

# Lycoming College, Pennsylvania; Private Coll/Univ - General Obligation

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## Credit Profile

US\$5.96 mil tax exempt rev bnds (Lycoming Coll) ser 2019RR1 due 11/01/2033

*Long Term Rating*

A-/Stable

New

### **Lycoming Cnty Auth, Pennsylvania**

Lycoming Coll, Pennsylvania

### **Lycoming Cnty Auth (Lycoming Coll)**

*Long Term Rating*

A-/Stable

Downgraded

### **Pennsylvania Hgr Educl Facs Auth, Pennsylvania**

Lycoming Coll, Pennsylvania

### **Pennsylvania Hgr Ed Fac Auth (Lycoming College) ser 2003 AA2, ser 2004 CC**

*Unenhanced Rating*

A-(SPUR)/Stable

Downgraded

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings lowered its rating to 'A-' from 'A' on Lycoming County Authority, Pa.'s and the Pennsylvania Higher Educational Facilities Authority's existing revenue bonds, issued for Lycoming College. In addition, S&P Global Ratings assigned its 'A-' rating to the Lycoming County Authority's series 2019 RR1 refunding bonds, issued on behalf of the Association of Independent Colleges and Universities of Pennsylvania Financing Program for Lycoming College. The outlook is stable.

The lower rating reflects our opinion of the college's weakened demand profile with continued enrollment pressure in fall 2018 on an already small enrollment base (1,137 full-time equivalent students) and very high tuition discounting, which has led to deficit operating performance. At this time, a lower rating is precluded by the college's solid available resource ratios.

We assessed Lycoming's enterprise profile as adequate, characterized by a small and declining enrollment base that has seen significant pressure in recent years, a very high and growing tuition discount rate, and moderate student demand metrics for the rating. We assessed the financial profile as strong, with solid financial resources, but offset by deficit operations, high tuition dependence, and significant declines in net tuition revenue the past several years. Combined, we believe these credit factors lead to an indicative stand-alone credit profile of 'bbb+'. As our criteria indicate, the final rating can be within one notch of the indicative credit level. In our opinion, the 'A-' long-term rating on the bonds better reflects Lycoming's significant cash and investments compared with outstanding debt.

The rating further reflects our view of Lycoming's:

- Solid financial resources for the rating, with expendable resources of \$172.8 million as of June 30, 2018, or 231% of

operating expenses and 419% of pro forma debt;

- Detailed initiatives to address enrollment and demand pressures, as well as identified resources to fund these plans--though enrollment has not yet stabilized; and
- Manageable debt and moderate pro forma maximum annual debt service (MADS) burden of 4% of fiscal 2018 expenses.

In our view, offsetting factors include:

- Very small enrollment base with limited demand and modest student profile and enrollment declines of nearly 15% since fiscal 2015;
- Very high tuition discount rate that has grown from 53% in fiscal 2013 to 70% in fiscal 2018, which we believe is not sustainable;
- Continued operating pressure; and
- Significant annual net tuition revenue decreases that, due to the college's high dependence on tuition and student-generated fees (79%), stresses operations.

The approximately \$5.69 million of the series 2019 RR1 bonds will be used to current refund the college's series 1998 and series 2004 for bonds for interest rate savings. The RR1 bonds will be fixed rate.

We also anticipate that the college will be dividing its series 2013 S1 bonds into two subseries, consisting of the 2013 S1 bonds (which will remain in weekly variable rate, supported by a letter of credit, for approximately \$5.565 million) and the 2013 S1A bonds (which are expected to be converted to a five-year mode, ending in 2024). Our review of Lycoming incorporates their plans to convert a portion of the 2013 S1 bonds to term mode. We believe that Lycoming has sufficient liquidity and market access to support the term mode bonds. A supplemental indenture provides for the splitting of the series into two subseries and anticipate this will occur June 1, 2019. At the time of conversion of the series 2013 S1 bonds to term mode, the rating will be 'A-/Stable'.

As of fiscal 2018, the college had \$44.3 million of debt outstanding, including \$690,000 in notes payable. Pro forma with this transaction, the college will have \$41.853 million in debt outstanding. Also on a pro-forma basis, management anticipates its variable rate debt will be approximately 25% of its overall debt portfolio, multi-mode debt will be approximately 7%, and fixed rate debt will be approximately 58%. All bonds are a general obligation (GO) of the college, secured by a security interest in its pledged revenue. In our view, pro forma maximum annual debt service (MADS) of \$3.03 million in 2032 results in a moderate debt burden at 4.0% of fiscal 2018 operating expenses. According to management, the college does not expect to issue additional debt during the next two years.

Founded in 1812, Lycoming College is a private, coeducational, four-year college in Williamsport, Penn., in the north central part of the state. Lycoming College focuses exclusively on undergraduate education with a liberal arts and sciences curriculum. The student base remains very regional, with about 56% of students originating from Pennsylvania and the rest from neighboring states.

## Outlook

The stable outlook reflects S&P Global Ratings' opinion that over the next two years the college will work to improve its enrollment, stabilize tuition discounting, and improve operating performance. We also expect available resources to remain solid and do not anticipate the college issuing additional debt during the two-year outlook period.

### Downside scenario

We could consider lowering the rating during our two-year outlook period if the college experiences sustained negative operating performance, a marked decline in financial resources, or continued weakening in enrollment and demand despite the college's strategic efforts in that area. A negative rating action could also result if the college were to issue a significant amount of new debt, though this is not currently expected.

### Upside scenario

Though not expected for the two year outlook, a higher rating could be considered if Lycoming stabilizes or increases its enrollment, improves its demand metrics, and if operations were to improve. We also would expect financial resources to remain consistent with current levels.

## Enterprise Profile

### Industry risk

Industry risk addresses the higher education sector's overall cyclicity and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk when compared with other industries and sectors.

### Economic fundamentals

The student base remains very regional, with about 56% of students originating from Pennsylvania and the rest from neighboring states, which we view as a limiting factor for enrollment growth. However, we do note that the percentage of new freshman in-state students has declined to 50% in fall 2018 from 64% in fall 2012. As such, our assessment of Lycoming's economic fundamentals is anchored by the Pennsylvania GDP per capita.

### Market position and demand

Enrollment at Lycoming College continues to be pressured due to a decreasing demographic and a highly competitive market, with full-time equivalents (FTEs) further falling 5.7% in fall 2018 to 1,137 from 1,206 in fall 2017. This is in addition to FTE declines of 3.6% in fall 2017, 2.0% in fall 2016 and 4.7% in fall 2015. We view Lycoming's overall enrollment base as small and somewhat limited, serving only undergraduate students. We believe the rating could be further pressured if management is not able to stabilize the declines. We recognize the management team has been making investments in programs, facilities, and academic initiatives to stem the declines. In addition, the college is working with a consultant to manage enrollment and financial aid. The college expects to improve enrollment by increasing international recruitment, reduce its reliance on in-state students by recruiting in areas with population growth including Texas and California, focusing on opportunities in secondary and tertiary markets, improving its

digital marketing, and collaborating with charter schools.

Consistent with a consultant's suggestion to the college to increase its applicant base, freshman applications increased a significant 26.5% in fall 2018, after an increase of 2.6% in fall 2017. Applications for fall 2019 have already surpassed fall 2018 levels and admits and deposits are trending up as well. Management is projecting overall enrollment to remain flat in fall 2019 and is projecting a freshman class of between 350 and 362 (compared to a freshman class of 323 in fall 2018 and 282 in fall 2017). Matriculation has historically been around 26%, but weakened to 23% in fall 2017 and 20.2% in fall 2018 with the larger application base, and we expect weakening will continue in fall 2019. Freshman selectivity has improved to 65.6% in fall 2018 compared to 73.6% in fall 2014. Student quality, measured by the average SAT score of 1,107 in fall 2018, remains slightly above the national average. The freshman-to-sophomore retention rate weakened to 75% in fall 2018, which is weaker than historical levels around 80%. Management believes its retention rate will improve in fall 2019 as its current freshman class was of stronger academic quality than the previous year. The six-year graduation was 67% in fall 2018.

Lycoming College is very regional with just 44% of students coming from outside Pennsylvania. We expect that this percentage will continue to increase, as each incoming class since fall 2012 has shifted to a smaller percentage of in-state students. According to management, Lycoming competes with other small private colleges in central Pennsylvania such as Susquehanna College, Elizabethtown College, Albright College, and Juniata College. In addition, Lycoming also competes with Pennsylvania State University, a public university approximately 75 miles to the southwest.

Lycoming College is currently raising funds toward a \$65 million campaign whose goals include raising funds for capital projects and scholarships. To date, the college has surpassed its goal with \$71 million raised. While the campaign is expected to end in June 2019, we anticipate that fundraising efforts will continue. In fiscals 2017 and 2018, the college raised approximately \$1.5 million each year toward its annual fund, which has improved from around \$1 million about five years ago. The alumni participation rate was 21% in 2018, which we view as comparable relative to peer institutions' rates.

### **Management and governance**

Lycoming College's president, Dr. Kent Trachte, began his tenure on July 1, 2013. The vice president for finance and administration has been at the college since 2012 and in the role since 2013. We consider the college's management team experienced and stable, with no major changes at the school or board level outside of the normal rotation cycle. We also view management's budgeting practices as conservative and practical, though pressured enrollment has recently affected operations. We believe management has made a number of investments in its programming and facilities to attract students, but also recognize that the college operates in a very competitive market with demographic pressures that will make it increasingly more difficult to attract students.

Lycoming operates under the guidance of a strategic plan, whose goals include enhancing academic excellence, creating a distinctive residential environment, and student success, among others. We view the college's strategic planning favorably and believe the college is achieving many of its goals as it has established many new academic programs, worked to updates its facilities, and success with fundraising.

While management does not budget for depreciation, it budgets for debt service. In addition, the college has a

\$500,000 contingency built into the budget. We consider Lycoming's endowment adequate compared with peer institutions, and we note that the college has some operating flexibility, since its effective endowment spending rate is below average at 3.9% compared to a policy of 5%. Furthermore, approximately 80% of the college's endowment is unrestricted, which we view favorably and gives the college some flexibility as it manages through its enrollment challenges.

## Financial Profile

### Financial management policies

The college has formal policies for investment management. It operates according to a five-year strategic plan and meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to weaken its future ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure and a comparison of these policies to comparable providers.

### Financial performance

Prior to fiscal 2014, Lycoming College has a history of surplus operating performance, which contributed to the college building its unrestricted funds. Since then, the college has been making intentional investments in its programs, facilities and academic initiatives, which led to some pressure in fiscals 2015 and 2016 (with operating deficits of negative 1.4% and negative 0.6%) as the college began to make strategic investments into its enterprise profile. Operations were significantly weaker in fiscals 2017 and 2018, as these strategic investments continued, coupled with declines in net tuition revenue as enrollment projections did not meet expectations and discounting escalated. The college generated a full-accrual deficit in fiscal 2018 of \$1.9 million (negative 2.5% margin) and a deficit in fiscal 2017 of \$3.24 million (negative 4.3% margin). Though management has worked to lower its operating expenses, net tuition revenue has decreased for six years in a row, including an 8.1% decline in fiscal 2018, which further pressures operations.

Given the enrollment decline in fall 2018 and expectation that discounting will remain very high (with an overall tuition discount rate around 72%-73%), we anticipate operating performance will remain pressured over the outlook period.

Although Lycoming does not budget for depreciation, management indicates it has historically used 50% of surpluses to fund capital projects that meet deferred maintenance needs. Despite this practice, the average age of plant remained what we consider high at 18.4 years at fiscal year-end 2018, compared with the category median of 13.6 years. We do note that the age of plant has been gradually improving from 22.7 in fiscal 2013, but remains high. According to management, the college is in the process of completing a campus master plan to address plant renovations.

Like many private colleges of its size, Lycoming remains highly dependent on student-generated revenue; tuition and auxiliary revenue accounted for 79% of fiscal 2018 adjusted operating revenue, which is down from 82% in fiscal 2017 as the college's total endowment draw has increased (which includes its true endowment and plant funds). Net tuition revenue has tumbled significantly in recent years because of increases in tuition discounting and enrollment declines. Net tuition revenue was down 8.1% in fiscal 2018, 7.6% in fiscal 2017, 9.3% in fiscal 2016, and 7.6% in fiscal 2015.

Lycoming has steadily increased its tuition discounting to respond to the demographic pressures of the Pennsylvania market and in an attempt to maintain enrollment. In our view, overall tuition discounting is high and unsustainable at 70.1% in fiscal 2018. This is considerably higher than the college's discount rate in fiscal 2013 of 53.4%. This is also nearly double the discount rate for our 'A' rating category medians (36.0%). Management believes the discount rate should stabilize around 72% or 73% going forward, as it now has all four classes in under the higher discounting rate. In our view, net tuition revenue growth will continue to be pressured by a growing discount rate, and enrollment declines if entering classes remain below target. We view the high discount rate as a key factor pressuring the rating.

### **Available resources**

Lycoming's available resources remain solid for the rating and a key positive credit factor, in our opinion. As of June 30, 2018, available resources, (as measured by expendable resources), were \$172.7 million or 230.7% of fiscal 2018 operating expenses and 418.6% of pro forma debt compared to a category median of 91.5% for expendable resources to operations and 1571.8% for expendable resources to debt. Cash and investment ratios were even stronger with \$211.9 million equal to 2.83x operations and 513.30x pro forma debt. We expect that management could draw on its reserves over the near term as it continues to invest in its enterprise profile, but believe that available resources will remain consistent with the current rating.

The endowment, which had a market value of \$207.6 million as of June 30, 2018, is nearly 80% unrestricted. The endowment spending policy is 5% of a 12-quarter-moving average. The college withdrew a total of \$9.267 million from the endowment in fiscal 2018, of which \$6.747 million was used toward the annual operating budget. The difference includes additional draws for specific projects or purposes not used to support operations. These additional draws were from the "plant" fund, which is included in the endowment figure, but is not included in the formula for the annual operations draw. Historically, management has focused on growing the endowment and has not drawn on it for operational support. However, over the past few years the college has begun to take an annual draw being used to support its strategic initiatives. The draw of the total endowment related to the operating budget was 3.9% in fiscals 2018 and 2017, 3.8% in fiscal 2016, and 3.2% in fiscal 2015. We believe that a draw of 3.9%, lower than the 5% policy, does offer the college some flexibility as it navigates its enrollment declines.

We view the endowment asset allocation as moderately conservative with approximately 54% equities, 18% in diversifiers, 6% in real assets, 14% fixed income, 5% in cash, and 3% in legacy private investments, which we consider representative of portfolios of similar size and allocation. Management indicates about \$75 million of Lycoming's investments are very liquid with availability for daily redemption.

### **Debt and contingent liabilities**

As of fiscal 2018, the college had \$44.3 million of debt outstanding, including \$690,000 in notes payable. Pro forma with this transaction, the college will have \$41.853 million in debt outstanding. Also on a pro forma basis, management anticipates its variable rate debt will be approximately 25% of its overall debt portfolio, multi-mode debt will be approximately 7%, and fixed rate debt will be approximately 58%. All bonds are a general obligation (GO) of the college, secured by a security interest in its pledged revenue. In our view, pro forma maximum annual debt service (MADS) of \$3.03 million in 2032 results in a moderate debt burden at 4.0% of fiscal 2018 operating expenses. According to management, the college does not expect to issue additional debt during the next two years.

Existing debt of the college includes \$17.79 million of the fixed rate series 2013 MM1 bonds, \$4.70 million of the weekly variable rate 2001 I1 bonds, and \$4.00 million of the series 2013 S2 bonds, which are multi-modal with a rate reset in November 2019. On a pro forma basis, the approximately \$5.69 million of the series 2019 RR1 fixed rate bonds will be used to current refund the college's series 1998 and series 2004 bonds for interest rate savings. We also anticipate that the college will be dividing its series 2013 S1 bonds into two subseries, consisting of the 2013 S1 bonds (which will remain in weekly variable rate, supported by the existing letter of credit, for approximately \$5.565 million) and the 2013 S1A bonds (which are expected to be converted to a five-year mode, ending in 2024). A supplemental indenture provides for the splitting of the series into two subseries. The conversion of variable rate debt to multi-mode is being done to reduce the college's variable rate debt and reliance on a third party for liquidity support.

Lycoming College, Penn.: Enterprise And Financial Statistics						
Enrollment and demand	--Fiscal year ended June 30--					--Medians for 'A' rated Private Colleges & Universities--
	2019	2018	2017	2016	2015	2017
Headcount	1,142	1,223	1,272	1,289	1,357	MNR
Full-time equivalent	1,137	1,206	1,251	1,276	1,339	3,632
Freshman acceptance rate (%)	65.60	64.00	69.60	71.20	73.60	63.50
Freshman matriculation rate (%)	20.20	22.90	26.30	26.40	26.80	MNR
Undergraduates as a % of total enrollment (%)	100.00	100.00	100.00	100.00	100.00	78.00
Freshman retention (%)	75.00	80.00	79.00	79.00	79.00	85.50
Graduation rates (six years) (%)	67.00	67.00	72.00	64.00	64.00	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	73,037	72,146	71,461	66,738	MNR
Adjusted operating expense (\$000s)	N.A.	74,899	75,386	71,860	67,716	MNR
Net operating income (\$000s)	N.A.	(1,862)	(3,240)	(399)	(978)	MNR
Net operating margin (%)	N.A.	(2.49)	(4.30)	(0.56)	(1.44)	1.37
Change in unrestricted net assets (\$000s)	N.A.	3,502	12,680	(6,622)	(2,774)	MNR
Tuition discount (%)	N.A.	70.10	68.20	64.50	61.50	36.00
Tuition dependence (%)	N.A.	60.40	62.60	61.30	66.80	MNR
Student dependence (%)	N.A.	79.10	82.40	80.70	87.60	86.40
Health care operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Research dependence (%)	N.A.	1.00	1.00	1.10	1.00	MNR
Endowment and investment income dependence (%)	N.A.	12.70	13.00	13.50	6.90	MNR
Debt						
Outstanding debt (\$000s)	N.A.	43,315	44,040	43,855	44,190	102,893
Proposed debt (\$000s)	N.A.	8,540	N.A.	N.A.	N.A.	MNR
Total pro forma debt (\$000s)	N.A.	41,285	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	3,030	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.03	2.72	2.59	2.79	MNR
Current MADS burden (%)	N.A.	4.17	3.98	4.18	4.43	5.00



## Lycoming College, Penn.: Enterprise And Financial Statistics (cont.)

Enrollment and demand	--Fiscal year ended June 30--					--Medians for 'A' rated Private Colleges & Universities--
	2019	2018	2017	2016	2015	2017
Pro forma MADS burden (%)	N.A.	4.05	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	207,600	200,823	183,383	194,189	223,898
Cash and investments (\$000s)	N.A.	211,929	205,822	190,374	204,930	MNR
Unrestricted net assets (\$000s)	N.A.	175,662	172,160	159,480	166,102	MNR
Expendable resources (\$000s)	N.A.	172,827	170,520	155,994	173,463	MNR
Cash and investments to operations (%)	N.A.	283.00	273.00	264.90	302.60	146.10
Cash and investments to debt (%)	N.A.	489.30	467.40	434.10	463.70	253.50
Cash and investments to pro forma debt (%)	N.A.	513.30	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	230.70	226.20	217.10	256.20	91.50
Expendable resources to debt (%)	N.A.	399.00	387.20	355.70	392.50	171.80
Expendable resources to pro forma debt (%)	N.A.	418.60	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	18.40	17.20	18.80	19.80	13.60

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 =  $100 \times (\text{net adjusted operating income} / \text{adjusted operating expense})$ . Student dependence =  $100 \times (\text{gross tuition revenue} + \text{auxiliary revenue}) / \text{adjusted operating revenue}$ . Current debt service burden =  $100 \times (\text{current debt service expense} / \text{adjusted operating expenses})$ . Current MADS burden =  $100 \times (\text{maximum annual debt service expense} / \text{adjusted operating expenses})$ . 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.

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