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Summary:

**Puerto Rico Port Authority
Luis Munoz Marin International
Airport; Ports/Port Authorities**

Primary Credit Analyst:

Laura A Macdonald, New York (1) 212-438-2519; laura_kuffler_macdonald@standardandpoors.com

Secondary Credit Analyst:

Joseph J Pezzimenti, New York (1) 212-438-2038; joseph_pezzimenti@standardandpoors.com

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Puerto Rico Port Authority Luis Munoz Marin International Airport; Ports/Port Authorities

| Credit Profile | | |
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| Puerto Rico Port Auth, Puerto Rico | | |
| Luis Munoz Marin Intl Arpt, Puerto Rico | | |
| Puerto Rico Port Auth (Luis Munoz Marin Intl Arpt) | | |
| <i>Unenhanced Rating</i> | BBB-(SPUR)/Stable | Downgraded |
| Puerto Rico Port Auth, Puerto Rico | | |
| Luis Munoz Marin Intl Arpt, Puerto Rico | | |
| Puerto Rico Port Auth (Luis Munoz Marin Intl Arpt) | | |
| <i>Long Term Rating</i> | BBB-/Stable | Downgraded |
| Many issues are enhanced by bond insurance. | | |

Rationale

Standard and Poor's Rating Services has lowered its rating on the Puerto Rico Port Authority's \$58.5 million revenue bonds outstanding, Issued for the Luis Munoz Marin International Airport (LMM), three notches to 'BBB-' from 'A-'. The outlook is stable. The downgrade reflects the authority's weak financial performance and increased reliance on Government Development Bank for Puerto Rico (GDB; BBB/Stable/A-2) to fund its capital and annual interest expense.

In our opinion, the rating reflects the following credit weaknesses:

- The authority's financial performance, which is integrally related to the fiscal climate of the commonwealth of Puerto Rico (BBB-/Stable) and the GDB, which provides the authority with or guarantees subordinate bank lines of credit;
- A history of weak combined debt service coverage on the senior and subordinate debt and generally weak liquidity;
- Significant volatility in the form of airport enplanements and cruise ship passengers; and
- Relatively high dependence on American Airlines Inc. (B-/Negative/--) and American Eagle service, constituting more than 60% of total enplanements.

We believe the following credit factors mitigate these weaknesses:

- Strong support from GDB, which provides the authority with substantial liquidity through lines of credit;
- Monopolistic control over all of Puerto Rico's airports and most of its ports;
- Operational and financial diversity from the authority's two principal facilities--LMM and the Port of San Juan; and
- A relatively high proportion of origination and destination (O&D) passengers (74%).

Securing the authority's \$58.5 million in revenue bonds outstanding is a pledge of net revenues of the authority facilities, which include 11 commercial airports and nine ports. A debt service reserve funded at the lesser of maximum annual debt service or 10% par amount of bonds provides additional security. The authority has substantial subordinate debt outstanding. A subordinate lien on authority revenues secures the subordinate-lien loans, currently at \$570.8 million. The GDB largely guarantees these loans. The subordinate loans have no minimum coverage requirement and a missed payment would not result in a default under the senior-lien indenture.

Puerto Rico's primary air traffic facility, LMM, is located on about 1,600 acres, six miles from downtown San Juan. After several years of healthy enplanement growth and recovery from the Sept. 11, 2001, terrorist attacks, passenger traffic growth has fallen since 2007. In 2007 and 2008 traffic declined 3% and 1%, respectively, due to rising fuel costs and the faltering regional economy. LMM enplaned 5.1 million passengers in fiscal 2008 and accounted for more than 90% of the authority's enplanements. Airline traffic still depends on tourism. For the four months year to date, enplanements fell 14.7%. For fiscal 2009, the airport has budgeted a 28% decline in enplanements due to American's reduced operations at the airport and the recession. American and American Eagle announced reductions in seat capacity by 45% as of September 2008. The decline in growth largely stems from fewer connecting passengers as American scales back its connecting operations and relies more on its mainline operations for service to the eastern Caribbean.

The authority's seaport facilities include wharves and piers for passenger terminal and general cargo facilities, special wharves for container and bulk cargo, and auxiliary support facilities. The Port of San Juan is the authority's busiest maritime port. Containerized cargo totaled about 7.5 million short tons in fiscal 2008, which has risen by about 2% annually since 2004. The authority's maritime facilities handled 9.4 million short tons in fiscal 2008; growth has been flat in the past five years. Cruise ship activity is a major component of the authority's seaport operations; it has increased about 3% per year since 2004. Cruise ship passengers totaled 1.5 million in 2008. Management has budgeted an 8% decline in cruise passengers for fiscal 2009 due to the recession. The decline is not as significant as on the aviation side of operations because cruises tend to book in advance and the cruise lines can offer significant discounts to ensure that ships are full.

The authority's financial operations fluctuate considerably due to a number of factors, including cyclicity in operations, a lack of strict controls on operating expenses, difficulties in collecting receivables, and a rising use of bank lines to support both operating and capital needs. However, we believe new management is committed to restoring the finances of the authority by providing greater expense controls and looking to enhance revenues. The authority's aviation and maritime segments have historically been relatively balanced, we believe, with aviation constituting 55% of fiscal 2008 total operating revenues, and maritime, the rest. The aviation operations obtain about half their revenues from the airlines and had a cost per enplaned passenger of more than \$9 budgeted for fiscal 2009. Fiscal 2008 maritime revenues totaled \$79 million, of which 16% was related to Continental Shipping Inc.; 7% from Horizon Lines of Puerto Rico Inc.; and 6% from Crowley Liner Services Inc. Fiscal 2008 cruise-related revenues totaled about \$13 million, of which 64% relates to Carnival Cruise Lines.

Debt service coverage on a senior-lien basis has been strong, in our view, covering senior-lien annual debt service by at least 2.2x in the past five years (fiscals 2004-2008). Aggregate debt service coverage in this same period is weak, we believe, covering senior-lien annual debt service and interest expense on various GDB and private lines of credit. Aggregate debt service coverage has been below 1x on a cash-flow basis from 2005-2007, due to rising interest expenses on the subordinate lines of credit. For fiscal 2008, combined senior and subordinate coverage is more than 1.15x, and we expect it to be 1.02x in fiscal 2009. However, from fiscals 2007-2009, the authority has paid part of

its interest expense on its subordinate lines of credit through a prefunded interest account that is also debt-financed. This line provided \$9.8 million in interest expense in fiscal 2007, and \$20.5 million in fiscal 2008; in fiscal 2009, we expect it to provide for \$20.4 million. Without this capitalized interest line, coverage on a combined basis would have been below 1x in 2008 and 2009. Although we believe the authority's senior-lien debt service coverage is strong, it has significant subordinate debt outstanding of about \$570.8 million, while senior revenue bond debt totals only \$58.5 million. While this subordinate debt is either with or guaranteed by the GDB, it remains a burden in that it has not covered the interest payments from net revenues in recent years. However, even during years of fiscal stress, the authority has sizably increased its borrowing lines primarily with GDB and other banks, to its current total. Should the GDB's support for the authority weaken, absent any financial improvement, we could lower the rating further. Liquidity for the authority is weak, we believe, with only \$3.1 million in unrestricted cash and investments at fiscal year-end 2008.

New management, in place since November's elections, faces many challenges and is working on implementing various revenue enhancement measures and reducing expenses. However, none of these will begin to take effect until fiscal 2010. Among the revenue-enhancing measures is a review of the tariffs at the regional and international airports. We also expect nonairline revenues to increase by raising concession space at the airport and implementing parking fees at the regional airports. Expense reductions should also occur as a result of closing some airports, reducing headcount, and increasing collection efforts on bad debt expenses. Should management not reduce expenses and increasing revenues such that it remains unable to meet its interest payments on the subordinate bank lines, the rating could be lowered.

Outlook

The stable outlook reflects our expectation that the authority will manage its financial operations such that debt service coverage on a senior basis remains strong, while aggregate debt service coverage exceeds 1.0x. If we lower the rating on either Puerto Rico or the GDB, the rating on the authority could face downward pressure. In addition, should the GDB's support of the authority's operations weaken, we could lower the rating.

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