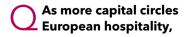
Harnessing tourist cosystems to drive returns



Hospitality investment in southern Europe is no longer just about beds and beaches, argues Arrow Global's John Calvão

Providing a diverse range of leisure options is now crucial to attracting yearround visitors and maximizing income across the region. Over the past five years, Arrow Global has built a substantial portfolio of hospitality businesses throughout southern Europe. The London-based private credit and real estate specialist operates across lending, special situations and real estate equity. Fund principal John Calvão explores the demand drivers behind the sector and how to identify opportunities in a market attracting an increasing volume of capital.



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where are you seeing the greatest risk/reward dislocations?

The European hospitality market has become more mature and competitive over the past five years. Large discounts are a thing of the past, and the best opportunities tend to be found outside adviser-led bidding processes. There is still value in smaller deals that are family-owned, but often they require significant capex and repositioning.

In the United States and northern Europe, few hotels are still owned by the people and families who built them. Ownership has evolved into different capital and management structures, with many US hotels now held by long-term core capital, such as insurance funds or real estate investment trusts.

In contrast, ownership in Europe remains highly fragmented, particularly in the south, where many hotels are still family-owned. These families have often done an excellent job building and running their businesses, but the next generation may not share the same passion. As a result, assets are gradually being transferred into institutional hands.

Many European properties have yet

to undergo the rebranding, repositioning, capital expenditure and stabilization needed to make them appealing to a core institutional investor targeting a 6 or 7 percent yield. It therefore falls to value-add investors like us to do the hard work of repositioning first before the asset can find a permanent home with an institution.

A value-add strategy in an operationally intensive sector like hospitality has risks, from supply chain cost increases to labor shortages, so how can industry participants manage those risks?

Scale is a crucial advantage in your platform. If you own 20 hotels, you can offer far greater job security than if you manage only one. We are the fourth-largest hotel operator in Portugal, for example, so we are well known in the market and have built a strong reputation, which helps us attract and retain talent.

That said, there is no avoiding the fact that Europe faces an overall shortage of workers. The key is to make your resort the place where people want to work. We place a great deal of emphasis on staff progression and training, and we provide staff housing, so employees have an affordable place to live and do not face long commutes. Having large local platforms such as Norfin and Details also helps to manage construction and refurbishment capex, as it allows us to purchase materials in bulk and offer repeat business to developers.

Is that where having local operations teams can make a difference?

When you are committing capital expenditure, you need to achieve higher occupancy and stronger room rates. The principle is straightforward: you improve facilities to offer better-quality services, which in turn generates higher revenues. You cannot do that from behind a desk. That is why we have substantial local teams and deep expertise



The Palmares golf resort and residences is thoughtfully integrated into the natural landscape of the Algarve coast in southern Portugal

How important is embedding sustainability into a hospitality strategy?

Our investors are very focused on ensuring that ESG remains a core part of the agenda, and we also feel a strong responsibility to operate in the right way. On the social side, we are developing housing not only for our staff, but also affordable housing as a way of giving back to the community. We have also introduced initiatives such as inviting children from the local area to attend our golf academy free of charge.

There are often straightforward environmental improvements that deliver genuine value. When a hotel has not been refurbished for decades, a refit can dramatically reduce water and energy consumption. We install solar panels on the roofs of our hotels and residential units to create solar communities that feed excess power back into the local grid. We are also focused on reducing water usage across all our golf courses. At the Els Club Algarve, for example, we have cut consumption by 40 percent by upgrading the irrigation system and using recycled water.

in this area, and why we acquired the hotel and leisure management platform Details. It ensures that our strategy is sound and gives us confidence that when we invest, we achieve measurable results.

The way value is created varies across Portugal, Spain, Italy and France. Once again, local knowledge is one of the most important differentiators. You need the right relationships with airports, tour operators, vendors and the golfing (leisure) community to understand how the entire ecosystem functions and how its elements support one another.

As an operator, what shifts in occupancy and length

of stay are you observing across the region?

We have focused primarily on southern Europe and on destinations rather than individual hotels. It is more of a resort leisure strategy, encompassing not only accommodation, but also an ecosystem of uses that includes hotels, branded residences and amenities such as marinas and golf courses. Key assets in our portfolio include the Vilamoura resort in Portugal and the recently opened Els Club Algarve, the first Ernie Els-designed golf course in Europe.

For northern Europeans, southern Europe is comparable to Florida for the US. Low-cost airlines have opened up these destinations for short-stay travel, allowing people to visit for a few days to enjoy the sunshine.

In locations such as Greece or Sardinia, the tourist season can be short because it is heavily weather dependent. However, when visitors travel for sporting activities, occupancy becomes less seasonal. At Vilamoura, for example, our strategy includes owning the entire ecosystem, including six hotels, five golf courses, an expanded marina, an equestrian center and various residential and touristic apartment projects, making it a yearround destination.

More recently, we have seen an increase in transatlantic visitors as airlines have launched direct flights from the US to southern European destinations such as Portugal, the Algarve, Madeira, Sicily and Majorca. These travelers tend to stay longer, typically at least seven to 10 days. A growing number of US citizens now hold passports and are choosing to holiday in Europe rather than in Mexico or the Caribbean.

This influx of international travelers helps to lift both average daily rate and revenue per available room, but it also introduces a different and often more demanding clientele. Longer-stay guests expect a higher level of service, such as a concierge who can arrange activities, or for their apartment to be pre-stocked with groceries before arrival.

Where are you seeing the greatest opportunity in the hospitality sector?

We have a credit opportunities fund, a real estate equity fund and a lending fund, which allows us to access opportunities across non-performing loans, direct lending and real estate equity. The cost of capital for these strategies differs significantly. Our credit opportunities strategy targets high-teen returns, while our lending fund operates in the low double digits.

Within lending, the usual refinancing opportunities exist, but bridge financing is a particularly interesting

"You need the right relationships with airports, tour operators, vendors and the golfing (leisure) community to understand how the entire ecosystem functions and how its elements support one another"

space. A borrower may need to close a deal immediately, yet obtaining financing from a local bank can take several months. In such cases, they will use a 12-month bridge. Banks are effective at financing stable assets, but their processes can be bureaucratic. We can move more quickly, and we understand the product because we are equity investors in hospitality ourselves, not simply lenders.

When we own a hospitality asset outright, it is because we believe in the full investment story. We undertake a value-add strategy to refresh or transform the asset, while also controlling the surrounding tourist ecosystem. We may already have complementary projects planned nearby. Often there is a residential component to the investment. We might construct an apartment building or sell land plots for villas, creating a consistent revenue stream. A strong asset with steady income can always be sold to an institutional buyer.

In the early stages, there is considerable strategic assessment. We ask whether it is an asset we want to own and enhance, or one where we prefer to be repaid through our credit position and exit. We have executed mezzanine financing on high-quality assets where senior debt or equity positions would not generate the high-teen returns we target. We have operated across many different points in the capital structure.

Frequently, we identify opportunities through the credit route, including distressed situations. During the pandemic, for instance, some hotels carried heavy debt burdens while revenues declined sharply. Once the equity was wiped out, opportunities arose to acquire assets through court-ordered sales or insolvency processes. More commonly in southern Europe, however, a new generation within a family business may not wish to commit fresh equity or undergo restructuring, preferring instead to transfer the asset to an owner with cheaper capital and greater experience in repositioning.