Cross-border real estate investments in Italy:
recent history, current situation and perspectives

Nomisma

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CROSS-BORDER REAL ESTATE INVESTMENTS IN ITALY: RECENT HISTORY, CURRENT SITUATION AND PERSPECTIVES

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INTRODUCTION

After a long period dominated by solely domestic players, the Italian real estate market has undergone a profound restructuring of operations and regulations, gradually preparing the market for the arrival of cross-border investments.

Today, during what has been described as the worst recession in 70 years, an analysis of the opportunities and critical aspects of the market is necessary in order to understand where and how a recovery might take place.

Throughout Europe and the rest of the world, the decade from 1997-2007 was one of enormous growth due largely to the huge amounts of liquidity available, driving up real estate prices and distributing real estate investments ever further and wider. Property prices increased throughout the world, supported by financial instruments that magnified investment opportunities. During this period, Italy too went through an extraordinary moment with the domestic real estate market being transformed quicker than ever before. The first real estate funds incorporated under Italian law were launched, the securitization of mortgages added further impetus to the market, the professional management of corporate portfolios and state-owned properties became increasingly important and a number of spin-offs took place to retain a core business. The introduction of the Euro made investments easier and new forms of retail were found, abandoned urban areas were upgraded, and so on.

These changes are both the cause and effect of the opening of the domestic market to foreign investments, based on important opportunities and business development, rendering the Italian market less provincial. Italy began to see the presence of merchant banks, investment funds, pension funds, specialist finance companies, securitizers, developers and asset managers, improving the sector and its overall transparency.

Then, after the global financial melt-down of 2007/2008, becoming acute in Q1 2009, markets changed quickly and shifted onto different bases. Less finance, more attention to basics. This has been the case in the real estate market too, which is now gearing up to face the future on this new basis. Investment decisions and evaluations are now based on these fundamentals and on the characteristics of asset managers.

The aim of this document is to describe the evolution of the Italian market from the mid-nineties to today and to analyze how the input of new capital from abroad has made the market more transparent and renewed its operations. This brief history will focus on the most important changes, on the lessons learnt and the challenges and opportunities for the future.

The survey includes some synthetic information about property funds in Italy, an essential tool for understanding the transformation of Italy into a vanguard real estate market with some of the most advanced features in the world.

1.

1. THE ITALIAN ECONOMY AT PRESENT


SAI


ASSICURAZIONI

The global economy is gradually emerging from the worst downturn of the past seventy years and financial markets have improved in recent months. Nevertheless, while major advanced economies have joined emerging and developing countries on the road to recovery, the outlook is still fraught with substantial uncertainty and downside risks.

The global recovery is off to a stronger start than anticipated but is proceeding at different speeds in the various regions. Following the deepest global downturn in recent history, economic growth solidified and broadened to advanced economies in the second half of 2009. In 2010, world output is expected to rise by 4%. In most advanced economies, the recovery is expected to remain sluggish compared to past standards (forecast 2.1% growth in 2010 GDP in advanced economies as a whole and +1% in the Euro area), whereas in many emerging and developing economies activity is expected to be relatively vigorous, largely driven by buoyant internal demand.

Forceful and coordinated measures by the leading economies have stopped the sharp decline in the global economy that occurred last winter and stabilized the financial markets. However, the process of recovery is far from being completed and the damage inflicted to the financial markets has yet to be fully repaired. Strong policy actions are still needed to secure a durable recovery and to rebuild a regulatory system able to ensure that the financial markets will respect fundamental rules of propriety, integrity and transparency.

Considering the early stage of the recovery, great care should be taken to avoid a premature withdrawal of stimuli. At the same time, it is not premature to prepare exit strategies so that, once the time is right and recovery firmly established, the exceptional measures enacted to support the economy and the financial sector can be phased out in a coordinated way.

Italy's economic recovery is unfolding broadly in line with the rest of Europe. Since late spring, and more convincingly over last summer and fall, the main indicators have rebounded noticeably:

- household and business confidence, as well as other leading indicators, have exhibited a recovery;
- industrial production has improved and a gradual rebuilding of inventories is now underway;
- foreign industrial orders also rose;
- private consumption should be underpinned by low inflation;
- recovery in global demand will support exports.

These developments suggest a rebound in activity in 2010. The pace of growth thereafter remains uncertain.

As far as 2009 GDP is concerned, the contraction is likely to be around 5%, largely due to the sharp fall in the first part of the year. We expect a 2010 recovery by 1%, at a similar pace of Euro Area, while in 2011 the Italian growth is supposed to be slightly weaker than Euro zone (1.3% vs 1.6%).

Figure 1.1

GDP growth: Italy and Euro area

* Forecasts.

Source: IMF, January 2010.

Although it has been affected much less than other advanced countries by the financial crisis and the collapse of the housing sector, Italy's economy is exposed to trends in global demand, subdued to the importance of its export sector and the large weight of manufacturing in the domestic product. Net exports were a drag on growth and investment fell sharply, also due to historically low levels of capacity utilization and tightening credit conditions.

Moreover, private consumption suffered from declining employment and a collapse in confidence.

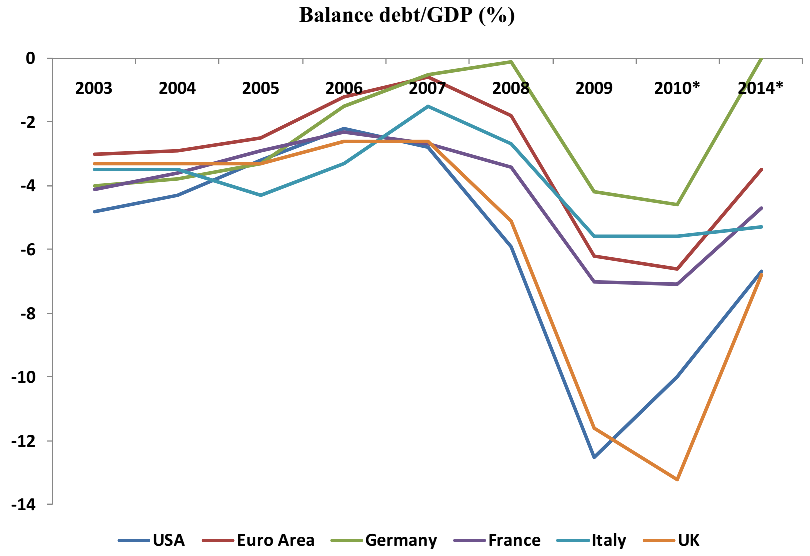
Despite some weaknesses, the labour market has fared better than neighbouring countries. The unemployment rate reached 8.5% by the end of 2009 (it is 8.8% in the OECD area), up from a 6.0% low in mid-2007.

Indeed, government measures have cushioned the impact of the crisis on the labor market and the most vulnerable segment of the population. During the crisis, the Italian Government adopted measures to support the economy and ensure social cohesion. More specifically, the Government took action to:

- support the flow of credit to the economy
- sustain income and consumption
- extend economic stabilizers
- strengthen and accelerate public investment
- encourage private investment.

This approach allowed automatic stabilizers to work, without adding any discretionary deterioration in public finances. The rise in the net borrowing requirement is projected to slightly exceed 5% of GDP on average in 2009-2010, while the increase in the debt-to-GDP ratio will be less pronounced than in other EU countries due to the relatively small size of the public intervention that was needed in support of the financial sector.

Figure 1.2



* Forecasts.

Source: IMF.

The chart above shows that the shift in both aggregates is likely to be substantially smaller in Italy than in other most advanced countries.

2.

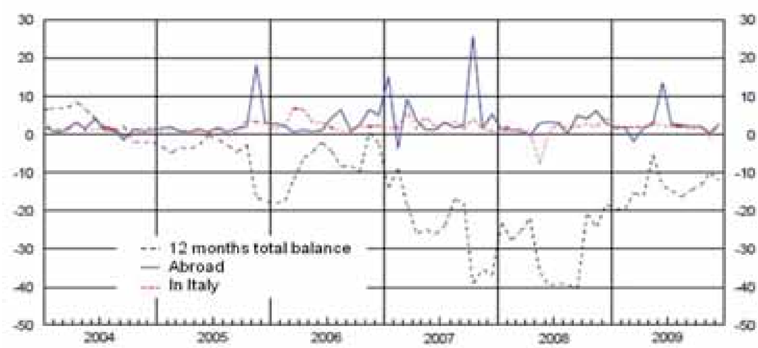
2. ITALIAN COMPETITIVENESS


CASSA DI RISPARMIO

In order to understand the role of Italy in relation to foreign investors and the perceived competitiveness of the country, the best tool is the flow of investments into and out of the country in the recent past. The data provided by the Bank of Italy show that Italy is a net exporter of capital, investing more abroad than foreign countries invest in the country.

Figure 2.1

Direct investments to and from Italy (€ bn)



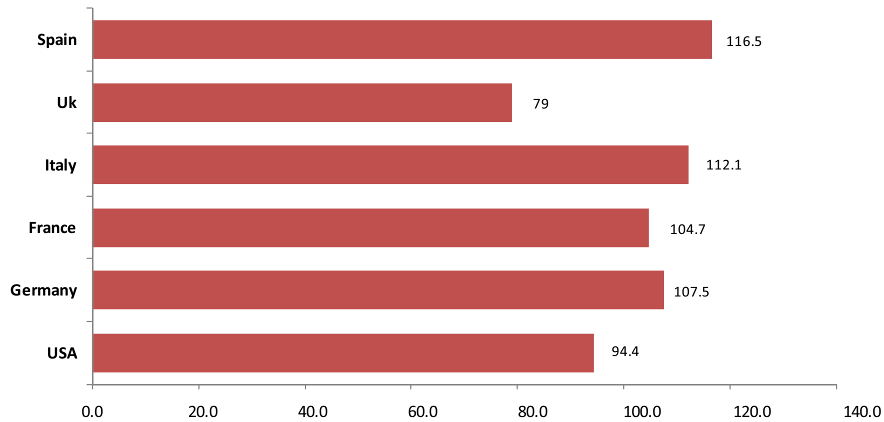
Source: Bank of Italy.

The maximum levels of outflows of capital from Italy were reached between the second half of 2007 and the beginning of 2008, levelling off in 2009 with a net outflow of € 12 bn.

Despite this, as measured by the Bank of Italy, the level of competitiveness of the country has risen considerably in the last decade. If the competitiveness of Italy in 1999 was 100, in 2009 it was 112 (up 12% during the period), out-performed only by Spain of the big five in Europe.

Figure 2.2

Increase in competitiveness (1999=100): 2009 compared to 1999



Source: Bank of Italy.

A similar improvement in the competitiveness of the country is shown by the recent Ernst & Young "Country Attractiveness Survey", which monitors the level of attractiveness of European countries for foreign investments. Countries outside Europe are less competitive due to the risks involved. Italy is not among the top positions but was nevertheless up from 15th to 13th between 2008 and 2009.

Table 2.1

Top 15 locations for foreign direct investments in Europe (Ranking 2008-2009)

Country	Rank 2009	Rank 2008
UK	1 ⇔	1
France	2 ⇔	2
Germany	3 ⇔	3
Spain	4 ⇔	4
Poland	5 ⇑	7
Romania	6 ⇔	6
Russia	7 ⇑	8
Belgium	8 ⇓	5
Switzerland	9 ⇑	10
Netherlands	10 ⇑	11
Ireland	11 ⇑	14
Hungary	12 ⇓	9
Italy	13 ⇑	15
Czech republic	14 ⇓	12
Sweden	15 ⇓	13

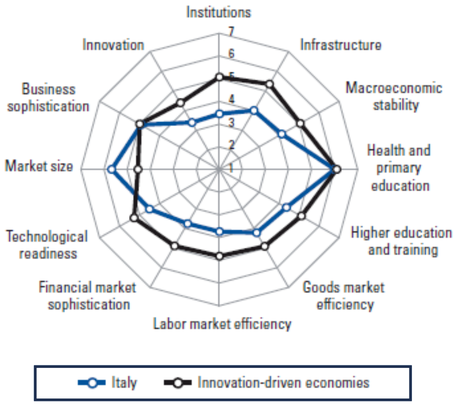
Source: Ernst & Young, 2009.

With reference to its specific features, which determine its performance, Italy excels in "business sophistication", i.e. the efficient production of goods and services, and in the strength of industrial parks. Italy also benefits from its large market size (the 9th largest in the world) which allows for significant economies of scale.

Its weaknesses remain its excessive bureaucracy, a rather rigid labour market (able, nonetheless, to emerge from the crisis with a lower level of unemployment than elsewhere) and a high level of public debt (which has not deepened during the recession, unlike elsewhere among developed economies), as shown by the graph set out below, summarizing Italian competitive factors compared to other advanced economies, taken from the World Economic Forum.

Figure 2.3

Competitiveness factors in Italy compared to other advanced economies



Source: World Economic Forum, 2009-2010.

3.

3. THE DEVELOPMENT OF FOREIGN INVESTMENTS IN THE ITALIAN REAL ESTATE MARKET

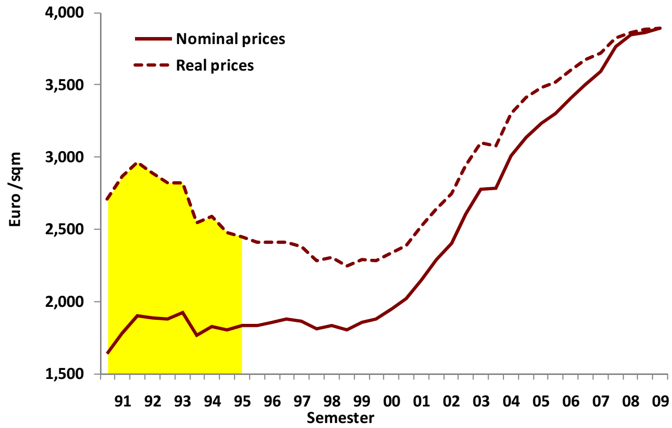
This chapter summarizes the most important developments in the recent history of the Italian real estate market, focusing on the milestones that have often been determining very rapid changes. The analysis includes a number of phases in the real estate cycle, for which a graph is given each time, showing house prices at the time. Housing currently represents over 80% of the Italian real estate market and hence is a good indicator of the overall real estate market. For each phase, the leading trends are shown and the main transactions are listed (the list is not complete but is certainly representative) involving cross-border investors.

1991–2000

The last decade of the twentieth century was one a tale of two halves: the first five years were characterized by an international economic crisis negatively impacting the real estate sector; the crisis abated in the mid-nineties but the effect on the property sector was still evident until ‘96 or the beginning of ’97, when the upturn began.

Figure 3.1

Average prices for housing in the main Italian cities (1990-1995)



Source: Nomisma processing of data from Consulente Immobiliare.

In addition to the economic situation, the political and legislative picture was uncertain, making foreign investors particularly reluctant to commit to the market. In fact the level of investments from abroad investors was quite low – albeit up from € 94 bn in 1991 to € 400 bn in 1993 - and there was no coherent approach to the Italian market.

The overall market was in a position of “wait and see” and the upturn was delayed by the expectation of large-scale sell-offs by major property owners, which were continually postponed. It wasn’t until the mid-nineties that insurance companies, banks and social security institutes began to sell off their properties.

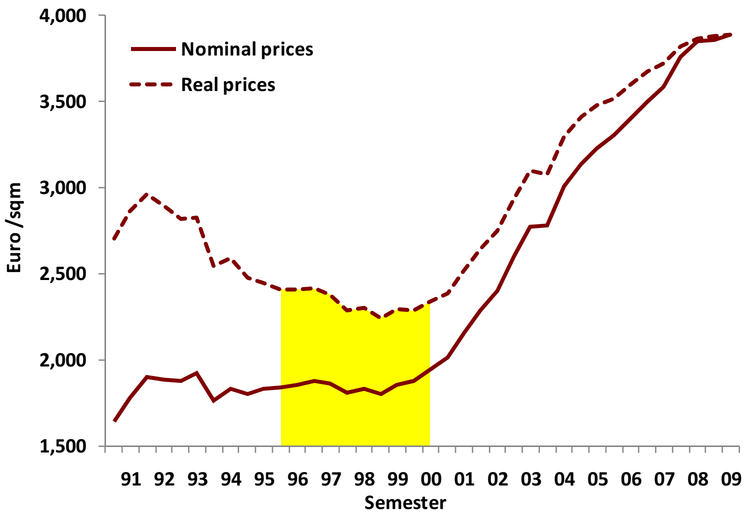
The market began to pick up towards the end of the nineties.

The second half of the nineties was negatively impacted by the high cost of borrowing and the expectation of a fall in interest rates. Taxation also penalized the market in a situation of economic difficulty.

This situation led to pessimism in the real estate market, keeping foreign investors away until the end of 1996.

Figure 3.2

Average prices for housing in the main Italian cities (1996-2000)



Source: Nomisma processing of data from Consulente Immobiliare.

Turning our attention to the second half of the nineties, the market began to pick up, leading to the boom of the following decade.

The sell-off of large property assets, the fall in interest rates and the economic upturn all stimulated the market and the perception of business opportunities in Italy, starting in 1997, when foreign and domestic investors began to create alliances. Major players were merchant banks and their investment funds.

The leading activities affecting foreign investors during this period were:

- The creation of closed-end real estate funds
- The securitization of mortgages
- Spin-off of the real estate assets of banks, insurance companies and industrial groups
- Outsourcing of the property management of large owners
- Alliances and JV between foreign and domestic investors/operators.

These activities created the basis for the boom in the Italian real estate market over the following decade.

Box 3.1

Leading cross-border transactions in Italy (1997-2000)

Year	Actor	Transaction
1997	**Morgan Stanley Real Estate Funds**	Agreement with **Pirelli RE** for the management of a property portfolio based on office developments.
1997	**Morgan Stanley**	First securitization in Italy: acquisition from **Banca San Paolo** of about € 100 mn of mortgages for about € 240 mn.
1998	Deutsche Bank **-** through SGR **Deutsche Bank Fondimmobiliari** (incorporated in 1997 and now known as **RREEF)**	Launch of the first closed property fund under Italian law, called "Valore Immobiliare Globale" with initial assets of € 159 mn.
1999	**Tmw** (the German Ergo Victoria Group), **Carlo De Benedetti** and C. **Sapa**	Shareholders agreement for the control of the 51% of the capital of **Aedes.**
2000	**Goldman Sachs** (through Whitehall Fund)	Acquisition of the properties sold off by **ENI** with a value of ca. € 1.14 bn.
2000	**Lehman Brothers** and **Beni Stabili**	Acquisition of part of the property assets of **Telecom Italia** for € 2.9 bn.

Source: Nomisma.

2001–2005

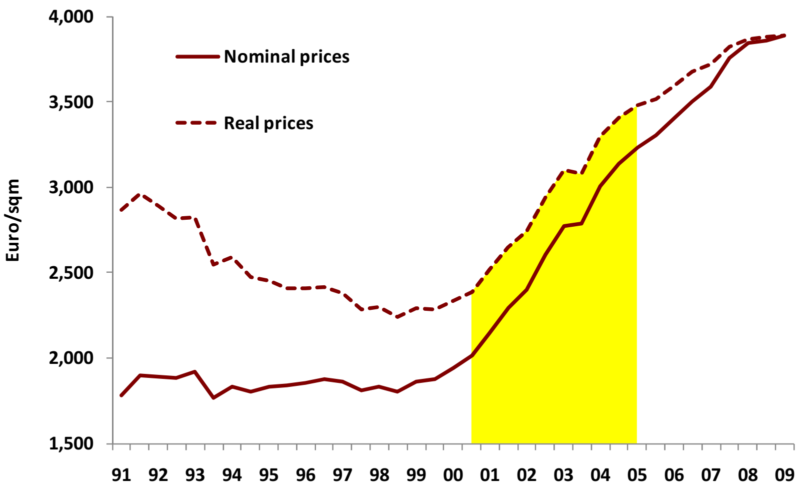
At the beginning of the new century, the Italian property market became more efficient and highly developed, based on an international model.

The basic drivers behind the property boom were:

- The introduction of the Euro;
- Institutional action, including new regulations and behaviour (greater transparency of information, Law 351/2001 on the securitization of public properties, Law 410/2001 concerning the creation of real estate funds with public involvement);
- Technological developments such as Internet and the electronic/digital revolution;
- New investor and end-user needs (indirect investments, listed property companies, sophisticated real estate funds such as hedge funds).

Figure 3.3

Average prices for housing in the main Italian cites (2001-2005)



Source: Nomisma processing of data from Consulente Immobiliare.

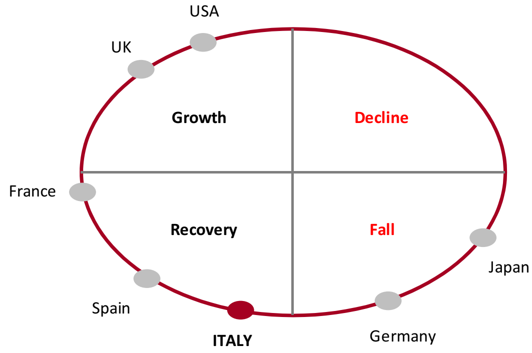
In addition, Italy, pressured by the sole currency, accelerated the process of integration with other European economies in a framework of increasing globalization, making each domestic market the theatre of international investment. Among investors, particularly important were those with dollars (or sterling), able to take advantage of the weakness of the Euro to buy properties at high discounts.

With a slight overall fall in property investments in Europe during 2002, compared to the previous year, Italy recorded a boom in property investments with an increase of € 3.5 bn, including € 1.3 bn managed by foreign investors (70% from outside Europe). This was an increase of 59% on 2001 and of 61% for foreign investors (Jones Lang LaSalle).

During the first five years of the new century, Italy was considered the country with the highest investment potential partly due to its position in the international real estate cycle with recovery coming much later than in other European countries and in USA.

Figure 3.4

The positioning of the Italian property market within the international market at the beginning of the 21st century



Source: Nomisma.

This delayed recovery in the Italian property market encouraged foreign investors to take an interest in investment opportunities in the country despite the growing strength of the Euro, driving prices up for buyers with other currencies.

The attraction of Italy was based on the expectation of further growth, particularly in certain areas and market sectors, due to the strong demand verse a limited supply of quality properties. Interest shifted from the two principal cities (Milan and Rome where the low risk and consolidated markets made yields relatively low) to other areas (provincial cities, mainly in the north, subsequently in the south) searching for more remunerative opportunities. At the same time the market diversified from conventional investments (in offices) to more innovative sectors with higher yields, such as retail, logistics, tourism, etc.

In the first few years of the century, the number of acquisitions of real estate portfolios increased (due to spin offs) following negotiations or often crowded auctions where prices were driven up considerably.

At the same time, the development of financial instruments led to a leap in quality in the Italian market, with many foreign banks buying Italian banks and securitizing mortgages.

The real estate fund sector evolved (following the example of other European countries, more focalized on indirect investments in the real estate market) through the opportunity to set up funds exclusively reserved to qualified investors and thanks to the proliferation of transactions, not only of an opportunistic nature, due to the numerous value added and core investments available, giving an indication of the maturing of the market.

The market also made progresses in terms of transparency, although it is not easy to establish if this was the cause or effect of increasing investments. Whichever way, transparency and high demand created a virtuous circle with evident benefits to investors, closing the gap with other developed markets. In particular, this was the period when (i) the Nomisma/IPD property index was launched, an instrument bringing Italy into line with other international markets in terms of measuring the performance of property investments, and (ii) training sessions began to be organized in property finance, due to the need for specialization in the sector.

Box 3.2

Leading cross-border transactions in Italy (2002)

Actor	Transaction
PORTFOLIO ACQUISITIONS	
Deutsche Bank, **GE Capital Real Estate** and **Bonaparte**	Acquisition of the property assets of **Banca Popolare di Novara e Verona**, for € 307 mn.
Tiglio I and Tiglio II - two companies controlled by the **Morgan Stanley Real Estate Fund**, through a JV with **Pirelli & C. Real Estate**	Transfer of properties for a total amount of of € 3.3 bn.
M&A, JV	
Whitehall fund (owned by **Goldman Sachs)**	Purchase of **Telemaco (**the property investment vehicle of Beni Stabili, Telecom Italia and Lehman Brothers) for € 1.1 bn.
Pirelli & C. Real Estate and **Soros Real Estate Investors**	Creation of a JV relating to industrial properties. Soros has a 75% stake, Pirelli & C. Real Estate 25% and management responsibilities.
JV between **Morgan Stanley RE Fund** and **Pirelli & C. RE**	Acquisition of 100% of **Immobiliare San Babila**, (previously owned by the **Fiat Group**, the real estate vehicle of Toro) for € 240 mn.
Lehman Brothers	Acquisition of 49% of the capital of **Bipielle Real Estate** for € 150.8 mn, including the real estate portfolio of the Bipielle Group (Banca Popolare di Lodi).
PROPERTY/AREA INVESTMENTS	
“Depfa Europa 1” (owned by the Dutch management company **Aareal Property Services)**	Investments in Italy amounting to about € 300 mn. The “Depfa Europa 2” fund was launched with an investment of € 500 mn, entirely in Italy.
Klepierre	Acquisition from **Carrefour** of 11 shopping arcades in Italy for € 226 mn.
Grosvenor	Acquisition from **Cassa di Risparmio di Parma e Piacenza**, of 1 building in Milan for office development, covering 13,500 sqm, for € 22.2 mn.
CGI - German fund	Payment of € 40 mn to COIN (in lease back) for the Le Barche shopping centre in Venice Mestre.

Source: Nomisma.

Leading cross-border transactions in Italy (2003)

Actor	Transaction
PORTFOLIO ACQUISITIONS	
JV between **Pirelli & C. Real Estate and Morgan Stanley Real Estate Fund**	Assignement of the property portfolio of Proprietà Immobiliari (**RAS**) for about € 1.25 bn (the remainder to the Progestim-Norman 95 consortium, for about € 420 mn).
Pirelli & C. Real Estate in JV with **Morgan Stanley** (Dolcetto)	Take over of the prestige property package (87 properties in over 20 Italian cities, for € 980 mn) of **Fondiaria-Sai**.
M&A, JV	
Morgan Stanley	Agreement with **Pirelli & C. Real Estate** for the extension of the duration of the JV.
Pirelli & C. Real Estate and the **Peabody Fund** (JV between O'Connor Capital Partners and JP Morgan Chase)	Agreement in the retail and entertainment segment.
PROPERTY/AREA INVESTMENTS	
Doughty Hanson	Sale to German funds **Degi** and **WestInvest** respectively the Bodio Center (newly built business center) and the L'Oreal HQ, both in Milan, for € 280 mn.
Morgan Stanley (through its Eurozone Office Fund)	Acquisition of Campari HQ in Via Turati, Milan for about € 47 mn.
UBS Group	Acquisition from Impregilo of its HQ in Sesto San Giovanni (MI) for € 46 mn.
Hammerson property company	Opening of an office in Milan for its property investments in Italy.
Prologis	Payment of € 60 mn for four plants near Milan for logistics, then rented to Tnt Traco.

Source: Nomisma.

Leading cross-border transactions in Italy (2004)

Actor	Transaction
PORTFOLIO ACQUISITIONS (AND SPIN OFFS)	
Db Real Estate Global Opportunities 1B, L.P and **Cdc-Ixis** (JV)	Sale of New Real Estate for € 1.4 bn involving 887 properties, mostly used by Enel Group.
Carlyle Group	Acquisition of **San Paolo Imi** properties for € 325 mn. The Group also sold 7 properties in the Italian portfolio of the Cerep fund for about € 83 mn.
M&A, JV	
Morgan Stanley Management	Increasing of its holding in Aedes to 5.2%. Morgan Stanley Real Estate Funds signs an agreement for the purchase of 2.1% of Pirelli & C. Real Estate.
PROPERTY/AREA INVESTMENTS	
Axa Real Estate Investment Management	Acquisition of three office properties in Milan and Rome for € 115 mn. It also buys two office properties in Rome for € 70 mn.
ProLogis Italy	Agreement with NYK Logistics, an international logistics company, for the creation of a facility of 33,055 sqm in the ProLogis Industrial Park in Romentino.
Axa Investment Deutschland	Acquisition of a shopping centre in Civitavecchia for € 24.5 mn. The property becomes part of the portfolio of the German open fund Immoselect.
Deutsche Bank Real Estate Investment	Acquisition the Fashion District Outlet complex in Valmontone (Rome) from the Fashion District Group.
Deka (German property fund)	Acquisition of a logistic park near Piacenza for € 55 mn.
Sonae Immobiliaria	Consolidation of its presence in Italy, where it has already completed two development projects, in Brescia and in Pavia.

Source: Nomisma.

Leading cross-border transactions in Italy (2005)

Actor	Transaction
PORTFOLIO ACQUISITIONS (AND SPIN OFFS)	
Pirelli Re and **Morgan Stanley Real Estate Funds** (MSRE)	Acquisition of Glenbrook Operae for € 255 mn (for 131 properties, formerly Unipol, mainly for offices).
M&A, JV	
Hines	Deal with Fondiaria SAI Group for the development of Città della Moda in the Garibaldi–Repubblica district of Milan.
Pirelli RE (35%) and **Deutsche Bank RW** (65%)	Agreement to incorporate a JV for investments in the retail and entertainment sector (aim of the new company is to acquire assets in Italy for over € 1 bn, both through the purchase of existing portfolios and through the promotion of development schemes).
PROPERTY/AREA INVESTMENTS	
Aareal Bank	Acquisition from Tecnocovering of a logistics centre in Vignate for about € 20 mn.
Henderson-Warburg Kag	Acquisition of an executive office facility in Milan for € 16.5 mn, part of an investment plan in Italy amounting to € 170 mn.
Cerep (pan-European fund of **Carlyle**)	Sale of properties in the north-east for € 100 mn. The properties are part of the package purchased from Sanpaolo Imi including 231 buildings for an overall value of € 325 mn.
Sonae Sierra	Acquisition of two shopping and leisure centres in Marcon (Venice) and Monselice (Padova), additions to the Sierra Fund portfolio.
Tishman Speyer (American investment and development company)	Completion of the first investment in Italy.
ProLogis	Acquisition of a land south of Padova to build a new logistics facility called the ProLogis Park Padova. The Group also buys 150,000 sqm of land in the province of Bologna to develop the Prologis Park Bologna including three logistics warehouses.
SECURITIZATIONS	
Whitehall fund (**Goldman Sachs**)	Securitization of most of the former **Eni** property portfolio (20 executive office buildings, industrial properties and land for € 979.2 mn).

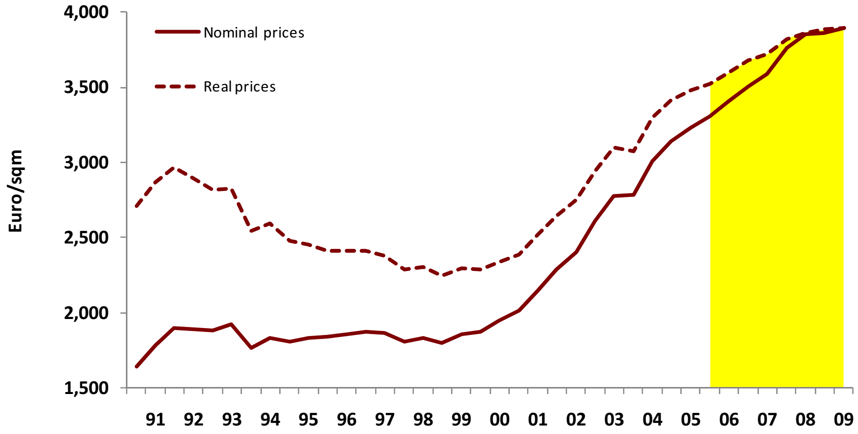
Source: Nomisma.

2006–2009

Following years can also be parted into two halves. In 2006 and 2007 the property boom, which had begun at the end of the nineties, reached the peak of the cycle. At the end of 2007, the market slowed and then went into meltdown between the end of 2008 and the beginning of 2009. The economy went quickly from boom to bust with repercussions on finance and real estate investments.

Figure 3.5

Average prices for housing in the main Italian cities (2006-2009)



Source: Nomisma processing of data from Consulente Immobiliare.

2006 was the peak of the Italian real estate investment market, aided by increased transparency compared to other European countries. According to the Jones Lang La Salle Transparency Index, Italy acquired the definition of "transparent market" in 2004, on the basis of the most advanced standards.

The innovative instruments created at the end of the nineties were used to their full potential, assisting the real estate boom.

This is the period of mortgages' securitization, when the financing of properties as a whole (real estate funds playing a primary role) reached a peak. These are the years of so-called FIRE (Finance Insurance Real Estate), with numerous new actors and professional skills coming into the market – proof of this is the increasing number of associations and representatives during this period, indicating a far greater weight in the overall economy than just five years earlier.

The boom period was characterized not only by investments in existing real estate but also in property development, urban renovation and architectural commitment, supported by easy access to relatively cheap loans.

In addition to traditional investments, more innovative sectors came onto the scene, such as logistics (considered a good investment to diversify the risk from offices) and the hotel industry.

Alongside their investment activity, companies operating in the Italian real estate market merged and formed joint ventures, with the acquisition of shares in Italian property companies by foreign groups. The Italian and foreign markets became closely knit during this period.

Total cross border investments in Italy rose (58% of the total) and closed-end unlisted real estate funds remained the largest foreign investors' choice, followed by German open funds mainly in offices and retail.

The leading transactions in 2006-2007 are listed below.

Leading cross-border transactions in Italy (2006)

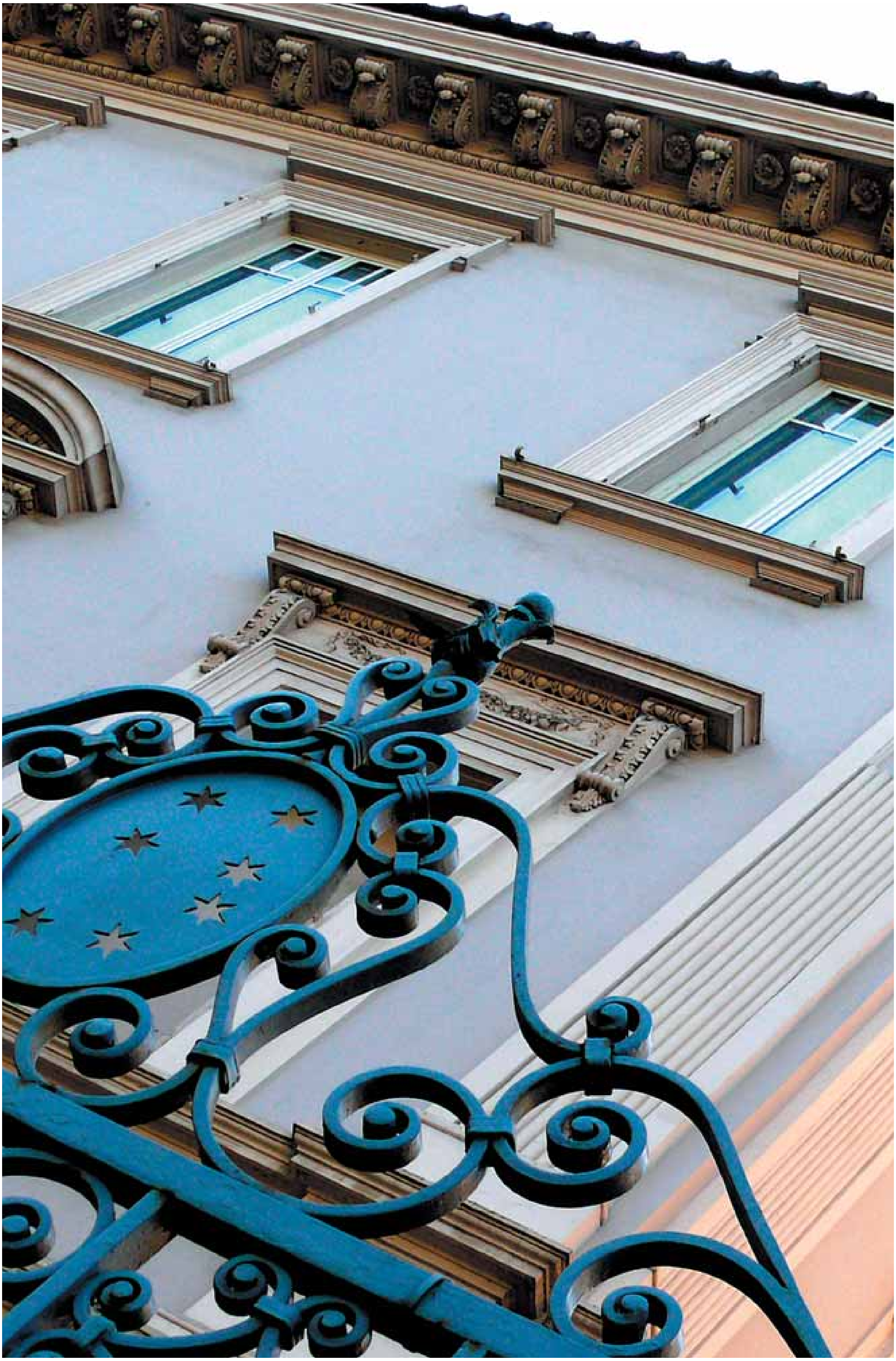
Actor	Transaction
PORTFOLIO ACQUISITIONS (AND SPIN OFFS)	
Carlyle and **Operae**	Acquisition of a property package from Beni Stabili for € 255 mn.
Carlyle	Acquisition of a portfolio of properties for € 91 mn from **Reale Mutua Assicurazioni**.
M&A, JV	
Morgan Stanley Investment Management	Acquisition of a shareholding of 2.043% in Risanamento.
IVG Immobilien	50/50 JV with **Aedes** for the management of an office portfolio and the launch of the Petrarca property fund (€ 375 mn).
NH Hoteles	Agreement with **Framon Hotels** of Messina creating a new company called NH-Framon Italy Hotel Management with a value of € 49.4 mn, controlled two thirds by the Spanish company.
PROPERTY/AREA INVESTMENTS	
Orion Capital Managers	Acquisition of an executive office complex of 30,000 sqm in Milan from Bpi for € 59 mn.
Credit Suisse Asset Management (CS Euroreal Fund – Frankfurt)	Acquisition from Coopsette of "Le Befane" shopping centre for € 244 mn.
DEGI	Acquistion of the "Valdichiana" Outlet Village in Tuscany for € 88.5 mn.
Warburg-Henderson Kag (JV between Warburg and Henderson Global Investors) - through Warburg-Henderson Pan-Europa Fonds Nr.3	Acquisition of a retail park in the province of Bologna for € 20 mn - it is the fourth transaction in Italy in a year by Warburg-Henderson: 2 properties in Milan, and 1 retail park in Lucca.
SECURITIZATIONS	
Pirelli RE (33%) and **Calyon** (67%)	Creation of a JV for the purpose of working in the non performing loans sector. The JV buys a packet of non performing loans for € 195 mn from Banco Popolare di Verona e Novara.
Société Générale	Acquisition of portfolios of mortgages issued by **Iccrea** and **Bcc Nord Est** for € 1 bn.
Merrill Lynch International	Agreement for the acquisition of five NPL portfolios from the prior JV between Pirelli and Re/MSREF and creation of a JV with **Pirelli RE** for the purposes of investing in the tourist/hotel sector in Italy.
Bnl and Royal Bank of Scotland	Launch of the fourth securitization transaction of housing mortgages originated from Banca Nazionale del Lavoro for € 675 mn.
Pirelli RE and Morgan Stanley Corporate Credit	Payment of € 345 mn for an NPL portfolio (valued € 927 mn).

Box 3.3

Leading cross-border transactions in Italy (2007)

Actor	Transaction
PORTFOLIO ACQUISITIONS (AND SPIN OFFS)	
Pirelli Re and the RREEF Global Opportunities Fund II (65%)	Winning of a tender from ENPAM for a portfolio of 29 properties in various sectors, for € 305 mn.
Carlyle (through its Italian vehicle Cerep)	Acquisition of old property portfolios from Diomira, a housing fund, from Portafogli misti and from Orione Immobiliare. The buy-out has a value of € 150 mn.
M&A, JV	
Alony Hetz Properties and Investments (an Israeli property company)	Acquisition of 3.675% of Pirelli RE shareholding for € 60 mn, becoming the second-largest owner of la Bicocca.
Lehman Brothers Real Estate Partners and B. Consulting (company specializing in the development of logistics, retail and housing projects)	Setting up of a JV with the aim of building shopping centres, retail parks and integrated property projects in Italy.
PROPERTY/AREA INVESTMENTS	
TMW Pramerica Property Investment GmbH, the company managing the EuRetail property fund	Acquisition from Pioneer Investment Management SGRpA, the “Le Masserie” shopping centre in Ragusa for € 60 mn.
ITALIAN REAL ESTATE FUNDS	
GE Real Estate	Consolidation of its presence in the Italian market through the acquisition of 70% of the Redwood Fund (closed property fund reserved to the most highly qualified investors and dedicated to investments in the retail sector in Italy).
Foncière des Régions	Gaining of indirect control of Beni Stabili Gestioni (as part of the larger transaction involving the integration of the Italian company into Foncière des Régions).

Source: Nomisma.



The mood of the market began to change radically in the second half of 2007.

In August that year the subprime mortgage crisis broke out in the USA, with mortgage holders defaulting due to higher interest rates. The high level of leverage (with LTV often at 100%) and the profile of borrowers (often with low incomes, no assets and precarious jobs, so-called “ninjas” – no income, no job, no asset -) led to an implosion of American finances, with two effects: the depreciation of housing, with many repossessed homes being sold off cheaply to recover loans and a worldwide financial crisis as banks throughout the world which had acquired AAA securitized sub-prime loans began to fail.

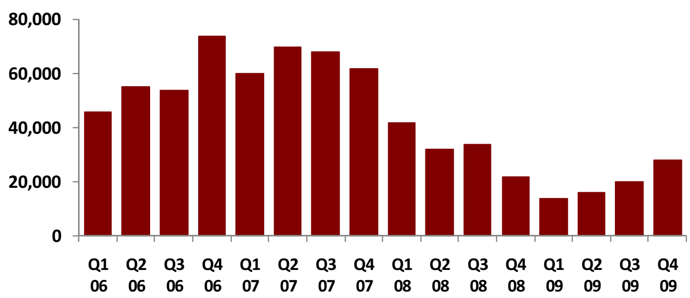
The crisis of the American financial and real estate market struck hard and quickly, but mistakenly it was believed the meltdown would not reach other markets, including Italy. But the devastating effects of the crisis could not be isolated to the USA with doubts about bad loans held by banks everywhere, uncertainty about the true value of securities and assets and the consequent drying up of new loans. Specifically, the underlying risk of loans drove up the cost of borrowing to the point where finance was simply not available and the real economy began to grind to a halt. Consequently, in 2008, the crisis spread geographically and from Wall Street to Main Street, until the financial and economic crisis was worldwide.

As a result, real estate investments in Europe during 2008 slowed out of lack of finance and the dependence of the sector on leverage, with a high debt/equity ratio.

The mechanism began to break down with banks paralyzed by uncertainty and write-downs. The total volume of investments in Europe at the end of 2008 was drastically down, to less than half the peak of the previous year, from over € 244 bn in 2007 to about € 120 bn in 2008 and just € 70 bn in 2009: in 2 years investments were about a quarter of the peak period. As can be seen in the graph below, in the second half of 2008 and above all in Q1 and Q2 2009, real estate investments crumbled. Only after 7 consecutive quarters of falling investments, did a recovery begin, in Q2 2009, suturing the market after the blood-letting. The final data for 2009 are at the level of 2003-2004.

Figure 3.6

European Investment Turnover (€ mn)

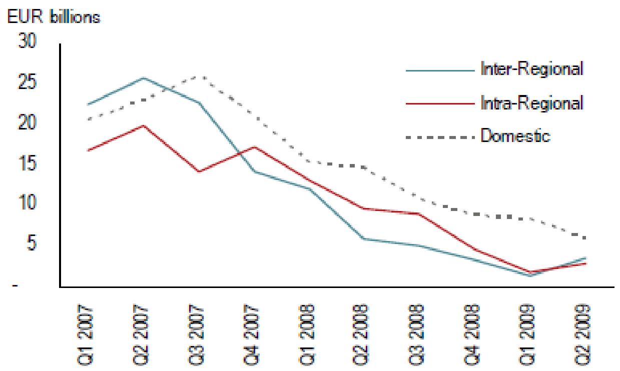


Source: CB Richard Ellis.

In this context, the share of cross-border investments in Europe fell significantly, to recover slowly only at the end of 2009. In such a critical market phase, transactions tend to take place locally and markets close up.

Figure 3.7

Cross border and domestic investment in Europe (€ bn)



Source: Jones Lang LaSalle.

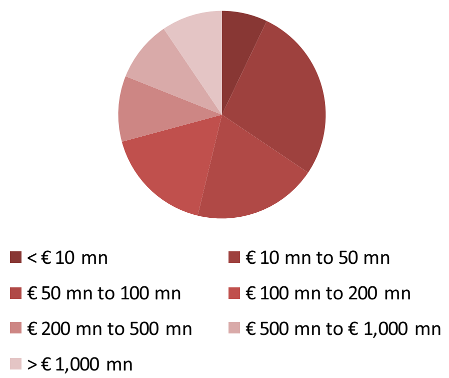
Given the difficulty in obtaining new loans, equity driven investors prevailed in the market, but only relatively average or low-value deals were done.

In addition, investors (responding to the fall in demand) became cautious and weighed up opportunities more thoughtfully. Hence asset quality became increasingly important, in technical and functional terms, in terms of income stream and the reliability of tenants (“back to basics”). Valuable assets continued to attract interest from investors with the rest of the market practically frozen.

The fall of investments in 2008 reflects the fall in large transactions segment of interest to international investors (the average size of deals fell from € 42 mn in 2007 to € 29 mn in 2008).

Figure. 3.8

Investments in Europe by deal size (2008)

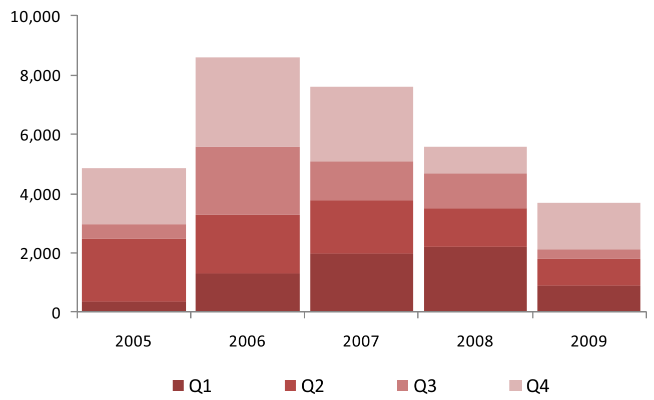


Source: CB Richard Ellis.

In relation to the Italian market, direct commercial property transactions in 2009 amounted to € 3.6-3.7 bn according to DTZ, with a reduction of about 36% on the same period in 2008, substantially returning to the level of 2003-2004.

Figure 3.9

Volume of property investments in Italy (€ mn)

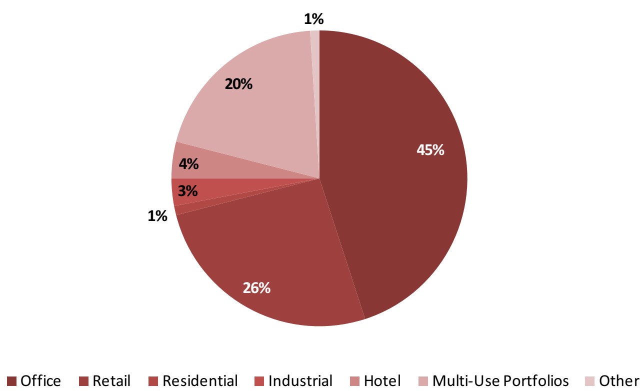


Source: DTZ.

Investors remain focussed on high-quality locations: offices are the leading sector, followed by retail. Foreign investors tend to prefer retail with a larger return on investments.

Figure 3.10

Transaction by property type in Italy (2009)



Source: CB Richard Ellis.

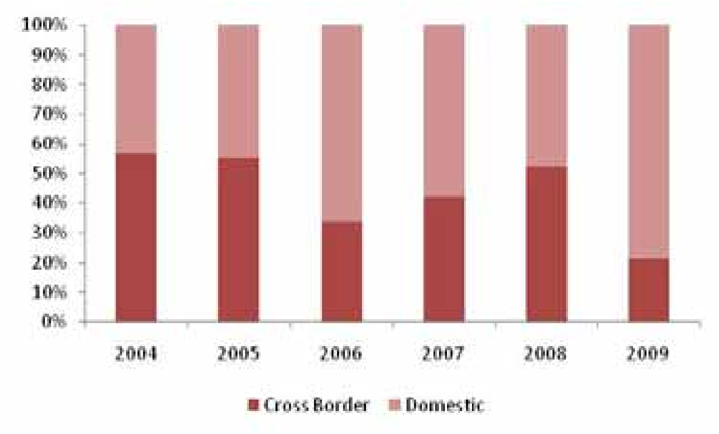
Figure 3.11

Italy sector investment by purchaser origin (2009 € bn)

Source: CB Richard Ellis.

Figure 3.12

Direct real estate investment volume in Italy by origin of Investors (%)

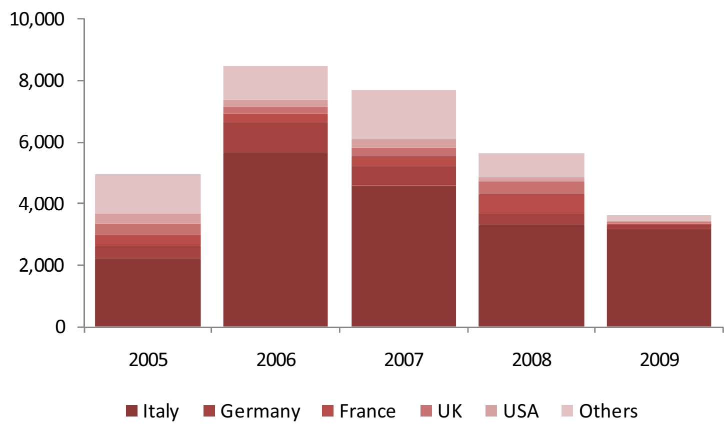


Source: Nomisma processing of data from BNP Paribas and Jones Lang LaSalle.

Analyzing the rolling direct investment volume and according to Jones Lang LaSalle and BNP Paribas, it is clear that the weight of cross-border operations has increased with a discontinuous trend until year end 2008. At that point international investors counted for more than half of total real estate investments, without considering the potential increase including indirect investments. The sharp decline in the number of transactions beginning in 2008 continued throughout the following year. Volumes are low if compared to 2006-2007 but investor confidence appears to be returning. In particular, cross-border investments fell even more sharply than the market as a whole (the same is true of Europe as a whole), with local actors substantially unchanged. The reason for this is that some Italian listed real estate companies, already experiencing financial problems, decreased their presence in the market before it went into reversal, while other domestic property companies and private investors have not been affected by the financial crisis thanks to more conservative approaches and have continued to invest in real estate.

Figure 3.13

Italy investors by Purchaser Origin (2009 € mn)

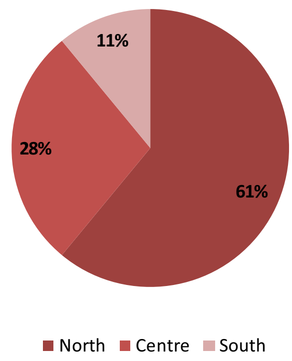


Source: DTZ.

As can be seen in the graph below, in 2009 in Italy there continued to be a high concentration of investments in northern regions (Lombardy 43%, Emilia Romagna 9%) totalling 61%, whilst in the centre investors were confined to Lazio (20%) and Tuscany (6%), making 28% of the total. The south has only a marginal role, with11% of total investments.

Figure 3.14

Property investments by geographical area (2009)



Source: DTZ.

In terms of foreign investors, the leading actors are still equity-backed funds which usually do not rely on leverage (pension funds are a major case in point), German open funds and institutional funds seeking to rent. In addition to these consolidated investors in Italy, some hedge funds are now considering investment opportunities but are held back by the lack of credit and the reluctance of sellers to grant interesting discounts. The approach to the market of Asian and Middle Eastern investors is remarkable, with sovereign funds leading the way and preferring Italy over other European countries after the credit crunch, a phenomenon that, together with traditional long-term investments, could help to stabilize the market.

As abroad, sale & lease back transactions are becoming more popular. They are carried out by owners (mainly banks, but also corporations) wishing to hive off property from their core businesses and liquidate their assets in view of the difficult economic and financial situation, giving rise to financial real estate transactions with underlying core assets that are particularly appetizing to institutional investors in Italy and abroad.

The leading transactions in 2008-2009 are shown below.

Box 3.4

Leading cross-border transactions in Italy (2008)

Actor	Transaction
M&A,JV	
Colony CFN Capital	Setting up of a JV with Colony Ventures and Compagnia Fondiaria Nazionale (CFN) in the Operae di Vittorio Casale Group with the aim to invest up to € 3 bn.
PROPERTY/AREA INVESTMENTS	
ING Real Estate and **GIC Real Estate**	Setting up a JV for the acquisition of a new shopping centre in Rome East, owned by **Gruppo PAM** for about € 400 mn
Newco 50% owned by **Lehman** and **Caf (Capital Value Services)**	Acquisition of 30% of MPS Gestione Crediti SpA for € 30 mn; the company manages a portfolio of € 1 bn of non performing loans.
Macquarie Bank	Sale to Barclays of a portfolio of mortgages issued in Italy for € 1 bn.
Rewe Group	Strengthening of its position in Italy through the acquisition of 18 supermarkets trademarked **Uni.**
Doughty Hanson & Co Real Estate	Acquisition of a land in Padova covering 68,615 sqm.
Eriv (fund in the Axa Reim Group)	Acquisition from Tecno Real Estate part of the Retail Park "Borgo Commerciale Brunelleschi" in Melfi (PZ).
Henderson Global Investors (Azzurro Italian retail property fund)	Acquisition of properties in various Italian cities for € 145 mn.
Schroder Property Investment Management	Acquisition of properties (35,000 sqm) for logistic uses for about € 20 mn and another logistics facility in Pomezia covering 28,000 sqm from the Matrix fund for € 25 mn (Via the Schroder Eurologistic Fund N. 1 fund, it makes an agreement for the purchase of a logistics centre for € 44.3 mn and also invested € 47.7 mn to buy two further properties in Bologna and Novara.
Commerz - German property funds	Acquisition of the Edison Business Center under construction in Sesto San Giovanni (€ 125 mn) and of an hotel in Orio al Serio (€ 18 mn).
Warburg-Henderson Global Investors JV	Acquisition of "Il Borgo" shopping centre in Asti (19,000 sqm) for € 50 mn.
Prologis	Investment of about € 15 mn to buy 25,000 sqm in the Vailog Park in the province of Piacenza and the Prologis European Properties Fund II acquires a complex of 20,000 sqm in Milan.
ITALIAN REAL ESTATE FUNDS	
Mhrec (**MPS Asset Management Sgr** fund and **Hines**)	Acquisition of a property in Rome of 19,000 sqm for € 50 mn.
RREEF Alternative Investment Sgr (Rutenio fund)	Acquisition of a property in Rome from the Toti Group for about € 100 mn.

Leading cross-border transactions in Italy (2009)

Actor	Transaction
PROPERTY/AREA INVESTMENTS	
Henderson Global Investors	Acquisition of the Barberino designer outlet (FI) from **McArthurGlen** for about € 125 mn. Subsequently, in 2010, a further 6,000 sqm was added to the outlet, in addition to the existing 21,500 sqm; HGI was also authorized by the Bank of Italy to start up two new property funds for investments exclusively in Italy, called DSPF1 and DSPF2
The Arab sheik **Hamed Al Hamed** of Abu Dhabi	Acquisition of the hotel complex of la Perla Ionica in Acireale for € 46 mn.
Schroder Property Investment Management Italy	Sale of a logistics facility in the province of Milan to Pramerica Real Investors for about € 26.8 mn.
The American Group **Horwarth**	Launch of a specialist investment fund in hotels called Gma Capital, with 2 hotels, one in Rome and one in Milan.
SECURIZATIONS	
The **Whitehall** property fund (managed by Goldman Sachs)	Acquisition of almost 900 non performing and sub-performing loans guaranteed by Italian properties, with a value of about € 120 mn.
ITALIAN REAL ESTATE FUNDS	
Gic - Singapore Investment Corporation	Acquisition of units of Omicron Plus, managed by Fimit SGR, paying about € 80 mn.
The **Carlyle private equity fund**	Setting up of the newco Carlyle Real Estate SGR Spa, with a share capital of € 1.5mn, focussing on the management of property funds investing solely in Italy.

Source: Nomisma

4.

4. ITALIAN REAL ESTATE FUNDS


SANPAOLO


SANPAOLO

As stated above, one of the instruments mostly contributing to the development of the Italian real estate market and attracting foreign capital whilst increasing market transparency has been the real estate fund.

Ten years have passed since the introduction of this instrument into Italy in 1999 through regulatory reform following some rudimentary and failed experiments in the eighties.

During the last decade real estate funds have been subject to a continous change in regulations, often determining their development over time.

From funds essentially working in the retail market through the acquisition of portfolios (ordinary funds) they have diversified into products appealing to the most demanding clients. In addition, they began with core investments in properties in prime locations and in traditional sectors but then diversified into innovative sectors (hotels and industry) in secondary locations. Of core importance was the extension of the instrument to the public sector which is still using it to increase the value of, and/or sell off, its property assets.

The following pages therefore deal with the regulatory framework applicable to the sector and the market today.

About the instrument

Italian real estate funds are defined as segregated funds that invest exclusively or predominantly in real estate assets, real estate rights and equity interests in real estate companies. An Italian real estate fund is not a legal entity (with separate legal personality) but rather a pool of real estate investments jointly held by multiple unitholders, managed on behalf and in the interest of the unitholders by an “asset management company” (Società di Gestione del Risparmio, “SGR”).

The SGR must be an Italian joint-stock company with registered office and head office in Italy; an SGR can carry out its activity of management of investment funds upon authorization by Bank of Italy and Consob, which requires that Board of Directors’ members have strict professional and integrity requirements. The SGR is sole responsible towards the investors for all management activities, including asset management, property management and fund management. Italian real estate funds are “closed-end investment funds”, meaning that the redemption of the invested capital and the distribution of earned profits can take place only at pre-determined moments according to general regulations and to specific provisions contained in the fund rules (“Regolamento”). Typically:

(a) units redemption can take place only at the end of the duration of the fund, but the Regolamento may, leaving discretion to the BoD of the SGR, allow for partial redemptions in connection with divestments of assets if opportunity of re-investment are not foreseen (it is important to highlight that the Italian law also foresee the possibility to establish “closed flexible fund”, whose Regolamento may, in case of funds with multiple subscription windows, leaving discretion to the Board of Directors of the SGR, allow for partial redemptions also in connection with issue of new fund-units, within the limit of new raised money and with the possibility to make use of new debts (considering the measure defined by law);

(b) profits are distributed to the unitholders according to the provisions of Regolamento upon decision of the SGR. Usually the resolutions of profit distribution are taken in connection with the approval of annual or infra-annual results. Profits are however distributable only for the part that is not tied to revaluation of assets registered but not realised through a sale.

Italian real estate funds can be set up through real estate assets’ contribution or cash subscription:

- Cash fund: investors subscribe for fund-units in cash and the capital raised is later invested in real estate assets, real estate rights and equity interests in real estate companies;
- Contribution fund: the fund is set up through contribution of real estate assets and equity interests in real estate companies by contributors who may partially or totally place the fund-units (in relation to the number of contributors and their targets) on the market;
- Mixed fund: it is set up through cash subscription and contribution.

Italian real estate funds may raise money through a single issue or through multiple issues, according to the need and to investment opportunities. The fund-units can be freely transferred between investors. In case of "Reserved funds", the fund-units can be transferred only among investors holding certain professional characteristics.

Italian real estate funds can be either listed or not listed and it is possible to set up a fund with only a few unitholders. However as a liquidity provision for retail investors, Italian law requires the filing of an application for listing within 24 months after the completion of the initial offer if the value of fund-units is lower than € 25,000. As a general rule, fund-units may be made available to: (i) the general public, whether the fund is listed or not; or (ii) only to specific categories of investors. In this latter regard, it is possible to set up "Reserved funds" that are accessible only to qualified investors (e.g., pension funds, insurance companies, investment firms, banks, stockbrokers, foreign persons/entities who, pursuant the laws of their respective home countries, conduct the same type of activities carried out by the foregoing persons, as well as individual/entities who can demonstrate the possession of specific expertise and experience in transaction involving financial instruments, etc.) and for which investment restrictions are looser than those affecting general funds. In any case the participation in Italian real estate funds is regulated by the rules of the fund that must provide for the characteristics of the fund and its operations.

In addition, Italian law allows the setting up of "Speculative funds" only accessible to a maximum of 200 investors; the value of the relevant fund-units shall not be lower than € 500,000. Speculative funds can operate with limited restrictions.

With regard to the indebtness, ordinary funds and Reserved funds have a limit to leverage at 60% of the real estate assets value (and at 20% of other assets) while such limitations do not apply to Speculative funds.

As mentioned, Italian real estate funds are strictly disciplined by specific regulations and are supervised by Bank of Italy and by the Italian regulatory authority for financial markets (Consob). The relevant rules are set forth both in primary and secondary legislation, including statutes and regulations issued by the Bank of Italy, the Ministry for Economic Affairs and by Consob.

In particular, under Italian law, the SGR is charged with the drafting of the fund rules (the so-called Regolamento). The Regolamento sets forth the fund's operational rules and must be approved by Bank of Italy before any offer of the fund-units to investors takes place. In particular the Regolamento disciplines, within the limit set forth by the law and regulations of the above-mentioned public authorities, all relevant issues, including:

- Duration;
- Typology;
- Investors: qualified investors ("Reserved fund") or retail ("Retail fund");
- Characteristics of the fund, investment policies, expenses, fees;
- Subscription (single/multiple), redemption of fund-units and distribution of the profit;
- Governance.

Table 4.1

Key points of real estate funds incorporated under Italian law

Istitution modalities	▪ Cash collection: the fund raising activity takes place through a cash collection, followed by the real estate investments' phase (i.e. "Fondi ordinari") ▪ Assets contribution: fund raising activity takes place through the contribution of real estate assets, real estate rights and shareholdings in real estate companies and other real estate indirect investments (i.e. "Fondi ad apporto") ▪ Cash collection and Assets contribution: fund raising activity takes place through cash collection and/or assets contribution (i.e. "Fondi misti")
Unitholders	▪ The fund needs more than one unitholder ▪ Italian law focus particular attention to the fund's unitholders structure, whit a potential risk for elusive funds of a penalizing tax system (i.e. "Fondi Familiari")
Management activity	▪ Management activity is delegated to a specialized management company (i.e. SGR) ▪ Each fund is a segregated asset
Corporate governance	▪ The SGR is responsible for the management and the value enhancement of the Fund, however Unitholders are involved in the corporate governance through proper control bodies: ✓ Unitholders Meeting, that may adopt resolutions regarding changes in management/investment policies, substitution of the SGR, fund's anticipated winding-up and other matters defined by the law or by the Regolamento; ✓ Advisory Committee, that may adopt binding and non-binding resolutions concerning various management aspects in accordance to the law in force .
Duration	▪ Max duration: 30 years
Portfolio criteria	▪ At least 2/3 of the fund's total assets has to be invested (up to 24 months since the first subscription) in real estate assets, real estate rights and shareholdings in real estate companies and other real estate indirect investment (i.e. "Investimento Tipico")
Leverage	▪ Max leverage up to 60% of the Investimento Tipico (an higher leverage is possible only for speculative funds)
Listing	▪ Obligatory listing for funds with a unit initial price less than € 25,000 ▪ Optional listing for other funds
Bank of Italy's control	▪ Management company activity is subject to Bank of Italy's supervision ▪ Each fund could be launched only after the approval of the fund rules by Bank of Italy ▪ Listed funds are supervised also by Borsa Italiana S.p.A. and CONSOB

Referring to the tax regulations applying to real estate funds, the scheme below represents a brief overview of the fiscal regime.

Table 4.2

Principal tax regulations applying to real estate funds incorporated under Italian law

Fund's tax system

Yearly fund's taxes	▪ Fund's income is not subject to IRES and IRAP ▪ This exemption is applied for every fund's income ▪ Unique exception are Fondi Familiari, that are subject to a yearly taxation of about 1% of the fund's NAV
Contribution funds: entry tax and VAT system	▪ Italian contribution entity could opt for the application of a substitute tax of IRES+IRAP (i.e. ordinary rates: 27.5% + 3.9%) equivalent to 20% on the capital gains arising from the contribution of the real estate asset ▪ This tax could be paid in 5 years ▪ In case of contribution of predominantly rented real estate assets, the operation is not subject to the ordinary Mortgage and Cadastral Tax (usually equivalent to 2% of the sale value); the Mortgage and Cadastral Tax is applied in a fixed rate (€ 168 each one)

Tax system on distributed profits

Companies operative in Italy (i.e. Snc, Sas, Srl, Spa, etc.)	▪ 20% on the profits (dividends and capital gains) distributed to unitholders ▪ Profits are considered into the company income tax
Pension funds and investment funds	▪ No taxes are applied
Non-resident unitholders	▪ No taxes are applied to unitholders resident in countries enclosed in the "White List"
Other unitholders (i.e. natural person)	▪ 20% on the profits (dividends and capital gains) distributed to unitholders ▪ No other taxes on fund's profits

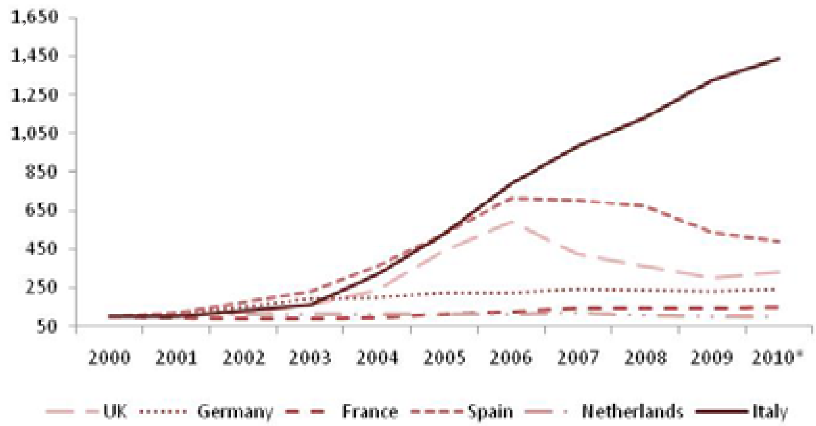
Market size and features of Italian real estate funds

Despite the crisis of the underlying property market, in H1 and H2 2009 the Italian property fund market continued to expand, with 39 new property funds starting up, making a total of 267 now operating, with net assets for approximately € 27 bn.

Analyzing the Italian industry within the European market, it is clear that the real estate fund's industry shows everywhere a good trend considering the global decrease of real estate values. In particular, it is important to highlight that in Italy and in France real estate funds continue their growth in term of numbers of operating funds and asset under management, growth also planned for 2010 (as shown in the graph below).

Figure 4.1

NAV trends of real estate investment funds in the major European countries (2000=100)



* Data estimated.

Source: Nomisma processing of Scenari Immobiliari data.

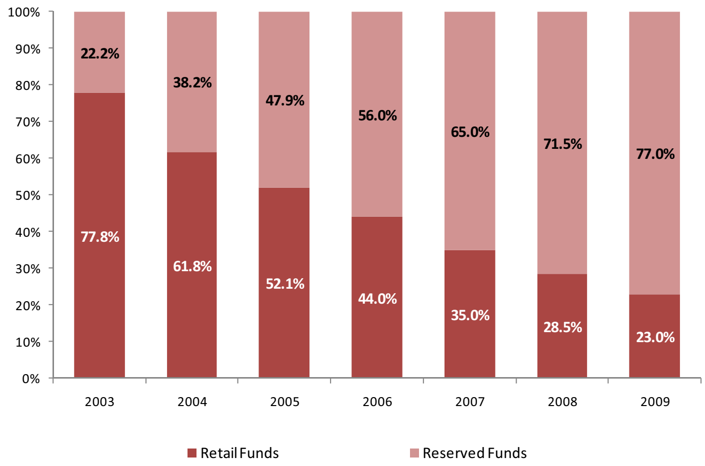
With particular reference to the Italian market, alongside this expansion, radical changes occurred in the sector, as summarized below:

1. increasing use of funds reserved to qualified investors, and decrease in retail funds;
2. a clear distinction between ordinary funds and aggregated funds, the latter reaching about 83% of the market.

Up to 2003, ordinary funds for a retail public were the only option available, but subsequently the market underwent profound change, becoming quite the reverse of what had been by the beginning of the decade. There was a growing use of initiatives related to aggregated funds for qualified investors, which now dominate the market (a little under 90%) and have featured exclusively among new market instruments. The percentage of reserved funds is a little less in terms of assets managed by the two types of fund.

Figure 4.2

Breakdown of net assets by client type



Source: Nomisma processing of Assogestioni data.

Based on Bank of Italy data, there are 63 asset management companies (SGR) active in Italy, of which 47 work exclusively in the sector of real estate investment funds.

Table 4.3

Number of property funds approved or pending approval on 31 October 2009

	Reserved		Total
Aggregated*	*No*	*Yes*	
No	21	24	**45**
Yes	6	216	**222**
Total	27	240	**267**

(*) *According to specifications of fund regulations, the effective start up is not necessarily undertaken.*

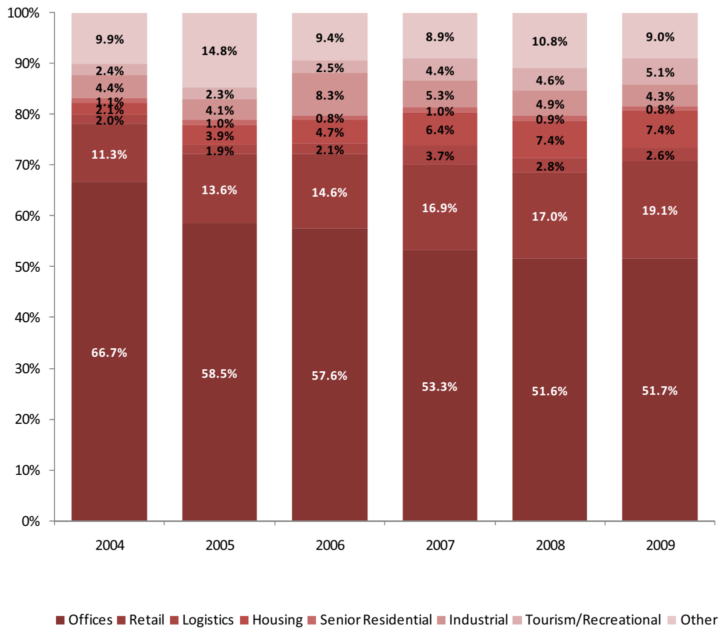
Source: Nomisma processing and estimates of data from Assogestioni and Bank of Italy.

Out of the 267 real estate funds authorized by the Bank of Italy, 23 are listed in the MIV market of the Italian Stock Exchange. At the end of February 2010, the market capitalization of listed vehicles totalled € 3.5 bn.

With reference to the asset allocation of investments by funds, in the very last years a tendency started towards higher a balance in real estate investments, based on European experience, reducing the office portion. This reduction, from 66.7% in 2004 to 51.7% today, has only been partly offset by the retail sector, up in the same period from 11.3% to 19.1%, still lower than the European average.

Figure 4.3

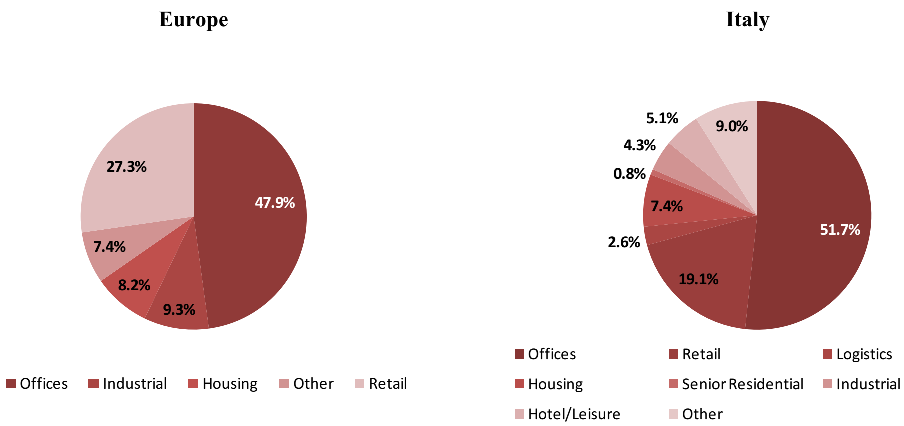
Breakdown of the asset allocation of Italian real estate funds by sector (2004-2009)



Source: Nomisma processing of Assogestioni data.

Figure 4.4

Breakdown of the asset allocation of real estate funds by sector in 2009: Italy vs Europe



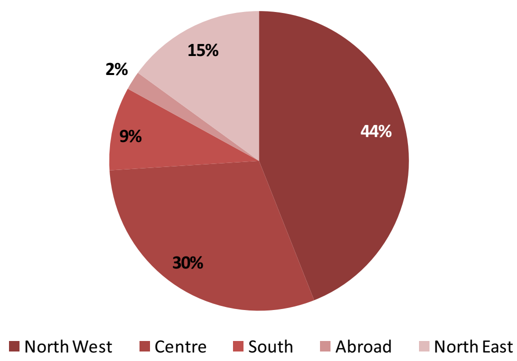
Source: Nomisma processing of various sources.

The geographical asset allocation of Italian real estate funds in 2009 was concentrated on the markets in the north-west (dominated by Milan and Lombardy) with 43.8% of the total, followed by central Italy (30.4%), the north-east (14.7%) and the south and islands (8.9%).

Investments abroad were a mere 2.2%.

Figure 4.5

Breakdown of the asset allocation of real estate funds by geographical area



Source: Nomisma processing of Assogestioni data.

The performance of real estate funds

After two negative semesters, (H2 2008 and H1 2009) the overall performance returned to show slightly positive trends (+0.7%). Comparing the UK property fund Index with the Italian Index it is possible to remark that Italy suffered less from the real estate crisis affecting the whole Europe.

European trend, on the opposite, caused important losses to UK property funds up to H1 2009 with a -15.7% return. During H1 2009, anyway the UK market recorded a significant rebound (+12.3) leading the Index to the precrisis level.

The more stable trend of the Italian real estate funds index can be due to the little number of operative vehicles compared to other markets and, at the same time, to the lower decrease of the Italian real estate market.

The property fund market in Europe was negatively impacted by the worldwide slump and suffered a setback in 2008, particularly in the second half of the year. According to IPD, the index of European Property Funds, between 2007 and 2008, the sector fell by 17.2% (in local currency).

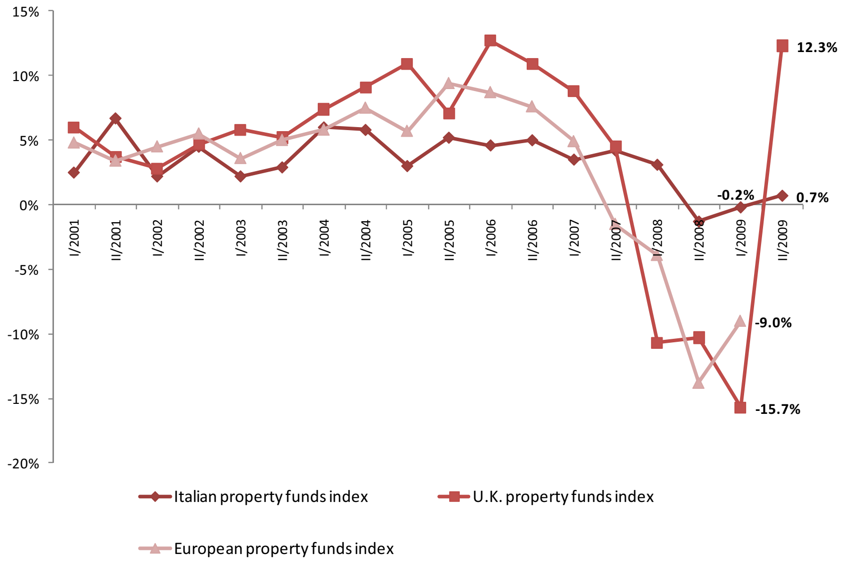
This drop was dramatic in the second half of the year, with a fall of 13.8%, compared to just 3.9% in the first half of 2008. This average somewhat conceals huge variations in performance, from falls of up to 80% in some cases, to increases of up to 25%. This volatility is due to the brusque change in interest rates during 2008 (above all for the British pound), penalizing the already negative performances of property funds in the UK, where the property market collapsed further than elsewhere in Europe. English property funds took the brunt of the crisis in terms of income, whilst other European property funds returned profits.

Within this context, Italian property funds lost only 1.3% in H2 2008 and 0.2% in H1 2009, H2 2009, at 0.7%. In Europe the overall trend was to the downside, significantly in H2 2008 and marginally in H1 2009, showing the stability of the Italian instruments.

Figure 4.6

Index of European, U.K. and Italian real estate funds – Total 6-monthly Returns

(percentages calculated in local currency)



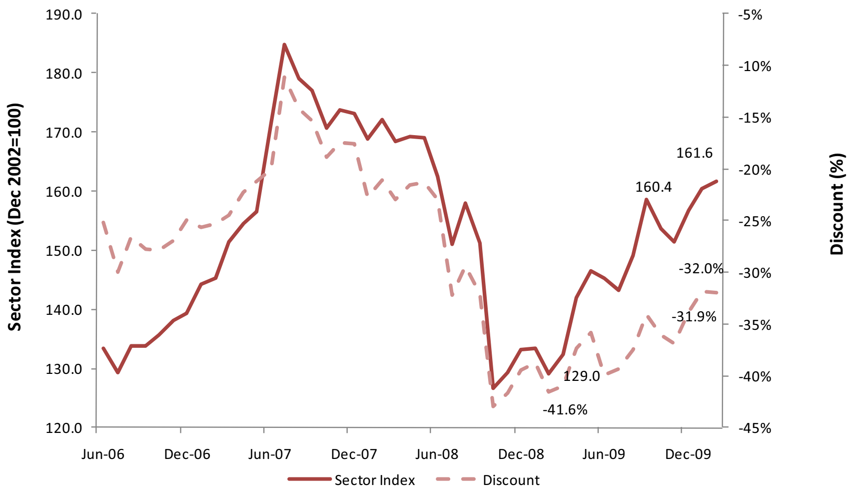
Source: Nomisma processing of IPD data.

The sector of listed property funds has also been trying to pull itself out of the doldrums after 2008 collapse, when the average discount expressed by quotations on NAV reached as high as 42.9%.

The upturn in equities from February 2009 has certainly helped the sector, which nonetheless is struggling to return to pre-crisis levels.

Figure 4.7

Development of quotations and discounts in relation to the NAV of listed real estate funds



Source: Nomisma processing of data from BNP Paribas Real Estate research.

5.

5. THE PERSPECTIVES FOR REAL ESTATE INVESTMENTS IN ITALY


SANPAOLO
INTESA SANPAOLO

In the light of the analysis in the sections above, concerning the development of the Italian property market in recent decades, it can be seen that in the mid-nineties the market was dominated by a few domestic actors and was practically unleveraged and with few IT instruments; in 15 years, the market has completely changed, with a strong foreign presence, highly-developed financial sector's support and a far higher degree of transparency.

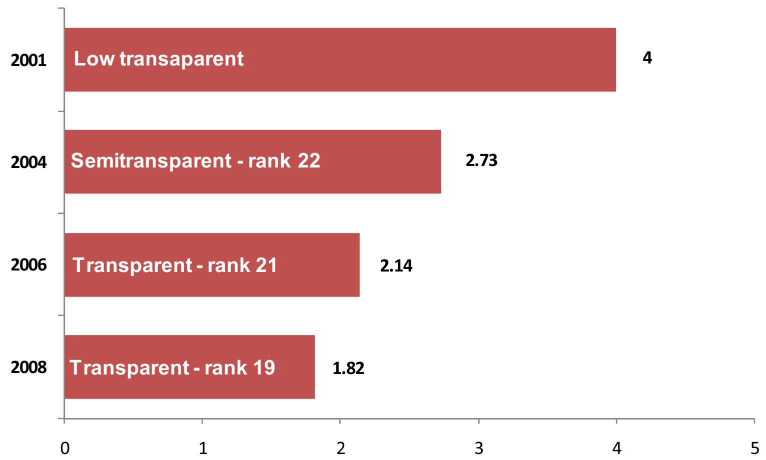
In this regard, it is worth remembering that over the last decade the Italian property market has grown much more transparent in terms of its activities, the players in the market and the financial instruments used, encouraged by the presence of real estate funds and the role of regulatory changes.

This improvement is reflected in the Jones Lang LaSalle Transparency Index, where Italy has gradually moved up the table, due to its improved performance[1].

In just a few years, Italy has moved from a country with a low degree of transparency (out of 50 countries) to a market now considered (actually since 2006) fully transparent, ranked 19th in the world. This result is even more significant in the light of the fact that the Index now includes 80 countries, many of them in direct competition with Italy.

Figure 5.1

Transparency score trend of the Italian real estate market



Source: Jones Lang La Salle.

By the end of 2009 and moving into 2010, the global economy and the real estate market seem to have passed their worst moments. The prevailing sentiment amongst business is still cautious, but several international investors are turning again to Italy seeking selected investment opportunities. The main factors that could drive the investment market in Italy over the short term are:

- distressed-property opportunities, due to increasing difficulties, faced by most banking groups, related to technical defaults through breach of loan to value covenants or renewal of debts in a maturity period (almost € 40 bn of debt concerning real estate loans will mature in 2010 - according to Jones Lang LaSalle's estimates). Whilst some lenders may be hoping for a market recovery in the short time to solve the situation without the need for intervention, other important banks are evaluating alternative ways (to be executed through a complex debt restructuring process) that could be potentially interesting for equity capital investors;

[1] The index analyzes four key factors:
- Availability of accurate financial and market information
- Regulatory and legal environment
- Security of legal title and enforceability of property rights
- Financial disclosure and governance of listed real estate companies
- Zoning and building codes.

Originally, the index was based on a small number of countries, but now it includes over 80.

- prime properties across all sectors, because capital will be potentially targeted on high quality assets (not many) with relatively secure income streams, also considering the current weak rental market;
- relocation activities, considering that the occupier demand is expected to soften and that a number of companies aim to further cost cutting;
- public real estate assets: with the Italian State facing high levels of debt there will be a renewed pressure to reduce real estate exposure and cash in from disposal activities;
- retail assets, even if investors seem to be very selective in terms of locations and partners adopting defensive strategies during this uncertain phase;
- new credit available, even if it will be focused on prime rated borrowers.

In particular, considering the current market trend, as stated earlier, what are the prospects for anyone wishing to invest in the Italian market and what is the current role of international market players?

A solid market with a low volatility

During the expansion phase of the last property cycle, in 1997-2007, the Italian real estate market grew in value, but not in line with foreign markets.

Table 5.1

1997-2007 change in prices of houses in leading markets

South Africa	393	France	144
Ireland	240	Belgium	131
UK	213	Denmark	128
Spain	190	New Zealand	123
USA	165	Netherlands	102
Australia	159	Italy	102
Sweden	149	Canada	78

Source: Economist.

Similarly, the Italian market shrank in terms of values and quantities but less than other markets. According to the latest data, between 2008 and 2009, prices fell on average by 4/5% for Italian properties, but by up to 30% in countries with higher inflation statistics during the expansion phase.

One of the factors contributing to the greater resilience of the Italian market is the lower leverage of the entire system, particularly of families, and hence its ability to cope better with the credit crunch.

Given that, an investment in Italy could be seen as an excellent defensive strategy, insuring investments against market fluctuations.

Lack of quality assets

Many parties (users and investors) complain about the poor quality of property assets in Italy. These assets are often old and poorly maintained, with prudent and conservative zoning and developing policies generally adopted by local and central authorities.

These factors tend to defend quality properties against falling prices and also indicate that many cities have a large number of areas that could be upgraded successfully.

Luxury housing in Italy does very well. Although a niche market only, the small number of truly high-quality properties are an excellent defensive investment. According to the most recent data from Nomisma and Tirelli & partners, who have been monitoring the luxury housing markets in Rome and Milan for the past seven years, this market has consistently out-performed the mass market.

Need to upgrade existing properties

As a result of the above described situation, property assets need upgrading to meet the requirements of modern users, with a focus on cost saving and energy efficiency.

Upgrading has been a major topic in Italy for many years. In 1997 new regulations were introduced to encourage renovation work on housing, and the number of applications for such work rose year by year up to 2009 record level.

At the end of the nineties many city authorities upgraded once abandoned city areas, using special funds created for the purpose.

Increasing transparency and attractiveness of the market

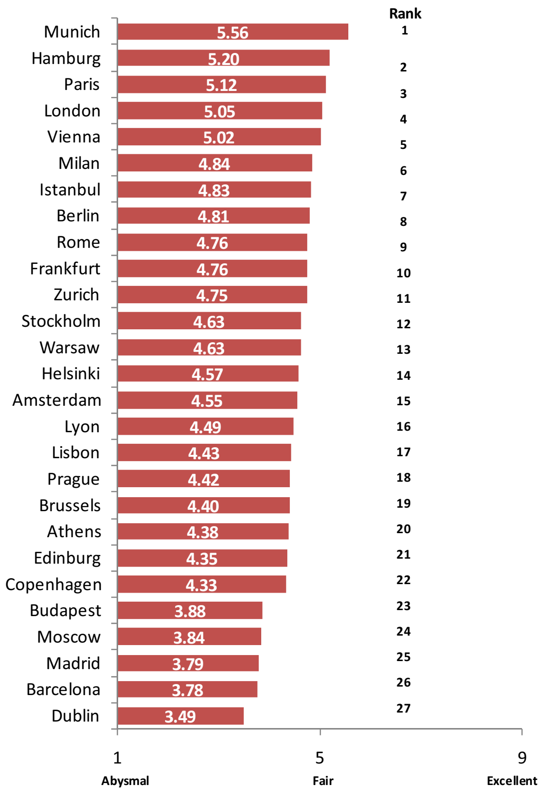
As described above, the Italian real estate market has gradually narrowed the gap with other European markets, reaching top rankings in competitiveness and market transparency. This has made the Italian market more attractive to foreign investors over the past ten years.

According to ULI, the recent report entitled "Emerging trends in real estate Europe 2010" has reported improving positions for the property markets performance of Italian cities. Milan has moved up from 18th in 2009 to 6th place out of the 27 cities surveyed (Rome is 9th).

Milan was 9th in terms of new investment opportunities, and Rome 14th.

Figure 5.2

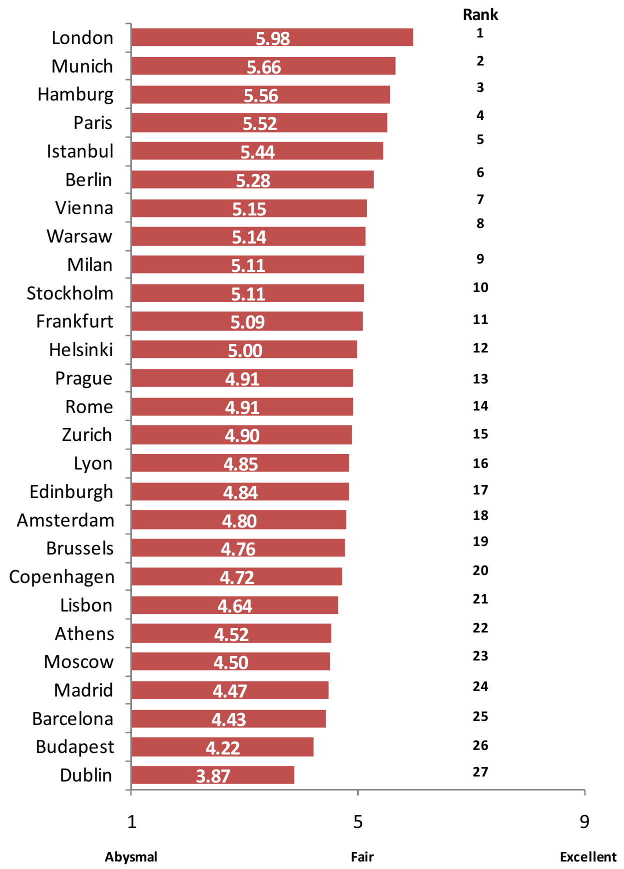
Existing property performance – Ranking of European cities



Source: ULI/PWC, 2010.

Figure 5.3

New property acquisitions - Ranking of European cities



Source: ULI/PWC, 2010.

Opportunities outside Milan and Rome

As can be seen from the summary of real estate investments in Italy over recent years, not only Milan and Rome have attracted investments, but also a number of secondary cities.

This is due to the well-known matter, proper of the Italian economy, that many provincial cities have lively economies with their own characteristics of excellence and special skills (the "Italy of a hundred cities"). Italy is not a country dominated by two city economies, so investments tend to follow the attractions of other cities in terms of manufacturing, construction and services.

Importance of the retail sector

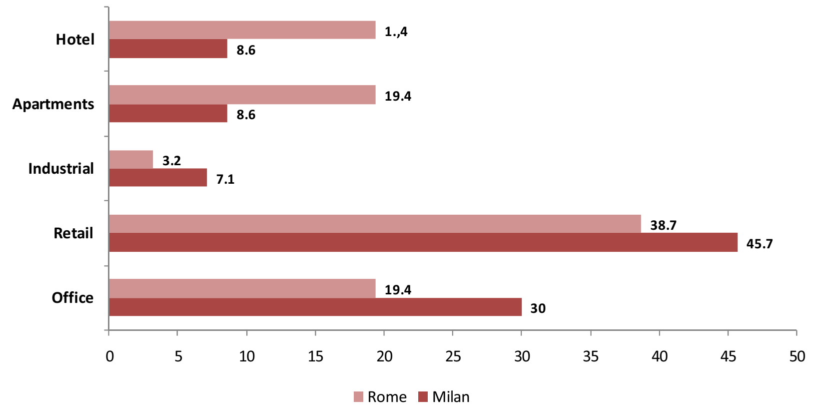
The Italian retail sector is important for the national and international economy. On the one hand, the number of shopping centres per thousand inhabitants is lower in Italy than elsewhere in Europe, but, on the other, parts of the country are at the vanguard of the retail industry. The centre and south of Italy are still characterized by the presence of traditional shops.

Opportunities in the retail property sector in Italy are well-known to investors, above all foreign investors, who dominate the market. The importance of the Italian retail market was highlighted by the World Economic Forum which commented on its excellence and ranked it 9th out of over 100 countries.

The ULI/PWC report saw the main investment opportunities in Milan and Rome within the retail sector.

Figure 5.4

Best sectors for acquisitions by city (%)



Source: ULI/PWC, 2010.

Thanks to this Italian peculiarity, the retail sector, and, more specifically, the segment relating to shopping centres, did not suffer a slow-down, and continued to provide new facilities. Italy is one of the most active countries in Europe in this sector, with about 2 mn square meters of shopping centres coming onto the market in 2009-2010.

The market is not appealing just in terms of new centres, but also for a better asset management and requalification (i.e. extensions) of the exisiting stock.

Importance of the tourist sector

Among the emerging sectors, tourism is the one which deserves mention in relation to the real estate market, based on the country's tourist trade. Hotel facilities and vital infrastructure are lacking (although the High-Speed railway network is making up for this, to some extent), but the recent re-appointment of a Minister of Tourism suggests that the government is focusing some attention on the sector.

According to the Country Brand Index 2008, Italy is top in terms of its artistic and cultural heritage, and 2nd for history and cuisine, although the Tourist Competitiveness Index of 2008 places Italy 28th (Spain is 5th, Germany 3rd, USA 6th, France 10th). The WTO report of 2008 shows Italy 5th as a tourist destination and 4th for tourist turnover.

Today, in Italy there are over 1 mn hotel rooms and 33,500 hotels throughout the country. This places Italy 4th behind USA (4.4 mn rooms), Japan (over 1.5 mn rooms) and China (over 1.3 mn rooms), much larger countries than Italy.

The hotel industry is nonetheless at full capacity. Rather than new hotels, what is needed is the upgrading of existing hotels focusing on both properties and management aspects.

This is happening to some extent. The number of 1 and 2-star hotels in the country has gone down in recent years, with a corresponding increase in higher quality hotels. In the past decade, the number of 3-star hotels has increased from 33.4% to 49.7% of the total, and 4-star hotels have increased from 6.7% to 11% with 5-star hotels up from 0.2% to 0.7% of the total. A similar trend can be seen in the number of beds and rooms.

Table 5.2

World ranking by history *(2008)*	**World ranking by art and culture** *(2008)*
1. Egypt	1. Italy
2. Italy	2. France
3. France	3. Egypt
4. Greece	4. Japan
5. Israel	5. Greece
6. UK	6. UK
7. China	7. Israel
8. India	8. India
9. Perù	9. China
10. Japan	10. Germany

Source: Country Brand Index, *2008*.

Publicly owned properties

One of the leading actors in the Italian property market is the public administration in its various guises.

The state owns a large number of properties worth an estimated a value of € 420 bn by 2007; 56% of these properties are used by the state, whilst the remainder is rented to third parties at very low yields.

Low earnings and the chronic need to meet expenses and finance investments, as well as the marginal nature of property holdings for the functioning of the state, have led to sell-offs at various levels, with several opportunities for private investors, anxious to snap up properties of unquestionable value, mainly for their location.

Table 5.3

Publicly owned properties (€ bn)

Authority	Book value	Estimated market value	Rents received	Portion used directly	Portion used by third parties
State and Social Security Institutions	42	72	0.05	63%	37%
Territorial administrations	149	349	4.91	68%	32%
Regional Authorities	4	11	0.1	59%	41%
Provincial Authorities	12	29	0.06	80%	20%
City Authorities	93	227	2,31	60%	40%
Public institutions	15	29	n.a.	90%	10%
Incl.:Healthcare authorities	*13*	*25*	*n.a.*	*90%*	*10%*
Incl.: others	*2*	*4*	*n.a.*	*90%*	*10%*
Social Housing	25	53	1	10%	90%
Total	**191**	**420**	**5**	**56%**	**44%**

Source: Nomisma processing of data from Public Administration Accounts 2004.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Credit institutions least hit by the financial crisis

In past years the Italian banking industry has been transformed by the increasing competition coming from foreign banks. Numerous mergers and acquisitions and the subsequent increase in the average size of banks, as well as in their efficiency, have helped Italian banks to weather the financial storm.

The crisis struck while banks were completing their restructuring, with new experimental forms of corporate governance and a greater penetration of foreign markets. The system remains strongly characterized by credit brokerage for families and businesses, strong roots to the territory and a balanced structure of assets.

The impact of the crisis was therefore somewhat softened in Italy, with lower an exposure to derivatives and less dependence on “wholesale” deposits.

By the end of 2008 structured credit instruments were less than 2% of the assets of leading banking groups. The ratio between wholesale deposits and overall funding for Italian banks was 29%, against a Euro-zone average of 41%.

A fundamentally sound brokerage model, together with a tight regulatory framework and prudent watchdog authorities, protected Italian banks from the hurricane proper of other markets.

Despite worsening revenues, banks have maintained assets above minimum standards. At the end of last year, the coefficient of capitalization of major groups, given by the ratio of assets on assets weighted by risk reached an average 10.4%, while the highest levels of capitalization abroad often reflect the massive injection of public money.

Compared to international markets, leverage – the ratio of total assets to basic assets – is lower in Italy than elsewhere.

This contributes to the reliability of the Italian financial system, able to provide solid partners for investment and entrepreneurial opportunities.

Presence in the territory of local partners and skilled operators

The level of professional skills in the real estate sector has increased not just quantitatively but above all qualitatively, with compliance for some time with the toughest international standards and best practices (e.g. RICS, IPD, etc.).

Important associations have been set up in all sectors of the market (Assoimmobiliare, Assogestioni, ASPESI, AICI, FIAIP, IFMA, etc.) and many promotional initiatives, conferences, seminars and exhibitions are continuously set up.

University courses and post-degree specialist courses now abound at leading Italian universities, training future professionals in the real estate sector, with a balanced blend of technical, economic, legal and financial skills. It is a dynamic and rapidly changing world which has attracted the likes of Morgan Stanley and Goldman Sachs since 2000 (these were among the first to arrive in Italy) giving rise to important JVs and alliances, initiating a new market strategy in the country.

Still today, and even more than in the past, local players are a solid and reliable reference for international investors seeking synergies and partnerships in Italy for a large range of investment opportunities.

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