Italian Spotlight – Q1 2023

SPOTLIGHT
Savills Research

Italian Investment Market

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After a record 2022, Q1 2023 closes with an expected slowdown

Highlights

- In terms of investment volumes, Q1 2023 recorded an expected slowdown despite number of deals increased
- Uncertainty related to the macroeconomic environment and rising financing costs have slowed down investment activity
- Logistics returned to be the main sector, contributing to 32% of quarterly volumes
- In logistics, strong demand from operators led take-up to the second best result in five years
- The living sector was the second asset class in the quarter, sustained by strong fundamentals and favourable outlook
- Hospitality proved to be resilient and held back by a lack of trophy assets; number of tourists, ADR and RevPar are expanding
- The market has been mainly characterized by domestic capitals and small size transactions
- ESG factors will become increasingly relevant for both investors and occupiers
- Price adjustment in H1 2023 will be followed by a stabilisation in the second part of the year, which will bring a recovery in investment volumes
- Like interest rates, yields will remain higher compared to data registered in recent years of expansionary policy

Q1 2023 KPIs

TOTAL INVESTMENT VOLUMES
900 mln €
-73% YoY

NUMER OF DEALS
56
+2% YoY

SOURCE OF CAPITAL
60% domestic

GEOGRAPHIES
46% regional markets

LOGISTICS | PRIME NET YIELD
5.00%
+110 bps YoY

HIGH STREET | PRIME NET YIELD
3.50%
+25 bps YoY

OFFICE | PRIME NET YIELD
4.00%
+110 bps YoY

SHOPPING CENTRE | PRIME NET YIELD
6.50%
+60 bps YoY

Macro-economic Outlook

The global scenario is still dominated by uncertainty. Global economic growth will decline this year due to rising interest rates. However, a robust labour market, easing price pressures and supply constraints will support activity. Italy economic trend remains positive although gradually slowing down. Growth in exports and investments continued to support the economy and the labour market.

In March, Italian CPI continued to slow down but remained high (+7.6%), thanks to the favourable dynamics of the prices of energy goods. Core inflation stabilised at +6.3% and does not show any signs of abating, nor does the 'shopping trolley' inflation affecting households. The increases in the production chain were almost entirely passed on to consumers with effects on consumptions and sales, which grew in value terms but decreased in volume.

The propensity to save has rapidly declined to record lows (5.3% in Q4 2022). The growth in households' disposable income (+7% YoY), together with the strong growth in consumer prices, led to a significant decrease in purchasing power (-3.7%). The resilience of final consumption expenditure (+12.8%) was therefore accompanied by a marked decline in the savings rate.

In March, the consumer confidence index improved for the second month in a row, while business sentiment also increased, driven by industry and, to a lesser extent, by services.

According to Consensus Economics, Italian GDP is forecasted to register an increase of 0.4% in 2023 thanks to the normalisation of energy and commodity prices and despite the full effect of rate hikes on economic activity. Inflation is projected to remain high for long. Accordingly, a reversal of monetary policy is unlikely at least for the next 12 months.

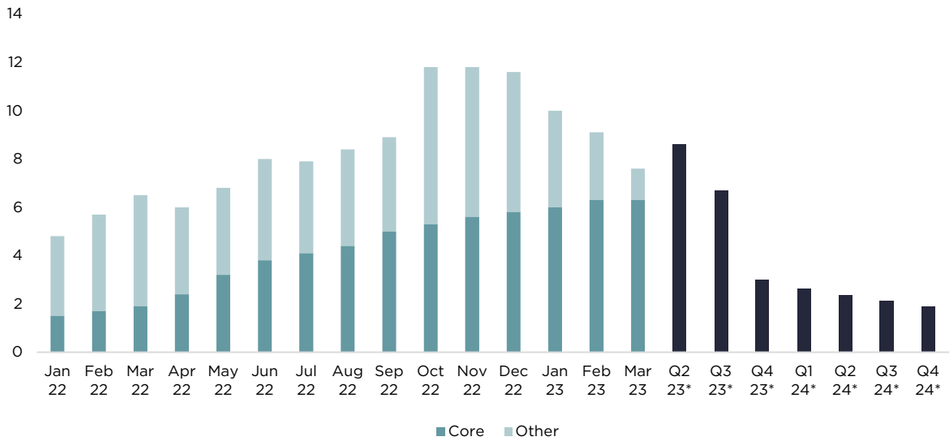
GDP
+1.4% YoY
(Q4 2023)

UNEMPLOYMENT RATE
8% (-46 bps YoY)
(February 2023)

CPI
+7.6% YoY
(March 2023)

GOVERNMENT BOND YIELDS 10 YEARS
4.27% (+248 bps YoY)
(February 2023)

CPI (% YoY)



Commercial Real Estate Investment Market

In Q1 2023, around € 900 mln was invested in the Italian commercial real estate market, registering a 73% YoY decrease. The slowdown followed a record 2022 and had already started in Q4. As expected, the uncertainty surrounding the macroeconomic environment and the increase in financing costs slowed down activity.

Considering the number of deals, the market remained dynamic with 56 deals closed in the first quarter compared to a five-year average of 43, however the average volume per deal decreased with a prevalence of transactions below € 50 mln.

As usual for periods of uncertainty, the national sources of capital prevailed (60%) on the buyer side.

In terms of geographies, Milan confirmed to be the preferred destination, registering 43% of the investment volume, followed by Rome (11%). Thanks to the positive trend of logistics and hospitality sectors, the other Italian cities accounted for 46%.

Logistics confirmed its relevance in the Italian panorama, representing around 32% of total investments, underpinned by a strong leasing demand, low vacancy and increasing rents.

Strong fundamentals sustained the living & healthcare sectors, driven mainly by the student housing segment: this segment is the most mature one, where we are starting to see transactions of up and running products.

Hospitality continued to perform well, reaching the 3rd place by investment volume in Q1 2023. The market remained liquid in major cities, but held back by a very limited supply, particularly of trophy assets.

With around € 100 mln, office investment volumes are significantly declining despite a market that remains dynamic on the occupier side. Milan remained central, but regional markets increased their market share.

In Q1 2023, rental levels remained stable for high streets while prime shopping centre rents partially included the inflation trend; offices and logistics registered an increase sustained by high demand for grade A assets and low vacancy rate. Although liquidity towards the sector remains high, the rise in interest rates continued to affect the yield trend causing a further decompression in the first three months of the year.

Investment volumes

LOGISTICS
290 mln €
-56% YoY

LIVING
280 mln €
-48% YoY

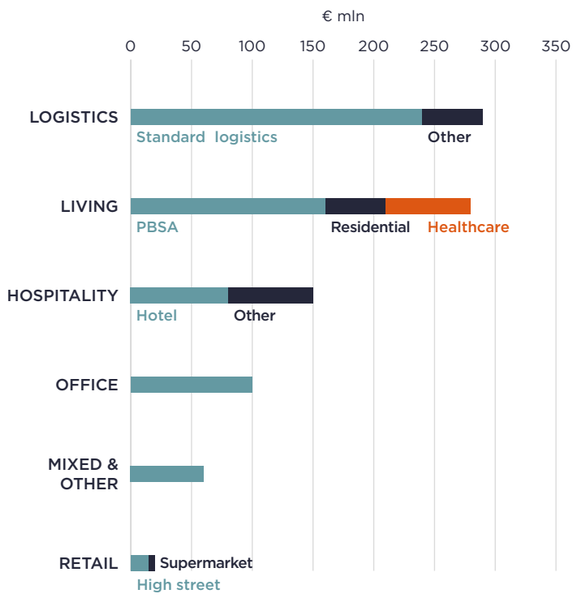
HOSPITALITY
150 mln €
-66% YoY

OFFICE
100 mln €
-93% YoY

MIXED & OTHER
60 mln €
-64% YoY

RETAIL
20 mln €
-90% YoY

Total investment volume Q1 2023



Market Outlook

Investment activity is slowing as yields adjust in the current challenging scenario. Price discovery in H1 2023 will be followed by a stabilisation in the second part of the year, which will bring a recovery in investment volumes. The stabilisation of interest rates and costs and the easing of inflation's expectation during 2023 will lead to a more favourable market in 2024. Like interest rates, yields will remain higher compared to data registered in recent years of expansionary policy, remaining at or slightly above values at the beginning of 2023. In sectors characterised by demand constraints, rental growth is expected to partially offset yield decompression.

Investors' strategies remain focused on sectors with good fundamentals, i.e. sectors characterised by a strong mismatch between supply and demand and low vacancy rates, which therefore offer good prospects for rental increase. "Beds&sheds", together with hospitality, have not only proven to be resilient, but also to have solid fundamentals. In terms of geography, we expect a growing market share in regional markets, thanks mainly to logistics and hospitality.

ESG factors will become increasingly relevant for both investors and occupiers and this will lead to a further polarisation between prime and secondary assets.

> In the current complex scenario, investment activity has experienced an expected slowdown. Strong occupier demand sustains beds&sheds and rental growth. In H2 2023, the stabilisation of interest rates will result in increased activity in the market.



Office

After the outstanding result achieved in 2022, office volumes slowed down in Q1 2023, reaching € 100 mln, a figure down both on Q1 2022 (-93%). The number of transactions also decreased: 10 transactions were recorded, all characterised by a small average size of less than € 20 mln.

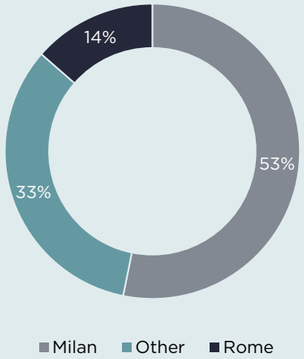
Milan confirmed to be the first investors' target but to a lesser extent than the trend of recent years. Secondary locations such as Torino, Reggio Emilia and Napoli characterized the quarterly activity, collecting a total of circa € 40 mln.

Despite the wait & see approach that have characterized the quarter, several deals are in pipeline, as investors are still interested in a segment that has proven to be resilient.

The leasing market confirmed to be highly dynamic; in Milan take-up slightly slow down (Q1 2023: 85,000 sqm, -10% compared to the last 5 years average), but number of transactions increased. In Rome, a big deal drove the quarterly absorption which has slightly outperformed Milan.

Strong demand for Grade A assets is supporting prime rents, which reached a new record high in Milan: 700 €/sqm/y (+8% YoY).

Q1 2023 Investments by geography



Logistics

The logistics sector returned to be a top priority in 2023, being the first asset class in terms of investment volumes with a total of € 290 mln. Although volumes are down compared to Q1 2022, they are in line with the average of Q1 of the last 5 years.

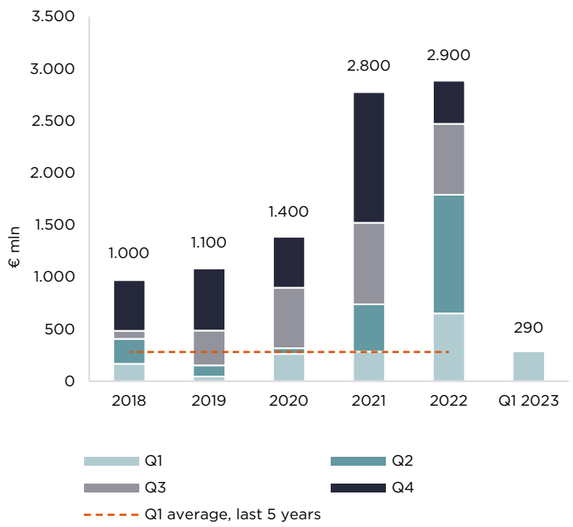
This asset class was the most dynamic of the quarter, collecting 17 deals, one of which was a portfolio deal. The transactions were characterized by small size: none exceeded € 50 mln.

The north continues to be the first destination, collecting over 85% of volumes; Milan and Verona represented once again the most appealing locations, characterizing more than half of volumes. In line with the historical trend, the market continues to attract foreign capitals, but to a lesser extent.

The leasing market achieved positive results: in Q1 2023 the take-up reached around 630,000 sqm, a figure lower compared to the record Q1 2022, but 38% up on Q1 average of the last 5 years.

The high demand for letting space and an attractive market in terms of pricing compared to the large European markets, confirm this sector at the centre of investors' strategies.

Investment volume



Hospitality

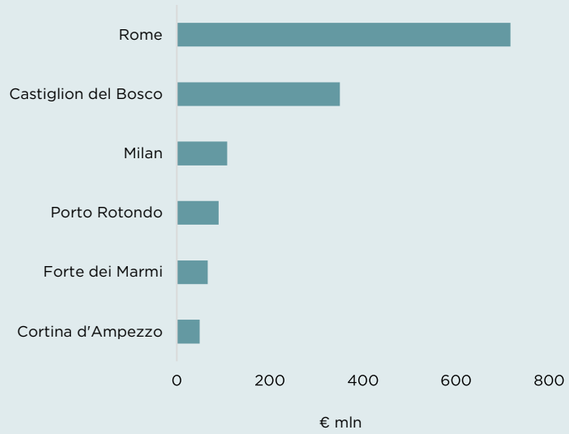
In 2022, the easing of Covid restrictions in Italy has translated into a rebound for the hospitality sector and provisional figures are positive. Although they are still slightly below the pre-Covid figures, the number of tourists increased by 40% in 2022 compared to the previous year. The number of overnight stays show positive signals too, rising up by 37% YoY. ADR and RevPar are also on the rise.

In the last quarter, the sector was the third in terms of volumes, with a total of around € 150 mln. Even if volumes slow down compared to Q1 2022, the sector confirmed to be dynamic with a total of 9 transactions recorded in the last quarter (+4 YoY).

The province of Firenze was the most sought after, attracting one third of quarterly investments across 3 deals. Several operations refer to redevelopments of existing assets.

Despite the general trend, international capital continues to dominate this sector, with a share of 84% in the quarter.

2022 - Q1 2023 Top 6 cities by investment volume



Retail

Retail investment volumes continued to be limited also in Q1 2023, reaching just € 20 mln, a figure down by 90% on the same quarter of the previous year. Average deal size sensibly decreased too, from € 37 mln in Q1 2022 to € 6 mln in Q1 2023.

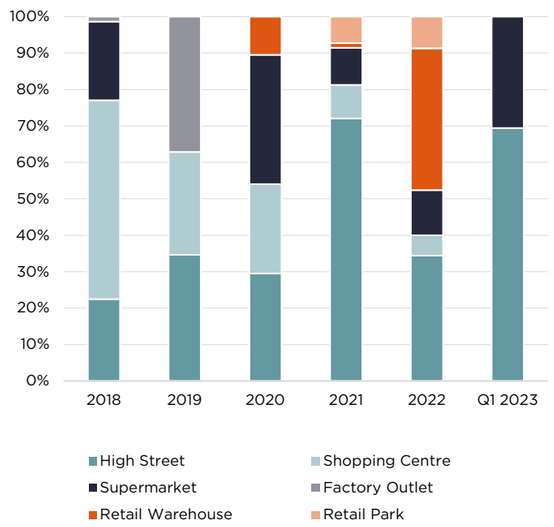
High street attracted the largest share (€ 15 mln) across the closing of 2 deals, one in Rome and one in Milan. On the out of town side, only one transaction was recorded concerning a former cinema to be converted into a supermarket.

Shopping centre transactions continued to be limited: core products are not on the market while the gap between buyer and seller expectations on pricing for secondary stock is still large.

Prime net yields increased also in Q1 2023 (+25 bps on the previous quarter) for shopping centres, retail parks, retail warehouse and supermarkets due to the shortage of liquidity in the sector. High street prime yield remained stable on the previous three months but increased by 25 bps YoY.

Regarding prime rents, high street ones continued to show stability in Milan and Rome, while prime shopping centre rents showed an increase partially incorporating the inflation trend.

Investment volume by segment



Living & Healthcare

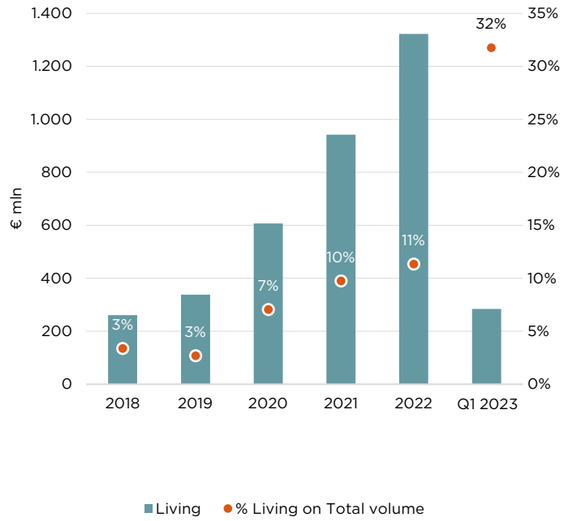
Living sector continues to appear resilient, being the second asset class in terms of volumes with around € 280 mln. Quarterly volumes are down YoY (-48%), but increased by 46% on the Q1 last 5 years average. The sector's weight has grown exponentially over the last years and in Q1 2023 it represented 32% of total investments.

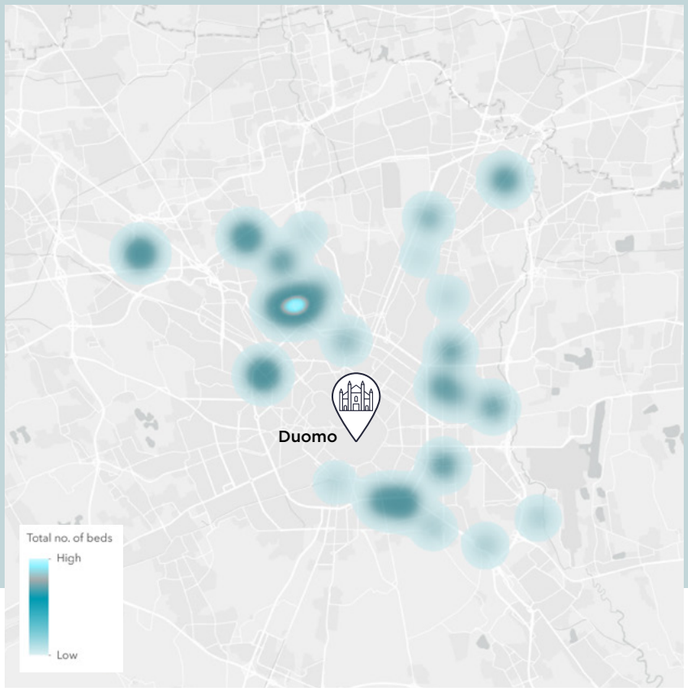
Student housing was the main contributor to the quarterly result, accounting for more than half of living volumes. This segment is the one that has consolidated the most and where we are beginning to see transactions of income producing products.

The healthcare has solid fundamentals, remaining a niche product in the Italian market; it no longer includes only care homes, but also clinics and hospitals. In the quarter, it represented 26% of the volume thanks to three transactions, two of which were located in Piemonte and one in Rome.

The residential sector is characterized by various development projects and therefore presents volatile volumes. In the last quarter five transactions were recorded related to build to sell, senior living and social housing products for a total of around € 50 mln.

Living investment volumes (LHS) and % on total volumes (RHS)





Milan, student housing pipeline, 2023-2025

The high interest in student housing is accompanied by a strong pipeline. In Italy as a whole, around 9,000 beds are currently under construction and expected to be completed by 2025.

Milan is the most dynamic city, where 12 projects have been identified that will add more than 5,000 beds to the market.

Despite this, the offer of beds should remain insufficient to meet the potential demand of a growing number of mobile students. Provision rate (total number of beds divided by the total number of university students) stands today at 6% and should increase at 13% in 2025.

The increasing number of mobile students and tendency to move for work and study will sustain the market and contribute to push rental growth further.



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