The Evolution of Fund Finance

The Next Generation

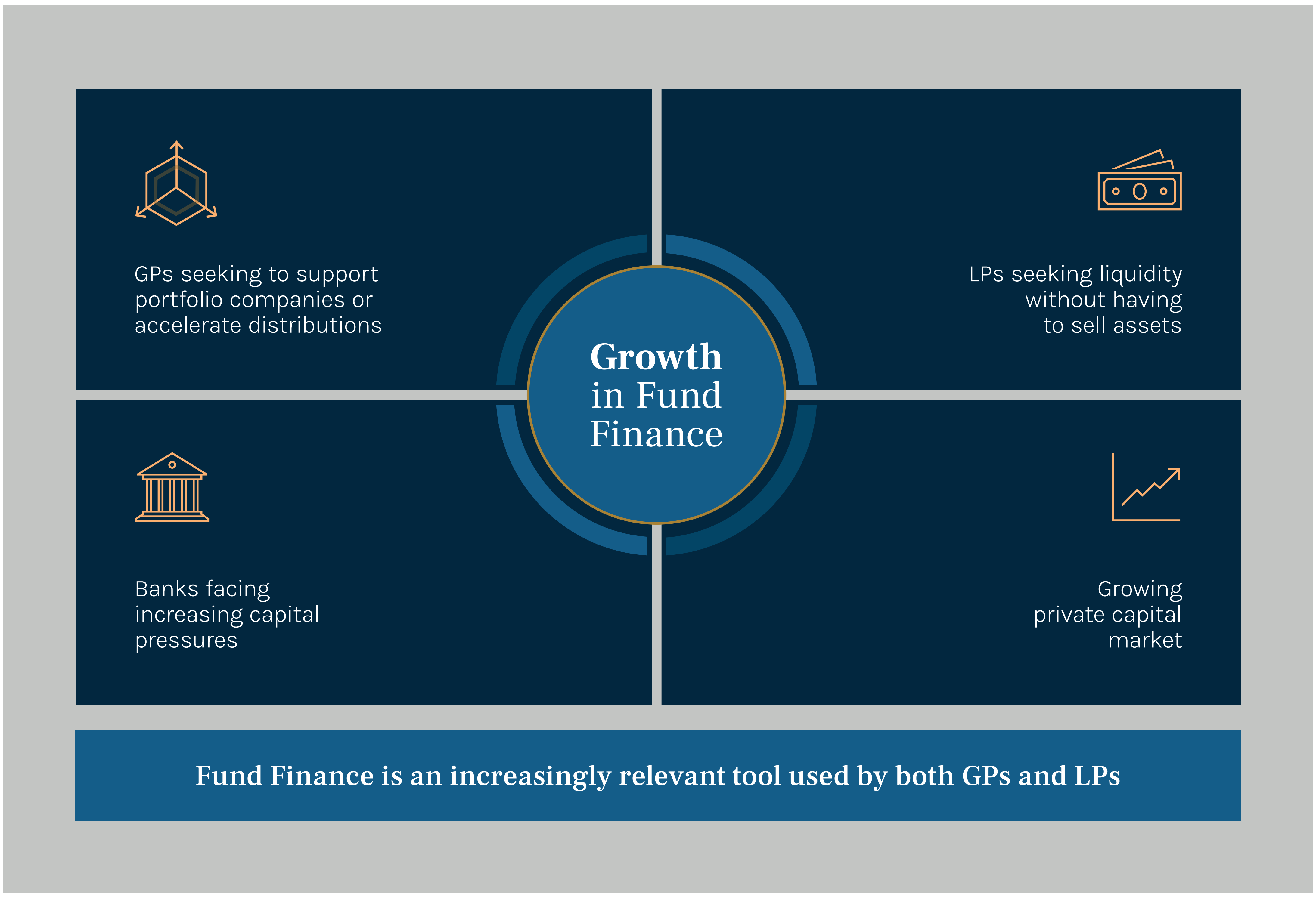
October 2024

ARES

Introduction

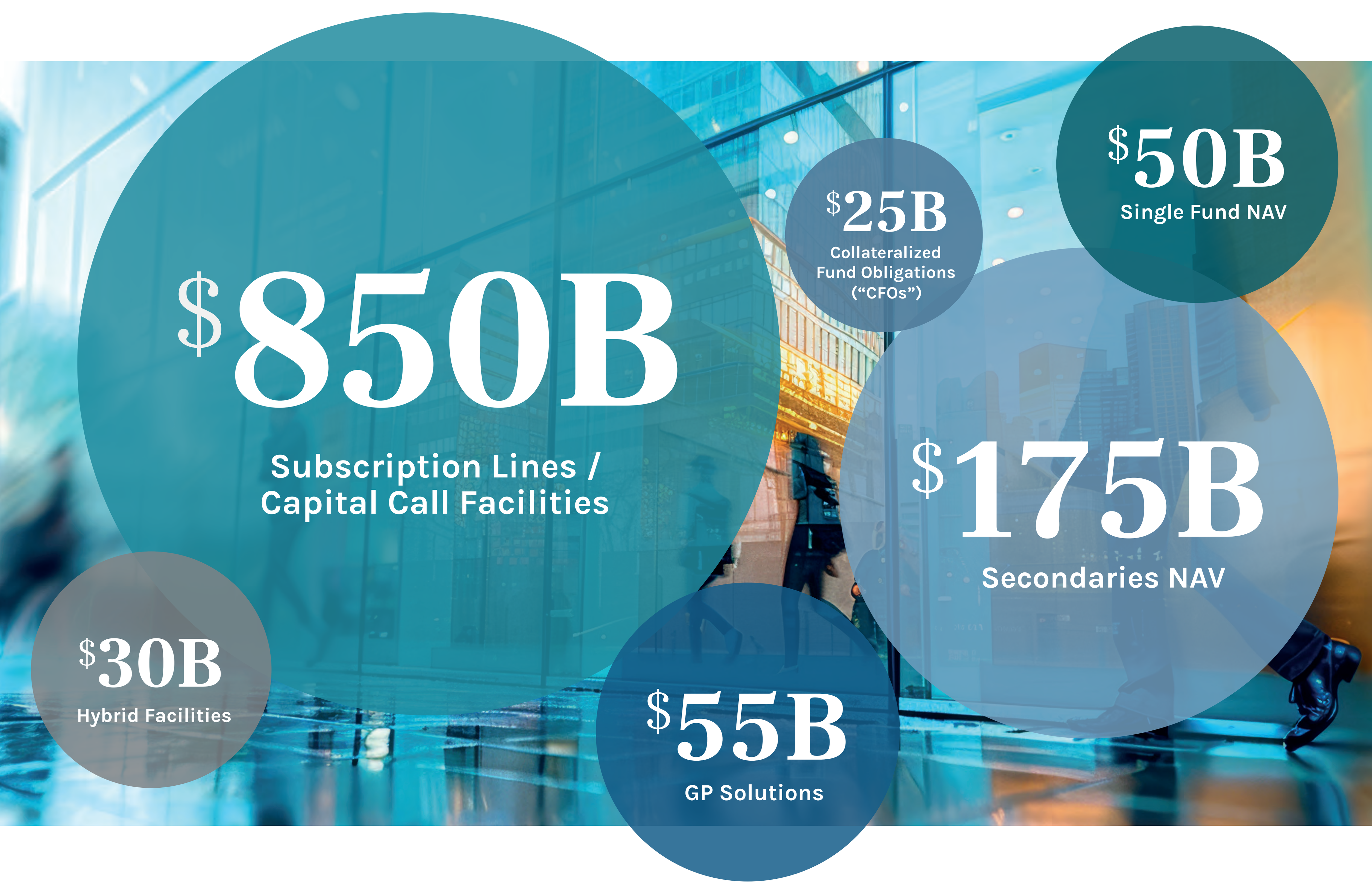
What Is Fund Finance and Why Is It in Focus?

“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]

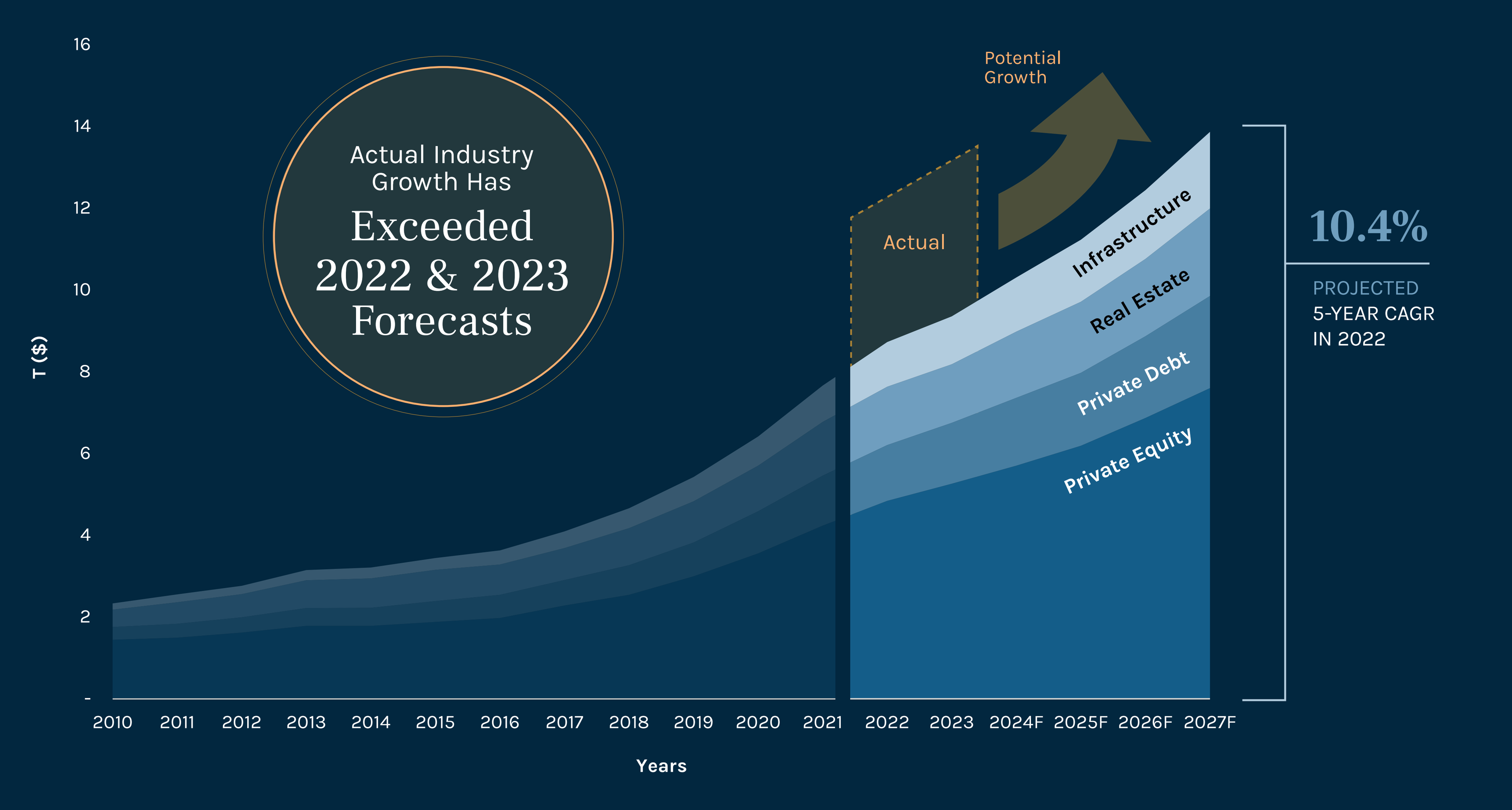
> 83% of lenders reported an increase in the number of NAV transaction opportunities over the last year[2]

> Utilization of NAV-based financing could grow as much as sixfold by 2030[3]

> We expect the ~$150B in NAV facilities ... to double within the next two years[4]

Private Capital AUM Growth[1,2]

Private capital AUM was forecasted to become a ~$14T market by 2027. However, the industry is already outpacing those projections[5]

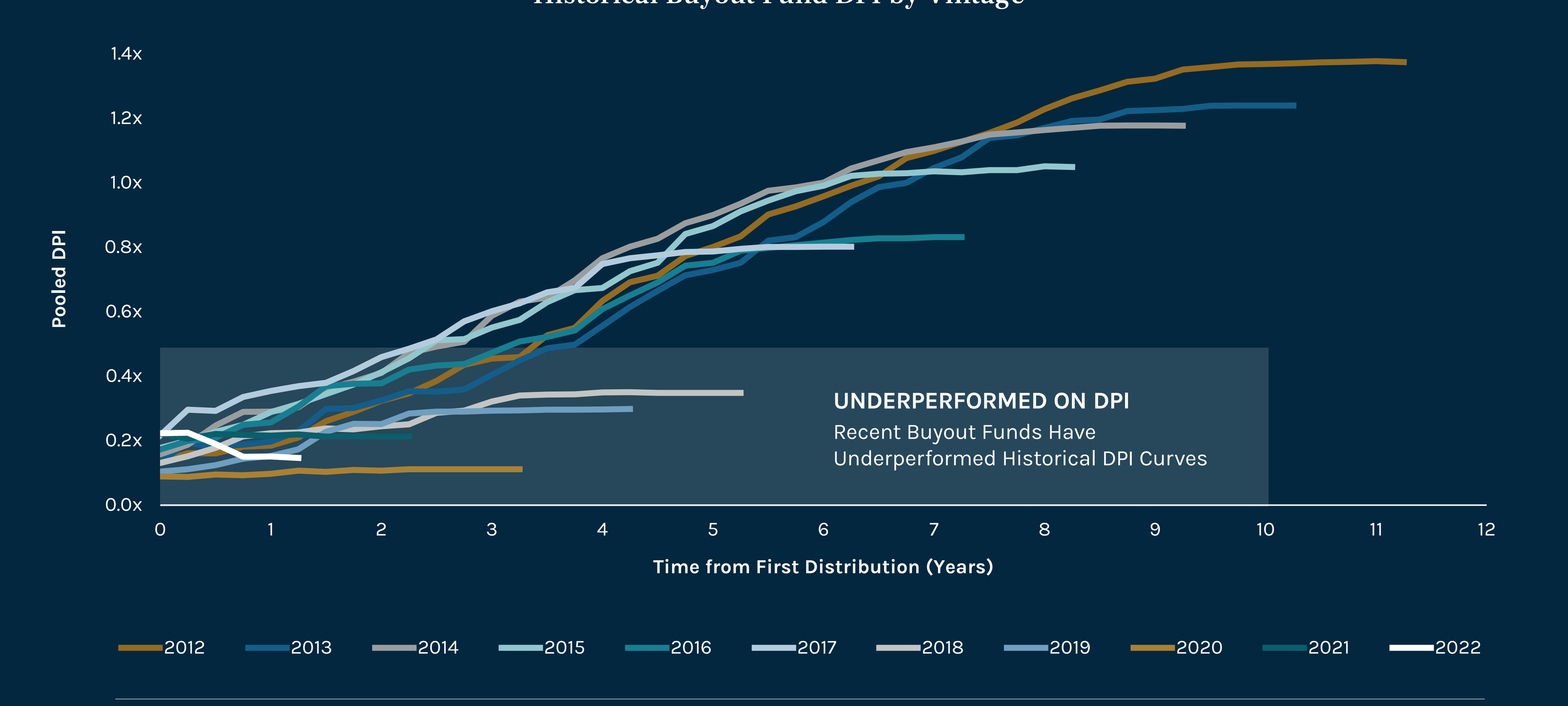


Note: For illustrative purposes only. Forecasts are inherently limited and should not be relied upon as indicators of actual or future outcomes.

Significant growth trajectory in private capital AUM is expanding the potential collateral for Fund Finance

Asset Monetizations Have Slowed Substantially...

Historical Buyout Fund DPI by Vintage

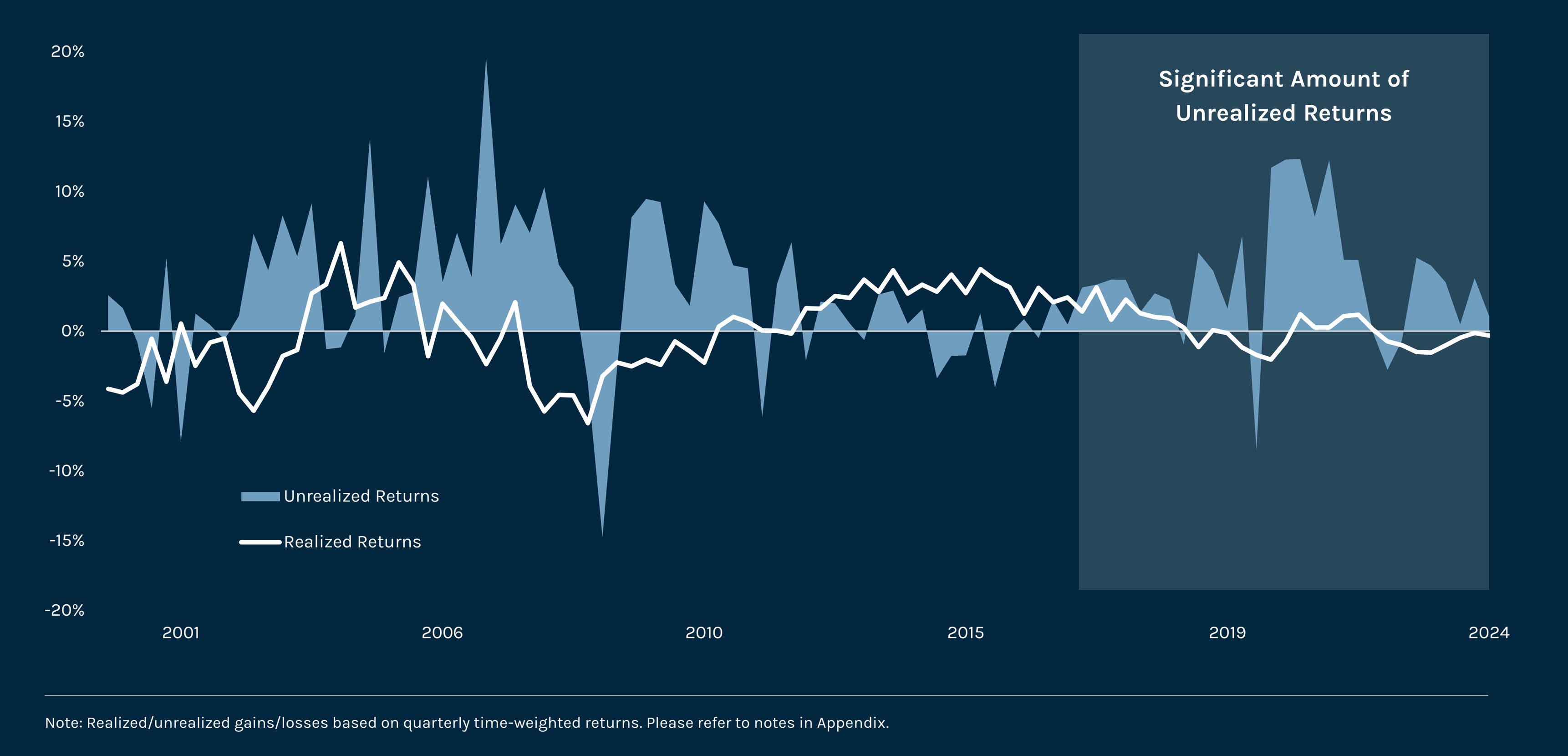


Note: For illustrative purposes only. Please refer to notes in Appendix.

Increasing Deal Duration for Private Equity Assets

... Leading to Significant Unrealized Returns

Aggregate Buyout Fund Realized vs. Unrealized Returns



Note: Realized/unrealized gains/losses based on quarterly time-weighted returns. Please refer to notes in Appendix.

This combination creates increasing demand for Fund Finance

> 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

Ares projects the total Fund Finance market will grow significantly → **$1.2T** 2024 → **$2.5T+** 2030

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

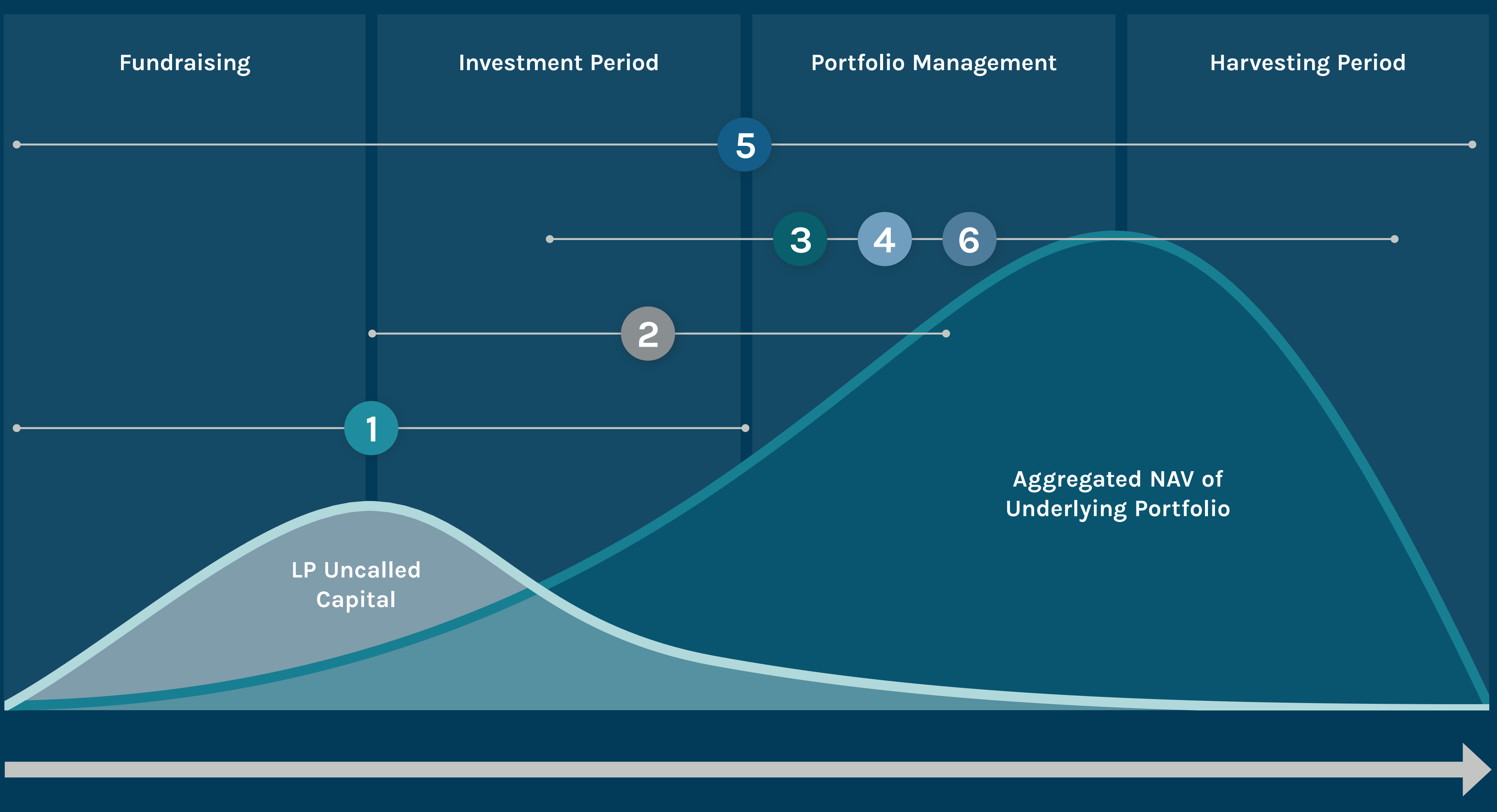
CFOs

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?

Illustrative Use of Fund Finance Facilities Across Fund Life Cycle



Subscription Lines

- Cash management
- Acquisition financing

1

Hybrid Facilities & NAV Facilities

- Cash management
- Acquisition financing
- Leverage / fund recapitalization
- Return of capital
- Alternative to LBO and IPO
- Support of portfolio companies

2 3 4

GP Solutions

- Fundraising
- Non-dilutive strategic capital raises
- Leverage for GP commitments

5

CFOs

- Regulatory capital efficiency
- Leverage / recapitalization of fund portfolios

6

Note: For illustrative purposes only. Please refer to notes in Appendix.

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[6]

90%
SUBSCRIPTION FINANCE MARKET GROWTH FROM 2017-2022[7]

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

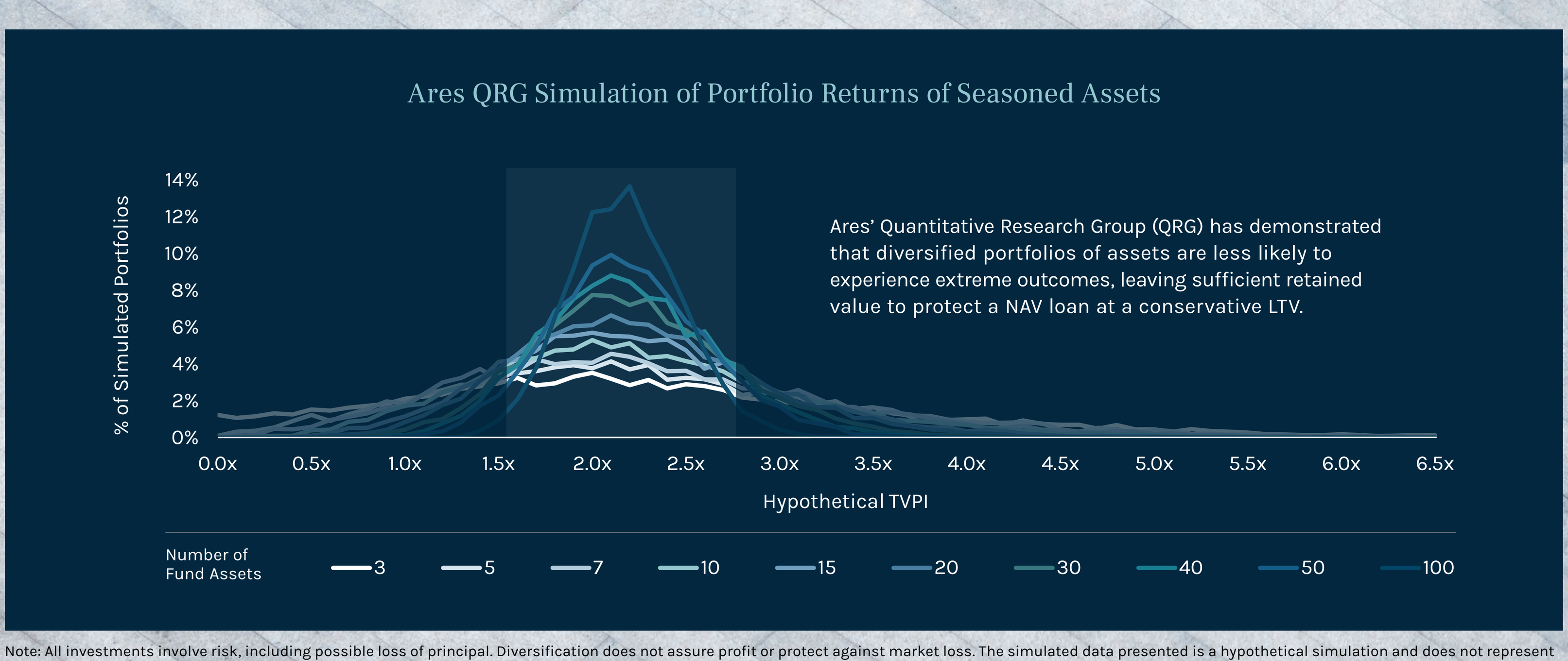
KEY USERS
Typically private equity sponsors, with increasing usage across other strategies

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%



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

5th Percentile	25th Percentile	50th Percentile	75th Percentile	95th Percentile
0.8x	1.3x	1.7x	2.1x	3.1x

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

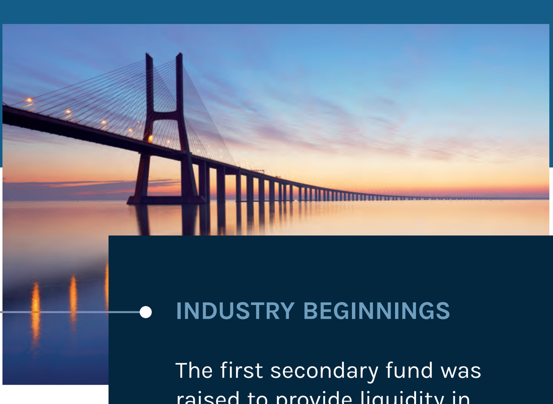
LTV
Approximately 50% for Single A with ability to advance further for BBB and BB / preferred equity

Historical Performance in Downturns[9]

- 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

Past, Present and Future

Fund Finance Has Existed in Various Forms Since the 1980s



1980s

INDUSTRY BEGINNINGS

The first secondary fund was raised to provide liquidity in the market for LP interests in private equity funds[10]

1990s / Early 2000s

SUBSCRIPTION LINES

First subscription lines were executed, historically to real estate funds[11]

2000s

PRECURSORS TO NAV

Fund of hedge funds financing and CFOs were executed

SECONDARIES AND PRIVATE CREDIT NAV

Banks start providing financing to private credit and secondary funds

2010s

GP SOLUTIONS

GP solutions grew out of the market for GP seeding and management company financing

PRIVATE CREDIT ENTRANTS

Post-GFC, private credit market participants began entering the Fund Finance market, and single fund NAV financing became more prevalent

RATINGS EVOLUTION

KBRA published the first version of its investment funds methodology, the first step in a series of actions which deepened the involvement of rating agencies within Fund Finance

SECONDARIES NAV

Secondary volumes exceeded $20B for the first time in history and reached $85B[12] in 2019, providing a stronger foundation for the diversified NAV financing market

2020s

HYBRID FACILITIES

The market saw an increased use of hybrid facilities, provided by both traditional banks and other market entrants (e.g., private credit and insurance)

CAPITAL RELIEF

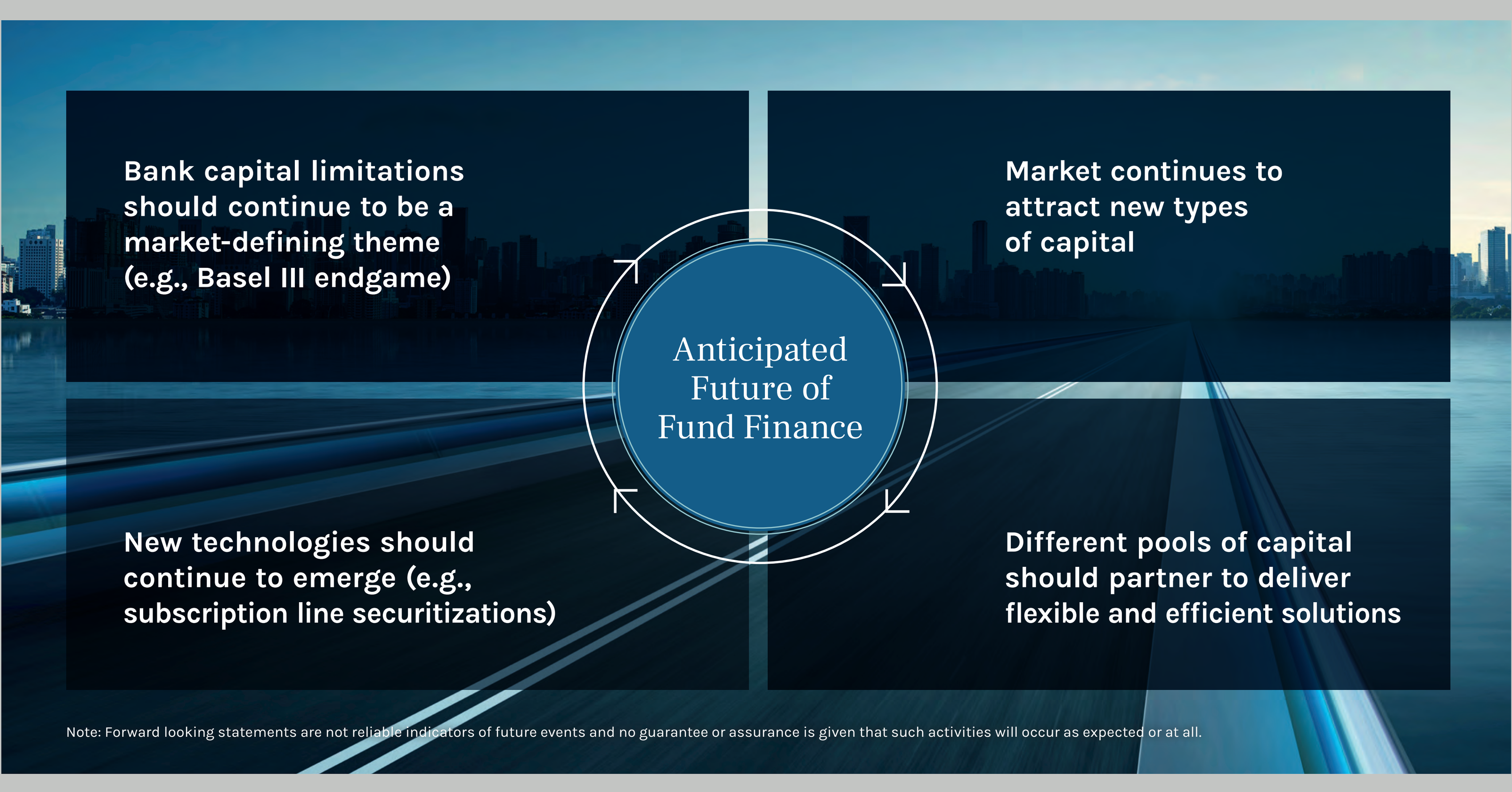
First subscription line bank capital relief trade was executed, initiating a trend of risk transfer transactions within Fund Finance to address capital constraints and regulatory considerations

CFO MOMENTUM

CFOs gained traction in a liquidity-constrained and difficult fundraising environment, coinciding with evolving NAIC guidance

The Future of Fund Finance

> "We believe market participants who have strong sponsor networks and flexible, scaled capital are best positioned to drive this asset class forward."
>
> **Richard Sehayek** | Managing Director & Head of Fund Finance, Ares Alternative Credit



Market Participants

With additional capital constraints and regulatory changes, banks increasingly need to partner with insurance, asset managers and other investors to fulfill the growing demand of today's Fund Finance market

Banks

Increasingly partner with private credit and insurance given capital constraints and regulatory pressure

- Bloomberg — Goldman Sachs Sells SRT Tied to $2 Billion of Private Fund Loans
- Financial Times — Citi to Slash Lending to Buyout Funds as New Capital Rules Bite
- BNN Bloomberg — Morgan Stanley Selling Bonds Tied to More Than $4 Billion of Private Loans

Insurance

Increasingly active, typically by partnering with private credit and banks to invest in capital-efficient structures

- Insurance Asset Risk — The Rise of NAV Financing Attracts Attention of Insurance CIOs
- Cadwalader, Wickersham & Taft LLP — Insurance Companies in NAV, CLOs and Rated Feeders
- Private Funds CFO — Fund finance: Why insurance companies can make good lenders

Private Credit

Flexible capital providers can play a key role in the Fund Finance market by both partnering with other sources of capital and working directly with sponsors

- Institutional Investor — Private Equity's Woes Spur Rise in NAV Loans – and Managers Offering Them
- Investment & Pensions Europe — NAV Finance Takes Hold as a Niche Form of Private Credit

Please refer to notes in Appendix.

Key Sponsor Considerations: Transparency and LP Concerns

It is important to consider how GPs should approach the use of NAV loans in response to LP concerns, as highlighted by recent press publications

The Institutional Limited Partners Association **(ILPA)** released guidance on how GPs should address potential LP concerns around NAV facilities in July 2024[13]

LP Concerns			
Limited insight into use	Lack of governance and LP involvement / notification	Increasing leverage and risk	Increased use to drive distributions

80% of NAV facilities have been utilized to support portfolio companies[14]

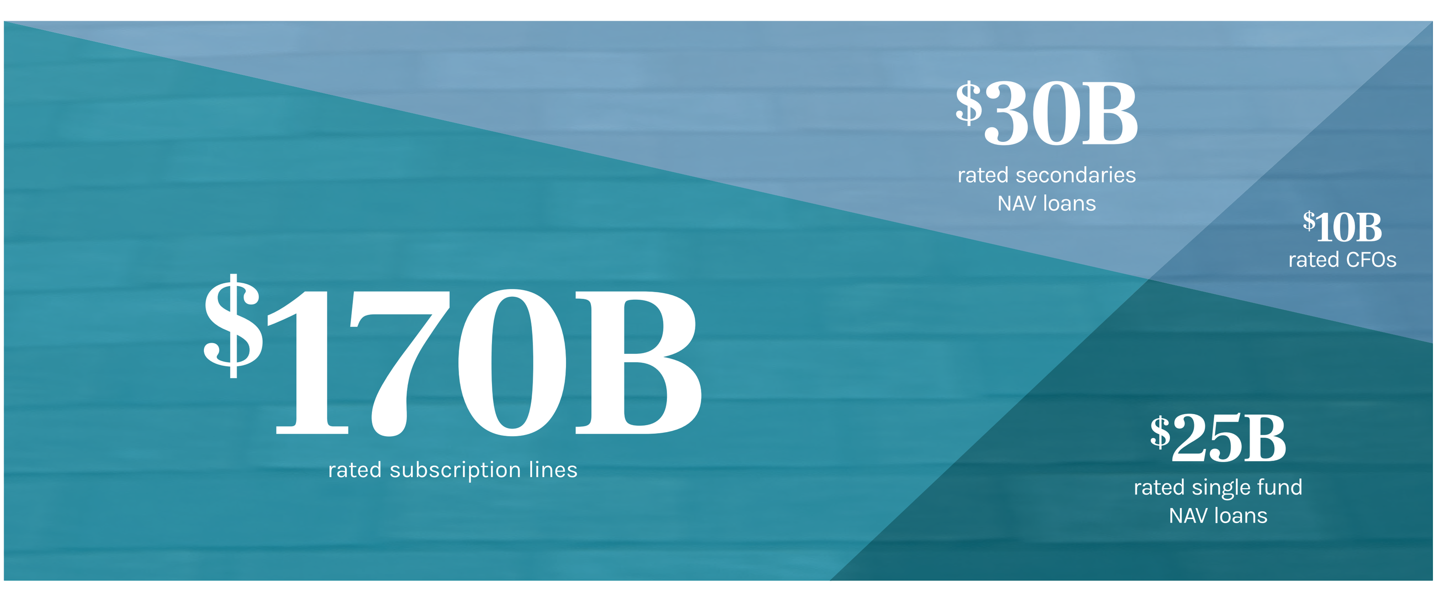
Key Points for GPs to Communicate

- ☑ Rationale and use of proceeds
- ☑ Key economic terms
- ☑ Size, structure and controls
- ☑ LP obligations

Increased Ratings to Address Capital Treatment

It is also important for lenders to understand the rating agency and NAIC considerations given (i) insurance companies are becoming prevalent key investors and (ii) the increasing focus on banks' and investors' capital efficiency

Estimated Size of the Rated Fund Finance Market



Please refer to notes in Appendix.

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
1,000+ investment professionals across Ares Credit, Real Estate, Private Equity, Secondary Solutions and Strategic Initiatives	**3,000+** active investments in portfolio companies across Ares strategies	**~$447B** in firmwide AUM across the Ares platform[15]
78 Alt Credit investment professionals (one of the market's largest dedicated teams)[16]	**$60B** of Fund Finance transactions reviewed since 2022[17]	**~$54B** deployed in Alternative Credit since inception[17]

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Note: certain charts, exhibits and text may print across page breaks.

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	1. 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. 2. Source: Secondaries Investor, Predicting the next decade: The rise of NAV lending, June 2023. 3. Source: Institutional Limited Partners Association, New ILPA Guidance Encourages LP-GP Dialogue, Transparency around NAV-based Facilities, July 2024. 4. Source: S&P, CreditWeek: How Are Funds Using Net Asset Value Loans?, May 2024. 5. Source: Preqin: Future of Alternative 2027, October 2022.
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	6. 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. 7. Source: Fitch Ratings, 2023.
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	8. Source: Burgiss, Data on United States Leveraged Buyout Funds, March 2024.
CFOs	9. Source: Financial Times, Collateralised fund obligations: how private equity securitised itself, November 2022.
Fund Finance has Existed in Various Forms Since the 1980s	10. Source: Coller Capital, About Private Market Secondaries, 2024. 11. 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. 12. Source: Setter Capital, Volume Report, 2019.
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	13. Source: ILPA, NAV-Based Facilities Guidance for Limited Partners and General Partner, 2024. 14. Source: Fund Finance Association (2022).
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	15. 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. 16. As of October 2024. 17. As of June 30, 2024.

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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