

The Virgin Islands Consortium

Firm Owned By Warren Buffet Gives WAPA 'BB Minus' Rating

Business / **Published On May 04, 2015 11:35 AM /**

John McCarthy **May 04, 2015**



ST. THOMAS – One of the Big Three credit rating agencies approved by the U.S. Securities and Exchange Commission in New York has given the Virgin Islands Water and Power Authority a “BB” and a “BB-” rating on two bond issue series, but rated them “stable” overall.

The Fitch Rating – generated by Warren Buffet's Berkshire Hathaway Company – gave the following ratings for:

--\$134,860,000 electric system revenue bonds, series 2012A, 2010A, 2010B, 2010C, 2003 at 'BB';

--\$103,330,000 electric system subordinated revenue bonds, series 2007A, 2012B, 2012C at 'BB-'.

A "BB" rating means WAPA is less vulnerable to non-payment than other speculative bond issues in the near-term, but that it faces major ongoing uncertainties or exposure to adverse business, financial and economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

The following contains excerpts of the Berkshire Hathaway report:

Security

The electric system revenue bonds are secured by a pledge of net electric revenues and certain other funds established under the bond resolution. The electric system subordinated revenue bonds are secured by a pledge of net revenues that are subordinate to the pledge securing the electric system revenue bonds.

Key Rating Drivers

Weak Financial Profile: WAPA remains challenged by extremely high retail rates (\$0.39/kWh), a reliance on lines of credit for working capital needs and weak cash flow. Although lower fuel oil prices have reduced the cost of electricity from fiscal 2014 levels, multiple base-rate increases enacted in recent years have yet to yield sustained improvement in financial performance.

Power Supply Diversification: Fitch views positively the authority's ongoing efforts to diversify its power supply by converting its oil-fired generating plants to tri-fueled capability with liquefied petroleum gas (LPG, or propane) as the primary fuel source initially. Recent project cost increases and delays in project completion are concerning, but Fitch believes the project should ultimately have a stabilizing impact on electric rates, accounts receivable and declining sales.

Inadequate And Regulated Cost-Recovery Mechanism: Electric rates are regulated by the Virgin Islands Public Service Commission (PSC), which has authorized cost recovery through both base rates and a levelized energy adjustment clause (LEAC) for fuel and other related costs. Delays inherent in both the regulatory process and the recovery mechanism impair liquidity and limit financial flexibility.

Challenged Service Area: The authority serves a geographically and economically challenged service territory largely dependent on tourism and government employment. Strains related to the USVI's narrow economy and fiscal challenges (implied general obligation [GO] rating, 'BB-' with a Negative Outlook) are compounded by the authority's high electric rates, declining sales and per capita personal income levels that approximate just half of the U.S. average.

High Accounts Receivables: Government receivables have continued to escalate, inhibiting WAPA's ability to collect needed revenue and offsetting positive headway made in reducing deferred fuel balances, customer receivables and reimbursable costs owed by the authority's water utility.

Rating Sensitivities:

Diminished Liquidity: WAPA's inability to maintain sufficient cash reserves and bank lines of credit would likely prompt a negative rating action.

Implementation of Fuel Diversity: Positive rating consideration may be warranted as a result of the pending conversion to LPG and improved fuel diversity. However, positive rating action will depend on the extent to which fuel savings are used to bolster the authority's financial profile.

Rating Relationship To Government: Continued deterioration in the USVI's fiscal condition and credit quality could ultimately have rating implications for WAPA's ratings given the authority's status as an instrumentality of the government, as well as the government's position as the authority's largest customer.

Credit Summary:

The USVI is an organized, unincorporated U.S. territory 40 miles east of the Commonwealth of Puerto Rico with a population of approximately 106,000. WAPA operates both a vertically integrated retail electric system and a water treatment and distribution system, both of which are independently financed with separate liens on net revenues securing the outstanding debt of each system.

The customer base is almost evenly divided between the interconnected islands of St. Thomas and St. John, and St. Croix, and is largely composed of residential and small commercial users (98 percent). WAPA's remaining customers include its largest, the Virgin Islands government, as well as several large commercial users.

Sales to the government and the 10 largest non-governmental users accounted for approximately five percent and 7.7 percent, respectively, of the authority's total revenue in fiscal 2013, exposing the authority to very little customer concentration. While no individual non-governmental customer accounts for more than 2 percent of total revenue, more than half of the largest users are tourism dependent hotels and resorts.

Adequate But Isolated Operations

WAPA owns and operates a total of seven generation facilities on the islands of St. Thomas and St. Croix, as well as limited backup generation on St. John (2.5 MW). The generation facilities on both St. Thomas and St. Croix are located at single sites but include several steam and combustion turbine units that largely mitigate operating risk and protect against unit outages. Total capacity available on each island is well in excess of peak demand.

All of the authority's generating units are currently fueled by oil, although efforts to advance a number of alternative energy initiatives including LPG, wind, solar and waste to energy are ongoing. Importantly, the authority's plant conversions to LPG are underway pursuant to a master agreement (the agreement) WAPA signed with Vitol Virgin Islands Corp. (Vitol) in June 2013. The conversions were initially expected to be complete by the latter part of 2014, but delays in installing the necessary infrastructure have pushed the projected completion date back by almost one year, to the second half of 2015.

The agreement obligates Vitol to initially fund all costs related to the installation of necessary infrastructure, as well as the physical conversion of eight generating units. Total infrastructure and conversion costs were initially estimated at \$87 million, but project delays have led to a sizeable increase in the all-in projected cost, now estimated at \$150 million. As a result, WAPA's obligation to repay VITOL for all related costs pursuant to the agreement was recently extended from seven to 10 years, albeit with a lower interest rate. WAPA officials continue to project the use of LPG will lower its energy costs by approximately 30%, although a detailed forecast demonstrating the cost savings has not been made available.

Weak Financial Profile

The authority's financial profile weakened considerably between fiscals 2010-2013, reflecting the confluence of significantly higher fuel costs, inadequate cost recovery, rising annual debt service, declining sales and the continued financial strain attributable to the water system and overdue receivables from the government.

Consequently, Fitch calculated debt service coverage of all obligations, including outstanding GO notes, averaged just 0.90x over that span before improving modestly to about 1.0x in fiscal 2013. For fiscal year-end 2014, debt service coverage declined to 0.83x, largely due to a 5.8% decrease in energy sales. With the inclusion of motor fuel tax revenues, which are dedicated to funding capital expenditures and debt service related to new generation projects, all-in coverage improves to just under 1.2x.

Liquidity, not including lines of credit available for working capital, remained low with just 11 days cash on hand at the close of fiscal 2013. Including the available lines of credit, the authority maintained a more acceptable 30 days of liquidity on hand. Similar metrics at the close of fiscal 2014 were 13 days and 23 days, respectively.

Recent funding of certain capital projects from existing reserves diminished WAPA's unrestricted cash position even further from \$10.8 million at the close of the prior fiscal year to approximately \$3 million as of Jan. 1, 2015, although officials expect to be reimbursed from proceeds from a pending RUS loan before the current fiscal year ends.

High Retail Rates

WAPA's retail rates continue to rank significantly higher than the average for all U.S. States and other U.S. Territories, including the Guam Power Authority (GPA; rated 'BBB-' and 'BB+', respectively, with a Negative Rating Outlook) and Puerto Rico Electric Power Authority (PREPA; rated 'CC', Watch Negative). Fitch believes the authority's flexibility to raise rates will continue to be challenged as a result.

Since 2010, WAPA has requested two base rate increases with both of them approved in 2012 and 2013,, providing roughly \$15.7 million in additional recurring revenue. Positively, approved increases in the LEAC in recent years have reduced the authority's deferred fuel balance significantly, from a peak of \$55 million in March 2013 to a more modest balance of \$8.6 million. Considerably lower oil prices in the current fiscal year have allowed WAPA to reduce its LEAC by about one-half, from \$0.41/kWh in January 2014 to \$0.21/kWh in March 2015. While the lower rate provides a degree of rate relief for customers, WAPA's overall rate remains high at \$0.39/kWh.

