C A D W A L A D E R

Qualified Borrowers and Portfolio Company Loans

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The credit parties under a subscription credit facility may require flexibility in providing funds to their portfolio companies. Instead of using their own capital to make an equity investment in one of their portfolio companies or making an interfund loan, the credit parties may request that lenders under the subscription credit facility provide loans directly to their portfolio companies. Most lenders will accommodate this request by permitting portfolio companies to borrow under the credit agreement as “qualified borrowers” while other lenders will provide the requested funds through a separate portfolio company loan agreement.

This article will provide an overview of qualified borrower mechanics in a traditional subscription credit facility versus establishing a separate portfolio company loan agreement.

<u>Qualified Borrower</u>

A qualified borrower often is defined in the credit agreement as any entity in which a borrower or guarantor (a “Fund Party”) owns a direct or indirect ownership interest, or through which a Fund Party may acquire an investment, the indebtedness of which entity will be guaranteed by such Fund Party pursuant to its limited partnership agreement. In practice, qualified borrowers are generally portfolio companies, holding companies, special purpose vehicles or other affiliate subsidiaries of a Fund Party. A qualified borrower may join a credit facility by (i) the execution of a joinder agreement to the credit agreement or a promissory note in favor of the lenders, and (ii) the execution of a guaranty by a Fund Party pursuant to which the Fund Party guarantees of obligations of such qualified borrower under the Credit Agreement.

The hallmark of a subscription credit facility is the ability to secure loans by the unfunded capital commitments of the limited partners of each Fund Party and the collateral accounts into which capital contributions are funded. The lenders will rely on such unfunded capital commitments as their primary source of repayment. Because qualified borrowers do not have any third-party limited partners making capital commitments to such qualified borrower, lenders will provide loans to such qualified borrowers on an unsecured basis. However, any Fund Party that provides a guaranty for a qualified borrower’s obligations will be liable for all loans made to such qualified borrower resulting in such loans ultimately being secured by the unfunded capital commitments of such Fund Party. While the Fund Parties may be jointly and severally liable for the loans made by qualified borrowers, qualified borrowers are only liable for loans made to such qualified borrower and are not likewise jointly and severally liable for loans made to Fund Parties or other qualified borrowers.

Upon joining the credit facility, qualified borrowers may receive loans and/or letters of credit on the same terms as a Fund Party under the credit agreement. Loans to qualified borrowers will accrue interest at the same rate, unless otherwise specified, which is most likely at a lower interest rate than it could obtain under its own debt facility because the lenders are relying on the guaranty of the Fund Parties and not the credit profile of the qualified borrower itself. Loans made to qualified borrowers will reduce the availability under the credit agreement in the same manner as Loans to Fund Parties and may create more opportunities to increase utilization of the credit facility. There may be a few financial covenants that are not applicable to qualified borrowers as such covenants will track the financial performance of the Fund Parties. Prior to joining a qualified borrower to the credit facility, lenders should evaluate the governing documents of the Fund Parties and whether such documents include any restrictions on guarantees as part of the overall leverage limitation or any other leverage limitation such as a limit on the amount of guarantees based on a percentage of aggregate capital commitments or a clean-down requirement with respect to guarantees.

Portfolio Company Loan Agreement

Instead of including qualified borrower mechanics in the credit facility, other lenders will prefer to document loans to such portfolio companies, holding companies, special purpose entities or other affiliate subsidiaries through a separate short-form loan agreement. This allows the lenders to structure the loans to portfolio companies on different terms from the credit facility. We frequently see these portfolio company loan agreements structured as term loans with principal obligations due on the maturity date, which is set to match the maturity date of the credit facility so that the maturity date of the portfolio company loan agreement will automatically extend with any extension of the maturity date under the credit facility. The term loans will vary from one advance at the outset of the loan to multiple advances during the draw period not exceeding a specified amount. Lenders may maintain the same interest rate in the credit facility or consider a different interest rate, taking into account the credit profile of the portfolio company. Similar to the qualified borrower mechanics, loans to portfolio companies are on an unsecured basis and will require a guaranty from the related Fund Party.

Conclusion

The qualified borrower structure under subscription credit facilities offers a relatively quick and efficient means of providing liquidity solutions for the Fund Borrowers and their portfolio companies. From the lender’s perspective, there is no increased credit risk lending to a qualified borrower or portfolio company as long as the guaranty and collateral remain in effect.