

PORTUGUESE LEASE MARKET: TIME FOR INVESTORS TO MOVE IN?

* Nuno Antunes

Frozen rents, unsurpassable difficulties in the termination of contracts by landlords, easy assignments of lessee positions without change and major hindrances to tenant eviction, amongst other features, have characterised the Portuguese lease market scene. Changes in the legal regime carried out in the 1990s fell well short of what was required. They were insufficient to promote an efficient competition in the market. All in all, since mid-1970s, the lease market has effectively been stalled, due to tenant overprotection.

Hailed as a true reform by the Government, the NULR is said to be aiming to promote the whole of the lease market (housing and non-housing), return confidence to the economic agents, rationalise public and private resources, modernise commerce, improve housing quality, further urban rehabilitation and attract private investment to the real estate market. No doubt these are ambitious objectives.

Much of the debate in Portugal has hitherto surrounded the socio-economic impact of the implementation of the changes made. Issues such as rent update, complexity of the regime, conservation and rehabilitation aspects, and market speculation have hit the headlines. Associations of tenants and landlords have sided with each other in the criticism directed to the NULR, albeit for different reasons.

How much of this new regime truly appeals to sizeable investors however, is the question to be asked now. Time and again, announced reforms of the Portuguese real estate lease regime either defrauded expectations or succumbed altogether. For the first time, there seems to be some hope for the Portuguese lease market.

A New Regime

Portugal has a New Urban Lease Regime (NULR). It was enacted by Law no. 6/2006, of 27 February 2006 and entered into force on June 28 last. Pursuant thereto, on June 14, ancillary legislation to the NULR was approved by the Council of Ministers. It versed various matters relating to income and rent subsidies, arbitral city council committees, building maintenance and compulsory works, tax definition of vacant building and lease contracts. Further ancillary legislation is expected to be enacted concerning the use of space in shopping centres, public real estate and leases involving public entities, the role of real estate and pension investment funds in urban rehabilitation, and the creation of an observatory for housing and rehabilitation.

Key Changes

The changes brought in by NULR cut across the Portuguese legislative framework, bearing upon substantive and adjective law, and spreading as far as tax law and registration. For reasons of brevity, the changes made cannot be examined here in detail. As such, only the key broad aspects of the NULR shall be outlined, bearing in mind the interests of potential investors.

In terms of how the contracts are categorised, the NULR brought some simplification. To a prior four-fold partition of lease contracts (including housing, commerce and industry, liberal profession, and others), we have now a bipartition, between housing and non-housing lease contracts. Different rules may apply for each type of contract. But it should be noted that the 'housing regime' is the default regime, applying to non-housing contracts in the absence of specific rules.

The most important point to underline as far as commercial leases are concerned, relates to contractual freedom. The NULR emerges as an attempt to improve the contractual balance

between landlords and tenants, coming a long way in improving the position of the former. This is essential for a proper remuneration of investment capitals.

For instance, in the case of commercial leases, aspects of the utmost relevance, such as duration, termination, and renewals are now a matter for the parties to freely agree upon. No commercial lease will entail for the lessor inescapable rules imposed by law. In the absence of provisions on these matters, the law stipulates, in general, that the “housing regime” applies subsidiarily, while specifying that the contract is deemed to have been entered into for a term of 10 years, with termination by the lessee being only possible with prior notice of at least 1 year.

Improvements relate also to the fact that all lease contracts will be covered by NULR. Existing contracts (with distinct treatment being given to the contracts entered into prior to, and after, the 1990s changes) will be governed by a transitional regime, which insofar as possible seeks to eventually bring them in line with new contracts entered into under the NULR. The perpetuation of old regimes has worked against market forces, and has been at the root of the virtual inexistence of a lease market in Portugal.

In the case of assignments of existing non-housing leases of indeterminate duration an “escape valve” has been created. Landlords are now entitled to terminate the contract in certain instances with a 5-year prior notice. Very low rents, totally out of context with market prices, will not continue to be a source of income for lessees in such transactions. The downside of it – the fact that current lessees (who benefit from very low rents) will see the transfer-value of the properties reduced virtually overnight – is good for the market. Ultimately, such properties leased at very low rents were acting upon the market as unfair competition. This ‘escape valve’ comprises also the cases of leases in which the lessee is a company. Any assignment of participating interests that determines a change of 50% or more of the issued capital opens the door thereto.

Further, transfer of leases *mortis causa* has been limited, offering a positive development. In the case of commercial leases, it can only take place in those situations whereby the successor has been undertaking, jointly with the lessee, the business activity set up in the leased premises for more than 3 years.

Equally positive from the point of view of balancing-up the position of landlords and tenants is the possibility of the former to terminate the contract on the basis of breach of contract. This was not allowed previously. At the same time, from an exhaustive list of grounds for termination, the NULR has now made allowance for unlisted grounds, provided the general requirement – breach of contract – is complied with.

At the level of adjective law, finally, there is a point to be made. Whereas in the past evictions had always to take place through judicial proceedings, the NULR opens the door for evictions based on extrajudicial writs of execution. In spite of its limited scope, this is a major development, as it will allow a swifter resolution of certain disputes.

A Market Open for Business

With respect to the real estate lease market in Portugal, questions are now posed in rather different terms. Have the market choke points of the past been removed? It remains to be seen. Only future developments can provide an answer; and many factors will determine the actual outcome of this reform. When is the time right for investors to move in? Some market distortions will continue to exist on account of existing contracts. But they will tend to fade away. Those investors who move sooner into the market will have one key advantage: sensibility to and prior knowledge of the market, for use in future, sizeable investment decisions. Notwithstanding the attention that will indubitably have to be paid to the implementing practice, one idea appears thus safe to convey. The Portuguese lease market is now open for business.

* *Associate*