S&P Global
Ratings

# RatingsDirect®

## Summary:

# Sonoma Clean Power, California; Retail Electric

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

**Secondary Contact:**
David N Bodek, New York + 1 (212) 438 7969; david.bodek@spglobal.com

## Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

## Summary:

# Sonoma Clean Power, California; Retail Electric

| Credit Profile | | |
|---|---|---|
| Sonoma Clean Power ICR | | |
| *Long Term Rating* | A/Stable | Affirmed |

## Credit Highlights

- S&P Global Ratings affirmed its 'A' issuer credit rating (ICR) on Sonoma Clean Power (SCP), Calif.
- The outlook is stable.

### Security

The ICR represents our view of SCP's capacity and willingness to meet its financial commitments as they come due and does not apply to any specific financial obligation. SCP has no outstanding debt and no future debt plans.

### Credit overview

SCP is a community choice aggregator (CCA) formed in 2014 to procure retail electric commodity on behalf of about 230,800 electric customers across 13 members in Sonoma and Mendocino counties. The CCA directly competes with the service area's incumbent investor-owned utility, Pacific Gas and Electric Co. (PG&E; BB/Stable), to provide customers the energy portion of their electric service. (PG&E's transmission and distribution assets deliver the electricity.)

The ICR reflects our view of SCP's growing and diversifying low- and no-carbon-emitting resources through 27 primarily medium and long-term fixed-price contracts, robust income levels throughout the service area, improved fixed-charge coverage (FCC) to 1.7x, and robust cash position at about $152 million, equivalent to 260 days of operating expenses in 2023. Somewhat offsetting these credit strengths are the ease at which customers can opt out of service and the projected negative margins in fiscal years 2025 and 2026, which management plans to offset with rate stabilization funds from excess margins in fiscal 2023 and expected for 2024. Nevertheless, management reviews rates annually, and the board has supported rate increases in the past, even when that means rates are less competitive than PG&E's.

The rating further reflects our view of the following:

- SCP's customer base is primarily residential, with robust income levels, and stable annual average participation rates at around 85%.
- Management frequently reviews rates, and the board has demonstrated willingness to increase rates as needed even when that meant rates were higher than PG&E's.
- FCC and cash have risen to extremely robust levels for fiscal 2023 and projected for fiscal 2024.
- SCP has protective joint power authority member agreements with counties and municipalities that create

economic barriers to exiting SCP, tempered by the relative ease with which retail customers can return to PG&E.

Partly offsetting the above strengths, in our view, are the following:

- Direct retail competition with PG&E limits SCP's rate-setting flexibility. If the CCA's all-in energy bills were to become materially more expensive than PG&E's, we believe customers could opt out of SCP.
- There is uncertainty about the level of the power charge indifference adjustment (PCIA) SCP must include in its rates, which we view as potentially constraining rate-making flexibility. The PCIA amount varies year to year, partially depending on market prices for the resale of that power, and could pressure the CCA's financial metrics (as it did in fiscal 2021) and/or competitiveness.
- Although residential rates are currently about 3% below PG&E's, we note that PG&E's rates are elevated (137.9% of California's average retail system rate in 2022), which could weigh on financial flexibility.
- SCP faces indirect exposure to wildfire risk because it relies on PG&E's transmission and distribution assets, although SCP does not have direct asset ownership, which tempers the potential wildfire exposure compared to other asset-owning utilities. PG&E's need to fund wildfire liabilities or mitigation could lead it to socialize these costs among all users of its transmission and distribution systems. In turn, higher delivery charges could negatively affect overall rate affordability, and limit SCP's ability to increase rates without precipitating demand deterioration.

### Environmental, social, and governance

We believe SCP's environmental risk exposure is low, based on its predominantly carbon-free resource portfolio. SCP is well positioned to meet California's stringent renewable portfolio mandates, as well as evolving federal requirements, given its predominantly renewable power portfolio (over 50% eligible renewable and 90% non-carbon emitting). 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. SCP has added solar plus storage to its portfolio and is looking into potential geothermal projects for long-term base load. We also note SCP could face indirect exposure to wildfires from events caused by PG&E's transmission and distribution assets.

We believe SCP has slightly elevated exposure to social capital factors. Although SCP's total bundled bill is slightly below PG&E's, bills are still high when compared to state and national levels, which could frustrate future financial flexibility. Accounts receivables increased during and after the pandemic but have since subsided back to pre-pandemic levels. We continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion. Although the rate of inflation as measured by the Consumer Price Index (CPI) has softened, Bureau of Labor Statistics data shows that electricity price inflation continues to outpace the broader CPI. The amalgam of increases in delinquent credit card, consumer, and auto loans, along with financial pressures associated with the resumption of student loan payments and weaker than historical household savings rates, will likely compound the financial pressures electricity consumers face. Potentially exacerbating issues of energy affordability are weakening economic indicators, such as S&P Global Economics' forecast of a 25%-30% recession risk within the next 12 months, which is elevated relative to the historical baseline. A cooling labor market, geopolitical risks, and a potentially disruptive election, might add to recessionary pressures. (See "A Cooling U.S. Labor Market Sets Up A September Start for Rate Cuts," published Aug. 6, 2024, on RatingsDirect.)

Finally, we view SCP's governance factors as generally credit supportive, with regularly updated long-range financial forecasting, strong policies and planning, and evolving risk and financial management practices. Management has a minimum reserve target of 180 days of operating expenses, but targets 280 days of operating expenses. Nevertheless, 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 our anticipation that SCP's customer retention rates will remain strong, FCC in 2023 and expected for fiscal 2024 will be extremely strong, robust liquidity will reduce but not eliminate counterparty and customer migration risks, and diverse resource portfolio will continue to have some exposure to short-duration contracts but continue to limit the utility's exposure to increasingly stringent emissions regulations.

### Downside scenario

We could lower the rating if SCP's evolving risk management practices (which incorporate the PCIA into its financial risk management planning and a potentially lower hedged position) cause financial metrics to deteriorate, including liquidity given planned use of rate stabilization fund (RSF) funds and delay in PCIA changes. We could also lower the rating if opt-outs rise, cost of future power purchase agreements increase, or counterparty nonperformance erodes competitiveness or results in a decline in FCC or liquidity.

### Upside scenario

We do not expect to raise the rating in the next two years, given the projected decline in FCC for fiscal years 2025 and 2026 and the use of RSF funds to bolster revenues in lieu of potentially larger rate increases, the inherent risks posed by direct competition for the retail customer base, and already high electric rates that could reduce financial flexibility.

## Credit Opinion

### Enterprise profile

SCP serves a diverse customer base that consists of about 50% retail residential sales, which we consider more stable than a highly concentrated commercial or industrial customer base. The weighted average income levels throughout the service area and Sonoma County are robust at 123% and 130% of the national average, respectively. However, we note that some areas may have less financial flexibility, given about 14% of the customer base exhibits below-average income levels at a weighted average rate of 85% of the national average.

New customers are automatically enrolled in SCP services unless they opt out, and opt-out rates have been generally stable at around 13%. However, at the end of 2023, SCP turned over 1,900 customers to PG&E to shut off for nonpayment, given these customers cannot be shut off by SCP. This mainly consisted of a one-time release from the expiration of amnesty for nonpayment due to the pandemic. The opt-out rate increased to 13.8% and has since declined to about 13.6% in June 2024. Once a customer has been shut off for nonpayment by PG&E, it would have to re-enroll in SCP services. New customers and customer turnovers tied to move-outs and move-ins have kept opt-out rates generally stable, even when SCP's rates were less competitive than PG&E's. We view the relative ease with which

SCP customers can return to PG&E, including the absence of any fees, as a potential exposure to SCP's revenue stream.

Management reviews rates frequently throughout the year, and the board has demonstrated willingness to increase rates above PG&E's when needed, but for the most part largely follows the direction of PG&E. From May 2020 through March 2022, SCP set rates about 5% above PG&E's, and this did not result in a significant uptick in opt-out rates. More recently, in July 2024, PG&E reduced rates, which prompted SCP to reduce rates; the net change resulted in an approximately 3% savings for an SCP customer on a total bill basis relative to PG&E, and the rate reduction is not expected to materially affect SCP's financial performance. Nevertheless, rates are still elevated, and we believe that a material change in competitiveness could prompt an increase in opt-outs.

SCP has a diverse power portfolio of largely non-carbon-emitting resources. SCP has about 27 power supply contracts, consisting of a combination of rated and unrated entities. Fuel sources based on actual 2023 gigawatt-hour consisted of hydro (48%), geothermal (17%), biomass (12%), wind (9%), solar and storage (8%), and other (6%). The weighted average length of contracts is about seven years, though it has increased since management layered in longer-term contracts. However, we note other various financial risks associated with the power portfolio including short-term contracts that have exposure to recontacting, unrated counterparties, and potential for non-performance from suppliers. Somewhat mitigating this risk is SCP's Risk Oversight Committee, which assesses counterparty exposure.

We understand that management's contracted annual energy supply versus the projected load forecast is sufficient at 83% (2025), 89% (2026), and 83% (2027), dropping down to 56% thereafter. Management has financial and physical hedging targets; however, management's strategy is evolving to price in the PCIA when executing the hedging program: As market power prices rise, the PCIA declines, somewhat allowing existing retail rates to absorb higher market prices without the need for rate increases. Additionally, management plans to incorporate various protections including the rate stabilization fund (RSF), recognizing deferred revenue, increasing rates, potentially using reserves down to the minimum target, and a potential new credit facility. This new strategy could expose SCP to spot and day-ahead market prices and more volatile market prices. We will continue to monitor how the evolving strategy affects financial performance both from a liquidity and FCC perspective.

### Financial profile

SCP has no debt; however, S&P Global Ratings calculates FCC to reflect our view that SCP is funding its contracted power suppliers' recovery of investments in generation capacity. Applying that adjustment, we calculated accrual-basis FCC of 1.06x in 2021, 1.33x in 2022, 1.74x in 2023, and based on 11 months of fiscal 2024, 1.8x estimated for fiscal 2024. In fiscal 2022, there was a transfer in from the RSF of about $26 million; excluding this transfer, FCC would have been weaker at 1.02x, and conversely, fiscal 2021 would have been stronger pre-transfer out at 1.11x. The lower FCC in prior years was due to a higher PCIA, diminished hydrology conditions, and high market prices. The decline in the PCIA in recent years and rate increases have facilitated robust operating margins.

Despite recent robust financial performance, management is projecting negative margins in fiscal years 2025 and 2026 driven by new contracts and expiration of favorable financial hedges. We understand that management plans to use its RSF to close this gap, in lieu of larger rate increases. SCP has a minimum reserve target of 180 days and a target of 280 days. We understand that once reserves reach this level, management sets aside a portion of this into the RSF. These

funds are projected to be used in fiscal years 2025 and 2026 to offset projected lower margins.

In our view, current liquidity is robust and sufficient to protect against unforeseen spikes in market prices or other costs. Unrestricted cash and investments rose to $151.7 million (260 days of operating expenses) in fiscal 2023 from $85 million (170 days) in fiscal 2021. Based on results for 11 months of fiscal 2024, liquidity rose to $230 million. Management estimates to draw down liquidity to about $194.5 million by fiscal 2026 mainly in the form of deferred revenue. Further, we understand management is considering a credit facility to provide a liquidity cushion during the timing and unpredictability of the PCIA.

**Sonoma Clean Power, California--key credit metrics**

| | --Fiscal year ended June 30-- | | |
|---|---|---|---|
| | **2023** | **2022** | **2021** |
| **Operational metrics** | | | |
| Electric customer accounts | 230,868 | 230,108 | 229,028 |
| % of electric retail revenues from residential customers | 50 | 50 | 50 |
| Top 10 electric customers' revenues as % of total electric operating revenue | 7 | 7 | 7 |
| Service area median household effective buying income as % of U.S. | 123 | 130 | 129 |
| **Financial metrics** | | | |
| Gross revenues ($000s) | 277,933 | 215,854 | 187,835 |
| Total operating expenses less depreciation and amortization ($000s) | 208,764 | 187,959 | 182,860 |
| Debt service ($000s) | N.A. | N.A. | N.A. |
| Debt service coverage (x) | N.M. | N.M. | N.M. |
| Fixed-charge coverage (x) | 1.7 | 1.3 | 1.1 |
| Total available liquidity ($000s)* | 151,704 | 78,281 | 85,097 |
| Days' liquidity | 265 | 152 | 170 |
| Total on-balance-sheet debt ($000s) | 0 | 0 | 0 |
| Debt-to-capitalization (%) | 0 | 0 | 0 |

*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. N.M.--Not meaningful.

## Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

Copyright © 2024 by Standard & Poor’s Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor’s Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an “as is” basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT’S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P’s opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com/ratings (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.spglobal.com/usratingsfees.

STANDARD & POOR’S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor’s Financial Services LLC.