EXPERT Q&A

GPs are turning towards NAV financing as the market demands more flexible solutions and offers diversification for investors, says Arcmont's head of NAV Financing, Peter Hutton

The growing appeal of NAV for borrowers

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Q Could you start by explaining how you look at the NAV financing universe from a direct lending perspective?

We believe NAV financing is a much more strategic capital solution for sponsors than direct lending because a lender is really partnering with the sponsor and its LPs on a whole-of-fund basis versus with management teams and sponsors on a single-asset basis.

Alignment plays a really interesting role here, which is why sponsors want to partner with a lender that they trust and have executed multiple transactions with in the past.

Because the lending is much more strategic, providers need to have scale, need to know the assets and need to be able to provide a general, comprehensive financing solution. If you are lending at NAV level with no real appreciation of the underlying assets, you are only fulfilling half of that role, from our perspective.

The other interesting difference from direct lending is from an underwriting perspective. While an allocation to NAV financing is similar to direct lending – in that it is at floating rate plus fixed spread, it is senior secured credit with typically a BBB rating and it offers direct lending-like returns – from an underwriting perspective it is completely different. Lenders need experience in multiple asset classes.

Direct lending experience is very helpful in doing single-asset due diligence and structuring these loan instruments, but you also need specialist NAV experience and dedicated secondaries skills to do the cashflow modelling and understand how fund balance sheets work.

Plus, you need fund of funds experience to diligence a sponsor and really ask them the right questions, rather than just relying on what you are given.

Finally, it really helps to have LP

know-how – having spent eight years working in-house at an LP myself, I can see how valuable that is for these deals. All those elements are not really as relevant to direct lending, but in NAV financing you need them because it is a much more holistic underwriting process. Providers are trying to be more of a partner to sponsors, solving for a comprehensive range of needs and speaking their language, rather than just lending on a transactional basis.

That is one reason the barriers to entry are much higher in the NAV financing market than they are in direct lending. There are about 750 GPs that have raised direct lending funds globally, as per an industry market report published in June 2024, and we think that the number of dedicated NAV funds will be about 2 or 3 percent of that.

Q Why are sponsors increasingly turning to NAV financing?

We estimate that adoption of NAV financing among European mid-market GPs has reached approximately 22 percent, based on Arcmont research (including conversations with 165 European buyout sponsors) and data from an industry market report as of September 25 2025.

There are a number of reasons for this trend. First, there has been a structural shift towards greater flexibility and capital availability for sponsors more broadly. We have seen that in direct lending after the global financial crisis, when banks retreated from the market, and alternative lenders such as Arcmont stepped in with enhanced flexibility, a more nuanced approach to risk underwriting, increased responsiveness and deep pools of capital.

Similarly, subscription credit facilities – which were still relatively nascent a decade ago – have experienced significant growth. According to a 2014 Mayer Brown market review, the market has since expanded to an estimated $900 billion by 2024 (source: Cadwalader), with nearly all private funds now utilising these facilities. Secondaries are also growing extraordinarily strongly.

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So, NAV financing is just the latest example of that general structural shift as sponsors get more sophisticated and demand multiple financing options.

Secondly, over the past 10 years, 47 percent of all value creation by private equity has come from multiple expansion (according to a 2024 Bain & Company report). As interest rates have gone up, we think it is unlikely that multiple expansion can contribute to value creation in the same way going forward.

Sponsors are holding assets for longer, according to a 2025 Bain & Company report, and periods of macro instability mean they are delaying selling assets, so they need to do more value creation to generate the same returns as before. M&A is one of the most natural levers to achieve that, and NAV financing can significantly enhance sponsors' available capital to do deals. So, it becomes an attractive tool fully aligned with the value creation objectives of sponsors and their LPs.

According to our research, if a GP executes a NAV facility, 80 percent for M&A and 20 percent for distributions (in line with the ILPA market estimates as of July 2024), the average increase to a GP's net internal rate of return is 100-175 basis points, and can often be higher (this estimate is indicative and has been produced by Arcmont based on a number of assumptions). For that reason, we expect to see meaningful growth from sponsors looking to maximise value creation and enhance their fundraising potential.

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Sponsors that are not familiar with the range of solutions on offer risk losing out on those value creation opportunities and potentially being left behind by their competitors. That is now well recognised by the largest funds and their limited partners, and it is trickling down into the mid-market.

Q Are there any perceptions of risk within the asset class that you would like to debunk?

There used to be a perception that investors were not keen on NAV financing. Education, as with all new asset classes, is paramount. We want to be thought leaders in this space, which is why we have published two white papers and several NAV 101 videos on LinkedIn this year, but really it is about spending time with sponsors and walking through not only how NAV works or how NAV enhances a fund's net IRR and net MOIC, but also clearly explaining the diversification advantages of a conservative LTV NAV loan compared with overlevering at the asset level.

There is also still some concern about the risks, with a perception that it is leverage on leverage. Our view is that NAV loans are a lower-risk, higher-potential return form of leverage that enables sponsors to capture M&A opportunities previously not possible with traditional financing. So, it is increasing the size of the overall pie.

If a sponsor is looking to do an incremental acquisition, for example, and needs capital to do that, they have three main options. First, raising additional senior debt, which puts a burden on the company's cashflow and is limited by covenants. Second, raising additional junior debt, which is typically more expensive and could be at an LTV in the capital structure that is uncomfortable for the sponsor. Or third, equity, which is expensive and may be needed elsewhere for rainy day purposes.

NAV financing is an attractive alternative because at any point through the value creation period of the fund it can accelerate M&A. That effectively generates additional equity at the company level with a decent cost of capital offering a strong arbitrage opportunity too.

The amount of firepower that sponsors can raise is also larger with NAV financing because the collateral basis is the entire fund versus a single company.

Finally, this is typically PIK interest so there is no additional cash burden for the underlying companies and no distraction for the underlying companies or their management teams.

If you want to do a transformative M&A transaction, or raise additional capital for multiple businesses in a single deal, then a conservatively structured NAV loan is very attractive. ■

How do you see the role of NAV financing developing with the broader future of alternatives?

From a demand perspective, sponsors are increasingly seeing their fund investments as not just a series of asset returns, but a fund return. That is already evidenced by the fact subscription lines are ubiquitous, recognising those facilities as helpful to smooth out capital calls. In the same way, we think NAV facility deployment will continue to grow as sponsors and their LPs increasingly focus on managing their funds' gross to net bridge.

There is a growing acceptance of the benefits of NAV financing by sponsors and their largest institutional LPs, so we also see NAVs becoming increasingly standardised in sponsor LPAs. Whether driven by the Institutional Limited Partners Association or the Loan Market Association, there will be more standardisation and that will be welcomed.

In practice, most lenders in the NAV financing market today are already practising and preaching full transparency and early engagement to make sure sponsors are educated, aligned and well informed about the use of these products.

The supply-demand imbalance will continue to become even more significant. We also see demand for NAV financing picking up through our colleagues at our sister fund Churchill Asset Management in the US, as well as in Europe. By focusing 100 percent on the mid-market on both sides of the Atlantic, leveraging our broad skill set, existing deep relationships with sponsors and extensive knowledge of their underlying assets, we see dealflow increasing, and look forward to being well positioned to grow with this market.

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