October, 2022

Office snapshot

Q3 2022 – Market Overview

Milan and Rome, Italy

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1. Our Key Takeaways

1

The Italian economy shows some resilience

The **Italian economy decelerated** in **2022** amid higher geopolitical uncertainty stemming from the **war in Ukraine**, but latest GDP numbers in Q2 came in higher than expected, largely supported by **consumption** and **investment**.

2

Investors remain prudent but rents will 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.

3

Hybrid working is here to stay

The **JLL Global Future of Work Survey 2022** shows that 76% of clients would never go full remote, but that the hybrid working model is set to be the norm: 53% of respondents will make hybrid work a permanent feature, while 77% agree or strongly agree that it will be the key to attract and retain talent.

2. The Italian Economy

Although the Italian economy decelerated in 2022 amid higher geopolitical uncertainty, GDP growth in Q2 surprised on the upside, largely supported by consumption and investments.

The latest release by the Italian National Statistics Office (ISTAT) highlights a GDP growth of **+1.1%** in **Q2 2022**, mainly driven by consumption (+1.5%) and investments (+0.4%), while govt expenditure, net exports and inventories were all negative drivers.

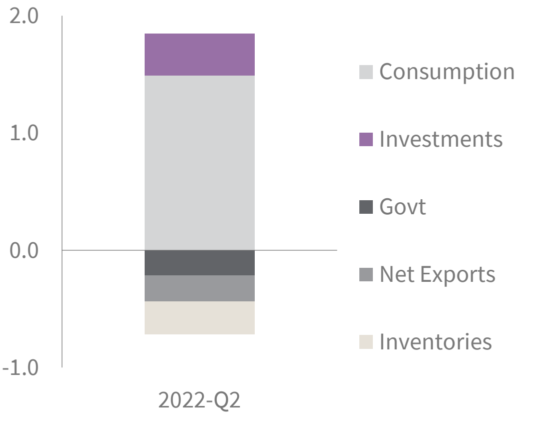
On the consumption front:

- The **end** of the **pandemic restrictions** and the re-opening of **international tourism** surely provided an uplift to growth.

On the investment front:

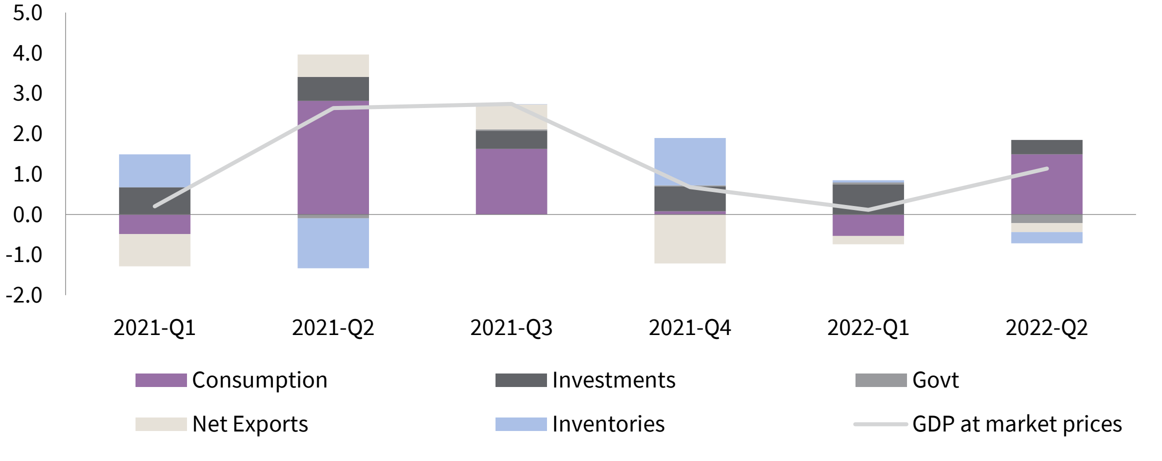
- Firstly, **Italy's Recovery and Resilience Plan** (EUR 235bn) may be feeding through to GDP.
- Secondly, firms may be allocating more capital in response to challenges on **global supply chains**.

Contribution to GDP growth Q2 2022 QoQ %



Source: JLL Research elaborations on ISTAT data

Contribution to GDP growth QoQ %

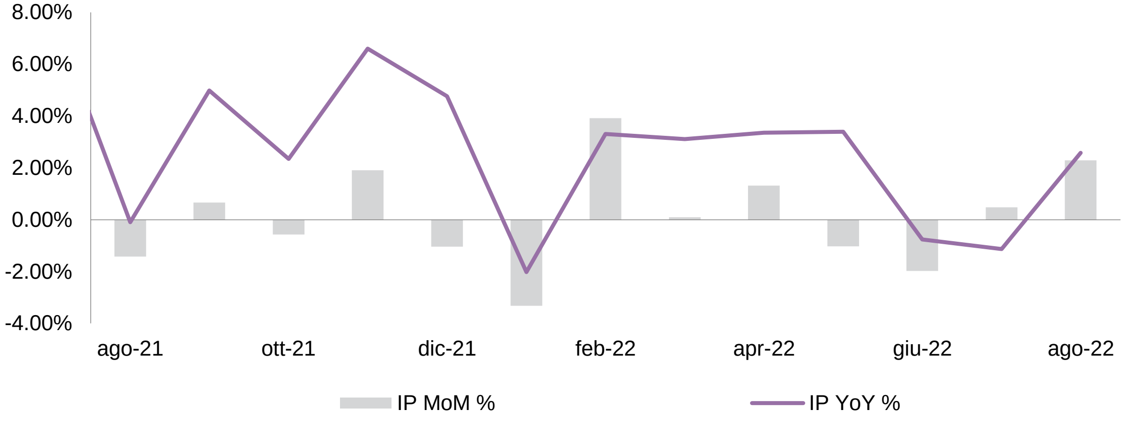


Source: JLL Research elaborations on ISTAT data

Latest **industrial production** data in **August** pointed to a somewhat surprising expansion of **+2.3% MoM** (+2.58% YoY)**.** However, this estimate should be taken with a pinch of salt: August is a very volatile month due to the holiday season.

Indeed, the change in average industrial production over the last three months versus the previous three months remains in contraction territory around -1.2%.

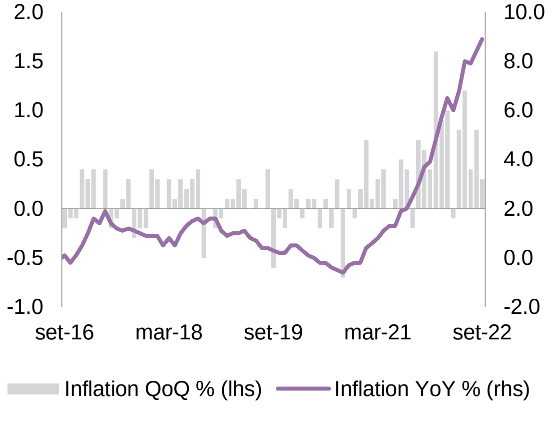
Industrial Production - Aug 2021 to Aug 2022



Source: JLL Research elaborations on ISTAT data

Annualized headline **inflation** (HICP) reached **8.9% in September** (up from 8.4% in August), one of the highest reading since 1985. According to market consensus, inflation will remain elevated throughout the rest of the year and will only start to decrease in 2023.

Inflation - Sep 2016 to Sep 2022



Source: JLL elaborations on ISTAT data.

Macro Forecasts (Italy)	2022F	2023F
Gross Domestic Product	3.3	-0.1
Industrial Production	0.6	1.4
Consumer Prices (%)	7.8	4.4
Govt Balance (% GDP)	-5.5	-4.5
10yr govt bond yield (% EOP)	4.1	3.7

Source: Oxford Economics as of 28th Sep 2022.
Data: annual percentage changes unless specified.

3. The Office Capital Market

The **office sector** confirmed its dynamism in Q1-Q3 2022 by recording **57 deals** and **€4 bn investments** (+95% YoY). These numbers confirm the solid attractiveness of the sector which now accounts for almost 43% of total real estate investment volumes, with the number of deals increasing by +12 on a year-on-year basis. It's also worth to mention that around € 265 mln of office volumes will change destination use towards the living / residential sector.

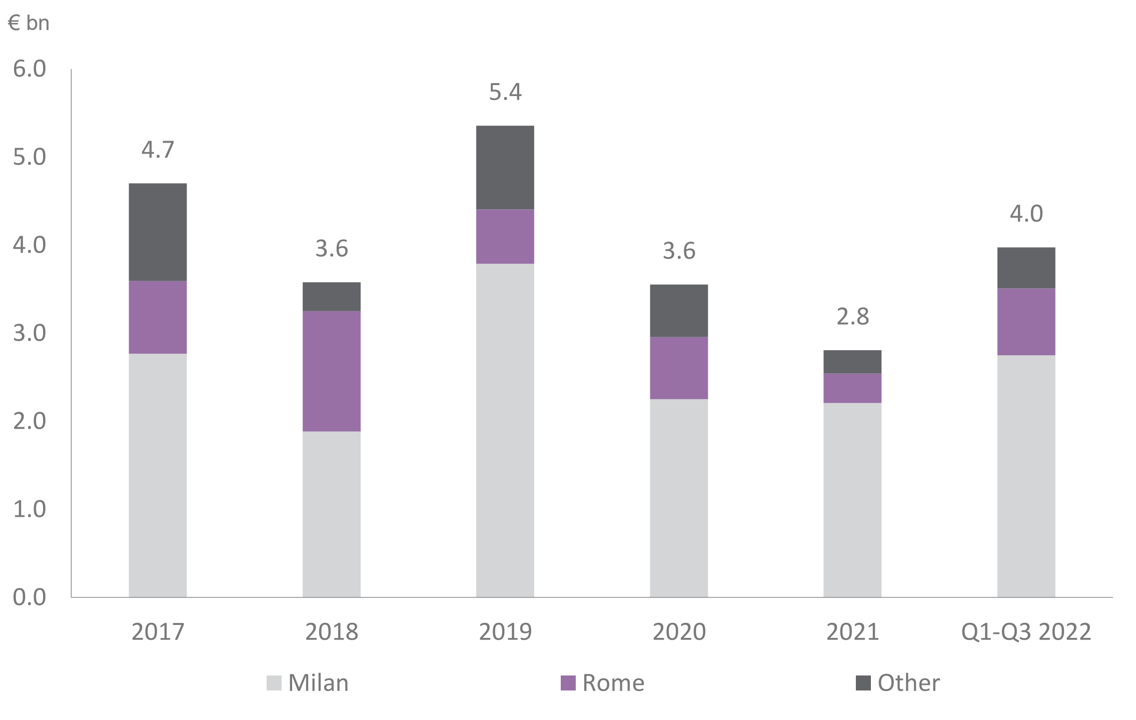
Milan remains the key investment driver, attracting around **€2.7 bn** volumes (69% of the total) spanned across 38 deals, located in both the central and peripheral areas of the city.

Rome continues to grow albeit at a more moderate pace, recorded 9 deals since the beginning of the year, for a total of around **€ 0.8 bn**, mainly located in Centre and EUR submarkets.

Most volumes were allocated by domestic capitals (42%), while international investors account for around 35% (we don't account for unknown origin of capital)

Prime net yields in Q3 increased by +25 bps both in Milan (3.30%) and Rome (3.75%) compared to Q2.

Office Investment Volumes (€m)



Source: JLL Research elaborations

The Key Numbers Q1-Q3 2022

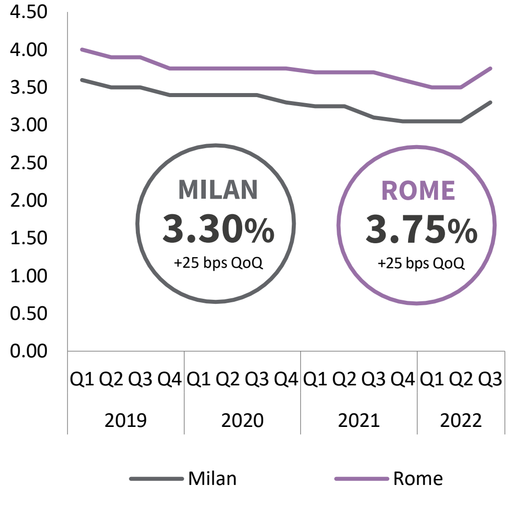
Milan

Investment volume	**€ 2.7 bn**
N° of deals	**38**
Single deals	**33**
Deals over €100m	**7**
Average size	**€69 m**
Transactions in the Historic Centre	**10**

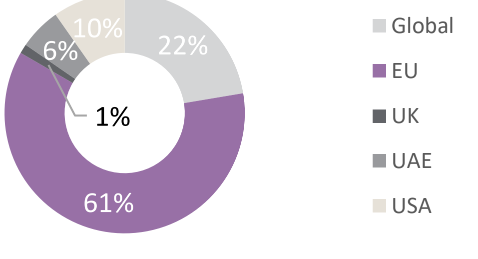
Rome

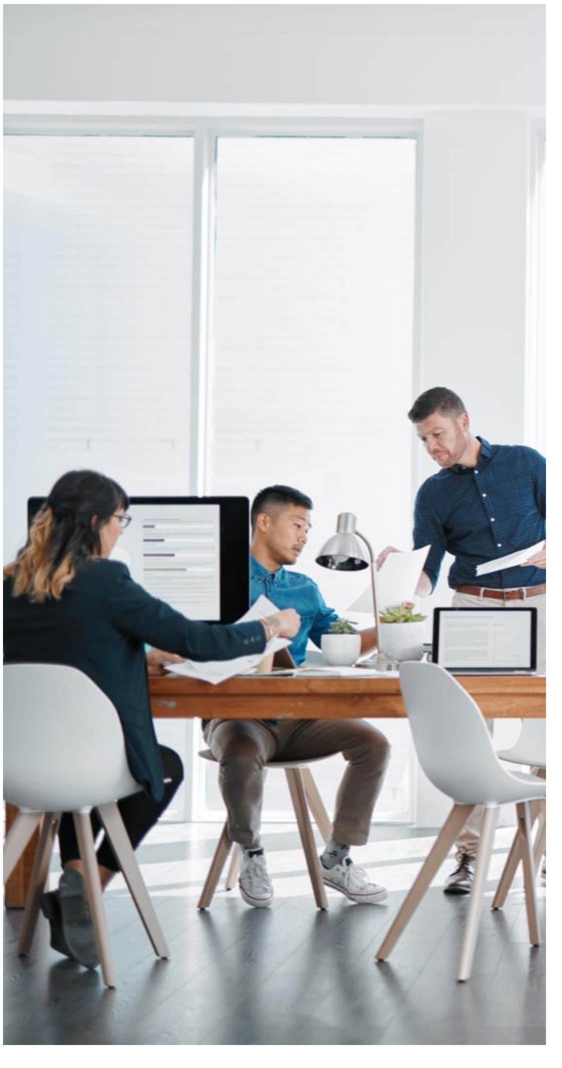
Investment volume	**€ 0.8 bn**
N° of deals	**9**
Single deals	**9**
Deals over €100m	**4**
Average size	**€65 m**
Transactions in the Historic Centre	**3**

Prime yields as of Q3 2022



Office Investment by Capital geography





4. The Office Occupiers Market

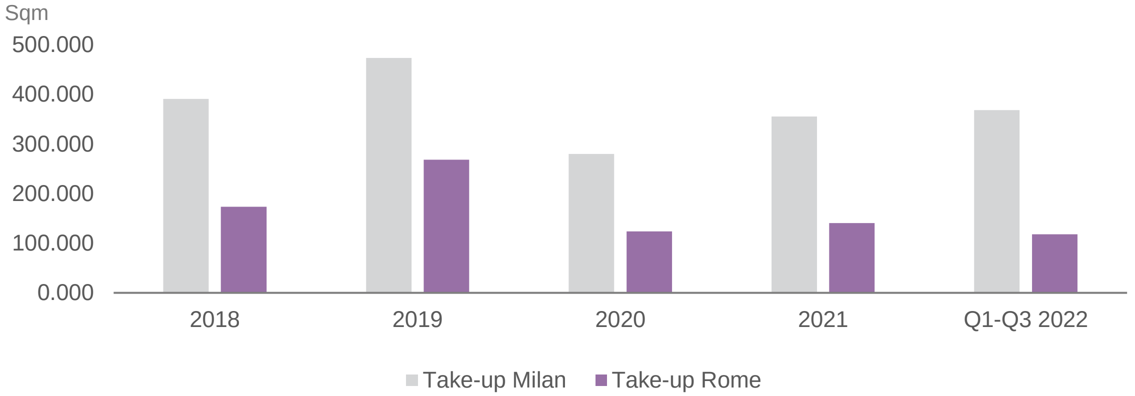
Office leasing side increased in take-up both in Milan and Rome

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.

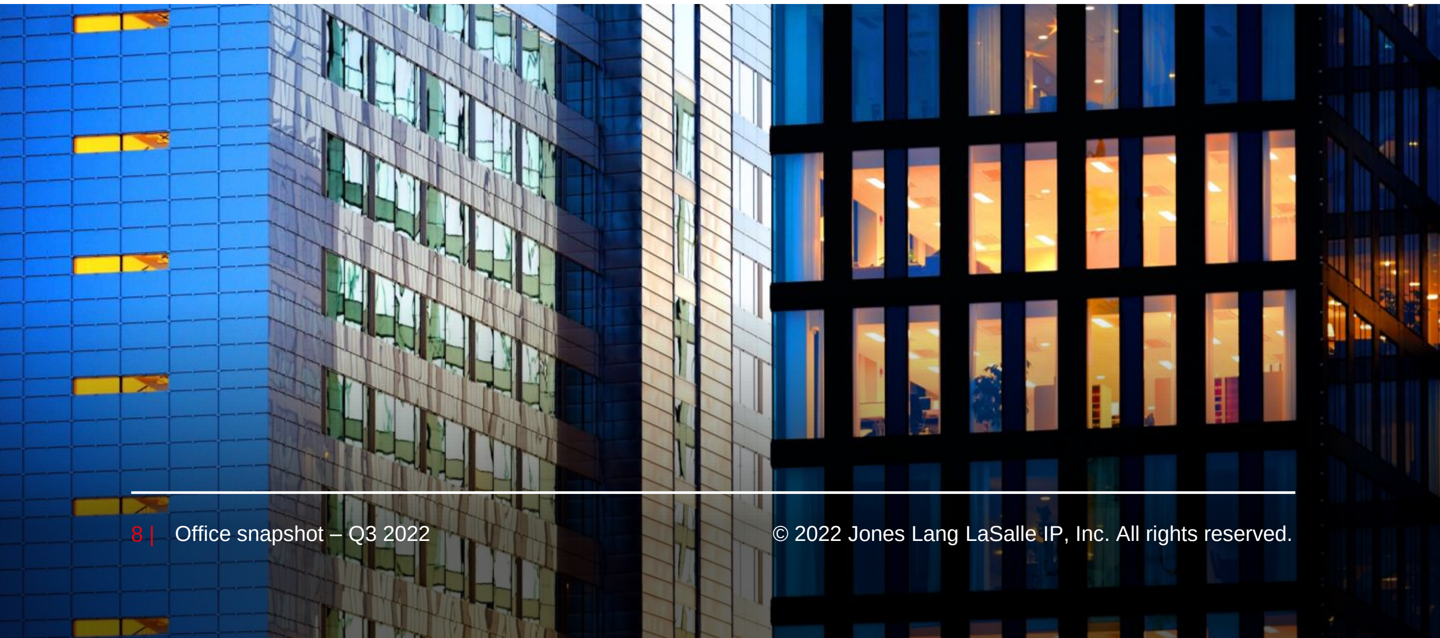
Milan reached some **368,000** sqm in Q1-Q3 2022, up by +40% YoY across **224** transactions. The demand of office space was dominated by deals below 1,000 sqm (61%) and by grade A office spaces (76%). Around 35% of the demand targeted offices in central submarkets (CBD, Historic Centre, Centre), 28% in Periphery, 21% in Hinterland area, and 16% in Semi-centre.

Take-up in **Rome** increased too, totalling around **118,000** sqm (+24% YoY) thanks to **110** deals. The demand was mainly focused on the E.U.R. submarket (36%), Centre-Semicentre (26%) and CBD (21%), while grade B spaces seem to be the most sough after (60%) because of the low offer of grade A assets in the capital.

Office Take-Up | Q1-Q3 2022



Source: JLL Research elaborations



The Key Takeaways

Milan

Take-up	**368,000 sqm**
5 years average	**372,722 sqm**
Vacancy grade A	**2.4%**

Rome

Take-up	**118,000 sqm**
5 years average	**184,981 sqm**
Vacancy rate	**6.1%**

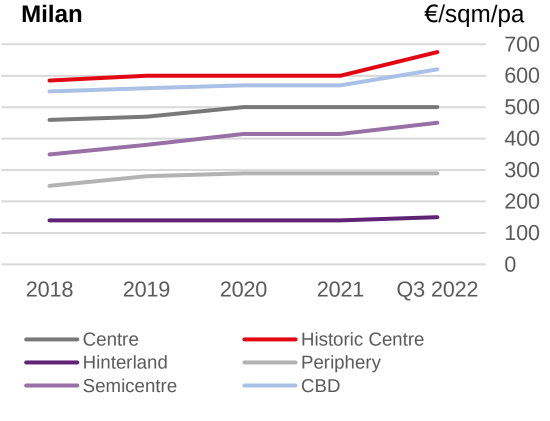
Prime rents are stable at **520 €/sqm/pa** in Rome, +30 €/sqm/pa up YoY. In Milan, rents raised (+25 €/sqm/pa from Q2 2022), reaching **675 €/sqm/pa**, with +75 €/sqm/pa YoY.

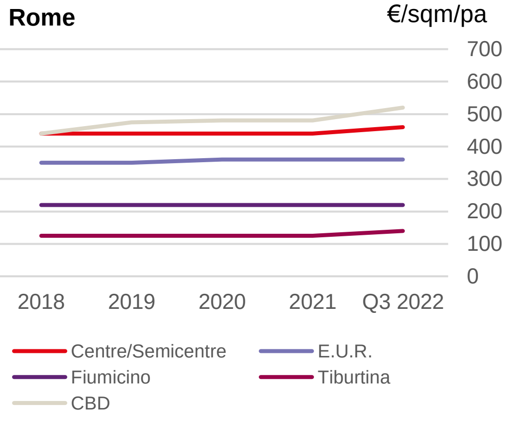
Rents are generally expected to raise up some more by the end of the year, confirming the interest in A-grade and high-quality spaces and the competition for these assets.

Total future supply*	**Milan**	**Rome**
2022	**119,000**	**20,000**
2023	**312,000**	**196,000**
2024	**287,000**	**138,000**
2025	**173,000**	**47,000**

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

Office Occupier Market – Prime Rent by Submarket



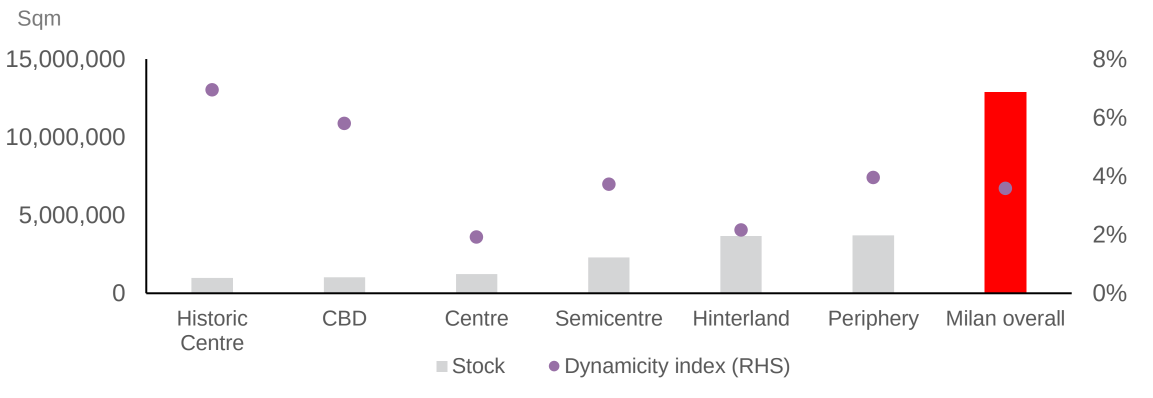


Source: JLL Research elaborations

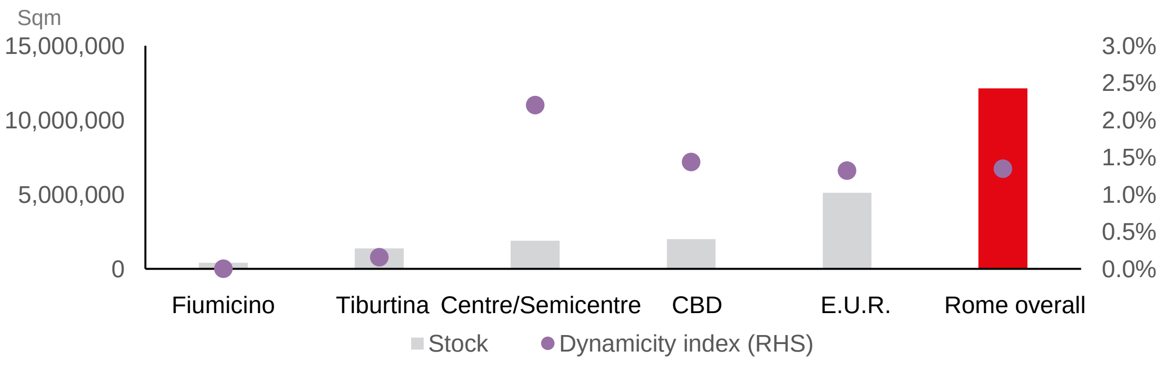
Office Market dynamicity: stock analysis

The two main Italian office markets have an almost equivalent stock, however they show some differences in terms of quality. This is reflected in take-up levels and in the dynamicity of both markets.

In the last 12 months, an average of 3.6% of the Milanese stock saw the signing of a new leasing contract, while in Rome the index was equal to 1.3%. In Milan, Historic Centre (6.9%) and CBD (5.8%) were the most dynamic submarkets with a dynamicity index well above the average, while Periphery also registered an index at 4% sharp.



In Rome, Centre/Semicentre was the most dynamic submarket with a 2.2%, followed by CBD and EUR, respectively at 1.4% and 1.3%; both Centre/Semicentre and EUR submarkets are more active than the city average. Demand and asset quality drive submarkets' trend.

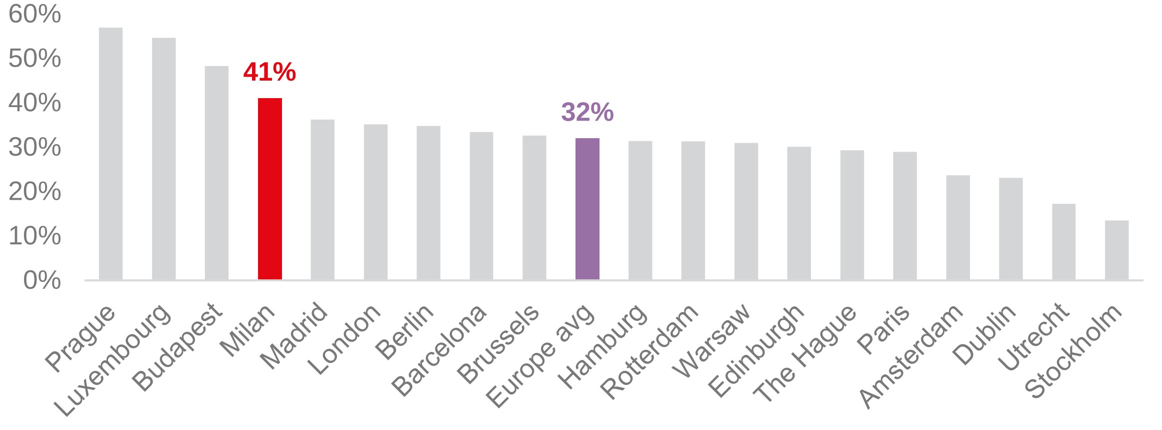


Source: JLL Research elaborations

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

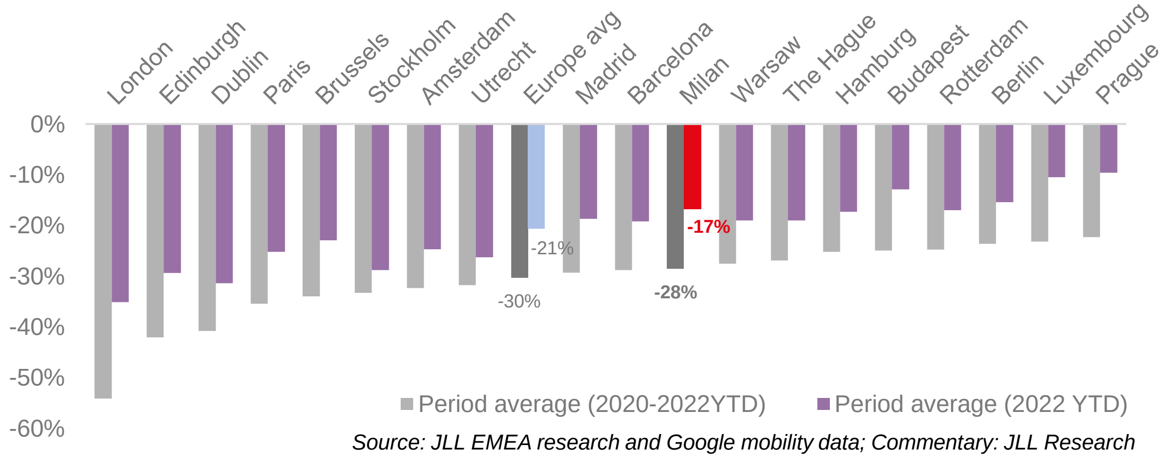
According to European office mobility recovery data (2020-2022 YTD pulled on Oct 2022), re-entry to European offices is at its highest point since the onset of the pandemic, according to JLL data. Based on the portfolios of JLL clients across Europe, re-entry estimates show workplace mobility levels improved around 32% compared to pandemic levels as an average.

Improvement in workplace mobility levels - 2022 YTD vs entire pandemic period



Milan is doing especially well compared to the European average, with a 41% improvement in workplace mobility compared to the pandemic period, fourth in Europe and ahead of big markets like London or Madrid. When compared to pre-pandemic levels Milano shows resilience, faring better than the European average of difference with the pre pandemic period (-17% versus -21% avg.), meaning people are coming back to the office in force.

Workplace mobility - % difference from pre-pandemic levels



Source: JLL EMEA research and Google mobility data; Commentary: JLL Research

The JLL Future of Work Survey 2022

The Future of Work Survey 2022 looks at workplace trends relevant to senior CRE executives, investors and occupiers. Our research confirms beyond doubt that the hybrid model will have lasting impact. Some key stats include:

- 76% of JLL clients would never consider becoming a remote-only organization;
- 72% of CRE professionals agree that the office will remain central to their organization's work ecosystem;
- 53% will make hybrid work a permanent feature;
- 77% % agree or strongly agree that it will be the key to attract and retain talent.

Key takeaways from the research:

Hybrid working is here to stay and calls for the rejuvenation of the office
The research confirms beyond any doubt that the hybrid model will have a lasting impact

Investing in quality space will be a greater priority than expanding total footprint, in the near term
Offering hybrid working options will be critical for attracting and retaining talent

Environmental and social aspirations will shape future portfolio transformation
Real estate is an essential enabler in the ESG journey to achieve both **S**ocial and **E**nvironmental goals

CRE functions need to double down on smart technology investments
Without sustained investment in technology and data, it will become more challenging to achieve performance and resilience goals

Real estate needs are becoming more sophisticated and complex
Organizations will seek input from specialists aligned to their priority areas of investment

1,095 responses from Decision Makers & Corporate Occupiers across 13 key markets worldwide (43% EMEA, 35% APAC and 22% AM, with 72% office spaces occupiers)

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. Annual average GDP growth from 2011 to 2020 has been generally disappointing, but things are gradually changing. So far, the combination of fiscal and monetary policy easing certainly helped the country to escape economic stagnation.

On the **capital markets** front, things look a bit different than a few years ago: the higher presence of international investors provides further liquidity and depth to the office sector.

The first three quarters of 2022 were very good for the sector, which grew by +95% on a year-on-year basis. But rising inflation, interest rates and consequently tighter monetary policy may temper the outlook in Q4.

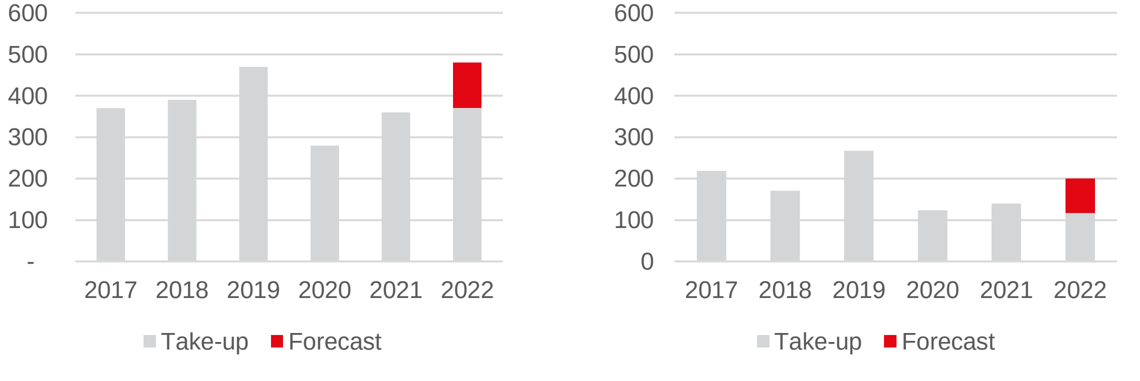
In EMEA and Italy, the impact of the pandemic on Office markets is now fading, with many companies embracing the so-called 'hybrid' working model. Companies are re-thinking their strategies, in many cases by reducing their office space requirements.

This contributes to other pull/push effects: pent-up demand that arose due to grade A shortage and disruption in the development pipeline, which in turn determines a flight to quality.

Demand for top quality spaces is also sustained by the growing popularity of hybrid work and attention towards attractive office spaces: this will allow companies to retain talents and therefore place the office sector as a central space in the work environment.

The market-wide trend in corporate consolidations and prime space relocations will likely place further pressure on aggregate vacancy levels for the remainder of 2022.

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.

Government bond yields have been rising 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. More recently, the volatility stemming from the UK Govt bond market has contributed to the yields rise.

Our Three Scenarios for the Italian Office Market in Q4 2022

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.	**Investments** and market liquidity to strengthen as investors gain confidence to start deploying allocated capital. **Yields** should remain generally stable. **Rents** expected to grow as economic conditions improve and occupiers' demand returns to pre-pandemic levels.
Muddling-through ›	The covid crisis 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.	**Investments** in the office asset class remain attractive although rising inflation and global uncertainty temper the outlook. **Yields** should accelerate but head back towards the long run average once macroeconomic context stabilises. **Rents** should increase 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.	**Investments** should suffer as investors assume a more tactical stance between govt bonds and real estate assets. **Yields** should spike before reverting to long run average after a longer adjustment period. **Rental growth** should suffer because of recessionary pressures.

Source: JLL Research

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