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## District Of Columbia Housing Finance Agency; General Obligation; Other

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# District Of Columbia Housing Finance Agency; General Obligation; Other

## Credit Profile

District of Columbia Hsg Fin Agy ICR

*Long Term Rating*

A/Stable

Upgraded

**District of Colu Hsg Fin Agy certs of part ser 1998**

*Unenhanced Rating*

A-(SPUR)/Stable

Upgraded

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services raised its long-term issuer credit rating (ICR) on District of Columbia Housing Finance Agency (DCHFA) by one notch to 'A' from 'A-'. At the same time, Standard & Poor's raised its underlying rating (SPUR) on the agency's series 1998 (Radian Asset Guaranty-insured) certificates of participation (COPs) by one notch to 'A-' from 'BBB+'. The outlook is stable.

The ratings reflect our view of:

- The high quality and very low risk profile of DCHFA's asset base;
- The strong financial performance, with sufficient capital adequacy ratios at the 'A' level;
- The minimal general obligation (GO) debt exposure; and
- The active management team, which has a strong, positive relationship with the district government.

Offsetting these strengths, however, is our view of the agency's declining investment income.

DCHFA continues to show what we consider strong financial performance, reflected by improving profitability and leverage ratios, in our view. The agency, has, in our view, an active management team that has sustained a high-quality, low-risk asset portfolio consisting of mortgage loans and mortgage-backed securities (MBS) either insured by government and private mortgage insurance providers or backed by Ginnie Mae, Fannie Mae, or Freddie Mac MBS. Although DCHFA has one of the smallest loan portfolios of all state HFAs with a Standard & Poor's ICR rating, the management team continues to make changes and adjustments as needed to provide successful affordable housing programs. As of Sept. 30, 2012, DCHFA's asset base stood at \$1.08 billion, down marginally from fiscal 2011. Equity dropped to 8.70% of total assets in fiscal 2012, with a \$94 million fund balance. Still, this ratio has increased steadily over the past five years. Although the size of the asset base has fluctuated over the past couple years due to prepayments and fewer new loans being generated, it does not affect the ICR on DCHFA, in our view, given the strength of the asset portfolio, which is complemented by strong profitability ratios and a low risk profile.

In addition, the agency's net income reached \$8.9 million in fiscal 2012, a marked increase from \$2.9 million in fiscal 2011. DCHFA's profitability, as measured by return on assets (ROA), also rose in fiscal 2012, to 0.82% from 0.26% in fiscal 2011. The agency's net interest margin (NIM) continues to improve year after year, reaching its highest level --

.97% -- in fiscal 2012, up from .52% in fiscal 2011. We believe the agency's profitability and leverage ratios are strong enough to support the 'A' ICR, given the limited risk profile of the existing asset and debt base.

## Outlook

The stable outlook reflects our opinion of the high quality of DCHFA's asset base, low-risk profile, and its strong equity position. DCHFA's financial performance continues to improve and increase profitability, while its five-year average profitability ratios are comparable with those of its 'A' rated peers. DCHFA's ability to maintain a strong financial performance while expanding its avenues for growth, and its ability to leverage the resources needed to fulfill its planned portfolio diversification, are keys to its improved credit quality. Conversely, should DCHFA witness significant declines in its financial performance in terms of profitability/equity position, and program management that impairs its financial strength, we could lower the ratings.

## Asset Quality: High Quality Loans And MBS

DCHFA's fiscal 2012 asset base totaled \$1.08 billion following a marginal decrease from the preceding year. This decline is primarily attributed to a 29% drop in the agency's short-term investments due to a release of the agency's remaining escrow funds. These funds were held under DCHFA's multifamily and single-family New Issue Bond Program (NIBP), which was used to fund various projects. Other factors contributing to the investment portfolio decline are the use of prepayments to call bonds within a 1996 single-family indenture, and regularly scheduled debt service payments. In addition, the asset base's size has fluctuated in recent years due to low origination, high prepayments, and the low interest rate environment that many HFAs are experiencing.

As of fiscal 2012, the agency's loan portfolio stood at \$868 million, representing a 4.66% increase over fiscal 2011. DCHFA's asset portfolio consisted of mortgage loans enhanced by Ginnie Mae, Fannie Mae, and Freddie Mac (80%); investment securities (18%); and other assets (2%) (see charts 1 and 2). The total loan portfolio consisted of:

- \$88 million in single-family mortgage loans,
- \$778 million in multifamily mortgage loans,
- \$1.5 million in McKinney Act loans, and
- \$585,126 in loans warehoused under the general fund.

Roughly 90% of DCHFA's mortgage portfolio consists of multifamily loans, while the remaining 10% are single-family loans. Approximately 99% of the agency's single-family loan portfolio was backed by Ginnie Mae, Fannie Mae, or Freddie Mac MBS as of Sept. 30, 2012, and is an agency obligation. DCHFA has three 'AA+' rated single-family parity resolutions (1988, 1996, and 2009 NIBP), with asset-to-liability ratios of 102.56%, 109.11%, and 412.29% as of Oct. 1, 2012, respectively. The agency's 1988 resolution is in runoff, while its 1996 resolution has not originated new loans or issued debt within the past couple years. The agency is exploring different options, such as working with the community, to increase loan activity within the 1996 resolution.

As of Sept. 30, 2012, 14% of DCHFA's multifamily loan portfolio was backed by Ginnie Mae or Fannie Mae MBS. Of the \$868 million mortgage loans in DCHFA's portfolio, \$778 are multifamily conduit issues. Since the loans as conduit

issues are the developers' sole obligation, DCHFA bears no direct or indirect financial risk (excluding Federal Housing Administration (FHA)-risk-share loans, where the agency must cover 10% of the mortgage loss (which represents 2% of the total loan portfolio). Furthermore, DCHFA does not realize any earnings gained from these mortgages, except for those associated with issuer fees. Although conduit issues are not an agency obligation, our review of the financial ratios includes the conduit issues.

DCHFA participates in the Department of Housing and Urban Development (HUD) FHA 90/10 Risk-Share program, whereby a multifamily project is FHA-insured for 90% of the mortgage, while the agency insures 10%. To be eligible to participate in this program, the agency deposited \$500,000 into an Eagle Bank collateralized account. With every risk-share project, an FHA placement fee of 1% of the mortgage balance is collected and deposited into the reserve account. As of Sept. 30, 2012, the outstanding principal balance on risk-share insured loans was \$155 million, with a reserve balance of \$2.5 million. We assess a 100% loss on the 10% the agency is obligated to cover. DCHFA has sufficient liquid reserves (\$81 million) to cover the loss. As of fiscal 2012, two properties -- Elsinore Courts Apartments and Parkway Overlook East & West Apartments -- were in default. The agency subsequently filed a claim and paid off the underlying bonds on both properties. We understand Elsinore Courts is currently occupied and covering its operating expenses. The property was sold in October 2012, with the agency recording a \$236,591 loss on its disposition. Meanwhile, Parkway Overlook East & West saw HUD abate its Section 8 Housing Assistance Payment subsidy due to successive Real Estate Assessment Centre failures in 2007. We understand the agency has HUD's written approval to initiate disposition of the Parkway Overlook property. The agency expects its subsequent losses to be minimal. As of Sept. 30, 2012, the agency has a contingent liability under the general fund to cover the estimated loss exposure.

The agency's multifamily properties are monitored and managed by DCHFA's compliance and asset management group. Asset managers ensure all procedures and guidelines are compliant with DCHFA requirements, as well as low-income housing tax credit regulations and FHA/HUD requirements. The asset and management group's focus through the monitoring process is to provide long-term, quality affordable housing and to protect DCHFA assets and bondholder investments. The projects are divided into risk-sharing and non-risk-sharing, while debt service and uncollected rent ratios are monitored throughout the fiscal year. The agency also uses watch list criteria for the multifamily projects, which can be found on its website. We believe this process allows for prudent property management by providing detailed information on the monitoring, review, and evaluation process. With a proactive approach to providing affordable housing, we believe DCHFA will continue to build its asset base.

The loans in DCHFA's bond programs pose minimal risk to its overall asset quality and general fund balance, in our view. The single-family bond programs are primarily guaranteed by MBS, while the multifamily bond programs are mostly issued as conduit debt, with no risk to DCHFA. Furthermore, given the low risk associated with their loans, DCHFA has seen very few nonperforming assets and delinquencies through its programs compared to traditional whole loans.

Chart 1

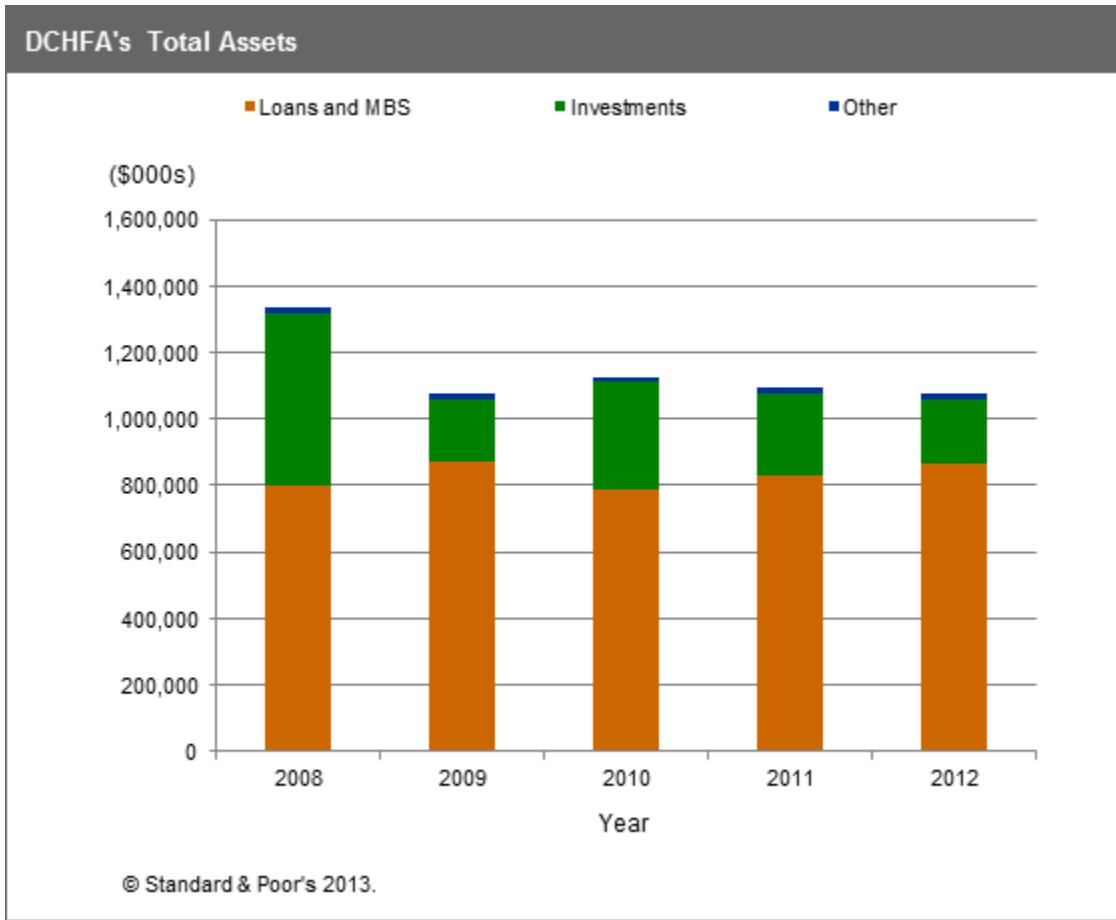
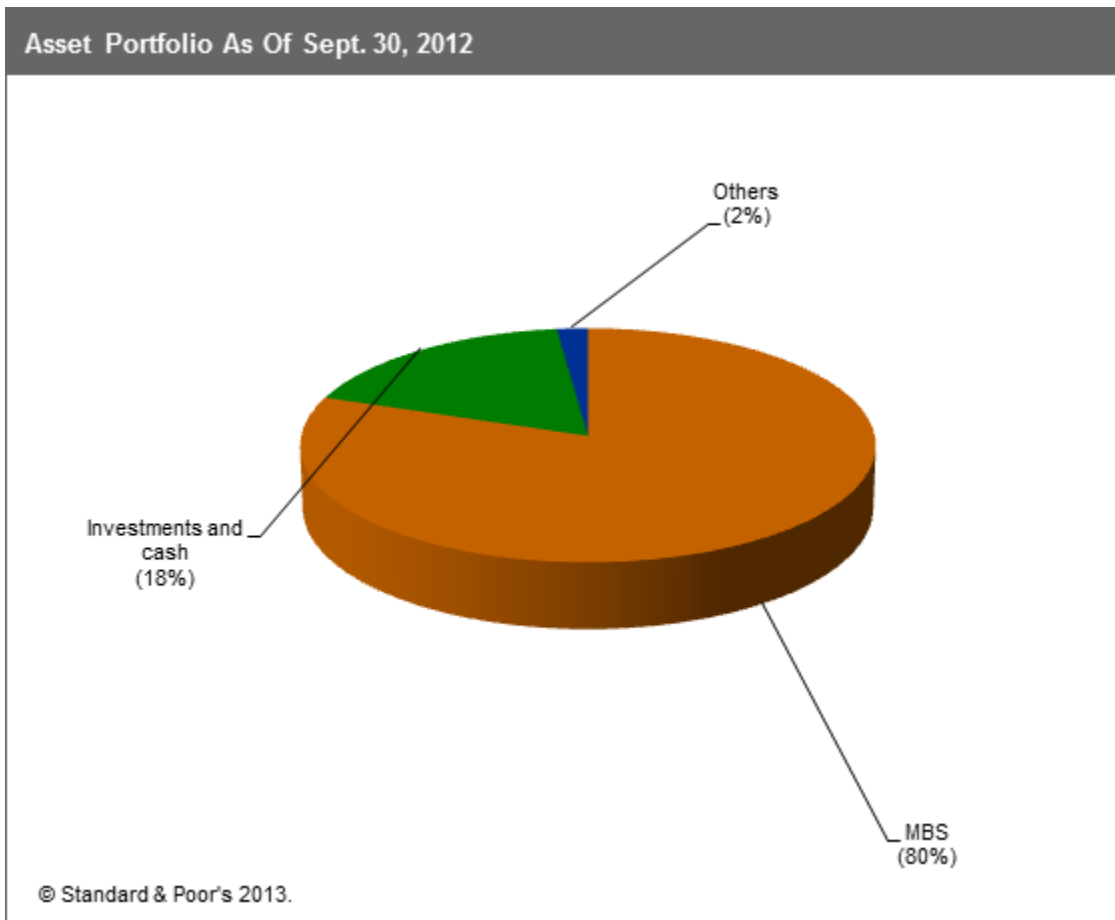


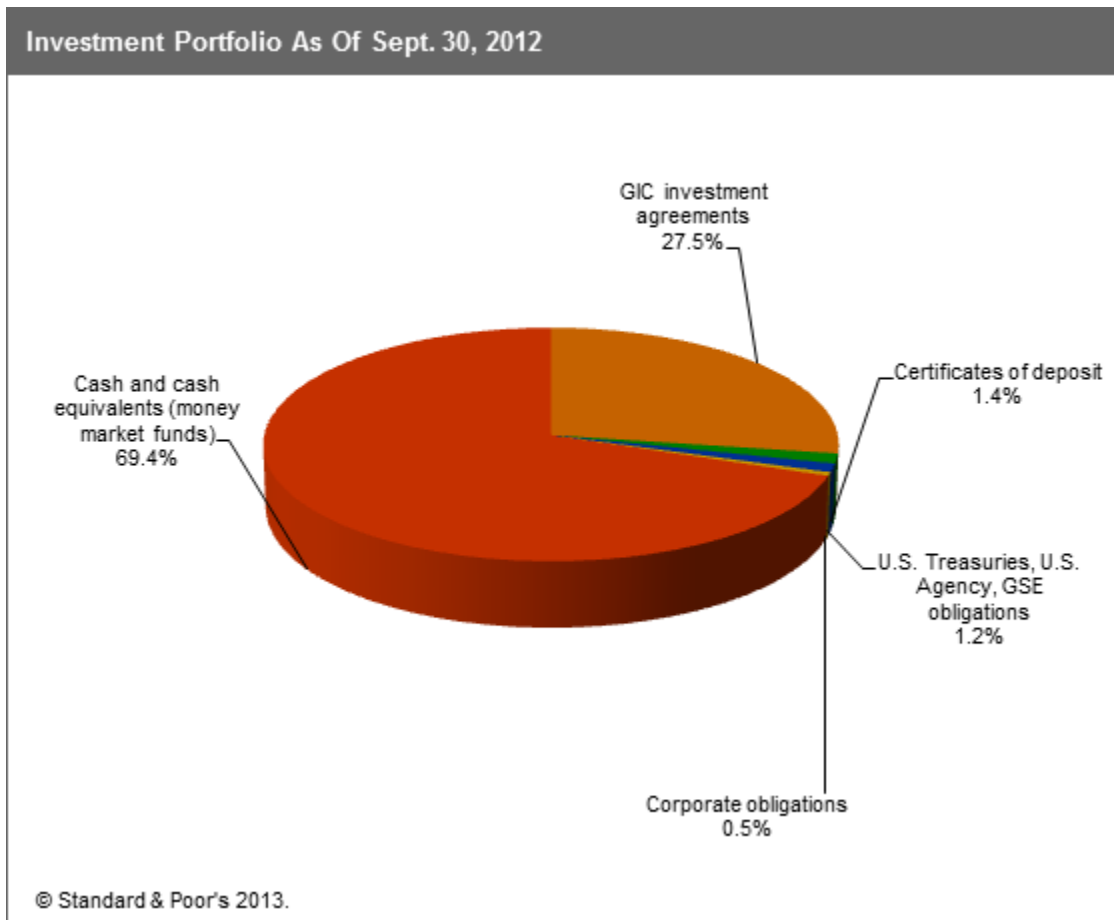
Chart 2



## Investments

DCHFHA has conservative yet prudent investment guidelines, in our view. These guidelines require general fund investments to be investment grade and approved by the agency's board of directors. Funds from bond issuances are governed by covenants of the trust indenture. Our ratings on DCHFHA's investment providers range from 'A-' to 'AA+', which we consider high-quality investment securities. The agency's investment portfolio was \$196 million as of fiscal year-end 2012, following 22% and 23% decreases in fiscals 2011 and 2010, respectively. A portfolio increase between fiscals 2009 and 2010 was primarily driven by rising short-term investments attributed to DCHFHA's NIBP participation. In fiscals 2011 and 2012, the agency released escrow funds to fund various multifamily projects. As shown in chart 3, about 69.4% of DCHFHA's funds are invested in money market funds and other cash equivalents, with the remaining 27.5% in investment agreements. Like many HFAs, DCHFHA's recent investment yields are down, resulting in a lower proportion of revenues from investments.

Chart 3



## Earnings Quality And Financial Strength

DCHFA's fiscal 2012 equity base was \$94 million, an approximate 21% decrease from fiscal 2011 (see table 3). As a result, the agency's equity as a percentage of total assets decreased to 8.70% in 2012 from 10.85% and 9.91% in 2011 and 2010, respectively. Still, this ratio remains strong vis-à-vis the agency's 'A' rated peers, in our view. Furthermore, after adjusting for potential losses, DCHFA's capital adequacy is strong, in our view, signifying that it has sufficient available funds to support any risks in its bond programs.

As of Sept. 30, 2012, the agency's revenues totaled \$67 million, up 2.30% from the preceding year. The increase is primarily due to a 4% rise in interest income from loans in 2012 and is complimented by falling expenses. As a result, net income rose to \$8.9 million in fiscal 2012 from \$3 million in fiscal 2011 (see chart 4). This subsequently increased DCHFA's profitability (in terms of ROA) to 0.82% in 2012 from 0.26% in 2011. The agency's NIM also continues to improve, increasing to 0.97% in fiscal 2012 from 0.52% in fiscal 2011, 0.42% in 2010, 0.02% in 2009, and 0.01% in 2008 (see table 1).

As exhibited in table 2, the five-year averages (2007-2011) for DCHFA's profitability ratios are in line with the agency's

'A' rated peers. All of these ratios were higher in fiscal 2012 with the exception of NIM, which we consider low compared with the agency's 'A' rated peers. Still, we view DCHFA's profitability and leverage ratios as sufficient to support the current rating, given the limited risk profile of the agency's existing asset and debt.

**Table 1**

<b>Financial Ratio Analysis</b>						
	2008	2009	2010	2011	2012	Five-year average
<b>Profitability (%)</b>						
Return on average assets	0.22	(0.05)	0.52	0.26	0.82	0.35
Return on assets before loan loss provision and extraordinary item	0.22	(0.06)	0.51	0.27	0.83	0.35
Net interest margin	0.01	0.02	0.42	0.52	0.97	0.39
<b>Asset quality (%)</b>						
Nonperforming assets/total loans and real estate owned	0.00	0.00	0.00	0.00	0.00	0.00
Loan loss reserves/total loans and MBS	0.00	0.00	0.00	0.00	0.00	0.00
Loan loss reserves/nonperforming assets	0.00	0.00	0.00	0.00	0.00	0.00
<b>Leverage (%)</b>						
Total equity/total assets	6.83	9.73	9.91	10.85	8.70	9.20
Total equity and reserves/total loans and MBS	11.41	11.99	14.19	14.31	10.80	12.54
<b>Liquidity (%)</b>						
Total loans and MBS/total assets	59.85	81.11	69.84	75.84	80.50	73.43

**Table 2**

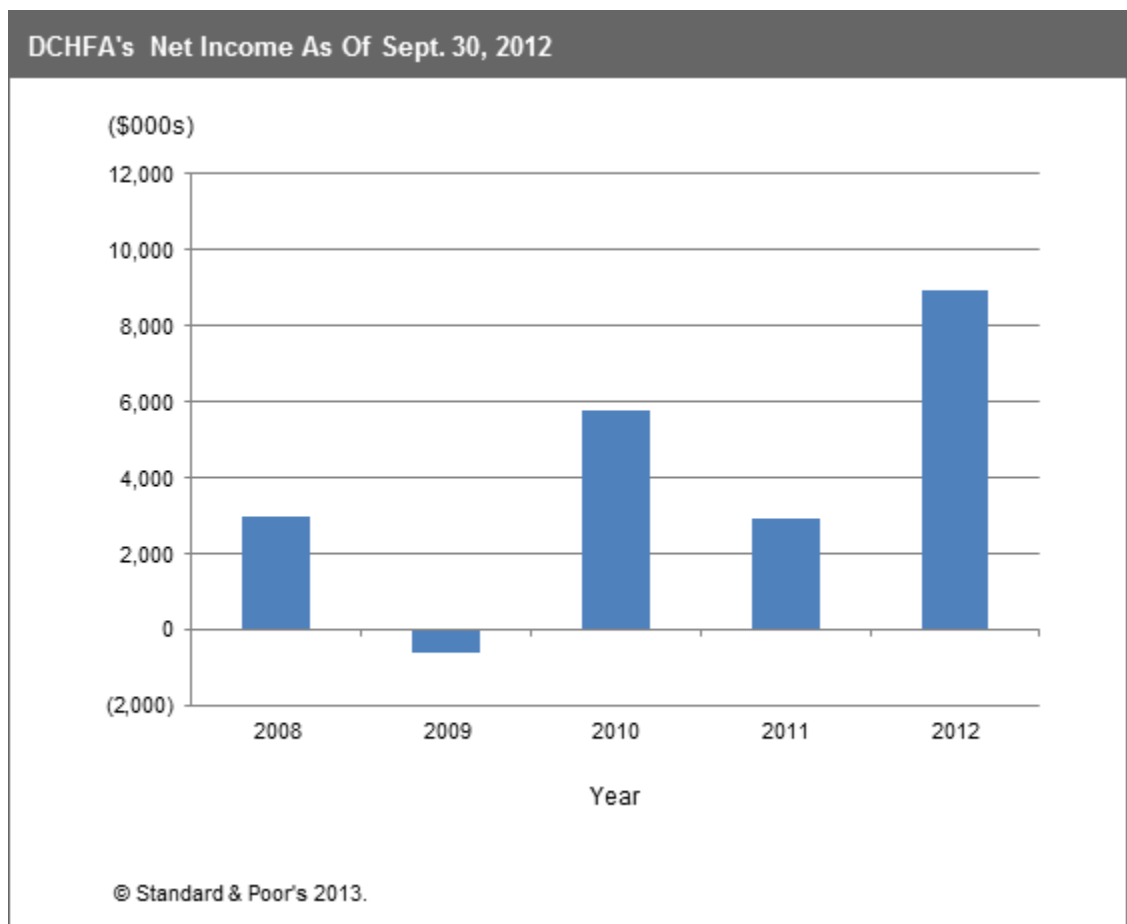
<b>Five-Year Average Financial Ratios</b>						
	<b>--2008-2012--</b>		<b>--2007-2011--</b>			
	<b>DCHFA</b>	<b>DCHFA</b>	<b>All 'A+' HFAs</b>	<b>All 'A' HFAs</b>	<b>All 'A-' HFAs</b>	<b>All HFAs</b>
<b>Profitability (%)</b>						
Return on assets	0.35	0.34	0.83	0.02	(0.16)	0.53
Return on assets before loan loss provision and extraordinary item	0.35	0.37	0.87	0.33	0.03	0.72
Net interest margin	0.39	0.35	1.25	0.50	0.73	1.11
<b>Asset quality (%)</b>						
Nonperforming assets/loans + REO	0.00	0.00	3.92	7.15	3.22	3.37
Loan loss reserves/total loans	0.00	0.00	3.59	0.59	0.65	2.07
Loan loss reserves/nonperforming assets	0.00	0.00	132.92	8.05	14.16	1,030.83
<b>Leverage (%)</b>						
Total equity/total assets	9.20	8.88	16.46	7.44	11.58	17.20
Total equity and reserves/total loans	12.54	12.98	29.60	10.28	17.11	26.01
<b>Liquidity (%)</b>						
Total loans/total assets	73.43	68.23	63.91	63.66	70.09	72.09



**Table 3**

Trend Analysis					
	2008	2009	2010	2011	2012
Total assets	1,334,738	1,075,617	1,127,432	1,094,052	1,078,253
% change	0.16	(19.41)	4.82	(2.96)	(1.44)
Total debt	1,167,051	904,516	955,765	902,726	872,336
% change	2.52	(22.50)	5.67	(5.55)	(3.37)
Total equity	91,142	104,646	111,721	118,725	93,823
% change	(3.44)	14.82	6.76	6.27	(20.97)
Revenues	80,632	75,866	63,800	65,628	67,140
% change	(16.17)	(5.91)	(15.90)	2.87	2.30
Net income	2,984	(600)	5,751	2,927	8,936
% change	(69.46)	(120.11)	1,058.50	(49.10)	205.30
Total loans and MBS	798,853	872,451	787,431	829,770	868,445
% change	9.96	9.21	(9.74)	5.38	4.66

**Chart 4**



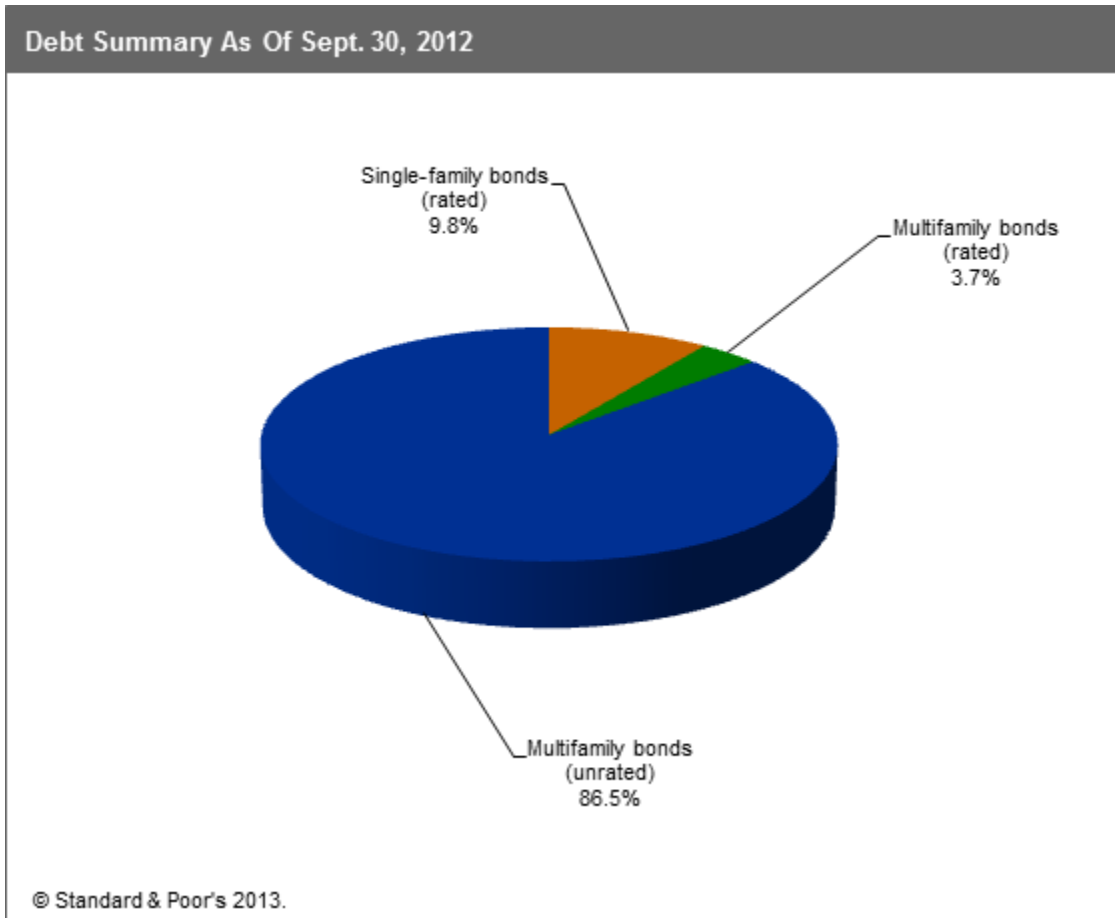
## **Debt**

As of Sept. 30, 2012, DCHFA's total debt was down 3.37% from the previous fiscal year to \$872 million. This overall net decrease is attributable to principal payments and redemptions exceeding new bond issuances. Of total debt, \$786 million is related to multifamily conduit bonds and multifamily NIBP bonds (which have no recourse to the agency); \$85 million consists of single-family program bonds and single-family NIBP escrowed bonds; and \$925,000 consists of COPs. Of total debt, 90% comprises multifamily bonds and 10% is single-family, most of which are issued at fixed rates. Of total outstanding debt, 9.8% of the agency's single-family bonds and 3.7% of its multifamily bonds are rated by Standard & Poor's (see chart 5).

As of Sept. 30, 2012, all single-family and multifamily NIBP bonds were released from escrow. The agency converted \$14.15 million in single-family NIBP escrow bonds into tax-exempt mortgage revenue bonds. In addition, \$5.12 million in single-family NIBP escrow bonds were released as tax-exempt bonds to fund one multifamily project, and \$5.73 million in unexpended NIBP bond proceeds were redeemed. Concurrently with the release of the NIBP escrow bonds, the agency issued \$92.23 million in market bonds.

The agency also issued COPs to finance the purchase of its office building, of which approximately \$925,000 (less than 1% of total agency debt) was still outstanding as of Sept. 30, 2012. The certificates are insured by Radian Asset Guaranty. The COPs are a general obligation of the agency subject to annual appropriation but are payable from any available agency funds. The rating on the COPs is dependent on the agency's GO pledge. We believe the certificates' overall impact on the agency's bottom line should be minimal. DCHFA's GO debt exposure is negligible because all of its active bonding programs carry standalone ratings that are higher than the ICR, which we attribute to the pledged collateral's strength and stability and the resolutions' performance. As a result, the programs do not rely on general agency funds.

Chart 5



## Management

The agency is served by an active, stable senior staff that continually seeks ways to actively improve financial performance and programmatic operations. Management sets goals and objectives primarily through a five-year plan and works diligently to achieve its programmatic and administrative objectives.

The agency is governed by a five-member board of directors, appointed by the mayor and confirmed by the District Council. Board members serve two-year terms. DCHFA has, in our view, a strong relationship with the district government. As further evidence of the district's support, it enacted legislation in September 1996 that eliminated the agency's appropriated debt and interest. This lifted the financial burden of having to repay initial funds provided to the agency to begin operations. The agency has no other loans outstanding with the district, and the district has never appropriated any agency funds despite difficult economic conditions. Standard & Poor's will continue to monitor DCHFA's relationship with the District Council.

DCHFA is a proactive agency, in our view, seeking relationships outside its local area to meet its mission of providing affordable housing. We understand that relationship-building and creating partnerships with developers, employers,

realtors, and lenders is a high priority for DCHFA. Warehousing mortgages is an additional avenue the agency uses to promote single-family market growth. DCHFA also manages a number of housing development and rehabilitation programs intended to provide affordable housing and improve existing housing stock.

The agency regularly searches for new ways to generate additional revenue, and it is actively seeking debt refunding, restructuring, and refinancing opportunities in its existing portfolios. DCHFA has looked into recapitalizing and extending affordable housing requirements for existing projects. As part of its business plan, we understand the agency is considering a 50/50 HUD Risk-Share Program (currently a 10/90 option). They also plan to expand servicing capacity by potentially becoming a GNMA servicer for FHA-risk-share transactions and other FHA-insured multifamily loans, if and when HUD/GNMA approves the plan. The agency has also secured a line of credit with PNC Bank to satisfy potential interim financing needs for both single-family and multifamily projects. In the event this credit line is used, it will be assessed against the impact to DCHFA's overall financial position and risk profile.

## **Economy**

On many fronts, the district's underlying economy has shown signs of modest improvement, although many challenges remain. Unemployment is lower compared to a year ago, with seasonally-adjusted unemployment listed at 8.5% for December 2012. District job growth continues but at a lower rate, with public sector contractions somewhat offset by private sector gains. In addition, the population is increasing: for the last four years, we understand the district's population is in excess of 2% annually.

The housing market was volatile from 2007 to 2010, but -- unlike other states -- the district did not lose many of its prior gains during the recession, while the net drop in purchase-only housing prices was a mere 3%, according to the Federal Housing Financing Agency. The district's total taxable value declined in fiscals 2010 and 2011 before increasing by 5.2% in fiscal 2012 to \$146.5 billion. Total market value is likewise higher for 2012, by 4% to \$229.9 billion, of which about 35% is tax-exempt due to the large governmental and non-profit presence in the district.

Fiscal 2012 economic reports show a 12.8% rise in condominium sales but a 6.2% reduction in single-family home sales from the prior year. Still, average single-family unit prices are up about 4.8% year over year. According to Mortgage Bankers Association data, the district's subprime and prime mortgage foreclosure rates diverged slightly during first quarter 2013: the district saw 6.7% of subprime and 2% of prime mortgages enter foreclosure, compared to 10.8% and 32.5% nationwide, respectively. With these rates, the district's subprime foreclosure rate is ranked 19th in the U.S. for the quarter. Our state and local government credit conditions forecast projects housing starts to increase by 38% and 39% in 2013 and 2014, respectively.

We believe the District of Columbia's economic fundamentals provide a nurturing environment for DCHFA's loan portfolio. However, this has not sparked loan production within its single-family bond resolution. We expect the district's 30-year fixed mortgage rate to remain below 5.0% through fiscal 2014. As a result, DCHFA will continue to struggle with loan production financed through mortgage revenue bonds.

**Table 4**

	<b>Industry Economic Outlook For U.S. Public Finance Housing In 2013-2014</b>						<b>--Actual--</b>
	<b>--Forecast/scenarios--</b>						
	<b>--Downside§--</b>		<b>--Baseline*--</b>		<b>--Upside§--</b>		
	<b>2013</b>	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2012</b>
<b>Macroeconomic indicators</b>							
Thirty-year fixed mortgage rate (%)	2.88	3.30	3.37	3.86	4.17	5.29	3.66
Ten-year treasury note yield (%)	1.11	1.71	2.06	2.61	3.15	4.22	1.80
Unemployment rate (%)	8.55	9.05	7.27	6.60	7.06	6.07	8.07
Real GDP (% change)	(0.54)	1.04	2.95	3.02	3.19	4.03	2.26
Total nonfarm payrolls (% change)	0.13	0.19	1.95	2.34	2.20	2.72	1.43
Consumer price index (% change)	0.80	1.82	1.49	1.99	2.46	1.66	2.08
Households (mil.)	123.40	124.62	123.81	125.36	123.77	125.46	122.14
Median single-family existing home prices (\$000s)	169.94	165.42	177.04	178.48	178.01	178.99	175.36
Median new homes sale prices (\$000s)	226.96	224.66	236.10	240.97	224.40	221.54	240.46
New home sales (mil. units)	4.47	5.18	4.97	5.83	5.26	6.08	4.53
Single-family housing starts (mil. units)	0.44	0.55	0.75	1.01	0.81	1.09	0.53
Multifamily housing starts (mil. units)	0.27	0.32	0.36	0.45	0.36	0.47	0.24
Federal government spending	(3.80)	(3.60)	(2.90)	(3.20)	(2.90)	(3.20)	(1.60)

\*Based on Beth Ann Bovino's "U.S. Economic Forecast: New Year's Resolutions", published Jan. 16, 2013, on RatingsDirect.

§Based on Beth Ann Bovino's "U.S. Economic Forecast: We Can Work It Out", published Dec. 21, 2012, on RatingsDirect.

## Related Criteria And Research

USPF Criteria: Housing Finance Agencies, June 14, 2007

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