

**PART 4:**

**Proposed  
Legal  
Documentation**

# Proposed Legal Documentation

In this section, we review key legal terms in older LPAs that relate to NAV-based facilities and propose sample legal language for new LPAs that would establish clear expectations and guardrails regarding use of these facilities.

## GP Treatment of NAV-Based Facilities in Older LPAs


Because NAV-based facilities are a newer development in private equity fund finance, most older LPAs do not explicitly consider NAV-based facilities, which results in inconsistencies around how GPs treat them today. Some GPs have taken the approach that the existing borrowing provisions in older LPAs allow for discretion to implement a NAV-based facility without engaging the fund's LPs and/or seeking clearance from the LPAC.

Other GPs have taken the approach that they need LPAC consent or a waiver to utilize a NAV-based facility consistent with LPAC authority to approve deviations to the borrowing permitted under the LPA. In these instances, the GP requests the LPAC provide a waiver to broadly allow for use of NAV-based facilities. The waiver is generally not tied to a specific facility.

Where LPAs are silent on NAV-based facilities, LPs should review the fund borrowing provisions and the fund-level leverage provisions of the LPA. Specifically, the Limitation on Indebtedness provisions should prescribe what type of borrowing the fund is allowed to incur. Below is example language from the *ILPA Model LPA*:

*7.2.1 The Fund may not borrow amounts, issue guarantees or otherwise incur indebtedness except on a short-term basis for periods of less than six months to finance investments pending receipt by the Fund of Drawdowns, provided (i) that any borrowing from the General Partner, the Fund Manager or their respective Affiliates shall (A) contain terms that are no less favorable to the Fund than could be obtained in arm's-length negotiations with unrelated third Persons for similar borrowings and (B) require the prior written consent of the Advisory Committee, and (ii) that, at any time, the aggregate liability of the Fund with respect to all such borrowing, guarantees and indebtedness does not exceed the lesser of (A) [X]% of the total Commitments and (B) the aggregate amount of Remaining Commitments.*

*7.2.2 Subject to Section 7.2.1, the Fund Manager or the General Partner may establish a credit facility for the Fund with one or more financial institutions, pursuant to which the Fund's obligations are secured by a pledge or other grant of a security interest and the assignment by the General Partner to the relevant lender of the rights of the General Partner to deliver Drawdown Notices to the Limited Partners and to enforce all remedies against Limited Partners that fail to fund their respective Remaining Commitments in accordance with the terms hereof (a "Credit Facility").*



**ILPA recommends that LPs proactively discuss NAV-based facilities with their GPs to understand whether fund documents have been interpreted to exclude facilities at the SPV/master holding company from fund-level leverage provisions.**

Language similar to that in the *ILPA Model LPA*, which is relatively common, expressly allows the manager to take out a subscription line of credit but does not expressly consider a NAV-based facility with the fund or an SPV as a borrower. When they encounter an LPA with this type of language, LPs should ask their GPs if they interpret that they have the power to utilize a NAV-based facility, considering they are not expressly addressed in the LPA.

Fund-level leverage provisions limit the total amount of leverage that the fund can take out, generally as a percentage of overall commitments, remaining commitments or the net asset value of the fund. When a fund takes out a NAV-based facility, one or more SPVs or a master holding company are created below the fund-level, but above the portfolio companies, to incur the indebtedness. Some GPs have taken the view that the SPV or master holding company is technically outside the scope of the fund itself, and thus not included in any fund-level leverage limitations. As a result, LPs would not be able to know how much leverage the fund has taken out at the levels above the portfolio companies. Additionally, without LPA-imposed limits, GPs may be able to take out more leverage than would otherwise be prudent or utilize facility proceeds for reasons not aligned with the fund and LPs.

ILPA recommends that LPs proactively discuss NAV-based facilities with their GPs to understand whether fund documents have been interpreted to exclude facilities at the SPV/master holding company from fund-level leverage provisions.

### Addressing NAV-Based Facilities in Newer LPAs

Moving forward, newer LPAs should address NAV-based facilities to ensure a shared set of expectations and guardrails around permissible uses. New LPA language should delineate the reporting expectations around NAV-based facilities. Additionally, LPA language should clearly define limits to the amount of leverage that a GP is able to incur through NAV-based facilities throughout the life of the fund. This is critical to understand the risks associated with a potential fund investment. Lastly, LPA language should clearly define the term “NAV-based facility” so any SPV used counts toward the calculation of the leverage limit but does not encapsulate SPVs or borrowing structures set up to other forms of debt (i.e., single company portfolio debt.).

New LPAs should set shared expectations around how NAV-based facilities are reported. For example, the *ILPA Model LPA* requires:

*15.2.1 Until the final liquidation of the Fund, the General Partner shall cause the Fund to prepare and provide to each Limited Partner the following:*

*15.2.2.8 the amount of debt for which the Fund generally, and any Portfolio Investment particularly, is directly or indirectly encumbered, as well as whether or not any such debt is recourse to the Fund or to a Portfolio Company or is cross collateralized among other investments or vehicles managed by any Interested Person.*

*15.2.3.5 a report of the total debt and credit in use by the Fund, including with respect to any Credit Facility: (a) the balance and percentage of total uncalled capital; (b) the number of days outstanding of each Drawdown; (c) the current use of proceeds from each facility; (d) the net internal rate of return with and without the use of the Credit Facility; (e) the terms of the Credit Facility (including but not limited to any upfront fees as well as drawn and undrawn fees); (f) costs to the fund (including but not limited to interest and fees); and (g) any such further information the GP shall deem appropriate.*

Additionally, borrowing provisions within new LPAs should include concepts that encapsulate NAV-based facilities, so that LPs are informed as to the amount of leverage a fund is able to incur through traditional fund-level leverage as well as through NAV-based facilities. For example:

*The fund may incur indebtedness for borrowed money (including by way of entry into a subscription facility **or a NAV-based facility**) provided (i) that any Subscription Facility borrowing shall be on a short-term basis for periods of less than [six months] to finance investments pending receipt by the Fund of Drawdowns, (ii) that any borrowing from the General Partner, the Fund Manager or their respective Affiliates shall (A) contain terms that are no less favorable to the Fund than could be obtained in arm's-length negotiations with unrelated third Persons for similar borrowings and (B) **in the case of a NAV-based facility, require the prior written consent of the Advisory Committee**, and (iii) that, at any time, the aggregate liability of the Fund with respect to all such borrowing, guarantees and indebtedness **(including, without limitation, pursuant to a NAV-based facility)** does not exceed [X]% of the total Commitments and, in the case of a Subscription Facility, the aggregate amount of Remaining Commitments. For the avoidance of doubt, indebtedness incurred by a Borrowing Facility shall be subject to the restrictions in this section.*

*"NAV-based facility" means any borrowing or preferred equity financing at the Partnership level or at the level of any Borrowing Subsidiaries for the purpose of facilitating or funding Investments (including for follow-on investments), paying or reimbursing Partnership Expenses or other Partnership obligations or financing distributions to Limited Partners, which borrowing or financing is secured in whole or in part by all or substantially all of the fund's assets including equity Investments or distributions in respect thereof.*

*"Borrowing Subsidiary" means one or more Persons or arrangements formed beneath or alongside the Partnership or an Alternative Investment Vehicle to facilitate the obtaining, administering or securing of, or primarily in connection with, obtaining a NAV-based facility or similar borrowing arrangement, including such Persons or arrangements formed to hold more than one Portfolio Companies for such purpose.*

ILPA is not recommending a specific percentage threshold to limit the amount of NAV-based facility exposure. That exposure should be determined by LPs and GPs during fund negotiations based on the strategy of the fund and relevant risk factors. However, a clear limit is essential for LPs to understand the risks associated with their investments.

Additionally, new LPA terms should outline the role and responsibilities of the LPAC as it relates to NAV-based facilities. Specifically, the LPA should outline that the GP needs to obtain LPAC and/or LP approval for all conflicts of interest associated with a NAV-based facility.

ILPA recommends that GPs seek LPAC and/or LP approval to address any conflicts of interest that could be perceived arising from the transaction, regardless of whether the LPA expressly addresses NAV-based facilities.<sup>7</sup>

Finally, LPs should be wary of LPA provisions that give GPs broad authority to implement NAV-based facilities with little LPAC or broader LP oversight. LPs should also be wary of any language which preclears conflicts associated with NAV-based facilities or could be interpreted as doing so.

**ILPA recommends that GPs seek LPAC and/or LP approval to address any conflicts of interest that could be perceived arising from the transaction, regardless of whether the LPA expressly addresses NAV-based facilities.**

<sup>7</sup> Recommendations on how GPs should consider engaging the LPAC can be found in Part 3.



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