

## FULL PAPER - REIT VALUATION IN THE PHILIPPINES

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### OVERVIEW

The paper will give a detailed discussion on the effectivity of the enabling law for the adoption of REIT or Real Estate Investment Trust in the Philippines, specifically on the valuation practice considering that the country is considered an emerging economy. The paper will also attempt to come up with recommendations on a feasible action plan on how to better address the constraints of the law and the practice of valuation in the Philippines.

### INTRODUCTION

Republic Act (R.A.) No. 9856 “An Act Providing the Legal Framework for Real Estate Investment Trust and For Other Purposes” lapsed into law on December 17, 2009. It was published in two newspapers of general circulation on January 25, 2010. Thus, its effectivity is on February 9, 2010 or fifteen (15) days from such publication. The Securities & Exchange Commission released the Implementing Rules & Regulations on 13 May 2010.

### SALIENT PROVISIONS OF THE PHILIPPINE VERSION OF THE REIT LAW

The listing of a Philippine REIT corporation shall follow the following requirements:<sup>i</sup>

1. *Minimum Public Ownership.* A REIT shall be a public company and to be considered as such, a REIT shall: (a) maintain its status as a listed company; and (b) upon and after listing, have at least one thousand (1,000) Public Shareholders each owning at least fifty (50) shares of any class of shares, and who, in the aggregate, own at least one-third (1/3) of the outstanding capital stock of the REIT.
2. *Capitalization.* A REIT shall have a minimum paid-up capital of Three Hundred Million Pesos (Php300,000,000.00) at the time of incorporation which can either be in cash and/or property.
3. *Independent Directors.* At least one-third (1/3) or at least two (2), whichever is higher, of the board of directors of a REIT shall be independent directors.
4. *Organization and Governance.* As a public company, the REIT shall have such organization and governance structure that is consistent with the Revised Code of Corporate Governance and pertinent provisions of the SRC<sup>ii</sup> and its IRR. The REIT shall hold such meetings as provided for in its Constitutive Documents pursuant to the Corporation Code.

Allowable investments under the REIT include:<sup>iii</sup>

1. Real estate.

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- a. A REIT may invest in real estate located in the Philippines, whether freehold or lease hold. At least seventy-five percent (75%) of the Deposited Property of the REIT shall be invested in, or consist of, income generating real estate. Deposited Property that should be invested in Income-generating Real Estate located in the Philippines shall in no case be less than 35% of the Deposited Property.
  - b. A REIT may invest in income generating real estate located outside of the Philippines; Provided, that such investment does not exceed forty percent (40%) of its Deposited Property and only upon special authority from the Commission. The Commission in issuing such authority shall consider, among others, satisfactory proof that the valuation of assets is fair and reasonable.
  - c. An investment in real estate may be by way of direct ownership or a shareholding in a domestic special purpose vehicle constituted to hold/own real estate, subject to the conditions provided under these Rules.
  - d. Acquisition of a real estate shall include the ownership of all rights, interests and benefits related to the ownership of the real estate.
  - e. The real estate to be acquired by the REIT should have a good track record for three 3 years from date of acquisition.
2. Real estate-related assets, wherever the issuers, assets, or securities are incorporated, located, issued, or traded
  3. Evidence of indebtedness of the Republic of the Philippines and other evidence of indebtedness or obligations, the servicing and repayment of which are fully guaranteed by the Republic of the Philippines, such as, but not limited to, treasury bills, fixed rate treasury notes, retail treasury bonds, (denominated either in Philippine or in foreign currency) and foreign currency linked notes.
  4. Bonds and other evidence of indebtedness issued by:
    - a. the government of any foreign country with which the Philippines maintains diplomatic relations, with a credit rating obtained from a reputable credit rating agency or a credit rating agency acceptable to the Commission that is at least two (2) notches higher than that of ROP bonds; and
    - b. supranationals (or international organizations whose membership transcends national boundaries or interests, e.g. International Bank for Reconstruction and Development, Asian Development Bank).
  5. Corporate bonds of non-property privately-owned domestic corporations duly registered with the Commission with a current credit rating of at least "A" by an accredited Philippine rating agency.
  6. Corporate bonds of a foreign non-property corporation registered in another country provided that the said bonds are duly registered with the Commission and the foreign country grants reciprocal rights to Filipinos.
  7. Commercial papers duly registered with the Commission with a current investment grade credit rating based on the rating scale of an accredited Philippine rating agency at the time of investment.
  8. Equities of a non-property company listed in a local or foreign stock exchange, provided that these stocks shall be issued by companies that are financially stable, actively traded,

possess good track record of growth and have declared dividends for the past three (3) years.

9. Cash and Cash Equivalent Items.
10. Collective investment schemes duly registered with the Commission or organized pursuant to the rules and regulations of the BSP; provided however that: (i) the collective investment schemes must have a track record of performance at par with or above the median performance of pooled funds in the same category as appearing in the prescribed weekly publication of the Net Asset Value Per Unit of the Collective Investment Scheme units; and (ii) new collective investment schemes may be allowed provided that its fund manager has at least a three (3) year track record in managing pooled funds.
11. Offshore mutual funds with ratings acceptable to the Commission.
12. Synthetic Investment Products, provided that: (i) Synthetic Investment Products shall not constitute more than five percent (5%) of the Investible Funds of the REIT, (ii) the REIT shall avail of such Synthetic Investment Products solely for the purpose of hedging risk exposures of the existing investments of the REIT; (iii) the Synthetic Investment Products shall be accounted for in accordance with PFRS; (iv) the Synthetic Investment Products shall be issued by authorized banks or non-bank financial institutions in accordance with the rules and regulations of the BSP and/or the SEC; and (v) the use of Synthetic Investment Products shall be disclosed in the REIT Plan and under special authority from the SEC.

A full valuation of a REIT's assets shall be conducted by an independent Property Valuer, duly accredited by the Commission, at least once a year. No valuer shall value the same REIT for more than three (3) consecutive years. Subject to a curing period of three (3) years, the REIT may, however, re-engage the services of said property valuer. The Valuation Report, including the standards of asset valuation and valuation methodology shall be disclosed in the Annual Report of the REIT.<sup>iv</sup> Rule 9 of the Implementing Rules and Regulations of the REIT Law outlines the requirements of the Property Valuer to be hired by the REIT Company.

#### Qualifications Required of a Property Valuer.

- a. The appraisal company shall be registered with the Commission;
- b. The certifying officer of the appraisal company shall be a professional appraiser duly licensed by the DTI or the Professional Regulatory Board of Real Estate Service pursuant to R.A. 9646 and an officer/member of good standing any registered association of appraisal companies;
- c. At the time of application, the company shall have a minimum experience of five (5) years in the appraisal business;
- d. It shall have professional services for at least one (1) commercial bank and two (2) public companies;
- e. The appraisal company or any of its directors/officers shall have no adverse judgement on any administrative, civil or criminal case involving its appraisal business;
- f. It shall be solvent and in sound financial condition.

The foregoing qualifications shall be supported by appropriate documents.

#### General Obligations of a Property Valuer-

The Property Valuer shall value all the real estate of the REIT, on the basis of a full valuation with physical inspection in respect of the site of the real estate and an inspection of the building(s) and facilities erected thereon once a year, and in any event for the purposes of issuance of new Investor Securities. The Property Valuer shall also produce a valuation report on real estate to be acquired or sold by the REIT or where new shares are offered by the REIT or in any other circumstances required by the Commission. The contents of the valuation report shall comply with these Rules.

#### Criteria for Acceptability of the Property Valuer-

The Property Valuer shall be a company that:

- a. provides property valuation services on a regular basis.
- b. Carries on the business of valuing real estate in the Philippines;
- c. Possesses the requisite licenses required under relevant Philippine rules and regulations;
- d. Is accredited by the Commission;
- e. Has key personnel who possess the requisite licenses and are qualified to perform property valuations;
- f. Has sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities;
- g. Has robust internal controls and checks and balances to ensure the integrity of valuation reports and that these reports are properly and professionally prepared in accordance with international best practices;
- h. Has adequate professional insurance to cover its usual risks; and
- i. Complies with the Fit and Proper Rule under the Rules.

#### **HITCHES TO THE FULL IMPLEMENTATION OF THE REIT LAW**

Despite the excitement during the passage of the REIT Act of 2009, there is still a dearth in the REIT market. Stakeholders have identified reasons why they are reluctant to form a REIT corporation. The primary issues identified were: (a) imposition of the 12 percent value added tax on the transfer of real property to a REIT even if the transfer is a tax-free exchange; (b) imposition of the 67 percent minimum public ownership (MPO) rule; and (c) requirement of an escrow equivalent to corporate income tax breaks, prior to the REIT's compliance with the 67 percent MPO requirement.

The REIT law provided that the MPO shall not be less than one-third (1/3) of the outstanding capital stock of the REIT. Pursuant to this, the implementing rules and regulations issued by the SEC imposed an MPO equivalent to at least 40 percent of the outstanding capital stock of the REIT in the initial year. This MPO must be increased to 67 percent within three years from listing.

The Securities and Exchange Commission (SEC) issued on 27 April 2011 indicating the increase in the initial public float to 40% and then to 67% within the next three years. The rationale per the Department of Finance (DOF) is that the increase in public ownership will encourage the recycling of capital. As the Philippine REIT market is still in its infancy stage, the imposition of the 67 percent MPO discouraged real estate holding companies from creating REITs, as it required

them not to have majority ownership and control over the REIT. This lack of control and majority interest clearly discouraged the sponsors from contributing their best performing real estate properties into the REIT.

Another requirement of the BIR that unnecessarily made setting up a REIT inordinately expensive is the requirement that the income tax waived in the first two years of operation in view of the dividend deduction be put in escrow, to be released only upon showing that the REIT has achieved the required 67 percent MPO within three years from listing. This requirement will needlessly tie up much needed capital of the REIT, which should have been better used in the operations of the REIT.

It is clear, that the prohibitive requirements of the regulations that were imposed after the law has been passed have caused the inability of the REIT market to develop in the Philippines. There can be no clearer proof of the detriment of the requirements than the lack of REITs actively trading in the Philippines almost nine years from the time the law has been approved.

### **AN ANALYSIS OF THE REIT LAW FROM A VALUER'S POINT OF VIEW**

The very reason why the REIT Law did not take off is that it is flawed. However, looking at it from a valuer's point of view, it is both a boon and a bane. It is a boon to appraisal companies which have the track record to meet the minimum requirements of the law, but also a bane because of the stringent requirements to be able to value the REIT, might have led to the monopoly of international valuation companies, marginalizing local appraisers/valuers. Going over again the criteria for acceptability, the following may be detrimental to the appraisal practice of local practitioners.

	<b>Criteria for Acceptability</b>	<b>Remarks</b>
a	provides property valuation services on a regular basis.	Check
b	Carries on the business of valuing real estate in the Philippines;	Check
c	Possesses the requisite licenses required under relevant Philippine rules and regulations;	Issuances of new licenses to new appraisers have been decreasing after the requirement for a degree in BS Real Estate Management has been decreed.
d	Is accredited by the Commission;	As of April 30, 2018, there are only 18 accredited appraisal companies by the Commission
e	Has key personnel who possess the requisite licenses and are qualified to perform property valuations;	For qualification
f	Has sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities;	An accredited appraisal company must pass through financial hurdles
g	Has robust internal controls and checks and balances to ensure the integrity of valuation reports and that these reports are properly and professionally prepared in accordance with international best practices;	For qualification
h	Has adequate professional	The accreditation guidelines require that the

Criteria for Acceptability	Remarks
<p>insurance to cover its usual risks; and</p> <p>Complies with the Fit and Proper Rule under these Rules.</p>	<p>appraisal company has a professional liability insurance for errors and omissions in the amount of at least Five Hundred Thousand Pesos (P500,000.00) or such higher amount the Commission may require given the extent and amount of exposure. A conviction in the first instance shall be considered sufficient ground for disqualification. Applicants shall submit the pertinent clearance relative thereto.</p>

## VALUATION ISSUES

- Only a number of Filipino valuers are adept in doing income approach in the practice of their profession. Appraisers working with multinational real estate service providers are adept at doing income approach as their clients consist of fund managers, investors and other multinational companies. Local appraisal companies, normally cater to mortgage banking clients, where the valuation approaches used are mostly market and cost approaches. Of the eighteen (18) accredited appraisal companies with the SEC, only three (3) are considered as multinational asset valuers, namely Santos Knight Frank (a franchise of Knight Frank), Colliers International Philippines and FTI Consulting Services.
- Another challenge that needs to be hurdled by appraisal companies is the lack of transparency by developers. They are not willing to open internal data bases to share rent rolls, occupancy, etc.
- The Philippine Valuation Standards (PVS) was only updated in 2017 to be consistent with International Valuation Standards (IVS) 2017. PVS 2017 has yet to be published as at the time of writing of this paper. The first PVS was published in 2009, which was IVS compliant. It took almost ten (10) years before the update was done. The challenge is to keep the lag time shorter from the time a new issue of the standards comes out and the local adoption of the international standards.
- The updating is not the issue but the adherence to the standards is a matter for enforcement. Although the valuation profession is a regulated profession in the Philippines, it is only the licensing aspect that is being policed by government regulators. The PVS is being promulgated by the Department of Finance, Bureau of Local Government Finance, which has the power over government assessors only for taxation purposes. Private appraisers are left to police their own ranks, which is as now, should be done by valuation professional organizations (VPO).

## MOVING FORWARD

- Revisit the status of the REIT Law and the government's stand to make it palatable to developers.

A comprehensive tax reform package otherwise known as The Tax Reform for Acceleration and Inclusion and (TRAIN) Law, or Republic Act No. 10963 was signed into law on December 13, 2017. One amendment introduced by the TRAIN law may help push the development of the REIT market in the country.

Section 109 of the Tax Code has been amended to include transfers of property under Section 40 (c) (2) of the Tax Code or tax-free exchanges as exempt from value added tax.

With the above amendment of the Tax Code, stakeholders are expecting the BIR to issue the amendment to Section 7 of Revenue Regulations No. 013-2011, which imposed a 12 percent VAT on the transfer of property to the REIT even under tax-free exchange conditions.

The TRAIN amendment directly addresses one of the main reasons cited by property developers as hindrance to forming REIT corporations. With the amendment, property owners can now transfer qualified real property assets to the REIT corporations without incurring the 12 percent value added tax.

Fortunately, as early as 2016, the SEC has expressed willingness to lower the MPO to 33 percent. With the 12 percent VAT removed by the TRAIN Law, investors are now expecting the SEC to make good on its promise to amend the MPO requirement.

- Revisit the regulatory sphere for valuation in preparation for the full implementation of the REIT Law.

Inasmuch as the SEC is the regulatory body to monitor the implementation of the REIT, it is suggested that the SEC apply for institutional membership with the International Valuation Standards Council (IVSC), which would enable them to impose sanctions on companies valuing REITs to be fully compliant with the IVS.

- Make necessary recommendations for feasible and viable action plan.

While government is revisiting the implementing rules and regulations of the REIT Law, the appraisers/valuers should come up with an action plan that would be feasible and viable, in preparation for its full implementation. Following is a list of suggested action plans with timelines.

	Suggested Action Plan	Timeline
1	Printing of PVS 2017	As soon as possible
2	Valuation Professional Organizations (VPOs) to conduct trainings/seminars on PVS 2017 in compliance with Continuing Professional Development (CPD) credit units	As soon as PVS 2017 is printed and disseminated
3	Valuation Professional Organizations (VPOs) to conduct trainings/seminars on the REIT Law with Continuing Professional Development (CPD) credit units	As soon as possible
4	Valuation Professional Organizations (VPOs) to conduct intensive trainings/seminars on the Income Approach with case studies and Continuing Professional Development (CPD) credit units	As soon as possible
5	The Professional Regulation Commission, Professional Board of Real Estate Service (PRC-PRBRES) to revisit course content of the Bachelor of Science in Real Estate Management to make sure that the REITs and valuation of properties as listed should be taken up comprehensively	Within one year
6	The Securities and Exchange Commission to apply for institutional membership with the International Valuation Standards Council (IVSC) to be able to police accredited appraisal companies valuing REITs	Within one year

## **SUMMARY**

While it is true that the Philippine version of the REIT Law is flawed, there is no reason why appraisers/valuers should not improve their craft to be able to show that they understand the intricacies of valuing the assets of the REIT companies. In fact, REIT or no REIT, there are minimum requirements that an appraiser/valuer should meet – learning and adopting the international valuation standards and having in their DNA, the core values as dictated in the International Ethical Standards (IES) such as accountability, confidentiality, conflict of interest, financial responsibility, integrity, lawfulness and reflection.

Fingers crossed, the only way to go is to move forward.

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<sup>i</sup> Rule 4 Section 5 of the Implementing Rules & Regulations of the REIT Law

<sup>ii</sup> "SRC" refers to Republic Act No. 8799, otherwise known as the Securities Regulation Code of 2000, and its Implementing Rules and Regulations as amended.

<sup>iii</sup> Rule 5 Section 1 of the Implementing Rules & Regulation of the REIT Law

<sup>iv</sup> Rule 5 Section 10 of the Implementing Rules & Regulations of the REIT Law