

FUND FINANCE FRIDAY

European Financing Structures Involving UHNWIs and Family Offices

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By Mathan Navaratnam
Special Counsel | Fund Finance

It is no secret that fund managers are becoming increasingly resourceful in their efficient use of leverage in the net asset value (“NAV”) space of the fund finance market (see [Financial Times article](#)). What we have seen since the onset of the pandemic is an increasing number of financing solutions tailored towards family offices and ultra high net worth individuals (“UHNWI”) looking to leverage against their existing limited partnership interests in private funds (“LP Interests”).

Many of these deals are provided (or originated) bilaterally by the private wealth team of a financial institution familiar with fund financing products. However, we have seen a number of deals where the relevant relationship manager introduces their fund finance colleagues to the relevant team acting for the family office or UHNWI to help develop a fund financing solution to help release value from LP Interests so that the family office or UHNWI (as the case may be) has greater firepower in pursuit of their investment strategies. In almost all cases, there is a strong existing relationship between the private wealth relationship manager and the UHNWI/family office (or their representatives).

Fund Finance Friday previously published articles on considerations in NAV transactions from a U.S. perspective ([here](#) and [here](#)) and many of those considerations apply to NAV facilities to UHNWIs/family offices in the European market.

The usual structure for this type of financing follows those more commonly seen secondaries deals in that a wholly owned special purpose vehicle (“SPV”) (commonly structured as a limited company or as a limited partnership itself and established in a familiar offshore jurisdiction) holds the LP Interests (and is the investor of record for the underlying fund). The SPV is then the borrower under the financing and security is given over the SPV (either as share security or, if the SPV is a limited partnership, security interests over the limited partnership interests in the SPV itself and security interests over its general partner) as well as bank account security over the accounts in which distributions and other proceeds from LP interests are paid.

Given that UHNWI/family office NAV financing is predominantly a relationship product between the relevant financial institution and the UHNWI/family office, the structures are more bespoke than usual secondary NAV financing. For example:

1. the purpose of the financing can include upstreaming the proceeds of loans to aid investment by related entities;
2. the owner of the interests (the “Parent”) in the SPV is usually a guarantor;
3. as the SPV is usually established for the purposes of the financing and commonly holds just enough LP Interests to comply with financial covenants, there are creditworthiness covenants biting on the Parent;
4. in some cases, the UHNWI is required to provide a personal guarantee in favour of the lender (and they may also be subject to creditworthiness tests);
5. as the UHNWI will have a deep and wide business relationship with the lender, assets outside of LP Interests frequently contribute to the calculation of financial covenants within the financing (such as equities, securities, fixed income instruments and gold); and
6. some financings have no fixed termination date and are largely repayable through agreed cash sweeps and on demand (with a relatively generous notice period).

As the main collateral in support of this type of financing is the value of LP Interests, as mentioned in the other *Fund Finance Friday* articles referred to above, careful legal due diligence should be undertaken on the investment documents relating to the LP Interests to analyse potential hazards/restrictions in taking security over the SPV (for example, the underlying limited partnership agreement relating to an LP Interest may contain restrictions around indirect security and/or changes to ultimate beneficial owners and therefore solutions to this need to be put in place). In addition to this, ownership documents relating to the LP Interests (such as subscription agreements and side letters) should be reviewed.

As many private fund GPs extended the life of their funds during the pandemic when asset valuations were negatively affected, the need for family office/UHNWI financing significantly increased in order to bridge a liquidity gap faced by numerous investors. The recent developments in sanctions law and policy adopted globally is likely to affect a small number of these deals being established. However, given the current economic climate (especially in respect of inflation rates in Europe,) coupled with banks and European UHNWI/family offices looking for liquidity solutions as well as new entrants to the NAV secondaries fund financing market (who already have close connections to UHNWIs and family offices in other parts of that lender’s business,) then we fully expect this area of fund financing to continue to grow significantly this year and next year.