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NEWS & ANALYSIS

GPs up fund-level borrowing to optimise management and performance

Higher caps for borrowing limits and more flexibility on fund life extensions are among fund terms trends in a difficult fundraising market, according to Proskauer.

Managers are increasingly seeking more flexibility on fund-level borrowing, fund life and investment period extensions, according to findings from law firm Proskauer.

Investors continue to have a significant focus on fund leverage and some are less comfortable with extensive borrowing, the firm detailed in separate Fundraising Terms and Trends in European and North America Buyout Funds reports.

"As in recent years, there is a strong trend towards higher fund-level borrowing limits at all fund sizes," according to Proskauer's findings. The majority (71 percent) of European funds' borrowing limits are in the 20-30 percent range, while 63 percent of the funds in the sample have limits of 30 percent or greater. This represents a significant increase from 49 percent in the previous year's report.

Meanwhile, Proskauer's inaugural report for North America found that 47 percent of funds surveyed have borrowing limits of 30-50 percent.

"Borrowing continues to be an area where we're seeing managers seek more flexibility in general, both in terms of the amount borrowed and the type of borrowing that funds are able to do," Ryan Carpenter, a Boston-based private funds partner at Proskauer, told Private Equity International.

"When taken together with the general movement towards increased capacity for recycling of proceeds and follow-on investments, these trends reflect GPs' increasing preference to have multiple tools available to deploy capital later in the fund's life in ways that were previously more constrained.

He also noted that for managers seeking the ability to add NAV or hybrid facilities, there are a lot of conversations with investors around the intended use case for those borrowings.

LPs expect a disciplined approach from GPs, added Chris Elson, a private funds partner in the firm's London office. "What LPs will let a GP borrow will reflect the past practice of a GP and how it ties in and is communicated with the wider fund strategy."

He noted that the borrowing limits are set and negotiated with LPs in the context of specific fundraisings. "The long-term relationship between GP and LP is important and careful communication on borrowing expectations from vintage to vintage is key here."

Across both markets, the lion's share of funds (87 percent in Europe and 80 percent in North America) continue to have an initial term of 10 years. Fundraising periods in both Europe and North America is 12 months in the overwhelming majority of funds, while the investment period is between five and six years.

On fundraising extensions, the most common is that funds may be extended by either two or three single-year extensions and varies across fund sizes, the report found.

In addition, the range of GP-led liquidity options now available to managers has "relieved pressure on fund terms and so we do not expect a marked lengthening in the term of traditional buyout funds in fund terms in the coming years", the report noted.

Elson added that due to the maturity of the industry, big picture fund terms tend to be relatively settled and there are nuanced shifts on an annual basis, driven in part by the economic environment and developments in the industry. These include management fee rate; fee discounts for large, loyal and early investors; GP commitment and preferred return.

"The length of the fund term is a good example because it reflects the wider toolkit of options that GPs have at their

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disposal with respect to liquidity options," Elson said. Funds continue to give GPs discretion to extend the fund term by at least one year, he said. LPAC approval is then an increasingly common requirement after that period, particularly for Europe funds. "Flexibility in the LPA on fund term gives GPs the optionality to assess the full range of available options and how and when they exit investments and manage the fund," he added

Similarly, across US buyout funds surveyed, there is a long-term trend towards more flexibility around extending fund life and investment periods stretching longer, Carpenter said. "We're seeing some of that generated by selecting a later date to use as the reference point for determining the end of the investment period."

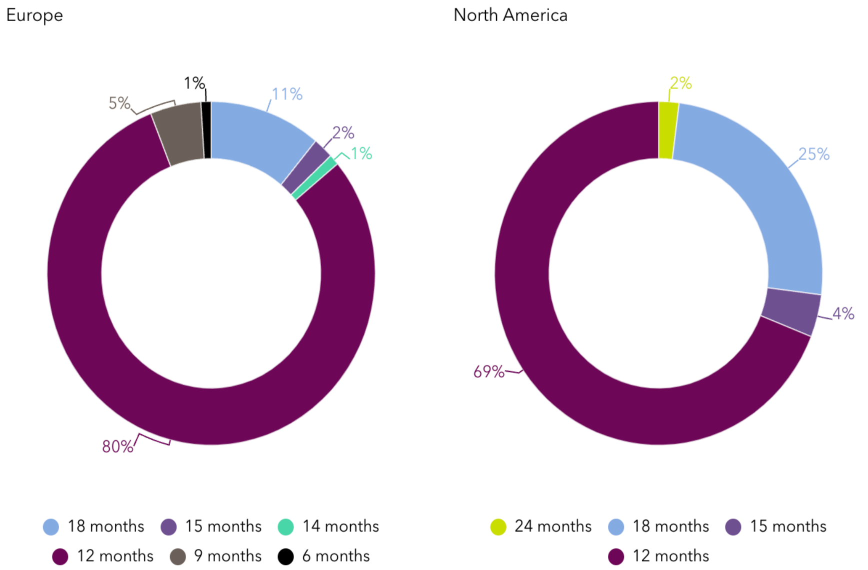
"In a difficult fundraising market, a GP's choice of fund terms is one of the levers that they have to decide on, the others being how quickly they want to raise capital, how much they want to raise, and then the wider project management strategy around that. So in this market, pushing on all of speed, size, and terms all at the same time means that, with the exception of a number of in-demand GPs, it may be more difficult," Elson said.

If a GP chooses to keep its terms consistent while pushing on size and/or speed, it may be able to achieve a more efficient fundraising process, he said.

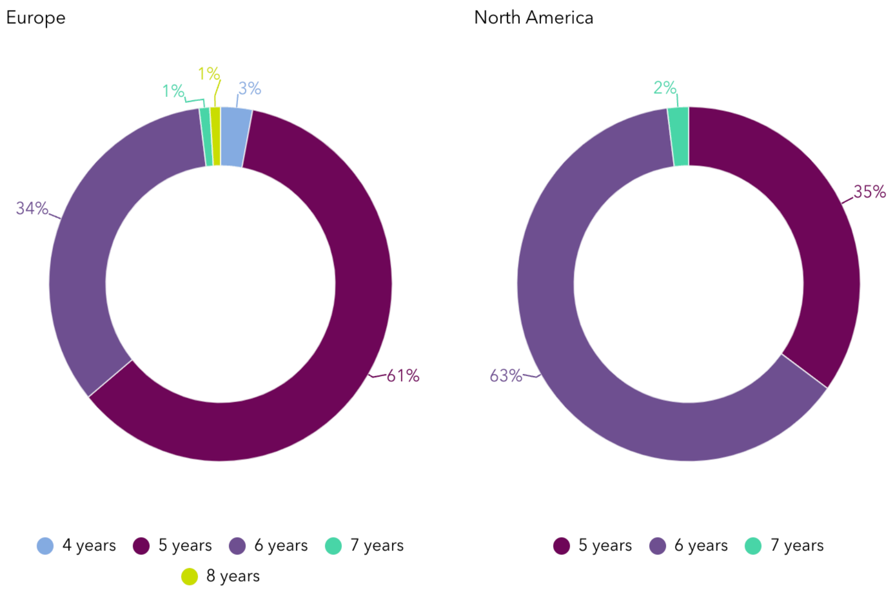
Proskauer's analysis covers 29 key LPA terms and conditions from 71 European-focused buyout funds and 25 key LPA terms and conditions from 78 North America-focused buyout funds. All funds were raised from 2022-23.

FUNDRAISING TERMS AND TRENDS

Fundraising period (% of respondents)



Investment period (% of respondents)



Source: Proskauer Rose

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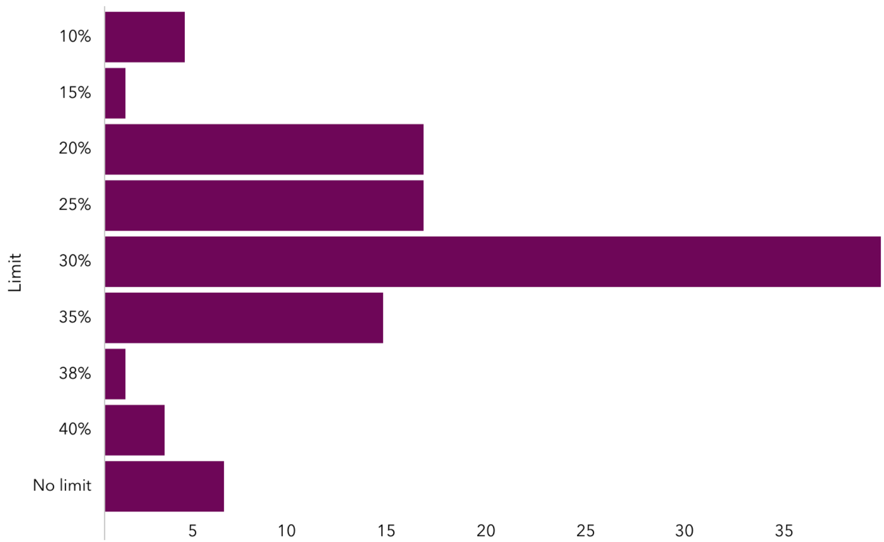
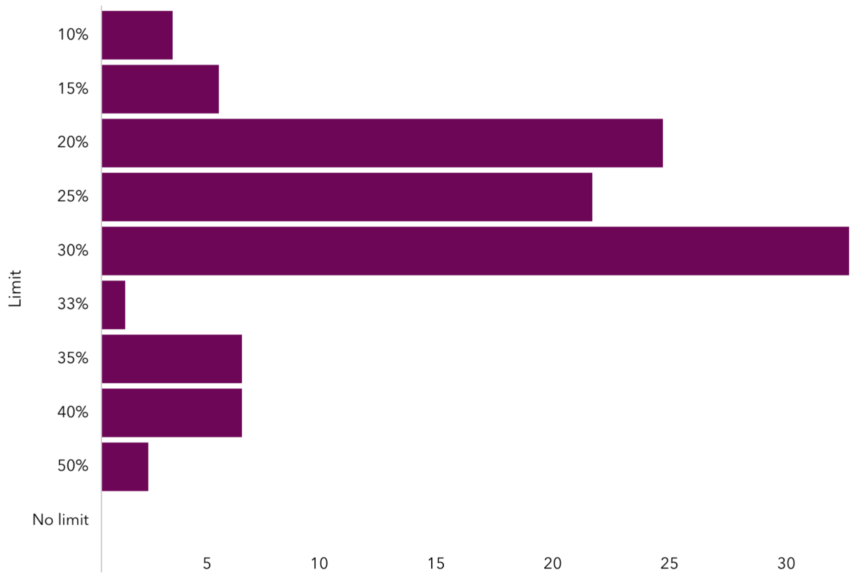
Limits on sub-lines, bridge facilities and fund level borrowing (% of respondents)

Europe



North America



Source: Proskauer Rose