MOODY'S INVESTORS SERVICE

CREDIT OPINION
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New Issue

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Lexington (City of) TN Electric Enterprise

New Issue - Moody's Assigns Aa3 to Lexington Electric Enterprise, TN's Electric Revenue Bonds

Summary Rating Rationale

Moody's Investors Service has assigned a Aa3 rating to Lexington Electric Enterprise, TN's $7.4 million Electric System Revenue Refunding Bonds, Series 2017. Concurrently, Moody's maintains the Aa3 rating on the system's outstanding electric revenue bonds.

The Aa3 rating reflects a moderately-sized, largely residential customer base, satisfactory financial operations, manageable debt burden, and adequate legal protections for bondholders.

Credit Strengths

» Strong coverage levels

» Moderately-sized customer base

» Reliability record of Tennessee Valley Authority (TVA)

Credit Challenges

» Narrow cash position decreasing financial flexibility

Rating Outlook

Outlooks are not typically assigned to ratings with this level of debt outstanding.

Factors that Could Lead to an Upgrade

» Substantial increase in customer base

» Significant increase in cash position providing greater financial flexibility

Factors that Could Lead to a Downgrade

» Continued decrease in cash position further limiting financial flexibility

» Substantial decrease in customer base

» Increase debt ratio

Key Indicators

Exhibit 1

Lexington (City of) TN Electric Enterprise					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	19 years				
System Size - O&M (in $000s)	41,738				
Service Area Wealth: MFI % of US median	69.71%				
Legal Provisions					
Rate Covenant (x)	1.20				
Debt Service Reserve Requirement	DSRF funded at MADS				
Financial Strength					
	2012	2013	2014	2015	2016
Operating Revenue ($000)	47,545	46,714	47,507	46,865	45,559
O&M ($000)	42,742	41,975	42,824	42,373	41,738
Long-Term Debt ($000)	16,380	15,880	15,370	14,845	14,300
Annual Debt Service Coverage (x)	4.72	3.78	3.62	3.40	2.84
Cash on Hand	136 days	115 days	94 days	106 days	99 days
Debt to Operating Revenues (x)	0.3x	0.3x	0.3x	0.3x	0.3x

Source: Moody's Investors Service

Detailed Rating Considerations

Service Area and System Characteristics: System Provides Electric Service to Relatively Stable West-Central Tennessee Area

Lexington City's Electric System is a distribution system only, and it distributes electricity purchased exclusively from the Tennessee Valley Authority (TVA, Aaa stable) to a moderately-sized customer base within the City of Lexington (A1), the majority of Henderson County (A1), all of Decatur County (A2), the northern section of Hardin County (A1) and a small section of Carroll County (A2).

The system's customer base, largely rural, has grown slightly at an average rate of 0.6% since 2012, reaching a total of 22,449 in fiscal 2016. The service area is largely agricultural, and officials expect similar growth in the base going forward, given the availability of land for new development.

The majority of the system's customers are classified as residential (80%). Income levels in both Henderson and Decatur counties are weaker compared to national averages, with median family income of 55.2% and 70.2% of the nation, respectively. Unemployment in both counties, at approximately 6.2% (Henderson County) and 6.3% (Decatur County) for November 2016, remain well above state (4.6%) and national (4.4%) levels.

The TVA relationship is a key credit strength, which includes a reliable power supply and formulaic fund transfers to city government by TVA (compared to US city-owned electric utilities). An important advantage in the Authority's relationship with TVA has been the ample capacity and strong reliability record of TVA, which has protected municipal distributor system customers from facing price spikes that have become more common in the deregulated wholesale marketplace.

Debt Service Coverage and Revenue Metrics: Electric System has Maintained a Healthy Financial Position

Moody's expects the electric system's financial operations to continue to be well-managed, given the expectation of satisfactory coverage levels going forward. To date coverage levels have been solid with debt service coverage ratios of 2.84 times in Fiscal 2016. In 2016, there was a dip in coverage due to a lawsuit that was settled, a total of $287,674 was paid out in 2016. Even with the expense associated with the lawsuit, the coverage is expected to remain strong going forward. Rates were increased in October 2016 which will provide improved revenues in fiscal 2017. In addition, the refunding is being structured with Maximum Annual Debt Service occurring in fiscal 2018 as opposed to 2031. After fiscal 2018, debt service will decrease leading to further improved coverage.

The system also transfers an annual payment in lieu of taxes (PILOT) to the city's General Fund, which is considered subordinate to debt service. The coverage figures listed above include the PILOT payment as a revenue.

The net working capital has leveled out to about 23% of expenditures. Fiscal 2010 represented a low of only 8.6% of expenditures. Management intends to continue to invest in the system.

LIQUIDITY

Days cash on hand has been declining but is still stable with 99 days cash on hand in fiscal 2016. This is down from 136 days in fiscal 2012, however the system anticipates improving liquidity in fiscal 2017 due to the recent rate increase. Going forward, management anticipates further rate increases to parallel increases in expenses.

Debt and Legal Covenants: Satisfactory Legal Protections for Bondholders

The resolution provides adequate legal protection for holders of the Series 2017 bonds. The bonds have a senior lien on net revenues and are on parity with the outstanding debt. The resolution includes a rate covenant that requires annual net revenues to be 120% of total annual senior lien debt service and 100% of any subordinate lien debt. The Debt Service Reserve, which is currently cash-funded in the amount of $1.1 million, or the Maximum Annual Debt Service (MADS). Additional bonds that are parity to the current debt may be issued if the 12 of the prior 18 month's net revenues are equal to 120% of MADS, or if a rate increase in place would have provided such coverage on a pro forma basis.

DEBT STRUCTURE

All the system's debt is fixed rate.

DEBT-RELATED DERIVATIVES

The system is not party to any derivative agreements or swaps.

PENSIONS AND OPEB

The Lexington Electric System has a single employer retirement plan called the Retirement Plan for Employees of Lexington Electric System. The system contributed $663,487 or 1.6% of expenditures. In addition, the system contributed 42.1% of the OPEB contribution or $133,002. The combined pension and OPEB contribution was 1.9% of expenditures in fiscal 2016.

Management and Governance

The district is strengthened by a strong management team with a willingness to raise rates to maintain adequate debt service coverage and healthy liquidity. Rates are increased in conjunction with TVA rates and management is in the process of shifting the rate structure to have a fixed charge cover the fixed expenses of the system.

Legal Security

The bonds are secured by a first lien on the electric system net revenues.

Use of Proceeds

Proceeds will be used to refund the system's 2007 bonds. The expected savings is approximately $381,570 or 5.4% of refunded principal.

Obligor Profile

Lexington City's Electric System is a distribution system only, and it distributes electricity purchased exclusively from the Tennessee Valley Authority to the City of Lexington (A1), the majority of Henderson County, all of Decatur County, the northern section of Hardin County and a small section of Carroll County.

Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

LEXINGTON (CITY OF) TN ELECTRIC ENTERPRISE

Issue	Rating
Electric System Revenue Refunding Bonds, Series 2017	Aa3
Rating Type	Underlying LT
Sale Amount	$7,400,000
Expected Sale Date	02/13/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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