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Ratings

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Summary:

Lynchburg, Virginia; General Obligation

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Table Of Contents

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Credit Profile		
US$26.5 mil GO pub imp rfdg bnds ser 2017 due 09/01/2039		
Long Term Rating	AA+/Stable	New
Lynchburg GO		
Long Term Rating	AA+/Stable	Affirmed
Lynchburg GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Lynchburg, Va.'s series 2017 general obligation (GO) public improvement refunding bonds. At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the city's existing GO debt. The outlook is stable.

A pledge of the city's full faith credit and resources and an agreement to levy ad valorem property taxes without limitation as to rate or amount secure these bonds.

We understand the city will use proceeds from this issue to advance refund all or a portion of its existing series 2009A GO public improvement bonds, and crossover refund all or a portion of its existing series 2009B GO public improvement bonds, (Taxable-Build America Bonds) and pay interest on the bonds until the crossover date.

The ratings reflect our assessment of the following factors for the city:

- Adequate economy, with market value per capita of $76,719 and projected per capita effective buying income at 70.9%, but that is benefitting from a local stabilizing institutional influence;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2016, which closed with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 30% of operating expenditures;
- Very strong liquidity, with total government available cash at 38.1% of total governmental fund expenditures and 4.3x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 8.9% of expenditures and net direct debt that is 88.8% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Very strong institutional framework score.

Adequate economy

We consider Lynchburg's economy adequate. The city, has an estimated population of 79,537. The city benefits, in our view, from a stabilizing institutional influence – Liberty University. The city has a projected per capita effective buying income of 70.9% of the national level and per capita market value of $76,719. Overall, the city's market value grew by 1.0% over the past year to $6.1 billion in 2016. The city unemployment rate was 4.8% in 2016.

The city anchors the Lynchburg/Campbell County combined metropolitan statistical area (MSA) and is located in the foothills of the Blue Ridge Mountains along the James River in the center of the commonwealth. Lynchburg is the employment and retail base of a four-county region and continues to be an employment hub with a significant number of people commuting in to the city for work. The city is mature, yet a healthy amount of redevelopment and expansion of existing businesses continues. Lynchburg continues to work with the Economic Development Authority (EDA) to promote future growth and redevelopment and has established several new initiatives to achieve these goals, including a local enterprise redevelopment program, and the establishment of a revolving loan fund. Recent economic development projects include: the redevelopment of the historic Virginian Hotel ($25 million investment), and various retail expansions, including the construction of The Fresh Market. More recent economic development announcements include a $4 million investment by Pacific Life Insurance Co. to open a business center creating over 300 new jobs over the next three years and a $4.2 million investment by Convergys Corporation establishing an office that will create more than 600 new jobs over the next three years. Lastly, the Academy Music Theatre is set to be restored. Located in the downtown area, it is anticipated that the theatre will serve as a magnet for continues economic development.

The health care, retail, higher education, and manufacturing sectors anchor the employment base. Leading employers include: Liberty University (8,000+ employees), CENTRA Health (7,000+), AREVA (nuclear power, 1,000+), Lynchburg city schools (1,500+) and J.Crew Outfitters (500+). In addition, within the city's boundaries are five higher education institutions, with Liberty University being the largest. Total enrollment accounts for 25% of Lynchburg's total population and, in our opinion, is a contributing factor to its lower wealth levels. Liberty University, recognized as the nation's largest private non-profit online educator, continues with its sizable campus renovation and expansion project. Construction is expected to continue through 2019, and as a result, the project has spurred additional development, primarily in retail. The city's tax base has remained relatively constant with assessed value (AV) increasing 4.3% since 2012 to $6.1 billion in 2016. Management expects AV to increase modestly over the next one to two years as the future economic development is added to the tax base.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our Financial Management Assessment methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Lynchburg's fiscal and debt practices are based on a series of comprehensive policies that it adopted in 1999 and updated as necessary through a regular review process. The city uses five-year historical trend analysis, commonwealth, and federal estimates and data projections, and economic forecasts to develop its annual revenue and expenditure assumptions. Management monitors the budget through formal processes, and it tracks revenues and expenditures daily and makes quarterly reports on the results to the city council based on adopted policy. Each mid-March, the city's financial management team makes formal recommendations for budget adjustments to the city council based on budgeted numbers compared with actual results.

A six-year capital improvement program (CIP) serves as the basis for annual capital appropriations and debt financing requirements; management updates the CIP annually with identified funding sources. On an informal basis, the city maintains a five-year long-term financial forecast for revenues and expenditures and includes certain assumptions. The city adheres to comprehensive formal debt management policies in planning and addressing its capital needs, including:

- A policy that limits the city's debt service-to-budget to 10% of budgeted general expenditures,
- A limit on total debt to 4.5% of full market value,
- A principal amortization target of 60% over 10 years at the end of the five-year CIP, and
- The city's pay-as-you-go appropriations of at least 10% of the annual CIP.

The city has its own investment policy that it reviews annually with its financial advisor. Reports are made and shared with the city manager and city council on a quarterly basis. The city recently adjusted and strengthened its long-adopted reserve policy, which calls for the maintenance of undesignated general fund balance at 10% of operating revenues.

Strong budgetary performance

Lynchburg's budgetary performance is strong in our opinion. The city had deficit operating results in the general fund of negative 5.3% of expenditures, but a surplus result across all governmental funds of 4.6% in fiscal 2016. Our assessment accounts for the fact that we expect budgetary results could improve from 2016 results in the near term.

Lynchburg's budgetary performance has been strong overall, in our view, benefitting from conservative budgeting practices and several formal fiscal policies. The city has a stable revenue stream with little exposure to volatile revenues. Property taxes accounted for 42% of general fund revenues, rising to over 72% when all local taxes, such as sales and use, meals, and business licenses are included. The city continues its historically conservative budgeting practices and generates surpluses, net of transfers annually, with the exception of fiscal 2015 and 2016, as the city had increased capital costs relating to the construction of the new high school. Property tax rates have remained relatively unchanged over the past decade, increasing in fiscal 2013 to $1.11#?#$100 from $1.05#?#$100 in anticipation of funding school-related capital needs and remaining constant through fiscal 2016. In fiscal 2016, the city closed with a $10.05 million deficit, net of transfers to the city and school capital projects funds. Although the drawdown was unusually large, a drawdown was planned for. After several years of surpluses, with revenues coming in over budget and expenditures well under budget, and growing reserve levels, the city made the conscious decision to transfers a greater amount than originally budgeted for several capital projects as well as increased capital costs related to the construction of the new high school. Ultimately, this brings the general fund balance closer to 15% of expenditures and above the formal 10% policy.

With fiscal 2017 just recently closed, management is projecting to close with a $5.5 million surplus; of which $3.5 million will be added to the committed portion of general fund balance and $2.0 million being added to the unassigned portion of general fund balance. Almost all local revenues are expected to be above budget while expenditures were below.

The city's fiscal 2018 budget totals $187.7 million and includes a modest reduction in transfers to the capital projects fund. In addition, the fiscal 2018 budget includes a 1% rate increase to the lodging tax, which should continue to aid in the maintenance of the city's stable financial operations.

Given the city's strong fiscal operations coupled with projections for near-term surpluses, we do not expect the city's budgetary performance to weaken over the next several years.

Very strong budgetary flexibility

Lynchburg's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 30% of operating expenditures, or $58.2 million. The available fund balance includes $43.0 million (22.4% of expenditures) in the general fund and $15.3 million (8.0% of expenditures) that is outside the general fund but legally available for operations.

Audited fiscal 2016 general fund reserves were $42.9 million or 22.4% of expenditures after adjusting for transfers. In addition, when reserves outside the general fund are included, levels rise to $58.2 million or 30% of expenditures. These reserve levels are well above the city's formal policy of 10%. For fiscal 2017, management is projecting to close with a surplus, keeping reserves in line with prior years and about 15% of expenditures. As such, we do not expect the budget flexibility score to change in the near term.

Very strong liquidity

In our opinion, Lynchburg's liquidity is very strong, with total government available cash at 38.1% of total governmental fund expenditures and 4.3x governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

In our opinion, the city has strong access to external liquidity, as it has issued GO debt frequently over the past 20 years. The obligor has contingent liquidity risk exposures that we consider manageable at the current rating level. The exposures come from $10 million of debt sold directly to a bank facility, previously done in 2013. There are no acceleration provisions and the city maintains sufficient liquidity. In addition, the city does not hold any investments we deem aggressive.

Adequate debt and contingent liability profile

In our view, Lynchburg's debt and contingent liability profile is adequate. Total governmental fund debt service is 8.9% of total governmental fund expenditures, and net direct debt is 88.8% of total governmental fund revenue. Overall net debt is low at 3.0% of market value, which is in our view a positive credit factor.

Additional near to moderate additional capital needs include the remodeling of the Sandusky Elementary School and the construction of a new police headquarters. In order to finance these and various other projects, we understand, the city is contemplating roughly two-year lines of credit (LOC). Each LOC would be taken out roughly every two years, with a permanent financing, depending on the life of the asset, up to 20 years. Under the LOC approach, the city would not begin paying principal back before the projects are officially undertaken, thus aiding cash flow and debt service levels.

Lynchburg's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 6.9% of total governmental fund expenditures in 2016. Of that amount, 5.6% represented required contributions to pension obligations, and 1.4% represented OPEB payments. The city made its full annual required pension contribution in 2016.

The city participates in the Virginia Retirement System (VRS) and makes 100% of annual required contributions (ARC). The combined ARC pension costs and OPEB pay-as you-go costs for fiscal 2016 totaled 6.9% of expenditures. The pension plan has a funded level of 70% with a net pension liability of $103.05 million.

For the fiscal year ended June 30, 2016, the City's annual required contribution (ARC) was $4.9 million with an unfunded actuarial accrued liability of $91.6 million. This was based on an actuarial valuation as of July 1, 2016, utilizing a 4.0% discount rate and a 30-year amortization period. The city's annual contribution was $2.7 million, leaving a net OPEB obligation of $7.7 million. The city has not established an OPEB Trust and makes contributions on a pay-as-you-go basis. The rate was changed to 4.0% in 2016 from 6.75%. In our opinion, annual OPEB costs will rise (but not substantially), yet remain manageable.

Very strong institutional framework

The institutional framework score is very strong.

Outlook

The stable outlook reflects our view of Lynchburg's consistent financial performance and stable economy, which is supported by very strong budget flexibility, liquidity, and management. The growing area economy, which serves as an anchor for the region, lends stability to the rating. As such, we do not expect to revise the rating over our two-year outlook horizon because we believe the city will maintain its very strong financial position and manage its debt burden.

Upside scenario

In our opinion, if the city were to experience significant improvements in overall economic indicators, and maintain them, and its debt and liability positon were to improve while all other factor averages being held constant, we might raise the rating.

Downside scenario

Conversely, if budgetary performance or debt and contingent liability were to decline, placing fiscal pressure on the city, or economic indicators were to erode, we might lower the rating.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.