

The Virgin Islands Consortium

Moody's Downgrade 'Significantly Affects' Government's Debt Restructuring Plans, Finance Commissioner Says

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ST. THOMAS -- Moody's [downgrade](#) of the Virgin Islands Government's four liens of matching fund revenue bonds, issued through the Virgin Islands Public Finance Authority, "significantly affects" the proposed \$55 million restructuring that has been included in Governor Kenneth Mapp's fiscal year 2017 budget, Finance Commissioner and Public Finance Authority Executive Director Valdamier Collens, above, told members of the Committee on Finance at the Earl B. Otley Legislative Hall on Wednesday.

"It affects it because of the downgrade -- which, as you know, is primarily a result of the PROMESA [Puerto Rico Oversight, Management and Economic Stability Act] and what's going on in Puerto Rico. What happens is now the cost of capital and interest rates yields have now spread a bit more wider," Mr. Collens said.

Moody's, however, said that the downgrade came as a result of the government's challenged financial position, which has increased the possibility that it will use the matching fund revenue credit for new deficit financings. 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.

The downgrade was referred to by Senator Clifford Graham, the powerful chairman of the Committee on Finance, as the elephant in the room, and both he and Mr. Collens noted that Standard and Poor's, along with Fitch -- the two other respected ratings firms in the U.S. -- have placed the territory's bonds -- to include gross receipts and rum cover-over matching funds -- on a downgrade watch.

Mr. Collens explained why the downgrade essentially prevents the government from restructuring the \$55 million debt.

"Whereas we were between the 4 1/2 to 5 percent or even lower in some of the bonds that we've issued in recent years, this effect has caused the projected yields to be up 2 to 3 percent higher, and in that regard, it would not make a whole lot of sense to restructure, [for example], your mortgage for a higher rate when you're already getting a lower rate."

The executive director said the administration met with Moody's prior to the downgrade, "and we're continuing to meet with Moody's to ascertain what the government can do to get its rating back within the striking zone of investment grade."

Moody's main concern, as outlined in its press release, is the risk that the Government of the Virgin Islands will use the matching fund revenue credit for new deficit financings, thereby weakening the trustee's likelihood of return on investment. But Mr. Collens said the Mapp administration has no such plans.

"It's not an option that the government has ever used, nor does it intends to use said option," Mr. Collens said. He said Moody's has suggested putting an irrevocable letter of instruction in place that primarily says, "The trustee will receive the funds on an annual basis until such time that all the bonds are paid off in accordance with the indenture (contract or agreement). And it's irrevocable, so it will always go to the trustee that's in place, and so except for the new amount, there's no need to what bank account the monies will go to."

That language is already in the agreement, Mr. Graham pointed out. Mr. Collens concurred and said that the letter would serve to strengthen the agreement.

The downgrade leaves what Mr. Graham referred to as a "gaping hole" in the 2017 budget, since it has effectively canceled the idea of restructuring, which was intended to meet the upcoming year's budget obligations. Mr. Collens said both the legislative and executive branches of government would have to work together to find a solution.

Mr. Graham also suggested that the downgrade could affect a myriad of government departments and agencies that have asked for more funding than what was recommended by the governor.

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 downgrade also reflects 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. But it did not identify which rum company had seen decreased exports.