

Private Credit January 2025

Fund finance: NAV financing unlocked

Partners Group's 360° examination of NAV-based facilities from the perspective of lenders, borrowers and fund investors

Key takeaways

- **The market for NAV financing, a form of fund-level lending that is primarily backed by the net asset value of the underlying fund, is estimated at USD 100 billion and is expected to grow significantly**
- **NAV solutions can enhance value for LPs through additional investment capacity and efficient capital management, but transparency and clear purpose are key**
- **For GPs, the evolving NAV financing market offers a wider array of fund financing options and flexible, cost-effective access to capital**
- **With a focus on capital preservation and bespoke structuring, NAV lenders can achieve attractive risk-adjusted returns**

In recent years the private markets industry has been presented with a range of fresh challenges including a tough environment for asset exits and slower fundraising processes. In this context, net asset value (NAV) financing has emerged as a potential tool to address some of the industry's pivotal issues. The market for NAV solutions is estimated to be USD 100 billion currently and is expected to grow significantly in the future.

We believe that NAV financing can play a beneficial and transformative role within private markets both in the current market environment, but also in the longer term.

Our broad investment platform has allowed us to gain exposure to NAV financing activities from many perspectives over the years. On one hand, as a

general partner (GP), we may consider prudently adopting these solutions to strengthen our own funds. On the other, we also operate as a limited partner (LP) through our partnerships business, investing in funds raising such credit facilities. More recently, we have expanded our Private Credit capabilities in this space, providing NAV facilities to a range of private markets managers.

While recognizing the differing views on NAV financing across the broader market, we leverage Partners Group's differentiated position to analyze the case for NAV financing from the LP, GP and NAV lender angles.

In this paper, our goal is to provide a nuanced and insightful understanding of NAV financing and its potential impact on private markets.

The authors



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The LP perspective: Enhancing portfolio value

As an investor with over 25 years of experience investing in more than 2,200 private markets funds globally and with over 280 advisory board seats, we have observed a marked increase in discussions around the adoption of NAV financing in recent years. With our position as an investor in funds using these facilities, we have carefully assessed their potential benefits and implications from an LP's viewpoint.

Our experience demonstrates a growing potential for using NAV-based facilities to enhance portfolio value. In practice, these solutions can create additional investment capacity for a fund and enable more efficient management of capital, allowing funds to deploy 100% of committed capital to maximize returns.

Examples include the provision of capital for new platform investments and add-on acquisitions for portfolio assets, as well as for repaying debt at the portfolio company level.

However, we see some opaqueness in the interactions between LPs and GPs with regards to NAV facilities.

In certain instances, Limited Partnership Agreements (LPAs), particularly in older funds, lack clarity on the process that GPs are required to follow when raising a NAV facility. This lack of transparency has given rise to misaligned expectations, with some LPs expressing frustration when GPs undertake NAV facilities without involving or notifying their investors. Additionally, some investors have raised concerns regarding the potential use of NAV facilities by GPs to bolster underperforming investments or as distributions to LPs. In these cases, clear communication and interaction with LPs are even more critical.

Clarity is paramount

As LPs, we seek transparency and effective communication from the GPs we invest with, and this expectation also applies to the use of NAV financing. GPs should clearly outline the rationale for using these financing tools and demonstrate the added value they can deliver to investors. In newer fund vintages, we are increasingly witnessing the inclusion of specific language pertaining to the use of NAV facilities in LPAs to enhance clarity and align expectations.

As an LP, Partners Group is increasingly advocating for transparency regarding NAV financing, including recommendations on engagement within Limited Partner Advisory Committees and clear language on expectations around the use of NAV facilities in new LPAs.

We believe such initiatives can help bring clarity for all stakeholders. While each situation requires individual evaluation, we are open to the use of NAV financing when its value to investors can be clearly articulated and justified.



Christopher Bone
Partner, Head of Private Credit Europe/Asia

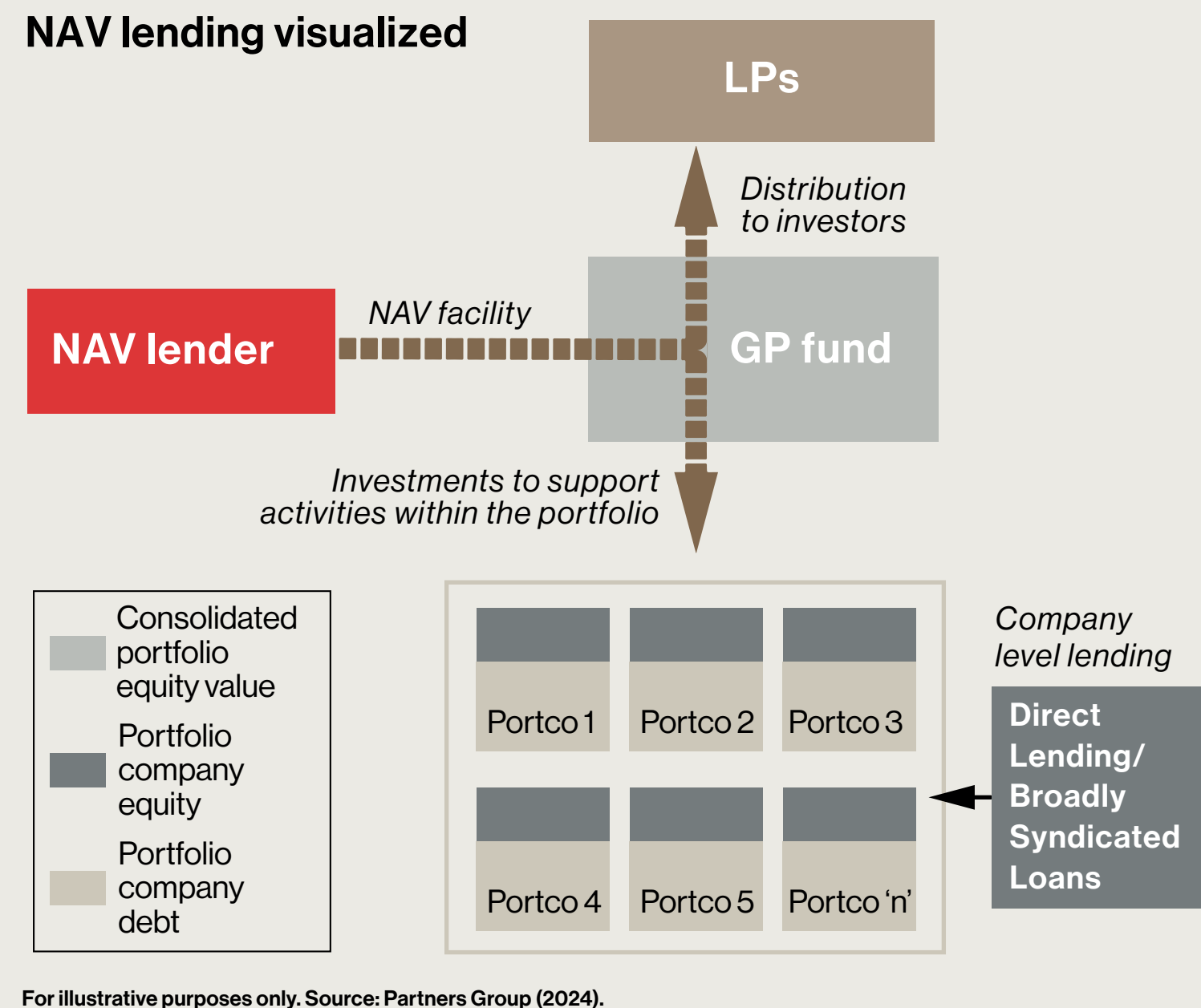
“We leverage Partners Group's differentiated position to analyze the case for NAV financing from the LP, GP and NAV lender angles.”

What is NAV financing?

NAV financing is a form of fund level lending that is primarily backed by the net asset value (NAV) of the underlying fund. These solutions can be used as a liquidity tool across various fund portfolios in different asset classes. While NAV financing within private equity portfolios has become a more prominent solution recently, it has been a part of the financial landscape for many years, with semi-liquid, secondary and credit funds traditionally using these solutions.

This type of financing can be used to support activities within the portfolio, such as financing acquisitions or facilitating distributions to investors. The broader diversification of assets within a portfolio allows GPs to secure more favorable terms and pricing, with greater flexibility in the structure.

In some cases, lenders could request for the NAV loan to be evaluated by a rating agency. A credit rating reflects the credit worthiness of the fund, with a higher rating typically resulting in lower interest cost on the NAV loan.





Victoria Stewart
Global Head Fund Financing

“While NAV financing has been around for many years, the more recent development of these solutions for private equity funds is a valuable expansion of the fund financing toolkit. This is creating more versatile solutions catering to diverse needs, allowing us to put in place the most value-enhancing structure for our specific objectives.”

The GP perspective: Expanding the financing toolkit

Partners Group has an in-house Fund Finance team dedicated to raising and structuring fund-level financing solutions, including NAV financing, to our funds. While as a GP we prioritize the prudent use of debt and emphasize the necessity of justifying the need and cost of a NAV facility, we aim to be at the forefront of market innovation, actively exploring new tools to address the individual needs of each portfolio and maximize the value created for investors.

Our view is that the growing market for NAV financing is a valuable expansion of the fund financing toolkit, offering a cost-effective means to

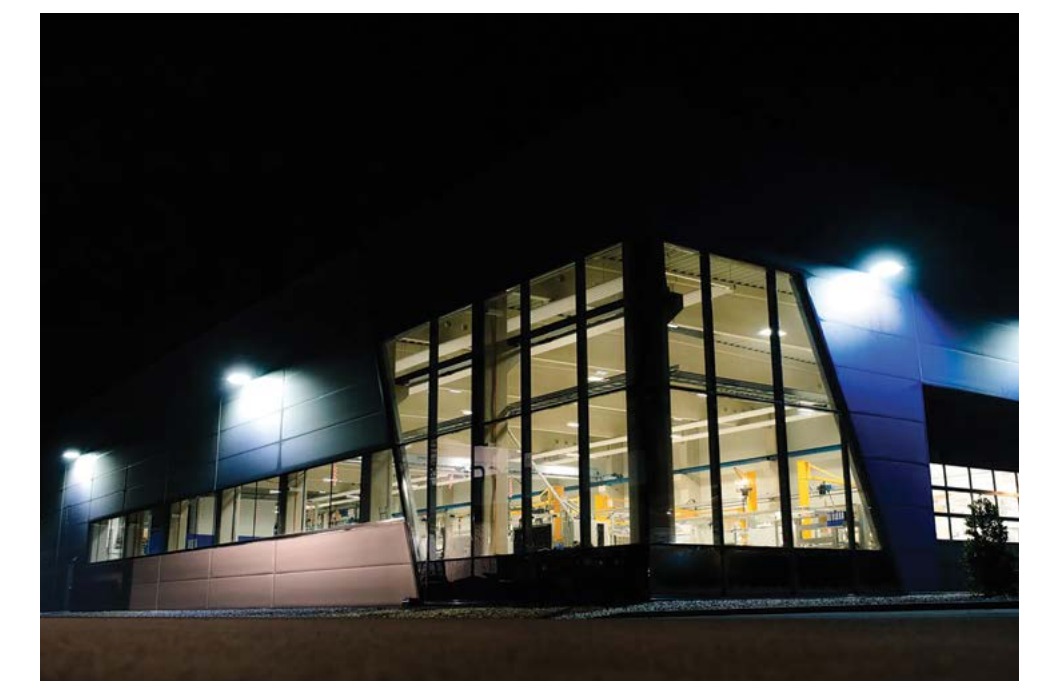
access capital. Specifically, these solutions provide lenders with portfolio diversification characteristics through the cross-collateralization of the portfolio, which ultimately can reduce the cost of debt for borrowers. Furthermore, their versatility offers GPs a wide range of use cases relevant to different market environments and objectives.

Prudence through flexibility

In a positive development for GPs, the expanding and evolving NAV financing market is introducing more versatile solutions that cater to a diverse range of needs. For instance, GPs that prioritize flexibility and maintaining control over portfolio companies can opt for a "recourse-lite" structure, which provides lenders with recourse over cash flows from asset realizations but not over the GP's underlying equity stakes.







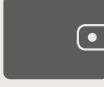



In structuring NAV facilities for our portfolios, our Fund Finance team dedicates considerable effort to selecting the most appropriate and value-enhancing structure.

This includes a comprehensive discussion of the security package associated with the facility, pricing, loan-to-value (LTV) ratio and the use of proceeds. This meticulous approach helps ensure the optimal outcome for the fund and aligns with our commitment to maximizing the value delivered to our investors.



NAV lending levers

Selected parameters typically available for GPs to customize NAV facility packages

- | | |
|--|--|
|  ✓ Security package
Secured / Unsecured |  ✓ Cash sweep mechanisms |
|  ✓ Provider
Bank / Fund |  ✓ Day 1 drawn amount
Fully drawn / Undrawn |
|  ✓ Use of proceeds
Portfolio investment / Distributions |  ✓ Covenant headroom |
|  ✓ Pricing |  ✓ Valuation challenging rights |
|  ✓ Opening Loan-to-Value (LTV) Ratio |  ✓ Maturity |



Katherine Bradbrook
Private Credit

“Conservative LTV ratios, covenants and cross-collateralization ensure robust protection and stable returns, creating an attractive risk-return profile for NAV lenders.”

The NAV lender perspective: Balancing protection and opportunity

With over 20 years of experience in Private Credit, Partners Group provides a diverse range of asset-level financing solutions, including Broadly Syndicated Loans and Direct Lending. Recognizing the appealing risk-return profile of NAV lending, we have expanded our internal capabilities and made a series of NAV lending investments to private equity portfolios. As investor interest grows, we have also recently launched a dedicated Fund Finance Strategy. In our capacity as lenders, our focus centers on capital preservation and ensuring maximum downside protection for our investments. We believe NAV facilities include several features which minimize downside risks, including conservative LTV ratios, maximum LTV covenants, and cross-collateralization across a diversified asset portfolio ensuring multiple cash flows for debt repayment.

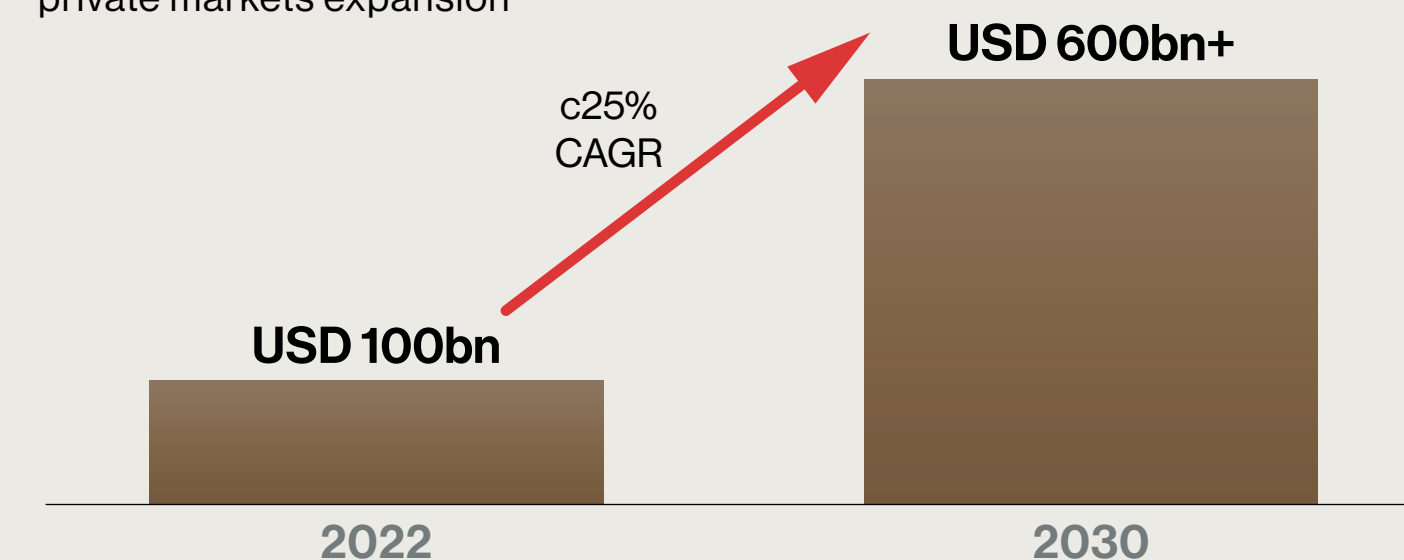
Additionally, since these facilities are tailored to the profile of the underlying portfolio, lenders can negotiate bespoke structures (including security packages) that address the specific risks applicable to any given portfolio.

Market opportunity

We see great potential for the expansion of NAV financing as an investment strategy, along with adjacent fund finance products including LP and GP financing. Market growth is supported by the overall expansion of private markets funds and the increasing penetration of these solutions as they become more accepted and understood.

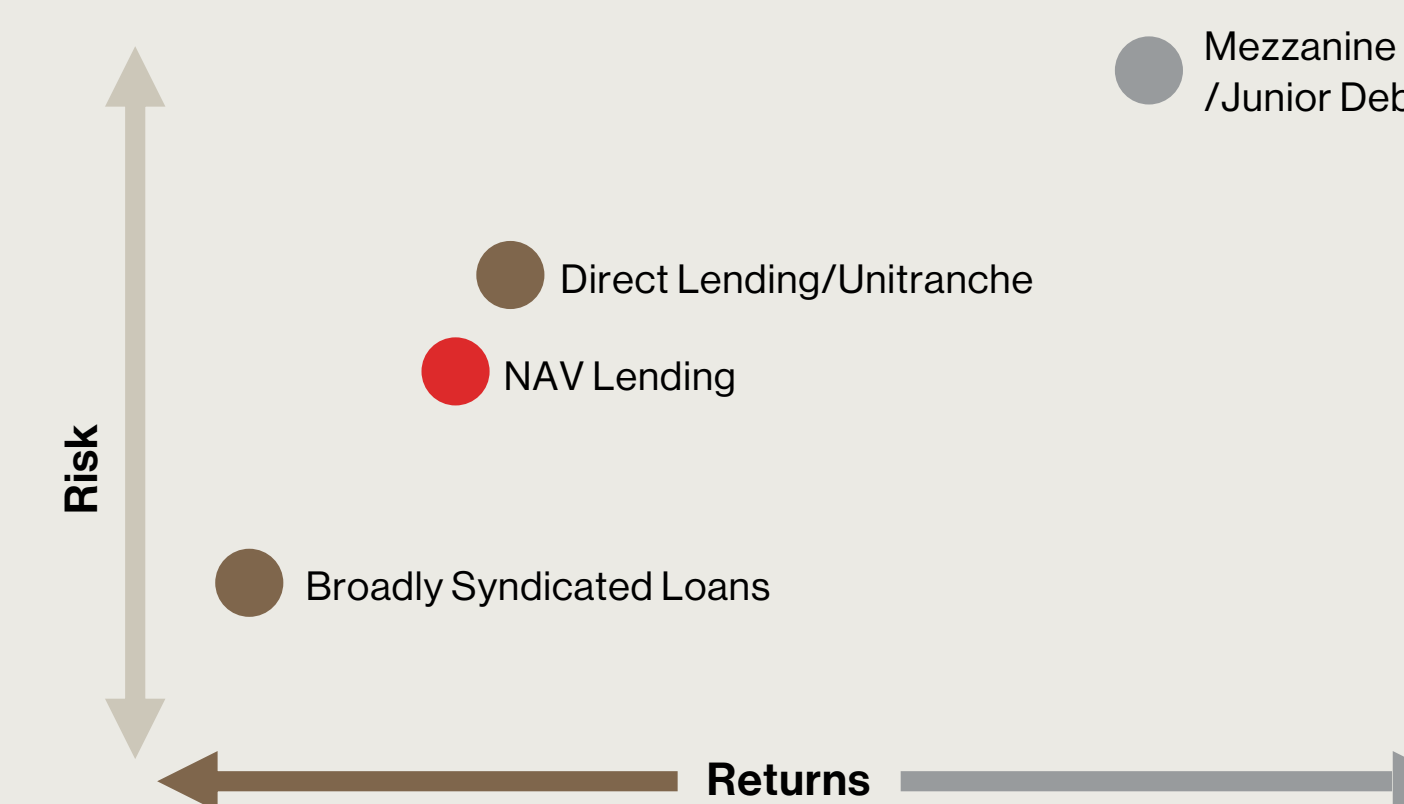
NAV financing market opportunity

Global growth projection based on expected market uptake and private markets expansion



Source: Prequin (2023). For illustrative purposes only.

Risk-return analysis of private credit solutions



For illustrative purposes only. Source: Partners Group (2024).

Moreover, we anticipate sustained demand for NAV financing in the coming years as a significant amount of funds will enter their mature phases, which is precisely the time when the use of NAV facilities becomes more relevant. In our view,

this combination of factors offers a long-term runway of opportunities for NAV lenders.

We are well positioned to address the opportunity set in the NAV financing market. Through our global investment platform, we have established relationships with hundreds of private equity sponsors. Our relationships are multi-faceted, with multiple teams across the platform interfacing with a sponsor. Given our background in Private Credit, we take a bottom-up investment approach to assessing each NAV loan, analyzing each individual company in the portfolio.

Navigating an evolving landscape

As the new macroeconomic regime solidifies, we anticipate the factors driving demand for NAV financing in recent years to evolve into long-term trends. The need for flexibility, liquidity and efficient capital management within funds is becoming increasingly prevalent across regions, asset classes and fund sizes, thereby creating a dynamic and expanding opportunity set for lenders.

With this 360° examination of NAV financing, we aimed to identify the benefits and implications of this innovative financing solution for the various stakeholders.

Our assessment emphasizes that transparency and a clear purpose are essential in justifying the value of NAV facilities to LPs. The addition of NAV-based facilities to the financing toolkit presents a promising opportunity for GPs, while lenders could potentially expand into a growing asset class with an attractive risk-return profile and downside protection. In the evolving landscape of private markets, balancing innovation and prudence will be key to ensuring that the expanding opportunities presented by NAV financing benefits all stakeholders.

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