

# RatingsDirect®

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## Summary:

# Spotsylvania County, Virginia; Appropriations; General Obligation

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# Spotsylvania County, Virginia; Appropriations; General Obligation

### Credit Profile

US\$19.01 mil GO pub imp and rfdg bnds ser 2020 dtd 09/15/2020 due 01/15/2040

*Long Term Rating*

AAA/Stable

New

## Rating Action

S&P Global Ratings assigned its 'AAA' rating to Spotsylvania County, Va.'s \$19.01 million general obligation (GO) public improvement and refunding bonds, series 2020. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the county's GO debt outstanding as well as its 'AA+' rating on the county's appropriation-backed debt outstanding. The outlook on all ratings is stable.

- The county's full faith and credit pledge to levy and collect an annual ad valorem tax on all locally taxable property secures the series 2020 public improvement bonds and GO bonds outstanding. Proceeds will finance various public school, transportation, and public safety capital projects.

Spotsylvania County's appropriation debt issued through the county's economic Ddevelopment authority is secured by annual payments and basic rent payments made by the county. Based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" (published Nov. 20, 2019), we rate these obligations one notch lower than the county's general creditworthiness, as reflected by the GO rating, to account for the appropriation risk associated with the payments.

### Credit overview

The county's general creditworthiness is characterized by a strong and growing tax base that benefits from its location within the Washington DC metropolitan statistical area (MSA), in addition to a long history of strong financial operations supported by very strong management policies and practices, including six consecutive years of audited operating surpluses through fiscal 2019. Management regularly reviews and updates its policies in order to maintain best practices. Historically, Spotsylvania County has maintained low debt levels, supported by sizable annual pay-as-you-go capital contributions, which have helped it maintain a low overall debt burden. Furthermore, we believe the county's total fixed costs and retirement liabilities should remain relatively low given the county's well-funded retirement plans and low debt burden.

We believe Spotsylvania County's is well-positioned to withstand the impacts of the COVID-19 pandemic given the county's strong financial position and resilient local economy. The county's long track record of positive financial operations and very strong reserve levels, in addition to the receipt of Coronavirus Aid Relief and Economic Security (CARES) Act funds, which will help offset increased costs associated with the pandemic, provide the county with

ample ability in our view to absorb near-term revenue disruptions and increased expenses.

Nevertheless, as with most local governments, we believe challenges associated with the pandemic and a national recession could add some pressure to Spotsylvania County's budgets in the next one-to-two years. In line with our view of the ongoing economic contraction, we expect revenues to lag their historical performance. (For more information, see "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020 on RatingsDirect.) We note management made a number of spending adjustments in preparation for potentially reduced revenues and increased expenses. Specifically, for the fiscal 2021 budget, the county eliminated a proposed 7-cent tax rate increase as well as merit and cost-of-living-adjustment salary increases and other discretionary expenses, put a hold on capital spending, and implemented a hiring freeze. As a result of these expense adjustments, the fiscal 2021 budget is structurally balanced and management does not expect a material change to reserves at fiscal year-end despite some of the near-term challenges. Therefore, we do not expect to change the rating in the near term. Our outlook is generally for two years, but we see some risks due to the pandemic and U.S. recession over the next six-to-12 months.

Spotsylvania County's GO bonds are eligible to be rated above the sovereign, because we believe the county can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013), the county has a predominately locally derived revenue base, with nearly 85% of general fund revenue derived from local sources in fiscal 2019, coupled with independent taxing authority and treasury management.

The GO rating reflects our view of the county's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 47% of operating expenditures;
- Very strong liquidity, with total government available cash at 75.7% of total governmental fund expenditures and 5.6x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 13.5% of expenditures and net direct debt that is 68.4% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 74.1% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

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

Our rating incorporates our view regarding the indirect risks posed by the COVID-19 pandemic. Absent the implications of the pandemic, we consider the county's environmental risks in line with those of the sector. We believe Spotsylvania County's governance risks are below average given the county's numerous formalized policies and long-term planning initiatives that management undertakes to mitigate risk to its financial operations and

infrastructure. In addition, in our view, social risks are below those of the sector given the county's strong demographic trends, consisting of good long-term population growth, as well as housing affordability compared to neighboring Northern Virginia jurisdictions that we believe support the county's economic development efforts and tax base expansion.

The county's strong and growing local economy with access to the greater Washington, DC, MSA, combined with a history of strong financial operations and very strong reserve levels, provides significant rating stability. Spotsylvania County maintains these very strong reserves despite cash-funding a substantial portion of capital needs, which has helped it keep debt levels low. Given the county's conservative budgeting and numerous formalized financial policies and practices, we expect Spotsylvania County will maintain its strong financial operations despite the current economic recession and pandemic.

## **Stable Outlook**

### **Downside scenario**

Although not expected, if the county's budgetary performance materially deteriorates due to the effects of the pandemic or some other unforeseen reason, thereby leading to a significant reduction in general fund reserves, we could lower the rating.

## **Credit Opinion**

### **Strong economy**

We consider the county's economy strong. Spotsylvania County, with an estimated population of 137,200, is located in the Washington-Arlington-Alexandria, MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 109.4% of the national level and per capita market value of \$141,287. Overall, the county's market value grew by 8.1% in 2019 to \$19.4 billion in 2020. The county unemployment rate was 3.0% in 2019, although we note it has increased significantly in recent months due to the national recession and pandemic.

Spotsylvania County is located about halfway between Washington, DC, and Richmond, Va., and residents benefit from access to a strong regional economy with many job opportunities. While nearly three-fourths of the labor force commutes outside the county for employment, Spotsylvania County continues to expand and diversify its employment base, targeting growth in health care, manufacturing, defense/IT/cyber, and tourism.

Leading local employers include:

- Spotsylvania County Schools (education);
- Spotsylvania County government (local government);
- HCA Virginia Health System (hospital);
- Walmart (retail); and
- CVS Health Corp., (a distribution warehouse).

The county's population has increased by 9.8% within the past 10 years, with steadily increasing assessed value (AV) in the same period. Spotsylvania County reassesses every other year, with the most recent completed in 2018, resulting in an 8.2% increase to residential values and a 5.7% increase to commercial values. We note values are expected to increase by 8.9% because of the 2020 reassessment. Officials note the county continues to see a strong housing market with median home price increases of 28% over the past five years to \$314,400 as of April 2020. We anticipate the county's already very diverse economy will continue to expand slowly and steadily in the near term. The top 10 taxpayers account for just 4.3% of AV.

Although we note the aforementioned strengths, local economic activity has suffered as national and global economies have experienced a recession, driven by the COVID-19 pandemic and the social distancing measures intended to stem the spread of the coronavirus. County-level unemployment spiked to 11.0% in April 2020 and stands at 8.3% as of June 2020. Though elevated, the county-level rate remains level with the state rate (8.4% for June 2020), and well below the U.S. rate (11.1% for June 2020). County-level unemployment has consistently trended below the U.S. rate. In our view, this trend, and the fact that it has carried through to the current recession, suggests a relatively high degree of resiliency for the local economy.

### **Very strong management**

We view the county's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights of the assessment include the following:

- Conservative revenue and expenditure assumptions that incorporate historical as well as long-range financial forecasting.
- Budget performance reports are presented quarterly and include budget-to-actual and year-to-date benchmarks; the budget may be amended throughout the year.
- Spotsylvania County maintains annually updated five-year financial forecasts for all of its major funds with varying assumptions and identifiable risks in the out years.
- The county maintains a five-year rolling capital improvement plan (CIP) of identified projects, costs, and funding sources.
- A formally adopted investment policy with earnings and holdings that it reviews at least quarterly.
- A formal debt management policy targets net debt at no more than 3% of estimated market value, and the ratio of debt service expenditures as a percentage of governmental fund expenditures should not exceed 12%, with a goal of lowering this to 10% by the end of 2025.
- A comprehensive reserve policy tied to liquidity and contingency planning needs, including a general fund reserve equal to at least 11% of general fund and school operating fund revenues; a budget stabilization reserve equal to \$5.0 million; and an economic opportunities reserve for the purpose of funding matches to state grants, funded at \$2.0 million.

### **Adequate budgetary performance**

Spotsylvania County's budgetary performance is adequate in our opinion. The county had surplus operating results in the general fund of 3.1% of expenditures, and slight surplus results across all governmental funds of 1.1% in fiscal

2019. Our assessment accounts for our expectation that fiscal years 2020 or 2021 could experience some budgetary challenges and some deterioration relative to fiscal 2019 audited results, primarily because of risks associated with the pandemic and the national recession. General fund operating results of the county have been stable over the past three years, with a result of 3.9% in 2018 and a result of 1.4% in 2017.

For analytic consistency, we have adjusted data to include recurring transfers, in and out, as revenues and expenditures, as well as for one-time revenues and expenditures, particularly bond-funded capital needs.

In fiscal 2019, audited results indicate revenues increased by 4.5% for the year, while expenses rose by 3.9%. Overall, the county increased general fund reserves by \$8.4 million for the year. Management attributes fiscal 2019 results to revenues exceeding expectations (largely from real estate and personal property) and expenditures coming in less than projected, primarily due to conservative budgeting and unexpended budgeted expenditures.

The fiscal 2020 budget totaled \$291 million in general fund revenues and included the appropriation of \$5.2 million in reserves, consisting mostly of a \$4.2 million transfer to the capital projects fund in excess of the county's fiscal policy level. Management indicates that projected results for the year show general fund revenues are estimated to total \$293 million, or 0.6% better than budget due primarily to sales taxes, interest earnings, and intergovernmental revenues more than offsetting real and personal property taxes coming in slightly below budget. In addition, the county received \$11.9 million in CARES Act funding, \$8.0 million of which was used in fiscal 2020, which helped offset pandemic-related expenses that the county incurred within the last three months of the fiscal year. General fund expenses are projected to be 2.8% below budget due primarily to conservative budgeting. As a result, we understand the county expects to end the year with potentially the use of about \$1.0 million in reserves, leaving its reserve position essentially unchanged.

The fiscal 2021 adopted general fund budget included a number of adjustments to the recommended budget following the onset of the pandemic. The county set its tax rate at 80.944 cents, or nearly 4 cents below the prior-year rate of 84.74 cents, and slightly below the equalized rate of 81 cents, with the board adopting a significantly reduced budget in light of the pandemic. In order to balance the budget given the reduced tax rate and the anticipated reduction in economically sensitive revenues, management enacted the following measures:

- Eliminated cost of living and merit salary increases;
- Eliminated increased contribution to other postemployment benefits (OPEB);
- Eliminated tuition reimbursement and training other than that mandated or required;
- Reduced pay-as-you-go funded capital to the policy minimum level;
- Eliminated transfer of cash to the transportation fund; and
- Reduced support to regional service providers such as the jail.

Through first-quarter fiscal 2021, management indicates it anticipates a \$3.9 million loss from sales, meals, hotel, and business license taxes. As a result, the county is currently budgeting for the use of \$3.9 million of its \$5.0 million stabilization reserve; however, management indicates it is being very conservative in its assumptions and that there's a very good chance it will not need to draw down its stabilization reserves. Furthermore, on top of the \$11.9 million in

CARES Act funding received a few months ago, \$8.0 million of which was spent in fiscal 2020, Spotsylvania County expects to receive an additional \$11.9 million for fiscal 2021. Although the county could draw down reserves by a few million dollars in fiscal 2021, we do not anticipate the overall reserve position materially changing. In addition, given the county's history of strong performance stemming from conservative budgeting, we expect performance will likely exceed current estimates.

Property taxes are the county's primary source of general fund revenue, accounting for about two-thirds of revenue. Other taxes, including local sales and meals taxes and fuel taxes account for about 16% of revenues. We note the county's real property tax rate of 80.94 cents for fiscal 2021 is one of the lowest compared to that of other counties in the Commonwealth, providing ample financial flexibility.

### **Very strong budgetary flexibility**

Spotsylvania County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 47% of operating expenditures, or \$129.0 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. The available fund balance includes \$94.2 million (34.6% of expenditures) in the general fund and \$34.8 million (12.8% of expenditures) that is outside the general fund but legally available for operations.

Specifically, the county maintains \$32.2 million in its capital projects fund and \$2.6 million in its transportation fund that we understand is completely unrestricted and has been accumulated through general fund transfers. Management indicates these reserves could be reclassified if necessary with board approval.

As part of the annual budget process, the county appropriates a contingency equal to 0.25% of general fund expenses. This contingency is meant to cover unforeseen expenditures of a nonrecurring nature that arise during the course of the fiscal year, or to meet relatively minor increases in service-delivery costs. Spotsylvania County maintains comprehensive policies governing its reserves.

Highlights of these policies include:

- Designating the fiscal stability reserve as a committed reserve and increasing the required reserve level to 11% of general fund and school operating fund revenues projected for the subsequent fiscal year. We include these reserves in our analysis of available reserves as officials confirm they can be made available by the board;
- A budget stabilization reserve to address potential revenue declines or other economic stress placed on the budget, which the county funded with a balance of \$1 million in fiscal 2016, with 0.25% of general fund and school operating fund revenues projected for the subsequent fiscal year budget to be added until the fund reaches \$5 million. At the end of fiscal 2019, it stood at \$5.0 million;
- Formalizing the health insurance reserve to equal incurred, but not reported, claims plus three months of average claims, with a balance totaling \$4.7 million; and
- A \$2 million economic opportunities reserve, fully funded, for the purpose of funding matches to state grants and to provide incentives as necessary.

Spotsylvania County has a history of adding to available reserves (assigned and unassigned) annually. Although we understand reserves could be reduced slightly in fiscal years 2020 and 2021, we do not expect the county's overall

flexibility to materially change and we expect flexibility will remain very strong.

### **Very strong liquidity**

In our opinion, Spotsylvania County's liquidity is very strong, with total government available cash at 75.7% of total governmental fund expenditures and 5.6x governmental debt service in 2019. In our view, the county has strong access to external liquidity if necessary.

We believe the county's strong access to external liquidity is supported by frequent debt issuances, including GO bonds. Although the state allows for investments that we view as permissive, the majority of Spotsylvania County's investments are in highly rated and liquid mutual funds and fixed income securities, which we do not view as aggressive. The county has consistently had very strong liquidity and we do not anticipate this will diminish.

Spotsylvania County has issued privately placed fixed rate GO debt and economic development authority lease revenue debt. We have reviewed the terms and conditions and do not believe they pose a risk to liquidity.

### **Strong debt and contingent liability profile**

In our view, Spotsylvania County's debt and contingent liability profile is strong. Total governmental fund debt service is 13.5% of total governmental fund expenditures, and net direct debt is 68.4% of total governmental fund revenue. Overall net debt is low at 1.2% of market value, and approximately 74.1% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

Each year the county adopts a five-year CIP with funding sources identified. However, following the onset of the pandemic, management determined there would be a need to adjust the amount of pay-as-you-go funding and therefore the CIP as a whole. We understand the county will adopt a revised CIP for fiscal years 2022-2026 this fall.

We understand the CIP for fiscal 2021 totals \$81.6 million, consisting of \$13.4 million for general government, \$1.9 million for transportation projects, \$13.5 million for school projects, and \$52.8 million for utilities. Ultimately, we believe the county will be prudent and conservative in how much additional debt it issues in light of its strong debt management policies. As a result, we do not expect to see any material changes to its debt profile.

### **Pension and other postemployment benefits**

- We do not view pension and OPEB liabilities as an immediate credit pressure because required contributions currently make up a relatively small portion of total governmental expenditures. If required contributions were to materially increase in the next few fiscal years, we believe Spotsylvania County's fiscal stability would not be greatly affected because of the county's sizable reserves.
- Contributions slightly exceeded our static funding metrics, which over time could improve funding levels.

As of June 30, 2019, the latest measurement, county employees participated in:

- The Virginia Retirement System: 92.5% funded, with a proportionate net pension liability of \$13.8 million for county employees, with a current discount rate of 7.0%.
- A length-of-service award program for volunteer firefighters: 61.3% funded, with a net pension liability of \$3.5 million. The funded ratio decreased as a result of a change in the discount rate to 3% from 6%, which we view as prudent.

- A single-employer, defined-benefit OPEB plan that provides health and dental insurance during retirement for eligible retirees and their dependents. The OPEB unfunded actuarial accrued liability totals \$90.2 million as of June 30, 2019; and
- A Line of Duty Act plan for employees and volunteers in hazardous duty positions with an OPEB liability of \$9.2 million.

We note contributions exceeded our static funding metrics, indicating the county is making good progress meeting its current and future liabilities. As a result, we do not expect plan contributions to change materially over the next couple of years.

Spotsylvania County also participates in a cost-sharing plan for school board employees and an agent multiple-employer plan for school board political subdivision employees. The board pays all contributions as a discrete component unit of the county. Consistent with our analysis, which does not incorporate the school board's financial performance into the county's general financial performance, we elected not to consider the board's retirement liabilities or contributions as part of Spotsylvania County's liabilities. We note that the school board's two defined-benefit pension plans have a total net pension liability of \$114,428 and \$184.1 million, respectively. In addition, the board has a net OPEB liability of \$10.1 million associated with the group life insurance program, \$19.8 million relating to health insurance, and \$241.9 million relating to OPEB.

Spotsylvania County's combined required pension and actual OPEB contributions totaled 1.8% of total governmental fund expenditures in 2019. The county made its full annual required pension contribution in 2019.

### Very strong institutional framework

The institutional framework score for Virginia counties is very strong.

## Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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
- 2019 Update Of Institutional Framework For U.S. Local Governments

### Ratings Detail (As Of August 25, 2020)

Spotsylvania Cnty GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
<b>Spotsylvania Cnty Econ Dev Auth, Virginia</b>		
Spotsylvania Cnty, Virginia		
Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) APPROP		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) APPROP		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

**Ratings Detail (As Of August 25, 2020) (cont.)**

Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) APPROP		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) APPROP		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<b>Spotsylvania Cnty Indl Dev Auth, Virginia</b>		
Spotsylvania Cnty, Virginia		
Spotsylvania Cnty Indl Dev Auth (Spotsylvania Cnty) APPROP (AMBAC)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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