Research
Italy | February 2024

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Office snapshot

Q4 2023 – Market Overview

Milan and Rome, Italy

SEE A BRIGHTER WAY

Content List

01
Our Key Takeaways

The Italian economy is expected to grow by 0.5% in 2024

Looking ahead, latest market projections indicate an average GDP growth of +0.5% in 2024. The impact of inflation is slowing down and there are signals that interest rates will fall towards the end of 2024.

Investors are prudent but Italian office market fundamentals remain solid

Office investments recorded a significant slowdown in 2023 across EMEA. This trend has been exacerbated by a **wait-and see approach** and weak global sentiment driven by post-pandemic structural shifts in the way of working. Despite the challenging economic environment, the fundamentals of the Italian office market are confirmed, thanks to a resilient occupiers' demand.

Office occupiers' demand still high in Milan and Rome

In 2023 Rome reached a new record in terms of office take-up (+70% YoY). Milan showed a slowdown (-15%) after a very good performance in 2022, but with a positive variation QoQ and YoY in Q4 2023 (respectively +40% and +10%). Occupiers' demand is still high in both cities with an increasing focus on sustainability.

02
The Italian Economy

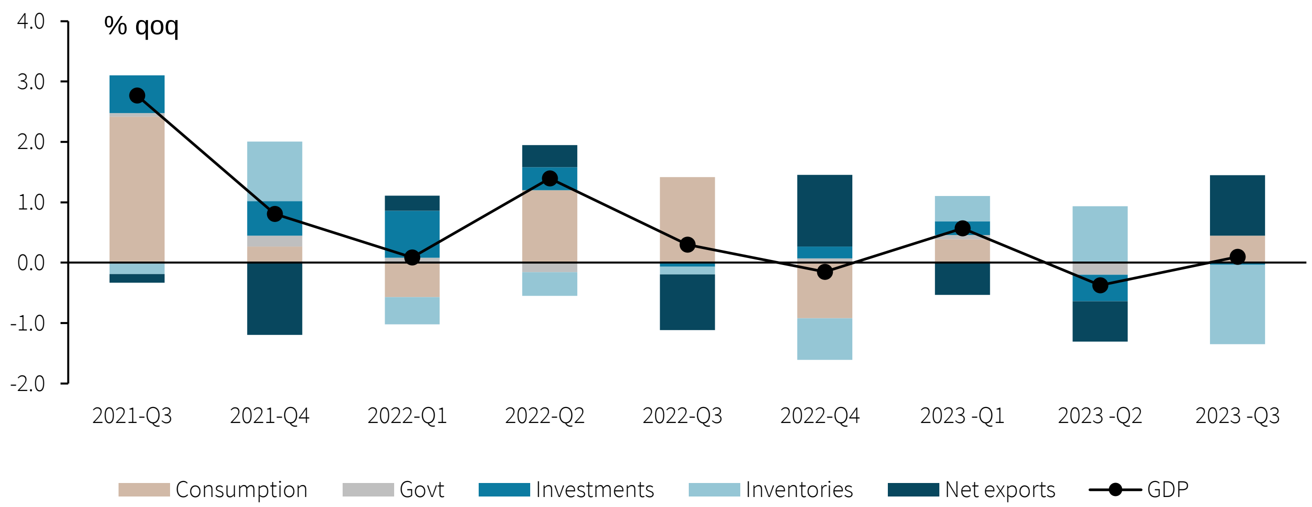
Projections for Italian economy indicate an average GDP growth of +0.5% in 2024

In Q3 2023 the Italian economy posted a GDP increase of 0.1% in comparison with both the previous quarter and the third quarter of 2022. Q3 data were impacted by the continued weakness in the manufacturing PMI – Italian industry despite the continued resilience in more services-oriented sectors. Net exports and consumption drive positively GDP evolution.

Latest market projections indicate an average GDP growth of +0.7% in 2023 and a +0.5% 2024 forecast.

The impact of high inflation and interest rates persists, but there are signals that, overall, economic conditions are on an improving trend: Inflation remains high by historic standards, but it has peaked and is now slowing quickly and it's going to stabilize below 2%; commodity prices have fallen, supply chain disruption and costs have eased; interest rate tightening cycle is drawing to an end.

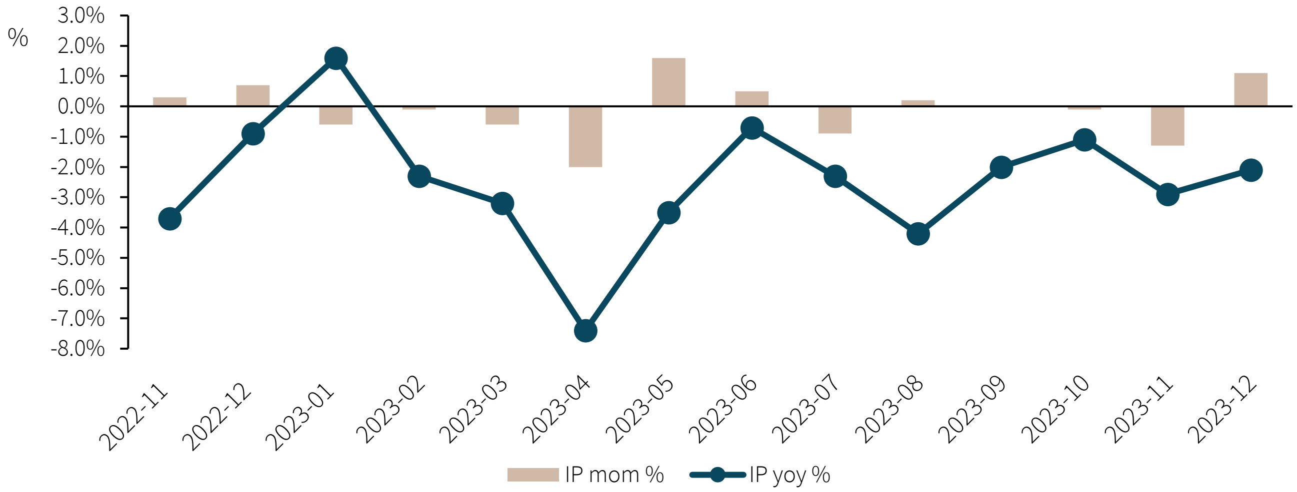
Contribution to GDP growth QoQ%



Source: JLL Research 2023

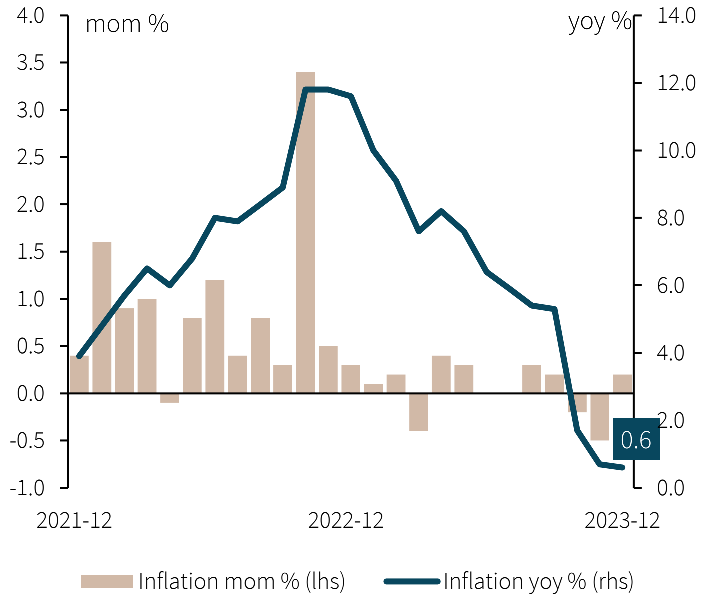
Industrial production in **December** posted a seasonally-adjusted increased of 1.1% **MoM** (-2.1% YoY on a calendar adjusted basis). The change of the average of the last three months with respect to the previous three months was -0.5%.

Industrial Production - December 2022 to December 2023



Source: JLL Research elaborations on ISTAT data.
Note: seasonally-adjusted qoq data; calendar-adjusted yoy data

Annualized headline **inflation** (HICP) reached **0.6% in December** (down from 0.7% in November). Looking ahead, headline inflation should continue to slow down throughout the year. Core inflation, however, will take longer before it starts to come down, despite recent developments in the energy market.



Forecasts (Italy)	2023F	2024F
Gross Domestic Product	0.7	0.5
Industrial Production	-2.3	1.2
Consumer Prices (%)	5.6	1.6
Govt Balance (% GDP)	-5.3	-4.5
10yr govt bond yield (% EOP)	3.7	4.0

Source: JLL elaborations on ISTAT data.

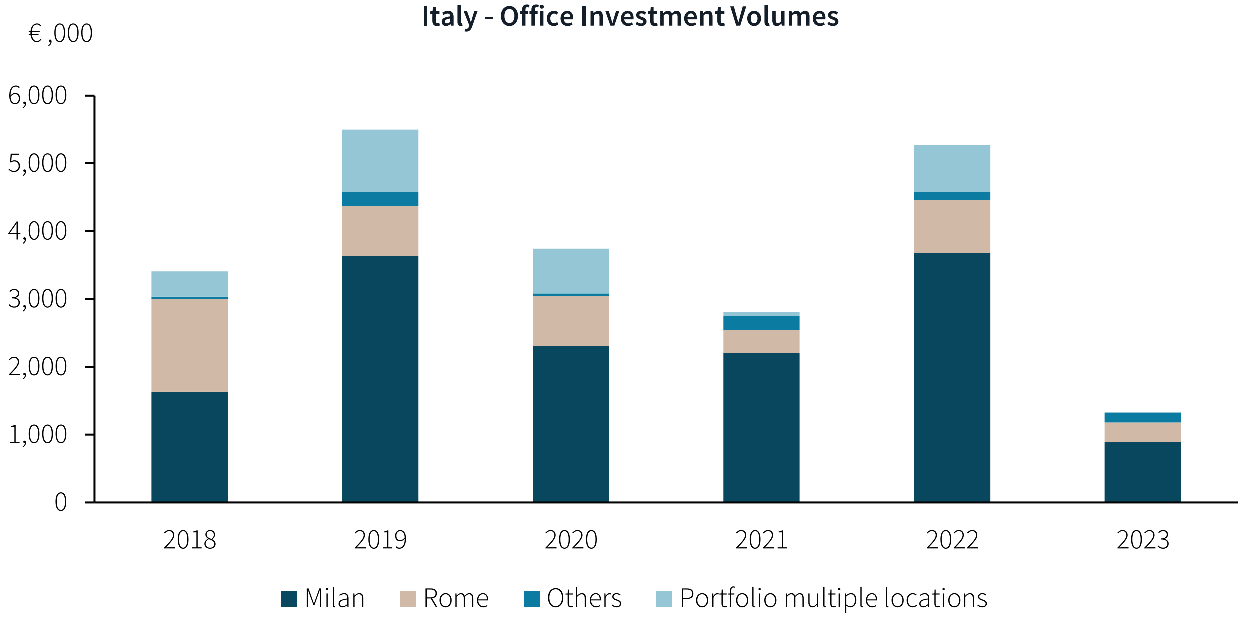
Source: Oxford Economics and Consensus as of January 2024. Data: annual percentage changes unless specified.

03
The Office Capital Markets

From the capital markets standpoint, the office sector in EMEA recorded **€39.7bn** in 2023, -56% year-on-year, a sharper decline than the overall market, which fell by 44%. Inflationary pressure have characterised 2023 and further interest rate rises have prolonged the slowdown in transactional activity. Weak global sentiment around the office sector has exacerbated this despite sustained performance in European occupational markets.

In Italy, 48 **office investment** deals amounting to approximately €1.3 Bn* were recorded in 2023, with a -75% YoY contraction. The relatively sharp drop of the Italian market volumes is partly explained by the record performance during 2022 (€5.3 Bn). In addition, Q4 data showed increasing QoQ volumes with offices the second asset class in terms of overall capital markets investment volumes.

Italy - Office Investment Volumes



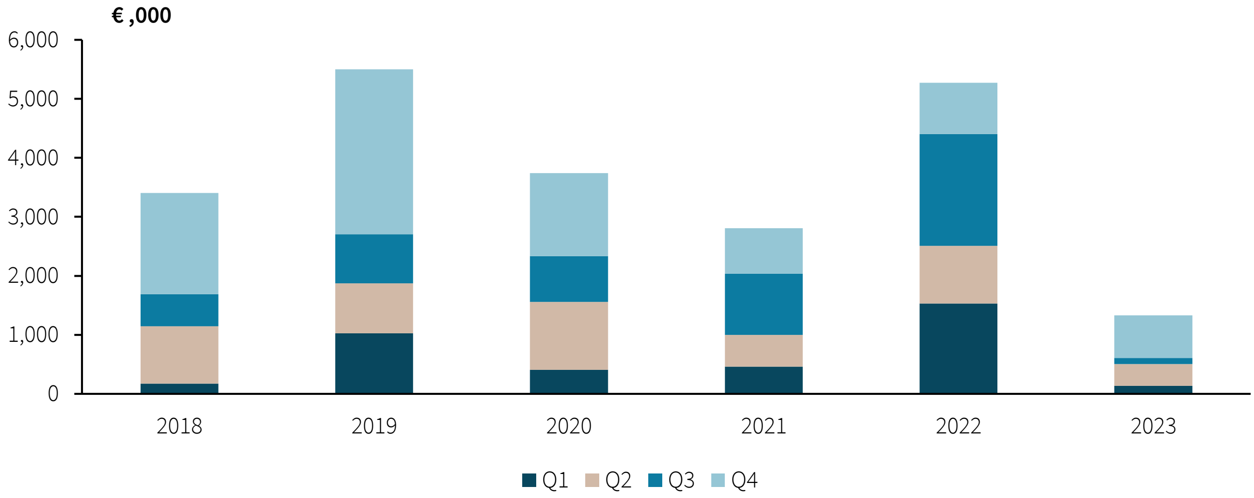
Source: JLL Research elaborations
*Aedes delisting share deal office portion included

In terms of **risk profile**, in the Italian market the dominant investment strategy was Core accounting for around 53% of total volumes. This was due also to the relative size of two single core asset transactions in Milan CBD of around € 300 Mn. It's also worth mentioning that around 13% of total volumes that were invested in offices aimed at changing the use destination of the buildings to other uses, including the living / residential and the hospitality sector. Institutional investors are the main source of capital for both Core and Core+ investments.

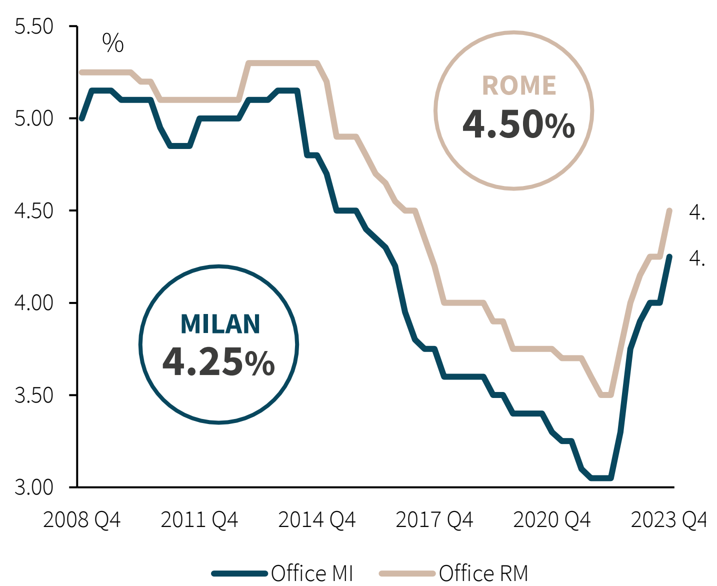
Milan remains the preferred destination, attracting approximately **€900 Mn of** volumes (67% of the total) spanned across 23 deals, located in both the central and peripheral areas of the city. **Rome** follows through by recording 14 deals and around **€290 Mn** (some 22% of the total). Some other €135 Mn (10% of the total) were recorded in other locations, predominantly single asset deals.

Prime yields in Q4 2023 increased by 0.25 bps in Milan (4.25%) and Rome (4.50%) compared to Q3 2023. Prime yields maintained a competitive position compared to other prime European cities that generally have experienced a higher yield decompression. This is also due to an active basket of private buyers, that being in most of the cases equity buyer, can actually compete with institutional investors in this market environment.

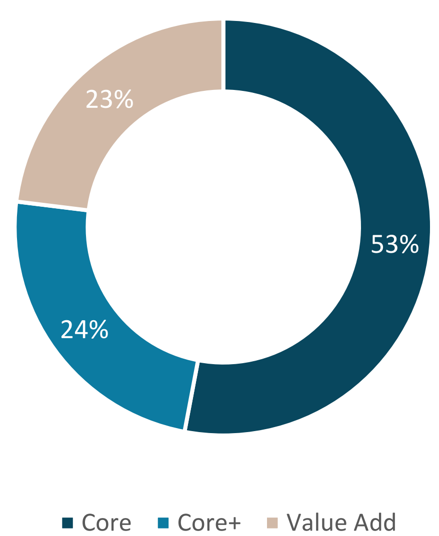
Office Investment Volumes



Office Prime yields as of Q4 2023



Office Investments by risk profile



Source: JLL Research elaborations

The Key Numbers 2023

Milan	
Investment volume	€0.9 Bn
N° of deals	23
Single asset deals	22
Deals between €50 - €100m	3
Average ticket size	€39 m

Rome	
Investment volume	€0.3 Bn
N° of deals	14
Single asset deals	13
Deals between €50 - €100m	0
Average ticket size	€21 m

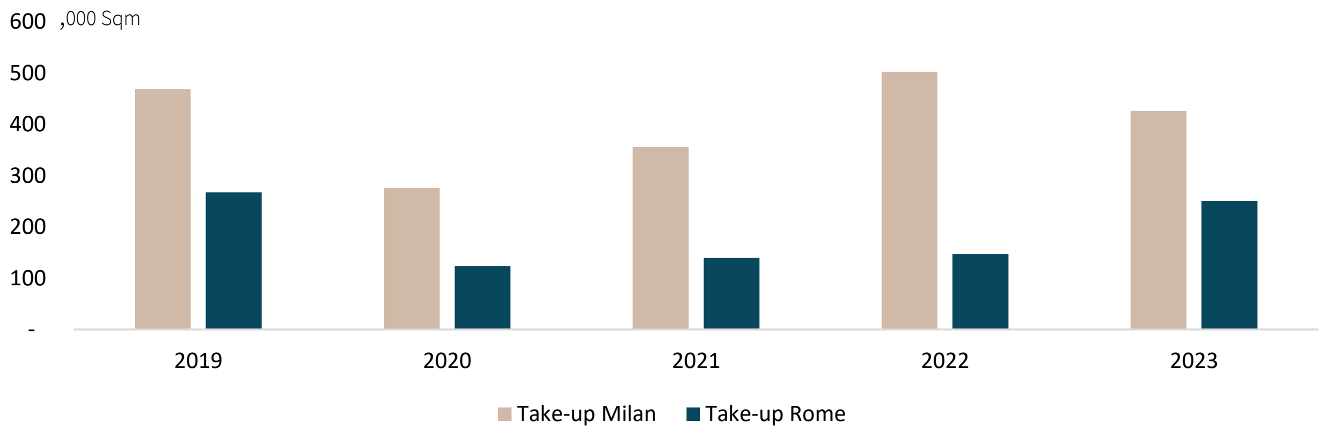
Source: JLL Research elaborations

04
The Office Occupiers Market

In 2023 office take-up **Milan** recorded around **426,000** sqm across **321** transactions with a significant additional sub-lease portion for further 42,000 sqm. Despite YoY underperformance(-15%) mainly due to the record reached in 2022, we had a positive result in Q4 (+40% QoQ and +10% YoY).

Demand for office space was dominated by deals below 1,000 sqm (66%). Despite a lower number of large deals above 5,000 sqm, we must highlight two pre-lets, one of over 30,000 sqm in the Semi-Centre area of Citylife and the other of 45,000 sqm in the Hinterland area of San Donato Milanese. **Grade A** office spaces accounted for 74% of the total. In terms of locations, **27%** of the take-up targeted offices in the **Central submarkets** (CBD Duomo, CBD Porta Nuova and Centre), 27% in the Semi-centre, 22% in the Periphery and 23% in the Hinterland. Take-up in **Rome** totalled around **250,000** sqm (+70% YoY) across **251** transactions, a significant increase mainly due to a single pre-let transaction in Q1 of around 50,000 sqm which reflects the high take-up portion for Core E.U.R. (29%) and one leasing transaction of 30,000 sqm in Q2 in the Centre (21%). E.U.R. Submarkets accounted for a 19%, CBD for 16%; the remaining 15% was distributed among other areas.

Office Take-Up (in thousands sqm) | 2019 – 2023



Source: JLL Research elaborations

Prime rents were stable in Q4 2023 in Milan at **700 €/sqm/pa**, and in Rome at 520 €/sqm/pa.
Rental growth is expected to slow down in most geographies in 2024, except for a few selected growth opportunities, while the interest in grade A and high-quality spaces will remain stable, along with the competition for these assets.
Vacancy rate in Q4 was at **8.4%** in **Milan**, with a **grade A** rate of 2.7% while in **Rome** was at **7%** as an average, with a grade A rate of 1.4%.

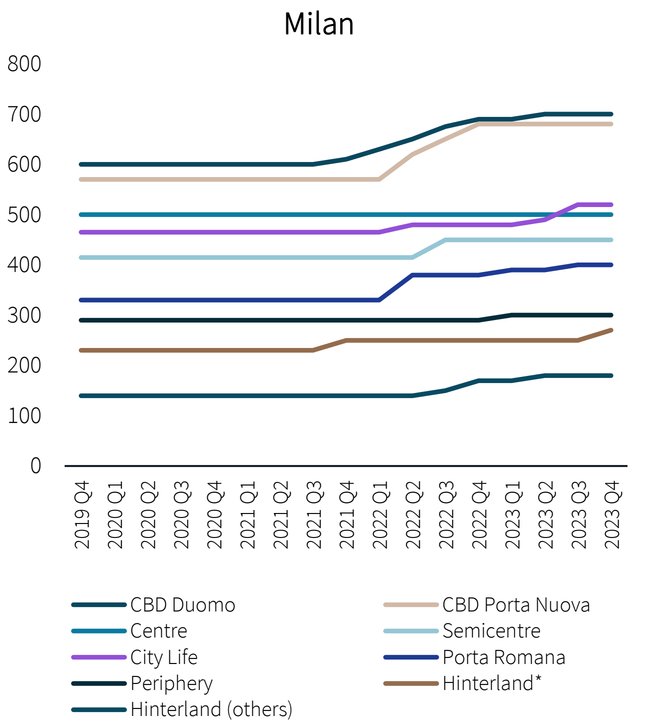
The Key Takeaways

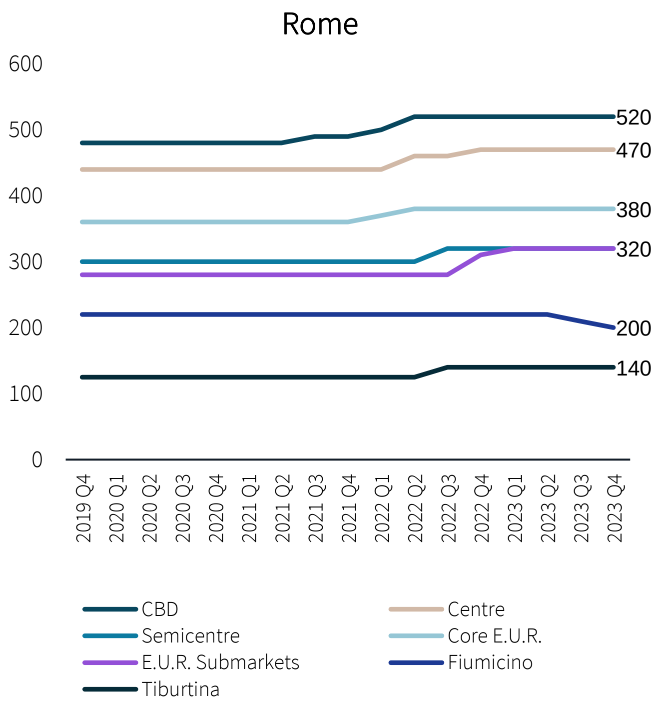
Milan	
Take-up	426,000 sqm
5 years average	405,900 sqm
Vacancy rate	8.4%

Rome	
Take-up	251,000 sqm
5 years average	186,000 sqm
Vacancy rate	7%

Source: JLL Research elaborations

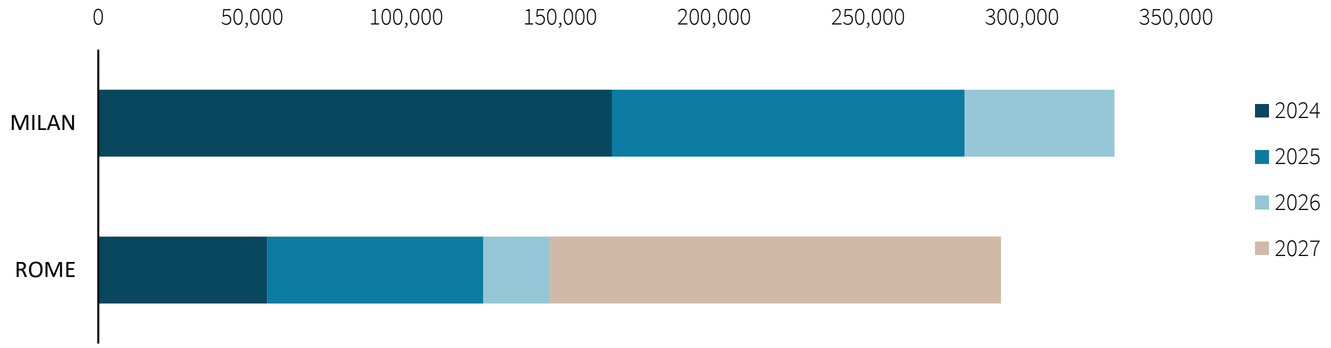
Office Occupiers Market – Prime Rents by Submarket (in €/sqm/pa)





*Segrate sub-market represents prime rents for the Hinterland.

Speculative future supply* (sqm)



*Under constructions only speculative supply

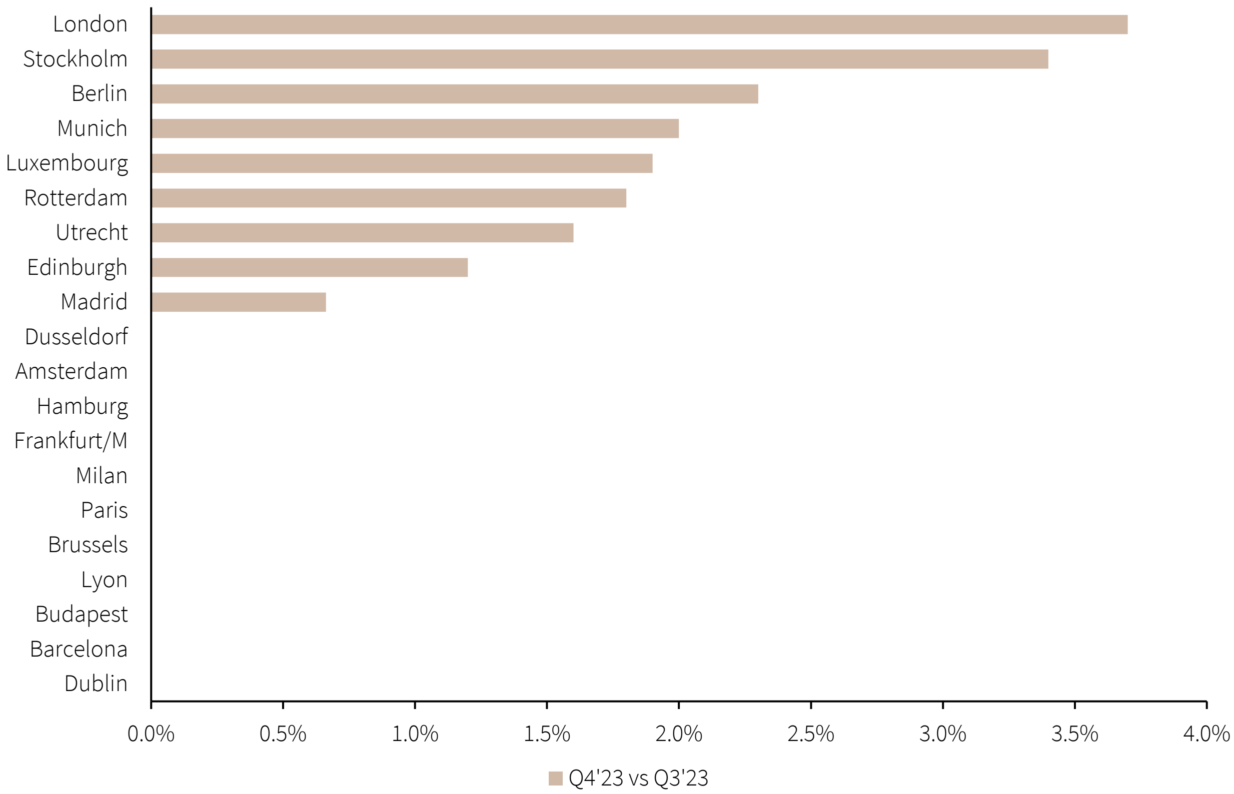
Source: JLL Research elaborations

EMEA office leasing market update

In the main European markets, caution, market uncertainty, and transaction delays have impacted take-up levels in 2023, recording **8.7 million sqm** (-18% YoY).

However, Q4 2023 data (2.5 M sqm) showed a significant upward movement in leasing volumes QoQ (+20% up from Q3 2023), despite they are still down on a yearly basis (-6% YoY). While structural issues such as hybrid working and sustainable building requirements are impacting decision making, it's the cyclical issues that hold back the willingness to transact. The trend of downsizing for better quality space in central locations continued through the end of the year. The tight market conditions in some CBDs are pushing out demand into other well-connected core fringe locations. The European Office Rental Index continued to increase in Q4 2023 (+1% q-o-q). At 4.4%, annual European office rental growth also remains well above the 10-year average of 3.8%. Prime rents will likely continue to rise, supporting the case for an exceptionally tight top-end of the market. However, the pace of rental growth is expected to slow down, falling below 3% in 2024. In Q4 2023 Rental increases were witnessed in nine of 23 Index markets.

Prime rents: quarterly change (Q4'23 vs Q3'23)



Source: JLL Research elaborations

5. Looking Ahead

Focus on A-grade high-quality assets with good sustainability metrics.

Looking ahead, while the **economic environment still feels challenging**, inflation is on the way down and is forecast to continue to decline over the coming months. Reduced supply chain disruption, fall in international energy prices and commodities prices dropping back to more historically-normal levels should help headline inflation to move down.

As a result, central banks are believed to be at or close to the end of their tightening cycles.

More stable interest rates will increase visibility and confidence in underwriting, which will in **turn improve market sentiment and encourage return of investment in 2024.**

Yields should continue to decompress but head back towards the long run average once macroeconomic environment stabilizes.

Occupiers will be even more focused towards grade **A high-quality assets** with excellent sustainability metrics.

Hybrid-work model is established but we see also an increased momentum in corporate return-to-office strategies beginning to improve attendance and occupancy.

Prime rents will likely continue to rise, supporting the case for an exceptionally tight top-end of the market. However, the pace of rental growth is expected to slow down, falling below 3% in 2024. Milan is among the main Markets.

We expect a market-wide trend in corporate consolidations, space rationalization, increasing subleases, prime space relocations and increasing focus on 2030 sustainability goals as deadline approaches.

05

Our Three Scenarios for the Italian Office Market

ECONOMY

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Base case

- **Geopolitical uncertainty** has increased and is unlikely to abate with elections in major economies in 2024
- **Inflation** has fallen as energy and commodity prices have fallen. Risks are to the upside from renewed supply
- **Interest rates** are at their peak and are widely expected to fall in 2024
- Despite **tighter lending conditions** there remains consistent demand for borrowing, particularly for refinancing existing debts, as well as for capex finance. **Opportunities** are likely to build, as the volume of debt maturities increases
- **Prime yields** reach the top of their cycle. The cost of debt funding remains high
- **Rental growth** to soften as inflation eases

Upside case

- **Geopolitical uncertainty** will not impact worldwide, and resilient economy allows confidence to remain stable as future conditions are becoming more predictable
- **Core inflation** has started to fall rapidly and will remain around 2% throughout the year
- **Interest rate** outlook is more predictable as there are fewer changes ahead in 2024. More predictable rates make underwriting easier
- **Investments** strengthen as investors gain confidence to start deploying allocated capital. Most markets perform well
- **Prime yield** decompression stops in the short term and a new compression phase starts. **Rents** expected to grow in all markets and submarkets

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Downside case

- **Geopolitical uncertainty** increases and is unlikely to abate with elections in major economics in 2024
- **Inflation** is not beaten yet and risks of a new price shock are rising; upside risk to inflation include supply chain fragmentation, climate shocks and armed conflicts
- Central banks should keep **interest rates** high for as long as necessary to bring and stabilize inflation down
- **Investments** suffer as investors flee to core markets. Most markets deteriorate
- **Prime yield** decompression set to continue for a while before reverting to long run average. **Rental growth** suffers in recession-hit sectors while remains stable or shows moderate growth in resilient segments

Jones Lang LaSalle S.p.A.
www.jll.it

Milano
Via Agnello, 8 - 20121
Phone: +39 02 85 86 86 1
Fax: +39 02 85 86 20 1

Roma
Via Bissolati, 20 - 00187
Phone: +39 06 42 00 67 1
Fax: +39 06 42 00 67 20

To find out more about JLL services, contact:

Stefania Campagna
Head of Markets Italy
stefania.campagna@jll.com

Alberico Radice Fossati
Head of Capital Markets Italy
alberico.radice@jll.com

Marco Pancotti
Head of Office Agency – Milan
marco.pancotti@jll.com

Sven Ole Sommer
Head of Capital Markets – Rome
ole.sommer@jll.com

Luca Villani
Head of Occupiers Services & Work Dynamics Italy
luca.villani@jll.com

Francesca Fantuzzi
Head of Research Italy
francesca.fantuzzi@jll.com

Massimo Livi
Head of Office Agency – Rome
massimo.livi@jll.com

Flavia Ferri
Senior Research Analyst
flavia.ferri@jll.com

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