

FUND FINANCE FRIDAY

Market Uncertainty and Fund Finance

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The Fund Finance industry returned from the Miami conference to the most volatile two-week period since the financial crisis. With the coronavirus slowly spreading, the equities markets swinging wildly, Joe Biden surging in South Carolina and on Super Tuesday, Mike Bloomberg and Elizabeth Warren suspending their campaigns, and the Fed implementing an emergency 50 basis point rate cut (whew!), there has been a lot to keep up with. With this backdrop, I have closely reviewed our business metrics and connected with a number of industry leaders this week to try and identify any potential impacts for the fund finance markets. Below are my observations.

On the positive side, the fund finance markets have not felt any tangible business impact from the virus or the related market pullback and volatility; it's "business as usual." Every banker I talked with indicated that their opportunity flow has continued uninterrupted and that the number of prospective deals is accelerating, not slowing. No one I spoke with has observed any movement in transaction pricing, implemented a hiring pause or made a revenue adjustment to their 2020 budget. Positively, funds are not reporting any treasury challenges, including with respect to capital calls sent to investors in China. Similarly, our forward indicators at Cadwalader confirm this anecdotal feedback. Both our February hours accrued on prospective matters and number of partnership agreements reviewed project very favorably, with February exceeding January (which greatly exceeded December).

But on the negative side, it is early days. The equities pullback really only started in earnest on February 24, 2020, and there has not been much time for an impact on private markets to manifest. Time is needed to see how things will play out.

From a practical perspective, nearly every bank is reporting significant restrictions on international travel and moderate restrictions on domestic, non-essential travel. Some are requiring self-reporting of personal travel to affected locales. Many are conducting widespread work-from-home trials in preparation for a potential required work-from-home scenario. And a number are watching the impact of the rate cut and decline in the 10-year yield on net interest

margins. Many conferences and events have been cancelled or postponed, and travel schedules are in flux. Many funds have reported to the banks a conversion of investor road shows to video conference presentations. We've also heard that funds have been asking banks to confirm their treasury capabilities in a work-from-home scenario.

Trying to forecast what is ahead, my expectation is that March will be extremely busy. There are a lot of deals in progress and a lot of funds that have had an initial investor closing but that have not yet selected a facility lender. We expect that clients will press hard to get these facilities closed promptly in light of the future uncertainty. We are all hands on deck to be ready. We have also beta-tested our own work-from-home capabilities to ensure we are prepared.

I remain optimistic for the remainder of the year. I do think, however, it would be naïve to think our market is pure Teflon and that these headwinds will not have some temporary impacts to our businesses. Travel restrictions, event cancellations and public market volatility will defer fundraising at least somewhat, and the equity market pullback will make bid-ask spreads more difficult to bridge, at least for a short period. I could see aggregate facility utilization across the industry declining a few percentage points in the second quarter as new investments and new facility borrowings pause for a bit. I also expect new investor capital commitments to drag a little in the second quarter, as investors take stock of their asset allocations and their inability to find yield in fixed income. Longer term, based on the incredibly solid performance of both private capital and fund finance during the crisis, we continue to hold our very positive outlook.

Chris Van Heerden, an Associate on our team at Cadwalader, is a former Managing Director on the CMBS research desk of a major investment bank. We are asking Chris to lean into analyzing the virus's impact on our market and to focus more of his time to researching, tracking and forecasting prospective implications for the industry. *FFF* will do its best to keep you informed and updated each week as the market evolves. But, for now, all traffic lights remain green.