Out of the Ordinary | Investec Specialist Bank

Looking down to drive returns up: hybrids and NAV facilities

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When we're out talking to industry, common themes begin to emerge. At two recent London events we attended – the BVCA panel in Fund Financing, and the Fund Finance Association Conference – fellow attendees agreed that capital call lines are both well used, and properly understood.

Another area of agreement is that facilities secured by 'looking up', against the undrawn commitments of fund LPs, are easy to find. But when it comes to facilities outside of this box, GPs find solutions harder to come by. This is despite the fact that $300bn in assets are held in funds that arguably sit outside of their investment period.

The transfer of value from undrawn commitments into fund assets is a natural part of a fund's lifecycle, and this transition doesn't mean that the portfolio stops needing tools to help manage cashflows and fund investments.

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This is intended for investment professionals, and not for retail use.

Our experience out in the market confirms that GPs are keen to discuss facilities to use in funds post-investment period. Such facilities are typically secured partially by undrawn LP commitments and asset NAV ('hybrid facilities'), or wholly focused on the underlying NAV ('NAV facilities'). These facilities can be used in a range of situations, but three tend to be the most dominant:

'hybrid facilities', or wholly focused on the underlying 'NAV facilities'

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Investing 100% of fund commitments/bridging the recycling of management fees

- Funds often have the ability to recycle distributions to the value of costs, fees and expenses, in order to try to invest up to 100% of LP commitments in value-generative assets
- Cashflow timings don't always work with distributions coming after investment opportunities
- Facilities are therefore sought to bridge this timing mismatch
- The additional returns here can be significant and will enhance both the Fund multiple and IRR

Bolt-on financing: building value

- Unexpected opportunities often present themselves to acquire a bolt-on, or inject value-enhancing follow-on capital into an asset
- It may be inefficient to use LP equity, or perhaps not possible, due to commitments being earmarked or used elsewhere
- An NAV or hybrid facility can be structured to enable this value creation

Protecting value

- Fund portfolio companies often hit speed bumps and need additional capital support
- Restructuring programs can be implemented using capital provided by a hybrid or NAV facility

We all recognise that an alternative tool to equity is becoming ever more important for GPs, who need to look for every opportunity to drive value in their funds. That need to drive value doesn't begin and end with a fund's investment period; a portfolio company doesn't stop needing capital just because that period is over. Bespoke financing solutions, ranging from debt to preferred equity, have helped to bridge that gap. More and more managers are 'looking down' – in order to drive returns up .

If you have any questions on this topic, or any others on fund lending or GP financing, then please contact me or one of the team and we'll be happy to discuss with you.

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