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Servicer Evaluation: Torchlight Loan Services LLC

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Ranking Overview				
Servicing category	Overall ranking	Subrankings		
		Management and organization	Loan administration	Outlook
Commercial special	ABOVE AVERAGE	ABOVE AVERAGE	ABOVE AVERAGE	Stable
Financial position				
SUFFICIENT				

Rationale

S&P Global Ratings' ranking on Torchlight Loan Services LLC (TLS) is ABOVE AVERAGE as a commercial mortgage loan special servicer. On Oct. 1, 2020, we affirmed the ranking (please see "Torchlight Loan Services LLC Special Servicer Ranking Of ABOVE AVERAGE Affirmed," published Oct. 1, 2020). The outlook for the ranking is stable.

Our ranking reflects TLS':

- Long track record of successfully resolving commercial real estate loans and managing real estate-owned (REO) assets;
- Good leverage of technology to enhance operations including the use of a third-party asset management and special servicing system;
- Internal control environment, which includes internal and external audits and a well-defined committee approval process;
- Employee training program, which supplements on-the-job training with some formal training sessions; and
- Experienced senior management, albeit with lower experience and tenure than its peers.

Furthermore, Torchlight Investors LLC (TI) maintains a disaster recovery and business continuity plan with assistance from the third-party vendor that maintains the company's systems and network, including response procedures to address operational disruption as a result of a pandemic event. In March 2020, TI implemented its plan due to the COVID-19 pandemic. Management reported that there were no disruptions to the company's operations or data facilities and that all of its employees are currently working remotely.

Since our last review (see "Servicer Evaluation: Torchlight Loan Services LLC," published Jan 9, 2019), the following changes or developments have occurred:

- In the first half of 2020, 36 loans were transferred to special servicing mostly due to the COVID-19 pandemic leading to an increase in the active special servicing portfolio unpaid principal balance (UPB) by approximately 100% from year-end 2019.
- TI reassigned four employees, including personnel with previous loan workout experience, to the special servicing asset management group increasing its asset manager count from three to seven.
- TI implemented Zoom and DocuSign across the company when all employees were mandated to work from home

due to the COVID-19 pandemic.

- TLS worked with the vendor of its special servicing system to create enhanced performing loan surveillance capabilities and improved reporting.
- Named CMBS special servicing assignments decreased by approximately 36% while named CMBS UPB decreased by approximately 50% (from June 30, 2018 to June 30, 2020).

The outlook is stable. TLS has responded to challenges posed by the COVID-19 pandemic by implementing the technology needed for its employees to work remotely and transferring experienced employees to the special servicing asset management group. Despite challenges faced by the unexpected increased volume in the current environment, we believe that TLS has the necessary employees, control environment, and technology to administer its portfolio.

In addition to conducting an on-site meeting with servicing management, our review includes current and historical Servicer Evaluation Analytical Methodology data through June 30, 2020, as well as other supporting documentation provided by the company.

Profile

Servicer Profile	
Servicer name:	Torchlight Loan Services LLC
Primary servicing location	New York, N.Y.
Parent holding company	Torchlight Investors LLC
Loan servicing system	Backshop

TLS is the commercial mortgage loan special servicing arm of TI. Formed in 1995, TI provides commercial real estate investment management services, including portfolio management, commercial real estate lending, and distressed debt workouts. As an SEC-registered investment advisor, TI manages funds and separate accounts that invest in mortgages and mezzanine loans, preferred equity, equity, and CMBS, including as a B-piece buyer. As of June 30, 2020, TI had approximately \$3.3 billion in assets under management and was actively fundraising for its seventh opportunity fund for which it is targeting \$1.5 billion.

TLS acts as the special servicer primarily on U.S. CMBS fixed-rate, conduit transactions in which TI affiliates are the B-piece investors. It also handles occasional third-party assignments, mostly through reverse inquiry or retention after a change in the directing certificate holder on CMBS transactions. As of June 30, 2020, TLS' named CMBS special servicing volume was \$9.1 billion in UPB across 23 transactions, a decrease from \$18.1 billion across 36 transactions at the time of our last review. As of the same time, TLS also acted as the named special servicer on one commercial real estate collateralized debt obligation transaction with a UPB of \$34.2 million, as well as one Freddie Mac K-Series transaction with a UPB of \$1.2 billion.

Table 1

Total Servicing Portfolio						
	UPB (mil. \$)	YOY change (%)⁽ⁱ⁾	No. of assets	YOY change (%)⁽ⁱ⁾	No. of staff⁽ⁱⁱ⁾	YOY change (%)⁽ⁱ⁾
Special servicing						
June 30, 2020	796.4	100.3	38	192.3	20	25.0
Dec. 31, 2019	397.5	(42.8)	13	(45.8)	16	0.0
Dec. 31, 2018	695.2	(21.9)	24	(42.9)	16	33.3
Dec. 31, 2017	889.7	(10.9)	42	(17.6)	12	(42.9)
Dec. 31, 2016	998.8	--	51	--	21	--

(i) June 30, 2020, YOY change based on the prior year end. (ii) TLS began including members of TI's financial control group in the number of staff starting in Dec. 31, 2018 due to an organizational change. TLS--Torchlight Loan Services LLC. TI--Torchlight Investors LLC. YOY--Year-over-year. UPB--Unpaid principal balance.

Management And Organization

The management and organization subranking is ABOVE AVERAGE.

Organizational structure, staff, and turnover

The TLS special servicing group consists of seven senior and junior asset managers, including the head of special servicing. The special servicing group is a part of TI's asset management department, which also includes an asset management and analytics group that conducts asset management on private equity and debt investments held in funds managed by the company. TLS' head of special servicing reports to TI's head of asset management, who also has previous special servicing experience. The special servicing team relies on other departments within TI for support and oversight including members of the TI financial control group and the special servicing committee, which includes senior staff from TI and TLS. TI's financial control group performs special servicing 1099 reporting, invoice processing and management, revenue management and reporting, external auditor management, and special-purpose entity (SPE) management, while the six person special servicing committee provides oversight on key special servicing decisions, including approving business plans for loan resolutions and REO asset sales. Members of the TI financial control group and the special servicing committee are included in TLS's 20 staff members (see table 1).

In the first half of 2020, TI transferred four employees, including three with previous loan workout experience, from other parts of the organization to the TLS special servicing asset management group in conjunction with the high volume of special servicing transfers resulting from the COVID-19 pandemic. As result of these transfers, TLS had an asset-to-asset manager ratio of 5.4 as of June 30, 2020, which, in our view, is indicative of manageable workloads and sufficient capacity to handle what management anticipates from subsequent near- and medium-term COVID-19 pandemic-related transfers.

While the firm has been in existence for many years, we note that TLS' senior and middle management, asset managers, and other non-management staff possess levels of industry experience that are generally below levels reported by its peers. Reported company tenure levels are also lower than levels reported by ranked peers (see table 2).

Table 2

Years of Industry Experience/Company Tenure(i)								
	Senior managers		Middle managers		Asset managers		Staff	
	Industry experience	Company tenure						
Special servicer	20	10	13	8	12	6	8	2

(i)As of June 30, 2020.

TLS experienced 18.8% turnover in 2019, which is consistent with, if not slightly lower than, its ranked peers, as the industry at the time continued to adjust to smaller active pre-COVID-19 pandemic special servicing portfolios.

Turnover was 6.3% in the first half of 2020, which represents one employee departure.

Training

TLS provides its management and staff with on-the-job training supplemented with some formal training sessions that are mostly hosted by external vendors. Unlike some of our larger ranked servicers, TI does not have fully dedicated training personnel; however, we believe that TLS has a suitable training program and protocols for a special servicing operation of its size. To date, formal training session topics have included lender liability, compliance training, and keys to becoming a workout specialist. TLS also receives companywide compliance trainings, including workplace harassment and cybersecurity.

On-the-job training in the first half of 2020, focused heavily on the new asset managers, who transferred from other parts of TI, including training on Backshop and common special servicing legal issues. The newly transferred asset managers have also been shadowing TLS asset managers with more recent special servicing experience to help facilitate knowledge transfer.

TLS targets 40 hours of training per employee, which we view as a good training goal. It satisfied its training hour target in 2018 and 2019. Employees averaged 12 hours of training in the first half of 2020.

Systems and technology

We believe TLS has effective technology to meet its special servicing requirements. The company continues to focus on technology enhancement projects to streamline its asset management and REO accounting functions. A third-party vendor hosts and maintains TI's network and systems and provides data backup routines and disaster recovery preparedness. Key elements of its systems, applications, technology, and security environment are discussed below.

Servicing system applications

- Asset managers use Backshop as a workflow tool with automated system tickler functionality to manage loan workouts from special servicing transfer until resolution. Backshop facilitates CRE Finance Council Investor Reporting Package reporting, business plan creation, net present value (NPV) scenario analysis, and business plan review and approval.
- TLS utilizes SAP Concur for automated invoice approval and expense tracking. The system also stores vendor data that allows asset managers to better negotiate the fee for service.
- TI uses Microsoft SharePoint for electronic document storage.

In response to its office closure in March 2020 due to the COVID-19 pandemic, TI implemented DocuSign for remote transaction authorizations and Zoom to conduct internal and external remote meetings. Improvements to Backshop were also implemented since our last review, including enhanced performing loan surveillance capabilities and improved reporting. TLS is working with Backshop's vendor to create more customization of the surveillance modules in the system and improve ad hoc system reporting in 2020.

Business continuity and disaster recovery

TI monitors the disaster recovery protocols performed by two companies: the vendor that hosts Backshop (Backshop vendor) and the IT vendor that hosts and maintains TI's network and systems (network and systems vendor). The network and systems vendor maintains a primary data center in Jersey City, N.J. and a secondary data center in Sacramento, Calif. The data is continually replicated from the production to the disaster recovery environment and tape back-ups are maintained. TLS indicated that in the event of a disaster, the vendor can restore key servicing functions within one hour. TLS reviews the Backshop vendor's disaster recovery policies and procedures (P&Ps) on a regular basis. TI tests disaster recovery and business continuity annually; the most recent test in April 2020 cited no material exceptions.

TI utilizes a work-from-home business continuity strategy, which includes TLS staff. It also has an agreement to use some temporary office space in Atlanta, Ga. if needed. Employees use Citrix for remote access. TI implemented its business continuity plan starting in March of 2020 in response to the COVID-19 pandemic.

Cybersecurity

TI maintains a cybersecurity P&P manual with oversight from the Chief Operating Officer (COO), who acts as the information security coordinator. The manual outlines the technical and physical safeguards that all employees must take to protect sensitive information. In addition, the P&P calls for annual cybersecurity training. TI limits access to sensitive information to only those who need the information to perform legitimate business tasks. TI's access control group, comprised of members of the senior membership team, monitors system user IDs and removes access when employees leave the company.

The network and systems vendor monitors all company systems for unauthorized use and maintains network firewalls and system security patches. It also hires a different third party to conduct a regular security assessment and semiannual network penetration testing of the network and system that hosts TLS' data and information. The most recent test performed in April 2020 cited no material exceptions. Additionally, the network and systems vendor facilitates a program that sends TI employees quarterly phishing simulation emails to test and increase employee awareness on the risk of these attacks.

Internal controls

TLS maintains an effective internal control environment that includes well-documented P&Ps, quality control measures, and internal and external audits.

Policies and procedures

TLS' special servicing P&Ps are available to all servicing employees via SharePoint. They provide both the company's

overall policy and a detailed list of the procedural steps needed to complete important special servicing tasks. Since our last review, the P&Ps and supporting materials have been updated to reflect the shift of the job responsibilities to TI's financial controls group from the former special servicing operations group. TI's COO reviews the P&Ps annually with input from TLS' senior managers.

Compliance and quality control

As an SEC registered investment advisor, TI has a contract with a compliance officer, who oversees TI's code of ethics, which all employees, including TLS staff, must read and adhere to. TI's code of ethics includes protocols for the proper handling of non-public material information and confidentiality. The compliance officer also advises TLS on any potential conflicts with the investment advisory side of the business.

TLS uses management compliance reports to measure compliance with different pooling and servicing agreement (PSA) reporting requirements. Asset managers also use standard checklists for tasks, such as new special servicing transfers, transition to REO, and returning assets to the master servicer.

Internal and external audits

TI has a contract with an independent accounting firm to conduct a biennial internal audit of TLS' operations. The independent accounting firm sets the scope of the audit in consultation with TI's management. TLS appointed a new independent accounting firm to conduct these audits since our last review. The most recent audit covered the full-year 2018 and focused on risks associated with cash collection and administration, accounts payable and advances, special servicing administration, Backshop workflow, and investor and master servicing reporting. Several medium- and low-risk issues were identified. Management provided corrective actions and target completion dates for each issue noted. All recommendations have been implemented and all issues have been remedied.

TLS has effective controls in place to facilitate Regulation AB (Reg AB) compliance, including REO accounting reviews. TLS uses an independent accounting firm to perform annual Reg AB testing. The report covering 2019 was satisfactory with no issues noted.

Insurance and legal proceedings

TLS has represented that its directors and officers, as well as its errors and omissions insurance coverage, are in line with the requirements of its portfolio size. As of the date of this report, there were no material servicing-related pending litigation items.

Loan Administration

The loan administration subranking is ABOVE AVERAGE.

TLS has a long track record of successfully managing and disposing of troubled assets encompassing approximately \$11 billion in par value across the U.S., including complex assets. TLS tracks its liquidation recovery rates for special servicing loan resolutions, which according to the company, have consistently exceeded industry averages.

Like other S&P Global Ratings-ranked special servicers, TLS experienced a sudden increase in special servicing

transfers due to the COVID-19 pandemic in the first half of 2020 with the portfolio growing by approximately 100% by UPB from a reported post-Global Financial Crisis (GFC) low at the end of 2019 (see tables 1 and 3). Consistent with the industry trend, the vast majority of TLS' first half of 2020 transfers were retail and lodging assets. TLS quickly returned seven COVID-19 pandemic-related transfers to the master servicer in the first half of 2020 (see table 4). None of these loans were in default and TLS does not plan to charge any associated special servicing workout fees.

TLS' active special servicing portfolio has become heavily weighted towards loans with just three REO assets remaining in the portfolio due to the influx of special servicing loan transfers in the first half of 2020 accompanied by continued sales of REO assets before the onset of the COVID-19 pandemic. Though the remaining REO portfolio is small, the average hold time of these assets is longer than its ranked peers, because it includes some of the most challenging pre-GFC assets to liquidate. TLS must sell one CMBS industrial REO asset prior to year-end due to real estate mortgage investment conduit (REMIC) requirements, which is of some concern. TLS indicated that they were currently marketing the asset for a sale in October.

Table 3

Special Servicing Portfolio															
	June 30, 2020			Dec. 31, 2019			Dec. 31, 2018			Dec. 31, 2017			Dec. 31, 2016		
	UPB (mil. \$)	No.	Avg. age (ii)												
Active inventory															
Loans	725.1	35	8.2	268.2	9	23.1	174.3	10	26.8	549.5	22	17.8	535.7	21	17.6
Real estate owned	71.3	3	69.2	129.4	4	66.3	520.9	14	38.1	340.1	20	34.6	463.1	30	37.0
Total(i)	796.4	38	13.0	397.5	13	36.4	695.2	24	33.4	889.7	42	25.8	998.9	51	29.0

(i) Totals may not add due to rounding. (ii) Avg. age reflects the time in months from the date the loan first became specially serviced to the reporting date. UPB--Unpaid principal balance.

Loan recovery and foreclosure management

TLS displays effective and proactive loan recovery and foreclosure management protocols to efficiently resolve nonperforming loans across a broad spectrum of property types. Highlights include:

- Upon a loan's transfer to special servicing, the assigned asset manager obtains all of the necessary documents from the master servicer and trustee, if necessary, and completes an initial file review. The asset manager also sets up the loan in Backshop.
- Asset managers hire an external attorney for consultation shortly after a loan transfers into special servicing. The head of asset management must approve all legal engagements.
- If necessary, the asset manager or special servicing support staff may engage a vendor from the preferred vendor list to obtain inspections, appraisals, broker opinions of value, and environmental condition reports.
- Asset managers complete business plans that recommend a course of action, based primarily on NPV analysis.
- All major decisions, including workout business plans, must be approved by TLS' special servicing committee prior to seeking controlling classholder representative approval. The special servicing committee can review business plans and provide feedback in Backshop and also meets regularly to discuss assets. According to company P&Ps, if

the approved course of action is not completed within 120 days of approval, the asset manager must re-present the business plan to the special servicing committee.

- TLS senior managers hold weekly meetings to review the whole special servicing portfolio. Loan workout strategies and the aging of special servicing assets are discussed, and updates are made in Backshop.
- If TLS decides to commence a foreclosure action, the asset manager, in consultation with external legal counsel, moves to secure any rent from the property and determines if an updated environmental assessment and appraisal are needed. The special servicing committee and controlling classholder representative must approve foreclosure bids. TLS also has a checklist for asset managers to follow while transferring assets to REO, including a requirement to have external counsel form a SPE, ensure that the phase I environmental report is current as defined in the respective PSA, and create an REO business plan.

Table 4

Total Special Servicing Portfolio--Loan Resolutions															
	2020(iii)			2019			2018			2017			2016		
	UPB (mil. \$)	No.	Avg. age(ii)												
Resolutions															
Loans	82.9	7	1.1	119.4	5	26.4	63.1	8	10.3	345.7	19	9.2	535.8	47	10.0
Foreclosed loans	0.0	0	N/A	0.0	0	N/A	386.1	8	22.2	102.3	9	8.0	183.9	16	16.4
Total(i)	82.9	7	1.1	119.4	5	26.4	449.2	16	16.3	448.0	28	8.8	719.7	63	11.6
Resolution breakdown															
Returned to master	82.9	7	1.1	4.4	1	8.3	49.9	4	10.0	152.7	2	16.8	98.8	9	11.9
Full payoffs	0.0	0	N/A	14.8	1	4.0	6.5	2	9.9	70.3	9	5.4	256.8	25	7.3
DPO or note sale	0.0	0	N/A	100.1	3	39.8	6.8	2	11.1	122.7	8	11.7	180.2	13	13.8
Foreclosed loans	0.0	0	N/A	0.0	0	N/A	386.1	8	22.2	102.3	9	8.0	183.9	16	16.4
Total/average(i)	82.9	7	1.1	119.4	5	26.4	449.2	16	16.3	448.0	28	8.8	719.7	63	11.6

(i) Totals may not add due to rounding. (ii) Avg. age reflects the time in months from the date the loan first became specially serviced to the reporting date. (iii) Data only includes the first six months of the year. UPB--Unpaid principal balance. DPO--Discounted payoff.

REO management and dispositions

TLS demonstrates sound REO asset management and sales oversight. Its asset managers handle both loans and REO assets. REO sales volume has decreased in recent years because TLS steadily sold the majority of its GFC-related REO assets. According to TLS, the low gross proceeds versus market value received in 2019, as well as through the first half of 2020, were a result of GFC assets (including two large malls) that were the most difficult to liquidate, accompanied by third-party appraisals that didn't accurately capture the assets' value (see table 5). Notable aspects of TLS' REO asset management and dispositions include:

- Asset managers submit REO business plans for approval to the special servicing committee via Backshop. The REO business plans contain an asset disposition strategy, a property management strategy, a property budget approval request, and budget assumptions. Special servicing committee members review the plans and provide approval in Backshop.
- Asset managers select property managers and brokers from approved vendor lists.

- Property managers must prepare annual budgets for each property for REO asset managers, the head of special servicing, and the head of asset management to approve. Unbudgeted expenses require approval from the asset manager.
- TLS uses a third party to conduct thorough property manager audits of a portion of the REO portfolio. The third party conducted three property management audits for TLS in 2020.
- Brokers provide monthly reports describing all marketing activities associated with the property. TLS does not generally contract brokers for more than 180 days to list the property. This allows for flexibility in re-listing the property because of poor broker performance.
- The asset manager seeks approval from the special servicing committee before accepting a purchase offer and only if the offer falls within pre-approved parameters, as outlined in the REO business plan.

Table 5

Total Special Servicing Portfolio--Real Estate-Owned Sales															
	2020(i)			2019			2018			2017			2016		
	Amount (mil. \$)	No.	Avg. REO hold period (mos.)												
Estimated market value	9.9	1	55.4	126.9	7	27.2	89.3	11	28.1	159.3	20	22.0	212.8	37	19.7
Gross sales proceeds	6.7	--	--	97.0	--	--	89.6	--	--	152.4	--	--	197.1	--	--
Net sales proceeds (ii)	11.3	--	--	104.6	--	--	80.1	--	--	151.7	--	--	197.1	--	--
Gross sales proceeds/market value (%)	67.3	--	--	76.5	--	--	100.3	--	--	95.7	--	--	92.6	--	--
Net sales proceeds/market value (%)	113.7	--	--	82.4	--	--	89.6	--	--	95.2	--	--	92.6	--	--

(i) Data only includes the first six months of the year. (ii)The net sales proceeds in 2019 and 2020 includes capital that TLS initially held from the trust for potential future expenses but later returned to the trust after the asset was sold. REO-- Real estate-owned.

REO accounting and reporting

TLS' controls and procedures for property-level accounting and oversight are sound. Highlights include:

- TI's financial controls group sets up a minimum of two separate operating accounts for each REO property with an external bank: one for disbursements and one for rent collection.
- The disbursement account can only be funded according to the terms of a pre-approved annual budget that requires TLS dual signatory approval.
- The property manager completes monthly financial statement reviews, which are reviewed for any variances from the budget by an REO asset manager.
- Monthly bank reconciliations are reviewed and approved by the financial controls group.

Subcontracting management

TLS handles the management and oversight of subcontractors in a controlled and effective manner. With input from the head of special servicing, the asset manager is generally responsible for engaging third-party service providers, monitoring their performance, and authorizing payment. Vendors must meet TLS' standards for qualification (geographic and product expertise, licensing, insurance, and professional designations). TLS maintains an approved vendor list that the head of special servicing and the head of asset management must certify annually. SAP Concur stores vendor data providing a resource for asset managers when negotiating cost of service with subcontractors. TLS does not use any TI affiliates as vendors.

Performing loan surveillance

TLS takes a relatively proactive approach to surveillance for both performing and nonperforming loans, though it does not have a dedicated surveillance team within its special servicing group. It uses a proprietary credit model that runs algorithmic tests based on loan performance indicators, including debt service coverage ratio, debt yield, occupancy, and tenant rollover. TLS also regularly reviews loan performance reports from master servicers and holds monthly calls with master servicers to discuss loan status. Topics during these calls include:

- Current watchlists, delinquency reports, upcoming maturities, and anticipated repayment dates;
- New special servicing loan transfers;
- Advancing and recoverability; and
- Other loan issues such as cash management, loan covenants, and significant deferred maintenance items and insurance claims.

Borrower requests

TLS addresses borrower requests in a well-controlled manner. All borrower requests are re-underwritten by the asset manager and reviewed by the special servicing committee. During the first half of 2020, TLS processed 23 borrower consents, including 14 leasing consents, three loan assumptions, and six other requests. TLS processed 58 borrower requests in 2019. TLS did not report any forbearance agreements in the first half of 2020.

Legal department

We believe the legal function is well-controlled. Special servicing relies primarily on external legal counsel for consultation on legal matters. TLS maintains an approved third-party legal counsel vendor list. Only the head of special servicing or another authorized signatory may execute a legal engagement letter. Furthermore, asset managers review and approve all legal invoices before payment.

Financial Position

The financial position is SUFFICIENT.

Related Research

- Torchlight Loan Services LLC Special Servicer Ranking Of ABOVE AVERAGE Affirmed, Oct. 1, 2020
- Select Servicer List, Sept. 25, 2020
- Servicer Evaluation Spotlight Report™: U.S. Commercial Mortgage Servicers Preparing For Impact From COVID-19, April 3, 2020
- Servicer Evaluation: Torchlight Loan Services LLC, Jan. 9, 2019
- Analytical Approach: Global Servicer Evaluations Rankings, Jan. 7, 2019

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