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Research Update:

Government Development Bank for Puerto Rico Long-Term Issuer Credit Rating Lowered To 'BB-'; Outlook Negative

Primary Credit Analyst:

Sunsierre Newsome, New York (1) 212-438-2421; sunsierre.newsome@standardandpoors.com

Secondary Contact:

E.Robert R Hansen, CFA, New York (1) 212-438-7402; robert.hansen@standardandpoors.com

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Overview

- We believe that the recently passed legislation allowing certain Puerto Rican public entities, including the Puerto Rico Highways and Transportation Authority (HTA), to restructure their debt obligations could lead to a potential shift in the Commonwealth's historically strong willingness to continue to meet its obligations to bondholders.
- The Government Development Bank for Puerto Rico has exposure to three public corporations aggregating approximately \$2 billion in loans, the largest of which is the HTA, which could be restructured.
- As a result, we are lowering our long-term issuer credit rating on the Government Development Bank for Puerto Rico to 'BB-' from 'BB' and affirming our short-term issuer credit rating at 'B'.
- The outlook is negative, reflecting the substantial uncertainty on whether restructurings of the debt of such public corporations will take place and concerns around the impact that such restructurings could have on GDB's capitalization and financial condition.
- In a related action, we lowered the rating of the Commonwealth of Puerto Rico general obligation and appropriation debt ratings to 'BB' from 'BB+'. The outlook is negative. (See "Puerto Rico GO Rating Lowered One Notch To 'BB' Following Debt Legislation; Outlook Negative," published July 11, 2014.)

Rating Action

On July 11, 2014, Standard & Poor's Ratings Services lowered its long-term issuer credit rating on the Government Development Bank for Puerto Rico (GDB) to 'BB-' from 'BB'. The outlook is negative. We are also affirming our short-term issuer credit rating on GDB at 'B'. We lowered the stand-alone credit profile to 'b+' from 'bb+'.

Rationale

The rating action reflects the increased likelihood that GDB could suffer material losses following the enactment of the Puerto Rico Public Corporation Debt Enforcement Act, which allows certain Puerto Rican public corporations of the Commonwealth to seek protection from creditors through a debt restructuring.

GDB significantly depends on the ability of the Commonwealth and its public corporations to repay their debt. GDB has lending exposures to three public corporations aggregating about \$2 billion. These loans could be restructured. The Puerto Rico Electric Power Authority (PREPA), which has \$40.4 million outstanding to GDB, as of June 30, 2014, recently announced it may delay certain payments currently due and that it will continue discussions with lenders to evaluate various alternatives to improve its financial situation. (See "Puerto Rico Electric Power Authority Revenue Bonds Downgraded To 'B-' From 'BB' On Inability To Renew Liquidity Facility," published July 9.) The Highways and Transportation Authority (HTA) is GDB's largest borrower, with about \$2 billion outstanding as of June 30, 2013. This is a material exposure relative to the GDB's equity capital of about \$2.4 billion. As such, if the HTA restructures its debt, it is possible that GDB could incur material losses.

We believe the enactment of the bill is indicative of the mounting economic and fiscal challenges for the Commonwealth as a whole, which could lead to additional liquidity pressures in the long term. While the Commonwealth's general obligation debt is excluded from the act, we also believe enactment of the legislation itself signals a potential shift in the Commonwealth's historically strong willingness to continue to meet its obligations to bondholders, particularly in the event of constrained market access.

We anticipate economic challenges to persist in Puerto Rico over the next 12 months despite the recent enactment of a balanced budget for fiscal 2015. Although from a credit standpoint we view the recent enactment of a balanced budget for fiscal 2015 as favorable, we nevertheless continue to view the Commonwealth's fiscal situation as precarious. This also bodes negatively for GDB. Given GDB's heavy concentration to Puerto Rico's weak public entities, the potential for restructuring to occur, the uncertainty of the degree to which GDB's capital could be impaired, and the lack of clarity surrounding GDB's plans to navigate those circumstances, we are lowering our business position assessment to "very weak" from "weak." This results in revising our stand-alone credit profile to 'b+' from 'bb+'.

We consider GDB a government-related entity (GRE) based on our view that the link between GDB and the Commonwealth is very strong. GDB plays a very important role for the government, given that it provides funding to the Commonwealth and other Puerto Rican public corporations and that it is a fiscal agent to the Commonwealth and its instrumentalities. Based on our GRE criteria, we now incorporate one notch of uplift from the stand-alone credit profile into the issuer credit rating on GDB.

Outlook

The negative outlook reflects the substantial uncertainty on whether restructurings of the debt of public corporations that are borrowers of GDB will occur and concerns around the impact such restructurings could have on GDB's capitalization and financial condition.

Specifically, we believe that if GDB's largest borrower, the HTA, restructures its debt, it could result in material losses for GDB. We could lower our ratings on GDB if such restructurings occur and the losses GDB incurs are material to a degree that GDB's capital or financial profile would be impaired. We could also lower our ratings on GDB if we lower our rating on the Commonwealth. In our view, GDB remains vulnerable given its high lending concentration and interconnectedness to the Commonwealth. Alternatively, we could revise the outlook to stable if conditions stabilize in the Commonwealth or if we become convinced that in the event that GDB's largest borrowers would restructure their debt, the impact on the GDB would be limited.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BB-/Negative/B	BB/Watch Neg/B
SACP	b+	bb+
Anchor	bbb+	bbb+
Business Position	Very Weak (-5)	Weak (-2)
Capital and Earnings	Very Strong (+2)	Very Strong (+2)
Risk Position	Weak (-2)	Weak (-2)
Funding and Liquidity	Below average and adequate (-1)	Below average and moderate (-1)
Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	-1

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Puerto Rico GO Rating Lowered One Notch To 'BB' Following Debt Legislation; Outlook Negative, July 11, 2014
- Under Pressure: Puerto Rican Bank Ratings Face Several Major Hurdles, May 19, 2014
- Government Development Bank for Puerto Rico 'BB/B' Ratings Off CreditWatch Negative Following Puerto Rico Bond Issuance, April 3, 2014
- Government Development Bank for Puerto Rico, Feb. 19, 2014
- Banking Industry Country Risk Assessment: U.S., Sept. 26, 2013

Ratings List

Downgraded; Off CreditWatch; Outlook Negative

	To	From
Government Development Bank for Puerto Rico Counterparty Credit Rating	BB-/Negative/B	BB/Watch Neg/B

Downgraded; Off CreditWatch

	To	From
Government Development Bank for Puerto Rico Senior Unsecured	BB-	BB/Watch Neg

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