

The Virgin Islands Consortium

Government's Plan To Borrow \$110 Million Comes At Higher Interest Rate Because Of Bonds Downgrade

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ST. THOMAS -- The Government of the Virgin Islands, relative to borrowing, is in an unfamiliar position. Unfamiliar because for years the government has borrowed money to fill budget deficits, and the market has generally dealt fairly with the G.V.I., lending to the government with an interest rate that hovered around 4 to 5 percent.

A drastic new reality shook the territory when venerable U.S. ratings firm Moody's [downgraded the government's four liens of matching fund revenue bonds](#) -- issued through the Virgin Islands Public Finance Authority and secured by matching fund revenues -- which are remittances paid by the federal government to the G.V.I. of a portion of federal excise taxes collected on rum produced in the territory and shipped to

the U.S. mainland.

Now, the government's borrowing interest rate will most likely be between 6 to 7 percent, said Finance Commissioner Valdamier Collens, speaking during a budget wrap-up hearing in the Committee on Finance at the Earl B. Ottley Legislative Hall on Monday, along with Office of Management and Budget Director Nellon Bowry, and other Mapp administration officials.

Still, the government plans on borrowing a total of \$110 million (not through the original plan to restructure \$55 million of debt, which has become implausible because of the downgrade, but rather through a straightforward mechanism) to meet its 2017 budget shortfall, which will be paid at the new high interest rate of 6 to 7 percent, according to Mr. Collens.

As he'd expressed at a recent hearing, Mr. Collens said the downgrade was triggered by a few things, a major reason being the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA), which placed Puerto Rico's fiscal affairs under direct federal control and established a legal framework for reducing its \$72 billion load of debt. PROMESA includes provisions similar to Chapter 9 municipal bankruptcy and bondholders have long seen PROMESA as a way for the federal government to allow Puerto Rico to legally not pay its debt; a notion that has greatly diminished Puerto Rico's standing in the bond market and, by proxy -- even if the territory is no longer tied to PROMESA -- the U.S. Virgin Islands, according to Mr. Collens.

Mr. Bowry also argued that the Puerto Rico measure had affected the territory's bond rating. But Moody's not once in its press release explaining the downgrade, cited PROMESA as part of its decision-making relative to the territory's bonds.

Mr. Collens pointed to other structural issues highlighted by Moody's downgrade. Moody's said 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.

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," reads the release.

"What they were saying is, basically, if there was for example a major catastrophe in the Virgin Islands, the current mechanism -- where payments go from the Department of the Interior directly to our trustee to pay the debts., which is not the case in Puerto Rico -- the Virgin Islands could make a change," Mr. Collens said, explaining one of Moody's key reasons for issuing the downgrade.

[In July](#), Mr. Collens said that the downgrade essentially prevented the government from restructuring its debt, some \$55 million.

"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," he said.