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Virtual Event Series

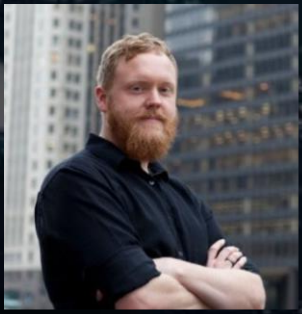
Alternative Financing for Funds

Guest Speaker:

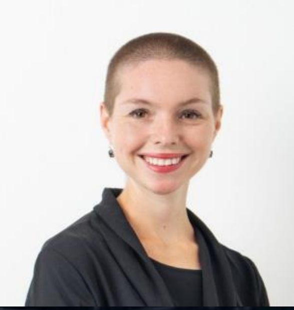
Barbara Fleming

Head of VC & Private Equity
Grasshopper Bank

Hosts:



Kenny Estes
CEO and Founder
Diffuse



Ayla Kremb
Chief of Staff
Diffuse

DiffuseTap: Alternative Financing for Funds

In our session featuring **Barbara Fleming, Head of VC & Private Equity at Grasshopper Bank**, we covered the most overlooked ways of how a fund can do financing by partnering with a bank, and great alternative financing strategies that all emerging managers have to know about.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speaker

Barbara Fleming is a banker turned entrepreneur. With over 30 years of experience within the banking space, she has helped launch five business lines. She specializes in melding sales, designing exceptional service with flawless execution to produce profitable portfolios. Barbara is an experienced leader and sales manager who has coached many disciples-turned-renowned leaders in the banking industry. LinkedIn: @barbarafleming

About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: Barbara, would you mind doing a couple-sentence introduction on yourself?

BARBARA FLEMING: Sure. Thank you, Kenny and Ayla, this is a really great opportunity. The bar is really high now since I've got folks that are beating last week's number, so hopefully I do a good job here.

So, I am currently with Grasshopper Bank as one of the founding folks, and I head up the division working with venture and private equity.

So basically, we have a three-legged stool at Grasshopper Bank. We also work very closely with portfolio companies of our investors as well as portfolio companies that are not institutional or VC-backed — those companies that are just solid companies and bootstrapped. And then, our third leg is the core C&I business.

We're a relatively new bank. We're about 20 months old, so we don't have any bad habits yet. And we're really, really focused on building a book collaboratively. One of the reasons Kenny and I got connected is that we are truly trying to democratize access to financing tools for emerging managers, and smaller companies. It's really easy, quite frankly, as a banker to do a hundred-million-dollar deal. But it's really tough to do a million-dollar deal when there's hair on the deal, and you have to spend time and get creative around the deal. So that's where we are playing these days.

KENNY: That is great. Thank you for the introduction. So, the way we do this is we do it as a fireside chat, where we just ask questions. I'll kick it over to Ayla, my partner in crime, to really get that started.

AYLA KREMB: So, the first one, and I think this is probably a good starting point, is what kind of alternative financing or funding options are there for emerging fund managers? We'd love to hear some things that most haven't thought about.

BARBARA: Absolutely. One of the things that you have at your fingertips is the power of three legal entities. Most venture and private equity firms have a fund, a management company, as well as a GP entity, and each one of these entities has different needs. So, financing options for funds are most common. You want to be able to write a check today and call capital in the future. A capital call bridge finance tool is typically used. If your fund is seasoned, older, and now you're out of the investing period, there's also net asset value (NAV) facilities that are available.

The biggest difference is, with a capital call line, you're bridging between the investment and calling capital. With a nav line, you're actually bridging between the receipt of liquidity proceeds from your portfolio companies and distributions to your LPs. A lot of folks don't tell you about the nav facilities, but we've looked at both of those holistically. And we, as well as most bankers, try to elongate the relationship with these tools.

So, for example, you guys are managing a 10-year pool of capital. That pool of capital has different needs during its lifecycle, and there's different opportunities with that. I think two things that are completely underutilized in the emerging manager space are GP commitment facilities, as well as the management company facility.

Let's start with the GP commitment facilities. What that means is with a little skin in the game, as a general partner, you would be able to finance a portion of your commitment to the funds. A couple of advantages for that is most emerging managers are committing one to two percent based on the total capital of the fund. That's pretty typical. That could be meaningful for some of the emerging manager teams, whether you're coming out of another organization where you have commitments, or all the capital that you have you're putting into the company just to get it off the ground, on top of having a commitment.

What a GP commitment facility will do is allow you to finance a portion of your commitment over the life of the fund. And the bank gets paid back when there's liquidity that ties to your GP commitment. Now, in some cases, some banks are going to require a personal guarantee. At Grasshopper, we don't care. We don't require a personal guarantee. In lieu of personal guarantees, we actually have the management companies step in as the guarantor.

So, let's talk about the management company. The management company is the backbone of your venture or private equity firm. It is the one entity that's responsible for collecting management fees, your revenue, making payments to your vendors, and all of the expenses.

Working capital lines are really important. Companies that have front loaded a lot of their expenses and, or, have lumpy payments throughout the first year – when you front load your expenses, you're usually relying on that first capital call, and all the management fees that you're getting from that first capital call are going out to pay the front load of expenses.

What a working capital line will allow you to do is spread out those expenditures. Otherwise, you can pay your lawyer, you can pay the vendor, you can pay your placement agent. This will give you about a year on a working capital line to pay that down. So therefore, you're not starving your first capital call, and the first batch of management fees are coming in, you can spread that out across the year.

And then, there are term loans. Term loans are very flexible. What we tend to do is ask “what's the need?” If it's a short- term need, a revolver is best, where you're going to go in and out just balancing between when expenses hit and when you're collecting management fees. Versus long-term expenses, which could be a signing bonus for a partner you want to bring in, or a CFO you want to bring on. It could also be for placement agent fees, it could be the acquisition, some office space where you have a large cash deposit to support the lease, and things like that.

Don't underestimate term loans, they are pretty inexpensive. And it gives you more than 12 months to spread out some long-term expenses you have.

KENNY: That is great. There's a lot there. And some of it, in our experience, is pretty unique to Grasshopper bank and what you're doing over there, and how much you’re willing to be flexible. So, the audience here is largely emerging managers, and many of them are setting up fund number one. So, the GP commit line, when you structure that, is it something like, twenty percent loan to value with a fifteen percent interest rate? What is the actual rough sketch of the terms, and how does that work? Can you give us a little bit of detail?

BARBARA: Absolutely. So, rule of thumb, typically with a Grasshopper facility, you'll be able to finance up to seventy percent of your commitment. And that's an aggregate number. The perfect example is, we put a facility in place last year, the fund is actually in its second year of operations, almost at the end of the second year of operation. And that worked out fine, because the seventy percent advance rate is on the aggregate capital that had been called to date.

So, what happens is that that first capital, that first advance under the credit facility, was basically one hundred percent. We just want you to have some skin in the game. We touched on the fact that we try to underwrite every facility without personal guarantees, but we do rely on the management company as that guarantor. And for emerging managers, typically the GP ownership and the management ownership are the same. So, that usually is not a rub.

What you can also do with the GP facility, and the way in which we structured it, is we put the power of the facility in your fingertips, not in ours. And what I mean by that is we're not underwriting to each individual partner’s personal financial condition. Honestly, we've found no value in that because typically, we don't have to lean on it anyway. And it's just a hassle. You guys would have to fill out personal financial statements every quarter and send us all kinds in boatloads of reporting. There’s just no value there.

So, what we've tried to do is streamline this process. The purpose of putting the power of having that facility at the general partner legal entity level, as opposed to individuals, is that you guys can decide which partner on the team has access to the facility. You can actually use it as a recruiting tool.

Let's say you wanted Kenny to join the team. What gets him over the finish line is having access to a credit facility to help fund the portion of his commitment so you can decide who you want to have access to that. And then on the back end, let’s say Ayla, myself, and Kenny are partners, and Kenny doesn't use a facility ever. What happens is, on the backside when there's a distribution, Kenny will walk away with one hundred percent of his allocated distributions.

It will not be tact to pay down the line because he did not use the line. So, we have trackers and things like that, but my portion of distribution, if I still have some outstandings on the facility — I’m gonna use to pay that down. So those are some key distributions.

And I think the other last piece is the term of the facility. We mirror the natural life of the fund. Most funds have a ten-year life. You have a ten-year term loan. Interest only up to six years, it just depends on what your investment period is. You may have this facility with quarterly payments on the interest only.

And then at the back end, whether that's four or five years, we'll just do a straight-line amortization. And by that time, you would have been able to plan for the amortization coming up. So hopefully, you've saved some of the management fees where you can pay it off, and also start seeing some realization in the portfolio.

KENNY: That's great. And I wanted to do one more follow up to one from the chat. How do you do your pricing on that in terms of interest rate? What is that, and then also, optically, how do LPs view that product? So, if you're doing a GP line, and you're saying, “hey, we'll do seventy percent loan to value and one hundred percent on first close," because depending on how that prorates out (or whatever the right word is,) do they view that still as you having skin in the game, when there's no personal guarantee? Or do they kind of abstain from that?

BARBARA: Good questions. So, let's take the last question. LPs, how do they look at it? These days, investors in early managers understand the need and basically the commitment that the GP is making to the fund, and how the GP could be a stretch. Most investors are not going to have an issue with the fact that you have access to a credit facility because some GPs would use an equity line on their home, or use some type of margin account for funding that management fee waivers, or management fee offset. Most of the LPs are not going to give you any issues with that.

Now, what I've seen sometimes, is that GPs are not their own best friends. So, within your fund formation documents, I have seen limitations on GPs being able to do this. Just be cognizant of the fact that your formation documents do not restrict you from getting a credit facility for a GP facility. That's key. And Kenny, I'm sorry, what's the first question again?

KENNY: I think the audience wants to know pricing. What do you do, and how do you do that?

BARBARA: Absolutely. So, democratizing access to these tools means also not being crazy with their pricing. We're typically prime plus three and a quarter to prime plus one percent. And over the ten-year life, you'll have a facility fee upfront, usually twenty pips. So, on a million dollars, we're talking $2,000, and then legal fees to just document the deal.

And that's running anywhere from seven to $9,000 upfront. So, we're not going to charge you four or five percent. It is a little more expensive than, say, a home equity loan these days. But it is a great tool that you can use when needed.

AYLA: Awesome. I think one of the follow up questions that you mentioned is a bit on structuring the term sheets in a way that's friendly to getting financing. One of the main questions we also had and we discussed previously was from a structuring perspective, in order not to lose out on these financing options, what else should GPs really think about as they're getting ready to take advantage of financing?

BARBARA: Absolutely. So, I touched on the organizational documents. That is important. Be sure that you do not create a self-inflicted wound, which would restrict you from getting any of these financing tools. Honestly, I know how to work around most of these. What you don't want to do is have to go back to the majority of your LPs for consent to get a capital call line, or the majority LPs to get their consent.

Maybe getting consent from an advisory committee is actually much easier, but there are different regulations out there that you'll need to work with. Example for venture funds the size of a credit facility you can have, by the way, is 15% of your commitments. And how long you can have the fund in debt, by the way, that's 120 days. Those are regulatory requirements, so we'll need to stay within that. So, the operating agreements are very important.

I also say transparency. You don't want to have a rub with an LP because they didn't know you were using financing tools and things like that. At the end of the day, especially in the emerging manager space, most of the cap tables have high net worth individuals and small family offices. It's just the reality that an emerging manager fund may need these tools.

And so, explaining how these tools actually benefit the limited partner, you can provide some type of predictability on capital calls, maybe quarterly, maybe it's five times a year. But that allows the LP to prepare better with its own cash management and forecasting. So, if you've got a seed or a pre seed fund, you're doing a lot of small deals, the last thing you want to do is issue five capital calls in a month or a quarter.

So, there's lots of advantages. Again, watch your operating documents, be transparent with your investors, and try not to give the LPs too much say over your use of these fund tools, if possible.

AYLA: So, that kind of brings us back to our chat here. People are pummeling our authority with questions. They have a really good one. So, with his previous funds, sometimes he was able to arrange a loan facility internally with his own LPs, usually, for up to five to six percent of the AUM. What are the advantages of using someone like Grasshopper versus trying to go internally?

BARBARA: So usually, if you're going internally, where an LP is stepping up, that's a pretty good rate, four to five percent. If you went with us, obviously, the expense is lower. You're not giving up economics in the deal, neither to us. And a lot of LPs will want some enhanced economics or reduced management fees. So, above and beyond the interest they may be charging you, they typically want a piece of either one of those. And second, these facilities are long term. The average life of a capital call line of credit is seven and a half years. So, year after year you renew it. You may tweak the size and things like that, but it's a long-term tool that you and the bank are familiar with.

And you're also establishing relationships with the bank. I will also say that by leveraging a bank, and using a bank for a capital call line, you want to deepen the relationship. Not just a capital, you don't want a transaction, you don't want to just have a capital call line. But if you’re like Grasshopper and you have a portfolio of tech companies, that is something we would be interested in banking those companies.

And so, what you want to do is broaden the relationship with the bank. And then, when you come around to fund two or fund three, you’ve got a little bit of a carrot also with the bank as far as pricing and potential structure, and things like that.

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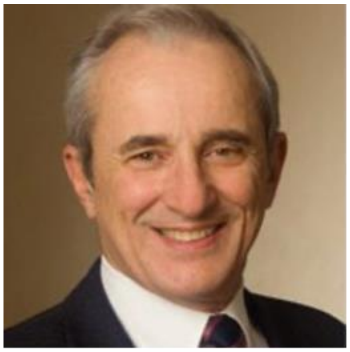
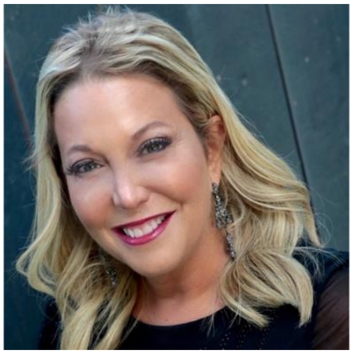


Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

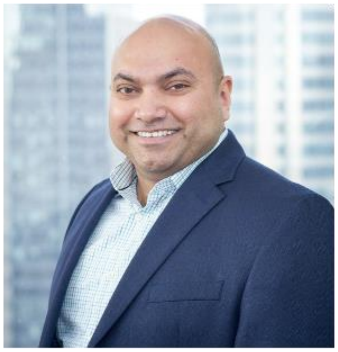
Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on



Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on



Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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