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PORTUGAL ON THE MOVE

Essential BUSINESS

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Awaiting the avalanche

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Supporting Portuguese events

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Adding value

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The lost year

Where there's muck there's money

Non-performing loans (NPLs) have increased significantly in Portugal, but also across Europe since the financial crisis in 2008. But Portugal's banks are in much better shape to deal with the fallout from the current health crisis, and for some companies, there's money to be made from default portfolios

TEXT **CHRIS GRAEME**

Between 2008 and 2014 Portugal's banks suffered a veritable rash of Non-Performing Loans (NPLs).

This had been mainly due to poor supervision and governance, aggressive lending and acquisition strategies, loose credit underwriting policies, high exposure to sectors that were most impacted by the financial crisis (such as real estate and in Portugal over-leveraged tourism resorts) and lax credit controls.

After some years of improvement, the situation looks set to deteriorate again, with the prolonged economic downturn pushing highly leveraged borrowers into financial difficulties and leading to a large number of defaults.

Increased regulatory requirements for NPL management (including the European Central Bank (ECB) Asset Quality Reviews, harmonisation of NPL classification and disclosures, and the introduction of specific NPL codes and directives, have also contributed to the increase in the overall NPL pool in Europe as a whole.

And with the end of moratoria in Portugal from September this year (the government is discussing extending it with banks for some cases until 2022), the Portuguese banking sector is likely to suffer a rash of credit defaults and bankruptcies, as loans and interest once again have to be paid, undoing some of the hard work achieved by the banks in recent years.

The ratings agency Moody's forecasts that bank NPLs will increase by around 9% with the end of the moratorium, compared to 5.5% in 2020 and the Bank of Portugal concurs.

Nevertheless, Portugal's banks have set aside a buffer of up to €2Bn to offset the expected exposure. Caixa Geral de Depósitos alone has set aside €300 million to cover "credit default and other unexpected impairments" resulting from the pandemic.

And just as well. In the first nine months of last year, the net results of Portugal's banks plummeted 65% to €588 million like-for-like on 2019 because of the pandemic and the money set side for impairments.

The Association of Portuguese Banks (APB) in its summary for Q4, 2020 states that the total offset for eventual impairments stood at €2.05Bn, which corresponds to an increase of 66%. In this context, the profitability of the banks has again suffered a setback with profitability ratios of around 1.7% when for the same period in 2019 it was 6.2%. The ratio for covering NPLs was boosted to 55.9%. In 2019 it stood at 51.5%.

The asset quality of Portuguese banks has improved significantly over the past 4 years. As of June 2019, a bumper year for the Portuguese economy as a whole, which grew 2.2% (0.4 pp year-on-year), the banking system showed considerable improvement in terms of efficiency, liquidity, asset quality profitability and solvency, and had been quite successful in clearing around €20 billion in NPLs off its balance sheets.

According to the Portuguese Banking Association (APB) solvency was strongly reinforced: CET1 reached 14.3% in 2019 (versus Core Tier 1 of 7.4% in 2010), liquidity (loan-to-deposit ratio of 87-1% versus 158.7% in June 2010; liquidity coverage ratio at 218.5%; although still low, profitability improved (RoE reached 4.9%); non-performing loans had an impressive downwards development in Portugal, falling by €33.3 billion since the maximum level of €50 billion in June 2016.

AIMING FOR A SOFT LANDING

The president of the Portuguese Banking Association, Fernando Faria de Oliveira, says that the impacts of the recession on the banking sector, its profitability, and in terms of an increase in loan defaults and therefore NPLs/NPEs (Non-Performing Exposures) is inevitable and will only be fully felt when the moratoria, granted in line with the guidelines set out by the European Banking Authority (EBA) and viewed by it as a tool to

avoid cash-flow problems and not insolvencies, finally end.

It is why the Portuguese banking sector has always argued that the ending of the moratoria should be done in a "planned and phased manner" to ensure a "soft landing" and avoid a "cliff-edge" occurrence resulting from companies which, despite being viable, might not, by the end of the moratoria, be in a condition to generate enough cash-flow to meet their loan obligations.

"In Portugal, despite the banks having increased cash provisions to offset credit defaults risks, it is difficult to calculate the potentially disruptive effects of the withdrawal of the moratoria, how the quality of assets will evolve, and the extent of losses," says Faria de Oliveira.

"Those banks with larger capital ratios and less ratios of NPLs will, naturally, be in a better state to face the fall-out from the crisis while planning and monetary, fiscal, prudential and recovery support mechanisms are all determining factors in dealing with the crisis and off-setting its effects on the Portuguese banking sector," adds Portugal's bank association chief.

BETTER PREPARED

Paulo Macedo, the CEO of state-run bank Caixa Geral de Depósitos, which is preparing the sale of €450 million in NPLs, says that Portugal's banking system is much better prepared and capitalised to overcome the current crisis and have an active role in assisting the country's economic recovery.

The sale of NPL portfolios in Portugal was down by 87.5% to €1 billion in 2020, according to the real estate evaluation and asset advisory consultant Prime Yield's latest market study 'Keep an Eye on the NPL & REO Markets' (Real Estate Owned).

"Activity in Portugal represented a notable fall (87.5%) on the volume of around €8 billion transacted in 2019, as a result of a direct impact of the pandemic which froze operations and redirected focus on the financial system and government's extraordinary financial support for the Portuguese economy through moratoria," says Nelson Rego, the General Managing Director of the company that has offices/representations in Lisbon, Madrid, São Paulo, Maputo, Luanda, Cape Verde and Athens.

Despite the fall, investor interest in this type of asset has remained, however, and the sale of NPL portfolios is expected to step up in the first half of this year.

"Since January, the sector has already seen portfolio deals worth €700 million, while another €1.2 billion is already in the pipeline, including ones that are already being negotiated or are already on the market," says Rego.

For example, Novo Banco announced in March that it had signed a purchasing and sale contract with Burlington Loan Management DAC, a company linked to and advised by Davidson Kempner European Partners LLP based in Ireland, for a portfolio of NPLs and assets with a nominal value of €216.3 million in December 2020.

According to the bank owned by US vulture fund Lone Star and managed by António Ramalho, this operation should have a direct (and positive) impact on the results and capital of the institution this year.

Last year, Novo Banco had other portfolio sale processes underway, namely 'Project Carter' comprising 12,000 loans that had been sold to the CRC fund in a consortium with Arrow.

This involved a portfolio of NPLs with a price tag of €79 million, but which ended up being sold for €37 million. The bank said at the time that the deal had been "marginally positive" and had a "direct impact" on its capital.

And in February this year, bank BPI sold an NPL portfolio for €300 million to the European-wide Luxembourg based fund LX Partners (LXP), an entity that describes itself as "a principal investor whose mission is to provide its partners with exposure to opportunities at arm's length, with preferred terms".

Millennium bcp, another bank with a large presence in Portugal, was busy last year preparing to sell a portfolio of NPLs to the same fund that had purchased the rather curiously named portfolio for distressed assets 'Nata 2' ('Nata' means cream in Portuguese) from Novo Banco. Presumably, the 'cream' was less than fresh.

This time, again, the fund involved was Davidson Kempner and the portfolio, called 'Project Ellis' was for sale at €170 million, while a second portfolio, 'Project Webb' was sold to the fund Arrow for €450 million.

Francisco Virgolino, Head and Partner of NPL&REO Portugal at Prime Yield says: "Naturally, the pandemic has delayed or even required the restructuring of various NPL sale processes in 2020."

Despite a slowdown being expected last year in the market, in the region of -25% to around €6,000, 2020 was a rough year for the sector with less than €1 billion transacted.

"The market was almost at a standstill until September when we noticed some renewed activity and various deals began to be closed towards the end of the year," adds Virgolino.

THE OUTLOOK FOR 2021

The Managing Director and Head of Portfolio Valuation at Prime Yield (Gloval), Nelson Rego, thinks that 2021 should be a dynamic year.

"On the one hand, business from 2020 coming through is progressing at a healthy rate, with close to €2 billion worth of portfolios on the market from amongst operations that have already been achieved, and others that have been either identified or are currently underway," Rego says.

"On the other, apart from the growing interest from investors in this segment, the offer of NPL portfolios should grow considerably this year," he adds

Rego also points out that with the end of the moratoria in September, an avalanche of credit defaults is expected, while the pressure will be kept up on banks to deleverage their stagnant and underperforming assets, so new and very interesting operations in market offer should appear.

"According to the Prime Yield forecast undertaken for the study, if 15% of the amount subject to moratoria ends up as Non-Performing Loans, that means a

Essential **Assets**

further €6.9Bn of national NPL stock coming on line," says Prime Yield's Francisco Virgolino. "To get some idea, that amount corresponds to more than half of the current stock of NPLs in the system. However, this impact will only be visible by the end of the year, and especially in 2022."

UNDER PRESSURE

The Portuguese banking sector will continue to feel under strong pressure in 2021. Despite the expected economic recovery, whenever it comes, the "burden of non-performing loans will weigh heavily on its financial institutions this year," according to the Canadian rating agency DBRS.

"Banks in Portugal continued to reduce NPLs by €9 million in 2020, however, Portugal's banks still hold high levels of NPLs and have high NPL ratios relative to other European banks and above the average of our sample," DBRS states.

"Some €46 billion in loans are frozen due to the moratoria regime (EBA) and there are many concerns about how much of this volume can turn into NPLs. The real impact will only become visible from Q4 2021, but we think that 15% of current loans in moratoria could become NPLs," says Rego.

"This would mean another €6.9 billion entering the stock, which then would go up to over €20.0 billion, bringing "fresh" portfolios to the market. So, even though there is all this uncertainty around when the moratoria will end, one thing is certain: the NPL stock will grow in Portugal over the next 18 months, as well as the potential for deals. And investors are keeping track of events to find out where the best opportunities will lie," concludes Nelson Rego, Managing Director and Head of Portfolio Valuation of Prime Yield.

One thing is for sure, whenever the moratoria finally come to an end, a large proportion of borrowers, both companies and families and individuals, will resume payments on loans and interest, but the capacity of those borrowers to make payments will depend on the economic shock experienced in Portugal later this year and into 2022. ■

Prime Yield
A prime player in property consultancy

Nelson Rêgo is undoubtedly one of the giants in the Portuguese real estate consultancy landscape. Born into a property development family, he started his own consultancy in 1999 and went on to found Prime Yield in 2005. Since its partnership with the Spanish Gloval, it is now one of the big players on the Iberian peninsula

INTERVIEW **CHRIS GRAEME**

Essential Business: When and why did you start Prime Yield?

Nelson Rêgo: We were established in 2005. Our focus is on consultancy and asset valuation services for companies and other institutional entities, aiming to provide the best tools to support our clients' decision making. We wanted to create value-added services to make the decision process of all stakeholders in real estate easier.

How has the company expanded from a relatively small Lisbon-based real estate consultancy to a major player on the Iberian peninsula?

We have grown considerably since 2018 when we became part of the Gloval Group. Today we have over 300 professionals working in seven countries: Portugal, Spain, Brazil, Greece, Cape Verde, Angola and Mozambique.

Our approach was different from our competitors precisely because it was based on a development matrix that focused on the Portuguese-speaking countries since we have this shared language bond. However, we approach every single market in a totally independent way, while at the same time using a matrix of common shared standards based on the certifications obtained in each market and on a global level by the Royal Institute of Chartered Surveyors (RICS).

The company's vision through this business model is to enable its clients to analyse operations using the same criteria, regardless of geography, but with full recognition of the cultural aspects and specificities of each country. This was key for our internationalisation project strategy.

What differences and similarities have you noticed working in these different countries to Portugal?

Looking into Portugal and the other Portuguese-speaking Countries, I would say that the only common factor is the language. The real estate markets in the African Countries, and even in Brazil, are totally different from those in European countries such as Portugal and Spain. The major challenge in those countries is the difficulty for the populations in these countries getting access to the residential market. Also, mortgage financial systems and interest rates are a challenge. The level of maturity, professionalisation and the way those markets work are completely different from Portugal and Spain. Between Portugal and Spain, I would say there's a difference mainly in the dimension of the market.

Angola has had a rough time over the past few years. Is now the right time for construction companies and real estate investors to invest in this and other African markets like Mozambique and Cape Verde?

Despite being severely hit by economic adversity, and also having social and political instability, these are countries with huge potential for the real estate markets. There's a lot to do both in the residential and commercial segments, and the companies that have the ability to remain active in these markets, even if with a more cautious approach for the time being, will be the ones leading the way when these economies reset.

What is Prime Yield's main ambition?

Our main goal is to become the reference in valuation & advisory services in Southern Europe and Latin America.

What makes you different from the larger international real estate consultants?

I would say we are a boutique concept that creates a customised experience for our clients and have a very personal and close contact between our teams and all of the company stakeholders.

Besides, we have an approach to our clients that focuses on providing intelligence Services for those who want to achieve excellence, building trust between the company and the client, based on independence and competence.

Prime Yield/Gloval has built a strong reputation on the back of meticulously researched market studies. Was this part of your initial strategy?

This is a key strategy for our company and an important point of differentiation. Since the very beginning, we have been proud to make an active contribution towards a more transparent market. So, we have always invested strongly in research, providing to all the parties free information about prices, values, occupation, trends and outlooks.

This free access is very important for us, as it is our way of contributing towards a better market. Most of our team has worked with us since 2005, and this long-term commitment is one of the reasons why our studies have been so successful. All revenues from our market studies research department come from the advisory side of the business.

What makes a good real estate consultant in your mind? What are the essential qualities?

Someone that is very well informed but always wanting to learn more, proactive, professional and always paying rigorous attention to accuracy and details.

You lived and worked through the Great Recession in 2008-2015. How did you survive and what is different about the current crisis in the way it is affecting, both positively and negatively, the consultancy segment and the commercial and residential real estate market?

The days we live in are really uncertain, and not even interest rates are relevant to the current market at present because they have reached their lowest levels ever. You can't even bank on management strategies based on an internationalisation and diversification diptych in the short and medium-term because we are all faced with a global pandemic that affects everyone and everywhere at the same time.

This is why this paralysis in economic activity which has lasted a whole year to March will unequivocally have a negative impact on the real estate market. In a more detailed and focused analysis of each of the segments, it is easy to draw some conclusions, but we believe that the different segments of the real estate market will recover more quickly than the previous crisis that began in 2008.

Against this backdrop, information will be the key for companies that want to keep up on top of their game and consultancy can have a key role in providing intelligence.

As for the markets, generally Portugal is now a much solid and mature market. Its real estate market is very internationalised and this has been very important for the market's resilience.

What are some of the big-ticket deals Prime Yield was involved in, in 2020?

We had been involved in the most important hotel transaction of the year (Real Hotels Group) and in the valuation and advisory of one of the most important resorts (Quinta da Ombria).

Prime Yield has launched a new service to help in company restructuring. Is that because you can see a growth in this area after the moratoria end in September?

Up-to-date and accurate information is an essential tool for successful companies. This is even more important in times of uncertainty. Putting information in context is, at such moments, especially critical for decision making and for the positive development of companies.

The end of moratoria will be a challenge for many companies, but, in general, the present time is one of increased challenges, with a pandemic that is disrupting economic and business activity transversally and will go down in history. Many companies will have to rethink their business plans and/or need to reevaluate their assets, including real estate assets and other ones, in order to face the future better prepared.

By providing our assurance services we want to actively support companies in improving the quality and timeliness of the information that supports their business and consolidate their relationship with their stakeholders, considering the nuances of this time of unprecedented challenges.

Our expertise allows us to advise and help companies. Assurance services will help businesses mitigate risk, preserve liquidity, renegotiate and restructure financing, preserve assets and anticipate opportunities. We have a comprehensive and accurate approach that will enable companies to make strategic decisions in several business areas, supporting their needs through a multidisciplinary team of experts.

Prime Yield is part of Gloval which is a leader in integrated valuation, engineering, consultancy and real estate consultancy and analysis. Has the partnership been successful?

We have been part of Gloval since December 2018 and the outcome has been very positive. It enabled us to explore new markets in Europe such as Spain and Greece, while our partner Gloval entered the Portuguese-Speaking Countries where we operate.

How did you start out in life? When did you begin working in the real estate sector and was it something you had always wanted to do?

I was born into a real estate development family. From the very start, I was familiar with the construction sector. I graduated with a degree in property management and development and after that, I start teaching in a university and set up my first valuation and advisory company in 1999. Since then, I have never looked back! ■