

# Key Takeaways from ILPA's New Guidance on NAV-Based Facilities in Private Equity

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PRACTICES Fund Finance

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## Introduction

In December, Haynes Boone partner LeAnn Chen, along with Sherri Snelson from White & Case and Adam Summers from Fried Frank, presented a Strafford Webinar on the background and market conditions that led to the Institutional Limited Partners Association NAV-Based Facilities Guidance (the “**Guidance**”) for limited partners (“**LPs**”) and general partners (“**GPs**”),<sup>1</sup> and the impact the Guidance is having on the net-asset-value (“**NAV**”) lending industry. The panelists drew on their extensive experience representing sponsors and lenders in the industry and commented on several trends they have seen over the past few months since the Guidance was issued.

## Background and Market Conditions

NAV-based financing has existed in various forms for over a decade. In recent years it has also seen significant growth in the private equity industry. Given the variety of fund strategies, there is a wide range of different NAV structures. NAV facilities for private equity strategies may differ significantly from those for secondaries funds and credit funds.

## Market Perception

Given this rapid growth and non-uniformity of NAV facilities, it is not surprising that LPs ask questions about this product, especially where a NAV facility is used for distributions to LPs and such distributions are recallable. Around 31 percent of participants in a survey at NAVember indicated that they were aware of an LP expressing concern with the use of leverage through a NAV facility. However, publicly available sources indicate only a minority of NAV facilities have been used for distributions to LPs, with the highest estimate putting it at 20 percent<sup>2</sup> and other sources citing three to five percent.<sup>3</sup>

## ILPA's Guidance

Like all other ILPA guidelines, the NAV Guidance is designed to provide general parameters for improving transparency and encouraging a more productive dialogue between GPs and LPs. Of note, the Guidance is designed to address the use of NAV facilities for private equity strategies only.

## Transparency

GPs vary in their communication with LPs regarding the implementation and purpose of NAV facilities. LPs sometimes learn about these facilities only through distribution notices or financial reports after the facility is already in place.

## Governing Documents

Older Limited Partnership Agreements (“**LPAs**”) often do not provide clear guidance on NAV facilities. Many are silent with respect to the use of NAV facilities or contain robust language regarding the use of subscription line facilities, which may be drafted broadly to also apply to NAV facilities. Some GPs and their counsel will point to the private placement memorandum or other communications with LPs to support their decision to enter into a NAV facility. Others seek limited partnership advisory committee (“**LPAC**”) consent or provide the LPs with notice.

## Recommendations

ILPA makes the following recommendations in the NAV Guidance:

1. **LPAC Consent:** Unless expressly approved in the LPA, GPs should seek LPAC consent before implementing a NAV facility. Regardless of express LPA approval, if the NAV facility will be used for distributions, LPAC approval should be obtained to avoid any conflicts of interest.
2. **Transparency:** Whether seeking LPAC consent, as detailed above, or notifying the LPs about the use of a NAV facility, the Guidance details the information that should be provided: rationale, use of proceeds, size, structure, controls, key economic terms, etc.
3. **Legal Documentation:** LPAs should incorporate language expressly defining the permissible use of a NAV facility, setting clear limits on the amounts and acceptable use cases. The Guidance includes sample LPA language for GPs and their counsel to consider.

## Impact

The Guidance helps address LP questions regarding NAV facilities and may promote more productive communications between LPs and GPs. Since July, the panelists have seen an increase in LPA provisions expressly referencing the use of NAV facilities. While they had not seen any LPA incorporate the exact model language recommended by ILPA, the Guidance is helping to increase the amount of dialogue between LPs and GPs around these facilities.

## Side Letters

Of particular note, the panelists highlighted issues created by some LPs’ attempt to restrict the use of NAV facilities through side letters. NAV lenders and their counsel usually do not have access to such side letters and rely on representations made by the fund on due authorization and non-contravention. To avoid any misunderstanding with any LPs, NAV lenders and their counsel should specifically ask GPs whether there are any side letters prohibiting or restricting the use of NAV facilities and require representations from the fund and the GP that there are no such side letters.

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<sup>1</sup> <https://ilpa.org/wp-content/uploads/2024/07/ILPA-Guidance-on-NAV-Facilities-2024.pdf>

<sup>2</sup> Fund Finance Association, as quoted in the Guidance.

<sup>3</sup> “**3%** of the \$16.4B of NAV loans funded in 2023 were used for distributions.” (Source: 17Capital as quoted in the *Financial Times*). **4%**, per Fund Finance Partners NAV Lending Index Q4 2024. **5%**, per responses to survey at Haynes Boone NAVember 2024 event.