FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Vestavia Hills, AL's $22.1MM GO Rfdg Warrants and IDR 'AA+'; Outlook Revised to Stable

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Fitch Ratings - Chicago - 09 Jun 2020: Fitch Ratings has assigned a 'AA+' rating to the following Vestavia Hills, AL (the city) GO warrants:

--$4.3 million GO refunding warrants, series 2020A;

--$17.8 million GO taxable refunding warrants, series 2020B.

The warrants are expected to sell in June via negotiation. The proceeds will primarily be used to refund various outstanding warrants, and pay the cost of capital projects in the city including a new community center and parks and transportation improvements.

In addition, Fitch affirms the following ratings at 'AA+':

--City's Issuer Default Rating (IDR);

--approximately $103 million outstanding GO warrants.

The Rating Outlook is revised to Stable from Positive.

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SECURITY

The warrants are general obligations of the city payable from all lawfully available revenues and funds, and secured by an irrevocable pledge of the full faith and credit of the city on an equal and proportionate basis of payment with all present and future general obligation indebtedness of the city, and subject to the prior payment of the necessary and reasonable expenses of operating the city.

ANALYTICAL CONCLUSION

The 'AA+' ratings on the city's GO warrants and IDR reflect a demonstrated ability to maintain healthy reserves through economic cycles, a low long-term liability burden with no current plans for additional debt, and broad revenue and spending flexibility. The revision of the Outlook to Stable from Positive reflects revenue growth prospects that are likely to remain solid over time despite near-term uncertainty posed by the current recession.

ECONOMIC RESOURCE BASE

Vestavia Hills is an affluent residential community with a 2018 estimated population of 34,461, which is up 1.3% since the 2010 US Census. The city is located approximately three miles south of downtown Birmingham, with the majority of the city falling within Jefferson County with parts reaching out into Shelby County.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Growth prospects for revenues are solid and have improved with the city's ongoing economic development. The city has no independent ability to raise property taxes, but flexibility in sales tax and other locally generated revenues such as business licenses and fees provide a greater ability to offset expected revenue declines in a moderate economic downturn.

Expenditure Framework: 'aa'

Expenditure needs are expected to grow at a pace along the lines of revenue growth. The state's flexible work force environment provides the city significant control over personnel costs, which the city applied through merit and hiring freezes during the last recession. Fixed costs are manageable and largely devoted to debt service.

Long-Term Liability Burden: 'aaa'

The city's liability burden is very low. Direct debt is the primary driver of the liability, and the city has no future debt plans after the current issuance.

Operating Performance: 'aaa'

Fitch expects the city to display a high level of financial resilience in the current economic decline given a stable revenue history, sizable reserves, and superior level of overall budgetary flexibility in the form of its revenue raising ability and solid expenditure flexibility.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--A sustained increase in revenue growth levels in line with or above GDP growth;

--Natural pace of spending slower than or equal to expected revenue growth.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Material and prolonged deviation in the city's financial management and operating practices could pressure the rating;

--Although not expected, an increase in the long-term liability burden to a level that exceeds 10% of personal income.

-- A sustained decline in unrestricted general fund reserves to a level inconsistent with an 'aaa' assessment and expectations for a slow recovery due to the pandemic.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

The recent coronavirus outbreak and related government containment measures worldwide create an uncertain global environment for U.S. state and local governments and related entities in the near term. While Vestavia Hills' most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

Due to conservative budgeting of revenues and strong early fiscal 2020 results, the city is expecting a budget surplus for the year, even after factoring in the effects of the coronavirus pandemic. The city is not anticipating any use of fund balance in fiscal 2020, which ends on September 30, and is also expecting growth in revenues in fiscal 2021, barring a significant worsening of the pandemic. Although the city is not anticipating the need to make any major cuts to the fiscal 2021 budget, it plans to scrutinize all discretionary spending and will make expenditure reductions if they become necessary. The city's combined emergency reserve and unassigned general fund balance totals more than $15 million (approximately 44% of general fund budget), and as such, the city is not expected to encounter liquidity issues. Total available general fund balance at the end of last audited fiscal year was just under $14.4M.

CREDIT PROFILE

Vestavia residents benefit from the proximity to the city of Birmingham's deep, diverse and stable employment base built around the education and health service sectors. Vestavia's workforce is highly educated, with income levels more than double the Alabama median and well above the national level. The city's unemployment rate is well below both the state and nation.

The city is largely built-out and the population is stable. The city's tax base is diverse and stable with median home values more than double that of the county and state. Assessed value (AV) declined a moderate 7% throughout the recession, recovered to the prerecession peak as of fiscal 2016, and has continued to increase.

REVENUE FRAMEWORK

City operations are funded from a diverse mix of revenues. The largest source, sales tax, provides 39% of general fund revenue in fiscal 2018, followed by property taxes

(37%) and business licenses and permits (18%).

Fitch expects the pace of revenue, in the absence of policy action, to grow ahead of inflation consistent with historical results. Permit activity has been solid in recent years, with new investment continuing to come in strong with fiscal 2020 numbers to date already exceeding those of the full fiscal 2019. The grocery store Publix will be opening two additional 48 thousand sf stores in 2020, which should lead to growth in sales tax revenues. The impact of the coronavirus pandemic on sales tax revenues has been moderate to date but the long-term impact remains unknown.

The city has no independent ability to increase property taxes, as state law requires city approval, subsequent approval from the state legislature and voter approval during a municipal election. Other taxes and fees are more flexible − both sales tax and business tax rates are set by the council and there is no express constitutional or statutory maximum on the rates levied by the city. The city's current total sales tax rate of 10% (of which four percentage points is levied by the city) is equal to that of many surrounding localities and at the highest rate levied in the state, limiting the practical ability to increase the sales tax in the near term.

EXPENDITURE FRAMEWORK

Over half of the city's spending is for public safety expenditures, followed by public works at 23% and general government at 18% in fiscal 2018.

As with most local governments, Fitch expects the city's pace of spending will generally match or slightly exceed revenue growth. The high level of service delivery provided in the wealthy community will drive spending.

Total carrying costs for debt service, required pension contributions and other post-employment benefits (OPEB) contributions were 18% of total governmental fund spending for fiscal 2018. Carrying costs are primarily devoted to debt service. Overall carrying costs are expected to remain stable given an absence of additional borrowing plans in the city's capital improvement plan. The city's workers are restricted by state law from organizing, which Fitch believes contributes to a high degree of control over personnel costs.

LONG-TERM LIABILITY BURDEN

The city's long-term liability burden associated with overall debt and Fitch-adjusted net pension liabilities (NPL) is low at 5% of residents' estimated personal income, and Fitch expects the burden to remain stable. The primary driver of the metric is the city's direct debt, followed by the overlapping debt of Jefferson County. The city reports no other major capital needs beyond its current $58 million capital plan with the exception of some transportation projects that are expected to be supported from grants and existing capital funds.

The city participates in the Alabama Employees' Retirement System (ERS), an agent multiple-employer plan. The Fitch adjusted NPL utilizing a 6% investment return assumption shows a combined plan assets to liabilities ratio of 56%. Fitch notes the plan's use of a 30-year rolling amortization schedule and 7.75% investment return assumption will likely prolong the pension plan's weak funding position. The city annually makes the full actuarially determined contributions and the Fitch-adjusted NPL is equal to less than 1% of personal income as of fiscal YE 2018. The city's OPEB liability is very modest and manageable for the city, representing 0.02% of personal income in fiscal 2018. The plan is funded on a paygo basis from the city and from plan member contributions.

OPERATING PERFORMANCE

Fitch believes the city's superior level of budgetary flexibility combined with an available fund balance of $14.4 million in fiscal 2018 (35% of spending) provides the highest gap-closing capacity with which to absorb the financial shock resulting from the coronavirus outbreak and related economic downturn while maintaining strong financial resilience. The city's conservative formal reserve policy sets aside 25% of prior year spending as committed for emergency purposes.

The assumptions of Fitch's Analytical Stress Test (FAST) model, which relates historical tax revenue volatility to U.S. GDP to support assessment of operating performance under Fitch's rating criteria, has been updated to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. This scenario generated by the FAST model assuming a 5.6% GDP decline results in a first year decline of 9.4% in the city's general fund revenues. The FAST's outputs do not constitute a forecast and are an approximation of possible future revenue volatility for individual issuers to aid in peer comparability among issuers under Fitch's rating criteria. Fitch expects management will close any resulting budget gap stemming from the coronavirus with a mix of policy actions targeting both revenue enhancements and spending cuts.

The city has a significant history of conservative budgeting that produces operating surpluses while not deferring capital spending or other obligations. General fund reserves were maintained at 20% of spending or higher throughout the last recession and the city has bolstered reserves in seven out of the last eight fiscal years.

The fiscal 2020 approved budget was a 4% increase over the previous year. The fiscal 2020 budget of $46.1 million included merit increases and a 1% COLA, which together represented a 4.91% increase over the previous fiscal year. Similar to recent years, the budget was balanced without appropriating fund balance. Year-to-date revenues (the fiscal YE is September 30) are exceeding budget estimates through April. Management anticipates adding to general fund reserves at fiscal YE due to the positive year-to-date results and a conservative assumption for revenue collections through the remainder of the fiscal year. Fitch believes these projections are reasonable based on Fitch's retail sales tax stress scenario (34% decline annualized) and the city's sales tax base. The bulk of the city's sales tax payers are grocery and drug stores, which have performed reasonably well during the pandemic. Grocery sales including food purchases are taxable in Alabama, mitigating declines in other sales tax revenues. Vestavia Hills expects declines in its business license taxes and retail and restaurant sales activity will occur; however, the city is monitoring non-essential spending to help limit the overall impact on operations.

The fiscal 2019 budget of $44.4 million was the first budget to incorporate the one percentage point increase in the city's sales tax rate that was passed by the city council in April 2018. The new sales tax generated roughly $5 million (roughly 10%

of general fund revenues) in fiscal 2019, and is largely devoted to debt service for previously issued GO warrants, but by ordinance 25% of the revenues will also fund the capital reserves. Fiscal 2019 revenues came in $2.6 million ahead of budget according to 2019 draft audit numbers. The positive budget variance after transfers out led to a $2.1 million increase in general fund fund balance.

Given the preliminary results of the 2020 budget, the city is forecasting growth in fiscal 2021 revenues, barring a severe worsening of the pandemic in Vestavia. As such, the city is not planning on any major spending reductions; however, the formation of the fiscal 2021 budget is only in preliminary stages. Fitch expects management will continue to budget conservatively and scrutinize future discretionary spending helping to mitigate declines in the city's unrestricted reserve fund balance.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			F
Vestavia Hills (AL) [General Government]	LT IDR	AA+ Rating Outlook Stable	Affirmed	A C F
• Vestavia Hills (AL) /General Obligation - Limited Tax/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	A C F

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Vestavia Hills (AL)	EU Endorsed

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