FUND FINANCE association

FFA spotlight

Demystifying GP Finance

a discussion with:

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FFA spotlight

Demystifying GP Finance

General Partner (GP) finance is emerging as a distinct and increasingly vital component of the fund finance landscape. Shelley Morrison caught up with Helen Griffiths, Anthony Lombardi, and Gianluca Lorenzon, to explore the nuances of GP finance, its structures, market evolution, and the strategic role it plays in fund manager development, succession planning, and competitive positioning. As the market for GP finance matures, understanding these nuances and building strong relationships with providers will be key to unlocking its full potential.

Shelley: GP finance appears to be a broad umbrella term that covers a wide range of different financing options and structures. Anthony, what exactly are we talking about here?

Anthony: There are three main types: There is GP financing, where the borrower is the GP itself and the financing will be secured against the commitment that the GP is making into its fund or funds, the distributions from its pledged commitments, (typically via a bank account pledge) any fee income, and potentially carry. Manco financing is very similar to GP financing, but the management company is the borrower, and the financing is secured against the management fee incomes that the manager receives. Then there is employee or co-invest financing, where employees or a vehicle owned by the employees receive financing, so that the employees can make their commitments into the fund and the distributions from their pledged commitments (typically via a bank account pledge). Similar to a GP financing, this is secured against the employee's commitments. Unlike other types of fund finance (such as NAV or subscription lines), GP financing is not secured against fund assets or uncalled capital, but rather against the relevant commitments, distributions from the relevant commitments and related income streams – it's a different type of credit risk.

Helen: GP financings are often relationship-led solutions. Sometimes they are put in place to support growth across different strategies and through different vintages as they evolve, other times they can be more concentrated, supporting a one or two funds' commitment and co-invest commitments. From a sponsor perspective, it creates very strong ties between the solution provider and the partners, as opposed to a subscription facility, which tends to be more led by the CFO or the capital markets team and have more of a transaction nature. As everyone is aware, there has been a huge evolution in the fund finance market and an influx of liquidity to different product types in the asset class; it's not just banks and credit funds anymore, and innovation in the type of solution allows providers to stand out from the crowd. For a sponsor, there are many different ways to create value for your GP or for your management and to allow leverage to support your growth and financial commitments.

Gianluca: GP finance has a different credit profile from other products. We generally view it as a very strong credit profile because the lender can often count on different sources of repayments from the GP stake or the management fees of the fund, or the overall pool of the Manco fees, or even from personal illiquid assets outside of the GP. There are different ways of arranging GP financing, and it is always nuanced, often complex and the transactions are frequently very small. Because of these factors, transactions are often hard to execute.

Demystifying GP Finance

Helen: Pricing remains hugely variable. New non-bank entrants in the market often require ratings to deploy capital and the GP finance market is no exception to this, which is helping GPs to access cheaper capital. There remain some bespoke arrangements with concentrated solutions or solutions for new manager, while alternatively a GP might be seeking financing for a single fund or a highly concentrated asset pool or continuation vehicles – here, the pricing becomes a little bit more of a hot topic.

Shelley: Given that this type of fund finance is quite distinct from other types of fund finance like NAV facilities and subscription lines, if I'm a GP, where do I go to discuss this? Which type of lenders are providing this type of finance?

Helen: Not all providers of subscription or NAV financing will be able to offer a GP solution. Some bank lenders provide this solution through their private client or private bank offering, and others have this as a corporate bank offering. Then you also have the relatively newer players to the GP finance market, such as the credit funds and non-bank lenders, who tend to offer a slightly different solution with longer tenors. This type of solution remains relatively bespoke and relationship-oriented. When the GP business is properly understood by the provider, this relationship will endure. The GP solution tends to remain with the original lender as the GP evolves, grows and develops. Capital call and subscription facilities tend to move around providers a little bit more and follow the lowest pricing, etc.

Gianluca: Liquidity in this financing segment has grown significantly over the last 24 to 36 months as more fund players enter the market and see it as a stand-alone product.

We are then seeing several banks responding and entering/re-entering this area to also do stand-alone GP financing – probably and sensibly – as a relationship unlocker. However, liquidity is still patchy because of the complexity of transacting coupled with the average deal size. Additionally, borrowers expect this to be priced as a very good credit which it generally is. You therefore get into a loop that is complex and cheap, so a number of players won't do them. Finally, there's a cultural aspect to this. We see that US managers are happy to pay significantly more than their European counterparts because they are more focused on the cost of capital relative to returns, whereas in Europe we find that people are much more focused on the actual cost of capital for the credit risk. However, as we are starting to see liquidity return, we see also a cultural shift from managers and accept, at least for now, that pricing is often a factor of scarcity as opposed to risk.

> **"Liquidity in this financing segment has grown significantly over the last 24 to 36 months as more fund players enter the market and see it as a stand-alone product"**

Anthony: We have seen lots of private credit funds become active in GP financing over the last 12 months and provide long dated facilities which can be slightly more expensive, but give more flexibility. Banks have responded to the competition and have also offered long or longer tenors.

Shelley: I've observed an increase in demand for GP finance over the past couple of years. It's a topic that's coming up more and more in conversations with GPs and the banks. Why is that?

Gianluca: It's a number of things. First, there has been a slow-down in exits. If a manager has not had many exits, the individuals maybe don't have the resources to commit their stake into a new fund so they will need to borrow. Second, fundraising is hard for most people right now, and if you can differentiate yourself by increasing your GP commitment to 4% rather than the standard – say 2% – all things being equal, you'd be preferred to your competitor. GP finance can then give a manager a competitive edge.

Demystifying GP Finance

Anthony: We definitely see pressure from some LPs for GPs to have more 'skin in the game'. Another thing we've seen is an increased focus on succession planning: there is more focus from LPs on how funds are putting their succession plans in place, and they are actually then demanding that some of the younger portfolio managers are part of the GP. GP financing is a tool which can be used to permit the newer members of the investment team to acquire their stakes in the GP as part of that succession planning. Finally, we're seeing diversification – established GPs are moving into additional asset classes such as PE moving into private credit, and other GPs are using GP financing to acquire whole investment teams to manage a new strategy.

Helen: Historically, GP finance was considered to be quite specialist and unusual, and there was concern that the LPs may not agree with the fact that they were leveraging their management fee. Due to increased transparency and communication with LPs and institutions like ILPA, it is now more acceptable to put leverage in place in relation to your own GP commitment and cash flows.

Shelley: Do you see any common barriers or roadblocks when working with a GP to put this type of solution in place?

Helen: We have encountered a fact pattern in which some partners wish to participate in a leverage solution and others don't, or where there are or have been exiting equity holders who can frustrate a 'normal' recourse package. I think it's fair to say that any barriers can typically be overcome through clever structuring. Yes, there will be variations and restrictions in LPAs and management agreements, but the main roadblock for a lot of providers in the market is really understanding the equity dynamic, discretionary and fundraising variables in free cashflow and being able to forecast how those will perform over the life of the facility. It's how these variables are modelled in the financial covenants and how growth optionality is factored in that sets one lender apart from the others. It allows a lender to show their understanding and sensitivity to partners' demands and exit plans and those who may have left the business historically. That, I think, is the relationship winner from a finance provider's perspective.

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Gianluca: These facilities are often not straightforward, as they can require bespoke structuring for the different structure setups, collateral pools and needs. It pays for a GP to do upfront due diligence to avoid surprises. However, lenders are very flexible in this area when it comes to trying to find solutions and understanding how to manage the eventual roadblocks.

Anthony: Understanding all the underlying documentation is really key. It's important to understand not just the GP or fund constitutional documents, but also any other material documents, including credit facility documents in place in the fund structure. These can have an impact on, for example, key person provisions; the flow of distributions or management fees going up to the GP, etc., which will impact key terms in a GP financing such as cash sweep mechanics or prepayment obligations. This is also particularly important when it comes to investor attitudes to GP financing. In one transaction we worked on recently, we had several different vintages of funds, and some of the older vintages of funds restricted the GP from pledging its commitment or raising financing, whereas some of the later vintages didn't. The GP had to get consent from the relevant LPs to pledge those vintages of commitment. ■

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