NAV Financing Market Report

2022/23

Introduction

Rede Partners is delighted to publish its NAV Financing Market Report 2022/23, our latest White Paper based on proprietary research and market insights. Drawing on data from Rede's 2023 Lender Survey, our research sheds light on an inherently opaque market that is growing in significance. The report provides an overview of the current state of the private equity fund financing market, examining key trends, challenges, and future opportunities.

Our research allows us to estimate the volume and value of deals completed during 2022 and how this compares to prior years. It also helps analyse some of the pricing mechanics of NAV facilities, the shift in margins we have seen over 2022 (as well as other key additional costs sponsors should consider) and recent developments regarding security structures for deals completed in the last 12 months.

The NAV financing market has grown to become an important source of liquidity for private equity funds, allowing private equity managers (the GPs, sponsors, or borrowers) to leverage unrealised investment portfolios at a fund level, providing capital for new investments and / or distributions to limited partners (LPs). Despite this growth, data on the NAV financing market remains limited, particularly any concrete or current data that highlights ongoing trends.

Our research, including data from our NAV Lender Survey, provides valuable insights for all market participants – GPs who wish to understand the risks, benefits and typical parameters of these financings; LPs who must factor in the effects of NAV financings into their investment decisions and portfolio management; and lenders who have to navigate an increasingly competitive environment in which to identify the most attractive transactions.

About NAV Financings

The development of the private equity NAV financing market has been a rapid one. As recently as 2018, NAV financings were rare in the private equity buyout market and unfamiliar to GPs and LPs alike. Since then, however, there has been a progressive change in attitudes across the market, with the benefits of this type of financing becoming far better known. Private equity managers have used NAV financings as a capital-efficient way to leverage their portfolios, allowing them to fund new investments, repay debt, or provide liquidity to their LPs. Meanwhile, lenders are increasingly open to entering these types of financings given their attractive risk-adjusted returns, their underlying asset coverage and the ability to bolster their existing sponsor relationships.

NAV financings can take a variety of forms, including term loans, revolving credit facilities, and preferred equity-like structures. For GPs, a particular advantage of NAV financing is increased flexibility over traditional portfolio company debt, which is often subject to onerous covenants. The diversification benefits of borrowing against a portfolio of assets mean GPs can secure attractive pricing and terms without necessarily pledging specific assets as collateral. Hybrid facilities, which include a fund's remaining uncalled commitments and NAV as part of the security package, help to reduce the risk-return profile and are another form of NAV financing for GPs to consider. A growing segment is NAV financing at the GP level (GP financing). Here, the security package can include the GP's carried interest, the GP's fund commitments and management fees. GP financing can help support a franchise through succession planning, offer an alternative to a minority stake sale, seed alternative strategies and help GPs reach their desired level of GP commitment to new funds.

The pricing and key terms of these loans vary widely depending on the composition of the underlying portfolio, the perceived value of the underlying assets, the security structure and the lender risk appetite. Rede has advised on NAV financing facilities from $50m to over $1bn facilities for a variety of purposes. The common thread linking these deals tends to be the Loan-to-Value (LTV) ratio which typically falls within a limited range. Within private equity, conventional NAV facilities rarely venture north of 25% LTV, and unless the capital is needed for a specific use case, not smaller than 5% LTV.

NAV financings are not, however, without risk - for example, if the value of the underlying assets declines before the borrower pays down the facility, the lender(s) may require the GP to provide additional collateral or take steps to pay down the loan. GPs should also consider tax implications – which may vary considerably by jurisdiction, as well as the risk of reputational harm if the sponsor is seen to be taking on too much leverage.

Defining our scope

Our market statistics (i.e. completed deal value and volume of deals) are defined as NAV financing facilities applied at the level of a fund, backed by all or part of the portfolio of equity positions of direct Private Equity, Venture Capital, or Growth Equity funds. This definition does not include facilities lending to the General Partner/management company, Fund of Funds or secondary portfolios.

Key findings

1 NAV financing remains resilient in face of dramatic fall in broader leveraged loan market

While the estimated total value of successfully completed NAV financing transactions declined slightly in 2022 compared to the previous year, the total number of completed deals has risen. Overall, the market has remained resilient when compared to the broader leveraged finance market

2 Lenders are seeing more NAV opportunities than ever before

83% of lenders reported an increase in the number of NAV transaction opportunities over the last year. We estimate that, on average, lenders saw 21 deals in 2022, up from an average of 16 deals the previous year

3 Margins have risen, but not as steeply as feared

Given the macroeconomic turbulence of the last year, margin increases over the last 12 months have been modest, allowing sponsors to capture market arbitrage. Over 75% of lenders raised pricing by less than 200bps in 2022 – while 6% of lenders actually lowered their margins

4 Sponsor/lender existing relationships: Important but not vital

GPs considering a NAV financing can confidently look beyond their roster of existing lender relationships. While an existing relationship between GP and lender is helpful, 61% of lenders have worked with sponsors where there was no pre-existing client relationship

5 Are step-in rights and challenge rights stepping up?

Borrowers have been reconsidering the level of security provided for NAV facilities. Over 77% of lenders saw a drop or flattening in unsecured deals in 2022 (i.e. deals without step-in rights). At the same time, valuation challenge rights remain a hot topic when negotiating NAV facilities

1 NAV financing remains resilient in face of dramatic fall in broader leveraged loan market

While the estimated total value of successfully completed NAV financing transactions declined slightly in 2022 compared to the previous year, the total number of completed deals has risen. Overall, the market has remained resilient when compared to the broader leveraged finance market

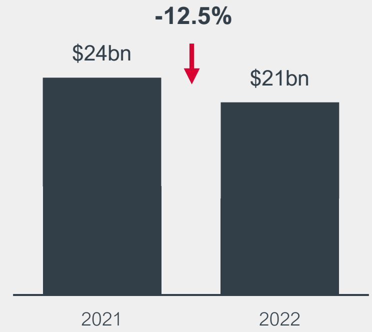
Completed deal value dropped by only 12.5% in 2022 despite considerable macro headwinds…

Rede estimates that the overall value of NAV financing transactions completed in 2022 was $21bn, representing a fall of approximately 12.5% since 2021, when we estimated total deal value to be $24bn[1]. This modest decline stands in stark contrast to the significant slowdown in the overall leveraged loan and high-yield market in the US and Europe over the same period. The drop in the value of deals completed is also likely exaggerated by the lack of multi-billion dollar NAV transactions over the last 12 months. A particular outlier was responsible for skewing the data in 2021, for example, was the $4bn Soft Bank fund financing facility led by Apollo Global in Q4-2021.

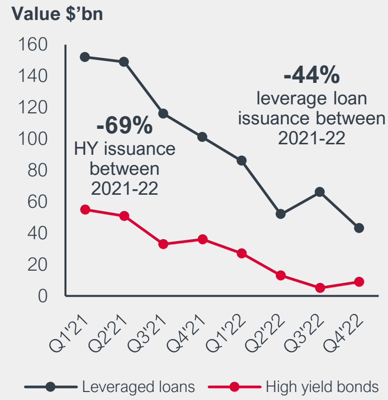
Across the globe, capital markets have faced serious headwinds, including increasing interest rates, inflation, and geopolitical tensions; with knock-on effects felt strongly in all areas of leveraged finance. In 2022, leveraged loan issuance in the US was down 24% from the $1.4 trillion achieved in 2021, while in Europe, leveraged loan issuance was down 44%. US high-yield activity suffered an even steeper decline, with 2022 issuance dropping by 78% lower than 2021[2]. At the start of 2023, capital markets liquidity as a percentage of GDP was at 1.4%, the lowest level since April 2009, falling from post-GFC heights of 8.3% in July 2021[3].

Added to this, the NAV financing market had some specific challenges of its own, in particular, an increased focus on private equity valuations. Against this background, the resilience of the NAV financing market is striking.

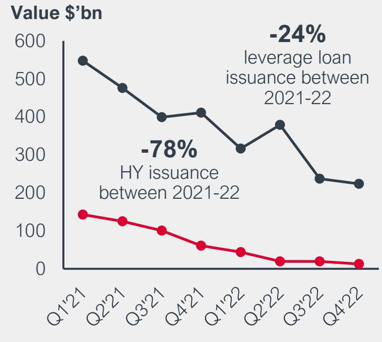
Value of NAV financing deals completed



European high yield and leveraged loans issuance by value[4]



North American high yield and leveraged loans issuance by value[4]



1. This estimate is based on the survey responses and the visibility that the survey provides on the size of the market, in addition to known deals in the market
2. White & Case (February 2023)
3. KKR GMAA Analysis, Bloomberg, Bank of America (January 2023)
4. Debtwire (February 2023)

1 NAV financing remains resilient in face of dramatic fall in broader leveraged loan market

…highlighting the underlying momentum building within the segment

Rede believes the lower decline experienced by NAV financing compared with the broader leveraged finance market is the result of a number of factors: (i) declining liquidity from alternative sources, (ii) attractive risk-return profile relative to subscription lines for lenders and asset level refinancing for borrowers, and (iii) the growth in the number of market participants and available capital.

NAV financings are becoming more widely recognised and understood as an important fund management tool, driving increased market adoption. Anecdotally, Rede's team has noted a surge in awareness, conversations and newsflow on NAV financing transactions over the past year. With underlying growth already strong enough to overcome much of the macro challenge presented last year, it would be reasonable to expect a further acceleration of the market in the near term as understanding amongst sponsors, lenders, and LPs reaches critical mass.

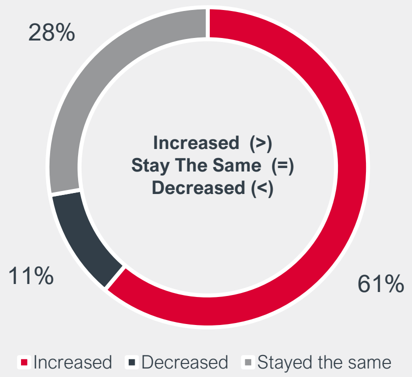
Furthermore, the increased number of NAV financings completed this year and the many deals in process, is, we believe, attributable to a fall in 'traditional' exit activity seen during 2022. With highly volatile markets and a harder financing environment, private equity managers found it increasingly difficult to maintain a strong flow of distributions back to limited partners during 2022. Exit volumes slowed considerably while individual deal refinancings became more challenging to achieve at an attractive price. At the same time, showing strong distribution performance (DPI) from recent funds became increasingly important to private equity firms seeking to raise capital in a much tougher fundraising market. Against this backdrop, NAV financings presented an alternative opportunity to increase capital distributions to LPs and accelerate DPI – and Rede's survey data shows a strong increase in the number of NAV financing transactions our lenders saw for which the sole purpose was increasing DPI.

An important alternative source of liquidity in today's tougher exit market

Broadening the scope of the market even further, Rede has noted that the GP-led secondary market is also increasing it's use of NAV financing as a way to enhance returns, raise additional capital or implement a deferred payment solution when raising continuation vehicles. Implementing continuation fund-level financing is more adapted to Multi-Asset Transactions or Strip Sales versus Single Asset Transactions. These facilities provide sponsors with more flexibility and an additional pool of capital, other than equity from traditional secondary investors. It is worth noting that continuation vehicle financing falls outside the parameter and scope of our 2023 Lender Survey, and is therefore not included in the market statistics.

NAV financing adoption remains subject to limited partnership agreements (LPA) and other fund governance documentation provisions. Restrictive provisions in funds' legal documents may create a slight drag on the expansion of the NAV financing market in the short term, as older vintage funds, in particular, often contain onerous limitations on fund-level borrowing. However, Rede has noted sponsors have been able to adjust their recent vintage fund LPAs to accommodate greater flexibility on fund-level indebtedness.

Volume of transactions for the sole purpose of increasing DPI



2 Lenders are seeing more NAV opportunities than ever before

Lenders closed more deals in 2022, suggesting average transaction sizes are falling

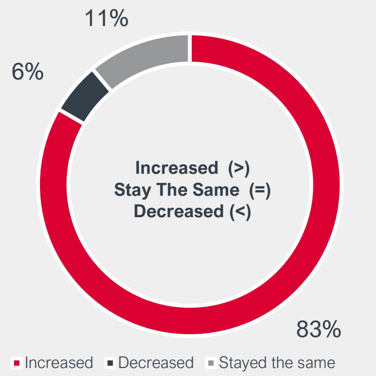
Despite a fall in total deal value, the absolute number of completed NAV financing transactions appears to be rising. We estimate that the weighted average number of deals completed for each active lender was five NAV financing transactions in 2022, up 25% from four deals in 2021.

Taken together, the fall in total deal value and rise in deal volumes indicate that the average deal size has decreased over the last year. This may be for a number of reasons. Rede's anecdotal experience suggests that GPs took a more conservative, approach to leveraging their funds in 2022, given the more challenging macro environment, seeking slightly lower LTV facilities – lenders themselves may also have been less comfortable offering loans with higher LTVs. Meanwhile, the growing market acceptance of NAV financings and the range of market participants has opened up the opportunity for GPs managing smaller funds, who will naturally seek smaller facilities.

Lenders are seeing more NAV opportunities than ever before, some of the drop in average deal size may be attributed to a small number of outlier deals in 2021, such as the $4bn Soft Bank fund financing referred to previously.

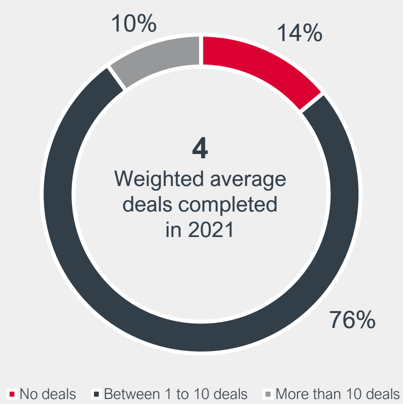
> "Despite a fall in total deal value, the absolute number of completed NAV financing transactions appears to be rising."

Volume of transactions brought to market compared to 2022



NAV financing deals completed in 2022

NAV financing deals completed in 2021



2 Lenders are seeing more NAV opportunities than ever before

Lenders are seeing more NAV financing opportunities than ever cross their desks…

83% of lenders reported an increase in the number of NAV transaction opportunities over the last year. We estimate that, on average, lenders saw 21 deals in 2022, up from an average of 16 deals the previous year

It is clear that lenders are seeing a significant uptick in NAV financing dealflow, with 83% of lenders reporting that they saw an increased number of deals in 2022 vs 2021. Meanwhile, a year ago, 78% of lenders told us they saw more NAV financing opportunities in 2021 than in 2020 – highlighting real momentum building within this segment.

Rede estimates that the average lender received 21 NAV financing opportunities in 2022, a 31% increase over the estimated 16 they saw in 2021. Of note, a third of lenders evaluated more than 30 deals in 2022, compared to one-fifth in 2021, while at the other end of the scale, the proportion of lenders who saw less than five deals dropped from 25% to only 11%.

This is not a theme exclusive to NAV financing transactions. Rede has also seen a similar increase in GP financing opportunities, which makes sense as, these two deal types are driven by the same market fundamentals, rely on the same lender universe and underlying collateral. For the lenders and borrowers, there are numerous synergies between these two financing solutions.

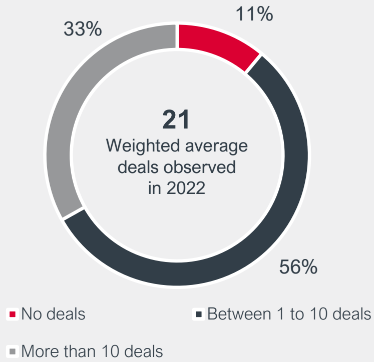
….driven by both market expansion and increasingly formalised transaction processes …

It is Rede's view that the increase in dealflow experienced by the lenders is driven by two factors: an absolute rise in deals coming to market, and an increase in the number of lenders reviewing each deal.

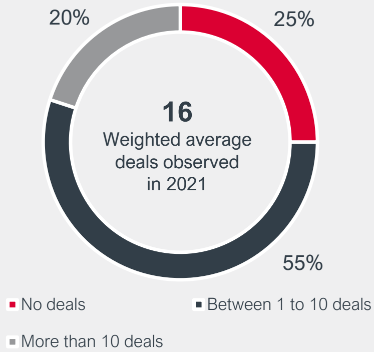
Given the rise in the number of completed transactions detailed in the previous section, the increasing dealflow experienced by lenders is further evidence of the growing popularity and enthusiasm for these facilities – underpinned by better awareness amongst GPs of their benefits and greater understanding and acceptance of their use by LPs.

Meanwhile, Rede believes that part of the rise in dealflow is attributable to an increase in the number of NAV financings that are intermediated by financial advisors who take a more formal approach to lender selection. This is driving a trend toward an increase in the number of lenders approached on each transaction, creating greater competitive tension and – hopefully for GPs – more attractive pricing and terms as the end result. Rede estimates that 28% of NAV financing deals completed in 2022 were intermediated by a financial advisor, with anecdotal experience that this figure is on the rise. GPs are increasingly choosing to appoint third party advisers when considering raising a NAV facitilty, valuing the support and market insight an advisor brings and allowing them to optimise structuring, marketing and negotiation from initial concept to completion.

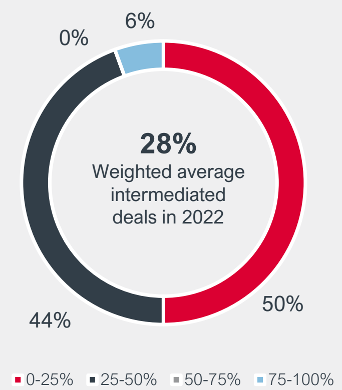
NAV financing deals observed in 2022



NAV financing deals observed in 2021



% of NAV financing opportunities intermediated by a financial advisor



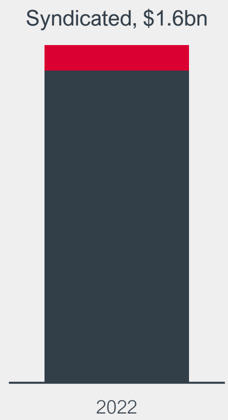
2 Lenders are seeing more NAV opportunities than ever before

…as well as a trend toward wider syndication of NAV facilities by lead lenders

Rede's research indicates that in 2022, approximately 15% of total completed NAV financing deal value was syndicated out to third parties. Syndication occurs when lead lenders underwrite a portion of a NAV facility above their desired hold amount, and then sell down or 'syndicate' out their excess exposure to third parties – typically key relationships including large insurance clients. The syndication process is not the same as involving 'minority lenders' in the process. Minority lenders come into the process pre-closing and, crucially, at the borrower's discretion. Syndication typically occurs after closing the transaction (although in some cases simultaneously to closing); however, this process is at the discretion of the lead or original lender. The borrower is not involved in these negotiations or discussions. A common feature of syndicated processes is that post-closing and pre-syndication, the lead lender will appoint a credit rating agency to privately rate the NAV loan, making it easier to distribute to the insurance market. Although we do not have survey data on syndication from previous years, Rede has noted a growing enthusiasm amongst lenders to syndicate out deals. Indeed, the majority of NAV financings advised by Rede over the last 12 months involved some element of syndication. The result of this trend is a broadening of the total bench of lenders with access to the NAV loan market. In Rede's view, this trend is likely to lead to a greater standardisation of NAV facility term sheets. Lead lenders will increasingly approach negotiations through the lens of their eventual syndication targets, focusing on clarity and simplicity in order to avoid the risk of syndication failure.

Quantum of NAV loans syndicated to 3rd parties in 2022

Total:
$21bn



3 Margins have risen, but not as steeply as feared

Given the macroeconomic turbulence of the last year, margin increases over the last twelve months have been strikingly modest, allowing sponsors to capture market arbitrage. Over 75% of lenders raised pricing by less than 200bps in 2022 – while 6% of lenders actually lowered their margins

The overall cost of NAV facilities has risen, but much of this is accounted for by sharp rises in the base rate rather than increased margins…

The all-in-cost of a NAV facility includes the margin above a base rate (often EURIBOR or SOFR, depending on geography and currency) – and a variety of upfront fees, commitment fees and legal and advisor expenses specific to the transaction.

Since March 2022, base rates have increased to combat the tide of rising inflation stemming from the Covid-19 hangover, supply chain issues, and the conflict in Ukraine. Three-month EURIBOR has risen from -50bps in March 2022 to +280bps in March 2023, while 90-day SOFR has risen from near zero to +445bps over the same period. Most NAV loans are structured as floating rate loans; so rising base rates directly impact the all-in cost of capital of existing NAV loans, many of which had a base rate floor of 0% but no cap.

But what of margins? Despite macro headwinds, Rede's research shows that lenders did not increase their spreads significantly over 2022. Margins have not risen nearly as fast as base rates – we estimate that on average lenders increased spreads by approximately 140bps over the year. Only 30% of lenders increased margins by 200bps or more, while a select few lenders have actually decreased their spreads over the year.

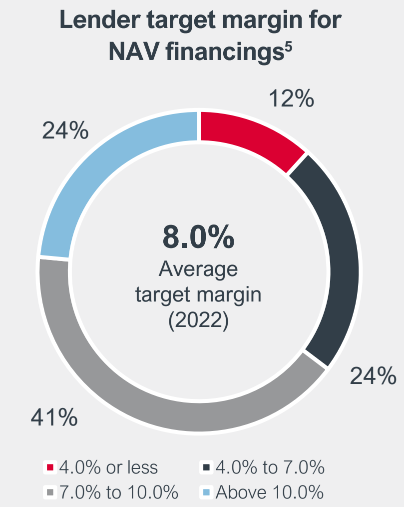
There are a number of potential explanations for this. To avoid higher margins, sponsors may opt for more secured solutions to keep down the cost of capital. Meanwhile, rising base rates are accretive to credit fund lenders' returns – so credit funds can continue to offer attractive margins over a higher base rate and still exceed their carried interest hurdle (which is usually fixed).

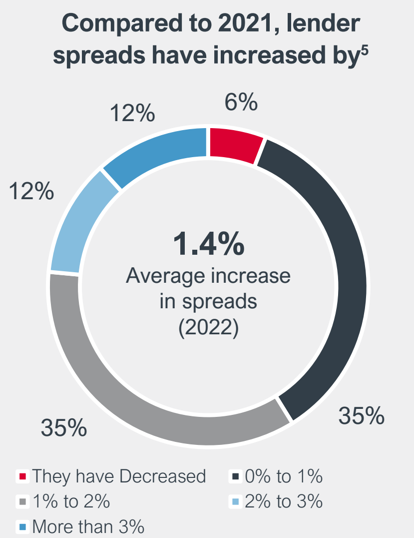
…which continue to hover around 8%, on average…

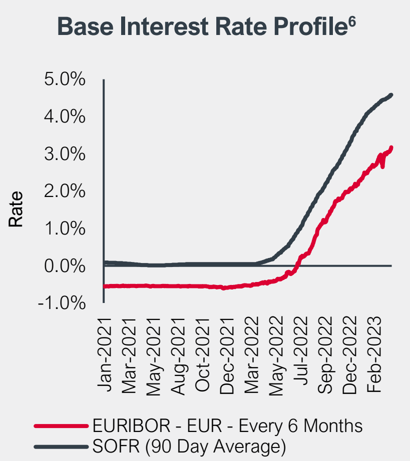
While lenders report a fairly wide dispersion of target returns, the majority (65%) of lenders target margins of between 4% and 10% above base rates, with 41% of lenders seeking margins between 7% and 10%.

There is a perception within the fund financing market among sponsors that the margin or cost of capital should be maintained below the traditional 8% hurdle rate of a private equity buyout fund (if the circumstances and structure allow). This threshold remains important when considering the structure and merits of these transactions. Our survey data suggests that lenders remain mindful of this limit, with average margins hovering exactly around the 8% mark for 2022.

There are a number of credit funds operating in this space, promising higher all-in returns than 8%. Back leverage is one way for credit funds and LPs alike to enhance their returns and operate in a space they would normally avoid. The banks provide the back leverage to these credit funds to invest in the NAV facilities and take a first lien on the security. This allows alternative lenders to become a true multi-faceted partner with their key GP relationships.







5. Excluding the base rate
6. S&P Capital IQ

3 Margins have risen, but not as steeply as feared

…although a growing group targeting much lower margins highlights changes within the lender base

Comparing this data against last year's survey results highlights one important change: a substantial increase in the number of lenders reporting target returns of less than 4% above the base rate. Rede's 2022 results showed a 62% increase in the number of lenders targeting below 4% margin vs 2021.

What is behind this change? One possible interpretation is that the growing number of lenders seeking lower margins is indicative of more bank lenders entering the market. Often investing from their balance sheets, banks are typically more able to invest in lower-returning opportunities (<4% margin) than alternative credit funds. Rede's anecdotal experience suggests this may indeed be the case – although it is not easy to substantiate this view with concrete data at this time. While an influx of more flexible lenders may come as welcome news to GPs, sponsors should be aware that these lower cost of capital facilities may come with some additional constraints around security, covenants, challenge rights, etc.

Compared with asset-level financing, NAV facilities are becoming an increasingly attractive option for GPs in a rising rate environment

In certain circumstances the cost of a NAV facility has become increasingly attractive on a relative basis in comparison to portfolio company-level financing. For sponsors seeking to refinance multiple companies in a mature portfolio, a strong argument exists to consider a NAV facility at the fund level. A NAV facility is likely to have a lower cost of capital than several individual portfolio company refinancings – in part due to the competitive dynamics at play described above and in part due to the obvious diversification benefit presented by financing across a package of multiple assets rather than a single company. An added bonus is that the proceeds of a NAV financing loan are fungible and can be allocated flexibly by the GP across its portfolio as required.

4 Sponsor/lender existing relationships: important but not vital

GPs considering a NAV financing can confidently look beyond their roster of existing lender relationships. While an existing relationship between GP and lender is helpful, 61% of lenders have worked with sponsors where there was no pre-existing client relationship

The majority of lenders are willing to provide NAV financing to GPs outside of their existing client base…

When considering a NAV financing facility, sponsors may often assume that the eventual counterparty will be selected from amongst its existing roster of lenders or banking relationships – those who have participated in financing packages for portfolio companies, provided subscription credit lines for their funds or advised on purchases or sales of investments. However, Rede's survey data shows that this need not be the case. Although 39% of lenders have only participated in deals where they have an existing client relationship with the sponsor, the majority are willing to look outside of their client base and provide facilities to new, non-existing relationships. Lenders often see NAV financings as an opportunity to expand their client roster, with the potential for further partnership opportunities.

From a sponsor's perspective, branching out into new lender relationships can be helpful because not all lenders offer the same set of products or solutions. Sponsors may also have outgrown their existing lender relationships. A NAV financing process offers an opportunity to meet with a whole new set of top-tier lenders that can provide them with the required solution.

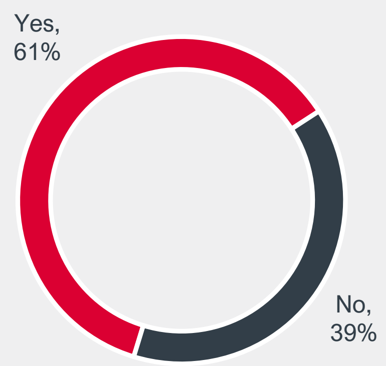
….although pre-existing relationships can be valuable to both lenders and sponsors

Having said this, an existing relationship between sponsor and lender may offer advantages at two critical points during the NAV financing transaction process: diligence and syndication.

For lenders, existing relationships offer a greater sense of familiarity with the manager, as well as a greater understanding of assets within the fund. When entering diligence, this gives the lender a natural head start over third parties who must start their analysis from scratch. Ultimately it may also lead them to take a more nuanced approach to pricing the risk profile of the portfolio in question, and allow them to offer a more attractive term sheet for the transaction.

For many larger facilities, several lenders often make up a consortium of 'term takers' or 'minority lenders' behind a lead lender. When considering allocations to minority lenders, GPs naturally tend to favour existing relationships with whom they already have a comfortable working relationship. In particular, experience of the lender's legal processes can be highly valuable to GPs if it can reduce the length and complexity of term sheet negotiations. This is also true for the GP's relationship with the lead lender, which can ease the dialogue and legal documentation process.

Have you participated in a transaction(s) where you did not have a pre-existing relationship with the sponsor?



5 Are step-in rights and challenge rights stepping up?

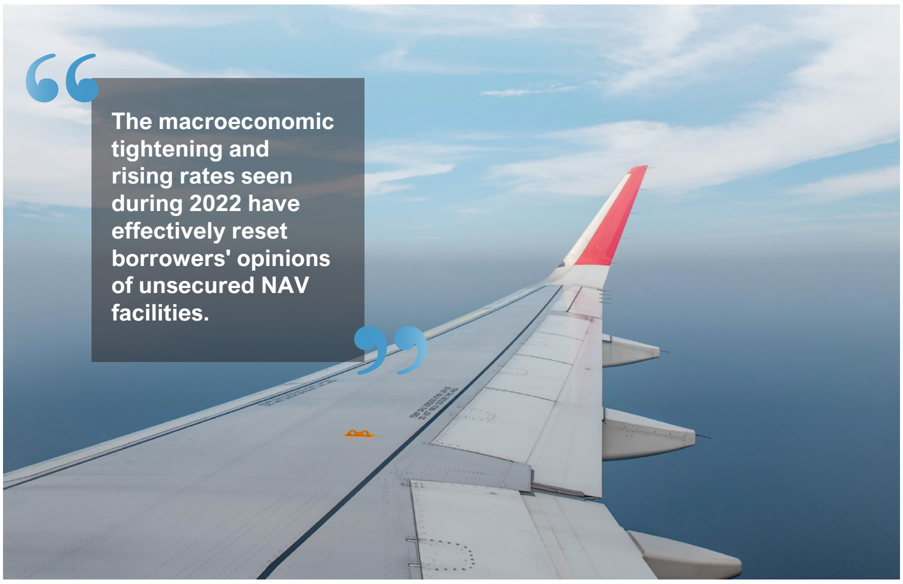
Lately, borrowers have been reconsidering the level of security provided for NAV facilities. Over 77% of lenders saw a drop or flattening in unsecured deals in 2022 (i.e. deals without step-in rights). Meanwhile, valuation challenge rights remain a hot topic when negotiating NAV facilities

Step-in rights are becoming more common…

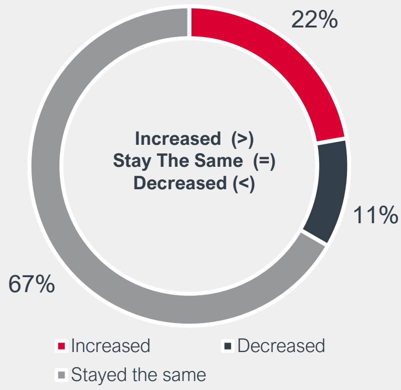
A number of transactions Rede has advised upon to date have been 'recourse light' i.e. the lender has no step-in rights to the underlying assets in the event of a default. This solution is now well understood within the lender community, and provides a desirable solution for the sponsor – in an event of default scenario, the lender does not have the ability to seize control of the underlying fund assets in any circumstances, which would be damaging to the GP's franchise.

In 2021, a majority of lenders (65%) had executed on a recourse-light deal, and 85% of lenders would execute on this structure. Interestingly, the momentum for this structure has somewhat slowed over 2022, with over 77% of lenders seeing a drop or flattening in deal volume for deals without step-in rights.

What is driving this change? Structure, security and pricing are all directly linked. It is possible that the macroeconomic tightening and rising rates seen during 2022 have effectively reset borrowers' opinions of unsecured NAV facilities. Where before, lenders were willing to offer attractive margins on no-recourse structures. Today, lenders are unwilling to offer the same pricing they did for these structures 12 months ago. The reaction from sponsors/borrowers has been to look towards more secured facilities that would command a lower cost of capital. Secured loans have lower margins than unsecured loans because they are backed by collateral that the lender can seize and sell if the borrower defaults on the loan. This enhanced control is received to reduce the lender's risk of loss.

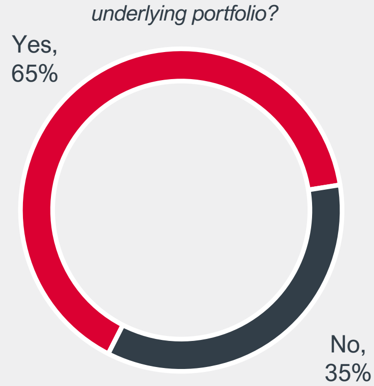


Volume of NAV financing structures with no direct step-in rights



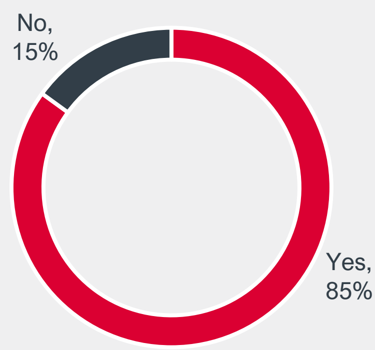
Execution (2021 Survey)

Have you executed a structure where there are no direct step-in rights for the underlying portfolio?



Capacity (2021 Survey)

Would you be able to execute a structure where there are no direct step-in rights for the underlying portfolio?



5 Are step-in rights and challenge rights stepping up?

…and valuation challenge rights are a hot topic…

Valuation challenge rights remain a hot topic for negotiation when NAV financing facilities reach the term sheet stage. Naturally, private equity managers are resistant to training their asset valuations revalued by a third party every quarter, so a pragmatic approach is applied. Similar to 'hawk eye' in tennis, the lenders may have a couple of valuation challenges per year. The lenders are only allowed to challenge if they believe there is a material difference in valuations (to be defined within the facility agreement). An approved list of valuation agents is often agreed at closing. If the lenders call a challenge, and there is no change in the valuation, they are responsible for paying the valuation agent. If there is a change in valuation, which triggers a covenant breach, the borrower pays and has to manage the covenant breach.

Valuation challenge rights are one area where credit funds can differentiate from banks and offer facilities with limited to no challenge rights. This is a bid variable that the banks cannot usually match and could be the deciding factor for a sponsor. However, the sponsor may be sacrificing a lower cost of capital for the covenant-light terms.

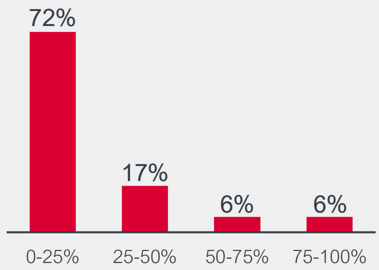
The data suggests that very few deals are completed with no form of challenge rights, as 72% of participants saw less than a quarter of deals with no valuation challenge rights. Given the current risk-off market going into 2023, it is unlikely that this number will move down from here.

…with private credit ratings a key emerging trend

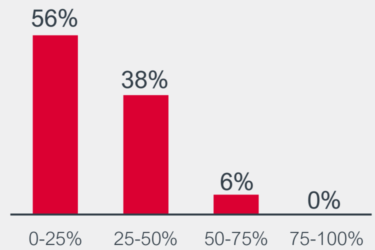
We are observing a growing trend of lenders seeking a private credit rating for NAV loans. The credit rating process can be completed before closing the transaction but is often completed afterwards. Lenders desire a credit rating for a NAV loan to enhance their ability to syndicate down the loan to third parties, such as US pension fund and insurance clients, which may require ratings above a certain threshold on credit investment opportunities. This process should be light touch for the sponsor and is the lender's responsibility. All ratings are private and not publicly disclosed.

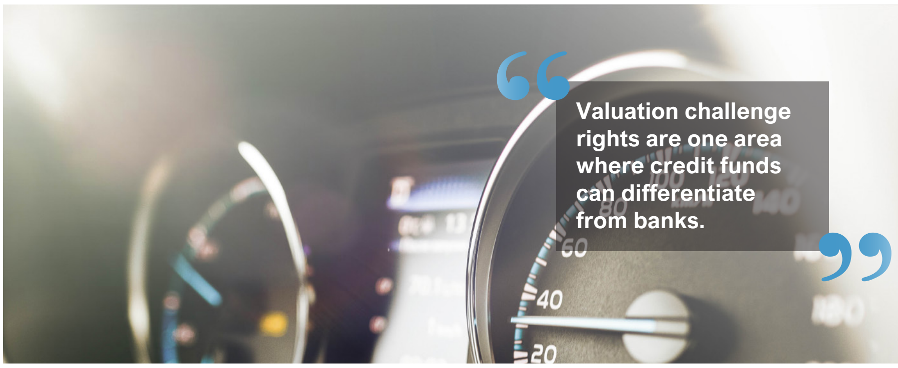
Rede's survey data suggests that although many NAV financing transactions do receive a rating, it is below half of the deals in the market today. An investment-grade rated NAV loan will likely generate a lower margin than a similar non-rated loan. Sponsors may begin to use this strategy more to lower their cost of capital, and it is likely that we will see more privately rated NAV facilities as the market expands.

What percentage of deals are you seeing with no valuation challenge rights?



What percentage of NAV financing opportunities received a credit rating from a rating agency?





Conclusion

Based on Rede's survey results and our anecdotal evidence, we can conclude that although the total value of deals completed in 2022 has stagnated, this is likely to be temporary. The volume of transactions brought to market has increased, and NAV financing transactions are being contemplated more and more by sponsors for various uses, including providing a liquidity solution to LPs, accelerating DPI and raising additional firepower for new investments, follow-on capital or defensive purposes.

We are seeing the market deepen with a proliferation of new participants in the space. This will have an impact on the supply and demand balance, which is helpful for sponsors as the market will be able to provide a wider variety of solutions while also creating more competition among lenders to win attractive deals.

Pricing has not altered significantly over the last 12 months, with the modest increase in margins not being as dramatic as the rise in base rates. Recourse light structures, which were particularly prevalent in 2021, have lost some momentum compared to previous years. The lower-than-expected margin increase over 2022 and the pulling back of recourse light structures may be related, as sponsors are actively choosing to opt for more secured facilities with additional covenants to bring down the cost of capital. As always, in this quickly evolving market, there are many creative solutions and many levers to pull to make sure all parties, sponsors and lenders alike, are able to achieve optimal outcomes and reach their goals.

Nonetheless, the lack of well-defined standards for this market means many sponsors are still getting comfortable exploring this space and the opportunity on offer. Sponsors tapping the market over the past two years have enjoyed an early mover advantage, setting some market standards, but this does not mean that new entrants into the market can't create novel structures to achieve new objectives. We are regularly advising pioneering solutions, whether bespoke NAV structures, hybrid continuation fund financings or new deferral solutions.

Will NAV financings follow the path of acceptance previously trodden by Subscription Credit Lines?

The arc of development for these types of transactions can be compared to that of the Subscription Credit Line market. Only a decade ago, this market was in its nascent stages and subscription lines were often viewed as an aggressive fund management technique. Now, sublines are a prevalent feature in almost 90% of all private equity funds, and GPs failing to make use of them may have to face probing LP questions as to the reasons for their absence. It is Rede's view that the NAV financing market is on track to see similar levels of adoption within private equity funds by 2030.

Unlike sublines, which are relatively uniform products, NAV facilities can be far more varied and diverse in their terms, structure and uses. As adoption increases, it will be important for the market to develop a clear set of standardised best practices and defined processes for NAV financings, ensuring strong buy-in from all stakeholders and mitigating the risk of any default.

In 2017, ILPA issued its first guidance document on sublines, recommending quarterly and annual disclosures regarding sublines impact on unfunded commitments and performance, as well as costs and key terms. These were further tightened up in 2020, and now encourage GPs to disclose the size and balance of any subline and the net IRR performance with and without the use of such facilities[7]. In Rede's experience, GPs are already following a similar approach with the use of NAV facilities.

7. Private Equity International (2020)

Looking ahead

Outlined below are a set of predictions and trends we expect to play out in the NAV financing market over 2023 and beyond. These trends are likely to shape this sector over the coming years, and those who are able to adapt and innovate will be best positioned to succeed.

1 **2023 will see an increase in both deal volume and value.** With a full pipeline of opportunities, Rede is expecting a busy year ahead

2 **NAV financing solutions will continue to branch off into a variety of different solutions and markets;** such as continuation fund financing solutions, which are often structured as hybrid deals (secured on the NAV and uncalled capital); refinancing existing debt and other deferred type payment structures

3 **Sponsors will find more and more purposes for NAV financing facilities,** and the fungible capital will start to be used as a lower cost of capital means to acquire platform investments, refinancing companies, cornerstone funds and more creative solutions

4 **Greater scrutiny and guidelines to be published by industry bodies** on the uses, disclosures and reporting of NAV lines in the sponsor's portfolio. This will also be driven by LP's demands to understand these facilities in more detail (and perhaps as investment opportunities)

5 **We will see an increasing proliferation of syndicated NAV loans,** which in turn will increase the proportion of rated NAV facilities (looking to access insurance capital), and tranched facilities where one lender takes a lien on the assets for a lower cost of capital and the other party a 2nd lien for a higher return

6 **GP financing will become increasingly utilised by GPs to help support their franchise through succession planning,** offer an alternative to a minority stake sale, seed alternative strategies and help GPs reach their desired level of GP commitment to new funds

Definitions and survey methodology

Definitions

NAV financing transactions

Our market statistics (i.e. completed deal value and volume of deals) are defined as NAV financing facilities applied at the level of a fund, backed by all or part of the portfolio of equity positions of direct Private Equity, Venture Capital, or Growth Equity funds. This definition does not include facilities lending to the General Partner/management company, Fund of Funds or secondary portfolios.

Lenders

Lenders in this report refers to several types of institutions operating in the NAV financing space, including, but not limited to, banks, credit funds, limited partners with credit strategies, and insurance companies.

Borrowers

Borrowers of NAV financing in this report refer to the private equity fund managers who raise, invest and manage the portfolio investments against which they are borrowing. They may also be described as General Partners (GPs), sponsors or private equity managers.

Margin

The margin referred to in this report is the fixed initial cost of capital above base rates at which lenders price NAV financing facilities. It is one element of the all-in cost of a NAV facility, alongside base rates and other fees and expenses.

Interest rates, or base rates

These refer to the interbank benchmark interest rate set by the governing bodies and used as a floating rate above the margin, which borrowers need to include in their all-in cost of capital for NAV loans. The two most relevant rates are EURIBOR (Euro Interbank Offered Rate) and SOFR (Secured Overnight Financing Rate), but other rates may apply.

Methodology

In March 2023, Rede launched its NAV Financing Lender Survey to gain a broader view of the current state of the market segment. All of Rede's key lender relationships in the NAV financing space were invited to participate in the Survey, including banks, credit funds, limited partners and insurance companies.

The Survey consisted of 10 questions that were designed to provide a comprehensive understanding of the market. Rede partners reached out to over 50 of its lender relationships active in this market for responses to the Survey.

Participants

The participants that answered the Survey were 72% non-banks (credit funds, limited partners, insurance companies and other lenders) and 28% banks.

Limitations

It is important to note that the Survey is limited to the responses of 19 lenders and may not be representative of the entire market. Additionally, the Survey is based on the lenders' perceptions and experiences and may not reflect the views of private equity fund managers or investors.

About Rede Transactions

Rede Partners is a leading independent fundraising advisor to the private markets industry. Founded in 2011, Rede has raised over €100 billion in total across primary fundraising and GP-led transactions, as well as completing multiple high-value strategic advisory assignments.

With a well-resourced 100-strong team based in London, New York, Hong Kong and Amsterdam, Rede has a rigorously implemented, focused approach combining a comprehensive service offering across the entire spectrum of investor-facing activities, and a long-term business development perspective. The Firm's business model is underpinned by an unwavering commitment to delivering against its clients' objectives, helping them tackle the challenges and seize the opportunities of today's capital raising environment. Focusing on quality over quantity, Rede engages only with firms after establishing strong conviction in the manager's calibre, values and future potential. Institutional investors around the globe trust Rede to seek out and bring them the market's most compelling investment opportunities.

Rede Transactions prides itself on its creativity and ability to manage processes to achieve a win-win solution for its sponsor clients, existing investors and new funding partners. Rede Transactions' multiple advisory capabilities, including NAV or fund financing the full range of SR led secondary transactions, enable GPs to maintain ownership of assets for longer and provide liquidity to LPs. These solutions allow for additional time, control, and fresh capital to execute value creation plans.

To date, the Rede Transactions team has advised on a total of 36 engagements, totalling over €9bn of transaction volume.

Rede's Transactions team members have broad ranging experience, from the buy-side, sell-side and direct private equity and is supported by the weight of the wider Rede platform.

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