MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Lynchburg, VA's $132.4M GO Public Improvement Bonds, Series 2014A and 2014B

Global Credit Research - 27 May 2014

Affirms Aa2 on $153M of outstanding GO debt

LYNCHBURG (CITY OF) VA
Cities (including Towns, Villages and Townships)
VA

Moody's Rating

ISSUE		RATING
General Obligation Public Improvement and Refunding Bonds, Series 2014A (Tax-Exempt)		Aa2
Sale Amount	$118,400,000	
Expected Sale Date	06/03/14	
Rating Description	General Obligation	
Taxable General Obligation Public Improvement Refunding Bonds Series 2014B		Aa2
Sale Amount	$14,000,000	
Expected Sale Date	06/03/14	
Rating Description	General Obligation	

Moody's Outlook NOO

Opinion

NEW YORK, May 27, 2014 --Moody's Investors Service has assigned a Aa2 rating to the City of Lynchburg's (VA) $118.4 million General Obligation Public Improvement and Refunding Bonds, Series 2014A (Tax-Exempt), and $14.0 million Taxable General Obligation Public Improvement Refunding Bonds, Series 2014B. The bonds are secured by the city's general obligation (GO), unlimited property tax pledge. Concurrently, Moody's has affirmed the Aa2 rating on the city's $153 million of outstanding GO debt.

Proceeds from the Series 2014A bonds will primarily fund the construction of Heritage High School, as well as various other general government, transportation, water and sewer projects and will refinance an outstanding line of credit with Carter Bank & Trust and a portion of the Series 2006 bonds. The Series 2014B bonds will refund a portion of the Series 2005 bonds. The refunding is expected to result in an estimated net present value savings of $1.4 million, or 5.5% of refunding principal, with no extension of maturity.

SUMMARY RATINGS RATIONALE

The Aa2 rating reflects the city's stable and diverse tax 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 sound financial position and above average debt burden.

STRENGTHS:

- Stable and diverse tax base

- Healthy reserve levels

CHALLENGES:

- Above average debt burden
- Below average wealth levels

DETAILED CREDIT DISCUSSION

STABLE AND DIVERSE TAX BASE SERVES AS REGIONAL COMMERCIAL CENTER

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 2.1% average annual growth in full valuation over the last five years and is now fully valued at $5.9 billion. While growth has slowed slightly in this central Virginia community from pre-recession levels, assessed valuations increased by 0.4% in fiscal 2013 and are expected to grow at a modest rate going forward. This continued growth reflects both the introduction of new industry, expansion of existing industries, as well as rising residential values. In 2013, AREVA NP, the world's largest nuclear power plant designer, manufacturer, and service provider, announced almost $11 million in new machinery and equipment expenditures as part of a $26.3 million investment in its Operational Center of Excellence for Nuclear Products and Services. In addition, Babcock and Wilcox Company (rated Ba1/stable), who manufactures naval nuclear reactors for the U.S. Department of Energy and is headquartered in the city, announced $1.5 billion in contracts and orders for the naval reactor program in fiscal 2014. Management reported that Babcock and Wilcox is expecting potential layoffs in the near-term due to financial pressures at the federal government level, but timing and the extent of the layoffs is still uncertain.

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. These programs include the development of two publicly owned industrial parks, the creation of a small-business assistance center with loans and low-cost office space, and the use of various targeted incentives including subsidized land, infrastructure, and cash grants. 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 addition to a number of other manufacturing firms, the city contains a large regional shopping mall, as well as several big box retailers, which collectively serve the surrounding areas. Centra Health (rated A2/stable), the city's largest employer with 6,100 employees, provides three health and rehabilitation centers within Lynchburg. The city also includes five colleges, with a combined enrollment approximating 21,206, including Liberty University (rated Aa3/stable), which has aggressive growth plans reportedly intended to expand its 12,000 student body to 20,000 over the next 10 years. Liberty University is also undergoing a $600 million campus transformation. Approximately one-quarter 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 (81.1%) and national (85.9%) medians. The city's unemployment rate of 6.8% is on par with the nation (6.8%), but above the state rate of 5.3% as of March 2014.

HISTORY OF SOLID FINANCIAL PERFORMANCE; ADDITIONAL SURPLUS EXPECTED IN FISCAL 2014

In what proved to be a challenging year for many issuers due to the economic recession, Lynchburg was able to continue to add to its reserves and maintain its healthy financial position. Lynchburg has a history of consistently solid reserve levels, with unassigned/undesignated General Fund balance averaging 18% of revenues over the last five years. Overall, the city has increased General Fund balance to $49.4 million (29.2% of General Fund revenues) in fiscal 2013 from $37.2 million (23.0% of General Fund revenues) in fiscal 2009. Most recently, the city ended fiscal 2013 with a $1.0 million operating surplus due to positive revenue performance and conservative budgeting of expenditures. Tax revenues were over-budget due to the positive performance of delinquent property, personal property, meals, and business license taxes. The city also increased the property tax rate by six cents to $1.11 in fiscal 2013. Unassigned fund balance increased to $31.7 million (18.7% of General Fund revenues), well above the city's policy of 10%. The city also transferred $10.6 million to the Capital Projects Fund, as the city consistently transfers unassigned year-end reserves in excess of its 10% policy. The city maintains $17.6 million ($13.5 million in Capital Projects Fund and $4.1 million in School Capital Projects Fund) in additional reserves outside of the General Fund that could be used to support operations. Total available reserves amounted to $67.1 million, or a sound 39.6% of General Fund revenues, in fiscal 2013.

The fiscal 2014 budget represents a 3.8% increase from the fiscal 2013 budget and includes $7.1 million in appropriated fund balance for capital projects which is consistent with City Council's adopted financial policies. Based on preliminary projections, the city expects to end fiscal 2014 with at least a $4 million increase in General

Fund balance to $53.4 million. 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. While the fiscal 2015 budget has not yet been adopted, the proposed budget represents a 2% increase from the fiscal 2014 budget and includes $7.8 million in appropriated fund balance for capital projects. The proposed fiscal 2015 budget includes a 2% salary increase for both city and school employees, a $7.3 million transfer for capital, and a $2.7 million increase in debt service primarily due to the current issuance. These costs are partially offset by continued growth in property and other local taxes. Overall, the proposed fiscal 2015 budget provides for an unassigned fund balance of 10.2% of General Fund revenues.

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 3.5% of full valuation and net of $194.6 million in enterprise debt due to the self-supporting nature of the city's water and sewer systems. 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 $231 million five-year Capital Improvement Plan (2015-2019) primarily consists of $86.4 million for schools ($75.1 million included in current issue), $48.3 million for transportation projects, and $45.9 million for self-supporting water and sewer projects. Approximately 43% of the Capital Improvement Plan will be funded with additional bonds and another 25% with pay-as-you-go contributions from the city. Amortization is below-average with 51.7% of principal retired within 10 year, but is in-line with the useful life of the financed assets. Debt service represented a modest 6.9% of operating expenditures in fiscal 2013. All of the city's debt is fixed rate and the city is not party to any derivative agreements.

The city and the city school board participate in the Virginia Retirement System defined benefit pension plan administered by the Commonwealth of Virginia (GO rated Aaa/stable). In fiscal 2013, the city's annual required contribution (ARC) was $10.4 million (4.9% of operating expenditures), while the ARC for the school board pension was $5.9 million (2.8% of operating expenditures). The city contributed 100% of its ARC for both of its pension plans in fiscal 2013. The city's combined adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is $303.3 million, or approximately an above-average 1.48 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 total ARC for the city's OPEB totaled $3.5 million (1.6% of operating expenditures) and the school board's OPEB ARC totaled $1.0 million (0.5% of operating expenditures) in fiscal 2013. The city contributed 107.9% of the ARC ($3.8 million or 1.8% of operating expenditures), while the school board contributed 32.5% of the ARC ($338,048 or 0.1% of operating expenditures). Fixed costs including annual pension, OPEB and debt service expenditures summed to a moderate 16.3% of fiscal 2013 expenditures.

WHAT COULD MAKE THE RATING GO UP:

- Continued growth in tax base

- Increased reserve levels

- Reduced debt burden

WHAT COULD MAKE THE RATING GO DOWN:

- Sizable decline in tax base

- Weakening of reserves

- Elevated debt burden

KEY STATISTICS

2013 Tax Base Size - Full Value (in 000s): $5,927,980

2013 Full Value Per Capita: $76,784

2010 Median Family Income as % of US median: 68.3%

2013 Fund Balance as % of Revenues: 23.0%

Five-Year Dollar Change in Fund Balance as % of Revenues: 8.04%

2013 Cash Balance as % of Revenues: 24.27%

Five-Year Dollar Change in Cash Balance as % of Revenues: 4.14%

Institutional Framework: Aaa

Operating History - Five-Year Average of Operating Revenues/ Operating Expenditures: 1.01x

Net Direct Debt/Full Value: 3.47%

Net Direct Debt/Operating Revenues: 0.96x

Three-Year Average of Moody's Adjusted Net Pension Liability/Full Value: 4.54%

Three-Year Average of Moody's Adjusted Net Pension Liability/Operating Revenues: 1.30x

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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