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Fund Finance Friday

Concentrate on Debt Limits

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A common feature included in credit agreements is a limitation on the amount of the unfunded capital commitment of a single investor (or the aggregate unfunded capital commitments of a class of investors) that can be included in the calculation of the borrowing base on any date of determination. Such feature serves to protect a lender against too great of an exposure to a single investor (or class of investors) and better ensures that the borrowing base is comprised of a diversified pool of unfunded capital commitments. In the early stages of fundraising, the investor pool may be limited in number and largely comprised of a short list of anchor investors. The application of a concentration limit can significantly diminish the calculation of the borrowing base under these circumstances. As such, borrowers often ask that the application of concentration limits commence on a predetermined date after closing the facility or, in the most lenient of circumstances, after the borrower has completed fundraising. Depending on the composition of the investors at closing and based on expected future investors in the borrower, a lender may be willing to accommodate this request. However, this compromise has led some lenders to take a closer look at the debt limitations to be imposed on a borrower during the “concentration limit holiday.”

The limitation on indebtedness covenant in a credit agreement often includes a cross reference to the requirements and limitations on indebtedness set forth in the applicable partnership agreement. Those limitations often set the maximum amount of indebtedness that a borrower can incur as a percentage of aggregate capital commitments. Although that percentage may vary from partnership agreement to partnership agreement, it is often applicable to any indebtedness incurred under a subscription credit facility.

In exchange for temporarily waiving concentration limits, we have seen lenders impose a tighter limitation on the incurrence of indebtedness than is otherwise in the partnership agreement during the period in which the concentration limits do not apply. The rationale for imposing such a debt limitation is that the lender has a greater exposure to a single investor based on that investor’s uncalled capital commitment comprising a greater portion of the borrowing base than the lender would otherwise prefer. As a result, the lender would like to limit the overall amount of indebtedness that the borrower may incur until the investor pool is more diverse and the concentration limits are applied. The extent of that limitation varies from deal to deal, but this remains a consideration at the structuring stage where the investor base is expected to be highly concentrated for a period of time after closing.