CADWALADER

FUND FINANCE FRIDAY

# European GP Solutions

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**Sam Hutchinson:** Many of you know that the Cadwalader London fund finance team recently expanded its service offering by bringing on board Mike Hubbard, previously responsible for loan distribution at Lloyds Bank. Whilst this isn't the first time a law firm has brought banking experience in-house, it is the first time that this has been done in the fund finance industry.

**Sam Hutchinson and Michael Hubbard:** Many have asked: "Why now and what value does this add?" "Has the Cadwalader London fund finance team moved into the 'advisory business'?" The second question is easy to answer. No, we haven't. This expansion isn't taking us into a new direction or part of a new strategy. It is ensuring our European GP clients receive the best possible service they can to navigate through the fund finance market which is inherently private and which all of our readers we're sure will agree has experienced more innovation in the last three years than our industry has seen in the last 25 years.

As to the first question − why now and what value does this add? − it was clear to us some time ago that the skill set divide between lenders and lawyers in the fund finance space, unlike many other finance sectors, was incredibly blurred. Many lenders understand fund structures, issues involved in diligence underlying the different types of fund finance transactions, and technical issues arising from fund documents better than the average lawyer, and many lawyers were as adept, if not better, at putting people together and originating trades than many lenders. This trend was already happening. But clients still needed both traditional skill sets to make the deals happen. Bringing these two skill sets together under one roof made complete sense to us: a one-stop shop for our GP clients to have a partner to work with them through their fund documentation establishment to ensure potential fund finance trades are available to them; give insights into the market, products and participants, which can be a real challenge for GPs in a private market; execute the trade; and then provide the aftercare to ensure GPs fulfil their post-execution responsibilities under the finance documentation. We may be the first in the industry, but we don't expect to be the last by any stretch. The synergies between the two skill sets coming together in this industry, which is full of innovation and development, are undeniable.

Let's put the complexities of navigating our industry into context (noting these observations are European-focused).

Taking a look firstly into the capital call market, we anticipate that there are now in excess of 60 lenders servicing GPs and alternative asset managers, providing up to €14bn of liquidity for any single transaction. The lender base continues to be predominantly bank-driven, with just 7% of the assumed total liquidity belonging to institutional capital, driven by the revolving nature of the facilities that are less appealing to these investors. Contrary to popular belief, capital call facilities are far from being commoditised, with competing and differing demands and requirements from the distinct pools of liquidity, whether it be drawn profile/clean down requirements, approach to due diligence on ancillary documentation such as side letters and LPAs, covenant structures (*i.e.*, coverage ratio vs borrowing base) or commitment basis (committed vs uncommitted). The largest syndicated transaction executed in the European market to date totalled €8bn, garnered from some 30 lenders.

Moving to the more structured end of the credit spectrum, NAV trades have become an increasingly popular product used across a multitude of asset classes. The peak of the pandemic made these facilities essential for managers to create liquidity in underlying portfolios and to accelerate distributions, but NAV has now become a staple product to enhance returns for investors. In light of the inflationary pressures and conflict in Ukraine impacting equity markets and valuations, NAV is expected to continue to be the buzzword in the market.

The liquidity available to managers for NAV facilities is anticipated to be in the region of €7bn for any given trade. As with the capital call liquidity, this does not necessarily provide an accurate reflection of individual liquidity pools, with many nuances to the structures and appetite across the lender base. Conversely to capital call liquidity, the underlying lenders that provide these structures are far more balanced, with nearly half (44%) of the liquidity provided by the institutional market. This is primarily driven by the drawn nature and yield profile of the structures. NAV as a product has been around for some time, but the innovation we are seeing from lenders has created sub-structures, with preferred equity positions becoming increasingly popular. Whilst there is a premium for said structure, the flexibility afforded to Managers and the ability to raise debt outside of restrictive covenants in LPAs has been an appealing trade-off.

Continuing the theme of NAV lending, GP-led restructurings and the creation of continuation vehicles have become an increasingly popular product for both managers and lenders. These are more akin to hybrid facilities, with the transferring LPs and new undrawn commitments from new and existing investors forming part of the collateral pool to lenders alongside the fairly concentrated asset recourse. The nature of these vehicles provides low levels of uncalled capital, typically in the 1:1 or 1.1:1 levels, however, making the risk profile more appealing for a broader base of lenders than traditional NAV facilities and for a large number of lenders that can't do pure play leverage. Pricing, unsurprisingly, has historically been the mid-point between capital call and NAV lines.

Now try to navigate all of this as a GP who has maybe never used a fund finance product line, or only one product line, or whose fund size has grown such that they need a broader spectrum of lenders and they're not sure whom to ask? Not an easy task in a private market. Fund finance products are relationship products. We all hear that a lot, but it is absolutely true. And navigating this market has to be done with that at the forefront of every decision that is made when choosing product and participant. It isn't about the cheapest price or even necessarily the most flexible terms. It's establishing who will be there as a partner to a manager through the good times and the bad. And, hopefully, our experience in the market and interweaving banking expertise with our existing team goes some way to being able to achieve that with our GP clients.

**Sam**: It's great to have Mike on board to complete the circle for us and, most of all, for our clients. Feel free to drop Mike a note **here**.