Fund Level Financings: Ten Considerations for Capital Call Facility Borrowers through the COVID-19 Crisis

April 8, 2020

COVID-19 is placing stress on financing markets throughout the private equity industry, making it paramount for sponsors to consider the impact on all of their sources of liquidity at both the fund level and portfolio company level. In that context, this debrief suggests practical considerations for sponsors in relation to their capital call facilities.

THE MARKET DYNAMIC

- Capital call financing is still flowing, but there are nuances.
- Some lenders are increasing pricing as their cost of capital has increased. There is particular pressure on U.S.-dollar-denominated loans.
- Some lender credit committees are being more conservative about approving larger financings, making for tighter capital availability for mega-funds.
- There is a bias by lenders toward current sponsor relationships, raising the bar for first-time lending arrangements.
- Lenders are wary of sponsors raising facilities that won't get used for six months or more. That, in turn, is placing pressure on pricing of commitment fees.
- Notwithstanding these headwinds, existing transactions are closing and we have seen multiple new transactions come to fruition.

- The fund finance market currently remains robust and, provided that material numbers of limited partners ("LPs") do not default on their commitments as a consequence of the crisis, we expect the majority of fund finance lenders to support sponsors through these uncertain times.

WHAT SHOULD SPONSORS BE THINKING ABOUT?

- **Speak to your lenders**: Capital call facilities are traditionally relationship-based loans. However, the growth in fund sizes has meant capital call facilities have necessarily been provided by broader lender groups. It is important in these uncertain times for sponsors to understand how lenders are viewing their loan portfolio and relationship with you as a sponsor.

- **Extend debt maturities**: Consider whether your capital call facilities have upcoming maturities, and whether it would be prudent to ask early for an extension.

- **Listen to LPs**: Your LPs may be asking for the facility to be used as much as possible to alleviate LP liquidity issues.

- **Retain liquidity**: Although LPs may request for you to draw the facility in full, it may be prudent to consider retaining some capacity to borrow under the facility going forward.

- **Consider compliance issues**: Market circumstances may have implications under the terms of your capital call facilities. Sponsors should review their facility and the relevant thresholds as a risk assessment measure. For example:

  - payment defaults or delays by LPs will likely result in those LPs falling out of the borrowing base;

  - above an aggregate threshold of LPs, payment defaults or delays by LPs will likely result in an event of default under the facility;

  - similar provisions may apply if an LP's creditworthiness drops or it has other solvency issues;

  - lender transfer provisions take on increased importance—how much flexibility does a lender have to transfer its lender commitments?

  - in a default scenario, the scope of distributions covenants becomes relevant and may restrict more than just distributions to LPs—sponsors should consider what payments are restricted if there is a default or event of default.

- **Consider fund facility terms before giving leeway to LPs**: If LPs ask for extra time to fund capital calls, discuss this with your lenders before taking a step that may cause the LP to fall out of the borrowing base.

- **Have your LPs invested in the fund?**

  - For funds at the start of their life, consider calling capital from LPs if investments to date have only been funded from the capital call facility. LP interests are more closely aligned to the interests of the fund if they have "skin in the game."

  - Similarly, sponsors should anticipate required repayment of outstanding loans under the facility, and consider the appropriate time to call capital from LPs to repay the same. If there is any concern around LP's funding, it would be prudent to allow more time to call capital.

- **Broaden lender relationships**: The fund finance market is large (with more than 50 lenders offering capital call facilities). With examples of some lenders retrenching, it is important to expand your relationships. Debevoise knows the majority of lenders in the market and can make introductions.

- **Uncommitted facilities**: The vast majority of capital call facilities are committed. However, certain sponsors prefer uncommitted facilities as there is no commitment fee. In these uncertain markets, we recommend considering whether to convert uncommitted lines into a committed facility.

- **Take advice**: We have been advising our sponsor clients on how best to deal with fund level liquidity needs through the crisis, and are very happy to discuss with you further.

Should you wish to discuss any of the issues raised, please don't hesitate to get in touch with the Debevoise fund finance team.

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For more information regarding the coronavirus, please visit our Coronavirus Resource Center.

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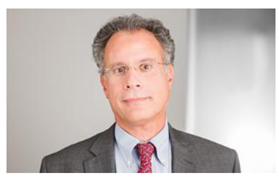

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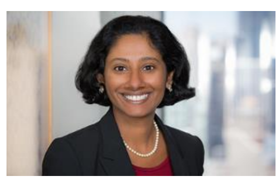

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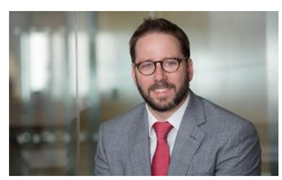

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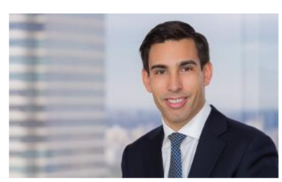

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