ITALIAN REAL ESTATE MARKET: H1 2018

AUGUST 2018

Overview H1 2018

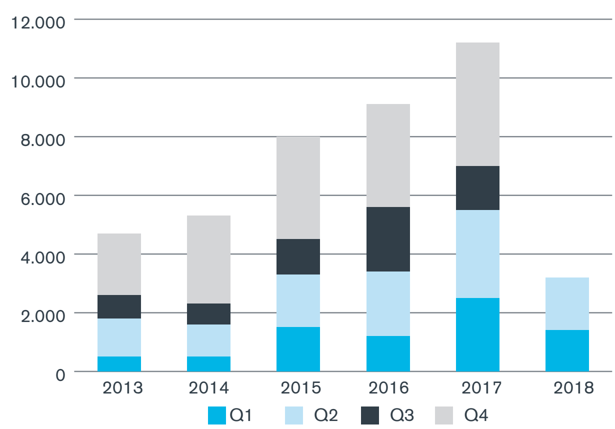
MACROECONOMIC OVERVIEW

In the first half of 2018, the Italian Gross Domestic Product (GDP) recorded positive but fragile results. Exports and investments decreased and as a result private consumption slowed. Positive signs of recovery are highlighted by the Organization for Economic Co-operation and Development (OECD) reporting that the Italian employment rate reached 58%, close to its historical peak. However, Italy still has one of the lowest employment rates among the OECD countries. Large deals recorded in the secondary market coupled with effective polices applied to the banking system led the stock of Non-Performing Loans (NPL) to decline to 20%, compared to the peak recorded during the crisis (341bln of euro of Non Performing Loans in 2015). In addition, the development of structural, social and fiscal policies useful for tackling regional and social divides will be fundamental for supporting the country's macroeconomic growth.

INVESTMENTS

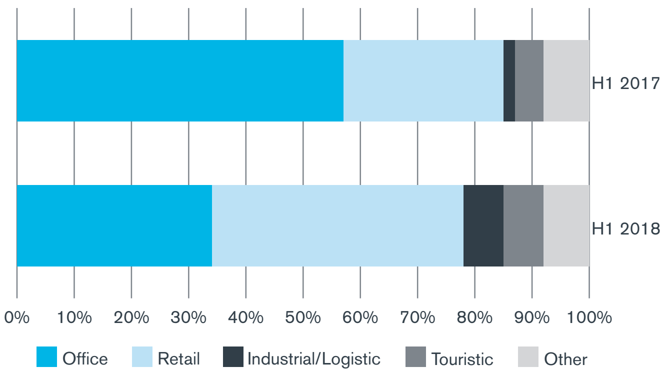
The slowed growth rate of macroeconomic indicators reflects the Italian real estate market trend, even if it follows the West European area dynamics. With the increase of volume in investments since the start of the crisis, 2017 was a peak year for national real estate. In this sense, the slowdown recorded in the first six months of 2018 was inevitable. The main difference between the current decrease of investments and the downturn recorded in 2012-13 is related to the nature of influencing factors. During the crisis the decline in investments was related to financial threats of real estate players, whereas in the first half of 2018 the decline in investments is due to the lack of attractive products. In other words, demand is actually lagging as investors are waiting for value add opportunities and new developments and/or refurbishments.

Real Estate investments in Italy



Duff & Phelps REAG R&D on various sources

Real Estate investments by asset class



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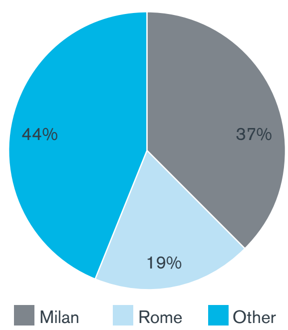
Investments by location (mln of euro).



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MARKET HIGHLIGHT

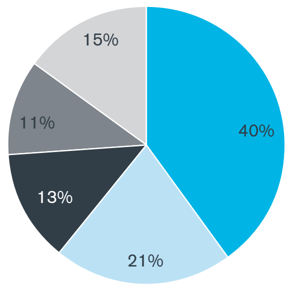
According to Institutional sources some of the key drivers of housing refurbishments and private construction investments allocated in new non-residential buildings are fiscal incentives and positive sentiment in the Italian real estate market. In the first half of 2017, the number of building permits increased by 11.7% compared to the same period of 2016, supporting the relaunch of construction of new residential spaces. Finally, the development of public buildings and infrastructure projects are still struggling to receive funding from the Italian public authorities.

In the first half of 2018, real estate investments in Italy were 3.2 billion euro, a decrease of 42% compared to the first half to 2017. However, despite the decrease, the volume of deals is above average compared to the first half of the last five years.

The main reason for the decrease of investments is related to a generally expected adjustment of the market after the exceptional results of 2017. Office building transactions were the most affected by this slow-down trend due to both the lack of value-added buildings and investors' desire to wait for the conclusion of new building developments and/or refurbishments in the most attractive cities: Milan and Rome. The commonality between real estate developments in Milan, the gateway city, and Rome, the capital, is the regeneration of brownfield and peripherical urban areas. The decrease of investments in the historically most attractive asset class has highlighted deals in other areas such as the retail and tourism sectors, which are both driven by e-commerce.

Some exogenous factors could explain this phenomenon: according to official sources[2], the positive trend of tourism recorded in 2017 will continue and foreign visitors will increase in both primary and secondary heritage cities (e.g. Catania, Palermo, Venice and Rome). In this scenario, we expect an increase in the demand for high-quality accommodation as well as retail spaces in high streets and shopping centres in the main cities.

Origin of foreign investors (mln of euro)



Duff & Phelps REAG R&D on RCA data

The diversification of deals by asset class has influenced the location of investments. Rome and Milan remain the most attractive cities (37% and 19% of the country's total transactions, respectively). Foreign investors lead the way with 60% of the total volume of investments.

In the second half of 2018 there will be a number of players taking a "wait and see" approach before investing in the Italian real estate market.

KEY DRIVERS

- Portfolio diversification
- Fintech, digital economy and digital society
- Industry 4.0
- New housing solutions (senior/student housing, short-term rentals, apartments, condos, hotels, etc.)
- Brownfield

	Office		Retail: high streets		Logistics	
	Prime rents (€/sqm/year)	Prime gross yields (%)	Prime top rents (€/sqm/year)	Prime gross yields (%)	Prime rents (€/sqm/year)	Prime gross yields (%)
Milan	500 - 600	4.0 - 4,4	8,000 - 11,000	3.2 - 3.5	50 - 60	6.5 - 6.7
Rome	400 - 500	4.5 - 5.0	8,000 - 11,000	3.5 - 3.8	45 - 55	6.6 - 7.0
Turin	250 - 300	5.8 - 6.4	3,500 - 4,500	4.0 - 4.4	45 - 50	7.3 - 7.8
Venice	375 - 425	5.0 - 5.5	5,000 - 5,500	3.5 - 3.8	n.a.	n.a.
Bologna	250 - 300	5.6 - 6.2	4,000 - 5,000	4.0 - 4.4	50 - 55	6.6 - 7.2
Florence	350 - 400	5.0 - 5.5	7,500 - 8,500	3.5 - 3.8	55 - 60	6.8 - 7.4
Napes	275 - 325	6.2 - 6.8	2,500 - 3,500	5.0 - 5.5	40 - 50	7.5 - 8.0
Bari	200 - 300	6.2 - 6.8	1,500 - 2,500	5.2 - 5.7	40 - 45	7.8 - 8.5

Please note that the above data refers to top locations. Rent and gross yield reported are maximum and minimum values of each market respectively.

Elaboration on Duff & Phelps REAG internal sources.

[1] Associazione Nazionale Costruttori Edili (ANCE)

[2] Italian National Institute of Statistics (ISTAT)

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