

CREDIT OPINION

31 August 2017

New Issue

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Lynchburg, VA

New Issue - Moody's assigns Aa2 to Lynchburg VA's \$26.5M GO Refunding Bonds Series 2017

Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 rating to the City of Lynchburg's (VA) \$26.5 million General Obligation Public Improvement Refunding Bonds, Series 2017. We maintain a Aa2 rating on the city's \$217 million of GO debt outstanding. The Aa2 rating reflects the city's stable and diverse tax base that is supported by the presence of multiple higher education institutions and a large regional health care facility. The rating also reflects the city's satisfactory financial position and above average debt burden made manageable by comprehensive policies and self-supporting enterprise debt.

Credit Strengths

- » Sizable tax base stabilized by institutional presence
- » Near-term economic growth and diversification expected to continue
- » Strong operating results driven by conservative management

Credit Challenges

- » Continued use of reserves for one-time capital could limit financial flexibility
- » Above average debt burden

Rating Outlook

Outlooks are generally not assigned to local government credits with this amount of debt outstanding

Factors that Could Lead to an Upgrade

- » Increased reserve levels
- » Reduction in debt burden

Factors that Could Lead to a Downgrade

- » Sizeable decline in tax base
- » Reduction in reserves
- » Significantly increased debt burden

Key Indicators

Exhibit 1

Lynchburg (City of) VA	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value (\$000)	\$ 5,888,731	\$ 5,930,510	\$ 5,945,181	\$ 6,002,828	\$ 6,041,007
Full Value Per Capita	\$ 77,835	\$ 77,556	\$ 76,587	\$ 76,804	\$ 76,784
Median Family Income (% of US Median)	82.1%	78.3%	78.0%	77.4%	77.4%
Finances					
Operating Revenue (\$000)	\$ 207,769	\$ 215,005	\$ 220,116	\$ 226,546	\$ 230,816
Fund Balance as a % of Revenues	23.4%	23.0%	24.8%	23.5%	18.7%
Cash Balance as a % of Revenues	26.2%	24.3%	27.3%	26.3%	20.7%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 190,419	\$ 117,138	\$ 117,104	\$ 258,510	\$ 193,781
Net Direct Debt / Operating Revenues (x)	0.9x	0.5x	0.5x	1.1x	0.8x
Net Direct Debt / Full Value (%)	3.2%	2.0%	2.0%	4.3%	3.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.3x	1.4x	1.2x	1.4x	1.6x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	4.9%	4.9%	4.6%	5.2%	6.1%

Source: Moody's Investors Service, Lynchburg VA CAFRS 2012-2016, US Census

Recent Developments

In Fiscal 2016 the city transferred \$10 million from its General Fund for one-time city capital maintenance purposes, reducing total fund balance to \$42.9 million (23.7% of revenues) and reducing unassigned fund balance to \$25.5 million from \$32 million in fiscal 2015. Officials expect to add \$2 million to unassigned fund balance in Fiscal 2017. Capital transfers for city purposes were reduced in the fiscal 2018 budget to \$3.3 million. We will continue to monitor the city's use of reserves for one-time purposes, officials expect to remain in compliance with all fund balance policies despite possible one-time use of reserves.

Detailed Rating Considerations

Economy and Tax Base: Regionally Important Local Economy Continues to benefit from Diversification and Strong Institutional Presence

The city's economic base is expected to remain stable given a diversified private employment base with ongoing investment and the presence of multiple higher education institutions and a large regional health care facility. A regional commercial center in central Virginia (Commonwealth of) (GO rated Aaa/stable), Lynchburg has experienced a moderate 2% average annual growth in full valuation over the last five years and is valued at \$6.1 billion. Continued growth is expected in 2017 as diversification efforts continue. In fiscal 2017 private companies invested over \$80.4 million in the city and created 322 jobs while commercial building permits totaled \$155 million.

Expansion of existing businesses reflects the city's economic development strategy focused on encouraging firms already located in the city to remain and expand their facilities. The city has also invested in a variety of redevelopment projects designed to revitalize the downtown area by attracting new commercial tenants and residential housing. In 2016 Pacific Life announced its new location in the city and an investment of \$4 million and 300 new jobs. Adding to the city's revitalization efforts is the 115 room boutique Virginian hotel expected to open in March 2018. Downtown currently contains nearly 900 apartment, lofts condos and downtown business have increased by 205% in 10 years with assessed value nearly doubling since 2004.

Lynchburg also benefits from a number of stabilizing higher education institutions and the health care industry. [Centra Health](#) (rated A2/negative), the city's second largest employer with 6,100 employees, provides three health and rehabilitation centers within

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Lynchburg including a new Community Access Network facility scheduled to open in the fall. Lynchburg is home to five colleges, with a combined enrollment approximating 20,172, including [Liberty University](#) (rated Aa3/stable), which has aggressive growth plans and is committed to maintaining its 15,000 student population. The university recently underwent a large scale \$600 million campus transformation. Approximately 25% of the city's population is full-time students. Lynchburg's wealth indicators were below average representing 68.3% of the state and 79.7% of the nation, while per capita income represents 67.2% of the state and 79.0% of the nation. It should be noted that the presence of a sizable student population tends to negatively skew wealth indices. Full value capita, at \$76,784 also remains below state and national medians. The city's unemployment rate of 4.9% is above the nation and state medians but has declined from its peak of 8.5% in 2010.

Financial Operations and Reserves: Satisfactory Financial Operations with Sizable Reserves Despite One-Time Capital Transfer in Fiscal 2016

Lynchburg has a history of consistently solid reserve levels, with unassigned General Fund balance averaging over 17% of revenues over the last five years. Most recently, the city ended fiscal 2016 with a drop in total fund balance following a \$10 million transfer to the city's Capital Project Fund for one-time capital. Tax revenues were over-budget due to the positive performance of personal property and meals taxes. Total fund balance equaled \$42.9 million or a satisfactory 23.7% of revenues.

The city maintains additional flexibility outside of the General Fund with the Schools Capital Project Fund which totaled \$4.5 million in fiscal 2016. Growth in economically sensitive revenues (meals, lodging and sales tax) as well as business license revenues continue with mostly positive growth annually since 2011. In fiscal 2016 sales taxes were essentially flat (-0.1%), business license taxes declined slightly by 0.8% while meals and lodging tax revenues grew by 4.4% reflecting a strengthening local economy. Officials expect rebounding business license tax revenues in fiscal 2017, or a 9.4% increase reflecting ongoing development.

Based on preliminary projections, the city expects to end fiscal 2017 with an approximate \$2 million increase in Unassigned General Fund balance. This anticipated increase in reserves is attributable to the positive performance of various local taxes including personal property, meals, and sales taxes, as well as conservative budgeting of expenditures. The fiscal 2018 budget represents a 1.6% increase from the fiscal 2017 budget and includes \$4.4 million in appropriated fund balance for one-time uses which is consistent with City Council's adopted financial policies the budget also includes a \$3.3 million transfer to capital (down 24% from fiscal 2017).

LIQUIDITY

Lynchburg's liquidity position remains strong with Operating Fund net cash as a percent of revenues of averaging more than 20% for the last five fiscal years. Fiscal 2016 cash totaled \$43.4 million or 20.7% of revenues

Debt and Pensions: Above Average Debt Burden Expected to Remain Manageable

The city's debt burden is expected to remain manageable in the near-term despite additional borrowing plans given anticipated enterprise support for a significant portion of current and future long-term debt. The city's direct debt burden is an above average 2.6% of full valuation and net of approximately \$75 million in enterprise debt due to the self-supporting nature of the city's water and sewer systems. The city's Revenue Supported Debt policy requires that enterprise funds meet a debt service coverage ratio of at least 1.2 times.

A substantial portion of sewer debt has been issued to comply with the city's combined sewer overflow (CSO) special order requirements. Management indicates that it will continue to raise rates to comply with the special order and to fund additional debt service. The city's \$307 million five-year Capital Improvement Plan (2018-2022) funds city, school, and other (airport, water, sewer, stormwater) capital projects and primarily consists of \$66 million in transportation projects, \$37 million of sewer projects and \$32 million schools projects.

Majority of the capital plan will be funded with self-supporting GO debt, pay go, low-interest state loans and state grants approximately \$100 million of the plan will be funded with additional GO borrowing through a 2 year line of credit draw down program.

Despite a relatively elevated debt ratio, debt service represented a modest 7.2% of operating expenditures in fiscal 2016.

DEBT STRUCTURE

All of the city's debt is fixed rate.

DEBT-RELATED DERIVATIVES

The city is not party to any derivative agreements.

PENSIONS AND OPEB

The city and the city school board participate in the Virginia Retirement System defined benefit pension plan administered by the Commonwealth of Virginia. The city contributed 100% of its ARC for both of its pension plans in fiscal 2016. The city's combined adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$430 million or 1.15 times operating revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities. We determined the city's share of liability for the state-run plans in proportion to its contributions to the plans.

The city and school board also provide Other Post-Employment Benefits (OPEB) to employees. The city contributed 60% of its OPEB ARC in fiscal 2016 and 20.3% of the school board's OPEB ARC. The total net obligation for both plans equaled \$11.8 million in fiscal 2016.

Lynchburg's total fixed costs (pensions, debt service, and OPEB) accounted for a manageable 17% of fiscal 2016 expenditures.

Management and Governance

Lynchburg has strong management including sound policies covering fund balance and reserves, debt, and capital planning.

Virginia Cities have an Institutional Framework score of Aaa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector has one or more major revenue sources that are not subject to any caps. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Virginia is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Legal Security

The bonds are secured by the city's general obligation unlimited tax pledge.

Use of Proceeds

The 2017 Refunding bonds will refund the city's outstanding 2009A and 2009B Build America Bonds for an expected net present value savings in excess of 5% without extending debt maturity.

Obligor Profile

Located in central Virginia approximately 70 miles south of [Charlottesville](#) (rated Aaa/stable), Lynchburg acts as a commercial center for the region. The city is home to five higher education institutions, including Liberty University, the largest private university in the Commonwealth.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

Ratings

Exhibit 2

Lynchburg (City of) VA

<u>Issue</u>	<u>Rating</u>
General Obligation Public Improvement Refunding Bonds, Series 2017	Aa2
Rating Type	Underlying LT
Sale Amount	\$26,500,000
Expected Sale Date	09/12/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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