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Management Company Facility Considerations

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Many subscription facility lenders will offer management company facilities as a means to further develop their existing relationship with a fund sponsor. A management company facility is typically a revolving facility in favor of the fund sponsor's management company (or investment manager) as the borrower. The loans and letters of credit issued under the facility may be used as working capital for the management company's day-to-day operational expenses, including the payment of rent, salaries, year-end bonuses, service provider fees and other administrative expenses.

This article will discuss the management fees earned by the management company, the common covenants included in management company facilities and additional considerations regarding the payment of management fees.

Management Fees and Collateral

Management company facilities are usually secured by: (1) any management fees, including any fees for the provision of consulting, advising, investment or management services, that are due and payable to the management company; (2) the deposit accounts into which management fees are or may be deposited; and (3) an all asset pledge of the management company's personal property.

A management company will earn management fees for the provision of investment or management services for investment funds (such investment funds, "Managed Funds"). The investors in a Managed Fund will pay the management fees, which are based on a percentage of the capital commitments made by such investors to the Managed Fund.

The terms of the management fees are usually included in either the management agreement or the partnership agreement (or other governing document) of the Managed Fund. However, the investors in a Managed Fund may have side letter agreements with the Managed Fund that amends the terms of the management fee. For example, a Managed Fund may agree to a reduce the percentage or total amount that an investor may be required to pay in management fees.

Prior to providing a management company facility, a lender will want identify the Managed Funds. Frequently, a lender will already be familiar with the Managed Funds if it is also the subscription facility lender for such Managed Funds.

It is important to confirm that the management fees are contractually due and owing to the management company pursuant to the management agreement or a similar agreement with the Managed Funds. Without such an agreement, the management company does not have the legal ownership of the management fees to pledge as security to the lender.

Further, a lender will want to diligence the management agreements, partnership agreements of the Managed Funds and investor side letters to determine the amount of management fees payable and when such fees are due (annually, semi-annually or quarterly), whether there are any reductions, waivers or offsets of management fees, when a management fee may be terminated and whether there are any restrictions on the management company pledging the management fees as security for a credit facility. These determinations will allow the lender to confirm if the terms regarding the management fee match up with projected management fees and to mitigate for any risks in the loan agreement.

Common Covenants

The loan agreement for a management company facility will include various covenants tailored to the facility structure, the credit risk of the management company and the management fee income stream. We see a range of covenants, including the following:

- Constituent Documents: A covenant prohibiting the management agreement, the partnership agreement (or other governing document) of the Managed Funds or the investor side letters from being amended, modified or changed in a way that reduces or postpones the payment of any management fees or otherwise adversely affects the rights or remedies of the lender under the loan agreement.
- Management Fee: A limitation deferring, postponing, offsetting or waiving any management fees or directing management fees to any person other than the management company.
- Minimum Management Fee: Requirement that the management company will receive a minimum amount of management fee revenue, calculated on over a trailing twelve month period and project a minimum management fee revenue for the immediate succeeding twelve month period.
- Coverage Ratio (of Debt Service Ratio): The management company will maintain a minimum coverage ratio (or debt service ratio) of the management company's adjusted net income to interest expenses (or the sum of principal payments over the following twelve month period, plus outstanding indebtedness and all interest (without duplication)).
- Clean-Down: The management company will agree to pay the outstanding principal balance of all loans and maintain a zero balance for a specified period of time with specified frequency.

Additional Considerations

Depending on the credit risk of the management company, a lender may consider supplemental credit support. This may be in the form of a guaranty by the founding members of the management company, the general partner of the Managed Funds or another affiliated entity. The guaranty may include covenants related monitoring the creditworthiness of the guarantor(s), including the liquidity of the guarantor(s) to cover liabilities. A lender may also consider including a pledge of the management company's equity interest in Managed Funds or the rights to distributions from such equity interest.

As previously noted, the management fee is paid by the investors of the Managed Funds and accordingly, the loan agreement for a management company facility will include the failure of such investors to fund the management fee as an event of default. While a lender may already be familiar with the investors in the Managed Funds because it is the subscription facility lender to such Managed Funds, the lender under a management company facility may consider requiring notice under the loan agreement if any investor to a Managed Fund fails to fund any capital contribution when due.

A lender will want to consider whether the Managed Funds are borrowers or may become borrowers under a subscription facility, especially when the lender is not the subscription facility lender. Some subscription credit facilities will expressly provide that during a cash control event the payment of the management fees will be subordinated and inferior in right and payment to the obligations the Managed Funds owe the subscription facility lender. This subordination could impact the ability of the management company facility lender to be repaid.

A subscription facility lender in in the best position to recognize the benefits of providing a management company facility to its fund sponsor. This lender will already be familiar with the Managed Funds and the investment strategy, have an existing working relationship with the management team, and have already diligenced the partnership agreement and investors of the Managed Funds. Many of these factors are factors to consider in understanding credit risk in lending against management fees and in developing adequate covenants under the related loan agreement to mitigate such risks.