DRAFT 4 August1999

4. INTERNAL DEBT MANAGEMENT - continued

4.4 *"Regional Wafer Supply - Net Debt to levy 300%; Nef Financial* Costs *to* Levy 40%"

4.4.1 Effectiveness of Measurement Mechanisms

The Regional Water Supply internal borrowing ratios are a quasi-interest coverage ratio and a quasi-gearing ratio of a similar nature to those used in Section 3.2 and our comments on the effectiveness of these measures (i.e. that standard commercial ratios would not be appropriate) outlined in the previous section hold.

4.4.2 Appropriateness of Internal Borrowing limits

Based on actual figures for 1998, the Net Financial Costs to Levy ratio implies an EBITD interest coverage ratio limit of 1.5 times (actual was 2.1 times). This is not unrealistic for an infrastructure asset, particularly given WRC's ability to rate/levy, but we regard it as at the top end on a long term sustainable basis. Based on current interest rates the Net Debt to Levy ratio represents a much tighter constraint and, all other things being equal, appears conservative.

Regional Water Supply is a highly capital intensive department (with the single largestdebt requirement of WRC's departments/business units) and a revenue stream of which over 80% is derived from a discrete water supply levy (which is imposed directly on the four city councils based on usage). Based on this, we believe the trigger thresholds imposed, which exceed the WRC 'average' as defined bytheborrowing limits set in Section 3.2, are justified.

4.4.3 Suggested Internal Borrowing Targets

Our approach to establishing appropriate internal borrowing targets for Regional Water Supply has been to benchmark the department against other utilities on the basis that WRC will require each of its departments to reflect its own credit risk. This has been facilitated by utilising data taken from S&P for infrastructure investors. The following table is an extract from a S&P Infrastructure Report entitled "Rating Methodology for Global Power Utilities".

4. INTERNAL DEBT MANAGEMENT - continued

FINANCIAL RATIO MEDIANS	Funds From Operations Interest Coverage (x)		Funds From Operations To Total Debt (%)		Total Debt To Total Capital (%)	
	A	BBB	A	BBB	A	BBB
Transmission and distribution companies	3.25	2	15	10	55	65
Generators	6.75	4.25	42	27	35	45
Verticallyintegratedcompanies	4.25	2.75	27	18	45	56

Note:
Financial ratio medians are the average of ratios derived from Standard & Poor's financial projections for companies rated both publicly and confidentially.

In the absence of industry average information for other utility sectors, we have assumed that power utilities represent a proxy for Regional Water Supply, Flood Protection and Regional Parks which share many similar characteristics. For WRC's investment in Regional Water Supply we have assumed that "vertically integrated companies", meaning those with both generation and distribution capacity, best reflect the characteristics of Regional Water Supply operations.

The S&P average ratios are for 'BBB' and 'A ' rated entities. WRC currently has a AA- rating which it wishes to maintain, therefore, we would expect it to target ratios that are slightly more conservative than those shown in the 'A' category. Nevertheless, we feel that water supply is very low risk, particularly given the monopoly supplier position (and rating ability) of WRC and this therefore supports more aggressive ratios. If these effects offset each other and Regional Water Supply targets the average S&P ratios for an 'A' rated company then this implies a Free Funds from Operations to Net Debt ratio of 27% and Free Funds from Operations to Financial Costs ratio of 4.25 times[16]. Backsolving to reach these levels (see Appendix VI - Implied Internal Borrowing Targets), the trigger thresholds set on the implied internal borrowing targets would be Net Debt to Levy 201% - 204% and Net Financial Costs to Levy 13%.

Based on this analysis our view is that the appropriate internal borrowing targets for Regional Water Supply are approximately 220% for the Net Debt to Levy ratio and, given the need for some flexibility in the quasi-interest coverage ratio (the calculations have been based on existing, historically low interest rates), around 20% for the Net Financial Costs to Levy ratio.

16 We have not used the Total Debt to Total Capital ratio to derive implied internal borrowing targets given difficulties in determining capital allocations for the various departments/business units.