Is Cash King? Deferred Consideration and Specie/in-Kind Transactions in the Context of Private Equity NAV Financings

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Net asset value (NAV) facility documentation, at least in the context of private equity, has evolved to a large extent on the assumption that borrower funds will usually execute transactions in cash - paying cash on completion for assets acquired, and similarly disposing of assets for cash. The broad drafting assumption has also typically been that distributions by fund borrowers to their investors will almost always be made in cash.

However, these assumptions are not always borne out in practice. The dynamics of individual transactions for the sale and purchase of private equity assets, as well as the market's response to changing macroeconomic conditions, may make it necessary or desirable for NAV borrowers to sell assets for partial deferred consideration, or to purchase assets on a deferred consideration basis. Indeed, in some markets such as private equity secondaries, it is already very common for significant portions of purchase consideration to be deferred, and NAV financing documentation has developed in line with this principle.

Meanwhile, fund documentation generally provides sponsors with the flexibility, at least in principle, of selling assets for consideration "*in-specie"* or "in kind," for instance in return for shares, or even of making returns to investors in kind.

In our experience, the European NAV financing market has begun to consider these two issues – *deferred consideration transactions* and *in-specie distributions* – in more detail when drafting documentation. We consider the emerging documentary trends in this article.

As with many areas of NAV financing, this is an area where there can be expected to be some alignment of interest between sponsor and lender. For instance, it will generally be in the interests of the sponsor, as well as its lender, to ensure that any receivable is of sufficient quality that it is paid. However, there may be a degree of tension between the sponsor's desire for flexibility in managing its portfolio in response to changing opportunities and market conditions, and the lender's desire for control over the parameters against which it has lent, and in-principle preference for the immediate liquidity of, and prepayment from, cash.

Deferred consideration in private equity NAV deals

Disposal of investments for deferred consideration

When considering how to treat disposals for deferred consideration in NAV documentation, two questions in particular are fundamental:

- to what extent the sponsor should have the freedom to sell assets other than for immediate cash consideration in full; and
- whether, and on what conditions, the receivable represented by any entitlement to deferred consideration should itself be treated as an investment for the purposes of the NAV facility documents, and be included in the calculations of net asset value and loan-to-value (or similar financial covenant concepts).

It is worth noting that definitions of "Investment" in NAV facility agreements may be sufficiently broad that, in principle, a receivable for deferred consideration on sale could, itself, constitute an "Investment." In our experience in larger-cap transactions it is quite common, though not universal, for NAV documents to incorporate a definition of "Investment" from the fund's own documentation (such as the limited partnership agreement ("LPA")). LPAs are typically drafted broadly to afford sponsors flexibility and so it would be quite common for a sale receivable to be counted as an "Investment" for those purposes. We have in some circumstances seen, however, the definition of "Investment" in NAV facility agreements limited to private equity investments, such that a receivable would not constitute such an "Investment" (with the various knock-ons throughout the documentation).

Sponsors will typically wish for flexibility to be able to sell investments for partial cash consideration, and will cite the need to be responsive to market opportunities and challenges. Lenders will generally recognise alignment of interests with the sponsor in ensuring that, for instance, the creditworthiness of the purchaser is properly appraised. However, lenders may wish to regulate transactions of this type, which involve swapping private equity assets of the kind against which the credit was written for deferred receivables which may to some extent be conditional, and which do not immediately produce cash proceeds that can be swept to pay down the loan.

In our experience, outright prohibitions on disposals for deferred consideration are rare, but may be seen where there is a concentrated portfolio or a portfolio financing of lesser quality assets. However, we have seen lenders succeed in negotiating quantitative caps on the amount of deferred sale consideration that borrowers are permitted to accept, capping for instance by reference to a maximum percentage of total transaction consideration, or an absolute cap on the amount of deferred consideration that can be outstanding at any one time. The typical arm's length undertaking also acts as a governor for the terms of the deferral being 'fair and reasonable'.

Approaches to giving credit to deferred consideration receivables in net asset value and loan-to-value metrics vary. Some lenders may push to exclude such receivables from these metrics entirely, while others will be willing to afford credit for deferred consideration where the only condition to payment is the lapse of time – in other words it is unconditional and non-contingent. Where other conditions and contingencies, such as earn-out hurdles, apply to the purchaser's obligation to pay the deferred amounts, lenders are likely to be more conservative about affording credit.

Whatever treatment is agreed in principle for deferred consideration, it is important for both parties to consider the "knock on" effects throughout the documentation. For instance, if an entitlement to deferred consideration constitutes an "Investment" (or equivalent), then it is likely to be subject to various controls such as representations and undertakings throughout the document. Assuming deferred consideration receivables are capped, they may, however, be insufficiently large to constitute a "material investment" or "relevant investment" (or equivalent term) for the purposes of, for instance, determining cash sweep ratios (which are sometimes set by references to the number of remaining material/remaining investments). Additionally, upon eventual cash settlement of the deferred consideration, lenders will typically require the proceeds to be swept (and may refer to this as a 'catch-up' sweep), and care will need to be taken to ensure that cash sweep provisions including the *de minimis* provisions and any linkage between the relevant disposal and the timing of the sweep do not provide any unintended exemption from the cash sweep in these circumstances.

Acquisition of investments in return for deferred consideration

Conversely, a borrower may wish to be able to defer its own payment obligations in respect of the purchase of investments, and for borrowers in segments such as private equity secondaries, this may constitute normal practice.

For lenders, the issue will be that any deferred payment obligation constitutes a liability of the borrower in respect of its investment portfolio, which lenders will usually wish to see offset against the value of the investments, especially if it is non-contingent. There are various ways that this is achieved. One solution frequently arrived at in documentation is that the value of any such deferred consideration obligation is deducted from the net asset value of the investments. There may be discussions as to how the obligation is then actually netted from the "value" side of the LTV covenant, with the two options being either a deduction from the aggregate net asset value of all assets, or a deduction from just the value of the relevant individual asset, with the mathematical outcome being potentially different if the relevant individual asset is in negative equity. As an alternative to a deduction against the "value" of the assets, another solution seen is that the amount of the deferred consideration is added to the "indebtedness" side of the LTV covenant (and no deduction is made to the "value"). Again, this alternative treatment achieves a different mathematical outcome.

Additionally, in both instances quantitative limits on the absolute or relative amount of such deferred consideration may be considered, where lenders have particular concerns about the financial liability represented by outstanding obligations for deferred consideration. Finally, there may also be a discussion as to the potential to subordinate the payment of such deferred consideration, either structurally or contractually.

"In specie" / in-kind transactions in private equity NAV deals

Receipt of consideration in kind

It is possible that private equity investments might be disposed of in return for consideration in kind, as, for instance, where they are exchanged for privately held or listed shares or other securities.

Similar to the position regarding deferred cash consideration, one issue for parties to consider is whether credit is given for the value of such in-kind consideration while the borrower fund retains them. Sponsors will typically desire this flexibility to avoid cashless receipts prejudicing the loan-to-value ratio, and will argue that they are adequately incentivised to manage cash receipts appropriately to ensure repayment obligations and any cash pay interest are serviced. Lenders may agree to this position at least so long as the consideration in kind consists of conventionally marketable assets such as securities. Again, key from a lender's perspective will be ensuring that the loan documentation appropriately regulates such investments while they are held by the Borrower and that cash sweep provisions will apply in respect of the proceeds of any eventual liquidation of such assets.

Returns in kind to investors

Fund documentation may provide for the option of returns to be made to investors *in specie* or in kind. While we have not seen this arise in practice in the context of a private equity NAV financing, it is an option that fund borrowers may be unwilling to see closed off.

From a lender's perspective, the primary concern is that distributions in kind do not bypass the cash sweep principle, i.e., that if a distribution in kind is to be made, an appropriate portion of the value of the assets being distributed is paid to the lenders by way of the agreed cash sweep mechanism, before the asset is disposed of by distribution.

The consensus solution which we have seen emerging is that, before a distribution can be made in kind, the fund must liquidate for cash a portion of such asset's value equivalent to the percentage of cash proceeds that would be swept to the lenders in the event that the asset were, instead, sold in an all cash transactions (or, at least, source an amount in cash equivalent to the amount that would otherwise result from such liquidation). The resultant cash portion must then be used to prepay the loan before the remaining assets can be distributed. Although the drafting can be complex, our experience has been that this principle is usually agreed as meeting the requirements of both sponsor and lender.

Again, it is important to ensure that definitions of "distribution" (or similar) adequately capture distributions in kind, where they are permitted, such that, for instance, general restrictions on distributions (e.g., no distributions permitted while a Default is continuing or while a valuation challenge, where applicable, is ongoing) apply to in-kind distributions just as to cash.

Conclusions

In an evolving and (at present) turbulent market, it is fair to say that assets may be less likely to be bought and sold for pure cash in full at the time of completion of the relevant acquisition or disposal. As we've identified above, both sponsors and lenders need to be alive to key concepts in connection with any such non-cash transactions. Market practice in relation to both *deferred consideration transactions and in-specie distributions* is evolving, but our experience has been that the market is paying closer attention to these issues in documentation, and solutions are typically found that address the point expressly in a manner that balances legitimate concerns of both lenders and sponsors. We're on hand to discuss.

Yale Eyes Secondaries Sale: Who's Next?

April 25, 2025

By **Chris van Heerden**
Director | Fund Finance

Right after Patrick Calves **wrote about** "continued momentum in the secondaries market, supported by both cyclical and structural tailwinds" in last week's FFF, Yale University's **plans to sell** up to $6 billion is dominating private equity news this week.

Aside from its size—15% of the endowment's total assets and around an estimated 30% of its PE holdings according to Bloomberg—Yale's contemplated sale raises questions about setting a precedent. The "Yale Model" advanced by David Swenson advocated for an expanded role for private investments in endowment portfolios, consistent with a long investment horizon, and as an alternative to unnecessary return concessions for liquidity. Swenson's book, *Pioneering Portfolio Management: An Unconventional Approach to Institutional Investment*, significantly influenced institutional portfolio management after its publication in 2000.

When an industry leader decides to trim up to nearly a third of its PE portfolio, the natural question is who else could follow. Other university endowments are obvious candidates for secondaries sales in light of the pressure some may face to tap endowments to replace Federal subsidies. More broadly, the ongoing distributed to paid-in capital (DPI) drought could pressure other institutional investors, particularly when considered in the context of a declining dollar and overall portfolio performance pressure due to failure of Treasury prices to offset declines in risk assets in 2025.

So, yes, we expect significant acceleration in secondaries transactions, and we expect LPs to look to a broader portfolio finance toolkit, including LP interest financing, pref equity, and securitization, to free up liquidity without realizing a potential discount to NAV in a secondary sale.

Cadwalader Advises Barings and Citibank on Landmark $2.4 Billion Structured Funding Transaction

April 25, 2025

As reported in *The Lawyer* today, Cadwalader has represented Barings (as investor) and Citibank (as agent) on a market-leading structured funding transaction for Coller to broaden fundraising for Coller's investments in private market secondaries.

The $2.4 billion deal, which closed on April 10, is the largest-ever structured funding facility of its kind in the secondary market to invest in both private equity and private credit secondaries.

As noted in the official press release, “this transaction led by Coller's Structured Solutions & Insurance team builds on its track record of capital raising though innovative structured solutions, having raised $1.1bn for the Firm's Credit platform through similar structures earlier this year. This is Coller's 5th structured note issued since 2020. Barings acted as the Lead lender for the transaction with Coller Capital and Ares providing the credit enhancement."

The Cadwalader team representing Barings was led by partner Angie Batterson and law clerk Justin Larson, and the team representing Citi was led by partner Gregg Jubin and special counsel Mike Gonzalez.

Read the article on *The Lawyer*'s website **here** (subscription required).

Cadwalader Welcomes Matthew Worth!

April 25, 2025

Please join us in welcoming Matthew Worth to the UK Fund Finance team as a Partner.

His arrival follows the recent additions of **Bronwen Jones** and **Douglas Murning**, further strengthening the firm's transatlantic fund finance capabilities.

Matt joins Cadwalader from a leading global law firm, bringing deep experience across fund finance, private credit, and the broader spectrum of debt financing. He has particular strength advising on NAV financings and direct lending matters for private equity sponsors, and has also handled a wide range of transactions including leveraged finance, infrastructure finance, special situations and restructuring.

Learn more **here**.

Fund Finance Hiring

April 25, 2025

Fund Finance Hiring

Here is who's hiring in Fund Finance:

Mitsubishi UFJ Trust and Banking Corporation, New York Branch is seeking an Fund Finance Account Officer- VP to join its office in New York. The VP will work through all aspects of the transaction lifecycle to help the team originate fund finance transactions, including both subscription finance and NAV based facilities. Learn more **here**.

Bayview Asset Management is seeking a highly motivated Analyst to join its growing Fund Finance team in NYC. The Analyst will support the origination, underwriting, and execution of NAV-based and other fund finance transactions. Responsibilities include financial analysis and modeling, preparing investment materials, assisting with due diligence, and collaborating with internal teams across risk, legal, and operations to ensure smooth deal execution. The ideal candidate will have strong analytical skills, attention to detail, and a desire to grow within a dynamic, fast-paced investment environment focused on private market financing solutions. If interested, please reach out to Shannon Schwab at **shannonschwab@bayview.com**.

Cadwalader, Wickersham & Taft LLP is seeking associates with three to six years of relevant experience for its Fund Finance practice in New York, Charlotte or London. Qualified candidates will have experience in syndicated lending, commercial lending, leverage finance, fund formation, CLOs, asset-based lending, NAV financings or acquisition financings. Candidates must possess excellent academic credentials and solid legal experience. Selected candidates will get extensive interaction with preeminent bank, asset manager and lending clients. If interested, please reach out to Margaret Cart at **Margaret.Cart@cwt.com**.

Pantheon is seeking an Capital Markets Associate in London to support their global debt and FX operations, ensuring optimal management of financial exposures while delivering value to clients. Learn more **here**.