July, 2022

Office snapshot

H1 2022 – Market Overview

Milan, Italy

Table of content

1. Our Key Takeaways

1

The Italian economy is now facing headwinds

The **Italian economy decelerated** sharply in **Q1 2022** amid higher geopolitical uncertainty stemming from the **war in Ukraine**, but the latest GDP growth numbers came in higher than expected, largely supported by **investment**.

2

A Hybrid working model is the key to success

Our **JLL EMEA Workforce Preferences Barometer** reveals that the hybrid working model is becoming very popular: 60% of office workers would like to go full hybrid today while 55% are doing so already.

3

Investors remain prudent but rents may rise further

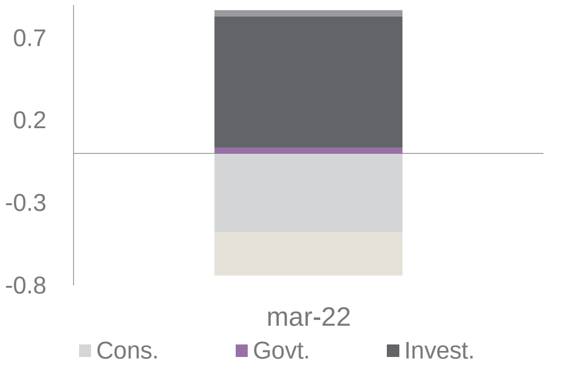
Looking ahead, risks to **GDP** growth are **skewed to the downside** because of **rising inflation** and **tightening financial conditions.** Although investors remain cautious, properties are now more **institutionalised,** and this should increase broader market liquidity. Additionally, the **occupiers' market** is recovering from the pandemic lows, with Milan already at a higher level than 2019. This should continue to drive **profitability** and push **rents** further over the coming months.

2. The Italian Economy

The Italian economy decelerated sharply in 2022 amid higher geopolitical uncertainty, but GDP growth in Q1 surprised on the upside, largely supported by investments.

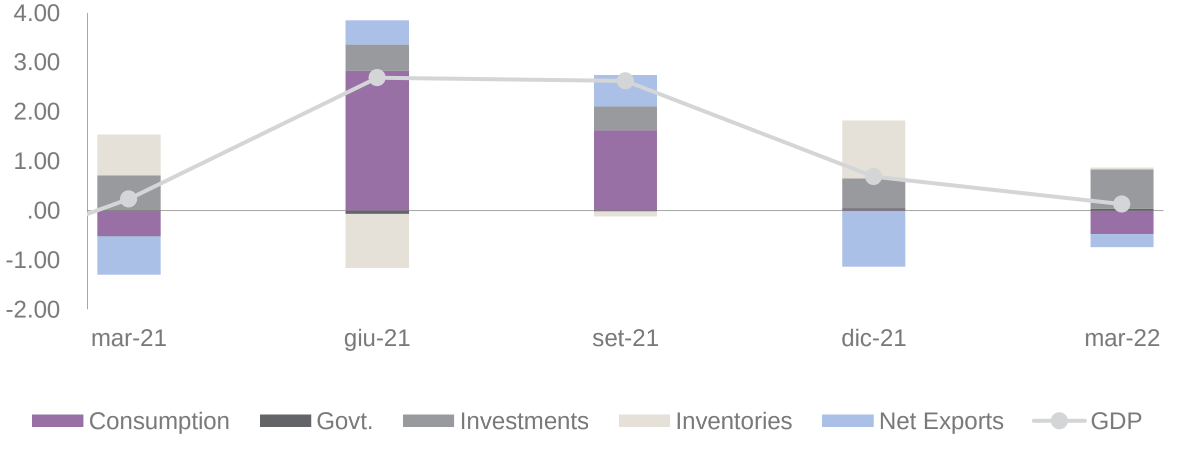
After the strong rebound of GDP growth in 2021, the Italian economy **decelerated** in the first quarter of 2022 (Q1 2022) amid higher **geopolitical uncertainty** stemming from the **Russia-Ukraine conflict**. Although a deceleration was largely expected, the latest release by the Italian National Statistics Office (ISTAT) highlights a moderate growth of +0.1% in Q1 2022, mainly driven by **investment** (+0.8%), while **consumption** (-0.5%) and **net exports** (-0.3%) were both negative drivers. This seems counterintuitive: with higher geopolitical uncertainty and rising input costs investments should be weaker. However, two key reasons might explain this.

Contribution to GDP growth Q1 2022 QoQ %



Source: JLL Research elaborations on ISTAT data

Contribution to GDP growth (last 12m) QoQ %

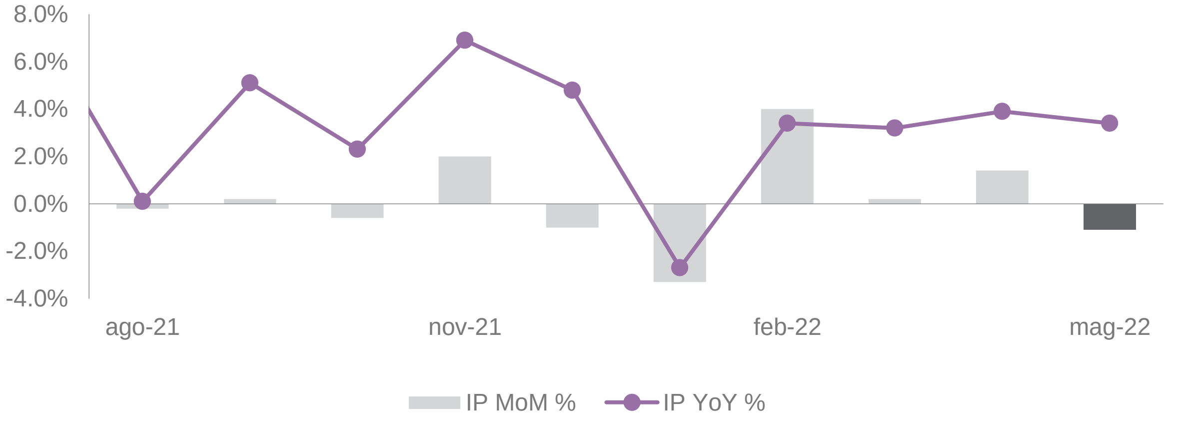


Source: JLL Research elaborations on ISTAT data

Firstly, **Italy's Recovery and Resilience Plan** (EUR 235bn) may be feeding through to medium and long-term growth. Secondly, firms might be allocating more capital in response to rising challenges on **global supply chains**.

Latest **industrial production** data in May 2022 indicated a **contraction of -1.1% MoM**, although the trend versus the same period of last year remains positive **(+3.4% YoY)**.

Industrial production (last 9 months)



Source: JLL Research elaborations on ISTAT data

Annualised headline **inflation** (HICP) reached **8.5% in June** (up from 7.3% in May), the highest reading since 1986. According to market consensus, inflation will remain elevated throughout the rest of the year and will only start to decrease in 2023.

Summary of Macro Indicators	**2020**	**2021**	**2022F**	**2023F**
GDP	-9.1	6.6	2.9	2.2
Industrial production	-11	11.7	0.3	4.2
Consumer prices	-0.1	1.9	5.8	0.9
Unemployment rate (%)	9.4	9.5	8.9	9.1
Current a/c balance (% of GDP)	3.7	2.4	0.8	0.9
Government balance (% of GDP)	-9.6	-7.2	-5.4	-4.2
Cen. bank policy rate (%, EOP)	0	0	0.5	0.8
10yr govt. bond yield (%, EOP)	0.5	1.2	3.1	3.1

Source: Oxford Economics

3. The Office Capital Market

The office sector confirmed to be the first asset class for Capital Markets investors

The **office sector** confirmed to be the most dynamic in H1 2022, recording **39 transactions** and representing the 40% of the investments with around **€ 2.5 bn** (+186% YoY). Volumes show a steady pickup compared to one year ago, with the number of deals (+15 YoY), testifying the solid attractiveness of this sector.

Milan continues to drive the volumes, representing the 54% of the total across 24 deals, located in both the central and peripheral areas of the city. **Rome** recorded 8 deals since the beginning of the year, for a total of around € 740 mln, mainly located in Centre and E.U.R. submarkets.

Most volumes were allocated by international capitals (77%), while domestic investors were involved in 9 deals for around € 488 mln.

In Q2 2022 **prime net yields** remain stable in both Milan (3.05%) and Rome (3.50%) compared to the previous quarter, but decreasing on an YoY terms.

Source: JLL Research elaborations

The Key Numbers

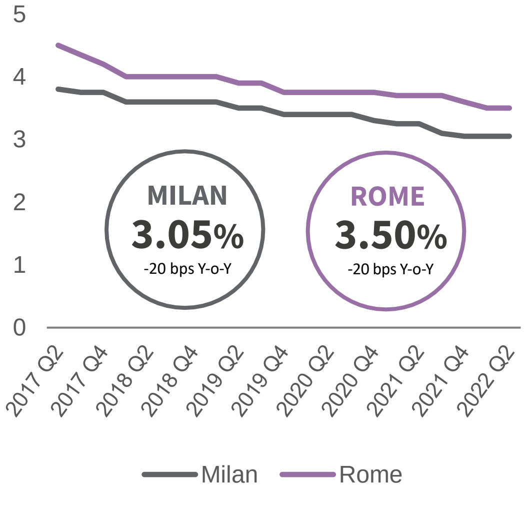
Milan

Investment volume	**€1,370 mln**
N° of deals	**24**
Single deals	**20**
Deals over €100m	**3**
Average size	**€56,6 m**
Transactions in the Historic Centre	8

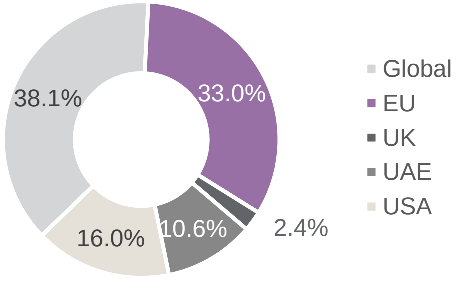
Rome

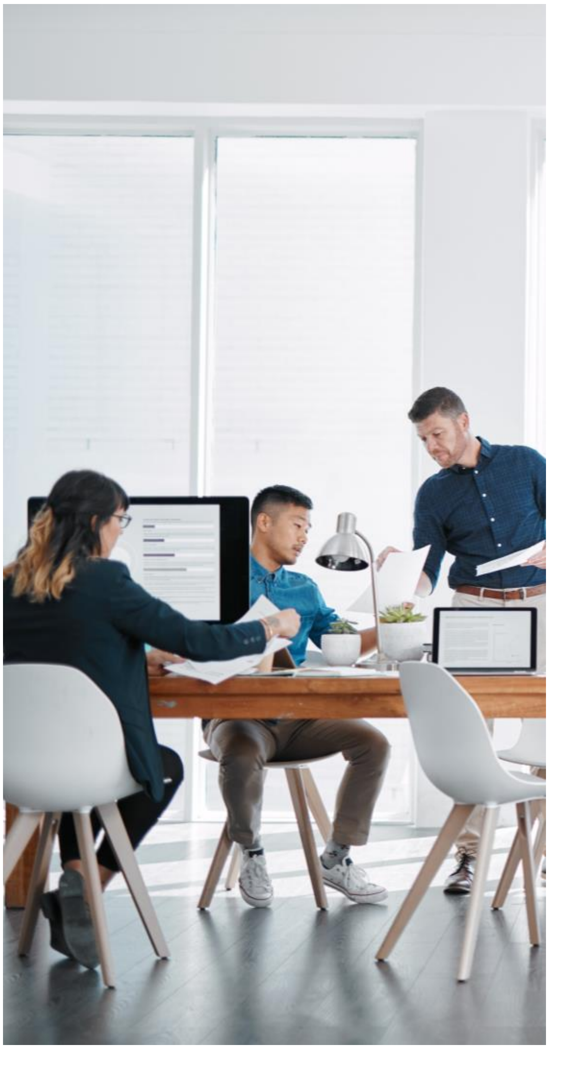
Investment volume	**€740 mln**
N° of deals	**8**
Single deals	**8**
Deals over €100m	**4**
Average size	**€92,4 m**
Transactions in the Historic Centre	2

Prime yields



Office Investment by Capital geography





4. The Office Occupiers Market

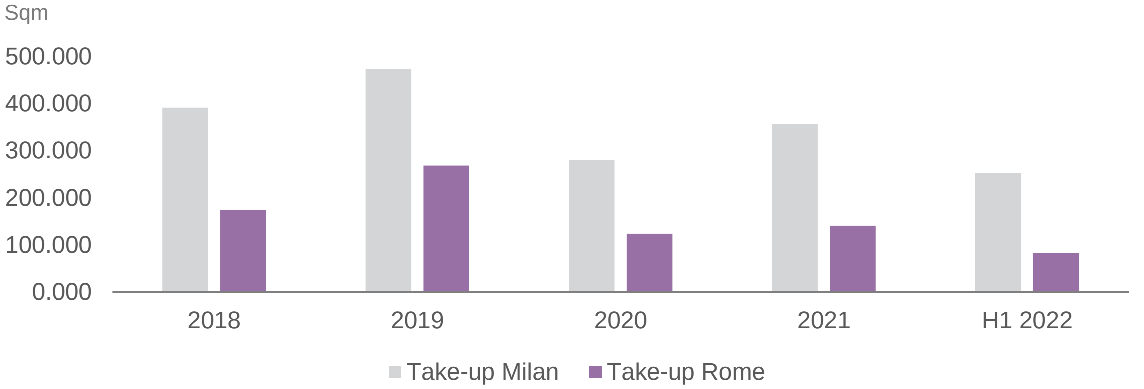
Office leasing side increased in take-up both in Milan and Rome

Corporate occupiers will continue to seek to ensure flexibility within new leases, while employees will also seek a measure of flexibility in their working lives.

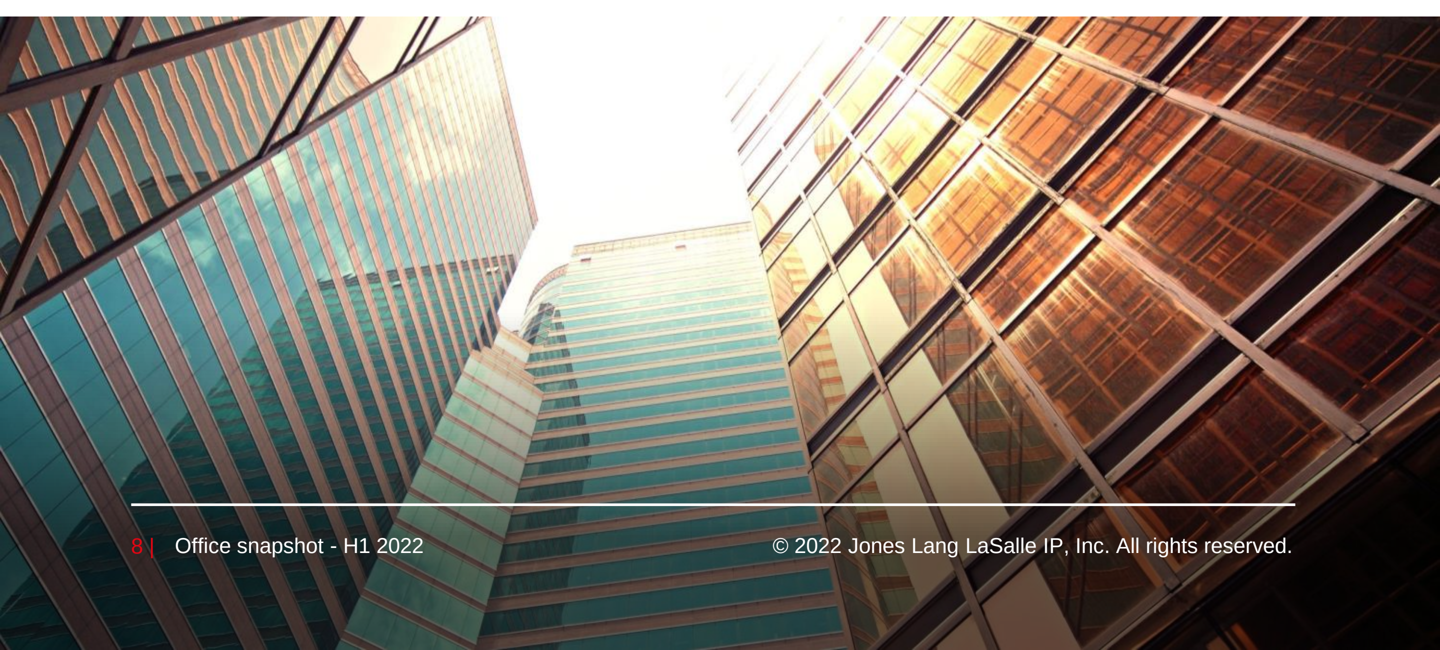
Milan reached around **252,000** sqm in H1 2022, up by +39% YoY across **148** transactions. The demand of office space was dominated by deals below 500 sqm (41%) and by grade A office spaces (74%). Around 38% of the demand targeted offices in the central submarkets (CBD, Historic Centre, Centre), 27% in the Hinterland area, 22% in the Periphery and 14% in the Semi-centre.

Take-up in **Rome** increased too, totalling around **82,500** sqm (+18% YoY) thanks to **79** deals. The demand was mainly focused on the E.U.R. submarket (33%), CBD (27%) and Centre-Semicentre (25%), while also grade B spaces seem to have a vast preference (61%).

Office Take-Up | H1 2022



Source: JLL Research elaborations



The Key Takeaways

Milan	
Take-up	**252,000 sqm**
5 years average	**372.015 sqm**
Vacancy grade A	**2.4%**

Rome	
Take-up	**82,500 sqm**
5 years average	**184.294 sqm**
Vacancy rate	**6.2%**

Prime rents increased to **520 €/sqm/pa** in Rome, +20 bps up from last quarter and +40 bps up YoY. In Milan, rents raised too +20 bps from Q1, reaching **650 €/sqm/pa**, with +50 bps YoY.

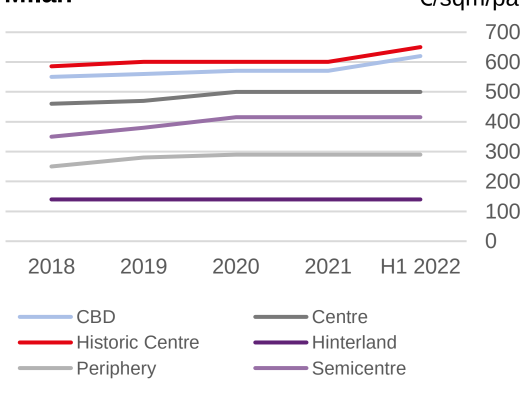
Rents are generally expected to raise up by the end of the year, confirming the interest in A - grade and high-quality spaces and the competition for these assets.

Total future supply*	**Milan**	**Rome**
2022	**278,000**	**65,000**
2023	**341,000**	**187,000**
2024	**178,000**	**170,000**
2025	**129,000**	**-**

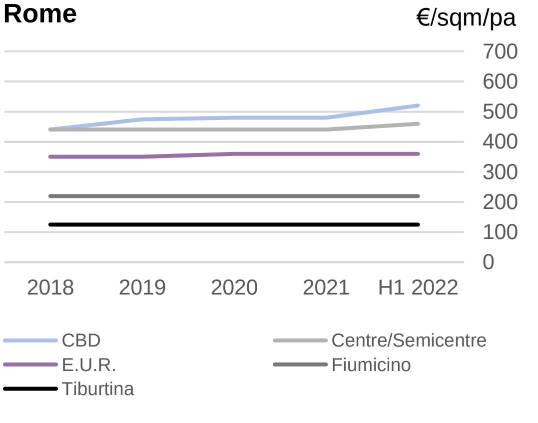
**Including pre-let, owner occupation and speculative supply*

Office Occupier Market – Prime Rent by Submarket

Milan



Rome



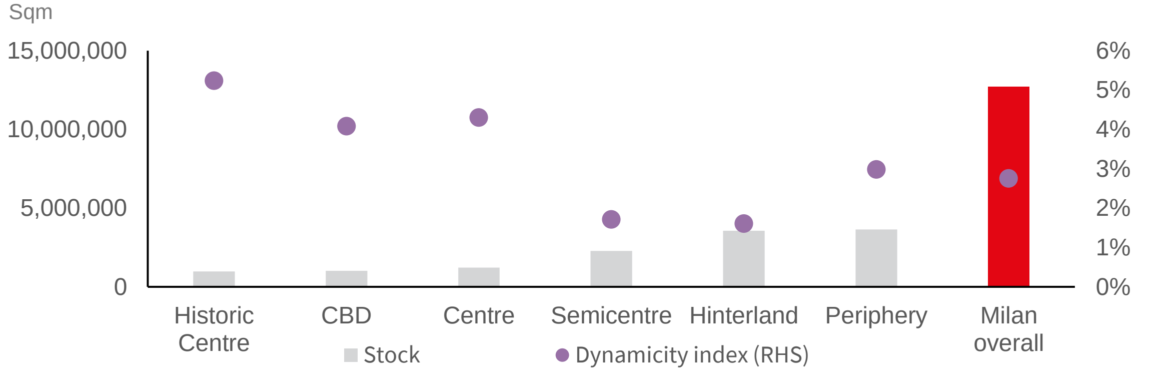
Source: JLL Research elaborations

Office Market dynamicity: stock analysis

In the two main Italian office markets, office stock is almost equivalent, but they are different in terms of quality. This is reflected in take-up levels and in the dynamicity of the two markets.

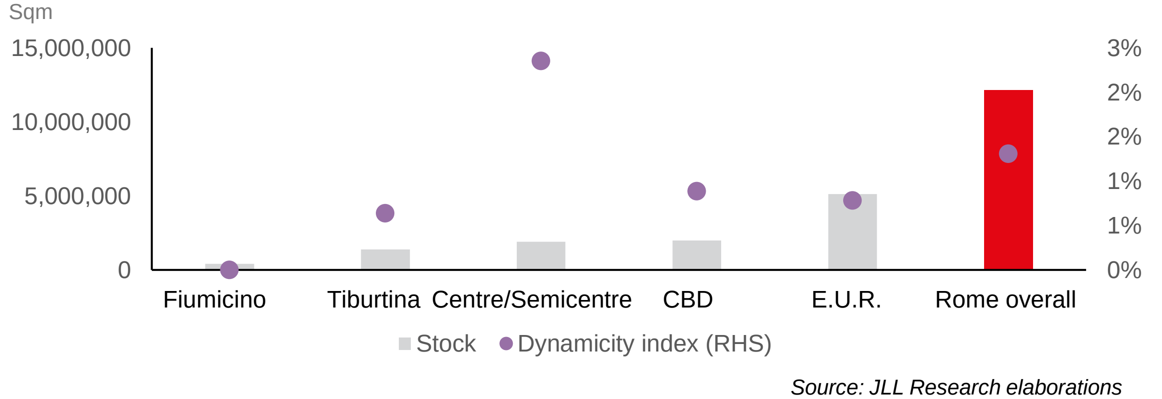
In the last 12 months, 3% of the Milan stock saw the signing of a new leasing contract, while in Rome the index was equal to 1%. In Milan, Historic Centre, Centre and CBD were the most dynamic submarkets with a dynamicity index well above 4%. Milan Periphery also registered an index above the City average, at 3%.

Dynamicity index by submarket - Milan



In Rome, Centre/Semicentre was the most dynamic submarket with a 2.5%, followed by CBD and EUR, respectively at 0.8% and 0.7%; only Centre/Semicentre submarket is more active than the city average. Demand and asset quality drive submarkets' trend.

Dynamicity index by submarket - Rome

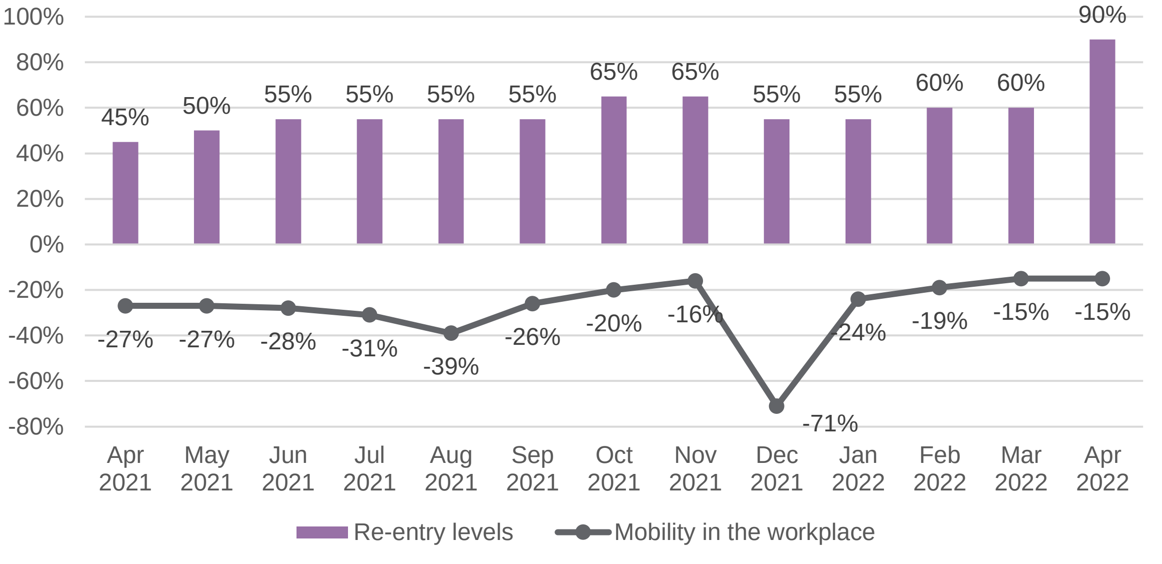


Source: JLL Research elaborations

Return to the office and new normal: adapting to post- pandemic worklife

Re-entry to European offices is at its highest point since the onset of the pandemic, according to JLL data. Based on the portfolios of JLL clients across Europe, re-entry estimates show office use back to around 70% of pre-pandemic levels.

Milan – Re-entry levels VS Mobility in the workplace

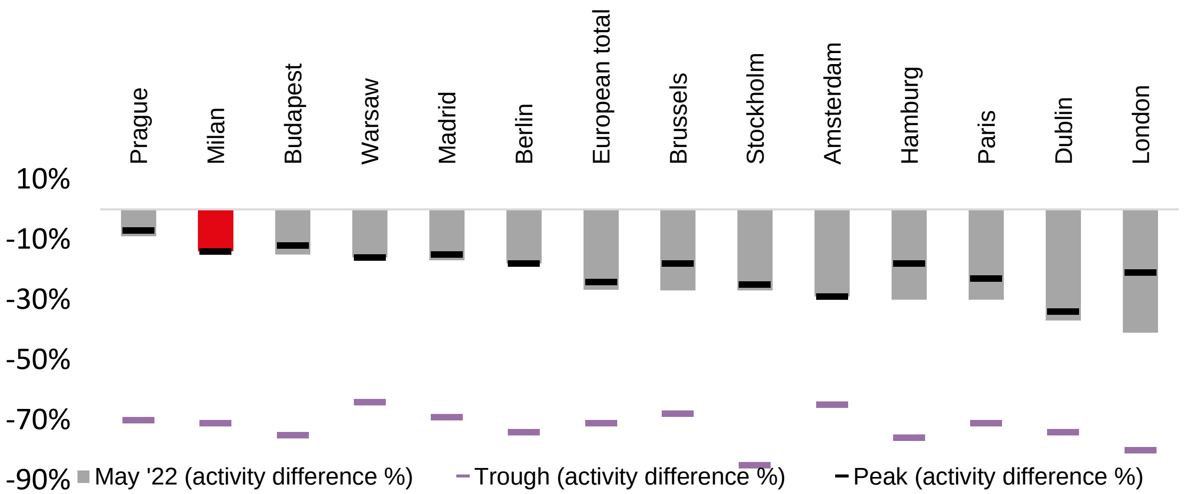


Source: JLL Research, Commentary: Europe's return to the office reaches post-pandemic high – June 2022

However, it's important to note that this does not mean that offices are occupied at max capacity for 70% of the working week. Peak usage sways significantly between Monday and Friday. Nevertheless, occupancy by employees is trending back towards a pre-pandemic normal.

Mobility data from Google shows a similar trend, with European cities moving well past the inactivity seen at the depth of the pandemic. Overall mobility in Europe is now down by just 27% when comparing the month of May with typical pre-pandemic levels.

Average European office mobility variance from pre-pandemic baselines (past 12 months)



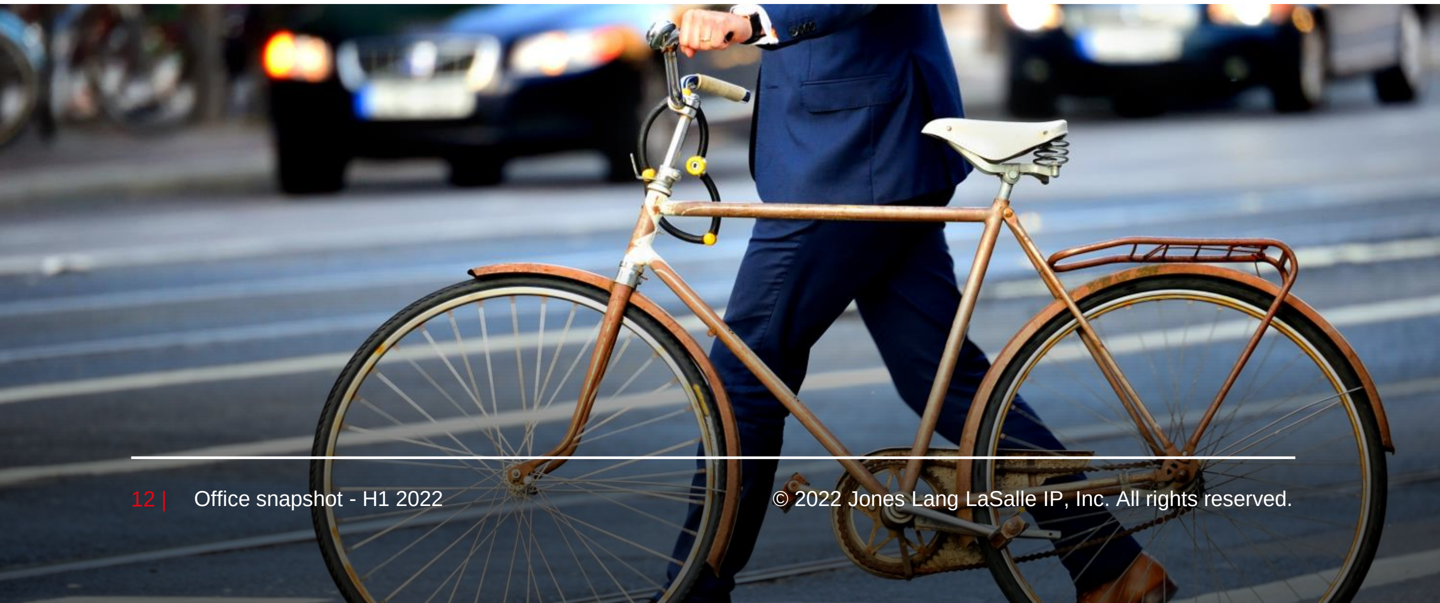
Source: JLL Research, Commentary: Europe's return to the office reaches post-pandemic high – June 2022

New Office Drivers stemming from the new normal

Shrinking surfaces, although not that significant, as workspaces are being integrated with shared areas, not just for work purposes but also for team meetings and socialisation.

Workspace flexibility and optimisation, with more distanced workstations to avoid crowding and a high overall density of people.

ESG standards or holistic sustainable approach, with positive impact on the built environment, on people's lifestyle, and on the territory.



The rise of the Hybrid working model

The latest edition of The Global JLL Research Workforce Preferences Barometer reveals that the hybrid working model has become the most popular way of working today among office workers.

60% of office workers want to work in a **hybrid style** today **and 55% are doing so already,** that means the hybrid work has reached an "optimal point".

6 in 10 employees expect to be supported with technology and financial assistance for expenses linked to remote work. Less than 4 in 10 currently benefit from these types of initiatives.

This workstyle is especially appreciated by Managers (75%), Gen Z (73%), Gen Y (67%) and Caregivers (66%).

While the sense of being more productive at home for heads-down work keeps growing, **25% of the workforce feels isolated** today and unable to nurture close relationships with their colleagues.

Only 48% of the workforce believe that their company is a great place to work today.

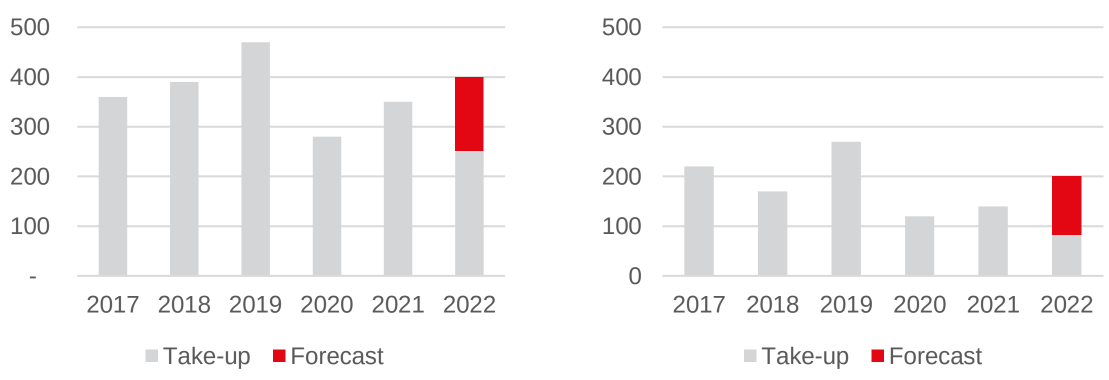
59% of employees **expect to work in a company that supports their health and wellbeing**, a number that **was -15% less in March 2021.** This is now ranked as the second priority at work, after quality of life and even before salary.

5. Looking ahead

Long-term growth prospects remain above the pre-covid period

After decades of economic stagnation, Italy found its **way back to growth** in the aftermath of the post-pandemic crisis. Although the annual average GDP growth from 2011 to 2020 has been generally disappointing, things are changing in the post-pandemic period. So far, the rebound from the covid crisis and the combination of fiscal and monetary policy easing have helped the country to find its way back to growth.

Take up forecast: Milan (left) and Rome (right)



Source: JLL Research elaborations on Oxford Economics Forecasts

But the balance of risks remains skewed to the downside

High inflation, tightening financial conditions, the continuation of the **Ukraine** conflict and the uncertain development of the pandemic crisis suggests further uncertainty in the coming months.

Fiscal policy remains broadly **supportive**: the govt provided a further **stimulus of EUR 14 bn** (0.8% of GDP) to help low-income families and firms to cope with higher prices. But rising consumer prices will squeeze **real incomes** and businesses will continue to suffer **high input costs** due to rising energy prices and disruptions in global supply chains.

Government bond yields have been rising too with the 10Y reaching 2.65% on average in Q2 2022, mainly due to a combination of higher market volatility, rising inflation and monetary policy tightening.

Our Three Scenarios for the Italian Office Market 2022 vs Baseline

Name	Scenario assumptions	Macro Implications	Market Implications
The goldilocks ››	The pandemic crisis comes to its final chapter, while Russia and **Ukraine** reach a **solution** to end hostilities. The global economic **outlook improves** as business and consumer confidence peak.	**Inflation pulls back**, therefore central banks limit the increase in interest rates. Both domestic demand and labour market conditions improve, spilling over to the housing market. Risk premia on government bond yields decline.	Govt bond yields decrease as inflation pulls back. **Investment volumes** and market liquidity should improve. **Prime yields** should remain stable while **rents** should grow as occupiers' demand returns to pre-pandemic levels.
Muddling-through ›	The covid crisis almost comes to an end, but pandemic restrictions take time to disappear. The **Ukraine** conflict does not stop but countries reach a **temporary compromise** that should keep market volatility under control.	**Inflation rises** but central banks keep it under control, at the expense of lower growth. Labour market not as tight as the goldilocks scenario, but interest rates higher than historical average with higher risk premia than the goldilocks scenario.	Govt bond yields increase as inflation rises and central banks raise benchmark rates. **Investment volumes** should remain supported due to stronger presence by institutional investors compared to historical average. **Prime yields** should increase while **rents** should grow at a slower pace, although existing rent contracts should factor in higher inflation.
Stagnation ‖	The covid crisis resumes as we get closer to the winter, potentially with large vaccination programs and travel restrictions. The **Ukraine** conflict drives financial market volatility **boosting inflation**. **Labour market** conditions **deteriorate**.	**Inflation rises even more** but domestic demand and labour market conditions deteriorate. Central banks act too little too late and they are forced to increase interest rates drastically, with the economy sliding into **recession**. Risk premia embedded in govt bonds is higher than the other two scenarios.	**Investment volumes** should decrease as investors assume more tactical stance between govt bonds and real estate. On the occupiers' side the hybrid working model reduces demand for space. **Prime yields** increase even further while **rents** generally suffer because of **recessionary pressures**.

Source: JLL Research

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