The Virgin Islands Consortium

W.A.P.A. Bonds Downgraded Further; Outstanding Debt At $227 Million

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ST. CROIX -- The Virgin Islands Water and Power Authority's bond rating has been downgraded yet again by Moody's, a major U.S. ratings firm. The latest downgrades of the authority's senior electric system revenue bond rating to B1 from Ba2, and the electric system subordinated revenue bond rating to B2 from Ba3, comes a month after a Moody's downgrade that sent W.A.P.A.'s bonds into junk status.

The latest rating action concludes the rating review for downgrade that was initiated on March and continued on June 2.

According to Moody's, the rating action was prompted by growing pressure on W.A.P.A.'s financial longer-term prospects in light of the authority's direct exposure to economic stresses in the U.S. Virgin Islands, and an inability to disconnect itself from local economic conditions, from the slow albeit improved payment pattern of governmental customers and a very high adjusted net pension liability (around $220 million). The amount of this pension liability, which approximates W.A.P.A.'s funded debt, was disclosed for the first time in the authority's 2015 financials, which were recently published, according to Moody's.

As of June 30, the authority had approximately $127 million in electric system revenue bonds outstanding and approximately $100 million in subordinated electric system revenue bonds.

Moody's says the rating action also considers the authority's weak liquidity management characterized by the failure to extend drawn credit lines of around $23 million until their due date end of June 2016. Moody's says it understands that FirstBank Puerto Rico has extended its line of credit for one year and W.A.P.A. is still in negotiations with Banco Popular de Puerto Rico to extend the credit lines in the coming days. The ratings firm said W.A.P.A. has historically relied on these credit lines to manage working capital and governmental receivables pressure.

"Should all of VI WAPA's lines of credit be extended, as we anticipate, undrawn availability under the lines is limited. Moreover, we estimate that VI WAPA currently has around $26 million of cash on balance sheet including the proceeds from the $13 million Rural Utilities Services loan," Moody's says.

W.A.P.A.'s liquidity profile is further pressured by the need to repay its fuel supplier, Trafigura Trading LLC, past due amounts that approximate $25 million. While the firm's expectation is that these amounts will be paid in small increments over an intermediate time frame, the repayment of these obligations add stress to the liquidity profile.

The firm acknowledged the potential benefit to W.A.P.A.'s credit quality from the incremental revenue growth if the Public Services Commission of the Virgin Islands (PSC) completes the pending base rate hearing process as well as an additional hearing of a previously denied emergency rate case filing. However, such revenue increases, should they occur, need to translate into a sustained improvement in liquidity and financial metrics. As a point of reference, while PSC approved rate increases have strengthened the Authority's financial performance, Moody's calculate that Moody's fixed charge coverage ratio was below 1.0x for four of the past five years.

Moody's says W.A.P.A.'s rating recognizes the challenges of operating within an island economy with relatively sluggish growth, high unemployment and a narrow local economy that is dependent on discretionary tourism, and the ongoing struggle of the authority to cover its cost base and operate its facilities efficiently given significant excess capacity, the age of its equipment and high retail rates. The rating acknowledges the regulatory support the utility has received as it has progressed toward the near completion of a project to convert its base-load generation resources from oil-fueled to tri-fueled (initially propane), thereby lowering the cost of electricity for Virgin Islands ratepayers while reducing its deferred fuel balances.

"We view the completion of this project as an important milestone towards strengthening VI WAPA's long-term credit quality," says Moody's. "That said, the conversion project, while likely to be completed this year, has been delayed and is substantially more costly than originally contemplated. VI WAPA faces a $150 million obligation to the contractor VITOL that will amortize over 10 years starting after the completion of the LPG/propane-based power generation project later this year."

Rating outlook

The negative rating outlook reflects the authority's weak liquidity profile,which we believe will persist, assuming its existing credit facilities are refinanced, in the absence of incremental revenue growth and better liquidity management.

Factors that could lead to an upgrade

A rating upgrade is currently unlikely. However the outlook could be stabilized in case of:

Successful refinancing of all outstanding credit lines

Rate increases supporting improved cost recovery and translating into better liquidity and the improvement of financial metrics with Moody's total fixed charge coverage ratio improving to 1.0x

Factors that could lead to a downgrade

Further deterioration in VI WAPA's liquidity profile and financial metrics which threaten the long-term sustainability of the authority