THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW

FOURTH EDITION

Editors
Adam Emmerich and Robin Panovka

THE LAWREVIEWS

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PREFACE

Publicly traded real estate companies and real estate investment trusts (REITs), with help from real estate private equity, have transformed the global real estate markets over the past 25 years. Their principal innovation, and secret sauce, is 'liquid' real estate. Unlike traditional property ownership, equity in publicly traded real estate vehicles is highly liquid, and can be bought and sold in large volumes, literally in minutes, on numerous global exchanges.

Publicly traded real estate vehicles have an aggregate market capitalisation of approximately US$1.7 trillion globally, including over US$1 trillion in the United States and approximately US$200 billion in each of Europe and Asia. As public REITs and other vehicles have aggregated these properties and grown in scale and sophistication, so too have real estate-focused private equity funds, playing an important role catalysing hundreds of billions of dollars of REIT and real estate M&A transactions and IPOs.

However, despite the massive growth, the potential growth is far larger both in long-standing REIT markets and in newer REIT jurisdictions, where the trend is more nascent. With increasing development and urbanisation, the world is producing more and more institutional-grade properties, and a growing percentage of this expanding pool – an estimated US$5 trillion and counting, so far – will inevitably seek the advantages of liquidity by migrating to the publicly traded markets. The growth is expected to be both local and cross-border, with approximately 40 countries already boasting REIT regimes.

REITs and other publicly traded vehicles for liquid real estate have grown because they are often a superior vehicle for stabilised assets. Greater liquidity and transparency – and often superior governance – are attractive to investors, resulting in a lower cost of capital and superior access to vast amounts and varieties of capital in the public markets. In addition to cheaper capital, REITs and other public vehicles benefit from efficiencies of scale, sophisticated management and efficient deal structures, to name just a few advantages. With these advantages, the global march of real estate to the public markets seems unstoppable.

This publication is a multinational guide for understanding and navigating the increasingly complex and dynamic world of liquid real estate and the transactions that mostly produce it. The sea change in the markets, sometimes called the 'REIT Revolution', has meant that major real estate transactions have migrated from 'Main Street' to 'Wall Street'. They now often take the form of mergers, acquisitions, takeovers, spin-offs and other corporate transactions conducted in the public markets for both equity and debt. They have grown exponentially in complexity and sophistication, and increasingly represent cross-border multinational transactions fuelled by the now global real estate capital markets and M&A deal professionals. And they are often intermediated by international investment banks rather than local brokers, and financed with unsecured bonds or commercial mortgage-backed securities. In a fair number of cases they are catalysed by private equity firms or similar actors, sometimes building portfolios to be taken public or sold to public real estate companies, and sometimes through buyouts of public real estate companies for repositioning or sale.

To create this publication, we have invited leading practitioners from around the globe to offer practical insights into what is going on around the conference tables and in the markets in their jurisdiction, with an eye to cross-border trends and transactions. As will quickly become evident, the process of liquefying real estate and the transactions involving public real estate companies require a melding of the legal principles, deal structures, cultures and financial models of traditional real estate, public company M&A and private equity. None of this, of course, happens in a vacuum, and transactions often require expertise in tax, corporate and real estate law, not to mention securities laws and global capital markets. Each of our distinguished authors touches on these disciplines.

We hope this compilation of insight from our remarkable multinational authors produces clarity and transparency into this exciting world of 'liquid real estate' and helps to further fuel the growth of the sector.

Adam Emmerich and Robin Panovka
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Chapter 18

PORTUGAL

João Gonçalo Galvão[1]

I OVERVIEW OF THE MARKET

Commercial real estate investment in Portugal set a new record in 2018, reaching a historical €3,500 million threshold, representing a 54 per cent increase over 2017 (an already record-breaking 50 per cent increase over 2016). This figure was mostly the result of high-ticket deals involving shopping centres and transactions of several office portfolios.

Retail continued to lead investor preferences, making up for 43 per cent of the total annual investment. In this particular area, Lisbon took the Iberian podium in 2018, accounting for approximately 28 per cent of the total value traded, the average value per operation being circa €193.4 million. This figure represented a smaller number of deals compared to Madrid, but with considerable value, including two transactions of more than €400 million.

Aside from retail, other classes of assets also benefited from investment diversification; the office sector totalled 27 per cent of all investment, and the industrial and logistics sector accounted for a relevant investment volume despite their less robust profile in the national landscape. As a consequence of booming tourist activity, the Portuguese hotel industry had a strong year, with investment around €230 million, including the transaction of the hotel Intercontinental Porto Palácio das Cardosas for the record value of €500,000 per room.

Also marking 2018 was the initial push from national banks to decrease the amount of non-performing loans (NPL) and real estate owned (REO) in their balance sheets so as to abide by European regulations; about 15 portfolios were sold during 2018 for an aggregate value of €7.5 billion, REO transactions being purported to amount to circa €1.3 billion.

A stable political and economic context also contributed to these record figures; according to the Portuguese Central Bank, the Portuguese economy registered a 2.1 per cent increase in 2018, slowing down slightly when compared with the 2017 number, where a 2.8 per cent increase was registered.

1 João Gonçalo Galvão is a partner at Campos Ferreira, Sá Carneiro & Associados. The author would like to thank António Rocha Mendes, partner and head of tax at the firm, for his contribution to Subsection IV.v on tax considerations.

II RECENT MARKET ACTIVITY

i M&A transactions

The start of 2018 brought the news of the acquisition by Tiekenveen Holding BV (an Auchen Group subsidiary), to the Blackstone Group, of the shopping centre schemes Forum Sintra, Forum Montijo and Sintra Retail Park, totalling 131,462 square metres of gross leasable area (GLA), for a value of €411 million.

Also on sale by Blackstone was Almada Forum, a 230-shop scheme of 82,000 square metres bought by Spanish SOCIMI Merlin Properties in July 2018. This asset had been previously acquired by Blackstone from Commerzbank back in 2015, for a value of approximately €224 million.

In January 2018 Spanish ORES SOCIMI bought a supermarket and stand-alone portfolio (comprising two hypermarkets, two supermarkets and two stores) of 47,424 square metres from Sonae Retail Properties for €86 million.

In addition, investment in assets for urban development also showed a consistent increase in 2018. Regarding the most relevant deals, the spotlight goes to the sale of the city-centre grounds of the old Feira Popular location to Fidelidade Property for €273.9 million (foreseeing construction of a total of 239,264 square metres, mostly for services and residential).

ii Private equity transactions

As part of a sale-and-leaseback transaction, the 'Mistral portfolio' comprising 16 high-street retail properties, two of which are located in Lisbon, with 35,000 square metres of GLA was sold in January 2018 by Inditex/Zara España S.A. to Deka Immobilien funds' Deka-ImmobilienEuropa and to WestInvest InterSelect for a value of €400 million.

Also in January 2018, Axa Investment Managers acquired, on behalf of their clients Dolce Vita Tejo, the second largest shopping centre in Portugal of 80,360 square metres, for €230 million, from the North American Baupost fund (90 per cent) and Eurofund Investments (10 per cent).

In June 2018 National Teixeira Duarte group sold to the Kildare PE fund the Lagoas Park office park, comprising 13 office buildings as well as a retail gallery, with an area of 85,000 square metres, for €375 million, in what was the largest deal in the history of the Portuguese office sector.

In July 2018 the Apollo Global Management fund acquired a portfolio of 277 assets, 70 per cent of which are residential, located in Lisbon, Porto and other regions to Fidelidade – Companhia de Seguros, S.A. and Fidelidade – Property Europe, S.A. for a value of €350 million.

In the tourism sector, Deutsche Bank sold to the Carlyle Group and to Explorer Investments the Penha Longa Hotel & Golf Resort for a rumoured value of €100 million.

III REAL ESTATE COMPANIES AND FIRMS

i Publicly traded REITs and REOCs – structure and role in the market

In January 2019 the long-awaited Portuguese REIT regime was finally approved pursuant to Decree-Law 19/2019, of 28 January, which came into force on 1 February (with an amendment already being expected to be published and come into force during the third quarter of 2019). This Decree-Law created the real estate investment and management companies (SIGIs) for the purpose of promoting and driving the national real estate market, particularly in the lease sector.

SIGIs can either be newly incorporated entities or result from the conversion of previously existing companies or collective investment entities (OII) under the form of companies. SIGIs are required to take the form of share companies, with or without public subscription, with a minimum share capital of €5 million, which within one year of their incorporation or conversion should be traded in a regulated market or in a multilateral trading system located or operating in Portugal or in another EU or EEA Member State. Of such trade, at least 20 per cent of the share capital of SIGIs should be dispersed between investors holding, individually, no more than 2 per cent of the respective voting rights (the amendment to Decree-Law 19/2019 being expected to set this 20 per cent threshold for the end of the third complete year of trading and raising it to 25 per cent at the end of the fifth year).

The corporate scope of SIGIs should consist of the acquisition of rights over real estate for leasing or other permitted contractual arrangements, including the development of construction or rehabilitation projects. Provided that a number of relevant legal requirements are met, SIGIs may also hold shareholdings in other SIGIs or similar companies located within the EU, as well as participation units in OII or real estate investment funds or companies for residential lease (FIIAH or SIIAH). Rights over real estate and interests in other entities should account for at least 80 per cent of the SIGIs' total assets, with the value of rights over leased properties or properties subject to other permitted contractual arrangemets, amounting to 75 per cent of the total asset's value.

Although the new SIGIs regime represents the cornerstone of REIT regulations in Portugal, the respective tax regime was not initially clear and the anticipated amendment to Decree-Law 19/2019 should clarify that the OII tax framework shall apply to SIGIs. As SIGIs have not yet had the chance to cause an impact, other than by real estate funds (as detailed in the following subsection), real estate M&A is mostly driven by commercial limited liability companies by shares or quotas, usually qualified as REOCs pursuant to their corporate scope, consisting of the development and management of real estate assets, as well as of the sale and purchase of assets for their subsequent resale.

ii Real estate PE firms – footprint and structure

Key domestic players in the private equity sector, such as ECS, Explorer, Magnum Capital or Oxy Capital, are primarily enrolled in venture or growth capital. Funds have, however, been set up to conduct investment in the real estate sector, namely in companies with attractive real estate assets for development or tourist operation.

Private equity investment in the real estate sector has therefore been deployed either through private equity or venture capital funds; more traditionally, investment is made through OII in the form of real estate funds or companies. The latter are collective investment schemes similar to funds but structured as share companies with a fixed or variable share capital (respectively named SICAFI or SICAVI) whose assets are held in ownership and managed either by self-management[2] or third-party management. The share capital of OII in the form of companies is represented by nominative shares without nominal value, which are issued and traded as per the rules that govern the participation units of real estate funds.

2 Although subject to the organisation requirements and duties applicable to managing entities, including with regard to the managed assets and the respective investors, as well as own-funds' requirements.

Pursuant to the most recent Annual Activity Report of the Portuguese Securities Commission on 2017 private equity investment (focused on venture capital activity),[3] released on December 2018, the real estate sector was the target of around 10.3 per cent of the total value invested by Portuguese venture capital firms and funds; this means that from the €3,535.5 million invested by this sector in 2017, around €64.15 million targeted the real estate segment, the majority of such investment deriving from funds. In recent years the trend showed the increased weight of the real estate sector as a target of private equity investment in Portugal; in any case, the 2017 figures represent a small decrease in comparison with 2016, where the real estate sector was the target of 10.6 per cent of the total value invested.

As for real estate funds operating in Portugal (including investment funds, special funds and management funds of real estate assets), most recent available data referring to the end of the first quarter of 2019[4] reports the existence of 217 funds with €10.875 million of net asset value under management, this representing an increase of €37.3 million when compared with similar statistics reporting to the end of the first quarter of 2018. Statistical data shows their larger appetite to invest in offices or service-type assets (with €3,215.6 million invested), whereas commerce/retail assets take second place (with €1,993.6 million), followed by other types of assets and housing (representing, respectively, €1,724.7 million and €1,206.7 million), industrial assets (€318.1 million), tourism (€273.2 million) and logistics assets (€187 million).[5]

It should in any case be noted that by the end of the first quarter of 2019, €7.8087 million was invested by real estate funds in completed construction, whereas land (€1.7167 million), other construction projects (€975.1 million) and rehabilitation construction (€135.1 million) followed investment preferences.

IV TRANSACTIONS

i Legal frameworks and deal structures

Overview

Typically, the sale and purchase of real estate assets can be structured either via a direct asset deal or, indirectly, via a share deal targeting the acquisition of the entire share capital or participation units of the company or fund that owns the relevant asset or portfolio.

Option between asset deals and share deals is driven by commercial or economic, financial, legal, tax and other considerations, but also taking into account the nature and type of purchaser and potential risks and liabilities susceptible of being inherited, with typical investors favouring asset deals. Potential ring-fencing concerns and legacy issues are also usually deemed as downsides to share deals (more appropriate for continuity solutions), although they have the advantage of allowing foreign investors to step into an already existing corporate vehicle with a low investment set-up. More complex corporate structures (such as mergers or demerges) are less common in effecting the transfer of real estate assets.

3 As per statistical information provided by the Portuguese Securities Commission in www.cmvm.pt/pt/Estatisticas.

4 As per statistical information provided by the Portuguese Securities Commission in www.cmvm.pt/pt/Estatisticas.

5 Assets may not be all located in Portugal.

A note should also be made to the potential qualification of asset deals as involving the transfer of an undertaking as a going concern, the dividing line being clearer in those transactions where the business performed in the target asset has more relevancy than the underlying property.

Transactions can either arise from private or off-market processes – the rule for traditional deals involving developers or a low number of assets – or be the result of organised competitive procedures, the latter being standard for processes involving high-profile assets or large portfolios, as well as whenever banks or listed entities are involved. The highly regulated profile and complexity inherent to bidding processes also makes them more lengthy and costly.

There is no standard time frame for the completion of a real estate M&A transaction, the duration of any deal depending on a number of factors, taking into account the risk-prone or risk-free approach of the parties, required regulatory clearances or fillings, the option to dismiss or limit any due diligence exercise, as well as by the need to address or remedy any material issues arising thereof and considered critical.

As for the typical contractual conditions of real estate transactions, as a result of common-law influence any significant acquisition will follow international terms and clauses, both as to what concerns methodologies (such as the use of preliminary agreements, due diligence investigation) and the contents of contractual documentation (use of representations and warranties, indemnities, disclosures, etc.).

NBO and due diligence

The submission of a non-binding offer or letter of intent is usual in more complex or high-value transactions, in particular involving qualified investors, followed by the formalisation of a non-disclosure agreement regulating access to more detailed information concerning the asset.

The due diligence stage follows submission of the initial offers and may accommodate more than one investor reviewing the relevant information package. Legal due diligences have as their primary concern to identify any contingencies or negative consequences that may be triggered by the envisaged transaction, although different levels of analysis naturally apply depending on whether or not the operation is to be structured as an asset or share deal (for example, concerns around change of control or ownership provisions susceptible to motivating termination of key agreements or the acceleration of debt due under credit facilities or loans are more standard in share deals). The common backbone focuses, in any case, on the verification of ownership and encumbrances over the relevant real estate assets, tax status as well as on regulatory, planning and licensing requirements (including environmental) applicable thereto. High emphasis is likewise placed on the analysis and assessment of compliance levels under material agreements or other arrangements encumbering the asset (e.g., concession agreements, lease agreements or shop use agreements). Labour matters may also be relevant for share deals or whenever asset deals are susceptible of being configured as transfer of a business as a going concern.

Technical due diligence to the properties is also usually performed, entailing inspections and surveys to assess their suitability, construction status and existence of any structural or hidden defects. Verification of environmental matters, both from a legal and technical perspective, also assumes paramount importance to investors when perusing potential business opportunities, including assessment of the presence of any potentially hazardous or dangerous substances in the properties. Finally, deals involving assets for development may also require careful review and validation of any approved or ongoing licensing procedures and urbanisation commitments.

Deal security measures

Typical deal security measures are normally deployed by qualified investors, often in conjunction with exclusivity negotiation periods. Exclusivity clauses are more usual in transactions with several interested investors, being demanded for reasonable periods of time (normally from 60 to 120 days, although no standard duration rule exists), in particular where one bidder seeks an exclusive negotiation period at an advanced stage of the process.

Far from being standard practice, break-up fees may be set in complex transactions, mostly seeking to protect the investor if a seller terminates negotiations at an advanced stage or elects another bidder. Although less usual, break-up fees may also be agreed to protect the seller in the cases where the sales procedure has a negative impact on ongoing businesses or on the overall value of the targeted asset.

Match rights' undertakings may also be set forth in some transactions, awarding bidders the possibility of meeting or matching competitive offers presented by other interested parties.

When considering real estate transactions, pre-emption rights and other similar third-party rights are unavoidable to assess, either by clearing the risk in advance or otherwise developing strategies to deal with any such rights that may bring a degree of uncertainty to the deal until a very late stage of the process.

Acquisition agreement terms

Promissory sale and purchase agreements

Real estate transactions are commonly preceded by the execution of a binding promissory sale and purchase agreement, setting forth the reciprocal undertakings from seller and purchaser concerning the envisaged transaction.

This type of agreement is usual if execution of the transaction is subject to the fulfilment of conditions precedent (including, if applicable, anti-trust clearance) or conditional to the purchaser obtaining required financing. Typical conditions precedent in asset deals concern waiver of applicable pre-emption rights, notably from public entities (municipalities and state entities responsible for the safeguard and protection of historical and architectural heritage) as well as from tenants or other co-owners. As for share deals, most common conditions precedent relate to required consents or authorisations so as to avoid triggering change of control provisions or the acceleration of debt due under credit facilities or loans that are to be kept in place. In deals involving development projects, approval of envisaged planning may also be construed as a condition precedent.

Upon execution of a promissory agreement, a deposit is normally made as advance payment of due consideration, the percentage thereof varying as agreed by the parties (market practice often points to a 10–15 per cent range). As per default legal provisions, this deposit will be lost or will have to be returned in double if, respectively, the promissory purchaser or seller fail to execute the definitive agreement; in case the promissory purchaser was awarded possession of the property the same may opt to request the return of the deposit in single, but accrued of a compensation in an amount equivalent to the market value of the property at the date of breach, minus the agreed consideration. Alternatively, the non-breaching party may apply for the compulsory enforcement of the promissory agreement.

Also relevant in promissory agreements is the provision of the representations and warranties that are agreed by the parties and that are subject to repetition on completion date.

Completion of the sale

The sale of real estate requires execution of a public deed executed before a notary or, alternatively, sale and purchase agreement with certified signatures, or sale and purchase agreement executed before the land registry as per a relatively standard form (the last two options being less common in major transactions).

Execution of the sale is preceded by the verification of ownership of the seller over the real estate and of its capacity to dispose of the property. If existing, any charges or encumbrances over the property are usually discharged simultaneously with payment of the consideration (the most common being cancelling the mortgages). Subsequent registration of the acquisition is required before the land registry to prove ownership, as well as before the tax authorities.

As for share deals, completion does not require execution of any deed before a notary or even of an authenticated or notarised document, with the parties agreeing on the definitive transfer of the envisaged participating interest under a private document. Ancillary transfer formalities are, however, required, most notably delivery of share certificates (or deposit thereof in case of book-entry form shares) for share companies or registering the change of shareholding structure before the commercial registry in case of quota companies.

Representations and warranties

The most standard representations and warranties in any real estate M&A transaction concern the following topics:

a capacity and authority of the seller;

b binding nature of the agreement and no contravention with other commitments or undertakings entered into by the seller;

c lawful title, possession and ownership over the relevant asset;

d no charges or encumbrances over the asset or limiting its use or transferability (being sold unoccupied of any persons or goods, with the exception of existing tenants, shopkeepers, etc.);

e validity of all licences, authorisations and permits required for the property;

f compliance with applicable legal provisions, namely on environmental, technical and safety requirements;

g suitability of the asset for the respective use and inexistence of hidden or structural defects;

h inexistence of pending or threatened litigation, claims or disputes susceptible of affecting the asset or the transaction; and

i inexistence of debts related to ownership and operation of the property, including due and proper payment of all taxes, charges and fees.

Additional representations and warranties may also apply to share deals, in particular concerning ownership over the participating interest to be transferred, good standing of the entity to be acquired, compliance with agreements, as well as labour matters.

Guarantees and other

Protection from potential issues or contingences detected during the due diligence or that may arise post-completion is usually sought through a combination of specific indemnities and compensation for breach of the representations and warranties.

Furthermore, and so as to secure the seller's obligations, it is also not uncommon for M&A deals targeting material assets to provide additional measures to mitigate the purchaser's risk, including price retention or withholding (until certain milestones or conditions are verified), escrow agreement mechanisms, first-demand bank guarantees, parent company guarantees or comfort letters, among other things.

ii Hostile transactions

No hostile transactions have occurred with regard to public real estate companies.

iii Financing considerations

Funding used in national real estate M&A transactions follows standard financing schemes.

Typically, a loan agreement is entered into by the purchaser together with the associated security package (which is in line with international common practice), loan-to-value percentage varying on a case-by-case basis (despite usually fluctuating between 65 per cent and 80 per cent as the common maximum threshold).

The most frequent and relevant collateral in real estate deals is the granting of a mortgage over the target asset or portfolio. However, in share deals careful construction of the funding facility and security package is required in order to avoid financial assistance constraints (pursuant to which a target company is prohibited from supplying funds or providing any collateral so that a third party can acquire its share capital).

Security packages for transactions involving commercial real estate may also require the pledge of receivables or the assignment of receivables by way of security, as well as the assignment of income arising from real estate (mainly rents); in share deals, pledges over the target shares may also be required.

It should, however, be noted that the growing popularity of Portuguese real estate assets, by capturing the attention of international players, is bringing in a relevant inflow of foreign equity and therefore injecting additional liquidity and resources into the market.

iv Tax considerations

Taxes levied on the transfer and ownership of real estate

The acquisition of property and other rights over real estate located in Portugal is subject to property transfer tax (IMT) levied over the consideration paid or the tax registration value of the property,[6] whichever is higher. The tax is levied at the rate of 5 per cent and 6.5 per cent, applicable to rural and urban properties respectively. Several exemptions may apply, including on the acquisition of properties for resale, urban rehabilitation or the acquisition of assets by real estate investment funds or companies for residential lease.

The acquisition of real estate is also subject to stamp duty at the rate of 0.8 per cent. This tax is levied on the same value that is relevant for IMT purposes.

6 The registration value is computed through the application of an objective formula, which normally results in a value lower than the property's fair value.

The owner or the holder of usufruct or surface rights over Portuguese real estate is subject to a municipal property tax (IMI), levied on the tax registration value of urban and rural properties. IMI is due by the rightholder on 31 December of the relevant year, the tax being levied at rates varying (according to the municipality) between 0.3 per cent and 0.45 per cent for urban properties, and 0.8 per cent for rural properties. An 'Additional to the IMI' (AIMI) is levied on the sum of the tax registration value of all the urban properties held by each taxpayer, as at 1 January of each year, at the rate of 0.7 per cent for tax basis until €1 million, 1 per cent to the portion of the tax basis between €1 million and €2 million and 1.5 per cent over the tax basis exceeding €2 million.

Share deals versus asset deals

Gains realised by companies on the transfer of shares are subject to income tax at the rate of 22.5 per cent or 25 per cent for resident and non-resident entities respectively. Although gains on the transfer of shares by resident companies and by non-residents are generally exempt from tax in Portugal, this exemption does not apply to gains realised on the transfer of land-rich companies (companies in which the majority of its assets consist of real estate located in Portugal). Capital gains realised by individuals on the transfer of shares are always subject to a flat rate of 28 per cent.

Gains realised on the transfer of land-rich companies by non-residents are exempt under some double tax treaties, most noticeably the treaties with the Netherlands and Luxembourg.

Gains realised on the transfer of real property in Portugal are always subject to income tax in Portugal at the same rates described above. Note, however, that individuals (resident and non-resident) may elect to apply the general progressive rates on 50 per cent of the capital gain (in lieu of the flat rate). Only 50 per cent of the capital gains realised in the transfer of tangible fixed assets are included in the taxable income, provided that the realisation amount is reinvested in the two subsequent years.

The acquisition of a participation representing at least 75 per cent of the share capital of, inter alia, private limited liability companies by quotas is subject to IMT, levied at the higher of the tax registration value or the accounting value of the properties held by the company. No IMT applies on the transfer of shares in a corporation.

Commercial operation of real estate

Portuguese properties' rental income is subject to income tax in Portugal. The tax is levied at the rate of 22.5 per cent or 25 per cent for companies, respectively resident and non-resident and 28 per cent for individuals. The rental income of resident individuals attributable to a business is subject to tax at the general progressive rates (up to 50.5 per cent on income in excess of approximately €80,000).

General business deductions are allowed, including amortisation and interest (up to 30 per cent of adjusted earnings before interest, tax, depreciation and amortisation or €1 million — whichever is higher). Individuals who are not deemed to be carrying out a business are allowed only maintenance and repair deductions.

Investment vehicles

The typical investment vehicles are companies and collective investment entities.

The most common structure is to hold the properties through a Portuguese corporation that is held by a Luxembourg holding company. The Portuguese company is funded through a mix of equity and debt. This structure may offset amortisation and interest expense against most of the company's operating income. Dividend and interest payments to the Luxembourg holding company should be exempt from tax under the parent-subsidiary and interest and royalties directives. Capital gains on the sale of the Portuguese company's shares are exempt from tax under the Luxembourg-Portugal tax treaty.

Also common are investments through OII under the form of real estate funds or companies. These are subject to a special tax incentive status regime that, following a 2015 amendment, is based on the 'exit' taxation method, thus aligning it with similar tax regimes of most jurisdictions and allowing for an easier comparison between domestic and international collective investment entities.

Although collective investment entities are subject to income tax, the following classes of income are exempt: capital income (property income and capital gains) and expenses related thereto, except from offshore entities; certain non-deductible charges for tax purposes; income and expenses related to management and other commissions that reverted to the entities.

Distributions and redemption gains realised by participation unit holders are subject to taxation at 25 per cent or 28 per cent (for resident corporate entities or individuals, respectively) or 10 per cent (to non-residents). Gains realised by non-residents on the transfer of participation units are exempt from tax in Portugal.

v Cross-border complications and solutions

As a general rule, in Portugal there are no restrictions on foreign investment, which is granted the same level of protection as domestic investment, no specific registration or legal or regulatory protection measures applying. Other than in specific sectors (in particular in those that may affect the public order or the public health, involve the exercise of a public authority or relate to national security), there are no particular limitations on foreign investment, although a number of restrictions and consent requirements may apply both to foreign and domestic investments in regulated areas.

In what specifically concerns transactions targeting real estate assets, it should in any case be noted the more stringent legislative package approved in 2017 concerning, on one hand, anti-money laundering and anti-terrorism funding measures (as per Law 83/2017),[7] and, on the other, the obligations concerning identification of the ultimate beneficiary holding direct or indirect control over legal entities (pursuant to Law 89/2017).

In line with these requirements, know your customer procedures performed by collective investment entities and financial entities also entail the disclosure of extensive information from the counterparties, bringing additional clarity and transparency to transactions.

V CORPORATE REAL ESTATE

Following the Portuguese bailout programme (that officially ended in May 2014) and in the wake of the austerity policies enforced thereunder, a tendency was noted for Portuguese businesses to refocus on their main activities while disposing of assets and businesses that

7 According to Law 83/2017, the formalisation of any real estate transactions requires express indication of the used payment method and timing.

were not essential. This divestment trend created attractive opportunities in the commercial real estate sector, with mostly international players (without liquidity constraints) seeking to take advantage of the sale of quality assets at very competitive prices during the crisis years.

Some national groups have also undertaken corporate restructures with a view to segregating their real estate assets from their operational activities, although no reference can be made to a substantial track record in this respect.

Other than that, the most typical procedure for monetising corporate real estate has consisted of sale and leaseback-type operations, favouring either purchasers from the financial sector or real estate investors with an appetite for core assets with low risk that can provide a stable yield.

VI OUTLOOK

2019 is expected to be another year of growth, although it is unlikely that it will surpass the records set in 2018. Despite more modest expectations (with investment in commercial real estate being estimated to reach around €2.5 billion), 2019 should remain well above the average of the last decade, as a stable political environment and recovering economy continue to make Portugal a preferred target for foreign investment. Prime yields should linger around 4.5 per cent in office and street retail, 4.75 per cent in shopping centres and 6.5 per cent in logistics.

The shopping centre market has reached maturity, with a residual offer growth of 50,000 square metres in new GLA being mostly due to expansions and renewals of already existing schemes. The lack of retail real estate should therefore confirm a shift in investment preferences, with the office and logistic sectors playing a larger role together with alternative assets, such as hospitals and other collective equipment. The new concepts of co-living and co-working will increasingly become part of the landscape, as student housing, senior residences and work hubs capture investment interest. Hotel and tourism-related assets should also remain an appealing investment option, as Portugal continues to be an on-trend destination.

The scarcity of big-ticket deals means that the development of new assets will be critical for a sustainable pipeline, with rising construction costs and scarcity of workforce being a point of concern. Although more conservative in terms of investment profile, residential development is required to flourish whilst expanding city boundaries, in particular aiming at the national middle-class segment often seen as the engine of the lease market, even more so considering that residential pricing is too high for the average income level.

The banking sector should continue offloading NPL and REO portfolios into the market, as a value between €25 billion and €30 billion in NPL portfolios is purported to still be up for sale, in what are expected to be very disputed deals with opportunistic investors seeking an alternative to the stock market and to low interest rate returns.

As for the Portuguese REITs (SIGIs), these should only have an impact from 2020 onwards, as now is the time to incorporate the first vehicles and gather capital for investment.

However, difficulties are posed by some contradictory legislative policies; in the same year that saw the Portuguese REITs come to light, the urban lease law suffered significant amendments hindering the incorporation of a professional residential lease market in Portugal, by offsetting the flexibility introduced in 2006 with a view to, at the time, strengthening the rental market.

Appendix 1

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