

# Investing in NPL in Portugal: The Time is Now!

# #2.2018

AUTUMN UPDATE  
PREPARED BY PRIME YIELD

Portugal is on a sustained path in reducing Non-Performing Loans (NPL), shortening the stock in €16 bn since June 2016 and the ratio in almost a third to 12.7% (Q1 2018). But there's still much to be done and Banks are now more pressured to fasten the deleveraging process, which in a context of increasing demand for this type of product, favourable Economic conditions and a buoyant property market could boost NPL sales in the next two years for a value of over 5,2 bn.

## Economy

Although maintaining an upward trend, the Portuguese Economy began 2018 slightly moderating its pace of growth, with GDP increasing 2.1% (y-o-y) in Q1, which compares with the 2.4% growth recorded over the previous quarter. Nevertheless, in Q2 (official figures by the National Statistics Office INE) GDP growth further accelerated (+2.3% y-o-y), driven by a more intense positive contribution of domestic demand (due to the acceleration of private consumption), while investment presented a less intense growth. This residual slowdown was already expected, as forecasts of the Portuguese Central Bank (Banco de Portugal) point to a GDP growth of 2.3% in 2018, (2.7% in 2017, the best performing year in over 17 years). The Portuguese Economy performed under the Euro Area average (+2.5% y-o-y) in Q1, although the latter also experienced a slowdown vis-à-vis the previous quarter (+2.8% y-o-y). As for the Q2, the pace of the Euro Area aggregated performance continued to decelerate (+2.1% y-o-y), thus putting Portugal above the European average.

PORTUGAL GDP GROWTH Q2 2018

# 2.3%

EURO AREA GDP GROWTH Q2 2018

# 2.1%

## Property Market

Following two strong years, the Portuguese property market continues to experience a very dynamic moment in 2018, once again common to both commercial and housing segments and in a context of buoyant demand and supply shortage. This unbalance is even pointed out as one of the main drivers for the continued housing price growth, a trend that is already spreading country-wide and that is not confined, as before, to Porto and Lisboa city centres (firstly) and their respective Metropolitan Areas. According to recent data by INE (the National Statistics Office) house prices increase 12.2% in Q1 2018 (y-o-y), thus further accelerating from the 10.5% growth recorded in the end of 2017 and being the highest growth ever recorded by INE (since 2009). The transaction of dwellings is also on the rise, with a total 40,716 units traded in Q1 2018, a 15.7% increase over the same period in 2017. These sales exceeded €5,4 bn, 25.7% more than the same period in 2017.

GROWTH OF HOUSING PRICES  
(Q1 2018 YoY)

# 12.2%

HOUSING SALES VOLUME  
(Q1 2018)

# €5,4bn

COMMERCIAL PROPERTY INVESTMENT  
EXPECTED IN 2018

# +€3bn

The first half of 2018 is also confirming the strong year in commercial property investment volumes, with a record high of about €1,5 bn transacted and a pipeline of deals (considering deals already completed in Q3) that should double this figure, bringing the annual traded volume to an unprecedented €3 bn volume. As for the occupational markets, office take up ended July with 115,000 sqm, a 31% rise over the previous year results. Rents in offices and in retail are showing an upward trend, as the current existing supply is not enough or not able to meet the demand requirements.

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## NPL Stock and Ratio

Benefiting from an Economic recovery environment and the rise in property prices, the Portuguese financial system has significantly reduced the NPL stock since June 2016, when the volume of “bad debt” reached the maximum peak of about €50,5 bn. Since then and until December 2017, NPL in Portugal decrease about €13,5 bn to €37 bn (data by Central Portuguese Bank Banco de Portugal) and another €2,5 bn were already out of the Bank’s balance sheet in Q1 2018, bringing the total amount of NPL reduction from June 2016 to €16 bn. The progress in the Companies segment (Non-Financial Corporations) was very important to the overall decrease, as this continues to be the dominant segment for NPL (65% of the total amount). Between June 2016 and December 2017, the stock of NPL in the Corporate segment has reduced by €8,9 bn (to €24,2 bn), adding another €1,1 bn already in Q1 2018. As for households, NPL amounted €12,9 bn in June 2016, reaching €9,8 bn in December 2017.

In Europe, the total stock of NPL in the Euro Area accounts €688 bn in Q1 2018 (Supervising Banking Statistics of ECB, July 2018), already reflecting a decrease of €33 bn over December (€721 bn) and €177 bn compared with Q1 2017.

As for the NPL ratio (to total gross loans, in %), Portugal took very strong steps in reducing it over the last two years, falling about one quarter (4.6 percentage points) from 17.9% in June 2016 to 13.3% as of December 2017. A further compression in this ratio to 12.7% (as for Q1 2018) as already been reported. Impressive progress, but still very far from the 4.8% NPL Euro Area average ratio (ECB) as for Q1 2018 and from the 5% ceiling that the European partners are setting. Again, the company segment recorded the highest NPL ratio (23.8 % in Q1 2018), but backed some 6.5 pp from the 30.3% in June 2016. As for the household segment, the ratio now stands at 7.1% (as of December 2017) from the 9.2% recorded earlier in June 2016 and as even further declined in Q1, backing 2,6 pp from that peak almost two years ago.

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## Potential NPL Deals

2017 was a year of major improvements in tackling NPL, with stock reducing by sales and write-offs, as well as debt recovery, especially for households. 2017 and 2016 are estimated to have had similar annual NPL trading volumes (of about €2 bn), but the current year is expected to record stronger activity, as Banks are more available to dispose these portfolios, recognizing that this can be the most efficient way to fasten the reduction of NPL out of their balance sheets and meet the European targets, at the same time that there is an increasing demand for this type of product, property prices are rising and this could be a very interesting alternative investment. The national bank Caixa Geral de Depósitos is one of the most active players in the market, estimated to dispose about €1,8 bn in NPL during 2018, at a time when it still has a €6,8 bn NPL stock (as of June 2018). Other large banks also report high NPL stocks - €8,8 bn in Novo Banco and €3,6 bn in Millennium bcp as of June 2018 -, having ambitious targets in reducing their exposure to “bad debt”. Portugal is expected to further boost NPL sales during 2018 and 2019, recording an annual average growth of 15% to 20%, which means that 2018 can reach €2,4 bn traded and 2019 over €2,8 bn, totalling €5,2 bn in the next two years.

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## About Prime Yield | NPL&REO Services

Established in 2005 and with over 4000 assets valued in 2017, Prime Yield delivers valuation, research and advisory/consultancy services and has been focusing on the NPL&REO market, specializing in Portugal and Brazil. Thinking about the players (buy and sell) who want to be actively involved in the transaction of this type of assets, the company created the new business area NPL&REO Services, also supported by Prime AVM&Analytics, an advanced technological solution that allows NPL’s investors and sellers to have property valuations in a fast, simple and reliable way both for single assets or entire portfolios (RESI or CRE). Prime Yield is regulated by RICS and REV-TEGoVA, also holding a certification in Quality and Environmental Management (NP EN ISO 9001 and NP EN ISO 14001).

NPL STOCK (Q1 2018)

€35,4<sub>bn</sub>

NPL RATIO TOTAL (Q1 2018)

12.7%

NPL RATIO HOUSEHOLDS (Q1 2018)

6.6%

NPL RATIO COMPANIES (Q1 2018)

23.8%

ESTIMATED NPL TRANSACTION VOLUMES (2018)

€2.4<sub>bn</sub>

2018 NPL TRANSACTION Y-O-Y EXPECTED GROWTH

20.0%