Land use conversion under the Agrarian Reform Law

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I am pleased to share my thoughts on one of the most controversial subjects involving agrarian reform: land use conversion. Having been part of the Depart-ment of Agrarian Reform (DAR), which a lot of people love to hate, I always welcome the opportunity to share my thoughts on any matter that has something to do with the implementation of the Comprehensive Agrarian Reform Program (CARP).

Alam po nimo, noong nasa DAR pa ako bilang Director ng Special Concerns Office, ang pakiramdam ko ay para kaming mga bibingka, may apoy sa itaas at sa ibaba. There were landowners who were angry with the Department either because their agricultural lands were placed under the CARP or the compensation they got for their land was too low. If, on the other hand, the DAR does not find a particular landholding suitable to agricultural production (therefore “unCparable”), it is the farmers who are after our necks. Up to now, even some of our family’s landholdings in Pampanga have not been paid for by the Land Bank of the Philippines. So please don’t tell my Mom where I used to work.

Overview of the Agrarian Reform Laws

Presidential Decree No. 27, promulgated on October 21, 1972, declared that tenant-farmers of private agricultural lands primarily devoted to rice and corn under a system of share-crop or lease tenancy shall be deemed owners of a portion constituting a family size farm of five hectares. Under this law, the landowner has the right to retain an area of not more than seven hectares.

On June 15, 1988, RA No. 6657, otherwise known as the Comprehensive Agrarian Reform Law (CARL) was enacted. The CARL placed under its coverage all public and private agricultural lands, regardless of tenurial arrangement and commodity produced, for distribution to qualified farmer-beneficia ries of not more than three hectares of agricultural land. The landowner was granted the right to choose a compact and contiguous area to be retained by him which, shall not exceed five hectares. In addition, three hectares could be awarded to each child of the landowner if the child was actually tilling the land or directly managing the farm.

Any sale, disposition, possession of private land executed by the landowner in violation of the CARL was declared null and void. Exempted from this prohibition on transfer are lands not exceeding five hectares chosen by a landowner as his retention area.

I earlier referred to land use conversion as “controversial” because DAR has oftentimes been accused of stifling industrialization in its effort to restructure the pattern of land ownership. The DAR, however, is mandated to implement a program which is designed to eliminate existing defects in the agrarian structure and pave the way for social and economic development.

While agrarian reform is one of the most important thrusts of this government, it also goes without saying that industrialization is another. Agrarian reform cannot be pursued independently of industrialization.

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Land, however, being a limited and scarce resource, is subject to competing demands. Most pressing of these is the need to convert agricultural lands for residential, commercial, and industrial purposes.

It is for this reason that our legislators found the need to regulate the conversion of lands to other uses by including provisions in RA 6657 that will prevent the indiscriminate change of land use.

Sec. 65 of RA 6657 reiterated the authority of DAR to convert the use of agricultural lands and laid down the conditions therefor.

It states, thus:

"After the lapse of five (5) years from the award, when the land ceases to be economically feasible and sound for agricultural purposes, or the locality has become urbanized and the land will have a greater economic value for residential, commercial or industrial purposes, the DAR, upon application of the benefici

Non-negotiable for conversion

1. All irrigated lands where water is available to support rice and other crop production
2. All irrigated lands where water is not available for rice and other crop production but within the areas programmed for irrigation facility rehabilitation by the Department of Agriculture and National Irrigation Administration
3. All irrigable lands already covered by irrigation projects with firm funding commitments at the time of the application for land use conversion or reclassification

Legal Mandate

The land use conversion authority of the Department of Agrarian Reform (DAR) is embodied in Sections 4 & 5 of Executive Order No. 129-A and Section 65 of RA 6657.

Sec. 4 (j) of Executive Order No. 129-A authorizes DAR to approve or disapprove the conversion, restructuring or reallocation of agricultural lands into non-agricultural uses. Sec. 5 of the same E.O. states that DAR shall have "exclusive authority to approve commercial, industrial and other land uses as may be provided for by laws."

Conversion, Reclassification and Exemption, Distinguished

Before we proceed to the discussion of the rules and procedures governing land use conversion, let us first take a look at the definition of three concepts which has been interchangeably used in referring to land use: conversion, reclassification, and exemption.

Conversion is the act of changing the current use of a piece of land into some other use. Specifically for the DAR, land use conversion refers to the change from agricultural to non-agricultural land use.

Land use reclassification refers to the act of allocating lands to different activities or classes of land uses, evolved and enacted through the town planning and zoning processes.

Although reclassification and conversion are similar in that they both determine whether a parcel of land should be used for agricultural or other purposes, they are different in approach.

Reclassification is a power exercised by municipal or city governments through the town planning process taking into account the needs of the inhabitants for space, housing, industrial, commercial and other non-agricultural uses.

Conversion goes through the DAR's evaluation process with takes into account the tenants and farmworkers, if any, on the landholding including the payment of disturbance compensation.

Exemption, on the other hand, refers to lands which are not, to begin with, considered as agricultural and are, therefore, not convertible under the CARP.

Example of these are lands which have a slope of more than 18% and are undeveloped.

DAR Rules and Regulations

To implement the above-cited provisions of the law, the DAR has promulgated Administrative Order No. 12, series of 1994 entitled "Consolidated and Revised Rules and Procedures Governing Conversion of Agricultural Lands to Non-Agricultural Uses."

Following is a summary of the said administrative order:

Conversion may be allowed if at the time of the application, the lands are reclassified as commercial, industrial and residential in the new or revised town
plans promulgated by the Local Government Unit (LGU) and approved by the Housing and Land Use Regulatory Board (HLRB) or by the Sangguniang Panlalawigan (SP).

If at the time of application, the land still falls within the agricultural zone, conversion shall be allowed only on the following instances:

1. when the land ceases to be economically feasible and sound for agricultural purposes, as certified by the Regional Director of the Department of Agriculture (DA); or

2. when the locality has become highly urbanized and the land will have a greater economic value for residential, commercial or industrial purposes, as certified by the local government unit.

If the city/municipality does not have a comprehensive development plan and zoning ordinance duly approved by HLRB/SP but the dominant use of the area surrounding the land subject of the application for conversion is no longer agricultural, or if the proposed use is similar to, or compatible with the dominant use of the surrounding areas as determined by the DAR, conversion may be possible.

In all cases, conversion shall be allowed only if DENR issues a certification that the conversion is ecologically sound.

Pursuant to Administrative Order No. 20, Series of 1992 (Interim Guidelines on Agricultural Land Use Conversion) and Memorandum Circular No. 54, Series of 1993 of the Office of the President, the following are non-negotiable for conversion:

1. All irrigated lands where water is available to support rice and other crop production.
2. All irrigated lands where water is not available for rice and other crop production but within areas programmed for irrigation facility rehabilitation by the Department of Agriculture (DA) and National Irrigation Administration (NIA).
3. All irrigable lands already covered by irrigation projects with firm funding commitments at the time of the application for land use conversion or reclassification.

No application for conversion shall be given due course if (1) the DAR has issued a Notice of Acquisition under the compulsory acquisition (CA) process; (2) a Voluntary Offer to Sell (VOS), or an application for Voluntary Land Transfer (VLT) has been filed, or (3) the subject property is included in a land use conversion plan.

In all cases of petition for conversion resulting in the displacement of farmer-beneficiaries, the displaced farmers shall be entitled to a disturbance compensation, which should not be less that five (5) times the average of the annual gross value of the harvest on their actual landholdings during the last five (5) preceding calendar years. In addition, the DAR shall exert all efforts to see to it that free homelots and assured employment for displaced beneficiaries are provided by the applicant/developer.

To prevent circumvention of coverage under the CARP, conversion shall be granted only upon evidence that the project to be established therein is viable and beneficial to the community affected and that the land development phase of the area is five (5) hectares or less. Should the area exceed five (5) hectares, an additional year shall be allowed for every five (5) hectares of a fraction thereof but in no case the completion of the development extend beyond five (5) years from the issuance of the Order of Conversion.

**Legislative and Executive Issuances**

Several issuances that are pertinent to conversion have been promulgated, to wit:

1. Memorandum Circular No. 54 issued by the President implementing Sec. 20 of the Local Government Code, which authorized LGUs to reclassify agricultural lands.
2. Department of Justice Opinion No. 44, Series of 1990 which states that lands already classified for residential, commercial or industrial use, as approved by the Housing Land Use Regulatory Board may be converted to other use.

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Financial leverage, capital structure, and homemade leverage

By Junette A. Perez
Assistant Professorial Lecturer,
Management of Financial Institutions

How should the firm go about choosing its debt-equity ratio or its capital structure? As investors, do we have an option should the firm's proposed capital structure does not seem agreeable to us? Or do we have an alternative should the firm refuse to change its original capital structure?

From Tables 2 and 3 (see boxed tables next page), four observations could be made:

1. Financial leverage increases returns to shareholders (ROE and EPS).
2. The effect of financial leverage depends on EBIT, the higher the EBIT, leverage is beneficial.
3. However, shareholders are also more exposed to risk and,
4. Because of the impact of financial leverage on expected returns (EPS) to shareholders and riskiness of its stocks, the capital structure of the firm is an important consideration for investments.

While the first three (#'s 1, 2 and 3) are correct, the last one(#4) is not! Why? Because of the technique of homemade leverage.

Homemade leverage allows investors to adjust the amount of financial leverage by borrowing (leveraging) and lending (unleveraging) on their own. The process uses personal borrowing to change the overall amount of financial leverage to which an individual could be exposed. It actually makes no difference whether the company adopts the proposed capital structure (in Table 3) or maintains the original capital structure, simply because any shareholder could simply create homemade leverage at the personal level.

Let us illustrate, using the data shown on Table 4.

III. Suppose XYZ, Inc. (the company where you invested) does not support the proposed capital structure. If you would like to have an EPS of P3.00 per share, what could you do?

Create leverage. You borrow P2,000 at 10% and use this amount along with the original P2,000 to buy 200 shares. To illustrate:

Original Capital Structure and Homemade Leverage

<p>| | |</p>
<table>
<thead>
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</thead>
<tbody>
<tr>
<td>EPS (original)</td>
<td>P2.5 / share</td>
</tr>
</tbody>
</table>
| Earnings for 200 shares | P500
| (200x2.5/share) | |
| Less: Interest on P2,000 at 10% | P200 |
| Net Earnings | P300 (the exact payoff under the proposed capital structure) |

How do we know how much to borrow? (in this case, P2,000)
You simply replicate XYZ's proposed capital structure of debt to equity ratio of 1.0 at the personal level.

IV. Now suppose XYZ, Inc. adopts the proposed capital structure but you prefer the original capital structure, what could you do?

Undo leverage. Unlever the stocks that you own from XYZ, Inc. by selling 50 shares for P1,000 then loan out the P1,000 pesos for 10%. To illustrate:

Original Capital Structure and Homemade Leverage

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<tbody>
<tr>
<td>EPS (proposed)</td>
<td>P3.00 / share</td>
</tr>
</tbody>
</table>
| Earnings for 50 shares | P150
| (P3/share x50 shares) | |
| Plus: Interest on P1,000 | P100 (P1,000 x 10%) |
| Total Payoff | P250 (the exact payoff under the original capital structure) |

See LEVERAGE next page
Table 1. XYZ, Inc. Capital Structure

<table>
<thead>
<tr>
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<th>Current</th>
<th>Proposed</th>
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<tbody>
<tr>
<td>Assets</td>
<td>P8,000,000</td>
<td>P8,000,000</td>
</tr>
<tr>
<td>Debt</td>
<td>0</td>
<td>P4,000,000</td>
</tr>
<tr>
<td>Equity</td>
<td>P8,000,000</td>
<td>P4,000,000</td>
</tr>
<tr>
<td>Debt to Equity ratio</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Share price</td>
<td>P20 / share</td>
<td>P20 / share</td>
</tr>
<tr>
<td>Share outstanding</td>
<td>400,000 shares</td>
<td>200,000 shares</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>EBIT</td>
<td>P1,000,000</td>
<td>P1,000,000</td>
</tr>
</tbody>
</table>

Table 2. Current Capital Structure: No debt; with 400,000 shares outstanding

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<tbody>
<tr>
<td>EBIT</td>
<td>P1,000,000</td>
</tr>
<tr>
<td>Interest</td>
<td>0</td>
</tr>
<tr>
<td>Net Income</td>
<td>P1,000,000</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>12.5% (P1 million / P8,000,000)</td>
</tr>
<tr>
<td>Earnings per share (EPS)</td>
<td>P2.5/share (P1 million / 400,000 shares)</td>
</tr>
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Table 3. Proposed Capital Structure: With debt of P4 million

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<table>
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<tbody>
<tr>
<td>EBIT</td>
<td>P1,000,000</td>
</tr>
<tr>
<td>Interest</td>
<td>P400,000 (P4,000,000 x 10%)</td>
</tr>
<tr>
<td>Net Income</td>
<td>P600,000</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>15% (P600,000 / P4,000,000)</td>
</tr>
<tr>
<td>Earnings per share (EPS)</td>
<td>P3.0/share (P600,000 / 200,000 shares)</td>
</tr>
</tbody>
</table>

Table 4. XYZ, Inc. Capital Structure

<table>
<thead>
<tr>
<th></th>
<th>Proposed</th>
<th>Original</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPS</td>
<td>P3.0/share</td>
<td>P2.5/share</td>
</tr>
<tr>
<td>Earnings for 100 shares (for a start)</td>
<td>P300</td>
<td>P250</td>
</tr>
<tr>
<td>Cost for an investor at 100 shares at P20/share</td>
<td>P2000</td>
<td>P2000</td>
</tr>
</tbody>
</table>

LEVERAGE...
from previous page

Again, how do you know how much amount to loan out?

Remember, that in the proposed capital structure, XYZ, Inc. borrowed an amount equal to half its value (P4 million). You could then unlever by simply loaning out money in the same proportion (P2,000 divided by 1/2). One thousand pesos (P1,000) divided by P20/share equals 50 shares.

The next question is, why do people care to do this?

Perhaps, investors and directors of corporations themselves would like to believe that they could not be placed at any disadvantaged financial situation where they are stuck up with no choice. In other words, with homemade leverage, anything is possible.

References


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