

RatingsDirect®

Deutsche Wohnen SE

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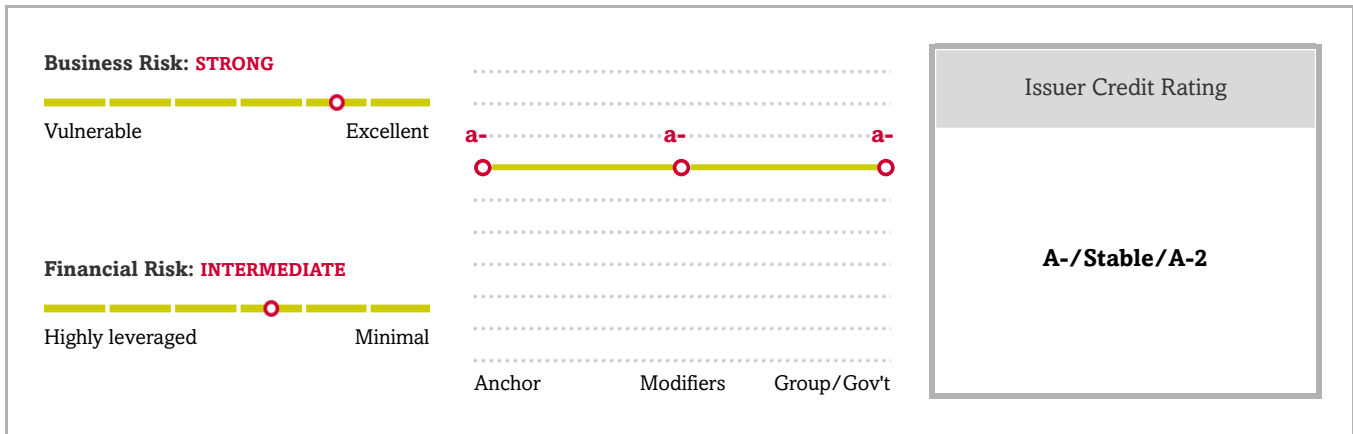
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Deutsche Wohnen SE



Credit Highlights

Overview

Key Strengths

Second-largest listed German residential landlord with a portfolio of €21.2 billion as of Sept. 30, 2018, comprising about 166,000 residential and commercial units and 7,440 nursing home beds.

Main focus on the residential segment in Germany, entailing stable cash flow streams, thanks to favorable market fundamentals, such as growing demand with limited supply.

Low cost of debt and strong capacity to cover interest with a ratio of EBITDA to interest forecast at well above 4.0x over the next two years.

Moderate financial policy, with our S&P Global Ratings-adjusted debt-to-debt plus equity ratio forecast at 40%-42% over the next two years.

Key Risks

Geographic concentration to Germany, and in particular its capital Berlin, representing about 70% of total portfolio.

Risk of further tightening of rent regulation in Germany, which could harm like-for-like rental growth, in particular related to modernization spending.

Expected moderate increase in the share of the higher-yielding nursing homes business in line with the company's strategy. While the nursing homes segment has lower margins, it benefits from positive demographic trends and a favorable regulatory environment.

Deutsche Wohnen has expanded in nursing homes with acquisitions totaling €750 million year to date. During 2018, Deutsche Wohnen has continued expanding its nursing home segment with the acquisition of a total of 37 nursing facilities with a purchase price of approximately €750 million. As of Sept. 30, 2018, the company's total exposure to the nursing homes segment amounted €1.3 billion, or approximate 6% of total asset portfolio. While we view the nursing home business as a lower-margin segment, which bears additional risk to certain operators, demand for nursing homes will remain solid, given the demographic trends and a favorable regulatory environment.

Additional regulation measures agreed by the German Housing Summit should have limited impact on Deutsche Wohnen. On Sept. 30, 2018, the German Housing Summit set out a number of plans to try to speed up the construction of housing and limit rent increases. Despite agreements reached regarding the increased social housing construction, construction child benefits, or special amortization schemes, we believe the most relevant change for German residential landlords is the extension of the review period of the rent index (so-called "Mietspiegel") to six years from currently four. Although the impact of this change is difficult to measure at this stage, we believe that the underlying demand-supply gap in metropolitan areas in Germany is not addressed and therefore will not stop rents growing further.

Outlook: Stable

The stable outlook reflects our view that German residential real estate company Deutsche Wohnen's portfolio should continue to generate resilient cash flows and positive like-for-like growth in its residential portfolio and nursing homes segment. We believe that the continued high demand for midsize residential apartments in affordable buildings in Deutsche Wohnen's main metropolitan locations, in particular Berlin, should support rental income and further boost asset value, although likely at a more moderate pace than in the past couple of years.

In our base case, we assume that the EBITDA interest coverage ratio will remain well above 4x over the next two years, and debt to debt plus equity at 40%-42%.

Downside scenario

We could lower the rating if debt to debt plus equity increases above 45%, which would most likely occur if Deutsche Wohnen funds large acquisitions or higher-than-anticipated capital expenditures (capex) with a high proportion of debt. We would also consider a negative rating action if EBITDA interest coverage drops below 3x, although this is not part of our base-case scenario.

Upside scenario

An upgrade would be contingent on Deutsche Wohnen's ability to improve its credit metrics with a debt-to-debt plus equity ratio decreasing to below 35% while maintaining like-for-like rental growth for its residential portfolio and high occupancy levels. In light of the current stated financial policy, we believe this scenario to be unlikely in the long term.

Our Base-Case Scenario

S&P Global Ratings forecasts real GDP growth for Germany for the next two years of about 1.5%-1.8%, while we expect inflation to remain stable at 1.8% over the same period. We believe that this macroeconomic environment should support residential landlords' ability to increase their rents, while we anticipate supply and demand dynamics to continue to be above the German average in Greater Berlin.

Assumptions	Key Metrics																		
<ul style="list-style-type: none"> • About 8%-10% overall revenue growth for 2018, mainly stemming from the acquisitions of over €980 million residential assets and approximately €750 million nursing homes this year. • In the residential segment, we anticipate above 3% organic annual rental growth in the next two years, mainly stemming from the continuously strong performance of its Berlin assets where demand exceeds the new limited supply in the market, assuming no major further tightening of German rent regulations. • Robust and stable occupancy rates of about 98% for the residential segment, as well as for nursing homes and assisted living. • EBITDA margins to remain at about 65%, excluding the privatization business but including the nursing homes and assisted living segment. • Uplift in the asset portfolio valuation of approximately 6%-8% in 2018. We forecast 4%-6% growth in the portfolio valuation for 2019 and 2020, which we view as relatively conservative for Berlin, which tends to perform better than the country on average. • Regarding asset rotation, we anticipate further acquisitions in the nursing homes segment in 2019-2020, in line with the company's intention to increase its exposure to this segment. In line with the management guidance, we assume privatization sales to be about 1,000 units per year, but we understand that it may change on an opportunistic basis. • We assume an overall capex of about €300 million-€350 million annually over the next two to three years, reflecting its €1.5 billion total capex program. • We forecast the 2019 dividend payment will increase to about €300 million-€330 million, conservatively assumed as cash dividend. 	<table border="1"> <thead> <tr> <th></th> <th style="text-align: center;">2017A</th> <th style="text-align: center;">2018E</th> <th style="text-align: center;">2019E</th> </tr> </thead> <tbody> <tr> <td>EBITDA interest coverage (x)</td> <td style="text-align: center;">4.6</td> <td style="text-align: center;">~5</td> <td style="text-align: center;">4.8-5</td> </tr> <tr> <td>Debt to debt plus equity (%)</td> <td style="text-align: center;">40.4</td> <td style="text-align: center;">40-42</td> <td style="text-align: center;">40-42</td> </tr> <tr> <td>Debt to EBITDA (x)</td> <td style="text-align: center;">12.5</td> <td style="text-align: center;">12-13</td> <td style="text-align: center;">12-13</td> </tr> </tbody> </table> <p>A--Actual. E—Estimate</p>				2017A	2018E	2019E	EBITDA interest coverage (x)	4.6	~5	4.8-5	Debt to debt plus equity (%)	40.4	40-42	40-42	Debt to EBITDA (x)	12.5	12-13	12-13
	2017A	2018E	2019E																
EBITDA interest coverage (x)	4.6	~5	4.8-5																
Debt to debt plus equity (%)	40.4	40-42	40-42																
Debt to EBITDA (x)	12.5	12-13	12-13																

Base-case projections

Like-for-like rental income growth should continue in our forecast horizon. We assume like-for-like rental income will continue growing above 3% the next 12 to 24 months, which we assume owing to the company's modernization efforts and new lettings. Taking into account the stable tenant turnover of 8% annually, rental income growth of leased flats should be limited.

Long fixed debt maturity profile should prevent impact on Deutsche Wohnen if interest rates start rising. We believe that Deutsche Wohnen is well positioned for short-to-medium term interest rate increases. The company has a debt maturity length of nearly eight years with exposure to mainly fixed interest rates. We believe that asset valuation growth could slow, while downside protection on the company's rents are reflected in the regulated market environment and lower-than-market rent levels.

Company Description

Deutsche Wohnen is one of the largest publicly listed residential property companies in Germany. As of Sept. 30, 2018, its portfolio comprised approximately 166,000 residential and commercial units, as well as about 7,440 nursing home beds, for a total fair value of about €21.2 billion.

The company is listed on the German stock exchange and its largest shareholder is BlackRock Inc., with 10.2%.

Business Risk: Strong

Deutsche Wohnen's large portfolio of income-producing residential and nursing properties--worth about €21.2 billion as of Sept. 30, 2018--underpin the company's business risk profile. It is the second-largest residential property holding company in Germany (after Vonovia, which has a portfolio of about €40 billion).

Deutsche Wohnen's strategy is to focus on affordable apartments, leased at €6.5 per square meter on average as of Sept. 30, 2018. We tend to view residential properties as less cyclical and volatile than most other commercial real estate segments, in particular in the affordable segment. In addition, we believe the German market provides strong fundamentals to real estate landlords. These include long average tenant stays (12-14 years versus less than five years in the U.K. or France), a cultural preference for renting rather than owning, despite good price affordability ratio, and a currently healthy domestic economy.

Our assessment also reflects Deutsche Wohnen's focus on German metropolitan areas with favorable market dynamics. Its residential portfolio in particular is focused on Greater Berlin (70.8% of residential units as of Sept. 30, 2018), which benefits from favorable demand and supply dynamics. In this context, Deutsche Wohnen has been able to maintain a very low vacancy rate in its residential portfolio (2.1% as of Sept. 30, 2018). It has also achieved robust like-for-like rental growth in the past few years; +3.5% in the past 12 months to Sept. 30, 2018, for its overall residential portfolio, and +3.8% for Greater Berlin only, over the same period. Although we anticipate in our base case that this trend should continue, the regulated residential property market limits realization of rent upside potential in line with market rents.

Deutsche Wohnen's scale, scope, and diversity remain lower than that of its residential peers such as Vonovia or

Akelius. However, we believe that Deutsche Wohnen's large concentration in Berlin allows the company to benefit from economies of scale, as illustrated by a low cost ratio of about 11% (corporate expenses to gross rental income).

We understand that Deutsche Wohnen intends to increase the share of its nursing homes segment to as much as 15% of the group's EBITDA from 6.5% of S&P Global Ratings adjusted rolling-12-months EBITDA on Sept. 30, 2018. The contribution to earnings of the nursing homes segment would increase significantly after the acquisitions of about €750 million made in 2018, and we expect the company to make further acquisitions in the nursing homes segment in the next 12 to 24 months. Gross margins in this segment are lower than in the residential segment, as Deutsche Wohnen partly acts as the facility operator. As of Sept. 30, 2018, the company operates 24 nursing facilities out of 59 owned facilities. The nursing home segments benefit from favorable demographic trends, thanks to the ageing population in Germany, a supportive regulatory environment, and a higher yield (about 6%) than in residential. Deutsche Wohnen's portfolio also enjoys an above average occupancy rate (about 98%) in this segment compared with the market average, which is much lower, mainly as a result of existing nursing units not at required standards (85%).

Peer comparison

Table 1

Deutsche Wohnen SE -- Peer Comparison					
Industry Sector: Real Estate Investment Trust or Company					
	Deutsche Wohnen SE	Unibail-Rodamco SE	Gecina	Vonovia SE	Akelius Residential Property AB
Rating on Nov. 28, 2018.	A-/Stable/A-2	A/Stable/A-1	A-/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2
(Mil. €)	--Fiscal year ended Dec. 31, 2017--				
Revenues	864.9	2,078.40	562.5	1,719.70	419.5
EBITDA	552.6	1,556.10	430.1	1,128.30	225.9
Funds from operations (FFO)	400.6	1,313.10	327.7	809.9	80.7
Interest Expense	120.4	226.9	100	326.1	142.8
Net income from cont. oper.	1,717.90	2,439.50	1,895.60	2,410.70	785.8
Cash flow from operations	520.3	1,244.90	230.6	660.2	85.7
Capital expenditures	227.4	1,349.50	378.2	1,043.00	282.6
Dividends paid	268.1	1,084.50	322.2	314.1	835.1
Cash and short-term investments	363.7	574.7	122	229.9	15.8
Debt	6,931.20	14,731.30	8,641.30	14,799.70	5,079.50
Equity	10,211.00	22,693.20	11,014.40	16,541.20	4,606.00
Debt and equity	17,142.20	37,424.50	19,655.70	31,340.90	9,685.60
Valuation of Investment Property	19,952.90	41,109.40	16,667.10	32,553.30	10,405.00
Adjusted ratios					
Annual revenue growth (%)	11.7	2.3	12.1	8.7	0.3
EBITDA margin (%)	63.9	74.9	76.5	65.6	53.9
Return on capital (%)	3.1	4.4	2.7	2.4	2.3

Table 1

Deutsche Wohnen SE -- Peer Comparison (cont.)					
EBITDA interest coverage (x)	4.6	6.9	4.3	3.5	1.6
Debt/EBITDA (x)	12.5	9.5	20.1	13.1	22.5
FFO/debt (%)	5.8	8.9	3.8	5.5	1.6
Total debt/debt plus equity (%)	40.4	39.4	44	47.2	52.4

Financial Risk: Intermediate

Deutsche Wohnen's leverage ratio has remained stable compared with last year. Our ratio of debt to debt plus equity is 42.4% as of Sept. 30, 2018 (36.5% reported loan to value [LTV]), and we anticipate that it should stay well below 45% over the next two years.

Deutsche Wohnen has maintained its low cost of debt (1.3% as of Sept. 30, 2018) and maintains a long average debt maturity profile that is greater than seven years as of Sept. 30, 2018. Its ratio of EBITDA to interest is also currently very robust at 5.1x for the rolling 12 months to Sept. 30, 2018, and we anticipate that the company should be able to maintain it well above 3x over the next two years.

Financial summary

Table 2

Deutsche Wohnen SE--Quarterly Data*						
Industry Sector: Real Estate Investment Trust or Company						
	2018			2017		
	September	June	March	December	September	June
(Mil. €)						
Revenues	901.7	888.5	878.0	864.9	839.3	818.2
EBITDA	588.5	575.6	561.8	552.5	554.5	548.6
Funds from operations (FFO)	446.0	433.2	420.1	400.2	383.1	379.6
Interest expense	112.9	113.3	109.2	120.6	129.4	129.6
Net income from continuing operations	1,770.5	1,700.4	1,773.9	1,717.9	1,644.6	1,625.9
Cash flow from operations	497.6	568.4	506.0	520.6	154.2	149.7
Capital expenditures	276.1	252.1	240.0	227.4	208.6	182.0
Dividends paid	202.3	7.9	268.1	268.1	268.3	274.1
Cash and short-term investments	674.2	489.3	350.6	363.7	395.0	323.1
Debt	7,919.3	7,103.8	6,980.9	6,931.4	6,550.5	6,511.3
Equity	10,775.1	10,582.3	10,316.2	10,211.0	9,146.6	9,111.8
Valuation of investment property	21,720.0	21,028.1	20,077.9	19,952.9	18,316.9	17,768.2
Adjusted ratios						
EBITDA margin (%)	65.3	64.8	64.0	63.9	66.1	67.0
Return on capital (%)	3.0	3.0	3.1	3.1	3.5	3.4
EBITDA interest coverage (x)	5.2	5.1	5.1	4.6	4.3	4.2
Debt/EBITDA (x)	13.5	12.3	12.4	12.5	11.8	11.9

Table 2

Deutsche Wohnen SE--Quarterly Data* (cont.)						
Industry Sector: Real Estate Investment Trust or Company						
	2018			2017		
	September	June	March	December	September	June
(Mil. €)						
Debt/debt and equity (%)	42.4	40.2	40.4	40.4	41.7	41.7

*Rolling 12 months' data.

Liquidity: Adequate

We assess Deutsche Wohnen's liquidity as adequate, supported by our forecast that the company's liquidity sources will exceed by more than 1.2x over the next 12 months to Oct. 1, 2018.

Our assessment of liquidity is supported by Deutsche Wohnen's good track record of accessing the equity and capital markets and its strong relationships with German banks.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • About €228.6 million of unrestricted cash available and an addition of around €400 million of undrawn committed bank lines, maturing in more than 12 months; • Our forecast of about €450 million to €470 million of cash funds from operations; and • Committed funding for acquisitions of a total of approximately €500 million. 	<ul style="list-style-type: none"> • About €56 million of short-term debt maturities, including debt amortization; • Roughly €300 million of capex spending for the next 12 months, albeit we understand that most of it is not committed; and • €680 million of committed acquisitions, related to residential, as well as the nursing home business.

Debt maturities

Deutsche Wohnen SE -- Debt Maturities	
(Mil. €)	
2019	17
2020	615
2021	162
2022	568
Thereafter	7,183
Total debt	8,545

Covenant Analysis

Compliance expectations

We expect that the company will maintain adequate headroom (greater than 10%) under all remaining covenants.

Requirements

Most of the company's bank debt facilities were granted for the purpose of financing real estate assets. Loan agreements are therefore mostly secured by land charges and assignments of rental payments, and most of them include financial covenants, such as LTV ratios, a debt service coverage ratio, and exit yields or multiples ratios.

In addition, the company has covenants under documentation for its outstanding corporate bonds, mainly relating to interest coverage ratio (greater than 1.8x) and the LTV ratio (at less than 60%).

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Sept. 30, 2018, the company's capital structure comprises 67% secured debt and 33% unsecured debt. Unsecured bonds are issued under Deutsche Wohnen SE.

Analytical conclusions

The issue ratings on Deutsche Wohnen's senior unsecured debt are currently rated at 'A-', in line with the long-term issuer credit rating. The company's ratio of secured debt to total fair value assets as of Sept. 30, 2018, was 25%, well below our threshold of 40%.

Reconciliation

Table 3

Reconciliation Of Deutsche Wohnen SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)										
--Rolling 12 months ended Sept. 30, 2018--										
Deutsche Wohnen SE reported amounts.										
	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditures
Reported	8,591.5	10,434.0	901.7	621.6	2,802.0	111.2	621.6	495.2	202.3	276.1
S&P Global Ratings' adjustments										
Interest expense (reported)	--	--	--	--	--	--	(111.2)	--	--	--
Interest income (reported)	--	--	--	--	--	--	3.5	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(32.6)	--	--	--
Operating leases	6.8	--	--	2.0	0.5	0.5	1.5	1.5	--	--

Table 3

Reconciliation Of Deutsche Wohnen SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)										
Postretirement benefit obligations/deferred compensation	56.3	(1.3)	--	--	--	1.2	(1.7)	1.1	--	--
Surplus cash	(624.3)	--	--	--	--	--	--	--	--	--
Dividends received from equity investments	--	--	--	0.2	--	--	0.2	--	--	--
Non-operating income (expense)	--	--	--	--	6.4	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	(0.2)	--	--
Non-controlling Interest/Minority interest	--	342.4	--	--	--	--	--	--	--	--
Debt - Fair value adjustments	(114.4)	--	--	--	--	--	--	--	--	--
Debt - Put options on minority stakes	3.4	--	--	--	--	--	--	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	--	(35.3)	(35.3)	--	(35.3)	--	--	--
D&A - Asset Valuation gains/(losses)	--	--	--	--	(2,188.6)	--	--	--	--	--
Total adjustments	(672.2)	341.1	0.0	(33.1)	(2,217.0)	1.7	(175.6)	2.4	0.0	0.0
S&P Global Ratings' adjusted amounts										
	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from Operations	Cash flow from operations	Dividends paid	Capital expenditures
Adjusted	7,919.3	10,775.1	901.7	588.5	585.0	112.9	446.0	497.6	202.3	276.1

Ratings Score Snapshot

Issuer Credit Rating

A-/Stable/A-2

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: a-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of November 28, 2018)

Deutsche Wohnen SE

Issuer Credit Rating

A-/Stable/A-2

Ratings Detail (As Of November 28, 2018) (cont.)

Senior Unsecured	A-
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Issuer Credit Ratings History

09-Dec-2016	A-/Stable/A-2
11-Feb-2016	A-/Stable/--
15-Oct-2015	A-/Watch Neg/--
18-Jun-2015	A-/Stable/--
20-Apr-2015	BBB+/Stable/--
17-Feb-2015	BBB+/Watch Neg/--
25-Nov-2014	BBB+/Stable/--

*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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