

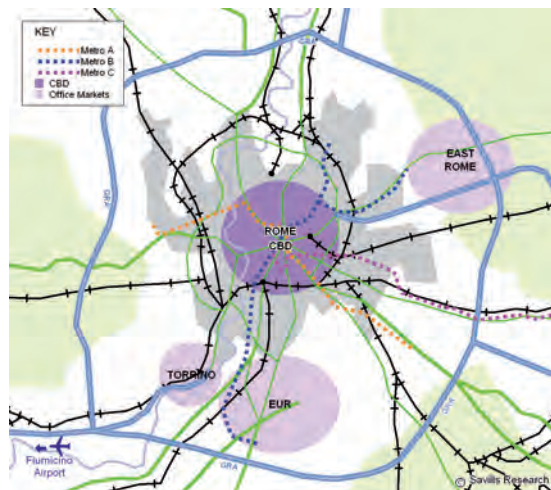
# Milan and Rome Office market report

## Spring 2008

### Survey Area - Milan



### Survey Area - Rome



**“Despite the slowdown in the number of transactions, Milan and Italy continue to attract international investor interest. We do not expect a major yield correction as the market is not considered overpriced.”**

Lionello Rosina - Head of Italy



- The focus of occupier demand is shifting towards consolidation and rationalisation in both Rome and Milan office markets.
- The factors of quality and efficiency of office accommodation are high in the list of occupier prerequisites and total occupational costs are expected to reflect this.
- Slowdown in demand due to negative business confidence is expected to hold back development activity in Rome and to cause a slight, temporary rise in availability in Milan.
- Rents will stabilise in 2008. In the medium term average positive rental growth is expected in line with inflation.
- The global credit crisis is causing a slowdown in negotiations for investment transactions. Prime office yields have softened by 25 to 50 basis points since the end of 2007.
- The compression of yields over the past few years has been the result of strong investor demand and maturing market conditions.

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# Milan office market

## Economy

Annual real GDP growth in 2007 was 1.5%, with a significant contraction of industrial production in the fourth quarter of the year. The main driver of growth was domestic demand, particularly private consumption. Since the beginning of 2008 business confidence has dropped and consumer price inflation is on the rise. Following the victory of the centre-right party in April, economic reforms are expected.

## Milan

### Demand

Despite the fact that the number of companies looking to acquire new premises since the beginning of 2008 is on the rise, overall the level of demand is lower compared to the high levels seen at the end of 2007. This is due to the smaller size of requirements as the focus of occupiers is shifting towards consolidation and rationalisation of the space they occupy. The average unit size mostly in demand falls within the 500-1,500sqm range, while there has been a significant growth in the number of enquiries for units below 500sqm. On the other hand the number of large (>5,000sqm) requirements has dropped since the end of 2007.

Greatest occupational activity, both in terms of number of enquiries and volume of transactions, comes from the following sectors: Banking and finance companies, which also have the larger requirements in terms of space, IT, Technology, Services and Industrial companies.

With regards to the locations in demand, the Peripheral submarkets are preferred as they are increasingly able to meet occupier requirements, in terms of both quantity and quality. Moreover, due to the improvement of infrastructure they are becoming increasingly accessible both by public transport and car access. The centre continues to benefit from the prestige of the location and occasionally from the historic value of the buildings, but it cannot offer such technologically advanced buildings as found in Peripheral or out of town locations.

It has become of ever increasing importance for the vast majority of tenants that total occupational costs reflect quality of space and location as well as actual size requirements. As a result, in Milan as in many other major markets worldwide, buildings which are sustainable and offer energy savings are ever more under demand. It is widely recognised that such characteristics reduce overall occupational costs, whilst acting to increase and maintain a property's marketability and its value into the future. Even for sustainable buildings, however, occupiers continue to demand market-level rents.

## Supply

The majority of new developments are being built on a speculative basis, but the ones that combine high standards and proximity to public transport connections may be taken-up even before completion. The development pipeline includes a significant amount of new stock that will come onto the market over the next two to five years as part of large-scale mixed use regeneration projects as well as longer term pipeline schemes.

### Mega projects in the pipeline - Office element

Name	Office element (sqm)	Expected completion year
Milano Fiori Nord Phase A	29,000	2008
Milano Fiori Nord Phase B	12,000	2009
Milano Fiori Nord Phase C	78,000	2010
Porta Nuova	139,000	2013
Citylife	100,000	2014
Santa Giulia	163,000	2008 onwards

Source: Savills

### Rental levels

Rental levels in prime locations have remained stable during the first two quarters of 2008, with some growth in certain secondary areas. Rental growth has been higher in Peripheral and out of town locations that offer high quality accommodation at lower occupational costs. Rents vary significantly subject to the property characteristics and location. This is especially the case in locations in Milan's Periphery where quality can be very high for new, well located developments, but Grade B or C buildings in poorly connected areas also exist.

Rents in the semi-centre range from €240/sqm/year for secondary accommodation to €300/sqm/year for prime properties. In out-of-town locations rents are somewhat lower at €210-240/sqm/year. Prime CBD rents, excluding off-market peaks, may be as high as €460/sqm/year.

## Rome

### Demand and take-up

Public administration requirements for space have always been fundamental for the Rome occupier market and have created a stable market with a constant level of letting activity. Since the beginning of

# Rome office market

## Italy investment market

2008, activity has been relatively quiet, due to subdued business confidence and in anticipation of the outcome of the national elections in April. The public sector continues to make a significant contribution and is particularly active, driven mainly by consolidation and modernisation, with requests in the region of 3,000-5,000sqm.

As far as regards the private sector, the largest companies, including multinationals, maintain their important presence in the country's capital city, regardless of whether or not they now also have headquarters in Milan. Demand for new space in the private sector is shaped by the rationalisation of occupied offices. Even though this type of operation entails an ever greater attention to economic issues, tenants are not generally prepared to sacrifice quality standards. In fact the majority of demand requests continue to be for Grade A space, although concluded transactions relate to both Grade A and B buildings, reflecting the actual composition of Rome's office stock today. Occupier requests tend to be for units falling within the 1,500 –2,000sqm size range.

The EUR submarket is the subject of the majority of occupier demand. As well as modern accommodation, it offers very good accessibility by both public and private transport, and is also easily accessible from Fiumicino airport. The area of Tiburtina is mainly targeted by companies from the technology sector, as well as by back office operations due to more economic rental levels.

### Supply and vacancy rate

The vacancy rate in both the CBD and the EUR areas is very low. High quality space is absorbed across the city so that the majority of premises remaining vacant in fact refer to lower grade properties. Some major proposed development projects should address this by supplying new, quality space onto the Rome market, with specifications meeting international office occupier requirements. Overall the demand and supply situation remains quite balanced. This is expected to be maintained, especially as developments tend to proceed subject to identified occupier requirements rather than speculatively.

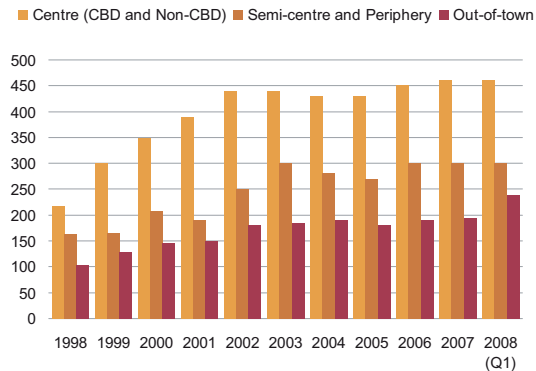
Most new schemes in the pipeline are found primarily in non-central locations such as the EUR district, where town planning regulations are more flexible, allowing new projects to be developed. However a number of large scale mixed use developments that include a substantial amount of office accommodation are venturing into new or less established locations. Some of the large pipeline office developments have been selected by public administration departments as part of their relocation plans.

### Rental levels

Rental levels in the Rome office market continue to

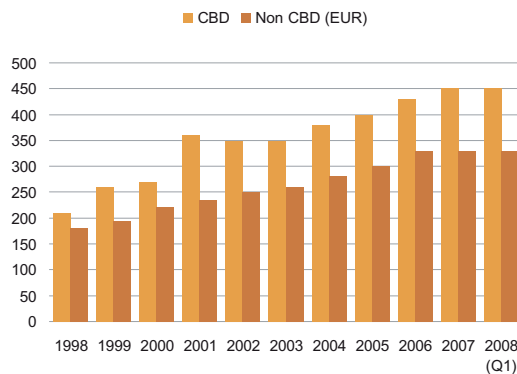
remain overall stable, with prime CBD rental values even showing a slight increase over the short term. Given the range of stock quality, it is important to note that rental growth refers to the volume of prime properties and locations within the Rome office occupier market, which is relatively limited.

### Milan prime office rents per submarket



Source: Savills

### Rome prime office rents per submarket



Source: Savills

### Italy Investment Market

The Italian real estate investment market has remained an attractive target for both national and international investors during the first few months of 2008. Over the past few years the market matured and has experienced a strong yield compression, although prime yields have not dropped below 5.0% as seen in other prime office locations across Europe. The turbulence in the global financial markets caused by the US sub-prime mortgage crisis last year has resulted in longer negotiation periods as well as stricter financing conditions. In addition to this, yield compression has come to a halt and prime income returns for offices have moved out by 25 to 50 basis points in the first quarter of 2008.

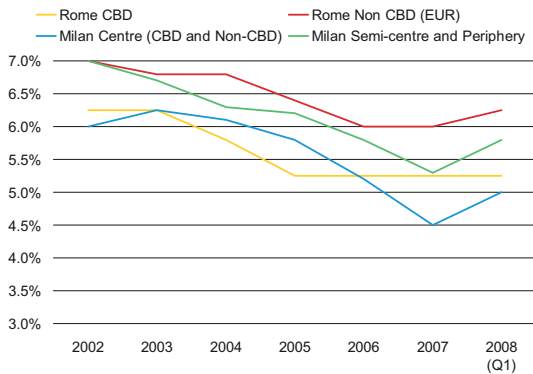
Market data show a greater level of investment market activity in Milan in comparison to Rome. This is due primarily to a relatively greater supply of quality, investment-grade product, coupled with a more mature market. As a result, yield compression has been less

# Outlook

dramatic in Rome over the past two years. Currently prime office yields in Milan are in the region of 5.0%-5.75% and in the region of 5.25%-6.00% in Rome depending on the location.

A range of non-Italian investors have demonstrated a strong interest in new projects and developments, although they may sometimes be more encouraged by greater depth in the Milan market. There continues to be a greater presence of local operators in the Rome investment market, whereas Milan now accommodates a more significant volume of international real estate investment.

## Milan and Rome prime office yields



Source: Savills

## Outlook

Available economic indicators suggest that economic activity will remain subdued in the first half of 2008, and is expected to increase in the remaining two quarters. Overall real GDP growth is projected by the European Commission to be 0.5%. Private consumption will lose momentum and private sector investment is expected to stagnate affecting both corporate sector and households. The economic uncertainty is expected to affect the level of demand in both centres. Given the amount of new or renovated space in the pipeline in Milan, a temporary rise in immediate availability may be noted by the end of the year. In the medium to long term, new development projects in Rome and Milan should improve the overall quality of available space and offer more choice to occupiers. Part of the older stock may then become obsolete and require renewal or a change of use. Our prediction for the medium term average rental growth in the Milan and Rome markets is that it will remain positive in line with inflation, driven by infrastructure improvements.

Regarding investment activity we believe that the second half of the year will become more active as capital allocations to real estate will have to materialise. Given the lack of transaction evidence at the moment it is hard to predict at what level buyer and seller expectations will meet. However we project any further upward shift of yields to be relatively limited as the market has not become overpriced.

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