ITALIAN REITS SEEK REVIVAL

LACK OF HARMONISATION IN ITALY'S REAL ESTATE INVESTMENT STRUCTURES RISKS DAMAGING THEIR GROWTH OUTLOOK

BY **VIRNA ASARA**

With a market size of just over €2 bn, the Italian listed property industry seems a world away from its European peers, where France alone, for instance, has a market capitalisation of around €50 bn. Despite efforts to revive the market in 2007 with the introduction of real estate investment trusts (known as SIIQs in Italy), Italy's listed sector has remained a minor player and even shrunk in size in the past years, having witnessed a number of delistings, most recently of IPI and Immobiliare Lombarda. Today, plans by the industry's giant, Beni Stabili, to adopt REIT status have lifted hopes of a market revival, but experts say that conflicting legislation in force for investment funds remains a major strain on the development of the sector.

'When the government enacted the SIIQ regime, there was a general fear that these structures would be competing with the property investment funds,' says Aldo Mazzocco, chief executive of Beni Stabili. 'These concerns prompted governance bodies to stiffen limits for converting to the new fiscal schemes.'

Majority-owned by French group Foncière des Régions, Beni Stabili is gearing up for adoption of SIIQ status from 2011, but Mazzocco says the legislation is still in need of fine-tuning and he is urging local financial institutions to take the opportunity to implement reforms. 'The market regulators have yet to understand that we are not competing with the real estate funds. Instead, I believe that the property fund market would benefit from the creation of an Italian SIIQ segment, in terms of a more active and dynamic investment market.'

The Italian SIIQ legislation imposes Europe's highest conversion tax (20%) and some of the tightest restric-

IN BRIEF

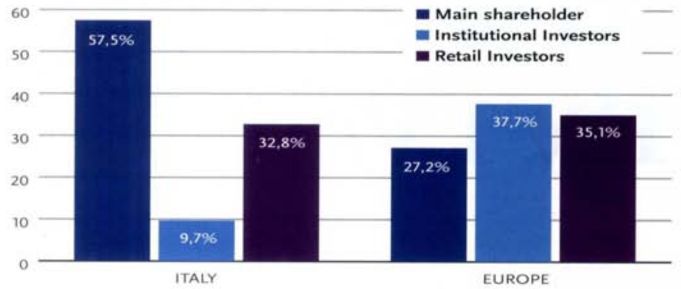
- Beni Stabili gearing up for REIT conversion
- SIIQ regulations among the strictest in Europe
- Tax constraints hampering growth of the sector

ITALIAN LISTED PROPERTY COMPANIES

LISTED COMPANY	DESCRIPTION	OWNERSHIP	MARKET CAP € MLN
Beni Stabili	Property investor	Controlled by France's Foncière des Régions, expected to become a SIIQ in 2011	1,117
IGD SIIQ	Property investor & manager	Controlled by Italian cooperatives. First company to receive SIIQ status	359
Pirelli & Co. RE	Property manager	Expected to become a public company, currently controlled by the Pirelli Italian Industrial Group	288
Aedes	Property manager	Controlled by Italian private investors	155
Brioschi Sviluppo Immobiliaire	Developer	Controlled by Italian private investors	147
Risanamento	Developer and investor	Controlled by creditors	93
Gabetti Property Solutions	Property services	Controlled by Italian private investors	29
TOTAL			**2,187**

SOURCE: INTERMONTE SIM

OWNERSHIP BREAKDOWN OF ITALIAN VS EUROPEAN REAL ESTATE STOCK



SOURCE: INTERMONTE SIM

tions on shareholding structures, including a 51% limit for controlling shareholders and a minimum free float of 35%, with each investor owning no more than 2%. This compares to a 60% shareholding threshold and a 15% minimum free float in France, which at the time inspired Italian lawmakers.

TAX BOTTLENECK

However, the law's major bottleneck is a 20% tax for foreign companies investing in a SIIQ, in a country where international institutions have long enjoyed full tax exemption on participations in real estate funds. Mazzocco: 'This disparity has largely favoured the growth of the real estate fund market to the detriment of the SIIQ sector.' As recently as June 2010, the

'The late introduction of the REIT regime is a big missed opportunity for the Italian property sector'

country took tentative steps towards harmonisation by proposing to scrap tax breaks for property funds as part of Italy's 2010 Budget Law. However, the new directive has prompted harsh criticism from the property industry and few believe it will eventually be enforced. Far from welcoming the proposal, Mazzocco says the initiative represents a step in the wrong direction. 'The reasoning should be to try to make the Italian SIIQs more appealing to international players by introducing the same fiscal breaks that now benefit the real estate funds – not to make both of them less attractive!'

At a time of reduced investors' confidence worldwide, he laments the failure by the country's financial system to understand the importance of the tax-transparent REITs in attracting foreign capital. Beni Stabili, which in April placed 7% of its capital and a €225 mln bond on the open market, has seen foreign investors account for as much as 84% of total demand, with subscribers including major international names such as Goldman Sachs, JP Morgan and State Street Corporation. 'We raised €314 mln in less than four hours from major international names, which demonstrates the attractiveness of the SIIQ structure for foreign institutions,' he points out. 'We hope that Beni Stabili's success in attracting capital flows from abroad will prompt regulatory bodies such as the Consob, the Bank of Italy and the Borsa to make these schemes more attractive.'

IGD Siiq, the sole Italian REIT to date, boasts many institutional investors in its shareholder base, 80% of which are foreign players, including New York-based asset manager European Investors Incorporated, with nearly 5%. Because of the general opacity of the market, foreign institutions are drawn to the transparency and simplicity of the REIT structure rather than to direct property investment, says Claudio Albertini, CEO of IGD Siiq. 'The Italian market has historically been dominated by trading rather than long-term management, making direct investment less attractive for institutions looking for a low risk and stable income.' In fact, the country has a dearth of asset managers specialised in working out homogenous portfolios and presenting them to institutional players for investment. Albertini, who took the helm of IGD in May last year, says that the Italian SIIQs have been constrained by a number of factors including competition from real estate funds, stiff requirements and the spreading financial crisis. 'However, the stumbling block is that in the Italian law, REITs are taxed regularly (over 31%) on property sales,' he says. 'This basically prevents them from taking a more active role in the market and favours a less dynamic management of the portfolio.'

EUROPE'S MIDGET

Despite being the eurozone's third-largest economy, Italy accounts for less than 1% of the European listed real estate industry. Market experts agree that the small size of the market is largely a result of local banks' attitude towards the quoted market. 'Local listed real estate companies have limited advantages in terms of market visibility and access to funding,' explains Alberto Villa, senior analyst at Intermonte Sim, a Milan-based brokerage firm. 'Italian financiers do not favour the quoted sector when granting credit. Nor have listed vehicles ever benefited from increased visibility on the part of local institutional investors.' Moreover, the lack of harmonisation in the country's investment laws has favoured the expansion of property funds over the past decade, Villa adds. 'The SIIQs were introduced after the property market had already experienced its boom period and the possibility to spin off large portfolios into REITs was already gone. We see this as a big missed opportunity for the sector,' Villa says.Historically, both retail and institutional investors looking to access Italian real estate had no choice other than to take property on to their books or buy into the – often less transparent – real estate fund market. 'For years, investing in a fund has been the preferred option for institutional investors,' says Sara Bellenda, an analyst at CBRE Investors in London. Even though REITs today offer an attractive alternative, Bellenda does not expect a swift growth of the listed sector in the near future. 'The local market is very heterogeneous in terms of property stock. In the retail sector, we have a number of listed companies – mostly foreign firms such as Klépierre, Eurocommercial and Corio – which provide access to the country's retail park in a transparent manner, but in the office segment we lack a large homogenous market similar to the City or Canary Wharf in London or La Défense in Paris. Basically, banks and insurers control a major part of the office portfolios but not in a format which is tradable,' she notes.

Beni Stabili and IGD Siiq aside, market experts say that the other local listed firms are not eligible for REIT status due to the mixed profile of their businesses and a recent wave of restructuring which has swept the market. 'They have different business models, ranging from property services to development, with just two of them being pure property investment companies,' Villa points out. Pirelli, which two years ago was tipped as a potential candidate for the launch of a SIIQ, is now seeking to become a pure property services group, while players such as Aedes and Risanamento are still struggling to find a way out of the crisis.

LOCAL FUND MANAGERS

Looking ahead, Villa sees the local fund management and banking industries as a potential source of future REITs. Major fund managers seeking to liquidate some of their vehicles, such as BNL Fondi Immobiliari, could decide to transfer assets to a newly created SIIQ if they are unable to complete their divestment programmes successfully. Villa: 'We may see this in the next couple of years.' Similarly, Italian financial institutions including Unicredit and Intesa Sanpaolo have recently taken billions worth of real estate on their balance sheets and the launch of a REIT could become a profitable choice. 'Depending on the stock market performance, they may soon consider spinning off part of these portfolios into REIT structures,' he concludes. ■

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G-REITS REMAIN NICHE MARKET – FOR THE TIME BEING

Germany endorsed legislation on real estate investment trusts (REITs) in early 2007. Greeted with enthusiasm by the sector, the launch of the tax-efficient schemes was soon faced by a plethora of regulatory constraints and further hindered by the onset of the financial crisis. Although a dozen firms initially pledged to adopt REIT status, only two companies – Hamburg's Alstria Office and Munich's Fair Value – eventually opted for the tax-transparent regime and it was not until February 2010 that the country saw the creation of a third real estate investment trust, with the conversion of Duisburg-based Hamborner. Also this year, CR Capital Real Estate, a Berlin-based listed property company founded in 2008, has confirmed plans to convert to the new fiscal scheme in 2011, following its listing on the Frankfurt stock exchange. Even so, the market capitalisation of the German REIT market today remains limited, amounting to as little as €700 mln. In comparison the UK, which introduced REITs around the same time as Germany, currently boasts over 20 REITs with a market cap of well over €20 bn. 'In the UK there is a much longer tradition with public companies, while in Germany the market is dominated by open-ended and closed-end funds and the implementation of a REIT regime was a much greater change in investors' perception. Therefore, we expect G-REITs to remain a niche segment for the time being,' says Hans Volkert Volckens, chairman of the German real estate federation (ZIA). According to market experts, one of the major factors hampering growth of a G-REIT segment is the 45% loan-to-value threshold. Meant as a cap on leverage, during the financial crisis this requirement strongly reduced possibilities to adopt the regime for a number of companies, due to falling property values. Other disputed points in the legislation include a tight limit on direct shareholdings of only 10%, which compares to a 30 to 60% shareholding threshold in other European countries, and the exclusion of residential property constructed before January 1, 2007 from G-REIT status. Although the industry is still pushing for the latter requirement to be eased, the limit has so far helped rule out several potential REIT candidates.