EXPERT Q&A

There are opportune markets available for experienced local lenders, say Arrow Global's Toni McDermott and Richard Roberts

Staying local for diversified investment opportunities

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The common theme underpinning Arrow's lending and opportunistic credit strategies is the integrated local platform, which gives access to granular residential real estate-backed loans and investments, according to the firm. We sat down with Toni McDermott, Arrow Global's chief investment officer for credit and lending, and Richard Roberts, the firm's head of origination and M&A, to find out more.

Q How are you adapting your strategy for the current market?

Richard Roberts: The market across Europe is still transitioning from an era of excess cheap credit when the market was awash with liquidity. We're now in an era when inflation and interest rates are staying higher for longer. On the lending side, we benefit from the higher rates environment and continue to see attractive opportunities to back strong sponsors at sensible leverage and attachment points, which augurs well for us.

Toni McDermott: At the same time, banks are retreating from asset classes that are operationally heavy and inefficient from a capital point of view under the finalised Basel 3.1 rules. It makes more sense under the new rules for them to focus on regulated mass market lending at one end of the scale, and large platinum clients on the other. So, we step into that space, where the requirement for local know-how and operational heft plays to our strengths, built up over many years.

On the opportunistic credit side, our local platforms have unparalleled visibility on NPLs, single-name distressed opportunities and special credit opportunities. We focus on deals that are backed by hard assets, where we can value, access and liquidate or add value to the underlying collateral.

These are opportunities that you

have to be present and local to see, at a level of granularity that does not suit a centralised investment model. We have a large footprint in six European jurisdictions, giving us very good diversification of opportunity.

Q What are the primary sources of dealflow for opportunistic credit and distressed debt funds in today's market?

TM: A lot of people are talking about commercial real estate, but it is not where we are focused. That market is obviously going through a major restructuring, and while there are opportunities from time to time, we are not ready to call the bottom there yet.

We are picking our spots in areas that play to our strengths. We focus on living sector assets, which are in chronic undersupply – for example, in southern Europe, we put a lot of effort and capital into hospitality credit, which is an area we know very well. Our starting point in both lending and opportunistic credit is whether the underlying assets are good and liquid.

Q How is credit quality within private debt portfolios being affected by current economic conditions?

TM: Consumers and corporates are under more stress. Their safety cushions have been eroded but we are not seeing that translate into wholesale distress, downgrades or banks selling large books of NPLs. Most of the stress is being absorbed, which is a testament to the improvement in lending standards over the last decade.

RR: It's important to point out that we don't participate in the syndicated lending market. Almost all of our deals are bilateral. Whether it's a bridge loan, development financing or a distressed loan, we are price makers and underwriting term setters. We are not tagging onto other people's terms or getting dragged down to the lowest common denominator. The off-market nature of the businesses means we can shape transactions on a deal-by-deal basis.

Borrowers ascribe value to and are willing to pay for consistency and for flexible capital that's delivered on time. The people we tend to work with like the way we work and appreciate having a reliable partner and the industrial expertise we have in our platforms.

Q How are LPs evaluating private debt's role

Q How do you expect opportunistic credit and distressed debt strategies to evolve in the next few years in Europe?

RR: In the coming years, opportunistic credit and distressed debt strategies in Europe will increasingly focus on specialisation and deep market knowledge. As the market becomes more segmented and nuanced, having a granular understanding of specific sectors and local markets will be crucial.

We expect to see a greater emphasis on sectors that demonstrate resilience and offer stable returns, such as certain segments of the real estate market, particularly those with supply constraints and essential services including life sciences and logistics.

Moreover, the role of technology and data analytics in our decision-making processes will become even more pronounced. Sustainability and ESG considerations will play an increasingly central role as investors are increasingly demanding that their capital is deployed in a manner that aligns with broader societal goals.

TM: In essence, a more nuanced, data-driven and socially responsible approach that navigates the complexities of the European market while delivering value to investors.

"Borrowers ascribe value to and are willing to pay for consistency and for flexible capital that's delivered on time"

RICHARD ROBERTS

in refinancing scenarios, particularly as borrowers shift away from traditional bank financing?

TM: Institutional investors understand very well that it's a very good time to provide senior secured capital to borrowers who are delivering assets that are in short supply. They know that we are able to charge appropriately for what we provide and that we benefit from historically high base rates, plus appropriate margins and fees for more adaptable and flexible capital.

This is a locally-led, relationship-driven, operationally heavy business, especially in the granular/mid-market sector. This suits Arrow's vertically integrated model of owning and growing best-in-class platforms across Europe. Our positioning close to the ground in six countries where we can do repeat business with trusted clients has very much resonated with our investors.

Q Are LPs concerned about market volatility affecting opportunistic credit and asset backed lending?

RR: We address risks in a pretty unique way, in that we own and operate 20 platforms and we manage about £80 billion ($102 billion; €94 billion) of assets. The vast majority of it is owned by some of the world's largest banks and investors, so we have this remarkable insight into performance across asset classes: secured, unsecured, real estate, consumer, commercial or SME.

It's almost like being the canary in the coal mine, in that we are able to see where the risks and opportunities are, where the stress is coming and can underwrite and price accordingly.

TM: Our proposition to our investors is not based on a macro view on rates or reliant on GDP growth. On opportunistic credit, we are mining the opportunities that more than 2,000 people in our platforms see across six jurisdictions, built up over 19 years.

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>
> **TONI McDERMOTT**

In our lending businesses, we focus on sectors where the fundamentals are strongly supportive. We favour liquid residential collateral where there is chronic undersupply across our markets, supporting long-term price resilience, which has enabled us to write attractively priced business that benefits from favourable covenants and collateral, offering robust protection in all market cycles. You don't have to be an optimistic macroeconomist to feel comfortable about 60 percent LTV senior financing on an apartment block in Rotterdam or Manchester.

RR: From our perspective, we've been doing this for 19 years. We do around 100-150 granular deals a year. With the majority being off-market, bilateral and with repeat sellers, we don't need massive economic shifts to happen.

Q How are managers of opportunistic and distressed debt funds integrating ESG and DE&I criteria into their investment approaches?

TM: ESG is naturally in the middle of everything we do. Our lending allows people to refurbish energy inefficient stock or to build accommodation that's in short supply. This is a social need. Our target niche is urban, multifamily housing that is within reach of people on average incomes.

RR: And the majority of our business, especially on the opportunistic and distressed side, comes from banks. So, banks that have asked us to manage portfolios for them apply their own lens and they only sell to people who continue to treat the customer fairly and manage assets properly.

They don't want to work with people who come in and out of the country on a short term or take a transitory approach to doing business. If you buy a portfolio from a bank and then treat their customer inappropriately, they won't sell to you again. ■