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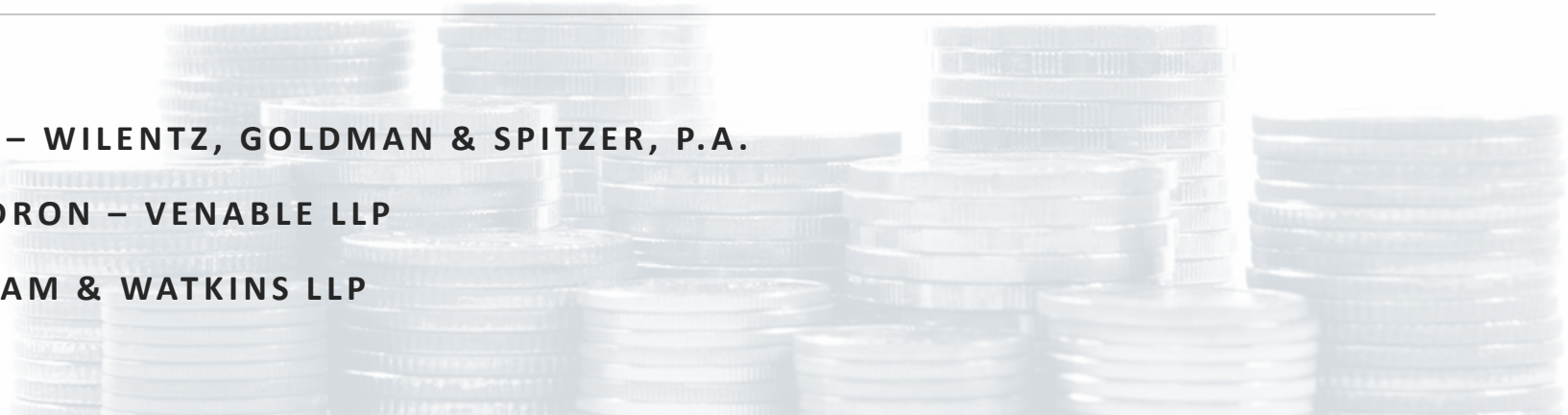
The What, Why and Where of Fund Finance

PRESENTED BY:

YESSICA J. PINALES COOMBS – WILENTZ, GOLDMAN & SPITZER, P.A.

LEONELA (LEO) VACCARO PADRON – VENABLE LLP

JEFFREY J. SAAVEDRA – LATHAM & WATKINS LLP



Meet Your Presenters

Yessica J. Pinales Coombs - Wilentz, Goldman & Spitzer, P.A.

Yessica J. Pinales Coombs is an associate in the Banking and Financial Services group at Wilentz, Goldman & Spitzer, P.A. She represents lenders and borrowers in commercial financing transactions, including leveraged financing, asset-based financing, private equity sponsor finance deals, commercial real estate acquisition and refinancing, and non-real estate financing.

Prior to joining Wilentz, Yessica served as a judicial law clerk in the New Jersey Superior Court. She earned her law degree from St. John's University School of Law, where she was a part-time evening student while working full-time as an Assistant Vice President and Financial Center Manager at Bank of America. Before transitioning to law, Yessica spent five years in the banking industry, where she identified and implemented solutions to mitigate financial risk and assisted in financial fraud investigations.

Actively engaged in the legal community, Ms. Pinales is a member of the Hispanic Bar Association of New Jersey, the Hispanic National Bar Association, and the Middlesex County Bar Association. Though Yessica was raised in New York, she takes pride in the cultural values of her native homeland, the Dominican Republic. She currently resides in Newark, New Jersey, with her husband and two daughters. Outside of work, she enjoys traveling, running long distances, and she loves to dance.

Ms. Pinales is a fluent Spanish speaker.

Ms. Pinales was recognized in the "Ones to Watch" 2022, 2023, and 2024 list byBest Lawyers in America.

Leonela (Leo) Vaccaro Padrón – Venable LLP

Leonela (Leo) Vaccaro Padrón is an experienced finance attorney who has been representing bank and non-bank lenders, as well as borrowers of all industries and sizes, in a broad range of financing transactions for over 13 years. She is counsel at Venable LLP and is resident Venable's Miami office.

She has extensive experience in fund finance (subscription lines, NAV facilities, GP and management lines of credit, hybrids and other structures), asset-based and asset-backed lending (including warehouse facilities, REPOs, accounts receivables financings and factoring transactions, among others), leverage finance, project finance, direct lending, secured and unsecured working capital facilities, DIP lending and distressed credits, among others. She also advises clients regarding how to monitor compliance with existing financing arrangements and has ample experience structuring transactions to optimize the capital structure of her borrower-side clients and to mitigate credit risks for her lender-side client.

Leo is a native Spanish speaker and is fluent in English and French. She is also proficient in Portuguese and Italian. Prior to joining Venable LLP, she worked for major law firms in New York, Paris and Milan and served as in-house senior legal counsel at a major infrastructure developer.

Jeffrey J. Saavedra – Latham & Watkins LLP

Jeffrey J. Saavedra is an associate in the New York office of Latham & Watkins and a member of the firm's Finance Department and Structured Finance Practice.

Jeffrey has experience in a variety of structured finance, securitization, warehousing, and other secured financing transactions, representing banks, issuers, underwriters, placement agents, borrowers, lenders, and other financial institutions. In particular, Jeffrey works on the financings of a range of traditional and esoteric asset-backed securities in an assortment of industries, such as music, fintech, energy, receivables, and other emerging sectors.

Jeffrey maintains an active pro bono practice and has primarily represented Latino clients in a range of matters including asylum, intellectual property, corporate governance, and military discharge status upgrades.

Jeffrey serves as a member of various Latham affinity groups and is currently serving as a Local New York Co-Leader of Latham's Hispanic/Latin American Lawyers Group (2024-2025).

He is a former President of the Dominican Bar Association (2023), a recipient of the *El Awards* 2023 by El Diario, recognizing notable Latino community leaders, and in 2024 received a *Top Lawyer Under 40 Award* from the Hispanic National Bar Association.

Jeffrey remains active with New York Law School, including currently serving on the Alumni Board and speaking on panels discussing both commercial and diversity related topics.

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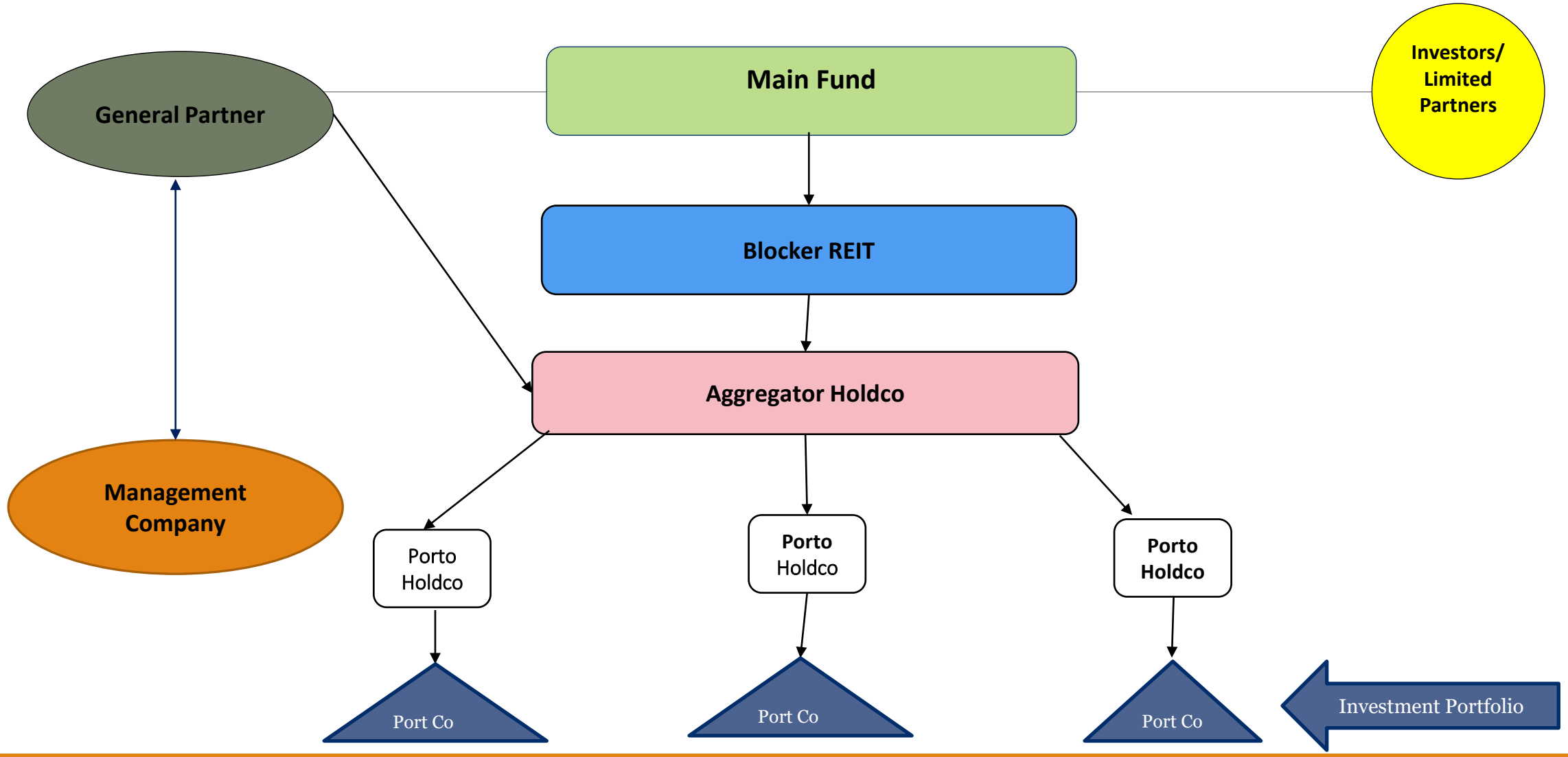
What is Private Equity?

What is Private Equity or “PE”?

- Private equity or “PE” refers to private capital from various types of investors which is pooled in a fund (typically with a limited partnership structure) and deployed to purchase a variety of assets.
- PE funds’ initial source of capital is its investor’s capital commitments. After the PE fund progresses in its investment cycle, it receives additional capital from the revenues generated by the assets the PE fund invests in.
- PE funds also use a variety of debt products, generally referred to as fund finance products, to maximize their capital structure.
- The main goal of a PE fund is to enhance the value of its investments (which can be companies, real estate, equity, debt, among others) through strategic, operational, and financial improvements.
- The are various types of PE funds, such as LBOs, growth capital funds, venture capital, debt funds, among others.
- As of June 2024, PE Funds’ assets under management (“AUM”) globally are estimated to be $4.7 trillion

Typical PE Fund Structure



What is a PE Fund?

- The main fund ("PE Fund") is typically a limited partnership managed
  - Managed by a general partner or management company
- PE are generally not registered with the SEC
- PE Funds generally are registered investment advisors the Investment Company Act of 1940
- Investors become limited partners in the PE Fund and commit to contribute capital
- The Fund will invest in a variety of assets (e.g., companies, loans, loan originators, real estate, mortgage services, debt, etc).
- Each investment typically has its own holding company, which is siloed from other investments of the PE Fund.
- The structure of any particular Fund is tax driven and varies broadly depending on the types of investors, the types of investments, and jurisdictions involved.

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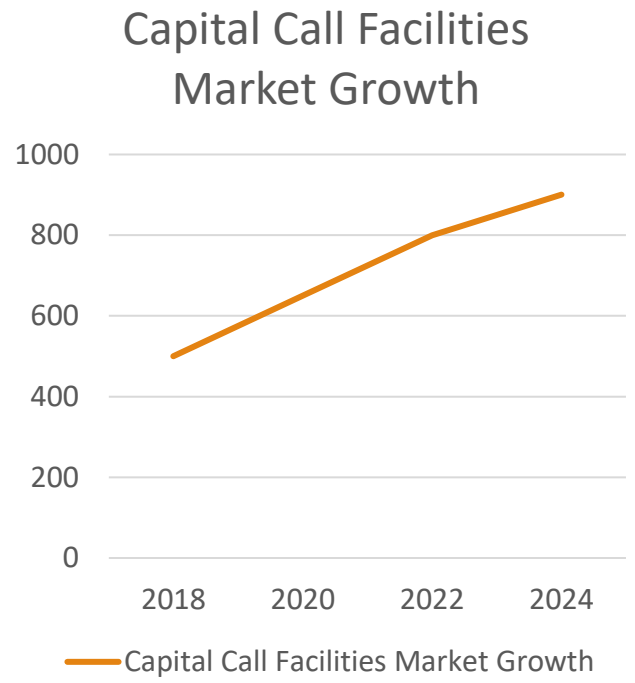
What is Fund Finance?

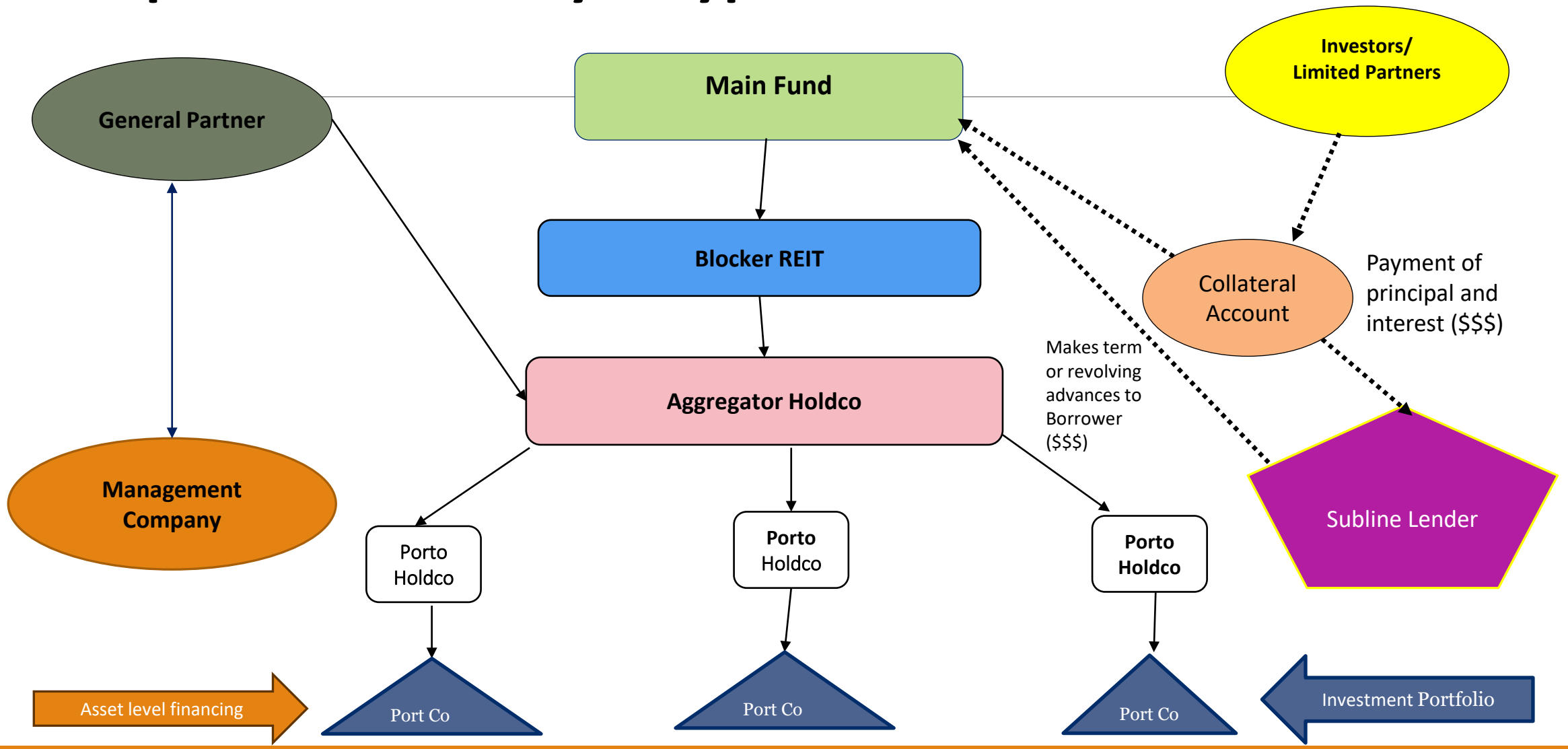
What is Fund Finance?

- "Fund Finance" refers to the various types of financing products used by PE Funds across the PE Fund's structure and throughout the PE Fund's lifecycle to maximize its capital structure.
- Most common fund finance products include, but are not limited to:
  - Subscription line, or capital call, lines of credit
  - Net Asset Value ("NAV") credit facilities
  - GP lines of credit
  - Management company fees lines of credit
  - Asset-level financings (e.g., warehouse facilities)
  - Hybrid facilities
- As of 2024, the size of the capital call facilities market was about $900 billion
- As of 2024, the aggregate size of the fund finance market across all products was about $1.2 trillion



What is a Capital Call Facility?

Capital Call Facility – Typical Structure



Capital Call Facilities Explained

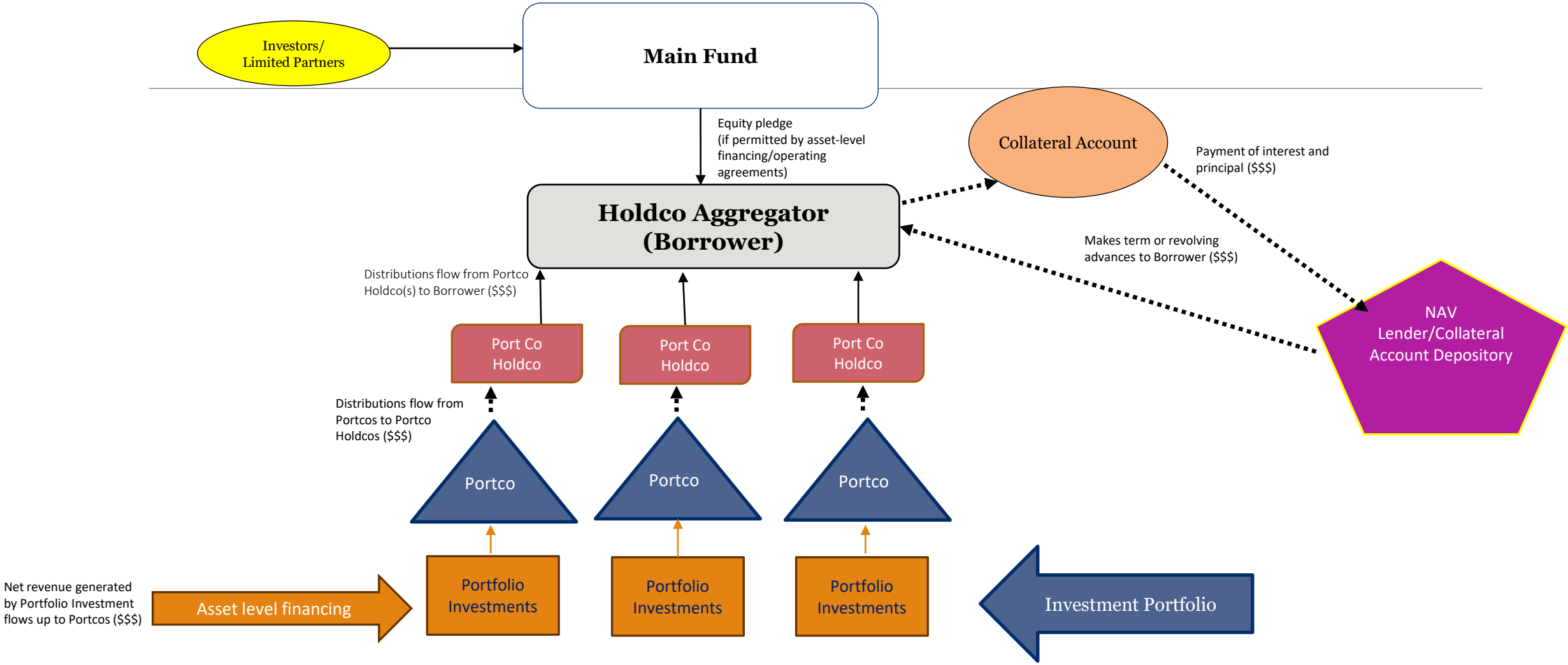
- A subscription, or capital call, line of credit is indebtedness incurred at the PE Fund level that is based off of, and secured by, the PE Fund's investors capital commitments to the PE Fund.
- The capital call facility allows the PE Fund to "bridge the gap" between the time it calls capital from investors and the date on which capital call proceeds are received.
- A capital call facility is not recourse to the PE Fund's investors and the investors have no liability for the PE Fund's indebtedness under the facility.
- The capital call lender will size the borrowing base as a percentage (referred to as the "advance rate") of the uncalled capital commitments of a subset of investors (referred to as Eligible Investors).
  - The advance rate will vary depending on the type of investor
- Eligible Investors must satisfy certain Eligibility Criteria, and are typically classified as:
  - Rated Investors
  - Non-rated included investors
  - Designated investors
- Exclusion Events will result in Eligible Investors ceasing to be Eligible and being excluded from the Borrowing Base

Capital Call Facilities – Key Features

- The collateral for a capital call facility will include:
  - The PE Fund's right to its investors' capital commitments, uncalled capital, capital call proceeds, rights to make capital calls and bank accounts into which capital call proceeds are deposited
  - Since the GP of the PE Fund is tasked with calling capital on the PE Fund's behalf, the GP will also grant a security interest over its rights to call capital
    - The GP is not a guarantor and is not liable for the PE Fund's obligations to the capital call lender. It only provides a security interests over its rights to call capital on behalf of the PE fund.
  - Lender's counsel will conduct a bankability analysis of the PE Fund's and each investor's fund documents
    - LPA
    - Subscription agreement
    - Side letters, if any
  - Borrowing Base Certificate delivered periodically (e.g., with each Borrowing Request, with each quarterly and annual financial statement, upon certain investor transfers and exclusion events, etc)
    - Mandatory prepayments triggered upon occurrence of Borrowing Base Deficiency
  - Cash Control Events will give capital call lender the right to block PE Fund's and GP's access to Collateral Account
  - Key Man Events
  - Defaulting Investor triggers
  - Negative covenants include:
    - Restrictions on additional indebtedness at the PE fund level
    - Restrictions on additional liens
    - Restrictions on GP's and investors' transfers of interests in PE Funds
  - Some capital call lenders have started including depository relationship covenants
  - Financial covenants are rare in capital call facilities (though can be found in after-care facilities of hybrid facilities)

What is a NAV facility?

NAV Facility – Typical Structure



NAV Facilities Explained

- Borrowing Base / Availability is determined by multiplying an advance rate (expressed as a %) times the eligible NAV of Eligible Investments (minus, in some cases, the excess concentration amount).
  - Advance rates can range anywhere from 10% to 90% and is a credit decision made by the lender's underwriting and credit teams.
    - Usually, deals with higher advance rates have a more asset-based / warehouse structure.
- Eligible Investments are a subset of the Fund's investment that meet certain Eligibility Criteria.
- Eligibility Criteria is specific to the type of assets in the investment portfolio (e.g., real estate assets, loans, equities, etc.)
- If investments fail to satisfy any of the Eligibility Criteria, an exclusion event occurs which results in the specific investment ceasing to be an Eligible Investment and being excluded from the Borrowing Base.
  - If exclusion triggers a Borrowing Base deficiency, either a mandatory prepayment in the amount of the deficiency needs to be made, or additional Eligible Investments need to be included into the Borrowing Base to cure the deficiency.
- In some hybrid facilities, the borrowing base also includes an amount equal to a separate advance rate times the uncalled capital commitments of the fund's investors.
- Diligence includes:
- Non-contravention analysis of:
  - Obligors' operating agreement
  - Portfolio investment documents
  - Other debt instruments (including at the asset-level)
- Ownership structure of portfolio investments
  - In-depth understanding of (i) what net cash generated by underlying investments is distributable to obligors and (ii) how the cash generated by the underlying investments flows up to the obligors
- Lien searches on obligors, credit support providers, direct owners of underlying investments
- In hybrid deals, bankability analysis of fund operating agreements and investor documents

NAV Facilities – Key Features

- Collateral for NAV facilities is deal specific and can depend on:
  - Structure of fund
  - Non-contravention analysis of operating agreements, investment documents and other indebtedness in the fund structure
  - Nature of investments
- Collateral for NAV facilities always includes the distributions (including liquidation proceeds) on account of the underlying investments made to the obligors and the bank accounts into which such distributions are made.
- Collateral for NAV facilities may include:
  - Direct pledge of investments
  - Equity interests in direct or indirect owners of underlying investments
    - Distributions made to obligors on account of the pledged equity interests
- In hybrid deals, collateral will also include a pledge of fund's investors' capital commitments, the fund's and general partner's right to make capital calls and bank accounts into which capital contributions are deposited.

NAV Facilities – Key Features

- Key covenants can include:
  - Requiring the distributions payable to the obligors on account of the underlying investments be deposited into pledged collateral accounts
  - Depending on the type of underlying investment and how they are managed, requirement to deliver payment direction letters
  - Mandatory prepayments if Borrowing Base Deficiency occurs as a result of an exclusion event
  - Mandatory prepayment of net cash proceeds on liquidation/disposition/transfer of underlying investment
  - Negative and/or double negative covenants
  - Restrictions on additional Indebtedness
  - Restrictions on structure changes
  - Right to (i) periodic (quarterly or annual) valuations by a third-party appraiser selected by Lender and (ii) mandatory prepayment if the third-party valuation results in a Borrowing Base deficiency
  - Guaranties/equity commitments from parent entities
  - Minimum Deposit Relationship

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What is a Securitization?

In a Nutshell

- We put assets in a box and raise finance against that box
- What goes in the box?
  - Assets with stable & predictable cashflows
  - Maintain a capital value
- What is the box?
  - Bankruptcy-remote SPV
  - Typically an LLC or an LP
- Who are the finance parties?
  - Bank lenders
  - Other investors (typically QIBs and/or Accredited Investors)

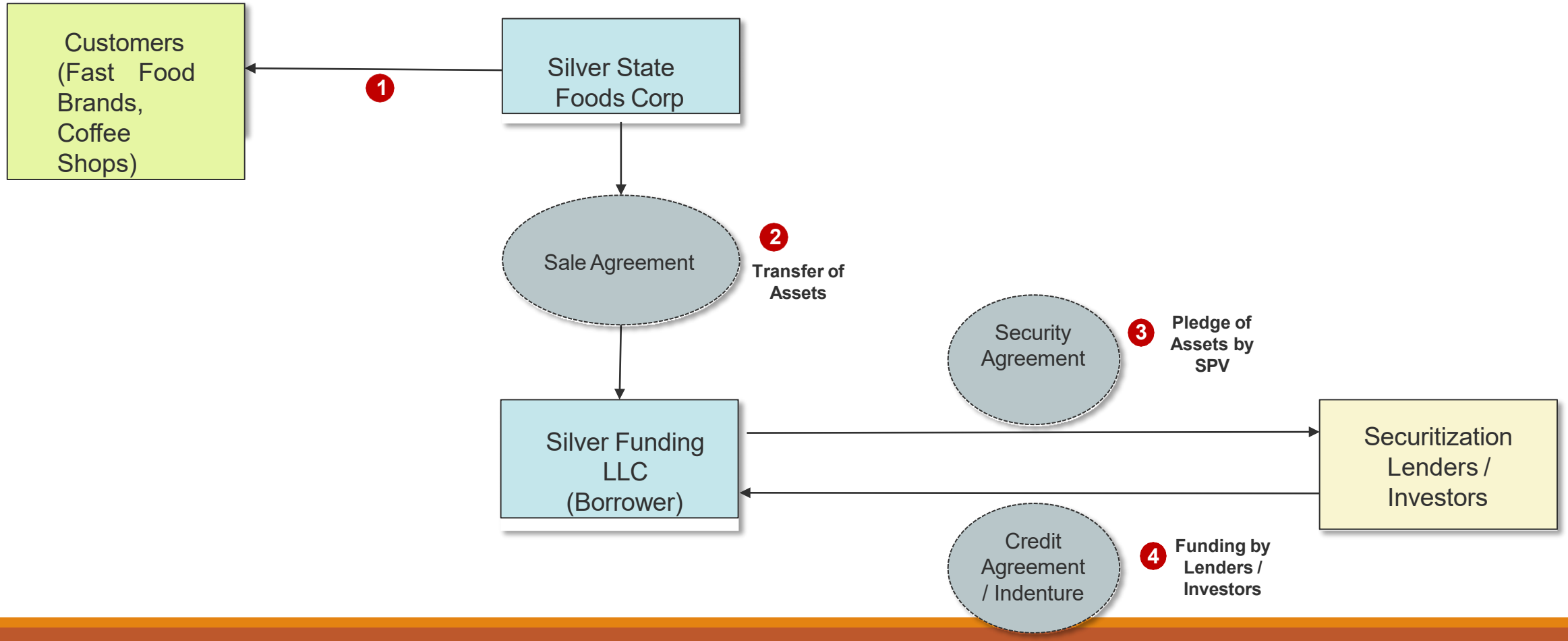
Why Do a Securitization?

Benefits for Sponsors/Originators	Benefits for Lenders/Investors
Higher rated securities & lower financing costs	Predictable stream of cash flow from assets
Access to different investors	Different risk/return profiles available within one offering
Match funding for amortizing assets	Assets isolated from risk of problems of the sponsor
Avoid restrictive covenants	No competing lenders/investors with interests in the assets
Financing often available in times of stress	Highly rated securities not elsewhere available

Securitization vs. Secured Loans

"Conventional" Secured Loan	Securitization
Is a secured transaction	Is a secured transaction
Borrower is an operating company that already exists in the company's org chart	Borrower is a special-purpose, bankruptcy-remote company, or SPV, that will be newly created solely for the purpose of the securitization
Collateral consists of multiple types of assets (usually all the borrower's assets)	Collateral consists of a single type of cash- flowing assets
Financial covenants to test performance (EBITDA and similar tests)	"Borrowing Base," "Loan-to-Value" (LTV) or "Debt Service Coverage Ratio" (DSCR) tests (focus on the asset value / cash flow)
Financing agreements are structured to work for the company as it currently exists	Company is structured to optimize the financing

What Does a Securitization Look Like?



What Assets Can You Securitize?

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Conventional Asset Classes

- Mortgages
- Auto loans
- Student loans
- Credit card receivables
- Trade receivables
- Capital Call loans

Esoteric Asset Classes

- Digital Infrastructure (data centers)
- Energy (traditional, renewable)
- Media and Sports
- Cryptocurrency
- Music Catalogues
- Net Lease
- Supply Chain Finance
- Telecommunications (cell tower, DAS broadcast tower)
- Transportation (aircraft, rental car, shipping, railcar)
- Whole Business

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Can a Capital Call Facility be Securitized?

Capital Call Facilities Securitization – Proof of Concept

- In October 2024, Goldman Sachs ("GS") completed a $500 million rated securitization deal backed by a subline pool (ie, the Capital Street Transaction).
- The Capital Street Transaction was the first, broadly syndicated, publicly rated securitization of sublines.
- Structured as an asset-backed notes issuance by a newly-formed, bankruptcy remote SPV to which GS transferred a portion its subline portfolio.
- The SPV was initially funded by equity from investors (including Blackstone) and, subsequently, by the proceeds from the issuance of the notes (net of payments to the various parties involved in the securitization).
- Final capitalization of the SPV post closing was 90% Class A Notes, 5% Class B notes, and 5% equity.
- The SPV issued two types of notes: Class A notes (rated "AAA", priced at SOFR plus 1.35%) and Class B notes (rated "AA", priced at SOFR plus 1.60%).
- Notes purchasers were mostly US insurance companies and asset managers – list of purchasers is not public.
- Because sublines are mostly revolving lines of credit, contributing them to a securitization pool can be difficult because the proportion of the notional amount of each line changes as borrowers draw and repay.
- The solution – GS contributed only funded amounts of the sublines.

What did the asset pool look like?

- The subline pool backing the notes included the funded portion of about 30 sublines made by GS to a variety of funds (e.g., buyout, private credit, real estate and multi-strategy funds).
- Eligibility criteria applicable to the pool is not fully known, but we do know that (i) Sponsors of the sublines must have more than $20 billion in AUM; (ii) fund borrowers of the sublines must have over $250 million in uncalled capital commitments and/or net asset value; (iii) minimum funded spread cannot exceed Term SOFR plus 3.25%; and (iv) whitelist of subline borrowers for sublines to be added to the pool.
- We also know that there are concentration limits on (i) the GPs and the fund borrowers involved in the underlying sublines (ranging from 5%- 7.5%, depending on the sponsor) and (ii) maturity of the underlying sublines (no more than 50% of the sublines in the pool can have maturities longer than 1.1 years.
- Pool is revolving, which allows for replacement of sublines in the pool that mature prior to the maturity of the notes.