



Fitch Affirms Guam Power Authority's Rev Bonds; Outlook Revised to Stable

Fitch Ratings-New Delhi/Sydney/Singapore-30 September 2015: Fitch Ratings has affirmed Guam Power Authority's (GPA) revenue bonds as follows:

--\$566.5 million senior revenue bonds, 2014 series A, 2012 series A and 2010 series A, at 'BBB-';
--\$14.2 million subordinated revenue bonds, 2010 series A, at 'BB+'.

The Rating Outlook is revised to Stable from Negative.

SECURITY

Senior lien bonds are payable from a first lien on net revenues of GPA. Outstanding subordinated revenue bonds are also payable from net revenues, subject to payment of the senior bonds. A default on the subordinated revenue bonds would not trigger a default on the senior revenue bonds.

KEY RATING DRIVERS

SOLE POWER PROVIDER: GPA provides 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.

OUTLOOK REVISION TO STABLE: The revision in Outlook reflects Fitch's recognition of the potentially longer timeframe GPA believes it could take to fully implement its plan to reduce its dependence on oil-fired generation through a system-wide conversion to dual-fuel generation. While costs associated with the plan could remain significant, a longer time horizon should provide sufficient capacity to absorb additional debt plans and related costs.

POWER SUPPLY DIVERSIFICATION: 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. Despite the anticipated cost, Fitch expects the plan will ultimately result in a newer, significantly more efficient generation fleet that allows for greater diversity in fuel supply.

WEAK BUT IMPROVED FINANCIAL PROFILE: Financial results are typically weak with historical Fitch

calculated debt service coverage closer to 1.0x and minimal cash reserves. Financial metrics improved in fiscal 2014 with Fitch calculated debt service coverage increasing to a more acceptable 1.34 xs and liquidity reaching about 40 days of cash on hand. Fitch expects modest but continued improvement through fiscal 2019 based on the authority's most recent financial forecast and declining debt service requirements. Longer-term operating results will depend on the timing of planned debt issuances and projected base rate increases.

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 ECONOMY: 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 acceptable 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 Guam Power Authority rating will be determined largely by the authority's ability to effectively implement and manage its proposed energy conversion plan while maintaining financial metrics sufficient to support the planned increase in leverage. Project costs and related debt levels beyond what is currently forecast could result in negative rating pressure.

CREDIT PROFILE

POWER SUPPLY CONVERSION

The authority is in the early stages of gaining the necessary regulatory approvals needed to execute its resource implementation plan, which primarily includes construction of two 60 MW combined cycle units (CCUs) with dual fuel capability expected to be complete by 2020. Construction of an additional 60 MW combined cycle unit within the 2020-2021 timeframe is also being considered, although the project is likely to occur given the unexpected loss of one of GPA's primary generating units due to a recent fire.

The balance of the resource implementation plan calls for the retirement of the Cabras Power Plant upon completion of the three combined cycle units, the retrofit of two existing generating units to burn ULSD, and the installation of an energy storage battery system. The eventual conversion of the new and existing units to LNG is not expected to occur before 2021 at the earliest based on the authority's expectations for a protracted permitting process that could take up to five years.

In the interim, officials believe the overall efficiency of the new units expected to come online coupled

with the utilization of ULSD will bring the system into compliance with the EPA's maximum achievable control technology (MACT) standards and position the authority to meet potential requirements under the Clean Power Plan.

All-in costs and related debt issuance plans supporting the system-wide conversion to LNG were expected to be significant, prompting Fitch to revise the Outlook to Negative from Stable in August 2014. While the project costs are expected to remain sizeable, authority officials now believe execution of the final phase of the plan (installing and converting all generating units to LNG) will be at GPA's option. Accordingly, the total cost of the resource implementation plan could potentially change and spread out over a longer time horizon than initially expected.

HIGH LEVERAGE EXPECTED TO CONTINUE

The authority expects to rely significantly on debt issuance to fund the vast majority of costs associated with the fuel diversification plan. All-in costs related to the system-wide conversion to LNG are significant, estimated at approximately \$691 million based on a 2014 feasibility assessment that assumed the conversion is completed by 2021. Fitch expects debt service costs will rise considerably as a result, although the full impact of the additional debt will not occur until beyond the authority's current financial forecast period of 2015-2019.

Current leverage ratios, including debt to funds available for debt service and equity to capitalization, are weak but consistent with the current rating at 8.8x and 17.1%, respectively. Subordinate lien obligations will fully mature on Oct. 1, 2015, resulting in a sizable \$15 million decline in annual debt service payments beginning in fiscal 2016. In addition, remaining capital lease payments ramp down significantly in 2018 before fully concluding in 2019. The reduction in annual debt service costs should provide GPA with some capacity and flexibility to absorb the additional leverage programmed into the current capital plan.

WEAK BUT IMPROVED FINANCIAL PROFILE

The authority's financial metrics improved in fiscal 2014 as a slight decline in annual energy sales was positively offset by a 6% base rate increase. All-in Fitch calculated debt service coverage and liquidity improved to a more acceptable 1.34x and 39 days of cash on hand from below 1.0x debt service coverage in fiscals 2013 and 2012 and 17 days cash in both years.

Operating income based on preliminary financial results though the first nine months of fiscal 2015 is largely unchanged from the same period in fiscal 2014. Accordingly, Fitch expects year-end debt service coverage of about 1.40x in fiscal 2015, in line with projected financial results provided in 2014.

GPA's financial forecast shows Fitch-calculated debt service coverage increasing over the next three fiscal years before leveling out in the outer years at about 1.4x. The forecast conservatively assumes electric rates are held constant and modest declines in energy sales continue. The forecast benefits from

scheduled declines in debt service payments and conservatively excludes the planned military buildup.

TOURISM-BASED ECONOMY

Guam receives over 1.3 million visitor arrivals annually, the majority of which are from Japan. The government has worked aggressively to grow its visitor base, successfully expanding a visa waiver program to include Russia and working to add mainland China, an effort that if successful has the potential to significantly increase economic activity on the island.

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 increase in military personnel, 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 is down considerably at 7.7% compared to about 13% midway through 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 .5%, indicating consistently strong collection rates of annual revenue.

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Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012)

U.S. Public Power Rating Criteria (pub. 18 May 2015)

(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864007)

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