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Fund Finance Friday

Is This the End . . . ?

December 19, 2025

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It feels like yesterday that I worked on closing my first credit facility, sitting almost in the same spot that I am now, albeit now a little higher in the sky (by one floor precisely). If there is one thing that the past few years have taught me, it is that the fund finance industry and its products are ever evolving (see, e.g., recent developments in **private credit** and **tranche B facilities**), and of course many (if not all) of these developments are focused on liquidity solutions for borrowers and lenders alike.

Today, it seems only natural as we continue to grow with our clients (and in turn, their clients) that lenders are increasingly seeing a demand for financing solutions for aging funds, including those that may exceed the expiration of their term. In this article, we delve into an overview of structuring considerations for financing end of fund term subscription credit facilities.

The End of the Commitment Period – Not the End?

Consider a credit facility for a new fund – every lender will require as part of its diligence process a thorough enquiry into the commitment period (also known as the investment period) of the fund. This is because the collateral upon which such facility is underwritten (i.e., the obligations of the limited partners to fund capital contributions) is generally tied to the investment period. The big question is what happens during a suspension or termination of the commitment period and how does this affect the ability of the lender to call capital after an event of default? To mitigate the risk that the limited partners cease funding after the expiry of the commitment period, the credit agreement will often set a maturity date that is the earlier of (a) an agreed upon tenor (typically between one to three years), and (b) some period e.g., 90 days before the end of the commitment period. However, given the increasing popularity of subscription credit facilities, most limited partnership agreements are now expertly drafted to address this concern and require, at minimum, that investors must fund capital contributions for the repayment of debt, notwithstanding any suspension or termination of the commitment period.

The End of the Fund Term – is this the End?

The next consideration, which often gets far less limelight in the context of new transactions, is the term of the fund. Given most subscription credit facilities have a tenor of one to three years, and funds typically have a minimum term of ten years, lenders may not require the implementation of any specific structural mitigations at the outset to address the end of a fund's term beyond broadly prohibiting the dissolution or termination of any credit party, and building a buffer into the maturity date such that the facility terminates well in advance of the last day on which the limited partners are obligated to fund capital for the repayment of the obligations owing under the facility. Although these mitigating provisions are commonplace in our transactions, as lenders increasingly deal with aging funds, borrowers have increasingly begun to ask for financing solutions to facilitate, amongst other things, follow-on investments and the orderly liquidation of the fund's assets after the end of its term.

Now, why not simply have the fund extend its term by obtaining the necessary consents pursuant to its constituent documents from either its general partner and/or its investor advisory committee? Of course, that is always an option and one that we see frequently employed. However, what happens when the fund cannot, for a plethora of potential

reasons (including, to state the obvious, the exhaustion of all in-built extension options), extend the fund term but still has a need for liquidity?

<u>End of Fund Term Facilities - You're Winding Me Up!</u>

As discussed above, a lender's primary concern as it relates to any subscription credit facility is its ability to call capital from the investors to repay the obligations as and when required. You may ask, how can a lender provide financing to a fund whose term has ended? The answer is simple – there is a distinction between the end of the fund term, upon which the fund typically commences its dissolution, and the actual termination of the fund. Dissolution does not occur overnight and can be a drawn out process, depending on the fund's strategy related to the winding up of its assets and activities.

On this basis, a credit facility remains feasible but a lender should only permit borrowings for purposes for which the fund itself can validly call capital from its investors. This requires careful diligence of the fund's constituent documents – including, but not limited to, the following considerations:

1. Does the partnership agreement explicitly list the type of activities the fund may engage in after the end of its term?
2. Does the partnership agreement specify the purposes for which the fund may call capital after the end of its term (and correspondingly, the purposes for which the investors are obligated to fund)?
3. Local law considerations – are there statutory protections or case law in the relevant jurisdiction with respect to enforcing against a borrower after the end of its fund term?

The appropriate structural mitigations will depend on the answers to the above questions – but lenders should consider use of proceeds restrictions that are tied to purposes for which the investors remain obligated to fund capital contributions, representations and/or certifications relating to use of proceeds as additional conditions precedent to borrowings, and negative covenants related to filing for a winding up and/or termination of the fund while obligations remain outstanding. In certain situations, it may be appropriate to automatically reduce the lender commitments upon repayment of the obligations, or to implement a cash sweep of distributions from the sale of the fund's assets.

<u>A Happy Ending</u>

By including the structural mitigations set forth above, similar to any run of the mill subscription line, a lender legally has recourse to the unused capital commitments of the investors (which, at the end of a fund's term, may be made up of **recallable capital**). In practice, whether a fund would actually call upon its investors after the end of its term is a matter that we must let play out on its own. Certainly, for a fund that is establishing (or continuing) a credit facility after the end of its term, it would be remiss not to have strategic conversations with its investors to forecast the potential need to drawdown to repay such facility. However, in the ordinary course a fund is not in fact obliged to call capital as its source of repayment and there are no prohibitions on it choosing to repay a facility using realizations from its investments or by accessing some other source of funds (a fact that applies throughout any life stage of a fund).

So, what if a fund never calls capital for an end of term facility? To a savvy financier this may look and smell akin to an unsecured net asset value loan, but the underwriting risk for the lender remains tied to the investors' contractual obligations to fund (which obligations, if structured correctly, remain subject to the same typical investor default remedies) and on that basis, there is certainly value in keeping this financing solution in the toolkit.

If in doubt, you know who to call.