

Guam Power Authority

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Credit Profile

Outstanding Revenue Bonds, Various Series

<i>Long Term Rating</i>	BBB-/Stable	Upgraded
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Outstanding Revenue Bonds, Series 1999

<i>Unenhanced Rating</i>	BBB-(SPUR)/Stable	Upgraded
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Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services raised its standard long-term rating and underlying rating (SPUR) on Guam Power Authority's existing revenue bonds to 'BBB-' from 'BB+'.

The upgrade reflects, in our opinion, the authority's sustained trend of improved operational and financial performance, including:

- The authority's baseload assets are more available and the authority is using them more efficiently, allowing the authority to reduce dependence upon the costlier diesel-fired peaking units. While historically these fuel-oil burning baseload units had averaged as low as 83% of all energy production, the fiscal 2007 output was in excess of 97%. These improvements will allow the authority to shift emphasis on its capital program to continued efforts for place more of its transmission and distribution (T&D) system underground as well as implementing overall T&D system stability and reliability improvements.
- Guam Public Utilities Commission continued support to the authority under the Consolidated Commission on Utilities governance structure that oversees both Guam Power Authority and Guam Waterworks Authority. The authority continues to be supported in its twice-a-year levelized energy adjustment clause (LEAC) fuel adjustment portion of its rates, as well as the authority to be more aggressive towards delinquent customers and illegal connections.

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- The territory's improved economy, both in the near-term with increased tourism to the island and related expansions in that sector, as well as long-term prospects associated with the fact that Guam stands to gain as many as 8,000 U.S. Marines and 9,000 dependents from Okinawa 2017. The U.S. and Japanese governments have made a \$10.3 billion commitment to this end. The U.S. Navy in fiscal 2007 alone accounted for 16.8% of authority revenues.

The rating remains constrained in our opinion by uncertainty regarding the general government's ability to address a series of long-term liabilities due to the authority. We believe that general government's authorization of a \$271.6 million general obligation (GO) bond authorization, in which general government management has represented to us that a portion of proceeds could be used to fund some of its long-term liabilities-including potentially to the authority, to be a positive development but not one which is yet measurable. During fiscal 2007, the authority, along with its external auditor, wrote down this receivable by about \$13.5 million, deeming it not realistically collectible. While the general government has since 2003 been able to pay its current bills for utility services, there remains uncertainty as to the likelihood of the general government's ability to continue to make substantial progress on its accounts payable and promissory notes due to the authority. In mid-2008, however, the general government was actually able to pay authority the \$13.5 million in question.

The fiscal 2007 audited financial statements, show the authority was carrying a \$12.4 million accounts receivable from the general government, and \$23.4 million in combined promissory notes receivable from the general government's public school system and department of public works, versus about \$312 million in total revenues. The long-term rating on the authority could still be pressured by if the general government's situation does improve. However, on Oct. 28, 2008, we upgraded Guam to 'B+' from 'B', based on greater political consensus to enhance revenues and control expenditure growth, as well as leadership more fully addressing plans on how to fund all of the substantial unfunded long-term liabilities on Guam's balance sheet.

Fiscal 2007 audited results demonstrate, in our opinion, the sustained period of good financial performance. This includes about 1.50x annual debt service coverage, and 1.21x fixed charge coverage when factoring in the authority's capital lease obligations to its independent power producers. The authority still has obligations, including capacity payments, associated with its capital leases. However, for several consecutive years authority-owned baseload units have provided nearly 98% of all energy requirements. The on-balance-sheet cash and equivalents of \$25 million was equivalent to a modest 36 days on hand. Moderating the liquidity position is the fact that the authority has a good history of support from Guam Public Utilities Commission, which approved the authority's request to recover its fuel costs, including stored inventories and hedge losses, as well as a \$10 million line of credit that typically is used for fuel purchases and repaid within the fiscal year.

The Guam Public Utilities Commission has pending for its review a 5.8% LEAC-related reduction, to become effective in February 2009. Base rates have not had to be adjusted in more than a decade. The fiscal 2007 results follow audited fiscal 2006 results that showed very similar results, including 1.6x annual debt service coverage (DSC) and similar levels of cash on hand; management is also expecting similar results for fiscal 2008 based on its unaudited estimates. This is a marked improvement from as recently as fiscals 2002 and 2003, when coverage was below 1.0x and cash flows were extremely challenged due to two major typhoons within about a 10-month span. The Federal Emergency Management Agency (FEMA) has fully reimbursed the authority for approved claims relating to past typhoons. Maintenance of reasonable net margins and liquidity levels are important

given the fact that authority management has identified more than \$110 million in projects in its fiscal 2009-2013 capital plan, including finishing its near-completed efforts to strengthen or place underground its key transmission and distribution assets; management currently has no additional bonding plans until at least 2012, with pay-as-you-go annual capital expenditures of \$20 million to \$25 million annually. An additional update to the capital improvement plan is pending, as the authority is jointly planning some of its infrastructure requirements with other agencies and the U.S. Department of Defense in advance of the marine relocation.

Guam Power Authority is a vertically integrated electric utility that provides service to approximately 46,000 customers on the island of Guam, the largest and southernmost of the Mariana Archipelago, approximately 1,500 miles southeast of Tokyo. The authority is a statutorily autonomous component unit of the general government and, as such, would transfer or loan money to the general government only at the discretion of the Consolidated Commission on Utilities; surplus net revenues otherwise stay within the authority's coffers.

The upgrade affects about \$368 million in existing revenue bonds.

Outlook

The stable outlook reflects Standard & Poor's expectation that the authority's financial performance is sustainable given the improvements to its operations and regulatory relationship and to Guam's economy. A higher rating is still precluded by the lack of certainty regarding the general government's ability to reduce its long-term liabilities with the authority and how much that may affect the authority's cash flows, ability to fund revenue requirements, and rates. The territory will always face risks associated with vulnerability to the tourism industry, due to factors such as economic cycles (especially in Asia) and severe weather events. However, the general government remains one of the authority's largest customers and failure to make realistic progress on the general government's long-term liabilities with the authority could continue to hamper the authority. Additional financial challenges will be funding identified T&D system improvements in a prioritized and proactive manner, establishing and maintaining emergency liquidity reserves as a hedge against the next severe weather event, and maintaining the supportive regulatory relationship that have benefited the authority since the implementation of its new governance structure in 2003.

Military Infusion To Spur Guam Economic Boom

The U.S. Department of Defense (DoD) will be Guam's major economic driver. Because of Guam's location and its value as the U.S.' westernmost strategic military installation in the Pacific region, its value to the military is paramount to 21st Century operations. Essentially untouched during the 2005 Base Realignment and Closure process, the island will instead see a massive military buildup, slated for completion between 2014 and 2017 and peaking from about 2010-2014, during the next seven to 10 years. The current DoD population is about 14,200, including active-duty military personnel. By the end of the buildup, that total should reach 40,000, including the relocation of 8,000 marines and 9,000 dependents from Okinawa by 2014. While current active-duty levels in Guam are 6,420 troops and 7,690 dependents, those numbers should climb to 18,930 and 19,140, respectively.

The investment by DoD includes not only operational facilities and military housing but also major on- and off-base infrastructure investment, including \$1.25 billion for an additional highway to link Andersen Air Force Base and Naval Base Guam. It is also likely the DoD will directly, or jointly in

partnership with some or all of Guam's various utilities, enhance electric, water, sewer, and solid waste service utility infrastructure. These enhancements should affect Port of Guam and the airport, especially for air cargo, similarly; therefore, both are updating their planning and infrastructure.

Given that the U.S. military's total economic effect, including outlays indirectly related to the relocation of 8,000 marines plus their dependents, on Guam's economy will likely exceed the \$10.2 billion in direct outlays, the general government stands to benefit, with improved cash flows likely to benefit the authority and other independent agencies and authorities. Guam Economic Development and Commerce Authority has secured grants from various federal agencies to pay a consultant to create a master plan to help Guam prepare for the buildup and provide assistance to the Joint Guam Program Office, which will lead the buildup.

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