

Fund Finance Friday



Mandatory Prepayment Cure Plans in NAV Facilities

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NAV facilities typically measure risk level using the ratio (the “LTV Ratio”) of the loan principal to the value of the eligible assets supporting the borrower’s loan obligations (the “Eligible Assets”). When negotiating the terms of a NAV credit facility (often at the term sheet phase), one critical point of negotiation is the maximum permitted LTV Ratio (the “Maximum LTV Ratio”). If at any time during the term of a credit facility the LTV Ratio exceeds the Maximum LTV Ratio (a “Maximum LTV Breach”), the borrower may be required to make a prepayment to cure the Maximum LTV Breach (as further described below).

A Maximum LTV Breach may occur as a result of, for example, a reduction in the value of one or more Eligible Assets, the occurrence of an adverse event with respect to one or more assets (such as bankruptcy or a legal or regulatory proceeding) causing such asset to be deemed ineligible to support the borrower’s loan obligations, the application of concentration limits on the Eligible Assets or a complete or partial sale or realization of one or more Eligible Assets. When a mandatory prepayment is required in connection with the occurrence of a Maximum LTV Breach, these credit facilities may permit a borrower to follow an approved plan of action to bring the LTV Ratio back into compliance over an extended period of time (which may be necessary given the illiquid nature of the borrower’s assets).

This article will explore a few key features of mandatory prepayment cure plans and how we often see these points negotiated between lenders and borrowers in credit facility documentation. In addition to the features discussed below that we commonly see, we also see borrowers and lenders negotiate bespoke terms for these cure plans, which may be tailored to a specific borrower and its portfolio.

Mandatory Prepayment Cure Plans and the Cure Period

Typically, the occurrence of a Maximum LTV Breach constitutes a mandatory prepayment event under the credit facility documentation, requiring the borrower to make a prepayment of the outstanding loans in an amount sufficient to cure the Maximum LTV Breach within a specified number of days (which may be extended to align with any capital call mechanics in the borrower’s organizational documents if the borrower provides evidence to the lender within a specified number of days that it has called capital from its investors in an amount sufficient to cure the Maximum LTV Breach) from the date that the Maximum LTV Breach occurred (or in some cases, the earlier of knowledge by the borrower of the Maximum LTV Breach and receipt by the borrower of notice from the lender of the Maximum LTV Breach). However, as noted above, in some transactions the borrower may be offered an opportunity to submit a plan of action to the lender setting forth in reasonable detail the actions that the borrower proposes to take to cure the Maximum LTV Breach (a “Cure Plan”).

If a Cure Plan is submitted and approved by the date that the mandatory prepayment resulting from the Maximum LTV Breach would have become due and payable (such date, the “Cure Plan Deadline”), the borrower may have an additional specified number of days from the date that the Cure Plan was approved in order to comply with the Cure Plan and cure the Maximum LTV Breach (such period of time during which the Cure Plan is in effect, the “Cure Period”). If either (i) no Cure Plan is submitted to the lender by the Cure Plan Deadline or (ii) the borrower’s proposed Cure Plan is rejected, the mandatory prepayment will typically become due and payable (a) in the case of clause (i), on the Cure Plan Deadline or (b) in the case of clause (ii), within a specified number of days from the date that the borrower received notice that its proposed Cure Plan was rejected. If at any time during an ongoing Cure Period the

LTV Ratio further increases, such increase will ordinarily constitute a new mandatory prepayment event requiring a separate Cure Plan.

How Do You Cure?

To cure a Maximum LTV Breach, the borrower will need to restore the LTV Ratio to below the Maximum LTV Ratio or, on some transactions, to no greater than a specified target LTV Ratio (the "Target LTV Ratio"). We often see both the Maximum LTV Ratio and the Target LTV Ratio step down incrementally over time as a credit facility gets closer to maturity.

In order to reduce the LTV Ratio, a borrower generally has two options: (i) reduce its loan obligations by making a payment or (ii) increase its Eligible Assets, which may require approval by the lender. A Cure Plan may include actions reasonably expected to accomplish one or both of these options.

Approval Standard

In most bilateral credit facilities that permit the borrower to submit a Cure Plan for a mandatory prepayment resulting from a Maximum LTV Breach, the borrower will submit its proposed Cure Plan to the lender, the lender will review and discuss any necessary changes with the borrower, and the lender may accept or reject the proposed Cure Plan in its discretion. In the case of a rejection, the borrower may be given the ability to propose an alternate Cure Plan for approval.

For syndicated facilities, the same approach is generally taken but the agent is responsible for review and approval or rejection of any proposed Cure Plan, most often acting at the direction of the lenders or a certain subset of the lenders.

Following the Cure Plan

During a Cure Period, the borrower is typically required to keep the lender reasonably informed of its pursuit of and progress towards the Cure Plan. If at any time while a Cure Plan is in effect the lender determines that (i) the borrower is not keeping the lender reasonably informed of its pursuit of the Cure Plan, (ii) the Cure Plan can no longer be implemented, (iii) the borrower is not diligently pursuing the execution of the Cure Plan or (iv) the Cure Plan is no longer reasonably likely to result in the Maximum LTV Breach being cured by the end of the Cure Period, the lender may terminate the Cure Period by notice to the borrower and the borrower will be required to pay the mandatory prepayment within a specified number of days from the borrower's receipt of such notice; however, some transactions will permit the borrower to instead propose a new Cure Plan within such specified number of days.

If on the last day of a Cure Period the borrower has not sufficiently cured the Maximum LTV Breach, the mandatory prepayment will be due and payable on such date. The credit facility documentation should make clear that if such mandatory prepayment is not paid on the last day of the Cure Period, an event of default has occurred in connection with the borrower's failure to make a payment of principal on the loans.