PARA BELLUM ADVISORS

FAMILY OFFICE · MULTI-GENERATIONAL PROPERTY PORTFOLIO

Rates Hedge Redesign for a Family Office with Long-Duration Property Debt

SCENARIO TYPE	Family Office – Multi-Generational, Commercial Property Portfolio
ASSET CLASS	Commercial property, long-dated floating-rate debt, pay-fixed interest rate swap
RISK FOCUS	Instrument mismatch, governance fracture, gross cash flow reporting, legacy ISDA terms, no pre-committed review framework
PRIMARY OFFER	Hedge Rebuild™
RELEVANT SERVICES	Dual-bucket liability framework · Instrument mix redesign · ISDA and CSA renegotiation · Consolidated net reporting · Governance reset

THE SITUATION

The property was performing. The debt was manageable. The hedge was the problem.

A multi-generational family office had assembled a substantial commercial property portfolio over two decades – industrial assets, suburban office, and some mixed-use – financed through a combination of bank debt and private credit facilities, most of it floating rate. When rates were low, that was a deliberate choice: cheap floating debt funded cash-flowing assets with long hold periods.

To manage the interest rate risk, the family office had entered a pay-fixed, receive-floating interest rate swap several years earlier. When rates moved sharply, the floating-rate debt became materially more expensive. The swap moved into the money as designed: the locked-in fixed rate was below prevailing floating rates, and the economic benefit of the hedge was real.

What the governance process was not prepared for was the cash flow picture it was receiving. Floating rate debt interest payments were rising each month and being reported gross. The swap was generating an offsetting economic benefit, but that benefit was not fully visible: the ISDA documentation had been entered on legacy terms with a high bilateral threshold, meaning the family office could not call variation margin from the counterparty until the MTM moved past a material level. The economic gain existed but treasury was not yet seeing the offset in cash.

The result was a governance process looking at rising debt costs on one side of the ledger and limited visible offset on the other. The Investment Committee was asking whether the hedge was working. The CIO was explaining, for the third consecutive quarter, why the net economic position was sound while the reported cash flows told a different story. The pressure that built was not to improve the structure – it was to unwind a hedge doing exactly what it was meant to do, at exactly the moment when unwinding it would crystallise the interest rate exposure it was managing.

HOW THE REPORTING PROBLEM FORMS

Pay-fixed swap programmes for property debt are designed around the interest rate exposure, without adequate attention to how the cash flow mechanics will be presented when the hedge actually activates.

When rates rise, the pay-fixed party benefits economically. The fixed rate being paid is below the floating rate being received on the swap, and below the floating rate being paid on the underlying debt. The two

largely offset: rising debt cost is absorbed by the rising swap receipt. The net interest burden is close to the fixed rate locked in at inception.

The problem is presentation. Most family office reporting systems do not net the swap cash flows against the debt cash flows automatically. Debt interest is reported through the property entity. The swap sits in a separate treasury or investment vehicle. The Investment Committee sees debt costs rising in one report and swap-related items in another – without a single line showing the net economic position.

Legacy ISDA documentation compounds this. High bilateral threshold provisions require MTM to exceed a material level before variation margin can be called. In a fast-moving rate environment, the swap moves into the money quickly but the threshold delays incoming margin by weeks or months. Treasury sees no variation margin inflow to offset the rising debt payments it is funding. The hedge is working in economic terms. It is invisible in cash flow terms.

WHAT TYPICALLY BREAKS

Instrument-to-liability mismatch

A single pay-fixed swap on the aggregate debt notional treats all debt as structurally equivalent. Property portfolios carry a mix of durable exposures – assets held indefinitely – and discretionary exposures – assets that might be sold or refinanced. Hedging a discretionary exposure with a long-dated fixed-rate instrument creates an orphaned position if the asset exits.

Documentation design working against governance

Legacy ISDA terms with high bilateral thresholds delay incoming variation margin by weeks or months in a fast-moving rate environment. The threshold that seemed immaterial at low rates creates cash flow opacity at exactly the moment the hedge is most needed – eroding Investment Committee confidence in a programme that is economically sound.

Reporting that presents costs without offsets

A hedge presented in a different report from the liability it protects will always look like a cost rather than an offset. The governance process never sees the net economic position that justifies the programme. When questions arise, the reporting provides no basis for a confident answer.

No pre-committed review framework

Under what conditions should the hedge be reduced? What triggers prompt review? Who has authority to act? Without answers embedded before the hedge goes on, every subsequent decision is reactive and emotionally charged – and the default becomes unwinding a working structure under pressure.

THE STRUCTURAL INSIGHT

The balance sheet of a multi-generational family office with property debt is not one problem. It is two.

There are structural exposures: debt on assets the family intends to hold indefinitely, where the interest rate risk is real, persistent, and should be closed. These warrant long-dated hedges designed to endure across regimes.

There are discretionary exposures: debt on assets that might be sold, refinanced, or repositioned within the hedge tenor. These are exposures where flexibility matters and where a long-dated fixed-rate commitment creates optionality risk rather than managing it.

A dual-bucket liability framework separates these two categories explicitly and designs different instruments for each. Structural exposures can tolerate instruments that reduce optionality in exchange for certainty: longer-dated swaps, fixed-rate term debt, or forward-starting structures that lock in rate protection without requiring immediate premium outlay. Discretionary exposures warrant instruments that preserve flexibility: shorter-dated structures, caps rather than swaps, or accepting the floating rate exposure on assets where exit timing is not predictable.

For the structural bucket, the existing swap was retained but resized to match the debt on those specific assets. The ISDA documentation was renegotiated: the bilateral threshold was reduced to a level that allows

variation margin to flow within days of the swap moving materially into the money – eliminating the visibility gap that had been driving governance pressure. A forward-starting swap was layered in on a portion of the structural exposure to extend rate protection beyond the current tenor without requiring immediate additional carry cost.

For the discretionary bucket, the swap exposure was replaced with interest rate caps. Caps have a defined upfront premium cost, generate no variation margin in either direction, impose no margining requirements beyond the initial premium, and carry no orphan risk if the underlying asset is sold before expiry. For a governance process already strained, that trade-off was clearly worth making.

A consolidated reporting framework was built to present debt costs and swap economics on a net basis – a single view showing the effective fixed rate across the portfolio, the floating rate payable without the hedge, and the net cash flow impact of the programme.

INTENDED OUTCOMES

- Investment Committee received a net economic view of the programme for the first time – rising debt costs and swap receipts presented together; the confusion between gross reporting and economic reality was eliminated.
- ISDA renegotiation meant variation margin flows in a timely way, visible in treasury, and attributable to the hedge in reporting – margin call conversations stopped being governance crises.
- Dual-bucket separation removed orphan risk – when a transitional asset was sold twelve months later, the cap on that exposure simply expired; exit economics were clean.
- Pre-committed review framework embedded – defined triggers for reconsidering hedge ratios, pre-authorised CIO decision rights within specified parameters, annual review cadence that re-underwrites the programme against the current portfolio.
- A hedge that behaves because it reflects the reality of the balance sheet, and a governance process that can sustain it because it understands what it is looking at.

WHERE THIS APPLIES

Most relevant where a family office holds a mixed property portfolio financed with floating-rate debt; has an existing swap programme designed around aggregate notional rather than individual liability characteristics; and is experiencing governance pressure driven by reporting opacity or legacy ISDA terms rather than genuine economic failure of the hedge.

Less relevant where the property portfolio is homogeneous in hold-period intent; governance reporting already presents debt and derivative economics on a net basis; or debt is already at fixed rates and the swap programme is unnecessary.

TYPICAL ENGAGEMENT PATH

Hedge Rebuild™ – interest rate programme redesign and governance reset.

Secondary: Dual-bucket liability framework, instrument mix redesign across swap and cap structures, ISDA and CSA renegotiation, consolidated net reporting framework, Investment Committee reporting pack, pre-committed review framework.

Illustrative case study for discussion purposes only. Details have been anonymised and stylised to represent a common engagement pattern rather than a specific client mandate. Outcomes depend on market conditions, counterparty documentation, and accounting constraints. Not investment advice.