

*In the opinion of Bond Counsel, under existing law and subject to conditions described in "TAX MATTERS" herein, interest, including accrued original issue discount on the Series 1998 A, Series 1998 C, Series 1998 D and Series 1998 E Bonds (a) will not be included in gross income for federal income tax purposes and (b) will not be an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. Under existing law, interest, including accrued original issue discount, on all Series 1998 Bonds, including the Series 1998 B Bonds, is exempt from personal income taxes imposed by the United States Virgin Islands, any state, other territory or possession of the United States or any political subdivision thereof, or by the District of Columbia, as described in the section "TAX MATTERS" herein.*

**\$541,820,000**

## **VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY**

### **Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes)**

|                             |                                     |                                   |  |  |
|-----------------------------|-------------------------------------|-----------------------------------|--|--|
| <b>\$289,075,000</b>        | <b>\$26,015,000</b>                 | <b>\$81,170,000</b>               | <b>\$39,130,000</b>                    | <b>\$106,430,000</b>                   |
| Series 1998 A               | Series 1998 B                       | Series 1998 C                     | Series 1998 D                          | Series 1998 E                          |
| (Senior Lien/<br>Refunding) | (Senior Lien/<br>Refunding/Taxable) | (Senior Lien/<br>Working Capital) | (Subordinate Lien/<br>Working Capital) | (Subordinate Lien/<br>Capital Program) |

**DATED: May 1, 1998**

**DUE: October 1, as shown on the inside cover**

The Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes) Series 1998 A (Senior Lien/Refunding), Series 1998 B (Senior Lien/Refunding/Taxable), Series 1998 C (Senior Lien/Working Capital), Series 1998 D (Subordinate Lien/Working Capital), and Series 1998 E (Subordinate Lien/Capital Program) (collectively, the "1998 Bonds") are issuable in minimum denominations of \$5,000 and integral multiples of \$5,000 in excess thereof and will be issued initially as a single registered bond for each maturity registered of each series in the name of Cede & Co., the nominee of The Depository Trust Company ("DTC"), New York, New York. Beneficial ownership interests in the 1998 Bonds (defined below) will be available for purchase in book-entry form only. Except in limited circumstances, purchasers of Bonds will not receive physical delivery of the 1998 Bond certificates, as further described herein. Principal of, Redemption Price of, if applicable, and interest payable on April 1 and October 1 of each year, commencing on October 1, 1998, on the 1998 Bonds, will be paid by the Paying Agent to DTC, who will remit payment to DTC Participants, with such payments to be subsequently disbursed to the beneficial owners of the 1998 Bonds, as further described herein. Certain 1998 Bonds shall be subject to redemption prior to maturity as described herein. (See "THE 1998 BONDS".)

The 1998 Bonds are being issued by the Virgin Islands Public Finance Authority (the "Authority") (i) to advance refund certain of the currently outstanding bonds of the Authority and the Government of the Virgin Islands (the "Government"), (ii) to pay in full the principal and accrued interest on the \$106,845,000 United States Virgin Islands Revenue Anticipation Note which was issued to pay certain working capital expenses of the Government and to provide additional working capital for the Government, (iii) to fund various capital projects in the Territory of the United States Virgin Islands, (iv) to fund the Series Debt Service Reserve Accounts and (v) to pay certain costs of issuing the 1998 Bonds. The 1998 Bonds will be issued under and secured by the Indenture of Trust, dated as of May 1, 1998 (the "Indenture") by and between the Authority and United States Trust Company of New York, as trustee (the "Trustee"). The Trustee will act as Registrar and Paying Agent for the 1998 Bonds. The 1998 Bonds will be secured by five special limited obligation loan notes (the "Matching Fund Loan Notes") issued by the Government pursuant to a Loan Agreement, dated as of May 1, 1998, among the Authority, the Trustee and the Government (the "Loan Agreement").

**THE 1998 BONDS ARE LIMITED SPECIAL OBLIGATIONS OF THE AUTHORITY PAYABLE FROM AND SECURED BY A PLEDGE OF THE TRUST ESTATE WHICH INCLUDES CERTAIN FUNDS ESTABLISHED UNDER THE INDENTURE, INCLUDING THE PLEDGED REVENUE ACCOUNT AND THE RESPECTIVE DEBT SERVICE RESERVE ACCOUNTS. THE MATCHING FUND LOAN NOTES ARE SPECIAL LIMITED OBLIGATIONS OF THE GOVERNMENT AND ARE SOLELY SECURED BY A PLEDGE OF REVENUES RECEIVED BY THE GOVERNMENT FROM THE UNITED STATES DEPARTMENT OF THE TREASURY AS A TRANSFER OF FEDERAL EXCISE TAXES IMPOSED AND COLLECTED UNDER THE INTERNAL REVENUE CODE OF 1986, AS AMENDED, IN ANY FISCAL YEAR, ON RUM PRODUCED IN THE UNITED STATES VIRGIN ISLANDS AND EXPORTED TO THE UNITED STATES WHICH IS SUBJECT TO FEDERAL EXCISE TAX THAT QUALIFIES FOR TRANSFER TO THE GOVERNMENT (THE "MATCHING FUND REVENUES"). (SEE "MATCHING FUND REVENUES".)**

The 1998 Bonds shall under no circumstances constitute a general obligation of the Authority, the United States Virgin Islands or the United States of America nor shall the 1998 Bonds be evidence of a debt of the United States of America or the United States Virgin Islands nor shall the United States of America or the United States Virgin Islands be liable thereon. The Authority has no taxing power.

Payment from the Trust Estate of the Series 1998 D Bonds and the Series 1998 E Bonds (referred to collectively as the "Subordinate Lien Bonds") will be subordinate to payment from the Trust Estate of the Series 1998 A Bonds, the Series 1998 B Bonds and the Series 1998 C Bonds (referred to collectively as the "Senior Lien Bonds").

**THE PURCHASE AND OWNERSHIP OF THE 1998 BONDS INVOLVES CERTAIN INVESTMENT RISKS. INFORMATION CONTAINED ON THIS COVER IS A SUMMARY ONLY. PROSPECTIVE PURCHASERS OF THE 1998 BONDS ARE ADVISED TO READ THIS OFFICIAL STATEMENT IN ITS ENTIRETY. (SEE "BONDHOLDER RISKS".)**

#### **Maturities, Amounts, Interest Rates and Prices or Yields (On Inside Cover)**

*The 1998 Bonds are offered, subject to prior sale, when, as and if issued by the Authority and accepted by the Underwriters, subject to the approval of legality by Hutton & Williams, Washington, D.C., Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by their counsel, Hawkins, Delafield & Wood, New York, New York. It is expected that the 1998 Bonds will be available for delivery to DTC in New York, New York on about May 14, 1998.*

**Salomon Smith Barney**

**CIBC Oppenheimer**

**Morgan Stanley Dean Witter**

**PaineWebber Incorporated**

April 30, 1998

**MATURITIES, AMOUNTS, INTEREST RATES  
AND PRICES OR YIELDS**

**\$289,075,000  
SERIES 1998 A BONDS  
(SENIOR LIEN/REFUNDING)**

| <u>Maturity</u> | <u>Amount</u> | <u>Interest<br/>Rate</u> | <u>Price or<br/>Yield</u> | <u>Maturity</u> | <u>Amount</u> | <u>Interest<br/>Rate</u> | <u>Price or<br/>Yield</u> |
|-----------------|---------------|--------------------------|---------------------------|-----------------|---------------|--------------------------|---------------------------|
| 2009            | \$13,135,000  | 5.20%                    | 5.30%                     | 2013            | \$16,245,000  | 5½%                      | 100%                      |
| 2010            | 13,835,000    | 5.20                     | 5.35                      | 2014            | 17,165,000    | 5½                       | 100                       |
| 2011            | 14,580,000    | 5.30                     | 5.40                      | 2015            | 18,135,000    | 5½                       | 5.52                      |
| 2012            | 15,380,000    | 5.40                     | 5.45                      |                 |               |                          |                           |

**\$60,795,000 5½% Term Bond maturing October 1, 2018 at 99%**  
**\$81,700,000 5½% Term Bond maturing October 1, 2022 at 98¼%**  
**\$38,105,000 5¼% Term Bond maturing October 1, 2025 at 99¾%**  
 (Plus Accrued Interest)

**\$26,015,000  
SERIES 1998 B BONDS  
(SENIOR LIEN/REFUNDING/TAXABLE)**

| <u>Maturity</u> | <u>Amount</u> | <u>Interest<br/>Rate</u> | <u>Price or<br/>Yield</u> | <u>Maturity</u> | <u>Amount</u> | <u>Interest<br/>Rate</u> | <u>Price or<br/>Yield</u> |
|-----------------|---------------|--------------------------|---------------------------|-----------------|---------------|--------------------------|---------------------------|
| 1998            | \$8,765,000   | 6.28%                    | 100%                      | 2001            | \$3,265,000   | 6.99%                    | 100%                      |
| 1999            | 7,525,000     | 6.69                     | 100                       | 2002            | 2,410,000     | 7.11                     | 100                       |
| 2000            | 4,050,000     | 6.83                     | 100                       |                 |               |                          |                           |

**(Plus Accrued Interest)**

**\$81,170,000**  
**SERIES 1998 C BONDS**  
**(SENIOR LIEN/WORKING CAPITAL)**

| <u>Maturity</u> | <u>Amount</u> | <u>Interest Rate</u> | <u>Price or Yield</u> | <u>Maturity</u> | <u>Amount</u> | <u>Interest Rate</u> | <u>Price or Yield</u> |
|-----------------|---------------|----------------------|-----------------------|-----------------|---------------|----------------------|-----------------------|
| 2000            | \$3,960,000   | 5%                   | 4.55%                 | 2005            | \$10,555,000  | 5½%                  | 5.10%                 |
| 2001            | 5,225,000     | 5                    | 4¾                    | 2006            | 11,150,000    | 5½                   | 5.15                  |
| 2002            | 6,575,000     | 5                    | 4.85                  | 2007            | 11,780,000    | 5½                   | 5.20                  |
| 2003            | 9,480,000     | 5                    | 4.90                  | 2008            | 12,455,000    | 5½                   | 5¼                    |
| 2004            | 9,990,000     | 5½                   | 5                     |                 |               |                      |                       |

(Plus Accrued Interest)

**\$39,130,000**  
**SERIES 1998 D BONDS**  
**(SUBORDINATE LIEN/WORKING CAPITAL)**

| <u>Maturity</u> | <u>Amount</u> | <u>Interest Rate</u> | <u>Price or Yield</u> | <u>Maturity</u> | <u>Amount</u> | <u>Interest Rate</u> | <u>Price or Yield</u> |
|-----------------|---------------|----------------------|-----------------------|-----------------|---------------|----------------------|-----------------------|
| 1999            | \$3,005,000   | 5½%                  | 4.70%                 | 2004            | \$3,965,000   | 6%                   | 5.40%                 |
| 2000            | 3,175,000     | 5½                   | 4.95                  | 2005            | 4,210,000     | 6                    | 5½                    |
| 2001            | 3,355,000     | 5½                   | 5.15                  | 2006            | 4,470,000     | 6                    | 5.55                  |
| 2002            | 3,540,000     | 5½                   | 5¼                    | 2007            | 4,750,000     | 6                    | 5.60                  |
| 2003            | 3,745,000     | 5½                   | 5.30                  | 2008            | 4,915,000     | 6                    | 5.65                  |

(Plus Accrued Interest)

**\$106,430,000**  
**SERIES 1998 E BONDS**  
**(SUBORDINATE LIEN/CAPITAL PROGRAM)**

**\$30,095,000 5¾% Term Bond maturing October 1, 2013 at 5.90%**  
**\$39,665,000 5¾% Term Bond maturing October 1, 2018 at 98¾%**  
**\$36,670,000 6% Term Bond maturing October 1, 2022 at 99¾%**

(Plus Accrued Interest)

**VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY**  
**1050 Norre Gade**  
**Suite 102**  
**Charlotte Amalie**  
**St. Thomas, United States Virgin Islands 00802**

**BOARD OF DIRECTORS**

The Honorable Roy L. Schneider, M.D., Governor - Chairman  
Juan Centeno, Commissioner of Finance - Executive Director  
Nellon L. Bowry, Director of the Office of Management and Budget - Secretary  
Paul Arnold, St. Croix Representative  
Roy Jackson, St. Thomas/St. John Representative

**TRUSTEE**

United States Trust Company of New York  
New York, New York

**BOND COUNSEL**

Hunton & Williams  
Washington, D.C.

**FINANCIAL ADVISOR**

Public Financial Management, Inc.  
Philadelphia, Pennsylvania

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE 1998 BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.



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## **OFFICIAL STATEMENT**

**\$541,820,000**

### **VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY**

#### **Revenue and Refunding Bonds**

#### **(Virgin Islands Matching Fund Loan Notes)**

**\$289,075,000 Series 1998 A (Senior Lien/Refunding)**

**\$26,015,000 Series 1998 B (Senior Lien/Refunding/Taxable)**

**\$81,170,000 Series 1998 C (Senior Lien/Working Capital)**

**\$39,130,000 Series 1998 D (Subordinate Lien/Working Capital)**

**\$106,430,000 Series 1998 E (Subordinate Lien/Capital Program)**

## **INTRODUCTION**

The purpose of this Official Statement, which includes the cover page and the appendices, is to furnish certain information concerning the Virgin Islands Public Finance Authority (the "Authority") and the sale and delivery of its Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes), Series 1998 A (Senior Lien/Refunding) (the "Series 1998 A Bonds"), Series 1998 B (Senior Lien/Refunding/Taxable) (the "Series 1998 B Bonds"), Series 1998 C (Senior Lien/Working Capital) (the "Series 1998 C Bonds" and, together with the Series 1998 A Bonds and the Series 1998 B Bonds, the "Senior Lien Bonds"), 1998 Series D (Subordinate Lien/Working Capital) (the "Series 1998 D Bonds") and Series 1998 E (Subordinate Lien/Capital Program) (the "Series 1998 E Bonds" and, together with the Series 1998 D Bonds, the "Subordinate Lien Bonds") (collectively, the "1998 Bonds") in the aggregate principal amount of \$541,820,000. The 1998 Bonds are being issued pursuant to an Indenture of Trust, dated as of May 1, 1998 (the "Indenture"), by and between the Authority and United States Trust Company of New York, New York, as trustee (together with any appointed successor trustee, the "Trustee"), and the Loan Agreement, dated as of May 1, 1998 (the "Loan Agreement"), by and between the Government of the United States Virgin Islands (referred to herein as the "Government") and the Authority. The 1998 Bonds are being issued pursuant to the Virgin Islands Revised Organic Act 48 U.S.C.A. 1574 et seq. (West 1987), as amended (the "Revised Organic Act"), 1988 United States Virgin Islands Act No. 5365, 1997 Virgin Islands Act Nos. 6152 and 6190, 1998 Virgin Islands Act Nos. 6197 and 6227 and other applicable law (together, the "Act") and the Taxpayer Relief Act of 1997 (Pub. L. 105-34, Aug. 5, 1997, 111 Stat 788) and other applicable law. All capitalized terms not defined in this Official Statement have meanings as defined in Appendix A entitled "GLOSSARY OF TERMS".

Proceeds from the 1998 Bonds will be used: (i) to advance refund the Prior Bonds (hereafter defined), (ii) to pay in full the principal and accrued interest on the \$106,845,000 Revenue Anticipation Note (hereafter defined) and to provide additional working capital for the Government, (iii) to fund various capital projects in the Territory of the United States Virgin Islands (the "Virgin Islands"), (iv) to fund the respective Debt Service Reserve Accounts (hereafter defined), and (v) to pay certain costs of issuing the 1998 Bonds.

The 1998 Bonds are payable and secured by a pledge of the Trust Estate as further described and as defined herein. Payment from the Trust Estate of the Subordinate Lien Bonds will be subordinate to payment from the Trust Estate of the Senior Lien Bonds. A default on the Subordinate Lien Bonds shall not result in a default on the Senior Lien Bonds.

The 1998 Bonds will be secured by five special limited obligation Matching Fund Loan Notes issued by the Government pursuant to the Loan Agreement. The Government will be obligated under the Matching Fund Loan Notes to make payments to the Authority in amounts sufficient to pay all principal, premium, if any, and interest on the 1998 Bonds when due and to make the amount on deposit in the respective Debt Service Reserve Accounts equal to the applicable Debt Service Reserve Requirement pursuant to the terms of the Indenture. The Matching Fund Loan Notes have been issued in anticipation of the receipt of the Matching Fund Revenues over the full term of the Matching Fund Loan Notes, which Matching Fund Revenues are projected to be in excess of the amount necessary to pay all the principal of, premium, if any, and interest on, the Matching Fund Loan Notes which

secure the 1998 Bonds. However, no assurances can be given as to the sufficiency of Matching Fund Revenues for such purpose.

Matching Fund Revenues are those revenues received by the Government from the United States Department of the Treasury as a transfer of federal excise taxes imposed and collected under the Internal Revenue Code of 1986, as amended (the "Code") in any Fiscal Year on any product produced in the Virgin Islands and exported to the United States and that is subject to federal excise tax that qualifies for transfer to the Government (the "Matching Fund Revenues"). Rum is the principal article presently produced in the Virgin Islands and exported to the United States that is subject to federal excise tax that qualifies for transfer to the Government under the applicable provisions of the Revised Organic Act and the Code. Matching Fund Revenues have been transferred to the Government since 1954 in accordance with certain Acts of the United States Congress. (See "MATCHING FUND REVENUES" and "THE RUM INDUSTRY".)

This Official Statement describes, among other items, the 1998 Bonds, the Loan Agreement, the Matching Fund Loan Notes, Matching Fund Revenues, the Special Escrow Agreement (as hereafter defined), the Indenture, the Authority and the Virgin Islands. The descriptions do not purport to be comprehensive or definitive and reference is made to the Loan Agreement, the Special Escrow Agreement and the Indenture for full and complete statements of the provisions thereof. Copies of the Indenture, the Loan Agreement, and the Special Escrow Agreement, including the form of the 1998 Bonds and the Matching Fund Loan Notes, are available at the office of the Trustee, 114 West 47th Street, New York, New York 10036-1532 (212-852-1034), and at the Authority, 1050 Norre Gade, Suite 102, Charlotte Amalie, St. Thomas, United States Virgin Islands 00802 (340-714-1635); Attention: Amadeo I.D. Francis, Director of Finance and Administration.

**THE PURCHASE AND OWNERSHIP OF THE 1998 BONDS INVOLVE INVESTMENT RISKS. PROSPECTIVE PURCHASERS OF THE 1998 BONDS ARE ADVISED TO READ THIS OFFICIAL STATEMENT IN ITS ENTIRETY. FOR A DISCUSSION OF CERTAIN RISKS RELATING TO THE 1998 BONDS, SEE "BONDHOLDER RISKS" HEREIN.**

## **VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY**

### **Purposes and Powers**

The Authority was created in 1988 by United States Virgin Islands Act No. 5365 of the Legislature of the Virgin Islands (the "Legislature") as a public corporation and autonomous governmental instrumentality for the purposes of aiding the Government in the performance of its fiscal duties and in effectively carrying out its governmental responsibility of raising capital for essential public projects. Under its enabling legislation, the Authority is vested with, but not limited to, the following powers: (i) to have perpetual existence as a corporation, (ii) to borrow money and issue bonds, (iii) to lend the proceeds of its bonds or other money to the Government or any agency, authority or instrumentality thereof or private enterprise in the Virgin Islands subject to the approval of the Legislature of the Virgin Islands, (iv) to establish one or more revolving loan funds with the proceeds of bonds issued by the Authority or issued by the Government or any agency, authority or instrumentality thereof, (v) to invest its funds and to arrange for the investment of the funds of the Government or any agency, authority or instrumentality thereof, (vi) to enter into contracts and agreements with the government of the United States, the Government and any agency, authority or political subdivision thereof, (vii) to make, modify and repeal by-laws, rules and regulations, (viii) to acquire, sell, lease, mortgage, pledge, dispose of or encumber property or interests therein, and (ix) to sue and be sued.

### **Management**

The powers of the Authority are exercised by a board of directors (the "Board of Directors") consisting of five members. The Governor of the Virgin Islands, the Commissioner of Finance and the Director of the Office of Management and Budget of the Virgin Islands, are members and serve ex-officio. The two remaining members are appointed by the Governor of the Virgin Islands with the advice and consent of the Legislature and represent the private sector. Of these two members, one must be a resident of the District of St. Thomas/St. John and one must be a resident of the District of St. Croix. Both must be experienced in the area of municipal finance. The

Governor of the Virgin Islands serves as Chairman of the Board of Directors while the Commissioner of Finance serves as the Authority's Executive Director and the Director of the Office of Management and Budget serves as Secretary to the Authority. Amadeo I.D. Francis serves as the Director of Finance and Administration of the Authority and is responsible for the administration and operation of the Authority. Mr. Francis has served as the Director of Finance and Administration of the Authority since 1993.

The following is a list of the current Board of Directors with their official posts or, for private sector representatives, their island of residency, and date of expiration of their current terms on the Board of Directors. The Governor of the Virgin Islands, the Commissioner of Finance and the Director of the Office of Management and Budget serve terms which are coincident with their terms in such offices. The Directors who represent the private sector serve 4-year terms.

| <u>Name</u>                                 | <u>Government Post<br/>or Profession/Residency</u>                     | <u>Term<br/>Expiration</u> |
|---|--|----------------------------|
| Hon. Roy L. Schneider, M.D., Chairman . . . | Governor of the Virgin Islands . . . . .                               | 1999 (ex officio)          |
| Juan Centeno, Executive Director . . . . .  | Commissioner of Finance . . . . .                                      | 1999 (ex officio)          |
| Nellon L. Bowry, Secretary . . . . .        | Director of the Office of Management<br>and Budget . . . . .           | 1999 (ex officio)          |
| Paul Arnold . . . . .                       | Personnel Manager, Virgin Islands<br>Aluminum Co., St. Croix . . . . . | 1997*                      |
| Roy Jackson . . . . .                       | Certified Public Accountant, St. Thomas . . . . .                      | 1997*                      |

\*Members serve until the appointment and confirmation of a successor.

In February 1990, the Authority created its Bond Proceeds Management Program. This program provides the Government and any agency, instrumentality, commission, authority or political subdivision of the Virgin Islands (other than the Virgin Islands Government Employees Retirement System ("GERS")) assistance with the investment of and accounting for bond proceeds in compliance with the arbitrage and rebate requirements of the Code, as amended. To date, the Government, the Authority and the Virgin Islands Water and Power Authority have participated in this program. Through this program, the Authority is responsible for the management of approximately \$45 million as of March 1, 1998.

### **Outstanding Indebtedness of the Authority**

**Bonds.** Since August 1989, the Authority has issued eight series of bonds in furtherance of its corporate purposes to raise capital for essential public projects. Five series of bonds are currently outstanding, including the Highway Revenue Bonds (Transportation Trust Fund) Series 1989 (the "Series 1989 Bonds"), the Revenue Refunding Bonds (Virgin Islands General Obligation/Matching Fund Loan Notes) Series 1992 A (the "Series 1992 Bonds"), and the Government Development Program Revenue Bonds (Virgin Islands General Obligation/Matching Fund Loan Notes), Series 1994 A, Series 1994 B and Series 1994 C (collectively referred to as the "Series 1994 Bonds") (the Series 1989 Bonds, the Series 1992 Bonds and the Series 1994 Bonds collectively referred to herein as the "Authority's Prior Bonds"). A portion of the proceeds of the 1998 Bonds will be used to refund the Authority's Prior Bonds. (See "PLAN OF FINANCE—Plan of Refunding".) As of March 1, 1998, \$15,677,643 of the proceeds of the Series 1989 Bonds, \$20,091,383 of the proceeds of the Series 1992 Bonds (which was released from the Series 1992 Bonds debt service reserve fund) and \$15,351,415 of the proceeds of the Series 1994 Bonds remained unexpended and have been reallocated and obligated to certain capital improvement projects.

**WICO Loan.** In December 1993, the Authority received a loan in the principal amount of \$19,000,000 from Banco Popular de Puerto Rico ("Banco Popular") to enable the Authority to repay an existing bond anticipation note issued by the Authority and held by Banco Popular for the purchase of the outstanding shares of The West Indian Company Limited ("WICO"), a corporation organized and existing under the laws of the United States Virgin Islands (the "WICO Loan"). WICO was purchased by the Government on June 30, 1993 and its stock assigned to the Authority. The principal assets of WICO are a 2,700 foot dock and related land and facilities, 7.235 acres of land on the St. Thomas waterfront, 3.9 acres of land at Estate Liverpool and a landmark mansion, together with 6 acres of land, located at Estate Catherineberg known as "Denmark Hill". The WICO cruise ship dock represents

a substantial revenue generating asset and is one the of the busiest cruise ship destinations in the world. Cruise ships visit this dock throughout the year and pay passenger fees, wharfage fees, agency fees and miscellaneous charges, such as water purchases.

The WICO Loan is evidenced by a special, limited obligation promissory note of the Authority (the "WICO Note"), which is payable solely from and secured by the pledge of certain revenues from WICO, all of whose issued and outstanding shares of stock are owned by the Authority. As of March 1, 1998, the balance due and payable on the WICO Loan was \$15,870,261. No recourse may be had for the payment of the WICO Note against the general funds of the Authority or the Matching Fund Revenues that secure the 1998 Bonds.

*Hospital Facilities Loan.* In June 1994, the Authority and the Government entered into a loan agreement (the "Hospital Loan Agreement") with Banco Popular de Puerto Rico for a loan in the principal amount of \$10,600,000 (the "Hospital Facilities Loan"). The proceeds of the Hospital Facilities Loan have been applied to capital improvements and equipment for the St. Croix and St. Thomas Hospitals.

The Hospital Facilities Loan is evidenced by a promissory note of the Government which constitutes a general obligation of the Government. In addition, the note is secured by a specific pledge of a \$2,000,000 increase in annual real property tax revenues due or to be collected from the Hess Oil Virgin Islands Corporation. As of March 1, 1998, the balance due and payable on the Hospital Facilities Loan was \$3,170,473. No recourse may be had for the payment of the Hospital Facility Loan against the general funds of the Authority or the Matching Fund Revenues that secure the 1998 Bonds.

## PLAN OF FINANCE

### General

The Series 1998 Bonds are being issued to: (i) refund the Government's Prior Bonds (hereinafter defined) and the Authority's Prior Bonds (collectively, the "Prior Bonds"), (ii) provide working capital, and (iii) finance certain capital projects. Proceeds of the 1998 Bonds will also be used to fund the respective Debt Service Reserve Accounts and pay costs of issuance of the 1998 Bonds. The Series 1998 A Bonds and Series 1998 B Bonds, together with other available moneys, refund the Prior Bonds. All Prior Bonds, excluding the Authority's Series 1989 Bonds, were secured in part by Matching Fund Revenues with a priority lien security structure. On June 12, 1997, Congress passed legislation amending the Revised Organic Act allowing the Government to issue parity lien debt. In addition in 1997, Congress enacted the Taxpayer Relief Act of 1997, which included a provision authorizing the Government to advance refund certain Prior Bonds that previously had been advance refunded. Replacing the priority lien structure with a parity lien structure will: (i) lower the debt service payments of the Government, (ii) allow the extension of the maturities of such debt, (iii) release other revenue streams pledged to the Prior Bonds, and (iv) consolidate the security for the Government's debt solely with Matching Fund Revenues. Proceeds of the Series 1998 C Bonds and Series 1998 D Bonds provide permanent financing for the Revenue Anticipation Note issued by the Government on February 10, 1998 and provide additional working capital. Proceeds of the Series 1998 E Bonds will finance various capital projects of the Government.

### Plan of Refunding

The Series 1998 A Bonds and the Series 1998 B Bonds (collectively, the "Refunding Bonds") are being issued to refund all of the currently outstanding Prior Bonds, which include the Government's Special Tax Bonds (General Obligation/Matching Fund/Hurricane Hugo Insurance Claims Fund Program) Series 1991 (the "Series 1991 Bonds") and its Subordinated Special Tax Bonds (General Obligation Matching Fund/Insurance Claims Fund Program) Series 1993 (the "Series 1993 Bonds", together with the Series 1991 Bonds, the "Government's Prior Bonds", and, together with the Authority's Prior Bonds, the "Prior Bonds"). The Refunding Bonds are being issued to refund each Series of the Prior Bonds to their earliest respective dates of maturity or redemption in accordance with the terms of each indenture pursuant to which the Prior Bonds were issued (each such indenture referred to as a "Prior Indenture"). All of the proceeds received by the Authority from the sale of the Series 1998 A Bonds and the Series 1998 B Bonds, other than accrued interest and amounts required to pay certain costs of issuance, will be transferred to United States Trust Company of New York, New York, New York, acting as Refunding Escrow

Agent (the "Refunding Escrow Agent") under an Escrow Agreement, dated as of May 1, 1998, between the Authority and the Refunding Escrow Agent. (See "SOURCES AND USES OF FUNDS".)

Funds necessary to refund the Prior Bonds will be held under the Escrow Agreement as cash or applied to the purchase of the Escrow Obligations consisting of direct and general obligations of, or obligations which as to principal and interest are unconditionally guaranteed as to full and timely payment by, the United States of America, to the payment of which the full faith and credit of the United States of America are irrevocably and unconditionally pledged, and such other securities as are authorized for the defeasance of each respective series of Prior Bonds pursuant to the terms of each applicable Prior Indenture (the "Escrow Obligations"). Such Escrow Obligations are scheduled to mature at such times and in such amounts and bear interest at such rates so that sufficient money will be available to pay, when due, the principal of, redemption premium, if any, and interest on the Prior Bonds. The Authority expects to pay, upon the earlier of maturity or redemption, each Series of the Prior Bonds in the aggregate principal amounts as set forth below:

| <u>Series</u> | <u>Outstanding<br/>Principal<br/>Amount</u> | <u>October 1<br/>Redemption<br/>Date</u> |
|---------------|---|--|
| Series 1989   | \$ 17,545,000                               | 1999                                     |
| Series 1991   | 20,885,000                                  | 2001                                     |
| Series 1992   | 205,935,000                                 | 2002                                     |
| Series 1993   | 9,235,000                                   | 2001                                     |
| Series 1994   | 26,695,000                                  | 2004                                     |

Simultaneously with the transfer of the Series 1998 A Bonds and Series 1998 B Bond proceeds to the Refunding Escrow Agent, the pledge of any revenues and other moneys, securities, funds and property pledged to each Prior Indenture and all other rights granted thereby, including any Government Loan Notes delivered as security for the Prior Bonds, shall be released, discharged and satisfied. In accordance with the terms of each Prior Indenture, the deposit of such moneys with the Refunding Escrow Trustee and the investment thereof in Escrow Obligations, will serve to fully discharge and defease the liens of the Prior Indentures and, thereupon, there shall be paid over to the Trustee certain amounts held under each of the respective Prior Indentures. Upon such defeasance, the Prior Bonds will not be subject to redemption other than as described above.

The mathematical accuracy of the computations of the maturing principal and interest rate on the Escrow Obligations to be purchased with the proceeds of the Refunding Bonds, together with any amounts currently held in the Prior Bonds debt service reserve funds under the Prior Indentures, and held pursuant to the Escrow Agreement to provide for the payment of the principal of, redemption premium, if any, and interest due and to become due on the Prior Bonds, will be independently verified by Causey, Demgen & Moore, Inc., independent certified public accountants. (See "VERIFICATIONS".) The Prior Bonds will be defeased pursuant to the terms of each respective Prior Indenture, and the holders of the Prior Bonds shall have no legal right to the Matching Fund Loan Notes pledged to the 1998 Bonds or the Matching Fund Revenues. (See "SECURITY FOR THE 1998 BONDS — Matching Fund Loan Notes".)

#### **Working Capital Financing**

Since Fiscal Year 1989, the Government has experienced substantial fluctuations in revenues and expenditures, resulting in both year end operating deficits and surpluses in the General Fund. (See Appendix F - United States Virgin Islands - Financial Position of the Government".) The operating deficits have had an adverse effect on the Government's cash position. As of January 1, 1998, the Government had outstanding in excess of \$40,000,000 of accounts payable to vendors and over \$66,000,000 of income tax refunds due to citizens and businesses of the Virgin Islands totalling over \$106,000,000. On February 10, 1998, the Government entered into a Loan Agreement, dated February 9, 1998, with Union Bank of Switzerland, New York Branch, Canadian Imperial Bank of Commerce, Inc. and Banco Popular (the "Interim Loan Agreement") to provide \$106,845,000 of interim financing for the payment of a portion of the past due vendor payments and the income tax refunds referred to above. In anticipation of the issuance of the 1998 Bonds, the Government issued its note to secure the repayment

of the Interim Loan Agreement (the "Revenue Anticipation Note"). The Revenue Anticipation Note is due and payable on October 2, 1998, but under certain circumstances a portion of the loan may be converted to a term loan that is due and payable on October 2, 2003. The Authority intends to pay, on behalf of the Government, the full principal balance and accrued interest due and payable on the Revenue Anticipation Note from the proceeds of the Series 1998 C Bonds and the Series 1998 D Bonds. The Authority also intends to finance approximately \$11,600,000 of additional working capital from the balance of the proceeds of the Series 1998 D Bonds.

### Capital Improvement Projects

During the past ten years, the Government has expended approximately \$145 million of bond proceeds for the construction of capital improvement projects throughout the Virgin Islands. These capital projects have included the construction and equipping of schools, emergency (and other) housing, the rehabilitation, refurbishing and equipping of hospitals and health centers, the renovation and construction of a pier, a criminal justice complex, solid waste land fills, and repair of other public buildings, among others.

The Government intends to use a portion of the proceeds of the Series 1998 E Bonds, together with certain federal funds and other funds of the Government, to finance a portion of the following capital projects:

|  | <u>Bond<br/>Proceeds</u> | <u>Federal<br/>Funds</u> | <u>Other<br/>Funding</u> | <u>Total<br/>Cost</u> |
|--|--------------------------|--------------------------|--------------------------|-----------------------|
| School Construction                    | \$                       | \$ -                     | \$ -                     | \$ 40,225,000         |
| Peace Corps Elementary School          | 9,225,000                | -                        | -                        |                       |
| Lockhart Elementary School             | 10,500,000               | -                        | -                        |                       |
| Bertha C. Boschulte Junior High School | 20,500,000               | -                        | -                        |                       |
| Waste Water Treatment Facilities       | 21,600,000               | 15,300,000               | 3,900,000                | 40,800,000            |
| Correctional Facilities                | 24,375,000               | -                        | -                        | 24,375,000            |
| Hazard Mitigation                      | 3,605,000                | 38,395,000               | -                        | 42,000,000            |
| Flood Control (Savan Gut)              | 795,000                  | 7,228,000                | 2,305,000                | 10,328,000            |
| Government House Renovation            | <u>3,400,000</u>         | <u>0</u>                 | <u>8,600,000</u>         | <u>12,000,000</u>     |
| Total                                  | <u>\$94,000,000</u>      | <u>\$60,923,000</u>      | <u>\$14,805,000</u>      | <u>\$169,728,000</u>  |

*School Construction.* The Department of Education of the United States Virgin Islands (the "Department") has established educational goals for all schools, of which one major goal is "to upgrade and rehabilitate public school facilities in an effort to strengthen the physical plant and equip them with the necessary technological infrastructure".

The Peace Corps Elementary School, the Lockhart Elementary School and the Bertha C. Boschulte Junior High School all suffered severe structural damage in Hurricane Marilyn and Hurricane Bertha and are scheduled to be rebuilt in their entirety. The overall capital budget for rebuilding these schools is approximately \$40,225,000.

The Peace Corps Elementary School was established in 1973 to service children on the east end of St. Thomas. The new school will be built to accommodate a student body of 500 and will serve grades kindergarten through six and special education with a staff of 75. It has a gross square footage of approximately 54,770 and will provide 16 regular classrooms, 10 special education classrooms, and a multipurpose room which will accommodate the cafeteria and auditorium (the "cafetorium") and an administration building. The estimated cost of the new facility is approximately \$9,225,000. Currently, students are accommodated in mobile units which were acquired shortly after Hurricane Marilyn.

The Lockhart Elementary School, located in St. Thomas, has a student body of 800 and serves kindergarten through sixth grade, with a staff of 90. A new facility will have a gross square footage of approximately 62,210, provide 28 regular classrooms, four special education classrooms and a multipurpose room which will accommodate

the cafeteria and auditorium ("cafetorium") and an administration building at a cost of approximately \$10,500,000. The student body at this school also is currently being served out of temporary mobile classrooms which were acquired shortly after the hurricanes.

The Bertha C. Boschulte Junior High School, located in St. Thomas, services 800 students, grades six through eight, with a staff of 130. The new school, approximately 120,587 gross square feet, will have 27 regular classrooms, eight special education classrooms, a cafeteria, a gymnasium and an 1000 seat auditorium in addition to laboratories and other support facilities. The budget for this new school is approximately \$20,500,000.

*Waste Water Treatment.* In September, 1995, the Government entered into an Amended Consent Decree with the United States Environmental Protection Agency (the "EPA") under which it is committed (i) to construct two regional waste water treatment facilities: the Mangrove Lagoon Regional Facility and outfall in St. Thomas and the Cruz Bay Regional Facility in St. John; (ii) to construct an outfall extension for the waste water treatment plant in St. Croix; (iii) to replace the Anguilla Force Main in St. Croix; and (iv) to implement plant-by-plant operational improvements and pump station rehabilitation throughout the Territory, including the replacement of equipment, repairs and maintenance at 37 waste water facilities.

The Cruz Bay Regional Facility, will be funded in part by an EPA grant and will be available for competitive bidding in mid 1998. The Cruz Bay project is currently funded by a \$5,300,000 EPA Grant. An additional \$600,000 is required from proceeds of the Series 1998 E Bonds to meet the projected bid price requirements. The design of the Mangrove Lagoon Regional Facility is now complete and should be available for competitive bidding in the very near future. The cost of the project is estimated at approximately \$26,000,000. Approximately \$10,000,000 is available from an EPA grant and the remaining approximately \$16,000,000 required to complete the construction is to be financed from proceeds of the 1998 Series E Bonds.

The Anguilla Force Main is a 24-inch diameter, 13,500 linear foot long pipe that carries wastewater from the Figtree Pump Station towards the St. Croix Waste Water Treatment Plant. The existing force main has experienced failures since 1991 due to external corrosion. These failures have resulted in discharges of raw wastewater into adjacent ditches, which drain into the ocean. The Consent Decree with EPA requires that the Government replace the force main. The Authority allocated \$1.9 million for this purpose in anticipation of a federal grant, which would complete total estimated costs, at that time, of \$2,200,000. Requests for proposals for the design and construction of the replacement force main were recently advertised and the winning bid was \$2,500,000 leaving a deficit of \$600,000 above available funding, which will be covered by a portion of the proceeds of the Series 1998 E Bonds.

The estimated cost of the pump station, wetwall upgrades, telemetry and waste water treatment plant rehabilitation required by the consent decree is estimated at approximately \$3,000,000. An additional \$1,000,000 will be needed for cleaning the ponds and other miscellaneous improvements for a total cost of approximately \$4,000,000. Two million dollars has been allocated by the Government from unexpended Prior Bond proceeds, leaving a deficit of approximately \$2,000,000 to be funded from the proceeds of the Series 1998 E Bonds.

An additional \$2,400,000 is required for project management and inspection services, for a total requirement of approximately \$21,600,000 from proceeds of the Series 1998 E Bonds.

*Correctional Facilities.* The Government is under a consent decree with the United States Department of Justice to provide improved incarceration facilities for prisoners in the Territory. To comply with the terms of the consent decree, the Government has prepared a Request for Proposals to qualified offerors to develop, design and construct a new 400 bed adult prison and 150 bed jail facility to be located at Estate Adventure on the Island of St. Croix. It is anticipated that the cost of this facility will be approximately \$24,375,000.

*Hazard Mitigation Projects.* In addition to providing disaster relief funds in the form of grants, the Federal Emergency Management Assistance Agency ("FEMA") assists governmental entities in implementing long-term hazard mitigation measures following the declaration of a major disaster. Through its Hazard Mitigation Grant Program (the "HMG Program"), FEMA will fund from 50% to 90% of eligible project costs of previously identified mitigation measures that benefit a declared disaster area. To take advantage of potential funding under the HMG Program, the Government has identified certain improvements. Through the HMG Program, FEMA is expected

to fund up to 90% of the eligible costs of certain hazard mitigation capital projects estimated at approximately \$42,000,000 with a Government contribution from certain proceeds of the Series 1998 E Bonds of approximately \$3,605,000. All of the hazard mitigation projects to be funded in part from proceeds of the Series 1998 E Bonds have a projected completion date of October 31, 1999.

*Flood Control (Savan Gut).* Proceeds totalling \$795,000 of the Series 1998 E Bonds will be applied to the implementation of major long-term flood control measures in Savan Gut on the island of St. Thomas. The Savan Gut Flood Control Project is under the auspices of a Project Cooperation Agreement between the U.S. Army Corps of Engineers and the Government. The project entails the removal of existing bridges, relocation of utilities and the construction of upstream extensions and adequate flow-ways. Additionally, as a result of the flood control construction, a number of items will be removed and restored to adhere to historic preservation considerations. The estimated completion time for the Savan Gut Project is eighteen months from startup, which is scheduled for June 1998. The federal government has contributed \$7,228,000 and the Government is providing \$2,305,000 to complete the project.

*Government House Renovation.* \$3,400,000 of the proceeds of the Series 1998 E Bonds will be applied to the payment of cost overruns on the renovation of office space housed within the historic Government House complex in Christiansted, St. Croix. Government House was built in 1747 and acquired by the Government in 1771 for use as the executive offices of the Danish government and has been used as government office space for the Government of the Virgin Islands for more than two centuries.

The Government has applied, and is intending to apply to the federal government for funding of certain additional capital projects. In the event the Government receives federal funding for capital improvements which have been approved for financing from proceeds of the Series 1998 E Bonds, the Government would reallocate such proceeds to other Approved Projects in accordance with the terms of the Indenture.



## SECURITY FOR THE 1998 BONDS

### General

The 1998 Bonds are payable from and secured by a pledge of the Trust Estate which includes certain funds established under the Indenture and the Matching Fund Loan Notes. Payment of the Subordinate Lien Bonds from the Trust Estate will be subordinate to the payment of the Senior Lien Bonds. The Matching Fund Loan Notes are special limited obligations of the Government and are secured solely by a pledge of the Matching Fund Revenues (as defined below).

Pursuant to the Indenture, the 1998 Bonds are secured by the Trust Estate which includes: (i) moneys deposited or required to be deposited in the Pledged Revenue Account, with respect to Senior Lien and Subordinate Lien Bonds, the Debt Service Accounts, and the Debt Service Reserve Accounts, including all right, title, and interest in and to the investments held in the respective Debt Service Accounts and Debt Service Reserve Accounts and any Credit Facility held in a Debt Service Reserve Account pursuant to the provisions of the Indenture; (ii) the Matching Fund Loan Notes, and the proceeds and collections therefrom, including all right, title and interest of the Authority in the Matching Fund Revenues; (iii) all right, title and interest of the Authority in the Loan Agreement; (iv) all right, title and interest of the Authority owned or hereafter acquired in and to proceeds from the sale of Bonds required to be deposited in the Construction Account pursuant to the provisions of the Indenture (except as limited below) and all right, title, and interest in and to the investments held in the Construction Account (except as limited in the Indenture) pursuant to the provisions of the Indenture and (v) any and all other property or security interest therein, of every name and nature from time to time hereafter by delivery or by writing of any kind granted, bargained, sold, conveyed, transferred, mortgaged, pledged and assigned as and for additional security under the Indenture.

THE 1998 BONDS ARE THE FIRST ISSUANCE OF BONDS UNDER THE INDENTURE. THE 1998 BONDS ARE LIMITED AND SPECIAL OBLIGATIONS OF THE AUTHORITY. PRINCIPAL, PREMIUM, IF ANY AND INTEREST ON THE 1998 BONDS ARE PAYABLE SOLELY FROM THE PROCEEDS OF REPAYMENT OF THE MATCHING FUND LOAN NOTES AND AMOUNTS PLEDGED PURSUANT TO THE INDENTURE AS DESCRIBED HEREIN.

THE 1998 BONDS DO NOT CONSTITUTE A GENERAL OBLIGATION OF THE AUTHORITY, OF THE GOVERNMENT OR OF THE UNITED STATES OF AMERICA. THE AUTHORITY HAS NO TAXING POWER. THE MATCHING FUND REVENUES PLEDGED TO PAY DEBT SERVICE ON THE 1998 BONDS ARE DERIVED FROM THE MATCHING FUND LOAN NOTES WHICH ARE SPECIAL LIMITED OBLIGATIONS OF THE GOVERNMENT. THE MATCHING FUND LOAN NOTES ARE SECURED SOLELY BY A PLEDGE OF THE MATCHING FUND REVENUES. SUCH PLEDGE OF THE MATCHING FUND REVENUES TO THE MATCHING FUND LOAN NOTES IS SUBJECT TO A PRIOR PLEDGE TO SECURE CERTAIN EXISTING DEFEASED INDEBTEDNESS OF THE GOVERNMENT. THE MATCHING FUND LOAN NOTES DO NOT CONSTITUTE GENERAL OBLIGATIONS OF THE UNITED STATES OF AMERICA, NOR SHALL THE UNITED STATES OF AMERICA BE LIABLE THEREON.

### Matching Fund Loan Notes

The 1998 Bonds will be secured by five special limited obligation Matching Fund Loan Notes (one for each Series of 1998 Bonds) issued by the Government pursuant to the Loan Agreement. The Government will be obligated under the Matching Fund Loan Notes to make payments to the Authority in amounts sufficient to pay all principal, premium, if any, and interest on the 1998 Bonds when due and to make the amount on deposit in the respective Debt Service Reserve Account equal to the applicable Debt Service Reserve Requirement pursuant to the terms of the Indenture. Pursuant to the terms of the Loan Agreement, the Government has authorized the issuance of the Matching Fund Loan Notes as security for the 1998 Bonds. The Matching Fund Loan Notes have been issued in anticipation of the receipt of the Matching Fund Revenues over the full term of the Matching Fund Loan Notes, which Matching Fund Revenues are anticipated to be in excess of the amount necessary to pay all the principal of, premium, if any, and interest on, the 1998 Bonds. However, no assurances can be given as to the sufficiency of Matching Fund Revenues for such purpose. (See "MATCHING FUND REVENUES".) The Government, the

Authority and United States Trust Company of New York, as Special Escrow Agent, have entered into a Special Escrow Agreement dated as of May 1, 1998 (the "Special Escrow Agreement") which provides for payment of all Debt Service payments on the 1998 Bonds in the next Fiscal Year, and the funding of any deficiency in the Debt Service Reserve Accounts prior to transfer of any excess Matching Fund Revenues to the Government for other uses.

The pledge of the Matching Fund Revenues by the Government under the Matching Fund Loan Notes is subordinate to a prior pledge of the Matching Fund Revenues which the Government has made in connection with its 1977 General Obligation Matching Fund Bonds and its 1978 General Obligation Matching Fund Bonds (collectively, the "Defeased Bonds") which were economically defeased with the proceeds of the Authority's Revenue Bonds (Virgin Islands General Obligation/Matching Fund Loan Note) Series 1989A, but continue to hold a prior pledge of Matching Fund Revenues. The Defeased Bonds include an \$11,873,000 final maturity of January 2, 2007 and a \$5,945,000 final maturity of July 1, 2008. The Defeased Bonds are secured by an irrevocable escrow (currently invested in United States government obligations). In connection with the issuance of the Authority's Series 1989A Bonds, Ernst & Young L.L.P. delivered its report verifying the sufficiency of the escrow to satisfy the debt service obligation of the Defeased Bonds. Due to the existence of the irrevocable escrow for the Defeased Bonds, it is not expected that Matching Fund Revenues will be required to pay any debt service on the Defeased Bonds.

### **Loan Agreement**

Under the Loan Agreement, the Authority shall lend to the Government the sum of \$541,820,000 as a loan which shall be evidenced collectively by the Matching Fund Loan Notes. The Government shall repay to the Authority, pursuant to the respective Matching Fund Loan Notes, in annual installments at a principal maturity schedule corresponding to each of the respective Series of 1998 Bonds. The Loan Notes shall bear interest from the issue date payable annually immediately upon receipt of the Matching Fund Revenues from the Special Escrow Agent, but in no event later than the second Business Day preceding October 1 of each year, commencing the second Business Day next preceding October 1, 1998, and ending on the second Business Day next preceding the respective final maturity of the Matching Fund Loan Notes. Each Matching Fund Loan Note may, at the option of the Government be redeemed, in whole or in part, prior to its maturity at the times, in the manner of and of the same maturities as an optional redemption of the Authority's respective Series of Bonds and at a redemption price equal to the respective Series of Bonds, pursuant to the terms of the Indenture.

The Government has covenanted in the Loan Agreement, among other things, to take all actions necessary to preserve, protect and enhance the pledge of Matching Fund Revenues and to request that the United States deliver and take all steps necessary to ensure the receipt of and the maximization of the Matching Fund Revenues to be received pursuant to Section 28(b) of the Revised Organic Act. The Government has further covenanted not to take any action or fail to take any actions that would in any way impair the Government's right to receive the maximum amount of Matching Fund Revenues to which it may be entitled. In the event that the federal government discontinues the payment of Matching Fund Revenues to the Government and substitutes another stream of revenues in lieu thereof (the "Substitute Revenues"), the Government covenants to use its best efforts to pledge such Substitute Revenues to repayment of the Matching Fund Loan Notes. The Government also has covenanted to include in each annual operating budget of the Government submitted to the Legislature an appropriation for the molasses subsidy and to use its best efforts to ensure appropriation by the Legislature of an amount sufficient to satisfy the rum producers' projected subsidy requirement for each Fiscal Year. (See "THE RUM INDUSTRY".)

The Authority also has covenanted in the Loan Agreement to use its best efforts to cause the Government to comply with the terms and the covenants set forth in the Loan Agreement.

### **Flow of Funds**

The Indenture provides that all Matching Fund Revenues received by the Trustee from the Special Escrow Agent and any such other revenues as may be received by the Trustee shall be deposited, upon receipt by the Trustee, to the credit of the Pledged Revenue Account, which is an account held by the Trustee. Amounts in the

Pledged Revenue Account shall be transferred annually not later than the Business Day immediately preceding the first day of each Bond Year by the Trustee, in the following amounts and in the following order of priority:

(a) to each Senior Lien Interest Subaccount for (1) any Senior Lien Bonds which are Fixed Interest Rate Bonds and (2) for any Senior Lien Bonds which are not Fixed Interest Rate Bonds, an amount that when added to any amounts on deposit in such Subaccount, will equal 100% of the interest accruing or to accrue with respect to all Interest Payment Periods that commence during the current Bond Year for such Bonds, subject in each case to any credit as contemplated in any applicable Supplemental Indenture;

(b) to each Senior Lien Principal Subaccount, an amount that, when added to any amounts on deposit in such Subaccount, will equal 100% of the principal due on the next succeeding Principal Payment Date;

(c) to each Senior Lien Credit Subaccount, an amount sufficient to pay any principal and interest then owing to a Credit Provider under the applicable Supplemental Indenture and Credit Agreement by reason of any drawing of amounts under the related Credit Facility for the payment of principal of or interest or premium on any Senior Lien Bonds subject to any required transfer, under other provisions of the Indenture or a Supplemental Indenture;

(d) to each Senior Lien Redemption Subaccount, the amount of Revenues required to redeem Senior Lien Bonds subject to redemption pursuant to the related Supplemental Indenture;

(e) to the Senior Lien Debt Service Reserve Account, and ratably to each subaccount therein (if applicable), the amount of any transfer required by the Indenture to restore any deficiency in the Senior Lien Debt Service Reserve Account and any Subaccount therein (or to pay any amounts there owing to a Credit Provider pursuant to a Credit Agreement relating to a Senior Lien Debt Service Reserve Account Credit Facility);

(f) to each Senior Lien Expense Subaccount, any amounts then due and owing to the Trustee, any Paying Agent, Bond Registrar, Credit Provider, the Special Escrow Agent, or other Fiduciary which are Bond Service Charges or Bond Related Costs for Senior Lien Bonds, and the Authority's Annual Administrative Fee, which otherwise have not been provided for above;

(g) to each Rebate Account for Senior Lien Bonds;

(h) to each Subordinate Lien Interest Subaccount for (1) any Subordinate Lien Bonds which are Fixed Interest Rate Bonds and (2) for any Subordinate Lien Bonds which are not Fixed Interest Rate Bonds (beginning in the first month of each Bond Year for Subordinate Lien Bonds which are not Fixed Rate Bonds) an amount that when added to any amounts on deposit in such Subaccount, will equal 100% of that portion of the interest accruing or to accrue with respect to all Interest Payment Periods that commence during the current Bond Year for such Bonds, subject in each case to any credit;

(i) to each Subordinate Lien Principal Subaccount, an amount that, when added to any amounts on deposit in such Subaccount will equal 100% of the principal due on the next succeeding Principal Payment Date;

(j) to each Subordinate Lien Credit Subaccount, an amount sufficient to pay any principal and interest then owing to a Credit Provider under the applicable Supplemental Indenture and Credit Agreement by reason of any drawing of amounts under the related Credit Facility for the payment of principal of or interest or premium on any Subordinate Lien Bonds provided, that the amounts of the transfers shall be reduced to the extent of moneys previously transferred or required to be transferred to said Accounts under other provisions of the Indenture or a Supplemental Indenture;

(k) to each Subordinate Lien Redemption Subaccount, the amount of Revenues required to redeem Subordinate Lien Bonds subject to redemption pursuant to the related Supplemental Indenture;

(l) to each Subordinate Lien Debt Service Reserve Account, and ratably to each Subaccount therein (if applicable), the amount of any transfer required by the Indenture to restore any deficiency in the Subordinate Lien Debt Service Reserve Account and any Subaccount therein (or to pay any amounts then owing to a Credit Provider pursuant to a Credit Agreement relating to a Subordinate Lien Debt Service Reserve Account Credit Facility);

(m) to each Subordinate Lien Expense Subaccount, any amounts then due and owing to the Trustee, any Paying Agent, Bond Registrar, Credit Provider, Special Escrow Agent or other Fiduciary which are Bond Service Charges or Bond Related Costs for Subordinate Lien Bonds and the Authority's Annual Administrative Fee which otherwise have not been provided for above;

(n) to each Rebate Account for Subordinate Lien Bonds;

(o) except as may be provided in one or more Supplemental Indentures to the contrary, to the Surplus Account for application pursuant to the Indenture.

### **Debt Service Reserve Accounts**

The Senior Lien Debt Service Reserve Account and the Subordinate Lien Debt Service Reserve Account established under the Indenture are referred to collectively as the Debt Service Reserve Accounts. The Trustee shall initially fund each Debt Service Reserve Account, as applicable, through a deposit to the credit of the respective Account from the proceeds of each Series of Bonds in an amount equal to the applicable Debt Service Reserve Requirement (if any) established in the Supplemental Indenture or, in lieu thereof, the Authority may cause a Debt Service Reserve Account Credit Facility to be delivered to the Trustee for such purpose. A valuation of each Debt Service Reserve Account shall be made on September 1 in each year pursuant to the Indenture. In the event the amount on deposit in such respective Debt Service Reserve Account is less than the applicable Debt Service Reserve Requirement because of any valuation of the investment securities or due to a payment made from such Account to cure an insufficiency of funds on any Interest Payment Date or Principal Payment Date, the Authority shall be required to restore the deficiency caused thereby by transfers of Revenues as described below. The Trustee shall notify the Authority and the Special Escrow Agent of the amount, if any, of the deficiency or excess in each Debt Service Reserve Account.

No later than the second Business Day preceding the first day of the next Bond Year (which is defined in the Indenture as the Fiscal Year) (after the transfers, if any, to the Debt Service Account pursuant to the Indenture), the Authority shall transfer or provide for the transfer to the Trustee for deposit in each respective Debt Service Reserve Account, an amount not exceeding the aggregate amount necessary, together with the amounts already on deposit in each Debt Service Reserve Account to make the amounts on deposit in such Debt Service Reserve Account equal to the applicable Debt Service Reserve Requirement, from Matching Fund Revenues then on deposit in the Special Escrow Fund established under the Special Escrow Agreement (but only to the extent not required to pay principal of and interest on any Defeased Bonds) with respect to the Senior Lien Debt Service Reserve Account and the Subordinate Lien Debt Service Reserve Account, respectively. The Trustee shall send written direction to the Special Escrow Agent (with a copy to the Authority) to transfer such amount, to the extent available after transfer pursuant to the Indenture, from the Special Escrow Fund established under the Special Escrow Agreement.

Pursuant to the terms of the First Supplemental Indenture of Trust, dated as of May 1, 1998, the Debt Service Reserve Requirement with respect to Senior Lien Bonds and Subordinate Lien Bonds, respectively, shall mean an amount equal to the least of (i) the maximum principal and interest due on the Senior Lien Bonds and the Subordinate Lien Bonds in the current or any future Fiscal Year, (ii) 10% of the original stated principal amount of the Senior Lien Bonds and the Subordinate Lien Bonds (or 10% of the issue price of the Senior Lien Bonds or the Subordinate Lien Bonds if required by the Code), or (iii) 125% of the average annual principal and interest due on the Senior Lien Bonds and on the Subordinate Lien Bonds in the current and each future Fiscal Year, as specified in the Indenture and the First Supplemental Indenture.

## **Additional Bonds**

All of the Bonds issued under a Supplemental Indenture shall collectively be a charge and lien upon the Trust Estate as provided in the Indenture and such charge and lien shall be prior to any other charge and lien upon the Trust Estate. Except as permitted in the Indenture, no obligations payable from Revenues or secured by a lien on the Trust Estate (except as to any Credit Facility or Liquidity Facility which secures Bonds or a specific Series of Bonds) shall be hereafter issued.

So long as no Event of Default has occurred and is continuing, the Authority may from time to time enter into a Supplemental Indenture providing for the issuance of Additional Bonds pursuant to the Indenture. Additional Senior Lien Bonds may be issued if the conditions set forth in the Indenture are met, including that (i) the average Matching Fund Revenues received by the Government for the immediately preceding three Fiscal Years prior to the issuance of such Additional Senior Lien Bonds equaled or exceeded 150% of the amount of maximum annual Adjusted Debt Service Requirement (including such proposed Additional Bonds) in the current or any subsequent Bond Year, (ii) the average Matching Fund Revenues projected to be received by the Government in the next succeeding two Fiscal Years following the issuance of the Additional Bonds is projected to equal or exceed 150% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Senior Lien Bonds and such additional Senior Lien Bonds and (iii) the average Matching Fund Revenues received in the three Fiscal Years prior to the issuance of such Additional Bonds equaled or exceeded 110% of the Adjusted Debt Service Requirement (including such proposed Additional Bonds), and the average Matching Fund Revenues projected to be received by the Government for the next succeeding two Fiscal Years following the issuance of the additional Senior Lien Bonds is projected to equal or exceed 110% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Senior Lien Bonds, such Additional Senior Lien Bonds and Outstanding Subordinate Lien Bonds.

Additional Subordinate Lien Bonds may be issued if the conditions set forth in the Indenture are met, including that (i) the average Matching Fund Revenues received by the Government for the immediately preceding three Fiscal Years available after payment of Debt Service on Outstanding Senior Lien Bonds and any Senior Lien Bonds to be issued simultaneously with such additional Subordinate Lien Bonds (the "Available Matching Fund Revenues") equaled or exceeded 125% of the amount of maximum Adjusted Debt Service Requirement in the current or any subsequent Bond Year; (ii) the average Available Matching Fund Revenues projected to be received by the Government in the next succeeding two Fiscal Years following the issuance of the additional Subordinate Lien Bonds is projected to equal or exceed 125% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Subordinate Lien Bonds and such additional Subordinate Lien Bonds; and (iii) the average Matching Fund Revenues received in the three Fiscal Years prior to the issuance of such Additional Bonds equaled or exceeded 110% of the Adjusted Debt Service Requirement (including such proposed Additional Bonds), and the average Matching Fund Revenues projected to be received by the Government for the next succeeding two Fiscal Years following issuance of the additional Subordinate Lien Bonds is projected to equal or exceed 110% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Subordinate Lien Bonds, such additional Subordinate Lien Bonds and Outstanding Senior Lien Bonds.

Such Additional Bonds may be for any purpose for which bonds or other obligations may be now or hereafter issued under the Act or as otherwise permitted under the laws of the Virgin Islands. Any such Additional Bonds may bear interest at any rate lawful at the time of the issuance thereof and may mature over any period of time not exceeding the maximum maturity permitted by law and may provide for such other payment terms and conditions as the Authority shall determine in a Supplemental Indenture. It is understood and agreed that any Additional Bonds shall be given a designation by year, alphabetical letter or other identifying language or symbol differentiating such Additional Bonds from other bonds then Outstanding as provided in the Supplemental Indenture authorizing the issuance thereof.

The Authority has the right to issue other bonds, notes or other evidences of indebtedness that are not secured by the Indenture and are not secured by a pledge of Matching Fund Revenues.

## THE 1998 BONDS

### General

The 1998 Bonds will be dated May 1, 1998, and will bear interest at the rates and will mature on the dates set forth on the inside cover of this Official Statement. Interest on the 1998 Bonds will be payable on April 1 and October 1, commencing on October 1, 1998. The 1998 Bonds are subject to redemption at the times and in the manner set forth below in "THE 1998 BONDS - Redemption". Pursuant to the Indenture, the Authority has appointed the Trustee as the Paying Agent and Registrar. Interest on the 1998 Bonds shall be calculated on the basis of a 360-day year consisting of twelve 30-day months and will be payable to Cede & Co., or such other owner of record as shown in the registration books of the Authority maintained by the Paying Agent as Registrar. The 1998 Bonds will be available initially in minimum denominations of \$5,000 and integral multiples of \$5,000 in excess thereof, in book-entry only form as described below.

### Authorization and Purpose

The 1998 Bonds will be issued pursuant to and secured by the Indenture and pursuant to United States Virgin Islands law. Proceeds of the 1998 Bonds will be used to (i) advance refund the outstanding Prior Bonds, (ii) repay the Revenue Anticipation Note, (iii) finance the payment of various capital projects, (iv) fund the Series Debt Service Reserve Accounts, and (v) pay certain costs of issuance of the 1998 Bonds.

### Senior/Subordinate Lien Structure

Payment from the Trust Estate of the Subordinate Lien Bonds will be subordinate to the payment from the Trust Estate of the Senior Lien Bonds. The failure to pay interest, principal or the Redemption Price on the Senior Lien Bonds, shall constitute a cross default on the Subordinate Lien Bonds. The failure to pay interest, principal or the Redemption Price on the Subordinate Lien Bonds, however, shall not constitute an Event of Default on the Senior Lien Bonds. In no event shall an Event of Default on any 1998 Bonds, as defined in the Indenture, result in the acceleration of the Senior Lien Bonds or the Subordinate Lien Bonds.

### Book-Entry-Only System

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the 1998 Bonds. The 1998 Bonds will be issued as fully-registered securities in the name of Cede & Co. (DTC's partnership nominee). One fully-registered 1998 Bond certificate will be issued for each series and maturity of the 1998 Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants ("Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations ("Direct Participants"). DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system also is available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchases of 1998 Bonds under the DTC system must be made by or through Direct Participants, who will receive a credit for the 1998 Bonds on DTC's records. The ownership interest of each actual purchaser of each 1998 Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 1998 Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in 1998 Bonds, except in the event that use of the book-entry system for the 1998 Bonds is discontinued.

To facilitate subsequent transfers, all 1998 Bonds deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. The deposit of 1998 Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 1998 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 1998 Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Notwithstanding any other provision herein to the contrary, the Authority and the Trustee may agree to allow DTC or its nominee to make a notation on any Bond redeemed in part to reflect, for informational purposes only, the principal amount and date of any such redemption.

Notwithstanding any other provision to the contrary, so long as any Bond of a Series is registered in the name of DTC or its nominee, all payments with respect to the principal or redemption price of, and interest on, such Bond and all notices with respect to such Bond shall be made and given, respectively, to DTC or its nominee.

In connection with any notice or other communication to be provided to Owners by the Authority, any agent thereof or the Trustee with respect to any consent or other action to be taken by Owners, the Authority, any agent thereof or the Trustee, as the case may be, shall establish a record date for such consent or other action and shall give DTC notice of such record date not less than 15 calendar days in advance of such record date to the extent possible.

Neither DTC nor Cede & Co. will consent or vote with respect to 1998 Bonds. Under its usual procedures, DTC mails an omnibus proxy (the "Omnibus Proxy") to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the 1998 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the 1998 Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on the payment date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payment date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, the Trustee or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

With respect to Bonds registered in the name of DTC, the Authority, the Trustee and any agent thereof shall have no responsibility or obligation to any Direct Participant or to any Beneficial Owner of such Bonds. Without limiting the immediately preceding sentence, the Authority, the Trustee and any agent thereof shall have no responsibility or obligation with respect to (i) the accuracy of the records of a Depository, its nominee, or any Direct Participant with respect to any beneficial ownership interest in the Bonds, (ii) the delivery to any Direct Participant, Beneficial Owner or other person, other than the Depository, of any notice with respect to the Bonds, including any notice or redemption, (iii) the payment to any Direct Participant, Beneficial Owner or other person,

other than DTC, of any amount with respect to the principal or redemption price of, or any interest on, the Bonds or (iv) any consent given or other action taken by DTC. The Authority, the Trustee and any agent thereof may treat DTC as, and deem the Depository to be, the absolute owner of each Bond for all purposes whatsoever including, (but not limited to) (1) payment of the principal or redemption price of, and interest on, each such Bonds, (2) giving notices of purchase or redemption and other matters with each such Bond, and (3) registering transfers with respect to such Bonds. The Trustee shall pay the principal or redemption price of, and interest on, all Bonds registered in the name of DTC or its nominee only to or upon the order of DTC, and all such payments shall be valid and effective to fully satisfy and discharge the Authority's obligations with respect to such principal or redemption price, and interest, to the extent of the sum or sums so paid. No person other than DTC shall receive a Bond of a Series evidencing the obligation of the Authority to make payments of principal or redemption price, and interest on, the Bonds of such Series registered in the name of a Depository to the Trustee of Written Order to the effect that DTC has determined to substitute a new nominee, and subject to the transfer provisions hereof, any references to the prior nominee contained herein or in a Supplemental Indenture shall refer to such new nominee.

DTC may determine to discontinue providing its services with respect to the Bonds of a Series at any time by giving reasonable written notice to the Authority, the Trustee and any tender agent for a Series of Bonds and discharging its responsibilities with respect thereto under applicable law.

The Authority, in its sole discretion and without the consent of any other Person, may terminate, upon provision of notice to the Trustee and any tender agent for a Series of Bonds, the services of the DTC with respect to a Series of Bonds if the Authority determines that the continuation of the system of book entry-only transfers through the DTC (or a successor securities depository) is not in the best interest of the Owners of the Bonds of the Series or is burdensome to the Authority.

Upon the termination of the services of DTC with respect to a Bond or upon the termination of the services of DTC with respect to the Bond of a Series, the Authority in its sole discretion may select a new Depository or determine that the Bonds of such Series shall no longer be restricted to being registered in the Bond Register in the name of DTC or its nominee. If the Authority determines to discontinue the services of a Depository, the Authority shall issue and the Trustee shall transfer and exchange Bond certificates for such Series as requested by the DTC or Direct Participants of like principal amount, series and maturity, in authorized denominations to the identifiable Beneficial Owners of the Bonds in replacement of such Beneficial Owners' beneficial interests in the Bonds. *The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Authority believes to be reliable, but the Authority assumes no responsibility for the accuracy thereof.*

NEITHER THE AUTHORITY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO SUCH DTC PARTICIPANTS, INDIRECT PARTICIPANTS, OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO THE PAYMENTS TO OR THE PROVIDING OF NOTICE FOR THE DTC PARTICIPANTS, THE INDIRECT PARTICIPANTS, OR THE BENEFICIAL OWNERS. PAYMENTS MADE TO DTC OR ITS NOMINEE SHALL SATISFY THE AUTHORITY'S OBLIGATION UNDER THE ACT AND THE INDENTURE TO THE EXTENT OF SUCH PAYMENTS.

## **Redemption**

### **Optional Redemption - Series 1998 A Bonds**

The Series 1998 A Bonds are not subject to optional redemption prior to October 1, 2008. The Series 1998 A Bonds maturing after October 1, 2008 shall be subject to redemption at the option of the Authority prior to their stated maturity, on or after October 1, 2008, in whole or in part, at any time in such order of maturity as the Authority shall determine, and otherwise by lot within a maturity, from any funds available therefor, at the respective redemption prices (expressed as a percentage of the principal amount redeemed) set forth in the table below, together with the interest accrued on the principal amount redeemed to the date fixed for redemption:



| <b><u>Redemption Period</u></b><br><b><u>(both dates inclusive)</u></b> | <b><u>Redemption Price</u></b> |
|---|--------------------------------|
| October 1, 2008 through September 30, 2009                              | 101%                           |
| October 1, 2009 through September 30, 2010                              | 100½                           |
| October 1, 2010 and thereafter  | 100                            |

#### **Optional Redemption - Series 1998 E Bonds**

The Series 1998 E Bonds are not subject to optional redemption prior to October 1, 2008. The Series 1998 E Bonds maturing after October 1, 2008 shall be subject to redemption at the option of the Authority prior to their stated maturity, on or after October 1, 2008, in whole or in part, at any time in such order of maturity as the Authority shall determine, and otherwise by lot within a maturity, from any funds available therefor, at the redemption prices (expressed as a percentage of the principal amount redeemed) set forth in the table below, together with the interest accrued on the principal amount redeemed to the date fixed for redemption:

| <b><u>Redemption Period</u></b><br><b><u>(both dates inclusive)</u></b> | <b><u>Redemption Price</u></b> |
|---|--------------------------------|
| October 1, 2008 through September 30, 2009                              | 101%                           |
| October 1, 2009 through September 30, 2010                              | 100½                           |
| October 1, 2010 and thereafter  | 100                            |

#### **No Optional Redemption - Series 1998 B Bonds, Series 1998 C Bonds and Series 1998 D Bonds**

The Series 1998 B Bonds, Series 1998 C Bonds and the Series 1998 D Bonds are not subject to optional redemption.

#### **Mandatory Sinking Fund Installment Redemption**

The Series 1998 A Term Bonds and the 1998 Series E Term Bonds are subject to redemption in part on each October 1, by operation of mandatory Sinking Fund Installment requirements, required by the Indenture to be on deposit on October 1 in the years and the amounts set forth below, at a redemption price equal to the principal amount thereof, together with the interest accrued thereon to the date fixed for redemption:

# **Sinking Fund Installments**

| <u>Year</u> | Series 1998 A Bonds<br>Maturing October 1, 2018 | Series 1998 A Bonds<br>Maturing October 1, 2022 | Series 1998 A Bonds<br>Maturing October 1, 2025 | Series 1998 E Bonds<br>Maturing October 1, 2013 | Series 1998 E Bonds<br>Maturing October 1, 2018 | Series 1998 E Bonds<br>Maturing October 1, 2022 |
|-------------|---|---|---|---|---|---|
| 1998        |   |   |   |   |   |   |
| 1999        |   |   |   |   |   |   |
| 2000        |   |   |   |   |   |   |
| 2001        |   |   |   |   |   |   |
| 2002        |   |   |   |   |   |   |
| 2003        |   |   |   |   |   |   |
| 2004        |   |   |   |   |   |   |
| 2005        |   |   |   |   |   |   |
| 2006        |   |   |   |   |   |   |
| 2007        |   |   |   |   |   |   |
| 2008        |   |   |   |   |   |   |
| 2009        |   |   |   |   |   |   |
| 2010        |   |   |   |   |   |   |
| 2011        |   |   |   |   |   |   |
| 2012        |   |   |   |   |   |   |
| 2013        |   |   |   | \$5,345,000                                     |   |   |
| 2014        |   |   |   | 5,665,000                                       |   |   |
| 2015        |   |   |   | 6,000,000                                       |   |   |
| 2016        | \$19,160,000                                    |   |   | 6,355,000                                       |   |   |
| 2017        | 20,245,000                                      |   |   | 6,730,000†                                      |   |   |
| 2018        | 21,390,000†                                     |   |   |   | \$6,965,000                                     |   |
| 2019        |   | \$22,600,000                                    |   |   | 7,555,000                                       |   |
| 2020        |   | 23,875,000                                      |   |   | 7,905,000                                       |   |
| 2021        |   | 25,225,000                                      |   |   | 8,375,000                                       |   |
| 2022        |   | 10,000,000†                                     |   |   | 8,865,000†                                      | \$ 9,240,000                                    |
| 2023        |   |   |   |   |   | 8,605,000                                       |
| 2024        |   |   |   |   |   | 10,645,000                                      |
| 2025        |   |   |   |   |   | 8,180,000†                                      |
| 2026        |   |   |   |   |   |   |
| 2027        |   |   |   |   |   |   |
|             |   |   | \$ 1,675,000                                    |   |   |   |
|             |   |   | 27,265,000                                      |   |   |   |
|             |   |   | 9,165,000†                                      |   |   |   |

† Final Maturity

### **Purchase of the 1998 Bonds**

Pursuant to the Indenture, the Trustee may purchase the 1998 Bonds on the open market whenever a redemption would otherwise occur, at the direction of the Authority, at such price not to exceed the principal of, and redemption premium, if any, on the 1998 Bonds which would be payable on the next redemption date.

### **Selection; Notice of Redemption**

In the event of any redemption of less than all of any Series 1998 Bonds, portions of the 1998 Bonds of such Series and maturity to be redeemed will be selected at random by the Trustee in such manner as the Trustee in its discretion may deem fair and appropriate; provided, however, that the portion of any of the 1998 Bonds of a denomination greater than \$5,000 to be redeemed shall be in the principal amount of \$5,000, or an integral multiple of \$5,000 in excess thereof. In selecting portions of such Bonds for redemption, the Trustee shall treat each such Bond as representing that number of Bonds of \$5,000 denomination which is obtained by dividing the principal amount of such Bond to be redeemed in part by \$5,000; provided, however, notwithstanding the foregoing, the Trustee shall revise the Bonds or portions thereof to be redeemed as determined by the foregoing, in any manner deemed by the Trustee in its sole judgment to be fair and reasonable, so that no Bond Outstanding following any redemption shall be in a principal amount less than an authorized denomination therefor. Notice of any such redemption will be mailed by the Trustee not more than 60 nor less than 30 days prior to the date fixed for the redemption thereof, to each registered holder of the 1998 Bonds selected for redemption. The Authority, so long as a book-entry method is used for the 1998 Bonds, will send any such notice of redemption only to DTC.

# Total Debt Service Requirements

| Fiscal Year | Series 1998 A |              | Series 1998 B |             | Series 1998 C |             | Series 1998 D |             | Series 1998 E |             | Total Debt Service* |
|-------------|---------------|--------------|---------------|-------------|---------------|-------------|---------------|-------------|---------------|-------------|---------------------|
|             | Principal     | Interest     | Principal     | Interest    | Principal     | Interest    | Principal     | Interest    | Principal     | Interest    |                     |
| 1999        | \$0           | \$14,502,864 | \$8,765,000   | \$1,310,662 | \$0           | \$3,976,638 | \$0           | \$2,075,058 | \$0           | \$5,739,233 | \$36,369,455        |
| 2000        | 0             | 15,821,306   | 7,525,000     | 927,901     | 0             | 4,338,150   | 3,005,000     | 2,181,063   | 0             | 6,260,981   | 40,059,401          |
| 2001        | 0             | 15,821,306   | 4,050,000     | 537,882     | 3,960,000     | 4,239,150   | 3,175,000     | 2,011,113   | 0             | 6,260,981   | 40,055,432          |
| 2002        | 0             | 15,821,306   | 3,265,000     | 285,463     | 5,225,000     | 4,009,525   | 3,355,000     | 1,831,538   | 0             | 6,260,981   | 40,053,813          |
| 2003        | 0             | 15,821,306   | 2,410,000     | 85,676      | 6,575,000     | 3,714,525   | 3,540,000     | 1,641,925   | 0             | 6,260,981   | 40,049,413          |
| 2004        | 0             | 15,821,306   | 0             | 0           | 9,480,000     | 3,313,150   | 3,745,000     | 1,441,588   | 0             | 6,260,981   | 40,062,025          |
| 2005        | 0             | 15,821,306   | 0             | 0           | 9,990,000     | 2,801,425   | 3,965,000     | 1,219,650   | 0             | 6,260,981   | 40,058,363          |
| 2006        | 0             | 15,821,306   | 0             | 0           | 10,555,000    | 2,236,438   | 4,210,000     | 974,400     | 0             | 6,260,981   | 40,058,125          |
| 2007        | 0             | 15,821,306   | 0             | 0           | 11,150,000    | 1,639,550   | 4,470,000     | 714,000     | 0             | 6,260,981   | 40,055,838          |
| 2008        | 0             | 15,821,306   | 0             | 0           | 11,780,000    | 1,008,975   | 4,750,000     | 437,400     | 0             | 6,260,981   | 40,058,663          |
| 2009        | 0             | 15,821,306   | 0             | 0           | 12,455,000    | 342,513     | 4,915,000     | 147,450     | 0             | 6,260,981   | 39,942,250          |
| 2010        | 13,135,000    | 15,479,796   | 0             | 0           | 0             | 0           | 0             | 0           | 5,345,000     | 6,107,313   | 40,067,109          |
| 2011        | 13,835,000    | 14,778,576   | 0             | 0           | 0             | 0           | 0             | 0           | 5,665,000     | 5,790,775   | 40,069,351          |
| 2012        | 14,580,000    | 14,032,496   | 0             | 0           | 0             | 0           | 0             | 0           | 6,000,000     | 5,455,406   | 40,067,903          |
| 2013        | 15,380,000    | 13,230,866   | 0             | 0           | 0             | 0           | 0             | 0           | 6,355,000     | 5,100,200   | 40,066,066          |
| 2014        | 16,245,000    | 12,368,869   | 0             | 0           | 0             | 0           | 0             | 0           | 6,730,000     | 4,724,006   | 40,067,875          |
| 2015        | 17,165,000    | 11,450,094   | 0             | 0           | 0             | 0           | 0             | 0           | 6,965,000     | 4,325,922   | 39,906,016          |
| 2016        | 18,135,000    | 10,479,344   | 0             | 0           | 0             | 0           | 0             | 0           | 7,555,000     | 3,899,397   | 40,068,741          |
| 2017        | 19,160,000    | 9,453,731    | 0             | 0           | 0             | 0           | 0             | 0           | 7,905,000     | 3,445,259   | 39,963,991          |
| 2018        | 20,245,000    | 8,370,094    | 0             | 0           | 0             | 0           | 0             | 0           | 8,375,000     | 2,967,034   | 39,957,128          |
| 2019        | 21,390,000    | 7,225,131    | 0             | 0           | 0             | 0           | 0             | 0           | 8,865,000     | 2,460,609   | 39,940,741          |
| 2020        | 22,600,000    | 6,015,406    | 0             | 0           | 0             | 0           | 0             | 0           | 9,240,000     | 1,923,000   | 39,778,406          |
| 2021        | 23,875,000    | 4,737,344    | 0             | 0           | 0             | 0           | 0             | 0           | 8,605,000     | 1,387,650   | 38,604,994          |
| 2022        | 25,225,000    | 3,387,094    | 0             | 0           | 0             | 0           | 0             | 0           | 10,645,000    | 810,150     | 40,067,244          |
| 2023        | 10,000,000    | 2,418,406    | 0             | 0           | 0             | 0           | 0             | 0           | 8,180,000     | 245,400     | 20,843,806          |
| 2024        | 1,675,000     | 2,096,297    | 0             | 0           | 0             | 0           | 0             | 0           | 0             | 0           | 3,771,297           |
| 2025        | 27,265,000    | 1,282,359    | 0             | 0           | 0             | 0           | 0             | 0           | 0             | 0           | 28,547,359          |
| 2026        | 9,165,000     | 257,766      | 0             | 0           | 0             | 0           | 0             | 0           | 0             | 0           | 9,422,766           |

\* may not add due to rounding

# SOURCES AND USES OF FUNDS

## SOURCES OF FUNDS

|  | Series 1998 A | Series 1998 B | Series 1998 C | Series 1998 D | Series 1998 E |
|--|---------------|---------------|---------------|---------------|---------------|
| Par Amount                                 | \$289,075,000 | \$26,015,000  | \$81,170,000  | \$39,130,000  | \$106,430,000 |
| Premium / (Original Issue Discount)        | (2,832,186)   | 0             | 1,454,097     | 830,063       | (1,038,479)   |
| Amount Released from Prior Bonds Debt      |               |               |               |               |               |
| Service Reserves and Debt Service Accounts | 21,397,322    | 2,529,163     | 0             | 0             | 0             |
| Accrued Interest                           | 571,325       | 62,474        | 156,655       | 81,745        | 226,091       |
| Total Sources                              | \$308,211,461 | \$28,606,637  | \$82,780,753  | \$40,041,808  | \$105,617,612 |

## USES OF FUNDS

|  |               |              |              |              |               |
|--|---------------|--------------|--------------|--------------|---------------|
| Deposits to Escrow Funds                   | \$278,795,488 | \$25,724,201 | \$0          | \$0          | \$0           |
| Deposit to Pay Revenue Anticipation Note   | 0             | 0            | 81,957,453   | 26,828,231   | 0             |
| Deposit to Working Capital Account         | 0             | 0            | 0            | 11,617,265   | 0             |
| Deposit to Construction Account            | 0             | 0            | 0            | 0            | 94,004,130    |
| Deposit to Debt Service Reserve Account    | 26,117,000    | 2,601,500    | 0            | 1,191,000    | 10,325,000    |
| Deposit to Debt Service Account            | 571,325       | 62,474       | 156,655      | 81,745       | 226,091       |
| Costs of Issuance / Underwriter's Discount | 2,727,648     | 218,462      | 666,645      | 323,567      | 1,062,391     |
| Total Uses                                 | \$308,211,461 | \$28,606,637 | \$82,780,753 | \$40,041,808 | \$105,617,612 |

## MATCHING FUND REVENUES

### General

The Secretary of the United States Department of the Treasury (the "Secretary of the Treasury") is directed to make certain transfers to the Government of certain excise taxes imposed and collected under the Code in any Fiscal Year on certain products produced in the Virgin Islands and exported to the United States mainland from the Virgin Islands. Rum is the principal article presently produced in the Virgin Islands and exported to the United States which is subject to federal excise tax that qualifies for transfer to the Government under the applicable provisions of the Revised Organic Act, as amended, and the Code. (See "THE RUM INDUSTRY".)

In order to encourage the Virgin Islands to raise local revenues, the amount required to be remitted to the Government by the Secretary of the Treasury pursuant to the applicable excise tax transfer provisions is limited to an amount no greater than the total amount of local duties, taxes and fees collected by the Government in the applicable Fiscal Year. The term "Matching Fund Revenues" is used to denote these payments. Such revenue collections by the Government have always substantially exceeded federal excise tax collections and the Government has been the recipient of the full amount of such excise tax collections permitted under Section 28(b) of the Revised Organic Act, as amended, Section 7652 of the Code and 48 U.S.C.A. §1645.

In 1976, Section 1574a of the Revised Organic Act was enacted, in part, to authorize the Government, under certain conditions, to issue bonds secured by Matching Fund Revenues to be received by the Government. Until 1978, the Code provided that the Secretary of the Treasury would determine the amount of excise taxes imposed and collected during the calendar quarter and transfer such amounts, on a quarterly basis, to a designated Government fund, to be expended as determined by the Virgin Islands Legislature. Section 1645 of the Revised Organic Act, enacted in 1978, changed the manner in which Matching Fund Revenues were paid. Under Section 1645, the Governor of the Virgin Islands, with the concurrence of the Office of Management and Budget, estimates the amount of federal excise taxes to be collected in the ensuing Fiscal Year. Prepayment of estimated Matching Fund Revenues for a Fiscal Year, which commences on October 1, is made to the Government prior to September 30 of the immediately preceding Fiscal Year and transferred to the designated Government fund. This prepayment is subject to subsequent adjustment for the amount of revenue actually collected by the Government and the actual amount of the above described federal excise taxes collected by the Department of Treasury during such Fiscal Year. Such adjustments are made to the requested prepayments for the next succeeding Fiscal Year. (See "THE RUM INDUSTRY" and "Appendix D - Verification of Matching Fund Revenues".)

The federal excise tax rate and the rate at which such excise taxes are eligible to be transferred back to the Government are set by Congress and codified in Sections 5001(a)(1) and 7652(b)(3) of the Code. Since the enactment of Section 1574a of the Revised Organic Act in 1976, until the amendments to Section 5001 and 7652 under the Deficit Reduction Act of 1984, the federal excise tax on distilled spirits produced in, or imported into the United States was \$10.50 per proof gallon, and the entire amount of such excise tax qualified for transfer to the Government. The Deficit Reduction Act of 1984 increased the excise tax under Section 5001 of the Code to \$12.50 per proof gallon but also provided a limit to the rate of federal excise taxes eligible to be transferred to the Government. Section 7652(f) provides that the amount eligible for transfer to the Government shall be the lesser rate of \$10.50 per proof gallon or the actual federal excise tax imposed under Section 5001(a)(1) of the Code.

Pursuant to the Omnibus Budget Reconciliation Act of 1990, the rate of the federal excise taxes was increased to \$13.50, but the transfer rate of such taxes to the Government remained unchanged at \$10.50. The Omnibus Budget Reconciliation Act of 1993 amended Section 7652(f) to increase the transfer rate to \$11.30 per proof gallon for a five year period ending on September 30, 1998.

Beginning on October 1, 1998, the amount of federal excise taxes transferred to the Virgin Islands will return, pursuant to Section 7652(f), to the lesser of \$10.50 per proof gallon or the actual excise tax imposed as provided in Section 5001(a)(1) of the Code. The Government has requested that the rate of the federal excise taxes transferred to the Government be increased to \$13.50 per proof gallon. Federal executive agency officials support this request for an increase in the amount of federal excise taxes transferred to the Virgin Islands and the President of the United States has included in his proposed Fiscal Year 1999 budget the rate of \$13.50 per proof gallon. Expiration of the rate of reimbursement is subject to change by Congress and no assurances can be given as to how or whether the Congress might change the rate of the transfer of such excise taxes to the Government.

Matching Fund Revenues are currently pledged, in whole or in part, in respect of payments due on the Prior Bonds and a portion of the Revenue Anticipation Note (which Prior Bonds and the Revenue Anticipation Note are being refunded or paid in whole from a portion of the proceeds of the 1998 Bonds) and the Defeased Bonds. (See "THE AUTHORITY - Outstanding Indebtedness of the Authority" and "PLAN OF FINANCE".)

MATCHING FUND REVENUES ARE DERIVED FROM CERTAIN EXCISE TAXES PAYABLE ON PRODUCTS, PRINCIPALLY RUM, PRODUCED IN THE VIRGIN ISLANDS AND IMPORTED INTO THE UNITED STATES. THERE CAN BE NO ASSURANCE THAT VIRGIN ISLANDS RUM PRODUCTION OR THE FEDERAL EXCISE TAX WILL BE MAINTAINED AT LEVELS SUFFICIENT TO GENERATE EXCISE TAXES AND MATCHING FUND REVENUES IN AMOUNTS SUFFICIENT TO PAY THE DEBT SERVICE ON THE 1998 BONDS. (SEE "THE RUM INDUSTRY" AND "BONDHOLDER RISKS".)

The following is a summary of Matching Fund Revenues received by the Government for Fiscal Years 1992 through 1997:

# Matching Fund Revenues

| Current Fiscal Year                            | 1992         | 1993         | 1994 <sup>(1)</sup> | 1995         | 1996         | 1997         |
|--|--------------|--------------|---------------------|--------------|--------------|--------------|
| <b>Calculation of Actual Advance Received</b>  |              |              |                     |              |              |              |
| Projected Tax Revenues for Current Fiscal Year | \$28,500,000 | \$29,000,000 | \$30,928,800        | \$52,500,000 | \$43,628,000 | \$46,150,000 |
| Plus/Minus Payment Adjustment                  | (151,246)    | (1,480,776)  | 30,800              | 207,923      | (600,347)    | (11,476,894) |
| Actual Advance Received                        | \$28,651,246 | \$27,519,224 | \$30,959,600        | \$52,707,923 | \$43,027,653 | \$34,673,106 |
| <b>Calculation of Payment Adjustment</b>       |              |              |                     |              |              |              |
| Adjustment from FY Advanced Tax Revenues       | 1990         | 1991         | 1992                | 1993         | 1994         | 1995         |
| Collected Tax Revenues                         | \$29,000,000 | \$29,000,000 | \$28,500,000        | \$29,000,000 | \$30,928,800 | \$52,500,000 |
| Payment Adjustment                             | 29,151,246   | 27,519,224   | 28,530,800          | 29,207,923   | 30,328,453   | 41,023,106   |
|  | (151,246)    | (1,480,776)  | 30,800              | 207,923      | (600,347)    | (11,476,894) |
| <b>Calculation of Collected Tax Revenues</b>   |              |              |                     |              |              |              |
| Proof Gallons Tapped <sup>(2)</sup>            | 2,717,219    | 2,799,588    | 2,888,424           | 3,630,363    | 3,773,558    | 4,037,496    |
| Effective Tax Rate                             | \$10.50      | \$10.50      | \$10.50             | \$11.30      | \$11.30      | \$11.30      |
| Collected Tax Revenues <sup>(3)</sup>          | \$28,530,800 | \$29,207,923 | \$30,328,453        | \$41,023,106 | \$42,641,207 | \$45,623,700 |

- <sup>(1)</sup> Congress authorized the change of the transfer rate for Fiscal Year 1994 from \$10.50 to \$11.30. However, the \$11.30 transfer rate is not reflected in Collected Tax Revenues until Fiscal Year 1995.
- <sup>(2)</sup> Reported monthly to Virgin Islands Office of Management and Budget by Bureau of Alcohol, Tobacco and Firearms ("BATF").
- <sup>(3)</sup> Adjusted after close of Fiscal Year to reflect actual gallons tapped as reported by BATF. Fiscal Year 1993 includes BATF adjustment of \$187,751.

Source: Government of the Virgin Islands and the WEFA Verification Report. (See Appendix D—"Verification of Matching Fund Revenues".)



The advance of Matching Fund Revenues to the Virgin Islands in Fiscal Year 1995 was \$52.5 million. This amount, which was paid to the Virgin Islands on September 29, 1994, was substantially in excess of prior year advances of Matching Fund Revenues. The projected level of rum exports was increased for Fiscal Year 1995 in anticipation of substantial changes at the VIRIL (hereafter defined) facility, including (i) the acquisition of VIRIL by Todhunter (hereafter defined) in February 1994 and (ii) the consequent expansion of the VIRIL rum production facilities. The anticipated changes at the VIRIL facility and the increase in the rate per proof gallon to be remitted to the Government materially affected the ability of the Department of Interior and the Government to accurately project rum production for that year. In Fiscal Year 1995, production increased substantially and exports of rum were much higher than in prior years; the increase in the transfer rate from \$10.50 to \$11.30 is also reflected in full for the first time in Fiscal Year 1995 collected Matching Fund Revenues. Appropriate adjustments for the \$52,500,000 advance received in Fiscal Year 1995, were made in the advance of Matching Fund Revenues the Government received in September 1996 for Fiscal Year 1997. Further, estimates by the Department of Interior and the Government have not varied significantly from the actual results in any year other than Fiscal Year 1995.

The following table presents Matching Fund Revenues projected by WEFA, Inc. ("WEFA"), an economic consulting firm, for Fiscal Years 1998 to 2003. WEFA was engaged to verify Matching Fund Revenues received by the Government from Fiscal Year 1992 through Fiscal Year 1997 and to project Matching Fund Revenues for Fiscal Years 1998 through 2003. A copy of their report is attached to this Official Statement. (See "Appendix D - Verification of Matching Fund Revenues"). The table also includes the Matching Fund Revenues used to determine the par amount of the 1998 Bonds to be issued.

**Pro Forma Debt Service Coverage**  
((\$000's))

|  | <b><u>Projected<br/>FY<br/>1998</u></b> | <b><u>FY<br/>1999</u></b> | <b><u>FY<br/>2000</u></b> | <b><u>FY<br/>2001</u></b> | <b><u>FY<br/>2002</u></b> | <b><u>FY<br/>2003</u></b> |
|--|---|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Matching Fund Revenues <sup>(1)</sup>                    | \$46,016                                | \$45,804                  | \$45,905                  | \$45,974                  | \$45,680                  | \$45,593                  |
| Matching Fund Revenues for<br>Debt Sizing <sup>(2)</sup> | 43,100                                  | 43,100                    | 43,100                    | 43,100                    | 43,100                    | 43,100                    |
| Debt Service on Senior Lien<br>1998 Bonds                | -                                       | 28,555                    | 28,612                    | 28,608                    | 28,606                    | 28,607                    |
| Debt Service on Subordinate Lien<br>1998 Bonds           | -                                       | 7,814                     | 11,447                    | 11,447                    | 11,448                    | 11,443                    |
| Coverage Based on:<br><u>WEFA Matching Fund Revenues</u> |   |                           |                           |                           |                           |                           |
| Senior Coverage  | -                                       | 1.60x                     | 1.60x                     | 1.61x                     | 1.60x                     | 1.59x                     |
| Subordinate Coverage                                     | -                                       | 2.21x                     | 1.51x                     | 1.52x                     | 1.49x                     | 1.48x                     |
| <u>Matching Fund Revenues for Sizing</u>                 |   |                           |                           |                           |                           |                           |
| Senior Coverage  | -                                       | 1.51x                     | 1.51x                     | 1.51x                     | 1.51x                     | 1.51x                     |
| Subordinate Coverage                                     | -                                       | 1.86x                     | 1.27x                     | 1.27x                     | 1.27x                     | 1.27x                     |

(1) Based on WEFA Constant Market Share Model, assuming \$11.30 per proof gallon ("WEFA Revenues").

(2) Based on average of the collected tax revenues for Fiscal Year 1995 through Fiscal Year 1997 shown in the chart on the immediately preceding page ("Sizing Revenues"); used to determine initial debt service coverage of 1.50x on Senior Lien Bonds and 1.25x on Subordinate Lien Bonds.

## **Verification of Matching Fund Revenues**

WEFA was engaged to verify the collection and transfer of federal excise taxes that qualify for transfer to the Government as Matching Fund Revenues for Fiscal Years beginning 1992 through 1997 and to develop projections for Matching Fund Revenues from Fiscal Year 1998 through 2003. WEFA's review of the records that document the Matching Fund Revenue collection and transfer process concluded that annual Matching Fund Revenues transferred to the Virgin Islands during the Fiscal Year 1992 through Fiscal Year 1998 period were consistent with excise taxes collected from United States distillers on purchases of bulk rum produced in the Virgin Islands and Customs duties levied on cased Virgin Islands rum.

In connection with its revenue projections, WEFA developed two models to project future Matching Fund Revenues. The first model, the Constant Market Share Model, projects Matching Fund Revenues as a function of historical rum excise tax revenues, resulting in projected Matching Fund Revenues averaging approximately \$45.8 million from Fiscal Year 1998 through Fiscal Year 2003. The Trend Market Share Model bases future revenue projections on historical rum production in the Virgin Islands and forecasts Matching Fund Revenues averaging approximately \$49.1 million from Fiscal Year 1998 through Fiscal Year 2003.

WEFA's models assumed: (i) a constant \$11.30 per proof gallon rate eligible for transfer to the Government, (ii) that VIRIL (hereafter defined) would maintain its operations in the Virgin Islands, and (iii) that VIRIL would maintain its production levels to meet future demand. WEFA found that, given the economic incentives provided to VIRIL by the Government, it was reasonable to assume that VIRIL would maintain its operations in the Virgin Islands. Furthermore, WEFA found VIRIL currently maintains a stable niche in the overall United States rum market and should continue to enjoy the benefits associated with its acquisition by Todhunter (hereafter defined) which further supported their conclusion that production capabilities would not limit VIRIL's future ability to meet demand.

## **Potential Federal Offset of Matching Fund Revenues**

The primary security for the 1998 Bonds are Matching Fund Revenues. The Government has obtained federal community disaster loan assistance from FEMA following the occurrence of certain natural disasters. In order to obtain such federal financial assistance, the Government entered into certain loan agreements with FEMA which provide that in the event of the occurrence of an event of default under such loan agreements, FEMA, or the Department of Treasury, may be authorized to intercept federal funds payable to the Government, which may include Matching Fund Revenues. (See "Appendix F — United States Virgin Islands — Outstanding Indebtedness of the Government".)

## **THE RUM INDUSTRY**

### **General**

Rum produced in the United States Virgin Islands is exported to the United States mainland, primarily in bulk, and sold to local and regional bottlers and rectifiers for sale under a variety of private label and regional brand names, and to certain other bottlers for use in prepared cocktails, liqueurs and drink mixes. Approximately 4,620,000 proof gallons of rum were exported from the Virgin Islands to the United States in calendar year 1997.

Consumption and sales of distilled spirits in the United States declined from 1979 to 1996. In 1996, however, the distilled spirits market in the United States showed an increase of 0.5% from the previous year. Rum's share of the distilled spirits market in the United States, during the period from 1975 to 1990, consistently increased from 3.8% in 1975 to a high of 8.5% in 1990. Between 1990 and 1993 this percentage fell slightly, but since 1994 rum consumption has increased and in 1996 represented 9.4% of the distilled spirits market as shown below.

### Distilled Spirits Market Share

|                   | <u>1989</u> | <u>1990</u> | <u>1991</u> | <u>1992</u> | <u>1993</u> | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|-------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Whiskeys          | 39.2%       | 37.7%       | 36.8%       | 36.1%       | 36.4%       | 35.8%       | 34.6%       | 33.3%       |
| U.S. Whiskeys     | 17.1        | 16.4        | 16.2        | 15.9        | 15.8        | 15.4        | 15.1        | 14.2        |
| Scotch            | 9.0         | 8.4         | 7.9         | 7.5         | 7.8         | 7.8         | 7.4         | 7.1         |
| Other Whiskeys(1) | 13.1        | 12.9        | 12.7        | 12.7        | 12.8        | 12.6        | 12.1        | 12.0        |
| Non-Whiskeys      | 60.8%       | 62.3%       | 63.2%       | 63.9%       | 63.6%       | 64.2%       | 65.4%       | 66.7%       |
| Rums              | 8.5         | 8.5         | 8.4         | 8.0         | 8.2         | 8.4         | 8.8         | 9.4         |
| Vodka             | 22.5        | 22.2        | 22.7        | 22.2        | 22.5        | 22.8        | 23.4        | 23.7        |
| Gin               | 8.4         | 8.5         | 8.6         | 8.5         | 8.5         | 8.8         | 8.6         | 8.4         |
| Others(2)         | 21.5        | 23.1        | 23.5        | 25.2        | 24.4        | 24.2        | 24.6        | 25.2        |

NOTE: Numbers may not add to totals due to rounding.

(1) Includes Canadian Whiskeys.

(2) Includes brandies, cordials, liqueurs, tequila and prepared cocktails.

Source: Adams' Liquor Handbook (1997).

According to the Adams' Liquor Handbook (1997), through the year 2001, rum consumption is expected to remain relatively stable. Early projections show 13 million 9-liter cases of rum being consumed in 1997 reflecting a 0.4% increase over 1996, with future projections showing rum consumption increasing up to 13.4 million 9-liter cases in the year 2001 with an annual compounding growth rate since 1996 of 0.7%. (See "Appendix D - Verification of Matching Fund Revenues").

### Virgin Islands Rum Industries, Ltd. and Todhunter International, Inc.

Rum has been produced in the Virgin Islands for more than 300 years. All of the rum currently produced in the Virgin Islands is distilled by Virgin Islands Rum Industries, Ltd. ("VIRIL"). VIRIL was founded in 1946 and has produced rum consistently since its inception. The VIRIL facilities consist of six principal buildings of approximately 200,000 square feet on 30 acres. Todhunter International, Inc. ("Todhunter"), a Delaware corporation with principal executive offices located in West Palm Beach, Florida, acquired VIRIL in February of 1994. VIRIL is a wholly owned subsidiary of Todhunter.

Todhunter has produced rum since 1971 and had competed with VIRIL in the bulk rum market since that time. To reduce costs through economies of scale, Todhunter acquired VIRIL in 1994 for \$16,000,000. In 1995, Todhunter invested over \$3,000,000 to expand the VIRIL facility to consolidate its rum production in the Virgin Islands. By transferring its bulk rum production (approximately 2,000,000 proof gallons per year) from its Florida facilities to the VIRIL facilities, Todhunter has reduced its cost of production and increased its margins making its products more competitive. Through the acquisition of VIRIL, Todhunter has benefited from the popularity and the good will or "market cache" of Virgin Islands rum and the molasses subsidy provided by the Government.

Since its acquisition of VIRIL, Todhunter has expanded the distribution of its flagship brand, Cruzan Rum, to new markets. It has increased production of its rums at the VIRIL facility by 40%; total production capacity at the VIRIL facility is approximately 8,800,000 proof gallons per year. The acquisition of VIRIL and the consolidation of its bulk rum production in the Virgin Islands has solidified its position as the largest producer of bulk rums for the United States. According to the Todhunter Annual Report for its Fiscal Year ending September 30, 1997, VIRIL has consistently dominated the bulk rum market in the United States. For Fiscal Year 1997, VIRIL budgeted rum shipments of 4,600,000 proof gallons. Actual shipments, however, were approximately 4,900,000 proof gallons. For Fiscal Year 1998, VIRIL is projecting shipments of approximately 4,785,000 proof gallons. For the first five months of Fiscal Year 1998, however, VIRIL shipped 2,057,300 proof gallons, up 11.30% for the same period in Fiscal Year 1997.

For Todhunter's fiscal year ending September 30, 1997, Todhunter had total assets in excess of \$95,000,000 and net sales in excess of \$77,000,000. Todhunter has five major lines of business: production of citrus and cane-based bulk alcohol for beverages and foods; production and bottling of case goods spirits; importing and marketing of premium branded spirits including Cruzan Rum, from the Virgin Islands and Porfidio Tequila from Mexico; production of vinegar, cooking wine and other alcohol-related products, and contract bottling of beverage

alcohol and other beverages. In addition to its status as the leading bulk rum supplier to the United States, Todhunter projects growth through its premium brands division. Todhunter believes its Cruzan branded rums, tropical flavored rums and cork-finished ultra premium rums are all well positioned to capitalize on the growth trend in dark and aged rum. The introduction of the premium tier brands as well as increased margins and distribution has resulted in greater investment opportunities in Todhunter's brands, as well as higher visibility in the retail trade. With the expansion of the rum market and shifts in consumer attitudes, Todhunter repositioned, re-packaged and launched several new rums in 1997. In 1997, bulk alcohol products represented 38% of all sales with Todhunter selling 11.3 million proof gallons of distilled products.

Sales and volume figures reflect the success of Todhunter's focus on new product development. In the United States, total Cruzan Rum sales were up 23% and sales of the Cruzan tropical fruit flavored rums were up 244% in 1997. Brand extension opportunities for existing core rum brands, including cork-finished ultra premium rums, will continue to drive new products. As a result of the expansion of the VIRIL facility and Todhunter's new business of importing, marketing and distributing branded alcoholic beverages, unit sales of rum and popular price spirits have increased. While net sales of popular priced spirits, other than branded beverages, have decreased due to soft demand in the United States, the Government has experienced an overall increase in Matching Fund Revenues since Todhunter's purchase and expansion of VIRIL.

Todhunter is a publicly traded corporation subject to federal securities law registration. For further information on Todhunter, the Annual Report filed pursuant to Section 13 or 15 (d) of Securities Exchange Act of 1934 (Form 10-K) may be obtained from the Securities and Exchange Commission.

### **Molasses Payments**

Molasses, the principal ingredient of rum, is a commodity traded in the international commodity markets. The price of molasses is therefore subject to fluctuation based upon supply and demand. All of the molasses used by the Virgin Islands rum producer is purchased on such commodity markets from sources outside the Virgin Islands.

The Government maintains a program, established pursuant to law, by which it stabilizes the cost of molasses to the Virgin Islands rum producer to ensure the competitive pricing of rum produced in the Virgin Islands. The effect of the molasses payments is to maintain the competitive position of the Virgin Islands rum producer relative to the rum producers in other countries in which local molasses supplies are readily available. Since 1967, the Government has authorized a molasses subsidy and since 1988 has provided the following molasses subsidies to the Virgin Islands rum producers:

**Molasses Subsidy Claims  
1988 to 1997**

| <u>Fiscal Year</u> | <u>Molasses<br/>Gallons</u> | <u>Dollar Amount<br/>Subsidy</u> |
|--------------------|-----------------------------|----------------------------------|
| 1988 . . . . .     | 3,233,178                   | \$ 973,405                       |
| 1989 . . . . .     | 4,612,406                   | 1,173,334                        |
| 1990 . . . . .     | 3,454,026                   | 829,189                          |
| 1991 . . . . .     | 4,072,687                   | 1,501,214                        |
| 1992 . . . . .     | 5,832,386                   | 2,009,090                        |
| 1993 . . . . .     | 4,294,917                   | 1,405,482                        |
| 1994 . . . . .     | 4,484,973                   | 1,406,132                        |
| 1995 . . . . .     | 5,316,699                   | 2,008,392                        |
| 1996 . . . . .     | 9,017,562*                  | 4,045,509*                       |
| 1997 . . . . .     | 5,296,588                   | 2,175,536                        |

\* Due to Hurricane Marilyn, a portion of the 1995 Fiscal Year subsidy payment was made in Fiscal Year 1996. It is anticipated that a portion of the 1997 molasses subsidy will be paid in Fiscal Year 1998.

Source: Virgin Islands Office of Management and Budget.

The molasses subsidy is administered by the Commissioner of Finance through the establishment of a legislatively mandated Molasses Subsidy Fund. The Molasses Subsidy Fund consists of amounts appropriated from time to time by the Legislature of the Virgin Islands exclusively for such purpose. Amounts available in the Molasses Subsidy Fund are requisitioned by the rum producer on a quarterly basis by certified vouchers to the Commissioner of Finance upon receipt of the molasses shipment. The Commissioner of Finance verifies the accuracy of such voucher and makes payment to the rum producer to the extent funds are available in the Molasses Subsidy Fund. The Governor includes in each Annual Budget submitted for approval to the Legislature of the Virgin Islands a request for appropriation for the Molasses Subsidy Fund based upon an estimate of molasses to be acquired by VIRIL for the next Fiscal Year. In the event of a deficiency in the Molasses Subsidy Fund, the Commissioner of Finance would seek legislative appropriation of additional funds, as required, from the Legislature of the Virgin Islands. The Legislature, however, is not obligated to appropriate such amounts. To date, the Legislature of the Virgin Islands has never failed to appropriate an amount sufficient to satisfy the annual subsidy required.

There can be no assurance that the molasses payments will continue in the future or that, if continued, such payments will be in amounts sufficient to ensure the viability of the Virgin Islands rum production.

#### **St. Croix Molasses Pier**

The Government has substantially completed the construction of the expansion and improvements to the St. Croix Molasses Pier which will increase the capacity for deliveries and storing of molasses and will increase the safety and availability of molasses cargoes to the island of St. Croix. The improvements to the St. Croix Molasses Pier, also known as the Third Port, consist of the construction of a 560 foot sheet pile bulkhead, dredging of the harbor to a depth of 32 feet, construction of a concrete apron for loading and unloading the tankers, installation of apron lighting and installation of potable water lines. Security fencing, asphalt and molasses pipelines and a partial roadway complete with lighting and signage are also part of the St. Croix Molasses Pier project. A highway connecting the Pier to the Container Port road is currently under design and the Pier will contain a 1.5 million gallon storage tank which will more than double the on-pier molasses storage capacity for the Virgin Islands rum producer.

The St. Croix Molasses Pier improvements will allow the docking of larger cargo vessels and the delivery of larger molasses shipments thereby reducing the per gallon shipping cost of imported molasses. The addition of a second storage tank also will permit the purchase of molasses when market conditions are most favorable and

produce economies of scale and safer conditions for storage of molasses. These improvements should enable the Government to continue to provide favorable conditions within the Virgin Islands for VIRIL to maintain its dominant position in the United States bulk rum market.

## BONDHOLDER RISKS

**THE PURCHASE AND OWNERSHIP OF THE 1998 BONDS MAY INVOLVE INVESTMENT RISKS. PROSPECTIVE PURCHASERS OF THE 1998 BONDS ARE URGED TO READ THIS OFFICIAL STATEMENT IN ITS ENTIRETY. THIS SECTION ENTITLED "BONDHOLDER RISKS" DOES NOT PURPORT TO PROVIDE INVESTORS WITH A COMPREHENSIVE ENUMERATION OF ALL POSSIBLE INVESTMENT RISKS. THE FACTORS SET FORTH BELOW, AMONG OTHERS, MAY AFFECT THE SECURITY FOR THE 1998 BONDS. IN ADDITION TO POSSIBLE ADVERSE AFFECTS ON SECURITY FOR THE 1998 BONDS, PURCHASERS SHOULD BE AWARE THAT THESE FACTORS, AMONG OTHERS, MAY ADVERSELY AFFECT THE MARKET PRICE OF THE 1998 BONDS IN THE SECONDARY MARKET. (SEE ALSO "SECURITY FOR THE 1998 BONDS".)**

*Matching Fund Revenues Sole Security for Matching Fund Loan Notes.* The 1998 Bonds are secured solely by the Trust Estate, including the Matching Fund Loan Notes. The Matching Fund Loan Notes are special limited obligations of the Government. The Government has not pledged its full faith and credit to the payment of the Matching Fund Loan Notes. The Matching Fund Loan Notes are secured solely by the Matching Fund Revenues, which are derived solely from the sale of rum produced in the Virgin Islands and subject to federal excise taxation. There can be no assurance that the United States Congress will not reduce the rate of the federal excise tax that qualifies for transfer to the Government under the applicable provisions of the Revised Organic Act or that the Congress will not amend or eliminate the federal excise tax. There also can be no assurance as to the amount of local duties, taxes and fees which will be collected by the United States Treasury and Customs and which would be available for transfer to the Government. (See "MATCHING FUND REVENUES".)

*Demand for Rum.* Consumption and sales of distilled spirits in the United States declined from 1989 through 1996. Rum consumption as a percentage of the distilled spirits market increased during this period from 8.5% in 1989 to 9.4% in 1996. Rum sales in the United States decreased from the high of 13.6 million 9-liter cases in 1990 to 11.7 million 9-liter cases in 1994. Since 1994, rum sales have steadily increased to the current level of 13 million 9-liter cases. No assurance can be given as to the future level of consumption of distilled spirits, or rum consumption, or the future market share to be garnered by Virgin Islands rum. (See "THE RUM INDUSTRY".)

*Single Production Source.* All the rum produced in the Virgin Islands is produced by a single producer, VIRIL, a subsidiary of Todhunter. There can be no assurance that VIRIL will continue to operate in the Virgin Islands or that it will continue to produce rum in sufficient quantities to generate Matching Fund Revenues sufficient to meet debt service on the 1998 Bonds. There also can be no assurance that another producer will not enter the bulk rum market and compete with VIRIL or that VIRIL will maintain its production quantity or current margins. (See "THE RUM INDUSTRY".)

*Fluctuating Price, Availability and Subsidy on Molasses.* Molasses, the principal ingredient of rum, is a commodity traded in the international commodity markets. The market price of molasses is therefore subject to fluctuation based upon supply and demand. Substantially all of the molasses used for Virgin Islands rum production is purchased on such commodity markets from sources outside the Virgin Islands. While the Government has provided a subsidy to stabilize the price of molasses and has covenanted to take actions necessary to maintain the subsidy in the future, there can be no assurance that such subsidy will be available in the future, that the Virgin Islands Legislature will appropriate such funds in the future, or that funds will be available for appropriation. There also can be no assurance that molasses will be available for the Virgin Islands rum production in the international commodity markets or, if available, will be at a price that the Government can afford. (See "THE RUM INDUSTRY".)

*FEMA Remedy of Federal Intercept.* The Government currently has outstanding \$157,100,000 (including \$13,413,985 of capitalized interest on the Hurricane Hugo Community Disaster Loan) in FEMA Community Disaster Loans and \$7,718,000 in FEMA State Share Loans. The Government has been actively negotiating with FEMA to convert its Hurricane Hugo and Hurricane Marilyn Community Disaster Loans into grants under existing FEMA regulations. To the extent not otherwise canceled, Community Disaster Loans become due and payable in accordance with the terms and conditions of the Government's respective promissory notes which provide that, in the event of a default by the Government, FEMA is entitled to recover the delinquent outstanding principal, plus any accrued and unpaid interest, under Federal debt collection procedures, including administrative offset against other Federal funds due the Government, which may include Matching Fund Revenues. In addition to Matching Fund Revenues, the Government receives on average each year, in excess of \$100,000,000 in direct Federal grants. The Government is current on its debt service payments on all FEMA loans. (See "Appendix F — United States Virgin Islands — Outstanding Indebtedness of the Government".)

*Deteriorating Financial Position of the Government's General Fund.* The Government has experienced substantial fluctuations in revenues and expenditures since Fiscal Year 1989. As a result, the Government had accumulated deficits in Fiscal Years 1995, 1996 and 1997 of approximately \$158,170,000, \$245,155,000 and \$221,216,000, respectively. The Government estimates an accumulated deficit for Fiscal Year ended September 30, 1998, of approximately \$287,000,000. The Government faces certain potential claims against the General Fund which are not reflected in the Government's financial statements. The most significant of these claims is the Government's contractual liability to various local labor unions for retroactive salary increases. The Government's recurring and accumulating deficits and its projected deficiency of revenues to cover expenditures in the foreseeable future could affect the Government's ability to provide funds to pay the FEMA loans and to continue the molasses subsidy. The Government has no current audited financial statements. The last audited financial statements for the Government were for Fiscal Year 1994. (See "Appendix F — United States Virgin Islands — Financial Position of the Government".)

*Federal Bankruptcy Code Presently Inapplicable.* The Bankruptcy Reform Act of 1978, Title 11, United States Code, as amended (the "Federal Bankruptcy Code"), provides a codified regime for the reorganization, liquidation or debt adjustment of various types of insolvent debtors. Generally, only a "person" or a "municipality" may be debtor in a case under the Federal Bankruptcy Code. The term "person" includes individuals, partnerships and corporations, but does *not* include any "governmental unit." For purposes of the Federal Bankruptcy Code, a governmental unit which cannot file for protection under the Federal Bankruptcy Code, would be (i) a Territory, such as the Government, or (ii) an instrumentality of a Territory, such as the Authority. The term "municipality" is defined to mean a political subdivision or public agency or instrumentality of a State. Therefore, neither the Government nor the Authority may be a debtor in a case under the Federal Bankruptcy Code. Consequently, no Bondholder would be able to avail itself of Federal Bankruptcy Code provisions protecting rights of creditors since the Government and the Authority are both "governmental units" and neither of them is a "person" or a "municipality" for purposes thereof. Since neither the Authority nor the Government are subject to the Federal Bankruptcy Code, there can be no assurance how the pledge of Matching Fund Revenues would be treated by a court of law in the event of an insolvency or other inability to pay debt by the Government or the Authority.

*Matching Fund Revenues Payment Procedures.* 48 U.S.C.A. §1645 (West 1987) ("Section 1645"), which provides for annual prepayments of Matching Fund Revenues to the Government, was adopted in 1978 and establishes procedures which are inconsistent with previously enacted Section 7652 of the Code which provides for quarterly payments of Matching Fund Revenues. The legislative history of Section 1645 contains indications of an intent to amend the Code; however, this was not reflected in the final version of Section 1645, as adopted. The Department of Interior and Treasury have consistently followed Section 1645 since 1978. There can be no assurance that these payment procedures will not be changed by statute or otherwise.

## LITIGATION

There is no litigation pending in any court or, to the best of the knowledge of the Authority or the Government, threatened, questioning the corporate existence of the Authority or which would restrain or enjoin the issuance or delivery of the 1998 Bonds, or which concerns the proceedings of the Authority or the Government taken in connection with the 1998 Bonds or the pledge or application of any Matching Fund Revenues provided for their payment, or which contest the powers of the Authority or the Government with respect to the foregoing.

## TAX MATTERS

### *Series 1998 A, C, D and E Bonds*

In the opinion of Bond Counsel, under existing law, interest, including accrued original issue discount ("OID"), on the Series 1998 A, Series 1998 C, Series 1998 D and Series 1998 E Bonds (collectively, the "Tax-Exempt Bonds") (a) will not be included in gross income for federal income tax purposes, (b) will not be an item of tax preference for purposes of the federal alternative minimum income tax imposed on individuals and corporations; however, with respect to corporations (as defined for federal income tax purposes) subject to alternative minimum income tax, such interest, including accrued OID, is taken into account in determining adjusted current earnings for purposes of computing such tax, and (c) will be exempt from personal income taxes imposed by the United States Virgin Islands, any state, other territory or possession of the United States or any political subdivision thereof, or by the District of Columbia. In the case of the Series 1998 A Bonds maturing on October 1, 2009 through 2012, October 1, 2015, October 1, 2018, October 1, 2022 and October 1, 2025 and all of the Series 1998 E Bonds (collectively, the "OID Bonds"), the difference between (i) the stated principal amount of each maturity of the OID Bonds and (ii) the initial offering price to the public (excluding bond houses and brokers) at which a substantial amount of such maturities of OID Bonds is sold will constitute OID; OID will accrue for federal income tax purposes on a constant yield-to-maturity method; and a holder's basis in such Series 1998 A Bonds and Series 1998 E Bonds will be increased by the amount of OID treated for federal income tax purposes as having accrued on the Series 1998 A and Series 1998 E Bonds while the holder holds the Series 1998 A and Series 1998 E Bonds. The Series 1998 C Bonds and the Series 1998 D Bonds are expected to be issued at prices greater than their principal amounts. A holder who purchases a Series 1998 C Bond or a Series 1998 D Bond at a premium to its principal amount must amortize bond premium as provided in applicable United States Treasury regulations, and amortized premium is to be treated as an offset against interest in such Series 1998 Bond and reduces the holder's basis in such Series 1998 Bond for federal income tax purposes. No other opinion is expressed by Bond Counsel regarding the federal tax consequences of the ownership of or the receipt or accrual of interest or OID or premium on the Tax-Exempt Bonds.

Bond Counsel's opinion will be given in reliance upon certification by representatives of the Authority as to certain facts relevant to both its opinion and the Internal Revenue Code of 1986, as amended (the "Code"). The Authority has covenanted to comply with various provisions of the Code regarding, among other matters, the use, expenditure and investment of proceeds of the Tax-Exempt Bonds and timely payment to the United States of America of any arbitrage rebate amounts with respect to the Tax Exempt Bonds. Failure of the Authority to comply with such covenants could cause interest, including accrued OID, on the Tax-Exempt Bonds to be included in gross income for federal income tax purposes retroactively to their date of issue. Bond Counsel will assume no responsibility for and will not monitor compliance with such covenants.

In addition to the matters above, prospective purchasers of the Tax-Exempt Bonds should be aware that the ownership of tax-exempt obligations may result in collateral federal income tax consequences to certain taxpayers, including without limitation financial institutions, property and casualty insurance companies, S corporations, foreign corporations subject to branch profits tax, corporations subject to the environmental tax, recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations. Prospective purchasers of the Tax-Exempt Bonds should consult their tax advisors as to the applicability and impact of such consequences.



In the opinion of Bond Counsel, interest on the Series 1998 B Bonds will not be excluded from gross income for federal income tax purposes under Section 103 of the Code. Therefore, it is expected that interest on the Series 1998 B Bonds will be includable in gross income based on the holder's method of tax accounting and, thus, subject to federal income tax to the same extent any other interest includable in gross income is subject to such tax.

Under existing law, in the opinion of Bond Counsel, interest on the Series 1998 B Bonds will be exempt from personal income taxes imposed by the United States Virgin Islands, any state, other territory or possession of the United States or any political subdivision thereof, or by the District of Columbia.

## **FINANCIAL STATEMENTS**

The financial statements of the Authority for the Fiscal Year ending September 30, 1997, appended hereto as Appendix E as part of this Official Statement, have been audited by Ernst & Young LLP, certified public accountants, as set forth in their report dated February 28, 1998, except for the second paragraph of Note 11, as to which the date is April 17, 1998, which report is also appended hereto. Such financial statements are included herein for informational purposes only, and the information contained in these financial statements should not be read to in any way modify the description of the security for the 1998 Bonds contained herein. The assets of the Authority, other than those pledged pursuant to the Indenture, are not pledged to nor are they available to 1998 Bondowners.

Audited financial statements for the Government are not included herein. The Government has no current audited financial statements. The last audited financial statements for the Government were prepared by Ernst & Young for Fiscal Year 1994.

## **VERIFICATIONS**

Causey Demgen & Moore, Inc., independent certified public accountants, has prepared a report to verify the mathematical accuracy the computation of the maturing principal and interest earned on the Defeasance Securities to be purchased with the proceeds of the Refunding Bonds and amounts transferred from the debt service reserve funds and debt service funds securing the Prior Bonds and held pursuant to the Escrow Agreement to provide for payment of the principal of, redemption premium, if any, and interest due and to be due on the Prior Bonds.

WEFA, Inc., Eddystone, Pennsylvania, an economic consulting firm, has been engaged to verify Matching Fund Revenues received by the Government from Fiscal Year 1992 through Fiscal Year 1997 and to project Matching Fund Revenues for Fiscal Years 1998 through 2003. (See Appendix D—Verification of Matching Fund Revenues".)

## **LEGAL OPINIONS**

Certain legal matters incident to the issuance of the 1998 Bonds are subject to the approving opinion of Hunton & Williams, Washington, D.C., Bond Counsel. The approving opinion of Bond Counsel, substantially in the form set forth in Appendix G hereto, is to be furnished upon delivery of the 1998 Bonds. Bond Counsel's approving opinion does not express any opinion with respect to information in this Official Statement. However, Bond Counsel will deliver an opinion at closing addressed solely to the Underwriters for their purposes which opinion will address the accuracy of certain information in this Official Statement. Certain legal matters will be passed upon for the Underwriters by their counsel Hawkins, Delafield & Wood, New York, New York.

## **FINANCIAL ADVISOR**

The Authority has retained Public Financial Management, Inc. of Philadelphia, Pennsylvania, as financial advisor in connection with the issuance of the 1998 Bonds. Although Public Financial Management, Inc. has assisted in the preparation of the Official Statement, Public Financial Management, Inc. is not obligated to undertake, and has not undertaken to make, an independent verification or to assume responsibility for the accuracy, completeness, or fairness of the information contained in the Official Statement. Public Financial Management, Inc. is an independent advisory firm and is not engaged in the business of underwriting, trading or distributing municipal securities or other public securities.

## **RATING**

The Senior Lien Bonds have been assigned a rating of "BBB-" by Standard & Poor's Ratings Services. The rating reflects only the view of Standard & Poor's Ratings Services and an explanation of the significance of the rating may be obtained from Standard & Poor's Ratings Services. There can be no assurance that the rating will continue for any given period of time or that it will not be revised or withdrawn entirely by Standard & Poor's Ratings Services, if, in its judgment, circumstances so warrant. Any such downward revision or withdrawal of the rating may have an adverse effect on the market price of the Senior Lien Bonds.

The Subordinate Lien Bonds are not rated.

## **CONTINUING DISCLOSURE**

The Authority has covenanted, and the Government has acknowledged and accepted, for the benefit of Bondholders, to provide certain financial information and operating data relating to the Authority and the Government by not later than 180 days following the end of the Authority's fiscal year beginning with the fiscal year ending September 30, 1999 (the "Annual Report"), and to provide notices of the occurrence of certain enumerated events. The Annual Report will be filed by the Authority with the Municipal Securities Rulemaking Board. The specific nature of the information to be contained in the Annual Report or the notices of material events is summarized in "Appendix H — Proposed Form of Continuing Disclosure Certificate". These covenants have been made in order to assist the Underwriters in complying with S.E.C. Rule 15c2-12 (the "Rule"). Neither the Authority nor the Government have been required to provide annual financial information or notices of material events pursuant to the requirements of the Rule.

## **UNDERWRITING**

The 1998 Bonds are being purchased by Smith Barney Inc., CIBC Oppenheimer, Morgan Stanley & Co. Incorporated and PaineWebber, Inc. (the "Underwriters"). The aggregate purchase price payable by the Underwriters for the 1998 Bonds is \$537,339,703. The Underwriters are obligated to purchase all of the 1998 Bonds, if any are purchased, the obligation to make such purchase being subject to certain terms and conditions set forth in the Purchase Contract by and between the Authority and the Underwriters, the approval of certain legal matters by counsel and certain other conditions. The Underwriters will receive an aggregate underwriting discount of \$3,992,083 in connection with the underwriting of the 1998 Bonds. Salomon Smith Barney is a service mark of Smith Barney Inc. Smith Barney Inc. and Salomon Inc. are affiliated but separately registered broker/dealers under common control of Salomon Smith Barney Holdings Inc. Salomon Brothers Inc. and Salomon Smith Barney Holdings Inc. have been licensed to use the Salomon Smith Barney service mark.

The initial public offering price and other terms respecting the offering and sale of the 1998 Bonds may be changed from time to time by the Underwriters after the 1998 Bonds are released for sale, and the 1998 Bonds may be offered and sold at prices other than the initial offering price, including sales to certain dealers (including

dealers who may sell the 1998 Bonds into investment accounts, some of which may be managed by the Underwriters) and certain dealer banks and banks acting as agents.

Morgan Stanley & Co. Incorporated ("Morgan Stanley") has entered into a written agreement with Popular Securities, Inc. ("Popular Securities"), a subsidiary of Popular, Inc., pursuant to which Popular Securities has agreed to cooperate in connection with Morgan Stanley's provision of underwriting and investment banking services to the Authority with respect to the 1998 Bonds. Pursuant to these arrangements, the existence of which has been disclosed to the Authority, Popular Securities will be entitled to receive a portion of Morgan Stanley's actual net profits, if any, in connection with the underwriting of the 1998 Bonds.

#### **MISCELLANEOUS**

In this Official Statement, any summaries or descriptions of provisions in the Indenture or the Loan Agreement and all references to other materials not purported to be quoted in full are only brief outlines of certain provisions thereof and do not constitute complete statements of such documents or provisions. Reference is hereby made to the complete documents relating to such matters for further information, copies of which may be obtained from the principal corporate trust office of the Trustee.

Any statement in this Official Statement involving matters of estimates or opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the Authority and the owners or holders of, or of interests in, any of the 1998 Bonds.

Financial and statistical information has been provided by the Authority and the Government, certain of its agencies and instrumentalities and other sources deemed reliable by the Authority and the Government. The Underwriters are not responsible for any of such information nor have the Underwriters independently verified such information.

The execution and delivery of this Official Statement has been duly authorized by the Authority.

#### **VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY**

By: /s/ Roy L. Schneider, M.D.  
Chairman of the Board

Dated: April 30, 1998



## APPENDIX A

### GLOSSARY OF TERMS

#### DEFINITIONS OF CERTAIN TERMS IN THE INDENTURE, THE FIRST SUPPLEMENTAL AND THE LOAN AGREEMENT

Certain terms used in the Indenture, the First Supplemental Indenture and the Loan Agreement are defined below unless otherwise defined herein or the context clearly indicates otherwise. When and if such terms are used in this Official Statement they shall have the meanings set forth below. Any capitalized term used in this Official Statement regarding the Indenture and the Loan Agreement and not defined herein shall have the meaning given such term by the Indenture and the Loan Agreement.

Act means, collectively, the Virgin Islands Revised Organic Act, 48 U.S.C. 1574-1574c (West 1987), 1988 V.I. Act 5365, 1997 V.I. Acts 6152 and 6190 and 1998 V.I. Acts 6197 and 6227, and other applicable law, as the same may be amended from time to time.

Act of Bankruptcy means (i) the entity under consideration shall have applied for or consented to the appointment of a custodian, receiver, trustee or liquidator of all or substantially all of its assets; (ii) a custodian shall have been appointed with or without consent of such entity; (iii) such entity has made a general assignment for the benefit of creditors, or has filed a voluntary petition in bankruptcy, or a petition or an answer seeking reorganization or an arrangement with creditors or to take advantage of any insolvency law; (iv) such entity has filed an answer admitting the material allegations of a petition in any bankruptcy, reorganization or insolvency proceeding, or taken any action for the purpose of effecting any of the foregoing; (v) a petition in bankruptcy shall have been filed against such entity and shall not have been dismissed for a period of 60 consecutive days; (vi) an order for relief has been entered under the Bankruptcy Code with respect to such entity; (vii) an order, judgment or decree shall have been entered, without the application, approval or consent of such entity by any court of competent jurisdiction approving a petition seeking reorganization of such entity or appointing a receiver, trustee, custodian or liquidator of such entity or substantially all of its assets, and such order, judgment or decree shall have continued unstayed and in effect for any period of 60 consecutive days; or (viii) such entity shall have suspended the transaction of its usual business.

Accreted Value means with respect to any Bond that is a Capital Appreciation Bond, for each authorized denomination, an amount equal to the principal amount of such Capital Appreciation Bond (determined on the basis of the initial offering price for such denomination at maturity thereof) plus the amount of earnings which would be produced on the investment of such principal amount, assuming compounding (as set forth in the applicable Supplemental Indenture) beginning on the dated date of such Capital Appreciation Bond and ending at the maturity date thereof, at a yield which, if produced until maturity, will produce an amount equal to such denomination at maturity. As of any Valuation Date, the Accreted Value of any Capital Appreciation Bond means the amount set forth for such date in the applicable Supplemental

Indenture authorizing such Bond and as of any date other than a Valuation Date, the sum of (i) the Accreted Value on the preceding Valuation Date and (ii) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date and the denominator of which is the number of days from such preceding Valuation Date to the next succeeding Valuation Date, using for such calculation 30 day months and a 360 day year and (2) the difference between the Accreted Values for such Valuation Dates.

**Additional Bonds** means Bonds other than the Initial Series of Bonds.

**Adjusted Debt Service Requirement** means, for any period, as of any date of calculation, the aggregate Debt Service on Outstanding Senior Lien Bonds or Subordinated Lien Bonds, for such period taking into account the following adjustments:

(i) With respect to Bonds that bear interest at a Variable Interest Rate, the aggregate Debt Service thereon is determined as if each such Bond bore interest at the Certified Interest Rate; provided, however, (1) if the Authority (A) enters into a Qualified Swap Agreement with a Swap Provider requiring the Authority to pay a fixed interest rate on a notional amount, and (B) has made a determination that such Qualified Swap Agreement was entered into for the purpose of providing substitute interest payments for a particular maturity of Bonds in a principal amount equal to the notional amount of the Qualified Swap Agreement, then during the term of such Qualified Swap Agreement and so long as the Swap Provider under such Qualified Swap Agreement is not in default under such Qualified Swap Agreement, the interest rate on such Bonds shall be determined as if such Bonds bore interest at the fixed interest rate payable by the Authority under such Qualified Swap Agreement, and (2) if (A) Bonds of a specific maturity within a Series bear interest at a Variable Interest Rate and Bonds which bear a Variable Interest Rate of another Series with the same maturity are issued in an equal principal amount to the first such Series of Bonds of the same maturity and (B) the Variable Interest Rate of the first Series of such Bonds varies inversely to the Variable Interest Rate of the second Series of such Bonds of the same maturity so that the combined interest rate for the aggregate principal amount of such Bonds of the same specific maturity for both such Series is determined by the Authority to result in a combined fixed interest rate, then so long as the same principal amount of each maturity of such Series of Bonds remain Outstanding, the aggregate Debt Service thereon shall be determined as if all such Variable Rate Bonds of such Series and maturity bore interest at the combined fixed interest rate so determined by the Authority with respect to such aggregate principal amount of such Bonds.

(ii) With respect to Fixed Interest Rate Bonds, if the Authority (1) enters into a Qualified Swap Agreement with a Swap Provider requiring the Authority to pay a variable interest rate on a notional amount and (2) has made a determination that such Qualified Swap Agreement was entered into for the purpose of providing substitute interest payments for a particular

maturity of Bonds in a principal amount equal to the notional amount of the Qualified Swap Agreement, then during the term of such Qualified Swap Agreement and so long as the Swap Provider under such Qualified Swap Agreement is not in default under such Qualified Swap Agreement the interest rate on such Bonds is determined as if such Bonds bore interest at the Certified Interest Rate on the notional amount of such Bonds.

(iii) Except to the extent described in (iv) below, with respect to Bonds secured by a Credit Facility, the aggregate Debt Service thereon shall be deemed to include all periodic Bond Related Costs and other payments to (including any payments required to reimburse) the related Credit Provider (including any Debt Service Reserve Account Credit Provider), but shall not include any amounts payable as principal of and interest and premium with respect to any reimbursement obligation to such Credit Provider except and to the extent that such payments on such reimbursement obligation are required to be made to the Credit Provider in excess of any corresponding Debt Service with respect to such Bonds during such period.

(iv) With respect to Optional Tender Bonds, the aggregate Debt Service thereon shall not include any amounts payable to a Credit Provider pursuant to any reimbursement obligation arising as the result of the payment of any purchase price with respect to such Bonds on a Purchase Date except to the extent that, and for any period during which, the Authority is obligated to reimburse the Credit Provider for payments made by such Credit Provider directly or indirectly in satisfaction of any obligation to purchase such Bonds on any Purchase Date following the application of any proceeds of any remarketing of such Bonds.

(v) The aggregate Debt Service for any period on any Bonds shall not include (1) any interest which is payable from Capitalized Interest which is to be transferred to the Debt Service Accounts for payment of interest on such Bonds or (2) the amount of Debt Service on Bonds to be paid from amounts in a Debt Service Reserve Account at the time of such computation for the period in question, but only if any such amount described in (1) or (2) is available and is to be applied under the applicable Supplemental Indenture to make interest payments on such Bonds when due.

(vi) If the Authority enters into a Qualified Swap Agreement with a Swap Provider requiring the Authority to pay any amount in excess of the amount to be received by the Authority in connection therewith for the period for which any calculation of Adjusted Debt Service Requirements is to be made hereunder, then, to the extent not taken into account in (i) and (ii) above, the net amount of such payments which may be required of the Authority (using the Certified Interest Rate or its equivalent for such purpose if such amount is subject to any variation and excluding any breakage fees or termination

payments paid by the Authority) shall be included in Adjusted Debt Service Requirements.

For purposes of this definition of Adjusted Debt Service Requirements, the principal and interest portions of the Accreted Value of Capital Appreciation Bonds and the Appreciated Value of any Deferred Interest Bonds becoming due at maturity or by virtue of Mandatory Sinking Fund Requirements shall be included in the calculation of accrued and unpaid and accruing interest or principal installments on the date on which or for the period during which such amounts become due and payable unless otherwise specified in the Supplemental Indenture authorizing such Capital Appreciation Bonds or Deferred Interest Bonds.

**Aggregate Debt Service** for any period means, as of any date of calculation, the sum of the amounts of Debt Service for such period with respect to the Bonds.

**Annual Administrative Fee** means the amount authorized to be transferred annually from the Senior Lien Expense Account and the Subordinated Lien Expense Account to the Authority to pay the Authority's expenses in accordance with the annual budget approved by the Board of the Authority.

**Annual Debt Service** means, as of any date of calculation with respect to a specified Bond Year, Debt Service plus any premium, if any, payable for the Bonds in the respective Bond Year.

**Appreciated Value** means with respect to any Bond that is a Deferred Interest Bond until the Interest Commencement Date thereon, for each authorized denomination, an amount equal to the principal amount of such Deferred Interest Bond (determined on the basis of the initial offering price for such denomination at the Interest Commencement Date thereof) plus the amount, of earnings which would be produced on the investment of such principal amount, assuming compounding (as set forth in the applicable Supplemental Indenture) beginning on the dated date of such Deferred Interest Bond and ending on the Interest Commencement Date, at a yield which, if produced until the Interest Commencement Date, will produce an amount equal to such denomination at the Interest Commencement Date. As of any Valuation Date, the Appreciated Value of any Bond that is a Deferred Interest Bond means the amount set forth for such date in the Supplemental Indenture authorizing such Deferred Interest Bond and as of any date other than a Valuation Date accruing for that period or due and payable on that date, the sum of (i) the Appreciated Value on the preceding Valuation Date and (ii) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date and the denominator of which is the number of days from such preceding Valuation Date to the next succeeding Valuation Date, and (2) the difference between the Appreciated Values for such Valuation Dates.

**Approved Project** means any public improvement or public undertaking authorized by act of the Legislature of the Virgin Islands and by resolution of the Authority to be financed with the proceeds of Authority bonds.



**Authority** means the Virgin Islands Public Finance Authority, a body corporate and politic constituting a public corporation and autonomous governmental instrumentality of the Government of the Virgin Islands, or, if said Authority shall be abolished, any authority, board, body or officer succeeding to the principal functions thereof.

**Authorized Officer** means the Executive Director or Chairman of the Authority or any other person authorized by the Authority to perform an act or sign a document on behalf of the Authority for purposes of the Indenture or a Supplemental Indenture as set forth in a Supplemental Indenture or a certificate of the Authority which has been delivered to the Trustee.

**Bankruptcy Code** means the Federal Bankruptcy Code, 11 U.S.C. § § 101, et seq. and any amendments thereto.

**Board** means the Board of Directors of the Authority.

**Bond** or **Bonds** means any bond or bonds, as the case may be, issued pursuant to the Indenture or any Supplemental Indenture, and may include notes, commercial paper, or other obligations and shall include Senior Lien Bonds and Subordinate Lien Bonds.

**Bond Counsel** means an attorney or firm of attorneys nationally recognized expertise in matters relating to the issuance of obligations by states and local governments and political subdivisions thereof.

**Bond Register** means the register maintained by the Bond Registrar pursuant to the Indenture.

**Bond Registrar** means the Trustee, any successor trustee or bond Registrar appointed as Bond Registrar pursuant to the Indenture.

**Bond Related Costs** means (i) all costs, fees and expenses of the Authority incurred or reasonably related to any Liquidity Facility, Credit Facility, any remarketing or other secondary market transactions and any Qualified Swap Agreement (whether requiring the Authority to pay fixed or variable amounts and excluding breakage fees on or termination payments under such Qualified Swap Agreements) that the Authority has determined was entered into for the purposes of providing substitute interest payments for a particular Series or maturity of Bonds, (ii) initial and acceptance fees of any Fiduciary together with any fees of Bond Counsel, attorneys, feasibility consultants, engineers, financial advisors, remarketing agents, rebate consultants, accountants and other advisors retained by the Authority in connection with a Series of Bonds and (iii) any other fees, charges and expenses that may be lawfully incurred by the Authority relating to Bonds, including, without limitation, any obligation of the Authority to a Credit Provider for a Series of Bonds to repay or reimburse any amounts paid by such Credit Provider due to payment under such Credit Facility and any interest on such repayment obligation.

**Bond Service Charges** means for any applicable time period or date, principal of and premium, if any, and interest payments due and the fees, expenses and costs of the Trustee, Bond Registrar and Paying Agent, if any, on any of the Bonds accruing for that period or due and

payable on that date. In determining Bond Service Charges accruing for any period or due and payable on any date, Mandatory Sinking Fund Requirements accruing for that period or due on that date shall be included together with any amount required to be paid for the replenishment of any Bond Reserve Account.

**Bond Year** means for each Series of Bonds a period of twelve (12) consecutive months beginning on October 1 in any calendar year and ending on September 30 of the succeeding calendar year; provided that for purposes of Section 148 of the Code the Authority may elect a different Bond Year for any Series of Bonds.

**Borrower** means the Government of the Virgin Islands.

**Business Day** means any day that is not a Saturday, Sunday or legal holiday in the United States Virgin Islands or a day on which the Trustee, the Special Escrow Agent or banking institutions organized under the laws of the United States Virgin Islands are legally authorized to close.

**Capital Appreciation Bonds** means any Bonds as to which interest is payable only at the maturity or prior redemption thereof. For the purposes of (i) receiving payment of the redemption price, if any, of a Capital Appreciation Bond that is redeemed prior to maturity, and (ii) computing the principal amount of Capital Appreciation Bonds held by the Owner thereof in giving any notice, consent, request, or demand pursuant to the applicable Supplemental Indenture for any purpose whatsoever, the Accreted Value of a Capital Appreciation Bond as of a specific date shall be deemed to be its principal amount as of such date.

**Capitalized Interest** means that portion of the proceeds of any Series of Bonds together with any available earnings thereon that are intended to be used to pay interest due or to become due on any Bonds.

**Certified Interest Rate** means a rate estimated and certified by the financial advisor to the Authority as the rate that would be borne by a Variable Rate Bond if on the date of such certification such Bond was issued as a Bond bearing interest at a fixed rate to its stated maturity.

**Code** means the Internal Revenue Code of 1986, as amended from time to time. Each reference to a Code section herein shall be deemed to include the Treasury Regulations proposed or in effect thereunder and applicable to the Bonds.

**Construction Account** means the account of that name established pursuant to the Indenture.

**Corporate Trust Office** means the principal corporate trust office of the Trustee in which the corporate trust business of the Trustee shall, at any particular time, be principally administered, which office is, at the date as of which the Indenture is dated, located at 114 West 47<sup>th</sup> Street, New York, NY 10036 except that, with respect to presentation of Bonds for payment or registration of transfer and exchange and the location of the Bond Register, such term means the office or agency of the Bond Registrar in said city at which at any particular time its corporate

agency business shall be conducted, which is, at the date as of which the Indenture is dated, is the same address as the corporate trust office as indicated above.

**Cost of Issuance** means the items of expense payable or reimbursable directly or indirectly by the Authority and related to the authorization, sale and issuance of Bonds which items of expense shall include without limiting the generality of the foregoing: travel expenses; printing costs; costs of reproducing documents; computer fees and expenses; filing and recording fees; initial fees and charges of the Trustee; initial fees and charges of Credit Providers or other parties (including specifically providers of bond insurance policies and surety policies) pursuant to remarketing, indexing or similar agreements; discounts; legal fees and charges; auditing fees and expense; financial advisor's fees and charges; costs of credit ratings; insurance premiums; fees and charges for execution, transportation and safekeeping of Bonds; and other administrative or other costs of issuing, carrying and repaying such Bonds and investing the proceeds thereof.

**Cost of Issuance Account** means the account of that name established pursuant to the Indenture.

**Counsel's Opinion** means an opinion signed by an attorney or firm of attorneys of recognized standing in the field of law relating to municipal bonds (who may be counsel to the Authority) selected by the Authority and reasonably satisfactory to the Trustee.

**Credit Agreement** means any reimbursement agreement or similar instrument between the Authority (and, if so drafted, the Trustee) and a Credit Provider with respect to a Credit Facility.

**Credit Facility** means a letter of credit, surety bond, liquidity facility, insurance policy or comparable instrument furnished by a Credit Provider which is rated in one of the two highest rating categories by the Rating Agency rating the Bonds with respect to all or a specific portion of one or more Series of Bonds to satisfy in whole or in part the Authority's obligation to maintain a Debt Service Reserve Requirement with respect thereto or to secure (a) the payment of Debt Service (which may include the premium due on payment of a Bond), on Bonds of a specified Series, or a specific portion thereof, (b) the payment of the purchase price (which may include accrued interest to the date of purchase) of Bonds of a specified Series, or a specific portion thereof, on the applicable purchase dates or tender dates, or (c) both the payment of Debt Service on a specified Series of Bonds, or a specific portion thereof.

**Credit Provider** means the bank, insurance company, financial institution or other entity providing a Credit Facility or Liquidity Facility pursuant to a Credit Agreement.

**Current Interest Bonds** mean all Bonds which are not (a) Capital Appreciation Bonds or (b) prior to the Interest Commencement Date, Deferred Interest Bonds.

**Debt Service** for any period means, as of any date of calculation and with respect to any Series of Bonds then Outstanding, the Bond Service Charges on such series. For purposes of this definition, unless provided to the contrary in an applicable Supplemental Indenture authorizing the issuance of Capital Appreciation Bonds and Deferred Interest Bonds, the scheduled principal

and interest portions of the Accreted Value of Capital Appreciation Bonds and the Appreciated Value of Deferred Interest Bonds becoming due at maturity or by virtue of Mandatory Sinking Fund Requirements shall be included in the calculations of accrued and unpaid and accruing interest or principal payments in the year in which such payments are required to be made.

**Debt Service Account or Accounts** means the Senior Lien Debt Service Account or the Subordinate Lien Debt Service Account, or, collectively, the Senior Lien Debt Service Account and the Subordinate Lien Debt Service Account, as applicable.

**Debt Service Reserve Account** means the Senior Lien Debt Service Reserve Account or the Subordinate Lien Debt Service Reserve Account established pursuant to the Indenture, as applicable.

**Debt Service Reserve Accounts** means collectively the Senior Lien Debt Service Reserve Account and the Subordinate Lien Debt Service Reserve Account established pursuant to the Indenture.

**Debt Service Reserve Account Credit Facility** means a Credit Facility provided to satisfy all or any portion of a Debt Service Reserve Requirement.

**Debt Service Reserve Account Credit Provider** means the Credit Provider of a Debt Service Reserve Amount Credit Facility.

**Debt Service Reserve Requirement** means, as of any date of calculation, the sum of the Debt Service Reserve Requirements applicable to Series of Bonds then Outstanding. The Debt Service Reserve Requirement may be calculated individually for each Series of Bonds or in the aggregate if more than one Series of Bonds are issued at the same time, and as set forth in the applicable Supplemental Indenture. The Debt Service Reserve Requirement may be satisfied by cash, Permitted Investments or a Debt Service Reserve Account Credit Facility, or any combination thereof.

**Defeasance Securities** means

(i) direct and general obligations of, or obligations which as to principal and interest are unconditionally guaranteed as to full and timely payment by, the United States of America, to the payment of which the full faith and credit of the United States of America is irrevocably and unconditionally pledged. The obligations described in this paragraph are hereinafter called "*United States Government Obligations*;" and

(ii) pre-refunded municipal obligations meeting the following conditions:

- (1) the municipal obligations (A) are not subject to redemption prior to maturity or (2) the trustee has been given irrevocable instructions concerning their calling and redemption and the issuer of such municipal obligations has covenanted not to redeem such municipal obligations other than as set forth in such instructions;

- (2) the municipal obligations are secured by cash or non-callable United States Government Obligations that may be applied only to interest, principal and premium payments of such municipal obligations;
- (3) the principal of and interest on such United States Government Obligations (plus any cash in the escrow fund) are sufficient to meet the liabilities of the municipal obligations;
- (4) the cash and United States Government Obligations serving as security for the municipal obligations are held by an escrow agent or trustee; and
- (5) the United States Government Obligations are not available to satisfy any other claims, including those against the trustee or escrow agent.

**Deferred Interest Bonds** means any Bonds as to which accruing interest is not paid prior to the Interest Commencement Date specified in the Supplemental Indenture authorizing such Series.

**Depository or DTC** means The Depository Trust Company, New York, New York, and its successors and assigns.

**Escrow Agent** shall mean U.S. Trust Company of New York as Escrow Agent under the Escrow Deposit Agreement.

**Escrow Deposit Agreement** shall mean the Escrow Deposit Agreement dated as of April 1, 1998, between the Authority, the Government and the Escrow Agent providing for the refunding and defeasance of the Prior Bonds and the investment of certain proceeds of the Series 1998 A Bonds and Series 1998 B Bonds.

**Escrow Fund** shall mean the Escrow Fund established by the Escrow Deposit Agreement.

**Fiduciary or Fiduciaries** means any bank or other organization acting in a fiduciary capacity with respect to any Bonds whether as Trustee, Paying Agent, Bond Registrar, tender agent, escrow agent or any or all of them, as may be appropriate.

**First Supplemental Indenture** means the First Supplemental Indenture of Trust between the Authority and the Trustee dated as of April 1, 1998, authorizing the issuance of and securing the Initial Series of Bonds.

**Fiscal Year** means the Authority's fiscal year, which is presently October 1 to the following September 30.

**Fitch** means Fitch Investor Service, Inc., or any successor thereof which qualifies as a Rating Agency hereunder.

**Fixed Interest Rate Bond** means (i) a Bond, the interest rate on which is established (with no right to vary) at the time of calculation at a single numerical rate for the remaining term of such Bond, or (ii) all of those Bonds of a specific maturity described in clause (2)(A) and (B) of paragraph (i) of the definition of Adjusted Debt Service Requirement.

**Funds** means those funds and accounts specified in the Indenture.

**Government** means the Government of the United States Virgin Islands.

**Indenture** means the Indenture of Trust dated as of April 1, 1998, between the Authority and the Trustee and, as to each Series of Bonds, the Supplemental Indenture pertaining thereto, as the Indenture or any Supplemental Indenture may from time to time be amended or supplemented in accordance with the terms hereof.

**Independent Counsel** means an attorney, or firm thereof, admitted to practice law before the highest court of any state in the United States of America, the United States Virgin Islands or the District of Columbia and not an employee on a full-time basis of either the Authority or the Trustee (but who or which may be regularly retained by any one or more of them).

**Independent Verification Analyst** means a firm retained by the Authority to prepare the certificates required pursuant to the Indenture in connection with the issuance of Additional Senior Lien or Subordinate Lien Bonds.

**Initial Series of Bonds** means the Series 1998 A, Series 1998 B, Series 1998 C, Series 1998 D and Series 1998 E Bonds.

**Interest Commencement Date** means, with respect to any particular Deferred Interest Bonds, the date specified in the applicable Supplemental Indenture authorizing such Deferred Interest Bonds (which date must be prior to the maturity date for such Deferred Interest Bonds), after which interest accruing on such Deferred Interest Bonds shall be payable with the first such payment date being the applicable Interest Payment Date immediately succeeding such Interest Commencement Date.

**Interest Payment Date** means each date specified in a Supplemental Indenture as a date for the payment of interest to Owners of Bonds of a specific Series.

**Interest Payment Period** with respect to any Bond or Series of Bonds, means, if prior to the first Interest Payment Date, the period from but not including the date specified in each Supplemental Indenture as the date for commencement of accrual of interest for such Bond or Series and after the first regularly scheduled Interest Payment Date means the period from but not including a regularly scheduled Interest Payment Date, in each case to and including the next regularly scheduled Interest Payment Date, provided that any Supplemental Indenture may adjust this definition with respect to any Bond or Series of Bonds authorized to be issued thereunder in

order to provide for the proper computation of or the timely transfer of amounts payable with respect to interest borne by such Bond or Series of Bonds on any Interest Payment Date.

**Issue Date** means, for the Bonds of a particular Series, the date on which the Bonds of such Series are delivered against payment therefor.

**Letter of Representation** means the Letter of Representation from the Authority to the Depository in substantially the form set forth in Appendix A hereto, such form as may be acceptable to the Authority and the Depository.

**Liquidity Facility** means any agreement with a Credit Provider under or pursuant to which it agrees to purchase Optional Tender Bonds provided that the debt obligations of such Credit Provider are rated in one of the two highest Rating Categories by S&P, Moody's or Fitch.

**Loan Agreement** means a loan agreement by and between the Authority and the Borrower, as the same may from time to time be amended or supplemented in accordance with the terms thereof.

**Loan Notes** means, with respect to each of the Series 1998 A, Series 1998 B, Series 1998 C, Series 1998 D and Series 1998 E Bonds or any future Series of Additional Bonds, the special limited obligation note in the aggregate principal amount of each of the respective Series 1998 A, Series 1998 B, Series 1998 C, Series 1998 D and Series 1998 E Bonds or such Series of Additional Bonds issued by the Authority for the benefit of the Borrower, each note signed by the Borrower and delivered to the Authority, and collectively, all such Loan Notes.

**Mandatory Sinking Fund Requirements** means the principal amount of Term Bonds which are required to be redeemed by mandatory sinking fund redemption, in the principal amounts at the prices and on the dates as set forth in the applicable Supplemental Indenture.

**Mandatory Tender Date** means a date on which a Series of Bonds, or specific Bonds included in such Series, are required to be purchased by, or on behalf of, the Authority as provided in the Indenture or in the Supplemental Indenture authorizing such Series of Bonds.

**Matching Fund Revenues** means amounts paid to the Special Escrow Agent on behalf of the Government of the Virgin Islands pursuant to Section 28(b) of the Revised Organic Act, 48 U.S.C. §§ 1574-1574c (West 1987), or any successor provisions thereto.

**Moody's** means Moody's Investors Service, a corporation organized and existing under the laws of the State of Delaware, its successors and assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority, by notice to the Trustee.

**1998 Approved Projects** mean the projects authorized to be financed with the proceeds of the Series 1998 E Bonds pursuant to the First Supplemental Indenture.

**Officer's Certificate** means a certificate signed by an Authorized Officer.

**Optional Tender Bonds** means any Bonds which by their terms may be tendered by and at the option of, or required to be tendered by, the Owner thereof for payment or purchase by the Authority or another party prior to the stated maturity thereof, or the maturities of which may be extended by and at the option of the Owner thereof, provided, however, a Supplemental Indenture may expressly provide that specific Bonds are not "Optional Tender Bonds" if, in the reasonable judgment of the Authority, the tender requirements of such Bonds are not of the character intended to be included within this definition.

**Outstanding Bonds, Bonds Outstanding and Bonds then Outstanding** means as of the date of determination, all Bonds theretofore issued and delivered under the Indenture as from time to time supplemented except:

- (i) Bonds theretofore canceled by the Trustee or Paying Agent or delivered to the Trustee or Paying Agent canceled or for cancellation;
- (ii) for which payment or redemption moneys or securities (as provided for in the Indenture) shall have been theretofore deposited with the Trustee or Paying Agent in trust for the Owners of such Bonds; provided, however, that if such Bonds are to be redeemed, notice of such redemption shall have been duly given pursuant to the Indenture or irrevocable action shall have been taken to call such Bonds for redemption at a stated redemption date;
- (iii) Bonds in exchange for or in lieu of which other Bonds shall have been issued and delivered pursuant to the Indenture; and
- (iv) Optional Tender Bonds deemed tendered in accordance with the provisions of the Supplemental Indenture authorizing such Bonds on the applicable tender, adjustment or conversion date, if interest thereon shall have been paid through such applicable date and the purchase price thereof shall have been paid or amounts are available for such payments as provided therein (but not if held for reoffering).

In determining requisite percentages of the Owners of aggregate principal amount of Bonds Outstanding for the purposes of direction, consent, approval or waiver under the terms and provision of the Indenture and any Supplemental Indenture: (1) the aggregate "principal amount" of any Bonds that are Capital Appreciation Bonds shall be determined by their Accreted Value as of the date of such determination, and (2) the aggregate "principal amount" of any Bonds that are Deferred Interest Bonds shall be determined by their Appreciated Value as of the date of such determination and provided, however, that in determining whether the Owners of the requisite principal amount of Outstanding Bonds have given any request, demand, authorization, direction, notice, consent or waiver hereunder, Bonds owned by the Authority shall be disregarded and deemed not to be Outstanding Bonds, except that in determining whether the Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent, or waiver, only Bonds which the Trustee knows to be so owned shall be disregarded.

Each Supplemental Indenture may further specify the conditions under which a Credit Provider will be deemed the Owner of Outstanding Bonds for purposes of consents hereto.



**Owner or Bondowner**, or any similar term, means any Person who shall be the registered owner of any Bond or Bonds.

**Participants** means those broker-dealers, banks and other financial institutions from time to time for which the Depository holds Bonds as securities depository.

**Paying Agent** means any commercial bank or trust company organized under the laws of the United States Virgin Islands, any state of the United States, or the United States of America, or any national banking association designated as paying agent for the Bonds, and its successor or successors hereafter appointed in the manner provided in the Indenture or a Supplemental Indenture.

**Permitted Investments** means any of the following securities, if and to the extent the same are at the time legal for the investment of funds held under the Indenture:

(i) direct obligations of the United States or obligations guaranteed as to principal and interest by the United States;

(ii) general obligations of any state, territory, possession or commonwealth of the United States with a rating at the time of purchase in either of the two highest Rating Categories as designated by any Rating Agency;

(iii) prerefunded obligations of any state, territory, possession or Commonwealth of the United States or political subdivision thereof secured by cash or obligations listed in subsection (i) above, with a rating at the time of purchase in one of the two highest Rating Categories as designated by S&P or any Rating Agency then rating the Bonds;

(iv) obligations of the Government of the United States Virgin Islands, or obligations guaranteed as to both principal and interest, by the Government of the United States Virgin Islands with a rating at the time of purchase in one of the two highest Rating Categories as designated by S&P or any Rating Agency;

(v) obligations issued, or the principal of and interest on which are unconditionally guaranteed, by any agency or instrumentality of or a corporation wholly owned by the United States with a rating at the time of purchase in one of the two highest Rating Categories as designated by any Rating Agency;

(vi) repurchase agreements with banks, savings and loan associations or trust companies organized under the laws of the United States Virgin Islands, the United States, or any state, territory, possession or commonwealth of the United States, provided, however, that any such bank, savings and loan association or trust company shall have a combined capital and surplus at least equal to \$200,000,000 and, further provided that (1) such agreements are fully secured by obligations set forth in (i), (ii), and (iii) above; (2) such collateral is not subject to liens or claims of third parties; (3) such collateral has a market value at least equal to (102%) of the

amount invested and is held by the Trustee or its agent or, in the case of uncertificated securities, are registered in the name of the Trustee as pledgee; (4) the Trustee has a valid security interest in such collateral and (5) such agreement shall provide that the failure to maintain such collateral at the level required by clause (3) for a period of 10 days will require the Trustee or its agents to liquidate the investments; and (6) shall be rated in one of the two highest Rating Categories as designated by S&P or any Rating Agency then rating the Bonds.

(vii) investment agreements, guaranteed investment contracts or similar funding agreements issued by insurance companies or other financial institutions; provided that (1) such agreements are fully secured by obligations set forth in (i), (ii) and (iii) above; (2) such collateral is not subject to liens or claims of third parties; (3) such collateral has a market value at least equal to (102%) of the amount invested and is held by the Trustee or its agent or, in the case of uncertificated securities, are registered in the name of the Trustee as pledgee; (4) the Trustee has a valid security interest in such collateral, (5) such agreement shall provide that the failure to maintain such collateral at the level required by clause (3) for a period of 10 days will require the Trustee or its agents to liquidate the investments; and (6) such insurance company or financial institution is rated in one of the two highest Rating Categories designated by S&P or any Rating Agency then rating the Bonds;

(viii) U.S. dollar denominated bankers' acceptances with domestic commercial banks which have a rating on their short-term certificates of deposit on the date of purchase in the highest short-term rating category by a national rating agency and maturing no more than 360 days after the date of purchase. (Ratings on holding companies are not considered as the rating of the bank); and

(ix) Certificates of deposit with domestic commercial banks which have a rating on their short-term certificates of deposit on the date of purchase in the two highest short-term rating categories by S&P or any Rating Agency rating the Bonds and maturing no more than 360 days after the date of purchase. Certificates of deposit will be placed directly with depository institutions and secured by obligations set forth in (i), (ii) and (iii) above; (2) such collateral is not subject to liens of claims of third parties; (3) such collateral has a market value at least equal to (102%) of the amount invested and is held by the Trustee or its agent or, in the case of uncertificated securities, are registered in the name of the Trustee as pledgee; (4) the Trustee has a valid security interest in such collateral and (5) such agreement shall provide that the failure to maintain such collateral at the level required by clause (3) for a period of 10 days will require the Trustee or its agents to liquidate the investments; and

(x) Investments in a money market fund rated in the two highest rating categories by S&P or any other Rating Agency rating the Bonds including money market funds sponsored by the Authority; and

- (xi) Commercial Paper issued by U.S. Corporations which is rated at the time of purchase in the two highest short-term rating category by S&P or any other Rating Agency rating the Bonds and which matures not more than 270 days after the date of purchase.

Any such Permitted Investment may be purchased or sold by, from or through the Authority or the Trustee. The Authority will not direct the Trustee to hold investments described in (vi), (vii) and (viii) unless arrangements satisfactory to the Trustee are in place to verify and monitor compliance with such provisions.

**Person** means an individual, a corporation, a partnership, an association, a joint stock company, a trust, any unincorporated organization or a government or political subdivision thereof, or any other legal entity or groups of legal entities.

**Pledge Agreement** means a Pledge Agreement entered into with respect to a specific Series of Bonds or specific Bond within a Series of Variable Rate Bonds and related to the Credit Facility for such Bonds.

**Pledged Revenue Account** means the fund by that name established pursuant to the Indenture.

**Principal Installment** means, as of any date of calculation and with respect to the Bonds, so long as any Bonds thereof are Outstanding, (i) the principal amount of Bonds due on a certain future date, or (ii) the unsatisfied balance of any Sinking Fund Installments due on a certain future date for the Bonds.

**Principal Payment Date** means any date on which a Principal Installment is scheduled to become due on Bonds whether by scheduled maturity or Mandatory Sinking Fund Requirements or otherwise.

**Prior Bonds** shall mean Prior Bonds previously issued by the Authority or the Government, including collectively,

(a) the Authority's Revenue Bonds (Virgin Islands General Obligation/Matching Fund Loan Note) Series 1989 A (the "1989 A Bonds"), which Series of Bonds have been economically defeased;

(b) the Authority's Highway Revenue Bonds (Transportation Trust Fund) Series 1989B (the "1989B Bonds");

(c) the Government's Special Tax Bonds (General Obligation Matching Fund/Hugo Insurance Claims Fund Program) Series 1991 (the "Series 1991 Bonds");

(d) the Authority's Revenue and Refunding Bonds (Virgin Island General Obligation/Matching Fund Loan Notes) Series 1992A (the "Series 1992 Bonds");

(e) the Government's Subordinated Special Tax Bonds (General Obligation Matching Fund/Insurance Claims Fund Program) Series 1993 (the "Series 1993 Bonds"); and

(f) the Authority's Government Development Program Revenue Bonds (General Obligation/Matching Fund Loan Notes) Series 1994 A, Series 1994 B and Series 1994 C (the "Series 1994 Bonds").

**Proportionate Basis** means, when used with respect to the redemption of Bonds of a specific Series, that the aggregate principal amount of such Bonds of each maturity of such Series to be redeemed shall be determined as nearly as practicable by multiplying the total amount of funds available for redemption by the ratio which the principal amount of Bonds of that Series to be redeemed bears to the principal amount of all Bonds of that Series then Outstanding; provided that if the amount available for redemption of Bonds of any maturity is insufficient to redeem a multiple of the minimum authorized denomination of such maturity, such amount shall be applied to the redemption of the highest possible integral multiple of the minimum authorized denomination of such maturity. For purposes of the foregoing, Term Bonds shall be deemed to mature in the years and in the amounts of the Mandatory Sinking Fund Requirements set forth in the applicable Supplemental Indenture. Any Bonds purchased with moneys which would otherwise be applied to redemption on a Proportionate Basis on the next succeeding Payment Date shall be taken into account in determining Proportionate Basis with respect to such redemption. When used with respect to the purchase of Bonds, Proportionate Basis shall have the same meaning as set forth above, substituting "purchase" for "redemption," and "purchased" for "redeemed."

**Purchase Date** means the date on which any Outstanding Bonds are purchased pursuant to the Indenture or any applicable Supplemental Indenture.

**Qualified Swap Agreement** means an agreement between the Authority and a Swap Provider (i) which agreement is either approved by, or following review of such agreement the rating upon all affected Bonds is confirmed by, each Rating Agency then rating the Swap Provider, and (ii) under which the Authority agrees to pay the Swap Provider an amount calculated at an agreed-upon rate or index based upon a notional amount and the Swap Provider agrees to pay the Authority for a specific period of time an amount calculated at an agreed-upon rate or index based upon such notional amount, where the Swap Provider, or the Person who guarantees the obligation of the Swap Provider to make its payments to the Authority, has unsecured obligations rated, as of the date the swap agreement is entered into, in one of the two highest applicable Rating Categories by each Rating Agency then rating such Swap Provider or other Person who guarantees such obligation.

**Rating Agency** means Moody's, S&P and Fitch or any successor or comparable Rating Agency as long as such Rating Agency shall maintain an outstanding rating on any Series of Bonds.

**Rating Category** means a generic securities rating category, without regard to any refinement or gradation of such rating category by a numerical modifier or otherwise.

**Rebate Account** means the Rebate Account established pursuant to the Indenture and the applicable Supplemental Indenture.

**Rebate Amount Certificate** shall have the meaning set forth in the First Supplemental Indenture.

**Rebate Requirement** means the amount required to be paid to the United States Treasury pursuant to Section 148(f) of the Code.

**Record Date** means with respect to an Interest Payment Date for the Bonds, unless otherwise provided by any Supplemental Indenture, the fifteenth day (or if such day shall not be a Business Day, the preceding Business Day) next preceding such Interest Payment Date.

**Redemption Price** means with respect to any Bond, the principal amount of such Bond plus the applicable premium, if any, payable upon redemption thereof pursuant to such Bond, the Indenture or the applicable Supplemental Indenture.

**Related Agreements** or **Related Documents** means any Credit Facility, Credit Agreement or Pledge Agreement related to a Series of Bonds or a specific portion thereof, including security agreements or instruments heretofore or hereafter made for the benefit and with the consent of the Trustee or a Credit Provider as creditor to secure payment of any Series or Bonds or a specific portion thereof or any amount due to a Credit Provider; but excluding the Indenture and all Supplemental Indentures; provided, that the term "Related Agreements" or "Related Documents," when used in relation to a specific Series of Bonds or a specific portion thereof, shall include only such Related Agreements or Related Documents as have been entered into for such Series of Bonds or a specific portion thereof, and shall not include documents, agreements or other items entered into only for the purposes of a different Series of Bonds or a specific portion thereof.

**Remarketing Agent** means the firm appointed as Remarketing Agent for a specific Series of Optional Tender Bonds.

**Remarketing Agreement** means the Remarketing Agreement for a Series of Bonds or a specific portion thereof, including any amendments and supplements thereto, between the Remarketing Agent and the Authority.

**Revenues** means (i) any proceeds and collections from any Loan Notes deposited in the Pledged Revenue Account, including any investment earnings earned thereon, and (ii) any proceeds which arise with respect to any disposition of the Trust Estate.

**S&P** means Standard & Poor's Ratings Services, a corporation organized and existing under the laws of the State of New York, its successors and assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "S&P" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority, by notice to the Trustee.

**Senior Lien Bonds** means obligations of the Authority issued pursuant to any Supplemental Indenture as Senior Lien Bonds permitted by the Indenture.

**Senior Lien Capitalized Interest Subaccount** means the subaccount by that name in the Senior Lien Debt Service Account established by the Indenture and the applicable Supplemental Indenture.

**Senior Lien Credit Subaccount** means a subaccount by that name in the Senior Lien Debt Service Account or Senior Lien Debt Service Reserve Account, as applicable, established pursuant to the Indenture.

**Senior Lien Debt Service Account** means the fund by the name established pursuant to the Indenture.

**Senior Lien Debt Service Reserve Account** means the fund by that name established pursuant to the Indenture.

**Senior Lien Expense Account** means the Account by that name established pursuant to the Indenture.

**Senior Lien Interest Subaccount** means the Subaccount by that name in the Senior Lien Debt Service Account established pursuant to the Indenture and the applicable Supplemental Indenture.

**Senior Lien Redemption Subaccount** means the subaccount by that name in the Senior Lien Debt Service Account established pursuant to the Indenture.

**Senior Lien Principal Subaccount** means the subaccount by that name in the Senior Lien Debt Service Account established pursuant to the Indenture and the applicable Supplemental Indenture.

**Series** means all Bonds, delivered on original issuance in a simultaneous transaction, regardless of variations in maturity, interest rate, Sinking Fund Installments, or other provisions.

**Series 1998 Arbitrage Rebate Fund** shall mean the Arbitrage Rebate Fund established pursuant to the First Supplemental Indenture.

**Series 1998 Bonds** shall mean collectively the Authority's \$541,820,000 Revenue and Refunding Bonds, Series 1998 A, Series 1998 B, Series 1998 C, Series 1998 D and Series 1998 E, authorized to be issued pursuant to the First Supplemental Indenture.

**Series 1998 A Bonds** shall mean the \$289,075,000 Revenue and Refunding Bonds, Series 1998 A (Senior Lien Refunding) authorized to be issued pursuant to the First Supplemental Indenture.

**Series 1998 B Bonds** shall mean the \$26,015,000 Revenue and Refunding Bonds, Series 1998 B (Senior Lien/Refunding/Taxable) authorized to be issued pursuant to the First Supplemental Indenture.

**Series 1998 C Bonds** shall mean the \$81,170,000 Revenue and Refunding Bonds, Series 1998 C (Senior Lien/Working Capital), authorized to be issued pursuant to the First Supplemental Indenture.

**Series 1998 D Bonds** shall mean the \$39,130,000 Revenue and Refunding Bonds, Series 1998 D (Subordinate Lien/Working Capital), authorized to be issued pursuant to the First Supplemental Indenture.

**Series 1998 E Bonds** shall mean the \$106,430,000 Revenue and Refunding Bonds, Series 1998 E (Subordinate Lien/Capital Program), authorized to be issued pursuant to the First Supplemental Indenture.

**Series 1998 Debt Service Reserve Requirement** shall mean an amount equal to the least of (a) the maximum principal and interest due on the 1998 Senior Lien Bonds and on the 1998 Subordinate Lien Bonds in the current or any future Fiscal Year, (b) 10% of the original stated principal amount of the 1998 Senior Lien Bonds and on the 1998 Subordinate Lien bonds (or 10% of the issue price of the 1998 Senior Lien Bonds or the 1998 Subordinate Lien bonds if required by the Code) or (c) 125% of the average annual principal and interest due on the 1998 Senior Lien Bonds and on the 1998 Subordinate Lien Bonds in the current and each future Fiscal Year, as specified in the Indenture and the First Supplemental Indenture.

**Series 1998 Senior Lien Bonds** shall mean the Series 1998 A Bonds, the Series 1998 B Bonds and the Series 1998 C Bonds.

**Series 1998 Subordinate Lien Bonds** shall mean the Series 1998 D Bonds and the Series 1998 E Bonds.

**Series 1998 Construction Subaccount** shall mean the Series 1998 Construction Subaccount of the Construction Account established pursuant to the First Supplemental Indenture.

**Series 1998 Cost of Issuance Subaccount** shall mean the Series 1998 Cost of Issuance Subaccount of the Cost of Issuance Account established pursuant to the First Supplemental Indenture.

**Series 1998 Interest Subaccount** shall mean the Series 1998 Interest Subaccount established pursuant the First Supplemental Indenture.

**Series 1998 Principal Subaccount** shall mean the Series 1998 Principal Subaccount established pursuant to the First Supplemental Indenture.

**Series 1998 Senior Lien Debt Service Reserve Account** shall mean the Series 1998 Senior Lien Debt Service Reserve Account of the Senior Lien Debt Service Reserve Account established pursuant to the First Supplemental Indenture.

**Series 1998 Senior Lien Debt Service Reserve Requirement** shall mean for the Series 1998 Senior Lien Bonds an amount equal to the least of (a) the maximum principal and interest due on the Series 1998 Senior Lien Bonds in the current or any future Fiscal Year, (b) 10% of the original stated principal amount of the Series 1998 Senior Bonds (or 10% of the issue price of the Series 1998 Bonds if required by the Code) or (c) 125% of the average annual principal and interest due on the Series 1998 Bonds in the current and each future Fiscal Year.

**Series 1998 Subordinate Lien Debt Service Account** shall mean the Series 1998 Subordinate Lien Debt Service Reserve Account of the Subordinate Lien Debt Service Reserve Account established pursuant to the First Supplemental Indenture.

**Series 1998 Subordinate Lien Debt Service Reserve Requirement** for the Series 1998 Subordinate Lien Bonds shall be an amount equal to the least of (a) the maximum principal and interest due on the Series 1998 Subordinate Lien Bonds in the current or any future Fiscal Year, (b) 10% of the original stated principal amount of the Series 1998 Subordinate Bonds (or 10% of the issue price of the Series 1998 Bonds if required by the Code) or (c) 125% of the average annual principal and interest due on the Series 1998 Bonds in the current and each future Fiscal Year.

**Sinking Fund Installment** means with respect to any Series of Bonds an amount so designated which is established pursuant to the Supplemental Indenture authorizing such Series of Bonds.

**SLGS** means United States Treasury Obligations, State and Local Government Series, as provided for in the United States Treasury Regulations 31 CFR 344.

**Special Escrow Agent** means U.S. Trust Company of New York, the special escrow agent under the Special Escrow Agreement, or any successor thereto.

**Special Escrow Agreement** means the Special Escrow Agreement by and between the Authority, the Special Escrow Agent and the Borrower dated as of the date the Initial Series of Bonds are issued, as the same may be supplemented or amended from time to time.

**Special Escrow Fund** means the Special Escrow Fund established under the Special Escrow Agreement.

**Special Record Date** means if the Authority shall be in default in payment of principal or interest due, a special Record Date for the payment of such defaulted principal or interest established by notice mailed by the Trustee on behalf of the Authority; notice of such Special Record Date shall be mailed not less than 10 days preceding such Special Record Date, to the owner at the close of business on the fifth Business Day preceding the date of mailing.



**Subordinate Lien Bonds** means obligations of the Authority issued pursuant to the First Supplemental Indenture as Subordinate Lien Bonds permitted under the Indenture.

**Subordinate Lien Capitalized Interest Subaccount** means the subaccount by that name in the Subordinate Lien Debt Service Account established pursuant to the Indenture and the applicable Supplemental Indenture.

**Subordinate Lien Credit Subaccount** means a subaccount by that name in the Subordinate Lien Debt Service Account or Subordinate Lien Debt Service Reserve Account, as applicable, established pursuant to the Indenture.

**Subordinate Lien Debt Service Account** means the fund by that name established pursuant to the Indenture.

**Subordinate Lien Debt Service Reserve Account** means the fund by that name established pursuant to the Indenture.

**Subordinate Lien Expense Account** means the account by that name established pursuant to the Indenture.

**Subordinate Lien Interest Subaccount** means the subaccount by that name in the Subordinate Lien Debt Service Account established pursuant to the Indenture and the First Supplemental Indenture.

**Subordinate Lien Principal Subaccount** means the subaccount by that name in the Subordinate Lien Debt Service Account established pursuant to the Indenture and the First Supplemental Indenture.

**Subordinate Lien Redemption Subaccount** means the subaccount by that name in the Subordinate Lien Debt Service Account established pursuant to the Indenture.

**Supplemental Indenture** means any indenture amending or supplementing the Indenture in accordance with the terms hereof.

**Surplus Account** means the Surplus Account established pursuant to the Indenture.

**Swap Provider** means the counter party with whom the Authority enters into a Qualified Swap Agreement.

**Tax Covenants** means the covenants of the Authority expressed in or incorporated by reference in the Indenture, or in the corresponding section of a Supplemental Indenture providing for assurance of the preservation of the tax-exempt status of the interest on a Series of Tax-Exempt Bonds.

**Tax-Exempt Bonds** means Bonds issued pursuant to the Indenture for which the Authority receives, on the date of the closing therefor, an opinion of Bond Counsel to the effect

that interest on such Bonds is excludable from the gross income of the owners thereof for federal income tax purposes under section 103 of the Code.

**Tax Opinion** means, with respect to any action requiring such an opinion hereunder, a Counsel's Opinion to the effect that such action, of itself, will not adversely affect the exclusion of interest on any Series of Tax-Exempt Bonds from gross income for Federal income tax purposes.

**Tax Regulatory Agreement** means that agreement between the Authority and the Government of the Virgin Islands dated as of the date the Initial Series of Bonds are issued, as amended from time to time, relating to the requirements of Sections 148 and 103 of the Code for exemption of interest on the Tax-Exempt Bonds from Federal income tax.

**Taxable Bonds** means any Bonds which are not Tax-Exempt Bonds on the date of original issue thereof.

**Term Bonds** means Bonds which are designated in a Supplemental Indenture as subject to scheduled Mandatory Sinking Fund Requirements prior to maturity.

**Treasury Regulations** means all final, temporary or proposed Income Tax Regulations issued or amended with respect to the Code by the Treasury or Internal Revenue Service and applicable to the Bonds. Any reference to a section of the Treasury Regulations shall also refer to any successor provision to such section hereafter promulgated by the Internal Revenue Service pursuant to the Code and applicable to the Bonds.

**Trust Estate** means the Revenues and the rights to receive the same, the tangible and intangible properties, rights and other assets described in the Granting Clauses of the Indenture as from time to time supplemented, and (with respect to a specific Series of Bonds or specific Bonds within a Series) such funds, rights, properties and assets pledged to secure a Series of Bonds or specific Bonds within a Series pursuant to a Supplemental Indenture.

**Trustee** means U.S. Trust Company of New York, a federal banking association duly organized and existing under the laws of the United States, designated as trustee under the Indenture, and its successor or successors hereafter appointed in the manner provided in the Indenture.

**Valuation Date** means with respect to any Bonds that are Capital Appreciation Bonds or Deferred Interest Bonds, the date or dates set forth as such in the Supplemental Indenture authorizing such Bonds on which specific Accreted Values or Appreciated Values, respectively, are assigned to such Bonds.

**Variable Interest Rate** means a variable interest rate or rates to be borne by a Series of Bonds or other obligations or by any Bond within a Series of Bonds. The method of computing such variable interest rate shall be specified in the Supplemental Indenture authorizing such Bonds or Related Agreements approved thereby.

**Variable Rate Bonds** means any Bond that bears interest at a rate which is not established at the time of calculation at a single numerical rate for the remaining term of such bond.

**Written Order** means a written direction of the Authority to the Trustee signed by an Authorized Officer.



## APPENDIX B

### SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

The following is a summary of certain provisions of the Indenture. Such summary does not purport to be complete or definitive and reference is made to the Indenture for a full and complete statement of the terms and provisions and for the definition of capitalized terms used in this summary and not otherwise defined under **"Definitions of Certain Terms in the Indenture and the Loan Agreement."**

**Pledge of Revenues.** The Bonds shall be special, limited obligations of the Authority payable as to principal or Redemption Price, if any, and interest thereon, in accordance with their terms and the terms and provisions of the Indenture solely from Revenues, and secured by a lien on and security interest in the Trust Estate, subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. The Authority has no taxing power and its debts are not debts of the United States Virgin Islands or any political subdivision of the United States Virgin Islands. No holder of the Bonds shall have the right to compel any exercise of the taxing power of the United States Virgin Islands to pay the principal of or interest on the Bonds.

**Authorization of Bonds.** The Indenture authorizes Bonds of the Authority to be issued and designated as "Revenue Bonds (Virgin Islands Matching Fund Loan Notes)" or "Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes)," as applicable. The aggregate principal amount of the Bonds under the Indenture and Supplemental Indenture is not limited except as provided in the Indenture, the Act, or as may be limited by law.

**Sinking Fund Redemption; Purchase.** The Bonds of any Series issued pursuant to the Indenture and a Supplemental Indenture may be subject to optional, mandatory or extraordinary redemption or prepayment on a scheduled or other basis, provided that the Mandatory Sinking Fund Requirements of Bonds of a particular Series and maturity shall be reduced to the extent the Bonds of that Series and maturity have been optionally or mandatorily redeemed prior to or on the date scheduled for payment of the specified principal amount and at the redemption prices specified in the applicable Supplemental Indenture.

**Additional Bonds; Other Revenue Obligations.** All of the Bonds issued under a Supplemental Indenture shall have a lien upon the Trust Estate as provided in the Indenture and shall be prior to any other charge and lien upon the Trust Estate. Except as permitted by the Indenture, no obligations payable from Revenues or secured by a lien on the Trust Estate shall be hereafter issued. If no Event of Default has occurred or will contemporaneously, the Authority may issue Additional Bonds with a Supplemental Indenture.

**Additional Senior Lien Bonds.** (a) Senior Lien Bonds shall be payable from Revenues and secured by a lien on the Trust Estate (except as to any Credit Facility which secures only a specific Series of Bonds or specific Bonds of a Series) on a parity basis with all Outstanding

Senior Lien Bonds and any Additional Senior Lien Bonds that may be hereafter issued if the Trustee shall receive:

- (i) a certificate of the Authority that no Event of Default under the Indenture has occurred and shall continue to exist immediately following the date of issuance of the Senior Lien Bonds to be issued; and
  - (ii) a certificate of an Independent Verification Analyst stating: (1) (A) the actual amount of Matching Fund Revenues received by the Borrower for its immediately preceding Fiscal Year, (B) the average amount of Matching Fund Revenues received by the Borrower for the immediately preceding three Fiscal Years prior to the issuance of such Additional Senior Lien Bonds and (C) the average Matching Fund Revenues projected to be received by the Borrower in the next succeeding two Fiscal Years following issuance of such Additional Senior Lien Bonds; (2) the maximum annual Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Senior Lien Bonds after giving effect to the issuance of the proposed Senior Lien Bonds; and (3) (A) that the average Matching Fund Revenues received by the Borrower for the immediately preceding three Fiscal Years equaled or exceeded 150% of the amount of maximum Adjusted Debt Service Requirement in the current or any subsequent Bond Year, (B) the average Matching Fund Revenues projected to be received by the Borrower for the next succeeding two Fiscal Years following the issuance of the Additional Bonds is projected to equal or exceed 150% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Senior Lien Bonds and such Additional Senior Lien Bonds and (C) the average Matching Fund Revenues projected to be received by the Borrower for the next succeeding two Fiscal years following the issuance of the additional Senior Lien Bonds is projected to equal or exceed 110% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Senior Lien Bonds, such Additional Senior Lien Bonds and Outstanding Subordinate Lien Bonds.
- (b) For purposes of the certifications described in the Indenture, there shall be excluded from the Adjusted Debt Service Requirement any amounts otherwise due or to become due on Outstanding Bonds which are to be refunded and will be no longer Outstanding as a result of the issuance of such Additional Senior Lien Bonds.
- (c) Any Supplemental Indenture that authorizes Senior Lien Bonds under this Section shall establish the amount that shall be the Debt Service Reserve Requirement to be funded in connection with such Series of Bonds and may amend the Indenture in order to provide for the funding, application and replenishment of any account within the Senior Lien Debt Service Reserve Account in connection therewith, provided that no such amendment may adversely affect the Bonds of any Series then Outstanding except such Series of Senior Lien Bonds.

(d) If the Senior Lien Bonds are subject to mandatory purchase or are to be purchased upon optional tender by the Owners thereof, any amounts required to be segregated or set aside by the Authority to fulfill its purchase obligation shall be deemed additional Adjusted Debt Service Requirements with respect to the related Series of Senior Lien Bonds in the amounts and at the times such amounts are required to be so set aside.

(e) The conversion of Senior Lien Bonds that are Variable Rate Bonds to Fixed Interest Rate Bonds shall not be treated as the issuance of additional Senior Lien Bonds subject to the other requirements of this Section unless the interest rate to be borne by such Senior Lien Bonds from and after the date of conversion will exceed the Certified Interest Rate taken into account for the purposes of computing Adjusted Debt Service Requirements.

(f) Prior to the issuance of any Series of Senior Lien Bonds under the provisions of this Section, and as a condition precedent thereto, the following documents and showings shall be executed and delivered:

(i) A Supplemental Indenture, executed by the Authority and the Trustee, providing for the issuance of such Senior Lien Bonds and the terms and conditions thereof; and

(ii) An Authority certificate setting forth information sufficient to satisfy the Trustee that the requirements set forth above have been fulfilled.

**Additional Subordinate Lien Bonds.** (a) Additional Subordinate Lien Bonds payable from Matching Fund Revenues and secured by a lien on the Trust Estate on a junior and subordinate basis to the payment obligation to the Senior Lien Bonds may be issued on a parity basis with all Outstanding Subordinate Lien Bonds if the Trustee shall receive:

(i) a certificate of the Authority that no Event of Default under this Indenture has occurred and shall continue to exist immediately following the date of issuance of the additional Subordinate Lien Bonds to be issued; and

(ii) a certificate of an Independent Verification Analyst stating (1)(A) the actual amount of Matching Fund Revenues received by the Borrower for its immediately preceding Fiscal Year, (B) the average amount of Matching Fund Revenues received by the Borrower for its immediately preceding two Fiscal Years prior to the issuance of such Additional Subordinate Lien Bonds and (c) the average Matching Fund Revenues projected to be received by the Borrower in the next succeeding two Fiscal Years following issuance of such Subordinate Lien Bonds; (ii) the maximum annual Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Subordinate Lien Bonds after giving effect to the issuance of the proposed Subordinate Lien Bonds; and (3)(A) that the average Available Matching Fund Revenues of the Borrower after payment of Debt Service on any Senior Lien Bonds then outstanding or any Senior Lien Bonds to be issued simultaneously with such Additional Subordinate Lien Bonds (the "Available

Matching Fund Revenues") for the immediately preceding three Fiscal Years equaled or exceeded 125% of the amount of the maximum Adjusted Debt Service Requirement in the current or any subsequent Bond Year and (B) the average Available Matching Fund Revenues projected to be received by the Borrower for the next succeeding two Fiscal Years following the issuance of the Additional Subordinate Lien Bonds is projected to equal or exceed 125% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Subordinate Lien Bonds and such Additional Subordinate Lien Bonds and (C) the average Matching Fund Revenues projected to be received by the Borrower for the next succeeding two Fiscal Years following issuance of the additional Subordinate Lien Bonds is projected to equal or exceed 110% of the Adjusted Debt Service Requirement in the current or any subsequent Bond Year on Outstanding Senior Lien Bonds and Outstanding Subordinate Lien Bonds.

(b) For purposes of the certifications described above, there shall be excluded from the Adjusted Debt Service Requirements any amounts otherwise due or to become due on Outstanding Bonds which are to be refunded and will be no longer Outstanding as a result of the issuance of such Additional Subordinate Lien Bonds.

(c) Any Supplemental Indenture which authorizes Additional Subordinate Lien Bonds shall establish the amount which shall be the Debt Service Reserve Requirement to be funded in connection with such Series of Additional Bonds and may amend the Indenture in order to provide for the funding, application and replenishment of any account within the Subordinate Lien Debt Service Reserve Account in connection therewith, provided that no such amendment may adversely affect the Bonds of any Series then Outstanding except such Series of Additional Subordinate Lien Bonds.

(d) If the Additional Subordinate Lien Bonds are subject to mandatory purchase or are to be purchased upon optional tender by the Owners thereof, any amounts required to be segregated or set aside by the Authority to fulfill its purchase obligation shall be deemed additional Adjusted Debt Service Requirements with respect to the related Series of Subordinate Lien Bonds in the amounts and at the times such amounts are required to be so set aside.

(e) The conversion of Subordinate Lien Bonds which are Variable Rate Bonds to Fixed Interest Rate Bonds shall not be treated as the issuance of additional Subordinate Lien Bonds subject to the other requirements of this Section unless the interest rate to be borne by such Subordinate Lien Bonds from and after the date of conversion will exceed the Certified Interest Rate taken into account for the purposes of computing Adjusted Debt Service Requirements.

(f) Prior to the issuance of any Series of Additional Subordinate Lien Bonds, and as a condition precedent thereto, the following documents and showings shall be executed and delivered:



(i) A Supplemental Indenture, executed by the Authority and the Trustee, providing for the issuance of the Additional Subordinate Lien Bonds and the terms and conditions thereof; and

(ii) An Authority certificate setting forth information sufficient to satisfy the Trustee that the requirements of this Section have been fulfilled.

(g) No Subordinate Lien Bond may be accelerated as long as any Senior Lien Bonds are outstanding.

**Refunding Bonds.** Additional Bonds may be issued to refund Outstanding Bonds. The Additional Bonds may be on a parity with or subordinate to the Bonds that are being refunded and are not required to satisfy the tests for issuance of Additional Senior Lien Bonds or Additional Subordinate Lien Bonds if the aggregate Debt Service on the Refunding Bonds is equal to or less than aggregate Debt Service on the Refunded Bonds, provided that Additional Senior Lien Bonds issued to refund Outstanding Subordinate Bonds must satisfy the requirements for issuance of Additional Senior Lien Bonds.

**Supplemental Indenture.** A Supplemental Indenture authorizing the issuance of a Series of Bonds may modify the terms of those Bonds and the prescribed form thereof in a manner consistent with the Indenture.

**Credit Facilities.** The Indenture or any Supplemental Indenture does not limit the Authority's right to obtain a Credit Facility for the benefit of the Owners of all or any portion of any Series of Bonds issued hereunder. Each Credit Facility shall be held by the Trustee for the sole and exclusive benefit of the Owners of the Series of Bonds secured by such Credit Facility and not be an asset available for the benefit of the Owners of any other Bonds.

**Book-entry System.** Ownership of one or more fully registered Bonds for each maturity of each Series of Bonds shall be registered in the name of Cede and Company, as nominee for the Depository Trust Company ("DTC"). Payments of interest on, principal of, or any premium on such Series of Bonds shall be made to the account of the DTC on each payment date at the address indicated for the DTC in the Bond Register by transfer of immediately available funds. DTC maintains a book-entry system for recording ownership interests of its Direct Participants, and the ownership interests of a purchaser of a beneficial interest in the Bonds will be recorded through book entries on the records of the Direct Participants. With respect to Bonds registered in the name of DTC, the Authority, the Trustee and any agent thereof shall have no responsibility or obligation to any Direct Participant or to any Beneficial Owner of such Bonds as specified in the Indenture. DTC may determine to discontinue providing its services with respect to the Bonds of a Series at any time by giving reasonable written notice to the Authority, the Trustee and any tender agent for a Series of Bonds and discharging its responsibilities with respect thereto under applicable law. Additionally, the Authority may terminate, upon provision of notice to the Trustee and any tender agent for a Series of Bonds, the services of the DTC with respect to a Series of Bonds if the continuation of the system of book entry-only transfers is not in the best interests of the Owners of the Bonds of the Series or is burdensome to the Authority.

The Authority may select a new Depository or discontinue the services of a Depository and issue Bond certificates.

**General Provisions.** The Bonds shall be in minimum denominations of \$5,000, or in integral multiples thereof in the form set forth in the exhibit to the appropriate Supplemental Indenture. The Authority shall execute the Bonds by the manual or facsimile signature of the Governor of the Virgin Islands with the seal or facsimile seal of the Authority and attestation by the manual or facsimile signature of the Secretary of the Authority in accordance with the provisions of the Indenture. The Bonds shall be transferable only upon the books of the Authority by the Trustee. In all cases in which the privilege of exchanging Bonds or transferring registered Bonds is exercised, the Authority shall execute and the Trustee shall authenticate and deliver Bonds in accordance with, and subject to the restrictions of, the Indenture. Neither the Authority nor the Trustee shall be required (a) to transfer or exchange Bonds for a period beginning on the Record Date next preceding an interest payment date for the Bonds and ending on such interest payment date, or for a period of fifteen days next preceding the date (as determined by the Trustee) of any selection of Bonds to be redeemed or thereafter until after the mailing of any notice of redemption; or (b) to transfer or exchange any Bonds called or tendered for redemption, in whole or in part.

**Exchanges and Transfers of Bonds.** The Indenture provides when a Bond is exchanged or transferred, the Authority shall execute and the Trustee shall authenticate and deliver Bonds in accordance with the provisions of the Indenture. Bonds surrendered for exchange or transfer shall be canceled by the Trustee. The Authority may only make a charge sufficient to reimburse it for any tax or other governmental charge required to be paid with respect to such exchange or transfer. The Indenture provides specific time periods when the Authority and the Trustee cannot be required to transfer or exchange Bonds.

**Redemption.** Bonds subject to mandatory, optional or extraordinary redemption prior to maturity pursuant to any Supplemental Indenture shall be redeemable, upon notice, at such times, at such Redemption Prices and upon such terms in addition to the terms contained in the Indenture as may be specified in any Supplemental Indenture. At the election or direction of the Authority, the Board shall notify the Trustee of the Authority's decision to redeem and of the particulars of the redemption. If less than all of the Bonds of like maturity of any Series shall be called for prior redemption, the Trustee shall randomly select the particular Bonds or portions of the Bonds to be redeemed.

**Notice of Redemption.** When the Trustee shall receive notice from the Board, acting on behalf of the Authority, of its election or direction to redeem Bonds pursuant to the Indenture, and when redemption of Bonds is required or authorized pursuant to the Indenture, the Trustee shall give notice, in the name of the Authority, of the redemption of such Bonds, which notice shall specify the Series and maturities of the Bonds to be redeemed, the redemption date and the place or places where amounts due upon such redemption will be payable and, if less than all of the Bonds of any like Series and maturity are to be redeemed, the letters and numbers or other distinguishing marks of such Bonds so to be redeemed, and, in the case of Bonds to be redeemed in part only, such notice shall also specify the respective portions of the principal amount thereof to be redeemed. Such notice shall further state that on such date there shall become due and

payable upon each Bond to be redeemed the Redemption Price thereof, or the Redemption Price of the specified portions of the principal thereof in the case of Bonds to be redeemed in part only, together with interest accrued to the redemption date, and that from and after such date interest thereon shall cease to accrue and be payable. Such notice shall be mailed by the Trustee by first class mail, postage prepaid, not more than 60 days nor less than 35 days before the redemption date, to each of the Owners of any Bonds or portions of Bonds which are to be redeemed, at their last addresses, if any, appearing upon the Bond Register, but any defect in, or the failure of any Bondowner to receive, any such notice shall not affect the validity of the proceedings for the redemption of Bonds. Notwithstanding the foregoing, failure to mail any such notice pursuant to the Indenture to any particular Owner of a Bond shall not affect the validity of any proceedings for the redemption of any other Bond.

**Payment of Redeemed Bonds.** Notice having been given in the manner provided in the Indenture, the Bonds or portions thereof so called for redemption shall become due and payable on the redemption date so designated at the Redemption Price, plus interest accrued and unpaid to the redemption date, and, upon presentation and surrender thereof at the office specified in such notice, such Bonds or portions thereof shall be paid at the Redemption Price, plus interest accrued and unpaid to the redemption date. If there shall be called for redemption less than all of a Bond, the Authority shall execute and the Trustee shall deliver, upon the surrender of such Bond, without charge to the owner thereof, for the unredeemed balance of the principal amount of the Bond so surrendered, at the option of the Owner thereof, Bonds of like Series and maturity in any of the authorized denominations. If, on the redemption date, moneys for the redemption of all the Bonds or portions thereof of any like Series and maturity to be redeemed, together with interest to the redemption date, shall be held by the Paying Agent so as to be available therefor on said date and if notice of redemption shall have been given as aforesaid, then, from and after the redemption date interest on the Bonds or portions thereof of such Series and maturity so called for redemption shall cease to accrue and become payable. If said moneys shall not be so available on the redemption date, such Bonds or portions thereof shall continue to bear interest until paid at the same rate as they would have borne had they not been called for redemption.

**Creation of Accounts, and Subaccounts; Deposit of and Use of Moneys.** The proceeds of each Series of Bonds and all Revenues and other sums pledged and assigned by the Indenture to the Trustee for the benefit of Bondholders are to be deposited to the Accounts established by the Indenture and shall not be subject to any lien or attachment by any Creditor of the Authority or any Credit Provider or other person other than the lien of the Indenture. The Accounts and separate Subaccounts within the Accounts created with respect to each series of Bonds under the Indenture shall be held and administered by the Trustee or the Authority in accordance with the terms of the Indenture and may include the following:

- (1) The Pledged Revenue Account, to be held by the Trustee;
- (2) The Senior Lien Debt Service Account, to be held by the Trustee with such separate Subaccounts as provided in the Indenture or Supplemental Indenture, including, any of the following accounts therein:
  - (A) A Senior Lien Interest Subaccount;

- (B) A Senior Lien Principal Subaccount;
- (C) A Senior Lien Redemption Subaccount;
- (D) A Senior Lien Credit Subaccount with respect to each Credit Facility which is not a Debt Service Reserve Account Credit Facility;
- (E) A Senior Lien Expense Subaccount;
- (F) A Senior Lien Purchase Subaccount;
- (G) A Capitalized Interest Subaccount;
- (H) Any other Account or Subaccount established by the applicable Supplemental Indenture.

(3) The Senior Lien Debt Service Reserve Account, to be held by the Trustee, with such separate Series Senior Lien Debt Service Reserve Subaccounts and Senior Lien Credit Subaccounts therein as in any Supplemental Indenture;

(4) The Subordinate Lien Debt Service Account, to be held by the Trustee with such separate Subaccounts therein as provided in the Indenture or Supplemental Indenture creating such Series of Subordinate Lien Bonds, including, applicable accounts therein:

- (A) A Subordinate Lien Interest Subaccount;
- (B) A Subordinate Lien Principal Subaccount;
- (C) A Subordinate Lien Redemption Subaccount;
- (D) A Subordinate Lien Credit Subaccount with respect to each Credit Facility which is not a Debt Service Reserve Account Credit Facility;
- (E) A Subordinate Lien Expense Subaccount;
- (F) A Subordinate Lien Purchase Subaccount;
- (G) A Capitalized Interest Subaccount;
- (H) Any other Account or Subaccount established by the applicable Supplemental Indenture.

(5) The Subordinate Lien Debt Service Reserve Account, to be held by the Trustee, with such separate Series Subordinate Lien Debt Service Reserve Subaccounts

and Subordinate Lien Credit Subaccounts therein as the Authority shall determine in any Supplemental Indenture;

(6) The Construction Account, to be held by Trustee or by the Authority with such separate Subaccounts therein as the Authority shall determine in any Supplemental Indenture;

(7) The Cost of Issuance Account and such subaccounts therein as the Authority shall determine in any Supplemental Indenture, to be held by the Trustee; and

(8) A Rebate Account, to be held by the Trustee; and

(9) A Surplus Account, to be held by the Authority.

**Construction Account.** A Construction Account shall be established, which will contain the amounts required by the provisions of the Indenture and each Supplemental Indenture. There also may be paid into the Construction Account, at the option of the Authority, any moneys received by the Authority from any source unless otherwise required to be applied by the Indenture or any Supplemental Indenture. Segregated Subaccounts may be created within the Construction Account with money held in such Subaccounts separately from other moneys in the Construction Account. Money in the Construction Subaccounts shall be disposed of only in the manner provided in the Supplemental Indentures authorizing such Subaccounts. These separate, segregated Subaccounts and all funds, investments thereof and investment income earned thereon may be pledged (and a lien and security interest therein may be granted) to secure for any period of time the payment of principal of and/or the purchase price of any or all of any Series of Bonds issued pursuant to such Supplemental Indenture. Such pledge, lien and security interest may be prior and superior to the lien and pledge on the Construction Account granted by the Indenture securing the Bonds generally. Moneys in the Construction Account can pay for: (i) the Costs of the Approved Projects, (ii) with respect to special Subaccounts created within the Construction Account by a Supplemental Indenture, all authorized uses stated in such Supplemental Indenture, and (iii) to the extent of shortfalls in a Debt Service Account, the payment of interest on or principal or Redemption price of the Bonds when due.

**Pledged Revenue Account.** There is created a Pledged Revenue Account, held by the Trustee into which the Trustee shall deposit as received from the Special Escrow Agent pursuant to the Escrow Agreement all Matching Fund Revenues received under the Loan Notes and additional amounts designated for deposit into the Pledge Revenue Account by the Indenture or under a Supplemental Indenture. Moneys in the Pledged Revenue Account in the following order of priority shall be transferred annually until there are no Bonds Outstanding under the Indenture.

(i)(1) to each Senior Lien Interest Subaccount;

(A) for Senior Lien Bonds which are Fixed Interest Rate Bonds, an amount that, when combined with amounts on deposit in such Subaccount, equals 100% of that portion of the Adjusted Debt

Service Requirements and constitutes all of the interest accruing or to accrue during the current Bond Year; and

(B) for any Senior Lien Bonds which are not Fixed Interest Rate Bonds, an amount that, when combined with amounts on deposit in such Subaccount, equals 100% of that portion of the Adjusted Debt Service Requirements and constitutes all of the interest accruing or to accrue for Interest Payment Periods that commence in the current Bond Year;

(i)(2) Subject to any credit in the Senior Lien Capitalized Interest Subaccount to be used for Capitalized Interest and any earnings thereon, to the extent required to be used and available for payment of interest on specific Senior Lien Bonds as contemplated in any applicable Supplemental Indenture and, in connection with paragraph (1) above, (A) any net payments the Authority is required to make for Qualified Swap Agreements shall have the same claim upon Pledged Revenues as interest on the Series of Senior Lien Bonds to which the Qualified Swap Agreement relates; and

(B) as of each Interest Payment Date for Senior Lien Bonds described in paragraph (i)(1)(B) above, to the extent that the actual interest payable with respect to such Senior Lien Bonds for any Interest Payment Period is less than the amount deposited into the Senior Lien Interest Subaccount, then the excess amount is a credit to reduce the amount required to be deposited in the next succeeding month or months; and then

(ii) to each Senior Lien Principal Subaccount, an amount that, combined with subaccount deposits, equals 100% of the principal due on the next succeeding Principal Payment Date on the Series of Senior Lien Bonds payable from such Senior Lien Principal Subaccount; and then

(iii) to each Senior Lien Credit Subaccount, an amount sufficient to pay any principal or interest owed to a Credit Provider under the applicable Supplemental Indenture and Credit Agreement due to a drawing from the related Credit Facility for the principal of or interest or premium on any Senior Lien Bonds if the amount transferred is not greater than the sum of (1) amounts received under the related Credit Facility for payment of amounts to or for the benefit of Owners of Senior Lien Bonds secured by such Credit Facility and (2) interest thereon at the lesser of (A) the rate specified in the Credit Agreement or (B) the applicable rate of interest on the Senior Lien Bond or Bonds paid out of the proceeds of such Credit Facility and provided that such transfer amounts shall be reduced by the amount transferred or required to be transferred under the Indenture or Supplemental Indenture; and then

(iv) to each Senior Lien Redemption Subaccount, the amount of Revenues required to redeem Senior Lien Bonds subject to redemption pursuant to the related Supplemental Indenture; and then

(v) to the Senior Lien Debt Service Reserve Account and ratably to each Subaccount therein (if applicable), the amount required to restore any deficiency in the Senior Lien Debt Service Reserve Account and any Subaccount therein or to pay any amounts owed to a Credit Provider relating to a Senior Lien Debt Service Reserve Account Credit Facility; and then

(vi) to each Senior Lien Expense Subaccount, any amounts then due and owing to the Trustee, any Paying Agent, Remarketing Agent, Bond Registrar, or Credit Provider, Special Escrow Agent or other Fiduciary for Senior Lien Bond Services Charges and Bond Related Costs that relate to administration and remarketing and the Authority's Annual Administrative Fee if not provided for in (i), (ii), (iii) or (iv) above; and then

(vii) to each Rebate Account, the amount for Senior Lien Bonds required by and applied in accord with the Indenture; and then

(viii)(1) to each Subordinate Lien Interest Subaccount,

(A) for Subordinate Lien Bonds which are Fixed Interest Rate Bonds, an amount that, when combined with amounts on deposit in such Subaccount, equal 100% of the Adjusted Debt Service Requirements and constitutes all of the interest accruing or to accrue for all Interest Payment Periods during the current Bond Year; and

(B) for Subordinate Lien Bonds which are not Fixed Interest Rate Bonds, an amount that, when combined with amounts on deposit in such Subaccount, equals 100% of that portion of the Adjusted Debt Service Requirements and constitutes all of the interest accruing or to accrue for Interest Payment Periods that commence in the current Bond Year, subject to the credits provided for in clause (2) below;

(2) Subject to any credit in the Subordinate Lien Capitalized Interest Subaccount to be used for Capitalized Interest and any earnings thereon, to the extent required to be used and available for payment of interest on specific Subordinate Lien Bonds as contemplated in any applicable Supplemental Indenture and, in connection with paragraph (1) above

(A) any net payment the Authority is required to make for Qualified Swap Agreements shall have the same claim upon Revenues as interest on the Series of Subordinate Lien Bonds to which the Qualified Swap Agreement relates; and

(B) as of each Interest Payment Date for Subordinate Lien Bonds which are described in paragraph (ix)(1)(B) above, to the extent that the actual interest payable with respect to such Subordinate Lien Bonds in any Interest Payment Period is less than the amount deposited into the Subordinate Lien Interest Subaccount, then the excess amount is a credit to reduce the amount otherwise required to be deposited; and then

(ix) to each Subordinate Lien Principal Subaccount, an amount that, combined with Subaccount deposits, equal 100% of the principal due on the next succeeding Principal Payment Date on the Series of Subordinate Lien Bonds payable from such Subordinate Lien Principal Subaccount; and then

(x) to each Subordinate Lien Credit Subaccount, an amount sufficient to pay any principal or interest then owing to a Credit Provider under the applicable Supplemental Indenture and Credit Agreement due to drawing from the related Credit Facility for the principal of or interest or premium on any Subordinate Lien Bonds if the amount transferred is not greater than the sum of (1) amounts received under the related Credit Facility for payment of amounts to or for the benefit of Owners of Subordinate Lien Bonds secured by such Credit Facility and (2) interest thereon at the lesser of (A) the rate specified in the Credit Agreement or (B) the applicable rate of interest on the Subordinate Lien Bond or Bonds paid out of the proceeds of such Credit Facility and provided that such transfers shall be reduced by the amounts required to be transferred under the Indenture or Supplemental Indenture; and then

(xi) to each Subordinate Lien Redemption Subaccount, the amount of Revenues required to redeem Subordinate Lien Bonds subject to redemption pursuant to the related Supplemental Indenture; and then

(xii) to the Subordinate Lien Debt Service Reserve Account and ratably to each Subaccount therein (if applicable), the amount required to restore any deficiency in the Subordinate Lien Debt Service Reserve Account and any Subaccount therein or to pay any amounts then owed to a Credit Provider relating to a Subordinate Lien Debt Service Reserve Account Credit Facility; and then

(xiii) to each Subordinate Lien Expense Subaccount, any amounts then owed to the Trustee, any Paying Agent, Remarketing Agent, Bond Registrar, Credit Provider, Special Escrow Agent or other Fiduciary for Subordinate Lien Bond Service Charges and Bond Related Costs that relate to administration and remarketing and the Authority's Annual Administrative Fee if not provided for in (ix), (x), (xi), (xii) and (xiii) above; and then



(xiv) to each Rebate Account for Subordinate Lien Bonds, the amount and the application required by the Indenture; and then

(xv) except as may be provided in one of more Supplemental Indentures to the contrary, to the Surplus Account.

Solely for the purpose of administering these payments, any interest payable on Capital Appreciation Bonds or, prior to the Interest Commencement Date, on Deferred Interest Bonds, shall be deemed to be "due" in the Bond Year when payment is scheduled to be made and to be "principal" for (a)(ii) and (x) above rather than "interest" under paragraphs (i) and (ix) above.

**Costs of Issuance Account.** The Trustee may establish within the Cost of Issuance Account a separate, segregated account for the benefit of one or more Series of Bonds as provided in the applicable Supplemental Indenture. There shall be deposited in the Cost of Issuance Account, from the proceeds of each Series of Bonds, the amount specified pursuant to the Supplemental Indenture creating such account. Costs of Issuance Fund moneys shall be used only to pay Costs of Issuance of a Series of Bonds. The Trustee shall disburse from the Series 1998 Costs of Issuance Account all amounts required to pay the Costs of Issuance then due and payable. Any moneys remaining in the Costs of Issuance Fund with respect to any Series of Bonds shall be transferred by the Trustee to the related subaccount in the Construction Account. The Authority may, however, certify and direct the Trustee by the 180<sup>th</sup> day to retain moneys in the Cost of Issuance Account or direct transfer to a person or Account other than the Construction Account or related Account if the moneys are not derived from the proceeds of the applicable Series of Bonds.

**Debt Service Accounts and Subaccounts.** The Indenture establishes a Senior Lien Debt Service Account and a Subordinate Lien Debt Service Account (collectively, the "Debt Service Accounts") and various subaccounts within the Debt Service Accounts. Upon issuance of any Series of Bonds, the Trustee shall deposit to the applicable Interest Subaccount amounts from the proceeds of each Series of Bonds equal to accrued interest received from the sale of such Bonds. Amounts on deposit in the Interest Subaccount shall be used to pay interest for the respective Series of Bonds on each Interest Payment Date. If on any Interest Payment Date amounts on deposit in the applicable Interest Subaccount are insufficient to pay the amount of interest coming due on the applicable Series of Bonds, the Trustee shall transfer to the Interest Subaccount amounts from, respectively, the Pledged Revenue Account, the Redemption Subaccounts, the Construction Accounts, the respective Series Debt Service Reserve Account or the Principal Subaccount.

The Trustee shall transfer on first day of each Bond Year amounts from the Pledged Revenue Account to each Principal Subaccount and use such amounts on each Principal Payment Date to pay principal due on each respective Series of Bonds. If on such Principal Payment Date amounts on deposit in each respective Principal Subaccount are insufficient to pay principal coming due on the applicable Series of Bonds on the Principal Payment Date, the Trustee shall transfer to the Principal Subaccount amounts from, respectively, the Pledged Revenue Account,

the Redemption Subaccounts, the Construction Account, the respective Series Debt Service Reserve Account or the Interest Subaccount.

Amounts to be used by the Authority to prepay any Series of Bonds shall be deposited into the respective Series Redemption Subaccount and applied to purchase Bonds to be surrendered to the Trustee as a credit against Debt Service Requirements when due or to pay principal of and premium, if any, of a Series of Bonds subject to and called for redemption. Any funds transferred to a Redemption Subaccount from the Construction Account as excess proceeds shall be applied only to redeem Bonds of the Series from which such Construction Account proceeds were derived.

The Trustee shall transfer moneys from the Pledged Revenue Account to the respective Expense Subaccounts for each Series of Bonds and use such amounts to pay at the direction of the Authority to any payee amounts specified, including the Authority's Annual Administrative Fee.

Amounts in the respective Purchase Subaccounts, if any, shall be used as directed in the applicable Supplemental Indenture to purchase the related Series of Bonds.

If required by an applicable Supplemental Indenture, the Trustee shall create a Credit Subaccount for a Series of Bonds that are secured by a Credit Facility. Amounts drawn under such Credit Facility to pay principal or interest shall be deposited into the related Principal Subaccount or Interest Subaccount or Purchase Subaccount and applied to the purpose for which they were drawn.

Amounts on deposit in each respective Capitalized Interest Subaccount shall be transferred on each Interest Payment Date and shall be credited against the transfer then due from the Pledged Revenue Account.

**Deficiencies in the Interest Subaccounts or Principal Subaccounts.** In the event, the amount on deposit at a payment date in the Interest Subaccount or the Principal Subaccount is not sufficient to pay the full interest on or principal of all Outstanding Bonds of any Series then due, the Authority shall immediately cure such insufficiency with a draw from the Surplus Subaccount. If amounts available in the Surplus are insufficient, the Trustee shall transfer to the respective Interest Subaccount or Principal Subaccount an amount equal to the deficiency in the following order:

- (i) the Pledged Revenue Account;
- (ii) the Senior Lien Redemption Subaccount or any Subordinate Lien Redemption Subaccount (other than amounts held therein to pay and redeem Bonds for which notice of redemption has theretofore been given, and amounts held therein to defease Outstanding Bonds);
- (iii) the Construction Account (to the extent held by the Trustee and such application is permitted by the Supplemental Indenture governing

same and the Authority certifies that such amounts are not required for payment of costs of an Approved Project);

(iv) the Series Subaccount of the Senior Lien Debt Service Reserve Account if the payment is for principal of or interest on the related Series of Bonds;

(v) the Senior Lien Principal Subaccount (for deficiencies in the Interest Subaccount); and

(vi) the Senior Lien Interest Subaccount (for deficiencies in the Principal Subaccount).

(a) Deficiencies in the Senior Lien Interest Subaccount shall be fully cured prior to curing any deficiency in the Senior Lien Principal Subaccount.

**Debt Service Reserve Accounts.** The Trustee shall initially deposit to the credit of the Series Subaccount of the Debt Service Reserve Account from the proceeds of each Series of Bonds in an amount equal to the Debt Service Reserve Requirement (if any) for that Series. Thereafter each Series Subaccount of the Debt Service Reserve Account shall be maintained at the Debt Service Reserve Requirement for the related Series by transfers to the Debt Service Reserve Account from the Pledged Revenue Account. If, however, the deposit in a Series Subaccount of the Debt Service Reserve Account is less than the Debt Service Reserve Requirement for the related Series, the Authority shall be required to restore the deficiency. The Authority shall transfer any amounts on deposit in the Surplus Account and, to the extent the full deficiency cannot be so cured, such amounts shall be applied ratably to each Series Subaccount within the Debt Service Reserve Account which has a deficiency. To the extent any deficiency remains, transfers shall be made pursuant to the process in **"Deficiencies in the Interest Subaccount or Principal Subaccount"** above. Deficiencies caused by a valuation of the investment securities shall be cured no later than the first day of the Bond Year following the determination that such vacancy exists.

If on any Interest Payment Date or Principal Payment Date there are not sufficient amounts in any Interest Subaccount or Principal Subaccount to pay interest or principal coming due after the transfers required under the Indenture, the Trustee shall transfer from the Debt Service Reserve Account to the Interest Subaccount or Principal Subaccount, as the case may be, amounts sufficient to make up any deficiency. The Trustee may not draw on any Debt Service Reserve Credit Facility until all cash and any investment Securities in the related Debt Service Reserve Account have been liquidated.

If the Debt Service Reserve Requirement is to be satisfied pursuant to any Supplemental Indenture with a Credit Facility the Trustee shall create a Debt Service Reserve account to such Credit Facility and shall deposit into such account all amounts drawn under the related Credit Facility.

All income derived from investment of amounts on deposit in the Debt Service Reserve Fund shall be retained therein if the amounts on deposit in such Debt Service Reserve Fund is less than the Debt Service Reserve Requirement; otherwise such earnings shall be transferred to the respective Debt Service Accounts and Subaccounts if necessary to pay any deficiency and then at the written direction of the Authority to the Rebate Account or the Surplus Account.

**Rebate Account.** Moneys on deposit in the Rebate Account are not subject to the lien or pledge of the Indenture. If amounts in the Rebate Account are in excess of the Rebate Amount, such excess amounts shall be transferred to the Pledged Revenue Account. If amounts on deposit in the Rebate Account are insufficient to make payments required under the Indenture, the Authority shall transfer to the Trustee within five (5) Business Days, the amount of such deficiency.

**Surplus Account.** Moneys held in the Surplus Account may be used for transfers to the Debt Service Accounts and Debt Service Reserve Accounts to maintain required balances therein, for transfers to the Construction Account or Subaccount to pay costs of Approved Projects or for any other lawful purpose as directed by the Authority.

**Pro Rata Payments.** In the event the amount then on deposit in the Senior Lien Interest Subaccount or Principal Subaccount or in the Subordinate Lien Interest Subaccount or Principal Subaccount on an Interest Payment Date or Principal Payment Date is not sufficient to pay the full amount of interest on and principal of all Outstanding Senior Lien Bonds then due and such deficiency cannot be cured as provided in the Indenture, the Trustee shall nonetheless pay out all moneys on deposit in the Senior Lien Interest Subaccount and Senior Lien Principal Subaccount to the persons entitled thereto, pro rata according to the amount owed to each and pay out all moneys on deposit in the Subordinate Lien Interest Subaccount and Subordinate Lien Principal Subaccount to the persons entitled thereto, pro rata according to the amount owed to each. These pro rate payments are subject to provisions as to Credit Facilities or other amounts which a Supplemental Indenture may pledge or otherwise provide.

**Investments.** If there are Bonds Outstanding and no Event of Default has occurred or is continuing, an authorized Officer may invest moneys on deposit to the credit of the Construction Account, Pledged Revenue Account, any Debt Service Account, and any Debt Service Reserve Account.

**Transfer.** At the option of any Owner, Bonds may be exchanged for an equal aggregate principal amount of Bonds of other minimum denominations, or multiples thereof, of the same series and maturity upon surrender of such Bonds at the Principal Office of the Registrar duly executed by the Owner or his duly authorized attorney, and upon payment of the charges of the Registrar and the Authenticating Agent or the Trustee for exchange. Neither the Authority nor the Trustee shall be required to transfer or exchange (i) Bonds for a period beginning on the Record Date next preceding an interest payment date and ending on such interest payment date, or for a period of fifteen days next preceding the date determined by the Trustee or any selection of Bonds to be redeemed or thereafter until after the mailing of any notice of redemption or (ii) Bonds called or tendered for redemption, in whole or in part.

**Additional Bonds and Other Revenue Obligations.** The Authority may issue one or more series of Additional Bonds in accordance with the conditions of the Indenture and the Loan Agreement and lend the proceeds thereof to the Government pursuant to the Loan Agreement to provide funds for the Cost of undertaking or completing a Project or the Cost of refunding all or a portion of the Outstanding Bonds of any one or more series or of any Long-Term Indebtedness other than Bonds. Except as permitted under the restriction on Additional Senior Lien Bonds and Additional Subordinate Lien Bonds, no obligations payable from the Revenues or secured by a lien on the Trust Estate (except as to any Credit Facility or Liquidity Facility which secures Bonds or a specific Series of Bonds) may be issued.

**Events of Default.** Each of the listed events shall constitute an "Event of Default," provided that no Event of Default with respect to any Subordinated Lien Bonds shall cause an Event of Default on any Senior Lien Bonds, as set out in the Indenture and as follows:

(a) payment of interest on any Series of Bonds shall not be made when the same shall become due and payable; or

(b) payment of the principal or Redemption Price of any Series of Bonds or of a Sinking Fund Installment shall not be made when the same shall become due and payable; or

(c) the Authority shall fail to observe or perform in any material way any covenant, condition, agreement or provision contained in any Bonds or in the Indenture or any Supplemental Indenture on the part of the Authority to be performed other than those set forth in the Indenture, and such failure shall continue for thirty (30) days after written notice specifying such failure and requiring the same to be remedied shall have been given to the Authority by the Trustee, which notice may be given by the Trustee in its discretion and shall be given by the Trustee at the written request of the Owners of not less than twenty-five percent (25%) in principal amount of any Outstanding Bonds; provided, however, that if said default be such that it cannot be corrected within the applicable period, it shall not constitute an Event of Default if corrective action is instituted by the Authority within the applicable period and diligently pursued until the default is corrected and an Authorized Officer of the Authority has delivered to the Trustee a certificate to that effect; or

(d) an "Event of Default" as such term is defined in any Loan Agreement; or

(e) the occurrence of an Act of Bankruptcy by the Authority.

Provided however, that in no event shall an Event of Default with respect to any Subordinate Lien Bonds cause an Event of Default on any Senior Lien Bonds.

**Rights of Owners.** Anything in the Indenture to the contrary notwithstanding, subject to the limitations and restrictions as to the rights of the Owners set forth in the Indenture, upon the happening and continuance of any Event of Default, the Owners of not less than twenty-five percent (25%) in principal amount of any Series of Bonds then Outstanding shall have the right upon providing the Trustee security and indemnity reasonably satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby, by an instrument in writing executed

and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings to be taken by the Trustee under the Indenture. The Trustee may refuse to follow any direction that conflicts with law, the Indenture or any Supplemental Indenture or would subject the Trustee to personal liability without adequate indemnification therefor.

**Restriction on Action by Owners.** No Owner of any of the Bonds shall have any right to institute any suit, action or proceeding in equity or at law for the enforcement of any trust under the Indenture, or any other remedy under the Indenture or on said Bonds, unless such Owner previously shall have given to the Trustee written notice of an Event of Default and unless the Owners of not less than twenty-five percent (25%) in principal amount of any Series of Bonds then Outstanding shall have made written request of the Trustee to institute any such suit, action, proceeding or other remedy. After the right to exercise such powers or rights of action, as the case may be, shall have accrued, and shall have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers in the Indenture granted, or to institute such action, suit or proceeding in its or their name; nor unless there also shall have been offered to the Trustee security and indemnity reasonably satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby, and the Trustee shall not have complied with such request within a reasonable time; and such notification, request and offer of indemnity are hereby declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the trusts of the Indenture or for any other remedy under the Indenture or Supplemental Indenture; it being understood and intended that no one or more Owners of any Series of Bonds secured by the Indenture shall have any right in any manner whatever by his or their action to affect the security of the Indenture, or to enforce any right under the Indenture or under the Bonds and that all proceedings at law or in equity shall be instituted, had and maintained for the equal benefit of all Owners of Outstanding Bonds, subject to the provisions of the Indenture and any Supplemental Indenture.

**Waiver of Events of Default; Effect of Waiver.** The Trustee may waive any Event of Default hereunder and its consequences and shall do so upon the written request of the Owners of at least a majority in principal amount of all Outstanding Bonds, provided, however, that there shall not be waived (i) any event of default pertaining to the payment of the principal of any Bond at its maturity date or redemption date prior to maturity, or (ii) any event of default pertaining to the payment when due of the interest on any Bond, unless prior to such waiver or rescission, all arrears of principal (due otherwise than by declaration) and interest, with interest (to the extent permitted by law) at the rate per annum borne by the Bonds in respect of which such event of default shall have occurred on overdue installments of interest, and all arrears of payments of principal when due, as the case may be, and all expenses of the Trustee in connection with such event of default, shall have been paid or provided for, and in case of any such waiver or rescission, or in case any proceeding taken by the Trustee on account of any such event of default shall be discontinued or abandoned or determined adversely, then and in every such case the Authority, the Trustee and the Bondholders shall be restored to their former positions and rights hereunder.

**Priority of Payment.** All Senior Lien Bonds issued under and secured by the Indenture shall be equally and ratably secured by and payable from the Senior Lien Debt Service Account without priority of one Senior Lien Bond over any other, except as otherwise expressly provided

(i) in the Indenture with respect to Senior Lien Bonds of a specific Series (or specific Senior Lien Bonds within a Series) secured by a Credit Facility or (ii) in a Supplemental Indenture, or (iii) with respect to moneys or assets whether or not held in the Senior Lien Debt Service Account pledged to secure one or more Series of Senior Lien Bonds (or specific Senior Lien Bonds within a Series) and not other Bonds. All Subordinate Lien Bonds issued under and secured by the Indenture shall be equally and ratably secured by and payable from the Subordinate Lien Debt Service Account without priority of one Subordinate Lien Bond over any other except as otherwise expressly provided (i) in the Indenture with respect to Subordinate Lien Bonds of a specific Series (or specific Subordinate Lien Bonds within a series) secured by a Credit Facility or (ii) in a Supplemental Indenture or (iii) with respect to moneys or assets whether or not held in the Subordinate Lien Debt Service account pledged to secure one or more Series of Subordinate Lien Bonds (or specific Subordinate Lien Bonds within a Series) and not other Bonds. Upon the occurrence of an Event of Default, all moneys collected pursuant to action taken pursuant to the Trustees' or Bondowners' remedies hereunder after payment of the costs and expenses of the proceedings resulting in the collection of such moneys and of the expenses, liabilities and advances incurred or made by the Trustee and after any other prior application of such moneys has been made as is required by law shall be deposited in such Account or Accounts described in the Indenture as the Trustee deems appropriate; and all moneys in the Debt Service Accounts (and at the discretion of the Trustee except when otherwise required), excluding however (1) any moneys held in trust for the payment of any Bonds or interest thereon which have matured or otherwise become payable prior to such Event of Default, (2) any moneys (such as Credit Facility proceeds) pledged exclusively to secure one or more specific Series of Bonds (or specific Bonds within a Series) shall be applied as provided as follows and (3) moneys in the Senior Lien Debt Service Account and Senior Lien Debt Service Reserve Account shall be applied solely to payment of Senior Lien Bonds and money in the Subordinate Lien Debt Service account and Subordinate Lien Debt Service Reserve account shall be applied solely to payment of Subordinate Lien Bonds.

**Application of Moneys.** Unless the principal of Bonds shall have become due and payable, all such moneys in the respective Accounts and Subaccounts securing such obligations shall be applied consistent with the respective priorities of liens and the respective purposes for such accounts each as follows:

**FIRST:** To the payment of installments of interest then due on the Senior Lien Bonds in the order of the maturity of the installments of such interest, and if available amounts are insufficient to pay in full any particular installment, then to the payment ratably, according to amounts due and without discrimination or privilege and

**SECOND:** To the payment of the unpaid principal of and redemption premium, if any, on any of the Senior Lien Bonds which shall have become due (other than Senior Lien Bonds which have matured or otherwise become payable prior to such Event of Default and Moneys for the payment of which are held in trust, in the order of their due dates, and if the available amounts are insufficient to pay in full the unpaid principal and redemption premium, then to the payment ratably according to amounts due without discrimination or privilege, and

**THIRD:** To the payment of interest on and the principal of the Senior Lien Bonds as thereafter may from time to time become due, all in accordance with the provisions of the Indenture; and

**FOURTH:** To the payment of all installments of interest then due on the Subordinate Lien Bonds in the order of the maturity of the installments of such interest, and if the available amounts are insufficient to pay in full any particular installment, then to the payment ratably according to amounts due without discrimination or privilege; and

**FIFTH:** To the payment of unpaid principal of and redemption premium, if any, on any of the Subordinate Lien Bonds due, which shall have become due (other than Subordinate Lien Bonds, which may have matured or otherwise become payable prior to such Event of Default and moneys for the payment of which are held in trust, in the order of their due dates, and if the amount available shall not be sufficient to pay in full the unpaid principal and redemption premium, if any, on Subordinate Lien Bonds due, then to the payment ratably according to amounts due and without discrimination or privilege; and

**SIXTH:** To the payment of interest and premium, if any, on and the principal of the Subordinate Lien Bonds and to the redemption of such Subordinate Lien Bonds, as thereafter may from time to time become due all in accordance with the provisions of the Indenture; and

**SEVENTH:** To reimburse the Trustee for costs and expenses described in the first unnumbered paragraph of this Section and not reimbursed thereunder.

**Duties, Immunities and Liabilities of Trustee.** The Trustee shall, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in the Indenture and no implied duties or obligations shall be read into the Indenture against the Trustee. The Trustee shall, during the existence of any Event of Default (which has not been cured), exercise such of the rights and powers vested in it by the Indenture, and use the same degree of care and skill in their exercise as a prudent individual would exercise or use under the circumstances in the conduct of his own affairs.

The Trustee is not required to risk or expend its own funds or otherwise incur any financial liability in the performance of any of its duties if it shall have reasonable grounds for believing that repayment of such funds or adequate indemnity against such risk or liability is not assured to it.

In accepting the trust created by the Indenture, the Trustee acts solely as Trustee for the Owners and not in its individual capacity.

The Trustee makes no representation or warranty, express or implied, as to the compliance with legal requirements of the use contemplated by the Authority of the funds under the Indenture or any Supplemental Indenture. In no event shall the Trustee be liable for incidental, indirect, special or consequential damages in connection with or arising from the Indenture or Supplemental Indenture.



The Trustee shall not be responsible for the sufficiency, timeliness or enforceability of the remedies. The Trustee shall have no responsibility in respect of the validity or sufficiency of the Indenture or any Supplemental Indenture or the security provided hereunder or the due execution hereof by the Authority, or the due execution of any other document by any party (other than the Trustee) thereto, or in respect of the validity of any Bonds authenticated and delivered by the Trustee in accordance with this Indenture or to see to the recording or filing (but not refiling) of the Indenture, any Supplemental Indenture or any financing statement or any other document or instrument whatsoever.

The Trustee shall not be deemed to have knowledge of any Event of Default under the Indenture unless and until an officer of its corporate trust department shall have actual knowledge thereof.

The Trustee shall not be liable or responsible because of the failure of the Authority to perform any act required of it by the Indenture or any Supplemental Indenture or because of the loss of any moneys arising through the insolvency or the act or default or omission of any depository other than itself in which such moneys shall have been deposited under the Indenture or any Supplemental Indenture. The Trustee shall not be responsible for the application of any of the proceeds of the Bonds or any other moneys deposited with it and paid out, invested, withdrawn or transferred in accordance herewith or for any loss resulting from any such investment. The Trustee shall not be liable in connection with the performance of its duties under the Indenture except for its own misconduct, negligence or bad faith.

The Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Holders of a majority in principal amount of the Outstanding Bonds relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee or any trust or power conferred upon the Trustee under the Indenture or any Supplemental Indenture.

**Removal, Resignation of Trustee, Successor Trustee.** The Authority in its sole discretion may remove the Trustee without cause at any time if no Event of Default has occurred and is continuing and shall remove the Trustee if at any time requested to do so by an instrument or concurrent instruments in writing signed by the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding (or their attorneys duly authorized in writing) or if at any time the Trustee shall cease to be eligible or shall become incapable of acting, or shall commence a case under any bankruptcy, insolvency or similar law, or a receiver of the Trustee or of its property shall be appointed, or any public officer shall take control or charge of the Trustee or its property or affairs for the purpose of rehabilitation, conservation or liquidation, in each case by giving written notice of such removal to the Trustee, and thereupon shall appoint a successor Trustee by an instrument in writing.

The Trustee may resign by giving written notice of such resignation to the Authority and by giving notice of such resignation by mail, first class postage prepaid, to the Owners at the addresses listed in the Bond Register. Upon receiving such notice of resignation, the Authority shall promptly appoint a successor Trustee by an instrument in writing.

Any removal or resignation of the Trustee and appointment of a successor Trustee shall become effective upon acceptance of appointment by the successor Trustee. If no successor Trustee shall have been appointed and shall have accepted appointment within 45 days of giving notice of removal or notice of resignation as aforesaid, the resigning Trustee, or any Owner (on behalf of himself and all other Owners) may petition any court of competent jurisdiction for the appointment of a successor Trustee, and such court may thereupon, after such notice (if any) as it may deem proper, appoint such successor Trustee. Any successor Trustee appointed under the Indenture shall signify its acceptance of such appointment by executing and delivering to the Authority and to its predecessor Trustee a written acceptance thereof, and thereupon such successor Trustee, without any further act, deed or conveyance, shall become vested with all the moneys, estates, properties, rights, powers, trusts, duties and obligations of such predecessor Trustee, with like effect as if originally named Trustee herein; but, nevertheless, at the written request of the Authority or of the successor Trustee, such predecessor Trustee shall execute and deliver any and all instruments of conveyance or further assurance and do such other things as may reasonably be required for more fully and certainly vesting and confirming to such successor Trustee all the right, title and interest of such predecessor Trustee in and to any property held by it under this Indenture and shall pay over, transfer, assign and deliver to the successor Trustee any money or other property subject to the trusts and conditions herein set forth. Upon acceptance of appointment by a successor Trustee as provided in this subsection, such successor Trustee provide notice of the succession of such Trustee to the trusts hereunder by first class mail, postage prepaid, to each Paying Agent and to the Owners at their addresses listed in the Bond Register.

Any Trustee appointed shall be a trust company or bank having the powers of a trust company, having a corporate trust office in the United States, having a combined capital and surplus of at least one hundred million dollars (\$100,000,000), and subject to supervision or examination by federal or state authority.

**Merger or Consolidation of Trustee.** Any company into which the Trustee or any Paying Agent may be merged or converted or with which it may be consolidated or any company resulting from any merger, conversion or consolidation to which it shall be a party or any company to which the Trustee or any Paying Agent may sell or transfer all or substantially all of its corporate trust business provided such company shall be eligible under the Indenture, may succeed to the rights and obligations of such Trustee or Paying Agent, as the case may be, without the execution or filing of any paper or any further act, anything herein to the contrary notwithstanding; provided that upon the sale or transfer of corporate trust business as a result of such merger or consolidation, so long as no Event of Default has occurred and is continuing, the Authority may by an instrument in writing appoint a successor Trustee or Paying Agent other than the company resulting from such merger, conversion or consolidation by the Trustee or the Paying Agent.

**Liability of Fiduciaries.** Facts in the Indenture, in the Indenture, in any Supplemental Indenture and in the Bonds shall be taken as statements of the Authority, and neither the Trustee nor any Paying Agent assumes any responsibility for the correctness or makes any representations as to the validity or sufficiency of the Indenture, any Supplemental Indenture or of the Bonds other than in connection with the duties or obligations therein or in the Bonds

assigned to or imposed upon it. The Trustee shall, however, be responsible for its representations contained in its certificate of authentication on the Bonds. Neither the Trustee nor any Paying Agent shall be liable in connection with the performance of its duties under the Indenture, except for its own negligence or default. The Trustee or any Paying Agent may become the Owner of Bonds with the same rights they would have if they were not Trustee or Paying Agent, respectively, and, to the extent permitted by law, may act as depository for and permit any of their officers or directors to act as a member of, or in any other capacity with respect to, any committee formed to protect the rights of Owners, whether or not such committee shall represent the Owners of a majority in principal amount of the Bonds then Outstanding.

**No Recourse on the Bonds.** No recourse shall be had for the payment of the principal of or interest on the Bonds or for any claim based thereon or on the Indenture against any member or officer of the Authority or any person executing the Bonds and no such member, officer or person shall be liable personally on the Bonds.

**Right to Indemnification.** The Trustee shall be under no obligation to institute any suit, or to take any remedial proceeding under the Indenture, or to enter any appearance in or in any way defend in any suit in which it may be made defendant, or to take any steps in the execution of the trusts hereby created or in the enforcement of any rights and powers hereunder, until it shall be indemnified to its satisfaction against any and all reasonable costs and expenses, outlays, and counsel fees and other disbursements, and against all liability not due to its willful misconduct, negligence or bad faith.

**Supplemental Indenture Without Consent of Bondowners.** For any one or more of the following purposes and at any time or from time to time, a Supplemental Indenture of the Authority may be entered into, which, without the requirement of consent of Bondowners, shall be fully effective in accordance with its terms:

(a) To provide for the issuance of a Series of Bonds and to prescribe the terms and conditions pursuant to which the same may be issued, paid or redeemed; provided, however, that such Supplemental Indenture shall not conflict with the Indenture as theretofore in effect;

(b) To add to the covenants and agreements of the Authority in the Indenture, other covenants and agreements to be observed by the Authority which are not contrary to or inconsistent with the Indenture as theretofore in effect;

(c) To add to the limitations and restrictions in the Indenture, other limitations and restrictions to be observed by the Authority which are not contrary to or inconsistent with the Indenture as theretofore in effect;

(d) To confirm, as further assurances, any pledge under, and the subjection to any lien or pledge created or to be created by, the Indenture, of any moneys, securities or fund, or to establish any additional funds or accounts to be held under the Indenture;

(e) To cure any ambiguity, supply any omission, or cure or correct any defect or inconsistent provision in the Indenture;

(f) To insert such provisions clarifying matters or questions arising under the Indenture as are necessary or desirable and are not contrary to or inconsistent with the Indenture as theretofore in effect;

(g) To modify the Indenture or the Bonds to permit qualification under the Trust Indenture Act of 1939 or any similar Federal statute at the time in effect, or to permit the qualification of the Bonds for sale under the securities laws of any state of the United States;

(h) To make such changes as may be necessary to obtain an investment grade rating or to maintain or upgrade any rating for all or any Series of Bonds by a Rating Agency;

(i) To grant to or confer upon the Trustee for the benefit of the Owners any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Owners or the Trustee;

(j) To subject to the lien and pledge of the Indenture additional revenue, properties or collateral;

(k) To evidence the appointment of a separate trustee or a co-trustee or the successor of a Trustee and/or Paying Agent hereunder;

(l) To modify, eliminate and/or add to the provisions of the Indenture to such extent as shall be necessary to prevent any interest on Tax-Exempt Bonds from becoming taxable under the Code; or

(m) To make any other change which in the judgment of Authority and Trustee is necessary or desirable and will not materially prejudice any non-consenting owner of a Bond.

**Supplemental Indenture With Consent of Bondowners.** Any modification or amendment of the Indenture and of the rights and obligations of the Authority and of the Owners of the Bonds thereunder, in any particular, may be made by a Supplemental Indenture, with the written consent (a) of the Owners of at least fifty-one percent (51%) in principal amount of the Bonds Outstanding at the time such consent is given, and (b) in the case less than all of the several Series of Bonds then Outstanding are affected by the modification or amendment, of the Owners of at least fifty-one percent (51%) in principal amount of the Bonds of each Series so affected and Outstanding at the time such consent is given; provided, however, that if such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified like Series and maturity remain Outstanding, the consent of the Owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under this Section. No such modification or amendment shall permit a change in the terms of redemption or maturity of the principal of any Outstanding

Bond or of any installment of interest thereon or a reduction in the principal amount or the Redemption Price, if any, thereof, or in the rate of interest thereon without the consent of the Owners of such Bond, or shall reduce the percentages or otherwise affect the classes of Bonds the consent of the Owners of which is required to effect any such modification or amendment, or shall change or modify any of the rights or obligations of any Fiduciary without the filing with the Trustee of the written assent thereto of such Fiduciary in addition to the consent of the Bondowners. For these purposes, a Series shall be deemed to be affected by a modification or amendment of the Indenture if the same adversely affects or diminishes the rights of the Owners of Bonds of such Series.

**Defeasance.** The pledge and other moneys and securities pledged under the Indenture and any Supplemental Indenture and all covenants, agreements and other obligations of the Authority to the Bondowners shall cease and be satisfied if the Authority shall pay or cause to be paid, or there shall otherwise be paid: (i) to the Owners of all Bonds the principal or Redemption Price, if applicable, and interest due or to become due thereon, at the times and in the manner stipulated in the Bonds and in the Indenture and any Supplemental Indenture and (ii) to the Trustee all amounts due and owing the Trustee. Subject to the Indenture provisions, any Outstanding Bonds shall, prior to the maturity or redemption date thereof be deemed to have been paid if (i) in case any of said Bonds are to be redeemed on any date prior to their maturity, the Authority shall have given to the Trustee irrevocable instructions and notice of redemption, (ii) there shall have been set aside irrevocably in trust, in compliance with the Act, an amount which shall be sufficient to generate the principal of and the interest on which when due to provide moneys which, together with the moneys, if any, set aside in trust, in compliance with the Act, at the same time, shall be sufficient, to pay when due the principal or Redemption Price, if applicable, and interest due and to become due on said Bonds on or prior to the redemption date or maturity date thereof, as the case may be, and (iii) in the event said Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Authority shall have given the Trustee in form satisfactory to it instructions to mail a notice to the Owners of such Bonds that the deposit required by (ii) above has been made with the Trustee and a verification report from an independent certified public accountant confirming the sufficiency of the Defeasance Securities received by the Trustee and that said Bonds are deemed to have been paid and stating such maturity or redemption date upon which moneys are expected to be available for the payment of the principal or Redemption Price, if applicable, on said Bonds.

**Notice.** Any Notice, demand, direction, request or other instrument authorized or required by the Indenture to be given to or filed with the Authority or the Trustee shall be deemed to have been sufficiently given or filed for all purposes of the Indenture if and when sent by registered mail, return receipt requested.

## **THE FIRST SUPPLEMENTAL INDENTURE**

The following is a summary of certain provisions of the First Supplemental Indenture. Such summary does not purport to be complete or definitive and reference is made to the First Supplemental Indenture for a full and complete statement of the terms and provisions and for the definition of capitalized terms used in this summary and not otherwise defined under "Definitions of Certain Terms in the Indenture, the First Supplemental, and the Loan Agreement."

**Authorization and Details of 1998 Bonds.** The First Supplemental authorizes the issuance of the Authority's \$289,075,000 Revenue and Refunding Bonds, Series 1998A (Senior Lien/Refunding) (the "Series 1998A Bonds"), the \$26,015,000 Revenue and Refunding Bonds, Series 1998B (Subordinate Lien/Refunding/Taxable) (the "Series 1998B Bonds"), the \$81,170,000 Revenue and Refunding Bonds Series 1998C (Senior Lien/Working Capital) (the "Series 1998C Bonds"), the \$39,130,000 Revenue and Refunding Bonds, Series 1998D (Subordinate Lien/Working Capital) (the "Series 1998D Bonds") and the \$106,430,000 Revenue and Refunding Bonds, Series 1998E (Subordinate Lien/Capital Program) (the "Series 1998E Bonds").

The Series 1998A Bonds, the Series 1998B and Series 1998C Bonds are designed as Senior Lien Bonds and Series 1998D Bonds and Series 1998E Bonds are designed as Subordinate Lien Bonds.

**Bonds Equally and Ratably Secured.** Except as hereinafter provided, including specifically for differences between the Senior Lien Bonds and the Subordinate Lien Bonds, the Series 1998 Bonds shall in all respects be equally and ratably secured.

**Details of the Senior Lien and Subordinate Lien Bonds.** The Bonds shall be dated April 1, 1998, shall be issuable as fully registered bonds in the denomination of \$5,000, or any multiple thereof, and shall bear interest paid semiannually on each April 1 and October 1 in the years and amounts specified in the First Supplemental Indenture.

**Conditions of Issuing Series 1998 Bonds.** In addition to the conditions set forth in the Indenture for issuance of a Series of Bonds, prior to the issuance of the Series 1998 Bonds, the Authority must deliver to the Trustee the following:

(a) a certificate of the Authority in form satisfactory to the Trustee to the effect that the proceeds of the Series 1998 Bonds, together with any other available funds, and earning on any investments of such proceeds or funds, will be sufficient to pay the principal of the Prior Bonds, the interest which will have accrued thereon to the respective redemption or maturity date and any premium with respect thereto;

(b) a report from a verification agent that verifies that amounts deposited in the Escrow Account will be sufficient to pay principal of and interest which will

have accrued on the Prior Bonds to the respective redemption or maturity and any premium with respect thereto;

- (c) executed counterparts of the Escrow Agreement;
- (d) executed counterparts of the Letter of Representation; and
- (e) an opinion of counsel that with the deposits of the required amounts in the Escrow Account, the Prior Bonds have been defeased and are no longer entitled to a lien on the Fund Estate securing the Prior Bonds.

**Securities Depository Provisions.** Initially, one certificate for each maturity of each Series of Series 1998 Bonds will be issued and registered to the Securities Depository, or its nominee, in a book-entry system.

**Optional Redemption.** As directed by the Authorized Representative of the Authority, the Series 1998A Bonds and Series 1998E Bonds are subject to redemption upon payment of the redemption prices specified in the First Supplemental Indenture. If less than all of the Series 1998 Bonds of any Series are called for redemption, they shall be called in such order of maturity as the Authority may determine. The portion of any Bond to be redeemed shall be in the principal amount of \$5,000 or some multiple thereof, owner upon the surrender thereof. Notice of redemption shall be given in the manner set forth in Indenture.

**Application of Proceeds of Series 1998 Bonds; Application of Related Amounts.** The First Supplemental provides for the deposit and application of the Series 1998 Bonds as follows:

(a) The proceeds of the Series 1998A Bonds in the amount of \$284,617,226.07 shall be applied as follows:

(1) \$257,398,166.18 shall be transferred to the Escrow Agent and deposited in the Escrow Fund to be applied as set forth in Section 1 of the Escrow Agreement.

(2) \$571,324.95 representing accrued interest on the Series 1998A Bonds, shall be deposited by the Trustee in the Series 1998A Subaccount in the Senior Lien Interest Subaccount of the Senior Lien Debt Service Account;

(3) \$26,117,000 representing the allocable share of the Series 1998 Senior Lien Debt Service Reserve Requirement, shall be deposited by the Trustee in the Series 1998 Senior Lien Debt Service Reserve Account; and

(4) \$530,734.94 representing the allocable share of the Cost of Issuance, shall be deposited by the Trustee into the Cost of Issuance Account.

(b) The proceeds of the Series 1998B Bonds in the amount of \$25,912,284.04 shall be applied as follows:

(1) \$23,195,038.38 shall be transferred to the Escrow Agent and deposited in the Escrow Fund to be applied as set forth in Section 1 of the Escrow Agreement.

(2) \$62,474.17 representing accrued interest on the Series 1998B Bonds, shall be deposited by the Trustee in the Series 1998B Subaccount in the Senior Lien Interest Subaccount of the Senior Lien Debt Service Account;

(3) \$2,601,500 representing the allocable share of the Series 1998 Senior Lien Debt Service Reserve Requirement, shall be deposited by the Trustee in the Series 1998 Senior Lien Debt Service Reserve Account; and

(4) \$53,271.49 representing the allocable share of the Cost of Issuance, shall be deposited by the Trustee into the Cost of Issuance Account.

(c) The proceeds of the Series 1998C Bonds in the amount of \$82,265,339.04 shall be deposited as follows:

(1) \$81,957,452.59 shall be transferred by wire, together with \$26,828,231.02 from the proceeds of the Series 1998D Bonds, to the Union Bank of Switzerland, New York Branch, as agent for itself, CIBC Inc. and Banco Poplar de Puerto Rico, to pay the \$106,845,000 outstanding principal amount and accrued interest to the May \_\_, 1998, on the Government's Revenue Anticipation Note issued on February 10, 1998;

(2) \$156,655.42 representing accrued interest on the Series 1998C Bonds, shall be deposited by the Trustee in the Series 1998C Subaccount in the Senior Lien Interest Subaccount of the Senior Lien Debt Service Account;

(3) \$0 representing the allocable share of the Series 1998 Senior Lien Debt Service Reserve Requirement, shall be deposited by the Trustee in the Series 1998 Senior Lien Debt Service Reserve Account; and

(4) \$151,231.03 representing the allocable share of the Cost of Issuance, shall be deposited by the Trustee into the Cost of Issuance Account.

(d) The proceeds of the Series 1998D Bonds in the amount of \$39,793,340.22 shall be deposited as follows:

(1) \$26,828,231.02 shall be transferred by wire, together with \$81,957,429.59 from the proceeds of the Series 1998C Bonds, to the Union Bank of Switzerland, New York Branch, as agent for itself, CIBC Inc. and Banco Poplar de Puerto Rico, to pay the \$106,845,000 outstanding principal amount and accrued interest to May \_\_, 1998, on the Government's Revenue Anticipation Note issued on February 10, 1998;



(2) \$81,744.72 representing accrued interest on the Series 1998D Bonds, shall be deposited by the Trustee in the Series 1998D Subaccount in the Subordinate Lien Interest Subaccount of the Subordinate Lien Debt Service Account;

(3) \$11,617,265.46 shall be transferred by wire to the Government of the Virgin Islands to be used to pay certain working capital expenses of the Government;

(4) \$1,191,000 representing the allocable share of the Series 1998 Subordinate Lien Debt Service Reserve Requirement, shall be deposited in the Subordinate Lien Debt Service Reserve Account; and

(5) \$75,099.02 representing the allocable share of the Cost of Issuance, shall be deposited by the Trustee into the Cost of Issuance Account.

(e) The proceeds of the Series 1998E Bonds in the amount of \$104,751,513.48 shall be deposited as follows:

(1) \$94,004,130 be deposited by the Trustee into the Series 1998 Subaccount in the Construction Account and used to pay the costs of the 1998 Approved Projects that are included on Exhibit B attached hereto.

(2) \$266,090.99 representing accrued interest on the Series 1998E Bonds, shall be deposited by the Trustee in the Series 1998E Subaccount in the Subordinate Lien Debt Service Account;

(3) \$10,325,000 representing the allocable share of the Series 1998 Subordinate Lien Debt Service Reserve Requirement, shall be deposited by the Trustee in the Series 1998 Subordinate Lien Debt Service Reserve Account; and

(4) \$196,292.49 representing the allocable share of the Cost of Issuance, shall be deposited by the Trustee into the Cost of Issuance Account.

**Creation of Subaccounts.** The First Supplemental Indenture establishes within the Construction Account a Series 1998 Construction Subaccount to receive a portion of the proceeds of the Series 1998E Bonds to pay the costs of the 1998 Approved Projects. Within the Interest Accounts and Principal Accounts of the Series 1998 Subordinate Lien Debt Service Account, there shall be established a Series 1998 Subordinate Lien Interest Subaccount and a Series 1998 Subordinate Lien Principal Subaccount to receive moneys to be used in accordance with of the Indenture. The First Supplemental Indenture creates within the Senior Lien Debt Service Reserve Account a Series 1998 Senior Debt Service Reserve Subaccount to be funded at the time of the delivery of the Series 1998 Senior Lien Bonds in an amount equal to the Series 1998 Senior Lien Debt Service Reserve Requirement pursuant to the Indenture. Within the Subordinate Lien Debt Service Reserve Account, there will be established a Series 1998

Subordinate Lien Debt Service Reserve Subaccount, which shall be funded in an amount equal to the Series 1998 Subordinate Lien Debt Service Reserve Requirement pursuant to the Indenture. There shall be established a Series 1998 Cost of Issuance Subaccount in the Cost of Issuance Account, in which the portion of the proceeds of the Series 1998 Bonds specified in the First Supplemental shall be deposited to pay costs of issuance related to the Series 1998 Bonds.

**Security for Series 1998 Bonds.** The Series 1998 Senior Lien Bonds shall be equally and ratably secured under the Indenture with any other Senior Lien Bonds issued pursuant to the Indenture, without preference, priority or distinction for any Senior Lien Bonds. The Series 1998 Subordinate Lien Bonds shall be equally and ratably secured under the Indenture with any other Subordinate Lien Bonds issued pursuant to the Indenture, without preference, priority or distinction for any Subordinate Lien Bonds.

**Arbitrage Rebate Fund.** The First Supplemental establishes the Series 1998 Senior Lien Arbitrage Rebate Fund and the Series 1998 Subordinate Lien Arbitrage Rebate Fund to be held separately by the Authority to receive from legally available moneys for payment of the rebate obligations under the Code (the "Rebate Amount"). These funds cannot be used to pledge to the payment or pay the Series 1998 Bonds. Except when not legally required, the Authority shall pay from amounts in the 1998 Arbitrage Rebate Fund the Rebate Amount to the United States of America in accordance with Section 148(f) of the Code, as amended, Treasury Regulation Section 1.148-1, as amended, and the First Supplemental Indenture.

**Special Default Provision.** No failure to make payments of interest of or principal on any Series 1998 Subordinate Bonds shall constitute an Event of Default under this First Supplemental Indenture unless no 1998 Senior Lien Bonds are outstanding.

## APPENDIX C

### SUMMARY OF CERTAIN PROVISIONS OF THE LOAN AGREEMENT

The following is a summary of certain provisions of the Loan Agreement. Such summary does not purport to be complete or definitive, and reference is made to the Loan Agreement for a full and complete statement of its terms and provisions and for the definition of capitalized terms used in this summary and not otherwise defined under "**Definitions of Certain terms in the Indenture and the Loan Agreement.**"

**The Loan.** The Authority, on the terms and conditions set forth in the Loan Agreement, shall issue, sell, and deliver the Series 1998 Bonds to the Underwriters and make a Loan of the proceeds of the Bonds to the Government.

**Repayment of the Loan.** The Government promises to repay the Loan and observe the terms and provisions of the Loan Agreement. In consideration of the issuance of the Series 1998 Bonds by the Authority, the Government agrees to execute the Series 1998 Matching Fund Loan Notes, including the Series A Note, the Series B Note, the Series C Note, the Series D Note, and the Series E Note. The Government shall repay the Loan Notes in annual installments upon receipt of the Matching Funds Revenues but not later than the Second Business Day next preceding October 1 in each year in the amounts equal to the amounts due for principal of Redemption Price, and interest on the Series of Bonds that each Loan Note secures.

**Redemption of the Loan Notes.** Each individual Series Note may, at the option of the Government of the Virgin Islands, be redeemed, in whole or in part, prior to its maturity at the times, in the manner of and on the same maturities as an optional redemption of the Authority's respective Series 1998 Bonds and at a redemption price equal to the principal amount, plus accrued interest thereon to the date of redemption and any premium required to provide for the payment of the optional redemption of the Authority's respective Series 1998 Bonds.

**Application of Proceeds.** The Authority shall deposit all funds received from the proceeds of the Series 1998 Bonds into the respective Accounts and Subaccounts in accordance with the Loan Agreement.

**Security.** The Revenues pledged to pay the debt service on the 1998 Bonds are derived from the Matching Fund Loan Notes. The Matching Fund Loan Notes are special limited obligations of the Government and are secured solely by a pledge of the Matching Fund Revenues. The Loan Notes are not debts of the United States of America and the United States of America is not liable on the Loan Notes. The Series 1998 Bonds shall under no circumstances constitute a general obligation of the Authority, the United States Virgin Islands, or the United States of America nor shall the United States of America or the United States Virgin Islands be liable thereon. The Authority has no taxing power. Through the Loan Agreement, the Government pledges and assigns its interest in the Matching Fund Revenues and the Special Escrow Agreement to the Trustee as security for the payment of the Series 1998 Loan Notes and consents therein to the deposit of the Matching Fund Revenues into the Special Escrow Fund.

The deposits are subject to the priority of payment of the principal of and interest on certain Defeased Bonds of the Government heretofore issued. The Series A Note, Series B Note and the Series C Note shall be considered to be issued simultaneously and on a parity basis with respect to each other and shall have priority over the Series 1998B Note, Series 1998 D Note and the Series 1998 E Note regarding the payment of principal and interest out of the Matching Fund Revenues. The Series 1998 D Note and the Series 1998 E Note shall be considered to be issued simultaneously and on a parity basis with respect to each other regarding the payment of principal and interest out of the Matching Fund Revenues.

**Representations and Warranties of the Government.** The Government makes the following representations and warranties to the Authority:

(a) As of the date hereof, the amount of Matching Fund Revenues anticipated to be received by the Government is a sum which, during the period the Loan Notes are outstanding, is in excess of the amount necessary to pay the principal of and interest on the Loan Notes, on the Defeased Bonds and the Series 1998 Bonds.

(b) The Government is duly authorized and has full power and authority to execute, deliver and perform its obligations under this Agreement, the Special Escrow Agreement and the Loan Notes.

(c) The execution, delivery and performance by the Government of this Agreement, the Special Escrow Agreement and the Loan Notes (i) have been duly authorized by all necessary action on the part of the Government; (ii) do not conflict with, or result in a violation of, any provision of law or any order, writ, rule or regulation of any court or governmental agency or instrumentality binding upon or applicable to the Government; (iii) do not and will not conflict with, result in a violation of, or constitute a default under, any agreement, resolution, mortgage, indenture or instrument to which the Government is a party or by which the Government or any of its property is bound; and (iv) do not and will not result in, or require, the creation or imposition of any mortgage, deed of trust, pledge, lien, security interest or other charge or encumbrance of any nature upon or with respect to any property of the Government.

(d) No authorization, consent, approval, permit, license, exemption of or filing or registration with, any court or governmental department, commission, board, bureau, agency or instrumentality is or will be necessary for the valid execution, delivery or performance by, or enforcement against or by, the Government of the Loan Agreement or the Loan Notes.

(e) This Agreement, the Special Escrow Agreement and the Loan Notes when executed and delivered by the Government will, assuming the due execution of and delivery by the other parties thereto, constitute, the legal, valid and binding obligations of the Government enforceable against the Government in accordance with their terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or other similar laws hereinafter enacted or principles of equity affecting the enforcement of creditors' rights generally as such laws may be applied in the event of insolvency, reorganization or other similar proceeding of, or moratorium applicable to, the Government.

(f) The Government is duly authorized under all applicable laws to pledge and assign the Special Escrow Agreement and Matching Fund Revenues for the payment of principal and interest on the Loan Notes. The Special Escrow Agreement and Matching Fund Revenues pledged and assigned hereby to the payment of principal and interest on the Loan Notes, subject to the rights of the holders of the Defeased Bonds, will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to or of equal rank with, the pledge created by the Loan Agreement, and all action on the part of the Government to that end has been and will be duly and validly taken.

(g) There are no suits, actions, proceedings or investigations pending or, to the best knowledge of the Government, threatened against or affecting the Government or any of its properties, before or by any court or governmental department, commission, board, bureau, agency or instrumentality, which involve or would materially adversely affect any of the transactions contemplated or by the Loan Notes, or which, if determined adversely, could have a material adverse effect on the financial condition, properties or operations of the Government, or adversely affect the authority of the Government to perform its obligations under the Loan Agreement or under the Loan Notes.

(h) The Government is not, in any material respect, in breach of or in default under any applicable law or administrative regulation of the United States Virgin Islands or of the United States, relating, in each case, to the issuance of debt securities by the Government, or any applicable judgment, decree or loan agreement, note, resolution, ordinance, agreement or other instrument to which the Government is a party or is otherwise subject, the consequence of which or the correction of which would materially and adversely affect the financial condition or operations of the Government as a whole.

(i) The statements of the Government contained in certain specified sections of the Official Statement fairly present the economic and demographic information, the financial position and results of operations of the Government, respectively, as of the dates and for the periods therein set forth, and as of the date of delivery of the Loan Notes, and the Government's assumptions underlying all estimates contained in the Official Statement are reasonable under the circumstances described therein.

(j) At the time of issuance of the Loan Notes, other than the Defeased Bonds and Prior Obligations, there are no other bonds, notes, or other evidences of indebtedness of the Government outstanding that are secured by the Matching Fund Revenues.

**Covenants of the Government.** The Government covenants and agrees that, among other actions, the Government shall:

(a) Observe and comply with the terms and conditions of and perform all of its obligations under the Loan Agreement, the Loan Notes and Special Escrow

Agreement, and will pay all amounts payable by it according to the terms of the Loan Agreement.

(b) Promptly notify the Authority and the Trustee in writing of the occurrence of (i) any Event of Default under this Loan Agreement and (ii) any default under documents governing any debt of the Government.

(c) Request that the United States deliver and take all steps necessary to ensure the receipt of the maximum amount of Matching Fund Revenues for which the Government is eligible, and deposit such funds in the Special Escrow Fund.

(d) Observe and comply with the terms and conditions of and perform all of its obligations under the Special Escrow Agreement.

(e) Defend, preserve and protect the pledge of the Matching Fund Revenues under the Loan Notes and all rights of the holders of the Loan Notes against all claims and demands of all third parties.

(f) Consent to the assignment pursuant to the Indenture, of all right, title and interest of the Authority in the Loan Agreement, and all amendments, modifications and renewals thereof, to the Trustee, reserving to the Authority, however, the rights providing that notices and other communications be given to the Authority.

(g) Provide to the Authority within 180 calendar days of the end of each Fiscal Year a financial report summarizing annual receipts of Matching Fund Revenues.

(h) No later than 90 days after the close of the fiscal year, the Commissioner of Finance of the Government of the Virgin Islands shall deliver to the Trustee a certificate of the Pledged Revenues available, after satisfaction of any prior lien debt service, and relevant debt service coverage calculations for such Fiscal Year.

(i) Include in the annual operating budget of the Government submitted to the Legislature an appropriation for the Molasses Subsidy and use its best efforts to ensure appropriation by the Legislature of a subsidy on molasses.

(j) Not revoke or amend in any way the Special Escrow Agreement or terminate the Special Escrow Agreement or revoke or amend the "Order" in any way that materially adversely affects the rights of any holder of the Loan Notes.

(k) Not Issue any Additional Senior Lien Bonds or Subordinate Lien Bonds, other than in conformance with the terms of the rate covenant set forth in the Indenture.

(l) Not take any action, or fail to take any action, if any such action or failure to take action would adversely affect the exclusion from gross income of

the interest represented by the Series A Note, the Series C Note, the Series D Note and the Series E Note (collectively, the "Tax-Exempt Notes") and the Series 1998 A Bonds, the Series 1998 C Bonds, the Series 1998 D Bonds, and the Series 1998 E Bonds (collectively, the "Series 1998 Tax-Exempt Bonds") under Section 103 of the Code. The Government will not directly or indirectly use or permit the use of any proceeds of the Tax-Exempt Notes and the Series 1998 Tax-Exempt Bonds or take or omit to take any action that would cause the Tax-Exempt Notes and the Series 1998 Tax-Exempt Bonds to be "arbitrage bonds" within the meaning of Section 148(a) of the Code. To that end, the Government will comply with all requirements of Section 148 of the Code to the extent applicable to the Tax-Exempt Notes and the Series 1998 Tax-Exempt Bonds. Without limiting the generality of the foregoing, the Government agrees that there shall be paid from time to time all amounts required to be rebated to the United States of America pursuant to Section 148(f) of the Code and any temporary, proposed or final Treasury Regulations as may be applicable to the Tax-Exempt Notes and the Series 1998 Tax-Exempt Bonds from time to time.

(m) Not fail to include in the annual operating budget of the Government a subsidy on molasses at a level that ensures that rum production in the Virgin Islands remains competitive with production in competing jurisdictions.

(n) Not take any actions, or fail to take any action that would in any way impair the Government's right to receive the maximum amount of Matching Fund Revenues to which it may be entitled.

(o) In the event the federal government discontinues the payment of Matching Fund Revenues and substitutes another stream of revenues thereof, the Government will use its best efforts to pledge the substitute revenues to repayment of the Matching Fund Loan Notes.

**Events of Default.** The occurrence of any of the following events shall be an "Event of Default" under the Loan Agreement:

(a) The Government shall fail to pay when due any amount payable on the Loan Notes; or

(b) The Government shall fail to perform or observe any term, covenant or agreement contained in this Agreement on its part to be performed or observed and any such failure shall remain unremedied for 30 days after written notice thereof shall have been given to the Government by the Authority or the Trustee, provided, however, that if said default be such that it cannot be corrected within the applicable period, it shall not constitute an Event of Default if corrective action is instituted by the Government within the applicable period and diligently pursued until the default is corrected; or

(c) An "Event of Default" under the Indenture.

**Rights on Default.** If an Event of Default shall happen and shall not have been remedied, then, and in every such case, the holder of the Loan Notes may (i) sue to collect sums due under such Loan Notes, (ii) compel to the extent permitted by law, by mandamus or otherwise; the performance by the Government of any covenant made in this Agreement or the Loan Notes, and (iii) examine the books and records of the Government to account for all moneys and securities constituting the Matching Fund Revenues.

**Continuing Obligation.** Until the date on which all amounts due and owing to the Authority from the Government pursuant to the Loan Notes shall have been paid in full or otherwise provided for, the Agreement is a continuing obligation of the Government and shall (i) be binding upon the Government, its successors and assigns and (ii) inure to the benefit of and be enforceable by the Authority and the Trustee and their respective successors, transferees and assigns.

**Amendments, Changes, and Modifications.** The Governor, on behalf of the Government, and with the consent of the Authority and the Trustee, may execute a supplement to this Agreement curing any ambiguity or curing, correcting or supplementing any defect or inconsistent provision contained in this Agreement or making such provisions in regard to matters or questions arising in this Agreement as may be necessary or desirable and as shall not materially adversely affect the interests of the holder of the Loan Notes. Such supplement shall become effective upon the filing with the Government an instrument of the holder of the Loan Notes approving such supplement. In addition, the Governor may execute a supplement to this Agreement at any time and from time to time modifying any provision of this Agreement with the consent of the holder of the Loan Notes, except as provided in the Indenture.



VERIFICATION OF MATCHING FUND REVENUES

**Verification and Projection of  
Virgin Islands Government  
Revenues from Rum  
Shipments to the US**

Submitted to:

**Salomon Smith Barney**

Prepared by:

**WEFA, Inc.  
Regional Services**

**April 1998**



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## Introduction

WEFA, Inc. was contracted by Salomon Smith Barney ("SSB") in connection with SSB's work as senior managing underwriter for the expected issuance of Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes) Series 1998 A, B, C, D and E (the "Bonds") by the United States Virgin Islands ("VI") Public Finance Authority (the "Authority"). These bonds will be secured by revenues from certain excise taxes levied on VI rum shipments to the United States and subject to transfer to the VI Government (the "Matching Fund Revenues"). WEFA was asked to verify the collection and transfer of these federal excise tax revenues to the Virgin Islands Government since the VI's Fiscal Year (FY)<sup>1</sup> 1992 and to develop a trend line to project these revenues through FY 2003.

## Executive Summary

### *Revenue Verification*

We reviewed records that document the Matching Fund Revenue collection and transfer process during the period from FY 1992 through FY 1997. This review indicated that the annual Matching Fund Revenues transferred to the Virgin Islands Government are consistent with excise taxes collected from US distillers on purchases of bulk VI rum and Customs duties levied on cased VI rum. This conclusion is based on a review of the way in which Matching Fund Revenues are calculated and transferred, which involves a process of revenue projections and subsequent adjustments based on actual revenues collected. Between FY 1992 and FY 1997 certain revenue transfers did not equal the amounts that would be expected, given this projection and adjustment process. Because these discrepancies were minimal, however, we considered them immaterial.

### *Revenue Projection*

We developed two models to project future Matching Fund Revenues. The most conservative model, our Constant Market Share Model, projects Matching Fund Revenues as a function of US rum consumption. This model generates a relatively flat revenue stream consistent with the model's projection of flat US consumption, as well as the projection of rum consumption contained in the *Adams Liquor Handbook (1997)*. This model projects that growth in US rum consumption and, subsequently, Matching Fund Revenues, will range from -0.64% to 0.86% during the FY 1998 through FY 2003 period, with annual Matching Fund Revenues averaging \$45.8 million. This average assumes that the Government's current "cover-over" rate (i.e. the portion of excise tax revenues actually transferred to the Virgin Islands) remains unchanged at \$11.30 per proof gallon. Alternative revenue streams were generated to reflect possible changes in this rate.

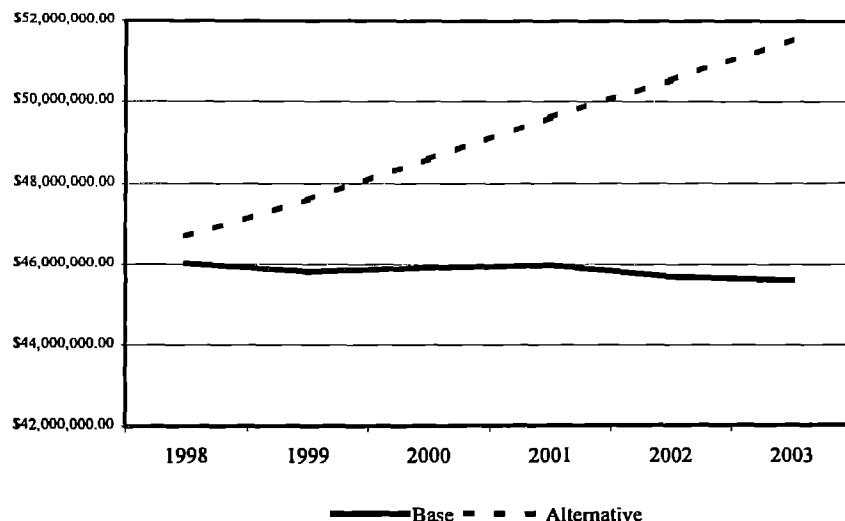
The second model, our Trend Market Share Model, projects Matching Fund Revenues as a function of historical rum excise tax revenues. The growth rate of these revenues has generally exceeded US rum consumption growth since 1989, implying continuing increases in the VI's market share of US rum sales. This model projects greater growth in Matching Fund Revenues than the first model of between 1.86% and 2.32% during the FY 1998 through FY 2003 period, with annual revenues averaging \$49.1 million. This model implies an increase in the Virgin Islands' share of the US rum market between 1996 and 2003. As with the first model, this average assumes that the Government's \$11.30 per proof gallon cover-over rate remains unchanged. Alternative revenue streams were also generated for this model to reflect possible changes in the cover-over rate.

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<sup>1</sup> The Virgin Islands Fiscal Year begins on October 1 and ends on September 30.

The graph below illustrates the Matching Fund Revenues projected by these two models for the FY 1998 through FY 2003 period at the \$11.30 per proof gallon cover-over rate.

**Projected Matching Fund Revenues FY 1998 - FY 2003**  
**Base, Consumption-Based Model**  
**and Alternative, Revenue-Based Model**



#### **Revenue Estimate and Transfer Process**

The Virgin Islands Government receives revenue from US federal excise taxes that are levied on VI rum shipped to and used for consumption in the United States. Virtually all of this rum is produced by a single producer, Virgin Islands Rum Industries Limited ("VIRIL"), a wholly-owned subsidiary of Todhunter International, Inc. ("Todhunter"). US federal excise taxes levied on VI rum are paid by US distributors when they bottle VI rum shipped in bulk to the US, and are collected by the Bureau of Alcohol, Tobacco, and Firearms ("BATF") of the US Department of Treasury ("Treasury"). BATF collects these taxes at the rate of \$13.50 per proof gallon. Currently, the portion of these revenues which is actually transferred to the Virgin Islands Government is, by statute, \$11.30 per proof gallon. These federal excise tax collections, based on the \$11.30 rate, are known as the "cover-over" Matching Fund Revenues received by the VI.<sup>2</sup> This current cover-over rate will expire on September 30, 1998, and subsequently revert to \$10.50 unless an alternative rate is adopted. The Clinton Administration has proposed, in its FY 1999 budget, that the new cover-over rate be set at \$13.50 per proof gallon. Monies collected by the US Customs Service on cased rum (rum produced and bottled in the VI and exported to the US), also currently computed at the \$11.30 rate, are also included in Matching Fund Revenues.

<sup>2</sup> The term "cover-over" revenue can also be used to refer to all tax revenues collected on the sale of rum in the United States and transferred to the Virgin Islands, including Caribbean Basin Initiative ("CBI") funds. These CBI funds are collected from excise taxes on rum imported into the US from sources other than the Virgin Islands and Puerto Rico. For this report, only those funds generated from VI rum exports to the US were considered since it is these revenues that comprise the Matching Fund Revenues and are pledged to secure the Bonds.

These collections are typically small in magnitude compared to bulk collections, as about 99% of Virgin Islands rum is exported in bulk to the US.

Matching Fund Revenues are not transferred to the Virgin Islands directly as they are collected by BATF. Instead, the process by which they are received by the VI involves an annual advance of monies, based on projected tax revenues (referred to as the "base advance"), and subsequent adjustments to this advance. These adjustments are equivalent to the difference between the base advance and actual earnings two FYs earlier. Therefore, the amount of Matching Fund Revenues received by the Virgin Islands Government during a given FY does not equal the "cover-over" amounts collected during the same 12-month period. For example, the FY 1997 advance would equal projected FY 1997 revenues adjusted by the difference between the FY 1995 base advance and actual FY 1995 collected tax revenues. These actual monthly collected federal excise tax revenues are reported by BATF through Monthly Cover-Over Reports submitted to the US Department of Interior ("Interior").

Each year, the Virgin Islands Government requests the VI's Matching Fund Revenue advance through a letter submitted by the Governor to Interior. The Governor's request is based on an estimate by the Virgin Islands Office of Management and Budget ("OMB") of rum production and the resulting federal excise tax revenues to be collected and the appropriate adjustment for that year. This adjustment is based on collected tax revenues two fiscal years earlier. Interior then determines the amount that will be transferred to the Government, and requests that Treasury transfer that amount to an account held by the Special Escrow Agent acting on behalf of the VI Government (the "Escrow Account"), pursuant to a certain Special Escrow Agreement by and between the Government and the Special Escrow Agent (the "Special Escrow Agreement"). This Special Escrow Agent is United States Trust Company of New York.

#### **Data Verification**

Because Matching Fund Revenues are being used to secure the Bonds, it is the flow of these funds that was the focus of our data verification efforts. Specifically, our objective was to confirm that the Matching Fund Revenues collected in the US and eligible for transfer to the VI Government equaled the funds actually transferred to the VI Government. Confirming this flow of funds is complicated by the fact that, as described above, revenues are subject to an advance and adjustment process. The following sources were used to document this process and were the primary components of the verification process:

1. **Department of Interior letters to Treasury requesting the annual transfer of Matching Fund Revenues to the Virgin Islands.** These letters provide three central pieces of information:
  - a) estimate of annual VI excise tax revenues, previously referred to as the base advance;
  - b) the adjustment to be made to this base advance based on the actual excise taxes collected in the second preceding FY; and
  - c) the adjusted amount to be transferred to the Escrow Account held by the Special Escrow Agent on behalf of the Virgin Islands Government.
2. **BATF Monthly Cover-Over Reports.** These reports document the amount of federal excise taxes collected monthly by the BATF and eligible for transfer back to the VI, based on the \$11.30 rate. They therefore provide a record of the amounts the Virgin Islands actually earned through the federal excise tax collected on rum in a given month. The reports detail the four components of the Virgin Islands' total net monthly rum earnings, which are defined below:

- a) Bulk Spirits collections - revenue collected from bulk rum purchases, calculated at the \$11.30 per proof gallon rate;
  - b) Customs collections - Customs collections on cased rum, computed at the \$11.30 per proof gallon rate;
  - c) Adjustment to Bulk - correction applied to account for discrepancies discovered in past Bulk Spirits collections calculations; and
  - d) Adjustment to Customs - correction applied to account for discrepancies discovered in past Customs collections calculations.
3. **Bank Statements.** The annual Matching Fund transfer is deposited into the Escrow Account. Bank statements for this account provide a record that the transfer amount requested by the Department of Interior was in fact received on behalf of the Virgin Islands Government.

In addition to these documents, we collected information from OMB, Virgin Islands Rum Industries Limited, and the Virgin Islands Alcohol Control Board ("ACB"). OMB records information associated with the federal excise tax revenue collection process and provided a series of spreadsheets that they use to track rum revenues and shipments. In preparing its estimate of federal excise taxes to be available for transfer to the VI, OMB reviews historical rum shipments and earnings, and projected rum shipments and sales prepared by VIRIL for the next FY. Although the Governor uses OMB's estimate in making annual transfer requests to the Department of Interior, it is ultimately Interior that determines the amount of the advance that is used for the fund transfer. Therefore, a verification of OMB's forecasts and subsequent requests was not performed. OMB's information did, however, provide a supplement to other data sources.

We also collected rum shipment records, known as Monthly Shipment Reports from ACB. VIRIL regularly reports its US shipments to ACB and these reports provide a record of this shipment information. Since, however, excise taxes are only collected on rum once it is bottled, shipment figures do not directly relate to revenues. There is also a lag between the time when rum is shipped and the time when it is bottled, and therefore taxed. As a result, monthly shipments will not be expected to equal monthly tax revenue. Even if this timing issue could be perfectly accounted for, other factors, such as evaporation and the fact that rum tapped for distribution at US military bases or US export is not subject to federal excise taxes, would account for the discrepancy between actual shipments and actual federal excise tax revenue collected.

While shipment records do not figure into the revenue verification process, these reports are proof that the Virgin Islands Government does regularly record rum shipments. They also illustrate that VIRIL has maintained a relatively steady level of shipments to the US during the verification period.

## Verification Findings

The following chart summarizes the data received and used for the Matching Fund Revenue verification.

**Inventory of Data Received, FY 1992 - FY 1997**

| <b>Fiscal Year</b> | <b>Interior Advance Request Letter</b> | <b>Monthly Cover-Over Letters<sup>1/</sup></b> | <b>Bank Statement</b> |
|--------------------|--|--|-----------------------|
| 1992               | √                                      | √  |                       |
| 1993               | √                                      | √  |                       |
| 1994               | √                                      | √  |                       |
| 1995               | √                                      | √  | √                     |
| 1996               | √                                      | √  | √                     |
| 1997               | √                                      | √  | √                     |

<sup>1/</sup>Also reviewed Cover-Over Letters for FY 1990 and FY 1991 so that FY 1992 and FY 1993 advances could be verified.

In addition to these records, a nearly comprehensive set of ACB monthly shipment reports was received. The report for only one month in the FY 1992 through FY 1997 period was missing. For this month, we were able to obtain information from a shipment spreadsheet provided by VIRIL. Missing shipment data, however, is not a significant problem for the revenue verification process since Matching Fund Revenues are based on what is actually bottled, not what is shipped.

It should also be noted that we reviewed data from the sources above for years prior to the verification period. This review, while not formally included in our data verification, did not present any information that contradicts our verification findings.

## Verification Questions and Findings

### *Verification Questions*

In order to verify the excise taxes collected and the Matching Fund Revenues transferred to the VI Government, we addressed the following questions for the FY 1992 through FY 1997 time period:

1. For each year, what is the difference between the base advance for a given year, and actual earnings for that year, as recorded in BATF's Monthly Cover-Over Reports? Note that we expect that the difference for each year will be used to adjust the base advance in the second fiscal year immediately following.
2. Do annual funds authorized for transfer to the VI equal the base advance for a given year adjusted by the difference discussed in item one, for two fiscal years earlier?
3. Are the annual transfer amounts authorized by the Department of Interior equal to deposits transferred to VI accounts?

## Verification Findings

Our findings with regard to these questions are as follows:

1. In order to verify actual earnings, we compiled data from BATF's Monthly Cover-Over Reports. The earnings figure used for Matching Fund Revenue calculations, according to BATF, is the "Total" figure, i.e. the sum of Bulk Spirits, Customs, Adjustment to Bulk, and Adjustment to Customs. Annual cover-over amounts from these reports for the verification period are detailed below. Note that the cover-over rate increased from \$10.50 to \$11.30 per proof gallon at the beginning of FY 1994.

**BATF Monthly Cover-Over Reports  
Components of Matching Fund Revenues, FY 1990-FY 1997**

| Fiscal Year | (a)<br>Bulk Spirits (\$) | (b)<br>Customs (\$) | (c)<br>Adjustment<br>to Bulk (\$) | (d)<br>Adjustment<br>to Customs (\$) | TOTAL (\$)    |
|-------------|--------------------------|---------------------|-----------------------------------|--------------------------------------|---------------|
| 1990        | 28,735,178.45            | 8,185.21            | 221,062.69                        | 0.00                                 | 28,964,426.35 |
| 1991        | 27,319,420.71            | 1,505.72            | 198,293.02                        | 0.00                                 | 27,519,219.45 |
| 1992        | 27,943,258.16            | 15.03               | 586,594.47                        | -3.53                                | 28,529,864.13 |
| 1993        | 30,633,882.04            | 19.44               | -1,238,291.98                     | 62.22                                | 29,395,671.72 |
| 1994        | 29,782,689.33            | 59.63               | 545,373.27                        | 0.00                                 | 30,328,122.23 |
| 1995        | 41,002,332.97            | 9,692.90            | 11,080.84                         | 0.00                                 | 41,023,106.71 |
| 1996        | 43,579,475.37            | 16,145.29           | -954,413.99                       | 0.00                                 | 42,641,206.67 |
| 1997        | 46,020,134.23            | 1,987.83            | -398,421.88                       | 0.00                                 | 45,623,700.18 |

Source: BATF Monthly Cover-Over Letters, FY 1990 - FY 1997.

- (a) Bulk Spirits - revenue collected from bulk rum purchases, calculated at the \$11.30 per proof gallon rate.
- (b) Customs - Customs collections on cased rum, computed at the \$11.30 per proof gallon rate.
- (c) Adjustment to Bulk - correction applied to account for discrepancies discovered in past Bulk Spirits collections calculations.
- (d) Adjustment to Customs - correction applied to account for discrepancies discovered in past Customs collections calculations.

As described above, Adjustments to Bulk and Adjustments to Customs are corrections applied to account for reporting discrepancies in past calculations. Typically, these adjustments result from BATF audits of past reports. There have been years when relatively large adjustments were applied, as in FY 1993. This is partly due to the fact that certain past audits have included multiple years.

Enhancements in BATF's reporting processes, however, are likely to result in the reduction of future adjustments. These enhancements have been put in place largely in response to OMB, which has actively requested improvements in BATF's reporting processes. The specific enhancements that BATF has developed include improved coordination among their internal offices, and an analysis process to help BATF detect distillers with repeated reporting problems. Distillers will be monitored on a monthly basis to help improve the timeliness and regularity with which reporting errors are detected and subsequently corrected. In addition, a targeting program has been developed to ensure that distillers are audited on a regular basis. Combined, these enhancements should allow BATF to detect and address reporting problems quickly, and thereby reduce the need for future adjustments. To the extent that adjustments are still necessary, the fact that corrective action would be taken in the same year should make it less likely that large adjustments covering multiple years will be applied to earnings in the future.

For each year, the difference between total earnings and the base advance for that year represents the amount by which projected revenues differed from actual Matching Fund Revenues. This difference is used two fiscal years later to adjust the current FY base advance amount. The following table details these differences, and the fiscal years in which they were applied as an adjustment.

**Components of Annual Adjustment Applied to Matching Fund Revenues  
FY 1992 through FY 1997  
Base Advances, Actual Excise Tax Collections and Subsequent Differences**

| FY In Which Adjustment Applied | Adjustment From FY | Projected Matching Fund Revenues (\$) <sup>1/</sup> | Totals from Cover-Over Reports (\$) <sup>2/</sup> | Expected Adjustment (\$) |
|--------------------------------|--------------------|---|---|--------------------------|
| 1992                           | 1990               | 29,000,000.00                                       | 28,964,426.35                                     | -35,573.65               |
| 1993                           | 1991               | 29,000,000.00                                       | 27,519,219.45                                     | -1,480,780.55            |
| 1994                           | 1992               | 28,500,000.00                                       | 28,529,864.13                                     | 29,864.13                |
| 1995                           | 1993               | 29,000,000.00                                       | 29,395,671.72                                     | 395,671.72               |
| 1996                           | 1994               | 30,928,800.00                                       | 30,328,122.23                                     | -600,677.77              |
| 1997                           | 1995               | 52,500,000.00                                       | 41,023,106.71                                     | -11,476,893.29           |

Source: <sup>1/</sup> Department of Interior letters to Treasury and Virgin Islands OMB.

<sup>2/</sup> BATF Monthly Cover-Over Reports.

- Once we determined these differences, we verified that these differences were, in fact, the amounts used to adjust annual base advances for the expected FYs. In order to do this, we compared these differences to information included in the Department of Interior's letters to Treasury.

**Differences Between Expected Adjustments and Actual Adjustments  
FY 1992 through FY 1997**

| Fiscal Year        | Projected Matching Fund Revenues (\$) <sup>1/</sup> | Actual Advance (\$) <sup>2/</sup> | Actual Adjustment (\$) | Expected Adjustment (\$) <sup>3/</sup> | Difference Between Expected and Actual Adjustment (\$) |
|--------------------|---|-----------------------------------|------------------------|--|--|
| 1992               | 28,500,000.00                                       | 28,651,241.00                     | 151,241.00             | -35,573.66                             | 186,814.66   |
| 1993               | 29,000,000.00                                       | 27,519,220.00                     | -1,480,780.00          | -1,480,780.55                          | 0.55   |
| 1994               | 30,928,800.00                                       | 30,959,601.00                     | 30,801.00              | 29,864.13                              | 936.87   |
| 1995               | 52,500,000.00                                       | 52,707,921.00                     | 207,921.00             | 395,671.72                             | -187,750.72  |
| 1996 <sup>4/</sup> | 43,628,000.00                                       | 43,027,653.00                     | -600,347.00            | -600,677.77                            | 330.77   |
| 1997               | 46,150,000.00                                       | 34,673,107.00                     | -11,476,893.00         | -11,476,893.29                         | 0.29   |

Source: <sup>1/</sup>, <sup>2/</sup> Department of Interior letters to Treasury and Virgin Islands OMB.

<sup>3/</sup> Derived from BATF Monthly Cover-Over Reports.

<sup>4/</sup> FY 1996's advance was received in two stages.

As indicated by this table, actual adjustments are reasonably close to expected adjustments for most years in the verification period. There are notable exceptions, however, specifically in FY 1992 and FY 1995. In reviewing data for these years, we have found the following possible explanations for these differences.



- a. The adjustment used for the FY 1992 advance was derived from FY 1990 earnings. Earnings data provided by OMB suggest that there may have been an adjustment to December 1989 earnings of approximately \$186,816. OMB's records of earnings for FY 1989 reflect the unadjusted, bulk spirits revenue from BATF's Monthly Cover-Over Reports. The report that we received from BATF for this month indicates bulk spirits revenue of \$2,509,631.15, which is \$186,815.85 less than OMB's record of \$2,696,447.00. While there is no BATF documentation to confirm an adjustment specifically in this amount, the fact that OMB's figures imply an adjustment so close to the amount in question suggests that a later adjustment to December 1989 earnings was made.
- b. The difference in question for FY 1995, which is based on FY 1993 actual earnings, suggests that perhaps the December 1989 adjustment discussed in item a, above, was applied in FY 1993. As indicated by the example Monthly Cover-Over Report, detailed reasons for earnings adjustments are not specified by BATF. As a result, BATF's adjustment for a given month could be comprised of a number of individual component adjustments. For FY 1993, a net total adjustment of -\$1,238,229.76 was applied. The fact that the difference in question for the FY 1995 adjustment (-\$187,750.72) is so close to the FY 1992 adjustment discrepancy (\$186,414.66) suggests that BATF applied a FY 1990 earnings adjustment in FY 1993 that was approximately \$187,000.

The aggregate of differences between the FY 1992 through FY 1997 period is minimal, and is equal to about \$332.00. This is an immaterial difference, given the magnitude of earnings figures.

3. The bank statements that we have received match the Department of Interior request letters. While there are three years in the verification period for which bank statements were not available, we did not consider this material. Based on the documentation we do have, there is no reason to believe that Matching Fund transfers officially requested by the Department of Interior were not deposited into the VI's Escrow Account.

## **Revenue Forecast**

### **Base Projection: Constant Market Share**

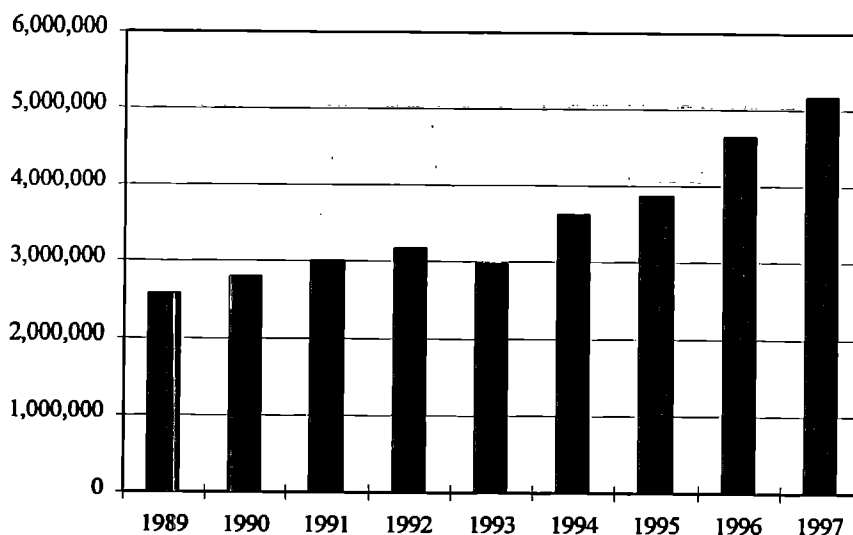
#### ***Assumptions***

To forecast Virgin Islands rum excise tax revenues, we focused on forecasting US rum consumption. This focus was based on several assumptions. First, we assumed that demand for bulk Virgin Islands rum would grow at the same rate as overall US rum demand. In other words, its share of the US rum market would remain steady. Second, we assumed VIRIL would be able to maintain its current level of production. Third, we assumed that VIRIL would maintain its production facilities in the Virgin Islands.

The first two of these assumptions appear to be supported by recent experience, as documented by ACB shipment data. This data, which is graphed below, indicates that VIRIL has maintained steadily increasing shipment levels from 1989 through 1997. VIRIL maintained these production levels in the context of declining rum consumption in the US. The only exception is 1993, when a slight decline in shipments was reported. VIRIL's production capabilities were enhanced during this time period by its February 1994 acquisition by Todhunter International, Inc., a major distiller and supplier of brandy and rum to the beverage alcohol industry. Todhunter's purchase of VIRIL has had a significant impact on the production of rum at the VIRIL distillery. The VIRIL facilities were expanded by 40% in 1995 and now have the capacity to distill 25,000 proof

gallons of rum per day. Todhunter also shifted a substantial part of its domestic rum production to the Virgin Islands. VIRIL is currently operating at 70% of capacity.

**Proof Gallon Shipments of Bulk Virgin Islands Rum to the US  
Calendar Year 1989 through 1997**



Source: Virgin Islands Alcohol Control Board, *Monthly Shipment Reports*; Virgin Islands OMB.

The rum market is differentiated into branded and bulk segments. The much larger branded segment, led by Bacardi, sells at a much higher margin than the bulk segment. The bulk market is led by VIRIL which has 90% of the bulk market. By virtue of its small size and low margin, the bulk market has proven unattractive to aggressive expansion by Bacardi and others. There is no reasonable basis to anticipate a change in this competitive market structure. VIRIL occupies a stable niche in the overall rum market.

Furthermore, the fact that VIRIL is currently operating at approximately 70% capacity and has a significant level of productive capacity in relation to the size of the bulk market renders new entry by small producers unattractive. The security of VIRIL's future place in the rum market is further enhanced by the fact that Virgin Islands Rum does have name recognition, or "market cache" which should help secure future demand.

The third assumption is further based on the assumption that certain advantages that VIRIL currently enjoys by being in the Virgin Islands will continue to exist. These advantages include a molasses subsidy and a range of tax incentives currently in place. The molasses subsidy is provided by the Virgin Islands Government in order to maintain the competitive position of the Virgin Islands rum industry. According to VIRIL and Todhunter, this subsidy does indeed represent a significant advantage of operating in the Virgin Islands. Given the Government's continued need for Matching Fund Revenues, and the Government's long-standing commitment to the rum industry, the Legislature has authorized the subsidy since 1967. We have assumed the subsidy will remain at its current levels for the purpose of this forecast.

We also assume that tax incentives that are currently enjoyed by VIRIL will remain in place. Specifically, Industrial Development Commission ("IDC") benefits extend a 90% income tax

reduction to businesses, like VIRIL, that meet requirements related to promoting the growth, development and diversification of the Virgin Islands economy. VIRIL continues to enjoy the full 90% tax abatement. Changes in these advantages could also affect future production decisions.

A demand- rather than a supply-based model is a more conservative approach for projecting future growth and relies on actual recent experience. Furthermore, since rum must actually be bottled in order to generate tax revenue for the VI, and no revenues are generated simply by sending shipments to the US, it is reasonable to link revenues as closely as possible to actual demand. An alternative model, based on historical rum excise tax revenues rather than consumption was also developed. This model is described in "Alternative Projection: Trend Market Share" below.

Through our research, it is clear that vigorous marketing efforts are being made by Todhunter to increase rum sales. These efforts include advertising targeted at the "high-end" market, and attempts to encourage alternatives to traditional rum drinks, such as rum and coke. In recent years, these efforts appear to have been associated with significant increases in rum consumption. During 1995, rum consumption grew by 3%, followed by an even stronger 7% increase in 1996. If marketing efforts continue to be successful, US rum consumption, and subsequently Virgin Islands tax revenues, could increase further. The extent of this success, however, remains to be seen, and we therefore did not project continued growth at this rate. Since the forecast builds on 1996 consumption, however, recent gains in actual consumption are reflected in our projections.

#### *Model Development*

Using rum consumption data for the 1985 to 1996 period, we developed a regression model that projects rum consumption as a function of the recent time trend for rum consumption and per capita income. The consumption data used in this model was obtained from the *Adams Media Liquor Handbook, 1997*, and is detailed below.

**US Consumption of Rum, 1985-1996**  
(9-Liter Cases)

| <b>Year</b> | <b>Rum<br/>Consumption</b> |
|-------------|----------------------------|
| 1985        | 14,118,377                 |
| 1986        | 13,052,851                 |
| 1987        | 13,450,740                 |
| 1988        | 13,334,940                 |
| 1989        | 13,191,117                 |
| 1990        | 13,564,115                 |
| 1991        | 12,324,756                 |
| 1992        | 11,890,375                 |
| 1993        | 11,927,692                 |
| 1994        | 11,712,877                 |
| 1995        | 12,092,860                 |
| 1996        | 12,941,870                 |

Source: *Adams Media Liquor Handbook, 1997.*

The model we developed using this consumption data has an R-square of 0.93, meaning that it explains 93 percent of the variation in rum consumption over the 1985 through 1996 time period. In terms of predictive ability, this R-square indicates a very strong model with a high level of statistical significance. This regression model is expressed by the following equation:

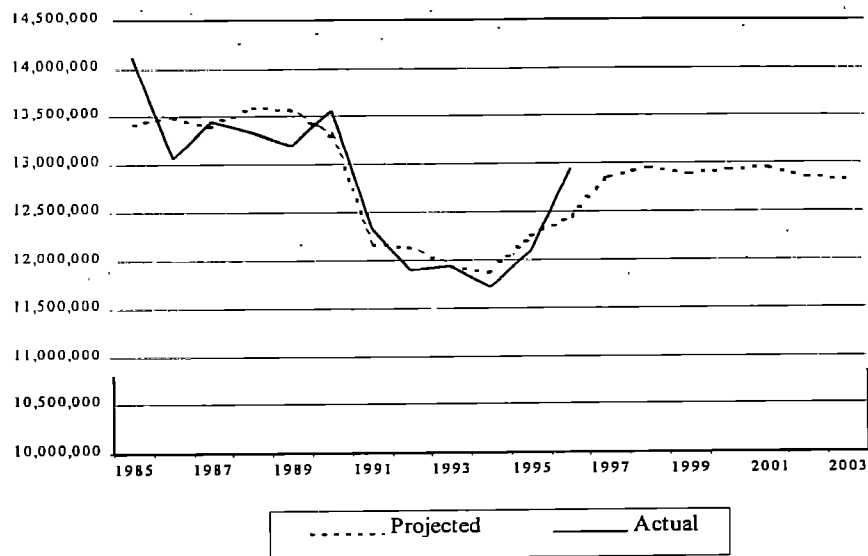
$$\begin{array}{l} \text{US} \\ \text{Rum} \\ \text{Consumption} \\ \text{Per Adult} \end{array} = (-3.70 * \text{Year}) + (6.61 * \text{Real US Personal Income Per Adult}) + (7230.75)$$

Once this equation was developed, we used it to project consumption for the calendar year 1997 through 2003 time period since 1996 was the last year for which consumption data was reported in the *Handbook*. We then calculated the annual growth rate implied by the projections for each year in the forecast period. Our consumption projections and corresponding growth rates are included in the table below. The graph that follows illustrates actual and projected US rum consumption. For years preceding the 1997 through 2003 consumption forecast period, the "Projected" line on this graph indicates the rum consumption that our model would have projected for those years.

**US Consumption-Based Model**  
**Projected US Rum Consumption, 1997 - 2003**  
(9-Liter Cases)

| <b>Year</b> | <b>Projected<br/>Consumption</b> | <b>Growth Rate</b> |
|-------------|----------------------------------|--------------------|
| 1997        | 12,849,719                       |                    |
| 1998        | 12,959,722                       | 0.86%              |
| 1999        | 12,899,583                       | -0.46%             |
| 2000        | 12,927,654                       | 0.22%              |
| 2001        | 12,946,573                       | 0.15%              |
| 2002        | 12,863,680                       | -0.64%             |
| 2003        | 12,839,630                       | -0.19%             |

**US Consumption-Based Model  
Actual and Projected US Consumption of Rum  
(9-Liter Cases)**



Again, assuming that demand for VI rum would maintain the same levels of growth as overall US rum consumption, we applied the consumption growth rates for the forecast period to figures on VI rum taxed in the US. Specifically, we used the total revenue figures found in BATF's Monthly Cover-Over Reports.

The growth rates computed by our model indicate relatively flat US rum consumption throughout the forecast period. These growth rates are consistent with, although lower than, rates projected in the *Adams Liquor Handbook, 1997*. Adams projects a 0.4% increase in rum consumption in 1997. In the longer term, Adams projects a compound annual growth rate of 0.7% between 1996 and 2001.<sup>3</sup> This would imply 2001 US rum consumption of 13.4 million 9-liter cases, 3.9% higher than our estimate of 12.9 million 9-liter cases.

#### *Revenue Projection*

We began this revenue forecasting process by applying the forecasted growth rate for 1998 rum consumption to FY 1997 total revenues. This generated a revenue forecast for FY 1998. We then applied the forecasted growth rate for 1999 rum consumption to this FY 1998 forecast to arrive at a projection for FY 1999 revenues. We continued this process through 2003, and the subsequent forecasted revenues are indicated below. Note that these revenue projections assume that the current tax rate realized by the Virgin Islands Government, \$11.30 per proof gallon, remains unchanged.

<sup>3</sup> *Adams Media Liquor Handbook, 1997*. p. 137.

**US Consumption-Based Model  
Projected Total Revenues, FY 1998-2003  
\$11.30/p.g. Rate**

| <b>Fiscal Year</b> | <b>Projected Revenues</b> |
|--------------------|---------------------------|
| 1998               | \$46,016,064.00           |
| 1999               | \$45,804,390.11           |
| 2000               | \$45,905,159.77           |
| 2001               | \$45,974,017.51           |
| 2002               | \$45,679,783.79           |
| 2003               | \$45,592,992.20           |
| <b>Total</b>       | <b>\$274,972,407.38</b>   |

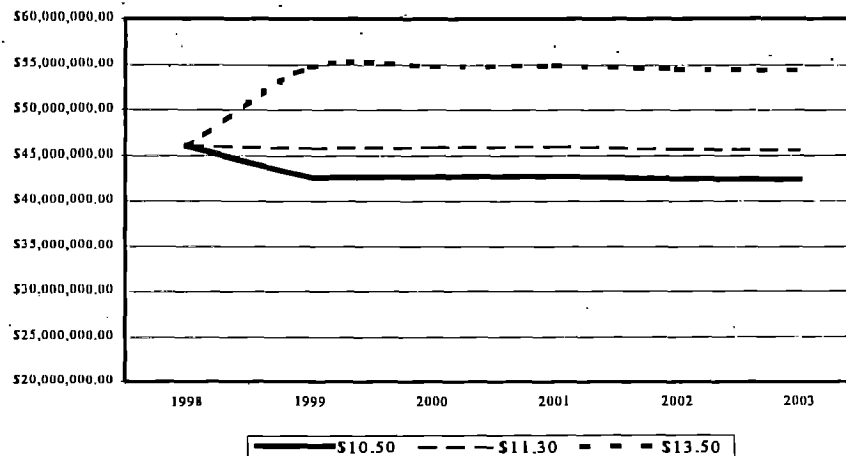
We generated two alternative revenue stream projections, using a \$13.50 and \$10.50 rate from FY 1999 forward. The \$13.50 rate reflects the Clinton Administration's current budget proposal, while \$10.50 is what the rate will revert to if this \$13.50 proposal is not adopted and the US Congress does not otherwise extend the current \$11.30 per proof gallon rate which expires on September 30, 1998. A graph of the revenues associated with these rates follows.

**US Consumption-Based Model  
Projected Total Revenues, FY 1998-2003  
\$13.50/p.g. and \$10.50/p.g. Rate Beginning in FY 1999**

| <b>Fiscal Year</b> | <b>Projected Revenues</b> |                         |
|--------------------|---------------------------|-------------------------|
|                    | <b>\$13.50/p.g.</b>       | <b>\$10.50/p.g.</b>     |
| 1998*              | \$46,016,064.00           | \$46,016,064.00         |
| 1999               | \$54,722,058.98           | \$42,561,601.43         |
| 2000               | \$54,842,447.51           | \$42,655,236.95         |
| 2001               | \$54,924,711.18           | \$42,719,219.81         |
| 2002               | \$54,573,193.03           | \$42,445,816.80         |
| 2003               | \$54,469,503.96           | \$42,365,169.75         |
| <b>Total</b>       | <b>\$319,547,978.66</b>   | <b>\$258,763,108.73</b> |

\*Note: 1998 calculated at \$11.30/p.g. rate since new rate would not apply until FY 1999.

**US Consumption-Based Model  
Projected Total Revenues, FY 1998-2003  
\$10.50, \$11.30 and \$13.50 per Proof Gallon Rates**



It should be noted explicitly that our projected growth rates were applied to the FY 1997 total adjusted figures included in BATF's reports. These adjusted amounts do not equal the value of rum that was actually tapped in FY 1997. Instead, they represent the actual FY 1997 amount, with bulk and Customs adjustments applied to account for past reporting discrepancies. We chose to use this adjusted figure because past experience does suggest that FY 1997 earnings figures are subject to future adjustment. There is no way of knowing how large these adjustments will be, or if they will be positive or negative. By using the adjusted figure for 1997, however, we assume there will be an adjustment, and conservatively assume that this adjustment will be negative. There is some upside chance that this adjustment will not be as large as that included in the FY 1997 total, since our model projects 1997 rum consumption to be strong.

**Alternative Projection: Trend Market Share**

In addition to our demand-based model, we produced a projection of Matching Fund Revenues based on historical rum excise tax revenues. Specifically, we used the Total Revenue figures in BATF reports to project future earnings. The growth rate of revenues has generally exceeded US consumption growth since 1989. This implies an increasing VI market share of US rum consumption, and this alternative model is based on this trend. An increasing future VI market share would be supported by the assumption that Todhunter's marketing efforts, which have been aimed at attracting "high-end" consumers, continue to be successful. It should be noted that part of the trend toward an increase in the VI's market share of US consumption is associated with Todhunter's 1994 acquisition of VIRIL and the subsequent expansion of VIRIL's production facilities.<sup>4</sup>

This model projects Matching Fund Revenues as a function of the recent time trend for revenues and real personal income per adult. This model has an R-square 0.93, and is represented by the following equation.<sup>5</sup>

<sup>4</sup> Note that this alternative model, like the consumption-based model also assumes that VIRIL will be able to maintain its current level of production, and will maintain its production facilities in the Virgin Islands.

<sup>5</sup> In the following equation Step (95) is a dummy variable that represents Todhunter's acquisition.

$$\text{Total Revenue} = (0.00486 * \text{Year}) + (5.27 * \text{Real Personal Income Per Adult}) + (36.4 * \text{Step}(95))$$

This equation generated the projected revenue stream provided below. This table includes a revenue stream at each of the cover-over rates described above, i.e. \$10.50, \$11.30, and \$13.50 per proof gallon. Note that in FY 1998, only the \$11.30 rate is applied, since any change in this rate will not be applied until FY 1999. Also included is the annual growth rate implied by this revenue projection.

**Alternative Revenue-Based Model**  
**Projected Total Revenues and Implied Growth Rate, FY 1998-2003**  
**\$10.50, \$11.30 and \$13.50 per Proof Gallon Rates**

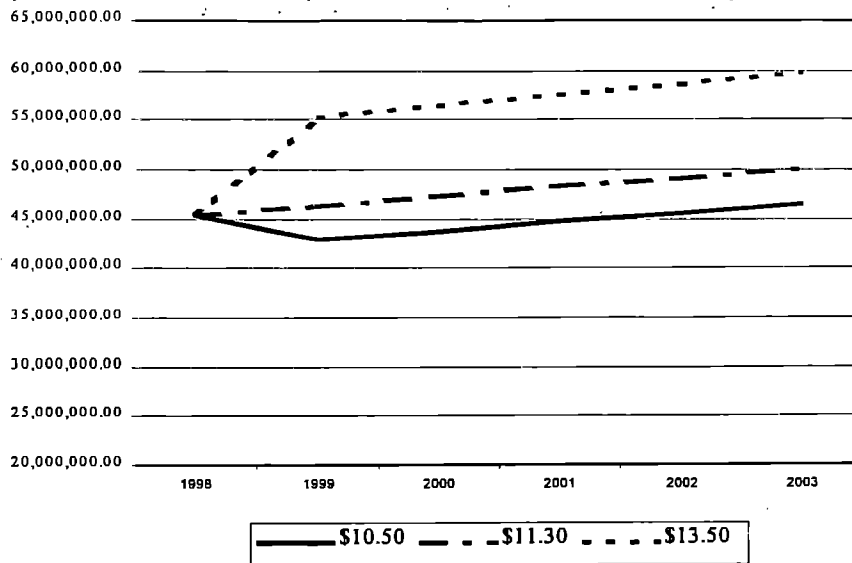
| Fiscal Year  | Growth Rate | Per Proof Gallon Cover-Over Rate |                       |                       |
|--------------|-------------|----------------------------------|-----------------------|-----------------------|
|              |             | \$10.50                          | \$11.30               | \$13.50               |
| 1998*        | 2.32%       | 46,683,348.26                    | 46,683,348.26         | 46,683,348.26         |
| 1999         | 1.96%       | 44,227,644.97                    | 47,597,370.30         | 56,864,114.97         |
| 2000         | 2.11%       | 45,160,488.52                    | 48,601,287.65         | 58,063,485.25         |
| 2001         | 2.07%       | 46,095,949.16                    | 49,608,021.47         | 59,266,220.34         |
| 2002         | 1.86%       | 46,955,446.31                    | 50,533,004.12         | 60,371,288.11         |
| 2003         | 1.95%       | 47,872,820.67                    | 51,520,273.67         | 61,550,769.43         |
| <b>Total</b> |             | <b>276,995,697.89</b>            | <b>294,543,305.47</b> | <b>342,799,226.36</b> |

\*Note: 1998 calculated at \$11.30/p.g. rate since new rate would not apply until FY 1999.

These three revenue streams are illustrated by the following graph:



**Alternative, Revenue-Based Model  
Projected Total Revenues, FY 1998-2003  
\$10.50, \$11.30 and \$13.50 per Proof Gallon Rates**



The growth projected by this model implies that the VI will increase its share of the US rum market between 1996 and 2003. Specifically, it implies an increase in market share from approximately 15.0% in 1996 to about 18.3% in 2003.

#### **Conclusion**

Our review of the records that document the Matching Fund Revenue collection and transfer process confirm that annual Matching Fund Revenues transferred to the VI during the FY 1992 through FY 1997 period were consistent with excise taxes collected from US distillers on purchases of bulk VI rum and Customs duties levied on cased VI rum. The actual advances that have been transferred to the Government are consistent with the projection and adjustment process as described by BATF and the VI Office of Management and Budget. Specifically, actual advances received in each year are reasonably close to the base advances for that year adjusted by the difference between projected and actual earnings for two FYs earlier. While there are years in the verification period when actual transfers did differ from the transfer that would be expected using this projection and adjustment calculation, these differences are relatively small, and are, on balance, immaterial.

WEFA's Constant Market Share Model which projects Matching Fund Revenues as a function of US rum consumption projects that Matching Fund Revenues will average approximately \$45.8 million from FY 1998 through FY 2003, assuming a constant \$11.30 cover-over rate.

WEFA's Trend Market Share Model which projects Matching Fund Revenues as a function of historical rum excise tax revenues forecasts Matching Fund Revenues averaging \$49.1 million in the forecast period, again assuming a constant \$11.30 per proof gallon cover-over rate.

Both models assume that VIRIL will maintain its operations in the VI, and will be able to maintain its production levels to meet future demand. WEFA found that, given the economic incentives provided to VIRIL by the Government for maintaining operations in the VI, it was

reasonable to assume that they will maintain their operations in the VI. Furthermore, WEFA found that VIRIL currently maintains a stable niche in the overall US rum market, and should continue to enjoy the benefits associated with its acquisition by Todhunter. This supports WEFA's assumption that production capabilities will not limit VIRIL's future ability to meet demand.

APPENDIX E

AUDITED FINANCIAL STATEMENTS OF THE AUTHORITY



■ 787 Seventh Avenue  
New York, New York 10019

■ Phone: 212 773 3000

Report of Independent Auditors

Board of Directors  
Virgin Islands Public Finance Authority

We have audited the accompanying balance sheets of the Virgin Islands Public Finance Authority (the Authority) as of September 30, 1997 and 1996, and the related statements of revenues, expenses and retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Virgin Islands Public Finance Authority at September 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

*Ernst & Young LLP*

February 28, 1998, except for  
the second paragraph of Note 11,  
as to which the date is April 17, 1998

# Virgin Islands Public Finance Authority

## Balance Sheets

|  | September 30         |                      |
|--|----------------------|----------------------|
|  | 1997                 | 1996                 |
| <b>Assets</b>                            |                      |                      |
| Cash                                     | \$ 1,612,425         | \$ 1,653,172         |
| Short-term certificate of deposit        | 6,800,000            | 5,700,000            |
| Loans receivable                         | 232,810,000          | 238,390,000          |
| Bond issuance and loan origination costs | 1,558,197            | 1,712,588            |
| Restricted assets:                       |                      |                      |
| Cash                                     | 3,760,589            | 1,160,891            |
| Investments                              | 45,742,070           | 57,418,686           |
| Pooled investments                       | 21,828,383           | 24,584,081           |
|  | <u>71,331,042</u>    | <u>83,163,658</u>    |
| Assets held in trust:                    |                      |                      |
| Investments                              | 20,502,999           | 18,875,181           |
| Pooled investments                       | 11,308,768           | 6,519,562            |
|  | <u>31,811,767</u>    | <u>25,394,743</u>    |
| Property and equipment                   | 20,649,576           | 19,999,897           |
| Other                                    | 1,625,270            | 1,609,238            |
|  | <u>20,649,576</u>    | <u>19,999,897</u>    |
|  | <u>1,625,270</u>     | <u>1,609,238</u>     |
| Total assets                             | <u>\$368,198,277</u> | <u>\$377,623,296</u> |
| <b>Liabilities and equity</b>            |                      |                      |
| Liabilities:                             |                      |                      |
| Accrued expenses and other liabilities   | \$ 1,437,449         | \$ 1,565,086         |
| Bonds payable                            | 250,175,000          | 257,780,000          |
| Long-term debt                           | 16,123,101           | 16,706,797           |
| Due to VI Government                     | 44,841,085           | 48,454,131           |
| Payable from assets held in trust        | 24,061,557           | 17,511,372           |
| Total liabilities                        | <u>336,638,192</u>   | <u>342,017,386</u>   |
| Equity:                                  |                      |                      |
| Contributed capital                      | 6,000,000            | 6,000,000            |
| Retained earnings:                       |                      |                      |
| Restricted                               | 24,802,518           | 28,847,445           |
| Unrestricted                             | 757,567              | 758,465              |
|  | <u>25,560,085</u>    | <u>29,605,910</u>    |
| Total equity                             | <u>31,560,085</u>    | <u>35,605,910</u>    |
| Total liabilities and equity             | <u>\$368,198,277</u> | <u>\$377,623,296</u> |

See accompanying notes.

Virgin Islands Public Finance Authority  
Statements of Revenues, Expenses and Retained Earnings

|  | <b>Year ended September 30</b> |                            |
|--|--------------------------------|----------------------------|
|  | <b>1997</b>                    | <b>1996</b>                |
| <b>Revenues</b>  |                                |                            |
| Taxes, fees and fines                                    | \$12,969,366                   | \$13,592,904               |
| Interest income:   |                                |                            |
| Loans receivable   | 17,633,166                     | 17,989,908                 |
| Investments  | 5,912,681                      | 6,273,738                  |
| Other income   | 8,868,603                      | 7,305,614                  |
|  | <u>45,383,816</u>              | <u>45,162,164</u>          |
| <b>Expenses</b>  |                                |                            |
| Interest   | 19,983,111                     | 20,667,015                 |
| General and administrative                               | 7,111,712                      | 5,480,398                  |
| Amortization of bond issuance and loan origination costs | 124,457                        | 146,909                    |
| Capital expenditure grants                               | 6,662,721                      | 1,303,067                  |
|  | <u>33,782,001</u>              | <u>27,597,389</u>          |
| Income before transfers                                  | 11,501,815                     | 17,564,775                 |
| Transfers to VI Government                               | <u>15,547,640</u>              | <u>16,996,288</u>          |
| Net (loss) income  | (4,045,825)                    | 568,487                    |
| Retained earnings at beginning of year                   | <u>29,605,910</u>              | <u>29,037,423</u>          |
| Retained earnings at end of year                         | <u><u>\$25,560,085</u></u>     | <u><u>\$29,605,910</u></u> |

*See accompanying notes.*

# Virgin Island Public Finance Authority

## Statements of Cash Flows

|  | <b>Year ended September 30</b> |                     |
|--|--------------------------------|---------------------|
|  | <b>1997</b>                    | <b>1996</b>         |
| <b>Operating activities</b>  |                                |                     |
| Net (loss) income  | \$ (4,045,825)                 | \$ 568,487          |
| Adjustments to reconcile net income to<br>net cash used in operating activities: |                                |                     |
| Amortization   | 154,391                        | 146,909             |
| Depreciation   | 718,638                        | 647,224             |
| Gain on sale of property and equipment   | (1,346)                        | (6,250)             |
| Changes in operating assets and liabilities:                                     |                                |                     |
| Accounts receivable  | (73,660)                       | (82,068)            |
| Cash and other assets held in trust  | 52,122                         | (44,459)            |
| Accrued expenses and other liabilities   | (127,180)                      | 565,552             |
| Due to VI Government   | (3,613,046)                    | (4,916,167)         |
| Payable from assets held in trust  | 6,550,185                      | (28,063,225)        |
| Net cash used in operating activities  | (385,721)                      | (31,183,997)        |
| <b>Investing activities</b>  |                                |                     |
| Purchases of investments   | (409,778,126)                  | (266,544,951)       |
| Investment maturities  | 412,656,965                    | 300,082,039         |
| Principal payments on loans receivable   | 5,760,000                      | 5,465,000           |
| Proceeds from sale of property and equipment                                     | 74,831                         | 9,703               |
| Net cash provided by investing activities  | 8,713,670                      | 39,011,791          |
| <b>Capital and related financing activities</b>                                  |                                |                     |
| Principal payments on bonds and loans payable                                    | (8,188,696)                    | (7,736,368)         |
| Loan to V.I. Government Development Bank   | (180,000)                      | -                   |
| Net cash used in capital and related<br>financing activities                     | (8,368,696)                    | (7,736,368)         |
| Net (decrease) increase in cash  | (40,747)                       | 91,426              |
| Cash at beginning of year  | 1,653,172                      | 1,561,746           |
| Cash at end of year  | <u>\$ 1,612,425</u>            | <u>\$ 1,653,172</u> |

*See accompanying notes.*

# Virgin Islands Public Finance Authority

## Notes to Financial Statements

September 30, 1997

### 1. Authorizing Legislation and Organization

The Virgin Islands Public Finance Authority (the Authority) was created by Virgin Islands Act No. 5365, "The Government Capital Improvement Act of 1988", for the purposes of aiding the Government of the Virgin Islands (the Government) in the performance of its fiscal duties and in effectively carrying out its governmental responsibility of raising capital for essential public projects. Under the enabling legislation, the Authority is vested with, but not limited to, the following powers: (i) to have perpetual existence as a corporation, (ii) to borrow money and issue bonds, (iii) to lend the proceeds of its bonds or other money to the Government or any agency, authority or instrumentality thereof, (iv) to establish one or more revolving loan funds with the proceeds of bonds issued by the Authority or issued by the Government or any agency, authority or instrumentality thereof and, (v) to invest its funds and to arrange for the investment of the funds of the Government or any agency, authority or instrumentality thereof.

For financial reporting purposes the Authority is a component unit of the Government of the Virgin Islands.

### 2. Summary of Significant Accounting Policies

#### Basis of Presentation

The accompanying financial statements have been prepared on the enterprise fund concept. Accordingly, the financial statements have been prepared using the accrual method of accounting.

The Authority adopted the provisions of Governmental Accounting Standards Board Statement No. 20 "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting" (GASB No. 20). In adopting GASB No. 20, the Authority elected not to apply all Statements and Interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) Opinions and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure issued after November 30, 1989.

#### Description of Accounts

The activities of the Authority are segregated into the following accounts:

Operating Account: The Operating Account was established for purposes of depositing funds available to the Authority for payment of administrative expenses, other operating expenses, and expenses not associated with specific bond accounts or trustee activities.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Description of Accounts (continued)**

Revenue Bonds Series 1992 A and 1992 B Account: Activities related to the Revenue Bonds Series 1992 A and Series 1992 B are recorded in this Account. The Series 1992 A and Series 1992 B bonds were issued to advance refund the previously outstanding Revenue Bonds Series 1989 A and Series 1989 B.

Government Development Revenue Bonds Series 1994 A, 1994 B and 1994 C Account: Activities related to the Revenue Bond Series 1994 A, B and C are recorded in this account. These bonds were issued to fund various capital improvement and economic development projects on the island of St. Croix.

Government Construction and Revolving Loan Account: Proceeds of the Series 1989 B bonds were deposited with the Authority to make distributions to the Government and loans to agencies, instrumentalities, commissions, authorities and political subdivisions of the Government for the purpose of financing capital projects approved by the Legislature or otherwise authorized by law.

Housing Trust Fund Account: The Housing Trust Fund Account was established for purposes of depositing funds available to the Authority for payment of administrative expenses and other operating expenses associated with the Government's housing programs. During 1996 the Housing Trust Fund Account was closed and resources were transferred to the Operating Account.

Transportation Trust Fund Account: Activities related to the Highway Revenue Bonds (Transportation Trust Fund) Series 1989 are recorded in this Account. These bonds were issued to provide funding for the maintenance, improvement, repair and construction of the road and highway system in the Virgin Islands.

The West Indian Company Account: Activities related to the operations of the West Indian Company (WICO), purchased by the Government of the Virgin Islands during fiscal year 1993 and subsequently assigned to the Authority, are recorded in this account.

Depository Trust Account: Funds deposited with the Authority for investment purposes by the Government or any agency, authority or instrumentality thereof are recorded in the Depository Trust Account.



Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Investments**

Investments are carried at amortized cost. Premiums and discounts are amortized (accreted) over the terms of the underlying investment under the interest method.

Investments are restricted by various bond resolutions of the Authority and the Act, generally, to direct obligations of the U.S. Government, the Virgin Islands, or any state, territory, possession or Commonwealth of the United States, specific bank obligations, investment agreements or similar funding agreements, shares or other interests in mutual funds, trusts or investment companies, corporate commercial paper, and money market portfolios consisting of any of the foregoing.

Earnings on investments restricted for debt service obligations are retained in the Revenue Bond Series 1992 A and 1992 B Account until the valuation date (see Note 7). At the valuation date, excess earnings, if any, may be transferred to the Rebate and Surplus Indenture Accounts. The Authority is authorized under the Indenture to withdraw funds from the Surplus Account for operating expenses.

Earnings on investments restricted for debt service obligations in the Government Development 1994 Revenue Bond Series A, B and C Accounts are retained in the Debt Service Reserve Account until the valuation date (See Note 7). Excess earnings may be transferred to the Rebate Fund or may be used for any other purpose permitted by law.

Earnings on investments restricted for debt service obligations in the Transportation Trust Fund are retained in the Debt Service Reserve Account until the valuation date (see Note 7). Excess earnings in the Transportation Trust Fund Accounts may be transferred to the Rebate Account or may be used for any other purpose permitted by law.

**Operating Transfers**

Operating transfers include distributions to the Government of the Virgin Islands from excess revenues of the Transportation Trust Fund and interest earned on the other funds.

**Capital Expenditure Grants**

During 1997 approximately \$6,650,000 (approximately \$1,300,000 in 1996) was disbursed from the Transportation Trust Fund to the Government of the Virgin Islands for road and/or highway projects authorized by the Legislature of the U.S. Virgin Islands pursuant to Act No. 5672. These disbursements are recorded as capital expenditure grants in the accompanying Statement of Revenues, Expenses and Retained Earnings.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Property and Equipment**

Property and equipment is recorded at cost and depreciated using the straight-line method over the estimated useful life of the asset. Expenditures for maintenance, repairs and renewals are charged to expense as incurred, whereas major improvements are capitalized as additions to property and equipment.

**3. Cash and Investments**

The Authority utilizes a cash and investment pool to manage certain investments. Although investments from different bond issuances and investments held for the Government may be combined within the pool, separate records are maintained of each account within the pool.

Earnings on pooled investments are allocated to each bond and depository account based on the percentage of each account's shares held in the pool to total shares outstanding in the pool.

**Cash**

At September 30, 1997 and 1996, the carrying amounts of the Authority's unrestricted cash were \$1,612,425 and \$1,653,172, respectively, all of which were collateralized by investment securities held by the banking institutions, except for \$581,700 and \$879,200 in 1997 and 1996 respectively, related to the West Indian Company. The WICO deposits in excess of FDIC insurance are not collateralized.

**Investments**

Investments include restricted investments and investments held in trust.

Pursuant to the requirements of the Indenture of Trust, certain assets of the Government are maintained in reserve accounts controlled by the Authority, and may be used only for the payment of principal and interest on the Series 1992 A and 1992 B bonds, the Government Development Revenue Bonds Series 1994 A, B and C, and the Transportation Trust Fund bonds.

Pursuant to the requirements of the Loan Agreement between the bank and the Government, certain assets are maintained in a reserve account controlled by the Authority for the payment of principal and interest on the long-term note obtained to finance the acquisition of The West Indian Company.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**3. Cash and Investment (continued)**

**Investments (continued)**

The cash and investments in the reserve accounts at September 30, 1997 were as follows:

|                                | Revenue<br>Bond Series<br>1992 A<br>and 1992 B | Revenue<br>Bonds Series<br>1994 A,<br>B and C | Transportation<br>Trust Fund | The West<br>Indian<br>Company | Total               |
|--------------------------------|--|---|------------------------------|-------------------------------|---------------------|
| <u>Restricted:</u>             |  |   |                              |                               |                     |
| Debt service reserve           | \$22,543,876                                   | \$3,060,023                                   | \$ 3,466,638                 | \$1,623,236                   | \$30,693,773        |
| Bond fund                      | 170,610  |   | 3,819,579                    |                               | 3,990,189           |
| Project fund                   |  | 18,910,120                                    |                              |                               | 18,910,120          |
| Construction<br>and bond funds |  |   | 15,678,720                   |                               | 15,678,720          |
| Transportation fund            |  |   |                              |                               |                     |
| CBI Revenue Fund               |  | 2,058,240                                     |                              |                               | 2,058,240           |
|                                | <u>\$22,714,486</u>                            | <u>\$24,028,383</u>                           | <u>\$22,964,937</u>          | <u>\$1,623,236</u>            | <u>\$71,331,042</u> |

These investments may be categorized into three levels to provide an indication of risk assumed. These categories are as follows:

Category 1 - Includes deposits and investments that are insured, registered, collateralized, or for which the securities are held by the Authority or its agent in the Authority's name.

Category 2 - Includes deposits and investments that are uninsured, unregistered or uncollateralized for which the securities are held by the brokers' or dealers' trust department or agent in the Authority's name.

Category 3 - Includes deposits and investments that are uninsured, unregistered, or uncollateralized for which the securities are held by the broker or dealer, or by its trust department or agent but not in the Authority's name.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**3. Cash and Investments (continued)**

**Investments (continued)**

Restricted cash and investments in the reserve accounts, separated by category, as of September 30, 1997 were as follows:

| Deposit Type    | Category     |   |   | Carrying Amount |
|-----------------|--------------|---|---|-----------------|
|                 | 1            | 2 | 3 |                 |
| Restricted Cash | \$ 3,760,589 |   |   | \$ 3,760,589    |

| Investments                                  | Category     |   |   | Carrying Amount | Approximate Market Value |
|--|--------------|---|---|-----------------|--------------------------|
|  | 1            | 2 | 3 |                 |                          |
| Certificate of Deposit                       | \$ 2,200,000 |   |   | \$ 2,200,000    | \$ 2,365,000             |
| Money Market Fund                            | 3,946,401    |   |   | 3,946,401       | 3,946,400                |
| Commercial Paper                             | 15,612,675   |   |   | 15,612,675      | 15,612,000               |
| U.S. Treasury Notes                          | 12,877,207   |   |   | 12,877,207      | 12,292,600               |
| Federal Home Loan Mortgage Corporation Notes | 1,963,336    |   |   | 1,963,336       | 1,963,300                |
| Federal Home Loan Bank Notes                 | 4,085,678    |   |   | 4,085,678       | 4,085,000                |
| Federal National Mortgage Association Notes  | 27,485,156   |   |   | 27,485,156      | 27,480,700               |
| Total investments                            | \$67,570,453 |   |   | \$67,570,453    | \$67,775,700             |
| Total cash and investments                   | \$71,331,042 |   |   | \$71,331,042    |                          |

Virgin Islands Public Finance Authority

Notes to Financial Statements (continued)

3. Cash and Investments (continued)

Investments (continued)

Restricted cash and investments in the reserve accounts at September 30, 1996 were as follows:

|                      | Revenue<br>Bond Series<br>1992 A<br>and 1992 B | Revenue<br>Bonds Series<br>1994 A,<br>B and C | Transportation<br>Trust Fund | The West<br>Indian<br>Company | Total               |
|----------------------|--|---|------------------------------|-------------------------------|---------------------|
| <u>Restricted:</u>   |  |   |                              |                               |                     |
| Debt service reserve | \$22,355,602                                   | \$ 3,289,520                                  | \$ 3,262,627                 | \$1,160,791                   | \$30,068,540        |
| Bond fund            | 218,578  |   | 15,106,565                   |                               | 15,325,143          |
| Project fund         |  | 22,196,589                                    |                              |                               | 22,196,589          |
| Construction         |  |   |                              |                               |                     |
| Transportation fund  |  |   | 18,414                       |                               | 18,414              |
| CBI Revenue Fund     |  | 1,452,795                                     |                              |                               | 1,452,795           |
|                      | <u>\$22,574,180</u>                            | <u>\$26,949,081</u>                           | <u>\$32,479,606</u>          | <u>\$1,160,791</u>            | <u>\$83,163,658</u> |

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**3. Cash and Investments (continued)**

**Investments (continued)**

Restricted cash and investments in the reserve accounts, separated by category, as of September 30, 1996 were as follows:

| Deposit Type    | Category    |   |   | Carrying Amount |
|-----------------|-------------|---|---|-----------------|
|                 | 1           | 2 | 3 |                 |
| Restricted Cash | \$1,160,791 |   |   | \$1,160,791     |

| Investments  | Category     |   |   | Carrying Amount | Approximate Market Value |
|--|--------------|---|---|-----------------|--------------------------|
|  | 1            | 2 | 3 |                 |                          |
| Certificate of Deposit                             | \$ 2,365,000 |   |   | \$ 2,365,000    | \$ 2,365,000             |
| Money Market Fund                                  | 15,568,130   |   |   | 15,568,130      | 15,568,000               |
| Commercial Paper                                   | 13,043,870   |   |   | 13,043,870      | 13,044,000               |
| U.S. Treasury Notes                                | 25,550,288   |   |   | 25,550,288      | 25,503,000               |
| Federal Home<br>Loan Mortgage<br>Corporation Notes | 10,071,820   |   |   | 10,071,820      | 10,072,000               |
| Federal Home Loan<br>Bank Notes                    | 3,911,548    |   |   | 3,911,548       | 3,912,000                |
| Federal National<br>Mortgage<br>Association Notes  | 11,492,211   |   |   | 11,492,211      | 11,490,000               |
| Total investments                                  | \$82,002,867 |   |   | \$82,002,867    | \$81,954,000             |
| Total cash and<br>investments                      | \$83,163,658 |   |   | \$83,163,658    |                          |

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**4. Loans Receivable**

The Authority loaned the proceeds of the Revenue Refunding Bonds Series A and B (the 1992 bonds) to the Government. The loans, which are secured with pledged matching fund revenues pursuant to Section 28(b) of the Revised Organic Act of the Virgin Islands (the Matching Fund Revenues), bear the same base interest rates, maturities, and repayment terms as the related bonds payable (see Note 7).

The Authority loaned the proceeds of the Government Development Revenue Bonds Series 1994 A, B, and C (the 1994 bonds) to the Government. These loans, which are secured by the Transportation Trust Fund Revenues, Caribbean Basin Initiative Revenues and Matching Fund Revenues, bear the same base interest rates, maturities, and repayment terms as the related bonds payable (see Note 7).

The Authority loaned \$180,000 of the Series 1989B Revolving Loan Fund proceeds to the V.I. Government Development Bank. The loan remain in total at 8.45% annually and will be repaid in 78 equal installments commencing on May 1, 1997.

**5. Assets Held in Trust**

As of September 30, 1997 and 1996, the Authority managed the following investments for the Government and a Virgin Islands Government Agency:

|                                   | 1997<br>Carrying<br>Amount | 1996<br>Carrying<br>Amount |
|-----------------------------------|----------------------------|----------------------------|
| Virgin Islands Government:        |                            |                            |
| Portfolio investments             | \$27,814,934               | \$18,875,181               |
| Pooled investments                | 767,378                    | 1,484,952                  |
| Virgin Islands Government Agency: |                            |                            |
| Pooled investments                | 3,229,455                  | 5,034,610                  |
|                                   | <u>\$31,811,767</u>        | <u>\$25,394,743</u>        |

These restricted assets may be categorized to provide an indication of risk assumed. The risk categories are described in Note 3. All of the above investments are included in Category 1. The carrying amount of the investments approximate market value at September 30, 1997 and 1996. Fair value was determined by reference to market prices.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**6. Property and Equipment**

A summary of WICO's property and equipment at September 30, 1997 and 1996 follows:

|                                    | 1997                 | 1996                 |
|------------------------------------|----------------------|----------------------|
| Land and land improvements         | \$ 5,037,451         | \$ 5,167,121         |
| Wharf, buildings and installations | 15,734,064           | 15,693,021           |
| Equipment and furnishings          | 752,987              | 638,849              |
| Construction in process            | 1,504,780            | 186,737              |
|                                    | <u>23,029,282</u>    | <u>21,685,728</u>    |
| Less accumulated depreciation      | 2,379,706            | 1,685,831            |
|                                    | <u>\$ 20,649,576</u> | <u>\$ 19,999,897</u> |

**7. Bonds Payable**

On June 15, 1992 the Authority issued Revenue Bonds Series 1992 A and B. The bonds amounted to \$232,740,000 and are not guaranteed by the Government. The Government has pledged certain revenues, as discussed below, to repay the bonds. The proceeds of the Series 1992 A and B bonds were used to advance refund all the outstanding Revenue Bonds Series 1989 A and B.

The proceeds of the Series 1992 Revenue Bonds were placed in an irrevocable trust to provide for all future debt service payments on the Series 1989 Revenue Bonds. Accordingly, the trust account assets and the liability of the Series 1989 Revenue Bonds are not included in the Authority's financial statements. At September 30, 1997 \$194,680,000 of defeased bonds were outstanding.

The Authority issued the Government Development Revenue Bonds Series 1994 A, B and C on October 28, 1994. These bonds amounted to \$29,635,000 and are not guaranteed by the Government. The Government has pledged certain revenues, as discussed below, to repay the bonds. The proceeds of the Series 1994 A, B and C bonds will be used to fund various capital improvements and economic development projects on the island of St. Croix.

The Authority issued the Highway Revenue Bonds (Transportation Trust Fund) Series 1989 on November 30, 1989. These bonds are not guaranteed by the Government. The Government has pledged certain revenues, as discussed below, to repay the bonds.



Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**7. Bonds Payable (continued)**

Pledged Revenues

The Government has pledged the Matching Fund Revenues, as described below, to the timely payment of principal and interest on the Revenue Bonds Series 1992 A and B. The pledge of matching fund revenues is subordinated to the pledge securing other obligations of the Government issued prior to fiscal year 1992. These other obligations consist of the Special Tax Bonds 1991 Series (the Hugo Bonds), and certain bonds which were defeased with the proceeds of the 1989 Revenue bonds.

The Secretary of the United States Department of Treasury makes certain transfers to the Government of substantially all excise taxes imposed and collected under the internal revenue laws of the United States in any fiscal year on certain products produced in the Virgin Islands (primarily rum), and exported to the United States from the Virgin Islands. The amount required to be remitted to the Government by the Secretary of the Treasury is an amount no greater than the total amount of local revenues (primarily taxes) collected by the Government in each fiscal year. As a result, the term "matching fund revenues" is used to denote these payments.

Estimated prepayments of matching fund revenues are made to the Government prior to the beginning of each fiscal year, subject to adjustment for the amount of local revenue actually collected by the United States Department of Treasury during such year. Such adjustments are made to the estimated prepayments for a subsequent fiscal year.

The Government has pledged the Transportation Trust Fund Revenues, Caribbean Basin Initiative Revenues and Matching Fund Revenues to the timely payment of principal and interest on the Government Development Revenue Bonds Series 1994 A, B and C. The pledge of the Transportation Trust Fund Revenues and of Matching Fund Revenues are subordinated to the pledge securing other obligations of the Government issued prior to fiscal year 1994. These other obligations consist of the Revenue Bonds Series 1992 A and B, the Highway Revenue Bonds (Transportation Trust Fund) Series 1989, the Hugo Bonds, and certain bonds which were defeased with the proceeds of the 1989 Revenue bonds.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**7. Bonds Payable (continued)**

The Government will use the Series 1994 Bond proceeds to (i) offer loans in participation with commercial banks, Federal agencies and other financial institutions; (ii) guarantee loans made by commercial banks, Federal agencies and other financial institutions; (iii) make direct loans, equity investments or provide other forms of financing assistance; and, in certain circumstances, (iv) invest in the stock or partnership interest of specific projects in St. Croix. Act No. 6006 provides that in all instances, entrepreneurs or owners must make an equity investment of at least twenty-five percent (25%) of the total cost of the project. Eligible uses include the acquisition of fixed assets (other than land), acquisition of machinery and equipment, and working capital.

As of September 30, 1997 the Authority had a certificate of deposit, included in restricted assets amounting to approximately \$2.2 million as a guarantee for a loan to be made by a bank for the development of a hotel project.

The Government has pledged motor fuel taxes, highway users' taxes, motor vehicle registration fees, drivers' license fees, and traffic law violation fines to the timely payment of principal and interest on the Highway Revenue (Transportation Trust Fund) Series 1989 Bonds. These revenues are deposited in a trust account upon collection, and are transferred to the Bond Fund and Debt Service Reserve Fund, until fully funded. When the balances in the Bond Fund and Debt Service Reserve Fund are sufficient to meet debt service requirements, the revenues may be used for expenses of the Transportation Trust Fund. Any remaining surplus is transferred to the Government.

A summary of bond activity during fiscal year 1997 and 1996 follows (in thousands):

|                               | 1992<br>Revenue Bonds<br>Series A | 1994<br>Revenue Bonds<br>Series A | 1994<br>Revenue Bonds<br>Series B | 1994<br>Revenue Bonds<br>Series C | Highway<br>Revenue<br>Bonds | Total            |
|-------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------|------------------|
| Balance at September 30, 1995 | \$215,125                         | \$5,660                           | \$3,835                           | \$19,235                          | \$21,110                    | \$264,965        |
| Principal payments            | (4,485)                           | (225)                             | (150)                             | (605)                             | (1,720)                     | (7,185)          |
| Balance at September 30, 1996 | 210,640                           | 5,435                             | 3,685                             | 18,630                            | 19,390                      | 257,780          |
| Principal payments            | (4,705)                           | (240)                             | (160)                             | (655)                             | (1,845)                     | (7,605)          |
| Balance at September 30, 1997 | <u>\$205,935</u>                  | <u>\$5,195</u>                    | <u>\$3,525</u>                    | <u>\$17,975</u>                   | <u>\$17,545</u>             | <u>\$250,175</u> |

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**7. Bonds Payable (continued)**

Bonds payable at September 30, 1997 and 1996 are comprised of the following:

|   | 1997                 | 1996                 |
|---|----------------------|----------------------|
| Revenue Bonds:  |                      |                      |
| 1992 Series A Bonds, 1996 to 2018<br>interest at 6.25% to 7.25%   | \$205,935,000        | \$210,640,000        |
| Government Development Revenue Bonds:   |                      |                      |
| 1994 Series A Bonds, 1995 to 2010<br>interest at 6.5% to 7.125%   | 5,195,000            | 5,435,000            |
| 1994 Series B Bonds, 1995 to 2010<br>interest at 6.625% to 7.375%   | 3,525,000            | 3,685,000            |
| 1994 Series C Bonds, 1995 to 2010<br>interest at 7.45% to 10.45%  | 17,975,000           | 18,630,000           |
| Highway Revenue Bonds (Transportation<br>Trust Fund) Series 1989, 1990 to 2004,<br>interest at 6.75% to 7.70% | 17,545,000           | 19,390,000           |
| Total Bonds Payable   | <u>\$250,175,000</u> | <u>\$257,780,000</u> |

Interest on all bonds is payable semi-annually on April 1 and October 1, and principal is payable annually on October 1. One month prior to the payment date (the valuation date), the Authority is required to determine the adequacy of the amounts deposited in the debt service reserve based on the fair market value of the investments recorded in the accounts. If the amounts deposited in these accounts are not in compliance with the requirements of the Indentures of Trust, earnings on the investments are to be retained in these accounts. If amounts deposited in these accounts are sufficient, earnings on investments may be transferred to the Operating Account.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**7. Bonds Payable (continued)**

Interest paid during the years ended September 30, 1997 and 1996 was as follows:

|   | 1997                | 1996                |
|---|---------------------|---------------------|
| Revenue Bonds Series 1992 A                   | \$15,114,238        | \$15,394,550        |
| Govt. Development Revenue Bonds Series 1994 A | 381,706             | 396,331             |
| Govt. Development Revenue Bonds Series 1994 B | 265,069             | 275,006             |
| Govt. Development Revenue Bonds Series 1994 C | 1,873,503           | 1,924,021           |
| Highway Revenue Bonds Series 1989             | 1,487,208           | 1,616,208           |
|   | <u>\$19,121,724</u> | <u>\$19,606,116</u> |

Maturity dates and debt service requirements as of September 30, 1997 for the bonds are as follows (in thousands):

| October 1 | Revenue Bonds<br>Series 1994 A |                | Revenue Bonds<br>Series 1994 B |                | Revenue Bonds<br>Series 1994 C |                 |
|-----------|--------------------------------|----------------|--------------------------------|----------------|--------------------------------|-----------------|
|           | Principal                      | Interest       | Principal                      | Interest       | Principal                      | Interest        |
| 1998      | 255                            | 366            | 170                            | 254            | 720                            | 1,816           |
| 1999      | 270                            | 350            | 185                            | 243            | 785                            | 1,751           |
| 2000      | 290                            | 331            | 195                            | 231            | 865                            | 1,678           |
| 2001      | 315                            | 310            | 210                            | 217            | 950                            | 1,596           |
| 2002      | 335                            | 288            | 225                            | 202            | 1,050                          | 1,505           |
| 2003-2006 | 1,605                          | 900            | 1,085                          | 634            | 5,420                          | 4,861           |
| 2007-2010 | 2,125                          | 392            | 1,455                          | 278            | 8,185                          | 2,250           |
|           | <u>\$5,195</u>                 | <u>\$2,937</u> | <u>\$3,525</u>                 | <u>\$2,059</u> | <u>\$17,975</u>                | <u>\$15,457</u> |

| October 1 | Revenue Bonds<br>Series 1992 A |                  | Highway Revenue<br>Bonds |                | Total            |
|-----------|--------------------------------|------------------|--------------------------|----------------|------------------|
|           | Principal                      | Interest         | Principal                | Interest       |                  |
| 1998      | 4,960                          | 14,808           | 1,985                    | 1,348          | 23,101           |
| 1999      | 5,240                          | 14,482           | 2,140                    | 1,197          | 23,059           |
| 2000      | 5,535                          | 14,131           | 2,300                    | 1,033          | 22,999           |
| 2001      | 5,845                          | 13,754           | 2,480                    | 856            | 22,935           |
| 2002      | 6,180                          | 13,350           | 2,670                    | 665            | 22,865           |
| 2003-2006 | 28,665                         | 48,706           | 5,970                    | 699            | 84,040           |
| 2007-2011 | 49,220                         | 47,569           |                          |                | 96,789           |
| 2012-2016 | 67,235                         | 27,190           |                          |                | 94,425           |
| 2017-2018 | 33,055                         | 3,630            |                          |                | 36,685           |
|           | <u>\$205,935</u>               | <u>\$197,620</u> | <u>\$17,545</u>          | <u>\$5,798</u> | <u>\$426,898</u> |

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**7. Bonds Payable (continued)**

Other Maturity Information

The Revenue Bonds 1992 Series A, the Government Development Revenue Bonds Series 1994 A, B and C, and Highway Revenue Bonds 1989 Series maturing after the following dates are redeemable at the option of the Authority at prescribed redemption prices expressed as a percentage of the principal amount, as follows:

| 1992 Series A Revenue Bonds<br>Maturing    | Price |
|--|-------|
| -----                                      | ----- |
| October 1, 2002 through September 30, 2003 | 102%  |
| October 1, 2003 through September 30, 2004 | 101%  |
| October 1, 2004 through September 30, 2018 | 100%  |

| 1994 Series A and B and C Revenue Bonds<br>Maturing | Price |
|---|-------|
| -----   | ----- |
| October 1, 2004 through September 30, 2005          | 102%  |
| October 1, 2005 through September 30, 2006          | 101%  |
| October 1, 2006 and thereafter                      | 100%  |

| Highway Revenue Bonds<br>Maturing          | Price |
|--|-------|
| -----                                      | ----- |
| October 1, 1999 through September 30, 2000 | 102%  |
| October 1, 2000 through September 30, 2001 | 101%  |
| October 1, 2001 through September 30, 2004 | 100%  |

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**8. Long Term Debt**

On July 1, 1993 the Authority obtained a short-term note payable to a bank to finance the acquisition of WICO in the amount of \$18,000,000 with an interest rate of 5.24%. On December 21, 1993, the short-term note was refinanced with a long-term loan in the amount of \$18,150,000 with an interest rate of 5.75%. The loan is payable in 239 monthly installments of \$127,428, including interest, and a final payment comprised of the principal sum outstanding and all accrued interest unpaid to the date of the final payment. Future minimum payments of principal for the five years subsequent to September 30, 1997 and thereafter are as follows:

|            |                      |
|------------|----------------------|
| 1998       | \$ 618,000           |
| 1999       | 655,000              |
| 2000       | 693,000              |
| 2001       | 734,000              |
| 2002       | 768,000              |
| Thereafter | <u>12,655,000</u>    |
|            | <u>\$ 16,123,000</u> |

The Authority has pledged WICO's revenues to the timely payment of principal and interest of this long term debt. Interest paid during fiscal years 1997 and 1996 for this loan amounted to \$945,442 and \$1,060,899, respectively.

**9. Retained Earnings**

Retained earnings of the Government Development Revenue Bonds Series 1994 A, B and C, the Revenue Bonds Series 1992 A and the Highway Revenue Bonds are restricted until all debt service requirements have been met in accordance with the Indentures of Trust. Retained earnings on the Government Construction and Revolving Loan Account and the Depository Trust Account are restricted for the purposes for which the Accounts were established.

**10. Commitments**

The Authority is committed to provide capital, not to exceed \$5.5 million, to acquire an equity interest in a tourism project in St. Croix.

In October 1996, the Authority signed a letter of credit reimbursement agreement (the Agreement) with a commercial bank relating to the Revenue Refunding Bonds Series 1992A. Under the terms of the Agreement, the bank issued an irrevocable letter of credit in favor of the Authority in the amount of \$19,879,550, which will be substituted for the cash and investments in the debt service reserve fund. The debt service reserve funds will be used for certain capital projects in the Virgin Islands.

Virgin Islands Public Finance Authority  
Notes to Financial Statements (continued)

**10. Commitments (continued)**

Under the terms of the Agreement, the letter of credit expires May 30, 2003. Advances under the line of credit will bear interest at a base rate equal to the higher of (1) the bank's base commercial lending rate, or (2) the rate quoted by the bank to dealers in the New York Federal Funds Market for the overnight offering of dollars by the bank for deposit, plus ½%. Undrawn amounts under the line of credit are subject to a facility fee of .75%.

**11. Subsequent Events**

On December 24, 1997, WICO paid dividends amounting to \$500,000 to the Authority. The Authority subsequently transferred this amount to the Government of the U.S. Virgin Islands. Existing loan covenants on WICO's debt, restricting the payment of dividends, were waived by the financial institution.

The Board of Directors of the Authority plans to authorize the issuance of The 1998 Revenue and Refunding Bonds (1998 Bonds) for approximately \$550,000,000. The proceeds of the 1998 Bonds will be used: (i) to advance refund all prior bonds issued by the Authority (ii) to pay in full the principal and accrued interest on a \$106,845,000 note payable by the Government of the United States Virgin Islands (iii) to fund various capital projects in the Government of the United States Virgin Islands (iv) to fund the debt service revenue accounts of the 1998 Bonds and (v) to pay certain costs associated with issuing the 1998 Bonds. The issuance of these bonds requires, among other things, the approval of the Legislature of the U.S. Virgin Islands.

## **Report of Independent Auditors on Other Financial Information**

The audited financial statements of the Authority and our report thereon are presented in the preceding section of this report. The following financial information is presented for purposes of additional analysis and is not a required part of the financial statements of the Authority. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.



**Virgin Islands Public Finance Authority**  
**Combining Balance Sheet**  
**Year ended September 30, 1997**

|  | Operating<br>Account | Revenue Bonds<br>Series 1992 A<br>B Account | Revenue Bonds<br>Series 1994 A,<br>Series 1994 B<br>and Series 1994<br>C Account | Government<br>Construction<br>and Revolving<br>Loan Account | Transportation<br>Trust Fund<br>Account | The West<br>Indian<br>Company<br>Account | Depository<br>Trust<br>Account | Total                |
|--|----------------------|---|--|---|---|--|--------------------------------|----------------------|
| <b>Assets</b>                            |                      |   |  |   |   |  |                                |                      |
| Cash                                     | \$ 585,068           |   | \$ 273,154   |   | \$ 172,507                              | \$ 581,696                               |                                | \$ 1,612,425         |
| Short-term certificate of deposit        |                      |   |  |   |   | 6,800,000                                |                                | 6,800,000            |
| Loans receivable                         |                      | \$205,935,000                               | 26,695,000   | \$180,000   |   |  |                                | 232,810,000          |
| Bond issuance and loan origination costs |                      |   | 443,002  |   | 628,752                                 | 486,443                                  |                                | 1,558,197            |
| Restricted assets:                       |                      |   |  |   |   |  |                                |                      |
| Cash                                     |                      | 22,714,486                                  |  |   | 2,137,353                               | 1,623,236                                |                                | 3,760,589            |
| Investments                              |                      |   | 2,200,000  |   | 20,827,584                              |  |                                | 45,742,070           |
| Pooled investments                       |                      |   | 21,828,383   |   |   |  |                                | 21,828,383           |
| Assets held in trust:                    |                      |   |  |   |   |  |                                |                      |
| Investments                              |                      |   |  | 502,169   |   |  | \$20,502,999                   | 20,502,999           |
| Pooled investments                       |                      |   |  |   |   |  | 10,806,599                     | 11,308,768           |
| Property and Equipment                   |                      |   |  |   |   | 20,649,576                               |                                | 20,649,576           |
| Other                                    |                      |   |  |   |   | 1,542,770                                |                                | 1,625,270            |
| <b>Total assets</b>                      | <b>\$ 585,068</b>    | <b>\$228,649,486</b>                        | <b>\$51,522,039</b>  | <b>\$682,169</b>  | <b>\$23,766,196</b>                     | <b>\$31,683,721</b>                      | <b>\$31,309,598</b>            | <b>\$368,198,277</b> |
| <b>Liabilities and equity</b>            |                      |   |  |   |   |  |                                |                      |
| Liabilities:                             |                      |   |  |   |   |  |                                |                      |
| Accrued expenses and other liabilities   | \$ 87,549            |   | \$ 4,000   |   | \$ 181,162                              | \$ 1,164,738                             |                                | \$ 1,437,449         |
| Bonds payable                            |                      | \$205,935,000                               | 26,695,000   |   | 17,545,000                              | 16,123,101                               |                                | 250,175,000          |
| Long-term debt                           |                      | 96,485                                      |  | \$ 4,500  | 61,606                                  |  | \$ 97,457                      | 16,123,101           |
| Due to (from) other PFA funds            | (260,048)            | 19,376,327                                  | 20,684,076   |   | 4,780,682                               |  |                                | 44,841,085           |
| Due to VI Government                     |                      |   |  |   |   |  | 24,061,557                     | 24,061,557           |
| Payable from assets held in trust        |                      |   |  |   |   |  |                                |                      |
| <b>Total liabilities</b>                 | <b>(172,499)</b>     | <b>225,407,812</b>                          | <b>47,383,076</b>  | <b>4,500</b>  | <b>22,568,450</b>                       | <b>17,287,839</b>                        | <b>24,159,014</b>              | <b>336,638,192</b>   |
| Equity:                                  |                      |   |  |   |   |  |                                |                      |
| Contributed capital                      |                      |   |  |   |   | 6,000,000                                |                                | 6,000,000            |
| Retained earnings:                       |                      |   |  |   |   |  |                                |                      |
| Restricted                               |                      | 3,241,674                                   | 4,138,963  | 677,669   | 1,197,746                               | 8,395,882                                | 7,150,584                      | 24,802,518           |
| Unrestricted                             | 757,567              | 3,241,674                                   | 4,138,963  | 677,669   | 1,197,746                               | 8,395,882                                | 7,150,584                      | 25,560,085           |
|  | 757,567              | 3,241,674                                   | 4,138,963  | 677,669   | 1,197,746                               | 14,395,882                               | 7,150,584                      | 31,560,085           |
| <b>Total equity</b>                      | <b>\$ 585,068</b>    | <b>\$228,649,486</b>                        | <b>\$51,522,039</b>  | <b>\$682,169</b>  | <b>\$23,766,196</b>                     | <b>\$31,683,721</b>                      | <b>\$31,309,598</b>            | <b>\$368,198,277</b> |
| <b>Total liabilities and equity</b>      |                      |   |  |   |   |  |                                |                      |

**Virgin Islands Public Finance Authority**  
**Combining Statement of Revenues, Expenses and Retained Earnings**  
**Year ended September 30, 1997**

|  | Operating<br>Account | Revenue Bonds<br>Series 1992 A<br>and Series 1992<br>B Account | Revenue Bonds<br>Series 1994 A,<br>Series 1994 B<br>and Series 1994<br>C Account | Government<br>Construction<br>and Revolving<br>Loan Account | Transportation<br>Trust Fund<br>Account | The West<br>Indian<br>Company<br>Account | Depository<br>Trust<br>Account | Total        |
|--|----------------------|--|--|---|---|--|--------------------------------|--------------|
| <b>Revenues</b>                        |                      |  |  |   |   |  |                                |              |
| Taxes, fees and fines                  |                      |  |  |   | \$ 12,969,366                           |  |                                | \$12,969,366 |
| Interest income:                       |                      |  |  |   |   |  |                                |              |
| Loans receivable                       |                      | \$15,114,238   | \$2,518,928  |   |   |  |                                | 17,633,166   |
| Investments                            | \$ 28,107            | 1,855,365  | 1,368,672  | \$ 31,244   | 1,414,182                               | \$ 385,590                               | \$ 829,521                     | 5,912,681    |
| Other income                           |                      |  |  |   |   | 8,868,603                                |                                | 8,868,603    |
|  | 28,107               | 16,969,603   | 3,887,600  | 31,244  | 14,383,548                              | 9,254,193                                | 829,521                        | 45,383,816   |
| <b>Expenses</b>                        |                      |  |  |   |   |  |                                |              |
| Interest                               |                      | 15,114,238   | 2,518,928  |   | 1,487,208                               | 862,737                                  |                                | 19,983,111   |
| General and administrative             | 898,117              | 141,482  | 39,748   |   | 431,940                                 | 5,600,425                                |                                | 7,111,712    |
| Amortization                           |                      |  | 36,725   |   | 87,732                                  |  |                                | 124,457      |
| Capital expenditure grants             |                      |  |  |   | 6,662,721                               |  |                                | 6,662,721    |
|  | 898,117              | 15,255,720   | 2,595,401  |   | 8,669,601                               | 6,463,162                                |                                | 33,782,001   |
|  | (870,010)            | 1,713,883  | 1,292,199  | 31,244  | 5,713,947                               | 2,791,031                                | 829,521                        | 11,501,815   |
| Income before interfund transfers      |                      |  |  |   |   |  | (809,349)                      | -            |
| Interfund transfers                    | 869,112              |  | (10,393)   |   | (49,370)                                |  |                                | -            |
| Income before transfers                | (898)                | 1,713,883  | 1,281,806  | 31,244  | 5,664,577                               | 2,791,031                                | 20,172                         | 11,501,815   |
| Transfers to VI Government             |                      | (1,355,000)  |  |   | (14,192,640)                            |  |                                | (15,547,640) |
| Net income (loss)                      | (898)                | 358,883  | 1,281,806  | 31,244  | (8,528,063)                             | 2,791,031                                | 20,172                         | (4,045,825)  |
| Retained earnings at beginning of year | 758,465              | 2,882,791  | 2,857,157  | 646,425   | 9,725,809                               | 5,604,851                                | 7,130,412                      | 29,605,910   |
| Retained earnings at end of year       | \$ 757,567           | \$ 3,241,674   | \$ 4,138,963   | \$ 677,669  | \$ 1,197,746                            | \$ 8,395,882                             | \$ 7,150,584                   | \$25,560,085 |

**Virgin Islands Public Finance Authority**  
**Combining Statement of Cash Flows**  
**Year ended September 30, 1997**

|   | Operating<br>Account | Revenue Bonds<br>Series 1992 A<br>and Series 1992<br>B Account | Revenue Bonds<br>Series 1994 A,<br>Series 1994 B<br>and Series 1994<br>C Account | Government<br>Construction<br>and<br>Revolving<br>Loan Account | Transportation<br>Trust Fund<br>Account | The West<br>Indian<br>Company<br>Account | Depository<br>Trust<br>Account | Total          |
|---|----------------------|--|--|--|---|--|--------------------------------|----------------|
| <b>Revenues</b>   |                      |  |  |  |   |  |                                |                |
| Net income (loss)   | \$ (898)             | \$ 358,883   | \$ 1,281,806   | \$ 31,244  | \$ (8,528,063)                          | \$ 2,791,031                             | \$ 20,172                      | \$ (4,045,825) |
| Adjustments to reconcile new income<br>(loss) to net cash (used) provided by<br>operating activities: |                      |  |  |  |   |  |                                |                |
| Amortization  |                      |  | 36,724   |  | 87,732                                  | 29,935                                   |                                | 154,391        |
| Depreciation  |                      |  |  |  |   | 718,638                                  |                                | 718,638        |
| Gain on sale of property and equipment  |                      |  |  |  |   | (1,346)                                  |                                | (1,346)        |
| Changes in operating assets and liabilities:  |                      |  |  |  |   |  |                                |                |
| Accounts receivable and other assets  |                      |  | (2,753)  |  |   | (70,907)                                 |                                | (73,660)       |
| Cash and other assets held in trust   |                      |  |  |  |   | 52,122                                   |                                | 52,122         |
| Due to/from PFA operating account   | 12,939               |  | (13,263)   |  | 181,162                                 | (303,898)                                | (4,120)                        | (127,180)      |
| Accrued expenses and other liabilities  |                      | (218,577)  | (3,955,564)  |  | 561,095                                 |  |                                | (3,613,046)    |
| Due to VI Government  |                      |  |  |  |   |  | 6,550,185                      | 6,550,185      |
| Payable from assets held in trust   |                      |  |  |  |   |  | 6,566,237                      | (385,721)      |
| Net cash (used in) provided by operating activities   | 12,041               | 140,306  | 2,653,050  | 31,244   | (7,698,074)                             | 3,215,575                                |                                |                |
| <b>Investing activities</b>   |                      |  |  |  |   |  |                                |                |
| Purchase of investments   |                      | (136,244,786)  | (3,244,179)  | (31,244)   | (175,395,057)                           | (8,704,247)                              | (86,158,613)                   | (409,778,126)  |
| Investment maturities   |                      | 136,104,480  | 6,170,383  | 180,000  | 184,909,726                             | 5,700,000                                | 79,592,376                     | 412,656,965    |
| Principal payments on loans receivable  |                      | 4,705,000  | 1,055,000  |  |   | 74,831                                   |                                | 5,760,000      |
| Proceeds from sale of property and equipment  |                      |  |  |  |   |  |                                | 74,831         |
| Net cash provided by (used in) investing activities   |                      | 4,564,694  | 3,981,204  | 148,756  | 9,514,669                               | (2,929,416)                              | (6,566,237)                    | 8,713,670      |
| <b>Capital and related financing activities</b>   |                      |  |  |  |   |  |                                |                |
| Principal payments on bonds and loans payable   |                      | (4,705,000)  | (1,055,000)  |  | (1,845,000)                             | (583,696)                                |                                | (8,188,696)    |
| Loan to V.I. Government Development Bank  |                      |  |  | (180,000)  |   |  |                                | (180,000)      |
| Net cash used in capital and related financing activities   |                      | (4,705,000)  | (1,055,000)  | (180,000)  | (1,845,000)                             | (583,696)                                |                                | (8,368,696)    |
| Net increase (decrease) in cash   | 12,041               | -  | -  | -  | (28,405)                                | (297,537)                                | -                              | (40,747)       |
| Cash at beginning of year   | 573,027              | -  | -  | -  | 200,912                                 | 879,233                                  | -                              | 1,653,172      |
| Cash at end of year   | \$ 585,068           | \$ -   | \$ 273,154   | \$ -   | \$ 172,507                              | \$ 581,696                               | \$ -                           | \$ 1,612,425   |

## APPENDIX F

### UNITED STATES VIRGIN ISLANDS

#### General

Under the terms of the Revised Organic Act, the Virgin Islands is an unincorporated territory of the United States with separate executive, legislative and judicial branches of government. The legislative power of the Virgin Islands is vested in the Legislature, a unicameral, popularly elected body consisting of 15 members who serve two-year terms (the "Legislature"). The Legislature has jurisdiction over "all rightful subjects of legislation" not inconsistent with the laws of the United States made applicable to the Virgin Islands.

Executive power resides with a Governor and a Lieutenant Governor who are elected every four years. The Governor is responsible for execution of local laws, administration of all activities of the executive branch and appointment of department heads and other employees. The current Governor of the Virgin Islands is the Honorable Roy L. Schneider, M.D. and the current Lieutenant Governor is the Honorable Kenneth E. Mapp, both of whom originally assumed office on January 2, 1995, and whose current terms expire on January 2, 1999.

Judicial power is vested in the District Court of the Virgin Islands, which has jurisdiction of a District Court of the United States, and in the Territorial Court of the Virgin Islands, a court established by local law with jurisdiction over all local matters. Within the District Court there is an appellate division which reviews judgments of the Territorial Court. The United States Court of Appeals for the Third Circuit has appellate jurisdiction over the District Court and its appellate division. The judges of the District Court of the Virgin Islands are appointed by the President of the United States with the advice and consent of the United States Senate and have lifetime appointments. The Territorial Court judges are appointed by the Governor and confirmed by the Legislature and serve for terms of six years.

As an unincorporated territory of the United States, the Virgin Islands is subject to the power of Congress to make rules and regulations respecting the Virgin Islands, pursuant to Article IV, Section 3 of the Constitution of the United States.

Residents of the Virgin Islands have been citizens of the United States since 1917. However, apart from express Congressional grants of rights, such as the Bill of Rights in Section 3 of the Revised Organic Act, residency in the Virgin Islands does not carry with it the full range of rights which accompany citizenship in any of the states.

Residents of the Virgin Islands do not have the right to vote in national elections for the President and Vice President of the United States. The Virgin Islands has an elected, non-voting delegate to the United States House of Representatives. The delegate may vote in legislative committees and participate in floor debate but may not vote in Congress acting as a Committee of the Whole.

#### Economic and Demographic Information

##### *Geography, Landscape and Climate*

The United States Virgin Islands — also known as the U.S. Virgin Islands or more commonly the Virgin Islands — is located some 1,600 miles southeast of New York City, about 1,075 miles from Miami, and 60 miles east of Puerto Rico. Approximately 70 small islands, islets and cays make up the Virgin Islands. The principal islands are St. Croix, St. Thomas, St. John and Water Island. St. Croix, the largest of the four islands, has an area of 84 square miles and lies entirely in the Caribbean Sea. It is marked by undulating hills that rise gently to the north and lagoons that lie on the south coast. It has two main urban centers—Christiansted to the north and Frederiksted to the west—both lie on a broad central plain. St. Thomas, which lies approximately three miles west of St. John, is 32 square miles in area. It is distinguished by a ridge of east-west hills that rise abruptly from the sea. It is marked by numerous sandy beaches along the shoreline, including Magens Bay, considered one of

the finest beaches in the Caribbean. The main urban center Charlotte Amalie, which also is the capital of the Virgin Islands, is surrounded by a landlocked harbor. St. John is a 20-mile square area located approximately three miles east of St. Thomas. Its topography is similar to St. Thomas with steep, rugged hills and white-sandy beaches. About two-thirds of the island is preserved as the Virgin Islands National Park. Water Island is located just a few hundred yards from the harbor in Charlotte Amalie. Water Island was transferred to the Virgin Islands in December 1996 from the exclusive jurisdiction of the Department of Interior. The Virgin Islands boasts a near-perfect climate throughout the year, with temperatures ranging between 70°F and 90°F with an average of 78°F. Humidity is low and annual rainfall averages 40 inches.

### *Population*

The 1995 Population and Housing Survey estimates the population of the Virgin Islands at 109,677. St. Thomas has the largest population—54,289 people. There are 51,389 people on St. Croix and 4,030 people on St. John. The latest population estimate for 1996 is 113,245 people.

**Table 1**  
**United States Virgin Islands**  
**Population**  
**1992-1996**

| <u>Year</u> | <u>Population</u> | <u>Percentage Increase (Decrease)</u> |
|-------------|-------------------|---------------------------------------|
| 1992        | 106,869           | 1.8                                   |
| 1993        | 108,705           | 1.7                                   |
| 1994        | 110,440           | 1.6                                   |
| 1995        | 109,667           | (0.7)                                 |
| 1996        | 113,245           | 3.3                                   |

Sources: United States Census Bureau; and the Eastern Caribbean Center, University of the Virgin Islands.

### **Employment**

Civilian employment grew by 1.2 percent between 1987 and 1997 — from 43,600 to 44,140. As shown in Table 2 below, employment peaked in 1993, a result of industrial-related construction activity driven in part by repair of hurricane damage, an increase in tourist trade and an increase in local consumer demand. The most recent decline in employment is partly attributed to a downturn in tourism and a decrease in jobs following Hurricane Marilyn in 1995. In recent months, however, there has been a steady expansion in the job market. In 1997, the Virgin Islands' labor force grew by 2.5 percent to 46,890. Modest growth in employment is expected to continue due to continued reconstruction activity, the Government capital improvement program to be financed in part with 1998 Bond proceeds and tourism-related development.

With the exception of 1995, the Virgin Islands unemployment rate has been consistently lower than the average for the United States. After reaching a record low of 2.8 percent in both 1990 and 1991, the unemployment rate rose to 3.5 percent in 1992 and 1993. Since 1994, the unemployment rate for the Virgin Islands has been at an average of 5.5 percent. The Virgin Islands unemployment rate in 1997 was 5.7 percent. While St. Croix's unemployment rate increased to 6.5 percent in 1997, St. John and St. Thomas registered declines in their unemployment rates to 5.2 percent.

The following table presents total labor force and total employment for the Virgin Islands and unemployment rates for the Virgin Islands and the United States for the years 1992 through 1997.

**Table 2**  
**United States Virgin Islands Labor Force,**  
**Employment, Unemployment and Unemployment Rates and**  
**The United States Unemployment Rates**  
**1992-1997**

| <u>Year</u> | <u>Labor Force</u> | <u>Employment</u> | <u>Unemployment<br/>Rate<br/>Virgin Islands</u> | <u>Unemployment<br/>Rate<br/>United States</u> |
|-------------|--------------------|-------------------|---|--|
| 1992        | 49,940             | 48,210            | 3.5   | 7.5  |
| 1993        | 53,530             | 51,780            | 3.5   | 6.9  |
| 1994        | 50,380             | 47,550            | 5.6   | 6.1  |
| 1995        | 47,810             | 45,070            | 5.7   | 5.6  |
| 1996*       | 45,450             | 43,060            | 5.2   | 5.4  |
| 1997        | 46,830             | 44,140            | 5.7   | 4.7  |

**Sources:** Virgin Islands Bureau of Labor Studies Reports; and the U.S. Department of Labor, Bureau of Labor Statistics.

\* Hurricane Marilyn struck the Virgin Islands in September 1995 resulting in substantial damage to the islands and a significant disruption of business operations resulting in reduced employment.

Private sector employment is fueled by tourism and related services. In 1997, services were the largest share of private sector employment accounting for 35 percent. Wholesale and retail trade accounted for 34%, while construction, mining and manufacturing accounted for 16%. Federal and local government accounted for 13,800 jobs or 24.5% of total employment in 1997 with local government accounting for 93% of all public sector jobs (See Table 3). Government employment fell slightly in 1997 to 13,800 from 14,040 in 1996. A small decline in both the Territorial Government and federal government employment caused the public sector employment to decline by 1.7%. Reduction in Territorial Government staff due to retirement and resignations accounted for the drop in the public payroll, while the decline in federal jobs resulted from a cut-back in staff no longer required for hurricane relief efforts.

The following table sets forth annual wage and salary employment by sector for the years 1992 to 1997.

**Table 3**  
**Annual Wage and Salary Employment**  
**United States Virgin Islands**  
**1992-1997**

|  | <u>1992</u>  | <u>1993</u>   | <u>1994</u>   | <u>1995</u>   | <u>1996</u>  | <u>1997</u>   |
|--|--------------|---------------|---------------|---------------|--------------|---------------|
| Private sector                               | 30,930       | 34,740        | 30,810        | 28,550        | 26,980       | 28,500        |
| Construction & mining                        | 4,010        | 5,440         | 1,890         | 1,370         | 2,400        | 2,200         |
| Manufacturing                                | 2,810        | 2,870         | 2,900         | 2,500         | 2,340        | 2,210         |
| Transportation, comm.<br>& public utilities  | 2,610        | 2,670         | 2,680         | 2,580         | 2,280        | 2,420         |
| Wholesale & retail trade                     | 9,780        | 10,460        | 10,690        | 9,890         | 9,200        | 9,790         |
| Finance, insurance<br>& real estate          | 2,050        | 2,260         | 2,140         | 1,820         | 1,790        | 1,830         |
| Services                                     | <u>9,670</u> | <u>11,040</u> | <u>10,510</u> | <u>10,390</u> | <u>8,970</u> | <u>10,050</u> |
| Non-agricultural wage<br>& salary employment | 44,810       | 48,650        | 44,620        | 42,260        | 41,020       | 42,300        |
| Federal government                           | 810          | 820           | 850           | 1,020         | 970          | 900           |
| Territorial government                       | 13,070       | 13,090        | 12,960        | 12,690        | 13,070       | 12,900        |

Source: Virgin Islands Bureau of Labor Statistics.

The following table sets forth selected tourism - related employment for the years 1992 to 1997.

**Table 4**  
**Selected Tourism-related Employment**  
**U. S. Virgin Islands**  
**1992-1997**

|                                     | <u>1992</u> | <u>1993</u> | <u>1994</u> | <u>1995</u> | <u>1996*</u> | <u>1997</u> |
|-------------------------------------|-------------|-------------|-------------|-------------|--------------|-------------|
| Hotels & Other Lodging<br>Places    | 3,750       | 4,220       | 4,250       | 3,910       | 2,580        | 3,380       |
| Gifts Shops                         | 2,420       | 2,450       | 2,400       | 2,210       | 2,080        | 2,060       |
| Eating & Drinking Places            | 2,360       | 2,590       | 2,420       | 2,290       | 1,980        | 2,030       |
| Transportation                      | <u>580</u>  | <u>650</u>  | <u>610</u>  | <u>570</u>  | <u>500</u>   | <u>500</u>  |
| Total tourism-related<br>employment | 9,110       | 9,910       | 9,600       | 8,980       | 7,140        | 7,990       |

Source: Virgin Islands Bureau of Labor Statistics.

\* Hurricane Marilyn struck the Virgin Islands in September 1995 resulting in substantial damage to the islands and a reduction in tourism and business operations causing reduced employment.

Presented below are the ten largest private sector employers in the Virgin Islands.

**Table 5**  
**United States Virgin Islands**  
**Ten Largest Employers**  
**(1997)**

| <u>Name of Employer</u>                | <u>Principal Business</u> |
|--|---------------------------|
| Hess Oil V.I. Corp.                    | Oil Refining              |
| Industrial Maintenance Corp.           | Maintenance               |
| Frenchman's Reef Beach Resort          | Resort Hotel              |
| Pueblo International                   | Supermarkets              |
| Kmart Corp.                            | Department Store          |
| Caneel Bay Corp.                       | Resort Hotel              |
| V.I. Telephone Corp.                   | Utility                   |
| C & C Construction & Maintenance Corp. | Construction              |
| Ritz-Carlton V.I.                      | Resort Hotel              |
| The Westin Resorts                     | Resort Hotel              |

Source: Virgin Islands Department of Labor, Bureau of Labor Statistics.

### **Tourism**

In 1997, 2.1 million visitors arrived in the Virgin Islands, an approximately 20% increase over the previous year. Air arrivals have rebounded within the past year, up 10.1% to 509,200 from 462,300 in 1996. A record number of 1.6 million cruise passengers arrived in the Virgin Islands in 1997, an increase of 23% over 1996. Hotel occupancy declined in 1996 to 51.6%, due to Hurricane Marilyn, rising slightly to 53.3% in 1997. Total room nights occupied in the Virgin Islands increased by 15% in 1997 over 1996, from 722.0 to 828.7.

**Table 6**  
**United States Virgin Islands**  
**Visitor Arrivals (thousands)**  
**1992-1997**

|                             | <u>1992</u>    | <u>1993</u>    | <u>1994</u>    | <u>1995</u>    | <u>1996</u>    | <u>1997</u>    |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>U.S. Virgin Islands:</b> |                |                |                |                |                |                |
| Air Visitors                | 652.4          | 714.5          | 678.5          | 570.0          | 462.3          | 509.2          |
| Cruise Passengers           | <u>1,277.3</u> | <u>1,208.7</u> | <u>1,242.9</u> | <u>1,171.3</u> | <u>1,316.4</u> | <u>1,619.0</u> |
| Total Visitors              | <u>1,929.7</u> | <u>1,923.1</u> | <u>1,921.4</u> | <u>1,741.3</u> | <u>1,778.7</u> | <u>2,128.2</u> |
| <b>St. Thomas\St. John:</b> |                |                |                |                |                |                |
| Air Visitors                | 490.5          | 544.9          | 535.3          | 433.4          | 310.3          | 368.2          |
| Cruise Passengers           | <u>1,272.0</u> | <u>1,195.3</u> | <u>1,226.6</u> | <u>1,066.5</u> | <u>1,308.2</u> | <u>1,560.2</u> |
| Total Visitors              | <u>1,762.5</u> | <u>1,740.2</u> | <u>1,761.9</u> | <u>1,499.9</u> | <u>1,618.5</u> | <u>1,928.4</u> |
| <b>St. Croix:</b>           |                |                |                |                |                |                |
| Air Visitors                | 161.9          | 169.5          | 143.2          | 136.6          | 152.0          | 141.0          |
| Cruise Passengers           | <u>35.9</u>    | <u>31.3</u>    | <u>53.5</u>    | <u>229.8</u>   | <u>88.2</u>    | <u>178.0</u>   |
| Total Visitors              | <u>197.8</u>   | <u>200.8</u>   | <u>196.7</u>   | <u>366.4</u>   | <u>240.2</u>   | <u>319.0</u>   |

\* Actual, not thousands.

Source: United States Virgin Islands Bureau of Economic Research.



**Table 7**  
**United States Virgin Islands**  
**Hotel and Other Tourist Accommodations**  
**1992-1997**

|                              | <u>1992</u> | <u>1993</u> | <u>1994</u> | <u>1995</u> | <u>1996</u> | <u>1997</u> |
|------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>St. Thomas/ St. John:</b> |             |             |             |             |             |             |
| Total rooms/units            | 3,911       | 4,184       | 4,193       | 3,898       | 2,876       | 3,237       |
| Number of hotels             | 39          | 39          | 37          | 34          | 27          | 31          |
| Condominium/other units      | 804         | 833         | 827         | 730         | 581         | 678         |
| Occupancy rate (percent)     | 56.8        | 62.0        | 62.0        | 63.3        | 52.5        | 55.4        |
| <b>St. Croix:</b>            |             |             |             |             |             |             |
| Total rooms/units            | 1,138       | 1,221       | 1,268       | 1,257       | 1,211       | 1,168       |
| Number of hotels             | 20          | 21          | 23          | 22          | 21          | 21          |
| Condominium/other units      | 402         | 335         | 332         | 341         | 344         | 339         |
| Occupancy rate (percent)     | 46.8        | 56.8        | 41.6        | 45.8        | 49.8        | 47.1        |
| <b>U. S. Virgin Islands:</b> |             |             |             |             |             |             |
| Total rooms/units            | 5,050       | 5,406       | 5,461       | 5,154       | 4,087       | 4,406       |
| Number of hotels             | 59          | 60          | 59          | 57          | 48          | 52          |
| Condominium/other units      | 1,206       | 1,167       | 1,160       | 1,071       | 925         | 1,018       |
| Occupancy rate (percent)     | 54.7        | 60.9        | 57.4        | 59.0        | 51.6        | 53.3        |

Source: United States Virgin Islands Bureau of Economic Research.

**Table 8**  
**United States Virgin Islands**  
**Visitor Expenditures (millions of dollars)**  
**1992-1997**

|                                      | <u>1992</u>  | <u>1993</u>  | <u>1994</u>  | <u>1995</u>  | <u>1996</u>  | <u>1997</u>  |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>United States Virgin Islands:</b> |              |              |              |              |              |              |
| Tourists                             | \$519.7      | \$615.0      | \$621.1      | \$534.7      | \$336.1      | \$281.6      |
| Excursionists                        | 296.5        | 286.7        | 298.5        | 287.6        | 351.9        | 319.6        |
| Day-trip by air                      | 31.7         | 31.0         | 27.0         | 23.0         | 34.6         | 31.3         |
| Cruise passengers                    | <u>264.7</u> | <u>255.7</u> | <u>271.5</u> | <u>264.6</u> | <u>317.2</u> | <u>288.3</u> |
| Total expenditures                   | \$816.1      | \$901.7      | \$919.6      | \$822.3      | \$688.0      | \$601.2      |

Source: United States Virgin Islands Bureau of Economic Research.

## **Tax Incentives Programs**

The Government offers various tax incentives which promote industrial and economic development in the Virgin Islands. The most notable incentive program was created by the Legislature in October 1975. The Industrial Development Commission (the "Commission") was created to promote the growth, development and diversification of the economy of the Virgin Islands (the "Industrial Development Program"). Qualifying businesses—corporations, partnerships or sole proprietorships—receive various benefits if they meet certain criteria.

To qualify for tax incentives, investors must invest at least \$50,000, exclusive of inventory, in an eligible business and employ at least ten Virgin Islands residents full-time. A beneficiary receives a substantial reduction in, or an exemption from, all taxes imposed on businesses. Most importantly, the industrial development legislation permits a 90% income tax reduction, resulting in a maximum tax rate of less than four percent on income for approved operations. Tax benefits also extend to passive income from certain qualifying investments, such as the Virgin Islands government obligations. The 90% reduction extends to dividends received by a beneficiary's Virgin Islands resident shareholders. Currently, over 70 enterprises are operating with incentive benefits granted pursuant to the Industrial Development Program, and an additional nine enterprises are awaiting final certification to the Commission. Investors receiving tax benefits under this program include hotels and other tourism-related businesses, goods-producing enterprises, and businesses serving customers outside the Territory.

## **Transportation**

The Virgin Islands are accessible by air from around the world. The Cyril E. King Airport Terminal on St. Thomas was completed and opened in October 1990. The expansion of the runway to 7,000 feet was completed and opened in December 1992.

The Henry E. Rohlsen Airport Terminal on St. Croix is currently undergoing major renovation and expansion and is slated for completion in late 1999. Upon completion, the terminal's square footage will double its existing size to 181,000 square feet. Talks are underway and funding is being sought through the Federal Aviation Administration to expand the runway from 7,600 feet to 10,000 feet.

The island of St. John can be reached by seaplane and ferry boat. Inter-island ferry service provides, several times daily, passenger service between St. Thomas and the nearby British Virgin Islands. The Virgin Islands internal transportation needs are served by a large number of taxis, taxivans, open-air buses, the public transit system (VITRAN) and rental cars.

## **Financial Management, Budgeting and Controls**

### *Budgetary Process*

The Fiscal Year of the Government begins on October 1 of each year. The Governor is required by law to submit to the Legislature an annual budget of capital improvements and operating expenses for the following Fiscal Year no later than May 30. The Fiscal Year 1998 Budget was submitted by the Governor to the Legislature on May 30, 1997, and approved by the Legislature on September 26, 1997. The annual budget is prepared by the Virgin Islands Office of Management and Budget ("OMB"), working in conjunction with other Government departments and agencies. If a budget has not been approved before the commencement of any Fiscal Year, then the appropriations for the preceding Fiscal Year, insofar as they may be applicable, are automatically deemed reappropriated item by item.

The Legislature, in its consideration of the budget for each Fiscal Year, may modify or change the Governor's submission. The Legislature is obligated by law to pass a final budget no later than September 30, the last day of the Fiscal Year. Upon passage by the Legislature, the budget is submitted to the Governor, who may eliminate any item by a line-item veto but not increase or insert any new item in the budget. The Governor also

may veto the budget in its entirety and return it to the Legislature with his objections. The Legislature may override any veto by the Governor (including any line-item veto) only by a vote of two-thirds of its members.

Once the budget is enacted, fiscal control over expenditures made pursuant thereto is exercised by the Governor through the Director of OMB. During any Fiscal Year in which the resources available to the Government are not sufficient to cover the appropriations approved for such year, the Governor, through the Director of OMB, may take administrative measures to reduce expenses. The Governor also may make recommendations to the Legislature for new taxes, or any other necessary action to meet the estimated deficiency. It has been the practice of the Director of OMB, when making funding adjustments, to allot funds in the following order of priority: to the payment of the interest on and amortization requirements for public debt; to the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain and certain commitments to protect the name, credit and good faith of the Government; and to current expenditures in the areas of health, protection, education and welfare.

#### *Fund Structure and Accounts*

The Government maintains certain funds pursuant to authority set forth in the United States Virgin Islands Code.

The Government has established three fund types: Governmental Fund Types, Proprietary Fund Types and Fiduciary Fund Types, and two account groups: General Fixed Assets Account Group and General Long-Term Debt Account Group. Although General Fixed Assets and General Long-Term Debt are classified as account groups, these account groups possess the basic characteristics of funds.

Government Fund Types include the General Fund, the Special Revenue Funds, the Debt Service Funds and the Capital Projects Funds. The Proprietary Fund Types are composed of the Enterprise Funds. The Expendable Trust Funds, Pension Trust Fund and Agency Funds comprise the Fiduciary Fund Types.

The General Fund is the Government's largest fund as it accounts for the operations of the three branches of government. The General Fund accounts for all revenues and receipts not required to be accounted for, or deposited in, other funds and for the major portion of Government expenditures. Tax receipts represent the majority of the General Fund revenues.

#### *Basis of Accounting*

The Government utilizes a modified accrual basis of accounting. Revenues in the Governmental Fund Types are recognized when the cash is received and expenditures when paid or when accounts payable are recorded. Uncollected revenues are reflected as receivables. Provisions for receivables and payables are established at year end in the report of undesignated fund balance.

Expenditures are made pursuant to an allotment process. Budgetary control is exercised at the department level and through the allotment process. Encumbrances and expenditures cannot exceed total allotment amounts. Encumbrances are employed to record purchase orders, contracts and other commitments so that the appropriate amounts of appropriations are reserved to cover future estimated expenditures. Encumbrances outstanding at year end are reported as reservations of fund balance for the subsequent year's expenditures. The authority to liquidate the encumbrance, provided no service has been rendered, is carried forward with the appropriation. Before September 30 of the next Fiscal Year, the Government must administratively liquidate outstanding encumbrances unless funding is available until expended, or an administrative determination is executed by the Commissioner of Finance. In the Proprietary Fund Types, revenues are accrued.

## *Financial Reporting*

The annual reports of the financial operations of the Government, to date, have not been audited by independent accountants since Fiscal Year 1994. The Government has contracted with KPMG Peat Marwick LLP to audit the financial statements of the Government for Fiscal Years 1995 and 1996. The audit is to be performed in accordance with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB) which is the standard-setting body for establishing accounting and reporting principles. Audited financial statements for Fiscal Year 1995 are expected by May 30, 1998 and for Fiscal Year 1996 by December, 1998.

KPMG Peat Marwick LLP has not reviewed any information presented in this Official Statement nor has KPMG Peat Marwick LLP participated in the preparation of the discussion of the section of this Official Statement included in this Appendix F - United States Virgin Islands - entitled "Financial Position of the Government" or this subsection "Financial Reporting" presented in this Official Statement.

## **Revenues and Expenditures of the Government**

### *General*

The principal sources of revenues for the Government are: United States federal income taxes (collected locally as Virgin Islands income tax); real property taxes; taxes and fees levied by the Government under its own locally applicable internal revenue laws; federal excise taxes imposed on goods entering the United States from the Virgin Islands and other fees and taxes collected by the federal government (such as Matching Fund Revenues and customs duties).

The Revised Organic Act sets forth the taxes imposed by the United States Government, the proceeds of which are paid into the Treasury of the Virgin Islands, including: customs duties, the United States income tax, any taxes levied by Congress on the inhabitants of the Virgin Islands, and quarantine, passport, immigration and naturalization fees collected in the Virgin Islands. In addition, the Government has the power to impose local taxes which include real property taxes, gross receipts taxes, excise taxes and hotel room taxes. There are no political subdivisions with taxing power in the Virgin Islands.

### *Matching Fund Revenues*

The Federal excise tax on rum exports from the Virgin Islands to the United States currently accounts for all of the Matching Fund Revenues. Rum is the principal article presently produced in the Virgin Islands and exported to the United States which is subject to Federal excise tax that qualifies for transfer to the Government. (See "MATCHING FUND REVENUES".)

## **Additional Tax Revenues**

*General.* Tax collections from tax sources for Fiscal Years 1991 to 1997 are presented below. For a description of the Government program to provide tax relief and subsidies to certain businesses to promote economic growth, see "ECONOMIC AND DEMOGRAPHIC INFORMATION - Tax Incentive Programs".

**Table 9**  
**Components of General Fund**  
**For Fiscal Years 1992-1997**  
**(in thousands)**

| <b>TAXES</b>                 | <b>1992(a)</b>          | <b>1993(a)</b>          | <b>1994(b)</b>          | <b>1995(c)</b>          | <b>1996(c)</b>          | <b>1997(c)</b>          |
|------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Real Property                | \$ 32,938               | \$ 51,785               | \$ 35,208               | \$ 50,590               | \$ 20,110               | \$ 45,682               |
| Income                       | 210,266                 | 247,245                 | 223,286                 | 222,952                 | 210,841                 | 214,406                 |
| Gross Receipts               | 84,411                  | 89,063                  | 79,198                  | 76,689                  | 85,378                  | 86,622                  |
| Trade & Excise               | 15,319                  | 15,773                  | 14,868                  | 12,541                  | 18,006                  | 12,134                  |
| Other Taxes                  | <u>4,126</u>            | <u>3,479</u>            | <u>2,616</u>            | <u>2,773</u>            | <u>2,596</u>            | <u>3,539</u>            |
| <b>Total Taxes</b>           | <b>\$347,058</b>        | <b>\$407,345</b>        | <b>\$355,176</b>        | <b>\$365,545</b>        | <b>\$334,932</b>        | <b>\$362,383</b>        |
| Other Sources of Revenue (d) | <u>15,260</u>           | <u>19,665</u>           | <u>14,158</u>           | <u>12,411</u>           | <u>12,395</u>           | <u>12,032</u>           |
| <b>Total Revenues</b>        | <b><u>\$362,318</u></b> | <b><u>\$427,010</u></b> | <b><u>\$369,334</u></b> | <b><u>\$377,956</u></b> | <b><u>\$347,327</u></b> | <b><u>\$374,418</u></b> |

Source: Virgin Islands Department of Finance.

(a) Presented from the 1992 CAFR and 1993 CAFR on a non-GAAP basis.

(b) General Purpose Financial Statement.

(c) Unaudited revenue reports of the Department of Finance.

(d) Other Sources of Revenues include fees, permits, licenses, custom duties and miscellaneous service charges.

**Income Taxes.** The principal source of revenue for the Government is income taxes. The Naval Appropriations Act, 1922, and Section 28(a) of the Revised Organic Act created a separate tax structure for the Virgin Islands that mirrors the Code.

A United States taxpayer who is a permanent resident of the Virgin Islands satisfies his United States income tax obligations by filing his return with, and paying income taxes to, the Government, even if his income is from non-Virgin Islands sources. A non-resident of the Virgin Islands pays income taxes on his Virgin Islands source income to the Government, and is entitled to a foreign tax credit therefor on his United States Federal tax return if the taxpayer is a United States citizen or United States domestic corporation.

In Fiscal Year 1997, income tax collections were approximately \$214.4 million, comprising 57.3% of General Fund Revenues and in Fiscal Year 1996, income tax collections were approximately \$210,841 comprising 60.7% of the General Fund.

**Real Property Taxes.** The Government imposes a tax on all real property in the Virgin Islands equal to 1.25% of the assessed valuation of such property. The assessed value of the real property is equal to 60% of its appraised value, as defined by statute. Noncommercial real property is reassessed every two years and commercial real property is reassessed annually. The proceeds of this tax are paid into the General Fund, with the exception of the first \$1.5 million of such tax collected annually, which must be deposited into the St. John Capital Improvements Fund.

All real property not expressly exempt is subject to the real property tax. Exemptions include (i) property of the Federal government, (ii) property of the Government, (iii) property used for religious, educational, literary, scientific and charitable purposes, (iv) property subject to the homestead exemption, and (v) property for which exemptions have been granted by the Industrial Development Commission.

In Fiscal Year 1997, real property taxes were approximately \$45.7 million, comprising 12.2% of General Fund Revenues and in Fiscal Year 1996, real property taxes were approximately \$20.1 million comprising approximately 5.8% of General Fund Revenues.

*Gross Receipts Tax.* Individuals and entities doing business in the Virgin Islands are required to pay a tax of 4.0% on the gross receipts of such business. The tax is broad and extends to most sellers of services and goods. The proceeds of the gross receipts tax are paid into the General Fund, except that the first \$250,000 of such tax collected annually must be deposited in the Moderate Income Housing Fund. "Gross receipts" means "all receipts, cash or accrued, of the taxpayer for services or derived from trade, business, commerce or sales, and the value accruing from the sale of tangible personal property or services, or both, including rentals, fees and other involvements, however designated, without any deduction on account of the cost of the property sold, the cost of materials used, labor cost, royalties, taxes, interest or discount paid, and any other expenses whatsoever".

Certain businesses are exempt from the application of the gross receipts tax. For example, every person, partnership, firm, corporation or association whose gross receipts are less than \$150,000 per annum is allowed a \$5,000 exemption per month or a \$60,000 exemption per annum. In Fiscal Year 1996, real gross receipts taxes were approximately \$85.4 million, comprising 24.6% of General Fund revenues and in Fiscal Year 1997, were approximately \$86.6 million, comprising 23.1% of General Fund revenues.

*Excise Tax.* Individuals and entities doing business in the Virgin Islands are required to pay an excise tax on all articles, goods, merchandise or commodities manufactured or brought into the Virgin Islands for any business use or purpose, based on the volume or value of each such article, good, merchandise or commodity. The tax covers most articles, goods, merchandise and commodities. Items specifically exempt from such excise tax include educational materials, nutritive foodstuffs, coal, fuel oil and liquid gas, molasses used for the production of rum, animal feed and commercial fertilizers, motor vehicles requiring licensing of highway use, items for sale to the Federal government, the Government or an instrumentality of either one, and items imported or manufactured in the Virgin Islands which are exported to purchasers who take delivery and actual possession outside of the Virgin Islands. An exemption also is extended to franchised bus operators, costume jewelry manufacturers, Industrial Development Commission beneficiaries, certain film-making and other related professional equipment and licensed insurers.

There is a general exemption from the excise and gross receipts taxes for agencies of the Government or the Federal government, religious, charitable, benevolent or educational organizations when not engaged in the conduct of business pursuits for profit, and transactions involving a charitable or benevolent purpose.

In Fiscal Year 1997, trade and excise tax collections were approximately \$12.1 million, comprising 3.2% of General Fund revenues.

#### *Federal Customs Duties*

An additional source of revenue consists of Federal customs duties imposed on goods brought into the Virgin Islands from countries other than the United States. Federal customs duties collected in the Virgin Islands (less the cost of collecting such duties) are deposited into the General Fund. Foreign goods shipped from United States distributors are subject to a duty equal to 6% less the duty paid to United States Customs upon entering the United States. Articles imported from the United States into the Virgin Islands are subject to a tax equal to the internal revenue tax imposed in the Virgin Islands on goods manufactured in the Virgin Islands. Customs duties are collected and administered by the United States Customs Service.

Any importation of goods from the Virgin Islands into the United States requires the full payment of duties, except as to goods manufactured, grown or produced in the Virgin Islands which are exempt from duty under general headnote 3(a) of the United States Tariff Act of 1930. Such products qualify for exemption so long as the cost of raw materials from foreign sources is no more than 70% of the sale value of the finished goods in the United States, or 50% of products excluded from the Caribbean Basin Economic Recovery Act, which exemptions are based upon labor input per unit.

## **Expenditures**

A significant portion of the Government expenditures consist of appropriations for the administration and operation of the Government's institutions and facilities (such as educational facilities, health and hospital facilities, correctional facilities and courts) and for the operation of the Government's departments and agencies (such as the Virgin Islands Police Department, Housing, Parks and Recreation, Economic Development, Agriculture, Human Services, Department of Planning and Natural Resources and general administration).

Expenditures also are required under legally binding contractual agreements that the Government has previously made or existing statutes which have continuing applicability. Contractually required expenditures include amounts for debt service payments. Expenditure totals also include amounts from the General Fund contributed to the University of the Virgin Islands, inter-fund transfers for special projects and operating and capital funding for other semi-autonomous authorities.

## **Outstanding Indebtedness of the Government**

*FEMA Loans.* In addition to other forms of disaster relief assistance received from FEMA by the Government in the aftermath of Hurricane Hugo, the Government was the beneficiary of a Community Disaster Loan from FEMA. The total amount available under the Community Disaster Loan was \$89,912,000 of which the Government drew down approximately \$50,100,000 over a three year period. Of the \$50,100,000 drawn down by the Government, FEMA has authorized the cancellation of \$21,014,000 leaving a principal balance of \$42,500,000 (which amount includes \$13,413,985 of capitalized interest).

Following Hurricane Marilyn, the Government was eligible for Community Disaster Loan assistance in an aggregate principal amount of \$127,225,00 of which the Government has drawn down \$114,300,000 and which amount is currently due and owing. In addition to the Community Disaster Loans, FEMA has also provided the Government financing under its Loans of non-Federal Share program (the "State Share Loan") in the aggregate principal amount of \$10,521,000 of which the Government has drawn down \$9,519,000. As of March 1, 1998, the Government has \$7,718,000 of State Share loans outstanding.

The purpose of the Community Disaster Loan is to compensate the Government for (a) projected revenue losses resulting from a declared disaster, during the three Fiscal Years following such disaster, and (b) increases in general municipal operating costs caused by a declared disaster over the same respective three year period following such disaster. Interest on the Hurricane Hugo Community Disaster Loan accrues at a rate of 8.25%; on the Hurricane Marilyn Community Disaster Loan and the State Share loan at an annual rate of 6.35% from the actual date of each disbursement by FEMA. The Government continues to negotiate with FEMA in order to reschedule or receive forgiveness for the Community Disaster Loans as permitted under FEMA Rules and Regulations. Under FEMA Rules and Regulations, the Government may receive a loan cancellation based on, among other factors, the level of the Government's net revenues during the three years following the disaster.

The terms of each Community Disaster Loan provide that if the Government fails to make payment on the Community Disaster Loan when such payment is due and payable, FEMA is authorized to take, or cause to be taken, action under the Federal debt collection authorities to recover the outstanding principal plus interest, including administrative offsets against other Federal funds due to the Government (which may include Matching Fund Revenues), actions which will exclude the Government from Federal financial and non-financial assistance and benefits under Federal programs and activities and/or referral to the United States Department of Justice for enforcement and collection. The Community Disaster Loan also provides that any default in payment under the Community Disaster Loan shall constitute a default under any other instrument evidencing a debt of the Government owing to or insured by the United States Government, acting through FEMA, or securing or otherwise relating to such debt, and default under any such other instruments ("Additional FEMA Debt") shall constitute a default under the Community Disaster Loan. In addition, the Community Disaster Loan also provides that the Government's failure to make payment when due allows FEMA, at its option, to declare all or any part of the Community Disaster Loan or any Additional FEMA Debt immediately due and payable. (See "BONDHOLDER RISKS".)

The Community Disaster Loan, by its terms, is secured by a pledge of the full faith and credit and taxing power of the Government.

**DOI Loan.** Pursuant to Public Law 99-190 of December 19, 1985, 99 Stat. 1185, 1238 and a Loan Agreement dated as of October 20, 1988 by and between the Government and the Assistant Secretary of Territorial and International Affairs of the DOI a loan in the amount of \$1,903,000 was made by the DOI to the Government for construction of an extension to the Alexander Hamilton Airport (now known as Henry E. Rohlsen Airport) runway in St. Croix (the "DOI Loan"). The DOI Loan is required to be repaid at a rate of four percent (4%) per annum over a period of twelve (12) years. In the event of a default, the DOI has been authorized, without further notice or need of any judicial proceeding, to assign the Government's right to receive Caribbean Basin Initiative Revenues and to receive directly from the Department of the Treasury, to the extent needed to pay the outstanding balance of the loan, including interest and late charges, the CBI Revenues otherwise payable to the Government. As of December 30, 1997, the balance owed on the DOI loan was \$737,000.

## **Financial Position of the Government**

### ***General***

Since Fiscal Year 1989, the Government has experienced substantial fluctuations in revenues and expenditures, resulting in both year-end operating deficits and surpluses in the General Fund. With the exception of Fiscal Years 1990, 1991 and 1993, the Government's expenses have exceeded revenues in each Fiscal Year. In Fiscal Years 1990 and 1991 the General Fund closed with an operating surplus due largely to the availability of the FEMA Community Disaster Loan proceeds during of Fiscal Year 1990. In Fiscal Year 1993, revenues increased due to, in large part, hurricane restoration related construction. The occurrence of Hurricane Hugo, Hurricane Marilyn and Hurricane Bertha, coupled with a general slowdown in the United States economy at the end of Fiscal Year 1989, had widespread repercussions on revenues and expenditures of the General Fund through the Fiscal Year ended September 30, 1997. As a result, except as set forth above, the General Fund closed each Fiscal Year with a deficiency of revenues, after adjustments for operating transfers and other financing sources.

The following discussion of the financial position of the Government is based upon, for Fiscal Years 1988 through 1993, unaudited financial statements prepared by the Department of Finance and compiled by Ernst & Young LLP on a non-GAAP basis. Financial statements prepared on a GAAP basis for the Fiscal Year ended September 30, 1994 have been audited by KPMG Peat Marwick LLP. The audit for Fiscal Year 1995 is expected to be available by May 30, 1998. For the Fiscal Years ended September 30, 1996 and 1997, information presented on General Fund performance is based upon unaudited estimates of the Department of Finance on a non-GAAP basis. Financial information presented for Fiscal Year 1998 is based upon the approved 1998 annual budget.

### **Accumulated and Recurring Operating Deficits**

As a result of recurring operating deficits, the Government, at the end of Fiscal Year 1995, had an accumulated deficit (as measured by General Fund undesignated fund balance) of approximately \$158,170,000 which increased to \$245,155,000 at the end of Fiscal Year 1996. For Fiscal Year 1997, the accumulated deficit declined to \$221,216,000. For Fiscal Year 1998, the Government is projecting an annual operating deficit of approximately, \$109,800,000 and an accumulated deficit of approximately \$287,000,000. The projected Fiscal Year 1998 accumulated deficit over-estimates the deficit because it does not include certain non-tax revenues, some of which have been collected and others, the Government reasonably believes, will become available and will therefore reduce the annual deficit for Fiscal Year 1998; such non-tax revenues equal approximately \$95,000,000 and include such revenues as Community Disaster Loan ("CDL") Loan proceeds, real property tax lien sales, and transfers from local funds. The accumulated surplus or deficit represents the deficiency or surplus, as applicable, of total revenues over expenditures, after adjustments are made for other sources and uses of funds, and commitments for future expenditures. This is represented and carried forward in the undesignated fund balance of the next Fiscal Year. Examples of such sources and uses are transfers in and out of Special and Other Funds, transfers to other governmental units, and future commitments to pay obligations such as the CDL Loan, and the State Share Loan.



Other examples are encumbrances carried forward, obligations arising out of appropriations carried forward, and other amounts legally restricted or otherwise considered not "expendable available financial resources".

The fluctuations in revenues and expenditures and recurring annual operating deficits during the period Fiscal Year 1995 through Fiscal Year 1997 have had a corresponding impact on Total Fund Balance of the General Fund. For the Fiscal Years ended September 30, 1995 through September 30, 1997, the Total Fund Balance was as follows:

**Table 10**  
**Total Fund Balance**

|                               | <u>1995</u>   | <u>1996</u>    | <u>1997</u>   |
|-------------------------------|---------------|----------------|---------------|
| Undesignated Fund Balance     | (\$158,170)   | (\$245,155)    | (\$221,216)   |
| Add:                          |               |                |               |
| Fund Balance Reserves for:    |               |                |               |
| Encumbrances                  | 25,753        | 35,728         | 31,628        |
| Income Tax Refunds            | 28,261        | 30,024         | 0             |
| Appropriation Carried Forward | 11,217        | ( 9,181)       | 4,493         |
| Interfund Loans               | 15,000        | 9,600          | 0             |
| CDL/FEMA State Share Loan     | 0             | 48,960         | 0             |
| Bargaining Unit Obligation    | 0             | 0              | 7,500         |
| Total Reserves:               | <u>80,231</u> | <u>115,131</u> | <u>43,621</u> |
| Total Fund Balance            | (\$77,939)    | (\$130,024)    | (\$177,595)   |

The undesignated fund balance provides an appropriate measure of the accumulated surplus or deficit of unrestricted resources of the General Fund. At such time as the Government's audited financial statements for Fiscal Years 1995, 1996 and 1997 are completed, adjustments will be made to Total Fund Balance which may increase or decrease the unreserved fund balance (deficit) of the General Fund as presented in accordance with GAAP.

#### **General Fund Cash Position**

The recurrence of annual operating deficits has had an adverse impact on the Government's cash position. As of March 1, 1998, the Government estimates the General Fund cash deficit to be approximately \$114,855,000 and anticipates this shortfall to remain unchanged for the Fiscal Year ended September 30, 1998. As of March 1, 1998, cash (and cash equivalent) balances of the Government totaled \$106,764,000 which is comprised of \$47,706,000 of Special and Other Funds and \$58,882,000 of General Fund moneys. With legislative authorization, Special and Other Funds are available for General Fund purposes. To date, the Government has financed the General Fund cash deficit by interfund transfers, some of which have been authorized by legislative approval, and the issuance of the Revenue Anticipation Note as an interim borrowing for working capital needs.

During Fiscal Year 1997, two years real property tax bills were issued for calendar years 1995 and 1996. (Real property tax bills for a calendar year are customarily issued the following calendar year.) Hurricanes Marilyn and Bertha struck the islands during Fiscal Years 1995 and 1996 contributing to the delay in the issuance of the 1995 and 1996 calendar year real property tax bills. The due dates for the calendar years 1995 and 1996 real property taxes was February 28, 1998. This delay in issuance of tax bills together with the deferred due date for receipt negatively impacted the collection of these taxes during Fiscal Years 1996 and 1997. Consequently, a significant portion of those real property tax collections will be made and recognized during Fiscal Year 1998, thereby resulting in an incremental collection of this category during Fiscal Year 1998.

It is expected that the Government will also receive approximately \$15 to 20,000,000 in revenues for Fiscal Year 1998 through the sale of delinquent real property tax bills.

### **Deficit Reduction Measures**

The Government currently is undertaking the development of a comprehensive financial plan. The international management consulting firm of Core International has been engaged by the Government under a grant from the Department of Interior to develop a series of detailed revenue enhancement and expenditure reduction initiatives. The Government also has retained Public Financial Management, Inc., a financial consulting firm experienced in assisting municipalities in financial distress, to draft a comprehensive financial plan similar to the financial plans developed for cities such as Philadelphia, Washington D.C., New Haven and Miami. In response to the Government's current deficit, the Government, together with its consultants, intends to develop a comprehensive financial recovery plan to: (1) curtail expenses, (2) increase revenues and (3) in the long-term expand the economy. The development of these plans are scheduled to be completed in Fiscal Year 1998.

### **Labor Relations**

There are 14 distinct labor organizations subject to approximately 24 collective bargaining agreements and a total of 49 pay plans currently in place for Governmental employees. As specific disciplines are not grouped under a single pay plan, it is common to have clerical and non-professional workers, in different departments throughout government represented by different unions. Of the approximately 12,900 government workers, including employees of all three branches of the Government, approximately 9,435 belong to unions.

Currently, the Government has a contractual liability to various local labor unions for retroactive salary increases aggregating approximately \$125,900,000 million accruing from Fiscal Year 1992 through the Fiscal Year ending September 30, 1997 (exclusive of interest). While such liabilities are not binding under Virgin Islands law until appropriated by the Legislature, the union contracts are valid and binding obligations of the Government which may, upon action of the Legislature, become a current liability of the Government payable from the General Fund.

In Fiscal Years 1997 and 1998, the Government negotiated certain agreements with 11 unions with respect to such retroactive salaries which resulted in waivers of the retroactive salary obligations with respect to such unions of approximately \$65,000,000.

**APPENDIX G**

**FORM OF PROPOSED OPINION OF BOND COUNSEL**

Upon delivery of the Bonds, Bond Counsel proposes to issue its approving opinion in substantially the following form:

May \_\_, 1998

United States Virgin Islands  
Public Finance Authority  
1050 Norre Gade  
Suite 102  
Charlotte Amalie, St. Thomas  
U.S. Virgin Islands 00802

United States Virgin Islands Public Finance Authority  
Revenue and Refunding Bonds  
Series 1998A (Senior Lien/Refunding)  
Series 1998B (Subordinate Lien/Refunding/Taxable)  
Series 1998C (Senior Lien/Working Capital)  
Series 1998D (Subordinate Lien/Working Capital)  
Series 1998E (Subordinate Lien/Capital Program)

Ladies and Gentlemen:

We have examined the applicable law and certified copies of proceedings and documents relating to the issuance and sale by the United States Virgin Islands Public Finance Authority (the "Authority"), of its \$ \_\_\_\_\_ Revenue and Refunding Bonds, Series 1998A, Series 1998B, Series 1998C, Series 1998D and Series 1998E (collectively, the "Series 1998 Bonds"). Reference is made to the form of the Series 1998 Bonds for information concerning their details, including payment and redemption provisions, their purpose and the proceedings pursuant to which they are issued.

The Series 1998 Bonds are issued under and are equally and ratably secured by an Indenture of Trust dated as of May 1, 1998, as supplemented by a First Supplemental Indenture of Trust dated as of May 1, 1998 (collectively, the "Indenture"), each between the Authority and United States Trust Company of New York, as Trustee (the "Trustee") which assigns to the Trustee, as security for the Series 1998 Bonds issued pursuant to the Indenture (a) the Series 1998A Note, the Series 1998B Note, the Series 1998C Note, the Series 1998D Note and Series 1998E Note (collectively, the "Matching Fund Loan Notes") in the aggregate principal amount of \$ \_\_\_\_\_ of the United States Virgin Islands (the "Government") and (b) the rights under the Loan Agreement dated as of May 1, 1998 between the Authority and the Government (the "Loan Agreement"). Additional Senior Lien Bonds and additional Subordinate Lien Bonds on a parity with the respective Series of Series 1998 Bonds may be issued on terms provided in the Indenture. Terms used but not defined herein are defined in the form of the Series 1998 Bonds and in the Indenture.

United States Virgin Islands  
Public Finance Authority  
May \_\_, 1998

We have examined and relied on the record of proceedings of the Authority and the Government in connection with the authorization and issuance of the Series 1998 Bonds and have made such investigation of law and such further reviews, inquiry or examination as we deemed necessary or desirable in rendering the opinions set forth herein. Without undertaking to verify the same by independent investigation, we also have relied on (a) computations provided by Causey, Demgen & Moore, the mathematical accuracy of which has been verified by them, relating to the yield of investments in the Escrow Fund established in connection with the refunding of the Prior Bonds, the sufficiency of such investments to pay when due the principal of and premium and interest on the Prior Bonds and the yield on the Prior Bonds and the Series 1998 Bonds, and (b) certifications, representations, documents and opinions of representatives of the Authority and the Government as to certain facts relevant to our opinion and requirements of the Internal Revenue Code of 1986, as amended (the "Code"). The Authority and the Government have covenanted to comply with the provisions of the Code regarding, among other matters, certain tax-exempt obligations, the use, expenditure and investment of the proceeds of the Series 1998 Bonds and the timely payment to the United States of any arbitrage rebate amounts with respect to the Tax Exempt Bonds, all as set forth in the proceedings and documents relating to the issuance of the Series 1998 Bonds (the "Covenants").

Based on the foregoing, we are of the opinion that:

1. The Authority is duly created and validly existing under provisions of the Act.
2. The Series 1998 Bonds have been duly authorized and issued in accordance with the Act, and constitute valid and binding limited obligations of the Authority payable solely from the Trust Estate. The Series 1998 Bonds are special obligations of the Authority. The Series 1998 Bonds shall be without recourse to the Authority. The Series 1998 Bonds shall not be general obligations of the Virgin Islands, shall not be a pledge of or involve the faith and credit or the taxing power of the Virgin Islands and shall not constitute a debt of the Virgin Islands. The Authority has no taxing power.
3. The Indenture has been duly authorized, executed and delivered by the Authority and, assuming the due authorization, execution and delivery thereof by the Trustee, constitutes a legally binding agreement of the Authority, pledges the Trust Estate created by the Indenture, to the Trustee as security for payment of the principal of and premium, if any, and interest on the Series 1998 Bonds and is enforceable against the Authority in accordance with its terms.
4. The First Supplemental Indenture is authorized and permitted by the Indenture and complies with its terms, has been duly authorized, executed and delivered by the Authority,

United States Virgin Islands  
Public Finance Authority  
May \_\_, 1998

constitutes a valid and binding agreement of the Authority, and is enforceable against the Authority in accordance with its terms.

5. Under existing law, interest on the Series 1998 A, Series 1998C, Series 1998D and Series 1998E Bonds (collectively, the "Tax Exempt Bonds") (a) is not included in gross income for Federal income tax purposes and (b) is not an item of tax preference for purposes of the Federal alternative minimum income tax imposed on individuals and corporations; however, with respect to corporations (as defined for Federal income tax purposes) subject to the alternative minimum income tax, such interest is taken into account in determining adjusted current earnings for purposes of computing tax. Failure by the Authority and the Government to comply with the Covenants could cause interest on the Tax Exempt Bonds to be included in gross income for Federal income tax purposes retroactively to their date of issue. We express no opinion regarding other Federal tax consequences of the ownership of or receipt or accrual of interest on the Bonds.

6. Under existing law, interest on the Series 1998 Bonds is exempt from personal income taxes imposed by the United States Virgin Islands, any state, other territory or possession on the United States or any political subdivision thereof, or by the District of Columbia.

7. The rights of the holders of the Series 1998 Bonds and the enforceability of such rights, including the enforcement by the Trustee of the obligations of the Authority under the Indenture, may be limited or otherwise affected by (a) bankruptcy, insolvency, reorganization, moratorium and other laws affecting the rights of creditors generally, and (b) principles of equity, whether considered at law or in equity.

Our services as bond counsel to the Authority have been limited to delivering the foregoing opinion based on our review of such proceedings and documents as we deem necessary to approve the validity of the Series 1998 Bonds and the tax-exempt status of the interest on the Tax Exempt Bonds. This opinion does not address the financial resources of the Authority, its ability to provide for payment of the Series 1998 Bonds or the accuracy or completeness of any information, including the Authority's Preliminary Official Statement dated April \_\_, 1998, and its Official Statement dated May \_\_, 1998, that may have been relied upon by anyone in making the decision to purchase Bonds.

Very truly yours,

HUNTON & WILLIAMS

## APPENDIX H

### PROPOSED FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (the "Disclosure Certificate"), dated May 14, 1998, is executed and delivered by Virgin Islands Public Finance Authority (the "Authority") in connection with the issuance of its \$541,820,000 Virgin Islands Public Finance Authority Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes), Series 1998 A Bonds, Series 1998 B Bonds, Series 1998 C Bonds, Series 1998 D Bonds and Series 1998 E Bonds (collectively, the "1998 Bonds"). Capitalized terms used in this Certificate which are not otherwise defined in the Indenture shall have the respective meanings specified above.

#### The Undertaking

1. Purpose of this Disclosure Certificate. This Disclosure Certificate is being executed and delivered for the benefit of the holders of the 1998 Bonds and delivered in order to assist the underwriters of the 1998 Bonds (the "Underwriters") in complying with the provisions of Section (b)(5)(i) of Rule 15c2-12 (the "Rule") promulgated by the Securities and Exchange Commission (the "SEC") under the Securities and Exchange Act of 1934, as the same may be amended from time to time.

2. Disclosure. (a) The Authority shall provide certain financial information in accordance with the provisions of Section (b)(5)(i) of the Rule as follows:

(i) Annual Financial Information with respect to each Fiscal Year of the Authority, commencing with the Fiscal Year ending on or after September 30, 1999. "Annual Financial Information" means, collectively: (A) Audited Financial Statements for the Authority prepared in accordance with generally accepted accounting principles; (B) an update of the tabular information presented in the Official Statement dated April 30, 1998 with respect to the 1998 Bonds under the headings "MATCHING FUND REVENUES", "THE RUM INDUSTRY", "OUTSTANDING INDEBTEDNESS OF THE AUTHORITY" and "Appendix F - United States Virgin Islands" (or, in substitution of Appendix F, the immediately preceding Fiscal Years' audited financial statements of the Government, if available); and (C) the information regarding amendments to this Agreement required pursuant to this Certificate;

(ii) the Authority shall provide within forty-five (45) days of the end on each quarter of each Fiscal Year, quarterly summaries of the information provided by the Virgin Islands Bureau of Alcohol Control Board on rum shipments and excise taxes collected as reported by the Bureau of Alcohol, Tobacco and Firearms submitted to the United States Department of the Interior with respect to Matching Fund Revenues; and

(iii) the Form 10-K of Todhunter, as and only as required, pursuant to Section 13 or 15(d) of Securities Exchange Act of 1934.

The descriptions contained in clause 2(a)(i)(B) above constituting Annual Financial Information are of general categories of financial information and operating data. When such descriptions include information that no longer can be generated because the operations to which it related have been materially changed or discontinued, a statement to that effect shall be provided in lieu of such information.

(b) The Authority will provide annually the financial information described in subsection (a)(i) and (iii) (as required) above (the "Continuing Disclosure") within 180 days after the end of the Authority's Fiscal Year, commencing not later than March 1, 2000, for the Authority's Fiscal Year ending September 30, 1999, to each nationally recognized municipal securities information repository ("NRMSIR") and to the appropriate state information depository ("SID"), if any is hereafter created.

(c) Any of the Continuing Disclosure may be included by specific reference to other documents previously provided to each NRMSIR and to the appropriate SID, if any is hereafter created, or filed with the SEC; provided, however, that any final official statement incorporated by reference must be available from the Municipal Securities Rulemaking Board (the "MSRB").

(d) The Authority will provide in a timely manner to each NRMSIR or the MSRB and to the appropriate SID, if any is hereafter created, notice specifying any failure of the Authority to provide the Continuing Disclosure by the date specified.

VIRGIN ISLANDS PUBLIC  
FINANCE AUTHORITY

Attest:

By: \_\_\_\_\_  
An Authorized Officer

Acknowledged and Accepted By:

Government of the Virgin Islands

By: \_\_\_\_\_

Date: May 14, 1998

**EXHIBIT A**  
**to Continuing Disclosure Agreement**

Filing information relating to the Nationally Recognized Municipal Securities Information Repositories approved by the Securities and Exchange Commission (subject to change):

Bloomberg Municipal Repositories  
P.O. Box 840  
Princeton, NJ 08542-0840  
or  
100 Business Park Drive  
Skillman, NJ 08558  
Internet address: [munis@bloomberg.com](mailto:munis@bloomberg.com)  
Telephone: (609) 279-3200  
Fax: (609) 279-5962

Kenny Information Systems, Inc.  
Attn: Kenny Repository Service  
65 Broadway, 16th Floor  
New York, New York 10006  
Telephone: (212) 770-4595  
Fax: (212) 797-7994

DPC Data Inc.  
One Executive Drive  
Fort Lee, NJ 07024  
Internet address: [nrmsir@dpcdata.com](mailto:nrmsir@dpcdata.com)  
Telephone: (201) 346-0701  
Fax: (201) 949-0107

Thomson NRMSIR  
Attn: Municipal Disclosure  
395 Hudson Street, 3rd Floor  
New York, New York 10014  
Telephone: (212) 807-5001 or (800) 689-8466  
Fax: (212) 989-2078



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**Thomson Municipal Services, Inc.  
395 Hudson Street  
Third Floor  
New York, NY 10014**

Virgin Islands Public Finance Authority