

Research

San Diego Housing Commission, California; General Obligation

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San Diego Housing Commission, California; General Obligation

Credit Profile

San Diego Hsg Comm ICR

Long Term Rating

AA/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA' issuer credit rating (ICR) on the San Diego Housing Commission (SDHC), Calif. The outlook is stable.

The ICR reflects our assessment of the following credit strengths:

- Extremely strong overall management and a strategic plan that supports the commission's mission to provide quality low-income housing;
- Very strong enterprise risk profile supported by economic fundamentals reflective of the high cost of housing in San Diego;
- Very strong financial profile, due to an extremely strong debt profile and liquidity position, and financial policies that offset a low score for financial performance;
- The very strong essentiality of SDHC housing, as evidenced by a waiting list of approximately 23,000 for public housing and more than 37,500 for housing choice vouchers; and
- Strong development arm that maximizes external resources, which has been successful in developing mixed-finance projects.

Partially offsetting the preceding credit strengths, in our view, are SDHC's:

- Appropriation risk associated with strong reliance on federal funding streams, including the risk of underfunding of federal operating fund subsidies and the federal housing choice voucher program, and the potential for decline in federal capital fund grants, and
- Weak financial performance, due to reductions in federal subsidies.

Created in 1979, SDHC is one of the newest public housing authorities (PHAs), and its fairly young housing stock includes approximately 2,300 multifamily units within scattered sites throughout the City of San Diego.

A key rating factor is our view of the management team and what we consider its well-developed strategic plan with clear goals and overall objectives. Standard & Poor's believes that SDHC's management has the wherewithal to balance new development and rehabilitation prudently, in a manner that makes the most use of its resources, to improve its overall housing stock. In 2009, SDHC transitioned out of the federal public housing program in favor of a private-sector affordable housing real estate model. In our view, SDHC effectively maintains a level of financial stability while achieving its overall affordable housing goals.

Standard & Poor's believes SDHC has demonstrated a strong ability to leverage resources and to develop partnerships

in its efforts to revitalize its communities, as evidenced through the housing commission's multifamily mortgage revenue bond program. Since 1982, the bond program has issued more than \$1 billion in tax-exempt bonds to provide below-market-rate financing for affordable housing projects. Although the housing commission acts as the issuer of the bonds, there is no financial liability to the city, the housing authority, or the housing commission in connection with the issuance or repayment of bonds. The bonds are special, limited obligations of the housing authority payable solely from private revenue sources such as project cash flows and equity payments.

Factors constraining the rating, in our view, include the current environment of federal appropriations for PHAs. The U.S. Department of Housing and Urban Development (HUD) is the main source of public funding for affordable housing, and as an entity of the federal government, it is bound to congressional budget decisions; its funding declined by 12% between 2008 and 2012. Sectors with less federal support will see more financial stress. Declining or stable asking rents, which are subject to income restrictions, offset some of the benefits that affordable multifamily properties enjoy, such as declining vacancy rates, relatively stable operating costs, and locations in low-cost markets. Without explicit federal guarantees, the ratings on these properties are much more subject to market forces.

Outlook

The stable outlook reflects our view of SDHC's management and what we consider clear, directive strategic plans to maximize its position in the San Diego market. We believe that current and future market demand for affordable housing far outweighs SDHC's existing and planned portfolio, as evidenced by a strong need for this segment of the housing market. A key factor to maintaining the rating, in our view, will be SDHC's ability to preserve market stability and tenant occupancy for continued profitability of its portfolio due to the low reliance on federal subsidies for its units. In addition, the stable outlook reflects our view of SDHC's participation in business activities that provide the commission with additional income sources. The commission's inability to maintain and/or increase additional leveraged resources, net working capital, and/or profitability could in the long term impair its financial strength and have a negative credit impact. In addition, further stresses in the commission's financial profile (i.e., EBITDA-to-revenues ratio falling below 10%, or the liquidity ratio declining below 1.5x) could result in a rating downgrade. We do not anticipate raising the rating during the two-year outlook period.

Comparative Analysis

Table 1 details how SDHC compares in key measurements with three international entities (L&Q Housing in London, Stadgenoot in Amsterdam, and Housing New Zealand) and four U.S. PHA peers (Philadelphia, Boston, Chicago, and Houston). The commission differs from other rated U.S. PHAs (which traditionally operate under the Public Housing Program) in its transformation from public housing units in favor of a private sector, affordable housing real estate model, as evidenced by its significantly high social rent as a percentage of market rent in the main region of operation, which averaged 60.5% from 2010 through 2012. Like those of other rated U.S. PHAs, the commission's revenue stream is primarily derived from federal subsidies; however, SDHC's subsidies are mostly in the form of rental assistance payments. SDHC's financial profile is very strong, in our view, and is in line with those of other U.S. PHAs.

Table 1

Comparative Analysis								
ENTITY	Enterprise Profile				Financial Profile			
	Average Social Rent as % of Market Rent	Annual Pop. Growth (%)	Average Dwelling Price as a Percentage of National Average	Vacancy Rates (3yr Average) (%)	EBITDA/Revenues (%)	Debt/EBITDA (X)	EBITDA/Interest (x)	Liquidity Ratio
L & Q	40.0	0.8	40.0	2.0	32.1	16.9	1.2	1.59
Stadgenoot	55.0	1.4	55.0	2.5	36.4	17.4	1.5	1.79
Housing New Zealand	92.6	1.2	92.6	3.0	45.1	4.6	4.0	0.81
Philadelphia PHA	15.4	0.1	97.4	3.1	28.3	2.9	21.7	3.85
Boston PHA	20.6	1.2	128.7	2.0	13.8	3.7	106.8	7.40
Chicago PHA	16.9	0.4	103.8	6.6	33.6	1.1	17.2	8.83
San Diego PHA	60.5	1.2	162.7	6.1	14.0	3.6	7.0	2.50
Houston Housing	43.8	2.2	78.4	3.5	11.0	8.9	22.6	4.37

Extraordinary Government Support

Standard & Poor's views SDHC as a government-related entity (GRE), and therefore, we apply applicable criteria. Under the GRE criteria, we view SDHC as having a "strong" link with the U.S. federal government based on the federal government policy, supported by what we see as a track record of providing strong credit support for the public housing sector under certain circumstances. We also view SDHC as having a "limited importance" role to the government because in our view, a credit default of SDHC would have a limited impact for the government. According to our criteria, this combination of the "strong" link and "limited importance" role leads us to believe that there is a moderate likelihood of extraordinary support that may be available to this GRE when required. Despite this, SDHC's stand-alone credit rating of 'AA' is in a rating category under which a moderate likelihood of support would not result in a raised rating.

Enterprise Profile

Industry risk: U.S. PHAs' focus on affordable housing lends further stability with low competitive risk

The U.S. PHA industry risk scores a '2' (see table 2), a combination of individual assessments: a sub-score of '2' for cyclical risk and a sub-score of '2' for competitive risk, with no adjustment for the supportiveness of government policies toward the industry. Economic cycles are most likely to affect U.S. PHAs more than other types of social services because real estate fluctuations can change asset values. Real estate markets can be overbuilt, leading to depressed occupancy rates, rentals, and property values; residential rental markets typically pose less risk relative to other property classes, and U.S. PHAs' focus on affordable housing typically lends further stability. Competitive risk is fairly

low, due to effective barriers to entry in many jurisdictions, minimal risk of substitution, and overall stable trends in growth and margins. In addition, ongoing government subsidies, other support, and oversight limit volatility, with the overall importance of the service delivered, limit the potential for negative government intervention, in our opinion.

Economic fundamentals and market dependencies

SDHC was established by the San Diego City Council for the benefit of housing low-income San Diegans through a variety of programs. These programs include owning and managing housing units, providing rental assistance for families and individuals, offering financial assistance for qualifying first-time homebuyers, and rendering both financial and technical assistance to low-income households whose older homes need rehabilitation. SDHC owns and/or operates more than 2,300 family and elderly units in 154 sites scattered throughout the city, 154 of which are public housing units. In addition, SDHC administers more than 14,000 housing choice vouchers. SDHC provides housing services for more than 75,000 residents of San Diego and is the youngest PHA in the U.S., with its oldest housing development built in 1979.

In 2009, SDHC launched its multiyear plan to transition out of public housing units in favor of a private sector, affordable housing real estate model. This allowed SDHC access to equity and, in our view, to better utilize revenues generated by 1,366 apartment units at 150 properties previously under HUD control. Simultaneously, SDHC received housing choice vouchers for the like amount of transitioned PHA units. Under this transition, HUD mandated that the commission add 350 additional affordable housing units so that current residents of public housing will remain fully supported. The result of the transition is evident in an average social rent as a percentage of market rent in the operating region of 61%, which is higher than that of most U.S. PHAs we rate, and more in line with international social housing providers.

Standard & Poor's believes that SDHC's importance to the market it serves is very strong. Like many other PHAs in the country, the market demand for SDHC's housing services exceeds the supply available, as evidenced by the number of people on the waiting list versus available units. SDHC has been, in our view, the leading provider of affordable housing opportunities for lower-income families and individuals in San Diego for at least the past 10 years. As of fiscal 2013, SDHC's housing choice vouchers waiting list contained more than 37,500 households, which indicates a significant need for affordable housing in the service area. The public housing waiting list was almost 23,000 families in fiscal 2013.

SDHC is a Moving to Work (MTW) demonstration agency with HUD. The MTW demonstration program allows SDHC to be exempt from certain Public Housing and Housing Choice Voucher regulations by permitting the commission to combine operating, capital, and tenant-based assistance funds into a single agencywide funding source and creating new and additional housing programs to meet local need.

Standard & Poor's believes the conversion of public housing units to SDHC-owned units, and subsequent increase in Section 8 vouchers, along with SDHC's MTW designation will enable the commission to grow its affordable housing program. With the significant wait list for the housing choice vouchers and because SDHC administers the vouchers for San Diego, we believe that the additional housing units mandated by HUD will not encounter low utilization and occupancy rates. We believe this is evident as occupancy rates for SDHC-owned property have historically experienced full utilization with a long waiting list.

Strategy and management

Standard & Poor's believes SDHC's business plan provides a clear and exhaustive path for the commission to pursue. In 2004, the commission's leadership team began utilizing three-year business plans as a strategic management tool to identify priorities, guide SDHC's activities, and align staff and resources behind common goals. The commission is currently operating under the 2011 business plan. The plan breaks down all goals into 49 strategies in support of five business plan goals. Each goal has a starting date, action to implement, measurements of completion, scheduled completion date, and an estimated cost and funding source.

The five goals are:

- Broaden the housing commission's mission to provide affordable housing for a wider San Diego population, from assistance for the homeless to opportunities for workforce housing.
- Model effective application of private sector techniques in a public sector operation.
- Become a national model in initiating and implementing new, progressive ideas to address affordable housing needs across the country.
- Provide a positive customer experience through the seamless, efficient, and professional delivery of programs and services.
- Continue to be an employer of choice in San Diego by offering professional development initiatives and treating staff members in a fair and equitable manner.

SDHC is governed by the San Diego Housing Authority. The mayor recommends, and the San Diego City Council approves, seven members to serve as the more general structure of the SDHC board, who report to the nine city council members. The functions of the San Diego Housing Authority are to provide public and affordable housing to San Diegans; these functions are performed by SDHC. Consistent with HUD regulations, two of the appointees are residential members, including one elderly resident member.

SDHC's organizational structure comprises a president and chief executive officer (CEO), chief of staff, two senior vice presidents, and four vice presidents. The president and CEO is responsible to the board of commissioners and the San Diego Housing Authority. SDHC's chief of staff, the senior vice presidents, and two vice presidents report to the president and CEO, while two vice presidents report to the chief of staff.

SDHC's senior staff team consists of experienced professionals, in our view, with more than 40 years of public housing authority and affordable housing experience, collectively. SDHC has a formal succession plan that is administered through the commission's specialized professional development program. In July 2013, SDHC appointed its interim executive vice president and chief of operating officer as the commission's executive vice president and chief of operating officer.

Asset quality and operational performance

SDHC owns and operates more than 2,300 units in 154 multifamily projects, including 39 scattered single-family homes throughout San Diego. Included in its portfolio are 1,366 housing units that were formerly public housing units, mixed-use sites (including commercial components), and mixed-finance properties, with market-rate units mixed in with properties. Unit size ranges from one-bedroom to five-bedroom units. The bulk of the portfolio consists of two- and three-bedroom units.

The unit occupancy rate has generally been steady during the past five years, averaging about 95%. Rent collected as a percentage to gross rent charged has remained steady during the past five years, with approximately 97% of rent collected on average.

Standard & Poor's believes SDHC is proactively working to meet and exceed its HUD mandate to build 350 new affordable housing units. In 2013, SDHC added 78 units to its public housing portfolio from the state's subsidized program into the commission's public housing program, and by fiscal year-end (FYE) 2014, an additional 35 units are expected to be transferred to SDHC's public housing program, increasing its public housing stock to 189 from 76 in 2012. Management has indicated that SDHC plans to continue increasing SDHC's affordable housing portfolio by seeking evaluating additional acquisition opportunities. Standard & Poor's believes that the scope of work for the development of these units is within SDHC's realm of experience.

Financial Profile

Financial performance: mostly stable, but low EBITDA-to-revenues ratio

SDHC's score of '5' results from the average EBITDA-to-revenues ratio (E/R ratio) of 14%, which has improved since our last review, but remains low compared to those of other PHAs. Furthermore, in fiscal 2012, the commission's EBITDA and revenues slightly dropped, primarily due to a 1% decrease in federal subsidies. For FYE 2013 management anticipates growth in the commission's financial performance, due to increases in federal subsidies and revenues, based on draft FYE 2013 financial statements.

Despite the improvement in the financial ratios, and anticipated growth in the commission's financial performance in 2013, we believe that SDHC's financial performance remains vulnerable during the two-year outlook period. Due to sequestration, we project EBITDA and revenues will dip in FY 2014, in which the commission faces a 5% across-the-board reduction to its HUD programs. We project the three-year average E/R ratio will fall to 12%, based on audited fiscal 2012, draft FYE 2013 financial statements, and our 2014 projections.

Although we anticipate a decline in the commission's financial performance, the 12% E/R ratio remains at the range that is commensurate with the '5' score for financial performance. Should the E/R ratio fall below 10%, a score of '6' would result, which could lead us to lower the rating to 'A+' from 'AA'.

Debt profile: extremely strong debt profile among global and U.S. peers

SDHC's debt obligations are low, which is in line with the majority of U.S. PHAs we rate. The commission's debt-to-EBITDA ratio of 3.6x is moderate compared to those of other U.S. PHAs and low among those of international social housing providers. To help fund the costs of long-term development projects, SDHC's outstanding debt grew to \$125 million in 2011 from \$67 million in 2010; as of fiscal 2012, debt outstanding is about \$127 million. In addition, the commission's EBITDA-to-interest ratio is also extremely strong, in our view, at 7x. Both measurements lead to a final score of '1'.

Liquidity: ratios fluctuate but remains extremely strong

Historically, SDHC's liquidity ratios have been extremely strong (as high as 67.3x in 2007), in our view, but have dropped in recent years (see table 2). Despite the fluctuation and sharp decline in the commission's liquidity ratios, the

ratio remains extremely strong (at 2.5x in 2012), in our view, and is in line with those of most other rated U.S. PHAs and stronger than those of other international social housing providers. The drop in the commission's liquidity ratios is largely due to significant increases in debt service payments in 2011 (to \$7.7 million from \$3 million) and 2012 (to \$30.6 million, which also includes pay downs and refinancing of debt). SDHC anticipates debt service to fall to approximately \$9 million and \$7 million in 2013 and 2014, respectively. Based on draft FYE 2013 financial statements and our 2014 projections, the liquidity ratio could improve to roughly 4.5x.

Due to the strength of its liquidity ratio, we gave a score of '1' to SDHC's liquidity position. Should the liquidity ratio fall below 1.5x, a score of '2' would result, which could lead us to lower the rating to 'A+' from 'AA'. Based on the financial information and projections we received from management, we do not expect the liquidity ratio to fall below 1.5x in the two-year outlook period.

Financial policies: positive credit impact, with a high degree of transparency

Standard & Poor's believes that SDHC's financial policies are well established and contain sufficient oversight and prudence consistent with our '1' score. SDHC is among the highest-rated housing authorities that have represented high profitability. The commission's finances are managed through its finance department, which consists of four units: budget, general ledger, accounts payable/accounts receivable, and treasury. SDHC's financial management benefits from thorough planning and budgeting, and implementation is enhanced through an extensive financial reporting system.

SDHC follows all applicable HUD requirements concerning cash management and the investment of funds not required for current operations. SDHC's investments are short term in nature and consist of treasuries, mortgaged-backed securities backed by government-sponsored entities, collateralized repurchase agreements, and other federally supported instruments. Maximum maturity under the investment policy is six months.

Table 2

San Diego Housing Commission Financial Summary					
	2008	2009	2010	2011	2012
Assets					
Total current assets	90,274,579	48,245,038	73,496,074	106,547,651	76,770,076
Total long-term assets	278,024,286	340,627,563	389,358,859	435,166,354	489,072,772
Total assets	368,298,865	388,872,601	462,854,933	541,714,005	565,842,848
Average total assets	352,944,518	378,585,733	425,863,767	502,284,469	553,778,427
Liabilities					
Total current liabilities	7,737,947	8,830,481	11,509,235	34,965,187	13,340,560
Total long-term liabilities	31,743,527	29,678,495	68,507,722	102,234,175	127,663,932
Total liabilities	39,481,474	38,508,976	80,016,957	137,199,362	141,004,492
Net assets/equity					
Net assets/equity, end of the year	328,817,391	350,363,625	382,837,976	404,514,643	424,838,356
Average equity	312,806,405	339,590,508	366,600,801	393,676,310	414,676,500
Total liabilities & net assets/equity	368,298,865	388,872,601	462,854,933	541,714,005	565,842,848

Table 2

San Diego Housing Commission Financial Summary (cont.)					
Revenue					
Rental income	16,294,790	22,800,191	22,427,140	24,309,910	27,859,151
Total contributions and grants	173,328,498	169,455,958	189,101,021	184,749,521	182,893,336
Other income	1,539,636	1,645,817	3,546,925	4,204,555	1,362,742
Total revenues	193,248,282	195,550,563	216,888,499	216,131,592	214,074,341
Expenses					
Operations and maintenance	7,779,665	6,664,735	5,065,696	10,130,088	8,258,469
Housing assistance payments	126,587,352	139,234,699	144,790,881	145,876,110	147,823,240
Real estate taxes	--	--	--	--	--
Depreciation/amortization	2,980,926	2,367,288	2,595,635	4,047,879	4,146,564
General & administrative	23,212,144	24,934,030	29,658,480	30,976,651	31,987,997
Other expenses	5,618,803	4,561,061	7,074,276	4,698,932	5,879,572
Total operating expenses	166,178,890	177,761,813	189,184,968	195,729,660	198,095,842
Adjustments to net operating income					
Gain (loss) on sale of assets	(132,480)	--	--	858,442	(49,695)
Tax expense	--	--	--	--	--
Interest and investment income	6,858,050	6,374,263	7,312,333	6,974,862	8,817,530
Capital contributed/capital grants	--	--	--	--	--
Interest expense	1,772,989	1,785,551	3,001,349	6,558,569	6,555,862
Other expenses	--	831,228	--	--	--
Other income	--	--	459,836	--	--
Change in net assets/equity (net income)	32,021,973	21,546,234	32,474,351	21,676,667	18,087,689
Net assets/equity at beginning of the year	296,795,418	328,817,391	350,363,625	382,837,976	404,514,643
Net assets/equity, end of the year	328,817,391	350,363,625	382,837,976	404,514,643	422,505,416
Operating activities					
Change in net assets/equity (net income)	32,021,973	21,546,234	32,474,351	21,676,667	18,087,689
Net cash provided by operating activities	13,511,937	21,345,455	31,449,793	30,720,256	18,461,429
Investing activities					
Net cash provided by investing activities	(9,867,233)	(13,139,224)	(56,435,525)	(26,125,336)	7,873,303
Financing activities					
Net cash provided by financing activities	(4,689,396)	(4,665,859)	23,818,894	492,181	(23,558,130)
Net increase/decrease in cash equivalents	(1,044,692)	3,540,372	(1,166,838)	5,087,101	2,776,602
Key measurement					
EBITDA (\$)	31,823,307	21,941,589	33,300,515	31,008,380	26,680,925
Debt (\$)	30,450,915	27,769,404	67,468,770	125,321,940	127,168,402
Debt service (\$)	1,706,621	4,504,164	3,299,774	7,736,259	30,552,139
Voids, vacancy (%) of revenues	4.8	--	7.0	3.6	7.7
Arrears (% of revenues)	0.9	2.8	4.7	1.3	4.7
Average social rent as a percentage of market rent in the main region of operation	20.20	14.70	16.80	16.50	16.50
Average dwelling price as (%) of national average	113.9	113.9	113.9	113.9	113.9

Table 2

San Diego Housing Commission Financial Summary (cont.)					
EBITDA/revenues (%)	16.5	11.2	15.4	14.3	12.2
Debt/EBITDA (x)	1.0	1.3	2.0	4.0	4.8
EBITDA interest coverage (x)	19.6	13.0	13.1	5.9	5.0
Funds from operations (\$)	15,463,524	22,522,877	32,037,936	26,930,192	15,618,576
Cash from operation (\$)	13,511,937	21,345,455	31,449,793	30,720,256	18,461,429
Cash and liquidity (\$)	80,877,737	38,559,582	59,139,671	99,123,998	67,108,555
Net working capital (\$)	82,536,632	39,414,557	61,986,839	71,582,464	63,429,516
Working capital excluding cash (\$)	1,658,895	854,975	2,847,168	(27,541,534)	(3,679,039)
Source of liquidity (\$)	96,048,569	60,760,012	93,436,632	129,844,254	85,569,984
Use of liquidity (\$)	1,706,621	4,504,164	3,299,774	35,277,793	34,231,178

Related Criteria And Research

Related Criteria

Criteria: Public And Nonprofit Social Housing Providers, July 11, 2012

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