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## Eiendoms kreditt AS

**Primary Credit Analyst:**

Sean Cotten, Stockholm (46) 8-440-5928; sean.cotten@spglobal.com

**Secondary Contact:**

Helena Cederloef, Stockholm (46) 8-440-5920; helena.cederloef@spglobal.com

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# Eiendomskreditt AS

<b>SACP</b>	<b>bbb</b>	+	<b>Support</b>	<b>0</b>	+	<b>Additional Factors</b>	<b>0</b>
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<b>Anchor</b>	<b>a-</b>	
<b>Business Position</b>	Weak	-2
<b>Capital and Earnings</b>	Very Strong	+2
<b>Risk Position</b>	Moderate	-1
<b>Funding</b>	Below Average	-1
<b>Liquidity</b>	Adequate	

  

<b>GRE Support</b>	0
<b>Group Support</b>	0
<b>Sovereign Support</b>	0

  

**Issuer Credit Rating**

BBB/Negative/A-2

## Major Rating Factors

<b>Strengths:</b>	<b>Weaknesses:</b>
<ul style="list-style-type: none"> <li>Very high capital levels.</li> <li>Conservative approach to risk underlined by high collateral values.</li> <li>No credit losses since establishment in 1998.</li> </ul>	<ul style="list-style-type: none"> <li>Uncertain business strategy due to the impact of proposed regulatory changes on the owners' capital consolidation of Eiendomskreditt's exposures.</li> <li>Concentration of the business model on commercial real estate in southern and western Norway.</li> <li>Small size and very low market shares.</li> </ul>

**Outlook: Negative**

S&P Global Ratings' negative outlook on Norwegian mortgage company Eiendomskreditt AS reflects uncertainties in the entity's business position following changes to the regulatory framework in Norway that are set to increase disincentives for interbank exposures. A resolution is expected within our two-year outlook horizon, likely during 2016. We could lower the rating if the regulation leads to a material change in Eiendomskreditt's financial or operational strategy, for instance if the main owner banks terminate their strategic cooperation with Eiendomskreditt as a financier of commercial real estate, or if new owners brought in materially change the strategy.

In addition, the outlook reflects the negative trend we see for economic risk in Norway's banking system in general, and in southern and western Norway in particular, largely driven by oil prices. Continued deterioration in oil-related industries could hurt asset quality and result in credit losses for Eiendomskreditt, which has a large share of loans in commercial real estate in southern and western Norway.

We could revise the outlook to stable if the uncertainties regarding future ownership and strategy were resolved. We would also need to observe an improvement in economic conditions, in particular stabilization in the west of Norway, most likely driven by a further improvement in oil prices.

**Rationale**

Eiendomskreditt's stand-alone credit profile (SACP) is 'bbb', reflecting the 'a-' anchor we assign to financial institutions operating in Norway, as well as the company's weak business position, very strong capital and earnings, moderate risk position, below average funding, and adequate liquidity, as our criteria define these terms. 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'.

We base our assessment of economic risk on our view that Norway has a wealthy government, supported by returns from the country's global investment fund, considerable oil revenues, and a predictable political environment. The Norwegian economy is undergoing a transformation due to a decline in oil investments and steep contraction of the oil price, but GDP continues to grow as the depreciation of the Norwegian krone (NOK) in recent years has restored competitiveness for Norway's exporters. Falling policy rates, competition for mortgage market share, and immigration-led population growth continue to support increases in residential house prices, with the exception of the oil-concentrated Rogaland region, including Stavanger. As a result of rising asset values, household debt continues to accumulate at a pace exceeding disposable income and presents a growing risk for the economy. There are signs that consumer confidence is falling and we expect bank losses due to the direct and indirect impacts of lower oil investment. However, given the government's stimulus capabilities, tax cuts, a relatively high share of government employment, low interest rates, low unemployment, and strong social safety nets, we anticipate the rise in credit losses

to remain manageable for banks with diversified national exposures.

Our assessment of industry risk for Norwegian banks reflects the proactive regulator, relatively high capital requirements, and a focus on improving banks' liquidity. We also note the government's history and ability to provide impartial liquidity support to the sector. The market is dominated by DNB Bank, other Scandinavian banks, and domestic savings bank alliances, though we note that there is heavy competition for mortgage market shares, which has compressed lending margins in recent years. Restrictions on domestic investments by the global fund result in a large export of capital which is repatriated to some degree by the banks' use of international wholesale funding. However, the expanding domestic bond market, a large share of foreign parent funding, and the likelihood of liquidity support from the government help offset some of the risk from what we see as a structural lack of deposits.

**Table 1**

Eiendomskreditt AS Key Figures						
--Year-ended Dec. 31--						
(Mil. NOK)	2016*	2015	2014	2013	2012	2011
Adjusted assets	4,716	4,682.2	4,870.1	4,877.7	4,498.3	3,918.4
Customer loans (gross)	3,752	3,794.2	4,019.0	4,125.5	3,772.7	3,168.1
Adjusted common equity	433	425.5	404.1	380.3	299.1	261.4
Operating revenues	14.0	47.1	61.2	62.5	46.4	34.8
Noninterest expenses	4.3	19.2	18.7	18.9	15.9	15.0
Core earnings	7.3	20.2	31.6	31.4	22.0	14.3

\*First-quarter 2016. NOK--Norwegian krone.

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

We consider Eiendomskreditt's business position to be weak, due to its small size--total assets stood at Norwegian krone (NOK) 4.9 billion (€510 million at 9.6 NOK/€) at year-end 2015--very low market shares in Norway's residential and commercial real estate markets, and geographic and sector concentration. Eiendomskreditt is owned by 84 banks covering the cooperations of Frende (45% ownership share), Eika (31%), Sparebank (6%), and unaligned savings banks (18%).

Eiendomskreditt provides residential mortgages and commercial real estate loans, mainly to customers in the five largest counties of southern and western Norway. In addition to its geographic concentration, Eiendomskreditt is concentrated in the commercial real estate sector and has the highest share of loans to this sector among domestic Norwegian banks. Loans to the commercial real estate sector accounted for about three quarters of the entity's total lending as of end-2015, and we expect this share to increase further, as competition is lower and thus profitability higher in this sector.

Concerns about the interconnections of financial institutions in Norway have led the Norwegian regulator to implement changes that could affect Eiendomskreditt's relationship with its owner banks. The two key disincentives are the increase in risk weights on interbank exposures to 100% from 20% and the requirement for owner banks to consolidate financial institutions with over 50% ownership by other financial institutions in their capital assessment. While there continues to be some uncertainty about how this will affect Eiendomskreditt and its relationship with current owner banks, in our view, a material reduction in the distribution of loans via owner banks could have a

significant impact on Eiendoms kreditt's business position. We expect to gain a clearer view of the regulator's intentions for Eiendoms kreditt during 2016. This is likely to lead to new decisions on ownership and strategy, which will play an important role in determining the entity's future. However, it is uncertain whether Eiendoms kreditt will be in scope for the consolidation requirement on the basis that it underwrites all transferred loans, initiates a large share of its loan book, and that there is no shareholders agreement between the owner banks. The regulatory capital consolidation process is subject to a transition period until January 2018. We regard the entity as being well aware of the situation, and we believe that the recent announcement of a rights issue to the investment company AS Atlantis Vest, giving it a 24.99% ownership stake with the option to increase to 49%, may facilitate a solution.

**Table 2**

<b>Eiendoms kreditt AS Business Position</b>						
	<b>--Year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2016*</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Total revenues from business line (mil. NOK)	14.0	47.1	61.2	62.5	46.4	34.8
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0	100.0
Return on equity	6.8	4.9	8.1	9.1	7.6	5.8

\*First-quarter 2016. NOK--Norwegian krone.

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

We assess Eiendoms kreditt's capital and earnings as very strong, based on a risk-adjusted capital (RAC) ratio of 20.2% at end-2015 and our projected RAC ratio of above 20% over the next 18-24 months. Our calculation of Eiendoms kreditt's RAC ratio includes two additional tier 1 hybrid instruments totaling NOK75 million, which we include in our measure of total adjusted capital. We believe Eiendoms kreditt's capital levels will be supported over the coming two years by modest growth, the absence of dividend payouts, and cost-efficient operations. We expect Eiendoms kreditt to have credible buffers above regulatory capital requirements by the end of 2016, which would support improvements in credit growth in the following years. In addition, the company expects to raise NOK122 million by a rights issue to AS Atlantis Vest by the fall of 2016. The raised capital is intended to increase Eiendoms kreditt's buffers to regulatory capital ratios, as well as to fund growth in the long term. If the capital increase goes through, we would expect the entity to start paying dividends in 2017.

Our capital forecast assumes that a solution will be found that allows interested owner banks to continue to use Eiendoms kreditt as a funding tool for their commercial real estate lending.

**Table 3**

<b>Eiendoms kreditt AS Capital And Earnings</b>						
	<b>--Year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2016*</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Tier 1 capital ratio	15.0	14.9	13.9	12.2	9.8	10.1
S&P Global Ratings RAC ratio before diversification	N.M.	20.2	18.3	16.2	N.M.	N.M.
S&P Global Ratings RAC ratio after diversification	N.M.	11.4	10.3	9.6	N.M.	N.M.
Adjusted common equity/total adjusted capital	85.2	85.0	84.3	90.5	100.0	100.0
Net interest income/operating revenues	90.3	107.3	96.2	96.7	89.5	96.8
Fee income/operating revenues	1.5	0.7	0.5	0.5	0.9	1.0

Table 3

Eiendomskreditt AS Capital And Earnings (cont.)						
	--Year-ended Dec. 31--					
(%)	2016*	2015	2014	2013	2012	2011
Market-sensitive income/operating revenues	6.9	(9.3)	2.0	1.4	7.5	(0.4)
Noninterest expenses/operating revenues	30.4	40.7	30.5	30.2	34.2	43.0
Preprovision operating income/average assets	0.8	0.6	0.9	0.9	0.7	0.5
Core earnings/average managed assets	0.6	0.4	0.6	0.7	0.5	0.4

\*First-quarter 2016. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Eiendomskreditt AS Risk-Adjusted Capital Framework Data					
(NOK 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
<b>Credit risk</b>					
Government and central banks	40,172	0	0	2,009	5
Institutions	846,740	157,138	19	126,402	15
Corporate	2,584,601	2,584,600	100	1,875,066	73
Retail	1,273,079	455,550	36	312,845	25
Of which mortgage	1,255,663	439,488	35	301,359	24
Securitization§	0	0	0	0	0
Other assets	0	0	0	0	0
Total credit risk	4,744,592	3,197,288	67	2,316,323	49
<b>Market risk</b>					
Equity in the banking book†	5,617	5,613	100	45,076	802
Trading book market risk	--	0	--	0	--
Total market risk	--	5,613	--	45,076	--
<b>Insurance risk</b>					
Total insurance risk	--	--	--	0	--
<b>Operational risk</b>					
Total operational risk	--	106,963	--	117,392	--
(NOK 000s)		Basel II RWA		S&P Global Ratings RWA	% of S&P Global Ratings RWA
<b>Diversification adjustments</b>					
RWA before diversification		3,335,113		2,478,790	100
Total Diversification/Concentration Adjustments		--		1,897,706	77
RWA after diversification		3,335,113		4,376,496	177
(NOK 000s)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
<b>Capital ratio</b>					
Capital ratio before adjustments		496,539	14.9	500,528	20.2

**Table 4**

<b>Eiendomskreditt AS Risk-Adjusted Capital Framework Data (cont.)</b>					
Capital ratio after adjustments†	496,539	14.9	500,528	11.4	

\*Exposure at default. §Securitisation exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions.

‡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--Norwegian krone. Sources: Company data as of Dec. 31, 2015, S&P Global Ratings.

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

We consider Eiendomskreditt's risk position to be moderate, reflecting its increasing concentration in the commercial real estate sector, single-name concentration, and relatively large exposure to the oil-reliant southern and western regions of Norway.

The share of commercial real estate lending within total customer loans has grown steadily to about 75% at end 2015, from about 40% in 2009. The company has continued to hold high collateral standards and has maintained its pristine credit loss history. In addition, Eiendomskreditt provides residential mortgage loans across the nation via its own sales channels and cooperation with an internet comparison site, as well as its exclusive relationship with the Norwegian homeowners association.

Despite its concentration in a volatile sector, we consider Eiendomskreditt's underwriting process to be conservative. Our view is underscored by loan-to-value limits of 65% and 55% of collateral values for residential and commercial loans, respectively, both of which are below the regulatory requirements for inclusion in the company's covered bond pool. In our view, this has contributed to strong asset quality, best demonstrated by an absence of credit losses since the company started operations in 1998. We also note that Eiendomskreditt performs its own credit analysis on loans transferred from its owners, ensuring that such loans fit the company's risk profile.

Eiendomskreditt has still never had a credit loss since its establishment in 1998, in spite of some defaults, since the entity's high collaterals and priority position has led to full recovery. However, given the volatility in commercial real estate we believe that the liquidity of the Norwegian commercial real estate market and the valuations of associated collateral could come under pressure during a period of stress, and lead to more substantial credit losses in the future. In particular, we note the uncertainty created by the significant reduction in the oil price over the past two years as a risk factor for Eiendomskreditt's exposures.

**Table 5**

<b>Eiendomskreditt AS Risk Position</b>						
	<b>--Year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2016*</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Growth in customer loans	(4.5)	(5.6)	(2.6)	9.4	19.1	10.4
Total diversification adjustment / S&P Global Ratings RWA before diversification	N.M.	76.6	77.9	69.3	N.M.	N.M.
Total managed assets/adjusted common equity (x)	10.9	11.0	12.1	12.8	15.0	15.0
Gross nonperforming assets/customer loans + other real estate owned	0.5	1.9	2.1	3.8	2.1	0.5
Loan loss reserves/gross nonperforming assets	6.2	1.6	1.4	0.8	1.5	6.9

\*First-quarter 2016. RWA--Risk weighted assets. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

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

We assess Eiendoms kreditt's funding as below average. The company is dependent on wholesale funding, particularly the rather fragmented domestic covered bond market, making it susceptible to erosion of market confidence in turbulent economic conditions, in our view. In addition, our assessment also considers the lack of direct access to the central bank. We do not consider potential support from the owner banks in our funding assessment.

Eiendoms kreditt's stable funding ratio, as measured by S&P Global Ratings, stood at 99.5% at end-2015, an improvement from 86% just two years earlier, given the reduction in issued debt maturing in less than one year and a reduction in the loan book. In 2014, the ratio stood at 113.7%, but the difference mainly consists of relatively large buybacks of own bonds close to maturity in 2014.

A similar impact is seen on the entity's liquidity ratios. We assess Eiendoms kreditt's liquidity as adequate, with a ratio of broad liquid assets to short-term wholesale funding at 1.0x at end-2015.

We expect that these ratios will remain volatile, yet comfortable, due to the impact of debt falling due within one year, given the small number of outstanding issues.

**Table 6**

Eiendoms kreditt AS Funding And Liquidity						
	--Year-ended Dec. 31--					
(%)	2016*	2015	2014	2013	2012	2011
Core deposits/funding base	0.0	0.0	0.0	0.0	0.0	0.0
Long term funding ratio	N.M.	83.2	96.6	87.4	76.1	77.7
Stable funding ratio	N.M.	99.5	113.7	98.8	86.0	88.2
Short-term wholesale funding/funding base	N.M.	18.8	3.8	13.8	25.6	24.0
Broad liquid assets/short-term wholesale funding (x)	N.M.	1.0	4.6	1.0	0.5	0.7
Net broad liquid assets/short-term customer deposits	N.M.	N.M.	N.M.	N.M.	N.M.	N.M.
Short-term wholesale funding/total wholesale funding	N.M.	18.5	3.7	13.7	25.6	24.0
Narrow liquid assets/3-month wholesale funding (x)	N.M.	57.3	52.4	6.9	2.1	3.9

\*First-quarter 2016. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

### External support: No notches of uplift to the SACP

We consider Eiendoms kreditt to be of low systemic importance and consequently do not factor any extraordinary government support into the ratings. We do not include any group support in the ratings, despite the company's ownership by 84 domestic savings banks.

## Related Criteria And Research

### Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011

- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

## Related Research

- Banking Industry Country Risk Assessment: Norway, Dec. 11, 2015
- Nordic Banks Stay Resilient To Negative Rate Noir, March 24, 2016

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 27, 2016)

### Eiendoms kreditt AS

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

### Counterparty Credit Ratings History

01-Jul-2014	BBB/Negative/A-2
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### Sovereign Rating

Norway (Kingdom of)	AAA/Stable/A-1+
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\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's 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.

### Additional Contact:

Financial Institutions Ratings Europe; FIG\_Europe@standardandpoors.com

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