

July 12, 2007

Basel-Country (Canton of)

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Table Of Contents

Major Rating Factors

Rationale

Outlook

Comparative Analysis

System Support And Predictability

Economy

Management Capacity And Institutional Legitimacy

Financial Flexibility

Budgetary Performance

Liquidity And Debt Management

Debt Burden

Contingent Liabilities

Financial And Economic Statistics Tables

Basel-Country (Canton of)

Major Rating Factors

Strengths:

- Good financial performance, with operating surpluses and after capital expenditure surpluses
- Highly sophisticated management
- Net contributor to the Swiss fiscal equalization system
- High wealth levels on a national and international comparison
- Increasingly diversified economy, with good growth prospects, particularly for the pharmaceutical industry

Issuer Credit Rating

AAA/Stable/A-1+

Weaknesses:

- Slight pressure on budgetary performance in the medium term
- Limited revenue-raising flexibility on the tax side, owing to tax competition between cantons

Rationale

The ratings on the Canton of Basel-Country, located in northwest Switzerland, are supported by its good financial performance, highly sophisticated management, and only moderately high debt levels. The canton also benefits from its diversified economy and high wealth levels. These positive rating factors are mitigated by limited tax-raising flexibility and some forthcoming pressure on budgetary performance resulting from increasing expenditure (new equalization system and health and social costs in the medium term).

In the past, budgetary performance has been consistently good, with operating surpluses averaging 6.5% of operating revenues and surpluses after capital expenditure of 0.5% of total revenues over the past five years (2002-2006). The positive economic development, with unexpected high tax revenues as well as lasting effects from a savings program, helped to close 2006 better than budgeted.

Debt is currently moderately high, at 38.5% of operating revenues in 2006, but is trending downward, accelerated by additional liquidity and surpluses achieved. The canton still holds considerable amounts of cash and equivalents, which was invested to match future debt maturities and reduce the debt level.

Savings measures and the deployment of additional revenues to repay debt demonstrate the high commitment of the cantonal administration to achieve a financially sound performance and position.

The canton's net financial liabilities at year-end 2006 were 25% of total revenues, which compares very well on a Swiss and international comparison.

Basel-Country's economy grew above the Swiss Confederation as a whole in 2006, repeating performances seen in previous years. The economic structure is highly diversified, with some dominance of chemicals and pharmaceuticals production, as well as in mechanical engineering products. Owing to the importance of neighboring urban center Basel, the canton has a higher secondary output (39%) than the Swiss average (27%). Wealth levels in

Basel-Country are in line with the Swiss average and above EU15 average. Generally, unemployment levels are low on a Swiss and international comparison, and currently stands at a stable 2.8%, compared with 3.3% for Switzerland.

Outlook

The stable outlook reflects Standard & Poor's Ratings Services' expectation that Basel-Country will continue its stable budgetary performance in the medium term. Year-to-date figures for 2007 indicate a good performance slightly higher than budgeted figures. We expect the government to continue its commitment to contain expenditure. Furthermore, the debt burden and net financial liabilities are expected to decline. The rating could come under pressure if the canton were to return to ongoing deficits after capital expenditure.

Comparative Analysis

Basel-Country's economy is small compared with most of its peers yet, like the Regional Municipality of Halton (AAA/Stable/--) in Canada, benefits from its proximity to an urban center and from the dominance of one or more industrial sectors. The canton's budgetary performance is weaker than those of some peers (see table 1). Its German peer State of Bavaria (AAA/Stable/A-1+) faces a similar burden of contingent liabilities from a public sector bank, but is under greater pressure from unfunded pension liabilities that have led to extraordinary high net financial liabilities.

Table 1

Basel-Country (Canton Of)--2006 Peer Comparison							
	AAA Median	Basel-Country (Canton Of)	Aargau (Canton Of)	Basel-City (Canton Of)	Bavaria (State Of)	Halton (Regional Municipality Of)	Zurich (Canton Of)
Issuer credit rating ^{§§}	N/A	AAA/Stable/A-1+	AA+/Positive/A-1+	AA+/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/--	AAA/Stable/--
Three-year averages, using actual results only							
Operating balance (% of operating revenues)	10.8	7.1	8.8	8.3	5.6	22.3	5.2
Balance after capital expenditures (% of total revenues)	1	1.4	2.4	3.0	(2.3)	7.5	(2.3)
Capital expenditures (% of total expenditures)	16.4	8.3	11.5	7.4	10.9	27.0	11.7
Transfers received (% of total revenues)	18.6	18.6	22.6	9.8	6.2	11.9	26.7
2006 (mil. CHF)							
Total revenues	3,414.1	2,681.1	3,600.0	4,060.8	54,629.7	646.4	10,365.8

Table 1

Basel-Country (Canton Of)--2006 Peer Comparison (cont.)							
Modifiable revenues (% of operating revenues)	55.4	80.9	75.3	89.9	10.8	82.8	71.3
Direct debt (at year-end)	288.5	1,031.7	1,567.0	2,959.6	38,882.4	187.5	6,544.9
Direct debt (% of operating revenues)	14.1	40.0	45.9	74.4	73.8	33.2	66.0
Direct debt (% of GDP)	0.3	8.0	5.5	12.6	6.2*		5.6
Tax supported debt (% of total revenues)	10.1	38.5	43.5	72.9	83.0	6.0	76.8
Net financial liabilities (% of tot rev)	N/A	24.7	40.7	92.2	341.6**	(103.3)	80.2
Interest (% of operating revenues)	1.4	1.5	1.9	2.9	3.2	1.3	2.5
Debt service (% of total revenues)	2.1	1.4	9.3	16.1	11.2	3.8	7.7
Free cash & equivalents (% of debt service)	722.8¶	39.7¶	262.5	95.3	0.0*	2,845.1	226.7*
Population (000s)	889,591.0¶	264,858.0¶	562,697.0¶	186,899.0¶	12,433,640.0¶	406,160.0*	1,255,852.0¶
Unemployment rate (%)	N/A	N/A	N/A	N/A	6.0*	7.4¶	N/A
GDP (nominal) per capita, unscaled	N/A	N/A	N/A	N/A	50,173.5*	N/A	N/A
GDP per capita (% of national average)	N/A	N/A	N/A	N/A	118.8*	N/A	N/A
GDP (real) growth (%)	N/A	N/A	N/A	N/A	1.3*	N/A	N/A
Total revenues (% of GDP)	14.2§	20.69§	12.72§	17.27§	8.15*	N/A	8.84§

§Figures for 2006. *Figures for 2005. ¶Figures for 2004. **This ratio is calculated using Standard & Poor's estimates of unfunded pension liabilities for German states. §§Ratings at July 12, 2007. CHF--Swiss francs. N/A--Not applicable. N.A.--Not available.

System Support And Predictability

Net contributor to fiscal equalization system

Switzerland has a financial equalization system with vertical and horizontal components, which redistributes revenues from the financially stronger and wealthier cantons to the financially weaker ones, compensating for the varying levels of financial and economic strength among the 26 cantons. Based on specific parameters, an index of financial strength is derived for each canton. In addition to revenue equalization ("direct equalization"), the federal government participates proportionally in certain expenditure items ("indirect equalization").

The index of financial strength is recalculated every two years and redefines contributors and beneficiaries of the

equalization scheme. The current index, which is valid for 2006/2007, is 109 for Basel-Country (the Swiss average is 100). Basel-Country still ranks seventh out of the 26 cantons in the index.

Implementation of reformed equalization system from 2008

The underlying principles of the Swiss cantonal equalization system have been renegotiated, as the current scheme is considered unfair. Among the criticisms is that it does not sufficiently reduce the disparities between the cantons; it sets the wrong incentives, as parts of it are expenditure-based (indirect equalization); and is too complex. The new system will be based on tax potential rather than tax revenues, allowing for more flexibility and higher efficiency for cantons on the expenditure side. The new equalization system, which will go into effect from 2008, should result in increased equalization compared with the current system. According to latest calculations, this is expected to burden the Canton of Basel-Country by Swiss franc (CHF) 19 million per year from 2008 onward, meaning it will remain a contributor to the system.

Under the new equalization system, the Canton of Basel-Country and the Canton of Basel-City (AA+/Stable/A-1+) plan to expand their cooperation. They intend to coordinate their health and hospital sector planning, education sector (university and colleges), infrastructure (public transport, airport, and river harbors), and cultural affairs.

Redistribution of responsibilities between canton and municipalities

Some years ago, Basel-Country implemented a new municipal equalization system, based on a redistribution of responsibilities between the canton and municipalities. These new tasks and the (inner-cantonal) municipal equalization system have had a neutral effect on the canton. Municipalities are required to balance their accounts in each financial plan within a five-year period. Municipal supervision is strict. The canton can nullify illegal acts by municipalities (this has only occurred once), issue instructions, or suspend local self-administration. A special equalization fund amounting to CHF8 million has been set aside to provide last-resort assistance to municipalities.

Economy

The canton's economy is integrated into the Swiss economy nationally and integrated internationally into the Upper Rhine Euro Region, consisting of two million inhabitants, and includes the German region of southern Baden and the French southern Alsace. The canton benefits from excellent access to national and international traffic, as it is a gateway to Germany and France (highways, railways, airport, and Rhine river shipping). Nevertheless, its close and improving interrelationship and interdependence with the city of Basel is important from a regional perspective.

In 2008, Switzerland will join the Schengen convention. This will remove restrictions on border traffic, and is expected to be beneficial to cantons near to national boundaries, such as Basel-Country.

Strong population characteristics

With nearly 270,000 inhabitants, Basel-Country represented 3.6% of the Swiss population at year-end 2006. Forming the major part of the surrounds of the nearby city of Basel, the population in the canton is expected to grow by about 5% by 2030.

The age structure reflects the Swiss average, showing a slightly aging trend, with 17% older than 65 in 2005. The dependent population represents 38%, which corresponds with the Swiss average.

Prospering wealth and leading economic growth area

In 2004, Basel-Country's cantonal income per capita was about CHF52,000, which is well in line with the Swiss average. Over the past five years, Basel-Country has increased its relative wealth position continuously compared with its Swiss peers, ranking it eighth out of 26.

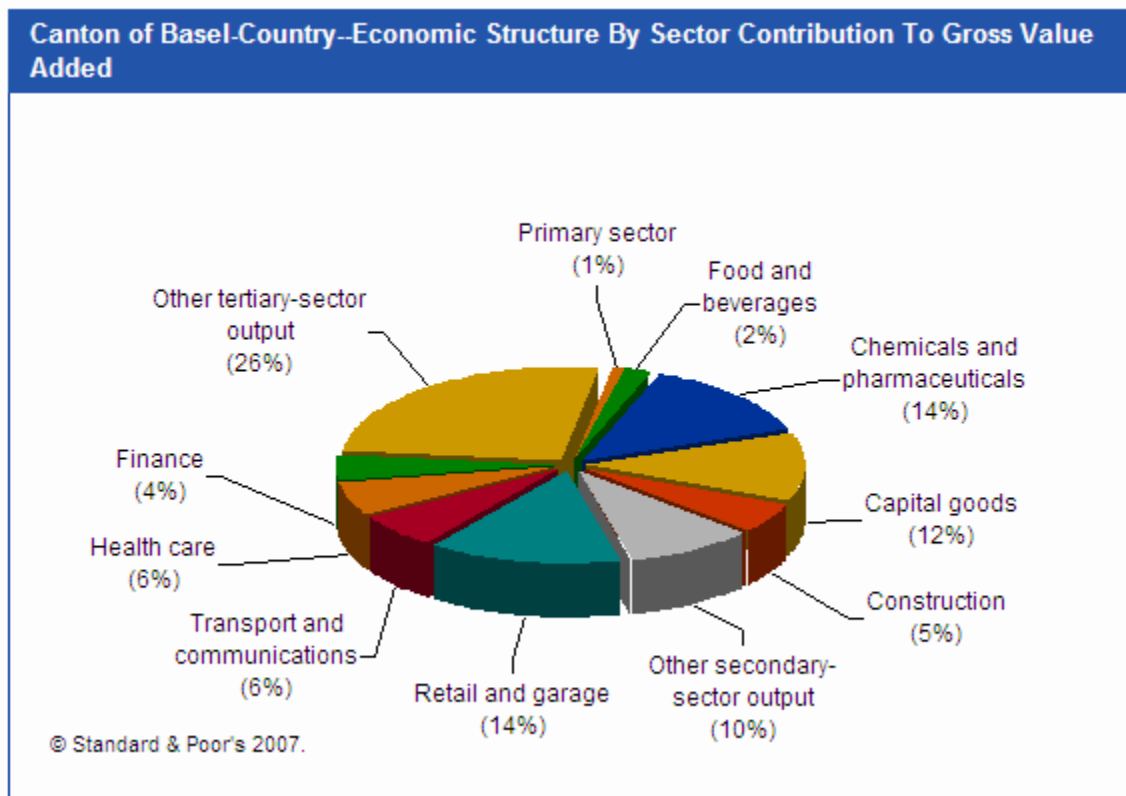
The Swiss GDP growth rate for 2006 was 2.7%, following improved domestic and international economic conditions. For 2007, a rate of 2.4% or more is expected and about 2% thereafter, which appears reasonable. Basel-Country is expected to be among the growth leaders in Switzerland, benefiting from the now more cycle-resistant diversified structure of the canton's chemical-pharmaceutical sector. The canton's real GDP growth is expected to be more than 2% over the next few years.

Diversified economic structure

The economic structure of Basel-Country is well balanced, although there is some dominance of the chemical and pharmaceutical sector. The canton has a higher degree of industrialization than the Swiss average, with secondary sector output at 39% and tertiary sector output at 60%, compared with 27% and 71% nationally (see chart 1). This structure is partly the result of a shortage of areas for manufacturing sites in the neighboring Basel-City as well as the lack of a large agglomeration in Basel-Country, which attracts business and financial services to a limited extent only.

The chemical-pharmaceutical industry plays a key role in northwestern Switzerland, for example, Novartis AG (AAA/Stable/A-1+) and Roche Holding AG (AA+/Stable/A-1+) have their headquarters in that region. The industry's products contributed 13.9% to gross value added in the canton and added more than 17% of gross value added to northwest Switzerland, with the trend increasing. As this sector is divided into five subsectors, which are not highly correlated, the individual risk for a single subsector will not affect the other and should keep the economic fabric stable. Capital goods have a 12% share in gross value added (northwest Switzerland 6%). Therefore, the chemical-pharmaceutical sector, in combination with the capital-goods sector, represents both a strength and a weakness for the cantonal economy, but is better balanced than in the neighboring canton, Basel-City.

Chart 1



Low unemployment levels

Employment distribution by sector is split 3% primary, 34% secondary, and 63% tertiary. It is not concentrated in single employers, instead is relatively broadly spread.

Unemployment in Basel-Country has consistently been lower than the Swiss rate. In 2006, the canton's unemployment stood at 2.8% (down from 3.3% in 2005), compared with the 3.3% national average (down from 3.8% in 2005). A large number of the canton's residents (nearly 20%) commute to work in neighboring cantons, such as Basel-City, or to France or Germany.

Economic policy, which is stability-oriented, aims to further diversify the economic structure. Furthermore, Basel-Country and Basel-City together promote the life sciences industry and related services, and improve the international competitiveness in the region.

Management Capacity And Institutional Legitimacy

Consensus-based democracy

The cantonal parliament consists of 90 members ("Landrat") and is elected every four years. The last elections in spring 2007 reelected a right-wing majority. Six parties are represented.

At the same time, the government ("Regierungsrat") is directly elected by the people for a four-year term. The government consists of five, mostly right-wing members, each heading a department of cantonal administration. The

next elections for the parliament and government will be held in spring 2011.

One of the cantonal parliament's key roles is to approve annual budgets, including a three-year financial plan as well as annual accounts. Compulsory or facultative referenda and initiatives are held several times per year concerning cantonal or federal matters.

At the commencement of the legislative period, the government is required to present its plan to parliament for approval. The plan of the new government is expected to be presented in autumn 2007.

The last government's proposals have been either implemented or are in the process of being implemented. The general review of responsibilities and services, the implementation of a specific control system, and group function responsibilities for separated entities, are among these proposals.

Financial Flexibility

Lower-than-average tax burden compared with competitors

Although the canton has the right to determine the tax rates for personal income, wealth, and corporate profits, tax competition among the cantons makes it difficult to increase the tax multiplier. In 2006, the tax index for individuals (92.5%, compared with the Swiss average of 100%) was the ninth lowest, but for corporate taxes it was fifth highest (114.2%). The overall tax index ranking for Basel-Country is eighth at 96.2%. One of the government's political objectives is to stabilize, or even reduce, the tax burden to remain competitive compared with its neighboring cantons. From 2007, the canton lowered personal income taxes and from 2008 a cut of corporate taxes is planned.

Tight expenditure control

In recent years, the cantonal government has successfully implemented several measures to keep expenditure under control. Tax increases would only be considered as a last resort.

The canton has additional room for financial maneuver in its capital expenditure. In the near future, these are expected to stabilize at about 8% of total expenditure. Capital expenditure would only be cut if necessary. If the financial situation requires, capital expenditure could easily be postponed, as the canton's infrastructure is of the highest standard.

Budgetary Performance

Sound past financial performance

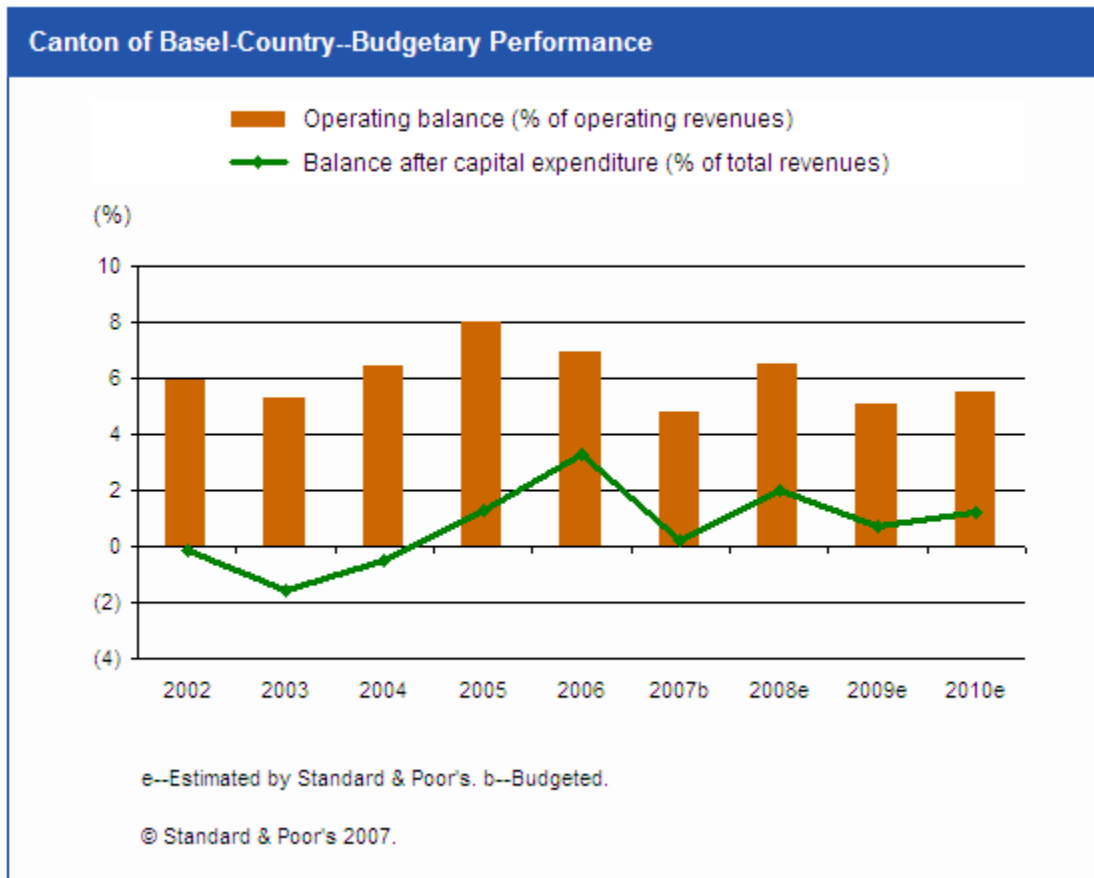
Basel-Country has a proven track record of sound budgetary performance. Operating surpluses averaged 6.5% of operating revenues, and surpluses after capital expenditure averaged 0.5% of total revenues over the past five years (2002-2006). In general, budgets have been outperformed in year-end accounts.

Actual results for 2006 were better than budgeted. The operating surplus came in at 6.9% of operating revenues compared with 5.6% budgeted, and the surplus after capital expenditure was 3.3% of total revenues compared with a budgeted deficit of 1.0%. Expenditure was around budgeted levels, but revenues came in higher than budgeted.

Continuation expected in 2007

For 2007, the canton is budgeting an operating surplus of 4.8% and a surplus after capital spending of 0.2%. Year-to-date figures indicate a very good performance, and budgeted figures are expected to be outperformed. Standard & Poor's believes that the canton will be willing and able to achieve surpluses after capital expenditure in the medium term (see chart 2).

Chart 2



Liquidity And Debt Management

Comfortable liquidity position

The canton has implemented rolling liquidity planning. Regular payment streams exist on the expenditure side (such as wages), but revenues culminate at the end of January (vehicle tax), March (direct federal tax), and September (state taxes). Financial assets (cash and equivalents) amounted to CHF391 million or 16% of operating expenditure at year-end 2006.

Moderate debt-service levels

Debt management is conservative, with currently no use of floating-rate funds or derivative instruments. An CHF100 million authorization exists for both, however. In 2006, debt service decreased to 1.4% of total revenues.

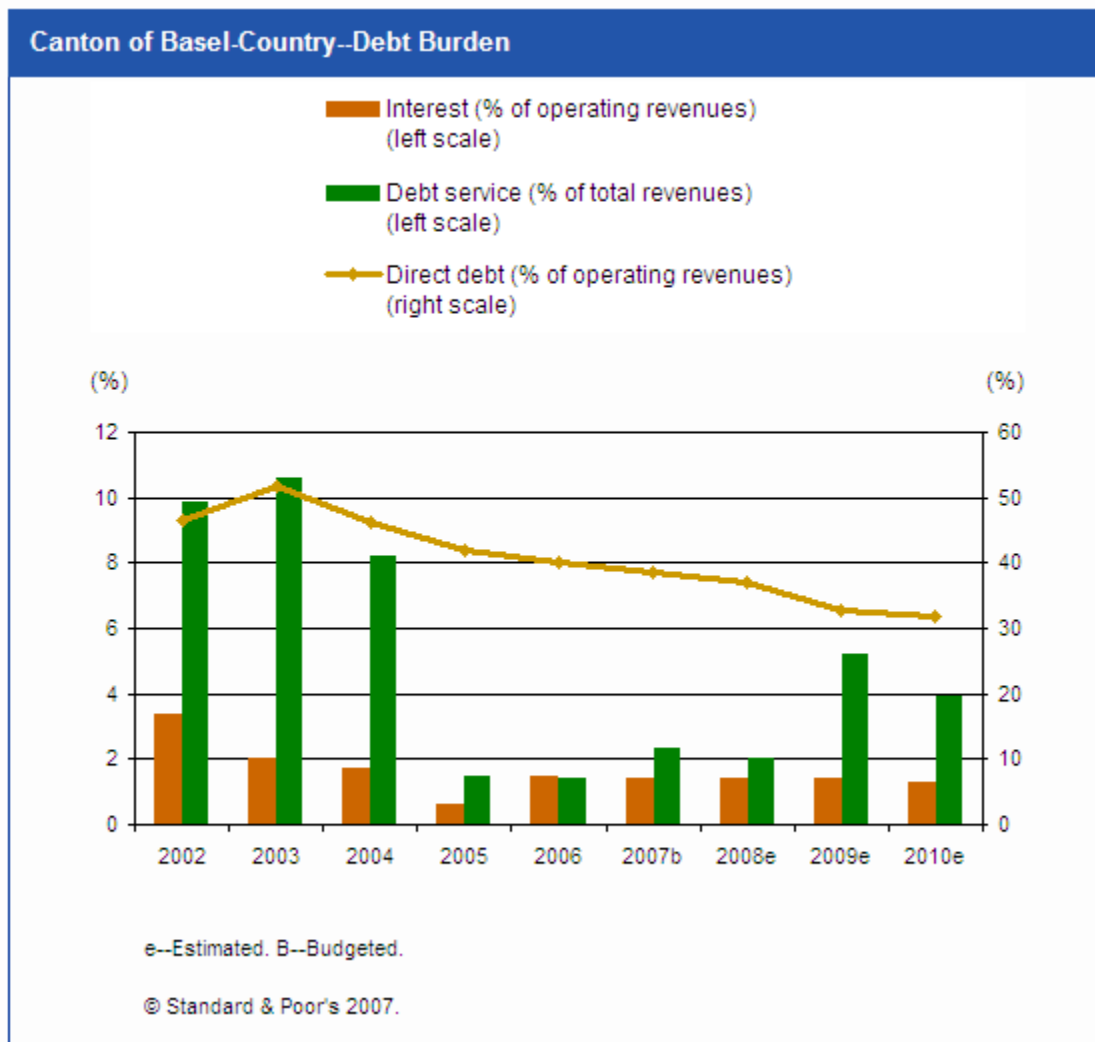
Interest payments account for a low 1.5% of operating revenues.

Debt Burden

The canton has managed to decrease its debt over the past few years to CHF1 billion or 38.5% of operating revenues in 2006 (down from more than 50% some years ago). This debt level is moderately high compared with national and international peers. The canton still holds considerable cash and equivalents, which will be used to repay outstanding debt as it falls due in the medium term. Standard & Poor's therefore expects the canton's debt burden to reduce further toward 30% of operating revenues in upcoming years.

Debt figures include equity contributions of CHF160 million to Basellandschaftliche Kantonbank (AAA/Stable/A-1+). The bank has to reimburse the canton for the full interest service of the equity contribution. Debt figures from 2007-2010 (see chart 3) include the planned repayment of outstanding debt when it falls due using the liquidity. At year-end 2006, about 60% of Basel-Country's outstanding debt was in public bonds, while the remainder was in the form of insurance and bank loans. The canton has no foreign-currency denominated liabilities.

Chart 3



In addition, the canton guarantees the actuarial underfunding of its pension fund. Currently, this accounts for 7% of actuarial liabilities and represents 9% of total cantonal revenues. However, the canton has partially set aside provisions, so it is only liable for a net CHF20 million or less than 1% of total revenue, which is favorably low on a Swiss comparison. Therefore, the canton's operating accounts are not burdened by additional contributions to the fund's annual pension payments.

Net financial liabilities at year-end 2006 were 25% of total revenues, which compares very well on a Swiss and international comparison.

Contingent Liabilities

The canton's largest contingent liability is Basellandschaftliche Kantonalbank. In addition to the capital already injected into the bank, the canton is legally required to guarantee all of its liabilities.

Further contingent liabilities stem from legally required guarantees and accounted for 2% of its operating revenues in 2006. Beside Basellandschaftliche Kantonalbank, Basel-Country has several interests in public and private companies (transport, higher education institutions, and hospitals). For public companies, it is the canton's intention to operate via defined service contracts, which add to operating expenditure.

Participations in private companies are only held if their operations are of regional importance and affect the canton's economy and finances.

Financial And Economic Statistics Tables

Table 2

Basel-Country (Canton of)--Financial Statistics									
--Year ended Dec. 31--									
(Mil. CHF)	2010e	2009e	2008e	2007b	2006	2006b	2005	2004	2003
Operating revenues	2,680.0	2,608.0	2,594.0	2,513.6	2,580.9	2,435.0	2,377.9	2,269.4	2,110.0
Operating expenditures	2,532.0	2,475.0	2,426.0	2,392.8	2,402.4	2,298.4	2,188.4	2,124.1	1,999.0
Operating balance	148.0	133.0	168.0	120.8	178.4	136.6	189.5	145.2	111.0
Operating balance (% of operating revenues)	5.5	5.1	6.5	4.8	6.9	5.6	8.0	6.4	5.3
Capital revenues	0.0	0.0	0.0	130.0	100.2	100.3	59.1	40.3	45.0
Capital expenditures (capex)	115.0	115.0	115.0	246.1	189.6	212.5	216.6	197.1	190.1
Balance after capex	33.0	18.0	53.0	4.7	89.1	24.4	31.9	(11.6)	(34.1)
Balance after capex (% of total revenues)	1.2	0.7	2.0	0.2	3.3	1.0	1.3	(0.5)	(1.6)
Debt repaid	70.0	100.0	15.0	25.0	0.0	0.0	0.0	150.0	185.0
Net budget loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance after debt repayment and onlending	(37.0)	(82.0)	38.0	(20.3)	89.1	24.4	31.9	(161.6)	(219.1)
Balance after debt repayment and onlending (% of total revenues)	(1.4)	(3.1)	1.5	(0.8)	3.3	1.0	1.3	(7.0)	(10.2)
Gross borrowings	70.0	0.0	0.0	0.0	0.0	0.0	0.0	200.0	270.0
Balance after borrowings	33.0	(82.0)	38.0	(20.3)	89.1	24.4	31.9	38.4	50.9
Balance after borrowings (% of total revenues)	1.2	(3.1)	1.5	(0.8)	3.3	1.0	1.3	1.7	2.4
Total revenues (% of GDP)	N.A.	N.A.	18.8	19.8	20.7	19.6	19.6		
Modifiable revenues (% of operating revenues)	79.3	79.1	77.3	78.9	80.9	79.9	80.3	81.4	85.2
Capex (% of total expenditures)	4.3	4.4	4.5	9.3	7.3	8.5	9.0	8.5	8.7
Operating-revenue growth (%)	2.8	0.5	3.2	(2.6)	8.5	2.4	4.8	7.6	(7.1)
Operating-expenditure growth (%)	2.3	2.0	1.4	(0.4)	9.8	5.0	3.0	6.3	(6.4)
Direct debt (debt outstanding at year-end)	856.0	856.0	956.0	971.0	1,031.7	996.0	996.7	1,051.0	1,092.9
Direct debt (% of operating revenues)	31.9	32.8	36.9	38.6	40.0	40.9	41.9	46.3	51.8

Table 2

Basel-Country (Canton of)--Financial Statistics (cont.)									
Direct debt (% of GDP)	N.A.	N.A.	6.9	7.3	8.0	7.7	8.0		
Tax-supported debt (% of total revenues)	31.9	32.8	36.9	36.7	38.5	39.3	40.9	45.5	50.7
Interest (% of operating revenues)	1.3	1.4	1.4	1.4	1.5	1.5	1.6	1.7	2.1
Debt service (% of total revenues)	3.9	5.2	2.0	2.3	1.4	1.4	1.5	8.2	10.6
Cash plus committed facilities (% of operating expenditures)	15.4	15.8	16.1	16.3	16.3	18.3	19.2	2.8	5.9
Cash (% of debt service)	558.6	391.0	2,606.7	1,564.0	N.A.	N.A.	N.A.	39.7	37.1

b--Budgeted. e--Estimated. N.A.--Not available

Table 3

Basel-Country (Canton of)--Economic Statistics							
--Year ended Dec. 31--							
(Mil. CHF)	2008f	2007e	2006	2005	2004	2003	2002
Population	272.3	270.9	269.6	268.0	266.0	264.4	263.2
Population growth (%)	0.5	0.5	0.6	0.7	0.6	0.5	0.5
Unemployment rate (%)	2.2	2.4	2.8	3.3	3.4	2.9	1.9
GDP (real) growth (%)	2.0	2.0	2.9	1.5	N.A.	N.A.	N.A.

f--Forecast. e--Estimated. N.A.--Not available.

Ratings Detail (As Of July 12, 2007)*

Basel-Country (Canton of)

Issuer Credit Rating AAA/Stable/A-1+

Issuer Credit Ratings History

21-Nov-2001 AAA/Stable/A-1+

Default History

None

Population

269,600 (at year-end 2006)

Per Capita GDP

CHF48,809 (2006 estimated)

Current Government

Right wing majority in the parliament; The government consists of five, mostly right-wing members, each heading a department of cantonal administration. Head of the financial department is Mr. Adrian Ballmer (reelected in 2007).

Election Schedule

Last election in February 2007

Next election in spring 2011

*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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