

Fund Finance Insights: Term Tranche Components in Subscription-Secured Facilities

September 8, 2025 Emily Fuller, Danielle Baxter, Milad Amani

PRACTICES Fund Finance

Introduction

The fund finance market continues to grow at a phenomenal rate. With new players and alternative structures expanding the scope of the market, subscription secured financings (i.e., a facility secured against the uncalled capital commitments of a fund's investors and certain related rights, referred to in this article as a "sub-line") remains the most commonly used product. Demand for sub-lines is expected to continue as 61 percent of lenders and 54 percent of sponsors participating in the Haynes Boone [2024 Fund Finance Annual Report](#) anticipated an increase in borrowings under sub-lines in 2025.

Sub-lines have traditionally been structured as revolving facilities, but we are seeing an increased number of term loan tranches (herein referred to as "term tranches") being offered as part of the overall financing package driven by the innovative structuring of sub-lines in a depressed exit market and the subsequent longer hold of assets. The Haynes Boone [2024 Fund Finance Annual Report](#) shows 39 percent of lenders offered term tranches in some portion of their sub-lines and we expect this trend to continue to increase. In this article, we look at what is driving this change, the benefits to both lenders and borrowers, and several potential pitfalls.

Sub-lines: Usage and Background

Historically, sub-lines have mainly been used to manage a fund's liquidity by bridging the period between drawing down commitments from investors and making an investment. This allows a fund to act quickly when making new investments in a competitive market as a borrower will typically be able to draw on a credit facility on 2-3 business days' notice, whereas the period for calling capital from investors and receiving their capital contributions usually requires a minimum notice period of at least 10 business days.

Revolving loan facilities are ideal for this purpose, as they allow the borrower to draw amounts when they have identified an investment and then repay the loan with the proceeds of a capital call made on investors. Amounts repaid can then be reborrowed, which means that the line can be used for multiple investments.

Revolving Loan vs. Term Loan

As mentioned above, revolving loans can be borrowed, repaid and reborrowed for the duration of the availability period under the facility, which customarily ends shortly before the termination date. A term loan, on the other hand, is a "one-time" loan that cannot be reborrowed once drawn down. A term loan may require fixed payments over the term of the loan (known as amortisation) or full repayment in one bullet payment at the end of the loan. A traditional term loan will be utilised within a relatively short period after signing the facility agreement, whereas a revolving tranche provides the flexibility to be utilised over a longer period as and when needed. However, a term loan could

be structured with a 'delayed draw,' which would allow the borrower to draw predefined amounts at certain points in time (e.g., every three months).

Liquidity and Regulation; Why Include a Term Tranche?

As the final stages of Basel IV (also known as 'Basel III Endgame' in the U.S.) are implemented in response to the 2008/2009 financial crisis, banks will be required to update their models for how they calculate capital adequacy reserves. Several methods are available to banks when calculating the risk profile of assets. Whichever method would require the bank to set aside the most capital is the method the bank will be required to apply. Banks will be required to hold a higher percentage of less risky capital compared to the amount of capital deployed as a buffer to any potential downturn. This increases the pressure on banks to ensure that the capital they are deploying is being put to work and is generating returns.

An issue that banks face in the sub-line market is that such lines are not always fully utilised. As sub-lines are often put in place for bridging and working capital purposes, a sponsor may treat the line as a 'nice to have' liquidity tool without actually drawing on the line, or the sponsor may face requirements from investors to repay loans in a short timeframe. For lenders, this means that the capital they have set aside for such a sub-line will be incurring a commitment fee only (also known as an 'unused fee') with no margin payments. We often see a bifurcated commitment fee structure where the fee is higher if less than, for example, 50 percent of the total facility is drawn to encourage utilisation. During the liquidity crunch over the last few years, the risk of a line remaining underutilised or unutilised saw many banks prioritising sponsor relationships where they knew the line would be used. It is for this reason that uncommitted sub-lines also increased in popularity when liquidity was scarce, as they do not attract the same regulatory treatment. Although borrowers benefit from not having to pay a commitment fee, many sponsors require the absolute certainty that their lender will fund when requested to do so, which cannot be guaranteed on an uncommitted line.

In light of increased capital adequacy requirements and the focus on utilisation, term tranches within sub-lines offer multiple advantages. First, the availability period for drawing under the term tranche is likely to be within a very short period following closing, avoiding the possibility that the tranche remains undrawn and ensuring that a lender's commitment is 'put to work' and yielding margin payments.

Second, term tranches provide an appealing opportunity for a lender to either sell down to a wider variety of lenders, or for these additional lenders to come in at closing so that banks can free up balance sheet by not having to hold the amount committed under the term tranche. Term tranches are also attractive to institutional investor lenders who can provide the money up front without having the administrative burden of dealing with the multiple draws and repayments associated with a revolving line. Many institutional investors are interested in investment grade sub-lines as a relatively risk-free, lucrative asset class, making non-bank lenders backed by institutional capital ideal partners for those bank lenders who are looking to free up balance sheet.

Cost of Funding and Pricing – Banks and Non-Banks

The potential benefits that including a term tranche in a sub-line could bring to lenders are mentioned above, but what are the advantages to borrowers? Ultimately, if the term tranche is taken up by non-bank lenders, it could mean lower pricing for a borrower.

Typically, bank lenders will either engage in interbank borrowing or lend off deposits to fund their own lending activities. As such, bank lenders will have to pay the interest incurred in obtaining such capital. Conversely, many non-bank lenders are funded by equity investments from institutional investors and do not have the same interest payments to pass on to a borrower through their lending margin. Institutional investors and non-bank lenders can therefore charge lower margins than bank lenders in order to realise returns, often resulting in the cost of borrowing under the term tranche being lower than the cost of borrowing under the revolving tranche. If the facility allows, borrowers may use this to their advantage by utilising the term tranche to repay outstanding amounts under the revolving tranche.

Subordinated Tranches

As well as providing an opportunity for non-bank lenders to come in, term tranches can provide an opportunity for other bank lenders to take a piece of the deal. 'Subordinated tranches' (or 'tranche B facilities') can be structured as revolving or term tranches. This subordinated tranche allows a separate group of lenders to provide commitments in addition to those provided under the senior revolving tranche. Typically, the subordinated tranche will apply higher advance rates against borrowing base investors' uncalled commitments. Due to the higher risk involved with lending at higher advance rates, the pricing under the subordinated tranche will be higher than the pricing under the senior tranche. As many regional or challenger banks will have higher internal pricing hurdles to be able to participate in a deal, the subordinated tranche may provide an opportunity that would have otherwise not been viable for them. For sub-lines, the majority of subordinated tranches will be subordinated in terms of repayment, which can be documented in the payment waterfall in the facility agreement, and the subordinated tranche lenders and the senior tranche lenders will share in the same collateral package.

Market Drivers

Over the last few years, the exit market has been significantly subdued, partly caused by a deal downturn and a higher interest rate environment. This has led to sponsors holding on to assets longer than they may have originally anticipated to avoid selling at the bottom of the market. The protracted realisation of assets means that distributions that investors would receive on the sale of an asset are also delayed. Rather than requiring investors to remain in an investment for a longer period than expected, many sponsors give investors the option of whether they want to continue participating in the investment until a more beneficial time to sell, or exit and receive their returns. By selling an asset to a continuation vehicle (i.e., a fund vehicle established for the sole purpose of acquiring an asset or assets from a related fund that is nearing maturity), investors can choose whether they 'roll' their investment in that asset into the new vehicle or are satisfied from the proceeds of the sale to the new vehicle. Where a sponsor has 'repeat investors' across its fund vintages, it is also beneficial to the sponsor to distribute to investors as it provides those investors with the liquidity needed to commit to any new fund being raised by the sponsor. Even when the investor is not applying the distributions received to a new fund commitment, such distributions are likely to be recallable (and will increase the amount that the fund or a sub-line lender can call from the investor in order to satisfy its capital commitment). As continuation vehicles are formed for the sole purpose of holding either single assets or a very concentrated number of assets, rather than making new investments, their debt requirements differ from that of a new fund looking to put a sub-line in place at the beginning of its investment period. Term loans can be ideal for this longer hold period and any asset sales can be factored into the amortisation timeframe. We expect the downturn in deals and the need to hold assets for longer to continue as, at the date of writing this article, tariffs imposed by the U.S. have caused uncertainty in the markets by disrupting supply chains and triggering the revaluation of assets.

Potential Considerations with Term Tranches in Sub-Lines

There are several issues to consider when documenting a sub-line that contains both a revolving tranche and a term tranche. The first of these is the tenor of loans that can be drawn under each of these two types of tranches. In recent years, the average tenor of sub-lines is approximately 1 – 2 years. This has shortened from a typical tenor of 2 – 3 years from a few years ago as parties have been reluctant to lock in pricing and commitments for longer periods of time due to several factors, including volatility in interest rates. In some instances, there may be debt restrictions in the borrower's governing documents or lender policies that limit how long debt can be outstanding for. This may require each loan drawn down under the facility to be 'cleaned-down' and repaid within a certain amount of time of being drawn, e.g., 6 or 12 months. Frequent clean-down provisions are not typically an issue for loans drawn down under a revolving tranche as such loans tend to be used for bridging purposes and can be re-drawn once repaid. However, due to its 'one-time draw' nature, loans under term tranches may be more appropriate where the borrower is looking to put in place longer-term leverage, rather than to bridge investments, and having restrictive clean-down requirements in relation to loans under a term tranche could defeat the purpose of having such a tranche.

If there are no such restrictions on how long debt can be outstanding for, then another issue to consider is who should act as agent under the facility agreement if the term tranche is in place for a longer period than the revolving tranche. In a scenario where one of the bank lenders who has a commitment under the revolving tranche is agenting the deal and all term tranche lenders are non-bank lenders with no agency function, thought needs to be given as to whether the bank agent is prepared to stay on in the agent role in relation to the term tranche after they have ceased to be a lender. An alternative option would be to appoint a third-party agent.

Another consideration is the amount of the term tranche in relation to the amount of the revolving tranche and the investors' uncalled capital commitments. While the amount available to a borrower under the revolving tranche will fluctuate with the borrowing base, the term tranche will be utilised within a few days of closing the facility. As the fund matures and calls capital, the borrowing base will decrease, thereby limiting availability under a revolving tranche. For this reason, the term tranche often has a smaller commitment size than the revolving tranche and repayment provisions may be beneficial to help the fund maintain sufficient availability under the revolving tranche. To ensure that there is no collateral deficit, a coverage ratio may also be included which, if breached, would require the term tranche to be paid down until any deficit is rectified.

Consideration should also be given to the collateral package, especially if a bullet repayment of the term loan is due after expiry of the revolving tranche, when the value of uncalled capital commitments remaining is likely to be lower than when the facility was initially entered into. In such cases, term loan lenders may consider structuring the facility as more of a 'hybrid' and taking security over underlying assets, as well as over any remaining uncalled commitments. Alternatively, the amortisation repayments under the term tranche will correspond with the decreasing amount of uncalled capital commitments to ensure that amounts outstanding under the term tranche are not disproportionate to the reduced amount of uncalled capital commitments at the end of the facility. Typically, we see lenders under the revolving tranche and the lenders under the term tranche share in the same collateral package as 'secured parties' and rank *pari passu*, though absent an event of default, credit facilities may require any repayment to be applied to term loans first (for the reasons stated above, mainly ensuring there is liquidity under the revolving tranche).

If a term loan is being provided to a continuation vehicle, then the usual considerations when lending to such a vehicle need to be contemplated. These considerations include ensuring that a

third-party valuation was obtained when determining the price at which assets should be sold to the continuation vehicle. A 'fairness' opinion is often provided in order to avoid any fraudulent conveyance issues and ensure that the sale to the continuation vehicle was a true sale on an arms' length basis. Where the proceeds of an asset sale are being distributed up to those investors who have opted not to participate in the continuation vehicle, the constitutional documents of the seller fund should also be reviewed to check whether such distributions are recallable.

Conclusion

The recent term loan boom that we have seen in the fund finance market has been partly driven by changing regulation, as well as market conditions. Term tranches, along with other balance sheet management tools such as credit risk transfers, significant risk transfers and obtaining external, public ratings, have helped create more liquidity in the market and have encouraged non-traditional lenders to step into this space. We expect the usage of these tools to continue, which will allow the additional liquidity available to banks to be deployed in even more creative ways as the fund finance market evolves.