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FUND FINANCE FRIDAY

Gravity Does Not Apply?

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We received the same question multiple times last week: How was the fund finance market up so materially in 2018 while fund formation data from Preqin was down? While fund formation is, of course, the lifeblood of fund finance and both the number of funds closed in 2018 (1,733, down 28% from 2017) and aggregate capital raised ($757 billion, down from $925 billion in 2017) were down last year, there are a host of contributing factors explaining the discrepancy:

- **Time Lag**. There is frequently a gap between the closing of a fund and the consummation of a subscription facility. A good number of 2017 vintage funds entered their credit facility in 2018. Calendar-year comparisons do not perfectly account for this time lag.
- **Market Penetration**. While likely contributing less than in years past, there is still contribution from new fund families entering their first facility and/or increasing the size of their facilities. To illustrate, we estimate the size of the global subscription facility market to be slightly greater than $500 billion. Various estimates of dry powder peg aggregate uncalled capital between $1.9 and $2.3 trillion. While a subscription facility sized at 25% of fund size might be typical, a 25% advance rate is well below normal. If market size to dry powder creates an industry wide advance rate of around 25%, there is still inherent global demand in the macro.
- **Concentration in the Top Tier**. Preqin data shows that investor capital continues to concentrate with top-tier sponsors. The lenders we work with bank these top-tier sponsors; we less frequently see the sub-regional lenders that bank community- and local-focused funds. Thus, the declines in fund formation data are disproportionately borne by lenders outside of our purview.
- **Fund Finance Is Greater than Subscription**. Fund finance is experiencing growth unrelated to dry powder collateral. Hybrid, NAV-based, and GP facilities, etc. all have increased in acceptance. The growth in debt funds and secondary funds – both extensive users of non-subscription fund finance products – has positively contributed.

- **Post-Investment Period Usage**. While facility sizes naturally decrease and eventually pay off during a fund's harvest period, they seem to be decreasing more slowly and paying off later in the fund life cycle than in the past. Thus, for lenders that measure growth based on aggregate loan commitments, reduced runoff rates are also a positive contributor. We would love to see a bank provide some hard data around this, but we are confident in our anecdotal assessment.
- **Preqin Data Is Preliminary**. We suspect there is a slight lag between fund closings and reporting to Preqin, as fund sponsors prioritize year-end investor reporting, etc. Preqin does a terrific job of getting data to the market quickly, but we suspect that final 2018 numbers will move up incrementally from current marks.