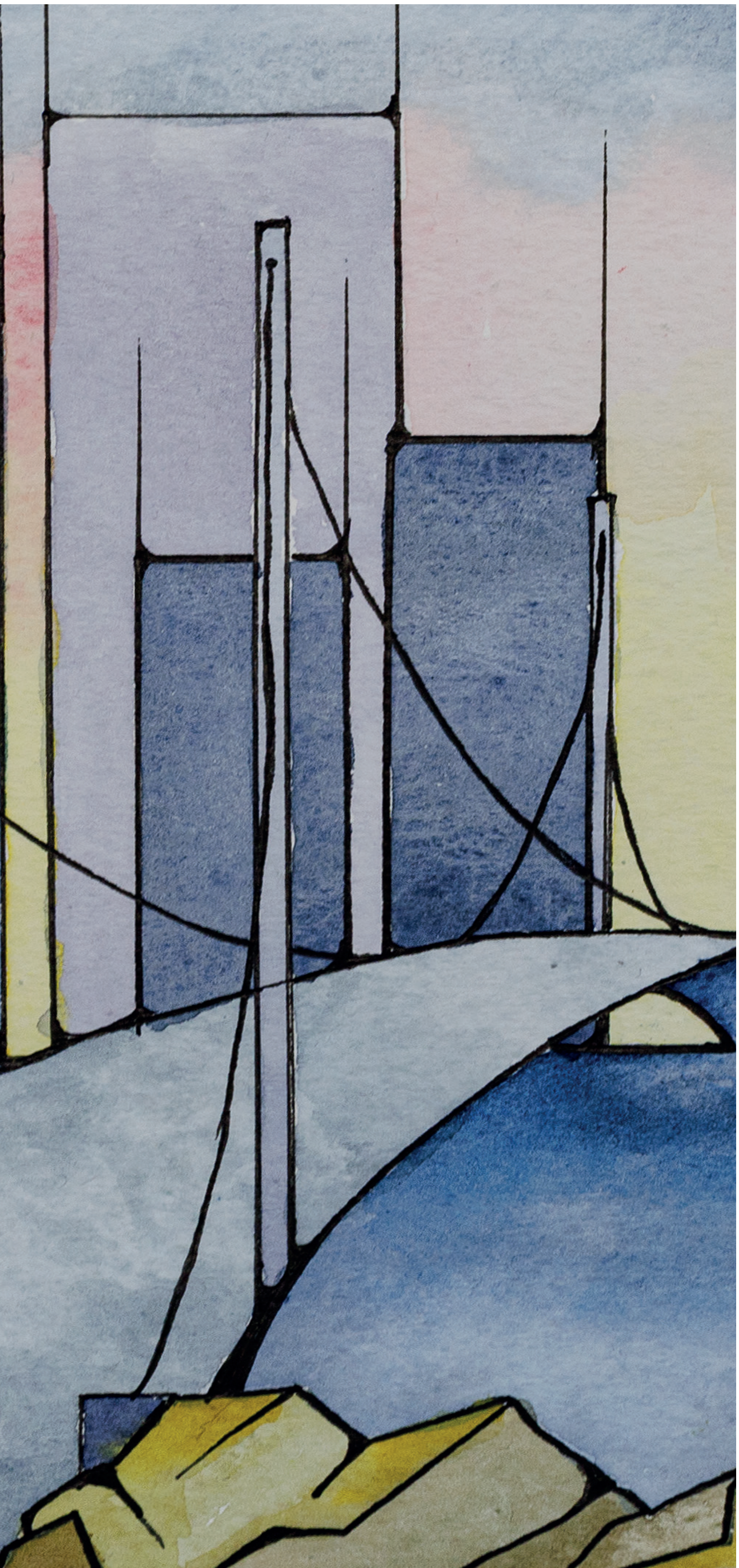
Fund finance advisors assess the market



FOR this final article in Brickfield's Fund Finance Advisory Focus series, we asked leading advisors for their thoughts on what has undoubtedly been a tough market in 2023. They were universally positive about the immediate and medium term despite continuing financial headwinds. Continued innovation is significantly helping many funds continue to access capital, while advisors are now focusing on delivering maximum value by unlocking new sources of liquidity for under-pressure fund managers and streamlining services to offset rising costs.

As market conditions continue to prove challenging, sponsors and lenders are increasingly exploring alternative financing options, such as relationship-based lending, more flexible facilities, and NAV facilities to navigate the uncertain market environment.

In short, securing capital call facilities is not the game it was a year ago, says **Sarah Lobbardi**, Founder of **Avardi Partners**. "We have experienced a challenging fundraising environment in recent months, which seems to be a continuing trend," she says, adding that traditional bank lenders are facing capital constraints and selective appetite, with the market withdrawals of Citi and Credit Suisse exacerbating the situation.

Relationship-based lending

This has resulted in a growing trend of relationship-based lending and increased pricing for capital call facilities, Lobbardi explains. "There is now a greater demand for non-bank lenders, and traditional bank lenders are reassessing their balance sheet management to boost velocity. As a result, sponsors are exploring new ways to finance their funds, including more flexible capital call facilities, hybrids, and NAV facilities."

It is much more difficult now to secure capital call facilities than it was three years ago, says **James Rock-Perring** at **CSC**. "Banks are more precious about using their capital and cost of funds and margins are up. They are more focused on existing relationships and in the US, for example, there are only a handful of perhaps seven to 10 lenders who may be open to new relationships. Europe is also difficult and first-time funds may not achieve sourcing a line whilst mid-market funds will find it more difficult. Large managers will still secure facilities but will need more banks as ticket sizes have reduced."

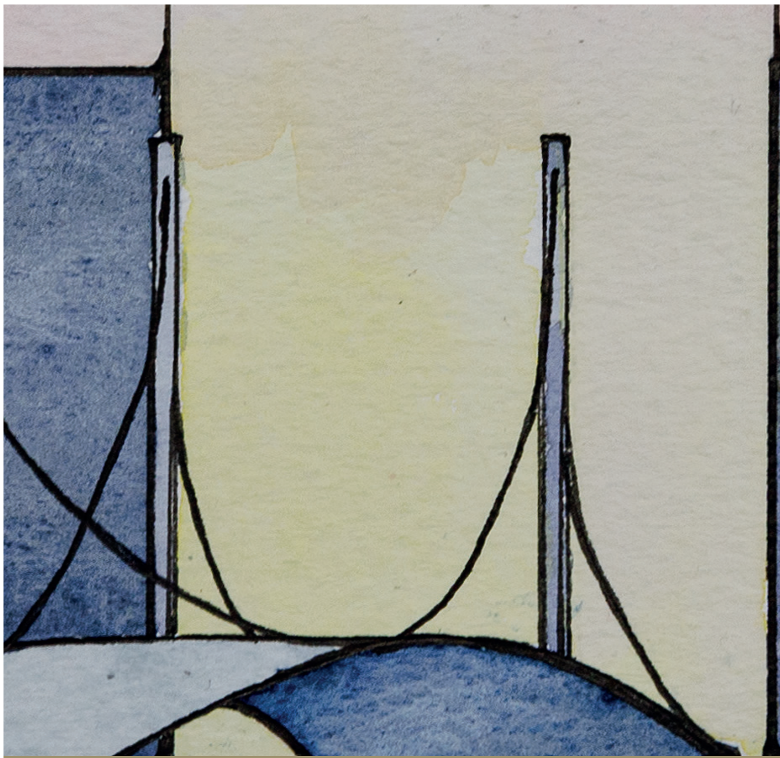
In the NAV space, Rock-Perring adds: "There is a strong supply of capital (most definitely from non-bank lenders) and demand is strong."

While some believe that liquidity will improve with the entrance of non-bank lenders and reduced demand due to slower fundraising, the industry is nevertheless braced for an overall volatile market ahead. **Jamie Mehmood** of **Deloitte** highlights the challenging market conditions, with a more selective supply of liquidity for sub lines, especially in the US. "Slower fundraising and slower exits are undoubtedly also major challenges for managers in the current market, which lenders are increasingly trying to solve," he says.

The NAV market

NAV facilities have become increasingly popular across all asset classes, particularly in the private equity space. **Gianluca Lorenzon**, from **Validus Risk Management**, states: "We are at an inflection point. Less liquidity in the market is the main issue affecting clients, but pricing is also causing trouble." The widening credit spreads and higher base rates have significantly increased the all-in cost compared to just a year ago, Lorenzon adds.

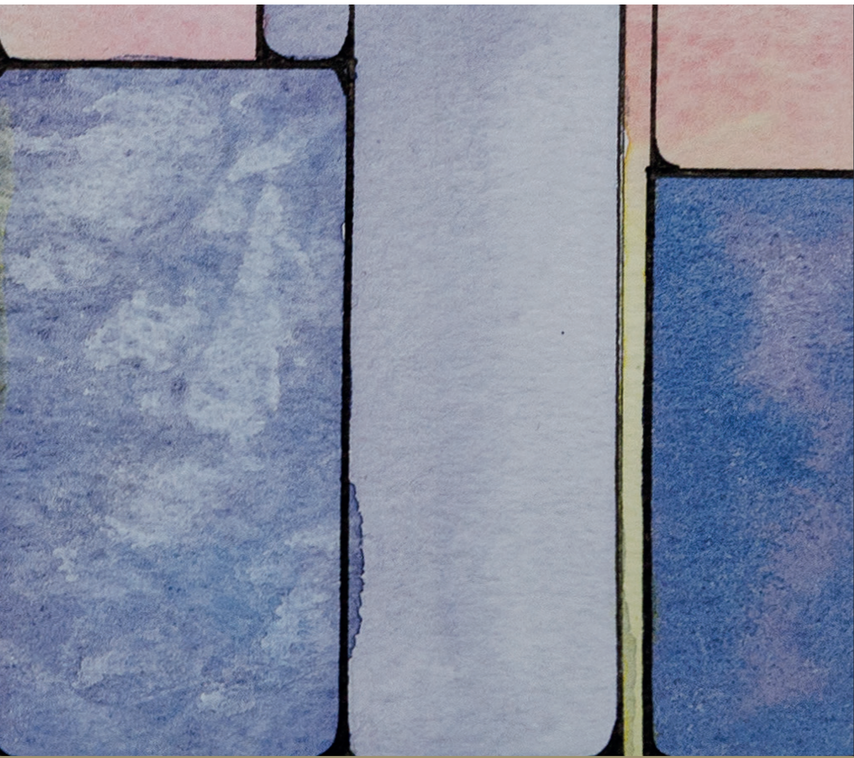
According to **Khizer Ahmed** of **Hedgewood Capital Partners**, market conditions have been challenging, primarily due to the limited supply of balance sheet from



traditional lenders who are focusing on conserving their balance sheets and meeting the requirements of existing clients. "Deals are taking longer to close, and pricing has shifted in favour of lenders," he says.

Institutional capital has been considered as an alternative source of liquidity for borrowers, but even they face constraints. **Michael Hubbard** at **Cadwalader, Wickersham & Taft** explains that the subscription finance market remains challenging with a dearth of liquidity, while the NAV market is fairly liquid but faces underwriting risk in portfolio-level assets and an uncertain economic backdrop.

Despite these challenges, there is still optimism in the market, and the fund finance community's sense of collegiality that we know so well is shining through, as fund managers, lawyers and advisors all work together with lenders to get the deals across the line. **Zac Barnett** from **Fund Finance Partners** describes the current fund finance market as "the most lender-friendly in 20 years," highlighting



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continued interest rate hikes, scarcity of bank balance sheet, and protracted financing timelines as its key characteristics.

Rise in hybrid facilities

Higher interest rates and slower fund raising is curtailing demand in the capital call space, so if interest rates abate and fund-raising picks up, the liquidity gap will widen, says James Rock-Perring at CSC. "Fitch, for example, has started to rate capital call lines and this may help alleviate the pressure on banks who need to hold more capital against these loans in the US. We will definitely see the increase in the amount of hybrid facilities (recourse to uncalled capital and NAV/assets) as lenders become more creative in trying to provide liquidity throughout the life of a fund."

As we saw with the COVID pandemic (the aftermath of which is still influencing market conditions to a degree) fund finance is proving the strength of its foundations, and it clearly has not gone unnoticed.

While traditional lenders might be pressing the pause button for the moment, plenty of alternative lenders have entered the market in the last 18 months, and others are closely looking at the possibility.

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