MOODY'S
INVESTORS SERVICE

Rating Action: Moody's places Central Falls' (RI) Caa1 general obligation rating on review for upgrade, affecting $14 million in outstanding debt

Global Credit Research - 29 Jun 2012

RIHEBC 2007B pool Ba1 rating affirmed and stable outlook assigned, affecting $17 million

New York, June 29, 2012 --

Moody's Investors Service has placed the City of Central Falls' (RI) Caa1 general obligation rating on review for upgrade, affecting $14 million in outstanding General Obligation bonds. Moody's has also affirmed the Ba1 rating assigned to the Rhode Island Health and Educational Building Corporation's (RIHEBC) Series 2007B bonds, affecting $17 million in outstanding debt, and assigned a stable outlook.

SUMMARY RATINGS RATIONALE

The review for upgrade reflects the increased likelihood that the city will exit Chapter 9 bankruptcy after the Rhode Island General Assembly's recent appropriation of transitional payments to retirees and the filing of an updated bankruptcy plan in federal bankruptcy court. The city has continued to make general obligation debt service payments subsequent to the bankruptcy filing and there have so far not been any challenges to these payments by other creditors. The review will consider the terms of the final bankruptcy plan, any last-minute challenges to the plan by creditors, and the city's plan to balance its operating budget going forward, including payment of debt service as well as pension contributions and OPEB payments. We expect to conclude our review within the next 90 days.

The Ba1 pooled financing rating and stable outlook assigned to RIHEBC's 2007B bonds incorporates Central Falls' Caa1 GO rating as well as the city's limited (6.6%) portion of the pooled debt. The significant amount of debt service (34.22% of the pool) directly paid to RIHEBC by the state and the availability of the State of Rhode Island's (GO rated Aa2/negative outlook) intercept of state aid for the remainder of the participants' debt service provide strong additional security and lifts the pool rating above the weakest link rating of Caa1. Additional factors incorporated in the Ba1 rating are the strong mechanics, included in the RIHEBC pool agreement, historic state support for school construction projects, and RIHEBC's ability to intercept certain state aid related to construction of school facilities. Proceeds from the 2007B bonds were originally loaned to the four participating units of government to fund various school capital improvement projects.

STRENGTHS

-Active state oversight of the city's bankruptcy proceedings, financial operations and cash flow with state legal default protection

-Ratified collective bargaining agreements between the city and its unions

-Implementation of city's six-year plan which balances budgets from fiscal 2013 through fiscal 2017

-Improved, but still stressed, financial position and adequate liquidity

-Expected transfer of locally-administered pension plans to state's Municipal Employee Retirement System (MERS)

-The state's ability to intercept aid due to the city to mitigate potential bondholder losses

CHALLENGES

-Ongoing bankruptcy proceedings that could affect payment of general obligation debt

-High unfunded pension liabilities, despite significant reductions

-Small tax base and weak demographic profile

OUTLOOK

The review for upgrade reflects the city's progress toward conclusion of bankruptcy proceedings after several significant obstacles were cleared. The Rhode Island General Assembly appropriated $2.6 million for transitional payments to retirees, which is intended to ease the severe reductions negotiated in bankruptcy proceedings. Additionally, an updated plan of adjustment and six-year financial recovery plan have been filed by the city's receiver with the US bankruptcy court. If the city's plans are approved, as submitted, by the bankruptcy judge, the city will exit bankruptcy but would remain under some form of state oversight for at least five years, another positive factor. The review will incorporate the timing and outcome of bankruptcy proceedings, as well as the city's fundamental long-term credit characteristics, which remain stressed.

WHAT COULD MAKE THE RATING GO UP:

-Timely of approval bankruptcy plan

-Exit from bankruptcy and maintenance of structurally balanced operations

-Improved funding for long-term liabilities

WHAT COULD MAKE THE RATING GO DOWN:

-Prolonged bankruptcy proceedings that result in further financial deterioration and risk of default

-Significant changes to bankruptcy plan resulting in structural imbalance

-Inability to improve funding of long-term liabilities including pension and health care

-Successful legal challenges to state legislation providing priority lien for bondholders

RATING METHODOLOGY

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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