MAY 7, 2021

Prepay Transaction Overview

EAST BAY COMMUNITY ENERGY

Prepay Overview

- An energy prepayment is a long-term non-recourse financial transaction between a tax-exempt Load Serving Entity (LSE) and a taxable financial counterparty (bank, called “Prepay Supplier") utilizing the municipal bond market.
  - Bond notional is expected in the ~$600MM-$800MM range
  - LSE utilizes prepay in order to lower customer energy costs
- Municipal utilities (and tax-exempt entities such as CCAs) in the US can prepay for a supply of electricity or natural gas from a taxable entity and fund that prepayment with tax-exempt municipal bonds. The LSE must sell the commodity to their retail end-users residing within their traditional service area.
  - This structure is well known and regularly used for gas and is now being applied towards renewables PPAs
  - Codified in US Tax Law. Since first prepayments of natural gas were done in the early 1990s, the IRS issued rules allowing tax-exempt prepayments and Congress enacted legislation specifically allowing the transactions (National Energy Policy Act of 2005; Section 1327)

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Prepay Overview

Structure:

- Term: Typically 30-year term with repricing periods every 5-7 years due to the optimal taxable vs. tax-exempt spreads
- Transacting Parties:
  1. Tax-exempt Load Serving Entity (LSE, also called "Prepay Buyer") - EBCE
  2. Taxable financial counterparty (bank, called "Prepay Supplier") - Morgan Stanley
- Process:
  1. Prepay Supplier is assigned the existing energy supply contract(s) held by LSE through a limited assignment agreement
  2. Municipal bonds issued by conduit, amounting to combined notional value of assigned contracts
  3. Prepay Supplier pays the contract price to PPA Seller, immediately transferring all electricity and attributes to LSE
  4. LSE pays the Prepay Supplier at discounted rate, achieving procurement cost savings
- Takeaway: Prepay Supplier is effectively the energy supplier and is prepaid for future energy deliveries. The prepay supplier holds and utilizes capital and provides a discount to the Prepay Buyer that is enabled via the spread between the taxable and tax-exempt borrowing costs.

Benefits:

- Lower energy procurement costs: Savings over 30-year term estimated to be 5-15% per year on power quantities delivered under prepay, compared to spot market purchases and current contracts; subject to change based on market conditions at the time that the bond is issued.

Risks:

- Regulatory: Addressing risks related to compliance with SB350 and Emissions Performance Standard (eg. retaining the 10-year long-term contracting requirement)

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EBCE Prepay Parties

Joint Prepay Buyer: Silicon Valley Clean Energy

- EBCE and SVCE issued the RFP together, are preparing a joint transaction in which both CCAs assign contracts, share costs and benefits

Counsel: Orrick, Herrington & Sutcliffe (Bond & Tax) | Chapman & Cutler LLP (Disclosure & Issuer's)

- Both firms selected through solicitation issued June 2020

Prepay Supplier: Morgan Stanley

- Selected through solicitation issued November 2019

Municipal Financial Advisor: PFM

- Selected through solicitation issued September 2020

Bond Issuer: California Community Choice Financing Authority

- 3 of 4 Founding Members have received Board approval for JPA formation (EBCE, MCE, SVCE)
- 3CE seeking Board approval mid-May

Key Elements of a Prepay Transaction

Power Contract Assignment:

- Existing renewable PPAs are assigned to the taxable Prepay Supplier. The LSE continues to ***take and pay*** for energy and attributes delivered through the contract at a discount.
- The assignment is a limited assignment of rights and energy products whereby the LSE continues to serve as scheduling coordinator to the extent applicable and all operational requirements continue to remain.
- All other terms of the PPA are unchanged.
- If the prepay program terminates early, Prepay Supplier fails to perform, or LSE fails to perform, the LSE forgoes the future savings and the assigned PPA contract is put back to the original LSE.

Debt:

- <u>Non-Recourse</u>: Prepays utilize non-recourse municipal bonds and are ***not*** secured or guaranteed by the referenced entity (i.e. the CCA). Rather the debt is recourse to the Prepay Supplier. This significantly protects the CCA and mitigates risk related to the payment of power contracts novated through the prepay.
- <u>Off Balance Sheet for LSE</u>: Bonds are issued by a municipal bond conduit.

Prepay Sizing and Discount

- The total bond notional may be as high as $1.5bn and will be dependent on the CA bond market appetite. The expected notional is in the $600-800MM range.
  - EBCE will seek the maximum bond raise while maintaining the optimal bond rates
  - The amount represents the present value of the PPA cashflows over the 30-year life of the transactions

- This initial transaction is being split between SVCE and EBCE and will amount to approximately $12-16MM of annual procurement costs running through the prepay and translate to $1.2-1.6MM of annual savings for each CCA.
  - The transaction assumes an increase in the cashflows running through the prepay over the 30-year life reaching $20-25MM in annual procurement costs running through the prepay by the end of the transaction.
  - As the transaction moves forward, the arbitrage value goes down since the present value benefits reduce with a shorter remaining tenor. The future discount rates will be reset every 5-7 years and be dependent on future bond market conditions, but this puts downward pressure on the future discounts.
  - There is a negotiated minimum discount that, if not met by the Prepay Supplier, allows the LSE a walkaway right.

- Ultimately the discount is established by the spread between taxable and tax-exempt rates and deducts all transaction related costs, which include fees associated with bond underwriting, counsel (bond, disclosure, underwriter's, prepay), financial adviser, swap counterparty, credit rating, etc.

- 5-7 years is the optimal bond spread tenor currently. Maintaining this spread over a 30-year transaction life maximizes the available discount. This requires a repricing and re-issuance of bonds every 5-7 years. This allows for a re-pricing and a reset of the discount rate. In general, a high interest rate environment will lead to a higher discount rate.

Key Documents

Prepaid Agreement

- Details the flow of power and payments between the parties (Prepay Supplier, conduit issuer, and the CCA)
- Lines out all scenarios in which the deal might terminate early
- Similar terms to Power Supply Contract

Repricing Agreement

- Sets forth terms for remarketing, repricing for future interest rate periods

Power Supply Contract

- Sets forth terms for which CCAs receive energy for 30-year terms
- <u>1 of 2 documents signed by CCAs directly</u>

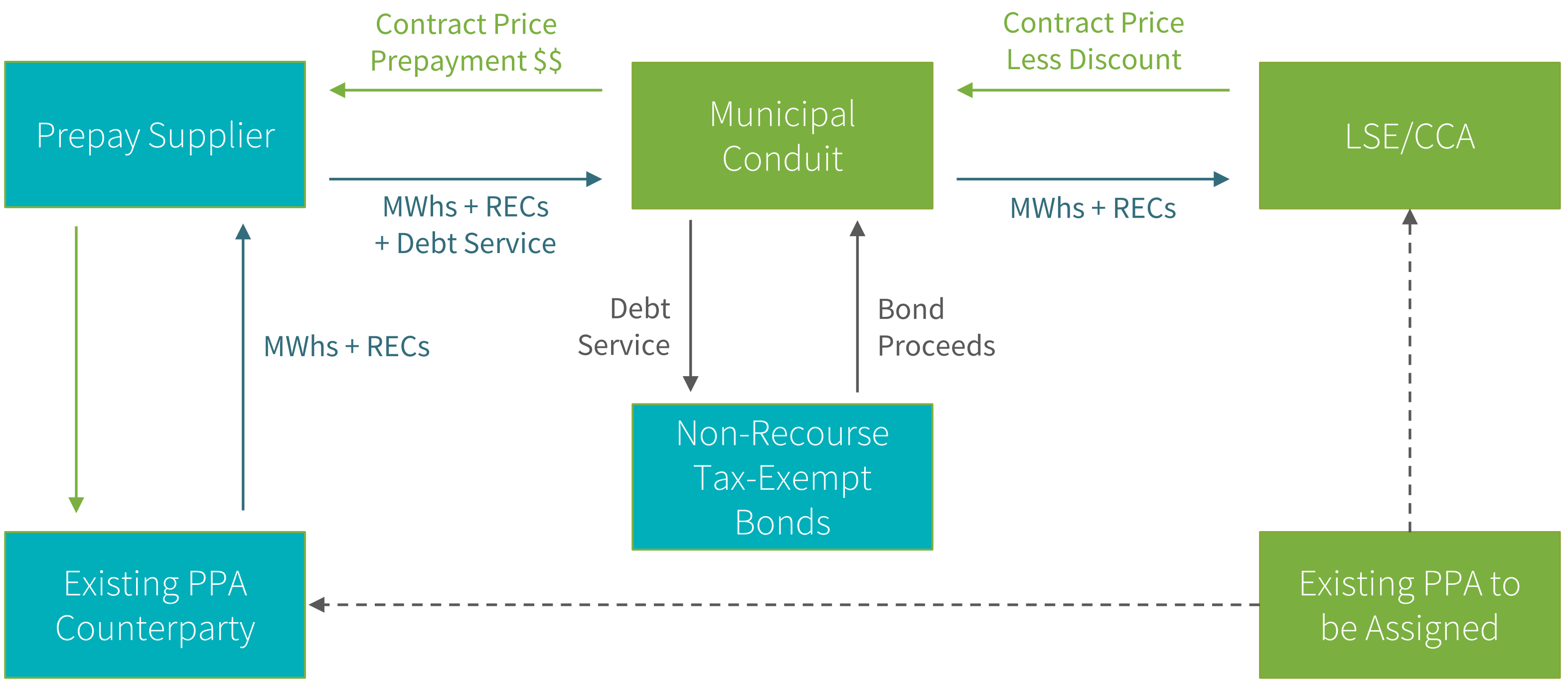
Letter Agreement

- Sets out terms for future assignments by CCAs
- <u>1 of 2 documents signed by CCAs directly</u>. Signed by Prepay Supplier, CCAs, and CCCFA (conduit issuer JPA)

Commodity Swap Documents

- Documents pursuant to which the price of the commodity is hedged with a 3rd-party swap counterparty (to insulate transaction from market variations)
- Dormant for initial bond period, but turns on when transaction moves from fixed to floating pricing after initial period

Prepay Structure



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Benefits

- Savings over the 30-year term expected to be 5% - 15% per year on power quantities delivered under the prepay structure compared to spot market purchases / current contracts. Discount rates may fluctuate up or down in future years.

- EBCE can continue to enter into similar transactions in future years to increase procurement cost savings. It is foreseeable that EBCE enters into 5-10 prepay transactions to achieve annual savings of $10-20MM. The limitations are based on the bond market investor appetite, market conditions with meaningful taxable and tax-exempt spreads, and the available headroom to ensure that EBCE will have the procurement related costs to safely assign in for a 30-year transaction life.

- Favorable risk allocation where EBCE only pays for energy that is delivered (same as contracts today)

- Debt is non-recourse to EBCE

- Rating agencies comfortable with comparable deals at SMUD, SCPPA, others

Risks

- If this transaction does not materialize: Loss of out-of-pocket costs $25-50k and staff time
  - Consultants all contingent on successful deal
  - Consultants are all paid from deal proceeds vs. EBCE directly
- Opportunity cost of higher savings through a prepay transaction or alternative structure initiated at a different time
- Regulatory risk related to reclassifying a long-term PPA as a short-term PPA, making it ineligible for SB350 qualification
- Political risk associated with a transaction collapsing due to non-compliance to tax codes

Timeline

November 2019 through September 2020:

- Got enabled with legal and advisory representation
- Began structuring and document negotiations with Morgan Stanley

Oct. – June 2021:

- Continued document negotiations, preparation
- Identification and prelim assignment discussion of power supply contracts
- Documents ready to execute in coming weeks-months

Bond raise and initiation of prepay could occur anytime in next 3-6 months

Factors That May Impact Timing:

- Markets: Taxable vs. tax-exempt spreads need to exist in a meaningful way to achieve discounts we are seeking, and current rate environment is not optimal though market conditions are rapidly improving. Important to get docs in place to be able to transact quickly when markets open back up, though market conditions could delay timeline of deal execution.
- Assignment Consents: Still need to identify commodity transactions for assignment, and timeliness of consents could extend the timeline of deal execution.

Market Statistics

- Nationwide: 90+ municipal transactions
  - $50+ Billion combined notional contract value
- California: 11 municipal transactions
  - $5.7 Billion combined notional contract value
- Active Suppliers: Goldman Sachs, Morgan Stanley, Royal Bank of Canada, Citi, TD Securities
  - All investment grade rated financial institutions
- Resource Types:
  - Majority of transactions to date have been exclusively for natural gas, remainder including an electricity 'switch' at a certain year.
  - The same tax law and similar transaction structure enables the program for electricity from renewables contracts, as well. The market is seeing activity and preparation for these transactions, particularly from CCAs.