

CREDIT OPINION

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 Rate this Research

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Watertown (City of) NY

Update to credit analysis following removal of negative outlook

Summary

Watertown, NY (Aa3) benefits from strong financial reserves that provide stability due to volatile revenue sources. The rating also incorporates the city's elevated but manageable long-term liabilities, and a modestly sized tax base that benefits from the proximity of the Fort Drum United States military base.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The coronavirus crisis is not a key driver for this rating action. We do not see any material immediate credit risks for the city. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the city changes, we will update the rating and/or outlook at that time.

On September 1, the city's issuer and general obligation limited tax ratings were affirmed and the negative outlook was removed.

Credit strengths

- » Solid cash levels and financial reserves
- » U.S. Army base at Fort Drum provides stability to economy and tax base

Credit challenges

- » Exposure to volatile revenue sources
- » Below average socio-economic characteristics
- » Elevated debt burden
- » Large OPEB liability

Rating outlook

Outlooks are usually not assigned to local government credits with this amount of debt outstanding. The removal of the negative outlook reflects management's conservative budgeting which has led to ample reserves and liquidity

Factors that could lead to an upgrade

- » Significant growth in tax base

- » Material improvement in socio-economic profile

Factors that could lead to a downgrade

- » Declines in reserves deeper than what is currently projected
- » Material increase in long-term liabilities

Key indicators

Exhibit 1

Watertown (City of), NY	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value (\$000)	\$1,174,735	\$1,178,797	\$1,155,107	\$1,161,254	\$1,133,398
Population	27,250	26,997	26,437	26,057	-
Full Value Per Capita	\$43,110	\$43,664	\$43,693	\$44,566	N/A
Median Family Income (% of US Median)	75.9%	71.8%	67.2%	64.2%	0.0%
Finances					
Operating Revenue (\$000)	\$40,258	\$41,690	\$43,844	\$46,141	\$46,678
Fund Balance (\$000)	\$14,319	\$13,863	\$13,887	\$14,157	\$16,400
Cash Balance (\$000)	\$16,197	\$14,721	\$15,267	\$15,255	\$17,137
Fund Balance as a % of Revenues	35.6%	33.3%	31.7%	30.7%	35.1%
Cash Balance as a % of Revenues	40.2%	35.3%	34.8%	33.1%	36.7%
Debt/Pensions					
Net Direct Debt (\$000)	\$32,522	\$35,755	\$35,925	\$34,160	\$33,866
3-Year Average of Moody's ANPL (\$000)	\$66,579	\$76,011	\$80,400	\$74,794	\$70,706
Net Direct Debt / Full Value (%)	2.8%	3.0%	3.1%	2.9%	3.0%
Net Direct Debt / Operating Revenues (x)	0.8x	0.9x	0.8x	0.7x	0.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	5.7%	6.4%	7.0%	6.4%	6.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.7x	1.8x	1.8x	1.6x	1.5x

Source: audited financial statements; US Census Bureau; Moody's Investors Service

Profile

Watertown, NY is located 11 miles east of Lake Ontario and 22 miles south of the St. Lawrence River and Canadian border. The city has a population of about 26,000.

Detailed credit considerations

Economy and Tax Base: Moderately sized tax base supported by Fort Drum army base

The city's \$1.2 billion tax base will remain stable as its significant government and military presence help offset lower resident wealth and incomes. Over the past five years, full value has grown by a compound annual rate of 0.3%.

The city benefits from the stabilizing presence of the Fort Drum military base, which has grown to over 30,500 people since being established in 1984. Although not located within the city limits, Fort Drum is located 7 miles from the city center, acting as a major employer and major customer for the city's water and sewer operations.

As the county seat, Watertown benefits from being the region's government and legal center. Over 23% of county-wide jobs are in the government sector. The largest taxpayers – mostly utilities, apartments, and shopping centers – make up 12.4% of 2020 assessed valuation.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Wealth levels in the city are below average. Median family income represents 62% of state and 67% of national levels, while median home values represent 45% of state and 68% of national levels. Full value per capita of \$45,129 is about half the state average.

The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to the tourism, healthcare, retail, oil and gas and international trade sectors could suffer particularly severe impacts.

Financial Operations and Reserves: Strong reserve levels provide buffer against volatile revenues

City finances will be challenged in the short-term given ongoing pressure on sales tax revenues and state aid. However, management has positioned the city well to mitigate these revenue losses with conservative budgeting and ample reserves. Following a significant surplus in 2019, Available Fund Balance improved to \$16.4 million (35.1% of revenues). Fiscal year 2020 ended on June 30, 2020 and management is currently working through a number of accruals. However, given the state withheld 20% of state aid, which amounted to approximately \$924,000, management projects reserves to decline between \$750,000 and \$1 million. Sales tax revenues were approximately \$350,000 below budget. Given how late in the fiscal year the pandemic hit, management was particularly challenged to make too many changes to its fiscal 2020 budget to offset the revenue losses.

However, going into 2021, management reduced sales tax projections for the year by \$2.4 million. We see this as conservative given sales taxes would need to decline substantially in fiscal 2021 for this budget number to be hit. However, the city kept state aid flat, which poses a budget risk to 2021 if the governor continues to withhold (or officially cut) 20% state aid to the city. To offset the revenue declines in sales taxes, management reduced expenses and needed to cut a number of positions to do so. As a result of the expense reduction, management was able to keep appropriated fund balance at a reasonable level (\$435,000) and keep the property tax increase below the cap.

Also included in our analysts is the Water Fund and Sewer Fund. Unlike the General Fund, both of these funds do serve Fort Drum. Reserves and liquidity remain strong in both funds. Management notes that coronavirus has had no impact on either fund and the 2021 budget is conservative.

LIQUIDITY

Liquidity remains strong and will likely track closely to reserves.

Debt and Pensions: Elevated but manageable debt burden

The net direct debt burden, at 2.7% of full value, is relatively high for the rating category and is expected to remain elevated due to ongoing capital needs. The city is very active in receiving grants for the majority of its capital needs. Of the \$13.5 million in unissued but authorized debt, the vast majority will not need to be issued. Management may need to do a \$3 million borrowing for some bridge repair.

DEBT STRUCTURE

The city is not party to any interest rate swaps or derivative agreements.

DEBT-RELATED DERIVATIVES

The entire debt portfolio is fixed rate with 76% of principal retired in ten years. Fiscal 2018 debt service represented \$3.0 million or 6.5% of expenditures.

PENSIONS AND OPEB

The city's OPEB liability is much higher than its debt and pension liability and does pose a potential future credit pressure.

Exhibit 2

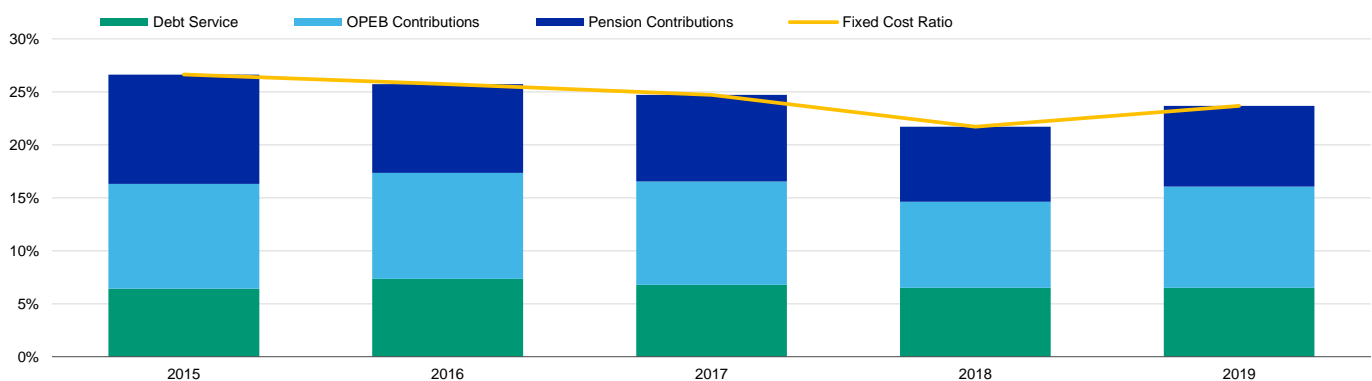
2019	\$\$\$ (000)	% of Operating Revenues	Discount Rate
Operating Revenue	46,678	n/a	n/a
Reported Unfunded Pension Liability	7,191	15%	7.00%
Moody's Adjusted Net Pension Liability	82,691	177%	3.83%
Reported Net OPEB Liability	133,350	286%	3.96%
Moody's Adjusted Net OPEB Liability	131,465	282%	4.07%
Net Direct Debt	33,866	73%	n/a
Debt & unfunded retirement benefits (Moody's adjusted)	248,022	531.34%	
Pension Contribution	3,561	7.63%	n/a
OPEB Contribution	4,458	9.55%	n/a
Debt Service	3,035	6.50%	n/a
Total Fixed Costs	11,053	23.68%	n/a
Tread Water Gap	(230)	-0.49%	n/a
Moody's Adjusted Fixed Costs	10,824	23.19%	n/a

Source: audited financial statements; Moody's Investors Service

While the liability is much higher than peers at the Aa3 rating category, management has noted it continues to look for ways to stabilize the liability and have it decline in the future. Failure to contain the growth on the liability will put pressure on the city's long-term liability profile.

The city's pension burden remains manageable though recent losses in the beginning of the year will result in increased contributions over the next three years. That being said, management continues to budget and make the full pension payment each year and pays it in December to get the discount offered by New York State.

Exhibit 3



Source: audited financial statements; Moody's Investors Service

Fixed costs are elevated but manageable. OPEB (10%) and pension (8%) remain the largest pieces of the fixed costs.

ESG considerations

Environmental

Environmental considerations are not material to the rating.

Social

As noted earlier, coronavirus is considered a risk. However, social considerations were not material to the rating outside of what was already noted in the economy and tax base.

Governance

Management is strong as evidenced by their maintenance of reserves at ample levels. Additionally, their 2021 budget lowered sales tax projections to a very conservative level which will help to offset any potential state aid losses for the year.

New York cities have an Institutional Framework score of "Aa", which is strong. New York Cities operate within a state-imposed property tax cap, which limits the ability to increase their operating levy by the lesser of 2% or CPI. However, this cap can be overridden at the local level, without voter approval and many local governments have done so when necessary. Unpredictable expense fluctuations tend to be low, reflected in expense growth being under 5% on average across the whole sector. Fixed and mandated costs are generally below 25% of expenditures. New York State has the additional constraint of the Triborough Amendment, which limits the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be low, however, reflective in expense growth being under 5% on average across the whole sector.

Rating methodology and scorecard factors

The US Local Government General Obligation Rating Methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 4

Watertown (City of), NY		
Scorecard Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$1,175,914	A
Full Value Per Capita	\$45,129	A
Median Family Income (% of US Median)	64.2%	Baa
Notching Adjustments: ^[2]		
Institutional Presence		Up
Finances (30%)		
Fund Balance as a % of Revenues	35.1%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	5.7%	A
Cash Balance as a % of Revenues	36.7%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	0.5%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.7%	A
Net Direct Debt / Operating Revenues (x)	0.7x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	6.0%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.5x	A
	Scorecard-Indicated Outcome	Aa3
	Assigned Rating	Aa3

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication

Source: audited financial statements; US Census Bureau; Moody's Investors Service

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