MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Baa2 issuer rating to Marin Clean Energy (CA) (MCE) ; stable outlook

16 May 2018

First Community Choice Aggregator (CCA) rated

New York, May 16, 2018 -- Moody's Investors Service has assigned a first-time Baa2 Issuer Rating to Marin Clean Energy (CA) (MCE). MCE is a not-for-profit community choice aggregator (CCA) with an established operating record as a California Joint Powers Authority (JPA). The rating outlook is stable.

RATINGS RATIONALE

The Baa2 Issuer Rating reflects the strength of the California Joint Power Agency (JPA) statute and the MCE JPA agreement which together underpin MCE's creation and business model, and help fortify the ongoing stability of its existing customer base. The rating further recognizes the self-regulated rate-setting authority afforded to MCE, its established track record of operations and consistently improving financial performance, and the economic strengths within its growing service territory. The Baa2 rating considers our belief that state and policymakers remain supportive of the CCA model as a tool to advance the use of renewable resources throughout the state, a key consideration, and we view the current relationship with the California Public Utilities Commission (CPUC) from a policy standpoint to be favorable to MCE's credit quality. MCE has an adequate liquidity profile driven in large part by growing internal liquidity sources. MCE's electric rates continue to remain moderately lower than investor-owned utility, Pacific Gas & Electric Company (PG&E: A3 negative), and we view favorably PG&E's role as the billing servicer for MCE's customers which help to support the strong performance of MCE's accounts receivable.

These credit strengths are balanced against several challenges facing MCE, the most significant of which relates to their ability to manage power procurement risk which can be accompanied by uncertainties concerning resource production variability and future market structure. While MCE has been able to manage the strong customer growth experienced over the last several years reasonably well, MCE's ability to procure resources to support future growth objectives introduces incremental risk.

A particular challenge is the potential for MCE 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 MCE's financial statements, MCE has entered into forward purchase commitments for delivery of renewable energy on an as-available basis that aggregates $1.8 billion at year-end 2017. In an extreme worst case scenario where there is a sudden decline in customer load, MCE could find itself in an under collected position should contracted power prices paid by MCE 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 may permanently limit customer load growth. To date, MCE has experiencd a very modest level of customers opting-out, with most of the migration occurring during the intial 120 day enrollment period. MCE appears to have mitigated the procurment risk by layering in contractual arrangements with differing tenors and going from a few suppliers to a diverse list of energy suppliers with no dominant contract and by maintaining a net short position in the mid to long term, and in an extreme case, has the ability to raise retail rates on its remaining customers if needed. Importantly, as part of the MCE's newly implemented energy risk policy, MCE manages its supply portfolio in the year forward net-short position, which minimizes the likelihood of this risk occurring and targets the maintenance of higher internal liquidity sources.

In addition to power procurement risk, additional challenges facing MCE are the newness of the CCA model within the California market, the continued evolution of the California electric market which continues to be on the cutting edge of change, the unresolved nature of the Power Cost Indifference Adjustment (PCIA) hearings with the investor-owned utilities, which could impact the cost competitiveness of MCE relative to the local investor-owned uility, and the pressure for MCE to maintain its customer value propostion as a provider of affordable renewable energy, as the business model offers customers choice.

A critically important rating consideration is the CCA's key governing documents including the California JPA statute requirement (Title 1, Division 7, Chapter 5, Article 1 (or Section 6500-6539) as well as MCE's JPA agreement which has been approved by each of the 33 participating municipalities, and which stipulates under Article 7 that the municipalities must pay their remaining cost obligations to MCE should they choose to depart from MCE. Article 7 is an important credit consideration as it is helps to mitigate MCE's substanital exposure to future power commitments and is the mechanism by which there could be recourse to each of the 33 participating municipalities should one elect to depart from MCE. While the ultimate legal underpinning of this municipal obligation to MCE has not been court tested as to its effectiveness, our rating recognizes that all participating members acknowledged and accepted this risk prior to becoming parties to the MCE-JPA agreement.

Under the California CCA structure, electricity is procured by MCE primarily from commercial suppliers and delivered through PG&E 's existing infrastructure with the utility continuing to provide transmission, distribution, billing and related collection services to MCE customers. Once a municipal ordinance is adopted for a municipality to join a CCA such as MCE, all customers in the municipality automatically enroll as CCA customers unless the customer elects to "opt-out" and return to PG&E in this case. A customer can "opt-out" before scheduled enrollment or anytime thereafter. Customers can opt-out without charge durring the first 60 days of service. A $5 residential or $25 commercial one-time exit fee is applied for customers who opt out after the first 60 days of service. MCE has not implemented additional charges (but could do so) given the very low "opt-out" rates and its continued customer growth.

A key aspect of the value proposition offered by MCE and other California CCAs is the requirement that renewable and clean energy be a major component of the customers' power supply mix. This value is one of the most significant factors that provides strength to the long-term business model. In that regard, during 2017, renewable energy accounted for 62% of MCE's retail sales. MCE customer base now exceeds over 400,000 customers making it the third largest municipally governed electric enterprise in California, behind Los Angeles Department of Water and Power (LADWP) (Aa2 stable) and Sacramento Municipal Utility District (SMUD) (Aa3 stable).

LIQUIDITY PROFILE

As alluded above, maintaining a strong liquidity profile is a key credit consideration when procuring power for customers. Liquidity provides time for MCE to react with its locally controlled rate setting and to implement other power procurement mitigation measures. The Baa2 Issuer Rating incorporates our expectation the MCE will maintain growing levels of internal liquidity on its balance sheet as its customer base expands and also has ready access to incremental external liquidity to supplement its liquidity profile. In that regard, the rating acknowledges MCE's new Board reserve policy as a credit positive, and recognizes MCE's continued ability to generate annual free cash flow.

At year-end FY 2017, MCE had unrestricted cash of $37 million or about 86 days cash on hand that is supplemented by a $25 million committed line of credit that has no conditionality for advances. Because of the significant addition of new customers during 2018 and MCE's ability to generate annual free cash, MCE projects cash on hand to exceed $60 million by FY 2019 representing more than 70 days cash on hand and 100 days liquidity on hand when factoring in the $25 million line of credit. MCE's working capital needs appear to be modest as it receives cash payments from PG&E each day for its portion of the PG&E bill while paying its suppliers for purchased power at regular intermittent times over the course of the month. As such, MCE is typically able to generate positive cash flow in each month, including the shoulder months of the year.

RATING OUTLOOK

The rating outlook is stable incorporating a view that the CCA business model will remain intact including the statutory and municipal ordinances that permit full cost recovery, that CCAs will continue to enjoy independent local retail rate-setting authority, that MCE will be able to manage power procurement risk and reach and maintain appropriate liquidity targets that support its growth.

FACTORS THAT COULD LEAD TO AN UPGRADE

-Continued trend of sound financial performance, including free cash generation, enabling days cash on hand to reach at least 150 days on a consistent basis with total liquidity levels able to mitigate a 20% load loss requirement should customers depart

-Demonstrated track record of managing power procurement and related liquidity risks

-Narrowing of remarketing risk

-Ability to demonstrate resiliency to technogical change or economic weakness

FACTORS THAT COULD LEAD TO A DOWNGRADE

-Liquidity profile not keeping pace with customer growth

-Change in direction in power procurement strategy to one more focused on ownership versus purchases which is aggressively financed and does not include protective covenants for debt or lease investors

-Incurrence of losses on a sustained basis from energy remarketing that drains financial liquidity

-Competitive position being challenged owing to lower cost options being offered by competitors and MCE's customers having to pay higher transition fees.

-Sudden increase in customers "opting-out" relative to historical levels

LEGAL SECURITY

Not Applicable

USE OF PROCEEDS

Not Applicable

PROFILE

With offices in San Rafael and Concord, CA, MCE is a California JPA founded in 2008 pursuant to the Joint Exercise of Powers Act and a public agency separate from its members. MCE provides electric service to retail customers as a CCA under the California Public Utilities Code Section 366.2.

MCE's mission is to address climate change by reducing energy related greenhouse gas emissions through renewable energy supply and energy efficiency at stable and competitive rates, while promoting local economic and workforce benefits. MCE provides electric service to retail customers and has the rights and powers to set rates and charges for electricity and services it furnishes, incur indebtedness, and issue bonds or other obligations. The parties to MCE's JPA consist of 33 local governments. Pursuant to the California Public Utilities Code, when new parties join MCE, all electricity customers in its service territory automatically become default customers of MCE for electric generation, and have the right "opt out".

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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