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Puerto Rico GO Rating Lowered To 'CCC-' From 'CCC+'; Outlook Is Negative On Likelihood Of Default Or Distressed Exchange

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NEW YORK (Standard & Poor's) June 29, 2015--Standard & Poor's Ratings Services has lowered its general obligation (GO) rating on the Commonwealth of Puerto Rico to 'CCC-' from 'CCC+'. At the same time, Standard & Poor's has removed the GO rating from CreditWatch, where it was placed with negative implications on April 24, 2015, and assigned a negative outlook.

In addition, Standard & Poor's has lowered its ratings to 'CCC-' from 'CCC+' on:

- Puerto Rico Sales Tax Financing Corp.'s (COFINA) first-lien and second-lien sales tax bonds;
- Puerto Rico Municipal Finance Agency's, the Puerto Rico Employees Retirement System's, and the commonwealth's general fund-supported appropriation and moral obligation bonds;
- Puerto Rico Infrastructure Financing Authority's (rum tax) and the Puerto Rico Convention Center District Authority's (hotel tax) debt; and
- Puerto Rico Highway and Transportation Authority's (HTA) rated debt.

The downgrades are based on our view that a default, distressed exchange, or redemption of the commonwealth's debt appears to be inevitable within the next six months absent unanticipated significantly favorable changes in the issuers' circumstances. We believe that the administration's embrace of a report released June 29, that it commissioned, which recommends consideration of a restructuring of the commonwealth's debts among other options, taken together with Puerto Rico's ongoing fiscal struggles—a diminished liquidity position, constraints on external market access for needed cash flow financing, and delay in enacting a budget for the new fiscal year that begins July 1—indicates that the potential for a restructuring of some or all of the commonwealth's debt is a significant possibility over the next six months.

We have placed all debt at the same 'CCC-' level, reflecting our view that all debt obligations are potentially at risk for possible restructuring due to the severity of Puerto Rico's current fiscal situation. The negative outlook reflects that there is at least a one in three chance we could lower the rating upon a formal announcement by Puerto Rico that it intends to undertake an exchange offer or similar restructuring that we classify as distressed, or that it has an intention to miss a debt service payment.

We understand the commonwealth intends to pay short-term notes due June 30 and general fund-supported obligations on July 1. However, we believe the commonwealth's very weak liquidity and difficulty in obtaining external market access for cash flow financing raises the likelihood of a debt restructuring within the next six months. In our view, Puerto Rico must obtain adequate external cash flow financing within that time frame even if pending bills that would allow the use of liquidity in state insurance and retirement funds were enacted into law and approved by their funds' respective boards. Adding pressure to Puerto Rico's liquidity and external market access is its most recent projection of a general fund operating deficit in fiscal 2015 and a larger than forecasted gap for 2016 with no clarity on when a budget will be finalized.

The new report "Puerto Rico--A Way Forward" by consultants Anne Krueger, Ranjit Teja, and Andrew Wolfe, released by the Puerto Rico Government Development Bank, identifies a "fast deteriorating" cash flow position and very large out-year central government budget gaps that approach the size of current full year general fund revenues. The report projects a fiscal 2016 budget gap of $3.7 billion, absent corrective action, which would rise to $6.0 billion by 2018 and higher in subsequent years. We view these projected out-year gaps as unmanageable in relation to fiscal 2015 estimated general fund revenue of only $9.6 billion. The report lists debt restructuring as an important government option.

OUTLOOK

Should Puerto Rico announce an intention to miss debt payments or undertake an exchange offer or similar restructuring that we classify as distressed, or if we conclude it has inadequate resources to meet an impending debt obligation, we could lower our rating within the year. Should Puerto Rico restore adequate liquidity without a debt exchange, which we view as not likely, we could raise the outlook or rating.

RELATED CRITERIA AND RESEARCH

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006

- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Special Tax Bonds, June 13, 2007
- General Criteria: The Interaction Of Bond Insurance And Credit Ratings, Aug. 24, 2009
- USPF Criteria: Moral Obligation Bonds, June 27, 2006
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

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