Lynchburg, Virginia

New Issue Report

Ratings

Long-Term Issuer Default Rating	AA+

New Issue

$26,500,000 General Obligation Public Improvement Refunding Bonds, Series 2017	AA+

Outstanding Debt

General Obligation Bonds	AA+

Rating Outlook

Stable

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New Issue Details

Sale Date: Sept. 12 via competitive sale.

Series: General Obligation Public Improvement Refunding Bonds, Series 2017.

Purpose: The proceeds of the bonds will be used to refund and defease certain outstanding GO bonds of Lynchburg (the city).

Security: The bonds are general obligations of the city, payable by a pledge of its full faith, credit and unlimited taxing authority.

Analytical Conclusion

The 'AA+' GO rating and Issuer Default Rating reflect the city's strong control of revenues and expenditures, as well as its solid budget management and healthy reserves. The city's long-term liability burden is manageable.

Economic Resource Base: Lynchburg is located along the James River in central Virginia, roughly 50 miles east of Roanoke. As of 2016, the city’s population was 80,212, up 6.1% from the 2010 census, outpacing the state and national population growth rates during the same period.

Key Rating Drivers

Revenue Framework: 'aaa' factor assessment. Revenues have been rising at a pace below U.S. GDP growth but above inflation. The city enjoys strong revenue flexibility given its independent legal ability to increase property taxes without limitation.

Expenditure Framework: 'aa' factor assessment. Fitch Ratings expects the natural pace of spending growth to remain in line with to marginally above revenue growth. Moderate carrying costs and broad flexibility to manage labor-related costs allow the city solid leeway to adjust spending throughout economic cycles.

Long-Term Liability Burden: 'aa' factor assessment. The combined burden of debt and unfunded pension liabilities is moderate at roughly 16% of personal income. The city's capital plan appears manageable, and its pension plan for general employees is well funded. However, the city's proportionate share of the net pension liability related to the state teachers' plan has risen in recent years in conjunction with a deferral of pension contributions to the plan driven by state budget policy actions.

Operating Performance: 'aaa' factor assessment. The city's healthy financial reserves are well in excess of its policy target, and, in conjunction with the city's superior ability to adjust revenues and spending, leave it very well positioned to address cyclical declines.

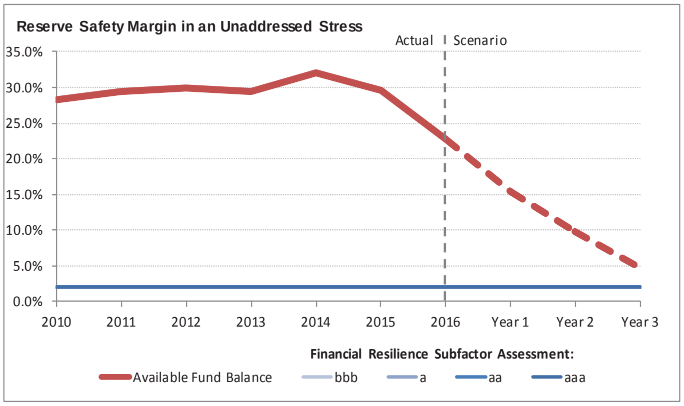
Rating Sensitivities

Increased Long-Term Liabilities: An increase in the city's long-term liability burden due to additional debt issuances beyond current expectations or further increases in the city's net pension liability could pressure the rating.

Lynchburg (VA)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

The city's strong financial resilience comes from a combination of its unlimited legal authority to increase property taxes, solid expenditure flexibility, and maintenance of a strong reserve cushion. A hypothetical unaddressed moderate economic decline scenario shows an operating reserve cushion that Fitch judges to be consistent with a 'aaa' financial resilience assessment. Moreover, Fitch expects that in the event of an actual revenue decline of this magnitude the city would maintain reserves at or above its policy level (an unassigned general fund balance equal to no less than 10% of revenue) through active expenditure management.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.1%	3.3%
Inherent Budget Flexibility	Superior		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2010	2011	2012	2013	2014	2015	2016	Year 1	Year 2	Year 3
Total Revenues	157,124	159,184	162,666	169,308	173,619	176,616	180,853	179,045	182,769	188,857
% Change in Revenues	-	1.3%	2.2%	4.1%	2.5%	1.7%	2.4%	(1.0%)	2.1%	3.3%
Total Expenditures	152,522	149,627	149,852	158,463	158,787	167,290	175,666	179,179	182,763	186,418
% Change in Expenditures	-	(1.9%)	0.2%	5.7%	0.2%	5.4%	5.0%	2.0%	2.0%	2.0%
Transfers In and Other Sources	14,017	17,152	283	4,148	62	23,561	8,603	363	370	383
Transfers Out and Other Uses	10,054	26,589	11,695	13,982	10,162	34,021	23,840	12,089	12,331	12,578
Net Transfers	3,963	(9,437)	(11,412)	(9,834)	(10,100)	(10,461)	(15,237)	(11,727)	(11,961)	(12,195)
Bond Proceeds and Other One-Time Uses	5,873	16,419	-	4,130	-	22,648	10,342	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	8,565	120	1,402	1,011	4,732	(1,135)	(10,050)	(11,861)	(11,955)	(9,756)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	5.5%	0.1%	0.9%	0.6%	2.8%	(0.6%)	(5.3%)	(5.8%)	(6.1%)	(4.9%)
Unrestricted/Unreserved Fund Balance (General Fund)	44,287	47,001	48,403	49,414	54,146	53,011	42,962	31,100	19,146	9,389
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	44,287	47,001	48,403	49,414	54,146	53,011	42,962	31,100	19,146	9,389
Combined Available Fund Bal. (% of Expend. and Transfers Out)	28.3%	29.4%	30.0%	29.4%	32.0%	29.7%	22.7%	15.3%	9.8%	4.7%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	8/31/17
AA+	Revised	Stable	4/30/10
AA	Affirmed	Stable	5/25/04
AA	Assigned	—	1/5/93

Related Research
Fitch Rates Lynchburg VA's $26.5MM GOs 'AA+'; Outlook Stable (August 2017)

Related Criteria
U.S. Public Finance Tax-Supported Rating Criteria (May 2017)

Credit Profile

Lynchburg's historically strong manufacturing and distribution base remains important to the local economy, although the growing presence of higher education, health services, industrial engineering and retail has broadened the city's economic base. Education and healthcare are the largest employment sectors in the city, which includes five higher education institutions. Growth potential for the higher education sector is promising, including the largest institution, Liberty University. Wealth levels are below the state and national averages.

Revenue Framework

The city's diverse revenue stream includes a mix of property, sales and meals taxes and other non-tax revenue. Property taxes are the most significant revenue source, accounting for roughly 40% of fiscal 2016 general fund revenues, followed by intergovernmental revenues at 20% and local sales and use and meals taxes each making up less than 10%.

General fund revenues have increased at a compound annual growth rate (CAGR) of 2.2% over the 10 years ended fiscal 2016, below the rate of national GDP growth but ahead of inflation without significant policy action. Fitch expects the future natural growth of revenues to remain moderate based on post-recession trends for taxable assessed value (TAV) and other local taxes.

The city's ability to increase its millage or tax levy has no legal limitation, which helps to insulate the city's revenue base against exposure to shifts in the city's tax base or economy.

Expenditure Framework

The city maintains healthy expenditure flexibility. Its spending associated with fixed carrying costs (i.e. debt and retiree benefits) is moderate. Public safety and educational spending are the largest expenditure items for the city, each making up roughly 25% of general fund spending. Virginia public schools are largely funded by a mix of state and local contributions. The amount of the local contribution is determined by the city council and is based on the state-determined performance standards for the school system. The city's fiscal 2017 contribution was about $8 million over the required local effort (RLE; approximately 4% of the fiscal 2017 general fund budget). The city has the legal ability to reduce spending to the RLE level, creating additional spending flexibility.

Expectations for continued population growth and moderate increases in the cost of services should more or less align the pace of spending growth with revenues over time.

The city maintains a significant level of expenditure flexibility due to the favorable work force environment, which prohibits labor contracts and gives management independent control of compensation and work rules. Carrying costs associated with debt service, actuarially determined pension payments and OPEB actual contributions make up 12% of governmental spending.

Long-Term Liability Burden

Long-term liabilities for debt and unfunded pensions are moderate at about 16% of personal income. The city's direct debt represents almost 7% of personal income, and principal amortization is average, with almost 60% scheduled for retirement within 10 years. The capital improvement plan for fiscal years 2018–2022 totals $184.9 million for general city and school capital projects and includes tax-supported debt financing of roughly $100 million.

Fitch's long-term liability burden calculation includes defined-benefit pension plans administered by the Virginia Retirement System (VRS) as agent plans for general employees and non-teacher employees of the component unit school system, and as a cost-sharing, multiple-employer plan for teachers. The combined ratio of assets to liabilities was about 63% in fiscal 2016, when adjusted by Fitch to reflect a 6% investment rate of return assumption versus the plan's 7% rate. Systemwide funding for the cost-sharing VRS plans declined in recent years, due in part to underfunding of actuarial contributions (partially used as a budget balancing measure for the state). Positively, the state's biennial budget plan for fiscal years 2017 to 2018 accelerates the phase-in for full actuarially determined employer contribution payments by one year to fiscal 2018.

The city offers OPEB to retirees and makes contributions on a pay-as-you-go basis. Full-time employees hired on or after July 1, 1996 are eligible to participate in the city's OPEB plan under an implicit rate subsidy. The unfunded OPEB liability as of June 30, 2016 was high at $91.6 million, or approximately 3% of personal income.

Operating Performance

The city's strong financial resilience comes from a combination of its unlimited legal authority to increase property taxes, solid expenditure flexibility and maintenance of a strong reserve cushion. For details, see Scenario Analysis, page 2.

The city ended fiscal 2016 with a general fund deficit of $10 million, or 5% of spending, largely due to a planned increase in transfers to the city's capital project fund and an increase in school spending for one-time expenses. The resulting unrestricted fund balance equaled almost $43 million, or a healthy 23% of spending.

The adopted fiscal 2017 budget totaled $185.7 million and included a $5.0 million appropriation of fund balance. Unaudited projections for fiscal 2017 show a roughly $2.0 million surplus as both revenues and expenditures outperformed the budget. The adopted fiscal 2018 budget increased slightly to $187.7 million and included a $4.4 million appropriation of fund balance. The property tax remained stable at $1.11 per $100 of assessed value, and the lodging tax was increased to 6.5% from 5.5% (plus a $1 room fee per night) to help fund capital projects.

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