STANDARD & POOR'S

Global Credit Portal®
RatingsDirect®

June 6, 2012

Summary:

Puerto Rico Public Finance Corp. Puerto Rico; Appropriations; General Obligation

Primary Credit Analyst:
Horacio Aldrete-Sanchez, Dallas (1) 214-871-1426; horacio_aldrete@standardandpoors.com

Secondary Contact:
Dave G Hitchcock, New York (1) 212-438-2022; david_hitchcock@standardandpoors.com

Table Of Contents

Summary:

Puerto Rico Public Finance Corp. Puerto Rico; Appropriations; General Obligation

Credit Profile		
US$500.0 mil govt facs rev rfdg bnds (Puerto Rico) ser U due 08/01/2041		
Long Term Rating	BBB/Negative	New
US$414.3 mil bnds (Puerto Rico) (Commonwealth Approp Bnds) ser A due 08/01/2031		
Long Term Rating	BBB-/Negative	New
Puerto Rico GO		
Long Term Rating	BBB/Negative	Outlook Revised

Rationale

Standard & Poor's Ratings Services has revised its outlook on the Commonwealth of Puerto Rico general obligation (GO) and appropriation debt ratings to negative from stable. The outlook revision is based on what we believe is a challenging economic and fiscal environment, which has the potential to delay a transition to structurally balanced budgets beyond fiscal 2013. In our view, structural balance by the end of fiscal 2013 remains critical to reducing the growth in the commonwealth's tax-supported debt, which has increased nearly 44% over the past three years primarily as a result of deficit financing. In our opinion, the current administration has taken decisive measures to restore fiscal balance. However, a steady economic recovery has failed to take hold, which we believe limits the government's ability to implement additional expenditure cuts and revenue enhancement measures in the near term. In addition, given the disproportionate reliance of Puerto Rico's economy on federal transfers, a significant reduction in these transfers as a result of the implementation of the Federal Budget Control Act of 2011 could result in additional headwinds for the island's economy. Furthermore, we believe that the commonwealth's upcoming legislative and gubernatorial elections could forestall progress on the adoption and implementation of a meaningful solution to its unfunded pension and retirement obligations, which could further complicate the achievement of structurally balanced budgets.

We could revise our outlook back to stable if the economy gains positive momentum, the commonwealth maintains fiscal discipline through fiscal 2013, and officials adopt and implement a credible solution to the commonwealth's unfunded pension and retirement liabilities. We could lower the rating by one notch if the economy deteriorates, the projected deficit for fiscal 2013 widens, or decisive action on pension reform is delayed beyond fiscal 2013.

Standard & Poor's assigned its 'BBB' rating to the Puerto Rico Public Buildings Authority's series U refunding bonds, guaranteed by Puerto Rico, and its 'BBB-' rating to the Puerto Rico Public Finance Corporation's (PFC) series 2012A refunding bonds. In addition, Standard & Poor's affirmed its 'BBB' rating on Puerto Rico's GO debt and its 'BBB-' rating on the commonwealth's appropriation debt. The commonwealth's full faith and credit pledge, including a constitutional requirement that provides a first claim on available commonwealth resources, secures the

GO bonds.

In our opinion, Governor Fortuño's $9.08 billion proposed fiscal 2013 budget continues to build on the same tenets of fiscal discipline of the last three fiscal years. Various legislative acts, which reduced the commonwealth's payroll headcount by 37,986 employees (a 19.7% reduction from fiscal 2009 levels), have resulted in a nearly 34% reduction in total government payroll expenditures in fiscal 2013 compared with fiscal 2009. Other operating expenditures, including subsidies and transfers to municipal corporations, have also seen a steady decline since 2010. The proposed fiscal 2013 budget represents a 16.6% reduction in general fund expenditures relative to fiscal 2009. On the revenue side, the administration's tax reform and revenues from Act 154 have resulted in a 7.5% increase in general fund revenues since fiscal 2011 to a projected $8.7 billion in fiscal 2013.

Despite this significant progress since 2009, structural budgetary balance remains elusive. A challenging economy, with anticipated GDP growth of 0.9% for fiscal 2012 and 1.1% for fiscal 2013, has delayed the administration's initial goal of achieving structurally balanced budgets by fiscal 2013. While the identified deficit of $333 million (3.6% of general fund expenditures) for fiscal 2013 is significantly lower than the $3.3 billion deficit in fiscal 2009 (30.3% of general fund expenditures), the estimation of expenditures for fiscal 2013 relies on the planned refinancing of approximately $575 million in GO debt to reduce the commonwealth's debt service requirements during fiscal 2013, which in our view increases Puerto Rico's deficit funding needs for fiscal 2013 to $908 million, or approximately 10% of general fund expenditures. While commonwealth officials anticipate ending fiscal 2012 on target with the budget (which included a $610 million deficit, or 6.6% of general fund expenditures), general fund revenues year-to-date are 1.4% below forecast. Officials attribute some of the lagging revenue performance, particularly in sales and use tax collections, to the delay in the implementation of improved collection measures (such as the sales tax lotto). However, we believe that the slower-than-anticipated revenue growth could also presage continued slow economic growth for the remainder of the fiscal year.

Deficit financing has been the primary reason for the recent increase in the commonwealth's tax-supported debt levels. Since 2009, the commonwealth's tax-supported debt has risen by $10.3 billion, or 43.7%. The majority of this increase ($9.2 billion) is attributable to debt issued by the Puerto Rico Sales Tax Financing Corporation (COFINA), whose corporate purpose was to fund the identified accumulated deficits through fiscal 2012. Under its current legal framework, COFINA no longer has authority to issue additional debt. We anticipate that future budget-balancing measures will rely on a combination of restructuring of existing GO and appropriation debt, and one-time revenue measures. The commonwealth's current tax-supported debt levels of approximately $8,500 per capita and 53% of GNP are significantly higher than the median for the 50 U.S. states of $932 per capita and 2.2% of GSP. Total public sector debt, which includes debt issued by the commonwealth's public corporations (some of which have received support from the general fund), is significantly higher, at 101% of GNP, and approximately $16,293 per capita.

While an improvement in the economy could reduce the commonwealth's debt in relation to the size of its economy, achieving structurally balanced budgets will be critical to the commonwealth's ability to gain the budgetary flexibility that we believe will be necessary to successfully address its unfunded pension and retirement liabilities.

Other factors that support our ratings include our opinion of the commonwealth's:

- High level of retirement liabilities. Although Puerto Rico closed its defined benefit system to new participants starting on Jan. 1, 2000, the funded ratio of its defined benefit system is extremely low, in our view, at 6.8% as of

June 30, 2011 (the latest actuarial study available). The actuarial study also estimates that even with the recent increase in contributions required by Law 116 of 2010, the defined benefit system's net assets would be exhausted in 2014 and all available assets would be exhausted by fiscal 2020, requiring a rapidly increasing amount of supplemental cash from the sponsoring entities, which include the commonwealth, several public corporations, and municipalities. We understand that the Fortuño administration is in the process of developing a comprehensive reform to its defined benefit system, but the adoption and implementation of a pension reform is unlikely before the gubernatorial and legislative elections in November 2012
- Strong ties to the U.S. economy, resulting in a significant flow of trade and income transfers, with exports to the U.S. accounting for approximately $46.4 billion (76% of GNP) in 2008. According to the U.S. Census Bureau, total income transfers from the U.S. to Puerto Rico totaled $13.5 billion (22% of GNP) in 2008 (the latest figure available), and
- Support from the Government Development Bank for Puerto Rico (BBB/Stable) which in our view provides a source of liquidity and market access for the commonwealth.

Based on the analytical factors we evaluate for U.S. states and territories, on a scale of '1' (strongest) to '4' (weakest), we have assigned a composite score of 3.0. Based on our criteria, an overall score of 3.0 is associated with an indicative credit level of 'A-'. Our criteria also specify overriding factors that may result in a rating different from the indicative credit level. In the case of Puerto Rico, we view its system support score and level of unfunded pension liabilities as overriding factors that result in a rating of two notches below its indicative credit level.

Outlook

The negative outlook reflects what we believe is a challenging economic and fiscal environment, which has the potential to delay a transition to structurally balanced budgets beyond fiscal 2013. In our view, structural balance by the end of fiscal 2013 remains critical to reducing the growth in the commonwealth's tax-supported debt, which has risen nearly 44% over the past three years primarily as a result of deficit financing. In our opinion, the current administration has taken decisive measures to restore fiscal balance. However, a steady economic recovery has failed to take hold, which we believe limits the government's ability to implement additional expenditure cuts and revenue enhancement measures in the near term. Given the disproportionate reliance of Puerto Rico's economy on federal transfers, a significant reduction in these transfers as a result of the implementation of the Federal Budget Control Act of 2011 could result in additional headwinds for the island's economy. Furthermore, we believe that the upcoming legislative and gubernatorial elections could forestall progress on the adoption and implementation of a meaningful solution to the commonwealth's unfunded pension and retirement obligations, which could further complicate the achievement of structurally balanced budgets.

We could revise our outlook back to stable if the economy gains positive momentum, fiscal discipline is maintained through fiscal 2013, and officials adopt and implement a credible solution to the commonwealth's unfunded pension and retirement liabilities. We could lower the rating by one notch if the economy deteriorates, the projected deficit for fiscal 2013 widens, or decisive action on pension reform is delayed beyond fiscal 2013.

Related Criteria And Research

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

- USPF Criteria: Contingent Liquidity Risks, March 5, 2012

Ratings Detail (As Of June 6, 2012)		
Puerto Rico pub imp rfdg bnds ser 2003C-5-2		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico pub imp rfdg bnds ser 2003 C-5-1		
Long Term Rating	BBB/NR/Negative	Outlook Revised
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico pub imp rfdg bnds ser 2012A due 07/01/2041		
Long Term Rating	BBB/Negative	Outlook Revised
Puerto Rico pub imp (AGM)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO		
Long Term Rating	BBB/NR/Negative	Outlook Revised
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO (wrap of insured) (CIFG & AGM) (SEC MKT)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO (wrap of insured) (FGIC) (ASSURED GTY) (SEC MKT)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO (wrap of insured) (RADIAN & FGIC) (SEC MKT)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO (wrap of insured) (SYNCORA) (ASSURED GTY) (SEC MKT)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO (AGM)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO (MBIA) (National) (SEC MKT)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico GO (AGM)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Long Term Rating	AA-/NR/Stable	Affirmed
Puerto Rico Indl Tour Ed Med & Environ Ctrl Fac Fin Auth ser 2001A (Humacao Judicial Ctr proj)		
Unenhanced Rating	BBB-(SPUR)/Negative	Rating Assigned
Puerto Rico VRDB subser A-2		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Long Term Rating	AA-/A-1/Stable	Affirmed
Puerto Rico Indl Tour Ed Med & Environ Ctrl Fac Fin Auth, Puerto Rico		
Puerto Rico		

Ratings Detail (As Of June 6, 2012) **(cont.)**		
Puerto Rico Indl Tour Ed Med & Environ Ctrl Fac Fin Auth (Puerto Rico) (Cayo Largo Inter-Continental Beach Resort Proj)		
Long Term Rating	BBB-/Negative	Outlook Revised
Puerto Rico Pub Bldgs Auth, Puerto Rico		
Puerto Rico		
Puerto Rico Pub Bldgs Auth (Puerto Rico) GO		
Long Term Rating	BBB/Negative	Outlook Revised
Puerto Rico Pub Bldgs Auth (Puerto Rico)		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Long Term Rating	BBB/Negative	Outlook Revised
Puerto Rico Pub Bldgs Auth (Puerto Rico) GO		
Unenhanced Rating	BBB(SPUR)/Negative	Outlook Revised
Puerto Rico Pub Fin Corp, Puerto Rico		
Puerto Rico		
Puerto Rico Pub Fin Corp (Puerto Rico)		
Long Term Rating	BBB-/Negative	Outlook Revised
Puerto Rico Pub Fin Corp (Puerto Rico)		
Long Term Rating	BBB-/Negative	Outlook Revised
Puerto Rico Pub Fin Corp (Puerto Rico)		
Long Term Rating	BBB-/Negative	Outlook Revised
Puerto Rico Pub Fin Corp (Puerto Rico) (Commonwealth Approp Bnds)		
Unenhanced Rating	BBB-(SPUR)/Negative	Outlook Revised

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.