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## Queen's University

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# Queen's University

## Rationale

The ratings on Queen's University, in Kingston, Ont., reflect Standard & Poor's Ratings Services' opinion of the university's strong enrollment demand profile, comprehensive course offerings, significant unrestricted financial resources, good government support, and broadening revenue diversity. In our view, Queen's tight budgetary environment and significant postemployment liabilities offset these strengths somewhat. However, we believe the university made positive changes to its pension plan funding through increased employee contributions and that it is making good progress toward addressing its forecast operating fund deficits. Moreover, we believe it has sizable financial resources it could draw on to meet financial deficits.

### Issuer Credit Rating

AA+/Stable/--

Queen's is a medium-size university with comprehensive program offerings (undergraduate and graduate arts and sciences, business, health sciences [including medicine], engineering, and law). It has a steadily increasing student population up 2.8% since the previous year with 22,518 full-time equivalent students (FTEs) in fall 2013.

In our opinion, the university benefits from strong enrollment demand, exceptional student quality, and high matriculation rates, which support its strong enterprise profile. Queen's first-year students had an average entry grade of about 88.9% for fall 2013, and its offer rate (the ratio of offers to applicants) was the lowest of its rated peers, at 41%.

The university's balance sheet gets a boost from its C\$376 million in unrestricted financial resources, which we calculate as internally restricted financial resources net of invested capital assets and pension liabilities and adding internally restricted endowments. This is one of the highest levels per FTE of its Canadian peers at C\$17,163. Queen's unrestricted financial resources are 170% of debt outstanding. Its significant unrestricted financial resources provides it with comparatively more financial flexibility than it peers and is a key credit strength, in our opinion.

Queen's is broadening its revenue diversity by introducing additional professional programs, laddered credentials, and programs to attract and retain international students (whose tuition is not subject to a regulatory cap).

In our view, offsetting its credit strengths are large increases in legislated pension deficit payments following the solvency payment exemption period, although this lies outside our two-year rating horizon. Queen's is making C\$14.4 million payments annually in respect of its going-concern deficit, as determined by the university's most recent pension plan valuation filed as of August 2011. It must file its next valuation as of August 2014, which will determine the university's going-concern payments starting after filing, and its solvency deficit payments that will start after the solvency exemption period ends as early as September 2015 (although this could be extended three years). If Queen's were to face large total pension payments in 2016 that put pressure on financial results and ultimately eroded the university's financial assets significantly, we could revise our outlook to negative. However, we require more clarity on the pension payments before taking any rating action.

In the past two years, Queen's has taken what we consider to be significant measures to mitigate the impact of its unfunded pension liabilities, which have risen to significant levels due to historically low discount rates and turbulent

capital markets. Of note, it has struck agreements with unions to raise employee pension contributions. It has also received support from the Province of Ontario in the form of a three-year solvency exemption, followed by a lengthened solvency deficit amortization window of 10 years (up from five), subject to it meeting certain conditions. A proposed amendment to the Pension Benefits Act would extend this exemption from solvency payments for an additional three years, but reduce the subsequent amortization period to seven.

Separately, Queen's has undertaken cost-reduction initiatives and new governance measures. These initiatives have improved the university's financial balance, and it posted its first consolidated surplus since 2008 (previous budgets had been balanced only after the drawdown of reserves). As part of its new budget model, Queen's will allocate revenues and expenses to the academic unit responsible for generating them. We expect this to lead some departments to amass reserves in some years and draw them down in others. As such, we expect to see fluctuations in the university's internally restricted financial assets as departments save and spend. This is a contrast from previous years, when Queen's drew down unrestricted net assets to meet what we considered to be structural operating deficits. We believe the magnitude of the pressure on internally restricted assets has eased substantially compared with the previous four years, which will better enable the university to maintain the strong net creditor position that makes it stand out financially from its Canadian university peers.

In accordance with our criteria for government-related entities, our view of Queen's "moderately high" likelihood of extraordinary government support reflects our assessment of its "important" role in the province, given that postsecondary education is one of Ontario's top priorities in both expenditure and mandate (after health care and school boards), and there are no viable private alternatives. The province's oversight, program approval rights, and tuition regulation over Queen's suggests a "strong link" with the province, in our judgment.

We have also used the "Principles Of Credit Ratings" in conjunction with "USPF Criteria: Higher Education" as our criteria foundation for our analysis of the university's creditworthiness. We feel that there is a sufficient degree of similarity between U.S. and Canadian public university systems such that we believe the U.S. higher education criteria is an appropriate methodology for evaluating Canadian universities' credit quality.

## Liquidity

We believe that Queen's exhibits "moderate" liquidity. It had unrestricted financial resources of about C\$376 million in 2013, compared with operating expenses of about C\$436 million or about 86% of operating expenses and 170% of debt outstanding. The university has a policy of maintaining minimal cash balances with single counterparties. Cash balances are now invested in diversified investments to reduce Queen's counterparty exposure. In fiscal 2013, the university had C\$46.8 million cash on its balance sheet. It also had investments of C\$931.1 million.

## Outlook

The stable outlook reflects our expectations that Queen's will continue its progress toward balancing its operating budget and not materially erode its unrestricted financial resources or increase its debt level beyond its planned issuance in respect of two new residences. We also assume the province will not significantly cut the university's funding or substantially alter the sector's tuition-setting regime. We could revise the outlook to negative, all else being equal, if Queen's suffers material setbacks in its efforts to eliminate its budget imbalance, or we come to expect its

legislated pension deficit payment obligations will rise significantly and will erode financial assets once the solvency exemption period ends. We consider the possibility of a positive rating action during our two-year outlook horizon unlikely, given the university's tight operating environment.

## Rating Methodology: Government Support And Government-Related Entity Criteria

In accordance with our criteria for government-related entities, our view of Queen's "moderately high" likelihood of extraordinary government support reflects our assessment of its "important" role in the province, given that postsecondary education is one of Ontario's top priorities in both expenditure and mandate (after health care and school boards), and there are no viable private alternatives. Our view also reflects the university's role as one of Canada's most reputable, and its significant research capacity. The province's oversight, program approval rights, and tuition regulation over Queen's suggests a "strong" link with the province, in our judgment. The government, while not a shareholder, has a policy supported by a track record of providing financial support to Ontario universities. Government grants account for about half the university's consolidated revenues.

Our stand-alone rating on Queen's incorporates the province's ongoing financial support as well as our view of the university's strong enterprise and financial profiles. It also incorporates Queen's "important" public policy role, particularly in eastern Ontario; its independent board and overall strong governance structure; and its substantial endowment. Although Ontario is facing significant fiscal challenges as it attempts to rein in a C\$14 billion deficit, we believe that postsecondary education will remain a top priority for the province and that overall support for the university sector will remain fairly stable.

Our rating on Queen's is two notches above that on its supporting government. The difference reflects our view of the university's independence from the government and the substantial size of its financial assets. We believe there is a measureable likelihood that Queen's financial resources would be sufficient to meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to the university. In addition, the difference reflects the university's ownership structure in which the government is neither an owner nor shareholder.

## Enterprise Profile

### University demand and enrollment

Established by Royal Charter in 1841, Queen's is a medium-size university with comprehensive program offerings (undergraduate and graduate arts and sciences, business, health sciences including medicine, engineering and law).

In our opinion, Queen's benefits from strong enrollment demand, exceptional student quality, and high matriculation rates, which support its competitive position. It had 21,904 FTEs in fiscal 2013, up 14.7% since 2008. This partially reflected graduate expansion efforts, which the university undertook alongside other Ontario universities following the province's promise to fund more graduate spaces. Queen's graduate students accounted for about 17.4% of total enrollment. Preliminary enrollment numbers indicate that FTEs will rise to 22,518 in fiscal 2014, and management

expects applications for fall 2015 to be strong.

The university's first-year students had an average entry grade of 88.9% for fall 2013. In fall 2012, its first year undergraduate offer rate (the ratio of offers to applicants) was the lowest of its peers, at 41.1%, while its ratio of acceptances to applicants was similar to those of its peers at 17.5%. The 2011 graduation rate at Queen's was what we view as high, at 88.9%. The university's first-year retention rate was 94.5% in 2012. Matriculation rates are 43%.

Although Queen's primarily draws students from Ontario, we think that its domestic and rising international reputation will continue to favorably affect enrollment demand and support greater geographic diversity. In particular, the university has made efforts to attract and support international students by putting in place English-as-a-second-language resources and bridging programs for international students.

## Management

Queen's is governed by three bodies including the board of trustees, the senate, and the university council. The university secretariat administers all three.

The board is responsible for Queen's overall operations, including overseeing financial matters, property, appointing vice-principals, and appointing (in conjunction with the senate), the principal. The board has 25 members: three ex-officio and 22 elected. It functions through a standing committee structure.

The senate is responsible for determining matters of academic character affecting the university, including student discipline. It has 68 members: 15 ex-officio and 53 elected. It functions through a standing committee structure consisting of 17 committees.

The university council was established by statute in 1874. Alumni elect its members. The council serves as both an advisory and ambassadorial body to the university as a whole and is responsible for the chancellor's election. Although it is not directly involved in operations, the council may bring to the senate or board any matter that it believes affects Queen's well-being and prosperity.

Queen's will have a new chancellor beginning in July 2014. Jim Leech, the current president and CEO of the Ontario Teachers' Pension Plan, will replace current chancellor David Dodge.

## Financial Profile

Starting in fiscal 2013, Queen's transitioned to new accounting standards for Canadian not-for-profit organizations. This led to the restatement of the previous year's financial results. For this report, we are reporting year-over-year changes based on the restated fiscal 2012 figures. The most important impacts of the restatements will be on capital assets (due to the remeasurement of land at fair value), liabilities (because the full unfunded status of the pension and other postemployment liabilities were recorded on the balance sheet), and deferred revenue (because of remeasurement of unrealized gains on externally restricted endowments). The total impact was a decrease to net assets of \$64 million. We expect the recognition of pension and investment gains and losses will increase financial statement volatility.

Like all Canadian universities Queen's must carefully balance its revenues and expenses. In 2009, the university posted an operating deficit of C\$51.2 million. Although its finances have improved since then, the university continues to face a difficult financial environment. In fiscal 2013, Queen's posted its first surplus since 2009. While an improvement, the university has forecast an operating deficit of C\$9.3 million in fiscal 2014 and balanced budgets for fiscal 2015 and 2016. It plans to draw down its reserves to meet shortfalls. Its core operating budget typically accounts for 55%-60% of its total university expenditures (its other expenditures relate to ancillary, research, consolidated entities, capital, and trust). Queen's does not prepare consolidated forecasts; rather, it prepares budgets for operations, capital, and ancillary services, the three funds where the university has most discretion in spending.

Queen's responded to its budget pressures with strict cost-containment and strong governance measures. Starting in fiscal 2011, it shifted the onus of funding contractual salary and benefit increases to units from central operations; it froze units' overall budget allotments in fiscal 2012. It also started the joint senate-board Queen's University Planning Committee to discuss key budget issues. The university adopted a new budget model for fiscal 2014, which will allocate revenues and expenses to the academic faculties and schools that generate the revenue. We don't expect this new budget model to increase revenues, but rather make financial units more cognizant of the costs and value of space. Moreover, Queen's has introduced three-year budget projections. Finally, the university has negotiated changes to salaries and benefits (its largest expense) to mitigate risks to financial results.

Queen's, along with other Ontario universities, has been negatively affected by new governmental measures, including reductions to the university's base operating grants and reduced grants based on enrollment of full-time international students and new requirements to meet efficiency targets. In addition, the Government of Ontario's new tuition framework caps yearly increases for undergraduate tuition fees at 3% (down from 5% under the previous framework) and caps the increases in graduate and professional fees to 5% (from 8%). The new framework will be in effect for four years starting in fiscal 2014.

In fiscal 2013, Queen's revenue growth exceeded increases in expenses. The university's consolidated revenues increased 7.5% to C\$799.2 million. The growth was driven by improved investment income and higher fee income. Queen's expenses increased 1% to C\$776.2 million. Salaries and benefits increased by 2.1%. Excess revenues over expenses before changes to employee future benefits remeasurement were C\$23 million; including these, it was C\$67 million.

### **Provincial operating grants and tuition**

In 2013, Queen's received about 44.6% of its total revenues from provincial and federal grants. The province primarily supports Ontario universities through operating grants based on a formula applied per FTE. The province and federal government also provide capital grants and fund research. The level of provincial support Queen's received in 2013 fell slightly from 2012 and is slightly below the average for the previous 10 years (based on government grants and contracts as a percent of total revenues). The province has provided support for Queen's, and other Ontario universities, over many years including through the recent financial downturn. Although the province is facing its own fiscal problems, which has led to declining financial support to the university sector, it has provided nonfinancial support in the form of relief for pension solvency deficit funding.

## Financial resources

Queen's has net assets of C\$823.4 million (C\$710.3 million endowment, C\$282.2 internally restricted assets, and an unrestricted deficiency of C\$169.1 million). Internally restricted assets include C\$244.8 million in invested capital assets. Endowment contributions were C\$23.9 million in 2013. The endowment annual spending rate is based on a modification of the Yale method formula. Given current projections, Queen's expects the payout for the next fiscal year to be approximately 3.5%.

The university manages its pooled endowment fund, pooled investment funds, and sinking funds with different mandates. It manages its pooled investment funds with a slightly more conservative mandate and limits them to Canadian equities, global equities and fixed income. It has a short-term horizon. The pooled investment fund's annual returns were 14.8%, up considerably from 1.5% the previous year. Queen's manages the pooled endowment fund with a long-term horizon, and it has some illiquid assets. The endowment fund asset allocation is 20% domestic equities, 40% foreign equities, 17% fixed income, 10% private equity, 3% hedge funds, and 10% real assets. The endowment fund's annual return was 15.4%, up from a low 1.9% the previous year. The university has an investment committee that determines the strategy for the pooled endowment and investment funds, as well as short-term investments and sinking funds.

## Fundraising

In 2012, Queen's launched its C\$500 million Initiative fundraising campaign. Donations in fiscal 2013 totaled C\$67 million, surpassing the C\$60 million annual goal. To date, the university estimates that it has reached 77% of the C\$500 million goal.

## Liquidity

We believe that Queen's exhibits moderate liquidity. It had unrestricted financial resources of about C\$376 million in 2013, compared with operating expenses of about C\$436 million or about 86% of operating expenses and 170% of debt outstanding. The university has a policy of maintaining minimal cash balances with single counterparties. It invests cash balances in diversified investments to reduce its counterparty exposure. In fiscal 2013, it had C\$46.8 million cash on its balance sheet. It also had investments of C\$931.1 million.

## Debt

As of fiscal 2013, Queen's had debt outstanding of C\$221.1 million, down from C\$227.3 million in 2012. This includes three bullet bonds (one due in 2032 and two in 2040), one amortizing bond (maturing in 2014) and a small mortgage. The university holds C\$42.2 million in sinking funds to repay its three bullet debentures outstanding. We do not net sinking funds from debt; rather, we include the sinking funds in our measure of internally restricted net assets. Queen's 2014 debt repayment will be C\$6.5 million.

The university is incurring additional debt to build residences that would support enrollment growth. It has approved two new residences, which will have 550 beds and an expected cost about C\$70 million. Queen's has entered a loan agreement (total amount C\$70 million) to finance these residences, which it will drawdown until November 2015. The loan is floating-rate, which the university is converting to fixed-rate via an interest rate swap.

Queen's maintains a defined contribution pension plan with a defined-benefit component that provides a minimum level of benefits, which is in a deficit position and requires ongoing deficit payments putting some pressure on the

university's cash flows. As of August 2013, Queen's estimates its going-concern deficit to be C\$108 million on a market basis and C\$164 million on a smoothed basis (up from C\$126 million based on the 2011 valuation), and a solvency deficit of C\$292 million (down from C\$332 million). Based on these valuations, the university's going-concern deficit payments would rise to C\$19.2 million (up from C\$14.4 million) and its solvency payments would be C\$16.0 million (it expected these to be C\$35.0 million). In total, this is improved from 2012. However, these figures could change by August 2014, when Queen's files its next pension plan valuation. The solvency payment estimates are based on a 10-year solvency deficit amortization period, which the government may grant to the university as stage 2 solvency relief. If granted, this would extend the solvency payment time frame from the current five years. The government has introduced legislation that would extend the solvency payment exemption for an additional three years, and require the deficit to be amortized over seven years. We expect greater clarity around the amount and timing of the pension deficit payments after Queen's files its valuation for August 2014. At that time, the university will be required to submit a plan for funding its deficits.

### Capital projects

Queen's has embarked on a number of significant capital projects recently, including two new academic buildings. Ongoing capital projects include the Isabel Bader Centre for Performing Arts, the Reactor Materials Testing Laboratory, and two new residences. Queen's will not begin any capital projects without an acceptable business case and committed funding for both the construction and operations of the new project.

The university faces moderate deferred maintenance requirements. It estimates its deferred maintenance is C\$243 million. The province has provided funding of C\$1 million to address deferred maintenance.

### Contingent liabilities

Queen's has moderate contingent liabilities that relate primarily to other postemployment benefits. Its 2013 other benefit's plan liabilities are C\$95.4 million. Other contingent liabilities include potential litigation payouts, which the university believes would be immaterial, and a small liability for the decommissioning of a joint subatomic physics laboratory.

Queen's University -- Peer Comparison						
	--Queen's University--		--University of Western Ontario--		--McGill University--	
	2013	2012	2013	2012	2013	2012
Issuer credit rating	AA+/Stable/--	AA+/Stable/--	AA/Stable/--	AA/Stable/--	AA-/Stable/--	AA-/Stable/--
<b>Enrollment and demand (%)</b>						
Headcount	24,042	24,343	N/A	N/A	38,779	37,835
Full-time equivalent (FTE)	21,904	21,713	31,018	30,679	31,336	30,482
Acceptance rate	41.1	40.5	54.2	57.1	N/A	43.5
Matriculation rate	42.6	45.1	21.4	20.5	N/A	48.4
Undergraduate FTEs as % of total FTEs	82.3	82.6	81.3	81.3	75.1	76.2
<b>Income statement (C\$000s)</b>						
Adjusted operating revenues	719,487	662,715	1,011,136	947,920	1,056,535	1,020,573



<b>Queen's University -- Peer Comparison (cont.)</b>						
Adjusted operating expenses	723,214	713,172	939,563	906,210	1,021,162	986,747
Estimated operating gain (loss) before depreciation	53,459	7,335	140,600	109,162	141,223	138,678
Estimated operating gain (loss) before depreciation per FTE	2,441	338	4,533	3,558	4,507	4,550
Change in unrestricted net assets	38,103	(58,608)	99,295	62,383	40,231	(24,958)
Tuition dependence (%)*	25.0	24.0	23.6	23.0	12.1	11.8
<b>Debt</b>						
Debt outstanding (C\$000s)	221,074	227,266	316,185	214,977	199,683	220,127
Current debt service burden (%) <sup>§</sup>	2.6	2.6	2.5	1.6	1.0	1.1
<b>Financial resource ratios (%)</b>						
Endowment market value (C\$000s)	710,251	616,797	431,853	371,732	1,089,182	970,821
Cash and investments (C\$000s) <sup>†</sup>	977,887	880,893	1,074,178	889,768	1,172,379	1,075,088
Adjusted UFR (C\$000s) <sup>‡</sup>	375,928	337,825	409,631	310,336	166,513	126,282
Cash and investments <sup>†</sup> to operations	135.2	123.5	114.3	98.2	114.8	109.0
Cash and investments <sup>†</sup> to debt	442.3	387.6	339.7	413.9	587.1	488.4
Adjusted UFR <sup>‡</sup> to operations	52.0	47.4	43.6	34.2	16.3	12.8
Adjusted UFR <sup>‡</sup> to debt	170.0	148.6	129.6	144.4	83.4	57.4
Unfunded pension and OPEB liabilities to total liabilities	17.0	20.7	24.5	25.7	9.2	7.2

\*Tuition dependence: net tuition revenue/adjusted operating revenue. <sup>§</sup>Current debt service burden: current debt service expense/adjusted operating expenses. <sup>†</sup>Cash and investments: cash plus short-term and long-term investments. <sup>‡</sup>Adjusted UFR: internally restricted net assets plus internally restricted endowments. UFR--Unrestricted financial resources. OPEB--Other postemployment benefits. N/A--Not applicable.

## Related Criteria And Research

### Related Criteria

- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- USPF Criteria: Higher Education, June 19, 2007

### Ratings Detail (As Of January 14, 2014)

#### Queen's University

Issuer Credit Rating AA+/Stable/--

Senior Unsecured AA+

#### Issuer Credit Ratings History

14-Dec-2012 AA+/Stable/--

**Ratings Detail (As Of January 14, 2014) (cont.)**

05-Aug-2010	AA+/Negative/--
01-Nov-2002	AA+/Stable/--

\*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.

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