IC Brief

PARA BELLUM ADVISORS

Cross-Currency Carry Leakage

Scenario Type: Project Finance – Operating Phase
Asset Class: Infrastructure / Energy / Transport
Situation Type: Operating-phase offshore debt synthetically converted into domestic currency via long-dated cross-currency swaps
Primary Issue: Persistent carry and basis leakage embedded in long-dated cross-currency hedges, inflating synthetic AUD funding costs despite "fully hedged" status

1. Decision Context

This scenario addresses an operating-phase project finance structure where offshore funding was converted into synthetic domestic debt at financial close.

The asset is mature. Construction risk is gone. Revenues are stable and covenants are being met. On paper, the liability stack remains "fully hedged."

Despite this, all-in funding costs have drifted materially higher than modelled.

The decision question is not whether FX risk exists.
It is whether the **synthetic funding structure remains fit for purpose** under current market conditions.

2. Structural Setup at Close

At financial close, the structure was:

- Offshore EUR / USD / JPY debt raised for pricing and tenor advantage
- Long-dated cross-currency swaps executed to convert liabilities into AUD
- FX risk neutralised in principle
- Treated internally as "synthetic AUD debt"

The structure delivered certainty, diversification, and headline cost savings.

3. How the Risk Actually Manifests

The risk does not present as a shock. It accumulates.

Over time:

- Cross-currency basis widens and remains structurally elevated
- Dealer funding spreads embedded in swaps become economically visible
- Reset timing between debt, swaps, and settlements drifts
- Margin and collateral volatility increase

- Liquidity becomes episodically trapped supporting derivatives

The project remains “hedged.” The synthetic AUD cost does not.

4. What Surfaces on Review

When decomposed properly, several signals typically emerge:

- The headline coupon was never the true cost of funds
- Material economics sit inside cross-currency basis and dealer margin
- Blunt unwind strategies would destroy embedded hedge value
- Collateral mechanics are draining liquidity and optionality

This is not a hedge failure. It is a **synthetic funding design problem**.

5. Why the Original Structure Becomes Misaligned

The structure was optimised for conditions at close: stable basis, long-term debt hold, and limited focus on refinancing or asset rotation.

Operating assets rarely behave that way.

As funding markets evolve and optionality becomes relevant, long-dated monolithic cross-currency swaps stop providing certainty and begin imposing rigidity.

6. Illustrative Structuring Logic

The objective is not perfect hedging. It is **functional synthetic funding**.

Effective responses typically focus on:

- Separating FX conversion, rate hedging, and funding intermediation
- Preserving embedded hedge value rather than crystallising losses
- Replacing rigid long-dated exposure with layered or adaptive structures
- Reducing collateral and counterparty concentration
- The goal is controlled coherence, not diagrammatic elegance.

7. Intended Outcomes

A successful restructure aims to deliver:

- Carry discipline – offshore funding behaves as intended
- Liquidity stability – collateral volatility becomes manageable
- Transparency – funding costs are explainable and governable
- Optionality – refinancing and asset sales are no longer hostage to swap MTM
- Governance clarity – ICs understand outcomes without hand-waving

Not lowest theoretical cost. **Controlled, durable economics.**

8. IC Takeaway

This was not a market failure and not an FX failure.

It was **carry leakage created by synthetic funding design**.

Treating it as a hedge or execution problem destroys value. Treating it as a structural funding problem restores control.

9. Applicability

Most relevant where:

- Offshore debt was raised for pricing or tenor reasons
- Long-dated cross-currency swaps were executed at close
- Refinancing, repricing, or asset rotation is realistic
- Collateral volatility has become noticeable

Less relevant where:

- Debt is short-dated or naturally matched
- Revenues physically offset liabilities
- FX exposure is intentionally retained

10. Engagement Path

Primary Offer: Hedge Rebuild™ – synthetic funding and basis architecture redesign

A full structural narrative is available for readers who wish to review the underlying mechanics, trade-offs, and remediation sequencing in greater detail.

Disclaimer

Illustrative scenario for discussion purposes only. Not a transaction summary or client-specific case study.