CADWALADER

Subscription Finance Loan Agreement Series, Part 9: Features and Limits of Accordion/Extension Options

October 4, 2019 | Issue No. 48

Accordion and Extension Options are a common feature of a number of financing documents in a number of sectors other than Funds Finance, not least in Leverage Finance and Real Estate Finance transactions. This week we focus specifically on why and how these are used in Capital Call/Subscription Finance transactions and on some of the common issues that arise when they are used.

So, first the why. This is relatively straightforward. Capital call/subscription facilities are, almost without exception, put in place at an early stage in the life of a fund, usually on or after first close and before the fund finally closes its doors to additional Investors. At that point, the fund will have targets as to the pace of spend on investments but no certainty around that, so it may well need some flexibility around the period during which facility utilisations are available. The fund may also have constraints under its LPA or other constitutional documents on the term of any facilities that it may take out. Additionally, and particularly if the fund puts a facility in place prior to final close, the fund will anticipate that it may require an increase in the amount of its facilities should its fundraising go to plan and the investor profile allows it. At the same time, while the fund will want the option of an increase, it will not want to pay commitment fees for the potential increased amount until it is reasonably certain it will actually need it.

If a fund does require an extension option, then the documentation and implementation process for this is usually pretty straightforward. The Facility/Credit Agreement will set out (i) the possible term or terms of such extension (usually this will be by way of allowing one or more extensions of 12 months), (ii) the notice period required for the extension to be implemented (commonly between 30 and 60 days or a similar period before the facility is due to terminate), and (iii) the conditions to any extension being granted (which will usually include a condition that no default or event of default has occurred, often a requirement for a payment of an extension fee, and sometimes a provision stating that the extension is at lenders’ discretion). Although this is much more common in implementing an accordion, there may be a provision allowing lenders to opt in or out of any proposed extension, with a proviso (in the case of an extension) that if a lender does opt out then the facility will continue, but only at the reduced level at which the remaining lender or lenders are committed.

For a lender, its only concern with an extension in a funds facility (which they or their counsel should check before the extension is granted) is that the period for which the extension is or

could be granted does not affect the fund's ability to draw down on the facility or the obligations of the investors to repay out of their commitments. In reality, this means ensuring that the extension period does not go past any trigger (such as the end of an investment period) in the fund documentation which may change the fund's and investors' obligations in this respect. Where the facility is secured, lenders should also check that the extension remains covered by such security and, if not, implement any necessary confirmations or further security to ensure that it is.

If a fund requires an accordion option, then again the documentation and implementation of this is relatively straightforward, although it can look somewhat less so. As with an extension option, the documentation will specify a notice period required before the accordion option is exercised, as well as the number of times and the period during which the option can be exercised. It will also specify the minimum and multiples of any amounts that can be requested as part of the accordion. The accordion may be "committed" (which means that the lenders are required to make it available absent a failure to satisfy any specific conditions of the accordion, such as the non-occurrence of a default or event of default) or "uncommitted" (which means that the viability of the accordion is at lender discretion). Or it may be a combination of the two. More often than not, an accordion will be uncommitted (or mostly uncommitted), and this is where the documentation can start to look complex. From the fund's perspective, it wants to know that it can make its best shot at obtaining the accordion at the level it requires (whether from the existing lenders or even new lenders) and from the existing lender's perspective, it will want at least first shot at providing that accordion. In documentation, this can lead to a number of frankly repetitious clauses in the accordion section that both allow existing lenders to retain options to provide the accordion (even if other existing lenders have rejected that option) over one, two or more "go rounds." This will be allied with a provision (once the existing lender option has been exhausted) allowing the fund to bring on board a new lender or lenders to form part of the syndicate.

For lenders, there are probably three issues to focus on with an accordion, leaving aside the question of whether or not they are committed or not to provide it. The first is to ensure (as with an extension option) that the fund documentation continues to permit the accordion to be taken out and does not affect either the fund's ability to utilise the accordion or the fund's and investors' obligations to repay. The second is to ensure that, in all jurisdictions where security might have been given for the facility, that security will continue to cover the accordion (and, if not, that new or further security or confirmations are put in place to ensure that it does).The third is to ensure that, to the extent that an accordion is not taken up equally by all the existing lenders, any existing commitments are adjusted between lenders so as to ensure that once the accordion is put in place, each lender is sharing equally both in existing utilisations and in ongoing (unutilised) commitments. The latter may require some adjustment mechanics to be included to allow this to occur relatively seamlessly.

A final word on accordions. Accordion wording is not part of the standard LMA documentation, but there is a similar clause (in the Leveraged LMA document), which commonly also appears in Fund Finance facilities, which allows for increases in existing lenders' commitments and/or for new lenders to be brought on board where there is a "defaulting" lender. This wording deals with a different situation and is usually far more straightforward than the terms used for the accordion, but the base assumptions and drafting are very similar.