



AQUILA
GROUP OF FUNDS®

DEVELOPMENTS IN CENTRAL FALLS, RI

August 3, 2011

Aquila Group of Funds - Our Perspective

On August 1, 2011, Central Falls, RI filed for bankruptcy under Chapter 9 of the Federal Bankruptcy Code. This was a rare move for a municipality, and municipal bond market analysts believe it is likely to remain uncommon. According to Jim Spiotto, a partner at Chapman and Cutler LLP and an expert on municipal bankruptcy, only 47 municipalities or counties have filed for bankruptcy since 1980 versus over 14,000 U.S. corporate bankruptcy filings in 2010.

There are some observers and investors who view these developments with a bit of relief, since they bring Central Falls closer to resolution of its financial problems. Given the requirements associated with a Chapter 9 filing, and the alternatives available to local governments, other municipalities in Rhode Island are not expected to follow a similar path. The circumstances leading up to the Central Falls filing had been well publicized, and there has been no apparent market reaction as of the August 2nd close.

Narragansett Insured Tax-Free Income Fund portfolio managers, Sal DiSanto and Jeff Hanna, are based in Rhode Island where they closely monitor tax-exempt issuers and the economic factors which impact those issuers. The Fund does not hold, and has not previously held, bonds issued by Central Falls, although developments related to debt issued by the municipality are being followed.

Within the Aquila Group of Funds, the investment strategy pursued by Narragansett Insured Tax-Free Income Fund is focused on high-quality general obligation and essential service revenue bonds, 90% of which are insured, with an intermediate portfolio maturity. In our view, this strategy facilitates our pursuit of the objectives of providing as high a level of current income exempt from state and Federal income taxes, as is consistent with capital preservation. We plan to continue investing prudently in pursuit of these objectives, and appreciate the opportunity to serve the investment needs of fund shareholders.

Background

Central Falls, the smallest city in Rhode Island, has struggled with under-funded pensions, and had previously attempted to negotiate reductions in pension and healthcare benefits with police, firefighters, and municipal employees, as an alternative to the bankruptcy filing.

The Chapter 9 filing came about after Robert G. Flanders, the state-appointed receiver and a retired state Supreme Court justice, was unable to negotiate significant concessions from unions representing police officers, firefighters and other city employees. In a public statement, Flanders said that in order to get "immediate savings" he was seeking federal court authority to reject collective-bargaining agreements with the city's employees. Under the bankruptcy filing, Flanders voided the police, fire and municipal employee contracts, will impose cuts to retired police and firefighter pensions to save \$2.5 million, and will begin

requiring that retirees and active employees pay 20% of their health-insurance coverage. Layoffs may also occur, but none have yet been announced.

Flanders stated that “Services have been cut to the bone. Taxes have been raised to the maximum level allowable. From the ashes of bankruptcy, Central Falls will rise again – a slimmer, sleeker city ready to stand on its own two legs as an independent municipality or to merge, marry or consolidate services with one or more of its neighbors.”

In July, Rhode Island passed legislation (Chapter 269, 2011, H 5736 Substitute A, Enacted 07/12/11) giving bondholders certain rights that ensure they will be fully repaid even in the event of bankruptcy. With that legislation in place, a Rhode Island government entity may not necessarily lose future access to capital markets, even after filing under Chapter 9. The legislation could be tested in bankruptcy court. The Central Falls case has been assigned to bankruptcy Judge Frank J. Bailey who set a status conference on August 3rd in federal bankruptcy court, Providence.

In June, Moody’s downgraded Central Falls to Caa1, which is 7 steps below investment grade, on concerns that the city and its public-safety pension plans would not be able to achieve financial stability. The rating agency has indicated that it will follow the bankruptcy court proceedings before making a further determination on the Central Falls rating.