DUFF & PHELPS

Real Estate Advisory Group

Real Estate Market Study on Italy's Retail Sector

PERCEPTION VS. REALITY: THE OPPORTUNITIES THAT MAKE PHYSICAL RETAIL THRIVE

Summary

The Duff & Phelps Real Estate Market Study focuses on Italy's retail industry. It showcases the investment opportunities the country's real estate retail market offers.

The retail real estate sector appears to be under-performing when viewed against the misleading vision of the retail world. Despite e-commerce and high competition, brick-and-mortar retail stores are not dead. They're performing well and continue to remain a profitable opportunity for investors.

Topics in this study include:

- Size of the market by asset classes
- Focus on shopping centers, retail parks, grocery stores and urban store/high street asset classes
- Drivers, trends and opportunities in Italy's retail industry

The Retail practice within the Duff & Phelps Real Estate Advisory Group (REAG) offers real estate services in the retail sector aimed at supporting retailers, developers, investors, banks and asset and property managers.

We are a trusted partner for our clients thanks to our in-depth knowledge of real estate retail spaces, which include shopping malls, retail parks, factory outlet centers, entertainment centers, theme parks, high street and luxury.

Focus on the Positive Drivers: The Retail Market Size

Considering all modern retail formats (shopping centers, retail parks, leisure centers and factory outlets) in terms of retail density, Italy stands at about **320 sqm** of GLA (Gross Leasable Area) per 1,000 inhabitants.

Geographically, the northern part of the country continues to maintain the highest density. The retail density in Italy is below the European average, but still quite remarkable.

Positive driver: The Italian market shows low evidence of saturation and there is opportunity for development, in particular as to large schemes

Source: CNCC Annuaria 2018
GLA SC+LC+FOC+RP

As to the stock in terms of retail premises intended for shopping centers, big boxes, retail parks, stores located in high-streets/in-town areas, we observe that there is a lot of fragmented product, characterized by granular private owners and low penetration of institutional landlords.

The size of the Italian market (in terms of stock and transactions) is small compared to other European countries.

- There's a strong potential in the coming years for Italy to upgrade or transform its existing stock.
- In general, retail premises are widespread throughout the country, with prevalence in the northern regions.
- Numerically the market is dominated by shopping centers (medium or small-sized). Retail parks are only 16% of the national retail offer, with an average size of 12,000 sqm of GLA, with high potential for growth, considering last available figures produced by CNCC as of 31/12/2018.

Focus on the Positive Drivers: The Retail Market Size

According to the National Council of Shopping Centers, there are 914 shopping centers in Italy (78% on total GLA - sqm) while the number of retail parks is only 214 (16% on total GLA - sqm), with a widespread presence in all Italian regions.

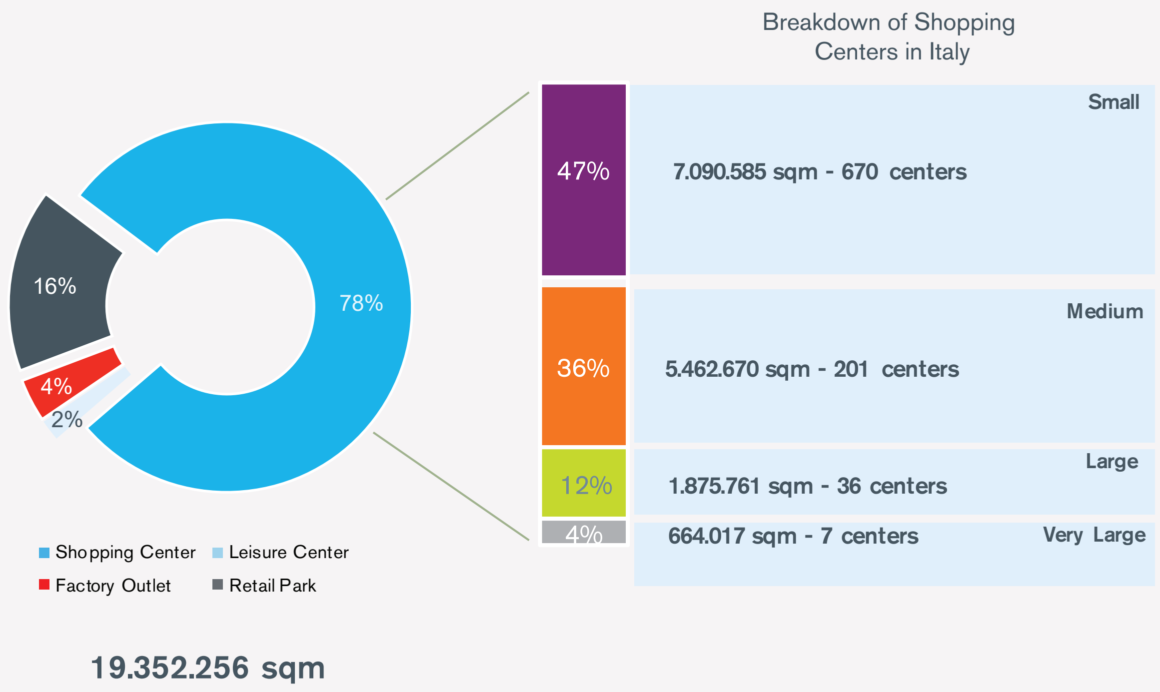
The stock of large-scale planned retail facilities (shopping centers, retail parks, leisure centers and factory outlets) is around 19,352,000 square meters.

44% of the total premises were built between 2000 and 2010 and are located mainly in Northern Italy (58%).

Typology	GLA - sqm	n°	% on GLA
Shopping Center	**15.093.033**	**914**	**78%**
Retail Park	**3.166.395**	**214**	**16%**
Leisure Center	347.212	23	2%
Factory Outlet	745.616	27	4%
Total - sqm	**19.352.256**	**1.178**	**100%**

Typology	GLA - sqm	n°	% on n°
Very Large	664.017	7	1%
Large	1.875.761	36	4%
Medium	5.462.670	201	22%
Small	7.090.585	670	73%
Total - sqm	**15.093.033**	**914**	**100%**

GLA Italy



Yields Trend %

The general trend over the last 10 years has seen a constant yield compression that has resulted in a slow return to the pre-crisis levels recorded in 2007. Over the course of 2018 yields remained stable, in particular for prime shopping centers and high streets in Milan and Rome, while the spread of rates for secondary centers is expanding to 7.00%-8.5% gross yields.

Appetite for secondary products is scant, unless rates are opportunistic. Quotations for these types of assets vary vastly depending on their location and on factors that are both exogenous and endogenous to the properties themselves. Outlook for 2019 is conditioned by the macroeconomic context of the country and the attitude of investors. Should the macroeconomic outlook improve, the prospects for the sector could stabilize for 2019.

High street assets remain one of the most sought-after types by investors, who pay a premium due to the limited supply of this product in top locations of primary and secondary cities in Northern Italy. The most appealing destinations for international retailers are still Rome and Milan, thanks to elevated tourist flows. High street properties in secondary cities, such as Bologna, Florence and Turin, have also witnessed a growing interest from institutional players. Less competition and higher yields, compared to primary cities, are attracting international investors.

The outlook for the next few months is positive: Despite the reduction of operations and the slowdown of the expansion plans, it is expected that shopping centers will remain a hotspot in retailers' strategy in Italy. Retail parks represent a very interesting and sought-after asset class, although a lack of product is evident.

Note:
Yields are defined as gross market cap rates.

GROSS YIELDS Q4 2018 - RANGES

HIGH STREET

- **Prime location – Top High Street**
  - **Milan Via Montenapoleone: 2.8% - 3.5%**
  - **Rome Via Condotti: 3.0% - 4.0%**
  - **Venice: 3.5% - 4.0%**
  - **Florence: 3.5% - 4.0%**
- **Prime location – Secondary High Street**
  - **4.0% - 6.0%**
- **Secondary location - High Street**
  - **4.5% - 7.0%**
- **Peripheral Areas – (stores and Medium Size Units)**
  - **6.0% - 8.0%**

SHOPPING CENTER

- **Prime**
  - **5.0% - 6.0%**
- **Top Secondary**
  - **5.5% - 7.5%**
- **Secondary**
  - **7.0% - 8.5%**

RETAIL PARK

- **Prime**
  - **5.5% - 7.5%**
- **Secondary**
  - **6.5% - 8.5%**

Asset Class: Shopping Centers Still Lead The Sector

- Small and medium-sized retail schemes dominate the industry (83% of total shopping centers).
- "Go big or go home": the pipeline is modest and is turning to regional mall schemes (product that is currently lacking in Italy).
- Polarization between regional malls and neighborhood centers.
- "Back to the City": Good supply to be developed in Italy, since it's a resilient product, it's less risky in terms of competition, it's dominant over its catchment area and it is located in wealthier and more stable areas.
- If a shopping center is well priced considering the catchment area, purchasing power and tenant mix, the investment risk profile could be very interesting; shopping centers in many cases are risky, as seen in other mature European countries but they have higher rates of return on investment.
- There is not a unique "recipe" for the future shopping mall, since success and failure are strongly affected by the specific context where a mall operates (catchment area, customers' social-economical profile, competitors' geography, etc.).

Asset Class: Retail Park

In the most mature European markets (Germany, France, the UK, the Nordics), retail parks represent a very sought-after asset class. In Italy a lack of product is evident and existing retail parks are mostly positioned in the low-end segment of the market.

The main positive drivers of retail parks are:

- Lower (€30/sqm) service charges compared to traditional enclosed shopping malls (€ 120-150/sqm).
- Lower cost of construction (approx. €800/sqm compared to €1,300/sqm for shopping malls).
- Retail parks can attain a dominant market position in their catchment area along with a high level of acceptance and strong customer loyalty, even though they are not prime in terms of GLA.
- More fungible: a retail park, if necessary, could be easily converted into other retail spaces, with lower capex compared to traditional enclosed malls.
- Low costs for retailers (rents + service charges) allow them to be competitive in terms of final prices of goods for consumers.
- More resilient to the effects of e-commerce.
- More liquid as an asset class: an investment size equals €15 - €30 million per property; this means that retail parks are of potential interest to a broad range of investors (in the Italian market it's easier to find a buyer for a retail park than to find one for a shopping center).

Asset Class: Grocery Sector

The sector shows signs of constant growth over the past few years.

- The turnover of major retailers in 2017 was €83 billion with an increase of 4.4% over 2016.
- Retailers still own many physical stores.
- Food retail segment will continue to primarily depend on offline channels in the coming years.
- The sector is characterized by leading sales and leaseback operations, which have allowed for consolidated expertise from management companies and investors to build an investment product that has been very successful in the market.

Asset Class: Urban Stores/ High Street

- Milan and Rome are still on the map of major locations for capital worldwide.
- Secondary cities are also interesting: these are in prime locations in the top tourist cities (Florence, Venice, Bologna, Verona, Turin).
- Increasing levels of urbanization and «back to the city» trend.
- New urban formats and ability to be resilient to digital disruption and changing customer behaviors.

Drivers, Trends and Opportunities

- **Restyling-Refurbishment and repositioning traditional shopping malls on the market:** physical space and location are still the foundations on which value is created, but retail spaces need to be rethink in order to meet new customers' expectations.

- **New formats** for integrating online and offline: This strategy blends techniques used in online marketing with those used in brick-and-mortar marketing. This is being done with the aim of identifying customers in the online space and then using a variety of tools and approaches to lure them to the offline space. For example, promoting events occurring in physical stores and keeping click and collect areas inside them. Shopping centers become a "Destination", they are no longer simply spaces for buying products.

- **New solutions** and spaces focused on "experience" with a consistent component of entertainment and free time. Concert and temporary/seasonal events should become more common in malls, in order to promote more innovative and attractive solutions that combine entertainment with social, educational (edutainment), cultural and sport activities.

- **Hybridization** (or integration) is one of the most evident innovations in retail. This happens when traditional stores offer food and beverage facilities, leisure/entertainment opportunities, spaces for events (for example, music) and for gathering to create a sense of community. Shopping centers are evolving from pure retail properties into multi-service destinations, with increasing dining, leisure and entertainment offerings, and public facilities, to create resilient centers.

- **Food and Beverage:** Traditional food courts are evolving to meet the requirements of modern customers, providing a unique dining experience, through the "gourmetization", leading to a higher positioning on the market.

- **Mixed use** is another key driver. What is evident now is renewed enthusiasm for mixed-use development that combines residential, recreational, commercial and cultural uses. Traditional underperforming enclosed malls can be transformed into multi-functional destinations, where customers can find a full range of opportunities, services and activities: from shopping and fun to daily services, agencies, medical clinics, co-working facilities and temporary offices.

  Finally, the design of "public space" in (and around) shopping centers becomes so essential in creating successful, lively and enjoyable spaces to intercept customer flows. Placemaking is an innovative approach in designing public spaces and redevelopment projects.

- **Tenant Mix:** Increasing leisure and food and beverage share (estimated to reach 20% in terms of GLA for new shopping center projects).

- **Design:** because of a large share of small and medium size shopping malls, there is an opportunity to re-shape the traditional French-based enclosed mall format into open-air malls. This format is often typical of larger mixed-use urban projects. From an architectural point of view, we're seeing an increasing shift towards green and eco-friendly, sustainable projects that have the "green building" certification. The key trend is to design bigger and more attractive shopping destinations that boast of richer entertainment and more leisure. The objective of this is to increase footfalls and time spent by customers in the malls.

Drivers, Trends and Opportunities

- **E-commerce** is having a heavy impact (concrete and perceived) on the retail industry.

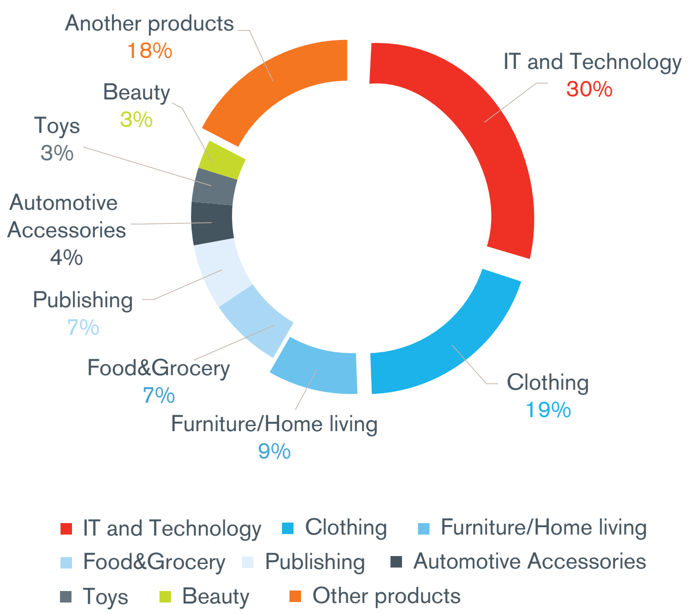
  The perception of retail has been affected by the influence of heavily negative news from the U.S.: large-scale store closures and huge falls in the share prices of listed shopping center owners. Although the sector in Europe and Italy is structured differently, there's a feeling that all is not well.

Online sales:

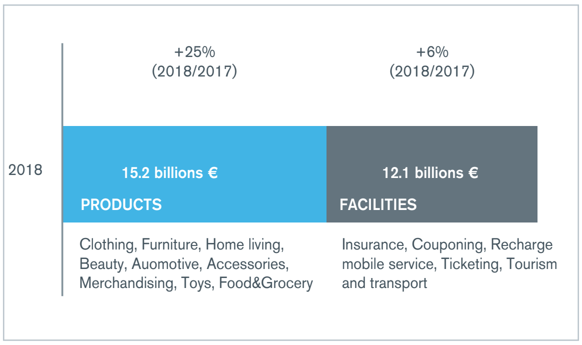
- Total amount of €15.2 billion in 2018
- Average sales per single online transaction is approximately €70
- E-commerce Product penetration is 5%

% E-commerce penetration (facilities + products) rate in Europe

Total Online Sales in 2018 for product category



E-Commerce demand between products and facilities



In conclusion, in Italy, despite e-commerce and its growing influence, we deem that there will be room and opportunities for brick & mortar retail.

Conclusion

The Italian market shows low evidence of saturation and there continues to be opportunity for development, in particular for large schemes, with a strong potential in the coming years for Italy to upgrade or transform its existing stock.

Shopping Centers are still leading the sector. When a shopping center is well priced considering the catchment area, purchasing power and tenant mix, the investment risk profile could be very interesting. “Back to the City” can also be a good format to be developed in Italy.

The major locations in Italy for the high-street asset class are still Milan and Rome together with secondary cities in prime locations in the top tourist cities.

Main key drivers show that shopping centers are becoming a “Destination” and, in this sense, existing retail spaces need to be reconfigured to meet new customers’ expectations, with new solutions focused on “experience”.

Despite e-commerce in Italy and its growing influence, there continues to be opportunities for brick & mortar retail.

In-depth knowledge of real estate retail spaces is necessary to take advantage of the best opportunities on the market and high level advisory and consulting is required to maximize the value of retail facilities and make important business decisions with confidence.

Real Estate Advisory Group

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