NAV loans uncovered

Observations from the 17Capital Credit Fund

Foreword from Co-Chairman of Oaktree, Howard Marks

17Capital

Foreword from Howard Marks

We partnered with 17Capital in 2022 with the intention of strengthening both firms' standing as partners of choice among private equity managers. Oaktree has provided capital solutions to the private equity community for over three decades, from senior secured loans and high yield bonds to mezzanine financing and rescue loans. In 17Capital, we saw a company reflecting elements of our own approach: operating in innovative credits markets with a robust focus on downside protection and risk control.

As this paper outlines, NAV financing is regularly misunderstood, as is often the case with innovations. When the founders of Oaktree first started operating in high yield bonds in 1978 and distressed credit in 1988, these nascent markets were treated with skepticism: who would want to lend money to low-rated companies or buy the debt of bankrupt companies? Now, sub-investment grade credit is a mainstay of institutional portfolios, and investors have come to recognize that skilled management of this asset class can unlock attractive risk-adjusted returns.

Likewise, when used prudently, NAV financing can be a powerful tool. As described in this paper, NAV loans are used primarily by well-performing private equity managers with the purpose of generating value for their LPs and succeeding in the intensely competitive private equity industry.

17Capital is a true pioneer in this asset class, having started up in the space in 2008. Since then, NAV financing has grown rapidly alongside the expansion of the private equity industry. There are reasons to believe this growth will continue, not least due to the sea change in interest rates that I've articulated: we aren't set to return to the era of ultra-low interest rates, and this should require private equity managers to seek new financing solutions.

I hope you find this paper useful, and I encourage you to reach out to our collaborators at 17Capital with questions about this intriguing space. They'd be happy to chat.

Howard Marks

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Written by:

Pierre-Antoine de Selancy
Managing Partner
17Capital

George Lee
Director, Investor Relations
17Capital

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Introduction

This paper presents key observations on NAV loans made to private equity funds, gained from our experience deploying the 17Capital Credit Fund over the past five years. It aims to clarify the role of NAV loans and explain how they create value for LPs in private equity funds. Before providing our insights, it's worth reflecting on the origins of the NAV finance market and 17Capital's role in its development.

The origins of the NAV finance market

Founded in 2008, 17Capital provided the original form of NAV financing: lending to LPs seeking to monetize their illiquid private equity fund stakes. NAV financing allowed LPs to use the value of their fund stakes as collateral against which to borrow money. This was significant because, unlike selling fund stakes on the secondary market to raise capital, LPs could retain ownership of their stakes and thus participate in future upside from the private equity portfolio.

Subsequently, private equity managers began to also seek NAV financing. To address this opportunity, 17Capital launched its inaugural Credit Fund in 2020, which was the first fund dedicated exclusively to providing NAV loans to private equity funds rather than LPs. The fund closed in 2022 at its hard cap of €2.6 billion and was fully deployed by the end of 2024.

Characteristics of NAV loans

NAV loans enable private equity managers to borrow money against the value of their fund portfolio. Managers can use this borrowed money to pay for accretive follow-on investments and strategic initiatives at portfolio companies. NAV loans can also be used by private equity managers to pay distributions to LPs, allowing managers to avoid selling assets they believe to have further growth potential.

NAV loans are offered to private equity managers by both banks and non-bank lenders. Non-bank lenders generally offer more flexible loan terms, for which they charge higher financing costs. This greater flexibility includes providing loans of a longer duration and with built-in extension rights.

Characteristics of these loans include:

- An average loan-to-value (LTV) ratio (i.e., the loan amount as a percentage of the fund's NAV) of approximately 10%, within a typical range of 5-25%.

- Seniority over cash flows when portfolio companies are sold. NAV lenders usually get paid back before LPs, but proceeds can be distributed to LPs if certain criteria relating to the performance of the loan are met.

- A cost that generally varies from SOFR + 400 bps to SOFR + 750 bps, depending on factors such as the LTV ratio, the size and diversification of the portfolio, and the loan structure and security package.

Key observations on NAV loans

A tool to fuel growth

> *20 out of the 22 NAV loans in the 17Capital Credit Fund were used for "money-in" purposes, not distributions of "money out".*

Traditionally, private equity funds invest approximately 80-90% of LPs' commitments, reserving the remaining capital for add-on acquisitions, fees, and other fund expenses. This creates an inefficient scenario for LPs in which a portion of their commitments isn't generating any return. For a typical private equity fund that charges fees based on committed capital, this also widens the gross-to-net performance differential, as fees are charged on all the committed capital but something less than 100% is at work.

In 20 out of the 22 NAV loans in the 17Capital Credit Fund, the loans were used to increase the private equity fund's investment capacity and enable the manager to productively invest closer to 100% of commitments. In these cases, the loans were used to (i) finance follow-on acquisitions, (ii) support value-creation initiatives, (iii) refinance existing debt, and (iv) less frequently, fund new investments. This was particularly effective for buy-and-build strategies in which the loans provided the capital for managers to pursue accretive add-on acquisitions.

In the remaining two cases, the loans were used to generate liquidity for LPs as part of a clearly communicated fund management strategy. Based on 17Capital's analysis of the roughly $26 billion of loans made by all NAV lenders to fund managers in 2024, we estimate that less than 5% of the volume (or $1.3 billion) was used solely for LP distributions, which is consistent with the findings of the Institutional Limited Partners Association and the Fund Finance Association.

NAV loans are made available to, and utilized by, well-performing funds

> *The average vintage of the funds that the 17Capital Credit Fund lent to was 2018. At the NAV loan date, the funds had averaged a net IRR and MOC of 34% and 1.6x, respectively.*

All the funds that borrowed from the 17Capital Credit Fund are performing well. They represent the manager's fifth fund in their specific series on average, and they're typically managed by large, institutional, multi-strategy private markets firms.

In 17Capital's experience, NAV loans are utilized by leading private equity managers whose returns on capital significantly exceed the cost of the loans, making these loans accretive to performance. NAV loans should not be thought of as rescue loans: if a fund is underperforming and its returns are below the cost of a potential NAV loan, no credible lender will offer financing.

NAV loans do not meaningfully increase fund risk

> *On average, the funds that borrowed from the 17Capital Credit Fund did so four and a half years years into their life. Before obtaining NAV loans, the funds had an average debt-to-EBITDA ratio of 5.4x, which increased to 6.9x after borrowing. In comparison, the market average debt-to-EBITDA ratio for loans issued to fund leveraged buyouts from 2020-23 (the investment period of the 17Capital Credit Fund) was 6.7x. This indicates that the total leverage level following a NAV loan is broadly comparable to the ratios that managers generate when making new investments.*

NAV loans, especially these provided by non-bank lenders, offer managers significant flexibility to accommodate the illiquid nature of private equity funds. They typically have maturities of up to five years, plus potential extensions, to align with a fund's harvesting phase and allow for natural repayment upon exit. Moreover, the loans offer a degree of LTV flexibility (in exchange for an increase in the interest cost), which allows private equity managers to avoid having to rapidly repay the loan principal upon a meaningful decrease in the value of the portfolio.

Private equity fund dynamics are not materially impacted by the implementation of a NAV loan, because the cost is borne by the fund, meaning both the fund manager and LPs want the loan to be accretive to overall returns. If the loan isn't accretive, the manager will lose out on carried interest. In short, all stakeholders benefit only if the value created by the NAV loan exceeds its cost.

Competition between fund managers, not the current economic environment, is driving the adoption of NAV loans

> *Throughout market cycles over the last 15+ years, NAV loans have been utilized by well-performing private equity managers looking to outperform their competitors.*

17Capital executed its first-ever NAV loan in January 2010, a €13.5 million loan to a UK-based mid-cap private equity manager. This financing enabled the manager to further invest in its portfolio and buy out minority shareholders in one of its companies. Fifteen years later, the primary use of NAV loans remains the same: financing portfolio growth to create value for LPs.

However, the rising adoption of NAV loans in recent years has led some onlookers to conclude that the loans are simply a product of the 2023-24 environment, which was defined by slow exits and low levels of liquidity. 17Capital believes the real explanation is more secular than cyclical. Early adopters of NAV loans have proven the value that they create, and the remaining private equity managers, even those that pride themselves on being slow to alter their approach, are increasingly considering using NAV loans.

After all, private equity managers face an intense fight to secure LP commitments, with 1,398[1] private equity funds currently fundraising. Managers that employ every tool at their disposal to maximize value for all stakeholders, including through using NAV loans, may be those who perform well enough to raise future funds.

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1. Source: Preqin as of 3 December 2024 (data criteria: Private equity buyout funds, open to investment/raising).

Conclusion

NAV loans are a strategic, value-enhancing financing tool for private equity managers, enabling them to optimize capital deployment, support portfolio growth, and navigate liquidity challenges. As evidenced by the 17Capital Credit Fund, these loans are predominantly used to fuel investment activity rather than to generate capital to distribute to LPs.

The loans are utilized by high-performing funds and managers with strong track records, ensuring that the loans remain accretive to overall fund performance. NAV loans do not meaningfully increase fund risk and, when structured appropriately, do not alter the alignment of interests between fund managers and LPs.

The persistent adoption of NAV loans reflects the competitive nature of the private equity industry and the need for managers to use every available tool to drive superior performance. As the industry continues to evolve, NAV loans will become an increasingly important tool for managers seeking to unlock further growth and deliver outstanding returns for their LPs.

Additional resources

Oaktree NAV Finance 101: The Next Generation of Private Credit (March 2024)

Rede: NAVigating NAV Financing: LP perception survey and lender market report (June 2024)

ILPA guidelines on NAV-based facilities (July 2024)

LMA Talks Loan Market – The evolving outlook NAV financing (February 2025)

NAV Loans Under the Microscope with 17Capital's Pierre-Antoine de Selancy | Bain & Company (April 2025)

Contact us

We hope you have found this report interesting. If you would like to discuss any of the points raised, or would like to find out more about investing in this asset class, please do not hesitate to contact the Investor Relations team at ir@17capital.com or find out more on our website: www.17capital.com

17Capital – Financing the private equity industry

17Capital is a private credit manager, specializing in NAV finance for the private equity industry. It provides non-dilutive capital to high-quality private equity management companies, funds, and institutional investors as part of their toolkit for value creation and portfolio management. Founded in 2008, 17Capital has completed over 100 investments and 50 exits, deploying more than $15 billion since inception.

OAKTREE

In 2022, Oaktree acquired a majority interest in 17Capital. The partnership gives 17Capital access to Oaktree's deep global network. 17Capital, continues to operate as an independent business, with its own product offerings and investment, marketing, and support teams.

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