Italy Commercial - H1 2022

SPOTLIGHT

Savills Research

Italian Investment Market

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Highlights

- In terms of investment volume, H1 2022 represented the best first semester ever recorded
- Offices came back as the investors' main target, followed by logistics
- It is almost certain that the ECB's official rates will move in both in July and September, to dampen inflation expectations and limit the transfer of price increases to goods
- Prospects remain solid for the remainder of the year, despite the risks
- Typically, in periods of uncertainty, there will be a focus on core assets, providing secured long income streams
- Further yield compression is unlikely over the next months
- Prime rents will reach higher levels for both offices and logistics
- Prime offices, logistics and hotels will remain in investors' focus together with living developments
- Trends in construction costs and rising financing costs will slow down value-added strategies

Total **6.1** bn €

▲ **100%** YoY

127 deals

OFFICE
2.2 bn €
▲ **201%** YoY
37% weight

LOGISTICS
1.8 bn €
▲ **147%** YoY
30% weight

LIVING & HEALTHCARE
0.7 bn €
▲ **54%** YoY
11% weight

HOSPITALITY
0.7 bn €
▲ **37%** YoY
11% weight

RETAIL
0.4 bn €
▲ **133%** YoY
7% weight

ALTERNATIVES
0.1 bn €
n.a. YoY
2% weight

MIXED & OTHER
0.2 bn €
n.a. YoY
2% weight

Macro-economic Outlook

The global scenario is currently dominated by uncertainty: the war in Ukraine continues and with it, commodity prices and material shortages, with which companies are having to contend. Conversely, the easing of restrictions are supporting tourism and services, but inflation is holding back household consumption.

In June, in Italy, inflation accelerated again to a level (+8.0%) not seen since January 1986. Inflationary tensions continued to spread from energy goods to other commodity sectors, within both goods and services. The core component recorded increases not seen since 1996. At the same time, the acceleration in the prices of foodstuffs, pushed the growth in those of the so-called 'shopping trolley' even higher (+8.3%).

Rising oil, gas, and coal prices are increasing the costs for businesses. Companies have largely absorbed their higher costs eroding margins. However, in the medium term this practise will turn out to be unsustainable and will lead to reduced or stopped production.

The increase in energy and food prices is squeezing households' purchasing power and this will affect the scale and pace of growth in good consumption, the recovery of which is now hampered by the greater uncertainty affecting confidence. Nevertheless, after two years of pandemic, the easing of restrictions is likely to support services and leisure expenditure. Propensity to save is still far from normalising to pre-Covid levels (12.6% Q1 2022).

The positive effects of PNRR (Recovery and Resilience Plan – Recovery Fund) and incentives could slow down, even if it will continue to sustain investments and construction: some of the planned projects may be difficult to realise at current prices while others will have to be postponed due to lack of materials.

In June, the Bank of England increased its base rate to 1.25% while the FED raised the benchmark rate by 75 bps to 1.75%. With the Ukraine war and pandemic-related prices pressures still much stronger than anticipated, the ECB is expected to raise the interest rates in both July and September, in order to bring inflation back down to 2% in the medium term. This will fail to reduce energy and food prices and could have a potential recessionary effect; the ECB move also aims to limit the weakening of the euro, which would fuel inflation in Europe even more.

The inevitable rise in interest rates is impacting government bond yields, making public debt more expensive, as well as loans, as borrowing money has become more difficult and expensive.

In June, the consumer confidence index worsened while business sentiment continued to improve mainly thanks to services sector and to pent-up demand that is sustaining industrial production (+2.3% YoY Jan-May). Companies in all economic sectors, on the other hand, are more cautious with possible long-term effects on investments.

According to Consensus Economics, after a growth of 6.6% in 2021, Italian GDP will register an increase of 2.7% in 2022 followed by a 1.6% in 2023, bringing Italy back to pre-pandemic levels by the end of the year.

CPI
+8.0% YoY
(June 2022, provisional)

GOVERNMENT BOND YIELDS 10 YEARS
2.99% (+201 bps YoY)
(May 2022)

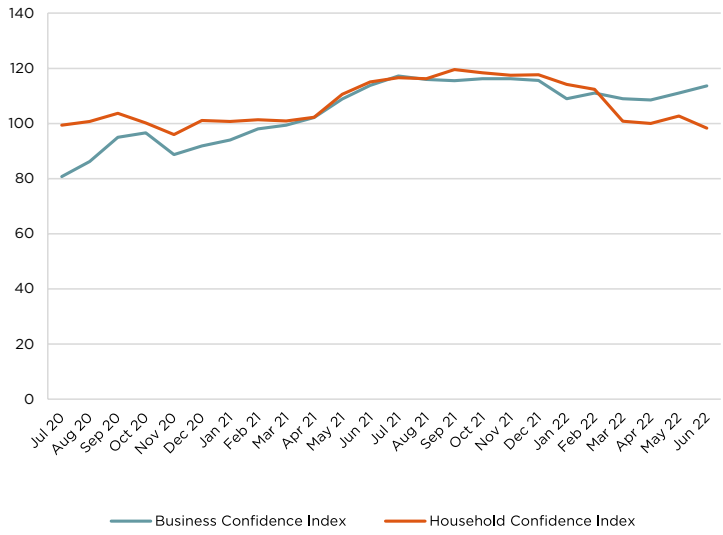
CONSTRUCTION COSTS' INDEX
+10.4% YoY
(May 2022)

INTEREST RATE – LOANS FOR HOUSE PURCHASE
1.81% (+43 bps YoY)
(April 2022)

Macro-economics KPIs

Italy (% YoY)	2012-19 average	2020	2021	2022 (F)	2023 (F)
GDP	0.04	-9.10	6.60	2.70	1.60
Consumer spending	-0.03	-10.60	5.20	2.50	1.70
Unemployment Int	11.45	9.40	9.50	8.60	8.50
CPI inflation	1.30	-0.30	2.00	6.70	2.90
ECB Refinancing rate	-0.14	0.00	0.00	0.94	1.55
Government bond yields 10 years	3.20	0.55	1.17	3.68	3.52

Confidence index



Source: Consensus Economics, Oxford Economics, ISTAT, Banca d'Italia

Commercial Real Estate Investment Market

In H1 2022, around € 6.1 bn were invested in the Italian commercial real estate market, registering a 100% increase compared to H1 2021. The first six months of 2022 represented the best first semester of the last 10 years. H1 2022 investments' volume surpassed the last 5 years' average by 41%.

The trend would have been positive even without the closure of the biggest deal of the semester: the selling of a € 842 mln portfolio from Enpam to Apollo was signed in March. This big deal accounted for around 14% of total investment volume. Mega deals' (> €100 mln) weight increased (50% of total investments) compared to H1 2021. Portfolio deals continued to grow, reaching 41% of the volumes transacted in the quarter.

Foreign capitals continued to be predominant, accounting for the 86% of the total investment volumes; Global and European capitals represented the biggest share.

In terms of geographies, Milan confirmed to be the preferred destination, registering 40% of the semester investment volume, followed by Rome (15%). Thanks to the positive trend of logistics and hospitality sectors, the other italian cities accounted for 46%; among this, Verona (logistics), Siena (hospitality) and Bologna (logistics and office) stood out.

With € 2.2 bn, offices returned to be the main sector in terms of investment volumes, followed by logistics. Rome and mainly Milan remained central, as well as grade A assets.

Logistics confirmed its relevance in the Italian panorama, representing around 30% of total investments. International investors confirmed to be the most active actors in the segment.

The resilient characteristics of the living & healthcare sectors sustained volumes. The H1 level was mainly driven by the residential segment; among the 19 deals of the quarter, several transactions involved lands and developments, while investors remained focused on Milan. As regards as healthcare, care homes and clinics drove volume.

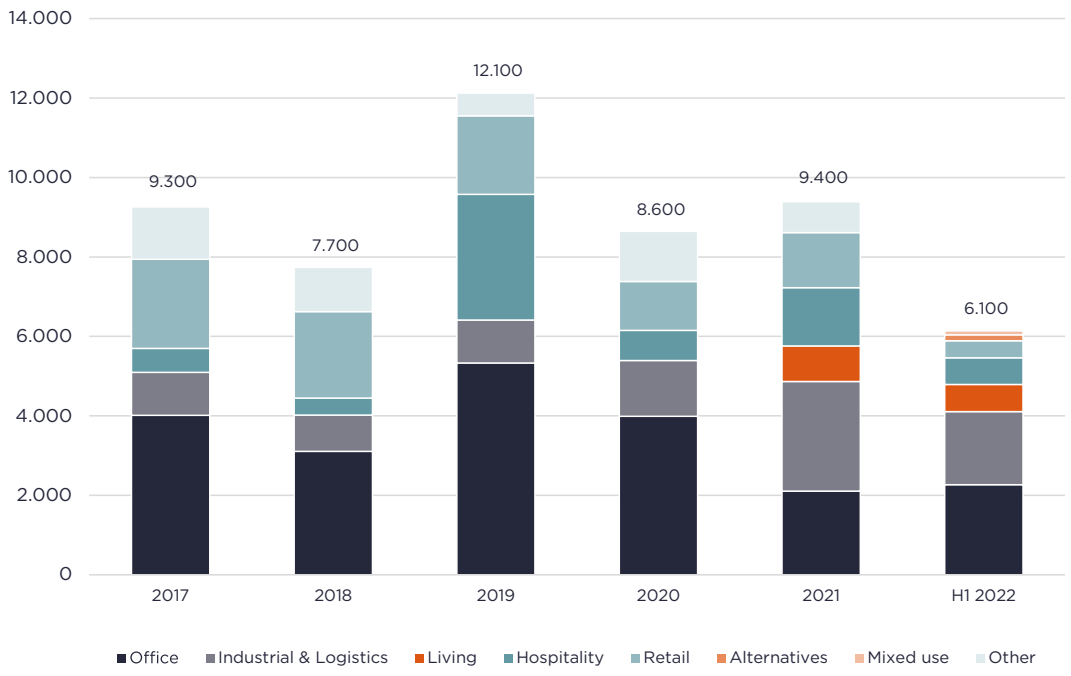
Following the great rebound of 2021, hospitality continue to expand, driven by solid fundamentals. Key leisure and business destinations have seen a rebound in investment volume. In May, the number of tourists is back above pre-covid levels.

Rental levels remained stable for high street while the shopping centre ones started to incorporate the inflation trend; offices and logistics registered an increase sustained by high demand for grade A assets and low supply. High competition for prime assets resulted in a further yield compression in office and logistics in Q1, followed by a stabilisation in Q2.

Despite the growing uncertainty, investors demand for the Italian CRE market will remain strong in the next months. The consolidation of new asset classes, good fundamentals and competitive pricing compared to other European markets will support investors' expectations and interest in the Italian market. Typically, in periods of uncertainty, there will be a focus on core assets providing secured long income streams. Further yield compressions are unlikely in the next months. Prime rents will reach higher levels for both offices and logistics. The reduction of the risk premium respect BTP and the rise of financing costs are elements of attention especially for secondary products and value add strategies.

> “H1 2022 exceeded expectations. Given the significant pipeline underway, the outlook remains solid for the next semester, although we expect more caution and selectivity from investors.”

Investment volume by sector



Office

The office sector came back to take the lion's share in terms of investment volumes in H1 2022 reaching around € 2.2 bn, representing the highest H1 ever recorded with a figure 43% higher than the last 5 year H1 average.

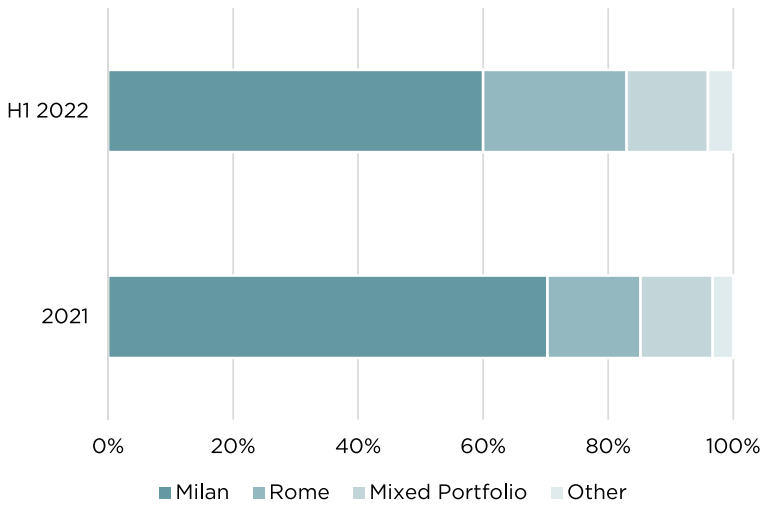
The semester was highly dynamic (33 deals were recorded) and characterized by the presence of several deals of huge dimensions. Among them it is worth mentioning the office component of Enpam portfolio (counting for around € 400 mln), the A2A portfolio sold in Milan, and the KPMG Headquarters in Rome. These operations combined accounted for 39% of the office volumes.

Milan continued to be the investors' first target: 59% of the total volumes were transacted in the city across the acquisitions of 34 assets. Deals were mainly related to assets located in the historical centre as well as in the peripherical areas of the city and presenting core or value add profile. Rome's market is gaining market share thanks to the closing of 7 single deals, in addition to several assets included in mixed portfolios.

More than 70% of the capitals were of international origin, confirming the high appetite for the sector; prime net yields decreased both in Milan and Rome, respectively at 2.90% and 3.5%.

Leasing activity remained positive, sustained by demand for flexibility and the need for a workplace that enables health and wellbeing. Prime rents continued to rise both in Milan (675 €/sqm/year) and Rome (500 €/sqm/year). That being said, another upsurge could occur by the end of the year.

Investment volumes by geography



Logistics

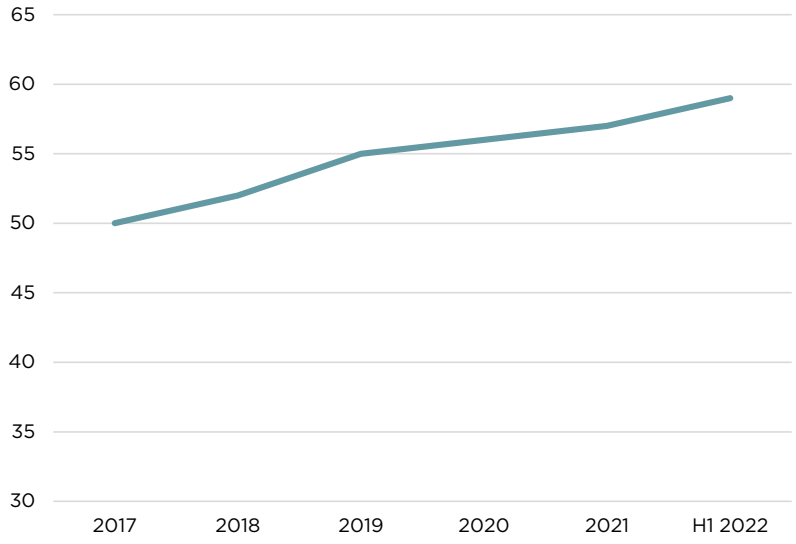
The logistics sector continued to attract strong interest from investors. It represented 30% of overall investment volumes since the beginning of the year with € 1.8 M, a new record high for a first semester. Volumes in H1 2022 increased in fact strongly both on H1 2021 (+147%) and on the last five year H1 average (+290%). Moreover, this asset class was the most dynamic one, recording 38 operations, 13 of which were related to portfolios.

In line with historical trends, the market was dominated by international capital (more than 97%). The investment activity continued to be concentrated in the North of the Country, where more than 85% of volumes were transacted. During the semester, Verona represented a top destination: here, 31% of transaction volumes took place across 6 deals. A great interest has been also observed in the clusters of Milan, Bologna and Novara.

Prime net yields are still at their lowest value (3.90%) but a slight decompression will be observed in the main markets by the end of 2022. However, higher Italian yields compared to core European locations may continue to keep liquidity in the country.

Logistics take-up remained elevated in the first six months of 2022, recording more than 1.5 m sqm and setting a new record for a first semester. The high demand for logistics space and the lack of products that meet the current needs of players (such as ESG criteria, automation, cold storage, and accessibility) will persist in the next month, leading to a further increase in prime rents.

Prime rent (€/sqm/year): Milan and Rome



Hospitality

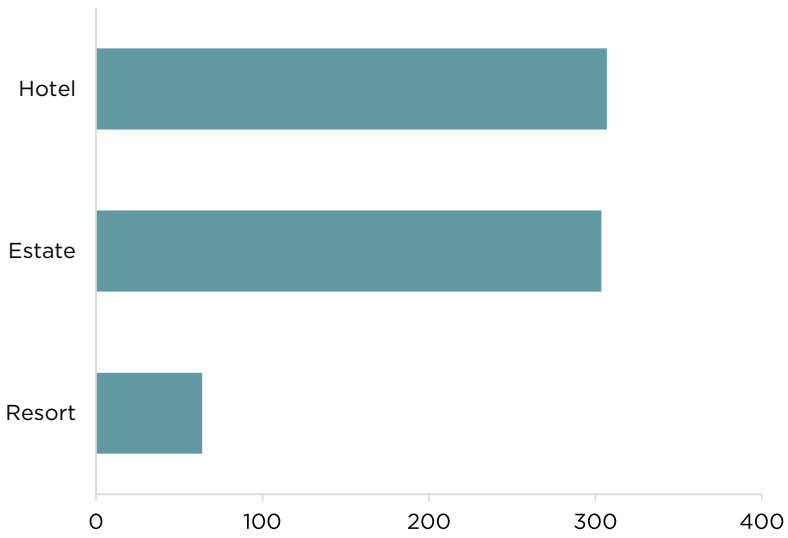
Since spring, the easing of Covid restrictions in our Country has translated into a rebound for the hospitality sector and provisional figures for summer are positive. Although tourist numbers in the first four months of 2022 are still below the pre-Covid level, in May overall tourists grew by 33.6% and international tourists by 45.8% compared to May 2019 (source: Federalberghi).

The investment volumes transacted in H1 2022 amounted to € 670 mln, a figure 37% higher compared to the first semester of the previous year but still below the last 5 years average. The assets acquired included estates, resorts and 5 stars category hotels as well as hotels to be totally renovated. The 19 exchanges assets are mainly located in Milan and Rome, as well as in the province of Padova, Sassari, Siena and Lucca.

A big deal drove the volumes, represented by the Castiglion del Bosco sold by the Ferragamo family and managed by Rosewood Hotels.

In the first semester, the capitals invested in the sector were mainly international (98%).

H1 2022 Investment volume by asset type



Retail

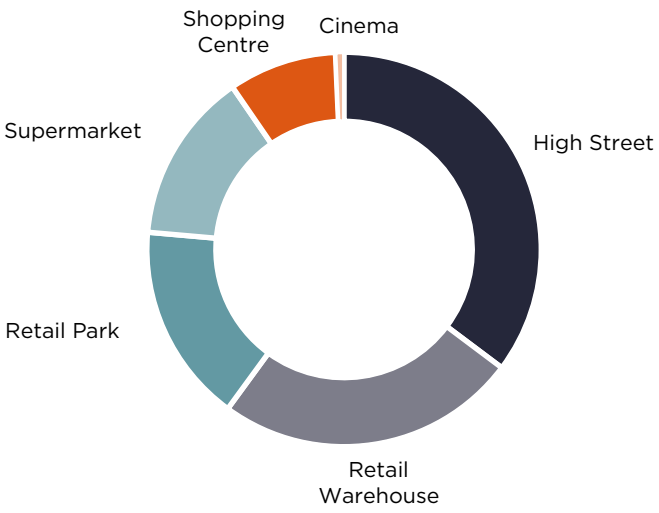
Retail investment volumes in H1 2022 were limited but showed the first sign of recovery: around € 400 mln were recorded, a figure equal to more than the double of the first semester of the previous year, but still lower (-42%) compared to the last H1 five years average. As in the general trend, this sector was characterized by a predominance of international buyers, which accounted for 72% of volumes.

High street attracted 35% of the investments across the closing of 4 deals. The city of Milan was the most sought after location (42%) mainly thanks to the sell of Eataly store acquired by COIMA; a great attention was nevertheless paid to Rome and to the South of the Country. On the other side, the out of town segment recorded 10 deals for € 280 mln. The retail warehouse segment drove the volumes with the acquisition of a portfolio of 10 assets, signed by CPI Property Group.

Prime net yields hold stable for both for High street (3.25%) and as well as for Shopping centre (5.90%). For the latter there is no evidence of prime product transactions, while the gap between buyer and seller expectations on pricing for secondary stock is still large. An increasing attention for the grocery segment is instead expected to be seen by the end of the year.

Regarding prime rents, high streets continued to show stability in Milan and Rome, while prime Shopping centres showed an increase due to inflation upsurge, and the high demand in prime centres. More incentives are anticipated to be granted, especially in the prime centres.

Investment volume by segment



Living&Healthcare

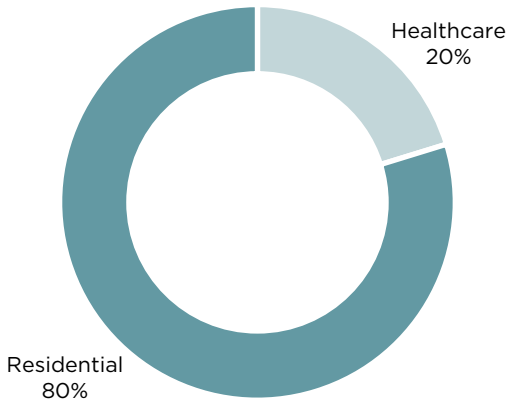
2021 saw the establishment of the living segment, driven by its solid fundamentals and positive macro-economics and demographic outlook. The rising star of the investment arena is now at the top of investors' agenda. In the next months, we will assist to the first transactions related to properties nearing completion and to up-and-running products.

Investors are looking to diversify the risk/return of their existing portfolios, so living products are becoming increasingly mainstream.

For the next months, prospects are expected to remain solid: living developments will remain in the focus of investors. Students and professionals are coming back to universities and offices in the main cities, sustaining the rental market and the increasing pressure to modernise the existing stock. Loan rates will tightening, providing a boost to PRS/multifamily demand as mortgages become less affordable. The increase in construction cost prices could affect the viability of some schemes, although demographics will continue to drive tenants' demand. Investors will continue to be focused on the sector, pushed by high demand and positive rental growth prospects.

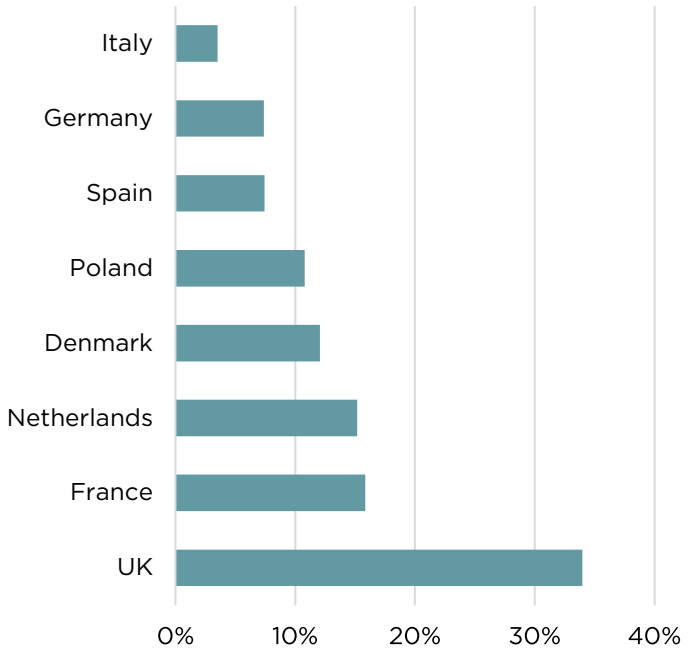
Strong rental growth is forecasted for both residential and student housing accomodations in cities like Milan and Rome, where the supply is significantly lower than the demand.

Investment volume by segment



"Given the current economic context, we expect the living sector to fare better than the others. With affordability issues likely to deteriorate in the near future, PRS have a bright future ahead."

PBSA - European provision rate*



As for PBSA, unmet demand for professionally managed products will accelerate investments on quality accommodation with adequate facilities and amenities to attract an increasing number of mobile students, Italian and international.

In the healthcare segment, ageing populations and a low level of beds per inhabitant will sustain demand and investments for adequate living facilities, able to meet a demand for modern supply and amenities. The consolidation of owners and operators will continue, alongside with redevelopment opportunities.

In terms of investment volume, the living sector accounted for € 680 mln (11% of total investment volume).

Residential and BTR developments drove volumes followed by the healthcare segment; the student housing sector is still held back by a lack of up-and-running products, but with a substantial pipeline of FF/FP opportunities in Tier 1 cities.

Milan registered the 76% of total investment volume while Rome registered the first BTR transaction. The source of capital is mainly international (84%).

Several milestone living transactions have been initiated in the last 2 years and refer to future development projects (e.g. Cascina Merlata, MilanoSesto, Sei Milano). Around 6,000 BTR apartments are in pipeline in Milan in the next years.

* Total number of beds divided by the total number of university students

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