S&P Global
Ratings

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Summary:

California Resource Efficiency Financial Authority Azusa; Retail Electric

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Credit Profile		
Azusa elec rfdg rev bnds		
Long Term Rating	AA-/Stable	Affirmed
California Resource Efficiency Fin Auth, California		
Azusa, California		
California Fincg Auth For Res Efficienty (Azusa) Elec (MBIA) (MBIA of Illinois)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on Azusa, Calif.'s outstanding electric system revenue bonds.
- At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the California Resource Efficiency Financial Authority's (FARECal) outstanding certificates of participation, issued on behalf of Azusa.
- The outlook is stable.

Security

Net revenues of the electric system are pledged for the series 2012B refunding revenue bonds.

Credit overview

The city of Azusa is located in Los Angeles County, about 24 miles east of downtown Los Angeles. The electric system serves about 17,000 customers and its service area encompasses the city's nine-square-mile incorporated area.

The city has entitlements to both electric power and transmission capacity pursuant to long-term contracts with the Southern California Public Power Authority (SCPPA) for the following projects: Palo Verde Nuclear Generation, the Hoover Uprating Project, various renewable energy purchased power agreements (PPAs), and shorter-term energy purchases from third parties, mainly for load optimization purposes. Energy is also purchased from the Lodi Energy Center natural gas plant, which is owned by the Northern California Power Agency (NCPA). Of total energy purchased, 24 percent is from owned generation, 30 percent under long-term contracts, 41 percent under short-term contracts, and 5 percent from the day-ahead market.

The electric system is in compliance with California's Renewable Portfolio Standards (RPS) through 2024. The California Energy Commission (CEC) regulations called for 33 percent of the district's retail load to be from renewable energy by 2020. The district has met each interim target and also the 33 percent requirement. Management projects that about 70 percent of Azusa's resource portfolio will be sourced from non-hydroelectric resources by 2030 as it continues to layer in additional PPAs and resources. The RPS requires 60 percent of load from renewables by 2030 and 100 percent from non-carbon-emitting resources by 2045. As the requirements increase, the electric system may have difficulty in meeting the mandates, as may all other California electricity providers. In addition, as the overall RPS percentage increases over time, there will be a corresponding decrease in energy sold from natural gas and/or unspecified sources. While California has a long track record of increasing regulations as well as altering the regulatory framework, we believe the district is in a favorable position to achieve mandated requirements, and the utility is planning ahead and expects to meet its renewable energy goals. Furthermore, the electric system has no direct exposure to coal-fired generation, which reduces exposure to future carbon emission regulations.

In the near term, we consider credit risks to be relatively manageable, given the system's stable customer base, good fixed-cost coverage (FCC) at the current rating level, and robust power supply.

The rating further reflects our view of the utility's:

- Robust service area economic fundamentals, reflecting a stable and diverse customer base with strong income levels;
- Below-average electric rates for the region, providing rate-raising flexibility. We believe Azusa's use of a power cost adjustment (PCA) provides for enhanced stability in its revenue stream, although the use of the mechanism is discretionary and the cost pass-through is reliant on management's continued execution;
- Favorable alignment of operations and management's strategic goals. The district maintains robust risk management policies and practices that are focused on management of its system to uphold its proactive regulatory posture, emergency preparedness, cyber security, environmental compliance, and system reliability. In our view, this high level of operational planning and risk management lends to the district's overall operational and financial stability. The utility maintains a diverse power supply portfolio, tempered by its exposure to California's stringent regulatory environment;
- Favorable financial metrics marked by a three-year historical fixed-cost coverage (FCC) average of 2.0x and good days' cash on hand at 258 as of fiscal year-end 2021. The utility is expected to draw down cash for its capital improvement program. We believe Azusa's limited capital needs, resulting from its role as a distribution utility, limit the need for heightened cash; and
- Low debt position with a manageable capital improvement plan.

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

- Exposure to wildfires within its service area, but in our view substantially mitigated by 100 percent underground Tier 2 and Tier 3 infrastructure;
- Recontracting risk related to the utility's short-term contracts; and
- Required compliance with future more stringent state RPS targets in the longer term.

Environmental, social, and governance

In our view, environmental risks facing the district, such as wildfires, drought, and earthquakes, are negative to credit quality. California wildfires have grown in intensity, size, and frequency over the past several years, and several catastrophic fires in in this region have resulted in the loss of lives and significant property damage. In our credit ratings, we are placing an even greater emphasis on the growing risks of wildfires and the corresponding influence on credit quality than we have historically. A small portion of Azusa's customer base falls within a California Public Utility Commission (CPUC) designated Tier 2 elevated wildfire threat area; however, 100 percent of the utility's distribution assets within this zone are underground, mitigating the threat of ignition. Nonetheless, we believe Azusa faces elevated environmental exposure due to its geographic proximity to potentially devastating wildfires. A formal wildfire mitigation plan is maintained that was last updated in June 2022.

We view social risks as credit neutral, as elevated health and safety risks due to the pandemic are abating. With regard to governance, the electric system has rate-setting autonomy and robust long-range capital and financial planning. However, we note that updated financial projections were not provided by management. We view governance risk as credit neutral.

Outlook

The stable outlook reflects our belief that the utility will continue to address escalating purchased power costs prudently through timely cost passthrough via either base rate increases or the use of its PCA mechanism. The outlook also reflects the lack of additional debt issuance and electric rates that will likely remain highly competitive for the region.

Downside scenario

While this is unexpected, we could lower the rating if a misalignment occurs between operating revenues and expenses, resulting in a trend of FCC at levels commensurate with those of lower-rated peers, and/or if liquidity were to materially decline as a result of extended recessionary pressures or an unexpected increase in power costs, without corrective action.

Upside scenario

We do not expect to raise the rating in the next two years give the budgeted decline in coverage metrics in 2023 due to rising expenses.

Related Research

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