

Fund Finance Friday



Syndicate Diligence Considerations

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Subscription credit facilities are a widely utilized product in the fund finance market, offering sponsors access to a reliable source of financing to bridge capital call and to lenders collateral backed by investors' capital commitments rather than the underlying portfolio assets of a borrower. With a borrowing base made up of creditworthy institutional investors and private wealth management clients that have a track record of meeting their obligations, the security and predictability that subscription credit facilities offer are particularly attractive to lenders.

As subscription credit facilities have become firmly established financing products in the market, and with the steady expansion of new lenders each year entering the space, an increase in multi-lender facilities seems plausible to provide lenders with more opportunities to diversify risk and enhance their visibility in the market by working with high-quality fund borrowers, sponsors, administrative agents and other lenders. You can read more in-depth coverage on the benefits and key considerations for syndications [here](#).

In this article, we will explore the complex due diligence landscape that syndicate lenders must navigate when seeking to join a new or existing credit facility. We will highlight the key areas lenders should focus on during their due diligence process to safeguard their interests and ensure they make informed decisions.

As the name suggests, a syndicated credit facility is provided by a syndicate of lenders and is administered by an agent bank ("Agent") who is frequently, but not necessarily, the lead bank in the deal. If the Agent is not assigned as the lead arranger, then it will work closely with the lead arranger(s) to originate and structure the credit facility and form the syndicate. Specifically, the Agent plays a hand in negotiating and finalizing the deal terms (e.g., loan size, pricing, repayment terms, etc.); drafting and negotiating the credit and security documents; reviewing the organizational documents of the credit parties; reviewing investor subscription agreements and side letters; conducting UCC and other searches; and coordinating the delivery of other standard closing deliverables (e.g., authority documents, incumbency certificates, responsible officer certificates, opinions from counsel, KYC diligence, beneficial ownership certificates, etc.). Once the facility is in place, the Agent will oversee the daily operations of the credit facility including, but not limited to, disbursing funds following a request for borrowing; receiving fees and payments and allocating such funds to the syndicate lenders; collecting and verifying financial statements, compliance certificates and investor reports and providing lenders with relevant updates on the borrower's performance; monitoring the borrowing base; and managing the process for approving amendments, waivers or consents.

The Agent plays the primary role in facilitating the relationship between the borrowers and the lenders from inception through maturity of the facility. Syndicate lenders entering a new or existing credit facility will rely heavily on the Agent to conduct upfront due diligence and handle administrative functions. As an example, syndicate lenders expect that, prior to closing and throughout the lifecycle of the facility, the Agent will perform a robust analysis of the collateral by vetting the creditworthiness and diversity of the investor base. Syndicate lenders will also look to the Agent to verify the enforceability of the uncalled capital commitments under the subscription agreements and identify any side letter

provisions that could negatively impact an investor's obligation to fund its capital commitments. In this same vein, the syndicate lenders expect the Agent to monitor the Borrower's compliance with financial and operative covenants in the credit agreement and alert the syndicate lenders to any breaches and/or events of defaults.

While lenders benefit greatly from the centralized role of the Agent, they must still conduct a detailed review of the key loan terms to evaluate their credit exposure relative to the offered collateral package. Lender's counsel should carefully examine the term sheet, credit agreement, fee letter and collateral documents, focusing on the following aspects for their lender clients:

- Total facility amount and whether a committed or uncommitted accordion applies, including if a swingline facility is contemplated, and the obligation of all revolving credit lenders to participate in swingline loans;
- Maturity date and whether a committed or uncommitted extension option is available;
- Facility pricing terms, such as arrangement fees, upfront fees, extension fees, letter of credit fees and facility increase fees;
- Borrowing base criteria such as advance rates, investor concentration limits, the borrowing base calculation and exclusion events;
- Procedures for funding loans; repayment of interest and principal; and mandatory prepayments following an overadvance;
- Pro-rata sharing provisions (i.e., confirmation of how principal, interest and fees are allocated among syndicate lenders);
- Applicable jurisdictions, regulatory considerations, sublimits, currencies and exchange rates;
- Joinder requirements for new credit parties such as qualified borrowers, AIV or parallel fund borrowers;
- Reporting requirements such as annual and quarterly reports, borrowing base certificate, capital calls, capital return notices, notice of default and investor events;
- The process for applying payments and proceeds of collateral (the "Waterfall Structure");
- Covenants, default triggers and remedies, including the agent's ability to accelerate payments and enforce remedies;
- "Revlon" or "Erroneous Payments" provisions that require lenders to return erroneous payments and give the agent recourse against any lender that refuses to do so.
- Voting Rights, including required lender, lender affected thereby and unanimous or "sacred rights" and "Serta" protections to augment voting rights of lenders to prohibit subordination of their claims.

Among the various loan terms mentioned above, lender voting rights are particularly noteworthy. In most syndications, the Agent and the lead bank negotiate the deal terms with the borrowers, providing them with significant influence over key decisions concerning the facility. However, to protect the interests of the lenders and ensure collective action, any material decisions, whether implemented through amendments, waivers or consents, will require approval from the syndicate lenders under clearly defined voting requirements set forth in the credit documentation.

There are three main types of voting rights typically found in syndicated credit facilities: "required lenders," "lenders affected thereby," and "unanimous consent." Required lender consent refers to majority approval, usually defined as lenders holding a pro-rata share of 50% or more of the total loan commitment. Required lender consent is typically required for any material amendments to the constituent documents of the borrowers, modifications to the Waterfall Structure after an event of default, and permitting the withdrawal of funds from the collateral account following a cash control event. Lenders affected thereby refers to the approval of only those lenders directly impacted by a proposed course of action such as modifications to such lenders' loan commitments, postponing or delaying the payment of any principal, interest, fees or other amounts due and modifications to facility pricing, such as a reduction in principal, interest or any fees. Unanimous action refers to the approval of all syndicate lenders and applies to changes in material deal terms including modifications to the borrowing base, advance rate or concentration limits, any reductions or suspensions of the uncalled capital commitments, any release or subordination of liens in the collateral and any modification or removal of voting rights or the percentage voting requirements or the definition of "required lenders."

It is important to mention that the foregoing analysis is not exhaustive, as different lenders may have unique concerns relevant to their specific investment objectives, risk tolerance or internal policies. Lender's counsel must tailor their reviews accordingly to ensure they provide their lender clients with a comprehensive overview of the transaction.