Current market and trends:

European fund financing – a reenergised but choppy market

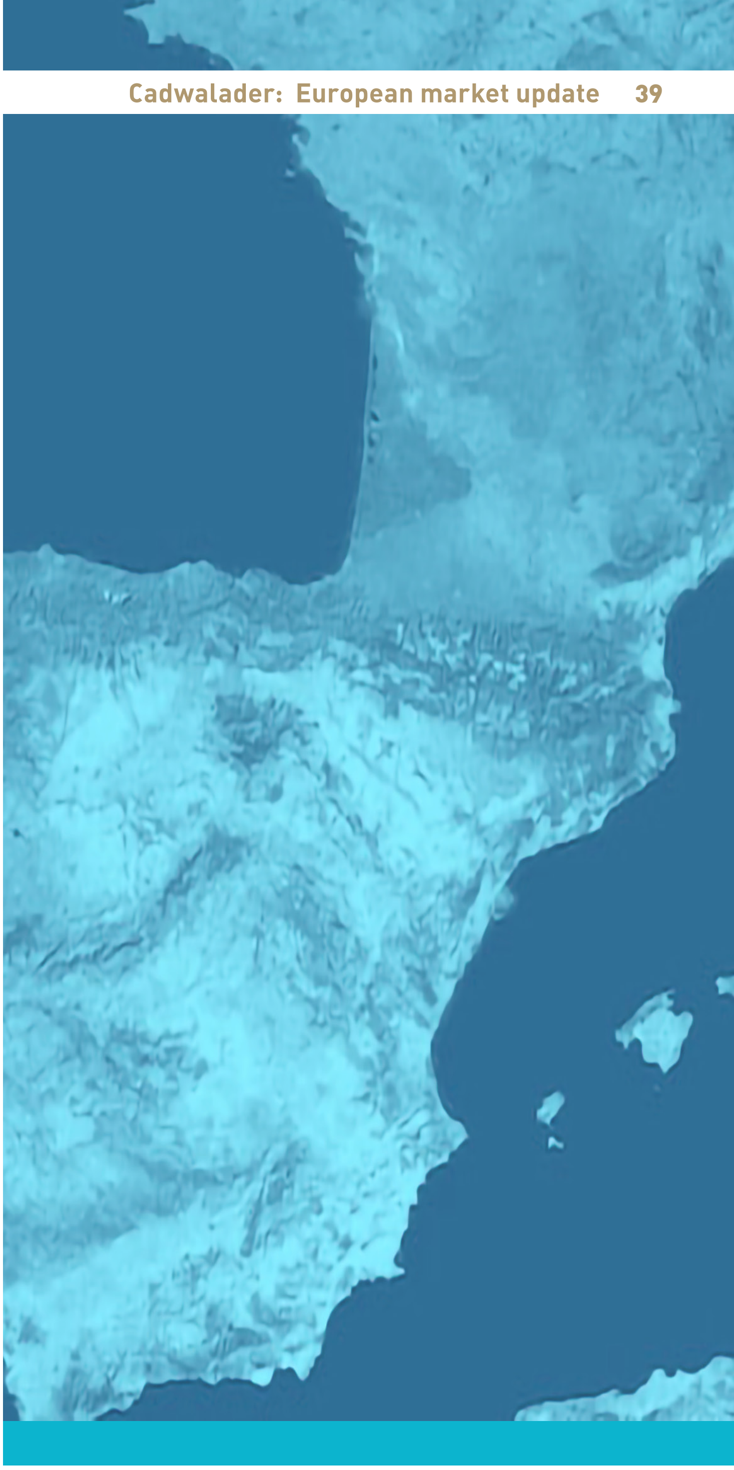
Bronwen Jones, **Douglas Murning**, **George Pelling** and **Matt Worth** of **Cadwalader** evaluate Europe's evolving fund finance market, highlighting NAV financing's growing role, increased lender competition, securitisation adoption and innovative blending of capital sources

The European fund finance market has been re-energised following disruption caused by the US regional banking crisis in 2023. However, fundraising by private equity sponsors has continued to be slow. Larger sponsors have drawn a greater share of available capital, and the average fund size has increased. Fund finance originations proved quite resilient in 2024 even as fundraising slowed, but the transaction volume did shift towards refinancing activity over new origination. Reflecting where the private equity industry stands in the business cycle, net asset value (NAV) financing was often used to power secondaries investment and continuation vehicles.

In a sign of continuing maturity and increasing efficiency in the fund finance market, as well as competition among lenders, transaction timeframes have shortened, and smaller participations have become the norm.

We expect to see fundraising improve in the remainder of 2025 as private wealth increases its appetite to engage with the private capital market and conditions in the private equity deal markets improve. If these expectations are fulfilled, we should see a healthier fund finance market with improving appetite for new deals.

For now, it's a good time to be a borrower. All segments of the fund finance market are experiencing pricing compression and a more favourable negotiating environment for borrowers. Transaction terms, as well as rates, have become more challenging for lenders. The macroeconomic outlook, including for interest rates, is characterised by uncertainty, and volatility could continue in 2025 given the questions around global growth, fiscal policies, trade, tariffs and inflation. A key question is how these matters



will affect demand, supply, and the balance between borrowers and lenders in the fund finance market.

In this article, we consider three particular trends that we expect to influence the European market in the year ahead. First, we expect NAV financing, with which the market is increasingly comfortable, to continue its growth and diversification given the vast pool of assets-under-management (AUM) it has yet to address. Secondly, market participants will increase the efficiency with which they source and blend debt capital from different pools. And thirdly, the use of securitisation and structured finance techniques in fund financing, particularly capital call financing, will increase and become a more familiar part of the European landscape.

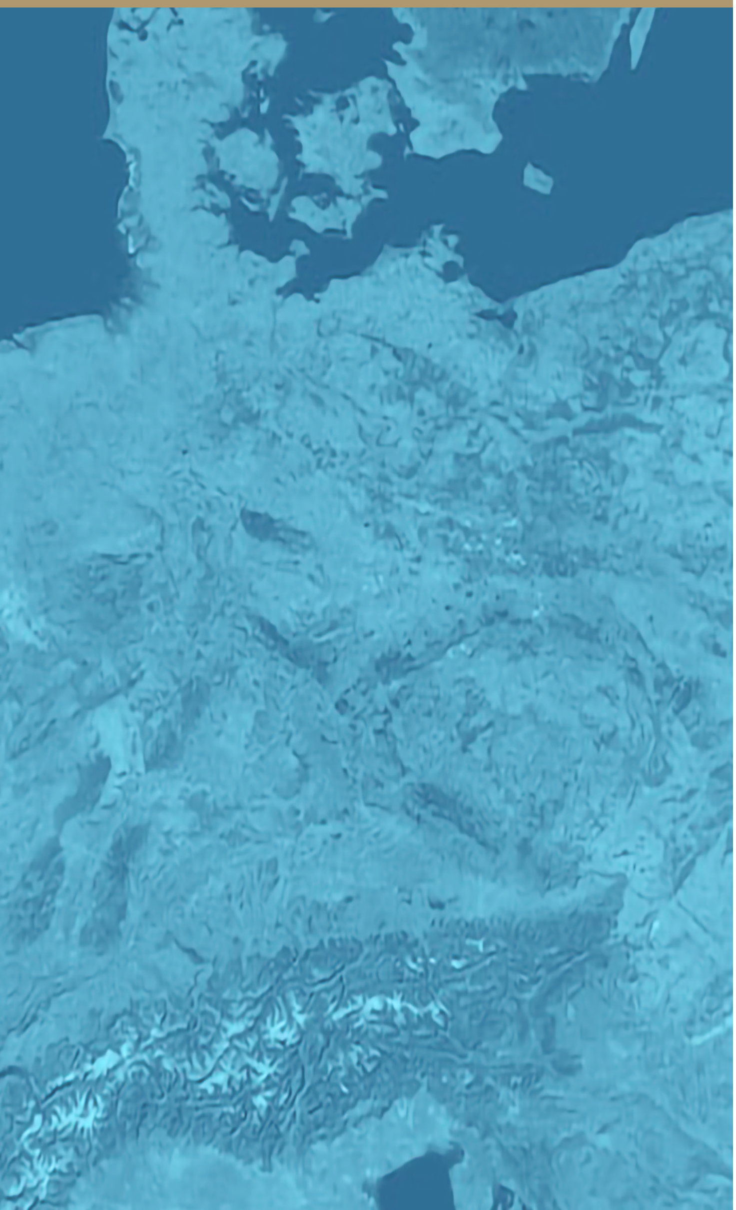
NAV financing is becoming mainstream

The NAV market has grown substantially, driven by increases in AUM. Global AUM have grown significantly in recent years, to a multitrillion- dollar level. In the context of this increase in the addressable market, NAV facilities are now a mainstream option for optimising a fund's capital structure, and are demonstrating their versatility as a tool. Alongside traditional NAV borrowing by mature primary buyout funds, NAV loans are now often used to finance secondaries portfolios and to support continuation vehicle (CV) transactions. We have seen the development of NAV-based acquisition financing, put in place to fund the closing of secondaries portfolio acquisitions. If, as expected, secondaries activity continues to be robust and appetite for CVs remains high, then we can expect NAV financing to continue its rise.

The release, last year, of the Institutional Limited Partners Association's guidance on the use of NAV facilities served to demonstrate growing acceptance of NAV financing as a mainstream fund financing tool, and the increasing comfort of investors and sponsors with the use of NAV facilities. Such clarity and standardisation around best practice is to be welcomed. There is also an increasing awareness that NAV loans are not used simply to fund earlier distributions to limited partners, but can be deployed for numerous purposes including supporting existing investments, funding bolt-ons and portfolio acquisitions, and providing liquidity in open-ended structures.

The range of participants in the NAV market continues to broaden, as do the types of investment being financed. Credit funds, infrastructure sponsors, mutual funds and family offices are all accessing the European NAV market, contributing to a rich and varied transaction mix. On the lender side, there have been many new entrants; the resultant competition has to some degree resulted in the price compression seen in other areas of fund finance, and in the buyout fund sector at least, we have begun to see some standardisation of terms, along with shorter deal timeframes and competitive tendering processes. However, strong demand and the ongoing diversification of structures and applications continue to provide profitable opportunities for lenders, especially those willing to break new ground.

Key negotiating points on NAV transactions typically include cash sweep terms and permitted deductions, the extent of security on offer (with stronger borrowers in the buyout segment continuing to push for “security light” structures), anti-layering restrictions, asset eligibility, diversity and exclusion criteria, and remedy and enforcement rights.



In summary, the European NAV market is showing increasing signs of maturity and acceptance, but with continued opportunity for innovation and diversification. In that respect at least, NAV lending looks a lot like subscription financing looked a decade ago, and we expect the year ahead to be characterised by continued evolution and growth.

New players and a new game?

Non-bank lenders now play an essential part in the fund finance market, and we expect this to continue. Private credit funds have become more flexible in their operations (for instance, with continued reductions in the funding notice periods they require) and may be more flexible in the types of risk they can assume; they have long played a leading role in NAV financing. On occasion, they can fill in where capital constraints reduce the amount of capital banks can deploy. Bank lenders retain powerful origination capability, can offer supporting services such as agency and loan servicing, and can frequently leverage wider relationships with fund borrowers that encompass other roles such as custody and administration. As in other financing segments, lenders arranging deals deploy distribution and structuring capabilities to retain the risk they wish to while passing other exposure on to different participants. The latter trend has opened the door to participation in fund finance by institutional investors such as insurers, and this is becoming commonplace in 2025.

The ability to “mix and match” capital sources appears to be increasing the efficiency of the fund finance market, and assists in matching demand for capital with supply at the right price point. This increasing sophistication should improve the market’s ability to respond quickly to new opportunities and risk types, and to develop new products. While many collaborations between lenders will continue to be ad hoc and responsive to the demands of specific borrowers and transactions, we are also seeing strategic collaborations between different funders, and the emergence of a class of private lender whose business model is founded on the ability to blend capital from different sources and provide borrowers with a tailored solution.

Product convergence continues between fund finance and capital markets

Perhaps the hottest topic in fund finance today is tapping into the capital markets to provide efficiency for both sponsors and investors. In search of solutions, fund finance is poised to borrow and modify securitisation technology and apply it to portfolios of fund finance facilities.

Currently, interest is focused on subscription line securitisation, reflecting among other things the relative maturity and standardisation of subscription line financing compared with, say, NAV financing. Fund finance is able to take advantage of technologies developed in the securitisation market over several decades, and so, for instance, attention in the fund finance securitisation segment is already focusing on synthetic securitisation models.

The growth of credit risk transfers (CRTs), known as significant risk transfers (SRTs) in Europe, also continues, with banks and subscription line lenders seeking capital relief for their risk-weighted assets and subscription line loan portfolios. Whilst the market is more active in the U.S. than in Europe, partly driven by regulatory differences, we think there will be an uptick of interest in Europe for those products. CRTs/SRTs and securitisation represent continuity in a trend of convergence between fund finance and capital markets products that also gave us the emergence of collateralised fund obligation (CFO) structures and, in the US market, rated feeder vehicles – both means of allowing institutional capital to invest in private funds without prohibitive regulatory capital costs.

Naturally, the adoption of securitisation and other capital markets techniques in fund finance will raise questions from market participants. A common discussion point is the difference between traditional, relationship-based subscription line lending on the one hand, and the less proximate connection between borrower and lender where risk is distributed via the capital markets. Generally, we would expect standard solutions to emerge to such issues as the fund financing market becomes more familiar with securitisation. The advantages of securitisation, including access to wider capital pools and an enhanced ability to optimise liquidity and pricing for lender and borrower, can be expected to have a telling effect, driving the adoption of securitisation in fund finance as has been seen in other financing markets. Borrowers are increasingly asking about securitisation at the origination phase of subscription line financings, a trend we expect will lead to higher deal volume, greater acceptance, standardisation and consequent efficiencies.

Looking ahead

Fund finance is not immune to uncertainties in the debt markets and wider global economy, but we consider the fundamentals to be strong. This is particularly so in NAV financing, at present, but will surely apply to the wider market if, as expected, new fundraising volumes improve in the year ahead.

A key question for the year to come is how pricing trends will be driven by demand patterns and the very healthy levels of interest in the market from new participants. Will increased lender participation intensify competition and further compress pricing, or will rising demand and further product diversification provide lenders with a recovery in margins? However that plays out, all segments of the fund finance market at present are characterised by product innovation and increasing efficiency, including the continued growth of NAV financing and its application to new segments and asset types, the increasing sophistication with which different sources of capital are blended, and the burgeoning use of capital markets techniques to improve liquidity, efficiency and pricing and provide new opportunities for risk distribution.

Cadwalader are delighted to be at the forefront of this evolution, in what is now a highly dynamic, more than trillion-dollar fund finance industry. ■

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About Cadwalader, Wickersham & Taft

Cadwalader's fund finance practice features a globally recognised, market-leading team with deep client relationships that span the full spectrum of fund finance. The team offers unrivalled expertise in all forms of fund finance – including capital call lines, GP facilities, and NAV facilities – enabling us to navigate the execution and management of complex solutions. As part of a seamless transatlantic team, we leverage our extensive knowledge of the UK, European, and US fund finance markets and legal frameworks to provide tailored advice for our clients.

We combine commercial insight, technical proficiency, and legal acumen to swiftly identify and resolve both legal and commercial challenges, ensuring that our clients' business objectives are achieved efficiently and in alignment with their values and processes. Our clients also benefit from the firm's deep bench and multidisciplinary approach, with our global Fund Finance lawyers collaborating with other premier practice groups to provide a comprehensive integrated approach to fund finance.

- Subscription-backed credit facilities and equity commitment facilities
- NAV facilities to all asset classes and ABC to credit funds
- Hybrid facilities
- Management fee facilities, GP and executive support financings
- Term financing arrangements such as prime brokerage, securities lending and repurchase structures
- Leveraged derivative arrangements such as total return swaps, barrier options, and forward transactions
- Hedge fund and private equity fund interests
- Securitisation and structured finance
- Collateralised fund obligations and rated feeders
- Capital relief and significant risk transfer trades
- Real estate investments

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