Italian Spotlight – H1 2023

SPOTLIGHT

Savills Research

Italian Investment Market

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After the slowdown in Q1 2023, deceleration continues in the second quarter

Highlights

- The first semester of 2023 recorded an expected slowdown in terms of investment volumes
- Uncertainty related to the macroeconomic environment and rising financing costs have slowed down investment activity
- Living sector took the lion's share thanks to its strong fundamentals
- The logistics sector was the most dynamic of the semester with 29 deals
- Office sector gained the 3rd place, contributing to 17% of volumes
- 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 small size transactions and secondary locations
- ESG factors will become increasingly relevant for both investors and occupiers
- Price adjustment is expected through all 2023 and will be followed by a stabilisation next 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

H1 2023 KPIs

TOTAL INVESTMENT VOLUMES
2.2 bln €
-64% YoY

NUMER OF DEALS
107
-9 YoY

SOURCE OF CAPITAL
59% foreign

GEOGRAPHIES
49% regional markets/ mixed portfolios

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
6.75%
+85 bps YoY

Macro-economic Outlook

The global scenario is still dominated by uncertainty, with economic growth slowing down this year due to worsening of financial conditions. Continuing price pressures and labour market rigidity postpone the end of the tight monetary policy. Italy economic trend remains positive despite a gradual deceleration. Sticky inflation and rising interest rates are holding back consumption and investments.

In June, inflation continued to contract (+6.4%), mainly thanks to energetic product and processed food prices. Core inflation slowed down at +5.6% and also the ‘shopping trolley’ inflation (10.7%) decreased. 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 rapidly declined to record lows in Q4 2022 (5.3%), followed by a slight improve in Q1 2023 (7.6%). The growth in households’ disposable income (+8.2% YoY), together with the continue growth in consumer prices, led to a further decrease in purchasing power (-0.3%). The resilience of final consumption expenditure (+12.2%) was therefore offset by the decline in the savings rate.

In June, the consumer confidence index improved for the second month in a row, while business sentiment slightly decreased, driven by manufacturing and, to a lesser extent, by retail trade.

According to Oxford Economics, Italian GDP is forecasted to register an increase of 1.2% in 2023 thanks to falling gas prices and growth in services. Inflation is projected to remain high for long. Accordingly, a reversal of monetary policy is unlikely at least for the next 12 months.

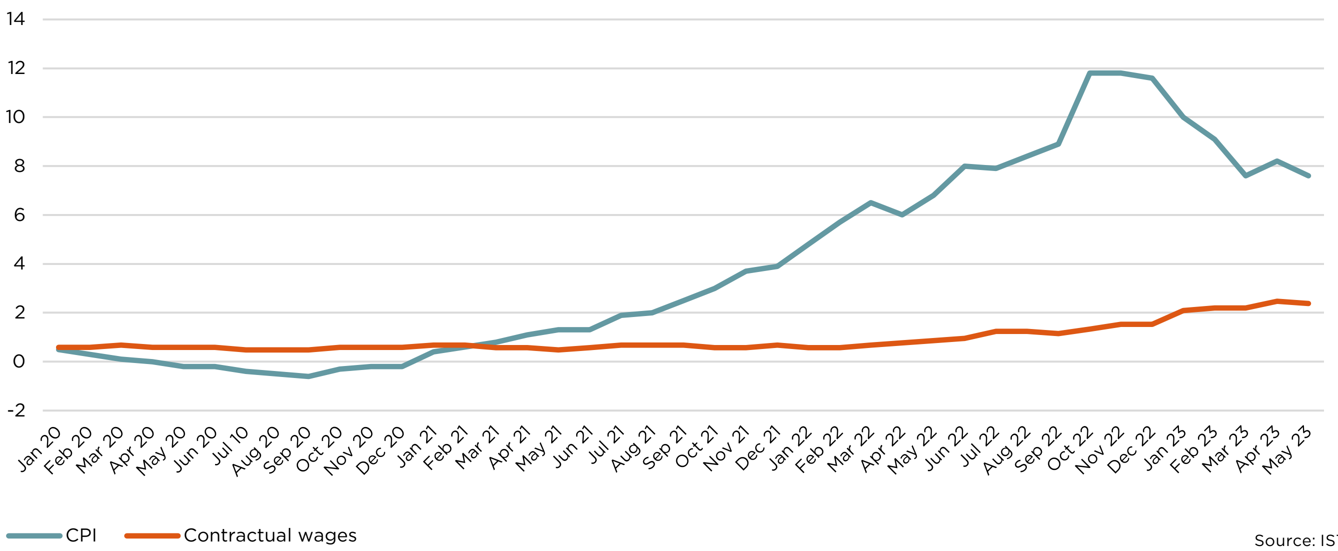
GDP
+1.9% YoY
(Q1 2023)

UNEMPLOYMENT RATE
7.6% (-48 bps YoY)
(May 2023)

CPI
+6.4% YoY
(June 2023)

GOVERNMENT BOND YIELDS 10 YEARS
4.31% (+132 bps YoY)
(May 2023)

CPI and wages (% YoY)



Source: ISTAT

Commercial Real Estate Investment Market

In H1 2023, around € 2.2 bln was invested in the Italian commercial real estate market, registering a 64% 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 107 deals closed in the first semester compared to a five-year average of 79, however the average volume per deal decreased with a prevalence of transactions below € 50 mln.

Despite the period of uncertainty, international currency continues to prevail (59%), a sign that the Italian market remains competitive.

In terms of geographies, Milan confirmed to be the preferred destination, registering 38% of the investment volume, followed by Rome (13%). Thanks to the positive trend of logistics and hospitality sectors, the other Italian cities accounted for 49%.

Strong fundamentals sustained the living & healthcare sectors; for the first time in our market, this emerged as the first asset class by investment volume. Volumes are mainly driven by the residential and healthcare segments.

Logistics confirmed its relevance in the Italian panorama, representing around 26% of total investments, underpinned by a strong leasing demand, low vacancy and increasing rents.

With around € 370 mln, office investment volumes are significantly declining despite a market that remains dynamic on the occupier side. The sector's pipeline is positive, but investor interest is dampened by concerns about new hybrid working models.

Hospitality continued to perform well, reaching the 4th place by investment volume in H1 2023. The share of investments linked to resorts and leisure destinations such as Sardinia and the lakes is growing.

In H1 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 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 followed by a stabilisation in Q2.

Investment volumes

LIVING
620 mln €
-13% YoY

LOGISTICS
570 mln €
-68% YoY

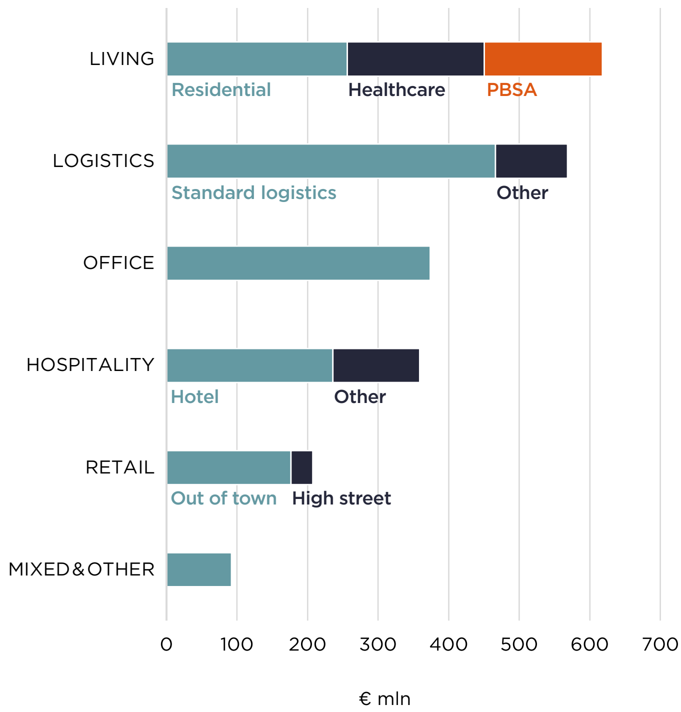
OFFICE
370 mln €
-83% YoY

HOSPITALITY
360 mln €
-55% YoY

RETAIL
210 mln €
-49% YoY

MIXED & OTHER
90 mln €
-63% YoY

Total investment volume H1 2023



Market Outlook

Investment activity is slowing as yields adjust in the current challenging scenario. The price discovery phase is continuing and will be followed by a stabilisation in 2024. The stabilisation of interest rates and costs and the easing of inflation's expectation, 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 values similar to the current ones for a long time. 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 proven to have solid fundamentals; selected office products, with returns in line with current financing and risk-free rationales, will remain in investors' focus. In terms of geography, we expect a growing market share in regional markets, thanks mainly to logistics and hospitality, but also to the living sector.

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 selected products in the office segment. There is a pick-up in transaction activity but a lively market recovery is postponed until 2024, when rates will stabilise.

Office

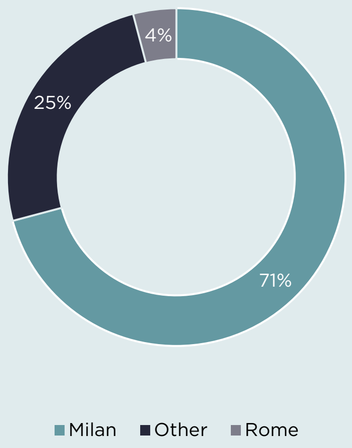
After the outstanding result achieved in 2022, office volumes slowed down in H1 2023, reaching € 370 mln, a figure down both on the previous semester (-83%) and on the last H1 5 years average (-76%). The number of transactions also decreased: 19 deals were recorded, all below € 100 mln, with market comparatively liquid up to a volume of about € 50 mln, beyond which only two transactions have taken place in the semester.

Milan confirmed to be the first investors' target but to a lesser extent than the recent years' trend. In the six-month period, 10 properties located in both central and peripheral areas of the city were sold, for a total of € 260 mln.

Secondary locations such as Torino, Reggio Emilia and Napoli characterized the half year activity, collecting 6 transactions for a total of circa € 70 mln.

Office take-up in Milan recorded approximately 180,000 sqm in the first semester of 2023, confirming the expected slowdown in leasing activity (-29% YoY). This decline is mainly ascribable to a shortage in grade A product that, coupled with a strong demand for Grade A assets and a tight availability, supported prime rents' increase over the last 12 months (+4% YoY).

H1 2023 Investments by geography



Logistics

The sector remained central to investors' strategies also in the first semester of 2023, being the second in terms of volumes and the most dynamic in the Italian scenario. The deals amounted to 29 and were characterized by small size: two-thirds were below €20 mln and none exceeded €100 mln.

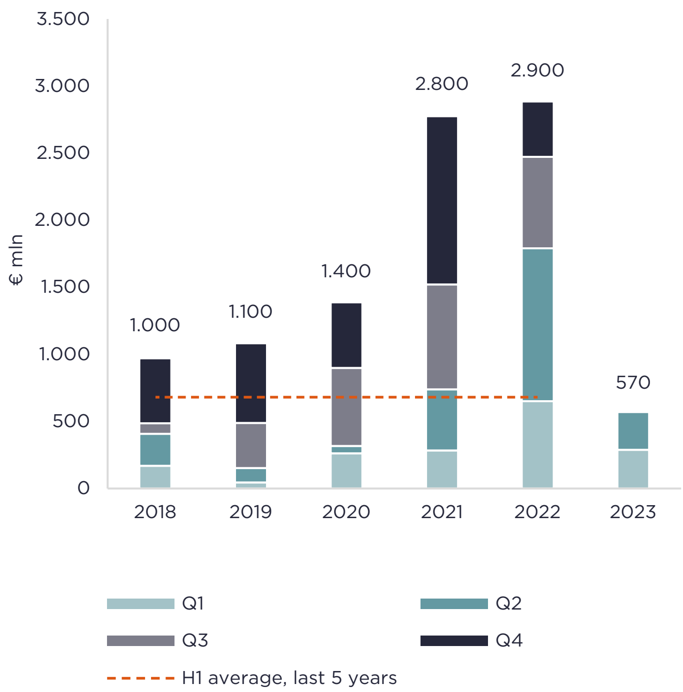
Volumes slowed down reaching €570 mln, a figure down comparing both to the same period of the previous year (-68%) and to the H1 last 5 years average (-16%).

The north continues to be the preferred destination, with Milan and Bergamo-Brescia in the forefront.

On the leasing side, the market reached brilliant results in the semester with around 1.5 million sqm leased, a figure in line with the record level of H1 2022. The number of operations was also high (83), with mainly medium-sized transactions (10,000-30,000 sqm).

Interest in the sector persists, and this is reflected in the number of investment deals and in a new record high take-up. The limited availability of space is encouraging new developments and supporting higher rents in the future.

Investment volume



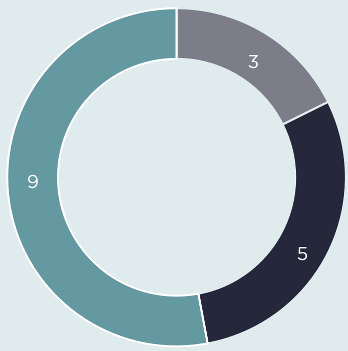
Hospitality

Tourism flows are rapidly recovering after the easing of Covid restrictions. Number of tourists (provisional data) increased by 27% in the first 4 months of the year compared to one year before and is just 8% down compared to the pre-Covid level. Number of overnight stays looks positive too, almost in line with 2019 figures and accompanied by an upsurge of ADR and RevPar.

In the last semester, the sector collected around € 370 mln, a figure 55% down YoY but justified by the absence of trophy assets in the market. The attention paid to the sector remains elevated: the semester recorded 17 deals, 8 of which involved re-developments of existing assets; a signal of the high interest paid by operators to enter or establish in the Italian market.

In the semester, Rome and Milan represented the most active locations, each recording 3 deals, while in the South and Islands two operations were closed. International capitals still dominate the market, characterizing more than 90% of half-year volumes.

H1 2023 number of deals by asset type



Retail

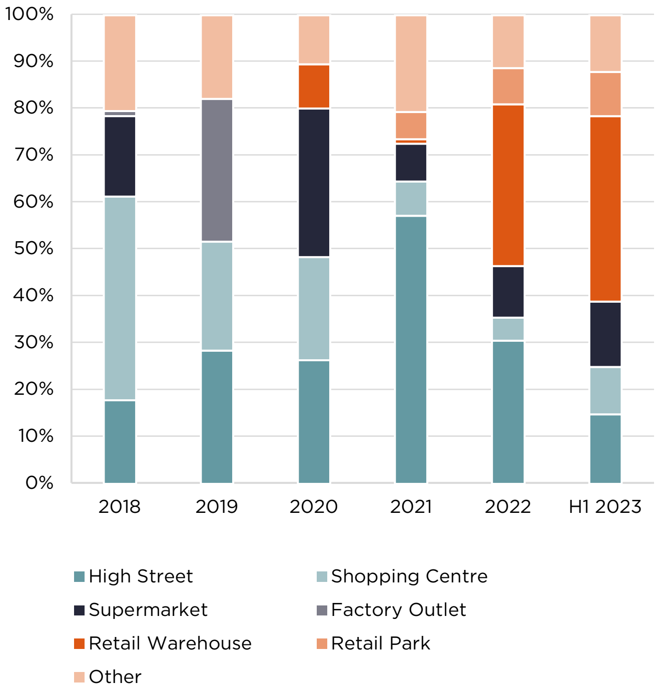
Volumes invested in the sector remained low also in the first semester of 2023 with around € 210 mln recorded, a figure 49% down YoY. The presence of national capitals is still high, representing circa 80% of the half-year volumes.

Out of town attracted mostly of the investments reaching € 180 mln across 13 deals. The retail warehouse segment was the most buoyant, thanks to the closing of a € 70 mln portfolio which represented the largest deal of the semester. Smaller size operations involved the selling of two shopping centers and three supermarkets.

The high street recorded instead only 15% of the half yearly volumes, with the average size falling below €10 mln. Milan remains the most targeted destination followed by Rome.

Over the last 12 months, prime yield decompressed for all the products. Retail park increased by 100 bps YoY, shopping centers by 85 bps and high street just by 25 bps. Another surge could occur by the end of the year.

Investment volume by segment



Living & Healthcare

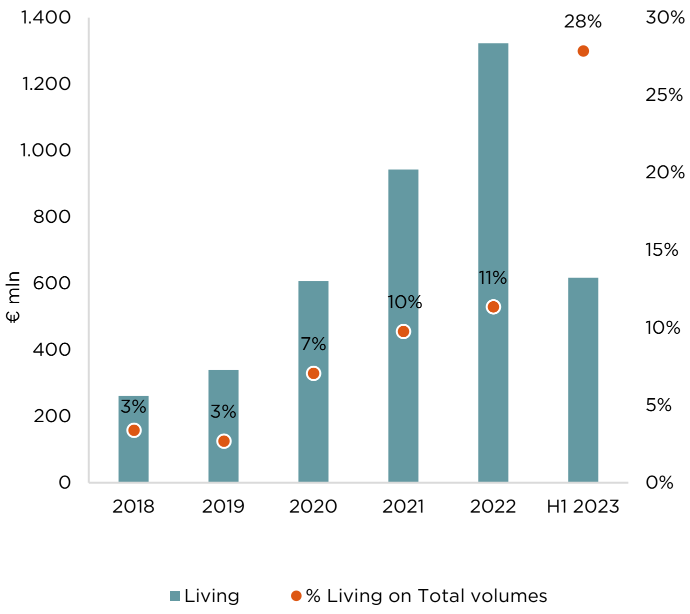
Living sector represented the first sector in terms of investment volumes in the semester with € 610 mln, attracting 28% of the total. The weight of the sector continues to grow and with this result a new record high has been reached. Moreover, volumes increased by 72% compared to the last H1 5 years average.

All the segments contributed to this brilliant result, especially the residential with around € 260 mln, comprising various products such as build to rent, build to sell, development projects, social housing and senior living solutions. Milan and Rome represented the main destinations, but regional markets are starting to attract investors' interest.

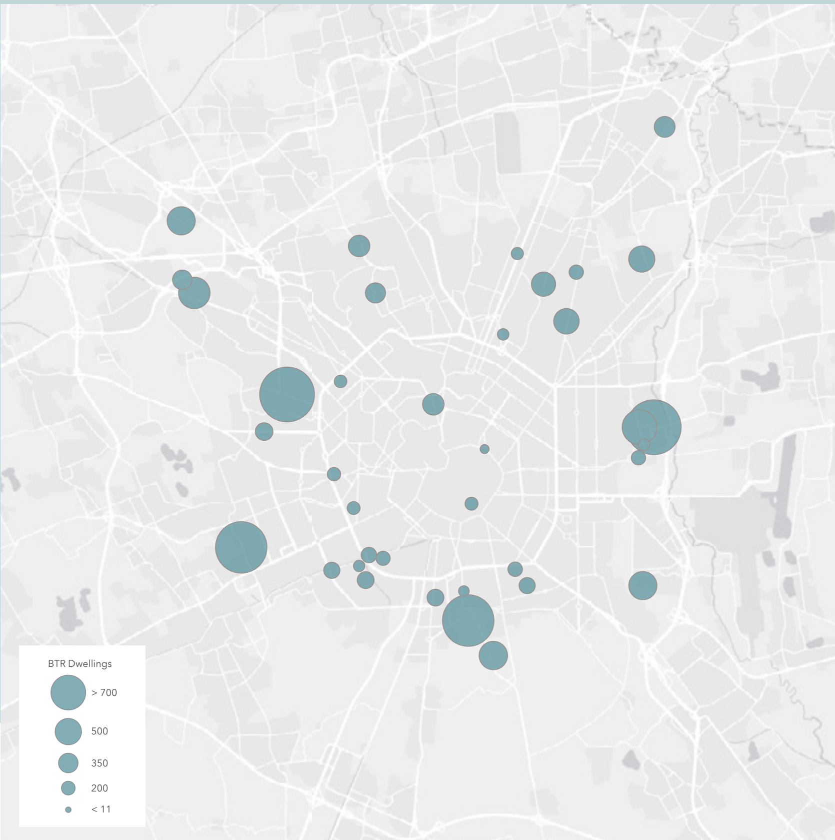
The healthcare performed well too, reaching around € 200 mln across 4 transactions, one of which was a large portfolio deal. There was a growing focus not only on care home facilities, but also on clinics.

Student housing represents the segment which consolidated the most and where we are beginning to register transactions of income producing products. Half year volumes were driven by a deal in Milan of more than € 100 mln, the highest of all sectors.

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



Milan, build to rent main projects in pipeline



The build to rent sector is establishing itself on the Italian scene now that we are starting to see the first completed constructions. Demand for high quality rental accommodation is increasing, driven by rising house prices, urbanisation and changing consumer preferences. It diversifies into different types of solutions, such as short rent, co-living, micro living social housing and senior living.

Build to rent projects are various and located across Italy, but especially in the city of Milan, where more than 80% of beds in pipeline are placed. Here, a total of 35 projects have been identified and expected to be completed by the end of 2026; more than 7,000 dwellings will be provided to the actual offer.

Investors are predominantly international and aim to develop a fresh offer enriched with amenities and embedded in a new urban regeneration scheme.

Savills Team

Please contact us for further information

Angus Potterton
CEO Italy
+39 348 8089136
angus.potterton@savills.it

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

Giacomo De Feo
Director,
Investment
+39 02 632814748
gdefeo@savills.it

Carlo Walder
Director,
Head of Industrial & Logistics
+39 349 9777787
carlo.walder@savills.it

Dario Leone
Director,
Head of Hospitality & Leisure
+39 335 5834151
dario.leone@savills.it

Eros Chiodoni
Director,
Head of Office Leasing
+39 349 4570599
eros.chiodoni@savills.it

Elena Zanlorenzi
Head of Research
+39 340 7701607
elena.zanlorenzi@savills.it

Manuela Nitti
Research Associate
+39 340 4773859
manuela.nitti@savills.it