

Reduce, Reuse, Recycle: Considerations When Funds Reduce Commitments to Launch the Next Vintage

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The private markets have seen a slowdown in fundraising these past few years as economic conditions continue to tighten and the denominator effect takes greater hold on institutional investors.¹ This fundraising slowdown is exacerbated by a difficult exit environment, which delays forecasted returns and distributions to investors. Demand for private capital commitments remains high; but funds are finding it increasingly difficult to meet fundraising targets.²

One technique used by some fund managers to aid in fundraising has been to reduce the capital commitments of investors in existing funds by releasing some portion of the unused capital commitments so those investors may participate in subsequent funds.³ For example, if a fund has more than enough uncalled capital to achieve its investment objectives, or if a fund's investment period has terminated and it will not utilize the excess capital, it may be able to reduce capital commitments in order to provide the investors more liquidity to invest in newer vintages.

If managers adopt this strategy and there is a subscription credit facility in place there are several considerations for both the lender and the borrower. First and foremost, any manager planning to release capital commitments needs to determine its ability to do so under their facility's credit agreement as (i) most facilities include covenants prohibiting reduction of capital commitments without some level of consent, and (ii) any release of capital, notwithstanding the impact on the borrowing base, is a release of collateral and could have credit implications even if a manager may not consider or think to be relevant.

Generally, subscription line credit agreements require the following prior to any release of capital commitments and a reduction of the related unused capital commitments:

- The payment of any mandatory prepayment that would result from such event after giving pro forma effect to the same; and
- Lender approval of such release (which approval may be limited to borrowing base investors, types of investors, or only for events impacting a threshold percentage of the aggregate capital commitments).

Both of these features are negotiated, and the tailoring of these provisions depends on a multitude of factors, including the composition of the borrowing base, the advance rate with respect to each borrowing base investor's capital commitment, the facility size, and the amount of unused capital remaining.

In general, the release of capital commitments and the corresponding reduction of unused capital commitments has a similar impact to the borrowing base and collateral pool as calling down and using that amount of capital for working purposes. However, there are subtle differences, and when approached with such a request to release capital commitments, lenders should consider the following:

- How will the release of capital be effectuated? Would it require an amendment to the LPA that separately needs to be approved?
- Would the fund accomplish the release via a pro rata reduction across all investors? If not, could existing concentration limits have unintended consequences to overall borrowing capacity or create a borrowing base deficiency resulting in a mandatory prepayment?
- In addition to an updated borrowing base certificate, what other documents will be required?
- Could the release of capital commitments affect any existing hurdle conditions?
- What is the overall strength of the fund after the release of these commitments? When a fund calls and uses capital, it may be for the benefit of the financial position of the fund (which lenders look to as a secondary source of repayment), whereas releasing capital has no positive effect on the fund's financial strength.

In any event, lenders should be informed of a fund manager's intention to release capital commitments as early as possible to ensure that the parties comply with the requirements under the credit facility and address any concerns that arise from the intended release prior to its enactment.

¹ [The Fundraising Slowdown and Subscription Credit Facilities](#), Haynes Boone (Jan. 31, 2023).

² [Stuck in Place: Private Equity Midyear Report 2023](#), *Bain* (Jul. 17, 2023) - "[E]very \$3 of current demand in the market is chasing just \$1 of supply. This imbalance is the worst it's been since the global financial crisis, and it may not improve in 2024 since many LPs may be pulling forward next year's allocations to fund things they find attractive today."

³ [Large Backers of Private Equity Are Asking For Their Money Back](#), *Bloomberg* (Jan. 11, 2024) - "Sovereign wealth funds and state pension providers are among investors telling money managers they'll only commit in their upcoming fund raises if their capital tied up in old funds is released..."