

Metropolitan Transportation Authority
Bond Rating Reports
Covering Fiscal Year 2009

Submitted as part of the MTA 2010 Annual Report
Pursuant to New York State Public Authorities Law Section 2800(1)(a)(2)(iv)

Metropolitan Transportation Authority Credit Ratings

MTA Credit	Moody's	Standard & Poor's	Fitch
Transportation Revenue	A3	A	A
TBTA — Senior Resolution	Aa2	AA-	AA
TBTA — Subordinate Resolution	Aa3	A+	AA-
State Service Contract	NAF	AA-	A+
Dedicated Tax Fund	NAF	AA	A+



Moody's Investors Service

Rating Update: MOODY'S DOWNGRADES METROPOLITAN TRANSPORTATION AUTHORITY (NY) TRANSPORTATION REVENUE BONDS TO A3 FROM A2; OUTLOOK IS STABLE

Global Credit Research - 03 Feb 2010

APPROXIMATELY \$12.6 B OUTSTANDING TRANSPORTATION REVENUE DEBT AFFECTED BY RATING ACTION

Mass Transit
NY

Opinion

NEW YORK, Feb 3, 2010 -- Moody's Investors Service has downgraded the rating on the New York Metropolitan Transportation Authority's (MTA) Transportation Revenue Bonds (TRBs) to A3 from A2. The rating revision affects the MTA's outstanding TRBs as well as the upcoming sale of \$600 million Transportation Revenue Bonds, Series 2010B-1 (Federally Taxable - Issuer Subsidy - Build America Bonds) and \$50 million Transportation Revenue Bonds, Series 2010B-2. The rating action was prompted by the MTA's revenue deterioration over the past several months, leading to increased financial strain and liquidity pressure after the MTA had already addressed declining revenues by reducing spending and proposing service cuts to take effect later this year. Specifically, the MTA learned this week that the new regional mobility payroll tax (RMT) is running significantly below projections that were already reduced late in calendar year 2009. The new revenue stream was approved by the state legislature last spring to provide recurring resources to enable the MTA to avoid severe service reductions and substantial fare hikes. Based on the estimates provided by the state, the MTA's December 2009 financial plan assumed that a portion (\$179 million) of the RMT for 2009 would be received in 2010. Based on discussions with the State Division of Budget, the MTA no longer expects to receive that amount and the forecast for RMT revenues has been lowered by up to \$200 million annually. State subsidies are also expected to be \$41 million below the original forecast for 2010. As a result, the MTA now faces a 2010 budget shortfall of approximately \$391 million, representing about 4% of projected revenues pledged to debt service on the TRBs.

These large downward revenue revisions follow on the heels of an unexpected shortfall of approximately \$372 million for 2009 (also about 4% of revenues) that the MTA had to address in December. Just weeks before the end of its fiscal year, December 31, 2009, the MTA learned that the New York State Legislature planned to withhold \$143 million in 2009 funds that had already been appropriated to balance a portion of the state's own projected budget gap for state fiscal 2010 (which ends March 31, 2010). Due to continued economic weakness, the forecast for existing MTA-dedicated taxes was also revised downward. Finally, the MTA lost an appeal of a TWU arbitration award, thereby adding costs, beginning in 2010, above those already in the proposed budget for salary adjustments.

In December, the MTA board approved, as required, a balanced budget for 2010 as well as a revised balanced budget for 2009 to address the shortfall identified at that time. The MTA now faces the task of closing another budget gap of similar magnitude. The MTA has high fixed costs for labor and debt service, and its flexibility to address continuing revenue pressures due to the recession has already been reduced by actions required over the past two years. Liquidity is already tight and will likely narrow further as a result of the downward revenue revision. While the MTA does not have a history of issuing cash flow notes, it did sell \$600 million in revenue anticipation notes (RANs) last June, repaid at maturity on December 31, 2009, to meet seasonal cash flow needs. The authority expects to issue approximately \$700 million in RANs in the near future.

The A3 rating incorporates the diversified revenue base that supports the bonds; adequate flexibility to manage a complex portfolio of variable rate debt and swaps; the track record of state and city support along with various bond programs that fund capital plans; and the essential service provided by the MTA to New York City and the seven surrounding New York metropolitan counties.

The transportation revenue bonds (TRBs) are secured by a gross pledge of the operating revenues of both the transit and commuter systems, as well as the Triborough Bridge and Tunnel Authority (TBTA) operating surpluses, subsidies from governmental entities, and certain other tax-supported operating subsidies. The TRB Series 2010B-1 Build America Bonds (BABs) will be offered as direct payment bonds for which a federal subsidy is paid directly to the issuer. The subsidy will not be pledged to the bonds and the MTA conservatively budgets gross debt service on the BABs. The BABs feature an optional extraordinary redemption provision should the BAB subsidy be repealed by Congress.

Credit Strengths:

- *Strong demand for an essential transportation network
- *Diversified revenue including dedicated taxes, fares, tolls, TBTA operating surplus, and governmental subsidies
- *Adequate flexibility to manage complex debt portfolio including variable rate demand bonds and swaps
- *System's resilience following major shocks such as 2001 World Trade Center attacks, 2002 recession, 2005 TWU Local 100 strike, and 2008-2009 recession
- *Significant investment over two decades in deferred maintenance and system expansion
- *Existence of five-year capital plan

Credit Challenges:

- *Consecutive downward revenue revisions of important new revenue stream (RMT)
- *State action to balance its own budget adds fiscal challenge
- *Recession exerts downward pressure on dedicated revenues and system use
- *Regional unemployment due to recession reduces use of bridges and tunnels, reducing surplus revenues from TBTA to support transit and commuter operations
- *Out year operating gaps
- *High fixed costs for labor related expenses and multiple collective bargaining agreements
- *Sizeable capital plan spending needs
- *Multi-level government involvement in the MTA's financial and capital planning creates complex political environment and adds to management challenges

UNEXPECTED BUDGET SHORTFALL PRESENTS NEW CHALLENGE FOR 2010

This week the MTA, the parent organization of the largest transit system

in North America, learned that it has an unexpected budget shortfall of about \$391 million for fiscal year 2010. The gap is largely due to the under performance of the RMT that was approved by the state legislature last spring to provide recurring resources to enable the MTA to avoid severe service reductions and substantial fare hikes. While the RMT was running below estimates last fall, a portion (\$179 million) of the shortfall was initially attributed to the timing of collections, and the MTA expected to receive that amount in 2010. Now, that amount has been eliminated and the RMT forecast has been reduced by up to \$200 million annually. In addition, the projection for state subsidies is \$41 million lower.

This latest shortfall comes on the heels of an unanticipated fiscal 2009 budget gap of about \$372 million. Since it emerged so late in the fiscal year, the timing of the gap left the MTA with few solutions except to push some of the problem into fiscal year 2010. The 2009 shortfall had two separate sources. First, the New York state legislature cut approximately \$143 million in MTA-dedicated tax funds when it addressed a portion of the state's own projected fiscal 2010 budget gap of \$3.2 billion. These funds had already been appropriated and the MTA was scheduled to receive them by the end of the calendar year (2009) which is also the end of the authority's fiscal year. Second, the MTA was notified that revenues from a new regional mobility payroll tax (RMT) were running over 20% below forecast. As a result, the MTA faced a shortfall of about \$229 million from that source. When implemented last year, the RMT was expected to produce about \$1.02 billion in fiscal 2009 and \$1.5 billion annually beginning in fiscal 2010, the first full year of collections. In December, approximately \$179 million of the 2009 RMT shortfall was attributed to timing and was expected to be made up during the MTA's fiscal 2010. The Division of Budget also projected in December that annual RMT receipts would be \$50 million lower than originally forecast, beginning with fiscal year 2010.

The shortfalls have occurred at a time when the MTA is facing forecast risks posed by the uncertain timing and strength of the economic recovery, which could further negatively impact revenues dedicated to the authority as well as system utilization. In addition, there are concerns that the state may continue to address its own budget gaps by withholding revenues dedicated to the MTA, as it did at the end of calendar year 2009. While the MTA has hired a consultant to help identify expenditure reductions, it is not anticipated that these expenditure reductions will close the entire gap. With significant fixed costs for labor and debt service, the MTA's options for spending reductions are limited.

The new revenue stream was approved by the state legislature in the spring of 2009 to provide recurring resources to enable the MTA to resolve large budget gaps that it faced starting in 2010 and growing annually. These shortfalls stemmed from the negative impact of the recession on a variety of MTA dedicated tax revenues and system utilization, sizeable fixed costs for labor expenses, growth in uncontrollable expenses such as pension fund contributions to offset investments losses, and escalating debt service costs due to borrowing for capital projects to maintain and expand an essential service for the New York City metropolitan area. Before the new tax was approved, the MTA planned severe service reductions and substantial fare hikes in order to balance its budget. The mobility tax is a 0.34% payroll tax on employers (both public and private) in the MTA transportation district, consisting of New York City and seven surrounding counties (Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester). The new revenues, along with fare and toll increases implemented in June 2009 and scheduled to increase again at the beginning of calendar years 2011 and 2013, provide recurring, though now further reduced, resources going forward.

Two private coach bus services have challenged the constitutionality of new RMT in Suffolk County Supreme Court. However, the plaintiffs have not served a motion seeking stay of collection.

BOARD ADDRESSED 2009 BUDGET SHORTFALL AND ADOPTED BALANCED BUDGET FOR 2010; PLANS IN PROCESS TO RESOLVE LATEST GAP

The MTA is required to have a balanced budget, and in mid-December 2009 the board adopted a revised balanced budget for 2009 as well as the 2010 budget. With essentially no time to cut spending, options to close the \$372 million shortfall for fiscal 2009 were limited to the use of reserves and actions that rolled the problem into 2010. These included cash management tools such as delaying scheduled pension payments across the fiscal year, buying some time for 2009 but increasing the MTA's spending in 2010. As part of its prudent management of potential risks such as a slower-than-expected economic recovery, the MTA retained reserves totaling \$123 million for 2009. These included \$38 million in general reserves plus another \$85 million identified in the November 2009 financial plan. The MTA used these reserves to address a portion of the unexpected gap as well as shortfalls in real estate related revenues which continue to under perform. The MTA also had \$106 million in agency baseline savings largely due to timing, including the delay of the TWU award, and 2009 debt service costs were estimated to be \$56 million below projections.

For 2010, the MTA's November 2009 financial plan (the most current) reflects certain positive variances from the July 2009 plan. While job losses have hurt ridership, system use is slightly better than expected, resulting in a positive net impact on fares and tolls for 2009 through 2013, the forecast period. In addition, certain costs for energy, health and welfare, debt service, and agency costs were lower than projected. These favorable results helped offset real estate taxes that dropped even more than expected. Higher than expected labor costs pose another budget challenge. Beginning in 2010, salary adjustments will be significantly higher than reflected in the November financial plan as a result of a ruling that is unfavorable to the MTA regarding the transit workers' union arbitration award for wage increases. The award added \$91 million to the budget in 2010, \$173 million in 2011, \$190 million in 2012, and \$196 million in 2013.

In order to adopt a balanced budget for 2010, the board approved actions on the spending side that provide recurring savings as well as continued funding for existing approved capital plans that will enable MTA to support its bridge and tunnel capital program as well as sizeable projects such as East Side Access for the Long Island Railroad and the Second Avenue Subway. The schedule for fare and toll increases remains unchanged. Bi-annual increases to yield a total of 7.5% are in place for 2011 and 2013. Given sizeable fixed costs for salaries, benefits, and debt service, the MTA's largest controllable costs are related to services. To that end, the adopted budget incorporates service reductions on certain subway and bus lines as well as the commuter railroads. In certain cases where transit alternatives are readily available, some subway and bus lines are slated to be restructured or eliminated entirely. The budget also reduces, by half, the current discount for K-12 students in 2010 and the plan would eliminate it entirely beginning in 2011. The full cost of student fares was paid by New York State and New York City until 1994. Pursuant to a 1995 agreement, the costs were divided equally among the state, the city, and the MTA. Over time, as MTA costs for student fares increased, reimbursements from the state and city did not keep pace. In 2009, New York State reduced its already low reimbursement from \$25 million to \$6 million. In 2010, the MTA also plans to make changes to its paratransit service for disabled riders in order to offset rising costs.

As a result of the board-approved budget actions, the MTA expected to end 2009 with a modest surplus of approximately \$31 million, about the same as projected in the November 2009 plan before the unexpected shortfalls emerged. The 2010 adopted budget was essentially break-even as was the projection for 2011 before the latest downward revenue revision.

Deliberations have begun to resolve the new 2010 shortfall, and are likely to focus on the expenditure side of the equation, particularly administrative costs. The MTA expects to release its updated financial plan in February 2010, as scheduled.

LIQUIDITY STRAIN INCREASES DUE TO DOWNWARD REVENUE REVISIONS AND REVENUE TRANSFER DELAYS BY STATE

While the MTA does not borrow regularly for cash flow purposes, the authority issued \$600 million in revenue anticipation notes (RANs) in June 2009 to meet cash flow needs through the end of calendar year 2009. Cash flow strain earlier in the year was largely due to a delay in the transfer of certain operating subsidies (known as MMTOA receipts) from the state to the MTA. Even before the state reduced its prior appropriation for 2009, cash flows were tight in that the revenues from the new mobility tax were not scheduled to be collected until the fall due, in part, to the complexity of implementing the additional payroll tax. In 2010, the MTA expects to receive the RMT transfers monthly, which will enhance the stability of the MTA's revenue stream. However, the annual amount has been reduced by about \$200 million, representing about 13% of the original projection. This, in combination with potential underperformance of other dedicated revenues and actions the state might take given its own fiscal condition, could further strain the MTA's liquidity position.

Despite the initial underperformance of the RMT, the MTA collected sufficient revenues in the payment fund by November 23, 2009, to repay the RANs. The notes were repaid in full including interest at maturity on December 31, 2009. The MTA plans to issue approximately \$700 million in RANs for 2010 in the near future.

FALL-OFF IN REAL ESTATE RELATED REVENUES PUTS STRAIN ON REVENUE STREAM

The MTA benefited from the run up in real estate related tax revenues as the city's housing and commercial real estate market soared in the earlier part of the decade. The MTA receives real estate-related taxes in two forms: 1) an urban tax which is a mortgage recording and real property transfer tax collected by New York City; and 2) portions of two mortgage recording taxes (MRT) on real property within the state, after payment of MTA headquarters expenses, including MTA police, and other deposits. As these MRT revenues declined and prior claims grew, less was available to the MTA for debt service on the TRBs and operating costs. In 2006, real estate taxes provided 12% of pledged revenues, up from 4% in 2003. These additional resources provided increased financial flexibility and

helped the MTA avoid higher fare increases over this period. As the real estate market cooled, these revenues dropped and provided about 9% of pledged revenues in 2008. The 2008 budget assumed a 21% year-over-year decline in real estate tax receipts. However, the fall-off (33%) was more precipitous than projected. Declines continued in 2009 and the out year forecast was revised downward.

COMPLEX DEBT PORTFOLIO; MANAGEABLE EXPOSURE TO VARIABLE RATE DEBT AND DERIVATIVE INSTRUMENTS

The MTA has a complex debt portfolio comprised of TRBs, TBTA senior and subordinate lien bonds and Dedicated Tax Fund bonds. MTA also has also issued State Service Contract Bonds whose debt is paid by the State of New York. The TRBs, which represent about 44% of the MTA's total combined \$26.8 billion outstanding debt (excluding state service contracts), are special obligations of the MTA, payable solely from transit and commuter system revenues, certain state and local operating subsidies, dedicated taxes, and operating surpluses of the TBTA after debt service payments on the TBTA's own debt. Proceeds of the transportation revenue bonds are used to finance certain capital projects to rehabilitate and improve transportation facilities of the MTA transit and commuter systems.

The MTA's policy is to have no more than 25% of its total debt in unhedged variable rate securities although unhedged variable rate debt currently represents about 10% of the total debt portfolio. As of January 2010, the MTA's total variable rate debt (including commercial paper, hedged and unhedged variable rate demand bonds, and auction rate securities) is approximately \$5.8 billion including Dedicated Tax Fund Bonds, TBTA General Revenue Bonds, TBTA Subordinate Revenue Bonds and certificates of participation, but excluding Service Contract Bonds (which are all in the fixed rate mode). Overall, the variable rate portion of the portfolio has declined and now makes up 22% of outstanding debt, down from 30% in 2004.

Liquidity facilities supporting the MTA's Transportation Revenue variable rate demand obligations include standby bond purchase agreements and letters of credit supplied by six different banks with facility expiration dates ranging from December 2010 to October 2012. Each liquidity facility has a term-out period of no less than five years and bank holding periods range from 91 to 180 days, providing flexibility for the MTA to remarket or refinance its variable rate debt if necessary. The MTA had substantial amounts of bank bonds at various times during the recent financial crisis, peaking at approximately \$1 billion in the fall of 2008 and declining

significantly by early 2009. The period of time during which any individual bond was in the bank bond mode was limited to a maximum of two weeks, demonstrating MTA's excellent market access. Since mid-April 2009, there have been no bank bonds.

Like many issuers, the MTA experienced failed remarketings of its auction rate bonds during the recent period of market turmoil. One series of transportation revenue bonds reached the maximum rate of 15% for a brief period in the fall of 2008. These were subsequently converted to variable rate demand bonds with liquidity support while insurance policies with CIFG and FSA were terminated. For budgeting purposes, the MTA assumes a 4% interest rate for its unhedged variable rate debt which is based on an analysis of historical variable rate market performance using the SIFMA Municipal Swap Index. Somewhat offsetting this conservative interest rate assumption is the fact that the MTA budgets at the fixed-payer swap rate for payment on its hedged variable rate securities, exposing the MTA to basis risk on these securities. However, overall interest costs came in below budgeted levels for 2008 as savings on unhedged variable rate debt more than offset increased basis cost on the MTA's hedged variable rate debt. For 2009, interest costs on the MTA's unhedged variable rate debt were below budget.

In order to hedge its interest rate exposure, the MTA has entered into numerous interest rate swaps. A swap policy adopted by the board has been in place since 2002 and MTA officials actively monitor their swap portfolio. The MTA has three floating-to-fixed interest rate swaps associated with its transportation revenue bonds in the notional amount of almost \$1 billion, including one forward swap effective November 15, 2012. Counterparties cannot optionally terminate swaps, only the MTA. The MTA's swaps are subject to termination in the event of a downgrade below investment grade of the MTA or the counterparty. Collateral posting is required by the downgraded party if its rating is below Baa1 and if the mark-to-market exceeds \$10 million. Additionally, collateral posting is required by the downgraded party if its rating is below Baa2 or not rated and if the mark-to-market exceeds \$0. Swap payments are on parity with the TRB debt service payments, but termination payments would be subordinate and the MTA could bond for those payments. The combined market value of MTA's TRB swaps was negative \$144.6 million as of September 30, 2009.

SIZEABLE ANNUAL DEBT ISSUANCES PLANNED TO HELP FINANCE SUBSTANTIAL CAPITAL PLANS

The Capital Program Review Board (CPRB) approved amendment to the

2005-2009 capital plan increasing the 2005-2009 capital program from \$19.145 billion to \$20.3 billion incorporating \$764 million for the Full Funding Grant Agreement (FFGA) for the Second Avenue Subway and \$267 million FFGA for East Side Access; the overall 2005 to 2009 Capital Program, including MTA Bridges and Tunnels to a total of \$23.7 billion for three distinct areas of funding needs: 1) the core program to insure the system's state of good repair (\$11.2 billion for transit and \$3.6 billion for commuter); 2) the system's expansion projects, including \$4.8 billion for the East Side Access for the LIRR and the Second Avenue Subway; and 3) a security program (\$495 million). About 40% of the funding sources for the 2005-2009 capital plan are expected to come from MTA bond proceeds, using a combination of the MTA's three primary securities: the TRBs, TBTA bonds, and DTF bonds. Federal funding is expected to cover just over one-third of the resources. The cost to extend the No. 7 Line, estimated at \$2.1 billion, is expected to be funded by New York City. TBTA, which funds its own capital needs, has a capital program of \$1.2 billion which is not subject to approval by the Capital Program Review Board.

There are two rebuilding projects in lower Manhattan: the Fulton Street Transit Center, which is federally funded, and the South Ferry Terminal, which opened in early 2009 and was also financed with federal money. On September 28, 2006, the MTA Board authorized the execution of two memoranda of understanding, one with the city with respect to the development of the MTA Long Island Rail Road yards on the west side of Manhattan and the other with the city and two city-controlled corporations with respect to the design, construction and funding of the No. 7 Line Extension from its current terminal at Times Square to a new terminal station at 34th Street and 11th Avenue. The proceeds that the MTA expected to receive from the rail road yards development were to be used as a funding source for the 2005-2009 MTA Capital Program. Given the delay in that development, that portion of the capital funding plan appears unlikely to be realized during the current capital program period.

Over the past 25 years, the MTA has invested \$78 billion in system restoration and improvements. These are reflected in significantly higher system performance measures such as vehicle miles traveled and mean distance between failures for both subway and bus systems. The MTA has been approved to receive approximately \$1.1 billion in formula ARRA stimulus grants, in addition to ongoing funding for capital projects.

Late last fall, the MTA released a proposed draft of its 2010-2014 capital program which focuses on two priorities, rebuilding and expanding the system. The 2010-2014 Capital Program will require CPRB approval. The

proposed 2010-2014 Capital Program which was sent to the CPRB totaled \$25.6 billion to cover \$18.8 billion in core investments, such as rolling stock replacement, equipment, track maintenance, signals, and station upgrades, \$5.7 billion for expansion projects, and the remaining \$1 billion for security and safety programs as well as a service center. It was vetoed on December 30, 2009 without prejudice. The MTA has indicated that it will be prepared to resubmit the Programs at the appropriate time before the end of the legislative session. The TBTA core capital program cost is \$2.5 billion and does not require CPRB approval.

In August 2009, the MTA also released a 20-year capital needs assessment for 2010 to 2029. Despite substantial system investments over the past several decades, the study has identified a significant backlog of assets that will require rehabilitation estimated to cost \$129 billion over 20 years. This will require funding sources that have not yet been identified. However, given the magnitude of the needs and the likely use of debt to finance a large portion of these capital needs as well as the MTA's normal capital program, debt service costs could rise substantially over time.

MOST RECENT RATING ACTION AND PRINCIPAL METHODOLOGY

The last rating action with respect to the MTA was on January 28, 2010, when the rating of A2 with a negative outlook was assigned to the MTA's Transportation Revenue Bonds, Series 2010B-1 (Federally Taxable - Issuer Subsidy - Build America Bonds) and \$50 million Transportation Revenue Bonds, Series 2010B-2.

The current rating assignment on the MTA's Transportation Revenue Bonds was assigned by evaluating factors we believe are relevant to the credit profile of the issuer, such as i) the business risk and competitive position of the issuer versus others within its industry or sector, ii) the capital structure and financial risk of the issuer, iii) the projected performance of the issuer over the near to intermediate term, iv) the issuer's history of achieving consistent operating performance and meeting budget or financial plan goals, v) the debt service coverage provided by such revenue stream, vi) the legal structure that documents the revenue stream and the source of payment, and vii) the issuer's management and governance structure related to the payment. These attributes were compared against other issuers both within and outside of the MTA's core peer group and the MTA's TRB rating is believed to be comparable to ratings assigned to other issuers of similar credit risk.

Outlook

The outlook for the transportation revenue bonds is stable reflecting Moody's expectation that the MTA will take actions, as it has in the past, to continue to balance its operations. The outlook incorporates the risk of continuing financial strain posed by several areas of uncertainty, These include: 1) further actions by the state to balance its own budget by withholding additional funds from the MTA; 2) a delayed or weaker than anticipated economic recovery that would negatively affect economically sensitive revenues that are dedicated to the MTA; 3) liquidity strain; and 4) continuing weakness in the regional economy leading to further job losses that would hurt system utilization and thus fare and toll revenues.

WHAT COULD CHANGE THE RATING - UP?

- Significantly reduced or eliminated funding gaps in out years of financial plans
- Sustained revenue improvement with reduced volatility
- Less reliance on debt to fund capital program
- Stable state and city support

WHAT COULD CHANGE THE RATING - DOWN?

- Emergence of budget gaps larger than currently expected
- Significantly strained liquidity
- Increased use of debt
- Significant weakening of tax-supported subsidies
- Return to a period of deferred maintenance

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Moody's Investors Service

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