S&P Global Ratings

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Guam; Appropriations; General Obligation

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Table Of Contents

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Credit Profile		
Guam GO		
Long Term Rating	BB-/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'BB-' long-term rating on the Government of Guam's (GovGuam) general obligation (GO) bonds and its 'B+' long-term rating on GovGuam's series 2010A certificates of participation (COPs; John F. Kennedy High School Project) and 2014 lease revenue bonds (Guam Facilities Foundation Inc. Project). At the same time, we affirmed our 'B+' long-term rating on Guam Education Financing Foundation's (GEFF) $13.3 million series 2016B COPs issued on behalf of GovGuam. The outlook is stable.

The ratings reflect our view of:

- Persistent general fund operating deficits, despite GovGuam's efforts, and limited progress toward improving its balance sheet and liquidity over the past five fiscal years, with gradual progress projected for at least the next five years;
- The government's extremely large unassigned general fund balance deficit position of $215 million, equal to 29.3% of general fund expenditures, as of audited fiscal 2016, worsening each year since fiscal 2013;
- The government's long-term forecast that projects that its total general fund balance deficit position may not be eliminated until fiscal 2021, two fiscal years later than projected in May 2016;
- The government's extremely high debt burden and limited financing flexibility, with possible additional general-fund-backed borrowings of approximately $100 million;
- GovGuam's lack of designated "rainy day" reserves and thin monthly available free cash, especially in fiscal 2016, when ending monthly cash balances for the combined general, special revenue, and federal grants funds were negative in nine of 12 months;
- Reliance on one-time sources to improve general fund balances, as general fund operating expenses have outpaced general fund revenue, even with including net transfers, during the past five audited fiscal years;
- The territory's narrow economic base with concentration in tourism and the military, which leaves it vulnerable to economic cycles and defense spending; and
- Reliance on tourism from Japan compounded by recent weakness in the Japan tourism market, with the number of visitors from Japan declining 3.4% in fiscal 2016 after declines of 5.6% in fiscal 2015 and 9.5% in fiscal 2014.

Partly offsetting the above weaknesses, in our view, are:

- Guam's strong visitor growth of 10.1% to 1.51 million in fiscal 2016, with visitors up 5.3% through July 2017;
- Continued good private sector and governmental investment, including another new luxury hotel and infrastructure investments;
- Guam's importance to the U.S. as a strategic military base, with significant investments being made or planned as it relates to the relocation of Marines to Guam from Japan;
- Good financial transparency, reporting, and financial policies, including a newly adopted debt management policy, although these policies have not been effective in materially strengthening GovGuam's balance sheet over the past

few years;
- Projected general fund results for fiscal 2017 that indicate a small yet positive general fund operating margin of $1.2 million;
- Improved cash management in recent months, with month-end balances positive yet slim for the past 13 consecutive months; and
- Significant improvement in Guam's unemployment rate to 5.4% as of September 2016, from 7.4% in March 2014 and a recent peak of 13.3% in March 2013.

The GO bonds, maturing in 2019, are secured by the full faith and credit of the Government of Guam and are outstanding in the amount of $15.2 million.

The 'B+' rating on the COPs reflects our view of Guam's:

- Covenant to annually budget and appropriate lease payments throughout the terms of the leases,
- Annual appropriation risk, and
- General credit characteristics cited above.

The Government of Guam continues to experience mixed results as pertains to our methodology for rating U.S. state governments and territories. Fiscal years 2014 and 2015, for which general fund surplus or break-even operating results were budgeted, instead ended with $60 million and $61 million deficits, and fiscal 2016, for which a $40 million general fund operating surplus was budgeted, instead ended with just a $13 million surplus. More important, general fund performance has continued to rely on various nonrecurring, nonstructural items (e.g., retroactive salary obligations and one-time accounting adjustments) in the few years in which the fund balance has improved, particularly with regard to bond issuance activity (including bond premium and bond proceeds). This persistent pattern of falling short of budgeted results casts doubt over the government's forecast general fund surpluses for fiscal years 2017 through 2022. The government's fiscal 2017 forecast as presented to us about 15 months ago had indicated a $14 million operating surplus; revised estimates as of August 2017 indicate a general fund surplus of just $1.2 million. The government's total general fund balance was negative $106 million as of audited fiscal 2016 (ended Sept. 30), equal to negative 14% of expenditures, with the unreserved or unassigned portion growing for a third consecutive year to negative $215 million.

We had noted in previous reports that improved financial trends in fiscal years 2012 and 2013 were mainly due to Governor Eddie Calvo's continued focus on several key priorities, including stricter cost controls, revenue enhancement, improved budgeting practices, more realistic cash flow projections, operational efficiencies, increased transparency, and economic growth. But given recent results, we now view the success of some of these initiatives as mixed. Partly to blame for the shortfalls, according to the government, is the slower-than-anticipated military buildup on the island. The timeline has been pushed back several times, and the actual number of troops relocating from Okinawa, Japan, has been reduced. Several large projects related to the buildup have recently been awarded, so the buildup appears to be gaining steam, and, according to the government, this should result in increased general fund revenue, particularly Section 30 revenue and business privilege taxes (BPTs).

Tempering the weak general fund results on an accrual basis is improved cash flow management over the past 13 months. While monthly ending cash balances for the combined general, special revenue, and federal grant funds were negative for the first nine months of fiscal 2016, monthly balances from July 2016 through July 2017 (13 months) were positive, albeit thin, ranging from $2.5 million to $20.5 million. Cash flow, while somewhat predictable now, is uneven, with large payments made in the first half of the fiscal year, whereas cash collections are the highest in the second half of the fiscal year. The Government of Guam has been making its promised tax refund payments in recent years (although required set-asides have at times fallen short), with about $60 million in remaining refunds due by Sept. 30, 2017. As opposed to the states in which the federal government pays the Earned Income Tax Credit (EITC) from the federal treasury, Guam must source payments from its general fund without federal reimbursement.

Another tempering factor is that many of Guam's economic metrics are improving. The unemployment rate declined to a low 4.0% as of March 2016 and was most recently reported at 5.4% as of September 2016. This represents significant improvement from 6.9% as of March 2015 and its recent peak of 13.3% in March 2013. Real GDP growth averaged 1.4% in fiscal years 2011 to 2015, with GDP at $5.7 billion in 2015, and several government and private sector investments that will strengthen the economy have recently been completed or are in progress. Among these projects are several new hotels either under construction, planned, or recently built, including the 419-room luxury hotel Dusit Thani, which opened in 2015. The hotels serve one of Guam's most important economic drivers, tourism, and address room capacity issues in light of record visitor volume of 1.51 million in fiscal 2016 (and all-time record visitor volume for calendar 2015), with fiscal 2017 visitors on pace for another record. Hotel occupancy tax (HOT) and BPT revenue continue to experience good growth, and the signing of the record of decision in August 2015 has given momentum to the marine relocation from Japan and its positive economic effects.

In our view, continued strong cash flow management, tighter financial controls, more realistic budget assumptions, and greater fiscal discipline are key to meaningful balance sheet improvement. In addition, steady and strong economic growth or even new revenue sources (a tax rate hike was recently proposed) may be necessary for Guam to realize significant improvement in its financial metrics. Whereas economics have improved and severe weather events have been a nonfactor, budget-to-actual performance continues to be credit negative. Guam does have reserve designations, including a combined 17% reserve on appropriations until the general fund deficit is eliminated, but the allotment controls do not apply to the department of education, Guam Community College, the legislative branch, or the judiciary, and these are a significant portion of GovGuam's budget.

Based on the analytical factors we evaluate for U.S. states and territories, we have assigned Guam a composite score of '3.1' on a four-point scale on which '1' is the strongest--no change from the previous score assigned in May 2016. Based on our criteria, an overall score of '3.1' is associated with an indicative credit level in the 'BBB' category. However, our criteria also specify overriding factors that may result in a rating below the indicative credit level. Several of these factors apply in the case of Guam, as discussed below.

In terms of system support, in U.S. territories and commonwealths the policy and fiscal relationship with the federal government may result in a system support score that is different from the score assigned to all states. In those cases, the rating may be multiple notches below the indicative credit level. Guam's system support score is below the level assigned to U.S. states, so we apply a negative adjustment of three notches to the indicative rating.

In addition, in cases of weak structural budget performance, and when the trend is exacerbated by low liquidity and sustained with no credible plan for reversal, we adjust the indicative rating downward by at least one notch. Guam has very thin internal liquidity, and the general fund has had persistent general fund deficits.

Furthermore, our criteria state that whenever we believe debt obligations are likely to increase most of the debt-burden-related ratios to levels more than a third higher than those indicated for a score of '4', we will lower the indicative credit level one notch. In Guam's case, even without regard to future debt obligations, a majority of its debt ratios are already more than a third higher than those indicated for a score of '4'.

In consideration of the above overriding factors that apply to Guam, we affirmed the Guam 'BB-' GO rating and 'B+' COP rating.

Outlook

The stable outlook reflects our anticipation that, during the next two years, the government will exercise fiscal discipline and control spending it deems necessary to better align revenue with expenditures and improve cash flow, especially given rising debt service requirements, recent negative budget variances, and uncertain revenue growth. We assume that the government will maintain at least marginally adequate unrestricted cash balances and adequate cash flow to allow it to operate and to maintain required service levels, and that it will prudently fund current but rising obligations. Improvement in various economic metrics such as tourism, employment, and visitor diversity help to mitigate risks.

Upside scenario

We could raise the ratings if the government is able to materially reduce the deficit position in its total and unassigned fund balance without the use of bond proceeds or other sources we deem nonrecurring or nonstructural, or if it meaningfully improves its liquidity or economic measures and we come to believe such improvement is sustainable.

Downside scenario

We could lower the ratings if economic trends worsen materially or other factors lead to inadequate financial performance, including the inability to meet current cash flow obligations, whether or not this includes debt service.

Government Framework

Guam law requires the executive branch of the government to submit a balanced budget, as the Government Claims Act (GCA) mandates that the governor recommend to the legislature a financial plan that contains revenue measures that support the budget. In terms of balanced budget adoption by the legislature, the GCA also mandates that all expenditures specify a funding source. The government has had limited success in implementing fixes to maintain a balanced budget once adopted.

The GCA also requires the governor to submit a fiscal realignment plan to address underperforming revenue if actual revenue is 3% or more below budget, and government code also provides that allotments be based on anticipated cash receipts to ensure sufficient cash for their payment. Regardless, the code also provides that sufficient funding always be provided for education, and this, in our view, limits financial flexibility. In addition, the government has in practice relied on borrowing rather than on real growth in recurring revenue or spending reductions to bring its general fund balance to a surplus position.

Guam has the full power and ability to raise revenue as it deems necessary, subject to the simple majority approval of the Guam Legislature and governor. Guam has demonstrated this ability historically, such as through tax rate increases. Guam's legislature is unicameral, which helps to facilitate approval of tax and other revenue-related issues. If the governor vetoes a law, a two-thirds vote of the legislature is required to override it. Past examples of adjusted revenue include the gross receipts tax, HOT, and various fees such as business license fees, customs and quarantine fees, or income tax service fees. But revenue increases in recent years have been insufficient to avert general fund deficits. The government recently introduced a bill to raise the BPT rate to 4.75% from 4.00%, with the additional revenue to likely support additional debt service and ongoing support for Guam Memorial Hospital.

Guam also has significant flexibility in adjusting disbursements, but has limited practical ability to make reductions in some areas such as education. Also, the judiciary, legislature, and community college lack specific allotment controls, although those departments have latitude to prudently manage cash flow. Voter initiatives have at times been placed onto the ballot, but none of these, in our view, has had a significant impact on the budget. The governor can issue an executive order to cut spending at any time for executive branch operations. Although Guam may have broad disbursement flexibility, some cost overruns have occurred during the past few years.

Guam is not legally bound to make GO debt a top priority, payable before all other disbursements, but the government reports that it does so as a policy matter. GO bonds exceeding $25 million require voter approval, but in some instances voter approval is waived. Guam's debt also may not exceed 10% of total assessed valuation (AV), with AV adjusted to 90% of appraised value. The government is permitted to and has historically issued GO deficit bonds. When GO debt is authorized, the government must identify revenue that will support such debt. Guam now has a formal debt management plan in place, although it lacks specifics, in our view, and the use of credit enhancement or derivatives is not authorized by law.

Institutional Framework/System Support

S&P Global Ratings bases its assessment of the institutional framework under which Guam operates on legal and regulatory environments, local customs and political practices, and precedents. The assessment also considers some of the future changes that are likely to strengthen or undermine such a framework. This results in a forward-looking opinion, consistent with our overall approach to ratings. Key analytical factors in our assessment are predictability, revenue and expenditure balance, and transparency and accountability, as detailed in our methodology for rating non-U.S. local and regional governments. (See our report published June 30, 2014 on RatingsDirect.)

The predictability of the institutional framework assesses the frequency and extent of reforms affecting the division of responsibilities and revenue between the levels of governments in a jurisdiction. In addition, it incorporates an analysis of the laws that affect tax flexibility, the organization of the electoral system, and limitations on the use of debt, among other factors. We also consider the predictability of the outcome of reforms when they occur, based on their pace of implementation and on Guam's ability to measure the short- and long-term impact that they will likely have on finances. Finally, it includes our assessment of a territory's ability to influence, and potentially veto, any decision taken at a higher level, particularly one that could adversely affect Guam's financing system. In light of these considerations, we view the predictability as average. Guam is governed by its own constitution, known as the Organic Act, and we view the government as stable and mature, with a limited number of reforms. Guam has a popularly elected governor and a unicameral 15-member legislature, and elects one nonvoting delegate to the U.S. House of Representatives. U.S. citizens in Guam vote in a straw poll for their choice in the U.S. Presidential general election, but because Guam has no electoral votes the poll has no significant impact. In sending delegates to the Republican and Democratic national conventions, Guam has some influence in national presidential races, but convention delegates are elected by local party conventions, not by voters in primaries.

In terms of revenue and expenditure balance, the analysis considers the overall adequacy of the revenue that Guam receives to cover its expenditure mandates, the existence of a fiscal policy framework imposing prudent limits on Guam's debt and deficit levels, and the availability of extraordinary support in exceptional circumstances. We view Guam's revenue and expenditure balance as below average but modestly improving. Guam's constitution requires it to submit a balanced budget, and Guam has sufficient autonomy with its revenue flexibility to manage its own finances, but often such financial management tools have been delayed or insufficient or reliant on limited and nonrecurring sources of funding (bond proceeds). Appropriations from the U.S. government, such as Section 30 and compact impact revenue, are generally predictable and timely. The fiscal policy framework is, in our view, weak, with a track record of general fund operating imbalances and increasing liabilities, but we do recognize that Guam is current in the payment of tax refunds to its citizens. Guam also has a statutory debt ceiling, but does not apply all forms of debt to the ceiling. In terms of extraordinary support, the U.S. Government provides Guam with certain grants to compensate for higher infrastructure needs resulting from factors that are unique to Guam's location and status as a U.S. territory, including annual compact impact funds, Section 30 revenue, and military spending. Other support includes financial support in the form of small-business grants, federal stimulus funding, and extraordinary support such as Federal Emergency Management Agency grants and disaster assistance loans. But several federal mandates are in place that Guam has limited ability to afford on its own, including costs associated with stipulated orders (water and wastewater system improvements), stringent requirements imposed by the Environmental Protection Agency and federal laws, and costs associated with EITC. Guam's government is highly centralized, with no overlapping governments, so Guam is responsible for a high level of intergovernmental assistance in most key areas of spending, such as education and public safety (which are shared costs in other states). Guam also has been using its general fund to back several loans issued by other departments, and has been subsidizing Guam Memorial Hospital. Flexibility is limited on a practical basis; for example, a constitutional provision prohibits cuts in education spending that would interfere with providing every student with an adequate public education. In addition, Guam cannot make cuts to the judicial branch per local law.

In our assessment of the transparency and accountability of Guam's institutional framework, we note that the strength of a public finance system also depends on national regulation of public-sector accounting systems, accountability of managers and politicians, and system transparency. We have observed that strong and predictable systems usually impose high standards for transparency and accountability. These standards are established by law or are supported by the country's general management culture. We believe that transparent and accountable systems promote the implementation of good practices, such as compulsory audits or external controls, full-accrual accounting, consolidated reporting requirements, and long-term financial planning with proper assessment of external and internal risks. Guam's transparency and accountability are good. The delineation of roles and responsibilities between elected officials (who set priorities) and managers (who implement them) is relatively clear, but one-time events, somewhat aggressive budgets, and the inability to accumulate meaningful reserves constrain budget and cash flow management. Guam, per the Organic Act, is required to submit to the U.S. Congress and the Secretary of the Interior a comprehensive annual financial report in accordance with the standards of the National Council on Governmental Accounting, and the timeliness of audits has improved significantly in the past few years. Interim financing reporting is, in our view, good, and Guam has released a comprehensive audited financial report for five consecutive years (fiscal years 2012 through 2016).

On a four-point scale on which '1' is strongest, we have assigned a '2.7' score to Guam's governmental framework.

Financial Management

Financial Management Assessment: Good

We characterize Guam's financial management practices as good under our financial management assessment (FMA) methodology. A good FMA indicates our view that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. The governor's fiscal policy committee meets weekly to discuss the government's current and future cash position and to track revenue, and the committee focuses on monitoring financial and economic events that have direct and indirect bearing on government revenue collections, operating expenditures, and overall financial stability. Several models are used to accomplish this, and most models are updated monthly. Departmental budgets are adjusted monthly based on operational requirements, and the Bureau of Budget and Management Research along with the Department of Administration produce a five-year general fund financial forecast that is updated semiannually at a minimum, and upon new developments or unanticipated economic or financial conditions. Various component units, such as the airport, have prepared separate long-term capital improvement plans, but no comprehensive plan consolidates all plans. Guam has a statutorily established permitted investments policy, and tracks investments and returns monthly. It also adopted a formal debt management plan in August 2017. Guam has a few reserve policies in place to set aside reserves over the course of the fiscal year and to prevent overspending, although the success of this has been uneven and the allotment controls do not apply to all departments.

Budget management framework

We continue to view Guam's budget management framework as weak, and steps to improve results have instead resulted in setbacks. Although the government has some latitude to adjust revenue and expenditures, it lacks a long-term track record of being timely or sufficient with such adjustments, and has historically struggled to prevent persistent general fund operating deficits, even as recently as fiscal years 2014 and 2015.

We do recognize, however, that the government has made considerable progress in recent years in paying down long-term liabilities such as unpaid tax refunds and past-due cost-of-living adjustments, and the government has made significant efforts to improve its budget. Reserve designations and allotment controls are in place to prevent overspending and to build reserves, and the government has developed several strategies to enhance revenue and control spending. But in our view, these policies have not yielded benefits. Assuming no change to the government's revenue and tax structure, real improvement in the government's budget situation continues to rely heavily on revenue enhancement initiatives, cost controls, stronger economic growth, and revenue diversification.

On a four-point scale on which '1' is strongest, S&P Global Ratings has assigned a '3' score to Guam's financial management.

Economy

Guam (population: 162,742 estimated as of July 2016) is the westernmost territory of the U.S., and the island encompasses 212 square miles. Guam's economic activity is largely based on tourism and military spending. Because of this, many of the government's economic development initiatives focus on these pillars, especially tourism. Hotel property owners have invested substantially in hotel renovations and expansions in recent years, with more than 600 new rooms available now compared with five years ago. The opening in 2015 of the 419-room Dusit Thani Guam hotel, which includes a ballroom and banquet rooms with a total seating capacity of 2,000, has helped to relieve hotel capacity issues. Construction of another 340-room luxury hotel, the Tsubaki Tower, is also underway with completion estimated by the end of 2018. Various airlines have increased capacity, and new airlines are serving additional markets, including China and South Korea, from which management anticipates strong visitor growth. This has helped offset the continued weakening tourism trends from Japan, where airlines have reduced service. The hotel occupancy rate was 83% as of 2016; during peak months occupancy rates approach 100%, indicating the need to continue to increase room capacity. The average room rate was $198, up significantly from $144 in 2011. Room inventory was 8,904, up from 8,285 in 2012.

Visitor arrivals to Guam totaled a record 1.51 million in fiscal 2016, eclipsing the 1.41 million in 1997 and increasing by a robust 10% over fiscal 2015. Guam also recorded 132,952 visitors in July 2017, an 8.1% increase versus July 2016 and the highest July volume ever. The number of visitors grew a healthy 5.3% for fiscal 2013, but growth slowed to 0.3% in 2014 to 1.34 million as a result of what we view as a significant 9.5% decline in visitors from Japan. The number of visitors grew 2.3% in fiscal 2015. The number of visitors from Japan declined an additional 5.6% in fiscal 2015 and 3.4% in fiscal 2016. South Korea and China together accounted for 36.6% of visitors in fiscal 2016, up from 18% in 2013, and this has mitigated the decline in visitors from Japan. Management has attributed the decline in visitors from Japan to several factors, including an increase in the sales tax in Japan that led to lower spending, devaluation of the yen, a trend toward domestic travel, an aging and decreasing population, reduced seat capacity, and increased competition for tourism with Southeast Asia. Guam Visitors Bureau projects 4% visitor growth in fiscal 2017 (year-to-date visitors through July are up 5.3%). Guam recently launched its Tourism 2020 Plan, with a goal to add 1,600 rooms to support a projected 2 million annual visitors by 2020.

Visitor arrivals remain highly concentrated, with Japan representing 50% of total visitors in fiscal 2016, but this has diversified from 79% in fiscal 2006. Although tourism diversification has its merits, with the Korean market at 34.8% of total visitors in 2016 from just 8% in 2009, the decline in visitors from Japan in fiscal years 2014 through 2016 is a credit risk given the importance of that market to Guam. The U.S. has a visa waiver in effect for several countries, including Japan, South Korea, and Taiwan, the three largest markets for tourism, which represent about 90% of annual visitors combined. The Government of Guam and Guam Visitors Bureau continue to work to expand the visa waiver program to visitors from mainland China, but little progress has been made as a result of security and intelligence concerns. Although Guam's request for a visa waiver for Chinese tourists continues, an agreement between the U.S. and China to extend short-term Chinese visas to 10 years from one year (and shorten processing time to three to five days) has, in our view, boosted the number of visitors.

The ongoing U.S. military buildup, while still a large undertaking, has been scaled back. Originally as many as 9,000 troops were to relocate to the island, mainly from Japan, between 2014 to 2017. A couple years ago, however, the DOD reported that the number would be closer to 4,700 active duty personnel, along with family members, support and civilian staff, vendors, and suppliers. What was once estimated at a $15 billion economic impact is now estimated at $8.7 billion. A record of decision, which identifies the final locations for additional bases and facilities to accommodate the marines, was released in August 2015. A 13-year period (revised from seven years) of moderate construction followed by a gradual phase-out is planned. All facets of Guam's government, from the general government to utilities, the port, and airport, have reached a general understanding with DOD that any impact from the relocation would be cost neutral to Guam, even if many of the details are undetermined. Two large military construction contracts totaling over $200 million (improvements to Marine Corps Base Guam and a Naval Base Guam sanitary sewer project) were awarded in August 2017.

Recent economic trends show improvement, but Guam's economic base is concentrated and vulnerable and the island's lack of economic diversity is an area of exposure. In addition, we believe that the island's small geography (it is one-seventh the size of the smallest of the 50 states, Rhode Island) and limited population base make it especially susceptible to financial and economic volatility. We also note that the level of system support from the U.S. government and Guam's ability to influence national reforms are significantly less than that for U.S states.

Tourism trends (visitors), room rates, occupancy rates, HOT revenue, and BPT revenue have demonstrated good growth during the past four fiscal years. More generally, however, Guam's economic performance has been just adequate during the past few years, with total jobs--63,250 as of March 2017--actually below the level realized in September 2009 (63,800). Also, real GDP growth trailed that of the U.S. in all but one year of the 2010-2015 period after outperforming it in 2008 and 2009. Guam's employment base is also relatively more concentrated than that of the U.S. as a whole, especially within governmental employment and construction, and the manufacturing job sector is very limited and weakening. We do note, however, that as of September 2016 Guam's unemployment rate declined to 5.4%, its lowest in several years but higher than the U.S. rate of 4.9% at that time. Other economic initiatives and events bode well for the island, including jobs created at Guam Regional Medical City, increased marketing efforts at Asian trade missions, large infrastructure projects, major projects related to the military buildup, and additional hotel and condo developments.

Guam's annual population growth has ranged from 0.1% to 0.6% since 2003, lagging the U.S. pace of 0.7% to 1.0% during the same period. We consider Guam's other key economic metrics weak. Guam's per capita GDP was just $34,234, or 70% of the U.S.' $50,577, in 2016. In addition, GDP growth has generally lagged that of the U.S. since 2009, and per capita effective buying income is just 26% of the U.S. level. Although we believe the military buildup and generally good tourism trends present Guam with favorable growth prospects, we also recognize that they could lead to an even more concentrated economic base.

On a four-point scale on which '1' is strongest, S&P Global Ratings has assigned a '3.1' score to Guam's economy.

Budgetary performance

Guam has a long history of structural imbalance or general fund operating deficits, and a very large unassigned general fund deficit that will likely take multiple additional years to reduce, and our rating reflects our view of this risk. We view Guam's balance sheet as constrained, with a substantial debt burden, obligations to retirees, negative fund balances, low cash, and contingent obligations. In addition, the government has not produced an audited general fund operating surplus prior to transfers or bond proceeds since 2008. Estimated results for fiscal 2017 indicate only a slight, $1.2 million general fund operating surplus, leaving little room for error. And given the island's exposure to various events beyond its control (e.g., weather-related and economic) and rising obligations, rating stability or improvement depend on strict expenditure controls along with the accumulation and maintenance of meaningful reserves. The government has a deficit elimination place in place that includes more conservative budgeting, more rigorous revenue enhancement measures, five new internal auditors to investigate and collect unpaid taxes, and four staff members dedicated to compliance and regulatory programs.

The two major sources of general fund revenue are income taxes (45%) and BPT (31%). Property tax revenue flows into an outside fund, as does HOT revenue, but money in those funds must be used to reimburse the general fund for GO debt service. The two leading general fund expenditures are education (31%) and police and fire (15%).

Liquidity

Guam monitors its cash on a daily basis and monitors monthly cash flow in its combined general, special revenue, and federal grants fund. Cash flow is forecast at least three months out, and disbursements are carefully made by analyzing incoming cash flow. Management reports that borrowing from other internal funds is not possible; financial flexibility instead relies on the use of rolling surplus cash balances, if any, and the delaying of disbursements. The government does have a $6 million bank line of credit it can also use without authorization, but hasn't used it in recent years. Cash balances are low and marginal and no rainy day reserve fund exists; monthly unrestricted cash balances were negative in nine months of fiscal 2016, but cash management has improved considerably since July 2016 with 13 consecutive months of positive monthly balances. Guam's general fund unrestricted cash balance was $39.9 million, or 5% of general fund expenditures, as of audited fiscal 2016. Guam's fiscal 2017 cash flow forecast (cash basis) estimates unrestricted cash of $13.4 million as of September 2017. The administration has a cash flow model that it uses to manage cash receipts and disbursements, allowing it to manage its funds more proactively. Although cash flow challenges remain given contingent obligations, rising debt service requirements, and the requirement to promptly pay income tax refunds, we believe that Guam's liquidity position and cash flow management are marginally adequate, and improving.

On a four-point scale on which '1' is strongest, we have assigned a '3' score to Guam's budgetary performance.

Debt and liability profile

Guam's debt burden (subject to the debt ceiling) has increased significantly during the past few years, by 44% to $1.1 billion as of fiscal 2016 from $763 million in fiscal 2010. Including other loans, leases, and COPs, and net of self-supporting debt, we calculate Guam's total debt at $1.28 billion. On a per capita basis, this is a very high $7,890. Even prior to the 44% increase in debt in 2010 to 2016, Guam's debt burden was already extremely high, in our view. Guam's total GO and tax-supported debt is an extremely high 61% of total personal income, 12% of general fund expenditures, and 22% of GDP. We view Guam's debt amortization as slow, with 30% of debt maturing during the next 10 years, and GovGuam's proportionate share of the existing defined benefit plan pension liability is very high at $5,308 per capita, or 41% of total personal income. The retirement system's three-year average pension funded ratio is a low 55%, and GovGuam did not entirely fund its statutorily required contribution in fiscal years 2014 through 2016.

The Guam Legislature reformed its pensions in 2016, creating two new retirement plans, known as the Defined Benefit 1.75 and Guam Retirement Security Plan. This was to address insufficient savings by members in the existing defined contribution plan. The government has no plans to fund its $1.98 billion other postemployment benefit liability ($12,174 per capita).

We consider all of these ratios very high, leading to a score of '4' per our criteria. In addition, the debt ratios in most cases are more than 33% higher than those that warrant a score of '4'. Given this, we have adjusted our rating on Guam down one notch from the indicative rating, as indicated earlier.

Given significant financing needs throughout the island, Guam has additional plans to borrow, including roughly an additional $100 million for a high school project. The government also may leverage its BPT credit further if the BPT rate increase to 4.75% is approved. While Guam's debt ratios are already significantly high and additional debt is unlikely to weaken its scoring on debt and liability under our rating criteria, we do believe that the annual servicing of this additional debt will make general fund deficits harder to avoid, and this could affect other scoring under our rating criteria.

On a four-point scale on which '1' is strongest, we have assigned a '4' score to Guam's debt and liability profile.

North Korea Threats

On Aug. 8, 2017, Guam made headlines around the world when North Korea's state-run news agency, KCNA, announced that North Korea's military was "examining the operational plan" to strike areas around Guam with medium- to long-range strategic ballistic missiles. The threat called out Guam's Andersen Air Force Base, and subsequently the waters about 19-25 miles off Guam's coast, as potential targets, where North Korea would fire missiles designed "to send a serious warning signal to the US." The indication from North Korea was that it would finalize its plans by mid-August. On Aug. 15, according to state media, North Korean leader Kim Jong-un reviewed his military's plans but opted to not move forward with the plan at that time, but at the same time Kim warned that "the U.S. should not test North Korea's self-restraint." In our view, despite the U.S.' protective measures in place, these threats could disrupt one of Guam's main economic pillars, tourism, as future visitors could opt to vacation elsewhere. We believe the threats could also lead to a meaningful population decline, but likely only if the situation worsens. If either of these outcomes occur, the result would likely be downward pressure on many of the ratings we maintain on Guam and related entities, including the GO (and COP), BPT and HOT ratings, and potentially other ratings. We believe it is too early to determine if, or to what extent, these threats will affect tourism or population, and we also note that this is not the first time Guam has been threatened. We also believe additional threats are likely given the ongoing tension, because Guam represents the closest American soil to North Korea, and given the substantial amount of U.S. military operations on the island.

Guam Education Financing Foundation's 2016B Certificates of Participation

GEFF's 2016B COPs represent fractional, undivided interests in base rental payments to be made by the Guam Department of Education (DOE), a department of the executive branch of Guam, under a lease agreement between the

Guam DOE, as lessee, and GEFF, as lessor. The obligation of the Guam DOE to make lease payments is limited, payable in part from compact impact funds (CIFs) provided by the Department of the Interior's Office of Insular Affairs and pledged under the lease, as authorized by Chapter 58 of Title 5 of the Guam Code Annotated, to secure its obligations to pay base rentals and additional rentals required under the lease.

We note that CIFs are not available for the lease payments due on Dec. 1, 2023, Dec. 1, 2024, and Dec. 1, 2025, known as "the "final years rentals." The final years rentals (and related COP interest and principal) will instead be paid by funds appropriated by the Government of Guam with no other pledged revenue stream. S&P Global Ratings does not assign unique ratings to different maturities of the same issuance. As such, although we assigned a rating of A/Stable to GEFF's contemporaneously issued series 2016A bonds secured by pledged CIF (based primarily on our federal future flow securitization criteria; see our report published April 1, 2016), we assigned an appropriation-backed rating of B+/Stable to the series 2016B COPs. The series 2016B COPs require interest-only payments until Oct. 1, 2024. Lease payments are not subject to abatement.

For more information, see our reports on GEFF's series 2016A bonds, published April 1, 2016, and series 2016B bonds, published May 4, 2016.

PROMESA

The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was signed into law on July 1, 2016. While the law provides Puerto Rico and possibly other U.S. territories access to a potentially more orderly process for debt restructuring, our credit ratings on Guam's GO bonds, COPs, and other debt reflect the relative likelihood of default and our view of its capacity and willingness to pay debt on an ongoing basis--not the process for restructuring debt if or when it defaults. The passage of PROMESA, as signed into law on July 1, 2016, establishes a financial oversight and management board to assist the Government of Puerto Rico, including its instrumentalities, in managing its public finances and providing an avenue whereby Puerto Rico can achieve fiscal responsibility and tap capital markets. PROMESA provides certain protections for eligible debtors that parallel those established under the federal bankruptcy code, including the ability to impose an automatic stay on creditor actions, provide an orderly forum for negotiations, and certify as to the sustainability of any proposed plan of adjustment for debts. While PROMESA establishes an oversight board only for Puerto Rico, we believe the bill's passage introduces the possibility that similar oversight boards could be established in other territories, such as Guam, especially if or when Guam experiences heightened fiscal distress. In our view, given the direct link between worsening fiscal distress and the likelihood of Guam's seeking to establish its own oversight boards, our ratings continue to focus on predefault credit fundamentals, including the ongoing ability to pay obligations in full and on time.

Ratings Detail (As Of August 30, 2017)		
Guam certs of part (John F. Kennedy High Sch Proj)		
Long Term Rating	B+/Stable	Affirmed
Guam GO bnds		
Long Term Rating	BB-/Stable	Affirmed

Ratings Detail (As Of August 30, 2017) (cont.)		
Guam Ed Fincg Foundn, Guam		
Guam		
Guam Ed Fincg Foundn (Guam) rfdg certs of part (Guam Pub Schs Fac Proj) (Guam) ser 2016B due 10/01/2026		
Long Term Rating	B+/Stable	Affirmed
Phoenix Indl Dev Auth, Arizona		
Guam		
Phoenix Indl Dev Auth (Guam) APPROP		
Long Term Rating	B+/Stable	Affirmed