

Market report

Italy investment

July 2016



SUMMARY

Investor interest expands to prime high street and alternative assets

■ The Italian economy is on a stable albeit slow recovery path. The economy is still burdened with a fragile banking sector. However, the creation of Atlante, a government backed private rescue fund, is aiming to support investor confidence and to address the NPL issue.

■ The investment market is going from strength to strength with H1 16 totalling over €3.4bn of investment transactions, circa 35% higher compared to the same period last year (excluding Porta Nuova).

■ International funds are taking on an ever more dominant role in the market.

The cross border investment volume accounted for more than half of the total investment volume in H1 16 and close to 65% of the deals. Domestic investors have also increased their activities raising their share from 24% in H1 15 to 34% in H1 16.

■ Prime yields have hit record lows compared to the previous pricing peak in 2007. Nevertheless they compare favourably to the long term government bond yields, which are also at historic low levels.

■ The high street market is dominating the retail scene with the closing of

transactions in primary cities such as Milan, Rome and Florence totalling €505m - a year-on-year increase of 80%.

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 “Prime assets will continue to be under investors' spotlight, while top yields will stabilise after a period of steep compression” Gianni Flammini - Savills Italy

→ Stable outlook for the economy

The outcome of the British referendum on Brexit is causing considerable volatility for the financial markets.

The impact the decision will have on markets (the property investment market in particular) is still unclear and related effects on the Italian economy are difficult to predict at this stage. Despite this, the positive trend of economic recovery has continued into 2016. In line with expectations, GDP grew by 0.3% in Q1, after a 0.2% expansion in Q4 last year, with private consumption stable at 0.3%. Although Q2 information remains mixed, our economists (Oxford Economics) maintain their view that quarterly GDP growth will only slow marginally to 0.2%, before strengthening somewhat in the second half of the year.

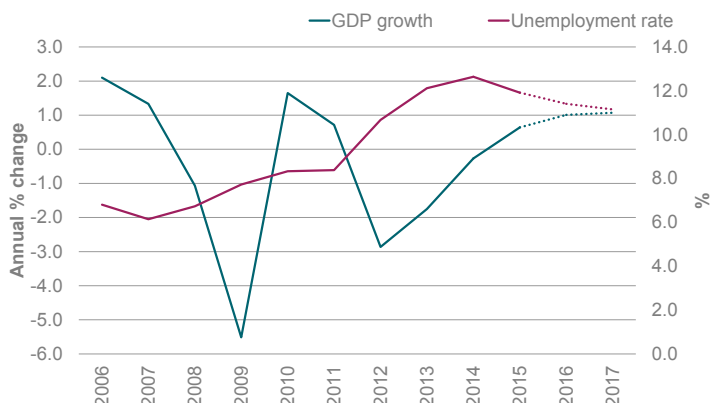
The economy is still burdened with a fragile banking sector characterised by a heavy load of non-performing loans (NPLs), whose gross amount at the end of February tallied almost €200bn. To support the banking sector, the Italian government announced the creation of Atlante, a government-backed private rescue fund. Atlante's capital stock of nearly €4.3bn was provided by a number of banks, insurers, bank-related foundations, as well as by the state-controlled Cassa Depositi e Prestiti bank. The fund will act as a buyer of last resort for unsold shares of distressed banks and will also buy NPLs, with the goal of kick-starting a market for these assets to be assessed whether the fund is large enough given the state of Italy's banking sector.

Eased financing conditions, healthy private consumption sustained by low inflation and stable labour market conditions are supportive to growth. Our economists expect the domestic recovery to continue through 2016 and 2017 and maintain their GDP growth forecast of 1% for 2016 and 1.3% for 2017.

Investment market going from strength to strength

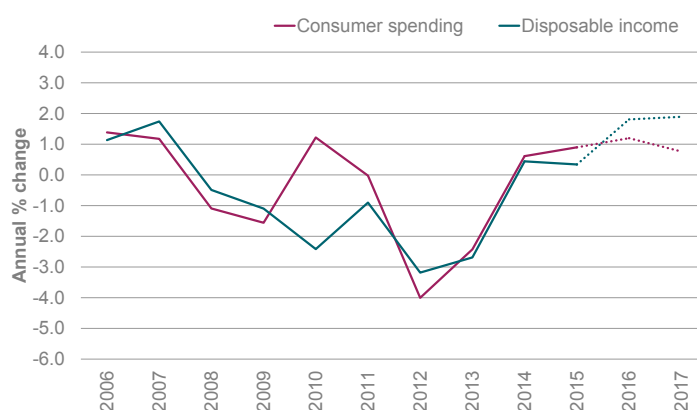
The investment market in Italy is going from strength to strength with the H1 16 investment volume totalling over €3.4bn - circa 35% higher compared to the same period last year.

GRAPH 1
GDP growth and unemployment indicate stable but slow recovery



Graph source: Oxford Economics

GRAPH 2
Private consumption and disposable income domestic demand is improving



Graph source: Oxford Economics

“The government backed rescue fund should stabilise the banking sector” Eri Mitsostergiou, Savills Research

In the first quarter of the year, about €1.7bn of investment transactions were closed including a number of deals that rolled over from 2015. The high volumes of the first quarter have been underpinned by the sale of some prestigious assets, some sold in batches in the form of small portfolios.

In the second quarter, the investment volume totalled €1.7bn with three Milan office buildings representing over €500m of the investment volume. The notable transactions were Via Monterosa 91 which was bought by Axa Reim, Vodafone Village bought by

Coima Sgr and Via Cordusio 2 bought by Hines.

In addition the recent takeover by Antin / Icamap / Borletti of the Grandi Stazioni long leasehold portfolio (14 assets) for a total amount in excess of €950m highlights the fervour in the Italian investment market. The transaction is currently at the final stages. The Antin / Icamap / Borletti group will manage the 14 assets in a long term basis (expiry 2040).

Surge in demand for retail

The office sector is suffering from a lack of product, particularly in the Milan prime market. As a result, investor demand is biased towards strong high streets across the country and prime regional shopping centres. Interest is still strong from investors who are looking into core plus and value add opportunities in good locations in prime and secondary cities.

In H1 16, office sector investments accounted for circa 46% of the activity, circa 40% above H1 15 investment volumes whilst the retail sector represented circa 26% of the total investment volumes.

A notable increase in volumes and share was also recorded in the 'other' or alternative commercial sectors (including hospitality) where volumes in H1 were about €761m capturing 22% of the total. Notable transactions were registered in the clinics sector (eg. San Giuseppe clinic has been bought by Enpam for a lot size in the region of €85m).

In H1 the vast majority of transactions were on a single asset basis, whilst portfolio transactions accounted for 21% of the total, down from 35% in H1 15.

Cross border investment accounts for more than half

The market has been characterised by higher demand from institutional investors for core product since the beginning of the year. As the market becomes more competitive a convergence of buyer and seller expectations underpins activity, although some pricing gaps are still evident for secondary assets.

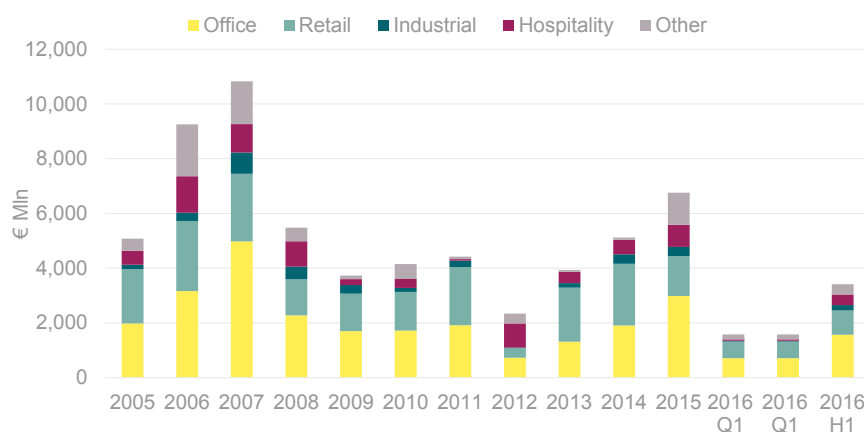
Favourable market conditions are, in part, fuelling the supply of product in the market, through fund liquidations or equity fund investors who are taking advantage of the point of the cycle to dispose selectively some of the most liquid assets in their portfolios.

International funds are taking on an ever more dominant role in the market. The cross border investment volume accounted for more than half of the total investment volume in H1 16 and close to 65% of the deals. The net investment position by source of

GRAPH 3

Commercial investment volumes in Italy

Surge of deals underpinned by the sale of prestigious assets and portfolios

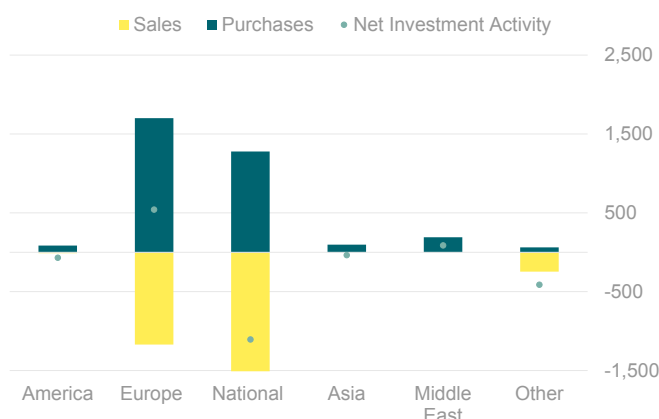


Graph source: Savills

GRAPH 4

Net investment by source of capital in H1 2016

European money accounted for over 50% of the total

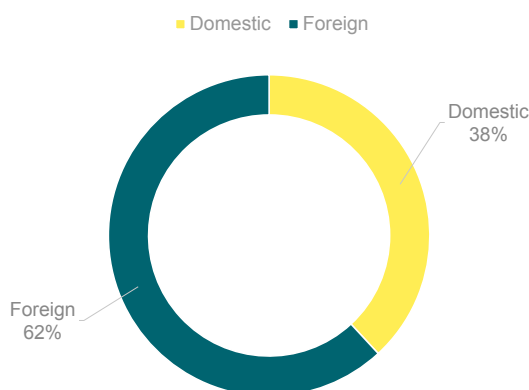


Graph source: Savills

GRAPH 5

Types of investors in H1 2016

International funds are taking on an ever more dominant role in the market



Graph source: Savills

capital highlights the predominance of European money (circa 80% on the total cross border investment). A notable decrease of the share of US money was observed, which accounted for only less than 5% of the total investment compared to 40% in the same period last year. Domestic players increased their activities, circa 35% of the total invested volume compared to 24% in H1 15, showing a gradual return to the investment scene.

Prime yields compressing fast

A material yield tightening has occurred over the past four quarters on some asset classes such as high street assets in primary and secondary cities, prime regional shopping centres and Milan offices, as well in other submarkets. Prime yields have hit record lows, if compared to the previous pricing peak in 2007. Nevertheless they compare favourably to the long term government bond yields, which are also at historic low levels, creating a gap of over 300 bps with average prime commercial property yields.

Office investment market

In the first quarter of 2016 the office sector confirmed its strong position in the Italian real estate market with total office volumes reaching circa €710m, which was 74% higher compared to Q1 15. This data includes some significant transactions such as the completion of the sale of three office buildings in Rome bought by Poste Vita / Zurich through Morgan Stanley for a volume in excess of €200m.

International investors remained the most active during Q1 16 with total invested volumes in the region of €390m. The net investment position by source of capital for the office sector highlights once again the predominance of European money

In the second quarter we registered over €850m pushing the total of the first half of the year at over €1.5bn circa 40% above H1 2015 office investment volumes.

Three major transactions in Milan accounted for circa 60% of the total invested volume in Q2 2016 (see table 1).

The market confirms the focus on core investments such as recently built or

just refurbished buildings, located in prime areas and fully or almost fully rented to "top tier" tenants. However, there are specific market players focusing on higher return investments such as value-add products.

International investors remained the most active during H1 16 with the investment volume totalling around €900m.

The net investment position by source of capital for the office sector highlights the predominance of European money considering the two recent transactions closed by Hines group (on behalf of Bayerische Versorgungskammer - BVK, Germany's largest pension scheme group) in Milan city centre.

Yield compression continued in the first part of 2016 mainly driven by the lack of product with good fundamentals linked to the wide demand from institutional investors.

Milan offices

The Milan office sector remains the powerhouse of the Italian investment market. In the first quarter of 2016 we registered circa €390m accounting for circa 55% of total office investment activity. In the second quarter of 2016, investment volumes in the Milan market confirmed the strong interest from investors with a total volumes in the region of €750m (85% of Q2 office volumes).

The fundamentals of the Milan market

remain positive with stable take up and rents and limited supply of high quality space. This has pushed prime rents up (€490 per sq m/year) over the course of last year and we expect them to remain stable until the end of 2016.

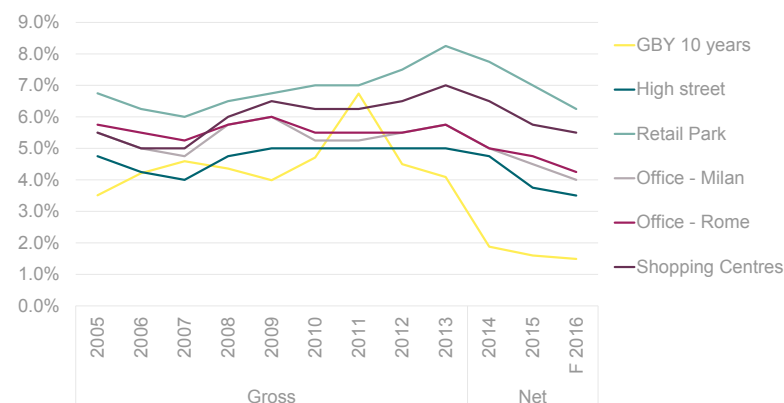
Prime office net yields were at 4.0% in Q2 16, 75bps down from Q2 15 and stable compared to Q1 16. Secondary yields moved in by 25 bps compared to last year and were at 5.0% on average. Prime non-CBD yields were in the region of 6.0%, 50 bps compared to 12 months before.

Rome offices

Despite the general increase of investor interest in the market, transaction volumes remain limited in Rome due to the lack of product, particularly offices. In the first half of 2016 we registered circa €90m of single asset transactions. However, a notable transaction of the first quarter of the year was the completion of a portfolio sale in Rome for a total volume in excess of €200m comprising three trophy assets in the historical city centre. In the second quarter of 2016 investment volumes were just in the region of €25m, but we expect that some opportunities will come into the Roman market with likely closing by year end.

The occupational market is still dominated by the public sector which is slowly consolidating and rationalising, but is not dynamic enough to trigger the development of new office stock, which remains

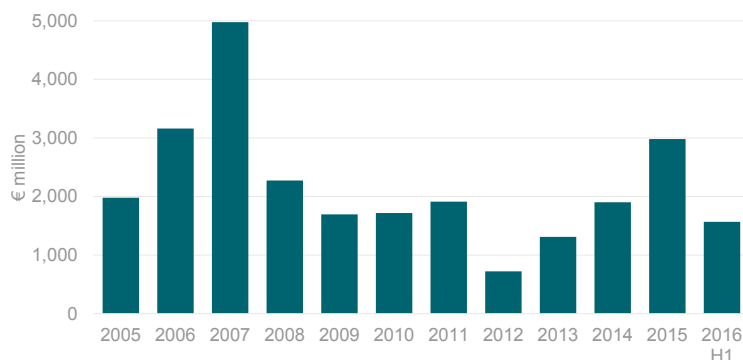
GRAPH 6 Prime yields and government bond yields yield gap is widening



Graph source: Savills

GRAPH 7

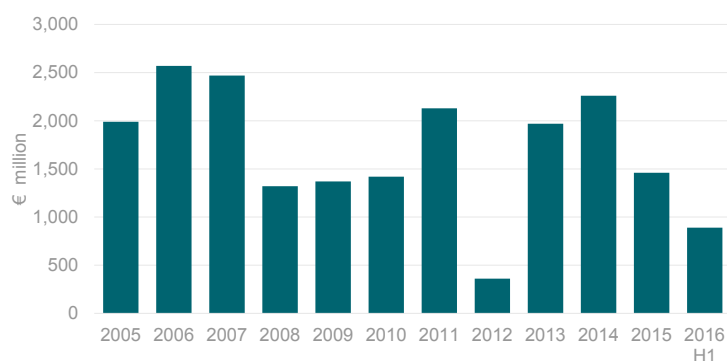
Office volumes invested in Italy H1 16 42% higher than H1 15



Graph source: Savills

GRAPH 8

Retail volumes invested in Italy 40% yoy rise in retail investment in the first half of 2016



Graph source: Savills

scarce. In addition some corporate companies like ENI and Telecom are in the process of rationalising their footprint in Rome.

In Rome prime office yields were at 4.25% in H1 16, 25bps below last year's level.

Retail investment market

Italy is a country with above average household disposable income, and strong tourist flows in some of its biggest cities. Investors continue to show preference in prime retail assets with strong fundamentals. Total retail volumes in Q1 16 reached circa €610m, an increase of over 200% rise compared to the same quarter last year. International investors are the most active players, particularly Europeans, with increasing interest from national players especially for high street products.

In the second quarter of 2016 retail volumes reached over €300m confirming the strong investor appetite for this sector and bringing the total investment volumes for the first half of 2016 in excess of €900m (circa 25% of total investment) with an increase of 40% compared to the same period of 2015.

As per the office sector, yield compression is mainly driven by a scarcity of product and huge demand from property investors for retail assets. We believe that further to the significant inward yield shifts experienced over the past twelve months, prime yields in the sector will stabilise in 2016.

Out-of-town retail investment

Regional shopping centres are a highly sought after product by investors, but few prime opportunities are currently

on the market. The supply of shopping centres is still below the European average and the rate of development completions has been falling over the past four years. Prime rents in the best shopping centres in the Milan region have been rising over the past two years and in Q2 16 were 2% higher compared to the same period last year.

Out of town retail investment volumes have fluctuated significantly over the past few years. The product is generally in high demand by investors but scarcity of product limits transaction volumes. The start of this year has been quite dynamic, as H1 volumes of OOT retail investment have already reached over €400m, exceeding last year's total by 10%.

The first quarter included two significant shopping centre transactions, I Petali in Reggio Emilia (circa €86m) by Tikehau IM and Collestrada shopping centre in Perugia (circa €100m) bought by Eurocommercial. In the second quarter we registered circa €185m including the closing of Meridiana shopping centre bought by Benson Elliott for a total volume in excess of €50m and Meraville retail park sold by Orion Capital for a volume in excess of €100m.

High street retail investment

The high street market is dominating the retail scene with transactions in primary cities such as Milan, Rome and Florence and a total volume in H1 of circa €505m - an increase of about 80% compared to the previous year.

The resilient characteristics of high street properties, with stable and lately rising rents, low vacancy rates and constant demand from retailers make it an attractive asset. The rising interest of institutional investors has been driving deal volumes and yield compression over the past few quarters.

Prime yields have compressed by 100bps in one year and a further 25bps in Q1 16. We believe that this year yields will stabilise in the region of 3.5% in Milan and Rome where they currently stand. Further material yield compression may be experienced in secondary cities as investor interest in the sector broadens.

The **Milan** high street is one of the

Key investment deals and yields by sector

The share of retail investments accounted for 26% of the total in H1 16

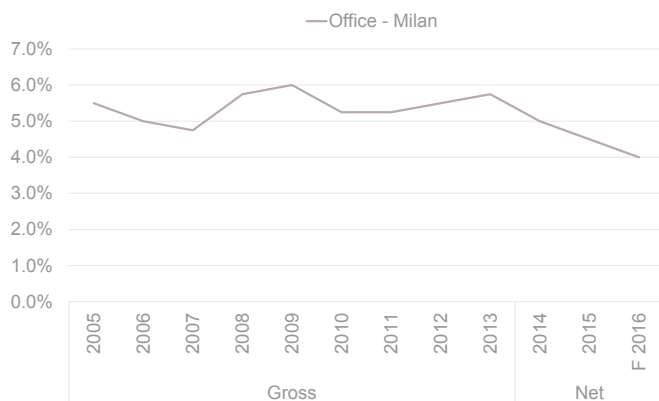
TABLE 1
Office and retail investments Q1 - Q2* 2016

NAME and LOCATION	BUYER	SELLER	APPROX. SALE PRICE (€ MILLION)	SECTOR
Great Beauty - 3 trophy assets, Rome	Poste Vita / Zurich /Morgan Stanley	Unicredit	220	Office
Via Monterosa 91, Milan	AXA IM - Real Assets	Partners Group	220	Office
Vodafone Village1, Milan	Coima Sgr	Gruppo Carminati	200	Office
Via Cordusio 2, Milan	Hines	Sorgente	130	Office
Via Montenapoleone, 15 Milan	Unity RE	IPI	120	Retail
MAC 567; Milan	Deka Immobilien	Doughty Hanson & Co European Real Estate II	115	Office
Collestrada Shopping Centre, Perugia	Eurocommercial	Fabrica SGR	106	Retail
Meraville Retail Park, Bologna	TH Henderson	Orion Capital Managers	> 100	Retail
Via Meravigli 7, Milan	Sofaz	Tecnoholding	97	Office
I Petali Shopping Centre, Reggio Emilia	Tikehau IM	CBRE Global Investors	86	Retail

Graph source: Savills

GRAPH 9

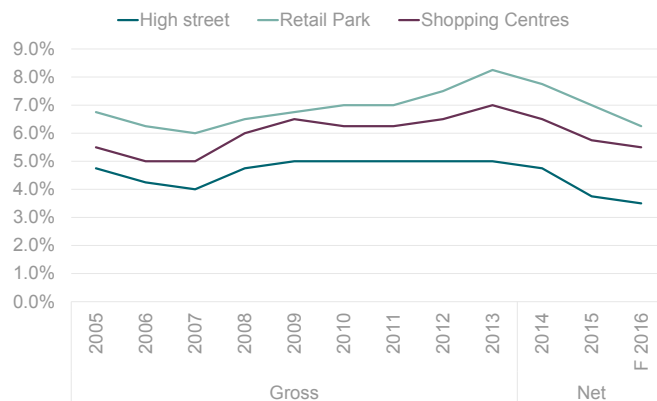
Prime office yields* Milan prime office yields should stabilise this year



Graph source: Savills, *Since Q1 14 yields are quoted net

GRAPH 10

Prime retail yields* Strong demand and tight supply of prime retail leads yield compression



Graph source: Savills, *Since Q1 14 yields are quoted net

TABLE 2
Industrial and Other investments Q1 - Q2* 2016

NAME and LOCATION	BUYER	SELLER	SALE PRICE (€ MILLION)	SECTOR
Hotel St. Regis / The Westin Excelsior, Florence	Jaidah Holdings	Starwood Hotels & Resort	190	Hotels
Ospedale San Giuseppe - Via San Vittore, 12, Milan	Antirion SGR / Enpam	Ente Ecclesiastico Provincia Lombardo Veneta	85	Other
3 logistic assets in Northern / Centre Italy	Prelios SGR (Logita Fund)	Undisclosed Vendor	75	Industrial
57 Telecom Properties	Madison Imperiale Fund managed by Prelios SGR	Meucci Srl	70	Other
Casa di Cura San Pio X, Milan	Humanitas	Fondazione Opera San Camillo	60	Other

Graph source: Savills

“The resilient characteristics of high street retail, with stable or rising rents, low vacancy and high demand is attracting investors” Marco Montosi, Savills Italy Investment

most diverse in Europe with upmarket and luxury brands particularly evident. Local population affluence and high tourist flows support the successful operation of these retailers, confirming Milan's title of the fashion capital of Europe. This makes Milan an attractive destination for international retailers, who, despite the weakness of the Italian economy, have proliferated over the past decade.

Rome, although not as dynamic as Milan, is mainly supported by high tourist flows and demand from international retailers to enter the market is high.

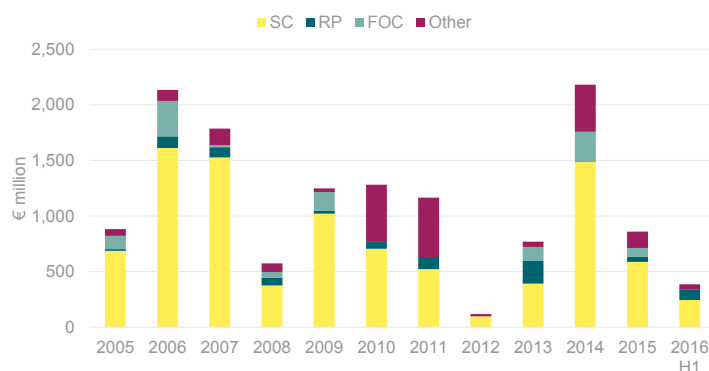
Venice and Florence, as Tier 1

touristic destinations are highly sought after. Investment appetite for such destinations, especially from European Institutional Investors, is as strong as Milan and Rome.

High street product in secondary cities such as **Bologna** and **Turin** is also experiencing growing interest from Institutional market players. Lower competition and higher returns compared to corresponding prime locations in primary cities, are attracting international investors such as German investors, who have dedicated investment vehicles for these kind of opportunities. ■

GRAPH 11

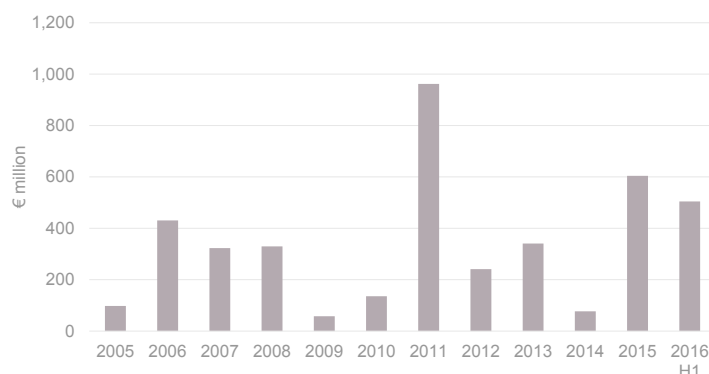
OOT retail investment volumes Scarcity of OOT retail product limits investment volumes



Graph source: Savills

GRAPH 12

High street investment volumes Investor demand is biased towards the best high streets across the country



Graph source: Savills

OUTLOOK

Steady demand for prime assets

■ Despite the effects of Brexit on Italian CRE being unclear, the general outlook for 2016 is positive as a growing number of investors are confident about the economic recovery in Italy. Investors are attracted by better returns, the devaluation of the euro, interest rates at historic lows and larger liquidity in circulation thanks to the banks' expansive policies.

■ The creation by the government of the private rescue fund Atlante should speed up the deleveraging process of the banking sector, restore confidence in the system and create a market for non-performing loans for investors who are interested in this type of product.

■ We believe that investment demand for the remainder of the year will continue to be driven by European investors, however, we also envisage national investors' buying activity to strengthen further.

■ Supply of product should increase as funds will take advantage of the improving market conditions, particularly the ones that purchased in the low point of the cycle in 2011-2012.

■ Prime locations of major Italian cities are most likely to benefit from this trend, while top yields for the best office and retail assets in Milan and Rome could stabilise this year following a few quarters of steep yield compression.

■ We believe that with government bond yields further decreasing and the gap with prime real estate widening, the attractiveness of the commercial real estate sector will be sustained.

“Prime yields have hit record lows but still compare favourably to the historic low long term government bond yields”
Marco Montosi, Savills Italy Investment

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