

New Issue: Moody's assigns Aa3 to Watertown, NY's \$15.8M GOLT Bonds

Global Credit Research - 16 Jun 2015

Aa3 rating affirmed on \$26M of parity debt

WATERTOWN (CITY OF) NY
Cities (including Towns, Villages and Townships)
NY

Moody's Rating

ISSUE	RATING
Public Improvement (Serial) Bonds, 2015 Series B	Aa3
Sale Amount \$5,810,000	
Expected Sale Date 06/17/15	
Rating Description General Obligation Limited Tax	

Public Improvement (Serial) Bonds, 2015 Series A	Aa3
Sale Amount \$10,000,000	
Expected Sale Date 06/17/15	
Rating Description General Obligation Limited Tax	

Moody's Outlook NOO

NEW YORK, June 16, 2015 --Moody's Investors Service has assigned a Aa3 rating to the City of Watertown's (NY) \$10.0 million Public Improvement (Serial) Bonds, 2015 Series A and \$5.8 million Public Improvement (Serial) Bonds, 2015 Series B. Concurrently, Moody's affirms the Aa3 rating on \$26 million in outstanding general obligation debt.

SUMMARY RATING RATIONALE

The Aa3 rating reflects the city's solid financial reserves despite volatile revenue sources. The rating also incorporates the city's elevated debt burden following the current issuance, and a modestly sized tax base that is growing but exhibits below average income and wealth levels, partially reflecting the presence of the Fort Drum United States military base.

OUTLOOK

Outlooks are usually not assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

- Significant growth in the underlying tax base

WHAT COULD MAKE THE RATING GO DOWN

- Fund balance declines beyond expected levels for fiscal 2015 and 2016
- Failure to structurally balance fiscal 2017 budget

STRENGTHS

- Solid cash levels and financial reserves

- U.S. Army base at Fort Drum provides stability to economy

CHALLENGES

- Exposure to volatile revenue sources
- Below average socio-economic characteristics
- High fixed costs

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: TAX BASE BOLSTERED BY GOVERNMENT, FORT DRUM MILITARY BASE

The city's \$1.2 billion tax base relies heavily on government and military presence. Wealth levels in the city are below average, with the median family income as of 2012 equal to 81% of the US median. Offsetting the below average wealth is the stabilizing presence of the Fort Drum military base. Although not located within the city limits, Fort Drum is located 7 miles from the city center, and houses 42% of those soldiers living off post. An estimated 17,269 soldiers and 3,799 civilians were employed at Fort Drum as of fiscal 2014. The base is also a major customer for the city's water and sewer operations.

Government is the largest employer in the city. Federal, state, and county government entities have offices in Watertown, which is the county seat. Other large employers in the city include the Samaritan Medical Center, which employs 2,500 people, as well as various manufacturers. The city's unemployment rate of 5.8% as of March 2015 was on par with the state unemployment rate.

Measures of property wealth are very below average. Full value per capita is equal to \$42,222, which is well below the median for New York cities. However, we believe this is largely due to the considerable amount of tax-exempt property within the city (approximately 31%). Despite being below average for this rating category, the tax base is healthy and has been growing.

FINANCIAL OPERATIONS AND RESERVES: STRONG MANAGEMENT PRACTICES COPE WITH UNDERPERFORMING SALES TAX REVENUES

The city's financial position remains solid despite reserve draws in three of the last four years and the expectation of draws in 2015 and 2016. Sales tax revenues, which make up 42% of the city's budget, are underperforming and are aggressively budgeted for fiscal 2016. While the base provides some stability in the city's sales tax revenues, a strengthening US dollar has reduced the amount of cross border traffic with Canada. Property taxes (20%), state aid (14%), and 10% from sales of excess power from a hydroelectric plant on the Black River make up the majority of the remaining revenues. To balance stagnant sales tax revenues and state aid management has raised property taxes in each of the 5 years, including 1 year where they pierced the property tax cap. Sales of hydroelectricity are entirely dependent on the flows of the Black River, which are difficult to predict.

The city finished fiscal 2014 with a \$330,000 General Fund operating deficit balance due primarily to underperforming sales tax, which were \$17.0 million or 5.98% below budget. Despite this, the city achieved savings through freezes on equipment purchases as well as limiting its pay as you go capital projects.

For fiscal 2015, the city reduced its sales tax estimate to \$17.5 million, which represented a decrease of \$610,000 or 3.4% below the 2014 budget. Despite this, management reports sales tax receipts through the first 10 months of the year are trending below budget by \$294,000. The city originally budgeted for the use of \$891,000 of reserves, including the self-insurance fund, and expects to use approximately \$600,000 of the appropriation. Assuming this appropriation, total fund balance would be reduced to \$15.3 million or a still strong 37.9% of budgeted 2015 revenues.

For fiscal 2016, the city's budget includes a 3.43% spending increase, 1.88% tax levy increase, a 2% increase in sales tax over the 2015 expected ending amount, and flat state aid. The 2016 budget was balanced with \$1.9 million use of reserves. Utilizing the full budgeted appropriation would bring total fund balance to \$13.4 million or 32.2% of budgeted 2016 revenues. We will monitor the city's ability to maintain strong reserves going forward. A deviation from the fund balance estimates above could result in negative rating action.

Liquidity

The city's cash position as of fiscal 2014 was healthy at \$16.9 million, or 42.5% of revenues. Liquidity was also healthy at the city's water and sewer funds, which had a combined \$3.7 million in unrestricted cash, accounting for 36.3% of fiscal 2014 revenues.

DEBT AND PENSIONS: MODERATE DEBT BURDEN PARTLY SUPPORTED BY ENTERPRISE REVENUES; MODERATE PENSION BURDEN

The city's direct debt burden, at 2.6% of full value and 0.76 times revenues, is relatively high for the rating category and is expected to remain elevated due to ongoing capital needs. Within the next year, the city anticipates borrowing approximately \$3.5 - 4 million to build a courtroom, purchase a fire engine, as well as other water and sewer upgrades and street reconstruction. The expected future issuances are partially offset by the city's rapid amortization of currently outstanding principal is above average with 91% paid within 10 years. The city's debt service is manageable at 6.6% of 2014 operating expenditures.

Debt Structure

All of Watertown's debt is fixed rate. After the current issue, the city will have \$30.3 million of long-term GO debt, all of which is rated. Approximately \$11.6 million of the city's debt is payable through its water and sewer operations, which are financially healthy and are excluded from the net debt burden calculations. Without excluding this self-supporting debt, the net direct debt burden would increase to 3.6% of full value.

Debt-Related Derivatives

Watertown has no derivatives.

Pensions and OPEB

While pension contributions have increased over the past five years, management has budgeted for the increases and has not opted to defer its pension payments. The city participates in the New York State and Local Employees Retirement System and the New York State and Local Police and Fire Retirement System (PFRS), two multi-employer defined benefit retirement plans sponsored by the State of New York (Aa1 stable). The city's combined adjusted net pension liability for 2013, under Moody's methodology for adjusting reported pension data, was \$66.6 million, or an above average 1.6 times total operating revenues. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities. We determined the city's share of liability for the state-run plans in proportion to its contributions to the plans.

The city also provides employees with Other Postemployment Benefits (OPEB) and as of fiscal 2013, had an unfunded actuarial liability of \$13.6 million, or 0.34 times operating revenues. The city does annual pay-as-you-go contributions which totaled \$3.8 million in fiscal 2014 was 55% of the total OPEB cost and 9.5% of annual operating expenditures.

The city's total fixed costs for 2014 including pension, OPEB and debt service totaled \$10.6 million, or a high 26% of operating expenditures.

MANAGEMENT AND GOVERNANCE: CITY TO BE CHALLENGED TO RETURN TO STRUCTURAL BALANCE

City management has typically budgeted expenditures conservatively revenue estimates have been falling short of budgeted expectations. The city also does detailed multi-year forecasting based on such as indicators such as CPI, or based on collective bargaining agreements. While management increased the tax levy beyond the cap via override in fiscal 2015 with a 10.5% levy increase and reduced its budgeted expenditures by 3.2%, sales tax receipts continue to underperform and are expected to remain weak, which we believe will challenge the city to return to structural balance in the near term.

New York cities, towns and villages have an institutional framework score of 'A' or moderate. Revenues are largely comprised of property, sales, and mortgage taxes, as well as building permits. Property tax revenues are subject to the tax cap but can be overridden with a 60% vote of the local legislative body. Economically sensitive revenues remain below peak levels prior to recession. Expenditures are largely predictable but the presence of strong collective bargaining groups make it difficult to reduce expenditures.

KEY STATISTICS

- 2015 Full value: \$1.2 billion
- 2015 Full value per capita: \$42,222
- 2008-2012 Median Family Income (American Community Survey 5-Year Estimates): 81% of US average
- Fiscal 2014 Available Operating Fund balance as a % of Revenues: 32.0% of operating revenue
- 5-year change in Operating fund balance as a % of Revenues: 2.5%
- Fiscal 2014 Operating net cash balance as a % of revenues: 42.5% of operating revenues
- 5-year change in Operating cash balance as a % of revenues: 12.0%
- Institutional Framework: A
- Five-year average of operating revenues / operating expenditures: 1.01 times
- Net direct debt as % of full value: 2.6%
- Net direct debt/operating revenues: 0.76 times
- 3-year average of Moody's adjusted net pension liability as % of full valuation: 3.5%
- 3-year average of Moody's adjusted net pension liability / operating revenues: 1.0 times

OBLIGOR PROFILE

The city of Watertown has a population of 27,023 and is located in the northern part of New York State (Aa1 stable), eleven miles east of Lake Ontario and twenty-two miles south of the St. Lawrence River (and Canadian border).

LEGAL SECURITY

The bonds are secured by the city's general obligation pledge as limited by the Property Tax Cap-Legislation (Chapter 97 (Part A) of the Laws of the State of New York, 2011).

USE OF PROCEEDS

Proceeds of the Series A bonds will provide funding for the design and reconstruction and expansion of the Fairgrounds Arena. Proceeds of the Series B bonds will provide funding for various water and sewer projects and road reconstruction.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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