JLL Achieve Ambitions

Q3 2020

Office snapshot

General Outlook

The global economy is experiencing a noticeable shock to growth in 2020 due to the coronavirus outbreak. In the summer months, the global outlook started to show timid and fluctuating signs of recovery. In September, as fresh lockdown measures are adopted to quell the rise in new infections, Eurozone PMI survey results show a reversed course as business faces an uncertain future. In Europe, trade is improving but there are signs of weakness in Asia. In USA, the economic activity is far from pre Covid-19 levels although unemployment is compressing. The worsening of the health crisis, especially outside of Italy, and growing concerns related to the short-medium term prospects accentuate the risks on the recovery in the coming months.

After a deceleration in 2019, the Italian economy recorded a deep downturn in GDP in H1 2020 (-11.8% YoY), mainly due to a slowing down in investment and export components. The slowdown affected all the economic segments, but the manufacturing and retail trade with a stronger intensity.

The recovery in employment continued slightly in 2019 followed by a slowdown (-2%) in the first 8 months of 2020. Industrial production improved during the summer. In September, business expectations on employment were improving in all the economic sectors and they were positive for the construction and retail trade. The gap between Italian (-0.5%) and European (0.4%) inflation (HICP) is increasing mainly due to transport costs. Following July improvement, inflation returns to be negative. In August 2020, the interest rate on Italian 10-year Government Bond stood at 1.03%, compressing for the 4th consecutive month. The spread against the German Bund fluctuated dramatically till the end of May; at the end of September the index slightly stabilized below 150 bps.

The new October decree has extended the state of emergency until the end of January 2021. ECB is adopting an unprecedent set of measures to mitigate the tightening of financial conditions across the euro area (PEPP, TLTRO, APP). Italy is set to receive the 28% of the Recovery Fund with the goal to rebuild after the Covid-19 pandemic and support investments in the green and digital transitions. The Governing Council expects the key ECB interest rates to remain at their present level or lower until the inflation outlook robustly converges at 2%.

2020 real estate market looks only partially affected by Covid-19. The impact of the pandemic became evident in some sectors and in the office leasing market. Investors strategies are focused on defensive sectors. This will continue to benefit industrial, multifamily, data centres and other alternative assets. Capital available for deployment into real estate is still high. For corporate occupiers, the short-medium term future will continue to be unclear.

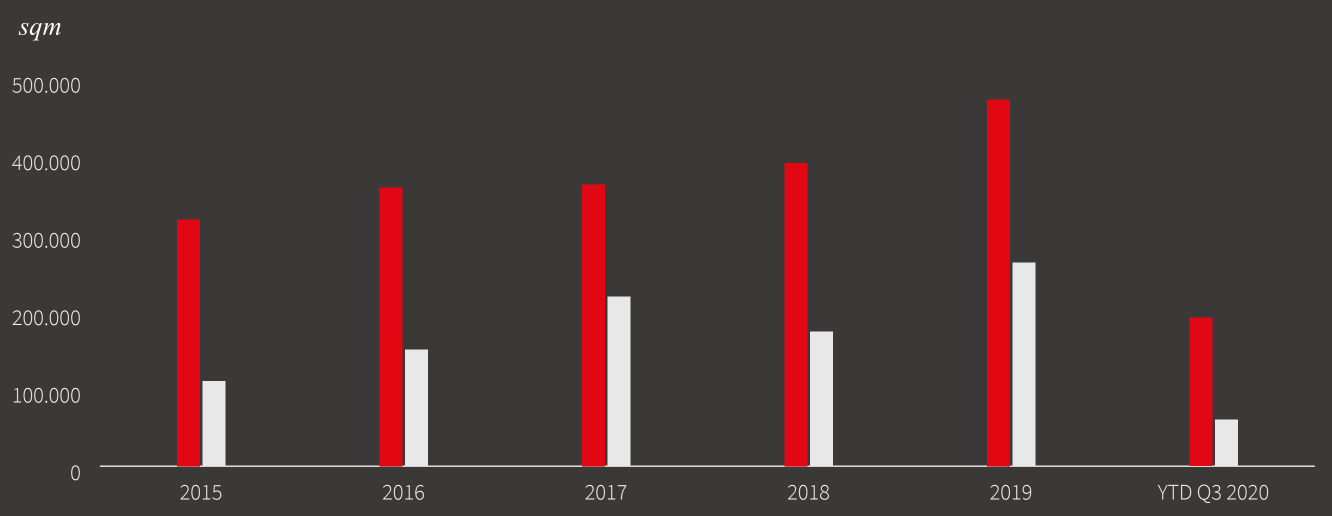
The global pandemic has undoubtedly pushed us into a global recession and in the short term this will have a direct impact on employment and, consequently, on the office demand. The global Covid-19 pandemic has proven to be an accelerant of change and transformation for many organizations. This is an opportunity for Corporate Real Estate leaders to rethink the historical workplace models as well as to accelerate the transformation of their portfolios. As the majority of leasing demands are on hold, most occupiers are focused on re-opening their offices. The office space still has a pivotal role to play in facilitating essential face-to-face activities that are not easily replicable online. Offices will remain a fundamental part of the corporate culture. In Italy, the first 9 months of 2020 recorded 87 investment deals for a total of around €5.3 billion, lower by 26% on the same period of 2019. The slowdown was mainly ascribable to the hotel sector downtrend; excluding the Belmond deal in Q2 2019, the variation drops at -13%.

The office sector was the most dynamic one, recording 31 transactions and representing the 43% of the volumes with around €2.3 bn. The decrease on the YTD volume is ascribable only to Q1, while the remaining 2 quarters of the year showed a positive trend compared with the same quarters of 2019, confirming the resilience of the office sector. Milan was once again the leading market for both leasing and investment, accounting for the 74% of the total office investment volume with 19 deals mainly transacted in the historical centre of the city. In Rome, one portfolio and 6 single asset deals were transacted for a total of around €360 m. Domestic capitals mainly affected the volumes (65%), while international investors were involved in 11 deals for around €780 m. Prime net yields remained stable in both Milan (3.40%) and Rome (3.75%), confirming the liquidity of prime assets in the main markets.

After the record absorption in 2019, take-up recorded a slow down both in Milan and Rome as uncertainty and disruption remain key concerns. In Milan, in Q3 2020 YTD, the leasing volume reached 190,000 sqm, down by 45% YoY and 30% on the last 5 years average. The demand of office space was dominated by deals below 500 sqm and by grade A office spaces (66%). The demand mostly targeted offices located in the CBD or Periphery submarkets.

In Rome, the absorption in the first nine months of the year totalled around 60,000 sqm, a lower performance than 2019 (-75%) and not in line with the last 5 years average (-54%). The number of transactions was consistent (66) and mainly interested the EUR and Centre/Semicentre submarkets. Prime rents and incentives remained stable both in Milan and Rome and in all their submarkets confirming the huge demand for grade A and high quality office spaces.

Occupier market



Milan

Take-up
190,000sqm

YTD Q3 last 5 years average
271,000sqm

Vacancy rate grade A
1.9%

sqm future supply

2020	**39,000**
2021	**241,000**
2022	**273,000**

Rome

Take-up
60,000sqm

YTD Q3 last 5 years average
131,000sqm

Vacancy rate
5.6%

sqm future supply

2020	**43,000**
2021	**118,000**
2022	**155,000**

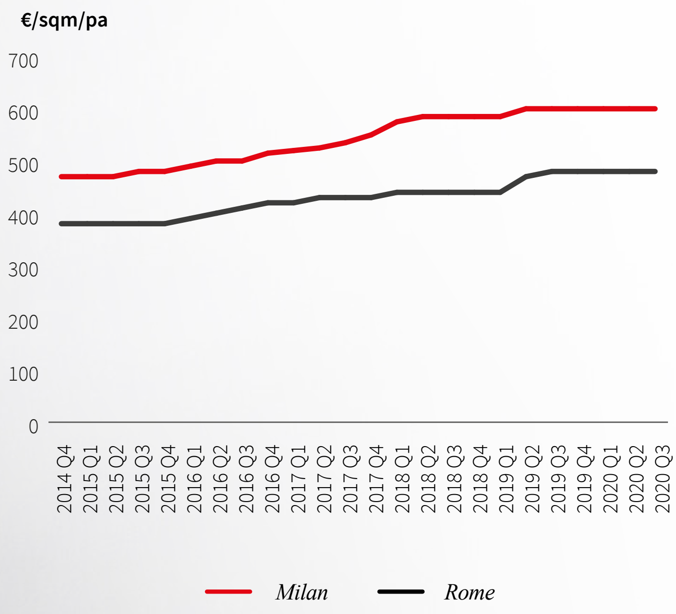
Rents

Milan (€/sqm/pa)

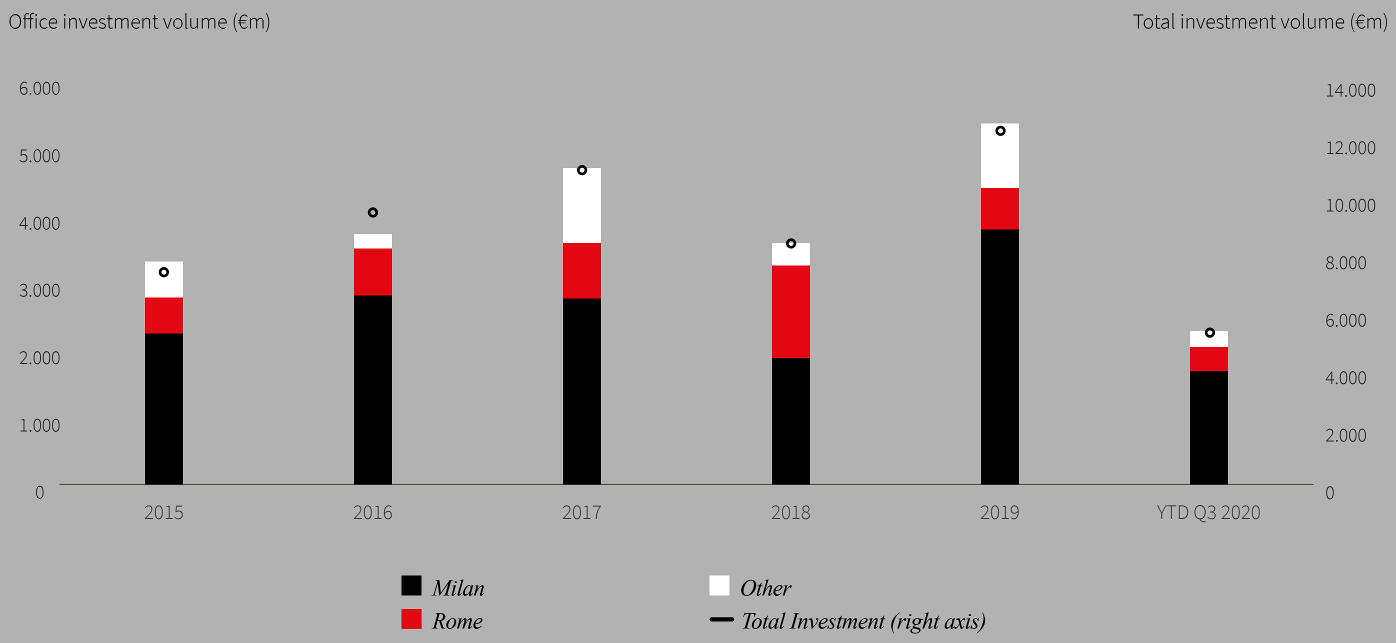
Historic centre	600
CBD	570
Centre	500
Semicentre	415

Rome (€/sqm/pa)

CBD	480
Centre	440
Semicentre	300
E.U.R.	360



Investment market



Milan

Investment volume: € 1,700 m
N° of deals: 19

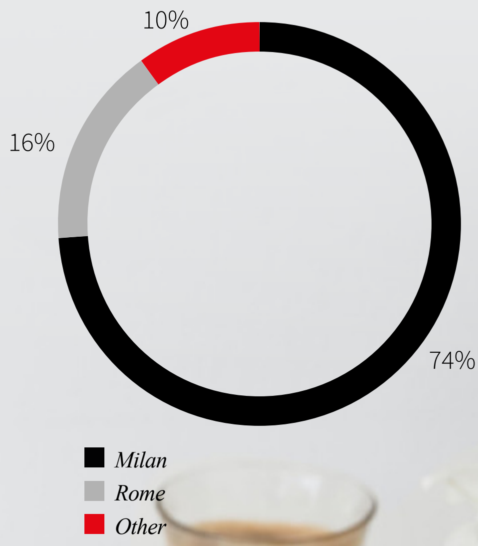
18 single and **1** portfolio deals

11 deals > €50 m

Average size: **€84 m**

5 transactions in the Historic Centre

Office investment volume by geography



Rome

Investment volume: € 360 m
N° of deals: 7

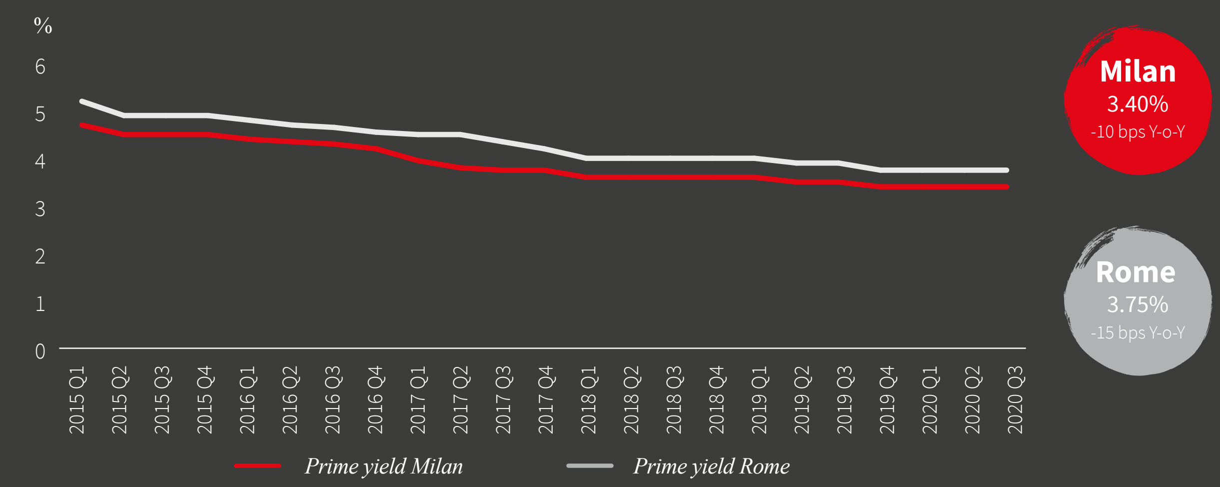
6 single and **1** portfolio deal

1 deals > €50 m

Average size: **€48 m**

3 transactions in the centre

Yields Q3 2020



Key themes

It remains unclear how long the pandemic will impact the global economy and what shape the recovery will take

Tenants requesting increased flexibility both in terms of lease length and adding/ shedding footprint during the contract

High competition on core products is maintening pressure on prime yields

Face rents continue to hold firm in the prime segment. However, tenants are putting more pressure on negotiations for second hand stocks

High difficulties in obtaining financing for value added operations is affecting the investment volume

Many companies across Europe are trying to put office spaces on the market. Sublease spaces is are likely to be a growing phenomenon

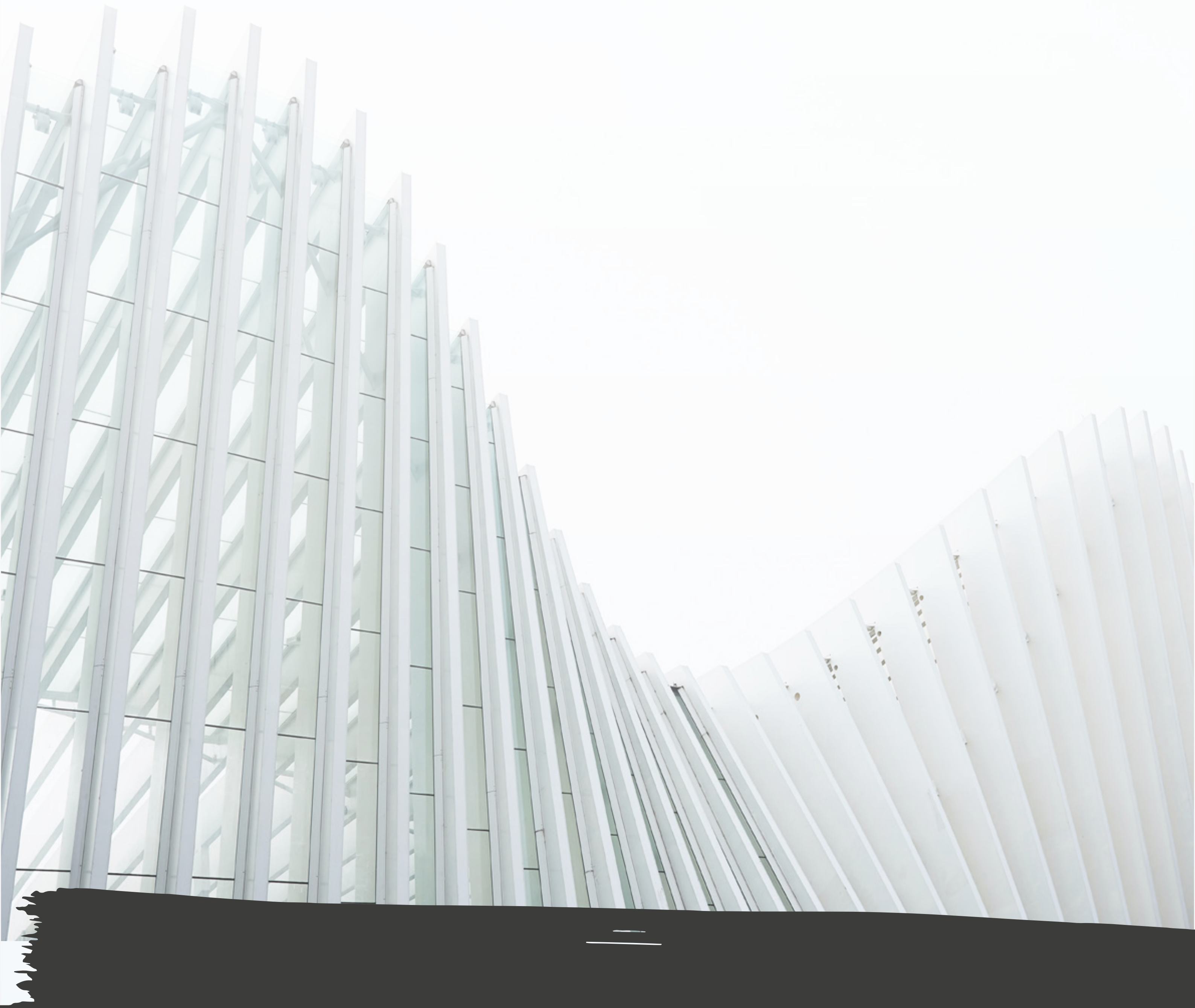
What to expect in the next 18 months?

- ESG factors
- High liquidity

- Core assets in prime location
- Polarization of prime and secondary assets

- Re-imagine the future of work
- Hubs&Clubs model

- Tenant friendly market
- Incentives increasing



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