Chapter 11
Fifteen Years of Italian Real Estate Investment Funds Across Different Market Cycles

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11.1 Introduction to Italian Real Estate Market

Between 1997 and 2007, Italy experienced a period of sustained growth in the real estate market and capital value growth has been strong in all sectors, as has income return on the commercial real estate sector. The real estate market was expansive and has been transformed by the introduction of new financial instruments as well as through foreign investors.

During this decade, different innovations and changes have been introduced in the market as bank mortgages' securitization, real estate spin-off, public real estate assets disposal, investment opportunities in new developments as well as in re-use of brownfields, new forms of professional management of real estate portfolios, and the introduction of property funds. Those opportunities and trends opened the domestic market to foreign investors, improving the sector and its overall transparency. Cross-border investors remained focused on high quality assets, mainly in the two major cities of Rome and Milan and, within those cities, the principal property investments available were offices and retail. In the residential sector, 80 % of families own their house, so investment in this sector was limited and with very low yields.

In 1999, the first Real Estate Investment Funds (REIFs) were introduced in the market. The timing of the introduction coincided with the upward trend of the property cycle and REIFs have been one of the investments that contributed to the development of the market. Their rapid diffusion was predominantly related to their status of as a tax efficient vehicle for property investments as well as a good opportunity for portfolio diversification.

After 2008, real estate investments and capital flows froze and the transaction activities dramatically reduced due to the lack of finance and to the dependence of

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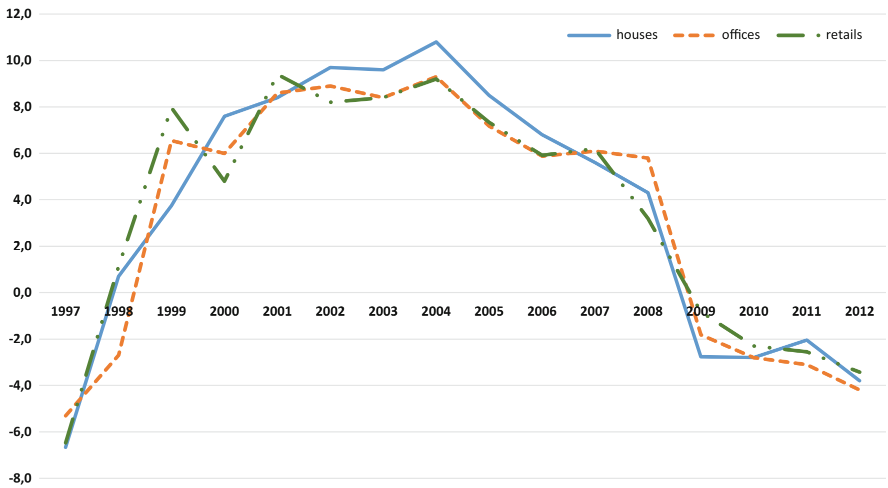

Fig. 11.1 Price variation (%) for houses, offices and retail – Nomisma, 1997–2012

the sector on leverage. The downturn in the real estate market has seen a massive decrease of property transactions (since 2005, – 47 % of residential and – 45 % of non-residential transactions, dropping down to 1985 level), while house prices have declined by 10 % since 2009 (Fig. 11.1). The purchase of a house via a mortgage plummeted 38 % and investments in residential and non-residential sectors dropped 21 % from 2008 and 32 % from 2003, respectively (Fig. 11.2). Recent public real estate assets disposal opportunities have struggled to attract bids.

Weak domestic demand and business activity as well as a rising unemployment rate were part of a continuous contraction of Italian economy. Lack of competitiveness, subdue bank lending, falling consumer spending, and political uncertainty suggest that the recession will continue throughout 2013 and the Italian economy will not experience any expansion. As industrial activity continues to decline, the industrial market suffers from a lack of demand and vacancy, with a poor prospect for the sector. In the office sector, international investors remain cautious and very selective as the political situation is not stable and the economy remains weak. In the retail market, investments remain constrained by financial restriction, weak consumer power and the overbuilding of shopping centres and retail warehouses. This has affected the performance and attractiveness of Italian Real Estate Investment Funds.

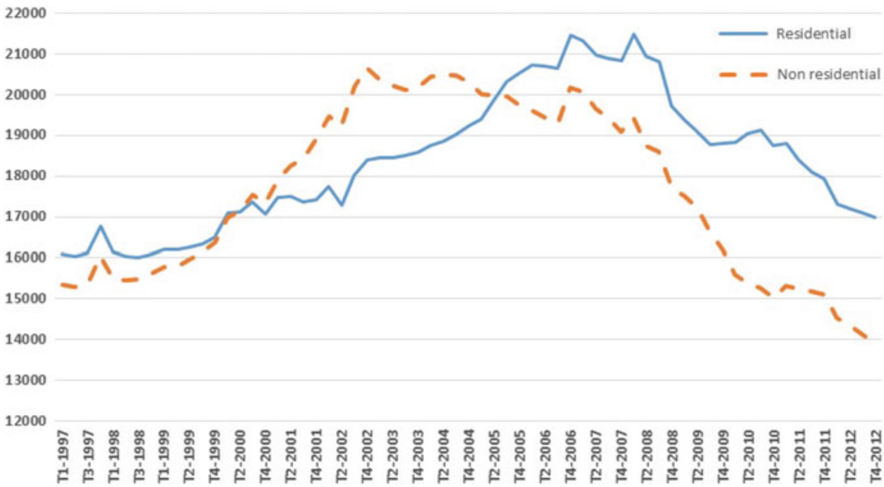

Fig. 11.2 Investment in residential and non-residential sectors – Istat, 1997–2012

11.2 Italian Real Estate Investment Funds

Italian Real Estate Investment Funds were first introduced in January 1994 through Law No. 86, which built upon previous legislation in 1983 and 1993 relating to open-end and closed-end funds respectively (Laws No. 77, 23/3/83 and No. 344, 14/8/93). Known as "Fondi di Investimento Immobiliare",[1] they are pools of assets represented by units and managed on behalf of investors by a SGR (Società di Gestione del Risparmio – Saving Managing Company).

It wasn't until 1998 that the attractiveness of REIFs was realised with the introduction of the D.lgs. 58, 24th of February 1998 (TUF[2]). This amendment repealed Law 86/1994 and redefined the definition of private and public saving within common funds. Prior to TUF, REIFs were much more inflexible. They had to operate within strict parameters relating to the characteristics of the fund, the operational restrictions and the functional scheme of the fund. This proved to be much too prescriptive and was considered an obstacle to entry into the market.

D.L. 351 of 25th September 2001, which became Law 410 of 23rd November 2001, introduced certain modifications to allow greater flexibility in the operation of REIFs. Law 410/2001 was concerned with liquidity in the property market, by introducing rigor and transparency and facilitating the use of public saving in indirect property investment and encouraging the disposal of property by more

[1] Real Estate Investment Funds.

[2] TUF stands for Testo Unico della Finanza. See also Ministerial Decree n. 228, 24th May 1999, Bank of Italy Regulation, 20th September 1999.

institutions. Transfers, buying and selling of properties in conflict of interests[3] were allowed. Other changes were introduced with further new laws[4] permitting funds to have the chance to create a REIF through property transfer, so that the new funds can benefit from an existing portfolio. In the past, this opportunity was a prerogative of public funds only. Different limits to leverage and a new tax system were introduced in order to boost the performance of REIFs in the market. The characteristics of closed-end funds were maintained introducing an element of flexibility with the opportunity to issue new units during the lifetime of the fund. The new funds were more transparent as they allowed investors to know the returns of properties and their valuation.

Law n. 122 dated 30th July 2012 introduced a new definition of REIFs, defined as an independent pool of assets collected from multiply investors (pluralità di investitori), with the aim of investing according to an investment plan. This new law stresses the separation of assets and liabilities of the investment funds from those of the SGRs and of each investors, providing that the fund is liable for the obligations incurred on its behalf by the related SGR.

Different entities are involved in REIFs activities. The SGRs asset management companies are supervised by the Bank of Italy and Consob[5] and regulated by provisions contained in different regulations issued by those two entities, together with the Ministry for Economic Affairs.

The SGR has a legal obligation to maximise the fund wealth and thus, the value of the shares through the active and efficient management of the property portfolio. The SGR is core in the decisions and investment strategies for the fund, it collects financial resources from the investors and buys properties, real estate rights and shares in properties companies according to the regulations. The added value of the fund is returned to the investors, while the SGR is paid a management fee by the funds.

A REIF is not a legal entity but rather a pool of investments held by multiple unit holders. REIF and SGR must be separate entities and the fund's asset cannot be held directly by SGR.[6] Special laws and rules have been introduced in order to ensure this separation and to avoid transactions, which demonstrate conflict of interest. The funds must be deposited with an authorized Bank (called Depository Bank[7]),

[3] Properties in conflict of interests are all properties of equity holders and with other companies that belong to the group.

[4] D.M. 47 of 31st of January 2003 from the Ministry of Economy and Finance, the Law 326 of 24th November 2003, the Law 350 of 24th December 2003, the Law 63/2005, the Law 262/2005 and the Law 266/2005.

[5] Consob: Commissione Nazionale per le Società e la Borsa – Companies and Stock Exchange National Commission, which is the Italian regulatory authority for financial markets.

[6] SGR must be an Italian joint – stock company (Società per Azioni, SPA) which can carry out the activity of management of investment funds complying specific regulatory requirement and upon authorization and supervision of Bank of Italy.

[7] The bank must be an Italian bank or an Italian branch of an EU bank, with professional experience, minimum assets and structure which guarantees an efficient management of the investments.

which carries out each transaction on the basis of SGR's instruction. This Bank is responsible for ensuring the fund's liquidity. The SGR has to prepare fund Prospectus,[8] which contains the operational rules and must be approved by the Bank of Italy before offering the units to the market and the investors,[9] with the exception of speculative funds, whose Prospectus does not need a prior approval.[10] Regulation defines the investors' participation in the fund, rights and obligation of fund's investors as well as the SGR and the depositary bank. The Prospectus sets the investment criteria, thresholds, the type of funds, the duration, the asset allocation, the governance the distribution of earnings, the risk concentration, the procedures for the fund's disposal, and other relevant issues. Moreover, SGR has to provide detailed information on financial profile, income structure and price trend of funds.

There is an external and independent valuation of the real estate held by a fund twice a year.[11] The SGR has to ask experts' opinion about the fair value of property which is going to be sold or bought by the fund. Different laws and regulations in the last decade have tried to introduce rules and best practice guidance in order to support high standards, objectivity and transparency of property valuations,[12] as well as the relationship between valuers and SGRs. There are a very small number of actors undertaking property valuations (Colombo and Marcelli 2009). Indeed, two major property valuation companies are responsible for the 75 % of the market, which may compromise the "independency" requested by legislation. However, fund managers remain completely responsible for real estate valuation and they are not obliged to comply with valuers' reports. The Bank of Italy provides general guidance for real estate valuation approaches.

REIFs are listed on the Italian Stock Exchange and shares are traded in the Market of Investment Vehicles (MIV). A quotation in the stock market is required if the individual share has a price of less than € 25,000. The quotation must be completed by 24 months after the subscription period. The fund length must not be over 50 years while there is not any indication about the minimum length required. REIFs can ask the Bank of Italy for a 3-year extension in order to sell all the properties included in the portfolio.

[8] In Italian "Regolamento".

[9] Regolamento sulla Gestione Collettiva del Risparmio, Bank of Italy, 14/04/2005.

[10] Law n. 122, 30/07/2010 and Law n. 106, 12/07/2011.

[11] See D.M. N. 228 of 24th of May 1999 for valuers' requirements.

[12] See Bank of Italy's Measure, 14th of April 2005; Bank of Italy and Consob Communication, 29th July 2010; Bank of Italy and Consob Communication 29th of October 2007; Assogestioni's Guidelines, 27th of May 2010.

11.3 Characteristics and Assets of REIFs

Italian REIFs can invest in:

– Real estate assets, real estate rights and shares in real estate companies;
– Listed and un-listed financial instruments;
– Bank deposits;
– Receivables and securities embedding receivable and any other asset that is traded and that has a value determinable on biannual basis.

In 2008 SGRs were allowed to invest part of their portfolio in units of other REIFs, both Italian and Foreign REIFs, or in SIIQs.

The principal requirement is that not less than two thirds of their equity should be held in real estate assets, real estate rights and in real estate companies' shares. However, this is rule can be relaxed to not less than 51 % as long as it is countered by holdings of 20 % or more in property related financial vehicles such as securitised properties or real estate rights. The remaining of the equity can be invested in financial instruments (listed or unlisted), bank deposits, receivables, transferable securities, which represent the liquidity of the funds.[13] These limits must be in place within 24 months of issue (or 48 for funds that invest in social housing).

Furthermore, regulations set out the following limitations on the activities of funds in order to guarantee an appropriate level of risk diversification. The fund may not invest, directly or through controlled companies, more than one third of its assets in one single asset; REIFs cannot be engaged directly in building activities though they can have more than 10 % of the equity in the share issued by the same building company.[14]

The amount of debt can be up to 60 % of the value of real estate asset, real estate rights and shares in real estate companies and the 20 % of other assets owned by the fund. The funds, which are not listed, can borrow money up to 10 % of the value of the fund in order to cover reimbursement.

Transfers, buying and selling of properties in conflict of interests are allowed with the following limits. The value of each property must not exceed 10 % of the funds value. The transaction made with shareholders of the SGR cannot exceed the 40 % of the total value of the fund, and the transactions made with the shareholders of the SGR and members of its group cannot exceed 60 % of the value of the fund. During the operation of the fund the value of those transactions are limited to 10 % of the total value of the fund each year. The investor must hold the shares subscribed after a contribution of assets to the fund for at least 2 years and for an amount not lower than 30 % of the value of the assets.

[13] According to Assogestioni, Funds' investments, in 2012, where divided in real estate and real estate rights (90.1 %), shares in real estate companies (2 %), transferable securities and liquidity (5.7 %), others investments (2.3 %).

[14] Bank of Italy, Measures 14th of April, 2005.

Unless the by-laws of the fund prescribe a distribution obligation, a fund has no obligation to distribute its profits during their lifetime. However, the funds are obliged to distribute all the proceeds deriving from their activity at the end of their duration.

11.4 Classification of Funds

Italian REIFs can be classified according:

– Type of investors;
– How funds are established;
– Their management;
– Legal form.

Classification according to investors includes public funds in which every investor could participate to the fund; private funds in which certain "qualified" investors can buy shares of the fund and speculative funds. Public funds, when units can be available to the public, are called "retail funds". The private funds (or "institutional funds") are dedicated to specific categories of investors, qualified for their financial experience of the market as property investors, banks and banking foundations, saving management companies, open-end investment companies (Sicav), pension funds, insurance companies, and other qualified investors.[15] REIFs for qualified investors have looser restrictions in comparison to public funds, as it is assumed that those investors have the know – how and the economic profile to undertake an investment with greater risk. While public funds cannot invest more than one third of the equity in just one property and no more than 10 % of the equity in shares issued by the same construction company,[16] in reserved funds those prudential rules do not apply.

Speculative funds ("hedge funds") are highly risky with relatively few investors. These funds have greater freedom in their decision-making and as long as they operate within certain restrictions, they are extremely flexible. The minimum price for the share is €500,000 and the maximum number of investors is 200. Those funds operate, virtually, with no limitations.

A second classification is based on how funds were established. Ordinary funds (or "blind pool funds") raise money through subscription and then invest in properties; contribution funds (or "seeded funds") acquire properties (real estate

[15] Qualified investors are defined in art. 31 of Consob Regulation 11522/1998. Reserved funds were introduced by D.lgs. 58 of 24th February 1998 (TUF), and are designed only for qualified investors. These are investors and institutions with experience in finance. They could be: banks, management-investment companies (Sgr), pension funds, insurance companies, finance companies, open-end companies and funds, mutual funds and private investors whose skill in financing and trading is recognised.

[16] Bank of Italy, Measure 14th April 2005.

assets, real estate rights or interests in real estate companies) and then sell shares in the funds; mixed if shares are subscribed both with money and with properties.

In addition, under Italian Law there is a more general categorisation of REIFs according to whether funds are created with private property/money contribution or whether funds are created through the contribution of public properties. The funds created with the contribution of public properties are formed by transferring public properties in the ownership of public administration and other public bodies. Public funds have a different structure from private funds created by the transfer of properties and real estate rights. Investors immediately receive shares that can be sold later. The properties transferred must be more than 51 % value of the total fund.

Another classification is founded on different management styles, risk profile and investments. Funds can broadly divided in three main categories:

– Core funds: those are low risk investments, which invest in income producing property with high standard tenants, with long-term contracts, usually in Milan or Rome. They use a low degree of leverage.
– Value added funds involve moderate risk as usually they are characterised by property in need of renovation in order to enhance their income, resulting in higher appreciation that core funds.
– Opportunistic funds mainly focus on buying, developing and selling a property, trading, or other riskier investments. Those funds have a higher degree of leverage in order to generate greater appreciation.

Italian REIFs can have two legal forms:

– Closed-end funds, in which the entire amount of the capital is determined during subscription and cannot be modified. This kind of fund does not allow its investors to sell their units to third parties and the returns are achieved at the end of the period.
– Semi closed-end funds are allowed to increase or modify their value by issuing new shares, according to specific requirements (shares must be subscribed within 18 months after the subscription period). This form gives investors the right to redeem their units only at certain intervals, or at the end of specific periods, under precise circumstances and amount.

11.5 Taxation Issues

Since 1999, the legal framework has been changed on different occasions, boosting the growth of REIFs. Italian REIFs are fully tax exempt.[17] As they are not subject to IRES (corporate income tax) or IRAP (Regional tax based on productive activities). No withholding tax is charged on income from capital derived by the fund (interests on loans or bonds, or bank accounts, dividends).

[17] Until the year 2003 they were subject to a net wealth tax equal to 1 % on the average net accounting value of the fund. This tax was introduced in 2008 and it was repealed in 2010.

Dividends distributed by funds are subject to a 20 % withholding tax withheld by the SGR. Investors are taxed in a different way after the Law n. 122 dated 30th July 2010 and Law n. 106 dated 12th July 2011, which aim to target a particular group of funds, so-called "family funds" (Bianchi and Chiarera 2012), with a more restrictive fiscal regime. This new tax framework is based on definition of the "plurality of investors". According to the new Law, REIFs are divided in two groups for tax purposes:

– Institutional REIFs;
– Non-institutional REIFs.

The first group includes funds entirely owned by any (or a combination of) public or private institutions, like states of public entities, pension funds and insurance companies, banks and other financial intermediaries, non-profit companies, corporate and contractual SPVs[18] owned for more than 50 % by any of the entities mentioned before. Also foreign institutional investors can invest with the same rules in REIFs, if included in the "White List". All other investors have to invest through the Non-institutional REIFs.

In the tax regime for institutional REIFs, the profits (income and dividends) are subject to a 20 % withholding tax withheld by SGR. Income includes both dividends and capital gains obtained through redemption or sale of units. This withholding tax is considered an account payment for corporate entities and as final payment for all other investors.

The withholding tax, however, does not apply if the beneficial owners of the proceeds are either Italian pension funds or Italian investment funds. Foreign persons that are resident in countries that allow an adequate exchange of information with Italian tax authorities are exempt from such withholding tax. A list of states providing an adequate exchange of information is laid down in a Ministerial Decree.[19] In very general terms, these are the countries that have concluded a tax treaty with Italy and have agreed a fully-fledged exchange of information clause. Profits distributed to investors who are residents in other countries, which have a double taxation treaty, the more favorable treaty regime can be claimed.

Non-institutional REIFs have three different tax regimes according to whether their investors are:

– Institutional investors
– Other investors with more than 5 % of the REIF units
– Other investors with less than 5 % of the REIF units.

For investors with less than 5 % of the REIF units, profits are taxed upon distribution or are tax exempt, according to the same rules applicable to institutional funds (treaty relief is applicable). If the investors have more than 5 % of funds' units the profits are attributed to the investor in proportion to the percentage of

[18] Special Purpose Vehicles.

[19] This is commonly referred as the "White List".

participation in the fund, regardless of its actual distribution. For resident investors, income must be included in the annual taxable income and taxed on the basis of the investor's tax regime.

Other indirect taxes are applicable to the real estate investments, as, for example, Property Tax IMU (Municipal tax, at a rate of 0.4–0.7 % of the cadastral value), 21 % VAT, in general, depending on the type of real estate and on individual circumstances, mortgage and cadastral taxes.

11.6 Italian Real Estate Funds and Market Structure

Growth in the number of funds since 1999 has been rapid and at the end of December 2012, there were 201 REIFs in Italy run by 24 different SGRs with an overall investment value is €25.53 M (Fig. 11.3) representing a growth of 0.4 % in comparison to the previous year (but a reduction of 1 % in comparison to June 12). After a constant growth during last decade, the market is now stable. Real estate funds are about 10 % of the total Italian investment market making Italy the third European market,[20] after Germany and Holland, with the 11 % of the market. However, the size of Italian funds is relatively small, with 95.5 % of the funds having a net asset value below €600M and 24 funds below €100M.

Italian real estate funds have targeted both private and institutional investors. Of the 201 REIFs registered at the end of December 2012, 22 of the funds are open to all investors representing 11 % of market, while 179 are reserved for only certain qualified investors taking 89 % of the market (Fig. 11.4). During 2012, 22 new funds were introduced into the market, but those funds are only for qualified investors while the last REIF for public investors was introduced 5 years ago. Also, the number of those funds is declining due to the closure of some funds. In essence, the history of REIFs in Italy can be divided in two periods: from 1999 to 2005 when the market was dominated by retail funds, and the following period, when the funds for qualified investors sharply increased in number.

Another important issue is the growth of funds with the contribution of a property portfolio (Fig. 11.5), over-taking in 2006 the funds by subscriptions. Indeed, the former now represents 80 % of the total market.

Speculative funds (hedge funds), which were introduced in 2005, represent 25 % of the market, with a NAV of €1,300M and about the 20 % of the leverage of the market.

The main differences between private and public funds are summarised below.

– Public funds (16 out of 22) are mainly funds with subscriptions, while private funds are constructed with property portfolio contributions (152 out of 179).

[20] Scenari Immobiliari, *I fondi Immobiliari in Italia e all'estero*, 2012.

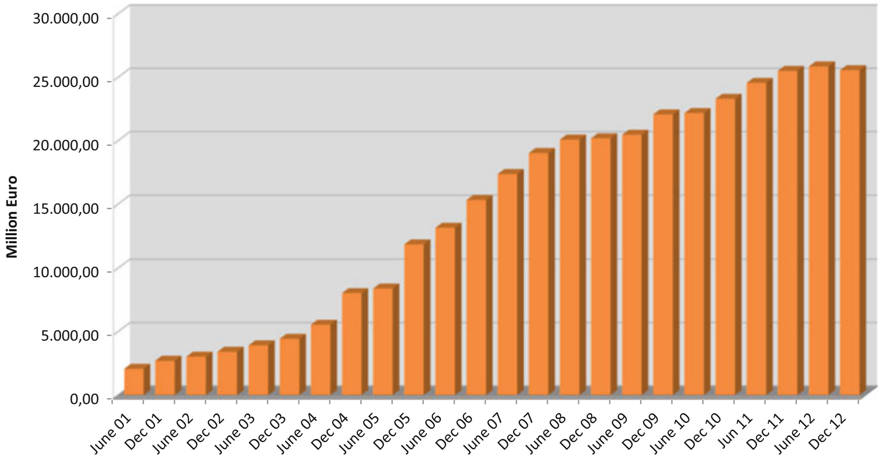

Fig. 11.3 The evolution of Italian REIFs 2001–2012

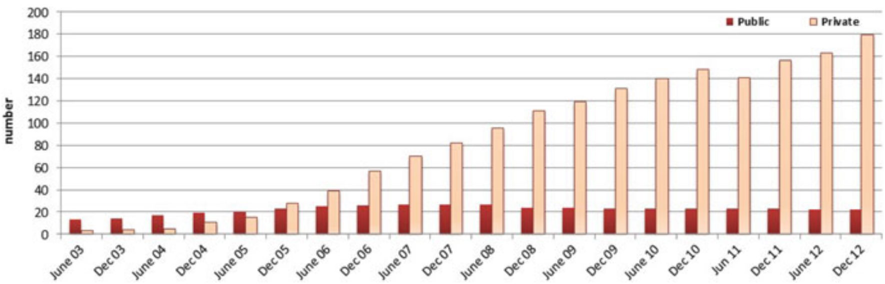

Fig. 11.4 The growth of the number of private REIFs 2003–2012

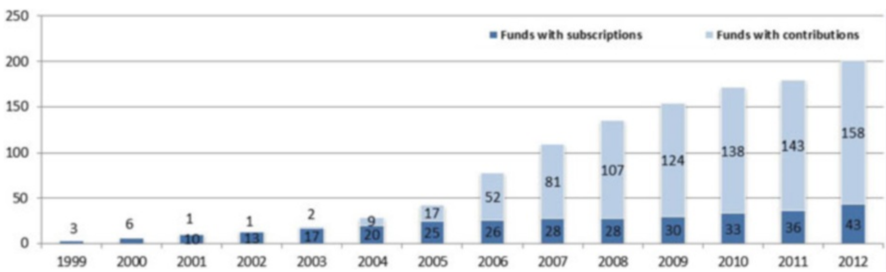

Fig. 11.5 The growth of the number of the funds created with property contributions

– Private funds (132 out of 179) are semi-closed funds[21] or (drawdown funds), which is possible only for 4 or 22 public funds.
– Portfolio composition: 48 private funds and 11 public funds have more that 60 % of their portfolio invested in offices.
– The total assets of public funds (retail) and private funds are diminishing.

The majority of the REIF vehicles in the Italian market are characterised by conservative management strategies. They tend to concentrate on a sector allocation in offices and retail. In other countries, where REIFs are well-recognised investment vehicles, there has been a natural segregation of fund types with specific funds concentrating on particular geographic areas, particular property sectors, development and regeneration or specific investment strategies. These have provided investors with a good alternative to the traditional REIFs. Many funds have exposure to real estate development, with a higher risk especially during the property market downturn.

As of December 2012, REIF allocation was 89.2 % by value invested in direct properties with the remaining amount split between liquid funds and indirect investment in property companies: €41,724M represented the total assets before the deduction of liabilities; the corresponding properties NAV was €37,208M. The activity mix of REIFs is mainly reserved to property and real estate rights, which are of increasing importance in the funds. There is poor diversification in all fund types. The majority of funds invest in offices, followed by retail and residential property (Fig. 11.6). The residential allocation has been boosted by the introduction of exclusive residential funds and those which invest in social houses. Investments in the industrial sector have been reduced in the last few years.

According to Assogestioni (2012), the part Italy with the greatest focus of REIFs (Fig. 11.7) is the North West (45.6 %), followed by the Centre (32.8 %), the North East (11.5 %) and South (8.2 %). Foreign investments are only 2.1 % and have fallen (in relative terms) with the increase in new domestic investments. REIFs invest abroad mainly in France, Belgium, UK and Germany.

The need to diversify more fully is the main issue for Italian funds, from the regional asset allocation perspective but especially in terms of sector allocation. Currently the funds seem to be poorly diversified and prone to risk with investments concentrated mainly in offices in Milan and Rome, the financial and the administrative capitals of Italy, and in trophy buildings, located in the best locations in these cities.

In December 2012 funds leverage was moderately lower in comparison to 2011 for public funds (€2,403M) while leverage has grown for private funds (€13,049M). Private funds had used 67 % of their possible leverage, while public funds use only 60 % of the possible leverage (Fig. 11.8).

[21] A semi-closed end fund allows an increase in the value of their initial capital by issuing new units.

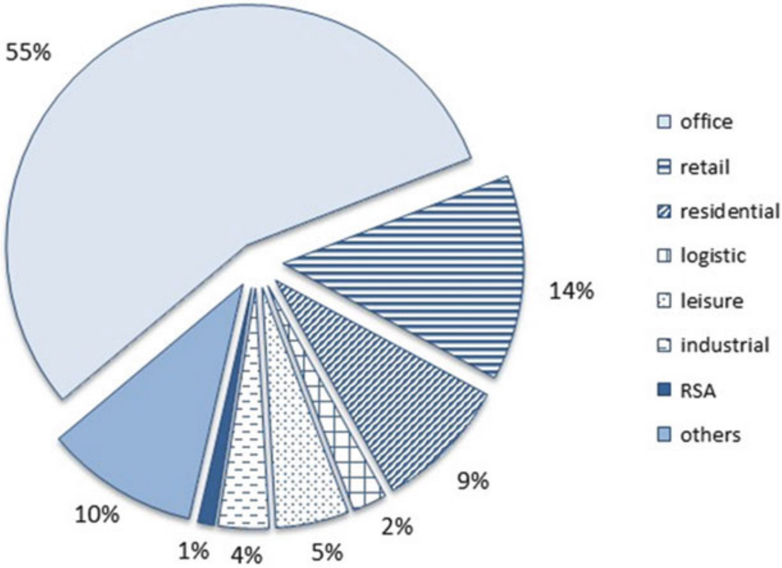

Fig. 11.6 Sector asset allocation in the REIFs, Assogestioni, 2012

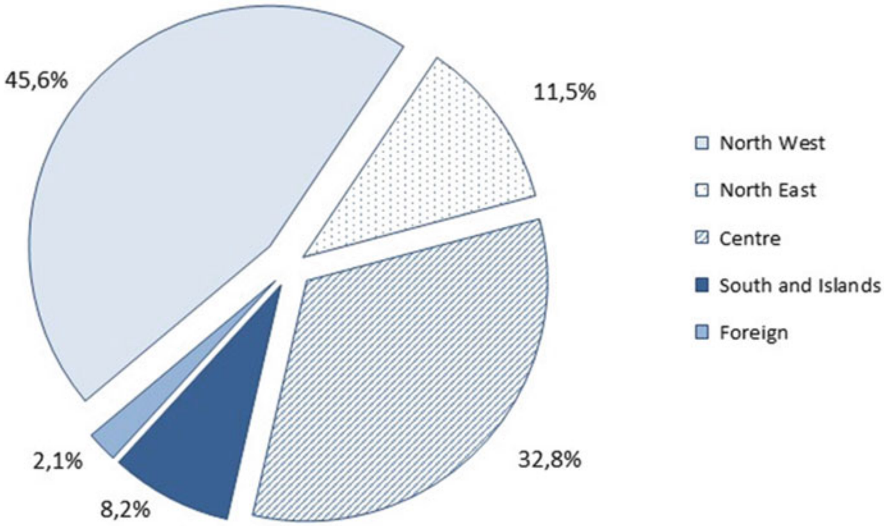

Fig. 11.7 Regional asset allocation in the REIFs, Assogestioni (2012)

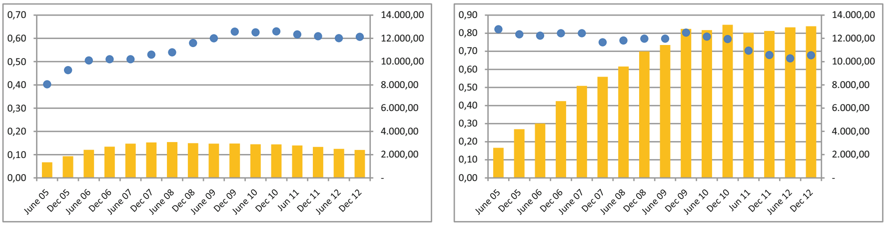

Fig. 11.8 Leverage and use of leverage – Assogestioni, 2012

11.7 Indexes and Transparency

The Italian market has experienced significant growth in transparency from a relatively low base level, largely due to REIFs. Within the Jones Lang LaSalle Global Transparency Index 2012, Italy, after a significant improvement in its transparency between 2004 and 2008, is now struggling to improve real estate transparency. The real estate transparency index in 2012 for Italy is 2.16[22] and is currently 20th in the index (below other European Countries as UK, the Netherlands, France, Switzerland, Germany, the Scandinavian countries, Ireland and Spain). The main issue is a paucity of available information at a national and local level and despite the progress made in the last decade, much needs to be done. In terms of corruption perceptions, Italy has a very low Index with more attention needing to be paid to the requirement for robust regulatory and legal frameworks, as well as transparency in real estate transactions. Performance indexes were introduced in 2000 by IPD,[23] and there is now three different indexes, namely the Annual Property Index,[24] the Biannual Property Index[25] and the Biannual Property Fund Index,[26] which were respectively +1.5 %, +0.5 %, −3.7 % on 31st of December 2012. The Property Fund Index (Fig. 11.9) showed a total return of −5.8 % for the full 2012, the second consecutive negative result and the lowest return in the index series.

The IPD Fund Index during 2012 showed a poor performance in comparison to equities (+13.3 % in the first half year and +11.7 % in the second half), bonds (+13 % in the first and +24.8 % in the second semester) and real estate equities

[22] Index goes from 1 (Highly Transparent market) to 5 (Opaque market).

[23] IPD – Investment Property Database, a UK based performance measurement company that has established indexing services in the UK (since 1988) and other countries around the world.

[24] The IPD Italy Annual Property Index measures ungeared total returns to directly held standing property investment from one open market valuation to the next.

[25] The IPD Italy Biannual Property Index measures ungeared total returns to directly held standing property investment from one open market valuation to the next.

[26] The IPD Italy Biannual Property Fund Index measures geared and ungeared fund total returns from one open market valuation to the next and analyses 42 funds with a Net Asset Value of 7.7 Million Euros.

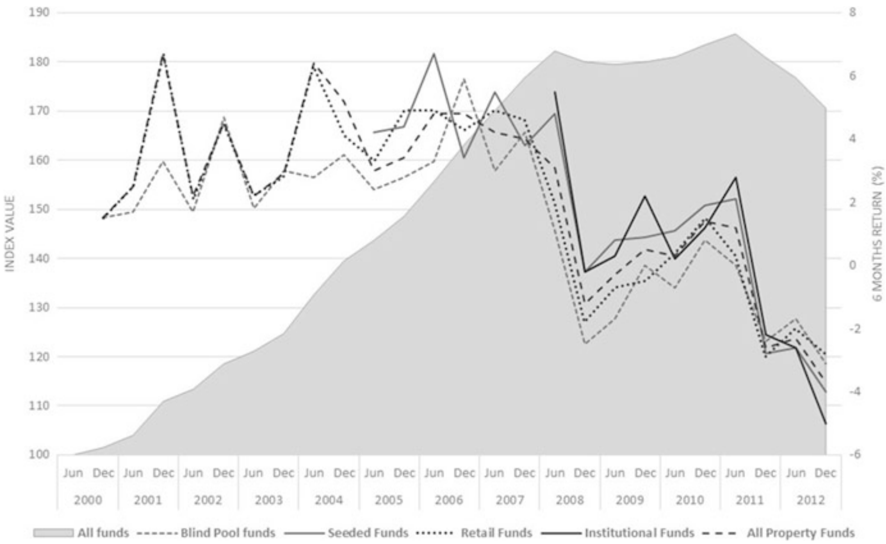

Fig. 11.9 IPD Property Fund Index, IPD data, December 2012

(+29 % and +27.7 %, first and second half year figures respectively). Nevertheless, in the long term, the 5-year annualised performance of funds measured by the IPD index showed a −0.8 %, compared to −11.4 % of equities and −20.4 % of real estate equities. During this period, only bonds recorded a positive performance with 6.2 %.

A further Property Fund Index, IFI, – Indice dei Fondi Immobiliari (Property Fund Index), provided by Trading System, considers the listed REIFs in MIV (Investment Vehicles Market) since December 2001.[27] This is a value weighted all share index, which shows the daily performance of property funds shares, weighted on their stock capitalization (factors in the size of the company). In total, 22 listed funds are included in this Index. The Paribas REIM Index is a value weighted all share index, founded in December 2002, shows the trend of these listed REIFs with an asset value of €1.900M, while the Paribas REIM DTN analysed the NAV discount of these funds (Fig. 11.10). They both consider the share price variation, the dividends and capital share refunds.

In 2012 the economic crisis affected all sectors, including the property market and also property funds. As shown by different indexes, the performance was very poor, and listed REIFs showed a performance of – 23 % in the listed market. At the beginning of 2013, the performance of listed REIFs turned positive, due mainly to the poor performance of bonds and a renewed interest by investors.

[27] The TradisSystem has also IFI – TR, Total Return Property Fund Index. It compares the different management of property funds, which reinvest the dividends.

Fig. 11.10 Reim Dtn – BPN Paribas, December 2002–March 2013

11.8 Characteristics of Italian REITs

The Budget Law for 2007 (Law n. 296, 27th December 2006) and then Law n. 174, 7th September 2007 introduced rules for Italian listed real estate investment companies, a new type of real estate investment vehicle, on the model of Real Estate Investment Trusts. The tax exemption regime for joint-stock companies can be applied to all companies, which are listed on the Italian capital markets and mainly performing real estate activities. The legislation requires companies to be registered as "Società di Investimento Immobiliare Quotate" (SIIQ, Listed Real Estate Investment Companies). The nature of Italian REITs does not differ from other countries; they are listed property companies with tax advantages, owning and letting income-producing properties.

In general terms, an Italian company[28] with its main activity letting properties and which meets the conditions may be subject to a special income tax regime.[29] In order to qualify as a SIIQs a company has to be a joint-stock company incorporated under Italian company law and resident in Italy, mainly performing property-letting activities. The companies must be listed on the Stock Exchange and decide for the

[28] It could be an Italian permanent establishment of an EU real estate company whose shares are listed on a regulated market.

[29] SIIQ Regime.

SIIQ regime by the expiry date of the financial year preceding that in which the SIIQ Regime will apply. Such an election is irrevocable. The value of the leased properties in SIIQs must represent at least 80 % of the assets of the company[30] and the incomes from property rental activities must be at least 80 % of total revenue in each fiscal year.

The SIIQ's shareholders cannot directly or indirectly own more than 51 % of the voting rights and more than 51 % of the of the profit sharing rights. At least 35 % of the SIIQ shares are held by shareholders, which cannot directly or indirectly own more than 2 % of the voting rights or 2 % of the profit sharing rights. Finally, at least 85 % of the profit from the rental activity must be distributed to the shareholders. If the total net income is lower than the income coming from rental activity, then the 85 % can be applied to the distributable profit. The SIIQ must keep separate books for the rental activities and for all other activities and it has to disclaim in its financial statements the criteria used for the allocation of the costs to rental and the other activities.

SIIQ status may be subject to a capital gain, as the assets of companies applying for the regime will step up to the market value as of the closing date of the previous financial year (in which the ordinary tax regime is applied). The capital gains, net of losses, arising from the transfer will be subject to a 20 % substitute tax. This particular tax regime is applied only if the properties are held for at least 3 years. At the taxpayer's option, the market value can be used as the new book value of the SIIQ. If the option is not exercised, the gain will be considered to be from activities other than rental activities and taxed according to ordinary rules. The SIIQ is exempt from corporate income taxes, both a national and regional level, for the income retained from the rental activity. All the other activities are subject to the ordinary tax regime. SIIQ companies can benefit from an income tax exemption from corporate income taxes, IRES, and various regional taxes, such as IRAP, though subject to possible regional surcharges.

The company has to distribute, each year, at least 85 % of the income coming from the rented properties. If the distributable net profit is lower that the profit yielded in the rental activity, such percentage applies to all distributable profit. At shareholder level, the income coming from the distributions of the SIIQ is subject to a 20 % withholding tax. This rate is reduced to 15 % for the residential properties rented according Law 431/1998. Withholding tax is levied as a definitive payment or as advance payment of taxes due, depending on the status of the investor.

Withholding tax, however, does not apply if the shareholder is an Italian pension fund; an Italian investment fund; or if the income is part of the results of individual management of portfolio. Tax losses suffered from the company in the financial year before the SIIQ regime can be used to offset the taxable base of the substitute

[30] The concept of 'real estate properties' includes interests in SIIQs or Non-Listed SIIQs that qualify as long-term assets according to article 11(2) of Decree 28 February 2005, no 38. Dividends on the mentioned interests in SIIQs, which are paid out of profits relating to the real estate lease activity, qualify as revenues derived from the real estate rental activity.

tax due to the increasing value of the assets and income derived from the activities, other than the exempt rental activity. Any capital gain due to the contribution of properties in exchange for shares in the company can be subject to the ordinary tax or to a 20 % substitute tax, at the choice of the taxpayer. In the latter option, the receiving company must hold the properties for at least 3 years.

The Law does not provide for any specification for the minimum value of the real estate properties owned by the SIIQ, the level of the debt raised or the mix between commercial and residential properties.

In Italy, there are only eight SIIQs with a market capitalization of €559M (May 2013). The reason for their unsuccessful introduction into the market were, among the others, an unclear legal framework as some specifications are not yet provided, the tax regime is not efficient with a general indifference for this listed investment vehicle. The limits significantly restrict the possibility of creating a SIIQ and the diffusion of this investment vehicle in Italy.

11.9 Conclusions

The significant growth of REIFs during the last 15 years showed their potential as a successful investment vehicle. However, due to the liquidity of the financial instrument and the crisis of the market, at the moment funds represent an opportunity only for institutional investors (banks, pension funds, insurance companies) looking for a balance between security of capital and good opportunities of income growth. In the last few years, no new retail fund was launched in the market, and only funds for qualified investors have shown a constant growth.

REIFs have some advantages of portfolio diversification, low risk of vacancy and efficient management, tax deduction in comparison to direct investment. The REIFs that sell into the market a portfolio of property already prepared (instead of buying products after the placing of shares) has brought advantages of the allocation of liabilities and tax deduction. REITs introduced, in the real estate market are characterised with more transparency, more efficiency and higher standards.

Despite the advantages of creating a plausible property backed asset, there are a number of factors that have hindered the increase of REITs in Italy. There is a lack of visibility, as in the first stage, the funds issue shares and then buy properties. Thus, the investors invest blind as they don't know the characteristics of the portfolio and the properties included. The secondary market is poorly developed with a lack of liquidity (about 1 % of the market capitalisation) caused by a small number of trades which can have a distorting effect on price formation mechanism, and also led to high discount between market values and net asset values. Exchange is very rare in the market; only investors who need liquidity are trying to sell their units. The market value discounted from the NAV is between 12 % and 77 % and the performance, for 2012 and as reported by Bloomberg, was negative for all funds (Fig. 11.11).

	Funds	Market Cap (€M)	Due date	% Market Cap	Price	Nav/share	Discount	1 month	YTD	1 year	Performance 2012
1	AEDES BPN INVESTIETICO	87,89	2015	4%	1449,00	2534,00	-42,8%	2,36	16,18	12,94	-34%
2	AMUNDI RE EUROPA	89,58	2016	4%	757,00	2116,00	-64,2%	-3,56	20,3	7,69	-27%
3	AMUNDI RE ITALIA	64,99	2016	3%	979,50	2306,00	-57,5%	-1,65	20,07	-1,65	-30%
4	BENI STABILI IMMOBILIUM 2001	39	2017	2%	1533,00	4249,00	-63,9%	1,26	15,29	-11,76	-38%
5	BENI STABILI INVEST REAL SECURITY	56,68	2013	3%	1002,00	2226,00	-55,0%	-1,66	2,34	8,88	-61%
6	BENI STABILI SECURFONDO	68,04	2014	3%	1134,00	2203,00	-48,5%	-6,51	7,34	5,74	-31%
7	BNL ESTENSE GRANDE DISTRIBUZIONE	163,94	2013	8%	1980,00	2656,00	-25,5%	4,71	27,2	14,95	-11%
8	BNL IMMOBILIARE DINAMICO	89,77	2020	4%	61,70	239,00	-74,2%	-3,79	1,67	-28,31	-26%
9	BNL PORTFOLIO IMMOBILIARE	119,25	2013	6%	977,50	1537,00	-36,4%	1,66	21,12	41,63	-45%
10	DB VALORE IMMOBILIARE GLOBALE	45,97	2014	2%	1490,00	3940,00	-62,2%	-0,27	-11,88	-6,09	-26%
11	IDEA FIMIT ATLANTIC 1	127,46	2013	6%	242,00	539,00	-55,1%	1,96	49,03	12,26	-1%
12	IDEA FIMIT ATLANTIC 2 BERENICE	99	2015	5%	165,00	360,00	-54,2%	-5,82	10,97	29,03	-46%
13	IDEA FIMIT FONDO ALPHA IMMOBILIARE	97,95	2015	5%	948,00	3701,00	-74,4%	-8,85	-10,4	-34,62	-30%
14	IDEA FIMIT FONDO BETA IMMOBILIARE	89,94	2015	4%	335,10	548,00	-38,9%	9,91	8,85	24,22	-31%
15	IDEA FIMIT FONDO DELTA IMMOBILIARE	61,71	2014	3%	29,50	97,00	-69,6%	1,63	-1,38	-1,77	-32%
16	INVESTIRE IMMOB OBELISCO	43,69	2015	2%	638,50	1914,00	-66,6%	-6,24	1,27	-2,44	-23%
17	MEDIOLANUM RE A	36,04		2%	3,40	6,00	-43,3%	13,34	7,94	-	0%
18	MEDIOLANUM RE B	202,88		10%	3,18	4,00	-20,5%	-3,61	-13,76	-	0%
19	OLINDA FONDO SHOPS	55,19	2014	3%	105,20	465,00	-77,4%	-3,78	-4,22	-33,21	-4%
20	POLIS FUND	85,33	2015	4%	661,50	2011,00	-67,1%	-1,05	9,26	-3,5	-26%
21	RISPARMIO IMMOB 1 ENERGIA	28,32	2018	1%	5900,00	6753,00	-12,6%	-10,67	-13,87	-29,17	-26%
22	TECLA - FONDO UFFICI	96,34	2014	5%	149,00	356,00	-58,1%	7,77	-4,09	-26,39	-48%
23	UNICREDITO IMMOBILIARE 1	227,04	2014	11%	1419,00	3013,00	-52,9%	-0,21	4,48	-3,37	-22%
24	VEGAGEST EUROPA IMMOBILIARE 1	45,97	2014	2%	430,10	1537,00	-72,0%	-0,27	-11,88	-6,09	-37%

Funds which asked for an extension period
Performance: Bloomberg data

Fig. 11.11 Listed REIFs, capitalisation, NAV, discount, performance

In 2012, income returns have been reduced by a constant growth of maintenance and management costs and introduction of new taxes. From the investor's point of view, there is uncertainty of the returns due to a general reduction of incomes.

REIFs are exposed to different type of risk. Property, economic, and liquidity risks are interconnected and associated with credit market conditions and financial constrains. Hence, the market downturn has affected the performance of REIFs.

Moreover, due to a flat rate transfer regime for funds liquidated before 2011, a certain number of funds have sought to dispose of their portfolio during the downturn of the property market, characterised by small number of transactions, illiquidity and scarcity of financing. During 2013–2015 circa 12 listed funds, owing approximately €2.7 BM of assets, will each reach their maturity and will liquidate a great number of properties. Central and local governments and authorities will sell their assets in the next 5 years in order to reduce the public deficit. Banks will be also disposing in the future, their real estate assets, according to their de-leveraging process. Due to this likely forthcoming over supply in the market, it is possible that the assets of the real estate funds will be re packed in other funds, with longer life, or within new funds or new vehicles.

REIFs still represent an opportunity for institutional and qualified investors, while retail funds for smaller investors are disappearing from the market. Funds could be an interesting opportunity for international investors, but the economic crisis and the uncertainty in the Italian market are not attracting those players. Furthermore, funds and SIIQs, due to the credit crunch and economic crisis, are not investing in new developments. Nevertheless, funds could still be an opportunity for public property disposal in the ownership of public administration and other public bodies.

Despite good performances showed in the first quarter of 2013, as the market is still struggling, investors are not currently seeing any future for SIIQ and for REIFS.

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