

MOODY'S

INVESTORS SERVICE

Rating Action: Moody's Downgrades Virgin Islands Matching Fund Rev. Bonds to B1 & B2 from Baa2 & Baa3; Outlook Negative

Global Credit Research - 30 Jun 2016

New York, June 30, 2016 -- Summary Rating Rationale

Moody's Investors Service has downgraded the ratings on the US Virgin Islands' four liens of Matching Fund Revenue Bonds, issued through the Virgin Islands Public Finance Authority, as follows: Senior Lien Bonds to B1 from Baa2; Subordinate Lien Bonds to B1 from Baa2; Subordinated Indenture (Diageo) Bonds to B2 from Baa3; and Subordinated Indenture (Cruzan) Bonds to B2 from Baa3. 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 \$1.24 billion in outstanding debt.

The rating downgrades primarily reflect a closer alignment of these special tax ratings with the Virgin Islands government's general credit position, which has continued to erode and reached a severely weak condition. The government's challenged financial position increases the possibility that it will use the matching fund revenue credit for new deficit financings, as it has in the past. Additionally, while the legal structure of the matching fund bonds is stronger than the government's unsecured general credit quality (see Legal Security, below) this has not been tested in a stress scenario, and warrants a closer alignment of the matching fund bonds with the government's credit as its finances weaken. Key characteristics of the government's general credit profile include: persistent general fund deficits addressed primarily with repeated deficit financings; very high and rising debt levels; declining gross domestic product and population; high unemployment; and a large unfunded pension liability. A further challenge is the government's need to access the capital markets to balance its budget and to bolster its liquidity, and the severe stress that could result without this access.

To a lesser extent, the downgrades also reflect a decline in pledged matching fund revenues and debt service coverage in 2015 primarily attributable to a reduction in shipments by one of the territory's two rum distilleries. Future coverage could decline further if the territory is successful in its plans for debt refinancing and new money issuances.

The ratings recognize that the bonds possess 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 to the US Treasury to the special escrow agent/trustee. 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. But we note the instruction to the US Treasury to make the direct payment must be renewed annually by the Virgin Islands government, and these structures have not been tested in a stress scenario where the government faces a severe lack of funds to provide basic services.

Rating Outlook

The outlook on the ratings is negative, reflecting the severe fiscal challenges facing the government, its need to access the capital markets to balance its budget, and the possibility that its liquidity and general credit profile could continue to deteriorate.

Factors that Could Lead to an Upgrade

Restoration and maintenance of structural budget balance by the primary government.

Factors that Could Lead to a Downgrade

Failure of the government to access capital market for planned financings.

Further erosion of government's liquidity.

Decline in matching fund revenues and debt service coverage due to further reduction in rum shipments by the

two distilleries.

Legal Security

Bond security is established by the trust indenture, the loan agreement, the special escrow agreement, and Virgin Islands statutes. 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. In the loan agreement the government covenants to direct the US Treasury to pay the pledged matching fund revenues directly to the trustee. This structure provides apparent bondholder protections and stronger credit quality than unsecured general obligation bonds, but it has not been tested in a severe stress scenario.

Use of Proceeds

Not applicable.

Obligor Profile

With the closure of the Hovensa oil refinery in 2012, the territory's economy is primarily concentrated in tourism. While there have been some positive trends in visitor counts since the recession, GDP continues to decline, dropping at a compounded annual rate of 2.7% from 2009 to 2014. Population fell from 115,852 in 2008 to 103,961 in 2014, while non-agricultural employment fell from 45,488 to 38,144 over the same period. Unemployment at 11.9% in 2015 was more than twice the US levels. Per capita personal income is 47.9% of the US level.

Government finances have been severely strained. Revenues fell abruptly in fiscal 2008 and 2009 as a result of the recession and operating losses at the Hovensa refinery. The government addressed the resulting deficits primarily with deficit financings. Revenues have recovered somewhat in recent years. The Hovensa refinery was recently sold generating a \$220 million one-time payment which will benefit government finances and liquidity in fiscal 2016. Nevertheless, the general fund still has a structural deficit. For fiscal 2017, the government estimates a structural imbalance of \$110 million and has proposed to address it with \$55 million in debt service savings from a debt refinancing and \$50 million from a new deficit financing.

Methodology

The principal methodology used in this rating was US Public Finance Special Tax Methodology published in January 2014. Please see the Ratings Methodologies page on www.moody.com for a copy of this methodology.

Regulatory Disclosures

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moody.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moody.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moody.com for additional regulatory disclosures for each credit rating.

Kenneth Kurtz
Lead Analyst
State Ratings
Moody's Investors Service, Inc.
One Front Street
Suite 1900
San Francisco 94111
US
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Nicholas Samuels
Additional Contact
State Ratings
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653



© 2016 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE. MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN

WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit

ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJJK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.