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Matching Fund Bonds Outlook Revised to Negative Amid Decline in Rum Excise Tax Revenues

KBRA lowered the rating outlook for the USVI’s Matching Fund Bonds as coverage dropped to 1.83x, below the 2.0x threshold, due to lower cover-over rates and reduced rum sales to the U.S. mainland over the past three years.

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The Matching Fund Special Purpose Securitization Corporation has seen its credit outlook revised from Stable to Negative, according to the latest surveillance report issued by Kroll Bond Rating Agency (KBRA). The adjustment reflects a persistent decline in pledged Matching Fund Receipts over the past three fiscal years, weakening coverage ratios and increasing concern over the territory's debt repayment capacity, according to an April 8 release issued by Kroll.

The Matching Fund Securitization Bonds, rated BBB by KBRA, are backed by rum excise taxes remitted from the U.S. Treasury to the U.S. Virgin Islands. These funds have been transferred via a true sale to a bankruptcy-remote entity, the Matching Fund Special Purpose Securitization Corporation, formed under Virgin Islands Act No. 8540 in 2022. The rating agency considers the legal structure strong, with the sale mechanism and statutory lien helping to insulate bondholders from the broader credit risk of the Virgin Islands government.

The outlook revision was prompted by a drop in Matching Fund Receipts, which declined 14.6% year-over-year to $181.1 million in FY 2025. Coverage of maximum annual debt service (MADS) has now dipped to 1.83x, falling below the 2.0x threshold for the first time and far short of the 3.0x level required for issuing additional bonds. At the time of the 2022 bond issuance, the pro forma MADS coverage stood near 3.0x.

This coverage erosion stems primarily from two factors:

1. A 20% reduction in the portion of rum excise taxes returned to the Virgin Islands—from $13.25 to $10.50 per proof gallon—as Congress allowed the extended cover-over rate to expire on December 31, 2021.

2. A 14.9% decline in the estimated volume of federally taxed rum proof gallons from FY 2023 to FY 2025.

Additionally, the FY 2025 Matching Fund Receipts reflect a $28.9 million "true-up" deduction due to the overestimation of excise tax revenues two years earlier, following the U.S. Treasury's standard adjustment practice.

The Corporation uses the Matching Fund Receipts to service the Matching Fund Securitization Bonds, with remaining revenues distributed to the Government of the Virgin Islands as holder of the Residual Certificate. Under agreements with the territory, approximately 46% of these residual funds are then distributed to the territory's two rum producers—Diageo and Cruzan—as part of economic development subsidy agreements. The rest is funneled to the Public Finance Authority to meet obligations to the Government Employees Retirement System (GERS). The downgrade was first reported by WTJX.

Despite the current strain, KBRA acknowledges the strengths of the transaction's legal design, including the statutory lien, the sale agreement, and the bankruptcy-remote structure of the Corporation, which together protect pledged revenues from broader fiscal risk.

The U.S. Treasury continues to support the system by depositing the full amount of Matching Fund Receipts into a restricted account managed according to U.S. Code §7652. Bond counsel's True Sale Opinion confirms that this structure does not increase the risk that the revenue transfer could be legally recharacterized as a secured loan rather than a sale.

While the current 1.83x MADS coverage technically meets debt service obligations, KBRA sees this as providing a "limited cushion," especially given the volatility of the revenue source. Risks include: Consumer preference shifts impacting rum sales; market competition; and the possibility of operational disruption or exit by one of the two rum producers.

The revenues are particularly vulnerable due to their narrow base—tied entirely to rum exports from just two companies located on St. Croix—and lack of diversification.

Moreover, while pledged revenues are bankruptcy-remote, payments made to the rum producers from the government's Residual Certificate receipts are not. Any interruption in these payments could reduce the economic incentive for continued production at current levels, further threatening Matching Fund revenues.

The rating could be improved if Congress reinstates the $13.25 per gallon cover-over rate and if U.S. rum sales stabilize or begin to grow again, thereby improving debt service coverage. However, KBRA warns that further erosion of Matching Fund Receipts or deterioration in debt coverage ratios could trigger a downgrade.

The Virgin Islands government has supported its bond obligations by structuring the Matching Fund Securitization Corporation as a bankruptcy-remote entity. Still, the long-term health of this funding stream—and the benefits it provides to the territory—depends on legislative action at the federal level and market performance by its two major rum producers.

For FY 2025, the Corporation's debt service coverage ratio stands at 1.83x, down from 2.14x in FY 2024 and 2.28x in FY 2023. This reflects a steady downward trend since the expiration of the enhanced federal cover-over rate and a simultaneous dip in production volume. The maximum annual debt service remains approximately $98.98 million.