IC Brief

Floating-Rate Basis Risk – Operating Assets

Scenario Type: Project Finance – Operating Assets
Asset Class: Transport Infrastructure (toll roads, regulated utilities, availability assets)
Situation Type: Operating-phase floating-rate debt with amended benchmark terms
Primary Issue: Interest leakage driven by benchmark and reset mismatch between debt and legacy hedges

1. Decision Context

This scenario addresses an operating-phase project finance structure where interest expense begins to diverge from modelled outcomes despite the asset being fully hedged.

The asset is mature. Cashflows are stable. There is no credit deterioration.

The IC decision is not whether rates have moved. It is whether the liability and hedge structure still behaves as designed after post-close documentation changes.

2. What Changed

Before close

- Debt and swaps referenced same 3-month benchmark

After close:

- Debt reset shifts to 1-month
- Hedge documentation unchanged

The amendment appeared neutral. Structurally, debt and hedge stopped moving together.

3. How the Risk Actually Manifests

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

As short-dated benchmarks reprice faster than term benchmarks:

- Loan resets occur sooner and higher
- Hedge cashflows lag

Fixed-rate exposure becomes structurally floating.

The asset remains “hedged” on paper. Cashflows do not behave that way.

4. What Surfaced on Review

- Forward exposure understated
- Embedded hedge value at risk
- Accounting pressure emerges
- Ownership fragmented

This is not a hedge failure. It is a structural interaction failure.

5. Structural Assessment

This is not a “wrong hedge” problem. It is a **constraint problem**.

Any solution must preserve:

1. Embedded hedge value
2. Debt stability
3. Explainable cashflow behaviour

Tearing down the hedge typically fails all three.

6. Illustrative Structuring Logic

Principles typically applied:

- Isolate structural basis from timing noise
- Preserve embedded value
- Restore convergence over time
- Resolve documentation and governance upfront

Objective: controlled coherence, not diagrammatic elegance.

7. Intended Outcomes

- Interest expense realigns with expectations
- Basis risk becomes explicit, bounded, and governable
- Embedded hedge value preserved
- Optionality restored

8. IC Takeaway

This was not a market failure and not a hedging failure.

It was a structural misalignment created by post-close documentation change.

Treating it as a rate view or execution issue destroys value. Treating it as a structural problem restores control.

9. Applicability

Most relevant where:

- Operating-phase project debt has shifted benchmark or reset conventions post-close
- Legacy swaps remain on original indices with material embedded value
- Cashflows are stable but interest leakage persists without a credit driver
- Hedge accounting, covenant optics, or refinancing plans heighten sensitivity to unexplained P&L noise

Less relevant where:

- Debt and hedges reset on identical benchmarks and conventions
- Facilities are short-dated or immaterial
- A near-term refinancing will naturally reset the structure
- No meaningful embedded hedge value exists

10. Engagement Path

Primary Offer: Hedge Rebuild™ – Basis risk analysis, overlay design, hedge realignment, accounting and documentation support

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.