

Puerto Rico Highways And Transportation Authority; Toll Roads Bridges

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Puerto Rico Hwy & Transp Auth hwy		
<i>Long Term Rating</i>	BBB+/Stable	Affirmed
Puerto Rico Hwy & Transp Auth		
<i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth hwy		
<i>Unenhanced Rating</i>	BBB+(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has affirmed its 'BBB+' rating on Puerto Rico Highways & Transportation Authority (PRHTA or the authority) series 2003 AA, subseries AA-1 and AA-2, highway revenue refunding bonds outstanding. In addition, Standard & Poor's affirmed its 'BBB' rating on the authority's series 2003H senior-lien transportation revenue refunding bonds. The authority plans to remarket these three series of bonds to convert them to fixed rate, in anticipation of a mandatory tender scheduled for July 1, 2010.

Standard & Poor's also affirmed its long-term ratings and underlying ratings on PRHTA outstanding highway revenue bonds at 'BBB+', the authority's senior transportation revenue bonds at 'BBB', and the authority's subordinate transportation revenue bonds at 'BBB-'.

The rating reflects the application of our government-related entities (GRE) criteria. The outlook on all ratings is stable.

In accordance with our criteria for GREs, our view of a "moderate" likelihood of extraordinary government support reflects our assessment of PRHTA's "limited" link with the government of Puerto Rico (BBB-/Stable) and our assessment of PRHTA's "important role" that it plays as the provider of mass transit services in San Juan and the operator of the major roads on the island. The assessment also reflects the history of support provided by the Government Development Bank for Puerto Rico (GDB; BBB/Stable/--) and its stated intentions to continue to support the authority as required. If the general obligation (GO) rating on the commonwealth changes, the ratings on PRHTA might also change.

As of June 1, 2010, the authority has \$1.6 billion in debt outstanding under its closed 1968 resolution, \$4.2 billion in senior bonds outstanding under the 1988 bond resolution, and \$362.4 million in subordinate bonds outstanding under the 1998 bond resolution. In addition, the authority has \$107.8 million in grant anticipation bonds (series 2004). With the remarketing of the series 2003 bonds, the authority will reduce its variable rate debt exposure to approximately 10% of its total debt portfolio.

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

- Constitutional law in Puerto Rico that grants the bondholders of GO debt a senior right to all available tax income, including taxes pledged to this issuance (pledged toll road income is excluded from this law);
- Dependence on continued economic prosperity and growth in pledged revenue streams to provide sufficient funding and resources for the capital improvement program (CIP) and increases in operating expenses for the tollways and Tren Urbano, the new mass transit system that the authority manages;
- Erosion of cash-flow coverage of all obligations. In recent years, operating expenses have increased substantially due to the operation of Tren Urbano. At the same time, tax revenues have seen only modest growth. The combination of these have resulted in the authority generating cash flow coverage of all obligations including the payment of operating expenses of only 0.6x in fiscal 2009. All obligations have been met through the use of available fund balances and interim lines of credit from the GDB. It is our understanding that the authority's current management is keen on reducing operating expenditures and year-to-date operating expenditures for fiscal 2010 are 18% lower than in fiscal 2009; and
- The challenge of effectively managing a large billion highway CIP through fiscal 2012 while containing project costs and ensuring that quality standards are maintained.

In our opinion, offsetting credit strengths include:

- The essential nature of PRHTA's highway and transportation system;
- The instrumental role the authority's highway and transportation system plays in the continued economic growth of the commonwealth; and
- A diverse pledge of gas taxes, motor vehicle fees, and toll receipts.

A very diverse mix of taxes and fees secure the bonds. PRHTA's operating expenses from the tollway are legally subordinate to debt service payments and are paid from surplus funds. For fiscal year-end 2009 (June 30), the authority's pledged revenues totaled an estimated \$593.6 million, of which toll revenues accounted for about 36%, followed by gasoline taxes (29%), petroleum taxes (17%), motor vehicle license fees (6%), and gas and diesel oil taxes (2.3%).

Although 1998 resolution bondholders have a junior claim on revenue pledged under the closed 1968 resolution, they benefit from the additional pledge of the first \$120 million in petroleum taxes per year. Petroleum tax revenue is not part of pledged revenues under the 1968 resolution. The authority's finances have been under pressure from the various tax revenues, which in general have not risen with the rate of inflation. For fiscal 2009, pledged revenues for the 1968 resolution bonds totaled an estimated \$419 million, generating strong gross revenue debt service coverage of 3.21x. Pledged revenues for the 1998 resolution bonds totaled an estimated \$426.2 million, which generated 1.76x coverage on the senior 1998 resolution bonds and 1.69x coverage on the combined senior and subordinate resolution bond. Combined gross pledged revenues totaled an estimated \$556.1 million, providing 1.49x coverage of combined annual 1968 and 1998 senior debt service and 1.46x coverage of all debt service. The authority pays operating expenses subordinate to debt service on both resolutions and can pay them from the 1998 construction fund to the extent money is available. Beginning in fiscal 2006, operating expenses increased, due primarily to the inclusion of operating costs for Tren Urbano.

The authority has not been able to meet its debt service requirements and operating expenses from recurring revenues and has had to rely on available money in the construction fund and on interim financing lines of credit from the GDB. Over the past 10 years, GDB has made available to the authority approximately \$949 million in credit lines. About 86% of this amount has been used to fund capital improvements, with the remaining 14% used

for working capital.

Outlook

The stable outlook reflects our assessment of the PRHTA's essential nature and diverse revenue pledge. The outlook also reflects our expectations that management will bring structural balance to the authority's finances while prudently managing its capital program. However, if the rating on the commonwealth should change materially, we could revise the rating on PRHTA's bonds due to the close link between the rating on the commonwealth and that on the authority.

Issuer

The Puerto Rico Highway Authority (PRHA) was created in 1965 as an autonomous public authority. Reorganization in 1971 abolished the authority's board of directors and vested management responsibilities with the commonwealth's department of transportation and public works (DTPW). The DTPW secretary now holds powers that previously belonged to the board of directors. The rationale behind the reorganization was to make the authority a part of the state's intermodal umbrella, consisting of five separate departments and directed by the DTPW. In 1991, PRHA was renamed the PRHTA. The authority's responsibilities have evolved, and now cover mass transit. This includes the construction, operation, and maintenance of the island's first mass transit rail facility, Tren Urbano. PRHTA is the only one of DTPW's departments that has its own funding sources. Its primary responsibilities include planning, construction, operation, and maintaining the island's highway system. It also owns and oversees privatized toll facilities (such as the Teodoro Moscoso Bridge).

The Authority Act grants PRHTA plenary power to fix, impose, alter, and collect tolls and other reasonable charges for the use of its transportation facilities. PRHTA charges tolls on the Luis A. Ferré toll highway (PR-52), which extends 67 miles from San Juan to Ponce; the De Diego toll highway (PR-22), which extends 52 miles from San Juan to Arecibo; PR-53, which will connect Fajardo and Salinas upon its completion, a distance of 57 miles, of which 37 miles have been completed; and the Martínez Nadal Expressway (PR-20), which extends six miles, connecting PR-2 with PR-1 at the La Muda sector near Caguas. The authority also began collecting tolls on PR-5 (which connects PR-2 to PR-199, Las Cumbres Avenue) and PR-66 in fiscal 2006. PR-66 starts in the city of Carolina and ends in the municipality of Canovanas, intersecting with PR-3. It is currently 9.2 miles long but is being extended to the municipality of Rio Grande; upon completion, it will be 12.4 miles long.

Management

The current administration has made expenditure control a top priority for the government of the commonwealth at large, including the authority. As such, management has implemented expenditure cuts that have resulted in an 18% reduction in operating expenditures in fiscal 2010 compared with fiscal 2009. For the next five years, management is projecting a reduction of approximately \$78 million (about 24%) in operating expenditures, which we view as difficult to implement, given the recent trends in operating expenditures and the current economic environment in Puerto Rico. These expenditure cuts include about \$27 million in cuts through staff reductions, as well as the elimination of approximately \$24 million in annual subsidies to the Tren Urbano.

In addition, management is considering executing a public-private partnership agreement for Puerto Rico Highway

22 (PR-22), which could achieve a significant upfront payment. The road currently accounts for 42% of toll revenues. Any sale or concession of PR-22 would only be completed if the current credit ratings on the authority are affirmed.

Legal Provisions

Although pledged revenues are deposited into a special fund, according to Puerto Rico's constitution, certain revenues could be redirected to pay the commonwealth's general obligation debt first, if other resources are insufficient. This applies to gasoline, diesel, and vehicle registration taxes, but not to toll road income. Although Puerto Rico has never used any resources allocated to PRHTA to pay its own debt, its fundamentally weaker credit profile results in a tighter link between the two entities.

Other than the above provision, we believe the flow of funds under the authorizing resolution is relatively standard for a highway debt financing. The authority has \$1.6 billion in debt outstanding under its closed 1968 resolution; \$4.2 billion in senior bonds outstanding under the 1998 bond resolution; and \$362.4 million in subordinate bonds outstanding under the 1998 resolution.

In our view, bondholders benefit from a gross revenue pledge. Monthly payments are made to principal and interest accounts, first on behalf of the 1968 bonds; then on behalf of the 1998 bonds; and then for the subordinate bonds. The 1968 and senior transportation bonds also benefit from debt service reserve accounts that are funded before making payments to the subordinate bond principal, interest, or reserve accounts. The subordinated revenue bonds have a junior lien on revenues. However, providing additional security is a highly funded reserve with a minimum required level set to the greater of 20% of bonds outstanding or 250% of maximum annual debt service. After satisfying the subordinate debt requirements, funds flow to the 1998 construction fund, to which the operating and maintenance costs can be paid. First available funds will replenish deficiencies in the debt service reserve account, if any.

Overall, securing the revenue bonds is a relatively diverse mix of revenue streams, consisting of:

- Gasoline taxes of 16 cents per gallon;
- First \$15 per vehicle of motor vehicle license fees;
- Toll road income;
- Diesel oil taxes of 4 cents per gallon; and
- The first \$120 million of petroleum tax income.

The petroleum tax revenue source is only pledged to bondholders secured under the 1998 resolution and does not benefit bondholders secured under the 1968 resolution. The petroleum tax is a wholesale per-barrel tax that declines as the price of a barrel of petroleum increases (see table).

Puerto Rico Highways and Transportation Authority -- Petroleum Tax	
Price of oil per barrel (\$)	Petroleum tax per barrel (\$)
16.00 and lower	6
16.01-24.00	5
24.01-28.00	4
28.01 and higher	3

The additional bonds tests are adequate, in our view, allowing the authority to issue additional senior and subordinated debt issuances only under the 1998 resolution if historical revenues provide 1.50x and 1.25x coverage of pro forma maximum annual debt service, respectively. The authority may only issue bonds under the 1968 resolution for refunding purposes.

Variable Rate Exposure

Following the proposed remarketing of the series 2003 bonds, the authority will have \$647 million in variable-rate debt (approximately 10% of its total debt outstanding). All of the authority's variable rate debt is synthetically fixed through six different swap contracts. As of June 4, 2010, the authority's mark-to-market on its six swaps was negative \$104.5 million. Given the deterioration in the credit quality of the insurer backing some of these swap transactions, the authority has been required to post collateral, the most recent posting of about \$9 million in May 2010. The potential collateral exposure upon downgrade of one of the counterparties is currently estimated at \$13.9 million, which management would cover with cash on hand or a credit facility provided by GDB.

Following the remarketing of the series 2003 bonds, the authority's variable rate debt portfolio will have only limited rollover risk. Of the total amount of variable rate debt outstanding, only \$200 million are variable rate debt demand obligations, backed by a line of credit that expires on May 27, 2011.

Related Criteria And Research

- General Criteria: Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- USPF Criteria: Toll Road And Bridge Revenue Bonds, June 13, 2007

Ratings Detail (As Of June 17, 2010)		
Puerto Rico Hwy & Transp Auth hwy (wrap of insured) (FGIC & RADIAN) (SEC MKT) <i>Unenhanced Rating</i>	BBB+(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth subord transp (wrap of insured) (FGIC & RADIAN) (SEC MKT) <i>Unenhanced Rating</i>	BBB-(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp <i>Long Term Rating</i>	BBB/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp rev bnds ser B dtd 05/15/2000 due 07/01/2001-2021 2026-2027 2029 2031 2035 2039 <i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp (wrap of insured) (ASSURED GTY & CIFG) (SEC MKT) <i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp (wrap of insured) (ASSURED & AGM) (SEC MKT) <i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp (wrap of insured) (FGIC & BHAC) (SEC MKT) <i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp (wrap of insured) (FGIC) (ASSURED GTY) (SEC MKT) <i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed

Ratings Detail (As Of June 17, 2010) (cont.)		
Puerto Rico Hwy & Transp Auth Sub Transp Rev Bnds <i>Long Term Rating</i>	BBB-/Stable	Affirmed
Puerto Rico Hwy & Transp Auth D (AGM) <i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth (wrap of insured) (FGIC & RADIAN) (SEC MKT) <i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth		
<i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth hwy		
<i>Unenhanced Rating</i>	BBB+(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth subord transp		
<i>Unenhanced Rating</i>	BBB-(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp		
<i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth transp VRDB ser 1998		
<i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
<i>Long Term Rating</i>	AAA/A-1+	Affirmed, Removed from CreditWatch
Puerto Rico Hwy & Transp Auth 1st lien transp		
<i>Unenhanced Rating</i>	BBB(SPUR)/Stable	Affirmed
Puerto Rico Hwy & Transp Auth, Puerto Rico		
Teodoro Moscoso Br, Puerto Rico		
Puerto Rico Hwy & Transp Auth (Teodoro Moscoso Br) spl fac		
<i>Long Term Rating</i>	BBB-/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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