

RatingsDirect®

Summary:

Washoe County School District, Nevada; General Obligation; School State Program

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Summary:

Washoe County School District, Nevada; General Obligation; School State Program

Credit Profile		
US\$130.48 mil GO (ltd tax) sch imp bnds ser 2021 due 06/01/2046		
<i>Long Term Rating</i>	AA/Stable	New
Washoe Cnty Sch Dist GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	AA/Stable	Affirmed
Washoe Cnty Sch Dist GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Washoe Cnty Sch Dist GO bnds (ltd tax) rfdg bnds		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Washoe Cnty Sch Dist GO (AGM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Washoe Cnty Sch Dist GO (BAM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Washoe Cnty Sch Dist GO (BAM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Washoe Cnty Sch Dist GO (BAM) (SECMKT)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to Washoe County School District, Nev.'s estimated \$130.480 million series 2021 general obligation (GO) school improvement bonds. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the district's existing GO debt. The outlook is stable.

The district's full-faith-and-credit pledge to levy a sufficient ad valorem tax to cover debt service secures the GO bonds. The levy is subject to the state's statutory limit of \$3.64 per \$100 of assessed value (AV). The total overlapping tax rate in fiscal 2020 is \$3.66, but two cents of the state rate is exempt from the \$3.64 cap. These rates are consistent with historical levels. If the levy limit is reached, GO debt takes priority and operating levies would require a reduction. Despite state constitutional and statutory tax-rate limitations, we do not differentiate between the district's limited-tax debt and its general creditworthiness, since the ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources, which supports our view of the district's overall ability and willingness to pay debt service.

Furthermore, the district has four bonds outstanding (roughly \$547 million outstanding, equal to 47% of the district's

debt portfolio) that are additionally secured by a lien on 0.54% sales and use tax imposed within Washoe County. Ultimate security is provided by the district's full faith and credit pledge. Under our "Obligations With Multiple Revenue Streams Criteria" (published Nov. 29, 2011), we base the rating on the district's limited-tax GO pledge, which we view as the stronger security even though the additional sales and use tax pledge provides sufficient maximum annual debt service coverage on bonds backed by the pledge.

Lastly, the district's 2014A GO bonds outstanding participate in the Nevada School District Bond Guarantee program, supported by the constitutional pledge of the Nevada permanent school fund's assets (roughly \$36.5 million outstanding, equal to 3% of the districts debt portfolio).

Proceeds from the series 2021 bonds will be used to construct a new middle school and renovate and equip various school facilities within the district's boundaries.

Credit overview

The district benefits from its inclusion in the broad and diverse Reno metropolitan statistical area, that serves as the regional economic center for Northern Nevada. Washoe County and Nevada have undertaken significant strides to diversify the county's taxing base beyond the volatile gaming and hospitality sectors by undergoing significant investments in the manufacturing and high-tech sectors in recent years. Despite some budgetary hurdles in recent years tied to a challenging state-funding environment, the district has maintained a strong overall financial position that is anchored by a proactive and sophisticated management team that utilizes a priority-based budgeting approach for structural balance as evidenced by its consecutive operating surpluses. Further supporting the rating is the district's strong financial management policies and procedures, reinforcing our view that management practices are well-reasoned and sustainable, that provide a meaningful hedge to external budgetary pressures. Although the state funding environment represents the most prevalent threat to financial stability over the short term, we recognize that the district is well positioned to traverse the near-term revenue volatility associated with the state funding formula due to its expanding tax base, strong reserves, and conservative budgeting practices. Accordingly, we expect that downside rating pressure will be limited through the next one-to-two years, absent a significant and unlikely decline in reserves.

While we expect the rating to remain stable, we recognize the potential for downside risk, because of the uncertainty COVID-19 presents during the next six-to-12 months. Rating stability will depend on the district's response to adjusting for any potential changes in state aid revenue and recession-related headwinds tied to the COVID-19 pandemic. (For more information, see "Staying Home For The Holidays" published Dec. 2, 2020, on RatingsDirect.

In our opinion, the district's general credit strengths include its:

- Broad and diverse tax base, along with recent strong AV growth, leading to extremely strong market value per capita;
- Sustained strong available reserves, averaging 10.3% of expenditures over the past three fiscal years;
- Strong financial management practices and policies, which should enable the district to sustain its strong financial position, despite a pressured state funding environment; and

- Affordable debt profile.

Partly offsetting the above strengths, in our view, are the district's:

- State statutes that limits the district's revenue-raising ability;
- Some economic exposure to the gaming and tourism industries although ongoing economic diversification had reduced its exposure; and
- Below average reserve levels when compared to similar rated peers.

Environment, social, and governance (ESG) factors

Our rating considers the ESG risks relative to the district's economic base, financial indicators, debt factors and long-term liabilities, and management. The rating incorporates our view of the health and safety risks associated with the COVID-19 pandemic and the potential budgetary effects should further state funding cuts occur. Overall, we consider the district's governance and environmental risks in line with our view of the sector standard.

Stable Outlook

Downside scenario

We could lower the rating if the district's financial performance deteriorates significantly, leading to a substantial decrease in reserves to levels that we no longer consider in line with those of comparable peers.

Upside scenario

Although unlikely given the current economic environment, we could raise the ratings if the district were to sustain operational surpluses for multiple years, leading to increased reserves maintained at levels comparable to higher rated peers, with all other rating factors remaining consistent.

Credit Opinion

Regional economic center for northern Nevada that continues to expand and diversify, which has helped minimize its exposure to the tourism and gaming industries

The district is coterminous with Washoe County, which is the state's second-most populous county, having roughly 475,600 residents. Additionally, the county is in a broad and diverse metropolitan statistical area (MSA). The area's leading employers are concentrated in the downtown core of Reno, the county seat. Due to the county's proximity to Lake Tahoe and Northern California, tourism is a key component to the local economy, which include hotel casinos, special events, and outdoor recreation. The county is home to several casinos, which account for six of the 15 largest employers. Leading the list are the Washoe County School District, Renown Regional Medical Center, and the county itself. We note that in recent years, the state and county have made efforts to diversify the taxing bases beyond the volatile gaming and hospitality industries, and the county has experienced significant investment in the manufacturing and high-tech sectors. Recent and planned developments within the county include Deantronics' medical device technology campus and Apple Inc.'s new cloud computing data center, amongst several others. In light of the economic downturn, management reports that economic development moderated somewhat compared to prior years,

but it has been primarily concentrated in temporary closures of businesses mostly related to the hospitality sector. However, economic activity continues within the county and management reported that the local economy has not experienced any major shutdowns or layoffs as a result of the pandemic.

After contracting in fiscal 2010 due to the national economic downturn, the district's property tax base has demonstrated healthy growth, surpassing its prior peak in 2019. The district's property tax base growth in recent years is largely tied to ongoing economic developments and appreciation. As a result, the district's tax base growth has averaged 6.8% over the past five years. Assessed value (AV) totaled \$19.9 billion million in 2021, while the district's corresponding market value totaled \$57 billion, which we consider extremely strong at \$120,829 per capita. The 10 largest taxpayers make up an estimated 3.0% of assessed value, which we consider very diverse. The median household effective buying income in the district is 106% of the national average, and the per capita effective buying income in the district is 105% of the national average, both of which we consider good. The Washoe County unemployment rate in 2019 was 3.2%, which was below state and national figures during the same timeframe. Furthermore, unemployment filings spiked in April 2020 to 20.4% spurred by the recent recession and social-distancing measures to slow the spread of the COVID-19 pandemic. Unemployment figures from the Bureau of Labor Statistics show that unemployment levels have started to stabilize as evidenced by the unemployment rate for Washoe County registering at 6.7% in September.

State funding formula reform although optimal funding is a prevalent risk

The principal funding mechanism for school funding is called the Nevada Plan, which includes State and local sources (property and sales taxes). The state-wide formula provides the difference between funding generated through local taxes and a minimum guaranteed per pupil funding amount determined for each district. The current formula has proved to be challenging for most Nevada school districts due to a difficult state funding environment coupled with the inability to autonomously increase revenues. However, the Nevada Plan will cease at the end of the current biennium (2020-2021) and will be replaced by a new funding model called the Pupil-Centered Funding Plan (SB 543). During the 2019 legislative session, Senate Bill 543 was passed and signed into law and will go into effect on July 1st, 2021. SB 543 directs all major local sources of school district funding, including the operating portion of locally derived property taxes school districts' portion of the state sales tax to a new State Education Fund. The new plan will consolidate categorical funding into a weighted per pupil amount, which will consider certain student characteristics such as being an English language learner, needing special education or being in a gifted and talented program. The plan is intended to provide a base level of adequate resources to all students and target additional funding based on student need. Essentially, the per pupil funding will follow the student. The new plan is expected to generally increase per pupil funding by roughly inflation and provide for a decrease in per pupil funding if state revenues are expected to decline. However, SB 543 creates the Education Stabilization account that when funded, will provide potential budgetary relief to school districts when collection of revenues results in the State Education Fund receiving less than 97% of the current year budget. Currently, the Nevada Commission on School funding is defining what optimal funding is and how to achieve this target of funding in an equitable manner.

Static Enrollment tied to demographic shifts; however, the district experienced a decrease in enrollment for fiscal 2021 stemming from COVID-19 pandemic health and safety concerns. While the county has experienced positive population growth due to a favorable economic environment, enrollment has been relatively stable and has increased

by an annual average of 0.3% the past five years, totaling 64,037 students in fiscal 2020. The key drivers for the district's static enrollment figures are largely tied to local demographic shifts that have caused birth rates to decrease and smaller household sizes. For fiscal 2021, enrollment declined more than 3.6% to 61,673. The spike in enrollment decline for 2021 is largely attributed to the COVID-19 pandemic causing some families to homeschool their children or delaying enrollment for children who are eligible for kindergarten for the current school year.

History of mixed operating results due to an arduous state-funding environment; however, the district has maintained strong reserves

The district's financial profile has improved recently after a string of operating deficits by producing operating surpluses in fiscal 2019 and 2020. Despite the operating shortfalls from fiscal 2016 to 2018, the district was able to preserve its available reserves above its formal fund balance policy of 8% to 10% of expenditures. Management attributes the financial transformation to transitioning to a priority-based budgeting framework that implemented sound budgetary controls allowing management to identify areas for meaningful expenditure savings. Furthermore, the district saw minor revenue improvements from increased property and sales tax receipts stemming from robust economic activity. Lastly, the district benefits from a locally approved initiative called WC-1, which imposes a sales and use tax of 0.54% to fund capital projects of the school district. The sales tax does not sunset and district officials state that the additional recurring revenue earmarked for capital projects will alleviate many of the capacity concerns for the district's schools and ease the potential future pressure on the general fund to support ongoing capital needs.

As a result of the COVID-19 pandemic and broader safety concerns, Washoe County School District moved to virtual learning in mid-March, which continued for the remainder of the 2019-2020 school year. Management reports the transition to online learning was smooth and expenses incurred due to the outbreak were largely offset by savings associated with the closure of schools and receipt of Coronavirus Aid, Relief and Economic Security (CARES) Act funding. The district has been allocated approximately \$9.9 million in funding from the Federal Elementary and Secondary School Emergency Relief ("ESSER") portion of the CARES Act. The bulk of this allocation will be used to COVID-19 related expenses such as WiFi hotspot devices and additional learning positions.

Audited results for fiscal 2020 reported a surplus net operating result of 2.5% of expenditures or \$10.6 million due to slightly higher revenues compared to budget and substantial operational savings. The district's operating result prior to other financing sources yielded a \$58.149 million. However, the district maintains a practice of subsidizing its special education fund from its general fund. Inclusive of transfers, the district's net change in available fund balance increased by \$10.6 million to a strong \$51.1 million or 11.9% of general fund expenditures. Property taxes showed an increase of 6.3% or roughly \$7 million when compared to prior fiscal year however, local school support taxes (LSST) was \$13.3 million lower than original budget due to the onset of the COVID-19 pandemic. The district was able to offset this loss due to an increase in school receipts from the distributive school account that compensated for the shortfall in LSST revenues. The underlying factors in the district's significant expenditure savings is largely tied to salary and benefit savings stemming from vacancies among full-time and substitute teacher positions, turnover of many long-tenured teachers and certified administrators. Furthermore, the district realized building utility savings due to the district's closure in response to the COVID-19 pandemic. The district depends primarily on locally derived revenue for general fund revenue (72%), followed by state aid (28%).

The district's adopted 2021 budget was balanced and incorporated updated budgetary assumptions to insulate its

budget from the uncertainty posed by the COVID-19 pandemic. However, shortly after adoption, Governor Steve Sisolak called a special legislative session in July 2020 to consider actions to resolve reduced state revenues. Nevada continues to face significant fiscal and economic pressures stemming from the global COVID-19 pandemic and subsequent recession due to its concentration in the tourism and gaming industry. Nevada is particularly susceptible to significant revenue declines relative to other states, given a relatively heavy dependence on discretionary consumer spending and sustained effects of the shutdown of the gaming and tourism businesses to contain the spread of the virus. However, we note that Nevada's recent prioritization of building reserves to strong levels has positioned it to be able to absorb some shock to its cyclical economy (for more information on Nevada, see our full analysis report, published Apr. 21, 2020, on RatingsDirect). Due to Nevada's \$1.2 billion budget shortfall the legislature passed Assembly Bill 3 (AB3) which significantly reduced, and in some cases, eliminated categorical grant programs for school districts. The impact was approximately \$16 million in reduced revenues for Washoe County School District. Furthermore, the district's enrollment decrease is estimated to result in a projected decrease in general fund per-pupil revenues of roughly \$12.5 million. To offset the projected shortfall, management identified approximately \$9.1 million in expenditure cuts by reducing its OPEB contribution, turnover savings, eliminations of teacher allocations, ESSER funding, and the use of roughly \$7 million in available fund balance. These budgetary adjustments were incorporated into the districts amended budget on December 8, 2020 with board approval. Barring any unforeseen circumstances, the district's projected available fund balance at fiscal-year end will be roughly \$44.1 million or 9.9% of budgeted expenditures.

While these expenditure cuts and minor use of reserves are expected to be sufficient to address the revenue shortfall in fiscal 2021, we note that further declines in state-aid funding from a prolonged economic recovery without corresponding budgetary adjustments could result in further use of available reserves, which would weaken the district's financial position in our view. However, we expect management will strive for fiscal stability by implementing necessary budgetary controls to keep its reserves at levels we consider strong. Furthermore, management expects to generate additional operational savings that will reduce or eliminate the need to appropriate fund balance to cover the budgetary gap by fiscal year end.

Potential litigation settlement not expected to reduce credit quality

It is our understanding that district could be liable for a portion of a recently approved Washoe county board settlement agreement stemming from property tax litigation related to Incline Village/Crystal Bay. Washoe County School District has objected to the terms of the settlement agreement and has filed a motion to intervene in the District Court litigation in order to participate in the terms of the refunding parameters agreed to by Washoe County. The District Court has not yet ruled on the school district's motion to intervene. At this time, it cannot be determined whether such motion will be granted and if litigation would be successful in reducing or eliminating any obligation by the District to pay a share of the County's obligations under the settlement agreement. While the school district expects the outcome to prove favorable, we recognize that district has sufficient liquidity to absorb the contested amount of \$19.5 million if the court's ruling is unfavorable. Fiscal 2020 year-end available cash balance was \$207.3 million, and the litigation represents approximately 9.4% of available operating cash on hand. Furthermore, the refunded payments would be phased in over a multi-year timeline mitigating an acute decline in liquidity and allow the district to budget accordingly.

Proactive and forward-looking management team with a Strong Financial Management Assessment

We revised our view of the district's management practices to strong from good under our Financial Management Assessment methodology, indicating in our view that financial practices are strong, well embedded, and likely sustainable. The revision reflects our understanding that the district maintains a formalized and robust long-term capital improvement plan that serves as blueprint to address school facility needs. The district's financial practices include the following:

- Conservative budgeting that incorporates historical information and outside sources to create projections and meaningful assumptions for both revenue and expenditures as well as for enrollment projections;
- The district provides monthly budget-to-actual updates to the board and can make changes when needed;
- Long-term capital plan that details funding sources and uses that is updated on a rolling basis;
- Management performs multiyear financial planning identifying out-year budget gaps to determine revenue and expenditure adjustments to maintain budgetary balance;
- The district has an investment management policy and provides holdings and earnings information to the board on a quarterly basis;
- The district's financial practices include a debt management policy that includes thresholds to monitor leverage and sets procedures for debt monitoring and oversight; and
- The district has a policy of maintaining a minimum of 8% to 10% of expenditures in the general fund reserve.

Large capital footprint but an overall affordable debt profile that's supported by a voter approved sales tax

Inclusive of the series 2021 issuance, the district's estimated net direct debt outstanding amounts to \$1.1 billion. At 2.4% of market value, we consider overall net debt low, and at \$2,588 on a per capita basis, we view it as moderate. With 42% of the district's direct debt scheduled to be retired within 10 years, amortization is slower than average. Debt service carrying charges were 10.3% of total governmental fund expenditures excluding capital outlay in fiscal 2020, which we consider moderate. We note that the district has additional flexibility in its debt service fund as excess funds above 25% of next year's debt service can be used to fund capital projects on a pay-as-you-go basis. Based on fiscal 2020 figures, the excess amount available to the district is approximately \$52.7 million. Currently, district officials report that there are no plans to issue additional debt in the horizon.

Despite potential increases to pensions, costs are likely to remain manageable

Pension and OPEB liabilities remain a source of modest budgetary pressure for the district, although we expect them to remain manageable.

While the district is not making full actuarially determined contributions toward its OPEB liability, the district's legal flexibility to alter OPEB and currently closed plan somewhat limits adverse credit impacts from its OPEB liability.

As of June 30, 2020, the district's largest plans include:

- The district participates in the Public Employees Retirement System of the State of Nevada: 76.5% funded, with a proportionate share of the plan's net pension liability of about \$716.1 million.
- Single employer defined benefit postemployment healthcare plan called the Washoe County School District Retiree

Health Benefits Plan (WCSDRHP): 15.12% funded, with a net OPEB liability of \$111.9 million.

The district provides two additional OPEB plans; Retiree Life Insurance Plan and the Nevada Public Employees' Benefits Plan (NPEBP). NPEBP is a single employer defined benefit postemployment healthcare plan administered by the State of Nevada and funded on a pay-as-you-go basis. It is 46.6% funded, with a net OPEB liability of \$46.3 million. The district's Retiree Life Insurance Plan is a single-employer defined benefit life insurance plan and administered through the district's OPEB trust fund. The plan is funded at 8.36% with a net OPEB liability of \$3.5 million.

In fiscal 2020, the district paid its full statutorily required contribution of \$54.8 million, or 6.2% of total governmental expenditures, toward its pension obligations. Its actual 2020 statutorily required pension contributions fell short of both static funding and minimum funding progress, indicating the district's pension liability is increasing each year. The district makes contractual contributions based on an actuarial calculation. The actuarially calculated contributions are on a level percent of payroll amortization basis over a closed 20-year period. The discount rate of 7.5% is higher than our guideline of 6.0%, indicating exposure to market volatility that may lead to budgetary stress. The static mortality assumption is expected to lead to periodic jumps in liabilities as the assumption is updated. In addition, in our view, a level percent amortization basis, increasing at a rate of 5.5% per year for regular employees and 6.5% for police/fire, defers contributions using one of the country's most aggressive payroll growth assumptions. If hiring or payroll growth does not keep pace with this assumption, future contributions could escalate even faster than assumed which we view as a negative credit factor. The negative amortization is somewhat mitigated by the reasonable short length of 20 years, in line with our guidelines.

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Credit FAQ: Financial Management Assessment In U.S. Public Finance, June 27, 2006
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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