

NEW ISSUE — FULL BOOK-ENTRY

RATING: See “Rating” herein.

In the opinion of Bond Counsel, under existing statutes, regulations, administrative interpretations and court decisions and subject to conditions described in “TAX MATTERS” herein, interest on the Series 2004A Bonds (a) will not be 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 tax imposed on individuals and corporations; however, interest on the Series 2004A Bonds held by certain corporations may be subject to federal income tax under certain circumstances described herein. Under existing statutes, interest on all Series 2004A Bonds is exempt from personal income taxes imposed by the United States Virgin Islands, by 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.



\$94,000,000
VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY
Revenue Bonds
(Virgin Islands Matching Fund Loan Note)
Series 2004A (Senior Lien)

DATED: December 1, 2004

DUE: October 1, as shown on
inside cover page

The Virgin Islands Finance Authority Revenue Bonds (Virgin Islands Matching Fund Loan Note) Series 2004A (Senior Lien) (the “Series 2004A 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 in the name of Cede & Co., the nominee of The Depository Trust Company (“DTC”), New York, New York. Beneficial ownership interests in the Series 2004A Bonds will be available for purchase in book-entry form only. Except in limited circumstances, purchasers of Series 2004A Bonds will not receive physical delivery of the Series 2004A Bonds 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 April 1, 2005, on the Series 2004A 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 Series 2004A Bonds, as further described herein. Certain Series 2004A Bonds shall be subject to redemption prior to maturity as described herein. (See “THE SERIES 2004A BONDS”.)

The Series 2004A Bonds are being issued by the Virgin Islands Public Finance Authority (the “Authority”) to (i) finance various capital projects in the Territory of the United States Virgin Islands (the “Territory” or “Virgin Islands”), as more particularly described herein, (ii) provide start-up capital for the newly created Virgin Islands Waste Management Authority, (iii) fund the Series 2004A Senior Lien Debt Service Reserve Subaccount and (iv) pay certain costs of issuing the Series 2004A Bonds. The Series 2004A Bonds will be issued under and secured by the Indenture of Trust, dated as of May 1, 1998 (as heretofore supplemented, the “Original Indenture”), by and between the Authority and The Bank of New York Trust Company, N.A., as trustee (the “Trustee”), and a Second Supplemental Indenture, dated as of December 1, 2004 (the “Second Supplemental Indenture”, and together with the Original Indenture, the “Indenture”). The Trustee will act as Registrar and Paying Agent for the Series 2004A Bonds. The Series 2004A Bonds will be secured by a special limited obligation loan note (the “Series 2004A Matching Fund Loan Note”) issued by the Government of the Virgin Islands (the “Government”) pursuant to a Loan Agreement, dated as of December 1, 2004, among the Authority, the Trustee and the Government (the “Series 2004A Loan Agreement”).

THE SERIES 2004A 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 SERIES 2004A SENIOR LIEN DEBT SERVICE RESERVE SUBACCOUNT. THE SERIES 2004A MATCHING FUND LOAN NOTE IS A SPECIAL LIMITED OBLIGATION OF THE GOVERNMENT AND IS 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”). THE SERIES 2004A BONDS ARE BEING ISSUED ON A PARITY BASIS WITH THE PRIOR SENIOR LIEN BONDS AND ANY ADDITIONAL SENIOR LIEN BONDS (AS SUCH TERMS ARE DEFINED HEREIN) HEREAFTER ISSUED PURSUANT TO THE INDENTURE. (SEE “MATCHING FUND REVENUES”).

The Series 2004A 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 Series 2004A 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 taxing power of the Government is not pledged for the Series 2004A Matching Fund Loan Note or the Series 2004A Bonds. The Authority has no taxing power.

THE PURCHASE AND OWNERSHIP OF THE SERIES 2004A BONDS INVOLVES CERTAIN INVESTMENT RISKS. INFORMATION CONTAINED ON THIS COVER IS A SUMMARY ONLY. PROSPECTIVE PURCHASERS OF THE SERIES 2004A BONDS ARE ADVISED TO READ THIS OFFICIAL STATEMENT IN ITS ENTIRETY. (SEE “BONDHOLDER RISKS”).

The Series 2004A 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 Buchanan Ingersoll PC, New York, New York, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by their co-counsel, Winston & Strawn LLP, New York, New York, and Duane Morris, LLP, New York, New York. It is expected that the Series 2004A Bonds will be available for delivery to DTC in New York, New York on about December 15, 2004.

Citigroup**M♦R♦ Beal & Company****Morgan Stanley**

December 2, 2004

\$94,000,000
VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY
Revenue Bonds
(Virgin Islands Matching Fund Loan Note)
Series 2004A (Senior Lien)

Maturities, Amounts, Interest Rates and Prices or Yields
\$94,000,000 Serial Bonds

Maturity Date <u>October 1,</u>	Principal <u>Amount</u>	Interest <u>Rate</u>	<u>Yield</u>	Maturity Date <u>October 1,</u>	Principal <u>Amount</u>	Interest <u>Rate</u>	<u>Yield</u>
2005	\$2,295,000	4.00%	2.50%	2015	\$4,625,000	5.25%	4.38%†
2006	2,980,000	5.00	2.66	2016	4,865,000	5.25	4.48†
2007	3,130,000	5.00	2.86	2017	5,120,000	5.25	4.53†
2008	3,285,000	5.00	3.10	2018	5,390,000	5.25	4.58†
2009	3,450,000	5.00	3.40	2019	5,675,000	5.25	4.64†
2010	3,625,000	5.00	3.67	2020	5,970,000	5.25	4.67†
2011	3,805,000	5.00	3.88	2021	6,285,000	5.25	4.69†
2012	3,995,000	5.00	4.04	2022	6,615,000	5.25	4.73†
2013	4,195,000	5.00	4.18	2023	6,960,000	5.25	4.80†
2014	4,405,000	5.00	4.28	2024	7,330,000	5.25	4.87†

(Accrued interest from December 1, 2004 to be added)

† Priced to October 1, 2014, the first date on which the Series 2004A Bonds are subject to optional redemption. (See “THE SERIES 2004A BONDS - Redemption”).

VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY

24 Honduras
Frenchtown
St. Thomas, United States Virgin Islands 00802
www.USVIPFA.com
Kenneth E. Mapp, Director of Finance and Administration

BOARD OF DIRECTORS

The Honorable Charles W. Turnbull, Governor – Chairman
Bernice A. Turnbull, Commissioner of Finance – Executive Director
Ira R. Mills, Director of the Office of Management and Budget – Secretary
Paul Arnold, St. Croix Representative
Roy Jackson, St. Thomas/St. John Representative

TRUSTEE

The Bank of New York Trust Company, N.A.
Jacksonville, Florida

BOND COUNSEL

Buchanan Ingersoll PC
New York, New York

FINANCIAL ADVISOR

Banc of America Securities LLC
New York, New York

This Official Statement is furnished in connection with the sale of securities as referred to herein and may not be reproduced or be used, in whole or in part, for any other purpose. The information and expressions of opinion herein are subject to change without notice. The delivery of this Official Statement, including the Appendices attached hereto, does not imply that information herein is correct as of any time subsequent to its date. No dealer, salesman or any other person has been authorized by the Authority, the Government or the Underwriters to give any information or to make any representation other than as contained in this Official Statement in connection with the offering described herein and, if given, or made, such other information or representation must not be relied upon as having been authorized by the Authority, the Government or the Underwriters. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Series 2004A Bonds in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration, qualification or exemption under the securities laws of any such jurisdiction. No dealer, broker, salesperson or other person has been authorized by the Authority, the Government or the Underwriters to give any information or to make any representations, other than those contained herein, in connection with the offering of the Series 2004A Bonds and, if given or made, such information or representations must not be relied upon. The information contained in this Official Statement has been obtained from the Authority, the Government and other sources which are believed to be reliable, based primarily on a review of such information and discussions with the Government and the Authority. While the Underwriters have no reason to believe such information is inaccurate or incomplete, no representation or warranty is made as to the accuracy or completeness of such information and nothing contained in this Official Statement is, or may be relied on, as a promise or representation by the Underwriters.

This Official Statement contains certain forward-looking statements and information that are based on the beliefs of the Authority, the Government and certain consultants retained by the Authority and the Government in connection herewith, as well as assumptions made by and information currently available to the Authority, the Government and such consultants. Such statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or expected.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2004A BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME, THE UNDERWRITERS MAY OFFER AND SELL THE SERIES 2004A BONDS TO CERTAIN DEALERS AND DEALER BANKS AND OTHERS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICES STATED ON THE COVER PAGE HEREOF, AND SAID PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

THE SERIES 2004A BONDS HAVE NOT BEEN REGISTERED WITH THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT OF 1933, AS AMENDED, NOR HAS THE INDENTURE BEEN QUALIFIED UNDER THE TRUST INDENTURE ACT OF 1939, AS AMENDED, IN RELIANCE UPON EXEMPTIONS CONTAINED IN SUCH ACTS.

The Underwriters have provided the following sentence for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as a part of, their responsibility to investors under federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

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OFFICIAL STATEMENT

\$94,000,000
VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY
Revenue Bonds
(Virgin Islands Matching Fund Loan Note)
Series 2004A (Senior Lien)

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 Bonds (Virgin Islands Matching Fund Loan Note), Series 2004A (Senior Lien) (the "Series 2004A Bonds") in the aggregate principal amount of \$94,000,000. The Series 2004A Bonds are being issued pursuant to an Indenture of Trust, dated as of May 1, 1998 (as heretofore supplemented, the "Original Indenture"), by and between the Authority and The Bank of New York Trust Company, N.A., Jacksonville, Florida, as successor trustee (the "Trustee"), and a Second Supplemental Indenture, dated as of December 1, 2004 (the "Second Supplemental Indenture", and together with the Original Indenture, the "Indenture"), and the Loan Agreement, dated as of December 1, 2004 (the "Series 2004A Loan Agreement"), by and among the Government of the United States Virgin Islands (referred to herein as the "Government"), the Trustee and the Authority. The Series 2004A 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"), Title 29 of the Virgin Islands Code, and 2004 Virgin Islands Act No. 6663, as amended by 2004 Virgin Islands Act No. 6675, Section 42 and other applicable law (together, the "Act") 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 Series 2004A Bonds will be used to: (i) finance the planning, development, constructing, renovating and equipping of a wastewater treatment facility on St. Thomas and a wastewater treatment facility on St. Croix and the repair and construction of certain wastewater collection systems on St. Thomas and St. Croix, (ii) finance the repairs, renovations and construction of solid waste facilities throughout the Territory of the United States Virgin Islands (the "Territory" or "Virgin Islands"), (iii) finance the repair and construction of public roads throughout the Territory, (iv) provide start-up capital for the newly created Virgin Islands Waste Management Authority, (v) fund the Series 2004A Senior Lien Debt Service Reserve Subaccount (hereafter defined) in an amount equal to the Series 2004A Debt Service Reserve Requirement, and (vi) pay certain costs of issuing the Series 2004A Bonds.

The Series 2004A Bonds, together with certain Prior Bonds and any Additional Bonds hereafter issued under the Indenture (as such terms are hereinafter defined), are payable and secured by a pledge of the Trust Estate as further described and as defined herein. (See "PLAN OF FINANCE".)

The Series 2004A Bonds will be secured by the Trust Estate, including, without limitation, a special limited obligation Matching Fund Loan Note (the "Series 2004A Matching Fund Loan Note") issued by the Government pursuant to the Series 2004A Loan Agreement. The Government will be obligated under the Series 2004A Matching Fund Loan Note to make payments to the Authority in amounts sufficient to pay all principal, premium, if any, and interest on the Series 2004A Bonds when due and to make the amount on deposit in the Series 2004A Senior Lien Debt Service Reserve

Subaccount equal to the Series 2004A Debt Service Reserve Requirement pursuant to the terms of the Indenture. The Series 2004A Matching Fund Loan Note has been issued in anticipation of the receipt of the Matching Fund Revenues over the full term of the Series 2004A Matching Fund Loan Note, 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 (i) the Series 2004A Matching Fund Loan Note, and (ii) the Matching Fund Loan Notes previously issued in connection with and which secure the Prior Bonds (hereinafter defined) (the "Prior Matching Fund Loan Notes"). However, no assurances can be given as to the sufficiency of Matching Fund Revenues for such purpose. (See "SECURITY FOR THE SERIES 2004A BONDS" and "MATCHING FUND REVENUES").

The Series 2004A Matching Fund Loan Note is secured by a pledge of Matching Fund Revenues on a parity basis with the Prior Matching Fund Loan Notes securing the Prior Senior Lien Bonds (as hereinafter defined) and any Matching Fund Loan Notes securing any Additional Bonds issued as Senior Lien Bonds under the Indenture.

Matching Fund Revenues are those revenues received by the Government from the United States Department of the Treasury, through the Secretary of the Interior, 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 Series 2004A Bonds, the Series 2004A Loan Agreement, the Series 2004A Matching Fund Loan Note, 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 Series 2004A Loan Agreement, the Special Escrow Agreement and the Indenture for full and complete statements of the provisions thereof. Copies of the Indenture, the Series 2004A Loan Agreement, and the Special Escrow Agreement, including the form of the Series 2004A Bonds and the Series 2004A Matching Fund Loan Note, are available at the office of the Trustee, 10161 Centurion Parkway, Jacksonville, Florida 32256 (904-645-1912), and at the Authority, 24 Honduras, Frenchtown, St. Thomas, United States Virgin Islands 00802 (340-714-1635); Attention: Kenneth E. Mapp, Director of Finance and Administration. www.usvipfa.com.

THE PURCHASE AND OWNERSHIP OF THE SERIES 2004A BONDS INVOLVE INVESTMENT RISKS. PROSPECTIVE PURCHASERS OF THE SERIES 2004A BONDS ARE ADVISED TO READ THIS OFFICIAL STATEMENT IN ITS ENTIRETY. FOR A DISCUSSION OF CERTAIN RISKS RELATING TO THE SERIES 2004A 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 encourage economic development through the issuance of special obligations issued to finance a project for the benefit of private parties which special obligations are payable out of revenue generated by the involved project and are payable to the Authority by said private party, (vi) to invest its funds and to arrange for the investment of the funds of the Government or any agency, authority or instrumentality thereof, (vii) to enter into contracts and agreements with the government of the United States, the Government and any agency, authority or political subdivision thereof, (viii) to make, modify and repeal by-laws, rules and regulations, (ix) to acquire, sell, lease, mortgage, pledge, dispose of or encumber property or interests therein, and (x) 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.

Kenneth E. Mapp serves as the Director of Finance and Administration of the Authority and is responsible for the administration and operation of the Authority. The Director of Finance and Administration is appointed by, and serves at the pleasure of, the Board of Directors.

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 or Profession/Residency</u>	<u>Term Expiration</u>
Hon. Charles W. Turnbull, Ph.D., Chairman	Governor of the Virgin Islands	Ex Officio
Bernice A. Turnbull, Executive Director.....	Commissioner of Finance	Ex Officio
Ira R. Mills, Secretary	Director of the Office of Management and Budget.....	Ex Officio
Paul Arnold	Human Resources Consultant, St. Croix.....	2001*
Roy Jackson	Certified Public Accountant, St. Thomas.....	2001*

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

Outstanding Indebtedness of the Authority

Parity Bonds/Subordinate Bonds

The Authority has issued and as of October 1, 2004 had outstanding \$335,015,000 principal amount of Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes), 1998 Series A, B and C (the “Prior Senior Lien Bonds”) and \$124,775,000 principal amount of Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes), 1998 Series D and E (the “Prior Subordinate Lien Bonds”); and, together with the Prior Senior Lien Bonds, the “Prior Bonds”). The Prior Bonds constitute “Bonds” under the Indenture. The Prior Senior Lien Bonds are equally secured and on a parity with and entitled to the same benefits as the Series 2004A Bonds. Payment from the Trust Estate of the Prior Subordinate Lien Bonds is subordinate to payment from the Trust Estate of the Prior Senior Lien Bonds and the Series 2004A Bonds.

The Government issued its 1977 General Obligation Matching Fund Bonds (the “1977 Bonds”) and its 1978 General Obligation Matching Fund Bonds (the “1978 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 (which themselves were defeased with a portion of the proceeds of the Prior Bonds), but continue to hold a prior pledge of Matching Fund Revenues. The 1977 Bonds have an outstanding principal balance of \$4,829,000 and a final maturity of January 2, 2007. The 1978 Bonds have an outstanding principal balance of \$2,810,000 and a 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 & Whinney 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.

Separately Secured Bonds and Obligations

Gross Receipts Taxes Bonds. The Authority has issued and as of October 1, 2004 had outstanding \$278,590,000 principal amount of Revenue Bonds (Virgin Islands Gross Receipts Taxes Loan Note) Series 1999 A (the “Series 1999 A Gross Receipts Taxes Bonds”) and \$268,020,000 principal amount of Revenue Bonds (Virgin Islands Gross Receipts Taxes Loan Note) Series 2003A (the “Series 2003A Gross Receipts Taxes Bonds”) (collectively, the “Gross Receipts Taxes Bonds”). Each series of the Gross Receipts Taxes Bonds are secured, on a parity basis, by Gross Receipts Taxes Loan Notes issued by the Government, which are payable primarily from Gross Receipts Taxes imposed and collected by the Government from individuals and entities doing business in the Virgin Islands. The Gross Receipts Taxes Loan Notes constitute general obligations of the Government secured by the full faith and taxing power of the Government. See also “—Swap Option Agreement” below for a discussion of the swap option entered into by the Authority with respect to a portion of the Series 1999 A Gross Receipts Taxes Bonds.

Swap Option Agreement. In February 2003, the Authority entered into a Swap Option Agreement (the “Swap Option Agreement”) with Lehman Brothers Special Financing Inc. (“LB SF”) with respect to a portion of the Series 1999 A Gross Receipts Taxes Bonds. The Authority received a premium payment from LBSF in the aggregate amount of \$8,367,000 in connection with the execution of the Swap Option Agreement. Under the terms of the Swap Option Agreement, on July 1, 2010, LBSF has the right to exercise its option to pay the Authority an amount equal to a variable rate of 64.00% of USD-LIBOR-BBA (the London Interbank Offered Rate for U.S. dollars compiled by the British Bankers’ Association) of an agreed upon notional value of \$174,870,000 (subject to annual decreases throughout the term) on a

monthly basis from November 1, 2010 until October 1, 2029 and in exchange the Authority shall pay LBSF an amount equal to a fixed rate of 5.27% of the agreed upon notional value on a monthly basis during the term. The net payments (excluding any termination payment) to be made by the Authority to LBSF under the Swap Option Agreement are also secured on parity with payments to the owners of the Gross Receipts Taxes Bonds.

Highway Bonds. The Authority has issued and as of October 1, 2004 had outstanding \$15,840,000 principal amount of Revenue Bonds (Federal Highway Reimbursement Anticipation Loan Note), Series 2002 (the “Highway Bonds”). The Highway Bonds are secured by and payable from monies derived from the United States Federal Highway Administration. The Highway Bonds mature in the years 2004 through 2013.

Y2K Bonds. The Authority has issued and as of October 1, 2004 had outstanding \$1,550,000 principal amount of Project Revenue Bonds, Series 1999 (the “Y2K Bonds”). The Y2K Bonds were issued to finance a portion of the Government’s Year 2000 compliance efforts. The Y2K Bonds are secured by periodic lease payments from the Government. The Y2K Bonds mature in 2005.

HOVENSA Bonds. The Authority has issued three (3) series of 30 year private activity bonds (in 2002, 2003 and 2004) in the aggregate principal amount of \$251,565,000 on behalf of HOVENSA, SA, an oil refinery located on the island of St. Croix (the “HOVENSA Bonds”). HOVENSA, SA is solely responsible for the payment of debt service on the HOVENSA Bonds. All of the HOVENSA Bonds were outstanding as of October 1, 2004.

WICO Guaranty. On November 20 2002, the Authority executed an Unlimited Continuing Guaranty in favor of Banco Popular de Puerto Rico (“Banco Popular”), pursuant to which the Authority agreed to unconditionally guarantee any and all indebtedness of The West Indian Company Limited (“WICO”), a wholly owned subsidiary of the Authority, to Banco Popular. As used in the Unlimited Continuing Guaranty, the term indebtedness includes, but is not limited to, the \$22,500,000 loan from Banco Popular to WICO made on November 20, 2002, which loan represents a consolidation of prior indebtedness of both the Authority and WICO to Banco Popular, and any modifications, amendments or refinancings thereof. The WICO Guaranty constitutes a direct and general obligation of the Authority. As of October 1, 2004, outstanding principal and interest on the underlying indebtedness guaranteed by the Authority pursuant to the Unlimited Continuing Guaranty aggregated \$21,406,589.

For a listing of the Authority’s bonds and similar obligations outstanding as of October 1, 2004, see “Appendix F — United States Virgin Islands — Outstanding Indebtedness of the Government.”

Audited Financial Statements

Audited financial statements of the Authority through and including the fiscal year ended September 30, 2003 are available on the Authority’s website at www.usvipfa.com. Such audited financial statements are also available from the nationally recognized municipal securities information repositories, and Digital Assurance Certification, L.L.C., the dissemination agent responsible for maintaining Authority compliance with its continuing disclosure undertaking with respect to the Series 2004A Bonds. See “CONTINUING DISCLOSURE; DISCLOSURE DISSEMINATION.”

The Series 2004A Bonds are secured solely by the Trust Estate established therefor under the Indenture, including amounts payable to the Authority by the Government under the Series 2004A Matching Fund Loan Note. Such amounts are to be derived from Matching Fund Revenues. The audited financial statements of the Authority do not contain detailed information regarding Matching Fund Revenues and the Series 2004A Bonds do not constitute a general obligation of the Authority.

Consequently, the audited financial statements of the Authority may be of limited relevance to a prospective purchaser of the Series 2004A Bonds.

Department of the Interior Report

Pursuant to its duties as government comptroller of the Virgin Islands (see “Appendix F — United States Virgin Islands — General”), in November 2002, the Office of Inspector General (“OIG”) of the United States Department of the Interior (“DOI”) issued a report (the “PFA Report”) which found that while the Authority had effectively raised capital through the issuance of bonds, it did not effectively manage bond proceeds or funds from its own budget. The OIG asserted in the PFA Report, among other things, that the Authority allowed bond proceeds to go unused for a period of time that may result in jeopardizing the tax-exempt status of the relevant bonds. In the PFA Report, the OIG mentioned three bond issuances from 1989 through 1992 whereby \$27.6 million of bond proceeds remained unused for six to eight and one-half years.

The Authority and the Government strongly disagreed, and continue to strongly disagree, with the assertions made in the PFA Report regarding the management of bond proceeds and its internal funds. Based on the advice of bond counsel, the Government believes the bond proceeds have been used in a timely and efficient manner in accordance with the Code so as not to jeopardize the tax-exempt status of the relevant bonds. It is also noted that the Authority’s independent public accountants did not qualify their reports for the Authority’s financial statements in regard to unspent bond proceeds and a contingent liability related thereto.

With respect to outstanding bonds of the Authority, at the present time, all of the \$94.0 million of proceeds from the issuance of the Prior Bonds intended for capital projects have been spent; with respect to the approximately \$13.6 million of proceeds from the issuance of the Y2K Bonds intended for capital projects, approximately \$600,000 remains unexpended; and with respect to the \$248.1 million of proceeds from the issuance of the Series 1999 A Gross Receipts Taxes Bonds intended to finance various working capital projects, approximately \$8.0 million remains unexpended. See “Appendix F — United States Virgin Islands — Outstanding Indebtedness of the Government.”

PLAN OF FINANCE

General

The Series 2004A Bonds are being issued to: (i) finance the planning, development, constructing, renovating and equipping of a wastewater treatment facility on St. Thomas and a wastewater treatment facility on St. Croix and the repair and construction of certain wastewater collection systems on St. Thomas and St. Croix, (ii) finance the repairs, renovations and construction of solid waste facilities throughout the Territory, (iii) finance the repair and construction of public roads throughout the Territory, (iv) provide start-up capital for the newly created Virgin Islands Waste Management Authority, (v) fund the Series 2004A Senior Lien Debt Service Reserve Subaccount in an amount equal to the Series 2004A Debt Service Reserve Requirement, and (vi) pay certain costs of issuance of the Series 2004A Bonds.

In 1998 the Authority issued the Prior Bonds in the aggregate principal amount of \$541,820,000. The Prior Bonds are currently outstanding in the aggregate principal amount of \$459,790,000. The Prior Bonds were issued as both Senior Lien Bonds and Subordinate Lien Bonds of which \$335,015,000 and \$124,775,000 are outstanding, respectively. The Series 2004A Bonds constitute a Series of Senior Lien Bonds under the Indenture and will be on a parity with the Prior Senior Lien Bonds and any Additional Bonds constituting Senior Lien Bonds hereafter issued pursuant to the Indenture as to security and source

of payment. The Series 2004A Bonds will be senior to the Prior Subordinate Lien Bonds as to security and source of payment. (See “SECURITY FOR THE SERIES 2004A BONDS”).

Capital Improvement Projects

During the past ten years, the Government has aggressively undertaken the construction of numerous 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 creation of cancer and cardiac care units, the renovation and construction of cruise ship piers, the expansion of airport terminals and runways, construction and repair of public roads and streets, construction of new wastewater treatment plants, the construction of marine cargo facilities, a criminal justice complex, solid waste land fills, and repair and restoration of historic public buildings, flood and hazard mitigation projects, improvements to beaches, parks and recreational facilities, law enforcement digital communication systems, tourism infrastructure facilities among others.

In December 2002, the Virgin Islands Federal District Court approved an agreement among the Government, the United States Department of Justice and the United States Environmental Protection Agency (the “2002 Stipulation to the Amended Consent Decree”), pursuant to which the Government committed to undertake certain capital improvement projects on a specific timetable in an effort to achieve full compliance with the requirements of the Clean Water Act and certain other Federal and local environmental laws and regulations. (See “Appendix F - United States Virgin Islands - Financial Position of the Government - Additional Expenditures”).

The Government intends to use a portion of the proceeds of the Series 2004A Bonds, together with certain federal funds, to finance a portion of the following capital projects:

	<u>Bond Proceeds</u>	<u>Federal Funds</u>	<u>Total Cost</u>
Wastewater Treatment Facilities	\$70,000,000	\$25,000,000	\$95,000,000
Solid Waste Facilities	5,000,000	-0-	5,000,000
Public Road Construction	10,000,000	-0-	10,000,000
	<hr/>	<hr/>	<hr/>
Total	\$85,000,000	\$25,000,000	\$110,000,000
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Wastewater Treatment Facilities

Wastewater Treatment Plants – St. Thomas and St. Croix

The principal requirement of the 2002 Stipulation to the Amended Consent Decree is the construction of two secondary wastewater treatment plants (“WWTPs”), one on St. Thomas and one on St. Croix. On March 24, 2004, the Government entered into contracts to accomplish this mandate. VWNA Caribbean LLC (“VWNA”), a special purpose entity organized by USFilter Operating Services, will design and build the WWTPs and operate the WWTPs for twenty years following the completion of construction. The obligations of VWNA are backed by a \$50 million guaranty from Veolia Water S.A., the largest water service provider in the world for municipal and industrial entities, with \$13 billion in annual sales in 2002.

Under the design, build and operate contracts, the fixed design/build construction prices for the St. Croix WWTP and the St. Thomas WWTP are \$25.6 million and \$26.7 million, respectively. The annual service fee will be in excess of \$1 million for each WWTP. On March 23, 2004, the Legislature enacted legislation approving the financing for the contracts. This legislation was signed into law on April 16, 2004 (Act No. 6663). Construction of the WWTPs is expected to commence in early 2005. The St. Croix facility is expected to take approximately 23 months to complete and should be ready for acceptance by December 2006. The St. Thomas facility is expected to take 25 months to complete and should be ready for acceptance by February 2007. The direct cost of the capital improvement portion of the WWTPs that will be financed with a portion of the proceeds of the Series 2004A Bonds is \$52,305,006. On the basis of the design, build and operate contracts, the additional annual operations and maintenance costs of each facility will be approximately five percent (5%) of such facility's design/construction cost, for a twenty year term of operation.

While Act No. 6663 authorizes the Authority to issue bonds for the construction of the WWTPs and other projects, there remains a requirement for additional resources to upgrade and construct collection systems on St. Croix and St. Thomas. Without this supporting infrastructure, the WWTPs cannot effectively meet the Territory's requirements for environmental services. Under Federal court mandate, the Government in the past year alone has invested approximately \$1.95 million in improvements to three pump stations, and another \$2.0 million in collection pipe repairs and replacements, all on St. Croix. At these same three pump stations, the Government currently is competitively bidding additional station upgrades, at an estimated cost of \$1.3 million. Also on St. Croix, the Government has expended an additional \$3.0 million for collection-system emergency repairs, and for pump installations and emergency generators. All together, the Government's commitment to this supporting infrastructure over the past year has been nearly \$7.0 million.

Improvements to LBJ, Figtree and Lagoon Street Pump Stations – St Croix

These improvements consist of the upgrade to the three major pump stations serving the Anguilla Wastewater Treatment Plant. Included in this upgrade package are repairs to the wet wells, floor gratings, stairways, ventilation, telemetry, lighting and other structural, mechanical, electrical and cosmetic repairs needed to bring the pump stations into proper and safe operational standing. Each pump station is in the process of having 3 new pumps installed, the cost of which is not included in this financing. The plans and specifications for this improvement project have been completed and, through a competitive bidding process, a contractor has been selected. Construction is anticipated to commence in December 2004, or by January 2005 and is expected to be completed within 6 months. These improvements have been estimated to cost approximately \$1.5 million and will be financed with bond proceeds.

Improvements to Long Bay, Cancryn and Airport Pump Stations – St Thomas

These improvements consist of the upgrade to the three major pump stations serving the Airport Lagoon Wastewater Treatment Plant. Included in this upgrade package are repairs to the wet wells, floor gratings, stairways, ventilation, telemetry, lighting and other structural, mechanical, electrical and cosmetic repairs needed to bring the pump stations into proper and safe operational standing. Each pump station will also need 3 new pumps installed, the cost of which is to be included in this project. It is expected that the plans and specifications for these improvements will be completed by March 2005 and will be advertised for competitive bidding. Construction is anticipated to commence in June 2005, and is expected to be complete within 6 months. These improvements have been estimated to cost approximately \$3.5 million and will be financed with bond proceeds.

Territory Wide Collection System Repair/Replacement of Failed System -- Pipeline and Manholes

The infrastructure consists of manholes and appurtenances, collection, service and interceptor sewers. The sewers in these areas vary in age and material but are similar in the extent of deterioration or collapse. For all interceptors and manholes, following an evaluation of the condition of the extended collection system, through cleaning, zoom TV and inline-CCTV inspection, the Territory will develop operation and maintenance and capital improvement protocol for the short and long-term replacement, repair, or rehabilitation of any pipelines and manholes that require immediate attention. This project is only for the repair, rehabilitation or replacement of those collection system pipelines and manholes requiring immediate attention.

The Territory has started the inspection program on St. Croix and after inspecting approximately 85% of the collection system on St. Croix, the Territory has replaced pipeline and manholes at a cost of over \$2 million just to satisfy the court ordered repairs alone. The inspections have indicated a badly deteriorated collection system on St. Croix and it is anticipated that equally as deteriorated systems will be found on St. Thomas and St. John. Costs for initial projects are only a small percentage of the costs needed to bring the collection system into minimal repair status. The estimated budget needed for the overall repair, rehabilitation or replacement of the collection system Territory wide is \$5.0 million per year for five (5) years just to get the system into a state of repair so that maintenance and normal capital improvement can be initiated. The Territory has solicited and selected a contractor to perform the condition inspections for the remainder of St. Croix, for St. John and for St. Thomas. The estimated inspection budget is approximately \$1.2 million and a contract is currently being negotiated.

The repair, rehabilitation and replacement projects for St. Croix (remainder), St. Thomas and St. John are to follow the St. Croix projects currently underway and it is expected that, given the results of the inspection and analysis of the system to date, these repairs will be designed and competitively awarded for construction through the next five years at a pace enabled by the ability to fund the construction.

The estimated direct cost of the capital improvement portion of these improvements that will be financed with bond proceeds is \$1 million (St. John), \$3 million (St. Thomas), and \$3 million (St. Croix) for a total cost of \$7 million. This estimate is based upon the Government's extensive experience under contracts for comparable work required for compliance with the Federal court mandate.

St. Thomas Wastewater-Langmouth Pump Station Decommission and Construct 3,000 LF of Collection System

The recently constructed Mangrove Lagoon Wastewater Treatment Plant and Pump Station started discharging effluent in June 2002. The collection system that was constructed with the treatment facility was meant to replace the aging and disintegrating collection system in the Anna's Retreat neighborhoods. While two old treatment facilities in those neighborhoods were decommissioned with the addition of the Mangrove Lagoon Treatment Plant, there still exists the need to replace, repair or rehabilitate the collection system in those neighborhoods. One such project that is necessary to the upgrade of the system is the construction of 3,000 LF of 18" pipe, with associated right-of-way, to eliminate two aging pump stations (Langmouth) and to redirect flows away from a neighborhood which has experienced odor problems and sewage overflows for 30 years. This project is expected to be designed and competitively advertised in FY 2005. Construction is expected to commence November 2005, however, with bond funding, the process could be accelerated and allow an aging pump station to be taken offline. The estimated direct cost of the capital improvement portion of this project to be financed with bond proceeds is \$2 million, based upon the Government's extensive experience under contracts for comparable work required for compliance with the Federal court mandate.

St. Thomas Wastewater-Weymouth-Rhymer Pump Station Decommission and Construct 1,000 LF of Collection System

This St. Thomas project consists of the construction of 1,000 LF of 18” pipe to eliminate another aging pump station (Weymouth-Rhymer) and to allow the government to provide sanitary sewer service to the largest commercial shopping area in the Territory (TuTu Park Mall and adjacent businesses). This project is expected to be designed and competitively advertised in FY 2005. Construction is expected to commence December 2005, however; with bond funding, the process could be accelerated and allow an aging pump station to be taken offline. The estimated direct cost of the capital improvement portion of this project to be financed with bond proceeds is \$1.5 million, based upon the Government's extensive experience under contracts for comparable work required for compliance with the Federal court mandate.

Solid Waste Facilities

Approximately \$5 million of the proceeds of the Series 2004A Bonds will be applied to repairs, renovations and construction of solid waste facilities throughout the Virgin Islands. It is anticipated the projects will consist of certain infrastructure improvements relating to two landfills located on St. Croix and St. Thomas.

Public Road Construction

A portion of the proceeds of the Series 2004A Bonds will be used to finance the repair and construction of public roads in the amount up to \$5 million on St. Croix and in the amount up to \$5 million on St. Thomas and St. John.

Start-Up Capital/Virgin Islands Waste Management Authority

In order to facilitate the implementation of the 2002 Stipulation to the Amended Consent Decree, on January 23, 2004, the Government approved legislation to create an independent Virgin Islands Waste Management Authority (“VIWMA”). The VIWMA has been authorized to implement an environmental user fee on goods produced within or imported into the Virgin Islands, and has been granted the power to issue bonds secured by its revenues or other dedicated funding sources. It is anticipated that, under the guidance of its Board of Directors, the VIWMA will operate and maintain all facilities dedicated to the management of solid waste and wastewater. Using dedicated revenues and other resources, the VIWMA is expected to have sufficient funds to operate and maintain the Virgin Islands environmental infrastructure, once mandated construction or upgrades have been completed.

An amount up to \$4 million of the proceeds of the Series 2004A Bonds will be provided to the VIWMA as start-up capital.

SECURITY FOR THE SERIES 2004A BONDS

General

The Series 2004A Bonds are payable from, and secured by, a pledge of the Trust Estate which includes certain funds established under the Indenture and the Series 2004A Matching Fund Loan Note. The Series 2004A Matching Fund Loan Note is a special limited obligation of the Government and is secured solely by a pledge and assignment of the Matching Fund Revenues. The Series 2004A Matching Fund Loan Note is secured by a pledge and assignment of Matching Fund Revenues on a parity basis with the Prior Matching Fund Loan Notes securing the Prior Senior Lien Bonds and any Matching Fund Loan Notes securing any Additional Bonds issued as Senior Lien Bonds under the Indenture. Payment of the

Prior Subordinate Lien Bonds from the Trust Estate is subordinate to the payment of Series 2004A Bonds and the Prior Senior Lien Bonds.

Pursuant to the Indenture, the Series 2004A Bonds are secured by the Trust Estate which includes: (i) moneys deposited or required to be deposited in the Pledged Revenue Account, the Senior Lien Debt Service Account, and the Series 2004A Senior Lien Debt Service Reserve Subaccount, including all of the Authority's right and title to, and interest in, the investments held in the Senior Lien Debt Service Account and the Series 2004A Senior Lien Debt Service Reserve Subaccount and any Credit Facility held in a Series 2004A Senior Lien Debt Service Reserve Subaccount pursuant to the provisions of the Indenture; (ii) the Matching Fund Loan Notes, including, without limitation, the Series 2004A Matching Fund Loan Note, and the proceeds and collections therefrom, including all of the Authority's right and title to, and interest in, the Matching Fund Revenues; (iii) all of the Authority's right and title to, and interest in, the Loan Agreements, including, without limitation, the Series 2004A Loan Agreement; (iv) all of the Authority's right and title to, and interest in, the proceeds from the sale of Series 2004A Bonds required to be deposited in the Series 2004A Construction Subaccounts pursuant to the provisions of the Indenture (except as limited below) and all right and title to, and interest in, the investments held in the Series 2004A Construction Subaccounts (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 SERIES 2004A BONDS AND THE PRIOR BONDS ARE THE ONLY BONDS ISSUED UNDER THE INDENTURE. THE INDENTURE PROVIDES FOR THE ISSUANCE OF ADDITIONAL BONDS. THE SERIES 2004A BONDS ARE LIMITED AND SPECIAL OBLIGATIONS OF THE AUTHORITY. PRINCIPAL, PREMIUM, IF ANY AND INTEREST ON THE SERIES 2004A BONDS ARE PAYABLE SOLELY FROM THE PROCEEDS OF REPAYMENT OF THE SERIES 2004A MATCHING FUND LOAN NOTE AND OTHER AMOUNTS PLEDGED PURSUANT TO THE INDENTURE AS DESCRIBED HEREIN.

THE SERIES 2004A 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 SERIES 2004A BONDS ARE DERIVED FROM THE SERIES 2004A MATCHING FUND LOAN NOTE WHICH IS A SPECIAL LIMITED OBLIGATION OF THE GOVERNMENT. THE TAXING POWER OF THE GOVERNMENT IS NOT PLEDGED FOR THE SERIES 2004A MATCHING FUND LOAN NOTE OR THE SERIES 2004A BONDS. THE SERIES 2004A MATCHING FUND LOAN NOTE IS SECURED SOLELY BY A PLEDGE OF THE MATCHING FUND REVENUES. SUCH PLEDGE OF THE MATCHING FUND REVENUES TO THE MATCHING FUND LOAN NOTE AND THE PRIOR MATCHING FUND LOAN NOTES IS SUBJECT TO A PRIOR PLEDGE TO SECURE CERTAIN EXISTING DEFEASED INDEBTEDNESS OF THE GOVERNMENT. THE SERIES 2004A MATCHING FUND LOAN NOTE DOES NOT CONSTITUTE A GENERAL OBLIGATION OF THE UNITED STATES OF AMERICA, NOR SHALL THE UNITED STATES OF AMERICA BE LIABLE THEREON.

Series 2004A Matching Fund Loan Note

The Series 2004A Bonds will be secured by the Trust Estate, including, without limitation, a special limited obligation Series 2004A Matching Fund Loan Note issued by the Government pursuant to the Series 2004A Loan Agreement. The Government will be obligated under the Series 2004A Matching Fund Loan Note to make payments to the Authority in amounts sufficient to pay all principal, premium, if

any, and interest on the Series 2004A Bonds when due and to make the amount on deposit in the Series 2004A Senior Lien Debt Service Reserve Subaccount of the Senior Lien Debt Service Reserve Account equal to the Series 2004A Debt Service Reserve Requirement pursuant to the terms of the Indenture. Pursuant to the terms of the Series 2004A Loan Agreement, the Government has authorized the issuance of the Series 2004A Matching Fund Loan Note as security for the Series 2004A Bonds. The Series 2004A Matching Fund Loan Note has been issued in anticipation of the receipt of the Matching Fund Revenues over the full term of the Series 2004A Matching Fund Loan Note, 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 Series 2004A Bonds and the Prior Bonds. However, no assurances can be given as to the sufficiency of Matching Fund Revenues for such purpose. (See “MATCHING FUND REVENUES”.)

The pledge of the Matching Fund Revenues by the Government under the Matching Fund Loan Note is subordinate to a prior pledge of the Matching Fund Revenues which the Government has made in connection with 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 (which themselves were defeased with a portion of the proceeds of the Prior Bonds), but continue to hold a prior pledge of Matching Fund Revenues. The Defeased Bonds consist of a series of bonds having an outstanding principal balance of \$4,829,000 and a final maturity of January 2, 2007 and a series of bonds having an outstanding principal balance of \$2,810,000 and a 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 & Whinney 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.

Special Escrow Agreement

The Government, the Authority and The Bank of New York Trust Company, N.A., as Special Escrow Agent, have entered into a Special Escrow Agreement dated as of May 1, 1998, as amended and supplemented by Amendment No. 1 thereto, dated as of December 1, 2004 (as amended and supplemented, the “Special Escrow Agreement”) which provides for the deposit of Matching Fund Revenues into the Special Escrow Account and payment of all Debt Service payments on the all Bonds outstanding under the Indenture due in the next Fiscal Year, and the funding of any deficiencies in the Debt Service Reserve Account prior to transfer of any excess Matching Fund Revenues to the Government for other uses. (See “Appendix B – Summary of Certain Provisions of the Indenture and the Special Escrow Agreement.”)

Series 2004A Loan Agreement

Under the Series 2004A Loan Agreement, the Authority shall lend to the Government the sum of \$94,000,000 as a loan which shall be evidenced by the Series 2004A Matching Fund Loan Note. Pursuant to the Series 2004A 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 2004A Matching Fund Loan Note. The Government has notified the Department of the Interior, Office of Insular Affairs, of the assignment and has instructed such department to transmit all Matching Fund Revenues to the Special Escrow Agent. The Government shall repay to the Authority, pursuant to the Series 2004A Matching Fund Loan Note, in annual installments in accordance with a principal maturity schedule corresponding to the Series 2004A Bonds. The Series 2004A Matching Fund Loan Note 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, 2005, and ending on the second Business Day next preceding the final maturity of the Series 2004A Matching Fund Loan Note. Amounts to be applied to the payment of interest on the Series 2004A Bonds on April 1, 2005 will be derived from Matching Fund Revenues received by the Special Escrow Agent prior to October 1, 2004. Such amounts are currently on deposit with the Authority and will be transferred to the Trustee for such purpose on the date of issuance of the Series 2004A Bonds. The Series 2004A 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 Series 2004A Bonds and at a redemption price equal to the Series 2004A Bonds, pursuant to the terms of the Indenture.

The Government has covenanted in the Series 2004A 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, 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 Series 2004A Matching Fund Loan Note. 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, as authorized by law, 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 Series 2004A Loan Agreement to use its best efforts to cause the Government to comply with the terms and the covenants set forth in the Series 2004A 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) 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 Account

In connection with the issuance of each series of Bonds, the Trustee shall initially fund each Debt Service Reserve Subaccount, as applicable, through a deposit to the credit of the respective Subaccount 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 Subaccount Credit Facility to be delivered to the Trustee for such purpose. A valuation of each Debt Service Reserve Subaccount 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 Subaccount 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 Subaccount 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 Matching Fund 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 Subaccount.

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 Subaccount, an amount not exceeding the aggregate amount necessary, together with the amounts already on deposit in each Debt Service Reserve Subaccount to make the amounts on deposit in such Debt Service Reserve Subaccount 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.

The Debt Service Reserve Requirement with respect to the Series 2004A Bonds shall mean an amount equal to the least of (i) the maximum principal and interest due on the Series 2004A Bonds in the current or any future Fiscal year, (ii) 10% of the original stated principal amount of the Series 2004A Bonds (or 10% of the issue price of the Series 2004A Bonds, if required by the Code), or (iii) 125% of the average annual principal and interest due on the Series 2004A Bonds in the current and each future Fiscal Year, as specified in the Indenture.

The Debt Service Reserve Requirement with respect to the Prior Senior Lien Bonds and the Prior Subordinate Lien Bonds, respectively, was established at 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.

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 Matching Fund 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 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 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 SERIES 2004A BONDS

General

The Series 2004A Bonds will be dated December 1, 2004, and will bear interest at the rates and will mature on the dates set forth on the cover of this Official Statement. Interest on the Series 2004A Bonds will be payable on April 1 and October 1, commencing on April 1, 2005. The Series 2004A Bonds are subject to redemption at the times and in the manner set forth below in "THE SERIES 2004A BONDS - Redemption". Pursuant to the Indenture, the Authority has appointed the Trustee as the Paying Agent and Registrar. Interest on the Series 2004A 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 Series 2004A 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 Series 2004A Bonds will be issued pursuant to, and secured by, the Indenture and pursuant to United States Virgin Islands law. Proceeds of the Series 2004A Bonds will be used to (i) finance the planning, development, constructing, renovating and equipping of a wastewater treatment facility on St. Thomas and a wastewater treatment facility on St. Croix and the repair and construction of certain wastewater collection systems on St. Thomas and St. Croix, (ii) finance the repairs, renovations and construction of solid waste facilities throughout the Territory, (iii) finance the repair and construction of public roads throughout the Territory, (iv) provide start-up capital for the newly created Virgin Islands Waste Management Authority, (v) fund the Series 2004A Senior Lien Debt Service Reserve Subaccount, and (vi) pay certain costs of issuance of the Series 2004A Bonds.

Senior/Subordinate Lien Structure

The Series 2004A Bonds constitute a Series of Senior Lien Bonds under the Indenture. Payment from the Trust Estate of the Subordinate Lien Bonds is 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.

Book-Entry-Only System

The Depository Trust Company ("DTC") will act as securities depository for the Series 2004A Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of the Series 2004A Bonds, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the 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 the 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 and provides asset servicing for over two million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Series 2004A Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2004A Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2004A Bonds ("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. Beneficial Owners are, however, 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 Series 2004A Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Series 2004A Bonds, except in the event that use of the book-entry system for the Series 2004A Bonds is discontinued.

To facilitate subsequent transfers, all Series 2004A Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2004A Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2004A Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Series 2004A Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Series 2004A Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an 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 Series 2004A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption premium, if any, and interest payments on the Series 2004A Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Authority or the Trustee, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Direct and Indirect 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 Direct and Indirect Participant and not of DTC nor its nominee, 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 Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

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

The Series 2004A Bonds maturing after October 1, 2014 shall be subject to redemption at the option of the Authority prior to their stated maturities, on or after October 1, 2014, 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 a redemption price equal to 100% of the principal amount thereof, together with the interest accrued on the principal amount redeemed to the date fixed for redemption.

Purchase of the Series 2004A Bonds

Pursuant to the Indenture, the Trustee may purchase the Series 2004A 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 Series 2004A 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 2004A Bonds, portions of a 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 Series 2004A 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 Series 2004A Bonds selected for redemption. The Authority, so long as a book-entry method is used for the Series 2004A Bonds, will send any such notice of redemption only to DTC.

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Debt Service Requirements

Series 2004A Senior Lien Bonds									
Fiscal Year	Outstanding Senior Lien Debt Service	Principal	Interest	Total	Total Senior Lien Debt Service	Outstanding Subordinate Lien Debt Service	Total Debt Service	Total Senior Lien Debt Service	Total Debt Service
2005	\$28,338,006	\$ -	\$1,608,046	\$1,608,046	\$29,946,052	\$11,445,631	\$41,391,683	\$29,946,052	\$41,391,683
2006	28,612,744	2,295,000	4,778,238	7,073,238	35,685,981	11,445,381	47,131,363	35,685,981	47,131,363
2007	28,610,856	2,980,000	4,657,838	7,637,838	36,248,694	11,444,981	47,693,675	36,248,694	47,693,675
2008	28,610,281	3,130,000	4,505,088	7,635,088	36,245,369	11,448,381	47,693,750	36,245,369	47,693,750
2009	28,618,819	3,285,000	4,344,713	7,629,713	36,248,531	11,323,431	47,571,963	36,248,531	47,571,963
2010	28,614,796	3,450,000	4,176,338	7,626,338	36,241,134	11,452,313	47,693,446	36,241,134	47,693,446
2011	28,613,576	3,625,000	3,999,463	7,624,463	36,238,039	11,455,775	47,693,814	36,238,039	47,693,814
2012	28,612,496	3,805,000	3,813,713	7,618,713	36,231,209	11,455,406	47,686,615	36,231,209	47,686,615
2013	28,610,866	3,995,000	3,618,713	7,613,713	36,224,579	11,455,200	47,679,779	36,224,579	47,679,779
2014	28,613,869	4,195,000	3,413,963	7,608,963	36,222,831	11,454,006	47,676,838	36,222,831	47,676,838
2015	28,615,094	4,405,000	3,198,963	7,603,963	36,219,056	11,290,922	47,509,978	36,219,056	47,509,978
2016	28,614,344	4,625,000	2,967,431	7,592,431	36,206,775	11,454,397	47,661,172	36,206,775	47,661,172
2017	28,613,731	4,865,000	2,718,319	7,583,319	36,197,050	11,350,259	47,547,309	36,197,050	47,547,309
2018	28,615,094	5,120,000	2,456,213	7,576,213	36,191,306	11,342,034	47,533,341	36,191,306	47,533,341
2019	28,615,131	5,390,000	2,180,325	7,570,325	36,185,456	11,325,609	47,511,066	36,185,456	47,511,066
2020	28,615,406	5,675,000	1,889,869	7,564,869	36,180,275	11,163,000	47,343,275	36,180,275	47,343,275
2021	28,612,344	5,970,000	1,584,188	7,554,188	36,166,531	9,992,650	46,159,181	36,166,531	46,159,181
2022	28,612,094	6,285,000	1,262,494	7,547,494	36,159,588	11,455,150	47,614,738	36,159,588	47,614,738
2023	12,418,406	6,615,000	923,869	7,538,869	19,957,275	8,425,400	28,382,675	19,957,275	28,382,675
2024	3,771,297	6,960,000	567,525	7,527,525	11,298,822	-	11,298,822	11,298,822	11,298,822
2025	28,547,359	7,330,000	192,413	7,522,413	36,069,772	-	36,069,772	36,069,772	36,069,772
2026	9,422,766	-	-	-	9,422,766	-	9,422,766	9,422,766	9,422,766

SOURCES AND USES OF FUNDS

The estimated sources and uses of the proceeds of the Series 2004A Bonds (exclusive of accrued interest) is expected to be as follows:

SOURCES OF FUNDS

Par Amount.....	\$94,000,000
Original Issue Premium	<u>4,765,056</u>
Total Sources	\$98,765,056

USES OF FUNDS

Deposit to Series 2004A Project Subaccount.....	\$85,000,000
Deposit to Series 2004A Waste Management Authority Subaccount.....	4,000,000
Deposit to Series 2004A Senior Lien Debt Service Reserve Subaccount.....	7,715,088
Costs of Issuance ⁽¹⁾	<u>2,049,968</u>
Total Uses	\$98,765,056

⁽¹⁾ The Costs of Issuance of the Series 2004A Bonds includes legal fees, Trustee fees, financial advisor fees, underwriter’s discount and other costs incurred in connection with the issuance of the Series 2004A Bonds.

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. The term “Matching Fund Revenues” is used to denote these payments. 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”.)

The amount of Matching Fund Revenues 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. Such revenue collections by the Government have, since 1954, 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 each 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. In 1978, Congress changed the manner in which Matching Fund Revenues were paid. Under Public Law 95-348, 48 U.S.C.A. § 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, through the Secretary of the Interior, 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 (the “Cover Over Rate”) are set by Congress and codified in Sections 5001(a)(1) and 7652(f) of the Code. The federal excise tax on distilled spirits produced in, or imported into the United States has over the years ranged from \$10.50 per proof gallon to \$13.50 per proof gallon. Until 1984, the entire amount of such excise tax qualified for transfer to the Government. As part of the Deficit Reduction Act of 1984, Congress increased the federal excise tax on distilled spirits from \$10.50 per proof gallon to \$12.50 per proof gallon, but capped the Cover Over Rate at \$10.50 per proof gallon. As part of the Omnibus Budget Reconciliation Act of 1990, Congress increased the federal excise tax rate on distilled spirits to \$13.50 per proof gallon, but maintained the cap on the Cover Over Rate at \$10.50. As part of the Omnibus Budget Reconciliation Act of 1993, Congress increased the Cover Over Rate, through September 30, 1998, from \$10.50 per proof gallon to \$11.30 per proof gallon. As part of the Tax Relief Extension Act of 1999, Congress increased the Cover Over Rate to \$13.25 per proof gallon from July 1, 1999 through December 31, 2001. As part of the Job Creation and Worker Assistance Act of 2002, Congress extended the \$13.25 per proof gallon Cover Over Rate from January 1, 2002 through December 31, 2003. As part of the Middle Class Tax Relief Extension Act of 2004, Congress extended the \$13.25 per proof gallon Cover Over Rate from January 1, 2004 through December 31, 2005.

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 Cover Over Rate.

Set forth below is a brief synopsis of the history of the Federal excise tax rates and corresponding Cover Over Rates per proof gallon of rum for the last twenty (20) calendar years:

<u>Year</u>	<u>Excise Tax Rate*</u>	<u>Cover Over Rate*</u>	<u>Legislation</u>
1984	\$12.50	Lesser of \$10.50 or the excise tax rate	The Deficit Reduction Act of 1984
1990	\$13.50	\$10.50	Omnibus Budget Reconciliation Act of 1990
1993	\$13.50	\$11.30	Omnibus Budget Reconciliation Act of 1993
1998	\$13.50	Lesser of \$10.50 or the excise tax rate	Section 7652f of the U.S. Code
1999-2002	\$13.50	\$13.25	Tax Relief Extension Act of 1999
2002-2004	\$13.50	\$13.25	Job Creation and Worker Assistance Act of 2002
2004-2005	\$13.50	\$13.25	Middle Class Tax Relief Extension Act of 2004

* Per proof gallon

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 SERIES 2004A BONDS. (SEE “THE RUM INDUSTRY” AND “BONDHOLDER RISKS”.)

The following is a summary of Matching Fund Revenues received by the Government for Fiscal Years 1999 through 2004:

Matching Fund Revenues⁽¹⁾
Fiscal Years 1999 - 2004
(\$000's)

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Projected Matching Fund Revenues for						
Current Fiscal Year.....	\$43,635	\$64,433	\$67,611	\$60,121	\$70,397	\$65,849
Plus/Minus Actual Adjustments for 2						
Fiscal Years Prior	<u>(526)</u>	<u>0</u>	<u>7,505</u>	<u>(1,749)</u>	<u>481</u>	<u>(2,752)⁽²⁾</u>
Actual Advance Received for Current Fiscal Year.....	43,109	64,433	75,116	58,372	70,878	63,097
Actual Excise Tax Collections for						
Fiscal Year at Matching Fund Rate	51,140	62,691	68,092	60,337	64,103	75,001
Expected Adjustments for 2 Fiscal Years						
Later.....	7,505	(1,742)	481	216	(6,294)	9,152

(1) All information is from the United States Virgin Islands Office of Management and Budget and the Global Insight, Inc. Projection of Virgin Islands Government Revenues from Rum Shipments to the US, which is included as Appendix D of this Official Statement.

(2) The 2002 Base Advance was originally calculated at \$63,089, but should have been \$60,121. The adjustment of the resulting difference of (\$2,968) was made in the 2004 advance.

Global Insight, Inc. ("Global Insight"), an economic consulting firm, was engaged to verify Matching Fund Revenues received by the Government from Fiscal Year 1992 through Fiscal Year 2004 and to project Matching Fund Revenues for Fiscal Years 2005 through 2009. A copy of their report is attached to this Official Statement. (See "Appendix D-Verification of Matching Fund Revenues"). The following table presents Matching Fund Revenues projected by Global Insight for Fiscal Years 2005 to 2009. The table also includes the Matching Fund Revenues used to determine the par amount of the Series 2004A Bonds to be issued.

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

	Projected FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Projected Matching Fund Revenues (Global Insight)	\$77,400	\$80,480	\$83,703	\$86,827	\$90,367
Expected Adjustments	<u>(6,294)</u>	<u>9,152</u>	<u>0</u>	<u>0</u>	<u>0</u>
Projected Base Advance	71,106	89,632	83,703	86,827	90,367
Matching Fund Revenues for Debt Sizing ⁽¹⁾	64,116	64,116	64,116	64,116	64,116
Debt Service on Prior Senior Lien Bonds	28,338	28,613	28,611	28,610	28,619
Debt Service on Series 2004A Bonds	<u>1,608</u>	<u>7,073</u>	<u>7,637</u>	<u>7,635</u>	<u>7,629</u>
Total Senior Lien Debt Service	29,946	35,686	36,248	36,245	36,248
Debt Service on Prior Subordinate Lien Bonds	<u>11,446</u>	<u>11,445</u>	<u>11,445</u>	<u>11,448</u>	<u>11,323</u>
Aggregate Debt Service	41,392	47,131	47,693	47,693	47,571
 Debt Service Coverage Based on: <u>Projected Base Advance</u>					
Senior Coverage	2.37x	2.51x	2.31x	2.40x	2.49x
Subordinate Coverage	3.60x	4.71x	4.15x	4.42x	4.78x
Aggregate Coverage	1.72x	1.90x	1.76x	1.82x	1.90x
 <u>Matching Fund Revenues for Debt Sizing</u>					
Senior Coverage	2.14x	1.80x	1.77x	1.77x	1.77x
Subordinate Coverage	2.99x	2.48x	2.43x	2.43x	2.46x
Aggregate Coverage	1.55x	1.36x	1.34x	1.34x	1.35x

(1) Based on average of the actual Base Advance collected for Fiscal Year 2002 through Fiscal Year 2004 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, 1.25x on Subordinate Lien Bonds, and 1.10x on an aggregate basis.

Verification of Matching Fund Revenues

Global Insight 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 2004 and to develop projections for Matching Fund Revenues from Fiscal Year 2005 through 2009. Global Insight'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 2004 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, Global Insight 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 \$83.8 million from Fiscal Year 2005 through Fiscal Year 2009. The Trend Market Share Model bases future revenue projections on historical rum production in the Virgin Islands and forecasts Matching Fund Revenues averaging approximately \$84.3 million from Fiscal Year 2005 through Fiscal Year 2009.

Global Insight's models assumed: (i) a constant \$13.25 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. Global Insight 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, Global Insight 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.

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. In recent years, Virgin Islands rum has also entered the more lucrative branded segment. Approximately 4.72 million proof gallons of rum were exported from the Virgin Islands to the United States in calendar year 2003.

The distilled spirits industry generally embarked on a period of expansion in the past decade. Previously U.S. consumption had been declining steeply since the early 1980s. By 1995 the volume of consumption had fallen to 137.3 million (9-liter) case, 28% less than the 190.9 million cases consumed in 1980. The year 1995 proved to be the trough of this cycle however. In the next 8 years, to 2003, consumption increased to 159.1 million cases, a gain of 15.9%. Moreover, at 3.8%, the annual growth in 2003 was the greatest of the period. Industry projections (*Adams Liquor Handbook (2004)*) are for further growth, averaging 2.3% annually over the next five years. Even so, consumption would be 5% below its historical 1981 peak.

Two broad socio-economic factors have been at work over this time. First, a growing health-consciousness among American consumers led to a reduction in alcohol consumption generally, and to a shift to beer and wine as hard liquor alternatives. Second, strong economic expansions during the 1980s and the 1990s boosted levels of disposable income to new heights. Consumer spending generally has surged, and has shifted to more expensive, premium products. This refinement in tastes of Americans has been reflected in a shift in the composition of the distilled spirits market. Demand has shifted from whiskeys to non-whiskeys, particularly to vodka and rum.

This transition has mirrored the nation's demographics as the now-aging baby boom generation dominates consumption, replacing the habits of the previous generations. Meanwhile, succeeding cohorts have more disposable income and have clearly driven the bar and restaurant market for premium cocktails. Total whiskey consumption, including American and imported, has declined from 31.9% of the spirits market five years ago, to 27.5% in 2003. Rum gained 2.3 percentage points of that market share, while vodka added 2 points to reach 26.2% of all liquor consumption.

The rum industry has exhibited robust growth in market share over the past decade. Its share has increased every year since 1992. At 12.3% of total liquor consumption in 2003, its share has climbed from 6.8% in 1980 and 8.3% ten years ago. Since 1995, rum consumption, in volume, has never increased at less than a 3.7% annual rate. 2003 consumption grew by 5.1% from 2002, to 19.5 million cases, a 67% increase over 1994. Total distilled spirits consumption grew by less than 14% over that time span. (See “Appendix D — Verification of Matching Fund Revenues”).

Distilled Spirits Market Share

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Whiskeys	31.9%	33.5%	29.6%	28.9%	28.3%	27.5%
U.S. Whiskeys	13.7	13.2	12.8	12.4	12.1	11.8
Scotch	6.7	6.4	6.2	6.0	5.9	5.7
Other Whiskeys ⁽¹⁾	11.5	13.9	10.6	10.5	10.3	10.0
Non-Whiskeys	68.1%	69.3%	70.4%	71.1%	71.6%	72.5%
Rums	10.0	10.8	11.4	11.9	12.1	12.3
Vodka	24.2	24.2	24.4	25.1	25.7	26.2
Gin	8.0	7.7	7.5	7.4	7.2	6.9
Others ⁽²⁾	25.9	26.6	27.1	26.7	26.6	27.1

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

(1) Includes Canadian and Irish Whiskeys.

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

Source: **Adams Liquor Handbook (2004)**.

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

General

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 eleven principal buildings of approximately 140,000 square feet on 33 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.

In 1999, Angostura Limited (“Angostura”), a Trinidad-based distiller, acquired 33% of Todhunter and has subsequently increased its ownership to 68% of the Company's outstanding common stock during Todhunter's fiscal year ending September 30, 2004.

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 goodwill or “market cache” of Virgin Islands rum and the molasses subsidy provided by the Government. Since 1995, Todhunter has continued to invest in VIRIL's facilities to expand production capacity, discharge treatment capacity, warehousing capacity and rum tank storage capacity.

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 67%; total

production capacity at the VIRIL facility is approximately 8,000,000 proof gallons per year. The acquisition of VIRIL and the consolidation of its bulk rum production in the Virgin Islands has solidified Todhunter's position as the largest producer of bulk rum for the United States. According to its Annual Report for the Fiscal Year ending September 30, 2003, Todhunter is the largest supplier of bulk rum to the United States market, with a market share of approximately 85%. For Fiscal Year 2004, VIRIL budgeted rum shipments of 5,739,400 proof gallons. Actual shipments, however, were 5,877,286 proof gallons. For Fiscal Year 2005, VIRIL is projecting shipments of approximately 6,000,000 proof gallons.

For Todhunter's fiscal year ending September 30, 2003, Todhunter had total assets in excess of \$139,000,000 and net sales in excess of \$90,000,000. Todhunter has four major lines of business: production of citrus and cane-based bulk alcohol for beverages and foods; production and bottling of case goods spirits (including contract bottling services); importing and marketing of premium branded spirits including Cruzan Rum, from the Virgin Islands and Hine Cognac from France, and production of vinegar, cooking wine and other alcohol-related products. 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, since 1997 Todhunter has repositioned, re-packaged and launched several new rums and continues to expand the Cruzan brand by introducing new flavors and rum concepts. In 2003, bulk alcohol products represented 39% of all of Todhunter's sales, with Todhunter selling 17.1 million gallons of bulk alcohol 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 27% and sales of the Cruzan flavored rums were up 24% in 2004. The Cruzan rum brand growth in 2004 has been largely the result of attracting new consumers to the brand's pioneering efforts in flavored rum development coupled with the growing popularity of flavored rum cocktails in the U.S. market. Cruzan rum is expected to continue to lead the percentage growth in the rum category with an increased focus on expanding distribution in key markets and accounts and gaining more critical mass opportunities in chains which feature flavored rum cocktails in their drink menus. As a result of the expansion of the VIRIL facility and Todhunter's new business of importing, marketing and distributing branded alcohol beverages, unit sales of rum have increased and the Government of the U.S. Virgin Islands 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 or in the investor relations section of Todhunter's website at www.todhunter.com.

2002 Government/EPA Memorandum of Understanding

In December 1996, VIRIL applied to the Virgin Islands Department of Planning and Natural Resources (the "DPNR") for renewal of its Territorial Pollutant Discharge Elimination System ("TPDES") Permit for its St. Croix distillery operations. In conjunction with the permit renewal, VIRIL requested that the renewed TPDES Permit contain a flow limitation allowing the distillery to increase its discharge by approximately 20% (from 115,000 gallons per day to 138,000 gallons per day). DPNR sought comments from United States Environmental Protection Agency (the "EPA") prior to renewal of the TPDES Permit, including comments on the proposed increase in the discharge limitation. In accordance with EPA regulations, until such time as DPNR considered VIRIL's renewal application, VIRIL was permitted to continue to discharge effluent within the limitations set forth in its prior TPDES

Permit (115,000 gallons per day). On August 21, 2002, the Government and the EPA entered into a Memorandum of Understanding documenting the EPA's agreement to support the renewal of the TPDES Permit provided that the Government make certain funding available to (i) conduct treatability studies regarding the VIRIL effluent and the means to mitigate its potential environmental effects in the vicinity of the discharge, (ii) identify practicable, available, reliable and cost-effective potential mitigation measures, and (iii) implement (or assist in the implementation of) such mitigation measures in the event such measures are determined by DPNR (after consultation with EPA) to be necessary and appropriate. Pursuant to the Memorandum of Understanding, the Government's obligation to fund such activities is limited to \$6,000,000. To date, the Government has deposited \$1.25 million into an interest bearing account in compliance with the terms of the Memorandum of Understanding. VIRIL's TPDES Permit was renewed by DPNR on August 27, 2002 and will expire on August 31, 2007. VIRIL has since been notified by the EPA that tests have detected low levels of toxicity in the discharge from its distillery operations which may be harmful to certain marine life exposed thereto. VIRIL and the Government are currently working with the DPNR and the EPA to identify appropriate mitigation measures. There can be no assurance that mitigation measures can be identified, or if identified, whether such measures can be implemented with the funds made available by the Government for such purpose. Mitigation could require further funding by the Government and/or VIRIL. There can be no assurance that the funding of such mitigation measures by VIRIL or liability and costs associated with possible enforcement actions by the EPA will not adversely affect VIRIL's financial condition or results of operation.

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 VIRIL is purchased on such commodity markets from sources outside the Virgin Islands.

The Government maintains a program, first established in 1967, by which it stabilizes the cost of molasses to Virgin Islands rum producers to compensate for the demise of the local sugar cane industry and ensure the competitive pricing of rum produced in the Virgin Islands. The effect of the molasses payments is to maintain the competitive position of Virgin Islands rum producers, after the demise of the Virgin Islands sugar cane industry, relative to the rum producers in other countries where local molasses supplies are readily available.

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 exclusively for such purpose. Amounts available in the Molasses Subsidy Fund are requisitioned by rum producers on a quarterly basis by certified vouchers to the Commissioner of Finance upon receipt of each molasses shipment. The Commissioner of Finance verifies the accuracy of such vouchers and makes payment to individual rum producers to the extent funds are available in the Molasses Subsidy Fund. The Governor includes in each Annual Budget submitted for approval to the Legislature a request for appropriation for the Molasses Subsidy Fund based upon an estimate of molasses to be acquired by local producers 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. The Legislature, however, is not obligated to appropriate such amounts. The following table sets forth the molasses subsidies that have been provided by the Government to the Virgin Islands rum producers since 1995:

**Molasses Subsidy Payments
1995 to 2004**

<u>Fiscal Year</u>	<u>Molasses Gallons</u>	<u>Dollar Amount Subsidy</u>
1995.....	5,316,699	\$2,008,392
1996.....	9,017,562*	4,045,509*
1997.....	5,296,588	2,175,536
1998.....	8,289,330	1,300,000
1999.....	7,763,675	2,969,725
2000.....	8,790,630	1,955,253
2001.....	8,622,054	2,570,733
2002.....	8,607,398	2,558,300
2003.....	6,765,893	3,477,651
2004.....	7,065,528	4,000,000

* Due to Hurricane Marilyn, a portion of the 1995 Fiscal Year subsidy payment was made in Fiscal Year 1996.
Source: Virgin Islands Office of Management and Budget.

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

In 1999, the Government completed construction of the Gordon Finch Molasses Pier on St. Croix which has increased the capacity for deliveries and storing of molasses and has increased the safety and availability of molasses cargoes to the island of St. Croix. The improvements 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 was completed in 2002. The on-pier molasses storage capacity for the Virgin Islands rum producer is 3 million gallons.

The St. Croix Molasses Pier improvements have allowed the docking of larger cargo vessels and the delivery of larger molasses shipments thereby reducing the per gallon shipping cost of imported molasses. It is expected that these improvements will enable the Government to continue to provide favorable conditions within the Virgin Islands for VIRIL to maintain its competitiveness in the United States rum market.

BONDHOLDER RISKS

THE PURCHASE AND OWNERSHIP OF THE SERIES 2004A BONDS MAY INVOLVE INVESTMENT RISKS. PROSPECTIVE PURCHASERS OF THE SERIES 2004A 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 SERIES 2004A BONDS. IN ADDITION TO POSSIBLE ADVERSE EFFECTS ON SECURITY FOR THE SERIES 2004A BONDS, PURCHASERS SHOULD BE AWARE THAT THESE FACTORS, AMONG OTHERS, MAY ADVERSELY AFFECT THE MARKET PRICE

OF THE SERIES 2004A BONDS IN THE SECONDARY MARKET. (SEE ALSO “SECURITY FOR THE SERIES 2004A BONDS”.)

Matching Fund Revenues Sole Security for Matching Fund Loan Notes. The Series 2004A Bonds are secured solely by the Trust Estate, including the Series 2004A Matching Fund Loan Note. The Series 2004A Matching Fund Loan Note is a special limited obligation of the Government. The Government has not pledged its full faith and credit to the payment of the Series 2004A Matching Fund Loan Note. The Series 2004A Matching Fund Loan Note is secured solely by the Matching Fund Revenues, which are derived solely from the sale of rum produced in the Virgin Islands and sold in the United States 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 and the Code 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. The distilled spirits industry generally embarked on a period of expansion in the past decade. The rum industry has exhibited robust growth in market share over the past decade. Its share has increased every year since 1992. At 12.3% of total liquor consumption in 2003, its share has climbed from 6.8% in 1980 and 8.3% ten years ago. Since 1995 rum consumption, in volume, has never increased at less than a 3.7% annual rate. 2003 consumption grew by 5.1% from 2002, to 19.5 million cases, a 67% increase over 1994. Total distilled spirits consumption grew by less than 14% over that time span. 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 today 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 Series 2004A 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. Moreover, no assurances can be given as to the continued viability of VIRIL or other Virgin Islands rum producers in the event that the molasses subsidy payments are decreased or discontinued in the future. (See “THE RUM INDUSTRY”.)

2002 Government/EPA Memorandum of Understanding. In December 1996, VIRIL applied to the DPNR for renewal of its TPDES Permit for its St. Croix distillery operations. In conjunction with the permit renewal, VIRIL requested that the renewed TPDES Permit contain a flow limitation allowing the distillery to increase its discharge by approximately 20% (from 115,000 gallons per day to 138,000 gallons per day). DPNR sought comments from the EPA prior to renewal of the TPDES Permit, including comments on the proposed increase in the discharge limitation. On August 21, 2002, the Government and

the EPA entered into a Memorandum of Understanding which provided that the Government make certain funding available to (i) conduct treatability studies regarding the VIRIL effluent and the means to mitigate its potential environmental effects in the vicinity of the discharge, (ii) identify practicable, available, reliable and cost-effective potential mitigation measures, and (iii) implement (or assist in the implementation of) such mitigation measures in the event such measures are determined by DPNR (after consultation with EPA) to be necessary and appropriate. Mitigation could require further funding by the Government and/or VIRIL. There can be no assurance that the funding of such mitigation measures by VIRIL or liability and costs associated with possible enforcement actions by the EPA will not adversely affect VIRIL's financial condition or results of operation. See "THE RUM INDUSTRY" – Virgin Islands Rum Industries, Ltd. and Todhunter International, Inc. – 2002 Government/EPA Memorandum of Understanding."

Government's Financial Condition. The Government has experienced substantial fluctuations in revenues and expenditures over the years. At the end of Fiscal Year 1999, the accumulated deficit of the Government was approximately \$239.7 million. As a result of certain cost cutting and revenue enhancement measures and improvements in the economy, the accumulated deficit was eliminated and the Government ended Fiscal Years 2000 and 2001 with an accumulated surplus of approximately \$77.2 million and \$181.9 million, respectively. In Fiscal Year 2002, a decline in revenues, primarily as a result of the general economic decline in the United States, the terrorist attacks in New York City and Washington, D.C. on September 11, 2001, and increased spending by the Government related to the implementation of earlier salary increases in 2001, led to a General Fund deficit of approximately \$75.4 million, resulting in a reduced accumulated surplus. Unaudited results for Fiscal Year 2003 indicate an approximate \$14 million surplus for the year, primarily due to approximately \$81.5 million of financing proceeds including certain bond anticipation notes. Preliminary results for Fiscal Year 2004 indicate an approximate \$24 million surplus for the year.

The Government faces certain potential claims against the General Fund which are not recorded in the General Fund because such liabilities do not meet the definition of a fund liability but are reflected in the Government's General Long-Term Debt Account Group. The most significant of these claims is the Government's contractual liability to various local labor unions for retroactive salary increases and current pay-rate increases. See "Appendix F — United States Virgin Islands — Other Factors — Labor Relations." The Government is taking certain actions to improve its financial health. See "Appendix F — United States Virgin Islands — Fiscal Recovery Efforts."

Audited Financial Statements. The Government has not been timely in completing its audited financial statements. The following sets forth the dates of KPMG's reports for the audited financial statements for Fiscal Years 1994 and 1995 and for Fiscal Years 1998 through 2002:

<u>Fiscal Year</u>	<u>Date of KPMG Report</u>
1994	December 13, 1996
1995	February 28, 1999
1998	July 7, 2000
1999	May 31, 2001
2000	January 25, 2002
2001	September 26, 2002
2002	April 23, 2004

The Government has contracted with KPMG to audit its financial statements for Fiscal Years 2002 through 2005, and it is expected that the audited financial statements for Fiscal Year 2003 will be available during the second quarter of 2005. The Government expects that, upon completion of the audit of Fiscal Year 2003, adjustments to the unaudited financial statements presented herein will be necessary. The Government can make no assurance that such adjustments will not be material. See "Appendix F —

United States Virgin Islands — Financial Management, Budgeting and Controls — Financial Reporting” and “Financial Statements of the Government.”

The basic financial statements of the Government for the Fiscal Year ended September 30, 2002, appended hereto as Appendix E as part of this Official Statement, have been audited by KPMG to the extent indicated in their reports thereon. Such basic financial statements have been included in reliance upon the reports of KPMG. Such reports refer to reports of other auditors and contain various qualifications. The report also contains an emphasis paragraph for the implementation of a new reporting model. See “FINANCIAL STATEMENTS OF THE GOVERNMENT” and Appendix E hereto. In addition, OMB Circular A-133 for Fiscal Year 2002 prepared by KPMG noted material weaknesses in internal controls over the financial report based on an audit of the basic financial statements performed in accordance with Government Accounting Standards and events of non-compliance with certain provisions of laws, regulations, contracts and grants that have a direct and material effect on the determination of basic financial statement amounts. Such basic financial statements are included herein for informational purposes only, and the information contained in the basic financial statements should not be read to in any way modify the description of the security for the Series 2004A Bonds contained herein. (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. Public Law 95-348, 48 U.S.C.A. §1645 (West 1987) (“Section 1645”), which provides for annual prepayments of Matching Fund Revenues to the Government, was enacted 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.

Limitation of Remedies. The Indenture does not provide for acceleration of the Bonds, including the Series 2004A Bonds, if an Event of Default occurs and is continuing.

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 Series 2004A Bonds, or which concerns the proceedings of the

Authority or the Government taken in connection with the Series 2004A 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

The Code establishes certain requirements which must be met at and subsequent to the issuance and delivery of the Series 2004A Bonds in order that interest on the Series 2004A Bonds will be and remain excludable from gross income for federal income tax purposes. Included among these continuing requirements are certain restrictions and prohibitions on the use of bond proceeds, restrictions on the investment of bond proceeds and other moneys or properties, and the rebate to the United States of certain earnings in respect of investments. Failure to comply with the continuing requirements may cause the interest on the Series 2004A Bonds to be includible in gross income for federal income tax purposes retroactive to the date of their issuance, irrespective of the date on which such non-compliance occurs. The Authority and the Government have covenanted to comply in the Indenture, the Series 2004A Loan Agreement and the documents relating to federal tax matters delivered at the time of delivery of the Series 2004A Bonds (the "Tax Certificates") with certain procedures, and have made certain representations and certifications, designed to assure satisfaction of the requirements of the Code.

In the opinion of Buchanan Ingersoll PC, New York, New York, Bond Counsel, and subject to the limitations set forth in the immediately succeeding paragraph, under existing statutes, regulations, administrative interpretations and court decisions as of the date of such opinion, the interest on the Series 2004A Bonds will not be included in gross income for federal income tax purposes pursuant to Section 103 of the Code. Furthermore, Bond Counsel is of the opinion that interest on the Series 2004A Bonds is not a specific "item of tax preference" for purposes of the federal alternative minimum tax imposed on individuals and corporations. Bond Counsel notes, however, that interest on the Series 2004A Bonds held by a corporation (other than an S corporation, regulated investment company, real estate investment trust or real estate mortgage investment conduit) is included in adjusted current earnings for purposes of calculating certain taxes including the federal alternative minimum tax imposed on corporations. Corporate purchasers of the Series 2004A Bonds should consult their tax advisors regarding the computation of any alternative minimum tax.

Bond Counsel expresses no opinion regarding other federal income tax consequences caused by the receipt or accrual of interest on the Series 2004A Bonds. The proposed form of the opinion of Bond Counsel is attached to this Official Statement as Appendix H.

Certain Series 2004A Bonds may initially be offered to the public at prices greater than the amounts payable thereon at maturity (the "Premium Bonds"). As a result of the tax cost reduction requirements of the Code relating to amortization of bond premium, under certain circumstances an initial owner of Premium Bonds may realize a taxable gain upon disposition of such Premium Bonds even though they are sold or redeemed for an amount equal to such owner's original cost of acquiring such Premium Bonds. Owners of Premium Bonds are advised that they should consult with their own tax advisors with respect to the tax consequences of owning such Premium Bonds.

In addition to the matters referred to in the preceding paragraphs, prospective purchasers of the Series 2004A Bonds should be aware that the accrual or receipt of interest on the Series 2004A Bonds may otherwise affect the federal income tax liability of the recipient. The extent of these other tax consequences may depend upon the recipient's particular tax status or other items of income or deduction. Bond Counsel expresses no opinion regarding any such consequences. Examples of such other federal income tax consequences of acquiring or holding the Series 2004A Bonds include, without limitation, that (i) with respect to certain insurance companies, the Code reduces the deduction for loss reserves by a portion of the sum of certain items, including interest on the Series 2004A Bonds, (ii) interest on the

Series 2004A Bonds earned by certain foreign corporations doing business in the United States may be subject to a branch profits tax imposed by the Code, (iii) passive investment income, including interest on the Series 2004A Bonds, may be subject to federal income taxation under the Code for certain S corporations that have certain earnings and profits, (iv) the Code requires recipients of certain Social Security and certain other federal retirement benefits to take into account, in determining gross income, receipts or accruals of interest on the Series 2004A Bonds, and (v) reductions or limitations in the earned income credit to taxpayers who may otherwise be eligible. In addition, the Code denies the interest deduction for indebtedness incurred or continued by a taxpayer, including without limitation, banks, thrift institutions and certain other financial institutions to purchase or carry tax-exempt obligations, such as the Series 2004A Bonds.

Bond Counsel is also of the opinion that interest on the Series 2004A Bonds is exempt under existing statutes from personal income taxes imposed by the United States Virgin Islands, by any state, other territory or possession of the United States or any political subdivision thereof, or by the District of Columbia.

Certain requirements and procedures contained or referred to in the Indenture, the Series 2004A Loan Agreement and the Tax Certificate and other relevant documents may be changed, and certain actions may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents, upon the advice or with the approving opinion of Bond Counsel. Buchanan Ingersoll PC expresses no opinion as to any Series 2004A Bonds or the interest thereon if any such change occurs or action is taken upon the advice or approval of bond counsel other than Buchanan Ingersoll PC.

Bond Counsel has not undertaken to determine in the future (or to inform any person) whether any actions taken (or not taken or events occurring or not occurring) after the date of issuance and delivery of the Series 2004A Bonds may affect the tax status of interest on the Series 2004A Bonds. No assurance can be given that future legislation or amendments to the Code, if enacted into law, will not contain provisions which could directly or indirectly reduce the benefit of the exclusion of the interest on the Series 2004A Bonds from gross income for federal income tax purposes.

All quotations from and summaries and explanation of provisions of law do not purport to be complete and reference is made to such laws for full and complete statements of their provisions.

FINANCIAL STATEMENTS

The financial statements of the Government for the Fiscal Year ending September 30, 2002, appended hereto as Appendix E as part of this Official Statement, have been audited by KPMG LLP, certified public accountants, as set forth in their report dated April 23, 2004, which report is also appended hereto. Such report refers to reports of other auditors and contains various qualifications. The report also contains an emphasis paragraph for the implementation of a new reporting model. 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 Series 2004A Bonds contained herein. The assets of the Government, other than those pledged pursuant to the Indenture, are not pledged to nor are they available to Series 2004A Bondowners.

LEGAL OPINIONS

Certain legal matters incident to the issuance of the Series 2004A Bonds are subject to the approving opinion of Buchanan Ingersoll PC, New York, New York, 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 Series 2004A 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 co-counsel Winston & Strawn LLP, New York, New York and Duane Morris LLP, New York, New York. Winston & Strawn LLP currently represents the Authority in other matters.

FINANCIAL ADVISOR

The Authority has retained Banc of America Securities LLC, New York, New York, as financial advisor in connection with the issuance of the Series 2004A Bonds. Although Banc of America Securities LLC has assisted in the preparation of the Official Statement, Banc of America Securities LLC 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.

RATING

The Series 2004A Bonds have been assigned a rating of “BBB” by Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc.

Such rating reflects only the views of such organization and an explanation of the significance of such rating may be obtained from such rating agency. There is no assurance that such rating will continue for any given period of time or that such rating will not be revised or withdrawn entirely by such rating agency, if in the judgment of such rating agency, circumstances so warrant. A revision or withdrawal of such rating may have an effect on the market price of the Series 2004A Bonds.

CONTINUING DISCLOSURE; DISCLOSURE DISSEMINATION

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, 2005 (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. In addition, the Authority has covenanted to provide within forty-five (45) days of the end of 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 (the “Quarterly Report”). The specific nature of the information to be contained in the Annual Report, the Quarterly Report and the notices of material events is summarized in “Appendix G - Form of Authority 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”).

In connection with certain prior continuing disclosure undertakings, the Government has failed to provide its audited financial statements on a timely basis. The Authority and the Government have complied with all other requirements of such undertakings in respect of the provision of financial information and operating data required thereby. The Government has established procedures designed to assure full compliance with such undertakings in the future.

Disclosure Dissemination Agent

In order to provide certain continuing disclosure with respect to the Series 2004A Bonds in accordance with the Rule, the Authority has entered into a Disclosure Dissemination Agent Agreement

(the “Disclosure Dissemination Agreement”) for the benefit of the Bondowners with Digital Assurance Certification, L.L.C. (“DAC”), under which the Authority has designated DAC as Disclosure Dissemination Agent.

The Disclosure Dissemination Agent has only the duties specifically set forth in the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent’s obligation to deliver the information at the times and with the contents described in the Disclosure Dissemination Agreement is limited to the extent the Authority has provided such information to the Disclosure Dissemination Agent as required by the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent has no duty with respect to the content of any disclosures or notice made pursuant to the terms of the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent has no duty or obligation to review or verify any information in the Annual Reports, Quarterly Reports, audited financial statements, notice of Notice Event or Voluntary Report (in each case as such terms are defined in the Disclosure Dissemination Agreement), or any other information, disclosures or notices provided to it by the Authority and shall not be deemed to be acting in any fiduciary capacity for the Authority, the Government, the Bondowners or any other party. The Disclosure Dissemination Agent has no responsibility for the Authority’s failure to report to the Disclosure Dissemination Agent a Notice Event or a duty to determine the materiality thereof. The Disclosure Dissemination Agent shall have no duty to determine or liability for failing to determine whether the Authority or the Government has complied with the Disclosure Dissemination Agreement. The Disclosure Dissemination Agent may conclusively rely upon certifications of the Authority at all times.

UNDERWRITING

The Series 2004A Bonds are being purchased by the underwriters identified on the cover page of this Official Statement (the “Underwriters”). The aggregate purchase price payable by the Underwriters for the Series 2004A Bonds is \$98,124,462.50 (representing the aggregate principal amount of \$94,000,000 plus an original issue premium of \$4,765,055.50 less the underwriters’ discount (as specified below)), plus accrued interest on the Series 2004A Bonds from December 1, 2004 to the date of delivery thereof. The Underwriters are obligated to purchase all of the Series 2004A 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 \$640,593.00 in connection with the underwriting of the Series 2004A Bonds.

The initial public offering price and other terms respecting the offering and sale of the Series 2004A Bonds may be changed from time to time by the Underwriters after the Series 2004A Bonds are released for sale, and the Series 2004A 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 Series 2004A 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”), 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 Series 2004A 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 Series 2004A Bonds.

MISCELLANEOUS

In this Official Statement, any summaries or descriptions of provisions in the Indenture or the Series 2004A 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 Series 2004A 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/ Charles W. Turnbull
Chairman

Dated: December 2, 2004

GLOSSARY OF TERMS

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APPENDIX A

GLOSSARY OF TERMS

CERTAIN DEFINED TERMS

Certain terms used in the Indenture, the Second Supplemental Indenture, the Special Escrow Agreement 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, the Supplements, the Special Escrow Agreement and the Loan Agreement and not defined herein shall have the meaning given such term by the Indenture, the Supplements, the Special Escrow Agreement 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 with 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 10161 Centurion Parkway, Jacksonville, FL 32256 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.
- (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.
 - (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.

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 May 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 Ratings, 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 May 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 including a regularly scheduled Interest Payment Date, in each case to the period from but not 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 to the Indenture, 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 of the Bonds the special limited obligation note in the aggregate principal amount of each of the respective Series of 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.

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.
- (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).
- (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.
- (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.
- (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.

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 Second 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 of 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 division of the McGraw-Hill Companies, 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.

Second Supplemental Indenture means the Second Supplemental Indenture of Trust, dated as of December 1, 2004, between the Authority and the Trustee, authorizing the issuance of the Series 2004A Bonds.

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 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 file Series 1998 D Bonds and the Series 1998 E Bonds.

Series 2004A Arbitrage Rebate Fund shall mean the Arbitrage Rebate Fund established pursuant to the Second Supplemental Indenture.

Series 2004A Bonds shall mean the Authority's \$94,000,000 Revenue Bonds, Series 2004A, authorized to be issued pursuant to the Second Supplemental Indenture.

Series 2004A Construction Subaccounts shall mean the Series 2004A Construction Subaccount and the Series 2004A Waste Management Authority Subaccount of the Construction Account established pursuant to the Second Supplemental Indenture.

Series 2004A Cost of Issuance Subaccount shall mean the Series 2004A Cost of Issuance Subaccount of the Cost of Issuance Account established pursuant to the Second Supplemental Indenture.

Series 2004A Debt Service Reserve Requirement shall mean an amount equal to the least of (a) the maximum principal and interest due on the Series 2004A Bonds in the current or any future Fiscal Year, (b) 10% of the original stated principal amount of the Series 2004A Bonds (or 10% of the issue price of the Series 2004A Bonds if required by the Code), or (c) 125% of the average annual principal and interest due on the Series 2004A Bonds in the current and each future Fiscal Year, as specified in the Indenture and the Second Supplemental Indenture.

Series 2004A Interest Subaccount shall mean the Series 2004A Interest Subaccount established pursuant the Second Supplemental Indenture.

Series 2004A Loan Agreement means the Loan Agreement, dated as of December 1, 2004, by and among the Government, the Authority and the Trustee, entered into in connection with the issuance of the Series 2004 Bonds.

Series 2004A Loan Note means the Government's \$ 94,000,000 principal amount 2004A Matching Fund Loan Note, executed and delivered to the Authority pursuant to the Series 2004A Loan Agreement.

Series 2004A Principal Subaccount shall mean the Series 2004A Principal Subaccount established pursuant to the Second Supplemental Indenture.

Series 2004A Project Subaccount shall mean the Series 2004A Project Subaccount of the Construction Account established pursuant to the Second Supplemental Indenture.

Series 2004A Redemption Subaccount shall mean the Series 2004A Redemption Subaccount established pursuant to the Second Supplemental Indenture.

Series 2004A Senior Lien Bonds or Series 2004A Bonds shall mean the Authority's \$94,000,000 Revenue Bonds (Virgin Island Matching Fund Loan Note) Series 2004A (Senior Lien) authorized to be issued pursuant to the Second Supplemental Indenture.

Series 2004A Senior Lien Debt Service Reserve Account shall mean the Series 2004A Senior Lien Debt Service Reserve Account of the Senior Lien Debt Service Reserve Account established pursuant to the Second Supplemental Indenture.

Series 2004A Senior Lien Expense Subaccount shall mean the Series 2004A Senior Lien Expense Subaccount of the Senior Lien Expense Subaccount established in Second Supplemental Indenture.

Series 2004A Waste Management Authority Subaccount shall mean the Series 2004A Waste Management Authority Subaccount of the Construction Account established pursuant to the Second Supplemental Indenture.

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 The Bank of New York Trust Company, N. A., successor to 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 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 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 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 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 Series 2004A Bonds from Federal income tax.

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 The Bank of New York Trust Company, N. A., successor to 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.

2004A Approved Projects shall mean the capital projects authorized to be financed with the proceeds of the Series 2004A Bonds pursuant to the Second Supplemental 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.

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**SUMMARY OF CERTAIN PROVISIONS
OF THE INDENTURE**

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APPENDIX B

SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE, THE SECOND SUPPLEMENTAL INDENTURE AND THE SPECIAL ESCROW AGREEMENT

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 "**Appendix A - Glossary of Certain Defined Terms**".

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 (3) 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 (2) 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 one hundred fifty percent (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 (2) Fiscal Years following the issuance of the Additional Bonds is projected to equal or exceed one hundred fifty percent (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 (2) Fiscal years following the issuance of the additional Senior Lien Bonds is projected to equal or exceed one hundred ten percent (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 (2) 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 (2) 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 one hundred twenty-five percent (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 (2) Fiscal Years following the issuance of the Additional Subordinate Lien Bonds is projected to equal or exceed one hundred twenty-five percent (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 (2) Fiscal Years following issuance of the additional Subordinate Lien Bonds is projected to equal or exceed one hundred ten percent (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 five thousand dollars (\$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 (15) 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 sixty (60) days nor less than thirty-five (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 title 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) Senior Lien Expense Subaccount;
- (F) Senior Lien Purchase Subaccount;
- (G) 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) Subordinate Lien Interest Subaccount;
- (B) Subordinate Lien Principal Subaccount;
- (C) 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) Subordinate Lien Expense Subaccount;
- (F) Subordinate Lien Purchase Subaccount;
- (G) 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 one hundred percent (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 one hundred percent (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 one hundred percent (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 one hundred percent (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 one hundred percent (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 one hundred percent (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) above and (xiii); 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 2004A 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 one hundred eightieth (180th) 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 the 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 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).

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 rata 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 (15) 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 or 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 another 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 forty-five (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 as may reasonably be required for more fully and certainly vesting and confirming to other things as 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 shall mail a 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 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 when less than all of the several Series of Bonds then Outstanding are affected by the modification or amendment, 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 sixty (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 SECOND SUPPLEMENTAL INDENTURE

The following is a summary of certain provisions of the Second Supplemental Indenture. Such summary does not purport to be complete or definitive and reference is made to the Second 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 "**Appendix A - Glossary of Certain Defined Terms**".

Authorization and Details of 2004A Bonds. The Second Supplemental Indenture authorizes the issuance of the Series 2004AA Bonds. The Series 2004AA Bonds are designed as Senior Lien Bonds.

Bonds Equally and Ratably Secured. Except as otherwise provided in the Indenture and the Second Supplemental Indenture, the Series 2004A Bonds shall in all respects be equally and ratably secured.

Details of the Series 2004AA Bonds. The Bonds shall be dated, December 1, 2004, shall be issuable as fully registered bonds in the denomination of five thousand dollars (\$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 Second Supplemental Indenture.

Depository Provisions. Initially, one certificate for each maturity of the Series 2004A 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 2004A Bonds are subject to redemption upon payment of the redemption prices specified in the Second Supplemental Indenture. If less than all of the Series 2004A Bonds of any Series are called for redemption, they shall be called in such order of maturity as the Authority may determine. That portion of any Bond to be redeemed shall be in the principal amount of five thousand dollars (\$5,000) or some multiple thereof, upon the owner's surrender thereof. Notice of redemption shall be given in the manner set forth in Indenture.

Application of Proceeds of Series 2004A Bonds; Application of Related Amounts. The Second Supplemental Indenture provides for the deposit and application of the Series 2004A Bonds.

Funds and Accounts. The Second Supplemental Indenture establishes within the Construction Account a Series 2004A Project Subaccount and the Series 2004A Waste Management Authority Subaccount. There shall be established within the Interest Account of the Senior Lien Debt Service Account the Series 2004A Interest Subaccount, within the Principal Account of the Senior Lien Debt Service Account the Series 2004A Principal Subaccount and within the Senior Lien Redemption Subaccount the Series 2004A Redemption Subaccount. The Second Supplemental Indenture establishes within the Senior Lien Debt Service Reserve Account a Series 2004A Senior Lien Debt Service Reserve Subaccount. There is established within the Cost of Issuance Account a Series 2004A Cost of Issuance Subaccount. There is established in the Senior Lien Expense Account a Series 2004A Senior Lien Expense Subaccount. Moneys in such subaccounts shall be used in accordance with the Indenture.

Security for Series 2004A Bonds. The Series 2004A Senior Lien Bonds shall be equally and ratably secured under the Indenture with any other Senior Lien Bonds issued pursuant to the Indenture.

Arbitrage Rebate Account. The Second Supplemental Indenture establishes the Series 2004A Arbitrage Rebate Account to be held by the Authority to receive from legally available moneys for payment of the rebate obligations under the Code (the "Rebate Amount").

Special Default Provisions and Indenture Amendments. No failure to make payments of interest of or principal on any Subordinate Lien Bonds shall constitute an Event of Default under the Second Supplemental Indenture.

For purposes of the Series 2004A Project Subaccount established in the Second Supplemental Indenture, clause (vi) of the definition of Permitted Investments shall include the following:

(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), (iii) and (iv) 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.

THE SPECIAL ESCROW AGREEMENT

The following is a summary of certain provisions of the Special Escrow Agreement and amendment thereto. Such summary does not purport to be complete or definitive and reference is made to the Special Escrow Agreement and Amendment No.1 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 "**Appendix A - Glossary of Certain Defined Terms**".

Flow of Funds. The Matching Fund Revenues received by the Government from the United States pursuant to the Revised Organic Act of the Virgin Islands shall be delivered to the Special Escrow Fund. The Special Escrow Fund is to be held by the Special Escrow Agent to provide for the following deposits (in order of priority);

(i) the deposit with the Trustee, or any paying agent, at the direction of the Government of the amount set forth in a certificate of the Government delivered to the Special Escrow Agent on or before the Second Business Day prior to October 1 of each Fiscal Year, of amounts required, if any (after taking into account any amounts required for the certain Escrow Agreement, dated as of August 1, 1989, (the "1989 Escrow") between the Government and Citibank, N.A., escrow agent delivered in connection with the defeasance of the Defeased Bonds), for payment of principal of redemption premium, if any, and interest on, Senior Lien Bonds and other amounts required to fund fully the Senior Lien Debt Service Account in such Fiscal Year or any prior Fiscal Year;

(ii) the deposit with the Trustee, or any paying agent, at the direction of the Government or any designated trustees or paying agents of the amount set forth in a certificate of the Government delivered to the Special Escrow Agent on or before the Second Business Day prior to October 1 of each Fiscal Year, of amounts required, if any (after taking into account amounts required pursuant to the 1989 Escrow), for payment of principal of, redemption premium, if any, and interest on, Subordinate Lien Bonds and other amounts required to fund fully the Subordinate Lien Debt Service Account in such Fiscal Year or any prior Fiscal Year and to replenish any Senior Lien Debt Service Reserve Account to the Debt Service Reserve Requirement or any Subordinate Lien Debt Service Reserve Account to the Debt Service Requirement Level;

(iii) the deposit with the Government, in accordance with the Special Escrow Agreement, of any amounts in excess of the deposits, if any, required above, which amounts may be applied by the Government for any lawful purpose.

Irrevocability of the Special Escrow Fund; Parity. The assignment of the Matching Fund Revenues and the escrow created in the Special Escrow Agreement shall be irrevocable as long as any Bonds are Outstanding under the terms of the Indenture. The holders of the Senior Bonds shall be on parity with each other and have a senior lien on any funds deposited in the Special Escrow Fund over the Subordinate Bonds, which shall be on parity with each other, but the payment of which shall be junior and subordinate to the payment of the Senior Lien Bonds until such funds are used and applied in accordance with the Special Escrow Agreement.

Termination. The Special Escrow Agreement shall terminate when no Bonds are Outstanding under the terms of the Indenture. Any moneys remaining in the Special Escrow Fund at the time of such termination shall be released to the Government.

**SUMMARY OF CERTAIN PROVISIONS
OF THE SERIES 2004A LOAN AGREEMENT**

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APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE SERIES 2004A LOAN AGREEMENT

The following is a summary of certain provisions of the Series 2004A Loan Agreement. Such summary does not purport to be complete or definitive, and reference is made to the Series 2004A 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 "**Glossary of Certain Defined Terms**".

The Loan. The Authority, on the terms and conditions set forth in the Series 2004A Loan Agreement, shall issue, sell, and deliver the Series 2004A Bonds to the Underwriters and make a Loan of the proceeds of the Series 2004A Bonds to the Government.

Repayment of the Loan. The Government promises to repay the Loan and observe the terms and provisions of the Series 2004A Loan Agreement. In consideration of the issuance of the Series 2004A Bonds by the Authority, the Government agrees to execute the Series 2004A Matching Fund Loan Note. The Government shall repay the Series 2004A Matching Fund Loan Note 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 the Series 2004A Matching Fund Loan Note secures.

Redemption of the Series 2004A Matching Fund Loan Note. The Series 2004A Matching Fund Loan 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 Series 2004A 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 Series 2004A Bonds.

Application of Proceeds. The Authority shall deposit all funds received from the proceeds of the Series 2004A Bonds into the respective Accounts and Subaccounts in accordance with the Series 2004A Loan Agreement.

Security. The revenues pledged to pay the debt service on the 2004A Bonds are derived from the Series 2004A Matching Fund Loan Note. The Series 2004A Matching Fund Loan Note is a special limited obligation of the Government and is secured solely by a pledge of the Matching Fund Revenues. The Series 2004A Matching Fund Loan Note is not a debt of the United States of America and the United States of America is not liable on the Series 2004A Matching Fund Loan Note. The Series 2004A 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. 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 2004A Matching Fund Loan Note 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 2004A Matching Fund Loan Note shall be considered to be issued on a parity basis with respect to the Series 1998 Senior Notes.

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 Series 2004A Matching Fund Loan Note is Outstanding, is in excess of the amount necessary to pay the principal of and interest on the Series 2004A Matching Fund Loan Note, and the Loan Notes issued in connection with the Series 2004A Bonds.

(b) The Government is duly authorized and has full power and authority to execute, deliver and perform its obligations under the Series 2004A Loan Agreement, the Special Escrow Agreement and the Series 2004A Matching Fund Loan Note.

(c) The execution, delivery and performance by the Government of the Series 2004A Loan Agreement, the Special Escrow Agreement and the Series 2004A Matching Fund Loan Note (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 Series 2004A Loan Agreement or the Series 2004A Matching Fund Loan Note.

(e) The Series 2004A Loan Agreement, the Special Escrow Agreement and the Series 2004A Matching Fund Loan Note 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 Series 2004A Matching Fund Loan Note. The Special Escrow Agreement and Matching Fund Revenues pledged and assigned hereby to the payment of principal and interest on the Series 2004A Matching Fund Loan Note, will be free and clear of any pledge, lien, charge or encumbrance thereon with respect thereto other than the Defeased Bonds, the Initial Series of Bonds and Additional Bonds prior to or of equal rank with, the pledge created by the Series 2004A 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 Series 2004A Matching Fund Loan Note, 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 Series 2004A Loan Agreement or under the Series 2004A Matching Fund Loan Note.

(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) At the time of issuance of the Series 2004A Matching Fund Loan Note, other than the Defeased Bonds and the Series 1998 Bonds, 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 Series 2004A Loan Agreement, the Series 2004A Matching Fund Loan Note and Special Escrow Agreement, and will pay all amounts payable by it according to the terms of the Series 2004A Loan Agreement.

(b) Promptly notify the Authority and the Trustee in writing of the occurrence of (i) any Event of Default under the Series 2004A 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 maximization 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 and if applicable, the Substitute Revenues, under the Loan Agreement and the security interest under the Special Escrow Agreement and all rights of the holders of the Series 2004A Matching Fund Loan Note 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 Series 2004A 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, and if applicable, the Substitute Revenues.

(h) No later than 180 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 Matching Fund 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.

(k) Not allow the Matching Fund Revenues to be encumbered by any lien, charge or encumbrance other than pursuant to any Additional Senior Lien Bonds or Subordinate Lien Bonds.

(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 2004 Bonds. The Government will not directly or indirectly use or permit the use of any proceeds of the Series 2004 Bonds or take or omit to take any action that would cause the Series 2004 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 Series 2004 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 Series 2004A 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 Series 2004A Matching Fund Loan Note.

Affirmative Covenants of Authority. The Authority shall use its best efforts to cause the Government to comply with the covenants set forth in the Loan Agreement.

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 Series 2004A Matching Fund Loan Note; 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 Series 2004A Matching Fund Loan Note may (i) sue to collect sums due under such Series 2004A Matching Fund Loan Note, (ii) compel to the extent permitted by law, by mandamus or otherwise, the performance by the Government of any covenant made in the Series 2004A Loan Agreement or the Series 2004A Matching Fund Loan Note, 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 Series 2004A Matching Fund Loan Note 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 the Series 2004A Loan Agreement curing any ambiguity or curing, correcting or supplementing any defect or inconsistent provision contained in the Series 2004A Loan Agreement or making such provisions in regard to matters or questions arising in the Series 2004A Loan Agreement as may be necessary, or desirable and as shall not materially adversely affect the interests of the holder of the Series 2004A Matching Fund Loan Note. Such supplement shall become effective upon the filing with the Government an instrument of the holder of the Series 2004A Matching Fund Loan Note approving such supplement. In addition, the Governor may execute a supplement to the Series 2004A Loan Agreement at any time and from time to time modifying any provision of the Series 2004A Loan Agreement with the consent of the holder of the Series 2004A Matching Fund Loan Note, except as provided in the Indenture.

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**VERIFICATION AND PROJECTION OF
MATCHING FUND REVENUES**

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

Submitted to:

Citigroup Global Markets, Inc.

Prepared by:

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December 2, 2004

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Introduction

Global Insight, Inc. was contracted by Citigroup Global Markets in connection with work as underwriter for the Virgin Island Public Finance Authority Matching Fund Loan Note Revenue Bonds. The bonds will be secured by revenues from certain excise taxes levied on Virgin Islands (“VI”) rum shipments to the United States and subject to transfer to the VI Government (the “Matching Fund Revenues”). Global Insight was asked to forecast the collection and transfer of these federal excise taxes.

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 2004. This review indicated that the annual Matching Fund Revenues transferred to the VI 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 2004 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

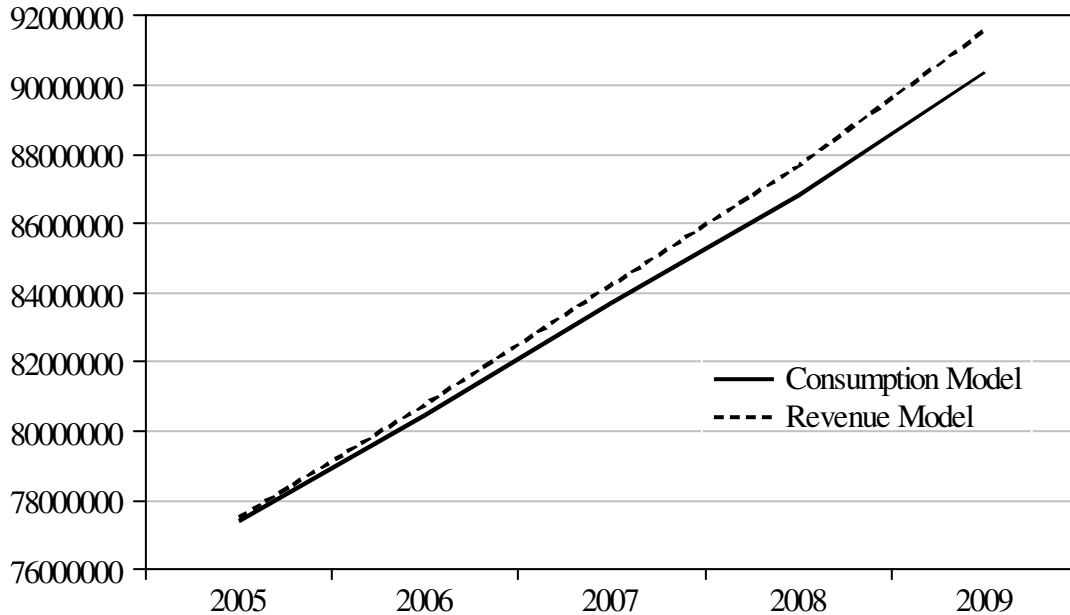
We developed two models to project future Matching Fund Revenues. The first model, our Constant Market Share Model, projects Matching Fund Revenues as a function of US rum consumption. This model, in accord with an upturn in the past decade, predicts an increasing revenue stream consistent with our forecast of higher US consumption, which is similar to the projection of rum consumption contained in the *Adams Liquor Handbook (2004)*. This model projects that growth in US rum consumption and, subsequently, Matching Fund Revenues, will range from 3.2% to 4.1% during the FY 2005 through FY 2009 period, with annual Matching Fund Revenues averaging \$83.8 million. This average assumes that the Government’s current “cover-over” rate (i.e. the portion of excise tax revenues actually transferred to the VI) remains unchanged at \$13.25 per proof gallon.

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, implying increases in the VI’s market share of US rum sales. This model projects slightly higher growth in Matching Fund Revenues than the first model of between 3.3% and 4.5% during the FY 2005 through FY 2009 period, with annual revenues averaging \$84.3 million. As with the first model, this average assumes that the Government’s \$13.25 per proof gallon cover-over rate remains unchanged.

Graph 1 below illustrates the Matching Fund Revenues projected by these two models for the FY 2005 through FY 2009 period at the \$13.25 per proof gallon cover-over rate.

Graph 1

Projected Matching Fund Revenues FY 2005 - FY 2009
Base, Consumption-Based Model
and Alternative, Revenue-Based Model



Revenue Estimate and Transfer Process

The VI 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 VI Government is, by statute, \$13.25 per proof gallon. These federal excise tax collections, based on the \$13.25 rate, are known as the “cover-over” Matching Fund Revenues received by the VI.¹ A cover-over rate of \$11.30 expired on September 30, 1998, reverting to a rate of \$10.50 per proof gallon. In fiscal year 2000, the rate increased from \$10.50 to the current rate of \$13.25 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 \$13.25 rate, are also included in Matching Fund Revenues. These collections are typically small in magnitude compared to bulk collections, as about 99% of VI rum is exported in bulk to the US.

¹ 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 VI, 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 VI 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.

Matching Fund Revenues are not transferred to the VI 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 VI Government during a given FY does not equal the “cover-over” amounts collected during the same 12-month period. For example, the FY 2003 advance would equal projected FY 2003 revenues adjusted by the difference between the FY 2001 base advance and actual FY 2001 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 the Interior (“Interior”).

Each year, the VI 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 VI 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 VI 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. **Interior letters to Treasury requesting the annual transfer of Matching Fund Revenues to the VI.** 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 VI 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 cover-over rate. They therefore provide a record of the amounts the VI 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;
 - b) Customs collections - Customs collections on cased rum,
 - 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 Interior was in fact received on behalf of the VI Government.

In addition to these documents, we also collected information from OMB. 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 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.

Verification Findings

Table 1 summarizes the data received and used for the Matching Fund Revenue verification.

**Table 1
Inventory of Data Received, FY 1992 – FY2004**

Fiscal Year	Interior Advance Request Letter	Monthly Cover-Over Letters^{1/}	Bank Statement
1992	√	√	
1993	√	√	
1994	√	√	
1995	√	√	√
1996	√	√	√
1997	√	√	√
1998	√	√	
1999	√	√	√
2000	√	√	√
2001	√	√	√
2002	√	√	√
2003	√	√	√
2004	√	√	√

^{1/}Also reviewed Cover-Over Letters for FY 1990 and FY 1991 so that FY 1992 and FY 1993 advances could be verified.

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 2004 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 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 1995, declined to \$10.50 in FY 1999, and increased to \$13.25 in FY 2000.

Table 2
BATF Monthly Cover-Over Reports
Components of Matching Fund Revenues, FY 1990-FY 2004

Fiscal Year	(a) Bulk Spirits (\$)	(b) Customs (\$)	(c) Adjustment to Bulk (\$)	(d) Adjustment 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
1998	50,239,651.31	15,255.34	53,216.22	0.00	50,308,122.87
1999	50,661,915.08	27,649.87	457,782.24	-7361.72	51,139,985.47
2000	58,947,063.81	11,136.58	3,732,477.89	0.00	62,690,658.28
2001	66,341,451.53	7227.61	1,743,039.50	0.00	68,091,718.64
2002	63,310,703.51	19.63	-2,974,189.24	0.00	60,336,533.90
2003	64,106,256.03	3.49	-3403.88	0.00	64,102,855.64
2004	65,316,014.38	8.77	9,684,513.20	0.00	75,000,536.35

Source: BATF Monthly Cover-Over Letters, FY 1990 - FY 2004.

- (a) Bulk Spirits - revenue collected from bulk rum purchases, calculated at the \$10.50 per proof gallon rate through FY1994, at the \$11.30 rate through FY1998, at the \$10.50 rate in FY1999, and then at \$13.25 through FY 2004.
- (b) Customs - Customs collections on cased rum, computed at the 10.50 per proof gallon rate through FY1994, at the \$11.30 rate through FY1998, at the \$10.50 rate in FY1999, and at \$13.25 through FY 2004.
- (c) Adjustment to Bulk - correction applied to account for discrepancies discovered in past Bulk Spirits collections calculations. The very large adjustment in 2004 was the result of a yearend adjustment of earlier monthly revenues from a \$10.50 rate to a \$13.25 rate.
- (d) Adjustment to Customs - correction applied to account for discrepancies discovered in past Customs collections calculations.

As described in Table 2 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, FY2000, FY2001, and FY2002. The FY2000 adjustment is the result of a change in the portion of the excise tax, or cover-over rate, from \$10.50 to \$13.25 during the fiscal year. The adjustments in FY1993, FY2001, and FY2002 were corrections to past calculations.

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. Table 3 details these differences, and the fiscal years in which they were applied as an adjustment. For example, the FY2002 advance of \$60,121,000 was \$215,534 greater than actual collections during that fiscal year. Thus, when the FY2004 advance was requested an adjustment of that amount was to be expected, decreasing the size of the FY2004 advance payment.

Table 3
Components of Annual Adjustment Applied to Matching Fund Revenues
FY 1990 through FY 2004
Base Advances, Actual Excise Tax Collections and Subsequent Differences

FY In Which Adjustment Applied	Adjustment From FY	Projected Matching Fund Revenues (\$) ^{1/}	Totals from Cover-Over Reports (\$) ^{2/}	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 ^{3/}	52,500,000.00	41,023,106.71	-11,476,893.29
1998	1996	43,628,000.00	42,641,206.67	-986,793.33
1999	1997	46,150,000.00	45,623,700.18	-526,299.82
2000	1998 ^{4/}	46,515,000.00	50,308,122.87	3,793,122.87
2001	1999	43,634,997.00	51,139,985.47	7,504,988.47
2002	2000 ^{5/}	64,432,940.00	62,690,658.28	-1,742,281.72
2003	2001	67,610,513.00	68,091,718.64	481,205.64
2004	2002	60,121,000.00	60,336,533.90	215,533.90
2005	2003	70,397,250.00	64,102,855.64	-6,294,394.36
2006	2004	65,849,003.00	75,000,536.35	9,151,533.35

Source: ^{1/} Interior letters to Treasury and VI OMB.

^{2/} BATF Monthly Cover-Over Reports.

^{3/} The large over-estimate in 1994 was the result of uncertainty over the impact of the recent Todhunter acquisition of VIRIL in 1994.

^{4/} The VI requested and received an early payment of \$3.8 million in December 1998 in recognition of the large forthcoming adjustment. This amount was the equivalent of the expected adjustment to be made in FY2000. Since this was paid in advance, there would be no expected adjustment in FY2000.

^{5/} There was an additional adjustment in FY2000, due to an increase in the excise tax. In FY2000, the initial request was based on \$10.50 cover-over rate, and there was an additional request made based on the increased \$13.25 cover-over rate.

2. 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 Interior's letters to Treasury.

Table 4
Differences Between Expected Adjustments and Actual Adjustments
FY 1992 through FY 2004

Fiscal Year	Projected Matching Fund Revenues (\$) ^{1/}	Actual Advance (\$) ^{2/}	Actual Adjustment (\$)	Expected Adjustment (\$) ^{3/}	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 ^{4/}	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
1998	46,515,000.00	45,596,124.00	-918,876.00	-986,793.33	-67,917.33
1999	43,635,000.00	43,108,700.00	-526,300.00	-526,299.82	-0.18
2000	64,432,940.00	64,433,000.00	60.00	0.00	60.00
2001	67,610,513.00	75,116,000.00	7,505,487.00	7,504,988.47	498.53
2002	60,121,000.00	58,372,000.00	-1,749,000.00	-1,742,341.72	-6,658.28
2003	70,397,250.00	70,878,000.00	480,750.00	481,205.64	-455.64
2004	65,849,003.00	63,097,000.00	2,752,000.00	2,760,466.00 ^{5/}	-8,466.10

Source: ^{1/}, ^{2/} Interior letters to Treasury and VI OMB.

^{3/} Derived from BATF Monthly Cover-Over Reports.

^{4/} FY 1996's advance was received in two stages.

^{5/} The expected adjustment for FY 2004 differs from that in Table 3 due to a revision in the Projected Matching Funds Revenue from \$63,089,000 to \$60,121,000.

As indicated in Table 4, 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 2004 period is minimal, and is equal to less than \$83,000. This is an immaterial difference, given the magnitude of earnings figures.

3. The bank statements that we have received match the 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 Fund.

The Rum Industry

The distilled spirits industry generally embarked on a period of expansion in the past decade. Previously US consumption had been declining steeply since the early 1980s. By 1995 the volume of consumption had fallen to 137.3 million (9-liter) cases, 28% less than the 190.9 million cases consumed in 1980. The year 1995 proved to be the trough of this cycle however. In the next 8 years, to 2003, consumption increased to 159.1 million cases, a gain of 15.9%. Moreover, at 3.8%, the annual growth in 2003 was the greatest of the period. Industry projections (Adams) are for further growth, averaging 2.3% annually over the next five years. Even so, consumption would be 5% below its historical 1981 peak.

Two broad socio-economic factors have been at work over this time. First, a growing health-consciousness among American consumers led to a reduction in alcohol consumption generally, and to a shift to beer and wine as hard liquor alternatives. Second, strong economic expansions during the 1980s and the 1990s boosted levels of disposable income to new heights. Consumer spending generally has surged, and has shifted to more expensive, premium products. This refinement in tastes of Americans has been reflected in a shift in the composition of the distilled spirits market. Demand has shifted from whiskeys to non-whiskeys, particularly to vodka and rum.

This transition has mirrored the nation's demographics as the now-aging baby boom generation dominates consumption, replacing the habits of the previous generations. Meanwhile, succeeding cohorts have more disposable income and have clearly driven the bar and restaurant market for premium cocktails. Total whiskey consumption, including American and Imported, has declined from 31.9% of the spirits market five years ago, to 27.5% in 2003. Rum gained 2.3 percentage points of that market share, while vodka added 2 points to reach 26.2% of all liquor consumption.

The rum industry has exhibited robust growth in market share over the past decade. Its share has increased every year since 1992. At 12.3% of total liquor consumption in 2003, its share has climbed from 6.8% in 1980 and 8.3% ten years ago. Since 1995 rum consumption, in volume, has never increased at less than a 3.7% annual rate. 2003 consumption grew by 5.1% from 2002, to 19.5 million cases, a 67% increase over 1994. Total distilled spirits consumption grew by less than 14% over that time span.

As has also occurred with vodkas, recent growth has been in premium brands, and in flavored varieties. These areas have been Cruzan's (VIRIL's leading brand) strength. It has achieved

double-digit growth for five consecutive years now. Its US rum market share has increased from 0.71% in 1998 to 1.95% in 2003, with 380 thousand cases sold. Bacardi is the clear industry leader in the rum market, while Cruzan is the sixth largest brand, trailing also Captain Morgan, Castillo, Malibu, and Ronrico. All of these rums are produced in the Caribbean. Total US imports of rum in 2003 were 29.4 million gallons. Puerto Rico was the leading source, with 19.8 million gallons, while the Virgin Islands shipped 4.72 million gallons. Mexico (1.7 million), Jamaica (1.1 million), and Barbados (0.8 million) also exported significant volume to the US.

The rum market is differentiated into branded and bulk segments. The bulk market is led by VIRIL, the largest supplier in the US, in which it sells rum to other beverage alcohol manufacturers. By virtue of its smaller size and lower margins, the bulk market has proven unattractive to aggressive expansion by Bacardi and others and VIRIL maintains a market share of 85 to 90%. There is no reasonable basis to anticipate a change in this competitive market structure. VIRIL occupies a stable niche in the overall rum market. Various US trade agreements, such as the Caribbean Basin Initiative, have resulted in advantages for the Virgin Islands, and also for Puerto Rico, in exporting to the US. While tariff protection on high-end, branded rums is due to be eliminated, low value, bulk rum will continue to be protected.

The fact that VIRIL is currently operating at less than 80% 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 VI Rum does have name recognition, or "market cachet" which should help secure future demand.

VIRIL also enjoys certain cost advantages. These include a molasses subsidy and a range of tax incentives currently in place. The molasses subsidy is provided by the VI Government in order to maintain the competitive position of the VI rum industry. According to VIRIL and Todhunter, this subsidy does indeed represent a significant advantage to operating in the VI. It allows VIRIL to purchase molasses at prices competitive with the costs of its Caribbean competitors. 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.

A significant tax advantage stems from VIRIL's use of citrus byproducts. End products are taxed based on ingredients rather than on alcohol content. The use of fortified citrus wine instead of distilled spirits results in an excise tax saving. (Though two and one-half gallons of citrus are required to replace one gallon of spirits, its excise tax of \$1.57 per gallon compares favorably with the \$13.50 imposed on spirits.)

We also assume that tax incentives that are currently enjoyed by VIRIL will remain in place. Specifically, the Economic Development Commission ("EDC") extends a 90% income tax reduction benefit to VIRIL as a means of promoting economic growth. VIRIL was first granted this abatement in 1987. Elimination of this benefit could also affect future production decisions.

Revenue Forecast

Forecast of April 1998

In early 1998, in conjunction with the Public Finance Authority's \$541 million Revenue and Refunding Bonds, WEFA (now Global Insight) produced a report projecting revenues from rum shipments to the US. We projected that Matching Fund Revenues would average from \$45.8 million to \$49.1 million from FY1998 to FY2003. These revenues assumed a cover-over rate of \$11.30. At a \$10.50 rate revenues were projected to average from \$43.1 to \$46.2 million.

At that time a conservative estimate of US rum consumption was adopted for prudent reasons. The available data at the time, through 1996, did not provide sufficient evidence of an end to the downward trend in consumption observed from 1985 through 1994. Consumption increased in 1995 and 1996 in concert with a very strong US economy. Econometric analysis suggested a continued strong negative trend was temporarily offset by strong income growth. *Adams* likewise projected growth of less than one half of one-percent for 1997.

At this time, however, the available data for 1997 through 2003 has definitively rejected the downward trend forecast. Econometric analysis with the new historical data, which reflects both the continued robust US economic growth, and the increasing popularity in the US of tropical drinks, suggests continued positive growth going forward.

Base Projection: Constant Market Share

Assumptions

To forecast VI 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 VI 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 VI.

The first two of these assumptions appear to be supported by recent experience, as documented by ACB shipment data. This data, which appears in Graph 2 below, indicates that VIRIL has maintained steady or increasing shipment levels from 1989 through 2003. VIRIL's production capabilities were enhanced during this time period by its February 1994 acquisition by Todhunter, 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, or 8.8 million gallons per year. Todhunter also shifted a substantial part of its domestic rum production to the VI.

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.

Model Development

Using rum consumption data for the 1985 to 2003 period, we developed a regression model that projects rum consumption as a function of the recent time trend for rum consumption and real personal income. The consumption data used in this model was obtained from the *Adams Media Liquor Handbook, 2004*, and is detailed in Table 5 below.

Table 5
US Consumption of Rum, 1985-2003
(9-Liter Cases)

Year	Rum Consumption
1985	14,118,000
1986	13,053,000
1987	13,451,000
1988	13,335,000
1989	13,191,000
1990	13,564,000
1991	12,325,000
1992	11,890,000
1993	11,928,000
1994	11,713,000
1995	12,093,000
1996	13,049,000
1997	13,540,000
1998	14,036,000
1999	15,568,000
2000	16,992,000
2001	17,870,000
2002	18,562,000
2003	19,509,000

Source: *Adams Media Liquor Handbook, 2004*.

The model we developed using this consumption data has an R-square of 0.84, meaning that it explains 84 percent of the variation in rum consumption over the 1985 through 2003 time period. In terms of predictive ability, this R-square indicates a strong model with a high level of statistical significance. This regression model is expressed by the following equation:

$$\text{Log (US Rum Consumption)} = - 0.02867 * \text{trend} + 2.04718 * \log (\text{Real US Personal Income}) + 55.5285$$

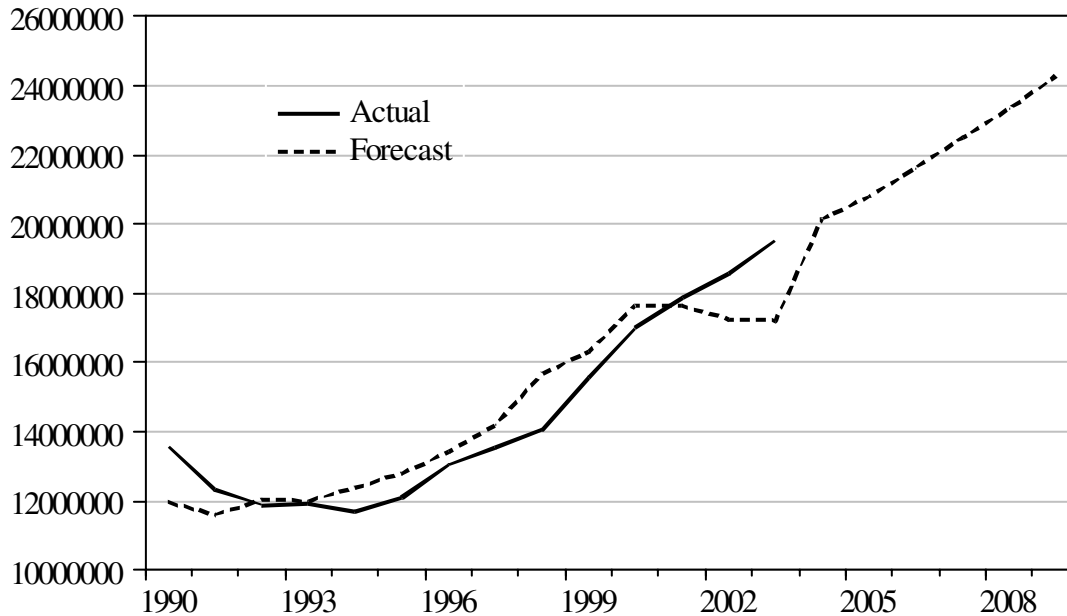
Rum consumption is found, as expected, to be positively correlated with income. The coefficient of 2.04718 in the equation indicates its demand elasticity with respect to income. That is, a 1% increase in real income leads to a 2.05% increase in consumption. The negative coefficient on the trend variable implies that, sans real income growth, consumption would decline over time, by 2.9% per year.

Once this equation was developed, we used it to project consumption for the calendar year 2005 through 2009 time period. 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 Table 6 below. Graph 3 on the following page illustrates actual and projected US rum consumption. For years preceding the 2004 through 2009 consumption forecast period, the “Projected” line Graph 3 indicates the rum consumption that our model would have projected for those years.

Table 6
US Consumption-Based Model
Projected US Rum Consumption, 2004 - 2009
 (9-Liter Cases)

Year	Projected Consumption	Growth Rate
2004	20,149,398	3.28%
2005	20,793,996	3.20%
2006	21,621,440	3.98%
2007	22,487,322	4.00%
2008	23,326,556	3.73%
2009	24,277,722	4.08%

Graph 2
 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 strong US rum consumption in the short term. These growth rates are higher than the rates projected in the *Adams Liquor Handbook, 2004*. Adams projects a 6.1% increase in rum consumption in 2004. Over a more extended period, Adams projects a compound annual growth rate of 3.3% between 2003 and 2008.² This would imply 2009 US rum consumption of 23.0 million 9-liter cases, 5.6% lower than our estimate of 24.3 million 9-liter cases.

Revenue Projection

We began this revenue forecasting process by applying the forecasted growth rate for 2005 rum consumption to FY 2004 total revenues. This generated a revenue forecast for FY 2005. We then applied the forecasted growth rate for 2006 rum consumption to this FY 2005 forecast to arrive at a projection for FY 2006 revenues. We continued this process through 2009, and the subsequent forecasted revenues are indicated below. Note that these revenue projections assume that the current tax rate realized by the VI Government, \$13.25 per proof gallon, remains unchanged.

² *Adams Media Liquor Handbook, 2004*.

Table 7
US Consumption-Based Model
Projected Total Revenues, FY 2005-2009
\$/per Proof Gallon rate

Fiscal Year	Projected Revenues	Expected Adjustment (from Table 3)	Projected Actual Revenues
2005	\$77,399,875	\$(6,294,394)	\$71,105,481
2006	\$80,479,804	\$9,151,533	\$89,631,337
2007	\$83,702,810	\$0	\$83,702,810
2008	\$86,826,628	\$0	\$86,826,628
2009	\$90,367,078	\$0	\$90,367,078
Total	\$418,776,196	\$2,857,139	\$421,633,335

It should be noted explicitly that our projected growth rates were applied to the FY2004 total adjusted figures included in BATF's (OMB) reports. These adjusted amounts do not equal the value of rum that was actually tapped in FY2004. Instead, they represent the actual FY2004 Matching Fund Revenues received, with bulk and Customs adjustments applied to account for past reporting discrepancies. We chose to use this adjusted figure because past experience suggests that FY2004 earnings figures will be subject to future adjustment. There is no way of knowing how large these adjustments will be, or if they will be positive or negative.

These bulk and customs adjustments are different from the Fiscal Year adjustment that is made by the Government with the advance payment. We have already detailed the adjustment received on the FY1998 advance. As the FY1999 advance was only \$43,108,700, our projection of earnings of \$48,790,360 implies an adjustment with the FY2001 advance of \$5,681,660. These funds are based on FY1999 earnings, included in Table 7 above, but would not be received until September of 2000.

The final column, projected actual revenues, provides an estimate of the actual revenues expected to be received, including the expected adjustments derived in Table 3.

Projected revenues of \$90.4 million in 2009 are associated with production levels of 6.8 million gallons, well within VIRIL's production capacity.

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 (OMB) reports to project future earnings. The growth rate of revenues has generally exceeded US consumption growth from 1989 to 2003. 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 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.³

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 0.98, and is represented by the following equation.⁴

Total Matching Fund Revenue =

$$- 2.008 * \text{Trend} + .0157 * \text{Real Personal Income} + 11.25 * \text{Step (95)} + 3938$$

This equation generated the projected revenue stream. Table 9 includes the revenue stream at the cover-over rate of \$13.25 per proof gallon. Also included is the annual growth rate implied by this revenue projection.

Table 9
Alternative Revenue-Based Model
Projected Total Revenues and Implied Growth Rate, FY 2005 - 2009

Year	Projected Revenues	Growth Rate
2005	\$77,497,462	3.33%
2006	\$80,761,297	4.21%
2007	\$84,232,245	4.30%
2008	\$87,663,898	4.07%
2009	\$91,585,195	4.47%
Total	\$421,740,098	

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 2003 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

³ 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 VI.

⁴ In the following equation Step (95) is a dummy variable that represents Todhunter's acquisition.

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.

Global Insight'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 \$84.3 million from FY 2005 through FY 2009, assuming a constant \$13.25 cover-over rate.

Global Insight's Trend Market Share Model which projects Matching Fund Revenues as a function of historical rum excise tax revenues forecasts Matching Fund Revenues averaging \$73.1 million in the forecast period, again assuming a constant \$13.25 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. Global Insight 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, Global Insight 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 Global Insight's assumption that production capabilities will not limit VIRIL's future ability to meet demand.

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**AUDITED FINANCIAL STATEMENTS
OF THE GOVERNMENT**

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GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Basic Financial Statements

September 30, 2002

(With Independent Auditors' Report Thereon)

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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KPMG LLP
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San Juan, PR 00918-1819

Independent Auditors' Report

The Honorable Governor of the Government of the
United States Virgin Islands:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Government of the United States Virgin Islands (the Government) as of and for the year ended September 30, 2002, which collectively comprise the Government's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Government's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the following component units:

- The Virgin Islands Public Finance Authority (PFA), a blended component unit, which represents 100% of the assets, fund balance, and revenue of the PFA Debt Service Fund (a major fund); 100% of assets, net assets, and revenue of the West Indian Company (a major fund); 3.07%, 2.86%, and 8.56% of the assets, net assets/fund balance, and revenue of the aggregate remaining fund information; 14.84%, 23.10%, and 18.20% of the assets, net assets, and revenue of the governmental activities; and 41%, 29%, and 28% of the assets, net assets, and revenue of the business-type activities.
- The Tobacco Settlement Financing Corporation, a blended component unit, which represents 1.12%, 0.22%, and 0.75%, respectively, of the assets, net assets/fund balance, and revenue of the aggregate remaining fund information, and 1.63%, 0.56%, and 0.18% of the assets, net assets, and revenue of the governmental activities.
- The Virgin Islands Port Authority, Virgin Islands Housing Authority, University of the Virgin Islands, Virgin Islands Public Television System, Virgin Islands Economic Development Authority, Magens' Bay Authority, Virgin Islands Government Hospital and Health Facilities Corporation (Roy L. Schneider Hospital and Juan F. Luis Hospital and Medical Center), and the Virgin Islands Housing Finance Authority, discretely presented component units, which collectively represent 66%, 80%, and 67%, respectively, of the assets, net assets, and revenue of the aggregate discretely presented component units.

These financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the activities, funds, and component units indicated above, are based on the reports of the other auditors.

Except as discussed in the following six paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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



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disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

The Government did not maintain accounting records for income tax receivables stated at \$87 million in the general fund and governmental activities as of September 30, 2002. It was impracticable to extend our procedures sufficiently to determine the extent to which the general fund and the governmental activities as of and for the year ended September 30, 2002 may have been affected by these conditions.

The financial statements of the Virgin Islands Lottery (the Lottery) have not been audited, and we were not engaged to audit the Lottery's financial statements as part of our audit of the Government's basic financial statements. The Lottery's financial activities are recorded in the Government's basic financial statements as a nonmajor enterprise fund and represent 0.10%, 0.41%, and 6.81%, respectively, of the assets, net assets, and revenue of the aggregate remaining fund information, and 2%, 7%, and 28% of the assets, net assets, and revenue of the business-type activities.

We were unable to obtain sufficient competent evidential matter supporting the Government's receivable for unemployment insurance contributions in the Unemployment Insurance Fund (a major fund) and the business-type activities as of September 30, 2002 due to inadequate records. The Government's records do not permit, nor is it practicable to extend our auditing procedures sufficiently to determine the extent to which the Unemployment Insurance Fund (a major fund) and business-type activities as of and for the year ended September 30, 2002 may have been affected by these conditions.

The report of the other auditors on the 2002 financial statements of the Virgin Islands Government Hospital and Health Facilities Corporation (Roy L. Schneider Hospital), a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence as to the propriety of transactions recorded in the statement of net assets as of September 30, 2001. Total assets and net assets as of September 30, 2001 amounted to \$78 million and \$68 million, respectively. Such amounts may affect the determination of results of operations for the year ended September 30, 2002.

The report of the other auditors on the 2001 financial statements of the Virgin Islands Housing Authority (VIHA), a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence to determine whether capital assets amounting to \$74 million were fairly stated.

The report of the other auditors on the 2002 financial statements of the Virgin Islands Housing Finance Authority (VIHFA), a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence to determine whether land held for sale amounting to approximately \$25 million was fairly stated.

The Government did not record a receivable for gross receipts taxes. Accounting principles generally accepted in the United States of America require the Government to record a receivable for taxes levied on gross receipts in periods prior to September 30, 2002 estimated to be collectible. The amount by which this departure would affect the assets, net assets, and revenue of the general fund and governmental activities is not reasonably determinable.

The basic financial statements do not include a provision for landfill closure and postclosure costs in long-term liabilities as required by accounting principles generally accepted in the United States of America. The effects of this departure from accounting principles generally accepted in the United States of America on the governmental activities have not been determined.

In our opinion, based on our audit and the reports of the other auditors, except for:

- the effects of not maintaining accounting records for income tax receivables stated at \$87 million nor recording a receivable for gross receipts taxes in the general fund and governmental activities and not recording a provision for landfill closure and postclosure costs in governmental activities, as described in paragraphs three, nine, and ten above, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the general fund of the Government as of September 30, 2002, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America;
- the effects of the adjustments, if any, as might have been determined to be necessary had the Lottery been audited for the business-type activities and had we been able to examine evidence regarding the receivable for unemployment insurance in the business-type activities and the Unemployment Insurance Fund (a major fund), as described in paragraphs four and five above, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the Unemployment Insurance Fund (a major fund) of the Government as of September 30, 2002, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America; and
- the effects of the adjustments, if any, as might have been determined to be necessary, had the other auditors been able to: (i) satisfy themselves as to the propriety of certain transactions of the Virgin Islands Government Hospital and Health Facilities Corporation (Roy L. Schneider Hospital) recorded in the statement of net assets as of September 30, 2001, (ii) obtain sufficient audit evidence to determine whether capital assets and land held for sale amounting to \$74 million and \$25 million in the financial statements of VIHA and VIHFA, respectively, were fairly stated, as described in paragraphs six, seven, and eight above, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate discretely presented component units of the Government of the United States Virgin Islands, as of September 30, 2002, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Finally, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the PFA Debt Service Fund, the West Indian Company, and the aggregate remaining fund information of the Government of the United States Virgin Islands as of September 30, 2002, and the respective changes in financial position and cash flows, where applicable, thereof, and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in notes 1 and 15, the Government has implemented a new financial reporting model, as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, GASB No. 37, *Basic Financial Statement—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, as of October 1, 2001.

The management's discussion and analysis on pages 5 through 14 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

April 23, 2004

Stamp No. 1987942 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

Introduction

The following discussion and analysis presents an overview of the financial position and activities of the Government of the United States Virgin Islands (the Government) as of and for the fiscal year ended September 30, 2002. Since this is the first year that the Government is required to present this format, only one year of financial data is presented. In future years, a comparative analysis will be presented.

Changes in Financial Reporting

The Government's financial reporting for this fiscal year uses a substantially revised format as compared to previous years. The new reporting focus is on the Government as a whole, and on the major individual funds of the Government. This is due to the implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management Discussion and Analysis—for State and Local Governments*, and GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, as amended for GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

The basic financial statements include government-wide financial statements, fund financial statements, and notes that provide more detailed information to supplement the basic financial statements.

Government-wide Financial Statements

The government-wide financial statements are designed to present an overall picture of the financial position of the Government. These statements consist of the statement of net assets and the statement of activities, which are prepared using the economic resources measurement focus and the accrual basis of accounting. This means that current year's revenue and expenses are included regardless of when cash is received or paid, producing a view of financial position similar to that presented by most private-sector companies.

The statement of net assets combines and consolidates the Government's current financial resources with capital assets and long-term obligations.

Both of the above financial statements have separate sections for three different types of the Government programs or activities. These three types of activities are as follows:

Governmental Activities – The activities in this section are mostly supported by taxes and intergovernmental revenue (federal grants). Most services normally associated with the primary government (PG) fall into this category, including general government, public safety, health, public housing and welfare, education, transportation and communication and culture and recreation.

Business-Type Activities – These functions normally are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities of the Government include the operations of the following major funds: (i) the unemployment insurance fund and (ii) the West Indian Company (WICO). Both of these programs operate with minimal assistance from the governmental activities of the Government.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

Discretely Presented Component Units – These are operations for which the Government has financial accountability even though they have certain independent qualities as well. For the most part, these entities operate similar to private sector businesses and the business-type activities described above. The Government's discretely presented component units are presented in two categories, major and nonmajor. This separation is determined by the relative size of the entities' assets, liabilities, revenue, and expenses in relation to the total of all component units.

Fund Financial Statements

Fund financial statements focus on the most significant (or major) funds of the Government. A fund is a separate accounting entity with a self-balancing set of accounts. The Government uses funds to keep track of sources of funding and spending related to specific activities. The Government uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

A major fund is a fund whose revenues, expenditures or expense, assets, or liabilities (excluding extraordinary items) are at least 10% of corresponding totals for all governmental or enterprise funds and at least 5% of the aggregate amount for all governmental and enterprise funds for the same item. The general fund is always considered a major fund. In addition to funds that meet the major fund criteria, any other governmental or enterprise fund that the Government believes is particularly important to the financial statements may be reported as a major fund.

All of the funds of the government are divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds

Governmental funds are accounted for using the modified accrual basis of accounting, which measures cash and other assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of the PG's general governmental operations and the basic services it provides. The reconciliation following the fund financial statements explains the differences between the governmental activities, reported in the government-wide financial statements and the governmental funds financial statements. The general fund and the debt service fund are reported as major governmental funds.

The general fund is the PG's primary operating fund. It accounts for all financial resources of the PG, except those required to be accounted for in another fund.

The PFA Debt Service Fund accounts for the resources accumulated, and payments made, for principal and interest on long-term general obligation debt issued by PFA on behalf of the Government.

Proprietary Funds

Services provided to outside (nongovernmental) customers are reported in enterprise funds. Enterprise funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. These are the same business-type activities reported in the government-wide financial statements.

The unemployment insurance fund and the WICO fund are major proprietary funds.

The unemployment insurance fund is a federally mandated program to manage unemployment insurance.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

The WICO fund accounts for the activities of WICO, that owns a port facility including a cruise ship pier, and manages a shopping mall and rental complex.

Fiduciary Funds

The Government is the trustee, or fiduciary, for several agency funds.

The fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets.

Financial Analysis of the Government As a Whole

Since comparable numbers are not available for prior years, the analysis of the Government's overall financial position under the accrual basis of accounting, will be limited to an analysis of the current year. A comparative analysis will be provided in fiscal year 2003.

Financial Analysis of the Primary Government (PG)

The total deficit of the PG amounted to \$431 million as of September 30, 2002. It represents the net effect of \$201 million invested in capital assets, net of related debt; \$225 million restricted by statute or other legal requirements, not available to finance day to day operations of the government; and \$857 million representing an unrestricted deficit of the PG. For the fiscal year ended September 30, 2002, the PG earned program and general revenue amounting to \$854 million, and reported expenses of \$891 million, resulting in a change in the deficit of \$37 million. As explained in note 14 to the basic financial statements, the Government has initiated specific actions to improve its future cash flows through the issuance of long-term debt, the development of a series of detailed revenue enhancement and expenditure reduction initiatives and the enactment of certain laws directed toward improving the Government's financial situation.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

A summary of net assets (deficit) and changes in net assets (deficit) for the primary government follows:

**Summary Schedule of Net Assets (Deficit) – Primary Government
September 30, 2002**

(In thousands)

	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Assets:			
Current assets	\$ 542,653	72,856	615,509
Capital assets	592,969	37,279	630,248
Other assets	1,975	497	2,472
Total assets	<u>1,137,597</u>	<u>110,632</u>	<u>1,248,229</u>
Liabilities:			
Current liabilities	260,259	13,096	273,355
Noncurrent liabilities	1,386,136	20,324	1,406,460
Total liabilities	<u>1,646,395</u>	<u>33,420</u>	<u>1,679,815</u>
Net assets:			
Invested in capital assets, net of related debt	183,746	16,955	200,701
Restricted	166,257	58,786	225,043
Unrestricted (deficit)	(858,801)	1,471	(857,330)
Total net assets (deficit)	<u>\$ (508,798)</u>	<u>77,212</u>	<u>(431,586)</u>

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

**Summary Schedule of Changes in Net Assets (Deficit) – Primary Government
Year ended September 30, 2002**

(In thousands)

	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Revenue:			
Program revenue:			
Charges for services	\$ 11,469	45,690	57,159
Operating grants and contributions	132,686	—	132,686
Capital grants and contributions	18,636	—	18,636
General revenue:			
Taxes	599,315	—	599,315
Transfers	(1,294)	1,294	—
Other general revenue	41,612	4,715	46,327
Total revenue	<u>802,424</u>	<u>51,699</u>	<u>854,123</u>
Expenses:			
General government	335,084	—	335,084
Public safety	45,230	—	45,230
Health	96,473	—	96,473
Public housing and welfare	62,440	—	62,440
Education	168,809	—	168,809
Transportation and communication	38,534	—	38,534
Culture and recreation	9,410	—	9,410
Interest on long-term debt	71,190	—	71,190
Unemployment insurance	—	22,276	22,276
West Indian Company	—	8,671	8,671
Lottery	—	14,054	14,054
Workmen's compensation	—	7,426	7,426
Other business-type activities	—	11,676	11,676
Total expenses	<u>827,170</u>	<u>64,103</u>	<u>891,273</u>
Change in net assets (deficit)	(24,746)	(12,404)	(37,150)
Net assets (deficit), beginning of year	<u>(484,052)</u>	<u>89,616</u>	<u>(394,436)</u>
Net assets (deficit), end of year	<u>\$ (508,798)</u>	<u>77,212</u>	<u>(431,586)</u>

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

Budgetary Highlights

The Office of Management and Budget of the PG prepares an annual executive budget subject to approval by the Governor and the Legislature of the Virgin Islands. The executive budget is prepared on a budgetary basis similar to the cash basis of accounting. The executive budget includes only those funds that are subject to appropriation by law. More information regarding budgetary procedures is provided in note 3 of the financial statements.

A summary of the budgetary report for the general fund of the PG, included on page 22 of the financial statements, follows:

Summary Statement of Revenue and Expenditures – Budget and Actual – Budgetary Basis – General Fund Year ended September 30, 2002

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Total revenue	\$ 477,026	477,026	416,970	(60,056)
Total expenditures	<u>601,021</u>	<u>604,061</u>	<u>548,425</u>	<u>55,636</u>
Excess of expenditures over revenue	<u>(123,995)</u>	<u>(127,035)</u>	<u>(131,455)</u>	<u>(4,420)</u>
Other financing sources (uses)	<u>81,245</u>	<u>81,245</u>	<u>87,666</u>	<u>6,421</u>
Excess of expenditures and other uses over revenue and other sources	<u>\$ (42,750)</u>	<u>(45,790)</u>	<u>(43,789)</u>	<u>2,001</u>

The PG realized a revenue variance of (\$60 million) due to declining tax revenue. The PG realized a \$55.6 million variance in expenditures, due to controlled spending imposed by revenue shortfalls.

For more information regarding the financial condition of the PG, see the Economic Condition and Outlook section of this report.

Capital Assets

During fiscal year 2002, the PG contracted with an independent national appraisal firm to develop a schedule of capital assets. The PG also developed standard capitalization thresholds and major classes of assets for all government entities.

Capital asset additions during the fiscal year amounted to \$38.7 million for governmental activities and \$4.5 million for business-type activities.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

The Government's capital assets include land, land improvements, buildings, building improvements, machinery, equipment, infrastructure, and construction in progress as follows:

Capital Assets – Primary Government

(In thousands)

	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Land and improvements	\$ 187,187	5,375	192,562
Buildings and improvements	390,630	38,859	429,489
Machinery and equipment	63,438	3,310	66,748
Infrastructure	103,170	—	103,170
Construction in progress	5,544	1,119	6,663
	<u>749,969</u>	<u>48,663</u>	<u>798,632</u>
Less accumulated depreciation	<u>(157,000)</u>	<u>(11,384)</u>	<u>(168,384)</u>
Total capital assets	<u>\$ 592,969</u>	<u>37,279</u>	<u>630,248</u>

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

Debt Administration

The Government issues both general obligation bonds and revenue bonds. The Revised Organic Act (48 U.S.C. Section 1574 (b)(ii) restricts the principal amount of general obligation debt which the Government may issue to no greater than 10% of the aggregate assessed valuation of taxable real property in the U.S. Virgin Islands. Following is a summary of bonds outstanding as of September 30, 2002:

Primary Government – Bonds Payable

(In thousands)

<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates</u>	<u>Balance</u>
1998 Series A, B, C, D, and E revenue and refunding bonds	2022	5.50% to 7.11%	\$ 499,495
1999 Project revenue bonds	2005	6.25%	7,295
1999 Series A general obligation bonds	2010	6.50%	7,260
1999 Series A revenue bonds	2029	4.2% to 6.40%	292,180
2001 Series A tobacco bonds	2031	5%	23,685
Subtotal			<u>829,915</u>
Less:			
Deferred amount on refundings			(3,696)
Bonds discount			(10,949)
Bonds accretion			(1,723)
Total			<u>\$ 813,547</u>

The 1998 Bonds are nonrecourse bonds secured by rum excise taxes remitted by the U.S. Treasury. The 1999 Series A Revenue Bonds are secured by the pledge of gross receipts, and along with the 1999 Series A General Obligation and Project Revenue Bonds are general obligations of the PG. Note 9 provides detailed information regarding all bonds of the territory.

During fiscal year 2002, the Tobacco Settlement Financing Corporation, a blended component unit, issued the 2001 Series A, Term and Serial Bonds amounting to \$23.7 million.

The PG made bond principal payments on all outstanding general and special revenue bonds amounting to \$19.3 million during fiscal year 2002.

Standard & Poor's and Moody's have given the Government's bonds ratings of "BBB" and "AAA", respectively. Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

At September 30, 2002, the PG had an outstanding Community Disaster Loan amounting to \$127.2 million and had accrued interest of \$32 million related to this loan.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

The PG also had an unrecorded actuarial valuation of unfunded pension plan liability estimated at \$815.9 million at September 30, 2002.

Other liabilities of the PG include:

Primary Government – Other Liabilities

(In millions)

Accrued compensated absences	\$	54
Retroactive union arbitration liability		368
Accrued litigation		4
Accrued disallowed costs		19
Total other liabilities	\$	<u>445</u>

Economic Condition and Outlook

The PG ended fiscal year 2002 with a deficit amounting to \$431 million, of which \$857 million relates to an unrestricted deficit. The PG is experiencing the combined challenge of revenue decreases and expenditure increases.

Revenue Decreases

The PG collects income tax revenue under the “mirror” income tax system. The Government’s tax laws “mirror” the U.S. Internal Revenue Service (IRS) Code, Rules and Regulations.

New Tax Acts passed by U.S. Congress in fiscal year 2003 will have a negative impact on revenue due to decreases in tax rates, expanded tax credits, and expanded tax deductions.

In connection with a real property tax case instituted against the PG in the U.S. District Court of the Virgin Islands, the Government was enjoined for a four-month period in fiscal year 2003 from appraising and assessing any real property taxes until it modified its system of appraisal to comply with certain court mandates. As a result, effective August 2003, it has been using the 1998 assessment value to issue tax bills and collect taxes, and expects to continue to do so until a new appraisal system is implemented which is intended to satisfy the court’s decision, or the decision is reversed on appeal. The PG is assessing the effect of this order on fiscal year 2003 revenue.

The Government is currently in litigation challenging the computation of its corporate franchise tax. Of the four cases brought against the Government, one is currently before the Virgin Islands Territorial Court, and the remaining three cases are currently on appeal.

Expenditure Increases

The PG faces the challenge of carryforward expenditures from prior fiscal years and increasing expenditures in the current fiscal year. Carryforward expenditures consist mainly of retroactive salary increases, which accumulated following Hurricanes Hugo, Marilyn, and Bertha in the years of 1990 through 1998.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2002

Current increasing governmental expenditures include: increased health insurance premiums, pharmaceutical premiums, unemployment insurance benefits, and salary expense.

In addition, the Government is still experiencing the impact of the general economic decline in the United States and the impact of the terrorist attacks on September 11, 2001.

Deficit Reduction Measures

The PG is implementing a number of deficit reducing measures including: (i) increase of local taxes including the highway users tax and stamp tax; (ii) implementation of new local taxes including an excise tax on importation of personal goods and a petroleum tax; and (iii) exerting greater control of expenditures through the budgetary process.

Contacting the Government's Financial Management

This financial report is designed to provide the Government's citizens, taxpayers, customers, and investors and creditors with a general overview of the Government's finances. If you have questions about this report, or need additional financial information, contact the Government of the U.S. Virgin Islands, Department of Finance, No. 2314 Kronprindsens Gade, St. Thomas, VI 00802.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets (Deficit)

September 30, 2002

(In thousands)

	Primary Government		Total	Component units
	Governmental activities	Business-type activities		
Assets:				
Cash and cash equivalents	\$ 96,869	7,133	104,002	62,615
Investments	227,693	—	227,693	24,442
Receivables, net	133,959	4,126	138,085	45,684
Internal balances	5,282	(5,282)	—	—
Loans and advances	—	5,417	5,417	2,369
Due from component units	15,365	—	15,365	—
Note receivable	—	—	—	15,689
Due from primary government	—	—	—	4,382
Due from federal government	24,929	—	24,929	5,673
Inventories	—	435	435	18,501
Food stamp coupons	4,740	—	4,740	—
Other assets	1,121	1,012	2,133	9,911
Restricted:				
Cash and cash equivalents	32,695	60,015	92,710	29,767
Investments	—	—	—	49,301
Other	—	—	—	195
Capital assets	592,969	37,279	630,248	704,380
Deferred expenses	1,975	497	2,472	3,344
Total assets	1,137,597	110,632	1,248,229	976,253
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities	55,722	4,486	60,208	69,695
Tax refund payable	53,134	—	53,134	—
Unemployment insurance benefits	—	8,610	8,610	—
Customer deposits	—	—	—	16,282
Due to primary government	—	—	—	15,365
Due to component units	4,382	—	4,382	—
Due to federal government	—	—	—	5,300
Lines of credit	—	—	—	20,000
Interest payable	55,425	—	55,425	3,803
Deferred revenue	89,703	—	89,703	3,546
Other current liabilities	1,893	—	1,893	12,006
Due within one year:				
Loans payable	—	1,030	1,030	152
Bonds payable	18,580	—	18,580	10,270
Other liabilities	29,325	—	29,325	56
Noncurrent liabilities:				
Due in more than one year:				
Loans payable	127,200	19,294	146,494	3,857
Bonds payable	794,967	—	794,967	165,653
Other liabilities	416,064	—	416,064	25,354
Total liabilities	\$ 1,646,395	33,420	1,679,815	351,339

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets (Deficit), continued

September 30, 2002

(In thousands)

	Primary Government		Total	Component units
	Governmental activities	Business-type activities		
Net assets:				
Invested in capital assets, net of related debt	\$ 183,746	16,955	200,701	523,889
Restricted for:				
Unemployment insurance	—	49,576	49,576	—
Debt service	132,637	—	132,637	—
Capital projects	33,620	—	33,620	—
Other purposes	—	9,210	9,210	53,320
Unrestricted (deficit)	(858,801)	1,471	(857,330)	47,705
Total net assets (deficit)	\$ (508,798)	77,212	(431,586)	624,914

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities

Year ended September 30, 2002

(In thousands)

Functions:	Expenses	Program revenue		Net (expense) revenue and changes in net assets			Component units	
		Charges for services	Operating grants and contributions	Capital grants and contributions	Governmental activities	Business-type activities		Total
Primary government:								
Governmental activities:								
General government	\$ 335,084	2,488	22,249	11,575	(298,772)	—	(298,772)	—
Public safety	45,230	2,375	14,916	—	(27,939)	—	(27,939)	—
Health	96,473	1,816	26,105	—	(68,552)	—	(68,552)	—
Public housing and welfare	62,440	1,114	45,037	—	(16,289)	—	(16,289)	—
Education	168,809	1,553	22,431	—	(144,825)	—	(144,825)	—
Transportation and communication	38,534	1,827	1,266	7,061	(28,380)	—	(28,380)	—
Culture and recreation	9,410	296	682	—	(8,432)	—	(8,432)	—
Interest on long-term debt	71,190	—	—	—	(71,190)	—	(71,190)	—
Total governmental activities	827,170	11,469	132,686	18,636	(664,379)	—	(664,379)	—
Business-type activities:								
Unemployment insurance	22,276	6,152	—	—	—	(16,124)	(16,124)	—
West Indian Company	8,671	9,995	—	—	—	1,324	1,324	—
Lottery	14,054	14,061	—	—	—	7	7	—
Workmen's compensation	7,426	7,652	—	—	—	226	226	—
Other	11,676	7,830	—	—	—	(3,846)	(3,846)	—
Total business-type activities	64,103	45,690	—	—	—	(18,413)	(18,413)	—
Total primary government	891,273	57,159	132,686	18,636	(664,379)	(18,413)	(682,792)	—
Component units:								
Virgin Islands Housing Authority	64,604	5,717	31,826	13,963	—	—	—	(13,098)
Virgin Islands Port Authority	47,232	33,951	19,844	—	—	—	—	6,563
Virgin Islands Water and Power Authority:								
Electric System	111,260	111,496	1,993	—	—	—	—	2,229
Water System	24,817	25,832	1,605	—	—	—	—	2,620
University of the Virgin Islands	57,852	10,402	39,696	4,758	—	—	—	(2,996)
Other component units	139,903	67,111	49,313	5,476	—	—	—	(18,003)
Total component units	\$ 445,668	254,509	144,277	24,197	—	—	—	(22,685)

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities, continued

Year ended September 30, 2002

(In thousands)

	Program revenue			Net (expense) revenue and changes in net assets			Component units
	Expenses	Charges for services	Operating grants and contributions	Primary government			
				Capital grants and contributions	Governmental activities	Business-type activities	
Total primary government and component units				(664,379)	(18,413)	(682,792)	(22,685)
General revenue:							
Taxes				\$ 599,315	—	599,315	—
Transfers				(1,294)	1,294	—	—
Interest and other				40,349	4,715	45,064	3,801
Tobacco Settlement Rights				1,263	—	1,263	—
Other general revenue				—	—	—	5,482
Total general revenue and transfers				639,633	6,009	645,642	9,283
Changes in net assets (deficit)				(24,746)	(12,404)	(37,150)	(13,402)
Net assets (deficit), beginning of year, as restated				(484,052)	89,616	(394,436)	638,316
Net assets (deficit), end of year				\$ (508,798)	77,212	(431,586)	624,914

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Balance Sheet – Governmental Funds

September 30, 2002

(In thousands)

Assets	General	PFA Debt Service	Other governmental funds	Total governmental funds
Cash and cash equivalents	\$ 56,619	—	40,250	96,869
Investments	73,376	121,611	32,706	227,693
Receivables (net of allowance for uncollectible):				
Taxes	127,471	—	5,013	132,484
Federal government	—	—	24,929	24,929
Accrued interest and other	741	—	637	1,378
Due from:				
Other funds	8,346	—	9,861	18,207
Component units	15,365	—	—	15,365
Food stamp coupons	—	—	4,740	4,740
Restricted cash	—	—	32,695	32,695
Other assets	—	—	1,121	1,121
Total assets	\$ 281,918	121,611	151,952	555,481
Liabilities and Fund Balances				
Accounts payable and accrued liabilities	\$ 38,321	—	17,401	55,722
Tax refund payable	53,134	—	—	53,134
Due to:				
Other funds	10,173	—	3,178	13,351
Component units	4,382	—	—	4,382
Deferred revenue	147,021	40,049	16,529	203,599
Other current liabilities	—	—	1,370	1,370
Total liabilities	253,031	40,049	38,478	331,558
Fund balances reserved for:				
Encumbrances	53,419	—	—	53,419
Debt service	—	81,562	15,926	97,488
Unreserved fund balance (deficit), reported in:				
General fund	(24,532)	—	—	(24,532)
Special revenue funds	—	—	58,568	58,568
Capital projects funds	—	—	38,980	38,980
Total fund balance	28,887	81,562	113,474	223,923
Total liabilities and fund balances	\$ 281,918	121,611	151,952	
Amounts reported for governmental activities in the statement of net assets (deficit) are different because:				
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.				\$ 592,969
Debt issued by the Government has associated costs that are paid from current available resources in the funds. However, these costs are deferred on the statement of net assets.				1,975
Deferred revenue in governmental funds are recognized as revenue in governmental activities.				113,896
Other long-term liabilities not available to pay for current-period expenditures and therefore, not reported in the funds				(55,425)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.				(1,386,136)
Deficit of governmental activities				\$ (508,798)

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Revenue, Expenditures, and Changes in Fund Balances
Governmental Funds

Year ended September 30, 2002

(In thousands)

	<u>General</u>	<u>PFA Debt Service</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>
Revenue:				
Taxes	\$ 387,893	137,076	30,485	555,454
Federal grants and contributions	—	—	151,322	151,322
Charges for services	4,923	—	6,546	11,469
Tobacco Settlement Rights	—	—	1,263	1,263
Interest and other	24,865	4,258	11,226	40,349
Total revenue	417,681	141,334	200,842	759,857
Expenditures:				
Current:				
General government	266,409	—	73,255	339,664
Public safety	37,718	—	6,180	43,898
Health	67,150	—	28,470	95,620
Public housing and welfare	30,178	—	31,948	62,126
Education	136,784	—	26,374	163,158
Transportation and communication	37,090	—	1,218	38,308
Culture and recreation	6,759	—	2,365	9,124
Capital outlays	—	—	38,710	38,710
Debt service:				
Principal	—	15,935	7,827	23,762
Interest	—	46,369	1,683	48,052
Bond issuance costs	—	—	3,311	3,311
Total expenditures	582,088	62,304	221,341	865,733
Excess (deficiency) of revenue over (under) expenditures	(164,407)	79,030	(20,499)	(105,876)
Other financing sources (uses):				
Bonds issued	—	—	23,685	23,685
Transfers from other funds	99,326	—	21,287	120,613
Transfers to other funds	(10,360)	(83,339)	(28,208)	(121,907)
Discount on bonds issued	—	—	(124)	(124)
Total other financing sources (uses), net	88,966	(83,339)	16,640	22,267
Deficiency of revenue and other financing sources under expenditures and other financing uses	(75,441)	(4,309)	(3,859)	(83,609)
Fund balance, beginning of year (as restated)	104,328	85,871	117,333	307,532
Fund balance, end of year	\$ 28,887	81,562	113,474	223,923

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

**Reconciliation of the Statement of Revenue, Expenditures, and Changes in
Fund Balances to the Statement of Activities – Governmental Funds**

Year ended September 30, 2002

(In thousands)

Net change in fund balances – total governmental funds	\$	(83,609)
Government funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays (\$38,710) exceeded depreciation (\$14,669) in the current period.		24,041
Revenue in the statement of activities that do not provide current financial resources are not reported as revenue in the funds.		43,860
Bond proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount by which proceeds (\$23,762) exceeded repayments (\$23,685).		77
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		10,588
Debt issuance costs, bond accretion, and bond discount are expenditures to governmental funds, but are deferred in the statements of net assets. This is the amount of debt issue costs, bond accretion, and bond discount for the year.		3,435
Certain interest and other costs reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount equivalent to the increase in interest payable, combined with the amortization of debt issue costs, bond discount, and the net accretion of debt issue discount.		<u>(23,138)</u>
Changes in net assets (deficit) of governmental activities	\$	<u><u>(24,746)</u></u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Revenue and Expenditures – Budget and Actual –
Budgetary Basis – General Fund

Year ended September 30, 2002

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Revenue:				
Taxes	\$ 452,714	452,714	387,893	(64,821)
Charges for services	7,100	7,100	4,239	(2,861)
Interest and other	17,212	17,212	24,838	7,626
Total revenue	<u>477,026</u>	<u>477,026</u>	<u>416,970</u>	<u>(60,056)</u>
Expenditures:				
Current:				
General government	162,728	162,728	243,237	(80,509)
Public safety	56,497	59,537	37,404	22,133
Health	96,493	96,493	68,168	28,325
Public housing and welfare	41,017	41,017	28,999	12,018
Education	183,578	183,578	136,058	47,520
Transportation and communication	44,376	44,376	28,905	15,471
Culture and recreation	16,332	16,332	5,654	10,678
Total expenditures	<u>601,021</u>	<u>604,061</u>	<u>548,425</u>	<u>55,636</u>
Excess of expenditures over revenue	<u>(123,995)</u>	<u>(127,035)</u>	<u>(131,455)</u>	<u>(4,420)</u>
Other financing sources (uses):				
Transfers from other fund	97,010	97,010	98,026	1,016
Transfer to other fund	(15,765)	(15,765)	(10,360)	5,405
Total other financing sources (uses)	<u>81,245</u>	<u>81,245</u>	<u>87,666</u>	<u>6,421</u>
Excess of expenditures and other uses over revenue and other sources	<u>\$ (42,750)</u>	<u>(45,790)</u>	<u>(43,789)</u>	<u>2,001</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets – Proprietary Funds

September 30, 2002

(In thousands)

	Business-type activities – enterprise funds			Totals
	Unemployment insurance	West Indian Company	Other funds	
Assets:				
Current assets:				
Cash and cash equivalents	\$ 353	5,728	1,051	7,132
Receivables, net				
Loans and advances	—	—	5,417	5,417
Accrued interest and other	—	1,606	2,521	4,127
Due from other funds	—	—	300	300
Inventories and other current assets	—	1,013	434	1,447
Total current assets	<u>353</u>	<u>8,347</u>	<u>9,723</u>	<u>18,423</u>
Noncurrent assets:				
Restricted cash and cash equivalents	57,833	2,181	—	60,014
Capital assets	—	31,452	5,827	37,279
Deferred expenses	—	497	—	497
Total noncurrent assets	<u>57,833</u>	<u>34,130</u>	<u>5,827</u>	<u>97,790</u>
Total assets	<u>58,186</u>	<u>42,477</u>	<u>15,550</u>	<u>116,213</u>
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities	—	1,315	3,170	4,485
Due to other funds	—	500	5,082	5,582
Unemployment insurance benefits	8,610	—	—	8,610
Loans payable related to capital assets	—	1,030	—	1,030
Total current liabilities	<u>8,610</u>	<u>2,845</u>	<u>8,252</u>	<u>19,707</u>
Noncurrent liabilities:				
Loans payable related to capital assets	—	19,294	—	19,294
Total liabilities	<u>8,610</u>	<u>22,139</u>	<u>8,252</u>	<u>39,001</u>
Net assets:				
Invested in capital assets, net of related debt	—	11,128	5,827	16,955
Restricted	49,576	9,210	—	58,786
Unrestricted	—	—	1,471	1,471
Total net assets	<u>\$ 49,576</u>	<u>20,338</u>	<u>7,298</u>	<u>77,212</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Revenue, Expenses, and Changes in Net Assets
Proprietary Funds

Year ended September 30, 2002

(In thousands)

	Business-type activities – enterprise funds			Total
	Unemployment insurance	West Indian Company	Other funds	
Operating revenue:				
Charges for services	\$ 6,152	9,995	29,543	45,690
Total operating revenue	<u>6,152</u>	<u>9,995</u>	<u>29,543</u>	<u>45,690</u>
Operating expenses:				
Cost of services	22,276	6,157	32,722	61,155
Depreciation and amortization	—	1,227	434	1,661
Total operating expenses	<u>22,276</u>	<u>7,384</u>	<u>33,156</u>	<u>62,816</u>
Operating (loss) income	<u>(16,124)</u>	<u>2,611</u>	<u>(3,613)</u>	<u>(17,126)</u>
Nonoperating revenue (expenses):				
Interest income	3,974	220	521	4,715
Interest expense	—	(1,287)	—	(1,287)
Total nonoperating revenue (expenses), net	<u>3,974</u>	<u>(1,067)</u>	<u>521</u>	<u>3,428</u>
(Loss) income before operating transfers	<u>(12,150)</u>	<u>1,544</u>	<u>(3,092)</u>	<u>(13,698)</u>
Transfers from other funds	—	—	2,594	2,594
Transfers to other funds	—	(1,300)	—	(1,300)
Change in net assets	<u>(12,150)</u>	<u>244</u>	<u>(498)</u>	<u>(12,404)</u>
Net assets, beginning of year (as restated)	<u>61,726</u>	<u>20,094</u>	<u>7,796</u>	<u>89,616</u>
Net assets, end of year	<u>\$ 49,576</u>	<u>20,338</u>	<u>7,298</u>	<u>77,212</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Cash Flows – Proprietary Funds

Year ended September 30, 2002

(In thousands)

	Business-type activities – enterprise funds			
	Unemployment insurance	West Indian Company	Other funds	Total
Cash flows from operating activities:				
Receipts from customers and users	\$ 6,152	10,051	29,442	45,645
Payments to beneficiaries	(16,561)	—	—	(16,561)
Payments to suppliers and employees	—	(6,248)	(38,329)	(44,577)
Net cash (used in) provided by operating activities	<u>(10,409)</u>	<u>3,803</u>	<u>(8,887)</u>	<u>(15,493)</u>
Cash flows from noncapital financing activities:				
Transfers (to) from other funds	—	(1,300)	2,594	1,294
Net cash (used in) provided by noncapital financing activities	<u>—</u>	<u>(1,300)</u>	<u>2,594</u>	<u>1,294</u>
Cash flows from capital and related financing activities:				
Acquisition and construction of capital assets	—	(1,578)	—	(1,578)
Principal paid on long-term debt	—	(957)	—	(957)
Interest paid on long-term debt	—	(1,287)	—	(1,287)
Net cash used in capital and related financing activities	<u>—</u>	<u>(3,822)</u>	<u>—</u>	<u>(3,822)</u>
Cash flows from investing activities:				
Interest and dividends on investments	3,974	220	361	4,555
Net cash provided by investing activities	<u>3,974</u>	<u>220</u>	<u>361</u>	<u>4,555</u>
Net decrease in cash and cash equivalents	<u>(6,435)</u>	<u>(1,099)</u>	<u>(5,932)</u>	<u>(13,466)</u>
Cash and cash equivalents, beginning of year (as restated)	<u>64,621</u>	<u>9,008</u>	<u>6,983</u>	<u>80,612</u>
Cash and cash equivalents, end of year	\$ <u>58,186</u>	<u>7,909</u>	<u>1,051</u>	<u>67,146</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:				
Operating (loss) income	\$ (16,124)	2,611	(3,613)	(17,126)
Adjustments to reconcile operating income (loss) to net cash (used in) provided by operating activities:				
Depreciation and amortization	—	1,227	434	1,661
Change in assets and liabilities:				
Receivables, net	—	37	(5,551)	(5,514)
Other assets	—	(220)	(72)	(292)
Accounts payable and accrued expenses	—	148	(106)	42
Due to other funds	—	—	21	21
Other liabilities	5,715	—	—	5,715
Net cash (used in) provided by operating activities	\$ <u>(10,409)</u>	<u>3,803</u>	<u>(8,887)</u>	<u>(15,493)</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Fiduciary Net Assets – Fiduciary Funds

September 30, 2002

(In thousands)

	Pension trust funds	Agency funds
	<u> </u>	<u> </u>
Assets:		
Cash and cash equivalents:		
Unrestricted	\$ 132,814	15,875
Restricted	126	—
Investments	1,194,001	11,979
Receivables, net:		
Loans and advances	94,480	—
Accrued interest	6,676	—
Other	12,445	—
Due from other funds	523	—
Capital assets, net	12,154	—
Other assets	16,281	—
	<u>1,469,500</u>	<u>27,854</u>
Liabilities:		
Accounts payable and accrued liabilities	101,580	27,593
Securities lending collateral	225,396	—
Due to other funds	—	97
Other liabilities	5,550	164
	<u>\$ 332,526</u>	<u>27,854</u>
Net assets:		
Held in trust for employees' pension benefits	<u>1,136,974</u>	
Total net assets	<u><u>\$ 1,136,974</u></u>	

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Changes in Fiduciary Net Assets

Year ended September 30, 2002

(In thousands)

	Pension trust funds
	<u> </u>
Additions:	
Contributions:	
Employer	\$ 50,595
Plan members	29,510
Total contributions	<u>80,105</u>
Investment income:	
Net depreciation of fair value of investments	(72,038)
Interest and dividends	47,296
Real estate – rental income (net of related expenses)	4,370
	<u>(20,372)</u>
Less investment expense	4,231
Net investment loss	<u>(24,603)</u>
Other income	264
Total additions	<u>55,766</u>
Deductions:	
Benefits paid	123,025
Refunds of contributions	3,199
Administrative and operational expenses	6,751
Total deductions	<u>132,975</u>
Change in net assets	(77,209)
Net assets, beginning of year	<u>1,214,183</u>
Net assets, end of year	\$ <u><u>1,136,974</u></u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2002

(1) Summary of Significant Accounting Policies

The Government of the United States Virgin Islands (the Government) is an unincorporated organized territory of the United States of America (United States). The powers of the Government are derived from and set forth in the Revised Organic Act of 1954, as amended. The Government assumes responsibility for public safety, health, public housing and welfare, education, transportation and communication, and culture and recreation.

The accompanying basic financial statements of the Government have been prepared in conformity with accounting principles generally accepted (GAAP) in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (GASB No. 34). This statement establishes new financial reporting requirements for state and local governments. The Government adopted the provisions of GASB No. 34 as well as other statements referred to below as of October 1, 2001 (see note 15). They require new information and restructure much of the information that governments have presented in the past. Comparability with reports issued in prior years is affected. With the implementation of GASB No. 34, the Government has prepared required supplementary information titled Management's Discussion and Analysis, which precedes the basic financial statements.

As previously mentioned, other GASB Statements and Interpretations were required to be implemented in conjunction with GASB No. 34. Therefore, the Government has implemented the following GASB Statements in the current fiscal year: GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities* (GASB No. 35), GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus* (GASB No. 37), GASB Statement No. 38, *Certain Financial Statement Note Disclosures* (GASB No. 38), and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

The accompanying basic financial statements have been prepared primarily from accounts maintained by the Department of Finance of the Government. Additional data has been derived from reports prepared by other departments, agencies, and public corporations based on independent or subsidiary accounting systems maintained by them.

(a) Financial Reporting Entity

The Government follows the provisions of GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14). This standard requires that the Government's financial reporting entity be defined according to specific criteria. According to the standard for financial reporting purposes, the Government is a primary government (PG). The PG includes all Government departments, agencies, boards, and organizations that are not legally separate. In addition to the PG, the financial reporting entity includes blended and discretely presented component units. Component units include all legally separate organizations for which the Government's elected officials are financially accountable, and other organizations for which the nature and significance of their relationship with the Government are such that exclusion would cause the basic financial statements to be misleading or incomplete. The criteria used to define financial accountability include appointment of a voting majority of an organization's governing body and (i) the ability of the PG to impose its will on that

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2002

organization or (ii) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the PG. The financial statements of the following component units are included in the financial reporting entity either as blended or as discretely presented component units in accordance with GAAP.

(1) **Blended Component Units**

The following public benefit corporations, while legally separate from the Government, meet the criteria to be reported as part of the PG because they provide services entirely or almost entirely to the Government:

Virgin Islands Public Finance Authority

The Virgin Islands Public Finance Authority (PFA) was created as a public corporation and autonomous governmental instrumentality by Act No. 5365, the Government Capital Improvement Act of 1988, with 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 the enabling legislation, PFA has the power, among other matters, to borrow money and issue bonds and to lend the proceeds of its bonds to the Government or any governmental instrumentality. The powers of PFA are exercised by a board of directors consisting of the Governor (Chairperson), the Commissioner of Finance, the Director of the Office of Management and Budget and two representatives of the private sector appointed by the Governor with the advice and consent of the Legislature. PFA activities are blended within the PG because it is so intertwined with the Government that, in substance, they are the same.

Tobacco Settlement Financing Corporation

The Tobacco Settlement Financing Corporation (TSFC) was created in September 2001 under Act No. 6428 as a separate and independent corporation of the Government to purchase the rights, title, and interest in tobacco settlement litigation awards and to issue revenue bonds supported by the tobacco settlement rights. The responsibility for the operations of TSFC is vested in a board of directors composed of three Government officials appointed by the Governor and two private citizens. The activities of TSFC are limited to activities conducted on behalf of the Government.

Complete financial statements of the blended component units can be obtained directly by contacting their respective administrative offices:

Administrative Offices of Blended Component Units

Virgin Islands Public Finance Authority
2400 Honduras, 2nd Floor
St. Thomas, V.I. 00802

Tobacco Settlement Financing Corporation
2400 Honduras, 2nd Floor
St. Thomas, V.I. 00802

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(2) **Discretely Presented Component Units**

The following component units, consistent with GASB No. 14, are discretely presented in the basic financial statements because of the nature of the services they provide and the Government's ability to impose its will. The component units are reported in a separate column to emphasize that they are legally separate from the PG and governed by separate boards.

Major Component Units

University of the Virgin Islands

The University of the Virgin Islands (the University) was organized as an instrumentality of the Government under Act No. 852 of March 16, 1962, in accordance with Section 6(a) of the Revised Organic Act of 1954, as amended. The purpose of the University is the stimulation and utilization of the intellectual resources of the people of the U.S. Virgin Islands and the development of a center of higher education. The powers of the University are exercised by a board of trustees consisting of 17 members as follows: Chairman of the Board of Education, Commissioner of Education, and the President of the University, all serving as members ex officio, 10 other members appointed by the Governor with the advice and consent of the Legislature, two other members elected by the board of trustees, one representative of the student body, and another of the teaching faculty. The University was not organized as a self-sustaining entity and therefore, receives substantial financial and other support from the Government.

Virgin Islands Port Authority

The Virgin Islands Port Authority (VIPA) was created as a body corporate and politic constituting a public corporation and autonomous government instrumentality by Act No. 2375 of December 23, 1968, with the purposes of owning, operating, and managing all types of air and marine terminals. The powers of VIPA are exercised by a board of governors consisting of the Commissioner of Economic Development and Agriculture (Chairperson), the Attorney General, the Commissioner of Public Works, the Director of the Small Business Development Agency, and five other persons appointed by the Governor with the advice and consent of the Legislature.

Virgin Islands Water and Power Authority

The Virgin Islands Water and Power Authority (WAPA) was created as a body corporate and politic constituting a public corporation and autonomous governmental instrumentality by Act No. 1248 of August 13, 1964, with the purpose of operating the water production and electric generation plants in the U.S. Virgin Islands. The powers of WAPA are exercised by a governing board consisting of nine members, all appointed by the Governor with the advice and consent of the Legislature, from which three are heads of cabinet-level executive departments or agencies and six, who shall not be employees of the Government. WAPA is required by its bond resolutions to maintain separate audited financial statements for each system (the Electric and Water Systems).

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Nonmajor Component Units

Economic Development Authority

The Economic Development Authority (EDA) was created by Act No. 6390 of December 21, 2000 as a body corporate and politic constituting a public corporation and semiautonomous instrumentality of the Government. EDA was created as an umbrella authority to assume, integrate, and unify the functions of the Economic Development Commission, the Small Business Development Administration, the Government Development Bank, and the Virgin Islands Industrial Development Park Corporation. The powers of EDA are exercised by a board of directors consisting of the members of the Virgin Islands Economic Development Commission, the Director of the Virgin Islands' Bureau of Internal Revenue and five members not employed by the Government, but appointed by the Governor with the advice and consent of the Legislature.

Virgin Islands Public Television System

The Virgin Islands Public Television System (PTS) was created as a body corporate and politic constituting a public corporation and autonomous instrumentality by Act No. 2364 on November 15, 1968, with the purpose of advancing the general welfare, education, cultural development, and awareness of public affairs of all the population of the U.S. Virgin Islands and to provide an effective supplement to the in-school education of children. The powers of PTS are exercised by a board of directors consisting of the Commissioner of Education, the Chairman of the Board of Education, three members appointed by the President of the Legislature, and four members, not more than two of whom should be employed by the Government and appointed by the Governor with the advice and consent of the Legislature. In addition, the Director of the Office of Management and Budget, the President of the University of the Virgin Islands, and the General Manager of PTS are ex-officio members of the board who are not entitled to vote.

Magens' Bay Authority

MBA was created as a corporate instrumentality by Act No. 2085 on December 20, 1967, with the purpose of acquiring, improving, and operating parks and beaches. The powers of MBA are exercised by a board of directors consisting of the Governor and six members appointed by the board of directors.

Virgin Islands Government Hospital and Health Facilities Corporation

The Virgin Islands Government Hospital and Health Facilities Corporation (VIGHHFC) was created by Act No. 6012 on August 23, 1994 and became active on May 1, 1999. Its purpose is to provide healthcare services and hospital facilities to the people of the U. S. Virgin Islands. The powers of VIGHHFC are exercised by a board of directors consisting of 15 members as follows: the Director of the Office of Management and Budget, the Commissioner of Finance, and 13 other members appointed by the Governor with the advice and consent of the Legislature. The VIGHHFC is composed of the Roy L. Schneider Hospital located in

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St. Thomas and the Juan F. Luis Hospital and Medical Center located in St. Croix. Both entities issue separate audited financial statements.

Virgin Islands Housing Authority

The Virgin Islands Housing Authority (VIHA) was created as a body corporate and politic constituting a public corporation and autonomous governmental instrumentality by Act No. 903 on June 18, 1962 with the purpose of providing housing for low-income families. The powers of VIHA are exercised by a board of commissioners consisting of seven members as follows: the Commissioner of Housing and Community Renewal and six other members appointed by the Governor.

Virgin Islands Housing Finance Authority

The Virgin Islands Housing Finance Authority (VIHFA) was created as a body corporate and politic constituting a public corporation and autonomous governmental instrumentality of the Government by the Act No. 4636 of October 20, 1981, with the purpose of stimulating low- and moderate-income housing construction and home ownership through the issuance of revenue bonds to obtain funds to be used for low-interest mortgage loans to qualified purchasers of low- and moderate-income housing. The powers of VIHFA are exercised by a board of directors consisting of the Commissioner of the Department of Housing, Parks, and Recreation (the Chairman), the Director of the Office of Management and Budget, and three persons not employed by the Government appointed by the Governor with advice and consent of the Legislature.

Complete financial statements of the discretely presented component units can be obtained directly by contacting their administrative offices:

Administrative Offices

University of the Virgin Islands
2 John Brewer's Bay
St. Thomas, V.I. 00802
Virgin Islands Port Authority
PO Box 301707
St. Thomas, V.I. 00803

Virgin Islands Water and Power Authority
PO Box 1450
St. Thomas, V.I. 00804

Virgin Islands Public Television System
PO Box 7879
St. Thomas, V.I. 00801

Economic Development Authority
1050 Norre Gade #5
St. Thomas, V.I. 00802

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Magens' Bay Authority
PO Box 10583
St. Thomas, V.I. 00802

Virgin Islands Government Hospital and Health Facilities Corporation
9048 Sugar Estate
St. Thomas, V.I. 00802

Virgin Islands Housing Authority
42 Annas Retreat
St. Thomas, V.I. 00802

Virgin Islands Housing Finance Authority
210-3A Altona
Frostco Center Building
St. Thomas, V.I. 00802

All financial statements of the discretely presented component units have a fiscal year-end of September 30, 2002, except for WAPA and VIHA that have a year-end of June 30, 2002 and December 31, 2001, respectively.

(3) Fiduciary Component Units

The following public benefit corporation is legally separate from the Government, meets the definition of a blended component unit and is presented in the fund financial statements along with other fiduciary funds of the Government. Fiduciary funds are not reported in the government-wide financial statements.

Employees' Retirement System of the Government of the Virgin Islands

The Employees' Retirement System of the Government of the Virgin Islands (known as GERS) was created as an independent and separate agency of the Government with the purpose of administering the Government employees' defined-benefit pension plan established as of October 1, 1959. The responsibility for the proper operation of GERS is vested in a board of trustees composed of seven members appointed by the Governor with the advice and consent of the Legislature.

Complete financial statements of this component unit can be obtained directly by contacting their administrative office:

Employees' Retirement System of the Government of the Virgin Islands
GERS Building, 3rd Floor
St. Thomas, V.I. 00802

(b) Government-wide and Fund Financial Statements

The government-wide financial statements (that is, the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the PG and its component units.

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For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the PG is reported separately from certain legally separate component units for which the PG is financially accountable. The statement of net assets presents the reporting entities' nonfiduciary assets and liabilities, with the difference reported as net assets.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenue includes (i) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (ii) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenue are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

(c) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

Government-wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Government considers most revenue to be available if collected within 90 days of the end of the current fiscal year-end. Grant revenue is considered to be available if collected within the 12 months after the end of the current fiscal year-end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, are recorded only when payment is due.

Income taxes, gross receipts, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the Government.

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Proprietary Funds, Fiduciary Funds, and Discretely Presented Component Units Financial Statements – The financial statements of the proprietary funds, fiduciary funds, and discretely presented component units are reported using the economic measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

Each proprietary fund has the option under GASB Statement No. 20 to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with a GASB pronouncement. The PG and most blended and discretely presented component units have elected not to apply FASB pronouncements issued after November 30, 1989 for its proprietary fund types. VIPA has elected to follow the FASB's pronouncements issued after November 30, 1989.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations.

(d) *Fund Accounting*

The Government reports its financial position and results of operations in funds, which are considered separate accounting entities and discrete presentations of those component units, which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. The new model as defined in GASB No. 34 establishes criteria (percentage of the assets, liabilities, revenue, or expenditures/expenses of either fund category or the governmental and enterprise funds combined) for the determination of major funds. The nonmajor funds are combined in a single column in the fund financial statements. The Government reports the following major funds:

Governmental Funds

The Government reports the following major governmental funds:

- ***General Fund*** – The general fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.
- ***PFA Debt Service Fund*** – The PFA Debt Service Fund accounts for the resources accumulated, and payments made, for principal and interest on long-term general obligation debt issued by PFA on behalf of the Government.

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Proprietary Funds

These funds account for those activities for which the intent of management is to recover, primarily through user charges the cost of providing goods or services to the general public. The government reports the following major proprietary funds:

- ***Unemployment Insurance Fund*** – The unemployment insurance fund accounts for the collection of unemployment assessments from employers in the U.S. Virgin Islands, and the payment of unemployment benefits to eligible unemployed recipients.
- ***West Indian Company*** – The West Indian Company (WICO) accounts for the activities of a cruise ship pier and shopping mall complex on the island of St. Thomas.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the Government in a trustee capacity, or as an agent for individuals, private organizations, and other governmental units. The following are the Government's fiduciary funds:

- ***Pension Trust Fund Accounts*** – The pension trust fund accounts for the activities of the Employees' Retirement System of the Government of the Virgin Islands, which accumulates resources for pension benefit payments to qualified employees.
- ***Agency Fund*** – The agency fund is custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

(e) *Cash and Cash Equivalents*

The Government follows the practice of pooling cash. The balance in the pooled cash accounts is available to meet current operating requirements and any excess is invested in various interest-bearing accounts and time deposits with eligible depository institutions.

Cash equivalents of the discretely presented component units consist of demand accounts, money market accounts, certificates of deposit with maturities of not more than 90 days from the date of acquisition, short-term U.S. government and its agencies obligations and repurchase agreements with a U.S. commercial bank maturing within three months and collateralized by U.S. government obligations. Cash and cash equivalents of the discretely presented component units are maintained in separate bank accounts, from those of the PG, in their own names.

(f) *Investments*

Title 33, Chapter 117 of the Virgin Islands Code (V.I. Code) authorizes the Government to invest in U.S. Government and agencies' obligations, mortgage-backed securities, repurchase agreements, commercial paper, local government obligations, and corporate debt and equity obligations. Investments are reported at fair value.

Investments in marketable equity securities in the pension trust fund are carried at quoted market values. Realized gains and losses on securities are determined by the average cost method. Investment in real estate is carried at fair value. Management has determined the fair value based

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upon an appraisal and a capitalization of net rental income. Member loans are valued at the outstanding loan principal balance less an allowance for estimated loan losses. Management believes that, based upon interest rate and risk factors, this valuation approximates fair value.

(g) Receivables

Tax receivables represent amounts owed by taxpayers for individual and corporate income taxes, gross receipts taxes and real property taxes. Tax revenue is recognized in the governmental fund financial statements when they become both measurable and available based on actual collections during the months subsequent to September 30.

Individual and corporate income tax receivables are comprised of actual collections during the next 90 days following the fiscal year-end related to tax returns due before year-end. Gross receipts tax receivables are comprised of actual collections during the month after year-end. Real property tax receivables are comprised of actual collections during the next 60 days after year-end.

Federal government receivables represent amounts owed to the Government for reimbursement of expenditures incurred pursuant to federally funded programs.

Accounts receivables are reported net of estimated allowances for uncollectible amounts, which are determined based upon past collection experience and current economic conditions.

The accounts receivable from nongovernmental customers of the discretely presented component units are net of estimated uncollectible amounts. These receivables arise primarily from service charges to users. Accounts receivable from the PG and other component units that arise from service charges do not have significant allowances for uncollectible accounts.

(h) Inventories

In governmental fund types, the costs of inventories are recorded as expenditures when purchased. The proprietary fund types and component units recognize an asset when the inventory is purchased and an expense when it is consumed. Inventories in proprietary fund types are primarily valued at the lower of cost or market using the first-in, first-out method.

(i) Restricted Assets

Restricted assets in the PG and discretely presented component units are set aside primarily for the payment of bonds, notes, construction funds and other specific purposes (see note 7).

(j) Capital Assets

Capital assets, which include land, land improvements, buildings, building improvements, machinery and equipment, construction in progress, and infrastructure assets are reported in the applicable governmental, business-type activities, and component unit columns in the government-wide financial statements.

The PG defines capital assets as assets which have an initial, individual cost of and a useful life of: (i) \$5,000 for personal property with a useful life of five years; (ii) \$50,000 for buildings and building improvements with an estimated useful life of 40 and 20 years, respectively; (iii) \$100,000

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for land improvements; and (iv) \$200,000 for infrastructure with an estimated useful life of 30 years. The value of land is capitalized.

Capital assets purchased or acquired are carried at historical cost or normal cost. The normal costing method to estimate cost based on replacement cost indexed by a reciprocal factor of the price increase from the appraisal date to the actual or estimated acquisition date was used to estimate the historical cost of certain land, buildings, and building improvements because invoices and similar documentation was no longer available in certain instances. Donated capital assets are recorded at fair market value at the time of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest costs are capitalized during the construction period only for business-type activities and various component units. The costs of routine maintenance and repairs that do not add value to the assets or materially extend asset lives are not capitalized.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds and component units' financial statements.

Capital assets of the PG are depreciated on the straight-line method over the assets estimated useful lives. There is no depreciation recorded for land and construction in progress.

The capital assets of the component units are recorded in accordance with the applicable GASB and FASB statements and under their own individual capitalization thresholds. The estimated useful lives of capital assets reported by the component units are: (i) 7 to 50 years for buildings and building improvements; (ii) 20 to 40 years for airports and marine terminals; and (iii) 3 to 20 years for vehicles and equipment.

The Government chose the option available under GASB 34 of not recording wastewater treatment facilities as information for this network of infrastructure asset was not available. These assets were deemed to be nonmajor relative to total infrastructure assets and are not reported.

(k) Tax Refunds Payable

During the calendar year, the Government collects individual income taxes through withholdings and payments from taxpayers. At September 30, the Government estimates the amount owed to taxpayers for overpayments during the first nine months of the calendar year. These estimated amounts and the actual tax refunds claimed for prior years but not paid at year-end are recorded as tax refunds payable and as a reduction of tax revenue.

(l) Deferred Revenue

Deferred revenue at the governmental fund level arises when potential revenue does not meet both the "measurable" and "available" criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Government has a legal claim to them, as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Government has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and the revenue is recognized. Deferred revenue at the government-wide and proprietary fund levels arises only when

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the Government receives resources before it has a legal claim to them. Also included in deferred revenue at all levels are the undistributed food stamp coupons.

(m) Long-Term Debt

The liabilities reported in the government-wide financial statements include the Government's bonds, long-term notes, and other long-term liabilities including vacation, retroactive union arbitration salaries, legal claims, and noncurrent federal fund cost disallowances related to expenditures of federal grants. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, government fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

(n) Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

(o) Net Assets

Net assets are reported in three categories:

- **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets. Significant unspent related debt proceeds are not included in the calculation of invested in capital assets, net of related debt. The unspent portion of the debt is presented as restricted net assets for capital projects.
- **Restricted Net Assets** – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – These consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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When both restricted and unrestricted resources are available for use, generally it is the Government's policy to use restricted resources first, then the unrestricted resources, as they are needed.

(p) *Postemployment Benefits*

In addition to the pension benefits in note 12, the Government provides postretirement healthcare benefits, in accordance with the V.I. Code to all employees who retire from the Government on or after attaining age 55 with at least 30 years of service; except for policemen and firemen who can retire with at least 15 years of service. Currently 5,343 retirees meet those eligibility requirements. Healthcare benefits are provided through insurance companies whose premiums are paid by the retiree and the Government. The Government contributes two-thirds of the of the healthcare benefits premiums. During the year ended September 30, 2002, the cost of providing healthcare benefits amounted to approximately \$11.4 million.

(q) *Compensated Absences*

The vacation policy of the Government provides for the accumulation of four, six, or eight hours for each full biweekly pay period depending on the time of entry into government service. At the beginning of each calendar year, vacation leave is limited to 480 hours (60 days). However, the excess of 480 hours is considered by GERS for service credit towards the employees' retirement. This vacation policy does not apply to professional educational personnel of the Virgin Islands Department of Education, who are entitled to pay for school vacations. Upon retirement, an employee receives compensation for unpaid vacation leave at the employee's base rate pay. As of September 30, 2002, the Government had accrued compensated absences amounting to \$52 million, including related benefits, of which \$28.4 million was included in noncurrent liabilities in the government-wide financial statements.

Employees accumulate sick leave at a rate of four hours for each full biweekly pay period up to a maximum of 180 days. Terminated employees do not receive payment for unused sick leave, therefore, a provision for accumulated sick leave is not required.

Compensated absences accumulation policies for the blended component units, the public university funds, and discretely presented component units vary from entity to entity, depending upon negotiated bargaining agreements and other factors agreed upon between the management of these entities and its employees.

(r) *Interfund and Intra-Entity Transactions*

The Government has the following types of transactions among funds:

- ***Interfund Transfers*** – Legally required transfers that are reported when incurred as “operating transfers from” by the recipient fund, and as “operating transfers to” by the disbursing fund.
- ***Intra-Entity Transactions*** – These are transactions between the PG and its component units, and among the component units. Transfers between the PG and its blended component units are reported as interfund transfers, except for transfers within the same fund type. Similarly, receivables and payables between the PG and its blended component units are reported as

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amounts due to, and due from other funds. Balances and transfers between the PG and discretely presented component units (and among those component units) are reported separately.

(s) Lottery Revenue and Prizes

The revenue, expenses, and prizes awarded by the Virgin Islands Lottery (the Lottery) are reported within the enterprise funds and are recognized as drawings are held. Moneys collected prior to September 30 for tickets related to drawings to be conducted subsequent to September 30 are reported as deferred revenue. Unpaid prizes awarded as of September 30 are reported as a fund liability.

(t) Risk Management

With some exceptions, the Government does not carry general casualty or liability insurance coverage on its properties or the acts of its employees, relying instead on self-insurance and/or statutory liability limitations. However, as a result of an agreement with the Federal Emergency Management Agency (FEMA), with respect to properties and structures damaged by Hurricane Hugo and repaired with federal disaster assistance funds, the Government has obtained insurance for certain hospitals, schools, and other insurable public buildings that were repaired with such federal assistance. The Government purchases commercial insurance covering physical losses or damages against its property. The limit of liability for all risks excluding earthquake and flood is \$10 million for each and every occurrence except for windstorm losses which has a \$5 million limit. For physical losses arising from earthquake or flood, the insurance policy shall pay the difference between \$5 million and \$25 million for each and every occurrence. If the annual aggregate amount of the losses arising from such types of peril exceeds \$40 million, the insurance covers an additional annual aggregate of \$10 million for earthquake and \$5 million for flood. For workmen's compensation, the Government has an enterprise fund that provides workmen's compensation to both public and private employees.

Certain component units are exposed to various risks of loss related to their specialized operations, which are mitigated by purchasing commercial insurance.

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(u) Future Adoption of Accounting Requirements

GASB has issued the following statements that the Government or its component units have not yet adopted:

<u>Statement number</u>		<u>Adoption required in fiscal year</u>
39	Determining Whether Certain Organizations Are Component Units – An Amendment of GASB Statement No. 14	2004
40	Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3	2005
41	Budgetary Comparison Schedules – Perspective Differences – an amendment of GASB Statement No. 34	2003
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2006
43	Financial Reporting for Postemployment Benefit Plans Other than Pension Plans	2006

The impact of these statements has not yet been determined.

(v) Reclassifications

The presentation of the separately issued financial statements of certain component units have been reclassified to conform to the account classifications used by the Government in the 2002 basic financial statements.

(w) Use of Estimates

Management of the Government has made a number of estimates and assumptions relating to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

(2) Component Units

The basic financial statements include the financial statements of the following discretely presented component units:

- University of the Virgin Islands
- Virgin Islands Port Authority
- Virgin Islands Water and Power Authority
- Economic Development Authority

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- Virgin Islands Public Television System
- Magens' Bay Authority
- Virgin Islands Government Hospital and Health Facilities Corporation
- Virgin Islands Housing Authority
- Virgin Islands Housing Finance Authority

Condensed financial information of all discretely presented component units follows (expressed in thousands):

Information on net assets	Virgin Islands Housing Authority	Virgin Islands Port Authority	Virgin Islands Water and Power Authority		University of the Virgin Islands	Other entities	Total component units
			Electric System	Water System			
Assets:							
Current assets	\$ 7,926	20,747	49,047	25,766	40,229	35,496	179,211
Due from primary government	—	695	—	—	3,568	119	4,382
Due from federal government	—	362	—	—	3,469	1,842	5,673
Restricted assets	4,527	11,852	26,918	8,558	12,382	15,026	79,263
Capital assets, net	74,169	231,753	170,378	51,425	42,161	134,494	704,380
Other noncurrent assets	—	150	2,203	991	—	—	3,344
Total assets	86,622	265,559	248,546	86,740	101,809	186,977	976,253
Liabilities and net assets:							
Current liabilities	9,690	12,095	56,693	11,810	10,712	24,332	125,332
Due to primary government	—	—	—	—	—	15,365	15,365
Due to federal government	—	—	5,300	—	—	—	5,300
Bonds payable	—	10,163	96,107	37,837	24,701	7,115	175,923
Notes payable	—	—	—	—	3,585	424	4,009
Other noncurrent liabilities	6,781	—	—	—	132	18,497	25,410
Total liabilities	16,471	22,258	158,100	49,647	39,130	65,733	351,339
Net assets:							
Invested in capital assets -- net of related debt	74,169	221,590	65,275	12,580	24,995	125,280	523,889
Restricted	—	3,894	13,978	7,510	27,790	148	53,320
Unrestricted (deficit)	(4,018)	17,817	11,193	17,003	9,894	(4,184)	47,705
Total net assets	\$ 70,151	243,301	90,446	37,093	62,679	121,244	624,914

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Information on statements of activities	Expenses	Program revenue			Total component units
		Charges for services	Operating grants and contributions	Capital grants and contributions	
Virgin Islands Housing Authority	\$ 64,604	5,717	31,826	13,963	(13,098)
Virgin Islands Port Authority	47,232	33,951	19,844	—	6,563
Virgin Islands Water and Power Authority:					
Electric system	111,260	111,496	1,993	—	2,229
Water system	24,817	25,832	1,605	—	2,620
University of the Virgin Islands	57,852	10,402	39,696	4,758	(2,996)
Other entities	139,903	67,111	49,313	5,476	(18,003)
Total activities	<u>\$ 445,668</u>	<u>254,509</u>	<u>144,277</u>	<u>24,197</u>	<u>(22,685)</u>
General revenue:					
Interest and other					3,801
Other general revenue					5,482
Total general revenue					<u>9,283</u>
Change in net assets					(13,402)
Net assets, beginning of year					<u>638,316</u>
Net assets, end of year					<u>\$ 624,914</u>

(3) Stewardship, Compliance, and Accountability

(a) Budgetary Process and Control

The V.I. Code requires the Governor to submit an annual balanced executive budget to be adopted by the Legislature for the ensuing fiscal year. The Governor is required by law to submit to the Legislature the annual executive budget no later than May 30. The annual executive budget is prepared essentially on a cash basis by the Virgin Islands Office of Management and Budget (OMB) working in conjunction with other Government offices and agencies. If the annual executive 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 annual executive budget, which includes those funds of the Government subject to appropriation pursuant to law, is composed of all proposed expenditures and estimated revenue for the Government. The Legislature enacts the annual executive budget through passage of lump-sum appropriations for each department. The Legislature may add, change, or delete any items in the annual executive budget proposed by the Governor. Upon passage by the Legislature, the annual executive budget is submitted to the Governor, who may veto the budget partially or in its entirety and return it to the Legislature with his objections. A gubernatorial veto can be overridden only by a two-third majority of all members of the Legislature. The Legislature is obligated by law to pass a final annual executive budget no later than September 30, the last day of the fiscal year. Supplemental budgetary appropriations' bills that are signed into law, may be created during the year without the identification of a specific revenue source to finance them. In August 1999, the Legislature enacted the Financial Accountability Act (Act No. 6289). The purpose of the Financial Accountability Act is to require by law, that the budget of the Government be balanced each year, and the appropriations in each fiscal year not exceed a verifiable revenue received.

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Once the budget has been 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 expenditures. The Governor may also make recommendations to the Legislature for new taxes or any other necessary action to meet the estimated deficiency.

Budgetary control is exercised at the department level through an allotment process. Encumbrances and expenditures cannot exceed total allotment amounts. The Government's department heads may make transfers of appropriations within the department. Appropriation transfers between departments and supplemental appropriations require executive and legislative branch approval. Unencumbered and unexpended appropriations, not designated, lapse at fiscal year-end. Also, encumbrances are established at fiscal year-end to pay certain expenditures for salaries and wages, travel and utility costs payable against current year appropriation authority but to be expended in the subsequent year.

(b) Budget/GAAP Reconciliation

The following schedule presents comparisons of the general fund legally adopted budget with actual data on a budgetary basis. Because accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of timing and entity difference in the deficiency of revenue and other financing sources over expenditures and other financing uses for the year ended September 30, 2002, is presented below (expressed in thousands):

Excess of expenditures and other uses over revenue and other financing sources – non-GAAP budgetary basis	\$ (43,789)
Timing difference – change in encumbrances	(7,985)
Entity difference – deficiency of revenue and other financing sources over expenditures and other financing uses – activities with budgets not legally adopted	<u>(23,667)</u>
Excess of expenditures and other financing uses over revenue and other financing sources – GAAP basis	<u>\$ (75,441)</u>

Controls over spending in special revenue funds not subject to appropriation are maintained at the Department of Finance by use of budgets and available resources (revenue). The Government makes appropriations to authorize expenditures for various capital projects. Budgets for capital projects normally remain available until completion of the project unless modified or rescinded.

(4) Cash and Investments

By law, banks or trust companies designated as depository of public funds of the Government and its various agencies, authorities and instrumentalities, are to maintain corporate surety bond or pledge collateral satisfactory to the Commissioner of Finance to secure all governmental funds deposited.

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At September 30, 2002, the PG and the discretely presented component units carrying amounts of cash and cash equivalents were covered by federal deposit insurance, corporate surety bonds, or by collateral held by the Government.

Legally authorized investments vary by fund, but generally include obligations of the United States or its States, Commonwealth of Puerto Rico, the Government of the U.S. Virgin Islands, or of any agency thereof, common and preferred stocks of any U.S. corporation, common and preferred stocks of any foreign corporation listed in any internationally recognized security exchange, certain bonds or other indebtedness issued by foreign governments or foreign corporations, certificates of deposit, collateralized repurchase agreements and certain corporate bonds. Specific bond indentures also provide investment requirements.

For the fiscal year ended September 30, 2002, the PG, discretely presented component units and fiduciary funds has classified their investments into three risk categories. Category 1 includes investments that were insured or registered or for which the securities were held by a government entity, or its agent, in the entity's name and investments for which the entity has safekeeping responsibilities but no equity or ownership interest or control. Category 2 includes uninsured and unregistered investments for which the securities were held by the counterparty's trust department or agent in a government entity's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent but not in a government entity's name. The investments of the PG, discretely presented component units by custodial credit risk categories at September 30, 2002, were as follows (expressed in thousands):

Primary Government – Investments

	Category			Reported amount
	1	2	3	
Commercial paper	\$ 99,997	—	—	99,997
Certificates of deposit	61,996	—	—	61,996
Federal Home Loan Bank	1,782	—	—	1,782
	<u>\$ 163,775</u>	<u>—</u>	<u>—</u>	163,775
Investments not categorized:				
Pooled investments				63,918
Total investments				<u>\$ 227,693</u>

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Discretely Presented Component Units – Investments

	Category			Reported amount
	1	2	3	
U.S. government and agency securities	\$ 19,068	—	—	19,068
Common stocks	896	—	—	896
Corporate bonds	3,401	—	—	3,401
Certificates of deposit	4,314	—	—	4,314
Money market funds	1,471	—	—	1,471
Investment contracts	2,234	—	—	2,234
Mortgage-backed securities	—	6,608	—	6,608
Other investments	—	1,083	—	1,083
	\$ 31,384	7,691	—	39,075
Investments not subject to classification:				
Mutual funds				22,479
Other				12,189
Total investments				\$ 73,743

The investment balance consists of the following:

Unrestricted	\$ 24,442
Restricted	49,301
Total investments	\$ 73,743

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Fiduciary Funds – Investments

	Category			Reported amount
	1	2	3	
U.S. government and agency securities	\$ 182,160	—	—	182,160
Corporate obligations	97,015	—	—	97,015
Foreign bonds	88,503	—	—	88,503
Common stocks – U.S.	368,392	—	—	368,392
Common stocks – foreign	38,731	—	—	38,731
Collateralized debt obligations	145,907	—	—	145,907
	<u>\$ 920,708</u>	<u>—</u>	<u>—</u>	<u>920,708</u>
Investments not categorized:				
Investments held by broker – dealers under security loans:				
U.S. government and agency securities				180,354
Common stocks – U.S.				39,723
U.S. Common stocks – foreign				5,320
Mutual funds				14,896
Pooled investments				11,979
Real estate				33,000
Total investments				<u>\$ 1,205,980</u>

The pension trust fund's investments in marketable securities are administered by several professional investment managers and are held in trust by a commercial bank in the name of GERS. The investments in marketable securities generated interest and dividend income of \$36.4 million. During the year ended September 30, 2002, GERS' investments (including gains and losses on investments bought and sold, as well as held during the year) (depreciated) appreciated in value as follows (expressed in thousands):

U.S. government and government-guaranteed obligations	\$ 2,316
Corporate bonds – U.S.	2,469
Corporate bonds – foreign	10,644
Common stocks – U.S.	(83,977)
Common stocks – foreign	(9,823)
Collateralized debt obligations	10,150
Mutual funds	(3,817)
Net depreciation of fair value of investments	<u>\$ (72,038)</u>

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GERS participates in securities lending program administered by State Street Bank & Trust (the Custodian). Loans are generally terminable on demand. The system may be exposed to off-balance sheet risk in the event a borrower is unable to meet its contractual obligation. The Custodian must receive collateral at a minimum of 102% of the market value of the security for domestic borrowers, and 105% for foreign borrowers. The securities are marked-to-market, and settlements are made with the borrowers on a daily basis by the Custodian. At September 30, 2002, approximately \$225.4 million of securities were on loan.

(5) Receivables

Taxes receivable at September 30, 2002 consist of the following (expressed in thousands):

Income	\$	94,444
Real property		33,027
Gross receipts		<u>5,013</u>
	\$	<u><u>132,484</u></u>

The Naval Appropriations Act, 1922, and Section 28(a) of the Revised Organic Act created a separate tax structure for the U.S. Virgin Islands that mirrors the Internal Revenue Code of 1986, as amended. Income taxes are due from every corporation, partnership, individual, association, estate, or trust that meets the filing requirements of the U.S. Internal Revenue Code. A U.S. taxpayer who is a permanent resident of the U.S. Virgin Islands satisfies his Virgin Islands income tax obligations by filing his return with and paying income taxes to the Government. Virgin Islands residents are taxed by the Virgin Islands on their world-wide income. A nonresident of the U.S. Virgin Islands pays income taxes on his U.S. Virgin Islands source income to the Government. The revenue is recognized in the general fund in the fiscal period for which the income tax return was filed. The revenue from income tax withholding and estimated payments are recognized in the general fund as collected, net of estimated tax refunds.

Corporate income taxes are due by the 15th day of the third month following the close of the fiscal year and become delinquent if not paid on or before the due date.

Partnership and trust income taxes are due by April 15 of the following year for which the income tax was levied. Trust income taxes must be paid by the tax filing date.

Property taxes are levied each calendar year on all taxable real property located in the U.S. Virgin Islands. The revenue is recognized in the general fund and in the fiscal period for which the property tax was levied, provided the tax is collected within 60 days subsequent to fiscal year-end, unless the facts justify a period greater than 60 days.

The Office of the Tax Assessor is responsible for the assessment of all taxable real property. Noncommercial real property subject to taxation is reassessed biannually and commercial real property subject to taxation is reassessed annually. The Tax Assessor prepares an annual assessment roll and schedule of collections for each parcel of real property that is used by the Department of Finance, as the basis for issuing tax bills to all taxpayers in the U.S. Virgin Islands.

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Property taxes are to be levied by May 15 of each year in the name of the record owner on January 15 of the same year. The taxes are due on September 30 and become delinquent if not paid by October 30. The taxes assessed become an enforceable first lien against the real property as of the levy date.

For businesses with gross receipts of less than \$150,000 per annum, gross receipts taxes are levied on a monthly basis, based on a 4% of gross receipts in excess of \$5,000. Businesses with annual gross receipts of more than \$150,000, lose the \$5,000 monthly exemption. The gross receipts tax is due within 30 calendar days following the last day of the calendar month collected.

Receivables in the government-wide financial statements also include accrued interest and other amounting to \$1,378,000 and \$97,000 of amounts due from the agency fund to the governmental activities.

Loans and advances receivable at September 30, 2002, consist of the following (expressed in thousands):

	<u>Primary government</u>	<u>Fiduciary funds</u>	<u>Component units</u>
Mortgage loans	\$ 9,625	26,373	—
Personal loans	—	69,872	—
Other loans and advances	963	1,235	2,369
Subtotal	<u>10,588</u>	<u>97,480</u>	<u>2,369</u>
Less allowance for uncollectible accounts	<u>(5,171)</u>	<u>(3,000)</u>	—
Loans and advances, net	<u>\$ 5,417</u>	<u>94,480</u>	<u>2,369</u>

(6) Interfund Transactions

(a) Operating Transfers

Operating transfers constitute the transfer of resources from the fund that receives the resources to the fund that utilizes them. The most significant transfers to the general fund from other governmental funds include a \$73.2 million transfer from the debt service fund representing tax revenue in excess of bonds debt service requirements and a \$25.6 million transfer from the nonmajor governmental funds, \$5.6 million from the PFA Blended Capital Projects Fund for reimbursement of capital outlays made by the general fund and \$20 million from the Government's debt service fund representing tax revenue in excess of bonds debt service requirements. Transfers to nonmajor governmental funds consisted primarily of \$10.1 million transferred from the debt service fund and \$10.3 million from the general fund. Other significant transfers include a transfer of \$2.6 million from PFA Blended Capital Projects Fund to the King's Alley Management Fund (a nonmajor enterprise fund).

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Interfund transfers for the year ended September 30, 2002 consisted of the following (expressed in thousands):

<u>Transfer to</u>	<u>General fund</u>	<u>PFA Debt Service Fund</u>	<u>Nonmajor governmental funds</u>	<u>Enterprise fund – West Indian Company</u>	<u>Nonmajor enterprise funds</u>	<u>Total</u>
General fund	\$ —	73,212	25,614	500	—	99,326
Nonmajor governmental	10,360	10,127	—	800	—	21,287
Nonmajor enterprise	—	—	2,594	—	—	2,594
Total	\$ 10,360	83,339	28,208	1,300	—	123,207
Transfer from						
General fund	\$ —	—	10,360	—	—	10,360
Debt service fund	73,212	—	10,127	—	—	83,339
Nonmajor governmental	25,614	—	—	—	2,594	28,208
Enterprise fund – West Indian Company	500	—	800	—	—	1,300
Total	\$ 99,326	—	21,287	—	2,594	123,207

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(b) Due From/To Other Funds

The following table summarizes interfund receivables and payables at September 30, 2002 (expressed in thousands):

<u>Due to</u>	<u>General fund</u>	<u>Nonmajor governmental funds</u>	<u>Enterprise fund – West Indian Company</u>	<u>Nonmajor enterprise funds</u>	<u>Pension trust fund</u>	<u>Agency fund</u>	<u>Discretely presented component units</u>	<u>Total</u>
General fund	\$ —	3,178	500	4,668	—	—	15,365	23,711
Nonmajor governmental	9,350	—	—	414	—	97	—	9,861
Total governmental funds	\$ 9,350	3,178	500	5,082	—	97	15,365	33,572
Proprietary fund – nonmajor enterprise	\$ 300	—	—	—	—	—	—	300
Fiduciary funds – pension trust fund	\$ 523	—	—	—	—	—	—	523
Discretely presented component units	\$ 4,382	—	—	—	—	—	—	4,382
<u>Due from</u>								
General fund	—	9,350	—	300	523	—	4,382	14,555
Nonmajor governmental	3,178	—	—	—	—	—	—	3,178
Total governmental funds	\$ 3,178	9,350	—	300	523	—	4,382	17,733
Enterprise fund – West Indian Company	500	—	—	—	—	—	—	500
Nonmajor enterprise	4,668	414	—	—	—	—	—	5,082
Total proprietary funds	\$ 5,168	414	—	—	—	—	—	5,582
Fiduciary funds – agency fund	\$ —	97	—	—	—	—	—	97
Discretely presented component units	\$ 15,365	—	—	—	—	—	—	15,365

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The due from/to other funds include \$4.9 million due from the general fund to the Emergency Molasses Fund (nonmajor governmental fund) from unpaid appropriations. Other balances composing the due from/to other funds, include \$2.7 million from the Bond Proceeds Fund (nonmajor governmental fund) to the general fund and \$500,000, from WICO (nonmajor enterprise fund) to the general fund. In addition, \$4.4 million from the Lottery, (nonmajor enterprise fund) to the general fund consisting primarily of 8% of the total Lottery revenue that is required to be transferred to the general fund.

The due to PG balance is composed of \$10.8 million due from VIGHHFC, a discretely presented component unit. This liability exists because a portion of payroll expenditures that the Government processes are ultimately the responsibility of the Medical Center. The due from PG is mainly composed of \$3.5 million and \$695,000 due to the University and VIPA, respectively.

(7) Restricted Assets

(a) Primary Government

Restricted assets of the PG include cash and cash equivalents for debt service and sinking fund requirements.

(b) Component Units

Restricted assets of component units include cash and cash equivalents, investments, and receivables as follows (expressed in thousands):

Restricted Assets – Component Units

Debt service and sinking fund requirements	\$ 14,174
Construction funds	4,604
Renewal and replacement funds	834
Endowment funds	3,830
HUD project funds	4,527
Revolving loan fund	1,798
	<hr/>
Total cash and cash equivalents	29,767
	<hr/>
Investments:	
Debt service and sinking fund requirements	16,950
Construction funds	14,494
Renewal and replacement funds	3,481
Endowment funds	8,552
Other	5,824
	<hr/>
Total investments	49,301
	<hr/>
Other:	
Accrued interest receivable	195
	<hr/>
Total restricted assets of component units	\$ 79,263
	<hr/> <hr/>

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(8) Capital Assets

(a) Primary Government

The capital assets activity for the governmental-type activities funds for the year ended September 30, 2002 is summarized as follows (expressed in thousands):

	<u>Beginning balance (as restated)</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets, not being depreciated:				
Land	\$ 172,907	10,723	—	183,630
Construction in progress	11,311	8,158	13,925	5,544
Total capital assets, not depreciated	<u>184,218</u>	<u>18,881</u>	<u>13,925</u>	<u>189,174</u>
Capital assets, being depreciated:				
Land improvements	3,557	—	—	3,557
Infrastructure	84,818	18,352	—	103,170
Buildings and improvements	390,099	531	—	390,630
Machinery and equipment	48,566	14,872	—	63,438
Total capital assets, being depreciated	<u>527,040</u>	<u>33,755</u>	<u>—</u>	<u>560,795</u>
Less accumulated depreciation for:				
Land improvements	1,158	149	—	1,307
Infrastructure	5,821	3,169	—	8,990
Buildings and improvements	108,708	5,779	—	114,487
Machinery and equipment	26,644	5,572	—	32,216
Total accumulated depreciation	<u>142,331</u>	<u>14,669</u>	<u>—</u>	<u>157,000</u>
Total capital assets, being depreciated, net	<u>384,709</u>	<u>19,086</u>	<u>—</u>	<u>403,795</u>
Governmental-type activities capital assets, net	<u>\$ 568,927</u>	<u>37,967</u>	<u>13,925</u>	<u>592,969</u>

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Capital assets activity for the enterprise funds for the year ended as of September 30, 2002, is summarized as follows (expressed in thousands):

	Beginning balance (as restated)	Additions	Reductions	Ending balance
Capital assets, not being depreciated:				
Land and land improvements	\$ 5,375	—	—	5,375
Construction in progress	526	593	—	1,119
Total capital assets, not depreciated	<u>5,901</u>	<u>593</u>	<u>—</u>	<u>6,494</u>
Capital assets, being depreciated:				
Buildings and improvements	35,491	3,368	—	38,859
Machinery and equipment	2,842	535	67	3,310
Total capital assets, being depreciated	38,333	3,903	67	42,169
Less accumulated depreciation	<u>9,820</u>	<u>1,631</u>	<u>67</u>	<u>11,384</u>
Total capital assets, being depreciated, net	<u>28,513</u>	<u>2,272</u>	<u>—</u>	<u>30,785</u>
Business-type activities capital assets, net	\$ <u>34,414</u>	<u>2,865</u>	<u>—</u>	<u>37,279</u>

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Depreciation expense was charged to functions/programs of the PG for the year ended September 30, 2002 as follows (expressed in thousands):

Governmental activities:	
General government	\$ 6,008
Public safety	1,332
Health	853
Public housing and welfare	314
Education	5,651
Transportation and communication	511
	<u>14,669</u>
Total depreciation expense – governmental activities	\$ <u>14,669</u>
Business-type activities:	
WICO	1,197
Lottery	67
Other	367
	<u>1,631</u>
Total depreciation business-type activities	\$ <u>1,631</u>

The capital assets activity for the fiduciary funds for the year ended September 30, 2002, is summarized as follows (expressed in thousands):

	<u>Beginning balance (as restated)</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets, not being depreciated:				
Land	\$ 2,245	—	—	2,245
Total capital assets, not depreciated	<u>2,245</u>	<u>—</u>	<u>—</u>	<u>2,245</u>
Capital assets being depreciated:				
Buildings and improvements	10,947	—	—	10,947
Total capital assets being depreciated	10,947	—	—	10,947
Less accumulated depreciation	<u>943</u>	<u>95</u>	<u>—</u>	<u>1,038</u>
Total capital assets being depreciated, net	<u>10,004</u>	<u>(95)</u>	<u>—</u>	<u>9,909</u>
Capital assets, net	\$ <u>12,249</u>	<u>(95)</u>	<u>—</u>	<u>12,154</u>

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2002

(b) Component Units

Capital asset activity for the discretely presented component units for the year ended September 30, 2002 is summarized as follows (expressed in thousands):

	Beginning balance (as restated)	Additions	Reductions	Ending balance
Land	\$ 74,607	3,248	178	77,677
Buildings and improvements	1,046,692	159,861	96,944	1,109,609
Infrastructure – airport and marine terminal facilities	70,452	14,035	—	84,487
Personal property and equipment	75,596	11,203	1,654	85,145
Construction in progress	64,111	43,979	75,355	32,735
Capital assets	1,331,458	232,326	174,131	1,389,653
Less accumulated depreciation	630,235	59,215	4,177	685,273
Capital assets, net	\$ 701,223	173,111	169,954	704,380

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Notes to Basic Financial Statements

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(9) Long-Term Liabilities

Long-term liabilities activities for the year ended September 30, 2002, were as follows (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>	<u>Amounts due thereafter</u>
Governmental activities:						
Bonds payable:						
1998 Series revenue and refunding bonds	\$ 511,340	—	(11,845)	499,495	12,525	486,970
1999 Project revenue bonds	9,915	—	(2,620)	7,295	2,785	4,510
1999 general obligation bonds, Series A	7,990	—	(730)	7,260	780	6,480
1999 Series A revenue bonds	296,270	—	(4,090)	292,180	4,305	287,875
2001 Series A, tobacco bonds	—	23,685	—	23,685	—	23,685
Subtotal bonds payable	825,515	23,685	(19,285)	829,915	20,395	809,520
Less:						
Deferred amount on refundings	(4,312)	—	616	(3,696)	(616)	(3,080)
Bonds discount	(11,772)	(124)	947	(10,949)	(947)	(10,002)
Bonds accretion	—	(1,975)	252	(1,723)	(252)	(1,471)
Total bonds payable	809,431	21,586	(17,470)	813,547	18,580	794,967
Loans payable:						
FEMA State Share	4,477	—	(4,477)	—	—	—
Marilyn CDL	127,200	—	—	127,200	—	127,200
Total loans payable	131,677	—	(4,477)	127,200	—	127,200
Other liabilities:						
Accrued compensated absences	49,559	4,443	—	54,002	28,402	25,600
Retroactive union arbitration	368,512	—	—	368,512	—	368,512
Litigation	11,045	2,217	(9,091)	4,171	923	3,248
Accrued disallowed costs	26,289	—	(7,585)	18,704	—	18,704
Total other liabilities	455,405	6,660	(16,676)	445,389	29,325	416,064
Total governmental activities	\$ 1,396,513	28,246	(38,623)	1,386,136	47,905	1,338,231
Business-type activities:						
Notes payable:						
WICO (see note 13d)	\$ 21,281	—	(957)	20,324	1,030	19,294
Total notes payable	21,281	—	(957)	20,324	1,030	19,294
Total business-type activities	\$ 21,281	—	(957)	20,324	1,030	19,294

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(a) Debt Margin

Pursuant to 48 U.S.C. Section 1574(b)(i) of the Revised Organic Act, the Government may issue revenue bonds for public improvements or undertakings authorized by an act of the Legislature, without limitation as to principal amount. Such revenue bonds are payable solely from the revenue directly derived from and attributable to such public improvements or undertakings. Pursuant to 48 U.S.C. Section 1574(b)(ii), the Government is authorized to issue general obligation bonds for any public purpose provided that no such indebtedness is in excess of 10% of the aggregate assessed valuation of the taxable real property in the U.S. Virgin Islands. In addition, pursuant to 48 U.S.C. Section 1574a (Public Law 94-932), the U.S. Virgin Islands is authorized to cause to be issued bonds or other obligations in anticipation of the matching funds to be received from the federal government pursuant to 26 U.S.C. Section 7652(b)(3). There is no legal limit on the value of bonds that the Government may issue pursuant to 48 U.S.C. Section 1574a. The Legislature of the U.S. Virgin Islands must authorize all bond issuances. PFA is authorized to issue bonds for the purpose of financing any project or for the purpose authorized by the Legislature. Given that PFA's powers to issue bonds are derived from 48 U.S.C. Section 1574(b), the bonds issued by PFA are subject to the limitations of said 48 U.S.C. Section 1574(b). On August 23, 1999, the Legislature amended the V.I. Code to add a Mandatory Balanced Budget Provision. Such provisions, specifically Title 2 of the V.I. Code Section 256, provide that the amount of debt of the Government existing on October 1, 2000 shall be the debt limit of the Government, exclusive of bond principal and interest that may become due. The debt limit specified under Title 2 of the V.I. Code Section 256 does not include bonds authorized by law for which a specific source of revenue is identified and committed to retiring those bonds. As used in Title 2 of the V.I. Code Section 256, the term "debt" means the total accumulated unpaid obligations that are due and payable, including unpaid income tax refunds, amounts owed to vendors, and current year unpaid debt service obligations, if any. As used in the statute, the term "debt" does not include that portion of principal or interest on bonds that is not yet due and payable.

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Notes to Basic Financial Statements

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(b) Bonds Payable

Bonds payable outstanding at September 30, 2002 are comprised of the following (expressed in thousands):

Primary Government – Bonds Payable

<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates</u>	<u>Balance</u>
1998 Series A, B, C, D, and E revenue and refunding bonds	2023	5.50% to 7.11%	\$ 499,495
1999 Project revenue bonds	2005	6.25%	7,295
1999 Series A general obligation bonds	2010	6.50%	7,260
1999 Series A revenue bonds	2029	4.2% to 6.40%	292,180
2001 Series A tobacco bonds	2031	5%	23,685
Subtotal			<u>829,915</u>
Less:			
Deferred amount on refundings			(3,696)
Bonds discount			(10,949)
Bonds accretion			<u>(1,723)</u>
Total			<u>\$ 813,547</u>

On May 1, 1998, PFA issued the revenue and refunding bonds series 1998 A, B, C, D, and E amounting to \$541.8 million, secured by general obligation notes issued by the Government. These bonds were issued for the purpose of, among other things, advance refunding of previously issued bonds in order to obtain lower interest rates. The economic gain obtained by this advance refunding is the difference between the present value of old debt service requirements and the new debt service. This refunding resulted in a debt service saving of approximately \$40 million and an economic gain of approximately \$19 million.

The proceeds of the 1998 Series A and B Bonds were placed in an irrevocable trust account to provide for all future debt service payments on the Highway Revenue Bonds Series 1989, Series 1991, Series 1992, Series 1993, and Series 1994 Bonds. At September 30, 2002, \$220.7 million of the above-mentioned defeased bonds were outstanding.

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. At September 30, 2002, \$176.9 million of defeased bonds were outstanding. All assets held by irrevocable trusts for refunding of prior outstanding debt and the corresponding liabilities are not included in the Government's basic financial statements.

The 1998 Series C Bonds and the 1998 Series D Bonds were issued to pay, on behalf of the Government, the full principal balance and interest due and payable on the Revenue Anticipation

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Note, issued in February 1998. The remaining balance of the 1998 Series D Bonds amounting to approximately \$11.6 million was primarily provided to the Government for additional working capital. The net proceeds of the 1998 Series E Bonds amounting to \$104 million were primarily designated to fund the construction of certain capital projects amounting to \$94 million. The remaining \$10 million was deposited in a debt service reserve account.

The U.S. Department of the 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 U.S. 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 U.S. Department of the Treasury is an amount no greater than the total amount of local revenue (primarily taxes) collected by the Government in each fiscal year. As a result, the term "matching fund revenue" is used to denote these payments. The Government has pledged the matching fund revenue, as described above, to the timely payment of principal and interest on the 1998 Series A, B, C, D, and E Bonds. Thus, amounts to be received by the Government from federal excise tax, mostly in rum, are deposited directly in a trust account until the 1998 Bonds are paid in accordance with the Indenture of Trust.

Estimated prepayments of matching fund revenue 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 U.S. Department of the Treasury during such year. Prepayments of matching fund revenue are recorded as deferred revenue in the accompanying statement of net assets and the balance sheet of the governmental funds and reversed against revenue in the following year. The adjustments for actual collections made to the estimated prepayments are recorded in the year determined.

In November 1999, the U.S. Congress approved an increase in the rate of federal excise taxes on rum transferred to the Government from \$10.50 to \$13.25 per proof gallon. The increase was retroactive to July 1999 and will be effective through December 31, 2003.

Interest on the revenue and refunding bonds series 1998 A, B, C, D, and E and 1999 bonds are payable semiannually on April 1 and October 1, and principal is payable annually on October 1. The Government is responsible for all principal and interest payments on the 1998 Series bonds. The principal due on October 1, and interest payments due on October 1 and April 1 are funded by the matching fund revenue and deposited into the debt service reserve accounts.

On April 13, 1999, a loan agreement was made between and among the Government, the PFA, International Business Machine Corporation (IBM), Banco Popular de Puerto Rico, and U.S. Trust Company of New York (Y2K Loan). The purpose of this loan was to finance certain costs of compliance by the Government with Year 2000 computer systems issues. The loan was evidenced by the Government's issuance of General Obligation Bonds Series 1999 A amounting to \$18 million. Principal and interest is payable semiannually on January 1 and July 1. On July 9, 2001, the Government paid the outstanding IBM portion of the bonds amounting to \$7.4 million.

The Bonds are secured by the full faith and credit and taxing power of the Government, including a pledge on annual real property tax revenue from its taxation of the Hovensa Oil Refinery (the Refinery) which revenue is deposited in the Hovensa Property Tax Fund and a contingent pledge of all franchise taxes on Foreign Sales Corporations collected by the Government (Franchise Tax

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Revenue). Pursuant to the Hovensa Oil Contract, the Refinery agreed to pay \$12 million annually of real property taxes on the refinery properties. Foreign sales corporations qualified to do business in the Virgin Islands must pay a franchise tax of \$1.50 for each thousand dollars of capital stock issued (Franchise Tax).

On April 13, 1999, PFA also issued Project Revenue Bonds (the 1999 Project Revenue Bonds), amounting to \$13.5 million on behalf of the Government, to finance a portion of the Government's Year 2000 (Y2K) compliance efforts, including the costs related to transportation, installation, and related hardware, software, and consulting services and related expenses. The 1999 Project Revenue Bonds are secured by lease payments made by the Government to PFA pursuant to a municipal lease purchase agreement, dated April 13, 1999. Such lease payments shall be funded by appropriation from the real property taxes deposited in the Hovensa Property Tax Fund and all franchise taxes on a subordinated basis and subject to any superior rights of the Series 1999 A General Obligation Bonds. The 1999 Project Revenue Bonds mature on January 1, 2005 with interest payable semiannually on January 1 and July 1.

On November 16, 1999, PFA issued the 1999 Series A Revenue Bonds amounting to \$299.9 million. These bonds were issued to: (i) pay certain working capital obligation of the Government; (ii) repay the Government outstanding tax and revenue anticipation notes; (iii) fund the Series debt service accounts; and (iv) pay certain costs of issuing the bonds.

The Government pledged gross receipts taxes for the timely payment of the principal and interest on the 1999 Series A Bonds. Interest is payable semiannually on April 1 and October 1, and principal is payable annually on October 1. Gross receipts revenue amounted to \$97.2 million for the year ended September 30, 2002.

On November 20, 2001, TSFC issued Tobacco Settlement Asset-Backed Bonds amounting to \$21.7 million aggregate principal. The proceeds were used for the purpose of (i) purchasing all rights, title, and interest in certain litigation awards under the Master Settlement Agreement (MSA) entered into by participating cigarette manufacturers, (ii) issuance of Tobacco Settlement Asset-Backed Bonds to pay the purchase price for the rights, and (iii) to provide funds for hospital and healthcare projects in the U.S. Virgin Islands. As of September 30, 2002, the outstanding debt amounted \$23.7 million.

Interest on the 2001 bonds is payable semiannually on each May and November 15, beginning with May 2002 for the term bonds amounting to \$15.5 million and convertible capital appreciation bonds amounting to \$8.2 million, with a nominal value of \$6.2 million.

The convertible capital appreciation bonds accrete interest prior to November 15, 2007 and accrue interest subsequent to that date. Interest on the capital appreciation bonds will compound on May 15th and November 15th.

Bonds payable at September 30, 2002, amounted to \$22 million with accumulated accretion of \$1.7 million. Under early redemption provisions any MSA payments exceeding annual debt service requirements of the 2001 Series A Tobacco Bonds must be applied to early redemption of principal. MSA payments and interest earnings on the trust funds during the year ended September 30, 2002, resulted in redemption of \$520,000 on November 15, 2002.

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Debt service requirements at September 30, 2002 were as follows (expressed in thousands):

Governmental Activities – Bonds											
	Revenue Bonds Series 1998 A		Revenue Bonds Series 1998 B		Revenue Bonds Series 1998 C		Revenue Bonds Series 1998 D		Revenue Bonds Series 1998 E		
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
Year:											
2003	\$	—	15,821	2,410	86	6,575	3,714	3,540	1,642	—	6,261
2004		—	15,821	—	—	9,480	3,313	3,745	1,441	—	6,261
2005		—	15,821	—	—	9,990	2,801	3,965	1,220	—	6,261
2006		—	15,821	—	—	10,555	2,236	4,210	974	—	6,261
2007		—	15,821	—	—	11,150	1,640	4,470	714	—	6,261
2008-2012		56,930	89,164	—	—	24,235	1,351	9,665	585	23,365	34,976
2013-2017		90,950	52,122	—	—	—	—	—	—	37,530	19,362
2018-2022		103,090	23,783	—	—	—	—	—	—	45,535	6,827
2023-2027		38,105	3,636	—	—	—	—	—	—	—	—
2028-2032		—	—	—	—	—	—	—	—	—	—
Total	\$	<u>289,075</u>	<u>247,810</u>	<u>2,410</u>	<u>86</u>	<u>71,985</u>	<u>15,055</u>	<u>29,595</u>	<u>6,576</u>	<u>106,430</u>	<u>92,470</u>

	General Obligation Bonds Series 1999 A		Project Revenue Bonds Series 1999		Revenue Bonds Series A 1999		Tobacco Bonds Series A 2001		Total governmental activities		
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
Year:											
2003	\$	780	459	2,785	413	4,305	17,935	—	870	20,395	47,201
2004		830	408	2,960	236	4,540	17,703	—	774	21,555	45,957
2005		885	353	1,550	48	4,765	17,470	—	774	21,155	44,748
2006		945	295	—	—	—	17,351	—	774	15,710	43,712
2007		1,005	232	—	—	—	17,351	—	774	16,625	42,793
2008-2012		2,815	280	—	—	34,585	99,243	5,470	3,869	157,065	229,468
2013-2017		—	—	—	—	—	77,028	7,700	3,869	136,180	152,381
2018-2022		—	—	—	—	81,115	58,930	3,130	3,312	232,870	92,852
2023-2027		—	—	—	—	69,015	35,472	3,755	2,011	110,875	41,119
2028-2032		—	—	—	—	93,855	8,623	3,630	1,408	97,485	10,031
Total	\$	<u>7,260</u>	<u>2,027</u>	<u>7,295</u>	<u>697</u>	<u>292,180</u>	<u>367,106</u>	<u>23,685</u>	<u>18,435</u>	<u>829,915</u>	<u>750,262</u>

(c) Notes Payable

The Government and FEMA entered into a Community Disaster Loan Agreement (CDL) on June 14, 1996. The purpose of the 1996 CDL was to enable the Government to continue to provide vital municipal services such as public health and safety, police and fire protection and the operation of public schools, among other things, after the Government had suffered a substantial loss of tax and other revenue as a result of Hurricane Marilyn which occurred in 1995. The loan proceeds were not intended to provide funds to finance capital projects, nor the repair or restoration of public property damaged by Hurricane Marilyn. The CDL, by its terms, is secured by a pledge of the full faith, credit and taxing power of the Government.

Pursuant to 44 Code of Federal Regulations (CFR), Section 206.366, Subpart K, the Government submitted an Application for Administrative Loan Cancellation in Connection with Hurricane Marilyn 1067-60 CDL in June 2001. By this application the Government requested cancellation of \$127.2 million in principal drawdowns and the attendant accumulated interest to date.

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In November 2003, FEMA notified the Government the results of its review of the Application for Administrative Loan Cancellation in connection with Hurricane Marilyn. As a result of such review, FEMA concluded that only \$19.7 million of principal and associated interest was eligible for cancellation. The Government continues to pursue its request for cancellation.

The 1996 CDL accrues interest at the annual rate of 6.35% and was scheduled to be paid in 40 quarterly payments starting on June 26, 2001. The Government plans to pursue its rights under FEMA rules and regulations for administrative cancellation of all or part of the Hurricane Marilyn CDL. The Government also intends to pursue relief through federal legislation, if necessary, following administrative proceedings before FEMA. The 1996 CDL loan outstanding principal balance as of September 30, 2002 amounted to \$127 million.

In addition to the 1996 CDL, FEMA provided the Government a state share loan on May 3, 1996. The loan provides the Government with funds to be used for the matching portion of FEMA programs. The loan accrues interest at an annual rate of 6.35% with final maturity in August 2002. As of September 30, 2002, the outstanding principal balance of this loan had been paid.

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 to the Government, which may include matching fund revenue.

Debt service requirements for notes payable outstanding at September 30, 2002 were as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year:			
2003	\$ —	42,365	42,365
2004	14,047	7,730	21,777
2005	14,540	6,841	21,381
2006	15,485	5,895	21,380
2007	16,492	4,889	21,381
2008-2012	66,636	8,197	74,833
Total	<u>\$ 127,200</u>	<u>75,917</u>	<u>203,117</u>

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(d) Component Units – Bonds Payable

Bonds payable of discretely presented component units are those liabilities that are paid out of resources pledged by such entities. These revenue bonds do not constitute a liability or debt of the PG. Bonds payable outstanding at September 30, 2002 are as follows (expressed in thousands):

<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates</u>	<u>Balance</u>
University of the Virgin Islands:			
General obligation bonds of 1995	2003	6.12% to 7.82%	\$ 399
General obligation bonds of 1999	2029	6.50% to 7.75%	24,390
Various building bonds	2004	3.00% to 7.50%	359
Virgin Islands Water and Power Authority (Electric System)			
Revenue bonds of 1999	2022	4.25% to 5.30%	100,435
Virgin Islands Water and Power Authority (Water System)			
Revenue bonds of 1999	2018	4.90% to 5.50%	40,985
Virgin Islands Port Authority			
Revenue bonds of 1998	2005	3.45% to 4.50%	10,301
Virgin Islands Housing Finance Authority:			
Revenue bonds of 1995	2027	5.50% to 6.50%	4,365
Revenue bonds of 1998	2028	4.10% to 5.25%	2,750
Subtotal			<u>183,984</u>
Plus unamortized premium			558
Less unamortized discount			(776)
Less deferred amount on debt refunding and reacquisition costs			<u>(7,843)</u>
Bonds payable, net			<u>\$ 175,923</u>

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Following is a schedule of changes in long-term debt for discretely presented component units for fiscal year 2002 (expressed in thousands):

	Beginning balance	Additions	Reductions	Ending balance	Amounts due within one year	Amounts due thereafter
Bonds payable:						
University of the Virgin Islands	\$ 26,188	—	(1,487)	24,701	1,185	23,516
Virgin Islands Water and Power Authority:						
Electric System	99,349	—	(3,241)	96,108	3,945	92,163
Water System	39,172	—	(1,336)	37,836	1,725	36,111
Virgin Islands Port Authority	13,486	—	(3,323)	10,163	3,285	6,878
Virgin Islands Housing Finance Authority	7,910	—	(795)	7,115	130	6,985
Total bonds payable, net	<u>186,105</u>	<u>—</u>	<u>(10,182)</u>	<u>175,923</u>	<u>10,270</u>	<u>165,653</u>
Notes payable:						
Roy L. Schneider Hospital	269	—	(187)	82	82	—
Economic Development Authority	365	—	(23)	342	24	318
University of the Virgin Islands	3,633	—	(48)	3,585	46	3,539
Total notes payable	<u>4,267</u>	<u>—</u>	<u>(258)</u>	<u>4,009</u>	<u>152</u>	<u>3,857</u>
Other long-term liabilities:						
University of the Virgin Islands	132	—	—	132	—	132
Virgin Islands Housing Authority	13,899	—	(7,118)	6,781	—	6,781
Economic Development Authority	585	8,579	—	8,380	56	8,324
Juan Luis Hospital	—	812	—	812	—	812
Roy L. Schneider Hospital	—	407	—	407	—	407
Virgin Islands Industrial Development Park	40	2	—	42	—	42
Virgin Islands Housing Finance Authority	6,765	2,091	—	8,856	—	8,856
Total other long-term liabilities	<u>\$ 21,421</u>	<u>11,891</u>	<u>(7,118)</u>	<u>25,410</u>	<u>56</u>	<u>25,354</u>

The University issued general obligation bonds in 1994 for the financing or refinancing of the construction of the St. Croix and St. Thomas residence halls and ancillary facilities. These bonds have sinking fund requirements whereby principal payments and interest is being deposited quarterly into a debt service account held by the trustee. These bonds are general obligations of the University and are collateralized by gross revenue, excluding the required appropriations for debt service made by the Government.

On December 29, 1994, the University issued additional general obligation bonds totaling \$5 million to be used for the refinancing of certain equipment. These bonds also require the University to establish a debt service reserve fund, which is to be maintained at a sum equal to 5% of the bond proceeds. These bonds are secured by the refinanced equipment and are being paid in semiannual installments of approximately \$413,000, including interest.

During fiscal year 2000, the University issued the 1999 Series A Bonds. The University issued these bonds to finance a portion of the construction, furnishing, and equipping of various facilities of the University, to refund \$14.1 million outstanding principal amount of general obligation bonds 1994 Series A issued by the University, to fund a debt service reserve fund for the 1999 Series A Bonds, and to pay certain cost issued under and secured by an indenture of trust dated as of December 1,

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1999 between the University and the trustee. The 1999 Series A Bonds maturing on or after December 1, 2010 are subject to redemption prior to maturity at the option of the University, as a whole or in part of any date, on and after December 1, 2009 at the redemption prices ranging between 100% and 102% of their principal amount, plus accrued interest to the date fixed for redemption. At September 30, 2002, \$14.1 million of 1994 Bonds are considered defeased and outstanding.

The various building bonds payable of the University as of September 30, 2002, are collateralized by mortgages on its property, by a pledge of the gross revenue derived from the operation of certain student and faculty housing and service facilities, a lien and pledge of funds available to the University for general operation purposes as required under the bond indenture agreements, and by annual grant payments that the U.S. government has agreed to fund as a debt subsidy. The bonds are subject to redemption at predetermined amounts, which may include penalties, as provided in the indentures agreements. These indentures require the University to meet certain funding requirements for repair and replacement reserves, and bond sinking funds.

The bonds payable of the Virgin Islands Water and Power Authority (Electric System) consist of Electric System Revenue and Refunding Bonds. The Electric System Revenue and Refunding Bonds of \$110.9 million were issued in June 1998. The proceeds from the bonds, and approximately \$14 million in funds from the existing debt service and debt service funds, were used to repay the lines of credit of the Electric System in the amount of \$18 million, to provide for approximately \$30 million in funds for the construction of certain capital projects, and to pay underwriters discount and issuance costs of approximately \$1.7 million. The remaining proceeds were used to purchase direct obligations of the U.S. government which were placed in an irrevocable trust with an escrow agent to provide all future debt service on the remaining \$69 million principal amount of the 1991 Series A Electric System Revenue Bonds. At June 30, 2002, \$55.9 million of the original principal amount of the defeased 1991 bonds remained outstanding.

The advance refunding of the 1991 Series A Electric System Revenue Bonds resulted in a difference between the reacquisition price and the net carrying amount of the bonds of \$7.1 million. This amount is recorded as a reduction of the new bonds and is being amortized as a component of interest expense through 2011. The Electric System completed the refunding to reduce the interest rate component of its bonds, to pay down its outstanding variable rate lines of credit, and to provide for additional funds to finance certain capital projects. The transaction decreased debt service payments related to the refunded debt by \$5.2 million over the life of the new bonds and resulted in an economic gain of \$3.1 million.

Under the terms of the Bond Resolution relating to the Electric System Revenue and Refunding Bonds, payment of the principal and interest is secured by an irrevocable lien on the Electric System's net revenue (exclusive of any funds which may be established pursuant to the Bond Resolution for certain specified purposes), including the investments and income, if any, thereof.

The Bond Resolution contains certain restrictions and commitments, including the Electric System's covenant to establish and maintain reasonable rates, fees, rentals, and other charges to produce net electric revenue, as defined, that will be at least 125% of aggregate annual principal and interest. The

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Electric System's net electric revenue for the fiscal year ended June 30, 2002, was 183% of aggregate debt service.

The 1998 Series Electric System Revenue and Refunding Bonds are subject to redemption on or after July 1, 2008, as a whole or in part at any time at a redemption price of 101% in 2008, 100.5% in 2009 and 100% thereafter. The Electric System Revenue Bonds are subject to mandatory redemption if any significant part of the Electric System was damaged, destroyed, taken, or condemned, or any for-profit, nongovernmental investor shall acquire an ownership interest in some or all of the assets of the authority.

The bonds payable of the Virgin Islands Water and Power Authority (Water System) consist of Water System Revenue and Refunding Bonds. The Water System Revenue and Refunding Bonds amounting to \$42.6 million were issued in December 1998. The proceeds from the bonds and approximately \$750,000 in funds from the existing debt service reserve fund were used to repay the lines of credit balances of the Water System in the amount of \$2 million; to pay underwriters discount and issuance costs of approximately \$865,000; and to provide for \$750,000 in funding for a renewal and replacement reserve fund. The remaining proceeds were used to refund the 1990 Series A Bonds at a redemption price of 100% of the principal amount outstanding of \$20.4 million, and to purchase obligations of the U.S. government which were placed in an irrevocable trust with an escrow agent to provide all future debt service on the remaining \$17 million principal amount of the 1992 Series B Bonds. At June 30, 2002, \$15.2 million of the original principal amount of the defeased 1992 bonds remained outstanding.

The refunding of the 1990 Series A and 1992 Series B Bonds resulted in a difference between the reacquisition price and the net carrying amount of the bonds of \$3.8 million. The transaction increased debt service related to the refunded debt by \$9.8 million over the life of the new bonds as a result of extending the maturity date, and resulted in an economic gain of \$2.4 million.

Payment of principal and interest of the 1998 Series Bonds is secured by an irrevocable lien on the Water System's net revenue (exclusive of any funds which may be established pursuant to the Bond Resolution for certain other specified purposes), and funds established under the Bond Resolution, including investment securities. To provide additional security, the Water System has conveyed to the bond trustee, a subordinate lien and security interest in the Water System's general fund. The Water System is also required to make deposits in a debt service reserve fund in accordance with the Bond Resolution.

The Bond Resolution contains certain restrictions and commitments, including the Water System's covenant to establish and maintain reasonable rates, fees, rentals, and other charges to produce net water revenue, as defined, that will be at least 125% of aggregate annual principal and interest payments. The Water System's net water revenue for the year ended June 30, 2002 was 164% of aggregate debt service.

The 1998 Series Bonds maturing on or after July 1, 2010, are subject to redemption prior to their stated maturity date, at the option of the Water System, as a whole or in part at any time at a redemption price of 101% during July 1, 2009 through June 30, 2010 and 100%, thereafter.

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In October 1998, the VIPA issued the 1998 Airport Revenue Bonds Refunding Series A, the 1998 Rohlsen Terminal Airport Revenue Bonds Series A, and the 1998 Marine Revenue Bonds Refunding Series A, with principal amounts of \$19.3 million, \$3.1 million, and \$2.7 million, respectively. The bonds were issued for the advance refunding of previously issued bonds. The refunding resulted in a debt service savings of approximately \$3.2 million and an economic gain of \$2.4 million.

The Airport Revenue Bonds constitute special obligations payable solely from, and secured by a pledge of, net revenue of VIPA derived from its Airport System which consists of the airside and landside operations at the Cyril E. King Airport in St. Thomas and airside operations at the Henry E. Rohlsen Airport in St. Croix. The Rohlsen Terminal Bonds constitute special obligations payable solely from, and secured by a pledge of, net revenue of VIPA derived from the Rohlsen Terminal. In addition, net marine revenue are pledged for payment of the Rohlsen Terminal Bonds if revenue from the Rohlsen Terminal are not enough to meet the debt service requirements. The Marine Revenue Bonds are secured solely by the net available revenue of VIPA's Marine Division.

The Airport Revenue Bonds, the Marine Revenue Bonds, and the Rohlsen Terminal Bonds, do not constitute general obligations of VIPA, the Aviation or Marine Division, the Government, or the United States. The revenue of the Airport System is not available for the payment of principal or interest on the Marine Revenue Bonds or Rohlsen Terminal Bonds; likewise, the revenue of the Marine Division and the Rohlsen Terminal is not available to pay the principal and interest of the Airport Revenue Bonds except for any surplus of marine revenue which is available for any lawful purpose designated by VIPA. Neither the credit of the U.S. Virgin Islands nor that of its political subdivisions is pledged or available for the payment of principal or interest on the bonds. VIPA has no taxing power.

The bonds' indentures contain certain account restrictions and funding covenants to cover interest, debt service, maintenance, and other costs as specified in the corresponding bond indentures. Management of VIPA believes that VIPA has established the aforementioned required accounts and has complied with the contribution requirements with respect to the bonds. In addition, it is VIPA's management's opinion that VIPA has complied with limitations and restrictions imposed by the bonds indentures.

The bonds' indentures also specify certain debt service coverage requirements determined from net available revenue of VIPA's Airport System, the Rohlsen Terminal, and from the Marine Division. The provisions of each of the bonds' indentures require that rates and fees charged for the use of each facility should be sufficient to generate enough revenue to pay all operation and maintenance expenses, exclusive of depreciation and certain noncash charges, of the respective facilities, plus: (i) at least 125% of the principal and interest and redemption account sinking fund deposit requirement of each of the bonds becoming due during such year; (ii) the amount of the debt service reserve fund deposit requirement for such period; (iii) the deposit required to the Renewal and Replacement Fund; and (iv) the amount of the Capital Improvements Appropriations for such period.

In fiscal year 2002, VIPA did not meet the debt service coverage requirement of the Airport Revenue Bonds. As required by the bond indenture, effective February 1, 2003, VIPA increased the landing and passenger fees of the Airport System by approximately 25%. Management believes that the revenue resulting from the increase in rates will not be sufficient to comply with the debt service

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coverage requirement of the Airport System in fiscal year 2003 and that VIPA will have to use certain funds deposited in the sinking funds to meet the requirement.

VIPA entered into use agreements with certain airlines servicing the Airport System which provided the basis for determining landing fee rates and other charges to those airlines for the use of the Airport System facilities for as long as any of the Airport Revenue Bonds outstanding.

The proceeds of the 1998 Airport Revenue Bonds and the 1998 Marine Revenue Bonds were used, together with certain other funds of VIPA, to: (i) advance refund the outstanding aggregate principal amount of the 1989 Bonds and Marine notes, respectively; (ii) fund a required deposit to the debt service reserve fund; and (iii) pay certain costs of issuance of the respective bonds.

The Rohlsen Terminal Bonds were used to: (i) pay, in part, the cost of construction of certain improvements, extensions, betterments, and additions to the HERA airport in St. Croix; (ii) fund a required deposit to the Debt Service Reserve Fund; and (iii) pay certain cost of issuance of the Rohlsen Terminal Bonds.

The VIHGA issued the 1995 A and 1998 A Revenue Bonds for the purpose of building single-family housing. As of September 30, 2002, the 1995 A Revenue Bond Series amount was \$4.4 million and the 1998 A Revenue Bond Series amount was \$2.7 million.

The Authority has agreed in the indenture agreements for the bonds to deposit with the trustee the full amount of the bond proceeds. The funds will be used to purchase Government National Mortgage Association (GNMA) certificates acquired by the bond servicer. The servicer is obligated to pay the principal and interest due on the GNMA certificates to the trustee in an amount equal to the scheduled principal and interest payments of the underlying mortgages. All mortgage loans issued by the Authority must be originated by the participants and secured by a first priority mortgage lien on the applicable single family residences.

The bonds payable of the VIHA consist of several bonds issued in prior years for construction of the Low Rent Housing Program. The outstanding balance of the bonds at December 31, 2001 was \$18.3 million. Under the provisions of the contract, HUD serviced all guaranteed debt for the Authority during the year. HUD has affirmed that the guaranteed debt is no longer the liability of the Authority. The bonds payable of the VIHA are not included in the schedule below.

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Fixed maturities required to pay principal and interest on discretely presented component units' bonds payable with fixed maturities at September 30, 2002, are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year:			
2003	\$ 10,270	9,288	19,558
2004	9,975	8,839	18,814
2005	10,262	8,371	18,633
2006	7,125	7,877	15,002
2007	7,485	7,519	15,004
2008-2012	42,990	31,471	74,461
2013-2017	43,840	19,928	63,768
2018-2022	35,725	9,060	44,785
2023-2027	9,425	2,761	12,186
2028-2029	6,887	507	7,394
	<u>183,984</u>	<u>105,621</u>	<u>289,605</u>
Total	\$ 183,984	105,621	289,605
Plus unamortized premium	558		
Less unamortized discount	(776)		
Less deferred amount on debt refunding and reacquisition costs	<u>(7,843)</u>		
Bonds payable, net	\$ <u>175,923</u>		

(10) General Tax Revenue

For the year ended September 30, 2002, general tax revenue of the PG consisted of the following (expressed in thousands):

Income taxes	\$ 304,748
Gross receipts taxes	97,273
Property taxes	69,341
Other taxes	<u>127,953</u>
	\$ <u>599,315</u>

(11) Commitments and Contingencies

(a) Primary Government

The current labor relations environment of the Government is defined by 13 distinct labor organizations subject to approximately 30 collective bargaining agreements. As specific disciplines are not grouped under a single pay plan, it is common to have clerical and nonprofessional workers,

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in different departments throughout the Government represented by different unions. Of the approximately 9,534 government workers, including employees of the executive branch of the Government, approximately 6,620 belong to unions. The present collective bargaining statute requires binding arbitration for certain classified employees in the event of an impasse during salary negotiations between the Government and any union. Under this process, each side chooses an arbitrator and a third impartial arbitrator is selected by the chosen arbitrators. The arbitration panel investigates and reviews the issues in dispute and renders a final and binding decision. For other classified employees, the Government must decide to go to impasse or to enjoin any strike. The Government has contractual liabilities for retroactive union arbitration salary increases aggregating \$369 million accruing from fiscal years 1993 through 2001. Pursuant to Title 24 of the V.I. Code Section 374(h), no such contract is binding until appropriation of funds is made by the Legislature. Upon action of the Legislature, retroactive wages become a current liability of the Government payable from the general fund. Until such time, the liability is recorded as a long-term debt in the governmental activities column, in the government-wide financial statements. Retroactive union arbitration salaries account has not changed from fiscal year 2001. This is due to the fact that there was no retroactive salary increase in fiscal year 2002 because all unionized employees were brought to step according to their last negotiated wage agreement that went into effect September 1, 2001 for the fiscal year ending September 30, 2002.

The Government receives financial assistance from the federal government in the form of loans, grants and entitlements. Loans received are described in note 9(c). Noncash federal financial assistance programs received by the Government during fiscal year ended September 30, 2002, amounted to approximately \$17.9 million.

Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of resources for eligible purposes. Substantially, all grants are subject to audit under OMB Circular A-133. Disallowances as a result of these audits may become liabilities of the Government. At September 30, 2002, based on an evaluation of pending disallowances, the Government has recorded approximately \$18.7 million as other long-term liabilities in the governmental activities column of the government-wide financial statements.

Management of the Government believes that the future outcome of any changes in federal financial assistance programs will not have a material effect on the basic financial statements.

On September 23, 2002, the Government entered into a three-year compliance agreement with the U.S. Department of Education requiring that the Government develop integrated and systemic solutions to problems in managing its federally funded education programs. The compliance agreement focuses on the areas of program design and evaluation, financial management, human capital, and property management and procurement. In the event of noncompliance, the U.S. Department of Education may impose additional conditions or enforcement actions against the Government as authorized by the compliance agreement or by law.

The Government is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under the Title 33, Section 3411(c) of the V.I. Code, no judgment shall be awarded against the Government in excess of \$25,000 for tort

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claims filed under Government statutes. In cases involving several survivors, each award must be construed separately for purposes of applying the limitation upon recovery imposed by the Tort Claims Act. Under the Title 27, Section 166(e) of the V.I. Code, the Government's waiver of immunity is expanded to \$100,000 for medical malpractice actions, including actions for wrongful death based on malpractice. Under certain circumstances, as provided in Title 33, Section 3414 of the V.I. Code, the Government may assume the payment of a judgment entered against an officer or employee acted reasonably and within the scope of his employment. The Government may pay up to a maximum amount of \$100,000 of the settlement. With respect to pending and threatened litigation, the Government has accrued a provision for legal claims and judgments of approximately \$4.2 million for awarded and anticipated unfavorable judgments as of September 30, 2002. Management believes that the ultimate liability in excess of amounts provided would not be significant.

As of September 2002, the Government was a defendant in a lawsuit regarding the assessment of property taxes. Under the lawsuit, taxpayers asserted that properties should be assessed at actual value in accordance with the Organic Act of 1933. The U.S. District Court agreed with the plaintiffs and in May 2003, imposed an injunction on the collection of real property taxes for years subsequent to 1998. The Government complied with the Court order to develop a plan to implement the new valuation method, and the injunction was lifted in August 2003. Assessments will continue at the 1998 level until the new assessment method is in place, scheduled for fiscal year 2005.

State and federal laws and regulations require the Government to place a final cover on the Government landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site until compliance is achieved. In accordance with GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Cost* (GASB No. 18), the Government should perform a study of the activities that need to be implemented at the Government landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. In addition, GASB No. 18 requires that estimated landfill closure and postclosure care costs be accrued as a liability in the basic financial statements. The Government has not conducted the study needed to comply with the requirements of GASB No. 18; therefore, no liability has been accrued as of September 30, 2002.

Approximately \$94 million of the proceeds of the Series 1998 E Bonds, together with certain federal funds amounting to approximately \$61 million and other funding sources of approximately \$15 million are intended, to finance certain capital projects with estimated total costs of approximately \$170 million. The nature of the capital projects include the construction and improvements to wastewater treatment facilities, pursuant to a Consent Decree entered by the Government and the U.S. Environmental Protection Agency (EPA) in September 1995, with an estimated cost of approximately \$41 million.

Under the Consent Decree with EPA, the Government has committed to: (i) construct two regional wastewater treatment facilities in St. Thomas and St. John; (ii) construct an outfall extension for the wastewater treatment plant in St. Croix; (iii) replace the Anguilla Force Main in St. Croix; and (iv) implement plant-by-plant operational improvements and pump station rehabilitation throughout the Territory, including the replacement of equipment, repairs, and maintenance at 37 wastewater

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facilities. These projects are currently funded by EPA and the bond proceeds (see note 9). As of September 30, 2002, \$7.7 million of the proceeds of the Series 1998 E Bonds remained unexpended.

In fiscal year 2002, the EPA levied a fine of \$25 million against the Government for failure to comply with mandates pertaining to the management of solid waste disposal. In October 2002, the Government negotiated with EPA to pay \$1.6 million of this fine and in December 2002 appropriated \$8.4 million for the start-up costs associated with the Wastewater Treatment Facility on the island of St. Croix.

GERS filed a lawsuit in District Court, in April 2001, to recover approximately \$42.6 million in administrative payments, as well as \$23 million for breach of contract, from the general fund of the Government. No liability has been accrued as of September 30, 2002.

(b) *Discretely Presented Component Units*

WAPA estimates that capital expenditures in connection with continuing capital improvements will be approximately \$40 million for the Electric System and \$12.5 million for the Water System during the year ended June 30, 2002. WAPA is presently a defendant or codefendant in various lawsuits; however, any adverse outcome involving a material claim is expected to be substantially covered by the insurance. WAPA facilities were damaged by Hurricane Hugo in September 1989. WAPA reconstructed its system with proceeds from insurance and FEMA. On March 23, 1998, FEMA issued an audit report concluding that WAPA should refund approximately \$7.9 million aggregated questioned costs. Approximately \$2.6 million of these questioned costs are related to an oil spill that was subsequently settled with FEMA. During 1998, WAPA submitted a second appeal for \$4.4 million of the remaining questioned costs and agreed to refund approximately \$900,000 of questioned costs to FEMA. During 1999, FEMA denied WAPA's second appeal and formally closed the Hurricane Hugo disaster. At June 30, 2002, WAPA has recorded a liability of \$5.3 million for amounts owed to FEMA for overpayments related to these questioned costs. FEMA has not made a formal request for repayment of these funds.

In September 1995, WAPA's facilities suffered extensive damage from Hurricane Marilyn. During 1996, WAPA reconstructed its system with proceeds from insurance and FEMA. In March 1999, FEMA denied WAPA's claim for \$8.9 million of remaining expenditures related to the reconstruction. WAPA has subsequently reduced its claim to \$5.7 million and is currently negotiating with FEMA regarding reimbursement of these remaining expenditures. Although management of WAPA believes the ultimate resolution of this matter will result in WAPA receiving additional reimbursement for prior expenditures, WAPA has not recorded any amounts to reflect these potential recoveries in the accompanying financial statements.

At June 30, 2002, there was \$20 million outstanding under the lines of credit for the Electric and Water Systems, respectively, and no funds were available for borrowing under these lines. The lines of credit expire in April 2003, subject to annual renewal.

In connection with federal grants programs, VIPA is obligated to administer and spend the grant money in accordance with regulatory restrictions, and is subject to audit by the grantor agencies. In cases of noncompliance, the agencies involved may require VIPA to refund programs' moneys. During the normal course of business, VIPA is a defendant in various lawsuits. In the opinion of

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management and legal counsel, the outcome of these cases and resulting liability, if any, is either adequately covered by insurance or should not materially affect VIPA's financial position.

(12) Retirement Systems

(a) *Plan Description*

GERS is the administrator of a cost-sharing multiple-employer defined-benefit pension plan established as of October 1, 1959 by the Government to provide retirement, death, and disability benefits to its employees. The following description of the plan is provided for general information purposes only. Refer to the actual text of the retirement law in the V.I. Code, Title 3, Chapter 27 for more complete information. Regular employees are eligible for a full service retirement annuity when they have completed 30 years of credited service or have attained the age of 60 with at least 10 years of credited service. Members who are considered "Safety Employees," as defined in the V.I. Code, are eligible for full retirement benefits when they have earned at least 20 years of government service or have reached the age of 55 with at least 10 years of credited service. Regular employees who have attained the age of 50 with at least 10 years of credited service can elect to retire early with a reduced benefit. Senators and members of the Legislature may receive a retirement annuity when they have attained the age of 50 and completed six years of credited service or earned at least six years of credited service as a member of the Legislature. GERS is a blended component unit included in the financial reporting entity and is presented as a pension trust fund of the PG. GERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Employees' Retirement System of the Government of the Virgin Islands, GERS Complex, Veterans Drive, St. Thomas, V.I. 00802.

(b) *Funding Policy*

The Government's required contribution for the year ended September 30, 2002 was 14.5% of the member's annual salary. Since April 1, 1991, required member contributions are 8% of annual salary for regular employees, 9% for senators, and 10% for Act 5226 eligible employees. Through September 30, 2000, member contributions were refundable without interest upon withdrawal from employment before retirement. Subsequent to September 30, 2000, legislation was passed that provided for 4% annual interest on refunded contributions. The Government's contributions to the plan for the years ended September 30, 2002 amounted to \$50.5 million that represented 53.15% of the annual required contributions. In August 1994, legislation providing an early retirement incentive was passed. The legislation was subsequently amended on October 13, 1994, December 30, 1994, and December 5, 1995. Among other matters, the legislation allows a member of GERS who has a combined aggregate number of years of credited service plus number of years of age, equal to at least 75 years as of the date of the legislation to retire without reduction of annuity. Members, who have attained the age of 50 with at least 10 but less than 30 years of credited service, may add an additional three years to their age for this computation. Members with 30 years of service or who can retire without penalty under the V.I. Code shall have their average compensation increased by four percentage points.

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For each employee electing to retire pursuant to Section 8(a) of the Early Retirement Act of 1994 (the Act), the Government contributes to GERS, on a quarterly basis, an amount equal to the employer and employee contributions that would have been made until the employee reached the age of 62 had the employee not elected to retire under this provision.

For employees electing to retire under Section 8(b) of the Act, the Government contributes to GERS a sum equal to the additional contribution the employer and employee would have made had the employee received a salary 4% higher during the three years used to compute the employee's "average compensation" figure, plus a sum of \$5,000. Based on the calculation, this amount was \$16.1 million as of September 30, 2002. As of September 30, 2002, GERS has received \$6.9 million of such amount.

The actuaries of GERS have determined that the specific funding provided under the Early Retirement Act of 1994 is inadequate to cover the costs of the program. GERS is seeking to recover any unfunded costs of the program under a newly enacted provision of the retirement law, which provides that the employer will compensate GERS for the costs of any special early retirement program.

The University has two retirement plans in which all eligible employees are required to participate. The Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) is a defined contribution pension plan covering participating, full-time faculty members and other exempt employees, under which the contributions, including employees' contributions, are used to purchase annuities. There are no unfunded past service costs, and vested benefits are equal to the annuities purchased under TIAA-CREF. As of September 30, 2002, 232 faculty members and other employees were TIAA-CREF participants. The number of active participants from the University participating in GERS as of September 30, 2002 was 280. Total contributions made by the University to TIAA-CREF participant accounts amounted to \$738,822.

(13) Additional Information – Enterprise Funds

The enterprise funds are composed of approximately 47 funds and two entities that provide a variety of services to commercial and government entities as well as individuals. It includes the operation of health facilities, dock facilities, a shopping mall, lottery services, loan programs, insurance, housing facilities, commercial services, and others.

The significant funds and entities are as follows:

(a) *Virgin Islands Lottery*

The Lottery was created as an instrumentality of the Government by Act No. 3055 of May 28, 1971. The revenue is generated from the sale of tickets to pay administrative expenses and prizes and increase general fund revenue. The Lottery is required to transfer to the general fund not less than 8% of total revenue and the surplus, if any, from its operation in accordance with Title 32 of the V.I. Code. The prize money of a drawing for which the winning ticket is not sold, is carried over and added to the prize money of the next drawing. Any unclaimed prizes, after six months of being awarded, are retained by the Lottery for the payment of future prizes.

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(b) *Government Insurance Fund*

The Government Insurance Fund accounts for the operating results of the administration of the Workmen Compensation Law. The law was created on July 1, 1941, to insure workers in the event of work-related accidents. Revenue consists of premiums collected from all employers in the Virgin Islands. Expenses are mainly administrative and benefits provided to covered employees. Temporary benefits provided include medical rehabilitation, restoration of a portion of lost wages and vocational rehabilitation, when necessary continuous income benefits are paid for permanent total disability, lapsing upon death of the recipient.

(c) *Unemployment Insurance Fund*

The Unemployment Insurance Fund is a federally mandated program to assess employers for unemployment insurance. The assessments are remitted to the U.S. Treasury and drawdowns are made to pay eligible unemployed recipients. During the fiscal year ended September 30, 2002, the Territory collected \$4 million in insurance assessments and paid \$16.8 million in benefits. Of the amount paid in benefits, \$1.8 million was funded through the Temporary Extended Unemployment Benefits (TEUCA) of the Federal Reed Act Distribution of March 13, 2002. The Virgin Islands share of the Reed Act Distribution was \$1.95 million. As of September 30, 2002, the Government had a restricted balance of \$57.8 million with the U.S. Treasury to fund unemployment insurance claims.

(d) *The West Indian Company*

WICO is engaged in the operation of a dock facility and shopping mall in St. Thomas. The Government acquired all of the outstanding stock of WICO, on July 1, 1993, for a purchase price of \$54 million. In connection with the purchase, the Government obtained a short-term note payable amounting to \$18 million. On December 21, 1993, the note payable was refinanced with a long-term loan amounting to \$18.2 million with interest rate of 5.75% payable in monthly installments of \$127,000, including interest and a final payment comprised of the principal sum outstanding and all accrued unpaid interest to the date of the final payment.

In 2000, WICO obtained an additional long-term loan in the amount of \$8 million, bearing interest at 7.48%. Effective October 1, 2001, the loan is payable in 239 monthly installments of \$64,000, and a final payment of principal and interest outstanding. The revenue of WICO is pledged for the payment of principal and interest on the loans.

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Debt service requirements for loans payable outstanding at September 30, 2002 were as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year:			
2003	\$ 1,030	1,272	2,302
2004	1,093	1,209	2,302
2005	1,161	1,140	2,301
2006	1,234	1,067	2,301
2007	1,312	990	2,302
2008-2012	7,804	3,706	11,510
2013-2017	4,073	1,703	5,776
2018-2022	2,617	669	3,286
Total	\$ <u>20,324</u>	<u>11,756</u>	<u>32,080</u>

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(e) Condensed Financial Information of Significant Enterprise Funds

Condensed financial information of significant enterprise funds as of September 30, 2002 and for the year then ended is presented below (expressed in thousands):

Schedule of Net Assets

September 30, 2002

	Unemployment insurance	West Indian Company	Lottery	Government insurance fund	Other enterprise funds	Total enterprise funds
Current assets	\$ 353	8,347	1,573	6,839	1,011	18,123
Due from other funds	—	—	—	—	300	300
Other assets	57,833	2,678	—	—	—	60,511
Capital assets	—	31,452	94	—	5,733	37,279
Total assets	58,186	42,477	1,667	6,839	7,044	116,213
Current liabilities	8,610	2,345	2,380	367	423	14,125
Due to other funds	—	500	4,468	—	614	5,582
Other liabilities	—	19,294	—	—	—	19,294
Total liabilities	8,610	22,139	6,848	367	1,037	39,001
Net assets:						
Invested in capital assets, net of related debt	—	11,128	94	—	5,733	16,955
Restricted	49,576	9,210	—	—	—	58,786
Unrestricted	—	—	(5,275)	6,472	274	1,471
Net assets (deficit)	\$ 49,576	20,338	(5,181)	6,472	6,007	77,212

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Schedule of Changes in Net Assets

Year ended September 30, 2002

	<u>Unemployment insurance</u>	<u>West Indian Company</u>	<u>Lottery</u>	<u>Government insurance fund</u>	<u>Other enterprise funds</u>	<u>Total enterprise funds</u>
Operating revenue:						
Total operating revenue	\$ 6,152	9,995	14,061	7,652	7,830	45,690
Operating expenses:						
Operating expenses	22,276	6,157	13,910	7,426	11,386	61,155
Depreciation and amortization	—	1,227	67	—	367	1,661
Total operating expenses	22,276	7,384	13,977	7,426	11,753	62,816
Operating income (loss)	(16,124)	2,611	84	226	(3,923)	(17,126)
Nonoperating revenue (expenses):						
Total nonoperating revenue (expenses)	3,974	(1,067)	—	—	521	3,428
Income (loss) before transfers	(12,150)	1,544	84	226	(3,402)	(13,698)
Transfers from other funds	—	—	—	—	2,594	2,594
Transfers to other funds	—	(1,300)	—	—	—	(1,300)
Change in net assets	(12,150)	244	84	226	(808)	(12,404)
Net assets, beginning of year (as restated)	61,726	20,094	(5,265)	6,246	6,815	89,616
Net assets, end of year	\$ 49,576	20,338	(5,181)	6,472	6,007	77,212

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2002

Schedule of Cash Flows

Year ended September 30, 2002

	<u>Unemployment insurance</u>	<u>West Indian Company</u>	<u>Lottery</u>	<u>Government insurance</u>	<u>Other funds</u>	<u>Total enterprise funds</u>
Net cash provided by (used in) operating activities	\$ (10,409)	3,803	(115)	(31)	(8,741)	(15,493)
Net cash provided by (used in) noncapital financing activities	—	(1,300)	—	—	2,594	1,294
Net cash used in capital and related financing activities	—	(3,822)	—	—	—	(3,822)
Net cash provided by investing activities	3,974	220	—	—	361	4,555
Net decrease in cash and cash equivalents	(6,435)	(1,099)	(115)	(31)	(5,786)	(13,466)
Cash and cash equivalents, beginning of year (as restated)	64,621	9,008	1,070	5,205	708	80,612
Cash and cash equivalents, end of year	\$ <u>58,186</u>	<u>7,909</u>	<u>955</u>	<u>5,174</u>	<u>(5,078)</u>	<u>67,146</u>

(14) Liquidity

At September 30, 2002, the Government had an unrestricted deficit in the governmental activities amounting to \$859 million mostly attributed to long-term debt amounting to approximately \$1.39 billion, which was required to be recognized in the statement of net assets pursuant to the adoption of GASB No. 34. The Government has initiated specific actions to improve its future cash flows through the issuance of long-term debt, engaging a consulting firm to assist them in their efforts to develop a series of detailed revenue enhancement and expenditure reduction initiatives and the enactment of certain laws directed toward improving the Government's financial situation. In October 1999, the Government and the U.S. Department of Interior (DOI) entered into a Memorandum of Understanding (the MOU) whereby the Government agreed to use its best efforts to undertake certain deficit reduction initiatives. As a condition to certain new and additional federal financial and technical assistance included in or being proposed by federal appropriations or other legislation, certain financial performance and accountability standards were agreed upon by the Government, which the DOI believes are necessary for the Government to achieve long-term economic recovery. Pursuant to the MOU, the release of such new and additional federal funds to the Government is subject to compliance with such performance and verifiable objectives agreed upon in such agreement. The accountability and financial performance standards agreed upon in the MOU include: (i) preparation of five-year financial recovery plan to be provided to DOI within 90 days of the date of the MOU; (ii) a fiscal year 2000 budget mandating substantial reductions in departmental budgets and overall general fund fiscal year 2000 expenditures not to exceed \$432.1 million; (iii) absent extraordinary circumstances to maintain balanced budgets after fiscal year 2003 with any generated

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2002

surpluses applied to the reduction of the accumulated deficit and unfunded obligations; (iv) annual preparation of financial reports; and (v) efforts to reduce the outstanding debt of the Government. On October 29, 1999, the DOI and the Government entered into an amendment of the MOU, which amended the Government's requirement to seek change in the Virgin Islands public labor relations law to comply with federal labor law. Pursuant to such amendment, the Government, in collaboration with union representatives, is encouraged to pursue reform initiative through collective bargaining to bring fiscal solvency to the Government. In addition to the financial performance standards set forth in the MOU, the MOU further provides for the DOI and the Government to enter into a program of preservation and enhancement of the natural, cultural, and historic resources of the U.S. Virgin Islands to stimulate local economic growth through sustainable tourism. The Government is discussing with DOI certain events of noncompliance, remedial action necessary to comply with the provisions of the MOU and its effect on the Government's financial condition and results of operations.

In April 2000, the Economic Recovery Task Force submitted the five-year operating and strategic financial plan to the Governor for action. The plan provides over 200 recommendations that propose to reduce and eventually eliminate the structural budget deficit by restructuring and reforming Government operations and forging a partnership with the private sector intended to result in sustained growth.

In January 2003, the U.S. Department of Interior issued an Audit Report concluding that all criteria of the MOU were partially or substantially achieved except: (i) implementation of collective bargaining reforms to assist the fiscal solvency of the Government, and (ii) completion of comprehensive annual reports within 120 days of year-end and single audits within nine months of year-end. As part of the MOU, the Government has committed to maintaining balanced budgets after the fiscal year ended September 30, 2003, with any surpluses applied to liquidating outstanding debt. The U.S. Department of Interior acknowledged that it had not achieved its objective of providing funding for the V.I. Conservation Fund, and committed to providing funds for capital improvements, technical assistance, and other assistance once the Government has achieved substantial compliance.

As mentioned in note 16, in September 2003, the Government received a \$100 million Revenue Bond Anticipation Note for the payment of income tax refunds and operating expenses.

(15) Restatements

During the year ended September 30, 2002, the Government implemented several new accounting standards and an interpretation issued by GASB, as previously stated in note 1.

GASB No. 34, as amended by GASB No. 37, establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state and local governments, including statement formats and changes in fund types and elimination of account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statement balances were required.

GASB No. 35 establishes accounting and financial reporting standards for public colleges and universities within the financial reporting guidelines of GASB No. 34. The University reported as a discretely presented component unit adopted the requirements of GASB No. 35.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2002

GASB No. 38 requires certain note disclosures when GASB No. 34 is implemented. The provisions of these new standards have been incorporated into the basic financial statements and notes.

GASB Interpretation No. 6 clarifies the application of existing standards for distinguishing the respective portions of certain types of liabilities that should be reported as (i) governmental fund liabilities and (ii) general long-term liabilities of the Government. The provisions of this interpretation have been incorporated into the basic financial statements and notes.

These new accounting standards caused most of the accounting changes, changes in reporting entity, and restatements described in the ensuing discussions below. Changes and restatements for reasons other than the adoption of the above pronouncements are also explained below.

The following schedule reconciles the September 30, 2001 fund balance/net assets as previously reported by the primary government to beginning fund balance/net assets, as restated (expressed in thousands).

	September 30, 2001 fund balance/net assets, as previously reported	Fund reclassifications	Change in basis of accounting	September 30, 2001 fund balance/net assets, as restated
General	\$ 71,652	(24,835)	57,511	104,328
Debt service	\$ 110,262	(24,391)	—	85,871
Nonmajor governmental funds:				
Special revenue	\$ 13,837	49,001	(3,605)	59,233
Capital projects	57,566	7,744	(7,210)	58,100
Total	\$ 71,403	56,745	(10,815)	117,333
Enterprise funds:				
Unemployment insurance	\$ —	64,621	(2,895)	61,726
West Indian Company	20,094	—	—	20,094
Nonmajor enterprise funds	(2,026)	8,900	922	7,796
Total	\$ 18,068	73,521	(1,973)	89,616
Trust and agency funds:				
Pension trust	\$ 1,214,183	—	—	1,214,183
Unemployment insurance	64,621	(64,621)	—	—
Other expendable trust	16,419	(16,419)	—	—
Total	\$ 1,295,223	(81,040)	—	1,214,183

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Notes to Basic Financial Statements

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The most significant changes in fund structure occurring between fiscal year 2001 and 2002 include the following:

- Major funds were identified and separately reported based on criteria specified in GASB No. 34 and other qualitative factors. In prior years, all funds were reported by fund type, as defined by accounting principles generally accepted in the United States of America, without respect to whether the fund type was significant.
- A number of funds reported in agency funds were reclassified to the general fund.
- The expendable trust funds were eliminated and reclassified to the special revenue, enterprise, general, capital projects.

The following table summarizes changes to fund equities as previously reported in the balance sheet by certain discretely presented component units. The changes resulted primarily from implementation of these GASB statements and reclassifications in the manner of presentation of certain component units (expressed in thousands):

Beginning net assets, as previously reported	\$ 715,436
Restatements:	
Virgin Islands Housing Authority	(29,792)
Roy L. Schneider Hospital	2,215
Magens' Bay Authority	24
Economic Development Authority	(868)
University of the Virgin Islands	(48,699)
Beginning net assets, as restated	<u>\$ 638,316</u>

The beginning net assets' restatement noted in the VIHA was attributed to a change in 2000 depreciation expense and an overstatement of debt amortization fund in 2000. Beginning of year net assets were reduced by \$12 million for prior years depreciation and by \$17 million for debt amortization fund.

The beginning net assets' restatement noted in the Roy L. Schneider Hospital, the Economic Development Authority, and MBA was attributed to prior period adjustments.

The University was reported in previous years as a public university fund. With the implementation of GASB No. 34 and No. 35, the University is now reported within the same column as all other discretely presented component units. Changes in the beginning net assets of the University relates to the adoption of GASB No. 35, attributed to the depreciation of capital assets, reporting tuition and fee revenue net of certain scholarship allowances and reporting revenue from auxiliary enterprises net of cost of goods sold and scholarships and allowances. Beginning of year net assets was reduced by \$27 million for prior years infrastructure depreciation and by \$21 million for property, plant, and equipment adjustments.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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(16) Subsequent Events

(a) *Primary Government*

In November 2002, the Refinery entered into a resolution with the PG allowing the issuance of \$25.7 million private activity bonds to repay costs incurred in the construction of a coker plant completed in June 2002. All debt service amounts related to the bonds are paid by the Refinery.

In November 2002, the PG issued GARVEE bonds amounting to \$18.5 million under an agreement with the U.S. Federal Highway Administration. The bond proceeds are to be used for commercial port facilities. Federal highway funds are utilized for debt servicing requirements.

In September 2003, the PG received a \$100 million Revenue Bond Anticipation Note, Series 2003 from a local bank for the payment of income tax refunds and operating expenses of the Government. Interest on the loan is 3.25% for the first six months outstanding, and 3.5% thereafter.

In November 2003, the excise tax on rum of 13.5 cents per gallon was extended to December 2004. The amount had been set to expire on December 31, 2003.

In December 2003, the PFA issued \$257.9 million in Series 2003 A Revenue Bonds. The proceeds of the bonds will be used to: (i) repay the Revenue Bond Anticipation Note, Series 2003 of \$100 million mentioned above, (ii) fund certain necessary public safety and other public sector capital development projects, (iii) fund the Debt Service Reserve Account, and (iv) pay the costs of issuing the Series 2003A Bonds. The bonds are supported by pledged gross receipts taxes.

(b) *Component Units*

In June 2003, WAPA issued \$70 million in electric revenue bonds. The bonds will be used to pay off an existing line of credit and to fund capital projects.

In August 2003, the VIHA went into federal receivership due to default of the agreement that allows it to receive federal funding.

On January 16, 2003, the VIPA issued the Marine Revenue Bonds Series 2003A (AMT) and 2003B (federally taxable), with principal amounts of \$18,005,000 and \$17,425,000, respectively. VIPA plans to use the proceeds of the bonds to finance the dredging, rehabilitation, and construction of berthing piers for cruise and seagoing vessels at Crown Bay in St. Thomas, and the construction of certain buildings to be used for commercial, retail, and cultural purposes at the dock facilities.

In August 2003, the U.S. Department of Housing and Urban Development (HUD) declared VIHA to be in substantial default of its annual contributions contract with HUD and placed VIHA in receivership. HUD assumed possession of all assets, projects, and programs.

On January 23, 2004, the Waste Management Authority was created by Act No. 6638 as a nonprofit, public body corporate and politic of the Government with the purpose of providing environmentally sound management for the collection and disposal of solid waste, including operation and closure of landfills, and wastewater collection, transport, treatment and disposal in the Territory. A board of directors consisting of seven member who will be appointed by the Governor will govern the authority.

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UNITED STATES VIRGIN ISLANDS

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The information in this Appendix was obtained from the Government of the Virgin Islands and has not been independently verified.

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 of which lie on a broad central plain. St. Thomas, which is approximately 35 miles north of St. Croix, 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 protected deep water 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 approximately one-half mile from the harbor in Charlotte Amalie. Water Island was transferred from the exclusive jurisdiction of the Department of Interior to the Virgin Islands in December 1996.

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. It is not immune to hurricanes, however, and three significant ones in the last 15 years - Hugo, Marilyn and Bertha - caused considerable damage in the Virgin Islands.

Population

In 2003, the population of the Virgin Islands was estimated at 110,740. St Croix has the largest population - 54,277 people. There are 52,184 people on St. Thomas and 4,279 people on St. John. In 2003, the population of the Virgin Islands increased by 0.6% from 2002.

Table 1
Comparative United States Virgin Islands
and United States Population Growth
1950-2003

<u>Year</u>	<u>United States Virgin Islands Population</u>	<u>Annual Percentage Increase (Decrease)</u>	<u>United States Population</u>	<u>Annual Percentage Increase (Decrease)</u>
1950	26,665	--	152,271,417	--
1960	32,099	2.0	180,671,158	1.9
1970	62,468	9.5	205,052,174	1.3
1980	96,569	5.5	227,224,681	--
1990	101,809	0.5	249,464,396	1.0
1999	107,912	1.0	279,040,168	1.2
2000	108,612	0.7	282,177,754	1.1
2001	109,403	0.7	285,093,813	1.0
2002	110,026	0.6	287,973,924	1.0
2003	110,740	0.6	290,809,777	1.0

Sources: U.S. Census Bureau and United States Virgin Islands Bureau of Economic Research.

Per Capita Income

In 2003, per capita income of the Virgin Islands was \$17,581, an increase of approximately 2.0% from 2002. In comparison, the per capita income in the United States was \$31,632, an increase of approximately 2.4% for the same period.

Table 2
Comparative Per Capita Income
United States Virgin Islands and United States
1980-2003
(current dollars)

<u>Year</u>	<u>United States Virgin Islands</u>	<u>Annual Percentage Increase (Decrease)</u>	<u>United States</u>	<u>Annual Percent Increase (Decrease)</u>
1980	6,230	--	10,114	--
1990	12,799	10.5	19,477	9.2
1999	16,242	2.8	27,939	3.5
2000	16,567	2.0	29,847	6.9
2001	16,898	2.0	30,527	2.3
2002	17,236	2.0	30,906	1.2
2003	17,581	2.0	31,632	2.4

Sources: U.S. Bureau of Economic Analysis and United States Virgin Island Bureau of Economic Research.

Employment

Civilian employment grew during 1999, 2000 and 2001, reaching a peak of 46,370 in 2001. The improvement in the job market was largely a result of an increase in private sector jobs, particularly in tourist trade and construction. Civilian employment decreased by 0.8% in 2002, and by 3.0% in 2003. The labor force decreased by 3.0% in 2002 and by 2.3% in 2003 to 48,170. The general economic decline in the United States, combined with the continued effects of the terrorist attacks in New York City

and Washington, D.C. on September 11, 2001 (the “Events of September 11, 2001”), deepened the downturn in the manufacturing and industrial sectors, interrupted the pace of growth in the tourism and construction sectors, and exacerbated the weaknesses in the tourist-related service sector. Notwithstanding this, modest growth in employment is expected in 2004 due to tourism-related development activity, and construction through Government capital improvement programs is anticipated to continue through 2004.

The Virgin Islands’ unemployment rate increased to 7.0% in 1999 and remained relatively stable in 2000 and 2001. The unemployment rate rose to 8.8% in 2002 from 7.1% in 2001. Negative growth in the tourism and hospitality and the manufacturing sectors was the major influence on the overall weakening of the economy. The former sector was harmed by the general economic decline in the United States and the continuing effects of the Events of September 11, 2001, and the latter sector suffered from falling demand and the high cost of production. The increased unemployment rate in 2002 was also attributable to large increases in the labor force and stagnant job creation. The unemployment rate rose to 9.4% in 2003, primarily as a result of the completion of construction of the coker plant by HOVENSA, which left approximately 2,000 construction workers unemployed.

Table 3
United States Virgin Islands Labor Force,
Employment and Unemployment Rates and
United States Unemployment Rates
1999-2003

<u>Year</u>	<u>Labor Force</u>	<u>Employment</u>	<u>Unemployment Rate</u> <u>United States</u> <u>Virgin Islands</u>	<u>Unemployment Rate</u> <u>United States</u>
1999	46,400	43,140	7.0%	4.2%
2000	47,730	44,500	6.8	4.0
2001	49,900	46,370	7.1	4.7
2002	49,457	44,975	8.8	5.8
2003	48,170	43,640	9.4	6.0

Sources: United States Virgin Islands Department of Labor, Bureau of Labor Studies Reports, and the U.S. Department of Labor, Bureau of Labor Statistics.

About 70% of the jobs in the Virgin Islands are in the private sector. Private sector employment growth is fueled by tourism and related services. Although the services sector experienced negative growth during 2003, this sector accounted for 36.7% of private employment. Wholesale and retail trade accounted for 32.1%, while construction, mining and manufacturing accounted for 9.9%. Average employment in the private sector decreased by 4% in 2003 to 29,095 from 30,428 in 2002.

Total public sector employment, which accounts for approximately 30% of jobs in the Virgin Islands, declined slightly in 2003. There were 12,543 public sector jobs in 2003 compared to 12,701 in 2002. Federal and local government are the largest employers in the public sector, with local government comprising over 90% of all public sector jobs. The number of local government jobs was 11,638 in 2003 compared to 12,570 jobs in 1999. This trend of decreases in local government employment is expected to continue in 2004 as part of the Government’s cost-cutting measures, although the decline is likely to occur at a decreasing rate. In 2003, United States federal government jobs remained at an average of 905.

Table 4
Annual Wage and Salary Employment
United States Virgin Islands
1999-2003

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Private sector:					
Construction & mining	1,690	1,950	3,697	3,017	1,666
Manufacturing.....	2,430	2,480	2,191	2,148	2,019
Transportation, communications & public utilities	2,360	2,450	2,507	2,446	1,429
Wholesale & retail trade	8,820	8,950	9,602	9,787	6,845
Finance, insurance & real estate.....	1,940	1,950	1,931	1,918	2,370
Leisure & hospitality*.....					6,836
Information*					873
Services.....	10,450	11,240	12,113	11,195	10,733
Total Private Sector	<u>27,690</u>	<u>29,020</u>	<u>32,024</u>	<u>30,428</u>	<u>29,095</u>
U.S. federal government	880	860	905	905	905
Territorial government.....	12,570	12,170	11,438	11,796	11,638
Total Government.....	<u>13,450</u>	<u>13,030</u>	<u>12,326</u>	<u>12,701</u>	<u>12,561</u>
Total.....	<u>41,140</u>	<u>42,050</u>	<u>44,367</u>	<u>43,129</u>	<u>41,637</u>

Sources: United States Virgin Islands Department of Labor, Bureau of Labor Statistics.

* Annual Wage and Salary Employment data for 2003 has been converted from the 1987 Standard Classification (SIC) System to the 2002 North American Industry Classification System (NAICS). As a result of this conversion, data for 2003 may not be comparable with the data from prior years.

Table 5
Selected Tourism-Related Employment
United States Virgin Islands
1999-2002

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Hotels & Other Lodging Places	3,820	3,930	3,980	4,060	3,930
Gift Shops & Other Retail Stores.....	2,090	1,970	2,010	2,110	2,130
Eating & Drinking Places	2,090	2,010	2,100	2,290	2,300
Transportation.....	480	510	570	560	550
Total	8,480	8,420	8,660	9,020	8,910

Sources: United States Virgin Islands Department of Labor, Bureau of Labor Statistics.

Total tourism-related employment grew 2.8% between 2000 and 2002. In 2002, hotels and other lodging places accounted for 44.1% of the total tourism-related employment, eating and drinking places accounted for 25.8%, gift shops and other retail stores accounted for 23.9% and transportation accounted for 6.2%. As of the date of this Official Statement, data for 2003 was not available.

Presented below are the ten largest private sector employers in the Virgin Islands as of December 31, 2003.

Table 6
United States Virgin Islands
Ten Largest Employers
(December 31, 2003)

<u>Name of Employer</u>	<u>Principal Business</u>
HOVENSA L.L.C	Oil Refining
Kmart Corporation	Department Store
Turner St. Croix Maintenance	Maintenance
Ritz-Carlton Hotel VI Inc	Resort Hotel
Westin St. John Hotel, Inc.	Resort Hotel
Innovative Telephone Corp	Utility
Caneel Bay, Inc	Resort Hotel
Frenchman's Reef Beach Hotel	Resort Hotel
Plaza Extra Supermarket, St. Croix	Supermarket
Renaissance Grand Beach Hotel	Resort Hotel

Source: United States Virgin Islands Department of Labor, Bureau of Labor Statistics.

HOVENSA L.L.C. (“HOVENSA”), a limited liability joint venture between Amerada Hess and Petróleos de Venezuela that refines crude oil, is the largest manufacturer in the Virgin Islands and the industry’s strongest performer. The company owns and operates one of the largest crude oil refineries in the world located in St. Croix. In July 2002, the company completed the construction of a new 58,000 barrels per day delayed coking unit at the refinery. This coker unit began commercial operations in August 2002, and integration and performance testing was completed in September 2003. The Authority and the Government have issued private activity bonds to provide reimbursement to HOVENSA for certain costs of the construction of the new coker unit. See “GOVERNMENT OF THE VIRGIN ISLANDS - Outstanding Indebtedness of the Government” below.

Tax Incentives Programs

Economic Development Commission

The Government offers various tax incentives that promote industrial and economic development in the Virgin Islands. The most notable incentive program was created by the Legislature in October 1975. The Government of the Virgin Islands Industrial Development Commission, subsequently renamed as the Economic Development Commission (the “Commission” or the “EDC”), was created to promote the growth, development and diversification of the economy of the Virgin Islands (the “EDC Program”). Qualifying businesses - corporations, partnerships or sole proprietorships - receive various benefits if they meet certain criteria set forth in the legislation. Gross Receipts Taxes are eligible for abatement by the Commission that could result in a reduction of Gross Receipts Taxes payable to the Government.

To qualify for tax incentives, investors must invest at least \$100,000, exclusive of inventory, in an eligible business and employ at least ten Virgin Islands residents full-time. Small, locally-owned manufacturers of import substitutes or tourist souvenirs may receive EDC benefits for up to five years if they invest at least \$20,000 and have two employees. A beneficiary receives a substantial reduction in, or an exemption from, all taxes imposed on businesses, including the Gross Receipts Taxes. Most importantly, the industrial development legislation permits a 90% income tax reduction, resulting in a maximum tax rate of less than 4% 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. Benefits may be renewed for up to ten (10) years on St. Thomas and St. John and up to thirty (30) years on St. Croix. Currently, 100 enterprises are operating with incentive benefits granted pursuant to the EDC Program, 68 enterprises have been approved for the benefits but are not yet in operation and an additional 19 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.

While the Commission has had certain compliance monitoring requirements, historically it lacked adequate personnel to fully enforce compliance with the Commission program requirements. Recently, the Commission has developed more effective compliance monitoring mechanisms, including revocation and suspension hearings that allow the Commission to collect retroactive taxes owed by beneficiaries who fail to comply with Commission conditions. Regular meetings of the Commission occur on a quarterly basis. Revocation and suspension hearings occur on an as needed basis. Additionally, the Commission has a director of compliance and four compliance officers to oversee compliance issues.

The following is a table setting forth the Commission's historical applicant information:

Table 7
Economic Development Commission
Historical Applicant Information
1999-2003

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Number of Applications Received.....	22	28	24	48	78
Number of Applications Approved.....	14	21	19	45	53
Number of Applications Denied	3	4	2	0	3
Applications Pending	5	3	3	3	15
New Job Opportunities	557	1,163	619	1,202	1,097
Approximate Wages by New Applicants.....	\$30,489,677	\$26,168,955	\$18,321,940	\$36,955,860	\$43,285,393
Minimum Potential Investment of New Applicants	\$63,485,640	\$100,894,409	\$199,676,900	\$162,022,016	\$25,617,699

Source: Government of the Virgin Islands Economic Development Commission.

The EDC Program allows some qualifying investors to receive limited extensions or renewals of tax benefits, provided such investors fulfill certain criteria, including the ability to continue to promote industrial development in the Virgin Islands. The Commission is currently trying to limit the number of extensions or renewals of benefits in favor of granting benefits to new businesses in growing industries such as financial services industries, tourism and medical technology-based enterprises, which will further stimulate the economy of the Virgin Islands by providing positions for skilled labor and college educated personnel. The significant decrease in the minimum potential investment of new applicants from 2002 to 2003 was due to the absence of a major hotel operator application in 2003.

Section 934 Tax Incentives

Pursuant to 26 U.S.C. § 934 ("Section 934 Tax Incentives"), the Government may provide certain tax reductions in income tax liability incurred to the Virgin Islands. Such income tax reductions are permitted for (i) income derived from sources within the Virgin Islands or income effectively connected with the conduct of a trade or business within the Virgin Islands (but not with respect to any income tax

liability paid to the Virgin Islands by citizens or residents of the United States (who are not bona fide residents of the Virgin Islands)), and (ii) income derived by qualified foreign corporations from sources outside the United States and which is not effectively connected with the conduct of a trade or business within the United States.

The EDC program has been successful in recent years in marketing the Section 934 Tax Incentives to attract new businesses, particularly in the financial services sector, to the Virgin Islands and to generate significant new tax revenues for the Government. As part of the American Jobs Creation Act of 2004 (“Jobs Act”), Congress tightened (1) the eligibility requirements for qualifying as a bona fide resident of the Virgin Islands, and (2) the standards for determining the type and amount of income that may qualify for the Section 934 Tax Incentives as income effectively connected with the conduct of a Virgin Island trade or business. There can be no assurance that the new standards set forth in the Jobs Act will not adversely affect the number of EDC companies that have been established in the Virgin Islands, the number that may consider establishing in the Virgin Islands in the future, or the amount of tax revenues contributed by EDC companies to the Government.

Transportation

The Virgin Islands are accessible by air from around the world. The Cyril E. King Airport Terminal on St. Thomas opened in October 1990. The expansion of the runway to 7,000 feet was completed in December 1992.

The Henry E. Rohlsen Airport Terminal on St. Croix has undergone major renovation and expansion. The terminal’s square footage has doubled its previous size to 181,000 square feet. The runway has been further expanded to 10,000 feet.

Approximately 65 flights per week travel between the Virgin Islands and the United States mainland on five major airlines.

There are more than a dozen 30-minute flights per day between St. Thomas and St. Croix, as well as regular ferry service. The island of St. John can be reached by seaplane and private ferry boat. Inter-island ferry service provides passenger service between St. Thomas and the nearby British Virgin Islands several times daily.

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.

Utilities and Energy Use

The Virgin Islands Water and Power Authority (“WAPA”), an instrumentality of the Government, owns and operates electric power generation and distribution facilities on St. Thomas, St. Croix and St. John and currently is the sole provider of electricity in the Virgin Islands, with the exception of a limited number of commercial entities that produce electricity for their own use. WAPA provides electricity to approximately 50,000 customers. WAPA also operates a water production and distribution system and provides water service to approximately 10,000 customers. Gas is available from various companies throughout the Virgin Islands.

Electricity sales in 2003 increased by 2.2% from 2002 electricity sales, with sales to industrial users representing 47% of such sales, sales to residential users representing 36% of such sales and the remaining sales being to commercial users. Fuel consumption in 2003 decreased by 0.3% from 2002.

Tourism

Tourism is the largest industry in the Virgin Islands and represents the largest segment in the private sector.

Visitor Arrivals

In 2001, the Virgin Islands recorded its third consecutive year of growth in visitor arrivals. That year, a record 2.5 million visitors arrived in the Virgin Islands, 4.4% more than the preceding year. This improved performance was mainly the result of an increase in cruise passenger arrivals. Cruise passenger arrivals grew at a record pace to approximately 1.9 million in 2001, an increase of 7.0% from 2000. Air travel decreased slightly, 2.9%, as a result of the Events of September 11, 2001.

Even though the tourism industry experienced impressive growth in the early part of 2001, there was a sharp reduction in tourists in the fall and the winter of 2001, as a result of the Events of September 11, 2001. Growth for 2001 was far lower than expected and that trend continued into 2002. In 2002, visitors totaled 2.337 million, 6.6% less than the preceding year. Air visitor arrivals declined by 1.9% over 2001 and cruise ship passengers declined by 8.1% over 2001. The absence of ships calling on St. Croix from June to September of 2002 resulted in a 49% drop in cruise ship passenger arrivals to that island and contributed to the overall loss in visitor arrivals. Despite the difficulties faced by the Virgin Islands' tourism industry in 2002, the Virgin Islands fared better than many other Caribbean destinations that suffered double-digit reductions in arrivals.

The performance in the tourism sector during 2003 indicates that the sector is recovering. Total visitors increased to 2.393 million, a 2.4% increase from 2002. Cruise passenger arrivals increased by 2.0% as compared to 2002. The continuing absence of ships calling on St. Croix resulted in an 81% drop in cruise ship passengers to that island and slowed down the overall growth in visitors to the Virgin Islands. In 2003, air visitors to St. Thomas and St. John increased by 6.3% and the cruise passenger arrivals increased by 4.8% as compared to 2002.

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Table 8
United States Virgin Islands
Visitor Arrivals
1999-2003
(000's)

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
St. Thomas/St. John:					
Air Visitors	428.2	480.1	469.6	474.6	504.6
Cruise Passengers [†]	<u>1,363.3</u>	<u>1,719.8</u>	<u>1,790.5</u>	<u>1,671.3</u>	<u>1,751.9</u>
Total Visitors [†]	1,791.5	2,199.9	2,660.1	2,145.9	2,256.5
Number of Cruise Ship Visits* ...	776	949	909	812	878
St. Croix:					
Air Visitors	132.4	146.6	136.4	123.3	114.1
Cruise Passengers [†]	<u>164.6</u>	<u>232.4</u>	<u>237.4</u>	<u>120.5</u>	<u>23.0</u>
Total Visitors [†]	297.0	379.0	373.8	243.8	137.1
Number of Cruise Ship Visits* ...	89	139	138	60	25
Total U.S. Virgin Islands:					
Air Visitors	560.7	626.7	606.4	597.9	618.7
Cruise Passengers [†]	<u>1,403.6</u>	<u>1,768.4</u>	<u>1,891.4</u>	<u>1,738.7</u>	<u>1,773.9</u>
Total Visitors [†]	1,964.3	2,395.8	2,497.8	2,336.6	2,392.6
Number of Cruise Ship Visits* ...	795	1,014	976	845	888

*Actual, not thousands

[†] Totals by island include first and second port of entry arrivals. Total U.S. Virgin Islands arrivals include first territorial port of entry only; passengers visiting more than one U.S. Virgin Islands island during the same cruise are counted only once in the U.S. Virgin Islands total. Consequently, the U.S. Virgin Islands total will always be less than or equal to the sum of the two island totals as indicated above.

Source: United States Virgin Islands Bureau of Economic Research.

Hotel Occupancy

Hotel occupancy increased slightly in 2002 to 57.0%, from 56.6% in 2001, having decreased from 58.6% in 2000. In 2003, the hotel occupancy rate increased slightly to 57.2%. The actual number of hotel and condominium rooms increased to 5,092 in 2002, up slightly from 5,049 in 2001. In 2003, the number of hotel and condominium rooms fell slightly to 5,045. The closure of a few small hotels, particularly on St. Croix, accounted for the drop in available rooms. Total occupied room nights increased in 2002 to 1,057,488, a 1.7% increase from 2001. Occupied room nights for 2003 were 1,050,763, 0.6% less than the same period in 2002.

Table 9
United States Virgin Islands
Hotel and Other Tourist Accommodations
1999-2003

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
St. Thomas/St. John:					
Total rooms/units	3,768	3,794	3,835	3,899	3,864
Number of hotels	30	30	30	30	29
Hotel rooms	3,060	3,053	3,094	3,127	3,119
Condominium/other units	708	741	741	772	745
Occupancy rate (percent)	57.7	60.4	59.5	61.0	62.3
St. Croix:					
Total rooms/units	1,079	1,215	1,214	1,194	1,180
Number of hotels	18	19	18	17	17
Hotel rooms	765	891	888	864	866
Condominium/other units	314	324	326	330	314
Occupancy rate (percent)	48.6	50.7	46.9	43.4	40.5
Total U.S. Virgin Islands:					
Total rooms/units	4,847	5,019	5,048	5,093	5,044
Number of hotels	48	49	48	47	46
Hotel rooms	3,825	3,954	3,981	3,991	3,985
Condominium/other units	1,022	1,065	1,067	1,101	1,059
Occupancy rate (percent)	55.7	57.7	56.6	57.0	57.2

Source: United States Virgin Islands Bureau of Economic Research.

Total expenditures by all visitors (tourists, cruise passengers and other excursionists) to the Virgin Islands totaled \$1.2 billion in 2002, and \$1.27 billion in 2003, approximately 4% below the high of \$1.32 billion recorded in 2001.

Table 10
United States Virgin Islands
Visitor Expenditures
1999-2003
(in millions)

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Tourists	\$540.9	\$725.9	\$810.9	\$723.5	\$765.8
Excursionists:					
Day trip by air	21.4	18.2	18.2	18.4	19.7
Cruise passengers	392.7	461.8	493.4	453.4	485.0
Total	414.1	480.0	511.7	471.8	504.7
Total Expenditures	<u>\$954.9</u>	<u>\$1,205.9</u>	<u>\$1,322.5</u>	<u>\$1,195.3</u>	<u>\$1,270.5</u>

Source: United States Virgin Islands Bureau of Economic Research.

The Virgin Islands benefits from a \$1,200 duty-free exemption for articles purchased in the Virgin Islands and either mailed or taken back to the United States mainland from the Virgin Islands once each 30 days, without regard to the length of stay abroad while other countries in the Caribbean basin only have a \$600 duty-free exemption (a two-to-one advantage). The Conference Report to the Miscellaneous Tariff Act of 2004, which increases the duty-free exemption, has passed the U.S. House of

Representatives and is pending in the U.S. Senate. The Conference Report bill increases the duty-free exemption for the Virgin Islands to \$1,600 and for other countries in the Caribbean basin to \$800, still retaining the current comparative advantage. In addition, each adult is permitted to return with up to one gallon of duty-free liquor as compared to one quart from other areas. In response to falling U.S. tariff rates and increased competition from Caribbean neighbors, local customs duties and excise taxes were removed from selected tourist-oriented merchandise in 1982. As a result, prices of various luxury items, such as jewelry, china, cameras, leather goods, perfumes, watches and clocks, can be significantly below average United States mainland prices.

Construction and Real Estate

The construction sector recorded the highest rate of employment growth in 2002. Growth in construction sector employment was driven by private sector projects, such as HOVENSA's approximately \$615.0 million coker unit and the expansion and refurbishing of the Ritz-Carlton Hotel and Timeshare. Public sector infrastructure development projects, such as the St. Croix Henry E. Rohlsen Airport expansion, also fueled the growth in construction. Construction activity slowed in 2002 with the completion of the HOVENSA coker and hotel construction projects, and the number of construction jobs fell 44.8% in 2003.

The value of approved building construction permits, an indicator of current and future industry activity, decreased approximately 22.6% in 2000 and 18.7% in 2001. In 2002, permit value rose 57.5% due to increases in private residential and non-residential construction. However, total construction permit value dropped nearly 52% for the first quarter of calendar year 2002 and dropped even further in 2003. The slow implementation of public sector projects and obstacles to several projects in the private sector limited growth in the construction sector. To increase construction activity, the Government is planning to (i) fast-track the construction of a number of public sector capital projects such as roads, port facilities and housing developments and (ii) expedite the permitting process for a number of private sector tourism-related projects.

Table 11
United States Virgin Islands
Value of Construction Permits
1999-2003

Year	Total USVI (millions)	Percent Increase (Decrease)	St. Thomas/St. John (millions)	Percent Increase (Decrease)	St. Croix (millions)	Percent Increase (Decrease)
1999	260.9	36.2	159.9	10.0	101.0	118.6
2000	202.0	(22.6)	144.0	(9.9)	58.0	(42.6)
2001	164.3	(18.7)	106.6	(26.0)	39.9	(31.2)
2002	258.6	57.5	189.9	78.1	68.8	72.5
2003	255.6	(1.2)	174.7	(8.0)	80.9	17.6

Source: United States Virgin Islands Bureau of Economic Research.

Table 12
United States Virgin Islands
Residential Real Estate Market Sales Analysis
1999-2003

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
St. Thomas/St. John:					
Number of Homes Sold	205	209	218	224	249
Average Home Sales Price (\$).....	267,117	317,285	365,879	408,219	546,488
No. of Condominium Sales.....	142	158	168	218	295
Average Condominium					
Sales Price (\$).....	159,522	112,732	117,210	133,435	144,333
St. Croix:					
Number of Homes Sold	174	192	180	197	256
Average Home Sales Price (\$).....	212,399	231,187	181,335	230,244	330,557
No. of Condominium Sales.....	118	145	151	151	188
Average Condominium					
Sales Price (\$).....	101,053	126,880	126,155	116,186	132,633
Total U.S. Virgin Islands:					
Number of Homes Sold	379	401	398	421	505
Average Home Sales Price (\$).....	241,996	270,054	282,417	324,939	437,026
No. of Condominium Sales.....	260	303	293	396	485
Average Condominium					
Sales Price (\$).....	132,986	119,503	121,026	126,376	139,203

Source: United States Virgin Islands Bureau of Economic Research.

The table below presents the largest real property taxpayers in the United States Virgin Islands in 2003.

Table 13
Largest Real Property Taxpayers of the
United States Virgin Islands
2003

<u>Taxpayer</u>	<u>Assessment*</u>	<u>2003 Taxes</u>
HOVENSA L.L.C.....	\$1,871,047,207	\$14,000,000
Lockhart (Family)(St. Thomas & St. Croix).....	85,025,946	520,797
Topa Equities (St. Thomas & St. Croix).....	57,471,162	437,634
Tutu Park Mall Ltd.....	38,922,228	291,917
Palace Resorts.....	32,657,352	244,930
Hartman (Family).....	40,878,661	220,789
Innovative Telephone (St. Thomas & St. Croix).....	26,640,542	194,682
Sunny Isles Shopping Center (de Chabert Family).....	22,417,984	167,638
Four Winds Plaza.....	17,614,701	135,360
Davis Bay (Carambola).....	17,806,308	133,547
Banco Popular de Puerto Rico.....	16,233,083	121,748
St. Thomas Liquor Co.....	14,001,829	107,864
Boschulte Family.....	13,198,745	97,041
B&W Realty Investment, Ltd.	12,140,135	96,701
Cabrite Development Corp.	14,096,680	86,362
Dunhill Golf Associates.....	11,122,580	54,808
Buccaneer & Armstrong Group.....	14,853,258	26,301

* Assessments are at 100% of market value.

Source: United States Virgin Islands Office of the Tax Assessor.

Capital Program

Significant capital projects funded by the Government and its instrumentalities since 1998 are summarized below.

<u>Project*</u>	<u>Funded Amount</u> <u>(\$ millions)</u>	<u>Source of Funding</u>
Various Facilities and Building Improvements...	\$140.0	Bond proceeds
Hazard Mitigation.....	42.0	Bond proceeds and Federal funds
Wastewater Treatment Facilities.....	40.8	Bond proceeds, Federal funds, General Fund and other funding
School Construction.....	40.2	Bond proceeds
Rohlsen Airport Improvements.....	37.6	Bond proceeds, Federal funds, other funding
Crown Bay Cruise Ship Terminal.....	35.0	Bond proceeds
Road and Other Repairs.....	58.0	Federal funds
Correctional Facilities.....	24.4	Bond proceeds
Enighed Pond Port.....	16.0	Bond proceeds
Government House Renovation.....	12.0	Bond proceeds and other funding
Charlotte Amalie Waterfront Improvement	10.8	Bond proceeds
WAPA Infrastructure Project St. Croix.....	10.7	Bond proceeds
Flood Control.....	10.3	Federal funds, bond proceeds, other funding
Enighed Pond/Red Hook/Gallows Bay Port Improvements.....	9.7	Bond proceeds
Frederiksted Waterfront Development.....	6.0	Bond proceeds
Red Hook Ferry Terminal Improvement.....	6.0	Bond proceeds
Henry E. Rohlsen FAA Tower.....	4.5	Federal funds
Charles Harwood Phase I.....	4.0	Bond proceeds
Cruz Bay Parking Facility.....	3.0	Other funds
Sugar Estate Head Start.....	2.1	Federal funds
Housing Authority.....	2.6	Federal Funds
Housing Finance Authority.....	5.6	Other
Human Services.....	4.4	Federal/Local/Other
Housing, Parks & Recreation.....	10.0	Federal/Local/Other

* Not all projects have been completed as of the date of this Official Statement.

GOVERNMENT OF THE 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 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 is the Honorable Charles W. Turnbull, who assumed office on January 4, 1999, and was reelected to a second term that commenced on January 2003. The current Lieutenant Governor is the Honorable Vargrave A. Richards, who assumed office on January 6, 2003. The terms of the Governor and Lieutenant Governor expire on the first Monday in January 2007.

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 serve for ten years. 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 plenary power of Congress, under the Territorial Clause of the U.S. Constitution, to make rules and regulations respecting the Virgin Islands. In addition, Congress has the power to legislate directly for a territory or to establish the government for such territory subject to congressional control.

Pursuant to the Insular Areas Act of 1982, the OIG of the DOI performs the functions of government comptroller through audits of revenues and receipts and expenditure of funds and property of the Virgin Islands, as well as the other insular areas of Guam, American Samoa, and the Commonwealth of Northern Mariana Islands. In connection therewith, the OIG has issued numerous audit reports over the past several years regarding the Virgin Islands. See “GOVERNMENT OF THE VIRGIN ISLANDS - Financial Position of the Government - Department of the Interior 1998 Audit Report” and “- Other DOI Office of Inspector General Reports” below.

Residents of the Virgin Islands have been citizens of the United States since 1927. However, apart from express Congressional grants of rights, such as the Bill of Rights in Section 1561 of the Revised Organic Act, residency in the Virgin Islands does not carry with it the full range of rights that 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 on the House floor.

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 balanced executive budget of capital improvements and operating expenses for the following Fiscal Year no later than May 30. The annual executive budget is prepared by the Virgin Islands Office of Management and Budget (“OMB”), working in conjunction with other Government departments and agencies. The Legislature enacts the budget through passage of appropriations for each department and agency. The Legislature may add, change or delete any item in the Governor’s submission. Upon passage by the Legislature, the budget is submitted to the Governor who (in certain circumstances) may eliminate any item by a line-item veto but not increase or insert any new item in the budget within ten (10) days of receipt of the budget from the Legislature. The Governor also may veto the budget in its entirety and return it to the Legislature with his objections within ten (10) days of receipt of the budget from the Legislature. The Legislature may override a veto by the Governor (including any line-item veto) only by a vote of two-thirds of its members. The Legislature is obligated by law to pass a final balanced budget no later than September 30, the last day of the Fiscal Year. Subsequent to enactment of the Government Financial Accountability Act of 1999, 1999 Virgin Islands Act No. 6289, as amended (the “Financial Accountability Act”), supplemental budgetary appropriations bills that are signed into law may be made during the year only with the identification of a specific revenue source to finance them.

If the annual executive 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. For a discussion of the Fiscal Year 2005 Budget see “GOVERNMENT OF THE VIRGIN ISLANDS - Financial Position of the Government - Fiscal Year 2005 Budget.”

Once a budget is enacted, fiscal control over expenditures made pursuant to the budget is exercised by the Governor through the allotment process managed by 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, reductions in appropriations 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 education, safety, health and welfare.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Government considers most revenue to be available if collected within 90 days of the end of the current fiscal year-end. Grant revenue is considered to be available if collected within the 12 months after the end of the current fiscal year-end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, are recorded only when payment is due.

Income taxes, gross receipts, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the Government.

Proprietary Funds, Fiduciary Funds, and Discretely Presented Component Units Financial Statements – The financial statements of the proprietary funds, fiduciary funds, and discretely presented component units are reported using the economic measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

Each proprietary fund has the option under GASB Statement No. 20 to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with a GASB pronouncement. The PG and most blended and discretely presented component units have elected not to apply FASB pronouncements issued after November 30, 1989 for its proprietary fund types. The Virgin Islands Port Authority (“VIPA”) has elected to follow the FASB’s pronouncements issued after November 30, 1989.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations.

Fund Accounting

The Government reports its financial position and results of operations in funds, which are considered separate accounting entities and discrete presentations of those component units, which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. The new model as defined in GASB No. 34 establishes criteria (percentage of the assets, liabilities, revenue, or expenditures/expenses of either fund category or the governmental and enterprise funds combined) for the determination of major funds. The nonmajor funds are combined in a single column in the fund financial statements. The Government reports the following major funds:

Governmental Funds

The Government reports the following major governmental funds:

- **General Fund** – The general fund is the government’s primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.
- **PFA Debt Service Fund** – The PFA Debt Service Fund accounts for the resources accumulated, and payments made, for principal and interest on long-term general obligation debt issued by the Authority on behalf of the Government.

Proprietary Funds

These funds account for those activities for which the intent of management is to recover, primarily through user charges the cost of providing goods or services to the general public. The government reports the following major proprietary funds:

- **Unemployment Insurance Fund** – The unemployment insurance fund accounts for the collection of unemployment assessments from employers in the U.S. Virgin Islands, and the payment of unemployment benefits to eligible unemployed recipients.
- **West Indian Company** – The West Indian Company (WICO) accounts for the activities of a cruise ship pier and shopping mall complex on the island of St. Thomas.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the Government in a trustee capacity, or as an agent for individuals, private organizations, and other governmental units. The following are the Government’s fiduciary funds:

- **Pension Trust Fund Accounts** – The pension trust fund accounts for the activities of the Employees’ Retirement System of the Government of the Virgin Islands, which accumulates resources for pension benefit payments to qualified employees.
- **Agency Fund** – The agency fund is custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

Financial Reporting

The general purpose financial statements of the Government for Fiscal Years 1994 and 1995 and for Fiscal Years 1998 through 2001 and the basic financial statements for Fiscal Year 2002 have been audited by KPMG LLP, independent public accountants (“KPMG”), to the extent and for the years indicated in their reports thereon. Such reports refer to reports of other auditors, contain disclaimers over the balances and transactions of the enterprise fund caused by certain limitations in their audit scope and contain various qualifications. In addition, OMB Circular A-133 for Fiscal Years 2001 and 2002 prepared by KPMG noted material weaknesses in internal controls over the financial report based on audits of the general purpose and basic financial statements performed in accordance with Government Accounting Standards and events of non-compliance with certain provisions of laws, regulations, contracts and grants that have a direct and material effect on the determination of general purpose and basic financial statement amounts.

Special provisions for agreed-upon procedures for Fiscal Years 1996 and 1997 were entered into by the Government and KPMG and completed by KPMG in October 2003. The Government has contracted with KPMG to audit its financial statements for Fiscal Years 2003 through 2005, and it is

expected that the audited financial statements for Fiscal Year 2003 will be available during the second quarter of 2005. The Government expects that, upon completion of the audit of Fiscal Year 2003, adjustments to the unaudited financial statements presented herein will be necessary (including, without limitation, as a result of the conversion required by GASB 34 hereinafter described). The Government can make no assurance that such adjustments will not be material.

Revenues of the Government

General

The principal sources of revenues for the Government are: United States federal income taxes (collected locally as Virgin Islands income taxes); Gross Receipts Taxes and other taxes and fees levied by the Government under its own locally applicable internal revenue laws; real property taxes, federal excise taxes imposed on products of the Virgin Islands entering the United States; and other fees and taxes collected by the United States federal government. For a description of the Government's program to provide tax relief and subsidies to certain businesses to promote economic growth, see "ECONOMIC AND DEMOGRAPHIC INFORMATION - Tax Incentive Programs."

The Revised Organic Act sets forth the taxes imposed by the United States federal 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.

Unaudited revenues of the General Fund (budgetary basis) for Fiscal Years 1999 to 2004 are presented in the table below.

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**Components of General Fund (Budgetary Basis) Revenues
For Fiscal Years 2000-2004
Cash Basis
(\$000's)**

	2000		2001		2002		2003		2004	
Income ⁽¹⁾	\$254,470	57.0%	\$347,763	64.5%	\$343,690	66.2%	\$337,000	65.8%	\$383,589	61.8%
Gross Receipts ⁽²⁾	92,889	20.8	99,598	18.5	95,916	18.5	100,570	19.6	113,140	18.2
Real Property	60,867	13.6	50,495	9.4	46,044	8.9	36,510	7.1	74,279	11.9
Excise	16,251	3.6	15,715	2.9	12,802	2.5	13,335	2.6	18,267	2.9
FSC Franchise	5,545	1.2	4,915	0.9	3,172	0.6	708	0.1	294	.4
Other Taxes ⁽³⁾	4,441	1.0	4,006	0.7	4,859	0.9	11,118	2.2	17,787	2.8
Total Taxes	\$434,463	97.3%	\$522,492	96.9%	\$506,484	97.5%	\$499,241	97.5%	\$607,356	98.0%
Other Sources of Revenue ⁽⁴⁾	11,907	2.7%	16,542	3.1%	12,873	2.5%	12,945	2.5%	12,760	2.0%
Total Revenue	\$446,370	100.0%	\$539,034	100.0%	\$519,357	100.0%	\$512,186	100.0%	\$620,116	100.0%

- (1) Figures do not reflect income tax refunds paid. In Fiscal Year 2000, income tax refunds paid were approximately \$98.0 million; in Fiscal Year 2001, income tax refunds paid were approximately \$54.2 million; in Fiscal Year 2002, income tax refunds paid were approximately \$41.2 million; in Fiscal Year 2003, income tax refunds paid were approximately \$53.2 million; and in Fiscal Year 2004, income tax refunds paid were approximately \$71.4 million. Cumulative unpaid income tax refunds for Fiscal Years 2001 through 2002 total approximately \$1.4 million. (Source: Virgin Islands Bureau of Internal Revenue financial management system reports)
- (2) Does not reflect Required Annual Moderate Income Housing Fund Deposit.
- (3) Other Taxes include stamp taxes, inheritance taxes and corporate franchise taxes. There are currently four pending lawsuits challenging the Government's computation of its corporate franchise tax.
- (4) Other Sources of Revenues include, among other things, licenses, fees and permits, fines, forfeitures, penalties, rents and concessions, customs dues, bank fees and charges, and franchise fees.

Source: United States Virgin Islands Department of Finance unaudited revenue reports; except that, with respect to Gross Receipts Taxes for Fiscal Years 2000 through 2004, the Source is the Continuing Disclosure Quarterly Summary reports of the U.S. Virgin Islands Public Finance Authority certifying Gross Receipts Taxes Deposited with the Collecting Agent, and except as noted in Footnote (1).

Income Taxes

The principal source of revenue for the Government is income taxes. The Naval Appropriations Act of 1922 created a separate tax structure for the Virgin Islands that mirrors the Internal Revenue Code. To the extent the tax structure of the Virgin Islands mirrors that of the Internal Revenue Code, changes to the federal income tax laws may have an impact upon the Government's ability to collect taxes. The Government has the power to impose a territorial income tax. Currently, the Government has imposed a corporate income tax surcharge of 10%.

Income taxes are levied each year for every corporation, partnership, individual, estate or trust that meets the filing requirements of the Internal Revenue Code. A United States taxpayer who is a bona fide resident of the Virgin Islands satisfies his United States income tax obligation 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.

In Fiscal Year 2001, income tax collections increased by 37% as a result of, among other things, a general increase in the tax base, including an increase in the number of new companies locating to the Virgin Islands as beneficiaries of the EDC Program. In Fiscal Years 2002 and 2003, income tax collections decreased by 1.2% and 2.2%, respectively, mainly as a result of the national recession. In Fiscal Year 2004, income tax collections increased by 14.1% primarily due to increased tourism, an increased tax base as a result of the economic development program incentives, increased tax compliance

and certain tax increases implemented in 2004. These increases occurred despite a reduction in income tax rates which mirror those of the federal tax code.

Gross Receipts Taxes

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, without reduction for cost of goods sold or services or other expenses.

Real Property Taxes

Title 33 of the Virgin Islands Code, Section 2301 (the “Real Property Tax Statute”) imposes a tax on all real property in the Virgin Islands. The Real Property Tax Statute sets assessed value of real property based upon its actual value and assesses a real property tax levy equal to 1.25% of 60% of assessed valuation on an average basis. 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. In the Fiscal Year 2004 Budget, the Legislature proposed accelerating the collection of real property taxes by collecting such taxes in advance rather than in arrears, but the Governor vetoed the proposed budget and this provision did not become effective.

Noncommercial real property is reassessed every two years and commercial real property is reassessed annually. The Virgin Islands Office of the Tax Assessor prepares an annual assessment roll and schedule of collections for each parcel of real property that is used by the Virgin Islands Office of the Tax Assessor’s billing agent as the basis for issuing tax bills to all taxpayers in the Virgin Islands.

In Fiscal Year 2003, real property tax collections decreased as a result of a lawsuit by a group of taxpayers challenging the Government’s real property tax assessment process. Since May 2003, the Government has been enjoined from appraising and assessing any real property in the Virgin Islands until it has modified its system of appraisal to comply with certain court mandates. As a result, it has been using the 1998 assessment value to issue tax bills and collect taxes, and expects to continue to do so until a new appraisal system is implemented which satisfies the court’s concerns. In June 2004, the Third Circuit Court of Appeals upheld the May 2003 District Court ruling which compels the Government to modify its property tax assessment system. The District Court has approved the Government hiring of a consulting firm to modify the system over the next two years.

All real property not expressly exempt is subject to the real property tax. Exemptions include (i) property of the United States federal government subject to a \$10,000 payment in lieu of real estate taxes, (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 EDC. See “ECONOMIC AND DEMOGRAPHIC INFORMATION - Tax Incentive Programs - Economic Development Commission” above. In 2003, approximately 51% of all real property in the Virgin Islands was exempt from real property taxation. In addition, approximately 2% of all real property in the Virgin Islands was exempt from real property taxation due to EDC exemptions.

The following table presents property taxes, assessed value and exemptions for Virgin Islands real estate for the calendar years 1999 through 2003:

United States Virgin Islands
Property Tax - Assessed Value And Exemptions
1999-2003
(millions)

<u>Year</u>	<u>Total Assessed Value⁽¹⁾</u>	<u>Local and Federal Government⁽²⁾</u>	<u>Other⁽³⁾</u>	<u>EDC⁽⁴⁾</u>	<u>Taxed Assessed Value</u>	<u>Levy</u>
1999	\$16,577.5	\$7,021.2	\$1,168.8	\$346.3	\$8,041.2	\$58.6
2000	\$16,574.5	\$7,011.8	\$1,113.8	\$338.6	\$8,110.2	\$59.1
2001	\$16,614.5	\$7,105.2	\$1,122.8	\$345.7	\$8,040.8	\$58.6
2002	\$16,623.5	\$6,993.1	\$1,505.1	\$365.0	\$7,760.3	\$58.2
2003	\$16,859.1	\$6,993.1	\$1,498.3	\$354.7	\$8,013.0	\$60.1

- (1) Pursuant to Act No. 6297 the assessed value of real property is now equal to the actual value of such real property.
(2) Includes a national park on St. John.
(3) Includes exemptions for veterans, non-profit organizations, churches, farms and homesteads, an senior citizens.
(4) EDC Program provides exemptions for 10 to 15 years.

Source: United States Virgin Islands Office of the Tax Assessor.

The above table reflects the renewed HOVENSA property tax agreement for property assessed at \$1,867 million with an annual property tax levy of \$14.0 million.

Delays in the issuance of tax bills since 2000, as a result of the real property litigation discussed above, as well as real property taxpayers' failure to pay such tax bills as a result of such case, has negatively impacted the collection of real property taxes since 2000.

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 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 and for agricultural purposes, animal feed, poultry feeds and commercial fertilizers, motor vehicles requiring licensing for highway use, items for sale to the United States federal government, the Government or an instrumentality of either one, items imported or manufactured in the Virgin Islands that are exported to purchasers who take delivery and actual possession outside of the Virgin Islands, as well as paper, plastics, glass or wooden materials and supplies used to package foodstuffs grown, processed, bottled or produced in the Virgin Islands, spirits, perfumes, toilet waters, bath salts, tapestry, hand-woven fabrics, handmade carpets, sweaters, shawls, scarves and ties. An exemption also is extended to franchised bus operators, costume jewelry manufacturers, EDC beneficiaries, certain film-making and other related professional equipment and licensed insurers.

There is a general exemption from the excise tax for agencies of the Government or the United States 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.

The decrease in excise tax collections from Fiscal Year 2001 to Fiscal Year 2002 was primarily due to a change in applicable law expanding the types of articles/items exempt from such tax. Excise tax

collections in 2003 increased by 4%. Excise tax collections increased by 37% in Fiscal Year 2004 due, in large part, to increased imports resulting from the opening of a Home Depot on St. Thomas as well as the elimination of the exemption for personally imported items of less than \$1,000 in value.

Foreign Sales Corporations (“FSC”) Franchise Taxes

Until December 2001, the Virgin Islands benefited from the favorable tax treatment afforded to FSCs under the Code. The Virgin Islands was one of the first jurisdictions to enact local FSC legislation in order to attract FSCs and, since the initiation of the FSC program in 1984 by the United States federal government, consistently had a significant number of FSCs. Under the Virgin Islands’ local FSC legislation, a corporation that elected to be treated as a foreign sales corporation under the Code and met certain other requirements of the Code paid minimum franchise taxes ranging from \$400 to \$25,000 based upon foreign trade gross receipts and was entitled to reduce its franchise tax liability each year by an amount equal to 50% of the wages paid during the previous calendar year to employees who are Virgin Islands residents. The franchise tax was payable by June 30 of each year.

In response to recent decisions by the World Trade Organization (“WTO”), the United States Congress has passed, and the President has signed, the American Jobs Creation Act of 2004, which repeals the favorable tax provisions in the Code on which the Virgin Islands’ local FSC program has been based. In 2002, the Legislature amended the local FSC law to reduce the franchise tax liability of Virgin Islands-based FSCs pending resolution of the WTO dispute at the United States federal government level. As a result, FSC franchise tax revenues have declined significantly since Fiscal Year 2002. It is anticipated that FSC franchise tax revenues will decline to negligible levels as a result of the recent legislative action by the United States federal government.

Other Revenue Sources

Other sources of General Fund revenues include, among other things, licensing fees, permitting fees, fines, forfeitures, penalties, custom dues and miscellaneous service charges.

Additional Revenues of the Government

In addition to the taxes discussed above that comprise the primary General Fund revenues, there are additional taxes, fees and charges imposed by the Government that are dedicated for specific purposes.

Transportation Trust Fund Revenues

General. The Transportation Trust Fund (“TTF”) was created to secure the payment of principal of, redemption premium, if any, and interest on bonds issued by the Authority to finance maintenance, improvement, repair and construction on the road and highway system. Prior to the creation of the TTF, motor fuel and highway users’ taxes and traffic law violation fines were deposited into the Road Fund and driver’s license and motor vehicle registration fees were deposited into the General Fund. There are currently no outstanding bonds secured by the TTF for the purpose of financing highway projects. Pursuant to 2001 Virgin Islands Act No. 6455, the Legislature authorized the appropriation of \$12,800,000 from the TTF to the General Fund to fund salary increases and satisfy certain outstanding obligations owed to Government employees and retirees for use in Fiscal Year 2002. It is anticipated that the Legislature will appropriate in each Fiscal Year the estimated TTF revenues to the General Fund in satisfaction of such salary increases and unpaid obligations owed to Government employees and retirees. Any amounts remaining in the TTF following such appropriation are deposited into the Road Fund.

The following is a description of the taxes, fees and fines designated for deposit in the TTF.

Motor Fuel Taxes. A tax of 14 cents is levied on each gallon of gasoline and diesel fuel manufactured, sold, or consumed or otherwise disposed of in the Virgin Islands. The following are exempt from motor fuel taxes: (i) the Government; (ii) fuel used for fueling of aircraft, motorboats, yachts or any other motor vehicle not operating or intended for operation upon the public highway; and (iii) fuel used for industrial or other purposes not connected with the fueling of motor vehicles. Motor fuel taxes are collected throughout the Fiscal Year and are transferred directly to the Transportation Trust Fund.

Highway Users' Tax. Before registering a motor vehicle in the Virgin Islands for the first time, every person is required to pay a highway users' tax on the unladen weight of the vehicle at the rate of 16 cents per pound, provided that the minimum highway users' tax for any vehicle is \$25.00. The following are exempted from such tax: (i) those motor vehicles to be used as either a taxicab or a bus under a franchise granted by the Governor; (ii) up to two motor vehicles used by non-profit corporations; (iii) Government vehicles subsequently sold to individuals; and (iv) vehicles belonging to individuals transferred for military duty. Highway users' taxes are collected by the BIR and are deposited daily into the TTF.

Motor Vehicle Registration Fees and Driver's License Fee. Every motor vehicle must be registered annually with the Government and an annual fee for registration must be paid. Every three years, operators of both public and private use vehicles must renew their driver's licenses and pay the required fee. The registration and license fees range in unit value but have remained constant, with minor adjustments, since 1983. Registration and licensing fees are collected throughout the Fiscal Year by the Department of Police and are deposited daily in the TTF.

Traffic Law Violation Fines. The Government collects fines for traffic law violations. Traffic law violation fines are collected throughout the Fiscal Year by the Territorial Court and are deposited daily to the TTF.

The following table sets forth total TTF revenues for Fiscal Years 1999 through 2004:

**Transportation Trust Fund Revenues
Fiscal Years 1999-2004
Cash Basis
(\$000's)**

<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
12,746	\$12,737	\$13,258	\$13,609	\$14,744	\$15,414

Source: United States Virgin Islands Department of Finance unaudited revenue reports.

Matching Fund Revenues

For a discussion of Matching Fund Revenues see "MATCHING FUND REVENUES" in this Official Statement.

Hotel Occupancy Taxes

Pursuant to Title 33 of the Virgin Islands Code, Section 54, hotel guests in the Virgin Islands are required to pay a hotel tax of 8% of the gross room rate or rental. The hotelkeeper or innkeeper is responsible for collecting, reporting and remitting such revenues to the Government. All hotel room tax

revenues are deposited into the Tourism Advertising Revolving Fund. The following table represents hotel occupancy tax collections for Fiscal Years 1999 through 2004.

Hotel Occupancy Tax Revenues
Fiscal Years 1999 - 2004
Cash Basis
(\$000's)

<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
\$11,199	\$12,600	\$13,648	\$12,196	\$13,708	\$14,397

Source: United States Virgin Islands Department of Finance unaudited revenue reports.

The 10.6% decrease in hotel occupancy tax revenues from Fiscal Year 2001 to 2002 is directly attributable to the reduction in travel caused by the general economic decline in the United States and the Events of September 11, 2001.

Expenditures of the Government

A significant portion of the Government's expenditures consist of appropriations for the administration and operation of the Government's institutions and facilities (such as educational facilities, the Legislature, the Territorial Court and correctional facilities) and for the operation of the Government's departments and agencies (such as the Department of Tourism, 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, The Governor Juan F. Luis Hospital and Medical Center and the Roy L. Schneider Hospital, interfund transfers for special projects and operating and capital funding for other semi-autonomous authorities.

Financial Position of the Government

The following discussion of the financial position of the Government is based on financial information included in the audited financial statements for Fiscal Years 1999 through 2002 and unaudited financial reports prepared by the Department of Finance (prepared not using generally accepted accounting principles ("non-GAAP")) for Fiscal Years 2003 and 2004. The audited financial statements for Fiscal Year 2003 are expected to be available in the second quarter of 2005. The Government expects that, upon completion of the audit of Fiscal Years 2003 and 2004, adjustments to the unaudited financial statements presented herein will be necessary (including, without limitation, as a result of the conversion required by GASB 34 hereinafter described). The Government can make no assurance that such adjustments will not be material. See "GOVERNMENT OF THE VIRGIN ISLANDS - Financial Management, Budgeting and Controls - Financial Reporting." The financial statements of the Government for the Fiscal Years ended September 30, 1999, 2000, 2001 and 2002 have been audited by KPMG to the extent and for the years indicated in their reports thereon. Such reports refer to reports of other auditors, contain disclaimers over the balances and transactions of the enterprise fund caused by certain limitations in their audit scope and contain various qualifications. The 2002 report also contains an emphasis paragraph for the implementation of a new reporting model. In addition, OMB Circular A-

133 for Fiscal Years 2001 and 2002 prepared by KPMG noted material weaknesses in internal controls over the financial reports based on audits of the financial statements performed in accordance with Government Accounting Standards and events of non-compliance with certain provisions of laws, regulations, contracts and grants that have a direct and material effect on the determination of general purpose financial statement amounts.

General

Since Fiscal Year 1989, the Government has experienced substantial fluctuations in revenues and expenditures, resulting in deficits, from time to time, in year-end fund balances. For Fiscal Year 1999, total revenues in the General Fund and the Public Finance Authority Debt Service Fund* (the "Debt Service Fund") were approximately \$442.9 million and the combined deficit in the General Fund and the Debt Service Fund for that year was approximately \$54.2 million; as of the end of the year the combined accumulated deficit in the General Fund and Debt Service Fund was approximately \$239.7 million. For Fiscal Year 2000, total revenues in the General Fund and the Debt Service Fund were approximately \$525.8 million and the combined surplus in the General Fund and the Debt Service Fund for the year was approximately \$316.9 million primarily as a result of the issuance of the Series 1999 A Gross Receipts Taxes Bonds; as of the end of the year, after adjusting for the combined accumulated deficit from prior years, the combined surplus in the General Fund and the Debt Service Fund was approximately \$77.2 million. For Fiscal Year 2001, total revenues in the General Fund and the Debt Service Fund were approximately \$606.4 million and the combined surplus in the General Fund and the Debt Service Fund for the year was approximately \$104.7 million; as of the end of the year, after adjusting for the combined accumulated deficit from prior years, the combined surplus in the General Fund and the Debt Service Fund was approximately \$181.9 million. The General Fund and the Debt Service Fund are generally the unrestricted funds of the Government (subject to debt service payment requirements).

Revenues for Fiscal Year 2001 were higher than projected as a result of a strong national economy, increased tourism and resultant sales taxes on hotel occupancy, restaurant meals and other purchases. As a result, the Government paid certain long standing retroactive salary increases that the Government had owed to its employees for several years and implemented salary increases for certain employees.

The increase of \$49.5 million (719%) of combined revenues from interest and other revenues in the General Fund and the Debt Service Fund from Fiscal Year 1999 to Fiscal Year 2001 was primarily due to an increase in Matching Fund Revenues. The increases in combined deferred revenue liabilities of \$25.4 million (51.2%) in the General Fund and the Debt Service Fund from Fiscal Year 1999 to Fiscal Year 2000 and \$17.8 million (23.7%) from Fiscal Year 2000 to Fiscal Year 2001 was also related to the increase in Matching Fund Revenues and the treatment of such revenues as unearned income for financial statement purposes.

The Government's financial reporting for Fiscal Year 2002 uses a substantially revised format as compared to previous years and, as a result, the financial reports from prior years are not directly comparable, thus the financial information for Fiscal Year 2002 is presented below in separate tables. The new reporting reflects the implementation as of October 1, 2001, of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statement - and Management's Discussion and Analysis - for State and Local Governments*, and GASB Statement No. 35, *Basic Financial Statements - Management's Discussion and Analysis - for Public Colleges and Universities*, as amended for GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis -*

* Debt Service Fund of the Public Finance Authority does not secure Bonds issued by the University of the Virgin Islands.

for State and Local Governments: Omnibus, GASB Statement 38, Certain Financial Statement Note Disclosures, and Interpretation No. 6, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements.

For Fiscal Year 2002, total revenues in the General Fund and the Debt Service Fund were approximately \$559.0 million and the combined deficit in the General Fund and Debt Service Fund was \$79.8 million; as of the end of the year, after adjusting for the combined accumulated deficit from prior years, the combined surplus in the General Fund and Debt Service Fund was approximately \$110.4 million.

Based upon audited Fiscal Year 2002 results, gross revenues in Fiscal Year 2002 were \$854.1 million and total expenditures were \$891.3 million, resulting in a \$37.2 million deficit for the year and an accumulated deficit of \$431.6 million. The general economic decline in the United States and the impact of the Events of September 11, 2001 on travel and tourism, coupled with a change in law exempting more businesses from excise taxes, resulted in a reduction in revenues in Fiscal Year 2002. Based upon audited Fiscal Year 2002 results, total revenues decreased by approximately 8% from Fiscal Year 2001.

The following tables set forth the balance sheets, and revenues, expenditures and changes in fund balance for Fiscal Years 1999 through 2001 based on the Audited General Purpose Financial Statements for those years for the General Fund and the Debt Service Fund, the Balance Sheet - Governmental Funds and Statements of Revenue, Expenditures and Changes in Fund Balances - Governmental Funds for Fiscal Year 2002, and revenues and expenditures for Fiscal Year 2003 based on unaudited data provided by the Government for the general fund (budgetary basis). Revenues for Fiscal Year 2003 have been posted on a cash receipt basis and payables for such years, with respect to a portion of expenditures, have been based upon invoice receipt; consequently the information presented for Fiscal Year 2003 is on a non-GAAP basis.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS
GENERAL FUND AND DEBT SERVICE BALANCE SHEET
AS OF SEPTEMBER 30 FOR FISCAL YEARS 1999, 2000 AND 2001
(\$000's)

	<u>1999</u>			<u>2000</u>			<u>2001</u>		
	General	Debt Service	TOTAL	General	Debt Service	TOTAL	General	Debt Service	TOTAL
Assets and other debits									
Cash and cash equivalents	--	\$6,669	\$6,669	\$20,291	\$21,945	\$42,236	\$99,066	\$23,151	\$122,217
Investments	\$11,242	82,616	93,858	102,052	123,784	225,836	69,903	120,845	190,748
Receivables, net									
Taxes	45,543	--	45,543	45,528	4,174	49,702	58,400	5,425	63,825
Accrued interest	21	--	21	154	--	154	469	895	1,364
Other	310	--	310	343	--	343	345	--	345
Due from									
Other funds	6,274	--	6,274	8,870	--	8,870	12,987	--	12,897
Component units	4,337	--	4,337	3,727	--	3,727	2,498	--	2,498
Restricted assets									
Cash and cash equivalents	35,820	--	35,820	--	--	--	--	--	--
Investments	11,232	--	11,232	--	--	--	--	--	--
Other debits:									
Amount available for debt service	--	--	--	--	--	--	--	--	--
Amount to be provided for retirement of general long-term obligations	--	--	--	--	--	--	--	--	--
Total assets and other debits	<u>\$114,779</u>	<u>\$89,285</u>	<u>\$204,064</u>	<u>\$180,965</u>	<u>\$149,903</u>	<u>\$330,868</u>	<u>\$243,668</u>	<u>\$150,316</u>	<u>\$393,984</u>
Liabilities									
Accounts payable and accrued liabilities	\$127,926	--	\$127,926	\$50,529	--	\$50,529	\$34,882	--	\$34,882
Tax refunds payable	136,858	--	136,858	68,017	--	68,017	54,016	--	54,016
Due to									
Other funds	72,977	--	72,977	38,535	--	38,535	10,873	--	10,873
Component units	5,923	--	5,923	6,889	--	6,889	4,778	--	4,778
Interest payable	--	\$ 812	812	--	--	--	--	--	--
Deferred revenue	9,607	40,059	49,666	35,060	\$40,055	75,115	52,867	\$40,054	92,921
Tax and revenue anticipation notes	35,000	--	35,000	--	--	--	--	--	--
Notes payable	--	--	--	--	--	--	--	--	--
Bonds payable	--	--	--	--	--	--	--	--	--
Interfund loan payable	14,600	--	14,600	14,600	--	14,600	14,600	--	14,600
Other long-term liabilities	--	--	--	--	--	--	--	--	--
Total liabilities	<u>\$402,891</u>	<u>\$40,871</u>	<u>\$443,762</u>	<u>\$213,630</u>	<u>\$40,055</u>	<u>\$253,685</u>	<u>\$172,016</u>	<u>\$40,054</u>	<u>\$212,070</u>
Fund Equity and Other Credits									
Fund balances (deficits)									
Encumbrances	\$52,783	--	\$52,783	\$45,529	--	\$45,529	\$60,202	--	\$60,202
Debt Service	--	\$48,414	48,414	--	\$109,848	109,848	--	\$110,262	110,262
Other specified purposes	4,337	--	4,337	3,727	--	3,727	--	--	--
Unreserved									
Undesignated (accumulated deficit)	<u>(345,232)</u>	--	<u>(345,232)</u>	<u>(81,921)</u>	--	<u>(81,921)</u>	<u>11,450</u>	--	<u>11,450</u>
Total fund equity (deficit) and other credits	<u>(\$288,112)</u>	<u>48,414</u>	<u>(\$239,698)</u>	<u>(32,665)</u>	<u>\$109,848</u>	<u>\$77,183</u>	<u>\$71,652</u>	<u>\$110,262</u>	<u>\$181,914</u>
Total liabilities, fund equity (deficits) and other credits	\$114,779	\$89,285	\$204,064	\$180,965	\$149,903	\$330,868	\$243,668	\$150,316	\$393,984

**GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS
REVENUES AND EXPENDITURES
AS OF SEPTEMBER 30 FOR FISCAL YEARS 1999, 2000 AND 2001
(\$000's)**

	1999			2000			2001		
	General	Debt Service	TOTAL	General	Debt Service	TOTAL	General	Debt Service	TOTAL
Revenues:									
Taxes	\$388,738	\$41,370	\$430,108	\$334,869	\$141,346	\$476,215	\$391,612	\$151,301	\$542,913
Federal grants	--	--	--	--	--	--	--	--	--
Charges for services	5,897	--	5,897	5,287	--	5,287	7,083	--	7,083
Interest and other	<u>5,261</u>	<u>1,627</u>	<u>6,888</u>	<u>38,889</u>	<u>5,372</u>	<u>44,261</u>	<u>49,401</u>	<u>6,997</u>	<u>56,398</u>
Total revenues	<u>\$399,896</u>	<u>\$42,997</u>	<u>\$442,893</u>	<u>\$379,045</u>	<u>\$146,718</u>	<u>\$525,763</u>	<u>\$448,096</u>	<u>\$158,298</u>	<u>\$606,394</u>
Expenditures:									
General government	\$136,812	--	\$136,812	\$128,643	--	\$128,643	\$133,352	--	\$133,352
Public safety	46,457	--	46,457	38,260	--	38,260	38,280	--	38,280
Health	56,189	--	56,189	30,979	--	30,979	22,730	--	22,730
Public housing and welfare	32,604	--	32,604	30,190	--	30,190	27,085	--	27,085
Education	126,412	--	126,412	104,520	--	104,520	123,877	--	123,877
Economic and agricultural development	14,850	--	14,850	20,332	--	20,332	13,484	--	13,484
Transportation and communication	22,650	--	22,650	24,779	--	24,779	26,781	--	26,781
Culture and recreation	10,284	--	10,284	9,435	--	9,435	9,639	--	9,639
Capital outlays	3,864	--	3,864	--	--	--	--	--	--
Debt Service:									
Principal	--	\$12,060	12,060	--	\$12,745	12,745	--	\$28,427	28,427
Interest	--	<u>29,913</u>	<u>29,913</u>	--	<u>38,851</u>	<u>38,851</u>	--	<u>50,095</u>	<u>50,095</u>
Total expenditures	<u>\$450,122</u>	<u>\$41,973</u>	<u>\$492,095</u>	<u>\$387,138</u>	<u>\$51,596</u>	<u>\$438,734</u>	<u>\$395,228</u>	<u>\$78,522</u>	<u>\$473,750</u>
Excess (deficiency) of revenue over (under) expenditures	<u>(\$50,226)</u>	<u>\$1,024</u>	<u>(\$49,202)</u>	<u>(\$8,093)</u>	<u>\$95,122</u>	<u>\$87,029</u>	<u>\$52,868</u>	<u>\$79,776</u>	<u>\$132,644</u>
Other financing sources(uses):									
Proceeds from long-term debt issues	\$26,000	\$3,163	\$29,163	\$269,000	\$23,326	\$292,326	--	--	--
Operating transfers from other funds	16,984	6,704	23,688	73,822	201	74,023	\$120,604	--	120,604
Operating transfers from component units	500	--	500	--	--	--	--	--	--
Operating transfers to other funds	(9,105)	(4,688)	(13,793)	(32,236)	(57,215)	(89,451)	(4,925)	\$(79,362)	\$(84,287)
Operating transfers to component unit	<u>(44,581)</u>	--	<u>(44,581)</u>	<u>(47,046)</u>	--	<u>(47,046)</u>	<u>(64,230)</u>	--	<u>(64,230)</u>
Total other financing sources (uses), net	<u>(\$10,202)</u>	<u>\$5,179</u>	<u>(\$5,023)</u>	<u>\$263,540</u>	<u>(\$33,688)</u>	<u>\$229,852</u>	<u>\$51,449</u>	<u>(\$79,362)</u>	<u>(\$27,913)</u>
Excess (deficiency) of revenue and other financing sources over (under) expenditures and other financing uses	<u>(\$60,428)</u>	<u>\$6,203</u>	<u>(\$54,225)</u>	<u>\$255,447</u>	<u>\$61,434</u>	<u>\$316,881</u>	<u>\$104,317</u>	<u>\$414</u>	<u>\$104,731</u>
Fund balances (deficits)									
Beginning of fiscal year	<u>(\$227,684)</u>	<u>\$42,211</u>	<u>(\$185,473)</u>	<u>(\$288,112)</u>	<u>\$48,414</u>	<u>(\$239,698)</u>	<u>(\$32,665)</u>	<u>\$109,848</u>	<u>\$77,183</u>
End of fiscal year	<u>(\$288,112)</u>	<u>\$48,414</u>	<u>(\$239,698)</u>	<u>(\$32,665)</u>	<u>\$109,848</u>	<u>\$77,183</u>	<u>\$71,652</u>	<u>\$110,262</u>	<u>\$181,914</u>

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS
BALANCE SHEET – GOVERNMENTAL FUNDS
AS OF SEPTEMBER 30 FOR FISCAL YEAR 2002
(\$000's)

	General	PFA Debt Service	Other Governmental Funds	Total Governmental Funds
Assets				
Cash and cash equivalents	\$56,619	--	\$ 40,250	\$ 96,869
Investments	73,376	\$121,611	32,706	227,693
Receivables (net of allowance for uncollectible):				
Taxes	127,471	--	5,013	132,484
Federal Government	--	--	24,929	24,929
Accrued interest and other	741	--	637	1,378
Due from:				
Other funds	8,346	--	9,861	18,207
Component units	15,365	--	--	15,365
Food stamp coupons	--	--	4,740	4,740
Restricted cash	--	--	32,695	32,695
Other assets	--	--	1,121	1,121
	\$281,918	\$121,611	\$151,952	\$555,481
Liabilities and Fund Balances				
Accounts payable and accrued liabilities	38,321	--	17,401	55,722
Tax refund payable	53,134	--	--	53,134
Due to:				
Other funds	10,173	--	3,178	13,351
Component units	4,382	--	--	4,382
Deferred revenue	147,021	40,049	16,529	203,599
Other current liabilities	--	--	1,370	1,370
	\$253,031	40,049	38,478	331,558
Fund balances reserved for:				
Encumbrances	53,419	--	--	53,419
Debt Service	--	81,562	15,926	97,488
Unreserved fund balance (deficit), reported in:				
General fund	(24,532)	--	--	(24,532)
Special revenue funds	--	--	58,568	58,568
Capital projects funds	--	--	38,980	38,980
	28,887	81,562	113,474	223,923
	\$281,918	\$121,611	\$151,952	\$555,481

Amounts reported for governmental activities in the statement of net assets (deficit) are different because:	
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	\$592,969
Debt issued by the Government has associated costs that are paid from current available resources in the funds. However, these costs are deferred on the statement of net assets.	1,975
Deferred revenue in governmental funds is recognized as revenue in governmental activities.	113,896
Other long-term liabilities not available to pay for current-period expenditures and therefore, are not reported in the funds	(55,425)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not report in the funds.	(1,386,136)
Deficit of governmental activities	\$ (508,798)

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS
STATEMENT OF REVENUE, EXPENDITURES, AND CHANGES IN FUND BALANCES
AS OF SEPTEMBER 30 FOR FISCAL YEAR 2002
(\$000's)

	General	PFA Debt Service	Other Governmental Funds	Total Governmental Funds
Revenues:				
Taxes	\$387,893	\$137,076	\$ 30,485	\$555,454
Federal grants and contributions	--	--	151,322	151,322
Charges for services	4,923	--	6,546	11,469
Tobacco Settlement Rights	--	--	1,263	1,263
Interest and other	24,865	4,258	11,226	40,349
Total revenues	<u>417,681</u>	<u>141,334</u>	<u>200,842</u>	<u>759,857</u>
Expenditures:				
Current:				
General government	\$266,409	--	73,255	339,664
Public safety	37,718	--	6,180	43,898
Health	67,150	--	28,470	95,620
Public housing and welfare	30,178	--	31,948	62,126
Education	136,784	--	26,374	163,158
Transportation and communication	37,090	--	1,218	38,308
Culture and recreation	6,759	--	2,365	9,124
Capital outlays	--	--	38,710	38,710
Debt Service:				
Principal	--	15,935	7,827	23,762
Interest	--	46,369	1,683	48,052
Bond issuance Costs	--	--	3,311	3,311
Total expenditures	<u>\$582,088</u>	<u>62,304</u>	<u>221,341</u>	<u>865,733</u>
Excess (deficiency) of revenue over (under) expenditures	<u>(164,407)</u>	<u>79,030</u>	<u>(20,499)</u>	<u>(105,876)</u>
Other financing sources(uses):				
Bonds issued	--	--	23,685	23,685
Transfers from other funds	99,326	--	21,287	120,613
Transfers to other funds	(10,360)	(83,339)	(28,208)	(121,907)
Discount on bonds issued	--	--	(124)	(124)
Total other financing sources (uses), net	<u>\$88,966</u>	<u>(83,339)</u>	<u>16,640</u>	<u>22,267</u>
Deficiency of revenue and other financing sources under expenditures and other financing uses	<u>(75,441)</u>	<u>(4,309)</u>	<u>(3,859)</u>	<u>(83,609)</u>
Fund balance, beginning of year (as restated)	<u>104,328</u>	<u>85,871</u>	<u>117,333</u>	<u>307,532</u>
Fund balance, end of year	<u>\$ 28,887</u>	<u>\$81,562</u>	<u>\$113,474</u>	<u>\$223,923</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS
REVENUES AND EXPENDITURES
PRELIMINARY FISCAL YEARS 2003 AND 2004 RESULTS
(\$000's)

	<u>2003</u>	<u>2004</u>
Revenues		
Taxes	\$499,241	\$607,356
Licenses, Fees and Permits	5,847	5,918
Customs Dues	2,015	—
Fines, Forfeitures and Penalties	1,863	2,418
Miscellaneous/Other Revenues	3,218	4,424
Contributions		
Recurring Contributions	23,618	26,774
Internal Revenue Matching Fund	28,195	31,590
Financing Proceeds	81,500	28,625
Other	<u>7,508</u>	<u>---</u>
Total Revenues	<u>\$653,005</u>	<u>\$707,105</u>
Expenditure		
General Government	\$316,336	\$326,971
Public Safety	41,746	40,488
Health and Welfare	103,351	100,770
Education	147,868	148,064
Sanitation	13,703	12,313
Transportation	10,681	11,463
Culture and Recreation	5,256	5,381
Debt Service	<u>26,794</u>	<u>37,284</u>
Total Expenditures	<u>\$665,735</u>	<u>\$682,734</u>

Fiscal Year 2003 Results

Based upon preliminary Fiscal Year 2003 results, total revenues in Fiscal Year 2003 were approximately \$653 million and total expenditures were approximately \$665.7 million, resulting in a projected \$12.7 million deficit for the year, primarily as a result of proceeds from the issuance of a series of Bond anticipation notes (the "Series 2003 BANS"). This amount does not include cash and cash equivalent balances in Special Revenue Funds or Capital Project Funds. With legislative authorization, Special Revenue Funds are available for general fund purposes. In prior Fiscal Years, the Government has financed a portion of the general fund (budgetary basis) operating deficit by interfund transfers, certain of which had not been authorized by legislative approval, and interim borrowings for working capital needs. See "--Department of the Interior 1998 Audit Report" below.

Based upon preliminary Fiscal Year 2003 results, total revenues decreased by approximately 25% from Fiscal Year 2002. Revenues in Fiscal Year 2003 were negatively impacted by litigation initiated by certain commercial property owners which resulted in a decision by the Government to delay the issuance of commercial property tax bills and to exclude a due date on residential property tax bills that were issued. See "LITIGATION - Real Property Tax Case." In addition, federally mandated tax credits, which are mirrored in the Virgin Islands income tax returns, have resulted in a decrease in revenues, while the increased costs of health care benefits and additional retirement benefits for new employees have resulted in increased expenditures. In order to meet its immediate cash flow needs during Fiscal Year 2003, the

Government issued the Series 2003 BANs to certain local banks to fund certain vendor payments and to pay income tax refunds due. The Series 2003 BANs were refunded with the proceeds of the Series 2003A Gross Receipts Taxes Bonds, issued in December 2003. The Government also has recently instituted expenditure initiatives, including a reduction in health insurance costs for Government employees as a result of a new 65/35 cost-sharing policy.

It is expected that the audited financial statements for Fiscal Year 2003 will be available during the second quarter of 2005. The Government expects that, upon completion of the audit of Fiscal Year 2003, adjustments to the unaudited financial statements will be necessary (including, without limitation, as a result of the adoption of GASB 34 hereinafter described). The Government can make no assurance that such adjustments will not be material.

Preliminary Fiscal Year 2004 Results

Based on preliminary fiscal year 2004 results, total revenues in 2004 were \$707.1 million and total expenditures were \$682.7 million, resulting in a projected surplus of \$24.4 million for the year. In 2004 total revenues increased by 54.1 million or 8.3% (excluding financing proceeds, revenues increased by \$107 million or 18.7%). Total taxes increased by \$108.1 million or 21.7 percent. This increase, despite a lowering of overall income taxes rates which mirror those of the federal tax code, was attributable to the improvement in tourism, increases in the tax base as a result of the economic development program incentives, increased tax compliance, and certain tax changes implemented in 2004. Increase in property tax collections were primarily the result of late billing for property taxes in fiscal year 2003. The increase in expenditures was mainly attributable to higher tax refund payments higher costs for insurance and increases in utility rates.

Fiscal Year 2004 Budget

In May 2003, the Governor submitted to the Legislature a proposed balanced budget for Fiscal Year 2004 with total revenues and expenditures of general funds (budgetary basis) net of operating transfers equal to approximately \$565.5 million. In conjunction with his submission, the Governor proposed \$25.4 million in expenditure reduction initiatives including elimination of 40% of vacant positions. Additionally, the Governor proposed \$20.6 million in revenue enhancement initiatives. See "GOVERNMENT OF THE VIRGIN ISLANDS – Financial Position of the Government – Fiscal Recovery Efforts – Expenditure Reduction Initiatives."

On December 23, 2003, the Governor vetoed the Fiscal Year 2004 budget approved by the Legislature because the level of appropriations contained in that budget could not be sustained primarily because of its reliance on \$68 million in one-time, non-recurring sources of revenue. As a result of the Governor's veto of the budget in its entirety, the approved budget for Fiscal Year 2003 was considered re-appropriated pursuant to the provisions of Section 9(e) of the Revised Organic Act of 1954 as amended. On April 29, 2004, the Governor submitted his Fiscal Year 2004 supplemental budget request to the Legislature for its consideration. On May 7, 2004, the Legislature approved an amended version of the Governor's Fiscal Year 2004 supplemental budget and transmitted it on May 26, 2004, to the Governor for his consideration. On June 7, 2004, the Governor exercised his authority to veto certain line items in the Legislature's proposed Fiscal Year 2004 supplemental budget, including a \$9 million appropriation for union salary increases. On July 13, 2004, the Legislature exercised its authority to override the Governor's veto with respect to the \$9 million appropriation, among other items, thereby enacting it into law.

Fiscal Year 2005 Budget

The Governor submitted the proposed 2005 Fiscal Year budget to the Legislature on May 28, 2004 in the amount of \$565 million, which was \$25 million less than the amount appropriated for Fiscal Year 2004. On October 27, 2004, the Legislature approved a budget of \$9.3 million in excess of the executive budget to cover salary increases for unionized employees. Said budget was presented to the Governor on November 5, 2004. This budget is presently awaiting the Governor's signature. Should the Governor not sign it within 10 working days from the date of receipt, it would automatically become law.

Title 2, V.I.C. §26(c)(3) gives the Director of Office and Management and Budget the authority to modify or withhold planned expenditures at any time during the appropriation period if the Director finds that the tax revenues receipts, and surpluses will be insufficient to meet the authorized appropriations for the fiscal year's budget.

Accumulated and Recurring Operating Deficits

The causes of the structural imbalance experienced by the Government are multi-dimensional and include a large public sector payroll, the nature of a three-island economy and a narrow private sector base. This condition has been severely exacerbated by the damages caused by three major hurricanes within a 15-year period. Specifically, Hurricane Hugo in 1989 and Hurricane Marilyn in 1995 collectively caused damages of approximately \$3.0 billion. The Virgin Islands derives approximately 90% of its revenues from taxes. Federal tax cuts and federally mandated tax credits that are mirrored in the Virgin Islands tax code, as well as a court-mandated moratorium on property assessments and a national economic downturn have contributed to the stagnation in total net tax receipts since Fiscal Year 2001. Approximately \$90.2 million in extraordinary inflow items received in Fiscal Years 2001 through 2003, such as working capital loan proceeds, diminished the impact of declines in certain recurring revenues. On the expenditure side, payroll equals approximately 59% of General Fund (budgetary basis) outlays, partially as a result of the unique demands on the Government created by the three-island public service sector.

Financial Accountability Act

The Financial Accountability Act, enacted in 1999, mandates the enactment of a balanced budget with "Verifiable Receipts" each succeeding Fiscal Year. The purpose of the Financial Accountability Act is to require by law, that (i) the budget of the Virgin Islands be balanced each year, (ii) the appropriations in each Fiscal Year not exceed verifiable revenues received, (iii) the annual deficits be eliminated to prevent accumulation of debt, and (iv) the Government be current in the payment of its obligations to employees and vendors. To facilitate the effectiveness of the balanced budget requirement, the Financial Accountability Act requires that prior to each Fiscal Year (other than Fiscal Year 2001), and before enactment of the Government's budget, the Legislature shall adopt a statement of the prior two years' "Revenues" or "Verifiable Receipts" attested to by an independent certified public accountant and certified by the Governor. The Financial Accountability Act further provides that appropriations shall not exceed the certified coverage except to the extent waivers of such requirements are obtained. Waivers of such requirements of the Financial Accountability Act can only be granted by a two-thirds vote of the Legislature after the Legislature finds that an emergency exists, natural or otherwise. In addition, the Financial Accountability Act established an employee attrition plan, required the submission of a governmental reorganization plan, and established certain reporting requirements for the Government's financial officers, including the development of a comprehensive report demonstrating the Government's plans with respect to liquidating certain unauthorized interfund transfers. See "- Department of the Interior 1998 Audit Report."

Department of the Interior 1998 Audit Report

In September 1998, the OIG of the DOI delivered its final audit reports with respect to “Interfund Loans and Federal Grant Balances, Government of the Virgin Islands” (the “DOI Report”). The purpose of the review was to determine the amounts borrowed for the General Fund from Special Fund accounts during Fiscal Years 1995, 1996 and 1997 and the outstanding balances of such interfund loans and unobligated balances of federal grant accounts. The report found that: (i) as of September 30, 1997, the Government had outstanding operations related obligations (excluding bonded debt) of \$588,000,000 which included \$120,000,000 for unauthorized and unrecorded interfund loans, (ii) complete current and reliable information on the balances of federal grants awarded the Government was not available, and (iii) while the Government had made improvements in its operations, the Government continued to have problems in the areas of overall financial management expenditure control, revenue collection and program operations which had an adverse impact on its financial condition. The report made certain recommendations to assist the Government in achieving long-term improvements in its daily operations and overall financial condition. As of the date of issuance of the DOI Report, the OIG determined that the Government had resolved certain of its recommendations and was attempting to comply with the balance of such recommendations. In particular, shortly after the issuance of the DOI Report, the Government established separate accounts so as to prevent the commingling of federal and local monies.

While the Government acknowledges that certain interfund loans were made, the Government has disputed the amount of unauthorized transfers cited in the DOI Report. The Government determined that a portion of the interfund loans were the result of insufficient General Fund resources to pay gross payroll when due. In order to meet these obligations, the Government funded certain payroll taxes and benefits from certain Special Funds. As of September 2003, the Government estimated it owed approximately \$26.4 million to Special Funds. The Government has instituted policies and procedures to restrict net funding of payroll and associated interfund loans. The Government has proceeded to take actions to address each item noted in the DOI Report. The Government has substantially decreased its payroll obligations and curbed overspending by its departments. As acknowledged by the OIG, the Government is actively working to reimburse the affected Special Funds for such deficiencies and to implement procedures to ensure no unauthorized interfund transfers occur in the future.

Federally-Disciplined Programs

Department of Education “High Risk” Grantee Designation. In 1999, the United States Department of Education (“DOE”) designated certain Government departments receiving federal grants, including the Virgin Islands Department of Health and the Virgin Islands Department of Education, to be “high risk” grantees. As a result of high-risk designation, the DOE may impose certain special conditions or restrictions on its grants, including payment of a grant on a reimbursement basis. The DOE cited the cause of the “high risk” designation to be primarily the failure of the Government (as of that time) to conduct timely single audits since Fiscal Year 1994 in contravention of the Single Audit Act and findings by the OIG in the DOI Report regarding improper administration of funds received by the Government’s agencies.

The Virgin Islands entered into a three-year compliance agreement in September 2003 with the DOE whereby the DOE will continuously monitor the Virgin Islands’ compliance with the DOE’s requirements and, if the Virgin Islands is compliant, will continue to provide grants until the expiration of this compliance agreement. To monitor and ensure compliance, the Governor created a committee comprised of the heads of the various entities identified in the compliance agreement including the Office of Management and Budget, Department of Property and Procurement, Department of Finance, Department of Justice and Department of Education. Upon expiration, the DOE can decide to certify compliance and continue to provide grants on an ongoing basis or, if non-compliant, terminate such

grants or select an independent third party overseer of grant administration. The DOE has confirmed its intention to continue to provide federal education assistance through existing grants, however, the DOE has imposed additional reporting requirements such as detailing grant expenditures, and updating progress toward completion of outstanding single audit compliance efforts. The failure to comply with the conditions set forth by the DOE may result in the DOE taking appropriate enforcement action at any time, including imposition of additional special conditions.

Additional Expenditures. As a result of a consent order issued by the Virgin Islands District Court, the Government is required to expend approximately \$2.0 million to ameliorate the deteriorating conditions of the prisons on the Virgin Islands. Renovation of the prisons commenced in December 2003, and is expected to be completed by mid 2005.

Since 1985, the Government has been subject to a consent decree issued by the Virgin Islands District Court, governing the operation of its wastewater treatment plants (“WWTPs”). The consent decree was amended in 1996 and further modified in 2002 (the “2002 Stipulation to the Amended Consent Decree”) to establish deadlines for the construction of new secondary treatment facilities, including the replacement of the existing St. Croix and Airport Lagoon (“Charlotte Amalie”) WWTPs. Such projects are being financed with the proceeds of the Series 2004A Bonds. The 2002 Stipulation to the Amended Consent Decree requires that the new St. Croix WWTP be completed by the end of 2005 and the new Charlotte Amalie WWTP be completed by the end of 2006. The cost of both facilities is estimated at approximately \$50.0 million. The 2002 Stipulation to the Amended Consent Decree also establishes certain interim deadlines and performance standards that must be met by the Government pending completion of the new facilities. In addition, the 2002 Stipulation to the Amended Consent Decree establishes stipulated penalties for violation of any of the deadlines or performance standards set forth in the 2002 Stipulation to the Amended Consent Decree. The stipulated penalties for each day of violation of each interim deadline or performance standard range from \$500 per day to \$5,000 per day. As of the date of this Official Statement, the Government is current on all of its outstanding obligations pursuant to the 2002 Stipulation to the Amended Consent Decree.

Other DOI Office of Inspector General Reports

Pursuant to its statutory duties (see “GOVERNMENT OF THE VIRGIN ISLANDS - General”), the OIG of the DOI has issued numerous audit reports over the past several years, which have included claims of, among other things, ineffective revenue collection efforts, noncompetitive bidding and ineffective administration of contracts, and lack of oversight for use of federal funds. The Government has agreed with some of the findings of the audits and has disputed other findings. Government implementation of the various recommendations of the OIG included within these reports are in various stages of implementation.

In March 2002, the OIG delivered a report regarding “Management Challenges for Insular Area Governments, An Opportunity for Improvements.” This report was intended to identify what the OIG believed to be the major management challenges for the insular area governments, including the Government. This report noted that the Government continues to face severe financial difficulties. Audits of the Government conducted by the OIG since Fiscal Year 1999 have disclosed weaknesses in the financial and operational activities of various Virgin Islands services, departments and agencies. This report also stated that the Government's lack of adequate audit resolution and implementation of recommendations contributed to the existence of long-standing financial management deficiencies. As a result, the OIG stated that its audit reports often disclose problems that are identical or at least similar to ones that had been disclosed by prior audit reports. The Government has taken steps to improve its financial management systems.

In July 2003, the Office of Management and Budget (OMB) initiated corrective actions to respond to outstanding U.S. Office of Inspector General's (OIG's) audit recommendations dating back to 1991. As of October 15, 2004, OMB has received closure from OIG on 193 of the approximate 230 outstanding recommendations. OMB is presently pursuing the completion of the remaining 37 outstanding recommendations. See “- Fiscal Recovery Efforts - Financial Reporting and Financial Management System Improvements” below.

Fiscal Recovery Efforts

Expenditure Reduction Initiatives

Central to the Government's fiscal recovery plan is reduced Government spending. On June 1, 1999, the Governor issued Memorandum No. 021-99, directing a 50% reduction in overtime, implementing a strict hiring freeze on positions (other than federally funded positions) and stipulating a 5% reduction in personnel expenditures. This directive required that positions funded by federal grants be contingent upon the respective grant funding and that the position be terminated and not converted to a full-time Government position when the grant funds are fully expended. In addition, certain expenditure reduction recommendations included in the April 2000 Five-Year Operating and Strategic Financial Plan developed by a task force established by the Governor were also implemented. Some of the initiatives undertaken that have resulted in cost savings for the Government include: the implementation of a Governmental reorganization plan that consolidated several departments and agencies; the consolidation and renegotiation of Government leases; the enactment of an early retirement program and attrition program to complement the hiring freeze; the elimination of three paid holidays; and a realignment of cost sharing of health benefits between the Government (65%) and employees (35%). The Governor also recently proposed an additional 2% overall reduction in personnel and related costs as part of the Fiscal Year 2005 Budget, which is currently being considered by the Legislature.

The Government also has continued to pursue avenues to reduce its outstanding obligations. The Government has been successful in eliminating in full the \$46 million outstanding balance on its Hurricane Hugo Community Disaster Loan (“CDL”) and the \$184 million outstanding balance on its Hurricane Marilyn CDL, and has negotiated an agreement with the Federal Bureau of Prisons to eliminate a 10-year outstanding obligation to the Federal Bureau of Prisons. See “Federal Emergency Management Agency Loan Note” below. In part through working capital borrowing, the Government has been able to reduce accumulated debt obligations to taxpayers (income tax refunds), vendors, and intergovernmental agencies (e.g., the Virgin Islands Water and Power Authority). Furthermore, as a result of implementing certain previously unfunded but negotiated salary increases in Fiscal Year 2001, the Government eliminated the corresponding growth in unfunded obligations for retroactive pay increases.

The Government is contemplating the privatization of certain Government services to reduce the size of the Government while simultaneously enhancing the private sector. For example, servicing and collection of outstanding hospital receivables were outsourced to private collection agencies and the Police Department has begun privatizing vehicle towing services to reduce personnel and equipment costs.

Financial Reporting and Financial Management System Improvements

In recognition of the importance of financial reporting and the need to accurately and timely monitor its financial position, the Government has made significant strides in improving its financial monitoring and transparency. As of the beginning of Fiscal Year 1999, the Government's most recent independent audit of its financial statements was for Fiscal Year 1994. This was in contravention of the Single Audit Act and the Government was in jeopardy of losing its future federal funding. Accordingly,

completion of audited financial statements was given high priority. As of the end of Fiscal Year 2002, the Government had completed audits for five fiscal years (namely Fiscal Years 1995, 1998, 1999, 2000 and 2001). By the end of Fiscal Year 2003, agreed-upon procedures were completed by an independent auditor for Fiscal Year 1996 and Fiscal Year 1997. In April 2004, the Government also completed the audit for Fiscal Year 2002.

The Government has enhanced, and continues to enhance, the computerization of key departments (such as the BIR, Department of Finance, Department of Education, and Department of Property and Procurement) to better manage both Government receivables and payables and to avoid interest charges and penalties. The Government invested approximately \$9.0 million to automate the billing and collection system for income and real property taxes and brought a new processing system on-line. Additionally, the Government implemented a management and reorganization plan at the BIR to increase and improve the BIR's tax audits and to generally improve the timeliness and effectiveness of tax collections as well as to reduce tax refund liabilities. The new financial management systems of the BIR allow much more accurate and timely identification and categorization of delinquent tax receivables, which permits the Government to deploy its collection efforts more efficiently with maximum impact.

Private Sector Industry Initiatives

In order to decrease the dependence on public sector employment in the Virgin Islands, the Government recognizes the need to stimulate private industry to generate other employment opportunities and increased economic activity. Since 1999, the Government has significantly increased its marketing efforts and focus of its EDC Program to bring additional businesses to the Virgin Islands. The number of applicants from 1999 to 2003 more than tripled (from 22 to 78). In addition to the long-term effect on employment and revenues to the Virgin Islands that these businesses create, the impact of this new investment is also reflected immediately in the substantial increase in income tax revenues as a result of the relocation of the principals of the EDC beneficiaries to the Virgin Islands. The Government granted benefits to a wide variety of businesses, with a specific focus on financial services companies, and tourism- and medical technology-based enterprises. Legislation has been adopted that would qualify the marine industry for tax benefits by the Commission in an attempt to revitalize this industry. The Internal Revenue Service ("IRS") recently announced that it is investigating possible abuse by certain beneficiaries who may be using the EDC Program to obtain certain tax breaks for which they do not qualify. The IRS probe seems to be focused on beneficiaries of EDC benefits and not on the EDC Program. The Government is cooperating with the IRS in its probe. As described above (see "Tax Incentives Programs"), the Jobs Act tightened (1) the eligibility requirements for qualifying as a bona fide resident of the Virgin Islands, and (2) the standards for determining the type and amount of income that may qualify for the Section 934 Tax Incentives as income effectively connected with the conduct of a Virgin Islands trade or business. The Government is working with the U.S. federal government to develop fair, reasonable and administrable rules, as contemplated by the Jobs Act, in order to mitigate any adverse effects on the EDC program.

The Government also assisted various of the Virgin Islands' large private sector businesses to expand either facilities or production, creating both construction activity as well as increased employment opportunities. The Government and the Authority issued private activity bonds on behalf of HOVENSA, the Territory's largest real property taxpayer, to reimburse HOVENSA for a portion of the funding for an approximately \$615.0 million coker that was constructed beginning in 2000 and placed into service in 2002 that allows the refinery to process a wider range of petroleum sources. To further improve its production output, HOVENSA is scheduled to commence a clean fuels program which, according to its current cost estimate, is expected to require approximately \$446.0 million to complete. In April 2004, the Authority issued \$50,660,000 of industrial development bonds on behalf of HOVENSA to reimburse HOVENSA for certain costs of completing the coker and related facilities. The Government worked with

VIRIL and the federal Environmental Protection Agency to negotiate an effluent discharge agreement that permits VIRIL to increase production by up to 20% to better meet currently unsatisfied demand.

Recognizing the importance of tourism to the economy of the Virgin Islands, the Government undertook several projects to better facilitate and encourage visitor arrivals, including: improvement of the Red Hook Ferry Terminal; development of the Crown Bay Cruise Ship Terminal; improvements to the Charlotte Amalie waterfront; development of a commercial port at Enighed Pond in St. John; expansion of the St. Croix Henry E. Rohlsen Airport; redevelopment of the Kings Alley Hotel and Retail Walk in downtown Christiansted; and a new St. Croix Conference Center and Hotel. Other private sector projects recently completed or currently in progress encouraged by the Government include: the expansion and refurbishment of the Ritz-Carlton Hotel and Timeshare; and the new Yacht Haven Marina and Hotel. See “ECONOMIC AND DEMOGRAPHIC INFORMATION - Construction and Real Estate” and “ - Capital Program.”

The Government also is involved in the coordination and facilitation of two housing development projects in St. Thomas/St. John (\$77.0 million) and St. Croix (\$50.3 million). Funding for these projects is expected to come from the developers and homeowners as well as federal programs. The Governor submitted and received Senate approval to authorize the establishment of two technology parks to be operated by a newly created Research and Technology Park Corporation in conjunction with the University of the Virgin Islands. The purpose of these parks is to position the Virgin Islands in the rapidly expanding area of electronic commerce and intellectual property.

Memorandum of Understanding with the DOI

Existing Memorandum of Understanding. In October 1999, the Government and the DOI entered into a Memorandum of Understanding (the “MOU”) pursuant to which the Government agreed to use its best efforts to undertake certain deficit reduction initiatives. As a condition to certain new and additional federal financial and technical assistance included in or being proposed in federal appropriations or other legislation, certain financial performance and accountability standards were agreed upon by the Government which the DOI believes are necessary for the Government to achieve long-term economic recovery. Pursuant to the MOU, the release of such new and additional federal funds to the Government is subject to compliance with such performance and verifiable objectives agreed upon in such agreement. The accountability and financial performance standards agreed upon in the MOU include, among other things, (i) preparation of a five-year financial recovery plan to be provided to the DOI within 90 days of the date of the MOU; (ii) a Fiscal Year 2000 budget mandating substantial reductions in departmental budgets and overall General Fund Fiscal Year 2000 expenditures not to exceed \$432.1 million; (iii) absent extraordinary circumstances, to maintain balanced budgets after Fiscal Year 2003 with any generated surpluses applied to the reduction of the accumulated deficit and unfunded obligations; (iv) annual preparation of financial reports; and (v) efforts to reduce the outstanding debt of the Government. In addition to the financial performance standards set forth in the MOU, the MOU further provides for the DOI and the Government to enter into a program of preservation and enhancements of the natural, cultural and historic resources of the Virgin Islands to stimulate local economic growth through sustainable tourism.

In November 2002, the OIG of the DOI delivered its final audit report regarding compliance with the MOU by the Government and the DOI. According to this report, the Government had substantially achieved five, and partially achieved four, of the thirteen financial performance and reporting standards of the MOU that related to the Government. The report stated that in so doing the Government had improved its financial condition but that the assessment of the success of structural balance beyond Fiscal Year 2003 could not be judged until the financial statements for such year are completed. The OIG also reported that, with respect to DOI compliance issues, the DOI substantially achieved two, and partially

achieved one, of the five financial and environmental standards. The report also contains recommendations to facilitate the Government’s achievement of the other MOU requirements.

Proposed Memorandum of Understanding. The DOI and the Government are currently negotiating a memorandum of understanding regarding the fiscal and economic recovery of the Virgin Islands to supercede the existing MOU (the “Proposed MOU”). The Proposed MOU is expected to provide standards of financial performance and accountability to guide the Government in developing and implementing its fiscal and economic recovery program and in achieving a balanced budget. The Proposed MOU is expected to set forth the goals and commitments of the DOI with respect to additional federal financial and technical assistance that may be required to achieve the fiscal and economic objectives under the Proposed MOU.

Outstanding Indebtedness of the Government

General Obligation Debt

The Revised Organic Act restricts the principal amount of general obligation debt that the Government may issue to no greater than 10% of the aggregate assessed valuation of taxable real property in the Virgin Islands.

Outstanding Bonds and Similar Obligations

Outlined in the tables below are the general obligations of the Government issued either by the Government or the Authority, and the revenue obligations of the Government.

Summary of Outstanding General Obligations* (as of October 1, 2004)

<u>Issuer</u>	<u>Issue Description</u>	<u>Outstanding Amount</u>	<u>Security</u>
United States Virgin Islands	General Obligation Bonds, 1999 Series A	\$5,650,000	General obligation of the Government
Virgin Islands Public Finance Authority	Project Revenue Bonds, Series 1999 (the “Y2K Bonds”)	\$1,550,000	Periodic lease payments from the Government
Virgin Islands Public Finance Authority	Revenue Bonds, Series 1999A (Virgin Islands Gross Receipts Taxes Loan Note)	\$278,570,000	Gross Receipts Taxes Loan Note payable by the Government and general obligation of the Government
Virgin Islands Public Finance Authority	Revenue Bonds, Series 2003A (Virgin Islands Gross Receipts Taxes Loan Note)	\$268,020,000	Gross Receipts Taxes Loan Note payable by the Government and general obligation of the Government

Summary of Outstanding Revenue Obligations

Virgin Islands Public Finance Authority	Revenue and Refunding Bonds (Virgin Islands Matching Fund Loan Notes) 1998 Series A, B, C, D and E (the “1998 Bonds”)	\$459,790,000	Matching Fund Loan Notes payable by the Government
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Virgin Islands Public Finance Authority	Revenue Bonds (Federal Highway Reimbursement Anticipation Loan Note), Series 2002 (the "2002 Bonds")	\$15,840,000	Federal Highway Administration, monies derived from the United States federal government
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Federal Emergency Management Agency Loan Note

In the aftermath of the Hurricane Hugo and Hurricane Marilyn disasters, the Government qualified for certain direct loan programs authorized by the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. §§ 5121-5206 (the "Stafford Act").

Following the Hurricane Hugo disaster in September 1989, the Government qualified for a CDL of up to \$89,912,000, but drew down only \$50,100,000. Under the Stafford Act and FEMA's implementing regulations, FEMA is required to cancel administratively that portion of the principal amount of a CDL, together with associated interest that covers disaster-related operating revenue losses and unreimbursed disaster-related operating expenses incurred during the three fiscal years following the year of the disaster. On August 31, 1993, the Government petitioned FEMA for administrative cancellation of the loan. After four years of review, FEMA cancelled \$21,013,658 in principal, together with associated interest. Pursuant to a repayment agreement, dated November 14, 1995, the Government was obligated to repay the remaining principal and associated interest. Ultimately, the Government made a total of five quarterly payments on this loan, each in the amount of \$1,552,750, and received forbearance on making further payments until federal legislation was enacted appropriating to the DOI, for transfer to FEMA, funds in the amount required to cancel the loan entirely. On December 13, 2001, the DOI transferred to FEMA the funds required for cancellation of the Government's Hurricane Hugo CDL and FEMA's records show that the remaining balance of the Hurricane Hugo CDL was cancelled on that date.

Following the Hurricane Marilyn disaster in September 1995, the Government qualified for a CDL of up to \$127,224,568. On June 14, 1996, the Government executed a promissory note for repayment of its Hurricane Marilyn CDL debt, with payments due on or before June 16, 2001. The Government drew down a total of \$127,200,000. On June 11, 2001, the Government petitioned for administrative cancellation of the loan. On November 4, 2003, based on PricewaterhouseCoopers' ("PWC") review and analysis of the Governments' application for cancellation, FEMA issued an initial determination that \$19,700,717 in principal, together with associate interest, was eligible for cancellation.

FEMA provided the Government an opportunity to respond to the initial determination. An action plan was developed that outlined the Government's response to the initial determination. In a letter dated January 23, 2004, the Government transmitted to FEMA a Loan Cancellation Response to the initial draft determination made by PWC.

In February 2004, representatives of the Government met with FEMA officials and a representative of PWC (now IBM Consulting), in Washington D.C. to discuss FEMA's revised approach to addressing the cancellation request and the Government's pending Loan Cancellation Response. It was determined that a joint review process would be the most prudent method of addressing the cancellation request and the Government's response to the PWC draft report.

In April 2004, FEMA and IBM Consulting met on St. Thomas with the Government's representatives to review the Loan Cancellation Response and to clarify other outstanding issues of concern.

On October 25, 2004, FEMA notified the Government of its decision to cancel all of the principal and associated interest related to the Hurricane Marilyn CDL. In its cancellation letter, FEMA noted that the Government had inappropriately deposited a portion of the CDL funds in an interest-bearing account in violation of U.S. Office of Management and Budget regulations, FEMA regulations and the CDL loan agreement. FEMA requested that the Government remit \$21,700 in interest earned on such deposit. The Government has since remitted such funds to FEMA.

Other Factors

Labor Relations

There are 13 distinct labor organizations subject to 29 collective bargaining agreements and a total of 29 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. As of June 2004, of approximately 9,300 workers in the executive branch of the Government, approximately 7,850 belong to unions.

Currently, the Government has a contractual liability to various local labor unions relating to executive branch Government workers for retroactive salary increases aggregating approximately \$380.0 million accruing from Fiscal Years 1993 through 2003. In addition to retroactive salaries, the Government also has committed in its various union contracts to certain annual salary increases during the term of such respective contracts which, due to insufficient revenues, have not been reflected in the current salary rate for the individual union members. As of September 30, 2003, to bring union members current with the pay-rate terms of the existing contracts, would result in an increase to payroll for the next succeeding Fiscal Year of approximately \$12.0 million. 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.

As a result of the Government's inability to meet the contractual-liabilities of its various union contracts, certain unions and their members have staged periodic work actions against the Government. The job actions moderately interrupted the operations of the Government and had a mild financial impact (e.g., overtime pay to auxiliary personnel, loss of instruction to students, legal fees and associated costs). However, the Government was successful in obtaining permanent injunctions against such work actions, which has served as strong deterrents for future strikes and/or job actions. Additionally, in Fiscal Year 2002, the Government successfully negotiated to conclusion 12 collective bargaining agreements.

Government Employees Retirement System

The Employees' Retirement System of the Government of the Virgin Islands (known as GERS) requires that benefits promised under the law to members of GERS be funded on an "actuarial reserve" basis. As of September 30, 2001, the net assets of GERS were approximately \$1.2 billion.¹ The audit report of GERS for its 2001 fiscal year was qualified since (i) it was unclear if certain adjustments to \$18.7 million were required in specially designated pooled accounts, and (ii) the reasonableness of amounts due from the Department of Finance of \$5.0 million was questioned.

¹ The Government completes an Actuarial Evaluation every two years. Currently, the Government is in the process of completing an Actuarial Evaluation for the period ended September 30, 2003, and expects to have it completed by the end of the first calendar quarter of 2005.

According to an Actuarial Evaluation, dated as of September 30, 2001 (the “Actuarial Evaluation”), as of September 2001, the number of contributing members was approximately 9,303, the number of retirees was 5,514 and the number of surviving beneficiaries was 67. The total liability for future benefits to pensioners and beneficiaries is \$1,057.7 million. The valuation of the assets in the GERS is an estimate predicated upon the book value of such assets on a date certain. For the period ended September 30, 2002, benefits paid to retirees was approximately \$123.0 million. Employee and employer contributions rates to the system are as follows:

	<u>Employee Contribution Rate</u>
Members of the Legislature	9.0%
All other regular employees	8.0
Public Safety employees	10.0
Hazardous duty employees who elect early retirement system	10.0
Judges	11.0

Source: Government Employees Retirement System

The actuarial position suggests the amount which, when added to the total of employee contributions, will be sufficient to meet the actuarial costs. According to GERS, current employer contributions are 14.5% of membership payroll.

According to the Actuarial Evaluation, the statutory government and member contribution rates were not sufficient to meet the cost of the GERS. To meet the full actuarial cost (including the system’s current cost and the amount necessary to amortize the unfunded actuarial liability over 30 years from October 2, 2002), the contribution rates would have to be increased such that, in total, an additional 17.3% of payroll contribution or \$51.8 million would be necessary each year from some combination of member and/or Government sources. As of September 30, 2002, GERS’ unfunded actuarial accrued liability was approximately \$816.0 million.

The Government, acting as custodian, is responsible for the collection and disbursement of all loan repayments, employee contributions and employer contributions. Such amounts are deposited by the Government into a special account of the Special Revenue Fund held by the Government. Funds deposited in such accounts are legally restricted to expenditure for specified purposes.

Currently, there is a pending lawsuit against the Government seeking a declaratory judgment that it has violated its legal requirement to make sufficient contributions to the GERS. It is not expected that this lawsuit will have a materially adverse effect on the Government’s financial position.

Insurance

The Government’s enterprise fund provides workmen’s compensation for public and private individuals. The Government does not carry general liability insurance coverage on its properties or for the acts of its employees, relying instead on self-insurance and statutory liability limitations. However, as a result of an agreement with FEMA with respect to properties and structures damaged by Hurricane Hugo and repaired with federal disaster assistance, the Government has obtained insurance for hospitals, schools and other insurable public buildings that were repaired with such federal assistance. The Government currently maintains a blanket insurance policy (the “Policy”) covering buildings and structures set forth in a related schedule of values totaling approximately \$909.3 million. Such schedule of values sets forth the value of each building and/or structure covered by the Policy, as well as contents, computer and software receivables, valuable paper and equipment. The Policy has a loss limit of \$100.0 million for each and every occurrence, with a per occurrence sublimit of \$45.0 million in respect to windstorm and \$45.0 million in the annual aggregate in respect to flood. There can be no assurance that

the Government will not suffer a casualty or liability loss beyond the Policy limits of coverage or the limits of its self-insurance capabilities.

Litigation

Outlined below are the significant litigation cases and tax cases which impact the Government.

Franchise Tax Litigation Cases

There are currently four Virgin Islands cases challenging the Government's computation of its corporate franchise tax (the "Franchise Tax Litigation Cases"). The Franchise Tax Litigation Cases involve a dispute over the definition of the term "capital stock used in conducting business in the Virgin Islands," as found in Title 13 Virgin Islands Code Section 531(a)(the "Franchise Tax Statute"). The Government's position is that the Franchise Tax Statute taxes the amount paid to a corporation by shareholders for the issuance of shares, and any amount allocated to par value and paid in capital upon a subsequent reorganization. The plaintiff taxpayers (including certain domestic Virgin Islands corporations and foreign corporations doing business in the Virgin Islands) argue that the tax is calculated only on the par value of the stock. The issues presented in the Franchise Tax Litigation Cases relate only to domestic and foreign corporations doing business in the Virgin Islands.

During Fiscal Year 2002, the Government collected approximately \$1,329,000 in franchise taxes from domestic and foreign corporations doing business in the Virgin Islands. If the tax base during Fiscal Year 2002 had reflected only the "par value" of each company's stock, as urged by the plaintiffs taxpayers, the franchise tax collected from Virgin Islands domestic and foreign corporations during Fiscal Year 2002 could have been as low as approximately \$478,000, representing a decrease of \$851,000.

Virgin Islands law imposes a six-year statute of limitation on tax refund claims against the Government. Applying the Fiscal Year 2002 figures to the six years preceding Fiscal Year 2002, the Government, if the plaintiffs prevail in the Franchise Tax Litigation Cases, may be liable, with respect to Virgin Islands domestic and foreign corporations, to pay franchise tax refunds of approximately \$5,100,000 for overpayment claims covering the past six years. The approximately \$5,100,000 potential liability figure is based upon the assumption that: (i) the average number of domestic and foreign corporations in existence during the six fiscal years preceding Fiscal Year 2002 approximates the number of said corporations that were in existence in Fiscal Year 2002; (ii) the Fiscal Year 2002 collection levels apply to each of the six years preceding Fiscal Year 2002; and (iii) all corporations claiming a franchise tax refund have commenced the appropriate actions. It is unlikely that all of the aforementioned conditions shall apply. In the event the courts adopt the plaintiff taxpayers' interpretation of the Franchise Tax Statute, the actual liability incurred by the Government would most likely be substantially less than the approximately \$5,100,000 figure discussed above.

One of the Franchise Tax Litigation Cases is currently before the Virgin Islands Territorial Court. The remaining three Franchise Tax Litigation Cases are currently on appeal by the Government to the Third Circuit Court of Appeals. The remaining three Franchise Tax Litigation Cases were on appeal to the Third Circuit Court of Appeals; however, the Court dismissed the appeal because of a lack of a final judgment below resulting in a remand of the cases to the Virgin Islands Territorial Court.

Real Property Tax Case

In addition to the Franchise Tax Litigation Cases, there is a decision in a real property tax case that may have a fiscal impact on the Government. In a decision issued on May 12, 2003 in Berne Corp v. Government of the Virgin Islands, 2003 WL 21078073 (D. Virgin Islands) (the "Berne Decision"), a

consolidated case representing eight actions and 21 plaintiffs, the District Court of the Virgin Islands issued a permanent injunction enjoining the Government from appraising and assessing any real property in the Virgin Islands until the Government has modified its system of appraisal to comply with certain District Court mandates. Specifically, the order issued by the Berne Court enjoined the Government from assessing any and all real property in the Virgin Islands until: (1) the Virgin Islands' "property tax system has been certified as reliably and credibly assessing and taxing all real property on its actual value," (2) "the Board of Tax Review consistently holds hearings and reaches determinations on appeals within sixty (60) days," and (3) "the Department of Finance consistently remits any refunds awarded by the Board decision within thirty (30) days[.]"

Further, the order issued under the Berne Decision enjoined the Government from (1) issuing "any property tax bills for tax year 2002 and beyond" and (2) making any "further effort to collect any tax bills already issued for any property, commercial or otherwise, for tax years 1999, 2000, and 2001" unless and until "the Legislature amends 33 V.I.C. § 2402 to provide for the retroactive adjustment of the bills on all classes of property for 1999, 2000, 2001, 2003, 2004, and for a reasonable time thereafter until a fair and equitable system capable of reliably and credibly assessing all real property at actual value is in place." The Berne injunctions had the potential of depriving the Government of over \$50,000,000 in tax dollars annually.

In response to the Berne Decision, the Virgin Islands Legislature enacted Act No. 6586, which, among other things, amended 33 V.I.C. § 2402 to provide that:

[T]he Tax Assessor may issue tax bills and collect taxes at the 1998 assessment level, for all classes of real property, including commercial and non commercial real property, for the tax years 1999, 2000, 2001, 2002, 2003, and 2004, before the revision of the property tax and [resolution of] the Property Tax Litigation, provided that the tax due shall be subject to adjustment for each year according to the assessed value based on the new system implemented. The taxpayer shall be entitled to a credit applied to his subsequent years' tax bills or a refund for any overpayment that may have accrued as the result of the payment of any of his tax bills for any year from 1999 until the new system is implemented.

The Government enacted Act No. 6586 for the purpose of satisfying the conditions set out in the Berne Decision to lift the ban on the issuance and collection of the Government's 2002 real property tax bills and the collection of delinquent real property taxes from prior years. The Government used the 1998 assessment level as the basis for tax collection under Act No. 6586 as required by the District Court.

On August 13, 2003, the District Court entered an order permitting the Government to issue and collect from non-plaintiff taxpayers its 2002 real property taxes based on the 1998 assessments and to collect from non-plaintiff taxpayers delinquent real property taxes for prior years, also based on the 1998 assessments. Following the District Court's August 13, 2003 order, the Governor issued Executive Orders authorizing the issuance of the Government's 2002 real property tax bills and providing that such bills shall be due and payable by October 31, 2003. Also, based upon Act No. 6586, the Government subsequently issued its 2003 real property tax bills in June 2004. It anticipated that the Government will timely issue its 2004 real property tax bills based upon Act No. 6586.

The Government appealed the Berne Decision to the Third Circuit Court of Appeals. In a decision issued in June 2004, the Third Circuit upheld the Berne Decision. Given the adverse decision against the Government, the Government's use of the assessment methodology proposed by the plaintiffs could result in either an increase or decrease in taxes in each individual case. Accordingly, the financial impact to the Government of the adverse decision cannot be determined at this time.

**FORM OF AUTHORITY CONTINUING
DISCLOSURE CERTIFICATE**

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APPENDIX G

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (the “Disclosure Certificate”), dated December __, 2004, is executed and delivered by Virgin Islands Public Finance Authority (the “Authority”) in connection with the issuance of its \$94,000,000 Virgin Islands Public Finance Authority Revenue Bonds (Virgin Islands Matching Fund Loan Notes), Series 2004A Bonds (the “2004A 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 2004A Bonds and delivered in order to assist the underwriters of the 2004A 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, 2005. “Annual Financial Information” means, collectively: (A) Audited Financial Statements for the Authority prepared in accordance with generally accepted accounting principles; (B) Audited Financial Statements of the Government prepared in accordance with generally accepted accounting principles, if available (or, in the event that such Audited Financial Statements of the Government are not available, in substitution therefor, the tabular information presented in “Appendix F-United States Virgin Islands”); (C) an update of the tabular information presented in the Official Statement dated December 2, 2004 with respect to the 2004A Bonds (the “Official Statement”) under the headings “MATCHING FUND REVENUES” and “THE RUM INDUSTRY” and an update of the information under the heading “VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY - Outstanding Indebtedness of the Authority”; and (D) 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)(C) 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 April 1, 2006, for the Authority's Fiscal Year ending September 30, 2005, 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: December __, 2004

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 Repository

100 Business Park Drive
Skillman, New Jersey 08558
<http://www.bloomberg.com/markets/rates/municontacts.html>
Email: munis@bloomberg.com
Telephone: (609) 279-3225
Fax: (609)279-5962

DPC Data Inc.

One Executive Drive
Fort Lee, New Jersey 07024
<http://www.dpcdata.com>
Email: nrmsir@dpcdata.com
Telephone: (201) 346-0701
Fax: (201) 947-0107

FT Interactive Data

Attn: NRMSIR
100 William Street
New York, New York 10038
<http://www.interactivedata.com>
Email: NRMSIR@FTID.com
Telephone: (212) 771-6999
Fax: (212) 771-7390 (Secondary Market Information)
(212) 771-7391 (Primary Market Information)

Standard & Poor's Securities Evaluations, Inc.

55 Water Street, 45th Floor
New York, New York 10041
www.jjkenny.com/jjkenny/pser_descrip_data_rep.html
Email: nrmsir_repository@sandp.com
Telephone: (212) 438-4595
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**FORM OF PROPOSED OPINION OF
BOND COUNSEL**

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APPENDIX H

FORM OF BOND COUNSEL OPINION

[Date of Closing]

Virgin Islands Public Finance Authority
24 Honduras, Frenchtown
St. Thomas, United States Virgin Islands 00802

Re: \$94,000,000 Virgin Islands Public Finance Authority
Revenue Bonds (Virgin Islands Matching Fund Loan Note)
Series 2004A (Senior Lien)

Ladies and Gentlemen:

We have examined the record of proceedings in connection with the issuance by the Virgin Islands Public Finance Authority (the "Authority") of its Revenue Bonds (Virgin Islands Matching Fund Loan Note) Series 2004A (Senior Lien) in the aggregate principal amount of \$94,000,000 (the "Series 2004 Bonds"). The Series 2004 Bonds are issued under and pursuant to (i) Section 1574 through 1574c of the Virgin Islands Revised Organic Act of 1954, as amended (48 USC § 1541 *et seq.*) (the "Revised Organic Act"), (ii) Title 29 of the Virgin Islands Code, 2004 United States Virgin Islands Act No. 6663, as amended by Act No. 6675, Section 42 (collectively, the "Enabling Act" and, together with the Revised Organic Act, the "Act"), (iii) Bond Resolution No. 04-009, adopted by the Authority on June 2, 2004, as amended by Resolution No. 04-012, adopted by the Authority on September 20, 2004 (collectively, the "Resolutions"), and (iv) an Indenture of Trust, dated as of May 1, 1998, by and between the Authority and The Bank of New York Trust Company, N.A., as Trustee (the "Trustee"), as heretofore supplemented and amended, and as supplemented by a Second Supplemental Indenture of Trust, dated as of December 1, 2004, by and between the Authority and the Trustee (collectively, the "Indenture").

All capitalized terms, not otherwise defined herein shall have the meaning given such terms in Article I of the Indenture.

Under the Act, the Series 2004 Bonds are being issued for the purpose of providing funds to (i) finance the planning, developing, constructing, renovating and equipping of a wastewater treatment facility on the Island of St. Thomas and a wastewater treatment facility on the Island of St. Croix and the repair and construction of the wastewater collection systems on St. Thomas and St. Croix in the amount up to \$70,000,000 (the "Wastewater Projects"); (ii) finance the repairs, renovations and construction of solid waste facilities (the "Solid Waste Projects"); (iii) finance the repair and construction of public roads in the amount up to \$5,000,000 in the District of St. Croix and in the amount of up to \$5,000,000 in the District of St. Thomas and St. John; (iv) fund start-up capital of the Waste Management Authority in an amount up to \$4,000,000; (v) fund any necessary reserves and (vi) pay certain costs of issuing the Series 2004 Bonds.

The Series 2004 Bonds are equally and ratably secured by the Indenture, which pledges and assigns to the Trustee the Trust Estate.

The proceeds of the Series 2004 Bonds are being loaned by the Authority to the Government pursuant to a Loan Agreement, dated as of December 1, 2004 (the "Series 2004 Loan Agreement"), by

and among the Authority, the Government and the Trustee, against delivery by the Government of its \$94,000,000 principal amount 2004 Matching Fund Loan Note (the "Series 2004 Loan Note").

The Series 2004 Bonds are dated as of December 1, 2004, bear interest from that date on the unpaid principal amount thereof, at the rates set forth therein and in the Indenture, and mature on the dates set forth therein and in the Indenture. The Bonds are subject to redemption prior to maturity, in the manner and upon the terms and conditions set forth in the Indenture and the Series 2004 Bonds.

The Internal Revenue Code of 1986, as amended, and the regulations and rulings of the United States Treasury Department thereunder (collectively, the "Code") establishes certain requirements which must be met at and subsequent to the date of issuance and delivery of the Series 2004 Bonds in order that interest on the Series 2004 Bonds will be and remain excludable from gross income for federal income tax purposes. Included among these continuing requirements are certain restrictions and prohibitions on the use of bond proceeds, restrictions on the investment on bond proceeds and other moneys or properties and the rebate to the United States of certain earnings in respect of investments. Failure to comply with the continuing requirements may cause the interest on the Series 2004 Bonds to be includible in gross income for federal income tax purposes retroactive to the date of their issuance irrespective of the date on which such non-compliance occurs. The Authority and the Government have covenanted in the Indenture and the Series 2004 Loan Agreement, respectively, and in documents relating to federal tax matters delivered at the time of delivery of the Series 2004 Bonds (the "Tax Certificate") to comply with certain procedures, and have made certain representations and certifications, designed to assure satisfaction of the requirements of the Code.

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 2004 Bonds and have made such investigation of law and such further review, inquiry or examination as we deemed necessary or desirable in rendering the opinions set forth herein. Further, we have examined originals or copies, certified or otherwise identified to our satisfaction, of such instruments, certificates and documents as we have deemed necessary or appropriate for the purposes of the opinions rendered below. In such examination, we have assumed the genuineness of all signatures, the authenticity and due execution of all documents submitted to us as originals and the conformity to the original documents of all documents submitted to us as copies. As to any facts material to our opinion, we have relied upon, and assumed the accuracy and truthfulness of, the aforesaid instruments, certificates and documents, without having conducted any independent investigation.

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 2004 Bonds have been duly authorized and issued in accordance with the Act and the Resolutions, and constitute valid and binding special limited obligations of the Authority payable solely from the Trust Estate.
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, validly 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 2004 Bonds and is enforceable against the Authority in accordance with its terms.

4. Under existing statutes, regulations, administrative interpretations and court decisions as of the date hereof, interest on the Series 2004 Bonds will not be included in gross income for federal income tax purposes and is not an "item of tax preference" for purposes of computing the federal alternative minimum tax imposed on individuals and corporations. However, interest on the Series 2004 Bonds held by a corporation (other than an S corporation, regulated investment company, real estate investment trust or real estate mortgage investment conduit) is included in adjusted current earnings for purposes of calculating certain taxes including the federal alternative minimum tax imposed on corporation.

5. Under existing statutes, interest on the Series 2004 Bonds is exempt from personal income taxes imposed by the United States Virgin Islands, by any state, other territory or possession of the United States or any political subdivision thereof, or by the District of Columbia.

We have examined an executed Series 2004 Bond, and in our opinion, the form of such Bond and its execution are regular and proper.

In rendering the opinions set forth in paragraph 4 above, we have assumed the accuracy of certain factual certifications made by the Authority and by the Government in the Tax Certificate and the continuing compliance by the Authority and the Government with the covenants, provisions and procedures set forth in the Indenture, the Series 2004 Loan Agreement and the Tax Certificate, as may be applicable. In the event of the inaccuracy or incompleteness of any of the certifications made by the Authority or the Government, or of the failure by the Authority or the Government to comply with the covenants, provisions and procedures set forth in the Indenture, the Series 2004 Loan Agreement or the Tax Certificate, as may be applicable, the interest on the Series 2004 Bonds could become includible in gross income for federal income tax purposes retroactive to the date of the original execution and delivery of the Series 2004 Bonds, regardless of the date on which the event causing such inclusion occurs. We render no opinion as to the exclusion from gross income of interest on the Series 2004 Bonds for federal, territorial, state or local income tax purposes on or after the date on which any change occurs or action is taken or omitted under the Indenture, the Series 2004 Loan Agreement or the Tax Certificate by the Authority or the Government, or under any other relevant documents without the advice or approval of, or upon the advice or approval of any bond counsel other than Buchanan Ingersoll PC. We have not undertaken to determine in the future (or to inform any person) whether any actions taken or not taken or events occurring or not occurring after the date of issuance and delivery of the Series 2004 Bonds may affect the tax status of interest on the Series 2004 Bonds. No assurance can be given that future legislation or amendments to the Code, if enacted into law, will not contain provisions which could directly or indirectly reduce the benefit of the exclusion of the interest on the Series 2004 Bonds from gross income for federal income tax purposes.

The opinions contained in paragraphs 2 and 3 above are qualified to the extent that the enforceability of the Indenture, the Second Supplemental Indenture and the Series 2004 Bonds may be limited by applicable bankruptcy, insolvency, moratorium, reorganization or other laws affecting creditors' rights generally or as to the availability of any particular remedy. Except as stated in paragraphs 4 and 5 above, we express no opinion as to the federal, territorial, state or local tax consequences caused by the receipt or accrual of interest on the Series 2004 Bonds and holders of the Series 2004 Bonds should consult their tax advisors with respect thereto.

Our services as bond counsel to the Authority with respect to the issuance and delivery of the Series 2004 Bonds 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 2004 Bonds and the tax-exempt status of the interest on the Series 2004 Bonds.

Very truly yours,

BUCHANAN INGERSOLL PC

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VIRGIN ISLANDS PUBLIC FINANCE AUTHORITY

