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# Moody's Affirms Rating and Revises Outlook for Rhode Island

May 31, 2011



Credit rating agency, Moody's Investors Services, affirmed their Rhode Island general-obligation bond rating of Aa2 and revised their outlook to negative from stable. The change was announced by the agency on May 31st. Moody's also affirmed the Aa3 rating on Rhode Island appropriation debt and certificates of participation. Earlier in May another credit rating agency, Standard & Poor's Rating Services (S&P), affirmed their AA rating on Rhode Island debt (comparable to Moody's Aa2 rating), while improving their outlook from negative to stable.

## Moody's bond rating scale

The ratings assigned by Moody's are displayed here. The Aa2 rating is the third highest of 21 ratings in the Moody's scale, and applies to the mid-tier of their High Grade category. Investment grade bonds are those in the 10 highest rating categories, ranging from the highest, AAA, to the lowest investment grade rating which is Baa3.

## Budget issues

In revising their outlook on Rhode Island, Moody's cited the potential impact of rapidly escalating pension costs on the ability of the state to increase liquidity margins, diminish reliance on one-time measures to balance the state budget, and reduce the state's debt burden. The improved S&P ratings outlook reflects the firm's positive view of the state's financial management procedures. At the same time, S&P expressed concerns that the state's underfunded pension system will have a negative impact on the state's rating, if funding levels fall further

## Improvements and remaining challenges

Revenue collections have grown through April, 2011 versus the same period in FY 2010, with personal income taxes up 14% and total taxes up 7.7%. The Revenue Estimating Conference, in May, raised the FY 2011 forecast of total general revenues by 1.8% versus the November, 2010 projection, which represents over \$44 million. Throughout the recent recession, Rhode Island has maintained positive budget reserve account balances, which by state constitution, are required to represent 3% of revenue, phasing to 5% by 2013. Rhode Island tax-supported debt as of the 2011 calculation was 5.3% of total state personal income, which is higher than the 50-state median of 2.8%, but much lower than the 9% level reached in the early 1990s.

Funding for state employee pensions and other post employment benefits (OPEB) continues to present challenges for Rhode Island. The state's pension funded ratio, currently at 48%, is low relative to other states. Poor investment returns have contributed to a shortfall, and recent pension reforms have not had a significant impact on the liability. Recently adopted revisions to the actuarial assumptions used by the state retirement system will roughly double the state's required annual contribution, beginning in 2013. As of FY 2011, the state began funding OPEB on an actuarial basis rather than a pay-as-you-go basis. While unemployment in the state has declined slightly over the past year, it remains the highest in the nation at 10.9% as of April.

Moody's indicated that future credit analysis would improve in the event that state reserve levels are maintained, job growth and economic improvement aligns with national averages, and officials are able to restore and maintain structural budgetary balance. Factors that would have a negative impact on credit analysis were identified as a failure on the part of officials to address debt and pension liabilities, deterioration in state reserves and the balance sheet, economic weakness in the state in an environment of an improving national economy, and continued significant reliance on short-term budget strategies.

## Market reaction

There was little immediate market reaction to the change in outlook by the rating agencies. In addition, there has not been any material widening of yield spreads in the following market sessions.

Moody's Long-Term Bond Ratings	
1	Aaa Prime
2	Aa1
3	Aa2 High Grade
4	Aa3
5	A1
6	A2 Upper Medium Grade
7	A3
8	Baa1
9	Baa2 Lower Medium Grade
10	Baa3
11	Ba1 Non-Investment Grade
12	Ba2 Speculative
13	Ba3
14	B1
15	B2 Highly Speculative
16	B3
17	Caa1 Substantial Risks
18	Caa2 Extremely Speculative
19	Caa3 In Default with Little
20	Ca Prospect for Recovery
21	C In Default

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**Potential to motivate legislators**

The recent reports from both S&P and Moody's have the potential to serve as additional motivators to Rhode Island legislators in their efforts to resolve some of the difficult budgetary issues. Rhode Island officials are mobilizing to address the situation and plan to convene a special session on pension reform in October 2011.

**Narragansett Insured Tax-Free Income Trust**

In managing Narragansett Insured Tax-Free Income Trust, we continually monitor developments in the local economy and the impact those developments have on issuers of tax-exempt bonds in the state. We continue to pursue the objectives of the Trust; to provide as high a level of current income exempt from Rhode Island state and regular Federal income tax, as is consistent with preservation of capital.