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Puerto Rico Municipal Finance Agency; Miscellaneous Tax

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Puerto Rico Mun Fin Agy bnds ser A-C		
Long Term Rating	BBB-/Stable	Affirmed
Puerto Rico Mun Fin Agy misc tax		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico Mun Fin Agy (CIFG)		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services affirmed its 'BBB-' rating, and stable outlook on Puerto Rico Municipal Finance Agency's (MFA) bonds outstanding.

The rating reflects our view of the following credit strengths:

- A several obligation of participating municipalities, secured by a dedicated unlimited property tax levied by each municipality sufficient to cover the debt service on outstanding and proposed debt. Also pledged is a first lien on the basic property tax levied by municipalities, which has never been tapped to pay this debt service;
- Commonwealth appropriations of matching equalization funds, which historically have made up about 33% of total revenue dedicated to the payment of MFA debt service;
- A moral obligation pledge by the commonwealth to replenish the debt service reserve account, should any of the preceding sources prove insufficient to cover debt service; and
- Strong oversight by Government Development Bank for Puerto Rico (GDB) and strong coverage averaging 6x, based on the combination of special additional property tax, basic property tax, the municipal redemption fund balance, and commonwealth matching fund appropriations.

Limiting factors include:

- The presence of economically shallow participating municipalities whose individual tax bases may exhibit vulnerability during economic cycles; and
- The vulnerability of matching fund revenues, the appropriation of which could be affected by a downturn in the collection of the commonwealth's general revenues.

The bonds are secured by a several obligation of participating municipalities, secured by the full faith and credit of each municipality, including a dedicated property tax levied by each municipality sufficient to cover the debt service on outstanding and proposed debt. Also pledged is a first lien on the basic property tax levied by municipalities, which has never been tapped to pay this debt service. Commonwealth appropriations of matching equalization funds, which make up approximately 65% of estimated total revenue in fiscal 2010, are also pledged to the payment of MFA debt service. The security also includes a moral obligation pledge by the commonwealth to replenish the debt service reserve account, should any of the preceding sources prove insufficient to cover debt service. A total of 78 borrowers have taken out loans through the MFA totaling $426.8 million. The loans are concentrated among seven borrowers accounting for 58.8% of the total amount of the loans. San Juan is the single largest borrower, accounting for approximately 25% of the total. None of the borrowers is rated by Standard & Poor's.

The pledged revenues are collected by the central Municipal Revenues Collection Center (known by its Spanish acronym CRIM), on a pro rated basis for each participating municipality, with the amount needed for debt service deposited into a lock box--the excess is redistributed to the municipalities for operations after debt service obligations and reserve requirements are met. Added credit support is provided by a two-tier coverage test requiring minimum coverage for annual and maximum debt service to take on additional debt for municipalities that participate in the program. In addition, the monitoring mechanism prompts the GDB alert Standard & Poor's if the sum of any municipality's dedicated special tax levy (referred to as "CAE"), redemption fund balance, and the commonwealth's matching funds falls below 2x coverage of maximum annual debt service. This would trigger the intercept of basic operating property tax revenues and matching funds to be received by municipalities from the commonwealth. A reserve account is funded with MFA bond proceeds equal to the higher of a) 50% of maximum annual debt service (MADS) on the bonds; or b) 100% of the largest participating municipality's MADS. There is a moral obligation pledge on the part of the commonwealth to replenish the reserve fund if it is drawn on--an event that has never occurred. The program has a history of strong coverage of annual debt service, with average coverage for the payment of general obligation (GO) debt from all sources at 6x. The redemption fund balance provides individual coverage averaging 2.08x.

Outlook

The stable outlook reflects Standard & Poor's expectation that pledged redemption fund revenues will continue to provide strong coverage on annual debt service, and that the strong oversight mechanism implemented by GDB will remain in place.

Participating Municipalities/Structure

The MFA bonds are secured by a pledge of the debt service payments to be received from an underlying portfolio of GO bonds and notes issued by Puerto Rico's 78 municipalities and are secured by a pledge of the applicable municipality's ad valorem (property) taxes without limit as to rate or amount on all of its taxable properties. This unlimited tax is made up of two components. First, there is the CAE, which is a dedicated property tax of unlimited rate, the proceeds of which are deposited by CRIM into the municipality's redemption fund, a special fund held by GDB and used to service the municipality's GO debt. If the CAE revenues are insufficient, the bonds have a first lien on all other fixed-rate property taxes and other revenues of the municipality, including any commonwealth appropriations from a portion of its lottery revenues and commonwealth general fund monies that are paid to each municipality according to formulae established by the commonwealth and administered by CRIM.

The available revenues provide a diverse mix of funds available for repayment of municipal GO debt, including tax revenues from the 1.5% municipal sales and use tax. The municipal sales tax is collected by CRIM and jointly administered by the commonwealth Treasury department and the municipalities. The commonwealth Treasury sets aside 0.5% of the tax, which is dedicated for specific municipal uses such as solid waste, healthcare, etc, with the remaining 1% available for general purposes, including the repayment of municipal GO loans.

CRIM is responsible for the assessment, collection, and distribution of all municipal property taxes. CRIM is required by law to establish a trust fund at GDB known as the municipal redemption fund, which is the main source of repayment for municipal GO debt and MFA's bonds. The redemption fund includes the special additional property tax (CAE) collections levied by each municipality and collected by CRIM. If revenues in an individual redemption fund are insufficient to make debt service payments on the loans, CRIM is authorized to apply the revenues from that individual municipality captured in the matching fund to make debt service payments on its municipal debt. The matching fund includes revenues from commonwealth appropriations (2.5% of net internal general fund revenues), 35% of annual net revenues from the operation of the electronic lottery (currently capped at $26 million), and other transfers from the commonwealth's general fund to compensate for exemptions in taxable property.

There are a total of 78 municipalities participating in the MFA bond programs.

Commonwealth Oversight

The commonwealth's oversight powers, including the centralized collection and distribution of property taxes and other revenues owed to the municipalities, enhance the credit quality of the underlying municipal GO debt. CRIM is authorized by law to assess and collect all municipal property taxes and distribute the commonwealth's matching revenues to the municipalities. It first directs all property taxes collected to the GDB-held redemption fund to ensure the repayment of the municipality's GO debt. A first lien is placed on all property taxes collected for the repayment of debt. Most municipalities have fairly sizable redemption fund surpluses that, to the extent they do not exceed the next 12 moths' debt service on GO debt outstanding, can be used only for the repayment of such debt. Surpluses in excess of this amount can, at a municipality's option, be returned to the requesting municipality and used first for the payment of other statutory debts and then for general municipal purposes. Commonwealth law also provides for an equalization formula such that each municipality is guaranteed a minimum property tax revenue distribution regardless of its individual property tax collection performance.

GDB has executed a fiscal agency agreement whereby it is authorized and empowered to determine the amount and terms of the loans obtained by the participating municipalities. Furthermore, to obtain GDB approval for new municipal GO debt, participating municipalities must meet a two-tier test, which requires them to: 1) maintain a redemption fund balance and dedicated CAE property tax collections of at least 1x annual debt service; and 2) maintain 2x coverage of MADS based on the sum of their individual redemption fund balances, CAE property tax collections, basic property tax collections, and commonwealth contributions for the fiscal year preceding the fiscal year in which the proposed issue will be issued. In addition, the monitoring mechanism prompts GDB to alert Standard & Poor's if the sum of any municipality's CAE levy, redemption fund balance, and commonwealth's matching funds falls below 2x coverage of the municipality's MADS on its GO debt. This would trigger the intercept of basic operating property tax revenues and matching funds to be received by municipalities from the commonwealth.

Pledged Revenues

Municipal property tax revenues are broken into three levies. A 1.03% of assessed values (AV) special property levy is paid into the commonwealth's redemption fund, which is a GDB-held trust to make debt service payments on the commonwealth's (not the municipalities') debt. The special additional (CAE) property tax is the second part of the three levies and is the principal and intended source for the repayment of municipal GO debt. The special additional property tax is unlimited as to rate or amount, and used first for the payment of the levying municipality's GO bonds and notes. The third component of property tax is the basic property tax, levied at a maximum of 6% of the AV on all real property and 4% of the AV on real property. Since 1991, through an effort at decentralization these funds have been funneled to municipalities to provide equalization between larger and smaller municipalities. Before 1991, the basic tax was collected by the commonwealth. Commonwealth appropriations are used to equalize funding to local governments. These appropriations consist of 2.50% of net general fund revenues and 35% of net electronic lottery proceeds, up to a current annual cap of $26 million. General fund appropriations also provide reimbursement for a portion of the municipal property tax exemptions.

Municipal property tax revenues have remained relatively stable. Aggregate coverage of debt service based on the redemption fund balances and 2010 property tax collections is 6x, which we consider sound.

Related Criteria And Research

- USPF Criteria: Special Tax Bonds, June 13, 2007
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007