Moody's
INVESTORS SERVICE

New Issue: MOODY'S UPGRADES CITY OF WATERTOWN'S (NY) RATING TO Aa3 FROM A1 AND ASSIGNS Aa3 RATING TO $2 MILLION G.O. PUBLIC IMPROVEMENT (SERIAL) BONDS, 2011

Global Credit Research - 13 Jun 2011

Aa3 RATING APPLIES TO APPROXIMATELY $28 MILLION OUTSTANDING PARITY DEBT, INCLUDING CURRENT ISSUE

County
NY

Moody's Rating

ISSUE	RATING
Public Improvement (Serial) Bonds), 2011	Aa3

Sale Amount	$2,035,000
Expected Sale Date	06/28/11
Rating Description	general obligation

Opinion

NEW YORK, Jun 13, 2011 -- Moody's Investors Service has upgraded the City of Watertown's (NY) general obligation rating to Aa3 from A1 and assigned a Aa3 rating to $2 million Public Improvement (Serial) Bonds, 2011. The Aa3 rating applies to $26 million of previously issued parity general obligation. The bonds are secured by the city's general obligation, unlimited tax pledge and proceeds will largely be used for improvements to a parking lot in the downtown area.

RATING RATIONALE

The Aa3 rating reflects the city's sound financial position characterized by healthy reserves, a medium-sized tax base with below average wealth levels, and a manageable debt burden. Demonstrated strong fiscal management and financial planning as well as the city's increased role as a regional economic center contributed to the rating upgrade.

STRENGTHS

Strong General Fund balances

Strong financial planning

Stable tax base and role as a regional commercial center

CHALLENGES

Potential volatility of economically sensitive revenues

Budgetary impact of rising pension costs

STRONG RESERVES AND GROWTH IN SALES TAX COLLECTIONS DUE TO ROLE AS REGIONAL CENTER

Moody's anticipates that the city's financial position will remain strong given two years of healthy operating surpluses: $2.2 million and $0.9 million in fiscal years 2009 and 2010, respectively. This is a strong rebound from the fiscal 2008 $1.4 million operating deficit which resulted from underperforming sales taxes and reduced hydroelectric revenues caused by a record dry year. The city expects that capital improvements at the hydro plant will allow the plant to run more effectively should another dry season occur. In fiscal 2010 the city budgeted a $1.9 million operating deficit but , largely through expenditure control, the city achieved an operating surplus and the General Fund balance climbed to a substantial $14.6 million, or 39% of revenues. While the overall General Fund balance increased in fiscal 2010, the reserve for self insurance of general liability declined due to a claim of $600,000. This is the city's second claim since it began self insuring for general liability in 1985. Sales tax collections also outpaced budget in fiscal 2010. City officials report that a marketing program in the fall of 2010 to attract Canadian shoppers was an effective effort. Jefferson County (rated Aa3) is currently one of the leaders in the state for sales tax growth.

The city's fiscal 2011 operating budget essentially reflects the prior year's spending level, with less than a 1% increase for operating expenses. While the city again appropriated fund balance (approximately $1 million), officials report revenues and expenditures are coming in favorably as compared to budget such that an operating surplus is expected. A budget amendment of $1.1 million to pay down high coupon debt offsets the surplus and fund balance is likely to close just under $14 million. Given the nonrecurring nature of this appropriation and the long term benefits from the paydown, Moody's views this as a prudent use of reserves. Moody's believes that maintenance of healthy reserves is a key credit consideration, given the city's relatively high dependence on economically-sensitive sales tax revenues. Sales tax and other non-property tax items are the city's primary sources of revenue, accounting for about 44% of fiscal 2010 General Fund revenues. Sales taxes for fiscal 2011 are expected to come in $750,000 over budget or 4.6% over last year's collections. Fiscal 2010 sales tax collections were up 4.7%

The recently adopted fiscal 2012 budget increases General Fund expenditures by 5% and appropriates $1.5 million of fund balance, largely for capital projects. The two primary expenditure growth areas are Increased transfers to the Capital Projects Fund for pay-as-you-go financing (total of $1.4 million) and increases for pension costs. The percentage of covered payroll for pension costs grew to 16.9% for non-uniformed employees and 22% for police and fire. By fiscal 2015 these rates are expected to climb to 25% for non-uniformed and 32% for police and fire. On the revenue side, the city had a small reduction in the tax rate and is budgeting approximately a 3% increase in sales tax collections over the current year estimated collections.

STABLE TAX BASE ANCHORED BY MILITARY BASE

Moody's expects the city's $1.1 billion tax base will remain stable, reflecting the city's regional importance as the Jefferson County (G.O. rated Aa3) seat, and expected growth driven by an increasing military population. Watertown is considered a major retail and wholesale shopping center for northern New York and benefits from a diverse local economy. In addition, the city's economy benefits from its proximity to Fort Drum, located in the Town of LeRay, which is home to approximately 19,447 soldiers with an estimated 19,810 local family members; additionally, the installation employs 4,826 civilians. Accordingly, the city has experienced healthy residential development, as only one-third of the military population lives on-base. The average annual growth in full value of real property for fiscal years 2007 through 2012 is a sizeable 5.0%. City wealth levels are below state averages, with per capita income and median family income each at 69.9% of statewide averages. The 2000 poverty rate was high at19.3%, and full value per capita is a modest $38,913.

MANGEABLE DEBT BURDEN

Moody's anticipates that the city's above average debt burden will remain manageable given the city's rapid repayment of existing debt obligations (86% of principal repaid within ten years), ongoing use of cash for capital projects and modest future borrowing plans. The city's direct debt is above state and national medians at 1.7% of full value, but overlapping obligation are primarily school debt funded through State Building Aid, thus adjusted overall debt burden is a modest 1.7%. Debt service comprised a relatively high 10.5% of operating expenditures in fiscal 2010, but adjusts to 7.3% when deducting debt service supported by hydro plant revenues. The city updates its five capital improvement planannually and no borrowing is expected until next spring. Moody's believes that additional borrowing will remain manageable, as it will be absorbed by retiring debt. All the city's debt is fixed-rate and the city has no exposure to swaps or other derivative instruments.

WHAT COULD MAKE THE RATING GO UP

Significant additions to the tax base.

Significant increase in the socioeconomic profile of the city.

WHAT COULD MAKE THE RATING GO DOWN

Substantial reduction in reserves.

KEY STATISTICS:

2000 Population: 26,705

2010 Population: 27,023

2011 Full valuation: $1.1 billion

2011 Full value per capita: $38,913

Direct debt burden: 1.7%

Overall debt burden, adjusted for State School Building Aid: 1.7%

Payout of principal (10 years): 86.1%

Fiscal 2010 General Fund balance: $14.6 million (39.5% of General Fund revenues)

Per capita income as a % of State: 69.9%

Median family income as a % of State: 75.8%

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings and public information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of assigning a credit rating.

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