

RatingsDirect®

Summary:

Birmingham, Alabama; General Obligation

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Credit Profile

US\$46.0 mil GO rfdg bnds ser 2018A due 06/30/2044

Long Term Rating

AA/Stable

New

US\$40.0 mil GO warrants ser 2018B due 06/30/2044

Long Term Rating

AA/Stable

New

Rationale

S&P Global Ratings has assigned its 'AA' rating to the City of Birmingham, Ala.'s general obligation (GO) refunding bonds series 2018A and GO warrants series 2018B. The outlook is stable.

The city irrevocably pledges its full-faith-credit-and-taxing power to GO bond repayment. The property-tax pledge in Alabama is limited; the state has statutory-tax limitations that include levies for debt service. While the tax is technically limited, our analysis focuses on the strength of the full-faith-and-credit pledge. We rate the limited-tax GO debt on par with our view of the city's general creditworthiness, which we view as of equal credit quality to an unlimited-tax GO pledge.

Proceeds from the series 2018A bonds will refund the city's 2007A bonds for net present value savings. Proceeds from the series 2018B warrants will fund various projects throughout the city, including Bus Rapid Transit, Industrial Park, Legion Field, Boutwell, Central Library Stairs, and Wylam Library.

The ratings reflect our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Strong management, with "good" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with a slight operating deficit in the general fund and an operating deficit at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 41% of operating expenditures;
- Very strong liquidity, with total government available cash at 44.6% of total governmental fund expenditures and 4.7x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 9.5% of expenditures and net direct debt that is 128.4% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Strong economy

We consider Birmingham's economy strong. The city, with an estimated population of 210,782, is in Jefferson and Shelby counties in the Birmingham-Hoover MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 75.3% of the national level and per capita market value of \$84,129. Overall, the city's market value grew by 7.4% over the past year to \$17.7 billion in 2017. The weight-averaged unemployment rate of the counties was 5.9% in 2016.

Birmingham is in the central part of the state along the Interstate 20 corridor. It is the largest city in the state and remains a prominent hub for the service, financial, healthcare, manufacturing, and trade sectors. The city continues to benefit from the stabilizing institutional presence of the University of Alabama at Birmingham, the city's largest employer, and the Medical Center of the University of Alabama. Estimated enrollment at the university is 17,891 (8.4% of the population). The city continues to experience modest single-family residential construction, although new housing permits are down from their record high during 2005 to 2007. Multifamily projects, on the other hand, remain strong. Data generally suggest the city's population trend is negative, with growth in the MSA occurring outside the city limits, where the central business district still acts as a central location for employment. Birmingham's top 10 property taxpayers account for 14.4% of the total tax base and include Alabama Power Company, which accounts for about 6% of the total base. The city's market value has experienced modest annual growth since 2013.

City officials report ongoing developments. Stewart Industries, a commercial airline restoration business, is relocating its corporate headquarters to the city and operations to Birmingham Shuttlesworth International Airport. Stewart anticipates a workforce of 500 within five years and a need for further hangar space. DC Blox also has plans to purchase an industrial site for an initial \$230 million investment to build a data center complex. Autocar, a manufacturer of concrete, waste management, and garbage trucks opened its \$120 million manufacturing plant in a vacant factory straddling Center Point and Birmingham. Autocar employs 746 at the site. Given the stability of the university, the medical sector, and ongoing development, we anticipate Birmingham's market value to remain stable in the near term.

Strong management

We view the city's management as strong, with "good" financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Given the city's dependence on historically more volatile sales and use taxes, management utilizes several years of historical trends when building revenue and expenditure assumptions. Regular monthly budget to actual reports are provided to council and a formal midyear meeting is held where the budget is amended on an as-needed basis. Although long-range financial performance and expenditures are considered, the city does not use a formalized forecasting document. It has a five-year capital improvement plan that is adopted by council and updated annually, with the sources of funding for all projects identified. Birmingham has its own investment policies and reports to the council on holdings and earnings quarterly. It has also adopted debt management policies, which are widely communicated and followed. Lastly, the city has an ordinance to maintain general fund balance levels at 20% of annual revenues to deal with any potential changes in local revenues.

Adequate budgetary performance

Birmingham's budgetary performance is adequate in our opinion. The city had slight deficit operating results in the general fund of 0.9% of expenditures, and deficit results across all governmental funds of 7.5% in fiscal 2017.

Total governmental fund revenues are primarily derived from taxes (66% of total governmental fund revenues) and licenses and permit fees (16%). Taxes are further broken down into sales and use taxes (42% of tax revenues), occupational taxes (22%), property taxes (15%), business licenses (19%), and permits (2%). Historically the city has maintain stable financial performance, and in 2017 general fund expenditures (\$412.7 million) slightly outpaced general fund revenues (\$410.2 million) before adjustments or transfers. Birmingham did not fully fund its pension actuarial determined contribution (ADC) across all three funds, which is adjusted for in the city's expenditures and negatively affects total governmental fund results.

Officials report stable revenue streams in fiscal 2018. Tax collections remained relatively strong, providing for stable budgetary performance. In the past 10 years, sales and use tax collections have increased on average 4.32% annually, which includes one year-over-year decline of 3.5%. Following some discretionary use of revenues for one-time purposes, the city anticipates relatively stable financial performance in 2018, with a modest operating surplus.

Very strong budgetary flexibility

Birmingham's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 41% of operating expenditures, or \$172.4 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. The available fund balance includes \$83.3 million (20.0% of expenditures) in the general fund and \$89.1 million (21% of expenditures) that is outside the general fund but legally available for operations.

City officials have historically maintained a very strong financial position after accounting for certain one-time capital expenditures and routine transfers. In addition to very strong reserves held in unassigned general fund reserves, the city has a very sizable amount in the Birmingham Fund. This fund is considered a special revenue fund and accounts for proceeds the city received from the sale of the Industrial Water Board. It is treated as a reserve set aside for use in emergency situations or when revenue shortages or budgetary imbalances occur. Amounts not exceeding 5% of the five-year average market value of the fund by majority council vote may be appropriated. Amounts also may be appropriated for any lawful purpose with majority council vote and a declaration of extraordinary circumstance.

Very strong liquidity

In our opinion, Birmingham's liquidity is very strong, with total government available cash at 44.6% of total governmental fund expenditures and 4.7x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

Birmingham has demonstrated its ability to access the market through issuing GO bonds routinely over the past 15 years. The city participates in the Security for Alabama Funds Enhancement program. It does not budget for more than a 3% annual return on investment holdings. Most of the city's governmental fund investments are held in U.S. treasuries and certificates of deposit, which we consider liquid and nonaggressive.

While the city has various issues of privately placed debt and a recent variable-rate issue, we do not believe any of the

obligations present a near-term risk to its very strong liquidity. Birmingham has variable-rate GO warrants with Compass Bank dated June 29, 2017. The warrants carry a variable rate of 30-day LIBOR plus 1.45% and are callable at any time. The warrants authorize an amount of \$2 million and can be accessed at any time up to that amount. To date, the city has accessed \$450,000. It also has GO warrants dated June 29, 2017 with Citizens Bank. These warrants carry a variable rate of prime minus 0.75% and are callable at any time. As of June 30, 2017, \$500,000 was outstanding.

Very weak debt and contingent liability profile

In our view, Birmingham's debt and contingent liability profile is very weak. Total governmental fund debt service is 9.5% of total governmental fund expenditures, and net direct debt is 128.4% of total governmental fund revenue.

City council recently approved a \$90 million commitment over 30 years for renovations and a new stadium at the Birmingham-Jefferson Complex. The obligation will be incorporated in the 2019 budget and beyond. The city's commitment is in conjunction with funding sources from the Birmingham Jefferson Civic Center Authority, Jefferson County, and a car rental tax. While the city continues to examine debt for future projects, no specific plans for additional borrowing are set at this time.

In our opinion, a credit weakness is Birmingham's large pension and OPEB obligation. Birmingham's combined required pension and actual OPEB contributions totaled 6.5% of total governmental fund expenditures in 2017. The city made 60% of its annual required pension contribution in 2017. The funded ratio of the largest pension plan is 59.5%.

City employees participate in one of three single-employer defined-benefit pension plans: the Retirement and Relief System, the Firemen's and Policemen's Supplemental Pension System, and a much smaller unclassified Employees' Pension and Relief System. Separate boards of trustees administer these pension plans.

Birmingham's required pension contribution is its ADC, based on an actuary study. The funded status of the Retirement and Relief System, the city's largest plan with 3,852 active members and a net pension liability of \$707 million (\$23 million of which is associated with the airport), was 59.48% funded as of June 30, 2017, up from 48.5% the previous year. The plan's net pension liability as a percentage of covered employee payroll was 352.7%, which we consider high. Historically, the city has significantly underfunded its ADC for the Retirement and Relief System. Last year the state legislature removed the cap that restricted increases in contributions. While city contributions have increased modestly in the past few years, in 2017 Birmingham made only 54% of its annual required pension contribution. The plan uses a blended discount rate, combining the system's target rate of return with a tax-exempt bond interest rate. The rate for 2017 was 5.43%, which is on average lower than for most plans across the nation.

The city also underfunded the Firemen's and Policemen's Supplemental Pension System in 2017 by only making 85.5% of the ADC. The Firemen's and Policemen's System was 43.2% funded as of June 30, 2017, marginally lower than 43.6% the previous year. The plan's net pension liability was \$56.7 million. City officials have adopted increases in contributions to the plan in recent years with additional increases in contributions expected for 2019 and 2020. For fiscal 2019, increases in pension contributions will be about \$2.9 million for the Retirement and Relief Fund and more modest increases for police and fire. Officials note reaching the ADC contribution level is a priority, yet given the current funding status, we do not believe it will be attained in the near term. Officials are further examining the plans to find affordable ways to move closer to fully funding the ADC on an annual basis, including potentially returning to the

legislature for substantive plan changes. If Birmingham is unable to manage rising pension costs that negatively affect budgetary performance, this could lead to a negative rating action.

The city provides OPEB to employees. As of June 30, 2015, the most recent actuarial valuation date, the plan was not funded. Birmingham funds its OPEB obligation on a pay-as-you-go basis. The actuarial accrued liability for benefits equaled \$161,029,745, resulting in an unfunded actuarial accrued liability (UAAL) of \$161,029,745. The covered payroll (annual payroll of active employees covered by the plan) equaled \$190,001,968, and the ratio of the UAAL to the covered payroll equaled 84.75%.

Strong institutional framework

The institutional framework score for Alabama cities and towns is strong.

Outlook

The stable outlook reflects our view of Birmingham's consistently very strong budgetary flexibility and liquidity, as well as strength in the Birmingham-Hoover MSA economy. We do not anticipate changing the rating during the next two years because we believe that management will remain committed to maintaining the financial position despite the expected increase in pension costs.

Downside scenario

We could lower the rating if rising pension costs negatively affect the city's financial performance or flexibility. We could also lower the rating if the city fails to move toward fully funding its annual actuarial required contribution for its combined three pension plans.

Upside scenario

We could raise the rating if the city's economy expands and diversifies further, which improves wealth levels. We could also raise the rating if Birmingham's debt profile were to moderate significantly. However, this would require the city to successfully deal with its underfunded pension plans.

Related Research

- 2017 Update Of Institutional Framework For U.S. Local Governments

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