Hybrid Credit Facilities

For well over a decade, the most innovative asset management firms have utilized "Subscription Facilities" (subscription-backed credit facilities—also known as "capital call" or "capital commitment" facilities)—as an important source of liquidity for their funds and SMAs ("Funds"). At Fund Finance Partners, we have witnessed Subscription Facilities used in order to quickly access cash without calling investor capital, or as a bridge to capital calls or other permanent asset-level financing. In Subscription Facilities, lenders look to a Fund's uncalled capital commitments and rights to call capital as security for the loans and for purposes of calculating borrowing base availability. However, as Funds mature throughout their investment or commitment periods, especially after which most or all of the investor capital commitments have been funded, many Funds turn to net asset value ("NAV") credit facilities in which availability is based on the value of the Fund's portfolio investments (each a "NAV Facility"). Asset management firms turn to NAV Facilities on account of the diminished borrowing availability under a Subscription Facility, or because of the longer-term available for borrowing under the NAV facility. While both Subscription Facilities and NAV Facilities continue to grow in number and use, the principals of Fund Finance Partners have advised asset management firms regarding other financing options, including "Hybrid Facilities", which provide lenders with recourse to both the uncalled capital commitments (the typical collateral under Subscription Facilities) and the Fund's portfolio. Hybrid Facilities offer both Funds and lenders added flexibility in tailoring a financing package that works for all parties.

Subscription Credit Facilities: The original use of Subscription Facilities was helping Funds harmonize the timing and magnitude of capital calls. A Fund's governing documents typically require that its investors be provided at least 10-15 business days' notice prior to funding a capital contribution. Subscription Facilities, however, permit Funds to receive borrowings on short notice (often within one business day), permitting them to move quickly on time-sensitive investments and avoid the lead time required in calling capital from investors. Subscription Facilities also help Funds avoid the need to make frequent capital calls in small amounts for working capital and similar expenses, potentially including management fee payments.

Borrowing Base and Collateral: Loan availability under a Subscription Facility is subject to a borrowing base, which is customarily based on the value of the uncalled capital commitments of investors satisfying certain eligibility requirements, with advance rates based on the credit quality of the relevant investors. Lenders often impose concentration limits that specify the aggregate amount of capital commitments from a single investor or category of investors that may be included in the borrowing base. Subscription Facilities may also outline certain events that exclude investors from the borrowing base calculation. Lender diligence with respect to Subscription Facilities, therefore, is focused on the individual investors' ability to fund their respective capital commitments.

The Subscription Facility's collateral package consists of the unfunded commitments of the limited partners in the Fund to make capital contributions, and nothing else – especially not of the Fund's portfolio. Subscription Facilities typically involve a pledge by the Fund and its general partner of the following as collateral: (1) rights in and to unfunded capital commitments of the investors in the Fund; (2) rights to make capital calls and enforce the obligations of the investors to contribute capital; and (3) the deposit accounts into which the investors are required to fund their capital contributions. In a default scenario, in which a lender seeks to exercise remedies, the lender may force limited partners to make capital contributions, using the proceeds to repay the indebtedness under the Subscription Facility.

NAV Credit Facilities: As Funds mature beyond their investment or commitment periods, they have greatly diminished borrowing availability under traditional Subscription Facilities because investors have funded a majority of their capital commitments. Furthermore, lenders typically offer a longer-term when lending against performing portfolio collateral as opposed to uncalled capital commitments. NAV Facilities fill the gap by looking down to the net asset value of the Fund's portfolio instead of looking up to the investor capital commitments in determining borrowing availability. These facilities are particularly desirable to Funds that may have ongoing liquidity requirements, or which seek to generate a portfolio of assets in excess of the equity committed by limited partners.

Borrowing Base and Collateral: NAV Facilities require a significantly different credit underwrite than Subscription Facilities. Lenders have historically been cautious, but Fund Finance Partners has observed an evolution of creativity, terms and flexibility by some lenders. Indeed, Fund Finance Partners' principals have contributed some of that innovation and evolution. Loan availability under a NAV Facility is traditionally limited to the "Eligible NAV" of the "Eligible Investments," multiplied by an advance rate. Don't be surprised if relative liquidity (or illiquidity) of your Fund's collateral affects the advance rate. As with Subscription Facilities, concentration and other restrictions will apply. For example, there may be limits on how much value is attributable to any one portfolio investment or type of investment (whether a security or a single industry, for example). The lender's due diligence will often focus on the historical performance of each predecessor Fund's portfolio and any issues that may be related to the pledge and foreclosure on the collateral. Eligible NAV calculation is typically tailored so that it (a) excludes the fair market value attributable to investments subject to exclusion events, write-downs or concentration limits, (b) provides adjustments and recalculations based on financial reporting delivered to the Lender and is adjusted with any adverse credit or exclusion event in the portfolio.

Fund Finance Partners believes that the inflection point of any NAV Facility is the Lender's comfort with respect to the NAV calculations of the underlying portfolio investments. Your Fund's organizational or private placement documents probably contain valuation procedures, and those procedures should be acceptable to the lender. Lenders may request the right to have a third-party valuation provider evaluate certain investments if the valuations provided by the Fund seem inaccurate and/or require interim reporting covenants related to adverse credit events. Fund Finance Partners adamantly believes that your limited partners have already underwritten your investment management and valuation policies. Recognizing that your limited partners are subordinate to your lender, lenders should be comfortable with those established investment management and valuation policies.

The covenant package that a Fund grants a lender in a NAV Facility is different than a normal ABL or a Subscription Facility. A common covenant is that the Fund maintain a certain minimum NAV. Lenders often ask for mandatory prepayment provisions tied to investment performance, including following payments or other proceeds distributed from the underlying investments to the Fund. Other covenants that lenders request include prohibitions on transfers of investments during default or if an over-advance results, negative pledges, separate financial covenants beyond Eligible NAV and providing copies of all investment-related documents and compliance certificates. Fund Finance Partners has decades of experience in matching the appropriate covenant package to the applicable collateral and asset management firm. We believe that lender protection need not necessarily be obtained by onerous and overly broad covenant packages.

The Fund grants a security interest to the NAV Facility lender much in the same way as the Subscription Facility lender. The Fund pledges its rights in collection accounts into which such proceeds are deposited and covenants that all cash from its portfolio investments will be directed into these accounts. Typically, the Fund is prohibited from making withdrawals unless the borrowing base is satisfied on a pro forma basis.

Hybrid Facilities: Hybrid facilities present Funds with maximum flexibility in terms of satisfying liquidity needs, baking-in comparatively longer terms and maximizing both availability and eligibility, regardless of the stage of the Fund's life cycle. Hybrid facilities, like NAV Facilities, are useful to Funds that are nearing maturity of (or have matured beyond) their investment or commitment periods and have significant investment portfolio equity value. Unlike NAV Facilities, however, they are also useful to Funds that are earlier in their investment period. For example, some facilities take an aftercare approach, extending the life of an existing Subscription Facility by (a) modifying the borrowing base so that the advance rate for investment grade investors is increased to 100 percent, eliminating concentration limits or advancing 100 percent against all investors (not just certain investors) and (b) adding a covenant that the Fund must maintain a minimum NAV or comply with a debt coverage ratio. As a result, Fund Finance Partners has noticed Funds turning to longer-term hybrid facilities in their early stages—beginning with the first closing of investors into a Fund and extending until all investor capital commitments have been fully drawn down and the Funds are fully invested.

Borrowing Base and Collateral: Obviously, Hybrid Facility lenders will need to underwrite both the investors' creditworthiness and a pool of potentially unknown portfolio assets (as the loans under the facility may be used to purchase these assets). This means that asset managers should expect more due diligence, but Fund Finance Partners has the expertise and repetitions necessary to utilize prior fund performance and sample collateral memoranda to support a lender's underwrite of the modeled portfolio.

Collateral under hybrid facilities is determined on a case-by-case basis, but Fund Finance Partners is supremely capable to advise asset managers as they arrive at a mutual understanding in establishing a collateral package containing all or some form of the following, adjusting Hybrid Facility pricing if necessary:

1. A pledge by the Fund and/or its general partner of its rights in and to the unfunded capital commitments of the Fund's investors, as well as rights to make capital calls and enforce the obligations of the investors to contribute capital;

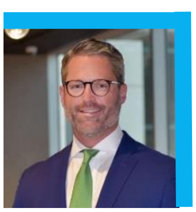
2. A pledge by the Fund of deposit accounts into which (a) the Fund's investors are required to fund their contributions and/or (b) the distributions and liquidation proceeds from the Fund's portfolio investments are deposited;

3. A pledge of equity interests in the holding companies through which the Fund holds its underlying investments (particularly in circumstances where underlying portfolio investment documentation prohibits a lien being placed on the asset); and

4. A pledge of the equity interests relating to the investments themselves to the extent not otherwise prohibited as noted above.

Hybrid facilities present a clear advantage to asset managers by facilitating continuous funding under a single credit facility (and without the costs and inconvenience of multiple refinancings) by drawing upon the collateral packages that have historically and successfully supported both Subscription Facilities and NAV Facilities.

As both Subscription Facilities and NAV Facilities continue to mature, Funds demand even more flexible financing solutions. Fund Finance Partners uniquely has the expertise necessary to optimize your Fund's traditional subscription-backed collateral pool while also explaining the value of your Fund's investment management acumen, and structuring practical financing around both. The "one-stop shopping" value that Fund Finance Partners offers benefits both asset managers and their investors by providing seamless liquidity without duplicating costs (both in terms of dollars and allocation of human resources) associated with refinancing or restructuring credit facilities instead of focusing energy on new opportunities.



Richard Wheelahan, III

Co-founder of Fund Finance Partners

Since 2007, Richard has been advising fund sponsors and lenders, in both an advisory and principal capacity. In addition to co-founding FFP, Richard is the general counsel, chief compliance officer and a director of Capitala Group, a $3 billion manager of debt and equity funds targeting lower middle market companies. Since joining Capitala Group in 2010, Richard has executed numerous capital markets initiatives on behalf of its investment vehicles and has overseen fund formation activity for nearly 10 years, developing comingled funds, SMA concepts, a Nasdaq listed BDC and joint ventures.