STANDARD & POOR'S

PUBLIC FINANCE

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Puerto Rico Municipal Finance Agency

Credit Profile		
US$426.835 mil Bonds, Series 2008A due 08/01/2033		
Long Term Rating	BBB-/Stable	New
Outstanding Bonds, Various Series		
Long Term Rating	BBB-/Stable	Affirmed
Outstanding Bonds, Various Series		
Unenhanced Rating	BBB-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services assigned its 'BBB-' standard long-term rating to Puerto Rico Municipal Finance Agency's (MFA) $427 million series 2008A bonds. The rating reflects our view of the following credit strengths:

- A several obligation of participating municipalities, secured by a dedicated unlimited property tax levied by each municipality sufficient to cover the debt service on outstanding and proposed debt;
- A first lien on the basic property tax levied by municipalities, which has never been tapped to pay this debt service;
- Commonwealth appropriations of matching equalization funds, which historically have made up roughly 33% of total revenue dedicated to the payment of MFA debt service;
- A moral obligation pledge by the commonwealth to replenish the debt service reserve account, should any of the preceding sources prove insufficient to cover debt service; and
- Strong oversight by Government Development Bank for Puerto Rico (GDB) and strong coverage averaging 5.8x, based on the combination of special additional property tax, basic property tax, the municipal redemption fund balance, and commonwealth matching fund appropriations.

municipalities and is secured by a pledge of the applicable municipality's ad valorem (property) taxes without limit as to rate or amount on all of its taxable. This unlimited tax is made up of two components. First, there is what is known by the Spanish acronym CAE, which is a dedicated property tax of unlimited rate, the proceeds of which are deposited by CRIM into the municipality's redemption fund, a special fund held by GDB and used to service the municipality's GO debt. If the CAE revenues are insufficient, the bonds have a first lien on all other fixed-rate property taxes and other revenues of the municipality, including any commonwealth appropriations from a portion of its lottery revenues and commonwealth general fund monies that are paid to each municipality according to formulae established by the commonwealth and administered by CRIM.

The available revenues provide a diverse mix of revenues available for repayment of municipal GO debt, including tax revenues from the recently implemented 1.5% municipal sales and use tax. The municipal sales tax is collected by CRIM and jointly administered by the commonwealth Treasury department and the municipalities. The commonwealth Treasury sets aside 0.5% of the tax, which is dedicated for specific municipal uses such as solid waste, healthcare, etc, with the remaining 1% available for general purposes, including the repayment of municipal GO loans.

CRIM is responsible for the assessment, collection and distribution of all municipal property taxes. CRIM is required by law to establish a trust fund at GDB known as the municipal redemption fund, which is the main source of repayment for municipal GO debt and MFA's bonds. The redemption fund includes the special additional property tax (CAE) collections levied by each municipality and collected by CRIM. If revenues in an individual redemption fund are insufficient to make debt service payments on the loans, CRIM is authorized to apply the revenues from that individual municipality captured in the matching fund to make debt service payments on its municipal debt. The matching fund includes revenues from commonwealth appropriations (2.5% of net internal general fund revenues), 35% of annual net revenues from the operation of the electronic lottery (currently capped at $26 million), and other transfers from the commonwealth's general fund to compensate for exemptions in taxable property.

There are a total of 65 municipalities participating in the MFA series 2008A bond program. The seven largest cities in the commonwealth—Bayamon, Carolina, Caguas, Guaynabo, Humacao, Ponce, and San Juan—account $250.2 million, or 58.6% of the proposed financing, and the remaining 58 small issuers account for $175.6 million of the issue. Carolina, the single-largest borrower, accounts for $94.6 million, or 22.2%, of the proposed financing.

Commonwealth Oversight

The commonwealth's oversight powers, including the centralized collection and distribution of property taxes and other revenues owed to the municipalities, enhance the credit quality of the underlying municipal GO debt. CRIM is authorized by law to assess and collect all municipal property taxes and distribute the commonwealth's matching revenues to the municipalities. CRIM first directs all property taxes collected to the GDB-held redemption fund to ensure the repayment of the municipality's GO debt. A first lien is placed on all property taxes collected for the repayment of debt. Most municipalities have fairly sizable redemption fund surpluses that, to the extent they do not exceed the next 12 moths' debt service on outstanding general obligation debt, can be used only for the repayment of such debt. Surpluses in excess of this amount can, at a municipality's option, be returned to the requesting municipality and used first for the payment of other statutory debts and then for

Limiting factors include:

- The presence of economically shallow participating municipalities whose individual tax bases may exhibit vulnerability during economic cycles; and
- The vulnerability of matching fund revenues, the appropriation of which could be affected by a downturn in the collection of the Commonwealth's general revenues.

The bonds are secured by a several obligation of participating municipalities, secured by the full faith and credit of each municipality, including a dedicated property tax levied by each municipality sufficient to cover the debt service on outstanding and proposed debt. Also pledged is a first lien on the basic property tax levied by municipalities, which has never been tapped to pay this debt service. Commonwealth appropriations of matching equalization funds, which make up roughly 33% of estimated total revenue in fiscal 2008, are also pledged to the payment of MFA debt service. The security also includes a moral obligation pledge by the commonwealth to replenish the debt service reserve account, should any of the preceding sources prove insufficient to cover debt service. A total of 65 borrowers have taken out 194 loans through the MFA totaling $426.8 million. The loans are concentrated among seven borrowers accounting for 58.8% of the total amount of the loans. Carolina is the single largest borrower, accounting for 22.2% of the total. None of the borrowers is rated by Standard & Poor's.

The pledged revenues are collected by the central Municipal Revenues Collection Center (known by its Spanish acronym CRIM), on a prorated basis for each participating municipality, with the amount needed for debt service deposited into a lock box—the excess is redistributed to the municipalities for operations after debt service obligations and reserve requirements are met (see table 1). Added credit support is provided by a two-tier coverage test requiring a minimum coverage for annual and maximum debt service to take on additional debt for municipalities that participate in the program. In addition, the monitoring mechanism prompts the Government Development Bank to alert Standard & Poor's if the sum of any municipality's dedicated special tax levy (referred to as CAE), redemption fund balance, and the commonwealth's matching funds falls below 2x coverage of maximum annual debt service. This would trigger the intercept of basic operating property tax revenues and matching funds to be received by municipalities from the commonwealth. A reserve account is funded with MFA bond proceeds equal to the higher of 50% of maximum annual debt service (MADS) on the bonds and 100% of the largest participating municipality's MADS. There is a moral obligation pledge on the part of the commonwealth to replenish the reserve fund if it is drawn upon—an event that has never occurred. The program has a history of strong coverage of annual debt service, with average coverage for the payment of general obligation (GO) debt from all sources at 5.8x. The redemption fund balance provides individual coverage averaging 1.77x.

Outlook

The stable outlook reflects Standard & Poor's expectation that pledged redemption fund revenues will continue to provide strong coverage on annual debt service, and that the strong oversight mechanism implemented by GDB will remain in place.

Participating Municipalities/Structure

The MFA series 2008A bonds are secured a pledge of the debt service payments to be received from an underlying portfolio of general obligation bonds and notes issued by 65 of Puerto Rico's 78 general municipal purposes. Commonwealth law also provides for an equalization formula such that each municipality is guaranteed a minimum property tax revenue distribution regardless of its individual property tax collection performance.

GDB has executed a fiscal agency agreement whereby it is authorized and empowered to determine the amount and terms of the loans obtained by the participating municipalities. Furthermore, to obtain GDB approval for new municipal GO debt, participating municipalities must meet a two-tier test, which requires it to: maintain a redemption fund balance and dedicated CAE property tax collections of at least 1x annual debt service, and maintain 2x coverage of MADS based on the sum of their individual redemption fund balances, CAE property tax collections, basic property tax collections, and commonwealth contributions for the fiscal year preceding the fiscal year in which the proposed issue will be issued. In addition, the monitoring mechanism prompts GDB to alert Standard & Poor's if the sum of any municipality's CAE levy, redemption fund balance, and commonwealth's matching funds falls below 2x coverage of the municipality's MADS on its GO debt. This would trigger the intercept of basic operating property tax revenues and matching funds to be received by municipalities from the commonwealth.

Pledged Revenues

Municipal property tax revenues are broken into three levies. A 1.03% of AV special property levy is paid into commonwealth's redemption fund, which is a GDB-held trust to make debt service payments on the commonwealth's (not the municipalities') debt. The special additional (CAE) property tax is the second part of the three levies and is the principal and intended source for the repayment of municipal GO debt. The special additional property tax is unlimited as to rate or amount, and utilized first for the payment of the levying municipality's GO bonds and notes. The third component of property tax is the basic property tax, levied at a maximum of 6% of the assessed value (AV) on all real property and 4% of the AV on real property. Since 1991, through an effort at decentralization these funds have been funneled to municipalities to provide equalization between larger and smaller municipalities. Before 1991, the basic tax was collected by the commonwealth. Commonwealth appropriations are used to equalize funding to local governments. These appropriations are comprised of 2.50% of net general fund revenues and 35% of net electronic lottery proceeds, up to a current annual cap of $26 million. General fund appropriations also provide reimbursement for a portion of the municipal property tax exemptions.

As table 1 below shows, municipal property tax revenues have shown steady growth. Commonwealth appropriations, on the other hand, have seen minor declines over the past five years. Aggregate coverage of debt service based on the redemption fund balances and 2008 property tax collections is a sound 5.7x. The seven large borrowers, which make up 58.76% of total loans, have maintained sound coverage of 1.59x based on dedicated tax collections and their redemption fund balance. Coverage based on dedicated tax collections and matching fund contributions is a solid 4.57x. The smaller borrowers, at 41.2% of loans, achieved coverage of 7.46x based on all revenues and 2x based on their redemption fund balances.

Table 1

Total Income From Pledged Revenues ($)

	Fiscal year-end June 30		
	2008	2007	2006
Municipal special additional tax (CAE)	218,652,974	216,687,520	204,394,504
Basic municipal property tax	338,943,207	334,046,350	328,955,267
Equalization monies from basic tax	227,587,651	222,341,822	220,269,674
Total municipal contributions	785,183,832	773,075,692	753,619,445
Commonwealth contributions	383,042,240	392,231,896	378,885,741
Total	1,168,226,072	1,165,307,588	1,132,505,186

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