Navigating the future of private credit through local expertise

Zach Lewy, founder, chief executive and chief investment officer of Arrow Global, explains the value of country-specific strategies

REFLECTING ON THE growing landscape of private credit, I am struck by the pivotal role that local expertise plays in navigating this evolution. Over the past few years, we've seen a significant change in how investors approach credit, particularly in a macroeconomic environment characterised by higher-for-longer interest rates and evolving regulatory frameworks. This paradigm shift is not just a passing trend; it represents a fundamental realignment of priorities and opportunities in the financial markets.

As part of this transformation, the growth in private credit assets under management (AUM) has been significant. This growth shows no sign of slowing with Preqin forecasting that private debt AUM will grow at a compound annual growth rate (CAGR) of 11.1 per cent from 2022 to 2028, reaching an all-time high of $2.8tn – almost doubling the 2022 figure of $1.5tn.

When interest rates were zero or even negative, the investment landscape was very different. If someone had told investors they could earn a 5.5 per cent risk-free return from government bonds, most would have jumped at the chance. Those days of ultra-low rates, however, are behind us. Today, investors are drawn to credit not only because of the higher yields but also because they can secure a top position in the capital structure – a position that is inherently attractive in a still uncertain economic climate.

The shift away from traditional assets in real estate equity, particularly underperforming office assets, and even from private equity, is reflective of a broader recognition that credit offers a more secure and often more attractive opportunity. The lure of holding a senior secured position, where you're being compensated well for the risks involved, cannot be overstated. However, seizing these opportunities requires more than just capital; it demands a deep understanding of local markets, regulatory environments, and economic trends.

The influx of capital into private credit has intensified competition, but the real question is not just about the amount of money flowing in – it's about the value you can extract from that capital. This dynamic is clear in the mass mortgage market, where large operations are focused on long-term profitability by getting homeowners on their books. Yet, for these lenders to make a significant impact on private credit, particularly in the more granular and operationally intensive segments, it will take time – and potentially low interest rates. It also requires a willingness and capability to manage operationally intensive assets on their balance sheets.

In contrast, our approach at Arrow Global has always been grounded in utilising local expertise to navigate complex sectors. Whether it's asset-based or real estate credit, the importance of understanding the complexity of each local market cannot be emphasised enough. In Europe, for example, asset-based finance is complicated by the need to operate across 44 heterogenous country regimes, each with its own legal, tax, and regulatory landscape. This is why 99 per cent of asset finance in Europe remains domestic – cross-border securitisation, while common in the US, is far more challenging here. But this challenge is also an opportunity for those with the right local knowledge. By focusing on country-specific strategies, we can unlock value that others might overlook.

Similarly, in real estate credit, the opportunities are significant but not without their complexities. Real estate debt is inherently more challenging than corporate debt due to the need for significant local expertise. The simple question is would you rather lend against a corporate entity at four to five times earnings or against real estate with a conservative 60 per cent loan-

to-value ratio? For me, the choice is clear. However, executing this strategy requires not just capital but also a robust local presence. We've made significant strides in this area, most recently acquiring key players like Amitra Capital in Spain and Interboden in Germany, building on the foundation and expertise we have developed through our earlier acquisition of Maslow Capital. This strategic expansion, coupled with securing substantial capital commitments, is not just about growth; it's about building a franchise that is deeply integrated into the local markets we operate in.

The political climate in Europe is another factor that cannot be ignored. The shift away from the political consensus that central banks should make mortgage costs cheaper and facilitate greater access to housing is a game-changer. With expansionary fiscal policies in the US and much of Europe, the pressure on central banks to act as a force of restraint will only increase. This will make owning assets more expensive than it was for previous generations, and this risk needs to be seriously considered in any investment strategy.

In this environment, private credit is evolving rapidly. It's no longer a niche market; it's becoming an established asset class with its own set of standards, benchmarks, and best practices. Yet, this evolution is still in its early stages. Just as the stock markets have been the subject of ongoing debates about the merits of active versus passive management, so too will private credit be debated. Should we offer more liquid credit options? Should we develop indices that track the performance of private credit? These are questions that will shape the future of the industry.

But while these macro-level trends are important, success in private credit ultimately comes down to scale, expertise, and local knowledge. It's not enough to simply follow the trends; you need to understand the underlying fundamentals of each market you operate in. This is particularly true in sectors like hospitality, where the growth of remote work, international travel and lifestyle migration is creating new opportunities, especially in Southern Europe, with a spotlight on Iberia. Financing the development or refurbishment of hotels, resorts, and related infrastructure is just one example of how private credit can capitalise on societal shifts. But to do so effectively, you need a deep understanding of the local market dynamics, from transaction sourcing to operational capabilities.

Looking forward, I am confident that Arrow Global's focus on local expertise will continue to set us apart. Whether we're navigating the complexities of asset-based finance in Europe, expanding our real estate credit portfolio, or exploring new opportunities in emerging sectors, our success will be driven by our ability to understand and respond to the unique challenges and opportunities of each local market. This is not just a strategy; it's the core of who we are and how we operate. And as the landscape of private credit continues to evolve, I believe that those who can combine global vision with local execution will be the winners. ■