

The Evolution of Fund Finance

The Next Generation

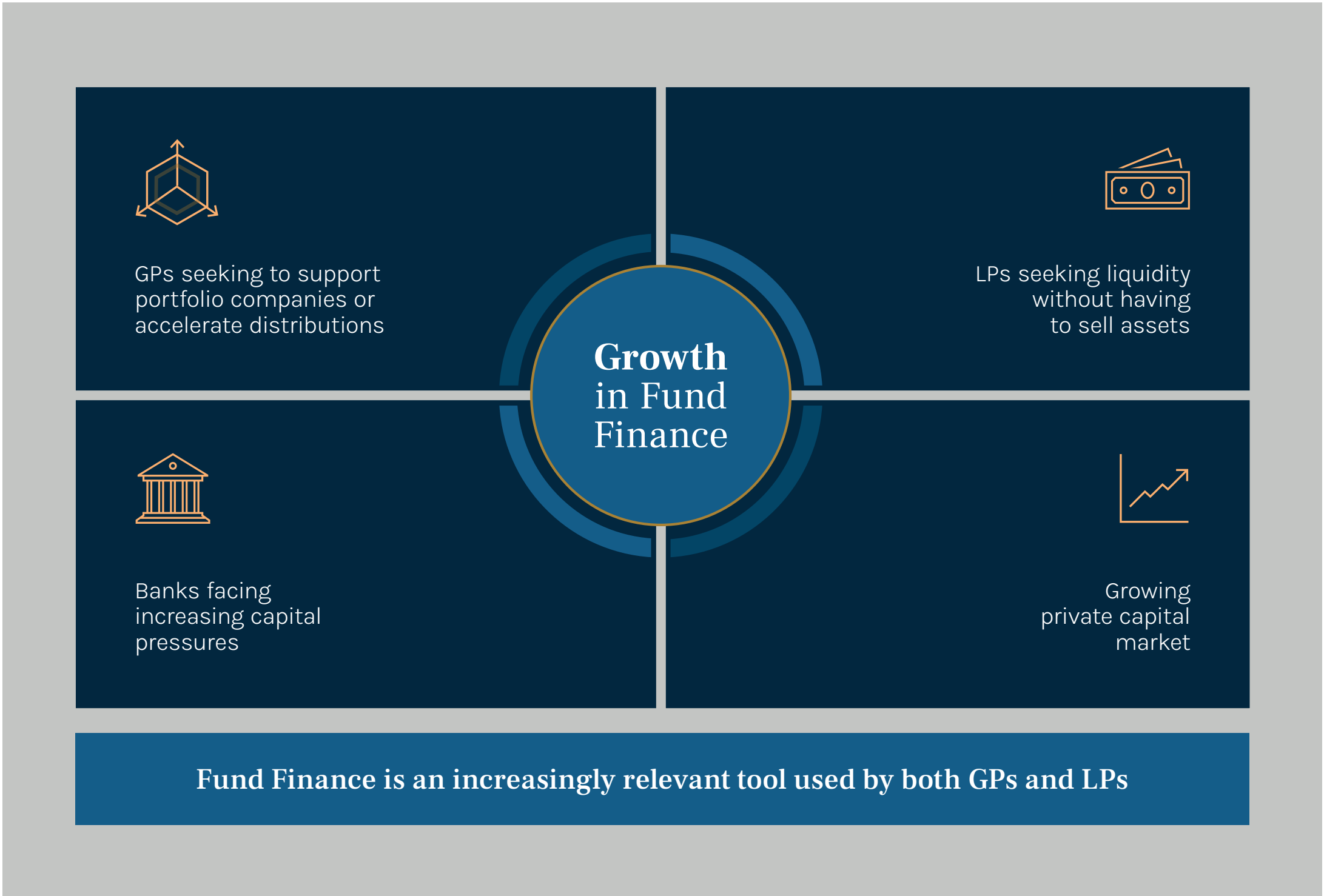
October 2024



Introduction

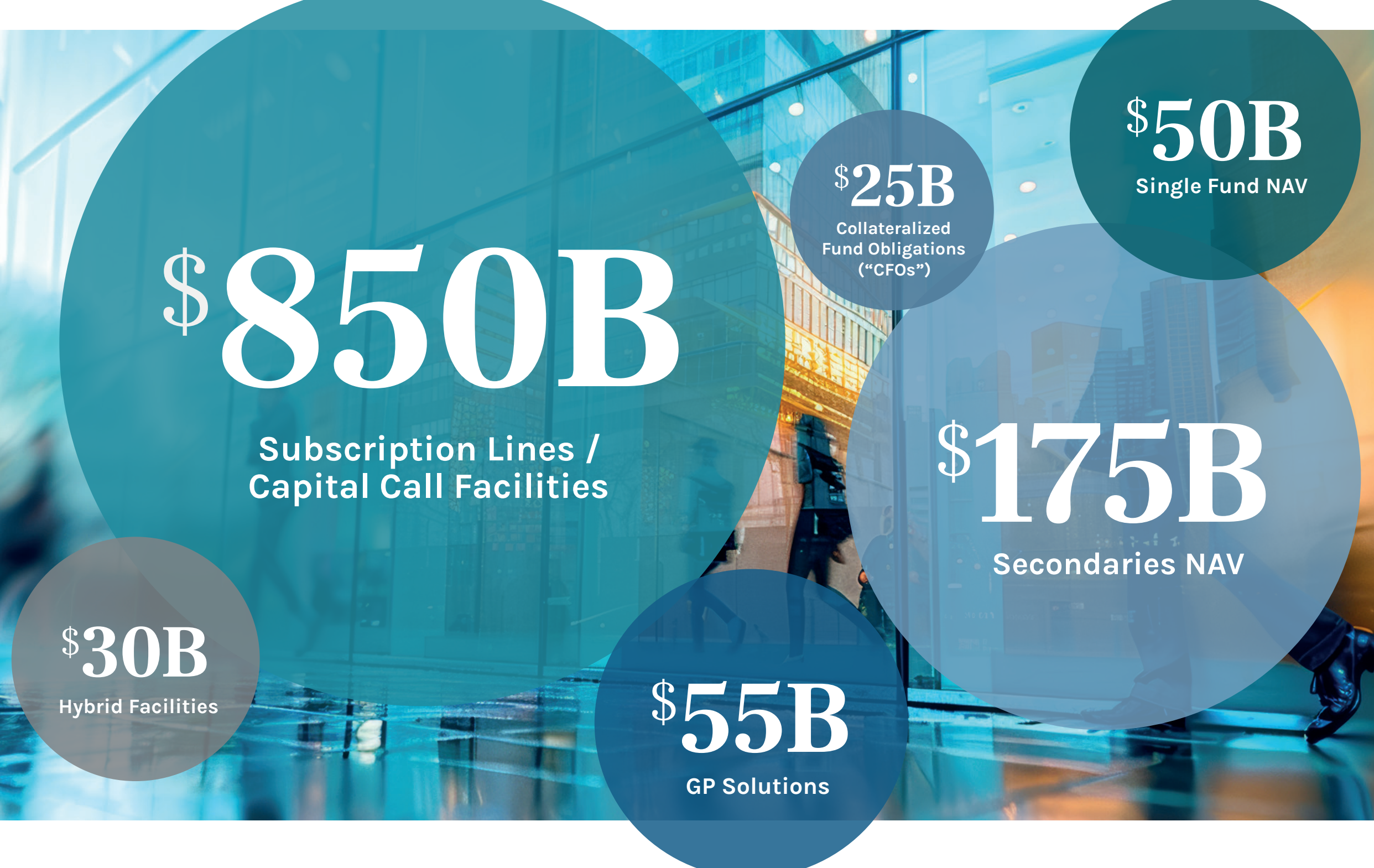
What Is Fund Finance and Why Is It in Focus?

“Fund Finance” broadly refers to financing for investment funds and asset managers



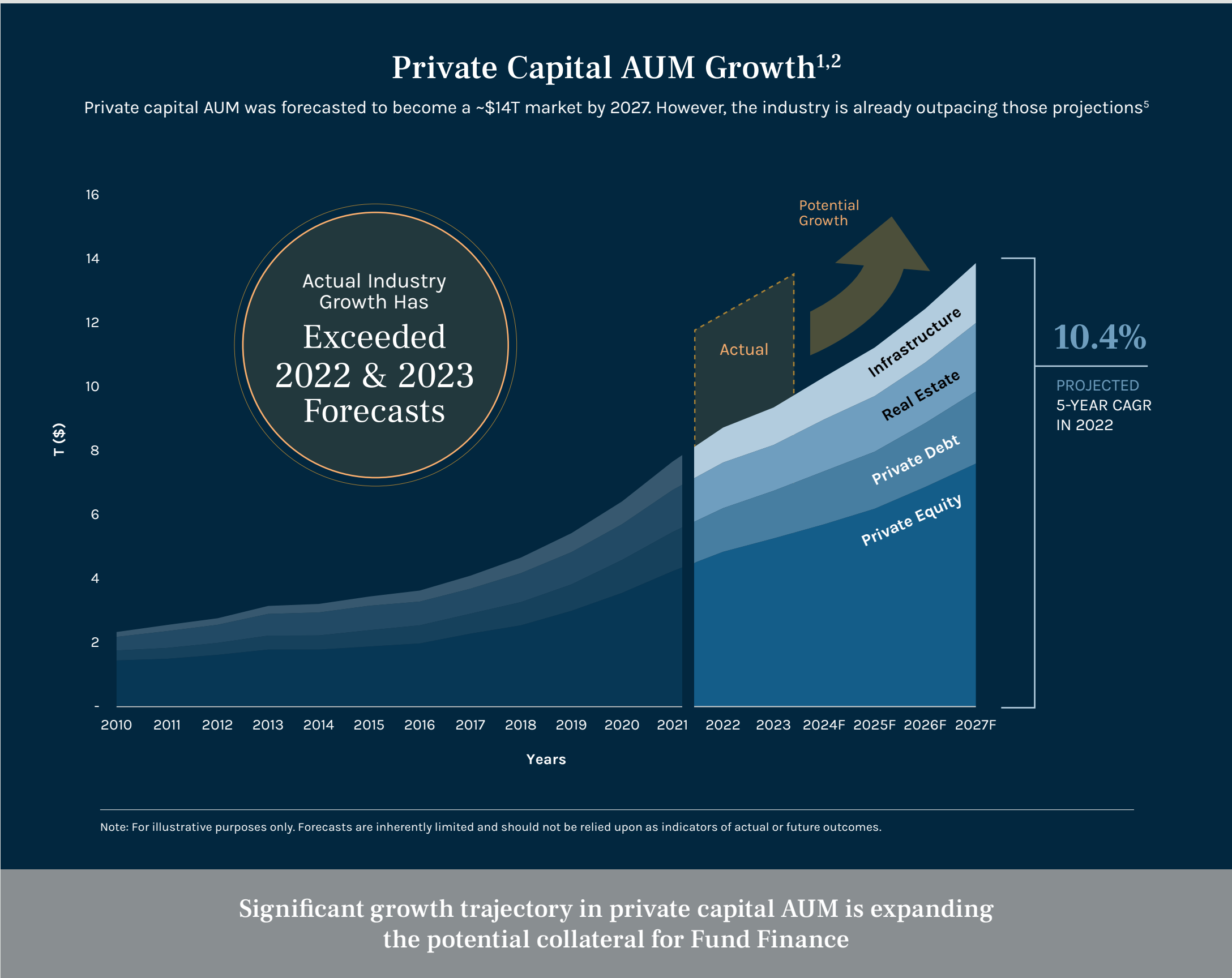
Size of the Market

Ares Estimates the Fund Finance Market to Already Be \$1.2T and Growing

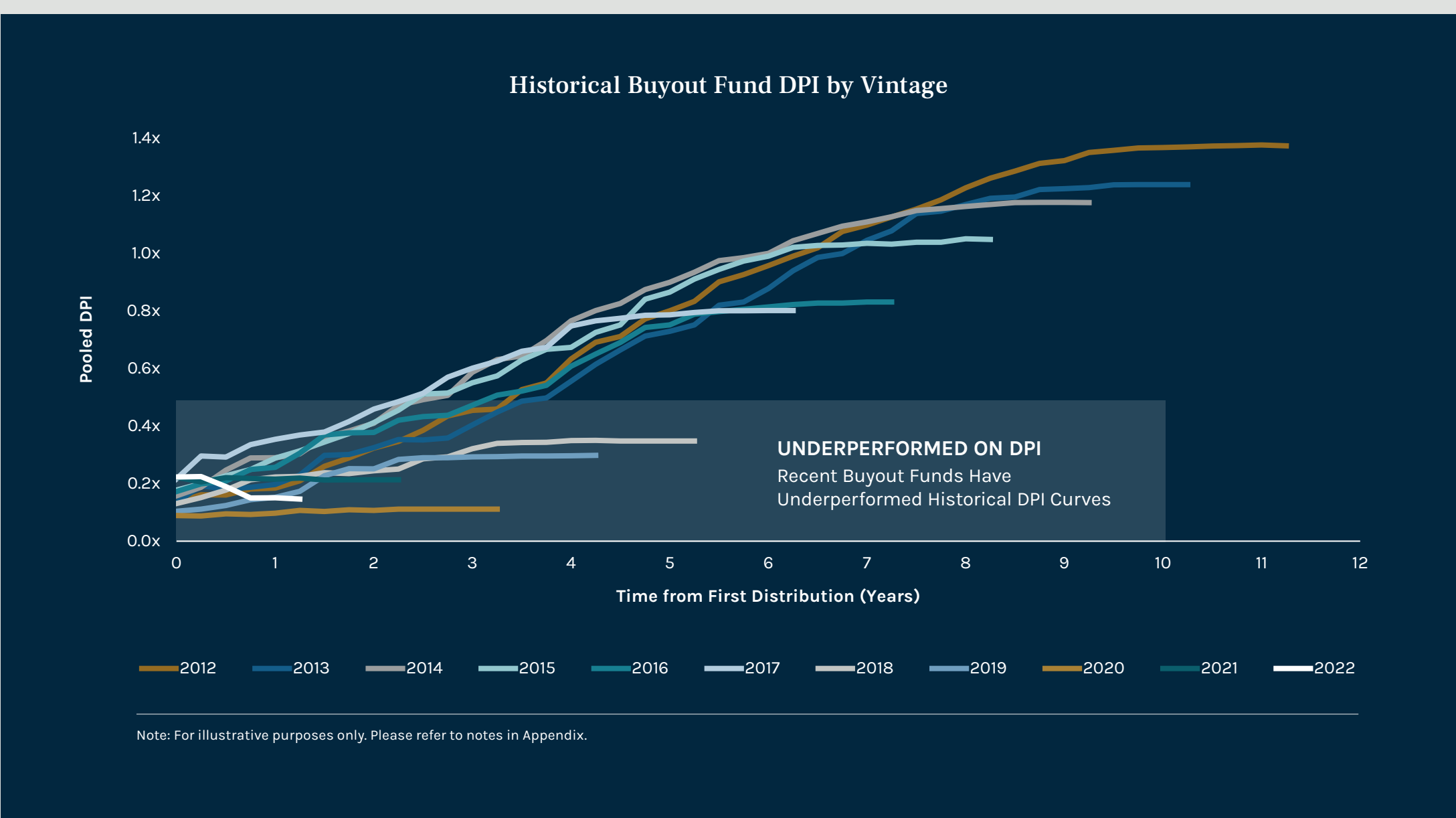


NAV Lending Is Growing Alongside Private Markets...

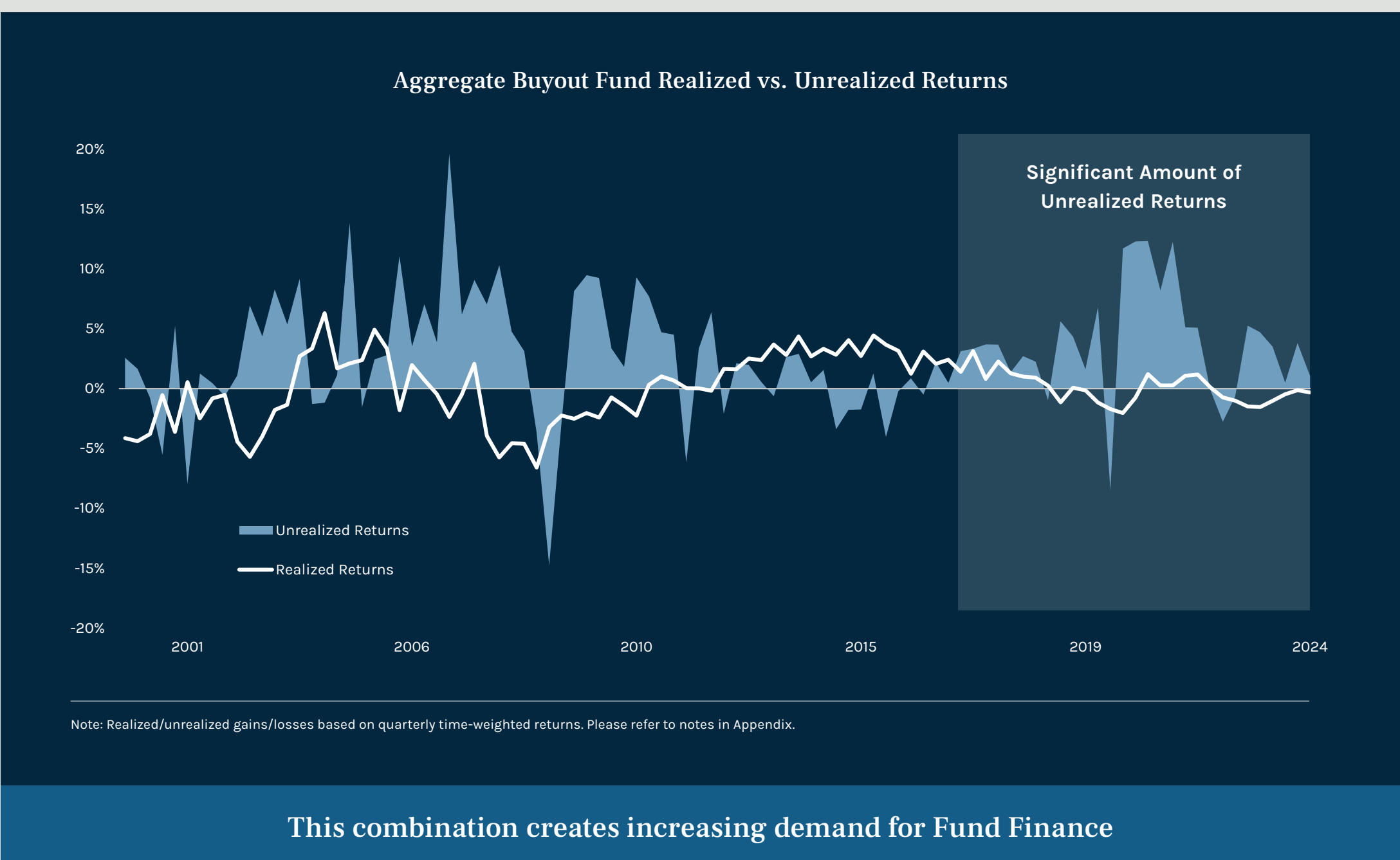
... but NAV loan usage remains limited at less than 3%¹



Asset Monetizations Have Slowed Substantially...



... Leading to Significant Unrealized Returns



“The Fund Finance market is where Direct Lending was in 2010, starting to experience exponential growth. We believe this \$1.2 trillion market is poised to more than double in the next few years. I expect market leaders with flexible capital will be the preferred counterparties for all things Fund Finance.

Michael Arougheti | CEO, Ares Management



Note: Projections and forward looking statements are not reliable indicators of future events and no guarantee or assurance is given that such activities will occur as expected or at all.



Defining the Asset Class

Common Forms of Fund Finance

Subscription Lines

Facilities secured by uncalled capital commitments from LPs to a fund, typically used for liquidity management / working capital

Hybrid Facilities

Facilities collateralized by uncalled capital commitments from LPs in addition to asset-level security, typically used by continuation vehicles to reduce the upfront called capital

Single Fund NAV

Facilities collateralized by the assets of a single fund (usually company stakes), typically used by investment funds for follow-on investment financing and LP distributions

Secondaries NAV

Facilities collateralized by a portfolio of LP interests, typically used by secondaries investors for portfolio acquisition financing or dividend recapitalizations

GP Solutions

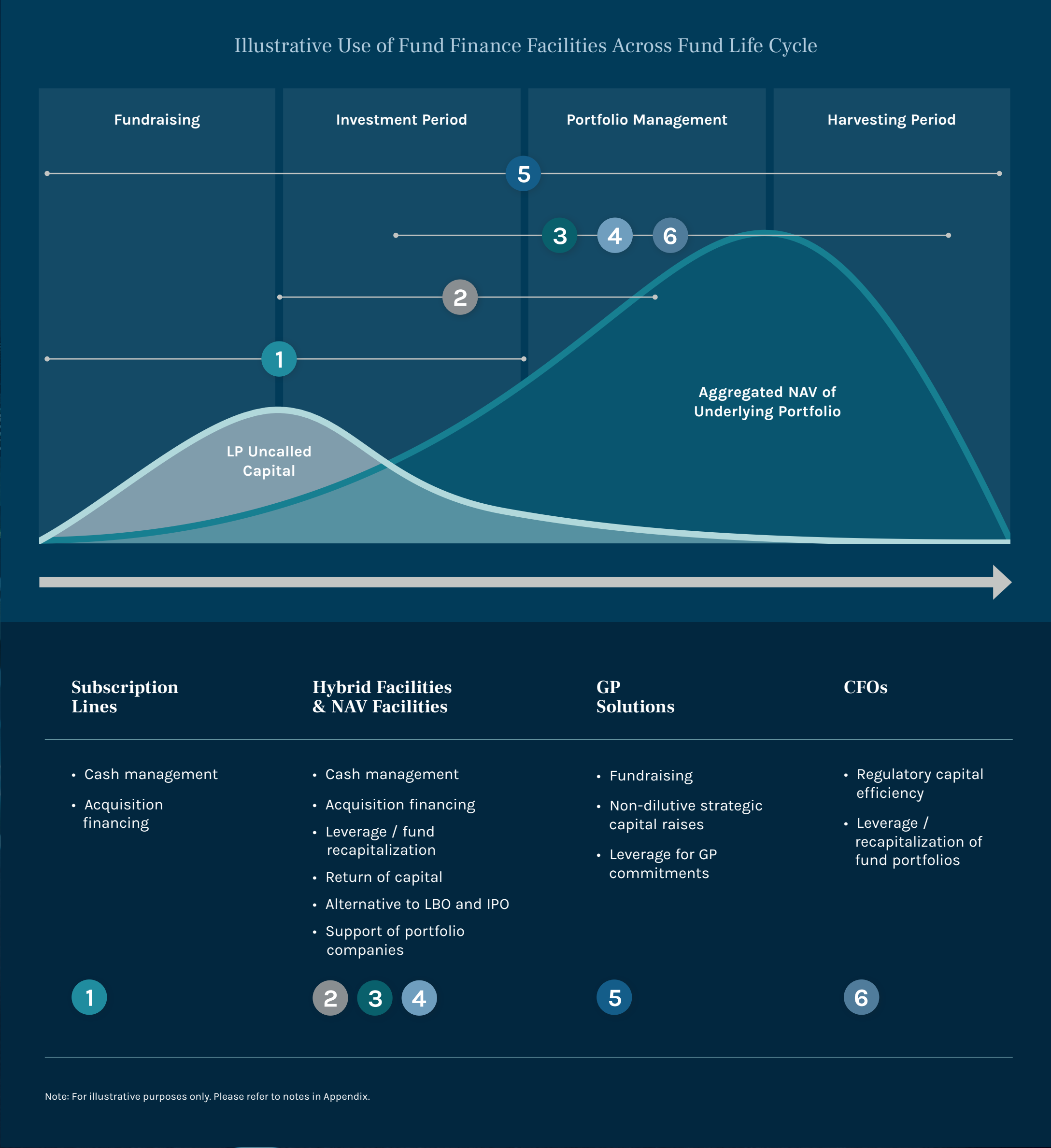
Capital solutions collateralized by management fees, balance sheet investments, carried interest or other assets of a GP, typically used to fund GP commitments, succession planning or dividends

CFOs

Tranched structures collateralized by interests in at least one fund that can be used by LPs to generate liquidity or rebalance assets

Types	Collateral	Underlying Strategies	Key Lenders
1 Subscription Lines	Uncalled Capital Commitments	All	Banks, Insurance
2 Hybrid Facilities	Uncalled Capital Commitments + Fund Positions	Primarily Buyout	Banks, Insurance, Asset Managers
3 Single Fund NAV	Fund Positions	Primarily Buyout, with increasing activities in Credit, Real Estate, Infra and Venture	Banks, Insurance, Asset Managers
4 Secondaries NAV	Diversified Pool of Private Funds	Primarily Buyout, with increasing activities in Credit, Real Estate, Infra and Venture	Banks, Insurance, Asset Managers
5 GP Solutions	Management Fees + GP Commitments + Carried Interests + Other Assets	All	Asset Managers
6 CFOs	One or More Private Funds	All	Insurance, Asset Managers

When and Why Do Managers Use Fund Finance Facilities?



An In-depth View

1

Subscription Lines

Financing secured by a fund's uncalled capital commitments

MOTIVATION

Used to manage an investment fund's short-term liquidity and funding needs

KEY USERS

Sponsors typically have subscription facilities for their funds across different strategies

KEY INVESTORS

Banks have traditionally dominated the space, though insurance investors are increasingly present in the market

TENOR

Short tenor, typically 1-3 years

RATING

Typically investment-grade

LTV

Typically 60-90% advance rate

Robust Downside Protection

There are limited known instances of defaults and principal losses on an estimated \$850B market

\$850B
ESTIMATED
SUBSCRIPTION
LINE MARKET*

90%
SUBSCRIPTION FINANCE
MARKET GROWTH
FROM 2017-2022⁷

Note: All investments involve risk, including possible loss of principal.

2

Hybrid Facilities

Financing secured by both uncalled capital commitments and fund assets

MOTIVATION

Used to manage an investment fund's capital calls and for acquisition financing

KEY USERS

Typically used by GPs at the request of key LPs, particularly for managed accounts, sidecar vehicles and continuation vehicles

KEY INVESTORS

Banks, insurance investors and asset managers

TENOR

Short tenor, typically 1-3 years

RATING

Can be rated investment-grade subject to structure and LTV

LTV

Typically 40-80% advance rate

“

We continue to see hybrid facilities achieve a cheaper cost of capital versus NAV lending by maintaining more downside protection with additional collateral interests.

Kevin Alexander | Partner, Ares Alternative Credit

Note: All investments involve risk, including possible loss of principal. References to "downside protection" or similar language are not guarantees against loss of investment capital or value. Please refer to notes in Appendix.

3

Single Fund NAV

Financing secured by a single fund's assets

MOTIVATION

Often used to support existing investments or manage DPI

KEY USERS

Typically private equity sponsors, with increasing usage across other strategies

KEY INVESTORS

Banks, insurance companies and credit-focused asset managers

TENOR

Moderate to longer tenor, often 3-5 years

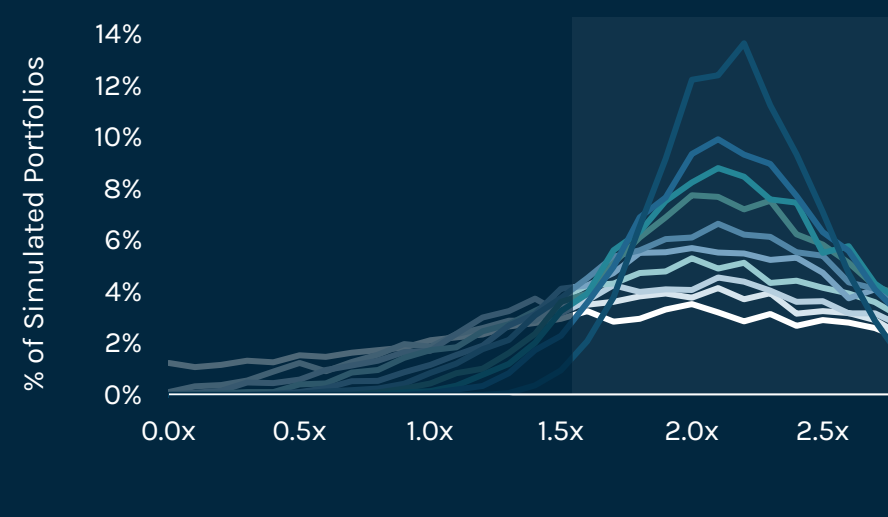
RATING

Structure-dependent, rateable deals can achieve investment-grade

LTV

Low LTV, typically 10-20%

Ares QRG Simulation of Portfolio Returns of Seasoned Assets



Ares' Quantified Research Group (QRG) has demonstrated that diversified portfolios of assets are less likely to experience extreme outcomes, leaving sufficient retained value to protect a NAV loan at a conservative LTV.

Note: All investments involve risk, including possible loss of principal. Diversification does not assure profit or protect against market loss. The simulated data presented is a hypothetical simulation and does not represent an actual fund or portfolio. Hypothetical returns have inherent limitations, do not represent investor returns, and actual investor returns may differ materially. Please refer to notes in Appendix.

4

Secondaries NAV

Financing secured by a diversified pool of funds

MOTIVATION

Typically used for acquisition financing or to manage DPI

KEY USERS

Secondary funds

KEY INVESTORS

Significant bank presence with increasing participation from insurance and asset managers

TENOR

Moderate to longer tenor, often 3-5 years

RATING

Investment-grade, structure-dependent

LTV

Typically below 50%

200+

Typical look-through portfolio company exposure

Single A

Secondaries NAV loans can be rateable as Single A / NAIC-1 given their diversity and LTVs

PE Fund Performance Based on TVPI (1980-2023)⁸

1,560 U.S. Buyout Funds Raised Since 1980

0.8x
5th Percentile

1.3x
25th Percentile

1.7x
50th Percentile

2.1x
75th Percentile

3.1x
95th Percentile



Conservative LTVs have historically provided robust downside protection against declines in NAV



Even assuming performance in-line with the worst 5th percentile, **stressed asset coverage is estimated to be 125%+**



Secondary funds typically have consistent cash flows from the underlying portfolio, allowing for timely amortization

5

GP Solutions

Financing secured by management fees, carried interest, GP commitments and co-investments

MOTIVATION

Used for strategic, non-dilutive capital raises or to support ongoing fundraises for new funds

KEY USERS

Sponsors seeking liquidity or additional GP or LP capital

KEY INVESTORS

Secondary funds, specialized GP solutions funds, and alternative credit funds

TENOR

Moderate to longer tenor, often 4+ years

RATING

Typically not rated

LTV

Highly variable but generally 50-70% of the value of pledged cash flows

Varied Motivations



Structured Fundraise

GPs raise structured LP or GP capital by pledging collateral and offering a preferred return opportunity while seeking to retain any upside

Leverage

GPs can leverage their commitments to their own funds

Stake Buyback

GPs can raise capital to repurchase previously sold minority stakes

6

CFOs

Financings of one or more funds where tranches of rated securities are created

MOTIVATION

Used for liquidity and duration in a capital efficient form, particularly for insurance companies

KEY USERS

LPs typically use CFOs for liquidity or leverage

KEY INVESTORS

Primarily insurance for senior tranches and credit funds or funds of funds for junior / equity tranches

TENOR

Long duration, often 7-12 year legal final and 4-5 year WAL

RATING

Tranched investment-grade and non-investment grade

LTV


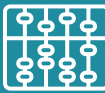

Approximately 50% for Single A with ability to advance further for BBB and BB / preferred equity

Historical Performance in Downturns⁹

- The first known instances of CFO issuances were in the early 2000s
- While several CFO securities were downgraded or restructured during the GFC, ultimately each of the rated bonds received full interest and principal repayment
- Performance of CFOs issued post-GFC has been robust



Conclusion

	Growing Tailwinds	Fund Finance continues to benefit from growing tailwinds
	Evolving Market Dynamics	Evolving market dynamics have allowed non-traditional market participants to play an increasing role
	Continued Partnership	Complementary Fund Finance solutions providers will continue to partner, seeking to deliver the most efficient results



It takes a powerful, integrated platform to create and provide these bespoke solutions.

Joel Holsinger | Partner & Co-Head, Ares Alternative Credit

Ares Platform Overview

Ares has harnessed industry experience and differentiated portfolio insights across its platform to strategically partner with GPs, LPs and other market participants

Investment Team	Portfolio Insights	Portfolio Scale
<div>1,000+</div> <div>investment professionals across Ares Credit, Real Estate, Private Equity, Secondary Solutions and Strategic Initiatives</div>	<div>3,000+</div> <div>active investments in portfolio companies across Ares strategies</div>	<div>~\$447B</div> <div>in firmwide AUM across the Ares platform¹⁵</div>
<div>78</div> <div>Alt Credit investment professionals (one of the market's largest dedicated teams)¹⁶</div>	<div>\$60B</div> <div>of Fund Finance transactions reviewed since 2022¹⁷</div>	<div>~\$54B</div> <div>deployed in Alternative Credit since inception¹⁷</div>

Authors



Richard Sehayek

Alternative Credit Managing Director

+44 (0)20 7072 1849
rsehayek@aresmgmt.com



Ludo Hashemi

Alternative Credit Vice President

+44 (0)20 7434 6443
lhashemi@aresmgmt.com



Kian Ivey

Alternative Credit Senior Associate

+1 (212) 515-3244
kivey@aresmgmt.com



Allen Lo

Alternative Credit Senior Associate

+1 (212) 301-0322
alo@aresmgmt.com



Phuong Dang

Alternative Credit Analyst

+44 (0)20 7434 6218
pdang@aresmgmt.com





Appendix

Footnotes

Ares Estimates the Fund Finance Market to Already Be \$1.2T and Growing	Based on Ares market observations as of October 2024. Data is subject to change at any time and there is no assurance that such trends will continue.
NAV Lending is Growing Alongside Private Markets	<div><div>1.</div><div>Based on Ares market observations as of October 2024. Data is subject to change at any time and there is no assurance that such trends will continue.</div></div> <div><div>2.</div><div>Source: Secondaries Investor, Predicting the next decade: The rise of NAV lending, June 2023.</div></div> <div><div>3.</div><div>Source: Institutional Limited Partners Association, New ILPA Guidance Encourages LP-GP Dialogue, Transparency around NAV-based Facilities, July 2024.</div></div> <div><div>4.</div><div>Source: S&P, CreditWeek: How Are Funds Using Net Asset Value Loans?, May 2024.</div></div> <div><div>5.</div><div>Source: Preqin: Future of Alternative 2027, October 2022.</div></div>
Asset Monetizations Have Slowed Substantially...	Source: Preqin.
... Leading To Significant Unrealized Returns	Source: Burgiss, August 2024.
When and Why do Managers use Fund Finance Facilities?	Source: Ares, August 2024. For illustrative purposes only.
Subscription Lines	<div><div>6.</div><div>Based on Ares market observations as of October 2024. Data is subject to change at any time and there is no assurance that such trends will continue.</div></div> <div><div>7.</div><div>Source: Fitch Ratings, 2023.</div></div>
Hybrid Facilities	Ares, 2024.
Single Fund NAV	Ares, 2024. For illustrative purposes only. Source: 17Capital, NAV Lending – The emerging opportunity for private debt investors, September 2021.
Secondaries NAV Lending	<div><div>8.</div><div>Source: Burgiss, Data on United States Leveraged Buyout Funds, March 2024.</div></div>
CFOs	<div><div>9.</div><div>Source: Financial Times, Collateralised fund obligations: how private equity securitised itself, November 2022.</div></div>
Fund Finance has Existed in Various Forms Since the 1980s	<div><div>10.</div><div>Source: Collier Capital, About Private Market Secondaries, 2024.</div></div> <div><div>11.</div><div>Source: Preqin, Special Report: Subscription Credit, June 2019; NLC Capital Call Finance – Reducing Borrowing Costs And Improving Operational Efficiencies, October 2021; MSCI, The Rise (and Rise) of Sub Lines in Private Capital, July 2023; Reed Smith, Capital Call Facilities: Basics, Challenges and Opportunities, November 2013.</div></div> <div><div>12.</div><div>Source: Setter Capital, Volume Report, 2019.</div></div>
Market Participants	Source: Ares. For illustrative purposes only. Based on Ares market observations as of October 2024. Data is subject to change at any time and there is no assurance that such trends will continue. Headlines source: Bloomberg, July 2024; Financial Times, September 2022; Bloomberg, October 2023; Insurance Asset Risk, October 2023; Cadwalader, June 2024; Private Funds CFO, April 2021; Institutional Investor, August 2023; IPE Magazine, September 2024.
Key Sponsor Considerations: Transparency and LP Concerns	<div><div>13.</div><div>Source: ILPA, NAV-Based Facilities Guidance for Limited Partners and General Partner, 2024.</div></div> <div><div>14.</div><div>Source: Fund Finance Association (2022).</div></div>
Increased Ratings to Address Capital Treatment	Based on Ares market observations as of October 2024. Data is subject to change at any time and there is no assurance that such trends will continue.
Ares Platform Overview	<div><div>15.</div><div>As of June 30, 2024, AUM amounts include funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and registered investment adviser.</div></div> <div><div>16.</div><div>As of October 2024.</div></div> <div><div>17.</div><div>As of June 30, 2024.</div></div>

Glossary

Abbreviation	Definition
AUM	Assets Under Management
CAGR	Compound Annual Growth Rate
CFO	Collateralized Fund Obligations
CIO	Chief Investment Officer
CLO	Collateralized Loan Obligations
DPI	Distributions to Paid In Capital
GFC	Global Financial Crisis
GP	General Partner
ILPA	Institutional Limited Partners Association
IPO	Initial Public Offering
KBRA	Kroll Bond Rating Agency

Abbreviation	Definition
LBO	Leveraged Buyout
LP	Limited Partner
LTV	Loan-to-Value
NAIC	National Association of Insurance Commissioners
NAV	Net Asset Value
PE	Private Equity
QRG	Quantitative Research Group
SRT	Significant Risk Transfer
TVPI	Total Value to Paid In Capital
WAL	Weighted Average Life

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