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FUND FINANCE FRIDAY

Managing Capital Calls During Turbulent Times

July 2, 2020 | Issue No. 84

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Everyone anticipated a correction in the marketplace, but it’s fair to say that no one expected it to come in the form of a global pandemic. But here we are. For GPs – especially emerging managers – using a capital call line is a very effective tool to manage capital calls. Let’s explore how capital call lines (also known as subscription lines) can help and what to expect from a bank vis-à-vis capital call lines and a banking relationship in general.

Use of a capital call line can be a best-practice cash management strategy for GPs in several situations. In today’s climate, they help provide needed liquidity relief to LPs by delaying a capital call by 60-90 days (or longer depending on the LPA). Accessing a line between closes can avoid overcalling from early LPs, especially during fluid situations like the coronavirus pandemic. Under more ordinary circumstances, a line helps avoid too frequent capital calls (more than four to five times a year) from LPs. Lines also provide leeway to meet time-sensitive deals as it relates to the 10 days – or more – typically cited in LPAs for LPs to make capital calls. Lastly, capital call lines address overcalling capital due to inaccurate forecasting of near-term deal activity that causes increasing cash balances and creates IRR drag. Now, perhaps more than ever, these are all occasions when a capital call line can be used to make managing cash flows easier for GPs.

A capital call line of credit can also be a boon to relationships with LPs. During these times, LPs are dealing with stressors of their own, and particularly small institutions, family offices, and HNWIs may need to generate liquidity to make a capital call by selling other assets at compromised values.

GPs today have several options when considering a capital call line of credit. Pricing is an important consideration but may not always be an easy apples-to-apples comparison. The cost of putting a capital line of credit in place would include consideration of the:

- Interest rate – typically a spread above or below the Prime rate (currently 3.25%)

- Unused fee – typically around 25 basis points and used to compensate the bank for reserve requirements
- Facility fee – upfront or annual charge for maintenance, etc. (also typically around 25 basis points)
- Legal documentation cost – includes *both* bank's legal fees as well as GP's legal fees

Other considerations should be a factor when considering a banking relationship:

- What does the bank's balance sheet look like?
- How experienced is the bank and its fund financing team?
- What is the size of the bank's fund finance – and its broader – business?
- How can the bank support portfolio companies?
- What are the bank's full banking capabilities?

Brad Smith, Executive Vice President and Head of Fund Finance at Pacific Western Bank, says, "We have not observed any abnormal borrowing patterns during the COVID crisis, as the majority of our clients have been drawing down and paying off their lines with a high degree of regularity. Further, we have not seen any LP defaults in our portfolio and hope that trend continues."

Securing a capital call line is an effective strategy for managing capital call lines during ordinary and extraordinary times. Choosing a banking partner that can deliver during good times and bad is a decision that serves GPs, and by extension LPs, well.