NAV Financings: A Review of the Year

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In collaboration with Emad Shahin, General Counsel at 17Capital.

The fund finance market stood up to, and flourished, through the initial impact of COVID-19 in 2020 as sponsors looked for liquidity, but it was unclear whether continued disruption from the pandemic would cause the fund finance market to take a different course. It is now clear that COVID-19 has permanently fuelled sponsors' desire to access all available sources of liquidity to capitalise on market dislocations such as that brought about during the pandemic. In this context, in 2021 the NAV financing market (financing at fund level based on the strength of the net asset value of the fund's underlying investments) matured and materially grew.

Historically, NAV facilities were limited to credit, secondaries and infrastructure funds operating with levered strategies. In the background, market participants whispered about a nascent NAV financing market for private equity funds, based on the strength of underlying PE portfolio investments (an inherently less liquid type of asset). Pre-COVID-19 this market didn't really develop, primarily because sponsors did not need to look to fund level to source financing for downstream portfolio companies. While PE NAV facilities were initially fuelled by a need for liquidity, sponsors' eyes are now open to the benefits of accessing fund level financing solutions for a variety of purposes. Recently, NAV financings have been used not only to make follow-on investments and provide liquidity to portfolio companies, but also to accelerate distributions to investors or as a bridge to make investments that are sold to subsequent funds of the sponsor.

Market Developments. 2020 saw the private equity NAV finance market develop and a handful of transactions close. These ranged from relatively small facilities to transactions of up to around £500m in size. Throughout 2021 the market accelerated, with the number and size of transactions increasing significantly, including facilities of up to around the £1 billion mark. We saw substantially more PE-focused NAV facilities close in 2021 from the prior year.

According to Emad Shahin, General Counsel of 17Capital, "as take-up became more widespread, market leading managers are increasingly aware of the flexible nature of

NAV finance and how it could be used as part of their toolbox for value creation and portfolio management, for a broad range of purposes such as investing for portfolio growth and liquidity management solutions."

One of the key developments in the fund finance market in 2021 was the expansion of NAV facilities from the domain of middle-market sponsors to upper-mid-market and large-cap sponsors. One consequence of this is that the terms of NAV facilities at the top end of the market have, in certain respects, coalesced with the terms of leveraged credit agreements as sponsors cherry-picked provisions from their leveraged finance forms. This has resulted in a product which is, in some respects, more flexible from a sponsor perspective, and correspondingly, a product that top-end sponsors are more routinely looking to access.

"As this market continues to mature rapidly" Emad notes, "we have been able to respond to the needs of managers by adapting the terms of individual finance arrangements accordingly. The facilities have become larger, and managers are demanding increased flexibility around terms, such as cash sweeps, duration, and security. 17Capital is at the forefront of this development and, with large dedicated pools of capital, has been able to respond and deliver solutions to managers quickly, which meet their requirements."

With growing demand, in 2021 the number of finance providers also started to expand. Until very recently, there had only been a handful of credible lenders of PE-focused NAV financings. That small group, including 17Capital, has worked with sponsors to develop NAV-financing structures and terms. The lender group is now seemingly expanding, as insurance providers and direct lenders see the benefits of entering a growing market.

Emad clarifies: "The rapid growth of the NAV finance market, and the arrival of more providers, demonstrates that this is a tool that should be in every manager's financial toolkit. This need for financial flexibility is heightened when you consider that the average private equity buyout fund now has an average life of over 15 years and the overall industry is sitting on an unprecedented $5tn in unrealized NAV. At 17Capital, we have seen record deal flow through the pandemic and closed deals of approximately $2.8 billion in 2021. The vast majority of these deals involved managers among the top 100 global private equity managers by size, and two transactions were closed with top ten managers, demonstrating the level of growing demand in the market by some of the largest managers."

Looking Forward. As we enter 2022, we expect that the NAV market will become ever more mainstream. While the product was originally developed in Europe, we expect it will be recognised and used more in the US. The anticipated increase in demand from borrowers is also expected to propel lenders such as credit funds and insurance providers to enter the market. That, in turn, may lead to structuring changes to the product, such as the use of ratings to help sell down of loans to insurance investors on a more favourable regulatory basis.

In conclusion, NAV facilities are here to stay and look set to become an essential part of sponsors' toolkits for accessing liquidity. These are exciting times for the fund finance market.

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