

# THE BOND BUYER

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## Regional News

Rhode Island House GOP Leader: Don't Pay 38 Studios Bonds

by: Paul Burton

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Rhode Island's top House Republican argued in a long letter to his colleagues that the state should not pay back the 38 Studios bonds, despite warnings of a general obligation downgrade from Moody's Investors Service.

"I can't believe anyone bought this stuff," Rep. Brian Newberry, R-North Smithfield, leader of a tiny GOP minority, said in an interview. He argues that the state would save money by not paying, even with a mult notch downgrade.

Following the demise of 38 Studios, a video-game company owned by former Boston Red Sox pitcher Curt Schilling, Rhode Island lawmakers are debating whether to pay moral-obligation debt that began with a \$75 million loan guarantee that the Rhode Island Economic Development Corp. issued in for the firm 2010.

Standard & Poor's on Thursday said its ratings on the 38 Studios bonds, and its AA rating of the state's general obligation debt, would not change, although it could take negative action if "Rhode Island or any other issuer waivers in its commitment to supporting its debt."

Three days earlier, Moody's warned of a downgrade, possibly mult notch, to Rhode Island's Aa2 GO and Aa3 appropriation rating should the state default. Moody's, which lowered the 38 Studios bonds two notches to Baa1 from A2, essentially likened moral obligation to full faith and credit.

The House Finance Committee in a 12-0 vote Tuesday, approved Gov. Lincoln Chafee's proposed \$8.2 billion state budget, which includes an initial \$2.4 million payment toward the 38 Studios bonds. The full House will debate the budget bill Tuesday.

Standard & Poor's cited the support of Chafee, House Speaker Gordon Fox, D-Providence, and Senate President Teresa Paiva-Weed, D-Newport, for paying the bonds, and legislation calling for default having died in committee.

Fitch Ratings also rates the state's general obligation bonds AA.

"I feel as though in the last few days there's been a concerted effort to steamroll this thing through," said Newberry, one of six Republicans in the 75-member House. "The governor and the speaker made a decision early on that they were going to pay this debt."

Newberry also said a short-notice appearance two weeks ago by Municipal Market Advisors managing director Matt Fabian before the finance committee was "to try to build a case that the leadership of the House could use in a floor debate to claim some type of expert authority to back their already hardened position that we should repay the bonds."

Fabian told the panel that defaulting on the debt could cost the state in the long run, and that the capital markets might shut off Rhode Island.

Chafee proposes the state pay \$2.4 million in fiscal 2014 and roughly \$12.5 million for each of the seven following years. Those payments, plus \$15.4 million available through capitalized interest and the capital reserve fund, would total \$104.6 million, budget officials estimate.

In his eight-page letter to colleagues, Newberry countered assertions by Director of Administration Richard Licht and Office of Management and Budget Director Peter Marino that defaulting on the bonds would hurt Rhode Island financially through higher interest rates.

Marino, citing Municipal Market Advisors data, said a 50 basis-point increase in yield results in a drop in value of 5% to 6% over 20 years. Given the state's roughly \$2.1 billion in outstanding debt overall, the loss in portfolio to bondholders could range from \$100 million to \$120 million, Marino said.

According to Newberry, the additional costs to the state over 10 years from a one-notch downgrade would be about \$2 million, less than the proposed payment this year alone toward the debt.

He also estimates that over eight years during a downgraded period, \$150 million of debt annually would cost Rhode Island \$15.8 million in additional interest.

"Compare this value to the amount Rhode Island will pay towards the 38 Studios' loan: \$89.2 million," Newberry said. "Even with a two-notch downgrade, Rhode Island will only pay \$31.6 million over the entire life of all the loans, not \$89 million."

A moral obligation bond, typically issued by a state agency, is secured by revenues from the financed project and by a nonbinding provision that the governor's budget would recommend money to cover the shortfall. Typically, such a bond authorizes but does not legally bind the legislature to appropriate the funding.

Newberry said retirement benefits for state workers, which were cut during the 2011 and for which he voted, were "similarly morally obligated."

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