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## Case Western Reserve University, Ohio; Private Coll/Univ - General Obligation

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### Table Of Contents

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Rating Action

Stable Outlook

Credit Profile

Enterprise Profile

Financial Profile

Related Research

# Case Western Reserve University, Ohio; Private Coll/Univ - General Obligation

## Credit Profile

US\$350.0 mil taxable bnds ser 2022C due 06/01/2122

*Long Term Rating*

AA-/Stable

New

### **Ohio Higher Ed Fac Comm, Ohio**

Case Western Reserve Univ, Ohio

Ohio Hgr Ed Fac Com (Case Western Reserve Univ) PCU-GO

*Long Term Rating*

AA-/Stable

Affirmed

## Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Case Western Reserve University (CWRU), Ohio's \$350 million series 2022C taxable bonds. At the same time, we affirmed our 'AA-' existing ratings on CWRU. The outlook for all debt is stable.

As of June 30, 2021, the last audit, CWRU had \$470.2 million of long-term debt outstanding. After fiscal year end in 2021, CWRU issued series 2021A and series 2021B bonds, in the amounts of \$29 million and \$35 million, respectively. In 2022, CWRU refunded portions of the series 2013 and 2016 bonds via a \$56 million direct-purchase arrangement (series 2022A). Incorporated also in the pro forma debt is CWRU's proposed 2022B direct-purchase agreement, in the amount of \$116 million, as well as the \$350 million taxable bond. The pro forma debt including debt issued after the last audit and the proposed series 2022B direct purchase and 2022C taxable bond is \$936 million. The series 2022C bonds are an unsecured general obligation of CWRU. Debt issued through the commission is secured by CWRU's general obligation (GO) pledge to make rental payments under a lease agreement with the commission. The university's obligation to make rental payments is absolute and unconditional and not subject to abatement, setoff, or counterclaim. Included in the debt figures is the operating lease obligation of about \$10 million as of fiscal year-end 2021, which we view as manageable relative to the overall balance-sheet position.

The series 2022 taxable bonds are expected to be issued as century bonds--with a bullet due at maturity in 2122. Proceeds from the issuance are expected to go toward financing a portion of a new interdisciplinary science building and other facilities of the university, paying capitalized interest on a portion of the series 2022C bonds during construction, and other capital projects. The interdisciplinary science building project cost is expected to be about \$300 million and about \$150 million will be funded from the series 2022C taxable funds. Management expects that the remaining \$150 million could come from fundraising or other internal sources. The 250,000 square foot building will allow for new labs and research space and growth in strategic areas with space for additional investigators and students. The series 2022B senior notes (unrated direct purchase debt) with New York Life are being issued to support a new residence hall with 600 beds to support growing enrollment. These issuances represent a material increase in CWRU's debt, weakening balance sheet ratios such as available resources relative to debt and debt burden. However, in our opinion, the additional debt can be absorbed given the enterprise profile that remains in line with the current

rating, solid operating results, and potential revenue generation and debt support from the projects. In addition, management notes that \$200 million from the issuance will be maintained as an "internal bank," which allows the university flexibility over time--funding for future capital projects, provide a bridge as fundraising funds are collected, or to provide for support over time for interest payments and the balloon payment at maturity, which should in part offset the additional debt.

Because of the COVID-19 pandemic, CWRU transitioned to virtual instruction for the second half of the spring 2020 semester. The university's operations improved in fiscal years 2020 and 2021 despite the COVID-19 crisis. CWRU received \$4.5 million in CARES Act funding in fiscal 2020; half of that amount was a pass-through for student emergency aid. The remaining funds helped offset the housing and dining refunds given in fiscal 2020. The university received another \$6.5 million in HEERF II funding, \$663,000 from Employee Retention Credit, and \$4.8 million from state funding for COVID-19-related issues in fiscal 2021. Management reports another \$11.8 million in HEERF III for fiscal 2022 (or beyond). To partially offset the loss in COVID-19-related revenue and increases in expenses, the university was able to make approximately \$80 million of expense reductions, including suspension of retirement contributions for faculty and senior staff, salary, and hiring freezes, voluntary salary reductions, postponement of some capital projects, and travel restrictions. In addition, the management team added in a contingency to the budget given the ongoing uncertainty related to the pandemic. Some of the expense efforts will be rolled back in fiscal 2022 (such as pension-related cuts), while others are structural changes to the expense base expected to be maintained.

For fall 2020, the university operated with a hybrid model with courses being offered in person, fully online, and blended courses and reduced on-campus housing for the fall 2020 semester, and occupancy was 40% compared with 92% the previous year. For fall 2021, applications and enrollment improved and for the full fiscal year, the university posted an improved operating margin despite COVID-19-related pressures. Management is projecting an operating surplus for fiscal 2022 similar to fiscal 2021 based on better-than-expected first-year enrollment and continued expense savings.

### **Credit overview**

We assessed CWRU's enterprise profile as very strong, characterized by improving enrollment and stable selectivity, but mitigated by weak matriculation rates for the rating. We assessed CWRU's financial profile as strong, with positive operations on a full-accrual basis and improved available resources for the rating given recent investment gains. These factors are offset by an increased pro forma debt burden and available resource ratios relative to debt that will be below median levels. Combined, we believe these credit factors lead to an indicative stand-alone credit profile of 'a+'. As of our criteria indicate, the final rating could be within one notch, and we believe that 'AA-' better reflects CWRU's solid enterprise profile that is more in line with 'AA-' peers given the expected enrollment growth and significant research focus.

The rating reflects our assessment of CWRU's following strengths, including its:

- Broad range of programs, research, and community medical coalitions, which have historically led to healthy demand metrics despite strong competition for its high-quality students;
- Consistently positive operating results on a full-accrual basis for the past several fiscal years; and
- Sizable cash and investments.

The rating reflects our assessment of the following weaknesses, including its:

- Low freshman matriculation rate of about 16% in fall 2021 compared with that of peer research institutions, indicative of significant national competition for high-quality students; and
- Significant increase in debt with the proposed transaction, which has led to an increase in the maximum annual debt service (MADS) burden from 2% to about 8.5%, on a 30-year smoothed basis.

The university has three bank lines of credit, totaling \$150 million, available for working capital. There is no balance on these lines at present.

CWRU, in Cleveland, is Ohio's largest private university. It offers a wide range of undergraduate, graduate, and professional degree programs, including arts and sciences, law, business, medicine, engineering, nursing, social work, and dentistry. The university's research base is extensive, in our view. CWRU received approximately \$390 million in external research awards and indirect cost recovery revenue in fiscal 2021, principally related to health sciences and the medical school. It received more when including revenue passed through to the Cleveland Clinic. CWRU's campus is one of the anchor institutions in University Circle, a 500-acre concentration of more than 40 educational, social, medical, cultural, and religious institutions at the eastern edge of Cleveland.

CWRU and the Cleveland Clinic have an agreement for development and operation of a new Health Education Campus, which includes an academic building and dental clinic. Occupancy began in the spring of 2019 and we understand that the operations are as expected, with management reporting a solid working relationship and financial performance to date. Cleveland Clinic provided the interim financing for construction and the two organizations are jointly fundraising toward the project. Based on the agreement (\$50 million in five equal payments), CWRU paid \$10 million in January 2021 and \$10 million in January 2022 with another \$30 million liability over a three-year period. We understand that funds are reserved for this liability.

The stable outlook reflects our expectation that CWRU will maintain stable to growing enrollment and demand; continue to produce positive operations on a generally accepted accounting principles basis; and, at minimum, maintain stable-to-improving available resources as it manages its increased debt burden.

### **Environmental, social, and governance**

Vaccine progress in the U.S. has helped alleviate some of the health and safety social risks stemming from the pandemic; however, the higher education sector remains at a greater risk from remaining uncertainties. We view the risks posed by COVID-19 to public health and safety as a social risk under our environmental, social, and governance (ESG) factors. Despite the elevated social risk, we view the university's environmental and governance risks as neutral factors in our credit rating analysis.

## **Stable Outlook**

### **Downside scenario**

We could consider a negative rating action if certain factors weaken such that enrollment, positive margins, or fundraising are no longer consistent with expectations and sufficient to offset the debt load. Any weakening in the

balance sheet from pro forma levels either due to more debt or reductions in available resources could also lead to a lower the rating.

### **Upside scenario**

A higher rating is not likely during the two-year outlook period given the increase in debt. However, we could consider a positive rating action over the long-term if the university's available resources improve such that capital projects and additional debt were absorbed and metrics were in line with a higher rating, and if it sees sustained robust full-accrual surpluses (excluding external, nonrecurring funding) as well as improvement in enterprise profile characteristics such as matriculation that is more in line with those of a higher rating.

## **Credit Profile**

### **Enterprise Profile**

#### **Market position and demand**

CWRU has a broad draw for students with about 27% coming from within Ohio. While the number of international students declined during the pandemic, it remains about 20% of total full-time equivalent (FTE) for fall 2021. Similar to many colleges and universities, CWRU's enrollment declined in fall 2020 as the pandemic continued, but then rebounded in fall 2021 with a 5.6% growth in FTE. As a comprehensive research institution, CWRU has a larger proportion of graduate and professional students (approximately 50% of FTEs for fall 2021) than many of its peers. Applications for fall 2021 increased significantly over 14% over the past year and the solid demand profile is characterized by increasing applications and selectivity offset by weak matriculation. The matriculation at 16% reflects a highly competitive landscape for the students. As expected, selectivity for fall 2021 was somewhat weaker than historical levels as management tried to offset some of the uncertainty in the current environment, although over the longer term, we expect selectivity and target class sizes to return to historical levels. The entering class in fall 2021 was the largest in the university history at 1,606. Student quality remained high as measured by average freshmen ACT and SAT scores. Retention and graduation rates have improved as well, reaching 94% and 85%, respectively. We understand that applications increased for fall 2022 and management has plans to grow undergraduate enrollment (with a goal of 6,500 students). In our view, CWRU's enrollment and demand profile is healthy with no material weakening expected in the near term.

CWRU closed its most recent campaign in December 2018, where it raised \$1.8 billion (above the announced \$1 billion goal, which was revised to \$1.5 billion) in the comprehensive campaign started in 2011. The campaign benefits funding for programmatic support, scholarships, capital projects, faculty chairs, and the annual fund. In addition, the university does joint fundraising with the Cleveland Clinic to support that project. CWRU is raising funds for scholarships and is exploring a campaign focused on scholarships, strategic capital projects, and research in the next one-to-two years.

#### **Management and governance**

Eric Kaler joined as president of the university on July 1, 2021. He was the former University of Minnesota president and has worked with leadership and the board to capitalize on his experience, which they note includes significant expertise in elevating research, expanding fundraising, forming collaborative partnerships, encouraging

entrepreneurship, and advocating for diversity, equity, and inclusion. There are no other major leadership changes expected in the near term.

CWRU's regulations and bylaws do not provide for a maximum size for its board of trustees. Members are generally limited to four-consecutive, four-year terms, and may move to emeritus status once their term ends. Most board members are also alumni. We understand that board turnover has been routine. The full board meets formally three times a year and has a committee system. Recent commitment from the board and management to invest in strategic initiatives such as growth in undergraduate population and research are significant and the increase in debt is material but supports these initiatives.

## Financial Profile

### Financial performance

CWRU typically produces operating surpluses on a full-accrual basis, with margins ranging from 1%-6% in recent years. Operating results on a full-accrual basis were improved in fiscal 2021, which was ahead of the previous year. The surplus reflected significant cost-saving measures in light of the COVID-19 pandemic and uncertainty, some support of federal funds, and fairly consistent research revenues with fewer expenses. For fiscal 2021, the negative COVID-19 effect is estimated at about \$45.5 million, with the most significant factors being lost auxiliary revenues and expenses associated with testing. For the full fiscal year 2021, however, management posted a robust surplus given its expense management efforts. For fiscal 2022, many of the structural expense management changes have been retained, and as of March 2022, management reports results that are ahead of the previous year. Increased enrollment, tuition increases, and expense management efforts (including a voluntary retirement program) should yield consistent operating margins. While CWRU will be bringing new projects online in the next few years, their incorporation should not compress margins given the revenue generation potential with the projects.

Beginning in fiscal 2019, CWRU adopted a new endowment payout policy, which compares the 10-year average of actual endowment activity and will adjust the annual distribution based on the comparison. The spending rate was maintained at 4.7% for fiscal years 2021 and 2022.

Operating revenue streams are relatively diverse compared with peers, although CWRU is primarily dependent on student-related charges to fund operations. In fiscal 2021, gross tuition and student fees represented 46% of total revenue. The next largest component of revenue is research. While the university receives a concentration of National Institutes of Health funding; we understand that management has focused on remaining competitive for federal grants and is exploring efforts to bolster foundation and industry awards. In our opinion, management is positioned to adjust its research enterprise, which should remain a significant focus and revenue diversifier.

### Available resources

CWRU's financial resource ratios are improved with growth in cash and investments due to a 31.5% investment return for fiscal 2021 and amortization and repayment of debt. However, pro forma resource ratios show declines, due to the outstanding debt nearly doubling on a pro forma basis. In our opinion, the ratios remain sufficient for the 'AA' category, though light when compared with medians and some peers. We calculate expendable resources as unrestricted plus temporarily restricted net assets (identified by management) minus net property, plant, and

equipment plus long-term debt. As of June 30, 2021, expendable resources totaled approximately \$1.4 billion, equal to 120% annual adjusted operating expenses and 152% of total pro forma debt. Total cash and investments, which includes restricted assets, were approximately \$2.35 billion as of fiscal year-end 2021 (June 30), excluding funds held by trusts, which the university does not manage, but are shown as assets on the financial statements. Cash and investments improved over historical levels given the recent investment gains and provide some capacity for the additional debt.

The university's private equity, real assets, and private credit investments have mandatory capital calls related to future investments. Unfunded calls remain manageable, in our opinion, at about \$311 million. The university reports that about \$321 million is available in same-day liquidity; it is our view that its liquidity profile mitigates its unfunded calls.

### **Debt and contingent liabilities**

Pro forma debt as of fiscal 2022 is approximately \$936 million (excluding premium and unamortized bond issuance costs). Resources relative to debt and debt burden will weaken with the significant addition of debt. We calculate maximum annual debt service (MADS) as the total debt service averaged over 30 years, resulting in a smoothed MADS of about \$100 million. Following the series 2022C taxable and 2022B issuance, the majority of the debt will be public, fixed rate debt though the series 2021B bonds are floating rate notes. Management notes that the variable-rate exposure is offset by CWRU's interest-rate swaps resulting in a synthetic fixed rate. There are no other debt plans in the two-year outlook period.

CWRU has entered into a direct purchase agreement with New York Life in October 2021 for \$56 million (series 2022A). The proposed series 2022B also with New York Life is expected to be for \$116 million. The executed series 2022A debt has events of default that trigger acceleration (though no financial covenants). We understand that the series 2022B debt will be structured similarly. However, CWRU has sufficient liquidity, in our opinion, to mitigate risk related to these non-public debt transactions with over \$300 million with same-day liquidity.

The university has four interest-rate swap contracts with a total notional amount of \$68.3 million. Three of the four contracts terminate in 2022 and the fourth in 2034. The contracts are floating-to-fixed rate and all have Morgan Stanley as counterparty. The mark-to-market value was negative \$13 million as of the end of fiscal 2021. The university reports that its collateral threshold is \$20 million. In our view, CWRU's swap portfolio reflects low credit risk at this time due to counterparty credit quality, the average economic viability of the swap portfolio over stressful economic cycles, and sound debt and swap management internal procedures.

The university offers both a defined-contribution retirement plan to employees (which, by definition, is fully funded) and a defined-benefit plan. According to management, the latter is now closed to new entrants. It had a funded status of negative \$87 million at the end of fiscal 2021 and is about 70% funded. Defined-benefit contributions are made annually according to actuarial valuations. The university offers a retiree health care plan, but reports no related liability on its balance sheet because the cost is paid entirely by retirees.



## Case Western Reserve University, Ohio Enterprise And Financial Statistics

|  | --Fiscal year ended June 30-- |           |           |           |           | Medians for 'AA'<br>rated private<br>colleges and<br>universities | Medians for 'A'<br>rated private<br>colleges and<br>universities |
|--|-------------------------------|-----------|-----------|-----------|-----------|---|--|
|  | 2022                          | 2021      | 2020      | 2019      | 2018      | 2020  | 2020   |
| <b>Enrollment and demand</b>                   |                               |           |           |           |           |   |  |
| Headcount                                      | 12,142                        | 11,465    | 11,874    | 11,891    | 11,824    | MNR   | MNR  |
| Full-time equivalent                           | 11,397                        | 10,792    | 11,076    | 11,072    | 10,917    | 8,288   | 3,451  |
| Freshman acceptance rate (%)                   | 30.2                          | 30.3      | 27.4      | 29.3      | 33.1      | 18.0  | 67.5   |
| Freshman matriculation rate (%)                | 16.0                          | 14.8      | 17.2      | 17.9      | 15.6      | MNR   | MNR  |
| Undergraduates as a % of total enrollment (%)  | 47.7                          | 47.4      | 45.3      | 44.3      | 43.6      | 65.1  | 80.3   |
| Freshman retention (%)                         | 93.7                          | 93.4      | 93.2      | 94.4      | 92.5      | 95.0  | 85.5   |
| Graduation rates (six years) (%)               | 85.4                          | 85.3      | 84.4      | 84.9      | 82.6      | MNR   | MNR  |
| <b>Income statement</b>                        |                               |           |           |           |           |   |  |
| Adjusted operating revenue (\$000s)            | N.A.                          | 1,252,752 | 1,277,812 | 1,230,105 | 1,195,955 | MNR   | MNR  |
| Adjusted operating expense (\$000s)            | N.A.                          | 1,177,230 | 1,227,899 | 1,197,534 | 1,163,479 | MNR   | MNR  |
| Net operating income (\$000s)                  | N.A.                          | 75,522    | 49,913    | 32,571    | 32,476    | MNR   | MNR  |
| Net operating margin (%)                       | N.A.                          | 6.42      | 4.06      | 2.72      | 2.79      | 1.20  | 0.70   |
| Change in unrestricted net assets (\$000s)     | N.A.                          | 117,923   | (33,787)  | 29,798    | 22,859    | MNR   | MNR  |
| Tuition discount (%)                           | N.A.                          | 39.7      | 40.6      | 38.8      | 38.6      | 39.4  | 39.3   |
| Tuition dependence (%)                         | N.A.                          | 42.2      | 39.9      | 39.9      | 39.4      | MNR   | MNR  |
| Student dependence (%)                         | N.A.                          | 45.6      | 45.0      | 46.1      | 45.4      | 59.4  | 85.3   |
| Health care operations dependence (%)          | N.A.                          | 0.0       | 0.0       | 0.0       | 0.0       | MNR   | MNR  |
| Research dependence (%)                        | N.A.                          | 20.4      | 20.6      | 21.5      | 21.8      | MNR   | MNR  |
| Endowment and investment income dependence (%) | N.A.                          | 8.1       | 6.4       | 6.7       | 7.0       | MNR   | MNR  |
| <b>Debt</b>                                    |                               |           |           |           |           |   |  |
| Outstanding debt (\$000s)                      | N.A.                          | 470,194   | 509,535   | 483,765   | 496,973   | 540,885   | 121,080  |
| Proposed debt (\$000s)                         | N.A.                          | 585,715   | N.A.      | N.A.      | N.A.      | MNR   | MNR  |
| Total pro forma debt (\$000s)                  | N.A.                          | 935,659   | N.A.      | N.A.      | N.A.      | MNR   | MNR  |
| Pro forma MADS                                 | N.A.                          | 100,141   | N.A.      | N.A.      | N.A.      | MNR   | MNR  |
| Current MADS burden (%)                        | N.A.                          | 2.22      | 2.12      | 2.06      | 2.20      | 4.20  | 3.90   |
| Pro forma MADS burden (%)                      | N.A.                          | 8.51      | N.A.      | N.A.      | N.A.      | MNR   | MNR  |



## Case Western Reserve University, Ohio Enterprise And Financial Statistics (cont.)

|  | --Fiscal year ended June 30-- |           |           |           |           | Medians for 'AA'<br>rated private<br>colleges and<br>universities | Medians for 'A'<br>rated private<br>colleges and<br>universities |
|--|-------------------------------|-----------|-----------|-----------|-----------|---|--|
|  | 2022                          | 2021      | 2020      | 2019      | 2018      | 2020  | 2020   |
| <b>Financial resource ratios</b>           |                               |           |           |           |           |   |  |
| Endowment market value (\$000s)            | N.A.                          | 2,004,374 | 1,570,559 | 1,568,311 | 1,539,302 | 1,922,226   | 237,574  |
| Cash and investments (\$000s)              | N.A.                          | 2,348,690 | 1,876,188 | 1,847,534 | 1,808,068 | MNR   | MNR  |
| Unrestricted net assets (\$000s)           | N.A.                          | 342,619   | 224,696   | 258,483   | 228,685   | MNR   | MNR  |
| Expendable resources (\$000s)              | N.A.                          | 1,419,326 | 1,144,072 | 1,053,313 | 1,050,654 | MNR   | MNR  |
| Cash and investments to operations (%)     | N.A.                          | 199.5     | 152.8     | 154.3     | 155.4     | 338.3   | 144.7  |
| Cash and investments to debt (%)           | N.A.                          | 499.5     | 368.2     | 381.9     | 363.8     | 447.8   | 294.2  |
| Cash and investments to pro forma debt (%) | N.A.                          | 251.0     | N.A.      | N.A.      | N.A.      | MNR   | MNR  |
| Expendable resources to operations (%)     | N.A.                          | 120.6     | 93.2      | 88.0      | 90.3      | 185.4   | 88.8   |
| Expendable resources to debt (%)           | N.A.                          | 301.9     | 224.5     | 217.7     | 211.4     | 261.5   | 180.6  |
| Expendable resources to pro forma debt (%) | N.A.                          | 151.7     | N.A.      | N.A.      | N.A.      | MNR   | MNR  |
| Average age of plant (years)               | N.A.                          | 18.5      | 16.9      | 17.2      | 15.9      | 13.9  | 14.5   |

N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100\*(net adjusted operating income/adjusted operating expense). Student dependence = 100\*(gross tuition revenue + auxiliary revenue) / adjusted operating revenue. Current debt service burden = 100\*(current debt service expense/adjusted operating expenses). Current MADS burden = 100\*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term and long-term investments. Expendable resources = unrestricted net assets + temp. restricted net assets - (net PPE- outstanding debt). Average age of plant = accumulated depreciation/depreciation and amortization expense.

## Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

### Ratings Detail (As Of June 1, 2022)

#### Ohio Higher Ed Fac Comm, Ohio

Case Western Reserve Univ, Ohio

Ohio Hgr Ed Fac Com (Case Western Reserve Univ) PCU-GO

Long Term Rating AA-/Stable Affirmed

Ohio Hgr Ed Fac Com (Case Western Reserve Univ) PCU-GO

Long Term Rating AA-/Stable Affirmed

Ohio Hgr Ed Fac Com (Case Western Reserve Univ) PCU-GO (MBIA) (National)

**Ratings Detail (As Of June 1, 2022) (cont.)**

|   |                  |          |
|---|------------------|----------|
| <i>Unenhanced Rating</i>                    | AA-(SPUR)/Stable | Affirmed |
| Many issues are enhanced by bond insurance. |                  |          |

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