



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

Fitch Ratings-New York-05 January 2017: Fitch Ratings has affirmed Guam Power Authority's (the authority, or GPA) revenue bonds as follows:

--\$566.7 million senior revenue bonds, 2014 series A, 2012 series A and 2010 series A, at 'BBB-'.

The Rating Outlook is 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 nearly 160,000 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 economy and the authority's customer base.

SOUND FINANCIAL RESULTS EXPECTED: Financial results improved in fiscals 2014 and 2015 with Fitch calculated debt service coverage increasing to nearly 1.5x and unrestricted liquidity reaching 39 days of cash on hand (DCOH). Fitch expects somewhat weaker, but satisfactory financial results through fiscal 2021 based on the authority's most recent financial forecast. However, the financial forecast does not include costs (whether structured as debt or purchased power) related to planned new generation by 2020. Without commensurate rate action, the additional costs could challenge financial results further.

POWER SUPPLY DIVERSIFICATION: GPA's power supply is sufficient to continue meeting its load requirements, despite the loss of approximately 79 MW of baseload resources in a 2015 fire. Fitch views positively the authority's

ongoing strategic energy plan to diversify the utility's fuel mix and facilitate compliance with environmental regulations through a conversion to dual-fuel generation. Projected costs related to the generation investment are sizable, but Fitch expects the plan will result in a newer, more efficient generation fleet that allows for greater diversity in fuel supply.

LEVERAGED UTILITY: Equity to capitalization weakened in fiscal 2015 to 11.2%, well below the median ratio of 24.6%. However, stronger cash flow in recent years has improved GPA's ratio of debt to funds available for debt service from a peak of 11x in fiscal 2011 to comfortably below the rating category median ratio of 8.2x in fiscal 2015. Leverage is likely to escalate further as plans to add generation are executed.

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. Current rates remain high at 19.5 cents/kWh, but have been reduced significantly in recent years amid lower fuel costs.

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 more manageable level and electric revenue collection remains strong despite the persistence of weak income levels and high electric rates.

RATING SENSITIVITIES

IMPLEMENTATION OF POWER SUPPLY PLAN: Stability in the rating will be determined largely by Guam Power Authority's ability to effectively implement and manage its proposed integrated resource plan while recovering costs and maintaining satisfactory financial metrics needed to support the planned increase in either direct or indirect leverage.

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, reaching an estimated 160,000 according to the 2012 U.S. Census.

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). Financial metrics are typically weak and constrained by high rates common among island utility systems.

IMPROVED FINANCIAL RESULTS

The authority's financial metrics improved in fiscals 2014 and 2015 as slight declines in annual energy sales were positively offset by a 6% base rate increase and a favorable decrease in annual debt service. Both all-in Fitch calculated debt service coverage and liquidity improved to more acceptable levels for the rating category, reaching 1.46x and 39 DCOH, respectively at fiscal year-end 2015. A bond indenture-required working capital fund provides additional liquidity if needed, increasing DCOH to a healthier level, equal to 73 days.

Preliminary, unaudited financial results for fiscal year-end 2016 show solid improvement in cash flow metrics as debt service obligations declined again, and energy sales increased by 2.2%, leaving Fitch calculated debt service coverage at nearly 1.90x.

POSITIVE CHANGES IN POWER SUPPLY PENDING

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 procure 180 MW from the construction of dual fired combined cycle units. The decision to finance the units directly with long-term debt or contract with an independent power

producer is currently being evaluated, although GPA remains committed to having the units online by the close of 2020.

GPA officials estimate the cost to construct the 180 MW of combined cycle capacity will approach \$400 million, although an undefined portion of the costs could potentially be offset by insurance proceeds related to a fire that occurred in August 2015 and resulted in the loss of two of its baseload generation units. The authority took steps to meet its load requirements following the fire by executing a capacity recovery plan, which included greater utilization of existing units, implementation of an interruptible load program with larger customers and the procurement and installation of a temporary power unit.

HIGHLY LEVERAGED UTILITY

Leverage ratios remain somewhat weak for the rating category and could deteriorate further within the next three years given tentative plans to issue a significant amount of additional debt. GPA's equity ratio weakened in fiscal 2015 to 11.2%, well below the median ratio of 24.6%, as new financial reporting requirements related to pension obligations had the effect of reducing the authority's total net asset position.

STABLE 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. However, given its location and small size, Guam is susceptible to natural disasters that can also affect its tourism-based economy. Visitors to Guam through June 2016 were reportedly up by nearly 11% compared to the same point in 2015, prompting the Guam Visitors Bureau to forecast annual growth of about 2% annually for the next several years.

The previously anticipated relocation of nearly 5,000 U.S. Marines from a base in Okinawa to Guam is reportedly proceeding following a protracted delay. The inflow of approximately \$56 million in grant money in July 2016 from the U.S. Federal Government for infrastructure related projects needed to support the military buildup demonstrates the U.S. Government's commitment to completing the relocation. 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.

The island's March 2015 unemployment rate continued to trend downward, falling to 6.9% in March 2015 (based on the latest data available) 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.

Contact:

Primary Analyst
Christopher Hessenthaler
Senior Director
+1-212-908-0773
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Dennis Pidherny
Managing Director
+1-212-908-0738

Committee Chairperson
Kathy Masterson
Senior Director
+1-512-215-3730

Media Relations: Alyssa Castelli, New York, Tel: +1 (212) 908 0540, Email: alyssa.castelli@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
(<https://www.fitchratings.com/site/re/750012>)
U.S. Public Power Rating Criteria (pub. 18 May 2015)
(<https://www.fitchratings.com/site/re/864007>)

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