Nº14 April / June 2021

PORTUGAL ON THE MOVE

Essential BUSINESS

NPLS
Awaiting the avalanche

FUNDS
Investors more cautious

BRANDS
Supporting Portuguese events

PRIME YIELD
Adding value

WEDDINGS
The lost year

NELSON REGO

Welcome to Essential Business, the 14th edition of the magazine.

In this issue, we highlight the importance of large, televised sporting and music events for brands in conveying their products and corporate messages to different audiences. We have focused on two events in Portugal: The Millennium Estoril Open which brands have decided to continue supporting this year in spite of no live spectators, and Rock in Rio, which although sadly has been cancelled this year, will return next year. We speak to João Stilwell Zilhão, partner of what has become Portugal's most famous tennis tournament, and Roberta Medina, the businesswoman and producer of what is now one of the world's most successful music festivals.

But brands do not confine their partnerships to events. The increasing trend for major international luxury lifestyle brands to become associated with residential properties has reached Portugal. We take a look at how major hotel chain brands are putting their exclusive names to branded residences, in both Lisbon and the Algarve. Essential Business also speaks to the managing director of the Portuguese Association of Resorts, Pedro Fontainhas, about why Portugal's top-quality resorts are becoming even more desirable during Covid-19, as overseas retired and relocated second-home buyers place a premium on space in low population density areas in some of Portugal's most beautiful places.

After the disaster that was 2020 and the first quarter of 2021, some of the moratoria granted to businesses will end, and with them, an expected avalanche of credit defaults or Non-Performing Loans is looming. We speak to Nelson Rêgo, director of Prime Yield (Gloval) who knows the NPL market in Portugal well and how profits can be made from restructuring businesses that, for one reason or another, have found it impossible to continue without external support.

Yet for all the business and tourism uncertainty last year, and so far for 2021, Portugal's commercial property assets look set to continue to enjoy the fairly strong demand from institutional and family office investors that it has had over the past four years. Essential Business asks both Nelson Rêgo of Prime Yield and Eric van Leuven of Cushman & Wakefield what is in store for Portugal's property market this year and beyond, and talks to several experts on the Portuguese real estate investment market.

Chris Graeme, Editor

Estatuto editorial

A revista Essential Business pretende dar a conhecer à comunidade empresarial e internacional em Portugal e a quem visita o país em trabalho, para eventos profissionais ou para investimento, a realidade e atualidade sobre negócios em Portugal.

Enquanto temas relacionados com a imobiliária e o turismo são uma presença constante, a revista e os seus suportes digitais cobrem todas as áreas de negócio, incluindo a saúde, o retalho e as mais diversas indústrias.

A revista Essential Business assume o compromisso de assegurar o respeito pelos princípios deontológicos e pela ética profissional dos jornalistas, assim como pela boa-fé dos leitores.

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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

Essential Assets

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 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. ■