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Rhode Island & Providence Plantations

Credit Profile		
US$144.665 mil GO cap dev loan bnds ser 2010BCD due 04/01/2025		
Long Term Rating	AA/Negative	New
Rhode Island & Providence Plantations GO		
Long Term Rating	AA/Negative	Affirmed
Short Term Rating	NR	Withdrawn

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' rating to Rhode Island & Providence Plantations' general obligation (GO) bonds series 2010B-D. At the same time, we affirmed our 'AA' rating on Rhode Island's GO debt outstanding. The outlook is negative, reflecting continued significant pressures on state finances, despite substantial ongoing actions to balance the budget and the availability of federal stimulus funding.

In our opinion, the ratings reflect our view of the following strengths:

- Good income levels, with median household effective buying income at 103% of the national level; and
- Good geographic location near the economies of eastern Massachusetts and eastern Connecticut.

In our view, offsetting factors include Rhode Island's:

- Projected budget gaps for fiscal 2010 and continued gaps of at least 12% through fiscal 2015, which could grow if economic conditions weaken more than current projections;
- A multiyear trend of revenues falling below projections, resulting in general fund deficits in fiscals 2007 through 2009 and year-end fund balances below statutory requirements; and
- Sizable unfunded pension liability (despite some relief following fiscal 2006 pension reform measures).

The GO bonds are secured by the state's full faith and credit. Rhode Island expects to issue the series C bonds as taxable Recovery Zone bonds, with the expectation of receiving a federal subsidy for the interest payments, although the state pledges to make the gross debt payments. The state will use the proceeds of this issue for various capital projects.

Rhode Island's most recent revenue and expenditure projections from November 2009 resulted in a $219 million budget gap for fiscal 2010, equal to 7% of revenues, and an $427 million gap for fiscal 2011, equal to about 15% of revenues. The governor and the state's House and Senate have produced their own versions of supplemental budgets to close the budget gap, but no supplemental budget has been approved yet.

The governor's supplemental 2010 budget proposes to close the gap primarily through expenditure reductions, the largest of which would be $42.8 million of pension savings by eliminating an automatic cost of living adjustment (COLA) for future retirees. This COLA elimination was previously proposed by the governor but not approved by the General Assembly. The supplemental budget also reduces local aid by $38 million and includes significant one-time savings, including a $22 million deferral of a repayment due to the state's capital expenditure fund, $21.3 million of property sales, and an acceleration of $27 million of federal stimulus stabilization funds to fiscal 2010 from fiscal 2011, which would increase the budget gap for fiscal 2011. Although state officials have demonstrated a willingness to make significant budget adjustments in previous years, additional substantial actions will be required to bring the state's budget into structural balance. Rhode Island was able to make significant expenditure reductions in fiscal 2008 and the fiscal 2009 enacted budget, but enacted limited revenue increases.

The proposed fiscal 2011 budget closes a $427 million gap (equal to 15% of revenues) primarily through $318 million of expenditure reductions, the largest of which are the elimination of a motor vehicle excise subsidy to local governments ($135 million) and savings from pension reform ($45 million). The governor has proposed allowing local governments to increase the motor vehicle excise tax sufficient to offset the state reduction. The proposed budget also includes an assumption that the federal Medicaid Assistance Program (FMAP) funding will be extended for six months to the end of fiscal 2011—which officials project to generate $95.2 million—and also proposes a $31 million bond issue to fund the fiscal 2011 cost of a historic properties tax credit. The 2011 proposed budget includes full actuarial funding of other postemployment benefits costs, which represents a $7.9 million increase from the projected pay-as-you-go cost for the general revenue budget. The state issued $350 million of tax anticipation notes for fiscal 2010, and officials project that these proceeds will be sufficient to support the state's cash flow needs for the fiscal year. The largest general revenue sources are the personal income tax and the sales and use tax; in fiscal 2009, these accounted for 58% of general revenues.

Rhode Island's long-range financial plan projects continued large budget gaps through 2015, the final year of the plan. The projected gaps are: $362 million for fiscal 2012 (12% of revenues); $416 million for fiscal 2013 (14%); $457 million for fiscal 2014 (16%); and $536 million for fiscal 2015 (18%).

Rhode Island's unemployment rate was 12.7% in February 2010, the third-highest rate in the nation, after peaking at 13.0% in September 2009. IHS Global Insight projects that employment losses in the state will continue until second-quarter 2010. In the last quarter of 2009, the annualized rate of job losses in the state was 2.9%, about equal to the third-quarter rate. The largest job losses were in construction, with an 11.2% year-over-year decline as of January 2010, and manufacturing, with a 10.5% year-over-year decline. In the past five years, the state's population has declined by 1.1%, to 1.06 million in 2008. State income levels have historically been on par with the nation's; in 2008, the state's household and per capita effective buying income levels were 103% and 104% of the national level, respectively.

Standard & Poor's considers Rhode Island 's financial management practices "strong" under its Financial Management Assessment methodology, indicating practices are strong, well embedded, and likely sustainable.

As of June 30, 2008, Rhode Island had $1.85 billion of net tax-supported debt, of which 56% was direct debt and 34% was subject to annual appropriation. The state's tax-supported debt was equal to 4.3% of personal income. In recent years, Rhode Island improved its debt ratios by defeasing debt with the proceeds of a $685 million tobacco securitization. The state has no exposure to variable-rate debt and no exposure to interest-rate swaps.

Outlook

The negative outlook reflects continued significant pressures on state finances, despite substantial ongoing actions to balance the budget and the availability of federal stimulus funding. We believe that additional economic deterioration beyond the state's current projections could further reduce economically sensitive revenues and make the achievement of structural budget balance more difficult. The way that eventual budget gap solutions are constructed will be an important component of our view of Rhode Island's creditworthiness. We could lower the rating if the state is not able to adopt long-term budget solutions that make significant movement toward structural budget balance.

Finances

Constitutional changes to reserves

In November 2006, state voters approved changes to the level and use of some of the state's reserve funds. Through fiscal 2008, the level of the budget reserve and stabilization account was set at 3% of resources, which is funded by limiting appropriations to 98% of estimated revenues. Once the stabilization account is fully funded, excess contribution goes into the Rhode Island Capital Fund annually. The constitutional changes increased the level of the reserve account to 5% of resources, to be funded by limiting appropriations to 97% of estimated revenues. In fiscal 2010, appropriations are limited to 97.6% of estimated revenues and the reserve fund will be capped at 3.8% of expenditures, and these levels will increase annually by 0.2% and 0.4%, respectively, until the constitutional levels are met in fiscal 2013. Through fiscal 2006, the state consistently maintained its statutory "rainy-day fund" at its legal maximum of 3% of revenues; this maximum level will increase over time to 5% due to a voter-approved constitutional amendment. However, the reserve was drawn down below the 3% level in fiscals 2007 through 2009.

Pensions: Growing unfunded liabilities despite reforms

Although the state achieved significant pension reform in 2005, its pension funding ratio has been declining. Rhode Island's funding ratios are among the lowest of any of the 50 states. As of June 30, 2008, which is the latest actuarial valuation, the Rhode Island Employees' Retirement System and the

State Teachers' Retirement System were 58% and 55% funded, respectively, with a combined unfunded actuarial accrued liability of $4.85 billion. With the changes put into place in fiscal 2006, the pension system is projecting to attain fully funded status in 2029, which is sooner and less costly than projected before the pension reforms, although this valuation does not account for market value losses at the end of calendar 2008. The governor has proposed significant changes to the pension system, such as eliminating COLA, in his fiscal 2010 supplemental budget request and fiscal 2011 proposed budget, but the legislature has not acted on these proposals.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of 10-May-2010)		
Rhode Island & Providence Plantations GO (FGIC)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Rhode Island & Providence Plantations GO (MBIA) (AMBAC)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Rhode Island & Providence Plantations GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.