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Fitch Rates Rhode Island's $144.7MM GO Bonds 'AA'; Outlook Negative Ratings

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Fitch Ratings-New York-07 May 2010: Fitch Ratings assigns an 'AA' rating to the following State of Rhode Island and Providence Plantations' general obligation (GO) bonds:

--$40.9 million consolidated capital development loan of 2010, series B (tax-exempt);
--$80 million capital development loan of 2010, series C (federally taxable-issuer subsidy-recovery zone economic development bonds);
--$23.8 million capital development loan of 2010, series D (federally taxable).

In addition, Fitch affirms the following ratings:

--$1 billion in outstanding GO bonds at 'AA';
--$232.8 million in outstanding appropriation-backed debt at 'AA-'.

The Rating Outlook is Negative.

The bonds are expected to sell via negotiation on or about May 10, 2010.

RATING RATIONALE:

--Rhode Island's economic performance has been among the worst of the states in the downturn. The most recent data suggests that the state's recovery, which is expected to be sluggish, has not yet begun. The state's real estate market continues to suffer.
--Longstanding financial controls remain in place, although the state's finances have been and continue to be strained, requiring significant one-time measures to resolve budget gaps.
--Debt ratios are above average, although still in the moderate range. Pension funding levels are low.

WHAT COULD TRIGGER A DOWNGRADE?

--The state's inability to implement sustainable budget solutions and address other long-term liabilities in the context of persistent revenue declines due to continued weakness in the state's economy.
--Continued deterioration in the state's economy and real estate market that further pressures financial flexibility.

SECURITY:

Bonds are general obligations of the State of Rhode Island and Providence Plantations, secured by a pledge of the state's full faith and credit.

CREDIT SUMMARY:

The Negative Rating Outlook, assigned in March 2009, continues to reflect Rhode Island's weak economy and severely strained financial position. After more than two years of severe job losses, Rhode Island's unemployment rate of 12.6% (March 2010) is among the highest of the states and well above the national average of 9.7%. Weak conditions in the economy and real estate market continue to pressure state revenues and challenge fiscal health and stability. After enacting a balanced fiscal 2010 budget, a fiscal 2009 deficit of approximately $62 million, and continued revenue declines as well as increased social service demands created a current year gap of $219 million. The fiscal 2011 budget gap is estimated at $427 million. While the governor has proposed plans to address both the fiscal 2010 and fiscal 2011 budget gaps, the state legislature has not yet resolved either proposal.

Rhode Island's economic performance throughout the recession has been amongst the weakest of the states. After adding jobs every year from 1992 through 2006, the state fell into the recession early, with year-over-year job losses beginning in August 2007. Although the pace of job loss has slowed somewhat in recent months, the March 2010 unemployment rate was high, at 12.6%, equal to 130% of the U.S. rate. The state's personal income indicators, although weak, have shown relative stability in the downturn, with the state's year-over-year quarterly declines not as severe as those of New England and the U.S. Per capita personal income is slightly above average; 2009 personal income equaled 104.8% of the U.S. The state's precarious economic environment is also exacerbated by real estate market conditions. After years of strong real estate market development and appreciation, Rhode Island has been seeing a steep market correction, with additional pressures from delinquencies, foreclosures, and subprime mortgages. The road to recovery in Rhode Island is projected to be long and slow, with some forecasts projecting continued declines in residential real estate for the next five years and other forecasts reporting that peak employment will not return until 2016.

Similar to Rhode Island's recent economic trends, the state's finances felt the effects of the recession early, with revenue declines beginning as early as November 2007. The state has used numerous measures to close budget gaps in recent years, including but not limited to steep cuts to state government spending and personnel, large cuts to local aid, utilization of federal stimulus money and other one-time solutions, implementation of pension reform, and increases to some fees and taxes. Fiscal 2008 closed with a deficit of approximately $43 million, even after deficit financing in the form of tobacco settlement bonds, and rather than utilize reserve funds, state officials opted to carry the shortfall into the fiscal 2009 budget. After enacting a balanced fiscal 2009 budget, declining revenues and increased expenditures resulted in a mid-year budget gap of roughly $360 million, which was subsequently closed with a combination of revenue measures, spending cuts, one-time solutions, and federal stimulus funds. Following downward revisions in the May 2009 consensus forecast, a new $70 million budget gap opened for fiscal 2009. After $22 million was appropriated from the state's reserve fund, the remainder was carried forward into the fiscal 2010 budget. At the close of fiscal 2009, the state's reserve carried a balance of $80 million, equal to 2.7% of revenues.

The enacted budget for fiscal 2010 totaled about $3.1 billion and resolved a budget gap of $553 million (roughly 18% of revenues) with a combination of federal stimulus funds, cuts to local aid, pension reform, and some undistributed savings and one-time measures. In the state's most recent economic forecast (November 2009), however, revenues were revised downward by $130 million for fiscal 2010; combined with increased spending for social services and the fiscal 2009 deficit, the current year budget gap stands at approximately $219 million, equal to 7.4% of estimated fiscal 2010 revenues. In December 2009, the governor presented a supplemental budget addressing the current year shortfall with cuts to local aid, additional pension reform, further reductions to state agencies, and one-time budget solutions (including land sales and delay of reserve fund replenishment). Discussions continue in both houses of the legislature, after the senate rejected the house budget bill at the end of April.

The May revenue estimating conference is currently underway and expected to end on May 10, 2010. Due to the recent flooding, the 2009 income tax return filing deadline was extended to May 11, 2010, which will make the analysis of actual income tax results as compared to forecast more difficult. At this time, state officials do not expect significant revenue revisions from the November 2009 forecast, as revenues through April are only 0.6% below the November estimate. Should actual income tax receipts vary widely from estimates made at the May 2010 conference, the three principals may exercise the option to reconvene.

In January 2010, the governor presented a budget for fiscal 2011 totaling $2.9 billion, which addressed a projected gap of $427 million. The governor's budget recommendations for addressing the substantial fiscal 2011 gap include $163 million in local aid cuts, $95 million in stimulus funds from two additional quarters of federal Medicaid reimbursement (FMAP), $32 million in other one-time solutions, and other cuts in state spending.

Fitch will continue to monitor the state's financial position and overall economy in light of recent and projected revenue declines. The state's ability to implement sustainable long-term budget solutions will be a key rating driver, and Fitch expects that the ability to achieve structural balance will become increasingly challenging as federal stimulus money is removed from the operating budget.

Rhode Island's debt ratios are on the high end of the moderate range, after increasing in fiscal 2009 with debt for transportation programs and bonding for the state's historic structures tax credit liability to provide budget relief. Net tax-supported debt of approximately $2.4 billion equals about 5.5% of personal income. Pension funding, at 60.9% as of June 30, 2008, is low, and the unfunded liability equals roughly 10% of personal income (2009). While the state has been successful in enacting some pension reform in recent years, the ability to address the low funding will be a significant long-term credit factor.

Applicable criteria available on Fitch's website at 'www.fitchratings.com' includes:

--'Tax-Supported Rating Criteria', dated Dec. 21, 2009.
--'U.S. State Government Tax-Supported Rating Criteria', dated Dec. 28, 2009.

Considerations for Taxable/Build America Bonds Investors

The following sector credit profile is provided as background for investors new to the municipal market.

State General Obligation Bonds:
The general obligation full faith and credit pledge is the broadest security a U.S. state government can provide to the repayment of its long-term borrowing, and therefore is the best indicator of its overall credit quality. State ratings generally fall within the two highest rating categories of 'AAA' or 'AA', with a few outliers. The top tier ratings reflect states' inherent strengths: states generally have broad economic and tax base resources and all possess sovereign powers under a federal government system, with substantial, although varying, control over revenue raising and spending. Given these inherent strengths, in only a few instances have the inability or unwillingness to address large financial challenges led to ratings below the 'AA' category. For additional information on State ratings, see U.S. State Government Tax- Supported Rating Criteria, dated Dec. 28, 2009.

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Additional information is available at www.fitchratings.com.