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Analysis

AUSTRALIA
Asia

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Victoria (State of) Australia

Financial and Debt Profile

Strong Financial Performance Supports Highest Credit Quality

Victoria's Aaa rating is supported by its sound financial performance and resultant healthy surpluses which are prudently used to reduce debt and increase contributions to the superannuation fund. Greater flexibility has allowed for tax reductions, as this year the state abolished mortgage stamp duty and reduced land tax rates.

In recent years positive financial results have been bolstered by the strong property market that boosted revenues well above budgeted expectations. Current spending has also grown, reflecting the increase in resources available to government, but at a slower pace, allowing the generation of surpluses once operating and capital expenditures are covered. Public corporations have moved into a deficit position, but this largely reflects increased investment in infrastructure and, does not present a rating concern, given their low debt levels,

The state's conservative budgetary practices have produced better-than-budgeted results over many consecutive years. In 2002/03 the general government sector generated a surplus equivalent to 2.6% of revenues, compared to the -1.6% deficit budgeted, as revenues rose 7.3% over budget while current expenditure growth was restrained to a more modest 2.9%.

Similarly, in 2003/04 the state had forecast a budget gap of -2.3% of revenues due to a ramp-up in social services, and a projected slower pace of growth in revenue due to an anticipated easing in the property market and the last phase of a payroll tax reduction. However, a much smaller gap of -0.4% of revenues was achieved as revenues exceeded budget by 7% with strong growth in conveyancing duties, higher dividend payments by water companies and an insurance fund, and robust interest income. Conveyancing duties grew 32% over budget and 16% over the prior year (in part, reflecting a one-time stamp duty related to the sale of Loy Yang power station). These gains offset a fall in gambling taxes related to the smoking ban in gaming institutions and in fines when the use of traffic cameras was suspended.

Current spending, however, also exceeded budget by a large margin, rising 5.2% over projections and 8% over the prior year, as the government took advantage of revenue gains to expand education, social security and welfare, housing and transport services and to reach new wage agreements with teachers, healthcare workers and public service. Rises in spending also reflected increased conditional commonwealth transfers.

The non-financial public sector moved into a deficit position in 2003/04, although the deficit of -2% of revenues was slightly less than the -3.2% budgeted. This result reflects the improvement in the general government sector as compared to budget and deterioration in the corporation sector due to a near doubling of capital spending by water companies and the assumption of lease costs from the public transit companies.

State Forecasts Small Deficits Over Medium Term

The general government sector's budgeted deficit is projected to widen to -2.3% of revenues in 2004/05, as a 4.1% projected rise in revenue is expected to be outpaced by a 4.9% rise in current expenses (compared to estimated results for 2003/04). Revenue projections reflect conservative estimates of tax growth-0.5% compared to 8.5% achieved in the prior year. This assumes an 11% reduction in conveyancing duties and incorporates a reduction in the land tax. However, strong growth in Commonwealth grants are projected to support revenue growth, including an increase in GST supported grants and special funds for roads. Higher interest income, dividends and recuperation of traffic fines are also expected to contribute to projected trends.

Current expenses are slated to be driven by enhancements to health and other social services, and related employee costs, in part reflecting the hiring of new nurses and the higher costs of new contracts signed with public transit companies. Capital spending is also projected to increase to A\$2.4 billion, above the four-year average spending rate of A\$1.9 billion.

On a cash basis, results are projected to remain in a small surplus position of 0.5% of revenues.

The non-financial public sector's gap is budgeted to widen considerably, from -2.0% registered last year to -5.0% this year. These projections incorporate the less favorable performance of the general government sector and a large projected increase in the corporate sector's deficit from -11% of revenues last year to -21% (16% before dividends).

The recently published mid-year results indicate that the state appears to be slightly ahead of its 2004/05 budget target, with the general government deficit now estimated to be -2.0% of revenues. Revenues are now expected to exceed projections, with larger GST-supported Commonwealth grants and increased revenues from public corporations offsetting less favorable performance in traffic fines and a decline in interest income, while expenditures--up to due to higher education and social service costs-- grow at a comparatively slower pace. The non-financial public sector's results are also expected to be slightly better than budget reflecting the improvements in the general government sector, while public corporations are on target, as an improved operating performance is offset by an expected higher level of capital spending.

Over the medium term, the budget projects that the general government sector will generate small deficits averaging -1.5% of revenues. After widening to -2.9% of revenues in 2005/06, as capital spending peaks, the budget gap will narrow to a minor deficit in 2007/08. These projections contrast with the state's prior record of healthy surpluses that averaged 3.6% over the four years through 2002/03, followed by an essentially balanced position in 2003/04. Projections reflect expectations that both revenue and current spending levels will grow at a slower rate. On a cash basis, a small surplus is expected to be maintained.

The state should be able to meet its budget objectives, although there are risks to the fiscal targets. Conveyancing duty revenues can be quite volatile-they have been growing rapidly over the past few years, doubling from A\$1.3 billion, or 9.5% of own-source revenues in 2001/02 to A\$2.4 billion, or 15.4% in 2003/04. A severe property market decline could have a large impact on revenues: a 20% drop in transaction duties and a 5% drop in prices would amount to around \$700 million, an amount equal to several times the general government's 2004/05 budgeted cash surplus of A\$152 (now estimated to be A\$199 million). While the state experienced a decline in conveyancing revenues of 50% over a two year period in the early 1990s, this severe scenario is unlikely today given much stronger fundamentals, including low interest and unemployment rates. Nevertheless, in recognition of this risk, the state has prudently incorporated a 17% fall in these revenues in its 2004/05 and 2005/06 estimates.

The state has relied on robust revenue growth to boost spending on services for the past four years and would likely find it difficult to downsize operations should revenues fall more than anticipated. For example, education grew by 7.1% a year on average and health care by 8.9% through 2003/04; these expenditures are now projected to grow at a much slower pace--by 2.9% and 3.7% a year respectively. Wage levels, which can place significant upward pressure on expenditures, have already been agreed upon which provides a degree of comfort to projections. Similarly, the state's infrastructure budget provides flexibility. The state's Growing Victoria reserve fund, used to finance capital expenditures, has provided a cushion in past years, but this fund will have been exhausted by year end 2004/05.

Debt Low; Manageable Increases Planned Due to Capital Spending

Victoria's debt burden is low and compares favorably with its counterparts in Australia and internationally. As of 2003/04, gross debt of the non-financial public sector was equal to 4.7% of GSP and 31.1% of revenues, and debt net of

financial assets (excluding Growing Victoria reserve) was 1.8 % of GSP and 11.8% of revenues. While asset sales were used in the mid-1990s to pay down a significant portion of the state's debt, Victoria has relied on fiscal surpluses to achieve debt reduction in more recent years. The state's modest debt level results in minimal debt service demands on the budget; 1.9% of general government revenues and 2.4% of non-financial public sector revenues.

Debt is expected to rise by A\$1.6 billion over the medium term to reflect, in equal amounts, the cash requirements of the general government and the corporations sector. However, given expected growth in revenues and GSP, the debt burden should show only moderate rises above its current very low position.

While the Treasury Corporation of Victoria (TCV) carries out borrowing for the state and its corporations, the ratios above include only debt of the non-financial public sector and not debt issued by the TCV for debt management purposes. All TCV debt is guaranteed by the state and is offset by substantial high quality and liquid financial assets. The total debt of the state is A\$14.2 billion; the debt of the non-financial sector is A\$9.7 billion. As in most Australian states, Victoria's debt is fairly short-dated, with 62% maturing in less than five years. Approximately 7% of the debt is in foreign currency and exposure to movements in exchange rates is mitigated through hedging.

The state's unfunded superannuation liabilities amount to 5.7% of GSP. Following increases in the liability in 2001/02 and 2002/03, in part due to investment losses, the liability declined significantly in 2003/04 to reflect better performance in equity markets, a change in actuarial assumptions and extra cash contributions of A\$1.6 billion in 2002/03 and A\$490 million in 2003/04. The state is ahead of its target of full funding by 2035.

Strong Commonwealth Support

Commonwealth transfers provide a significant and secure degree of support to state finances, amounting to 45% of general government revenues in 2003/04. The Commonwealth provides both unconditional and conditional grants (specific purpose payments) that comprise 57% and 31% of transfers respectively, and an additional 12% of grants are passed through to local governments and schools.

Unconditional grants are derived from a nationally collected Goods and Services Tax (GST), which is distributed in its entirety to the states based on an equalization formula. These grants provide a secure source of revenue because they are underpinned by an intergovernmental agreement codified in national legislation that cannot be amended without the agreement of all states and territories and the commonwealth. This source of funds is more closely tied to economic growth than the prior regime of grants and certain own-source state taxes, and therefore benefits the states revenue growth trajectory. At the same time, state budgets are now more exposed to the impact of an economic downturn on GST tax receipts. The increase in federal support also reduces the direct control states have over their revenues. While the commonwealth ultimately has the power to unilaterally modify the national legislation, as well as make changes to the specific purpose payments, it is unlikely to make large-scale changes that would adversely affect the states.

The state's share of GST-based grants can be affected by year-to-year variability in the inputs to the equalization formula as well as changes to the formula itself which is reviewed every five years. Under the most recent review completed in February 2004 the Victoria's share of grants was reduced so that, while the pool will rise by 4.3% in 2004/05, the state's portion is projected to rise by a lesser 3.6%.

Economic Profile

Economy Continues to Grow At Close to National Rate

Victoria is Australia's second largest state, representing 26% of the country's economy and encompassing nearly 5 million residents. Over the past nine years the state growth rate has matched the national rate, expanding 4% yearly. This growth has been supported by renewed population increases, which followed a period of lower immigration prior to 2001. While interstate immigration has declined recently, it is being replaced by greater gains in international immigration. The state has a relatively large manufacturing sector, which has gone through re-structuring and remains exposed to competitive pressures over the medium term.

In 2003/04 economic growth picked up as the economy expanded at a 3.7% rate compared to 3.3% in the prior year. The domestic economy grew at a slower pace--4.0% compared to 6.3% the year before--to reflect a less robust expansion in business investment, but exports began to recover as drought conditions eased and the global environment improved contributing to the strong overall growth in the economy.

The state projects growth of 3.25% for 2004/05, anticipating a slowdown in the housing sector and a pick-up in exports. So far, domestic demand has remained robust, growing at a 5% rate by the third quarter, while employment growth has been strong at 3% (as of October).

Rating History: Victoria, State of (Australia)

	Date	Rating
Senior Unsecured Domestic Rating	Feb 2000	Aaa
	Dec 1996	Aa1
	May 1995	Aa2
	Mar 1994	Aa3
	Oct 1992	A1
	May 1991	Aa2
	Jul 1990	Aa1

(P) = Provisional Rating

Related Research

Analysis:

[Australia, January 2004 \(80887\)](#)

Special Comments:

[Moody's Sovereign Ratings: A Ratings Guide, March 1999 \(43788\)](#)

Rating Methodology:

[Revised Country Ceiling Policy, June 2001 \(67679\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Victoria (State of), Australia

Debt (A\$ millions) [1], [2]

Fiscal Year ending June 30	2000	2001	2002	2003	Budget 2004	2004	Budget 2005
General Government [3]							
Gross Debt	6,694	6,708	6,753	6,660	6,570	5,953	6,868
as % of GSP	4.2	3.9	3.7	3.4	3.3	2.9	3.2
as % of Revenues	30.0	28.1	26.4	24.6	24.7	20.9	23.7
per capita (A\$)	1,412	1,396	1,390	1,356	1,315	1,197	1,366
Net Debt	2,975	2,158	1,029	1,300	2,241	1,403	1,942
as % of GSP	1.9	1.3	0.6	0.7	1.1	0.7	0.9
as % of Revenues	13.3	9.0	4.0	4.8	8.4	4.9	6.7
Net Debt - Excluding Growing Victoria [3]	3,975	3,276	2,392	2,110	2,301	1,600	1,947
as % of GSP	2.5	1.9	1.3	1.1	1.1	0.8	0.9
as % of Revenues	17.8	13.7	9.3	7.8	8.7	5.6	6.7
Non-Financial Public Sector							
Gross Debt	9,108	9,120	9,210	9,710	9,087	9,656	10,451
as % of GSP	5.7	5.3	5.1	5.0	4.5	4.7	4.9
as % of Revenues	36.5	34.4	32.2	32.8	31.8	31.1	33.1
per capita (A\$)	1,921	1,898	1,896	1,977	1,819	1,942	2,079
Net Debt	4,174	3,478	2,142	2,819	3,312	3,460	4,450
as % of GSP	2.6	2.0	1.2	1.5	1.6	1.7	2.1
as % of Revenues	16.7	13.1	7.5	9.5	11.6	11.1	14.1
Net Debt - Excluding Growing Victoria [3]	5,174	4,596	3,505	3,630	3,373	3,656	4,454
as % of GSP	3.2	2.7	1.9	1.9	1.7	1.8	2.1
as % of Revenues	20.7	17.3	12.3	12.3	11.8	11.8	14.1

Economic Trends

Fiscal Year ending June 30	2000	2001	2002	2003	2004	Budget 2005
Population (mil.) [4]	4.741	4.805	4.857	4.911	4.973	5.027
Nominal GSP (A\$ mil.) [5]	159,270	171,043	182,366	194,002	206,733	213,452
Real GSP growth rate (%) [6]	3.3	2.5	3.9	3.3	3.7	3.3
Inflation (CPI) [7]	2.6	6.0	2.8	3.3	2.2	2.0
Unemployment (%)	6.6	6.0	6.3	5.8	5.5	5.5

[1] Figures do not include debt issued by the Treasury Corporation for debt management purposes; In 2004 this amounted to A\$3.6 billion.

[2] 1999-2003 Actuals have been restated by the VIC State, in line with the restated ABS figures

[3] Growing Victoria is an infrastructure reserve fund established in fiscal year 2000-01. Its assets are earmarked for infrastructure projects and are thus not available to redeem debt.

[4] Estimated Resident Population, source ABS 2000-2003 are Revised Estimates and 2004 is a Preliminary Estimate. Budget figures use previous yr's ABS stat x budgeted population growth rate

[5] Current Prices, source: ABS 2003-04 publ, Budget figures use previous yr's ABS stat x Real GSP Gwth Rate

[6] Chain Volume Measures, source ABS 2003-04 publ, Budget figures are from Budget Papers

[7] Percentage change from previous financial year, source ABS Jun qtr 2004 publ, Budget figures are from Budget Papers

Victoria (State of), Australia

General Government - (A\$ millions) [1]

Fiscal Year ending June 30	2000	2001	2002	2003	Budget 2004	2004	Budget 2005
Revenue							
Taxation revenue	9,782	8,590	8,839	9,335	9,480	10,132	10,272
Current grants and subsidies	6,908	9,455	10,712	10,935	11,788	12,152	12,497
Capital grants	429	455	581	584	460	477	583
Sales of goods and services	2,617	2,829	3,078	3,114	3,008	3,228	3,233
Interest income	199	336	318	366	288	374	436
Other	2,354	2,244	2,059	2,758	1,574	2,135	1,944
Total Revenue	22,289	23,909	25,587	27,092	26,597	28,498	28,965
Expenditure [2]							
Gross operating expense	15,757	17,608	18,548	20,007	20,208	20,991	22,025
Nominal superannuation interest	806	859	827	937	955	916	855
Other interest expenses	453	478	444	477	460	537	453
Other property expenses	-	-	-	-	-	-	-
Current transfers	2,784	2,812	3,120	3,695	4,178	4,500	4,918
Capital transfers	629	881	923	373	374	581	184
Total Expenditure	20,429	22,638	23,862	25,489	26,174	27,525	28,436
Net Operating Balance	1,860	1,271	1,725	1,603	423	973	529
Net acquisition of non-financial assets							
Purchases of non-financial assets			1,888	1,977	2,131	2,345	2,471
Sales of non-financial assets			(148)	(30)	(67)	(127)	(81)
Gross fixed capital formation	1,337	1,217	1,740	1,947	2,064	2,218	2,390
less Depreciation	762	800	859	1,017	1,025	1,068	1,200
plus Change in inventories	36	-	(18)	2	-	6	(3)
plus Other movements in non-financial assets	(47)	208	41	(23)	-	(67)	-
Total net acquisition of non-financial assets	565	625	904	909	1,039	1,089	1,186
Net Lending / (Borrowing) [3]	1,295	646	821	694	-616	-116	-658
Adjusted for Accruals	581	17	567	-648	519	335	811
Cash Surplus / (Deficit)	1,876	663	1,388	46	-97	219	153

Financial Trends - General Government

	2000	2001	2002	2003	Budget 2004	2004	Budget 2005
% Change in Revenue	(3.4)	7.3	7.0	5.9	(1.8)	5.2	1.6
% Change in Expenditure	3.1	10.8	5.4	6.8	2.7	8.0	3.3
Expenditure per capita (A\$)	4,309	4,712	4,913	5,190	5,241	5,535	5,656
As % of GSP							
Net Lending / (Borrowing)	0.8	0.4	0.5	0.4	(0.3)	(0.1)	(0.3)
Cash Surplus / (Deficit)	1.2	0.4	0.8	0.0	(0.0)	0.1	0.1
Expenditure	12.8	13.2	13.1	13.1	13.0	13.3	13.3
As % of Revenues							
Net Lending / (Borrowing)	5.8	2.7	3.2	2.6	(2.3)	(0.4)	(2.3)
Cash Surplus / (Deficit)	8.4	2.8	5.4	0.2	(0.4)	0.8	0.5
Interest Expense	2.0	2.0	1.7	1.8	1.7	1.9	1.6
Intergovernmental Transfers	32.9	41.4	44.1	42.5	46.1	44.3	45.2

[1] 1999-2003 Actuals have been restated by the VIC State, in line with the restated ABS figures

[2] In Australia, the accrual term is Expenses.

[3] Financing surplus (requirement).

Victoria (State of) Australia

Non-Financial Public Sector - (A\$ millions) [1]

Fiscal Year ending June 30	2000	2001	2002	Budget 2003	2004	Budget 2005	2005
Revenue							
Taxation revenue	9,651	8,463	8,713	9,185	9,426	10,061	10,264
Current grants and subsidies	7,291	9,898	11,318	11,504	11,788	12,143	12,498
Capital grants	433	457	582	585	462	479	583
Sales of goods and services	5,760	5,880	6,140	5,906	5,079	5,513	5,663
Interest income	295	421	389	438	331	444	482
Other	1,521	1,392	1,425	2,013	1,481	2,412	2,066
Total Revenue	24,952	26,510	28,568	29,630	28,567	31,051	31,557
Expenditure [2]							
Gross operating expense	19,052	20,598	21,957	22,837	22,230	23,981	25,411
Nominal superannuation interest	806	859	827	937	955	916	855
Other interest expense [3]	610	637	596	622	619	745	644
Other property expenses	(2)	2	-	-	-	-	-
Current transfers	2,117	2,429	2,525	3,133	3,195	3,337	3,802
Capital transfers	133	220	611	134	504	149	191
Total Expenditure	22,715	24,746	26,515	27,664	27,503	29,129	30,903
Net Operating Balance	2,237	1,764	2,053	1,966	1,065	1,922	655
Net acquisition of non-financial assets							
Purchases of non-financial assets	2,144	2,484	2,795	3,391	3,089	3,451	4,071
Sales of non-financial assets	(217)	(497)	(215)	(218)	(153)	(219)	(163)
Gross fixed capital formation	1,927	1,987	2,580	3,173	2,936	3,232	3,908
less Depreciation	1,290	1,305	1,396	1,574	1,539	1,702	1,871
plus Change in inventories	-	5	(32)	32	26	(61)	2
plus Other movements in non-financial assets	103	210	238	189	-	1,090	186
Total net acquisition of non-financial assets	740	897	1,390	1,820	1,423	2,559	2,224
Net Lending / (Borrowing) [4]	1,497	867	663	146	-358	-636	-1,570
Adjusted for Accruals	489	-86	683	-615	175	277	777
Cash Surplus / (Deficit)	1,986	781	1,346	-469	-183	-359	-793

Financial Trends - Non-Financial Public Sector

	2000	2001	2002	Budget 2003	2004	Budget 2004	2005
% Change in Revenue	1.3	6.2	7.8	3.7	(3.6)	4.8	1.6
% Change in Expenditure	(2.0)	8.9	7.1	4.3	(0.6)	5.3	6.1
Expenditure per capita (A\$)	4,791	5,150	5,459	5,633	5,507	5,858	6,147
As % of GSP							
Net Lending / (Borrowing)	0.9	0.5	0.4	0.1	(0.2)	(0.3)	(0.7)
Cash Surplus / (Deficit)	1.2	0.5	0.7	(0.2)	(0.1)	(0.2)	(0.4)
Expenditure	14.3	14.5	14.5	14.3	13.7	14.1	14.5
As % of Revenues							
Net Lending / (Borrowing)	6.0	3.3	2.3	0.5	(1.3)	(2.0)	(5.0)
Cash Surplus / (Deficit)	8.0	2.9	4.7	(1.6)	(0.6)	(1.2)	(2.5)
Interest Expense	2.4	2.4	2.1	2.1	2.2	2.4	2.0
Intergovernmental Transfers	31.0	39.1	41.7	40.8	42.9	40.6	41.5

[1] 1999-2003 Actuals have been restated by the VIC State, in line with the restated ABS figures

[2] In Australia, the accrual term is Expenses.

[3] Does not include interest paid on debt issued by the Treasury Corporation for debt management purposes. In 2004, this amounted to A\$871 million.

[4] Financing surplus (requirement).

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