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Margin Isn't Where the Value Is

Why covenant headroom, cash control and usable extension rights often outweigh a few basis points of margin when a UK real estate facility is refinanced.

KEY FIGURE

03

£50,000

Annual value of a 25 bps margin saving on a £20m loan: real money, but a bounded saving.

KEY FINDINGS

- 01 A 1% arrangement fee on the same loan is £200,000, enough to absorb the margin saving over a short hold.
- 02 In our worked example, the cheaper facility's cash trap sits less than 2% below current income; the alternative allows about 10%.
- 03 Structural points deferred to documentation are hard to win once the timetable has momentum.

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Margin Isn't Where the Value Is

Borrowers negotiating a refinancing often make pricing the main event. In practice, more recoverable value can sit in covenant headroom, cash-control mechanics and usable extension rights. We start with the business plan, then test whether the structure protects it.

Pricing is only one part of the economic outcome

Margin deserves attention. It is visible, easy to compare and directly affects interest cost. It is also set within a relatively narrow range for a given sector, leverage band and risk profile. CBRE's 2026 lender survey found that median senior margins were broadly stable across most sectors, even though individual responses varied widely by lender type and geography.

DWS estimates that European prime senior margins had compressed by about 40 basis points from their 2024 peak to roughly 1.6% in early 2026. On a £20 million loan, a further 25-basis-point saving is worth £50,000 a year before fees. That is real money, but it is a bounded saving. A tight cash trap, weak cure rights or an unusable extension can change access to far more cash and can force a refinancing or equity decision at the wrong time.

~1.6% European prime senior margin in early 2026	~40 bps compression from the 2024 peak	£50,000 annual cost of 25 bps on a £20m loan
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Sources: DWS Europe Real Estate Debt Strategic Outlook, May 2026, and CBRE European Lender Intentions Survey 2026. The £50,000 calculation is illustrative and excludes fees, amortisation and hedging costs.

The margin is not the whole price

A complete cost comparison should use the same drawn balance and time horizon for every option. It should include arrangement, commitment, agency and extension fees; scheduled amortisation; hedge premium and break costs; and any prepayment or release price. These amounts can outweigh a modest spread difference over a short hold.

For example, a 1% fee on a £20 million facility is £200,000. A 25-basis-point margin difference over an 18-month hold is £75,000 on the same balance. The cheaper margin is not the cheaper route if its fees or exit costs absorb the saving. The comparison should therefore model the expected hold, an extension case and an early sale or refinance.

Structure determines the room to execute

A refinancing succeeds over its full term, not only on the day it closes. The useful comparison is therefore the whole facility: the price paid, the downside the covenants can absorb, the circumstances in which the lender controls cash, and the routes available if the asset is sold, refinanced or held for longer than planned.

These terms are file-specific. A credit committee sets them against the asset, sponsor, leverage and business plan, which gives a prepared borrower more scope to influence them. The credit paper must explain why the requested headroom is consistent with the underwritten risks and how the lender remains protected.

HOW A TERM SHEET BECOMES AN OPERATING OUTCOME

01 PRICE Margin, fees and hedge	02 HEADROOM Covenants and cure rights	03 CASH CONTROL Traps, sweeps and releases	04 EXIT Extensions, prepayment and transfer
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The cheapest headline price is not automatically the lowest-risk or lowest-cost facility. The answer depends on the borrower's income profile, capex programme, hold period and exit plan.



Where recoverable value usually sits

The first task is to convert the business plan into a term-sheet brief. That brief should define the downside the facility must withstand, the cash needed to operate the asset, the likely exit routes and the conditions the borrower can realistically satisfy. Only then can two offers be compared on a like-for-like basis.

WHERE RECOVERABLE VALUE USUALLY SITS

Term	What to settle	Why it changes the outcome
Covenant headroom	Test level, calculation basis, cure rights, testing dates and valuation mechanics	Determines how much income or value deterioration the facility can absorb before control shifts to the lender
Cash trap and sweep	Trigger, trapped account, permitted payments, cure and release conditions	Controls whether rent remains available for capex, distributions and the operating plan
Extension options	ICR and LTV tests, hedge length, fees, capex milestones and absence-of-default conditions	Shows whether an apparent option is usable when the borrower actually needs it
Hedging and prepayment	Required hedge, break costs, partial prepayment, release prices and make-whole language	Affects the cost of selling, refinancing or deleveraging before maturity
Transfer and flexibility	Change of control, permitted transferees, leasing, capex and additional debt	Determines whether the financing can accommodate the asset plan rather than restrict it

Definitions matter as much as trigger levels

Two term sheets can quote the same ICR covenant and still provide different headroom. One lender may test against the actual hedge rate; another may use a stressed rate. One may deduct amortisation from coverage or exclude rent that is subject to a break, expiry or incentive. Cure rights, testing frequency and the period required to release trapped cash also change the practical result. Each covenant should be rebuilt using the lender's definition and the borrower's projected cash flow.

A cheaper facility can carry less usable value

The illustration below uses a fully drawn, interest-only £20 million facility, £1.73 million of annual net income and a 4.75% fixed-rate hedge. It isolates four structural terms and ignores fees, amortisation, valuation tests and cure rights. The assumptions are examples, not market quotations.

ILLUSTRATIVE TERM-SHEET TRADE-OFF ON A £20M FACILITY

Measure	Option A Lower price	Option B More headroom
Margin	1.55%	1.70%
All-in interest rate	6.30%	6.45%
Annual interest	£1.26m	£1.29m
Current ICR	1.37x	1.34x
Cash trap trigger	1.35x	1.20x
Default covenant	1.25x	1.15x
Extension ICR	1.30x	1.15x

Option A saves £30,000 of annual interest. Its 1.35x cash trap sits less than 2% below current income, while Option B's 1.20x trigger allows about 10% income headroom. The calculations use the stated interest expense and assume no change in the test definition.

There is no universal winner. Option A may suit a stable asset with strong income visibility and a short hold. Option B may be more valuable where lease events, capex or a longer exit timetable create volatility. The decision should be made against a modelled base case and downside case, not from the margin line alone.



Negotiate structure before momentum shifts

Pricing is normally discussed early and anchored quickly. Structural points are often deferred to documentation, when the borrower has selected a lender, diligence is under way and the timetable has acquired its own momentum. At that stage, a request that changes the lender's credit approval can be difficult even if the commercial point is reasonable.

The better sequence is to identify the terms that affect the business plan before final bids, include them in the lender brief and compare responses in a written term-sheet matrix. Material deviations should be resolved before exclusivity. Counsel can then document an agreed commercial position rather than discover it.

THE TERM-SHEET POINTS TO SETTLE EARLY

Point	Question for the borrower	Decision required
Debt quantum	What leverage and coverage survive the downside case?	Set the acceptable loan amount and equity requirement
Covenants	Which tests apply, how are they calculated and what cure rights exist?	Protect sufficient headroom for the business plan
Cash control	When can rent be trapped or swept and how is it released?	Preserve operating cash for agreed capex and asset management
Extension	Are every option's conditions achievable in a plausible downside?	Treat only usable extension periods as tenor
Exit flexibility	What do hedging, prepayment, release and transfer provisions cost?	Keep sales, refinancing and portfolio changes executable
Documentation	Which commercial points cannot be left to lender counsel?	Record them in the term sheet before exclusivity

What we look at first

We start with the asset plan and the downside case. The key questions are how far income or value can fall before a cash trap or default, how much liquidity the asset needs during that period, whether an extension remains available in the same conditions, and what it costs to sell or refinance early. Margin is then judged alongside those answers.

- Compare covenant definitions as well as covenant levels. The same stated ICR can produce a different result if one lender assumes a higher interest rate, includes amortisation or excludes part of the income.
- Measure headroom in operating terms. Translate each trigger into the rent loss, vacancy, valuation decline or capex overrun that would activate it.
- Keep material commercial points in the term sheet. A point that needs fresh credit approval is not safely left to documentation.

The Chiltern view

Chiltern provides independent UK real estate debt advice to international owners and acquirers, and to the investment and asset managers acting for them. Financing Execution compares the complete economic and operational effect of each proposal, including margin, fees, debt quantum, covenants, cash controls, extensions, hedging, prepayment and conditions before drawdown.

The output is a written term-sheet comparison tied to the business plan and downside case. It gives the borrower a clear negotiation brief before lender selection and a commercial record for documentation. Chiltern acts for the borrower and approaches no lender without written approval.

NEXT STEP

Discuss a financing

Five facts. A written Initial Finance View within 48 hours. No fee, no obligation.

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Sources and basis

CBRE, European Lender Intentions Survey 2026, 16 June 2026, 134 Europe-based respondents; DWS, Europe Real Estate Debt Strategic Outlook, May 2026. Market evidence is combined with Chiltern's practitioner interpretation of commercial real estate term-sheet mechanics. Worked figures are illustrative and are not indicative terms.

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