July, 2023

Office snapshot

Q2 2023 – Market Overview

Milan and Rome, Italy

Table of content

1. Our Key Takeaways

The Italian economy is expected to grow by 0.9% in 2023

1

The Italian economy posted a GDP growth of **0.6%** in **Q1 2023**, mainly driven by consumption and domestic demand. This was an improvement from the -0.1% fall in Q4 2022. Looking ahead, latest market projections indicate an average GDP growth of **+0.9%** in 2023.

Investors are prudent but Italian office market fundamentals remain solid

2

Office investments recorded a significant slowdown in H1 2023 across Emea. This trend has been exacerbated by a **wait-and see approach** and weak global sentiment driven by post-pandemic structural shifts in the way of working. Despite challenging economic conditions, Italian office market fundamentals remain solid, with **high return to the office rates** compared to other markets.

Office occupiers' demand still high in Milan and Rome

3

In H1 2023 Rome reached a new record in terms of office take-up (+95% YoY). Milan recorded a slowdown after a very good performance in 2022, but with a positive variation QoQ in Q2 2023 (+7%). Occupiers' demand is still high in both cities with an increasing focus on sustainability.

2. The Italian Economy

The Italian economy held up well so far despite high global uncertainty : projections indicate an average GDP growth of +0.9% in 2023.

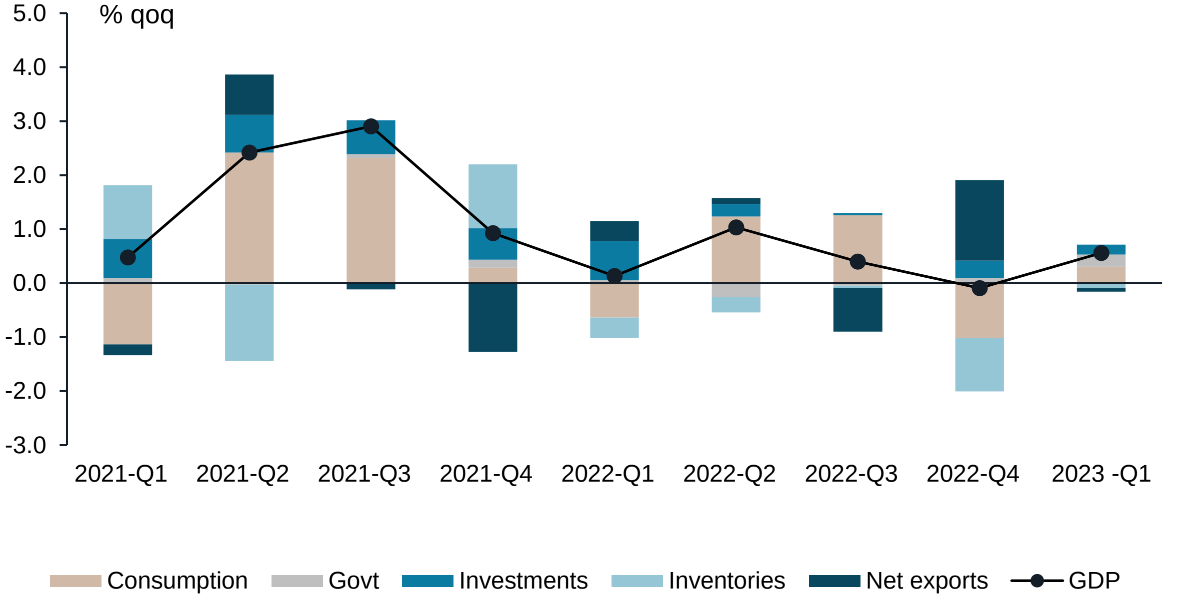
The Italian economy posted a GDP growth of **0.6%** in **Q1 2023**, mainly driven by consumption and domestic demand. This was an improvement from the -0.1% fall in Q4 2022.

The impact of high inflation and interest rates persists, but there are a few signals that overall, economic conditions are on an improving trend: **Inflation** remains very high by historic standards, but it has peaked and is now falling quickly; **commodity prices** have fallen, supply chain disruption and costs have eased; **Interest rate** tightening cycle is drawing to an end.

Looking ahead, Q2 data could be impacted by the continued weakness in the manufacturing PMI – Italian industry despite the continued resilience in more services-oriented sectors.

Having said this, latest market projections indicate an average GDP growth of **+0.9%** in 2023.

Contribution to GDP growth QoQ %

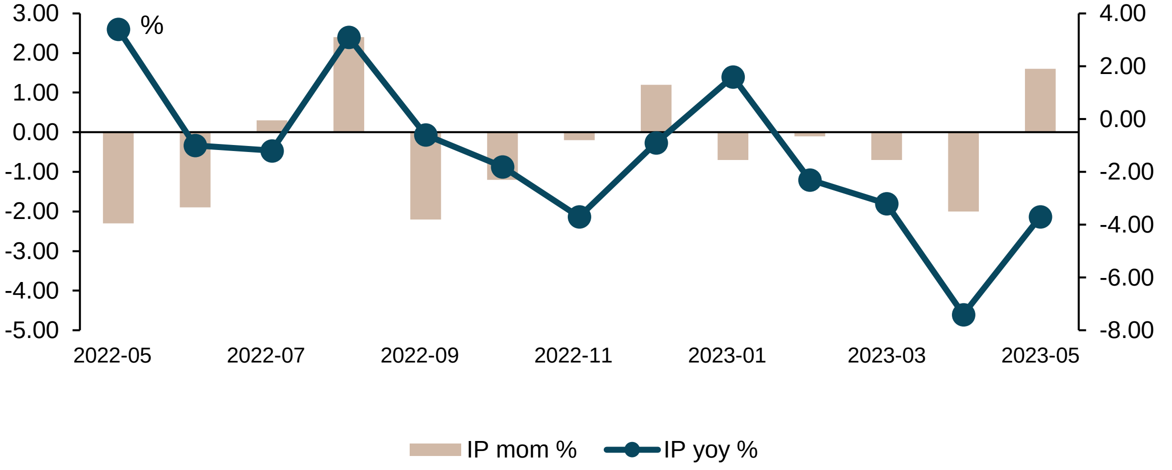


Source: JLL Research elaborations on ISTAT data

Industrial production in **May** posted a seasonally-adjusted increase of **+1.6% MoM** (-3.7% YoY on a calendar adjusted basis).

The change of the average industrial production over the last three months versus the previous three months was -1.8%.

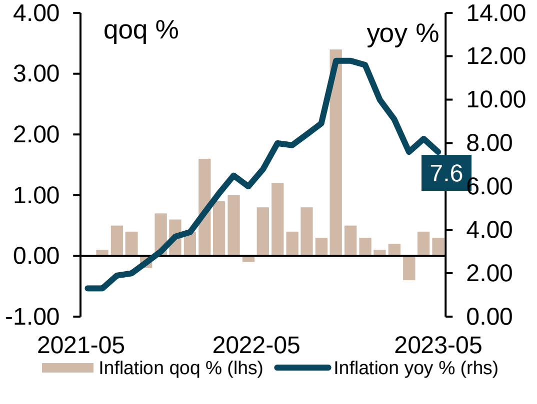
Industrial Production - May 2022 to May 2023



Source: JLL Research elaborations on ISTAT data.
Note: seasonally-adjusted qoq data; calendar-adjusted yoy data

Annualized headline **inflation** (HICP) reached **7.6% in May** (down from 8.2% in April). Looking ahead, headline inflation should continue to decline throughout the year. Core inflation, however, will take longer before it starts to come down, despite recent developments in the energy market.

Inflation - May 2021 to May 2023



Source: JLL elaborations on ISTAT data.

Forecasts (Italy)	2023F	2024F
Gross Domestic Product	0.9	0.8
Industrial Production	-2.0	3.0
Consumer Prices (%)	5.8	2.0
Govt Balance (% GDP)	-4.9	-3.2
10yr govt bond yield (% EOP)	4.0	3.9

Source: Oxford Economics as of 27th July 2023.
Data: annual percentage changes unless specified.

3. The Office Capital Markets

From the **capital markets** standpoint, the **office** sector in the **first half of 2023** recorded **€18.6 Bn** in **EMEA**, -62% YoY, in line with the overall market which was down by 54%. Continued inflationary pressure and further interest rate rises have prolonged the slowdown in transactional activity. Weak global sentiment around the office sector has exacerbated this despite sustained performance in European occupational markets.

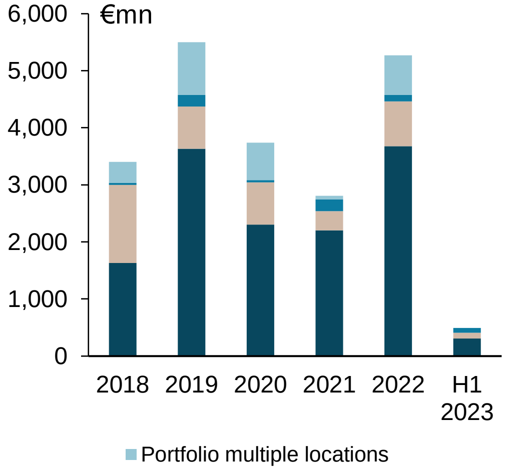
In Italy, 21 **office investment** deals amounting to approximately **€500Mn*** were recorded in H1 2023, with a **-80% YoY** contraction. The relatively sharp drop of the Italian market volumes is partly explained by the record performance during H1 2022 (€2.5 Bn). In addition, Q2 data showed increasing volumes QoQ with offices again the first asset class in terms of overall capital markets investment volumes.

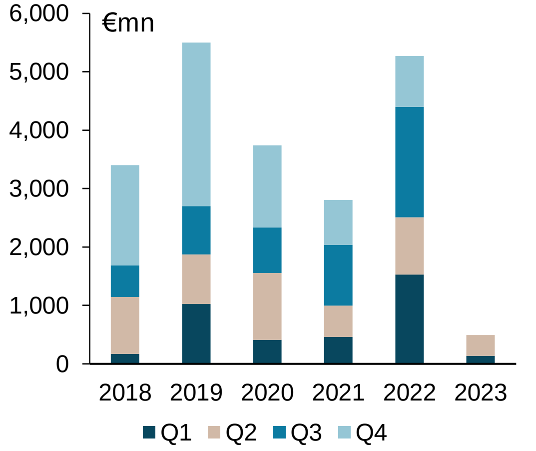
In terms of **risk profile**, in the Italian market the preferred investment strategy was **Core** accounting for around 47% of total volumes. This was due also to the relative size of a single core asset transaction in Milan CBD of around € 90 Mn. It's also worth mentioning that around 17% of total volumes that were invested in offices aimed at changing the use designation of the buildings to other uses, including the living / residential and the hospitality sector.

Milan remains the preferred destination, attracting approximately **€300 Mn** volumes (62% of the total) spanned across 10 deals, located in both the central and peripheral areas of the city. **Rome** follows through by recording 5 deals and around **€100 Mn** (some 20% of the total). Some other €88m (18% of the total) were recorded in other locations, predominantly single asset deals.

Prime yields in Q2 2023 increased by +10 bps in Milan (4.00%) and Rome (4.25%) compared to Q1 2023. Prime yields maintained a competitive position compared to other prime European cities that generally have experienced a higher yield decompression. This is also due to an active basket of private buyers, that being in most of the cases equity buyer, can actually compete with institutional investors in this market environment.

Office Investment Volumes





Source: JLL Research elaborations
**Aedes delisting share deal office portion included*

The Key Numbers H1 2023

Milan

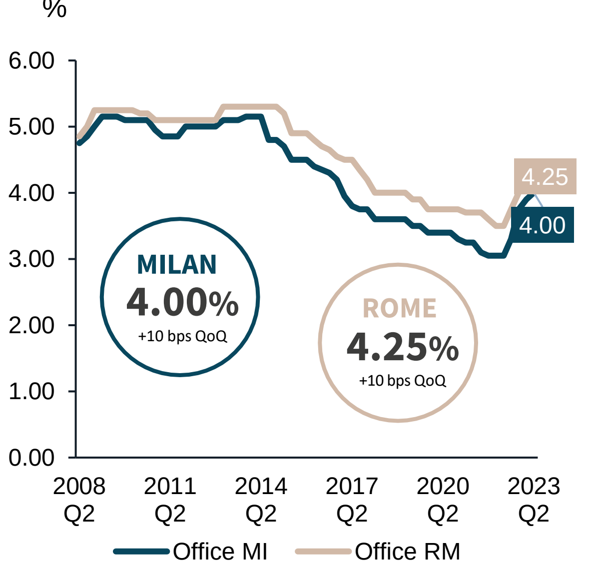
Investment volume	**€0.3 Bn**
N° of deals	**10**
Single asset deals	**9**
Deals between €50 - €100m	**2**
Average ticket size	**€31 m**

Rome

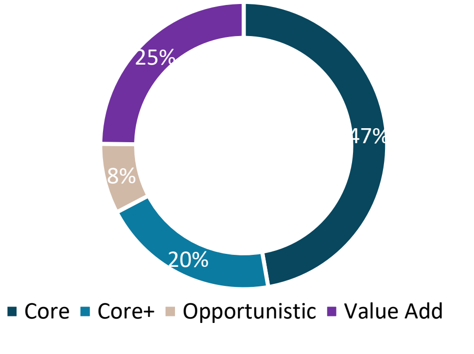
Investment volume	**€0.1 Bn**
N° of deals	**5**
Single asset deals	**4**
Deals between €50 - €100m	**0**
Average ticket size	**€19 m**

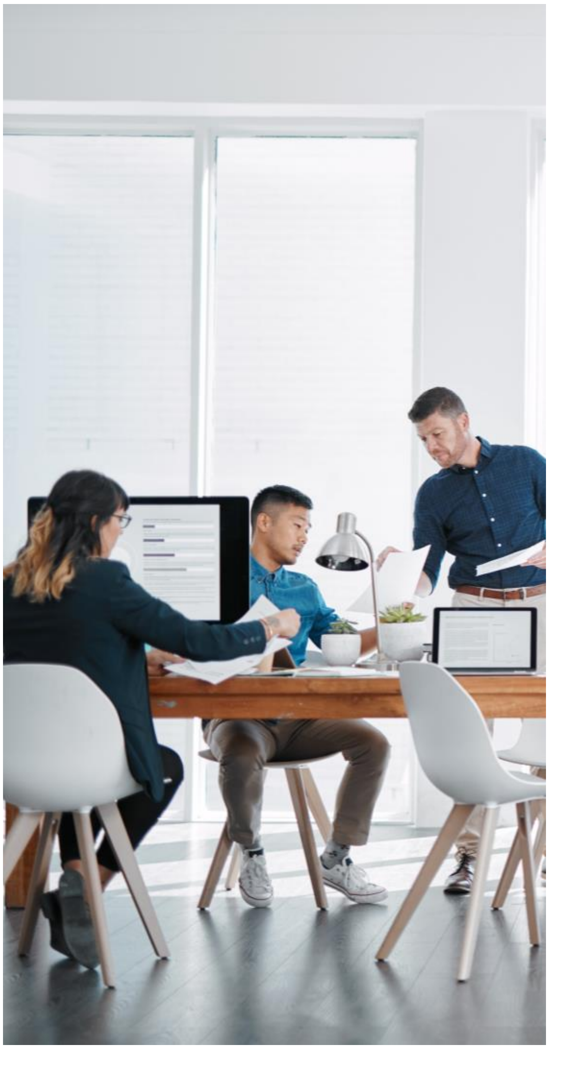
Source: JLL Research elaborations

Office Prime yields as of Q2 2023



Office Investments by risk profile





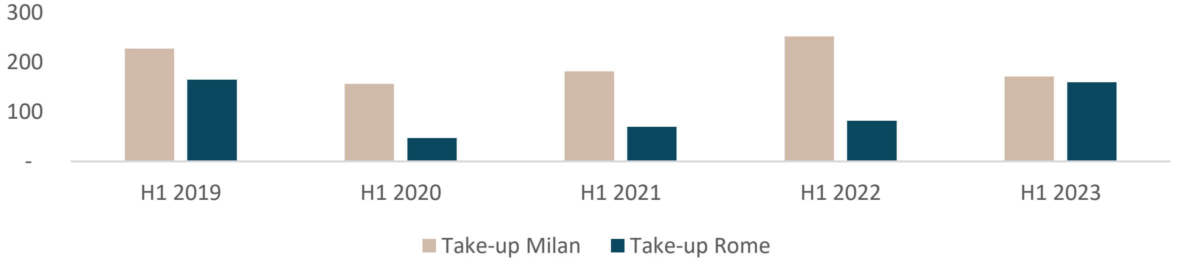
4. The Office Occupiers Market

In H1 2023 office take-up **Milan** recorded around **170,000** sqm across **149** transactions with a significant additional **sub-lease** portion for further 30,000 sqm. Despite YoY underperformance mainly due to the record reached in 2022, we had a positive QoQ variation in Q2 (+9%).

The demand of office space was dominated by deals below 1,000 sqm (72%) with a lower number of big deals above 5,000 sqm and one pre-let deal of around 30,000 sqm in the Semi-Centre area of Citylife. **Grade A** office spaces accounted for **65%** of the total. In terms of locations**, 36%** of the demand targeted offices in **central submarkets** (CBD Duomo, CBD Porta Nuova and Centre), 28% in Semi-centre, 22% in Periphery and 14% in Hinterland.

Take-up in **Rome** totalled around **160,000** sqm (+95% YoY) across **71** transactions, a significant increase mainly due to a single pre-let transaction in Q1 of around 50,000 sqm which reflects the high take-up portion for Core E.U.R. (30%) and one leasing transaction of 30,000 sqm in Q2 in the Centre (24%). E.U.R. Submarkets accounted for a 18%, CBD for 14%; the remaining 14% was distributed among other areas.

Office Take-Up (in thousands sqm) | H1 2019 – H1 2023



Prime rents are increasing in Milan at **700 €/sqm/pa**, +50 €/sqm/pa YoY and stable QoQ at **520 €/sqm/pa** in Rome.

Rental growth is expected to slow down in most geographies in H2 2023, except for a few selected growth opportunities, while the interest in A-grade and high-quality spaces will remain stable, along with the competition for these assets.

Vacancy rate in Q2 was at **9%** in **Milan**, with a **grade A** rate of **2.9%** while in **Rome** was at **7%** as an average.

Source: JLL Research elaborations

The Key Takeaways

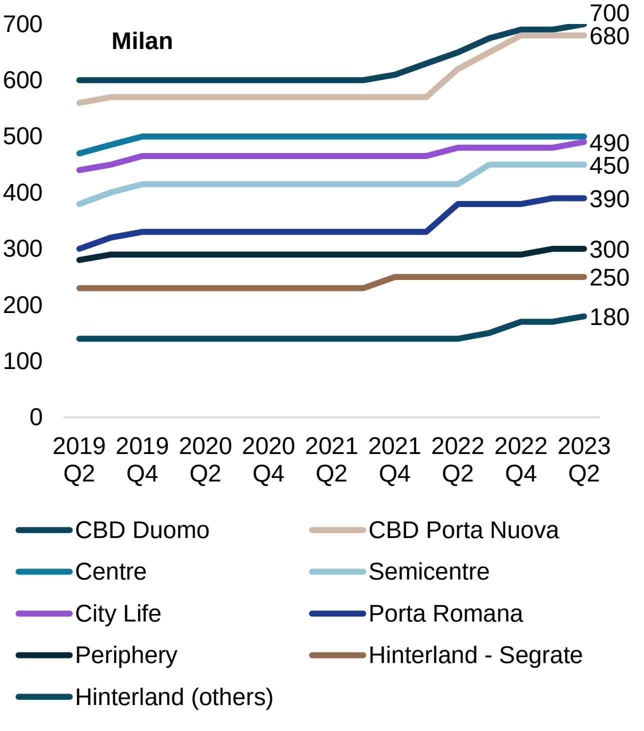
Milan

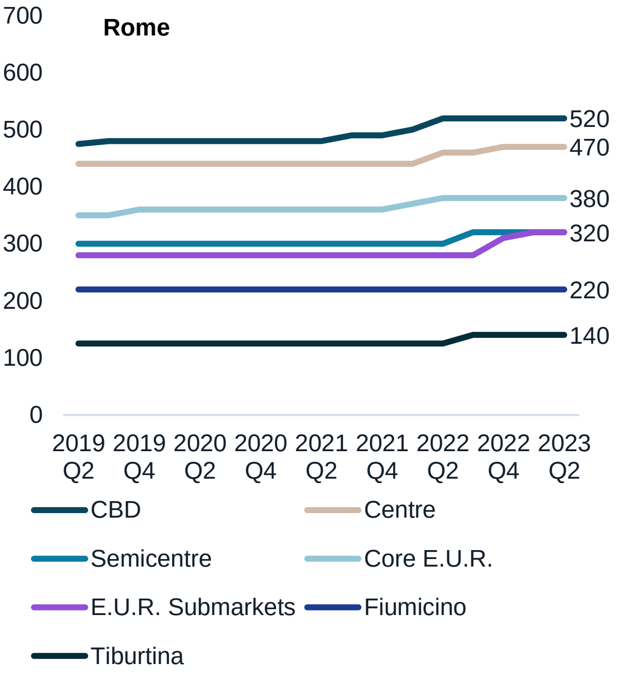
Take-up	**171,000 sqm**
5 years average	**198,000 sqm**
Vacancy rate	**9%**

Rome

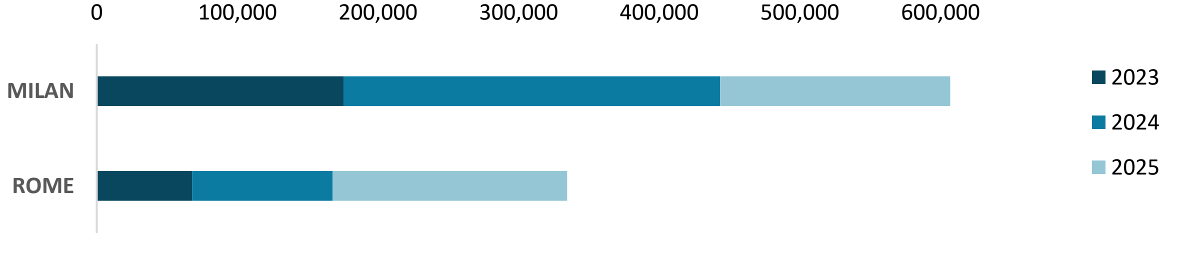
Take-up	**160,000 sqm**
5 years average	**105,000 sqm**
Vacancy rate	**7%**

Office Occupier Market – Prime Rent by Submarket (in €/sqm/pa)





Total future supply (sqm)



** Under constructions Including pre-let, owner occupation and speculative supply*

Source: JLL Research elaborations

EMEA office leasing market update

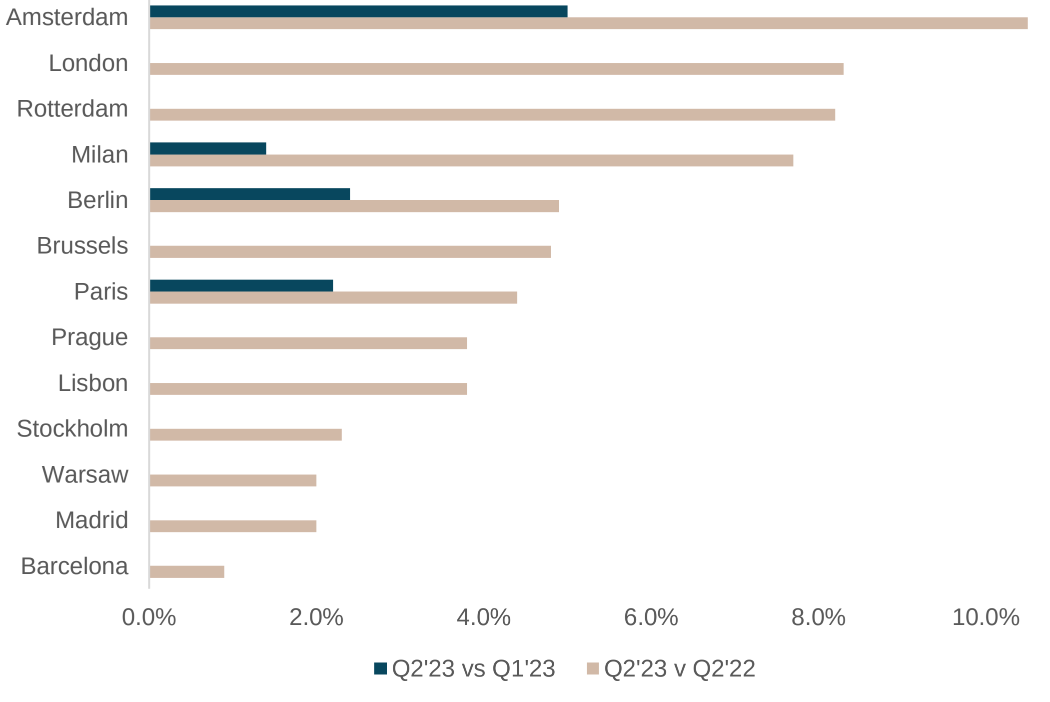
In the main European markets market uncertainty, cautiousness and transaction delays have impacted take-up levels in H1 2023. H1 2023 **leasing volumes** recorded **4 million sqm**, -25% compared to H1 2022; as a consequence, **take-up is expected to fall in 2023 before it rebounds again in 2024.**

Despite subdued demand and reluctance by corporates to make decisions on space requirements, appetite in the market for best-in-class product is evident, largely with strong ESG credentials, proximity to amenities and strong transport network connections. On balance, **cost pressures will result in a slowdown in expansionary demand**, heightened sublease activity and a focus on renewals and re-gears.

Supply constrains on new development and dwindling demand for older space will support **rise in refurbishments**, along with rising energy costs, whereas refurbished assets will be increasingly seen as a **more cost-efficient option than new buildings, and more sustainable** than a demolished/new-build office.

Prime rents will continue to rise, albeit at a slower rate. Sub-prime, outdated B and C-grade stock will inevitably face pricing pressure.

Prime rents: annual & quarterly change (Q2’23 vs Q1’23 – Q2’23 vs Q2’22)



Source: JLL EMEA research

5. Looking Ahead

Focus on A-grade high-quality assets with good sustainability metrics

Looking ahead, while the **economic environment still feels challenging**, inflation is now falling after reaching its peak in Q4 2022. Energy prices have fallen, too and this should help headline inflation to move down.

As a result, central banks are now thought to be approaching the conclusion of the tightening cycle.

More stable interest rates will increase visibility and confidence in underwriting, which will in **turn improve market sentiment and encourage return of investment in Q1 2024.**

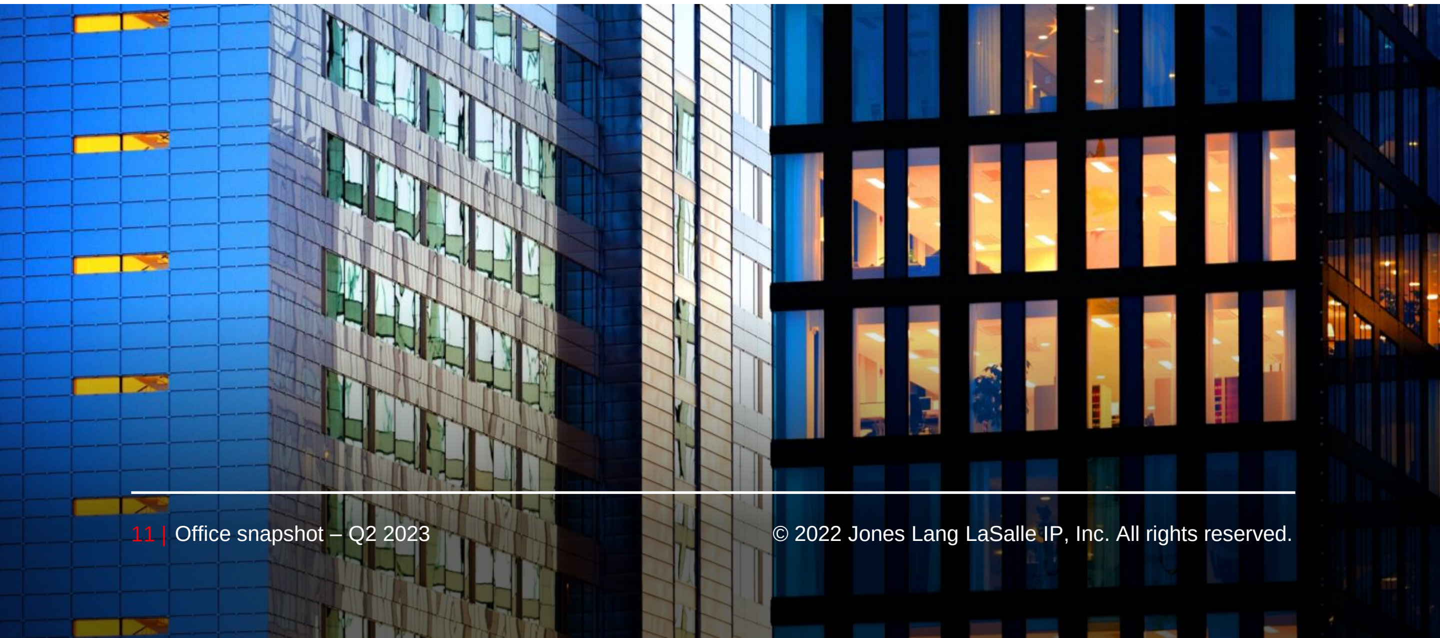
Yields should continue to decompress but head back towards the long run average once macroeconomic environment stabilizes.

Occupiers will be even more focused towards **grade A high-quality assets** with excellent sustainability metrics.

Hybrid-work model is established but we see also an increased momentum in corporate return-to-office strategies beginning to improve attendance and occupancy.

Prime **rental growth** is strong, with the European index up 1.5% and Milan is among the main Markets. This points to broadly supportive fundamentals.

We expect a market-wide trend in corporate consolidations, space rationalization, increasing subleases, prime space relocations and increasing focus on 2030 sustainability goals as deadline approaches.



Our Three Scenarios for the Italian Office Market in H2 2023

	Base case	Upside case	Downside case
Economy	• **Challenging economic conditions** but on an improving trajectory. • **Inflation** remains high, but is declining. Falling energy and commodity prices put downward pressure on inflation. • **Interest rates have further to rise**, then will stay high before being cut in late 2024.	• **Stronger growth** as confidence recovers faster. The banking crisis fizzles out. • **Inflation pulls back** driven by commodity prices and supply chains. • **Interest rates** don't rise any further and are cut sooner as inflation falls quickly.	• **Recent improvement in growth forecasts reverses** and more economies see periods of contraction. • **Inflation remains stubbornly high** and doesn't come down, while core inflation keeps rising in a wage-price spiral. • Central banks raise **interest rates** further, increasing debt costs and weighing on growth.
CRE	• **Global geopolitical uncertainty** continues to weigh on investment activity. Variation in performance across property types and markets. • **Prime yields** reach the top of their cycle. The cost of debt funding remains high. • **Rental growth** to soften as inflation eases.	• **Outlook improves and Investors become more confident** to start deploying allocated capital. Most markets and segments perform well. • **Prime yields** stop moving out and a new compression phase starts. • **Rents** expected to grow in all markets and submarkets.	• **Investments** suffer as investors flee to core markets. Most markets deteriorate. • **Prime yields** decompression continues as rates rise, and yields remain elevated. • **Rental** growth suffers in recession-hit sectors while remains stable or shows moderate growth in resilient segments.

Source: JLL Research

Contacts

Jones Lang LaSalle S.p.A.
www.jll.it

Milano
Via Agnello, 8 - 20121
Phone: +39 02 85 86 86 1
Fax: +39 02 85 86 86 20

Roma
Via Bissolati, 20 - 00187
Phone: +39 06 42 00 67 1
Fax: +39 06 42 00 67 20

Stefania Campagna
Head of Markets Italy
stefania.campagna@jll.com

Marco Pancotti
Head of Office Agency - Milan
marco.pancotti@jll.com

Luca Villani
Head of Occupiers Services & Work Dynamics Italy
luca.villani@jll.com

Massimo Livi
Head of Office Agency - Rome
massimo.livi@jll.com

Alberico Radice Fossati
Head of Capital Markets Italy
alberico.radice@jll.com

Sven Ole Sommer
Head of Capital Markets - Rome
ole.sommer@jll.com

Francesca Fantuzzi
Head of Research Italy
francesca.fantuzzi@jll.com
