

RESEARCH



MILAN

OFFICE MARKET OUTLOOK
Q4 2017

OCCUPIER TRENDS

INVESTMENT TRENDS

MARKET OUTLOOK

KEY FINDINGS

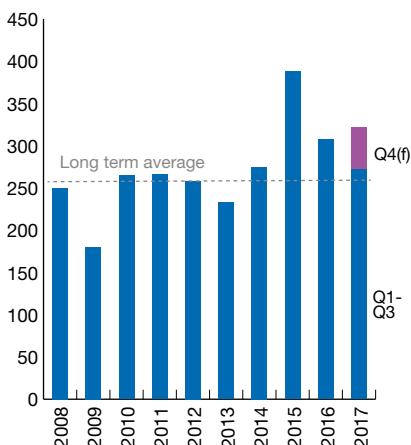
Office take-up was 273,000 sq m in the first nine months of 2017, making it the strongest period on record.

The development pipeline has grown, with around 220,000 sq m of office space under construction.

Prime rents have risen by 6% in 2017 to reach €530 per sq m per annum, exceeding the previous high.

Prime office yields have compressed to 4.25% and core products are expected to come under increasing pressure resulting in further yield compression.

FIGURE 1
Office take-up
sq m (000s)



Source: Knight Frank Research

OCCUPIER MARKET

Milan's attractiveness to occupiers is increasing. Leasing activity has intensified with trends reflecting a clear flight to quality.

Economic indicators are pointing towards one of the strongest years for Italy's economy since the financial crisis. The Italian economy is forecast to expand by 1% in 2017 benefiting from positive momentum across the currency bloc. Activity in Italy's service sector also reached its highest level in a decade in July, and although it has since eased, the economy is on a path towards recovery.

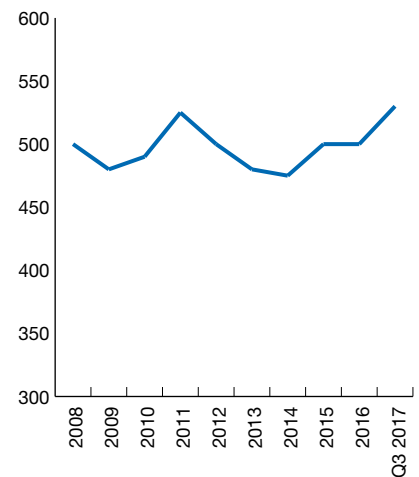
Despite the economic challenges in the past, Milan's office landscape has continued to burgeon. Over recent years, significant capital has been targeting assets with development upside, transforming Milan's skyline and expanding its premium quality stock reserves. Against this backdrop, occupier activity has intensified. In the first three quarters of 2017, office take-up reached record volume (273,000 sq m, Figure 1). Availability has continued to fall as a result, with vacancy rates currently standing at 12.0%. Most of the availability however is in peripheral areas, with CBD availability coming under pressure and limited availability in prime space.

Current market trends highlight a clear flight to quality as occupiers seek properties that add value to their business. Accordingly, the scarcity of available prime space on the market is creating strong competition for the best opportunities. As Milan's office pipeline improves, this will provide a welcome relief to occupiers. Renovations and refurbishments continue to feature prominently in the market. Around 220,000 sq m of office space is under construction. While availability may rise from its current level, any increases are likely to be only short-term due to ongoing robust occupier activity and high levels of pre-leasing.

The underlying market fundamentals are solid. Robust demand and a shortage in availability of prime product is driving rental growth. This is particularly evident in the CBD, which remains the most sought-after submarket, along with the decentralised areas, as they offer development upside.

Prime rental rates have increased by 6% in 2017, reaching €530 per sq m in Q3 2017 and exceeding the previous high (Figure 2).

FIGURE 2
Prime office rents
€ per sq m per annum

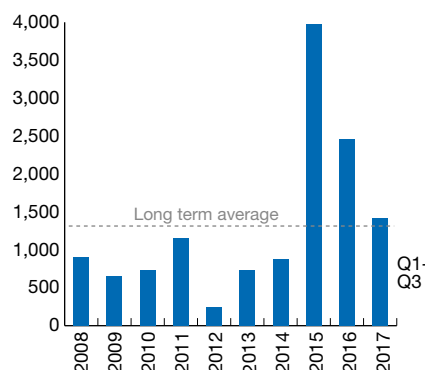


Source: Knight Frank Research



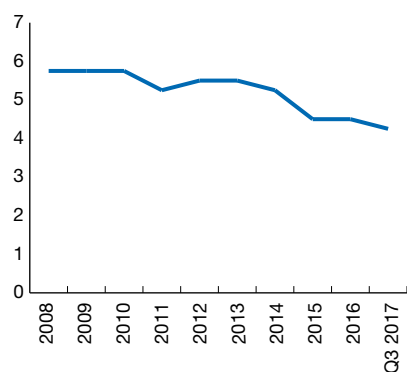
Porta Nuova district

FIGURE 3
Milan office investment volumes
€ million



Source: Knight Frank Research

FIGURE 4
Prime office yields
%



Source: Knight Frank Research

INVESTMENT MARKET

Milan's office market has maintained its appeal to both domestic and foreign investors. A total of €1.4 billion was invested into Milan's office sector in the first nine months of 2017, just shy of the same period last year (Figure 3). Growing interest in the market reflects the continued search for value in an expensive European property market.

Although core and core plus assets have been the primary targets, investors have been moving further up the risk curve and pursuing value-add assets given their opportunity for development upside. Domestic investors have traditionally been the primary protagonists in Milan's office

market. Italian investment fund, IDeA Fimit Sgr made the largest acquisition, purchasing the Edison Headquarters for €250 million. In recent times however, a raft of investors from the US, France, Germany and the Middle East have also been active players in the market.

The limited availability of core assets is leading to prime yield compression. Prime gross yields have tightened by 25 bps to 4.25% over the last year (Figure 4). Core products will however come under increasing pressure resulting in a widening of the yield differential between prime and secondary assets.

KNIGHT FRANK VIEW

Despite political uncertainty and the slow adjustment in the banking sector, Italy's economic growth prospects are improving. Both the occupier and investment markets continue to show a positive trend. Indeed, office take-up in Milan is expected to exceed, 330,000 sq m in 2017, making it the second strongest year in over a decade.

Italian commercial property offers significant opportunities. The office

landscape is continuing to be reshaped. Urban areas and obsolete buildings are undergoing redevelopment and conversion, leading to uplift in capital values and a subsequent increase in appetite to global investors. Importantly, foreign investors represent a significant share of the market and demonstrate Milan's global appeal and this will continue in 2018.

Key office investment transactions in 2017

| Quarter | Address | Seller | Buyer | Approximate price (€ million) |
|---------|---------------------------|----------------------------|-----------------------------|-------------------------------|
| Q3 | Edison HQ | Edison (EDF), Lazard Ltd | IDeA FIMIT sgr, ENPAM | 272 |
| Q1 | Milan Office | Allianz Insurance Plc | Kryalos AM, Blackstone | 117.5 |
| Q2 | Luxottica HQ | Beni stabili | Gruppo Luxottica | 114.5 |
| Q2 | Italian Offices | Credito Valtellinese | Beni Stabili SpA | 105 |
| Q1 | fmr Luxottica HQ | Leonardo Del Vecchio | Hines | 100 |
| Q1 | Via Borgogna 8 | Idea Fimit sgr | Fabrica Immobiliare Sgr | 85 |
| Q3 | Bodio Center 1, 2, 3 | CBRE Global Investors | AXA REIM | 83 |
| Q2 | Corso Di Porta Ticinese 1 | Generali Immobiliare Italy | Invesco | 61 |
| Q2 | Duomo 25 Offices | Statuto Group | CBRE Global Investors | 57 |
| Q2 | Fondazione Pirelli | BNP Paribas REIM | Savills IM, Aviva Investors | 53 |
| Q3 | Sassetti Office Tower | Invesco UK | ADIA, AXA Real Estate | 50 |

Source: Knight Frank Research / Real Capital Analytics



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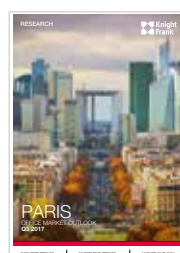
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