

## ILPA Issues New Guidance on NAV-Based Facilities

The Institutional Limited Partner Association (ILPA) has released its guidance on NAV-based facilities. The use of such facilities has expanded in recent years and the trend is expected to continue as General Partners seek additional liquidity at the end of the investment period, or once all commitments have been drawn.

NAV-based facilities are credit lines collateralized by all or part of a fund's investment portfolio and / or investment cash flows. NAV-based facility proceeds may be utilized to provide further funding to investments, pay expenses or accelerate distributions to investors. In contrast, subscription lines of credit are collateralized by Limited Partner commitments, and utilized to manage the timing and frequency of capital calls, particularly through the fund's investment period.

Often, one or more Special Purpose Vehicles (SPVs) are created to facilitate the NAV-based borrowing and the holding of collateral. The use of NAV-based facilities and associated SPV structures can result in a lack of transparency to Limited Partners with respect to loan terms, recourse to collateral, borrowing costs, and impact on unfunded commitments and performance, especially when loan proceeds are used to fund distributions. Recent discussions around levered performance have focused on subscription lines of credit; given their increasing prevalence, NAV-based facilities are now coming into focus. (Note that performance reporting will be separately addressed in ILPA's Quarterly Reporting Standards Initiative).

Consequently, ILPA has recommended that General Partners engage more proactively with Limited Partners around the use of NAV-based facilities, including:

- Absent explicit LPA language permitting the use of NAV-based facilities, the General Partner should obtain consent from the fund's Limited Partner Advisory Committee (LPAC) prior to entering into such an arrangement.
- Regardless of whether such explicit language exists, LPAC consent should be obtained to utilize the proceeds from a NAV-based facility to fund a distribution. Otherwise, the LPAC should be informed of the intent to utilize facility proceeds for other purposes.
- Future Limited Partnership Agreements (LPAs) should articulate the permissible uses of NAV-based facilities and establish borrowing limits.
- Once a NAV-based facility has been established, the General Partner should disclose to all Limited Partners the rationale for using the facility, its key terms (including size, interest rate, repayment terms, etc.), use of SPVs, collateral and other covenants, conflicts of interests, required consents and credit rating, if applicable.

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ILPA's guidance document is laid out as follows:

## **PART 1: Overview of NAV-Based Facilities and Current Market Practices**

A discussion of how NAV-based facilities are structured, the roles of lenders and rating agencies and how the Private Equity industry is currently using NAV facilities.

## **PART 2: LP Concerns Regarding NAV-Based Facilities**

A review of challenges that Limited Partners face when their managers use NAV-based facilities. This includes limited transparency and governance around NAV facilities, and specific challenges when a facility is used for a distribution or to support the existing portfolio.

## **PART 3: Recommendations for Improved Transparency and LP Engagement**

ILPA recommends that if the LPA does not give explicit permission to utilize a NAV facility General Partners should engage the LPAC for consent prior to implementing a facility. ILPA also recommends that General Partners should engage the LPAC for consent to utilize a NAV-based facility if the intended use case is for a distribution, regardless of LPA language.

## **PART 4: Proposed Legal Documentation**

ILPA recommends that General Partners and Limited Partners adopt language in LPAs moving forward that set guardrails around permissible uses of NAV-based facilities. This legal language should appropriately define "NAV-based Facilities" and set a clear limit to the amount a General Partner is able to incur through a NAV facility over the life of the fund.

## **PART 5: Recommended Disclosures Related to the Use of NAV Based Facilities**

ILPA recommends that General Partners disclose the rationale for the facility, the key terms of the facility and how any conflicts related to the facility were managed to all Limited Partners in the fund.

Further information can be obtained from the ILPA website (<https://ilpa.org/industry-guidance/principles-best-practices/nav-based-facilities/>) or from your Gen II representative.

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