The Virgin Islands Consortium

Ratings Firm Downgrades $1.24 Billion Of G.V.I. Rum Cover-Over Backed Bonds; Says Territory's Credit In 'Severely Weak Condition'

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ST. THOMAS -- One of the most venerable ratings firm in America, Moody's, five days ago downgraded the ratings on the US Virgin Islands' four liens of matching fund revenue bonds, issued through the Virgin Islands Public Finance Authority.

The bonds are secured by matching fund revenues which are remittances paid by the federal government to the Virgin Islands Government (G.V.I.) of a portion of federal excise taxes collected on rum produced in the territory and shipped to the U.S. mainland. The rating action affects approximately $1.24 billion in outstanding debt, according to

Moody's.

The move is sure to affect Senate hearings on Governor Kenneth Mapp's $260 million capital projects bill recently sent to the Legislature. Through the measure, Mr. Mapp is seeking to refund and restructure of all or a portion of certain series of the government’s outstanding matching fund revenue bonds and gross receipts taxes bonds; a move Government House says will allow the government to take advantage of current low interest rates and to provide cash flow relief by reducing debt service cost through fiscal year 2020.

But Moody's downgrade of the rum cover-over matching funds will impact the G.V.I.'s ability to secure the capital projects bond at the low rates the governor spoke of. Moody's says the rating downgrades primarily reflect a closer alignment of these special tax ratings with the G.V.I.'s general credit position, which Moody's says has continued to erode and reached a severely weak condition.

According to the release, seen here, the government's challenged financial position increases the possibility that it will use the matching fund revenue credit for new deficit financings, as it has in the past. It says while the legal structure of the matching fund bonds is stronger than the government's unsecured general credit quality, this has not been tested in a stress scenario, and warrants a closer alignment of the matching fund bonds with the government's credit as its finances weaken.

According to Moody's, key characteristics of the government's general credit profile include: persistent general fund deficits addressed primarily with repeated deficit financings; very high and rising debt levels; declining gross domestic product and population; high unemployment; and a large unfunded pension liability. A further challenge is the government's need to access the capital markets to balance its budget and to bolster its liquidity, and the severe stress that could result without this access.

Moody's says that, to a lesser extent, the downgrades also reflect a decline in pledged matching fund revenues and debt service coverage in 2015 primarily attributable to a reduction in shipments by one of the territory's two rum distilleries. The release did not identify which rum company had seen decreased exports. And it says future coverage could decline further if the territory is successful in its plans for debt refinancing and new money issuances -- something Mr. Mapp has been pushing for.

Moody's did, however, recognize that the bonds possess a number of structural features that provide bondholder protections and stronger credit quality than unsecured general obligation bonds, most notably the direct payment of pledged revenues to the US Treasury to a special escrow agent/trustee. The government has pledged and assigned matching fund revenues to the trustee for the benefit of bondholders, establishing a security interest in the revenues. The statutes are written to create a statutory lien on the revenues.

"But we note the instruction to the US Treasury to make the direct payment must be renewed annually by the Virgin Islands government, and these structures have not been tested in a stress scenario where the government faces a severe lack of funds to provide basic services," says the release.

Cherie Munchez, the governor's communications director, was unable to be reached on Tuesday for comment.

G.V.I. ratings outlook, according to Moody's

The outlook on the ratings is negative, reflecting the severe fiscal challenges facing the government, its need to access the capital markets to balance its budget, and the possibility that its liquidity and general credit profile could continue to deteriorate.

Factors that could lead to an upgrade

Restoration and maintenance of structural budget balance by the primary government.

Factors that could lead to a downgrade

Failure of the government to access capital market for planned financings.

Further erosion of government's liquidity.

Decline in matching fund revenues and debt service coverage due to further reduction in rum shipments by the two distilleries.