The Virgin Islands Consortium

Fitch, Moody's And Now S&P Downgrades USVI Bonds As Territory Barrels Towards Financial Collapse

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ST. THOMAS -- S&P Global Ratings has lowered its rating on the Virgin Islands Public Finance Authority's (VIPFA) senior-lien matching fund notes to 'B' from 'BB' and its rating on subordinate-lien matching fund notes, issued for the U.S. Virgin Islands, by two notches to 'B' from 'BB-', the ratings firm has announced via press release.

The outlook is negative.

The downgrades follow those of ratings firms Fitch and Moody's, whose actions have weakened the Virgin Islands Government's already weak standing with bondholders. The government, through the Public Finance Authority, issued an updated version of the press release that it issued on Wednesday, basically stating the same thing: "The report by the rating agency Standard and Poor’s pointed out important issues concerning the U.S. Virgin Islands debt and financial conditions. That is why the governor had ordered that a five-year plan be developed with the goal of reducing the government's deficit and developing a roadmap to fiscal stability. We believe the five-year plan is a blueprint to deal with reducing government structural deficits and provide fiscal balance and economic growth."

P.F.A. is referring to one of S&P's recommendations that the government work to offset its structural deficit of roughly $110 million, with a long-term plan that would generate new dollars. The P.F.A. says the five-year plan, dubbed the “sin” tax measure aimed at either introducing or increasing taxes on tobacco products, rum, beer and sugary drinks, as well as time share unit owners and internet purchases -- is the best way to stave off collapse, while improving the government's ability to access the market.

“The government has been working around the clock to enhance its liquidity situation which includes cuts in expenditures,” reads the statement. “The governor recently signed an irrevocable instruction letter to eliminate the notion that the government would divert matching fund revenues (rum cover-over taxes). More importantly, the government has experienced financial distress in the past and has never defaulted on any of its secured debt. The matching fund and gross receipt bonds are secure.”

S&P Credit Analyst Oladunni Ososami said that the downgrade "reflects our view of the USVI's constrained market access following the inability of the territory to sell senior- and subordinate-lien parity bonds after a rescheduled sale date and an attempt to go to market in January, as well as our view that credit quality could deteriorate further due to liquidity concerns if the USVI can't access external liquidity or make significant structural budget changes to address its cash flow needs in the near term.

S&P said the rating also reflects its view of a closer linkage between the territory's general fiscal condition and the repayment of the bonds, especially during times of significant fiscal distress given continued reliance on this revenue source to finance operating deficits.

"The negative outlook reflects our view that the continued significant economic, financial, and budgetary challenges the territory currently faces, absent corrective action, could lead to increased deficit financing," Ms. Ososami added, "and, over time, inadequate capacity or willingness to meet its financial commitment to its obligations, especially if liquidity continues to weaken."

An outlook revision back to stable would necessitate demonstrated improvement in the USVI's long-term fiscal performance and position so as to diminish its reliance on matching fund loan revenues to fund operating deficit, the release said. Along with the adoption of the long-term plan, S&P said the government would have to at a minimum begin to address its significant pressures, such as its largely unfunded Government Employees' Retirement System liability.

In its release on the downgrade on Tuesday, Moody’s said the territory's 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 bot 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.