

## ***INVESTMENT IN INTERNATIONAL REAL ESTATE – U.S. LAWYERS BEWARE***

***18<sup>TH</sup> ANNUAL REAL PROPERTY & ESTATE PLANNING SYMPOSIA  
WASHINGTON D.C. APRIL 25<sup>TH</sup> THROUGH APRIL 28<sup>TH</sup>, 2007.***

### ***THE CASE OF MEXICO.-***

#### **1. Acquisition of land by foreigners in the Restricted Zone in Mexico**

If the target property is located within the so-called “Restricted Zone” (as explained below), note should be taken of the foregoing. If not, please disregard this section.

##### **1.1 Analysis of the Applicable Restrictions and the New Foreign Investment Law**

###### **1.1.1 Applicable Restrictions**

Article 27 of the Mexican Constitution discusses the ownership of land and water. Article 27 grants the ownership of the land and water within the national territory to the Mexican Nation, and provides that the Nation will have the power to transfer ownership rights to these properties to private individuals, thereby creating private property.

Section I of Article 27 grants the right to acquire the dominion of land and water only to Mexican individuals and companies. It also grants to the State the discretionary power to grant the same right to foreigners, subject to the condition that foreigners agree with the Ministry of Foreign Affairs to consider themselves Mexican nationals and not to invoke the protection of their home governments with respect to the property acquired. If this covenant is breached, all rights to the property will revert to the Mexican Nation. Moreover, this Section prohibits foreigners from acquiring direct ownership over land and water located within 100 kilometers wide from the national border and 50 kilometers wide from the coastal shores (the “Prohibited” or “Restricted Zone”).

###### **1.1.2 New Foreign Investment Law**

The new Foreign Investment Law of 1993 (“FIL”) revoked previous decrees and regulations governing foreign investment in Mexico. However, it did not attempt to amend or modify Article 27 of the Constitution regarding the acquisition of land by foreigners in the Restricted Zone. Nevertheless, pursuant to the new FIL, foreign ownership in the Restricted Zone is available in the following cases:

1. If acquired for **nonresidential** purposes (i.e., industrial, commercial, or tourism activities), through participation in a Mexican company. Acquisition must be recorded with the Ministry of Foreign Affairs.
2. If acquired for **residential** purposes, through a trust. The Ministry of Foreign Affairs must authorize acquisition.

In order to establish a trust, prior authorization from the Ministry of Foreign Affairs in Mexico must be obtained. Such authorization grants to the beneficiary of the trust the right to the use and enjoyment of the land. This includes any benefit that may result from the operation and exploitation of it. The trust agreement must be in writing and be recorded before the Public Registry of Property.

The trust arrangement in Mexico involves a financial institution acting as trustee with respect to certain property interests. Only Mexican banking institutions authorized and regulated under Mexican banking laws can serve as trustees. The trustee holds title to the property for the beneficiary of the trust, who retains the economic benefits arising out of the property. As trustee, the Mexican bank acts on behalf of the foreign beneficiary in transactions involving the property held in trust. However, the beneficiary retains the use and control of the property and, except for direct acquisitions, makes the investment decisions with respect to the same. This includes the decision to transfer such property interest to another foreign or domestic purchaser.

Previously, the maximum term of a trust was 30 years. At expiration, the foreigner had to transfer its interest in the land to a qualified person, presumably a Mexican national or a foreigner with the permission of the Ministry of Foreign Affairs. The original 30-year periods never expired since the new FIL has extended this term to 50 years, which may in turn be renewed upon further request. Renewal must be requested 90 working days prior to its expiration and is subject to compliance with certain requirements. Renewal is **not** a one-time event. It may be renewed for as many times as requested. On this issue, we have obtained an official opinion from the National Foreign Investment Commission.

## **2. Collateral on Real Estate**

### **2.1 Analysis of the mortgage and the guaranty trust as security devices in Mexico**

There are two main forms of collateral on real estate.

**2.1.1 MORTGAGE (“Hipoteca”).** The most widely used security device in Mexico is the mortgage. In fact, mortgages are most popular among domestic and foreign banks. They extend to the natural accessions of the mortgaged property, any improvements and fixtures, personal property permanently attached to the property which cannot be separated therefrom without damaging it, new buildings constructed by the owner of the mortgaged land and additions to the mortgaged buildings. The practical, but critical disadvantage to this form of collateral is that the borrower is the owner of the property and retains title to it.

The mortgage has to be executed in a public deed, before a notary public in Mexico and recorded with the Public Registry of Property office where the land is located in order for it to be valid against third party’s claims. Mortgage recording fees are determined by each state. Most states base the public register’s tax on a percentage of the officially registered value of the property. Recording fees, along with the notary’s fee and the state tax on notary’s signature, are the most relevant costs incurred when recording a mortgage. The amount of fees paid will not cap the creditor’s right to recover any amounts due under the loan, even when the value of the property has increased.

In the event of default under the secured loan, there is a special judicial procedure to sell the land, and the court delivers the proceeds of such sale to the creditor. Although the procedure is intended to be expeditious, there are always risks involved in a judicial collection procedure. Foreclosure on a mortgage in Mexico should not take more than two years.

Note should be taken, however, that should your borrower become insolvent, foreclosure on your mortgage will suffer delays. Although infrequently tested, under the new Mexican bankruptcy laws it now appears that it is no longer possible to isolate the mortgaged property from the assets of the bankruptcy. In addition, new laws provide

for suspension of foreclosure proceedings on any assets of the bankruptcy if the debtor has already been declared in *concurso mercantil*. This is a term applied to debtor before being declared bankrupt. Suspension will last until an agreement to repay the debt is reached between debtor and creditor/s (*Etapa de Conciliación*). The *Etapa de Conciliación* is an effort to avoid bankruptcy and may last a year from the date debtor was declared in *concurso mercantil*.

If the creditor attempts to foreclose after debtor is declared in *concurso mercantil*, it will need to do so as a creditor at bankruptcy proceedings. If properly recorded, your mortgage lien will take priority over all other credits at bankruptcy, except for certain unpaid taxes and past-due wages for the previous two years.

**2.1.2 TRUST (“Fideicomiso en Garantía”).** The trust is widely used for many different purposes, including that described in 1.1.2 above, and may be used as a vehicle to guarantee debts. Property and rights of all types may be placed in a trust as collateral. The greatest advantage of a trust is that once property is transferred into the trust, it is legally segregated from the rest of the debtor’s assets. Therefore, even when a debtor is facing bankruptcy proceedings, all assets previously transferred into the trust will be excluded from the bankruptcy estate. Likewise, any liens for unpaid taxes and past due wages of the debtor will not be paid out of the trust assets.

In this case, the debtor conveys the land to a trust created at a Mexican banking institution, which will act as trustee for the benefit of the creditor. We always advise our clients to consider its use, since we deem it as an efficient means of foreclosing on collateral without the need of suing in court, since in the event of a default under the secured loan, the trustee bank may sell the land privately by incorporating certain foreclosure procedures in the trust agreement.

Note that Mexican law must govern trusts. Also, trusts affecting real property must be recorded at the Public Registry of Property. Recording prevents a third party from claiming to have acted as a bona fide party without knowledge of the recorded item.

Trustee fees are usually fixed upon a percentage over the amount of the negotiation, which may range from .5% to 1%. However, as competition has increased among trustees, their fees are now permitted to be negotiated substantially down. Registration and Notaries fees are fixed and are based on pre-determined rates.

### **3. Title Insurance in Mexico**

With the signature of Nafta, the flow of investment funds from US and Canada into the Mexican real estate markets demanded the financial structures to be in place in order to furnish long term mortgage funds into real estate developments under the same familiar structure to the USA capital markets. Title insurance operates not as a replacement but as a supplement addition to the existing system. The element of risk control is now in place through title insurance policies. Title insurance companies as First American and Stewart Title Insurance Co., offer owner and mortgagee policies adapted from the American Land Title Association (“ALTA”) policy forms insuring commercial and residential properties throughout Mexico, including beachfront and border properties. Policies can be issued in either US dollars or Mexican pesos and can be written to insure any recognized land interest in Mexico including direct ownership, leasehold and trust or beneficial ownership. Basic coverage provides a purchaser/lessee of real property, or a lender secured by real property, protection against loss in the event that title to the property is encumbered or defeated by the interest of third parties not otherwise disclosed in the policy. Among the risks against which the insured is protected are the following:

- a) Mortgages;
- b) Mechanic’s and /or tax liens;
- c) Easements;
- d) Contractual obligations restricting the use of the property; or
- e) Adverse possessions by a third party.

We have excellent relationships with both insurance companies and would be more than glad to put you in contact with any of their representatives for Mexico.

#### 4. Mortgage vs. Guaranty Trust – Comparison chart

For your prompt reference, following please find a comparison chart on the Mortgage vs. Guaranty Trust:

<b>MORTGAGE</b>	<b>GUARANTY TRUST</b>
Most common form of security arrangement in Mexico.	Only used for large or complicated transactions.
The mortgage deed must be executed before a Notary Public and recorded in the Public Property Register.	The trust agreement must be executed before a Notary Public. If a transfer of title in real property is involved, the trust agreement needs to be recorded in the Public Registry of Property. Only Mexican banks may act as trustees.
Establishing and registering a mortgage is much less expensive than establishing and registering a Trust.	Trust fees may be higher than the cost of establishing and registering a mortgage.
A detailed description of the property must be included in the mortgage deed, including improvements and fixtures.	The trust agreement must only fulfill formal requirements to transfer title under Mexican law.
In an event of default under a mortgage, the mortgagee may foreclose and enforce the sale of the mortgaged property through a judicial proceeding. The mortgagor may bid in the corresponding public auction. Once the sale takes place, the mortgagee has the right to be paid from the proceeds of the foreclosure proceeding. If the proceeds are insufficient, a deficiency judgment will be rendered.	No legal action needs to be brought to sell the property in the event of a default by borrower. The trustee bank may sell the property privately and pay the outstanding debt to the lender from the proceeds of such sale. <sup>1</sup> New changes to the applicable law do not limit recovery on the value of the property, thereby permitting creditors to sue on deficiency.
The property remains in debtor's hands. Under the new Mexican bankruptcy laws it now appears that it is no longer possible to isolate the mortgaged property from the assets of the bankruptcy, therefore if creditor attempts to foreclose after debtor is declared in <i>concurso mercantil</i> , it will need to do so as a creditor at bankruptcy proceedings. If properly recorded, your mortgage lien will take priority over all other credits at bankruptcy, except for certain unpaid taxes and past-due wages for the previous two years.	Trustee becomes the new title owner of real property transferred in trust. Therefore, debtors' creditors are unable to reach the property to satisfy unpaid debts in case of debtor's bankruptcy <sup>2</sup> .
Creditor has no control over the property. The mortgagor retains possession of the mortgaged property and continues to use and exploit the mortgaged assets.	As trustee, the Mexican bank acts on behalf of the trust beneficiary. Therefore, the beneficiary retains control of the property held in trust, even when the grantor retains possession of the property and continues to use and exploit the trust's assets, pursuant to the trust agreement's terms.

<sup>1</sup> Mexican due process principles require care when drafting conventional sale procedures.

<sup>2</sup> However, under certain circumstances, a court may rule that the real property continues to be in the hands of the debtor (e.g., if the debtor is declared bankrupt retroactively, before the date that the trust agreement was established). Nevertheless, a body of jurisprudence exists to the effect that the debtor no longer has title once the property is transferred in trust and all formalities with respect to transfer of title have been met.