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The Italian Alternative Investment Market

Key market trends in private equity, private debt, and real estate

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Introduction

Published in 2019, the preceding paper, "*The Italian asset management industry and the trends impacting its future*", came at a fascinating point in the asset management industry's evolution. Still recovering from multiple financial crises, including the European sovereign debt crisis, the Italian macro-environment was defined by political and economic instability. The paper aimed to highlight the self-described pillars of the asset management industry in Italy: demographic trends, regulation, technological developments, and the growing awareness of environmental, social and corporate governance (ESG) investing.

A critical trend explored was the impact of technology, also known as tech. Compared with the US market, the Italian market's lagging behavior led to the prediction that it would eventually gain ground. This prediction bore fruit as the COVID-19 pandemic acted as a catalyst for pre-existing tech trends, which we analyze in this paper. In particular, social distancing measures forced the adoption of new technological solutions. The tech industry features more prominently in this paper than in the preceding one, highlighting private equity funds' growing pursuit of the next tech company unicorn. Recent surges in the initial public offering (IPO) and funding round valuations of tech startups underscores this trend's pervasiveness and continuing relevance in the current market.

Similarly, the special purpose acquisition company (SPAC) boom in the United States, with US$55.2 billion (EUR46.5 billion[1]) raised in 2020, is expected to fuel this tech startup surge even further.[2] However, the recent crackdown by the US Securities and Exchange Commission (SEC) and the subsequent slow-down in activity could see this trend go either way in the coming months.[3]

ESG's final pillar is again a central topic today. The previous paper explored the tangible and intangible benefits to companies that focus on ESG. In 2020, ESG funds outperformed their parent benchmarks; assets under management (AUM) in active sustainable funds spiked by 45%, and AUM in passive sustainable funds by more than 80%[4].

The preceding paper briefly mentioned the rise of private markets and, in particular, the private debt and private equity funds that are the focus of this paper. In fact, it highlighted the two driving factors of the private market's rise: the passive investing trend and asset managers' struggle to generate the alphas to justify their environment where the "'search for yield' now drives investors"[5], these alternative investments will play an increasingly important role. Based on the previously mentioned premises, this paper aims to analyze alternative asset classes in Italy and, in particular, to provide an overview on ESG investing, technology, and the consequences of and subsequent reaction to the COVID-19 pandemic.

[1] The USD/EUR rate consistently applied in this paper is 0.8423 (as of 6 April 2021).

[2] Melvin Nusbaum, US Spac boom lures UK tech companies in blow to London, *Financial Times*, 26 February 2021.

[3] Lizzy Gurdus, Disinterest driving the SPAC slowdown is misplaced, money manager says, 1 May 2021.

[4] Attracta Mooney and Patrick Mathurin, "ESG funds defy havoc to ratchet huge inflows," *Financial Times*, 5 February 2021.

[5] Bank for International Settlements, *BIS Quarterly Review, December 2020*, 7 December 2020.

Alternative assets are on the rise amidst economic turmoil

Alternative assets are booming, as investors increasingly look to other sources of returns and diversification. Recent studies by Preqin estimate that global AUM across alternative investment classes have reached EUR9.64 trillion in June 2020 after a period of solid growth with a compound annual growth rate (CAGR) of 10.92% since 2010 and a predicted CAGR of 8.43% by 2025[6].

The growth of AUM in alternatives has significantly outpaced the growth of the global gross domestic product (GDP), with a CAGR of 2.81%[7].

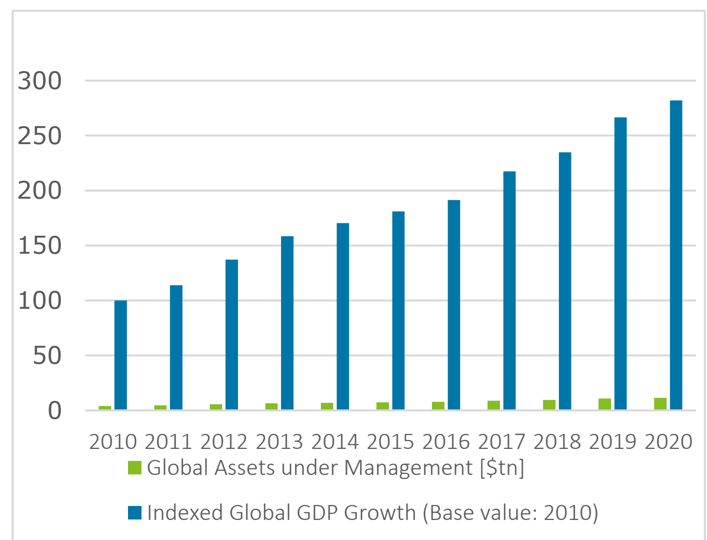
A superabundance of capital drove the shift to alternative asset classes, as investors seek opportunities with above-average returns in the ongoing low-interest-rate environment.[8] Moreover, hung deals, distressed companies, and additional mergers and acquisitions (M&A) activity offer solid returns for investors willing to provide liquidity.[9]

"Alternative assets are booming, as investors increasingly look to other sources of returns and diversification."

Future growth will mainly be driven by Asian markets as the world's economic center shifts eastward.[10] However, Europe is expected to offer abundant opportunities for the alternative investment industry. Additional regulations enacted after the global financial crisis of 2007–2008 (GFC), such as the Basel III and IV regulatory frameworks, will continue to reduce the amounts lent by banks to mid-market companies. As a result, these companies will seek alternative sources of capital.[11]

In its aim to investigate the trends shaping the alternative investment class, this paper focuses on the private equity, private debt and real estate markets, which are expected to be the most robust growing alternative investments in Italy.[12]

Global Alternative AUM vs GDP growth



Source: Preqin

[6] David Lowery, "*Future of Alternatives 2025: Preqin Forecasts Alternative AUM Growth of 9.8% through to 2025*", Prequin, 4 November 2020.
[7] The World Bank, "GDP (constant 2010 US$)", accessed 14 July 2021.
[8] AIFI, 2020 Il Mercato Italiano Del Private Equity E Venture Capital, 2020.
[9] Benefit Street, COVID-19 and the Private Debt Market, July 2020.
[10] Preqin, Alternatives in 2021, 4 February 2021.
[11] Blackrock, "European Middle-Market Private Debt", January 2018.
[12] Lowery, "Future of Alternatives 2025,".

Macroeconomic outlook

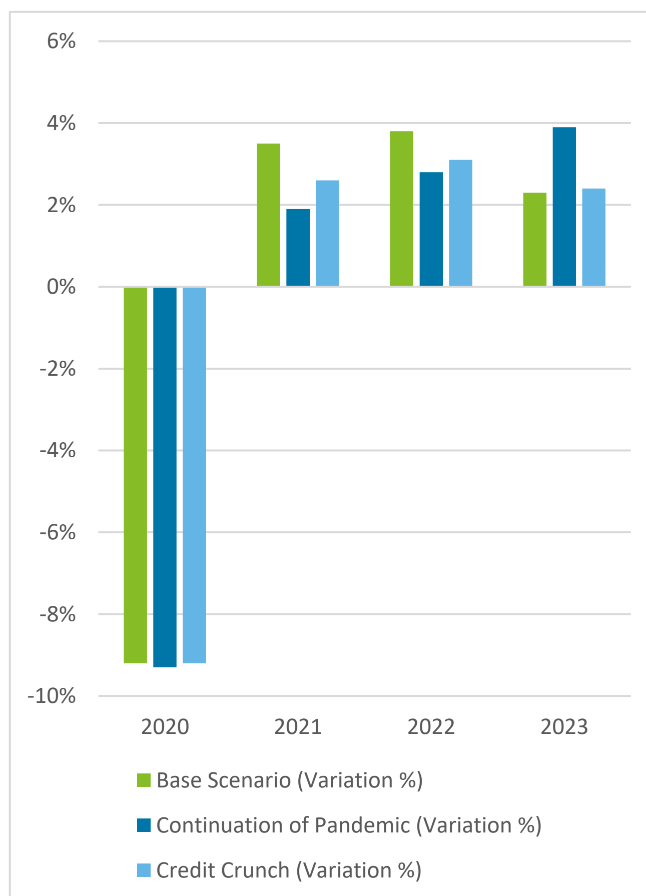
The pandemic ravaged the global economy. However, strong economies (such as the United States, China, and the United Kingdom) are already rebounding significantly, with their economic activity expected to return to pre-pandemic levels shortly.

However, there is widespread academic consensus in Italy that the Italian economy tends to never entirely overcome economic crises due to its slow-growing nature. Italy only emerged from the GFC-induced recession in 2015, and even then, its reported GDP lagged 4% behind its pre-crisis level[13].

The Italian GDP contraction was less severe than previously forecasted. After the huge fall in Q2 (-12.9%) and rebound in Q3 (+15,9%), the Italian economy's slowdown was less intense (-1.8%) than forecasts expected in the face of a COVID-19 second wave.[14]

In its forecasts, Bank of Italy considered three possible scenarios based on different durations of the pandemic and highlighted their respective growth expectations. In the base scenario, Bank of Italy assumed that the pandemic would be under control by H1 2021 and finally overcome by 2022. Under this hypothesis, the scenario forecasted a considerable rebound over the next three years (3.5% in 2021; 3.8% in 2022; and 2.3% in 2023) after a 9.2% contraction in 2020.

Banca d'Italia: Italian Macroeconomic Projections of Real GDP



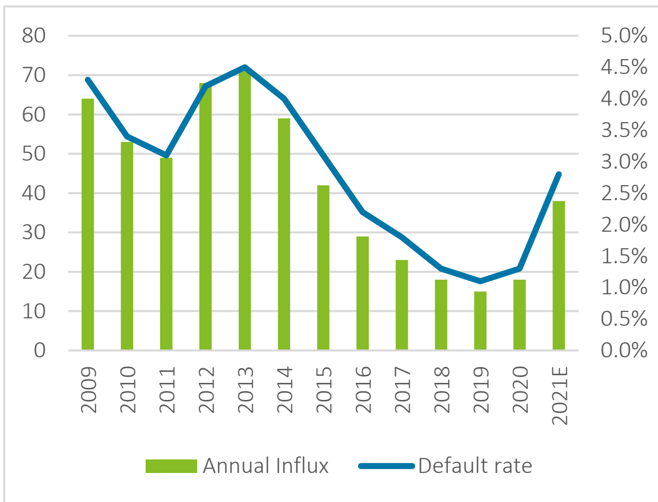
Source: CBRE Capital Advisors

A further potential hindrance to the Italian economy's recovery is represented by future growth in the stock of non-performing loans (NPLs). In previous financial crises, these assets have significantly distressed banks' balance sheets and hampered their ability to provide credit to the economy. The years following the sovereign debt crisis showcased a steady decline in the stock of non-performing exposures (NPEs). However, forecasts predict a significant rebound to EUR38 billion in 2021.

[13] Nordea Trade, "The economic context of Italy – economic and political overview," accessed 14 July 2021.

[14] I.Stat, "Gross domestic product, expenditure components and contribution to GDP growth," accessed 14 July 2021.

Impaired Credit - Annual Influx and Default Rates



Source: CBRE Capital Advisors

On 13 February 2021, Mario Draghi, the former president of the European Central Bank (ECB), became Italy's prime minister. Morgan Stanley forecasted that Draghi's appointment would boost the country's financial markets, thanks to an increased stability and confidence in Italian institutions.

Italian-German 10-year yield spread

Source: CBRE Capital Advisors

The COVID-19 crisis

The lockdowns and subsequent drop in consumption have allowed Italian households to double their gross savings from 8% to 19%[15]. On a global level, a New Policy Institute study estimated that, with luxury shops and holiday destinations closed, the richest 20% in the United Kingdom saved a total of GBP23 billion (EUR27 billion) during the first lockdown. This savings growth among the richest provides a pool of liquidity that will need to be invested elsewhere, consequently leading to increased demand for alternative investment opportunities.

Moreover, aid provided by the European Union sets the foundation for a major effort to repair the economic and social damages caused by the crisis, by creating a greener, digital and more resilient post-COVID-19 Europe to tackle current and future challenges.[16] These aims and those of the wider Euro-area coincide with recent trends in the alternative investments market: the creation of instruments that enhance sustainability and technology.

“The lockdowns and subsequent drop in consumption have allowed Italian households to double their gross savings from 8% to 19%”.

[15] Laura Serafini, "Le famiglie italiane reggono alla crisi, complici i risparmi dovuti al lockdown," *Il Sole 24 Ore*, 29 October 2020.

[16] European Commission, "Recovery plan for Europe", accessed 14 July 2021.

Market outlook

Investors seeking stability during the COVID-19 pandemic rushed to US treasuries to secure safe assets. Therefore, as bond prices grew, bond yields hit all-time lows, with the 10-Year Treasury falling to a minimum of 0.52% on 9 August 2020.[17] Turning to the equity market, after the sharp 35.4% drop between February and March 2020, the S&P 500 gained 75.3% from its low on 5 April 2021. The FTSE Mib experienced a similar trend with a fall of 44.5% followed by a gain of 62.3%. However, the rapid surge in prices raises questions about whether the current market is overvalued. The Shiller P/E ratio for the S&P 500 was at 35.17 (as of 26 March 2021), which is significantly higher than the peak level of around 26 reached before the GFC, but still far from the dot-com bubble peak of 44.2.[18]

The current high level is explained by historically low levels of interest rates. When these rates are applied to discounting firms' future cash flows, they lead to increased valuations. With momentum trading gaining in popularity among investors, a market downturn could possibly be aggravated. As a result, there are many uncertain factors in the equity markets, making alternatives a noteworthy option for investors.

"Investors seeking stability during the COVID-19 pandemic rushed to US treasuries to secure safe assets."

[17] US Department of the Treasury, Daily Treasury Yield Curve Rates.

[18] Yale - Robert Shiller, Online stock market data, February 2020.

Private equity

A summary of the market in Italy

In Italy, there were 155 entities active in the private equity sector in 2020, of which 53% were foreigners. At the end of 2019, the total value of private equity projects in Italian investors' portfolios was EUR15 billion, while the figure for foreigners amounted to EUR22 billion.

The private equity market in Italy has grown considerably over the past 10 years, with total operators increasing by 121%. However, the sector is still underpenetrated and in terms of operators, transactions and AUM, far from the levels seen in France, Germany, Spain and especially the United Kingdom. Several peculiarities have stymied the growth of private equity in Italy, such as the reluctance of the Italian family business system to open its equity capital to private funds.[19]

The main characteristics of the Italian private equity market

Sectors served by Italian private equity companies

From 2014 to 2018, the biotech, healthcare, computer and electronics (BHCE) sector averaged around 35% of the total private equity investments made in Europe, but accounted for just over 20% in Italy. These differences were offset by Italy's higher share of investments in energy and environment (35% compared with 20% in Europe).

In 2020, there was a total of 370 private equity investments operations in Italy, the majority in information and communications technology (ICT, 17.3%) and industrial goods and services (15.4%). Other important industries include healthcare (13.2%), retail (9%), food processing (7%), and biotech (6%).[20]

Structural differences compared with Europe, and development since the GFC

From 2014 to 2018, the Italian economy represented around 11% of the total European GDP. However, over the same period, private equity capital raised by Italian funds amounted to only 3% of the total capital raised in the European Union. And, private equity investments in Italian firms amounted to 7.2% of the European Union's total. Interestingly, there appears to be marked regional differences within Italy. In 2019, the Italian Private Equity and Venture Capital Association (AIFI) noted a total of 352 investments, of which 285 (81%) went to nine northern regions.21

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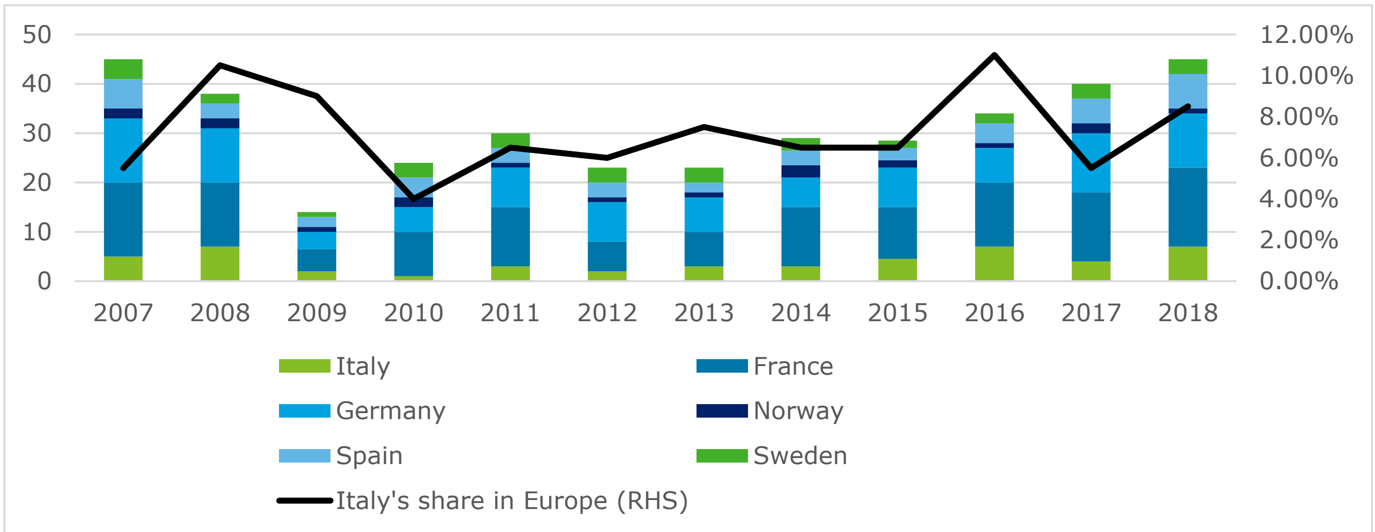
[19] AIFI, *2019 Il mercato Italiano del private equity, venture capital e private debt.*

[20] PWC, *Global and Italian M&A Trends FY20*, 26 January 2021.

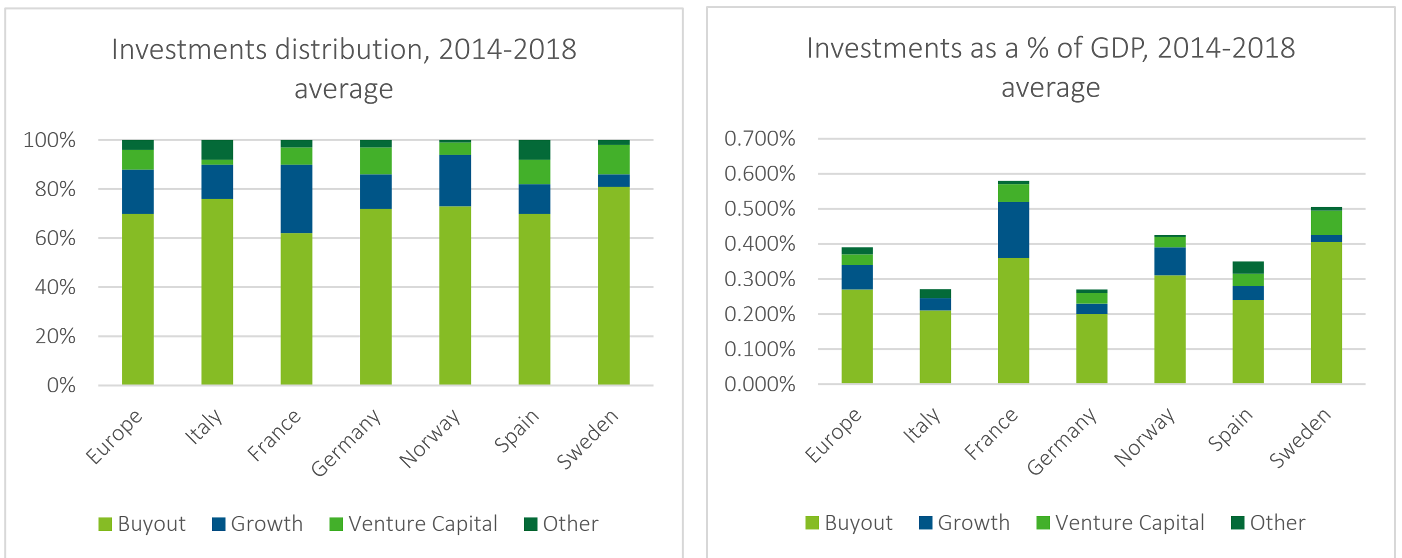
[21] OECD, Creating Growth Opportunities for Italian Companies and Savers, 2020; and AIFI, The Italian Private Equity and Venture Capital Market, H1 2020; and Alberto Calvo, Andrea Pappalardo, The Italian Private Equity Market a Decade After the Beginning of the Crisis, November 2017.

Private equity investments in Italy and selected European countries, 2007–2018



Source: OECD Capital Market Review

Private equity investments in Italy and selected European countries



Source: OECD Capital Market Review

Cultural characteristics of Italy compared with the United States

In 2019, Italian private equity funds raised a total of US$1.75 billion (EUR1.47 billion) compared with US$460 billion (EUR387.5 billion) raised by US funds.[22] Meaning that, while the US GDP was only 12 times larger than Italy's in 2019, 270 times more private equity capital was raised in the United States than in Italy. Moreover, in the same year, the total of private equity investments in the United States was 5,133, compared with only 352 in Italy.

It is important to note that the US economy differs from the Italian, and that Italy's comparably low levels of private equity activity is partially due to strong historical, political, and cultural differences. One cultural aspect hindering Italy's private equity development is the strong presence of family-run small- and medium-sized enterprises (SMEs) in the Italian corporate landscape.

First, ownership and management are often transferred between generations of the same family, leading to less innovation or desire for growth. This lack of innovative spirit and unwillingness to replace management when change is needed runs counter to the spirit of private equity, which is mainly aimed at restructuring for growth and change.

Second, owners of Italian SMEs tend to share a traditional outlook and remain strongly rooted in their origins and traditions, therefore distrusting the support of private equity firms. While the US market views corporate restructuring, transformation, and change of ownership as necessary for growth, Italian family firms can be reserved and hostile towards these activities. And, instead of regarding private equity funds as an instrument supporting economic development, Italian SME owners tend to view them as opportunistic and greedy corporate raiders that do not benefit their targets.[23]

"It is important to note that the US economy differs from the Italian, and that Italy's comparably low levels of private equity activity is partially due to strong historical, political, and cultural differences."

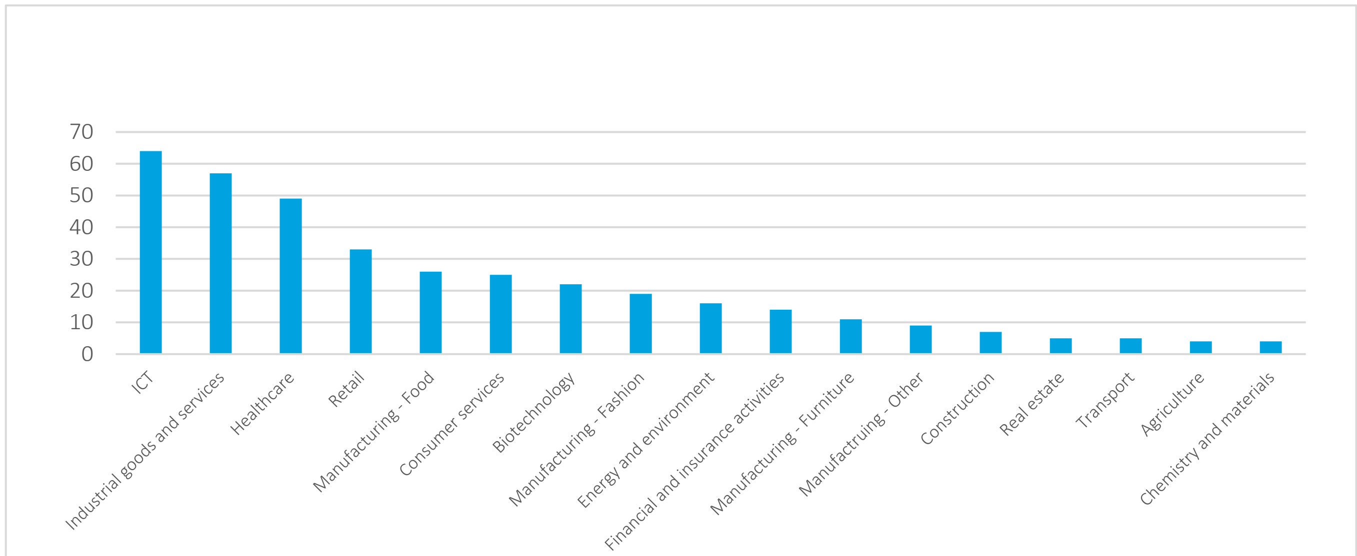
[22] Private Equity International, Fundraising Report FY2020, 20 January 2021.

[23] Alexandra Dawson, Private equity investment decisions in family firms: The role of human resources and agency costs, March 2011; and Casaleggio Associati, Lo stato del private equity in Italia, April 2018.

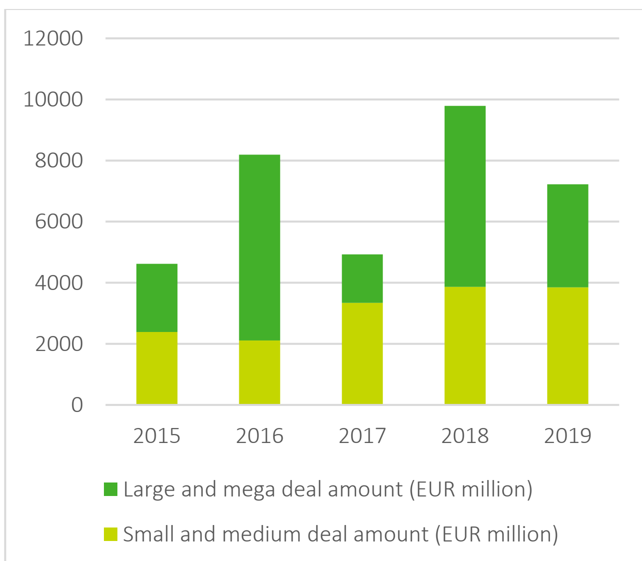
Private equity operations in Italy

Performance before the pandemic

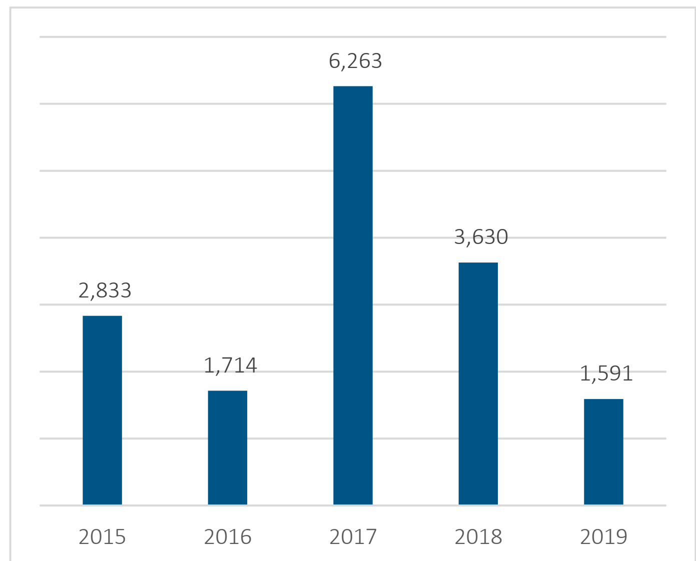
Sectoral distribution of the number of investments in 2019



Evolution of the invested amount by size of the operation



Evolution of collected capital (EUR million)

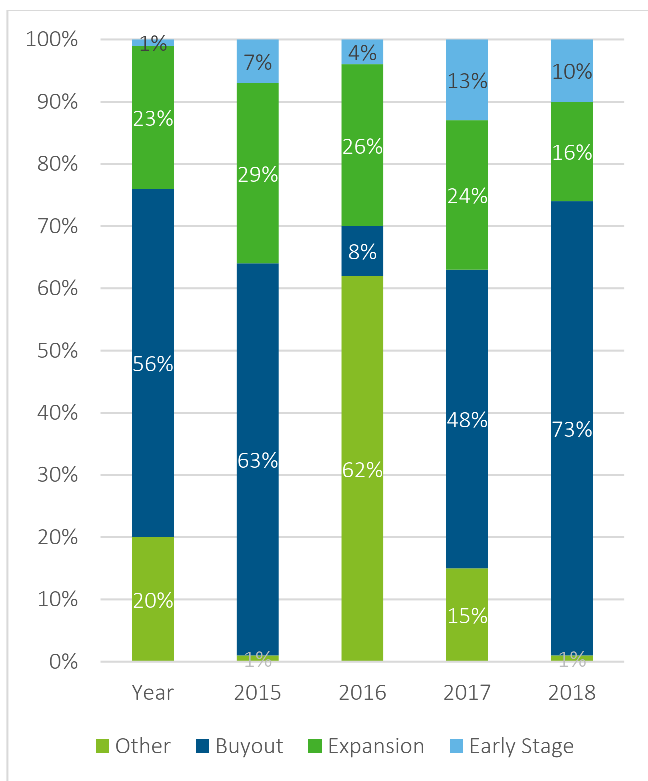


Source: Bain & Company, Global private equity report 2021

The capital collection of the Italian private equity sector fluctuated in the five years preceding the COVID-19 pandemic, with 2017 proving to be the best year with EUR6.2 billion collected[24]. This is an outlier compared with the historical average and almost four times more than collected two years later in 2019 (EUR1.6 billion).

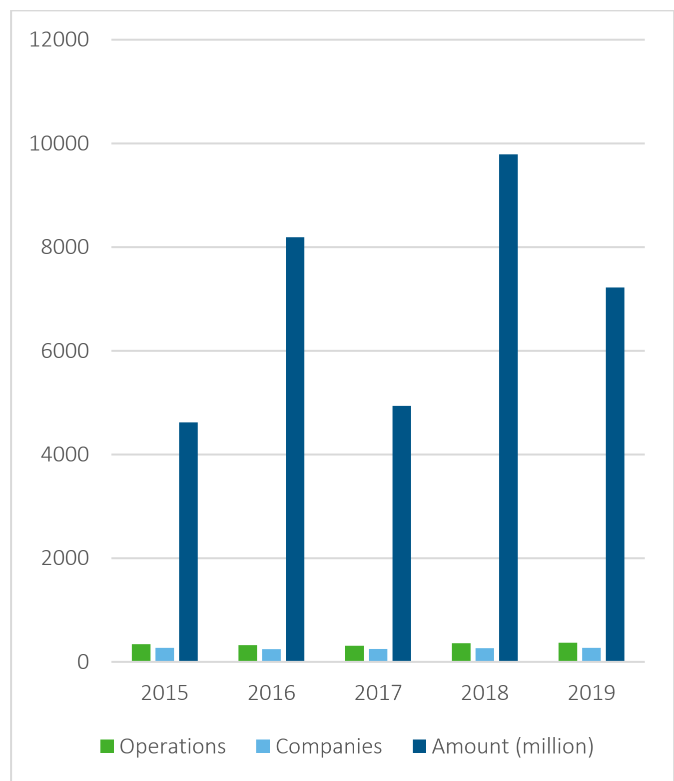
In 2019, the sector with the highest number of operations was ICT (64 deals), followed by industrial goods and medical services. Regarding high-tech companies, the number of operations remained steady (30–35%), while the total invested amount doubled in five years from 12% to 25%.

Market Collection by target investment type



Source: Bain & Company, Global private equity report 2021

Evolution of investment activity



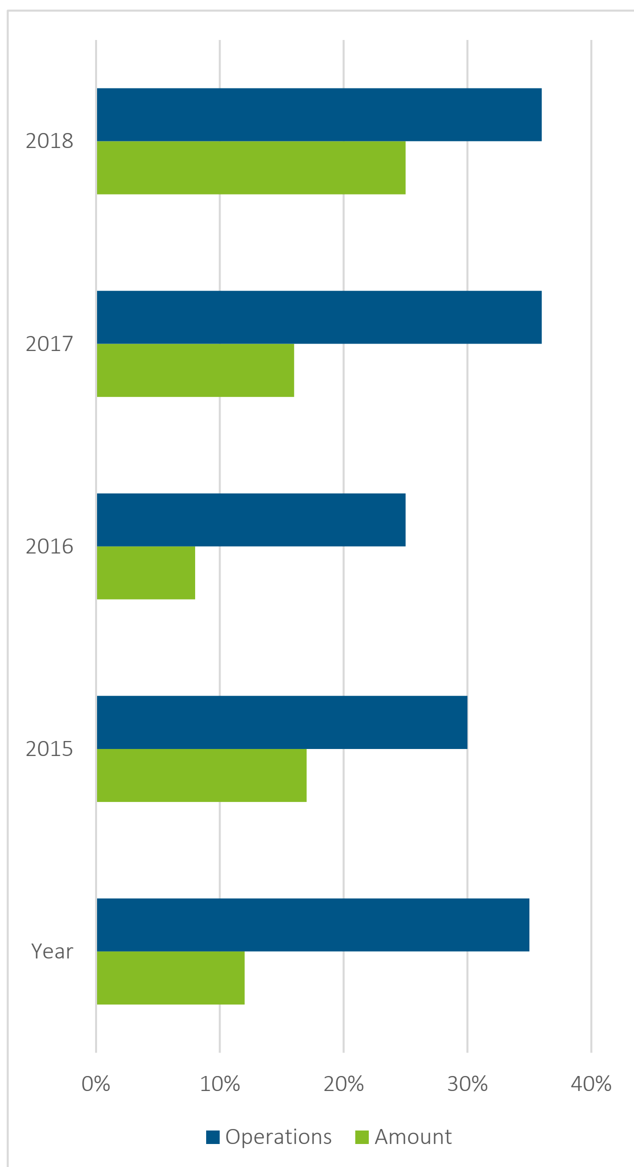
Source: Bain & Company, Global private equity report 2021

"The capital collection of the Italian private equity sector fluctuated in the five years preceding the COVID-19 pandemic, with 2017 proving to be the best year with EUR6.2 billion collected."

[24] EUR4.1 billion was raised by two funds alone—when adjusting for this information, the results are less skewed and more aligned with 2018's results and historical average.

Despite a lower number of operations, invested capital in 2016 and 2018 reached EUR8.1 billion and EUR9.8 billion respectively. This remarkable performance is partially due to the strong presence of large and mega deals (amounts higher than EUR150 million), accounting for an extra EUR6 billion.

Weight evolution % of investments



Source: Bain & Company, Global private equity report 2021

Current trends, perspectives, and challenges for the future of private equity in Italy

The European private equity market is also experiencing a growing diffusion of mega deals. In 2019, there were 47 mega deals and 34 deals between EUR500 million and EUR1 billion in business value, more than the previous peak year of 2018[25]. Additionally, in the first half of 2020, the deal volume outside the United States was US$143 billion (EUR120 billion), and for the first time since 2003, no US targets were among the top five deals.

In H1 2020, 30.6% of global private equity investments flowed into Europe. The European market's attractiveness is increasingly polarizing investments, as well as defining a future scenario that is highly competitive. This trend will certainly favor the development of the Italian entrepreneurial substrate.

Looking at the Italian private equity market, there are many qualities that make the country an attractive option for investors. Italy is the third-largest European economy and the second-largest manufacturer on the continent. Regarding private wealth, Italy ranks 10th worldwide. In 2018, the amount of private wealth amounted to EUR3.2 trillion. Expected growth remains in line with other European powers such as Germany, France and the United Kingdom[26] Moreover, companies investing in Italy can gain important intangible assets, tapping into a market where brand and technical knowledge in sectors such as luxury and fashion are undisputed worldwide.

[25] Steve Roberts and Elena Naydenova, *Private Equity Trend Report 2020*, PWC, February 2020.

[26] Giorgia Pacione Di Bello, "Italia, 10° posto mondiale per ricchezza privata," *We Wealth*, 8 July 2019.

While private equity funds may still encounter resistance from family firms to change their company management or restructure, it may be easier than before because of firms' liquidity needs due to the pandemic. Also, the current government has pledged to simplify Italy's bureaucracy to attract more capital, aware that Italy's strict regulation requirements have often dissuaded investors from pouring capital into the country.

Moreover, the sectors hit hardest by the pandemic may trigger the appetite of turnaround funds, which could make significant investments and seize the opportunity of historically low asset prices to benefit from significant returns over the investment period. Investment activity is also helped by fundraising across European private equity firms reaching its second highest value of all time of EUR92 billion in 2020 and possibly by NEXTGEN Recovery Plan investment and subsidies granted by the Italian government.

"While private equity funds may still encounter resistance from family firms to change their company management or restructure, it may be easier than before because of firms' liquidity needs due to the pandemic."

Private debt

How the market was born

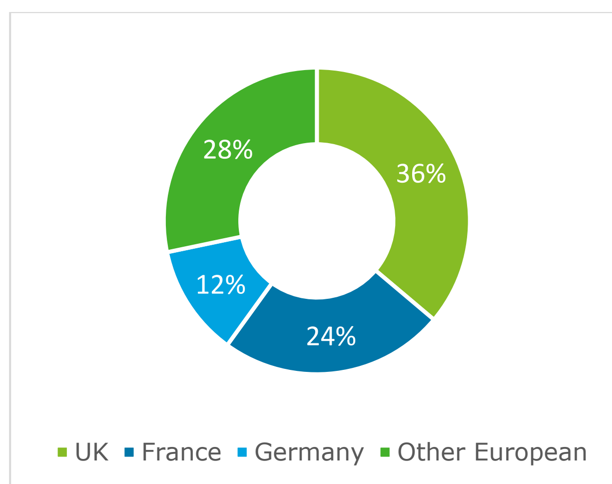
The Italian private debt market was ushered in by the introduction of “Decreto Legislativo N° 18/2016: Decreto Sviluppo”, a governmental decree that implemented a series of financial instruments to assuage the GFC’s economic slowdown.[27] Historically, the Italian corporate ecosystem has always relied heavily on bank debt. However, the GFC highlighted the flexibility and breadth of private debt instruments, solving both short-term needs through bills of exchange and medium-to-long-term needs with bonds.[28]

Characteristics of the private debt market in Italy

Compared with other European countries, the Italian private debt market is still underdeveloped, with the United Kingdom, France, and Germany taking the lead.

While the United Kingdom has historically been a hub for private credit, the impact of Brexit could see several deals moving from the United Kingdom to European countries[29]. A New Financial report found that 440 finance firms have moved some of their operations and a total of GBP1 trillion in assets to the European Union.[30]

Private Debt Sources by Country



Source: AIFI and Deloitte, February 2021

Most investments in Italy are in the business products and services sector, which accounts for roughly one-third of total private debt investments[11]. Likewise, most investments are targeted toward SMEs in Italy, similar to the United Kingdom, where EUR21.4 billion were lent to SMEs in 2018 and 2019[31].

In this context, fintech platforms took on a major role in non-bank direct lending, offering EUR1.7 billion to Italian SMEs throughout 2020.[32] Many of these platforms work with invoice financing, where investors can immediately finance 80–90% of the credit’s nominal value and collect the total amount later[33].
Regarding the maturity of funds, the Italian average is around five years.[34] Compared with the weighted average corporate bond maturity of 9.7

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[27] Marianna Di Paoli, Private Debt: analisi del contesto internazionale e focus sull'Italia, 2017.
[28] AIFI and Deloitte, *I fondi di private debt: un percorso per il mercato*, February 2021.
[29] BlackRock, *European Middle Market Private Debt*, January 2018.
[30] Eivind Friis Hamre and William Wright, "Brexit & The City: The Impact So Far," *New Financial*, April 2021.
[31] The FinTech Times, *SMEs Increasingly Turn To Private Debt Investors To Support Business Growth*, 15 February 2021.
[32] AIFI, 2020 Il Mercato Italiano Del Private Equity E Venture Capital
[33] Credimi.com, *Anticipo fatture: come ottenere liquidità con invoice financing*.
[34] AIFI, 2020 Il Mercato Italiano Del Private Equity E Venture Capital

years in advanced economies and 8.2 years in emerging markets and developing economies, Italian debt is significantly more short-term oriented. Signaling skepticism towards the future of the Italian economy, this short-term orientation leads to increased roll-over risk and more challenging long-term investments[35].

A summary of market intelligence gathered by Aon found that direct lending fund life in the United States ranges from six to eight years, while that of other private debt, such as distressed debt, averaged 10 years[36]. However, as investors become more acquainted with the instrument, maturities will tend to rise to guarantee higher flexibility and personalized products to borrowers.

Performance before the pandemic

Before the COVID-19 crisis hit, Italy's private debt industry was growing rapidly. It reached a peak of EUR1.31 billion invested in 2019, and grew at a compounded rate of 31% from 2016 to 2019[37]. The industry was roughly split evenly between foreign and domestic players.[38] The Italian private debt industry became more international in recent years, with its share of domestic players decreasing to 67% in 2017[39]. Italian private debt funds tend to invest around 60% of their funds internationally[11].

Performance in 2020

Despite the uncertainties of the COVID-19 pandemic, private debt in Italy continued to grow in 2020. There was an increase of 62% year over year in the number of investment operations (410 versus 253 in 2019) despite a 9% decrease in the total investment amount (EUR1.197 million versus EUR1.322 million in 2019). This points to a growth in companies using private debt financing.[40]

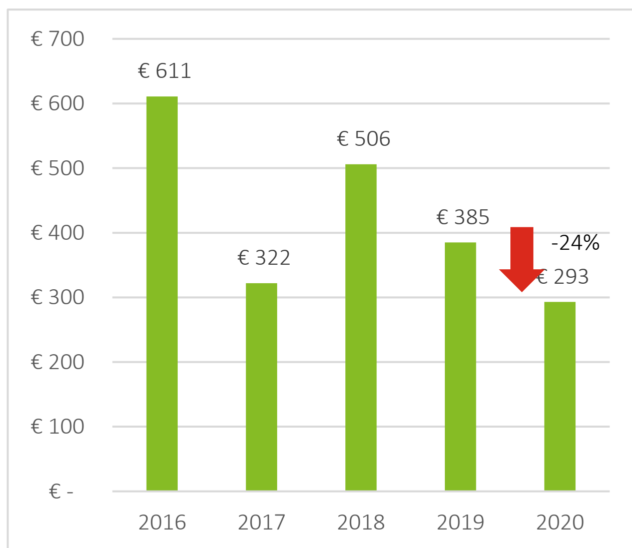
The COVID-19 pandemic is likely to have made private debt an increasingly relevant financing channel for Italian SMEs. They have been heavily affected by the economic crisis and require both new liquidity and restructuring to survive the difficult months of reduced business—10% of Italian SMEs risked insolvency following the first lockdown in 2020.[41] Despite the obvious economic problems, repayments increased by 23% compared with 2019, from EUR324 million to EUR400 million.[42]

In 2020, the biggest weakness of the Italian private debt market was the sharp decline in fundraising to EUR293 million, 24% less than in 2019 and 42% less than 2018. A similar decline was also seen in many international markets, as the pandemic heaped pressure on private debt managers. Given this asset class's relatively recent ascendancy, many of these private debt managers lack a track record in steering their funds through a severe

[35] Sophia Chen, Paola Ganum, Lucy Liu, Leonardo Martinez, and Soledad Martinez Peria, Debt Maturity and the Use of Short-term Debt, 2018.
[36] AON, *Direct Lending: An Investment Opportunity Within Private Debt*, March 2018.
[37] AIFI, *Private debt, primo semestre 2020: crescono raccolta, operazioni e rimborsi*, 17 September 2020.
[38] AIFI, *2019: The Italian Private Equity, Venture Capital and Private Debt Market*.
[39] AIFI, *2017: The Italian Private Equity, Venture Capital and Private Debt Market.*
[40] Anna Gervasoni (AIFI) and Andrea Azzolini (Deloitte), Il Private Debt nel 2020.
[41] Morya Longo, "Quante imprese italiane rischiano il fallimento a causa del lockdown?," *Il Sole 24 Ore,* 29 November 2020.
[42] Anna Gervasoni (AIFI) and Andrea Azzolini (Deloitte), Il Private Debt nel 2020.

economic crisis.[43] To retain trust and attract new investors, funds must focus on increasing transparency and improving covenant systems.[44]

Evolution of Independent Fundraising (EUR million)



Source: Pitchbook, 2021

The future of private debt in Italy

Given that it is operating below its potential and offering instruments of increasing popularity, the outlook of the Italian private debt industry is positive.

Banks' strong dominance over lending activities will decrease, as firms seek higher flexibility and more strategic support to heal the damages caused by the COVID-19 pandemic. Furthermore, given that banks issued a large amount of government-backed loans during the crisis, the consequences in terms of NPEs and their disposal regulation remain to be seen.

Technology will also play an increasingly important role, not only as a tool for improved and more flexible financing solutions but also as an investment sector, with ICT targeted by 15% of private debt investments in 2020.[45]

Finally, through imminent European regulation, ESG will be integrated into private debt instruments and fund decisions. This leads to more developed sustainability criteria and a rise in green bonds, financial instruments used to fund projects with environmental or climate benefits.

"Given that it is operating below its potential and offering instruments of increasing popularity, the outlook of the Italian private debt industry is positive."

[43] Andrew Woodman, Private debt rides out crisis despite fears of loose deal terms, 14 December 2020.
[44] Pitchbook, Global Private Debt Report, 2020; and AIFI: Il Private Debt nel 2020 - pp.4.

[45] Anna Gervasoni, *2020 il mercato Italiano del private debt*, AIFI, 4 March 2020.

Real estate

Main characteristics

Like many other countries, the recent pandemic crisis has hampered the Italian real estate market. This phenomenon hints at a possible new future regarding the preferences of both businesses and individuals. In particular, the health crisis has catalyzed trends such as investments in the logistics sector. However, the crisis has also generated plenty of uncertainty in the residential and commercial real estate markets.
It is worth noting that 2019 was an outstanding year for the sector, representing the asset classes' peak. Despite current uncertainties, its future outlook hints to a return to normal levels from 2023 onwards.

The hardest-hit sector has been *Hotellerie* (hospitality) due to restrictions on travel during the pandemic, which led to a drastic drop in demand and asset value. Professionals expect to see the most significant discounts in this asset class in the near future, while also predicting prices will swiftly catch up as soon as the crisis begins to ease.

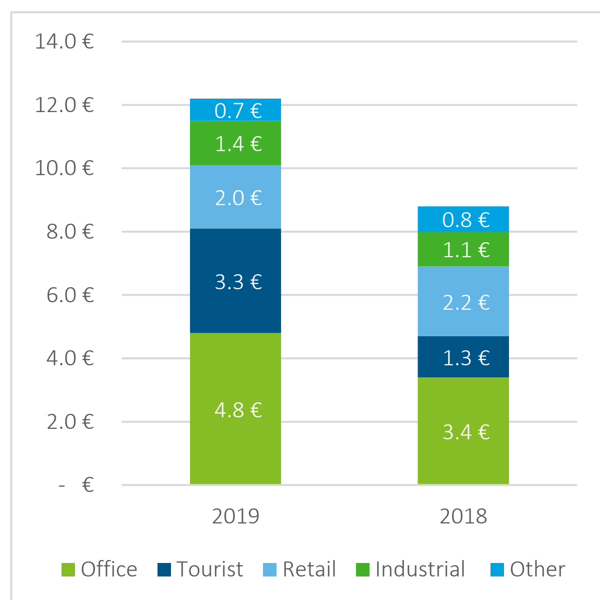
As mentioned earlier, the most exciting asset class will undoubtedly be logistics. E-commerce and internet-based services skyrocketed during the pandemic, with more people relying on these services to shop than ever before.

The bulk of the real estate market will still center around commercial real estate. However, the most significant uncertainties hover around this asset class. Smart working and sanitary precautions may convince firms to change their location and size preferences for their operational headquarters in the long term.

Market movements

In recent years, investments in commercial real estate have grown, mostly thanks to foreign investments in Italy. In 2019, the sector recorded an investment volume of EUR12.3 billion, 40% higher compared with 2018. Milan and Rome represented the key markets, accounting for about 37% and 15% respectively of total 2019 investment volumes.[46]

Investments in non-residential Real Estate (EUR billion)

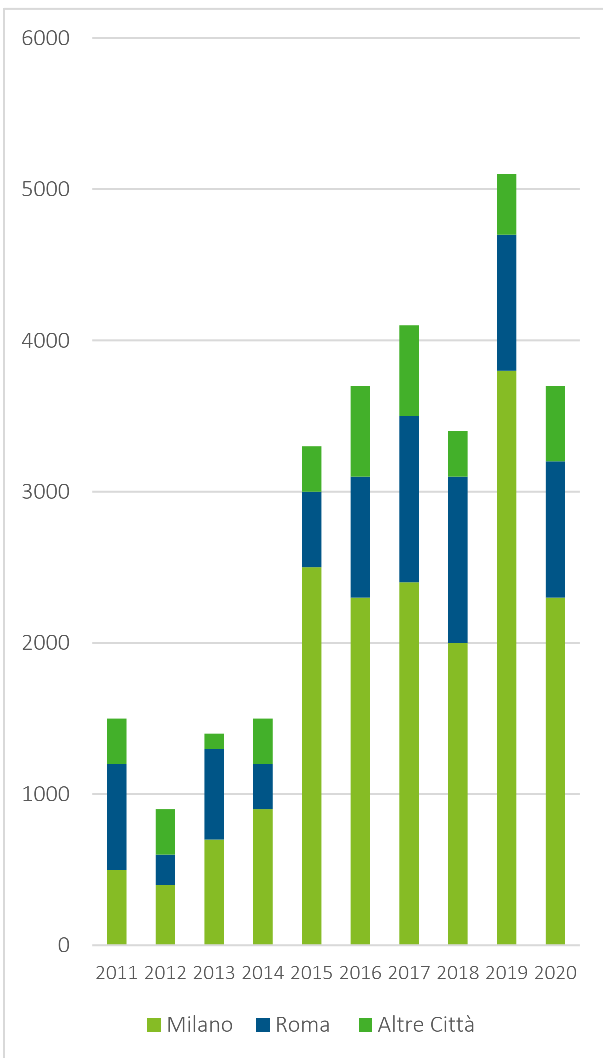


[46] Bebeez, The Italian NPL Market, July 2020.

Location-wise, in 2016, almost half the 64.4 million real estate units (an approximate EUR6 trillion market value) were located in the north of Italy, while about 30% of value was concentrated in the center and 20% in the south and the islands.

Given the market's rigidity, a similar distribution can be predicted in the coming years.

Office Investments in main Italian markets



Source: CBRE

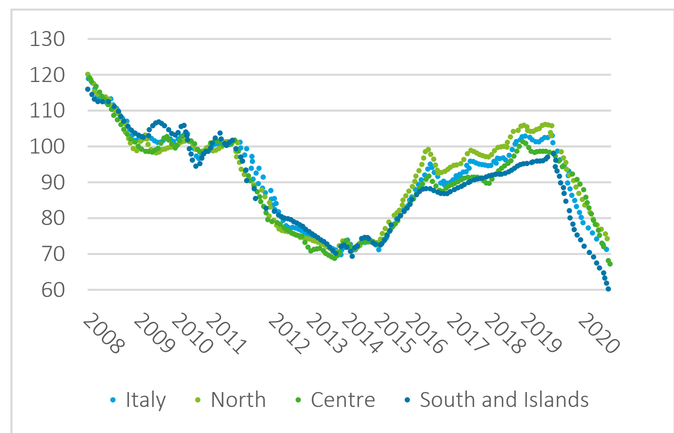
Average market value by location

Location	Average market value (EUR)	Average market value (EUR/m2)
South and islands	120,000	1,030
Center	210,000	1,800
North	170,000	1,470
Milan	261,000	2,960
Rome	323,000	3,150

Source: ISTAT

Despite high prices, Milan and Rome in 2020 still managed to maintain a significant gross rental yield of 4.8% and 4.6%[47] respectively, following an upward trend. This may be due to a higher demand for rental properties, coupled with a reduced supply due to properties increasingly being used for tourism purposes, which results in higher rent prices.[48]

General index of real estate units by geographical area: Q1-2008 - Q2 2020



Source: ISTAT

[47] Fabiana Megliola 06/2020, Tecnocasa.

[48] Elena Dal Maso, "Le città italiane dove la casa rende di più", *Milano Finanza*, 20 June 2020.

Real estate funds in Italy and their characteristics

The Italian market is dominated by professional foreign investors, which commonly use one of the following five types of investments: companies, investment funds (REIF), investment companies with fixed corporate capital (SICAF), real estate joint-stock companies (SIIQs), and direct investments. These differ regarding passporting rights, the extent of hands-on management of the assets, and the general legal structure.

Market trends

According to CBRE research, the 2021–2023 outlook for the real estate market will undoubtedly involve significant changes and developments of the following asset classes:

Offices[49]: contrary to the widespread belief that the office sector will decline due to high fixed costs and increase in smart working, the office sector is, in fact, undergoing a full transformation. It is expected that open spaces and coworking rooms in offices will increase in popularity as companies move toward a more collaborative working model. Financially, these changes will reduce the costs of construction, utilities, and office equipment.

Retail: the COVID-19 outbreak reinforced uncertainties around the retail sector, widely threatened by e-commerce's predominance and growth. However, physical stores will not progressively disappear and will remain a crucial part of the customer purchasing experience.

Logistics: according to the Observatory of the Politecnico of Milan[50], the turnover of Italian enterprises in the logistics sector was around EUR77.8 billion in 2020, representing almost 5% of Italy's GDP. The sector still boasts potential that will grow hand in hand with technology. Moreover, the need for faster services will require smaller and more optimally located logistics key points, rather than large structures on the outskirts of cities.

Hospitality: The growth of new online marketplaces for lodging, such as Airbnb and HomeToGo, have opened up an entirely new demand for short-term rents. Given the higher rates for short-term rents compared with longer ones, operators that can secure a constant flow of guests and achieve economies of scale in property management can earn superior returns than in the past. Nevertheless, the hotel segment, especially luxury, still represents an opportunity for real estate investors in cities like Venice, Milan, Florence and Rome.

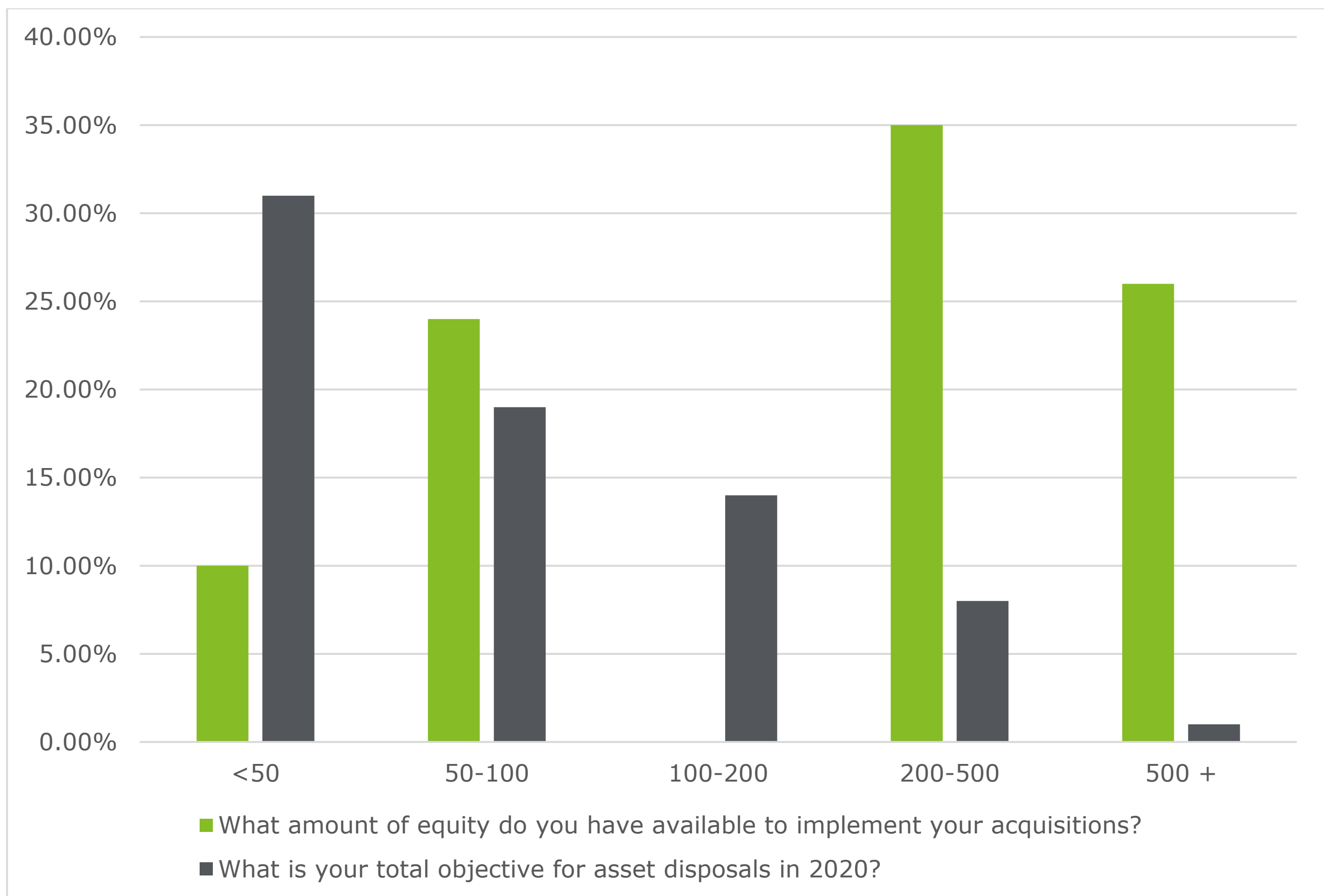
For example, the French group Covivio purchased seven hotels in Italy in September 2020 for a total of EUR573 million. The New York hedge fund Elliott Management also sold the well-known Bauer Hotel in Venice to the Austrian real estate group Signa. Moreover, to promote investment in the hospitality sector, the state-backed investor Cassa Depositi e Prestiti, the largest institutional hotel owner in Italy, launched a EUR2 billion real estate fund in 2020 to take over strategic hotel properties.

[49] Patrigest/Gabetti: Real Estate i trend post covid settore per settore, 2021.

[50] Politecnico di Milano, "Logistica e Covid-19: cala il mercato ma non si ferma l'innovazione", 2020

A recent paper by Cushman & Wakefield highlights the mismatch between demand and supply in real estate. Large funds (over EUR500 million) are able to spend 26% of their equity on acquisitions, but were only willing to spend 1% on asset disposal in 2020. On the contrary, small funds (of less than EUR50 million) have the capacity to spend 10% of their equity on acquisitions, but were willing to spend 31% in their asset disposal for 2020. Supply is not following demand, creating a lot of dry powder in the real estate investment sector.[51]

Mismatch between demand and supply in real estate



Source: Italian Real Estate Overview 2020, H1,Cushman & Wakefield

[51] Cushman & Wakefield, "Italian Real Estate Overview", 2020

How will things change in 2021?

In the short-term, people's preferences regarding the residential sector are more certain than other asset classes. There will be a shift to buildings that offer the following features:

- Multifunctional homes, with larger dimensions and modular spaces adapted for remote working;
- Outdoor spaces, terraces or gardens; and
- Condominium services, such as garages, gyms, or multifunctional rooms.

There will also be a greater interest in second homes thanks to the rise of remote working, which will presumably continue after the crisis, and people's increased propensity to spend holiday periods in their own homes.

Moreover, the government financial incentives of the 19 May 2020 decree no. 32 (Decreto Rilancio) created important development opportunities for the real estate sector, which will especially materialize in 2021. These include tax deductions of up to 110% for specific energy efficiency and anti-seismic works, the installation of photovoltaic systems, and systems for charging electric vehicles. Some experts predict that inquiries for these kinds of properties will increase in 2021 by up to 45%, as these requests increased by 32% between July and December 2020 when compared with the same period in 2019. [52]

Finally, international mitigation and regulatory efforts are likely to gain new momentum in 2021. The property sector must respond to investor demands by ensuring assets are managed responsibly and sustainably and in line with investor values. There is a lot of focus on net-zero buildings, which generate at least as much power as they consume through renewable sources, mainly solar panels. In fact, some of the newest buildings can generate excess energy that they can then sell to nearby buildings.

"There will also be a greater interest in second homes thanks to the rise of remote working, which will presumably continue after the crisis, and people's increased propensity to spend holiday periods in their own homes."

[52] Gabetti, Residential Overview, H2 2020.

REACTION TO THE **COVID-19 PANDEMIC**

Macroeconomic impact

Effects on the market

The COVID-19 crisis is unique from many perspectives. Best described as a "global sudden stop", it provoked sharp contractions in output and employment. Compared with previous crises, the COVID-19 crisis was the result of containment measures to tackle a health emergency, rather than an unraveling of existing financial imbalances[53].

Its uniqueness is most evident in the responses of fiscal and monetary authorities. To appreciate the extent of the measures taken, we can compare the Italian governments' stimulus packages to tackle the GFC with those of the COVID-19 pandemic in 2020.

In August 2008, the Italian anti-crisis decree provided a EUR6.4 billion stimulus package, followed by a second in February 2009 of EUR5.8 billion. In contrast, from March to May 2020 alone, Italy provided immediate fiscal impulses of EUR61.3 billion, deferrals of EUR235.3 billion, and other liquidity and guarantee measures of EUR571 billion to cushion the sharp shocks to aggregate supply and demand[54].

In Italy, the unforeseen contraction of supply was a direct effect of the lockdown and the interruption of non-essential production chains. The demand side was also heavily affected, with mobility restrictions provoking a sudden slump in consumption for certain products and services.

The crisis also triggered a wealth effect, as individual's financial assets initially lost value due to the negative performance of financial markets. However, they have mostly rebounded since then, with global equity indices reaching historically high levels — in 2021 the S&P 500 stands around 24% above the pre-pandemic peak of February 2020 and the FTSE Mib around just 3% lower.

As a result, volatility indices have stayed above average historical levels since the start of the downturn. This may have dissuaded more risk-averse investors from entering equity markets and, instead, encouraged them to embrace more alternative asset classes. Furthermore, in response to the downturn, central banks lowered their interest rates to sustain a recovery, which has extended the duration and development of the debt capital crisis. On a psychological level, uncertainty leads to demand paralysis, as individuals tend to limit consumption, postpone spending, and reinforce precautionary savings[55].

Italian economy's main macroeconomic indices changes between 2019 and 2020

Key macroeconomic figures	Δ% 2019–2020
GDP at current prices	-8.9%
Contribution of national demand to the GDP	-7.8%
Contribution of net export to the GDP	-0.8%
Gross fixed capital formation	-9.1%
Final consumption expenditure	-7.8%
Exports	-13.8%
Imports	-12.6%

Source: ISTAT, 2021

[53] Claudio Borio, The Covid-19 economic crisis: dangerously unique, 24 September 2020.

[54] Julia Anderson et al., The fiscal response to the economic fallout from the coronavirus, 24 November 2020.

[55] CONSOB, Dalla crisi sanitaria alla crisi economica, 2021.

Italian economy's main sectors changes between 2019 and 2020

Value added per sector	Δ% 2019–2020
Agriculture forestry and fishing	-6.0%
Mining and quarrying, manufacturing and other industrial activities	-11.1%
Construction	-6.3%
Services	-8.1%

Sources:[56 57]

Impact on private equity

Investment activity

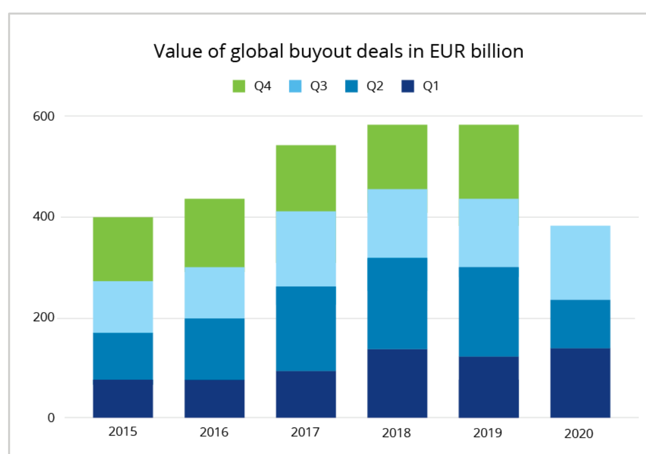
Towards the end of Q1 2020 and into Q2, the private equity industry experienced a large albeit short-lived shock. Total buyout value fell 22% from H1 2019 to EUR208.9 billion globally.[58] With the markets clouded with uncertainty, transactions were paused. Managers were focused on stabilizing the existing companies in their portfolios, drawing from existing credit lines, and reducing headcounts and costs.

A global survey of the top 200 private equity managers with a total of US$1.9 trillion (EUR1.6 trillion) in AuM found that, on average, 40% of companies controlled by private equity firms were somewhat affected and 9% were severely affected by the pandemic[59].

This is also in line with a European survey by Arthur D Little, stating that 44% of European companies used government aid for unemployment support, and 37% were granted government-backed loans for financing up until October 2020. Additionally, 90% of respondents expected more distressed debt deals, and 80% expected deal delays as a result of the pandemic.[60]

Despite this, activity strongly rebounded in Q3 2020, indicating that many of the paused transactions had eventually been resumed, with deal value rising year over year by 10% to reach US$148.1 billion (EUR124.7 billion).[61]

Value of global buyout deals (in EUR billion)



Source: Dechert, 2021

Total buyout value in Europe in Q1–Q3 2020 was incredibly resilient, rising slightly by 2% to EUR208.2 billion, compared with Q1–Q3 2019. However, volume dropped by 17% over the period to 1,716 deals—which was still a smaller drop than global buyout volumes.

[56] Istat, GDP and general government net borrowing, 01 March 2021.
[57] European Commission, Economic forecast for Italy, July 2021.
[58] Dechert, 2021 Global Private Equity Outlook, 2021.
[59] Gompers et al., Private Equity and COVID-19, October 2020.
[60] Krantz, J., Picq, G. and Fagerlund, J., The insight: Europe's private equity industry during COVID-19 and beyond, November 2020.
[61] Dechert and Mergermarket, 2021 Global Private Equity Outlook, 2 December 2020.

The solid levels of total buyout value were boosted by one of the biggest deals ever done in Europe: the EUR17.2 billion carve-out of ThyssenKrupp's elevator division by Cinven, Advent International and coal mining trust RAG-Stiftung. The deal was agreed at the end of February 2019, before the COVID-19 pandemic's major shock, and was closed in July 2020.

In Italy, in particular, investment activity in H1 2020 decreased compared with H1 2019 (-25.3% in value and -24.7% in transactions), with a total amount of EUR1.9 billion across 125 deals[62]. However, it is important to note that in previous years, most deals were done in the second half of the year (65% in 2019, 71% in 2018, and 61% in 2017) and the same was true for 2020.

In fact, Italy's total investment activity was around EUR6.6 billion at the end of the year, 9% lower than in 2019, which demonstrates remarkable resilience considering how the year started. This recovery was also due to many deals that were initially put on hold during the first months of the pandemic being closed after the summer.

There is also widespread consensus among fund managers that many deals are still on hold due to valuation issues. Many entrepreneurs want their company valued at pre-pandemic multiples, especially those companies that were not significantly affected by the pandemic and only experienced a one-off drop in earnings. Therefore, as the pandemic is kept under control and economic conditions improve, many of these deals are likely to close in 2021 and 2022, as more funds will be willing to offer valuations aligned with those of entrepreneurs.

Looking at venture capital in Italy, the sector continues to demonstrate consistent growth, despite the pandemic crisis. This is due to significant contributions from new investors and a culture shift in big Italian companies, which have expanded their interest and aid to innovative Italian firms. One example is the November 2020 EUR45 million investment in Aidexa, an Italian challenger bank for SMEs, by Generali Group, Banca Sella Group and Banca Ifis[63].

The year 2020 marked a record year for investments with 234 initial and follow-on deals, 58% more than 148 in 2019. However, total capital invested remained nearly unchanged at EUR595 million in 2020, indicating the average deal size had shrunk significantly compared with 2019. In 2020, there was also more focus on initial investments rather than follow-on. Furthermore, deals targeted ICT firms, representing more than 45% of all investments, a slight increase from the previous year.[64]

Investments of private equity funds by type in Italy in H1 2020 (in EUR million)

Investments of private equity funds by type in Italy in H1 2020	Value (EUR million)	YoY changes in value
Early stage	71	-31%
Buyout	1,600	+2%
Expansion	31	-89%
Infrastructure	177	-57%

Source: AIFI, 2020

Investments by sector

[62] Dechert and Mergermarket, 2021 Global Private Equity Outlook, 2 December 2020.

[63] Crunchbase Database, 2021.

[64] AIFI, Venture capital monitor, 2020.

Some industries benefited from the pandemic in 2020. In particular, one-third of global private equity investments were in technology and telecom, with a growing interest in IT services. Furthermore, 2020 also witnessed a rising interest in financials, particularly banking and payments.

While these areas were already the most favoured by private equity investors pre-pandemic, the crisis seems to have accelerated investments in these industries. This is likely due to their impressive returns, as well as the growing need for innovation and technological development in many of the companies on private equity portfolios. On the other hand, interest in consumer services and retail has plummeted globally, likely due to lockdown measures and lower retail spending.[65]

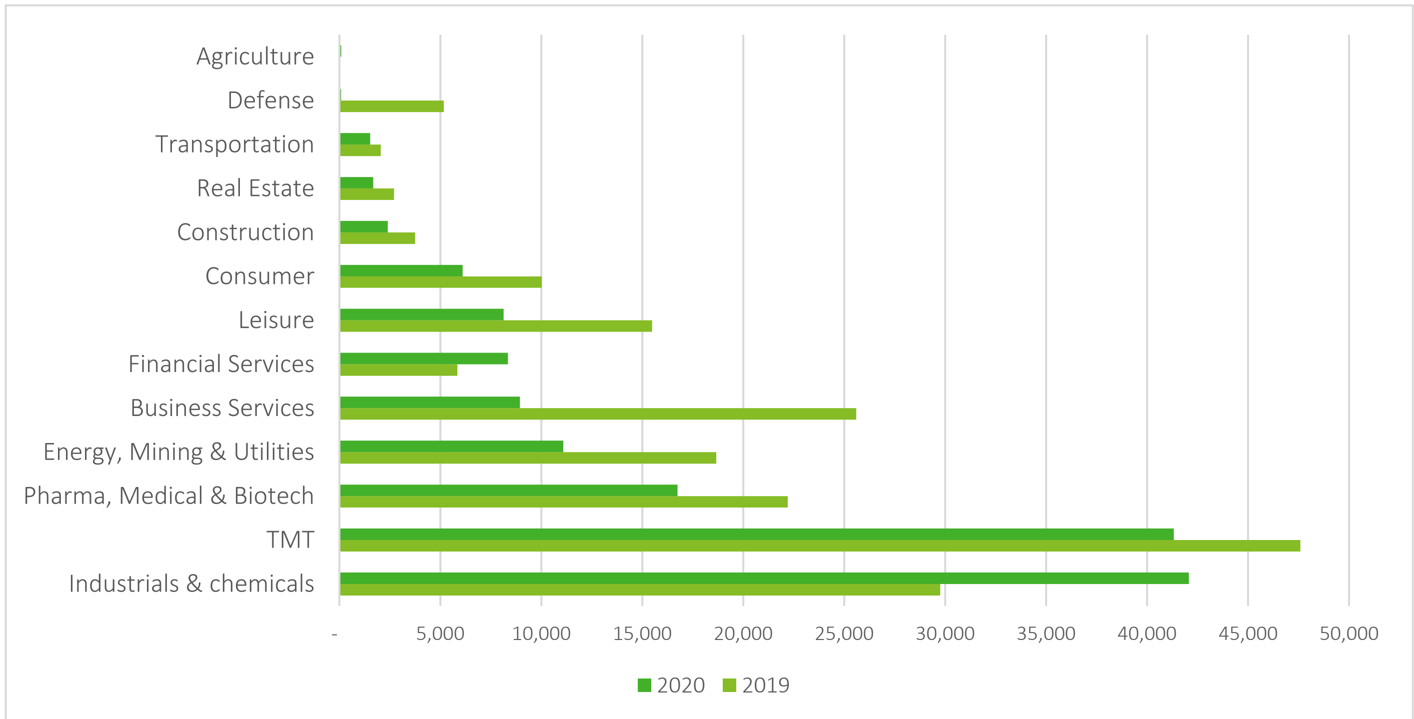
"Some industries benefited from the pandemic in 2020. In particular, one-third of global private equity investments were in technology and telecom, with a growing interest in IT services.

Industry	2019	2020		
	% of value			
Consumer goods	10%	13%	5%	10%
Consumer services	8%	12%	4%	12%
Financials	7%	6%	11%	8%
Healthcare	5%	9%	5%	8%
Industrials	11%	10%	10%	8%
Materials	5%	11%	6%	11%
Oil and gas	8%	2%	4%	1%
Real estate	10%	3%	5%	3%
Retail	2%	3%	4%	3%
Technology	19%	27%	24%	30%
Telecom	7%	2%	10%	3%
Utilities	8%	3%	11%	4%

Green: increase, Grey: unchanged, Red: decrease

[65] Bain and Company, Global private equity report 2021, 2021.

Private equity buyout value by sector in EMEA (US$M), 2019-Q3 2020



Source: Dechert and Mergermarket, 2021

Europe has mirrored these same trends, with investments in retail, consumer and discretionary segments even more affected due to the pandemic's wider spread and increasing lockdown measures. Technology, media and telecom remained impressively resilient, while industrial and chemical investments grew significantly (see graph)[66].

While it may look like healthcare deals also declined, activity picked up in the last quarter of 2020, and deal count fell only slightly compared with 2019 from 80 to 75. It is also worth noting that specialty pharma generated strong activity within biopharma. On the other hand, healthcare deal values declined, mainly due to a lack of mega deals compared with the previous year, such as the US$10.1 billion (EUR8.51 billion) Nestlé Skin Health transaction in 2019.[67]

The same trend was observable in Italy, where most deals were in ICT (30%), chemical, medical and pharmaceuticals (CMP, 17%) and industrial goods and services (13%). ICT was still the most popular investment sector, despite revenue falling on average 10% for Italian ICT companies, while the CMP sector's average revenues declined by just 1.2%.[68] The dominance of ICT investments may be partially due to a 2020 Italian tax incentive called "Industry 4.0", which introduced several innovations aimed at supporting companies' technological development and digital transformation. [69]

[66] Dechert and Mergermarket, 2021 Global Private Equity Outlook, 2 December 2020.
[67] Giovanni Battista Miani et al., Healthcare Private Equity in Europe: Steady Dealmaking despite Many Deferrals, 16 March 2021.
[68] Cerved Industry Forecast, Stime e previsioni sui ricavi dei settori 2020-22, March 2021.
[69] ESA Automation, Industry 4.0 and New Italian Tax Incentives in 2020, 19 December 2019.

Fundraising

The pandemic hit fundraising activity overall in Europe, especially in Q2 2020 where US$116 billion (EUR97.7 billion) was raised globally, compared with US$140 billion (EUR118 billion) in the same period in 2019. And, only 225 funds achieved their target in 2020, compared with more than 400 funds closed in Q2 2019, and more than 500 in Q2 2018.[70] This may be due to travel restrictions, as well as uncertain investors preferring safer and more liquid investments. However, fundraising recovered strongly in Q3 and Q4 to reach a total of US$989 billion (EUR 833 billion) for 2020—which, while trailing 2019's record of US$1.09 trillion (EUR918 billion), was still the third-highest value ever registered.[71]

On the other hand, fundraising in Italy was extremely positive in H1 2020. The amount raised more than doubled year on year to EUR960 million, and 14 funds closed the fundraising process. The major funding sources were insurance (43%), pension funds (18%) and public sector and institutions (16%). Ninety-four percent of capital came from domestic investors, with the intent of spending 40% of the capital on infrastructure.[72]

Future outlook

Future performance is looking hopeful, given that the private equity industry has tended to outperform public markets in previous downturns. For example, Cliffwater analyzed private equity investment programs at US state pension plans from 2000 to 2016. While private equity outperformed public equities by 440 basis points (bps) annually on average, in bull markets this margin slimmed down to 290bps, whereas in bear markets, this margin increased up to 660bps.[73]

The case for this is strengthened further by the incredible amount of US$1.7 trillion (EUR1.4 trillion) in funds available to be invested, of which EUR600 billion in Europe alone. Despite this, in 2020 managers were targeting an internal rate of return (IRR) of 22.6% on average, lower than the 27% reported in 2016. [74] However, based on a 2020 global survey[75], 76.8% of private equity firm managers were still optimistic about their ability to outperform public markets, with many still dedicating most of their time to sourcing and evaluating new investments. However, a difference has arisen between global and Italian investors, with the former apparently spending less time evaluating new opportunities.[76]

"Future performance is looking hopeful, given that the private equity industry has tended to outperform public markets in previous downturns."

[70] Preqin, Preqin Quarterly Update: Private Equity & Venture Capital Q2 2020, 2020.
[71] Bain & Company, Global private equity report 2021, 2021.
[72] AIFI, Il Mercato Italiano Del Private Equity E Venture Capital, 2020.
[73] Cliffwater, An Examination of Private Equity Performance among State Pensions, May 2018.
[74] Christophe De Vusser, How European Private Equity is Taking Coronavirus' First Punch, 03 June 2021.
[75] Gompers et al., Private Equity And Covid-19, 2020.
[76] AIFI, Il Mercato Italiano Del Private Equity E Venture Capital, 2020.

Exits

Impact of COVID-19 on Private Equity

	2019	2020	% change
Fundraising (EUR million)	385	293	-24%
Investments (EUR million)	1.322	1.197	-9%
Investments (operations)	253	410	62%
Reinvestments (EUR million)	324	400	23%
Investments (societies)	104	130	25%

Source: Mergermarket, 2021

Due to the uncertain environment, it is likely that certain assets will be held for a longer maturity by private equity funds as they wait for exit conditions to improve. In fact, 72.2% of managers were planning for an increased investment horizon in 2020, and only less than 1% a lower horizon. In certain situations, the general partner (GP) may even consider establishing a continuation vehicle.[77]

Despite this, US$232.9 billion (EUR196.2 billion) of exit value was announced globally in Q3 2020, which represented a 517% increase from the previous quarter and the highest value seen for several years. In the first three quarters of 2020, a total of US$369.8 billion (EUR311.5 billion) in exit was realized. While this represents a 6% fall in value and a 31% fall in volume from the previous year, it still represents a strong performance considering the rough conditions.[78]

In Italy, the same situation persisted. There were only 30 exits during the first half of 2020 compared with 66 in the previous year, with a value of EUR395 million compared with EUR886 million in H1 2019. This indicates managers' willingness to wait for better conditions to exit their investments.[79]

Impact on private debt

Overall activity

The Italian private debt sector remained active during the lockdown periods. In fact, the number of transactions increased by 62% (410 in 2020 versus 320 in 2019) despite a 9% decrease in the total investment amount (EUR1.197 million versus EUR1.322 million in 2019). Independent collects, such as those coming from individuals or private entities, decreased by 24%.[80]

The Italian Private Debt Market

	2019	2020	
Independent collects	EUR 385 M	EUR 293	-24%
Investments	EUR 1322M 253 operations	EUR 1197 M 410 operations	-9% +62%
Reimbursments	EUR 324 M 104 companies	EUR 400M 140 companies	+23% +25%

Source: AIFI, 2021

[77] Gompers et al., Private Equity And Covid-19, 2020.
[78] Dechert and Mergermarket, 2021 Global Private Equity Outlook, 2 December 2020.
[79] AIFI, Il Mercato Italiano Del Private Equity E Venture Capital, 2020.
[80] AIFI, Il mercato italiano del private debt 2020, 2020.

Given this positive trend in the number of operations, it is clear that the number of companies seeking private debt lies well below the sector's potential. In fact, Preqin projects this alternative investment to increase by 11.4% annually, from US$858 billion (EUR722 billion) in 2020 to US$1.46 trillion (EUR1.23 trillion) by the end of 2025.[81]

The Italian minibonds market is also operating below its potential. In 2020, Cerved Rating Agency identified 1,686 Italian companies that fulfilled the ideal criteria to emit minibonds, a total amount of EUR10.9 billion, including EUR7.2 billion that could involve sustainable or green bonds.[82] However, by 2020, there were only 352 minibond emissions in Italy with a total value of EUR133 million.[83]

In the coming years, private debt could play an important role in relaunching the economy after the difficulties faced during the pandemic. However, to do so, operators must be able to demonstrate solidity and provide confidence to Italian businesses by providing higher transparency and improving covenant systems.

Excluding lending platforms, 91% of 2020 transactions in Italy had an average denomination of less than EUR10 million. In fact, there was an increase of 9% in transactions up to EUR5 million (76% versus 67% in 2019) and a decrease of 6% in the number of transactions between EUR5 million and EUR10 million (15% versus 21% in 2019).[84] Following the global trend, hold sizes have shrunk. As less financing was available during the COVID-19 pandemic, private debt providers have preferred to reserve their capital for existing portfolio companies rather than investing in new large projects. They have become more risk-averse and are acting more cautiously.[85]

Moreover, the increase in private debt use is also caused by the rising population of basket bonds,[86] which still grant issuers low rates through effective basket diversification. These are asset-backed securities whose underlying assets are mini-bonds issued by SMEs in a specific industry or region. In 2020, there was a record of emissions, with six basket bonds totaling EUR450 million, indicating these will likely become an increasingly popular instrument in Italy's recovery.[87] As companies need liquidity, basket bonds allow for a reduction in issuing costs, as well as a longer duration and greater protection for the issues, making them ideal assets to hold during this turbulent period.[88]

Fundraising

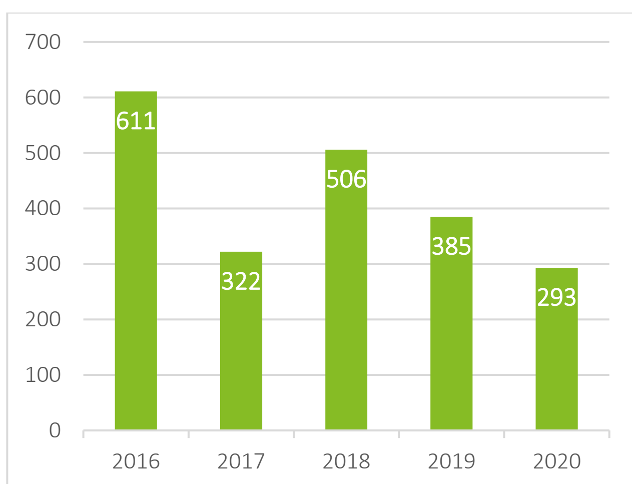
Private debt financing plummeted in 2020 due to the pandemic's economic slowdown. Globally, private debt funds amounted to US$109.7 billion (EUR92.4 billion), a decrease of 27.8% compared with 2019.[89] This marks the first significant drop in

[81] Abby Latour, "Private debt to grow 11% annually to 2025, Preqin survey says", 16 November 2020.
[82] BeBeez, "Il private debt in Italia ha un potenziale inespresso di 11 mld euro", 2020.
[83] Minibonditaly.it, Barometro minibond: market trends, 31 September 2020.
[84] AIFI, Il mercato italiano del private debt 2020, 4 March 2020.
[85] LCD News, "In the wake of coronavirus, the 'club' loan returns as hold sizes in private debt shrink", 29 May 2020.
[86] Basket bonds are an asset backed security whose guarantee is a pool of bonds issued by Italian SMEs and mid-caps.
[87] Valentina Magri, Il private debt in Italia ha un potenziale inespresso di 11 mld euro. Lo stima Cerved Rating Agency, 19 November 2020.
[88] BeBeez, Basket bond, ecco perché in questi mesi il mercato fa faville. Nuove emissioni in vista. Cosa si è detto al Caffé di BeBeez di ieri, 21 July 2020.
[89] Pitchbook, Global Private Debt Report, 2020.

fundraising after a decade-long upward trend since the GFC.

The Italian market suffered a similar downturn. In 2020, fundraising in Italy decreased by 24%, reaching EUR293 million compared with EUR385 million in 2019. While the first half of the year saw an encouraging gain of 10% (EUR195 million versus EUR178 million in 2019 H1), the private debt market slumped in the third and fourth quarters, as investors struggled to commit and took a cautious approach due to market uncertainty.[90]

Evolution of independent funding (in EUR million)



Source: AIFI

Investments by sector

Regarding the sectors of the financed companies in Italy during 2020, industrial goods and services were top with 33% of investment, followed by ICT with 15.3% and manufacturing-food with 10.8%. At the other end of the scale was health at 8.3% and energy at 6.8%.[91] While most sectors remained unchanged compared with 2019, ICT boasted the most substantial growth, increasing by 9% in 2020 due to an acceleration in digital transformation.[92]
Throughout 2020, 67% of private debt financing was dedicated to corporate development, while 22% and 11% were dedicated to leveraged buyouts (LBOs) and debt refinancing respectively. Despite the palpable economic problems, repayments increased by 23% compared to 2019 (from EUR324 million to EUR400 million).[93] Although this may signal resilience for some firms, 41% of repayments were carried out through refinancing.[94] When faced with an economic recession with record-low interest rates, refinancing became an attractive option.[95]

As for investor type, 64% of the capital raised came from insurance companies, 24% from institutional funds, and 10% from banks. While 90% of the capital raised came from Italian firms, international entities raised the remainder.[96]

Role of banks (and SMEs)

Although traditional banks were expected to take a more cautious approach during the COVID-19 crisis to the private debt industry's benefit, this may not be the case in Italy. The surge in state-guaranteed loans during the pandemic has actually helped banks continue direct-lending operations, running counter to the traditional pro-cyclical view of banks, with EUR10 billion loaned by May

[90] AIFI, Il mercato del private debt nel I semestre 2020, 2020.
[91] AIFI, "Il Private Debt nel 2020" – Webconference, 2020.
[92] AIFI, Il mercato italiano del private debt 2019, 2019.
[93] AIFI, Il mercato italiano del private debt 2020, 4 March 2020.
[94] AIFI, Il mercato italiano del private debt 2020, 4 March 2020.
[95] Carmen Reinicke, Here's how the Fed decision impacts your wallet, 17 March 2021.
[96] AIFI, "Il Private Debt nel 2020" – Webconference, 2020.

2020[97]. Time will tell regarding the effect on NPEs and their disposal regulation.

However, the pandemic has also boosted the private debt market's attractiveness, as well as its competitiveness against banks. As firms require more flexibility and strategic support to recover from the pandemic's impacts, banks' dominance in lending activities is expected to wane in the near future.

Because banks struggled to quickly and efficiently process the large wave of requests during 2020, most capital did not arrive promptly enough for many companies.[98] With this in mind, direct lending platforms face tremendous opportunities in the SME market due to their agility and technological capabilities. The private debt industry has an opportunity to position itself as a strong channel for long-term growth.

Covenants

Despite the government-mandated shutdowns, covenant packages generally remained in line with those written before the pandemic. In 2019, 87% of global leverage loans were covenant-lite. This type of financing imposes fewer restrictions on the borrower while providing less protection for the lender. With the uncertainty around the markets and issuance decreasing in 2020, it was expected that lenders would regain more control. Instead, of the US$195 billion (EUR164 billion) issued until mid-September 2020, 87% remained covenant-lite.[99]
In fact, most deals came with maintenance-based financial covenants, with only some cases involving multiple covenants such as leverage, fixed charge, or minimum earnings before interest, taxes, depreciation and amortization (EBITDA). Most importantly, the maintenance level covenants were not as strict as they were before.

However, the pandemic has triggered some covenant package trends. In fact, as of September 2020, 15 out of 19 private debt lenders expressed interest in working on restructuring covenants. One example is the fashion group Twinset, controlled by Carlyle, which was forced to restructure its economic and financial covenants on EUR170 million of debt mainly owned by debt funds to support the firm's recovery.[100]

"The private debt industry has an opportunity to position itself as a strong channel for long-term growth."

[97] Giorgio Leali, Italian banks under fire for being slow on coronavirus loans, 30 June 2020.
[98] PDI, Deep Dive: How is covid-19 changing private debt?, 1 September 2020.
[99] PDI, How cov-lite survived covid, 1 October 2020.
[100] Jeffrey Diehl, Q&A with Bill Sacher: Private Credit Considerations for Investors in 2021, February 2021.

Impact on real estate

Effects

Impact of the COVID-19 pandemic on the Italian housing market

The pandemic induced an overall drop of 22.2% in Italian real estate transactions between H1 2020 and H1 2019. The retail sector was the most affected, with transactions plunging by 28.6% due to the lockdown and the closure of retail stores. According to Confcommercio (Italian General Confederation of Enterprises, Professional Activities and Self-Employment), this was expected to have caused a loss of EUR22 billion in Lombardy alone.[101] Retail stores are still facing a difficult period; consequently, the number of assets in the market is expected to increase.

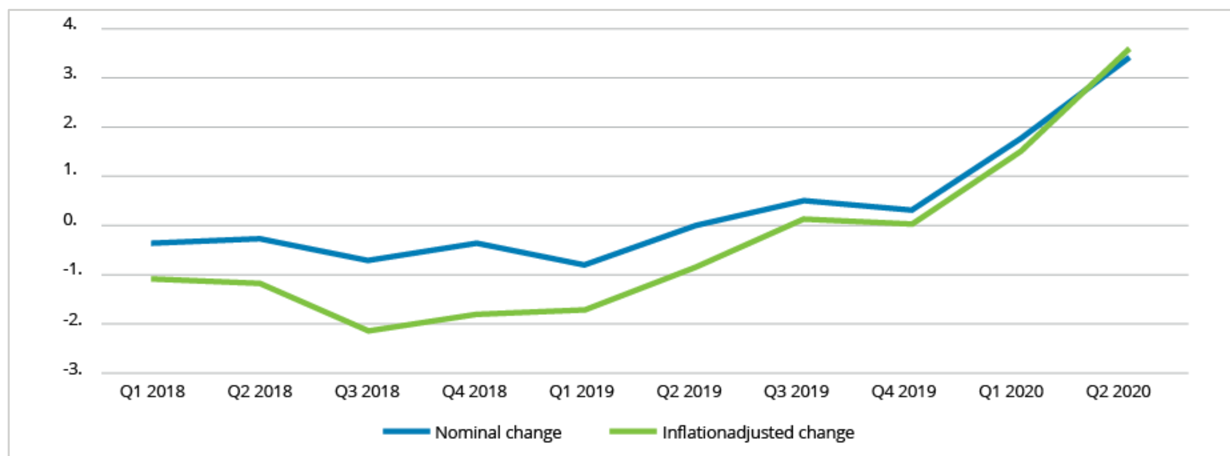
Real Estate Trends by Sector

Sector	Number of transactions Q1–Q3 2020	Variation with respect to Q1–Q3 2019
Residential	374,545	-13.9%
Retail	17,380	-21.5%

Sector	Volume of investment
Retail	EUR890 million
Hotel	EUR680 million
Logistics	EUR670 million

Source: Gabetti Solutions, I trend Covid settore per settore

Annual house price change in Italy 2018-2022 (per quarter)



Source: Statista and ISTAT

In the residential sector, annual house prices experienced a peak drop of 3.4% in Q1 2020. In the commercial sector, real estate investment volumes in Europe fell by 23% between 2019 and 2020, while the Italian market saw a 15.5% decline in the same period.[102]

[101] Confcommercio, Il Covid ha fatto perdere 22 miliardi alle imprese del commercio lombarde, 16 October 2021.
[102] Statista, Total commercial real estate investment volume in Europe from 2019 to 2020, by country, 2021.

Future outlook

Bank of Italy surveyed 1,269 Italian real estate agents on their predictions regarding selling prices, the number of homes on the market, and the number of potential buyers.[103]

According to the survey, 58.7% of agents expected the sale prices of new constructions to decline, as disposable income usually decreases and people refrain from investing without visibility during crises. 43.3% of agents expected an increase in the number of homes on the market, mainly due to an increased need for liquidity during crisis times. And, 30.4% of agents expected the number of potential buyers to increase, as investors tend to turn to tangible and safe assets such as real estate during economic crises.

The overall conclusion is that, while consumer preferences have changed, in general, the savings accumulated by the upper-middle class, coupled with low interest rates, have provided real estate investors with more resources, consequently pushing the demand for real estate assets.

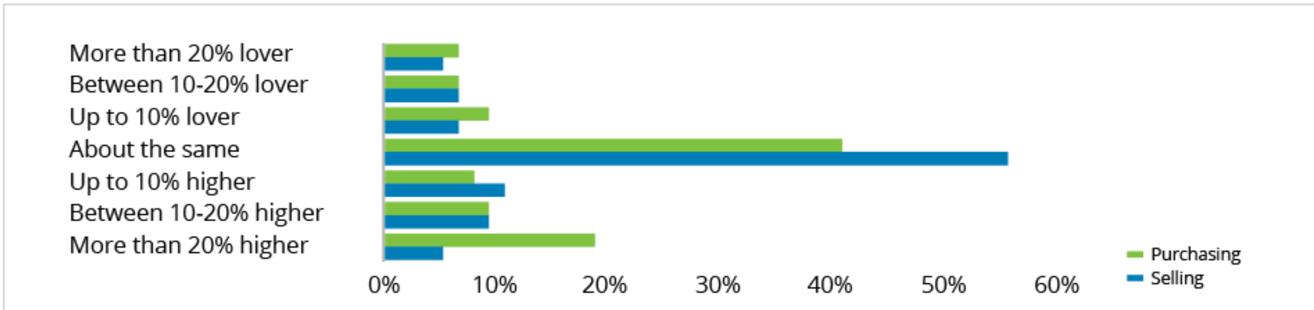
Hotel industry: during COVID-19, customers' concerns regarding their health and safety affected their willingness to travel and drove new client preferences, including a shift towards local and less crowded destinations. The hotel industry experienced an increase in domestic demand during the pandemic and hopes to recover from the crisis in 2024–2025.[104] As the number of remote workers grows, hotels may increasingly offer spaces and services to these workers. This could see business and leisure hotels merging, which are generally distinct, and catalyze the development of modulable spaces for smart working and events. For example, Singapore has inaugurated a new hotel concept for business travelers, Connect@Changi, where foreign businessmen can meet in person with Singaporeans, thanks to dedicated meeting rooms.

Residential: a Forbes study[105] shows that buyers are broadening their property searches and considering more neighborhoods, as the expectation of spending more time at home fuels the desire for more breathable and pleasurable properties. This has increased the demand for second homes, larger surfaces, and more open outdoor spaces.

Office: a Deloitte study[106] on the post-pandemic digitalization of work establishes four expected steps to attaining digital maturity: exploring digital, doing digital, becoming digital and being digital. Many companies have taken a holistic digital approach to smart working to improve their efficiency and strategy. For this reason, industry executives predict[107] heavy reductions on office rents as a result of COVID-19. Many rent deferral payments have been granted, as well as longer rent-free periods for new tenants.[108] Half of real estate investors (50%) believe demand for physical office space will decrease by up to 10% over the next three years.[109]

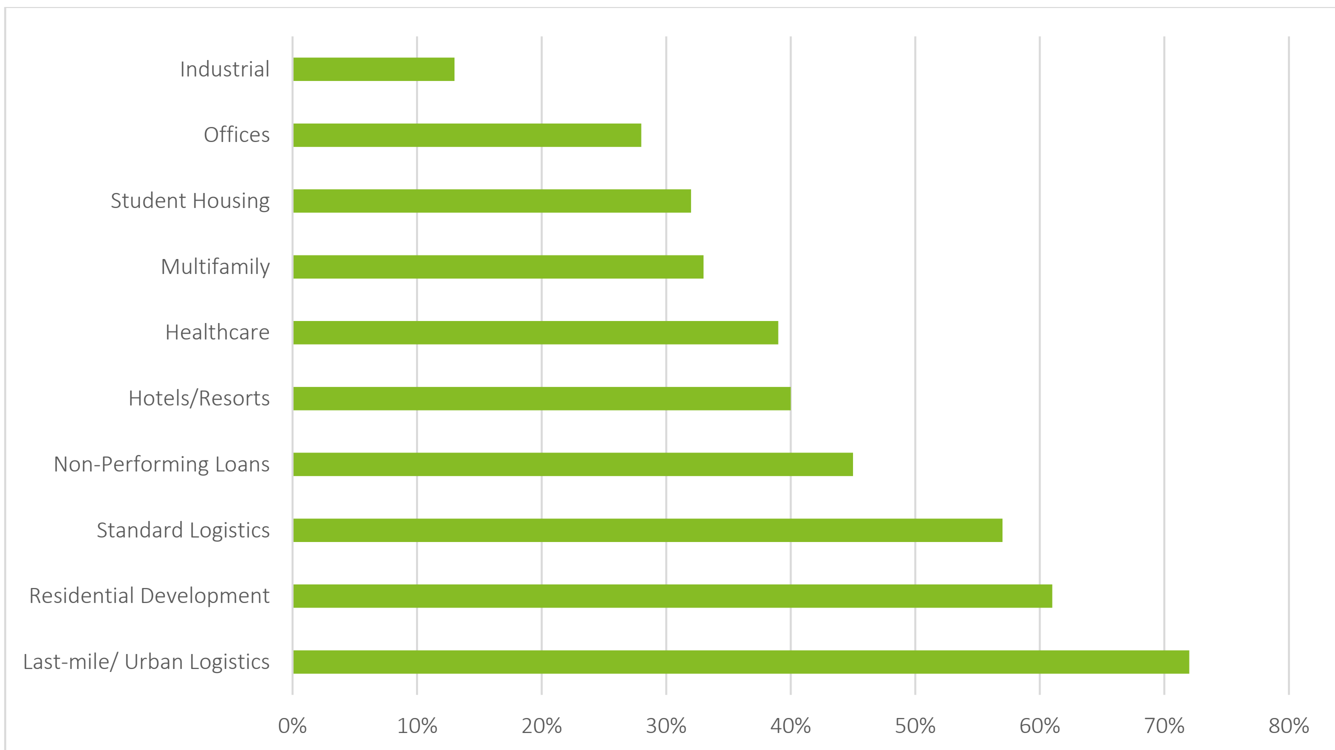
[103] Banca d'Italia, Sondaggio congiunturale sul mercato delle abitazioni in Italia, 4 March 2021
[104] McKinsey, The Travel Industry Turned Upside Down, 2020
[105] Forbes, The Most Searched Out-Of-State Home Buying Destinations, 2019.
[106] Deloitte, Returning to work in the future of work, 2020.
[107] KPMG International, Real Estate In The New Reality, 2020.
[108] SquirePattonBoggs, COVID-19 Government Measures in Real Estate Europe, 3 April 2020.
[109] CBRE, Investor Intentions Suvey EMEA, 2021.

Italy investor intentions survey 2021 – compared with 2020, what do you expect from your acquisition/disposal activity in 2021?



Source: CBRE Italy Investor Intentions Survey 2021

Italy investor intentions survey 2021: which asset class do you consider most attractive for 2021?



Source: CBRE Italy Investor Intentions Survey, 2021

Logistics: investment in 2020 grew by 3% to EUR1.4 billion, following on from a record year in 2019. This was due to high demand and competitive returns regarding other European markets. On the one hand, there was a consolidation in the research of opportunities regarding standard logistics real estate in primary markets, while on the other, the lowering of prime returns drove investors to look at new markets and types of assets. One example is the high demand for spaces dedicated to a last-mile function which, combined with a low supply, pushes investors to look at non-standard assets located closer to urban centers. Furthermore, the growth of e-commerce was one of the main drivers of 2020's strong results, with 46% of spaces having e-commerce as a final use.[110]
The COVID-19 pandemic catalyzed transformations that were already occurring. In the short term, real estate funds will make opportunistic transactions related to cash flow optimization or relocation of assets to protect themselves from the shock. This will guide the formulation of a new allocation strategy, lengthening the strategy to the medium-to-long term. Overall, investors have temporarily lowered fund collecting and changed liquidity clauses.[111]
Regarding landlords and tenants, landlords reported a reduction in their rental income as tenants asked to postpone their rental payments. The average discount margin compared with the lessor's initial claims has risen again to 4.8%. Prospects of future rental prices remain largely negative in the first quarter of 2021, reflecting the still particularly negative expectations in urban centers (-36.2%)[112]

Fund performance and manager choices

At the end of 2019, the directly owned value of the 505 real estate funds in Italy amounted to EUR91.5 billion (+10.9% year on year). This value, together with the net asset value (NAV) was expected to increase by roughly 4% in 2020. Therefore, while the pandemic certainly slowed funds' asset growth, they are still predicted to grow and expand, with directly owned real estate by funds expected to surpass the EUR100 billion milestone in 2021.[113]

Real estate funds in Italy - reserved retail funds (in EUR million)

	2015	2016	2017	2018	2019	2020*
Number of active funds (1)	425	440	458	483	505	518
NAV (2)	50,200	60,000	68,100	74,000	81,400	84,900
Directly owned real estate	57,300	66,900	74,600	82,500	91,500	95,000

**Estimate: (1) Funds authorized by the Bank of Italy that concluded the placement; (2) NAV on 31 December.*
Source: Banca d'Italia, I Fondi Immobiliari In Italia E All'estero, 2020

[110] Reuters, Commercial real estate in Italy, 2021
[111] FORBES, "What Your Reaction To The Pandemic Reveals About Your Real Estate Investing Style", 2020.
[112] Banca d'Italia, I Fondi Immobiliari In Italia E All'estero, 2020.
[113] Banca d'Italia, I Fondi Immobiliari In Italia E All'estero, 2020.

Overall, real estate experts are optimistic regarding the sector's outlook in the medium to long term. They also believe the pandemic will bring a huge influx of capital to exploit the opportunities arising from the downturn, such as the pandemic's severe impact on the tourism and hotel sector, which was already weak pre-pandemic.

Between January and March of 2020, Italy experienced a slightly higher influx of capital compared with the same period in 2019, followed by six months of contraction of around EUR6 billion of investments until September 2020.[114] Real estate, pension and investment funds have increased their focus on less risky assets to rebalance their portfolios—shifting their preference towards logistics and data centers, the best-performing asset classes.

The year 2020 closed with EUR8.8 billion of investments (down by 29% compared with 2019 but in line with 2018's results), registering new record investments for logistics and residential. Offices maintained their status as the best asset class; however, investors remained cautious and were waiting for the demand of occupiers to recover.[115]

For these investments, 59% of the capital came from foreign investors, compared with an average of 69% between 2015 and 2019.The traditional residential sector is recovering, but not without some important changes in client preferences.

The desire to own bigger properties, alongside the stability in prices and the uncertainty regarding future economic prospects, has shifted clients' attention away from city canters and towards newer real estate, which is easier and less costly to maintain. The distribution sector and large shops in the commercial sector have seen a reduction in margins and growth prospects. High street shops have also suffered, and are expected to perform negatively for several quarters. On the other hand, shops offering necessary goods and serving middle-class residential areas suffered less in 2020.

[114] CBRE Research, Real Estate Market Outlook, 2021.

[115] CBRE Research, Real Estate Market Outlook, 2021.

02 ESG IN ALTERNATIVE INVESTMENTS

Sustainable finance

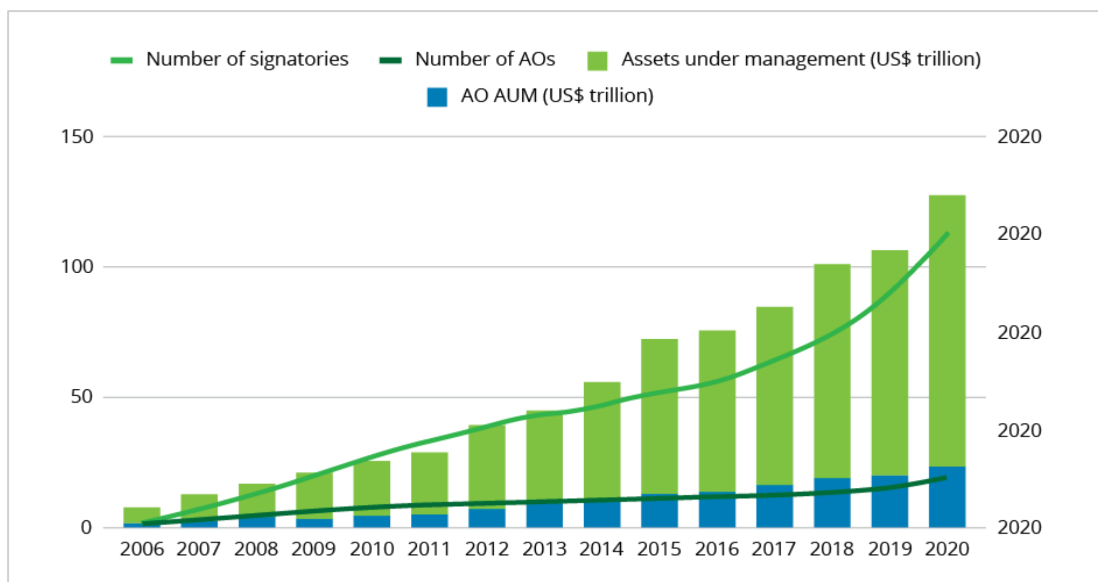
In 1970, Milton Friedman argued that firms pursuing social goals neglect their responsibility to their shareholders, in effect both imposing a tax and deciding how the proceeds should be spent. This mindset of corporate social responsibility (CSR) influenced academic and business thinking in the decades that followed.

More than 50 years later, things have radically changed. Businesses consider sustainability as an opportunity to create shared value for society at large, as well as their employees, shareholders, and other stakeholders.[116] [117] This understanding is the natural conclusion of system-thinking, which considers social and ecological issues to be part of a complex and broader system.[118]

A recent study of 25 meta-analyses with a sample size of 1 million observations found a significant positive correlation between corporate social performance and corporate financial performance, especially for highly visible enterprises.[119]

Investors can no longer ignore the fact that enterprises engaging in sustainable practices are more profitable than companies that do not. Therefore, it comes as no surprise that signatories to the Principles of Responsible Investment (PRI), the world's leading proponent of responsible investment initiated by UN Secretary-General Kofi Annan, increased from 100 at its launch in 2006 to 3,575 today, of which 70 are Italian.[120]

Development of PRI Signatories



Source: PRI, 2021

[116] Dyllick & Muff, Clarifying the meaning of sustainable business, 2015.
[117] Porter, Creating shared value, 2011.
[118] Berkes and Folke, Linking Social and Ecological Systems, 1998.
[119] Friede et al., ESG and financial performance: Aggregated evidence from more than 2000 empirical studies, 2015.
[120] PRI, About the PRI, 2021.

A 2020 McKinsey report found that C-suite leaders are willing to pay around a 10% premium to acquire a company with strong ESG credentials. More importantly, 83% of C-suite executives and investment professionals believe that ESG will contribute more to shareholder value in five years than today[121]. Interestingly, even the executives who did not believe that ESG contributes to shareholder value were still willing to pay the 10% premium, which demonstrates the magnitude of the culture surrounding ESG today.

ESG's robust culture is also reflected in portfolios' actual performance, as with renewable energy indexes overtaking the coal index from around 2013 onwards. This shows how far we have come from Friedman's days—not only is ESG not diminishing shareholder value, but non-compliant companies are becoming investment deal-breakers.

This success is not only due to an increased interest in responsible assets. Companies that consider ESG factors in their business decisions, as recommended by the Task-Force on Climate-Related Financial Disclosures (TCFD), are less exposed to risks because policy changes may prematurely make unsustainable assets obsolete.[122]

However, to reliably distinguish sustainable investment targets from their peers, additional transparency and a consistent taxonomy are required. The European Union's recent initiatives in this area, including amending the Non-Financial Reporting Directive (NFRD) and introducing the Sustainable Finance Disclosure Regulation (SFDR), may speed up the adoption of ESG-related considerations further.

In 2020, a study by the US SIF foundation found that 1 in every 3 dollars invested in the US has a sustainability mandate, amounting to roughly US$17.1 trillion (EUR14.4 trillion).[123]

In January 2020, the European Union presented the European Green Deal Investment plan, which highlights the detailed mobilization of EUR1 trillion of sustainable investments over the next decade from public and private investors.[124] This plan is one of several policies that will substantially affect both the European Union's economy and green infrastructure going forward. Sustainable finance, as a bridge between private capital and green investments, will play a crucial role in this policy, as highlighted by the European Union.[125]

Italy has a noted interest in the transition to green, as it is the second-most affected EU country by climate-related events. Italy's government is quite advanced in its willingness to incorporate environmental considerations in its budgets. The Italian Green Deal and the National Energy and Climate Plan mark the state's commitment toward a green transition. Moreover, the EUR20 billion fund allocated for investments between 2020 and 2034[126] is sure to require, like the European Green Deal, both private and public investors' support, further promoting the development of sustainable finance in Italy.

[121] McKinsey Sustainability, The ESG premium: New perspectives on value and performance, 12 February 2020.
[122] TCFD, Task Force on Climate-related Financial Disclosures, 2021.
[123] Financial Times - Michael Martin ESG: a trend we can't afford to ignore, 26 November 2020.
[124] European Commission, Overview of sustainable finance, 2021.
[125] European Commission, Sustainable finance, 2021.
[126] European Commission, Country Report Italy 2020, 26 February 2020.

It is important to note that, during the pandemic, governance issues have arisen regarding directors' duties when companies experience financial distress. Additionally, social aspects received special attention, with employee health and safety becoming an immediate priority for firms. This focus on social and governance issues has diverted attention away from the environmental issues typically at the heart of the ESG agenda.[127]

Sustainability in different investment classes

The following sections are a guide to the Italian responsible investment landscape, identifying the particularities of ESG in the private equity, private debt, and real estate markets. The focus is on performance, current trends, categories of instruments, and future outlook.

Private equity

In private equity, ESG considerations are mainly found in the selection of target companies and the subsequent management of the acquired firm.

The target selection process begins with the initial screening of the target company's industry. The most universally accessible checklist is the Ten Principles of the UN Global Compact,[128] which includes fundamental guidelines on human rights, labor, environment, and anti-corruption. The exclusion list of the International Finance Corporation (IFC)[129] also provides sustainability-minded private equity firms with an extensive list of projects to avoid.

Other organizations' guidelines on best target selection practices include the United Nations' "Principles of Responsible Investment" (UNPRI)[130] and the US research organization Private Equity Growth Capital Council (PEGCC). Bloomberg offers ESG data for more than 11,800 companies in more than 100 countries, providing investors with a variety of proprietary and third-party ESG scores to evaluate disclosure and performance and assess company activities relative to their peers. Refinitiv's ESG investment data covers 80% of global market cap in 76 countries, with ESG analysis through data points, standardized reports, indices, and scores.[131] [132]

After the initial screening, funds usually engage in ESG due diligence to closely scrutinize the target. Research by ALTIS shows that over 86% of funds "often" or "always" assess ESG factors through due diligence, mainly to assess ESG risks and comply with international voluntary standards or local laws and regulations.[133]

When it comes to portfolio management, the process of actively increasing the value of acquired targets, private equity firms usually actively engage in ESG transformation.[134] [135]

[127] Latham & Watkins, ESG in European Private Equity: The Effects of COVID-19, 22 June 2020.
[128] United Nations Global Compact, The Ten Principles of the UN Global Compact, 2021.
[129] IFC, IFC Exclusion List, 2007.
[130] PRI, Winners of the PRI Awards 2021, 2021.
[131] Bloomberg Professional Services, Unlock successful ESG investment with Bloomberg's data and solutions, 2021
[132] Refinitiv, ESG data, 2021
[133] Maria Cristina Zaccone and Matteo Pedrini – ALTIS, ESG Factor Integration into Private Equity, July 2020.
[134] Duke Gavin, Sustainable Private Equity Investments and ESG Due Diligence Frameworks, 2015.
[135] PRI, Integrating ESG in private equity, 2014.

Current trends in private equity ESG

The United Nations Sustainable Development Goals recognize that the financial sector plays a key role in implementing initiatives and determining the goals' success.[136] While many public companies are already taking a stance on sustainability as the pressure from consumers and policy-makers grows, private markets often remain out of the spotlight. However, the hands-on management of alternative investors is ideally suited to implementing sustainable initiatives.

In its 2021 Global Private Equity Report, Bain & Company argues that private equity investors will remain skeptical of shared value until there is consistent evidence of a positive link between ESG investing and private equity funds' returns. The report also acknowledges that many private equity investors are not waiting for return on investment (ROI) studies before engaging in ESG —with a growing segment of the industry believing investments in good governance, social welfare, and sustainability require a different set of key performance indicators (KPIs) to reliably measure improvements in ESG investing.[137]

Across the private equity industry, the importance of ESG activities is increasingly prevalent: they contribute positively to the environment and society and are seen as critical to developing a resilient and successful modern business. In the United Kingdom, for example, almost two-thirds of private equity firms take ESG principles into account when making investments, 48% provide detailed disclosures about their investments' ESG impact, and 25% even have a dedicated team or individual responsible for embedding ESG into the investment process.[138]

In addition, the main reasons behind the growth of ESG activities are likely to be the increasing demand of investors for greater ESG integration and transparency, government incentives, and the evolving regulatory environment. With regulatory disclosures becoming mandatory, institutional players' demand for sustainable investments will also increase.

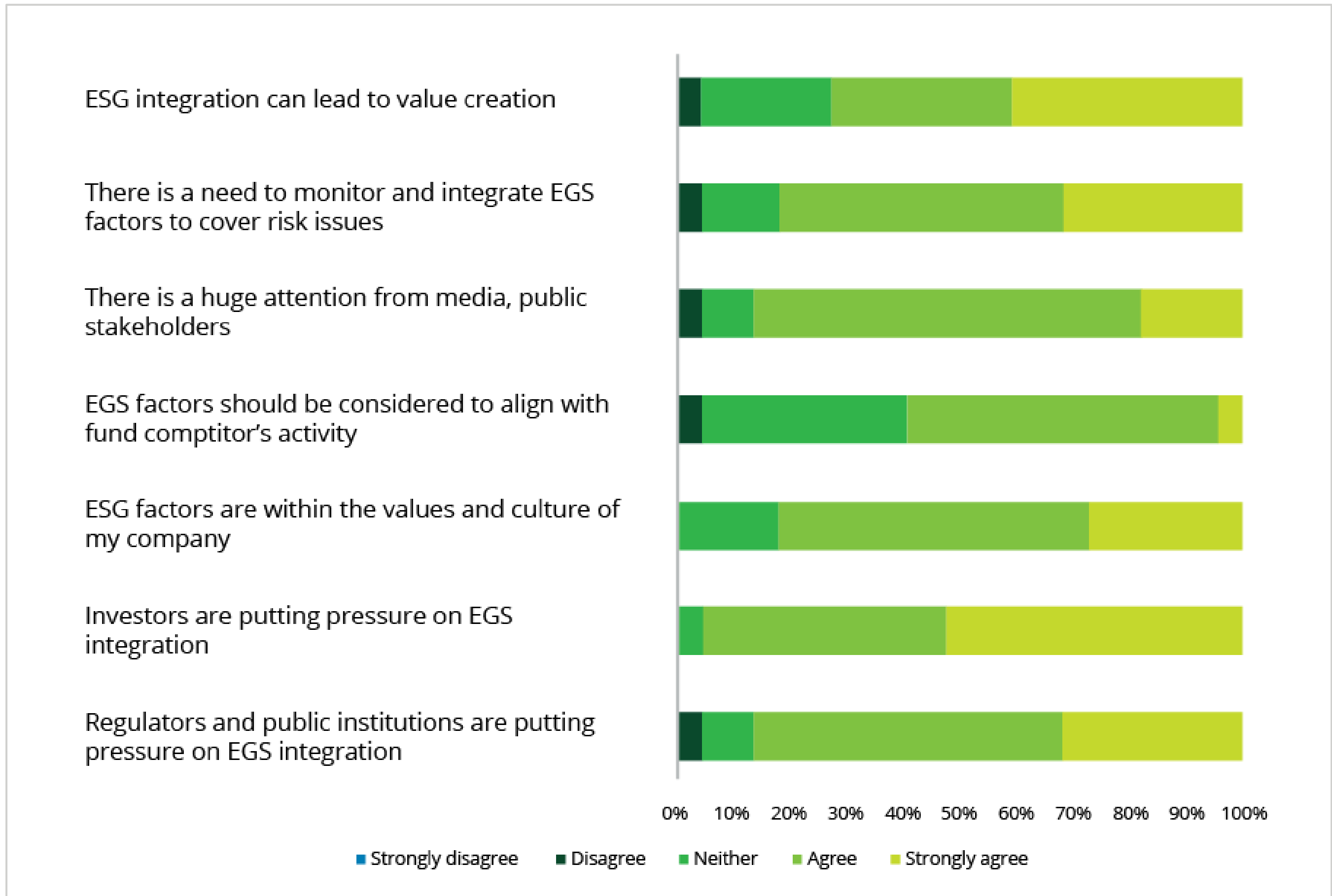
Regarding legislation, Italy is subject to the growing influence of EU regulations. In 2018, the European Commission published the "Action Plan on Sustainable Finance", which outlines measures for EU member states to achieve ESG sustainability. Italy reacted positively to this initiative and was actively involved in its development. CONSOB, the Italian market regulator, follows this action plan closely, which introduced regulatory supervision in areas already under CONSOB's direct competence, and ensures compliance with such plan.[139]

In a 2020 study by ALTIS, researchers surveyed private equity funds in different countries to uncover their motivations for engaging in ESG investing. The strongest drive was pressure from investors, with 95.3% of respondents reporting their investors were demanding ESG engagement. Of the respondents, 81.8% agreed or strongly agreed that ESG factors are integrated into their fund's values and culture, and 86.3% stated that regulators and public institutions are putting pressure on ESG integration.

[136] United Nations, Finance for sustainable development, 2020.
[137] Bain & Company, Global private equity report 2021, 2021.
[138] Financer Worldwide, From nice to have to mainstream: ESG in private equity, February 2021.
[139] PWC, Finanza Sostenibile, 2019.

Moreover, 86.4% of respondents agreed or strongly agreed that there is huge attention from the media and public stakeholders on the topic, and 73% believe ESG integration could lead to value creation.[140]

Why are ESG factors become increasingly important?



Source: Friede et al., 2015

The question of value creation will determine whether ESG will continue to gain traction in private equity. Measuring positive returns on ESG private equity investments is difficult and research on the topic is limited. However, historical data on public markets' returns suggests that ESG investing may enhance rather than detract from equities' performance.

From 2004 to 2020, a STOXX index of global ESG leaders has outperformed the STOXX Global 1800 Index by 37%. Moreover, a 2015 German meta-study analyzing more than 2,000 independent research efforts assessed that 63% of studies discovered a positive correlation between ESG investing and returns, and only 8% showed a negative effect.[141]

[140] Maria Cristina Zaccone and Matteo Pedrini – ALTIS, ESG Factor Integration into Private Equity, July 2020.
[141] Friede et al., ESG and financial performance: aggregated evidence from more than 2000 empirical studies, 2015.

Also, in ERM's 2020 Global ESG Survey, 93% of more than 50 private equity executives agreed that focusing on ESG-oriented targets will generate good investment opportunities and lead to positive returns.[142][143] Reasons for this correlation can range from reduced risk stemming from policy changes to improved quality, brand image, employee retention, and resource efficiency.

ESG in the Italian private equity market

The focus on sustainable and responsible investing and the need to measure, manage and mitigate ESG risks has grown significantly, both internationally and in Europe. The Italian market's interest in the topic continues to rise, both on the basis of growing demand from institutional investors, and by leveraging managers' greater awareness of the opportunities afforded by active involvement in sustainable investments. [144]

The Italian ESG investment market is growing steadily, with a focus on traditional strategies, including screening and exclusion of certain investment opportunities and consideration of international conventions. The market is also demonstrating a growing application of active engagement and voting policies. Pension funds and insurance companies are showing a particular interest in ESG: they both share a long-term investment horizon and, because of their fiduciary duty towards their members, are committed to responsible management of investment risks and opportunities. [145] [146]

Above all, Italian private equity firms should keep an eye on the rising importance of social issues, which previously tended to be overshadowed by environmental and governance topics. Italy has long been characterized by a high level of gender, social and territorial inequalities, a low rate of female participation in the labor market and a very high number of unemployed young people. In 2020, this situation was amplified by the pandemic. In addition, widespread economic, social and psychological distress exposed its citizens to various social risks.

As a result, the Italian government's 2020 report "Initiatives for relaunch Italy 2020–2022", puts social equity and sustainability at the heart of its strategy to mitigate the pandemic's effects.[147] Capital markets are already reacting to this political strategy by developing products that meet these objectives and focus on social issues.[148] Therefore, private equity firms are encouraged to pay particular attention to social issues in the target selection and management of Italian companies. However, funds should also closely observe environmental topics, which will continue to grow in importance in Italy.

Currently, Italian private equity funds committed to ESG can refer to the 2019 ESG guidelines set by the Italian Private Equity Venture Capital Association (AIFI). These provide general ESG principles for the investment, the monitoring and reporting, and the exit phases. The AIFI has long been committed to disseminating a sustainable culture across the financial community and

[142] Bain & Company, *Investing with Impact: Today's ESG Mandate in Private Equity*, 24 February 2020.
[143] ERM, *Eyes on the prize: unlocking the ESG premium in private markets*, 2020.
[144] AIFI, Linee guida ESG, 2021.
[145] AIFI, Private equity sostenibile, October 2015.
[146] Etica SGR, Studio Eurosif 2018: investitori istituzionali sempre più orientati all'SRI, 16 January 2019.
[147] Comitato di esperti in materia economica e sociale, Iniziative per il rilancio "Italia 2020-2022", June 2020.
[148] Fundspeople – Giovanna Vagali, La rivincita dei temi sociali negli investimenti ESG, 18 March 2021.

positions itself as a reference point for these issues in Italy.[149]

The importance of ESG in Italian private equity firms can be appreciated by looking at a random selection of some of the country's largest funds. Their investment strategies follow the recommendations, principles, and observations described so far.

One example is a leading Italian private equity firm, which manages EUR330 million in independent private equity funds dedicated to the Italian mid-market and is mainly focused on buyout transactions. The firm believes ESG to be "instrumental in ethical and balanced investment [activities that are] sustainable and ultimately beneficial to ... society and civilization." The firm has subscribed to the previously-mentioned PRI, has a special advisor for ESG implementation, and claims particular dedication to the issue during target selection.[150]

Italy's largest independent infrastructure fund manager with EUR5.5 billion AuM has subscribed to the PRI as well. Investing in transport and logistics, energy, distribution networks and telecommunication, the firm has developed extensive internal guidelines on responsible investments, publishes yearly ESG reports, and invests in renewable energy sectors. Moreover, the fund states the high presence of institutional investors among its sponsors encourages it "... to align economic return objectives with complying with responsible investment principles".[151]

A publicly-listed firm that specializes in investments in high-potential SMEs with EUR1.4 billion AuM incorporates ESG factors into its target selection strategy. The firm favors companies that contribute to the development of sustainability and has sustainable production and consumption models. With this approach, the firm follows an exclusion-inclusion selection strategy, actively including ESG criteria in their new target searches by following an internally generated list of extensive and demanding principles.[152]

Private debt

Introduction

The sustainable debt market is a growing investment category, reaching US$1.17 trillion (EUR985 billion) globally with issues of US$465 billion (EUR392 billion) in 2019, the highest volume ever recorded worldwide. While listed debt still represents the biggest slice of this market, non-listed instruments are gaining in popularity thanks to the multiple advantages they offer.[153]

ESG factors are becoming a more recurring part of debt instruments. ESG factors act as an insurance-like asset that is correlated with lower costs of debt and higher credit ratings, and these effects are even more significant in highly turbulent markets.[154] This flies in the face of ESG critics who claimed ESG investing would be revealed as mere hype once market volatility returned.

[149] AIFI, Linee guida ESG, 2021.
[150] Alto Partners, Private Equity a Supporto delle Piccole e Medie Imprese italiane, 2021.
[151] F2i, Trasformiamo la finanza in industria, 2021.
[152] Gequity, Società di investimento, 2021.
[153] IPE - Carlo Svaluto Moreolo, Private and green: Non-listed sustainable debt, April 2020.
[154] IDEAS – Sun Wenbin, Cui Kexiu, Linking corporate social responsibility to firm default risk, 2014.

ESG as a risk component

A more intricate way that ESG relates to debt instruments is through risk components, and the need to price ESG risk in. In general, ESG is considered a risk factor whose significance is linked to the investment horizon.[155] This suggests that a large portion of the priced-in risk relates to climate change and not only reputational or social factors.

These risk components explain the lower cost of debt associated with companies that perform well on ESG-related measures. The time horizon of the priced risk also demonstrates why private credit is an important part of sustainability financing; on average, private credit investors concentrate more on long-term credit quality compared with public investors.

Types of ESG instruments

Two of the most promising categories of ESG-related private debt offerings are green loans and sustainability-linked loans, which in 2019 represented a volume of US$170 billion (EUR143 billion), a growth of 200% from the year before.[156] Most of this volume came from sustainability-linked loans, which grew 168% to US$122 billion (EUR103 billion) in the same year. European collateralized loan obligations (CLOs) are also a class that is slowly but surely turning green, with its EUR1.5 billion market representing a 5.56% slice of the overall market. The trends emerging in Europe are similar to global ones, where green bonds and sustainability-linked loans are leading the growth in sustainable debt. [157]

The difference between sustainability-linked loans and green bonds (or loans) is a matter of flexibility. Sustainability-linked loans connect the coupon payments to the issuer's sustainability, while green loans are funds that must be used for "green" purposes; therefore, the issuer does not need to be sustainable. Sustainability loans are usually used for general corporate purposes, but the rates are variable according to the defined sustainability factors that must be met. The fact that sustainability-linked loans are more popular in Europe, and have driven the recent growth, may be due to a European focus on more sustainable corporations and not just sustainability projects.

Analysis of green bonds

Green bonds, on average, carry a significant 20–30bps negative premium—i.e., a lower cost of debt—in the primary market compared with traditional bonds. Green bonds in Europe tend to be issued at a premium with an average maturity of 8.75 years, a coupon of 3.40%, and an issuance yield of 3.27%.[158]

An advantage of green bonds, which makes them especially suitable for impact investments, is that funds can be used to finance sustainable projects even when the corporation is not categorized as particularly sustainable.

However, the benefits are asymmetrical. When corporations issue green bonds, they tend to exhibit more volatility, lower liquidity, and higher interest rates than their institutional green bond counterparts. Specifically, corporate green bonds are 0.8% less volatile than their brown bond counterparts, while institutional green bonds are

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[155] PRI, Spotlight on responsible investment in private debt, 2019.
[156] IPE - Carlo Svaluto Moreolo, Private and green: Non-listed sustainable debt, April 2020.
[157] Statista, Value of sustainable debt issued worldwide from 2017 to 2019, by type, 2021.
[158] Julia Kapraun - Christopher Scheins, (In)-Credibly Green: Which Bonds Trade at a Green Bond Premium, 2 May 2019.

nearly 10% less volatile. Similarly, corporate green bonds are around 1% more liquid while institutional green bonds are nearly 11% more liquid compared with their brown bond equivalents[159].
However, when private issuers commit to certifying the greenness of bonds, these comparative negative factors dissipate. For example, the 2018 article “The Price of Going Green” found that green bonds that use an external reviewer have a 7bps discount, whereas those that obtain certification from the Climate Bonds Initiative (CBI) receive a 9bps discount. This first involves an independent body researching and reviewing data (for example, Bloomberg New Energy Finance) and second, the bonds meeting the CBI’s requirements both pre- and post-issuance, as well as independently approved climate bond verifiers.[160]

With the European Union committing to the standardization of the green bond market, and Italy following suit, the private market for green bonds will likely become more uniformly “certified” and, consequently, will start to derive the same benefits as conventional bond markets, further driving its development.[161]

Green bonds are highly correlated with fixed income and currency markets, while weakly correlated with stocks, energy and high yield corporate bond markets. This has important implications for investors looking to include green bonds in their portfolios, as it provides some guidance on the attainable diversification benefits based on existing portfolios.[162]

Analysis of sustainability-linked loans/bonds

Sustainability-linked loans are seen as an asset class with broader appeal, as they do not require the funds be used for green projects.

In 2019, Enel issued the world’s first sustainable development goals (SDGs)-linked bond. The bond used a step-up mechanism that increases the rate by 25bps (the most common rate increase) if the company does not reach a 60% share of renewables across its production capacity by 31 December 2022.[163] However, recent instances have shown that the provision rate spreads fall in the range of 50–75bps, indicating a movement of norms as the market develops further.[164]

Not only is this novel provision important to investors, but its inclusion makes ESG loans eligible for CLOs, opening up a US$700 billion (EUR590 billion) market that makes up 60% of the demand for leveraged loans.

The main reason for this is the ECB’s decision to begin accepting bonds that have their coupon structure linked to certain performance targets—those in line with the United Nations Sustainable Development Group (UNSDG) or the EU Taxonomy Regulation—as collateral for Eurosystem credit

[159] MDPI – Bachelet, Becchetti, Manfredonia, The Green Bonds Premium Puzzle: The Role of Issuer Characteristics and Third-Party Verification, 19 February 2019.
[160] Suk Hyun, Donghyun Park, Shu Tian, The Price of Going Green: the Role of Greenness in Green Bond Markets, July 2018.
[161] MDPI - Ana-Belén Alonso-Conde, Javier Rojo-Suárez, On the Effect of Green Bonds on the Profitability and Credit Quality of Project Financing, 18 August 2020.
[162] MDPI - Ana-Belén Alonso-Conde, Javier Rojo-Suárez, On the Effect of Green Bonds on the Profitability and Credit Quality of Project Financing, 18 August 2020.
[163] Enel, Enel Successfully Launches A 500 Million Pounds Sterling “Sustainability-Linked Bond”, The First Of Its Kind On The Sterling Market, 13 October 2020.
[164] Latham & Watkins, Sustainability-Linked Finance Takes Off in 2020, 1 December 2020.

operations, and eligible purchases in outright monetary policy transactions.[165]

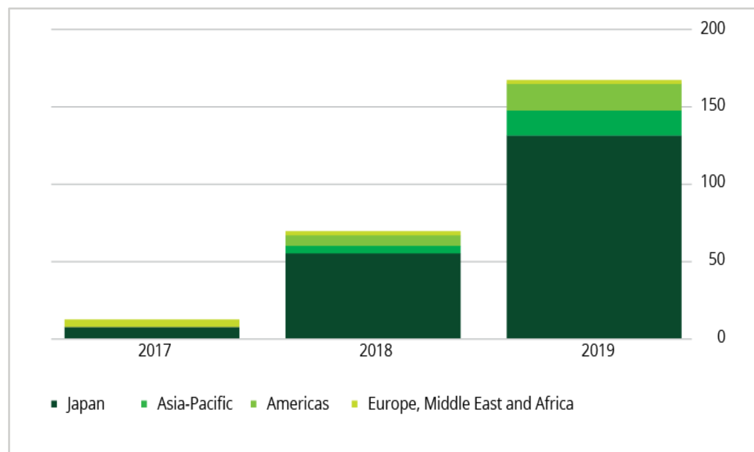
Although the step-up provision is generally the main method used to alter the coupon structure, there is also an alternative—a step-down provision. This essentially alters the coupon structure in the bond issuer's favor (i.e., lowering the coupon rate) when certain criteria are met.

However, especially within the sustainability-linked bond market, the step-down provision is less commonly used since investors are less willing (or capable) of accepting lower coupon rates when the targets are met. On the other hand, the step-up provision goes in favor of the bond investor. The increased demand, a result of this investor-favorable provision, may still benefit the issuer by offering market conditions that allow for better pricing. [166] [167]

European and Italian perspective

Europe leads the world in sustainability lending, as seen in the graph titled "Green lending soars in 2019". The European Green New Deal and Next Generation EU are expected to drive growth in the market for green debt securities, both in Europe and Italy. Italy's EUR24 billion ESG-related debt market represents just 6.9% of the overall European market, with 90% of issues represented by energy producers.[168] [169]

Green lending soars in 2019
Sustainability-linked loan volume (in $ billion)



Source: Financial Times, 2020

In March 2021, the Italian government tapped into the sustainable debt market for the first time, raising EUR8.5 billion in Europe's biggest green bond debut.[170] The total amount of bids for the same offering reached over EUR80 billion. The demand was especially strong amongst investors who were required to consider ESG factors in their portfolios. Italy's debut follows a trend of European governments using the green debt market to finance their recovery from the COVID-19 crisis. The overwhelming demand for Italy's debut created a so-called "greemium"—or green premium—with a final yield of 12bps from an initial guidance of 15bps.[171]

This reflects a broader trend that is seen around the world, where green bonds tend to be more

[165] European Central Bank,ECB to accept sustainability-linked bonds as collateral, 22 September 2020.
[166] Publications & Events, Sustainability-linked bonds: the new face of transition finance, 14 August 2020.
[167] NATIXIS - Timothée Pasquier, Dominique Blanc, Cédric Merle, SLBs, a new era for sustainable bonds investors?, 29 March 2021.
[168] Valentina Magri, Il private debt in Italia ha un potenziale inespresso di 11 mld euro. Lo stima Cerved Rating Agency, 19 November 2020.
[169] Financial Times, Green loans catch on in push for companies to clean up, 2020
[170] Earth.Org, Italy Raises €8.5bn in Europe's Biggest-Ever Green Bond Debut, 5 March 2021.
[171] John Ainger, Italy's Green Bond Demand Smashes Peers in Debut Offering, 3 March 2021.

oversubscribed than their vanilla counterparts. In 2020, green bonds in the United States were on average oversubscribed by 2.6x, while their vanilla equivalents were oversubscribed by 2.3x. In the European Union, green bonds were oversubscribed by 5.2x on average, whereas vanilla bonds averaged at 3.1x.[172] This oversubscription phenomenon contributed to Italy's greemium, with the average spread compression also higher for green bonds than their vanilla counterparts.[173]

The European Green Deal spurs innovation in European sustainable finance and creates more homogenous market conditions. The green debt market's consolidation and subsequent maturity will necessarily require an alignment between issuers and investors. This convergence and rebalancing of power may eventually eradicate the current higher shareholder returns and lead to conclusions that are substantially different from those of the present day.

Real estate

The Italian sustainable real estate sector is at its initial stage of development. The article "ESG and financial performance" published on the Journal of Sustainable Finance & Investment indicates its considerable potential, due to the asset class's positive or neutral correlation between financial performance and corporate social performance.[174]

In July 2020, COIMA SGR launched Italy's first real estate fund with measurable ESG goals, the COIMA ESG City Impact Fund. With progressive funding and a 20-year lifecycle, the fund expects to collect more than EUR1 billion and achieve an IRR of more than 10% during the development phase and a stabilized dividend of more than 5% during the income phase. The targeted sectors are tourism and residential real estate, with a special focus on urban regeneration projects at the neighborhood level. An example of this is the "Progetto Porta Nuova", which is completely requalifying Milan in terms of digitalization, energy efficiency and green spaces.[175]

Long-term orientation

The above-average importance of sustainability in real estate is unsurprising, due to the segment being directly affected by the rising risk of climate change and the resulting increase in insurance costs.[176] With real estate's long investment horizons, investors are more likely to see effects materialize in the following four areas, providing clear fiduciary duties to integrate ESG into investment decisions.

[172] Climate Bonds Initiative- Caroline Harrison, Godfrey Design, Green Bond Pricing In The Primary Market: January - June 2020, September 2020.
[173] Climate Bonds Initiative- Caroline Harrison, Godfrey Design, Green Bond Pricing In The Primary Market: January - June 2020, September 2020.
[174] Gunnar Friede, Timo Busch & Alexander Bassen, ESG and financial performance: aggregated, 2015.
[175] COIMA, COIMA SGR lancia il primo fondo italiano ESG di rigenerazione urbana, target a oltre €1 miliardo, 2020.
[176] Munich RE, "Risks posed by natural disasters", 2017.

1. Policy risk: increasing focus on reduced emissions puts assets at risk of stranding

Making up 36% of European greenhouse gas emissions, buildings are the single biggest driver of climate change.[177] Therefore, a significant reduction of emissions in this sector is needed to achieve Paris Agreement commitments and the United Nation's SDGs. Even though sustainability-related reforms in buildings are often the most cost-effective ones, emissions remain above planned levels and require further policy measures.[178] In the European Union, the European Commission has already tightened its regulatory grip with its Renovation Wave Strategy. Aiming to make Europe climate-neutral by 2050, it includes design competitions and funding as well as mandatory minimum energy performance standards.[179]

While public support and subsidies may provide opportunities for new projects, investors should be wary of the risk of stranded assets; properties may quickly become economically obsolete as regulatory standards move beyond levels that efficient renovation projects can reach.

2. Ecobonus: residential renovation projects are eligible for tax credits

While regulation may increase the risk of stranded assets, it may also create incentives for sustainable reforms. In Italy, the "Rilancio" decree of May 2020 introduced the "Superbonus 110%", a 110% tax deduction for expenses related to energy efficiency or anti-seismic reinforcement. Building on the incentives offered by the 2006 "Ecobonus", it provides several cost-saving opportunities for landowners willing to make their properties safer and more efficient by June 2022 (with extension until 2023 for condominiums and public housing).[180]
Currently, the largest incentives available are for the common areas of apartment buildings, especially the insulation of external walls and roofs. Other eligible projects include the installation of solar thermal panels, the replacement of heating systems, the installation of intelligent heating and cooling control systems, and the replacement of windows and window fittings.[181] Although only individual owners can benefit from these incentives, they may indicate new opportunities to investors.

[177] European Commission, Renovation Wave: doubling the renovation rate to cut emissions, boost recovery and reduce energy poverty, 2020.
[178] WGBC, 2019 Global Status Report for Buildings and Construction, 2019.
[179] European Commission, Renovation Wave: doubling the renovation rate to cut emissions, boost recovery and reduce energy poverty, 2020.
[180] Governo Italiano, Superbonus 110%, online il sito dedicato, 19 January 2021.
[181] https://www.enelx.com/it/en/resources/stories/2020/04/tax-credits-energy-saving - article was deleted, please evaluate whether you still want to keep the paragraph.

Available tax credits under Ecobonus (launched 2006) by type of project [182]

Code	Action		Maximum eligible deduction (C) (A)	Maximum eligible expense (E)	Deduction (%)
344	Reduction of heating energy demand of the whole building		100,000.00		65%
345	a) insulation of vertical walls, roof, slabs (*)		60,000.00		65%
	b) windows and shutters replacement (*)		60,000.00		50%
	c) installing solar shades (*)		60,000.00		50%
	d) actions on common parts, involving over 25% of the building surface area			40,000.00 (#)	70%
	e) same actions as In d) to achieve at least the average quality as per tables 3 and 4 of Annex 1, of the Italy's Ministerial Decree 26/06/2015 "Guidelines for the Energy Certification Decree"			40,000.00 (#)	75%
	f) actions as in d) and e) implemented in seismic zones 1,2 and 3, aimed to reduce seismic risks also, resulting in one lower class of the seismic risk classification			136,000.00 (#)	80%
	g) actions as In d) and e) Implemented In seismic zones 1,2 and 3, aimed to reduce seismic risks also, resulting in two or more lower classes of the seismic risk classifications			136,000.00 (#)	85%
346	Installing solar panels to produce domestic hot water		60,000.00		65%
347	a) full or partial replacement of heating systems with systems equipped with (* *)	1. condensing boilers that are at least class A efficient	30,000.00		50%
		2. condensing boilers that are at least class A effident and require the installation of advanced thermoregulation systems	30,000.00		65%
		3. condensing hot air generators	30,000.00		65%
		4. high effidency heat pumps, with low enthalpy geothermal systems	30,000.00		65%
		5. hybrid appliances with heat pump Integrated with a condensation boiler	30,000.00		65%
		6. micro-CHP systems	100,000.00		65%
		7. vil. replacing conventional water heaters with heat pump boiler for domestic hot water	30,000.00		65%
	b) installation of biomass heating system		30,000.00		50%
	c) installation of Building Automation systems				65%

(^) Deduction for a single building unit.
(*) If the actions are on the same real estate unit, the maximum deduction is equal to 60,000 euro.
(**) If the action concerns the installation of several appliances, the maximum deduction is equal to 30,000 euros, or to 100,000 euros if a micro-co-generator is installed.
(#) Times the number of real estate units of the building.

Source: Mondaq, 2020

3. Operations: retrofits offer lower operating expenses and higher rents

Investors in Italy and international markets are increasingly pursuing retrofit projects to lower their operating expenses. As around 80% of Italy's energy production uses gas, oil and coal, energy prices may increase even further amid increasing pressure to fade out high-emission energy production.[183] As Italy's energy prices are already some of the highest in Europe, retrofitting would provide an opportunity for significant cost savings.[184]

Heating, water heating, and lighting consumption makes up 51% of operational costs for office buildings and 57% for residential buildings, making natural lighting, insulation, and renewable heating sources attractive to investors.[185]

In addition to saving on operational expenses, retrofitting buildings can boost revenues due to high-quality tenants' increasing focus on sustainability. These tenants are often willing to pay top-of-the-market rents for sustainable properties, and frequently rent for longer periods,

[182] Mondaq - Lip Kian Ang and Biyerem Okengwu, Singapore: The Role Of ESG In PE Real Estate Investments, 14 November 2020.
[183] IEA, Italy, 2019.
[184] Eurostat, Electricity price statistics, October 2021.
[185] IFMA FOUNDATIONE - Kristian Peterson, Ross Gammill, The Economics of Sustainability in Commercial Real Estate, 2010.

leading to higher occupancy rates. This is especially true for buildings that offer upgraded technology (e.g., smart thermostats), sustainable materials with high comfort, and natural light to improve the building's environmental footprint as well as live ability.[186] [187]

In commercial real estate, well-established companies are also seeking sustainable future headquarters. For example, UnipolSai is working on restructuring its future landmark building nicknamed "Nido Verticale" in Milan. This will have minimum resource consumption thanks to solar panels installed at strategic points and a rainwater harvesting system integrated into its design.[188]

4. Environmental certifications in Italy

Even though affordable housing is still the focus of governments worldwide, and is named in the European Commission's Renovation Wave Strategy, Italian governments have frequently followed a more neo-liberal approach.[189]
For this reason, social-related risks are mainly reputational, with activists and tenant organizations exerting the most pressure.

Environmental certifications in Italy

With the Italian market's growing focus on sustainable real estate assets, investors should carefully consider ESG-related criteria in their investment decisions.
However, environmental certification protocols that allow investors to identify sustainable assets are fragmented in Italy, varying in content and application methods. Two main scoring-based schemes dominate the Italian market: the Italian Institute for the Innovation and Transparency of Procurement and Environmental Compatibility (ITACA) at the public level and Leadership in Energy and Environmental Design (LEED) for international private markets.[190]

For example, in the aforementioned COIMA ESG fund, every project will have specific ESG goals and parameters measured by an internal rating system. However, to guarantee its commitment, it will also adopt the Global Real Estate Sustainability Benchmark (GRESB) as well as the LEED® and WELL for Community certifications.

In addition to these international certifications, the Italian government introduced asset-level energy standards with its Interministerial Decree of 26 June 2015, which enacted the EU's Energy Performance of Buildings Directive (EPBD). The decree:

- Defined criteria for nearly zero energy buildings (NZEBs);
- Outlined methods for the calculation of energy efficiency classifications;
- Introduced obligatory audits of energy efficiency certificates in Italy's regions and provinces (a minimum of 2% per annum); and
- Set new minimum requirements.

This legislation also requires that energy efficiency certificates be prepared by a qualified expert for

[186] Andrea Bassi, Monica Moscatelli, Property Value and Sustainability. The Future of Living: Focus on Short-Term Rents in Italy, 2020.
[187] Mondaq - Lip Kian Ang and Biyerem Okengwu, Singapore: The Role Of ESG In PE Real Estate Investments, 14 November 2020.
[188] Niiprogetti, Il nido verticale, 14 February 2020.
[189] N. Caruso, Housing Policies in Italy: From Social Housing to Neo-Liberalism, 2017.
[190] Andrea Bassi, Monica Moscatelli, Property Value and Sustainability. The Future of Living: Focus on Short-Term Rents in Italy, 2020.

the purchase, renovation, construction, and rental of properties.[191]

Investors rewarded by market for increasing focus on sustainability

Given the strong pressure for energy-efficiency, properties in Milan that were rated highly energy efficient with a LEED® certificate saw an increase in value between 7 and 11%, depending on the certification level.[192]

Therefore, it comes as no surprise that many real estate owners have already decreased their portfolio's year-over-year carbon emissions and that many banks and investment managers, overseeing US$4 trillion (EUR3.4 trillion) worldwide, have already committed to adapting their business processes.[193]

Investors need to improve assets' energy efficiency in their portfolios

The Buildings Performance Institute Europe (BPIE) found that most buildings must, as a minimum, comply with the Energy Performance Certificate (EPC) A to achieve the 2050 decarbonization goal for European buildings.[194] In Italy, at least 90% of buildings are unable to achieve this certificate.[195]

As a result, if investors were to take a risk-based approach, they would exclude a large majority of available assets—and miss the opportunity to profit from improved margins and public funding for retrofitted projects.

Therefore, investors should:

- Incorporate sustainability metrics across the entire investment chain;
- Screen legacy problems before investments;
- Design human-centered buildings;
- Retrofit incompliant properties;
- Engage with tenants and stakeholders;
- Monitor external property managers; and
- Work actively with investment managers in indirect investments.

In Italy, as in Europe, the future of each asset class is firmly intertwined with ESG matters. With regulators and society demanding a green (and increasingly a socially conscious) economic model, investors and asset managers who adapt will reap the future benefits—and investors who do not integrate ESG into their investment processes risk missing out in the long term. In this sense, ESG calls for unity to solve shared challenges. First, investors must work towards quantifying the sustainable narrative and demand clearly defined and measured objectives towards a sustainable future. These well-defined criteria will help the collection and analysis of data, even for the SMEs that compose most of the Italian economic substrate. Finally, to implement change, alternatives investors must be able to not only work with the vast array of instruments but also at a multi-stakeholder level, taking not only returns but also valid interests from investors, policy-makers and society into account.

[191] PAE, Italian Energy Efficiency, June 2017.
[192] REBUILD ITALIA, LEED: La Certificazione Aumenta Il Valore Dell'immobile Fino All'11%.
[193] Clime & Strategy Partners- Tatiana Bosteels, Peter Sweatman, Sustainable Real Estate Investment Implementing The Paris Climate Agreement: An Action Framework, February 2016.
[194] BPIE, 97% Of Buildings In The Eu Need To Be Upgraded, 2014.
[195] ENEA, Energy: Italy, high energy efficient buildings are on the rise, 15 October 2020.

03 TECHNOLOGY IN ALTERNATIVE INVESTMENTS

Introduction

Tech plays a central role in today's market, and innovations will continue to influence the alternative investments sector. Tools like blockchain, artificial intelligence (AI) and big data have only begun to be explored, and their growth potential and applications look extremely promising.

To demonstrate the speed of change and the pervasiveness of these new technologies, here are some statistics:

- There are 4.38 billion internet users globally, with developing countries representing a large, unexploited potential.
- By 2025, 38.6 billion smart devices will collect, analyze and share data.
- In 2020, 70% of all tech spending was on cloud solutions.
- The global AI market is expected to reach US$126 billion (EUR106 billion) by 2025.[196]

This tech revolution has also transformed the world of alternative investments. Investments are driven by attractiveness, which is linked to potential. Notably, the tech revolution is not limited to a few emerging or limited sectors but has crossed over to several industries.

The pandemic has also accelerated some existing tech trends. Social distancing has driven the demand for and adoption of remote working tools, such as teleconferencing software and other communication and telecom channels, cloud services, and security software.[197]

This chapter analyzes how tech innovations have affected private equity, private debt and real estate. We have examined technology's impact on these asset classes in two ways: not just as an investment target, but also as a tool to invest more effectively.

Cross-cutting technologies in alternative investments

Some of the main tech developments are aimed at managing and analyzing the ever-increasing amount of data that is constantly being generated.

The use of big data and data-collection tools including social media, news feeds, web traffic, internet of things (IoT) sensors and proprietary databases will be crucial in corporate valuations and risk management.[198]

AI is already being widely employed to analyze vast volumes of data and predict possible outcomes. AI software market revenue is expected to hit more than US$120 billion (EUR101 billion) by 2025, from roughly US$10 billion (EUR8,4 billion) in 2018.[199]

[196] Statista - Shanhong Liu, Artificial intelligence software market revenue worldwide 2018-2025, 10 September 2021.
[197] Deloitte, Understanding the sector impact of COVID-19: Technology sector, 25 March 2020.
[198] Deloitte, Alternative data for investment decisions: Today's innovation could be tomorrow's requirement, 2017.
[199] Statista - Shanhong Liu,Artificial intelligence software market worldwide 2018-2025, 10 September 2021.

AI can significantly enhance risk management and compliance because it replaces subjective assessments with objective data analysis.[200]

Quantum computing (QC) has also recently seen a surge in investments, especially by financial institutions. While traditional computers operate through a binary system of 0 and 1, quantum systems can simultaneously represent 0 and 1 or a combination of the two. According to Goldman Sachs, QC could be introduced into markets in five years; however, it will initially be in an imperfect form.[201] An immediate application of QC is in Monte Carlo simulations, which are complex computations with a wide variety of applications, including portfolio and risk management.

Tokenization

The industry will develop further as it opens to retail investors, bringing a significant inflow of liquidity to alternative asset classes, which are traditionally deemed less liquid than public markets. One technology that could help enhance alternatives' future liquidity is asset tokenization.[202]

Tokenization involves converting the value stored in tangible or intangible assets into a digital token, usually handled through blockchain systems, which enables the transfer, ownership and store of value without using an intermediary.

Tokens can also certify the underlying asset's originality and authenticity. As a result, tokenization may help democratize alternative investments by allowing a broader range of investors to access these types of products.

Many assets could be easily tokenized, from real estate properties (already one of the most tokenized asset classes) to shares of company ownership or debt. Another interesting application of blockchain and tokenization is to check debt covenants through smart contracts. However, there is still room for improvement in this area, due to the difficulty of coding certain covenants into smart contracts, coupled with the complex regulation of many infrastructure assets financed through debt.[203]

"The industry will develop further as it opens to retail investors, bringing a significant inflow of liquidity to alternative asset classes, which are traditionally deemed less liquid than public markets."

[200] Deloitte, Artificial Intelligence: The next frontier for investment management firms, 2019.
[201] Financial Times, Goldman Sachs predicts quantum computing 5 years away from use in markets, 30 April 2021.
[202] OECD, The Tokenisation of Assets and Potential Implications for Financial Markets, 2020.
[203] Investors' corner BNP Paribas - Emmanuelle Pecenicic, A new white paper – Tokenisation of alternative investments, 5 February 2021.

Technology in private equity

The technology sector as a disruptor of traditional industries

Globally, the wider technology sector has always represented a large share of total private equity activity. In 2010, around 18% of buyout deals involved technology firms, i.e., firms with a main business model involving software, hardware or IT services. In 2020, this share increased to 29%—or to 32% when FinTechs are included—making it the sector that attracted the most private equity investments in 2020.

Several subsectors stand out. For example, gaming software represented around one-fifth of total technology deals, the largest rise of all subsectors (around 5%) compared with 2019. E-commerce constituted nearly 10% of total technology investments. Moreover, investments generally tended toward software-as-a-service (SaaS) based businesses, which have business models with particularly high retention rates. The hike in the share of tech-based private equity deals between 2010 and 2020 was due to a corresponding slump in investments targeting more traditional business models, such as industrial goods and services, media and entertainment, and retail.[204] This trend is in line with the disruption global economies are experiencing due to a relentlessly growing technology sector.

Equity markets are an example of why investors should consider disruption when selecting a target. Of 2009's top 10 global companies by market capitalization, only two maintained their position in 2019, with many of the others replaced by digital natives. Unsurprisingly, the two "survivors" were Apple and Alphabet, the only technology firms in 2009's top 10.

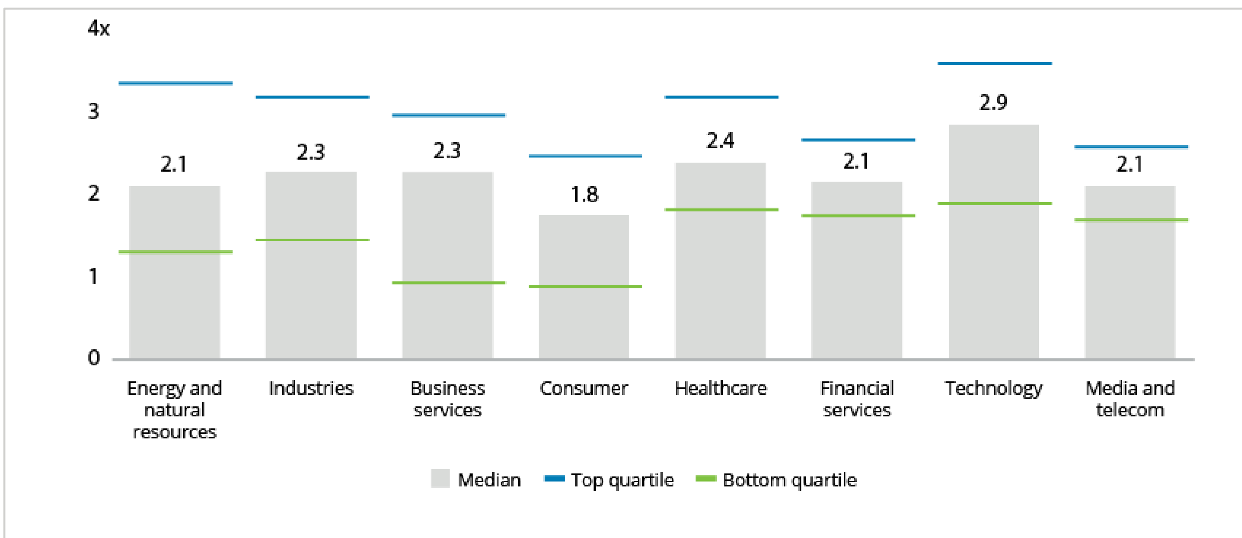
The search for disruptive companies as investment targets could explain the outstanding performance of private equity tech deals over the last 10 years. The private equity research firm CEPRES analyzed 72,772 global investments across 7,189 funds valued at a total of US$26.5 trillion (EUR22.3 trillion), and compared CAGRs across sectors. They concluded that, since 2011, the computer/technology sector produced around 15% higher CAGRs of revenue compared with the consumer sector, and around 20% compared with the industrial sector.[205] [206]

Moreover, an analysis of 2009–2020 private equity investment data by CEPRES and Bain indicates the tech sector outperformed all others based on the multiple on invested capital (MOIC). For private equity deals, the median MOIC stood at 2.9x, substantially higher than other sectors like consumer (1.8), energy and natural resources (2.1), financial services (2.2), media and telecom (2.1), or healthcare (2.4—second after technology). The top and bottom quartiles of the analyzed private equity deals were also highest in the tech sector.

[204] Bain & Company, Global Private Equity Report 2021, 2021.
[205] BCG - Martin Reeves and Kevin Whitaker, Disruptions, Delusions, and Defenses in Digital Transformation, 10 July 2019.
[206] European Parliamentary Research Service, Disruption by technology, September 2020.

Interestingly, the median MOICs also reveal the disruptive force of tech. Further analysis indicates the technology sectors' MOIC increased by 27% between the 2000–2008 period and the 2009–2020 period. In contrast, the traditional sectors' MOIC decreased over the same two periods; energy and natural resources by -9.5%, industrials by -8.7%, healthcare by -11.1%, and consumers by -28%.[207] [208]

Median top and bottom quartile MOIC (by sector)



Source: Bain

In Italy, as in the rest of the world, the tech sector plays a prominent role in private equity investments. In 2020, 38% of all Italian private equity deals and 14% of total amounts invested concerned tech companies. More specifically, 32.5% of private equity deals concerned ICT, 19.3% Medtech, 18.2% Biotech, and 15% Fintech and Insurtech.

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However, 89% of these tech transactions involved early-stage companies and were characterized by a significantly lower average investment size than in other market segments. This, along with the innovative nature of the previously-mentioned subsectors, could lead to the conclusion that private equity funds investing in Italian tech firms are less likely to be confronted with traditional industry disrupters; but rather with first movers operating in niches or creating new markets.[209]

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[207] Private Equity Wire, Will the technology sector always be a winner?, 2019.
[208] Bain & Company Global Private Equity Report 2021, 2021.
[209] AIFI, 2020 Il Mercato Italiano Del Private Equity E Venture Capital, 2020.

The role of the pandemic as a catalyst for the tech sector

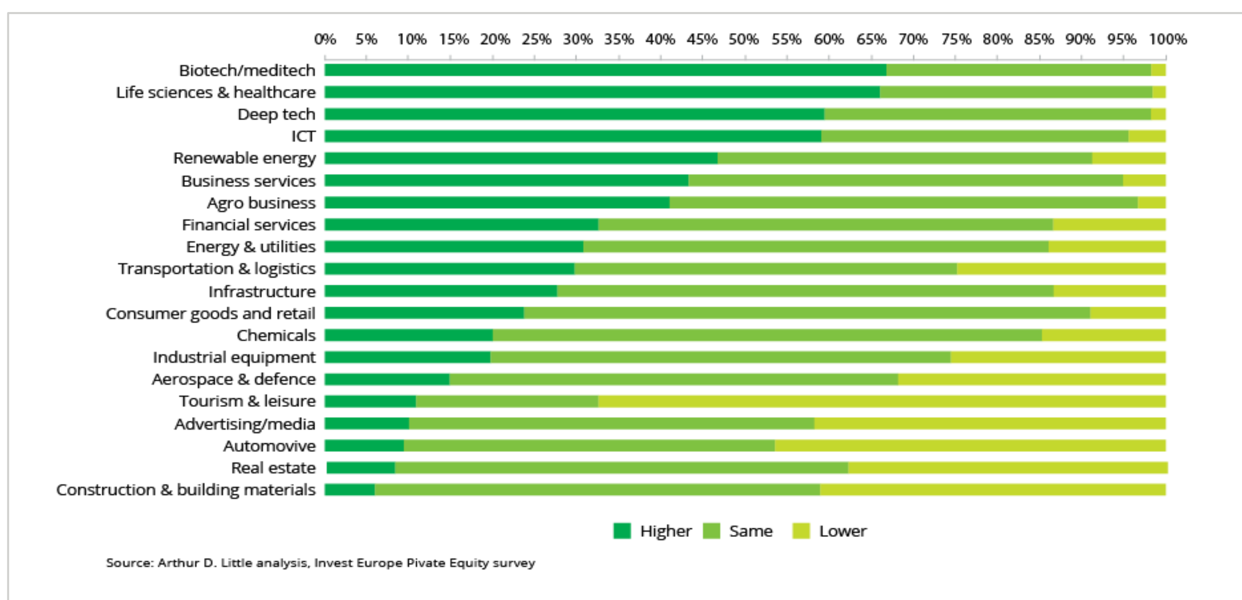
The pandemic represents the market's most significant disruptive force of the last decades. And while it is a non-technological disruptor—with many technologies often mitigating the stoppage of economic activities during lockdowns—COVID-19 has still significantly shaped the tech sector. In the wake of this trend, private equity firms should watch tech-based business models and markets even more closely.

During the pandemic, most private equity fund managers predicted that future tech investments would increase compared with 2019. In 2020, Arthur D. Little asked GPs which sectors they considered the most promising in during- and post-pandemic deal scenarios.

Regarding the Biotech/Medtech sector, over 67% of GPs expected an increase in investments, 31% predicted the same level of investment, and only 2% foresaw a decrease. In ICT and deep tech—which are organizations aiming to provide technology solutions based on substantial scientific or engineering challenges—nearly 60% of GPs expected to see higher investments, and fewer than 5% foresaw a decrease.

In contrast, less than a quarter of GPs were likely to allocate more funds to traditional industries (e.g., automotive, industrial equipment, or chemicals), with the remainder expecting the same or decreasing investment levels.[210]

Expected investment operation activity levels compared to 2019 in terms of target sectors (Europe, 2020)



Source: Adlittle

[210] Invest Europe, The insight: Europe's private equity industry during COVID-19 and beyond, November 2020.

Even though private equity firms operate in short to mid-term investment cycles, understanding which sectors are likely to continue booming after the pandemic is key. This growth may be sustainable in certain sectors, attracting private equity funds:

1. In 2020, spending on external digital collaboration tools rocketed, as 40% to 50% of employees worked from home in the second half of 2020. Morgan Stanley estimates that about 30% of this cloud spending during the pandemic could become permanent. [211]

2. Consumers' payment behavior shifted towards digital, which MS industry experts believe will be an enduring trend, serving as a longer-term tailwind for the entire sector.

3. The rapid global e-commerce growth accelerated by the pandemic reached nearly 25% in 2020, and is likely to influence consumer behavior that persists in post-pandemic times.

4. Virtual reality (VR) technologies shifted to the center of attention. Although some market participants still view VR as a niche technology for the consumer gaming market, the pandemic suggests potential in several markets, such as retail, real estate, education, and healthcare.[212]

In Asia, interest in tech firms is already growing: boasting more than 30% of total deal value, tech was the dominant sector for Asia Pacific funds in 2020. Moreover, as fund managers sought competitive advantages, there was a strong demand for Asia Pacific specialty offerings in 2020. For instance, KKR's anticipated US$15 billion (EUR12.6 billion) Asia technology private equity fund generated high investor interest.[213][214]

Technology as an investment tool for private equity

According to a 2020 McKinsey survey of executives, more than half of firms are refocusing their entire business around digital technologies or investing in technology to gain a competitive advantage. Nearly all respondents stated their companies have adopted innovative solutions during the pandemic to meet many of the new demands. Private equity firms were also affected by these trends, with the operational integration of tech gaining strong momentum in the sector.

With private equity investments growing and larger funds steadily increasing their market share, approaches had already started to shift in the last few years. Managers operating funds with a high number of limited partners (LPs) and portfolio companies were forced to adapt to the larger scales, volumes, and frequencies of their transactions and communications. As a result, they started moving from less structured, secured and scalable technologies (such as spreadsheets, emails or PDFs) to cloud-based solutions that facilitate communication both internally and externally with investors and portfolio firms. [215]

With the pandemic restricting travel and personal interaction, this digital communication shift has accelerated in private equity. Sustaining relationships with investors, the management teams of targets and other stakeholders has been a priority during COVID-19.

[211] Morgan Stanley, Is the Pandemic Accelerating Digital Disruption?, 7 August 2020.
[212] Morgan Stanley, Is the Pandemic Accelerating Digital Disruption?, 7 August 2020.
[213] IFC, The Impact of COVID-19 on Disruptive Technology Adoption in Emerging Markets, 2020.
[214] Prequin 2021 Preqin Global Private Equity & Venture Capital Report, February 2021.
[215] McKinsey, How COVID-19 has pushed companies over the technology tipping point—and transformed business forever ,5 October 2020.

However, technology's role in facilitating communication in the sector does not come without risk. As funds increase their reliance on externally provided technology, cybersecurity is on the rise. The risk of not implementing a cybersecurity plan is too high; therefore, fund managers must assess which platforms and procedures are the most secure when viewing and sharing sensitive data. [216]

Another tech trend relevant to private equity is AI. In a 2019 survey by Intertrust, 91% of respondents in the private equity industry believed AI is likely to have the biggest transformational impact on the sector by 2024.[217] AI is particularly helpful with target selection and investment decision-making, as relevant information is often buried within content-heavy sources like scanned documents, online articles, or social media content.

AI technology can help create automated systems that process and translate these large data volumes. And, the extracted information can then serve as the basis of machine-learning models that help identify investment rules.
For instance, the Stockholm-based private equity fund EQT has developed its own proprietary AI platform that leverages data and machine learning to recommend new deals, market analysis, add-on acquisitions and industry trends. It tracks millions of companies per day to help the firm assess businesses faster and spend more time on the best targets. They claim that several of their best-performing investments were sourced using Motherbrain, a proprietary platform of EQT that leverages machine learning and data science to provide recommendations for new deals.

Given the rapid developments in AI and machine learning and the ever-evolving opportunities for funds to access business-relevant data, private equity funds are encouraged to embrace these topics, be it with basic internally developed tools or with more sophisticated solutions from external providers.[218]

Blockchain technology is also starting to gain ground in private equity. According to the previously-mentioned Intertrust survey, 58% of respondents believe blockchain has the potential to disrupt their sector, while 33% say blockchain, AI and robotics are already being adopted in the industry and will become more widespread in the near future.[219]

Blockchain could provide stakeholders with a single source of immutable data, allowing them to access the information on the blockchain in the knowledge that it cannot be manipulated.

In particular, in a study by PEI, one fund manager asserts this cryptocurrency record system has clear applications for investor payments, onboarding, and self-authentication, predicting that all contract-related topics may be affected by blockchain over the next few years. For example, a fund's limited partnership agreement (LMA) could be digitized and saved on a blockchain, with all following events automatically taken into consideration, such as opt-outs or additional provisions. However, other experts still believe blockchain has some way to go regarding private equity, predicting it will be at least five years until the first industry standards are adopted. Private equity funds should closely observe this trend because, when useful solutions are developed, the quick adoption and understanding of this technology can provide a huge competitive advantage.[220]

[216] Real Deals - Nicholas Neveling, Webinar: Technology through the pandemic, 14 May 2020.
[217] Intertrust Group, Over 90% of private equity firms believe AI will disrupt their sector by 2024, 4 February 2019.
[218] EQT Group, Motherbrain.
[219] Intertrust Group, Over 90% of private equity firms believe AI will disrupt their sector by 2024, 4 February 2019.
[220] Private Equity news and analysis, Amy Carrol, Building out blockchain in private markets, 1 April 2021.

Technology in private debt

Overview

The Italian private debt market has been on an upward trend over the last decade. The increased availability of big data, and new technologies like AI, machine learning and blockchain, have evolved the sector. Tech has not only become an attractive investment sector due to its resilience, but also a powerful tool for all market players. Tech has enabled new market entrants, such as Fintech companies, to gradually disrupt the entire investment ecosystem.

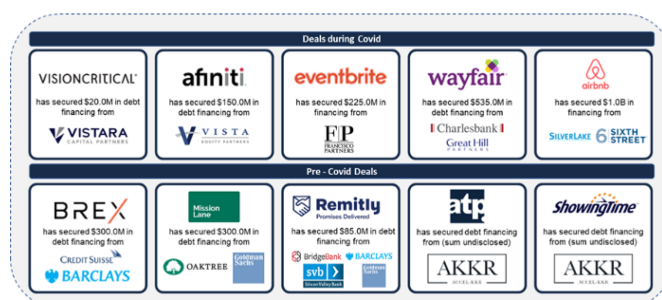
Technology as a target for private debt funds

Tech industry companies usually face high initial capital expenditures that need to be financed through credit. The Italian banking system can be reluctant to lend money to high-growing (but also high-risk) tech companies due to skepticism, or a limited to non-existent credit history. This creates many opportunities for the private debt sector, which can exploit this increase in companies seeking capital to earn attractive returns.

During 2020, the tech sector was insulated from the crisis despite market uncertainty, showing resilience and generating positive outcomes. In Italy, in particular, ICT rapidly grew as a target of private debt—while in 2019 it represented around 6% of the market, this rose to 16% in 2020.[221] While this is a smaller proportion compared with private equity, it still shows significant growth over a single year.

Investment in software and technology is expected to continue post-COVID-19. Due to the crisis' nature, healthcare IT spending is also likely to continue to grow, with a focus on payment services IT, supply chain IT, and population health analysis.[222]

Recent private debt deals (September 2020—United States)



Source: Allied Advisers

In the coming years, debt providers are expected to continue to invest in the technology sector, specifically in SaaS companies. The subscription-based business models of these companies make them a convenient investment for lenders, as they provide predictable revenue streams at regular intervals. For this reason, investors are supporting them with substantial leverage amounts. According to S&P LCD, the loan default rate among tech firms has stayed historically low at around 2.2%, and for software companies in particular, under 0.5%.

Technology as a tool for private debt funds

Private markets are characterized by various inefficiencies. The lack of operating scalability and the use of legacy systems, such as basic spreadsheets, are untenable as the private debt market grows exponentially. During the pandemic, tech played a groundbreaking role, allowing funds

[221] AIFI Report 2019, AIFI Report 2020.

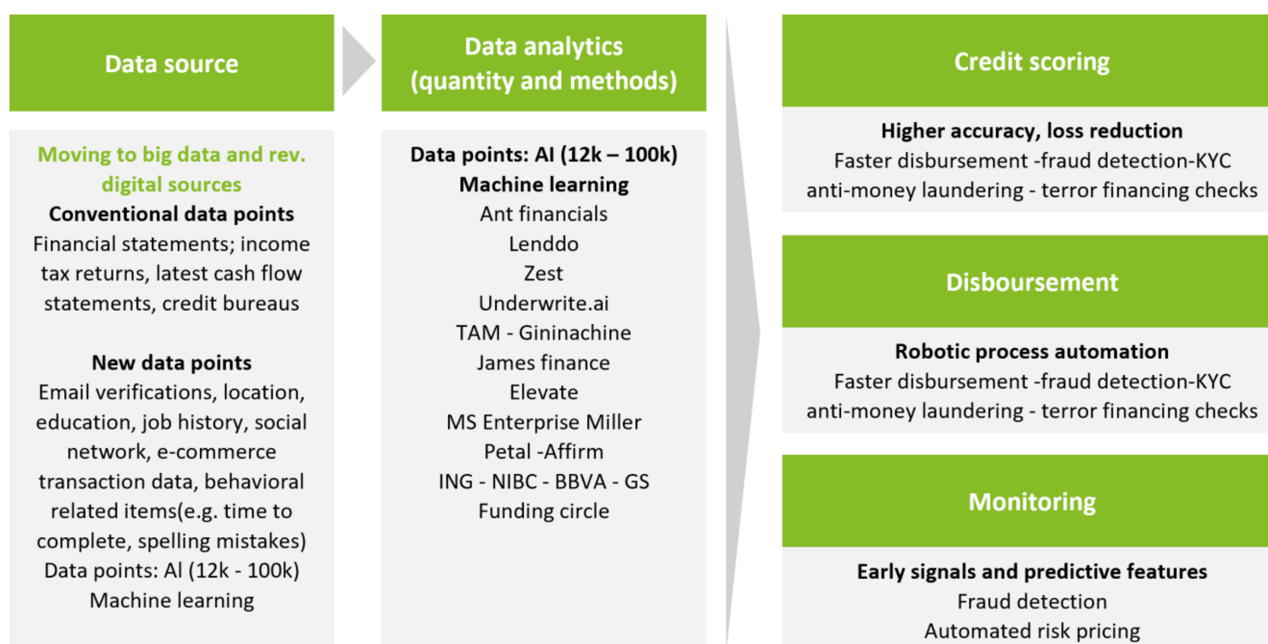
[222] Blackrock, Direct lending's next chapter, 28 May 2020.

that could access high-end data analysis software to achieve better results.[223] To mitigate the risks associated with existing platforms, and with competition intensifying, professionals require new technological tools that are scalable, repeatable, resilient and automated. [224]

Tech will likely reshape the current underwriting, portfolio management and risk assessment processes. New technological solutions are expected to affect the quality of credit scoring, company monitoring, and disbursement. While traditional scoring methods use an average of 25 data points, new technologies can process hundreds, fine-tuning the credit scoring results. Providers can then assess creditworthiness more effectively and accurately. [225]

The most advanced technologies like AI and machine learning will play a major role in the coming years,[226] allowing companies to extract third-party information and data to better understand the overall market, leading to a competitive advantage during market dislocation.[227] As the sector grows, investors will need more transparency and deeper due diligence processes, which tech will most likely address.[228] However, the role of professionals in the industry (especially in Italy) will remain a cornerstone of this sector, as human contact is unlikely to be completely replaced by technology.

Structure of AI-based Scoring Models



Source: InformaConnect Private Capital, 2019

[223] HIS Markit, Developing trends in private debt, 30 September 2020.
[224] Advent, The technology needed for the private debt expansion , 19 August 2020.
[225] InformaConnect, Technology in the private debt market: new opportunities for value creation, 1 May 2019.
[226] Vistra, Five trends in private debt for 2021 and beyond, 31 March 2021.
[227] HIS Markit, Developing trends in private debt, 30 September 2020.
[228] Advent, The technology needed for the private debt expansion, 19 August 2020.

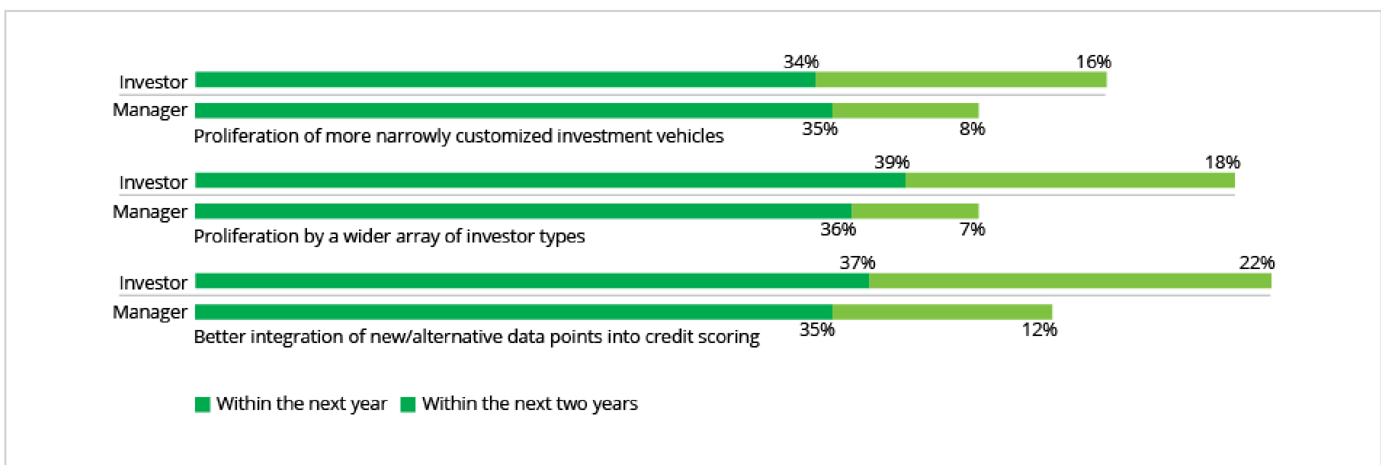
Investors and fund managers see tech's role in private debt differently. In a survey conducted by SEI and Preqin, investors were more forward-looking than managers regarding how tech would impact the sector. Half of all investors surveyed agreed that improvement in data analytics will foster the development and growth of more personalized investment vehicles, while slightly over half believed these tools will allow new types of investors to participate in the market.

However, there are several barriers to employing data analytics in private debt. The availability and quality of data are scarce because of the many restrictions on how information is shared. Data is usually confined to a small network of professionals, limiting its use in quantitative investing strategies. However, although this limitation could hinder the adoption of these tools, more meaningful insights could be extracted with the help of machine learning. [229]

Blockchain's emergence is also likely to transform the sector. The tokenization of private debt will allow market players to broaden their investor base. This conversion can bring substantial improvements, such as streamlining operational processes by automatizing reporting obligations or fractionalizing asset ownership.

Smart contracts could eliminate high transaction costs, enabling asset-backed securities to be easily traded. This transformation opens the market to the masses, both domestically and internationally, and also to investors previously unable to meet the minimum investment criteria. Therefore, blockchain can help increase transactions in the industry.

In which of the following ways do you see data analytics an impact on private debt?



Source: SEIC

[229] SEI, Private Debt: Preparing for the Unknown, 2018.

As developments in deep tech will increase efficiency, companies' focus will turn to resilience. Powerful tools and resources will not be enough for organizations to thrive if flexibility is not the cornerstone of their business. The pandemic has shown that contingency plans are necessary to mitigate risks against potential shocks. Companies with microservices and connected systems such as FinTechs and Investechs can pivot more easily, given the dynamic market requirements and growing technological transformations.

Fintech platforms

Fintech and Investech transformed the financial services industry in the same way Uber and Airbnb disrupted their respective industries—by eliminating the middleman. By enabling people to connect through new technological solutions, customers no longer need to engage with large financial institutions to carry out straightforward processes. [230]

In the coming years, the Italian Fintech ecosystem has the potential for enormous growth.

In an SEI Preqin survey, a third of investors emphasized how FinTechs could very likely displace traditional funds in the private debt market. [232]

Given that these platforms have disrupted personal lending so easily, we could also witness this disruption at an institutional level. While banks focused on cost optimization and operational efficiency, FinTechs were able to adapt their products to their customers' evolving needs and demands for trust, transparency, and user-friendly tools.

Because of their intrinsic nature, Fintech startups can attack micro-market niches, slowly eroding traditional banks' customer bases, while also remaining global. Their agility and flexibility in responding to the markets' challenges demonstrates their resilience, which will prove fundamental in the coming years.

While in 2011 there were 16 Fintech startups in Italy, the number mushroomed to 345 in 2020.[231]

Although small in size, the Italian Fintech ecosystem is diverse and boasts high potential.

[230] Huffpost, How InvesTech is disrupting the Finance Sector, and why this should get investors excited, 13 September 2016.

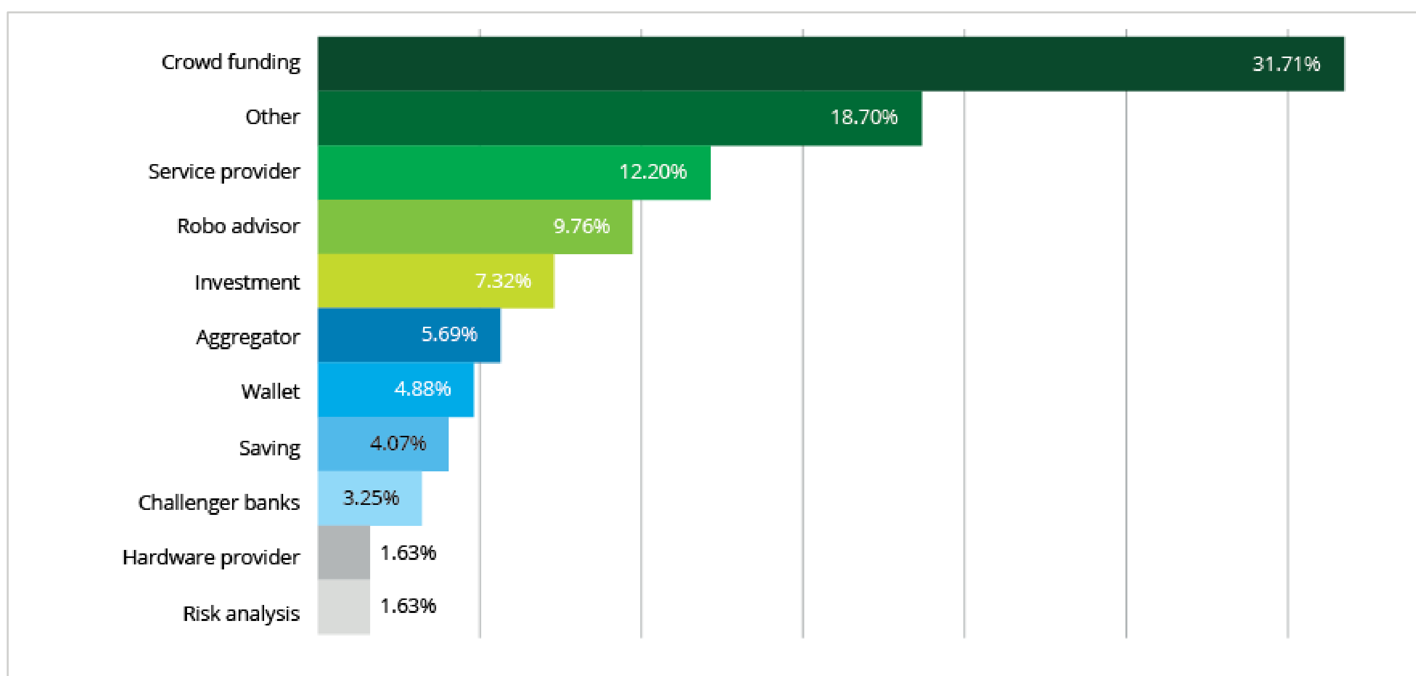
[231] Reuters, Fintech in Italy: overview, 1 March 2016.

[232] SEI, Private Debt: Preparing for the Unknown, 2018.

New regulations like the revised Payment Services Directive (PSD2) have eliminated the barrier to entry, allowing these platforms to flourish even further. [233] In these dynamics, banks are slowly becoming mere platforms on which FinTechs operate. In 2020, loans granted by Italian FinTechs amounted to EUR1.7 billion and financed a total of 5,500 companies.[234] FinTechs and Investechs play a crucial role in private debt, because they represent technology both as a sector and as a tool.

While these companies enjoy a huge amount of investment because of their growth capacity, they also serve the same sector that invests in them. Therefore, as the sector and its tools interact with each other, they build feedback loops that push further growth.

Overview of the fragmentation of services offered by FinTechs in Italy



Source: CeTIF

[233] CeTIF, CeTIF Fintech Lighthouse Outlook 2019, March 2020.

[234] BeBeez, Ten months of direct lending in Italy, November 2018.

Technology in real estate

Traditionally, real estate has been slower to adopt new trends compared with other industries. However, recent technological improvements have fundamentally affected the way property is designed, constructed, sold and maintained.

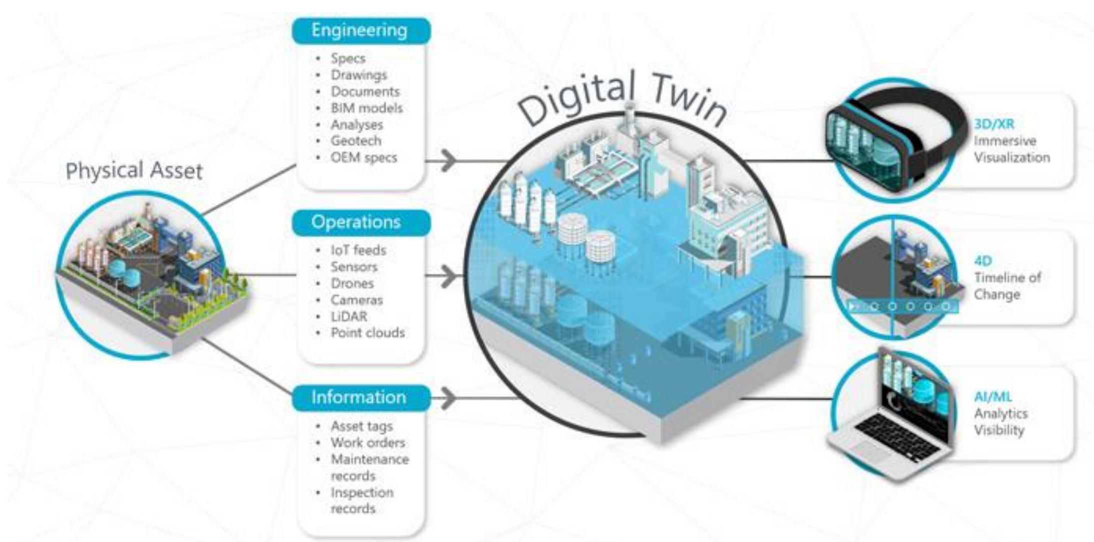
The COVID-19 pandemic has clearly changed how our society operates. Moving many activities to the digital world has triggered a growing need for integration, speed and efficiency. In real estate, this has not only led to smart buildings and new asset classes (e.g., data centers and smart warehouses), but also technologies that combine data and VR for property management and trade.

Smart real estate

Italy is one of the top European countries that uses the largest amount of energy per square meter in buildings.[235] In fact, the beauty of its historical buildings is often counteracted by poor energy efficiency and little to no technological integration. Besides the energy transition, which was explored in the ESG pillar of this paper, the development of IoT, 5G and automatization technologies will significantly improve the quality of buildings.

Buildings possess a wide array of systems, ranging from security and smart electrical panels to environment sensors. With the right tech, owners and property managers can gather real-time data and perform proactive maintenance, enabling maximum performance and offering a high-quality service to tenants.[236]

Definition of a Digital Twin by Bentley Systems



Source: AEC Magazine

[235] European Commission, Energy consumption per m², 2013.

[236] Forbes, The Top PropTech Trends: 6 Technologies Disrupting The Property And Real Estate Industry, 3 February 2020.

Building information modeling (BIM) is one of the most developed and promising technologies that allows the creation of digital twins, an exact copy of physical elements, processes and systems. By working in parallel with AI, which can interpret a large amount of data, these models can perform scenario analysis and value the cost-benefit of investments or interventions.

Technology will also transform how people interact with buildings. To ensure a safe and healthy environment, touchless services and the automatization of traditional processes such as lighting, heating, and door and gate control systems have flourished. In modern buildings, most services can be controlled from a smartphone, giving tenants more autonomy and allowing better efficiency.[237]

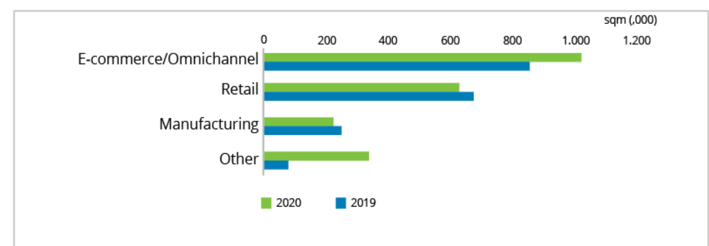
New asset classes

The high demand for tech services has also influenced the development of new and trending real estate asset classes.

In the retail sector, as consumers increasingly rely on e-commerce, shops will evolve into "smart-boutique" models, where tech completely changes the user experience. Augmented reality (AR) operated mirrors and sensors will not only capture data on how consumers react to products, but also display recommendations based on what the customer tries on.[238] This technological integration will reshape the way people shop and make the physical experience complementary to the online one, allowing retail real estate to survive.

The Italian logistics sector was also hugely affected by the COVID-19 pandemic's digital wave, with 2020 closing with an extraordinary EUR1.6 billion invested in the sector (+7% on 2019) and 1.3 million square meter take-up, only slightly below the record level of 2017. The main demand drivers were pre-lease transactions (50% of total), while built-to-suit/built-to-own (BTS/BTO) projects represented 75% of the total (53% in 2019).[239]

Effects of the COVID-19 Digital Wave by Sector



Source: CBRE RE Outlook 2021

E-commerce's rapid expansion—which covered 46% of 2020's total take-up—coupled with the growth of automation technologies and the need for faster delivery increased the demand for small-scale urban logistics centers with optimized transportation systems. Warehouses' connectivity and automatization, as well as their locations, are key to order processing.[240]

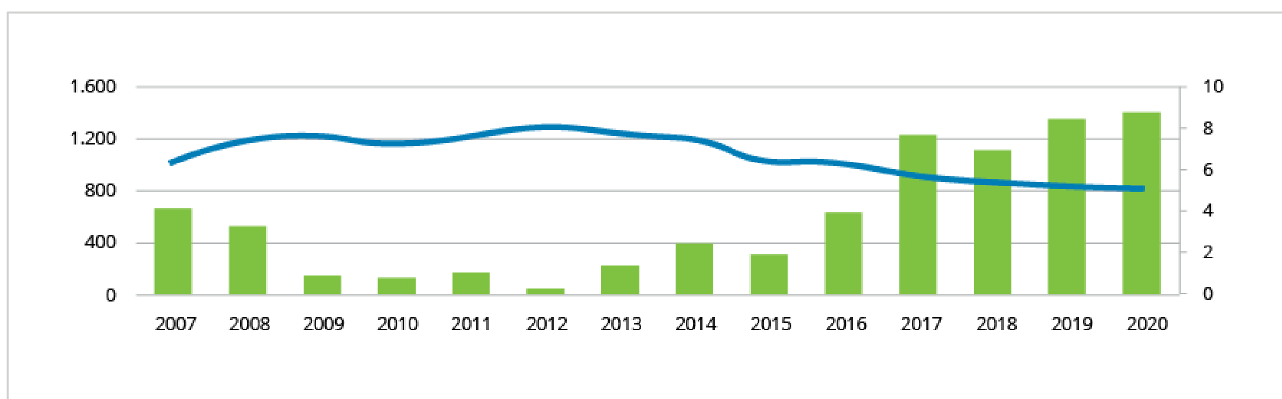
[237] Deloitte, Four Technology Trends Impacting The 2021 Commercial Real Estate Market, 2021.
[238] Econsultancy, 14 examples of digital technology in retail stores, 4 March 2021.
[239] Cushman & Wakefield Report, Italian Real Estate Overview 2020, 24 February 2021.
[240] Credit Suisse, Le tecnologie moderne stanno rivoluzionando il settore immobiliare, 11 June 2019.

As many Italian retailers have not yet developed strong online sales platforms, future opportunities are likely to arise in this sector. However, since many investors with different profiles are looking into the logistics sector, driving stronger demand and higher competition, there has been a prime yield compression. The year 2020 closed with a 4.75% prime yield in Milan, following a downward trend that began in 2012.[241][242] For e-commerce and other online services to function properly, structures like data centers are essential. These are centralized locations that house the computing equipment necessary to process large amounts of data. As Italian businesses and government agencies transition their platforms to the cloud, there is strong potential for future evolution in the sector.

Milan is already established as Italy's main data center location, and 2020 saw the birth of many disruptive projects. Amazon Web Services launched a full "Region" (a cluster of physical data centers) in May 2020, marking not only their first in Italy but also in southern Europe. In the same month, Microsoft announced a EUR1.5 billion investment plan to bring Azure to Italy.

In November, Google Cloud and TIM announced a partnership to develop data centers all across the country. Given Italy's strategic position connecting the Mediterranean region to Europe, Italy's data center market will continue to grow as 5G spreads and companies move to the cloud.[243]

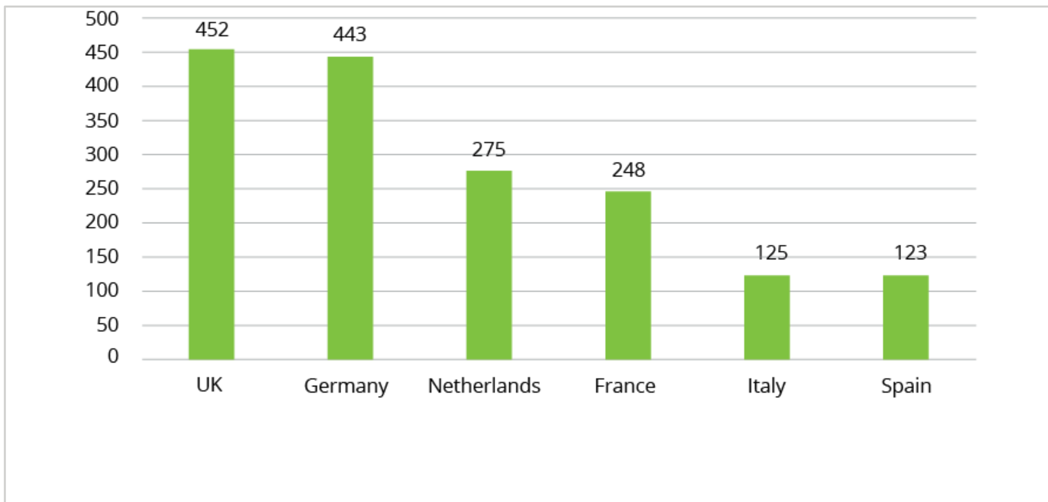
Investments and prime yields in the Italian logistics sect



Source: CBRE Italian Logistics Marketview

[241] Cushman & Wakefield Report, Italian Real Estate Overview 2020, February 2021.
[242] Assoimmobiliare.it, CBRE Italian Real Estate Market Outlook, 2021.
[243] Wallstreet Italia, Data center, un ruolo di primo piano per l'Italia, 14 December 2020.

Number of Data Centers in 2021



Source: Statista

Proptech

In the age of data centers, the ultimate disruptor is data. The digitalization of processes generates immense amounts of data that, if correctly interpreted, can generate powerful insights.

The Italian real estate market is hyper-fragmented, boasting more than 40,000 agencies but none with a relevant market share.[244] This makes valuation one of the biggest real estate challenges. Unlike bonds and equity instruments that are actively traded at every moment, buildings and properties suffer from high illiquidity and are often valued based on independent experts' opinions. This leads to higher error rates and the well-known problem of "NAV discount" for funds traded in open markets such as *Borsa Italiana*.
To make valuations more objective, precise and comparable, automated valuation models (AVM) leverage big data to identify property pricing more accurately and reduce subjectivity.

These models can consider not only historical real estate transaction data and macroeconomic variables, but also "hyper-local" data like demographics, crime rates, available income as well as internet and social media information. This is made possible by using machine learning software capable of interpreting data and generating insights.[245]

By leveraging the increased availability of data and AI technologies, more entrepreneurs have begun to enter the real estate sector, giving birth to PropTech—startups offering innovative products for the property markets. According to the Italian PropTech Monitor of the Politecnico di Milano,

there were 152 PropTech in Italy in December 2020, 41% more than in 2019. Proptech is divided into subsectors that include smart real estate, real estate Fintech, sharing economy, and professional services.[246]

[244] IlSole24Ore, Immobiliare, così la blockchain lo può innovare. In cinque mosse, 16 November 2020.
[245] Deloitte, La rivoluzione digitale nel Real Estate: a brave new world?, 24 May 2018.
[246] BeBeez, Aumentano del 41% le proptech italiane. Il 43% di esse è a caccia di finanziamenti. Lo rileva uno studio del Politecnico di Milano, 24 December 2020.

One example of Proptech is Casavo, the first instant buyer in Italy for the sale of houses online. The company uses an algorithm that compares trade data and other factors to provide instant valuations and close an entire purchase agreement in less than 30 days.

Other startups like Realhouse Srl are harnessing more disruptive technologies such as blockchain, which could completely transform the way property is traded. March 2020 marked Italy's first real estate tokenization, when a EUR4 million NPL was acquired from Unicredit. While the token is currently non-transferable, blockchain technology could make today's time-consuming transactions instantaneous, with the aid of real-time exchange and cybersecurity. In fact, the future may have an organized secondary market where investors can exchange "tokens" (fractions of properties as if they were stocks) that generate levels of liquidity, speed and transparency never seen before.[247]

Big data and blockchain's involvement with valuation and crypto payments, coupled with VR technologies for virtual tours and showrooms have allowed industry players to go drastically digital. For example, the Chinese real estate developer Sunac sold 70% of the apartments in a new complex online: 1,068 properties in 8 minutes and 16 seconds, a record time.[248] For these new buildings, AR increased the property's perceived value, creating realistic tours even before construction begins.

As well as revolutionizing how physical real estate properties are traded, blockchain is giving rise to a new "real estate rush" in a completely new territory—virtual worlds. In platforms like Decentraland, Sandbox, and Earth2, investors are buying land in the hope that, as VR develops, these will become coveted spaces for people to visit. As land is also finite in these metaverses, investors can gain either by renting or selling at a profit.[249]

In these worlds, exchanges are through cryptocurrencies—and properties are registered as NFTs, a unit of data on a blockchain that represents a unique digital item, such as virtual real estate. In the virtual metropolis "Genesis City", which is expected to become a major hub for virtual-reality commerce, even a basic 1,100 square foot plot can be valued at as much as US$200,000 (EUR168 billion).[250]
In 2020, the American rapper Travis Scott drew an audience of 27.7 million visitors to his concert in Fortnite, a popular online game. Similarly, virtual land will be used for games, casinos, art galleries, shopping malls and much more. For example, in Decentraland, Adidas has hosted a virtual fashion exhibition and Atari is building a giant retro arcade featuring its classic games.[251]

Despite the incredible potential, there is no guarantee these worlds will survive. Success will depend on whether enough people will want to live virtually, and not just those interested in blockchain. It is similar to social media platforms—

[247] IlSole24Ore, Una blockchain immobiliare a garanzia del mercato Npl, 2 March 2020.
[248] IlSole24Ore, Immobiliare, così la blockchain lo può innovare. In cinque mosse, 16 November 2020.
[249] Republic, Investing in Decentraland in 2021, 17 September 2021.
[250] Futurism, People Are Paying Insane Amounts of Real Money for "Virtual Real Estate", 6 December 2018.
[251] Reuters, The 'metaverse' bet: crypto-rich investors snap up virtual real estate, 19 April 2021.

while many exist today, only a few are expected to exist in the future.

In conclusion, technology is generating many opportunities for real estate investors, revolutionizing how property is built, sold and managed. Yet, it could also make certain asset classes obsolete—like physical offices being partially replaced by smart working, and other activities like shopping becoming increasingly virtual. Therefore, as exponential technologies collide, understanding how these advances could affect certain assets in the next few years will be crucial to guarantee successful returns.[252]

Conclusion

In this white paper, we investigated the dynamics that drive alternatives in Italy and how the COVID-19 crisis, technology, and ESG trends are making these asset classes an essential part of investors' portfolios. Italy, with its numerous SMEs and scant large conglomerates, was hit hard by the pandemic. This created an unforeseen scenario: low interest rates, a superabundance of capital, and firms urgently needing liquidity and restructuring. It revealed the weaknesses of our economy and demanded more sustainability, using the best tool we have at our disposal: technology.

The crisis hit as private equity, private debt, and real estate were on a growth path, but still far from the levels of other European countries.

The high level of savings accumulated by Italians has given rise to different investment opportunities across these classes. In private equity, historically low prices have generated an appetite for turnaround funds. In private debt, the need for liquidity, flexibility and strategic support means that funds play a crucial role in healing the damages caused by the pandemic. Finally, in real estate, behavioral changes in society are revolutionizing traditional asset classes.

Reaction to the pandemic

COVID-19 has had lasting effects on all three alternative investment classes. Private equity buyout values and transactions fell strongly in H1 2020 but rebounded in Q3, while in Italy, many deals that were put on hold at the beginning of the year were closed after the summer. Certain private equity target industries benefited from the pandemic's short-term effects, like technology, financials and utilities, while consumer goods and retail were some of the target industries that suffered the most.

While private debt performed well in H1 2020, lending activity decreased in H2, with investors reacting to the market's uncertainty. Overall, debt providers became more risk-averse and cautious. The Italian government guaranteed large amounts of loans during the pandemic, helping banks as a

[252] Forbes, The Impact Of Technology On Real Estate, 9 December 2020.

result. However, the current dominance of Italian banks in lending activities is still expected to decrease in the coming years.

In real estate, the retail sector was the most affected by the pandemic and the number of assets for sale is expected to increase. The commercial real estate sector saw tumbling investment volumes, with high street retail shops expected to perform poorly over the next few quarters.

In the Italian real estate industry, we discovered that professionals are optimistic about the outlook in the medium to long term, and observed that Italian funds are focusing on less risky assets to rebalance their portfolios.

Concerning the different subsectors, the traditional residential sector recovered quickly from the shock; investors' preferences shifted more towards logistics and data centres; hotels experienced a significant decline; and offices maintained their best asset class status. However, industry dynamics may change in the medium to long term—offices could suffer from increased smart working modalities, while hotels could strongly rebound as traveling returns to pre-pandemic levels and potentially increase further.

ESG

ESG is also actively shaping the three investment classes. Private equity fund managers are increasingly receptive to incorporating ESG in their investments due to the increasing demand for greater transparency and the evolving regulatory environment. In private debt, sustainability concerns are gaining traction. ESG investments are insurance-like assets that are correlated with lower costs of debt and higher credit ratings, especially in turbulent market periods. We pointed out that ESG in private equity can be implemented during target selection and when managing portfolio firms. While in private debt, ESG is mainly found in special offerings such as green loans, sustainability-linked loans, or European CLOs.

We described that Europe is leading the world in sustainable lending and that while Italy's sustainable lending activity is comparably low, the country's demand is rising. Moreover, we highlighted that Italy and the European Union are committed to the standardization and development of green bond markets. Regarding real estate, the European Union continues to push its sustainability agenda, which will eventually force investors to reconsider the value of their properties and investment opportunities.
In Italy, sustainable real estate is at an early stage, with more than 90% of buildings falling short of requirements to achieve the European Union's 2050 decarbonization goals. At the same time, new opportunities for retrofitting have arisen, with the national government and European Union offering incentives for landlords.

Tech

Companies operating in the tech industry have increasingly become the target of alternative funds in Italy. In 2020, ICT represented 38% of private equity and 16% of private debt deals in Italy, with strong expectations for future growth. And the real estate sector is providing infrastructure for ascending technologies, with the rise of data centers and smart logistics.

AI and machine learning are the main innovations that will affect the three classes. By processing large amounts of data, AI allows for models that

take thousands of factors into account, from social media and news information to real-time property data and worldwide financial statistics. In private equity and private debt, AI improves target selection, credit scoring and, ultimately, investment decisions. And in real estate, AI is increasing the accuracy of property valuation and enabling smart building management.

As funds move their operations and internal processes to cloud platforms, cybersecurity becomes a major risk. Blockchain is an obvious solution, as it allows for safe, instantaneous and cryptographed transactions. With smart contracts, funds will also be able to closely monitor and control financing. Finally, with tokenization, blockchain can open the alternatives market to the masses and allow for real-time, 24/7 global markets.
The current environment has generated critical growth opportunities for the alternatives industry. Turnaround funds have the chance to exploit the liquidity issues of many companies and profit from an effective reorganization of businesses and improving economic conditions. Advancements in technology, especially tokenization, could open the door to retail investors, creating a significant flow of liquidity into the alternatives market.

Looking forward, as in every industry, there may be threats on the horizon. The stringent regulation and fragmentation of ownership that typify the market are unlikely to change in the short term. Moreover, as the market grows, it will attract more international investors that could exploit profitable opportunities and drive some Italian players out of the market.

In the short term, the Italian alternatives industry's biggest challenges will be related to the unpredictability of future economic developments, the communication between funds and family-owned businesses, and the exploitation of the large pool of savings held by Italians.
To conclude, the pandemic has reshuffled the cards and catalyzed some transformative trends in the industry; ESG has become essential for investors and, consequently, for entrepreneurs; and technology plays the dual role of investment opportunity and enabler of future process innovation.

We expect the Italian market's growth to strengthen in the coming years and the gap with main European countries to progressively close. The currently unexploited potential identified in this research will be seized by market players seeking attractive returns, driving the growth of alternative investments in Italy further.

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