

Application of PFRS 15 “Revenue from Contracts with Customers” on Sale of Real Estate Properties under Pre-completion Contracts

Fact Pattern

1. For agreements for the construction of residential real estate in the Philippines, selling activities are usually performed while construction is in progress (“pre-selling”). Pre-selling activities will commence after appropriate requirements are complied with and License to sell (LTS) is issued to the developer per discussion below.
2. Project should generally be about 20% completed prior to the issuance of LTS for vertical real estate projects (high rise condominiums) (other requirements include approval of development plans, clearing of the site, construction of the project foundation). In some cases, temporary LTS may be issued to the developer. Temporary LTS will allow the developer to engage in pre-selling activities until the LTS is issued. However, all funds obtained from selling will be held in escrow. All amounts collected from buyers (e.g. reservation fees and down payments) prior to issuance of LTS are required to be deposited in an Escrow Fund.
3. A developer is required to post a performance bond as a requirement for the issuance of LTS. The performance bond is based on the total project cost. On a yearly basis, HLURB inspects the project and the performance bond is adjusted based on the total cost to complete. In case the developer fails to complete the project, the performance bond is forfeited in favor of HLURB and HLURB takes over the project.
4. A Contract to Sell (CTS) is executed when the buyer starts making equity payments. The buyer pays a deposit and makes payments throughout the construction period or even after project completion depending on the payment scheme agreed with the developer. The schedule of payments may not be related to the progress of the construction.
5. When the developer has obtained the LTS, there is no restriction on how the developer uses the payments received from the buyer. The developer is not required to set aside a fund for the specific use of the project.
6. The relevant building approvals by the authorities set out the construction plan and lay-out of the property that cannot be changed unilaterally by the developer. Any change in plan (alterations/modifications) should be approved by the relevant government body or majority of the existing buyers.

7. The buyer does not have the right to revise or dictate the features of the unit under construction (e.g., main structure, fittings and furnishing).
8. The rights of the buyer under a CTS are governed by the concept of “equitable interest” or “beneficial interest.” Equitable interest is defined as an interest held by virtue of an equitable title or claimed on equitable grounds, such as the interest held by a trust beneficiary. The concept of equitable interest is recognized by Philippine laws under the Civil Code of the Philippines (R.A. 386), and has been defined by jurisprudence as the profit, benefit, or advantage resulting from a contract, or ownership of an estate as distinct from the legal ownership or control.
9. The buyer can sell or transfer his/her right or interest on the asset to another person even before full payment for the property and before completion of construction subject to certain tax rules and legal requirements.
10. The buyer cannot transfer or assign its rights and obligations under the CTS without giving prior notice to and obtaining the consent of the developer. Further, some CTS give the developer the right of first refusal to purchase the CTS before it can be offered to a third party.
11. A provision in the CTS precludes the developer from transferring the specified unit to another customer. This is considered a substantive contractual restriction, as the customer could enforce its right to the promised asset if the developer seeks to direct the asset for another use.
12. A provision in the CTS specifies that the developer may annul the CTS if the buyer defaults in payments.
13. The buyer's rights are protected by Philippine laws, to wit:

(a) *Republic Act (RA) 6552 – “Maceda Law” (The Realty Installment Buyer Act)*

The Maceda Law gives the buyer, in the event of default, the right to pay within a grace period and the right to refund under certain conditions.

Please see Appendix A.1 or the full text of the Maceda Law.

(b) Presidential Decree (PD) 957 - Condominium and Subdivision Buyers' Protective Decree

PD 957 provides remedies to the buyer should the developer fail to develop the subdivision or condominium project according to the approved plans and within the time limit for complying with the same.

Please see Appendix A.2 for the full text of PD 957.