



# ESG-Linked Hedge Optimisation – Operating Infrastructure Assets

<b>SCENARIO TYPE</b>	Project Finance – Operating Phase
<b>ASSET CLASS</b>	Infrastructure / Renewables / Regulated Assets
<b>RISK FOCUS</b>	Misalignment between ESG performance, debt pricing, and hedge economics
<b>PRIMARY OFFER</b>	Structuring-as-a-Service™
<b>RELEVANT SERVICES</b>	Structuring-as-a-Service™ · Hedge Rebuild™ · ESG-linked derivative redesign · Hedge effectiveness review

## THE SITUATION

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The asset has been operating for years. Renewable generation, regulated utility, availability-based infrastructure – predictable cashflows, long-dated debt, and a capital structure put in place before ESG became commercially priced rather than rhetorically encouraged.

At financial close, the focus was orthodox: floating-rate project debt, vanilla interest rate swaps to fix cost of funds, standard covenants and reserve accounts. ESG was acknowledged but not monetised. Environmental performance was something the asset did, not something the capital structure paid for.

Since then, the world moved. Sponsors publish sustainability reports. Lenders roll out ESG scorecards. Peers refinance into sustainability-linked loans with margin ratchets and pricing incentives.

The asset did not suddenly become non-compliant. It simply was not built to capture value from behaviour it was already delivering. The embedded assumption – that ESG considerations could be layered onto debt later without touching the hedge – is where the problem starts.

## HOW THE TRAP FORMS

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It starts with administration, not strategy. A lender introduces ESG reporting requirements. A facility amendment references sustainability KPIs. A margin ratchet is proposed – five, maybe ten basis points if targets are met.

The asset already meets the metrics. Treasury signs off. The hedge is untouched. No one raises it. The swaps still fix interest costs; debt pricing improves slightly; everyone moves on.

Then a peer asset refinances. Same sector, similar risk, same lenders. Their all-in cost of debt is visibly lower – not just margin, but economic cost after hedging.

The uncomfortable realisation follows. The debt pricing has moved. The hedge has not. The project company is structurally long ESG performance on the asset side, but short ESG optionality on the liability side.

## WHAT TYPICALLY BREAKS

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### The asset bears the cost without the reward

The project is absorbing full ESG compliance cost – reporting, verification, governance overhead – while the capital structure remains priced as if none of that performance exists.

### Hedge accounting becomes fragile

Once ESG-linked variability enters the liability but not the hedge, effectiveness testing becomes harder to defend. Finance teams find themselves explaining P&L noise unrelated to operations.

### The hedge blocks the benefit

Legacy swaps reference vanilla benchmarks and static economics. When ESG-linked margin adjustments are layered onto the debt but not reflected in the hedge, the result is basis leakage. A pricing benefit becomes a partial illusion.

### Responsibility is diffused

Treasury manages what exists. Asset management assumes the hedge is inert. Sustainability teams focus on reporting, not capital structure. A persistent value gap belongs to no one and therefore remains unaddressed.

## THE STRUCTURAL INSIGHT

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The starting point is not adding ESG language to a hedge. It is recognising the constraint set the asset now operates within.

Legacy swaps were often executed at fixed rates that cannot be replicated. Unwinding them to achieve cosmetic alignment with amended debt terms typically destroys value far in excess of any ESG benefit. The goal is to adapt the hedge's behaviour without forfeiting its economic advantage.

Structurally, this usually means parallelism rather than substitution. ESG-linked variability is mirrored, bounded, or offset within the derivative framework so that margin improvements on the debt are not lost through basis effects.

Crucially, the hedge and the liability must move together. If sustainability performance improves financing costs, the hedge must reflect that improvement in a way that remains auditable, explainable, and stable through time. Accounting and governance are treated as design constraints, not afterthoughts.

## INTENDED OUTCOMES

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- ▶ ESG effort stops being a cost centre – sustainability metrics already being measured begin to express themselves in actual financing economics.
- ▶ Financing behaviour becomes predictable – interest expense and hedge performance track each other in a way that can be modelled, explained, and defended.
- ▶ Embedded value preserved – legacy hedges executed under earlier market conditions are not sacrificed to achieve surface-level alignment.
- ▶ Governance friction falls away – recurring tension between treasury, sustainability teams, and auditors dissipates once ESG-linked variability is structurally integrated.
- ▶ Optionality restored – refinancing, extensions, and asset sales become feasible without reopening unresolved hedge problems.

## WHERE THIS APPLIES

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Most relevant where assets are operational with stable ESG performance; debt has incorporated ESG-linked pricing features; legacy swaps remain vanilla and long-dated; and refinancing optionality matters to sponsors. Less relevant where assets are pre-completion, ESG metrics are immature or volatile, or debt and hedge were structured together recently under a sustainability-linked framework from the outset.

### TYPICAL ENGAGEMENT PATH

Structuring-as-a-Service™ – ESG-linked derivative and hedge redesign. Secondary: Hedge Rebuild™, hedge effectiveness review, accounting and documentation continuity. Scope confirmed following a focused diagnostic review.

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

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