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## Virginia Commonwealth University; Public Coll/Univ - Unlimited Student Fees

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# Virginia Commonwealth University; Public Coll/Univ - Unlimited Student Fees

## Credit Profile

Virginia Commonwealth Univ

Long Term Rating

AA-/Stable

Affirmed

## Rationale

S&P Global Ratings affirmed its 'AA-' rating on Virginia Commonwealth University's (VCU) existing general revenue debt. The outlook is stable.

We assessed VCU's enterprise profile as very strong characterized by historically stable enrollment but gradually softening demand profile. We assessed VCU's financial profile as very strong, with generally positive operating performance, manageable maximum annual debt service (MADS) burden, and below-average financial resource ratios for the rating category. Combined, we believe these credit factors lead to an indicative standalone credit profile of 'aa-' and a final rating of 'AA-'.

The rating reflects our opinion of the university's:

- Status as one of the three major research institutions in the commonwealth with \$209 million of sponsored research awards in fiscal 2016;
- Generally positive financial operations, despite full-accrual deficit, is expected for fiscal 2016;
- Sufficient demand and enrollment profile, coupled with an increasing graduation rate; and
- Successful fundraising history.

We believe somewhat offsetting credit factors include, what we consider, the university's below-average financial resources for the rating category with adjusted unrestricted net assets (UNA) of \$430.2 million in fiscal 2016, or 38.2% of fiscal 2015 operating expenses and 89.7% of debt based on unaudited financials.

A gross revenue pledge of the VCU, which we view as diverse and equivalent to an unlimited student fee pledge of the university, secures the bonds.

The VCU, in downtown Richmond, is an urban research university supported by Virginia. It is one of three major research institutions in the commonwealth, and management indicates increasing sponsored research is a major institution goal. The university's teaching hospital is VCU Medical Center, the largest medical center in Virginia with more than 800 beds. Total headcount enrollment at the VCU was 31,231 for the fall 2016. According to management, its goal is to improve graduation rates at the university.

The university, which consists of five campuses, includes 13 schools and three colleges, collectively offering more than 235 degree and certificate programs. It has a branch campus, the VCU School of the Arts in Qatar, in Education City, Doha, Qatar. Effective July 1, 2008, the commonwealth granted the university Tier 3 status pursuant to the Restructuring Act of 2005, which allows the university to remain a commonwealth institution but exercise more

autonomy over its operations, including procurement, capital outlay, finances, and human resources. Virginia Polytechnic Institute and State University, College of William and Mary, and the University of Virginia are also Tier 3 institutions.

The VCU opened a new medical building in spring 2013 that allowed it to increase the annual medical school class size to 216 students from 200. In 1997, the VCU Medical Center, formerly known as the Medical College of Virginia Hospitals, was transferred to the Virginia Commonwealth University Health System Authority, a subdivision of the commonwealth, from the VCU. Under the Governmental Accounting Standards Board Statement No. 14, the Virginia Commonwealth University Health System is considered a component, but legally separate, unit.

## **Outlook**

The stable outlook reflects our opinion that over the next two years, the university's demand profile and financial performance will likely remain stable, and financial resources will likely remain at current levels.

### **Downside scenario**

We could consider a negative rating action if the university were to issue significant new debt without a commensurate increase in financial resource ratios, or if there is negative operating performance beyond fiscal 2016, due possibly to commonwealth funding decreases or significant enrollment decreases.

### **Upside scenario**

A positive rating action is unlikely given the below-average available resources ratios of VCU. However, we could consider a positive rating action beyond the outlook's two-year period if commonwealth appropriations were to increase significantly, resulting in higher operating margins; if financial resource ratios were to strengthen compared with the rating category; and if the university were to maintain manageable debt burden.

## **Enterprise Profile**

### **Industry risk**

Industry risk addresses the higher education sector's overall cyclical 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**

In our view, the university has limited geographic diversity as it is predominantly regional. About 85% of fall 2016 students are from Virginia. As such, our assessment of VCU's economic fundamentals is anchored by the local GDP per capita.

### **Market position and demand**

After steady enrollment growth through fall 2010 and one-year decline in fall 2011, full-time-equivalent (FTE) enrollment has been generally stable over the past five years. Decreasing FTE enrollment in the university's graduate

programs, which account for roughly 12% of total enrollment, was offset by modest increases in FTE enrollment at the undergraduate level. The FTE enrollment of 27,698 in fall 2016, however, was consistent with the FTE enrollment of 27,707 in fall 2015, suggesting enrollment stabilization. The university has recently added some new graduate-degree programs, including Ph.D.'s in mechanical and nuclear engineering, healthcare policy and research, media art and text, and a masters of product innovation, and expects to launch several new masters and professional programs next year. Management expects graduate headcount to stabilize with the addition of these new programs.

Freshman applications increased by 5% to 17,177 in fall 2016 from 16,293 in fall 2015. The VCU's demand profile, although softening, remains consistent for the rating category in our opinion. The university accepted 75% of fall 2016 applicants; about 33% of these applicants matriculated. Roughly 85% of incoming students are residents of the commonwealth. Management indicates that increasing out-of-state student enrollment remains a goal for the university, and it plans to increase student recruitment efforts internationally. Transfer student enrollment remains a significant portion of entering students at the VCU, averaging 2,099 transfer students annually over the past five years. Transfer applicants decreased by a cumulative 14.1% to reach 4,731 in fall 2016 from a record high of 5,479 in fall 2,013. Freshman retention rate at 85.7% in fall 2016 is also, in our view, consistent with the category median. The six-year graduation rate has improved steadily to, in our opinion, an adequate 62.3% in fall 2013. Student quality, measured by standardized test scores, has remained consistent over the past five years; the fall 2016 SAT average remains, what we regard as, an adequate 1,096 compared with category medians.

The VCU has a successful fundraising history despite a low alumni-participation rate. Fiscal 2016 marked the third-highest record year of \$91 million gifts and pledges raised with an increase in both the overall number of donors and alumni donors, compared with a peak of \$120.3 million in fiscal 2012. Management expects the momentum to continue in fiscal 2017. The alumni-participation rate is, in our view, a low 6.7% in fiscal 2016. According to management, fundraising is an area of focus; the university has just entered the public phase of a \$750 million comprehensive campaign with more than \$440 million already raised toward that goal. According to management, the number of donors has increased recently.

### **Management and governance**

A 16-member board of visitors governs the VCU and supports the senior management team. Virginia's governor appoints board members, with confirmation from the state senate, for a maximum of two four-year terms. The board of visitors has administrative and financial oversight of the VCU's activities; the board's duties and responsibilities include, among others, setting tuition and fees, developing an institutional plan, determining academic programs, establishing administrative policies, approving debt issuances, and granting degrees.

Management reports four rotational turnover in board members since 2013. The senior management team is also generally stable with just three recent changes: Officials appointed a new chief executive officer of the VCU health system in June 2015, a new chief executive officer of hospitals and clinics started in October 2016, and a new vice president of finance and budget joined in May 2016. We believe a stable board and management team provide overall stability to the credit profile. We view the VCU as having strong institutional policies in place, including solid financial policies on debt, investments, and working cash; we regard these policies as a best practice. The college does not budget for depreciation expenses, which we don't view as best practice. However, in our opinion, the university budgets conservatively and proactively, which we believe has allowed it to manage through recent commonwealth

appropriation cuts effectively.

The VCU's current strategic plan centers on five main initiatives:

- Academic quality and success,
- Faculty retention and support,
- Knowledge and innovation advancement,
- Service-learning enrollment, and
- Fundraising.

The VCU is successfully achieving some of these goals through restructuring the senior management team, reviewing bylaws, and creating a separate investment subcommittee. A common investment manager was created in October 2015 for the VCU and all of its affiliates, allowing the VCU to maximize returns through a larger portfolio instead of smaller individual portfolios.

## Financial Profile

### Financial management policies

The university has formal policies for endowment, investments, and debt. It operates according to a six-year strategic plan. The college 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 negatively affect 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.

In line with our Dec. 15, 2015, publication "Incorporating GASB 68: Evaluating Pension Obligations under Standard & Poor's Higher Education and Charter School Criteria," we have made certain adjustments to the financial statements of public colleges and universities and certain public charter schools for financial results beginning with fiscal year end June 30, 2015 to enhance analytical clarity regarding the economic substance of the funding of liabilities, expenses and deferred inflows and outflows of resources associated with pension plan obligations and a change in accounting principle as detailed in GASB 68, "Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27". We believe these adjustments enhance analytical clarity from a credit perspective and result in more comparable financial metrics as long as states continue to be able and willing to fund these pension liabilities.

### Financial performance

Financial performance at the university has remained positive over the past five fiscal years, although a moderate full-accrual operating deficit is expected for fiscal 2016 based on unaudited results. For fiscal 2016, including institutionally funded financial aid, state operating appropriations, interest and dividend income, gifts and federal Pell revenues, the adjusted operating revenues equaled \$1.1 billion based on unaudited results. Total adjusted operating expenses, including institutionally funded financial aid, interest expense, and a \$4 million difference between total pension contributions and expenses, also equaled roughly \$1.1 billion in the fiscal year based on unaudited results. Net adjusted operating income reflected a deficit of \$4.4 million in fiscal 2016, compared with surpluses of \$27 million and \$4.6 million in fiscal 2015 and fiscal 2014, respectively. Management attributes the deficit in fiscal 2016 to increased

expenses associated with operations and maintenance, financial aid, hospital operations and searching costs for a new dean. Despite the expected one-time state funding cut of \$4.2 million, management is budgeting and projecting a surplus for fiscal 2017 through implementing necessary expense controls. Management expects another state funding cut of \$17.5 million (permanent cut \$15.4 million and a one-time cut of \$2.1 million) in fiscal 2018, but indicates that it will incorporate expense cuts accordingly in the budget planning process to achieve balanced operating results. Net tuition revenue has increased over the last decade, up by a cumulative 30% from fiscal 2011 to \$323.6 million in fiscal 2016 based on unaudited results.

Like other public universities, the VCU's revenue mix reflects a lower reliance on commonwealth operating appropriations due to multiple years of flat or reduced appropriations; therefore, it exhibits a proportionally larger reliance on net tuition and fees. Based on the unaudited results for fiscal 2016, net tuition and mandatory fees generated 37% of adjusted operating revenue, followed by commonwealth appropriations of 19%, grants and contracts of 15%, and auxiliary revenue of 12%. The VCU maintained a stable tuition level for new in-state undergraduates in fall 2016 at \$10,846. Including room and board, total in-state costs per student were \$23,049, a 9.3% increase from fall 2013, but only 1.9% increase from fall 2015. Management reports tuition and fees remain, what we consider, low among Virginia's doctoral institutions despite these increases. It expects very moderate tuition increase in the near future.

State appropriations from the commonwealth have witnessed an increase in the last four fiscal years (including fiscal 2016), barring a small decrease (0.5%) in fiscal 2015. The VCU received \$213.5 million of commonwealth appropriations for fiscal 2016; however, management anticipates commonwealth appropriations to decrease by \$4.2 million (or about 1.6% one-time funds) in fiscal 2017 and a further reduction of \$17.5 million (or about 8.2%, including a permanent cut \$15.4 million and a one-time cut of \$2.1 million) in state appropriations is expected in fiscal 2018. Management reports that it will offset shortfalls in commonwealth funding through expense cuts to achieve at least balanced results in fiscal 2017 and 2018.

The VCU also receives funding for capital projects. Capital appropriations decreased to \$42.7 million in fiscal 2016 (based on unaudited results) from \$27.2 million in fiscal 2015. Management attributes the increase in fiscal 2016 appropriations to the construction of the new School of Allied Health building.

In fiscal 2016, the VCU received \$209 million of external research funding compared with \$211 million the previous year. Federal research accounts for approximately 69% of research funding, approximately 41% of which is funding from the National Institute of Health. While concentration is comparable with the university's peer institutions, we recognize the relatively high level of concentration on federal funding. The indirect cost recovery rate through fiscal 2016 was 52%.

### **Available resources**

We consider the VCU's financial resources ratios below average for the 'AA' category. As of June 30, 2016, the university had \$430.2 million of adjusted UNA, including its foundations' UNA of roughly \$87.3 million and a \$304.2 million adjustment for GASB 68 pension liabilities or, in our opinion, a below-average 38.2% of fiscal 2016 adjusted operating expenses and 89.7% of total debt, based on unaudited statements. The VCU is further supported by five foundations, including:

- The VCU Foundation,
- The Medical College of Virginia Foundation,
- The VCU School of Engineering Foundation,
- The VCU School of Business Foundation, and
- The VCU Real Estate Foundation.

As of June 30, 2016, these five foundations had combined net assets of \$651.8 million, \$87.3 million of which was unrestricted; we have included this in our financial resource ratios, based on unaudited statements.

The university' total endowment of \$1.6 billion as of June 30, 2016, is housed at the individual foundations and at the university. In fiscal 2013, the university decided to combine its investments across affiliates with one investment manager; this increased its endowment market value to \$1.3 billion at fiscal-year end 2013 from \$438.1 million at fiscal year-end 2012. Management attributes this significant increase to the inclusion of the VCU's Health System endowment, which had not been included as part of the endowment figures in previous years. The VCU's endowment investments are invested somewhat, in our opinion, aggressively in alternatives (45%), equities (30%), fixed income (22%), and cash (3%). The university does not rely on its endowment for operations, which, in our opinion, provides additional budgetary flexibility.

### **Debt and contingent liabilities**

VCU has \$479.4 million of total debt outstanding, excluding foundation debt, based on fiscal 2016 unaudited results. About 88% is fixed-rate debt and 12% is variable-rate debt, including revenue bond debt, capital leases, installment purchases and line of credit. About \$63.2 million of debt is privately placed, which we view as contingent liabilities along the \$57.8 million variable rate debt. There are no financial covenants on any of its privately-placed debt other than minimum ratings requirements (Baa1/BBB+) and the submission of its annual audited financial statements and annual budgets to the supporting banks. We believe the contingent liabilities are adequately covered by \$423 million of unrestricted cash and investments that the university has as of fiscal 2016. In our view, the university has an average MADS burden of 4% in fiscal 2016, based on unaudited financials. University management indicates it has additional capital needs that will require further debt issuance outside the outlook's two-year period. It, however, indicates additional debt issuances will comply with current debt management policies, which are, in our opinion, relatively conservative. According to management, it could issue about \$54 million of additional debt for various capital projects during the next three years.

In addition, the university has two floating- to fixed-rate swap agreements with Deutsche Bank which effectively hedges all of its variable-rate debt. As of June 30, 2015, the total notional amount was \$60.5 million and the swaps represented a negative market value of \$9.2 million. Although the swaps account for, what we consider, a moderately high basis risk due to interest payments swapped to 67% of LIBOR, we believe it is offset by good swap management policies, low termination risk due to a comfortable spread between the university's current rating and rating triggers, and strongly rated counterparty that reduces the risk of counterparty default.

The university provides retirement benefits through two state defined-benefit plans- VRS State Employee Retirement Plan or the VaLORS plan and Optional Retirement Plans, which are defined-contribution plans. Management reports the university has been making required employer contributions to plans and per state statute, should the university not be able to make the required contributions, the state is ultimately responsible. It offers other postemployment

benefits through a cost-sharing multiple-employer retiree benefit plan, which it funds on a pay-as-you-go basis.

<b>Virginia Commonwealth University Financial Statistics</b>						
	<b>--Fiscal year ended June 30--</b>					<b>Medians for 'AA' rated public colleges and universities</b>
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2015</b>
<b>Enrollment and demand</b>						
Headcount	31,231	31,242	31,163	31,288	31,752	MNR
Full-time equivalent	27,698	27,707	27,776	27,689	27,710	32,632
Freshman acceptance rate (%)	74.5	72.4	68.9	64.0	60.2	71.7
Freshman matriculation rate (%)	33.1	34.7	34.4	36.4	38.1	MNR
Undergraduates as a % of total enrollment (%)	77.5	77.0	73.7	75.6	75.4	77.7
Freshman retention (%)	85.7	86.2	86.5	86.7	85.0	85.5
Graduation rates (five years) (%)	N.A.	57.9	56.6	53.9	51.0	MNR
<b>Income statement</b>						
Adjusted operating revenue (\$000s)	N.A.	1,121,011	1,085,992	1,035,409	988,250	MNR
Adjusted operating expense (\$000s)	N.A.	1,125,372	1,059,012	1,030,779	974,471	MNR
Net adjusted operating income (\$000s)	N.A.	(4,361)	26,980	4,630	13,779	MNR
Net adjusted operating margin (%)	N.A.	-0.39	2.55	0.45	1.41	2.10
Estimated operating gain/loss before depreciation (\$000s)	N.A.	58,788	89,855	65,095	68,389	MNR
Change in unrestricted net assets (UNA; \$000s)	N.A.	3,030	(266,741)	43,884	(473)	MNR
State operating appropriations (\$000s)	N.A.	213,480	203,699	204,695	194,224	MNR
State appropriations to revenue (%)	N.A.	19.0	18.8	19.8	19.7	21.0
Student dependence (%)	N.A.	48.5	47.8	47.3	46.6	42.4
Healthcare operations dependence (%)	N.A.	2.3	2.3	2.4	2.4	MNR
Research dependence (%)	N.A.	14.5	15.1	14.9	15.7	MNR
Endowment and investment income dependence (%)	N.A.	1.0	1.1	1.4	0.8	0.8
<b>Debt</b>						
Outstanding debt (\$000s)	N.A.	479,422	487,794	513,093	480,313	646,050
Total pro forma debt (\$000s)	N.A.	479,422	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	4.23	4.28	4.54	4.31	MNR
Current MADS burden (%)	N.A.	4.00	4.49	N.A.	N.A.	3.70
<b>Financial resource ratios</b>						
Endowment market value (\$000s)	N.A.	1,559,875	1,638,147	1,509,431	1,316,053	642,929
Related foundation market value (\$000s)	N.A.	651,841	677,155	666,322	596,336	612,539
Cash and investments (\$000s)	N.A.	509,025	541,328	510,504	448,227	MNR
UNA (\$000s)	N.A.	38,617	35,587	302,328	258,444	MNR
Adjusted UNA (\$000s)	N.A.	430,152	429,311	401,246	341,880	MNR

## Virginia Commonwealth University Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'AA' rated public colleges and universities
	2017	2016	2015	2014	2013	2015
Cash and investments to operations (%)	N.A.	45.2	51.1	49.5	46.0	51.7
Cash and investments to debt (%)	N.A.	106.2	111.0	99.5	93.3	162.6
Cash and investments to pro forma debt (%)	N.A.	106.2	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	38.2	40.5	38.9	35.1	30.3
Adjusted UNA plus debt service reserve to debt (%)	N.A.	89.7	88.0	78.2	71.2	86.7
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	89.7	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	12.3	11.5	11.1	11.3	12.4

N.A.--Not available. MNR--median not reported. 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 (net adjusted operating income/adjusted operating expense). Tuition dependence = 100 times (gross tuition revenue/adjusted operating revenue). Current debt service burden = 100 times (current debt service expense/adjusted operating expenses). Current MADS burden = 100 times (maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term and long-term investments. Adjusted UNA = Unrestricted net assets + unrestricted net assets of the foundation. Average age of plant = accumulated depreciation/depreciation and amortization expense.

## Ratings Detail (As Of November 18, 2016)

## Virginia Commonwealth Univ gen rev pledge bnds ser 2004A dtd 03/01/2004 due 05/01/2005-2021

*Unenhanced Rating* AA-(SPUR)/Stable Affirmed

## Virginia

## Virginia Commonwealth Univ, Virginia

Virginia Commonwealth Univ, Virginia

Virginia Commonwealth Univ gen rev pledge bnds ser 2006A&B VRDB

*Long Term Rating* AA-/NR/Stable Affirmed

*Unenhanced Rating* AA-(SPUR)/Stable Affirmed

Many issues are enhanced by bond insurance.

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