Staff Report Item 18

TO: East Bay Community Energy Board of Directors

FROM: Howard Chang, Chief Operating Officer

SUBJECT: Prepay Overview and Approval of Counsel, Financial Advisor, and Rating Agency (Action Item)

DATE: June 21, 2023

Recommendation

Adopt a Resolution authorizing the CEO or COO to negotiate and execute Agreements with the following firms for legal representation, financial advisory services, and rating agency services on EBCE's third energy prepayment transaction. The expected total costs are $850,000 and we are requesting authorization for up to $1,000,000 for the four Agreements, which includes an additional $150,000 for contingency that could be used to increase the cost(s) for one or more of the Agreements above the amounts listed below.

A. Orrick, Herrington & Sutcliffe – Bond Counsel and Tax Counsel for a total amount of $250,000
B. Chapman & Cutler LLP – Disclosure Counsel, Issuer's Counsel, and to prepare the Official Statement for a total amount of $175,000
   - PFM Financial Advisors LLC & PFM Swap Advisors LLC – Financial Advisor for a total amount of $150,000
C. Moody's Investor Service Inc – Credit rating of the prepay bond transaction for a total amount of $275,000

Background and Discussion

EBCE is preparing to execute a third energy prepay transaction. EBCE has a sizeable energy procurement portfolio needed to serve our load and expects to execute multiple prepay transactions over the next several years to realize procurement savings by utilizing its tax-exempt status. Staff is seeking to get enabled with the set of legal counsel, advisors, and other counterparties to replicate the prior transactions as efficiently as possible, while also continuing to make improvements upon the structure. EBCE plans to have documentation prepared in the June/July timeframe and seek board approval to move forward and go to market soon after. Depending on market conditions, EBCE could close on a transaction in the July and August timeframe.

Previous Energy Prepay Transactions:

EBCE executed two energy prepay transactions in 2021 and 2022, issuing through CA Community Choice Financing Authority (CCCFA), the JPA in which EBCE is a member. The annual savings from these first two energy prepay transactions totals nearly $7 Million at the outset.

EBCE and Silicon Valley Clean Energy (SVCE) jointly executed the first energy prepay transaction by a CCA on September 23, 2021, with a notional size of $1.48BN. For this first transaction, EBCE and SVCE jointly performed due diligence and negotiated the initial transaction over a 1.5yr period and issued a number of solicitations to select a number of counterparties and advisors. Included was a solicitation in November 2019 to identify potential Prepay Suppliers, through which Morgan Stanley (MS) was selected. MS is one of a small number of large financial institutions that is experienced in executing on the bond underwriting and prepay structuring aspects of this transaction. Additionally, the CCAs jointly issued a solicitation in June 2020, for the counsel roles, through which Orrick, Herrington & Sutcliffe and Chapman & Cutler LLP were selected. Both firms have significant experience representing parties on prepay transactions since the market inception in the 1990s, and both firms are industry leaders in serving the roles for which they've been selected. The CCAs also jointly issued a solicitation in September 2020, to identify municipal financial advisors. Given the niche market for prepayments, there are very few firms who provide this type of advisory service and experience. EBCE and SVCE reviewed and scored the respondents, ultimately selecting PFM Financial Advisors, LLC & PFM Swap Advisors LLC (PFM). Moody's Investor Service Inc. was selected due to their unique experience in rating prepayment type transactions and alternative rating agencies are not as suitable to complete such work.

Due to the nature of the repeat work of these transactions, EBCE has been successful in reducing the costs of working with these various parties, saving over $150,000 compared to initial contract costs. Additionally, the execution and transaction closing process has seen considerable efficiencies.

Prepay Parties:
The prepay transaction requires the selection and involvement of multiple parties. Names and functions are as follows:
Prepay Buyer: East Bay Community Energy
- <u>Role</u>: Provide energy contracts to flow through prepay

Prepay Seller: Morgan Stanley
- <u>Role</u>: Structure transaction and pay contract price to PPA provider
- *Note: No legal obligation or liabilities are being entered into currently; approval of counsel allows EBCE to negotiate documents with Morgan Stanley for which staff will later return to the Board for approval of the official prepay transaction and associated bond issuance.*

Municipal Advisor: PFM
- <u>Role</u>: Advise Prepay Buyer in negotiations; required by Municipal Securities Rulemaking Board (MSRB)

Bond Counsel: Orrick, Herrington & Sutcliffe
- <u>Role</u>: Represent bondholders

Tax Counsel: Orrick, Herrington & Sutcliffe
- <u>Role</u>: Provide tax opinion on transaction

Issuer's Counsel (*also known as Prepay Counsel or Prepaid Counsel*): Chapman & Cutler LLP
- <u>Role</u>: Represent issuer's interests, supporting drafting and negotiating terms of prepay agreement and associated energy supply agreements

Disclosure Counsel: Chapman & Cutler LLP

- Role: Prepare Official Statement / Prospectus

Bond Issuer: CCCFA

- Role: Issue municipal bonds for prepay

Timeline:

With this approval, staff will begin prepay structuring and document negotiations with Morgan Stanley. Draft documents should be prepared for a deal execution in the June/July timeframe. Staff anticipates bringing forward the prepay deal structure for approval in July 2023.

Prepay Structure Overview:
An energy prepayment – or 'prepay' – is a long-term financial transaction available to municipal utilities and tax-exempt entities such as CCAs that enables a meaningful power procurement cost savings opportunity. Utilizing the municipal bond market, a tax-exempt Load Serving Entity (LSE, also called "Prepay Buyer") and a taxable financial counterparty (bank, called "Prepay Supplier") enter into a 30-year agreement through which the LSE assigns existing power supply contracts to the Prepay Supplier. The Prepay Supplier pays the contract price to the PPA provider, while the LSE pays the Prepay Supplier at a discounted rate. The discounted rate is agreed upon in the prepay documents for the initial term of the bond and is based in part on the spread between the taxable and tax-exempt bond interest rates. The market availability of this interest rate spread is critical to the savings opportunity available to an LSE through a prepay. At future bond repricing periods, this discount rate will be reset, with a negotiated minimum discount rate.

Tax-exempt bonds are issued by a third-party conduit to raise funds for the prepay transaction, which flow to the Prepay Supplier. The LSE does a limited assignment of the PPA to the Prepay Supplier. The LSE is required to continue to perform under the contract, while maintaining rights to the electricity and attributes under the PPA. The Prepay Supplier utilizes the bond funds and provides a discount on the PPA to the LSE based on the spread between the taxable and tax-exempt rates. The discount is estimated at 8-12% but is subject to change based on market conditions.

The total combined present notional value of the assigned contracts flowing through the prepay over the 30 years is anticipated to be in the range of $500MM-1BN; these contracts can be long-term renewables PPAs or short-term commodity supply contracts. While the contracts are assigned to the Prepay Supplier, the LSE continues to ultimately take and pay for all the energy and attributes delivered through the contract; all other terms of the PPA remain unchanged. If the prepay program terminates early for any reason – either the Prepay Supplier or the LSE fail to perform – the LSE forgoes future savings and the assigned PPA is put back completely to the LSE.

Two key features of the municipal bonds utilized in a prepay greatly reduce risk to the LSE. First, the bonds are non-recourse to the LSE, meaning they are neither secured nor guaranteed by the LSE and EBCE will at no point be responsible for repaying the bonds. Secondly, prepays are off-balance sheet for the LSE as the bonds are issued by a third-party conduit.

Ultimately, prepays are employed to save ratepayers money while maintaining both (a) the economics for the PPA provider and (b) the terms of the energy supply contract. They have been used for natural gas transactions in the US since the early 1990s, with over 90 transactions completed nationwide ($50+ Billion) and 15 transactions completed in California. The same tax law[1] and similar transaction structure that enables the natural gas prepays enables the program for electricity, and specifically renewables contracts, creating an opportunity for CCAs to provide renewable energy at a lower cost than the IOU competition.

Financial Impacts

The financial impacts of this item pertain only to the counsel, financial advisor, and Moody's fees outlined below. These fees may be structured as contingent fees paid out of the proceeds of the prepay transaction upon the successful execution of the program. Alternatively, EBCE may pursue non-contingent fees based on an hourly fee structure, which is subject to further negotiation. In all cases, the total counsel, financial advisor, and rating agency fees total an amount not to exceed $1,000,000, which reflects the estimated total of $850,000 and $150,000 of contingency.

- Bond and Tax Counsel: $250,000
    - Contingent on a successful prepay execution
- Issuer's Counsel and Disclosure Counsel: $175,000
    - Contingent on a successful prepay execution.
- Financial Advisor: $150,000
    - Contingent on a successful prepay execution
- Transaction Credit Rating Services: $275,000
    - Fee is not contingent but would only be committed when the transaction is ready to go to market

It is important to also note the financial benefit available through the prepay. It is estimated to achieve an 8-12% discount per year on power quantities delivered under the prepay, compared to the assigned contracts. However, the exact discount will be dependent on the spread between taxable and tax-exempt debt rates. While savings are not guaranteed in the structure, there is no negative financial impact associated if the deal does not produce targeted savings levels.

Attachments

A. Resolution authorizing the CEO or COO to negotiate and execute agreements for legal representation, financial advisory, and Moody's credit rating services on EBCE's energy prepayment transaction; and
B. Prepay Presentation

[1] 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).

RESOLUTION NO. R-2023-xx

A RESOLUTION OF THE BOARD OF DIRECTORS OF THE EAST BAY COMMUNITY ENERGY AUTHORITY TO AUTHORIZE THE NEGOTIATION AND EXECUTION OF AGREEMENTS WITH ORRICK, HERRINGTON & SUTCLIFFE; CHAPMAN & CUTLER LLP; PFM FINANCIAL ADVISORS LLC & PFM SWAP ADVISORS LLC; AND MOODY'S INVESTOR SERVICE INC. TO SERVE AS COUNSEL, FINANCIAL ADVISOR, AND CREDIT RATING AGENCY ON THE ENERGY PREPAYMENT TRANSACTION

WHEREAS The East Bay Community Energy Authority ("EBCE") was formed as a community choice aggregation agency ("CCA") on December 1, 2016, Under the Joint Exercise of Power Act, California Government Code sections 6500 *et seq.*, among the County of Alameda, and the Cities of Albany, Berkeley, Dublin, Emeryville, Fremont, Hayward, Livermore, Piedmont, Oakland, San Leandro, and Union City to study, promote, develop, conduct, operate, and manage energy-related climate change programs in all of the member jurisdictions. The cities of Newark and Pleasanton, located in Alameda County, along with the City of Tracy, located in San Joaquin County, were added as members of EBCE and parties to the JPA in March of 2020.

WHEREAS The pursuit of a third energy prepayment enables a meaningful power procurement cost savings opportunity in which EBCE utilizes its tax-exempt status to access the municipal bond market to prepay energy supply contracts at a discounted rate,

WHEREAS Orrick, Herrington & Sutcliffe and Chapman & Cutler LLP were respectively selected for the respective counsel roles through a solicitation issued in June 2020,

WHEREAS PFM Financial Advisors LLC & PFM Swap Advisors LLC were selected for the financial advisor roles through a solicitation issued in September 2020,

WHEREAS Moody's Investor Service Inc. was selected for the Bond credit rating service due to its unique experience evaluating similar prepayment transactions, and

WHEREAS The combined fees for counsel services provided by the firms identified above shall not exceed $1,000,000.

NOW, THEREFORE, THE BOARD OF DIRECTORS OF THE EAST BAY COMMUNITY ENERGY AUTHORITY DOES HEREBY RESOLVE AS FOLLOWS:

<u>Section 1.</u> Authorize the CEO or COO to negotiate and execute Agreements with the following firms for legal representation on EBCE's energy prepayment transaction: Orrick, Herrington & Sutcliffe – roles of Bond Counsel and Tax Counsel, and Chapman & Cutler LLP – roles of Disclosure Counsel, Issuer's Counsel, and to prepare the Official Statement; PFM Financial Advisors LLC & PFM Swap Advisors LLC – role of Financial Advisor; Moody's Investor Service Inc. - role of bond transaction credit rating agency. The total combined costs to EBCE for the

four Agreements will not exceed $1,000,000 and the Agreements shall be approved as to form by the General Counsel.

ADOPTED AND APPROVED this 21st day of June, 2023.

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Elisa Marquez, Chair

ATTEST:

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Adrian Bankhead, Clerk of the Board

JUNE 21, 2023

Energy Prepay Transaction Overview

EAST BAY COMMUNITY ENERGY

Energy Prepay Introduction

Attachment Staff Report Item 18B

- 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.

  - Typically 30-year term, LSE committing ~$500MM-$1BN of energy supply contracts (combined notional values)
  - LSE utilizes in order to lower customer energy costs

- Prepay Supplier is assigned an existing energy supply contract, pays the contract price to PPA Seller and immediately transfers all electricity and attributes to LSE. LSE pays the Prepay Supplier at a discounted rate.

- 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 1990’s, the IRS issued rules allowing tax-exempt prepayments and Congress enacted legislation specifically allowing the transactions (National Energy Policy Act of 2005; Section 1327)

Energy Prepay Overview

- EBCE executed two energy prepay transactions in 2021 and 2022, issuing through CA Community Choice Financing Authority (CCCFA), the JPA in which EBCE is a member
- Annual savings from these first two energy prepay transactions totals nearly $7 Million at the outset
- Energy Prepay transactions are off balance sheet structures that allow EBCE to utilize its tax-exempt status to lower its energy procurement costs
- The discount that is applied to energy costs is based on the differential between taxable and tax-exempt dept spreads. These spreads are historically volatile and therefore optimal prepay timing is difficult to predict
- EBCE is preparing a third energy prepay transaction and anticipates going to market in the next 1-3 months if conditions are suitable
- Staff is seeking approval to get enabled with counsel, financial adviser, and the credit rating agency today and will seek approval from the board on moving forward with the transaction as early as July 2023

Existing Energy Prepay Transaction Summary

EBCE First Transaction – Jointly executed with SVCE

- First Energy prepay closed by a CCA
- Closed: Sept. 23, 2021
- Total Bond Proceeds: $1.48 Billion ("Green Bond" Certified)
- Initial Power Supply: 59 MW Around-the-Clock Carbon-Free Energy starting Jan 1, 2022
- Initial Bond Tenor Savings: 10 years

EBCE Second Transaction - Standalone prepay

- Third Energy prepay closed by a CCA
- Closed: July 12, 2022
- Total Bond Proceeds: $939 Million ("Green Bond" Certified)
- Initial Power Supply: 75 MW Around-the-Clock Carbon-Free Energy starting April 1, 2023
- Initial Bond Tenor: 6 years

EAST BAY COMMUNITY ENERGY

Historical Prepay Parties

Prepay Supplier/Bond Underwriter: Morgan Stanley

- Selected through solicitation issued November 2019

Municipal Financial Advisor: PFM Financial Advisors LLC & PFM Swap Advisors LLC

- Selected through solicitation issued September 2020

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

- Both firms selected through solicitation issued June 2020

Bond Issuer: California Community Choice Financing Authority

- EBCE membership approved by Board in April 2021, JPA formed June 2021; Founding Members are EBCE, MCE, SVCE, 3CE

Custodian: Bank of New York

- PFM issued solicitation early July 2021

Commodity Swap Counterparty: Natixis and RBC

- RBC was the swap counterparty in 2021 and Natixis was the swap counterparty in 2022

Credit Rating Agency: Moody's Investor Service Inc

Recommendation

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- Moody's Investor Service Inc – Credit rating of the prepay bond transaction for a total amount of $275,000

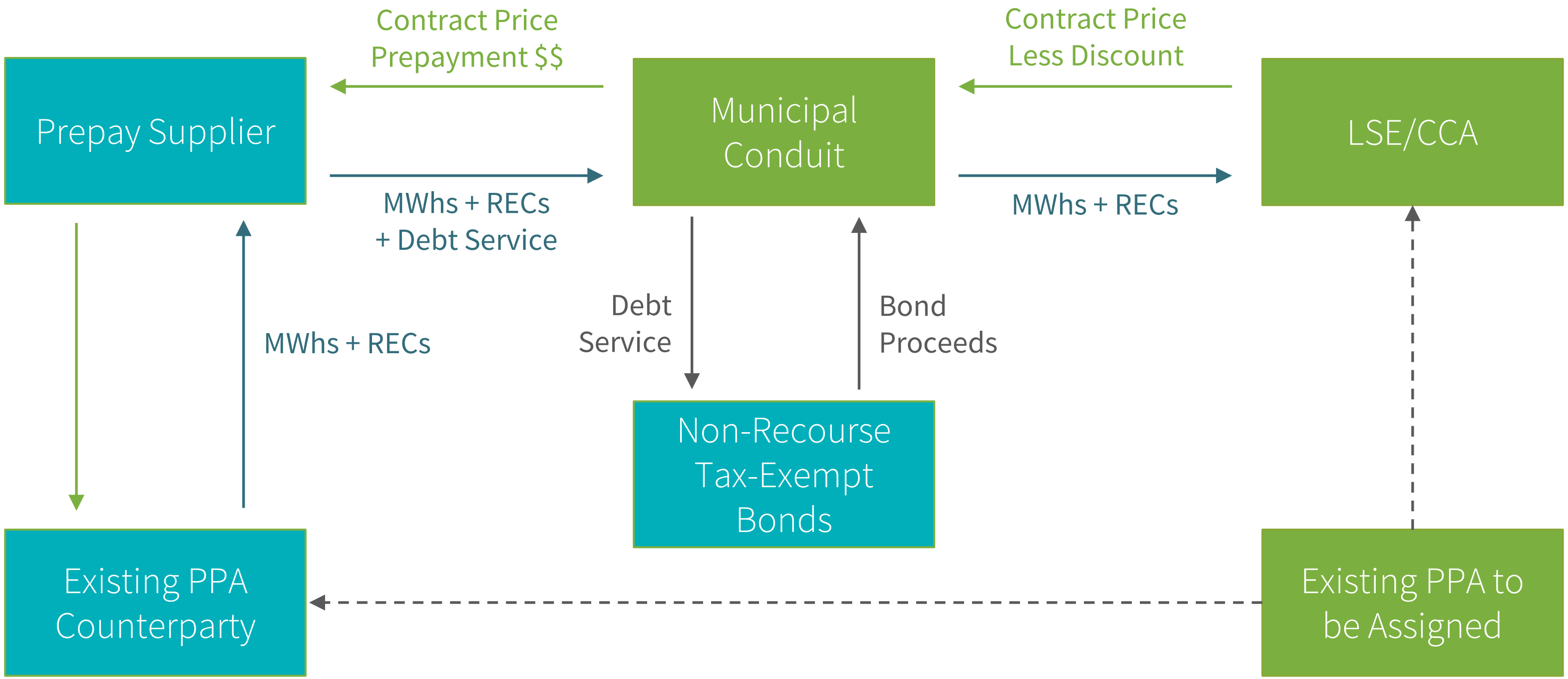
Attachment Staff Report Item 18B

Appendix

EAST BAY COMMUNITY ENERGY

Prepay Structure

Attachment Staff Report Item 18B



EAST BAY COMMUNITY ENERGY

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: Morgan Stanley, Goldman Sachs, JP Morgan, 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.

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.
- All other terms of the PPA are unchanged
- If the prepay program terminates early, prepaid 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
- Active Suppliers: Goldman Sachs, Morgan Stanley, JP Morgan Royal Bank of Canada, Citi, Bank of America are all investment grade rated financial institutions

Debt:

- Non-Recourse: 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 (i.e. the bank receiving the prepayment). This significantly protects the CCA and mitigates risk related to the payment of power contracts novated through the prepay.
- Off Balance sheet for LSE: Bonds are issued by a municipal bond conduit and arranged by the Prepay Supplier

EAST BAY COMMUNITY ENERGY

Prepay Sizing and Discount

- The total bond proceeds may be as high as $1.25bn and will be dependent on the CA bond market appetite.
  - EBCE will seek the maximum bond raise while maintaining optimal bond rates
  - The amount represents the present value of the PPA cashflows over the 30-year life of the transaction
- This transaction will likely translate to an estimated $2-3MM of annual savings for EBCE for the initial bond term.
  - The transaction assumes an increase in the cashflows running through the prepay over the 30-year life.
  - 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 5-10 years based on bond tenors 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 not to move forward in the repricing.
- 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, custodian, etc.
- 5-10 years is typically the optimal bond spread tenor. Maintaining this spread over a 30-year transaction life maximizes the available discount. This requires a repricing and re-issuance of bonds every 5-10 years and a reset of the discount rate. In general, a high interest rate environment will lead to a higher discount.
- The initial power flows for the transaction are anticipated to begin in 2024