

The Virgin Islands Consortium

Moody's Downgrades USVI's Rum Cover-Over Bonds Again

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As the territory's troubled financial condition becomes more pronounced, with the government apparently being unable to access the bond market to service its structural deficit of about \$110 million, the major U.S. ratings firms -- all of which have downgraded the territory before, some on multiple occasions, are once more setting their sights on the USVI's bonds, with Moody's on Tuesday downgrading the territory's four liens of Matching Fund Revenue Bonds (rum cover-over bonds), issued through the Virgin Islands Public Finance Authority, according to a [press release](#) the venerable ratings firm issued Tuesday.

Moody's downgrade of the territory's bonds comes on the heels of Fitch's downgrades, [which took place last week](#). Moody's also issued a negative outlook.

The downgrades have complicated an already complex and daunting situation for the Mapp administration, whose five-year economic growth plan was [formally submitted](#) to the 32nd Legislature this week. The downgrades are also putting pressure on senators to come up with plans to solve the territory's structural deficit problem, which sees the government borrowing yearly to satisfy its operational needs.

The rum cover-over bonds downgraded by Moody's on Tuesday are the Senior Lien Bonds to Caa1 from B1; Subordinate Lien Bonds to Caa1 from B1; Subordinated Indenture (Diageo) Bonds to Caa2 from B2; and Subordinated Indenture (Cruzan) Bonds to Caa2 from B2. The bonds are secured by matching fund revenues which are remittances paid by the federal government to the Virgin Islands' government of a portion of federal excise taxes collected on rum produced in the territory and shipped to the US mainland. The rating action affects approximately \$1.16 billion in outstanding debt.

According to Moody's, the downgrades were triggered by the territory's extremely weak financial position and liquidity, its apparent failure to access the capital markets for a planned deficit financing which would have balanced the current year budget and bolstered liquidity levels, and an increased possibility that the government may be forced to restructure its debt to address its financial problems. Key characteristics of the government's general credit profile include: persistent general fund deficits addressed primarily with repeated deficit financings; very high debt levels; declining gross domestic product and population; and a high unemployment. The Virgin Islands' government has an extremely large unfunded pension liability and the retirement system is projected to become insolvent by fiscal 2023.

Moody's says its latest ratings recognize 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 by the US Treasury to the special escrow agent/trustee. The government recently acted to strengthen the direct payment mechanism by [making the instruction to the federal government permanent and irrevocable](#). 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.

"We note, however, that these security provisions have not been tested in a stress scenario where the government faces a severe lack of funds to provide basic services and we believe they do not protect bondholders in the event that the government is forced to restructure its debt," Moody's said.

The government's fiscal 2017 budget anticipated new deficit financings including a bond sale and draws on a credit facility. The government scheduled a sale of \$219 million senior and subordinate matching fund bonds for December, but rescheduled the sale to January. The January sale was unsuccessful and was subsequently canceled.

Moody's also recognized the governor's five-year economic growth plan aimed at restoring structural balance by fiscal year 2019 with revenue increases and expenditure reductions. The plan would also increase government contributions to the retirement

system. But Moody's noted that the legislature has not enacted the revenue increases, and that it remains uncertain that the revenue and spending initiatives will actually generate the anticipated savings. Mapp has said that the bond market reacted favorably to his five-year plan, the so-called sin tax measure that would tax rum, tobacco, sugary drinks, beers, time share unit owners and even internet purchases.

On the territory's debt structure, Moody's said debt levels are high and have risen rapidly. As of November 1, 2016, the Virgin Islands had \$1.16 billion matching fund revenue bonds outstanding, including \$741 million senior, \$147 million subordinate lien bonds, \$232 million Diageo bonds, and \$35 million Cruzan bonds. The territory's net tax supported debt also included \$714 million gross receipts tax bonds (not rated) which are general obligations of the government additionally secured by a pledge of gross receipts (sales) tax revenues. Net tax supported debt totaled \$1.97 billion an increase of over \$700 million from 2009, largely the result of deficit financings. Net tax-supported per capita for 2016, at \$19,024, was 18 times Moody's 50-state median of \$1,025. Net tax-supported debt as a percent of GDP for 2014 was 53.6%, more than 24 times Moody's 50-state median of 2.2% and higher than the amount for all of the US territories and commonwealths except for Puerto Rico.

Moody's noted that that U.S. Virgin Islands' pension and other post employment benefits (OPEB) liabilities are high and a major credit challenge for the government. The employee retirement systems Unfunded Actuarial Accrued Liability (UAAL) increased from \$1.397 billion in 2009 to \$2.583 billion in 2015. Moody's average Adjusted Net Pension Liability (ANPL) for 2015 equaled \$3.76 billion or 418% of revenues, almost 5 times Moody's 50-state median of 85%. Annual contributions have been consistently far below both the Actuarially Determined Contribution and actual benefits paid. The 2015 valuation report projected the retirement system will become insolvent in fiscal year 2023. The government reported a OPEB UAAL of \$1.02 billion in 2013, the most recent valuation available.