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Puerto Rico Infrastructure Financing Authority; Appropriations; Miscellaneous Tax

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Puerto Rico Infrastructure Fincg Auth misc tax		
Long Term Rating	BBB+/Stable	Affirmed
Puerto Rico Infrastructure Fing Auth, Puerto Rico		
Puerto Rico		
Puerto Rico Infrastructure Fing Auth (Puerto Rico)		
Long Term Rating	BBB+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has affirmed its 'BBB+' rating on Puerto Rico Infrastructure Financing Authority's special tax revenue bonds. The outlook is stable. While the Puerto Rico Constitution provides that public debt of the commonwealth has a first-lien claim on available commonwealth taxes and revenues, including the excise taxes that secure the bonds, our outlook reflects our belief that even in the event of a one-notch downgrade of the GO rating on Puerto Rico to 'BBB-', commonwealth officials will continue to exclude excise rum-tax collections from the revenues available to pay GO debt service. Our view on the outlook and rating could change if we were to lower the GO rating on Puerto Rico to below 'BBB-' and we believe that there is a change in the commonwealth officials' willingness to exclude excise rum tax collections from the revenues available for the repayment of GO debt service

The ratings continue to reflect our opinion of the following credit factors:

- The 'BBB' rating on Puerto Rico' GO debt;
- The commonwealth's pledge to make annual appropriations to cover debt service in the event other pledged revenues are insufficient;
- The strong pledge of certain federal excise taxes received by the commonwealth, where the first $117 million will be segregated in a trust fund to cover the bond's fairly level $113 million annual debt service; and
- A strong two-pronged additional bonds test that requires 2x coverage based on all applicable excise taxes to maximum annual debt service (MADS) and the pledged segregated excise taxes exceeding 1x MADS.

A pledge of federal excise taxes secures the bonds. These taxes currently consist of federal excise taxes levied on rum produced in Puerto Rico and sold in the U.S. The U.S. collects excise taxes and returns a portion to the commonwealth. Pursuant to the amended Puerto Rico Infrastructure Financing Authority enabling legislation, the Puerto Rico Secretary of the Treasury is required to deposit the first $117 million received from fiscals 2010-2057 into the Puerto Rico infrastructure fund to pay authority debt service. Although the tax rate has been amended from time to time, the transfer rate has generally increased or remained stable. The permanent amount of federal excise taxes transferred to the Virgin Islands by law is the lesser of $10.50 per proof gallon and the actual excise tax imposed, which is $13.50 per proof gallon. Although the U.S. Congress has yet to approve the extension of the $13.25 per proof gallon, which expired on Dec. 31, 2011, the current extender legislation is pending. While there are no assurances that it will be approved, historically it has been at that rate since 1990. Since 1917, the U.S. has transferred a portion of federal excise taxes, generated from applicable items produced in Puerto Rico and shipped to the U.S. or consumed in Puerto Rico, to the commonwealth. Puerto Rico-produced rum currently accounts for about 70% of all rum sold in the U.S.

Diageo, the owner of the Captain Morgan brand, has transferred all of its production of Captain Morgan rum to the U.S. Virgin Islands starting in 2012, under a 30-year contract. We believe that the impact of the loss of the cover-over excise tax revenue from Captain Morgan production will be significant, but should not affect the authority's ability to sufficiently cover debt service on its outstanding bonds. Commonwealth officials estimate the loss of the Captain Morgan production will represent approximately a $140 million reduction in rum tax collections. Assuming the loss of these revenues starting in 2012, pledged excise tax revenues would generate 2.2x coverage of MADS, which we consider strong. This loss of revenue may be mitigated, at least in part, by the commonwealth's efforts to spur other leading rum producers' production, including Bacardí Corp., which recently announced a $145 million expansion and upgrade of its facilities in Puerto Rico.

During the past five years, the commonwealth has received the first $117 million of federal excise taxes by the end of the sixth month of each fiscal year. Adjusted historical collections for 2000-2012 excise tax revenues have produced MADS coverage on existing debt service requirements ranging from 2.08x-3.87x. Additional bonds can be issued if all applicable excise taxes exceed 2x MADS and pledged excise taxes exceed 1x MADS. The authority maintains a MADS reserve fund for parity debt issues outstanding. Fiscal 2012 pledged revenues produced 3.4x coverage of MADS, which we consider strong.

The 'BBB+' rating on the authority is higher than the rating on other commonwealth appropriation-backed debt, given the security provided by the excise taxes and the commonwealth's annual appropriation to cover any annual deficiency. The Puerto Rico Legislature, however, is not legally obligated to make such an appropriation. In addition, the Puerto Rico Constitution provides that public debt of the commonwealth will account for a first lien on available commonwealth taxes and revenues, including the excise taxes that secure the bonds. Accordingly, if needed, excise tax revenues are subject to being applied first to the payment of debt service on the commonwealth's public debt but only if, and to the extent that, all other available revenues of the commonwealth are insufficient for that purpose. Puerto Rico has never used federal excise tax revenues to pay debt service on its public debt. Commonwealth officials do not anticipate the issuance of additional parity debt.

Puerto Rico Infrastructure Financing Authority was created in 1988, pursuant to Act No. 44 of the Legislature of Puerto Rico, as amended, to promote public investment in infrastructure. The authority also has the ability to contract with public instrumentalities to provide technical, administrative, and advisory assistance; borrow funds to finance public infrastructure projects; and exercise management oversight over assisted agencies.

Outlook

The stable outlook is based on the strong coverage of projected MADS, and our belief that even in the event of a one-notch lowering of the GO rating on Puerto Rico to 'BBB-', commonwealth officials will continue to exclude excise rum-tax collections from the revenues available to pay GO debt service. We could lower the rating by several notches if we were to lower the GO rating on Puerto Rico to below 'BBB-' and we believe that there is a change in the commonwealth officials' willingness to exclude excise rum tax collections from the revenues available for the repayment of GO debt service.

Update On The Rum Industry In Puerto Rico

Consumption trends for rum in the U.S. have consistently increased over the past five years. According to information provided by the commonwealth, rum's share of the distilled spirits market in the U.S. has increased for the 16th consecutive year, registering a 1.3% increase in 2011 relative to the prior year. Bacardi remains the category leader, accounting for approximately 37% share of the rum market.

The three main Puerto Rico distillers that produce rum for sale in the U.S. are Bacardi, Destilería Serrallés, and Edmundo B. Fernandez Inc. Bacardí has the largest operation, accounting for the majority of total Puerto Rico rum sold in the U.S. in 2009. Serrallés is known for producing its Don Q brand rum as well as other brands. In August 2012, Bacardi announced a $145 million expansion to its facilities in Puerto Rico. This investment was facilitated by approximately $95 million in incentives over five years from the authority. This incentive is part of a broader effort by the commonwealth to maintain and expand its presence in the rum-production market, particularly given the increased competition from the U.S. Virgin Islands and other rum-producing Caribbean countries.

Related Criteria And Research

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

Ratings Detail (As Of September 6, 2012)		
Puerto Rico Infrastructure Fing Auth, Puerto Rico		
Puerto Rico		
Puerto Rico Infrastructure Fing Auth (Puerto Rico) (wrap of insured) (FGIC & BHAC) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Stable	Affirmed
Puerto Rico Infrastructure Fing Auth (Puerto Rico)		
Unenhanced Rating	BBB+(SPUR)/Stable	Affirmed
Puerto Rico Infrastructure Fin Auth spl tax		
Unenhanced Rating	BBB+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.