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Q+A: ActivumSG on going back to its roots in German distress

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Head of special situations Robert Červinka discusses the firm's positive approach to the current crisis

When Saul Goldstein started ActivumSG on the eve of the global finance crisis, it was one of the first London-based private equity firms to focus specifically on German real estate. Seventeen years and seven multi-billion-euro fundraisings later, the firm is still sticking to its three investment pillars: direct buying, building platforms and merging companies with the perspective of a sale or IPO.

The firm's most noticeable German activities include creating the residential developer Instone, which Activum floated on the stock exchange in 2018, the care home development platform Carestone and the fund management company Verifort. With 10 professionals based in the country, the firm also tackles rather complex individual projects, such as the refurbishment and letting of the Koros office in Mannheim.

Across Europe, the firm is invested in the residential developers ASG homes in Spain, VanWonen in the Netherlands and Nordstern in Denmark. It is also driving forward its hospitality footprint, particularly in Spain. In 2021, it acquired the Odyssey Hotel Group, which is managing about 25 European hotels.

Investment banker and private equity specialist Robert Červinka joined Activum SG in May 2023 as head of special situations, joining up with his old colleague Goldstein, with whom he had already made large real estate deals at Cerberus Capital Management in the noughties.

In the interim, Červinka had held management positions at Deutsche Bank RREEF (now DWS) and Ares, and served as an operating partner for various opportunistic investors.

Under his leadership, Activum is now poised to seize mispriced opportunities for debt and equity investments. Of the €550m raised for the firm's seventh fund, €250m is still available for investments in distressed situations, with a strong focus on Germany.

Červinka sat down with *Green Street News* to discuss how, after the real estate boom, Activum is now returning to its roots, readapting its strategy to a deeply stressed German market.

The word distress is on everyone's lips. What's your definition of a distressed market?

A distressed market is where assets or platforms become available at well below what you would consider to be “normal” market rates. This is not necessarily because they are bad assets, but because of solvency or cash-related issues for the asset owner.

The economic shocks over the last few years have led to more of these situations arising, and this is especially true in the context of the German market. These are situations that ActivumSG will be targeting for investment.

Aren’t we in a similar situation to 2009, when founder and CEO Saul Goldstein was initially active in the German market?

It’s quite similar. Then and now, all the situations that are highly levered are facing problems. But as opposed to 2009, the main distress here is due to fast rate increases which depressed values, and debt ratios have risen to a level where it will be hard to refinance for many firms in the market.

“So you don’t run out of money” – an ironic Sixt advertisement alluding to Signa’s stalled Elbtower development in Hamburg

Also, a number of German debt funds entered the scene over the past years, which were much more aggressive than banks and now it seems that they did not always do full due diligence. There are a lot of opportunities coming out of that as well.

Are we only talking about Germany here? Aren't there distressed opportunities in other European markets?

We are considering other geographies and other strategies as well. For example, we are looking at hospitality assets across Europe. We're looking at distressed opportunities across all our jurisdictions too, but we mainly see them in Germany at the moment.

There are distressed situations in the UK as well, but the German market is bigger and was a lot more aggressive in terms of leverage during the previous cycle. In the UK, transaction volumes came down after Covid and in the wake of Brexit, while in Germany transaction volumes were the highest during this period with the tightest yields. Therefore, there are a lot more firms in Germany exposed to refinancing risks.

I understand that you are considering the probability of a default to be highest for investments that were initiated in 2020-2021?

Yes, because investors who bought in those years have suffered the greatest price drop. Typically, commercial lending locks in hedging for four or five years, which is why we expect a funding gap of at least €17bn coming up in Germany from higher leveraged situations alone over the next two years.

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Especially during 2020-2021, value-add and opportunistic investments were both highly leveraged and based on business plans which depended on certain external factors that did not take place. The sudden unwinding of quantitative easing in particular made a lot of these business plans redundant.

And where are the opportunities for ActivumSG in such situations?

First, we are seeing a lot more assets being marketed at lower prices. If a real estate firm is under pressure and can afford to sell assets because they are not very highly levered, they will sell them. For example, the open-ended funds, who are currently dealing with a whole queue of redemptions, will be forced to start selling at some point.

Instone development at Luisenpark, Berlin

Secondly, we are increasingly seeing attempts from equity investors to refinance their senior loans, which in some cases isn't possible without new capital coming in. ActivumSG is a solution provider for this kind of gap. We want to take an active role in helping either the senior banks or the sponsors to improve the asset with fresh money. We are not depending on operating partners, as we have all the experience and the knowhow in-house.

Are you thinking more of equity or debt, or preferred equity deals?

It's going to be one after the other. Currently, we are seeing mainly debt and preferred equity deals to fund the gap existing in the market. This allows the stakeholder or equity investors to stay in the deal.

However, at some point, the banks will have to start realising or will have to start selling their more stressed loans. Then we will increasingly switch to buying the debt and agreeing on a structure with the borrowers in order to own the collateral and be in the equity.

If it's the most distressed sectors you are looking at – which are they at the moment?

Where we are mainly seeing signs of stress at the moment are offices, shopping centres and residential developments.

Many investors, even opportunistic ones, surrender to the task of finding mispricing opportunities in the office sector

Well, we don't. ActivumSG has a deep understanding of the German office market, because we have a large team on the ground. The firm started off life by making opportunistic investment plays into German offices in the wake of the GFC.

We see the current opportunity as one of going back to our roots in this sense.

In Germany, you have over 200 B cities and the best 30 B cities are still very strong in terms of economics, in terms of unemployment rates, population growth and more. We are not just looking at the top five cities.

> *"The firm started off life by making opportunistic investment plays into German offices in the wake of the GFC. We see the current opportunity as one of going back to our roots in this sense"*

Obviously, one needs to be careful considering the ongoing change in the office market since Covid. Vacancies have gone up significantly in the suburbs and in back-office locations, while central business districts are still holding up very well and there is still demand.

We also bear in mind that most investors and tenants have strong ESG requirements today. Therefore, it's a mix of those two things: a) if the location is right; and b) if the asset itself can be transformed into something ESG compliant.

Are you not joining the queue for German housing?

We are not expecting to see that much distress on existing residential assets. Banks will try to waive any breaches of covenants because the living sector is still cash generating. Residential rents are still growing significantly and at some point, the market will catch up.

ActivumSG's Iberia Fund I divested Hard Rock Hotel Madrid for €65m, after completing the conversion of the former office in 2022

It's different with residential developers. They had to be very aggressive in their underwritings until a few years ago, in terms of how many square metres they could build and what kind of exit values they would achieve. They also have very little equity, because they were able to raise bonds as soon as the business got bigger.

They are highly leveraged both with propco level debt, and on top the subordinated holdco level debt. As prices have come down and construction costs are still growing, their overall leverage often exceeds the existing values.

Do the different debt levels make it difficult for ActivumSG to enter these projects?

Sometimes there is some equity left on the propco level, but the holding level lenders make claims, so overall there is no equity. In such cases, we may try to cut a deal with the secured lenders.

> *"In the last few months, we bought into bonds of companies with existing properties because we thought that they were trading at attractive levels"*

On the other hand, once a developer goes insolvent the administrator will start piecemealing it and start selling asset by asset.

In such cases, the developers are not incentivised to take care of the projects anymore as their money is gone. The mezzanine lender can't do it either because they haven't got the people or the knowhow, and same with the seniors. They are all dependent on third parties who come in with fresh capital and know how to finish those projects.

Have you already bought into any of those distressed developments?

In general, there hasn't been many deals in Germany so far. For example, in the second quarter alone, we've seen only six office deals over €30m. In the last few months, we bought into bonds of companies with existing properties because we thought that they were trading at attractive levels. We were considering becoming active in the restructuring of those bonds, but instead we traded out as bond prices went up and avoided any risk of extensions.

But you had actually intended to get hold of the underlying assets in case the bond extension fails?

If the underlying assets are of certain value and the bonds are trading below that, we believe that is a reasonable way of getting exposure to real estate. In the current market we have only found a few situations where we would be ready to take the risk, though this could easily change in the not-too-distant future as the market continues to be in a state of flux.

You've raised €550m for your current fund. How much of it are still available for investments?

We have €250m of dry powder remaining that we can use to invest in some of these distressed situations I've been talking about. For the fund, our sweet spot is typically €50m per deal, though of course we are willing to make investments either side of this figure if it's an attractive opportunity.