

## NAV FINANCING AS AN ALTERNATIVE SOURCE OF FUNDING FOR EUROPEAN CLO MANAGERS

### THE RECENT SPOTLIGHT

Net asset value (“NAV”) financing has been a feature of the fund financing world for the past couple of decades<sup>1</sup>. More recently however, it has been viewed as an increasingly popular alternative source of funding for European CLO managers, particularly in light of a challenging 2022 – 2023 for CLO issuance.

### NAV FACILITIES IN A NUTSHELL

Unlike a fund subscription facility, which in summary, is a financing line secured primarily by undrawn LP capital commitments and the GP’s right to issue capital calls, a NAV facility is typically a private facility provided to a fund which is backed by the fund’s assets.<sup>2</sup>

A key distinction of NAV facility documentation compared to other credit lines is the inclusion of a borrowing base calculation based off the “net asset value” of the portfolio (i.e., the borrowing base will likely account for write-offs or significant declines in value of assets held, as well as the liabilities of the fund). To the extent utilised in a CLO context, the borrowing base would likely be similar to those seen previously in (what are now very uncommon) mark-to-market warehouses, with reference being made to the then market value of the underlying loan portfolio, net against any liabilities of the warehouse vehicle (e.g., administrative expenses).

### HOW MIGHT IT PROVE USEFUL FOR A EUROPEAN CLO MANAGER?

A NAV facility could provide interim funding before a CLO takeout to the extent a warehouse is nearing the end of its term, which may prove particularly useful if market conditions make issuance difficult, or could be used from the outset of a transaction as an alternative to a pre-CLO takeout warehouse line of credit. NAV facilities may also prove useful in the context of a permanent warehouse structure, a model adopted previously by some leading European and US origination funds.

Recently a lot of attention in the press has been given to middle market CLOs, which have historically been confined to the US market but are now increasingly likely to launch in Europe in the near term. NAV facilities may prove useful to direct lenders looking to access alternative sources of funding for their private credit portfolios, and given persisting rating agency concerns in Europe, could be structured as an unrated private financing instead of a publicly listed bond issuance.

### FEATURES OF A NAV FACILITY

- *Available facilities:* Subject to a borrowing base calculated by reference to the net asset value of fund interests satisfying eligibility criteria and within the parameters of pre-agreed concentration limits (structured similarly to a CLO).
- *Term:* Can be structured longer-term than CLO warehouses without the pressure of needing to complete a CLO takeout within a set timeframe.
- *Liability spreads:* Liabilities would not necessarily accrue spread from day one.
- *Management fees:* Unlike most CLO warehouses, collateral managers can obtain management fees under NAV facilities.
- *No rating of the debt:* As with a CLO warehouse, there is no strict requirement to have rating agencies rate the debt provided.
- *Security:* Similarly to a CLO, security would be granted over the assets and the various accounts of the borrower.
- *Prepayments:* In the event that the ratio of advances outstanding under NAV Facilities to the borrowing base (the “LTV Ratio”) exceeds a specified threshold, the NAV facility will often require the borrower to prepay loans in order to bring the facility into compliance with the maximum LTV Ratio.
- *Subordination and tranching:* In a CLO context, a NAV facility would most likely have tranching and subordination and be structured as a securitisation, with (i) those NAV facilities leaning towards the private middle market CLO type structure likely having senior through to mezzanine lenders, supplemented by a large equity piece at the bottom of the capital stack, and (ii) private warehouse type NAV facilities having a more limited investor base, likely with a senior lender and limited third party equity.

## RECENT MARKET INTEL

Over the past twelve months there has been significant press coverage on PE firms and private credit firms ramping up their use of NAV financing as lenders, notably: (i) Apollo Global Management announced in August 2023 that it would be offering \$4 billion in NAV loans in the coming years<sup>3</sup>; (ii) in late October 2023, it was reported that AXA Investment Managers' Prime unit, the investment division of the insurance company, was raising a \$400 million vehicle to provide NAV loans to private market borrowers<sup>4</sup>; (iii) HPS Investment Partners is ramping up the volume of net-asset value loans it provides and is aiming to take its overall tally as high as \$2 billion by the end of the year<sup>5</sup>; and (iv) approximately 20 insurance firms are investing in NAV loans to private funds, including Pacific Life, Allianz Life, Protective Life, MassMutual and Equitable Holdings Inc<sup>6</sup>.

<sup>1</sup> According to 17Capital, 2022 was a record year for NAV financing across the private equity industry, with 50 per cent. growth in deal volume for the 12-month period ending September 2022. There was a 40 percent increase in the average transaction size during the same period.

<sup>2</sup> Outside of a CLO context, this could be its equity or other partnership interests it owns (for example, for secondary funds or "fund-of-funds" borrowers).

<sup>3</sup> "Apollo to Lend Over \$4 Billion to Struggling Buyout Firms", Bloomberg, Laura Benitez, 15 August 2023.

<sup>4</sup> "AXA IM Private Capital Unit to Launch NAV Financing Fund", Bloomberg, Swetha Gopinath, 26 October 2023.

<sup>5</sup> "HPS Targets \$2 Billion in Total NAV Loans as Competition Mounts", Bloomberg, Silas Brown and Laura Benitez, 10 May 2023.

<sup>6</sup> "Apollo's Athene Among Insurers Ramping Up Private Equity Lending", Bloomberg, Miles Weiss, 1 May 2024

## FOR MORE INFORMATION

This briefing provides an overview of some common features of the transactions discussed and is not intended to be exhaustive. It does not constitute legal advice and is provided purely for informational purposes. We recommend that you seek specific legal, regulatory, tax and accounting advice for any transactions that you wish to undertake.

Our Structured Finance team is available to discuss any of these issues with you and answer any specific questions you may have. If you would like more information about the topics raised in this briefing, please speak to your regular contact at Weil or to any of the authors listed below:



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