

The 2013 Foreign Investors' Guide to

Real Estate Transactions in the Philippines

A complex system of laws, rules and regulations apply to real estate and real estate transactions in the Philippines. Key prohibitions on the ownership and disposition of lands are found in our organic law (*i.e.* the 1987 Philippine Constitution) while incentives and other regulatory mechanisms for the sale, purchase, lease and ownership of different types of real estate are scattered in various statutes and regulations. Local governments also regulate the ownership and disposition of real estate through various locality specific ordinances.

The legal complexity coupled with the absence of a unified system of laws and regulations that govern real estate transactions in the Philippines have made navigating the real estate landscape difficult and challenging. Admittedly, the difficulties and challenges are even more pronounced where foreign nationals and/or foreign companies are involved in the deal.

Owning Lands in the Philippines

The ownership of private lands in the Philippines is reserved to Philippine citizens and corporations that are considered Philippine nationals. The reservation to Philippine citizens and Philippine nationals of the right to own private lands is enshrined in the 1987 Philippine Constitution. Corollary, foreign nationals and foreign companies are prohibited from owning private lands in the Philippines and, the willful violation of these prohibitions is, in some instances, considered a criminal offense punishable by fines and imprisonment.

However, foreign nationals and foreign companies may indirectly own private lands in the Philippines by taking a minority interest (and only up to the extent of 40%) in corporations that are considered Philippine nationals. The Philippine Foreign Investment Act (as amended) and prevailing jurisprudence provide that for as long as the percentage of Filipino ownership in the capital stock of a corporation is at least 60% of the total capital stock entitled to vote in the election of directors of the corporation, the corporation is considered a Philippine national under Philippine law and may thus own private lands.

As an alternative to owning private lands, foreign nationals and foreign companies may, subject to the provisions of the Philippine Condominium Act, also own condominium units in condominium projects registered with the Philippine Housing and Land Use Regulatory Board. The term "condominium" in the Condominium Act is broadly defined and applies to commercial buildings.

Foreign nationals and foreign companies may also lease land. However, lease terms are regulated by law. A lease term that is unduly long will be viewed by Philippine courts as akin to virtual ownership of the leased land and this is prohibited.

As a general rule, a lease taken by a foreign national or a foreign entity can be for a term of 25

(Continued on page 2)



Inside this guide

Owning Lands in the Philippines

Owning Real Estate other than Lands

Typical Real Estate Transaction Structure

The Preliminary Step—Due Diligence

- Dealing with Registered Owners
- Liens and Encumbrances attached to Real Property
- Other Legal Requirements for the Transfer of Land

Documenting the Transaction
Taxes and Other Expenses

About SyCip Salazar Hernandez & Gatmaitan

Founded in 1945, SyCip Salazar Hernandez & Gatmaitan (SyCipLaw) has developed a leading expertise in real estate transactions. Such experience in real estate practice covers the simplest portfolio purchase to more complex deals and transactions, with clientele that range from individuals and major real estate developers to foreign governments.

The firm has assisted land developers on a variety of enterprises including industrial parks, recreational projects such as golf courses, and joint ventures for multi-use projects. The firm acted as counsel to the consortium that acquired majority of the shares in Fort Bonifacio Development Corporation, the owner and developer of prime lands converted from military use under the Bases Conversion Act. The firm advised the Government of Singapore in its investment in RCBC Plaza, the first vertical information technology ecozone.

The firm has acted for a joint venture company for the development of a proposed three-tower residential condominium project. Situated in Quezon City in the heart of Metro Manila, this medium-range residential condominium project expects its target market to include working couples who need a city home

(Continued from page 1)

years and may be renewed for another 25 years. The Philippine Investors' Lease Act allows the long-term lease of private lands by foreign investors, subject to certain terms and conditions, for the purpose of establishing industrial estates, factories, assembly or processing plants, agro-industrial enterprises and other similar endeavors. This law allows for a maximum lease term of 50 years renewable for another 25 years. A lease under the Investors' Lease Act is required to be registered with the Philippine Department of Trade and Industry.

Foreign companies that locate in government designated economic and industrial zones may also enter into lease agreements with a maximum lease term of 50 years renewable for another 25 years. The ownership of private lands in the Philippines is reserved to Philippine citizens and corporations that are considered Philippine nationals. The reservation to Philippine citizens and Philippine nationals of the right to own private lands is enshrined in the 1987 Philippine Constitution. Corollary, foreign nationals and foreign companies are prohibited from owning private lands in the Philippines and, the willful violation of these prohibitions is, in some instances, considered a criminal offense punishable by fines and imprisonment.

Owning Real Estate other than Lands

Since the prohibition in the 1987 Philippine Constitution only pertains to private lands, foreign nationals and foreign corporations may also take a 100% interest in buildings, machineries and other forms of real property other than lands.

While the general rule in Philippine law is that the ownership of real property adhered to land follows the ownership of the land, separate legal title over other forms of real property adhered to the land may be perfected and separated from the land where such are situated.

Typical Real Estate Transaction Structure

In light of the foregoing restrictions, a plain vanilla real estate transaction structure involving the entry of a foreign investor will typically involve a foreign national or foreign company taking a leasehold right over a parcel of land (with the maximum term permitted by law) and the full title to the buildings and other real property located on the land.

In some instances if the land is owned by a corporation that is a Philippine national, the foreign national or foreign company also takes the 40% ownership interest in the corporation that owns the land.

Foreign nationals and other foreign companies seeking to invest in real estate in the Philippines have a host of other structuring options for their investment. Construction projects for office buildings for instance may be constituted under the Philippine Condominium Act to allow foreign nationals and foreign entities to own specific areas in a building and at the same time, an aggregate of up to 40% ownership in the land.

Foreign investors intending to buy or lease property in the Philippines for purposes of establishing business or commercial operations in the Philippines also required to obtain a "license to do business" from the Philippine Securities and Exchange Commission.

Various investment vehicles are available to foreign investors and the appropriate investment vehicle will generally depend on the specific needs, the plans and the business model of the investor.

The Preliminary Step – Due Diligence

Foreign nationals and foreign companies are advised to seek legal representation and retain property advisors before entering into real estate transactions in the Philippines. Legal advisors can be retained to help identify legal risks and issues that may help foreign investors decide on whether or not to proceed with a particular real estate transaction. Property advisors can help guide foreign investors on commercial issues such as the purchase price for a parcel of land or the lease rate.

Some key legal issues that a foreign investor needs to face when dealing with real estate and which a legal advisor can identify in the course of a due diligence examination include:

(Continued on page 3)

(Continued from page 2)

Dealing with Registered Owners

Foreign investors should ensure that they are dealing with registered owners of the property. A person claiming ownership over land or other forms of real property should be able to present documents evidencing his/her title to such property.

Ideally, the ownership of private lands should be evidenced by a transfer certificate of title in the name of the registered owner. Registered owners retain an "Owner's Duplicate Copy" of the transfer certificate of title while the state, through the Philippine Land Registration Authority, retains the original copy of the title.

The copy retained by the state is the controlling copy of the title and it is advisable that a certified true copy of the title retained by the Land Registration Authority be inspected prior to any real estate transaction.

Condominium units in real estate constituted as a condominium project pursuant to the Condominium Act are covered by Condominium Certificates of Title issued by the Land Registration Authority.

Certain parcels of private land in the Philippines are not covered by transfer certificates of title. Possessors of these types of lands usually obtain a tax declaration (issued by the local government of the area where the land is situated) as proof of their ownership of the lands.

The ownership of buildings and real property other than land is evidenced by a tax declaration setting out such buildings and machineries owned by the registered owner. Typically, where the land and the buildings are owned by the same person or the same entity, only one tax declaration is obtained for both the land and the buildings standing on the land.

Liens and Encumbrances attached to Real Property

A foreign investor that purchases real estate takes title thereon subject to the liens and encumbrances that have been previously registered or annotated in the transfer certificate of title covering the land. For instance, a mortgage over the land constituted by the previous owner may be foreclosed even where, in the meantime, title to the land had passed on to a new owner. The term of registered real estate leases must also be respected by a transferee or buyer of the land.

In addition to being the most reliable proof of ownership of private lands, the copy of the Land Registration Authority of the transfer certificate of title covering a parcel of land will contain all registered encumbrances affecting the land. Certain liens and encumbrances may be registered without the consent of the owner of the land. Thus, the Owner's Duplicate Copy may not contain all registered liens and encumbrances that affect the land.

In some instances, liens and encumbrances are also registered and annotated in the tax declaration that covers the real estate.

Property owners may have agreed to certain contractual restrictions with respect to property registered in their name. Contractual restrictions which have been annotated in the transfer certificate of title are binding on the subsequent owner of the land. Typically, certain financing arrangements will require property owners to obtain the prior consent of banks before transferring or selling encumbered or mortgaged property. Building height and use restrictions are also registered on titles to the land.

The technical description of the land or the condominium unit appears in the transfer certificate of title or in the condominium certificate of title, respectively.

Other Legal Requirements for the Transfer of Land

Other legal requirements may affect the ability of an owner to sell or transfer real estate or the ability of the buyer to obtain registered title to the land. Generally, this depends on the nature of the real estate.

(Continued on page 4)

during work days, families who need a city dwelling for children who study in the university, and starting families who demand the convenience of proximity to work and leisure. The deal structure is interesting because of the nationality restrictions on ownership of private land and the commercial agreement of the partners on economic matters. The firm has also advised a joint venture company formed by PBCom and Filinvest on the construction of PBCom Tower in Makati City.

For More Information

Please contact your account partner or the authors of this Guide:

Emmanuel C. Paras

Head, Corporate Services

ecparas@syciplaw.com

John Paul V. de Leon

Associate

jpvdleon@syciplaw.com

SyCipLaw Center

105 Paseo de Roxas,

Makati City 1226 Metro Manila

The Philippines

Tel.: +632 982-3500

Fax: +632 817-3896

Email: sshg@syciplaw.com

Web: www.syciplaw.com

Publisher's Note

The *2013 Foreign Investors' Guide to Real Estate Transactions in the Philippines* is published by the Corporate Services Department of SyCip Salazar Hernandez & Gatmaitan. It is intended as a general primer on significant statutes and regulations that affect real estate transactions in the Philippines and contains only general information current as of 15 February 2013. Since key prohibitions are linked to the nationality of the entity that will hold title to land, the Guide approaches the real estate landscape from the perspective of foreign nationals and foreign entities seeking to invest in real estate. Readers are cautioned that matters set out herein do not constitute, and should not be relied upon as, legal advice. Entities or persons interested in investing in real estate in the Philippines or those who will be involved in real estate transactions in the Philippines are encouraged to seek specific legal advice with respect to their transactions.

To access other firm resources, please visit the SyCipLaw website (www.syciplaw.com).

To receive updates from the firm by email, subscribe to the SyCipLaw e-bulletin at http://eepurl.com/s_aXn.

Image on cover courtesy of Microsoft Corporation.

(Continued from page 3)

Legal requirements that may apply in some instances are as follows:

- Philippine law requires the consent of both spouses before property considered as conjugal in nature is encumbered or alienated. As a general rule, the sale or encumbrance of property without the consent of one of the spouses is void.
- Transactions which will result in the sale of all or substantially all of the property of a Philippine company require shareholder consent.
- Buildings designed and/or constructed by a Philippine national artist and buildings which are at least 50 years old are presumptively classified as Philippine cultural property and, under the National Cultural Heritage Act, may not be sold without prior clearance from Philippine cultural authorities.
- The sale of condominium units must be accompanied by a Condominium Certificate of Management issued by the condominium corporation that holds title to the land. The certificate attests that the sale of the unit to a foreign investor will not result in a breach of the required ownership limitations for corporations owning lands in the Philippines.
- Lands previously covered by the Comprehensive Agrarian Reform Act (as amended) and which have been awarded to farmer beneficiaries cannot be sold for a period of 10 years from the date of the issuance of the Certificate of Land Ownership Award. Such lands are classified as agricultural and cannot be used for other purposes unless reclassified by the Philippine Department of Agrarian Reform. No person can own more than 5 hectares of lands that are classified as agricultural.

Transferees of lands will be required to present a real property tax clearance issued by the local government of the place where the property is located before a new title is issued by the Land Registration Authority. The registration of the transfer of the land will not be allowed unless all unpaid realty taxes are paid.

Documenting the Transaction

Certain formalities are required to be observed in the sale of real estate. The absolute sale of real property should be made through a public instrument. Philippine law also mandates a specific form of notarial acknowledgement where the real property subject of the sale is covered by two or more transfer certificates of title. Documents of sale executed and acknowledged outside of the Philippines should be presented to a Philippine Embassy for authentication.

A Certificate Authorizing Registration issued by the Philippine Bureau of Internal Revenue will be required before the Land Registration Authority can issue a new transfer certificate of title in the name of the transferee.

Taxes and Other Expenses

The sale of real estate that is considered a capital asset will attract a capital gains tax equivalent to 6% of the purchase price or the zonal value of the property, whichever is higher. Where the real estate is an ordinary asset, the income of the seller or property owner is recognized as ordinary income subject. The sale of real estate considered as an ordinary asset is also subject to value added tax equivalent to 12% of the purchase price.

The execution of the document evidencing the absolute sale of the real estate will attract a documentary stamp tax equivalent to approximately 1.5% of the purchase price. Local governments also impose a local transfer tax equivalent to approximately 0.5% of the purchase price on the sale and transfer of the property.

The registration and issuance of a new title in the name of a transferee of the real estate is subject to registration fees amounting to approximately 0.25% of the purchase price. ■