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FUND FINANCE FRIDAY

FFF is FFT

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Fund Finance Closes Out Q2

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By Michael Mascia
Partner | Fund Finance

With the July 4th holiday in the States and many organizations taking Friday off, this week's *FFF* is *FFT*. "FFF: Industry Conversations" is taking the short week off, but will be back next Friday with a great lineup of contributors.

Cadwalader is updating its data project for the first half of 2020, which will be presented soon as well. Q2 2020 seemed to both drag on forever and fly by, depending on the day. Fund finance finished the quarter incredibly well from a credit perspective. While I'm yet to hear any real praise for fund finance professionals, four months of zero defaults during a global pandemic with a record macroeconomic falloff is a testament to the balance sheet management of the investors and funds and the quality of transaction structures crafted by the lenders. Great job. Now on to Q3 ...

I enjoyed reading Graham Bippart's timely series on fund finance in *Private Funds CFO* this week. He really dug in and worked hard to learn the market and its players and provided one of the most factually accurate and balanced pieces of press the fund finance market has received to date. It is refreshing to see the media focused on facts and not the inflammatory. I hope to have Graham on "FFF: Industry Conversations" soon so the market can get to know him a little better.

Special thanks to the team at Pacific Western Bank for their guest article in this week's edition. We welcome guest contributions if you have something you would like to submit. And congrats to Alexa Schult on her promotion!

Have a great weekend!

Managing Capital Calls During Turbulent Times

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By Chuck Tedeschi
Managing Director, Fund Finance | Pacific Western Bank

Everyone anticipated a correction in the marketplace, but it's fair to say that no one expected it to come in the form of a global pandemic. But here we are. For GPs – especially emerging managers – using a capital call line is a very effective tool to manage capital calls. Let's explore how capital call lines (also known as subscription lines) can help and what to expect from a bank vis-à-vis capital call lines and a banking relationship in general.

Use of a capital call line can be a best-practice cash management strategy for GPs in several situations. In today's climate, they help provide needed liquidity relief to LPs by delaying a capital call by 60-90 days (or longer depending on the LPA). Accessing a line between closes can avoid overcalling from early LPs, especially during fluid situations like the coronavirus pandemic. Under more ordinary circumstances, a line helps avoid too frequent capital calls (more than four to five times a year) from LPs. Lines also provide leeway to meet time-sensitive deals as it relates to the 10 days – or more – typically cited in LPAs for LPs to make capital calls. Lastly, capital call lines address overcalling capital due to inaccurate forecasting of near-term deal activity that causes increasing cash balances and creates IRR drag. Now, perhaps more than ever, these are all occasions when a capital call line can be used to make managing cash flows easier for GPs.

A capital call line of credit can also be a boon to relationships with LPs. During these times, LPs are dealing with stressors of their own, and particularly small institutions, family offices, and HNWIs may need to generate liquidity to make a capital call by selling other assets at compromised values.

GPs today have several options when considering a capital call line of credit. Pricing is an important consideration but may not always be an easy apples-to-apples comparison. The cost of putting a capital line of credit in place would include consideration of the:

- Interest rate – typically a spread above or below the Prime rate (currently 3.25%)
- Unused fee – typically around 25 basis points and used to compensate the bank for reserve requirements
- Facility fee – upfront or annual charge for maintenance, etc. (also typically around 25 basis points)
- Legal documentation cost – includes *both* bank's legal fees as well as GP's legal fees

Other considerations should be a factor when considering a banking relationship:

- What does the bank's balance sheet look like?

- How experienced is the bank and its fund financing team?
- What is the size of the bank's fund finance – and its broader – business?
- How can the bank support portfolio companies?
- What are the bank's full banking capabilities?

Brad Smith, Executive Vice President and Head of Fund Finance at Pacific Western Bank, says, "We have not observed any abnormal borrowing patterns during the COVID crisis, as the majority of our clients have been drawing down and paying off their lines with a high degree of regularity. Further, we have not seen any LP defaults in our portfolio and hope that trend continues."

Securing a capital call line is an effective strategy for managing capital call lines during ordinary and extraordinary times. Choosing a banking partner that can deliver during good times and bad is a decision that serves GPs, and by extension LPs, well.

PFCFO: Survey of Changing Subscription Credit Facility Market Conditions

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By Victoria Lee
Associate | Fund Finance

Private Funds CFO (“*PFCFO*”) recently published a series on the changing landscape of subscription credit facilities as a result of the pandemic. In “**Part 1**: The shifting landscape for subscription credit,” *PFCFO* finds that some demand for new relationships has shifted from the larger institutions to smaller lenders as the larger institutions have focused on existing relationships in the face of rising liquidity demand. *PFCFO* also finds that pricing has generally increased on applicable margins and LIBOR floors within these products in the market. In “**Part 2**: Take it to the limit,” *PFCFO* observes how decreased liquidity in the markets has led to high utilization of revolving credit facilities, increasing demand for such products and forcing banks to reassess overall liquidity positions. In “**Part 3**: “Real credit concerns for some lenders,” *PFCFO* discusses potential credit concerns in the market despite the general lack of institutional investor defaults in subscription credit facilities. In “**Sub line lenders look beyond LP collateral,**” *PFCFO* explores how lenders are incorporating additional safeguards beyond just the borrowing base to decrease risk of nonpayment, including net asset value covenants and other requirements for LPs to have “skin in the game.” In “**Part 4**: Rethinking returns… and relationships,” *PFCFO* finds new constraints for banks in the subscription credit industry, with the overall surge in demand forcing lender teams to compete internally for additional allocation based on product pricing. Finally, in “**Part 5**: Banks (trying) to sell down pre-COVID SCF exposures,” *PFCFO* observes that changes in the market relating to increased pricing has resulted in more difficulty for lenders in raising capital or selling down existing positions.

On the Move – Fund Finance Tidbits

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On the Move

Alexa Schult has been promoted to Director from Senior Credit Analyst at First Republic Bank. Alexa has six years of experience working with alternative investment firms.

Alexa started her banking career by supporting the daily cash management needs of companies across various industry types. Since 2015, Alexa has been focused on providing lending solutions to private equity firms and their funds under management.

Responsible for a large portfolio of subscription facilities, Alexa has also taken on community-building initiatives in the market through the Next Gen chapter of the Fund Finance Association.