

**Rating Action: Moody's upgrades City of Watertown, MN's GOs to Aa3 and assigns Aa3 issuer rating**

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New York, January 18, 2023 -- Moody's Investors Service has assigned a Aa3 issuer rating to the City of Watertown, MN. The issuer rating reflects the city's credit quality and ability to repay debt and debt-like obligations without consideration of any pledge, security, or structural features. Concurrently, Moody's upgraded the city's general obligation unlimited tax (GOULT) ratings to Aa3 from A1. This action concludes a review that was initiated on November 3, 2022 in conjunction with the release of the US Cities and Counties Methodology. The city has approximately \$21 million in outstanding debt.

**RATINGS RATIONALE**

The Aa3 issuer rating reflects the city's small but healthy economic base, robust financial position, albeit nominally small operations, and moderate leverage. While the city's full value per capita is lower than comparably rated cities, resident incomes are high at 141% of the national median. The city's economic growth rate lags the nation, though it is in line with peers at the Aa3 and will likely continue to exhibit stability due to its proximity to the Twin City metro area.

The issuer rating also reflects the city's exceptionally strong reserves, which are likely to remain steady. We expect the city's financial position to remain a credit strength, given strong budget management. Fiscal 2022 outcomes are tracking higher than budget and the fiscal 2023 budget includes a modest levy increase to keep up with inflation. The city closed fiscal 2021 with an exceptionally strong 139% of revenues in reserves. The city operates various enterprises. It's largest enterprises are its sewer and water, which benefit from strong liquidity. The storm water enterprise also has strong liquidity, but operated at a loss in 2021.

The issuer rating further considers moderate total leverage and fixed costs, which are expected to grow based on future debt plans. Total liabilities, consisting of direct debt, pensions, and other liabilities, were equivalent to over 350% of revenues. Management expects to either apply for a grant or issue additional direct debt totaling about \$7 million for construction of a water tower and various road projects. With revenue growth and continued retirement of principal debt in the interim, we expect the impact of the additional debt to be minimal. The city's fixed costs are low, representing less than 10% of revenues.

The Aa3 rating on the GOULT bonds is at the same level as the city's issuer rating because the city has pledged its full faith, credit and taxing power for repayment of the bonds. The bonds have a dedicated ad valorem tax, levied against all taxable property in the city without limitation as to rate or amount.

**RATING OUTLOOK**

Moody's typically does not assign outlooks to local governments with this amount of debt.

**FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS**

- Growth in resident wealth
- Diversification of the tax base

**FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS**

- Sustained declines in reserves
- Material increase to overall leverage or fixed costs

**LEGAL SECURITY**

Outstanding GOULT bonds are backed by the city's full faith and credit pledge and the authority to levy a dedicated property tax unlimited as to rate and amount. GOULT bonds are additionally secured by statute.

## PROFILE

The City of Watertown is located in Carver County in central eastern Minnesota (Aaa stable), approximately 25 miles west of the Twin City metro area, with a population of nearly 4,500 residents. The largest industry sectors that drive the local economy are manufacturing, health services, and retail trade.

## METHODOLOGY

The principal methodology used in these ratings was US Cities and Counties Methodology published in November 2022 and available at <https://ratings.moody.com/api/rmc-documents/386953>. Alternatively, please see the Rating Methodologies page on <https://ratings.moody.com> for a copy of this methodology.

## REGULATORY DISCLOSURES

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