

Waitakere City Council

Primary Credit Analyst:
Danielle Westwater,
Melbourne,
(61) 3- 9631- 2036;
danielle_westwater
@standardandpoors.com

Secondary Credit Analyst:
Brendan Flynn,
Melbourne,
(61) 3-9631-2042;
brendan_flynn
@standardandpoors.com

Major Rating Factors

Strengths

- Growth in low-risk revenue stream with absence of CCTOs
- Adequate cash flows
- Central government of New Zealand requires a transparent and forward-looking corporate governance structure

Weaknesses:

- High debt levels due to a challenging capital-expenditure program
- Pressure to support new infrastructure through debt given the city's rapidly growing economy

Rationale

The ratings on Waitakere City Council (Waitakere City) are supported by the council's strong flexibility to adjust rates and adequate cash and operating surpluses.

Waitakere City is located in the greater Auckland region, which lies in the northern part of New Zealand's North Island. The council has an estimated population of 192,000 people, representing about 4.7% of New Zealand's population.

Like all New Zealand councils, Waitakere City benefits from minimal legal limitations over increasing its

property rates. Compared to other growth councils such as Auckland City Council (AA+/Stable/A-1+), Waitakere City's proposed fiscal 2007 increase in general rates of 6.8% is modest. The council, therefore, has flexibility to undertake larger increases if they are deemed necessary in the future. Given the council's rates are secured against ratable properties, there is also a high degree of certainty in revenue collection. At fiscal 2006, revenue from rates is expected to account for nearly 69% of the core council's total operating income. Although Standard & Poor's believes there are some political constraints on rate increases, this only partially offsets the credit strength derived from revenue flexibility.

Further supporting credit quality is the absence of contingent risk associated with the ownership of large commercial entities, such as ports or electricity companies, which is a risk faced by some other New Zealand local governments.

Waitakere City continues to record adequate cash operating surpluses, which averaged more than 16% of operating revenue for the three years to fiscal 2006. The council is forecasting surpluses to remain adequate before growing strongly in the later years of the 2006-2016 Long Term Council Community Plan (LTCCP). Reflecting increased revenue-raising efforts, the cash operating position is likely to improve slightly over the next few years.

The ratings on Waitakere City are constrained by its high debt levels and

pressure to support new infrastructure resulting from the city's growing economy and population.

Waitakere City forecasts its net debt to increase to almost 190% of revenue in fiscal 2007, from about 152% of revenue in 2006. In its latest LTCCP, the council has forecast net debt to increase as a percentage of operating revenue until it peaks at more than 250% in 2010. This increasing debt is a result of a challenging capital expenditure program and capital expenditure deferred from previous years. Internal and external capacity constraints and Waitakere's historically conservative operating and capital budgeting history will diminish the likelihood of the council reaching this level of debt. Nevertheless, debt is likely to rise: Standard & Poor's estimates that under a realistic scenario, net debt could reach around about 175% of revenue by 2010.

Short-term credit factors

Waitakere City's short-term rating is 'A-1' and is supported by extremely strong liquidity. Liquid assets and debt sinking funds amount to NZ\$6 million, while Waitakere City also has access to a NZ\$85 million committed bank facility. Together, these easily offset the council's NZ\$39.5 million of short-term debt outstanding at June 30, 2006.

Outlook

The stable outlook reflects Standard & Poor's expectation that the council will not achieve its current LTCCP forecast capital expenditure program.

While the council's current LTCCP debt projections are inconsistent with the 'A+' rating, Standard & Poor's expects debt to come in lower than expected. In recent years, the council has averaged about 60% of its initially budgeted capital expenditure program and Standard & Poor's expects the council to achieve similar levels over Standard & Poor's forecast period.

The corresponding debt associated with a lower level of capital expenditure would leave the council sitting comfortably in the 'A+' rating category. A net debt burden near to Waitakere City's forecast 260% of operating revenue, which would be reached if the council achieved its aggressive LTCCP forecasts or failed to implement its proposed revenue measures, could be inconsistent with an 'A+' rating.

Any rating upgrade would require a strategic change of direction involving a shift away from infrastructure spending or a reduction in the council's forecast capital program. Standard & Poor's believes that both of these scenarios are unlikely in the near term.

Comparative Analysis

Waitakere City's strengths relative to its domestic and international peers include its growth in low risk-revenue streams with the absence of CCTO revenues. Offsetting these strengths is the council's weaker overall balance due to challenging capital expenditure plans.

Domestic Peers

Waitakere City's closest domestic peers are Auckland City Council (AA+/Stable/A-1+), Tauranga City Council (A+/Negative/A-1), and Greater Wellington Regional Council (AA-/Stable/A-1+). All three councils have forecast significant debt-funded capital expenditure, with Tauranga City, Waitakere City, and Auckland City facing the challenges and benefits inherent in strong population growth. All councils benefit from having a large proportion of their revenue streams coming from rates rather than from major CCTOs, and all face capacity constraints to deliver their challenging capital expenditure forecasts.

Relative to Auckland City, Waitakere City has a much higher debt burden and more aggressive capital plans. While Auckland City also faces similar challenges from population growth, the council is planning a proportionately less aggressive capital program.

Unlike Tauranga City, Waitakere City benefits from its close integration with the Auckland region. Both Tauranga City and Waitakere City are expected to reach similar levels of debt to 2010 (both driven by population growth), while Greater Wellington's forecast debt ramp-up is expected to be driven primarily by a number of one-off projects. Tauranga City is expected to reach its net external debt to operating revenue limit in fiscal 2010.

International peers

The Canadian City of Kingston (A+/Stable/-) and City of Thunder Bay (A+/Stable/-), and the German County of Miesbach (AA-/Stable/A-1+) are good international peers for Waitakere City.

Waitakere City's performance against its international peers is weaker, with its direct debt greater than all these peers except Miesbach. Waitakere City's comparatively higher capital expenditure is reflected in its overall cash balance being weaker than its international peers, although Waitakere City's operating cash balances are similar to most of its peer group. High debt levels are mitigated by a more supportive structure than Canada and New Zealand's environment of planning and transparency.

Table 1 Waitakere City Council 2005 Peer Comparisons

	Waitakere	Auckland	Greater Wellington	Tauranga	Miesbach	Kingston	Thunder Bay
Long-term issuer credit rating	A+	AA+	AA-	A+	AA-	A+	A+
Outlook	Stable	Stable	Stable	Negative	Stable	Stable	Stable
Country	NZ	NZ	NZ	NZ	Germany	Canada	Canada
Population	191,900	425,400	460,300	103,800	93,860	115,159	105,436
Total revenue (mil. NZ\$)	176.3	530.7	136.9	129.6	136.4	333.3	417.6
Three-year averages							
Accrual operating balance (% of operating revenue)	(21.2)	5.7	5.9	5.9	N.A.	N.A.	N.A.
Operating cash balance (% of operating revenue)	11.9	29.1	12.7	18.8	3.9	12.5	10.9
Capital expenditure (% of total expenditure)	32.7	41	7.7	43.5	14.9	21.3	24.2
Balance after capital exp. (% of op. revenue)	(17.2)	1.3	6.5	(19.6)	(4.7)	(7.1)	(11.6)
Year ended June 30, 2005							
Total direct debt (mil. NZ\$)	154.1	180	58	125	146.7	95.7	265.7
Direct debt (% of operating revenue)	102.1	38.5	43.6	118.5	113.4	30.4	68.4
Net debt (% of operating revenue)	114.2	(10.8)	5.8	126.1	N.A.	N.A.	N.A.

Waitakere—Waitakere City Council. Auckland—Auckland City Council. Greater Wellington—Greater Wellington Regional Council. Tauranga—Tauranga City Council. Miesbach—County of Miesbach. Kingston—City of Kingston. Thunder Bay—City of Thunder Bay. N.A.—Not available.

System Support and Predictability

The New Zealand local government system promotes a strong management culture and fiscal discipline among New Zealand councils, therefore providing a source of credit strength. The Local Government Act (2002) as the empowering legislation:

- Promotes tight financial management provisions;
- Requires funding and financial policies that are reviewed at least every three years;
- Promotes transparency around decision-making; and
- Requires extensive community consultation on the running of the council.

Long-Term Council Community Plans (LTCCPs) are required of the councils every three years, and must provide 10-year financial forecasts. These forecasts are integrated with the council's Annual Plan. The production of LTCCPs promotes a full

review of the council's priorities and includes a review of funding and financial policies, which are audited by Audit New Zealand.

Other strengths of the New Zealand system that support the rating include:

- Strict financial and non-financial reporting requirements;
- Balanced budgets that include meeting the cost of depreciation or providing the rationale for not doing so;
- Clear revenue and expenditure responsibilities between local and national governments, with an adequate level of taxation powers;
- Central government's track record of dismissing non-performing councils or taking remedial action prior to the council defaulting; and
- A strong possibility that the Crown will provide emergency support, if required.

Economy

In the short term, the structure of the council's local economy has a limited impact on credit quality given cyclical changes will not significantly impact the council's ability to generate rate revenue. However, over the long term economic structure may impact the credit rating as the economy affects the revenue and expense pressures placed on the council and their ability to attract future ratepayers.

Waitakere City's economy has a high level of integration with the Auckland region and, similar to Auckland City, has experienced strong population growth. In the five years to fiscal 2005, Waitakere City's population increased by about 14%. Forecasts indicate Waitakere City's population may continue to grow on average more than 1.5% per year over the next 10 years, and this will continue to place pressure on the council to support new infrastructure.

About half of Waitakere's residents commute to other parts of Auckland, which limits the ability of the local economy to increase its employment per head of population, especially given there is limited local industry. Irrespective of this, employment and economic activity in 2005 grew by 3.2% and 3.6%, respectively. Waitakere City's employment growth was driven by growth in the building, recreation, and social services sectors, and while strong it was lower than both the Auckland Region (4.7%) and the national rate (3.6%).

Increasing diversification has meant that the business services and the retail and distribution sectors now account for a larger proportion of Waitakere City's economic activity than its traditionally dominant industry, manufacturing. Retail and distribution continues to be the largest employer.

Management Capacity And Credibility

The Crown's legislative environment, which promotes a culture of planning, transparency, and consultation ensures a strong management culture and supports the rating on Waitakere City.

The preparation of LTCCPs at least every three years by all local governments in New Zealand ensures that councils have a forward-looking approach, and sets a baseline of operating performance, capital spending requirements, and funding strategies. Councils are also required to outline their financial management policies, although the benefit of such policies is diluted by a tendency to review management policies to reflect changing circumstances. For example, the council relaxed its debt and financial targets in its last LTCCP.

Infrastructure planning of Waitakere's management over the long term tends to be good with budgets set to support and implement the LTTCP. The council's capital spending has historically lagged behind budget, as the council experiences internal

and external capacity constraints to deliver its challenging capital expenditure program.

Waitakere City's operating revenue growth has fallen below operating expenditure growth (after Standard & Poor's adjustments) on average over the past four years. However, general rate increases in fiscal 2007 will see operating revenue growth at 22%, and forecasts suggest that operating revenue growth will outstrip operating expenditure growth at least until fiscal 2010.

Financial Flexibility

A key factor supporting Waitakere City's credit quality is the council's high degree of control over revenues and expenditure.

Revenue

While council rates revenue can be easily modified to accommodate the increased need for expenditure, thereby increasing the council's revenue flexibility, the availability of targeted rates to raise monies for specific projects is a further bonus.

Waitakere City has forecast an increase in its general rate for fiscal 2007 to meet increasing council operation costs. Compared to other growth councils, Waitakere City's proposed increase of 6.8% is modest (both Auckland City and Tauranga City have proposed rate increases of more than 10%).

Although substantial grants, subsidies, and financial contributions from other levels of government can diversify a council's revenue base, they can also restrict a council's financial flexibility. Waitakere City receives some revenue from the Crown in the form of grants and subsidies for operating purposes, and as such its financial flexibility has not been adversely impacted. In fiscal 2006, Waitakere City received NZ\$36.75 million or about 17% of total council revenue in the form of income for capital purposes.

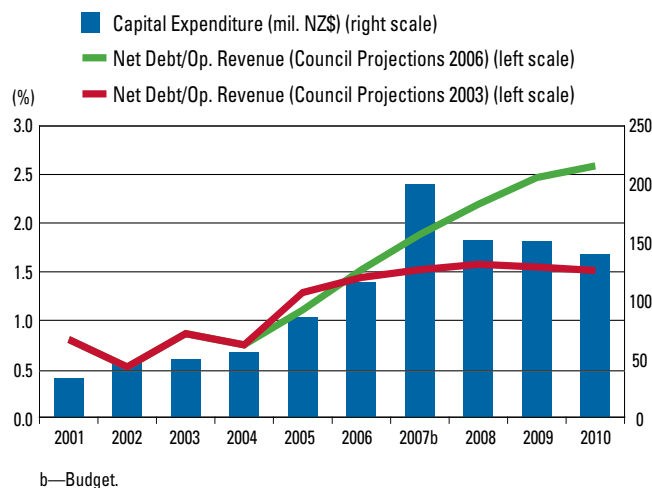
Of some concern however, is the recently announced central government inquiry into local government revenue raising. While an attempt to introduce legislation capping rates attracted no support within parliament, the central government has announced an independent commission of inquiry into local government funding which will report its recommendations in July 2007. If any legislative restriction were placed on councils, it would reduce their revenue flexibility and may impact on the council's ability to manage its debt obligations.

Expenditure

It is a credit strength that the council does not have responsibility for high-cost services such as health and education. Waitakere City's core services are limited to those areas generally provided by local government

Chart 1

Waitakere City: Forecast Rise In Net Debt/Operating Revenue



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such as road maintenance, street cleaning, water supply, wastewater, storm-water, refuse collection and disposal, and sport and recreational facilities. The council does not perform any significant welfare functions, which can be linked to economic cycles and are highly volatile, nor is Waitakere City responsible for the high growth health, education, and justice sectors.

Pressures on existing infrastructure and demand for new infrastructure assets, due to strong population growth, have resulted in capital expenditure making up about 39% of total budgetary expenditure in fiscal 2006. Capital expenditure is projected to remain at about 40% of total budgetary expenditure until 2010. Waitakere City is forecasting an annual capital expenditure program of about NZ\$168 million until 2010 (see chart 1).

Like other New Zealand councils, Waitakere experiences both internal and external capacity constraints that affect the delivery of its capital expenditure program. Such constraints reflect, in part, high labor force participation rates and low unemployment in the Greater Auckland region. Given this, Waitakere City has often fallen short of its planned capital expenditure levels, and Standard & Poor's expects that this trend will continue.

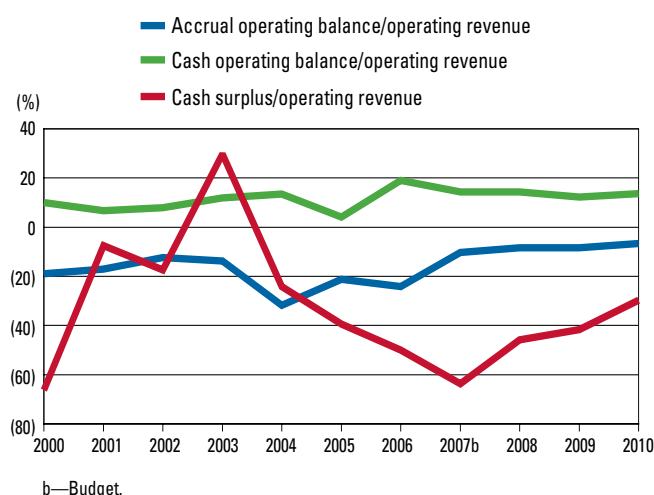
Budgetary Performance

Standard & Poor's make some accounting adjustments to Waitakere City's finances. Specifically, the major adjustment made relates to the exclusion of developer contributions and capital grants from both operating revenue as they are generally tied to capital projects and are not available to service debt.

Given the small contribution Waitakere's CCTOs make to the council's finances, Standard & Poor's considers the council's budgetary performance at the core council level.

Chart 2

Waitakere City: Capital Expenditure Driving Cash Deficits



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Waitakere City's budgetary performance has been adequate, although it consistently records accrual-operating deficits (using Standard & Poor's measures; see chart 2). Irrespective of this, the council expects its cash operating surpluses to remain strong, at around 14% of operating revenue over the next three years.

Waitakere City's large capital expenditure program also contributes to overall cash deficits, which are expected to persist at least until fiscal 2010. Historically, Waitakere's actual capital expenditure has been lower than budgeted. Particularly given the large size of the proposed capital expenditure program, Standard & Poor's believes there is greater potential for disparity between budgeted and actual capital expenditure. As such, Waitakere may record smaller than expected deficits.

Liquidity And Debt Management

Waitakere City short-term rating is 'A-1', and is supported by an extremely strong liquidity position. At the end of fiscal 2006, Waitakere City had about 17.3% or NZ\$39.5 million of the council's total borrowings due to mature within the next 12 months. The council's NZ\$6.0 million in cash and standby committed facilities of NZ\$85 million mitigate the potential refinancing risk of debt maturing within one year.

Table 2 Waitakere City's Debt Maturity Profile	
Category	Fiscal 2006 (Mil. NZ\$)
Less than 1 year	39.5
Between 1 – 2 years	0.5
Between 2 – 5 years	90.0
More than 5 years	98.5

The council's liability management and investment policy is clearly articulated in its LTCCP, and enforces five key limits. These limits are not onerous, and although Waitakere City is expected to remain within these limits to fiscal 2010, any failure to stay within these limits over the rating horizon may require a reassessment of the rating.

Debt Burden

Currently, Waitakere City's debt burden is manageable and sits comfortably in the 'A+' rating category. Since fiscal 2003, Waitakere City has increased its net debt to operating revenue three-fold. In fiscal 2006, debt levels reached 152% of operating revenues, and they are forecast to continue to grow to 259% by 2010. Over this time, Waitakere City's gross interest rate burden as a percentage of operating revenue is also expected to rise (*see chart 3*), so much so that the council revised the relevant liability management limit.

Waitakere City is forecasting about NZ\$200 million capital expenditure in fiscal 2007. However, Standard & Poor's has observed that many rated New Zealand local governments have a history of under-spending on their capital budgets, and therefore not reaching their projected debt levels. In the case of Waitakere City, the discrepancy between budget and actual in regard to debt targets has on average been around 40% over recent years. Given the size of the proposed capital expenditure program, and Waitakere City's history of not meeting its capital expenditure forecasts, it is likely that Waitakere City's debt levels will be lower than the 260% forecast for 2010.

Other Liabilities

Non-debt and contingent liabilities are small and support the council's credit quality. Direct guarantees given by the council to various community and sporting organizations are a little over \$500,000, and legal claims still pending amount to close to NZ\$3.9 million. The council is also defending its ownership of the Harbour View land that was vested to the council during the reorganization of councils during the late 1980s. No dollar value has been assigned to the defense of this case. There are still 31 outstanding weather tightness claims at a cost of NZ\$410,000. The council's wholly-owned subsidiaries and associates are debt free and have an insignificant impact on credit quality at the consolidated level. The council has no superannuation scheme for its employees.

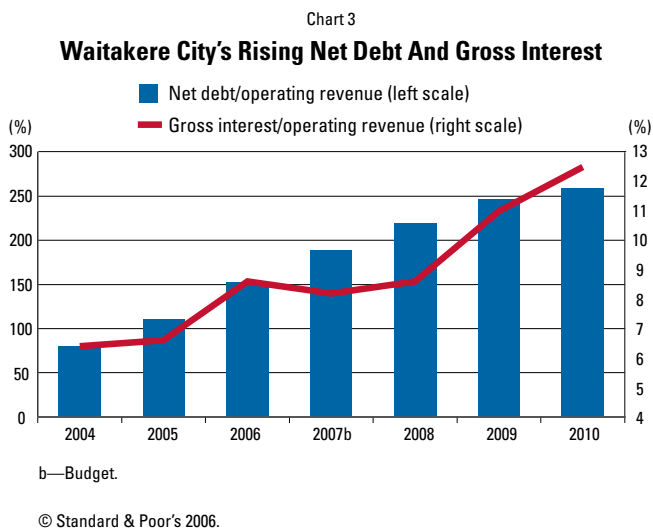


Table 3 Waitakere City Council Financial Statistics (Core Council)

	Years ending June 30					
	2008	2007b	2006	2005	2004	2003
Operating results (Mil. NZ\$)						
Rates	121.4	111.1	101.6	92.9	89.0	83.7
Fees, fines, and user charges	0	0	58.5	57.4	52.6	46.3
Interest received	0	0	1.1	0.7	0.5	1.7
Other operating revenue	72.1	67.2	(7.1)	(16.0)	(22.1)	(2.3)
Total operating revenue	193.5	178.2	154.1	135.0	119.9	129.4
Interest expense	16.6	14.6	12.6	8.9	7.6	7.5
Depreciation	38.7	34.3	31.2	27.8	27.3	25.8
Other operating expenditure	154.5	147.8	137.5	126.9	123.1	113.8
Total operating expenditure	209.8	196.7	181.3	163.6	158.0	147.1
Operating balance (accrual)	(16.4)	(18.4)	(27.2)	(28.6)	(38.1)	(17.7)
+ Depreciation	38.7	34.3	31.2	27.8	27.3	25.8
+ Other adjustments	5.4	9.8	23.9	6.3	27.1	7.4
= Cash operating balance	27.8	25.7	27.9	5.5	16.2	15.5
+ Asset sales	0	0	4.0	1.0	4.3	11.8
+ Other capital receipts (payments)	35.4	61.4	11.8	27.6	6.3	116.4
- Capital expenditure	151.8	200.5	116.0	86.1	55.4	49.5
- Net equity investment (policy)	0	0	0.6	1.3	0.5	55.7
Overall balance	(88.6)	(113.4)	(72.9)	(53.3)	(29.0)	38.5
Financial Performance Indicators						
Operating revenue growth (%)	8.6	15.7	14.1	12.5	(7.3)	5.9
Operating expenditure growth (%)	6.7	8.5	10.8	3.5	7.4	7.2
Accrual operating balance/operating revenue (%)	(8.5)	(10.3)	(17.7)	(21.2)	(31.7)	(13.7)
Cash operating balance/operating revenue (%)	14.4	14.4	18.1	4.1	13.5	12.0
Overall balance/operating revenue (%)	(45.8)	(63.6)	(47.3)	(39.5)	(24.2)	29.7
Gross interest expense/operating revenue (%)	8.6	8.2	8.2	6.6	6.4	5.8
Adjusted net interest expense/operating revenue (%)*	8.6	8.2	7.7	6.5	6.3	4.9
Adjusted cash operating balance net interest cover (x)*	2.7	2.8	3.3	1.6	3.1	3.5
Capital expenditure/total budgetary expenditure (%)	42.0	50.5	39.0	34.5	25.9	25.2
Balance Sheet (mil. NZ\$)						
Cash and liquid investments	0.9	0.9	6.0	5.0	6.4	30.0
Other non-current assets	30.3	29.4	33.1	33.9	19.4	15.4
Non-current assets	2,378.1	2,203.2	2,320.1	1,651.9	1,583.3	1,550.1
Total assets	2,409.3	2,233.4	2,359.2	1,690.8	1,609.1	1,595.5
Current loans	9.2	4.4	39.5	16.1	21.3	26.1
Current employee and other provisions	0.3	0.9	5.6	5.6	3.4	3.6
Other current liabilities	46.8	45.4	43.2	40.7	32.7	31.8
Non-current loans	415.8	331.9	188.5	138.0	80.9	70.7
Non-current employee and other provisions	6.9	6.5	7.4	8.2	7.7	11.7
Other noncurrent liabilities	0.0	(0.0)	0	0	0	(2.8)
Net worth	1,930.4	1,844.3	2,075.0	1,482.2	1,463.0	1,454.4
Total net worth & liabilities	2,409.3	2,233.4	2,359.2	1,690.8	1,609.1	1,595.5

Table 3 Waitakere City Council Financial Statistics (Core Council) (CONTINUED)

	Years ending June 30					
	2008	2007b	2006	2005	2004	2003
Memorandum Items						
Gross debt	424.9	336.3	228.0	154.1	102.2	96.8
Net debt	424.1	335.4	222.0	149.1	95.8	66.8
Present value of operating lease obligations	0	0	2.6	5.0	4.8	4.4
Contingent liabilities	0	0	14.3	18.6	9.4	12.8
Financial Position Indicators						
Debt Obligations						
Gross debt/operating revenue (%)	219.6	188.7	148.0	114.2	85.2	74.8
Net debt/operating revenue (%)	219.2	188.2	144.1	110.5	79.9	51.6
Adjusted net debt/operating revenue (%)*	219.2	188.2	145.8	114.2	83.9	55.0
Gross debt/cash surplus payback (years)	15.3	13.1	8.2	28.2	6.3	6.3
Adjusted net debt/cash surplus payback (years)*	15.3	13.0	8.1	28.2	6.2	4.6
Gross debt/capita (\$)	N.A	N.A	1,223.0	842.8	570.0	550.7
Net debt/capita (\$)	N.A	N.A	1,190.9	815.2	534.3	380.1
Non-debt Obligations						
Employee and other provisions/operating revenue (%)	3.7	4.2	8.4	10.2	9.3	11.8
Contingent liabilities/operating revenue (%)	0	0	9.3	13.8	7.8	9.9
Net Worth Indicators						
Net worth/total assets (%)	80.1	82.6	88.0	87.7	90.9	91.2
Change in net worth (%)	4.7	(11.1)	40.0	1.3	0.6	19.3

*Adjusted for imputed interest and debt burden of lease obligations. b—Budget.

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Level 37, 120 Collins Street
Melbourne VIC 3000
Tel: (61) 3-9631-2000

Level 27, 259 George Street
Sydney NSW 2000
Tel: (61) 2-9255-9888

Client Services: (61) 1300-792-553

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