



EXECUTIVE SUMMARY
Government of Guam Public Debt
OPA Report No. 14-01, April 2014

In our audit of the Government of Guam (GovGuam) Public Debt for the six-year period from fiscal year (FY) 2008 to FY 2013, we found that GovGuam's total public indebtedness (debt subject to the debt ceiling, debt not subject to the debt ceiling, and other primary government liabilities) increased by 54% from \$1.02 billion (B) in FY 2008 to \$1.57B in FY 2013 (unaudited). Public indebtedness was comprised of:

- Debt subject to the debt ceiling of \$1.11B in FY 2013, nearly quadrupled (273%) from \$296.9M in FY 2008. The largest increase from year to year was between FY 2008 and FY 2009 when the debt subject to the debt ceiling nearly tripled (148%) from \$296.9M to \$736.2M;
- Debt not subject to the debt ceiling [Certificates of Participations (COPs), notes payable, and loans] of \$148.6M in FY 2013 nearly doubled (93%) from \$77.1M in FY 2008; and
- Other primary government liabilities (short term obligations due within one year such as tax refunds, court-ordered payments, and other long-term liabilities) declined by over half (52%) to \$309.5M in FY 2013 (unaudited) from \$641.6M in FY 2008.

Table 1: Changes in Public Indebtedness (FY 2008 to FY 2013)

	<u>Oustanding Principal Balance as of:</u>					FY 2013 (Unaudited)
	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
A Public Indebtedness Subject to Debt Ceiling	\$ 296,914,241	\$ 736,183,415	\$ 743,937,170	\$ 789,586,720	\$ 1,126,063,917	\$ 1,108,023,558
B Debt Not Subject to Debt Ceiling	\$ 77,075,083	\$ 89,595,300	\$ 83,777,981	\$ 141,178,564	\$ 131,556,642	\$ 148,591,215
C Subtotal, Long-Term Debt [A+B]	<u>\$ 373,989,324</u>	<u>\$ 825,778,715</u>	<u>\$ 827,715,151</u>	<u>\$ 930,765,284</u>	<u>\$ 1,257,620,559</u>	<u>\$ 1,256,614,773</u>
D Other Primary Government Liabilities	\$ 641,568,919	\$ 565,084,165	\$ 640,224,766	\$ 690,017,505	\$ 447,623,544	\$ 309,527,522
E Total Public Indebtedness (Long-Term Debt & Other Primary Government Liabilities) [C+D]	<u>\$ 1,015,558,243</u>	<u>\$ 1,390,862,880</u>	<u>\$ 1,467,939,917</u>	<u>\$ 1,620,782,789</u>	<u>\$ 1,705,244,103</u>	<u>\$ 1,566,142,295</u>

The audit objectives were to determine the growth and magnitude of GovGuam's indebtedness and whether GovGuam has a formal debt management strategy. While GovGuam does not have a formal debt management strategy, it executed the following as part of its informal strategy:

- In order to accommodate the increased debt, GovGuam's debt ceiling was raised three times from 2007 to 2012, going from 35% to 100% of Guam's total real property's appraised value;
- GovGuam restructured some of its liabilities to long-term debt;
- GovGuam deferred principal payments and capitalized interest of \$84.1M; and
- GovGuam acquired some of its debt at investment grade.

As a result of its informal debt management strategy:

- GovGuam's annual debt service requirements nearly doubled from \$41.4M in FY 2008 to \$80.1M in FY 2013, and is expected to increase to \$106.9M or 33% by FY 2018; and
- GovGuam's 2012 debt-to-Gross Domestic Product (GDP) ratio of 26.4% was below the International Monetary Fund (IMF)'s 60% benchmark, yet other debt indicators reflected GovGuam's debt burden as high in comparison to the insular governments and states.

Public Indebtedness Increased 54% and Debt Ceiling Raised Three Times

Section 11 of Guam's Organic Act limits public indebtedness to 10% of the assessed value for property tax, where assessed value is calculated as a percentage of appraised value. To increase the debt limit (ceiling), the Legislature and Administration redefined the calculation of assessed value three times through public laws: from 35% to 70% in 2007, from 70% to 90% in 2009, and from 90% to 100% in 2012. As the debt ceiling was increased from 2007 to 2012, GovGuam issued bonds and loans backed by the full faith or guarantee of the GovGuam, to the point of nearly maximizing its debt limit. From FY 2008 to FY 2013, GovGuam's total public indebtedness increased by 54% from \$1.02B to \$1.57B.

The largest increase in GovGuam's total public indebtedness from year to year occurred between FY 2008 and FY 2009. GovGuam's total public indebtedness increased by 37% or \$375.3M from \$1.02B in FY 2008 to \$1.39B in FY 2009, primarily due to the issuances of bonds to pay for certain expenses of the government (i.e. Layon Landfill construction and Ordot Dump closure, payment of prior year's unpaid Cost of Living Allowances (COLA), and past-due tax refunds).

The restructuring of GovGuam's liabilities to long-term debt occurred in FY 2012, where two LO bonds were issued primarily to pay off obligations such as past-due tax refunds, COLA payments, and retirement contributions. As a result, other primary government liabilities decreased by 35.1% or \$242.4M from \$690M in FY 2011 to \$447.6M in FY 2012.

GovGuam's other primary government liabilities also decreased by 30.9% or \$138.1M from \$447.6M in FY 2012 to \$309.5M in FY 2013 due to the decrease in provision for tax refunds and COLA liability. Although these short-term obligations decreased, GovGuam's long-term debt and its associated debt service requirements will remain for the next 30 years.

Uses of Debt

Long term debts were incurred as follows:

- **\$664.4M for operations** [including \$388.9M for unpaid 2010 and prior year's tax refunds; \$126M for prior year's unpaid court-ordered COLA payments; and \$46.8M for prior year's past-due retirement contributions for the Department of Education (GDOE) and Guam Memorial Hospital Authority (GMHA)];
- **\$315.6M for capital improvement projects** [including \$139.7M for Court-ordered Layon Landfill construction and Ordot Dump closure; \$106.7M for GDOE schools; \$55.6M for the Guam Museum and other cultural projects; and \$13.3M for GMHA];
- **\$134.7M for bond issuance-related costs**; and
- **\$129.5M for restructuring prior debt**.

Deferral of Principal Payments and Capitalized Interest

As part of debt restructuring and to relieve GovGuam's cash flow to allow for smaller payments in early years, several debts have deferred principal payments and capitalized interest (paying interest with bond proceeds for a number of years) of \$84.1M. Deferring principal payments and capitalizing interest gives GovGuam time to grow the economy to have sufficient revenues for full debt service payments in later periods; however, this translates to higher repayment costs over the life of the debt. These methods add to the long-term cost of the issuance and are, to a limited degree, indicative of cash flow problems.

Debt Service Payments Almost Doubled

In line with the increase in debt issuances, GovGuam's debt service payments increased 93.5% from \$41.4M in FY 2008 to \$80.1M in FY 2013 (unaudited). Based on present outstanding debt,

the annual debt service requirements will vary each year due to the capitalization of interest and deferral of principal payments, and will increase to \$106.9M by FY 2018.

Table 2: Annual Debt Service Payments & Requirements (FY 2008 to FY 2018)
 Annual Debt Service Payments

FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
\$ 41,383,000	\$ 47,200,000	\$ 74,486,000	\$ 79,630,000	\$ 100,435,000	\$ 80,087,000

Projected Annual Debt Service Requirements

FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
\$ 86,077,218	\$ 111,617,032	\$ 93,104,405	\$ 99,761,190	\$ 106,922,787

Improved Investment Rating

GovGuam's present debts are investment grade, which influences the debt service payment requirements of future debt. S&P, one of three rating agencies utilized by GovGuam, gave GovGuam an improved credit score rating due to the current Administration's improved fiscal management practices and enhanced cash flow monitoring. However, S&P was concerned about GovGuam's "extremely high debt burden" and vulnerability to economic changes in its tourism and military industries.

No Formal Debt Management Strategy

S&P acknowledged that "Guam has no formal debt management plan or policies in place". We reviewed several debt indicators to determine how Guam compares to the 50 United States and other insular governments and found that GovGuam's 2012 debt-to-GDP ratio of 26.4% was below the IMF's 60% benchmark, yet other debt indicators were unfavorable, as follows:

- Guam's 2011 debt-to-GDP of 20.4% ranked 13th amongst the United States state governments, where New York was the highest at 28.6%;
- Guam's 2012 debt-per-capita of \$8,810 was the highest amongst the insular governments. In 2010, Connecticut was the highest among the states at \$5,236 and Puerto Rico was the highest at \$10,474; and
- Guam's 2012 debt-to-asset ratio remains unfavorable as it owed creditors and vendors \$1.46 for every \$1 of assets it owned.

Conclusion and Recommendations

Although GovGuam has an informal debt management policy, given the magnitude of GovGuam's total public indebtedness of \$1.57B, we recommend the GEDA Administrator develop and adopt a formal debt management strategy that is updated at least on an annual basis, using guidelines and best practices established by organizations such as the IMF and World Bank. We received the management response of the GEDA Administrator and Directors of Department of Administration and Bureau of Budget and Management Research. They concurred with our audit recommendation and provided further background perspective. However, they clarified or expressed disagreement with certain parts of our report, specifically: changes in public indebtedness; debt-per-capita and debt-to-GDP comparisons; and deferral of principal and capitalized interest.

Doris Flores Brooks, CPA, CGFM
 Public Auditor