Clifford Chance

BRIEFING

NAV FINANCING

There has been substantial development in the net asset value ("**NAV**") financing space in terms of both use cases and structuring, and also in terms of the providers of such types of debt, with an increasing number of non-bank lenders entering the fund financing market.

Key issues

1. **Expanded Use and Structures:** NAV financing is increasingly used across fund lifecycles—from follow-ons to new acquisitions—and is now supported by a broader range of non-bank lenders. "Certain funds" provisions are also emerging to ensure committed financing with minimal conditions.

2. **Managing Enforcement Risk:** LP concerns about lenders selling assets in default scenarios can be mitigated through structuring (e.g., lending to SPVs) and documentation (e.g., grace periods), limiting direct recourse to portfolio assets.

3. **Securitization for Credit Funds**: Credit funds often use securitized NAV facilities, offering higher advance rates and access to a broader investor base. While cost-effective, these structures come with added reporting and tax considerations.

4. **Investor Sensitivities and Best Practices:** Despite some LP concerns—especially when NAV financing is used for distributions—investor attitudes are evolving. Early LP engagement, transparency, and alignment with the fund's strategy are key to successful implementation.

INCREASINGLY WIDE USE CASE

NAV financing extended to private equity funds has an increasingly wide use case, and we are seeing them used not just to fund follow-on investments later in a fund's life cycle but also to fund new acquisitions in more recently launched funds. An accompanying feature has been the inclusion of "certain funds" provisions in some facility agreements to ensure that the initial acquisition financing made available by way of a NAV financing is available to the borrower with limited conditions. NAV financing can also be valuable in bridging receipt of disposal proceeds for an asset where there is a longer time frame between signing and completion.

ENFORCEMENT RISK

One of the concerns for LPs with regard to NAV financing is enforcement risk – can the lenders step in and sell the investment portfolio, likely at a discount, in the event of a default? There are various methods to address this concern, both via documentary terms (including generous acceleration grace periods) and structuring – NAV financing can, for example, be lent to SPVs established alongside the fund structure, with recourse to distribution proceeds from the fund's assets via turnover arrangements with investment holding companies, rather than direct recourse to the portfolio assets.

SECURITIZATION FACILITY

NAV financing for credit funds looks quite different to those borrowed by private equity funds, and are more likely to take the form of a securitization, given that there can be fixed eligibility criteria in respect of the underlying portfolio. A key benefit of a securitization facility is that a borrower can borrow at a higher advance rate against its portfolio than a standard, non-securitized NAV financing. It also brings in a much wider pool of investors, particularly if the product is rated, such as pension funds and insurers. For banks, the regulatory capital treatment for a securitization tends to be more favorable, which pushes the pricing down. On the other hand, there are reporting obligations with securitizations, which may add to the administrative burdens of the fund.

It is prudent to also bear tax considerations in mind when structuring NAV financing as different arrangements can lead to very different tax impacts for LPs and potentially disturb structures put in place in respect of specific investments.

INVESTOR SENSITIVIES

Similar to GP-led secondary transactions, NAV financings remain a point of sensitivity for some investors, particularly when these facilities are used for investor distributions. However, the picture is ever developing. For example, contrary to much of the press implying that LPs are instinctively averse to NAV financing, certain investors have sought to use NAV financing and other forms of leverage against their LP stakes to raise liquidity for themselves. Likewise, as touched on above, there are various documentary and structuring means by which key LP concerns around NAV financing can be addressed. When using any type of liquidity tool, having early engagement with LPs and giving consideration to gaining the LP Advisory Committee's approval for the transaction is essential (even where approval may not be technically required under the fund documents), alongside robust disclosure to investors, including a full explanation of the transaction, the assets in question and the fund's methodology for valuing those assets. Ultimately, the key is that the right liquidity solution is used with the right portfolio at the right time.

CONCLUSION

We expect NAV financing to become ever more mainstream and for LPs to become more comfortable with their use, within defined parameters, in the same way as with capital call facilities. Margin loans, repos and other derivative solutions have also found their place within the arsenal for some managers / GPs, although more general adoption will be impacted by their pricing as compared with other liquidity solutions.

If you would like to discuss NAV financing or explore other liquidity solutions, please feel free to reach out. Our team would be delighted to share our insights and assist you in navigating different liquidity solutions with confidence.

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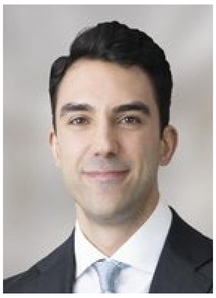

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