



RATING ACTION COMMENTARY

Fitch Affirms Connecticut Muni Electric Energy Coop and TRANSCO Revs at 'AA-'; Outlook Stable

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Fitch Ratings - New York - 05 May 2023: Fitch Ratings has affirmed the following ratings for Connecticut Municipal Electric Energy Cooperative (CMEEC) and Connecticut Transmission Municipal Electric Energy Cooperative (TRANSCO) at 'AA-':

Connecticut Municipal Electric Energy Cooperative:

- \$11.4 million 2021 series A, transmission services revenue bonds;
- \$19.3 million 2022 series A, power supply system revenue bonds;
- Issuer Default Rating (IDR).

Connecticut Transmission Municipal Electric Energy Cooperative:

- \$16.3 million 2021 series A, transmission system revenue bonds.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Connecticut Municipal Electric Energy Cooperative (CT)	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
Connecticut Municipal Electric Energy Cooperative (CT) /Electric System Revenues/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

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ANALYTICAL CONCLUSION

The 'AA-' long-term bond ratings and IDR for CMEEC and TRANSCO reflect very strong revenue defensibility, which is based on the long-term, all-requirements contracts and strong member credit quality that supports CMEEC's consolidated revenue base, as well as CMEEC's strong consolidated operating risk profile, and historically very low financial leverage.

While operating income declined in fiscal 2022, resulting in an increase in leverage ratio for the year, the weaker results stemmed from several non-recurring items including a restatement of the debt amortization associated with the refunded 2013 power supply bonds, a transmission revenue-true up credit for the year, and legal fees. Going forward, Fitch expects operating income and overall financial performance to return to pre-2022 levels, which should stabilize the leverage ratio at roughly 6.0x, a level supportive of the current rating.

Operating costs are low, although energy supply is concentrated in near-to-medium term market power purchases, subjecting CMEEC to variability in market pricing. In 2022, higher fuel costs and market energy prices led to a higher cost burden, but CMEEC's comprehensive hedging policy helps mitigate this risk, and costs have decreased in 2023. Capital plans are limited to minor maintenance with no new debt requirements projected through 2027.

CREDIT PROFILE

CMEEC is a joint action agency (JAA) that provides power to six municipal distribution system members in southern Connecticut: Groton Utilities, Bozrah Light & Power (BL&P), Jewett City Department of Public Utilities, Norwich Public Utilities, and the city of Norwalk's Second (South Norwalk) and Third (East Norwalk) Taxing Districts.

The members are provided electric service pursuant to long-term, full requirement replacement power sales contracts that extend through 2053, which is well beyond the final maturity of CMEEC's bonds. CMEEC also provides electricity to the Mohegan Tribal Utility Authority (MTUA) pursuant to a long-term wholesale contract that was recently extended to December 2031.

CMEEC created TRANSCO in 2009 as a separate, legal JAA to acquire a portion of the transmission assets of Connecticut Light & Power to provide transmission service to CMEEC's members. TRANSCO is comprised of the same six members as CMEEC.

CMEEC is obligated to pay all of TRANSCO's obligations on a take-or-pay basis, including debt service. The transmission-related agreements extend through 2052, beyond the final maturity of the transmission related debt (2042). CMEEC's payments to TRANSCO are paid as an operating expense, ahead of the utility's own debt service. TRANSCO is a blended component unit of CMEEC, and its financial performance is reported on a CMEEC combined basis. For fiscal year 2022 consolidated results, CMEEC's revenues are roughly 83% power supply related, 12% transmission, and the rest from member level rate stabilization fund transfers (some of which is comprised of billing for power supply).

CMEEC and TRANSCO's revenue bonds are separately secured but supported by the same six-member systems. Given that CMEEC is the obligor on all of TRANSCO's obligations, Fitch does not differentiate the debt ratings of the two joint action agencies.

KEY RATING DRIVERS

Revenue Defensibility: 'aa'

Unconditional Long-Term Contracts; Strong Member Credit Quality

The very strong revenue defensibility reflects the strong, unconditional contractual agreements between CMEEC and TRANSCO and their member purchasers, coupled with the high-credit quality of the largest member systems. Additionally, CMEEC and its members benefit from the independent authority to set their own electric rates to support cost recovery. Industrial customer concentration at a few of the member city systems moderately affects purchaser credit quality.

Operating Risk: 'a'

Low but Rising Operating Costs

CMEEC's operating cost burden is low, as measured by annual total operating costs per MWh sold. Unlike most other joint action agencies, CMEEC's power supply strategy requires active management of varied power purchases primarily from the New England power market (as administered by the Independent System Operator - New England), which exposes CMEEC to fluctuating market prices and limits operating cost flexibility.

A rise in market prices and purchased power costs in 2022 led to an increase in the cost burden to just over 11 cents per kilowatt hour. A mild winter coupled with natural gas supply surplus has led to much lower market energy pricing levels as of late, which is expected to lead to a decline in the operating cost burden in 2023 closer to previous levels.

Financial Profile: 'aa'

Stable Historical Financial Performance; Very Low Leverage Ratio

The financial profile remains very strong despite weaker 2022 operating income. Prospectively, with modest member sales growth and minimal capital requirements, CMEEC's leverage profile should remain supportive of the overall rating. Financial performance is anticipated to be stable according to CMEEC's financial pro forma, and financial metrics are expected to remain supportive of the rating even through Fitch's Analytical Stress Test (FAST) stress scenario.

Asymmetric Additional Risk Considerations

There are no additional asymmetric additional risk considerations

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A decline in CMEEC's consolidated leverage ratio, either through higher cash flow or reduced outstanding debt, to levels consistently below 5.0x through Fitch's base and stress case.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Sustained consolidated leverage of 8.0x or more in Fitch's base or stress case;

--Material decline in the largest members' credit quality;

--A rise in the operating cost burden or shift to higher lifecycle investment needs that leads to a lower operating risk assessment.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

SECURITY

CMEEC's power supply system revenue bonds are secured by a pledge of net revenues of CMEEC, which is derived from power sales contracts with its six member systems.

The TRANSCO bonds are secured by net revenues received by TRANSCO from CMEEC, which are ultimately derived from separate take-or-pay contracts with the same six member systems.

REVENUE DEFENSIBILITY

CMEEC and TRANSCO's very strong revenue source characteristics are supported by long-term, take-or-pay contracts for the sale of wholesale electric service to the distribution systems that extend beyond the life of the outstanding revenue bonds. The contract fixed costs, which include debt service, are absolute and unconditional, payable whether or not the power supply or transmission service is provided. Members are obligated to pay CMEEC's costs as an operating expense of their respective utility systems, ahead of their own debt service.

The member contracts include an unlimited step-up provision, which allows CMEEC to adjust wholesale rates as needed to fully recover costs, particularly if a member defaults. The unlimited step-up provision, in effect, limits bondholder exposure to any single member. CMEEC also provides electricity to MTUA pursuant to a long-term wholesale contract through 2031.

Rate Flexibility

CMEEC's very strong rate flexibility is based on its independent legal authority to adjust power supply rates to members as needed. Members are billed monthly and rates are not subject to external or regulatory approval, allowing for timely cost recovery.

CMEEC's wholesale rate averaged roughly \$85/MWh in 2017-2021, which is a competitive power supply price as evidenced by member average retail revenue per MWh below the EIA state average. Costs rose in 2022, leading to an increase in revenue requirements for the year that was closer to \$111/MWh in 2022, which is elevated but expected to be temporary as market pricing has declined in 2023 from a combination of milder than anticipated weather and stabilized fuel prices.

TRANSCO's rate is regulated by the Federal Energy Regulatory Commission (FERC). Positively, TRANSCO earns the FERC-approved 11.74% return on equity, which results in positive net margin on the TRANSCO asset that is used to offset the transmission cost to CMEEC's members. While a reduction in the regulated return on TRANSCO assets would reduce net margins, the net effect on CMEEC would be offset by the resulting lower transmission rate for its members.

Purchaser Credit Quality

CMEEC's purchaser credit quality is strong as measured by Fitch's Purchaser Credit Index (PCI) score of 1.6 for its two largest member utilities: Groton Utilities and Norwich Public Utilities. These two members represented approximately 57% of consolidated revenues.

The city of Norwich, CT is located 40 miles southeast of Hartford, along the Thames River, with a population of approximately 39,000. The economy is stable, but growth is modest. Key employment sectors include: government, healthcare, trade, transportation and manufacturing. The city is making a concerted effort to revitalize its downtown area, the business park and the harbor and has attracted some new businesses. The city's unemployment rate had been steadily improving but remains above the state and national averages. Income levels are below the state median but more closely approximate the national level. Norwich Public Utilities, the city-owned utility system, provides transfers to the city accounting for about 5% of general fund revenues.

The town of Groton, CT (tax-supported IDR 'AA+'/Stable) is located in southeastern Connecticut, along the east bank of the Thames River. Pharmaceutical and submarine manufacturing are key to the city's employment base, followed by healthcare, education and government. Submarines are built by Electric Boat, a division of General Dynamics (GD), and are home ported at the U.S. naval submarine base located in Groton. Electric Boat is providing economic growth for the city as it ramps up to build the next generation nuclear submarine for the U.S. Navy. Pfizer is the city's largest taxpayer, but energy requirements from the city utility are modest as the manufacturer has on-site fuel cells. GD is the city's second largest taxpayer at approximately 24% of total assessed value. Positively, median income levels for the town remain above the national average and the unemployment rate was equivalent to the U.S. figure of 4.4% in 2022.

Both city-utility systems are financially strong, with solid liquidity and low leverage. All of the member cities benefit from independent rate setting authority and maintain rate stabilization funds to help mitigate rate adjustments. The member cities all maintain purchase power adjustment factors to automatically pass-through CMEEC power cost changes.

Purchaser Credit Quality - Industrial Customer Concentration Risk

There is moderate industrial customer concentration for two of CMEEC's members: Groton Utilities and BL&P. Electric Boat accounted for a notable 25% of Groton Utilities' MWh sales for 2022 (or about 8% of CMEEC's load). Concentration is expected to increase further over the next few years as EB's facilities are expanded to produce the new Columbia class submarines.

BL&P, a smaller member providing electric service to approximately 3,000 customers, provides service to Airgas Inc, a manufacturer of varied gas products and equipment. Airgas accounts for about 73% of BL&P's load (or about 13% of CMEEC total sales).

While the members' industrial customer concentration is an asymmetric risk that moderately affects Fitch's assessment of the purchasers' credit quality, it does not constrain the overall strength of CMEEC's revenue defensibility assessment, as the large industrial users are long-standing customers of their respective member systems and they continue to benefit from competitive electric rates. Additionally, CMEEC can reduce its power purchases to mitigate the revenue impact of a loss of load, as it effectively managed the exit of its former wholesale customer, Wallingford Electric Division, in 2013.

OPERATING RISK

CMEEC's operating cost burden remains low despite an increase in purchased power expenses in 2022. As CMEEC's power supply portfolio is predominantly power contracts of three years duration or less, the wholesaler was able to take advantage of the historically low market power prices. From 2017-2021, the cost burden averaged roughly 8 cents/KWh. However, in 2022, an increase in fuel costs and market power purchases led to a rise in the cost burden to just over 11 cents. Positively, fuel costs and market prices, have decreased in 2023, which is expected to lead to lower operating expenses and a lower cost burden for the year.

Operating Cost Flexibility

CMEEC's flexibility to manage its power supply costs is considered weaker given the heavy reliance of the JAA's resource portfolio on short-to-intermediate term market purchases, which exposes CMEEC and its members to variability in market pricing. CMEEC mitigates this risk somewhat through a comprehensive enterprise risk management policy that applies a measured approach to procuring power supply at various amounts and intervals in time.

Environmental Considerations and Clean Energy Transition

CMEEC began working on a formal decarbonization policy starting in 2021 as part of management's long-term strategic initiatives to lower emissions. In 2022, CMEEC signed a long-term purchased power agreement for hydropower generated energy equivalent to about 10% of expected load through 2036. This agreement reduces CMEEC's market exposure while providing intermediate-term carbon reduction benefits. A more formal decarbonization policy is expected to be adopted later this year as CMEEC looks to further reduce its carbon footprint.

The state of Connecticut passed legislation requiring net zero carbon emissions for the energy sector by 2040. Positively, much of CMEEC's energy delivered in 2022 was renewable or carbon free, which could lessen the long-term risks and costs of complying with energy transition decarbonization requirements. Going forward, in addition to demand side management and peak shaving solutions, CMEEC will continue to evaluate adding new or existing low or zero-carbon generation sources in a cost-effective manner, including member solar, off shore wind projects and nuclear generation.

Capital Planning and Management

CMEEC's capital planning and management assessment is very strong. Following the completed sale of the 84MW Pierce generating project which lowered accumulated depreciation, the average age of CMEEC facilities declined to just nine years in 2021, which was considerably lower than plant age recorded previously. The age of plant increased in 2022 to 15 years due to a decline in annual depreciation expense over 2021 levels, although CMEEC's limited capital reinvestment needs and primarily wires-based infrastructure continue to support the 'aa' assessment.

Capital expenditures are projected to total just \$675,000 through 2027 focusing on routine maintenance. The capital plan will be internally funded. With no new debt in the forecast, consolidated net debt outstanding should gradually decline from \$68 million at YE 2022 to about \$56 million by 2027, assuming modest capital spending as projected.

FINANCIAL PROFILE

CMEEC's historical financial performance has been sound despite a gradual decline in off-market contracted sales over the past few years. CMEEC's flexible and fairly short-term portfolio of power purchases allowed it to largely offset the revenue impact associated with the load loss by reducing power purchases.

Fitch-calculated COFO has been somewhat variable with ratios of less than 1.0x in three of the past five years as members opted to utilize rate stabilization fund (RSF) transfers to support revenue requirements. Fitch considers the use of rate stabilization as a non-operating source of income and deducts these amounts from operating cash flows available for coverage metrics. The weaker COFO is not a credit concern given CMEEC's robust liquidity and the anticipated use of rate stabilizations funds. Overall, Fitch views CMEEC's liquidity profile as an important rating factor given the JAA's exposure to variable market prices.

CMEEC's consolidated net leverage had been trending lower since 2018 with a decline in debt outstanding. The leverage ratio was a very low 5.9x in fiscal 2021, but increased to 8.5x in 2022 due to several one-time cash expenses and deferral items that lowered operating income and funds available for debt service for the year. The liquidity profile is neutral to the assessment. Days cash and investments on hand totaled 165 days in 2022, which is lower than previous years but still considered supportive of the assessment. CMEEC's total liquidity cushion, which incorporates a \$40 million commercial bank line of credit, is very healthy at 275 days for YE 2022.

Fitch Analytical Stress Test - Base and Stress Cases

Fitch's forward-looking FAST model indicates CMEEC's financial leverage will improve from current levels in both the base and stress cases. The base case is informed by financial projections provided by CMEEC and includes limited sales growth and modest capital spending, and a decline in power purchase costs through the forward-look. The base case also incorporates expected debt principal amortization of roughly \$2.5 million annually and an estimated \$1 million in annual member distributions based on historical practice. The actual amount of member distributions is determined annually by CMEEC's board and could be higher or lower than Fitch's estimated amounts.

The base case indicates stable financial performance with adjusted funds available for debt service (FADS) of no less than \$40 million annually and a steady decline in adjusted net debt, which includes the capitalization of purchased power expenses. Under these base case assumptions, CMEEC's consolidated leverage remains very low, approximating 5.9x in year one (2023), and decreasing to 5.5x by 2026.

The FAST stress model incorporates a two-year decline in energy sales in 2023 and 2024 totaling 13.3% in aggregate, followed by a recovery of 6.6% in the subsequent three years. Under this stress case, CMEEC's leverage rises modestly to 6.0x in years one and two, and before declining to 5.6x by 2026. CMEEC's ability to reduce power purchases to offset the load and revenue loss is a key reason the large decline in sales in the stress case does not result in a comparable decline in revenues.

Debt Profile

The debt profile is neutral to the assessment. All of CMEEC and TRANSCO's outstanding revenue bonds are long-term, fixed-rate obligations with relatively level annual debt service. With limited projected capital expenditures of note through 2027 and

a declining direct debt burden, consolidated leverage should continue to be supportive of the rating despite the higher purchased power costs and associated fixed cost capitalization.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

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APPLICABLE CRITERIA

[U.S. Public Power Rating Criteria \(pub. 03 Mar 2023\) \(including rating assumption sensitivity\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 27 Apr 2023\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

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Connecticut Transmission Municipal Electric Energy Cooperative (CT)

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Utilities and Power US Public Finance North America United States
