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ILPA Releases NAV Guidance

July 26, 2024

Yesterday, the Institutional Limited Partners Association ("ILPA") issued guidance for Limited Partners (LPs) and General Partners ("GPs") around the use of Net Asset Value (NAV-)based financing facilities by private equity funds (the "Guidance" - see link at end of article). While ILPA recognizes that "NAV-based facilities can be a useful tool for capital structuring or to provide financing to support assets", ILPA is issuing the Guidance in response to LP concerns regarding the use of NAV-bases facilities today, including (i) limited transparency around their use, which inhibits LPs understanding of the impacts of these facilities, (ii) differing approaches among GPs in engaging LPs around their use (where LPAs are otherwise silent as to whether NAV-based facilities are permitted, which is often the case for existing funds), and (iii) a spectrum of approaches to reporting by GPs with respect to the impact of NAV-based facilities. ILPA advises that the Guidance is intended to provide general parameters for transparency and dialogue between LPs and GPs around the use of NAV-based facilities for private equity funds (*i.e.*, is not intended to address the use of NAV-based facilities in other contexts, *e.g.*, secondaries, private credit, or closed-end real estate funds). Notably, the Guidance does not (a) oppose the use of NAV-based facilities generally, (b) set out a subset of permissible use cases, or (c) seek to impose specific leverage limitations tied to the use of NAV-based facilities. It instead emphasizes a push for communication and transparency by GPs in their use of NAV-based financing. See below for a summary of ILPA's recommendations included in the Guidance and stay tuned for further analysis from the Cadwalader Fund Finance Team.

1. LPAC Consent. Unless a fund's LPA explicitly permits the use of NAV-based facilities or a fund's GP has received prior consent to utilize a NAV facility, the Guidance recommends that GPs seek LPAC consent prior to implementing a NAV-based facility. The Guidance recommends that as part of the LPAC consent process, GPs should provide a detailed disclosure of the following:
   a. rationale and use of proceeds for the NAV-based facility, including details on alternatives considered;
   b. size, structure, and controls relevant to the NAV-based facility (*e.g.*, whether the facility is secured or unsecured, revolving or term credit, and any key covenants – including cash sweep and mandatory repayment requirements);
   c. key economic terms (*e.g.*, interest rate, maturity date, PIK interest, etc.); and
   d. additional obligations of LPs imposed in connection with the NAV-based facility (*e.g.*, are any distributions of loan proceeds to LPs recallable).

2. LP/LPAC Engagement – Specific Use Cases. In addition to the above, the Guidance differentiates its recommended level of engagement by GPs with LPs based on the proposed use of proceeds for a NAV-based facility (*i.e.*, whether the facility will be used to generate distributions to investors or to support the fund's investment portfolio). See below:
   a. *Proceeds used to support the fund's portfolio*: Assuming that the GP has otherwise received prior consent to use a NAV facility (whether in the LPA or through prior LPAC approval), GPs should not be required to return to the LPAC for consent to use a NAV facility to support the portfolio.
   b. *Proceeds used to generate distributions to investors*: The Guidance highlights heightened LP concerns regarding the use of NAV-based facilities to generate early distributions, including the impact on IRR/DPI, interest expenses associated with these facilities, and the fact that resulting distributions may be recallable. Accordingly, prior to a NAV facility being put in place, even if a GP has received prior approval to enter into NAV facilities generally (whether in the LPA or through prior LPAC approval), the Guidance recommends that GPs should still seek LPAC approval if they intend to use any of the loan proceeds to generate a distribution to investors.
   c. Regardless of use case and whether a GP has received consent to enter into NAV-based facilities, ILPA recommends that GPs seek LPAC and/or LP approval to address any conflicts of interest that could be perceived arising from the transaction (*e.g.*, is the lender a related entity?).

3. Addressing NAV Based Facilities in LPAs

a. *Treatment of NAV-Based Facilities in Older LPAs*: For existing funds where LPAs do not specifically contemplate the use of NAV-based facilities, the Guidance recommends that LPs should (i) review the LPA borrowing leverage provisions and (ii) proactively discuss NAV-based facilities with their GPs to understand whether GPs have interpreted these provisions such that NAV-based facilities that utilize an SPV/master holding company structure beneath the fund are excluded from fund-level leverage provisions. Note: It is ILPA's position that NAV-based facilities constitute fund-level leverage and, as such, should be included in fund-level borrowing limitations.
b. *Addressing NAV-Based Facilities in Newer LPAs*: Moving forward, the Guidance recommends that newer LPAs should explicitly address NAV-based facilities, including:
    i. delineating the reporting expectations around NAV-based facilities;
    ii. clearly defining limits to the amount of leverage that a GP is able to incur through NAV-based facilities throughout the life of the fund; and
    iii. defining the term "NAV-based facility" (to differentiate between portfolio-level or fund-level leverage that uses an SPV/master holding company structure v. SPVs or borrowing structures utilized for other forms of debt, such as single company portfolio debt).

Link to ILPA NAV-Based Facilities Guidance: **https://ilpa.org/resource/nav-based-facilities-guidance/**