Global Fund Finance Symposium – a 10-point Summary of the NAV/Hybrid Facilities Panel

April 1, 2019

On March 26, we had the pleasure of speaking on the NAV and Hybrid Facilities Panel at the Global Fund Finance Symposium in Miami, consisting of Thomas Smith (Debevoise & Plimpton LLP), Steve Colombo (Goldman Sachs Asset Management), Vicky Du (Standard Chartered Bank), Brian Goodwin (J.P. Morgan Asset Management), Katie McMenamin (Travers Smith) and Adam Summers (Fried, Frank, Harris, Shriver & Jacobson). We have summarized a few of the topics covered during the discussion.

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What is a NAV facility? NAV facilities mean different things to different people. There really is no "one size fits all." A credit fund may conduct a levered investment strategy from inception of the fund. A secondaries fund may use a NAV facility to effect a dividend recap. A private equity fund may re-lever a concentrated pool of its investments. An open-ended infrastructure fund may rely on its NAV rather than its limited uncalled capital due to its open-ended strategy. These are just some of the potential uses of NAV facilities.

Market conditions. The fundraising climate remains generally positive, and there remains an abundance of liquidity in the market for sponsors to invest. This material liquidity in the market has, in part, caused asset prices to increase. In that context, leverage can help funds maximize returns from their investments.

Which asset classes lend themselves to NAV facilities? The key consideration is liquidity of the underlying investments. Credit funds and secondaries funds hold relatively liquid assets, which helps a NAV lender's credit analysis. Private equity investments are much less liquid. There are fewer lenders in the market willing to lend against illiquid assets, although the lender market is growing.

Structuring the financing – getting consents. Third-party consents may be needed to put in place a financing. The requirements will depend on the fund structure, security package and nature of underlying investments. For example, a secondaries fund effecting a dividend recap would need to consider whether it must obtain GP consents in respect of its underlying investments to transfer those investments under a new SPV, to give security over that SPV and for the lender to ultimately enforce security. Lenders will likely conduct diligence on the underlying assets to understand consent requirements.

Structuring the financing – lender security. Any sponsor wanting to raise a NAV facility should consider a lender's potential security package when setting up its fund investment structure. Lenders may ask to take security as close to the assets as possible, although ultimately this is a negotiation point (based in part on a cost vs. benefit analysis and required consents). Lenders may require at least a share pledge over holdco SPVs below fund level which hold the assets. Lender requirements (again) vary across lenders, structures and investment strategies.

Facility terms – who will value the assets? In any NAV facility, valuation of the assets is a key aspect. Many types of assets (such as private equity investments, secondaries investments and infrastructure investments) are difficult to value other than by the sponsor. In many NAV facilities, lenders will therefore accept the sponsor valuation of underlying assets, by reference to information in sponsor financial statements prepared for their limited partners (provided the sponsor evidences an appropriate valuation methodology). The valuation of credit fund assets is the main exception to this approach, and the valuation approach for credit fund investments is heavily negotiated. Credit fund sponsors may be prepared to accept that broadly traded loans can be valued by reference to quotes of dealers in the market. However, those sponsors would prefer to value any loan asset which is not valued by reference to such an objective mark using their own valuation method.

Facility terms – do they amortize? A balance must be struck between the strategy of the sponsor, on the one hand, and the need for the lender to de-risk and ensure repayment of the loan at maturity, on the other hand. Certain NAV facilities will amortize sharply, and others will not amortize at all. For example, a credit fund putting in place a levered fund strategy at the start of the life of the fund may not find it acceptable for its NAV facility to amortize before the end of the investment period as any such amortization would impact its levered investment strategy. On the other hand, a secondaries fund levering its existing portfolio towards the end of its investment period to return capital to its investors may be more willing to accept amortization of its NAV facility in line with its investment sell-down strategy at that time.

Facility terms – which assets form the borrowing base? Some sponsors may wish to borrow against the NAV of all investments in the fund. Other sponsors may wish to lever specific assets. The point is most keenly negotiated by credit funds, who will prefer that assets acquired after the NAV facility is put in place be automatically included in the facility borrowing base (subject to meeting pre-agreed eligibility criteria). Certain lenders are comfortable with this approach, whereas others require a veto right on inclusion of future assets in the borrowing base.

What are hybrid facilities? In offering a NAV facility, lenders look to the underlying assets of the sponsor for their credit support. On the other hand, subscription line lenders look to the uncalled capital of the limited partners in a fund for their credit support. A hybrid facility is a combination of the two types of facility, allowing a sponsor to put in place a single facility with both a subscription line element and a NAV element.

Hybrids vs. split NAV and capital call facilities. Credit funds may be presented with the option either to put in place a hybrid facility or raise split NAV and capital call facilities. There are reasons for pursuing each option. Sponsors preferring to split their facilities may find a wider group of lenders willing to provide the loans and may gain cheaper pricing overall. They may also gain the benefit of less fund-level regulation as only the subscription line covenants will apply to the main fund entity. On the other hand, sponsors preferring a hybrid facility only have to deal with one lender and one facility (although, as putting in place a hybrid facility may require collaboration between different sections of a bank, there may still be more than a single point of contact behind the scenes at that single lender). Importantly, they may also be able to ramp up their levered investments at the start of the life of the fund by relying on the uncalled capital credit at the time when the fund holds no or very few underlying investments.

There were numerous other aspects of NAV and hybrid facilities raised during the panel discussion, so please get in touch if you are interested in discussing these facilities further with us.

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Please do not hesitate to contact us with any questions.

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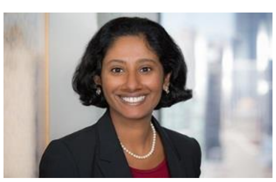

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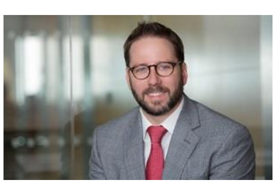

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