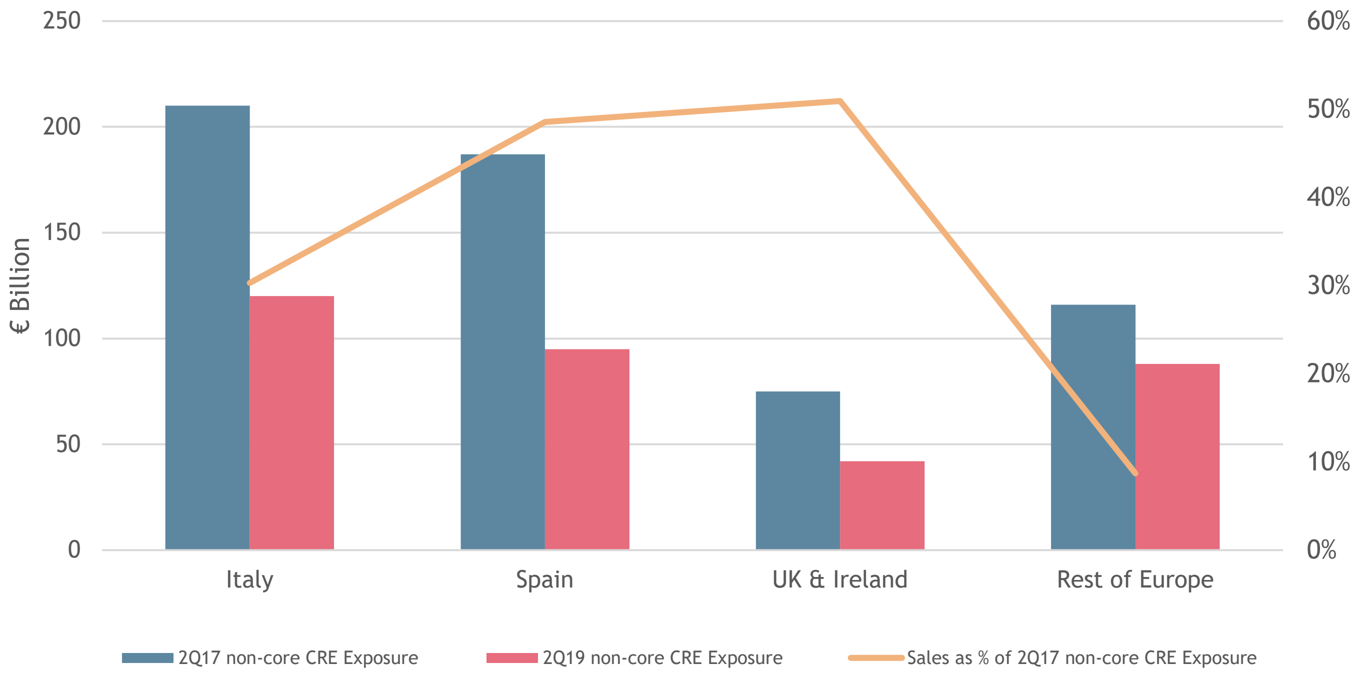
EUROPEAN RESEARCH MONTHLY UPDATE

JANUARY 2020

NIENTE ITALIA, NIENTE VERA DIVERSIFICAZIONE

- Despite its well documented political problems, Italy remains the fourth largest economy in Europe. Italian government bonds have more recently tightened to historical lows and are now more in line with the rest of Europe, helped by the ECB's quantitative easing policy and a solid domestic base of private investors.
- Across office, retail and logistics markets, Italy has shown the most attractive returns compared to other European markets over the last five years. However, our forecasts for the next five years are less optimistic with further recovery in capital values limited by our outlook on bond yields, with Italian returns expected to be broadly in line with the rest of Europe.
- Investment volumes have been increasing since 2012 and are estimated at €8bn for 2019. Italian volumes have been at 5% of the European total over the last five years, just below the 5.5% share of Spain. Offices made up 60% of Italian volumes and cross-border investors had a comforting high share of 67% over the last five years.
- At €120bn, Italian non-core loan exposure remains the highest of any single EU country. Italian NPL sales have been slower than Spain's and other high NPL countries; this delay means that there are still more NPL sales to be done. The related second order sales of former NPL collateral across Italy will offer value add and core investors further liquidity in the upcoming years.
- Finally, Italian offices offer strong diversification benefits for UK, German and French investors, based on historically low covariance's between Italian office market returns compared to other key European markets. Fund managers have not yet taken advantage of this diversification benefit as only c. 5% of Pan European fund strategies target Italy.

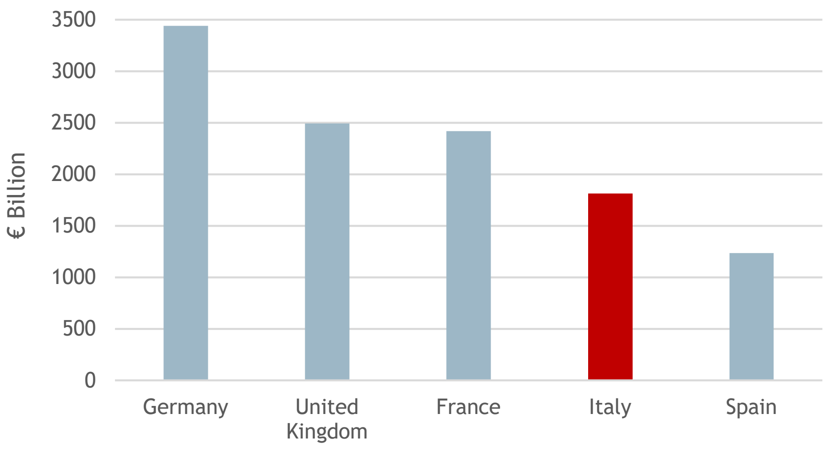
MORE ITALIAN NPL DEAL VOLUMES WILL TRIGGER MORE LIQUIDITY DOWN THE LINE



Sources: Evercore & AEW

ITALY IS THE FOURTH LARGEST EUROPEAN ECONOMY

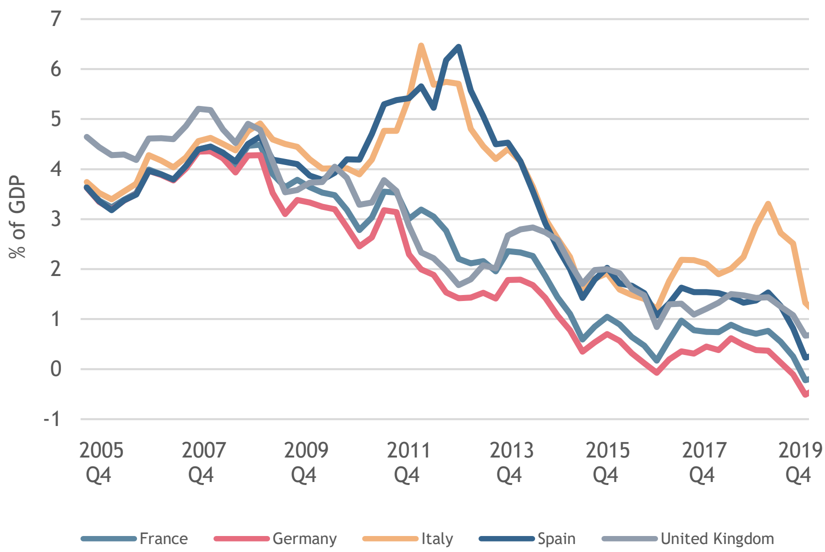
- Despite slow GDP growth over recent years, Italy remains the fourth largest economy in Europe with a 2018 GDP of €1.8tn.
- As the political situation in Italy continues to evolve with new political parties and coalitions emerging, the average length of recent governments has not really changed. In fact, other European countries are seeing similar, if not worse institutional instability.
- With the continuing negative headlines, it is important to remember that Italy's economy remains nearly 50% larger than Spain's and is only 25% smaller than France and the UK's.



Sources: Oxford Economics & AEW

ITALIAN BOND YIELDS MOVING BACK INTO LINE WITH REST OF EUROPE

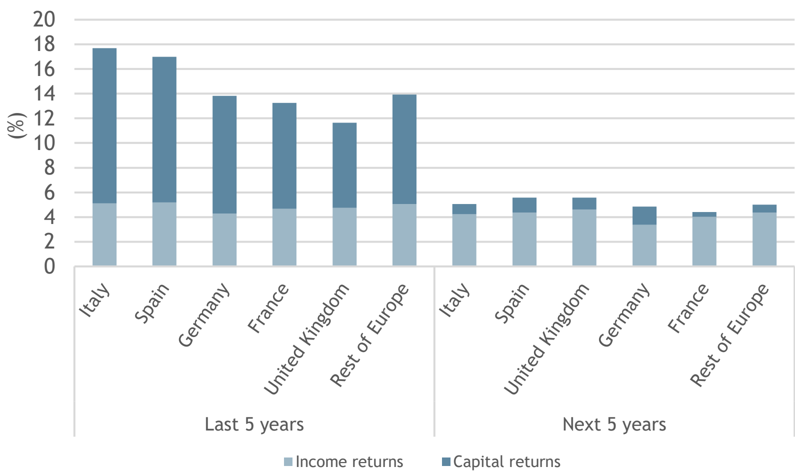
- Italian bond yields have remained high over the last two years as there has been no structural solution to Italy's high government debt and budget deficit.
- This might seem a bit unfair as the Italian budget deficit as a % of GDP has been lower than for France and Spain in both 2017 and 2018.
- As the ECB has continued its QE policies, Italian bond yields have come more in line with the rest of Europe over the last 9-12 months.
- This was also helped by short supply in the broader markets, since Italian investors hold many of their own government's bonds and other European countries have issued fewer government bonds.



Sources: Oxford Economics & AEW

PRIME PROPERTY RETURNS ALSO CONSISTENT WITH OTHER EUROPEAN MARKETS

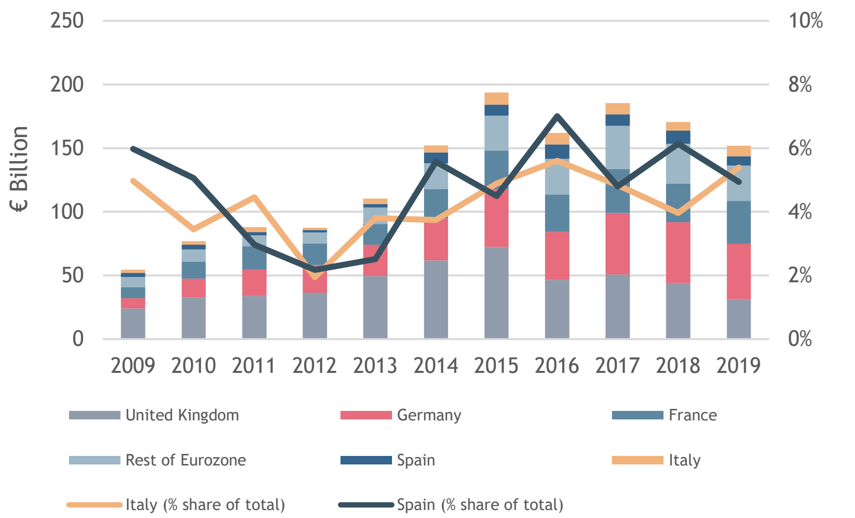
- Across office, retail and logistics markets, Italy has shown the most attractive prime returns compared to other leading markets in Europe over the last five years.
- Our forecasts for Italy for the next five years are less optimistic, but remain broadly in line with the rest of Europe.
- This is mostly due to lack of further capital appreciation, as we expect little further yield tightening.



Sources: CBRE & AEW

ITALIAN INVESTMENT LIQUIDITY HAS BEEN IMPROVING SINCE 2012

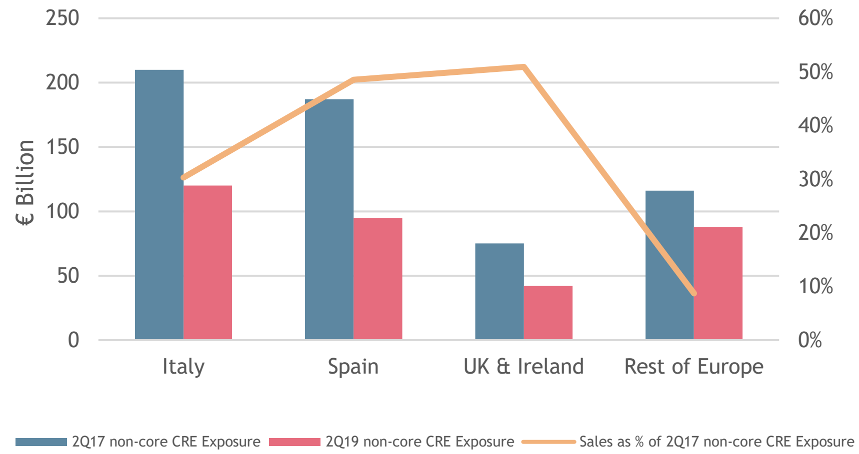
- Italian investment volumes are estimated at €8bn for 2019 and have been at 5% of the European total over the last five years.
- Spanish volumes have been slightly higher at 5.5% over the period driven in part by the more structured NPL work-outs there.
- We expect a delayed impact in Italy, as opportunity funds typically sell former NPL collateral to value-add or core investors.
- Italian 2019 volumes focused on offices at 60%, Milan and Rome were dominant, with retail volumes at 30%.
- Cross-border investors have had a surprisingly high average share of 67% over the last five years.



Sources: RCA & AEW

MORE ITALIAN NPL DEAL VOLUMES WILL TRIGGER MORE LIQUIDITY DOWN THE LINE

- At €120bn, Italian non-core CRE exposure remains highest of any single EU country, despite €90bn of NPL 2018-19 sales.
- Sales are slower in Italy at 30% of 2Q17 exposure compared to 50% in the other big NPL countries, Spain and UK & Ireland.
- NPL sales have been structured very differently in Italy compared to the coordinated and state-sponsored sales in Spain (SAREB) and Ireland (NAMA).
- The delay in NPL sell-offs from Italian banks means that there are still more NPL sales expected from Italian banks and activity from recent NPL buyers to sell off their acquired NPL collateral - more so then any other large market.



Sources: Evercore & AEW

ITALIAN DIVERSIFICATION BENEFITS REMAIN OPEN FOR PAN EUROPEAN FUND STRATEGIES

- According to INREV data, the allocation of pan European fund strategies to Italy is only 5.5% compared to 24.4%, 14.4% and 9% to Germany, France and the UK, respectively.
- Historical data for offices shows that the covariance of Italian office markets compared to other key European markets is very low.
- This means that French, German and UK investors can benefit from including Italian offices in their international diversification strategies.
- These are better results than for other markets, including the more volatile office markets of Spain.

Covariance	France	Germany	UK	Italy	Spain
France					
Germany	0.0029				
UK	0.0072	0.0071			
Italy	0.0016	0.0016	0.0006		
Spain	0.0098	0.0096	0.0135	0.0061	

Sources: CBRE & AEW

ABOUT AEW

AEW is one of the world's largest real estate asset managers, with €70.2bn of assets under management as at 30 September 2019. AEW has over 700 employees, with its main offices located in Boston, London, Paris and Hong Kong and offers a wide range of real estate investment products including comingled funds, separate accounts and securities mandates across the full spectrum of investment strategies. AEW represents the real estate asset management platform of Natixis Investment Managers, one of the largest asset managers in the world.

As at 30 September 2019, AEW managed €32.3bn of real estate assets in Europe on behalf of a number of funds and separate accounts. AEW has over 400 employees based in 9 offices across Europe and has a long track record of successfully implementing core, value-add and opportunistic investment strategies on behalf of its clients. In the last five years, AEW has invested and divested a total volume of over €20bn of real estate across European markets.

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