

CREDIT OPINION

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 Rate this Research

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Watertown (City of) NY

Update to credit analysis

Summary

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

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

The negative outlook reflects that reserves will continue to struggle keeping up with a growing budget resulting in a further decline in available fund balance as a percentage of revenues.

Factors that could lead to an upgrade

- » Significant growth in the underlying tax base
- » Material expansion of financial reserves
- » Significant reduction in long term liabilities

Factors that could lead to a downgrade

- » Continued operating deficits
- » Significant declines in fund balance
- » Material downsizing of operations at Fort Drum

Key indicators

Exhibit 1

Watertown (City of) NY	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value (\$000)	\$1,168,685	\$1,174,735	\$1,178,797	\$1,155,107	\$1,161,254
Population	27,590	27,250	26,997	26,437	26,437
Full Value Per Capita	\$42,359	\$43,110	\$43,664	\$43,693	\$43,925
Median Family Income (% of US Median)	80.0%	75.9%	71.8%	67.2%	67.2%
Finances					
Operating Revenue (\$000)	\$39,836	\$40,258	\$41,690	\$43,844	\$46,141
Fund Balance (\$000)	\$13,758	\$14,319	\$13,863	\$13,887	\$14,157
Cash Balance (\$000)	\$16,916	\$16,197	\$14,721	\$15,267	\$15,255
Fund Balance as a % of Revenues	34.5%	35.6%	33.3%	31.7%	30.7%
Cash Balance as a % of Revenues	42.5%	40.2%	35.3%	34.8%	33.1%
Debt/Pensions					
Net Direct Debt (\$000)	\$14,452	\$32,522	\$35,755	\$35,925	\$34,160
3-Year Average of Moody's ANPL (\$000)	\$52,622	\$66,579	\$76,011	\$80,400	\$77,241
Net Direct Debt / Full Value (%)	1.2%	2.8%	3.0%	3.1%	2.9%
Net Direct Debt / Operating Revenues (x)	0.4x	0.8x	0.9x	0.8x	0.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	4.5%	5.7%	6.4%	7.0%	6.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.3x	1.7x	1.8x	1.8x	1.7x

Data as of June 30 fiscal year end

Source: Moody's Investors Service and issuer's audited financial statements

Profile

Watertown, NY is located 11 miles east of Lake Ontario and 22 miles south of the St. Lawrence River and Canadian border. The town 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 12.5% of 2018 assessed valuation.

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 \$44,000 is about half the state average. As of December 2018, the unemployment rate measured 4.5%, which is modestly higher than the nation at 3.7%.

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

The city's financial position has slightly deteriorated given reserve draws in five of the last six years. Fiscal 2018 resulted in a \$397,000 operating deficit, as \$1.7 million in appropriated fund balance was not fully replenished even though sales tax revenues were \$150,000

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over budget and hydro revenues were almost \$1 million over budget. The deficit led to an available fund balance of \$14.2 million or 31% of revenues. The strong fund balance position provides a cushion for the city against its volatile revenue structure. The city's largest revenue sources are sales taxes at 40%, property taxes at 20%, and departmental income at 14%. The city's largest expenditures are public safety, making up 36% of the budget, employee benefits of 25%, and general government of 11%.

The fiscal 2019 budget increased by \$1.7 million or 4% and was offset with a 2.3% increase in the tax levy and the use of \$2 million of appropriated fund balance. Management is expecting another small deficit in fiscal 2019 as hydro revenues are down \$440,000 compared to budget, while sales tax revenues are up \$427,000 versus original budget.

The 2020 budget is currently being constructed and will be completed in late spring 2019.

LIQUIDITY

Cash and investments at the end of fiscal 2018 represented \$15.3 million or 33.1% of revenues.

Debt and Pensions: Elevated but manageable debt burden

The net direct debt burden, at 2.9% of full value, is relatively high for the rating category and is expected to remain elevated due to ongoing capital needs. In the near term, the city may undertake a courthouse project, which could cost up to \$5 million; however, discussions are still underway.

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 6.4% of expenditures.

PENSIONS AND OPEB

The city participates in the New York State and Local Employees Retirement System (ERS), and the New York State and Local Police and Fire Retirement System (PFRS), multi-employer, defined benefit retirement plans sponsored by the State of New York (Aa1 stable). The three year average combined net pension liability, under Moody's methodology for adjusting reported pension data, is \$77 million, or an average 1.67 times General Fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the reported liability information, but to improve comparability with other rated entities. We determined the city's share of liability for the state administered plans in proportion to its contributions to the plans.

Negatively, New York State law does not allow for local governments to fund a trust for retiree healthcare benefits (OPEB). While legislation to allow local governments to fund a trust is currently under discussion, the city continues to fund its annual OPEB cost on a pay-go basis. This cost was approximately \$4.3 million, or 9.2% of expenditures, in fiscal 2018. Absent legislation, or changes to benefits, the city's very large OPEB liability – measuring \$115 million or 2.5 times General Fund revenues – will continue to grow, placing pressure on future budgets.

Fixed costs, including annual debt service, pensions, and OPEB costs, totaled 23.4% of fiscal 2018 operating expenditures.

Management and Governance

The city's past willingness to override the state tax cap, combined with its conservative budgeting practices, have allowed it to amass a substantial reserve position. Additionally, the city maintains a five year capital plan, which is unusually strong given the city's size.

New York cities have an Institutional Framework score of A, which is moderate. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. 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 (before adjusting for exemptions and rollovers). However, this cap can be overridden at the local level, without voter approval. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. New York State has public sector unions and the additional constraint of the Triborough Amendment, which limits the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be moderate, or between 5-10% annually.

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