S&P Global Ratings

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Summary:

Silicon Valley Clean Energy Authority, California; Retail Electric

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Long Term Rating	A/Stable	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'A' issuer credit rating (ICR) on Silicon Valley Clean Energy Authority (SVCE), Calif.
- The outlook is stable.

Security

The ICR reflects our view of SVCE's overall creditworthiness and capacity and willingness to meet the utility's financial commitments in full as they come due. It does not apply to any specific financial obligation, as it does not consider the nature and provisions of those obligations, their standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of the obligations. SVCE has no debt outstanding.

Although SVCE operates as a joint power authority (JPA) with many member communities, it simultaneously provides direct retail service to all of its customers (albeit through the billing systems and physical assets of the incumbent investor-owned utility [IOU]). Given this direct retail service, we view SVCE's creditworthiness under the scope of our retail electric criteria.

Credit overview

The rating reflects SVCE's stable, diverse, and generally affluent customer base. In our view, these characteristics provide the community choice aggregator (CCA) with revenue stability. The rating further reflects SVCE's robust liquidity balances, healthy improvement in forecast financial metrics, and an overwhelmingly carbon-free energy portfolio.

Tempering these strengths are somewhat uneven historical fixed-charge coverage (FCC), the ease with which customers can transition back to the incumbent utility, and retail electric rates that are elevated relative to state averages but slightly advantageous compared with those of the incumbent IOUs. Additional risks are a power portfolio that is exposed to volatile market prices via spot purchases, and short- and mid-term purchases and contracts, coupled with contracted power supply counterparties that include several companies that either exhibit weak credit quality or that we do not rate.

Environmental, social, and governance

We believe that SVCE faces limited environmental risks. Purchases of low- and no-carbon resources provided over 98% of fiscal 2022 energy needs (including geothermal, hydroelectric, wind, solar, and nuclear generation). We believe

SVCE's current and projected 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 resource adequacy procurement compliance, resulting in the potential for financial penalties. Although these penalties are 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.

Although direct wildfire liability risk is low because SVCE outsources its transmission and distribution functions, public safety power shutoffs by the owners of the transmission and distribution systems serving SVCE's customers could nevertheless adversely affect the reliability of customers' electric service.

We believe SVCE faces slightly elevated social risk. Although residential rates are below those of Pacific Gas and Electric Co. (PG&E), we note that PG&E's rates are elevated (124% of California's average retail system rate in 2021), which could weigh on financial flexibility. However, this is mitigated somewhat by well-above-average effective buying incomes across SVCE's territory.

Finally, we view the utility's governance factors as generally credit supportive, as they include proactive risk management, robust JPA 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. We note that this opt-out rate has remained low--with overall participation rates at or above 96%.

Outlook

The stable outlook reflects our assessment of exceptionally strong incomes across the service territory that mitigate high rates, a robust and increasing liquidity balance that reduces but does not eliminate counterparty and customer migration risks, favorable customer retention rates, and a resource portfolio that limits 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 budgeted or unbudgeted power, energy storage, and/or capacity negatively affects competitiveness or financial performance, or if SVCE faces significant power supply counterparty nonperformance that erodes the CCA's competitive position and/or financial performance while simultaneously increasing dependence on wholesale market prices. We could also lower the rating if SVCE experiences customer opt-outs that leave it with meaningful surplus energy purchase commitments whose cost must be recovered either through liquidation into competitive wholesale markets or rate increases.

Upside scenario

We could raise the rating in the next two years if SVCE is able to successfully procure reliable and competitive power and capacity under longer-term contracts, while FCC sustainably approximates forecast results, and without material erosion of customer retention, rate competitiveness, or liquidity.

Credit Opinion

SVCE is a JPA originally formed in 2016 to procure retail electric commodity on behalf of about 278,000 electric customers across 13 members that include cities, unincorporated Santa Clara County, and towns in the Silicon Valley.

SVCE derives about one-third of its retail revenues from residential customers, which we view as somewhat concentrated. However, no single customer accounted for more than 0.5% of total retail revenues, mitigating this concentration.

PG&E, on behalf of SVCE, performs monthly retail electric meter readings, bills SVCE's customers, collects customer payments, and conveys over its transmission and distribution systems the electricity SVCE procures. PG&E segregates and remits to SVCE the revenues it collects for SVCE; we understand these revenues are insulated from an IOU bankruptcy.

Retail electricity customers who migrated to SVCE at the introduction of service in their area may return to their respective incumbent IOU on 60 days' notice. SVCE does not impose fees on departing customers. We consider the relative ease with which customers can return to their previous electric utility as a potential risk to SVCE's revenue stream. SVCE has historically maintained a strong track record of opt-out rates, less than 4% since the onset of the COVID-19 pandemic.

Representatives of SVCE's member jurisdictions comprise the CCA's board. The board sets the retail rates for the power it procures at a fixed discount to PG&E (4%, up from 1% historically). In addition to SVCE'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.

Elevated PCIA levels (coupled with a lower PG&E generation rate) in fiscal 2021 led to lower margins for SVCE and, in turn, below 1.0x FCC. FCC is S&P Global Ratings' internally adjusted coverage calculation, which treats a portion of purchased power costs as debt-like. FCC rebounded to about 1.3x in 2022 and is projected to increase to over 2.0x by 2027. However, we believe this historical variability in financial performance highlights the limitations in SVCE's rate-setting flexibility and its exposure to the PCIA. More important, the CCA maintains robust liquidity, in part to mitigate these exposures. Unrestricted cash and short-term investments totaled $167 million, or 192 days' worth of expenses, as of Sept. 30, 2022. We believe the continued maintenance of robust liquidity underpins the current rating, given the previously discussed operational risks SVCE faces. Management's forecast indicates levels climbing to nearly 500 days by 2027, although our view of forecast liquidity and coverage levels are tempered by historical unevenness and the aforementioned exposures.

SVCE's power portfolio is diverse, in our view, with no single contract accounting for more than 10% of total load, with the CCA gradually increasing the number of mid- to long-term power purchase agreements (PPAs), rather than spot or short-term contracts. Although we generally view positively the long-term price certainty these contracts provide, the possibility of customer dislocation could result in SVCE surplus power. Management reported the CCA can sell its excess energy position into the wholesale market, with no end-use restrictions attached to any of its PPAs; however, this would still expose the CCA to market pricing.

Related Research

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