Fund Financing – An Overview

Anastasia Kaup

December 2020

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Introduction

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Anastasia has represented sponsors (as well as their funds and portfolio companies), financial institutions, and other corporate clients, in a wide range of financing transactions. Anastasia structures, negotiates and documents complex financing transactions domestically and internationally at all levels of the organizational structure, with specific focuses on fund finance, private equity finance, and financing in distressed and opportunistic situations. Anastasia's experience counseling clients with transactions during downturns as well as growth cycles distinctively positions her to assist clients with a broad range of financing-related needs at any time.

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An Overview of Fund Financing

Fund Financing Generally

- Fund financing encompasses different types of debt and equity financing products for sponsors, their investment funds, and other affiliated entities and parties
- Types of fund finance credit facilities include:
  - GP line of credit
  - Management fee line of credit
  - Partner loan program
  - Capital call / subscription credit facility (SCF)
  - Umbrella credit facility
  - Net asset value (NAV) credit facility
  - Hybrid credit facility
  - Unencumbered asset pool (UAP) credit facility
- Can be structured as a revolving line of credit or a term loan, depending on the product
- Credit facilities can be bilateral, among a club of lenders, or more broadly syndicated
- For funds of all types and sizes (even funds with one investor)

Why Use Fund Financing?

- Fund financing can enable sponsors to achieve these and other goals:
  - Providing liquidity (e.g., in lieu of calling capital from investors, or for portfolio companies that have maxed out debt at the port. co. level)
  - Providing flexibility (e.g., obtaining funds quickly, sometimes the same day requested)
  - Bridging gaps in timing of cash flows
  - Making and leveraging investments
  - Backstopping late funding by LPs and increasing certainty of deal execution
  - Refinancing more expensive debt (e.g., of a portfolio company)
  - Smoother fund administration (e.g., less frequent capital calls on investors)
  - Providing capital to meet capital contribution obligations
- Depending on the product, the fund may be able to pass on costs to investors
- Benefits for the fund, investors, and other parties involved

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Borrowers and Financing Providers

- Parties who borrow / utilize fund financing include:
  - Sponsors of private equity and other types of investment funds
  - Management including individual principals of the sponsor
  - Investment funds and various investment vehicles
  - Portfolio companies
- Parties who lend fund financing include:
  - Many of the traditional “brick and mortar” banks
  - Investment banks and investment banking divisions of traditional banks
  - Private credit funds and other alternative lenders / investors

When Sponsors Utilize Fund Financing

- Different products are utilized at different stages of a fund's life cycle
- Some of the products overlap stages (beginning / middle / end)
  - SCF more likely to used toward the beginning or mid-stages of a fund's life cycle, because the collateral includes the uncalled capital commitments of the fund, and as those are drawn down to make investments, the borrowing base dries up
  - Umbrella credit facilities may include funds at varying stages of their life cycles
  - NAV credit facilities are more common in the mid-stage or later, after the fund has made at least a few investments that generate the NAV to borrow against
  - Other fund financing products (e.g., UAP credit facilities, and GP / partner / management lines) are more common in earlier stages
- Fund financing can be put in place concurrently with, or before or after, fund closings, depending on the product

Security for Fund Financing

- Typically secured by collateral (except for UAP) and senior / first priority debt
- The defining characteristics of these products are the collateral packages:
  - GP line of credit – GP's limited partnership interest in a fund
  - Management fee line of credit – management fee payments
  - Partner loan program – partners' limited partnership interests in a fund
  - Capital call / subscription credit facility and umbrella credit facility – equity capital commitments of LPs
  - Net asset value (NAV) credit facility – portfolio assets and pledge of equity of holding vehicles
  - Hybrid credit facility – SCF + NAV collateral
- In each case of the above, the collateral package may also include related contract rights and a security interest over any bank account into which payments / distributions are made

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Other Fund Financing Terms

- May be committed or uncommitted / demand-able line of credit
- Facility sizes range from a few million to a few billion $ / foreign currency
- Availability may include loans, letters of credit, FX or other derivatives products
- Credit facility obligations may be guaranteed by asset holding vehicles, main fund, and / or principals
- Example selected terms may include (depending on the product, market conditions, the creditworthiness of the borrower, and other factors):
  - 364 days to 5-year maturities
  - 1.5% - 5% interest rates
  - 20 bps - 50 bps fees (e.g., upfront, unused revolver, increase, or extension)
  - Up to 35% - 100% advance rates (for products with a borrowing base)
  - Small $ per draw fee (for smaller $ GP / management fee / partner loan program lines of credit)
  - Annual administration fee (for club or syndicated credit facilities)
- Fund may use multiple products at the same time, at different levels of the org. structure

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Structure Considerations

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Structure Considerations

- Many funds' organizational structures are quite complicated
- Some entities may not be able to become credit parties (parties to the credit facility documents) or act in certain capacities (e.g., guarantors) due to tax, ERISA, or foreign law reasons
- There are particular complications in structures with feeder and blocker, parallel fund, or alternative investment vehicles or REITs
- Consulting with counsel, during initial fund formation and with subsequent closings and changes in fund structure, can ensure maximum flexibility to utilize fund financing when desired

Documentation

Fund Organizational Documents

- It's vital that the fund's organizational documents permit, and not cause issues for, the fund financing
- The fund finance market has become highly sophisticated, so lenders and investors now expect to see certain language, such as on these topics:
  - Disclosure of credit facility to investors
  - Capital commitments are equity, not debt
  - Credit facility including pledge of collateral must be permitted
  - Lender must have right to exercise remedies upon default, including calling capital from investors
  - Investors agree to fund as and when called, without setoff, counterclaim or defense
  - Permission to share copies of fund / investor documents with lender and its advisors
  - Investors may require reporting regarding use of the credit facility
  - Investors may require periodic "clean-downs" or other restrictions on the terms / use of debt

Fund Organizational Documents (Continued)

- Different fund financing products require different language in org. documents
- Best practice is to consult with counsel early and often, including:
  - Prior to executing amendments to LPA or other fund documents
  - Prior to initially sending out drafts of any fund documents to third parties (e.g., investors)
  - Prior to making changes in fund structure (e.g., adding investment vehicles that would alter flow of capital from investors to the credit parties in a fund financing)
  - With each turn of the documents
  - At least 2 weeks prior to execution (lender approval may be required, and / or the lender may comment on the draft and the fund may want to accept and incorporate such comments to facilitate the financing)
- Expect to provide any lender with executed copies of documents promptly after execution

Recent Market Trends

Recent Market Trends

- The SCF market has slowed down a bit compared to pre-pandemic levels, while the market for partner / GP / management fee lines of credit, umbrella credit facilities, and NAV credit facilities has picked up
- Notable change in market supply and demand
  - Some lenders are over-concentrated with loans to certain types of funds and / or with certain products, and are not renewing those loans, or extending new loans in those areas, even to top-tier sponsors with whom they've had strong and long-standing relationships
  - Private credit funds and alternative lenders have stepped in to fill this gap
  - Pricing has increased compared to pre-pandemic, however there are still competitive terms available for many sponsors, such that it still makes sense to utilize fund financing
- LIBOR floors being added and increased, and flexible (i.e., not hardwired) LIBOR replacement language being added, to many credit facility documents
- Product performance (i.e., use of fund financing and repayment of obligations) remains strong notwithstanding the pandemic

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Thank You

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