FitchRatings

Public Finance
Tax-Supported
U.S.A.

Naugatuck, Connecticut

New Issue Summary

Sale Date: Week of July 12 via negotiated sale.

Series: $9,125,000 Certificates of Participation (COPs) (Naugatuck Incineration Facilities Project), Issue of 2021, Series A; $7,035,000 COPs (Naugatuck Incineration Facilities Project), Issue of 2021, Series B (taxable); $10,955,000 COPs (Naugatuck Wastewater System Project), Issue of 2021, Series A.

Purpose: Series A and B incineration facilities project COPs and series A wastewater system project COPs are being issued to support capital improvements of the systems and funding of debt service reserve funds for each series

Security: The COPs are backed by rental payments equal to COP debt service to be made by the borough pursuant to a lease agreement. The borough's payments are subject to annual appropriation. A separate fully funded debt service reserve fund has been established for each series of COPs.

The 'AA' IDR and GO bond ratings reflect the borough's high level of financial resilience, underscored by a combination of available reserves, unlimited revenue-raising authority, and solid expenditure flexibility that position it to withstand the challenges associated with a moderate economic downturn. Fitch expects Naugatuck's long-term liability burden to remain low to moderate based on its limited debt issuance plans. The borough-administered pension plans are closed to new hires and the planned issuance next month of pension obligation bonds is being sized to equal its current net pension liability with projected annual cost savings. Unfunded OPEB liabilities are high.

The COPs are rated one notch lower than the borough's IDR, reflecting the slightly higher degree of optionality associated with rental payments.

Economic Resource Base: Naugatuck encompasses a land area of roughly 16 square miles in east central Connecticut along state Route 8, approximately five miles south of Waterbury and within 35 miles of New Haven, Bridgeport, and Hartford. The borough's 2020 Census population is estimated at 30,905 down 3% from 2010.

Key Rating Drivers

Revenue Framework: 'aa': Naugatuck derives the bulk of its revenues from property taxes. Ten-year general fund revenue growth has been strong but reflects increases in the real property tax rate, as the pace of tax base expansion has been more moderate. Absent similar policy action Fitch would expect revenues to perform near the level of inflation based on the potential for some new residential, industrial and transit-oriented development as well as increases in state education aid.

Expenditure Framework: 'aa': Expenditure growth is expected to be in line with to marginally above the slow pace of natural revenue growth. Carrying costs for debt service, pension and OPEB contributions represent a moderate portion of total governmental spending and yearly pay-go spending for capital supports solid expenditure flexibility.

Long-Term Liability Burden: 'aa': The combined long-term liability burden of overall debt and Fitch-adjusted net pension liabilities is at the low end of the moderate scale at 10% of estimated personal income. Limited additional debt plans and an average pace of outstanding debt amortization are expected to keep the liability burden stable. The borough's pensions are closed to new hires; however, unfunded OPEB liabilities are high.

Operating Performance: 'aaa': Fitch expects the borough to manage through periods of economic decline while maintaining an adequate financial cushion for the current assessment

Ratings

Long Term Issuer Default Rating	AA

New Issues

$9,125,000 (Naugatuck Incineration Facilities Project) Certificates of Participation (AMT), Series 2021A	AA–
$7,035,000 (Naugatuck Incineration Facilities Project) Certificates of Participation (Taxable), Series 2021B	AA–
$10,955,000 (Naugatuck Wastewater System Project) COPs, Series 2021A	AA–

Outstanding Debt

General Obligation Bonds	AA

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (May 2021)

Related Research

Fitch Rates Naugatuck, CT's $16MM Incineration COPs and $11MM Wastewater COPs 'AA-' (July 2021)

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on the basis of its high control over revenues and spending, historically sound financial management and moderate use of fund balance within prescribed policy limits, if necessary.

Rating Sensitivities

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

- Expansion and diversification of the local economy supporting sustained growth in the tax base and exceeding Fitch's expectations for inflationary growth.
- A decline in the long-term liability burden to a sustained level well below 10% of personal income leading to what Fitch believes improves financial flexibility.

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

- A sustained weakening of natural revenue growth.
- A sustained increase in fixed cost spending associated with debt service and retiree benefits to a level above 20% of total governmental spending.
- While not expected, a trend of operating imbalances leading to a softening of the borough's overall financial resilience.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	7/8/21
AA	Revised	Stable	4/30/10
AA–	Affirmed	Stable	3/5/03
AA–	Assigned		6/27/02

Rating History (COPs)

Rating	Action	Outlook/ Watch	Date
AA	Assigned	Stable	7/8/21

Current Developments

Naugatuck did not experience a financial impact as a result of the pandemic, as revenue performance exceeded the fiscal year 2020 budget and expenditure savings were $3.9 million, offsetting budgeted use of fund balance of $4.24 million. Results included transfers out of $2.6 million to the borough's capital non-recurring fund. General fund results for fiscal 2020 show a modest net operating surplus and unrestricted fund balance of $16 million or 12% of spending.

Savings on insurance of $1.4 million were achieved partially from a workers' compensation credit combined with lower health insurance claims. In addition, a budgeted contingency of $0.8 million was not needed. Department of education spending was below budget by $0.44 million due to school closures.

The fiscal 2021 budget with spending of $121.7 million is up by $1.9 million and includes a half mill increase in the tax rate to 47.75 mills. Property tax collections are reportedly performing better than expected and building permit and recording fees have outpaced budget expectations. These preliminary revenue results along with expenditure savings are leading management to project a moderate surplus of around $0.2 million, negating the use of $3 million in appropriated fund balance.

The fiscal 2022 budget of $129.5 million reflects a 1.89% YoY increase in spending and includes no change in the tax rate. Additional property tax revenues reflect the 2% increase in taxable assessed values and a use of $2.4 million of fund balance. The budget includes $1.6 million for capital projects. Budget drivers are primarily education, employee salaries and benefits and debt service. The budget does not assume the use of American Rescue Plan ACT (ARPA) funds. Naugatuck has been allocated $9.2 million of ARPA moneys and an additional $13.5 million for the board of education, which will be distributed in two installments: this year and next.

Credit Profile

Naugatuck is a fairly mature community and residents exhibit wealth levels in line with national averages but slightly below the state's high levels. The borough's tax base has an estimated market value of $2.5 billion as of Oct. 1, 2020 and reflects a good mix of residential (65%) and commercial/industrial (15%) properties. The top ten taxpayers are diverse and represented 7.5% of the fiscal 2022 tax base. The borough is the largest employer; leading private sector employers include Wal-Mart, ION Bank, and a variety of manufacturers including YoFarm Yogurt Company.

Revenue Framework

Property taxes are the primary source of revenue for the borough, making up approximately two-thirds of general fund revenues. State aid, mostly for education, accounts for the bulk of remaining general fund sources.

The tax base is subject to revaluation every five years. Tax base values improved modestly by 5.5% following Oct. 1, 2018 (effective for the fiscal 2020 budget), reflective of new construction activity and appreciation of values. Changes in value between revaluations do not take into consideration sales of properties but reflect improvements and appeals activity. Tax base values improved by 1% and 2% for fiscal 2021 and 2022, respectively, reflecting building permit activity. Fitch expects a moderate increase in values in line with inflation based on new development expected to occur over the next few years, projects underway and a strong increase in housing values that has occurred similar to other areas in the state. Median housing prices increased 19% YoY through May according to the Zillow Group.

The strength of the borough's revenue framework lies in its revenue raising authority as the borough has independent legal ability to raise taxes without limit under Connecticut law.

Expenditure Framework

The bulk of the borough's spending is related to education and accounts for roughly 50% of the general fund budget. Public safety, public works and costs associated with the water pollution control authority round out operational spending. The borough is responsible for the provision of public education, the cost of which is funded by a combination of local contributions and state aid.

Fitch expects the natural pace of spending growth to match or marginally exceed revenue growth based a manageable level of expenses drivers and few service demand pressures.

Potential spending pressures associated with the city-owned wastewater treatment plant and sludge incineration facility have been mitigated as the plant manager, Veolia Corporation, and the borough have addressed federally mandated upgrades to the plant. The borough, Veolia and the water pollution control authority of Naugatuck have entered into a long-term service contract for wastewater treatment, capital improvements and asset management.

The contract includes provisions for profit sharing and rental payments to be made by Veolia to the borough essentially equal to the COP debt service. These rental payments are not pledged to COP holders. The borough does not currently charge residents a sewer fee or assessment for services but is legally permitted to do so should it be necessary to recoup costs associated with the operation of the facilities.

Additionally, planned issuance of the borough's pension obligation bonds is projected to result in annual savings as pro-forma debt service compared to the actuarially determined employer contribution (ADEC) (based on a 6% investment rate of return) is around $1 million to $2 million a year.

The borough maintains a solid level of expenditure flexibility. Carrying costs for debt service, pension and OPEB are moderate at 17% of fiscal 2020 governmental fund spending. Carrying charges for debt service are expected to increase slightly but will be partially offset by the lower ADEC. Management does not have near term debt plans.

Management has the legal ability to reduce non-public safety staff at any time if necessary. Union contracts are subject to arbitration but a decision may be rejected by a two-thirds vote by city council. A new arbitration panel would then be appointed by the state and their subsequent decisions are binding and required to take into consideration the financial capability of the employer.

Long-Term Liability Burden

The combined long-term liability burden for debt and Fitch-adjusted net pension liabilities is estimated by Fitch to be 10% of residents' personal income. The borough's overall debt, including its capital leases and a lease associated with the wastewater treatment plant, is the main driver of this metric as it represents about 6% of personal income. Fitch believes the

borough's liability burden will remain moderately low due to an average pace of principal amortization (52% within 10 years) and potential future borrowing plans.

The borough maintains two single-employer pension plans for its employees, exclusive of teachers, who participate in the state teachers' retirement plan. The borough's Fitch-adjusted estimated net pension liability of $69 million, based on a Fitch assumed 6% investment rate of return, is equivalent to 4% of personal income. The borough's pension plans were closed to new hires with various effective dates over the period of 2010 through 2012.

The borough's net OPEB liability was $228 million as of June 30, 2020, or a very high 13% of personal income. Recently negotiated contracts with the majority of its employees increase health care contributions from members and should help control growth in this liability going forward; however, Fitch does expect significant near-term improvement in this liability. The borough began contributing toward its OPEB trust in fiscal 2012 and the balance was $10.5 million at fiscal end 2020.

Operating Performance

Fitch expects Naugatuck will continue to maintain sound reserve levels for the current rating level throughout economic cycles given its relatively stable revenue performance, superior level of inherent budget flexibility in the form of revenue and spending control, and maintenance of reserves within policy levels through downturns. The borough's general fund balance policy calls for an 8% - 12% minimum unassigned level compared to spending.

The borough has prudently managed their budget through economic recovery and maintained fund balance levels within policy levels while incorporating a portion of the budget for capital pay-go. Fitch would expect the borough to manage conservatively during periods of economic downturns as it has in the past and restore a use of reserves during periods of recovery.

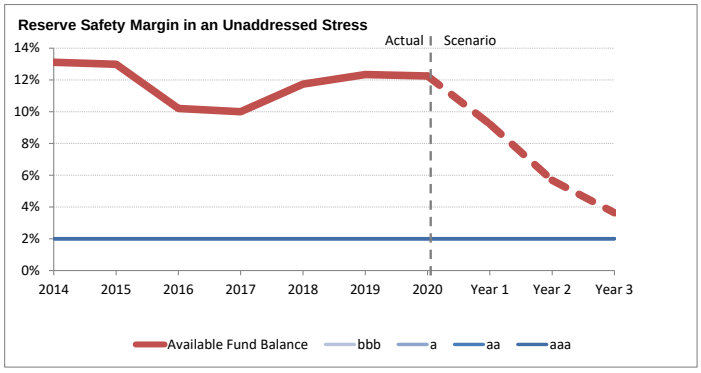
ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Naugatuck (CT)

Scenario Analysis

Ver 48



Analyst Interpretation of Scenario Results

Fitch expects Naugatuck will continue to maintain sound reserve levels for the current rating level throughout economic cycles given its relatively stable revenue performance, superior level of inherent budget flexibility in the form of revenue and spending control, and maintenance of reserves within policy levels through downturns. The borough's general fund balance policy calls for an 8% - 12% minimum unassigned level compared to spending.

Scenario Parameters:			Year 1	Year 2	Year 3
GDP Assumption (% Change)			(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)			2.0%	2.0%	2.0%
Revenue Output (% Change)	*Min Y1 Stress:* **-1%**	*Case Used:* **Moderate**	(1.0%)	1.4%	3.5%
Inherent Budget Flexibility				Superior	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2014	2015	2016	2017	2018	2019	2020	Year 1	Year 2	Year 3
Total Revenues	117,786	113,941	113,300	125,496	129,882	128,895	130,999	129,689	131,490	136,109
% Change in Revenues	-	(3.3%)	(0.6%)	10.8%	3.5%	(0.8%)	1.6%	(1.0%)	1.4%	3.5%
Total Expenditures	112,696	114,145	117,454	123,907	127,287	126,007	128,246	130,811	133,427	136,096
% Change in Expenditures	-	1.3%	2.9%	5.5%	2.7%	(1.0%)	1.8%	2.0%	2.0%	2.0%
Transfers In and Other Sources	63	2,982	3,583	1,754	1,568	-	76	75	76	79
Transfers Out and Other Uses	3,601	2,831	2,393	2,894	1,693	2,209	2,618	2,671	2,724	2,779
Net Transfers	(3,538)	151	1,190	(1,140)	(124)	(2,209)	(2,542)	(2,595)	(2,648)	(2,700)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus/(Deficit) After Transfers	1,552	(54)	(2,964)	449	2,471	679	211	(3,717)	(4,585)	(2,686)
Net Operating Surplus/(Deficit) (% of Expend. and Transfers Out)	1.3%	(0.0%)	(2.5%)	0.4%	1.9%	0.5%	0.2%	(2.8%)	(3.4%)	(1.9%)
Unrestricted/Unreserved Fund Balance (General Fund)	15,246	15,192	12,229	12,678	15,148	15,827	16,038	12,321	7,736	5,050
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	15,246	15,192	12,229	12,678	15,148	15,827	16,038	12,321	7,736	5,050
Combined Available Fund Bal. (% of Expend. and Transfers Out)	13.1%	13.0%	10.2%	10.0%	11.7%	12.3%	12.3%	9.2%	5.7%	3.6%

Reserve Safety Margins	Inherent Budget Flexibility				
Moderate	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

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