STANDARD & POOR'S

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November 4, 2009

Summary:

Puerto Rico; General Obligation; Joint Criteria

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Credit Profile		
US$350. mil pub imp rfdg bnds (Go Bnds) ser 2009B due 07/01/2039		
Long Term Rating	BBB-/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'BBB-' rating to the Commonwealth of Puerto Rico's series 2009B public improvement refunding bonds. At the same time, Standard & Poor's affirmed its ratings on Puerto Rico's debt outstanding. The outlook on all ratings is stable.

The 'BBB-' ratings reflect our opinion of the commonwealth's:

- Chronic budget deficits--in the past 10 years, the commonwealth's structural budget deficit ballooned to an estimated $3.2 billion in fiscal 2009 (42% of general fund revenues). While Governor Luis Fortuño's fiscal stabilization plan has received broad support from the legislature, we do not anticipate structurally balanced budgets until fiscal 2013, which in our opinion poses a significant implementation risk, particularly given the challenging economic environment.
- High debt levels, with GO, appropriation, and sales tax revenue debt currently at about $21.8 billion or 35.9% of gross national product (GNP) and $5,477 per capita--when about $31 billion in debt from public corporations, agencies, and municipalities is included, the commonwealth's total public sector debt is a very high 83% of GNP; and protracted economic recession, as evidenced by the GNP contraction of 1.9% in fiscal 2007, 2.5% in fiscal 2008, and an estimated 3.4% in fiscal 2009.

Factors that continue to support the ratings include our opinion of the commonwealth's:

- Strong ties to the U.S. economy, resulting in a significant flow of trade investment income and income transfers, which according to commonwealth officials account for as much as 22% of GNP; and
- Support from the Government Development Bank of Puerto Rico (GDB), which provides a stabilizing financial and management influence, as well as a source of liquidity and market access for the commonwealth.

In our opinion, Puerto Rico continues to face significant fiscal and economic challenges. However, in the nine months since his inauguration, the administration of Gov. Fortuño has made fiscal stability a priority. With broad support from the legislature, Gov. Fortuño implemented a fiscal reconstruction plan designed to regain budgetary structural balance by fiscal 2013. On Sept. 25, 2009, commonwealth officials announced the second and final round of layoffs the current administration implemented as part of its fiscal stabilization plan (Law 7 of 2009) to address a $3.2 billion structural deficit. The announcement of a net reduction of 13,774 permanent positions increased the total positions cut during the current calendar year to approximately 18,575 (about 12% of total central government employees). Commonwealth officials estimate that the most recent round of layoffs will bring the total budget cuts to approximately $1.2 billion or 60% of the required $2 billion in expenditure reductions required under Law 7. Commonwealth officials plan to achieve the remaining required savings through the consolidation and reduction of government agencies, savings in the commonwealth's share of Medicaid ("health card"), and a 15% reduction in all government service contracts.

The fiscal measures adopted by the Fortuño administration, represent, in our opinion, a factor that lends near-term stability to the credit of the commonwealth. However, we expect that Gov. Fortuño's fiscal reconstruction program will remain challenged by a potential further decline in economic growth and the potential growing political pressure to delay or modify the scope of the identified payroll and expenditure costs.

Gov. Fortuño's proposed fiscal 2010 budget assumes flat revenue growth relative to actual fiscal 2009 recurring revenues, and general fund expenditures of $7.6 billion. However, the proposed fiscal 2010 budget includes $2.5 billion in the Stabilization Fund, which commonwealth officials expect to establish with the proceeds from the sale of Puerto Rico Sales Tax Financing Corporation subordinate lien bonds. The Stabilization Fund will be used primarily to pay for the costs associated with the payroll reductions and buyout plans included in the commonwealth's fiscal reconstruction plan. When the expenditures associated with the stabilization fund are included, the commonwealth's structural deficit for fiscal 2010 would reach $2.6 billion, or in our opinion a high 34.5% of general fund recurring revenues. Commonwealth officials expect that the majority of the expenditures being funded through the Stabilization Fund will be nonrecurring in subsequent fiscal years, gradually closing the structural deficit by fiscal 2013.

Standard & Poor's deems Puerto Rico's financial management practices "standard" under its Financial Management Assessment (FMA) methodology, indicating the commonwealth's finance department maintains adequate policies in most, but not all, key areas.

Overall debt levels remain high compared with the debt of other state and local governments and similarly rated sovereigns. The commonwealth's GO debt reached $9.7 billion, or approximately127% of general fund recurring revenues at year-end fiscal 2008. In addition, the commonwealth has $2.66 billion in appropriation debt, $1.4 billion in GDB loans outstanding, and $5.2 billion in senior lien sales tax revenue bonds. Debt service expenditures on the debt supported by the general fund reached $392.9 million in fiscal 2009, or approximately 5.1% of general fund recurring revenues.

Outlook

The stable outlook reflects our expectation that the administration and legislature will remain committed to the goals outlined in the fiscal reconstruction plan, allowing the commonwealth to gradually achieve structurally balanced budgets. In addition, the stable outlook reflects Standard & Poor's assumption of continued liquidity, financial, and management support from GDB. However, in our view, GDB's stabilizing effect on the commonwealth rating has its limitations. The rating may be pressured if Puerto Rico's reliance on GDB to fund the deficit increases materially or if the government does not continue to implement measures in the near term to reduce the structural deficit. In our view, Puerto Rico's ability to use GDB only as a temporary source of flexibility to implement meaningful measures to narrow the budget deficit and not as a long-term source of deficit financing may affect the commonwealth's credit stability.

Related Research

- USPF Criteria: "GO Debt," Oct. 12, 2006
- USPF Criteria: "Appropriation-Backed Obligations," June 13, 2007

Ratings Detail (As Of November 4, 2009)		
Puerto Rico GO ser 1989A		
Long Term Rating	BBB-/Stable	Affirmed
Puerto Rico GO ser 1999, 2002A&B, 2005A		
Long Term Rating	BBB-/Stable	Affirmed
Puerto Rico GO ser 2000, 2003 C-4 & C-5 sub-series C-7 (cusip#745145Z21)		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO ser 2002A&B		
Long Term Rating	BBB-/Stable	Affirmed
Puerto Rico GO ser 2002A&B (wrap of insured) (SYNCORA GTY) & (FSA - SEC MKT)		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO ser 2002A&B, 2003A (wrap of insured) (RADIAN & FGIC) (SEC MKT)		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO ser 2004 A&B (FSA)		
Long Term Rating	AAA/A-1/Negative	Affirmed
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO ser 2007A subser A-1-A-9 RMKT		
Long Term Rating	AA+/A-1+	Affirmed
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO ser 2007A (wrap of insured) (FGIC) (ASSURED GTY) (SEC MKT)		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO var ser		
Long Term Rating	BBB-/Stable	Affirmed
Puerto Rico GO ser 2003C-4 & 2003C-5 (FSA)		
Long Term Rating	AAA/A-1/Negative	Affirmed
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO 2003 B-C (MBIA) (National)		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico VRDB ser 2008B		
Long Term Rating	AA+/A-1+	Affirmed, Removed from CreditWatch
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico GO		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed

Ratings Detail (As Of November 4, 2009) (cont.)		
Puerto Rico VRDB subser A-2		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Long Term Rating	AAA/A-1+/Negative	Affirmed
Puerto Rico VRDB subser A-3		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Long Term Rating	AAA/A-1/Negative	Affirmed
Puerto Rico VRDB subser A-4		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Long Term Rating	AAA/A-1+/Negative	Affirmed
Puerto Rico Pub Bldgs Auth, Puerto Rico		
Puerto Rico		
Puerto Rico Pub Bldgs Auth GO (Puerto Rico) ser I &J, K&L, Q		
Long Term Rating	BBB-/Stable	Affirmed
Puerto Rico Pub Bldgs Auth (Puerto Rico)		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed
Puerto Rico Pub Bldgs Auth (Puerto Rico) GO		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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