

Fund Finance Friday



Single-Asset Back-Leverage Facilities for Private Credit Loans

January 31, 2025



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As regular *Fund Finance Friday* readers know, articles in this newsletter often explore emerging trends in fund finance and fund finance-adjacent areas, and in this article, we will look at single-asset back-leverage (“SABL”) facilities for private credit loans—which are at the intersection of fund finance, structured finance and leveraged finance/private credit.

The rise of private credit, of course, has been one of the biggest stories in finance in the last decade, and some observers forecast that by 2028 the private credit market once again will double in size. This continued growth, as well as other market and regulatory forces affecting bank lenders, has promoted innovation in the space. Increasingly, and perhaps out of necessity, banks and private credit funds are often coming to view each other as mutually beneficial partners rather than competitors.

While there are a number of other structures that can provide private credit funds with back-leverage for their portfolios of loan assets—including as detailed by our colleagues in a recent *FFF* article [here](#)—single-asset back-leverage structures increasingly have become an option as well.

There are a number of reasons for an growing focus on this type of leverage structure, starting simply with the continued growth of the private credit market. As more and more private credit loans are originated, a number of these loans may lend themselves to a single-asset structure. Another reason is that the constantly evolving regulator landscape, including any potential changes related to the implementation of Basel III Endgame (which is a constantly moving target), have resulted in banks remaining very interested in maintaining favorable treatment of their assets within the risk-weighted asset (“RWA”) framework. As discussed further below, the SABL structure can provide significant additional benefits to both private credit funds and banks.

Structure

A key distinguishing feature of single-asset back-leverage facilities, as the name suggests, is that only one underlying asset is being financed. Generally, this is a funded term loan interest (although other asset types may be funded this way, as well). By contrast, for most types of financing facilities that provide fund-level leverage—e.g., traditional NAV facilities, subscription lines, asset-based lending facilities/CLOs and secondaries facilities—there is typically a focus on the diversity of the assets that are being financed in order to mitigate various risks. So the “single asset” nature of this product drives many of the structuring considerations.

In a widely dispersed collateral pool, there is typically less focus on detailed diligence or consideration of each asset. There is safety in large numbers. By contrast, in an SABL facility, one asset is the entire ballgame. Therefore, not surprisingly, there is a greater emphasis on performing diligence on the loan documents for the underlying loan asset since any non-performance, or unintended or unforeseen action under, the underlying loan asset would more directly, significantly and immediately impact the back-leverage facility.

Another distinguishing feature of SABL facilities, when compared to standard loan syndications or participations, is that these facilities may be structured to give the bank lender a senior position in the underlying loan, rather than a *pro rata* position that a simple loan assignment or participation would provide. In other words, the SABL structure may be designed to give the private credit fund the “first loss” piece of the underlying loan under certain circumstances. Because of this structure, the bank may be able to receive exposure to an underlying private credit loan from a relatively conservative senior position (which is reflected in margin), while the private credit fund could enhance its return either through arbitraging margins between underlying loan and the SABL facility and/or engineering a higher effective coupon (through deleveraging). As you can imagine, there are many ways to structure this trading of risks and rewards in order to benefit both parties.

Similar to other limited-recourse and non-recourse financings involving loan assets, lenders will typically look to isolate the underlying asset in a special purpose entity (“SPE”). The SPE will serve as the borrower under the SABL facility, and the credit support for the back-leverage facility will normally be limited to the underlying loan (although other credit support, such as bad actor guaranties, full guaranties or other credit support may be appropriate given the structure). Following the mechanics of structured finance, SABL facilities often contain a cash sweep mechanism, whereby payments from the underlying loan will be swept into a controlled account and applied at agreed intervals according to a payment waterfall. The waterfall is typically an area of keen negotiation among the parties.

Another key area of discussion is the SABL borrower’s control rights over changes to the underlying loan agreement. The private credit fund’s preference is generally to retain flexibility to deal with the underlying borrower (for economic as well as relationship reasons), while the bank’s interest is to make sure that the sole asset constituting its credit support is not modified in a way in which the bank does not approve. Depending on the nuances of the transaction, various solutions are utilized to address both parties’ interests.

Finally, both parties should carefully consider the terms of the underlying loan when agreeing on terms in the SABL facility. Borrowers will look to align payment dates and amounts on the SABL facility with payments on the underlying loan to minimize the need for capital injections. Lenders may look for the maturity of the SABL facility to be well inside the maturity for the underlying loan in order to minimize refinancing risk. The contours of the underlying loan directly shape the contours of the SABL facility.

Benefits

As alluded to above, SABL structures can provide significant benefits to both private credit funds and banks that are distinguishable from traditional, diversified back-leverage and from other direct participation by a bank (such as being a co-lender on a syndicated facility).

An obvious benefit to the private credit fund is the ability to enhance its returns as detailed above. The private credit fund also may be able to form a stronger relationship with its underlying borrowers without the direct involvement of any competitor funds or banks that might otherwise be part of the lending syndicate, as the underlying borrower may not have any direct interaction with (or even knowledge of) the bank lender’s existence. And without a long syndication process, the private credit fund may be able to provide quick loans to underlying borrowers on favorable terms. In addition, the use of a single-asset structure allows the fund to more easily match its leverage terms to a specific asset—for example, timing of payments, prepayments and other cashflows on the applicable underlying loan. Finally, the SABL structure has a great deal of flexibility—as with all things fund finance, having a Swiss army knife in your back pocket helps to address the tricky knots that can appear.

The benefits from the bank side are also numerous. Importantly, this product allows banks potential access to the rapidly growing asset class of private credit loans. An SABL facility can be tailored and structured to give banks a relatively conservative position in the capital stack, allowing for favorable pricing and opportunities with underlying loans that may be structured more aggressively than standard bank loans. In addition, it is possible to structure an SABL facility to allow banks to receive more favorable capital treatment for its position, and this in turn may allow it to offer more competitive pricing to private credit lenders seeking back-leverage.

Conclusion

Each SABL facility tends to be somewhat unique, and structures differ among different banks, different private credit funds and even deal-by-deal with the same participants. There is no one set “market standard,” and so practitioners and market participants should be flexible and creative. Because SABL facilities exist at an interesting junction between fund finance, structured finance, leveraged lending and bank regulatory matters, it is important to understand

each of these angles when considering a deal, and advisors with expertise in each of these practice areas will drive the best outcomes.