S&P Global Ratings

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Summary:

Clean Power Alliance, California; Retail Electric

Primary Credit Analyst:
Doug Snider, Englewood + 1 (303) 721 4709; doug.snider@spglobal.com

Secondary Contact:
Paul J Dyson, Austin + 1 (415) 371 5079; paul.dyson@spglobal.com

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Clean Power Alliance ICR		
Long Term Rating	A-/Stable	Rating Assigned

Credit Highlights

- S&P Global Ratings assigned its 'A-' issuer credit rating (ICR) to Clean Power Alliance (CPA), Calif.
- The outlook is stable.

Security

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

Credit overview

The rating reflects CPA's diverse, predominantly residential customer base, with member communities exhibiting typically above-average income levels throughout Los Angeles and Ventura Counties. These factors together provide the community choice aggregator (CCA) with economies of scale and rate setting flexibility. The rating is further supported by CPA's diverse and overwhelmingly low-carbon energy portfolio, which positions the CCA well relative to California's stringent renewable mandates.

These factors are tempered, in our view, by the ease with which customers can transition back to the incumbent investor-owned utility, Southern California Edison Co. (SCE). Additional risks include a power portfolio that is exposed to volatile market prices via short- and medium-term purchases and contracts, rising resource adequacy (RA) and delivery costs, and contracted power supply counterparties that include several companies that exhibit weak credit quality or that we do not rate, which could translate into nonperformance of current or future power contracts, in turn exposing CPA to the spot market.

Finally, while CPA has meaningfully built unrestricted liquidity balances over the past several years, we believe the CCA's current liquidity levels compare unfavorably with those of rated peers. We believe as a CCA, CPA faces heightened liquidity needs given the risks related to potential customer departures and/or energy supplier disruptions against the backdrop of its retail competition for its customers. Additionally, CPA projects lowering rates once it achieves its target liquidity levels consistent with its board approved reserve policy, which translates to a meaningful decline in projected fixed charge coverage (FCC). Accordingly, we have taken a one notch negative holistic adjustment to arrive at the 'A-' ICR.

CPA's enterprise risk profile further reflects retail electric rates that are lower when compared with the state average.

Moreover, CPA sets its rates based on its cost of service, which we believe provides it with ratemaking flexibility and ultimately allows it to cover costs in a generally predictable and reliable manner. However, CPA still considers its relative competitiveness to SCE when setting rates, which tempers this flexibility somewhat.

CPA's financial risk profile further reflects the following factors:

- FCC that has been generally stable, ranging from 1.09x to 1.13x between fiscal years 2020 and 2023 (unaudited). Our calculations based on management's forecast indicate FCC will improve dramatically in 2024 to over 1.2x before dropping back below 1.1x by 2026.
- The utility has no debt outstanding and no plans to issue debt in the near term.

Environmental, social, and governance

We believe that CPA faces limited environmental risks. Purchases of low- and no-carbon resources provided 100% of identifiable fuel sources in 2022. While about 40% of energy came from unspecified sources, which could contain a higher carbon content, long-term renewable projects will continue to increase as power purchase agreements (PPAs) come online. Ultimately, we believe CPA's energy portfolio positions the utility favorably relative to California's stringent and continually evolving regulatory landscape. However, management reported it posted a deficiency in its year-ahead resource adequacy procurement compliance in 2023 due to a shortage of available resources, resulting in an expected $4 million financial penalty. Although this penalty is manageable for the CCA, increasingly stringent procurement mandates could pressure financial metrics and/or force management's strategic planning to stray from its existing plans.

CPA faces indirect exposure to wildfire risk because it relies on SCE's transmission and distribution assets. The need to fund any wildfire liabilities or mitigation could lead SCE to socialize these costs among all users of its transmission and distribution systems. In turn, CPA's customers' higher delivery charges could negatively affect overall rate affordability, and limit CPA's ability to increase rates without precipitating demand deterioration. We understand if SCE is held liable, it would first use its Wildfire Expense Memorandum account, which is funded on an ongoing basis through delivery fees. Additionally, public safety power shutoffs by the owners of the transmission and distribution systems serving CPA's customers could nevertheless adversely affect the reliability of customers' electric service.

CPA's social risks are minimal, with residential rates generally remaining within a narrow band relative to those of SCE. SCE's rates are favorable relative to the state, according to the Energy Information Administration (EIA) (92.9% of California's average in 2021.) Additionally, CPA's service territory is generally characterized by healthy median household effective buying incomes (albeit with pockets of lower wealth), which further mitigates affordability challenges. Following stronger-than-expected U.S. economic growth through the third quarter of 2023, S&P Global Economics believes that recent business and consumer activity are not sustainable and projects slowing economic activity in the fourth quarter of 2023, along with tepid economic growth of 1.3%-1.4%, respectively in 2024-2025. (See "Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted," published Sept. 25, 2023, on RatingsDirect.) Although inflation is softening, S&P Global Economics projects elevated interest rates through 2024. Consequently, we continue to monitor the strength and stability of utilities' revenue streams for evidence of delinquent payments or other revenue erosion. However, we expect delinquencies will remain low and manageable given the nature of CPA's generally stable customer base and above-average income levels.

Finally, we view the utility's governance factors as generally credit supportive, as they include robust financial and operational forecasting, proactive risk management, robust contractual member agreements that limit both the ability and incentive for member departure, and strong policies and planning. However, the potential for retail customer opt-out is beyond management's control and tempers our view of the CCA's governance factors somewhat. This opt-out rate has remained low--with an overall participation rate of 93%.

Outlook

The stable outlook reflects our anticipation that CPA's diverse and generally affluent service territory will continue to support rate increases, if necessary, to maintain steady financial metrics with minimal customer opt-outs as a result. The outlook further reflects our expectation that CPA will continue to execute on its power supply plan, thus reducing exposure to increasingly stringent emissions regulations and competitive and potentially volatile wholesale markets.

Downside scenario

Over the next two years, we could lower the rating if the cost of future power, storage, delivery, and/or capacity constrain CPA's ability to maintain FCC of at least 1.1x or otherwise materially erode CPA's liquidity and/or competitive position. We could also lower the rating if CPA 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

Over the next two years, we could raise the rating if CPA continues to build liquidity while executing on its power supply plan and simultaneously maintaining its competitive position and rate affordability, regulatory compliance, participation rates, and FCC at least in-line with current levels.

Credit Opinion

Enterprise profile

CPA is a JPA originally formed in 2017 (with retail service beginning in 2018) to procure retail electric power on behalf of over 1 million accounts across 32 member communities Los Angeles and Ventura County. CPA derives about half of its retail revenues from residential, which we believe provides the CCA with revenue stability. Management added three new communities in 2022, with service beginning in March of 2024, together adding about an additional 4% load, which is manageable growth, in our view. Management indicated three new prospective members, representing 4.6% of load, have been identified and may join the agency in 2025 or 2026.

SCE, on behalf of CPA, performs monthly retail electric meter readings, bills CPA's customers, collects customer payments, and conveys over its transmission and distribution systems for the electricity CPA procures. SCE segregates and remits to CPA the revenues it collects for CPA; we understand these revenues are insulated from an investor-owned utility (IOU) bankruptcy.

Retail electricity customers who migrated to CPA at the introduction of service in their area may return to their respective incumbent IOU upon 30 days' notice. CPA 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 CPA's revenue stream. CPA's participation rate has been stable, around 93%, indicative of a somewhat inelastic customer base.

Representatives of CPA's member jurisdictions comprise the CCA's board. The board sets the retail rates for the power it procures. In addition to CPA's energy charges, the major components of the customer bills that SCE 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 ultimately constrains rate setting flexibility relative to SCE, in our view. The PCIA decreased significantly in 2022, which resulted in lower customer bills despite stable CPA rates. CPA expects to lower rates once it reaches its reserve target in 2025, which would enhance its rate affordability and overall competitive position but simultaneously erode net margins and, in turn, FCC.

Rather than strictly following SCE's rates up and down as many CCAs' rates do, which could result in uneven financial performance, CPA sets its rates based on its cost of service, with a secondary consideration given to competitiveness with SCE. We believe this rate setting practice provides the utility with greater ratemaking flexibility and ultimately allows CPA to recover costs more predictably and reliably in a wider array of market conditions. This model has resulted in CPA net rates (inclusive of the PCIA charge) exceeding those of SCE for certain periods in the past. Importantly, customer opt-outs have not increased markedly during these periods, suggesting an additional layer of ratemaking flexibility.

CPA's power portfolio is generally diverse in terms of both fuel and counterparty. However, we note that of the 44 signed purchase power agreements (PPAs), a large number are still in early stages (construction and/or pre-construction), which could lead to power shortfalls in the event a project unwinds. Moreover, we believe rising costs of RA, transmission and distribution, and volatile energy costs could result in additional cost pressures for CPA. To mitigate impacts of price spikes and market volatility, CPA has established hedging parameters, limited its maximum exposure in a given quarter to 15% of its total energy needs, with future balances stepping down thereafter. Despite the diversity among counterparties and hedging program, there is still risk associated with the low-rated or unrated counterparties nonperformance.

Financial profile

CPA does not have any debt; however, S&P Global Ratings calculates FCC to reflect our view that CPA 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 calculate FCC average 1.13x between fiscal years 2021 and 2023 (unaudited). Based on our calculations of management-provided projections, we expect FCC will improve through 2025 to over 1.2x, but drop precipitously thereafter, to about 1.06x following planned rate decreases. We would likely revisit our coverage assessment should CPA's FCC fall to and remain below 1.1x.

At fiscal year-end June 30, 2023, CPA had $293 million of unrestricted cash and investments (including a recently enlarged $160 million line of credit), equivalent to 98 days' of operating expenses. In our view, this provides a meaningful cushion for tempering exposures to potential customer departures or supplier disruptions. However, these levels are generally lower than those of comparable peers. Liquidity is projected to rise through the forecast period, to over 300 days' worth of operating expenses by 2030 (or 248 days without the line of credit.). We would likely revisit our liquidity assessment should CPA build and maintain liquidity in-line with forecast levels.

CPA currently has no on-balance sheet debt, with no plans to issue direct debt in the near or medium term.

Related Research

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