

Special Report of the Receiver

Comments on the Government of Guam's Application for Order
Suspending Weekly Payments

Civil Case No. 02-00022
United States of America v. Government of Guam
Guam Solid Waste Management Division

Prepared for:



U.S. District Court of Guam

Submitted by:



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Civil Case No. 02-00022
United States of America v Government of Guam

Solid Waste Management Division

This Report is submitted in response to the April 6, 2009 Order of the Court that GBB file its comments on the Government of Guam's application for an order suspending weekly payments.

The Government of Guam has requested that Court issue an order suspending weekly payments based on the passage of Public Law 30-007. The Receiver has urged the Government to authorize and issue Section 30 backed bonds for over five months. We have been supported in our recommendation by the Court, Mr. Jonathan Shefftz, the financial expert retained by the U.S. Justice Department in this case, Public Financial Management, Inc., the Guam Economic Development Agency and its financial advisers, and the Governor and his staff. Unfortunately, the Guam Legislature has been uncooperative and the delay that has resulted places the court in the position of having to consider this matter at a time when it potentially places the court approved schedule at substantial risk should the Government fail to acquire the bond funding in a timely manner.

It must be noted that even with the passage of Public Law 30-007, the Guam Legislature has not passed a "clean" bill authorizing the Government to proceed with Section 30 backed bonds for the Consent Decree projects. Instead, it has clearly tied these bonds to the success of the Government in borrowing an additional \$280 million for unrelated purposes, referred to herein as "G.O. deficit bonds". This action creates additional and totally unnecessary risks to the Consent Decree funding.

The Court has been very clear that nothing should be allowed to disrupt the construction schedule. The initial earthwork is underway and funded by the Trustee Account thanks to the Court's insistence on the initial \$20 million payment from the Government and the weekly payments ordered to be deposited since March 1, 2009. Even with this funding in place, the balance in the Trust Account is not adequate to fund the next phase of bidding on the project.

We anticipate beginning these bid processes in mid-June and these are the most expensive elements of the project that include the landfill systems and entrance facilities, the access road and the sewer line. Our total estimate for these contracts is in excess of \$65 million. We simply cannot bid these projects without the clear ability to guarantee payment to the contractors.

If the court maintains the weekly payments, we can proceed with these bids since this stream of income is demonstrable proof to potential contractors that they will be paid when the bills come due. However, if the court suspends the weekly payments to allow the Government to go to market, it becomes imperative that the bond proceeds actually be in place by June or the court ordered schedule will be compromised.

We have conferred with the Government and its advisers and bond counsel since passage of this bill and

GBB
April 8, 2009

2

are impressed with the confidence they express about successfully selling the Consent Decree project bonds. It has always been our belief that Section 30 backing would allow the bonds to achieve an investment grade rating that would, in turn, allow the bonds to be sold on reasonable terms even under difficult market conditions. It has also been our view that it would take several months to successfully sell the bonds given both market conditions and Guam's poor credit ratings.

The Government's financial adviser, its underwriters and bond counsel believe that the time needed to successfully sell the bonds can be significantly reduced by selling them as a stand-alone Section 30 pledge rather than bonds based on a revenue pledge from the Solid Waste Management Division with a Section 30 backstop. This may be correct and it is further supported by bond counsel's representation, made to us last week in a conference call on this matter, that they are in a position to quickly develop the necessary documents to support this approach.

While we agree that the approach outlined to us by the Government for selling the bonds for the Consent Decree projects has a reasonable likelihood of success, it is not without risk given Guam's difficult history in solid waste and its overall poor financial condition. This is why we anticipated in our initial recommendation that it could take several months to successfully market these bonds. The significantly shortened time-frame forced by the Legislature's resistance to meeting its obligations under the Consent Decree, is also now an additional risk factor.

The major risk to the success of the bonds for the Consent Decree projects, however, is the result of the Legislature's continued insistence on tying the sale of Section 30 backed bonds for the Consent Decree to the successful sale of \$280 million in G.O. deficit bonds for unrelated purposes. It should be remembered that the Government tried and failed to sell a portion of these bonds as recently as December 2008.

The Legislature, in authorizing the deficit bonds, also authorized the use of Section 30 backing for these bonds. While we have been assured by GEDA that Section 30 backing will be reserved for the Consent Decree projects, this assurance is not legally binding. If the Government decided to use Section 30 to back the deficit bonds it would not be available to back the bonds for the Consent Decree. A Section 30 pledge is clearly necessary to bring the bonds up to investment grade, a requirement if the Government is to successfully sell bonds to pay for the Consent Decree projects.

In its comments to GEDA which were submitted to the Court as a part of the Government's submission in this matter, Bank of America, the Government's own financial adviser states "we still do not believe the issuance of landfill bonds should be tied to the deficit bonds". They go on to outline several changes in the recent legislation designed to improve the G.O. deficit bond's marketability. Based upon these changes they "have received preliminary feedback from the underwriters that there may be appetite for Guam GO bonds at the 10% level in the current market". This is hardly a ringing endorsement of the likelihood of success. There is only certainty. If the deficit bonds do not sell there will be no bonds for the Consent Decree under the law the Government is asking the Court to rely upon.

The bond underwriters for both the deficit bonds and the Consent Decree bonds are optimistic in their assessment of the potential for success, but both agree, as does the Bank of America, that the weekly payments must be suspended to allow the Government to present a "clean disclosure" to potential investors. While the decision of what to disclose to investors is the Government's decision, which we assume will be based upon advice of Bond Counsel and Underwriter's Counsel, we believe that, under

GBB

April 8, 2009

3

the rules that govern such disclosures, the existence of this litigation and the Court's recent orders are material issues that must be disclosed to potential investors.

We recommend that any Order that would grant the Government's request to suspend weekly payments include a clear statement of the consequences of failure to successfully sell the bonds to pay for the Consent Decree projects in a timely manner that allows the Court approved construction schedule to be maintained. To accomplish this, we urge that that any Order explicitly state that if at least \$120 million of bond funding is not made available for the Consent Decree projects by June 30, 2009, weekly payments will be automatically reinstated and the Government will immediately be required to deposit the full amount of cash that would have been deposited had the weekly payments not been suspended. We further recommend that:

1. The Government and their underwriters and Bank of America submit progress reports to the Court outlining their progress in achieving the sale of the bonds on a biweekly basis and more frequently in the case of significant events that affect the success of their efforts to sell the bonds in a timely manner;
2. The Court seek assurances from the Government that the Section 30 pledge will be reserved for the bonds to fund the Consent Decree and not used in connection with the G.O. deficit bonds;
3. The Government provide assurances to the Court that it will move forward in a timely manner to sell any remaining debt to finance the closure of the Ordot Dump prior to June 30, 2010; and
4. Any trustee appointed by the Government in connection with the bonds to finance the Consent Decree be directed to work cooperatively with Citibank in its role as Trustee for the Receiver throughout the period of construction.

Any other approach, at this point, could result in delays of indefinite magnitude, which are clearly inconsistent with the Court-approved construction schedule and would place Guam at great risk of running out of space at the Ordot Dump prior to completion of the Layon Landfill.

Also attached to this Report is a letter from Public Financial Management, Inc. (PFM) providing its comments and recommendations for the Court's consideration. PFM is the largest independent Financial Advisory firm in the United States, advising over 2,100 state and local governments on debt management and other financial issues. While we commend all of PFM's comments to the Court for its consideration, we specifically urge the Court to authorize GBB to seek a fair market value opinion from a party independent of the underwriter to evaluate whether the SWMD has obtained a fair price on the Solid Waste Bonds. We believe this to be consistent with our fiduciary duty to the Court and the people of Guam. PFM is eminently qualified to provide this opinion and it is our intent to have them provide it should the Court approve our recommendation. PFM will be available by phone to address any questions the Court may have for them at the hearing scheduled for April 14, 2009.

As was noted in the information provided by the Government to the Court, the Government is also pursuing a loan to finance the Consent Decree projects from the United States Department of Agriculture (USDA). As the Court directed in its Order of February 13, 2009, we have made ourselves "available to the Government of Guam to assist" them in their application for this loan. At the Government's request we have made documents available, calculated certain cash flows and participated in conference calls. We are hopeful that the Government will be successful in this effort.

We appreciate the Court's consideration of our views in this important matter.

GBB

April 8, 2009

4



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April 7, 2009

Mr. David L. Manning
Receiver
Gershman, Brickner & Bratton, Inc. for
The United States District Court
Territory of Guam

Mr. Manning:

We offer our thoughts and considerations related to the proposed Solid Waste Management System Bonds (the "Solid Waste Bonds") to be issued by the Government of Guam as authorized by Bill No. 1 (2-S) dated April 1, 2009 (the "Bill").

It is our understanding that the Solid Waste Bonds are to be secured with revenues derived by the Government of Guam under Section 30 of the Organic Act ("Section 30 Revenues"). As such, we anticipate that the rating on the Solid Waste Bonds will be "Baa" by Moody's and "A" by Standard and Poor's as predicated by the current ratings on the outstanding Guam Power Authority Bonds which carry the same security pledge.

Given the rating assumption and the current market conditions, and barring any unusual circumstances, we agree with the representation made by the underwriters, Piper Jaffray ("Piper"), on the conference call held April 2nd (US) that there is a market for these bonds and that the bonds should sell at market rates below the 9% cap as established by the Bill.

The Bill also authorizes the issuance of deficit financing bonds (hereafter, referred to as the "GO Bonds") that can be secured by any one or more of the following (1) the full faith and credit of the government, or (2) a pledge of Section 30 Revenues. It is our understanding that based upon statements made by the underwriter of the GO Bonds, Citigroup ("Citi"), that the Government intends to secure these GO Bonds only with a GO pledge and to not utilize the Section 30 Revenue pledge. Based upon comments of Bond Counsel, we understand the GO Bonds must be issued prior to, or simultaneous with the issuance of the Solid Waste Bonds.

We understand that the District Court is requiring the Government of Guam to deposit \$993,700/week for land-fill projects to a Trustee until full funding of the Consent Decree projects is established. Moreover, the Attorney General has currently filed a motion to suspend the payments under the Consent Decree in order to make the Solid Waste Bonds marketable to potential investors.

While the final opinion is ultimately Bond and Underwriters Counsels' to make, we believe the weekly payments to the Trustee, whether temporarily suspended or not, require disclosure to potential investors in the offering documents of the GO Bonds. Investors should be made aware if the Solid Waste Bonds are not issued, there could be a material negative impact to the balance sheet of the Government. Accordingly, it will become imperative to construct and disclose to potential investors of the GO Bonds a comprehensive plan of finance that speaks to both issues. We believe a solid plan of financing, one that describes (1) the already enacted authority to issue both the GO Bonds and the Solid Waste Bonds, (2) the established credit mechanisms and the final ratings of each issue and (3) establishes a firm and legally mandated timetable for each bond's sale dates and closing dates, will give investors enough comfort to generate interest in the GO Bonds.



To further mitigate any concern regarding the disclosure, we think it is absolutely necessary for this timetable to mandate the sale of the Solid Waste Bonds as soon after the sale of GO Bonds as possible (no more than two weeks later). Given the current market conditions and if rates are set appropriately, we believe the GO Bonds and the Solid Waste Bonds could and should be sold within a week of one another.

We also believe that it will facilitate the marketing of the GO Bonds, increasing the likelihood of a successful sale and lowering cost of capital if the weekly payments are suspended prior to marketing the GO Bonds to the public.

If appropriately disclosed and marketed, we believe Citi will be positioned to offer the GO Bonds at market rates under the 10% rate cap established by the Bill. On our conference call last week, Citi and Piper have represented that they would be ready to proceed to market within 45-60 days following the official suspension of the weekly payments. If the suspension is made in the very near future, this timeframe should be sufficient to meet the schedule of the Consent Decree projects.

We are aware that the immediate and long-term budget of the Solid Waste Management Division (the "SWMD") and the successful execution of the Consent Decree projects are highly dependent on the successful sale of the Solid Waste Bonds. It is in the best interest of the SWMD to make sure Guam negotiates the lowest possible debt service costs the Solid Waste Bonds. Our current financing structure indicates that the value of one basis point in increased yield (.01%) on the Solid Waste Bonds equals approximately \$140,000 in additional debt service cost to the SWMD. For a credit of this quality, it is not unusual in today's illiquid market for negotiations on yields to vary within a range of 60 basis points or more. We would recommend that GBB seek a fair market value opinion from a third-party independent of the underwriter to represent that the SWMD has obtained a fair price on the Solid Waste Bonds. PFM has provided such fair market opinions on numerous occasions and would welcome the opportunity to assist in the price negotiations for the Solid Waste Bonds on behalf of SWMD.

We appreciate the opportunity to offer our opinion and welcome any further discussion to clarify our statements made herein.

Sincerely,

Public Financial Management

A handwritten signature in blue ink that reads "Lisa Daniel". The signature is fluid and cursive, with the first name "Lisa" and last name "Daniel" clearly distinguishable.

Lisa Daniel
Managing Director