

P R E S S R E L E A S E

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Pension systems' financial situation affects Puerto Rico's credit rating

Moody's downgrades Puerto Rico's credit rating by one notch, out of three it had upped it last year; recognizes progress achieved under the government's economic and fiscal reconstruction plan, but says more needs to be done to address the pension system's financial situation

SAN JUAN, P.R.- Credit rating agency Moody's assigned a rating of Baa1 with negative outlook to the general obligations of the Government of Puerto Rico, Government Development Bank ("GDB") president Juan Carlos Batlle announced today.

"As evidenced in Moody's own report, this downgrade of only one notch is due primarily to the financial situation of the government pension systems inherited from the past two administrations and the impact that it may have on the general fund," said Batlle. "Even with this downward adjustment, our credit rating by Moody's is still two notches above what we had when we came into office. In other words, we're still ahead thanks to the actions that we've taken so far," added the GDB president.

The new rating is one notch below the A3 rating that Moody's assigned to Puerto Rico's credit in April, 2010, when it upped the rating three notches, from Baa3—the level right before junk bond rating—to A3. Although that improvement in the rating assigned by Moody's took place at a time when the agency conducted a recalibration of its rating scales, the rating agency upped Puerto Rico's rating three notches, in recognition of the progress achieved by the Administration in its economic and fiscal reconstruction plan, instead of the only one notch received by the majority of the states that received an upgrade then.

"While the financial situation of the commonwealth is showing some improvement, it is still weak....The structural deficit has been reduced in the last two years: The Commonwealth has achieved this through strict spending control and conservative revenue forecasting...[b]ut the weak retirement system funding will challenge the commonwealth's finances and economy..." Moody's states in its report.

Batlle explained further that Moody's new Baa1 rating is at par with Fitch's BBB+ and one notch above the BBB rating Puerto Rico received from S&P last march when the latter upped Puerto Rico's credit rating for the first time in 28 years in recognition of the progress achieved by the Administration in the areas of fiscal reform, revenue enhancement, spending control and deficit reduction. "Puerto Rico's

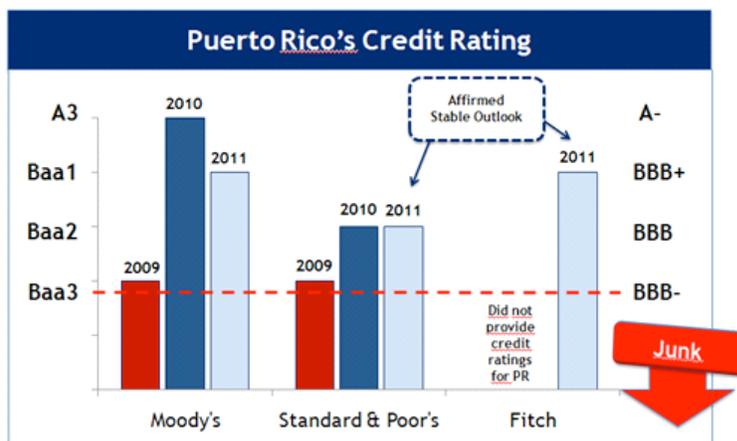
credit continues to be at the highest level it has been in decades, thanks to the actions we've taken to straighten our finances and lead our economy towards a sustainable recovery," said Batlle.

Batlle explained that although Moody's action was primarily due to the financial situation of the government's pension systems, it doesn't mean that the latter has deteriorated in the past year. "On the contrary, we're on the road to an improvement thanks to the measures we've already adopted, primarily by increasing employers' contributions to the systems, and Moody's report recognizes that much. This adjustment is essentially due to the fact that the credit rating methodology that Moody's uses now is stricter insofar as it accords a greater weight to the financial situation of the pension systems when it rates the fiscal situation of states and countries," Batlle explained. Recently, Moody's has taken similar action in the credit rating of other states such as New Jersey, Illinois, Connecticut, Kentucky and Rhode Island for reasons similar to the ones at play in Puerto Rico.

"What this means is that if we don't address the fiscal situation of the Government of Puerto Rico's pension systems, Puerto Rico's credit could be further affected negatively. That's why it's imperative that we continue the work we have started to provide concrete solutions to this problem," Batlle added.

Recently, the Administration approved legislation to inject \$162.5 million in fresh capital, which in 40 years will have generated \$1.5 billion to help defray the deficit of the pension systems. Further, legislation was also approved to increase the employer contribution to the pension systems in order to improve their financial health. Likewise, the Board of Trustees of the Government and Judiciary Employees Pension Systems approved new Regulations to reinstate the \$5,000 cap on personal and cultural travel loans which, according to actuarial studies, have eroded the liquidity of those systems since 2007.

In spite of this rating action, Moody's credit rating remains superior to the rating we inherited on January 2009



"The fact that Moody's kept our rating two notches above what we had two and a half years ago is a recognition of two things: first, that the actions that we have already taken to start fixing the pension systems after eight years of irresponsible management by the past two administrations go in the right

direction, but we need to do more; and, second, that what we have achieved in straightening our finances in general—like reducing the deficit more than any state—is what keeps our credit rating at the highest level it has had in 30 years,” said Batlle.

The GDB president explained further that the one notch downgrade in the rating announced by Moody’s today should have no effect on either Puerto Rico’s access to the capital markets or the cost of financing to the Government of Puerto Rico. “The capital markets at both the national and local levels had already taken into account the possibility of an adjustment on Moody’s part since May of this year, when it warned of the effect that the financial situation of the pension systems could have on Puerto Rico’s credit,” Batlle indicated. “This is evidenced by the great demand registered for our most recent Government of Puerto Rico bond issuances, one of \$304 million placed in the national capital markets last June and another one of \$756 million currently in the local capital market to finance the Schools for the 21st Century program which has already received indications of interest totaling more than \$830 million,” said Batlle.

The adjustment in Puerto Rico’s credit rating takes place merely three days after rating agency Standard & Poor’s (“S&P”) lowered, for the first time ever, the federal government AAA credit rating to AA+ with negative outlook. According to the S&P report, the adjustment in the federal government’s credit rating was due primarily to the fact that Congress and the White House were not able to reach an agreement to raise the federal debt ceiling in a reasonable time and the agreement they did reach, in S&P’s opinion, is not enough to stabilize the federal debt crisis in the medium term. S&P further indicated that the adjustment was also due to their understanding that the effectiveness and stability of U.S. public policy making has been weakened at a time of fiscal and economic challenges to a greater degree than originally anticipated when it announced its negative outlook of the federal government’s credit back in April 18, 2011.

This downgrade of the federal government’s credit rating will force the federal government to take very tough measures to achieve fiscal stabilization, all of which confirms the wisdom of the actions taken by the Gov. Luis Fortuño Administration two and a half years ago, which not only avoided a local government shutdown and a downgrade of our credit to junk bond rating, but garnered an marked improvement in the Island’s credit rating to a level it hadn’t had in decades.

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