KEYNOTE INTERVIEW

Grazing at the granular level

Smaller real estate assets can often be acquired at very favorable values, offering multiple exit ramps, says Arrow Global Group's Zach Vaughan

London-based Arrow Global Group, a vertically integrated European alternative asset manager, specializes in credit and real estate. Founded over 20 years ago, Arrow focuses on mid-market deals by having large local teams to source smaller, more granular assets, explains Zach Vaughan, head of real estate at Arrow Global Group.

"If you look at historical data of European private equity real estate performance, you will see that mid-market strategies generally outperform," explains Vaughan.

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Q Why a granular focus? Does that make it harder to execute on a large number of transactions?

What I found investing in Europe is that the best opportunities were smaller. When you have sourcing professionals that can source locally, you start to see some incredibly compelling opportunities. If you have a larger transaction, say of €100 million or more, it is likely to be intermediated in London, Paris, Frankfurt, or another major financial center. But if you find smaller deals, they are often done on a more bilateral basis. This means less intermediation and more liquidity.

Our goal at Arrow, whether it be opportunistic credit or real estate lending, is to try to bring exposure for our capital and our partners' capital to those higher-yielding, granular assets, having multiple ways of creating liquidity, and to do it at reasonable scale.

The challenge with this strategy is inherently the issue of scale. At Arrow, we can do this because of our local, directly owned and controlled businesses. Today we have 20 businesses around Europe with around 2,000 people, so we have the ability to source these more granular transactions.

Q What is the current outlook for investment opportunities in the real estate market?

I do not believe that there are going

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Q Does your investment strategy remain focused primarily on European distressed credit?
Arrow has always had an opportunistic focus, and historically has concentrated more on distressed credit positions. That has broadened as the capital base has, and we have created a new vertical in real estate lending. Our lending strategies are not designed to acquire distressed loans that will lead to direct asset ownership but are focused on performing loans where there is a chronic undersupply in the asset, such as multifamily or student accommodation.

Inevitably, because we focus on secured lending and credit, we end up with a lot of real estate, so that is a logical area to focus on. Eventually, we will look to put capital together for that strategy, but for now we are focused on opportunistic credit and lending.

to be enormous waves of large-scale buying opportunities with big pools of assets like there was during the GFC. The opportunity today is to find individual properties that need a capital solution: a stalled development, an existing owner under financial pressure or a lender looking to dispose of a loan.

For larger assets and portfolios that may not be re-financeable today, but where the sponsors are institutional and can provide operating support and/or some additional capital, the banks are extending their loans, which is what they should do. For smaller transactions with less institutional sponsorship, we are seeing the banks start to force sales.

In terms of sectors where we lend and provide capital, our focus is on for-sale residential, leisure, infill logistics and other living sectors like student housing.

Q How does the fragmented nature of the European commercial real estate market impact the sourcing of deals?
Our philosophy has always been to go to the places where you see opportunities, to go very deep and to be very local. As a result, we see a wider funnel of granular assets in Europe in terms of where they are coming from and who the sellers are.

We have about €80 billion of AUM, including assets we service for over 200 banks in Europe. In some cases, we are

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the logical purchaser of these assets because we know them very well since we are already servicing them. Over 85 percent of our transactions are directly sourced from banks or the underlying owners, so we see opportunities that others would not.

Most of our deals are closer to the €20 million mark than to €100 million. We think there is more opportunity for higher returns in these smaller transactions, in part because they are less intermediated and in part because they tend to be more liquid. Inherently, when dealing with an asset that is not worth hundreds of millions or billions of euros, there is a local capital base that can look at it.

Q Does having boots on the ground in European markets provide a strategic advantage in identifying and capitalizing on investment opportunities?

The type of assets we often acquire need work. In a perfect world, we would acquire great properties that just have broken capital structures.

A lot of the opportunity in creating value is that these assets have plans that have stalled because the prior sponsors did not have the capital or capabilities to execute them. What we do is provide capital and help execute business plans with our people. But that requires an exceptionally good understanding of either local planning, tax, legal and judicial frameworks, not to mention the universe of local contractors and how the local sales market operates.

Because of our people on the ground, we can get more comfort when it comes to underwriting and the people we are talking to about the business plan, about the underwriting and management, they are Arrow people. Ultimately, we are all part of one organization.

"Understanding the nuances of the local market is critical here"

"We think there is more opportunity for higher returns in these smaller transactions"

Q How do the diverse regulatory and market conditions across the continent affect business outcomes?

There are huge differences across the various European countries. You need to understand tax structures which vary by country, and you need to consider how lender and creditor rights work and how permitting and planning procedures work.

The financial model might allow for six months but our people on the ground would know that it could take up to 12 months or even more, so this gives us a better risk mitigation screen to protect ourselves.

It is when the market gets choppy, or things change that you really want to make sure you have done everything you can to protect yourself. Understanding the nuances of the local market is critical here.

Q Where are the opportunities across Europe, and is that expected to change in the years ahead?

Arrow has a presence in the UK, Ireland, the Netherlands, Italy, Spain and Portugal. Germany is a gap in our coverage, but it will not be for long. Our plan is to grow the platform where we see opportunity, and Germany is a country where we see that.

Germany has not seen the same level of distressed credit, compared to the rest of southern Europe over the past 20 years, but it remains Europe's biggest economy. Germany is very much a bank market and I have a feeling the banks there will be possibly faster to move in terms of adjusting, as debt positions mature, and we are starting to see that. We believe this will create a lot of opportunity both on the servicing side and the investment side of our business.

We consistently observe numerous transactions, and inevitably, as opportunities arise in other markets, we will investigate and learn. And typically, we like to do things by having people on the ground. ■