Trends in Fund Finance in light of COVID-19

Ramya Tiller
Partner, Debevoise & Plimpton

Wes Misson
Partner, Cadwalader

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Debevoise & Plimpton

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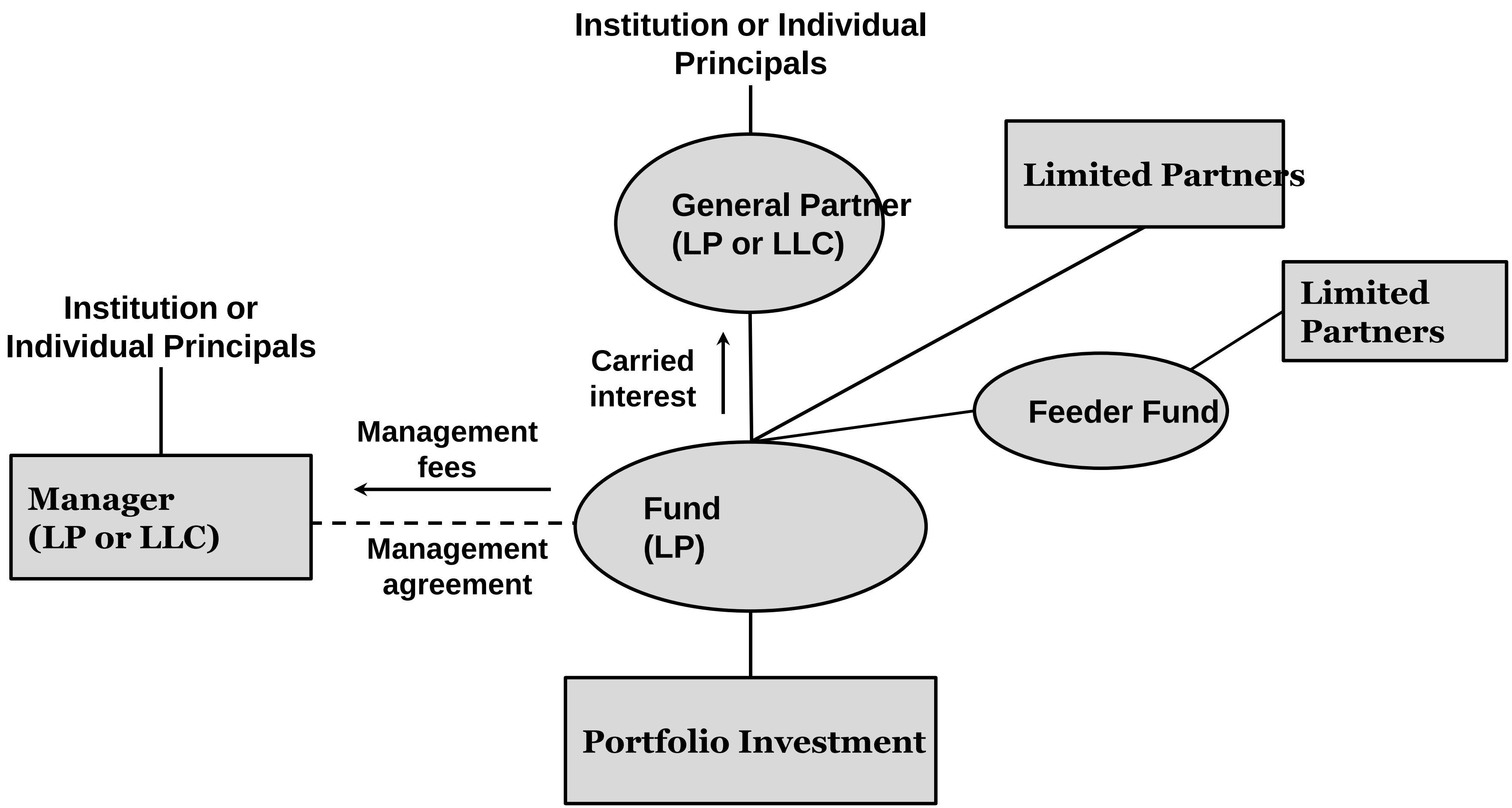
A Simple Fund Structure



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Common Fund Financing Structures

- Subscription Credit Facilities
- NAV Facilities
- GP-Sponsored Solutions

Subscription Credit Facilities - Overview

- Typically senior secured revolving facilities secured by the unfunded capital commitments of fund investors (i.e., the Fund and GP's right to call capital, receive contributions and enforce commitments) and accounts designated to receive capital contributions.
- The purpose is generally to provide financing for bridging of capital calls, on either a short-term or longer-term basis.
- Features
  - Typically committed, but not always; may be payable on demand
  - Typical maturity is 1-4 years
  - May include various features available in the wider revolving credit facility market (multicurrency, letters of credit, swingline, hedging)

Trends in Subscription Facilities

- Shift in market players:
  - some institutions have taken a pause on new originations or decided to service only existing clients or their portfolio
  - others have opportunistically stepped forward.
- Faster paced transactions in light of uncertainty.
- Higher pricing, including LIBOR floors materially above zero.
- Tightening of credit standards:
  - more lender friendly terms and less negotiation on risk elements.
  - more focus on the assets and investor pool.
  - more frequent reporting – i.e, borrowing bases monthly instead of quarterly, ability to confirm LP commitments, etc.
  - slight comeback of investor letters.

Trends in Subscription Facilities (cont'd)

- Credit performance remains relatively pristine:
  - only one known institutional investor default and related to a highly affected industry
  - very few late investor fundings – mostly HNW investors and family offices due to COVID-19 related impact
  - breaches of financial covenants have been rare – seen only in certain energy funds given disruption in the oil market.
- Massive uptick in portfolio and facility maintenance:
  - facility increases on both permanent and temporary basis
  - maturity extensions (including many coming early, with some lenders reducing their commitment of refusing to extend)
  - qualified borrower and AIV joinders: QB joinders now en vogue as a new found source of liquidity for liquidity starved portfolio companies
  - flip from uncommitted to committed lines.

Trends in Subscription Facilities (cont'd)

- ESG Mechanics incorporated into Subscription Facilities
- LPA amendments aplenty re:
  - a shift in investment focus (i.e, increased concentration limits for certain asset classes)
  - commitment reductions and/or reallocations to better positioned strategies
  - increased usage and availability of distributions as recyclable capital
  - overcall limitations including carve-outs for facility repayment.
- The rise of E-signatures.
- State filing office, DACA and KYC hiccups.
- Cayman Private Funds Law.
- Transaction structures have remained sustainable in the face of COVID-19, much as they did during the Great Recession in 08-09.

NAV Facilities - Overview

- Lenders “look down” to fund assets instead of “looking up” to capital commitments.
- Various uses:
  - Acquisition financing by secondaries funds
  - Financing alternative for open-ended funds
  - Levered investment strategy for credit funds
  - Dividend recaps and bridges to exit
  - Re-levering concentrated pool of investments
  - Since COVID-19, more sponsors are considering NAV facilities to provide liquidity for working capital and to fund downstream obligations in respect of portfolio investments.

NAV Facilities – Overview (cont'd)

- Calculating NAV:
  - Borrower Valuation Policy; Sponsor-reported; Lender determination
  - Challenges in calculating value when assets consist of investments in operating / portfolio companies and other illiquid assets.
  - Lender's right to periodically value collateral and dispute mechanics.
- Valuation Policy: Borrowers are generally required to revalue their portfolio investments consistent with a Valuation Policy, which must be disclosed to and approved by lenders.
- Revaluation Events: Material write-downs, asset sales and casualty events and other potentially bespoke events.
- Lender discretion if the Lender reasonably believes the Valuation reported by the sponsor or determined by the Borrower accurately reflects the value of the assets.

NAV Facilities – Overview (cont'd)

- LTV = Outstanding principal amount of loans plus cash : NAV of eligible assets (after giving effect to concentration limits and other applicable haircuts)
- Maximum LTV
  - If NAV decreases and the Maximum LTV is breached, Borrower will be required to either pay down the loan or propose a plan (subject to lender approval) to come into compliance with the applicable LTV within a specified period of time (e.g., 90 days).
- Some NAV facilities provide for periodic LTV step-downs, which could compound the need to prepay the loan.
- Some NAV facilities are structured in a manner such that the Applicable Margin moves with the LTV. As LTV increases (e.g., if NAV decreases), the Applicable Margin increases.

Trends in NAV Facilities

- Sponsors increasingly turning to NAV facilities from alternate lenders as a source of liquidity for invested funds with limited uncalled capital.
  - Use of proceeds may be opportunistic or defensive (or both), intended to increase investment capacity for lower-cost targets or to preserve value in any distressed portfolio assets.
  - Demand for delayed draw even in primarily defensive facilities.
  - Uptick of interest in concentrated NAV facilities, including by primary funds (including larger mid-cap funds).
  - Increased diligence and bespoke approaches to valuation, especially given current environment.
- May offset any lag in subscription facility origination.

Trends in NAV Facilities (cont'd)

- Valuation terms / rights potentially shifting more in favor of lenders.
  - COVID-19 did not have demonstrable negative impacts on Q1 results for portfolios. Negative impacts on Q2 results could result in valuation write downs, which could trigger LTV events.
  - Individual portfolio investments could also be subject to material exclusion events that permit the lenders to remove the investment from the NAV calculations.

GP-Sponsored Solutions

GPs are exploring alternative solutions for sourcing capital at the fund level.

- Preferred Equity Issuance
  - New investor(s) provide capital in exchange for priority distributions from some or all of portfolio investments.
  - More expensive than bank debt, but the terms could be more flexible (e.g., no specified maturity, unsecured, covenant light).
- Fund Restructuring
  - Transfer portfolio to a successor fund capitalized by new investors and existing investors who “rollover” into the new fund.