Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City

OFFICE OF THE GENERAL COUNSEL

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SEC-OGC Opinion No. 15-01
Whether real estate mortgage is considered "income-generating real estate" under the Real Estate Investment Trust Act of 2009

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Madam:

This refers to your letter dated May 20, 2014 concerning questions as to whether or not the National Home Mortgage Finance Corporation (NHMFC) may invest in real estate mortgages under a Real Estate Investment Trust (REIT), pursuant to Republic Act No. 9856, otherwise known as the Real Estate Investment Trust Act of 2009 (REIT Act).

As narrated in your letter, the primary purpose of NMHFC, a government-owned and controlled corporation organized under Presidential Decree No. 1267, is to develop and provide a secondary market for home mortgages granted by public and/or private home financing institutions. To this end, NMHFC has undertaken several programs, one of which is the issuance of *Bahay Bonds*. It is now considering other options to develop the secondary market for home mortgages, one of which is through a REIT.

Your queries are as follows:

> (1) Whether or not a REIT can invest in real estate mortgages under the REIT Act;
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> (2) Does a real estate mortgage that is amortized for a specific period of time and which generate interest income fall under the definition of "income generating real estate" under Section 3 (m) of the REIT Act and

Rule 3 (r) of the Implementing Rules and Regulations ("IRR") of the REIT Act;

(3) What are the limitations imposed on a REIT with respect to investments of its deposited property in real estate mortgages? ; and

(4) Can a REIT invest one hundred percent (100%) of its deposited property in real estate mortgages that generate income?

In relation to your first two queries, a REIT generally may be of three basic forms – equity trusts, mortgage trusts, and hybrid trusts, which comprise a combination of equity and mortgage trusts. Equity trusts purchase commercial real estate, such as apartment buildings and shopping centers, and derive their income primarily from rents. Mortgage trusts invest their assets in loans secured by mortgages in real property. Mortgage trusts may be divided into short-term mortgage trusts, which generally limit their investments to construction and land-development loans; and long-term mortgage trusts, which invest on completed projects with 20-30 year maturity periods. Long-term mortgage and equity trusts frequently seek to acquire some form of equity interest that will enable the investors to participate in the growth value of the project and acquire at least partial protection against inflation.[1]

The REIT Act defines a REIT as a stock corporation established in accordance with the Corporation Code of the Philippines, and the rules and regulations promulgated by the Securities & Exchange Commission principally for the purpose of **owning income - generating real estate assets**.[2] From the definition of the REIT Act, the law primarily recognizes equity trusts as the mode for establishing a REIT here in the Philippines. Specifically, Section 3 (m) of the REIT Act provides what may be considered as "income-generating real estate", thus:

> "**(m) "Income-generating Real Estate"** means real property which is held for the purpose of **generating a regular stream of income** such as rentals, toll fees, user's fees and the like, **as may be further defined and identified by the Commission. The Commission may promulgate rules to include real rights over real property, provided they generate interest or other regular payments to the REIT**." (Emphasis and underscoring supplied)

In order to determine the intent of the law, we resort to the legislative deliberations on the matter.[3] In his Explanatory Note to Senate Bill No. 63, Senator Edgardo J. Angara declared: *"The main purpose of real estate investment trusts is to provide small and large investors alike with the opportunity to participate directly in the ownership and financing of large-scale real estate projects at affordable rates of*

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[1] 15b Am Jur Legal Forms 2d, pg. 6-7.
[2] Section 3 (cc), REIT Act.
[3] SEC Opinion dated May 21, 1992, addressed to Mr. O. P. Victorino, citing Martin, Statutory Construction, citing Macondray & Co. vs. Eustaquio, 64 Phil. 446 (1937) and Daza vs. Villaroman, 69 Phil 12 (1939).

investment, without the disadvantages of illiquidity, high transaction and management costs, as compared to traditional private real estate ownership."[4]

He stated further: *"A 'real estate investment trust' is a stock corporation formed for the sole purpose of investing in income-producing real estate assets. Income producing properties include apartment buildings, office buildings, warehouses, medical facilities, hospitals, mixed industrial/office buildings and other commercial and residential properties. In other jurisdictions, the real estate investment trust regime has also been used to help develop the tourism industry by building resorts, hotels, shopping centers, outlets as well as develop other infrastructure projects like highways, railroads, prisons, and other similar projects."* In introducing the bill, he sought to provide a "*... legal framework ... designed to provide a similar structure for investments in the real estate industry in the same manner that mutual funds provide for investment in stocks and securities.*" (Underscoring in original.)

Thus, while a mortgage trust may be a proper subject of a REIT in other jurisdictions, it appears not to have been the primary intention under the REIT Act, as preference under the law was for equity trust transactions, particularly investments on tangible real properties *"generating a regular stream of income"*, producing consistent income arising from the said real estate investment in the form of rentals, fees, tolls and the like.

Moreover, for real estate to be considered as an investment in "income-generating real estate" under the REIT Act and its IRR, the same must consist of tangible real properties. This can be ascertained from a reading of the following: a. the information required for the REIT Plan (Prospectus) under Sec. 1.3 Rule 4 of the IRR, b. allowable investments of the REIT under Sec. 1 Rule 5 where it can only invest in real estate (Sec. 1.1), Real estate-related assets, regardless of where the issuers, the assets or the securities are incorporated, located, issued or traded (Sec. 1.2), government securities, other reputable corporate bonds or commercial papers, shares issued by listed local or foreign non-property corporations, registered collective investment schemes, rated mutual funds, and cash/ cash equivalent items, and c. enumeration of the sources of income in Rule 3 (r) of the IRR (rentals, toll and parking fees, storage fees, etc.), which usually refer to income or rentals arising from the lease of lands, buildings, machineries, instruments, structures and the like.[5] Moreover, Section 1.1 (a), Rule 5 of the IRR would indicate that the real estate is either freehold or leasehold in nature, which likewise refers to tangible immovables.[6]

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[4] Explanatory Note of Senator Edgardo J. Angara on Senate Bill No. 63 found at http://www.senate.gov.ph/lisdata/41193533!.pdf.

[5] "(r) **"Income-generating Real Estate"** means **real property which is held for the purpose of generating a regular stream of income** **such as, but not limited to**, rentals, toll fees, user's fees, ticket sales, parking fees and storage fees." (Emphasis and underscoring supplied)

[6] **"Rule 5 – Allowable Investments of the REIT**

"SECTION 1. Allowable Investments. A REIT may only invest in:

"1.1 Real estate. (a) A REIT may invest in **real estate located in the Philippines, whether freehold or leasehold**. 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

More importantly, the IRR further prescribes requirements based on a real estate's physical location, that is, whether the real estate is located inside or outside of the Philippines. These factors are indicative of, and consistent with, the physical and tangible nature of the real properties contemplated in Section 1.1, Rule 5 of the IRR.

Thus, it is opined that a REIT cannot invest in real estate mortgages under the present REIT Act.

While the REIT Act recognizes that other real rights over real property, which are considered real properties under the Civil Code, may be considered "income-generating real estate" [7] ***provided they generate interest or other regular payments to the REIT***, such would depend on a determination by the Commission. At present, the Commission deems it prudent to exclude it from the current rules.

As to your remaining queries, since it was opined that REITs are not allowed to invest in real estate mortgages or such other legal rights, any further questions relative thereto shall be rendered hypothetical, abstract, speculative and anticipatory in nature, such that the Commission, as a matter of policy, refrains from rendering any legal opinion thereon.[8]

It shall be understood that the foregoing opinion is rendered based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the courts, or upon the Commission in other cases of similar or dissimilar circumstances.[9] If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

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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." (Emphasis and underscoring supplied)

[7] Republic Act No. 9856, Section 3(m) "Income-generating Real Estate" means real property which is held for the purpose of generating a regular stream of income such as rentals, toll fees, user's fees and the like, as may be further defined and identified by the Commission. The Commission may promulgate rules to include real rights over real property, provided they generate interest or other regular payments to the REIT (underscoring ours).

[8] SEC Memorandum Circular 2003-15, No. 5.4

[9] SEC Memorandum Circular 2003-15, No. 7.