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Core investors return for the dawn of Italy's renaissance

Opportunistic and value add investors are to be expected in Italy, but the re-emergence of core players signals that the country's fortunes may be about to change – although structural problems remain.

"MANY LOCAL SELLERS ARE STILL HAVING DIFFICULTY ACCEPTING THE PRICES BEING OFFERED. AND THEY DON'T LIKE BEING TALKED DOWN TO BY BUYERS. WHEN IT COMES DOWN TO IT AND THEY THINK YOU ARE SERIOUS AND YOU MAKE A SERIOUS OFFER, THEY ARE MORE REALISTIC AND THINGS ARE BEING DONE AT YIELDS THAT ARE HIGHER THAN YOU WOULD HAVE EXPECTED."
Andrea Amadesi, Tristan Capital Partners

Opaque, difficult, in need of reform; but undersupplied and offering a premium to other markets around Europe.

Italy is a classic market in which opportunities abound for skilled real estate investors willing to take some risk and get to know local players well before diving in. Not easy, but potentially very lucrative.

The first quarter of this year confirmed that the market has undergone a renaissance, albeit a hard fought one. Volumes jumped by 400% to €3.7bn, compared to Q1 2014 according to data from Real Capital Analytics, higher than the €2.8bn recorded in southern European peer Spain, which has been one of the hottest investment markets over the past 18 months. This compares to investment volumes of €4.3bn for the whole of 2014, RCA data shows.

"The window to buy well will remain open for some time yet, perhaps 12-18 months," says Andrea Amadesi, senior director of Tristan Capital Partners Italy, which has just bought a €120m Italian retail portfolio from French REIT Altarea. "Yields are slowly trending lower, and you won't be able to buy core assets at opportunistic prices, but you can still buy very well."

Value add investors

Opportunistic and value add investors are continuing to snap up portfolios of medium and poor-quality assets, and while the banks are not yet major sellers (see p28) the listed and unlisted funds sectors are set to undergo a major deleveraging over the next two to three years, data compiled by *EuroProperty* shows.

And core investors are also starting to dip their toe back into the country, a sign that the market recovery is set to pick up pace. For those that know how to access the right opportunities, the potential is there.

First, the difficulties. While European Central Bank quantitative easing has increased the amount of liquidity looking to invest in Italy, according to Hines Italia chief executive Manfredi Catella, and the government is undertaking necessary reforms, the economic picture remains difficult.

Gross domestic product fell by 0.4% in 2014, but produced surprise growth of 0.3% in the first quarter of 2015.

"There was no oversupply like in Spain, but the real estate market is not just about supply, it is also about demand, and there has only been very marginal growth," says Catella. "Italy is a country that still has to go through a lot of structural changes before economic demand can come back and therefore demand for space can come back.

"The consensus is the economy is now more stable. The prime minister is doing well, and he is doing the right things and working on the right reforms, but you have to be realistic, this is not something anyone can fix quickly."

Marco Polenta, partner at Kervis Asset Management, which manages assets for investors including Cerberus, says: "The fundamentals are still not strong: there is not enough job creation, the leasing market is doing okay, but it is still a bit sketchy. Every decision from a corporate on whether to move offices takes a year or 15 months, because there is no urgency."

Data from JLL shows that office rents are improving in Milan and should start to improve in Rome in the second half of 2015. It reveals that leasing volumes in Milan increased by 30% in the first quarter of 2015.

There is also difficulty for overseas investors of all types in sourcing deals, due to both lack of stock and the particularities of the Italian market.

"There continues to be some strong cultural disconnects between local sellers and international buyers," Tristan Capital's Amadesi says. "Many local sellers are still having difficulty accepting the prices being offered. And they don't like being talked down to by buyers. But in the end it all depends whether they think you are a serious buyer. When it comes down to it and they think you are serious and you make a serious offer, they are more realistic and things are being done at yields that are higher than you would have expected."

"There is a shortage of core product for international buyers," Catella adds. "If you see who has looked here and how many deals have actually been done, there isn't enough product of international standard for global funds to buy. So the opportunity is in value-add assets or development, complex assets that need creative solutions. There is the opportunity to buy good property with that shortage of core assets and an improving macro picture to put together capital and a local execution platform to provide what intentional investors want."

But while banks and local private owners are difficult to do deals with, and the market is opaque and needs strong local knowledge, as Amadesi points out, opportunities to buy good property at higher yields is attracting international investors, including core buyers beginning to look at the market again for the first time since the downturn.

The main source of deals will be Italian funds, both listed and private, international fund managers and the Italian government.

"You have foreign sellers who have been holding on, selling some assets here and there, German, UK and Dutch funds that are liquidating portfolios, and you also have the Italian fund industry where there

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is a large liquidation that has to happen over the next two to three years," Kervis's Polenta says.

"They are not forced sellers but they are incentivised sellers, you can't buy at steep discounts because of their view of value, but they can trade. It is a big industry, maybe €30bn, so you could see €5bn-€10bn coming from there depending on how quickly they work," he adds.

Data from unlisted funds body INREV compiled by *EuroProperty* shows that there are funds with a total assets under management of €2bn which have liquidation dates before the end of 2016, and although some of these funds have the option to extend their life, the investors in these funds are increasingly voting to liquidate assets, having held on through the downturn, a separate report by INREV shows.

The largest of these funds is the Fondo Cloe fund managed by Prelios, which had nine core office assets valued at €406m at the end of 2014. The fund has a loan-to-value ratio of 60% and more than 10% of the units are owned by GIC.

Terminating funds

International fund managers with funds that are terminating include AXA Real Estate, BNP Paribas Real Estate Investment Management and Schroders.

Last year AXA and Apollo Global Management bought the 26-asset, €303m listed Olinda fund from Prelios. Blackstone achieved negative control of the €335m Atlantic 1 fund managed by Idea Fimit by buying 29% of the units.

Another major source of assets will be funds that own property leased to the Italian government. Fondo Immobili Publici (FIP) has been, and will continue to be, a rich seam for investors – as of June 2014 it had a portfolio of 238 commercial properties with a value of €2.7bn. The fund has a mandate to be wound down by 2019, with the potential to extend this by another three years to 2022. The leases on the properties expire in 2022.

CBRE was appointed to sell an initial package of €800m of assets last year, with Blackstone buying €200m, Cerberus €300m and Kennedy Wilson €300m, in its debut Italian deal.

Now JLL has been mandated to sell a portfolio comprising 10 assets with income of €11m a year. The previous portfolios sold by FIP have been trading at yields of 7-9%.

Indeed, portfolio deals with private equity firms are still a major driver of the Italian market, and make up a large portion of the transactions currently in process. Blackstone was seen as having "opened the market" when it started buying in 2013, and has now bought between €1.5bn and €2bn of assets in the country.

It was quickly followed by other large and less risk averse investors such as Cerberus, which has built up a portfolio of around €750m-€1bn, and Orion, which has bought more than €300m.

Initially, firms such as Blackstone and Orion focused on retail. "It is a market that is very specialist, and one where the involvement of local players is at present still somewhat limited, which creates an opportunity for international investors," says Amadesi.

Now a third wave of value add and opportunistic investors has arrived in the country, and their buying habits are a lot more varied.

EuroProperty revealed in March that TPG had made its debut investment in Italy with the purchase of a €220m loan from US bank Citi secured against a portfolio of industrial assets leased to Italian telecommunications firm Enel.

It is now understood to be in talks to buy a second portfolio of assets leased to a telecommunications firm: 160 assets totalling 100,000 sq m leased to Telecom Italia. It is paying a joint venture between Tristan Capital and IXIS around €90m for the portfolio.

Office portfolio

Goldman Sachs is understood to be paying around €90m for a portfolio of 30,000 sq m of office assets in northern Italy from Royal Bank of Scotland previously owned by Risanamento. It will undertake a refurbishment and re-leasing strategy.

And US fund KKR is understood to be buying a portfolio of assets from fund Tecla for around €50m. The portfolio comprises five offices and telephone exchanges leased to Telecom Italia.

But a key development for the Italian market is the arrival of core investors looking to buy well-leased, stable assets not because they feel they can buy at rock bottom prices, but because they want to be in the country for the medium to long term.

"The big thing for 2015 is the re entering of core buyers," says Cushman & Wakefield's Stephen Screene, a partner in Cushman's capital markets team. "Core is back, and you are seeing trophy assets in Milan city centre likely to trade at yields below 5%. There is capital looking at Italy from across the globe for quality retail and office assets."

One significant deal currently in train is the purchase of the 52,000 sq m Centro Leoni office tower in Milan for more than €100m by Amundi from a fund managed by UBS.

And in Rome a multitude of international investors are understood to have submitted bids for the €200m Great Beauty portfolio, named after the 2013 film directed by Paolo Sorrentino, which examines the beauty and underlying superficiality of Rome and its high society. The portfolio comprises three office assets totalling 46,000 sq m and includes a building built in 1588.

Other core buyers to have bought Italian high street retail assets include M&G, which bought a 3,745 sq m retail asset on Via Torino in Milan for around €80m, and Grosvenor Fund Management, which bought a 1,100 sq m building on the same street.

"We have had an office in Italy since 2006, and around the end of 2013 we started actively looking for opportunities again in the Italian market," says Pietro Clemente, head of Italy for Grosvenor Fund Management. "We are looking at high-quality high street retail assets in dynamic cities in northern Italy, also Rome and Florence. We are also interested in strong-performing shopping centres.

"We see good opportunities in cities where there are good pockets of private wealth in the north of Italy, and where there are good levels of tourist flow. But the market is very polarised.

"Among tenants, for a couple of years major brands willing to enter the market have been taking an attitude of wait and see, but there is demand again in those places where you have those pockets of wealth."

TH Real Estate is another investor now

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actively looking for opportunities in Italy, and is also in the process of investing in the retail market.

"We have clients that are focused also on Italy, looking at shopping centres and large retail parks," says Mario Pellò, head of investment for Italy at TH. "In offices international investors are currently less active because of the high vacancy.

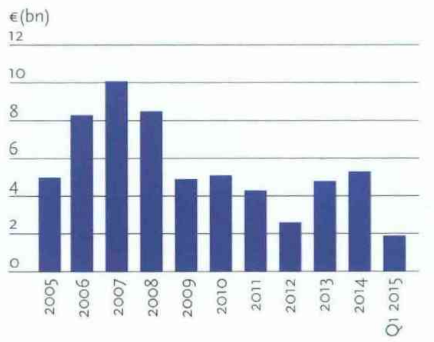
"It is still primarily an opportunistic and value-add market, but we have seen some yield compression and we are seeing some core investors starting to do deals. There is a huge quantity of capital around because of QE, and the UK, France and Germany are looking expensive. You still have a premium compared to other countries for good quality Italian assets.

"Part of the problem is that people are still anticipating more yield compression, which means many vendors don't want to sell now. No one wants to regret having been the one who sold and then yields fell another 50 basis points."

This arrival of core buyers is important, in that it provides a potential exit for some of the funds who were early movers in the market, although whether they have bought property that will appeal to that kind of buyer remains to be seen. The next phase needed for the Italian market is the re-emergence of domestic buyers, be they new listed vehicles (see page 31) or domestic funds and private investors. Combined with core international buyers this will be a sign of a market truly back on its feet. ◄

Real estate investment volumes in Italy

Q1 2015 was highest quarterly figure ever



Source: CBRE

Italian net real estate yields (%)

Prime high street has seen the biggest compression

	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015
High street prime	5.10	4.80	4.80	4.50	4.25
High street secondary	7.20	7.00	7.00	6.75	6.50
Shopping centre prime	6.23	6.00	6.00	6.00	5.75
SC good secondary	7.57	7.34	7.34	7.00	7.00
Retail park prime	7.90	7.90	7.90	7.75	7.75
Office prime MI	5.30	5.10	5.10	5.00	5.00
Office prime RM	5.30	5.30	5.30	5.25	5.15
Office good secondary	6.60	6.40	6.40	6.25	6.25
Office major provincial	7.50	7.50	7.50	7.25	7.25
Prime logistics	7.75	7.75	7.50	7.50	7.25

Source: CBRE

Biggest deals in Italy since 2012

Overseas investors dominate, and European core buyers are starting to emerge

Year	City	Name	Main use	Size (sq m)	Price (€m)	Yield (%)	Net yield (%)	Purchaser
2012	Rome	Rinascente	Retail	17,500	130			Central Retail Corporation
2012	Rome	Corso Italia 43/Via Tevere 50	Office	17,800	106	6.18		Fondo Antirion Core (ENPAM)
2012	Milan	Palazzo Biandrà	Office	13,300	100	5.5		Fondo Euripide (Cattolica Assicurazioni)
2013	Turin	Auchan portfolio – Project Granato	Retail		381	>8		Morgan Stanley
2013	Milan	Porta Nuovan (40% stake bought by QIA)	Mixed use	254,000	600			Qatar Holding
2013	Rome	Via del Corso	Retail	6,000	180			Ramsbury Estates (H&M)
2013	Florence	Four Seasons	Hotel	117	150			Famiglia Reale del QUATAR
2013	Rome	Market Central Da Vinci	Retail	56,616	128	8.9		GWM
2013	Rodengo Saiano – Brescia	Franciacorta Outlet Village	Retail	32,600	126	9		Blackstone
2013	Rome	Eden	Hotel		105			Sultan of Brunei
2014	Rome	Roma Est (50%)	Retail	97,000	205		5.9	GIC
2014	Cagliari	Forte Village	Hotel	756	180			Progetto Esmeralda (Fratelli Bazhaev)
2014	La Spezia	Le Terrazze	Retail	38,500	110		6.65	Union Investment (90%)
2014	Milan	Credit Suisse HQ	Office	15,000	114			Hines sgr on behalf of Qatar
2014	Genova	Fiumara	Retail	24,850	171.5		6.9	Allianz (50%)/Ing Insurance (50%)
2015	Milan	Porta Nuova (60% stake bought by QIA)	Mix- Used		900			Qatar Holding
2015	Milan	Piazza Cordusio	Office	50,000	345			Fosun

Source: CBRE