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FUND FINANCE FRIDAY

(Over) Call Me, Maybe

March 22, 2019 | Issue No. 19

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Last week, our colleague Amrita Maini published a succinct primer on overcall limitations (available here). Judging by the number of lender inquiries, we thought some data on their prevalence might be of interest. Based on the 252 fund finance facilities Cadwalader closed in the United States in 2017 and 2018, here's a survey of overcall provisions by the numbers.

First, a note on how we compiled the data. We analyzed overcall provisions by broadly dividing them into three categories: (1) restrictions that limit the use of overcalls to pay management fees, (2) limits applied to overcalls based on a percentage of the prior overcall (*i.e.*, "*the General Partner is authorized to make a subsequent capital call on the non-defaulting limited partners to make up the shortfall, provided that no limited partner shall be required to fund an amount in excess of 50% of the amount originally called*"), and (3) concentration-linked overcall limits that tie the overcall to an asset diversification provision (*i.e.*, "*the General Partner is authorized to make a subsequent capital call on the non-defaulting limited partners to make up the shortfall, provided that no limited partner shall be required to fund an amount in excess of the Fund's per investment diversification limits in Section X of this Agreement if such diversification limits were applied on a partner-by-partner basis*").

Following this approach, we found:

- 38% of funds had some form of overcall limitation in the fund's partnership agreement,
- 21% of funds imposed a management-fee overcall prohibition,
- About a two-thirds of overcall limits were percentage-of-prior-call type restrictions and one third were concentration linked limits, and

- Overcall limits were slightly more common in 2018, increasing in prevalence by 2% from 2017. It may be too early to call this a trend.

Two counterintuitive points emerge from the data: First, the larger facilities to the top tier sponsors were far *more* likely to include some form of overcall limit. That is, the sponsors with the greatest negotiation leverage are more likely to give overcall limitations to investors than smaller sponsors. This begs the question as to whether investors actually value overcall limitations and are insisting on them or if, instead, overcall limits just repeat in certain new funds because of repetition of historical precedent.

Second, for as much heartburn as overcall limitations cause lender credit committees, their presence does not seem to result in risk-adjusted pricing. Rather, our average facility with some form of overcall limitation priced 13 basis points *inside* average pricing for facilities without any limitation. Facility size and sponsor assets under management size had a far higher correlation on spreads than overcall limitations.

What we did not look at, and what would be interesting to validate, is whether facilities with overcall limitations tend to include tighter structural mitigants, such as, for example, tighter covenant packages, shorter cleandown periods, fair market value to cost triggers or tighter aggregate investor delinquency triggers. The product of such further study, we suspect, would be to reinforce our view that first principles—sponsor quality and the investor credit mix—still come first when it comes to pricing, even if it doesn’t always feel that way in the credit process.