THE UNITED STATES VIRGIN ISLANDS
OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE
Charlotte Amalie, V.I. 00802
340-774-0001

CREATION OF MATCHING FUND SECURITIZATION CORPORATION (SPECIAL PURPOSE VEHICLE)

Purpose: to improve liquidity, reduce debt burden for the Virgin Islands of the United States, and re-establish market access

BACKGROUND

The Government of the Virgin Islands (GVI), through the Virgin Islands Public Finance Authority (PFA), has previously sold bonds in order to provide funds for the cost of infrastructure and economic development, and to support rum production by Cruzan Viril Ltd. (Cruzan) and Diageo USVI Inc. (Diageo).

Currently, GVI receives a rebate of $13.25 per proof gallon of rum in excise taxes that the federal government collects for the rum that is manufactured by Diageo and Cruzan on St. Croix and sold on the U.S. mainland (Matching Fund Receipts or Rum Cover Over). These funds are collected by the US Treasury and transmitted to The Bank of New York Mellon, as trustee for the bonds, and held in an escrow account (lockbox) until they are distributed by the trustee. The monies are used to pay 1) periodic principal and interest to the bondholders, 2) the rum companies according to agreements executed for economic development, and 3) the GVI. This secured lockbox structure will remain in the new SPV bond indenture with the SPV replacing the PFA.

NEW BEGINNINGS

The much talked about and newly created Special Purpose Vehicle (SPV or Matching Fund Securitization Corporation) is similar to the fresh start we enjoy when we are able to refinance our mortgages, make lower payments, and use money previously budgeted to be spent on interest to make repairs and additions to our homes that will allow our families, our parents and even our tenants to live more comfortably.

As a result of the recently passed Bill #33-0363 by the 33rd Legislature, the new corporation will sell bonds and use the sale proceeds to purchase the right to collect the future Matching Fund Receipts revenue stream from the GVI. The GVI will then use the proceeds to pay off PFA's existing Matching Fund bonds, some of which carry interest rates up to 6.75% per year. The Territory will enjoy the benefit of saving money going forward as a result of paying off its existing $1.005 billion Matching Fund debt, which currently pays investors an average rate of approximately 5.58%, and replacing them with the new, approximately $900 million SPV bonds which are expected to pay an average rate of approximately 3.50% under current market conditions. The PFA will be relieved of any future obligation to the existing bondholders once their bonds are paid off on or after October

1st. The newly formed SPV will take on all responsibility for the debt to the new bondholders. The PFA will have ***no*** liability for the SPV debt.

Because the new debt will be an obligation of the SPV, the Matching Fund Receipts will only be paid to the SPV for as long as its bonds are outstanding so that it can pay off its debt in just 19 years. The GVI will still receive the residual receipts (monies remaining after all obligations are met) – the same as it does today under the PFA structure. Once the SPV's bonds are paid off, the SPV will be dissolved and all the Matching Fund Receipts will once again flow to the GVI and the rum companies. Based on the structure of the bonds and the amount of Matching Fund Receipts projected to be received, there will be over three dollars ($3) in Matching Fund Receipts for every one dollar ($1) of principal and interest to be paid on the SPV's bonds. This strong level of revenue support positions the SPV to earn an investment grade rating that will help sell its bonds in the current historically low interest rate environment. By comparison, the PFA's outstanding bonds only required a minimum of $1.50 of rum tax receipts for each dollar of debt service and, even with a debt service reserve fund (DSRF), are currently rated well below investment grade. This higher level of debt service coverage protection under the SPV eliminates the need for a new DSRF for the SPV's bonds.

DEBT SERVICE CONCERNS

In connection with the existing PFA Matching Fund bonds, a portion of the bond proceeds was set aside in a DSRF. This fund was established to provide additional security for the bondholders. If at any time there are insufficient Matching Fund Receipts to make a debt service payment on the bonds, the shortfall is drawn from the DSRF until it is exhausted. If that reserve fund is never drawn upon, it is released to pay the final year's interest and principal on the outstanding Matching Fund bonds. In fact, the existing DSRF has never been drawn upon. Because of the increased level of debt service coverage under the new SPV structure, the likelihood that any DSRF would ever be drawn upon is even more remote.

The amount currently in the DSRF will be used to reduce the amount of SPV bonds being issued thereby reducing the amount of interest to be paid on the new SPV bonds over the next 19 years. It is important to note that not having to borrow approximately $80 million to fund a new DSRF will allow the SPV to avoid approximately $40 million in future interest expense on the DSRF monies. The $80 million represents one year's principal and interest on the SPV Bonds. The cost of maintaining a debt service reserve fund of $130M has been quite expensive for the people of the Virgin Islands and has resulted in GVI receiving less of the residual rum tax receipts in the past. Because less of the Matching Fund Receipts will be needed to pay the lower amount of interest on the SPV's bonds, more of the Matching Fund Receipts will flow to the GVI to fund other necessary priorities.

The near-term benefit to the GVI as a result of this transaction is a projected $85 million in additional cash flow in each of the fiscal years 2021, 2022, and 2023.

OVERVIEW AND EXPLANATION OF THE SPV CORPORATION

Because of the poor credit ratings of the U.S. Virgin Islands over the last several years and the resulting lack of investor support for its existing debt, the GVI has not been able to access the bond market to raise funds for infrastructure improvements, economic development and funding for agencies such as health, education and the Government Employee Retirement System (GERS).

The high interest rates that the PFA currently pays on the existing Matching Fund outstanding debt make up part of the approximately $108 million in annual debt service payments. Given the current historically low interest rate environment, it is an opportune time to refinance this debt at a lower interest rate which may average approximately 3.50% under current market conditions if the SPV earns the expected investment grade credit rating. This transaction is expected to result in an additional $85 million in available funds annually for the GVI in each of the next three fiscal years. This money can be used, as in the past, for infrastructure and economic development. The overall savings over the life of the new bonds, and the investments made throughout the first 10 years will improve the lives of all Virgin Islanders and grow our economy.

The Governor will work with the Legislature to appropriate the funds to priority areas, including the GERS, and hurricane recovery projects.

A striking ancillary benefit of this financial structure could be the contribution from the GVI required by FEMA to release promised disaster recovery monies. The GVI has not been able to access these FEMA funds due to its inability to provide its local share of funding. For example, the GVI can unlock $90 million in pre-authorized federal grant money for every $10 million it can provide as a match. The $100 million in projects that can be financed with the FEMA monies will create an unprecedented economic development impact that the Virgin Islands has not enjoyed for many years. Income to companies in construction and related fields will bring in new gross receipts taxes that could be dedicated to the GERS. The work that these companies must perform will also lead to a more robust and resilient economy with greater employment opportunities and productivity for Virgin Islanders at a time when they are most needed.

After the initial three years of savings, there is projected to be additional cash flow savings annually in years four through ten. In years 11 through 19, the debt service payments on the SPV bonds will be higher than the payments on the existing bonds, but there is a projected overall savings over the life of the new bonds. In addition, the highest debt service payment in any one fiscal year on the new SPV bonds at approximately $80 million, will be lower than that of the currently outstanding bonds at approximately $108 million.

Critically important to the structure of the SPV is that all liability for payment of the new SPV bonds is removed from the Government of the Virgin Islands.

The SPV serves as an independent and autonomous entity of GVI. The Governor will chair the board and, in consultation with experts, will select four independent members with significant financial industry and legal experience. Virgin Islanders can be confident in the service of board members who, by law, are tasked with the fiduciary responsibility to the corporation and bear responsibility for the financial transactions of the entity. This configuration of board members is very similar to what exists in the V.I. Tobacco Settlement Financing Corporation (TSFC), which has performed flawlessly since 2001.

It merits mention that the credit rating of the TSFC was recently upgraded because the corporation was able to demonstrate its creditworthiness as an autonomous entity of the GVI. Similarly, the SPV is expected to have an investment grade credit rating that is significantly higher than that of the GVI. It is also important to note that under the new SPV structure, there will be **no new debt** for the people of the Virgin lslands. To the contrary, over $1 billion of outstanding PFA debt will be paid off.

Finally, the new SPV will provide a much needed means for the GVI to access the capital markets in the future by issuing highly rated debt to fund the government’s capital needs.

SUMMARY

The Special Purpose Vehicle is a structure that is known, accepted, approved and highly regarded by the investment community. Since the SPV is held at arms-length, just as is the VI Public Finance Authority, the VI Lonesome Dove Corporation, and the VI Tobacco Settlement Financing Corporation, the debt service obligation will not be that of the GVI. The debt will be the liability of the newly created SPV, which is bankruptcy remote, isolating the financial risk of the GVI. The debt service payments will be greatly reduced due to the significantly lower expected interest rates paid on the new SPV bonds. The rules of the SPV require the corporation to first pay the interest and principal to the bondholders before sending the balance of the Matching Fund Receipts to the GVI. The rum companies will also receive their proper allocations under their respective existing agreements which provide for their contributions to the economic development of the Territory. Finally, the new SPV will provide a means for the GVI to once again effectively access the capital markets, now and in the future, something it has not been able to do for several years.

Timing for this borrowing is optimum and may not last long as the US economy moves closer to recovery. Interest rates change daily and could move upward at any moment. The impending presidential election adds an additional layer of risk that interest rates could change significantly in the coming months. With the approval of the 33rd Legislature, savings for the Government of the Virgin Islands could begin on October 1st of this year.

The establishment of the SPV will set the US Virgin Islands on an upward trajectory to long term economic growth, plant the seeds of prosperity, create a new fiscal outlook and bring the Territory a fresh start.