

FUNDFINANCE^{COM}

The ABCs

OF NET ASSET VALUE FACILITIES

MAYER | BROWN

AGENDA

1. Overview
2. Collateral Packages
3. Borrowing Base
4. Appraisal Rights
5. Financial Covenants and Cash Sweeps
6. Enforcement



01

OVERVIEW

WHO

*Can be any kind of fund
(often seen with Credit, Infrastructure, PE
Secondaries and Hedge Fund of Funds)*

WHAT

*Leveraging the value of
the Fund's investment portfolio*

WHEN

*After a Fund has
accumulated investments
(usually mid to late in the Investment
Period or after the Investment Period)*

WHERE

*The Obligors are at the Fund level or
are Holding Vehicles below the Fund
(if the Fund holds investments indirectly)*

WHY

Liquidity for a Fund, either in addition to a subscription facility or instead of a subscription facility (e.g., when less capital is left to support an SCF)

Funding acquisitions, or making follow-on investments

Paying ongoing expenses or obligations with respect to existing investments prior to harvesting them

HOW

*Can be either a term loan or
a revolving loan*

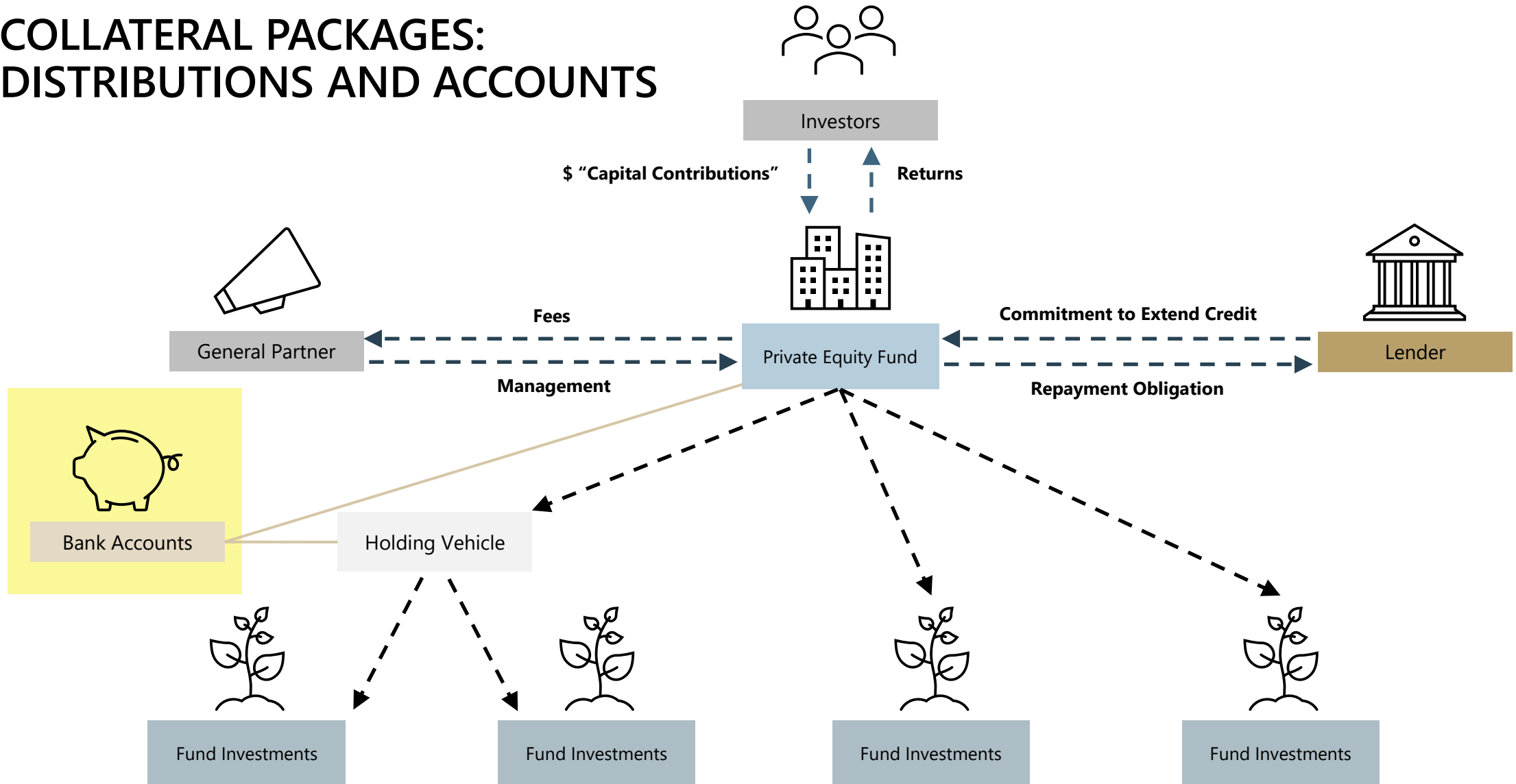
*The terms, covenants and collateral
packages vary widely based upon the
Fund's needs, asset class of investments
and other constraints*



02

COLLATERAL PACKAGES

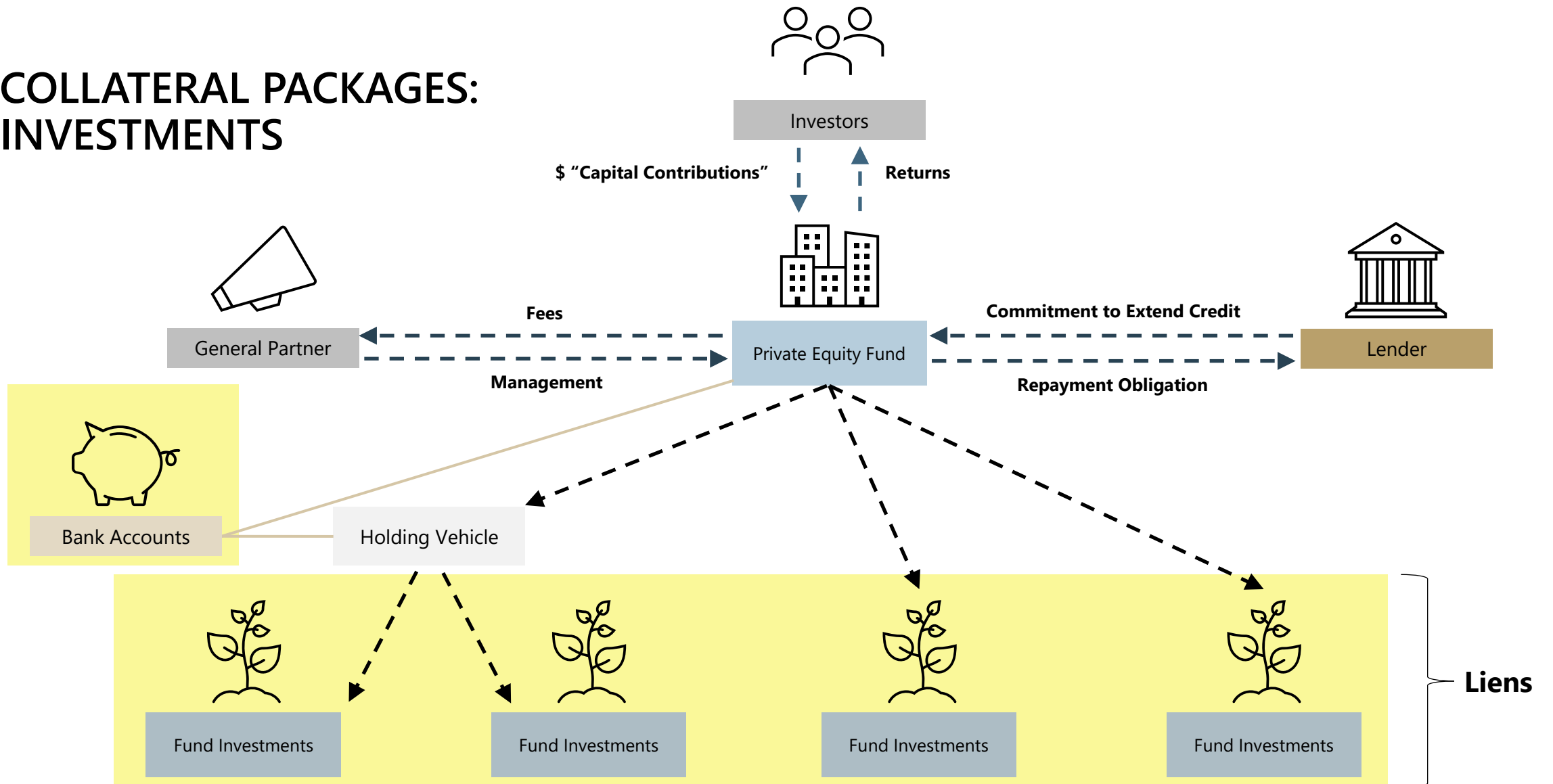
COLLATERAL PACKAGES: DISTRIBUTIONS AND ACCOUNTS



COLLATERAL PACKAGES: PLEDGE OF DISTRIBUTIONS AND ACCOUNTS

- Typical collateral for NAV deals of all types:
 - Rights to proceeds of sales or income from loan parties' Investments
 - Accounts of the loan parties into which such Investment proceeds are required to be deposited
- Limitations on withdrawals from such collateral accounts are negotiated. May either be:
 - Blocked (subject, potentially, to release of a portion upon satisfaction of certain conditions)
 - Freely available to Borrower, so long as there is no Default, a Mandatory Prepayment is not due and there is no LTV ratio breach

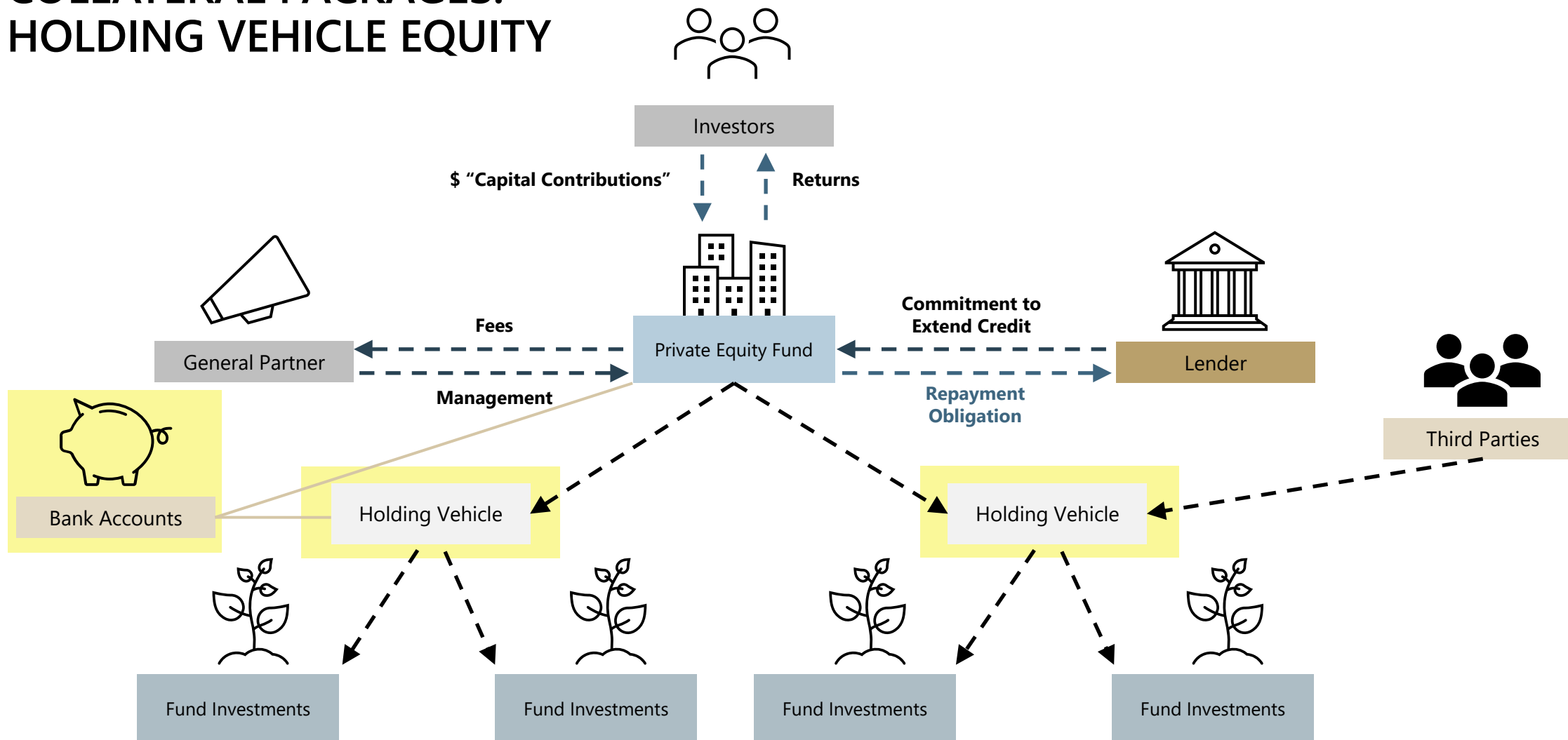
COLLATERAL PACKAGES: INVESTMENTS



COLLATERAL PACKAGES: PLEDGE OF INVESTMENTS

- Ideally, collateral package includes a direct pledge of Investments.
- More difficult to obtain because:
 - Investments may already be pledged in favor of Investment level or Holding Vehicle level debt
 - Investment level or Holding Vehicle level debt may otherwise prevent the pledge.
 - Consents may be required under the terms of the Investment.
 - Even if consent is obtained to the pledge, there may be further restrictions on a foreclosure or sale.
- Most often obtained with Credit Funds as loans can often be pledged (Warehouse lines).
- Not an “all or nothing” proposition: some deals will take pledges of only those investments that are not subject to above restrictions.

COLLATERAL PACKAGES: HOLDING VEHICLE EQUITY



COLLATERAL PACKAGES: PLEDGE OF HOLDING VEHICLE EQUITY

- Investments may be held by a Holding Vehicle beneath the Borrower.
- A pledge of the Borrower's equity in a Holding Vehicle may be obtained unless:
 - Equity is already pledged to support Holding Vehicle debt
 - Holding Vehicle level debt may not permit the pledge
 - If Holding Vehicle is not wholly owned, may require consents from other equity holders
 - If, under the terms of an Investment held through the Holding Vehicle, consent is required from the issuer of the Investment for an "indirect pledge"

COLLATERAL PACKAGES: THE REALITY

- While ideal to get the most robust collateral package, in reality, NAV financings are *bespoke* products and constraints around a Fund's already established portfolio, fund structure, and other debt may prevent such an ideal package.
- Borrower may not know what restrictions they have already agreed to with respect to their investments or other debt and may not want to take the time and effort to diligence.
- Even if feasible to obtain a "better" collateral package, the expense and time necessary to obtain it (e.g., moving investments or negotiating consents) may be commercially impracticable, particularly for deals where the NAV facility's size is small relative to the investment portfolio NAV.



03

BORROWING BASE

BORROWING BASE: ADVANCE RATES

Borrowing Base = Advance Rate X Net Asset Value of Eligible Investments

Advance Rates: Advance Rates are negotiated and vary based on asset class of Investments and other factors. Often see advance rates in the range of 10-55%.

- Generally, more liquidity → higher advance rate (cash, assets with robust secondary market)
- Other considerations:
 - Higher advance rates may impact pricing
 - May be changes in advance rates over life of facility
 - May be concentration limits

BORROWING BASE: ELIGIBILITY

Borrowing Base = Advance Rate X Net Asset Value of Eligible Investments

Eligible Investments

- Usually only a *subset* of a Fund's Investments are "Eligible" for inclusion into the Borrowing Base.
- Eligibility Criteria may include:
 - Consent to inclusion by the Agent or Lenders;
 - Specific types of assets or geography;
 - No lien on the asset (subject to exceptions in certain asset classes like Infra);
 - Must be owned directly or indirectly by the Borrower;
 - No "Material Investment Events" have occurred; and
 - Others negotiated based on investment portfolio's make-up.

BORROWING BASE: MATERIAL INVESTMENT EVENTS

Material Investment Events will *exclude* Eligible Investments from the Borrowing Base (potentially reducing borrowing availability or triggering a mandatory prepayment).

Common Material Investment Events include:

- Bankruptcy
- Failure to provide financial statements, or issuer is not a going concern
- Failure of the Borrower to fund payments to the Investment
- Borrower repudiates the Investment or breaches its material terms
- Liens on the Investment (*or* if Liens are permitted, foreclosure of such Liens)
- Material decrease in value above a threshold amount (25-30%)
- Transfer or sale of Investment
- Debt at the level of the Investment is in default or distributions halted
- If owned through a Holding Vehicle, any relevant event above occurs with respect to the Holding Vehicle

DEFINING NET ASSET VALUE

$$\text{Borrowing Base} = \text{Advance Rate} \times \text{Net Asset Value of Eligible Investments}$$

Goal: Quantify the obligor's equity value in an Investment on a look-through basis.

- "Reported" Fair Market Value of Eligible Investments *minus* aggregate Indebtedness/liabilities (*at Borrower, Holding Vehicles (if any) and Investment*).
- Source is negotiated (obligor's valuation policies, lower of obligor's book value and acquisition cost, or issuer-reported value, with any adjustments based on third party valuations).
- Reporting: Typically, quarterly, subject to mid-quarter adjustments (for sales, acquisitions, distributions, capital contributions, Material Investment Events).



04

APPRAISAL RIGHTS

APPRAISAL RIGHTS AND VALUATION CHALLENGES

Lenders may negotiate appraisal rights to validate the NAV reported by the Borrower.

- More likely to be seen in deals where there are illiquid assets and investments don't have third party marks or valuations

Key Negotiated Points:

- Who: Who is the Appraiser? Who is paying for the valuation?
- What: Entire portfolio or certain assets?
- When: Annually, after a Default, good faith belief by Lenders there is a discrepancy, market conditions?
- If a valuation differs:
 - Materiality thresholds?
 - How long does valuation stand? Permanent haircuts?
 - If the valuation is a range, which end of the range will apply?



05

FINANCIAL COVENANTS AND CASH SWEEPS

LOAN TO VALUE RATIOS

$LTV = \text{Outstanding Principal} \div \text{Borrowing Base}$, expressed as a percentage

- LTV's are often set to be "early warning triggers" to bring a Borrower to the table or to require repayment more quickly.
- There may be multiple LTV ratios. May be used as:
 - Closing condition (*Initial LTV*)
 - Borrowing condition (*Initial/Drawstop LTV*)
 - Financial covenant (*Maximum/Default LTV*)
 - Mandatory prepayment trigger (*Maximum LTV*)
- LTV can also be structured to step-down over time.

CASH SWEEPS

Cash Sweep LTVs:

- Determine when a Borrower may use Investment proceeds for its own purposes (or to make distributions to its investors) vs. when they must be used to repay the NAV facility.
- Require a certain percentage of investment proceeds be used to paydown the NAV facility if LTV is not maintained (Ex: If the LTV is higher than 40%, a 50% cash sweep is required).
- 100% cash sweeps are generally required if there is a mandatory prepayment due or a Default.

There may also be a recycling period construct (i.e., post-recycling period, 100% cash sweep).

OTHER FINANCIAL COVENANTS

Other Common Financial Covenants may include:

- Minimum Asset Tests and/or Minimum Number of Eligible Investments
- Liquidity Tests
- Maximum LTV ratio for certain core assets
- Maintenance of Unfunded Capital Commitments

There will also be a covenant limiting the Borrower's ability to incur other indebtedness.

ASSET SALES

- Borrowers are generally permitted to undertake asset sales so that the Fund can continue its normal course activities, including harvesting investments when optimal for the Fund and its investors.
- Asset sales will be subject to restrictions to protect Lenders, which may include:
 - Arm's length and/or fair value requirements.
 - Cash proceeds requirement and/or restrictions on payments in kind or deferred purchase price sale arrangements.
 - Diversification requirements to be maintained after giving effect to the sale.
 - LTV thresholds may not be breached after giving effect to the sale, unless net cash proceeds are applied to cure the breach.
 - Prohibition during an LTV breach or Default without Lender or Agent consent.



06

ENFORCEMENT

DEFAULTS & SOURCES OF REPAYMENT

- Investment proceeds are the primary source of repayment.
 - Capital commitments of investors may be a secondary source of repayment. Caveat: may not be much left or may already be subject to a Subscription Facility.

Typical Defaults include:

- Payment
- Bankruptcy
- Unpermitted distributions or asset sales
- Failure to maintain ownership structure/holding vehicles
- Failure to give material notices (including of Material Investment Events)
- Maximum LTV breach
- Significant failure to pay capital contributions required with respect to multiple Investments

DEFAULTS & REMEDIES

Typical Remedies include:

- Draw stop
- Acceleration
- Calling on a guaranty or capital call (if available as in a PE Secondaries deal)
- Blocking the collateral account and application of funds
- Requesting or requiring additional collateral (*Double Negative Pledge*)
- Remedies against other collateral, which may include:
 - If there is a pledge on Investments, foreclosure on Investments
 - If there is a pledge of equity in a Holding Vehicle, use of a power of attorney to direct actions relating to investments or foreclosure on pledged equity
 - Contractual remedies against Borrower, requiring them to cooperate or sell Investments

The logo consists of the words "MAYER" and "BROWN" in a white, uppercase, sans-serif font, separated by a vertical bar. The text is centered horizontally and vertically against a background of a complex, geometric pattern of overlapping, tilted rectangular shapes in shades of blue and brown.

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