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In Practice

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Differences between subscription line and corporate facilities

This article highlights five key differences between subscription line (capital call) facilities and typical bilateral corporate facilities (based on the Loan Market Association (LMA) documentation).

Capital call or subscription line facilities are facilities which are provided to private equity, real estate, or other funds, usually secured against the limited partner commitments in the fund. The facilities are different from typical corporate leveraged facilities, which are usually provided to operating companies secured against the assets of the operating group. The lender's recourse for subscription line facilities is typically only to the limited partners who have invested in the fund, by requiring drawdowns from limited partners to be made by the general partner or investment manager of the fund. To ensure drawdowns occur in a timely manner, the lender is usually given a security assignment or power of attorney in order to "step into the shoes" of the general partner or the investment manager and send out drawdown notices to limited partners, in the event that the general partner or investment manager fails to do so.

The five key differences between subscription line facilities and typical bilateral corporate facilities are as follows:

- **Parties:** In a corporate facility, the borrower will usually be a corporate entity, and the persons who sign on its behalf will be directors or a person who is duly authorised to sign the facility by the company's constitution or by a board of director's resolution. In a subscription line facility the contracting party will typically be a limited partnership entity. In most jurisdictions a limited partnership does not have any separate legal personality, and its general partner will be authorised under the limited partnership agreement to sign documents on its behalf. Very often the general partner itself is also a limited partnership entity and will have a corporate general partner that signs on its behalf. Consequently, the corporate general partner usually signs on behalf of the general partner limited partnership, signing on behalf of the fund. This signing authority should be set out in the facility agreement in both the parties' and execution clauses.
- **Basic definitions**: In addition to typical LMA definitions, subscription line facilities will also contain a number of basic definitions lifted from the limited partnership agreement such as:
  - "LP Commitments": The commitments by the limited partners to invest monies into the fund.
  - "Drawdown Notices": The notices to be sent out by the general partner or manager of the fund to limited partners requiring them to fund their commitments (not to be confused with a drawdown or utilisation under the subscription line facility).
  - "Suspension Period": The period during which limited partners are not required to fund their commitments usually due to certain key principals of the fund failing to dedicate sufficient time to the management and operation of the fund.
  - "Defaulting Party": A limited partner who has defaulted and failed to pay in its commitments within the time frame specified in the limited partnership agreement.
- **Thresholds**: The subscription line facility agreement will usually contain different thresholds which, if exceeded, will trigger events of default. These thresholds include defaulting party thresholds (if more than a given percentage of limited partners default), transfer thresholds (if more than a given percentage of limited partners transfer their interests in the fund to unapproved limited partners), withdrawing thresholds (if more than a given percentage of limited partners have their interests cancelled or withdrawn from the fund), and insolvency thresholds (if more than a given percentage of limited partners become insolvent).
- **Financial covenants**: Typical corporate leveraged loans will contain leverage ratio, interest cover, cash-flow cover, and possibly net tangible-worth covenants. In subscription line facilities there is usually only one financial covenant, which is the total undrawn limited partner commitments to the amount of debt of the fund. Sometimes the lender will also wish to have covenants that relate to the net asset value of the fund.
- **Representations, undertakings and events of default**: A subscription line facility agreement will contain the standard representations, undertakings, and events of default found in a corporate facility agreement. Representations and undertakings will be given by the fund, the general partner and, if relevant, the manager, depending on the financing structure. In addition, a number of representations, undertakings, and events of default will be included that are specific to subscription line facilities, such as:
  - *Excused Partners*: Undrawn LP commitments of the excused partners (ie, limited partners who have contractually agreed excuse rights with the fund – which entitle them in specific circumstances to be excused from contributing) do not exceed the excused partner threshold.
  - *Drawdowns Permitted and Shortfall*: Fund documents permit the general partner to validly deliver drawdown notices to the limited partners to repay loans made and to drawdown any shortfall from non-defaulting limited partners.
  - *Material Agreements*: No other material agreements that have been entered into by the limited partners, the sponsor, the fund, the general partner, or borrowing vehicle (except as disclosed to the lender).
  - *Material Amendments*: No material amendments shall be made to the fund documents.
  - *No Other Creditors*: No other creditors of the borrower or guarantors other than a very limited number of persons.
  - *No Restrictions on Assignment or Security*: No fund document contains any provision that prohibits or restricts the granting of security by the general partner or the fund.
  - *General Partner and Manager*: The General Partner and Manager shall not resign or be replaced. ■