



Moody's Investors Service

Global Credit Research

Rating Update

19 MAY 2005

Save as PDF



Rating Update: [Puerto Rico \(Commonwealth of\)](#)

MOODY'S DOWNGRADES PUERTO RICO G.O. RATING TO Baa2

Rating outlook remains negative on \$23.2 billion of outstanding G.O. Bonds and related debt affected by today's action. \$800 million TRAN notes downgraded to MIG 2.

State
PR

Opinion

NEW YORK, May 19, 2005 -- Moody's Investors Service has downgraded the Commonwealth of Puerto Rico's general obligation bond rating to Baa2 from Baa1, and kept the rating outlook negative. The downgrade reflects:

* the Commonwealth's deteriorating General Fund financial condition in fiscal years 2004 and 2005, both of which have seen large operating deficits financed with borrowing,

* a greater-than-expected decline in the Commonwealth-owned Government Development Bank's net liquidity position during 2005 (due in part to the acceleration of govern grant and loan disbursement funded GDB resources),

* a significant increase in the Commonwealth's outstanding tax-supported debt, now approaching 60% of personal income, as a result of the budgetary deficit financings in the past two years as well as borrowings for government capital projects, and

* on a positive note, the recognition by Commonwealth officials of the necessity of restoring structural budget balance as soon as possible, as embodied in the fiscal 2006 budget proposals advanced to date.

The rating change also reflects a continuing problem of very large and growing unfunded government pension liabilities, despite steps taken to increase the retirement age and close the system to new participants a few years ago. In addition, while the Puerto Rico economy is currently recording positive growth on many measures, it continues to expand at a slower pace than the US mainland and could see some negative effects in future from the government's expected efforts to balance the budget through tax increases and slowing the rate of expenditure growth. The Commonwealth's role in the local economy is very large relative to other U.S. state and municipal governments, and thus its budget actions have a greater potential effect. The economy is now highly concentrated in pharmaceutical manufacturing, an industry that has continued to prosper despite the almost completed phase-out of federal tax incentives for US firms operating on the island. We do not expect the big pharma firms to be directly affected by the Commonwealth's budget problems.

Today's rating action affects \$7.3 billion of outstanding G.O. bonds and \$3.5 billion of Commonwealth guaranteed debt issued by government agencies, which carry the Commonwealth's G.O. rating. In addition,

\$4.4 billion of outstanding Commonwealth appropriation bonds have been downgraded to Baa3 from Baa2, and \$800 million of outstanding Commonwealth Tax and Revenue Anticipation Notes (TRANs) have been downgraded to MIG 2 from MIG 1. A further \$8 billion of outstanding revenue bonds related to transportation and infrastructure programs, as well as pooled municipal loans, have also been downgraded to Baa2 and Baa3 (see detailed list below).

The downgrade of the Commonwealth's Fiscal 2005 TRANs to MIG 2 reflects the increased net cash needs of the General Fund, combined with the greater-than-expected decline in the GDB's net liquidity position. Discussions with the bank indicate that its ability to support the cash needs of the General Fund is now dependent to a high degree on the bank's continued access to the public commercial paper market, including substantial CP note rollovers prior to the June 29, 2005 maturity date of the TRANs. While we do not believe that market access problems are likely to occur, this no longer meets our MIG 1 standard for short-term municipal notes. The GDB's commercial paper is not rated by Moody's. We note that the Commonwealth is required to set aside one-third of the note repayment obligation in a segregated repayment account in each of the months of April, May, and June. As of this week, \$370 million of the \$812 million total requirement has been segregated.

A more detailed Moody's report on the Commonwealth's finances, including the budgetary solutions proposed to date for both fiscal 2004 and 2005, will be published within the next day or so. We note that the Commonwealth's GAAP-basis audit report for fiscal 2004 has been completed, and indicates an accumulated General Fund unreserved balance of negative \$1.47 billion, representing a sharp deterioration.

Outlook

The rating outlook for the Commonwealth remains negative at this time, reflecting the size of the government's current financial problems and the likelihood that turning these problems around will take time to achieve and involve inevitable implementation risks. We are encouraged by government proposals to attempt to achieve budget balance without borrowing in the next fiscal year, and to increase the level of recurring pension contributions. There is also a proposal to issue a large pension funding bond to boost the funding level.

What could change the G.O. rating - Down?

* Protracted structural budget imbalance and reliance on deficit borrowing, and/or inability to replenish the GDB's liquidity position

What could change the G.O. rating - Up?

* Demonstration of balanced budget results not reliant on deficit borrowing, successful replenishment of GDB liquidity, and increase in recurring budgetary support of pension system, all within context of continued growth of local economy.

LIST OF CURRENT RATING CHANGES

From Baa1 to Baa2:

Commonwealth of Puerto Rico, General Obligation Bonds

Puerto Rico Aqueduct and Sewer Authority, Revenue Bonds (Commonwealth guaranteed)

Puerto Rico Public Building Authority, Government Facilities Revenue Bonds (Commonwealth guaranteed)

Puerto Rico Highway and Transportation Authority, Highway Revenue Bonds

Puerto Rico Highway and Transportation Authority, Transportation Revenue Bonds

Puerto Rico Infrastructure Finance Authority, Special Tax Revenue Bonds

Puerto Rico Municipal Finance Agency, 1997 Bonds, 1999 Bonds, and 2002 Bonds

From Baa2 to Baa3:

Puerto Rico Public Finance Authority, Commonwealth Appropriation Bonds

Puerto Rico Housing Bank and Finance Agency, Commonwealth Appropriation Bonds

Puerto Rico Highway and Transportation Authority, Subordinated Transportation Revenue Bonds

Puerto Rico Highway and Transportation Authority, Special Facility Revenue Refunding Bonds (Teodoro Moscoso Bridge)

From MIG 1 to MIG 2

Commonwealth of Puerto Rico, Tax and Revenue Anticipation Notes, Series 2005

Analysts

Timothy Blake
Analyst
Public Finance Group
Moody's Investors Service

Tod Trabocco
Backup Analyst
Public Finance Group
Moody's Investors Service

Gail Sussman
Director
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

© Copyright 2006, Moody's Investors Service, Inc. and/or its licensors including Moody's Assurance Company, Inc. (together, "MOODY'S"). All rights reserved.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY COPYRIGHT LAW AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused

by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from \$1,500 to \$2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moody's.com under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."

Moody's Investors Service Pty Limited does not hold an Australian financial services licence under the Corporations Act. This credit rating opinion has been prepared without taking into account any of your objectives, financial situation or needs. You should, before acting on the opinion, consider the appropriateness of the opinion having regard to your own objectives, financial situation and needs.