

RatingsDirect®

Summary:

Watertown, Connecticut; General Obligation; Note

Primary Credit Analyst:

Christina Marin, Boston 617-530-8312; christina.marin@spglobal.com

Secondary Contact:

Rahul Jain, New York 212-438-1202; rahul.jain@spglobal.com

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Credit Profile

US\$6.4 mil GO BANs ser 2017 dtd 04/25/2017 due 01/25/2018		
<i>Short Term Rating</i>	SP-1+	New
US\$1.075 mil GO bnds ser 2017 due 04/15/2029		
<i>Long Term Rating</i>	AA+/Stable	New
Watertown GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' rating and stable outlook to the Town of Watertown, Conn.'s 2017 general obligation (GO) bonds and affirmed its 'AA+' rating, with a stable outlook, on the town's GO debt outstanding.

At the same time, S&P Global Ratings assigned its 'SP-1+' short-term rating to the 2017 bond anticipation notes (BANs), maturing Jan. 25, 2018. The short-term rating reflects our view that Watertown maintains a very strong capacity to pay principal and interest when the notes come due. The town maintains what we view as a low market risk profile because it has strong legal authority to issue long-term debt to take out the notes and is a frequent issuer that regularly provides ongoing disclosure to market participants.

The town's full faith and credit secures the bonds and notes. We understand that proceeds of the bonds and BANs will be used to finance school improvements and the purchase of a fire truck, among other capital items.

We base the long-term rating on our local GO criteria, reflecting our assessment of the following factors for Watertown:

- Strong economy, with market value per capita of \$114,045 and projected per capita effective buying income at 124% of the national level;
- Strong management, with "good" financial policies and practices under our financial management assessment (FMA) methodology;
- Strong budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Strong budgetary flexibility, with an available fund balance in fiscal 2016 of 11.5% of operating expenditures;
- Very strong liquidity, with total government available cash at 18.7% of total governmental fund expenditures and 2.1x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 8.9% of expenditures and net direct debt that is 76.9% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 73.7% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Strong economy

We consider Watertown's economy strong. The town, with an estimated population of 21,862, is located in Litchfield County. The town has a projected per capita effective buying income of 124% of the national level and per capita market value of \$114,045. Overall, the town's market value was stable over the past year at \$2.5 billion in 2017. The county unemployment rate was 5.0% in 2015.

Watertown is primarily a residential community, 30 miles north of New Haven and 35 miles southwest of Hartford, in Litchfield County. Primary employers include a private boarding school (The Taft School) and several manufacturing companies. The town's relatively low mill rate has attracted several commercial and industrial developments, which represent 12.5% of the tax base. Among the most recent developments are a new medical facility, the renovation of an old mill building into a food packaging plant, and the construction of a 79-unit assisted living facility. The economy remains very diverse, with the 10 leading taxpayers representing 5.8% of the tax base. Unemployment is below state and national averages at 5% in 2015.

Strong management conditions

We view the town's management conditions as strong, with "good" financial management practices under our FMA methodology. This indicates that financial practices exist in most areas, but that officials might not formalize or regularly monitor all of them.

The town does a three-year look-back in formulating the budget and tends to budget conservatively, which is evidenced in a history of balanced budgets. Although management doesn't do long-term financial planning, it does engage in capital planning with a detailed list of pending capital projects and proposed funding sources. The town also maintains an investment policy, a debt policy, and a fund balance policy.

Strong budgetary performance

Watertown's budgetary performance is strong in our opinion. The town had slight operating surpluses of 0.8% of expenditures in the general fund and of 0.5% across all governmental funds in fiscal 2016. General fund operating results of the town have been stable over the last three years, with a result of negative 0.3% in 2015 and a result of 0.1% in 2014.

Due to conservative budgeting, the town's operating performance has been consistent and balanced in recent years. In 2016, the operating surplus was driven by favorable tax collections, a mild winter, and revenues from new growth. Close to 70% of operating revenues come from property tax, with state aid making up the remaining 25%. In fiscal 2013, Watertown reported a 1.5% deficit (\$1 million) due to an unusual number of medical claims. In fiscal 2014, the town, which is self-insured, purchased stop loss insurance to prevent the issue from reoccurring. However, town officials report that medical claims are trending higher than budget in 2017, and that Watertown might have to draw on fund balance to pay claims. We expect that any impact on reserves will likely be mitigated by higher revenues from new growth. The town will switch healthcare providers to better control costs in the future.

In February 2017, the governor of Connecticut released a proposed budget that could fundamentally change intergovernmental revenues in the state, and could have negative implications for Watertown. The budget, if adopted as proposed, could result in a decrease in education cost-sharing revenues by as much as \$1 million for Watertown as well as higher pension costs of about \$1.4 million. See "Connecticut's Proposed State Budget Could Lead To

Significant Local Government Budgetary Uncertainty," published Feb. 16, 2017, on RatingsDirect. Town officials are budgeting for a \$1 million decline in state aid, which they expect to make up for lower state revenues with a 3% increase to property taxes and an anticipated increase in new growth revenues. It is unclear how Watertown would manage the increased pension costs, should that portion of the governor's budget proposal be adopted; however, in our view, the town maintains the flexibility to adjust revenues and expenditures to ensure structural balance.

Given the budgetary pressure associated with rising medical claims and uncertainty relating to state funding, we could revise our assessment of budgetary performance to adequate should the town fall into structural budget imbalance.

Strong budget flexibility

Watertown's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2016 of 11.5% of operating expenditures, or \$8.5 million.

Watertown has a reserve policy to maintain an undesignated fund balance of 7%-12% of the ensuing year's operating revenue, to which it has historically adhered. Given that medical claims have outpaced the budget, town officials predict that there could be a draw on fund balance by as much as \$1 million. This number could be less at fiscal-year end given higher-than-budgeted new growth revenues. We recognize that the town faces some budgetary pressure due to the fact it is self-insured. However, given the town's stop-loss insurance and history of conservative budgeting, we expect our evaluation of budgetary flexibility to remain at least strong during our outlook period.

Very strong liquidity

In our opinion, Watertown's liquidity is very strong, with total government available cash at 18.7% of total governmental fund expenditures and 2.1x governmental debt service in 2016. In our view, the town has strong access to external liquidity if necessary.

Further enhancing our view of the town's liquidity position is Watertown's strong access to external liquidity. It is a regular market participant, having issued debt frequently in the past several years, including GO bonds and short-term BANs.

Strong debt and contingent liability profile

In our view, Watertown's debt and contingent liability profile is strong. Total governmental fund debt service is 8.9% of total governmental fund expenditures, and net direct debt is 76.9% of total governmental fund revenue. Overall net debt is low at 2.4% of market value, and approximately 73.7% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

Following this bond issue, Watertown has about \$61 million of total direct debt outstanding, which includes \$6.4 million in BANs. Town management is expecting to undertake additional capital projects in the near future, which include a new space for the town hall and improvements to water and sewer lines. These projects are still in the planning phase, but management expects to issue \$7 million in new debt over the next two years, which will not likely impact our evaluation of Watertown's debt profile.

Watertown's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 3.4% of total governmental fund expenditures in 2016. Of that amount, 1.8% represented required contributions to pension obligations, and 1.6% represented OPEB payments. The town made its full actuarial determined contribution in 2016.

The town administers two pension plans: the town retirement system and the police benefit fund. The town also participates in Connecticut Municipal Employees Retirement Fund for all water and sewer employees hired before 1986. Watertown has made 100% contributions to all three plans in the past three years, which was about \$1.4 million in fiscal 2016. The funded ratio for the town retirement system is 87%, and for the police benefit fund it is 73%. The total pension liability for the police and town plans is \$49 million. All Watertown teachers participate in the State of Connecticut Teachers' Retirement System, a cost-sharing, multiple-employer, public employee retirement system, which is entirely funded by the state. Watertown also administers an OPEB plan for its employees. The OPEB liability is funded on a pay-as-you-go basis, and the town contributed \$1.3 million, or 43% of the annual required contribution, in fiscal 2016. The unfunded liability of this plan equaled \$42 million, and was 0% funded as of July 1, 2015.

Very strong institutional framework

We consider institutional framework score for Connecticut municipalities as very strong.

Outlook

The stable outlook reflects our view that Watertown's strong underlying economy, strong management practices, and predictable operating profile should translate into strong budgetary performance and operating flexibility over our outlook horizon. In addition, we expect Watertown to maintain strong reserves above 7% of annual expenditures based on historical adherence to its fund balance policy.

Upside scenario

We could raise the rating if economic indicators improve to levels comparable with higher rating peers, and if the town introduces stronger capital planning and financial forecasting documents.

Downside scenario

Although unlikely, we could lower the rating if financial performance deteriorates, putting pressure on available reserves.

Related Research

2016 Update Of Institutional Framework For U.S. Local Governments

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