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#WHYPORTUGAL 2021

# INVESTING IN REAL ESTATE IN PORTUGAL

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## INTRODUCTION

Following the end of Portugal's bailout programme by the European Union (EU), the International Monetary Fund (IMF) and the European Central Bank (ECB), which lasted from May 2011 until June 2014, Portugal has lived a period of steady economic growth with heavy investments in the property market.

From 2014 to 2017 foreign direct investment increased two times approaching pre-crisis levels, pushed by increased activity in the private sector, mergers & acquisitions and investments in residential and commercial real estate assets.

Portugal is also becoming one of the preferred European touristic destinations. The afflux of tourists led to increased investments in new hotels and residential projects for short term leases.

Still prices and yields in the current market conditions continue interesting to many investors, as local banks and corporations holding large real estate portfolios continue to dispose of their real estate assets.

The retail and office markets are also attracting the attention of investors. The valuation of street shops in prime areas in Lisbon and Oporto have peaked. The scarcity of new office space is also leading to new investments.

The ECB's quantitative easing measures, the liquidity of the financial markets and banks' openness to finance a growing demand for real estate finance are feeding investors' appetite for real estate assets in Portugal.

As Portugal emerges from its worst crisis in the last thirty years, the Portuguese real estate market continues to offer interesting opportunities, still with good valuation prospects.

This paper provides an overview of the Portuguese real estate market and main legal and regulatory issues affecting the investment in property in Portugal, including, types of property interests, lease contracts, financing real estate assets, investment structures and tax issues.



## GENERAL INFORMATION

Capital: Lisbon

Main District Capitals: Oporto, Coimbra, Aveiro, and Leiria

Area: 92,152 Km<sup>2</sup>

Currency: € / Euro

Population: 10 344 802 million (2021)

Working Population: 5.165,1 million (2020)

Unemployment rate: 6,1% (October 2021)

GDP per capita: €19.431,5 (2020)

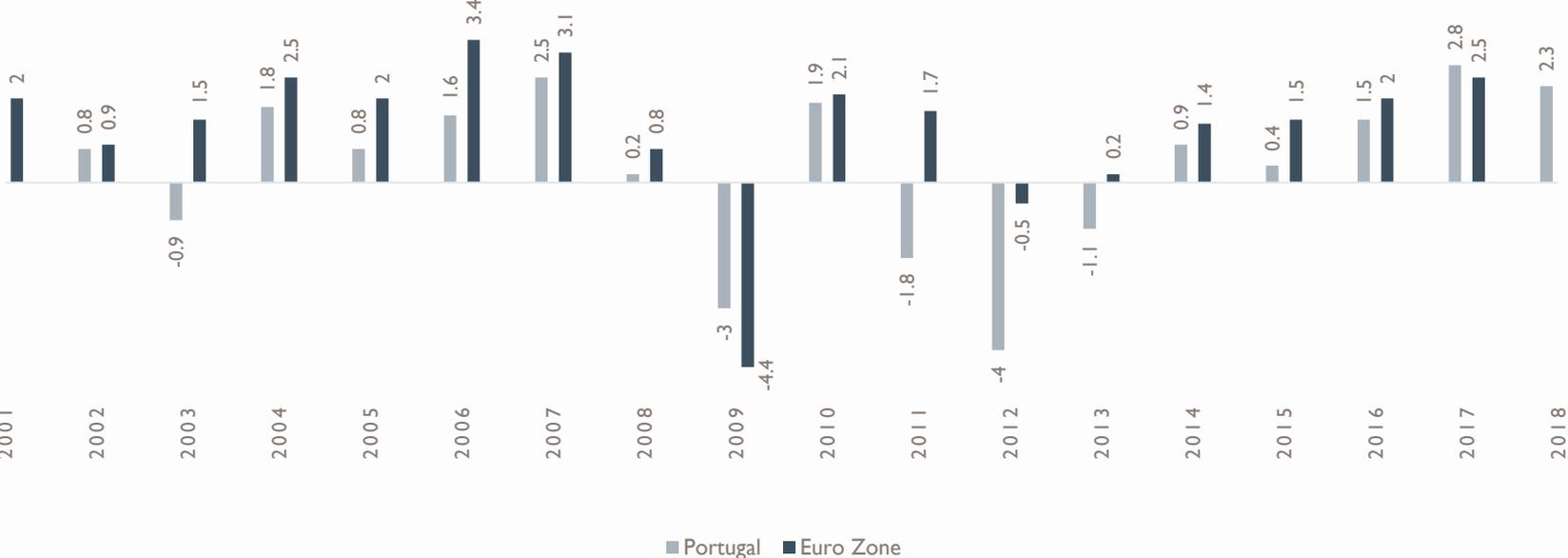
Exports of goods and services: €76.167,5 million (2019)

Imports of goods and services: €88.660,3 million (2019)

Portuguese National Statistics Institute (INE) and Pordata



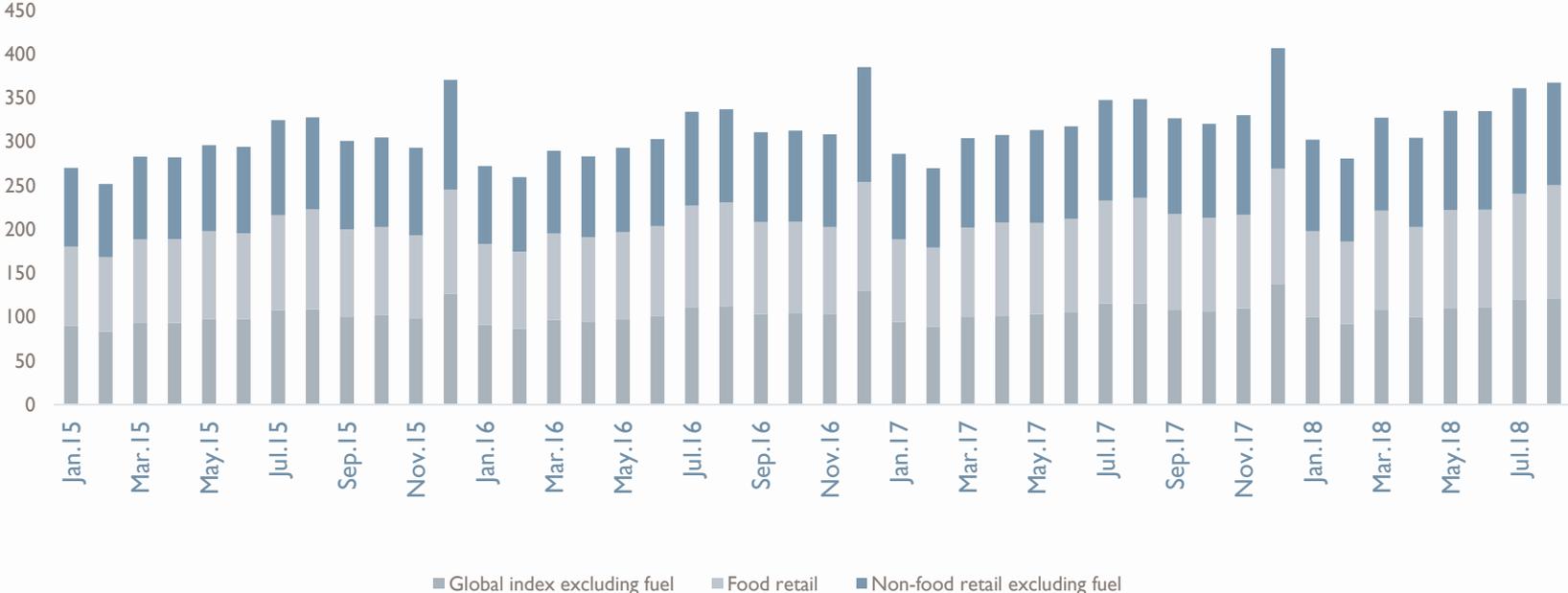
# GDP GROWTH



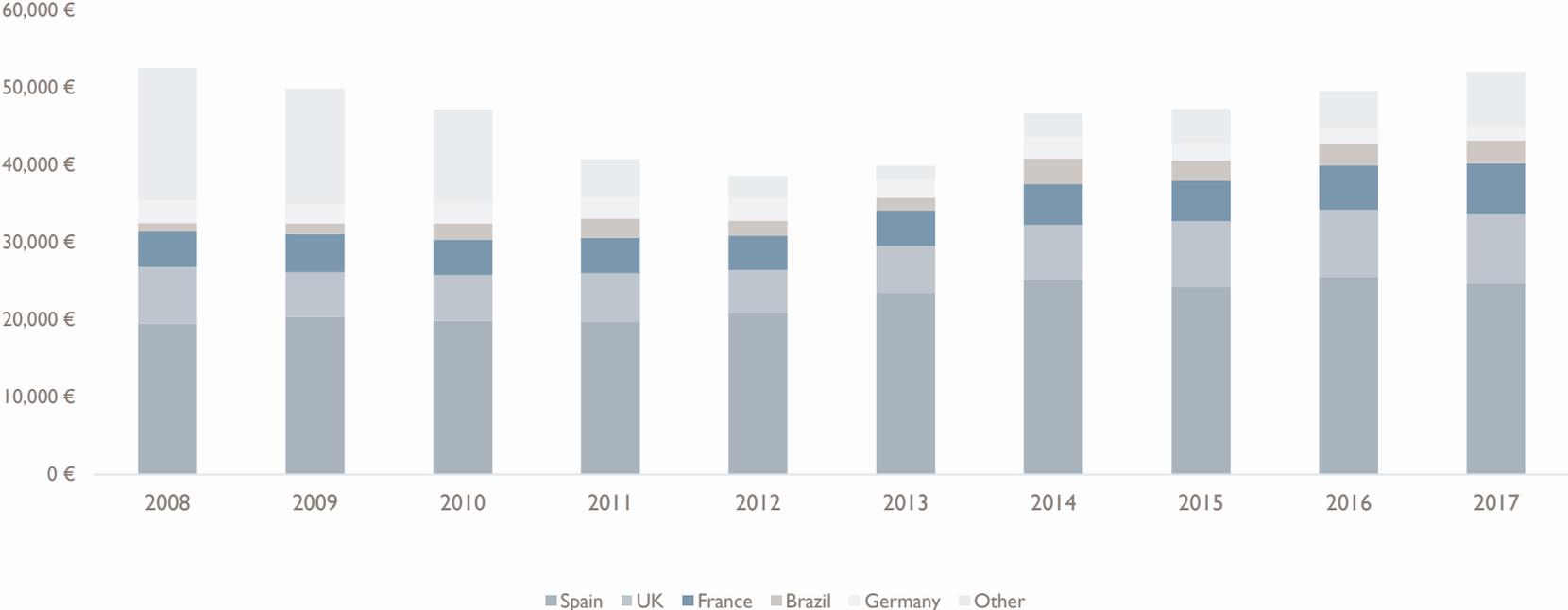
# CONSUMER PRICES INDEX



# RETAIL TRADE INDEX

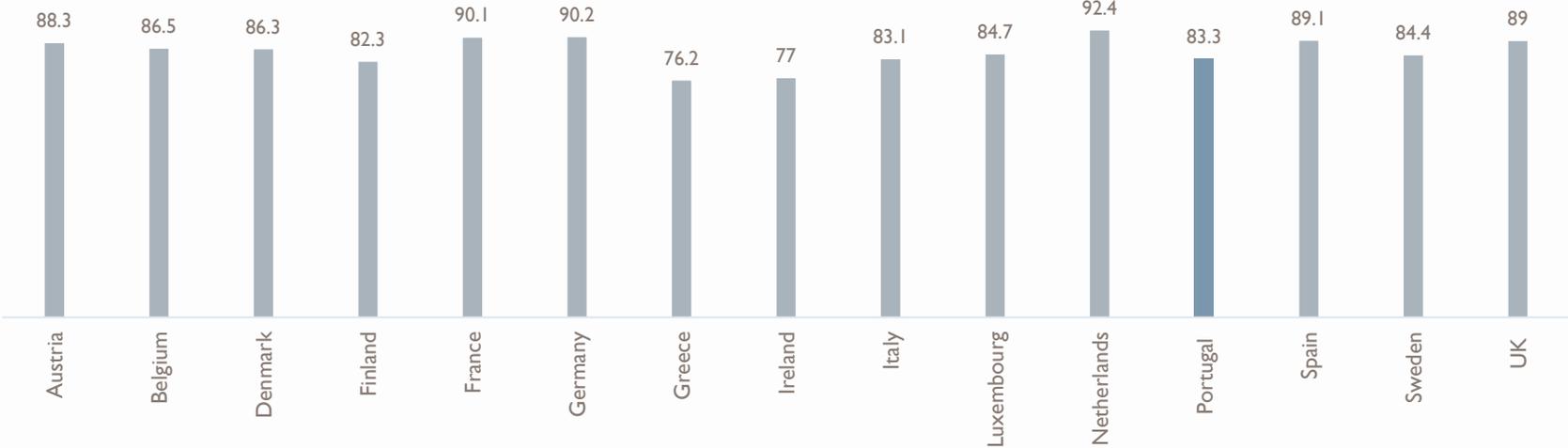


# FOREIGN DIRECT INVESTMENT BY COUNTRY OF ORIGIN



# QUALITY OF OVERALL INFRASTRUCTURE

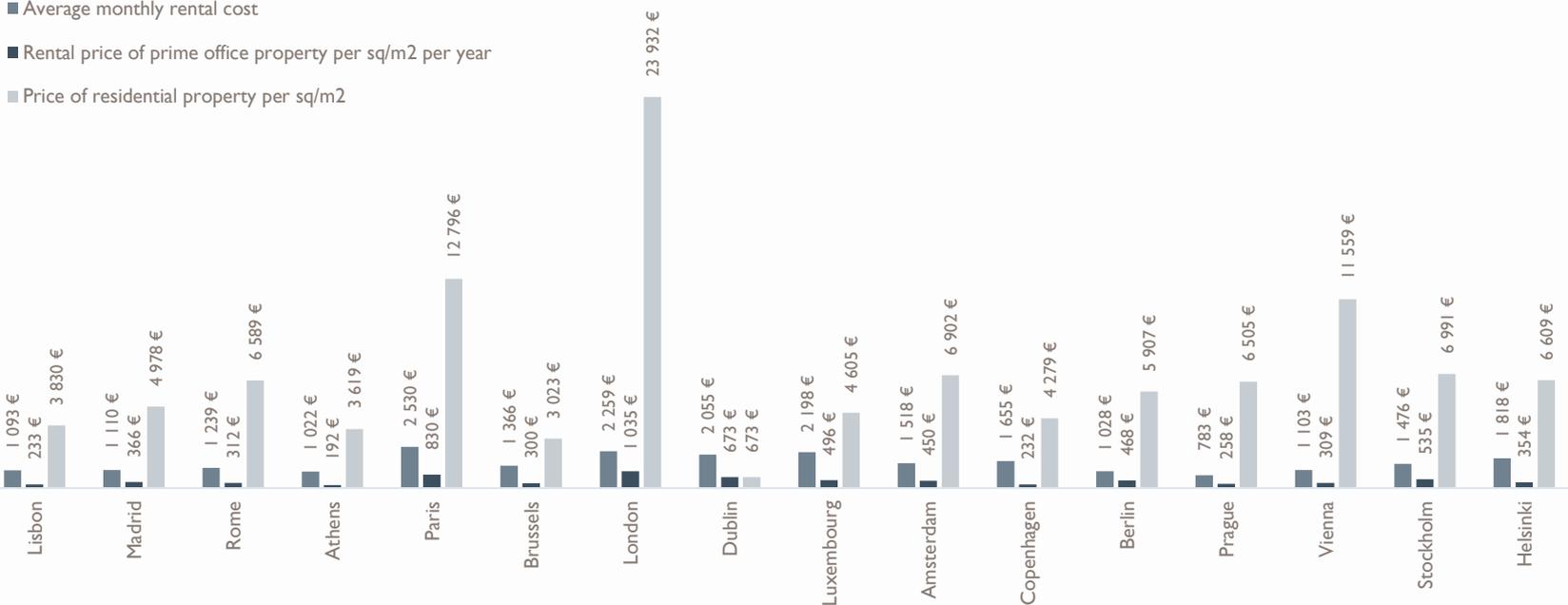
(0=worst, 100=best)



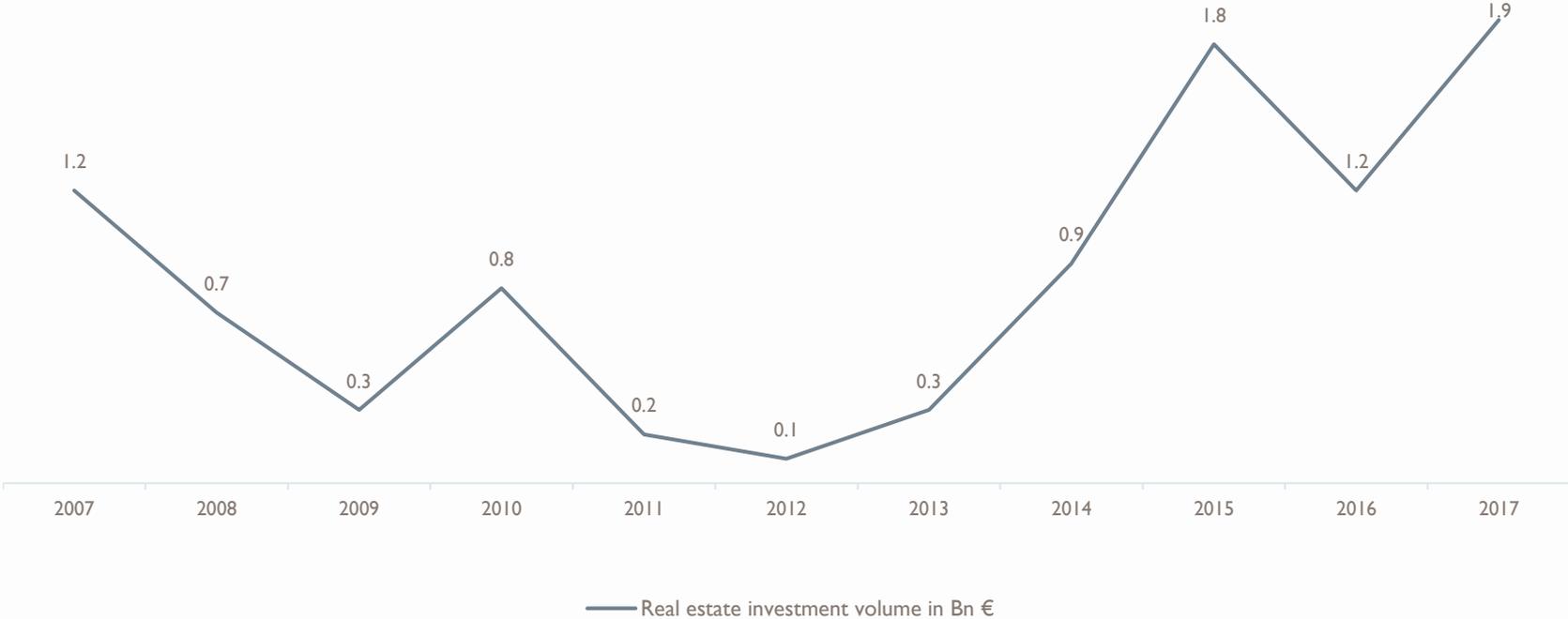
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# REAL ESTATE MARKET

# PROPERTY AND RENT VALUES IN EUROPE



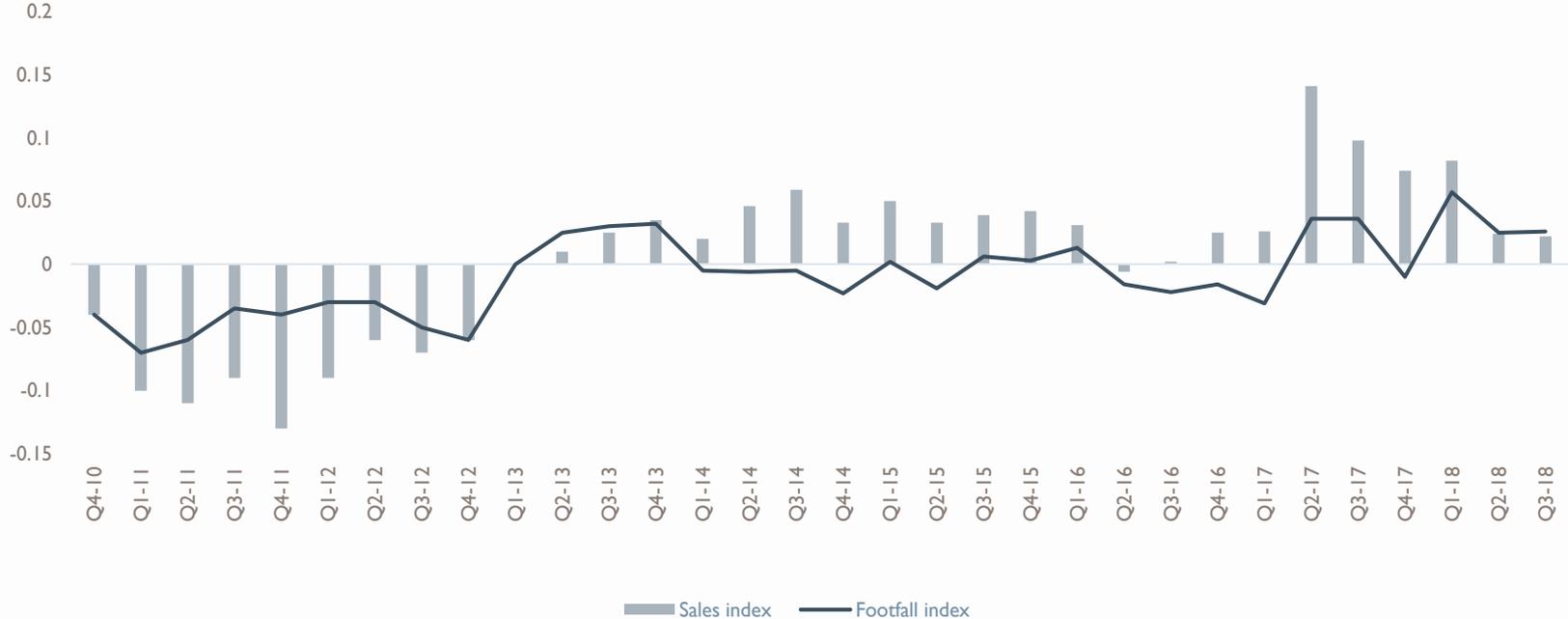
# REAL ESTATE COMMERCIAL INVESTMENT VOLUME



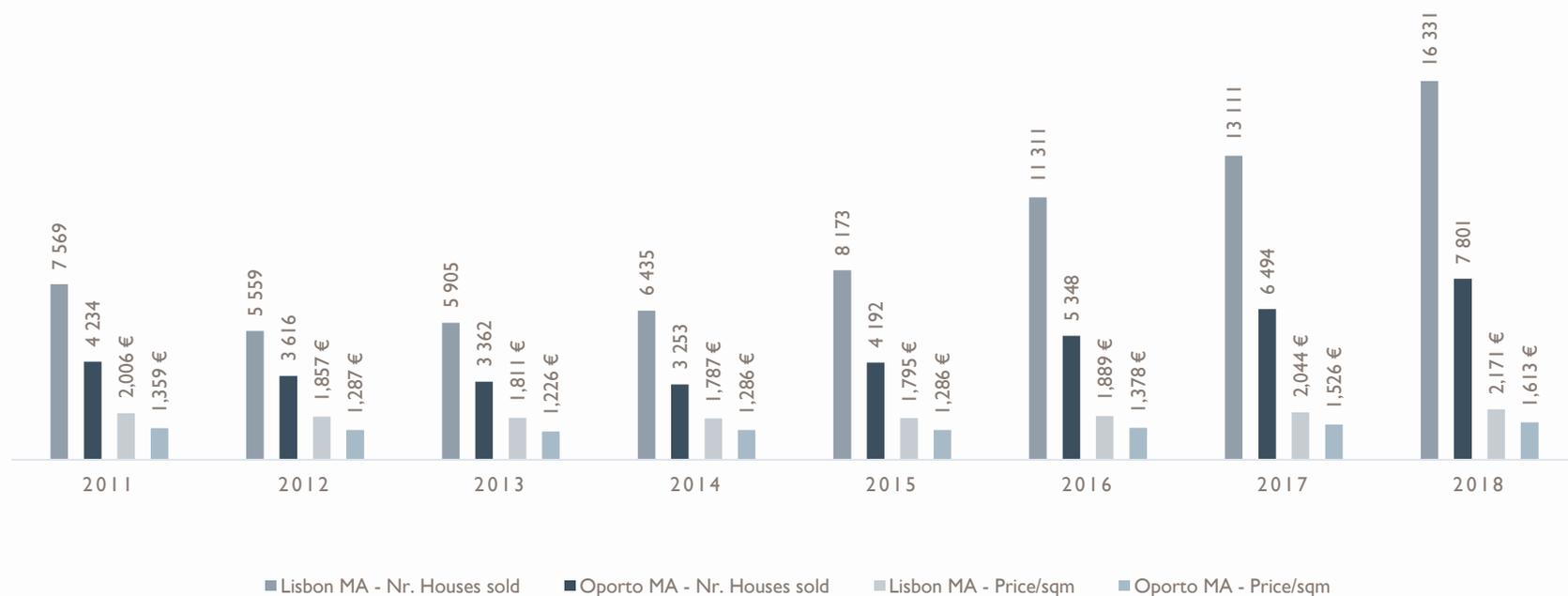
# YEARLY TAKE-UP



# APCC'S FOOTFALL AND SALES INDEX



## RESIDENTIAL MARKET (RESIDENCES SOLD IN LISBON AND OPORTO)





## FREEHOLD AND OTHER FORMS OF PROPERTY INTERESTS

Freehold (*direito de propriedade*) is the most common form of property in Portugal. Freehold gives the owner the rights to use, exploit and dispose of a certain immovable asset. These rights include the right to build on a property subject to the applicable licensing requirements.

Properties may be owned by more than one natural or legal person, where each owns a proportional and intangible share of the property. Each co-owner may dispose of his/her/its portion without the consent of the other co-owner(s), but the co-owner(s) will have a right of first refusal.

Portuguese law allows buildings or building developments to be divided in «fractions» where each fraction, which may be an apartment, a store or an office, is owned by a single owner and the common areas of the building are co-owned by the owners of the building's fractions.

The owners together constitute the community of owners of the commonly owned property (condominium) including the staircases, outside area, roof, etc. Each of the owners may freely dispose of or encumber his fraction of the property including his share in the condominium.

Other property interests recognised under Portuguese law include:

- Building rights (*direito de superfície*). Building rights give their holders the right to construct and maintain a building or plantation on the property or beneath it. The building right may be temporary or permanent, transferable or not; and
- Usufruct (*direito de usufruto*). Usufruct rights give their holder the right to use and collect the fruits of the property, which include the rents and other periodic revenues generated by the property.

In general, property and property-like interests (the so-called rights in rem) which are set out by the Portuguese Civil Code and other legislation are subject to registration with the land register and may only be constituted, mortgaged or transferred by way of a public deed executed before a notary. The public records of properties is available in the Internet. The registration of the acquisition, mortgages and other liens and encumbrances over immovable assets may be made online.

No property rights or similar rights may be created by contract other than in the manner specified in the law.

## LEASE RIGHTS

Commercial leases are the most common arrangement for the use of offices and retail stores in Portugal. Under a commercial lease, the lessor grants the lessee the right to temporarily use the leased property with the obligation to return it at the term of the contract.

Portuguese law allows the parties to freely stipulate the main terms and conditions of the lease, such as the rent, rent review conditions, cost allocation, duration, renewal conditions, termination options, etc.

The maximum term of commercial leases is 30 years. There is no statutory term and the parties are allowed to specify the applicable term. In the absence of a contract term, the implied statutory term is seven years. Typically, commercial leases for office space and stores have a duration of five to six years.

The rent is usually payable on a monthly basis, but different payment dates may be agreed. Rent free periods and rents including a variable component are common in Portuguese commercial and industrial leases. In most contracts rents are updated annually in accordance with the consumer price index (excluding housing) published by the National Statistics Institute (*Instituto Nacional de Estatística*), but the parties are free to use other criteria for reviewing rents.

The transfer of the position of the lessee included in the transfer of a business establishment (*trespasse*) does not require the consent of the property owner. The statutory rules on the termination of lease agreements by default of the tenant are mandatory.

Eviction of defaulting tenants must be enforced through court proceedings or, in some cases, through a special administrative eviction procedure carried out through the National Lease Office (*Balcão Nacional do Arrendamento*).

Leases of stores in shopping centres, retail parks and other similar developments where the owner or manager also provides certain management and operation services to the lessee are not subject to the statutory rules on leases, allowing the parties to freely determine the terms and conditions of the lease, subject only to general contract law rules and principles.

Rent-free periods, stepped-up rents and rents with variable components are common in shopping centre leases. The costs of utilities, services, maintenance and improvement works in respect of the shops are normally borne by the lessee in the form of «common service charges», which include management fees, other common areas related services and, sometimes, certain marketing costs.

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# STRUCTURING THE ACQUISITION

## GENERAL ASPECTS

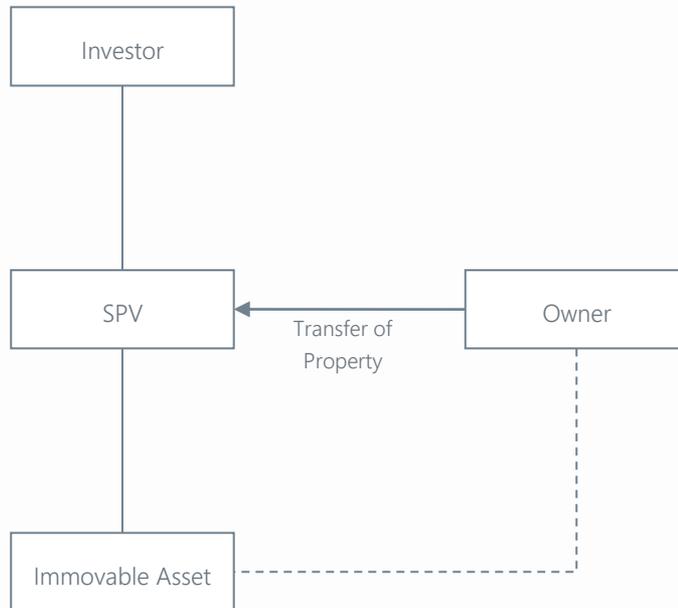
Investments in property in Portugal may be carried under any of the following structures:

- Direct ownership by the investors;
- Indirect ownership by way of the incorporation of a foreign special purpose vehicle (SPV); and
- Indirect ownership by way of the incorporation of a Portuguese SPV.

The incorporation of a foreign or Portuguese SPV is the most suitable scheme to hold property rights in Portugal, as it has advantages in the investments and divestment process, limits the liability of the investor and has a lower tax impact.

If the investors choose to incorporate a Portuguese SPV to carry out transactions in Portugal, they may opt between one of the following forms:

- A limited liability company;
- A real estate investment fund; and
- A real estate investment company.



## COMPANIES VS. REAL ESTATE INVESTMENT FUNDS

Typically public limited liability companies (sociedade anónima, SA) are better suited for investing in real estate than private limited liability companies (sociedade por quotas, Lda) as:

The transfer of shares is easier and can be made by transfer of the share title, while the transfer of shares in private limited liability companies requires, as a rule, the consent of the company and the registration of the transfer with the Commercial Registry Office; and

The acquisition of control over 75% or more of the shares or equity in private limited liability companies that hold immovable assets will be subject to real estate transfer tax.

If the investors intend to acquire several immovable assets in Portugal, it may be advisable to incorporate a real estate investment fund (fundo de investimento imobiliário, FII), especially for tax reasons.

The incorporation of a FII in Portugal is subject to the rules established in Law 16/2015, of February 24th 2015, which establishes the Collective Investment Funds Act. Also, property funds in Portugal are regulated and subject to an authorisation of the Portuguese Securities Commission (Comissão do Mercado de Valores Mobiliários, CMVM).

FII's may be open or closed funds depending on whether the participation units issued by FII's are variable or fixed. FII's may be mixed when the participation units are of both types.

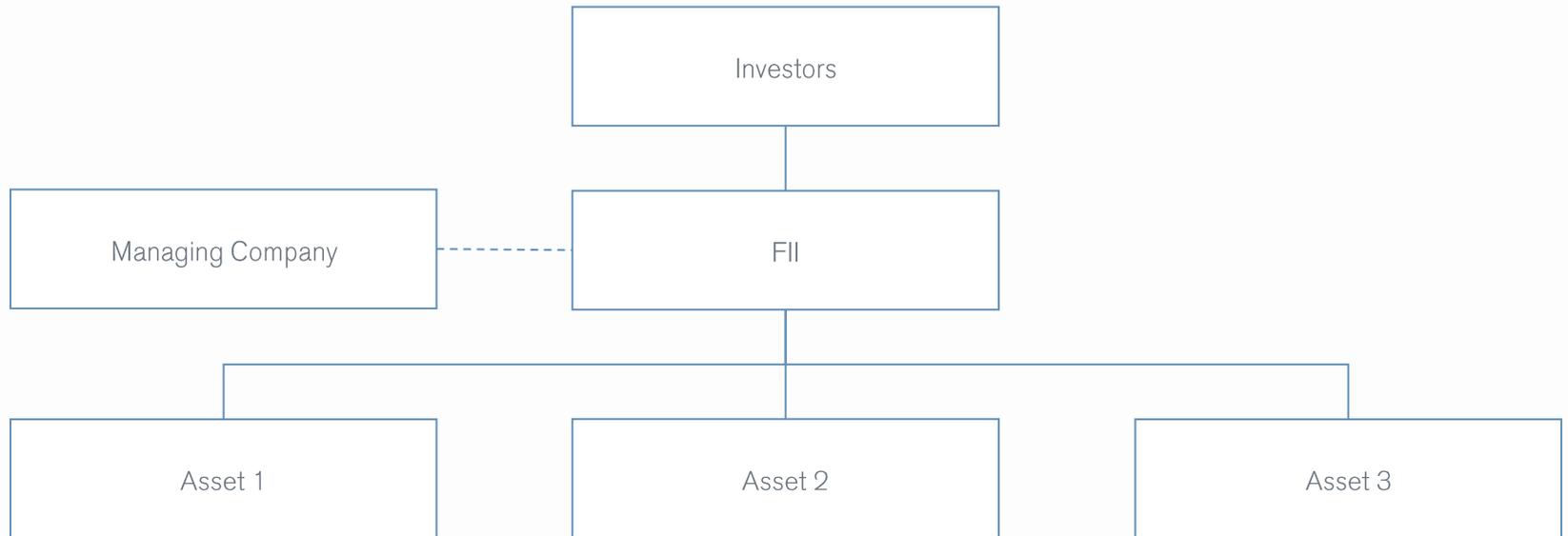
FII's can acquire any property rights over immovable assets for leasing, resale or any other economic purpose and any shareholdings in real estate companies, subject to certain limitations.

FII managers are financial companies incorporated with the sole purpose of acting as managers of FII's. FII managing companies must adopt the form of SA and be registered with the CMVM. FII managing companies must be incorporated with a minimum share capital of €50,000 or €300,000, depending on how the management is structured. The share capital must be represented by nominative shares.

The Collective Investment Entities Act sets a minimum capitalisation rule, which may burden transactions with an additional cost.

As a rule, the fund managing company's own funds must represent at least one quarter of the general fixed expenses of the year prior, plus 0,02% of the amount in excess of €250 million. FII's may issue participation units which may be sold by way of a private or public offerings. The participation units may be listed in a stock exchange.

## INVESTING THROUGH A FII



## REAL ESTATE INVESTMENT COMPANIES

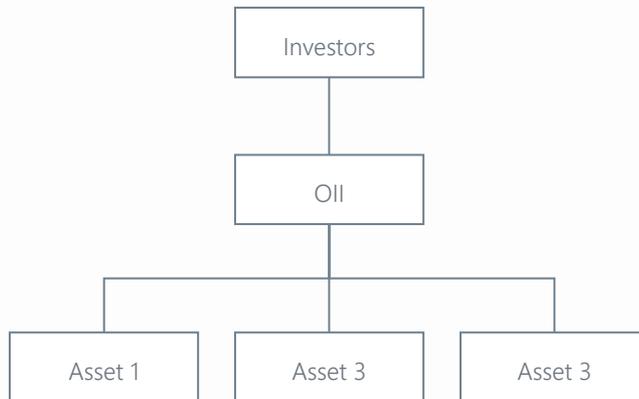
Since 2015, as an alternative to the incorporation of a FII, investors may also consider the incorporation of a real estate investment company (Organismo de Investimento Coletivo sob a Forma Societária, OII).

OIIs are financial intermediaries and are subject to the rules established in the Collective Investment Entities Act. The incorporation of OIIs is subject to the authorisation of the CMVM.

The following is a summary of the main rules governing the incorporation and management of OIIs:

- OIIs may be SICAFI or SICAVI, depending on whether their share capital is fixed or variable. SICAFI are subject to the rules of closed FII and SICAVI to the rules of open FIIs.
- If not self-governed, OIIs must be managed by fund managing companies. If the management is not entrusted to a fund managing company, OIIs will have to comply with the fund managing companies and FII minimum capitalisation requirements.
- OIIs must be incorporated with a minimum share capital of €50,000 or €300,000, depending on the management type. The share capital must be represented by nominative shares.

- OIIs must hold a minimum of €5 million of net assets.
- OIIs authorised by CMVM shall have its head office in Portugal, and its management run from Portugal.



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# FINANCING THE ACQUISITION

FINANCING THE ACQUISITION

## GENERAL ASPECTS

The financing of real estate investments may take a variety of forms. It is common to obtain financing from the following sources:

- Equity or shareholder loans;
- Bank debt/bonds; or
- Financial lease.

Under Portuguese law equity may assume a variety of forms:

- Ordinary and preferred shares; and
- Quasi-equity debt instruments.

Portuguese law allows the issuance of ordinary voting shares and non-voting preferred shares, which carry the right to receive a preferred dividend.

Preferred shares are a suitable form of funding to allow investors to recover their investment in the form of dividends. However, it must be noted that if the company cannot distribute profits in two successive years, the preferred shares will be provided with voting rights until dividends are paid.

The acquisition vehicle may also be funded by participating loans made by its shareholders that may take the form of supplementary capital contributions (prestações suplementares), accessory contributions (prestações acessórias) or convertible bonds.

Many banks and other financial investors usually provide funding of real estate assets under loan arrangements collateralized by the asset, or personally guaranteed.

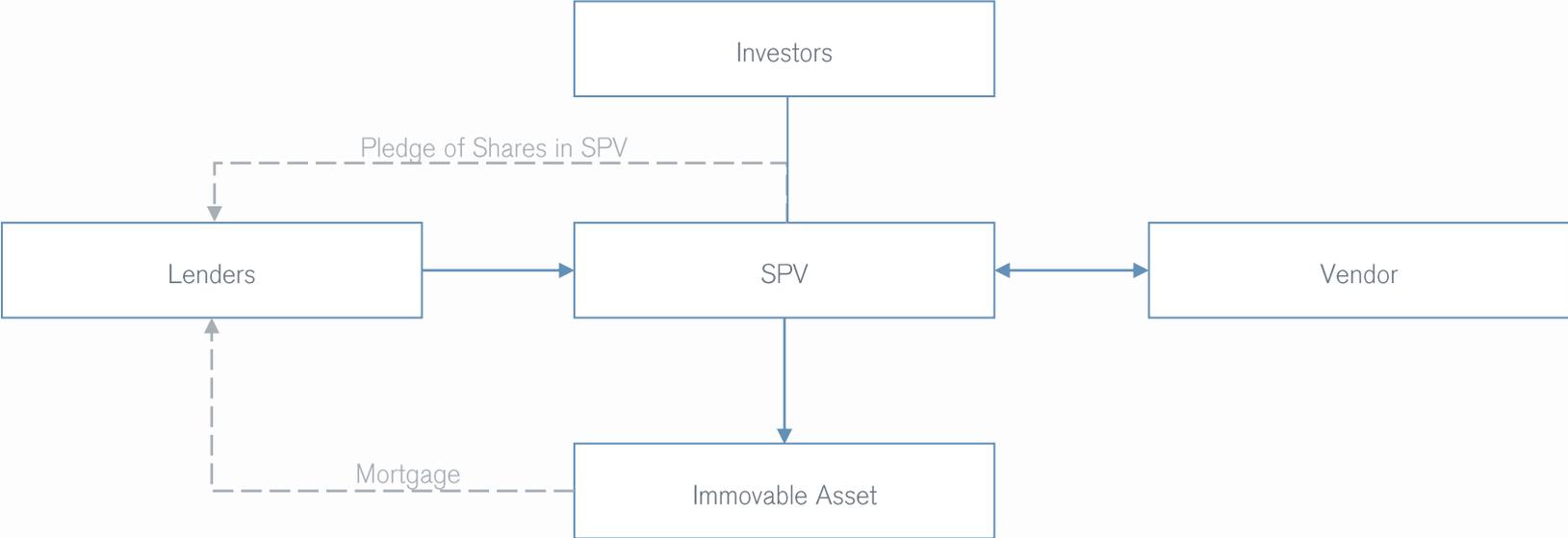
Collateral may be provided by way of mortgage over land, buildings and specified registered moveable property, pledge of moveable assets or assignment of proceeds.

Mortgages require the granting of a public deed, whereas the pledge would only need to be executed in writing in order to be valid and enforceable.

Pledges of shares of the real estate asset acquirer are also used. The pledge of shares is security provided by the investors whereas the mortgage is granted by the SPV that owns the property.

The choice of the most adequate form of collateral depends on the specific aspects of the transaction, the loan-to-value ratio of the property and the financial support given by the investor or investors that purchase the asset.

# LOAN SECURITY STRUCTURES: PLEDGE OF SHARES VS. MORTGAGE



## THE PLEDGE OF SHARES

Pledges are fixed charges created over the shares of the target or its subsidiaries, moveable assets or the business establishment of the target that give the lenders the ability to sell the assets or priority in the event of insolvency of the guarantor.

- Pledges may be enforced by:
- Court sale (*venda executiva*);
- Private sale (*venda extrajudicial*); or
- Foreclosure of financial pledges (*apropriação*).

Enforcement by way of a court sale is the default procedure. If the parties choose to allow the private sale of the pledges they must so establish in the deed of pledge.

Typically, Portuguese law agreements allowing for a private sale of the collateral are relatively loose, but to avoid court disputes and reduce the chances of such private sale being voided by other creditors or by the owner of the collateral the creditor should ensure that the sale is made at arm's length of the creditor, it is advisable that the pledge agreement details the sale procedure, including the methods for determining the assets valuation and for selecting the bidders invited to acquire the assets.

As a rule, Portuguese law does not allow the foreclosure of collateral. However, Decree-Law 105/2004, of 8 May 2004, which approved the legal framework applicable to the financial collateral arrangements, has allowed the foreclosure of financial pledges subject to the following conditions:

- At least one of the parties is a bank or another eligible entity;
- The collateral consists of cash or a financial instrument (shares, bonds and other securities);
- The secured obligations include payment obligations or the obligation to deliver a financial instrument; and
- The collateral is effectively provided to the collateral taker and the collateral arrangement documented by way of a contract or deed.

Under Decree-Law 105/2004, foreclosure of the collateral without a court proceeding is permitted as an alternative enforcement method provided that the parties agree on:

- The use of this method; and
- The valuation of the collateral

## THE MORTGAGE

A mortgage enables the lender to be paid with respect to the secured liabilities, with preference over the remaining common creditors, by the value of a certain immovable asset or another asset treated as an immovable asset, as is the case of ships and airplanes.

Mortgages must be created by a public deed and registered before the relevant land or property registry office.

The mortgage is a charge over the mortgaged property as a whole, including any fixed parts thereof, but not over the rents and other income generated by the mortgaged property.

The mortgage secures the payment of the borrower's liabilities and other accessory obligations provided that the mortgage deed so specifies. The mortgage only secures the interests accrued during the three years before the enforcement of the mortgage.

The mortgage continues to encumber the mortgaged property until the secured liabilities have been fully discharged.

In the event the mortgagor sells the mortgaged property to a third party, the purchaser of the mortgaged property, who is not personally liable for the secured liabilities, has the right to redeem the mortgage provided that it either discharges the secured liabilities directly or undertakes to deliver to the creditors the proceeds of the sale up to the amount of the secured obligations, otherwise the lien shall survive the sale.

Non-disposal covenants are not permitted. Provisions restricting the borrower's ability to sell or further encumber the mortgaged property are void.

The mortgagee may demand the replacement or the reinforcement of the mortgage if the mortgaged property is destroyed or its value is no longer sufficient to cover the secured liabilities.

The mortgagee cannot foreclose the mortgaged property unless otherwise authorised by a court.

## FINANCIAL LEASE VS. OPERATIONAL LEASE

Instead of immediately acquiring the property, investors may opt to enter into a financial lease (*locação financeira*) with a bank or another financial company.

In financial leases, the lessor buys the immovable asset and grants the lessee the right to use the asset against the payment of a rental during the agreed period of time. At the end of the lease, the lessee has the option to acquire the leased asset for a residual value. In general, the rentals and option price cover the price of the asset plus interests.

Financial lease agreements over immovable assets must be executed by way of a private deed and the signatures authenticated. Financial leases must be registered with the land register.

Under financial leases, the lessee will run all the risks and advantages inherent to the utilization of the asset. This means that the lessee instead of the lessor will depreciate the asset at the applicable rates.

An alternative form of financing the acquisition of the asset is to execute a sale and lease back agreement, whereby the investor sells the asset to another investor which leases it back to the investor under an operational lease agreement with the option to acquire the asset at the term of the agreement.

While in operational leases the rents are tax deductible, in financial leases only the interest component is tax deductible. However, the lessee is entitled to depreciate the real estate asset (excluding the land).

To get an optimal structure, the investor should take into account the accounting and tax provisions that allow the tax authorities to recharacterize the agreement and correct the annual returns of the lessee. Accounting Rule 9 establishes the provisions which imply the qualification of a lease as a financial lease, e.g.:

- The parties agree to transfer the freehold at the term of the agreement;
- The lessee has the option to purchase the asset for a price which is significantly lower than the fair market value of the asset on the date of the option exercise and it is highly likely that the lessee will purchase the asset;
- The duration of the lease covers almost all the useful life of the asset;
- On the date of the execution of the agreement, the value of the payments under the lease plus the purchase option and minus the additional costs, such as insurances, is higher or equal to the fair market value; or
- Due to its specific nature the leased asset may only be used, without adjustments, by the lessee.



## TRANSFER TAXES

The transfer of immovable property is taxable under the Municipal Property Transfer Tax (*Imposto Municipal sobre as Transmissões Onerosas de Imóveis*, IMT).

IMT is calculated based on the higher of (i) the tax value of the property or (ii) the declared purchase price.

IMT rates are the following:

6%, in case of residential urban properties;

6.5% for industrial or commercial urban properties;

5% for rural properties; and

10% in case the purchaser is an entity resident in a state, territory or region with a clearly more favourable tax regime.

In general, real estate transactions are exempt from VAT. Notwithstanding, under certain conditions, the seller or the lessor may opt to waive this exemption to be able to deduct the input VAT.

When no VAT is charged, stamp duty is charged the buyer of the property

at a rate of 0.8% on the higher of (i) the tax value of the property or (ii) the purchase price.

### IMT Rates

(property in mainland Portugal used exclusively for housing purposes)

Value (EUR.)	Rates	Deduction
Up to 92,407	0%	0.00
From 92,407 to 126,403	2%	(0,537.9)
From 126,403 to 172,348	5%	(1,727.4)
From 172,348 to 287,213	7%	(3,836.1)
From 287,213 to 574,323	8%	-
Above 574,323	6% (single rate)	

## PROPERTY TAX

Ownership of immovable property is subject to the Municipal Property Tax (*Imposto Municipal sobre Imóveis*, IMI).

IMI is levied on an annual basis payable in up to three instalments on the value of urban property and land property located in Portugal and is owed by the property or usufruct owner or the holder of the surface right of a real estate unit at the following rates:

- 0.8% on land and attached facilities (*prédios rústicos*);
- Between 0.3% and 0.45% on urban properties (*prédios urbanos*); and
- 7.5% on properties owned by entities resident in a state, territory or region with a clearly more favourable tax regime.

The applicable rate within these ranges will be determined by the municipalities on a yearly basis and increase threefold in the case of urban property left vacant for more than one year or of buildings in a state of ruin.

The urban buildings and apartments will be deemed not to be in use if the owner has not contracted the provision of essential public services or there is no consumption of water, electricity, gas and telecommunications for a period of one year.

Real estate located in Portugal is also subject to an additional tax (Additional IMI) which is levied over the aggregate tax value of residential property and land in excess of €600,000, in case of natural persons of 0.7%, up to €1 million, and 1%, over the excess of €1 million.

Legal persons are charged Additional IMI at the rate of 0.4%, save when the property is used by the shareholders or members of corporate bodies, in which case the natural persons rates will apply. Persons resident in a tax haven are subject to Additional IMI 7.5%.

Urban buildings subject to rehabilitation may be exempted from IMI for a period of three years after, which in certain cases can be extended for five years.

Property may be exempt from IMI if it has touristic utility and it is integrated in a touristic development project. The municipalities may recognize the social and historic value of buildings with historic shops and grant an exemption from IMI.

Also, at the request of the interested parties, the municipal authorities may grant a reduction of the applicable IMI rates, up to 25% and for a period of five years, if the property is energy efficient.

## TAXATION OF INCOME

Personal Income Tax (*Imposto sobre o Rendimento de Pessoas Singulares*) and Corporate Income Tax (*Imposto sobre o Rendimento de Pessoas Coletivas*, CIT) are charged over the overall income obtained by individuals and companies resident in Portugal and on any income obtained by non-resident individuals or companies which is attributable to a permanent establishment in Portugal or is deemed to having been obtained in Portugal.

In general, income obtained by non-resident companies is taxed at a rate of 25%. Income obtained by non-resident individuals will be taxed at a rate of 25%.

The rate over shareholders' dividends only applies where the participation exemption regime does not exist, in which case the dividends distributed are taxed at 25%. The participation exemption regime exempts dividends from taxation.

In principle, it is possible to exclude (fully or partially) the taxation of certain incomes under the applicable double tax treaty, the Parent-Subsidiary Directive and the Interest and Royalties Directive.

However, in order to benefit from these exemptions the SPV and/or the

investors may have to comply with certain conditions (e.g. minimum holding and minimum holding period).

### Portuguese Income Tax Rates

(applicable to the income obtained by non-resident individuals)

Taxable income	Rates
Net profits (permanent establishment)	21%
Dividends	25%
Interest	28%
Capital gains	28%

# TAXATION OF INCOME

## TAXATION OF SPVS

SPVs are charged over their taxable annual returns at the following CIT rates:

17% (up to €15.000, subject to de minimis rules); and

21% (above €15.000); and

25% (non-residents without Portuguese office).

In addition to CIT, municipalities charge a municipal surcharge (*derrama municipal*) of up to 1,5%.

A State surcharge (*derrama estadual*) of 3%, 5% and 9% will also apply to the net income in excess of €1.5 million, €7.5 million and €35 million, respectively.

When selling the asset, the difference between the purchase price and the sale price received is considered a capital gain subject to CIT. Capital gains resulting from the sale of shares will be subject to CIT, unless they benefit from exemption under the participation exemption regime.

## TAXATION OF FIIS

FIIs benefit from a special tax regime set out in the Tax Benefits Statute. The net income will be subject to CIT but will not be subject to municipal surcharge or State surcharge.

Rentals, capital gains and capital income obtained by the FII will be exempt from CIT, provided they are not paid by an entity with head-office in a state, territory or region with a clearly more favourable tax regime.

FIIs may deduct tax losses assessed in a certain tax period in the following 12 tax periods. The deduction may not exceed an amount of 70% of the respective taxable income of each period.

Stamp duty is levied over the net asset value of the FII at a rate of 0.0125% assessed quarterly.

Although the incorporation of a FII presents some advantages, the maintenance of the FII will require the payment of, among other costs, a monthly surveillance fee to the CMVM and management fees to the fund managing company. Therefore, this structure will only be viable in the event the investors wish to acquire several property rights.

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# SOBRE A MACEDO VITORINO

QUEM SOMOS & O QUE FAZEMOS

## QUEM SOMOS

A MACEDO VITORINO foi fundada em 1996, centrando a sua atividade na assessoria a clientes nacionais e estrangeiros em sectores específicos de atividade, de que destacamos o sector financeiro, as telecomunicações, a energia e as infraestruturas.

Desde a sua constituição, a MACEDO VITORINO estabeleceu relações estreitas de correspondência e de parceria com algumas das mais prestigiadas sociedades de advogados internacionais da Europa e dos Estados Unidos, o que nos permite prestar aconselhamento em operações internacionais de forma eficaz.

As nossa atuação é citada pelos diretórios internacionais, Legal 500, IFLR 1000 e Chambers and Partners, nomeadamente nas áreas de Direito Bancário & Financeiro, Societário e «M&A», Mercado de Capitais, Direito Fiscal, Projetos e Contencioso.

A nossa prática é multifacetada. Assessoramos algumas das maiores empresas nacionais e internacionais em diversos sectores de atividade comercial e industrial, assumindo especial relevância, a banca, a indústria, as telecomunicações, capital de risco e a tecnologia.

A MACEDO VITORINO representa:

- EMPRESAS NACIONAIS E MULTINACIONAIS
- BANCOS E INSTITUIÇÕES FINANCEIRAS
- FUNDOS DE INVESTIMENTO
- SOCIEDADES DE INVESTIMENTO E FUNDOS DE «PRIVATE EQUITY»
- ASSOCIAÇÕES EMPRESARIAIS, CIENTÍFICAS E ACADÉMICAS
- EMBAIXADAS E GOVERNOS
- EMPRESÁRIOS INDIVIDUAIS
- CLIENTES PRIVADOS

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