S&P Global
Ratings

RatingsDirect®

Summary:

Ava Community Energy, California; Retail Electric

Primary Credit Analyst:
Timothy P Meernik, Englewood + 1 (303) 721 4786; timothy.meernik@spglobal.com

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

Table Of Contents

Summary:

Ava Community Energy, California; Retail Electric

Credit Profile		
East Bay Community Energy ICR		
Long Term Rating	A/Stable	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'A' issuer credit rating (ICR) on Ava Community Energy (Ava), Calif. Ava changed its name from East Bay Community Energy in October 2023.
- The outlook is stable.

Security

At fiscal year-end 2023, Ava had no debt outstanding. The ICR reflects Ava's general creditworthiness and its capacity and willingness to meet its financial commitments as they come due. Because Ava provides retail electric service and is a public agency, S&P Global Ratings evaluates Ava's creditworthiness under the scope of our municipal retail electric and gas utilities criteria.

Credit overview

Ava, a community choice aggregator (CCA) that began operations in 2018, serves more than half a million customer accounts and, we believe, has achieved credit-supportive financial results. The CCA directly competes with the service area's incumbent investor-owned utility, Pacific Gas and Electric Co. (PG&E; BB-/Positive), for providing customers the energy portion of their electric service. (PG&E's transmission and distribution assets deliver the electricity.) Because of the direct competition, we believe Ava's rate-setting flexibility is somewhat limited given that customers could leave the CCA if its rates became uncompetitive relative to those of PG&E.

The rating further reflects our view of Ava's:

- Deep customer base of 640,000 accounts with residential customers responsible for more than 40% of Ava's kilowatt-hour sales, enhancing revenue stability;
- Protective joint powers agreements with member communities, requiring a departing member to provide six months' notice, receive Ava board approval, and make the CCA whole for any costs incurred to serve that member signed prior to its departure, serving, we believe, as a disincentive for a member to terminate its contract with Ava;
- Diverse power supply arrangements with a variety of contract types, geographic locations, and storage capabilities;
- Solid financial performance, including historical fixed-cost and imputed charge coverage (FCC) averaging 1.3x over the past three years, which we expect to continue, and considerable liquidity of 265 days at the end of fiscal 2023, which we expect will increase in the coming years; and
- Lack of debt, enhancing the CCA's financial flexibility.

Partly offsetting the above strengths, in our view, are Ava's:

- Power procurement uncertainty, as the CCA must balance its obligation to enter long-term contracts with a potentially volatile load profile given possible member community and/or individual customer exit from the CCA, as well as a need to balance its renewable mandates with the need for reliable baseload energy;
- High reliance on market purchases with the CCA obtaining a material amount of its electricity from short-term purchases, which we expect will continue for the next several years, although we recognize that the CCA's hedging practices considerably reduce Ava's exposure to elevated market prices, with typically more than 80% of projected load hedged at the start of each month; and
- Indirect exposure to wildfire liabilities incurred by PG&E for its transmission and distribution assets, noting California's strict inverse condemnation standard and PG&E's track record of equipment causing wildfires, although we recognize that the CCA has limited direct wildfire exposure given the absence of Ava-owned generation, transmission, or distribution assets.

Environmental, social, and governance

We believe Ava's exposure to climate transition risk is low because of its predominantly carbon-free resource portfolio that limits the potential for regulatory costs and positions the CCA well for California's renewable portfolio standard. In 2022, Ava's fuel mix of its standard offering was 49% eligible renewables and 0% fossil fuel resources, with about 28% unspecified. Ava plans for its fuel mix to be 100% carbon-free and at least 65% from eligible renewables by 2030. However, as a practical matter, the intermittency of renewable resources might frustrate Ava from achieving California's ambitious greenhouse gas emission goals in the absence of storage technology breakthroughs.

In our view, Ava has some exposure to social capital risks because the CCA's weighted average rate, inclusive of generation, transmission, and distribution charges, is meaningfully above the state average, reducing Ava's rate-raising flexibility. Ava sets its rates close to that set by PG&E, whose weighted average rate was 132% of the state average based on data from the U.S. Energy Information Administration. (We note that the transmission and distribution portion of the bill is set by and paid to PG&E.) Moreover, Ava has seen an increase in delinquencies over the past several years, indicating that some customers are facing payment 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 along with tepid economic growth of 1.5% in 2024 and 1.4% in 2025, which could further pressure Ava's delinquencies. (See "Economic Outlook U.S. Q1 2024: Cooling Off But Not Breaking," published Nov. 27, 2023, on RatingsDirect). Furthermore, although inflation has likely peaked, S&P Global Economics projects elevated interest rates through much of 2024. The combination of delinquent consumer, credit card, and auto loans, along with October's resumption of student loan payments and drawdowns of household savings garnered during the pandemic, will likely compound the financial pressures facing consumers. Consequently, we are monitoring the strength and stability of CCAs' revenue streams for evidence of delinquent payments or other revenue erosion.

We view Ava's risk management, culture, and oversight factors as credit-supportive, as they include robust joint powers agreements with members, full rate-setting autonomy, comprehensive policies and planning (including a risk management program with detailed hedging targets), and a sophisticated management team. The CCA produces detailed long-term financial forecasting and integrated resource plans, and participates in California utility proceedings.

We also believe that Ava performs appropriate due diligence when entering power supply contracts, including examining counterparties' financial well-being and requiring collateral postings. However, the potential for retail customer opt-out somewhat tempers our view of Ava's governance factors.

Outlook

The stable outlook reflects our expectation that Ava's rates will remain competitive with those of PG&E, enabling the CCA to avoid out-migration of customers. We also believe that Ava will maintain significant unrestricted reserves, providing flexibility to meet financial obligations.

Downside scenario

Over the next two years, we could lower the rating if power supply costs increase, which could either pressure the CCA's rate competitiveness and/or result in a reduction in unrestricted reserves, depending on management's actions. Also, if any of the member communities leave the CCA, Ava could be forced to sell surplus contracted power to the market. In the event that market prices decrease to levels significantly below those of the CCA's portfolio, Ava could face significant financial pressure, which could lead us to lower the rating.

Upside scenario

We could raise the rating if FCC and liquidity materially strengthen on a sustained basis as indicated in Ava's financial forecast, which assumes that the CCA maintains rates comparable to those of the incumbent investor-owned utility, yielding increasingly strong financial margins. However, if management opts to enhance rate competitiveness and not increase FCC and liquidity at forecast levels, the potential for a stronger rating is less likely.

Credit Opinion

In our view, the service area has favorable economic fundamentals. The CCA serves 15 member communities, all but one in Alameda County. Median household effective buying income in the county, which is part of the board and the diverse San Francisco Bay Area economy, is 155% of the national level. We also note no customer concentration in the service area with the top 10 customers accounting for only 5% of sales and the top customer 1%.

Ava has a large number of customer accounts, which we believe provides the CCA with considerable economies of scale. Ava has grown quickly in the years in which it has operated because all the accounts in the member communities that PG&E previously served were automatically switched to the CCA when that member community joined Ava. Customers have the option to opt out of Ava service and return to PG&E; there is no penalty to return to PG&E if this occurs within a set timeframe. However, the CCA's opt-out rate has been less than 5%, which we view as low and demonstrating Ava's value proposition.

Compared with the member communities, individual customers have a much lower barrier to leave the CCA, and this, in our view, constrains Ava's rate-raising flexibility. In its first few years of operations, the CCA, which has rate-setting autonomy, has offered customers a rate slightly lower than that which customers would have received from PG&E, while still increasing unrestricted reserves. (The CCA also has an offering that is slightly more expensive than the rate the customers would have received from PG&E.) We believe Ava's lower rate offering is a significant reason that the

CCA's opt-out rates have been minimal. If Ava's rates outpaced those of PG&E, we think more customers would opt-out and return to PG&E. Because of this, we think that rate-setting flexibility is somewhat limited and especially so for as long as the CCA intends to set rates relative to the PG&E rate.

We believe that FCC demonstrates healthy cost recovery, averaging 1.3x over the past three years. FCC is an S&P Global Ratings-calculated metric that treats a share of the CCA's purchased power expenses as debtlike instead of an operating expense. Using the CCA's forecast, we project that FCC will exceed 2x in each of the next several years, although we note that this assumes that the CCA doesn't increase its value proposition relative to that of the incumbent investor-owned utility. If Ava increased its value proposition, its FCC could be lower than the projected 2x.

The utility has considerable liquidity to meet operational and financial challenges. Available reserves, including undrawn amounts on a committed line of credit, exceeded $504 million, or 265 days of operating expenses, at fiscal year-end 2023. We believe Ava's risks associated with its core business model--specifically the potential for customer exodus, rate-setting constraints, and substantial purchases of market electricity--necessitate relatively enhanced reserves. The CCA has a formal liquidity target of 50% of operating expenses, which it exceeded in fiscal 2023, and we view this positively.

Ava has no debt outstanding, and we view this favorably. The CCA's management reports that Ava could incur debt if the associated assets were economical and fit within its risk management plan's tolerances. We note that if the CCA acquires direct or indirect ownership of capital assets, this could have implications for Ava's exposure to California's strict inverse condemnation standard related to wildfires.

Ava Community Energy key credit metrics

	--Fiscal year ended June 30--		
	2023	**2022**	**2021**
Operational metrics			
Electric customer accounts	640,000	640,000	640,000
% of electric retail sales from residential customers	41	41	46
Top 10 electric customers' sales as % of total electric retail sales	5	5	3
Service area median household effective buying income as % of U.S.	155	155	156
Weighted average retail electric rate as % of state	132	125	133
Financial metrics			
Gross revenue ($000s)	820,540	555,554	424,139
Total operating expenses less depreciation and amortization ($000s)	693,695	501,871	401,108
Debt service ($000s)	679	904	870
Debt service coverage (x)	186.8	59.4	26.5
Fixed-charge coverage (x)	1.6	1.3	1.1
Total available liquidity ($000s)*	504,279	228,029	205,662
Days' liquidity	265	166	187
Total on-balance-sheet debt ($000s)	0	0	0

Ava Community Energy key credit metrics (cont.)

	--Fiscal year ended June 30--		
	2023	2022	2021
Debt to capitalization (%)	0	0	0

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenue minus expenses divided by debt service. Fixed-charge coverage--Sum of revenue 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).

Related Research

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