Citizenship, Investment and the Future of Cyprus in a Global Economy

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One of the most frequently-asked questions I encounter is whether the Cypriot Citizenship by Investment Programme (CIP) is a bubble, and whether the current building boom in large construction projects in Cyprus can be continued.

This is a complex question which can only be answered by looking at multiple levels:

a. While large construction projects, such as the Del Mar project in Limassol or the Ayia Napa Marina headline the so-called "tower" projects, a large number of CIP projects have taken place with far smaller properties, such as villas and apartments.

b. It is the surge in smaller property investments (such as single villas or low-rise apartments) which designed to meet the € 2 million investment cap of the CIP that has caused property prices to rise. This has provoked angry reactions from ordinary citizens about the unsustainable, upward march of property prices.

c. A key issue is the extent to which the three-year holding requirement for a Cypriot investment will affect subsequent exits by investors. Many investors will simply keep € 500,000 in a property, and sell off the remaining investment made to get the passport. This may be a disadvantage for CIP investors who have invested in a single property for € 2 mln.

d. In terms of foreign demand, the appetite for citizenship by investment (CBI) or residence by investment (RBI) schemes is high and will continue to grow given the rapid growth in wealth and the attractiveness of a second passport.

e. We do not believe the current OECD and EU attempts to limit or eliminate the Cyprus CIP will be successful, except in purely cosmetic ways. We also note that other countries have far more active CBI or RBI programmes than Cyprus, including the United States.

This question of sustainability really illuminates a larger issue. Cyprus' economic model is based on attracting external sources of capital. Whether these are tourists, investors seeking passports, or funds setting up in Cyprus, the key issue is whether Cyprus really has a future in global markets for attracting foreign capital. The answer here is here is undoubtedly positive.

This article reviews the Cyprus CIP, its impacts on the property market, and what this means for Cyprus going into the future.

Citizenship Requirements under the Cyprus CIP

Cyprus has had a Citizenship by Investment Programme since at least 2008. According to the *Scheme for Naturalization of nonCypriot investors by exception on the basis of subsection (2) of section 111A of the Civil Registry Laws of 2002-2015,* the criteria for the CIP in Cyprus are:

1. An investment of at least € 2 mln in property in Cyprus;

2. An investment of at least € 2 mln in companies or organisations, or other purchase, of assets based in Cyprus. These companies must employ at least 5 staff and the object of their business must be in Cyprus;

3. An investment of at least € 2 mln in alternative investment funds (AIF) established in Cyprus, and regulated by the Cyprus Securities and Exchange Commission, and whose investments are made in Cyprus;

4. Combinations of the above investments, including the possibility to purchase at least € 500,000 of Cyprus government bonds, from primary issues.

Some caveats to these conditions:

- A high-ranking senior manager may apply, providing that s/he pays in at least €100,000 in tax over a three year period and provided that this tax has already been paid or prepaid;
- All applicants must be legal residents of Cyprus;
- All applicants must have a residence in Cyprus (a property) worth at least € 500,000;
- Due diligence and background checks apply;
- Additional guidance indicates that investments, apart from the € 500,000 primary residents, must be held for a minimum of three years.

These conditions are in force since 13 September 2016: previous iterations of the CIP had different conditions.

The Parliament of Cyprus voted on 01 February 2019 to alter the conditions of the Cyprus CIP programme: these changes are not reflected in the following criteria.

A careful analysis of these conditions reveals that, on paper at least, the most optimal path to citizenship involves being an individual manager resident in Cyprus, purchasing a property worth € 500,000, and paying € 100,000 in income tax from international holdings over three years. That’s € 33,333.33 per year. This barrier is almost laughably low, but of course we do not know the success rate of this application path versus the more expensive ones.

The second most optimal path is to purchase a property of € 500,000, and place the remaining investments in safe, liquid assets. For example, an investment company that buys US Treasuries or German bunds would, at the end of three years, liquidate the € 2,000,000 in bond holdings.

The least optimal paths to citizenship are to make investments in illiquid properties or companies with an uncertain valuation. This is precisely what many investors have apparently done, placing “single bet” investments on extravagantly-priced tower projects, or portfolios of property or possibly company shares.

Why would investors choose the least optimal route?

(a) Because they believe they “understand” the property market.
(b) Because they feel they can generate a capital return from it (capital appreciation).
(c) Because they believe they can generate a rental income from it (Airbnb).
(d) Because they have been advised to do so by the legion of lawyers, accountants and property agents who have an incentive to do so.

Basic Dimensions of the Cyprus CIP

Precise data involving the number of approved applications or the total investment are not available. However, there have been a number of information leaks or signals from various sources. These are summarized here, without any guarantee as to their validity.

Philenews, a leading national paper, published the results of a leaked Parliament of Cyprus document on 27/02/2018, in which the following data were published[1]:

Table 1: Cyprus CIP Passports Granted

Year	# CIP Granted	Notes
2008 – 2010	55	investors only
2013	112	investors & family members
2014	400	investors & family members
2015	679	investors & family members
2016	904	investors & family members
2017	1,013	investors & family members
2018 (2 months)	92	investors & family members
Total	3,255	

Source: Philenews, 2018

In the same time, a total of 5,808 citizenships were granted through the normal naturalization procedure, from 2001 – 23/02/2018.

According to the European Parliament, the Cyprus CIP was estimated to have brought in a total of € 480 million in investments in 2017.

[1] *Kathimerini Cyprus has published slightly different figures on 12 December 2018. Please see the list of sources for more information.*

According to statements of Minister of Energy George Lakkotrypis in Kathimerini (2019), the total revenue to Cyprus from the CIP totaled some € 4.8 billion from 2014 to 2017.

It is worthy to note that apart from a small application fee as well as direct or indirect taxes, none of the investments made under the Cyprus CIP actually accrue to the Cyprus government. The large majority of income goes to developers or other property/asset owners, and to the intermediaries that support them.

The Role of Highrise Luxury Property Investments

Much public interest is focused on large, keynote investments such as Pafilia's One or the Leptos/Zavos Del Mar project in Limassol. According to Stockwatch (2018), approximately 1,000 new luxury apartments will be brought online in the next 2-3 years, hosted in some 21 tower projects. Of these, 16 are in Limassol, 3 in Nicosia and 2 in Ayia Napa. Additional projects have since been approved, notably in Paphos.

We understand that the total number of new CIP approvals will be capped at about 700 per year by Cyprus, based on an interview given by Cyprus Minister of Finance Haris Georgiades on RIK.

So, if we assume that approximately 600 primary passports are provided per year, this is a total of 1,800 new citizens from 2019-2021. Compared with 1,000 apartments coming online, this means that actual demand is double the housing stock, assuming 100% of investors choose a tower investment for their CIP application.

In reality, we can understand that demand for tower property is not solely the interest of passport applicants. The Olympic Towers project in Limassol, which is the only highrise luxury residential property completed to date, has a large number of Greek and Cypriot owners who did not, at the time of construction, apply for a Cypriot passport.

There is abundant "natural" demand for highrise luxury property. While it is clear that CIP applicants play an important role in demand, we cannot say that 100% of demand comes from passport applicants.

The first key question is therefore at which point market saturation results, and either prices fall, or property remains empty. This question is beyond the scope of this article to answer. Absent real external or domestic pressure to end the CIP scheme, however, or some catastrophic exogenous event, we predict healthy demand for the next few years.

The second key question is what happens when the three-year holding period for property investments lapses. Anecdotal reports show that developers are offering a price or sales guarantee once the three year period lapses. A key determinant of future demand and pricing will also be at which rate properties "flip" between one CIP owner, who no longer needs the property, and another, new CIP applicant who does.

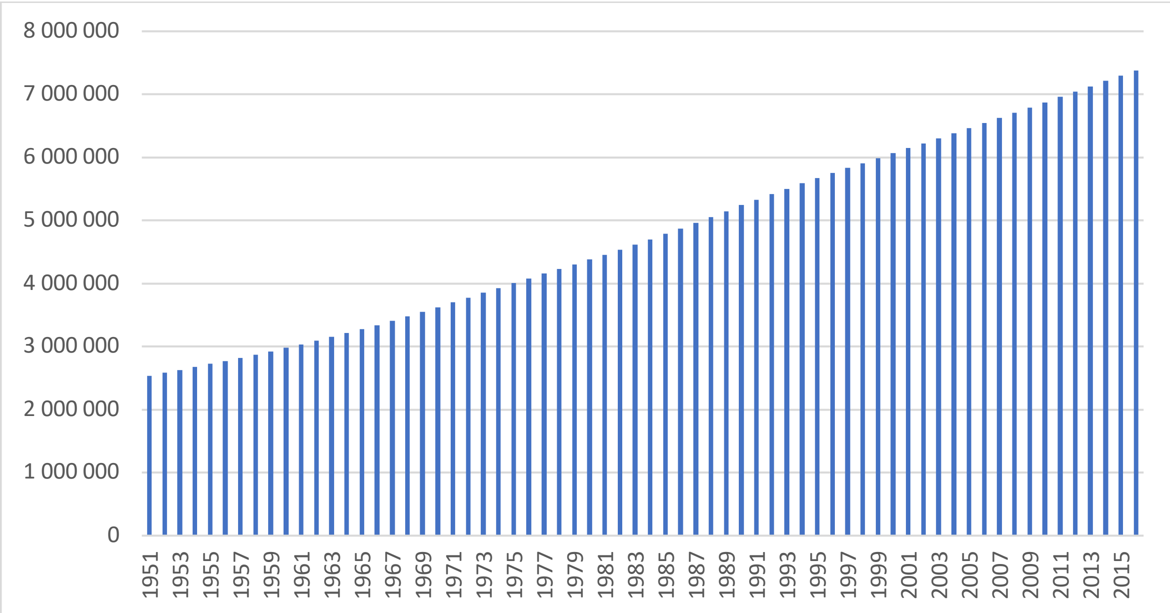
The third key question is whether an investment in luxury highrise property actually provides a financial return at market rates. Answering this question is beyond the scope of this article, since very little data is available.

Global Demand for Citizenship by Investment

It is important to understand that in the world today, the rate of economic prosperity and growth may be uneven, but is transforming key areas of the world.

According to the UN World Population Prospects 2017, the estimated global population rose from 2.54 billion people in 1950 to 7.38 billion in 2016. By 2050, this is expected to reach 9.8 billion, and by 2100 it is expected to reach 11.2 billion.

Figure 1: World Population Estimate



United Nations World Population 2017

This rapid growth in population drives growing wealth creation. The World Bank estimated global nominal gross domestic product in current USD at $ 80 trillion in 2017. The International Monetary Fund estimated global GDP at $ 88 trillion in 2018. Of this, approximately $ 53 trillion was in advanced economies, while $ 25 trillion was in developing economies.

Table 2: Leading Countries: Nominal World GDP ($ trillion, current)

Country	GDP, $ tln	Share
United States	21.48	24%
China	14.17	16%
Japan	5.22	6%
Germany	4.12	5%
India	2.96	3%
France	2.84	3%
United Kingdom	2.81	3%
Italy	2.11	2%
Brazil	1.93	2%
Canada	1.82	2%
Korea	1.70	2%
Russia	1.65	2%
World GDP	88.00	100%

World Bank, 2018

According to Ron Surz (2018), the global value of world equities markets was approximately $ 78 trillion in April 2018. Of this, the US stock market was valued at $ 34 trillion versus $ 44 trillion in all other markets.

According to Credit Suisse's World Wealth Report, by mid-2018 global wealth (as measured by wealth held by approximately 5 billion individuals) amounted to $ 317 trillion. This is far higher than world nominal GDP (at approximately $ 80 trillion in current dollars). According to Credit Suisse:

During the twelve months to mid-2018, aggregate global wealth rose by $14.0 trillion (4.6%) to a combined total of $317 trillion, outpacing population growth. Wealth per adult grew by 3.2%, raising global mean wealth to a record high of $63,100 per adult. The US contributed most to global wealth adding $6.3 trillion and taking its total to $98 trillion. This continues its unbroken run of growth in both total wealth and wealth per adult every year since 2008. Unsurprisingly, China is now clearly established in second place of the world wealth hierarchy. The country overtook Japan with respect to the number of ultra-high net worth (UHNW) individuals in 2009, total wealth in 2011 and the number of millionaires in 2014.

There are now 42 million millionaires worldwide. By 2023, global wealth is forecast to reach $ 399 trillion.

What does this mean for Cyprus?

- We are in a period where wealth assets are rapidly outstripping global economic activity, as measured by GDP.

- The most rapid rate of economic development is occurring in developing countries such as China or India.

- This economic development and accompanying political conditions will likely drive the demand for second passports as high net worth individuals seek fallback options.

Set against these numbers, granting 600 passports per year seems eminently possible. We do not see a potential reduction in foreign demand, at least not in supply terms of the number of HNWI eligible for a Cyprus passport under the CIP programme.

The Role of Regulation

The final issue that may affect the Cyprus CIP is the role of external regulation. Much has been made of recent declarations by the OECD and the European Parliament on the risks of various Citizenship by Investment Programmes.

It should be emphasized that:

a. Leaving morality aside: the decision on whether or not to extend nationality, under any circumstances, remains firmly within the jurisdiction of national sovereignty. This means that no one—not the European Commission or the European Council, nor the OECD—can require Cyprus to change its citizenship policy.

b. The recent OECD review (2018) of high-risk CBI/RBI programmes commented on the risks of potential money laundering under the Common Reporting Standards (CRS) guidelines. According to the OECD:

> *Not all RBI/CBI schemes present a high risk of being used to circumvent the CRS. Schemes that are potentially high-risk for these purposes are those that give a taxpayer access to a low personal income tax rate of less than 10% on offshore financial assets and do not require significant physical presence of at least 90 days in the jurisdiction offering the CBI/RBI scheme. This is based on the premise that most individuals seeking to circumvent the CRS via CBI/RBI schemes will wish to avoid income tax on their offshore financial assets in the CBI/RBI jurisdiction and would not be willing to fundamentally change their lifestyle by leaving their original jurisdiction of residence and relocating to the CBI/RBI jurisdiction.*

c. In the case Cyprus wants to comply with the OECD high risk guideline, it will have to significantly change its wider tax code for foreign investor incentives, as well as its CIP scheme. This would chiefly be to raise the national residency time from 60 to 90 days, and possibly to review exemptions from dividend income.

Finally, we have to mention that many other countries have CBI/RBI schemes. Perhaps the largest such scheme is that of the United States of America. The United States of America issues 10,000 EB-5 Visas per year, for investors who invest up to $ 500,000 in a US business. This leads to naturalization and citizenship with 5-7 years. This is a $ 5 billion a year programme.

Most interestingly, the largest source of EB-5 Visas per year are from China: the country with which the United States is currently in a major trade war and a series of allegations of spying and industrial espionage. Russia is the tenth largest source country by visas granted. (US State Department, 2018).

Conclusions

Globalisation, whether we agree with it or not, is creating wealth in unimaginable volumes. This wealth may be recorded in official GDP numbers, but it is also seen in the tremendous growth of wealth assets. Absent some catastrophic event, such as a global war or plague, it is difficult to see how this growth track will reverse.

In addition to creating wealth, this growth is taking place in countries where, for whatever reason, citizens seek the reassurance of having a second passport from a country where the rule of law prevails, and where human property rights and habeus corpus are maintained. Cyprus, despite many flaws, is an good country in this regard.

Cyprus is within its national sovereignty rights to provide a Citizenship by Investment Programme. Its membership of the European Union or the OECD does not in any way enable these two organisations to dictate its citizenship policies.

The key issue, therefore, is the extent to which:

a. The CIP programme benefits its applicants;
b. The CIP benefits Cyprus economically.

On the applicant side, evidence shows that while other countries may offer slightly more competitive programmes, Cyprus has successfully attracted some 500 primary investors in 2017, and the overall growth track of the programme is successful. There is international demand for Cypriot citizenship by investment.

Moreover, the most optimal path to Cyprus citizenship does not involve a high property investment component (€ 500,000 maximum): an investment can be structured in either liquid assets or tax payments, which may offer a far greater safeguard of future value.

On the economic side, the picture is considerably more difficult to understand:

- While popular anger is focused on 21 high-rise luxury developments announced, we have seen that even the 1000+ apartments eventually available here do not suffice for even 2 years demand, assuming that 100% of CIP applicants buy property here.

- We see that CIP investors are also buying “ordinary” property, including villas, apartments, and portfolios of property.

- This demand, and the “buzz” surrounding the CIP, is no doubt distorting the property market in key urban areas. The impact of this distortion, compared to other factors, such as the slow rate of middle-income new housing, and the relatively poor state of the existing housing stock, remain to be assessed.

I would like to conclude this article with four warnings.

My **first warning** is that it is clear that, as in the US sub-prime credit meltdown in 2008, the Cyprus government is socialising the risk of the CIP while privatising the benefits. Nearly 100% of direct financial costs of CIP go to developers and intermediaries. The government benefits only from a small application fee and subsequent taxes. Yet the national reputation of Cyprus citizenship is affected, which creates significant public costs.

In the 2013 financial crisis in Cyprus, it is interesting to note that in the years running up to the depositor haircut, angry declarations among German and other journalists, members of Parliament and other policy-makers and politicians were left unanswered. This led to a situation where, in 2013, Cyprus became the first EU country to feature a depositor bail-in, under the grounds that it was a “non-systemic” country, or a “casino economy”, or a haven for “dirty” Russian money.

The opinion of this consultant is that unless Cyprus implements a very strong programme of public affairs and transparency, the decisions that are being made now in regards to the CIP may become, at some point in the future, a major liability at a time when Cyprus needs international assistance the most.

My **second warning** is that the Government should review where the financial income from these investments is taking place. There are credible reports that some property owners and developers are not fully accounting for the value of each transaction in Cyprus, and that some funds from the wider development and sales process are being held offshore, unreported in Cyprus. This tends to take place before the final sale of a property to the foreign investor under CIP.

My **third warning** is that Cyprus still has a huge problem of non-performing loans (NPLs) as well as re-profiled loans. The CIP-fuelled activity in the property market has been sufficient to allow major developers, who often have debt in the hundreds of millions, to keep servicing their debt. As such, CIP is really less about government revenue, than about keeping developers and the banking system afloat. It is not clear how long this can continue on a sustainable basis. Rather than solving a problem, we risk exacerbating one.

My **fourth warning** is that allowing unchecked development of the property sector is one of the surest and quickest methods of alienating the population and creating distortions in the real economy. This has been seen time and time again in the United States, the United Kingdom, France, Italy and other countries. Cyprus already has a highly fragmented Parliament with a relatively high inclusion of radical parties on the left and right. Allowing housing prices to rise, and creating one law for the rich and another for the middle class, will only increase political polarization.

My personal estimate is that Cyprus will remain a beneficial investment destination for High Net Worth Individuals, and that the Citizenship by Investment scheme will continue. There are too many entrenched interests benefitting from the current system, including many members of Parliament and government. And countries far larger than Cyprus are following the same strategy of investor-led growth.

While I don't know how many of the 21 high-rises identified by Stockwatch will actually be built, I do know that enough will be built to affect our life in the years to come.

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