

FUND FINANCE FRIDAY

2021 European Fund Finance Industry Observations

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As we look to what the future holds for our industries in 2021, we reflect on 2020 and how it will be remembered for the year that a global pandemic resulted in the crushing of so many businesses and for countless human tragedies. But amidst the chaos and devastation, the fund finance and private markets quickly adapted to the changing work environment, and lenders worked to design innovative liquidity products and not just survived the pandemic but rose to the challenges it presented with resilience and innovation. Whilst the markets have stabilised to a degree, the global pandemic has thrust the various forms of fund finance products available to fund managers into the spotlight and allowed market participants to understand how beneficial and flexible these products can be. In a short period of time, we've seen the fund finance market grow and evolve rapidly to cater for the increased and varied demand.

We anticipate that 2021 will be a year of further growth and innovation in the fund finance industry, particularly with respect to NAV facilities, preferred equity solutions and structured fund financings for GP-led solutions, as exit timelines continue to be pushed out and GPs require additional liquidity for both their investments and their investors. Is this a view shared by the industry?

For this edition of *Fund Finance Friday*, we spoke to many of the major participants in Europe to gauge their views on the key themes and developments they expected to see in the fund finance and private markets in 2021. The feedback was resoundingly positive and, unsurprisingly, NAV facilities, the greater role of institutional capital in the fund finance space and a greater focus on ESG-linked products ranked highly as the key themes to watch out for in 2021. Thank you to all who provided their thoughtful insights for this edition.

Steve Burton, ICG: "Fund finance will go from strength to strength as all parties, GPs and LPs alike, realise the continued benefits. But big picture we will see an increase in NAV-type structures to generate liquidity in more mature strategies ... but not at the expense of the more vanilla market, which will continue to grow. I would also expect to see the post-COVID 'tightening' of documentation by lenders relax as we normalise and we refocus on the quality of

undrawn LP credit. Credit departments have become a little too much 'computer says no' for such a traditionally rational market. (I could add that lawyers will be key in this, with increased focus on commerciality critical.)”

Dadong Yan, Portfolio Manager, MassMutual: “Innovation in fund finance will continue to accelerate as asset managers seek better, more holistic solutions for their portfolio financing needs. At the same time, alternative lenders who understand the underlying asset classes and have experience structuring/executing these transactions will play a greater role in providing these bespoke solutions. For example, the adoption of NAV facilities or tailored GP solutions are still in early stages with tremendous runway ahead.”

Stephen Quinn, 17Capital: “Fund finance will continue its trend of rapid growth and evolution – particularly in areas such as NAV financing, driven by increased industry awareness and adoption by top-tier players. Despite the current market challenges, there will also be growth opportunities and the potential to enhance fund performance. This is exactly what we witnessed in 2020. NAV finance serves both defensive and opportunistic situations, and that broad application will support continued industry growth.”

Sabih Hussain, Barings: “With the partial closing of the fund finance industry last year, we have seen a number of lenders return late last year. The terms have also stabilised, and I see 2021 being an active year for fund finance in Europe.”

Shani Unantenne, ANZ: “We expect to see a buoyant fund financing market in 2021, with economic conditions continuing to provide a favourable backdrop for fund raising. With banks having managed through the initial stages of the crisis, we expect the financing market to become more liquid and competitive, albeit not quite to pre-COVID crisis levels. A major theme will be the ongoing development of ESG-linked facilities.”

Rupert Watkins, Anzere Advisory: “I expect that private fund fundraising will grow hugely from Q2 this year, and demand for fund finance will grow significantly. With the vaccination coming over the next few months and a clear path to the return to a more normal economy, growth in private equity mid-market should mean that more funds will be fundraising and coming to market; significant growth in leveraged loans due to low interest rates and demand for high-yield debt; GP facilities will be more important for funds in 2021 given the liquidity constraints from delayed exits; LP capital call margins will tighten towards the end of 2021. Margins increased across the market as bank capital became squeezed in 2020. This will ease as banks become more comfortable again with the risks on their books and will be more willing to advance at tighter margins than they were in the last half of 2020.”

Sarah Lobbardi, Avardi Partners: “We anticipate an increased number of NAV transactions for Private Equity funds in the next 12-18 months. As countries are entering lockdown restrictions again, GPs may consider NAV facilities to create additional liquidity buffers to cure potential breaches of debt covenants for underperforming assets while also using the additional liquidity to service the ongoing needs of existing investments. Overall, we expect the fund finance market to remain steady for 2021, with an increased volume of ESG financing and NAV facilities across debt, secondaries and private equity funds. On the advisory side, changes in the fund finance market due to COVID (price increase, ticket size reduced with more appetite for club deals, lending appetite volatility) alongside the need for liquidity have been drivers for managers to seek more support from advisors.”

Nicholas Armstrong and Helen Hoang, Bank of Ireland: “We expect to see: more private fund vehicles established in Ireland this year following the passing of the new Irish LPA Bill; fundraising to remain challenged this year certainly from an operational perspective, although we may see more successful virtual fundraises; ESG continuing to be a key item on LPs’ agenda this year and more sustainability-linked facilities in 2021; some teething issues around LIBOR transition and increased need for dialogue; subline pricing to continue to ‘normalise’ to something approaching pre-COVID levels, though perhaps with some short-term volatility if new lockdowns impact lenders’ wider loan portfolios and/or there are material delays in vaccine rollouts; and continued weakness in sterling acting as a powerful incentive for EUR or USD-denominated funds to acquire UK-based assets.”

Guillaume Hartog, BNP Paribas: “This year has been a very strong testament to the robustness of the fund financing market from a risk perspective; we experienced several retrenchments from players in this market and numerous requests from our clients to replace exiting/decreasing lenders. This was a market for players with track record and experience. We foresee another very active year for fund finance, and the private capital markets continue to attract investors as a sought-after asset class; we expect to see fund level financing technology continue to permeate all fund sizes and asset classes, as well as the secondary market in particular. The fund financing market will continue to be more standardized, mature, with market standard facility terms continuing to develop, facility external ratings to increase and more capital optimization in light of the coming Basel IV rules.”

Michael Peterson, Citco Capital Solutions Inc: “2020 proved to be a complicated year that ended up being a record year across the NAV lending space. While we expect capital calls to remain busy, we anticipate NAV demand to remain strong into 2021 as clients look to ‘play offense’ in supporting underlying portfolio companies. NAV facilities will allow funds to preserve liquidity, maximize returns and deploy capital across the investment sector.”

George Cherry and Billal Malik, Citi: “In the European subscription finance market for 2021, we see a continued increase in demand for ESG-linked facilities driven by sponsors, investors and the banks. Separately, we also see growth in uncommitted facilities as sponsors try to reduce the fixed cost of their facilities, particularly given uncertainty around future capital deployment and therefore facility usage. Equally, banks will look to reduce the capital requirements associated with their larger exposures, through uncommitted facilities or shorter tenors.”

Ahlem Ben Gueblia, Crédit Agricole: “While fundraising slowed in 1H 2020, it has been really strong in the 2nd half of the year, with some funds hitting their biggest fund size ever, often exceeding their hard cap. With so much capital to be deployed and the private markets showing some great opportunities (some created by the pandemic) as already observed at the end of 2020, the 2021 outlook for the fund finance industry is excitingly positive.”

Will Canty-Collins, Credit Suisse: “The Credit Suisse Fund Financing team believe that 2021 will see a continuation of the flow of more complex and bespoke financing transactions that we as a team executed throughout 2020. We expect that Investors will be looking to optimise their private market portfolios in the context of: net liquidity from capital calls and distributions, overall returns generated, as well as prevailing valuations given the ongoing global economic uncertainty. As a result of this analysis, we anticipate that there will be some investors seeking

near-term liquidity via the secondary market, and others looking to deploy the significant amount of available capital that has been raised in recent months in order to take advantage of valuation dislocations – resulting in what we hope will be a very active year for the fund financing market. We very much look forward to supporting our clients, both new and old, in 2021.”

Amit Mahajan, Crestline: “2020 was a remarkably busy time for the Crestline Fund Liquidity Solutions team. We were able to work with mature private equity funds whose portfolio companies were impacted by the pandemic, and provided those mature funds and their portfolio companies with critical bridge financing for a variety of scenarios, including debt restructuring, funding for growth, bridging to sale, and other purposes. We also provided capital for special situations, which allowed mature private equity funds to make acquisitions that were overall accretive to their NAV. We believe that while business normalcy may return slowly, many of the challenges and trends we saw in 2020 will continue in 2021, leading to another active year for our team.”

Jamie Mehmood, Deloitte: “The use case and familiarity of managers with a wider range of fund finance structures became more evident during 2020, demonstrating that they can complement asset-level financings and provide an additional degree of flexibility. This combination of fund-level and asset-level financing solutions has served to provide managers with ever-growing optionality when raising capital across the fund structure for a breadth of purposes, which is something we anticipate will become more engrained during 2021 with the continued and evolving challenges that the year is likely to bring. We also envisage that 2021 will continue to see GPs and managers opening up and diversifying their fund finance relationships/syndicate groups more broadly. Ever-increasing fund sizes, the uncertainty of COVID-19 and a broader toolkit of financing options available all underline the importance of holding, and being able to lean on, a wider number of established lender relationships. Our experience has shown repeatedly during the last year that running a full debt process has helped to deliver optimal financing outcomes against the current backdrop. Two longer-term trends which we expect to see becoming more prevalent in 2021 are the increasing use of sustainability-linked lending as it moves to centre stage, as well as increased direct activity from institutional liquidity across the fund finance spectrum.”

Marco Unti, Deutsche Bank: “We think 2020 has brought home to many fund managers the fact that having multiple sources of financing can be invaluable when liquidity in one or more markets dries up. Being able to support portfolio companies by borrowing at the fund level and downstreaming the proceeds as required has been a powerful tool for those managers that had suitable lines in place or could establish them quickly through their existing banking relationships. We see, in particular, renewed interest in the NAV product as both a defensive measure (*i.e.*, using the liquidity to support portfolio companies as required) and an offensive measure (*i.e.*, to fund follow-on investments when prices become attractive and/or to enable an IRR-boosting distribution to LPs).”

Gareth James, Ganymede Capital: “The pandemic has in a sense given a boost to the whole Alternatives segment – Private Equity and Direct Lending Funds for example, because they have long-term committed capital and are able to ride out the current short-term difficulties – sure, there will be some portfolio companies that have issues caused by COVID – but overall they are well placed to take advantage of investment opportunities created by the dislocation.

In the case of the direct lending funds, the pandemic has given further impetus to the already strong trend away from bank to non-bank lending. As the banks focus on existing clients and large corporate relationships and government support schemes, they continue to withdraw from areas like leveraged finance. The direct lending funds are also pushing into the large cap leveraged finance market and providing a real alternative to the syndicated loan market.”

Josh Bourone, Ganryu Capital: “The hybrid facility will be the new subscription line. Managers will broadly use more sophisticated fund finance tools that will be ever more tailored to their specific investment and value creation strategies. I also expect to see the ‘retailisation’ of private markets. The majority of larger players will launch new distribution channels and products dedicated to the retail market.”

Swagata Ganguly, Evercore: “I would say that the fund finance market will see increasing interest in 2021 from non-bank lenders such as insurance companies, pension funds and asset managers who are keen to get exposure to this debt asset class.”

Nick Parkhouse, Ernst & Young: “As a result of COVID, we expect PE portfolio company holding periods to push out. A combination of aging funds and need to further invest in such companies to offset IRR impact could lead to an increase in demand for NAV-based facilities. Given this demand is likely to come from mid-market PE and the ever-increasing levels of liquidity in credit funds, we expect not only ‘new demand’ but ‘new supply’ during 2021.”

Ian Taylor, ING: “In response to demand from GPs, we expect to see the volume of ESG-linked capital call facilities increase this year.”

James Rock-Perring, Intertrust: “I foresee continued growth and fund raising for private equity in 2021 and beyond, despite the COVID-induced economic crisis. Private equity has shown resilience in the past during periods of market volatility and dislocation and is better placed than most to deliver superior returns. Liquidity for pure subscription line facilities still appears robust and, on the asset recourse front, I have seen a marked increase in the number of institutional funds being able to participate in the concentrated NAV space. A number of credit and secondary funds are finding capital to deploy for existing fund vintage liquidity requests, and I expect more strategies to widen their mandate and adjust their return metrics to accommodate this in the short to medium term.”

Helen Griffiths and Grant Crosby, Investec: “We expect to see: institutional capital providing liquidity to the subscription finance market; more relationship banking – more so than ever a single, trusted point of contact is very important for GPs; whole lifecycle financing – lenders who have demonstrated flexibility in supporting GPs throughout the entirety of a Fund’s lifecycle will be on the front foot to be a truly holistic provider of fund financing solutions in a much more scalable way, from subscription lines through to more structured NAV-backed facilities; innovation rather than commoditisation of subscription finance structuring – the market will move towards offering capital call packages which include a combination of solutions for a fund such as a committed, RCF tranche together with an on-demand or uncommitted component. The RCF gives that certainty of funds and the on-demand facility provides additional capacity if needed without ongoing cost – minimizing any drag on fund returns; and growth in ESG-linked facilities for all sizes of managers.”

Jill Wilson and Scott Turner, Lloyds: “2021 is likely to see further dynamic shifts in the global fund finance market as GPs continue to seek innovative ways to utilise their fund collateral. We believe it will largely be more of the same and for demand to remain strong for pure subscription lines. Investors will continue their flight to quality in manager selection. Equity wrapped, hybrid structures and NAV products are nothing new, but we now see a number of new lenders aggressively entering the space where the returns are more attractive. Couple this with expected ongoing increased GP demand to drive and/or protect value in the context of a challenging economic backdrop, driven by COVID, and we see a strong growth story in NAV deals, both volume and type, during 2021 and beyond.”

Kieran Welsh, Marlborough Partners: “2020 was the year where the sponsor and investor community were educated on the full suite of fund finance products, and we predict 2021 will see that knowledge put into practice with many more asset backed and hybrid deals reaching the market.”

Stephanie Messac, Morgan Stanley: “We anticipate seeing further opportunities to finance portfolio acquisitions. It is our expectation that, following the impact of COVID in 2020, the secondary market will catch up through large-scale portfolio restructurings.”

Ben Griffiths, MUFG: “We expect to see sustained growth in subscription lines across regions and strategies. Private equity funds remain attractive to investors across the world, and following increased balance sheet tightening by banks, private credit funds have benefited from companies looking for alternative financing sources. Within the real estate space, funds across the capital structure and those focused on logistics are likely to attract asset allocations as many investors are treating them as a proxy for fixed income and credit exposure. As a large infrastructure franchise, we also see a strong pipeline across that strategy. Being a Japanese financial institution with a global focus, we continue to see Japanese investors and Japanese-focused funds taking a more prominent stance in Asia. Japan is one of the most sophisticated limited partnership markets in Asia, and Japanese institutional investors are allocating more to alternative assets, following the larger state-related investors’ lead.”

Russell Evans, National Australia Bank: “We’re anticipating continued growth in demand for sustainability linked fund finance solutions, and we’re pleased to see the speed at which the sector is adopting RFR ahead of LIBOR cessation.”

Hamid Aguerbal and Amira Hajili, Natixis: “We expect the fund financing market to remain stable at best in 2021 vs. 2020 in terms of volumes as a consequence of the COVID pandemic having slowed down fundraising in 2020. However, we believe that two main evolutions should keep the market strong. On the one hand, digitalization will protect fundraising. On the other hand, ESG awareness becoming a hot topic will lead more and more sponsors to include sustainability and governance factors in their investment guidelines with ESG KPIs added in their financing agreements with benefits in terms of pricing when complied with. On the lender side, we would also expect appetite for ESG-linked financings to increase. Pricing conditions which have picked up at the start of the pandemic seem to have normalized during Q4 2020. We would see the trend continuing, not necessarily going back to pre-crisis levels, though.”

David Proud, NatWest Markets: “We anticipate heavy utilisation of facilities/use of accordions reflecting intense activity in the PE space; ESG to become part of discussion for structure/pricing for all new subscription finance lines by the end of the year; an increase in

NAV lines (or mezz-type deals with limited recourse to capital commitments) for mature funds; a proliferation in corporate facilities at management company level to fund growth/diversification; and Portsmouth to miss out on promotion to the Championship in the play-offs...”

Gerhard Caspar, Nordea: “Despite the challenges of the COVID pandemic, we ended 2020 on a high note, with unprecedented levels of business activity. Much of that activity has carried over into the new year, and current discussions with clients on new opportunities are indicating continued strong activity throughout the year. A close, relationship-based cooperation between borrowers and lenders has once again proven its worth in finding solutions to complex financing needs during the more uncertain times we find ourselves in. We remain very positive on the long-term prospects of our industry.”

Fabien Bonavia, OakNorth Bank: “We expect the fund market to further evolve during the course of 2021. A wave of NAV fund facilities were expected in Q3 ‘20 which never materialised. We expect these to come to market in 2021 once government support tails off. You will also see funds of various sizes looking for subscription lines or hybrid facilities as they seek access to liquidity to ensure they can navigate through these unprecedented times. We anticipate that funds will be seeking investment opportunities in the healthcare sector, infrastructure and green energy.”

Adam Heaysman, Raiffeisen Bank: “As the growth in alternatives continues across the CEE region, managers of these funds are increasingly interested in fund level facilities and the benefits they bring. We are also seeing increased use of other fund structures, beyond the more traditional Lux vehicles, in the CEE region which does present some challenges when putting fund level facilities in place. We expect these trends to continue throughout 2021 and beyond.”

Marcus Carrington Palmer, Royal Bank of Canada: “We forecast: growth of the global fund finance market although the next super-cycle of flagship fund capital raisings isn’t forecast until 2022/23; importance of flexible, revolving fund level LP-backed credit, certainly given challenges for managers in securing desired/historic levels of investment level leverage in a COVID environment (noting geographic and sectoral differences) which we expect to lead to a rise in hybrid/NAV-based lending structures; capital raising will remain strong, especially for larger Tier 1-2 managers with a noticeable dominance of mega funds (~\$3bn+ capital raise), although capital raising is typically taking longer and managers needing to increase the number of fund closings to reach target which impacts the sizing/phasing of fund finance requirements with multiple accordion upsizes becoming a normal feature; longer dated fund investment periods and/or additional +1 extension features are increasingly being added; pricing remains wider than pre-COVID environment and is expected to remain stable for the near term; and some lenders have noticeably slowed loan origination while others have continued to increase origination volumes. There continues to be a flight to relationship, with lenders appearing to focus on deepening existing manager relationships and managers continuing to seek either large bilateral facilities or larger holds in smaller syndicates from their core relationship lenders.”

Spencer Goss, RBSI: “In a time when we have seen a genuine pulling together of government, investors, employees and the public, whatever decisions asset managers decide to take, they

must increasingly be seen to be doing so in a careful and purposeful way. It is hard to escape the sense that this crisis offers the chance for a genuine reset in how we run our societies and how investment strategies will underpin that change. And, of course, the drive for greater transparency, improved governance and more disclosure around environmental, social and governance (ESG) will also gather pace. This year may well prove to be pivotal as investment strategies adapt in the light of a genuine shock to the system. ESG is a fast-growing part of the global investment landscape and represents significant opportunity. But it is also a necessity, and the new European requirements on measuring and quantifying ESG performance are only the beginning, with further regulatory activity at the sectoral, national and international levels to follow in the next few years.”

Gavin Rees, Silicon Valley Bank: “I think the lion’s share of fund financing will continue be in the form of capital call lines, albeit the structures and purposes of these facilities continues to become more varied, such as to finance part of secondary portfolio purchases. NAV and pref equity will certainly continue to grow, though it will be interesting to see how many conversations translate into transactions. GP lines of credit will continue to cross the mind of almost all managers. But, then again, I firmly believed the market would tread water once COVID hit, so what do I know?”

Stuart McIntosh, SMBC: “I expect a continued increase in demand for NAV facilities, which to a certain extent favours institutional investors’ appetite given the operational burden of subscription facilities. I anticipate banks/non-banks to continue developing capabilities and seeking to carve out niches where they have specific expertise. Scale will be key. On the subscription line side, I think 2020 showed us that supply was not necessarily as deep as people had thought, with perhaps a veneer of lender liquidity having been created over previous years. It should be underlined that the market held up very well last year with GPs, LPs, lenders, law firms and advisors all pulling together. The long-term success of Private Markets will continue to drive core demand, so whilst I predict a move towards equilibrium as the market participants continue to adjust, I also envisage many lenders continuing to direct balance sheet towards either existing clients or core target clients during this year, which may increase bifurcation.”

Raghav Wadhawan, Standard Chartered: “We see sustainable finance continuing to play an increasingly important role in fund finance. Last year was a pivotal year: not only did COVID accelerate the shift towards sustainability more broadly, but we also saw some key innovative and first-time deals in fund finance. SCB completed some of the first deals for proceeds-linked ESG fund finance facilities in the U.S. and Europe markets, and we continue to see increasing engagement from Sponsors this year.”

Thomas Rapp, Wells Fargo: “We are fairly optimistic about the outlook for the European Fund Finance market in 2021 and beyond. We expect an increased number of fund raisings, especially for smaller and more opportunistic strategies which didn’t get enough traction with investors during 2020. Established sponsors and asset managers will continue to grow both organically and via acquisitions with the result of bigger fund raises and a more and more global focus. This will likely mean another year of growth for the traditional fund finance market. Consequently, there is a need for additional capital allocation into the market by existing players and new market participants. More innovative fund finance products like NAV lines,

longer term Management company loans and ESG-focused facilities will continue to develop and become standardized over time.”