RESEARCH

Knight Frank

MILAN

OFFICE MARKET OUTLOOK

Q4 2014

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

KEY FINDINGS

The Italian economy is in recession but there are tentative signs of improvement in some areas

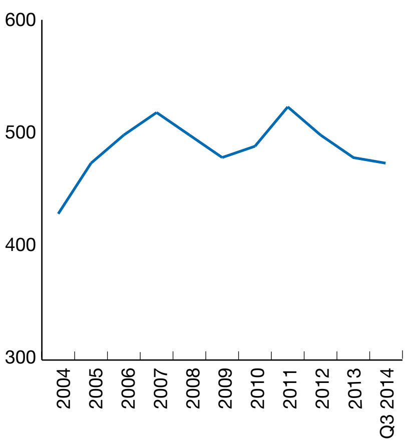
Occupier activity in Milan has been dominated by lease renegotiations but demand is accelerating

Take-up in 2014 should exceed 250,000 sq m – an increase on last year

At €475 per sq m per year, prime Milan office rents have reached their floor

Further yield compression is expected and rental growth should return in 2015

FIGURE 1
Prime office rents
€ per sq m per annum



Source: Knight Frank Research

OCCUPIER MARKET

While Italy remains in recession, there are some positive signs, with unemployment edging down (notably in the north of the country) and an increase in the demand for credit among businesses and consumers.

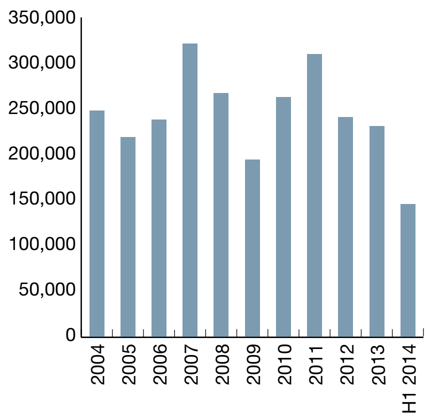
While economic forecasts suggest that growth should return next year, the government has postponed the balancing of its budget in line with revised fiscal forecasts.

The occupational market has nonetheless shown signs of improvement, with total H1 take-up amounting to 146,000 sq m, a good result given the subdued economic backdrop. While this was down on last year's H2, the figure is around double that for H1. Occupier activity in the first half of the year was dominated by lease renegotiations, rather than new deals, although leasing activity is traditionally stronger during the second half of the year. On the assumption that H2 will be at least marginally better, take-up for this year as a whole should exceed that of 2013 and may even reach its long term annual average of around 250,000 sq m.

While out-of-town locations with good transport links have seen strong interest, there is also evidence of a revival in tenant demand for higher quality space in the historic centre. A number of recent transactions demonstrate that consolidation and the release of surplus space continue to feature in the current market. However, the limited development of new space in recent years has prevented a serious rise in the vacancy rate (grade A) which currently stands at around 13%. The current development pipeline scheduled for delivery in the next three years stands at less than 200,000 sq m, with at least 50% already pre-let.

Rental levels for prime office space are down on last year to stand at €475 per sq m per year at the start of Q4, but appear to have stabilised at this level. In the short term, market sentiment is expected to remain cautious until there is more evidence that the economy is on the mend and it may be some time before rental growth returns to the wider market.

FIGURE 2
Office take-up
sq m



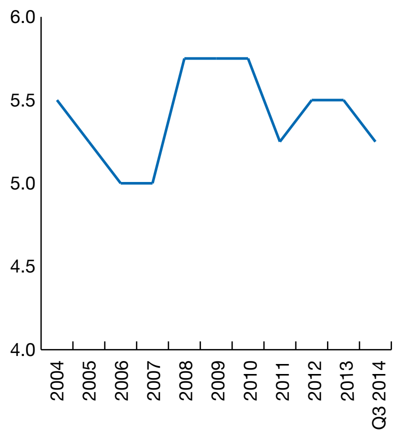
Source: Knight Frank Research

Key recent office leasing transactions

Quarter	Address	Tenant	Landlord	Passing rent (€m)
Q1 2014	Milanofiori U27	Nestlè	Generali Group	N/A
Q1 2014	Porta Nuova	Google	Hines/Qatar	2 (circa)
Q2 2014	Blend Tower	Windows on Europe	Generali Group	N/A
Q2 2014	via San Nicolao	Luxottica	Beni Stabili	5.4

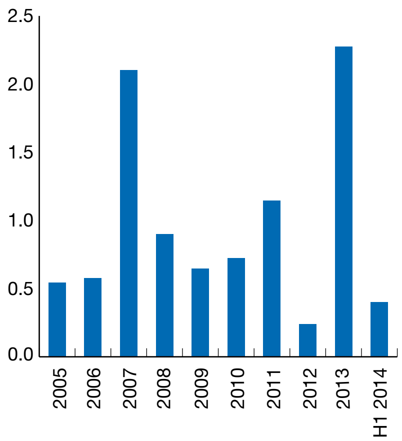
Source: Knight Frank

FIGURE 3
Prime office yields
%



Source: Knight Frank Research

FIGURE 4
Milan office investment volumes
€ billion



Source: Knight Frank Research

The Credit Suisse building on Via Santa Margherita, bought by the Qatar Investment Authority for €108m.

INVESTMENT MARKET

As with many European countries, the investment market has been recovering more quickly than the occupier market. While rents are flat, capital values have seen modest growth on the back of yield compression. Indeed, yields hardened from 5.5% at the end of last year to stand at 5.25% in Q3 2014, just 25bps above their peak in 2007.

Investment volumes for this year have so far been well down on 2013, with only around €400 million of offices being transacted in H1. However, the low level of activity is due largely to the lack of available product rather than a lack of investor interest and, based on deals currently in the pipeline, the last few months of this year are expected to see a sharp rise in activity. For 2014 as a whole, total investment in Milan offices may in fact come close to €1 billion, if a number of large deals being negotiated are concluded.

To-date, the largest deal of 2014 has been the Qatar Investment Authority's €108 million acquisition of the Credit Suisse building on Via Santa Margherita, following other purchases in 2012 and 2013. Other active investors include Luxembourg-based private equity firm GWM Group which recently acquired two office buildings (on Via Gattamelata and Via Gallarate) for a total of €38 million, in a sale and leaseback deal with PSA Peugeot Citroën. In Q3, Cerberus Capital Management and Deka Immobilien both made acquisitions.

Key recent office investment deals

Quarter	Address	Vendor	Purchaser	Price (€m)
Q1 2014	Telecom Italia HQ	Telecom Italia	Inarcassa	75
Q2 2014	Peugeot Citroen	Peugeot SA	GWM Group	16.3
Q2 2014	Peugeot Italia	Peugeot SA	GWM Group	21.7
Q2 2014	Milanofiori U10	Brioschi Sviluppo Immobiliare	AXA REIM	44.5
Q2 2014	Light Building	BlackRock Real Estate	Hines JV Famiglia Catella	45
Q2 2014	Credit Suisse HQ	Tishman Speyer	Qatar Investment Authority	108
Q2 2014	Via Tazzoli	FIMIT sgr	AXA Real Estate	20
Q2 2014	Milanofiori U27	Brioschi Sviluppo Immobiliare	Generali Group	69
Q2 2014	Prada HQ	Beni Stabili SpA	Prada	N/A
Q3 2014	Via Paracelso 22	FIMIT sgr	Cerberus	15.6
Q3 2014	Milanofiori 1F	FIMIT sgr	Cerberus	41.3
Q3 2014	Newest	CBRE Global Investors	Deka Immobilien	38

Source: Knight Frank

KNIGHT FRANK VIEW

Many investors will argue that "current Italian fundamentals don't look good" and it is true that there are concerns about Italy's lacklustre economic performance and its high level of public debt. However, as the recent turnarounds in the Irish and Spanish markets show, those willing to step into to the market during times of uncertainty can reap the best rewards as markets recover. Importantly, the various acquisitions by the Qatar Investment Authority demonstrate Milan's importance for sovereign wealth capital and that the city has appeal for global investors.

Italian commercial property still offers significant opportunities. For occupiers, it is currently possible to secure space on the most favourable terms for the best part of a decade, although the reawakening of tenant interest in the centre is a strong sign that rents have reached their floor. With a combination of stronger demand and a steadily falling supply of good quality space, rental growth should return in the latter part of 2015, which is likely to attract an increasing number of European and global investors.

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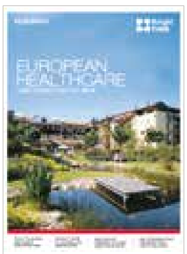

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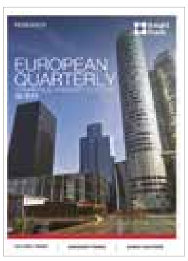

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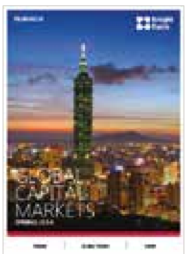

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