TESTIMONY OF
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DIRECTOR, OFFICE OF MANAGEMENT & BUDGET (OMB)
BEFORE THE
COMMITTEE ON FINANCE
OF THE
31ST LEGISLATURE OF THE U.S. VIRGIN ISLANDS
(HONORABLE CLIFFORD F. GRAHAM, CHAIRMAN)
FY 2017 Executive Budget Final Review Session
August 15, 2016 (9:00 AM)

Introduction

Good Morning to you Chairman Graham, and other members of the Committee on Finance, to other Senators of the 31st Legislature who are present; and to the listening and viewing audience. My name is Nellon L. Bowry, Director of the Office of Management and Budget (OMB). Pursuant to your invitation, I am accompanied by the following cabinet members: Mr. Marvin Pickering, Director of the Bureau of Internal Revenue (BIR); Mr. Delbert Hewitt, Chief of Staff and Mr. Ira R. Mills, Tax Assessor, both from the Office of the Lieutenant Governor and Mr. Valdamier O. Collens, Commissioner of the Department of Finance (DOF) and Executive Director of the Public Finance Authority (PFA).

Together with my fellow Cabinet members, I appear before you today to provide an update to the FY2017 Executive Budget proposal, which was originally submitted on May 29th of this year. Collectively, we will provide updates to the economic outlook, the revenue assumptions and the proposed appropriations that formed the basis of the FY 2017 Executive Budget. Specifically, our presentations will achieve the following purposes: provide an update on the Virgin Islands economic condition and outlook that provide a context for the Budget; discuss significant events since the original budget submission, which have impacted the FY 2017 budget plan; provide an update to the assumptions and estimates of the revenues and financial resources that support the proposed appropriations (as revised); provide proposed revisions to the FY 2017 appropriations requests; and provide an update on the cash position of the Government of the Virgin Islands (GVI).

Economic Conditions and Outlook - Update

The Virgin Islands Bureau of Economic Research (BER) is confirming its earlier assessment, which was presented at the time of the FY 2017 Executive Budget Overview that the Virgin Islands economy is emerging, albeit slowly, from the contraction that was triggered by the Great Recession of 2008 and exacerbated by the closure in 2012 of the Hovensa refinery.

BER summarizes the near term economic outlook as follows: "The economy will continue on its present course of mild improvements with major contributions coming from tourism, manufacturing and construction. In addition, several initiatives are being undertaken by Government, such as highway infrastructure improvements, energy and waste water improvements that will assist in the recovery. However, a strong recovery of private sector demand, including consumer and investment spending, is required to give momentum to the recovery that brings the economy back to its pre-recession growth."

Significant Subsequent Event

The most significant event to impact the FY 2017 proposed Budget, since its submission, has been the downgrade of the Matching Fund Bonds by Moody's Investment Services (Moody's), which was apparently triggered by the passage of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) by the U.S. Congress. As you are aware, on June 30, 2016, Moody's downgraded the ratings of the Virgin Islands Matching Funds Revenue Bonds as follows: both the Senior Lien Bonds and the Subordinate Lien Bonds were downgraded from Baa2 to B1; and both the Subordinated Indenture (Diageo) Bonds and (Cruzan) Bonds were downgraded from Baa3 to B2.[1] These five-step downgrades signify a lowering of the credit quality rating of these bonds, from "Investment Grade" to "Speculative" (Non-Investment Grade)[2]; at least in the estimation of Moody's. Significantly, as of today (August 12, 2016), these bonds are still rated Investment Grade quality by both Standard & Poor's Global Ratings (S&P) and Fitch Ratings (Fitch)[3].

How does the downgrade impact the FY2017 Budget? Recall that the Budget relied on $55 million in budgetary debt service savings from a proposed restructuring of the GVI's long-term debt. Our financial advisors have now indicated to us that the increase in interest cost on the Virgin Islands Matching Fund Bonds, resulting from the Moody's downgrade, has significantly changed the

[1] See attached "Moody's Rating Action" (Exhibit I)
[2] See attached "Rating Agency Credit Scale" (Exhibit II)
[3] Fitch has placed VI Matching Fund Bonds on "Rating Watch Negative". S&P's rating of all Virgin Islands debt are unchanged by the passage of PROMESA.

assumptions, in particular the interest rate assumption[4], of the GVI's planned debt restructuring such that the transaction, as contemplated, has now been deemed to be cost prohibitive. Instead, the GVI will pursue a more straight forward, new money, debt issuance, which will include a working capital component, sufficient to replace the $55 million. Accordingly, the FY 2017 Budget has been revised to replace $55 million in debt service budgetary savings, with $55 million in working capital financing from a new money debt issuance.

It is of significant note, that whereas the previously contemplated debt restructuring was expected to provide approximately $55 million in budgetary debt service savings, annually, for five years, the proposed new debt issuance provides budgetary relief for FY 2017 only. For that reason, the Administration will submit shortly a package of revenue generating measures, as part of a 5-year deficit reduction plan, which will address the forecasted budget gap from FY2018 and beyond. These measures will have to be properly vetted by this Body and, when approved, will require that administrative and other implementing logistics (people, processes and technology) be put in place, before they can begin to bear fruit. Therefore, the early submission is intended to provide sufficient time for proper vetting and implementation.

FY 2017 Budget Overview-Update

The overall effect of the proposed updates to the FY 2017 General Fund Budget is summarized in Table 1 below. It shows a net increase of $1.1 million in estimated resources, which is exactly offset by a $1.1 million increase in proposed expenditure appropriations; thereby resulting in no change to the $1.4 million in the excess of resources over appropriations.

Table 1: Summary FY2017 General Fund Budget Revision (Mills.)

		Original	Revision	Revised
1	Taxes, Revenues & Transfers	$ 667.9	$ 1.1	$ 669.0
2	Debt Financing	110.0	0.0	110.0
3	Revenues & Sources	$ 777.9	$ 1.1	$ 779.0
4	Expenditure Appropriations	(776.5)	(1.1)	(777.6)
5	Sources Excess of Appropriations	$ 1.4	$ 0.0	$ 1.4

[4] Approximately 200 basis points

In short the overall FY 2017 financial plan that was submitted in May 2016, remains essentially intact. The proposed revisions to revenues and appropriations are detailed below.

Revenue and Sources Estimates – Update

The updates to the FY 2017 revenue estimates resulted primarily from a review and analysis of actual collections for the major tax and revenue categories, through July 2016, as reported by the Bureau of Internal Revenue (BIR). The baseline projections were then adjusted, in some cases, for the effects of planned revenue enhancement initiatives. The BIR Director will be able to expound on these initiatives.

Table 2: Summary FY2017 General Fund Revenue Revision ($Mills.)

		Original	Revision	Revised
1	Tax Revenues, net	$ 577.9	$ 0.5	$ 578.4
2	Other Revenues	33.9	0.0	33.9
3	Fund Transfers, net	44.4	12.3	56.7
4	Debt & Other Financing	121.7	(11.7)	110.0
5	Total Revenues & Sources	$ 777.9	$ 1.1	$ 779.0

As shown in Table 2, the resulting revision to the estimates of General Fund resources is a miniscule $1.1 million increase, in the aggregate. Essentially, the $11.7 million reduction in other (non-debt) financing, is being offset by a $12.3 million increase in transfers to the General Fund from other Funds. The increase in transfers came from three Funds: $6.8 million from the Matching Fund; $3.0 million from the Insurance Guaranty Fund; and $2.5 million from the Community Facilities Trust Fund. Please note that the additional transfers from the Matching Fund will require legislation to temporarily suspend the transfer of $ 2.0 million to the St. Croix Capital Improvement Fund and $1.0 million to the Crisis Intervention Fund. A proposed draft of legislation is appended to my testimony.

Table 3: FY2017 Tax Revenue Update ($Mills.)

	Major Tax Categories	Original	Revision	Revised
1	Individual Income	$ 351.5	$ 10.7	$ 362.2
2	Corporate Income	74.3	(14.6)	59.7
3	Real Property	60.0	3.2	63.2
4	Gross Receipts	184.2	1.2	185.4
5	Other Taxes	36.4	0.0	36.4
6	Tax Refund & Debt Service	(128.5)	0.0	(128.5)
7	Tax Revenues, net	$ 577.9	$ 0.5	$ 578.4

The relatively minor $500,000 increase in net Tax Revenues, masks some more substantive changes in the four major tax categories. Specifically, as shown in Table 3, the estimates for individual income tax, real property tax and gross receipts tax were all revised upward; by $10.7 million, $3.2 million and $1.2 million, respectively—a total increase of $15.1 million. This was offset by a $14.6 million decrease in the estimate of corporate income tax.

Income tax collection in FY 2017 is expected to benefit from the additional taxes to be collected from salary increases to existing GVI employees, as well as from the filling of budgeted vacant and new positions. In the private sector, the ramp up of employment at the Limetree Bay Terminal facility as well as the addition of EDC beneficiaries with high net worth principals, is also expected to benefit individual income tax collections. The decrease in the estimate of corporate income tax reflects the fact that collection through July is $25 million (or 37.3%) less than for the same period in FY 2015. Director Pickering will be able to shed some light on the reason for this, as well as on-going and planned collection efforts by BIR.

Expenditure Appropriation Estimates- Update

Additional appropriations totaling $1.1 million are being requested in the Miscellaneous Section of the FY 2017 Budget for two Departments; the Department of Health (DOH) and the V.I. Police Department (VIPD). An amount of $350,000 is being requested for DOH to fund the Emergency Medical Technician (EMT)/Paramedics annual training and certification in compliance with National Emergency Medical Services (EMS) standards and guidelines. Thirty-nine line staff will receive this training. An amount of $750,000 is being requested for VIPD for off-island training for police officers. This training is designed to familiarize recruits with modern techniques in such areas as basic life support, first aid and CPR, as well as defense and ground tactics.

Conclusion

Mr. Chairman, as you are aware, a budget is a proposed financial plan that is based on assumptions, estimates and forecasts of the future. As such, it is inevitably subject to some margin of error and, therefore, to change. It is also fundamental to budgeting that estimated resources will not be sufficient to meet all of our needs. Indeed, the very essence of budgeting is the allocation of limited resources among seemingly unlimited claims against those resources. Within those constraints, we believe that we have proposed a budget that is reasonable and credible.

That concludes my statement.

END OF STATEMENT