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Report Card:
**The U.K. Social Housing Sector:
Managing The Effects Of The
Economic Downturn**

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Credit Trends

Given that housing associations in the United Kingdom operate in a counter-cyclical industry, one might expect they would be relatively safe from the effects of the global recession. While Standard & Poor's Ratings Services believes this is largely true, those associations that have expanded their remit and taken on more risky development and regeneration projects, along with several of those that have begun to use more sophisticated ways of managing interest rate risk, have left themselves more exposed to the ongoing volatility in economic and financial markets. Furthermore, in our opinion, the coming year will be a particular test for the U.K. social housing sector's new regulatory and investment regime, and will challenge the relevance and effectiveness of management and governance structures in these associations. Despite changes to the regulatory regime, however, we believe that government support for the sector remains strong and we expect this to continue.

Several factors have placed significant stress on housing associations in the past twelve months. Significantly, the sharp and unexpected movement in the yield curve in late 2008 forced some associations to post additional collateral under their swap agreements. Under some of these agreements, housing associations can post collateral that is either cash or property. However, because of an unexpected sharp movement in the yield curve, some housing associations did not have sufficient quantities of property charged to post as collateral, which meant cash was required at very short notice. Close monitoring of the situation by the regulator and negotiations between the banks and the relevant housing associations helped manage the situation and avoid any cash defaults. From a credit perspective, we believe it is important that housing associations are aware of the problems that can be caused by such volatility, and maintain adequate monitoring systems.

Sharp increases in spreads charged by banks also caught some housing associations unaware, especially those that had to refinance facilities. The sector continues to suffer from the effects of a shortage of private finance--a result of the liquidity squeeze affecting the main lending banks to this sector and a significant reduction in income from the sale of property that housing associations were expecting to make. As a direct result of the fall in the market value of property developed for sale or the value of land banks, some associations may also face the prospect of having to record impairments in asset values, which could lead to some loan covenant breaches. In the past, lending banks may have chosen not to enforce penalties, but we understand that they are now more reluctant and less able to do so. In extreme circumstances, some re-pricing of debt may take place, increasing short-term stress for housing associations.

Positively, we believe all housing associations have the flexibility to reduce costs when margins and cash generation are under pressure, including the ability to pull back on maintenance spending in the short term and reduce development spending where firm commitments have not been made. We understand that housing associations have made use of this flexibility, while at the same time showing greater caution about engaging in more market-oriented investments which carry higher risks in the current environment. Although reductions in maintenance spending does bring short-term reprieve, we consider that continued reductions would actually erode the underlying value of the

property portfolio and can be counter-productive.

We expect that housing association revenues will come under pressure from various sources. First, as Britain experiences deflation for the first time since the 1960s (which we expect to continue to the end of this year), rental income will be affected in financial year 2010 as rents are linked to the Retail Price Index. Rent increases are therefore likely to be considerably less than what many associations would previously have factored into their business plans. Further, the contraction of development programs--while releasing short-term pressure on cash demands--will also reduce income from rental flows and asset sales, thus constraining debt capacity and slowing down growth.

Depressed residential housing markets have led to an increase in unsold property stock (that is, property developed for outright sale and shared ownership), thereby increasing working capital needs, which in turn lead to increased carrying costs. Furthermore, we believe that projects that depended on asset sales in the short term to break even (which were often the norm before the credit crunch, given high house prices and low levels of regulated rent), may need to be managed very closely and possibly reappraised in light of the current adverse conditions. A related effect of the reduction of new building by developers in the housing market is the severely decreased number of "section 106" new building, and the reduction of related management contracts, which had previously helped support housing association revenues.

As we have said in the past, we believe that good governance and transparency are critical to help ensure that associations remain solvent while delivering on several government targets. So far, we have indeed seen evidence of associations taking tough decisions to safeguard their financial viability.

The U.K. housing association sector has also seen a newly introduced regulatory regime, which replaced the previous one under the Housing Corporation, an entity that served as both the regulator and the agency responsible for investment in the social housing sector. With the passing of the Housing and Regeneration Act 2008, the Tenant Services Authority (TSA) is now the regulator of affordable housing providers and is responsible for protecting both tenants and social housing assets, while the Homes and Communities Agency (HCA) is the national housing and regeneration agency for England. Both agencies are non-departmental public bodies and are sponsored by the department for Communities and Local Government (CLG). We believe these organizations have so far managed the risks associated with the transition from the previous regime, and we expect they will continue to do so. Furthermore, we expect that timely government support for the sector will continue.

Recent Rating Activity

In the past year, we have assigned an issuer credit rating to the London & Quadrant Housing Trust (A+/Stable/--), upgraded Sanctuary Housing Association by one notch to 'A+', and revised the outlook to negative for Home Group Ltd. In May 2008, at the issuer's request, we withdrew the rating on Affinity Sutton Group (see table 1 below for full ratings details).

The upgrade of Sanctuary Housing Association (SHA) reflects our opinion of SHA's strong operating and financial performance relative to the sector averages. Sanctuary also has limited exposure to property sales, which makes it less vulnerable than other associations in the current market. The outlook revision on Home Group reflected a weakening of the Group's fundamentals and uncertainties relating to changes in the management team of its care arm. Its coverage ratio excluding property sales has fallen below one, indicating that the Group is dependent on

property sales income to service its debt. While Places for People Group is in a similar position with regard to dependence on property sales, we anticipate that increased liquidity in the short term and senior management's prompt reaction to the adverse economic climate will prevent negative ratings pressure. Our assessment of social housing associations' business strategies and managements continue to be significant drivers of rating actions. Operating performance of the rated registered social landlords (RSLs) continues to be strong, with voids and arrears levels remaining below sector averages.

Table 1

| Issuer/Issuer credit rating*/Comments | Analyst |
|--|---|
| <p>Sanctuary Housing Assn. (A+/Stable/--) Sanctuary Housing Group (SHG) is a major player in the U.K. affordable housing sector. SHG, with Sanctuary Housing Association as the parent company, comprises 16 active subsidiaries providing social housing management, development, facilities management, and different kinds of care provision. Spiral Developments, a subsidiary, engages in development for outright sale. Sanctuary's social housing business continues to be its main revenue and surplus generation driver, with 84% of the number of units owned and managed designated social housing units. Our rating on SHG is based on the following strengths and weaknesses. Strengths: (i) Strong operating and financial performance trends relative to sector averages; (ii) Very well-managed organization, with a competent and experienced management; (iii) Good access to liquid funds and strong financial flexibility; (iv) Flexibilities with development program and our confidence in management's ability to re-phase as required; (v) Strong national presence in the social housing and care sectors, where demand continues to be strong. Weaknesses: (i) Some uncertainties in the macroeconomic environment, which could affect property sale income in the short to medium term; (ii) Rationalization across the group continues and could lead to some short-term upheaval in the organization. The stable outlook reflects our expectation that SHG will capitalize on its strengths and diversified business in these uncertain economic times. We believe management will be able to make difficult decisions and use the flexibilities available to maintain its strong business and financial profile. Continued strong financial performance, asset growth, and strengthening of the business risk profile could lead to a rise in the rating in the medium term. Conversely, cost pressures, expansion into lower margin businesses, and continued shortfall in property sales income against budget could put pressure on financial performance. Failure to maintain an appropriate level of financial cushion during a period of business growth and change could also put pressure on the rating.</p> | <p>Liesl Saldanha, Carl Nyrrerod</p> |
| <p>London & Quadrant Housing Trust (A+/Stable/--) London and Quadrant Housing Trust (L&Q) is the largest member and parent of L&Q Group. The Group has 57,000 homes spread across more than seventy local authorities in U.K. Apart from providing affordable housing, it also runs sheltered and supported housing, provides accommodation to key workers, and is engaged in shared ownership schemes. Our ratings on L&Q reflect the following strengths and weaknesses: Strengths: (i) High Demand for social and intermediate housing; (ii) Ready access to liquidity; (iii) High level of management expertise relative to the sector. Weaknesses include L&Q's exposure to falling prices and lack of liquidity in the U.K. housing market. The stable outlook on L&Q reflects our expectation that the Group will maintain strong operating margins, generating sufficient cash to pay debt-service costs despite a severe decline in revenue from property sales. We believe that L&Q's size, diversification, expertise, and access to long-term funding should provide adequate protection from the current recession. If L&Q can demonstrate its ability to adapt to this cycle, then in the medium term there may be some scope for an upgrade. Conversely, should the effects of the current recession, or an altered business strategy reduce the return on L&Q's assets or materially reduce its flexibility, then this could weaken the rating.</p> | <p>Hugo Foxwood, Liesl Saldanha</p> |
| <p>Places for People Group (PfP) (A/Stable/--) The Group owns and manages about 60,000 properties that are located across most parts of England, and--through Castle Rock Edinvar Housing Association (CREHA)--in Scotland. PfP provides a broad range of housing solutions, specialist care, support services, employment and training opportunities, and other related community facilities that are provided under the banner of social housing activities. In addition to its rented social housing activities, PfP builds properties for outright sale and market rent through its subsidiaries Emblem, Blueroom, and Lothian Homes (a subsidiary of CREHA). The Group also has in-house repair services and has a land-trading capacity through its Places for People Developments subsidiary. Our rating on the Group indicates the following strengths and weaknesses. Strengths: (i) Majority of operations benefit from regulation and government support; (ii) Strong management with demonstrated ability to take positive action in response to changes in market conditions; (iii) Good liquidity and financial flexibility; (iv) Significant asset base with a good geographic spread of properties. Weaknesses: (i) Downturn in U.K. housing market has constrained revenue from property and land sales to which PfP has significant exposure; (ii) Government support is not expected for commercial exposures; (iii) Absolute debt levels are high relative to similarly rated entities; (iv) Ongoing exposure to market risk via unregulated subsidiaries. The stable outlook reflects our opinion that, while the recent downturn in the U.K. property market has had negative implications on PfP's creditworthiness, PfP's orderly retrenchment of its previous development ambitions has reduced this negative impact in the medium term. PfP has sufficient liquidity for short- to medium-term needs and this provides comfort. The rating could be raised following a consistent improvement in operating revenues and debt-coverage ratios while maintaining current levels of flexibility. Conversely, the rating could be lowered if the low coverage ratios were to be maintained or decline further.</p> | <p>Richard Sugden, Liesl Saldanha</p> |

Home Group Ltd. (A/Negative/--)

Home Group Ltd. (HGL) provides general needs and supported housing, and develops low-cost homes. It manages more than 50,000 properties throughout England and Scotland, located mainly in north and southeast England. Although about 73% of the property portfolio is made up of general needs housing, this housing type provides just 52% of revenues. Care provision (supported housing and supporting people) generates about 40% of revenues and forms a major part of the group's turnover. Both businesses continue to return low margins. Although low margins are typical of care and support businesses, operating margins for HGL's social housing business also tend to be lower than for its peers. Our rating reflects the following strengths and weaknesses. Strengths: (i) A geographically diverse property portfolio, with strong demand for social housing in most areas of operation; (ii) Strong asset values and a significant unencumbered asset base; (iii) Good access to funds in the short term; (iv) Flexibilities exist within the development program; (v) Low debt per unit allows for higher net profit on sale. Weaknesses: (i) Several changes in management in the past year and some important management positions are yet to be filled; (ii) Increased dependence on property sales to service rising debt levels; (iii) Low (although increasing) debt burden that cannot be serviced from operational flows in the short term; (iv) Significant low-margin business, which affects the group's overall surplus levels and reduces coverage. The outlook is negative. This reflects our expectation that there may be continued weakening in both HGL's underlying fundamentals and reductions in property sale income. While re-structuring and re-organizing the business is part of HGL's strategy at this point, in time we believe that the flexibilities available may not be commensurate with the 'A' rating level in the short term. Continued weakening of the operational performance, cost over-runs, and the absence of a stable leadership team at the group and especially for the care business could lead to a lowering of the ratings. Conversely, the outlook could revert to stable if HGL strengthens cash generated from operations relative to development ambitions, delivers on a detailed program for drawing out efficiencies which we expect to be in operation, and manages to provide stability in the management team.

Liesl Saldanha,
Carl Nyrrerod

*Ratings as of May 8, 2009.

New Issue Ratings

In January 2009, we assigned a rating to Eden Funding No. 1 PLC's £2.4 billion secured debt issue, which was the first collateralized debt obligation (CDO) of U.K. social housing loans. On the closing date, both originators (The Royal Bank of Scotland PLC and National Westminster Bank PLC) identified a certain number of loans to constitute the portfolio. The assets forming the collateral pool in this transaction are exclusively secured loans to U.K. housing associations. On the closing date, each originator created a trust comprising, among other things, the loans as initial trust property, any further advances that the originators would make to the borrowers under existing facility arrangements, and the mortgaged properties securing the repayment of the loans. The issuer purchased a 99% beneficial interest in each originator trust, while each originator retained a 1% beneficial interest. The originators will manage the trust property for the benefit of the holders of the beneficial interests. The 'AAA' ratings assigned to the notes reflect the commensurate credit support in the form of subordination; the transaction's cash flow structure; and the transaction's legal structure, including the bankruptcy-remoteness of the issuer.

Also in January 2009, Places for People Homes Ltd. (PfPH) tapped their secured 2024 'AA-' rated bond for £180 million. The bonds are secured, full-recourse obligations of PfPH and are structured to withstand performance deficiency or insolvency of PfPH. The security includes mortgages and fixed-charges over approximately 4,065 identified properties, cash, and permitted investments. The bonds benefit from a number of structural supports, including a 12-month debt service reserve and the option to require a repair sinking fund if an independent surveyor believes it is required. The reserve helps to support full and timely payment of interest and principal over a range of Standard & Poor's stress scenarios. In addition, PfPH provides a general corporate guarantee and is obliged to provide additional properties and/or cash if the income from existing charged security does not meet minimum levels. This could be viewed as an additional source of liquidity support, as the corporate credit quality of the Places for People Group remains relatively strong at 'A/Stable/--'.

In March 2009, Sanctuary Capital PLC (SC), a vehicle set up to issue bond debt on behalf of Sanctuary Housing Assn. (SHA; A+/Stable/--) and other related subsidiaries, issued £200 million of bonds due in 2039. The rating is credit-linked to the corporate credit ratings on SHA. The bonds are expected to be secured by mortgages and

fixed-charges over approximately 6,780 identified properties, cash, and permitted investments. As SHA and future borrowing subsidiaries are ultimately responsible for the full and timely repayment of principal and interest on the bonds, the rating reflects the credit profiles of these ultimate borrowers and the credit enhancement provided by the security package and covenant structure. This level of credit enhancement, however, is insufficient to enable Standard & Poor's to notch the ratings on these bonds above the rating of the ultimate guarantor and borrower, the SHA. In line with our criteria, the rating on the bonds is not notched down from the rating of SHA, as we believe that at the 'A+' rating level, more than 30% of the principal outstanding will be recovered in the event of a default of the bonds and subsequent enforcement of security (see "Corporate Ratings Criteria 2008," published April 15, 2009, on RatingsDirect). The recovery value reflects our opinion of recovery of principal outstanding in a stressed scenario.

Issuance from the £3 billion Bank of Scotland social housing covered bond program continues with £1.4 billion issued in the last quarter of 2008. In all, £2.9 billion has been issued since 2004.

We continue to monitor all other structured bonds and covered bonds, and these have been performing as per expectations. As such, there have been no rating actions since closing. Most of these bonds provide long-term (25-40 years) funding for housing associations and in most cases tend to have a long "interest-only" period. In fact, principal amortization has begun for only three bonds listed in the transaction table below (the issues of Housing Association Funding, Places for People Homes, and Guinness Trust).

Table 2

| Primary participant/Ratings*/Comments | Initial issuance date | Analyst |
|---|-----------------------|--|
| <p>Bank of Scotland PLC Covered Bond Programme (social housing covered bond series 2004-1, 2005-1, 2006-1, 2008-1, and 2008-2) (AAA)</p> <p>The assets forming the collateral pool backing this covered notes program are secured loans to U.K. social housing associations. £2.9 billion has been issued under the £3.0 billion program. All quarterly performance tests have been met and there have been no rating actions since closing.</p> | Dec. 21, 2004 | Elton Eakins; Richard Sugden; Liesl Saldanha; |
| <p>Eden Funding No. 1 PLC (AAA)</p> <p>The assets are loans made to U.K. housing association by the originators of the transaction, National Westminster Bank PLC and The Royal Bank of Scotland PLC. £2.4 billion of 'AAA' rated notes were issued at financial close, together with an unrated subordinated tranche of £910 million. There have been no rating actions since closing.</p> | Jan. 29, 2009 | Vanessa Cecillon ; Hugo Foxwood |
| <p>Finance for Residential Social Housing PLC (AAA; AA; BBB)</p> <p>This transaction securitizes a portfolio of loans originated by The Housing Corp. and Tai Cymru (the Welsh housing corporation) to more than 1,000 providers of social housing, including housing associations and other registered landlords, to fund the provision and leasing to tenants of social housing. Initially a £969.2 million transaction that closed in April 1997, the current balance is £828.6 million as of the April 2008 reporting date. There has been a 15% paydown since closing. There were originally 38,206 loans, with 974 loans now remaining in the pool. The transaction is secured by variable-rate premium notes due to mature in December 2058. No loans are in arrears.</p> | April 4, 1997 | Mathias Herzog Liesl Saldanha |
| <p>The Guinness Trust (AA-)</p> <p>This £100 million transaction maturing in 2037 is backed predominantly by general-needs family units concentrated in high-demand areas in the south and east of England. Amortization began in November 2008. The transaction benefits from a debt service reserve equivalent of at least 12 months' debt service. Strong, stable rental flows have allowed the notes to perform as expected. At the last performance date in November 2008, net interest coverage stood at 1.40x, above the minimum level of 1.00x. There have been no rating actions since closing and we do not expect any security to be lost to the pool in the short term.</p> | Nov. 11, 1997 | Richard Sugden; Hugo Foxwood |
| <p>Harbour Funding PLC (AA-)</p> <p>This £276.3 million transaction maturing in 2044 was set up solely to issue notes and onlend the net proceeds to individual U.K. social housing associations under separate secured-loan agreements. The transaction benefits from a</p> | Oct. 10, 2003 | Richard Sugden; Hugo |

debt service reserve equivalent to 12 or 15 months' debt service depending on the assessed risk at the time of issue. A refinancing is expected in 2034. If this does not take place, the bond is expected to amortize by 2044 with a full cash sweep from 2034. Current cash flows are in line with our expectations and all associations drawing on the notes have met the minimum gross and net income levels. Net interest coverage at the most recent performance date of Sept. 30, 2008, ranges between 1.79x and 2.19x, comfortably above the minimum 1.42x required. Gross coverage performance has also been consistent, and there have been no rating actions since closing.

Foxwood

Haven Funding (32) PLC (AA-)

This £90 million transaction maturing in 2032 was set up solely to issue notes and onlend the net proceeds to nine registered U.K. social housing associations under separate secured-loan agreements. There has since been a prepayment by Westcountry Housing Association, reducing the number of borrowers to eight registered social landlords (RSLs). Amortization began in 2008, with a 35% bullet expected at maturity. Credit enhancements include a 12-month debt service reserve. Further protection is provided to bondholders to ensure sufficient cash is available for redemption through relevant tests, which could trigger payments to a sinking fund in 2024. Cash flows from the charged property portfolios are strong, with net income coverage performance ranging between 1.20x and 1.70x, comfortably above the minimum 1.07x at the last performance date on Nov. 30, 2008. All performance tests have been met and the transaction is performing in line with expectations. There have been no rating actions since closing.

Feb. 12, 1998

Richard Sugden; Hugo Foxwood

Haven Funding PLC (AA-)

This £273.3 million transaction maturing in 2037 was set up solely to issue notes and onlend the net proceeds to 12 registered U.K. social housing associations under separate secured loan agreements. This has since reduced to 10 participating RSLs. Amortization begins in 2017, with a 5% bullet payment due at maturity. Credit enhancements include a 12-month debt service reserve. Rental income is strong and coverage is above the minimum expected level. Net interest coverage ranges between 1.12x and 1.76x, comfortably above the minimum 1.12x at the last performance date Sept. 30, 2008. Performance remains in line with expectations. There have been no rating actions since closing.

March 11, 1997

Richard Sugden; Hugo Foxwood

Housing Association Funding PLC (AAA)

The assets forming the collateral of this transaction are secured loans to 11 U.K. registered social housing associations. Performance continues to improve and is stable overall. Rental coverage has increased year on year and was 1.35x at September 2008. This represents a substantial increase on the closing figure of 1.15x, reflecting a continuous steady increase in net rental income since closing. There have been three tap issues (1998, 2001, and 2005) since closing in 1997.

Feb. 19, 1997

Roneil Thadani
Richard Sugden;

Places for People Homes Ltd. (AA)

This is a £100 million senior secured debt transaction due in 2038 and backed by a geographically diverse portfolio of mostly general-needs properties. The notes are performing in line with expectations and amortization has begun. Rental flows remain strong and net interest coverage currently stood at 1.44x against the minimum required level of 1.1x at the last performance date on Sept. 30, 2008. There have been no rating actions since closing.

May 27, 1998

Richard Sugden; Liesl Saldanha

Places for People Homes Ltd. (AA-)

Since the tap in January 2009 for £180 million, the total amount outstanding is £380 million and due in 2043. The bond is secured by a geographically diverse portfolio of mostly general-needs properties and cash flows from these properties are expected to be sufficient to service and repay debt. Refinance of 100% of the principal is expected in 2024. Although failure to do so will not result in a bond default, it would allow bondholders to exercise their right over the security. The rental stream from the security, together with the early redemption sinking fund, is expected to allow for full amortization of the bond by the legal and final maturity date of 2043. The transaction also includes a 12-month debt service reserve. Performance to date remains stable and in line with expectations, with no breaches of covenants in the loan agreements and net interest coverage currently standing at 1.25x against a minimum of 1.19x at the most recent performance date on Jan. 31, 2009. There have been no rating changes since closing.

July 30, 2003

Richard Sugden; Liesl Saldanha

RSL Finance (No.1) PLC (AA-)

This £342.95 million transaction maturing in 2038 was set up solely to issue notes and onlend the net proceeds to five registered U.K. social housing associations under separate secured loan agreements. The transaction benefits from a 12-month debt service reserve. The performance of the notes has been in line with expectations to date and all covenants have been met. At the last performance date on Sept. 30, 2008, net interest coverage ranged between 1.28x and 2.04x, well above the minimum 1.18x. There have been no rating actions since closing.

Nov. 16, 1999

Richard Sugden; Hugo Foxwood

Sanctuary Housing Assn. (AA-)

This £110 million transaction maturing in 2031 involves the securitization of rental income received from properties owned by Sanctuary Social Housing Assn. Amortization begins in 2014 and a £42.2 million bullet repayment is due in September 2031. The transaction benefits from a 12-month debt service reserve. Rental income remains strong and

Dec. 6, 1996

Richard Sugden; Carl Nyrrerod

provides sufficient coverage for debt service payments. Net interest coverage of 1.29x was above the minimum level of 1.13x at the last performance date on Sept. 30, 2008. There have been no rating actions since closing.

Sunderland Housing Co. Ltd. (AA-)

This £239.5 million transaction maturing in 2042 involves the securitization of rental income received from a portfolio of 14,576 properties in northeast England owned by Sunderland Housing Co. Ltd. Amortization begins in 2022. The transaction benefits from a 15-month debt service reserve. Rental income is in line with expectations and income performance remains above minimum levels. At the last performance date on Sept. 30, 2008, net interest coverage was 1.92x against a minimum of 1.17x. There have been no rating actions since closing.

July 12, 2001

Richard
Sugden; Hugo
Foxwood

*Ratings are as of May 8, 2009. SPUR--Standard & Poor's underlying rating.

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