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FUND FINANCE FRIDAY

# NAV Deals Hit the Big Time

March 13, 2020 | Issue No. 68

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NAV – or net asset value backed – facilities have been prevalent in the fund finance market for some time now, but we've generally seen them used either by secondary fund managers leveraging mature positions or assets which are near-term cash generative (in recent times, on an increasingly more concentrated basis) or by credit fund managers where the underlying assets included in the borrowing base are strictly categorised and pre-set advance rates are agreed depending on the nature of the underlying asset.

Pure NAV deals in the context of primary private equity have been far fewer given the more concentrated nature of the portfolios and the absence of near-term regular distributions. However, in recent times, we have seen a significant increase in the number of large primary PE managers using and/or considering using these facilities to generate liquidity across their portfolios and increase their borrowing capacity, whether that be for accelerating liquidity to investors, to finance growth and value creation with follow-ons or to refinance asset-level debt. The continuing high entry valuations mean that GPs are having to work their assets harder to deliver the returns expected by their investors, with the result that the hold periods for investments is lengthening, leaving the GP without access to fund level liquidity for longer periods of time as capacity under a subscription line reduces or disappears.

The number of institutions that have the appetite and capability to provide these types of facilities is limited – and we have typically seen these trades executed predominantly where the lenders are already familiar with the underlying assets, making the credit assessment and credit underwrite for the trade much easier. However, we are now seeing a number of these types of deals done with large managers where there is no pre-existing relationship between the underlying asset(s) and the proposed lender and the product is being sought and provided on a standalone basis.

What is driving this trend?

On the lender side:

- Lenders are seeking higher returns as pricing pressure on other types of fund finance products provided to large managers – particularly subscription lines – continues.

- Lenders see the product as a tool to build deeper relationships with large fund managers where they may not be able to, or the return profile means that participating in the subscription line isn't viable for the lender. Having the capability to offer both subscription and asset lines can be a unique differentiating factor.

- As lenders become more familiar with fund finance products generally and have seen the strong performance of asset-backed lines across other sizes/types of managers and asset classes, the credit appetite for more complex structured facilities, particularly for the larger managers, becomes greater. Whilst the lender pool for these types of trades is still small, those lenders that are active have the infrastructure to carry out the asset-level due diligence necessary for the execution and portfolio management of these trades.

On the GP side:

- Where markets become difficult from an exit perspective, coupled with a continuing pressure on GPs to generate liquidity for investors, these facilities can provide that much-needed liquidity. Provided the LTV is set at an appropriate level, investors see the value in these facilities.

- There is a realisation that fund-level financing can solve for liquidity needs in respect of particular assets – whether that is because a particular asset is in distress or requires further investment where capital from the investors is either unavailable or the GP wants to reserve that capital – without a heavy price ticket, via the credit support given by other assets in the portfolio.

The tide is definitely turning for NAV lines, with the high capital inflows we've experienced for many years now in the larger funds and high valuations suggesting that large PE managers may experience greater challenges deploying that capital and creating liquidity for investors with the necessary knock-on effect on IRRs. The NAV lines that have been used across other asset classes and sizes of funds now seem increasingly more attractive to larger managers to solve for these challenges. Watch this space!