The Virgin Islands Consortium

Kroll Ratings Firm Gives GVI Refinancing Plan to Undergird GERS BBB Rating With a Stable Outlook

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The Bryan administration said Thursday that Kroll Bond Rating Agency has assigned a preliminary long-term rating of BBB with an outlook of "stable" to the recently approved Matching Fund Special Purpose Securitization Corporation bonds. The special purpose vehicle, or SPV, is being prepared for sale by the territory in a bid to secure funding for the Government Employees' Retirement System for 30 years.

The administration pointed to the BBB rating from Kroll as a positive sign as the government through the Public Finance Authority enters the bond market to secure the funding.

The special purpose vehicle was created by the Legislature through Act No. 8540 to issue the bonds. It is a separate entity from the government of the Virgin Islands and is a type of entity commonly used in municipal financing and carries its own bond rating separate from the GVI, the administration said.

According to Government House, the SPV allows the use of the Internal Revenue Matching Fund bonds, also called the rum cover-over bonds to be reissued for a significant reduction in interest and debt service costs to provide long-term financial support to GERS.

Rum cover-over bonds are taxes on rum made in the U.S. Virgin Islands and sold on the mainland that is remitted to the territory on an annual basis. The remittance has historically hovered around $250 million.

The administration said that preliminary to the issuance of the bond rating by Kroll, the U.S. Treasury and the Department of Interior agreed to Governor Bryan's instruction that the Matching Fund revenues paid out by Interior from the rum cover-over are to be deposited into a restricted account to be paid out to the SPV as the purchaser of the rum revenues while its bonds are outstanding.

"These are major steps in the process of issuing these bonds, and my team has prioritized the additional documents and steps still to be undertaken over the next three weeks before we get to the final goal," Governor Bryan said. "As anticipated, the SPV has received an investment-grade bond rating. The KRBA report also said this bond rating could be upgraded with the addition of 'incremental revenue streams.'"

In December 2020, Mr. Bryan's attempt to secure an SPV deal with the Legislature fell apart after it was revealed that Kroll was charged that year by the U.S. Securities and Exchange Commission on two matters relating to the rating of commercial mortgage-backed securities (CMBS), and of collateralized loan obligation combination notes (CLO Combo Notes). Kroll agreed to pay the S.E.C. more than $2 million to settle the charges.

According to the order pertaining to CMBS ratings, Kroll allowed analysts to make adjustments that had material effects on the final ratings but did not require any analytical method for determining when and how those adjustments should be made. The charges were published in September 2020 by the News File Corporation, a newswire firm offering broad access to media houses such as Thomson Reuters, Bloomberg, Dow Jones and Yahoo! Finance.

According to the S.E.C.'s order relating to CLO Combo Notes, Kroll's policies and procedures were not adequately designed to ensure that it rated CLO Combo Notes in accordance with the terms of those securities.

On Thursday, Gov't House said that in its pre-sale announcement, Kroll said "the combination of the Act, the bankruptcy remoteness of the Corporation, the Sale Agreement, and the Indenture provide the Bonds with a strong legal framework that KBRA believes will substantially insulate the pledged Matching Fund Receipts and the Corporation from the credit risk of the Virgin Islands."

Mr. Bryan concluded, "As we indicated previously, this rating is being given to the SPV as a separate entity from the GVI with a clean financial record and the use of proven revenues for supporting the issuance of its bonds that will go to support the undertakings of the GVI."

Act No. 8540 relies in part on low interest rates to see the best financial returns for the SPV as part of the refinancing; interest rates have been at historic lows due in part to efforts by the U.S. Federal Reserve to stimulate the economy. But on Wednesday the Federal Reserve raised interest rates for the first time since 2018, increasing its benchmark federal-funds rate by a quarter percentage point to a range between 0.25 percent and 0.5 percent.

This immediately triggered the 10-year yield and moved it higher, and in turn pushed the average rate on a 30-year fixed-rate mortgage to over 4 percent for the first time in three years. The same rate was 3.05 percent a year ago, according to Freddie Mac (via the Wall Street Journal).

It remains to be seen how the rate increase by the Federal Reserve will affect the government's efforts on the bond market.