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Abi: Let us talk about fund finance at a broad level. Can you give us a background of how you work with PE funds and the type of services you provide them?

Jeff: *We are a group that specializes and has expertise in working with private equity. We are investment thesis agnostic and work with real estate funds, infrastructure funds, and distressed debt funds. We are one of the few groups who not only work with clients on subscription facilities but also work with them in connection with the day-to-day banking. It is a holistic offering of banking and lending services dedicated to specialization and expertise in the private equity and private capital space.*

Abi: Talking about subscription line facilities specifically, can you provide a quick rundown of how this space has evolved up until the COVID situation in terms of credit line repayment terms and the impact on fund performance?

Jeff: *In the early days of fund finance, most managers looked to bridge between capital calls, and so the credit facility was very short-term in nature. As the industry has evolved with the popularity of capital call lines of credit subscription facilities, the repayment terms have been extended. Managers understand that there is an IRR enhancement feature of these fund facilities and the longer you can delay calling capital from your LPs, you can mitigate the j-curve of private equity.*

Abi: How do LPs perceive the IRR enhancement?

Jeff: *It depends on the motivations of the LPs. Some LPs are judged based on the IRR of the funds that they invest in and make commits to and so have got very comfortable with the extended repayment terms of the subscription facility, and are happy with the IRR enhancement and positive impact that the fund facility can have. Other LPs who have committed to a PE manager to have their money put to work like the administrative and the organizational impacts of a subscription facility and sort of organizing capital calls or planning for capital calls on a quarterly or bi-annual basis. It depends on an LP by LP basis.*

Abi: Considering the current situation, are you seeing GPs looking to pay down these credit lines or draw on them given the dislocation in the current market? Any other recent trends you are seeing with respect to how GPs are using these lines of credit?

Jeff: *Covid-19 has impacted the private equity landscape and managers have responded accordingly. I would say in the first couple of weeks when there was quite a bit of uncertainty in the market, there were some additional capital calls that were being made, and there were some additional funding on the line, but I would say all were within the margins as managers responded to the changing environment.*

Abi: Has there been a slowdown in new credit line requests or are phones ringing off the hook to see how you can help your clients?

Jeff: *Within the last week, week and a half, several managers have come to the market raising opportunity funds, raising a sub fund that was part of an existing fund or an annex fund to take advantage of the opportunities. We have some funds amending their LPAs. We had one manager, who, because of all of the dislocations in the market, especially in their industry of expertise, amended their LPA's, so they could put 20% of the funds commitments into public companies because they saw an opportunity there based on where the public market was trading for their particular niche.*

Abi: As you mentioned LPAs, are these facilities put into place in parallel when the fund is raised, or is it something that often happens after a fund is launched?

Jeff: *I would say both, but we like to get involved early and especially for a fund that is still drafting their LPA. There's certain language that a lender who is in my shoes would like to get into that LPA to make it crystal clear that the fund can put a subscription facility in place, and can pledge their LPs commitment as collateral for the loan.*

Abi: One key topic everyone is likely interested in hearing about is liquidity, and this applies from both the GP as well as the LPs perspective. GPs are likely assessing the liquidity situation of their existing portfolio companies and LPs are assessing how much and how soon liquidity will be needed for future capital calls. What are you hearing in that area?

Jeff: *I think the industry overall has done an excellent job of communicating with each other so that you can see quite a bit of communication between the GPs and the LPs. Some managers have weekly calls with their LP constituents. The GPs are going portfolio company by portfolio company to analyze the situation and see what the liquidity levels are like and if there is a need there to use our line of credit and potentially put an additional line of capital.*

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You can use our subscription facility to facilitate a loan to the portfolio company. We call them portfolio company notes or subsidiary notes, where the portfolio company is the direct borrower and the fund is the guarantor and you are using the construct of the subscription facility to put that line in place so if there are any portfolio companies that have liquidity needs and the fund is willing to guarantee, it is a great product for putting a bridge in place for a portfolio company to work through the next 12 to 18 months.

Abi: Are these portfolio company notes something new that you are doing to address the current situation or is that something that people are aware of and exists already in the market?

Jeff: *I think there is an awareness level as this has been out there and has been done before. It works better in times like this when the financing markets are a little tighter and banks become more conservative to offer decent terms. Some portfolio companies, especially the ones who have short term liquidity needs, could use these loans which are guaranteed from the fund and are relatively cost-efficient and cost-friendly thereby allowing them a little bit of extra time to stabilize themselves and then go back to the traditional financing markets.*

Abi: One of the disclosures we come across when supporting our clients monitoring covenants is the callable capital attributable to defaulting partners. LP defaults is likely a sensitive subject but how do you perceive your risk in the light of how other asset classes have trended (equity markets specifically with the denominator effect) and how in your view can GPs and LPs work together to ensure capital calls are met timely and that the LPs have plenty of notice?

Jeff: *LP defaults are rare and extremely rare under normal circumstances. Under Covid-19, the industry itself was fearful that this could be a time when we see LPs default. But, so far so good, we have been extremely lucky in that all of the bankers and Industry participants that I talk to, no one has seen any LP default and where they have, it has been sort of late payers administrative issues with folks working from home, maybe a high net worth individual with a liquidity issue but that high net worth individual makes up less than one percent of the overall commitments to the fund.*

Abi: Another area we help our GP clients monitor is the impact of the cost of leverage on performance, how has the change in the interest rate environment since the onset of the pandemic been reflected in new business?

Jeff: *I think that we have seen pricing trending up in response to the Covid-19 situation. Some of the banks have re-evaluated the risk of their portfolio and are not as keen to take up new businesses. As a result, we have pricing trend up anywhere from 25 to 75 basis points.*

Abi: Let's talk about scenarios now. Assuming we start to turn a corner in the back half of the year, what are your expectations on GP behavior as it relates to leveraging credit lines to put money to work given likely lower valuations?

Jeff: *We are hopeful and believe that there could be quite a rush of deal flow in Q3 and Q4, making for a very busy fall and winter. We are hoping that things normalize a bit and that a lot of transactions that were to close are folks that were looking opportunistically at opportunities because of the revaluation of assets and hopefully that pushes through to Q3 and Q4.*

Abi: Conversely, If we see a protracted shutdown along with worse than expected portfolio valuations, where do we see the GP shaking out in the same context?

Jeff: *If Covid-19 tends to be worse and we're all still stuck at home then you may not see as many deals. I think there's a lot of price discovery going on and, that's a significant component of whether or not these deals are going to be able to get done. If the buyers and sellers can agree on valuations or can't agree to the price, it's going to make it very hard for this scenario where there's a flood of deals in Q3 and Q4. So hopefully, that price discovery shakes out, and that willing buyers and willing sellers marry up.*