July 2019

5th Annual European Fund Finance Symposium
Covenantal Relationships Panel

Charlie Bischoff, a partner in our Finance team who co-heads our Fund Finance practice alongside Danny Peel, moderated the Covenantal Relationships Panel at the recent European Fund Finance Symposium in London last month. The panel consisted of Russell Evans (National Australia Bank), Kim Nguyen (Commonwealth Bank of Australia), Matthew Maguire (Park Square Capital) and Keith Pickard (InfraRed Capital Partners). The following are a selection of the key themes arising from the panel discussion.

SUBSCRIPTION FACILITIES

- **Covenant Package** – do market participants expect to see any financial covenants in addition to the usual capital call coverage ratio ("**CCCR**")? Downwards looking covenants are often asked for by lenders given the performance of the underlying investments may affect the investors' willingness to fund capital calls (including to repay fund level debt), however not always agreed upon by funds. A compromise sometimes seen in the market is the standard CCCR financial covenant combined with an information undertaking in relation to underlying asset performance.

- **CCCR and Advance Rates** – what are the factors which influence the level at which CCCR and Advance Rates are set? Funds will understandably seek to maximise the number of investors are included as QLPs and the respective advance rates applied to those investors. Ultimately, however, on a multi-lender deal, designation of QLPs may come down to the lowest common denominator given that different lenders may have different views on who should be included as a QLP. This is driven for the most part by the amount of information available to the lenders on the investor base (whether publically available, provided as part of the transaction or on a lender's data base having lent against that particular investor before). Typically, the more information available (assuming that information is not negative!), the potentially higher the advance rate. Equally, the concept of advance rates/CCCR varying over time depending on the extent to which investors have funded their commitments is also often seen in the market and can be helpful to both lenders (from a credit analysis point of view) and funds (as a means of maximising their borrowing base). Finally, it is worth noting that investor letters/acknowledgements, which are more commonly seen in the US market, may help with negotiating higher advance rates.

- **Cov Lite transactions** – what do we mean by cov lite in a fund finance context and how does it manifest itself in the covenant package? Although the cov lite concept is not nearly as established in the fund finance space as in the leveraged space, it usually manifests itself in the form of deals based on imperfect investor information (redacted side letters, master side letter tables only, undisclosed investors, limited investor information), deals with a reduced security package. Lenders sometimes will come under pressure to accept these types of deals when other lenders in the market – perhaps less well established ones – are willing to lend on this cov lite basis. It is worth noting, however, that GPs and managers are well aware that cov lite structures may cause issues for lenders (and therefore lead to more unattractive pricing) and will seek to balance their desire for structural flexibility with the need to achieve favourable pricing.

HYBRID FACILITIES

- **What is the appetite for these facilities and when are they appropriate/inappropriate?** – Funds often look for a hybrid facility for the theoretical flexibility it would offer them, but, in reality, lenders prefer to see an established portfolio of assets – hypothetical scenarios around potential investment portfolios are often not helpful for internal credit analysis. While for a number of years hybrid facilities were more talked about than actually utilised, lenders are now making them available with increasing regularity – often on the basis that the upwards and downwards looking financial covenant package will provide their credit teams with sufficient comfort where a CCCR or NAV covenant alone would not, on their own, have done so – and GPs are finding them useful financing tools to span a fund's life.

- **Within the various institutions which make available fund level facilities, which teams look after hybrid facilities?** – Sometimes, different teams will look at subscription lines and NAV lines, with the result that hybrid facilities may often look like a subscription with added bells and whistles, rather than a true hybrid facility. Equally, a subscription lender may be more willing to offer a subscription facility which then converts into a NAV facility owing to the higher pricing available on that type of line, rather than a NAV lender agreeing to make available a subscription line (with its associated lower pricing) which then only converts into a NAV facility at a much later date. Increasingly, however, lenders have been able to respond to GPs' specific hybrid requirements with experienced teams and structures which fit their needs.

NAV FACILITIES

- **When are distribution covenants/cash sweeps and leverage covenants relevant in NAV facilities and what parameters are typically seen in the market?** – The discussion often revolves around which distributions are recallable on the basis that lenders will typically be more willing to allow distributions if they can subsequently be recalled. Also critical will be the stage at which the fund is in its life – lenders will probably have less concern with distributions mid-life of the fund, but will be more concerned about the increasing concentration risk at the end of the fund's life. By way of example, there might be a percentage cash sweep at the end of the fund's investment period and then a full cash sweep once the number of assets has reduced to a certain level.

  These types of covenants will also be influenced by the asset class in respect of which the fund level financing is being put in place. Certain asset classes will be viewed more favourably than others because distributions to investors may be more predictable or consistent or the underlying assets themselves may be more liquid or easily/accurately valued. This will often result in a more linear, time-driven cash sweep (which would be more appropriate for a debt fund, for example) rather than a more lumpy, event-driven cash sweep (which would be more appropriate for an equity fund, for example).

FOR FURTHER INFORMATION, PLEASE CONTACT

10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7295 3000
F: +44 (0)20 7295 3500
www.traverssmith.com

Charles Bischoff
Partner, Finance

E: charles.bischoff@traverssmith.com
T: +44 (0)20 7295 3378

Danny Peel
Partner, Finance

E: daniel.peel@traverssmith.com
T: +44 (0)20 7295 3441

Katie McMenamin
Senior Associate, Finance

E: katie.mcmenamin@traverssmith.com
T: +44 (0)20 7295 3350

Jamie Parish
Senior Associate, Finance

E: jamie.parish@traverssmith.com
T: +44 (0)20 7295 3464