largely due to the 27% increase in power supply costs between fiscal years 2024 and 2025 due to high RA prices (although stabilized in the last year) and a significant rise in REC prices. Management's projections do not assume any rate increases, but we understand management would consider them if needed.

At fiscal year-end March 31, 2024, MCE had $436 million of unrestricted cash and investments (including a $60 million revolving credit agreement, the RSF, and investments with maturities from one-to-five years), equivalent to 291 days of operating expenses. In our view, this provides a robust cushion for tempering exposures to potential customer departures or supplier disruptions. Moreover, liquidity is projected to rise continually through the forecast period, providing additional cushion in the event of above-budget power costs or other expenses. In 2020, MCE created an operating reserve to defer revenue when financial results are strong and to use when financials are stressed. For fiscal 2023, this fund will total $70 million. We believe the maintenance of robust liquidity underpins the current rating, given the previously discussed operational risks MCE faces.

MCE indicated it is exploring the possibility of direct asset ownership through debt issuances if the additional debt and associated assets were economical and would fit within its risk management tolerances. No such projects or assets have been identified at present. We would revisit our assessment of MCE's debt and liabilities if the CCA added concrete plans to issue debt.

Marin Clean Energy, California--Key credit metrics			
	--Fiscal year ended March 31--		
	2024	**2023**	**2022**
Operational metrics			
Electric customer accounts	580,000	586,000	575,000
% of electric retail revenues from residential customers	49	51	51
Top 10 electric customers' sales as % of total electric retail sales (KWh)	7	7	7
Service area median household effective buying income as % of U.S.	146	149	149
Financial metrics			
Gross revenues ($000s)	863,199	655,596	487,703
Total operating expenses less depreciation and amortization ($000s)	622,502	602,625	473,384
Debt service ($000s)	0	0	-
Debt service coverage (x)	N.M.	N.M.	N.M.
Fixed-charge coverage (x)	1.7	1.2	1.1
Total available liquidity ($000s)*	496,380	277,729	209,627
Days' liquidity	291	168	162
Total on-balance-sheet debt ($000s)	N.A.	N.A.	N.A.
Debt-to-capitalization (%)	N.A.	N.A.	N.A.

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

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