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Q+A: Arrow Global on German entry – "A perfect storm is beginning to take shape"

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Rare distressed opportunity has emerged, says managing director Jay Patel

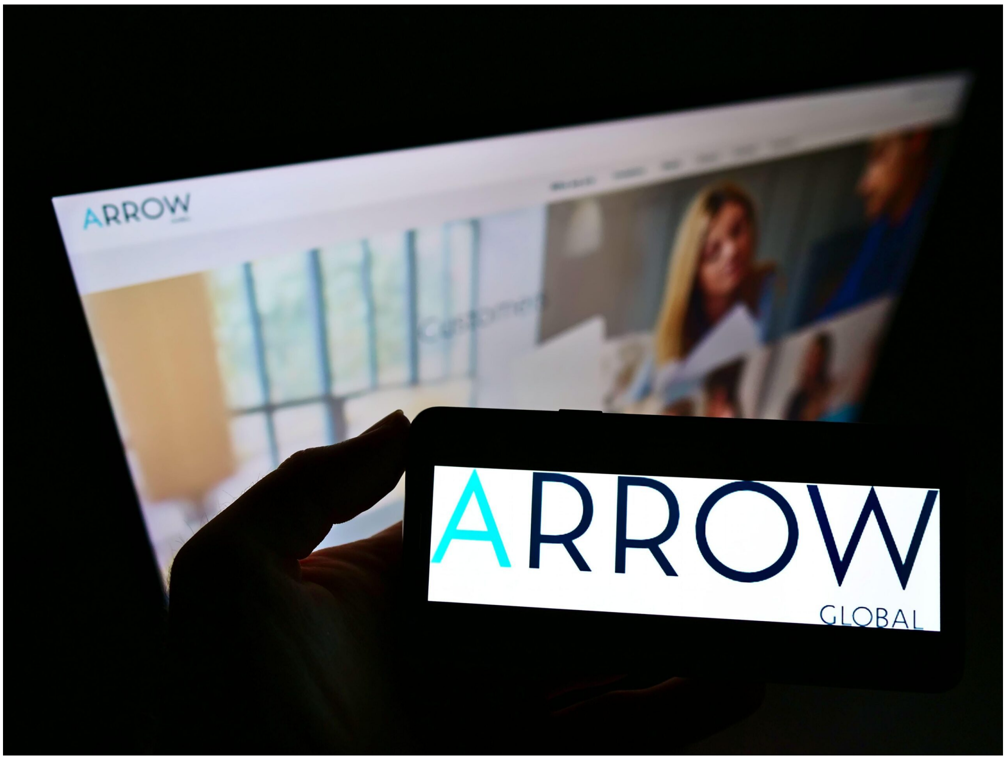
For distressed investors scouring the European landscape over the past 20 years, one great golden opportunity has been missing.

Now, with rising interest rates and a ticking timebomb in the construction industry, Germany seems to be on the table for opportunistic players.

In June, Arrow Global acquired the operating platform and assets of insolvent German developer Interboden. The acquisition includes all employees and related servicing contracts across offices in Düsseldorf, Berlin and Leverkusen. With a current GDV in excess of €500m and more than 65 staff, Interboden provides a jump-start for Arrow's forte, sourcing granular opportunities at under €50m on the ground.

Due to the wider economic climate and unusually transparent insolvency law, opportunities are emerging to pick up nearly complete projects at 30% to 80%

discount on the capital, Jay Patel, managing director for real estate and special situations at Arrow, told *Green Street News*.



The distressed specialist joined the manager last year, after stints at Signal Capital Partners, SVPGlobal and EQT Exeter.

“We believe a perfect storm is beginning to take shape, with current conditions representing just the tip of the iceberg,” he said.

Green Street News caught up with Patel on Arrow’s plan of attack, what’s different in Germany this crisis around, and opportunities in convenience retail.

What attracted you to Arrow?

Having spent 19 years navigating the challenges of sourcing deals across Europe, I’ve encountered many practical obstacles, especially as the market has grown more competitive.

One significant issue is the “herding” effect: most players focus on a similar deal size because they operate with broadly five-year funds, similar lockups, and a largely London-centric investment team covering the whole of Europe.

This creates a practical limitation – funds are forced to target deals over €50 m due to the effort and time involved in sourcing and closing a transaction. As a result, deals below €50m often have better returns.

> *“One significant issue is the ‘herding’ effect: most players focus on a similar deal size”*

Arrow’s vertically integrated model is uniquely positioned to address these challenges. With 23 platforms across eight countries and more than 2,000 professionals on the ground, Arrow stands apart. Digging deeper, our platforms are usually dominant local champions, and most of their employees have lived, worked, and studied in their respective countries.

This gives us access to truly deep and extensive relationships across a broad spectrum of stakeholders, including local banks, regional asset managers, prominent law firms, municipal authorities, and key industry leaders. This local expertise allows us to uncover granular, hard-to-access deals that are inaccessible with just one or two flights a week from London.

We target smaller deals that have genuine alpha, because the competition hasn’t eroded the value offered. Moreover, our local presence reduces reliance on intermediaries, which further enhances returns. This approach is proving effective, and the deal flow continues to grow.

Why have you made this acquisition in Germany?

Throughout my career, Germany has rarely been a market for opportunistic funds. As a cornerstone European economy with a safe haven status among investors, Germany has historically attracted low-cost capital from both international and domestic sources.

Even during the global financial crisis (GFC), German banks largely opted to “pretend and extend” and low-cost capital quickly returned, stifling opportunities for investors such as us. However, this playbook is unlikely to work this time around.

> *“What truly sets us apart is our ability to target small granular deals which mega-managers overlook or don’t see”*

We believe a perfect storm is beginning to take shape, with current conditions representing just the tip of the iceberg. We focus on living-oriented assets, such as residential-for-sale and student housing. We also have a strong bias toward hospitality, while actively exploring opportunities in logistics and retail.

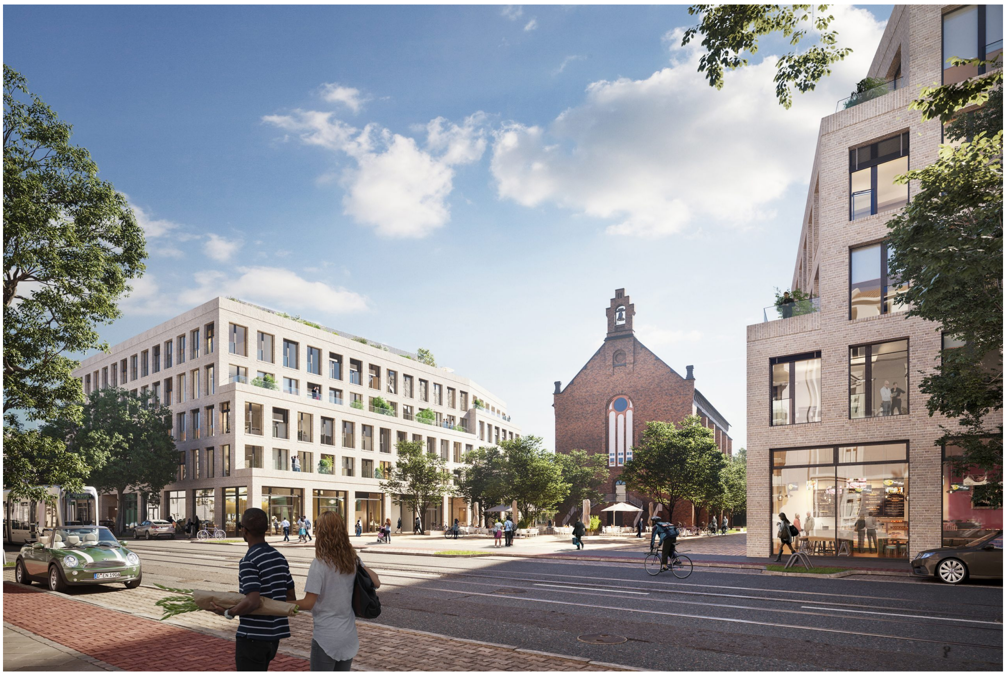
What truly sets us apart is our ability to target small granular deals which mega-managers overlook or don't see, as they are not vertically integrated in these markets in the way Arrow is. A knock-on effect of avoiding the competition is we can generate opportunistic returns in traditionally popular sectors, which our investors really appreciate.

What's different from the financial crisis?

We're now facing higher interest rates, decreased sales, and dwindling cash reserves. While some of these factors were present during the GFC, they didn't lead to widespread actionable distress. So, what are the key triggers this time?

What we are seeing on the ground is banks having to deal with more "hard" loan defaults, either in the form of nonpayment of interest or insolvencies which are more difficult to "pretend and extend" away, and therefore forcing them to act. Rather unusually, development loan interest is paid current in Germany, rather than rolled in to the facility, as is the case in the UK.

This creates a potential payment default trigger every month. With cash reserves now low and sales still slow, this is becoming a material hurdle. Additionally, if a company is on the brink of running out of cash and the directors fail to file for bankruptcy in time, they become personally liable, creating a further pressure point.



Interboden's Maxfrei development in Düsseldorf

Unlike during the GFC, banks now face a meaningful opportunity cost for holding these non-performing loans. Many of these were issued in a low-interest-rate environment, and can now be reissued at around 5%, making their previous "pretend and extend" strategy far less viable. Moreover, stricter regulations for banks holding non-performing loans adds to the pressure.

When a company does go insolvent, the government provides the insolvency administrators with 12 weeks of cash to cover salaries. This effectively starts a countdown to find a resolution, adding yet another layer of urgency.

What's the opportunity?

Unlike the drawn-out insolvency processes in countries like Spain, Italy or Greece, Germany's process is proving to be relatively efficient. In this expedited environment, being local, being first, acting quickly, and having cash readily available are critical advantages.

During past periods of systemic distress, we saw jumbo portfolios brokered by top-tier brokers in Mayfair. Now, however, the distress is highly localised and not centralised, creating a different dynamic.

> *“We target smaller deals that have genuine alpha, because the competition hasn’t eroded the value offered”*

Three years after Covid-19, many well-advanced developments are failing just before completion. In Germany’s eight major cities, we’re seeing 90%+ finished projects running out of funding. Often, projects in smaller cities – such as the seventh- or eighth-largest – are being sold by local insolvency practitioners without international connections, and much of the documentation remains in German.

Having highly local teams on the ground over the next 24 months will be critical. The dynamics strongly favour us, as we’re competing primarily with high-net-worth individuals and family offices, leaving substantial opportunities on the table for those able to bring certainty to the process. Currently, we’re seeing two to four of these opportunities a month in Germany and are carefully sifting through them.

We’re stepping into broken projects at discounts of 30% to 80% on historical equity, and typically anywhere between a 20% to 60% haircut on senior loans. For deals in the €20m-€30m range, we have multiple sources of liquidity on exit. Importantly, our strategy is to avoid prolonged exposure to market conditions and exit as efficiently as possible.

Why Interboden?

Starting in Q1 of this year, we began evaluating the best entry points for a highly granular, platform-led approach into Germany. Interboden emerged as an ideal partner. Founded in the 1950s, it is a local champion with a strong track record, particularly in Germany’s wealthiest regions, where it has focused largely on residential development.

Interboden has a team of nearly 75 employees on the ground and an impressive history of delivering standout projects. Its largest to date was a four-phase residential development with a total end value exceeding €1bn, which was ultimately sold to an institutional investor.

> *"Three years after Covid-19, many well-advanced developments are failing just before completion"*

Beyond being an exceptional developer, Interboden brings unique in-house expertise. It specialises in breaking down construction into smaller packages rather than awarding single large contracts. For projects that are 95% complete, this granular local expertise and robust supply chain management are invaluable for stepping in effectively.

Interboden's years of experience building this capability into the business made it a clear standout. This enables us to deliver strong bids within weeks – or sometimes even days. Additionally, the firm's extensive networks allow the team to identify and pursue early-stage opportunities, further enhancing Arrow's reach and capability.

Are there any strategies you could pursue outside of immediate distress?

We've recently been dedicating more attention to logistics in Germany. The country experienced an incredible bull run, heavily reliant on leverage, which became the norm for a prolonged period.

Now, as yields across the logistics sector begin to move outward, the key question is whether they've adjusted enough to deliver the returns we target. We believe they've just started to, and we're exploring a few promising opportunities.

One potential strategy involves targeting older-generation stock that owners now hold at an unfavourable basis. If they can't afford the necessary refurbishments, we have the opportunity to acquire these assets and upgrade them, unlocking their potential value.

What are you looking at in convenience retail?

We're approaching convenience retail as a small, niche allocation. Many investors are burdened by legacy issues, making it difficult for them to deploy capital into this sector. We aim to step into that gap.

When it comes to assets, the weaker players have already been "cut from the herd". During the pandemic, retail centres that maintained high footfall proved their resilience – those with a clear reason to exist continued to attract customers even in the most challenging circumstances.

Additionally, tenant insolvencies led to a rent reset, bringing rents into a range that allows tenants to profitably operate physical locations relative to their revenues. With this data in hand, our targets are well defined.

Retail rents are projected to grow faster than any other sector next year. This growth is partly due to the rent reset and the unexpectedly quick return of customers to physical stores, particularly in necessity-driven retail.


Arrow could pursue a convenience retail strategy in select European countries

Most retail centres have been held by banks for two to three years, during which time little capital has been invested in them. We're being offered substantial discounts at acquisition, accounting for deferred capex, while still achieving strong stabilised yields.

We're focusing on assets that maintained 90%+ occupancy during the Covid-19 pandemic, feature at least 30% convenience retail, and serve catchment areas of 200,000 to 300,000 people. Moreover, with replacement costs so high, no additional competing properties are likely to be developed.

These centres, while not comparable to a Westfield, serve a critical function in their regions and offer defensive, reliable opportunities for investment.

Where will you target for the retail strategy?

Germany is a key focus, given it has eight major cities capable of supporting centres of this type. The UK also offers highly attractive pricing for us, and we've explored opportunities in the Netherlands to a lesser extent.

We follow a strict checklist of five or six criteria, and if a potential asset doesn't meet those, we simply pass on it. While our approach is pan-European, it's not universally applicable across all countries. For example, we're not currently looking at Spanish retail because it's particularly challenging to acquire distressed assets there.

What do you see as the main theme of your equity investments over the next couple of years?

Across Europe, the overarching theme is localised distress, rather than systemic distress. We're identifying highly compelling granular opportunities with mid-20% returns, but these are only accessible to those deeply entrenched in local markets. By the time the opportunity has reached a desk in London, the alpha has usually been brokered away.

While Germany presents a significant opportunity, this dynamic applies broadly across Europe. For example, you can't effectively cover Spain by focusing solely on Madrid and Barcelona – you'll miss the opportunities emerging in southern Spain and other regional markets.

> *"Across Europe, the overarching theme is localised distress rather than systemic distress"*

We are relatively sector-agnostic, with a few exceptions. We avoid buying speculative land plots due to the significant construction and planning risk associated with this type of exposure, as well as offices, partly to ensure we provide our investors with liquidity. Beyond those two exclusions, we focus on sectors offering stability of returns.

Currently, much of our attention is on living sectors. By targeting smaller opportunities, we can generate strong returns in relatively safe sectors. Our investors see the value in the local infrastructure we've built across Western Europe and the priority access it provides to local deals.