A - Z of Fund Finance

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MEET THE AUTHORS

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ZOË CONNOR is a partner in the Finance Practice Group in the London office of Haynes and Boone and has extensive experience advising a variety of lenders, borrowers, private equity sponsors, VCs, specialist lenders, hedge funds, mutual funds, insurers, brokers and corporates across a range of cross-border syndicated and bilateral financing transactions, with particular focus on fund finance, speciality finance, structured finance and financial institutions lending as well as investment grade and general corporate lending. Zoë's practice covers the full range of fund finance products from subscription facilities to hybrid and NAV facilities as well as general partner/manager support, co-invest facilities, hedge fund leverage and other types of liquidity facilities provided to funds. Zoë also has significant experience in advising closed-ended and open-ended debt funds and their lenders in relation to leveraged facilities.

EMILY FULLER is an associate in the Finance Practice Group in the London office of Haynes and Boone. Emily acts on a full range of finance transactions, with a particular focus on fund finance, including syndicated and bilateral leveraged/NAV, hybrid and capital call facilities, speciality financings and real estate financings. Emily's practice focuses on acting for bank and non- bank lenders, sponsors and a variety of borrowers (including private equity, hedge, infrastructure, real estate and credit funds, corporate entities and joint ventures) and has also gained valuable experience of both open-ended and closed-ended offshore fund and co-investment structures.

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AIFMD

The EU's Alternative Investment Fund Managers Directive (AIFMD) regulates, amongst other activities, the marketing of alternative investment funds within the European Economic Area (EEA). Currently fund managers in the United Kingdom (U.K.) are able to manage and market their funds in the EEA under the passporting scheme. The passporting scheme allows businesses within one EEA member state to carry on business in another EEA member state without having to seek a separate licence in each EEA country in which that company wants to do business. Although it is still uncertain as to whether the U.K. will be able to rely on 'equivalence' to continue operating within the EEA post Brexit, it is likely that managers based in the U.K. will no longer be able to benefit from the passporting scheme in the same way. This would mean that U.K. based fund managers would need to operate within the EEA through the local private placement rules of the applicable EEA country.

Many managers and funds looking to borrow from an EU lender do not come within the remit of AIFMD, due to the fact that they often have a non EU manager or fund, and so the fund finance market should be able to continue as it has done previously by lending to non-AIFMD compliant managers/funds. It is envisaged that Brexit will have a limited impact on the fund finance market.

Where a borrower (typically structured in England as a limited partnership (see "**Limited Partnerships**" below) is subject to AIFMD, any alternative investment fund management agreement (AIFM Agreement) should be reviewed by lender's counsel at the due diligence stage and included within the definition of 'Fund Documents' in the facility agreement. By inclusion within this definition, any termination of an AIFM Agreement is likely to trigger an event of default. It is also usual for an event of default to be triggered if the alternative investment fund manager (AIFM) ceases to act as AIFM for the borrower and is not replaced by another suitable AIFM.

Borrowing Base

In a subscription line facility (see "**Subscription Line Lending**" below), the borrowing base is calculated on the value of the uncalled commitments of eligible investors. In order to assess the creditworthiness of investors and whether such investors should be included within the borrowing base, lenders will often require certain financial information in respect of the investors. Investors that are included within the borrowing base are referred to as 'Eligible Investors'. Eligible Investors are often then further categorised into 'Rated', 'Non-Rated' or other 'Designated Investors'.

In order to be included in the borrowing base, all Eligible Investors are required to meet certain conditions. These conditions vary depending on an investor's categorisation. In addition, the lender(s) (or the facility agent) is likely to request an absolute discretion as to whether an investor is included in the borrowing base, rather than automatic inclusion on satisfaction of the relevant conditions. The agent will also require the investor to provide a copy of its fund documents (typically its subscription agreement, side letter and any investor letter or, if relevant, ERISA information) and confirmation that no exclusion event has occurred.

Often different advance rates and concentration limits will apply to Rated, Non-Rated and other Designated Eligible Investors, meaning that the lender will only lend against a percentage of that investor's uncalled commitments.

In a NAV facility (see "**NAV Facilities**" below), the borrowing base is calculated on the value of the eligible amounts of each eligible investment multiplied by the relevant advance rate for such investment. In order for an investment to be eligible it needs to satisfy the lender's eligibility criteria and typically eligible amounts take concentration limits into account.

Co-Investment Vehicles

Where there is a co-investment structure (*e.g.* a parallel fund with its own investors but the same manager which is investing alongside the main fund in the same assets) the manager may also wish for the facility to be available to the co-investment vehicle. If both the main fund and the co-investment vehicle have access to the facility, the lender will typically want there to be cross-guarantees and cross-collateralisation included within the loan documentation. However, the lenders may agree for the main fund and the co-investment fund to be severally liable for their own obligations, or for liability to be capped at a certain amount. The co-investment fund will, however, be expected to grant the same call right and bank account security as the main fund.

Due Diligence

Due diligence on the borrower's fund documents should be carried out from the moment of instruction as, depending on the number of investors in the borrower, this could be a very lengthy process and it is better to be aware of any issues from the outset. Documents that the lender's counsel will typically want to review include the limited partnership agreement (LPA) of the borrower and any other constitutional documents of the general partner (GP) and any manager, any side letters of the investors in the borrower, the investors' subscription agreements and any investment management or investment advisory agreement(s).

When reviewing the LPA, the lender's counsel will be concerned with whether the GP has the power to borrow, guarantee and grant security on behalf of the fund. It is also important to pay attention to who has the right to issue call down notices to the investors (is this the GP or a manager?), how many days' notice is required to give notice of call downs and whether there are any details in particular that need to be included in the call down notice (for example, details of the relevant bank account into which contributions are to be paid). Lenders will also want to know whether call down notices can be issued to investors to repay debt after the end of any investment period, as if this is not the case then the term of the facility will need to be tied to the term of the investment period. Among other provisions that lender's counsel will look to flag in their review of the LPA are (i) overcall limitations (limits on the ability of the borrower to call capital from its investors), (ii) excused or excluded investors, (iii) cancellation, withdrawal, reduction, redemption or other similar rights in relation to undrawn commitments, (iv) flexibility for and consequences of alternative investment vehicles, and (v) subordination of investors' and fund parties' claims to those of the lender.

The lender's counsel will be looking for any provisions in the side letters which could prevent an investor from meeting a call down. Provisions with implications for lenders could include (i) 'most favoured nation' provisions, (ii) investment restrictions, (iii) placement agent provisions, (iv) sovereign immunity provisions, (v) provisions restricting the jurisdiction for the bringing of claims under the fund documents, and (vii) confidentiality obligations.

When reviewing the investors' subscription agreements, lender's counsel should not just verify that the name of the investor appears correctly but that the subscription agreement has been duly executed and that the amount and currency of the investor's commitment accords with the lender's records.

ERISA

If an investor is a pension or retirement fund, it may be classed as an 'ERISA investor' pursuant to the Employee Retirement Income Security Act 1974, as amended (ERISA). If a facility agreement is determined to create contractual privity between the lender and ERISA investors, this could result in a 'prohibited transaction' under ERISA.

A fund borrower may be considered to be a 'plan asset vehicle' if 25% or more of the borrower's interests are held by ERISA investors, and as such lending to such a borrower could be a prohibited transaction (as the plan asset vehicle would be deemed to be 'looked through') unless an exemption applies. A borrower may be exempt from the prohibited transaction rule if it qualifies as a 'venture capital operating company' (VCOC). A VCOC will not be considered to be a plan asset vehicle provided that all of the interests in the VCOC are not held by one ERISA investor or a group of ERISA investors controlled or sponsored by the same employer.

In addition, failure to comply with ERISA could expose the investor and the fund to significant liability and could trigger excuse rights that would permit an ERISA investor to avoid funding capital commitments. Whether an investor is an ERISA investor or not should be flagged and considered at the due diligence stage.

As further protection for ERISA investors, funds will often require ERISA investors to be investors in a feeder fund that will then feed into the main borrower fund. In this instance a 'cascading collateral structure' is put in place whereby the feeder fund will pledge to the main borrower fund its and its general partner's rights to call capital on its investors, and the main borrower fund will then on pledge to the lender its rights under the security documents between the main borrower fund and the feeder fund, so as to avoid contractual privity between the lender and the ERISA investors in the feeder fund.

Feeder Vehicles

Where feeder vehicles are used in the structuring of a fund, due diligence will need to be carried out on the borrower's fund documents as well as those of any feeder funds. The security package should capture the uncalled commitments of the feeder fund to the fund, as well as the uncalled commitments of the investors in the feeder fund to that feeder fund.

Lenders will often require any feeder funds to be obligors under the facility agreement, and as such the feeder funds will have to grant cross-guarantees and cross-collateralisation in relation to the fund's borrowing (albeit capped up to its relevant percentage allocation in the borrower).

GP Lines

Although not many banks offer credit lines to GPs for the purpose of funding a GP's fund commitment, there has recently been a slight increase in the number of banks/alternative lenders providing these types of facilities. Certain of those lenders will not however provide such GP commitment financings on a standalone basis, but may provide them alongside other financings.

Typically lenders providing credit lines to GPs, to help GPs finance their fund commitments, look to the distributions received from the underlying fund and/or the contractual rights to management fees for recourse purposes and therefore look to take security over such cash assets coupled with account security over the bank accounts into which such cash payments are made. Certain lenders also look for personal guarantees from members of the GP team as a starting point as well as security over the shares of the GP. Ultimately both pricing of these facilities and the required security/guarantee package depends on the profile of cashflows and the LTV coverage ratio.

Such GP commitment financings typically have a term of 5 years with lenders preferring to lend to the corporate GP, rather than directly to the individual members of the GP team. If the borrowers are the individual members then a number of consumer credit and FSMA (as defined below) issues need to be considered and addressed under the facility agreement, for example the provision of high net worth statements which acknowledge that the borrowers do not have the protection of the Consumer Credit Act 1974 or the Financial Services and Markets Act 2000 (FSMA).

In addition to credit lines for GP Commitment Financings, a number of lenders also provide strategic GP lines such as facilities for succession planning (enabling senior partners to realise equity and junior partners to fund their interest) and financing for GPs wishing to purchase secondary interests in their own funds.

In the last 12 to 18 months there has been an increase in alternative types of financing arrangements for funds. As well as GP lines, there has been an increase in the form of providing 'preferred equity' to investors, the purpose of which is to either fund follow-on investments, finance portfolio companies' working capital needs or increase a limited partner's investment capacity to finance commitment to the GP's new fund. Preferred equity deals are typically not secured in the conventional sense, but rather the preferred equity provider will be entitled to a preferred return on the cashflow of the underlying investments. Borrowers may find preferred equity attractive as an alternative to straight forward debt or equity as the borrower does not need to grant equity to the provider and can enter into this arrangement if there is already existing secured debt in the structure. A preferred equity provider will want to ensure that there is a waterfall in place under the facility agreement to ensure their repayment, even though there may not be a specific repayment date in place.

Hybrids

Hybrid facilities look down to the value of the underlying assets of the fund for recourse purposes as well as look up to the undrawn investor commitments. Almost always there are covenants in relation to both the undrawn investor commitments of the fund and the net asset value of the fund. Hybrids are particularly useful to funds that are looking for longer term financing that's available from first close until the end of the life of the fund. They can also be used to provide additional recourse to a lender where there is an issue with taking security over all of the uncalled commitments of investors.

Like NAV facilities, hybrid facilities are usually structured as term loan facilities and can be very bespoke in nature. Given their recourse is to both undrawn commitments and cash flows coming up from the underlying assets, hybrid facilities adopt features of both subscription line facilities (see "**Subscription Line Lending**" below) and NAV facilities (see "**NAV Facilities**" below).

ILPA

The International Limited Partner's Association (ILPA) published its paper "Subscription Lines of Credit and Alignment of Interests: Considerations and Best Practices for Limited and General Partners" in June 2017. In this paper, ILPA issued best practice guidelines on the use of subscription lines to both investors and fund managers. The 9 guidelines were as follows:

1. The IRR clock should start when the credit is drawn, rather than when capital is ultimately called from the investors;
2. Managers should make subscription finance disclosures to their investors in quarterly reports;
3. Managers are advised against using subscription line facilities to cover fund distributions;
4. Investor advisory committees should add subscription line financing to their meeting agendas;
5. Disclosure of investment details should not lag if capital calls are delayed due to the use of subscription line finance;
6. Managers should include the firm's official policy on credit lines as part of the due diligence pack provided to investors;
7. Investors should request that managers provide the impact of lines of credit on track record;
8. Investors evaluating the benchmark performance of managers should take into consideration the potential impact of these lines; and
9. Provisions addressing the use of subscription facilities within LPAs should delineate reasonable thresholds.

Many managers already include many of ILPA's recommended disclosures in their quarterly reports, but for those that don't, following ILPA's recommendations may be time consuming and administratively burdensome. The majority of investors are sophisticated investors who fully understand the use of subscription line facilities and appreciate the benefits they bring. Managers may also find ILPA's suggested thresholds for subscription lines and parameters for their use more prohibitive and lacking commercial consideration to adjust to evolving market conditions, such as limiting debt to 15 - 20% of all uncalled capital, limiting outstandings of a borrowing under subscription lines to 180 days, limiting the period of time for which such lines can be in place, lines being secured by investor commitments only and not by assets of investors or the fund (which may curtail the ability for lenders to make available NAV and hybrid type fund finance facilities), prohibiting on demand facilities and limiting total interest expense. For further information see Haynes and Boone's article: **"ILPA Calls on GPs for Subscription Line Transparency"**

Jurisdictional Issues

Certain elements of a fund finance transaction will be determined by which jurisdiction the borrowers (and other obligors) are domiciled in. The most obvious elements that will be affected by local jurisdictions are the fund structure and the conditions precedent. There are a variety of potential fund structures across jurisdictions, such as regulated or unregulated structures, limited partnership or investment company structures as well as trust arrangements. It makes sense to engage local counsel from the offset to ensure that any potential issues are flagged early in order to avoid any last minute delays to completion.

A non-exhaustive list of potential jurisdictional differences are as follows:

1. *Security* - how is security granted in that particular jurisdiction? Are there any specific perfection or filing requirements in relation to the proposed security and if so who is responsible for ensuring these are complied with?

2. *Legal opinions* – lenders typically require capacity and authority opinions in relation to the fund parties' entry into the finance documents, as well as opinions in respect of the enforceability of the finance documents and any security, but the jurisdiction of the borrower will dictate who is responsible for providing the opinions. In the U.S. it is market standard for the borrower's counsel to provide all legal opinions, whereas in the European market it is generally accepted that on fund finance transactions borrower's counsel will provide the capacity and authority opinions and lender's counsel will provide any enforceability opinions.

3. *Corporate authorisations* – are board, shareholder or investor approvals required? It is important that all parties understand the form of corporate authorisations that will be provided so as to include as granular a description as possible in the conditions precedent. Consider whether constitutional documents will also need to be amended and if so the process for doing that.

4. *Regulatory* - are there any local regulations that need to be adhered to in relation to borrowing, guaranteeing or granting of security? Are any regulatory consents required and if so what is the likely timeframe to obtain these?

5. *Tax* – is there withholding tax in any of the applicable jurisdictions? A local tax expert should be instructed to review the relevant finance documents.

Key Person Risk

When carrying out due diligence on the borrower's LPA and other fund documents, lender's counsel should be aware of when any keyman/key person provisions may be triggered. If certain key persons leave the fund/stop dedicating a certain amount of time to the business of the fund, the investment period of the fund may be suspended. If not reinstated within a certain time period, the investment period of the fund may be terminated. If the investment period of the borrower is suspended or terminated, the lender should consider whether it is still possible to issue call down notices to investors for the repayment of debt (see also "**Due Diligence**" above). The occurrence of a 'key person event' is sometimes a drawstop trigger or a trigger for mandatory prepayment under the facility agreement.

Limited Partnerships

Most funds in England and Wales are structured as limited partnerships (LPs). Limited partnerships are attractive due to their tax transparency however it should be noted that LPs registered in England and Wales do not have legal personality, and as such must act through a corporate or limited liability partnership GP (either directly or through a GP LP). Fund and finance documentation to be entered into by an LP should be executed by the corporate or limited liability partnership GP in its capacity as general partner of the LP or, if relevant, in its capacity as general partner of the GP LP which in turn acts in its capacity as general partner of the LP. Therefore it is important to check that all documentation has been duly executed in accordance with all GP and LP constitutional documentation.

The GP will be responsible for the management and operation of the LP and will also be responsible for the debts and obligations of the LP. Conversely, the investors (other than the GP, known as limited partners) shall not take part in the management or operation of the LP, otherwise they risk losing their limited liability status and becoming liable as if they were a GP.

The Limited Partnerships Act 1907 (as amended) is the governing law for LPs in England and Wales.

Manager

When carrying out due diligence on the fund documents, lender's counsel should be careful to check the roles of both the GP and any manager as it may be that the manager as well as the GP has the power to carry out certain acts on behalf of the fund, including issuing call down notices to investors. If this is the case then the call right security will need to be granted by the manager, possibly as well as the GP and the fund. The investment management agreement should also be reviewed for any provisions which could potentially cause an issue for the lender (see also "**Due Diligence**" above).

The investment manager should also be caught by certain provisions under the facility agreement. For example, it is common for the borrower to provide an undertaking that it will not remove its investment manager without the lender's (or the facility agent's) prior written consent and that any replacement investment manager be acceptable to the lender/facility agent in their sole discretion and provide similar conditions precedent (including security package) as provided by the outgoing investment manager. Any change to the investment manager, without such prior written consent, would typically trigger an event of default.

NAV Facilities

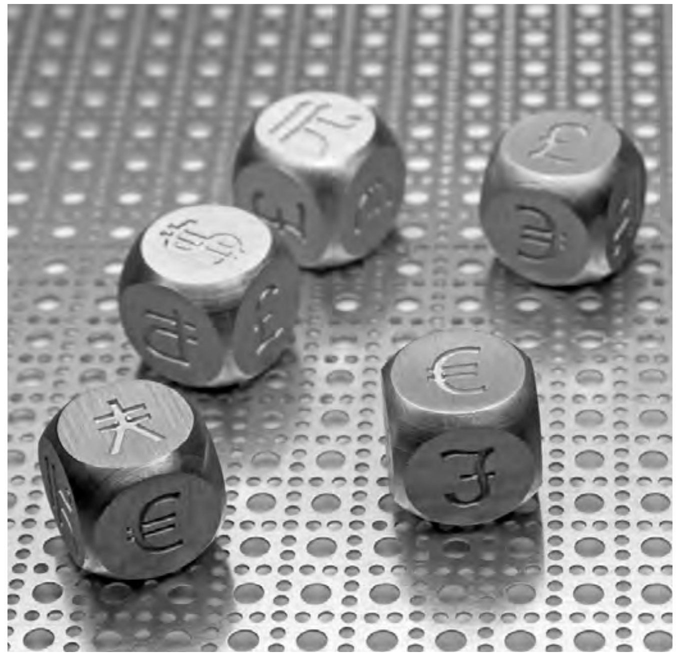
Net-asset value (NAV) or asset-backed facilities are facilities that are essentially secured against the underlying cash flow and distributions that flow up from the fund's underlying portfolio investments. The facility is usually provided to the fund itself, or an underlying SPV. NAV facilities are typically structured as term loans and have longer tenors than 'bridging' subscription line facilities. A NAV facility would typically be provided to a more mature fund when its investment period has ended and there are no or few uncalled capital commitments remaining.

It is important that LPAs are properly reviewed to ensure that such NAV facilities can be provided to the fund. Often LPAs restrict the fund's borrowings to the investor's remaining unfunded commitments which would prevent asset-backed borrowings in excess of such limit. In addition, NAV facilities may raise regulatory issues. Whilst the market view is that subscription facilities are not leverage for the purposes of AIFMD, this is not the position for NAV facilities to the extent that liabilities thereunder are not fully covered by investor commitments. Such NAV financings therefore need to be counted in the directive's leverage thresholds and are subject to the directives reporting obligations.

NAV facilities also require the lender and the borrower to pre-agree certain key factors in the facility agreement such as eligibility criteria, valuation methodology, concentration limits and advance rates for the fund's day one investments and those subsequently acquired. This may prove challenging for subsequent investments for some lenders, particularly where assets are not listed or rated, their valuation is reported by the fund manager using discretionary valuation methods, the assets are not liquid, there are a relatively small number of investments and/or where the acquired investments have not yet been fully funded. It is this increased risk profile which drives the higher overall cost of a NAV facility in contrast to cheaper subscription line financing.

Security packages for NAV facilities will vary depending on the type of fund, however it is likely that security will allow the lender to control the underlying assets or distributions paid on such assets, for example:

- *Secondary funds* – lender may take security over the LP interests that a secondary fund holds in other funds (there has however been a shift in the market from direct to indirect security over such collateral)
- *Credit funds* – lender may take security over underlying loan portfolio (again there has been a shift in the market from direct to indirect security over such collateral)
- *Private equity funds* – lender may take security over the shares in the asset holding vehicles



Open-Ended Funds

Whether a fund is open-ended or closed-ended largely depends on the nature of the investments to be made. For liquid investments, an open-ended fund is the usual choice. In contrast, closed-ended funds tend to be chosen for illiquid assets.

There are a number of distinguishing factors between open-ended funds and closed-ended funds, however perhaps the most concerning from a lender's perspective is the flexibility for investors in open-ended funds to redeem their interests. True open-ended funds require investors to fully fund all capital commitments at fund closing and permit redemption of equity at the election of the investor. Subscription line facilities would therefore not be suitable for such a fund, hence why lenders have historically not provided such facilities to those funds.

However nowadays we sometimes see more flexible open-ended fund structures, with expanded redemption and withdrawal rights for investors and which retain the concept of an unfunded capital commitment. Following careful due diligence of an open-ended fund's constitutional documentation, particularly around redemption timing and mechanics, and notwithstanding the additional open-ended fund feature of a changing pool of investors, a subscription line facility could be structured with finance documentation drafted to address lender concerns. Typically such concerns would be dealt with through additional covenants and events of defaults as well as additional investor exclusion events (tied to requests for redemption) and mandatory prepayment triggers in advance of redemption windows.

Otherwise, from a lender recourse perspective, open-ended facilities tend to be structured to look at the underlying assets and to include net asset value covenants, however such asset level financings are likely to be more expensive than cheaper subscription line facilities.

Power of Attorney

When taking security over the GP's/manager's and fund's rights to issue call down notices to investors, most security documents will also contain a power of attorney by way of security in order that the lender is able to 'step into the shoes' of the GP/manager and issue call down notices when and if the lender looks to enforce its security. The security documents will be governed by the laws of the jurisdiction in which the collateral is situated, and, depending on the jurisdiction, the issue of whether a power of attorney will survive insolvency should be considered. If a power of attorney does not survive insolvency then a secured party could be left in the position that it is unable to exercise this power of attorney if the borrower becomes insolvent and will have to look to the courts in order to enforce its security.

If the borrower is domiciled in England then typically a separate power of attorney by way of security will be taken, either in addition to any security agreement or as a stand-alone document if the transaction is unsecured.

If the transaction is secured, then any English law governed security agreement in respect of call down rights will be perfected by the receipt of notice by the investors. This perfection creates priority in favour of the security agent, and so even if the borrower subsequently breaches the usual negative pledge covenant contained in the facility agreement and/or security agreement (by granting security over the same call rights to another lender), the perfected security will take priority. A power of attorney on its own, however, does not have any priority and rather is a delegation of the GP's rights. If the GP then assigns the right to issue call down notices to another party at a later date, the perfected assignment will take priority over any existing power of attorney, and for this reason lenders prefer to take security by way of assignment and a separate power of attorney, rather than a power of attorney alone.

The GP's authority and capacity to execute a power of attorney should be checked under the fund documents. Depending on the jurisdiction of the borrower, there may also be special execution requirements for a power of attorney to be effectively executed (for example, in England and Wales, powers of attorney need to be signed as a deed). It should therefore always be ensured that any security documents containing a power of attorney and/or any separate power of attorney by way of security are executed correctly.

Quarterly Reports

It is market standard for a lender to request copies of the unaudited quarterly financial statements of the borrower (and any quarterly management reports) for each financial quarter, ideally as soon as they become available. The lender will also want to be provided with the audited financial statements of the borrower for that financial year as soon as they become available, or typically in any event within 120 days after the end of each respective financial year.

The financial statements to be provided pursuant to the information undertakings in a facility agreement may be a much negotiated point. The reports that the borrower is willing to provide will depend on the reporting obligations the borrower/GP has to its investors under the borrower's LPA as the borrower is unlikely to be willing to prepare additional reports for a lender.

The borrower may also be required to provide a 'compliance certificate' to the facility agent within a certain time period after the end of each financial quarter. This 'compliance certificate' is for the purposes of confirming that no event of default has occurred, no event has occurred which would result in an investor being excluded from the borrowing base and that the borrower is in compliance with any financial covenants contained in the facility agreement.

If there is a borrowing base mechanic incorporated in a subscription line or NAV facility agreement then it is likely that the lenders will also request a 'borrowing base certificate' to be provided following certain trigger events (such as each utilisation request, upon the occurrence of exclusion events, transfers of commitments and/or investments (as applicable), distributions and investment default events). This certificate will confirm that those investors are included in the borrowing base (see also "**Borrowing Base**" above) and that no event has occurred which would exclude such assets from the borrowing base.

REITs

Certain property funds may be structured as real estate investment trusts (REITs). A REIT is essentially an investment vehicle which allows investors to pool their money in order to invest in real estate. The trustee of the REIT will generally be responsible for the safe custody of the REIT's assets and will oversee the activities of the manager to ensure that they are in compliance with the trust deed and any applicable regulatory requirements. The manager of the REIT typically manages investments on the REIT's behalf.

Lending to REITs is wholly different from lending to the more familiar limited partnership structured fund. Rather than looking upwards at investor calls, as a lender will in a subscription line facility, lenders will need to base their risk analysis on the cash flow received by the REIT from the underlying collateral value. Facilities may be structured so that the manager is the borrower, and the REIT and any subsidiaries are obligors.

Loans to REITs may be secured or unsecured; if unsecured, as most REITs trade on major stock exchanges, the REIT will want to ensure that it can still access capital markets. If secured, a lender will want to take a charge over the underlying property of the REIT. Whether the facility is secured or unsecured, a lender will identify a pool of assets and will lend against a percentage of the value in that asset pool (i.e. the 'borrowing base'). Whether the transaction is secured or unsecured, typically a lender will require a negative pledge from the REIT to ensure that the pool of assets will remain unencumbered to third parties throughout the term of the facility.

Subscription Line Lending

A subscription line facility is a facility provided to a fund which is secured against the uncalled commitments of the fund's investors. These facilities are typically used to provide the fund with more liquidity and to 'bridge' the gap between calling down from investors and making investments. Most LPAs stipulate that investors must be given 10 business days' notice of any call down request, meaning that the fund will have to receive the monies before it can make what could be a very time sensitive investment. Under a subscription line facility, the borrower will be able to utilise the facility in a much shorter timescale. Due to the bridging nature of these types of facilities, they were typically provided on a short term tenor, however now we often see facilities with a tenor of up to 3 years, sometimes longer (see also "**Tenor**" below). Certain LPAs require that debt drawn is not outstanding after a certain period of time (say no more than 12 months), thereby requiring the borrower to clean down the particular loan by issuing a call down notice to investors and using the proceeds to pay off any indebtedness in respect of the relevant loan.

Historically, these facilities have been unsecured (especially in the European market) but the current market is more likely to see secured transactions taking place. The typical security package that a lender will look to take in a subscription line facility constitutes security assignment of the contractual right that the GP and fund (and potentially manager) have to issue call down notices to the investors, as well as an account charge over any collateral account into which contributions are paid.

The size of the commitment that a lender provides will be based upon the value of the uncalled commitments left in the fund (see also "**Borrowing Base**" above). For this reason, subscription line facilities are usually provided to a fund at the beginning of its life, before there have been many (if any) call downs from investors and when the value of uncalled capital is at its highest.

Tenor

As subscription line facilities have historically been used to provide liquidity to 'bridge' the gap between the making of investments and the calling down of capital commitments from investors, the tenor of such facilities was typically quite short (for example less than 18 months). However, as these types of facilities are increasingly being used for other purposes, such as the payment of the fund's operating costs, financing of any mark-to-market payments in respect of hedging or possibly any other purpose permitted in accordance with the borrower's LPA, then recently tenors have become longer. Hybrid and NAV facilities tend to have longer tenors, typically around 3 years or more (also see "**Hybrid**" and "**NAV Facilities**" above).

Umbrella Facilities

Umbrella facilities have become increasingly more popular with fund managers as they allow multiple funds with different investment strategies (and often their related parallel funds, feeder funds or alternative investment vehicles) to accede into pre-agreed facility structures as borrowers (and guarantors) as and when such fund groups are established. Having one facility agreement in place rather than separate facility agreements for each fund group means that fewer set-up costs are incurred by the manager, consistency is ensured across different fund groups and that fund managers are able to put fund financings in place for their managed funds quickly and efficiently.

An umbrella facility will typically be structured to enable an acceding fund group to establish a sub-facility under the facility agreement. Each sub-facility will typically have its own purpose, availability period, base currency, commitment, termination date, pricing and covenant ratios and may have certain commercial terms that apply to that sub-facility only. The facility agreement will dictate what information needs to be included in this sub-facility request (typically an agreed form is appended to the facility agreement). Clearly, the amount requested in each sub-facility request cannot exceed the aggregate available commitment under the master facility.

In addition, an umbrella facility will be drafted with a lot of flexibility to allow different types of fund vehicles to accede. There may also be a restriction on the number of sub-facilities that can be in place at any one time, for example the obligors' agent may be prohibited from delivering a sub-facility request if there are already 15 sub-facilities in place that the facility agent has agreed to. In order to utilise a sub-facility, an utilisation request, identifying the sub-facility to be used, will need to be submitted to the facility agent.

The lenders (and/or the facility agent) will almost always have sole discretion as to whether a new fund group can accede to the facility. The request will usually be made by the obligors' agent in the form of an accession letter addressed to the facility agent. By executing the accession letter, the acceding fund group agrees to be bound by the terms of the original facility agreement (as may be amended by the sub-facility request). Before acceding, the new fund group's fund documents will need to be subjected to the same due diligence as the original borrower. In addition, the fund group will have to satisfy certain conditions precedent, including the granting of additional security over investor call rights (in the case of subscription line facilities) and lender satisfaction with the creditworthiness of the acceding fund group's investors for borrowing base or financial covenant purposes. Other CPs to accession will typically include the provision of corporate authorities, legal opinions in relation to the capacity of the acceding obligors and the enforceability of the new security and accession documentation, officers' certificates, financial information and KYC documentation.

Fund groups will not want any cross collateralisation or cross guarantees between different fund groups, however will typically accept cross collateralisation and cross guarantees between the main fund, parallel fund, feeder funds and alternative investment vehicles in a particular fund group.

inVestors

Investors in different jurisdictions tend to favour fund vehicles that they are familiar with, for example investors based in the U.S. may favour the use of Delaware or Cayman structures, whereas European based investors may be more comfortable with Luxembourg, Maltese, Channel Island or Scottish domiciled funds. Asian investors have historically leant towards using Cayman investment vehicles but recently there has been an increase in the use of Australian, Singaporean and Hong Kong domiciled entities.

The jurisdiction of the investor will also be a consideration of the lender when contemplating the enforceability of capital call right security. If a lender enforces security and an investor fails to meet a call down request, what remedies does a lender have in that jurisdiction to enforce against that investor? Usually, any enforcement action will be brought in the courts of the jurisdiction as dictated by the security agreement. Any judgement made in a foreign court would then need to be enforced in the jurisdiction in which the investor is domiciled. Whilst this is not commonly an issue, as most courts in another jurisdiction will agree to enforce the rulings of a court in another respected jurisdiction, this should be a consideration of lender's counsel at the beginning of a transaction.

Investors may also be a variety of vehicles themselves, e.g. corporate vehicles, limited partnerships, individuals etc. The due diligence that a lender will be required to carry out will depend on the type of investors involved. For example, if an investor is an SPV for another entity, then a lender may require credit linkage documentation in order to link the SPV with its credit provider.

Women in Fund Finance

Women in Fund Finance (the WFF) is an initiative originally founded and supported by the Fund Finance Association and aims at increasing engagement, recognition and promotion of women leaders within the alternative investment fund finance industry by focusing on connecting women in the fund finance industry, creating a forum in which to educate women about the industry and promoting professional advocacy.

The WFF operates in both the U.S. and the U.K., with the U.K. committee being co-chaired by Haynes and Boone's head of finance in London, **Emma Russell**. To date the WFF has held networking events in New York and London and is looking to hold events in wider Europe in the near future. These events typically include both roundtable and panel discussions and focus on a variety of industry and career issues.

For more information on the WFF please visit the webpage (**https://www.womeninfundfinance.com/about**) or contact **Emma Russell** (contact details at the end of this article).

FOREX

Where a fund receives subscriptions from investors in one currency and draws down from its subscription line facility in a different currency, it makes sense to hedge the foreign exchange (FX) rates due to fluctuations in global currencies to ensure that the fund doesn't end up with a shortfall when repaying the facility.

A potential loss due to FX rates or any amounts payable by a fund under a FX forward agreement, e.g. fees due to the hedge counterparty, is essentially an 'indebtedness' of the fund. However, this indebtedness is arguably not a 'borrowing' and so any debt/borrowing restrictions in the fund's constitutional documents need to be considered carefully in light of potential FX liabilities.

If there is a percentage limit on the fund's ability to incur indebtedness; will the hedging 'use up' a proportion of this allowance? This is something the fund should also consider when drawing down on the facility.

It is often the case that FX hedging is secured; if the fund does grant security for any potential liability incurred under the FX forward agreement, does it specifically have authority under its constitutional documents to grant security in relation to that hedging (or does the authority only extend to granting security in relation to borrowing)? If security is granted against the uncalled capital commitments of investors, do the constitutional documents specifically authorise call downs from investors for the purposes of repaying hedging liabilities?

If a different team of the same bank lender takes on the role of hedge counterparty, then the hedge counterparty may look to rely on the lender-side of the bank to represent its interest in any security package. If the facility is syndicated, then the hedge counterparty should really think about who will represent its interests if the lender-side of its institution sells down its proportion of the debt at a later date. Conversely, if the fund's hedging liabilities increase significantly, then this could greatly increase the bank's overall exposure.

If the hedge counterparty is a non-lender, then any hedging liabilities will need to be subordinated behind the repayment of the credit facility. This may require a separate intercreditor agreement.

Are the hedging liabilities secured and if so is the hedging counterparty a party to the lenders' security package or are the hedging liabilities carved out of any negative pledge by being included in the definition of any 'permitted indebtedness/borrowing'?

The facility agreement may include a 'basket' for the amount of hedging liabilities which will be secured. This secured amount would rank *pari passu* with the amount due to the lenders under the facility agreement and would ultimately be deducted from the borrowing base to ensure that there are always sufficient uncalled capital commitments to satisfy the debt and the hedging exposure.

If the hedge counterparty shares the security package with the lenders then the facility agreement should be drafted to ensure that the hedging liabilities are included within the definition of 'secured liabilities/obligations' and the hedge counterparty is included within the definition of 'finance parties' on whose behalf the security agent has been appointed. It is often the case that the definition of 'finance parties' will include a carve out in respect of the hedge counterparty to ensure that it is only included when relevant, *e.g.* when being included as a 'secured party'. Similarly, any hedging agreement will be included within the definition of 'finance document' with the applicable carve out to ensure that the definition only includes any hedging agreement in the applicable circumstances, *e.g.* non-compliance with a finance document (including any hedging agreement) causing an event of default.

Year Ahead

The size of the English fund finance market alone was estimated to be circa £65billion in 2017, with the value of the global fund finance market being approximately $300billion. With the product becoming ever more popular with fund managers, particularly in growing markets outside of the U.S. and Europe, then 2018 is anticipated to be a busy year for both lenders and borrowers alike in this space.

The main areas of interest to watch out for in 2018 are the United Kingdom's ongoing Brexit negotiations and how this may affect lenders and borrowers based in the City of London (see also "**AIFMD**" above).

The publication of ILPA's revised principles in early 2018 will also be eagerly awaited by fund managers, as will the future of LIBOR and the Bank of England's reforms to the SONIA benchmark due to be published on 23 April 2018.

Zero Floors

An interest rate floor is the agreed upon minimum interest rate in relation to a floating rate loan. It is market standard for the interest rate of a loan to be calculated for each interest period on the basis of margin (i.e. the percentage agreed between principals which represents the lender's return for taking the credit risk of lending to the borrower) plus the applicable LIBOR or EURIBOR rate (or the benchmark rate for another currency).

A 'zero rate' may be implemented as a default rate where the applicable benchmark's interest rate on the relevant quotation day is below zero, thus providing a guaranteed minimum yield to lenders and protecting against currencies with a negative interest rate. This means that, on the basis that the interest rate of the loan is calculated at margin plus the benchmark interest rate, the interest rate of the loan payable by the borrower will still be the margin (plus the 0% benchmark rate).

The Loan Market Association adopted a zero floor concept for LIBOR in its standard documentation in 2012 and many fund finance lenders are now including zero floors in their facility agreements.

For further information on LIBOR see Haynes and Boone's article: **"The End of Libor"**.

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