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The Forum is the premier venue for in-house financial and operational professionals to hear best practices and industry developments from a wide spectrum of private debt industry peers through the investment cycle.

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Dear colleague:

At a time when financial oversight and operational excellence matter most, PDI CFOs & COOs Forum offers a much-needed roadmap to navigating this current crisis.

Our publications Private Debt Investor and Private Funds CFO have been at the forefront covering the devastating impact of COVID-19 on the private debt markets and, more importantly, how firms are responding in the midst of great uncertainty. Thus, we have compiled a compilation of select articles that reflect the most timely and pressing topics affecting today's market.

Please enjoy this complimentary compilation.
Articles featured in this white paper include:

COVID-19 checklist five areas of fund operations to consider

GPS ponder early repayments for credit lines as coronavirus threatens liquidity

Alternative lending and private debt what not to do in this crisis

Distress debt's appeal surges amid market uncertainty

I look forward to having you join us for the PDI CFOs & COOs Forum.

Thank you.
Sincerely,

Kwame Campbell
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Covid-19 checklist: Five areas of fund operations to consider

Lawyers from Paul Weiss pinpoint the areas of a private equity firm operations that may need to be adjusted to account for the coronavirus outbreak, including fund documentation, valuation and banking relationships.

The cascading impacts of the coronavirus outbreak (covid-19) on markets and businesses are creating a variety of challenges and opportunities for private equity funds. General partners may want to consider a variety of proactive steps, including reviewing investment objectives; altering fund documents; being more proactive in information sharing, valuations and reporting; reviewing borrowing limitations and derivative contracts; and other protective measures.

Broaden the investment mandate

The recent market turmoil arising from covid-19 will result in some GPs considering distressed and other non-traditional investment opportunities, including open market purchases of public equities. For existing private equity funds, the investment objectives set forth in the fund documents should be reviewed to explore whether or not they provide the flexibility to make these types of investments. For new private equity fund offerings, GPs may want to consider broadening the fund's strategy beyond traditional buyouts to include distressed investing for control, flexibility to invest in the debt of portfolio companies and possibly open market purchases of public equities. GPs will also need to understand the compliance and regulatory considerations (including filing requirements) pertaining to any such investments.

Alter the fund documents

- Offering Period: For ongoing fund offerings, GPs should expect delays in the offering process and may want to consider extending the offering periods of private equity funds beyond the customary 12 months. GPs may also wish to build in the flexibility for the consent of the advisory board or the GP to extend the offering period.
- Capital Commitment Rollover: GPs may want to consider asking LPs in existing private equity funds that are in liquidation or wind down to "reallocate" unfunded commitments into new distressed or other non-traditional strategies as a more efficient way of LPs' underwriting "new" commitments.
- Commitment Period: For ongoing fund offerings, GPs may want to consider building in commitment period extension mechanics (eg, the ability to extend by one or two years with the consent of the advisory board). For existing private equity funds that have the ability to extend commitment periods, GPs may want to consider seeking an extension now to get ahead of opportunities and ensure flexibility to draw on unfunded commitments.
- Term: For existing private equity funds nearing the end of their terms, GPs may want to consider seeking a term extension to provide additional time to weather a potential long-term financial downturn.
- Follow-On Investments: The expected need to provide additional capital to portfolio companies may put pressure on the follow-on provisions in fund documents (which typically cap the amount of follow-on investments at 15-20 percent of commitments after the end of the commitment period). GPs may want to consider whether, and to what extent, a follow-on investment is subject to these limitations if the follow-on investment is being funded without calling additional capital contributions (or through the use of leverage). If there is no follow-on investment capacity, or if follow-on capacity may be constrained down the road, GPs may want to consider if other means of credit support are available, such as portfolio company guarantees.

- Recycling: For ongoing private equity fund offerings, GPs may want to consider creating broader flexibility to recycle proceeds without regard to a specific timeframe (typically 12-24 months) or other than solely during the commitment period. GPs may want to consider the ability to treat special purpose vehicles as portfolio companies for purposes of enhancing recycling flexibility.
- LP Meetings: GPs may want to consider providing for alternative means of holding LP meetings, including by way of webcasts or other electronic means.
- Warehousing: GPs may want to consider the inclusion of warehousing provisions in fund documents to allow it or its affiliates to warehouse investments while private equity funds are in the offering period or are unable to obtain financing for an acquisition. Similarly, GPs may want to consider preserving flexibility to lend to funds or portfolio companies if traditional financing sources are not available.

Be proactive in information sharing, valuations and reporting

- Information Sharing/Selective Disclosure: GPs are encouraged to be proactive as LP requests for information regarding the manner in which funds and portfolio companies are dealing with issues arising out of covid-19's impact on operations. GPs should be consistent with the types of information and responses that are provided to LPs to mitigate selective disclosure issues. If LPs are inquiring about impacts on product demand, supply chain, working capital, valuation or dealflow, GPs may want to consider creating standard responses (consistent with how responses would be presented in DDQs) or holding an investor call to disseminate the information consistently to all LPs. GPs may want to seek feedback from portfolio companies in order to respond effectively and to ensure a consistent message is delivered to LPs, counterparties and customers.
- Valuations: The changing valuations of portfolio companies may impact the calculation of management fees, distribution waterfalls and clawbacks. GPs may want to give particular attention to the valuation provisions in their fund documents to ensure compliance therewith. GPs are also encouraged to consider the potential impact on any subsequent closings in process.
- Financial Statements: Many fund-level financial statements rely on the delivery of information from portfolio companies (which will likely be delayed given the current situation). GPs may want to review whether the fund documents have flexibility to go beyond the customary 90 or 120 day delivery timeframe or if the offering documents have disclosure relating to delayed reporting or force majeure risk. Potential delays beyond 120 days may have an impact on custody rule compliance as well.

A time for borrowings

- Increased Use of Leverage: Falling valuations and distressed or other non-traditional opportunities may drive increased use of leverage by private equity funds through the use of existing subscription line facilities (if capacity is available), total return swaps, margin loans or other alternative forms of financing. GPs may want to pay careful attention to borrowing limitations in fund documents and any requirement to reserve unfunded capital commitments for purposes of satisfying borrowings and other contingent liabilities.
- ISDAs/Derivative Contracts. GPs are encouraged to review their funds'/portfolio companies' derivative contracts to get ahead of any NAV triggers, margin calls or other contingent obligations that may arise in connection with outstanding derivatives transactions.

Consider protective measures

- Insurance: GPs may want to consider reviewing the expansion of insurance coverage applicable at the manager, fund and portfolio company level or consider what, if any, claims are available under existing coverage (eg, costs of cancelling business travel for investor or portfolio company board meetings).
- Secondaries: The market dislocation could lead to unique opportunities for GP-led secondaries, particularly in respect of individual portfolio companies that now need more time than otherwise expected to maximize value and distribute proceeds (instead, they now need an influx of new capital). In addition, investors may be looking for liquidity with respect to illiquid LP interests. Accordingly, GPs should be prepared for an uptick in secondary activity, including as a result of investors' defaults. ■

GPs ponder early repayments for credit lines as coronavirus threatens liquidity

Drawdowns could enable managers to pre-empt liquidity issues arising from the pandemic but may compound the problem for certain LPs.be adjusted to account for the coronavirus outbreak, including fund documentation, valuation and banking relationships. **By Alex Lynn**

Some general partners are considering early repayments for subscription credit line drawdowns in anticipation of potential liquidity issues among LPs arising from coronavirus.

Modern limited partnership agreements typically specify a clean-down period, or a deadline by which individual loan drawdowns need to be repaid. The Institutional Limited Partners Association suggests this period be no longer than 180 days, though it can vary from fund to fund.

"Funds with outstanding loans that are closer to the end of such clean-down periods could call capital to repay these loans early because they want to pre-empt any liquidity issues that LPs may have in a couple of months," Fi Dinh, a Singapore-based fund finance director at ING, told Private Equity International.

"A number of GPs that we spoke to have indicated they may consider [this option]."

Institutions such as underfunded pensions could face a liquidity crunch in the coming weeks and months following a rout in the public markets and slowdown in private market exit activity. Q1 is expected to be a write-off for sales, with Brookfield Asset Management among those shelving deals following disruption to travel and market stability.

The spectre of diminished liquidity could make early loan repayments an unappealing prospect for some LPs.

"Some of our sponsor clients have received calls from LPs instructing them to utilise subscription-backed credit lines as much and as long as possible," Zac Barnett, managing partner at debt advisory Fund Finance Partners, said.

"This is because LPs are expecting to receive numerous capital calls from GPs looking to stabilise certain of their portfolio companies in the downturn or amass cash so they'll be able to seize opportunities in the new world of attractively priced assets."

FFP is negotiating two credit line extensions for that reason.

Borrowing could be easier said than done. ING is among those taking a closer look at underlying portfolios as LPs are more likely to prioritise capital calls to a better-performing fund when facing liquidity issues, Dinh noted.

"Overall our lending rate has slowed in Q1 because there are fewer funds and facilities being raised, but generally the market is still seeing this as a short-term issue and there is still plenty of optimism around the long-term nature of this asset class."

At a broader level, the US Federal Reserve announced several measures on Sunday to encourage banks to lend, including slashing interest rates to nearly zero and lowering reserve requirements. The People's Bank of China and The Bank of Japan have also taken similar action.

"It's a little harder to get banks' attention on new transactions right now as they're understandably busy reviewing their existing portfolios and facing logistical and technological issues due to the disruption to traditional office working," Barnett said. "The end result is a much longer period from term sheet to execution."

The rise of uncommitted debt in recent years might be cause for concern as lenders are under no obligation to honour a drawdown. Such a move is, however, unlikely given the potential reputational impact to lenders that veto a utilisation request.

"We're aware of some difficult conversations around uncommitted draw requests and expect them to increase in frequency," Barnett noted. "Lenders will be reviewing their exposure to any one particular GP or – derivatively – LP during times of stress." ■

Alternative lending and private debt: What not to do in this crisis

There is light at the end of the tunnel for the private debt market as long as it learns from past crises, argues Gabriella Kindert of Mizuho Europe.

In the past decade, as the quest for yield surged, the exposure of investors has increased substantially to private assets. Are there some lessons learned from the previous decades and previous epidemics? What do we need to do?

Here are my thoughts in these trying times:

After severe stress, there is likely to be economic growth

Leading indicators suggest a severe disruption of some businesses already. Airline passengers are down by 30 to 40 percent for some carriers, hotel reservations are at a 10-year low, large events have been cancelled, even in less impacted countries. In many economies, like Italy, the situation is very difficult. The predominant worry around Europe is this: will neighbouring countries follow suit? Are we lagging a few weeks or just a few days behind?

As we are learning what our global interdependence means in practice, we have entered unknown territory. There seem to be no road maps of what will happen. Besides business implications, for the first time in our lives, many of us feel physically threatened and see Darwinist patterns evolving. One thing is for sure – it is not business as usual.

Unlike the 2008 crisis, the situation today did not stem from financial engineering and excess leverage. It is impacting companies across many sectors and it is threatening human life. When and how it will end, we don't know.

If we look at history, evidence indicates that the economic impacts of the 1918 influenza (referred to as "Spanish flu") were short term. Some businesses suffered severe revenue losses by up to 50 percent, but they were able to recover in subsequent quarters.

During the SARS epidemic in 2003, tourism suffered in Hong Kong. Across the entire region, tourism declined by 20 to 70 percent, according to the World Bank, but society recovered quickly. The patterns are always different, and history does not repeat itself, but it rhymes. Lessons from history show that policy responses need to be aligned between the private sector and governments to make this happen.

Liquidity is at risk. We need to waive automatic triggers that were invented to work in business as usual environments

What made the 2008 crisis bad was the downward spiral and selling pressure that were built in for illiquid instruments in illiquid markets.

As I have highlighted before, asset classes change behaviour if the investor base and the structure of the investment vehicle shift.

In each investment segment in alternative lending (leveraged loans, commercial real estate, infrastructure, private debt, direct lending, mortgages) today, the investor base is different. It is broader and larger. The search for yield drove institutional investors and private investors to invest in coupon payment instruments.

To some extent, the new investment vehicles are open-ended funds, built for collateralised loan obligation, and in segregated mandate form. CLO leveraged loans are currently already frozen, combined

with a widespread credit problem. There is a very high risk of fallen angel BBB corporate bonds entering into forced liquidation resulting from rating downgrades. The market is trillions in size.

Many institutional investors inserted measures linked to net asset value and liquidity, which will not work in the current market and will contribute to pro-cyclicality, fear and will likely to make the crisis a lot more severe.

Will investors panic and liquidate in the illiquid market? Several reports have been warning about open-ended structures offering liquidity (risk related to liquidity transformation). These exposures add to the risk of pro-cyclical behaviour in times of stress.

A bail-out should happen to address the downward spiral resulting from illiquidity. Now. To address these issues, coordinated support from lenders and policy responses are required. Rating actions should not trigger an automatic downward spiral where everyone loses.

ESG 2020: it is time to be a financial doctor, not a financial police agent

We have a few burning challenges and the ecosystem we created in (alternative) lending can provide quick solutions to channel the necessary financial support. As doctors cure patients, our responsibility is to cure and help the sick to recover. This is environmental, social and governance in practice in 2020. It is time to waive, cure and show goodwill.

How can we address key challenges during this time?

Aside from over-analysing facts and creating models, we need to rely on our survival instincts and creativity now more than ever before. Only with a principle-based approach will we maximise long-term value for all involved. Rules we made in the past for certain scenarios may not apply this time.

Defaults will rise. Value should be maximised.

Defaults will inevitably happen. The severity depends on how prolonged the crisis will be and at the moment, nobody knows.

Hardly any company can sustain a 30 to 40 percent drop in turnover. Which ones will default? It will depend on their:

1) Flexibility: financial and operational flexibility

2) Behaviour: lenders and sponsors

3) Support policy: Policy responses (tax deferral, rate cuts, new TLTRO liquidity facilities, demand stabilisation)

I believe there will be many companies that will need liquidity and potentially run out of cash without breaching any covenants. They may not be the most highly levered companies that will default but the ones that lack flexibility combined with operational stress.

Lenders should find solutions for impacted industries.

At the height of the SARS epidemic, Asian countries made various efforts to mitigate the impact: refunding employment taxes, concessions on utility bills, short-term loans, shouldering medical costs, extending subsidies.

Pain point	Potential solution
Liquidity issues	• Payment holiday/moratorium • Deferral • Liquidity support despite covenant breach, potential covenant break • Waive actions linked to ratings and rating downgrade • Waive automatic trigger linked to internal and external ratings • Close open-ended vehicles to protect all investors
Defaults	• Waive rating necessity until situation consolidates • Waive trigger levels linked to leverage • Create alignment focused on long term

Most impacted industries*	Opportunities and industries impacted positively
• Airline • Hospitality • Service (entertainment, personal services) • Industries relying on global supply chains (manufacturing) • Retail • Transportation networks	• Digital infrastructure • Healthcare (testing, diagnosis, disease control) • Collaborative platforms • Medical industries • Infrastructure investments (healthcare, ESG) • Local/regional supply chain – relocation • Diversify supply chain • Providing liquidity support to companies

Recent examples: (i) Ant Financial stopped updating credit rating scores in January 2020 until the situation consolidates; (ii) Italy has frozen mortgage payments for customers until the lockdown is lifted.

Further, securing corporate financing will be essential in the next weeks and development banks/policymakers can use the digital alternative lending infrastructure for efficient distribution of support funds. Quickly and efficiently.

The crisis will further increase the importance of private markets and digital-based lending

I believe the crisis will offer many interesting value opportunities for investors. The banking sector is likely to have huge issues to deal with and will need to shed assets further due to constrained lending capacity. On the other hand, there are high levels of dry powder in private equity and private debt funds, which will help make the shift towards non-traditional financial lenders.

The coupon-paying nature will offer attractive investment opportunities to retail and institutional clients in an environment where base rates are expected to remain low and value opportunities are present.

Though there is much negative publicity about private debt and leveraged loans, there is a substantial equity buffer in the capital structure. Many fundamentals remain strong. Credit investing is about long-term vision and we need to maximise the value for investors and support companies in difficult times, for the benefit of all stakeholders.

Conclusion

Extraordinary situations require extraordinary measures. Preventing asset prices and companies from unnecessary collapse is our collective responsibility. Consequently, lenders, policymakers, central banks and rating agencies should carefully weigh their actions.

The impact to our economy largely depends on our actions and the support we give to companies and customers today. We need to think about unintended consequences.

Someone once remarked, "A banker is a fellow who lends you his umbrella when the sun is shining but wants it back the minute it begins to rain."

Whether there is a grain of truth to that remark or whether it is just a general perception, today is the perfect time to practice true ESG. The rain is pouring out there. Let's give umbrellas to those who need them and eliminate measures that make the situation even worse. We need to apply a different mindset on how to preserve value. ■

Distressed debt's appeal surges amid market uncertainty

Bain Capital is the latest manager to target non-performing real estate loans, a strategy that has been attractive to institutional investors. **By Kyle Campbell**

Fresh from raising its first real estate fund, Bain Capital formed a half-billion-dollar venture in July to acquire distressed real estate debt. Joining forces with a New York lender, the Boston-based private equity firm sees opportunity in the loan-to-own space.

The group is allocating capital to the partnership from its credit platform's distressed and special situations strategy. But Bain is far from the only firm interested in non-performing loans.

Through the first two quarters of 2019, real estate funds that include distressed debt as part of their mandate closed on $18.75 billion, according to data from Private Debt Investor's sister title PERE, making it the most popular debt strategy this year. Funds focused on senior loans have closed on $4.6 billion while subordinate or mezzanine debt gathered less than $1.1 billion. For distressed debt, the H1 equity haul was the largest half-year volume for such vehicles over the past five years. Since the start of 2016, an aggregate of just $23.65 billion has been closed on by similar funds.

Much of the capital entering this space has gone into diversified real estate funds targeting equity and debt strategies. Lone Star raised the largest amounts, raking in $8.2 billion for Lone Star Fund XI and $4.7 billion for its Real Estate Fund VI. The next three-largest closings, however, involved debt or credit-specific funds. Cerberus Global NPL and Cheyne European Strategic Value Credit attracted $4.1 billion and $1 billion respectively, while Lone Star's $750 million second North America-focused residential mortgage fund rounded out the top five biggest funds targeting distressed debt.

A common thesis is that mature pricing has driven cap rates down, and that this has made some equity acquisitions less appealing. Taken in tandem with other market trends, some managers see this pricing environment leading to a rising demand for refinancing and, ultimately, to more defaults.

David DesPrez, Bain Capital Credit's vice-president of distressed and special situations, sees opportunities arising in three areas in particular: luxury condominiums, subsidised multifamily properties

and retail.

Underwriting is an issue in all three property types, he tells PERE, with developers and landlords assuming certain prices that now seem unattainable because of changing market dynamics or new regulations. He says Bain Capital Credit saw these trends playing out on a large scale in New York, where it has made SKW Funding, a private lender and distressed debt platform based in the city, its local partner.

"By almost every key metric – transaction volumes, average condo price, land prices – the New York City market peaked in the 2015-16 timeframe and we're seeing it come down, albeit slowly, from that peak," he says. "We are also seeing pullback from lenders, so it's become incrementally more difficult for borrowers to refinance or to get any outside-the-box debt."

Carol Faber, co-chair of the distressed property practice at Akerman, a Miami-based law firm, credits the uptick in interest to widespread uncertainty in the real estate market. Although there are few signs of distress in the market at present, she says many investors were wary of the long-running growth cycle. "People are starting to think a downturn is coming sooner than later," she says. "They want to be well positioned to take advantage, so they're talking about it and trying to raise money for it, but they aren't necessarily deploying it just yet."

Faber says although fund managers have been more disciplined with their use of leverage following the global financial crisis, the real estate debt space has also become more complex since then. "They sliced and diced the capital stack in a number of different ways, so to the extent that there is distress, the workouts will be a lot more complicated than they were last time," she adds. "But where there are challenges, there are also opportunities." ■

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