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Affordable housing in Portugal: A new trend for medium-term investors

Francisco Cabral Matos and Margarida Campelo of Vieira de Almeida & Associados consider why affordable housing in Portugal may be a trend for real estate investment because of its appealing tax regime.

The Portuguese real estate market has been a centre piece in the development of the Portuguese economy over the past years, attracting different profiles of investors, from high net worth individuals to international investment funds.

To a greater extent, this was a result of a series of successful initiatives that combined tax incentives with broader incentive programmes. From a tax standpoint, Portugal promoted the recovery of urban city centres through the urban refurbishment tax regime, which allows for property tax exemptions and a reduced VAT rate of 6% on construction works (compared to the standard 23%).

National and international developers reacted not only to these incentives, but to an increasing demand from private investors looking for real estate assets in Portugal. In fact, since January 2010 Portugal has been attracting thousands of families that relocate as a result of the non-habitual tax residents regime. This regime grants substantial tax benefits to those establishing their habitual residence in Portugal – which led to an increase in the demand for quality real estate.

Simultaneously, in 2012 Portugal launched the Golden Visa, an investment-based residence permit where one of the eligible investments consists in real estate located in Portugal. This programme alone represented a direct investment in real estate of €5.25 billion (approximately $6.27 billion) from 2012 to Q1/2021 according to official information.

The real estate market starts to show a transition from high-risk and fast-selling real estate to medium- to long-term investments on income producing assets. This trend is aligned with the expectation from public opinion that public authorities undertake measures to promote affordable housing for low- and medium-income households.

From a comparative standpoint, promoting affordable housing investment is also key for Portugal to remain a competitive player in the European market. The IMF Report highlights that "[e]very country in Europe uses policies to maintain and develop affordable housing", notwithstanding that measures are usually "complex, layered, and fragmented since they have often been designed and administered at subnational level".

The Portuguese approach combines national and local measures, to which one may add other 'general' tax and financial incentives targeting real estate investment. In line with the IMF Report's findings, Portugal has a fragmented set of measures that were triggered by the enactment of a National Affordable Housing Programme (NAHP), followed by local affordable housing programmes launched by some municipalities.

Affordable housing programmes

The NAHP, approved by Decree Law No. 68/2019, of May 22 2019, sets a common legal framework for affordable housing, including legal criteria, requirements and procedures for private rental contracts to become eligible for the available incentives.

This includes conditions to be complied by landlords (e.g. contract duration, maximum rental amounts per type of property, etc.) and by tenants (e.g. maximum household monthly income).

Moreover, the NAHP sets forth a tax exemption for personal income tax (PIT) and corporate income tax (CIT), for rental income derived from eligible properties/rental contracts.

Furthermore, the NAHP foresees that national measures may be executed in cooperation with municipalities and sets forth the terms and conditions for making local affordable housing programmes to be compatible with the national programme, notably to ensure that rental income may still fall within the CIT and PIT exemption.

Lisbon and Oporto – the two major cities in Portugal – took the lead approving local affordable housing programmes, interestingly based on two different approaches.

Lisbon Town Hall opted to make available assets that are under the public domain and relies on a public concession model. Investors are granted a surface right over real estate assets that are under public domain. Investors undertake to build/refurbish the real estate assets and to make available 70% of the available housing units with affordable rents. For the duration of the surface right (30 to 90 years) the remaining 30% of the housing units may be rented at arm's-length (the investor may also sell the surface right to a third party).

Oporto Town Hall adopted a sub-letting regime according to which the municipality acts as an intermediary between landlords and (sub-)tenants. Landlords willing to benefit from the affordable housing programme and benefits enter into a rental contract with Oporto Town Hall with preferential conditions (e.g. anticipation of rents) and the municipality then sublets the housing units to candidates that meet the requirements applicable to tenants, reducing exposure of the original property owners to tenant's risk rating.

Whilst the NAHP grants access to a CIT and PIT exemption on rental income received by landlords, local affordable housing programmes may ensure additional tax incentives on property taxes Note that according to the Portuguese tax system property taxes are a tax revenue attributable to the respective municipalities (over assets located in the respective territories), thus municipalities are allowed to provide property tax incentives.

The exiting local affordable housing programmes grant an exemption from municipal property tax (IMI), which is a tax due on an annual basis. In the future, municipalities may also consider an exemption from property transfer tax (IMT) to attract investors to buy and hold assets used for affordable housing.

In addition to the above, given the successful widespread of the urban refurbishment regime, constructions works that may be needed to remodel existing real estate assets will likely benefit from a reduced 6% VAT rate, which substantially reduces the CAPEX in the relevant projects (noting that VAT is in principle not recoverable in residential projects).

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