

## DEVELOPING REAL ESTATE IN MEXICO

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Development of real estate in Mexico whether for commercial, residential or industrial purpose is a complex activity, which involves many different aspects and proceedings, such as site location for the sales and marketing of the project. The first step is to locate the property site for your project.

It is important to note that due to changes made to Mexican law in 1992, the "Ejido" land has emerged as a new alternative for foreign investors. The "Ejido" is real estate set aside for the benefit of certain sectors of the Mexican society. However, due to the abovementioned changes, this land has become a very good option when buying real estate property, since in most cases its price is significantly lower compared to other types of lands.

When the perfect location for your project is found, it is required that at least the following be carried out:

### **I. Title Search**

The first advisable step is to perform a title search of the selected property. This title search may help detecting potential problems, such as commercial or tax liens, inaccuracy regarding the metes and bounds, missing links in the chain of title, all this, in order to avoid future litigation.

If the real estate property is to be located in an area which has been developed for some time (urban area, housing development area) the search should be minimal. However, if the land is located in an unpopulated or rural area, this title search should go back all the way to the granting of the original title. In rural areas, special care must be taken in the event the property is under the Ejido structure. As previously mentioned, "Ejidos" are rural communities subject to special regulations. Buying land from these communities requires special attention, since they are protected by a special Law and furthermore by an Agrarian Prosecutor, who provides them with special protection. For instance, when it comes to the granting of the property title, there are several prerequisites and proceedings to be performed in order to transfer the "Ejido" title to a private property title.

A title search must determine whether (i) the property's title was granted in compliance with all legal formalities and requirements, including the proper filings, (ii) there is a logical and sequential chain of title, (iii) the property is clear and free of any encumbrances and limitations, (iv) the metes and bounds from the public records coincide with the ones in the title, (v) there is existence of mortgages, liens or encumbrances on the property, and (vi) there is the possibility that the real property is affected by Federal Property such as creeks, federal roads, a federal maritime zone, etc.

On the other hand, as separate section, it is recommended that an independent engineer prepare a topographical survey, in addition to the zoning confirmation by the local, state or federal authorities, in order that pursuant to their state or local development programs the same may confirm whether the property is in accordance with the use for which it is intended to be developed; furthermore, if the property has any environmental limitations.

## II. Corporate Structure and Tax Planning

At the initial stage, a Mexican corporation must be created, most likely a "Sociedad Anónima" which is similar to a U.S. Inc., in order to avoid any personal liability. This corporation may acquire the real property by means of direct ownership or through a real estate trust. When developing homes for the U.S. market, a master trust is definitively one of the best options, and will also serve as an umbrella for subsequent sales.

Developing real estate requires a great deal of investment, and often, not all of the expenses can be deducted or credited in Mexico due to its strict tax regulations. Most often, a consulting agreement is executed between the Mexican corporation and the foreign investor, whether individual or corporation, in order to help the structure and plan the real estate business, as well as to have a valid deduction of expenses. Expenses are also incurred when locating the proper site for the development, and these may also be deducted by a finder's fee agreement between the foreign investor and the Mexican corporation. In addition, marketing expenses may be also transferred from the U.S. into Mexico by means of a brokerage agreement between the Mexican company and a foreign broker. However, special care must be taken in the wording of these agreements due to the fact that even the income received by the foreign companies may be taxable in Mexico, and therefore the Mexican company will have the obligation to withhold such taxes. For instance, in order that the fees derived from such Agreement not be taxable in Mexico, it must be clearly specified in the brokerage agreement that such services will be rendered outside of Mexico.

Even though development activities may start by entering into an agreement with a contractor. It is recommended that constructions start with the developer's own resources, through the incorporation of a Mexican construction company, based on the fact that this will give the developer more control over the building process, building schedules, etc. Therefore, a Mexican corporation may be incorporated exclusively for construction purposes. Foreign Investment Law places a 49% foreign capital limitation to Mexican corporations in the construction business. However, an application can be submitted to the National Commission on Foreign Investments for additional foreign capital. This limitation will cease to exist in 1999.

Under Mexican law, 10% of the profits derived from business activities must be shared and distributed among the company's employees. Therefore, it is advisable that a service company is created to provide all the human resources needed to develop the property. Finally, when the development is completed a homeowner's association must be created. Furthermore, to assure that the conveyance and restrictions of the project (ccr's) are

enforceable, special wording should be included in the ccr's, all this being in order to maintain the quality of the project.

As I mentioned in the first part of this article, once you have found the perfect location for your project, certain precautions should be taken, such as: conducting a title search, putting together the corporate structure and of course the proper tax planning. In addition to these issues, it is important to take into account other matters, such as the following:

### **III. Considerations on obtaining a subdivision permit**

In order to individualize an acreage property or to divide the same into lots, it is necessary to obtain a development authorization, which is issued by the state or municipal government. Development regulations have generally classified the different developments as: residential, tourist, commercial, industrial and farms. This distinction is made for an obvious reason: different rules may apply to different types of developments. Prior to applying for an authorization to subdivide, negotiations must be made with the competent authorities providing utilities, regarding the feasibility of providing water, sewage, electricity, and all other public services to the project.

Zoning is another important issue. Whether for industrial, commercial or residential purposes the city must authorize and certify that the land intended for development is suited for the project, in accordance with the city's urban development plans and zoning laws. Additionally, if the project is located close to a coastal ecosystem, an environmental impact authorization issued by the National Institute for Ecology will be required.

In order to obtain the authorization for the development's subdivision, a certain percentage of land must be donated in favor of the government such as: 10% of the marketable area, 3% for schools and 3% for parks and gardens. It is often possible to negotiate a buy-back with the government. This buy-back is done at an appraisal value which may also be subject to negotiations.

### **IV. Condominium Regime**

Instead of requiring a subdivision permit for the project a smaller project may be structured through a condominium regime, which does not entail a donation obligation to the government. A smaller project of 10 hectares, adjacent to a public street, may qualify for a condominium regime, which requires prior approval from the authorities. To obtain said approval a developer needs to evidence to the authorities that it is feasible to provide all the public services required for the project. This regime gives the exclusive ownership right of a unit or a part of the property and a co-ownership of the common areas of the project. Therefore each owner has the right to sell or lien their unit and the same will include the co-ownership right on the common areas.

Once the condominium regime is authorized, the owner must make a unilateral declaration before a Mexican Notary Public formalizing the creation of the condominium regime. The life of a condominium is regulated through its bylaws, regulations or CCR's, prepared for such

purposes. Condominium Laws have strong provisions to help enforce the payment of maintenance fees.

The CCR's of a project, and their enforcement, will ultimately provide the internal regulatory framework to ensure that the project will maintain its envisioned standards for future enjoyment.

Prior to buying a unit in a project, potential purchasers should request and review all the documents related to the creation of the condominium project to avoid any unpleasant surprises

## **V. Time Share**

Time Share transactions are not real estate acquisitions. What a buyer obtains in a transaction of this nature are lodging services for the use and enjoyment of tourism facilities in allotted period of time. There are basic things to look out for when planning to invest in a timeshare project in Mexico: i) that the contract has been approved by the Consumer Protection Agency (CPA); ii) that the project has been affected as a time share and that it has been recorded with the Public Registry of Property and Commerce.

The CPA's requirements to authorize a time share operation are: (1) that the timeshare services be domiciled in Mexico; (2) the property must be irrevocably affected for the operation of a timeshare; (3) the developer must post a bond in favor of consumers, promising to reimburse any moneys paid by them in the event the developer breaches the timeshare agreement; (4) the developers must obtain an insurance policy affording coverage in the event of a total or partial loss of the timeshare property. The insurance policy should also afford coverage for any personal injury sustained by the consumer; (5) the developer must determine and disclose any and all charges to be made to the consumers and; (6) developer must prepare the project's ccr's and include them with the application to be filed before the CPA for the agreement's approval and registration.

This process is an authorization per SE, however, the rule is that the timeshare developer may only sell with an agreement previously approved by the CPA. This agreement shall comply with other requirements provided by the timeshare regulations.

Evidently, there are many variations when it comes to real estate transactions. This article is intended only as an overview of the ways how some real estate transactions can be structured, and the issues commonly faced by investors. Whether your plans involve buying a home to retire, or developing that world class golf course you have always dreamed, it is recommendable that you obtain legal advice from a Mexican Counsel.