

Public Finance
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Bank of America



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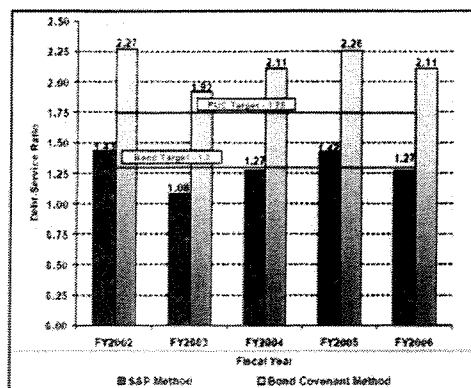
Randall V. Wiegand, CPA
Chief Financial Officer, Guam Power Authority
Harmon Business Office - Route 16
Harmon, Guam 96913

Dear Randy:

This memo is in response to your inquiry regarding the calculation of debt service coverage for budgetary and rate setting purposes on an ongoing basis. As you know, we have consistently presented to the market, the PUC's policy to set rates that would result in a minimum 1.75 times debt service coverage, which has resulted in positive feedback from investors, insurers and rating agencies. Any consideration by the PUC that would affect this policy is of great concern to us, as it may have an impact on the Authority's compliance with bond covenants and would likely have an effect on GPA's credit rating.

We should clarify the difference between calculating debt service coverage from a bond covenant standpoint versus a rating standpoint. GPA's bond covenants specifically outline the required calculation for 1.30 times annual debt service coverage on a net revenue (revenues less maintenance and operating expenses) basis, and GPA has met this test on an annual basis, in part due to the PUC's 1.75 times DSC policy. However, from a rating agency standpoint, the rate covenant is assumed to address all obligations, including senior and subordinate debt, as well as other system funding requirements. Arguably, the Independent Power Producer (IPP) contracts are a critical component of GPA's system and the rating agencies take this into consideration when calculating debt service coverage, for the sake of maintaining and improving GPA's credit rating.

It has been apparent over the last several years that GPA's credit rating has been negatively affected by the calculation of debt service coverage that treats the IPP contracts as additional senior lien debt. The chart to the right, provided by your staff in GPA's most recent presentations to Standard and Poor's (S&P) illustrates that there have been several years in which GPA's debt service coverage falls below the bond covenant target of 1.30 times, according to the rating agency calculation. Thus it seems only prudent for the PUC to maintain its rate setting policy in order to meet at least the bond covenant target of 1.30 times using the rating agency calculation. The extent to which the PUC adjusts the 1.75 times policy to compensate for this adjustment is a decision on which the Authority and PUC must agree so that the Authority's financial position is not compromised.



We have been working with the rating agencies to help improve GPA's credit rating back to an investment grade status. We believe that any change in the PUC's coverage policy that reduces the previously established coverage targets or reduces the resulting cash flow to the utility, will likely be viewed as a negative factor by credit rating agencies. This was confirmed in discussions with rating agencies this year. The method which has been historically used by the PUC is consistent with the debt service coverage formula used by rating agencies. We hope this is helpful in your discussion with the PUC. Please feel free to let us know if you have any questions.

Best Regards,

Margaret Guarino
Managing Director

Aulii Limfaco
Vice President