MARKET IN MINUTES
Savills Research

Italian Market Overview

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Economy

Euro Area GDP growth is forecast to slow sharply this year to 1.1% (FocusEconomics Consensus Forecast) due to lingering weakness in the manufacturing sector, a less favorable global backdrop and geopolitical concerns hampering investment and exports. Risks to the outlook remain elevated and include rising global protectionism, slower-than-expected growth in China, Brexit and sluggish domestic growth.

A new political scenario has recently been established in Italy. Last September, in fact, the Democratic Party (PD) and the 5 Star Movement (M5S) joined forces to form a new government, avoiding the election process. The newborn government has demonstrated a more open approach toward the European Union, giving higher chances to a favorable deal on the 2020 budget. The political crisis has thus been resolved; the new coalition has the next months to come to prove the market its solidity, crafting a convincing financial strategy.

In September, core and headline inflation remain moderate. Moreover, qualitative indicators suggest that in the short-term prices will continue to slightly grow (Istat, +0.3%).

In the first months of the year, the improved conditions of the labor market determined an increase of gross disposable income with positive effects on households' purchasing power and saving propensity. According to Istat, In August the estimate of employed remained stable while unemployed rate decreased (9.5%).

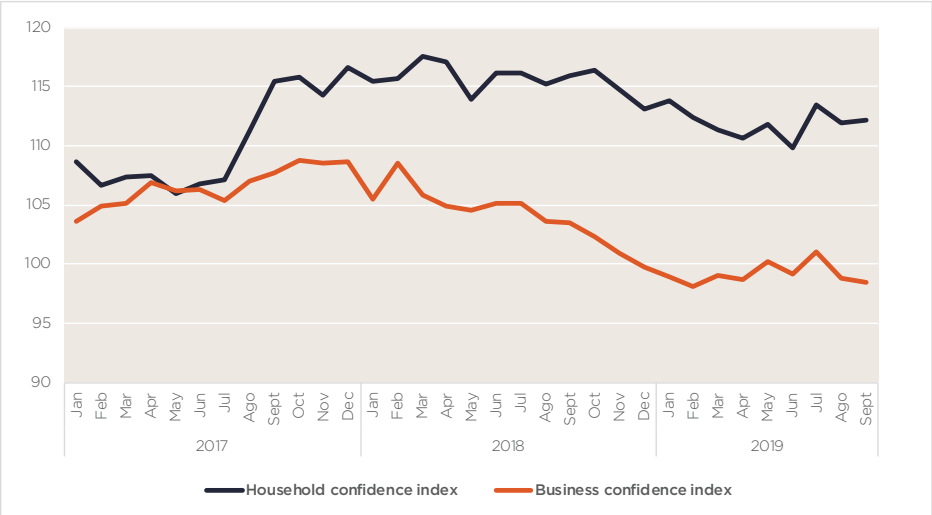
Based on the FocusEconomics Consensus Forecast of October 2019, a substantially stable economic growth in Q2 was registered by national accounts. The same is observed in Q3, due to a marginal growth in both domestic and external demand.

Major Economists agree in expecting a 0.1% growth on Italian economic in 2019. FocusEconomics Consensus Forecast panelists and Bank of Italy have instead different views on the 2020 scenario: while the former expects the Country's economic growth to rise by the 0.4%, the latter predicts a 0.8% increase.

Confidence Index

As reported by Istat data in September the confidence indicators gave conflicting signals: consumer confidence improved from 111.9 to 112.2 while the business confidence climate decreased only slightly passing from 98.9 to 98.5 with a particular fall in the manufacturing confidence component. The leading indicator remain negative confirming that the short-term perspectives for Italian production are weak.

Household and business confidence indices



***Source** Istat Data

TOTAL INVESTED Q3 2019 YTD

€ 7.4 bn

HOSPITALITY
€ 2.1 bn

OFFICE
€ 2.6 bn

RETAIL
€ 1.7 bn

LOGISTICS
€ 487 mln

OTHER
€ 517 mln

Investment Sector

With a value of 7.4 billion euros of investment at Q3 2019, the real estate market continues to show a strong interest from the investors for the Italian market (+44% compared to 2018).

Focusing on Q3, investments totalled 2.2 billion euros. As it has happened in the previous quarter, also this one sets a positive record in the last 5 years, having scored the highest amount.

During Q3 retail is the segment that register the highest value of transactions volume wise, followed right after by the office asset class (Retail: €900 million, Office: €800 million). Logistic, accounting for a total of €335 million invested confirming the strong appeal of this asset class.

The quarter has been characterized by some significant portfolios transactions both in the office segment and in the retail asset class, with a record transactions of three factory outlets bought by Orion for a value in the region of 500 million euros. Being the assets of these portfolios spread throughout Italy, in this quarter Milan and Rome have not taken the absolute lead in volumes of transactions registered. The third quarter of the year was in fact characterized by mega deal transactions (+100mln) representing circa 70% of the total invested volumes.

Capitals are mostly coming from foreign investors that, since the beginning of the year, have represented the 73% of the total transactions registered; domestic capitals on the other hand account for a total share of 27% . Among foreign investors, Europeans take the lead, representing the 69% of total transactions; American money follows with a 24% share.

It is foreseen an outstanding result in the next quarter to come thanks to the finalization of some important deals which are due to close by year end. Savills forecast of total investments in 2019 is set to a value in the region of €10 billion.

“The market is set to reach the record sum of € 10 bn of investment by the end of the year.”

Yield & Rents

Lower risk-free rates have been the influential driver of office yield compression across Europe's markets.

Office prime yield for Milan CBD remains stable at 3.5% whilst net yields in Milan non-CBD has seen a compression thanks to an increase of investor's interest for such location. In Rome the net prime yield in CBD remains stable at 4%.

Looking at prime rent, in Milan CBD the average rental level for prime offices remains confirmed at a value of 600 €/sq m/per year. As for Rome, rental levels averaged 430 €/sq m/per year in the CBD area.

Retail follows the path started at the beginning of the year, with selective interest for high-street assets and a more cautious approach for out of town opportunities, once compared to 2018, with main focus on dominant assets.

Net yields for prime high street assets is confirmed at 3%; prime shopping centers' yields are at 5%. High street rents in Milan prime locations, such as Montenapoleone, are set at 13,000 €/sq m/per year. while in the main street of Rome, Via Condotti, the prime rent is in the region of 11,000 €/sq m/per year

Logistics witnessed a reduction for prime locations, getting to the region of 5% net initial yield. Rental levels in the asset class for Rome and Milan fluctuate around 56 €/sq m/per year.

A low growth environment presents challenges and opportunities for European real estate investors. The weight of money targeting European real estate will keep yields low for the foreseeable future and we feel that the underlying risk of holding property ahead of bonds has not materially changed, which will continue to keep the yield spread with bonds stable. Rental growth rather than capital growth will be the main driver of returns in 2020.

Key Facts - Q3 2019 YTD (all asset classes)

SINGLE ASSET DEALS
71%

FOREIGN INVESTORS
73%

MILAN DEALS
29%

ROME DEALS
11%

Source Savills Data

Savills team

Please contact us for further information

Gianni Flammini
CEO Italy
+39 02 6328141
gflamminii@savills.it

Marco Montosi
Head of Investment
+39 02 632814749
mmontosi@savills.it

Maddalena Panu
Head of Research
+39 02 632814214
maddalena.panu@savills.it

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