STANDARD &POOR'S Global Credit Portal®
RatingsDirect

Research

## Summary:

# Puerto Rico Sales Tax Financing Corp.; Sales Tax

**15-Nov-2011**

| Credit Profile | | Current Ratings |
|---|---|---|
| **US$400.0 mil sales tax rev bnds, first sub ser 2011A-1 due 08/01/2043** | | |
| *Long Term Rating* | A+/Stable | New |
| **US$327.5 mil sales tax rev bnds, first sub ser 2011A-2 due 08/01/2043** | | |
| *Long Term Rating* | A+/Stable | New |
| **US$42.0 mil sales tax rev bnds, first sub ser 2011B due 08/01/2036** | | |
| *Long Term Rating* | A+/Stable | New |

## Rationale

Standard & Poor's Ratings Services has assigned its 'A+' rating to **Puerto Rico Sales Tax Financing Corp.'s** (COFINA) approximately $769 million in first subordinate sales tax revenue bonds, series 2011A and series 2011B. At the same time, Standard & Poor's affirmed its 'AA-' rating on the corporation's approximately $5.7 billion in senior lien sales tax revenue bonds outstanding. Standard & Poor's also affirmed its 'A+' rating on COFINA's first subordinate sale tax revenue bonds outstanding. The outlook is stable.

The ratings reflect our opinion of:

- The corporation's strong legal structure that successfully separates the revenue stream securing the bonds from the **Commonwealth of Puerto Rico** (general obligation rating: BBB/Stable);
- The resilient performance of the pledged sales tax revenues, which have exhibited only a modest decline despite the prolonged and deep recession Puerto Rico has experienced in the past four years; and
- COFINA's priority access to the entire 5.5% sales and use tax (SUT) that Puerto Rico collects, which provides adequate coverage of all senior and subordinate projected debt service payments, even under severe stress assumptions.

Constraining the ratings is our 'BBB' GO rating on Puerto Rico, because in our view the structure securing the bonds cannot completely isolate COFINA's bondholders from commonwealth's financial and economic condition. The ability to levy and collect SUTs depends directly on the underlying economic activity in Puerto Rico, which the government's financial condition can affect, and the structure supporting the bonds cannot entirely eliminate that dependence.

Commonwealth officials plan to use approximately $376 million of bond proceeds to fund the its cash flow needs for fiscal 2012. The rest will refund a portion of the corporation's bonds outstanding.

Debt service coverage of senior lien bonds is very strong, in our view. SUT revenues from the 2.75% dedicated to COFINA provided 3.22x coverage in fiscal 2011. Revenues from the entire 5.5% Commonwealth sales tax provided what we believe is a very strong 6.3x senior lien debt service coverage in fiscal 2011. Assuming that sales tax collections remained at 2011 levels, the 5.5% tax would provide sufficient coverage of senior-lien debt service through 2055. Debt service coverage on the first subordinate-lien provided by the entire tax is adequate, in our view, at 2.1x in fiscal 2011. If sales tax collections stay at fiscal 2011 levels, the tax would be insufficient to cover both the senior and subordinate bonds starting in fiscal 2029. We consider this to be an unlikely scenario, given the historical patterns of personal consumption and the sales tax base's resilience, which we expect will result in an overall increase in sales tax collections in the next 20 years.

The legislative act creating COFINA, Law 91 of 2006, separates and provides a priority interest in Puerto Rico's sales and use taxes for the bondholders. Law 91 provides that all revenues from SUT go directly to COFINA until a guaranteed base amount of tax collections is met. The statute further grants a statutory lien to bondholders on the commonwealth's sales and use tax revenues once any bonds are issued. In addition, the corporation is not permitted to voluntarily file for bankruptcy protection and cannot be forced into involuntary bankruptcy. Furthermore, Standard & Poor's received multiple legal opinions stating that Law 91 transfers property of the sales and use tax collections to COFINA. This effectively excludes the pledged SUT revenues from Puerto Rico's constitutional provision regarding the commonwealth GO debt's first-lien claim on all available revenues (also known as the claw-back constitutional provision).

COFINA is a corporate and political entity independent and separate from the commonwealth. It was created with the purpose of issuing bonds and using other means to pay or refinance all or part of Puerto Rico's extra-constitutional (appropriation) debt as of June 30, 2006 (totaling $6.8 billion). In early 2009, the legislature approved an amendment to Law 91 that expanded COFINA's corporate purpose to include funding the commonwealth's budget deficit through fiscal 2012; paying accrued obligations to suppliers; establishing a local stimulus plan; and creating emergency fund to cover expenses related to catastrophic events such as hurricanes and floods. To meet the corporation's expanded purpose, the amendment increased the percentage of sales tax receipts pledged directly to the dedicated sales tax fund (Fondo de Interes Apremiante, or FIA) to 2.75% from 1%. The FIA will be funded with the first revenues collected by the entire 5.5% SUT, until revenues reach the collections equivalent to the 2.75% dedicated sales and use tax or an annual guaranteed base amount, whichever is greater. The base amount increases by a 4% annual adjustment factor. Regardless of sales tax collections based on the 2.75% dedicated sales tax, Law 91 requires that all of the 5.5% SUT be applied to satisfy and fund the base amount before any money can be transferred to the general fund.

COFINA's ability to issue senior lien bonds remains limited by statute to the total amount of extra-constitutional debt as of June 30, 2006. In addition, the resolution requires that SUT revenues for the fiscal year before the additional bonds' issuance (increased by the 4% annual adjustment factor) provide at least 3.0x coverage of annual debt service on all existing and proposed senior-lien bonds. Consequently, COFINA will not issue additional senior-lien bonds unless it is to refund or to expects payment on extra-constitutional debt and related obligations and for refundings that provide annual savings. The subordinate-lien bonds have a two-pronged additional bonds test (ABT) that requires 102% of the annual combined senior and subordinate bond principal and interest payments due in each year to be less than the amended base amount for the corresponding year. The base amount equaled $550.1 million for fiscal 2010, escalated by 4% thereafter, and is capped at $1.85 billion. In addition, the subordinate-lien ABT requires that total sales taxes collected in the year before the bonds' issuance (increased by an annual factor of 4%) provide at least 2.0x coverage of combined annual senior and subordinate lien bonds in every year bonds are outstanding.

## Outlook

The stable outlook reflects Standard & Poor's expectation that the structural and legal strengths supporting COFINA's bonds will stay the same. In addition, the outlook reflects what we believe are the prospects for strong coverage of debt service from revenues from the 5.5% SUT to pay the base amount. The issuance of subordinate-lien debt in an amount that results in a potential significant reduction of annual debt service coverage due to an increased reliance on sales tax growth could result in downward pressure on the subordinate-lien rating.

## Related Criteria And Research

- USPF Criteria: **Short-Term Debt**, June 15, 2007
- USPF Criteria: **Special Tax Bonds**, June 13, 2007

**Ratings Detail** (As Of 15-Nov-2011)

| | | |
|---|---|---|
| **Puerto Rico Sales Tax Fin Corp sales tax ser 2007ABC, 2008A, 2009C** | | |
| *Long Term Rating* | AA-/Stable | Affirmed |
| **Puerto Rico Sales Tax Fin Corp sales tax ser 2007A (wrap of insured) (AMBAC & BHAC) (SEC MKT)** | | |
| *Unenhanced Rating* | AA-(SPUR)/Stable | Affirmed |
| **Puerto Rico Sales Tax Fin Corp sales tax ser 2007A (wrap of insured) (FGIC & BHAC) (SEC MKT)** | | |
| *Unenhanced Rating* | AA-(SPUR)/Stable | Affirmed |
| **Puerto Rico Sales Tax Fin Corp sales tax ser 2009A** | | |
| *Long Term Rating* | A+/Stable | Affirmed |
| **Puerto Rico Sales Tax Fin Corp sales tax ser 2010A, 2010C (AGM)** | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Affirmed |
| **Puerto Rico Sales Tax Fin Corp sales tax** | | |
| *Unenhanced Rating* | AA-(SPUR)/Stable | Affirmed |

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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