Private debt 2.0: a fundamentally sound investment

Zach Lewy from Arrow Global on distressed lending, Southern Europe's rising appeal, and why private credit is the right fit for long-term success

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What opportunities are you most excited about as we head into 2025?
We've conducted extensive data analysis on the €110bn of assets we service, giving us deep insight into contemporary performance.

What does the data reveal? First, businesses, loans, and investments made before 2022 are facing significantly more challenges in today's environment compared to those executed more recently. These earlier investments have endured COVID-19, inflation, and dramatic shifts in interest rates. Trillions of euros in outstanding loans from this period are now approaching refinancing in a vastly different financial landscape.

Banks are being forced to reconsider whether they want to extend loans they were comfortable issuing five years ago. In most cases, the answer is no. As a result, we are seeing a surge in restructurings. Borrowers seeking to renew their pre-2022 loans are experiencing payment distress at levels comparable to the peak of the pandemic.

We are actively assisting banks in these situations, either by managing restructurings or providing additional capital to bridge the gap.

Second, equity investment is picking up, which is helping unlock broader capital flows. Markets had been in a holding pattern due to elections worldwide, but with that uncertainty lifted, businesses are eager to move forward. Investors now have a clearer outlook and are ready to transact – at least until the next wave of economic shocks emerges.

What in general do you see as the attitude of investors toward returns from private credit?
I think all credit investors want to know that their capital is going to be preserved in all circumstances. So, the question then becomes: What is the highest return I can achieve without putting my capital at risk?

Quality, transparency, and simplicity tend to go hand in hand. Experienced investors seek reasonable returns from investments that are straightforward, transparent, and of high quality.

How can you hedge against risks in private credit?
As the private credit asset base matures, investors will have an increasing number of options for where and how they participate.
We offer loans with varying durations and seniority, allowing investors to tailor their approach based on ratings requirements, capital efficiency, or credit risk appetite. They can opt for the more senior part of the capital structure for greater security or take on slightly more risk in exchange for higher returns. If interest rates remain elevated, investors won't need to stretch too far to meet their return objectives.

Additionally, a kind of 'old wisdom' is emerging in a positive way – reinforcing the idea that transparency equals quality. A private credit product should have a clear, logical foundation, and it should be simple to track and understand.

How do you assess investment risks across key societal real estate sectors such as residential housing, data centers, and offices?
We assess opportunities by considering two key areas of risk. Let me give you some examples.

Take office investments – what trade are you really making? First, can you fill the building with tenants and generate cash flow? Second, can you sell that cash flow to a buyer? The first challenge is easing, but the second remains difficult. If you surveyed investors globally on their current office exposure versus their desired exposure in five years, you'd see a significant imbalance – many will be net sellers. Even if rental income holds up, an oversupply of sellers could drive down asset values.

Data centres present a similar dynamic. While it's reasonable to expect that, despite advances like DeepSeek, the demand for processing power will continue rising as AI integrates into business operations, the ultimate client base consists of just five hyperscalers. The scale of investment required is enormous, and exit options are limited unless the asset can be placed in a public REIT.

Residential real estate, however, passes both tests. Demand is broad, supply remains constrained, and individual units are relatively small, making them easier to manage. It may not be as exciting or cutting-edge as some other sectors, but it's a fundamentally sound and reliable investment.

How is the development of niche strategies in private debt changing the market?
Private equity gained prominence first, which in turn led to the rise of direct lending. This was straightforward for investors – senior debt was packaged within the same transaction, making it easy to understand.

Some private credit strategies may seem niche simply because they are less familiar. However, I would argue that bridge loans against houses, for example, are actually more mainstream than leveraged buyouts.

Looking ahead 10 years, private credit investments will likely be evaluated based on their risk-adjusted returns rather than their categorisation. Currently, the industry is still closely tied to its origins, with a heavy emphasis on direct lending. But over time, that weighting will shift as the market matures and diversifies.

What observations stand out for Europe?
Historically, Northern Europe has commanded a significant premium over Southern Europe. However, since 2022, performance in the south has improved to the point where that discount is no longer justified.

For a range of demographic, technological, and economic reasons, we believe Southern Europe is now entering a period of sustained tailwinds that will drive strong performance across the region. This is especially true in sectors like hospitality, where the growth of remote work, international travel and lifestyle migration is creating new opportunities that are very promising.

Financing the development or refurbishment of hotels, resorts, and related infrastructure is just one example of how private credit can capitalize on societal shifts. However, capitalizing on these opportunities requires more than just funding. It demands deep expertise in local market dynamics, from sourcing transactions to navigating operational complexities.

How do you see data and technology impacting private credit investment?
We dedicate significant time and thought to this area. The phase of becoming highly data-driven and applying data science is already complete – it is now deeply embedded in our business.
The real question is: how far do we take it? We already have a product where AI drives the first pass of underwriting on Italian construction claims. However, I believe many are underestimating the medium-term impact of AI becoming the dominant factor in business processes.

The cultural effects within organisations are complex. Some employees embrace AI and want to be early adopters, while others resist it entirely. Additionally, as a financial services company, we must carefully navigate security and regulatory considerations.

As firms continue integrating these technologies, these issues will become major discussion points for industry leaders.

Why do you believe private credit can perform in the long term?
That's a strategic question, but I think it's better approached from the opposite angle. Is it natural for banks to issue mortgages? Banks primarily fund themselves overnight, yet they offer five-, 10-, or even 20-year loans. Meanwhile, life insurance companies and pension funds have 30- to 40-year liabilities, making them, in theory, better suited to be long-term mortgage lenders.

Then there's the growth of asset managers. As firms continue to scale, it becomes increasingly logical for them to take on more of the work. We are moving toward a market where large investment houses offer such significant scale and expertise that they become essential players. Given that the capital they manage is inherently well-matched to credit investments, this shift represents a more structurally sound system, not a riskier one.

This leads me to question the assumption that private credit's rapid growth inherently creates risk. The more you examine its evolution, the clearer it becomes that the industry is developing on a solid foundation. The real question, then, is not whether private credit is sustainable, it's whether it could be growing even faster.

Arrow Global was founded in 2005 by **Zach Lewy**, CEO and CIO, with the ambition of building Europe's leading private credit and real estate investment platform. The firm's platform franchise creates sustainable value across a range of alternative asset classes, including opportunistic credit, real estate, and lending.

With the added advantage of key European regulatory licenses, Arrow Global currently services approximately €110bn in third-party assets under management (AUM).

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