

Servicer Evaluation: Hatfield Philips International Ltd. And Hatfield Philips Deutschland GmbH

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Opinion

Standard & Poor's Ratings Services' overall rankings on Hatfield Philips International Ltd. (HPI) and Hatfield Philips Deutschland GmbH (HPD) are AVERAGE as primary and special servicers of commercial mortgages in the U.K. and Germany.

The rankings reflect our view of the following:

- HPI is an established primary servicer of commercial mortgages in a pan-European context. Special servicing activity has increased in line with market trends and we understand that HPI and HPD are increasing resources to meet this challenge.
- HPI and HPD are increasing their marketing activity with a view to obtaining new instructions for additional business and we understand they are encouraged by their early progress. Since our last report, they have however received no new instructions.
- HPI and HPD have placed increased emphasis on staff retention and training, and for the period under review we have noted a reduction in staff turnover from previous years.
- Due to internal changes at the parent entity, LNR Property Holdings, the scheduled audit of HPI and HPD did not take place in 2009. We understand that the company has taken steps to remedy this, but we have not yet seen a full audit report.
- HPI made a new senior appointment in 2009—that of Compliance Director—and established a formal team of eight with the stated aim of increasing vigilance in this area.
- There has been a significant increase in the number of loans on the Commercial Mortgage Securities Association (CMSA) watchlist and loans transferred into special servicing. In our view, this highlights the challenging market conditions for commercial real estate at present and the increasing pressures that this will present for HPI and HPD in 2010 and beyond.
- The continued rollout of the operating IT system, Cassiopae, has continued and about 50% of all loans have now been migrated onto it. HPI and HPD advise us that they will continue the migration process and are scheduled to complete this in 2010.

Outlook

The outlook is negative for primary and special servicing for both HPI and HPD.

In this report, we comment on the delay in the internal audit beyond the three-year cycle which HPI and HPD had established. We consider this to present a considerable operational risk. We have, however, received a copy of the 2010 audit plan, which upon implementation may go some way toward mitigating this risk.

We also note the rapid increase in the number of loans on the CMSA watchlist which HPI and HPD maintains, as well as a further substantial increase in loans being specially serviced. HPI and HPD have increased staff resources in

these areas, but it is our view that significant further growth across these two areas would place further pressures on both primary and special servicing activity.

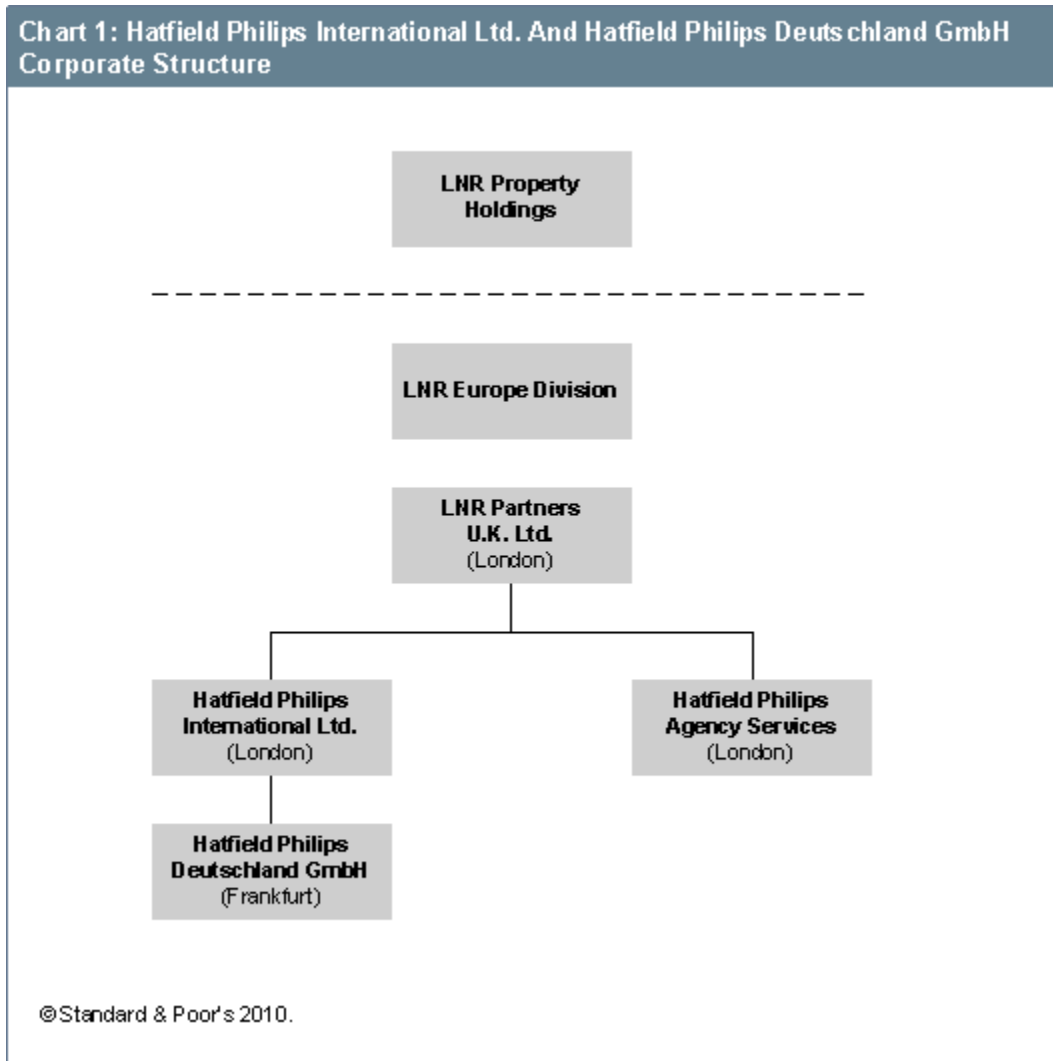
Company Profile

Hatfield Philips International Ltd. (HPI) was incorporated in 1997, and was a subsidiary of Hatfield Philips, Inc. (U.S.) until March 2003. In July 2004, it became a wholly owned subsidiary of LNR Partners Europe, a member of LNR Property Holdings. LNR Property Holdings was acquired in turn by Cerberus Capital Management and its real estate affiliate, Blackacre Capital Management LLC, in February 2005. LNR Partners Inc. retains a ranking of STRONG as a special servicer in the U.S.

HPI has its principal office in London and HPD is based in Frankfurt. They offer third-party primary and special servicing loan operations across Germany, the U.K., and Europe. From working principally for Lehman Brothers from its formation in 1997 through to 2007, HPI has experienced growth in the securitization portion of its primary servicing business. In addition to the Lehman Brothers structured vehicles, the client base now also includes Credit Suisse, ABN Amro, Societe Generale, Royal Bank of Scotland, IXIS, Goldman Sachs, Deutsche Postbank, and Santander.

Corporate Structure

Chart 1 shows the corporate structure for HPI and HPD.



Management And Organization

The ranking is AVERAGE for management and organization.

Strategy

HPI and HPD regularly review their strategic offerings and have looked to reposition themselves within the markets they operate in, with a view to taking advantage of their experience and market knowledge.

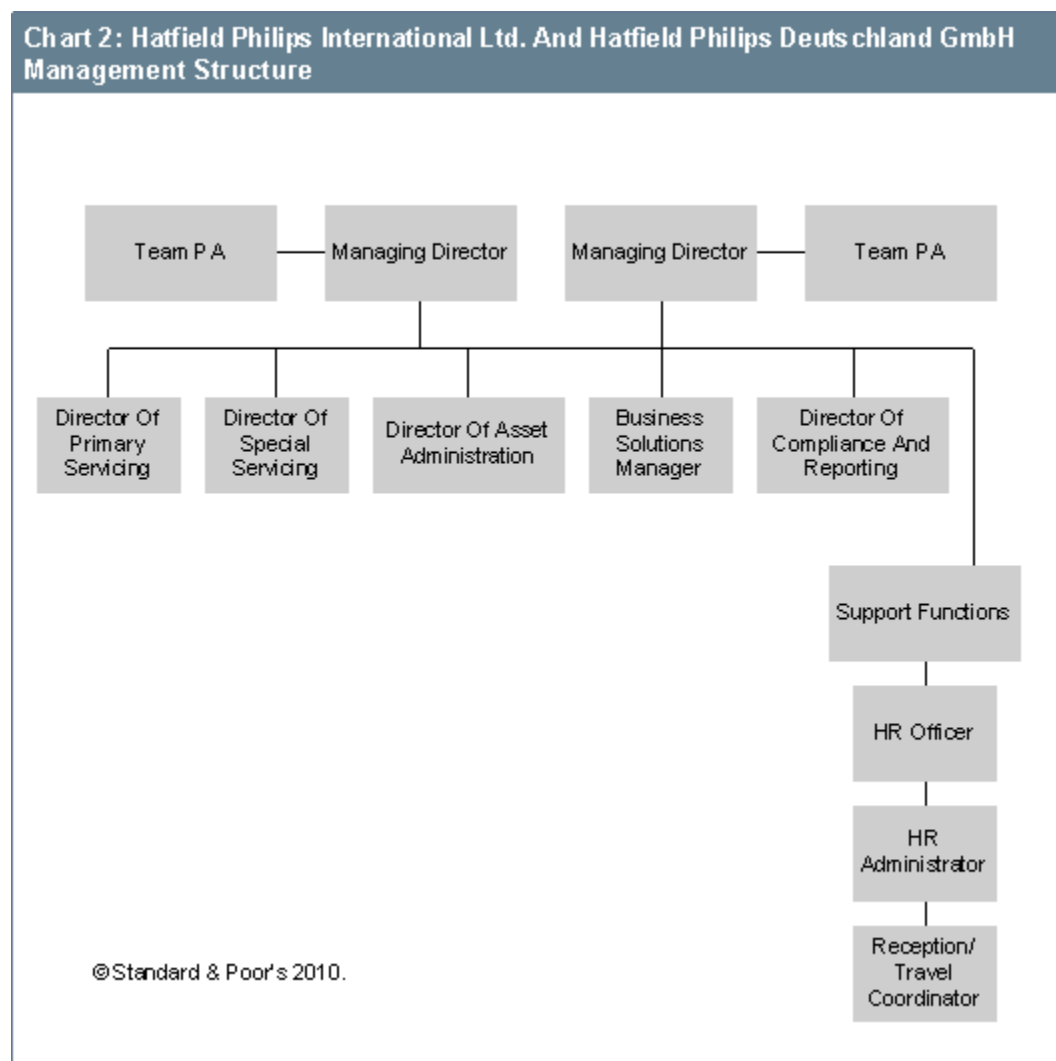
Both companies appear to be placing increased focus on marketing their offerings and we understand that they are in regular communication with existing and potential clients to ascertain what new business opportunities are open to them. They have employed a public relations company to assist with these marketing initiatives. To date, no new business has been obtained but HPI and HPD report that they are encouraged by the leads which the activity has generated.

HPI has created Hatfield Philips Agent Services (HPAS), which provides security and facility agent roles for

Lehman's Windermere and Excalibur programs. Once HPAS has completed migration of the agency roles for these programs (approximately 100 loans in total) from their current entities, it intends to roll this service out to the EU market. It recently started marketing these services and there have been some initial enquiries, which has encouraged HPI. We do not rank HPI for this activity.

Staff

Chart 2 shows the management structure.



There have been no significant changes to the corporate structure since our last review, although HPAS has been incorporated to facilitate the agency business now being undertaken (see chart 1 above). The management structure is largely unchanged, with the exception of the new post of Compliance Director (see chart 2). We comment further on this appointment later in this report.

The Human Resources department has a staff of five. It is principally a function under the control of HPI and HPD's parent, LNR, but the department is outsourced to HPI and HPD as required. Three of the team are based in London and two in Frankfurt, and in our view there is adequate resource to cover HR requirements in both jurisdictions.

There were 11 departures from HPI/HPD in 2009: three at senior/middle management level and eight at a lower level. Seven of the 11 were voluntary departures and all were within the primary servicing area. Consequently, staff turnover equates to about 15.3%, which is a reduction from previous years and is broadly in line with what we would expect of a servicer with an AVERAGE ranking.

There were 24 new hires over the same period, taking the total number of staff as of Dec. 31, 2009 to 85, of which 72 are based in the U.K. and 13 in Germany. Three of the hires were at senior/middle management level. The special servicing teams in London and Frankfurt have both been expanded to cope with the increased number of loans transferred into special servicing.

HPI/HPD undertakes staff appraisals annually, although we understand staff also receive more frequent one-to-one sessions. The company intends to introduce a staff survey for the first time in 2010. An external HR advisor has assisted in drawing the survey up. We view this as a positive step in maintaining communication between management and staff.

There has been increased emphasis on staff retention and the performance-related bonus scheme has been redesigned to increase emphasis on retention. HPI/HPD has a policy of promoting from within the organization where possible. There were a total of 11 promotions in 2009. In our view, this further promotes staff retention.

The analyst roles which existed have been extended and renamed as Associate Manager, a job title which HPI/HPD believes is more reflective of the new role. HPI and HPD believe this has enhanced employees' skills both individually and collectively.

HPI/HPD has also created the role of Portfolio Manager, whose function is to monitor the performance of the securitization teams with the aim of increasing consistency and effectiveness.

Table 1 shows the average industry experience and tenure of the staff by seniority. In terms of both industry experience and company tenure, the average numbers of years across HPI and HPD is appropriate to the ranking of AVERAGE.

Table 1

Industry Experience And Tenure		
Staff	Industry experience (years)	Company tenure (years)
Senior managers	26	9
Middle managers	10	2
Staff	6	2

Training and development

The number of training hours which staff are required to undertake has increased from previous years in line with corporate aspirations, from about 40 to 50 hours per employee. HPI and HPD have a stated commitment to staff training at all levels.

During 2010, HPI and HPD propose to run a series of courses with an emphasis on "soft" skills such as presentation and people-management skills.

In 2007, HPI employed six staff under an accredited Royal Institute of Chartered Surveyor (RICS) graduate scheme, which involved participants undertaking a two-year program incorporating six-month rotations in key operational

areas. Five of the six graduates have remained with the company through to completion of the program and are now fully integrated into HPI as full members of the RICS. The company's view is that the scheme has been a success and one which it will continue into the future, albeit with some minor modifications based on the experiences of the initial intake.

In our view, the company is at a size where it would benefit from a dedicated training manager. At present, this task is allocated to a member of the HR team who is not a specialist "trainer".

Audit

In our last report, HPI/HPD had advised us that an internal audit was scheduled for May 2009. Due to personnel changes at LNR in the U.S. at senior auditor level, the audit did not take place. Following the appointment at LNR of a new senior auditor, a review took place at the beginning of 2010 and we have received a copy of the outcome of the review. It indicates that there were no findings which the auditor considered would present operational difficulties.

In our opinion, the report is less comprehensive than we would normally expect particularly given that HPI and HPD are subjected to audits on a three-year cycle. We therefore consider that the timeframe since the last formal audit in 2006 creates an operational risk to HPI and HPD, and this has affected our outlook opinion.

We have received a copy of an audit plan for 2010, which has been produced by the compliance team. This appears robust and thorough, although we recognize that it is intended to supplement rather than replace the formal internal audit cycle carried out through a reporting line which is distinct from operational areas.

Going forward, LNR intends for its audit team in the U.S. to work closely with the compliance team at HPI/HPD in Europe. The senior auditor aims to have regular reviews to make the whole process more robust. With this arrangement in place, HPI/HPD does not consider it necessary to shorten the three-year cycle. The senior auditor did, however, indicate that the cycle would be reviewed and potentially shortened if there were any significant findings arising from the reviews.

Risk/Compliance

In the first half of 2009, HPI newly appointed a Compliance Director, and a team of eight now report to him. The team members have a complementary range of skills including legal and risk management.

The members of the team are not all new HPI appointments. Some have relocated from the primary and special servicing teams, having previously had a less direct compliance role within these areas. Since the appointment of the Director and the establishment of the team, an "audit-style" review has taken place across all business areas with emphasis on risk and procedures. As a consequence of the review, the company has implemented a number of changes or is continuing to do so. In our opinion, a dedicated compliance function will strengthen risk management and compliance, not only for the servicing of loans, but also for company regulatory requirements.

Policies and procedures

HPI and HPD operate with documented procedures covering all critical functions and processes. They regularly review these procedures, which are available in hard copy and electronically, with the aim of improving the effectiveness of the operation. Each department head and the director of operations must approve any amendments.

We have reviewed a number of the policies and procedures directives (such as watchlist criteria, annual reviews, and bank account operations) and we believe they strike a good balance between operational needs and risk.

There is a separate set of policies and procedures for special servicing, which in our view is appropriate.

Operating procedures include delegations of authority and regular meetings, reviews, and credit committees.

The newly established compliance team has undertaken a review of policies and procedures. Policies which have legal or regulatory implications for HPD are available in German; however, the majority are in English only. We understand that HPI is not concerned in this regard, as all HPD staff speak good English, but they do recognize that as a "medium-term" exercise it would be preferable to have all policies and procedures in both languages.

Systems

Staffing numbers in the IT department in HPI London remain unchanged at three, as indicated in our last report. Technology remains integrated with LNR, which provides greater interface among systems, as well as economies of scale. There are six staff within the business solutions department, which is a reduction of one from our last report.

There is a defined Change Management Policy which governs the coordination, control, communication, documentation, reporting, and approval of IT changes, and the company reviewed and revised this in August 2009. Responsibility for the policy sits with the Chief Information Officer at LNR. The policy appears detailed and appropriate to operations, in our opinion.

The two main portal systems that HPI and HPD now use are Inventory and Cassiopae, as detailed below.

Inventory.

- This contains asset-level information, including loan information, loan balance.
- It also provides reporting functionality for asset allocation and workload.
- The .NET application was originally developed by HPI's Business Solutions & Analysis (BSA) Team in 2008.
- There was a functionality upgrade in 2009 to provide additional structured data and reporting.

Cassiopae.

- Cassiopae has been developed as an off-the-shelf product specifically for HPI and HPD. It provides calculations in what HPI/HPD believes to be a consistent and disciplined manner.
- Cassiopae has been in parallel use following initial implementation in 2009. About 50% of the loan portfolios have now been migrated onto the system. Cassiopae has been developed to interface with Inventory and other systems.

HPI/HPD also uses the following systems.

Compliance.

- This tracks loan-level covenant compliance data for HPI loans under management.
- It was originally a Microsoft Access application developed in 2006 by HPI BSA Team/Infosys.
- The system was re-engineered by the BSA Team to a .NET application in 2007.
- There were functional improvements in 2009, including synchronization of loan details with Inventory.

Compliance Dashboard.

- This is an interactive reporting tool that provides a snapshot of real-time summary data from the Compliance application. The data can be filtered by client, asset manager, loan, or covenant.

- Summary data has drill-down capability for more detail.
- The system was originally developed by HPI BSA Team in February 2007.

RED Database.

- This is a reporting database currently used to produce CMSA reports for HPI's securitized portfolios.
- It contains detailed property-level data, including property financial and tenant data.
- The system is a Microsoft Access-based application originally developed by a former consultant in 2004.
- In 2006, BSA documented the database and updated it to accommodate CMSA European file formats.
- The system is fully supported by HPI's BSA team as of January 2006.

Red Views.

- This is a reporting repository primarily used by Investor Reporting that contains data from the CMSA files.
- It facilitates the creation of ad hoc queries for analysis and validation to ensure data integrity.
- The user interface has an easy-to-use drag-and-drop facility including pivoting and filtering tools.
- Data is accessed via BRIO or Microsoft Excel Query.
- The system was originally developed by HPI BSA Team in April 2007.

RADAR Database.

- This is a reporting repository for HPI loans under management developed with standard reports.
- This application was not fully implemented except for the HR module, which is still in use.
- The system is a Microsoft Access application developed by a former consultant in 2005.

Target.

- This is a loan servicing platform implemented in 2004.
- It was implemented, hosted, and supported by Vendor using a "Software as a Service" approach.

Links.

- This is a portfolio management application used for German loans under management.
- It is a .NET application originally developed by Infosys in 2007.
- The system is subsequently supported by HPI's BSA team.

We understand that there is a quarterly security audit for all of the above processes. HPI also informs us that there are appropriate firewalls and intrusion detection systems in place. Intrusion detection was last tested in September 2009, and we understand the results were successful.

HPI/HPD considers that there is current systems capacity for a 50% increase in business levels, which we believe should facilitate corporate growth plans if they can be achieved.

In our opinion, the phased rollout of Cassiopae should provide HPI and HPD with tangible operational benefits and increase automation, and therefore is likely in our view to improve workflows and risk control.

Business continuity/Disaster recovery plan

HPI/HPD last fully reviewed and updated the business continuity/disaster recovery plan in February 2008, but we understand that it makes routine necessary changes as required. The last test was in October 2009 for business

continuity and in November 2009 for disaster recovery, and we understand there were no major issues arising from either test.

The IT department at LNR has ultimate responsibility for the plan under the guidance of the LNR technology leadership committee. Within HPI, two teams have been established: the business continuity critical team and the business continuity team.

The "critical" team assesses potential situations and identifies whether the plan needs to be activated. The business continuity team is responsible for the activation, management, and communication to all staff of the business continuity plan.

Because of this level of security and preparedness, LNR believes that the London data center will withstand all but the most catastrophic events. With this in mind, the strategic objectives of the technical disaster recovery plan for LNR have moved toward High Availability solutions, rather than a traditional Hot-Site solution. The High Availability strategy includes the incorporation of redundant hardware and application systems. This redundancy has the added advantage and capability for load balancing—thus making use of the disaster recovery equipment to enhance the day-to-day delivery of application services.

LNR, however, continues to maintain a "backup and restore" strategy for those major catastrophic events where the entire geographic region is lost, or the building is compromised. Two corporate sites are potential recovery sites for the Europe's critical systems—the Newport Beach CPG Division and Miami Data Center locations.

LNR has categorized disaster scenarios as minor, major, or catastrophic, and it anticipates outage accordingly at 1-12 hours, 1-10 days, and over 10 days.

Plans are available both on and off site and on the company intranet, so all staff has access to it.

Loan Administration

The ranking is AVERAGE on HPI and HPD for loan administration.

Primary Servicing

The number of loans in primary servicing has reduced to 216 from 279, as indicated in table 2. The approximate gross book value (GBV) of the 216 loans is £24,826 million. Nearly 140 of these loans are scheduled to be repaid between now and 2012, so we expect that primary servicing activity will step up considerably in this period.

Table 2

Primary Servicing					
Portfolio under management	2009	2008	2007	2006	2005
Value (mil. £)	24.826	32.607	33.564	18.554	7.882
Number of loans	216	279	349	110	48
Number of properties	3,695	4,738	5,469	1,415	400
Special Servicing					
Portfolio under management	2009	2008	2007	2006	2005
Value (mil. £)	3,300.0	1,750.0	103.6	81.4	N/A

Table 2

Primary Servicing (cont.)					
Number of loans	33	10	3	3	N/A
Number of properties	554	403	4	6	N/A

N/A—Not applicable.

The number of staff in primary servicing is now 37, with 32 of those at HPI and the remainder at HPD. We are advised that the team has multi-jurisdictional and language capabilities. The company undertakes a number of more routine administrative tasks in London.

The companies have advised us that in their opinion, the role of a loan manager in primary servicing has evolved over the past couple of years from an administrative function to a more time-consuming and technically demanding, surveillance-type activity. This has resulted in HPI and HPD reducing the number of loans each loan manager has responsibility for. They introduced a daily activity log in 2009, which assists management in monitoring workloads and aims to ensure that higher-risk issues are dealt with in a timely manner.

HPI and HPD inform us that there is increasingly more dialogue now between the loan managers and borrowers as the loan manager's role has developed, this being actively encouraged by management. A key aspect of the loan manager role is meeting borrowers and undertaking property inspections. We understand that a total of 404 inspections took place in the second half of 2009 and that HPI and HPD review property tenancy schedules at a minimum quarterly.

The geographical split on the loans remains predominantly toward Germany (55% by € balance—down from 60.7% last year) and U.K. (21%—up from 18%). There are a number of other loans in other jurisdictions, such as France.

HPI and HPD introduced a borrower template in March 2009, the aim being to standardize the manner in which borrowers submit key information. All borrowers now use the template and the companies have noted the benefits of receiving concise, relevant data in a uniform format.

A committee operates to review loans which are on the watchlist, and this sits on a monthly basis. This committee does not necessarily review loans individually, but if any issues arise regarding specific loans, then they are escalated to the credit committee.

Credit committees are convened weekly, monthly, and as required for reviews and report sign-offs, such as quarterly asset summaries, and semiannual and annual credit reviews. In addition, management meetings are held weekly, and monthly team meetings include a general review of all accounts, the watchlist, and new transactions in the pipeline.

As of Dec. 31, 2009, there were 92 loans on the CMSA watchlist and a further 36 on an internal watchlist that HPI/HPD maintains. There are now 17 members of staff within the primary servicing team who are allocated to the management of the watchlist. The number of loans has grown considerably since our last report, when there were 38 loans on the CMSA watchlist. The majority of the current watchlist loans are for covenant breach (24) and for pending loan maturity (27). HPI/HPD grades the loans depending on their perception of the risks presented by the loan. We are advised that all loans on the watchlist are reviewed individually and escalated to credit committee if it is felt necessary.

The company also tracks the potential migration of loans from primary to special servicing using the watchlist

process as a barometer.

HPI and HPD inform us that they review all loans at a minimum annually, including those not on the watchlist, but that many are reviewed more regularly than this. The forum for the review is a credit committee, which comprises senior staff members as well as representatives from compliance.

We have reviewed a sample of credit committee papers. In our view, they would benefit from some streamlining, to enable the key information to be presented in a standardized manner.

Special Servicing

HPI and HPD have provided us with a flow chart covering the process they follow when a loan is to be transferred from primary to special servicing. We understand that the introduction of Cassiopae has brought systems benefits to special servicing, enabling the company to replace the previous Excel-based spreadsheets with an automated system, which has improved workflow between primary and special servicing. We expect that this will benefit HPI and HPD operationally.

Staffing numbers in special servicing has increased to 17, with nine in the U.K. and eight in Frankfurt. The teams are headed by two directors, one in each office. In addition to permanent staff, HPI/HPD has in the recent past employed staff on a fixed-term contract basis if it considers this will benefit workout activity. The companies believe that this flexible approach allows them to recruit individuals as required, with skills that may be suited to individual loans.

The special servicing directors participate in primary credit and watchlist committees. We consider this beneficial from a workflow planning perspective in terms of understanding how many loans could be transferred into special servicing, as well as the likely timescale and the nature of the loans/assets.

As of Dec. 31, 2009, there were 33 loans in special servicing, secured on 554 properties and with total unpaid principal balances of about £3.3 billion. When we published our last report, there were 10 loans in special servicing, totaling £1.75 billion. We also note that an increasing number of loans have been in special servicing for in excess of one year. In our opinion, the increasing numbers and the more prolonged workout periods highlight the challenges which HPI and HPD face. There were seven loan resolutions in 2009.

We reviewed samples of special servicing committee papers. The special servicing committee comprises experienced members of senior management and, as with primary committees, includes a representative of the compliance team. In our opinion, the inclusion of a committee member with a background in compliance is a prudent approach to take.

As with the primary servicing credit committee papers, we believe that those used for special servicing committees would benefit from streamlining and being formatted in a uniform manner.

Investor And Third-Party Reporting

In our last report, we indicated our view that reporting had improved over the previous year.

Investor reporting includes:

- Loan-level financial covenants (ICR, DSCR, and LTV);
- Loan-level ratio commentaries;
- Original loan summary/current loan/property/tenancy commentaries;
- Deal summaries;
- A contact page; and
- ECB data, when requested.

HPI and HPD look to issue reports approximately five days after quarterly bond payment dates. Access to the reports is also available via a secure website managed by Bank of America. We understand that this timescale is extremely responsive but can sometimes require HPI and HPD to report any data that may be missing at a later date.

The reporting process has been further automated using the Hyperion system. There are currently five staff in the investor reporting team.

During 2009, HPI and HPD have taken steps toward the formalization of processes which involves the publication of special notices to the investor market. We believe that this is a positive step in standardizing the communication process.

We understand that HPI and HPD target staff to respond to investor calls within one business day of receipt, which in our view is a proactive approach.

Insurance

We have reviewed copies of insurance schedules and these appear to cover the business risks we would expect with appropriate levels of cover.

Financial Position

We admit servicers to our Select Servicer List based on a number of factors, including our assessment of each firm's ability to maintain a SUFFICIENT financial position. We have removed HPI and HPD from our Select Servicer List because LNR Property Corp. (the ultimate parent of the servicers) currently does not meet our criteria to maintain a SUFFICIENT financial position (see "Related Criteria And Research").

The action is a consequence of our CCC/Watch Neg/-- rating on LNR Property Corp. and LNR Property Holdings (see "Related Criteria And Research"). In line with our criteria, a rating at this level is insufficient for us to allow HPI and HPD on our Select Servicer List.

This opinion does not replace that of a senior debt or counterparty credit rating on LNR Property Corp. and LNR Property Holdings.

Related Criteria And Research

- Standard & Poor's Revises Criteria Methodology For Servicer Risk Assessment, May 28, 2009
- Servicer Evaluation Ranking Criteria: U.S., Sept. 21, 2004

- Structured Finance Sector Report Card: How European Servicers Are Reacting To The Challenges Of The Economic Environment, April 21, 2010
- Structured Finance Sector Report Card: Low Lending Levels Continue To Constrain European Servicers' Portfolio Growth, Nov. 23, 2009
- LNR Property Corp. Ratings Placed On CreditWatch Negative Because Of Covenant Concerns, April 8, 2010
- Hatfield Philips International And Hatfield Philips Deutschland Removed From Select Servicer List, April 1, 2010
- Servicer Evaluation: Hatfield Philips International Ltd. And Hatfield Philips Deutschland GmbH, April 30, 2009
- Select Servicer List, published monthly

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