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Rating On Three Puerto Rico PFC Series Lowered To 'D' On Non-Payment

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NEW YORK (Standard & Poor's) Aug. 3, 2015--Standard & Poor's Ratings Services has lowered its rating on \$1.0 billion of Puerto Rico Public Finance Corporation (PFC) series 2011A, 2011B, and 2012A bonds to 'D' from 'CC' following a payment default on the bonds as of the close of business Aug. 3, 2015, the first business day following the Aug. 1 stated due date, which fell on a Saturday. Although a partial payment of \$628,000 in interest was made Aug. 3, the amount was far short of the \$58 million of principal and interest due. We assign a rating of 'D' to obligations in default of full and timely debt service on their due date, unless we believe that such payments will be made within five business days.

This first default by Puerto Rico on tax-supported debt represents a significant departure from Puerto Rico's past practice of timely funding of debt service. We believe the default signals severe liquidity distress, whereby Puerto Rico must now choose among which financial obligations it can honor, and presages other possible defaults as liquidity becomes further constrained during the next few months. The default follows the legislature's decision not to appropriate debt service for these bonds in its fiscal 2016 budget.

In our view, Puerto Rico's decision to deliberately miss the PFC bonds' relatively small \$58 million debt service payment, compared to annual revenues of about \$9 billion, indicates that short-term liquidity distress has taken priority over preserving access to debt markets. We believe the small, short-term improvement in liquidity will come at the cost of investors'

worsened perception of Puerto Rico's willingness to pay debt, at a time when Puerto Rico needs cash flow financing to avoid running out of cash in the next few months. Last year Puerto Rico sold \$1.2 billion of fiscal 2015 cash flow notes; the \$703 million general fund operating deficit recently disclosed for the fiscal year ended June 30, 2015, has likely placed additional liquidity pressure on the commonwealth. We believe the PFC default may further impede Puerto Rico's ability to obtain financing for cash flow needs.

We believe these bonds may have been selected due to their limited recourse for PFC bondholders in the event of legislative non-appropriation; the 2016 budget does appropriate debt service for other series of bonds. In addition, the Aug. 1 PFC payment represented the start of principal repayment for the PFC bonds, for \$36.3 million, and thus an increase in debt service from previous years' PFC interest-only payments.

RELATED CRITERIA AND RESEARCH

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Criteria: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013

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