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Fund Finance Friday

Key Takeaways from Wildgen GP and Management Fee Facilities Webinar

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Luxembourg law firm Wildgen last week hosted the seventh webinar in its fund finance series – a focus on GP and Management Fee Facilities. The panel was moderated by Michael Mbayi of Wildgen, and included Emily Rose of Silicon Valley Bank, William Lamain of Raiffeisen Bank International, Amira Hajili of Natixis, Richard Fletcher of Macfarlanes, and Brian Foster of Cadwalader. Here are *FFF*'s key takeaways from the panel.

Terminology

Sometimes the terminology can get mixed around and used interchangeably. In common parlance, the term "GP Facility" is often used broadly to cover any lending to a fund sponsor. But other times, "GP Facility" is used more specifically to describe a loan, the purpose of which is to help finance the GP's obligations to purchase equity in the funds it manages (including meeting capital calls). "Management Fee Facilities" are more like a corporate loan to a sponsor that focuses on the sponsor's key revenue streams: the management fee and earned carry. They can be for any reason that the sponsor needs financing, such as to pay bonuses, to outfit an office, to pay placement agent fees, to make an acquisition, etc. Often the collateral package includes the interests and cash flows from multiple funds, not just one.

Key Risks and Due Diligence

The key underwriting risks which the lenders focus on are the circumstances in which management fees and carry could be cut off, such as: (i) Under what circumstances could a sponsor be removed by the investors as the sponsor of the fund(s)?; (ii) Are there management fee offsets for things like advisory fees or board fees?; (iii) What is the likelihood that the subscription line lender takes exclusive control of the fund's capital contribution account during a default, which would cut off the ability of the fund to pay management fees?; and (iv) There could be a significant decrease in the value of the assets or illiquidity in the market, which prevents expected asset sales and the forecasted cash flows and carry.

Related due diligence includes: (i) legal review of the partnership agreements and the management fee agreements, looking for restrictions on the authority to pledge (there can be workarounds in the U.S. under the UCC); (ii) understanding the management fee waterfall; (iii) terms in which the management fee can be reduced, cancelled or subordinated; (iv) the sponsor's trailing earnings and current and projected financials; and (v) understanding the investment pool in an existing fund(s) to forecast potential carry to be earned.

Key Covenants, Negotiated Points and Unique Challenges

- The covenants often mirror the due diligence and seek to preserve similar levels of expected cash flow as contemplated at closing.
- Covenants can include: (i) minimum top-line revenue; (ii) minimum operating cash flow; (iii) limitations on investor defaults in the key fund(s); (iv) limitations on changes to the management fee and carry structure; (v) minimum AUM; (vi) minimum yearly management fee; and (vii) leverage ratio triggers.
- Key negotiating points include: (i) the repayment waterfall is often bespoke and highly negotiated; (ii) to what extent the management fees can be used to pay critical expenses of the sponsor during a default; and (iii) what are the

clean-down provisions (*i.e.*, the facility needs to be periodically reduced to $0 annually, but the sponsor would prefer to hold the loan outstanding for a longer period).

- Among the unique challenges: If not all the members (the people) at the sponsor are using the financing, some members may have concerns about the management fees being pledged to support the facility (*i.e.*, the bank is getting recourse to all the fees and carry, when the benefit of the loan only goes to some of the people).
- In a GP Facility, the lender needs a date certain as to maturity and repayment, but the dates of the future sale of the investments which generate the carry are inherently speculative.

Market Dynamics

- The volume of these facilities is very light compared to subscription finance, and only a subset of active subscription line lenders offer the products.
- The market is very bespoke; there are not really established market standards.
- These facilities are often done alongside a subscription facility for the new fund.
- The risks involved tend to lead to these facilities only being made available to very established sponsors with a positive track record across multiple funds.
- GP Facilities can be outstanding for as long as 10 years in order to enable time for the liquidation of investments.
- GP Facility demand is increasing for several reasons, including: (i) COVID-19 slowed some dispositions in prior funds, and sponsors need to make new capital commitments to the next funds; (ii) as sponsors grow and promote new partners, those partners often need cash to fund their capital calls; (iii) investors are at times pushing sponsors to put more skin in the game, increasing the size of GP capital commitments; and (iv) many sponsors are managing multiple strategies, which can often result in simultaneous fundraises and capital commitment obligations.
- There is a strong relationship aspect involved in this type of lending, as the facilities are for the sponsor itself and involve some intimacy with the principal’s personal financials.
- Lenders use GP and Management Fee Facilities to differentiate themselves and to go beyond subscription financing. Providing these financings can lead to a deeper understanding of the sponsor and enhance the relationship.
- As sponsors are growing, facility sizes are increasing, and more facilities are being syndicated.
- Alternative lenders are increasingly interested in providing Management Fee Facilities on a preferred equity-type basis.