

Rating Action: Moody's downgrades Puerto Rico GOs to B2 from Ba2, COFINA Senior-Sub to Ba3-B1; outlooks negative

Global Credit Research - 01 Jul 2014

Downgrades of Electric Power Authority (PREPA) and other Puerto Rico entities affect over \$61 billion total

New York, July 01, 2014 -- Moody's Investors Service has downgraded the Commonwealth of Puerto Rico to B2 from Ba2, affecting \$14.4 billion of outstanding general obligation (GO) bonds. Concurrently, commonwealth agencies and public corporations have been downgraded, affecting about \$46 billion of non-GO bonds, including \$15.6 billion of senior- and subordinate-lien bonds issued by the Sales-Tax Financing Corporation (COFINA), which respectively were lowered to Ba3 and B1. The Puerto Rico Electric Power Authority (PREPA) was downgraded to Caa2 from Ba3, while the Puerto Rico Aqueduct and Sewer Authority (PRASA) was downgraded to Caa1 from Ba3. The Puerto Rico Highway and Transportation Authority (PRHTA) was downgraded to Caa1 (senior 1998 resolution and 1968 resolution) from Ba3, and to Caa2 from B1 (subordinate 1998 resolution). For PREPA, PRHTA and PRASA, the newly lowered ratings remain under review for possible further downgrade. The debt of the Government Development Bank (GDB) was downgraded to B3 from Ba2, and the debt of the University of Puerto Rico was downgraded to Caa1 and Caa2. The outlook for the GDB as well as for commonwealth GO and related debt remains negative. All the rating and outlook changes incorporated in this action are listed at the end of this release.

SUMMARY RATING RATIONALE

The downgrades of Puerto Rico and its debt-issuing entities follow the commonwealth's enactment of a law (the Puerto Rico Public Corporation Debt Enforcement and Recovery Act) that will allow public corporations to defer or reduce payments on outstanding bonds. By providing for defaults by certain issuers that the central government has long supported, Puerto Rico's new law marks the end of the commonwealth's long history of taking actions needed to support its debt. It signals a depleted capacity for revenue increases and austerity measures, and a new preference for shifting fiscal pressures to creditors, which, in our view, has implications for all of Puerto Rico's debt, including that of the central government. Application of the law may further limit the commonwealth's market access, leaving it more vulnerable to financial risk and unable to fund capital projects.

The COFINA ratings have now been positioned closer to the GO, reflecting their increased susceptibility to any action that impairs bondholders' claims on sales tax revenues if the commonwealth invokes its police powers and acts to protect the health and safety of the general public ahead of bondholders. The new GO and COFINA bond ratings face heightened risk of default, given the commonwealth's stagnant economic conditions and disproportionately large debt burden.

Ratings now assigned to PREPA, PRASA and PRHTA and the Puerto Rico Convention Center District Authority are under review for further downgrade, reflect the escalating risk that these entities could default voluntarily under the new restructuring law. We have also lowered ratings on certain bonds previously considered as equivalent to the general obligation rating, or "capped" at the GO rating, because of their increased risk of default and potentially lower recovery rates than the GO. The ratings on Puerto Rico's pension funding bonds, as well as debt issued by the GDB and the Municipal Finance Agency, and the Puerto Rico Infrastructure Financing Authority (PRIFA, bonds secured by rum tax remittances from the federal government) were downgraded to B3 from Ba2 and are now rated one notch below the GO bonds due to our view that the expected loss rates on these securities are now higher. GDB has direct exposure to the risks implicit in the restructuring law, given its substantial loans to PRHTA and other public corporations.

SUMMARY OF DEBT AFFECTED BY LEGISLATION

Downgraded to Ba3 from Baa1; outlook negative

--COFINA Senior

-- Industrial Development (PRIDCO)

Downgraded to B1 from Baa2; outlook negative

--COFINA Subordinate

Downgraded to B2 from Ba2; outlook negative

--General Obligation

Downgraded to B3 from Ba2; outlook negative

--GDB notes

--Infrastructure Financing Authority (PRIFA)

--Municipal Finance Agency

--Pension funding bonds

Downgraded to B3 from Ba3; outlook negative

--Appropriation debt of commonwealth

Downgraded to Caa1 from Ba3; ratings under review

-- Aqueduct & Sewer Authority (PRASA)

-- Highway & Transportation (PRHTA)

Downgraded to Caa1 from Ba2; outlook under review

Convention Ctr (Hotel Occupancy Tax)

Downgraded to Caa2 from Ba3; ratings under review

-- Electric Power Authority (PREPA)

Downgraded to Caa2 from B1; ratings under review

-- PRHTA Subordinate-lien

Downgraded to Caa1 from Ba3; outlook negative

--University of Puerto Rico (System)

Downgraded to Caa2 from B1; outlook negative

--University of Puerto Rico (Facilities)

RATING METHODOLOGIES

The principal methodology used in rating the Commonwealth of Puerto Rico, Puerto Rico Municipal Finance Agency, Puerto Rico Public Buildings Authority, Puerto Rico Highway & Transportation Authority, Puerto Rico Aqueduct and Sewer Authority, Puerto Rico Infrastructure Financing Authority, Government Development Bank for Puerto Rico, Puerto Rico Public Finance Corporation, Puerto Rico Convention Center District Authority and Puerto Rico Employees Retirement System debt was US States Rating Methodology published in April 2013.

The additional methodology used in rating the Puerto Rico Highway & Transportation Authority debt, the Puerto Rico Infrastructure Financing Authority debt, and the Puerto Rico Convention Center District Authority debt was US Public Finance Special Tax Methodology published in January 2014.

The additional methodology used in rating the Puerto Rico Aqueduct and Sewer Authority debt was Analytical Framework For Water And Sewer System Ratings published in August 1999.

The additional methodology used in rating the Government Development Bank for Puerto Rico debt was Rating Transactions Based on the Credit Substitution Approach: Letter of Credit backed, Insured and Guaranteed Debts

published in March 2013.

The additional methodology used in rating the appropriation debt was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011.

The principal methodology used in rating the Puerto Rico Sales Tax Financing Corporation debt and the Puerto Rico Industrial Development Company debt was US Public Finance Special Tax Methodology published in January 2014. An additional methodology used in this rating was US States Rating Methodology published in April 2013.

The principal methodology used in rating the Puerto Rico Electric Power Authority debt was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011.

The principal methodology used in rating the University of Puerto Rico debt was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. The additional methodology used in rating the lease debt was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011.

Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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