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Virgin Islands Eyes End to Bond-Market Exile With Mega Deal.

- **Deal securitizes rum taxes to safeguard against bankruptcy**
- **'If you don't have a better idea, then support this one'**

The U.S. Virgin Islands has been locked out of America's bond market for years as it wrestles with the same economic forces that drove its bigger neighbor, Puerto Rico, into financial ruin.

Now, with a credit rating cut deeply into junk and under pressure to raise cash as a tourism drought stings its economy, the U.S. territory is seeking to sell nearly \$1 billion in debt this month by extending an unusual promise to investors: the bonds will be repaid even if it goes bankrupt.

The step, pitched to the island by investment bank Ramirez & Co. and a New York advisory firm, is similar to a tactic used by Puerto Rico and Chicago to pledge a big chunk of tax collections directly to public corporations that pay off debt backed by the revenue. That was intended to assure investors that the funds wouldn't be diverted even if their financial strains worsened, reducing the risk to bondholders and driving down their borrowing costs.

In the case of the Virgin Islands, it's pledging the nearly \$250 million a year it receives each year from the U.S. government, the territory's cut of the excise taxes on rum it ships to the mainland.

Governor Albert Bryan Jr., who has spearheaded the plan, said in a local news interview said it represents one of the territory's only options. "If you don't have a better idea, then support this one," he said.

The bond offering was set to be priced as soon as Thursday but has been delayed, according to two people familiar with the matter, who spoke on the condition of anonymity because they weren't authorized to discuss it publicly.

The sale will provide a major test of the \$3.9 trillion municipal bond market, where investors have continued to snap up riskier securities as benchmark yields hold near the lowest in decades. That's allowed some borrowers hard hit by the nation's economic collapse to easily raise cash.

The Virgin Islands' bonds are using a so-called bankruptcy remote structure. That involves steering the money to a newly created corporation and providing a legal pledge that the cash won't be siphoned off even if the government is forced to restructure its debts in federal bankruptcy court.

Bondholders have reason for skepticism. Lisa Washburn, a managing director for Municipal Market Analytics, said such a structure is not necessarily "bankruptcy proof," though it would likely give investors a better negotiating position. Even though Puerto Rico's bonds securitized by its sales taxes weren't walled off from bankruptcy, owners recouped as much as 93 cents on the dollar, more than other creditors stand to receive.

"The Virgin Islands could end up eventually in trouble," Washburn said. "If they end up in trouble,

it's my guess that the durability of this transaction is questioned."

Dennis Derby, a portfolio manager at Wells Capital Management, said a restructuring could still affect the bondholders even if the structure itself is bankruptcy remote. After paying debt service, the territory uses matching fund money to pay incentives to the rum producers. In a bankruptcy, those payments could be affected and threaten rum producers' operations within the territory, which could in turn end up affecting the securitized bonds because they rely on rum production for repayment, he said.

"Should there be a disruption in subsidies or incentives, that could cause problems with this particular matching stream," he said. "That's a risk."

Even before the slowdown in tourism caused by Covid-19, the Virgin Islands was struggling under outsize debts and a pension system projected in a 2018 valuation to run out of assets by the fiscal year starting October 2023 or sooner. In 2017, it stopped providing financial information to credit-rating companies after it was dropped far into junk amid speculation about its solvency.

Kroll Bond Rating Agency rates the nearly \$1 billion of bonds being offered by the territory's securitization corporation BBB, the second lowest investment-grade, because of the "strong protections."

The government is seeking to sell the debt before a bond payment is due on Oct. 1, a step that will allow it to push off some payments for the next three years.

While that will provide short-term relief, some officials are dubious. Senator Janelle Sarauw compared the bond deal to predatory lending that will just push off problems on future generations.

"Why do we want to tie up our greatest revenue stream for the next ten to 15 years?" she said in an interview.

On Sept. 17, territory lawmakers passed an amendment to the legislation that would cap the interest rate at 3.75%, which Sarauw said they did to make it "impossible" to price the bonds. Representatives from Ramirez, the underwriter, and Capital Markets Advisors, LLC, the financial adviser, on the bond deal did not respond to inquiries about the 3.75% rate cap.

In testimony on the new bond structure to the legislature, Virgin Islands Finance Commissioner Kirk Callwood said that it was an opportunity to take advantage of low rates and that "naysayers" were promoting bankruptcy.

Such a collapse, he said, would send a "message to the world that the U.S. Virgin Islands is neither capable, nor has the courage, to attempt to solve its challenges."

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— *With assistance by Michelle Kaske*