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Eiendoms kreditt AS

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Eiendomskreditt AS

| | | | | | | | | |
|-----------------------------|----------------------|-----------|---|--------------------------|----------|---|--|----------|
| SACP | bbb | | + | Support | 0 | + | Additional Factors | 0 |
| Anchor | a- | | | ALAC Support | 0 | | Issuer Credit Rating BBB/Negative/A-2 | |
| Business Position | Weak | -2 | | GRE Support | 0 | | | |
| Capital and Earnings | Very Strong | +2 | | Group Support | 0 | | | |
| Risk Position | Moderate | -1 | | Sovereign Support | 0 | | | |
| Funding | Below Average | -1 | | | | | | |
| Liquidity | Adequate | | | | | | | |

Major Rating Factors

| Strengths: | Weaknesses: |
|---|---|
| <ul style="list-style-type: none"> • Very high capital levels that are expected to remain very strong the next few years. • Conservative underwriting standards and strong risk management, resulting in traditionally good asset quality. • Established links with partner banks support new business generation. | <ul style="list-style-type: none"> • Reliance on the Norwegian covered bond market for funding and lacking direct access to the central bank. • Concentration of the business model on commercial real estate (CRE) in Norway. • Small size and very low market share. |

Outlook : Negative

S&P Global Ratings' negative outlook on Norway-based Eiendomskreditt AS (Eiendomskreditt) reflects our view that, despite economic risks in Norway having stabilized, we could lower the ratings within our two-year outlook horizon if Eiendomskreditt's growth strategy resulted in a material change in its risk appetite, a significant increase in loan concentrations, or increased operational risks, or if we saw early signs of asset quality deterioration.

We could revise the outlook to stable if we observed Eiendomskreditt successfully implementing its new growth strategy without compromising asset quality, while maintaining its elevated risk-adjusted capitalization and solid operational performance.

Rationale

Our 'BBB/A-2' ratings on Eiendomskreditt incorporate our view of the Norwegian banking industry as whole, the bank's very strong capitalization, balanced by a limited market share and concentrated business model, and in particular, exposure to concentrations in the Norwegian CRE market. In addition, the ratings are constrained by Eiendomskreditt's reliance on wholesale funding and the lack of direct access to central bank funding. We consider Eiendomskreditt to be of low systemic importance and consequently do not factor any extraordinary government support into the ratings.

Anchor: 'a-' for financial institutions operating only in Norway

Our bank criteria use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Norway is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

Our assessment of low economic risk in Norway reflects the country's wealthy government, which is supported by returns from its global investment fund and a predictable political environment. The contraction in oil prices over 2014-2015 has seen loose monetary policy prevail over the past several years. This, combined with a competitive mortgage market, has triggered an increase in property valuations and household debt, and contributed to material imbalances. At end-2017, debt-to-disposable income in Norway stood at 224%, which is high compared with other European countries.

However, because of stricter macroprudential regulations and increased housing supply, we have seen a reduction in house prices since the start of 2017. Nationally, this has meant annual nominal house price growth has slowed to about 1% over 2017, from 10% in 2016. The trend was even more marked in Oslo, where prices shrank by 3% in 2017 after growing by 22% in 2016. Many of the regulations introduced in 2017 are likely to be carried forward. Therefore, we anticipate that house prices will continue to contract over the next two years. In addition, bank losses related to oil and oil-related sector investment appear to have peaked in 2016 and we anticipate that, against the positive economic backdrop, asset quality will continue to improve.

Our view of industry risk is supported by Norway's banking regulator, which has been proactive in maintaining solid capital and liquidity requirements over the past several years. DNB Bank ASA remains the market leader, contributing about 30% of total lending. Most of the remaining market share goes to the larger domestic savings bank alliances (28%) and the other Nordic banks branches (24%). Lending margins have improved over the past year and now appear to be stabilizing at a slightly higher level; previously, they had been under pressure.

Restrictions on domestic investments by Norway's Government Pension Fund Global have resulted in a sizable outflow of capital, some of which is being repatriated through banks' use of international wholesale funding. However, Norway's expanding bond market, banks' receipt of funding from foreign parent companies, and likely liquidity support from the government help offset some of the risks from what we see as a structural lack of deposits.

Table 1

| Eiendomskreditt AS Key Figures | | | | | |
|--------------------------------|---------|---------|---------|---------|---------|
| --Year-ended Dec. 31-- | | | | | |
| (Mil. NOK) | 2017 | 2016 | 2015 | 2014 | 2013 |
| Adjusted assets | 5,081.3 | 4,605.8 | 4,682.2 | 4,870.1 | 4,877.7 |
| Customer loans (gross) | 4,302.3 | 3,599.1 | 3,794.2 | 4,019.0 | 4,125.5 |
| Adjusted common equity | 587.6 | 438.2 | 425.5 | 404.1 | 380.3 |
| Operating revenues | 69.7 | 58.2 | 47.1 | 61.2 | 62.5 |
| Noninterest expenses | 17.5 | 15.9 | 19.2 | 18.7 | 18.9 |
| Core earnings | 39.3 | 31.9 | 20.2 | 31.6 | 31.4 |

NOK--NOK-Norwegian krone. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Business position: Weak, due to very low market shares and a concentrated business model

Eiendomskreditt's small size--total assets stood at Norwegian krone (NOK) 5.1 billion (€517 million) at Dec. 31, 2017--weighs on its business position. The bank has a very low market share in Norway's residential and CRE markets, and high geographic and sector concentration. Eiendomskreditt is owned by two investment companies and 76 savings banks, for which Eiendomskreditt functions as a covered bond funding vehicle. As such, a high proportion of Eiendomskreditt's loans have traditionally been originated by the savings bank owners, supporting Eiendomskreditt's loan growth and income generation. However, in 2017, Eiendomskreditt significantly increased its in-house loan generation on the back of capital received from new shareholders. This decreased its dependence on loan generation by the partner banks. If Eiendomskreditt can maintain strong growth, generated in-house, it would strengthen its business profile, in our view.

Two investment companies, R Transit AS and Meteva AS, became new shareholders in Eiendomskreditt in 2017. They owned 24.99% of its capital each, as of December 2017. In addition to these, Eiendomskreditt's other major shareholders are Sparebanken Sogn og Fjordane (8.14%), Voss Sparebank (3.64%), and Luster Sparebank (2.31%). Other shareholders owned less than 2.2% each.

We consider the new investors supportive of Eiendomskreditt's growth strategy, which is focused on well-managed growth of good-quality exposure in areas where Eiendomskreditt has traditionally had good expertise--essentially, focusing on the CRE segment. This strategy acknowledges the very high competition in the mortgage market in Norway, which prompted Eiendomskreditt to gradually downsize its retail portfolio and shift its focus to CRE instead.

In light of its gradual downsizing of the retail portfolio, in accordance with its growth strategy, Eiendomskreditt is going to mainly focus on CRE loans to customers in the five largest counties of southern and western Norway. These are relatively wealthy areas, although the western regions are reliant on the oil sector, which could be vulnerable to oil price volatility. Over the past few years, due to low oil prices, this has led to falling house prices locally and increased unemployment. Nevertheless, so far, Eiendomskreditt's asset quality has been relatively strong. The recent increase in oil prices should further support strong asset quality in Eiendomskreditt' portfolio because it should have a positive impact on employment and income in the oil-dependent regions. At the same time, we continue to view the concentrations in the CRE segment as a vulnerability that may result in fluctuations in Eiendomskreditt's revenue generation.

We consider that the management team of Eiendomskreditt is stable and very experienced in the business the company focuses on. We also note that, since Eiendomskreditt is a relatively small company, it is subject to key-man risk with regards to its management team. The company addresses this risk by promoting a multi-functional focus among the management team members.

Table 2

| Eiendomskreditt AS Business Position | | | | | |
|---|-------------------------------|-------------|-------------|-------------|-------------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2017 | 2016 | 2015 | 2014 | 2013 |
| Total revenues from business line (currency in millions) | 69.7 | 58.2 | 47.1 | 61.2 | 62.5 |
| Commercial & retail banking/total revenues from business line | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Return on equity | 7.4 | 7.3 | 4.9 | 8.1 | 9.1 |

Capital and earnings: Very strong, due to very high and rising capital levels

We expect Eiendomskreditt's capital and earnings to remain very strong, based on a risk-adjusted capital (RAC) ratio of 23.3% at end-2017 and our projected RAC ratio in the 18%-20% range over the next 18-24 months. These metrics, together with Eiendomskreditt's very good cost efficiency over the past few years and stable earning profile, support our very strong capital assessment.

We anticipate that Eiendomskreditt will increase its loan book by up to 20% in 2018, while maintaining its focus on CRE, slowing down to about 15% annually in 2019-2020. The capital increase related to new shareholders in 2017 supported asset growth and helped Eiendomskreditt improve its RAC ratio to 23.3% as of end-2017, from 22.3% a year before. However, Eiendomskreditt will need significantly higher lending margins or new equity contributions to maintain the relatively aggressive loan growth beyond 2020. Although we expected some further improvement in net interest margins (NIM) in 2018-2019 and cost-efficient operations, we forecast a slight decrease in RAC over the next 18-24 months, assuming no new capital injections in 2019-2020 and a potential capital increase of up to NOK60 million in 2018.

We consider the quality of capital to be adequate. Core capital comprised 88% of total adjusted capital at end-2017 (85% at end-2016). Moreover, Eiendomskreditt's earnings capacity is reasonably strong, with an earnings buffer above 1% both historically and forecasted.

Table 3

| Eiendomskreditt AS Capital And Earnings | | | | | |
|---|-------------------------------|-------------|-------------|-------------|-------------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2017 | 2016 | 2015 | 2014 | 2013 |
| S&P Global Ratings RAC ratio before diversification | 23.3 | 22.3 | 20.2 | 18.3 | 16.2 |
| S&P Global Ratings RAC ratio after diversification | 11.8 | 11.9 | 11.4 | 10.3 | 9.6 |
| Adjusted common equity/total adjusted capital | 88.7 | 85.4 | 85.0 | 84.3 | 90.5 |
| Net interest income/operating revenues | 95.2 | 90.0 | 107.3 | 96.2 | 96.7 |
| Fee income/operating revenues | 2.7 | 1.0 | 0.7 | 0.5 | 0.5 |
| Market-sensitive income/operating revenues | 1.2 | 7.8 | (9.3) | 2.0 | 1.4 |
| Noninterest expenses/operating revenues | 25.1 | 27.4 | 40.7 | 30.5 | 30.2 |
| Preprovision operating income/average assets | 1.1 | 0.9 | 0.6 | 0.9 | 0.9 |

Table 3

| Eiendoms kreditt AS Capital And Earnings (cont.) | | | | | |
|--|------------------------|------|------|------|------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2017 | 2016 | 2015 | 2014 | 2013 |
| Core earnings/average managed assets | 0.8 | 0.7 | 0.4 | 0.6 | 0.7 |

Risk position: Moderate, reflecting concentrations in commercial real estate in Norway

We expect Eiendoms kreditt's risk position to remain moderate, reflecting its increasing concentration in the CRE sector, single-name concentrations, and exposure to the oil-reliant western regions of Norway. This is partly counterbalanced by Eiendoms kreditt's conservative underwriting standards and good asset quality track record.

The share of CRE lending within total customer loans has increased steadily to about 86% at end-2017, from about 40% in 2009, and we expect the share of CRE will continue increasing, given the bank's reduced focus on the direct residential mortgage lending and our expectations that the owner banks expect Eiendoms kreditt to focus on the CRE segment, where it has good expertise. In addition to concentration on CRE segment, Eiendoms kreditt's exposure to housing associations is growing, putting it at risk if this exposure is not managed cautiously.

About 70% of the lending is in the counties of Oslo, Akershus, Hordaland, and Rogaland. Although these are areas of high economic activity that have liquid real estate markets, the concentration carries some risks. In our view, the liquidity of the Norwegian CRE market and the value of the associated collateral could come under pressure during a period of stress. Nevertheless, we believe that this risk is stabilizing at the moment. Due to the stabilizing macroeconomic environment, housing prices started to ease at the beginning of 2017, after the Norwegian FSA introduced a number of macroprudential measures that seem to be successfully limiting household debt growth.

Moreover, the concentration risks are, to some extent, counterbalanced by Eiendoms kreditt's conservative underwriting process, underscored by loan-to-value (LTV) limits of 65% of collateral values for residential and 55% for commercial loans, as well as an average LTV ratio of 41% as of end-2017. After a period of practically no losses, in 2017, Eiendoms kreditt reported loan losses of NOK1.2 million. To a large extent, these losses related to an isolated case of fraud involving exposure to a housing association. In response to this case, the bank has amended its internal underwriting policies to tighten the conditions for lending to housing associations. Although we incorporate in our base-case scenario the expectation that in 2018-2019 the bank might incur loan-loss provisions at the level comparable to that of 2017, we think that tight underwriting criteria, including low LTV values and good risk management systems should support Eiendoms kreditt's solid asset quality going forward.

Table 4

| Eiendoms kreditt AS RACF [Risk-Adjusted Capital Framework] Data | | | | | |
|---|-----------|---------------|--------------------------|----------------|---------------------------|
| (NOK 000s) | Exposure* | Basel III RWA | Average Basel III RW (%) | S&P Global RWA | Average S&P Global RW (%) |
| Credit risk | | | | | |
| Government and central banks | 40,010 | 0 | 0 | 1,200 | 3 |
| Institutions and CCPs | 706,811 | 126,161 | 18 | 101,259 | 14 |
| Corporate | 3,086,075 | 3,088,224 | 100 | 2,238,874 | 73 |
| Retail | 1,242,334 | 677,512 | 55 | 288,097 | 23 |

Table 4

| Eiendomskreditt AS RACF [Risk-Adjusted Capital Framework] Data (cont.) | | | | | |
|--|-----------|-----------------------|-------------------------|-------------------------------|-------------------------------------|
| Of which mortgage | 1,242,334 | 677,512 | 55 | 288,097 | 23 |
| Securitization§ | 0 | 0 | 0 | 0 | 0 |
| Other assets† | 24,542 | 23,763 | 97 | 24,279 | 99 |
| Total credit risk | 5,099,772 | 3,915,660 | 77 | 2,653,709 | 52 |
| Credit valuation adjustment | | | | | |
| Total credit valuation adjustment | -- | 11,125 | -- | 0 | -- |
| Market risk | | | | | |
| Equity in the banking book | 5,617 | 5,613 | 100 | 55,608 | 990 |
| Trading book market risk | -- | 0 | -- | 0 | -- |
| Total market risk | -- | 5,613 | -- | 55,608 | -- |
| Operational risk | | | | | |
| Total operational risk | -- | 109,450 | -- | 130,749 | -- |
| (NOK 000s) | | Basel III RWA | | S&P Global RWA | % of S&P Global RWA |
| Diversification adjustments | | | | | |
| RWA before diversification | | 4,041,847 | | 2,840,066 | 100 |
| Total Diversification/Concentration Adjustments | | -- | | 2,783,060 | 98 |
| RWA after diversification | | 4,041,847 | | 5,623,127 | 198 |
| (NOK 000s) | | Tier 1 capital | Tier 1 ratio (%) | Total adjusted capital | S&P Global RAC ratio (%) |
| Capital ratio | | | | | |
| Capital ratio before adjustments | | 804,333 | 19.9 | 662,612 | 23.3 |
| Capital ratio after adjustments‡ | | 804,333 | 19.9 | 662,612 | 11.8 |

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. NOK--Norway Krone. Sources: Company data as of Dec. 31, 2017, S&P Global.

Table 5

| Eiendomskreditt AS Risk Position | | | | | |
|---|------------------------|-------|-------|-------|------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2017 | 2016 | 2015 | 2014 | 2013 |
| Growth in customer loans | 19.5 | (5.1) | (5.6) | (2.6) | 9.4 |
| Total diversification adjustment / S&P RWA before diversification | 98.0 | 87.2 | 76.6 | 77.9 | 69.3 |
| Total managed assets/adjusted common equity (x) | 8.6 | 10.5 | 11.0 | 12.1 | 12.8 |
| Gross nonperforming assets/customer loans + other real estate owned | 0.2 | 0.7 | 1.9 | 2.1 | 3.8 |
| Loan loss reserves/gross nonperforming assets | 18.0 | 4.6 | 1.6 | 1.4 | 0.8 |

Funding and liquidity: Concentrated funding base with a dependence on wholesale funding, in particular, Norwegian covered bonds

We consider Eiendomskreditt's funding to be below average over the next few years, underpinned by its predominantly wholesale funding profile. We also expect its liquidity position to remain adequate.

The below-average funding assessment reflects Eiendomskreditt's reliance on wholesale funding, particularly the rather fragmented domestic covered bond market. This makes it susceptible to the erosion of market confidence in turbulent economic conditions, in our view. Our assessment also considers the lack of direct access to the central bank. We do not consider potential support from the shareholders in our funding assessment. Eiendomskreditt's stable funding ratio, as measured by S&P Global Ratings, stood at 104.1% at end-2017. Its maturity profile has been gradually extending, partly because it has increased the share of commercial covered bonds in its funding.

We assess Eiendomskreditt's liquidity as adequate. As of end-2017, its ratio of broad liquid assets to short-term wholesale funding was 1.44x (0.99x as of end-2016). We expect that these ratios will remain volatile, yet comfortable, due to the impact of debt falling due within one year.

Table 6

| Eiendomskreditt AS Funding And Liquidity | | | | | |
|--|------------------------|------|------|-------|------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2017 | 2016 | 2015 | 2014 | 2013 |
| Core deposits/funding base | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Long term funding ratio | 90.6 | 79.5 | 83.2 | 96.6 | 87.4 |
| Stable funding ratio | 104.1 | 98.9 | 99.5 | 113.7 | 98.8 |
| Short-term wholesale funding/funding base | 10.9 | 23.2 | 18.8 | 3.8 | 13.8 |
| Broad liquid assets/short-term wholesale funding (x) | 1.4 | 1.0 | 1.0 | 4.6 | 1.0 |
| Short-term wholesale funding/total wholesale funding | 10.7 | 22.7 | 18.5 | 3.7 | 13.7 |
| Narrow liquid assets/3-month wholesale funding (x) | 3.7 | 44.2 | 57.3 | 52.4 | 6.9 |

Support: No notches of uplift to the SACP

We consider Eiendomskreditt to be of low systemic importance and consequently do not factor any extraordinary government support into the ratings. Equally, we do not include group support from any of the shareholders in the ratings.

We do not add any support uplift to Eiendomskreditt ratings under our "Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity," published April 27, 2015. We believe that it is generally unlikely that Eiendomskreditt would be subject to a well-defined bail-in resolution process, given its small size, limited complexity, and low systemic importance.

Additional rating factors:None

No additional factors affect this rating

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015

- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: Norway, May 11, 2018
- DNB Bank, Eiendomskreditt, Bank Norwegian Ratings Affirmed On Stabilizing Domestic Risks; DNB Bank Outlook Now Positive, March 26, 2018
- Nordic Banks' Capitalization Should Remain Stable Despite Revised Basel III Standards, Jan. 24, 2018

| Anchor Matrix | | | | | | | | | | |
|---------------|---------------|------|------|------|------|------|------|-----|-----|----|
| Industry Risk | Economic Risk | | | | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 1 | a | a | a- | bbb+ | bbb+ | bbb | - | - | - | - |
| 2 | a | a- | a- | bbb+ | bbb | bbb | bbb- | - | - | - |
| 3 | a- | a- | bbb+ | bbb+ | bbb | bbb- | bbb- | bb+ | - | - |
| 4 | bbb+ | bbb+ | bbb+ | bbb | bbb | bbb- | bb+ | bb | bb | - |
| 5 | bbb+ | bbb | bbb | bbb | bbb- | bbb- | bb+ | bb | bb- | b+ |
| 6 | bbb | bbb | bbb- | bbb- | bbb- | bb+ | bb | bb | bb- | b+ |
| 7 | - | bbb- | bbb- | bb+ | bb+ | bb | bb | bb- | b+ | b+ |
| 8 | - | - | bb+ | bb | bb | bb | bb- | bb- | b+ | b |
| 9 | - | - | - | bb | bb- | bb- | b+ | b+ | b+ | b |
| 10 | - | - | - | - | b+ | b+ | b+ | b | b | b- |

Ratings Detail (As Of May 31, 2018)

Eiendomskreditt AS

Issuer Credit Rating BBB/Negative/A-2
 Senior Secured AA+/Negative

Issuer Credit Ratings History

01-Jul-2014 BBB/Negative/A-2

Sovereign Rating

Norway AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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