Residential real estate: Lisbon's secure rental income initiative unlikely to stop gentrification

Lisbon city council's secure rental income programme, introduced this year to address real estate speculation and gentrification, is unlikely to be successful given the lack of owner incentives to adhere to it.

This commentary provides an overview of the Lisbon real estate market, the new housing initiative and the reasons we believe it will not be effective. We estimate that property owners who participate in the scheme will receive rental income that is on average 42% lower than the current market rate.

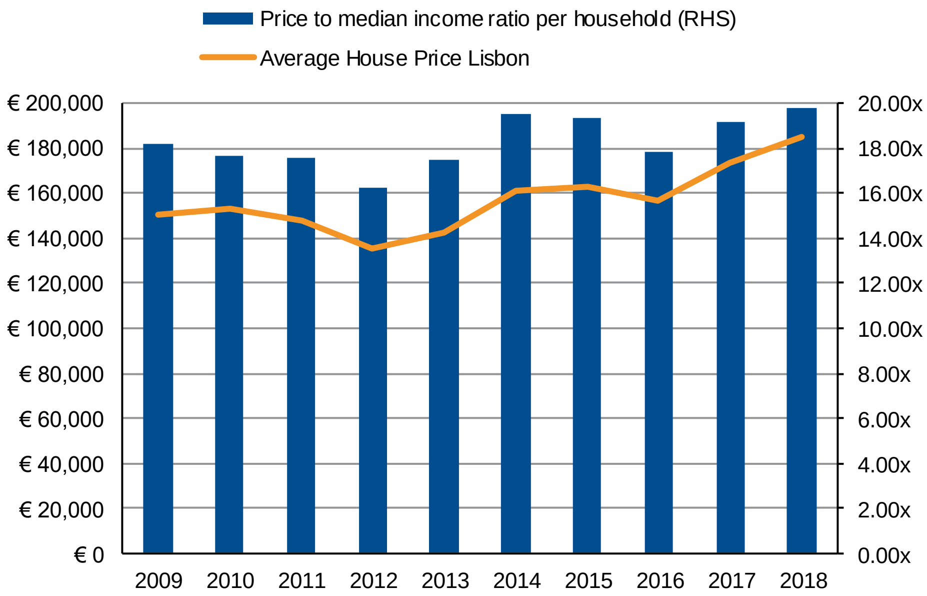
Booming rental market driven by tourism strains affordability

Lisboetas have been experiencing housing affordability issues in recent years. This is pushing residents out of the city to the suburbs or even further afield. There are two principal reasons for this:

- A rising affordability ratio has pushed them to rent rather than buy. Between 2009 and 2018, average house prices rose much faster than median net income per household (22.9% versus 13%). The price-to-income ratio rose to 19.7x in 2018 from 16.2x during 2012 Portuguese house price trough (**Figure 1**).
- A boom in tourism has put further pressure on the available stock of long-term residential rental space. Lisbon airport received 31m passengers in 2019, up from 20m in 2015, while Lisbon became the European city with the highest ratio of Airbnb properties (around 30 per 1,000 residents).

Consequently, residential rental values increased significantly in Lisbon and its surrounding suburbs. Annual growth rates rose from 12% to 18% in the last two years, significantly higher than the 10.8% national annual growth rate (**Figure 2**).

Figure 1: Lisbon residential market property price and affordability ratio



Sources: Scope, INE, Knight Frank

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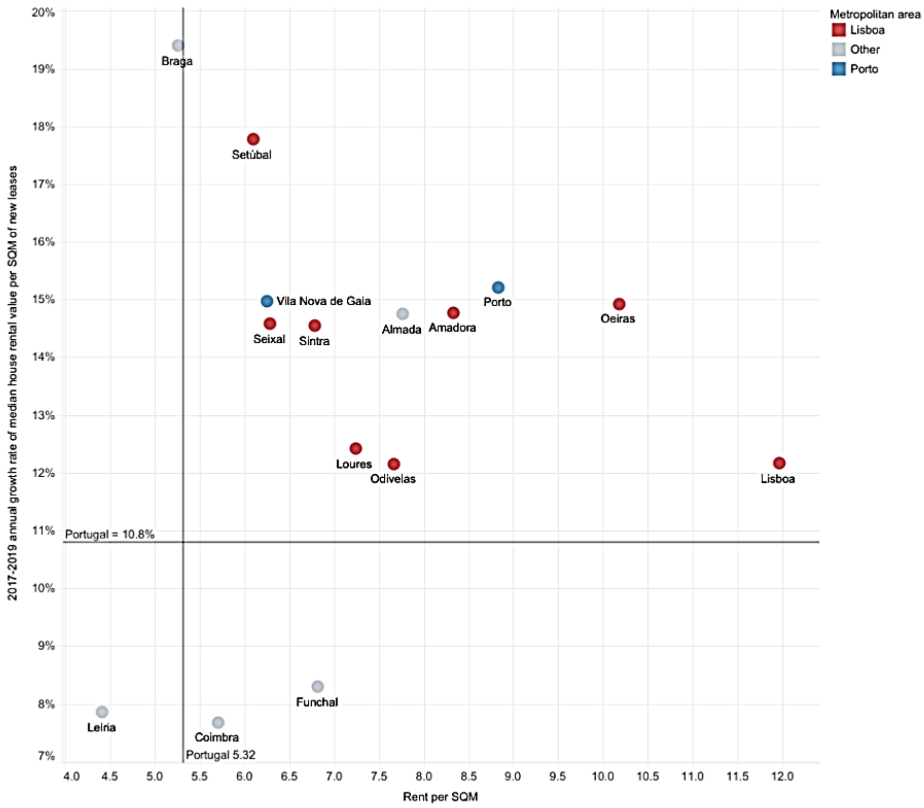
Figure 2: Portugal and Lisbon area residential market rental price growth



Sources: Scope, INE

Lisbon affordable housing initiative

Programa Renda Segura (PRS) – Secure Rental Income Programme

Efforts to slow rental price increases have emerged across Europe. In Berlin, rental prices are frozen; in Dublin rental increases are capped at 4% year-on-year; in Amsterdam developers have to allocate at least 40% of developments to social housing.

Lisbon City Council, which is responsible for urban planning within the municipal territory, has launched several initiatives to reverse trends towards gentrification and real-estate speculation. Its latest initiative, Programa de Renda Segura (PRS), is focusing on affordable rented houses.

The initiative wants to halt the exodus of Lisboteas from the city centre

PRS has two core objectives. One is to halt the exodus of Lisboetas from the city centre due to high property rental prices driven by tourism and the high number of short-term holiday lettings. Another critical objective is to prioritise the provision of affordable accommodation to people working in the healthcare, transport, teaching industries and other essential services post Covid-19.

Risk-free exposure for property owners with tax benefits

The programme offers a number of economic incentives for property owners, includes various tax exemptions – property registration tax, personal income tax and corporate income tax. The income it provides is in effect risk-free given apartments are leased to the city, which in turn takes the responsibility on finding tenants.

Eligible tenants under the programme must be permanent residents wishing to rent an entire property, subject to a minimum five-year contract, or temporary rentals for students wishing to rent a room for a minimum nine-month period.

Regulated rent according to the type of apartment from EUR 450 to EUR 1,000 per month

Rental contracts cap monthly rent according to the type of apartment from EUR 450 for T0 properties (i.e. studio apartments with no separate bedrooms) to EUR 1,000 for T6 properties (six bedrooms; for Lisbon only) subject to a maximum 10% add-on for furnished apartments (**Figure 3**). For short-term student leases, rents must not exceed 55% of the corresponding T0 rental price in the respective municipality.

Figure 3: Lisbon regulated monthly rent per apartment type (PRS programme)

Typology	T0	T1	T2	T3	T4 to T6
Monthly base rent	€ 450	€ 600	€ 800	€ 900	€ 1000
Reference size (sqm)	35	50	65	75	90

Source: Scope, Camara Municipal de Lisboa

Affordable housing market: attractive ESG-friendly investment

Affordable housing: attractive risk/return profile resilient to Covid-19 like shocks

Lisbon's latest affordable housing plan aims to offer property owners an attractive risk/return profile benefiting from a stable source of income resilient to sudden economic shocks like Covid-19 whilst addressing ESG-related issues which are increasingly important to investors and governments alike. On the environmental side, the programme has the potential to address the impact of climate change by reducing emissions generated by commutes by city-centre workers. On the social side, the programme aims to revitalise urban centres for residents and low-income households.

Scope's views on Lisbon PRS Programme

The PRS programme unlikely to be successful given the lack of owner economic incentives to adhere to the programme

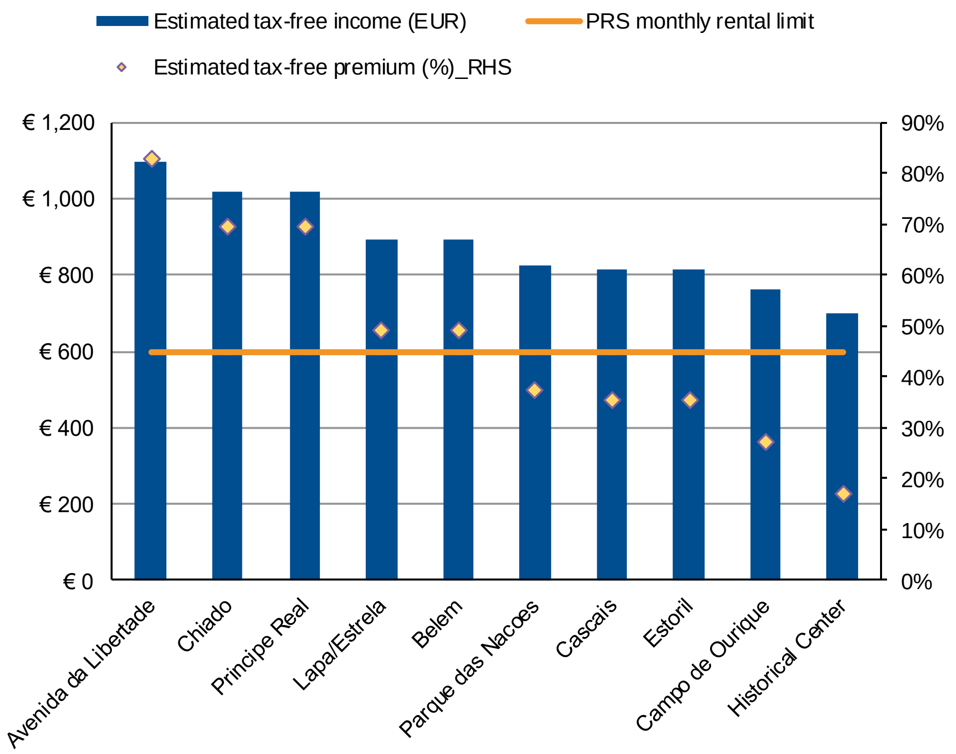
We believe the PRS programme is unlikely to curb rental price increases as intended. **Figure 4** below shows that open market rents for each of Lisbon's central districts are materially higher than the maximum EUR 600 monthly rent for a T1 under the PRS. The open market rental premiums to regulated PRS prices range from 17% to 84%.

The results to-date support our view. As of July, the number of contracts signed and approved under the PRS has been much lower than initial government expectations, with few property owners making their houses available to low-income households in the city centre.

PRS is a step in the right direction to address the effect of gentrification, but complementary policies will also be required. These could be in the form of incentives for landlords to redevelop vacant buildings or the purchase and redevelopment of such properties by the council, with the aim of increasing the stock available for PRS. However, it is in the interest of the city council to balance policy intervention and legislation with market forces to ensure that the Lisbon real estate market remains attractive to domestic and foreign investors.

The estimated net rental incomes are based on the following assumptions: T1 50 sqm apartment, 5.75% gross rental income yield; one annual month of vacancy, a cumulative 29% tax rate for rental property and municipality taxes, 35% of gross to net costs (for utilities and leasing commission).

Figure 4: Estimated Lisbon net rental income versus PRS regulated rents



Sources: Scope, INE, Knight Frank

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Scope's commercial real estate 2020 year-to-date research

Asset-type	Topics (hyperlink)	Geographic coverage	Franchise
Cross	What will the European CRE sector look like when the dust settles?	Europe	Structured
Retail	Europe commercial real estate: retail-exposed firms can weather Covid-19 crisis in the short term	Europe	Corporates
Retail/Malls	Maroon CRE loan: autopsy of a default. UK retail gloomy environment and loan legacy weaknesses	UK	Structured
Logistics	European logistics CRE: outdated assets unlikely to ride the momentum. Asset performance dispersion: a French market study	Europe / France	Structured
Cross	European real estate outlook 2020: property companies ride super-cycle; retail a weak spot	Europe	Corporates
Cross	Leasehold property: attractive investment opportunities with diverse risk drivers	Germany	Structured
Healthcare	Q&A: Healthcare real estate investment from a rating agency perspective	Europe	Structured

Scope's commercial real estate snapshot

Figure 5: CRE rating evolution

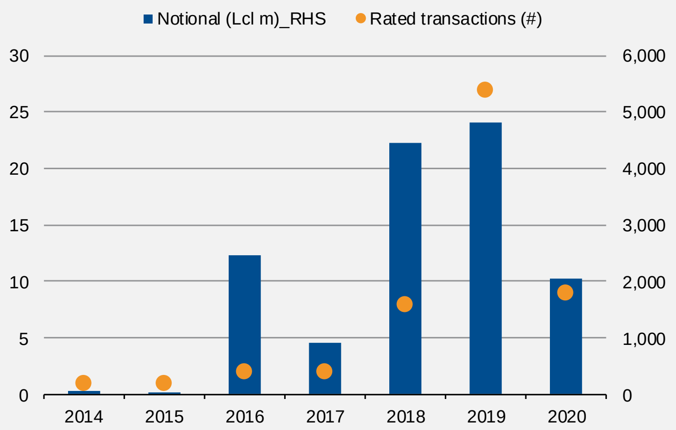


Figure 6: Geographic coverage (USA excl.)

Figure 7: Asset type coverage

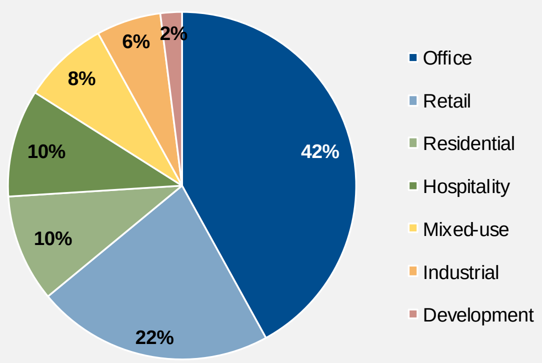
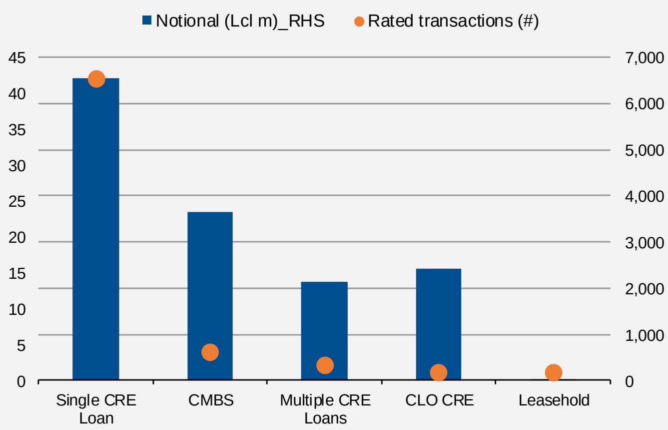


Figure 8: Financing type coverage



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