The Rise of Alternative Fund Lenders

The growth of the fund finance market, from the development of the subscription line and NAV or asset backed facility, to the array of products and credit lines now available, has been remarkable.

While banks have traditionally dominated this space, and that is expected to long continue, one recent trend we are seeing in our deals is the growth of alternative (non-bank) providers of this finance, including credit and specialist funds.

Alternative lenders in the fund finance space are not huge in number (at least as lender of record) but they are by no means new entrants, with their participation in the market pre-dating Covid-19. However, the increased need for GPs to be creative in their capital raising solutions because of the crisis has resulted in us seeing increasingly complex types of facilities being made available (and the consequent rise in pricing is creating more attractive yields for non-bank participants). With this, we may well see a greater appetite for fund finance products from alternative lenders, who can increasingly be on hand to offer liquidity solutions.

Subscription line facilities have not traditionally appealed to credit firms given, among other reasons, the relatively modest returns. However, alongside the growth in fund financing generally (including alternative structures, pref lines and GP financings), there has been an increase in specialist lenders and funds entering the market as lender.

Where banks cannot or will not lend, or if speedy access to capital is needed, then a credit firm may be able to step in. Typically alternative lenders are seen as being able to execute transactions more quickly (at least in theory). They are also well positioned to analyse the complex structures and alternative asset classes for which there is no or limited appetite from traditional lenders. They can generally offer increased flexibility on terms, creating more bespoke financing solutions, with a higher risk threshold and an ability to provide capital in distressed situations.

Any such advantage is of course off-set by the higher funding costs of borrowing from an alternative lender, who will generally look to generate minimum returns. And, based on the transactions we are working on, as it appears that the cost of subscription line and NAV facilities is increasing in both the US and Europe following on from the Covid-19 pandemic, this may further increase alternative lender interest in these offerings. While current rates are probably still too low to attract many alternative lenders into the "traditional" sub line market, which will likely remain the domain of the banks, there may be opportunities in the NAV lending field as well as other alternative structures and products where demand for liquidity is increasingly, and is expected to continue to be, high.

The increase in the demand for NAV facilities and other fund finance solutions is widely reported, and as the pandemic puts pressure on portfolio companies (and funds alike), there may be space for alternative lenders to provide the credit support and flexibility that is required, and that banks may, for the moment, not wish to provide.

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