PARA BELLUM ADVISORS

PROJECT FINANCE · OPERATING PHASE

Commodity Hedge Collateral Drag – Operating Assets

SCENARIO TYPE	Project Finance – Operating Phase
ASSET CLASS	Resources / Energy Infrastructure (LNG / Mining / Midstream)
RISK FOCUS	Liquidity erosion from derivative collateral mechanics
PRIMARY OFFER	Capital Efficiency Rebuild™
RELEVANT SERVICES	Capital Efficiency Rebuild™ · Commodity hedge re-engineering · CSA optimisation · Collateral diagnostic

THE SITUATION

The project is operating. Construction risk is behind you. Volumes are stable. Offtake agreements are in place. Debt service is being met comfortably.

At financial close, commodity price exposure was addressed in the orthodox way. Lenders required downside protection. Sponsors accepted it. Treasury executed a set of linear commodity hedges – typically swaps – covering a material portion of forecast production.

The hedges did what they were meant to do. They reduced revenue volatility. They supported DSCR modelling. They satisfied credit committees.

They were documented under standard ISDA and CSA terms negotiated years earlier, when price dynamics were calmer, correlations more stable, and liquidity stress scenarios theoretical rather than lived.

The assumption embedded in the structure was simple: hedges protect revenue, and collateral is a secondary technicality. That assumption holds – until market moves test it.

HOW THE TRAP FORMS

Nothing breaks immediately. Commodity prices move against the hedge position, but within tolerances. Margin calls arrive sporadically. Treasury processes them as part of normal operations.

The asset itself may be performing extremely well. Spot prices might even be favourable. Operating EBITDA looks strong. On paper, the project is healthy.

But margin is indifferent to operating performance. It responds only to mark-to-market.

As volatility increases, the cadence changes. Margin calls become larger, more frequent, less predictable. CSA mechanics that were once background noise move to the foreground. What had been treated as a technical annex to the hedge becomes a live liquidity drain.

WHAT TYPICALLY BREAKS

Liquidity erodes silently

Cash assumed to be available for debt service, reserve replenishment, or distributions is tied up as collateral. DSRA balances become sensitive. Treasury shifts to day-to-day cash management rather than strategic planning.

The hedge appears to contradict itself

The hedge is 'working' in a theoretical sense – protecting against price downside – yet the project is haemorrhaging liquidity while prices are strong. Board questions sharpen quickly.

Scale of exposure is underestimated

Initial internal analysis focuses on posted margin today. It rarely models forward exposure under plausible price paths. When the curve is interrogated properly, future collateral requirements often dwarf what has already been posted.

Options feel binary

Keep posting collateral and risk covenant pressure. Unwind hedges and crystallise large losses. Seek ad-hoc liquidity support. None of these were what anyone signed up for at close.

THE STRUCTURAL INSIGHT

The instinctive reaction is to fix the hedge. That is rarely the right starting point.

The starting point is a liquidity-first diagnostic – decomposing the hedge not by instrument type, but by cash behaviour: where margin is generated, why it is triggered, how it scales, and under what conditions it accelerates.

Often the problem is not that the hedge exists, but that its payoff profile is unbounded while liquidity is not.

Effective responses typically focus on restoring balance rather than eliminating risk. This may involve reshaping linear exposures into bounded ones, separating economic protection from collateral intensity, or reallocating positions to counterparties better aligned with the project's liquidity profile – without destroying embedded value or destabilising lender relationships.

INTENDED OUTCOMES

- Collateral drag becomes measurable, bounded, and governable – liquidity stops leaking unpredictably.
- Cashflow behaviour realigns with operating performance rather than being dictated by mark-to-market mechanics.
- Embedded hedge value is preserved rather than sacrificed under pressure.
- Management regains agency – the project carries commodity risk in a form proportionate to its balance sheet and operational reality.
- Decision-makers have clarity over how much risk is being carried, why it exists, and how it behaves under stress.

WHERE THIS APPLIES

Most relevant where long-dated, linear commodity hedges are in place; CSA terms require frequent cash margining; commodity prices have moved materially against the hedge; and liquidity buffers are finite or covenant-constrained.

Less relevant where hedges are short-dated or lightly margined, physical settlement naturally offsets exposure, or projects retain substantial unrestricted cash.

TYPICAL ENGAGEMENT PATH

Capital Efficiency Rebuild™ – Collateral & Liquidity Efficiency module. Secondary: Commodity hedge re-engineering, CSA renegotiation, collateral diagnostic. Scope confirmed following a focused diagnostic review.

Illustrative scenario based on common operating-phase project finance patterns. Details have been anonymised. Outcomes depend on hedge structure, counterparty documentation, market conditions, and accounting constraints. Not investment advice.