MOODY'S
INVESTORS SERVICE

Rating Update: Moody's affirms Baa2 on West Warwick, RI's $22M in outstanding GO debt; outlook stable

Global Credit Research - 07 Aug 2015

Affirms A1 enhanced rating

WEST WARWICK (TOWN OF) RI
Cities (including Towns, Villages and Townships)
RI

NEW YORK, August 07, 2015 --Moody's Investors Service has affirmed the Baa2 rating for West Warwick, RI's general obligation bond ratings. The outlook remains stable. Concurrently, we have affirmed the A1 enhanced rating with a stable outlook for the Rhode Island Health & Educational Building Corporation's Public Schools Revenue Bond Financing Program, Series 2014 A (Town of West Warwick Issue).

SUMMARY RATING RATIONALE

The Baa2 rating takes into account the town's moderately sized tax base, narrow financial position, manageable debt burden and average wealth levels. The rating also factors in the town's large pension and OPEB liabilities.

The A1 enhanced rating with a stable outlook is based on the Rhode Island Health and Educational Building Corporation (RIHEBC) monthly pay Intercept Program. As the RIHEBC monthly pay Intercept Program is a state-backed enhancement program, its rating is based on the state's Aa2 general obligation rating and stable outlook. For additional information regarding the State of Rhode Island's Aa2 rating, please see Moody's New Issue Report dated July 8, 2015. The state provides approximately 58% state building aid on outstanding school issuances.

OUTLOOK

The outlook is stable. The town just finished the 1st year of its five-year recovery plan in fiscal 2015 and the outlook assumes that the town will continue its efforts to maintain adequate reserve levels and to address its large pension and OPEB liabilities through the full funding of its pension OPEB liabilities.

WHAT COULD MAKE THE RATING GO UP

- Improvement in reserve levels

- Continued full funding of the town's pension and OPEB liabilities

- Material increase in taxable value

WHAT COULD MAKE THE RATING GO DOWN

- Erosion of reserve levels

- Underfunding of the town's pension plan annual required contribution

STRENGTHS

- Presence of the 5-year financial recovery plan

- Increased funding of pension and OPEB liabilities

- Improved financial position of School Unrestricted Fund

CHALLENGES

- Large pension and OPEB burden

- Weak reserve levels

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: MODERATELY SIZED TAX BASE WITH AVERAGE WEALTH LEVELS

The town's moderately sized $2.1 billion tax base has begun to stabilize following declines due to the regional real estate market downturn. After strong tax base growth through 2007, AV declined by a cumulative 25% through 2012. Values in 2013 and 2014 increased by a modest 1.4% and 0.8%, respectively. Furthermore, the city reports several economic development projects (both residential and commercial) underway in various stages of development, spurring some tax base growth in the near to medium term. The city's building permit values grew to $12.2 million in 2014 and $17.1 million in 2015, rebounding close to 2007 levels ($17.6M). The tax base is primarily residential (almost three-quarters of assessed value), but has a healthy commercial and industrial presence (15%).

Wealth levels for the city are average, with the town's median family income representing 103.7% of the national levels. Full value per capita is an average $70,604.

Like the state, the town's unemployment rate has dropped sharply from last year. The town's unemployment rate at 6.1% (May 2015), while above the US (5.5%), is only slightly higher than the state (5.8%)

FINANCIAL OPERATIONS AND RESERVES: TOWN MAINTAINS STABLE OPERATIONS

The town's reserves, while narrow, continue to show signs of stabilization. From fiscal 2009 to 2014, the town's operating reserves (combined General Fund and School Unrestricted Fund) increased from 0.8% to 7.4% of revenues, due to continued underfunding of its pension ARC. Notably, the School Unrestricted Fund's reserves have improved significantly over the last few years, ending fiscal 2014 with a healthy $2.7 million fund balance, a sharp improvement from fiscal 2011 when it had an accumulated deficit of $3.1 million.

Despite overall favorable operating results in fiscal 2014, individual operating fund performance was inconsistent. The General Fund experienced an operating deficit of $889,000, resulting a drop in unrestricted reserves to $3.4 million (or 5.3% of General Fund revenues). The deficit was attributable to an increase in pension contributions as well as greater than anticipated overtime pay, workers compensation and utility costs. The School Unrestricted Fund ended with a large $2.7 million surplus, primarily due to favorable variances to the budgeted medical and dental expenditures.

In fiscal 2015, the town expects to maintain balanced operations in their operating funds while also addressing long-term fiscal challenges. The town's fiscal 2015 budget increased 4.0% over the prior year's budget, and the town projects the General Fund will be flat in fiscal 2015 with a small surplus in the School Unrestricted Fund. Management reports the surplus in the School Unrestricted Fund resulted from lower than expected medical and dental costs as a higher number of employees participated in lower cost health plans then anticipated. Favorably, management has allocated resources to address their elevated pension and OPEB burdens. The town fully funded its fiscal 2015 pension ARC and at the end of June, made a small deposit ($240,000) to its irrevocable OPEB Trust.

The town's fiscal 2016 budget, which increased 3.7% to $89.5 million, is balanced with a 3.24% tax levy increase and the town is appropriating $200,000 to fund balance. Similar to fiscal 2015 and consistent with the 5-year Financial Plan, the town has budgeted to fully fund its pension ARC. Notably, the town has also budgeted for full funding of the OPEB ARC as well. The school's budget shows a modest $400,000 appropriation of reserves, a departure from the schools' fiscal 2014 and 2015 budgets.

Liquidity

The town's operating fund liquidity is adequate with net cash at $7.8 million or 9.1% of revenues. As of fiscal year end 2014, almost all of this cash resided in the General Fund.

DEBT AND PENSIONS: ELEVATED PENSION AND OPEB LIABILITIES; INCREASE IN DEBT

While additional debt issuance is expected over the course of the next 12 to 18 months, we expect the debt burden to remain manageable. The debt burden (including the FY2015 issuance of the 2014A bonds) is typical for RI towns and cities at 1.1%. In May, voters approved $24 million in bond authorizations for wind turbines, road improvements and purchase of the senior center. The town is anticipating issuing Bond Anticipation Notes in the next month for the wind turbine project. Debt levels would double if the debt was issued all at once. Given the town's rapid amortization of existing debt at 73% of principal over the next 10 years and reimbursement on the school bond issue from state building aid (amounting to about 58% of debt service), we believe debt levels will remain manageable. Debt service accounted for a moderate 3% of operating expenditures in fiscal 2014.

The Rhode Island Health & Educational Building Corporation's Public Schools Revenue Bond Financing Program, Series 2014 A bonds (Town of West Warwick Issue) are enhanced by RIHEBC's Monthly Intercept Program that has a A1 programmatic rating. This rating reflects the state's commitment to intercept state funds appropriated to participating borrowers to ensure timely debt service payment to bondholders and is notched off Rhode Island's Aa2 general obligation rating. See the June 17, 2014 report on the Series 2014 A bonds for additional information on the mechanics of the program.

Debt Structure

All of the town's debt is fixed rate.

Debt-Related Derivatives

The town is not a party to any debt-related derivative agreements.

Pensions and OPEB

The town participates in two defined benefit pension plans, the state administered cost sharing plans, ERS, and the locally administered Town Plan. The 2013 combined adjusted pension liability, under Moody's methodology for adjusting reported pension data, is $278 million, or an elevated 3.3 times operating revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the town's reported liability information, but to improve comparability with other related entities. The liability is expected to stabilize and begin to decline as a result of the reduced benefit payments and return to full ARC funding.

Last year, West Warwick successfully negotiated reforms to pension and health benefits for active employees and retirees, which will provide near-term and long-term financial relief. The town's severely underfunded pension system was deemed to be in "critical status" by the state, and as of July 1, 2013 and July 1, 2014 had a funded ratio of just 17.1% and 18.9%, respectively. The increase to 18.9% on July 1, 2014, represents a reversal of a trend of 15 consecutive years of a decline in the funded ratio. Major components of the reform include 5-year COLA freezes for retirees and increased employee contributions. The pension reforms resulted in a reduced pension ARC by more than $2 million in fiscal 2015 and allowed for full funding of the ARC in fiscal 2015. Fiscal 2015's ARC was $8.1 million, an amount that is forecasted to grow annually over the long term under it Funding Improvement Plan (FIP), including an increase to $8.3 million in Fiscal 2016.

Even with the pension reform, the town's pension liability will continue to present a long-term challenge. The town's state required FIP, under various assumptions, projects the funded ratio will not exceed 40% until 2027 at the earliest.

The town also significantly reduced health costs for employees, by negotiating increased co-pays and benefit contributions for retirees. The town historically funded OPEB on a pay-as-you-go basis, although the town will set aside additional amounts in a trust in fiscal 2016 to address this large liability. Favorably, the increase in OPEB funding is part of the Five Year Budget Plan and was included in the fiscal 2016 budget. At the end of fiscal 2015, the town made an initial deposit into the trust of $240,000. While still high, the reported liability as of fiscal year end 2014 at $58 million declined significantly from its July 1, 2011 valuation of $107.3 million.

The town's fixed costs are elevated and this limits operating flexibility. For fiscal 2015, even when incorporating the lower town pension ARC, we estimate that fixed costs (debt service, OPEB and town pension ARC, and state pension plan payments) comprise 21.9% of budgeted revenues. These costs will likely remain high in the coming years due to debt issuances and gradually increasing town pension contributions (as detailed in the FIP).

MANAGEMENT AND GOVERNANCE

Rhode Island cities have an institutional framework score of 'A' or moderate. Economically sensitive revenues account for a small portion of operating revenues, but cities rely on property taxes and state aid account for the largest amounts. Cities have the ability to increase the property tax levy up to the 4% cap. Expenditures are largely predictable but cities are challenged to reduce expenditures given a strong union presence in the state.

The presence of a management team that is showing a focus on maintaining fiscal stability and addressing its long term pension and OPEB challenges is a credit strength.

KEY STATISTICS

Equalized Value (EV), Fiscal 2015: $2.1 billion

EV Per Capita, Fiscal 2015: $70,604

Median Family Income as % of US Median: 103.7%

Available Operating Fund Balance as % of Revenues, Fiscal 2014: 6.3%

5-Year Dollar Change in Fund Balance as % of Revenues: 5.9%

Cash Balance as % of Revenues, Fiscal 2014: 9.1%

5-Year Dollar Change in Cash Balance as % of Revenues: -2.3%

Institutional Framework: "A"

5-Year Average Operating Revenues / Operating Expenditures: 1.00x

Net Direct Debt as % of EV: 1.1%

Net Direct Debt / Operating Revenues: 0.29x

3-Year Average ANPL as % of Assessed Value: 11.4%

3-Year Average ANPL / Operating Revenues: 2.73x

OBLIGOR PROFILE

West Warwick is located 11 miles south of Providence. Out of the 39 cities and towns in the state, West Warwick is the 10th largest with a population of 29,191 (2010 Census), down 1.3% from the 2000 Census.

LEGAL SECURITY

The bonds are general obligations of the city and are secured by an unlimited property tax pledge. The Series 2014A bonds are further enhanced by the state's state aid intercept program.

USE OF PROCEEDS

N/A

PRINCIPAL METHODOLOGY

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Analysts

Robert Azrin
Lead Analyst
Public Finance Group
Moody's Investors Service

Geordie Thompson
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA