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Country chapters

The evolution of subscription facilities in light of changing fund structures and financing needs

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Introduction

A subscription facility, also known as a capital call facility, is a credit facility made available to a private investment fund that is typically secured by (1) the unfunded capital commitments of the fund's investors, (2) the fund's rights to call capital, receive capital contributions and enforce the investors' funding obligations, and (3) the fund's bank account into which capital contributions are deposited. Fund borrowers can use capital call facilities for a variety of purposes, including to:

- bridge investor capital calls and other sources of capital that may not be ready at the time of an investment;
- avoid the need to call capital well in advance of closing an investment, or return capital contributions to investors if the investment is delayed or does not occur;
- smooth out investor capital calls by grouping them on a periodic basis rather than calling capital for each investment;
- avoid rebalancing between the initial and final closings of the fund;
- pay fees and partnership expenses, including organisational costs of the fund;
- cash collateralize hedging exposure with same or one business day's prior notice of borrowing;
- provide longer-term leverage during the life of the fund;
- enhance the fund's internal rate of return (or "IRR");
- obtain loans for portfolio companies (with a fund-level guarantee) at cheaper rates than may be available at the portfolio level; and
- issue letters of credit and provide other credit support for portfolio level activities.

More than a dozen years ago, capital call facilities were most commonly seen as relationship loans to real estate funds for the purpose of bridging capital calls to a large number of highly rated, institutional investors. The early facilities were often demand lines or 364-day lines of credit (renewable annually) provided by a single bank on either a committed or an uncommitted basis. It was not unusual for a fund sponsor to wait until after a fund's final closing to put a subscription facility in place and to terminate the facility when the fund's investment period ended. Over the last decade, however, as fund sponsors have become more cognizant of the various benefits afforded by capital call facilities, they have sought to put these facilities in place: (1) as soon as possible after the fund's initial closing; (2) so as to continue after the end of the fund's investment period; (3) for multiple borrowers, including the main fund, parallel funds and alternative investment vehicles, as well as holding or portfolio companies (i.e., "qualified borrowers") below the fund level; (4) in multiple currencies, to support the fund's global activities; (5) across a range of fund types, including private equity, real estate, energy, infrastructure and debt funds and funds-of-one; and (6) from a syndicate of lenders in larger facility amounts, to accommodate all of the fund's borrowing needs during its life, including the ability to increase the facility size on a permanent basis during fundraising, and on a temporary basis to finance specific investments.

At the same time that funds are making increased use of leverage, sponsors are responding to fund investment needs and investor demands by offering more alternative (and often complex) fund structures. The subscription facility market has expanded significantly to address these changing fund structures and increased financing needs. This article aims to highlight how evolving fund structures and changing needs for fund financing are playing out in the subscription facility market.

Fund structures: parallel funds, alternative investment vehicles, feeder funds, blockers & funds-of-one

Fund structures were initially straightforward: investors came directly into a single fund by subscribing for an interest in, and agreeing to make capital commitments to, a limited partnership. However, as sponsors broadened their investor base, this simple structure has evolved to accommodate new investors' legal, tax, regulatory, accounting and other needs. As a result, funds that used to operate as a single limited partnership now encompass various entities, including parallel funds, alternative investment vehicles, feeder funds, blockers and funds-of-one.

Parallel funds. In order to address the preferences of certain investors, including, for example, tax-sensitive investors focused on limiting exposure to unrelated business taxable income, many sponsors offer alternative options for investment known as parallel fund vehicles. A parallel fund is a sister to the main fund, has a separate pool of investors, and invests on a *pro rata* basis with its related main fund in each investment. By grouping all investors who share a similar structuring need in a single, separate parallel vehicle, the sponsor can address their need without impacting the manner in which other investors participate in investments. A parallel fund often has fewer investors than its related main fund and therefore a smaller pool of capital. However, because a parallel fund invests alongside its related main fund, the parallel fund will likely have similar borrowing needs as the main fund.

The limited partnership agreement of a parallel fund and its related main fund are typically interconnected in a number of key respects, including with respect to the overcall mechanics in the event of an investor funding default or excuse. For example, if a limited partner in the main fund defaults on a capital call or is excused from a particular investment, all of the non-defaulting (or non-excused) investors – including limited partners in the parallel fund – may be required to increase their capital contribution to make up the deficit. In such a case, the non-defaulting (non-excused) investors' obligations to contribute additional capital would be capped by their unfunded capital commitments, and would likely be subject to other limitations (e.g., an investor cannot be required to fund more than 150% of the initial capital contribution funded). Similarly, the main fund and its related parallel funds typically vote on a combined basis.

Alternative investment vehicles. Alternative investment vehicles ("AIVs") may also be created to address investors' tax and regulatory structuring needs for a particular fund investment or a subset of the investments made by the fund (for example, if the portfolio company is structured as a flow-through entity for tax purposes). The partnership agreement of the master fund entity (i.e., a main fund or parallel fund) will provide that its general partner has the authority to structure the making of all or any portion of an investment through an AIV and, as a result, each investor is obligated to make capital contributions directly to the AIV to the same extent, for the same purposes and on the same terms and conditions as they are required to make capital contributions to the related master fund. Capital contributions to an AIV reduce the unfunded capital commitment of each investor to the same extent as if the capital contributions were made to the master fund, and the investment performance of each AIV is typically aggregated with that of the master fund for purposes of the fund's waterfall.

Feeder funds. A feeder fund is an investment vehicle that "feeds" or invests into a master fund which, in turn, will invest the contributions of the feeder fund and any other investors. Rather than committing capital to a master fund, an investor may choose to sign a subscription agreement directly with a feeder fund. Feeder funds provide flexibility for certain investors with tax or regulatory concerns by, for example, electing to be taxed as a corporation for US federal tax purposes and thereby blocking certain undesirable tax attributes. Certain tax-exempt investors and foreign investors may choose to invest through a feeder structure taxed as a corporation to block unrelated business taxable income ("UBTI") and effectively connected income ("ECI"), respectively. Additionally, some sponsors may establish an aggregator fund for high net-worth individuals, which in turn acts like a feeder fund into a master fund.

Blockers. If a fund makes an investment that may result in its investors incurring UBTI or ECI (for example, if investing in an operating company that is itself a partnership or LLC or investing in real property), the fund may allow certain investors to make their capital contributions to a blocker entity, which is typically taxed as a C-corporation, as opposed to contributing directly to an AIV. A main benefit of this approach is to shield non-US investors from having to pay US income tax and file a US federal tax return, and to shield tax-exempt investors from recognising UBTI. Some funds will create a separate blocker for each flow-through investment that an AIV makes. Unlike a feeder fund, investors do not commit capital to blockers and there is no separate subscription agreement signed by an investor and the blocker. Additionally, depending on the ERISA and tax sensitivities of investors electing to contribute capital to blockers, the organizational documents of blockers will often specifically require that once capital is contributed to the blocker, the monies can only be contributed to the AIV(s) into which the blocker invests.

Funds-of-one. As the private funds market has evolved, funds have expanded their offerings to investors, and many large institutional investors have shifted to writing bigger cheques to a smaller number of funds. This trend has driven the rise of "funds-of-one", which are fund vehicles with a single limited partner. The fund-of-one approach provides a highly negotiated, customized product for an investor who wants more control over its fund. A fund-of-one may allow the single investor different economics from the investors in a commingled fund, or allow the single investor to create bespoke investment guidelines, including allowing for a wider approach than the focus of the master fund, and flexibility to invest across different asset categories over time. Additionally, a fund-of-one may be structured to insulate the investor from the overcall mechanics a classic commingled fund requires. This feature is particularly attractive to investors whose mandate or regulatory situation demands that they not have their capital commitment "collateralize" or backstop the capital commitments of other investors. The fund-of-one option offers this protection but still allows for investing with a related master fund.

Implications of fund structures on the borrowing base

The first subscription facilities were offered as relationship loans from a single bank to a preferred sponsor's commingled main fund. Early subscription facilities envisioned a simple borrower structure where all investors invested in a single fund. Typically, these facilities had minimal reporting obligations and included a simple coverage test requiring the fund to maintain sufficient uncalled capital commitments (or a multiple thereof) of all of its investors to repay the fund's outstanding borrowings and other indebtedness. As fund structures have evolved and borrowing needs have increased both in terms of amount and tenor, subscription facilities have become more complicated and many now contain detailed borrowing tests as well as additional reporting and other compliance requirements.

Large, syndicated, longer-term subscription facilities now frequently include tests that measure borrowing availability against a borrowing base of eligible investor commitments, rather than a simple uncalled capital coverage test. Lenders diligence each investor in the fund (including their subscription agreements, side letters, ratings and financial information) and assign advance rates to the uncalled capital commitments of only those investors that are deemed to be creditworthy. Those advance rates might range from 60% to 100%, depending on the credit quality of the individual investor, and might further be subject to concentration limits so that no single eligible investor comprises an unduly large portion of the borrowing base. The credit agreement will also set forth a list of exclusion events (such as bankruptcy or non-payment of capital contributions that continues for an agreed period of time) that will result in an eligible investor being excluded from the borrowing base.

Calculation of the borrowing base. A borrower is typically required to calculate its borrowing base on a periodic basis, including at the time of each request for loans and letters of credit, promptly following a capital call from its investors, in the event that any eligible investor is excluded from the borrowing base and with each quarterly compliance certificate. If, at any time, a borrower's outstanding loans and letters of credit exceed its borrowing base, the borrower will be required to make a mandatory prepayment to restore borrowing base compliance.

The imposition of a borrowing base test is fairly straightforward with a single fund structure. However, with the formation of parallel funds and their separate pools of capital, lenders and sponsors are faced with a challenge: either each parallel fund has to meet its own borrowing base test, or the facility has to be structured with a single borrowing base such that all borrowers benefit from (and the bank is secured by) a pool of capital that combines the capital commitments of the main fund and each parallel fund. A single borrowing base provides funds with certain advantages. First, there are reduced administrative burdens with calculating a single borrowing base. Second, depending on the characteristics of its investor pool, a parallel fund may not be able to obtain a credit facility with sufficient borrowing capacity unless the borrowing base also includes commitments of the main fund investors.

Joint and several liability. In order to maintain a single borrowing base while allowing parallel funds to access the entire credit facility, the commitments of all investors need to be available to repay the obligations of all borrowers under the subscription facility. To achieve this, some lenders insist that the main fund and its parallel funds be jointly and severally liable. With this approach, each borrower is liable for the full amount of the debt, and the lenders may call capital from investors in either or both of the main fund or any parallel fund during an event of default, regardless of which entity borrowed. However, this approach could have some significant pitfalls. For example, many limited partnership agreements limit how much debt a fund can incur to a percentage of capital commitments. As there is often a large disparity in the amount of investor commitments to parallel funds compared to the main fund, making a parallel fund jointly and severally liable for the obligations of the main fund could cause a parallel fund to violate the debt or investment limits in its partnership agreement. Even worse, depending on the borrowing needs of the larger main fund, a smaller parallel fund could be rendered insolvent immediately upon the initial borrowing by the larger fund.[1]

Guarantees. Guarantees raise many of the same issues as joint and several liability, because partnership agreements often include guarantees in the debt covenant calculation. An alternative approach to joint and several liability or mutual guarantees is to require that the main fund guarantee the debt of the parallel fund, with the parallel fund only liable for its own debt (and not the debt of the main fund). This approach may be difficult for some sponsors to accept because it treats investors in the main fund differently from the parallel fund investors. However, the possible negative ramifications may be mitigated by having the main fund and parallel funds execute a reimbursement and contribution agreement, providing that each fund will reimburse the other fund if, as a result of any payment it makes under its guarantee (or as a joint and several obligor), it pays more than its fair share of the debt. However, despite some of the benefits of such an agreement, guarantees and joint and several liability may be problematic from a funds and/or tax perspective.

Cross-collateralization. As a result of the challenges posed by guarantees and joint and several liability, the subscription facility market has evolved such that many lenders will, instead, accept cross-collateralization between main fund and parallel fund borrowers. With this approach, borrowings by the main fund and any parallel fund are on a several basis, but the obligations of each borrower are secured by the combined uncalled capital of all investors in each of the funds. The main fund borrower grants a lien on its uncalled capital (as well as the right to call capital contributions and the bank account into which such contributions are funded) in order to secure its own obligations and the obligations of the parallel fund borrowers, and *vice versa.*

Lenders have become comfortable with cross-collateralization for a number of reasons. First, subscription facilities tend to be significantly over-collateralized, which lessens the credit risk of a several borrowing structure. Second, because the pools of investor commitments of the main fund and each parallel fund ultimately support the borrowings of all fund entities, lenders benefit from a wider range of investors and a larger collateral base. Finally, overcall provisions in limited partnership agreements can often be calculated by looking at the capital commitments of the main fund and parallel funds as a whole (rather than on an individual fund entity level), which in turn reduces the risk that the bank will not be repaid if there are significant investor defaults.

Treatment of AIV borrowers. Due to the fact that an AIV has the ability to call capital from the full pool of investors who committed capital to the related master fund, there is no reason to have a separate borrowing base for any AIV of the master fund. Likewise, there is no need for a master fund to guarantee or provide any credit support to any of its related AIVs for their borrowings, or *vice versa*. From a funds and tax perspective, avoiding such linkage between a fund and its related AIVs is often critical because AIVs are typically set up to segregate particular tax attributes of an investment away from the master fund. Having an AIV provide credit support to the master fund (or *vice versa*) increases the risk that this segregation will not be respected. In order to preserve the separateness of each AIV for tax purposes, each AIV should secure only its own obligations and not the obligations of its related fund or other related AIVs. Therefore, joint and several liability, guarantees and cross-collateralization as between a master fund and its related AIVs should be avoided.

Treatment of funds-of-one. There can be some scenarios where a cross-collateralized structure will not work. For example, the partnership agreement for a fund-of-one may prohibit the fund from providing credit support to other related funds. The single investor in the fund-of-one may have specifically negotiated to participate in an investment vehicle where it would not be subject to any exposure from other investors. In these vehicles, there is no risk to the single investor that another investor might default.

Funds-of-one may have similar borrowing needs as a commingled main or parallel fund. However, to obtain financing, a fund sponsor will need to seek lenders that can lend to a vehicle on a several basis and are comfortable with the credit quality of the single investor and the lack of overcall ability to other investors or vehicles. A fund-of-one may have its own subscription facility or it could participate in a subscription facility with multiple fund-of-one borrowers, which provides for separate borrowing bases and separate borrowing sub-limits so that each fund-of-one may access only a portion of the facility depending on the relative size of its investor commitment. Alternatively, if the partnership agreements of the fund-of-one and a related commingled fund permit cross-collateralization between such funds, the fund-of-one may be a borrower under the commingled fund's subscription facility, with several borrowings but a combined borrowing base.

Challenges posed by SPVs & foreign investors. As funds seek to broaden their investor base, non-US investors and sovereign wealth funds, in particular, are becoming key players in the fundraising process. These investors may have tax, regulatory, confidentiality and other concerns that drive more complicated fund structures. For example, these investors may make a commitment to a fund through a special purpose vehicle that is specifically established for investing in the particular fund and therefore does not have any financial history. Given the relationships between the fund sponsor and the investor's ultimate parent, funds are often willing to accept a commitment from a special purpose vehicle without any guarantee or specific financial support from the investor's parent.

Lenders consider a number of factors when deciding whether to include the uncalled capital commitments of a foreign sovereign in the borrowing base, including confidentiality restrictions, available financial information, parent credit support and sovereign immunity. If a foreign sovereign requires confidentiality, it may be challenging for lenders to diligence the investor at the outset and on an ongoing basis. Also, many sovereigns will negotiate an exception to the fund's partnership agreement that would otherwise require the investor to provide financials periodically if requested by the general partner. Lender concerns are amplified when the capital commitment is made by a special purpose vehicle, but the sovereign itself (or an arm thereof) is not willing to provide a guarantee or comfort letter with respect to the special purpose vehicle's commitment. Although a fund sponsor may be willing to accept a naked commitment from a special purpose vehicle investor, lenders may have concerns about lending against that commitment. Additionally, some lenders are concerned about the assertion of sovereign immunity. Few sovereigns are willing or able to waive sovereign immunity (and, in fact, most explicitly reserve it), though many will acknowledge that the investment constitutes a private commercial action, which is often sufficient to get lenders comfortable. Finally, lenders express concern about their ability to enforce a judgment against a sovereign, even if they are able to obtain it.

Despite these challenges, many lenders have become comfortable lending against special purpose vehicles used by sovereign investors, especially if these entities have a good track record of funding. Some lenders include these investors in the borrowing base subject to a lower advance rate and/or a concentration limit. An alternative approach is to give borrowing base credit to the investor's capital commitment (or, if borrowing base credit has already been given, to increase the advance rate) only after a certain percentage of capital has been called and funded by the investor. At that point, the investor will have more "skin in the game" and the default remedies in the fund's partnership agreement (many of which the lenders have the right to enforce as part of their collateral package during an event of default under the credit facility) will be a more powerful deterrent to any failure to fund capital contributions.

Fund structures & collateral package

Feeder funds and the cascading pledge. In a secured subscription facility, a master fund grants a lien on the right to call capital from its direct investors, which includes any feeder fund. If some investors choose to commit capital to a feeder fund, as opposed to making a direct commitment to a master fund, lenders will likely need to diligence these underlying feeder investors when providing financing to a master fund. If a master fund wants borrowing base credit for the commitments of the investors in its feeder fund, lenders to the master fund may want a lien on the right to call capital from the feeder fund's investors, even though the debt is incurred by the master fund (and not the feeder). In order to accommodate such a request from lenders, the feeder fund and its general partner would enter into a security agreement to grant a security interest on such commitments in favour of the master fund, and the master fund in turn would enter into another security agreement to grant a security interest to the lenders on its right to call capital from its investors as well on-pledge its rights under the feeder security agreement. In the unlikely situation where there is an event of default under the subscription facility, this back-to-back security arrangement, or "cascading pledge", allows the lender (a) to step into the shoes of the general partner of the master fund and call capital from the master fund's direct investors (including the feeder), and (b) by way of the cascade, to step into the shoes of the general partner of the feeder fund and call capital from the feeder fund's direct investors. Even though, as a practical matter, upon receiving a capital call from the master fund (or its lender), the feeder fund would initiate a capital call on its investors to satisfy its capital contribution obligation, the back-to-back pledge enables the lender to call capital from the investors in the feeder.

HNW feeders. Some sponsors create feeder funds to pool capital commitments from a group of high net worth ("HNW") investors who may invest smaller amounts than institutional investors. Since the feeder fund is treated as a single investor of the master fund, this avoids having a large number of HNW investors admitted directly into the master fund. If a lender is unwilling to give much (if any) borrowing base credit to the commitments of these HNW investors, or that of the pooled vehicle investor through which they invest, the master fund borrower may wish to avoid having this vehicle sign cascade security documentation.

A benefit of this approach is that, because the pooled vehicle is the investor, the main fund need not report to its lender each transfer of HNW commitments. Regardless of the borrowing base treatment of such a pooled vehicle, the fund will also want to make sure that any event of default in the credit agreement based on significant investor funding defaults treats the pooled HNW vehicle as a single investor and includes only the default portion of the vehicle's contribution in any investor default calculation.

AIV borrowers. The limited partnership agreements of master funds will allow for the creation of AIVs, which may have the same borrowing needs as the related main fund or parallel fund. If a subscription facility is entered into early in the life of the fund, before all investments have been identified, it is likely that not all AIVs may be formed and joined as borrowers when the credit facility closes. In these circumstances, a fund will need to notify the lenders of new AIVs, and the lenders will need an opportunity to diligence each AIV. This process may be complicated if the AIV is formed in a jurisdiction that is different from the related fund borrowers, although there should be some efficiencies given that the lenders have already completed their diligence process on the underlying investors. There are also timing considerations for the fund to manage, as an AIV cannot be joined as a borrower until it has admitted investors and has the ability to call capital from the investors. Some partnership agreements or side letters require an investor review period before the AIV's partnership agreement can be amended and restated and investors can be admitted to the AIV. As a result, these timing considerations will need to be taken into account if the AIV intends to borrow for its first investment.

Depending on the nature of the investment(s) to be made by an AIV, the sponsor may determine that an AIV does not need access to a subscription facility. However, lenders may nevertheless be focused on all AIVs because these entities have access to the collateral package (i.e., the uncalled capital of investors) and therefore may require that all AIVs be added as borrowers to (and become bound by the negative pledge and other covenants under) the credit facility. Adding all AIVs as borrowers can increase administrative costs to the fund, particularly if an AIV is formed in a foreign jurisdiction where local counsel must be engaged or foreign law-governed security agreements may be required. As a compromise, lenders may agree not to require that all AIVs become borrowers, so long as the aggregate amount of capital contributions to the non-borrower AIVs either does not exceed an agreed threshold or result in a borrowing base deficiency under the credit facility.

Collateral accounts. As part of the collateral package for a subscription facility, the fund borrower typically pledges the bank account into which capital contributions are deposited by its investors. If there is an event of default, the lender will be permitted to step into the shoes of the general partner of the borrower, call capital into such borrower's pledged account, take control of the account, and apply the amounts therein to the payment of such borrower's credit facility obligations. If the account is not held with the administrative agent, the borrower will need to put a control agreement in place over its pledged account at closing. This tri-party agreement among the fund borrower, the administrative agent as secured party, and the depository institution can often take time to negotiate.

As fund structures have become more complicated, with master funds, feeders, blockers and AIVs all being able to receive capital contributions from the direct and/or indirect investors in the master fund, fund sponsors may find it administratively convenient (and cost-effective) to set up a single master collateral account for the main fund and a separate master collateral account for each parallel fund borrower. By having a single master collateral account, it is not necessary that a master fund's related feeders, blockers and

AIVs open separate accounts for capital contributions, pledge those accounts, administer those accounts, and arrange (and pay) for control agreements in respect of each of such separate accounts. Further, having a master account simplifies capital call notices and wiring instructions to investors by directing capital contributions to just one account. Each AIV appoints its related master fund as its agent to receive capital contributions on its behalf and to grant to the lender a lien on such capital contributions to secure the credit agreement obligations of such AIV. Similarly, each feeder and blocker either appoints its related master fund as its agent to receive capital contributions from its investors and to grant a lien on such contributions, or directs that capital contributions be deposited into that fund's master account. With a master account, the account holder agrees to act as agent for each of the appointing entities, agrees to grant a lien on the amounts in the account that are held for any such entity to secure the respective obligations of such entity, and acknowledges that it has legal title to the account (rather than equitable rights to the monies attributable to the other entities). It is best practice for the fund, as the account holder, to track the equitable owner(s) of the moneys in the account, as those amounts are held in trust by the fund for such other entities.[2]

Expanded features of subscription facilities

Qualified borrowers. Some funds have found it advantageous to structure borrowings below the fund, in which case it is helpful to have the ability to add other entities as borrowers under the subscription facility. For example, many subscription facilities allow the joinder of "qualified borrowers" or "portfolio company borrowers", which are entities that a main fund, parallel fund and/or AIV owns a direct or indirect ownership interest in, or through which such fund borrower may acquire an investment. Qualified borrowers do not have access to uncalled capital, and therefore do not provide collateral when joined as a borrower under the subscription facility. Instead, the lenders look to the applicable fund borrower(s) to guarantee this borrowing and secure that guarantee by the same collateral that secures its direct borrowings under the subscription facility. Because of this fund guarantee, qualified borrowers can access the subscription facility to the same extent as the fund borrowers, which may include flexibility to obtain letters of credit, and can serve as interim financing until a permanent financing is entered into at the portfolio company level.

Same-day borrowing / Multi-currency options. To take full advantage of a subscription facility, many funds look to lenders to provide same-day borrowing capacity, which allows borrowers to respond quickly to investment opportunities, cash-collateralize derivatives and manage their borrowing needs more efficiently. Similarly, many funds appreciate the flexibility to borrow and obtain letters of credit in foreign currencies, rather than having to borrow and manage currency exposure outside of the facility.

Changing needs during a fund's lifecycle. Given the attractiveness of subscription facilities, funds increasingly want the credit facility to be in place through each stage of the fund's life cycle. Each stage presents different challenges to a fund. During the fundraising stage, a fund may want to borrow (rather than call capital) to pay expenses, make investments and avoid rebalancing investor commitments as investors are added to the fund. However, putting a facility in place early in the life of the fund may mean that the investor pool is smaller and less diversified than it is expected to be after final closing, resulting in limited borrowing base capacity. Concentration limits may further reduce the borrowing base, so borrowers may need relief from concentration limits until the final closing of the fund.

A fund may also seek to structure the size of its credit facility to reflect its borrowing capacity. Early in its life, a fund borrower may want a smaller facility size, and thereby avoid paying a large upfront fee as well as unused fees on the portion of a larger facility that cannot be accessed due to a smaller borrowing base. As fundraising progresses, a fund borrower may want flexibility to increase its facility size by exercising an "accordion" option as investor commitments are added. Lenders may agree to an accordion option in the loan documentation, on either a committed or an uncommitted basis. From the borrower's perspective, a committed accordion provides assurance that the credit facility will grow along with the fund's borrowing capacity and long-term financing needs.

After the fundraising period is complete, there may be specific investment opportunities that a fund may wish to finance through use of a subscription facility. Some subscription facilities offer borrowers temporary increased capacity to meet one-off needs of the fund. This feature provides funds with flexibility to increase the facility size for a short-term period, rather than incur the cost of a permanent accordion that does not reflect the fund's longer-term needs.

Funds may face pressure in their subscription facilities when they are later in their lifecycle and there is less uncalled capital to support the borrowing base and the financing needs of the fund. To address these concerns, some sponsors seek increased borrowing base capacity later in the life of the fund. This increased borrowing base may take the form of increasing advance rates for investor commitments, including the values of the fund's investments in the borrowing base calculation, and/or admitting certain investors into the borrowing base that were previously not included.

Even after the end of the fund's investment period, many funds want flexibility to borrow for follow-on and follow-up investments and expenses. Although older credit facilities often terminated with the end of the investment period, newer credit facilities often permit credit extensions after the end of the investment period as long as the fund's partnership agreement permits the fund to call capital for the purposes of repaying such debt.

Conclusion

Access to a subscription facility can provide significant benefits to a fund throughout its life. As a result, sponsors who wish to incorporate a subscription facility into a fund's investment strategy should be mindful during negotiations with investors about how the fund expects to use leverage and how the fund's ultimate structure will impact its ability to obtain a subscription facility and the terms of such facility. Similarly, sponsors should work with their lenders to ensure that the subscription facility provides the fund with the desired flexibility, and ease of execution, to accommodate the fund's structure and financing needs from the fund's initial closing until the fund is no longer able to call capital to repay its debt. Specifically, sponsors may want their funds' subscription facilities to provide any or all of the following features:

- an accordion to permanently increase the facility (whether on a committed or an uncommitted basis) as the fund adds investor commitments;
- a holiday from borrowing base concentration limits during the fundraising period;
- the ability to temporarily increase the facility to accommodate specific investment opportunities;
- same-day borrowing capacity to enable the fund to respond quickly to investment opportunities and other financing needs;
- multicurrency capacity consistent with the fund's financing needs in foreign jurisdictions;

- a streamlined process for joining borrowers to the facility (whether they are parallel funds, alternative investment vehicles or qualified borrowers) and putting in place any related collateral security documentation (including cascade documents);
- a basket for non-borrower AIVs that do not need access to the facility and for which the fund does not want to incur the expense of joinders;
- a master collateral account structure for capital contributions to a master fund and its related entities;
- increased borrowing capacity after a significant percentage of capital contributions have been funded (whether by increasing advance rates or adding previously excluded investors to the borrowing base, or both);
- capacity to borrow after the end of the fund's investment period, and after a key person event, for follow-on and follow-up investments and other purposes for which the fund is permitted to call capital; and
- an extension option for the fund to extend the term of the facility (on a committed or an uncommitted basis) for one or more periods of 364 days.

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Endnotes

1. To mitigate this result, a facility that provides for joint and several liability, or for mutual guarantees, should include savings language that will limit the smaller fund's liability to the maximum amount that may be incurred without rendering it either insolvent or in violation of its partnership agreement.
2. It is important to confirm with tax and accounting advisors to make sure that this approach will work for a particular fund. Some funds may use a master account for the fund and its related AIVs but use a separate account for a feeder. If the feeder has a separate account for capital contributions, lenders may require a "cascading" pledge of the feeder account.

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