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Fund Finance Friday

Finance Forum Panel Recap – ‘NAV’igating the Secondaries Market’

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NAV lending and its progeny garnered great interest at Cadwalader’s annual Finance Forum, bringing together industry experts on the cutting age of structuring creative solutions for the ongoing liquidity needs of private fund managers. Joining the panel were Akhil Bansal, Managing Director and Head of Credit Strategic Solutions at Carlyle; Robert Camacho, Senior Managing Director at Blackstone; Phillip Titolo, Head of Direct Private Investments at MassMutual; and Michael Vasseghi, Managing Director and Head of Insurance Solutions at Morgan Stanley. Cadwalader Fund Finance partner Angie Batterson served as moderator.

The so-called net asset value (“NAV”) credit facilities took center stage as the theme of the panel, familiarly known as financing that “looks down” from the fund level to the net asset value of the underlying portfolio of investments in determining borrower availability for credit purposes. NAV facilities are particularly useful for mature funds in which investors have already funded a majority of their capital commitments (often utilizing a subscription facility that “looks up”) and the fund has deployed this equity into a portfolio of investments.

Insurance companies are no strange bedfellows to NAV lending, having spent the last five years providing liquidity solutions to investment managers and their private funds. Insurance companies’ appetite for investment grade risk at above market spreads, coupled with their experience in investing at the LP level based on their knowledge and expertise in underwriting managers, uniquely positions them with the requisite expertise to lend to private fund managers with more customized solutions than a traditional bank loan product. Insurance companies access these fund financings in two main legal forms: a bilateral bank loan type facility or through a true securitization format, both of which are assigned ratings by one of more of the rating agencies. The rating is based on the expertise and the track record of the manager and the process applied when selecting and monitoring investments. The application of this technology has also been applied to support the financing of a pool of limited partnership (or other) interests in investment funds.

These structures incentivize a broader set of investors (including regulated institutions) to participate indirectly in the investment strategy of the investment fund with enhanced returns. Titolo pointed out that insurance companies understand how to underwrite LP investments, as they are typically LPs themselves in other private funds. Titolo added that these lending transactions require a team experienced in both fund underwriting and private debt structuring, not an easy task in today’s market. Looking at more challenging economic markets ahead, the panelists noted that their strategy would be to focus on the GPs that they know best and with whom they have worked and underwritten already on NAV financings. The panelists predicted that a broader range of alternative investors would be amassing investment teams to enter this space over the next few years and that these investments can be tailored to a bilateral execution as well as a multi-lender club. Should market values of the portfolios decrease, the unique aspect of NAV financing is the embedded lender protections that accelerate amortization if certain LTV ratios are not met.

Panelists see this trend of non-bank lenders entering the space as an extension of traditional “private placement” debt, broader bank disintermediation and alternative asset manager’s need for fund finance solutions. In this environment, where borrower leverage can be difficult to obtain and the capital markets are challenging, sponsors are increasingly looking at financing solutions at the fund level. Vasseghi noted Morgan Stanley’s involvement in the fund finance market is both as an on-balance sheet lender as well as a lead structuring agent. He sees that each of these transactions tends to be bespoke, but are becoming more mainstream, as he has seen over 40 insurance companies participate in the fund finance space in some form over the past several years, with more inquiring each quarter. The panelists uniformly agreed that creative structures are particularly attractive when the asset-backed lending markets are suffering from margin compression. When regular way financing playbooks become challenged, keep an eye out for the incoming innovation leaders.

For more information on the key issues and considerations in PBNs and Rated Feeders, review our recent **presentation**.