



Thought leadership series: NAV finance - where is the market going?

The private equity industry has been in a more challenging environment for a number of years, with exits heavily down (2023 being at a near 10 year low), new investments being heavily down, and the impact of higher base rates continuing to hurt portfolio companies.

Yet PE firms are raising money, 2023 being a near record year, and as such dry powder understandably is at an all time high.

What does this mean for PE NAV facilities, which here we mean fund level facilities with recourse to all the assets of the fund, typically up to 10-15% LTV?

It is hard to separate the short term impact the current landscape has for the growth of PE NAV, with long term trends. But cutting through the noise of these past 2 years, and looking forward to a more normalised environment as we are starting to see, we feel that the era of PE NAV facilities becoming mainstream is really beginning.

A sensible and practical solution

To us, a PE NAV facility has always

been a valuable and flexible financing tool, a logical and sensible solution to wider borrowing needs of the fund, and when the wider PE trends return, we see it continuing its path to the mainstream.

- ◇ NAV financing generally is less restrictive, less covenant intensive, and for many funds, cheaper than portfolio company financing.
- ◇ NAV facilities will only ever be a small part of overall look through borrowings (the rest being obviously at the level of underlying portfolio companies) - up to 10-20% of a fund's overall borrowings.
- ◇ GPs are getting better at communicating their intentions and selling the advantages of NAV facilities to their LPs.
- ◇ Such facilities are generally not about increasing overall leverage levels, but improving flexibility.

Flexibility

We do believe that PE Funds should where possible take advantage of lender appetite for a fund level facility, and use these facilities as

needed from time to time, whether for money in, money out or money neutral (see table).

For example a GP might initially use a facility for a bolt-on, and maybe when that bolt-on can support direct borrowings,

"GPs are getting better at communicating their intentions and selling the advantages of NAV facilities to their LPs"

redeploy the capital in other areas, perhaps refinancing an underlying loan struggling to meet covenants elsewhere, or a further bolt-on.

Thought of as the most flexible and potentially cheapest source of finance, NAV facilities can be deployed where they are most needed over time, for the most difficult-to-finance pieces.

Whilst there are growing solutions to address LPAs that prohibit fund NAV finance, such as loans to portfolio companies backed by fund level equity commitment letters, or intermediate holding company

Uses of NAV Finance

Money in:

- proceeds used for bolt-ons, re-ups, equity expansion of existing portfolio companies, new deals

Money neutral/recycling

- proceeds used for refinancing existing debt in portfolio companies, replacing debt providers, or injecting equity to reduce debt balances at portfolio companies

Money out

- proceeds used for LP distributions, for example to allow LPs to speed up commitment to new vintages



utilisation, the fact remains that LPs need to be on board with a new NAV finance facility, but we see more and more LPs comfortable with NAV finance for the right reasons.

NAV lending risk profile

PE NAV lending provides a different risk profile to traditional leverage finance. It sits subordinated to the portfolio company leverage finance debt, but is diversified across a number of companies in the fund typically across different industries and sectors.

Leverage finance is not cross collateralised, so only one company needs to get into major difficulties for the lender to suffer losses.

For a NAV lender to lose money, most of the portfolio companies need to get into difficulties - essentially the whole private equity fund needs to go to near zero in equity value. This is why such lending, although structurally complex, is attractive, and attracting new lenders all the time.

Growth of lenders

There is growing appetite by existing and new NAV lenders.

Whilst new banks continue to enter

the space, most of the new entrants by number are from the credit funds, and now some institutional investors such as pension and insurance companies.

Many credit funds have launched dedicated funds for NAV finance, many more have dedicated teams but so far tapping existing funds.

“NAV finance to PE funds has the potential to be truly huge, over \$1tn, many multiples of today, hence the focus of credit funds”

Credit funds are also leading the drive to smaller facilities, meaning capacity for mid to lower-mid market funds to utilise NAV facilities is growing too.

Banks will remain major players, but have challenges ahead. With the anticipated effect of Basel 4 and CRD6/CRR3 having a detrimental impact on the way many banking entities are able to apply their internal Credit/Market Risk models to the calculation of RWA from non-rated collateral, we may see banks reacting in a combination of 2 ways:

- ◇ Withdrawing from lending against unrated collateral; or
- ◇ Packaging lending in ways to be Securitised, and/or on-sold to non-banking institutions.

NAV finance to PE funds has the potential to be truly huge, over \$1tn, many multiples of today, hence the focus of credit funds.

The market today

PE is obviously going through a very challenging period, and as such it is hard to know how much this has impacted the growth of NAV facilities (which have grown 30% per annum for the past 5 years, but from a low base).

- ◇ Exits have plummeted from a 2021 peak, in total buy-out deal value was \$438bn in 2023, from over \$1tn in 2021.
- ◇ LBO yields are now high, because of the base rate spikes over the last 2 years, making it hard to finance transactions, with difficult decisions coming in the next few years for sponsors where finance facilities are up for renewal.
- ◇ So not only are there fewer deals but debt multiples have had to reduce, cumulatively causing large reductions in the amount of syndicated LBO loan issuance.
- ◇ Private credit funds now provide nearly 85% of sponsor backed mid-market lending, a huge increase from the 50% or so it was some 7-8 years ago, and going forward we can see structurally a similar dominance in the NAV finance space.

In the current market, PE NAV facilities give sponsors the opportunity to refinance problematic or up for renewal underlying portfolio company borrowings, either by replacing loans or injecting equity to shore up ratios. It remains as always an option for transactions, be it bolt-ons, acquisitions or new strategic deals.

There now seems far less demand for LP distributions funded by PE NAV facilities, which can only be a welcome thing. 2 years ago they did address a real need from certain LPs for liquidity during the LDI turmoil, but most would agree that these are not healthy uses of such facilities.

But NAV facilities continue to grow from strength to strength, and we see this only accelerating with a return to more normal private equity markets.

Ganymede Capital, June 2024

Why you should speak to Ganymede

The fund financing landscape is complex and changing rapidly. Innovations in products, structures and the changing dynamics of supply of and demand for capital means that borrowers are increasingly faced with myriad choices and questions.

We at Ganymede Capital have the knowledge and experience of the fund financing industry to help borrowers navigate this ever changing landscape efficiently and effectively.

We:

- > Are independent and solely represent the interests of borrowers in seeking and negotiating innovative financing structures to meet borrower requirements;
- > Utilize the breadth of our lender network to seek the most cost effective and streamlined solutions for our clients;
- > Promote competition amongst lenders to ensure that borrowers can duly claim to have fulfilled their fiduciary responsibilities of seeking the most appropriate terms with respect to a given financing situation; and
- > Work with our clients at all stages of the financing process – seeking appropriate lenders, negotiating terms, running competitive bid processes, executing a structured transaction and helping clients navigate the post execution landscape until final maturity of the financing line.

Gareth James



- Former Global Head of Fund Derivatives and Finance at Deutsche Bank.
- Former Global Head of Alternative Asset Solutions at UBS Investment Bank.
- Founder and CEO of Trium Capital, a multi-strategy private markets asset manager.
- Qualified Solicitor, practiced securitisation and structured finance with Lovells.
- MA in Mathematics from the University of Cambridge.

Ken Goldsbrough



- Former Head of European Debt Advisory at Duff & Phelps, Houlihan Lokey and Greenhill.
- Former head of UK Corporate Banking at BNP Paribas, and senior lending positions including head of TMT and Head of Media and Comms at Barclays and GE Capital.
- Former Chairman of the Trustees of the Paribas Limited Pension Fund.
- MA in Modern History from the University of Oxford.

Paul Nix



- Former Head of NAV Fund Financing at Deutsche Bank.
- Former Head of Fund Financing at BNPP.
- Near 30 year career overseeing trading desks in Fund Finance and Fund Derivatives.
- BSc in Economics and Finance from Brunel University.

Continue the conversation

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