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Umbrella Academy: A Guide to Umbrella Facilities in Fund Finance

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Fund Finance Friday has previously provided an overview of traditional umbrella subscription facilities and their pros and cons – please see Wes Misson's excellent article published in **April 2019**. Those were simpler times. Over the two years since that article, we have seen more innovation in the market. As Wes noted at the time, these "complex but interesting creatures" continue to evolve.

The Cadwalader fund finance practice closed 13 umbrella facilities in 2020. Deal size averaged $135.4 million, not far off from the average deal size for "vanilla" subscription facilities. While deal count increased, we didn't see as many facilities with maximum commitments of more than $1 billion as we did in 2017–2019. This trend is consistent with the appearance of a wider variety of umbrella facilities in the market.

How to Structure an Umbrella Facility

An umbrella facility is a credit facility with multiple borrowing bases. Typically, given the separate borrowing bases, representations and warranties, covenants and events of default only apply to the set of borrowers that comprise a given borrowing base. Fees and expenses are also limited to the borrowers that comprise a given borrowing base, and usually the obligations of each borrowing base will not be cross-collateralized with the obligations of borrowers in other borrowing bases.

The key to structuring any umbrella facility is a "Fund Group" concept. Once the concept is implemented throughout the loan documents, then the credit facility can operate with separate borrowing bases, covenants and events of default. While conceptually simple, Fund Groups and related defined terms touch upon nearly every aspect of the credit agreement and

collateral documents. Essentially, anywhere a borrower or borrowing is mentioned, the lawyers drafting the documents must incorporate the appropriate Fund Group umbrella mechanics. In parallel, the bankers and their respective operations teams must account for multiple Fund Groups and borrowing bases, which may impose additional administrative burdens on the lender. The cost to set up and run umbrella facilities may therefore be considerably higher than a "vanilla" subscription credit facility. However, in certain situations, the flexibility of an umbrella facility's multiple borrowing bases justifies the additional cost.

Many Possibilities Under an Umbrella

It turns out the simplicity of the Fund Group concept is robust enough to accommodate a number of different fund structures. Recently, we have seen several innovative solutions designed by sponsors and lenders when there is a business reason for multiple borrowing bases – out of necessity due to fund structure or for the convenience of the sponsor.

The Traditional Umbrella: Fund Group Borrowers

The "traditional" umbrella is simply multiple related borrowers in each Fund Group. The borrowers of such Fund Group share a common borrowing base cross-collateralized with respect to each other borrower in such Fund Group. Fund Groups are often composed of a main fund and its alternative investment vehicles and parallel funds, and may also include overage funds and co-investment vehicles, to the extent such cross-collateralization is permitted with respect to all borrowers in the Fund Group. New Fund Groups can be added as new funds are raised and older Fund Groups can be removed without terminating the facility. While each Fund Group is typically governed by the same terms, NAV covenants and other provisions may apply only to late-stage funds that have called most of their capital commitments.

The Single-Investor Umbrella: Multiple Single-Investor Funds

If a sponsor has or intends to have multiple funds with a single investor, the sponsor may wish to join such funds into one umbrella facility. Ideally, each single-investor fund would be based on a similar set of governing documents so that the main structuring goal in the credit agreement will be assigning a borrowing base with respect to each single-investor fund.

The Pool Umbrella: Multiple Capital Groups in the LPA

If a fund's governing document, usually a limited partnership agreement, is structured in a way so that capital commitments are in segregated series or pools that cannot be cross-collateralized, a facility with umbrella mechanics can be a relatively straightforward solution to the problem. While the structuring of the credit facility will depend on the precise terms of the LPA, the multiple borrowing bases of an umbrella facility should, with some modifications, be able to accommodate the multiple capital pools set forth in such an LPA.

The Luxembourg Umbrella: Multiple RAIF Compartments

A more exotic umbrella is based on the Luxembourg Reserved Alternative Investment Fund (RAIF). It is possible to structure the RAIF as a borrower with multiple compartments, with each compartment being essentially a distinct borrower under the RAIF. In an umbrella facility based on such a RAIF, each RAIF compartment would have its own separate borrowing base, and

any test or covenant would be measured as to each compartment. (A Luxembourg RAIF's governing document may be supplemented or amended to reflect the addition of a new RAIF compartment, which could then be joined to the umbrella facility as a borrower pursuant to specialized joinder mechanics.) Given that the RAIF concept of "compartments" does not map precisely onto the traditional Fund Group concept, the Luxembourg RAIF Umbrella results in more complicated loan documents and is less commonly seen in the market.

Conclusion: When to Open an Umbrella?

As bankers and lawyers know, the bunny slopes of a term sheet discussion can quickly turn into a double black diamond when it comes to drafting the actual facility documents. To take one extreme example, one Luxembourg RAIF umbrella facility included hybrid comingled/SMA compartments with dedicated Cayman and Delaware feeders above each compartment in a cascade of local and New York law pledges.

As noted above, the upfront cost and administrative burden of an umbrella facility that is initially comprised of one or two Fund Groups may exceed what a sponsor would expect if it entered into an independent credit facility for each Fund Group. However, as more Fund Groups are added, the umbrella should become a relatively more efficient vehicle, assuming such Fund Groups share essential structural features.

In addition, an umbrella facility may be attractive to a lead lender because it makes it more likely that it will also be the lead lender for the next vintage of the fund. For sponsors, some umbrella facilities also provide for one aggregate maximum commitment which the borrowers can allocate and re-allocate among Fund Groups (with availability limited by the borrowing base of each fund group), potentially lowering the unused fees incurred by the sponsor and the total amount of capital that the lender has to allocate to the sponsor's credit facilities. Of course, the alternative to umbrellas is producing a strong precedent between a sponsor and lender which can be the basis for future facilities. It is up to the lender, the sponsor and their respective counsels to decide when an umbrella is the most desirable option for a given set of funds.