Debt Portfolio Manager

The Debt Portfolio Manager (DPM) is a passive debt management service designed to effectively manage interest rate risk in a manner appropriate to a client's individual business requirements.

Overview

This service is administratively efficient, automatically allocating new debt and refinancing maturing debt, within separate portfolio(s) of term fixed rate and / or term floating rate loans, in accordance with the interest rate risk management settings established by the client. WATC can also assist clients in determining the interest rate risk management settings most appropriate for their business.

Key Features

- **Automated Debt Management Service** - Automatically refinances stock lines as they mature.
- **Efficient** - Removes the need for manual client instruction, single transaction request for each drawdown, secured online transactions via the WATC Client Portal.
- **Portfolio Diversification / Hedging Benefits** - Allocates debt throughout the portfolio, hedging is done by WATC resulting in reduced interest rate volatility, without the risks and costs associated with using derivative instruments.
- **Risk Minimisation** - Refinancing and interest rate risks are kept to a minimum. Ability to match the nature of client's borrowing requirements, the term of financial assets and future cash flows.
- **Stability** - The fixed rate debt portfolio provides stability in clients' effective interest rate from quarter to quarter.
- **Variability** - Enables lower portfolio cost over the longer term by using term floating rate debt.

Parameters

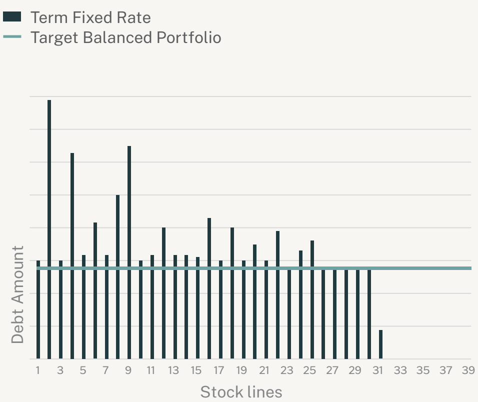
- **Portfolio Maximum Term** - Term fixed rate: 12 years / Term floating rate: 6 years
- **Balance** - Quarterly 'stock lines' of term fixed or term floating rate loans spread evenly out to the maximum maturity.
  Term fixed rate: up to 48 stock lines / Term floating rate: up to 24 stock lines
- **Interest** - Paid quarterly on maturity dates of the stock lines on the first month of each quarter being January, April, July and October:
  Term fixed rate: 15th of the quarter / Term floating rate: 21st of the quarter
- **Repayment of Debt at Face Value** - Available up to the amount of the maturing stock lines on maturity dates.

Transition Example

The example below shows the transition from a 100% Fixed Debt Portfolio to a Balanced 70% 10-year Fixed and 30% 5-year Floating DPM.

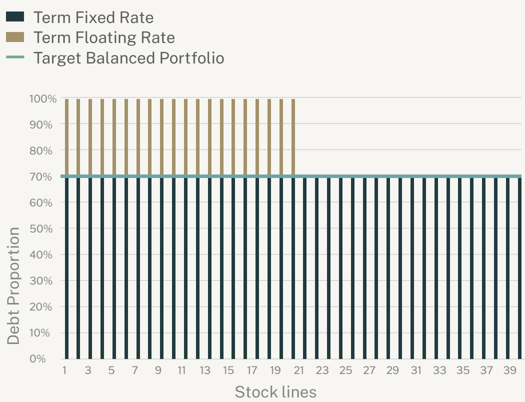
Prior to using DPM

Unbalanced portfolio with uneven maturities



Transition to DPM

Balanced portfolio, even stock lines



> **“The DPM is an excellent service balancing and diversifying our debt portfolio with minimal effort. It saves significant time by removing both the need to individually allocate maturities and the associated administrative effort. Using a portfolio approach, with a mix of Fixed and Floating rate debt, provides assurance of expected interest costs, as well as benefiting from lower interest rates with the use of Floating rate debt.”**
>
> Patrice Domingue
> Horizon Power

Efficient Debt Portfolio

Efficient Debt Portfolio
Defined from a risk / return perspective, this is a portfolio with a debt product combination that either:

- minimises risk for an expected level of interest cost; or
- minimises expected interest cost for a desired level of risk.

Efficient Frontier
Defines the set of portfolio product weights that will achieve either:

- the lowest risk (i.e. measured by the volatility of year-on-year changes in interest costs) for a given expected cost (measured as average interest rate over the analysis period); or
- the lowest expected cost for an assumed level of risk.

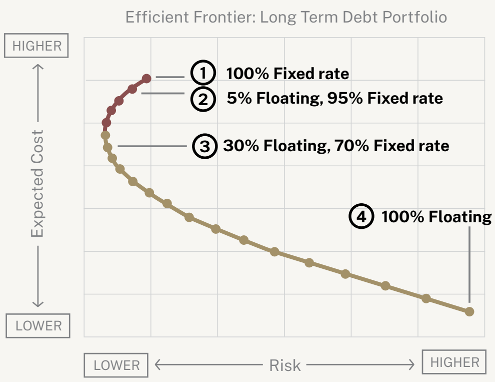
The ‘Efficient Frontier’ Concept
In the absence of a clearly defined revenue framework that has direct links to debt financing (e.g. charging is based on the weighted average cost of capital (WACC) or other contractual cost recovery principles), an agency’s debt management strategy should ideally target a debt portfolio mix between fixed and floating rate debt that lies on the Efficient Frontier.

WATC Research

Applicable to Agencies with Debt Portfolios Expected to be Maintained for the Foreseeable Future
The core component of the research is the modelling of historical data on market interest rates to assess the optimal product weights between a portfolio of:

- term floating rate debt with quarterly interest rate resets out to five years maturity; and
- term fixed rate debt diversified in quarterly maturities out to a ten-year term.

Summary Outcome of Most Recent WATC Modelling – Optimal Product Weights



Plotted on the graph are portfolios with different weightings of fixed and floating rate debt:

- ‘Inefficient’ portfolio because for each combination represented with a red dot, there is an alternative (i.e. a gold portion) with the same risk but a lower expected cost.
- Portfolio combinations of floating and fixed rate debt that lie on the Efficient Frontier.

1. 100% Fixed rate portfolio: the highest expected cost portfolio but not the lowest risk.
2. Each successive dot reflects adding an additional 5% of floating rate debt to the portfolio leading to lower expected cost.
3. 30% Floating, 70% Fixed is an “Efficient” portfolio: minimises expected cost at a low level of risk.
4. 100% Floating rate: Lower expected cost with higher level of risk.

This information is descriptive and general in nature and does not take into account your organisation’s specific financial objectives, situation and needs. Please contact your Client Relationship Manager before making any decisions in relation to WATC’s products and services, so they can provide information and advice on which options are suited to your organisation’s requirements.

Accessing WATC Services
Our services are available to all WA State government agencies and local governments. Contact us for more information and to discuss your specific business requirements.

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