

University of Puerto Rico

Primary Credit Analysts:

Joshua Stern
New York
(1) 212-438-1718
josh_stern@
standardandpoors.com

Secondary Credit Analysts:

Horacio Aldrete-Sanchez
Dallas
(1) 214-871-1426
horacio_aldrete@
standardandpoors.com

Credit Profile

Rated

US\$276.325 mil rev bnds ser Q due 06/01/2036	BBB
Sale date: 30-NOV-2006	
US\$294.54 mil Refunding rev bnds ser P due 06/01/2030	BBB
Sale date: 30-NOV-2006	

AFFIRMED

University of Puerto Rico, Puerto Rico

\$14.362 mil. Univ of Puerto Rico (Univ Sys) rev bnds ser C, D & F	BBB
\$182.930 mil. Univ of Puerto Rico univ sys rev bnds ser 0	AAA/BBB(SPUR)
University of Puerto Rico, Puerto Rico	
Puerto Rico Indl Tour Ed Med & Environ Ctrl Fac Fin Auth, Puerto Rico	
\$84.080 mil. Puerto Rico Indl Tour Ed Med & Environ Ctrl Fac Fin Auth	
ed fac rev bnds (Plaza Universitaria Proj) ser 2000A	AAA/BBB-(SPUR)
OUTLOOK:	NEGATIVE

Rationale

Standard & Poor's Ratings Services assigned its 'BBB' long-term rating to the University of Puerto Rico's series 2006 P&Q bonds and affirmed its standard long-term rating and underlying rating (SPUR) of 'BBB' on the University of Puerto Rico's (UPR) outstanding bonds. In addition, Standard & Poor's affirmed its underlying rating (SPUR) of 'BBB-' on the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority's series 2000A bonds, issued for the University of Puerto Rico (for the development of Plaza Universitaria). The long-term rating outlook continues to be negative.

The bonds are general obligations of the university and secured by revenues including tuition and fees, interest income, research overhead allowance as well as Commonwealth appropriations, if necessary. There is also a debt service reserve funded at maximum annual debt service (MADS). Bond proceeds will refund several issues of outstanding bonds, fund a

variety of capital projects as well as reimburse the Government Development Bank (GDB) \$82.5 million for previous projects.

UPR relies on the Commonwealth for more than 90% of its revenues and this dependence has been increasing. The rating on the Commonwealth's debt was lowered on May 24, 2005, to 'BBB' from 'A-' and the university's ratings were lowered at the same time. In July 2006 the Commonwealth approved Act 117, which instituted an island-wide 5.5% sales tax that went into effect on Nov. 15, 2006 and authorizes each municipal government to impose its own sales tax of 1.5% (of which 0.2% reverts to the General Fund). Development of a government-restructuring plan to realign government agencies and curb operating expenditure growth has also begun. Combined these initiatives have the potential to reduce the fiscal 2007 structural budget gap to \$325 million compared with budget imbalances of \$1.2 billion in fiscal 2006 and \$1.0 billion in fiscal 2005. In fiscal 2008, the sales tax's first full year of implementation, the budget gap is estimated to be just \$120 million. Officials are projecting a modest surplus by fiscal 2009.

Despite the downgrade of the university's debt in 2005, which reflects the weakened financial position of the Commonwealth, many institutional strengths of UPR remain. These strengths include:

- Continued strong financial support of the Commonwealth of Puerto Rico;
- UPR's role as the island's only comprehensive public university of higher education;
- Stable enrollment trends evidenced by relatively steady headcount, strong application levels, and continued strong new-student matriculation.

Additional strengths are a history of positive financial operating performance; several new sources of Commonwealth revenue and funding from a broader pool of revenues, of which UPR receives 9.6%; and adequate liquidity and a manageable debt burden.

UPR's weaknesses include:

- Significant dependence (90%) on Commonwealth-appropriated monies to fund the annual operating budget;
- Tuition rates that while recently increased after having remained unchanged for nearly a decade are still extremely low;
- The lack of a real history of fundraising, despite a huge alumni base of 450,000, and
- Limited financial flexibility, with a modest endowment fund of \$55 million.

The 'BBB-' SPUR on the Authority's bonds reflects a junior lien on pledged revenues (including tuition and fees, dormitory rental income, and research-overhead monies) that are securing UPR's senior debt, of which \$372 million is currently outstanding and will rise to \$648 million after this issue. The 'BBB-' rating considers the underlying commitment and support of UPR in ensuring the success of the project.

Outlook

The negative outlook on UPR's debt mirrors the negative outlook on the Commonwealth's debt. The negative rating outlook reflects the Commonwealth's track record of lax expenditure and budget controls, which have the potential to offset the revenue flexibility provided by the recently adopted sales tax. Management's ability to implement meaningful steps to curb operating expenditures, improve managerial and budgetary controls, and eliminate the government's reliance on operating budget loans from Government Development Bank of Puerto Rico are key determinants of the Commonwealth's rating stability. A trend of continued economic growth that is conducive to the expansion of private sector employment could have a positive effect on the Commonwealth's rating.

assuming Puerto Rico achieves structurally balanced budgets. Any positive effect on the Commonwealth's rating would likely have a positive effect on UPR's rating as well.

Appropriations/Operations

UPR's GO debt continues to be rated on par with the Commonwealth of Puerto Rico's GO debt ('BBB'/Negative) as a result of a legal structure directly linking island-wide revenue collection with university financial support. While this close link has historically benefited UPR, in terms of annual appropriations growth, UPR's revenue stream is vulnerable to Commonwealth economic slowdowns, which could lead to decreasing levels of operating support if Commonwealth revenues were to drop. Concerns are, however, mitigated by the institution's overwhelming role in Puerto Rico's higher education system, as UPR enrolls about 31% (64,471) of Puerto Rico's population currently attending college. In addition, the university has some admissions flexibility, as about 69% of its applicants are admitted each year, of which an extremely high 90%-95% enroll. Tuition rates, which hasn't risen for over a decade were raised by 33%, or \$10 per credit hour to \$40 in fall 2004. This resulted in about \$20 million of additional tuition income. Student charges are still significantly below the private colleges and universities in Puerto Rico.

Under Commonwealth Act 2 of 1966, UPR is allocated an amount equal to 9.6% of the average total revenue collected by the Commonwealth of Puerto Rico during the prior two fiscal years. The original allocation of 9% was increased to 9.33% in fiscal 1994 and to the current 9.6% in fiscal 1998. Appropriations have historically represented roughly 90% of UPR's operating budget. In fiscal 2006, appropriations from the Commonwealth were \$835 million, or nearly \$13,000 per student. Despite the lowering of the Commonwealth's rating, UPR still anticipates appropriations growth due to the funding formula, which is based on total revenues collected across the Commonwealth which should rise due to the new sales tax. Appropriations for the current fiscal year 2007 are projected at \$878 million and at \$915 million for fiscal 2008.

Operations at UPR have historically been balanced, supported by healthy appropriation increases although in 2005 UPR incurred a small overall operating loss. However on an unrestricted fund basis the university has had surpluses ranging from 2%-4% of budget each year since 1998. The unrestricted fund surplus was 2% for fiscal 2005 and over 5% for fiscal 2006 on an unaudited basis. UPR's unrestricted net assets have always been low and actually were negative-\$7.3 million at fiscal year-end 2005. UPR's endowment, which is all restricted, totals \$55 million, up from \$24 million in 2000.

Demand

Founded in 1900 as a school for the training of educators, UPR is today a comprehensive public research university offering baccalaureate-, graduate-, and doctoral-level degree programs in liberal arts and professional disciplines, including business administration and engineering. Each of UPR's 11 campuses, which in total enrolled 64,471 students during fall 2005, is responsible for addressing both curriculum and regional goals and is accredited by the Middle States Association. The largest campus enrolls more than 20,000 students and is located in San Juan. Nearly 90% of UPR's total system wide enrollment comprises undergraduates; however, strengthening graduate- and doctoral-level programs in engineering, science, and humanities, coupled with anticipated increases in extramural research sponsorship, should lead to slow, modest increases in graduate headcount in the future. After many years of growing enrollment, the number of students began declining in fall 2000. After a peak of

nearly 70,000 students, enrollment has decreased to 64,471 for fall 2005. UPR believes that 65,000 is closer to the historical levels for the system and expects stabilization at this level. UPR is hoping to increase its number of graduate students, part-time traditional students, and distance-learning opportunities.

Debt

UPR's long-term obligations amount to \$459.5 million, of which over \$84 million is subordinate debt. Although UPR's debt has more than doubled during the past decade and will be rising by nearly \$300 million with this issue, combined maximum annual debt service (senior and junior) of \$62 million is still manageable at 5.2% of the institution's operations.

UPR's current capital plan consists of construction, building renovations, and the modification of existing physical facilities in light of new technology, educational standards, and the requirements of modern building codes. The Commonwealth is contributing to some of the capital needs of the university. In April 2002, Law 1667 authorized the appropriation of \$60 million during the next six years to improve air quality in older buildings. Capital improvements have totaled \$202.6 million over the past five years and are planned to total another \$185 million through 2010. Bond proceeds will refund several issues of outstanding bonds, fund a variety of capital projects as well as reimburse the Government Development Bank (GDB) \$82.5 million for prior projects.

Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280. Copyright 2006 by The McGraw-Hill Companies, Inc. Reproduction in whole or in part prohibited except by permission. All rights reserved. Information has been obtained by Standard & Poor's from sources believed to be reliable. However, because of the possibility of human or mechanical error by our sources, Standard & Poor's or others, Standard & Poor's does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions or the result obtained from the use of such information. Ratings are statements of opinion, not statements of fact or recommendations to buy, hold, or sell any securities.

Standard & Poor's uses billing and contact data collected from subscribers for billing and order fulfillment purposes, and occasionally to inform subscribers about products or services from Standard & Poor's, our parent, The McGraw-Hill Companies, and reputable third parties that may be of interest to them. All subscriber billing and contact data collected is stored in a secure database in the U.S. and access is limited to authorized persons. If you would prefer not to have your information used as outlined in this notice, if you wish to review your information for accuracy, or for more information on our privacy practices, please call us at (1) 212-438-7280 or write us at: privacy@standardandpoors.com. For more information about The McGraw-Hill Companies Privacy Policy please visit www.mcgraw-hill.com/privacy.html.

Analytic services provided by Standard & Poor's Ratings Services ("Ratings Services") are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. Credit ratings issued by Ratings Services are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of credit ratings issued by Ratings Services should not rely on any such ratings or other opinion issued by Ratings Services in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or by the underwriters participating in the distribution thereof. The fees generally vary from US\$2,000 to over US\$1,500,000. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications.

Permissions: To reprint, translate, or quote Standard & Poor's publications, contact: Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-9823; or by e-mail to: research_request@standardandpoors.com.