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Puerto Rico Ports Authority; Ports/Port Authorities

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Puerto Rico Ports Authority; Ports/Port Authorities

Credit Profile		
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 & Poor's Ratings Services lowered its long-term rating and underlying rating (SPUR) to 'BBB-' from 'A-' on Puerto Rico Ports Authority's \$58.4 million outstanding revenue bonds. The outlook is stable.

The downgrade is based on the authority's weak financial performance combined with its increased reliance on the 'BBB' rated Government Development Bank for Puerto Rico (GDB; 'BBB') to fund its capital and annual interest expense.

The rating reflects the following credit weaknesses:

- The authority's financial performance is integrally related to the Commonwealth of Puerto Rico ('BBB-'), and GDB, which provide the authority with subordinate bank lines of credit or guarantees them;
- A history of weak combined debt service coverage on the senior and subordinate debt and generally weak liquidity;
- Significant volatility in airport enplanement and cruise ship passenger levels; and
- Relatively high dependence on American Airlines and American Eagle service, comprising more than 60% of total enplanements.

These credit weaknesses are partly mitigated by:

- Strong support from GDB, which provides the authority with substantial liquidity by offering lines of credit to the authority;
- Monopolistic control over all of Puerto Rico's airports and most of Puerto Rico's ports;
- Operational and financial diversity from the authority's two principal facilities--Luis Munoz Marin (LMM) International Airport and the Port of San Juan; and
- Relatively high proportion of origination and destination passengers (74%).

A pledge of the authority's facility net revenues, which includes 11 commercial airports and 9 ports, secures the \$58 million in revenue bonds outstanding. Additional security is provided by a debt service reserve funded at the lesser of

maximum annual debt service (MADS) or 10% par amount of bonds. The authority has substantial subordinate debt outstanding. A subordinate lien on authority revenues secures outstanding subordinate-lien loans, currently at \$574.2 million. These loans are largely guaranteed by the GDB. The subordinate loans have no minimum coverage requirement and a missed payment would not result in a default under the senior-lien indenture.

LLM, Puerto Rico's primary air traffic facility, is located on about 1,600 acres, six miles from downtown San Juan. LLM experienced several years of healthy enplanement growth and recovery from Sept. 11, 2001, but passenger traffic growth has been declining since 2007. In 2007 and 2008 traffic declined 3% and 1% due to rising fuel costs and the regional economy. LMM enplaned 5.1 million passengers in fiscal 2008 and accounted for more than 90% of the authority's enplanements. Airline traffic remains dependent on tourism. For the four months year to date, enplanements declined 14.7%. For fiscal 2009, the airport budgeted a 28% decline in enplanements due to American Airlines' reduction in its LMM operations and the current recession. American and American Eagle have announced reductions in seat capacity by 45% as of September 2008. The decline in growth largely stems from a decline in connecting passengers as American scales back its connecting operations at LMM and more heavily relies 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 grown by about 2% annually since 2004. The total volume of cargo handled by the authority's maritime facilities was 9.4 million short tons in fiscal 2008; growth has been flat over the past five years. Cruise ship activity is a major component of the authority's seaport operations and has grown at about 3% per year since 2004. Cruise ship passengers totaled 1.5 million in 2008. Management budgeted an 8% decline in cruise passengers for fiscal 2009 due to the current 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 cruises are fully booked.

The authority's financial operations have been subject to considerable fluctuations for several reasons including cyclicity in operations, a lack of strict controls on operating expenses, difficulties in collecting receivables, and a growing use of lines to support both operating and capital needs. However, new management appears to be committed to restoring the authority's finances by providing greater expense controls and looking to enhance revenues. The authority's aviation and maritime segments have historically been relatively balanced with aviation constituting 55% of fiscal 2008 total operating revenues and maritime constituting the remainder. About half of the aviation operations' revenues come 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, with 16% of that amount from Continental Shipping; 7% from Horizon Lines of Puerto Rico; and 6% from Crowley Liner Services. Fiscal 2008 cruise-related revenues totaled about \$13 million, of which 64% is related to Carnival Cruise Lines.

Debt service coverage on a senior-lien basis has been strong, covering senior-lien annual debt service by at least 2.2x over the past five years (fiscals 2004-2008). Aggregate debt service coverage over this same period is weak, covering senior-lien annual debt service and interest expense on various GDB lines of credit and private lines of credit. Aggregate debt service coverage has been less than 1x on a cash flow basis from 2005 to 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 expected to be 1.02x in fiscal 2009. However, from fiscal 2007 to 2009, the authority paid part of its interest expense on its subordinate lines of credit through a prefunded interest account that is also debt financed. In fiscal 2007, this line provided \$9.8 million in interest expense; \$20.5 million in 2008, and in fiscal 2009, this line is

expected to provide for \$20.4 million interest expense. Without this capitalized interest line of credit, coverage on a combined basis would have been less than 1x in 2008 and 2009. Although the authority's senior-lien debt service coverage is strong, the authority has significant subordinate debt outstanding of about \$570.8 million. Senior revenue bond debt totals only \$58.5 million, in comparison or only 9% of total debt. While this subordinate debt is with GDB or is guaranteed by GDB, it remains a burden on the authority in that they have not been able to cover 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 currently approved total. If GDB's support for the authority weakens, absent any financial improvement, the rating could be lowered further. The authority's liquidity is weak with only \$3.1 million in unrestricted cash and investments at fiscal year-end 2008.

The authority's new management, which has been in place since the elections, faces many challenges. It is working on many initiatives to improve operating performance by 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 in fiscal 2010. Nonairline revenues are also expected to increase by increasing concession space at the airport and implementing parking fees at the regional airports. Expense reductions should also occur through some airport closures, a reduction in headcount, and increased collection efforts on bad debt expenses. If management is not successful in reducing expenses and increasing revenues so that it remains unable to meet its interest payments on the subordinate bank lines, the rating could be lowered.

Outlook

The stable outlook reflects Standard & Poor's expectation that the authority will manage its financial operations so that debt service coverage on a senior basis remains strong, while aggregate debt service coverage exceeds 1.0x. If Standard & Poor's lowers its rating on Puerto Rico or GDB rating, the rating on the authority might be negatively affected. Additionally, if GDB's support of the authority's operations weaken, the rating could be lowered.

The Issuer

The authority, a public corporation, is charged with developing and managing maritime and air transportation to promote Puerto Rico's economy. The authority has a five-member board of directors, four of which are high-ranking commonwealth officials. Through its Maritime and Aviation Bureau, the authority operates 11 commercial airports and nine ports located throughout the island. Principal facilities include the Luis Munoz Marin International Airport in San Juan, the major airport for overseas service to and from Puerto Rico and the Port of San Juan, one of the busiest ocean terminals in the Caribbean.

Adequate Legal Provisions

Overall, the authority has an adequate legal structure. A pledge of net revenues of port authority properties secure the bonds. A debt service reserve funded at the lesser of maximum annual debt service (MADS) or 10% par amount of bonds provides additional security. Rates must be set to generate net revenues at the higher of indenture-required deposits, including maintenance reserve, or 1.25x coverage of MADS. Additional bond issuance is subject to a financial test covering a period five years after project completion, with a minimum coverage level of 150% MADS.

The authority has substantial subordinate debt outstanding. A subordinate lien on authority revenues secures outstanding subordinate-lien loans, currently at \$574.2 million, . These loans are largely guaranteed by GDB. The subordinate loans have no minimum coverage requirement and a missed payment would not result in a default under the senior-lien indenture.

Operations: Recent Decline In Airport Enplanement And Cruise Ship Passenger Levels

Puerto Rico's primary air traffic facility, Luis Munoz Marin International Airport (LMM), is located on about 1,600 acres, six miles from downtown San Juan. After several years of healthy enplanement growth and recovery following Sept. 11, 2001, passenger traffic growth at LMM has been declining since 2007. In 2007 and 2008, traffic declined 3% and 1%, respectively, due to rising fuel costs and the regional economy. LMM enplaned 5.1 million passengers in fiscal 2008 and accounted for more than 90% of the authority's enplanements. Airline traffic remains dependent on tourism. LMM has 36 gates in total.

The airport lead carrier is American Airlines (and its affiliates), which accounted for 61% of enplaned traffic in fiscal 2008. American operates out of 17 exclusive use gates under a long-term agreement that extends through March 2015. The remaining gates are leased to the other carriers under on a preferential basis through 2010. For the four months year to date, enplanements declined 14.7%. For fiscal 2009, the airport budgeted a 28% decline in enplanements due to American Airlines reducing its operations at the airport and the current recession. American and American Eagle have announced reductions in seat capacity by 45% as of September 2008. Other airlines, have managed to increase capacity or offer new or additional services. Thereafter, management assumes a further decline in 2010 of 2.4% before returning to growth, albeit at low levels (0.1%-1.6%) through 2013, the end of their forecast period. The decline in growth largely stems from a decline in connecting passengers as American scales back its connecting operations at LMM and more heavily relies on its mainline operations for service to the Eastern Caribbean.

The authority also operates several other airports on the island and has plans to close or reorganize some operations. The authority acquired Ceiba Airport from the U.S. Navy in February 2008. The estimated value of the transfer was \$88 million. The authority plans to operate Ceiba as a cargo airport but there will also be private-jet and commercial-airline service. The authority plans to close Fajardo Airport in fiscal 2009-2010 and all operations will be transferred to the newly acquired Ceiba Airport. Humacao Airport is expected to close also in fiscal 2009-2010 and operations will be transferred to Ceiba. The closing of these airports will yield operational savings. In addition, the authority is now leasing Mayaguez Airport to the municipality of Mayaguez, which covers the airport's operations and maintenance. Finally, the authority is considering privatizing Arecibo Airport.

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 grown by about 2% annually since 2004. The total volume of cargo handled by the authority's maritime facilities was 9.4 million short tons in fiscal 2008; growth has been flat over the past five years. Because Puerto Rico is a commonwealth, the authority's largest trading partner continues to be the U.S., which accounts for more than half of the total import and export cargo movement. Cruise ship activity is a major component of the authority's seaport operations and has grown at about 3% per year since 2004. Cruise ship passengers totaled 1.5 million in 2008.

Management budgeted an 8% decline in cruise passengers for fiscal 2009 due to the current 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 cruises are fully booked.

Capital Projects Underway

New management is in place and is currently evaluating the capital needs of the authority as well as their financial implications so no formal capital plan is in effect. The authority expects to open a new terminal A by year-end and an expansion of terminal D at LMM. In addition, the authority is looking to make utility improvements at Ceiba airport. Part of the funds for these projects comes from PFC. In addition, the authority has requested \$200 million under the U.S. economic stimulus package.

The authority is also continuing its plans to complete the modifications necessary to receive Royal Caribbean's 6,000-passenger Genesis class. The project's cost is \$24 million, with completion scheduled for fiscal 2010. The San Juan Waterfront project is the authority's main project at this time and entails the development of a large piece of waterfront property in San Juan, with a total estimated investment of \$2 billion. It will be developed in phases through 2024 and will consist of reconstructing a pier and public housing; a mega yacht marina, with a hotel and retail space; infrastructure improvements; and a park. Environmental studies are currently underway. The project will not be funded entirely by the authority.

Finances: Somewhat Volatile But New Management Dedicated To Improving Performance

The authority's financial operations have been subject to considerable fluctuations because of a number of factors, including cyclicalities in operations, a lack of strict controls on operating expenses, difficulties in collecting receivables, and a growing use of lines to support both operating and capital needs. However, new management appears to be 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 with aviation constituting 55% of fiscal 2008 total operating revenues and maritime constituting the remainder. About half of the aviation operations' revenues come from the airlines, which has a per-enplaned-passenger cost of more than \$9 budgeted for fiscal 2009. Fiscal 2008 maritime revenues totaled \$79 million,--16% from Continental Shipping, 7% from Horizon Lines of Puerto Rico, and 6% from Crowley Liner Services. Fiscal 2008 cruise-related revenues totaled about \$13 million, with 64% is related to Carnival Cruise Lines.

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strong, the authority has significant subordinate debt outstanding of about \$570.8 million. Senior-revenue debt totals only \$58.5 million, in comparison or only 9% of total debt. While the subordinate debt is with the GDB or is guaranteed by a GDB LOC, it remains a burden to the authority in that they have not been able to cover the interest payments from net revenues in fiscal 2008 and are not expected to do so fiscal 2009. However, even during years of fiscal stress, the authority has sizably increased its borrowing lines primarily with GDB and other banks, to its currently approved total. Most of the borrowings were for capital purposes. The authority's liquidity is weak with only \$3.1 million in unrestricted cash and investments at fiscal year-end 2008.

The authority's new management, which has been in place since the elections, faces many challenges. It is working on many initiatives to improve operating performance by 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 in fiscal 2010. Nonairline revenues are also expected to increase by increasing concession space at the airport and implementing parking fees at the regional airports. Expense reductions should also occur because of some airport closures, headcount reductions, and increased bad debt collection efforts. If management is not successful in reducing expenses and increasing revenues and remains unable to meet its interest payments on the subordinate bank lines, Standard & Poor's could lower its rating.

The authority's senior bonds are fixed rate. However, most of the authority's subordinate lines of credit are variable rate. The authority has entered into one floating- to fixed-rate swap for \$411 million on one of its lines of credit, leaving the authority with a net variable-rate exposure of 6%. GDB guarantees the authority's swap obligations. The authority has been assigned a Standard & Poor's DDP score of '2' on a scale of '1' to '4', with '1' representing the lowest risk and '4', the highest. The overall DDP score of '2' indicates that the swaps represent a low risk for the authority at this time.

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