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K&L Gates Real Estate Seminar:

European and Global Real Estate Trends - Opportunities for 2012/2013

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Trends and Prospects in European Property Markets

Peter Damesick
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K&L Gates Real Estate Breakfast Seminar
London, 18 September 2012

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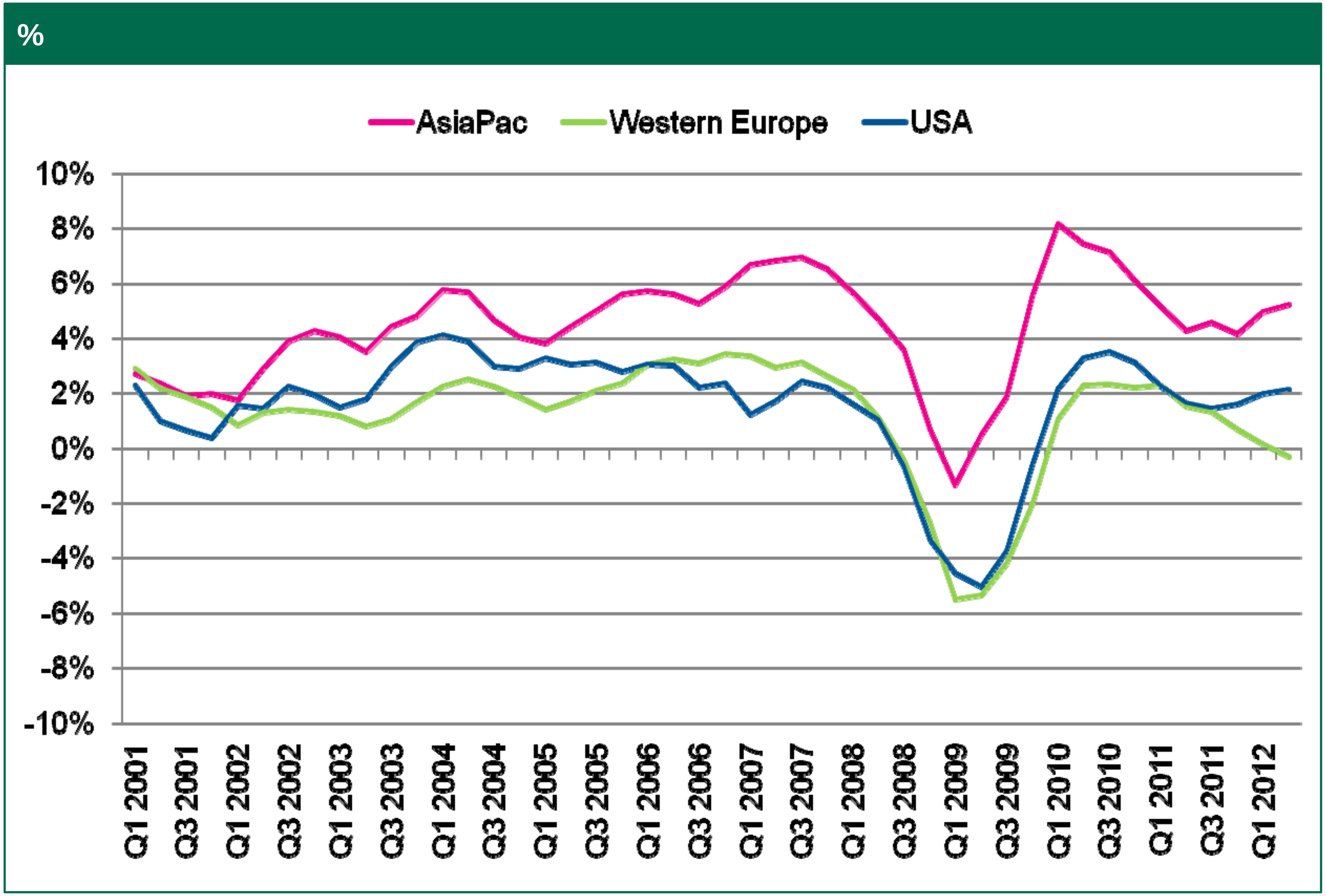
Key Topics

- Economic background
- Global real estate investment - recent trends
- Euro crisis: property markets impacts
- Polarisation in European investment markets
- Outlook: risks and alternative scenarios

Real GDP Growth

Year on Year % Change

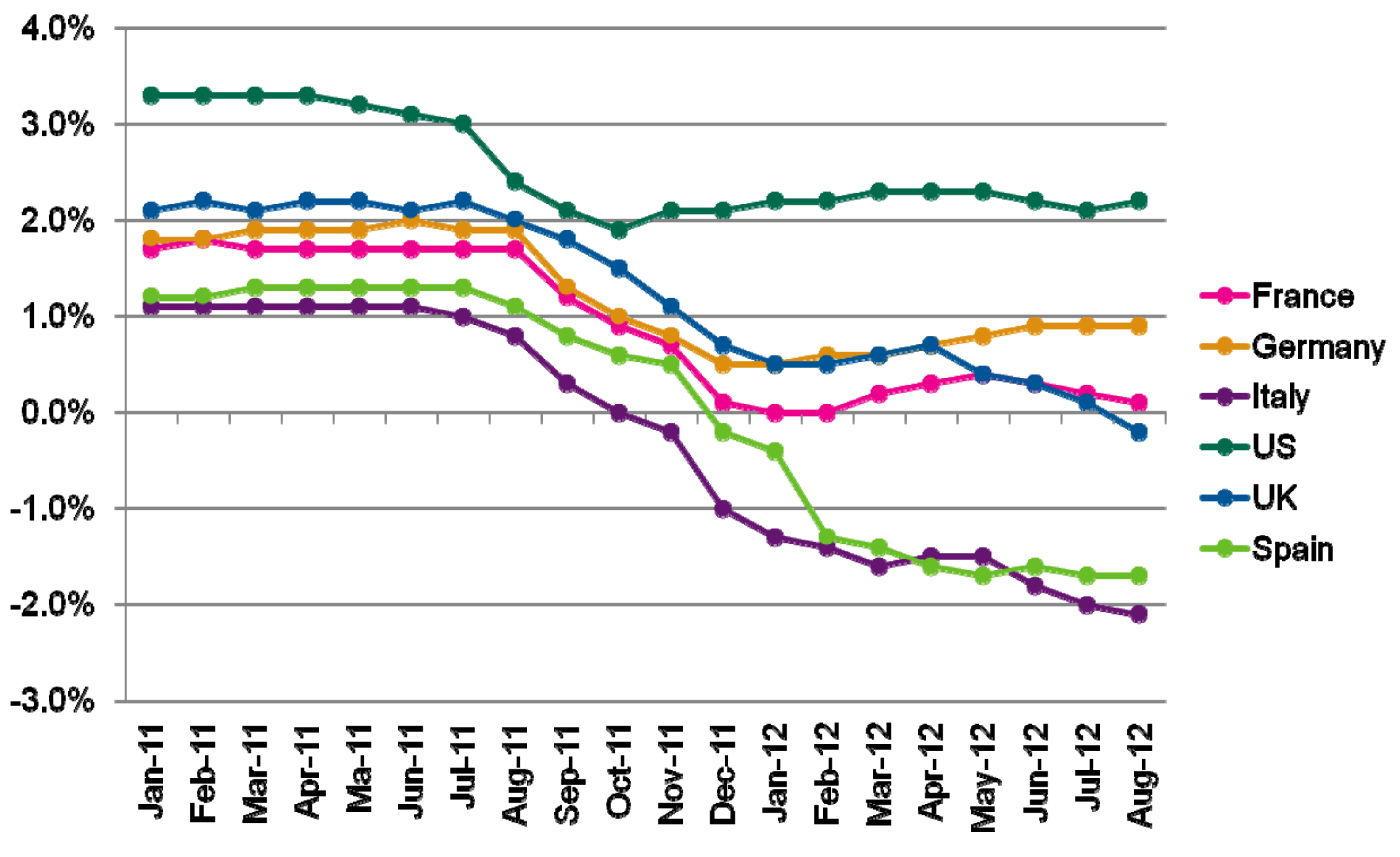


Source: IHS Global Insight, Oxford Economics

Changing economic sentiment

How forecasts for real GDP growth in 2012 have changed

GDP Growth (%pa)

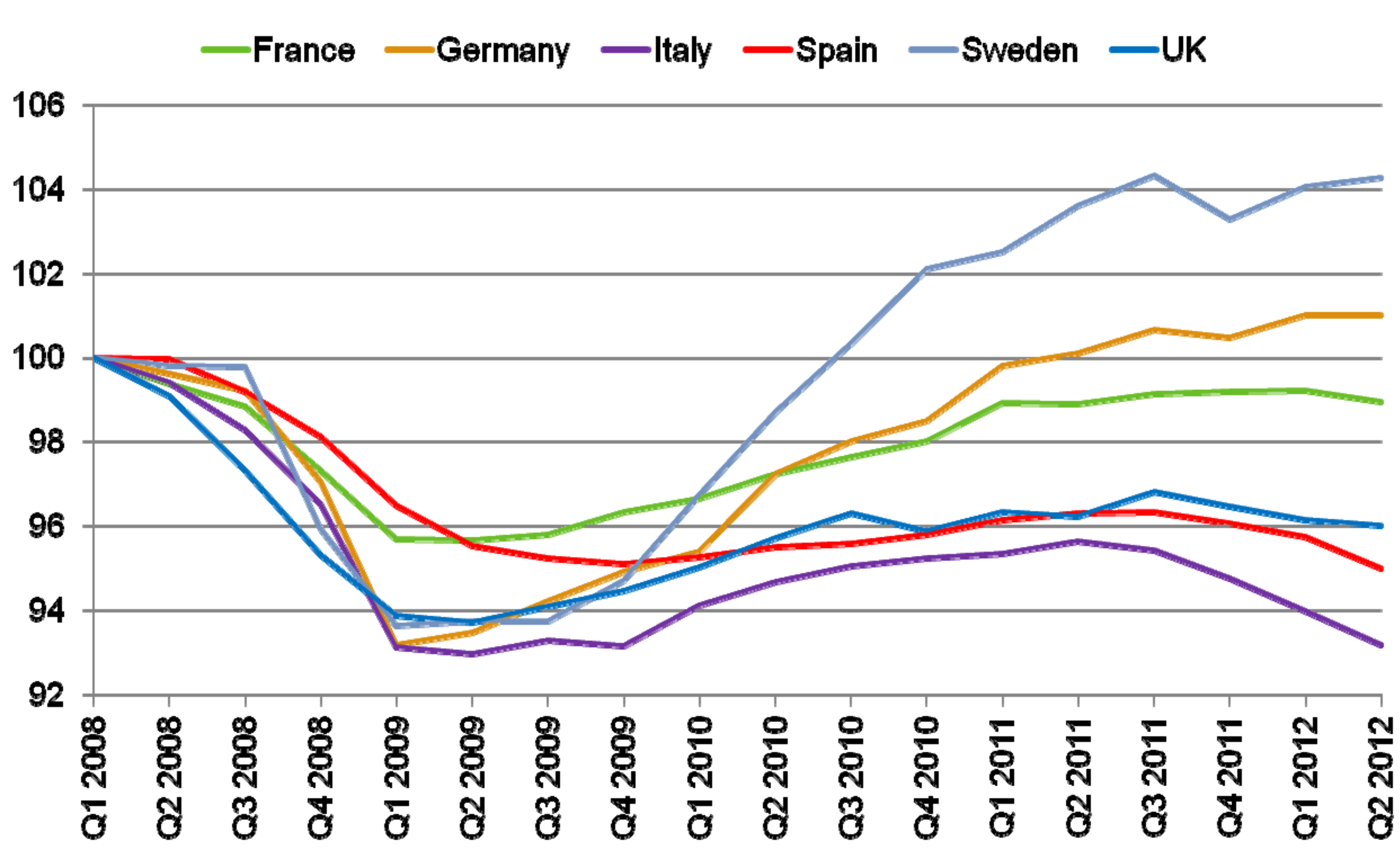


Source: Consensus Economics

Economic divergence in Europe

GDP, Q1 2008 = 100

Index of GDP



Source: CBRE, Oxford Economics

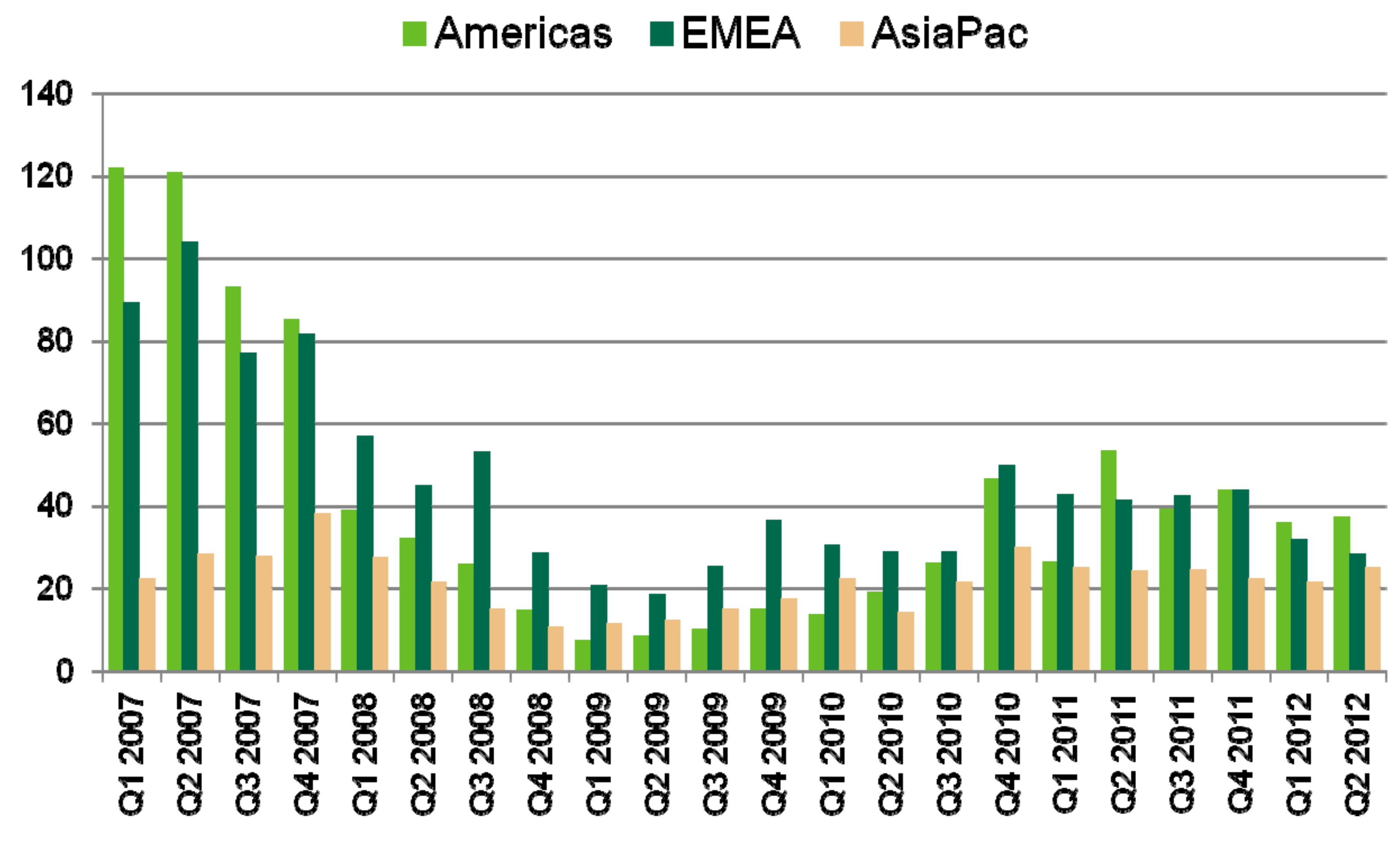
Eurozone Crisis: Costs of ‘Muddling Through‘

- **Crisis containment, with recurrent stress**
- **Economic position worsening over past year**
  - UK and euro zone in recession
  - Sharp contraction in euro periphery
  - European banking system troubled and fragmented
  - Deficit reduction policies becoming self- defeating
  - Growth outlook for 2013 weaker
  - Uncertainty continues, and itself stifles activity
- **ECB bond-buying: bazooka or buying time more?**

Global Commercial Real Estate Investment

Transactions: Offices + Retail + Industrials + Hotels

Billion €

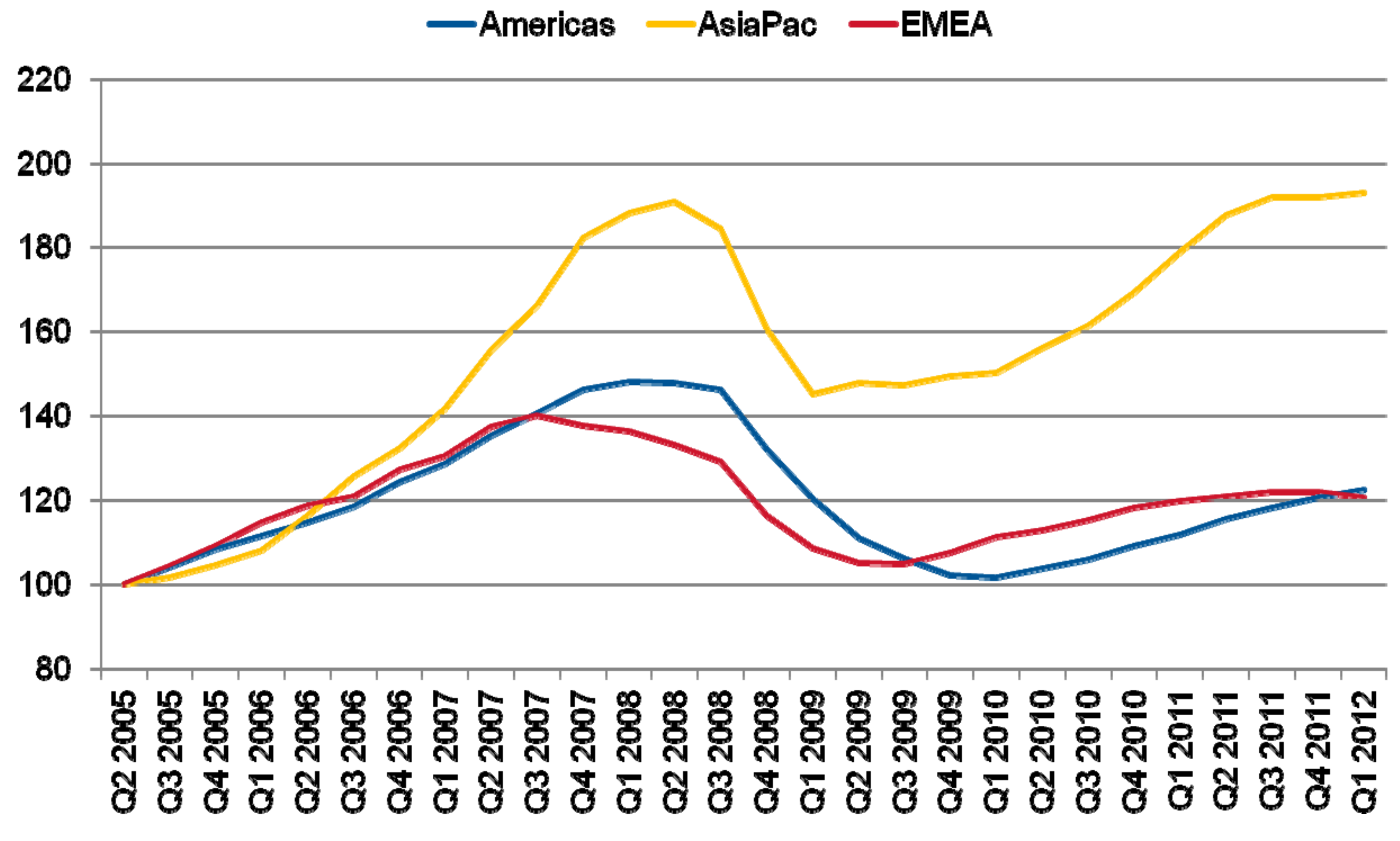


Source: RCA

CBRE Global Office Capital Value Indices

Asian values regain peak

Q1 2001 = 100



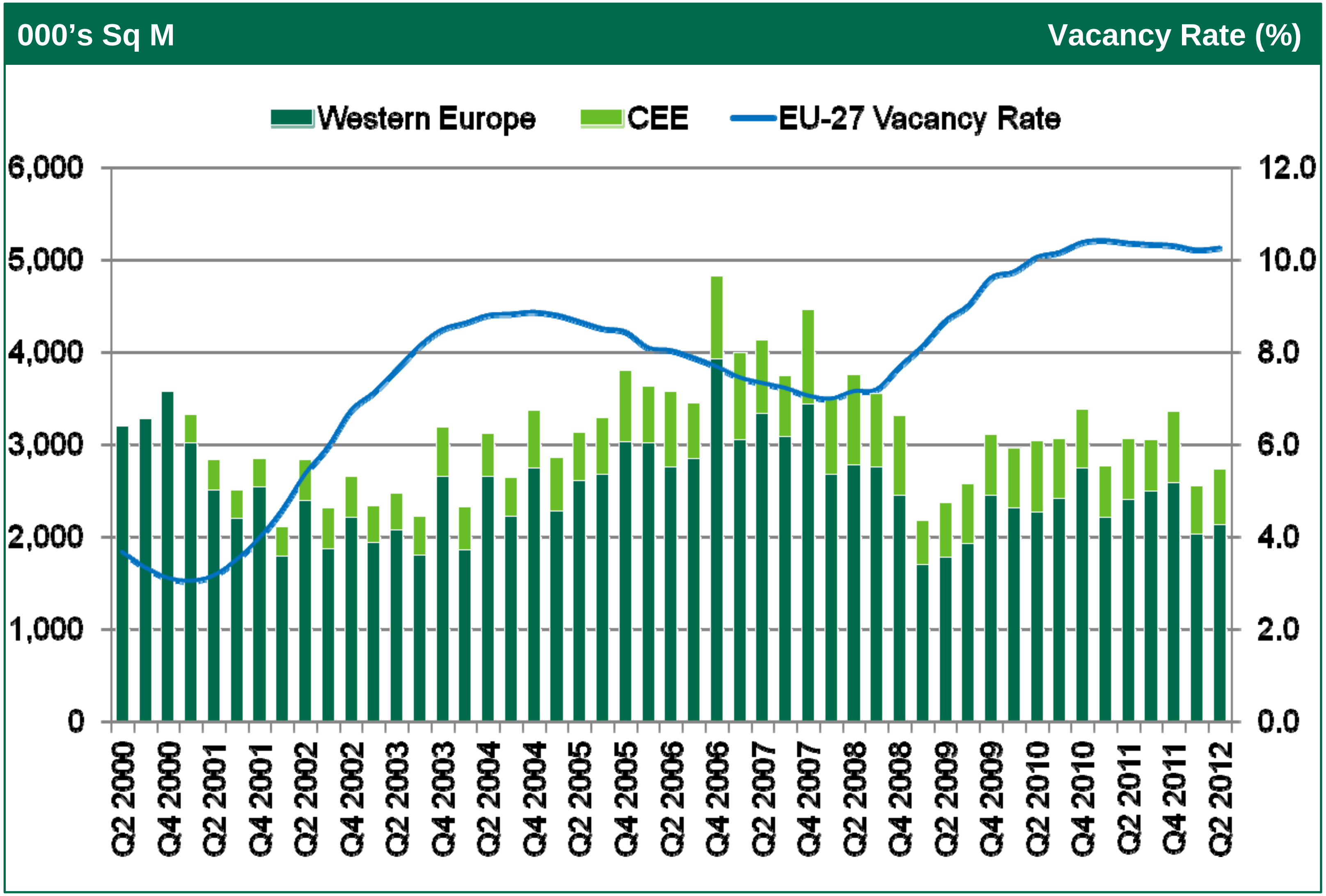
Source: CBRE

European Real Estate Markets in 2012

- **Occupier demand hit by uncertainty and weakening economies**
- **Office rents stalled or sliding**
- **Retail – demand concentrated on prime locations and dominant shopping centres**
- **Development in check**
- **Shortages of prime space; vacancy concentrating in lower quality property**

European Office Take-Up & Vacancy

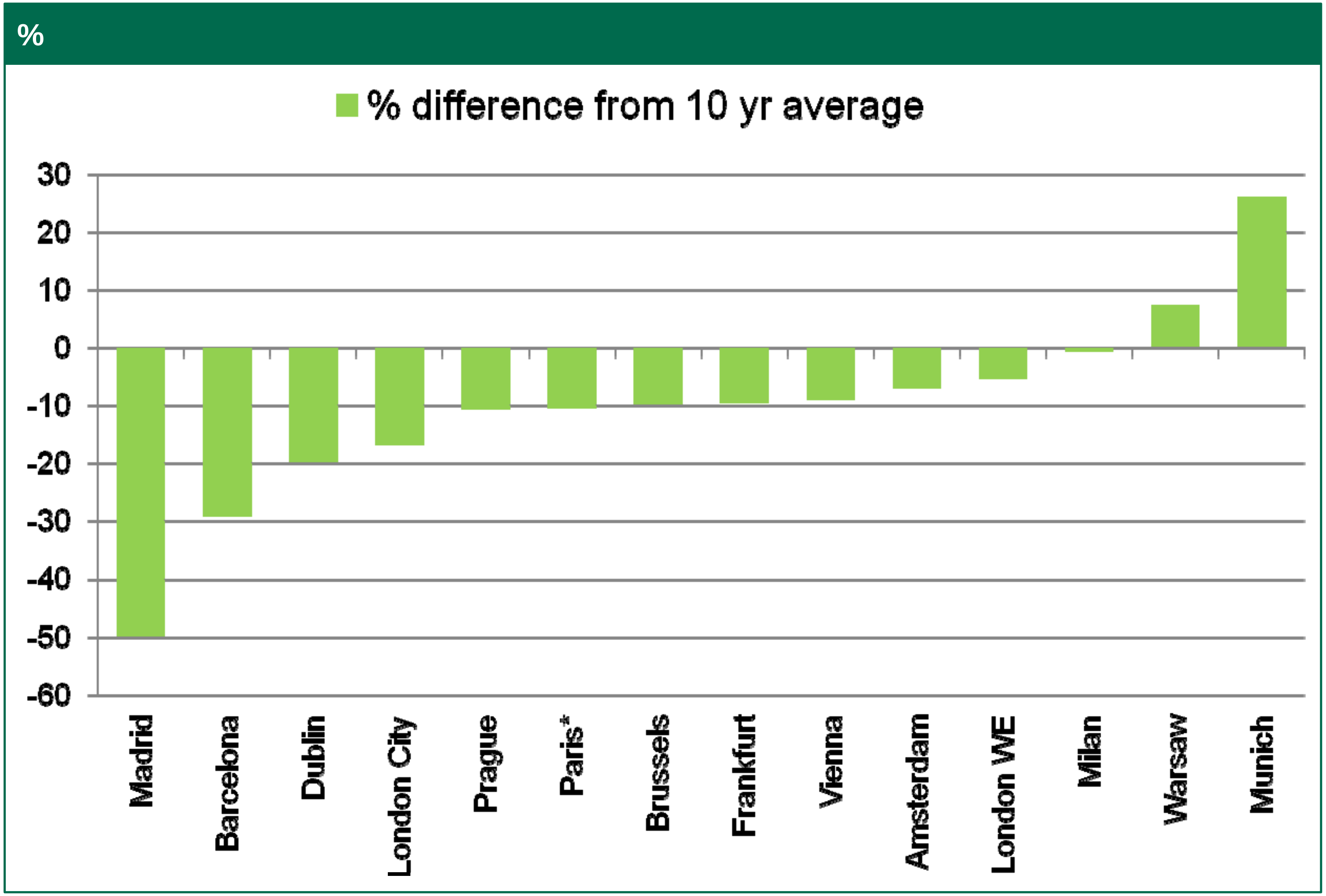
Take-up based on 28 Western Euro. markets, 10 CEE markets



Source: CBRE

Office Take-Up, Year to Q2 2012

Weak activity in Spanish office markets

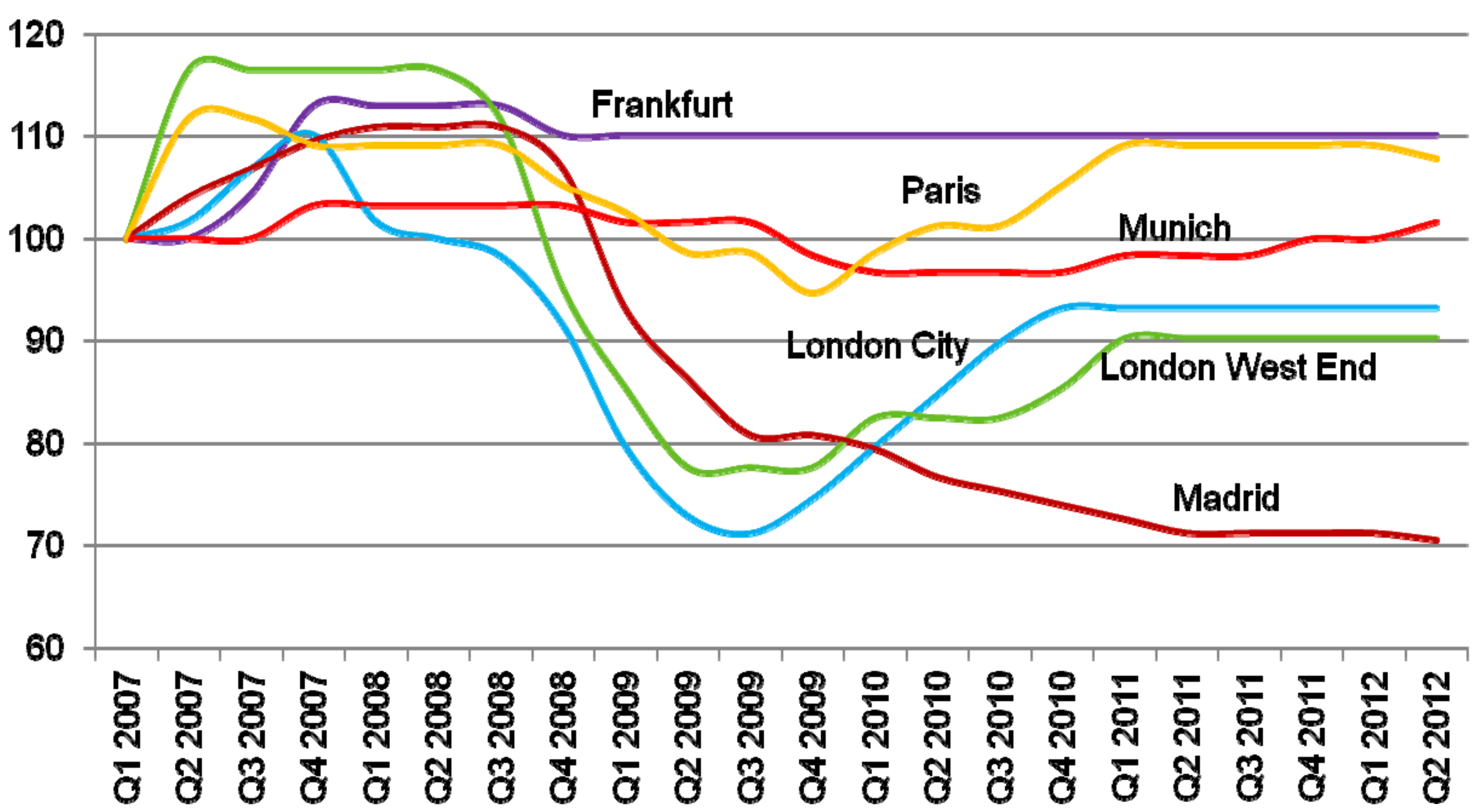


Source: CBRE. *Paris comprises Centre West, La Defense and Western Crescent submarkets

Prime Office Rents

Indexed to 2007

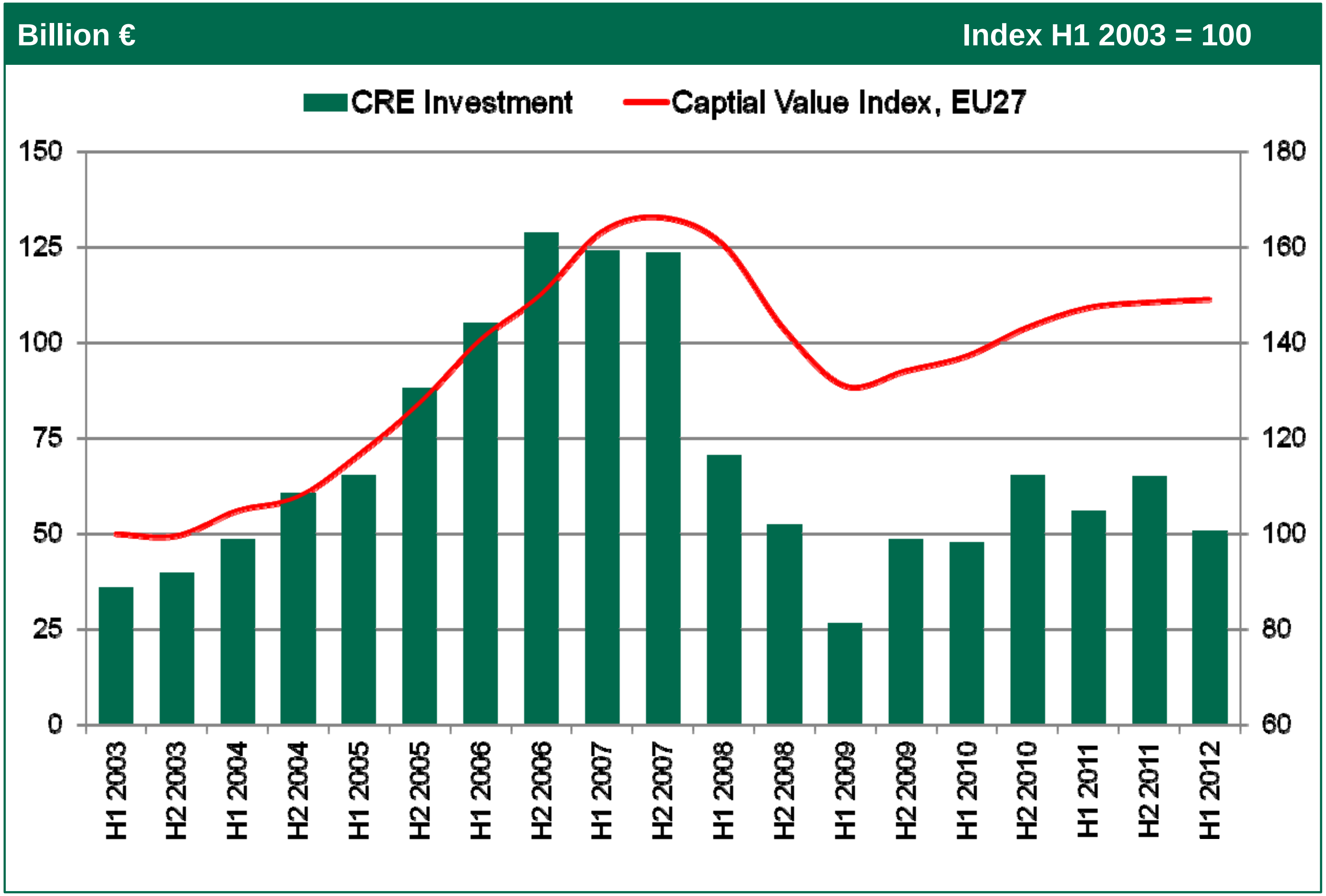
Q1 2007 = 100



Source: CBRE

Commercial Real Estate Investment in Europe

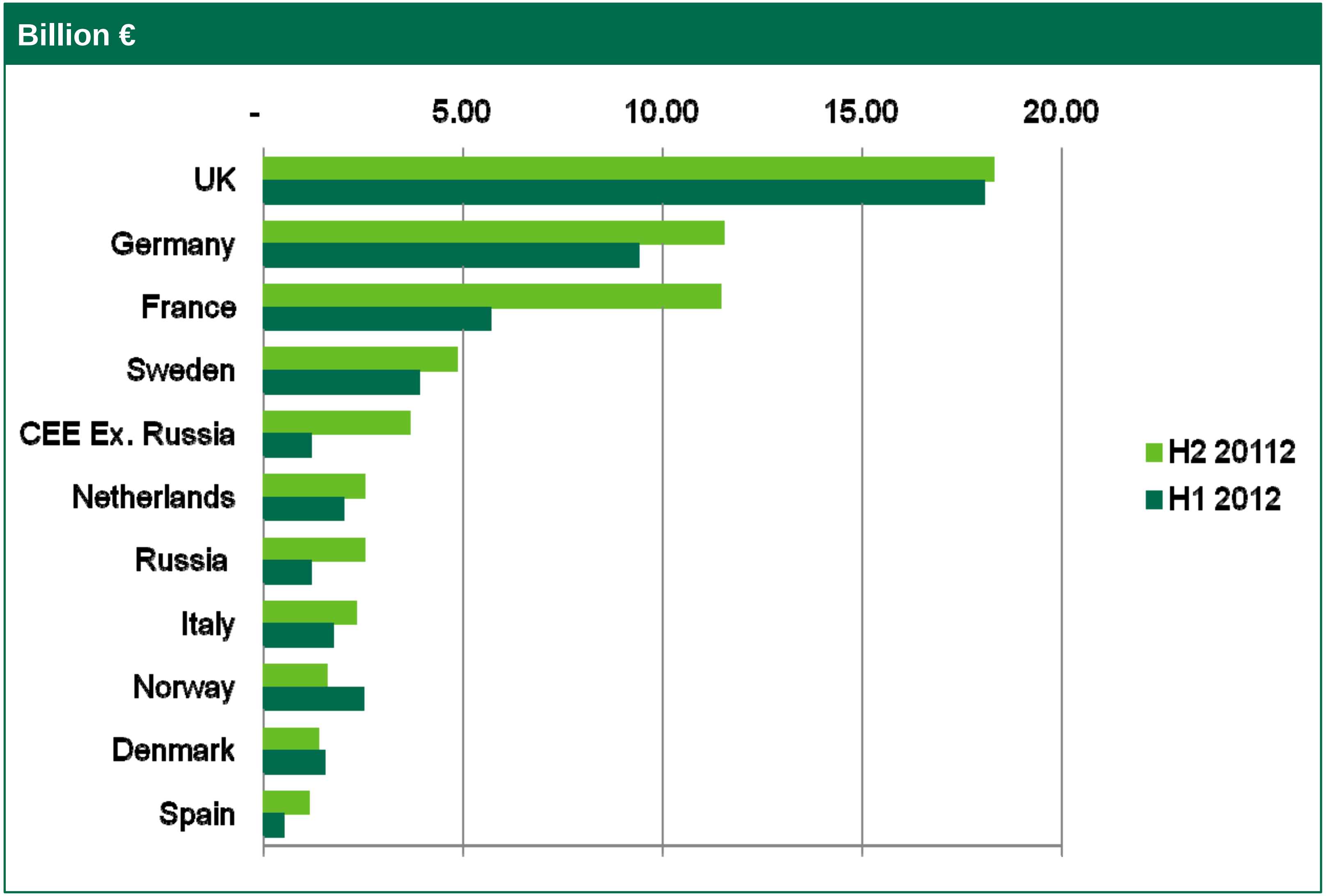
Market slows in 2012



Source: CBRE

Commercial Real Estate Investment Volumes

Most markets see fall in H1 2012



Source: CBRE, Property Data, KTI

Most Liquid European Investment Markets

H1 2012

	Turnover (€ million)	Change on H1 2011	% of European Market*
London	10,178	25%	20%
Paris	4,903	31%	10%
Stockholm	1,656	8%	3%
Oslo	1,618	111%	3%
Munich	1,580	104%	3%
Copenhagen	1,251	136%	3%
Moscow	1,000	-47%	2%
Berlin	951	5%	2%
Hamburg	787	-35%	2%
Frankfurt	748	-47%	2%

*Excluding indivisible multi-city portfolios

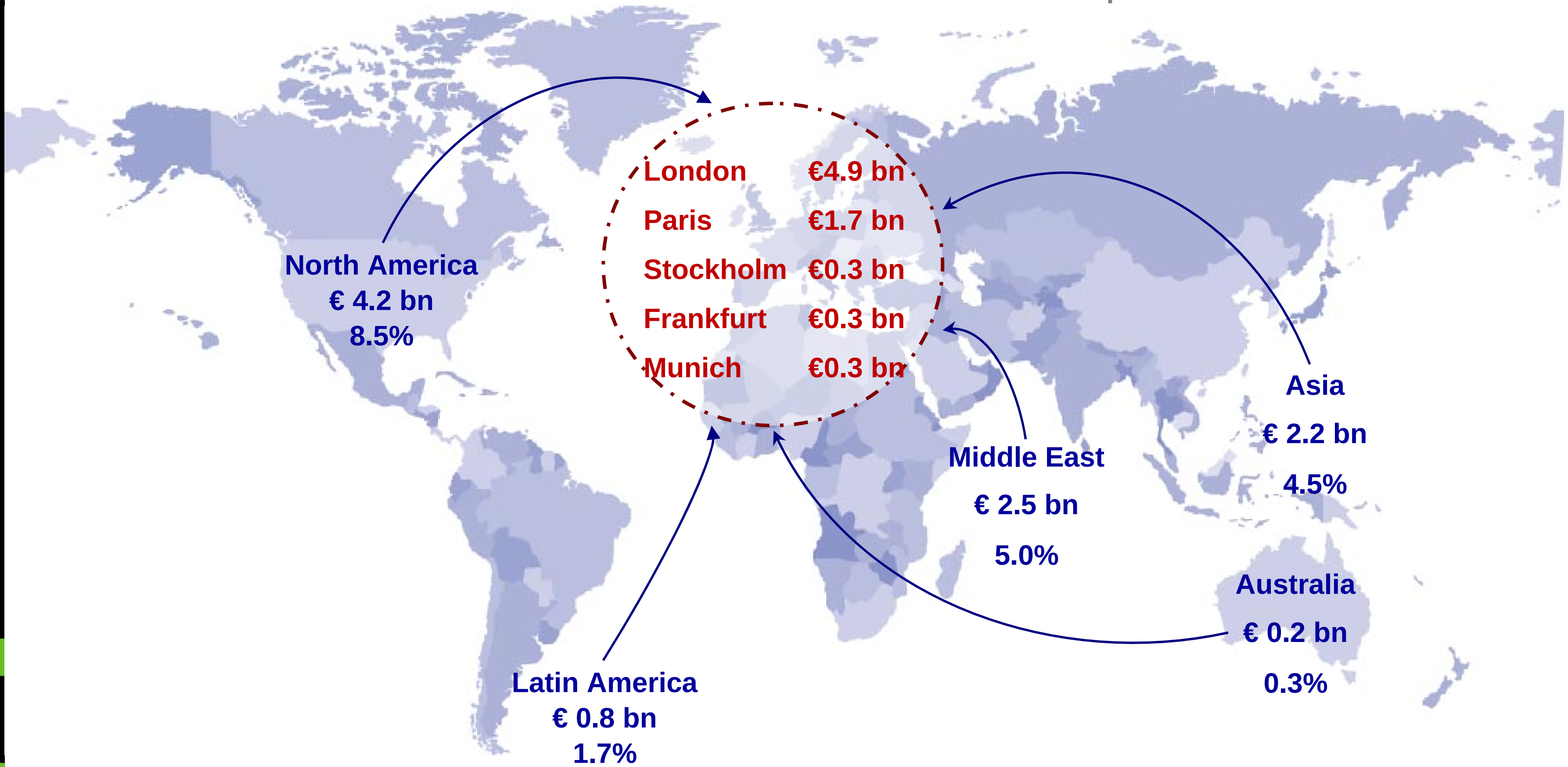
Source: CBRE

Cross-Regional CRE Investment in Europe

H1 2012

Almost €10 billion came from outside of the European region in H1 2012

Almost half of that capital was invested in London



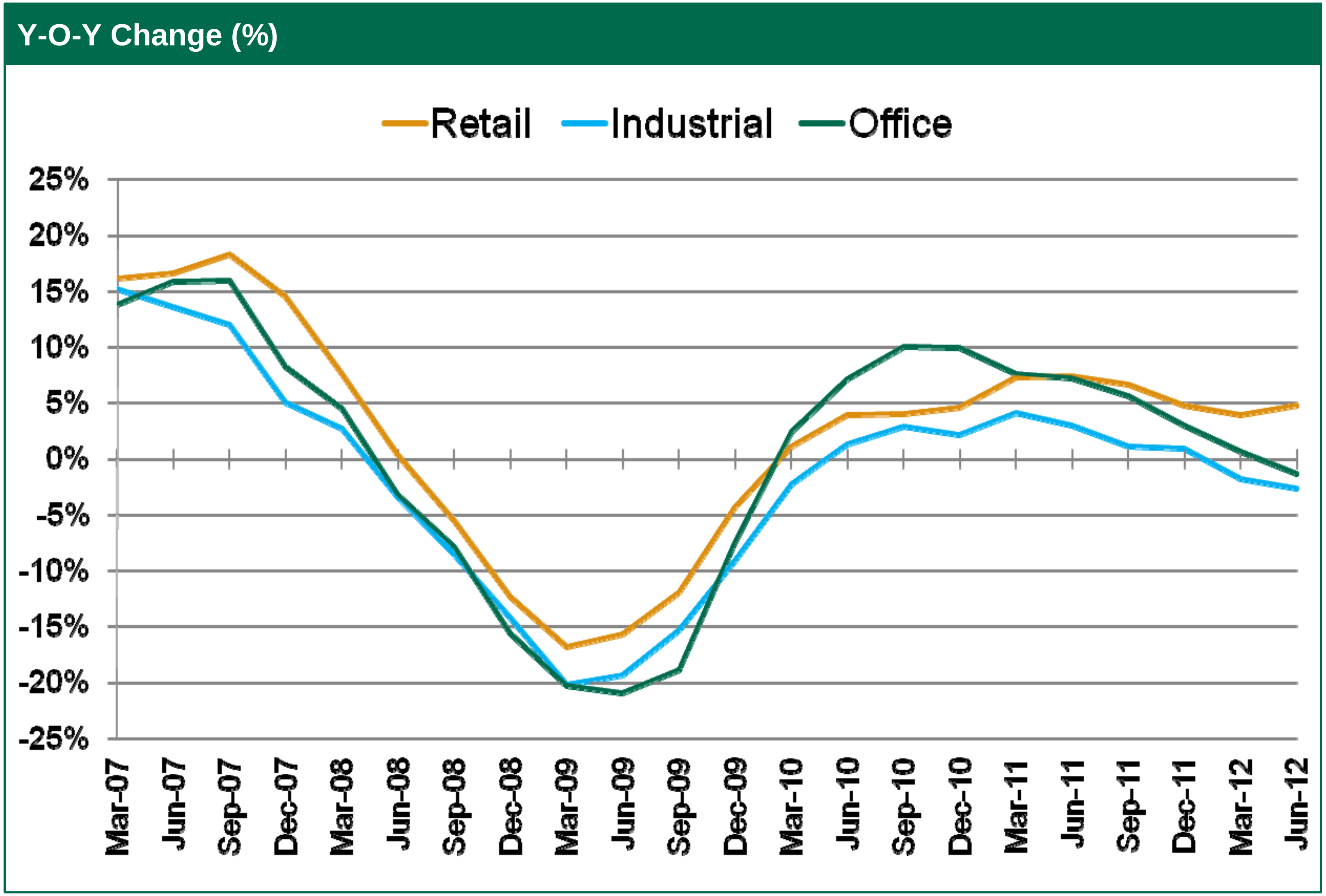
Source: CBRE, Property Data, KTI

Polarised investment market

- **Focus on prime in core markets**
- **Secondary suffering – investors shunning less secure income**
- **Relative shift to non-euro markets - UK and Nordics seeing less decline in activity**
- **Southern Europe particularly weak**
- **CEE – focus on Poland and Czech Republic**
- **Prime yields mostly stable**
  – Rising in southern Europe, Netherlands, UK regions

CBRE Prime Capital Value Indices, EU27

Offices and industrial back in negative territory

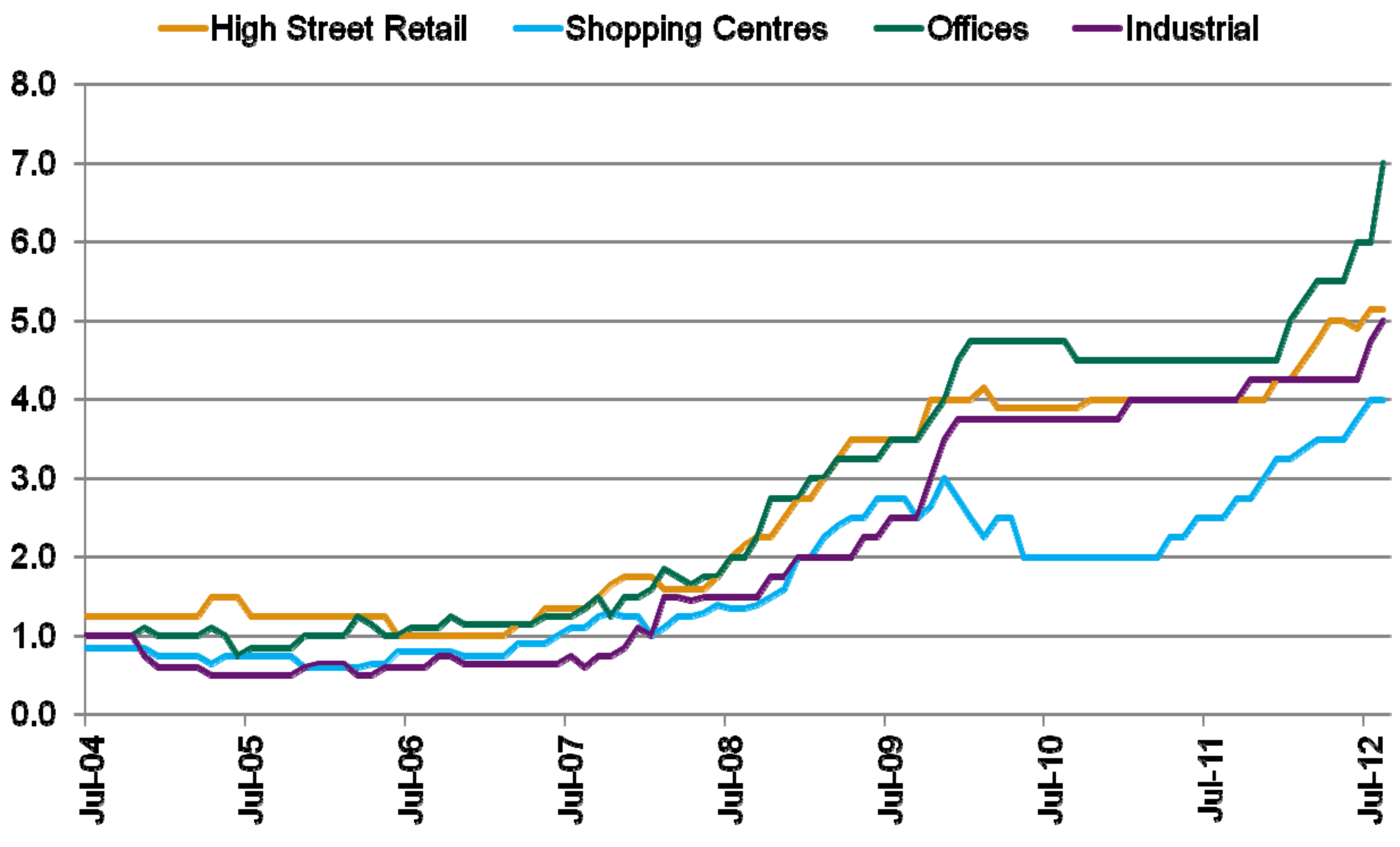


Source: CBRE

Prime vs secondary yield spreads: UK

Large yield gaps still widening

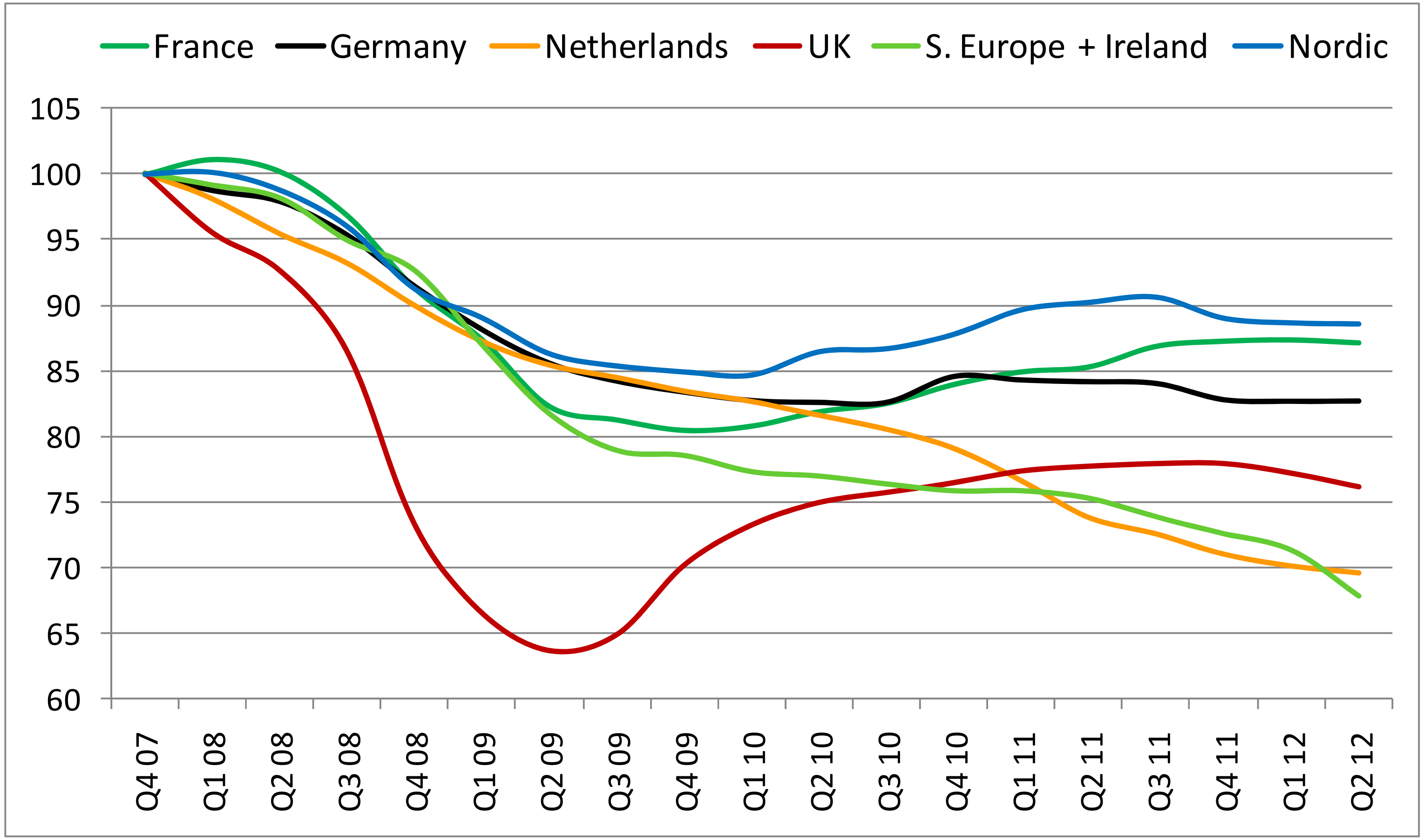
Secondary Yield – Prime Yield (PPTs)



Source: CBRE

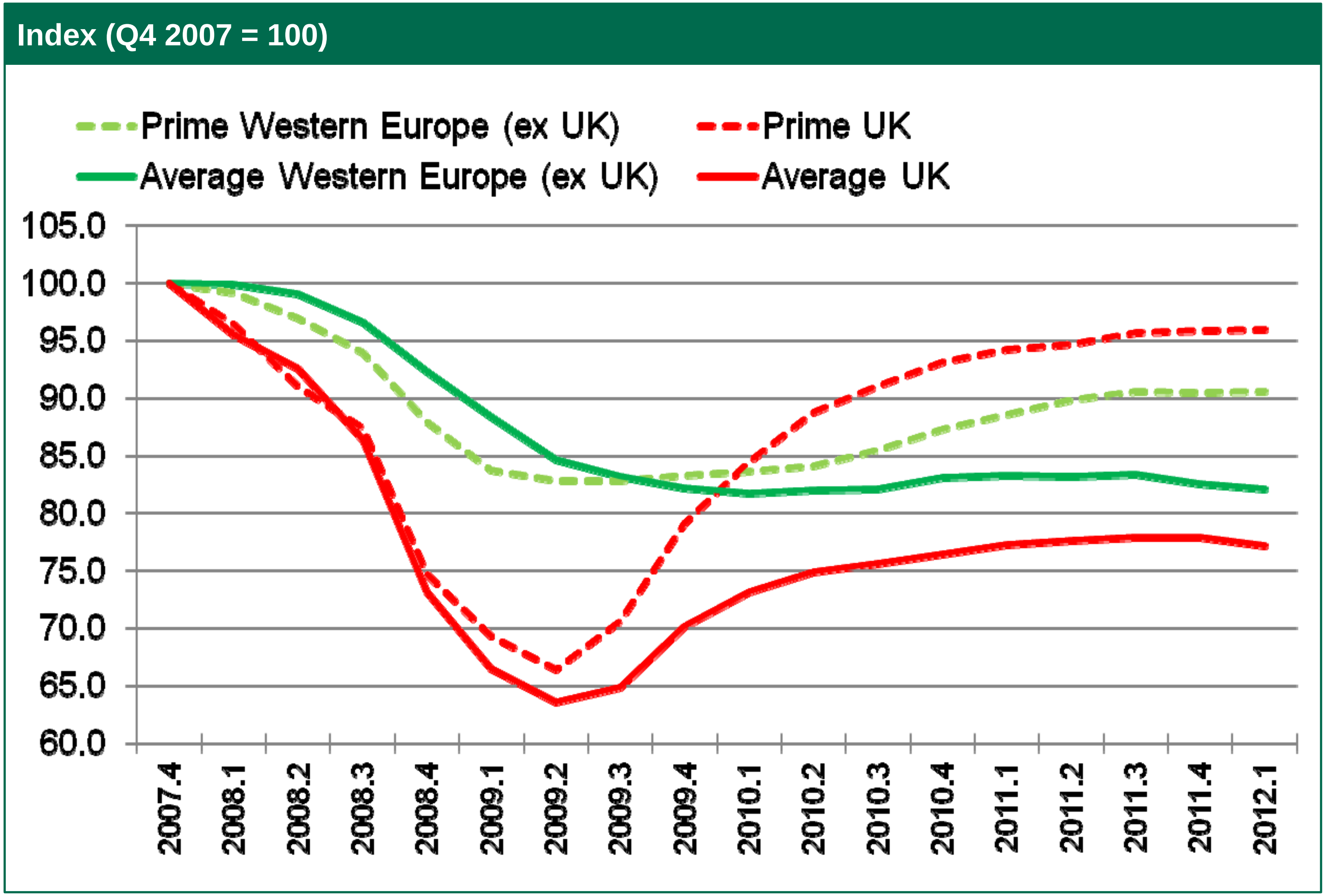
Portfolio Valuation Indices

Q4 2007 = 100



Source: CBRE European Valuation Monitor

Evolution of capital values



Source: CBRE

Outlook: Main case economic expectations

- Euro holds together
- Hesitant moves towards fiscal integration
- Austerity drives continued divergence in performance
- Growth slow to gain pace until 2014

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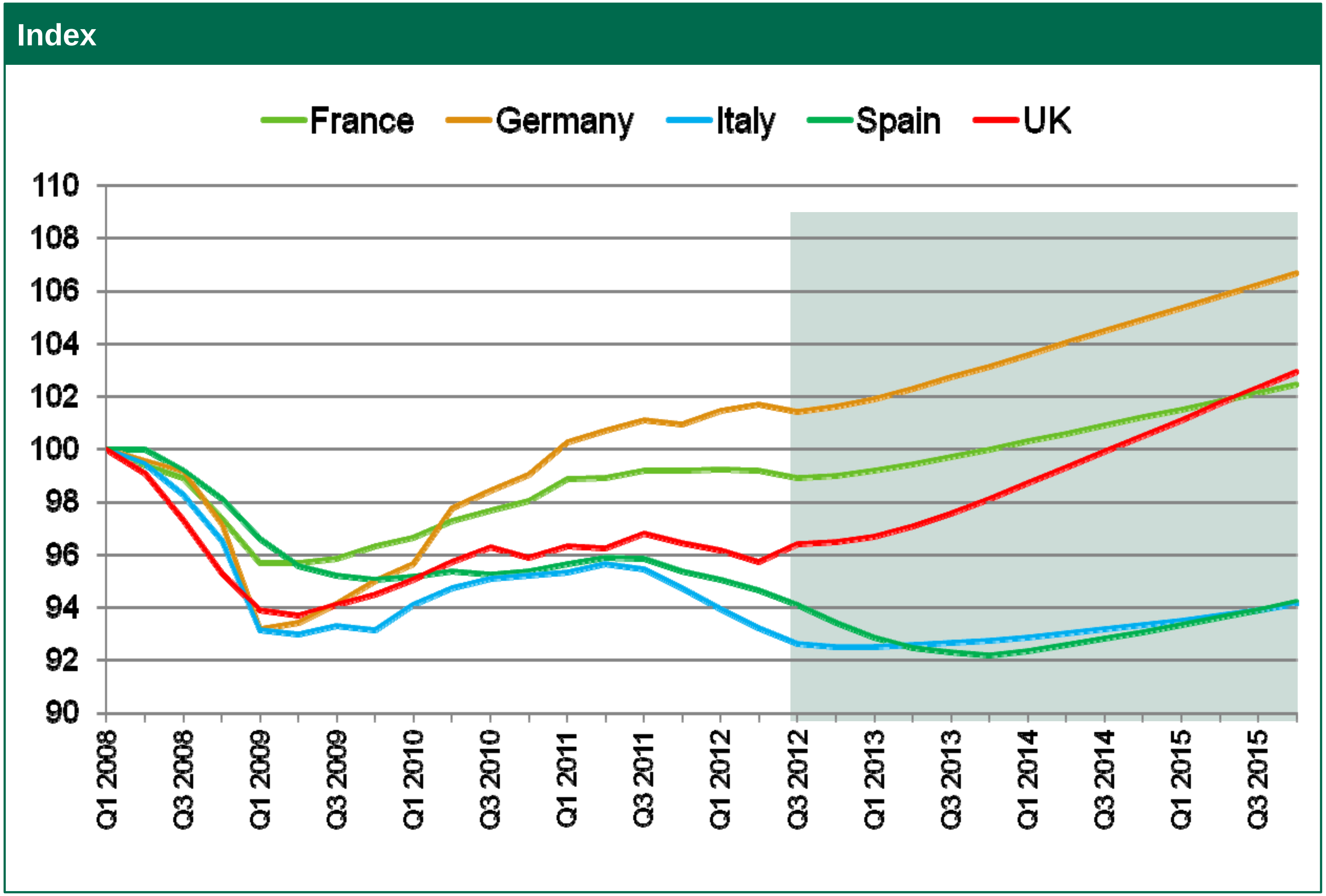
GDP Forecasts: Divergence sustained

Q1 2008 = 100



Source: CBRE, Oxford Economics

A Eurozone Breakup – What Might Happen?

- **Assume multiple exits - Greece, Spain, Portugal, Ireland and Italy all leave**
- **Downside Scenario 1 (pessimistic):**
  - Banking crisis; trade dislocation; prolonged recession; slow recovery
- **Downside Scenario 2 (less pessimistic):**
  - Governments intervene - banking crisis over quickly; improved competitiveness in exiting countries; “clearing the air” improves confidence, boosts investment and consumer recovery generally
  - Shorter recession and strong bounce-back pushes GDP above baseline forecast by 2018

Ingredients for an upside scenario

- **Policy credibility in euro area: tensions ease**
- **Reduction in uncertainty**
- **Increased confidence – consumers and business**
- **Virtuous circle of recovery begins sooner**
  - Consumer revival
  - Rise in business confidence – higher spending and investment
  - Stronger growth aids deficit reduction
  - Public finances improve

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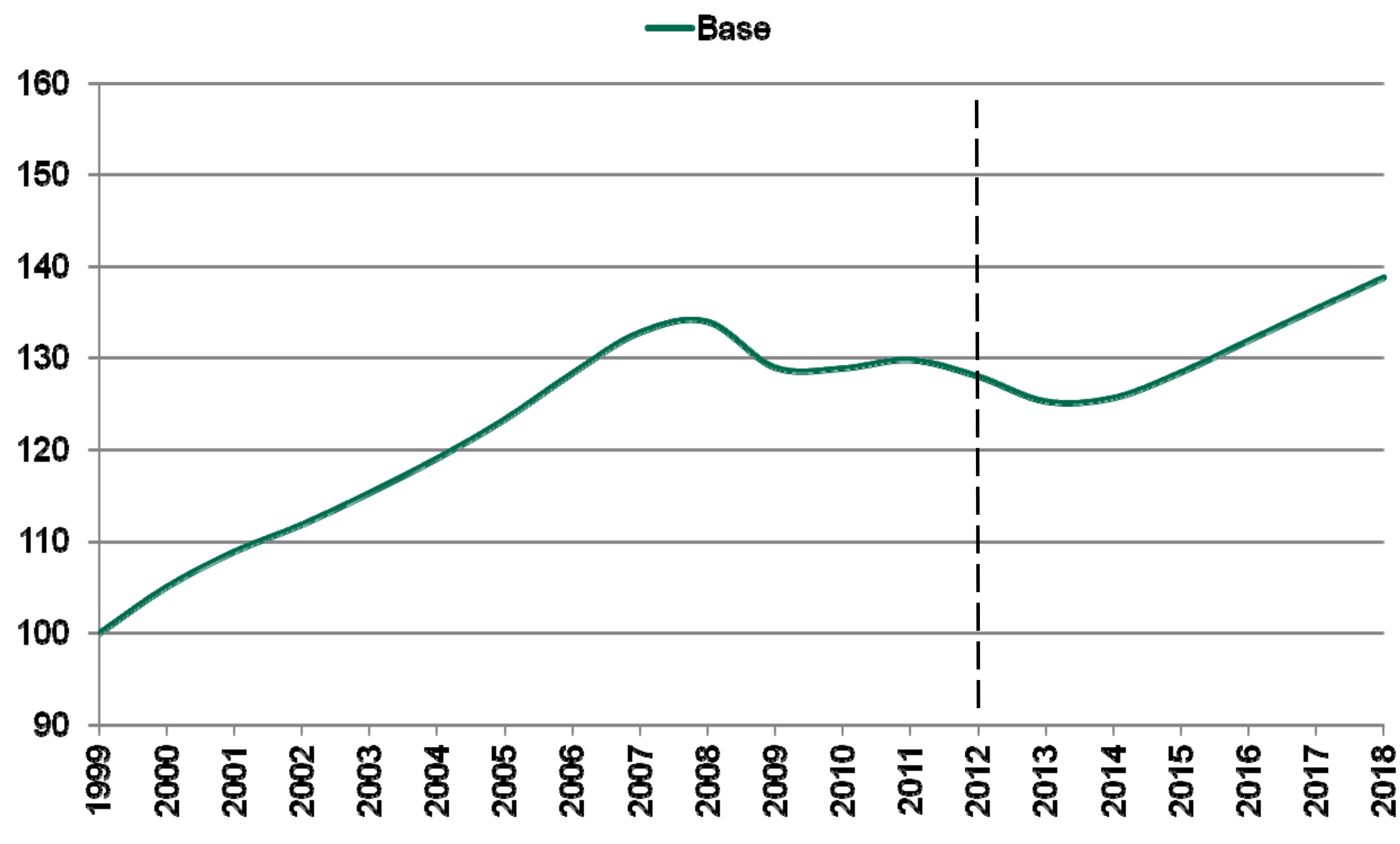
Alternative scenarios for Spanish GDP

Spain

1999 = 100

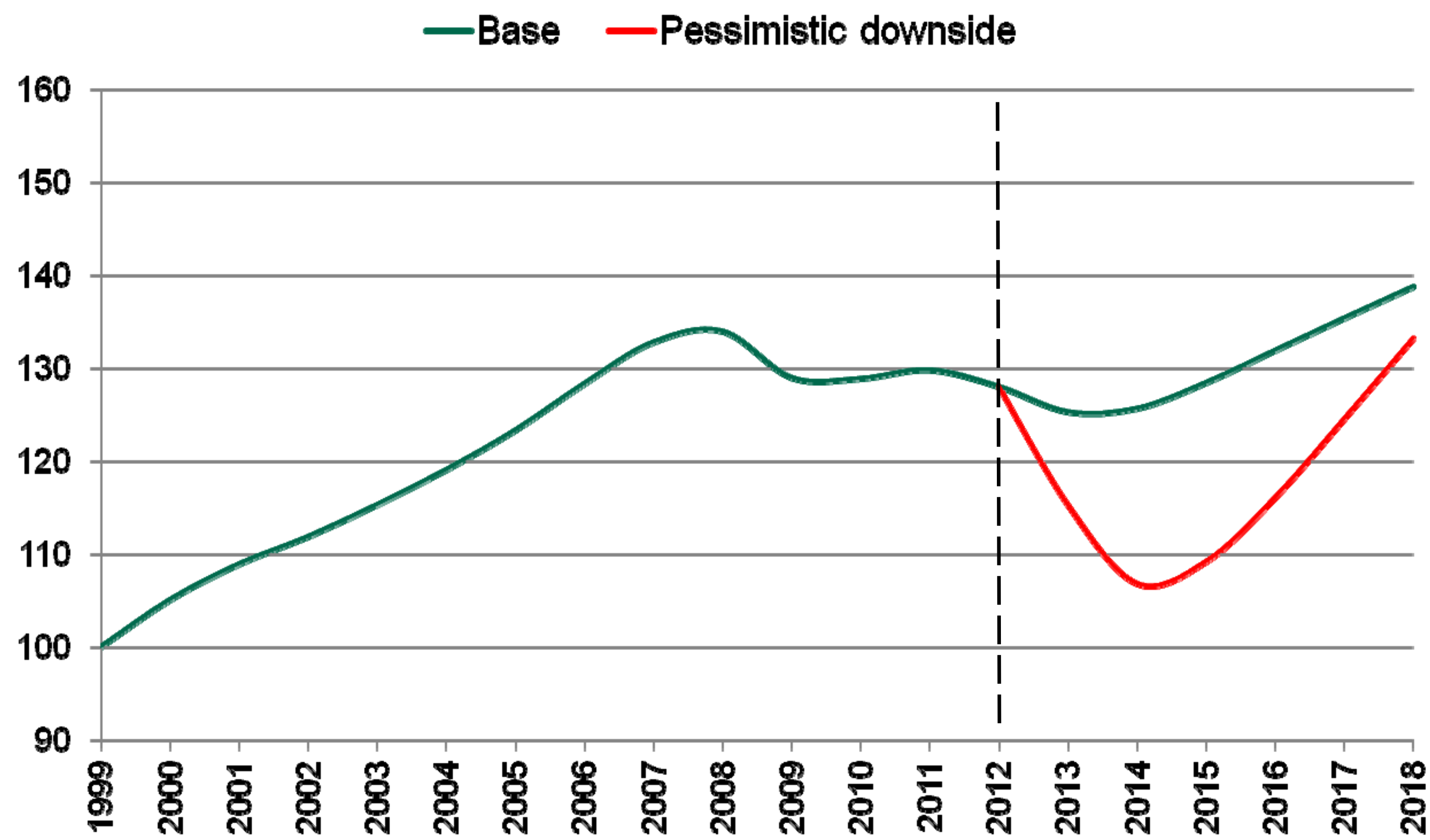


Source: CBRE, Oxford Economics

Alternative scenarios for Spanish GDP

Steep downturn after euro exit: 6 years to regain 2011 GDP

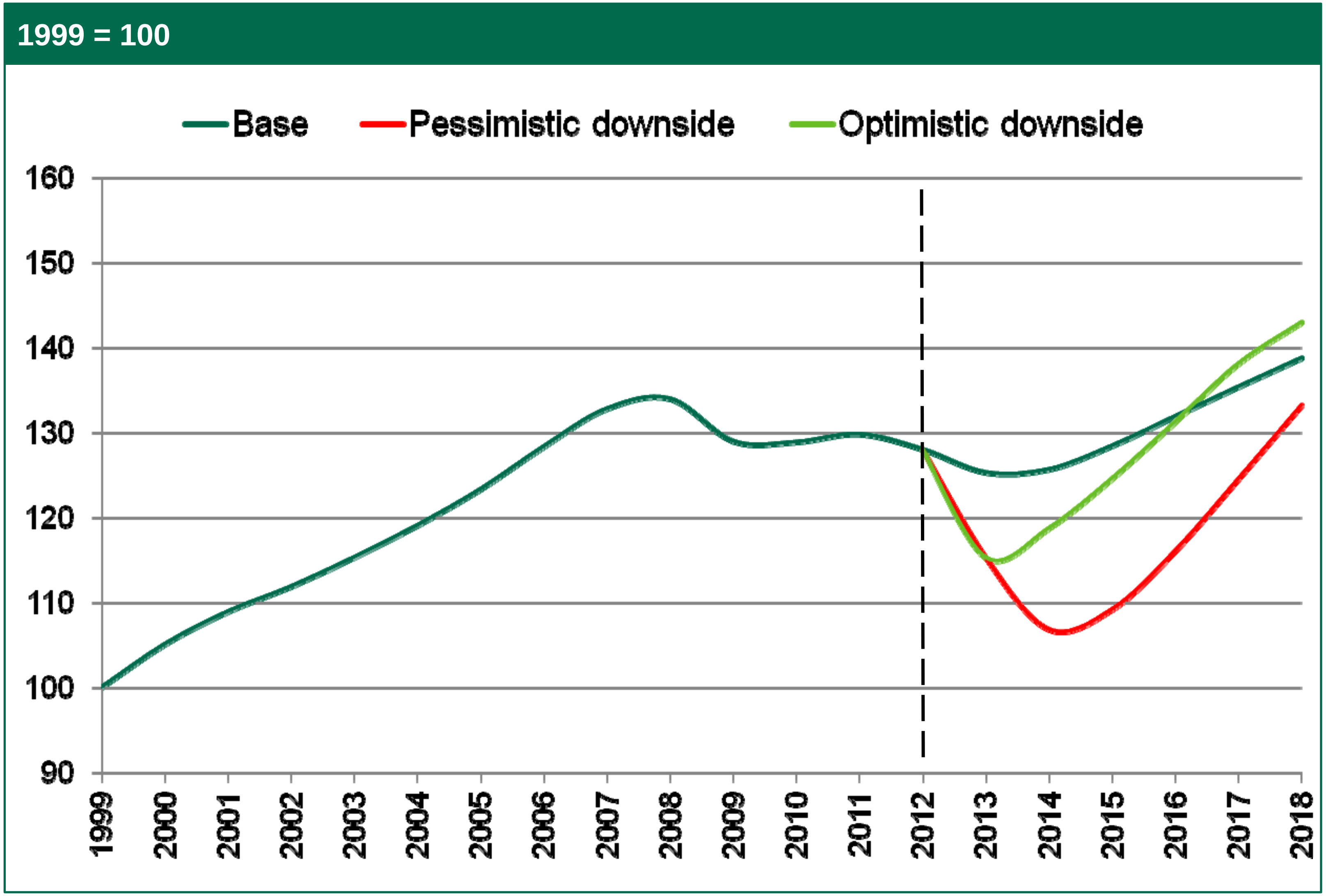
1999 = 100



Source: CBRE, Oxford Economics

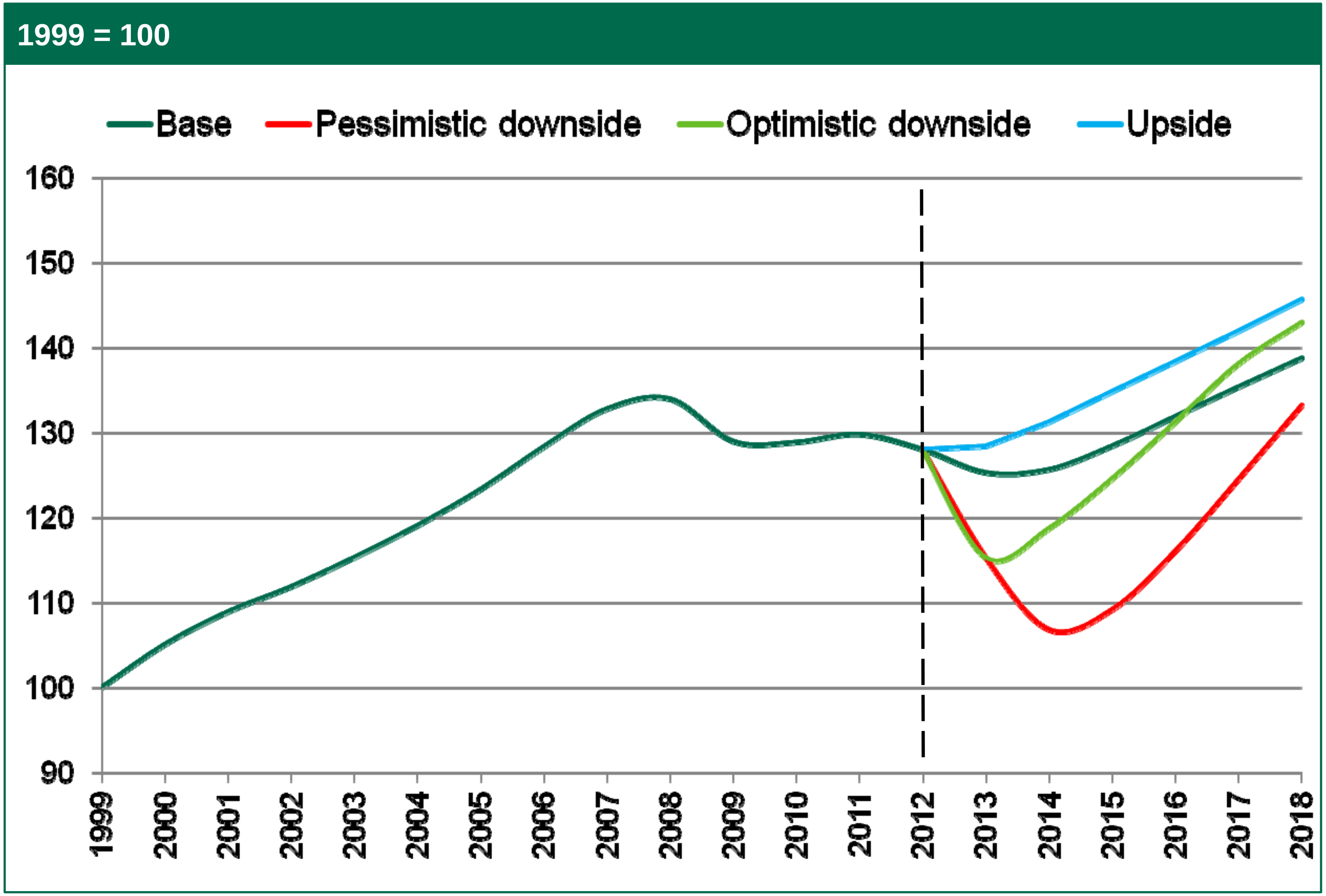
Alternative scenarios for Spanish GDP

Post-exit fall shorter and positive medium term



Source: CBRE, Oxford Economics

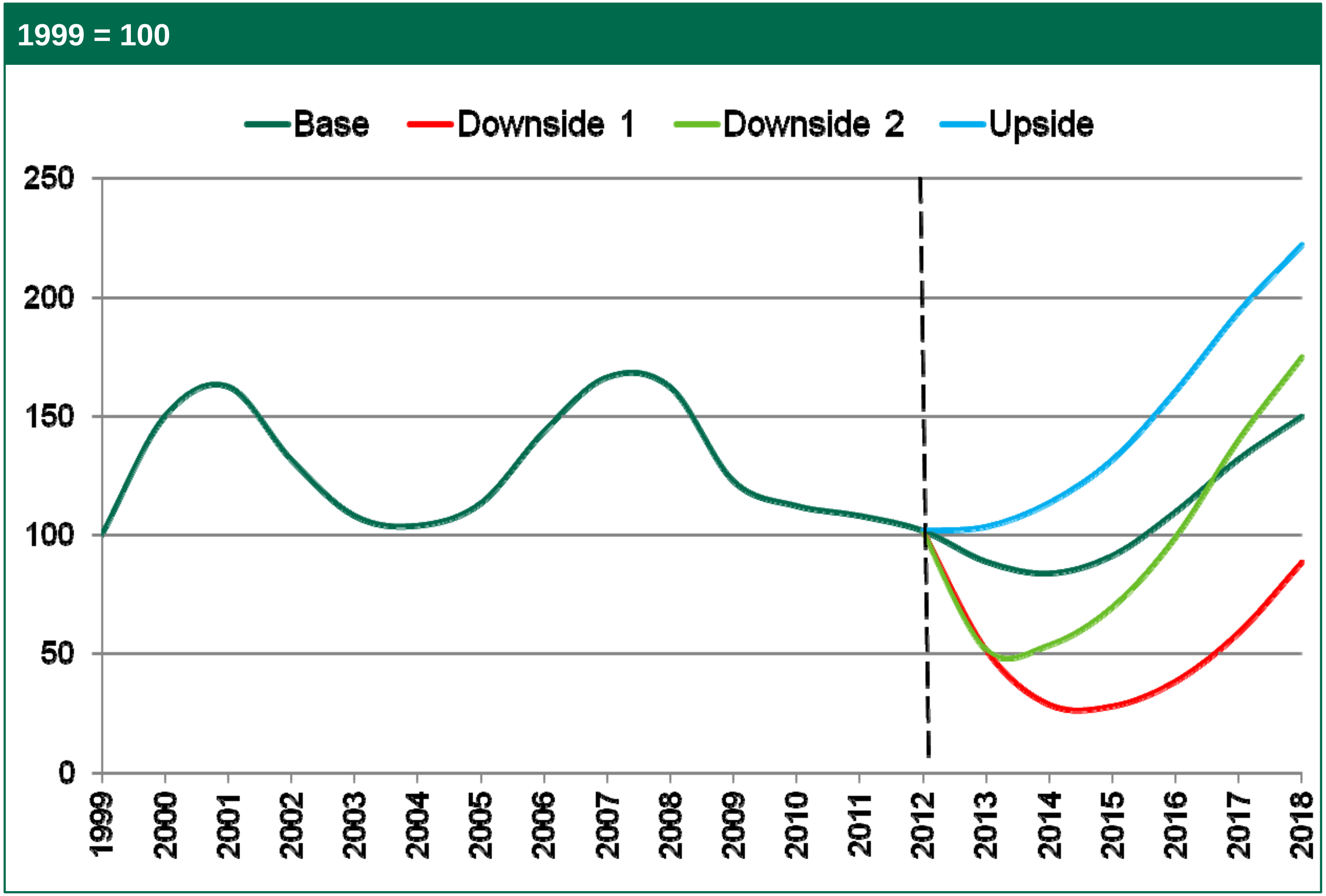
Alternative scenarios for Spanish GDP



Source: CBRE, Oxford Economics

Madrid Prime Office Rents

Rents show wide differently paths under alternative scenarios



Source: CBRE, Oxford Economics

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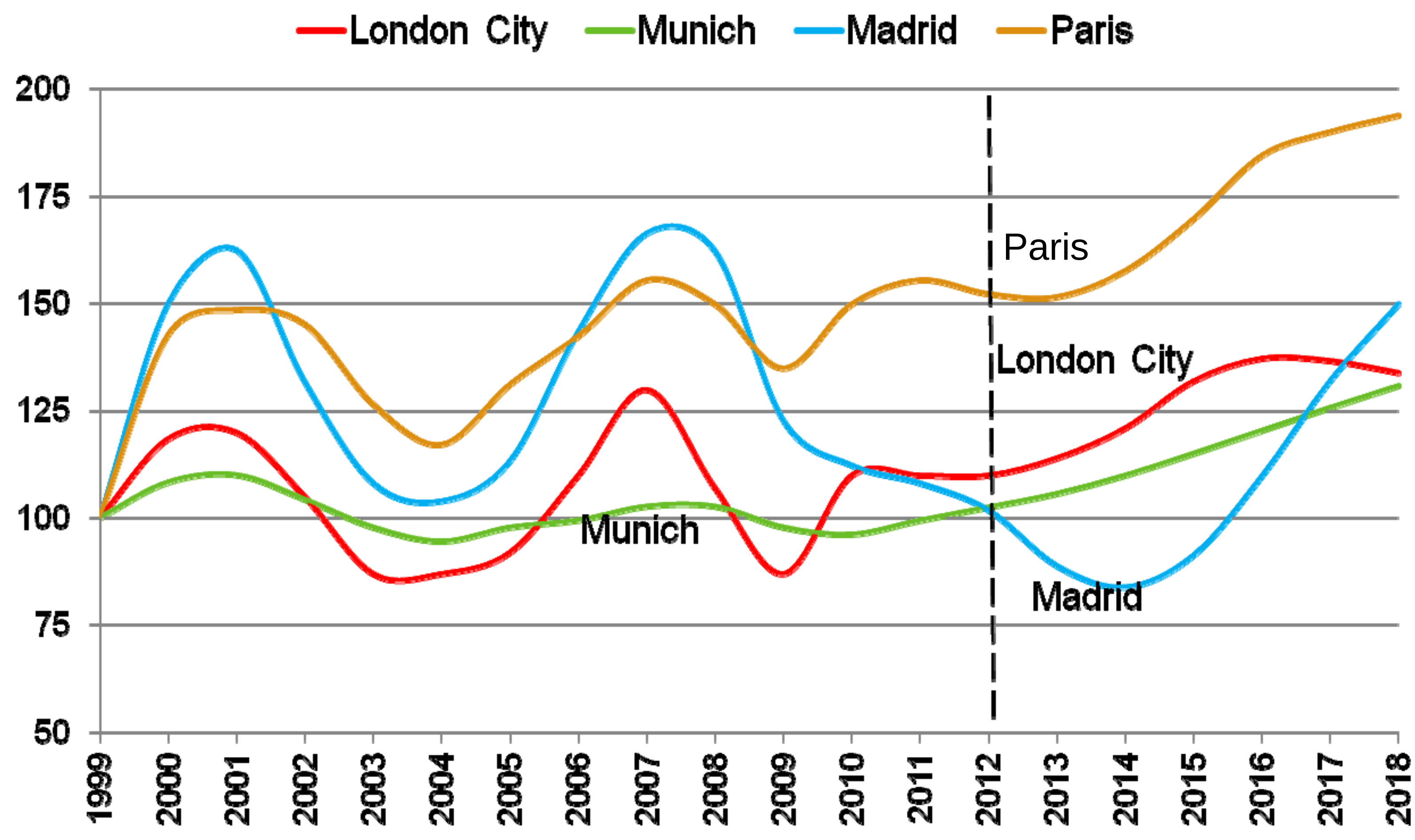
Prime Office Rent Indices

Main case forecasts

1999 = 100



Source: CBRE, Oxford Economics

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Conclusions

- **Uncertainty stifling activity in highly polarised markets**
- **Various scenarios for how euro crisis plays out**
- **Threat of euro break-up - serious dislocation and downturn in short term**
- **Medium term: *possibility* of robust upturn versus prolonged malaise**
- **Main case: euro stays intact: slow, bumpy recovery**
- **Risk aversion vs opportunistic strategies**

Trends and Prospects in European Property Markets

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Real Estate in Italy: From the downturn to the future

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Topics that will be discussed:

- The current (past?) real estate market in Italy
- The basics of the real estate legal system in Italy
- A (brighter?) future – the opportunities and sectors

The Real Estate market in Italy - 2012

Real estate industry overview in H1 2012

- Total volume of capital flows topped € 851 million in H1 2012 – € 650 million net of development deals

- Investment volume in H1 2012: 92% of purchases by Italian investors

Retail sector

- During the 2nd quarter of 2012, no deals in the retail sector have been completed

  This was due, *inter alia*, to the lack of prime products targetable by international investors

- Secondary market is generating interest from domestic investors

- Top-end retailers and high-street brands are still performing well

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Warehousing sector

- The warehousing sector has been affected by the general economic downturn

  Weak demand by investors has resulted in just 4 deals amounting approximately to € 40 million in H1, all of which were sales to owner occupiers

- Prime net yields have risen, reflecting the market conditions

Office sector

- Investment volumes in this sector during the 2nd quarter of 2012 amounted to € 53 million, bringing investment, in total to € 263 million in H1
- Over the first six months of the year, Rome and Milan attracted over 70% of capital invested in the sector
- The appeal of core assets is reflected in stable net yields in the historic city centre, business districts, wider central area and semi-centre, while peripheral markets have seen yields rise
- Obsolescence of city centre buildings boosts the need for brand new efficient office buildings in business districts
- Slow increase in the corporate occupiers market in business districts started from 2012

Basics of the Italian real estate legal system

Legislation - Ownership

- Real estate law in Italy is based on the 1942 Civil Code, subsequently amended and consolidated

- Commercial tenancy law is also based on Civil Code and on a specific tenancy act (L. 392/78)
- Ownership of real estate (land or buildings) is generally on a freehold basis (absolute ownership), but it may be burdened by environmental, artistic or other administrative liens

Property registration

- Catasto (*Cadastre*) and Real Estate Registry are the Italian system of identifying of land and real estate assets as well as registering of real estate rights

  The registers are kept by the Municipalities and are available on-line

- The information kept in the Real Estate Registry can be used to ascertain the property holdings of individuals or companies and the charges (e.g. mortgages) which might be held over their properties

- Sales and purchase agreements regarding real estate assets must be executed in writing upon penalty of being void. For public information purposes and certainty of rights, sale and purchase contracts and long term leases must be registered (i.e. "*trascrizione*") with the local Real Estate Registry and the relevant contracts must be executed in notarial form

Commercial tenancies

- Commercial leases are ruled by the Civil Code and by law 27 July 1978, no. 392 (the "**Tenancy Act**").
- Commercial leases must have a minimum duration of 6 years, renewable for a further 6 year period with a 12 month prior written withdrawal notice (there are restrictions on the landlord's side)
- In the case of hotels, the duration of the lease must be of 9 years, renewable for a further 9 year period with a 18 month prior written withdrawal notice

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Tenancy law

- The rent must be freely agreed upon by the parties. Annual indexation of the rent may be up to 75% of the ISTAT index variation for lease agreements having the mandatory minimum duration provided for at art. 27 of the Tenancy Act. If the duration is longer, then the ISTAT indexation can be higher

- Stepped rents need to be properly structured in the lease agreement to comply with legal requirements

A (brighter?) future – the opportunities and sectors

Opportunities in Italy

- The Eurozone is back on the agendas of real estate and infrastructure developers and investors
- The Italian economy has a strong industrial structure and is over-penalized by State bonds spread
- August 2012 may be seen as a turning point. Italy once again has a leadership role in European decisions

Opportunities in Italy

- **Hospitality and leisure**:

  Italian heritage (culture, natural beauty, locations, food, craftsmanship excellence) has no comparison in the world. Italy is a primary (and safe) destination for cultural and top-end tourism. Hospitality assets – particularly trophy assets in primary locations – are attracting investors

- **State-owned public assets privatization process**:

  This process has now started and many of the public prime real estate assets (valuable locations, city centres, cultural and historical value) will be on the market for sale and/or valorization with an enhanced and fast procedure for change of use destination

- PPP Infrastructures and Expo 2015

Privatization

- Stability legislation over 2011 and 2012 has provided the arrangements for a public asset manager to manage the real estate funds into which public real estate assets are to be contributed for valorization
- Funds have the scope to lead the valorization and privatization process
- Process is to be implemented in the next 2 - 3 years

Case study: the valorization and disposal of a prime public real estate asset

- Feasibility study for the valorization of the Sant’Orsola convent in Florence (city centre):
  - Usable area: 18.000 sq.m.
  - Property: Province of Florence
  - Legal scheme: long term concession over the asset to facilitate the investment with a reduced capital need
- Proposed allocated use:
  - Commerical
  - Museum
  - Student housing
  - International dance academy
  - Offices

Infrastructure PPP

- A favourable tax regime in order to promote the issuing and placement of project bonds and an enhanced possibility for PPP vehicles to place project bonds

- Significant tax exemptions for infrastructure PPP vehicles (under final discussion)

K&L Gates Italy - Real Estate

AREAS OF PRACTICE

Francesco Sanna is a partner in the K&L Gates Milan office and is Head of K&L Gates' real estate and construction Italian department. He focuses his practice on assisting international and domestic real estate funds, investors and developers. He also has extensive experience in structuring PPP and PFI deals, with particular focus on healthcare and energy sectors.

BAR MEMBERSHIP

Member of the Italian Bar. Enrolled with the "*Ordine degli Avvocati di Milano*"

EDUCATION

J.D., Catholic University of Milan Law School (1996)

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Questions?

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