FitchRatings

Fitch Affirms Guam Power Authority's Rev Bonds at 'BBB-'; Outlook to Positive

Fitch Ratings-New York-11 December 2017: Fitch Ratings has assigned a 'BBB-' rating to the following Guam Power Authority (the authority, or GPA) revenue bonds:

--Approximately $146.45 million senior revenue bonds, 2017 series A.

Proceeds from the planned issuance will be used to refund all or a portion of GPA's outstanding 2010 Series bonds.

In addition, Fitch has affirmed the rating on the following bonds:
--$464.96 million senior revenue bonds, 2014 series A, 2012 series A and 2010 series A at 'BBB-'.

The Rating Outlook on all the bonds has been revised to Positive from Stable.

SECURITY

Senior lien bonds are payable from a first lien on net revenues of GPA.

KEY RATING DRIVERS

SOLE POWER PROVIDER: GPA benefits from its position as the lone provider of retail electricity to the roughly 163,000 residents of the island of Guam, the westernmost territory of the U.S. The significant presence of the U.S. Navy provides stability to the island's otherwise limited economy, as well as the authority's customer base.

IMPROVED FINANCIAL RESULTS: Financial results remained sound in fiscal 2016 driven by sustained, stronger operating cash flow. Fitch calculated debt service coverage and coverage of full obligations were both 1.43x, and unrestricted liquidity reached about 154 days of cash on hand. Unaudited performance for fiscal 2017 suggests similarly sound performance, but with lower cash on hand.

OUTLOOK POSITIVE ON DEVELOPING RESOURCE PLAN: The Positive Outlook

reflects GPA's emerging resource plan and Fitch's expectation that the associated borrowing requirements - both direct and off-balance sheet - will be lower than previously estimated. Greater clarity related to both capital spending and funding should emerge during fiscal 2018.
POWER SUPPLY DIVERSIFICATION: GPA's current power supply remains sufficient to meet its load requirements, despite the loss of baseload resources to a 2015 fire. Fitch views positively the authority's ongoing strategic resource plan to diversify the utility's fuel mix and facilitate compliance with environmental regulations through a conversion to dual-fuel generation. Projected costs could be sizable, but Fitch expects the plan will ultimately result in a newer, more efficient generation fleet that reduces potential environmental regulatory risks and diversifies fuel supply.

HIGH RATES SUBJECT TO REGULATION: GPA's electric rates are regulated by the Guam Public Utility Commission (PUC), which authorizes cost recovery for fuel and other related costs. The PUC's responsiveness to requests for cost recovery in recent years is viewed favorably by Fitch, but delays are inherent in both the regulatory process and the recovery mechanism.
LIMITED ECONOMIC PROFILE: Guam exhibits a limited economy largely dependent on international tourism but generally supported by the presence of the U.S. military. Unemployment has fallen to a manageable level and electric revenue collection remains strong despite the persistence of weak income levels and high electric rates.

RATING SENSITIVITIES

IMPLEMENTATION OF RESOURCE PLAN: Implementation of a proposed resource plan by Guam Power Authority that results in manageable new capital spending, adequate cost recovery and satisfactory financial metrics to support the planned increase in leverage could result in an upgrade. Unexpected challenges related to the resources plan that drive financial metrics to historically weaker levels would likely result in a revision of the Outlook to Stable.

CREDIT PROFILE

Guam is the westernmost territory of the U.S., located closer to Asia than to the mainland United States. The island's population grew by a nominal 3% over the prior decade and is currently estimated at 163,000.

GPA provides electric generation, transmission and distribution service on a retail basis to a largely residential service territory. Customers are served primarily through owned generation, and to a lesser extent through three energy agreements with independent power producers (IPPs).

IMPROVED FINANCIAL RESULTS

The authority's improved financial metrics in fiscals 2015 and 2016 benefitted from energy sales growth (0.4% in 2015; 2.3% in 2016) and customer growth, as well as the continuing effects of the last base rate increase. Fitch calculated debt service coverage and coverage of full obligations remained solid at roughly 1.45x in both years. Fitch's debt service coverage calculation factors annual lease payments to IPPs into total annual debt service obligations, which remained relatively stable at approximately $60 million. Liquidity also improved to more acceptable levels. Cash on hand totaled 39 days in 2015 and grew to 154 days in 2016. Net adjusted debt to adjusted funds available for debt service (FADS) declined to 6.1x at fiscal yearend 2016 from 10.0x in 2012.

Preliminary, unaudited financial results for fiscal year-end 2017 show similarly solid performance on continued growth in energy sales (2.3%) and customers and stable debt service obligations. Fitch estimates debt service coverage and coverage of full obligations at 1.56x for the year on slightly lower debt service costs, and unrestricted cash balances of $53 million or 78 days. Net adjusted debt to adjusted FADS remained relatively stable at 6.4x.

CAPITAL SPENDING PLAN EVOLVING

Efforts to reconfigure GPA's power supply portfolio by implementing its integrated resource plan (IRP) remain ongoing and are generally viewed positively by Fitch. The strategic plan aims to reduce the authority's dependence on oil-fired generation and comply with existing and proposed environmental regulations principally by converting existing generation resources and building new generation as dual-fuel generation (natural gas and ultra-low sulfur diesel [ULSD]).

The authority is moving forward with plans to add 180 MW of dual-fuel combined cycle generation. GPA expects to issue a formal request for proposal to develop the units in fiscal 2018 following the GPUC's approval of procurement parameters and generation capacity. GPA officials estimate that the cost to construct the 180 MW of capacity will range from $350-$400 million. Financing for the project will likely be provided by the owner/operator, but direct financing options will also be evaluated. GPA is projecting commercial operation of the project by December 2021.

Capital spending through 2022, excluding investment for the proposed combined cycle units, appears manageable at $177 million. Spending is high at $70 million in 2018 reflecting the costs related to GPA's energy storage system project, but should moderate to approximately $26 million per annum thereafter. However, total spending will likely be considerably higher when costs associated with constructing the combined cycle units are included.

Funding sources for the program are expected to come from internally generated funds and remaining bond proceeds from a 2014 financing. Insurance proceeds related to the loss of Cabras unit 4 and an expected settlement related to Cabras 3 will also be used to reduce the cost of the combined cycle project. GPA has received $84 million in insurance proceeds to date and discussions with its insurer (Lloyd's of London) are ongoing. Total coverage under the policies is $300 million.

The results of GPA's bid for development together with its insurer discussions will ultimately determine the need for additional debt issuance - or the terms of the purchase agreement with an independent owner/operator - and the ultimate effect of leverage at GPA. Fitch anticipates that leverage as measured net debt to FADS could rise to levels approaching 9.0x in 2021/2022, which while high is lower than previously anticipated. These expectations are driving the Positive Outlook.

STABLE, BUT LIMITED ECONOMY

Tourism and the U.S. military are the primary contributors to Guam's economy, reportedly accounting for slightly more than half of the island's employment opportunities. Tourism, however, is variable and susceptible to natural disasters, economic conditions and other global event that may influence travel. Total arrivals in fiscal 2017 were reportedly up 3.2% compared to fiscal 2016, but September 2017 arrivals were 12.4% lower than September 2016 reflecting concerns about North Korea missile threats.

The previously anticipated relocation of nearly 5,000 U.S. Marines from a base in Okinawa to Guam is proceeding following a protracted delay. Since 2015, nearly $134 million in projects have been completed or awarded outside of the base directly and related to the military buildup demonstrating the U.S. Government's commitment to completing the relocation. An additional $185 million of investment is anticipated. The increase in military personnel in Guam, while smaller than previously expected, is still viewed positively by Fitch, as nearly all related infrastructure costs are expected to be borne by the U.S. Navy.

Other notable economic developments include the recent opening of a 420 room, high-end luxury hotel and adjoining convention center and a new private 130-bed hospital providing specialized care. Nearly 1,400 new hotel rooms are currently in the planning stages.

The island's unemployment rate continues to trend downward, falling to 5.4% in September 2016 compared to nearly 8% at the close of 2014 and 10.9% in September 2013. Similar to all U.S. territories, wealth indicators rank significantly lower than those of the U.S., although Guam's median household income is higher than its island peers. Despite the relatively weak levels, GPA's annual bad debt expense has remained low at less than 1%, indicating consistently strong collection rates of annual revenue.

For additional information, please see Fitch's full rating report dated Jan. 12, 2017.

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Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017) (https://www.fitchratings.com/site/re/898969)
U.S. Public Power Rating Criteria (pub. 18 May 2015) (https://www.fitchratings.com/site/re/864007)

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