Commentary

RMBS: End of the Golden Visa Scheme in Portugal and Its Implications

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Introduction

The consultation period for comments on the Portuguese government's proposed measures (Mais Habitação programme) concerning the country's residential property market ended on 24 March 2023 and following their approval by the Council of Ministers, they are now subject to parliamentary debate. These measures include topics relating to the owner-occupied segment as well as the rental market. Among those addressing issues concerning the former is the measure to end the concession of residency associated with new golden visas. In recent years, other European countries announced the end of similar schemes already.

This commentary delves into the impact of the golden visa scheme on the country's residential property market in recent years, as well as the potential implications arising from the recently announced measure concerning residential mortgage-backed securities (RMBS) with collateral originating from the country.

The weight of such transactions in the Portuguese residential property market is limited if we consider the overall volume and value of the transactions. However, these acquirers tend to purchase properties in specific regions of the country more than in others, which, aligned with their higher average purchase ticket and lack of new construction, among other factors, may have contributed to an increase in house prices since the mid-2010s in regions such as Lisbon and Algarve.

From an RMBS perspective, this decision is expected to only have a limited impact in the residential property market. However, in a medium-term horizon, were this to translate into reduced foreign investor interest, property prices could be negatively affected. In the short-term, other fundamentals should have a larger impact such as the adjustment of floating-rate loans, which are the predominant product, and the current uncertain macroeconomic environment. Nevertheless, the lack of new housing supply, tighter underwriting criteria and the recently announced mortgage affordability relief measures should limit any potential negative effects.

Overview of the Portuguese Golden Visa Scheme

The Portuguese golden visa scheme (Autorização de Residência para Atividade de Investimento or ARI) has been in force since 2012, a time when Portugal looked toward attracting overseas funds into the country, which was under an IMF-led financial assistance programme.

Following an early exit of the economic adjustment programme, the country benefited from a robust growth in tourism revenues and a renewed interest from foreign-based investors in the country. For more details on the country's recent economic performance, please refer to the press release titled, "DBRS Morningstar Confirms the Republic of Portugal at A (low), Stable Trend" published on 27 January 2023.

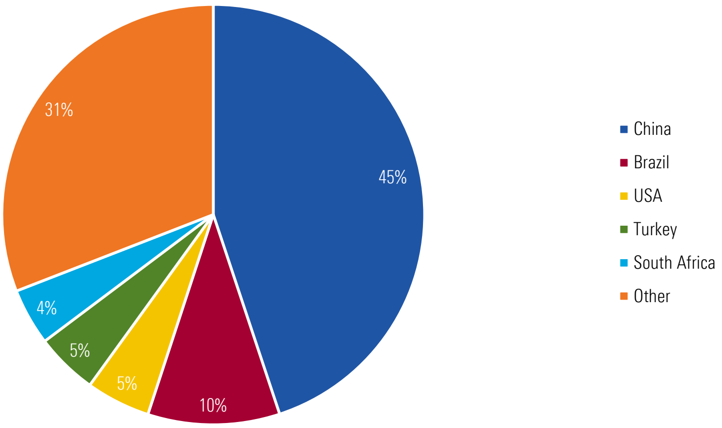
The scheme allowed foreign investors to request a residence permit for purposes of investment activities, which could be done either at an individual level or via a limited liability company established in Portugal or in another European Union country. The investment activities could be any of the following:

1. Capital transfer with a value equal to or above EUR 1.5 million;
2. Creation of at least 10 jobs;
3. Purchase of real estate property with a value equal to or above EUR 500,000;
4. Purchase of real estate property, with construction dating back more than 30 years or located in urban regeneration areas, for refurbishing, for a total value equal to or above EUR 350,000;
5. Capital transfers for investing in research activities, cultural initiatives, acquisition of units of investment funds or venture capital funds, or the constitution of a commercial society based in the country (different amount thresholds apply);
6. Family reunification.

According to the Portuguese border agency (Serviço de Estrangeiros e Fronteiras or SEF), between 2012 and today[1], 11,921 residence permits were granted under the golden visa scheme, with a majority through the acquisition of real estate (10,874). The most represented countries include China (5,304), Brazil (1,198), United States of America (607), Turkey (568), and South Africa (525).

The total amount that has been channelled into real estate acquisition is approximately EUR 6 billion, with more than 90% being directed toward the purchase of properties with a value equal to or above EUR 500,000 and the remaining for the acquisition and refurbishment of older properties (items 3 and 4 above, respectively).

Exhibit 1 Number of Golden Visa Residence Permits per Country of Origin



Source: SEF.

1 https://www.sef.pt/pt/Documents/mar_2023_ARI_CUMULATIVO.pdf

Last year, the Portuguese government had already aimed at curtailing property demand in the continental coastal areas, where the main cities are located, by restricting the requests for golden visas through real estate acquisition to only those dwellings located in the Autonomous Regions of the Azores and Madeira or in the inland territories[2].

The revised decision for the golden visa scheme, initially announced at the end of February this year alongside a wider package of measures for the residential property market, has been recently updated following the end of the public consultation and will broadly consist of the following:

- Revocation of the current juridical regime for golden visas, i.e., end of new concessions (applicable from the publishing date of the new law);
- Renewal of current concessions will be possible as long as these have been done according to the applicable legal regime in force until the new law is published; and
- Requests that have already been made but are pending a final decision remain valid.

The latest iteration of the new law has been watered down following some backlash and concerns regarding the abrupt impact of these measures, particularly regarding pending requests and renewal processes. A first draft set the 16 February 2023 as the deadline for new requests to be accepted under the current scheme and outlined the possibility of renewals only in cases where the immovable property was either being used for own residency or available in the rental market for a period no less than five years. The current version of the draft clarifies that the conditions for renewal and pending requests remain largely the same as before except for their conversion to another residency scheme, the residence permit for entrepreneur immigrants (Startup Visa)[3]. The final draft is now under parliamentary scrutiny before being sent for presidential sign-off.

This type of residential status by investment schemes was a popular feature across several other European countries, including Cyprus, Greece, Malta, Ireland, Italy, and Spain. Following the great financial crisis and the European sovereign debt crisis, many of these countries aghast with economic challenges, as was the case for Portugal, saw them as an advantageous channel to attract overseas investment into the country.

However, as of last year, the European Commission started to intensify its pressure on European governments to stop providing such schemes given the risks of sanctions-evasion and security concerns, on the back of the Russian invasion of Ukraine and rising geopolitical tensions between China and western countries.

Portugal follows the recent announcement of the Irish government to terminate its golden visa scheme and given the European Commission's recent recommendation, others could follow suit. Similarly, the United Kingdom has also terminated the possibility for new applications under its Tier 1 (Investor) scheme last year.

2 https://dre.pt/dre/en/detail/decree-law/14-2021-157236756

3 https://imigrante.sef.pt/en/solicitar/residir/art89-4/

Exhibit 2 Residence by Investment Schemes in the EU[1]

Country	Introduced in	Minimum Threshold Amount[2]	Type of Investment	In Force/Revoked
Portugal	2012	EUR 350,000	RE, C, IF, GB, BD, PG	Revoked
Ireland	2012	EUR 500,000	C, IF, PG	Revoked
Hungary	2012	EUR 250,000	GB	Revoked
Bulgaria	2005	EUR 300,000	RE, C, IF, GB, BD	In Force
Latvia	2010	EUR 250,000	RE, C, IF, GB, BD	In Force
Cyprus	2012	EUR 300,000	RE, BD	In Force
Netherlands	2013	EUR 1,250,000	C, IF	In Force
Spain	2013	EUR 500,000	RE, C, IF, GB, BD	In Force
Greece	2014	EUR 500,000	RE, C	In Force
Malta	2015	EUR 300,000	RE, C, GB	In Force
Estonia	2017	EUR 1,000,000	C, IF	In Force
Italy	2017	EUR 500,000	C, GB, PG	In Force
Luxembourg	2017	EUR 500,000	C, IF, BD	In Force

1 Residence by investment schemes may be of different types including investment in immovable property (RE), capital investment in company (C) or investment fund (IF), donation, or endowment to public good (PG), investment in government bonds (GB), and bank deposit (BD). Such schemes are different from citizenship by investment schemes.

2 Minimum threshold amount corresponds to investment required in immovable property for countries where this option exists.

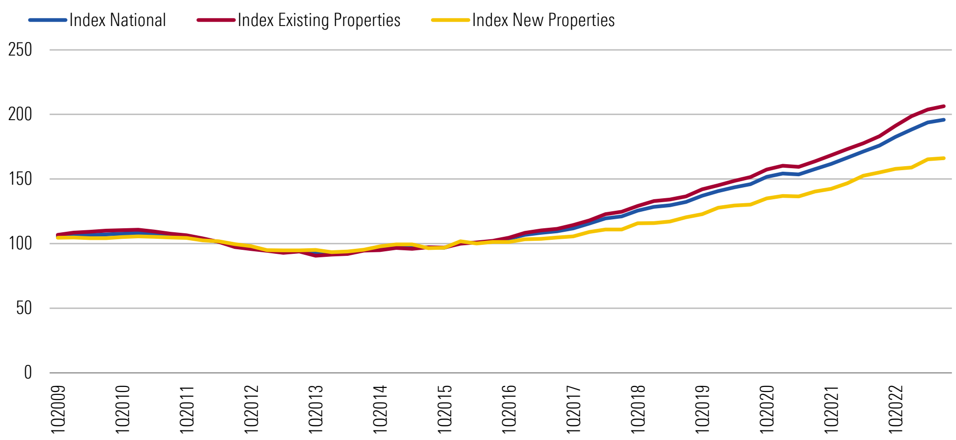
Sources: European Commission 2019 Report on Investor Citizenship and Residence Schemes in the EU and accompanying Staff Working Document. European Parliamentary Research Service 2021 Study - Avenues for EU Action on Citizenship and Residence by Investment Schemes: European Added Value Assessment.

The Portuguese Residential Property Market and the Impact of the Golden Visa Scheme

Portuguese residential property prices have been on an upward trend after bottoming out in the first quarter of 2013. Since then, house prices have more than doubled. As can be seen in the Exhibit 3, in recent years a clear divergence has arisen, with prices for existing properties growing faster than those of new properties.

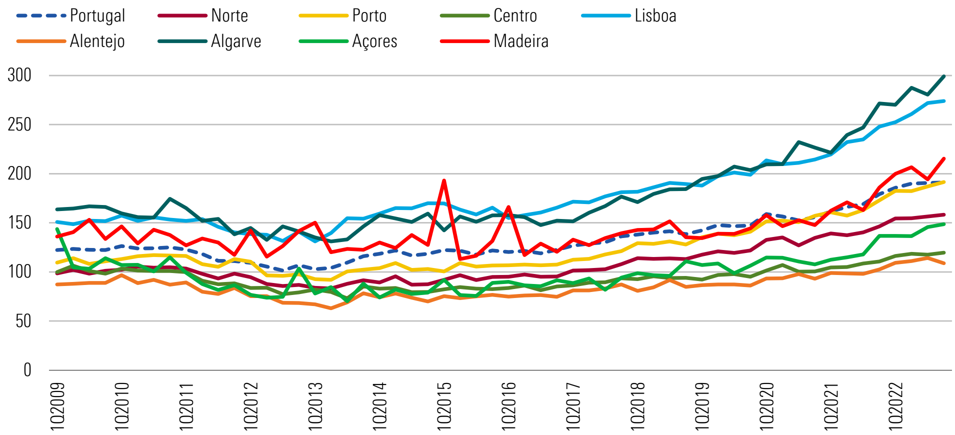
This could be due to a higher asking price for newer properties relative to the existing ones, thus helping the latter benefit from a higher base effect. Moreover, Portugal has a relatively old housing stock, which only in recent years has begun to be refurbished with the advent of greater tourism-related inflows and a better economic environment.

Exhibit 3 House Price Index (Base = 2015)



Source: INE.

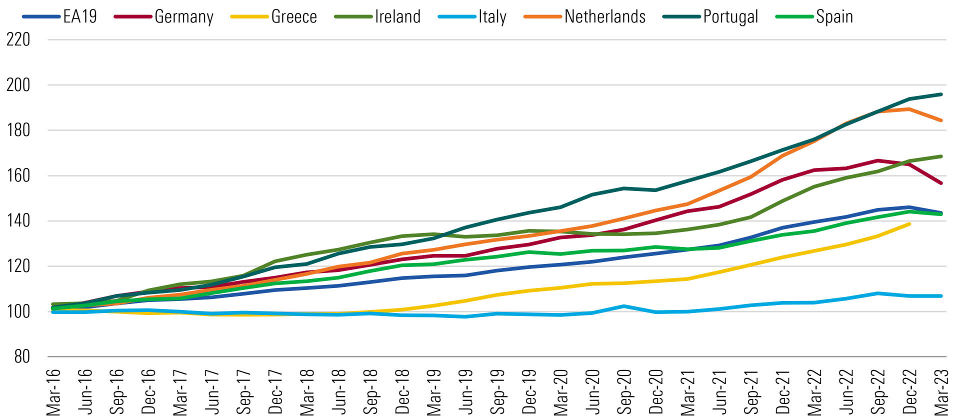
Exhibit 4 Average House Prices by Region (EUR thousands)



Source: INE.

As can be observed on Exhibit 5 below, since the middle of the past decade until today, Portugal has been one of the countries with the greatest house price appreciation in Europe.

Exhibit 5 Housing Price Index in Europe

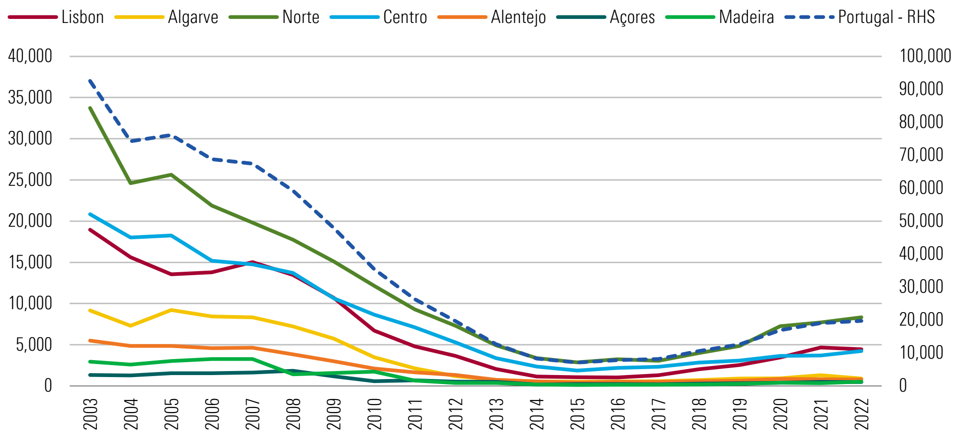


Source: Haver Analytics, Eurostat, Nationwide Building Society, Bank of Greece.

An important aspect of the Portuguese house price appreciation, one that is shared by other European countries, is the limited supply of residential properties in the face of increasingly higher demand. If we consider the amount of new residential dwellings built over the years, we can see a significant reduction which has only recently started to recover somewhat, but is still far from earlier levels.

The introduction of the golden visa scheme, along with the end of the IMF financial assistance package and the increased relevance of tourism in the country's economy, all gave their contribution to the bottoming out of new construction activity in 2015. Nevertheless, in the country as a whole, the number of new, completed residential dwellings at the start of the century was approximately 90,000 per year, while data for 2022 shows that it is now significantly below that, amounting to circa 20,000 per year.

Exhibit 6 New Construction of Residential Units (Volume)

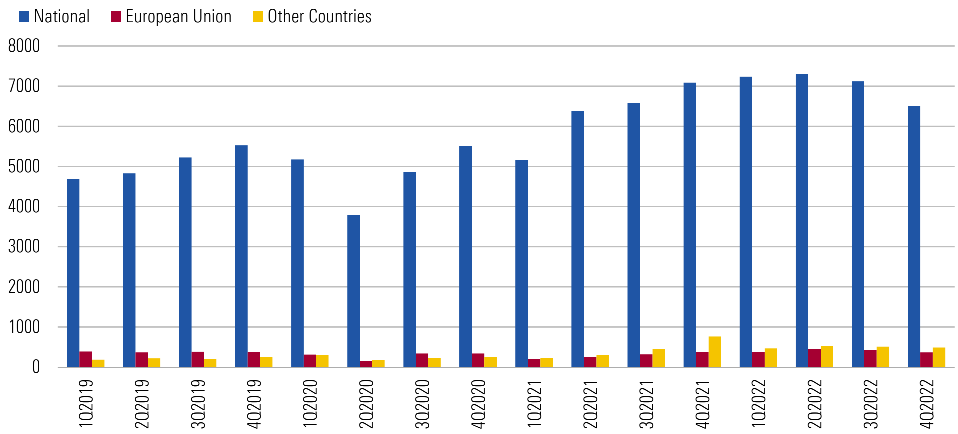


Source: INE.

Other market fundamentals such as a benign economic environment, low interest rates and stricter underwriting standards by Portuguese mortgage providers, arguably played a larger role in the recovery of the residential property market, which is further confirmed by the house price appreciation seen over the years. Recent data on the value of transactions also shows that the pandemic had a limited impact on the Portuguese housing market.

Furthermore, data from Statistics Portugal (Instituto Nacional de Estatística or INE) segregated by the fiscal domicile of the acquirer shows that citizens from EU and other countries represent only a small share of the Portuguese property market.

Exhibit 7 Value of Transactions by Fiscal Domicile (EUR Millions)

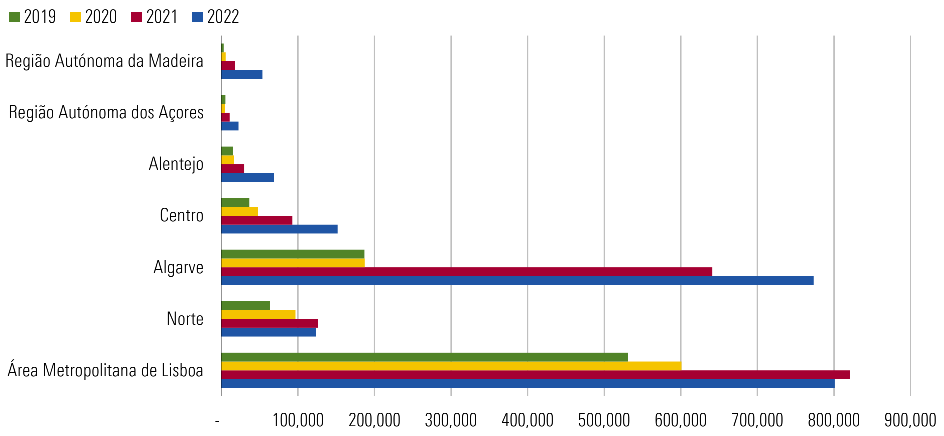


Source: INE.

Exhibit 7 above indicates that the overall impact of non-residents on the country's residential property market has been relatively limited. However, it is important to note that this category of buyers, which also includes golden visa beneficiaries, have paid a higher average purchase price and they tend to be more interested in acquiring properties in specific regions such as Lisbon, the capital city, or vacation destinations such as Algarve. In 2022, non-EU buyers paid, on average, more than EUR 400,000 for a property in Portugal, while domestic buyers paid, on average, EUR 179,000, which is less than half.

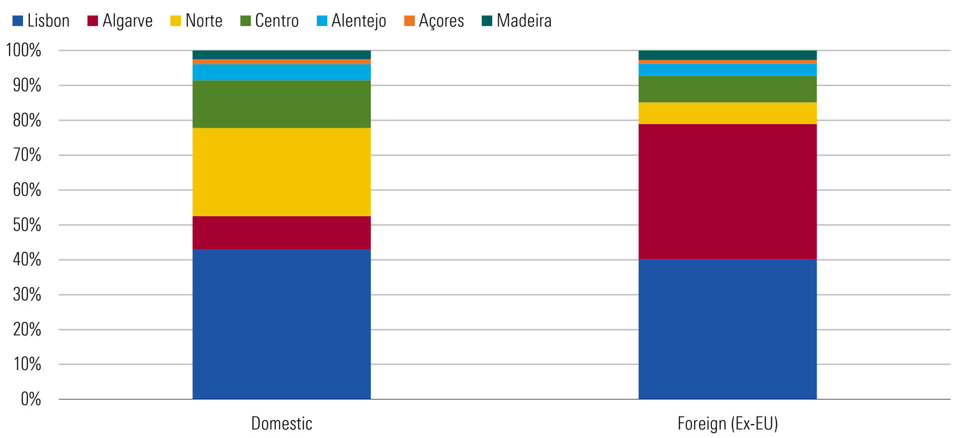
Moreover, in 2019 and 2020, non-EU buyers purchased almost 60% of the properties sold in Lisbon, with the rest sold to domestic buyers. While Lisbon's share of the non-EU buyers has reduced in recent years, Algarve has elicited greater interest from these buyers where their share has increased to 40% in 2022 from 20% in 2019. In the case of domestic buyers, properties acquired in this location amount to less than 10% of the total value of the residential property transactions. Exhibit 4 presented above illustrates these market dynamics and shows the price development in Lisbon and Algarve, which have outperformed the other regions.

Exhibit 8 Value of Transactions by Non-EU Buyers (EUR thousands)



Source: INE.

Exhibit 9 Distribution of Property Location per Type of Investor, Value (2022)

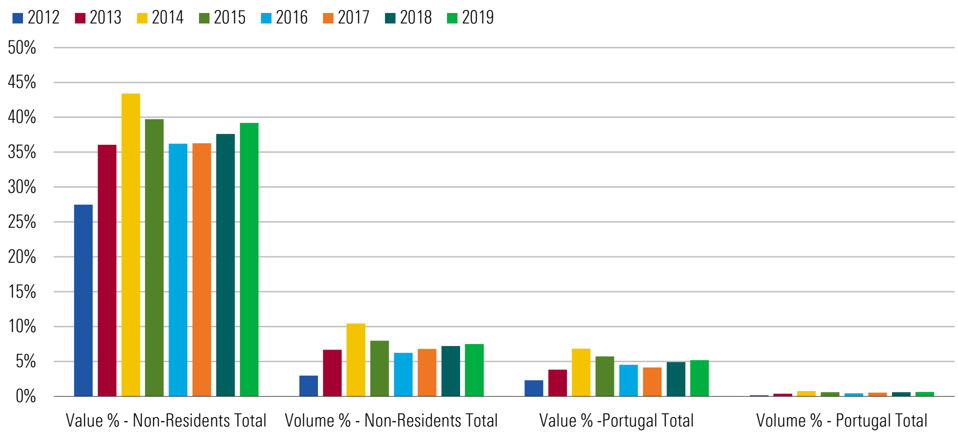


Source: INE.

Nevertheless, whilst the proportion of golden visa property acquisitions, in value terms, relative to the total acquisitions by non-resident buyers has been between 25% and 40% in recent years, in proportion to the total Portuguese market this has been roughly equivalent to only 5%. Furthermore, in overall volume terms this proportion is considerably smaller, accounting for only 7% of the non-residents market and 1% of the total market.

Certainly, these proportions are higher if we dive deeper into certain regional segments, particularly for Lisbon and Algarve; however, these transactions do not have a large representation in the overall Portuguese residential property market, therefore outside of those two regions the impact of the golden visa scheme appears to have been limited.

Exhibit 10 Golden Visa Property Transactions as a Share of Non-Resident and Country Total (Value, Volume)



Source: INE.

Potential Implications for the Residential Property Market and RMBS Transactions

Given the current macroeconomic environment of high inflation levels, rising unemployment and a corresponding cost-of-living crisis, as well as the change to a rising interest rate paradigm, the residential property market in Portugal should face a slowdown as far as the number of transactions and mortgages approved are concerned. Consequently, this drop in demand should also reverberate through house prices as investing conditions worsen and borrowers experience diminished borrowing capacity due to the higher interest rates and relatively high property prices, which react with a lag (compared to the former) to the current macroeconomic changes.

The end of the concession of new golden visas concludes a scheme that was developed at a time of financial difficulties for the country. This decision should have a limited impact in the residential property market since it was not a major driver transaction-wise, whether measured in value or in volume terms for the country as a whole. It may, however, have had a more localised impact particularly in the capital and Algarve, a much-sought-after tourism destination. Other factors such as the lack of new housing supply, a renewed foreign interest and the economic recovery since the lows of the early 2010s, seem to be more relevant in explaining the recent trend of property prices in the country.

Portuguese RMBS transactions rated by DBRS Morningstar typically do not include a relevant share of non-residents in their portfolios but may include some foreign nationals. The end of this scheme should not affect the performance of these deals in the short term, but were this to translate into reduced foreign investor interest in the country's residential property market, prices could be affected in the medium term.

As mentioned, there are other more important factors that will have direct repercussions for RMBS portfolios with Portuguese collateral, particularly given the rapid increase in interest rates, which have a near instant pass-through to the floating-rate loans paid by the borrowers, as well as the cost-of-living crisis, which is affecting borrowers' income in face of their debt servicing needs.

Nevertheless, the recent house price appreciation, tighter underwriting criteria, and government-endorsed relief measures to help owner-occupied borrowers with mortgage affordability stress (please refer to *Portugal Interest Rate Measures Likely to Aid Borrowers, but Medium Term Asset Quality Risks Remain*, published 9 February 2023) should limit any potential performance deterioration.

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