The Virgin Islands Consortium

Fitch Downgrades USVI's Issuer Default Rating And Dedicated Tax Bonds

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The outlook of the U.S. Virgin Islands future continues to dim as ratings firm after ratings firm continue to downgrade the territory's various bonds. On Tuesday, Fitch, which in August 2016 downgraded the territory's rum cover-over and gross receipt tax bonds, downgraded the U.S. Virgin Islands' Issuer Default Rating (IDR) and the ratings of the dedicated tax bonds issued by the Public Finance Authority (PFA). The ratings have also been placed on negative watch.

The downgrades are as follows, according to Fitch:

--USVI IDR to 'B' from 'B+'; --VIPFA senior lien matching fund revenue bonds to 'BB-' from 'BB'; --VIPFA subordinate lien matching fund revenue bonds to 'BB-' from 'BB'; --VIPFA matching fund revenue bonds (Diageo project) to 'BB-' from 'BB'; --VIPFA matching fund revenue bonds (Cruzan project) to 'BB-' from 'BB'; --VIPFA gross receipts tax (GRT) revenue bonds to 'BB-' from 'BB'.

The venerable ratings firm cited its increased concerns about the territory's liquidity following its difficulty in securing market access for a planned working capital borrowing. On Friday, Governor Kenneth Mapp warned the territory and lawmakers that if a sin tax measure was not adopted soon -- the governor's five-year economic growth bill that aims to raise taxes on products such as rum, tobacco, sugary drinks, internet purchases and timeshare unit owners, among others, or if the Senate failed to introduce a similar bill, which Mr. Mapp says will help raise tens of millions and eventually erase the territory's structural deficit, which totals $110 million this year -- then come February, the government would struggle to meet operational needs, including payroll, and would be completely incapacitated, relative to making payroll and other operational demands, by March.

> Failure to sell the planned bonds and the increased liquidity strain that would result would be expected to trigger [another] rating downgrade. - Fitch

“A rejection of the identification of new and immediate revenues to the territory, particularly to satisfy the financial markets that we’re moving out of structural deficits, would be a decision equal to saying that we would be cutting 11 to 14 percent of the budget for the Government of the Virgin Islands,” the governor said Friday during a press conference held at Government House on St. Croix. “That $110 million removal from the current budget of $787 million, I am not prepared to stand before the community and say this is exactly what that means, but I do not believe that there could be any person in this territory that believes that the removal of $110 million from the operating budget of the Government of the Virgin Islands, would not be an action that is painless.”

In its press release, Fitch says it believes the USVI's failure to date in securing sufficient market access for their planned offering of $219.23 million matching fund revenue bonds, series 2016A (senior lien) and 2016B (subordinate lien), raises concern regarding both the USVI's ability to access financial markets for their debt offerings as well as the USVI's ability to fund current operations and obligations from a severely strained cash position. Proceeds from the 2016A and 2016B bond offerings were to be applied to funding fiscal 2017 operations of the USVI in addition to other uses.

Fitch also highlighted the uncertain nature of the sin tax measure that Mr. Mapp said the bond market demanded before the U.S. Virgin Islands could gain access to funding. And while the governor said the bond market had reacted positively to the five-year economic growth plan measure -- assuring residents that once the measure was passed, access to the market would be once more open to the territory -- Fitch did not ascertain in its release that that was the case.

The ratings firm said the negative watch placed on the IDR and dedicated tax bonds will be resolved based on Fitch's assessment of the USVI's liquidity position and its ability to complete a working capital financing. Failure to sell the planned bonds and the increased liquidity strain that would result would be expected to trigger a rating downgrade.

Fitch further believes that the territory's current challenge in accessing the market for its debt obligations exacerbates concerns about the USVI's strained liquidity. The sale was originally planned for August 2016 to provide cash flow for the current fiscal year which began on Oct. 1, 2016. The extended delay in receiving the expected $147 million in working capital that was to be provided by bond proceeds, $116 million of which is to be applied to funding general government operations (out of the approximately $900 million General Fund budget), is expected by Fitch to further weaken the government's liquidity position in fiscal 2017.

The ratings firm also learned that investors have indicated an interest in the governor of the USVI delivering an irrevocable, rather than the annual, instruction letter to the U.S. Department of Interior for the U.S. Treasury to remit the rum cover-over advance payment to the trustee for the bonds. The revised instruction letter has been delivered by the governor to the DOI, according to Fitch.