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Cross-Referenced Debt Limits

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In the United States, while there are certainly exceptions, it has become a common market custom for the debt limitations in a subscription facility to simply incorporate the debt limitation(s) in the fund's partnership agreement (the "LPA"). We reviewed a facility recently where that construct had the potential for a syndicate member to get sideways with the terms of their initial credit approval, so we wanted to highlight the issue.

A large percentage of funds have debt limitations in their LPA, often limiting a subscription facility to 25% or 30% of aggregate capital commitments and true leverage as a percentage of NAV at the time of incurrence. While virtually all lenders need some level of maximum indebtedness in a facility, they are often comfortable with the threshold agreed to between the fund and the investors. The provision that caught our attention had a debt limitation in the LPA that was qualified by "unless otherwise approved by the Advisory Committee." The credit agreement simply required compliance with the LPA, which could in all likelihood be complied with even at a higher debt threshold if approved by the Advisory Committee. The bank's credit approval was not explicit with this potential increase nuance, leaving the possibility of a disconnect. We have seen several funds in the past that have, in fact, obtained approvals from advisory committees for temporary increases, so the risk may be a bit more than theoretical.

When facility debt limits are defined by cross-reference, lenders have typically incorporated changes to the applicable provision of the LPA as a "Material Amendment," requiring lender consent to the changes. But the voting threshold to approve an LPA amendment may at times be set at less than all lenders. Thus, lenders should be clear in their credit approvals when relying on a debt limitation like this that its change may not be an all-lender "sacred right" from a voting perspective.