Debevoise & Plimpton

The Debrief

Debevoise Webcast Highlights Recent Development in NAV Credit Facilities and Preferred Equity Solutions for Private Equity Funds

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On July 16, Ramya Tiller of our New York office and Andrew Rearick of our London office hosted a panel discussion featuring Tom Glover of Investec, Richard Golaszewski of 17Capital and Ted Moscoso of Goldman Sachs addressing two rapidly developing areas of the private equity fund-level financing market: NAV credit facilities and preferred equity solutions. Below are the key highlights of the discussion.

Repercussions of the COVID-19 pandemic have led to ab increase in interest. While NAV credit facilities and fund-level preferred equity solutions have been a tool available to private equity fund sponsors for some time, the economic repercussions of the COVID-19 pandemic have heightened sponsor interest in NAV financing and preferred equity as a non-dilutive, flexible and cost-effective source of additional capital that can be implemented quickly to address urgent needs.

NAV financing and preferred equity solutions can be tailored to address sponsor-specific needs. A sponsor may have a choice between a NAV credit facility and a preferred equity solution, but the specific needs of that sponsor will often drive it to prefer one or the other. NAV credit facilities usually have a lower cost of capital, however they usually require a larger pool of assets in the borrowing fund (3+ portfolio companies) and are subject to lower loan-to-value ratios and more restrictive covenants, as well as a fixed term maturity and a customary security package over all or some the assets of the borrower. Preferred equity solutions, by contrast, are typically more expensive, but offer more flexibility in terms of asset pool size and concentration, higher loan-to-value ratios and have no fixed maturity, no security and few covenants. A sponsor ultimately usually decides between the two options based on the sponsor's goals for the financing, the composition of the fund's portfolio and the projected capital requirements—as well as the parameters permitted by the fund's limited partnership agreement or other constitutional documents.

Post-COVID-19, resiliency of a fund's portfolio has emerged as an important consideration. Diversification of a fund's portfolio has always been a significant factor in the pricing of both NAV credit facilities and preferred equity solutions; however since the outbreak of the COVID-19 pandemic, providers are placing particular emphasis on portfolio resiliency. Specifically, financing providers are looking for a number of "high conviction" assets—portfolio companies that are seen as resilient to pandemic-related impacts, and may also be looking to a sponsor's historical performance during past economic downturns as an indicator of the fund's ability to weather future uncertainty.

Watch this space: innovation is afoot. Most sponsors exploring NAV credit facilities and preferred equity solutions in the second quarter of 2020 were looking to raise defensive capital; however financing providers have observed a quick transition in the early third quarter to sponsors who are looking to raise offensive capital to make opportunistic investments. As sponsors better understand the possibilities of NAV credit facilities and preferred equity, the panel expects to see innovation in the market accelerate as sponsors start to apply these tools creatively to address their funds' individual circumstances.

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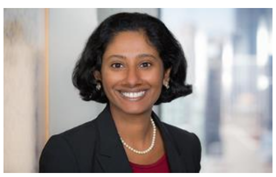

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