

Capital call facilities: key considerations and protections for private equity funds

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Key Takeaways

- Capital call facilities offer flexibility for private equity sponsors by bridging the gap between investments and capital contributions.
- Sponsors should review fund documentation, assess investor creditworthiness and plan for post-investment period needs.
- Proper structuring and documentation are crucial to maximize benefits and minimize risks in capital call facilities.

Capital call facilities have become an increasingly important tool for private equity sponsors, providing flexibility and efficiency in fund management. These facilities, typically structured as revolving credit lines, are secured against the uncalled capital commitments of a fund's investors.

The following summary outlines the principal features, key considerations and recommended action items for sponsors, fund managers and investors in connection with capital call facilities, as reflected in recent regulatory and market developments.

Overview of capital call facilities

Capital call facilities enable sponsors to bridge the timing gap between making investments and receiving capital contributions from investors. The facility is generally repaid once investors fund their capital commitments, typically within 30 to 90 days of a capital call notice. The security package for these facilities usually includes the sponsor's right to call capital, enforce payment and receive proceeds, as well as control over the designated bank account for capital contributions.

Key provisions and protections in fund documentation

1. Explicit borrowing and security authorization

It is essential that the fund's limited partnership agreement (LPA) expressly authorizes the partnership to enter into credit facilities, including those secured by uncalled capital

commitments. The LPA should also permit the general partner to assign its rights to call capital and exercise remedies in an enforcement scenario. The LPA should also include an acknowledgement by each partner of the ability to grant security in uncalled capital and the ability of a lender to enforce. Early inclusion of these provisions limits the need for future amendments and streamlines lender diligence.

2. Investor obligations and side letters

The LPA and related side letters should address the irrevocable and unconditional obligation of investors to fund capital calls. Sponsors must be mindful of any borrowing restrictions negotiated by institutional investors, often driven by pension or tax legislation. Side letters may also limit an investor's obligation to provide guarantees or documentation in connection with borrowings, which can impact the borrowing base and lender comfort.

3. Transfer restrictions

Transfer provisions in the LPA should be carefully reviewed to ensure that investor transfers, security interests or withdrawals require sponsor consent. The identity and creditworthiness of investors are critical to lenders and directly affect the borrowing base.

4. Post-investment period capital calls

If a capital call facility is expected to remain in place beyond the fund's investment period, the LPA should permit capital calls for the repayment of loans, including principal, interest and related expenses, after the investment period ends. Absent such provisions, lenders may require early termination of the facility.

5. Excuse rights and overcall limitations

Excuse rights, often included in side letters, allow investors to opt out of certain investments for regulatory or policy reasons. These rights should be narrowly tailored to apply only to the specific investment in question. Overcall limitations, which cap the amount a limited partner may be required to fund in the event of another investor's default, can affect the fund's ability to cover shortfalls and may be scrutinized by lenders.

Borrowing base considerations

The borrowing base is a central feature of any capital call facility, determining the maximum amount available under the facility. Lenders typically include only those investors with strong credit profiles, such as investment-grade institutions, in the borrowing base. High-net worth individuals, sovereign wealth funds and governmental pension plans may be excluded or included at reduced advance rates due to credit or sovereign immunity concerns. Sponsors should be aware of these dynamics when assembling the investor base and negotiating facility terms.

Action items for sponsors and fund managers

- **Review and update fund documentation:** Ensure the LPA and side letters explicitly authorize capital call facilities and address all relevant lender requirements.
- **Assess investor base:** Consider the creditworthiness and potential restrictions associated with each investor, as these will impact the borrowing base and facility terms.
- **Plan for post-investment period needs:** Confirm that the fund can call capital to repay facility obligations after the investment period, if necessary.

- **Monitor excuse and overcall provisions:** Evaluate the impact of any excuse rights or overcall limitations on the fund's ability to meet its obligations under a capital call facility.

Conclusion

Proper structuring and documentation of capital call facilities are essential to maximize their benefits and minimize risks for private equity funds. Sponsors and fund managers should proactively address the key considerations outlined above to ensure smooth execution and ongoing compliance with lender and investor expectations.