INREV RESEARCH & MARKET INFORMATION

INVESTOR UNIVERSE ITALY SURVEY 2012

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INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. Our aim is to improve the accessibility of non-listed real estate funds for institutional investors by promoting greater transparency, accessibility, professionalism and standards of best practice.

As a pan European body, INREV represents an excellent platform for the sharing and dissemination of knowledge on the non-listed real estate funds market.

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Naturally, those contributing information are not responsible for the views expressed in this report.

EXECUTIVE SUMMARY

This report provides estimates of the current and future size of the Italian institutional non-listed real estate universe in the context of the overall Italian institutional real estate universe. A further objective is to understand the strategies behind these real estate allocations.

The Italian institutions covered are pension funds, insurance companies and bank foundations. A survey of these institutions has been undertaken through interviews to acquire information about their real estate allocations and strategies. Overall the size of the investment market is €560.8 billion, of which €38.5 billion or 6.9% is invested in real estate. The sample survey group has total assets of €232.6 billion, of which €29.4 billion is invested in real estate. This group represents 41.5% of overall assets and 76.5% of the investment in real estate.

The great majority of indirect investments in Italy are through non-listed property funds and these are estimated to be €13.2 billion, representing approximately 34.4% of the investment in real estate. However, direct investment, at approximately €25.2 billion billion, accounts for 65.6% of the investment in real estate.

All Italian institutional investors are exposed to core funds, but value added and opportunity funds are also present in some portfolios. The funds are most commonly invested in the office sector followed by retail. Non-domestic real estate exposure is very rare, accounting for less than 1% of the total allocations of the sample.

The three primary motives for investing in non-listed real estate are taxation, access to expert and specialist management benefits of diversification of the portfolio. However the primary obstacle for investing through non-listed property funds is the lack of liquidity. This is especially the case as Italy is a relatively new market for fund units.

At 56.7%, a slight majority of respondents have not changed their positive view on real estate since the global financial crisis. They attribute this to its important diversification benefits in a multi-asset portfolio and its low volatility compared to other asset classes, particularly during a financial crisis. Even more so, almost two-thirds of respondents stated that their real estate allocations will increase in total value. Most have an increasing interest in non-listed real estate funds and some will only make new investments through these structures.

At the time of publication, a new pension fund (those established after 1992) was asking for authorisation to invest in real estate funds. If it succeeds, others are expected to follow suit. This would create a potential new important inflow of capital to indirect real estate investments, particularly non-listed real estate, which could amount to roughly €5.8 billion.

It is very likely that there will be an increase in real estate allocations by Italian institutional investors, and to non-listed property funds in particular. This is due to both the increase in real estate allocations by most investor categories and the general trend for new investments to be indirect. The combined effect could raise real estate allocations as a percentage of total investment from 6.9% to 7.6%, in three years. Similarly 50% of the real estate investment would be done indirectly with a clear preference for non-listed real estate. This would potentially increase the size on non-listed real estate investment by €10.7 billion.

1 INTRODUCTION

This is the seventh report of a series of studies INREV is conducting to estimate the current and future size of the European institutional non-listed real estate funds market. The aim of this report is to estimate the size of the Italian institutional market and the allocation Italian investors are making generally to real estate and, specifically, to the non-listed real estate funds.

A further aim is to understand the strategies behind investors' real estate asset allocations, the form these investments take and how these strategies may change in the future. In the past several industry organisations have published studies on the real estate allocations of Italian private pension foundations, but the real estate allocations of other institutional investors, such as pension funds, bank foundations and insurance companies are still under-researched. This survey looks at the total universe with a special focus on non-listed real estate funds.

This report provides estimates on the size and composition of Italian institutions' total real estate allocations. In particular, it focuses on non-listed property fund investments and their underlying investment strategies. The study is also based on the results of a survey through interviews conducted with players in the market, enhancing the accuracy and depth of the analysis.

Chapter 2 of the report provides an overview of the type and size of Italian institutional investors, while outlining the permitted forms of real estate investment. Then, Chapter 3 focuses on this real estate allocations and the various forms of real estate.

While Chapters 2 and 3 focused on overall universe figures, Chapters 4 to 7 analyse the survey results. Chapter 4 describes the sample of the research and its coverage of the real estate universe as well as different types of real estate exposure. Non-listed real estate is examined in detail in Chapter 5. Chapter 6 examines the real estate strategies adopted by institutional investors, the role of non-listed real estate within these strategies and investors' opinion on non-listed real estate funds. The final chapter presents indicative estimates of the probable changes to the non-listed real estate universe. The appendices contain more details on the Italian indirect vehicles, with a particular focus on Italian real estate funds that represent the great majority of non-listed indirect investments for Italian institutional investors. It also includes a description of the Italian pension fund system.

1.1 Methodology

This research has been conducted for INREV by Prof. Giacomo Morri in conjunction with Assoimmobiliare. The methodology follows a similar approach to previous INREV studies, which cover the institutional markets in the UK, Germany, the Netherlands, Sweden, France and Finland.

The data was collected both through a desktop review of the investors' universe and through interviews with a sample of investors between April and July 2012, which provided useful insights to better understand their strategies and views.

Some data has been collected from reliable sources such as ACRI, the Association of the Italian Bank Foundations; ADEPP, the Association of the Italian Private Pension Foundations, and ANIA, the Association of the Italian Insurance Companies as well as regulatory bodies including the Bank of Italy, Assofondipensione the Association of the Italian Closed Pension Funds, COVIP, the Pension Funds Authority, and ISVAP, the Insurance Companies Authority.

Real estate is defined to include both direct and indirect investments, securitised real estate debt and infrastructure. The analysis of the universe in chapter 2 and 3 make the distinction between direct and indirect real estate. The sample analysis (Chapter 4 to 7), makes the distinction between:

- direct equity investment, in which the investors maintain control over the real estate investment;
- non-listed equity investment (real estate funds, other collective investment schemes and funds of funds), in which the investors delegate the investment and management of the real estate to a third-party;
- other investments in real estate, which include all other vehicles linked to real estate such as listed companies, mortgage-backed securities, covered bonds, private debt and for the purpose of this report, infrastructure is also included.

1.2 Universe and Survey Sample

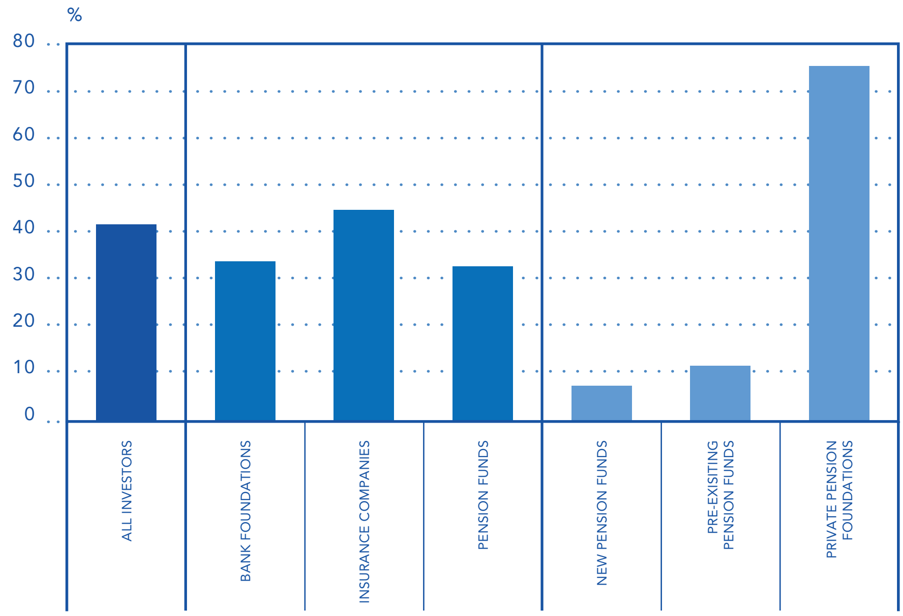
The universe covers investors making multi-asset allocation decisions to meet future liabilities such as pension funds, insurance companies and bank foundations. The total size of the Italian institutional universe across all asset classes is estimated at €561 billion at the end of 2011. This estimate is derived from the figures published in financial reports and other sources such as regulatory reports and interviews. Their total investment in real estate is calculated to be €38.5 billion, which represents 6.9% of their overall portfolio.

The survey sample comprises 30 investors: seven bank foundations, nine insurance companies, seven private pension foundations and seven other pension funds, from a total of 796 investment schemes that exist in Italy. Almost half of the investors or 363 are pre-existing pension funds which account for only 4.7% of the total assets universe but represent approximately 11.8% of overall investments in real estate.

The sample represents €232.6 billion total assets, which is 41.5% of the universe (Figure 01, page 07). Bank foundations represent 33.6%, insurance companies 44.6% and pension funds 32.5%. In this last category, private pension foundations have the largest proportion at 75.4%.

By real estate allocations, the sample accounts for 76.4% of the estimated real estate universe, which amounts to €29.4 billion.

FIGURE 01 / COVERAGE OF THE SAMPLE OF TOTAL ASSETS UNDER MANAGEMENT BY TYPE OF INVESTOR



2 DESCRIPTION OF THE ITALIAN INSTITUTIONAL MARKET

2.1 Investor categories

The universe of Italian institutional investors which are permitted to invest both directly and indirectly in real estate can be classified into three main categories:

1. Insurance companies.
2. Bank foundations.
3. Pension funds.

At the end of 2011 there were 142 Italian insurance companies. Those included in the study universe comprise the Italian subsidiaries of foreign insurance companies, but not the foreign subsidiaries of Italian insurers. It also excludes those funds which insurance companies manage on behalf of other investors (unit and index linked), thereby avoiding double-counting.

Bank foundations are non-profit legal entities whose mission – similar to charity foundations – is to enhance public utility services and promote the economic development of the territory. Bank foundations were first introduced in 1990 following an important reform of the credit system There are now 88 bank foundations but they only have a limited share of total investments as most of their resource are still invested in the originating banks.

Italian pension funds have significantly changed over the last twenty years with different investment rules. The following section provides an overview of the four subdivisions within pension funds, outlining their different investment strategies and real estate policies. More information on the Italian pension fund system may be found in Appendix B.

STATE PENSION FUNDS

State pension funds have always been allowed to invest directly in real estate. In 2008, to comply with EU directives on expected investment performance for public bodies, state pension funds were asked to respect a 7% threshold for real estate allocations as part of total investments. As of 2012 some of the existing funds merged into the National Institute for Social Insurance (INPS) and the rest were terminated. The INPS is still managing the partial disposal of its direct real estate investment to comply with the new limit, so it is no longer investing directly in real estate. For the purpose of this study, this fund will not be included.

PRIVATE PENSION FOUNDATIONS

Private pension foundations provide compulsory services to various professionals such as doctors, lawyers, notaries and journalists. This subset comprises two different type of foundations: those that became private in 1994 (Older PPF) and private newer foundations (Newer PPF).

Since 1996 all these funds have changed their legal forms into private foundations or associations, and therefore have gained autonomy on investment decisions and management. They must submit their balance sheets to COVIP, a public regulatory authority, within three years. They do not have constraints set by law as long as they maintain a balanced and prudent allocation of their assets and are able to meet future liabilities for pension payments over the long-term.

PRE-EXISTING AND NEW PENSION FUNDS

Pre-existing pension funds are those established before 1992. They can invest directly and indirectly in real estate, with certain limits that will be discussed in the following chapter.

New pension funds (open or contractual) can only carry out indirect real estate investments and have to outsource the investment management activity to an independent and professional third-party manager.

INDIVIDUAL PENSION PLANS

Individual pension plans operate as life insurance and are managed by insurance companies, brokers and management companies. There are 76 individual pension plans with total investments of €13.2 billion. These funds only invest in financial assets such as equities and bonds. There is no evidence of investment in real estate funds or investment strategies related to indirect real estate, although it is not possible to exclude the fact that there may be some real estate (listed shares) exposure included in their equity allocation; for the purpose of this report they are not included in the real estate market analysis.

2.2 Total assets of Italian institutional investors

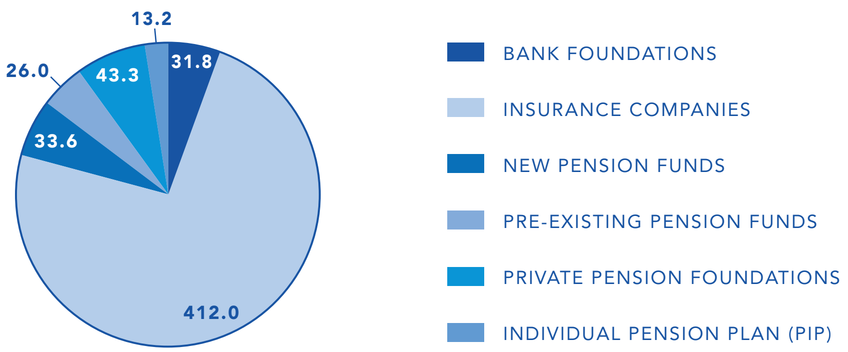
The market value of the total investment universe of Italian institutions is €560.8 billion. As Figure 02 shows, this universe is dominated by insurance companies which account for 73.5% and, to a lesser extent, by pension funds representing 20.8%.

The value of insurance companies' total investments is €412.5 billion, of which 76.6% is invested in fixed income, 13% in equities, and only a limited exposure to real estate of 4.6%.

All pension funds account for around €116.6 billion. This figure includes the total asset value of 22 private pension foundations of €43.3 billion, 363 pre-existing funds with total investments of €26.5 billion, 105 new pension funds of around €33.6 billion (comprising 38 contractual with €25.3 billion and 67 open with €8.3 billion) and individual pension plans with €13.2 billion.

FIGURE 02 / ITALIAN INSTITUTIONAL TOTAL ASSETS BY TYPE OF INVESTOR

€ BILLION



2.3 Permitted forms of real estate investment

Figure 03 briefly summarises the real estate investment restrictions of the different players. All players, except new pension funds, are allowed to invest directly in real estate, while all of them are allowed to invest indirectly, including into non-listed real estate funds. Nonetheless, there are some restrictions in place. Insurance companies can allocate 40% of their total investment to real estate with a limit of 10% in indirect real estate investment. Similarly, since 2010 bank foundations may invest up to 15% of their total assets directly in addition to any properties which are for their own occupation.

Pre-existing pension funds may invest in direct and indirect real estate to a maximum of 20% of the total assets and can manage their asset allocation without a third-party manager. Funds that exceeded that threshold when the law became effective in 2007 were granted a five year period to reduce direct investments to the new threshold.

This period ended in May 2012 with just 10 funds meeting the threshold, while nine still have direct allocations above the limit (three with over 40%) and are still attempting to divest. This delay is mostly explained by the current condition of the Italian property market. It is particularly difficult for these assets to be sold as a whole (portfolio divestment), especially for pension funds with governance issues around disposal strategies.

It is noteworthy that new pension funds are permitted to invest up to 20% of the assets of the pension fund indirectly and up to 25% of the asset value of the individual real estate fund equity through non-listed property funds. However, up to the date of publication, none had done so. This is mostly due to procedural problems related to the requirements of using a third-party asset manager, and because they are restricted to investing in assets with market value estimated on a monthly frequency. Similarly they require the Italian Pension Authority, COVIP to approve their internal management structure and any changes made to it, for the purpose of new indirect investments.

FIGURE 03 / INVESTMENT RESTRICTIONS BY TYPE OF INVESTOR

	BANK FOUNDATIONS	INSURANCE COMPANIES	PRIVATE PENSION FOUNDATIONS	PRE-EXISTING PENSION FUNDS	NEW PENSION FUNDS
DIRECT INVESTMENT	YES, MAXIMUM ALLOCATION 15% OF THE TOTAL ASSETS	YES	YES, WITH NO SPECIFIC LIMIT	YES, MAXIMUM ALLOCATION 20% OF THE TOTAL ASSETS	NOT ALLOWED
INDIRECT INVESTMENT	YES, WITH NO SPECIFIC LIMIT	YES, LIMIT 10% TOTAL ASSET	YES, WITH NO SPECIFIC LIMIT	YES, MAXIMUM ALLOCATION 20% OF THE TOTAL ASSETS	YES, MAXIMUM ALLOCATION 20% OF THE TOTAL ASSETS AND MAXIMUM SINGLE INVESTMENT ACCOUNTING LESS THAN 25% OF THE VALUE OF THE REAL ESTATE FUND
NOTE		*THE TOTAL AMOUNT CANNOT EXCEED 40% OF TOTAL INVESTMENTS*	*NOT ALLOWED TO INVEST IN PRIVATE OR SECURITISED DEBT WITH REAL ESTATE AS UNDERLYING ASSETS*	*DIRECT INVESTMENT EXCEEDING THIS THRESHOLD MAY BE CONFERRED TO REAL ESTATE FUNDS WITH NO LIMIT*	

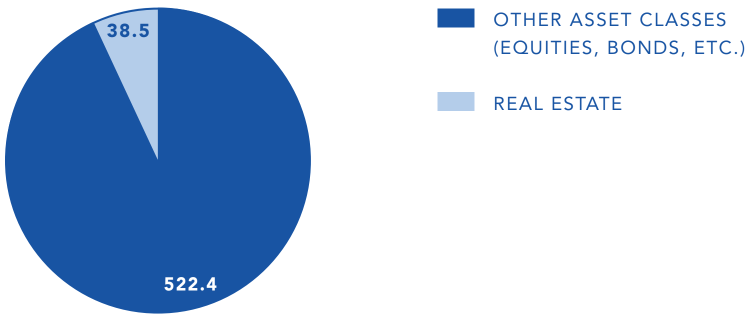
3 REAL ESTATE ALLOCATIONS

3.1 Italian institutional investors' real estate universe

Figure 04 illustrates that the €38.5 billion Italian institutional real estate universe represents 6.9% of the institutional universe. This figure may not include exposures to listed property companies, which are less common among Italian investors, but are also typically part of institutions' equity allocation. The Italian listed sector is mainly dominated by smaller retail investors and it is not comparable in size to the non-listed real estate sector. Similarly, corporate real estate which is occupied by investors is not included.

FIGURE 04 / ITALIAN INSTITUTIONAL TOTAL ASSETS BY TYPE OF INVESTMENT

€ BILLION



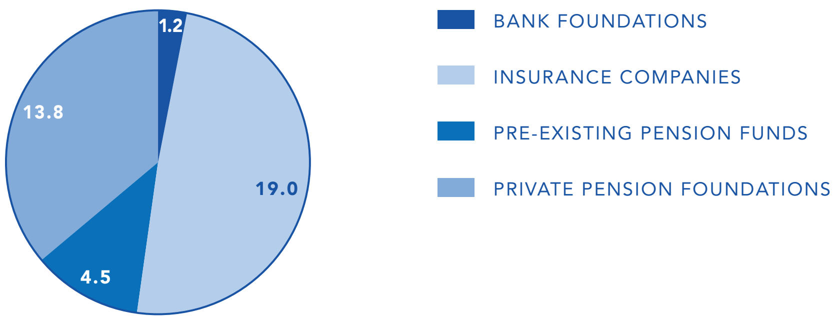
3.2 Real estate universe by type of investor

Figure 05 shows the predominance of insurance companies in the market with €19 billion invested. It also shows that insurance companies and private pension foundations dominate the real estate universe, together accounting for €32.7 billion, which equals over 85.1% of the total.

Only 32 pre-existing pension funds invest in real estate and account for €4.5 billion. Half of this is concentrated in just three funds and 75% of the total in seven funds. Private pension foundations have invested €13.8 billion in real estate, which represents 35.8% of the total. Bank foundations hold the smallest portion of real estate at 3.1%, which amounts to €1.2 billion.

FIGURE 05 / ITALIAN INSTITUTIONAL REAL ESTATE BY TYPE OF INVESTOR

€ BILLION

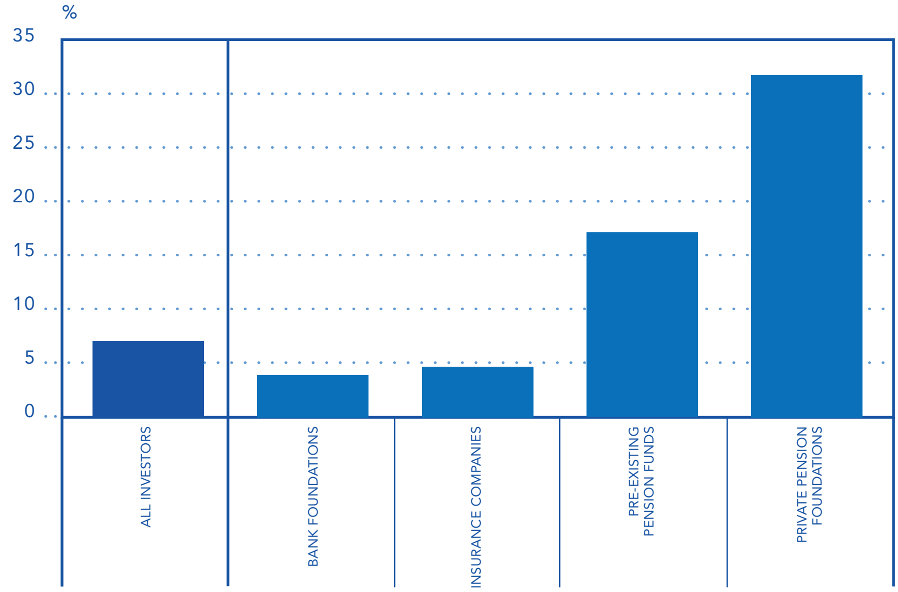


3.3 Proportion of total assets in real estate

Private pension foundations have the highest real estate allocation ratio across all investor types at 31.8% (Figure 06). Their exposure is particularly high as historically they were forced by law to invest in real estate. It is also worth noting that before the adoption of euro, Italy was always characterised as having high inflation rates so pension funds invested in real estate to hedge inflation.

Insurance companies and bank foundations have low allocations to real estate. It is estimated that insurance companies have invested around 4.6% of their total assets in real estate. In a similar vein, the 88 active bank foundations invest an average of 3.8% in real estate.

FIGURE 06 / PROPORTION OF TOTAL ASSETS IN REAL ESTATE

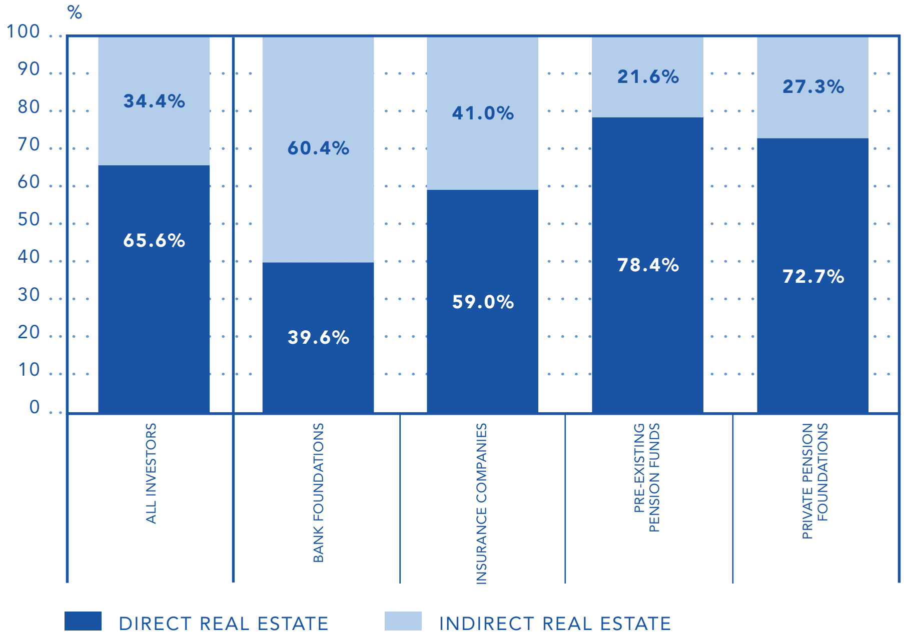


3.4 Types of real estate investments

Of the €38.5 billion invested in real estate, €25.2 billion is invested directly and €13.2 billion indirectly. Within the indirect portion, non-listed real estate funds represent the majority. The listed property market in Italy is very small and comprises just two REITS (SIIQs) with a total market value of around €1 billion. Besides, property shares are often included in the general equity allocation.

Direct real estate is the most important type of real estate investment for all groups of institutional investors except for bank foundations (Figure 07, page 13). Insurance companies and private pension foundations hold the largest portion by value with €11.2 billion and €10 billion respectively. This represents 59% and 72.7% of their total real estate investments. Similarly, pre-existing pension funds make 78.4% of their investment in real estate directly. However, bank foundations hold 60.4% indirectly.

FIGURE 07 / DIRECT AND INDIRECT REAL ESTATE INVESTMENTS BY TYPE OF INVESTOR



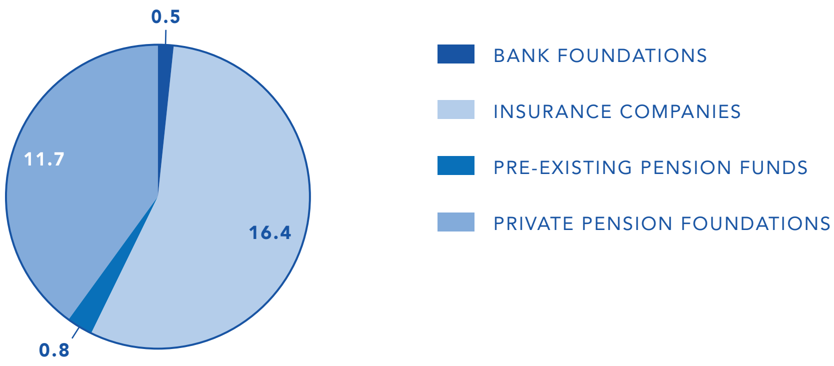
4 TYPE OF REAL ESTATE INVESTMENT

4.1 Sample coverage by institutional investor

The remainder of the analysis for this report is based on the survey sample of 30 institutional investors which participated in a set of interviews. These investors have €29.4 billion invested in real estate, representing 76.4% of the estimated real estate universe as described in the previous chapters. As Figure 08 shows, the distribution of the sample is similar to the universe (Figure 05, page 11), except for a lower representation of pre-existing pension funds. Bank foundations are over represented because some with a large real estate portfolio participated in the survey.

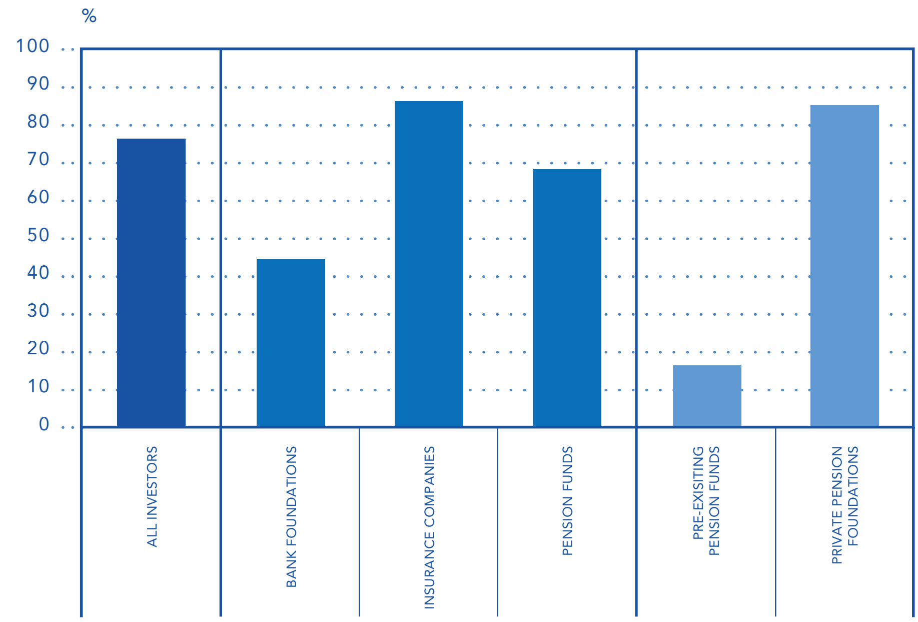
FIGURE 08 / REAL ESTATE EXPOSURES OF THE SAMPLE BY TYPE OF INVESTOR

€ BILLION



As Figure 09 (page 15) shows, there are noticeable differences in the coverage within the subgroups. Although the coverage of the overall investors is 76.4%, insurance companies are covered at 86.3% while bank foundations reach 44.6%. Pension funds are also significantly covered as a group at 68.3%. Nonetheless the coverage of private pension foundations is significantly larger than pre-existing pension funds. The first one is covered at 85.3% while the latter is covered at 16.6%

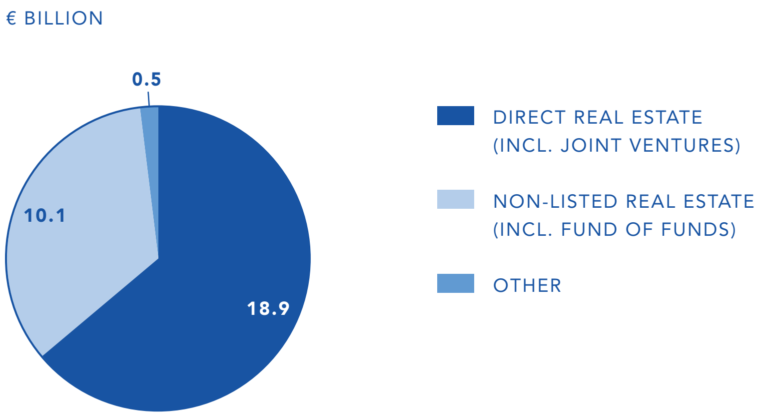
FIGURE 09 / REAL ESTATE COVERAGE OF THE SAMPLE BY TYPE OF INVESTOR



4.2 Types of real estate exposure

Investors were asked in which forms of real estate they actually invested in and the extent of their allocations. Figure 10 shows that of the €29.4 billion invested in real estate, €18.9 billion is held in direct real estate, including joint ventures. This is followed by non-listed property funds, which total €10.1 billion, and includes funds with one investor, multiple investors, and also funds of funds. Finally other real estate, such as shares of listed property companies (€19 million), infrastructure (€445 million) and securitised debt (€30 million) represent just €0.5 billion.

FIGURE 10 / TYPES OF REAL ESTATE EXPOSURE



4.3 Real estate investments by institutional investor type

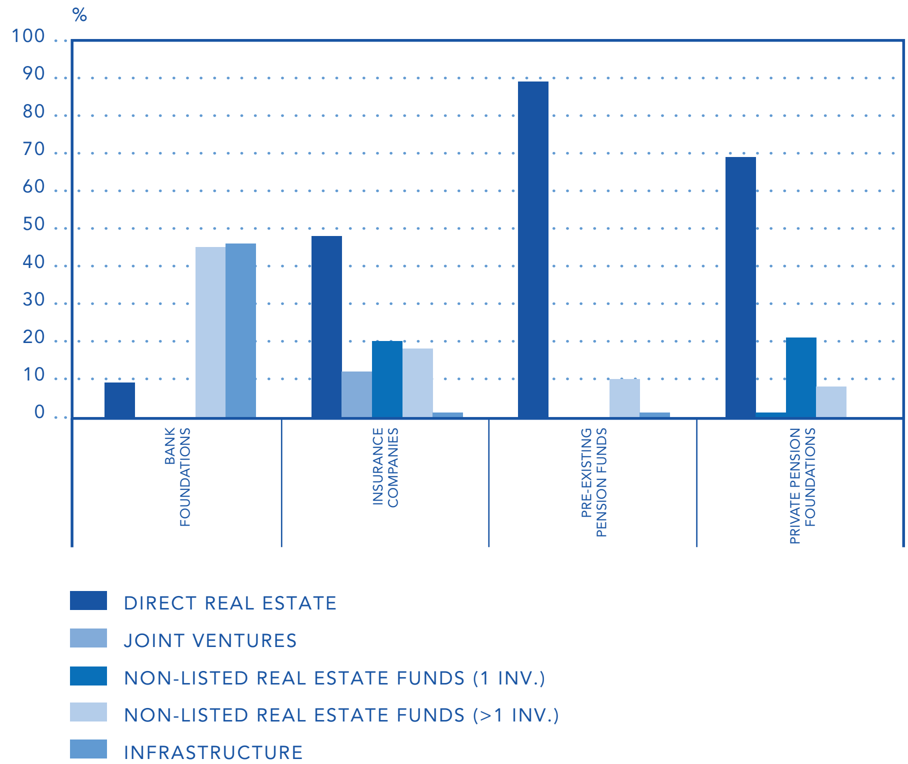
Figure 11 represents the type of real estate investments in the sample by investor. Insurance companies and private pension foundations are invested in most of the investment products, while bank foundations and pre-existing pension funds mainly invest in a few real estate types.

Direct real estate is the most common form of investment by number of respondents, but also real estate funds, particularly those with more than one investor, are frequent.

For the purpose of this research, investments in non-listed real estate funds are further divided in two categories according to the number of investors. This comprises those with one investor, which are classified as separate accounts within the INREV Guidelines but they often use the same kind of vehicle structure as other real estate funds, as well as funds with several investors. Insurance companies and private pension foundations more commonly use single investor funds. There is more information on Italian real estate funds in Appendix A.

Although funds of funds are included under non-listed real estate with more than one investor, their allocation is limited. The same is the case for real estate investment such as securitised debt and listed companies. These have not been included in Figure 11 because of their size. Most infrastructure investments are related to one infrastructure fund, which is subscribed to by several bank foundations. This is an appropriate investment for them as it aligns with mission to improve of public utility services and promote the economic development.

FIGURE 11 / TYPES OF REAL ESTATE INVESTMENT BY TYPE OF INVESTOR



5 NON-LISTED REAL ESTATE ALLOCATIONS

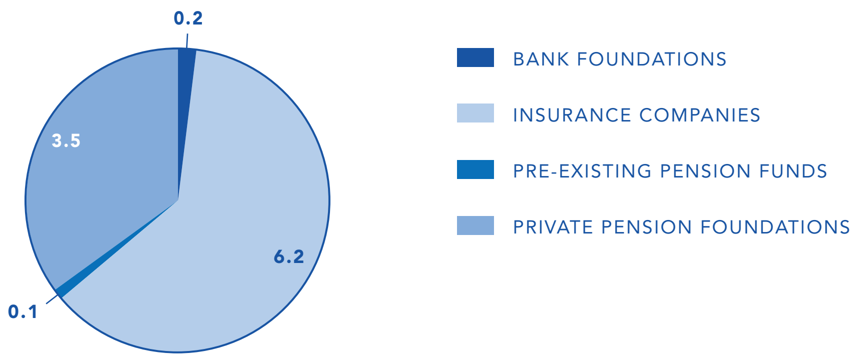
5.1 The non-listed real estate universe in Italy

According to the Bank of Italy, Italy had 303 non-listed real estate funds at the end of 2011 which totalled €39.7 billion. It is estimated that 70% of these funds are invested in, by financial institutions and companies (not included in this study), while the remaining part is divided into foundations, pension funds, insurance companies, public bodies and retail investments; both of the latter groups are excluded from this study. The sample covers €10.1 billion of non-listed investments which represents 76.4% of the amount which is invested in by foundations and pension funds and insurance companies in non-listed funds.

Figure 12 shows that insurance companies are the largest investor group in non-listed real estate funds and account for around €6.2 billion or 62.2% of the total. Private pension foundations are the second largest category holding €3.5 billion representing 34.7% of the investment in non-listed real estate. Bank foundations hold €0.2 billion or 2.4% of this investment, while pre-existing pension funds hold 0.8% which equals €0.1 billion. Although both types of private pension foundations have identical mandates as to which indirect real estate investments they can invest in, newer private pension foundations have very little non-listed investment in real estate at 4%, while older private pension foundations cover the remaining 96%.

FIGURE 12 / NON-LISTED REAL ESTATE INVESTMENT OF THE SAMPLE BY TYPE OF INVESTOR

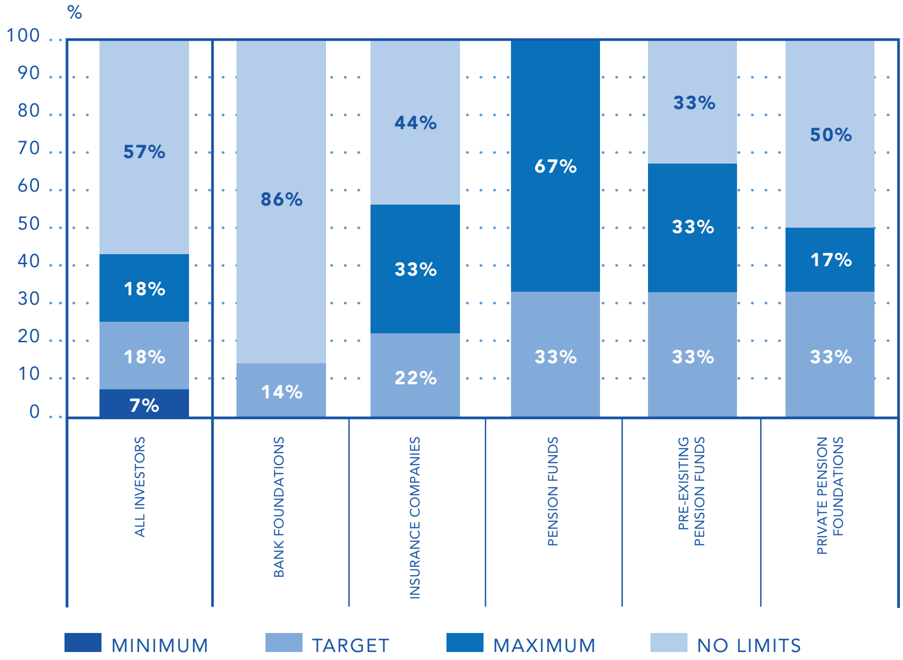
€ BILLION



5.2 Defined allocation to non-listed property investments

Investors were asked whether they had binding allocations and restrictions for their non-listed real estate investments (Figure 13). At 57.1%, the majority said there are no legal or statutory limits, while 17.9% has a maximum allocation. Only 18% has a target allocation and 7.1% has a minimum allocation. Even new pension funds, which do not yet have any exposure to real estate funds, have no internally set limits when it comes to these products. The lack of investments is due to practical issues related to investment procedures outlined in section 2.3.

FIGURE 13 / DEFINED ALLOCATION TO REAL ESTATE

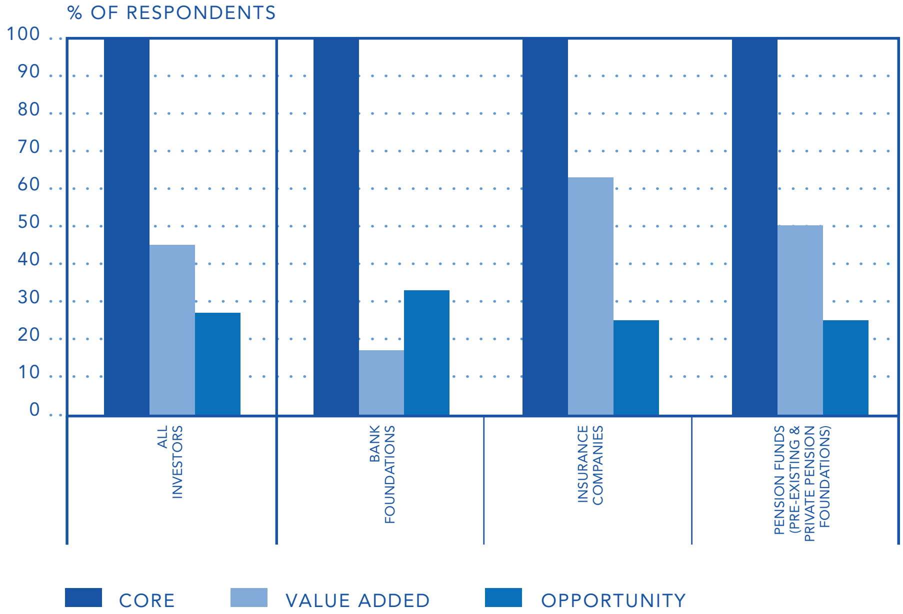


5.3 Current allocations to non-listed funds by investment style, sector and region

Interviewees with an allocation to non-listed real estate funds (22 out of 30) were asked how these investments broke down into the different property sectors and investment styles. To avoid possible identification of participants, all subgroups of pension funds have been grouped and are referred to as pension funds

As shown in Figure 14 (page 19), all respondents said they invest in core funds, followed by 45.4% in value added funds and 27.3% in opportunity funds. There are no great differences among different investor categories when it comes to style. Some opportunity funds which invest in residential development projects are popular with bank foundations, and in several cases they have invested in funds with development projects in their local areas.

FIGURE 14 / EXPOSURE TO NON-LISTED REAL ESTATE STYLES

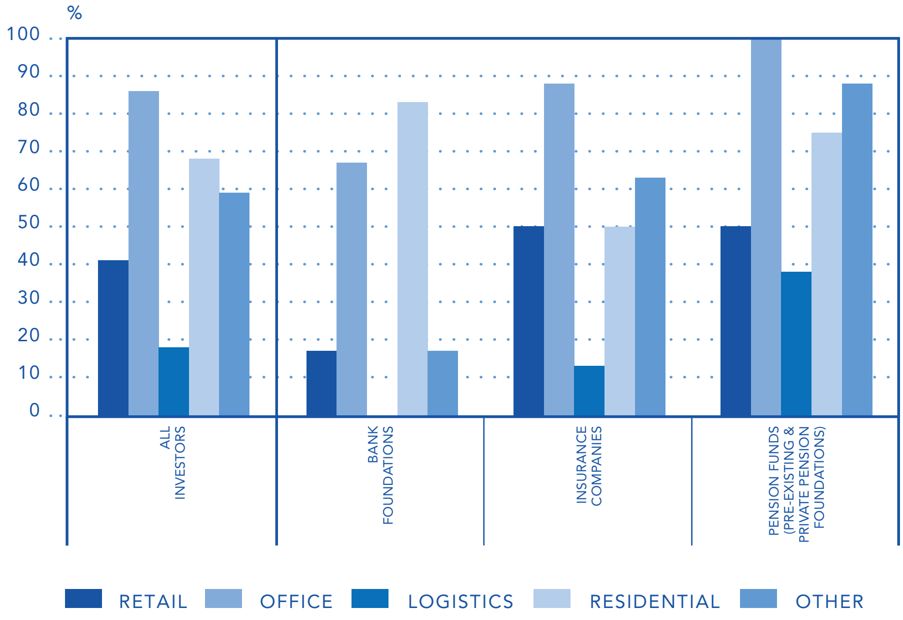


Pension funds and insurance companies invest across all property sectors in contrast to bank foundations, as Figure 15 (page 20) shows. All pension funds in the sample have exposure to funds investing in offices. Bank foundations invest in a smaller range of sectors with social housing being the most common.

The non-listed Italian property funds market is dominated by funds investing in offices and retail. Other sectors, such as hotel and health care represent a small percentage of allocations. The vast majority of funds, except for those dedicated to social housing, are multi-sector funds.

Even if the greater exposure is in funds investing in residential, it is important to underline that there are two main reasons. Some of these funds invest in social housing, which is in line with bank foundations' social mission. In other cases, particularly for pension funds, these funds were created by the transfer of their residential portfolios with the aim of divesting through a more efficient vehicle compared to direct disposals, in order to reinvest in funds with commercial real estate exposure.

FIGURE 15 / EXPOSURE TO NON-LISTED REAL ESTATE SECTORS



5.4 Non-listed funds by region

Non-domestic real estate allocations are very rare across all Italian institutional investors. According to the sample, less than 1% of total allocations are outside Italy. Historically, institutions only invested directly; therefore the domestic market suited their requirements. In the last few years they have started to invest cross-border, which has been mainly indirectly, but this trend is still limited. In addition, there are only a few investors with an internal structure able to manage international investments through non-listed property funds. This is due to a lack of knowledge of other real estate markets and of the foreign real estate asset management industry.

6 REAL ESTATE STRATEGIES AND THE PROS AND CONS OF INVESTING IN NON-LISTED REAL ESTATE FUNDS

All investors, regardless of whether they currently hold non-listed real estate investments, were asked to list the three most important reasons both for investing and not investing in real estate funds. All respondents except three investors answered.

6.1 The attractions of non-listed real estate funds

Figure 16 (page 22) shows that almost half of investors, 46%, rate the three primary motives for using non-listed real estate funds equally. These are access to specialist management, diversification for an existing multi-asset portfolio and tax reasons.

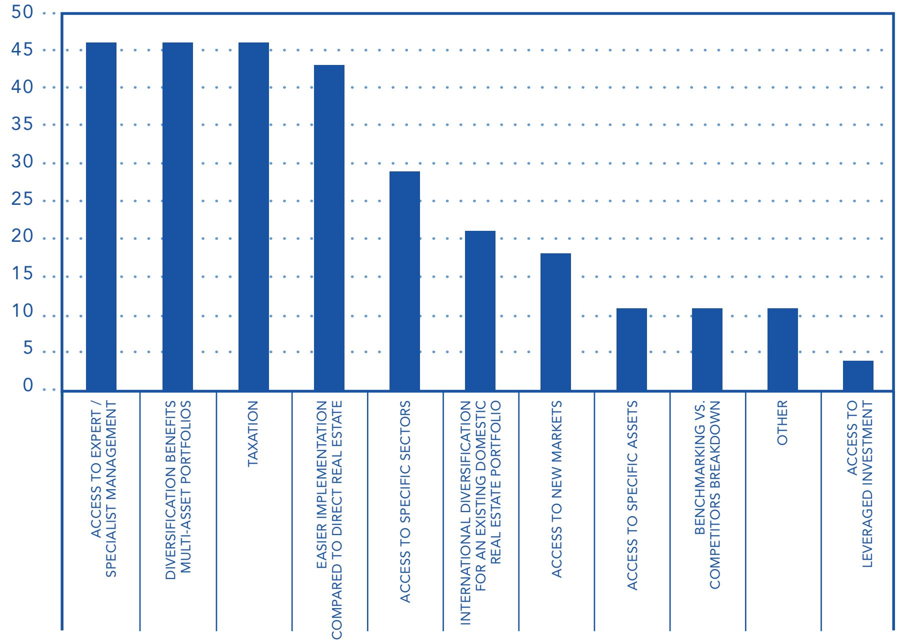
According to several interviewees, access to expert and specialist management is becoming increasingly important because of the difficulties in managing specialist properties such as retail or hotels. Interviewees also said that diversification benefits were important and real estate funds allowed them to get improved exposure to a diversified property portfolio. Taxation is equally important for Italian investors, especially private pension foundations, because by investing through funds they can avoid paying non-recoverable VAT on property acquisitions. The easier implementation of funds compared to direct real estate, especially in terms of market timing opportunities, was also seen as important by 42.9% of investors.

Other features, such as access to specific sectors, international diversification for an existing domestic real estate portfolio and access to new markets are considered secondary benefits but were also significant at 28.6%, 21.4% and 17.9% respectively. Access to leveraged investments is not considered an important reason, which is probably due to the low risk strateg of many investors, with some of them not using debt in their investments.

One factor that is not reflected in the survey but was highlighted by several insurance companies is that investing through real estate funds offers the possibility to better rebalance the portfolios of the different companies which belong to the insurance group. Indirect investments were also seen as granting a higher financial flexibility and lower transaction cost compared to direct investments.

FIGURE 16 / MOST IMPORTANT REASONS FOR INVESTING IN NON-LISTED REAL ESTATE FUNDS

% OF RESPONDENTS

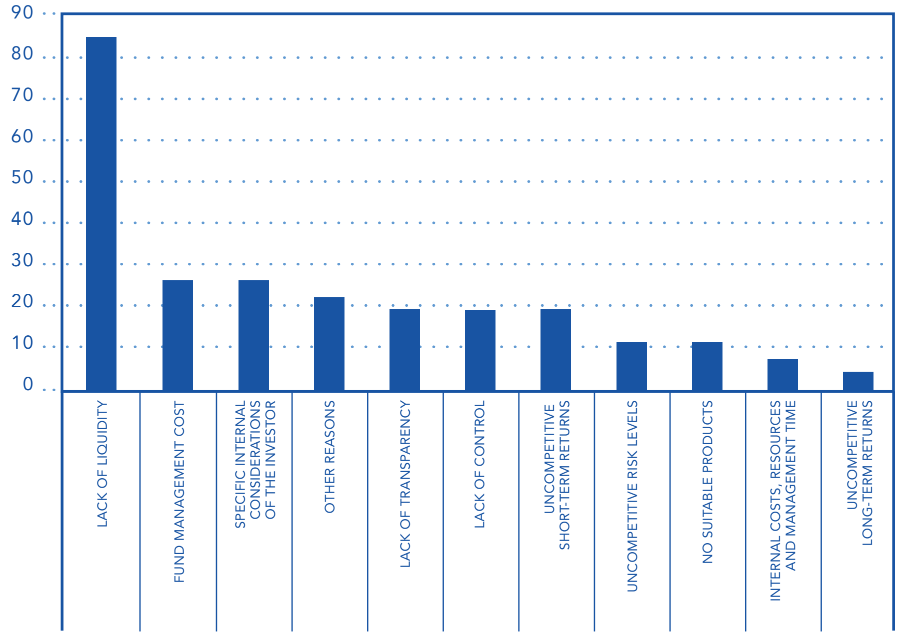


6.2 Concerns about investing in real estate through non-listed real estate funds

Figure 17 (page 23) shows that 85.2% off the respondent consider the lack of liquidity as the primary concern about non-listed real estate funds, especially as Italy is a relatively new market for funds. Investors are concerned that fund units cannot be easily sold because the secondary market is not well developed and is even more illiquid than the underlying property market. Other reasons are seen as less important such as specific internal considerations of the investor and fund management costs with 25.9% of respondents. The lack of transparency and control are both mentioned by 18.5% of respondents as well as the uncompetitive short-term returns. Other concerns related to returns, absence of suitable products and internal costs, resources and management time are not perceived as important by a large proportion of investors.

FIGURE 17 / MOST IMPORTANT REASONS FOR NOT INVESTING IN NON-LISTED REAL ESTATE FUNDS

% OF RESPONDENTS



Other less representative concerns emerged during the interviews. For example, new pension funds have to invest in assets with monthly valuations while Italian real estate funds usually have half-yearly reports. This was considered a minor technical issue with some possible solutions.

It is worth noting that some investors did not raise any concerns and agreed with all the proposed advantages. Generally, the whole sample had a good opinion of non-listed real estate funds. This has been confirmed by both the securitisation of many real estate portfolios that have transferred properties into non-listed funds and by the fact that new real estate investments are commonly through non-listed funds.

Most comments about investing in real estate through non-listed funds are positive. Some concerns arose in the selection of the fund manager as most interviewees pointed to this as the key point of indirect investment. A couple of interviewees mentioned concerns about the quality of some Italian fund managers. Reputation, past performance and size are considered important elements for the selection of a manager.

6.3 Non-listed real estate fund investment strategies

The responses to the survey reveal a number of different real estate strategies. The majority of respondents have, so far, pursued a predominantly direct real estate investment approach. However, in the last few years a shift from direct to indirect investments has been happening for reasons which are in part common to all investors and partially specific by type of investor.

In general, investors have become increasingly aware of the benefits of investing indirectly. Some institutional investors have been transferring part of their portfolios to funds or are investing through real estate fund structures where they are the sole investor. This way the fund has a dedicated strategy and can benefit from reduced taxation, especially VAT which is often not recoverable, and take advantage of specialised real estate asset managers.

Many bank foundations still own a significant share of the original bank that they were spun-off from and recently, due to the financial crisis and Basel III constraints, they have been forced to invest in new equity raises. As a consequence they have debt levels that do not allow them to consider new investment opportunities. This situation is causing concern for many bank foundations so they tend not to have a clear strategy on new investment opportunities including those in real estate. Some bank foundations are still investing in social housing real estate funds because this is one way they can fulfil one of their institutional purposes.

Insurance companies are increasingly considering indirect investments with the aim of improving allocations between subsidiaries of the group. To this extent, major insurance companies have already created an internal real estate asset management company to manage funds set up through the transfer of existing portfolios and to manage funds for third-party investors. Other insurance companies still consider their exposure to real estate too low and want to increase this by investing in non-listed real estate funds. In general, dividend returns are more important than expected total returns for insurance companies. This is due to the need to receive stable cash flows and because of the greater uncertainty from the capital return component.

Pension funds are moving from direct real estate to indirect in two ways. Some investors are contributing existing properties portfolios to funds – especially residential units to be divested – in order to take advantage of the non-listed property fund features. Other investors will now only invest in real estate through funds because of lower taxation (VAT) and the possibility to get access to specialised real estate management expertise. Some pension funds are also considering indirect investments abroad. Relying on foreign managers, who have a deeper knowledge of the international market and the indirect approach helps avoid all issues related to direct cross border investments. In general, most are setting an indirect only investment strategy, including those who are allowed to invest directly such as private pension foundations. Finally, new pension funds that still do not have any kind of real estate exposure are seriously considering investing through non-listed real estate funds, but still need to resolve some practical issues.

7 PROSPECTIVE CHANGES ON REAL ESTATE

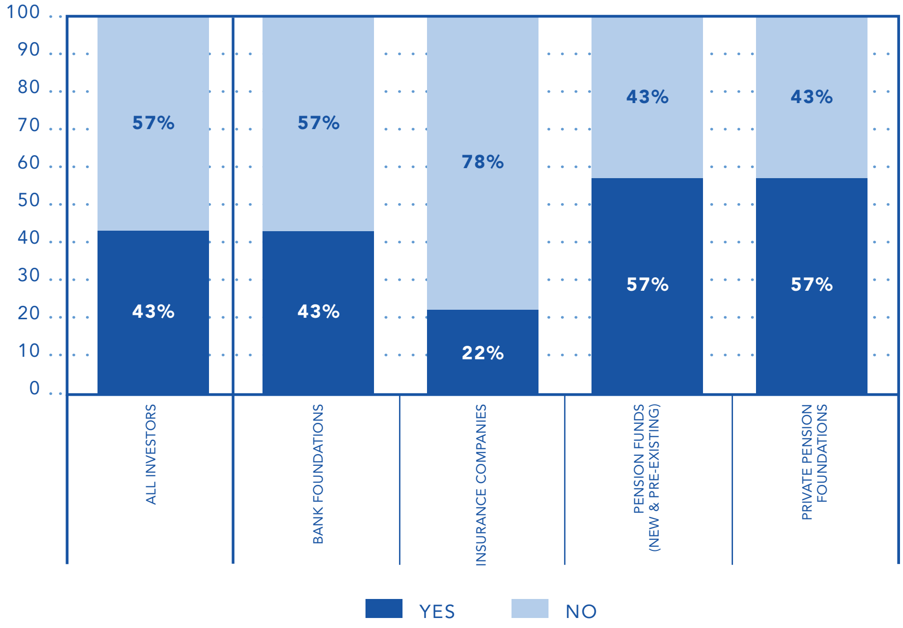
7.1 Changes on real estate view

In three years time, participants expect their total investments to be higher than today. There are major differences to this trend by type of investor, in part based on the dynamics of investments and divestments, but mainly affected by the current market volatility which is making forecasts difficult. The majority of investors expect to have some capital to invest and have a positive view of real estate investment.

To better estimate future changes, participants were also asked if their views on real estate investments have changed as a result of the financial market downturn. While the majority have not changed their views (56.7%), there is variability across the sample, especially between different investor categories.

FIGURE 18 / CHANGES OF VIEWS ON REAL ESTATE AFFECTED BY THE DOWNTURN

% OF RESPONDENTS



Investors that maintain a positive view of real estate mainly attribute it to its important diversification benefits for a multi-asset portfolio and its volatility compared to other asset classes, particularly during a financial crisis. Several investors believe that real estate is a good long term investment with low risk and, particularly now, has a better risk return ratio compared to other income oriented investments such as bonds.

Those that now have a less positive view on real estate think that its risk level has increased relatively and requires more careful selection and management. Some investors still expect a further reduction in property values, especially in Italy where the re-pricing process has been slower than in other countries. This suggests that some investors will look for alternatives to domestic investing. Some are now also considering investing in foreign markets and, emerging countries, in particular. Investments in infrastructure and alternative energy are now also under serious consideration.

Finally, participants were asked if, and to what extent, their current allocations will change over the next three years, but only few were able to provide a precise view on the variation. Almost two thirds of respondents stated that their real estate exposure will increase in total value, but they were not able to provide the proportion of total assets. Other investors, especially some pension funds, expect a reduction in their real estate exposure due to current over-allocation. This trend is not common to all pension funds.

Larger bank foundations appear to have increased their interest in indirect real estate. While the sample under observation is not totally representative, this appears to be a main trend for this type of investor. New real estate investments will mainly be through non-listed real estate funds, even though their activity could be limited due to the need to underwrite the capital increases in the original bank.

Major insurance companies are transforming their direct investments by transferring properties to funds, mainly using internal asset management companies. Even those not affected by this process are still considering increasing their exposure to non-listed property funds rather than direct real estate. Finally, pension funds' new investments will mainly be through non-listed property funds. The largest private pension foundations are also still considering an increase in their real estate allocations.

New pension funds are considering investing in real estate to have a more balanced allocation for their multi-asset portfolio. At time of publication, a new pension fund was asking the Italian Pension Funds Authority, COVIP, for authorisation to start investing in real estate funds. Others are waiting for the results of this first request and, if successful, they are expected to follow suit. This would create a potential new important inflow of money for indirect real estate investments. As they have no real estate exposure, it is likely that in the future they could reach similar allocations as other pension funds representing around one quarter of total investments. If the same real estate allocation as pre-existing pension funds is assumed (17.1%) an indicative estimate is that roughly €5.8 billion of new investment could be invested in non-listed funds in the future by these new pension funds.

Based on information from the interviews, it is estimated that in three years' time the overall Italian institutional AUM will increase in size by 16.2%, reaching €650.8 billion. Real estate allocations are also expected to grow from 6.9% to 7.6%. These combined effects will represent an increase from the current real estate allocation of €38.5 billion to €49.5 billion.

As a result of the growing interest in indirect real estate by institutional investors, 50% of the total allocation to real estate is expected to be invested indirectly. This means that within three years, the current €13.2 billion invested indirectly will rise to €24.7 billion. Most of the increase for indirect investment will be allocated to non-listed real estate funds, which could see their AUM increase by €10.7 billion.

APPENDIX A

INDIRECT INVESTMENTS IN ITALY: ITALIAN REAL ESTATE FUNDS AND THE SIIQ

Italian real estate investment funds (REIF) are tax exempt closed end funds that invest predominantly (at least two thirds of the asset value) in real estate and equity interests in real estate companies. A REIF is not a legal entity, but rather a pool of investments, divided into units held by multiple investors which are managed by an authorised savings management company (SGR) on behalf of and in the interest of the unit holders (subscribers).

REGULATORY MECHANISMS

REIFs are regulated by provisions contained in several statutes and regulations issued by the Bank of Italy, the Ministry for Economic Affairs (Ministero dell'Economia e delle Finanze) and the Italian financial markets authority (Commissione Nazionale per le Società e la Borsa – CONSOB). The operating activity, including net asset value (NAV) calculations, is conducted by a custodian bank.

REIFs can be classified on the basis of the type of investors to whom the fund's units are offered: either to the general public (retail funds) or to specific categories of investors only (reserved funds for qualified investors, for which investment restrictions are less strict). Speculative funds are a different category with a limit of 200 investors and a minimum unit value of over €500,000. They can operate virtually without limitations, especially for leverage. Funds can be set-up by as blind pool or by can seeded with existing properties.

REIFs are based on contractual relationships between several players involved in the management activity of the fund itself. It is possible to distinguish between core subjects and external subjects. Among the former, the most important are the managing company (the SGR), the investment committee, the advisory committee and the unit holders' assembly.

External players involved in the fund's operations are represented by the supervisory and regulatory authorities (Banca d'Italia and CONSOB), the custodian bank, the independent experts (appraisers), external advisors and other service providers.

The managing company (Società di gestione del Risparmio – SGR), an Italian limited partnership company (Società per azioni) is particularly important and it can carry out the activity of managing mutual funds upon authorisation by the Bank of Italy. The authorisation is released when, on the basis of all the information available and filed, the Bank of Italy reaches the conclusion that a "sound and prudent management" of the fund is guaranteed. Along with carrying out the management of investment funds, the SGR carries out the management activity of individual investment portfolios. The SGR may offer the fund units in other EU Member States in compliance with the relevant provisions set out by the Bank of Italy and in extra-EU States, upon authorisation by the Bank of Italy. In both cases, the offer is also subject to the laws and regulatory provisions of the foreign State involved.

In order to achieve full operating transparency, the SGR has the duty to draft the management rules (Regolamento) of each fund, which set forth the fund's operational rules and must be presented to the Bank of Italy.

INVESTMENT DIRECTIVES

Several operational rules have been laid out by the legislator in order to avoid potential misalignments of interests between the various players involved in the functioning of the fund. Assets of a real estate fund must be invested according to the directives set forth in the management rules. In particular, there are general limitations that apply to all real estate funds, and other specific constraints or exceptions that refer solely to particular categories.

The first class of general rules concerns the assets the fund can invest in. According to the Italian legislation, a real estate fund can invest in financial instruments listed on a regulated market, unlisted financial instruments, bank deposits, real estate assets, real estate rights and interests in real estate companies, receivables and securities embedding receivables and any other asset that is traded and that has a value determinable at least on a semi-annual basis, but it must invest at least two thirds of the equity in real estate assets, real estate rights and interests in real estate companies. These investment thresholds must be reached within 24 months from the beginning of the fund's activity. In order to guarantee the investors the opportunity to liquidate their investment in the fund, the law requires that when the minimum unit is worth less than €25,000 and are also offered to retail investors, an application to list on a stock exchange must be filed within 24 months after the closing of the initial offer.

In order to avoid an excessive concentration of risk and to promote effective diversification strategies, it is not possible to engage directly in development and to invest more than one third of the assets in the same property. The term of each fund must be consistent with the nature of its investment activity. The maximum term for REIFs is 50 years, although a three year period of grace can be requested in cases where there are delays in divesting the assets.

Most of the previous provisions are relaxed if the fund is for qualified investors and most of the limits for the concentration of risk do not apply. In particular, these funds are not obliged to diversify their investments. They can also concentrate their risk on certain operations which can guarantee them higher returns; can operate in conflict of interests with the shareholders of the SGR (excluding the directors, auditors and executive officers) up to 100% of the value of the fund, and can sell, acquire or contribute properties whose value exceeds the limit of the 10% of the total assets value. In particular, reserved and speculative funds can invest counter to the general constraints set up by the Bank of Italy on concentration of risk. Finally, speculative funds also benefit from a greater discretion in the choice of investment objects as they are not subject to the provisions restricting the assets they can invest in, with the exception of the fact that these must be explicitly stated in the fund's management rules.

Other provisions concern investor relations and the required disclosure of information. The NAV has to be calculated at least every six months in order to provide extensive information to the unit holders and to the market. This provision requires that all the assets, including properties, are subject external independent appraisals.

In order to protect investors and markets from the risks associated with funds employing excessive financial gearing, there are rules for the financing of the funds. Funds can use every financing instrument except issuing bonds. The legislator has also provided some clear rules on funds and financing activities. In particular it is possible for the fund to enter into loan agreements as a borrower for up to 60% of the value of the real estate assets, real estate rights and interests in real estate companies owned by the fund, and up to 20% of the value of other assets owned by the fund. Notably, these restrictions do not apply to speculative funds which are not subject to any debt limitations.

FISCAL FRAMEWORK

The fiscal framework has changed several times since the establishment of REIFs. REIFs are now tax exempt and are therefore not subject to the Italian corporate tax on income (Imposta sui Redditi delle Società – IRES) and to the Italian regional tax on productive activities (Imposta Regionale sulle Attività Produttive – IRAP). In addition no withholding tax is generally levied on income from capital derived by the fund (for example, dividends, interests, etc.).

REIF profits, dividends and capital gains, are taxed at the investor level according to the fiscal status of unit holders:

- qualified investors (institutional investors, such as Governments, public authorities, insurance companies, banks etc.) and non-relevant investors have a 20% withdrawal at profits distribution;
- private investors are subject to the 20% withdrawal as final taxation;
- companies or public entities pay taxes on general income. In other words, dividends and capital gains are revenues and withdrawing is an advance payment on the final tax amount due at the end of the year;
- profits for relevant investors (those which are not qualified investors but which own more than 5% of the fund's units) are taxed at investor level by transparency;
- in most cases there is a 20% withdrawal tax on the distribution of profits for foreign investors in white listed countries and total exemption for some institutional investors, such as pension funds, OICR, central banks and international entities.

SIIQ

SIIQ (Società di Investimento Immobiliare Quotata) is the REIT special tax regime for property companies in Italy that was introduced in 2007. An Italian joint-stock company (Società per Azioni) – the only legal form which can apply for the SIIQ status – which aims to exercise the option for the special SIIQ regime, must respect a number of different requisites:

- shares of the company must be listed on a regulated EU or EFTA countries stock market;
- no shareholder shall hold, directly or indirectly, more than the 51% of the voting rights in the general meeting nor be entitled to more than the 51% of the profit, the "control requirement";
- at least 35% of shares shall be held by shareholders holding, directly or indirectly, less than the 2% of the voting and dividend rights in the general meeting or which are entitled to less than the 2% of the profit, the "floating requirement";
- the company must carry out predominantly the activity of property leasing, which is deemed prevalent when at least 80% of the assets is made up of properties or investments in other SIIQ ("asset test") and at least 80% of the annual revenues results from the rental and leasing activities or from dividends distributed by other SIIQ ("profit test").

The major effect of the adoption of the SIIQ regime is that the income deriving from the leasing and renting of real estate properties or from the investment in other SIIQs is not subject to the Italian corporate tax on income (currently 27.5%) or to the Italian regional tax on productive activities (around 3.9%), but rather taxed directly at the investor level. The taxation, at the moment of the distribution of the dividends, is made through the application of a withdrawal as advance payment (individual shareholders) or as final tax (corporate shareholders) according to the tax payer. The income deriving from activities different from the leasing and renting of real estate properties and from the investment in other SIIQ, including the capital gains from the selling of properties or investments, is instead taxed according to ordinary fiscal rules.

These tax breaks however require the company to respect a number of constraints. First of all, the SIIQ is required to distribute annually at least 85% of the income derived from the leasing and renting activities and from the investments in other SIIQ. There are no capital gains distribution requirements. Second, the adoption of the special regime requires the company to reappraise each property at its fair value. Capital gains are taxed either according to the ordinary tax rules or at an equivalent tax, known as entry tax, payable in equal amounts in five annual instalments. Third, the SIIQ must keep separate accounting books for the activities related to the renting of real estate properties and investments in other SIIQ and the other activities.

The SIIQ status can be lost for a number of reasons, such as if the company does not distribute at least 85% of the total net profit, if it fails to meet the shareholder requirements or if it does not meet the asset requirement for two consecutive years. The loss of the SIIQ status does not imply any specific sanctions, although, of course, the tax benefits will terminate from the year following the one in which the qualification requirements are violated.

So far in Italy there are only two SIIQs. Other listed real estate companies are mainly developers or service companies, with limited market capitalisation and low free float, so they cannot be considered as indirect real estate investments.

APPENDIX B

ITALIAN PENSION FUND TYPES

Several changes have occurred in pension funds regulations over the last twenty years and but it has now stabilised. The universe of pension funds is based on how pension funds' core activity and can be divided into Three Pillars, according to Italian Law:

1. Public pension bodies and private pension foundations.
2. Pre-existing and new pension funds.
3. Individual pension plans.

The "First Pillar" is the oldest and comprises only compulsory pension services, both public and private.
Due to some recent reforms, all minor public pension funds belonging to the first pillar have been deleted, while the biggest two (INPDAP and ENPALS) have been merged into INPS, that is nowadays the only state pension fund in Italy. However, since they are not private investors, this type of pension funds it is not part of the present study. It is important to mention that since 1996 they have been selling part of their property portfolios to comply with a new legislation that forbids new direct investments in real estate, unless they are for the pension fund's occupation. In 2008, to comply with EU directives with respect to expected investment performance for public bodies, state pension funds were asked to respect a threshold of 7% real estate allocation of total investments. To comply with this limit, they are still managing the partial disposal of their direct real estate investment, mainly formed of offices and residential buildings, by selling properties or by contributing properties to real estate funds and selling units.

In 1993 a complementary pension system, the "Second Pillar", was introduced with the aim to fill the gap left by the old compulsory public pension system. This pillar consists of pre-existing funds (Pre-existing pension funds) and new pension funds, which in turn are divided into contractual and open pension funds. Contractual pension funds are reserved for certain categories of workers. Open funds are freely available to all workers both on individual basis and as a group. Pre-existing pension funds are allowed to invest both directly and indirectly in real estate and they represent an important player in the market. New pension funds are only allowed to invest indirectly, but so far they have not invested in real estate.

A "Third Pillar", introduced later, is the Piano Individuale Pensionistico (PIP), which translates as individual pension plan. These funds mainly invest in financial assets and do not have real estate investments, except possibly some property company shares in the general shares allocation.