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NAV-igating Liquidity Constraints: De-risking or Deception?

NAV Loans' Role in the PE Landscape

GPs are under pressure as high interest rates and valuation mismatches slow exits and drive a significant drop in distribution rates, straining LP patience.

Exit Values	Holding periods	LP Distributions
-26%	+35%	-63%
H1'24 vs H1'23	> 5 yr old investments	PE distribution rates[1]

In this context, **Net Asset Value (NAV) loans**, once a niche tool for private credit, are becoming increasingly relevant for GPs, sparking both **interest** and **debate**. NAV loans are **a low-cost, fund-level debt** solution that take repayment from a sweep of cash flows from **the underlying investments**. For GPs, NAV loans offer much-needed flexibility, but depending on the use case, can be a point of contention for LP's and portfolio company managers.

GPs Empowered By Varied NAV Loan Use Cases:

- **Liquidity to Support Struggling Investments**: Financing turnaround strategies when additional LP capital is unavailable
- **Accelerate Value Creation**: Lenient debt terms allow managers to focus on driving value rather than meeting covenants
- **Optimize Portfolio Capital Structure**: Simple way to solve over-equitized funds rather than doing multiple asset level refinances
- **Divestment Flexibility**: Delaying exits in poor market conditions or bridge funding gaps for continuation vehicles
- **LP Capital Returns**: Fund LP distributions to maintain expected returns when cash flow is delayed

Using NAV Loans to Fuel Portfolio Company Growth

Blackstone
>$1.0bn

Warburg Pincus
$1.0bn

- **Blackstone** is exploring a **>$1bn NAV loan** secured against its $19bn 2016 flagship *BCP VII* fund. The fund, which made its last investment in 2020, still holds c.$18bn worth of assets (c.$11bn of committed capital). Blackstone is likely to use the NAV loan as a **reserve for operational needs** and to **support and accelerate final value creation initiatives** required to achieve sizable enough exits for the remaining assets in the fund.
- **Warburg Pincus** secured a **$1bn NAV loan from Apollo** against its c.$15bn 2018 fund, marking its first use of institutionally sourced debt financing, in place of using traditional commercial banks. Warburg will pay a rate below 10% because the loan isn't being used to distribute cash to investors. The firm plans to use the new facility **to repay outstanding debt** to reduce exposure to commercial banks and **generate spare cash to support turnaround strategies for struggling assets** and **extract more value from prized assets.**

Using NAV Loans to Distribute "Recallable" LP Dividends

VISTA
$1.5bn

PAI PARTNERS
$1.1bn

- **Vista Partners** and **PAI Partners** both secured NAV loans exceeding $1bn, with notable portions allocated to **LP dividend distributions.** Vista earmarked as much as $500m for this purpose. This prompted **backlash from some Vista LPs**, whose NAV-funded distributions are **"recallable"**, meaning they need to have the money ready to repay if they are recalled.
- When the NAV underwriter stipulates that capital from a NAV loan used for LP distributions is recallable (which is common) this **shifts the ultimate risk away from the underlying fund assets, and onto the LPs.**
- Recallable or not, using NAV loans to facilitate distributions rather than to support portfolio companies **increases overall fund risk** by exposing portfolio companies to the idiosyncratic risks of others through cross-collateralisation. This practice has raised **concerns about transparency** and the true financial health of the funds.

NAV loans can be viewed as a powerful positive financial instrument in Private Equity if they are value accretive for GPs, LPs, and portfolio companies alike. When they are used to solve underlying portfolio company issues, value creation strategies, turnaround plans, or refinancing costly debt, they ultimately promote sustainable returns on capital. Whereas, directly distributing the loan proceeds to LPs without addressing the underlying portfolio issues might just be kicking the can down the road and highlights the need for greater transparency.

Notes: (1) Q1'24 private equity distribution rates vs 2015-2019 average

Sources: Bain & Company, Blackstone, Bloomberg, Cadwalader, Investec, MSCI, Neuberger Berman, Private Equity International, S&P