FitchRatings

One State Street Plaza
New York, NY 10004

T 212 908 0500 / 800 75 FITCH
www.fitchratings.com

July 17, 2007

Ms. Donna Witt
Director of Financial Services
Lynchburg
Financial Services
900 Church Street, 3rd Floor
Lynchburg, VA 24504

Dear Ms. Witt:

Fitch Ratings has assigned one or more ratings and/or otherwise taken rating action(s), as detailed on the attached Notice of Rating Action.

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We are pleased to have had the opportunity to be of service to you. If we can be of further assistance, please feel free to contact us at any time.

Sincerely,

Carolyn Tain
Senior Director
U.S. Public Finance

CT/tv

Enc: Notice of Rating Action
(Doc ID: 84606)

Notice of Rating Action

Bond Description	Rating Type	Action	Rating	Outlook/ Watch	Eff Date	Notes
Lynchburg (VA) GO public improv bonds ser 2007	Long Term	New Rating	AA	RO:Sta	10-Jul-2007	
Lynchburg (VA) GO bonds	Long Term	Affirmed	AA	RO:Sta	10-Jul-2007	

Key: RO: Rating Outlook, RW: Rating Watch; Pos: Positive, Neg: Negative, Sta: Stable, Evo: Evolving

Tax Supported
New Issue

Lynchburg, Virginia

Ratings

New Issue

General Obligation Public Improvement Bonds, Series 2007 ...... AA

Outstanding Debt

General Obligation Bonds .... AA

Rating Outlook .... Stable

Analysts

Ryan A. Greene
+1 212 908-0315
ryan.greene@fitchratings.com

Amy R. Laskey
+1 212 908-0568
amy.laskey@fitchratings.com

Issuer Contact

Donna S. Witt
Director of Financial Services
+1 434 455-3968

New Issue Details

$33,800,000 General Obligation Public Improvement Bonds, Series 2007, are scheduled to sell competitively on July 19. The bonds mature serially 2009–2027.

Security: The bonds are general obligations of the city for which its full faith and credit are irrevocably pledged.

Purpose: Bond proceeds will be used to finance various general government projects and refund the city's $16.5 million GO public improvement bond anticipation note, series 2006.

■ Outlook

The 'AA' rating reflects the city of Lynchburg's strong financial management, moderate debt levels, and mature economy. The manufacturing sector remains an important job producer, and economic diversification efforts continue, particularly in the city's industrial parks. Future debt needs are manageable, and the debt burden should remain moderate given the rapid amortization of outstanding bonds and the availability of user fees to support a portion of the city's GO bonds.

■ Rating Considerations

Located in central Virginia, Lynchburg has effectively dealt with many of the challenges that face historically manufacturing-based economies while continually developing its role as a retail center for the surrounding area. Lynchburg also serves as a regional provider of higher education and health care services. The unemployment rate, 3.7% in May 2007, has historically been above the commonwealth's low average but below the national average. Downtown and riverfront redevelopment activity continues to show momentum, with significant public and private investment yielding new residential, arts and entertainment, and civic facilities. Per capita personal income levels, while below average at 75% of the commonwealth and 81% of the national figures, are somewhat reflective of the city's significant student population.

Financial management is strong, as evidenced by adherence to formalized policies regarding fund balance, debt affordability, quarterly reporting, and midyear budget reviews. Reserve levels consistently exceed adopted policy targets. The city ended fiscal 2006 with a $10.3 million general fund surplus due in large part to a change in personal property tax collection methods. The unreserved general fund balance strengthened to $35.9 million, or 24.4% of expenditures, transfers out, and other uses. The fiscal 2007 budget includes use of the majority of the fiscal 2006 surplus to fund nonrecurring capital expenditures. Despite the budgeted draw on the fund balance, officials expect that strong tax and investment income revenue growth will yield actual reserve levels that are more consistent with average historical performance.

The $156.9 million fiscal 2008 adopted general fund budget represents a 5.6% increase in spending over the fiscal 2007 budget. It includes a $4.7 million fund balance appropriation for one-time capital expenditures and an above-average increase in tax revenues relative to prior fiscal years. Taxes are budgeted at 71.6% of total general fund revenues, and the budgeted levy represents a 5.9% increase over the fiscal 2007 level. City enterprise funds have healthy financial margins, aided by steady rate increases. However, the city remains under a special consent order to separate its storm water and sanitary sewer systems, and continued sewer utility rate increases will likely keep rates above average for the area.

Overall debt levels are moderate, at $2,260 per capita and 2.9% of taxable assessed valuation (TAV); outstanding debt amortizes rapidly. Capital needs outside of the sewer system upgrades are manageable due to the low rate of population growth and the presence of an established infrastructure. About one-third of the $300.8 million fiscal years 2008–2012 capital improvement plan (CIP) relates to the sewer system, which includes compliance with the special consent order regarding combined sewer overflows. The remainder of the plan addresses primarily school (21%) and general government (32%), including transportation, needs. Approximately 33% of the current CIP is funded through GO bonds, with another 26% financed by revenue bonds.

Strengths

- Strong financial performance and management, aided by formal policies.
- Regional retail and employment center for the four-county surrounding area.
- Moderate debt levels, with manageable future capital plans.

Risks

- Delayed execution of the combined sewer overflow control plan continues to escalate costs.
- Below-average wealth indicators.

Debt

Debt levels are moderate, with direct debt representing $2,260 per capita and 2.94% of TAV. GO debt issued for the water, sewer, and solid waste enterprise funds, which represents approximately 26% of all outstanding debt, is self-supporting through fees charged by the respective systems. A small amount of GO debt for the airport fund is not fully supported by fees. Amortization of the city's total direct debt is above average, with 63.2% retiring within the next 10 years.

The $301 million CIP, spanning fiscal years 2008–2012, is manageable, although larger than past CIPs. Self-supporting water and sewer system projects, including the improvements related to the combined system overflow program, account for approximately 43% of the total CIP, a figure that has grown over prior plan levels as costs escalate. Transportation and school-related projects cover an additional 24% and 21%, respectively. Funding sources include GO bonds, constituting 33% of the total; revenue bonds and Virginia Resource Authority loans (26%); literary fund loans (7%); and pay-as-you-go sources (34%), including federal and commonwealth grants.

Debt Statistics

($000)

This Issue	33,800
Outstanding Debt	119,219
Direct Debt	153,019
Overlapping Debt	0
Total Overall Debt	153,019
Debt Ratios	
Direct Debt Per Capita ($)*	2,260
As % of Taxable Assessed Valuation**	2.9
Overall Debt Per Capita ($)*	2,260
As % of Taxable Assessed Valuation**	2.9

*Population: 67,720 (2006 estimate). **Taxable assessed valuation: $5,213,371,000 (fiscal 2008). Note: Numbers may not add due to rounding.

The city council adheres to several debt affordability policies related to general fund-supported GO bonds and capital leases. New or newly revised policies for fiscal 2007 include limiting debt service expenditures to 10% of general fund plus school component unit expenditures, maintaining tax-supported debt below 4.5% of TAV, and maintaining a 10-year principal payout ratio of 60%. Fitch Ratings views the city's debt policies favorably as tools for guiding capital planning and maintaining manageable debt levels.

Lynchburg is part of the Virginia Retirement System. The city makes its annual required contribution (ARC) to the system, which was a combined $14.2 million in fiscal 2006 for the city and schools. The city and schools' combined OPEB liability is an estimated $41.7 million with a $4.1 million ARC, about double the annual pay-as-you-go amount. City officials allocated $250,000 in the fiscal 2008 budget to begin prefunding this liability.

Combined Sewer Overflow

Under a special consent order issued in 1994 by the Virginia Department of Environmental Quality (VDEQ), work continues on the efforts to fully separate the city's storm sewer and sanitary sewer systems. Through November 2006, city officials, along with an independent rate consultant, estimate that 100 of the 132 originally identified overflow points have been eliminated.

General Fund Financial Summary
($000, Audited Fiscal Years Ended June 30)

	2002	2003	2004	2005	2006
Taxes	79,972	80,652	85,775	91,739	103,012
Intergovernmental	26,465	28,410	27,296	27,321	30,392
Charges for Services	3,178	3,487	6,371	6,443	7,376
Other Revenue	5,910	5,418	2,755	3,517	5,011
Total Revenue	115,524	117,968	122,197	129,021	145,791
Expenditures	78,647	129,060	133,228	122,408	140,825
Net Transfers and Other Sources/(Uses)	(35,531)	10,369	12,925	(3,946)	5,332
Net Income/(Deficit)	1,347	(724)	1,894	2,667	10,298
Total Fund Balance	22,582	21,858	23,763	26,488	36,787
As % of Expenditures, Transfers Out, and Other Uses:					
Total Fund Balance	27.1	16.1	16.9	20.8	25.0
Unreserved Fund Balance	26.5	15.4	16.3	19.9	24.4
Unreserved, Undesignated Fund Balance	21.6	12.6	11.9	13.7	17.7

Note: Numbers may not add due to rounding.

The 1994 consent order did not stipulate fixed deadlines for the completion of the project. Instead, the special order set three compliance guidelines based on financial capability. The guidelines call for the following:

- Annual rate adjustments ensuring the average sewer bill equals at least 1.25% of median household income (MHI).
- A 1.1 times (x) to 1.5x sewer operating debt service coverage.
- Sewer reserve funds equal to no more than 25% of the subsequent year's budgeted operating expenditures.

The city met the requirements of the latter two guidelines in fiscal 2006 while narrowly missing the first guideline because of a change in sewer billing practices negotiated with the VDEQ. Officials plan to regain compliance with the first guideline by July 1, 2008, per the VDEQ's deadline.

Originally projected at a total cost of about $200 million, the remaining cost of the project is now estimated at $309 million unless the project can be substantially completed in less than the estimated 20–25 years. The majority of the remaining work to be completed occurs in the downtown area, which is projected to be more expensive due its complexity.

Financing for the projects has predominantly come from residential and commercial sewer usage fees, with federal and commonwealth grants somewhat helping to defray costs. Since July 1993, more than $167.6 million has been spent on the project, and grants received to date total approximately $35 million. While federal grant dollars have been in short supply, low and zero interest loans from the commonwealth remain available. Additionally, sewer rates are anticipated to increase by 4% annually — consistent with previous years — though larger increases may be necessary to support more costly projects in future years. Fitch notes that increasing project cost estimates, coupled with the city's already high sewer rates relative to surrounding areas, may pressure the funding source.

Finances

Lynchburg's financial position is sound. At the end of fiscal 2006, the city's unreserved general fund balance equaled $35.9 million, or a strong 24.4% of expenditures, transfers out, and other uses. The unreserved, undesignated general fund balance equaled $26.0 million, or 17.7% of spending and 17.8% of general fund revenues. In each of the past five fiscal years, the unreserved, undesignated fund balance has surpassed the city's fund balance target, recently strengthened to equal at least 10% of general fund revenues from 7%.

The city's fiscal 2006 $10.3 million general fund surplus was largely the result of a one-time change in personal property tax collection methods. The city budgeted $8.8 million of the gain for nonrecurring capital spending in fiscal 2007. The use of one-time gains for one-time capital spending is indicative of Lynchburg's prudent financial management practices.

Officials estimate having used only $6.6 million of the $8.8 million in budgeted general fund reserves in fiscal 2007. Growth in sales, meals, and lodging taxes, as well as investment income revenues, is expected to end the fiscal year over budget. A projected $19.4 million year-end undesignated general fund balance represents sound growth in reserves after discounting an exceptional fiscal 2006.

The fiscal 2008 adopted general fund budget totals $156.9 million and projects strong growth in general property tax revenues of 11.4%, mainly driven by the biennial revaluation that year. The revenue growth incorporates a decline in the real estate tax rate to $1.05 per $100 of TAV from $1.11, where it has been since fiscal 1998, and is the result of sound tax base growth. Total general fund revenues are budgeted to grow by 8.6% over the fiscal 2007 budget and general fund expenditures by 5.6%. The budget includes a $4.7 million transfer for capital expenditures.

To ensure the health of the water, sewer, solid waste, and airport enterprise funds, the city adopted policy targets related to fund balance and debt service coverage ratios for each. The water, sewer, and solid waste funds all met or exceeded policy targets. The exception is the airport fund, which receives a general fund subsidy that has declined in each of the past three fiscal years. The subsidy was about $400,000 in fiscal 2006. Officials plan to create a solid waste authority with neighboring counties that will be operational beginning in fiscal 2009 and to replace the city's solid waste enterprise fund. The authority will reportedly secure longer term landfill needs with a goal to ultimately operate debt free.

■ Economy

Population growth has been stagnant since the 1970s, as Lynchburg is largely a mature city. The Census Bureau estimates the 2006 population at 67,720, a modest 4% above the 2000 census figure of 65,269. Unemployment rates have declined each year since rising in 2001 and 2002 because of the shrinking technology and communications sectors. The May 2007 unemployment rate of 3.7% was above the commonwealth's low 2.8% and represented a small increase over the May 2006 rate. City unemployment has historically tracked below national and above commonwealth levels.

Manufacturing is important to the local economy, but the city also serves as the retail, health care, and higher education center for the region. Economic development efforts continue to focus on attracting higher paying manufacturing and research and development jobs to the designated industrial parks. The city's relatively affordable land and access to a more skilled work force given its proximity to numerous higher education institutions should aid in this effort.

The city's largest employer, Centra Health (4,401 employees), is adding a new tower and cancer center in Lynchburg, with total investment estimated at about $110 million. Areva NP North America, reportedly the world's largest nuclear power plant manufacturer, is expected to add 130 engineers by 2007. Growth in the service sector continues, and strong per capita retail sales reflect Lynchburg's established position as a retail center. Per capita retail sales far outpaced the commonwealth and surrounding counties' averages in 2006.

Downtown redevelopment efforts are ongoing, with $129 million of public and private investments reportedly made since 2000. Cultural attractions include the Amazement Square Children's Museum and the Renaissance Theater, both of which draw large audiences. A new $14 million federal courthouse and post office complex was completed in fiscal 2005. BluffWalk Center, which includes a boutique hotel with 43 rooms, a conference center, a high-end restaurant, and a microbrewery, is near completion. Construction of the mixed-use Wyndhurst and Cornerstone developments continues, and officials note that the rezoned Lakeside Centre will host 1.5 million square feet of additional retail, restaurant, and hotel space beginning in fall 2009.

TAV has grown an average of 6.4% annually over the past five fiscal years, and building permit values for 2006 equaled a strong 3.4% of TAV. The city's tax base should continue to grow as the aforementioned projects are included in the tax roll and continued enrollment gains in the city's universities attract more residents.

Liberty University has a current enrollment of about 10,000 students, with plans to expand to 25,000 students by 2020. The university completed more than $80 million of construction projects in 2006, including converting a former Ericsson facility into a new law school. Lynchburg College has reportedly experienced record growth in enrollment over the past five years, and total university enrollment represents about 25% of the city population.

Income levels are below average based on all indicators. Per capita personal income equaled 75% and 81% of the commonwealth and national averages in 2005, respectively. Median household money income equaled 66% and 77% of the commonwealth and national averages for the same period, respectively. These numbers are a product of an economy concentrated on the manufacturing and service sectors, a large student population, the lower cost of living in areas of central Virginia, and above-average poverty levels. At 19.1%, Lynchburg's individual poverty rate is nearly double the commonwealth's average.