



Hedging in UK Real Estate Finance Transactions - Part 2



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Following our [article](#) from last month, we continue with our discussion on hedging in real estate financing transactions by discussing the frequently negotiated tension points between the facility agreement and the Hedging Agreement.

Structural points to consider

Conflicts between documents. The Hedge Counterparty will start its negotiation from the expectation that the ISDA Master Agreement, Schedule and confirmation that govern its relationship with the Borrower shall prevail. We therefore need to consider the extent to which the provisions of the facility agreement can override those of the Hedging Agreement.

- There will be some general provisions agreed in the facility agreement (such as governing law, tax credits or duty to mitigate) which the Hedge Counterparty would not necessarily want to follow with respect to its Hedging Agreement.
- Separately, the definitions of Finance Party and Finance Documents will exclude, in many circumstances, the Hedge Counterparty and the Hedging Agreement, *i.e.*, the Hedge Counterparty would not necessarily have voting rights under the facility agreement.
- The Hedge Counterparty will also consider and restrict the adverse actions that the Borrower agrees to under the facility documents, *e.g.*, allowing the release of the security, amendments to the waterfall – and the Hedge Counterparty will negotiate that it has to be given sufficient notice of any such proposed changes and that its consent should be obtained before the Borrower can agree to any adverse changes.

Security. The Hedge Counterparty would aim to share the control over the security arrangements and their enforcement right with the senior lenders. They will also ensure that any security documents cover the Hedge Counterparty as a secured finance party and cover all payments under the swap as secured liabilities.

Priorities of Payment. The Hedge Counterparty will want to rank either *pari passu* with or senior to the senior lenders. Therefore, the Hedge Counterparty will review the waterfalls to ensure that principal and interest-type payments are only ever applied in accordance with the agreed order of priority and that no other leakage takes place.

Prepayment. The Hedge Counterparty will incur costs associated with the swaps if partial or full prepayment of the loans occurs. The Hedge Counterparty will therefore negotiate (i) having advance notice of any prepayment, probably in addition to being the recipient of all the transaction reports, with (ii) the calculations being made by the Hedge Counterparty on its side of the market and (iii) having the right to get paid, under the waterfalls, on the date that the repayment funds are applied.

Interest. Both the Hedge Counterparty and the senior lenders will consider if there are mismatches in the calculation of the applicable interest rate benchmarks, including the business day conventions, day count fractions, and the hierarchy of fallback provisions.

Ratings. Some deals may attempt to anticipate rating requirements associated with any potential securitisation and to write their swaps accordingly with a vast array of rating-agency-required ISDA modifications, as well as rating triggers and tightly-regulated routes to cure drops in the Hedge Counterparty's ratings. The Hedge Counterparty is likely to resist deviations from its "corporate"-style form that anticipate a securitisation.