

Research Update:

Los Angeles Dept. Of Water And Power, CA Various Ratings Affirmed, Removed From CreditWatch Negative; Outlook Negative

April 14, 2025

Overview

S&P Global Ratings affirmed the following ratings on, or driven by, Los Angeles Department of Water and Power (LADWP, or the department), Calif.'s power system and removed them from CreditWatch with negative implications, where they were placed on Jan. 14, 2025:

- Our 'A' long-term and underlying ratings on LADWP's power system revenue bonds;
- Our 'A-1' dual ratings on LADWP's power system's various variable-rate bonds outstanding, with liquidity facilities (standby bond purchase agreements) by TD Bank N.A., Barclays Bank PLC, JPMorgan Chase Bank N.A., and Bank of America N.A.; and
- Our 'A' long-term rating on revenue bonds issued by various Southern California Public Power Authority's (SCPPA) projects in which LADWP's power system is the sole or dominant participant, including Mead-Adelanto series 2016A bonds (sole), Mead-Phoenix series 2016A bonds (sole), Milford Wind Corridor Phase I Project (dominant), and Southern Transmission Project (dominant).

The outlook is negative.

The removal of LADWP's power system ratings from CreditWatch with negative implications reflects our view that downward credit pressure for the power system related to the investigation into the cause of January's Palisades Fire and related legal implications will likely play out over the next one to two years given our expectation that the investigation will take time. Further time will also allow us to examine LADWP's various initiatives to bolster its resilience, processes, sustainability, wildfire mitigation, and emergency management practices.

The negative outlook reflects several challenges facing the power system, including material ongoing risks from wildfires, increasing accounts receivable, and our view of rising affordability risks given many of these aforementioned credit pressures could result in higher rates to power system customers, following recent rate increases and an already elevated number of past-due accounts.

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Rationale

Security

Net revenue of LADWP's power system secures the bonds. LADWP's water system revenue is not pledged to power system bondholders. Key bond provisions include a rate covenant set at just 1x annual debt service and an additional bonds test set at 1.25x maximum annual debt service (MADS). Although we consider the rate covenant permissive, we do not view this as a material credit weakness because the power system has maintained coverage at levels significantly higher than this requirement. The 'A-1' short-term component on the department's variable-rate demand bonds reflect the liquidity facilities covering the bonds.

As of Feb. 1, 2025, the power system had \$11.5 billion in direct bonded debt outstanding. In addition to direct debt, the power system is responsible for \$3.0 billion of off-balance-sheet debt attributable to its share of joint projects developed by the Intermountain Power Agency and SCPPA. LADWP's power system treats its share of each of these projects' debt service as an operating expense.

In terms of SCPPA projects where LADWP's power system is the dominant participant, i.e., for SCPPA's Milford Wind Corridor Phase I Project bonds, LADWP's power system has a 92.5% entitlement share of the project and related obligations, and contractual provisions include a 100% step-up obligation by non-defaulting members upon a member default. With regard to SCPPA's Southern Transmission Project bonds, LADWP's power system has a 59.5% entitlement share of the project and related obligations, and contractual provisions include an unlimited step-up obligation by non-defaulting members upon a member default.

Credit highlights

The rating reflects our opinion that the power system continues to maintain healthy coverage and liquidity metrics, supported by an extremely large and mostly residential customer base and a dynamic rate structure that promotes timely and ample cost recovery. These strengths are partially offset by increasing financial risks caused by wildfires; growing capital needs in part due to the department's ambitious and aggressive plan to be carbon-free by 2035, 10 years ahead of state mandates; and elevated accounts receivable.

The rating additionally reflects our view of the following:

- Consistent and robust fixed-charge coverage (FCC) averaging about 1.8x over the past five years and, given that the department expects to meet board-approved minimum full obligation coverage of 1.7x, our expectation that it will sustain FCC near these levels;
- Robust service area economic fundamentals, reflecting LADWP's status as the largest municipal retail utility in the U.S., serving almost 1.6 million customers and a population of about 3.8 million (which promotes significant economies of scale), with median household effective buying income slightly above the national average, providing what we view as a diverse and stable revenue stream;
- Diverse and ample power supply portfolio that includes a growing renewable component that, on its own, represented 39.5% of retail energy sales in calendar 2023, and with coal-fired generation capacity scheduled to be eliminated by 2025;

- Liquidity position of \$1.8 billion, or 191 days' operating expenses, as of fiscal 2024, which, although sizeable, we now assess as only marginally adequate given increasing wildfire and other operating risks that could necessitate significant draws on available funds; and,
- Competitive rates according to 2023 data from the Energy Information Administration and the benefits provided by five uncapped cost pass-through and revenue-decoupling mechanisms that provide financial flexibility and revenue stability, including during periods of weaker demand.

We view the following factors as tempering the preceding strengths:

- Elevated physical risks related to wildfires, heatwaves, and drought, as well as energy transition investments that increase operating and capital costs and, specific to potential wildfire claims, could result in outsized contingent liabilities;
- Very large five-year capital plan that, at \$16.6 billion over fiscal years 2025 to 2029, is more than double that of the prior five years, driven in large part by energy transition plans and costs associated with physical risk mitigation that we believe could create affordability risks and pressure cost recovery;
- Increasing accounts receivable and allowances for doubtful accounts, which we believe indicates weakening affordability that could pressure future rate making flexibility; and
- Moderately high debt and liabilities, with debt to capitalization of 63% as of fiscal 2024, not including nearly \$3.0 billion in off-balance-sheet obligations.

The Federal Bureau of Alcohol, Tobacco and Firearms (ATF) is responsible for investigating the cause of the Palisades Fire. We note that the investigations are ongoing and that LADWP has not been determined to be the cause of the fire. That said, we acknowledge that there is uncertainty around how the state's "inverse condemnation" legal doctrine (under which a utility that has contributed to the ignition of a wildfire can be held liable in the absence of negligence) may be interpreted and applied in the future. Nevertheless, we believe that the current interpretation of the doctrine could lead to the imposition of substantial financial costs on electric utilities. We note at least one third party has already opened such a lawsuit against LADWP. Public power utilities such as LADWP do not have the benefit of the financial buffer provided by the \$21 billion California Wildfire Fund, which is only available for investor-owned utilities.

Given our analysis of damage caused by the Palisades Fire, we believe LADWP's vulnerability to financial liability claims from wildfires such as the ones in January could eclipse its liquidity and insurance coverage. We reflected this risk in our prior two-notch downgrade of the power system's bonds (and related ratings) on Jan. 14, 2025.

Environmental, social, and governance

We view governance factors as a key risk factor. We will continue to evaluate the sufficiency of preventative measures as more information about the Palisades Fire, particularly the cause and response capabilities, becomes available. LADWP reports that it is strengthening its senior leadership team to improve its resilience, processes, sustainability, and wildfire mitigation, and to optimize enterprise emergency management practices. Along these lines, several strategic executive appointments were recently made, including its CEO and Chief Engineer, who was hired in 2024. The department is also implementing systems to better identify risks and improve benchmarking, incorporating stakeholder feedback. In addition, LADWP has engaged an independent consultant to recommend changes needed to upgrade the scope of its 2026-2028

Wildfire Mitigation Plan and has engaged a law firm experienced in wildfire litigation to defend itself against the numerous lawsuits it is facing from the recent Palisades Fire. We view the execution of these initiatives as critical to the rating. LADWP has robust, formalized financial policies, including investment, reserve, and transfer policies, and sophisticated long-range financial and capital planning. Management also has robust cyber security protocols and practices in place.

We also believe California electric utilities such as LADWP's power system are increasingly vulnerable to financial liability claims from the effects of their infrastructure sparking wildfires, given increasing precipitation variability and severe windstorms.

For LADWP, these risks include:

- Uncertainty as to the cause(s) of the Palisades Fire. Given that the fire destroyed an estimated 6,833 structures and caused 12 deaths, a finding of liability against LADWP could lead to significant claims that we believe could exceed insurance coverage and available liquidity, likely leading to increased leverage and higher costs for customers, pressuring affordability and potentially eroding financial margins;
- A significant number of customers (approximately 158,000) and miles (563) of owned overhead power lines in Tier 2 Elevated and Tier 3 Extreme wildfire threat zones as designed by the California Public Utilities Commission (CPUC). We view this as increasing the likelihood LADWP's equipment could contribute to future wildfires and face material liabilities;
- LADWP's de-energization policy that, in our view, is less proactive or effective versus those of comparable in-state peers with similar risks and introduces liability and public safety risks that could outweigh de-energization risks to public health and safety;
- Wildfire litigation and/or liabilities from three wildfires (2017 Creek, 2019 Getty, and 2025 Palisades fires);
- The increasing frequency and severity of highly destructive wildfires in the state and continued volatile hydrological patterns and severe windstorms, both of which are likely due, at least in part, to climate change; and
- Credit contagion risks given LADWP's water system risks and Palisades Fire litigation alleging water supply mismanagement.

According to LADWP's 2023-2025 Wildfire Mitigation Plan, LADWP has determined that the potential benefits that could result from preemptive de-energization of overhead power lines during threatening conditions does not outweigh the potential adverse impact on customer health, safety, and quality of life. We view this as a credit risk given LADWP's aforementioned exposures in high-risk zones. On January 6, the day prior to the Palisades Fire's sparking, the National Weather Service issued red flag warnings for Los Angeles County forecasting "critical fire danger" and a "particularly dangerous situation" (its most extreme warning), indicating that strong offshore winds had the potential to be the strongest wind event of the season. Actual wind gusts reached 60 to 100 mph on January 7.

Wildfire mitigation practices include vegetation management, use of remote cameras, blocking reclosers, and strong collaboration with fire and emergency services, partly offsetting LADWP's wildfire liability risks. However, management's reluctance to use preemptive public safety power shutoffs diminishes the protective qualities of the aforementioned measures.

LADWP's power system is also exposed to the region's frequent droughts. When the wildfires erupted on January 7, at that point precipitation had been negligible since May 2024 after a

wetter-than-normal prior rainy season. This caused vegetation to flourish, only to die out and become wildfire fuel. The power system also has exposure to extreme heat, including a heatwave in September 2024 that caused certain transformers, substations, and feeders to be overloaded, leading to outages for about 146,000 customers. The department plans to increase substation capacity over the next few years to prevent a recurrence.

The power system's exposure to potential future costs related to carbon emissions also remains material, with coal representing 10% of total resources on an energy (megawatt-hour) basis and natural gas representing 32% in calendar 2023, although its coal exposure will cease by 2025 and its natural gas exposure will likely decline gradually, in line with LADWP's goal of being carbon-free by 2035.

Social capital risks are also elevated, in our view. While power rates, measured on a weighted-average basis by customer class, are 8.5% below the state average (as of 2023) and city median household effective buying income is 2.0% above the national average, suggesting good competitiveness, residential rates increased by an annual average of 4.0% between fiscal years 2018 and 2023, constraining affordability, given rising costs. Moreover, relative competitiveness reflects the state's investor-owned utilities' substantial rate increases, indicating that relative competitiveness and affordability are not synonymous. Also, during the peak of the pandemic, the department deferred disconnects for nonpayment, causing both receivables and allowances for doubtful accounts to increase. Accounts receivable represented 24.8% of retail revenues in June 2024 and continue to tick up according to data through Jan. 2025, rising from 20% in June 2023 and 10.5% in June 2019.

We continue to monitor the strength and stability of electric utilities' revenue streams given ongoing inflationary pressures on electricity prices (which have outpaced the broader Consumer Price Index inflation rate) coupled with higher operating and debt costs due to investments in emissions reductions, load growth, and climate resilience. S&P Global Ratings believes the administration's imposition of tariffs could exacerbate inflation by 50-70 basis points but observes that forecasting the duration and impact of tariffs is complicated by the high degree of unpredictability around policy implementation (see "'Liberation Day' Tariff Announcements: First Take On What It Means For U.S. And Global Outlook, April 3, 2025," on Ratings Direct). The economy's stressors and the associated financial pressures consumers face might make it more difficult for rate-setting bodies to harmonize the interests of utilities, their customers, and their investors, which in turn could negatively affect utilities' financial metrics.

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Risk management, culture, and oversight

Outlook

The negative outlook reflects our view of several challenges facing the power system, including wildfire litigation and/or liabilities from three wildfires, uncertainty as to the cause(s) of the January 2025 Palisades Fire, credit contagion risk given water system risks and Palisades Fire litigation, and increasing accounts receivable. The negative outlook also reflects our view of affordability risks given many of these aforementioned credit pressures could result in higher costs to power system customers, on top of recent rate increases and elevated past due accounts.

Downside scenario

There is a one-in-three chance that we could lower our ratings on the power system over the next one to two years, potentially by multiple notches, if utility infrastructure is identified as contributing to the Palisades Fire or other future wildfires, or if wildfires cause significant damage or customer dislocation. We could also lower the ratings if the power system's growing capital plan results in materially weakened affordability, competitive position, or financial metrics, if the department is unable to promptly address its growing accounts receivable, or if water system risks lead to higher risks for the power system.

Upside scenario

We could revise the power system's outlook to stable over the next two years if a final determination is made by investigators that the department's infrastructure did not contribute to the Palisades Fire or any other future significant wildfire and we believe contagion risks with the power system have eased; if progress is made on collection of past-due accounts; and if we believe financial metrics and rate affordability will remain strong despite rising costs associated with capital needs and power system resilience.

Credit Opinion

Wildfires in the region are growing in destructiveness

The Palisades Fire is the third-most destructive fire in state history based on the number of structures destroyed. According to Cal Fire, 15 of the state's 20 most destructive wildfires have now occurred during just the past 10 years. Our analysis of past fires, the potential replacement cost for properties destroyed in the Palisades fires, and the number of potential plaintiffs lead us to conclude that should LADWP be implicated in having ignited the fires, the potential liabilities could be significant and could eclipse immediate liquidity and insurance; however we believe it is possible that the power system could fund the liability with long-term debt, although significant rate increases would likely be needed to service the debt. LADWP was implicated as the cause of the 2019 Getty Fire and faces a lawsuit from the 2017 Creek Fire. We note that liabilities from those two events are likely to be substantially less than any liability from the Palisades fire given the vastly larger area affected in January.

LADWP also faces litigation alleging that water-supply limitations due to reduced water pressure may have contributed to the growth of the fire and generally alleging water supply mismanagement (see LADWP's water system report published April 14, 2025 for more).

In terms of infrastructure damage and other fire-suppression costs, LADWP reports estimated costs at \$75 million for the power system, which we believe is manageable. LADWP believes it will be eligible for at least 75% FEMA reimbursement (on January 8, then-President Biden, in his major-disaster declaration, approved the City of Los Angeles for 100% reimbursement for 180 days for emergency protective measures and debris removal); for the remainder of up to 25%, the California Governor's Office of Emergency Services can reimburse for up to 75% of eligible costs. In terms of revenue loss, the loss of 10,000 electric customers represents 0.8% of total power retail revenue, which we also view as manageable.

Wildfire liability insurance and system liquidity

Currently, LADWP has various insurance in place for wildfire liabilities (the first three in the list can be used for either the power or the water system), including:

- Primary self-insurance of \$106.25 million;
- Wildfire excess liability commercial insurance of \$121.5 million;
- Wildfire self-insurance trust fund of \$45.9 million;
- Power system self-insurance fund of \$232.5 million; and
- Water system self-insurance fund of \$29.8 million

The power system's liquidity and reserves totaled \$1.8 billion, or 191 days' cash, as of fiscal year 2024 ended June 30 (relatively unchanged as of unaudited Dec. 31, 2024), including \$1.1 billion in unrestricted cash, \$516 million in a debt reduction trust fund, and \$220 million in a rate stabilization fund, but excluding a \$300 million revolving line of credit that it shares with the water system (with an accordion feature to expand by as much as an additional \$200 million within 30 days' notice). If LADWP is found liable for contributing to the Palisades Fire or other future similarly destructive fires, we believe that the resulting claims or settlement could far exceed these available resources.

Power supply is ample and diverse, but energy transition plan could be costly

LADWP's power system has excellent shaft diversity, with energy sourced from multiple plants with good geographic dispersion, both owned and jointly owned, and through several power purchase agreements. The power system's energy mix for calendar 2023 included 39.5% renewables, 32.4% natural gas, 13.9% nuclear, 10.3% coal, and 3.9% large hydro. Resource adequacy is ample, with total net dependable capacity of 7,993 MW versus all-time peak demand of 6,502 MW (August 2017). Even with customer account growth forecast over the next five years, especially residential, the department forecasts flat retail energy sales as a result of energy efficiency. But beginning in 2030, management expects beneficial electrification and more significant load growth, including from industrial customers, to lead to increasing demand.

LADWP is in the middle of a highly capital-intensive period due to energy transition and ongoing system improvements. The department's jointly owned coal-fired Intermountain Power Project, its only coal-fired generation, is over 37 years old and will be shut down by July 1, 2025, and converted to a natural-gas-fired plant that can burn 30% green hydrogen initially, with a goal of 100% by 2045. This Intermountain Power Project Renewal Project has a cost of \$1.7 billion, with the department's share \$1.2 billion. The department is also phasing out several coastal gas-fired units by 2029.

Management expects these and other developments to accelerate LADWP's transition to 100% carbon-free energy by 2035, per a plan in development known as the LA100 Plan, successor to its 2022 Power Strategic Long-Term Resource Plan. The final LA 100 Plan is scheduled for completion by mid-2025. The department has recently added several solar, wind, and geothermal projects.

The department-modeled total power costs for 2022 through 2045 related to the recommended "Case 1" approach are estimated at more than \$80 billion, above the estimated \$60 billion per state mandate Senate Bill 100; this is largely due to more aggressive deployment of renewable energy, storage, infrastructure, and green hydrogen infrastructure. The \$80 billion figure includes various clean energy projects funded by developers (with whom the department will enter into power purchase agreements as off-taker) as well as distributed solar, so the department's net capital investment will be less. Nonetheless, the estimated average annual

impact on rates is approximately 8% versus about 5% for compliance with less aggressive state mandates, either of which could weaken rate affordability.

Increasing electric rates could pressure affordability but support continued sound metrics

While meeting energy transition targets will stress LADWP's average cost of power, LADWP's planned base rate adjustments and the availability of pass-through and decoupling mechanisms directly tied to these initiatives should maintain healthy financial metrics, in our view. The board approved a base rate increase of 1.5% for fiscal 2025. In addition, cost pass-through mechanisms are available to capture operating and regulatory cost changes, and portions of pension expenses, and the rate structure allows for recovery of judgment or settlement bonds through the variable energy adjustment factor (VEAF). Changes in the cost pass-through adjustments require only board approval, without review by the other bodies that must assess changes in base rates. Revenue attributable to pass-through adjustments represents about 56% of operating revenue.

As rate increases accelerate, higher bills could hinder the department's progress in addressing its growing receivables. The department expects collections to improve given that it began resuming disconnections for past-due residential customers in June 2024 and for commercial and industrial customers in June 2023, and it is working with customers to establish payment plans. The department's pass-through revenue within the rate structure also partly offsets these risks; even uncollectible accounts are recoverable through these adjustment factors (though customers will face increased rates). Despite growing receivables, power system cash flow from operations remained robust over the fiscal 2020-2024 period, hitting a high of \$1.5 billion in fiscal 2024.

Coverage metrics supportive of the current rating

We view the department's coverage metrics as consistent and credit-supportive, with FCC averaging 1.9x during audited fiscal years 2022 through 2024, and we expect similar future results. FCC treats off-balance-sheet debt service and imputed capacity payments to other suppliers as debt service rather than as operating expenses to reflect the utility's funding of suppliers' recovery of their capital investments in generation resources. Our calculation of FCC and debt service coverage also treats the city transfer as an operating expense. We view the department's projections as reasonable. While the LADWP makes sizeable transfers to the city's general fund, it projects that transfer payments will remain near recent levels as energy sales are expected to be virtually unchanged.

Debt-to-capitalization forecast to remain near current levels despite large CIP

In our opinion, the department's debt-and-liabilities burden is moderately high, suggested by debt to capitalization of 63% as of fiscal 2024, but the ratio is projected at no higher than 66% despite the department's large \$16.6 billion capital plan over fiscals 2025-2029 (and \$18.0 billion over fiscals 2026-2030, according to its preliminary budget, which is subject to change) to address system reliability and generation needs. The power system's pension and other post-employment benefits funds are approximately fully funded, which is credit positive. As LADWP adds debt to fund a portion of its 2025-2029 capital projects (which are 61% debt-funded), it will require moderate rate increases to preserve financial metrics.

Los Angeles Department of Water and Power, California -- Power System

	--Fiscal year ended June 30--	--Fiscal year ended June 30--	--Fiscal year ended June 30--
	2024	2023	2022
Operational metrics			
Electric customer accounts	1,588,000	1,575,000	1,565,000
% of electric retail revenues from residential customers	36	37	38
Top 10 electric customers' revenues as % of total electric operating revenue	9	9	9
Service area median household effective buying income as % of U.S.	N.A.	102	103
Weighted average retail electric rate as % of state	92	97	97
Financial metrics			
Gross revenues (\$000s)	5,228,478	5,372,347	4,595,242
Total operating expenses less depreciation and amortization (\$000s)	3,492,837	3,686,688	3,293,326
Debt service (\$000s)	750,314	708,133	667,165
Debt service coverage (x)	2.3	2.4	2.0
Fixed-charge coverage (x)	2.0	2.0	1.6
Total available liquidity (\$000s)*	1,826,481	2,165,618	2,237,820
Days' liquidity	191	214	248
Total on-balance-sheet debt (\$000s)	12,734,405	12,446,078	12,327,424
Debt-to-capitalization (%)	63	64	66

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

Related Research

Credit Risks Associated With Wildfires Are Increasing For California Public Finance Entities, Feb. 20, 2025

Los Angeles, CA General Obligation Bond Rating Placed On CreditWatch Negative Due To Risks Associated With Wildfires, Jan. 15, 2025

Ratings List

Outlook Action

Pooled	To	From
Los Angeles Dept of Wtr & Pwr, CA Wholesale Electric System Southern California Public Power Authority - Mead-Adelanto Project	A/Negative	A/Watch Neg
Los Angeles Dept of Wtr & Pwr, CA Wholesale Electric System Southern California Public Power Authority - Mead-Phoenix Project	A/Negative	A/Watch Neg
Southern California Pub Pwr Auth, CA Wholesale Electric System Milford Wind Corridor Phase I Proj	A/Negative	A/Watch Neg
Public Power	To	From
Los Angeles Dept of Wtr & Pwr, CA Retail Electric System	A/Negative	A/Watch Neg
Southern California Pub Pwr Auth, CA Wholesale Electric System Southern Transmission Proj 2nd Lien	A/Negative	A/Watch Neg

Los Angeles Dept. Of Water And Power, CA Various Ratings Affirmed, Removed From CreditWatch Negative; Outlook Negative

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.

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