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# New Issue: MOODY'S ASSIGNS Aa2 RATING AND STABLE OUTLOOK TO STATE OF RHODE ISLAND GENERAL OBLIGATION BONDS SERIES 2010 B, C, AND D

**Global Credit Research - 07 May 2010**

**APPROXIMATELY $1 BILLION GENERAL OBLIGATION BONDS OUTSTANDING RATED Aa2 WITH STABLE OUTLOOK**

Rhode Island (State of)
State
RI

**Moody's Rating**

| ISSUE | | RATING |
|---|---|---|
| General Obligation Bonds Consolidated Capital Development Loan of 2010, Series B (Tax Exempt) | | Aa2 |
| **Sale Amount** | $40,865,000 | |
| **Expected Sale Date** | 05/11/10 | |
| **Rating Description** | General Obligation | |
| General Obligation Bonds Capital Development Loan of 2010, Series C (Federally Taxable -Issuer Subsidy - Recovery Zone Economic Development Bonds) | | Aa2 |
| **Sale Amount** | $80,000,000 | |
| **Expected Sale Date** | 05/11/10 | |
| **Rating Description** | General Obligation | |
| General Obligation Bonds Capital Development Loan of 2010, Series D (Federally Taxable) | | Aa2 |
| **Sale Amount** | $23,800,000 | |
| **Expected Sale Date** | 05/11/10 | |
| **Rating Description** | General Obligation | |

**Opinion**

NEW YORK, May 7, 2010 -- Moody's Investors Service has assigned a Aa2 rating with a stable outlook to the State of Rhode Island's $40.865 million General Obligation Bonds Consolidated Capital Development Loan of 2010, Series 2010 B (Tax Exempt), $80 million General Obligation Bonds Capital Development Loan of 2010, Series C (Federally Taxable - Issuer Subsidy - Recovery Zone Economic Development Bonds), and $23.8 million General Obligation Bonds Capital Development Loan of 2010, Series D (Federally Taxable). The state plans to sell the bonds the week of May 10. Proceeds of the Series B bonds will be used for a variety of statewide projects while the Series C and D bonds will be used for transportation and affordable housing, respectively.

The Aa2 general obligation rating incorporates Rhode Island's institutionalized governance practices; maintenance of modest but positive general fund balances, including a fully funded budget reserve fund (BRF); narrow liquidity; and a weakened economy whose recovery is likely to lag the nation and thereby create continuing financial challenges for the state. Since fiscal 2007, before the current recession took hold, Rhode Island has faced persistent revenue under-performance and spending challenges. As a result, Rhode Island had to address increasingly larger budget gaps at a time when many other states were revising revenue estimates upward and rebuilding reserves as they recovered from the 2001 recession. In the past several years, Rhode Island has balanced its budgets with one-time solutions and increased its short-term borrowings for cash flow purposes. This raises concern regarding the state's likelihood of achieving structural budget balance in the near term, especially given the identified budget gaps for fiscal 2010 and forecast for fiscal 2011 as the state's economy remains weak.

Credit strengths are:

*Institutionalized governance practices such as bi-annual revenue estimating conferences and out year budget planning

*History of maintaining budget reserve fund at constitutional cap

*Improved debt ratios reflecting debt reduction policies

* Wide legal powers--similar to other state governments--to raise revenue and adjust spending in order to maintain fiscal solvency.

Credit challenges are:

*Consecutive budget gaps for fiscal years 2007 through 2010, and forecast for fiscal 2011, due to revenue underperformance and continuing spending pressures

*Past reliance on one-time budget solutions contributes to recurring budget shortfalls

*Combined available reserves reduced to resolve fiscal years 2007 through 2009 budget shortfalls

*Consecutive years of cash flow borrowing and slim cash margins underscore state's reduced liquidity

*Above average job losses in all sectors and very high unemployment rates undermine Rhode Island's overall economic growth prospects.

*Low pension funding ratios

STATE FACES $219 MILLION MID-YEAR BUDGET GAP FOR FISCAL 2010

The impact of Rhode Island's multi-year economic deterioration on the state's financial position is evident in the large budget gaps that have emerged following consecutive downward revenue revisions. The latest Revenue Estimating Conference (REC) projections (November 2009) show a budget shortfall of $219 million in the current year (fiscal 2010) budget, representing about 7% of general fund revenues. This follows a more substantial $553 million gap (about 18%) that the state addressed when the fiscal 2010 budget was adopted.

The legislature continues to deliberate the supplemental fiscal 2010 budget proposed by the governor to resolve the latest shortfall. The plan includes approximately $163 million in ongoing expenditure savings that from local aid cuts ($86 million), additional pension reforms ($41 million), and agency reductions ($21 million). As it has in recent years, Rhode Island would continue to rely on one-time budget solutions. The governor's plan has $65 million in one-time funds, including several land/property sales totaling $21 million and a $22 million deferral of the state's annual contribution to its capital fund for pay-as-you-go capital financing. The deferral requires legislative approval and the governor's fiscal 2011 budget plan includes a further deferral of the repayment until fiscal 2012. The continuing delay in the adoption of a supplemental budget for fiscal 2010 raises concerns about the likelihood of achieving ongoing expenditure savings with less than two months left in fiscal year 2010.

STATE FACES $427 MILLION GAP PROJECTED FOR FISCAL 2011

As revenues continue to under perform, many states have identified large budget gaps for fiscal year 2011. Rhode Island's projected $427 million budget shortfall for fiscal 2011 is sizeable at about 15% of general fund revenues, though not quite as big as the 18% gap that the state faced going into fiscal year 2010. The governor's budget proposal for fiscal 2011 includes recurring as well as one-time actions to balance the budget. There are no new taxes in the plan, although there are some tax credits aimed at providing tax relief to small businesses in the state. On the spending side, the governor has proposed the suspension of payments to reimburse municipalities for the state's $6,000 exemption on the motor vehicle excise tax. This would reduce local aid but save the state $135 million. If adopted as presented, the plan would allow municipalities to levy a supplemental tax to recover the lost revenues.

The governor also seeks to expand pension reforms by eliminating automatic cost of living adjustments (COLA). This would result in $45 million in expenditure savings in fiscal 2011. The governor's plan also includes additional furlough days to save $9 million in salaries in fiscal 2011 and a delay in the negotiated 3% COLA for state employees which would reduce salary costs by $10 million next year.

As in many states, Rhode Island relied heavily on the federal stimulus funds to bridge the gap between revenues and expenditures in fiscal years 2009 and 2010, and will continue that practice in fiscal 2011. The governor's plan reflects the use of $27 million in federal stabilization funds for K-12 education and a total of $191 million in Federal Medical Assistance Percentage (FMAP) money. However, $95 million of the FMAP money would come from an extension of the FMAP funding that has not yet been approved. Future credit reviews will focus on the state's plans for the eventual fall off in these one-time resources while also making progress toward the restoration of structural budget balance and rebuilding reserves drained during the recession. Rhode Island's out year estimates show sizeable budget gaps beginning with a $362 million deficit in fiscal 2012, reflecting the magnitude of the recession's impact on the state, the significant use of one-time actions that were taken to balance recent budgets, and a prolonged period of economic recovery relative to the nation.

TIGHT LIQUIDITY REFLECTS SIGNIFICANTLY REDUCED, THOUGH STILL POSITIVE, COMBINED AVAILABLE RESERVES

Reduced budget reserve fund levels have put a strain on Rhode Island's liquidity position. The state issued $120 million in cash flow notes in fiscal year 2007. Cash flow borrowings have grown substantially in the past several years, to $220 million issued in fiscal year 2008 and $350 million in fiscal years 2009 and 2010 due to further tightening of cash flow margins evident in reduced ending cash balances. The state finished fiscal 2009 with an ending cash balance of approximately $83 million after repayment of the 2009 notes, somewhat higher than the $50 million to $60 million initially projected. While not required, the state arranged a set-aside schedule for the notes as a precautionary measure. Satisfactory cash margins for the outstanding notes are dependent upon resolution of the state's fiscal 2010 budget gap.

STATE DEBT BURDEN SIGNIFICANTLY REDUCED, BUT REMAINS ABOVE AVERAGE

Rhode Island's debt burden has dropped considerably over the past 10 years, although the state's debt ratios remain above average. Total tax-supported debt for the 2009 median calculation was $1.9 billion, a modest increase from the prior year's level of $1.87 billion but the third consecutive increase in the state's debt level. Net tax-supported debt was 4.5% of total state personal income, ranking it 12th in the nation, up one notch from 2008. While still notably higher than Moody's 2009 50-state median of 2.5%, Rhode Island's debt burden remains well below the near 9% level the state experienced in the early 1990s. Rhode Island's debt per capita is also above average at $1,812 ranking it 9th, the same as last year. The 2009 median debt per capita for states was $865. These improved debt ratios reflect deliberate debt reduction policies, increased pay-as-you-go capital funding, as well as gains in personal income. The state also applied $295 million of its 2002 tobacco bond proceeds to the defeasance of outstanding general obligation bonds and certificates of participation for debt service savings.

Rhode Island has a modest amount of variable rate debt outstanding ($1.1 million) in economic development debt issued for the McCoy Stadium in the City of Pawtucket, for which the state receives modest payments from related ballpark revenues. The bonds are supported by a letter of credit with Bank of America. While the state's cash position is narrow, cash balances are sufficient to cover expenses on the variable rate debt should the need arise. The state has no exposure to derivative products.

PENSION FUNDING STATUS REMAINS LOW

Rhode Island's pension funding ratios are low relative to other states, but improved slightly between 2007 and 2008. For the state employees' pension fund, the funded ratio increased from 57.5% to 61.8% during the period July 1, 2007 to June 30, 2008. Similarly, the teachers' retirement system improved from 55.4% to 60.3% over the same period. While improved, the funding levels are well below the state's June 1999 funded ratio of about 84%. Together, state employee and teachers' plans make up about 86% of the state's pension programs. While the annual required contribution has been fully funded since the early 1980s, past generous retirement incentives and weak investment returns have contributed to below average funded ratios. The state employs a five-year smoothed market asset valuation and contribution rates are deemed sufficient to amortize the unfunded liability over a 30-year period which began in 1999. Pension reforms enacted in 2006 and following years should improve the state's pension funding position over time, although these do not apply to all employees. In addition, the state's pension funding ratios may decline further as market losses are factored into more current valuations. As a result, the state may need to increase its annual pension contributions, an additional expense that would compound the state's spending pressures at a time of rising health care costs and the state's tight financial position.

Rhode Island's unfunded liability for other post employment benefit costs (OPEB) is estimated at approximately $788 million as of June 30, 2007. This amount includes $680 million for state employees, $55 million for state police, $30 million for legislators, $14 million for judges, and $10 million for the state's share of teacher's OPEB costs. The state funded its OPEB obligation for fiscal year 2009 on a pay-go basis for current benefits to retirees. The $37.9 million contribution was slightly below ($4.2 million) the annual required contribution of $42 million. The legislature has delayed the actuarial funding of the state's OPEB costs until fiscal 2011 due to current budget constraints.

ECONOMY REMAINS WEAK WITH JOB LOSSES EXCEEDING NATIONAL AVERAGE

Rhode Island's year-over-year monthly total non farm job losses averaged 4.8 % in calendar year 2009, somewhat worse than the national pace of negative 4.3% last year. In March, Rhode Island's unemployment rate was 12.6%, well above the 9.7% level for the nation the same month. Still, the level has remained slightly below Rhode Island's previous peak of 13% in September 2009.

Rhode Island's manufacturing sector continues a decline that began more than a decade ago. There are also continuing losses in the construction sector reflecting weakness in Rhode Island's housing market, one of the hardest hit in the country. In 2009, Rhode Island lost jobs in all major sectors and the state's education and health services sector was essentially flat while it continued to grow in most other states.

Subprime exposure and foreclosure rates in Rhode Island have been well above average and will likely limit the state's overall economic growth in the near term. However, there are some positive signs with indications that early delinquency rates may be stabilizing and foreclosure rates slowing. As in many other states, the commercial real estate sector is weakening and could provide a drag on economic recovery once the residential housing market begins to improve.

LAST RATING ACTION AND METHODOLOGY

The last rating action was on April 1, 2010 when Moody's assigned a Aa3 general obligation rating to the State of Rhode Island's General Obligation Consolidated Capital Development Loan of 2010, Refunding Series A.

The principal methodology used in rating the State of Rhode Island's debt was Moody's State Rating Methodology, published in October 2004 and available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

RECALIBRATION OF RATING TO THE GLOBAL RATING SCALE

The rating assigned to the State of Rhode Island General Obligation Bonds Consolidated Capital Development Loan of 2010, Series 2010 B (Tax Exempt), General Obligation Bonds Capital Development Loan of 2010, Series C (Federally Taxable - Issuer Subsidy - Recovery Zone Economic Development Bonds), and General Obligation Bonds Capital Development Loan of 2010, Series D (Federally Taxable) was issued on Moody's global rating scale. Market participants should not view the recalibration of municipal ratings as rating upgrades, but rather as a recalibration of the ratings to a different rating scale. This recalibration does not reflect an improvement in credit quality or a change in our credit opinion for rated municipal debt issuers. For further details regarding the recalibration of Moody's U.S. municipal ratings to its global scale please visit www.moodys.com/gsr

**Outlook**

Rhode Island's credit outlook is stable reflecting Moody's expectation that the state will make appropriate adjustments as needed to restore balance. The state's ability to make progress toward structural budget balance and improve its liquidity will be important to future credit analyses.

What would make the rating move - UP

*Maintenance of stronger reserve levels

*Sustained economic improvement at least in line with national average based on various metrics including job growth

*Restoration and maintenance of structural budget balance

What could change the rating - DOWN

*Failure to adopt a plan to cover expenditures once federal fiscal stimulus monies are no longer available

*Deterioration of state's reserve and balance sheet position

* Persistent economic weakness indicated by lack of employment recovery when the rest of the nation rebounds

*Increased liquidity pressure reflected in narrower cash margins, increased cash flow borrowing, or a shift toward tactics such as delayed vendor or other payments to gain short-term liquidity relief

*Continued significant reliance on one-time budget solutions, particularly deficit financing

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