

## WHAT CAN AN AMERICAN BUY IN MEXICO?

The regulations on the sale of real property to foreigners are found in the Mexican Foreign Investment Law. An American (or any foreign national) can acquire land almost anywhere in Mexico with the permission of the Foreign Affairs Ministry. The only exception in the Foreign Investment Law is that foreigners may not acquire directly real property in the "restricted zone".

The restricted zone is the strip of land 100 km from the border and 50 km from the beach. If a foreigner wishes to acquire land in the restricted zone, he or she may enter into a trust agreement with a Mexican bank.

A Mexican company with foreign investment, even 100% foreign investment, may acquire fee simple title in the restricted zone as long as it is not used for strictly residential purposes. If the property is considered to be solely residential, the company must use a trust. The Regulations of the Mexican Foreign Investment Law state that residential real estate is real estate specifically to be used as a dwelling by the owner. The law provides a list of examples of real estate that seems residential, but is not considered as such by the law. According to the law, non-residential real estate includes, but is not limited to:

1. Time Share;
2. Real estate intended for both industrial, commercial or tourist use and residential use;
3. Real estate acquired by credit institutions in payment of debts;
4. Real estate bought by companies to be developed and sold. This would include apartments and residential communities; and
5. Generally, any real estate to be used for commercial, industrial or agricultural purposes, as well as, ranching, fishing, forestry, or to provide services.

The Regulations make clear that this list is not complete and that any questions of whether an activity is residential should be sent to the Foreign Affairs Ministry.

### Property Acquisition with Bank Trust

A Foreigner may not hold fee simple title to any land in the restricted zone. To purchase land in the restricted zone, a trust is necessary. In a trust, a Mexican bank holds title to the land while a foreign beneficiary has the right to use, enjoy, or even sell the land, and receive the proceeds. There are two principal steps to forming a trust: obtaining the trust permits and entering into the trust agreement.

To obtain a trust permit from the Ministry of Foreign Affairs, the parties must supply personal data, proof of title, and a description of the intended use for the property. The buyer must additionally agree to be considered as a Mexican with regard to his or her rights. This agreement is known as the "Calvo clause".

There is also a payment the buyer must make to the bank to act as the bank trustee. The standard rate that banks charge for a trust is approximately USD\$300 - \$1,000 per year. Trusts can be created for up to 50 years and may be renewed.

With the trust permit, the parties are ready to proceed to the transfer of title before the Mexican notary public. The notary needs various documents to transfer the title, including:

1. The previous title documents for the property;
2. A certificate of no tax liability. This certificate is used to prove that there are no outstanding property taxes nor other assessments on the property at the time of the agreement;
3. A certificate of no encumbrances. The certificate of no encumbrance shows that there are no liens on the property; and
4. An appraisal of the property. The commercial value of the property is used to compute property and other taxes.

## **The Notary**

Before a buyer can actually acquire real estate, he or she must go before a notary. For this reason, it is important to understand the role of the notary in the Mexican legal system.

Unlike American notary publics, all Mexican notaries are licensed attorneys. Notaries are also specially licensed by the state to insure the law is followed in certain transactions. They are held accountable for any transactions in which they are involved and can be held liable for any irregularities in the documents. Because there are few notaries and they are necessary for so many transactions, the notary is a prestigious position.

While the notary is a lawyer, it is not his or her job to advise the parties to a deal of any legal options they may have. As long as a document presented possesses all the legal formalities, it will be notarized and recorded. Notaries charge based upon an agreed table which varies according to the price of the property, but their fee can be in the thousands of dollars.

## **Acquisition Process**

Most real estate transactions have at least two steps:

The first step in purchasing property is the Promise to Purchase and Sell. The promise is a legally binding expression of the will of the parties to make a contract in the future. Admittedly, "promise" is probably the wrong choice of words, as a valid contract is formed. This agreement is especially convenient in the case of the American who wishes to buy real property through a trust and must wait for the paperwork. At the initiation of activities, the notary will file a notice which will put a temporary freeze on registrations of liens, ensuring the protection of priority to the buyer.

At the time of the Promise, the seller usually demands a deposit from the buyer to take the property off the market. The deposit is usually between 10% and 40% of the purchase price of the property. Mexican real estate custom does not include the use of escrow, which makes it more difficult to recover the deposit if the selling party backs out of the agreement. All the buying party is left with in such a situation is a lawsuit. We frequently recommend the use of escrow through a title company for the buyer's protection.

The second step is closing the transaction. The title to the property is transferred by the Definitive Purchase Sale Agreement. This contract must be in writing and recorded in the local Public Registry of Property. To record this agreement, the parties must go before a Mexican notary public.

Many Americans want to have title insurance on the property as a way to reduce liability. It is not common for Mexicans to possess title insurance, but there do exist companies that supply this, specifically for the benefit of Americans. However, this service is more expensive than the price that is charged in the United States.

The notary also withholds a number of fees and taxes. In addition to the notary fee, the notary withholds the income tax generated from the sale of the property, which is either a percentage of the gain or a percentage of the sales price of the property. Certain costs are most commonly borne by one party or another, but the parties are free to negotiate who will pay each cost. Customarily the buyer pays all transaction expenses, except the income tax owed by the seller. A ballpark idea on closing costs for the buyer can be around 4% - 5% of the purchase price.

In Mexico, inspections are not common, but are recommended in order to avoid future disappointments. Many times, real estate transactions are negotiated which state the sales price as less than the price that was actually paid. This is usually done to avoid or lessen taxes for the seller. Besides being illegal, this is not

a good idea. Any taxes avoided at the agreement stage will eventually have to be paid (at a higher rate) as capital gains taxes when the property is resold, unless the new owner continues to give the property an artificially low value.

## The Ejido

*Ejidos* are communal tracts of land, mostly agricultural in nature, which compose a large portion of Mexican real estate. *Ejidos* are considered to be the property of a whole community, rather than any single person. Members of the *ejido* (*ejidatarios*) hold partial title to the land; they can live and work on the land but they may not transfer it to another party. Before 1992, it was impossible for someone who was not an *ejidatario* to gain title to this land. The constitutional reforms of 1992 changed this rule and opened up *ejido* land, allowing it to be converted into private property.

Despite the reforms, buyers should be very careful when purchasing former *ejido* land as the pitfalls are numerous when transferring land from communal to private title. One should seek legal counsel prior to investing money on an *ejido* or former *ejido* property.

## MEXICO REAL ESTATE LAW: AN OVERVIEW

### Introduction:

Key of NAFTA. Gives US investors greater trust in Mexico.

Title Insurance increases confidence.

Mortgage financing and in some cases construction financing and equity development.

Searching for higher cap rates in Mexico.

Political Front. Election of Calderon, who will serve for 6 years has also given high optimism.

Real estate – many of the rules find their origin in the Constitution of 1917. More detailed rules can be found in the Mexican Foreign Investment Law and its Regulations. On line in English.

### The Restricted Zone:

100 kilometers (about 62 miles) from Mexico's international borders and 50 kilometers (about 31 miles)

from its coastline.

a) residential - use a trust; and

b) commercial – use a Mexican company. Regulations to FIL. High Penalty.

### **Ejido Property:**

The Agrarian Law of 1992 permitted the privatization of these communal farms.

No 99 years leases. Buying of possession certificates.

Privatization process, vote of 75% of ejiditarios. Hard to do. Then title is issued. Review this in the Agrarian Registry.

### **The Federal Zone:**

The federal maritime land zone consists of the first twenty meters of beach-front property on firm traversable ground. The twenty meter distance is measured from the high tide.

Free use and access to beaches.

You can obtain beach concessions. Important to ask for in due diligence.

2000 meter rule when property borders the beach area.

### **Water Rights:**

In Baja California common issue is dry river beds or washes (“arroyos”). (“Ley de Aguas Nacionales”).

Depending on size of the river bed, federal property can be 5 to 10 meters to each side. Important to review in the due diligence process.

### **Environmental Impact Study:**

In order to make a development, studies to be made with the Ministry of the Environment – rules can be found in Ley Gral de Equilibrio Ecologico y la Proteccion al Ambiente. Also state rules can apply.

Be sure to have enough time in due diligence.

**Trust:**

Fideicomiso. The 1993 new foreign investment law requires ownership of residential property through a trust, which requires a permit from the Ministry of Foreign Affairs.

Again, some recommend Mexican company. Also loses the chance of the income tax exemption on homes. Current corporate tax rate at 28%.

Asset Tax from 1.8% to 1.25%. Start Yr 4. Non-deductible. Amparo and lack of jurisprudence.

**Notaries:**

Very different from US. State law prohibits use of "notario publico" in

Texas to prevent confusion. Article at [pikofflaw.com](http://pikofflaw.com).

Expensive Closing. Budget around 5% for closing costs. Remember 2% of which is the transfer tax. Generally low property taxes.

## **Normal Structure**

Promise to Purchase Agreement. Down payment – escrow?

Closing before Mexican notary public.

Presales are common and pose a challenge. Builder uses your money to build your home. Hard to find construction financing. Delivery vs. Title issues and penalties.

Why High Mortgage Rates? Challenge for lenders:

- a) Labor Union Priority; and
- b) Tax liens.

Usual documents in closing:

- a) certificate of no liens;
- b) certificate of no debt;
- c) proof of water paid;

- d) preventive notice from notary public. Careful these can expire. Houston case; and
- e) Perhaps power of attorney – apostille stamp from Secretary of State in Austin.

#### Taxes

Corporate flat at 28%.

Sale of residence by foreigner is 25% of gross or one third of profits, you choose.

Declare full price in promise to purchase public deed.

## **USING AMERICAN FINANCING AND TITLE INSURANCE TO PURCHASE PROPERTY IN MEXICO**

With the changing of the Mexican Foreign Investment Law over the last few decades, many foreigners are now taking advantage of the opportunity to purchase real estate in Mexico. Homes and undeveloped land are being purchased at a rapidly increasing rate by citizens of the USA, Canada and other foreign countries. And with the ability to now obtain both financing and title insurance from American based companies, the transaction is much easier and less risky.

An American (or any foreign national) can acquire land almost anywhere in Mexico with the permission of the Foreign Affairs Ministry. An important exception in the Foreign Investment Law is that foreigners may not directly acquire real property in the “restricted zone”. The restricted zone is the strip of land within 100 km of the border and within 50 km of the beach. If a foreigner wishes to acquire land in the restricted zone, he or she may enter into a trust agreement with a Mexican bank in order to make their purchase. Since all of the Los Cabos and San Jose del Cabo areas of Baja Sur fall into this location, how does one purchase and finance their home or condominium or future building site in Baja Sur?

#### **Property Acquisition with a Bank Trust:**

A Foreigner may not hold fee simple title (in other words the actual title itself) to any land in the restricted zone. To purchase land in the restricted zone, a trust is necessary. In a trust, a Mexican bank holds actual title to the land while a foreign beneficiary, the purchaser, has the right to use, enjoy, or even sell the land, and receive the future proceeds. Certain requirements such as obtaining the trust permits and entering into the trust agreement, as well as paying required fees, must be undertaken in order to follow these laws.

## **The Acquisition Process:**

Aside from the use of a Mexican bank trust (fideicomiso) and the requirements of a Mexican Notario Publico, the process of buying either raw land or a house/condo in Mexico is similar to that typically found in the USA in terms of the ability to obtain both financing and title insurance.

Recently, several large companies have begun to offer financing in Mexico. These loans are typically collateralized by the real estate held in the trust, and usually do not exceed 70% of the value of the property. As with traditional purchases, a buyer should utilize the services of qualified and knowledgeable Mexico licensed lawyers, real estate brokers, lenders and title insurance companies.

Lenders will typically require that the property be appraised and that the title be searched to insure that the ownership is correct in terms of the Seller and any possible liens or other encumbrances. This is where having competent legal counsel comes into play. Also, the written documents used to sell real estate in Mexico are different than those used in the United States and elsewhere, so a competent real estate agent can help with those initial explanations when the process is first begun.

As mentioned above, American lenders will typically offer up to a 70% loan to value mortgage on a property in the Los Cabos and Baja Sur area, with shorter terms such as 2 – 5 years, although they may be amortized over 20 or 30 years, and may require minimum FICO credit scores. Different lenders have varying maximum loan amounts, with some lenders going as high as up to USD\$2,000,000 or more depending on the borrower.

Loans do have fees and potentially other pre-payment penalties or required documentation, so it is best to consider the qualifications and references of potential lenders to make sure they understand the Los Cabos market and have done business in that market previously. That way, you are hopefully avoiding potential pitfalls.

The advent of title insurance has been a real positive for foreigners buying property in Mexico. Many Americans want to have title insurance on the property as a way to reduce liability. While it is not common for Mexicans to purchase title insurance, many Americans, and their lenders, will require this added insurance. The use of a title company is also important in that it can provide escrow services so that the money paid for the purchase of a property is not distributed until the appropriate time, and after the appropriate due diligence and written documentation has taken place.

Also, when buying a condominium or a timeshare or other fractional ownership of real property, it is very important to make sure you and your lawyer have properly reviewed all condominium regimes, rules and

regulations and related documents as these will typically affect your legal and ownership rights. Many lenders and title companies will not be able to finance and insure your purchase until these documents have been finalized and filed of record into the public registry in Mexico.

## **Important Factors to Consider**

*Other areas of possible concern to be aware of when purchasing real property are:*

Make sure the Seller has the valid legal right to sell the real estate you are considering to buy;

Use a well respected real estate agent that is familiar with the Baja Sur area so they can tell you the pluses and minuses of your proposed purchase;

Use a lawyer that is licensed in the country of Mexico so that you can be sure that they understand all of the required processes to be followed when purchasing real estate, and that they are authorized to make all of the required government filings and other representations;

Use a lawyer that is fluent in both English and Spanish so as to save time and money during the process, as this will allow them to both interact with all required government officials as well as being able to properly and timely keep you informed as to the progress of your transaction;

Utilize the services of a title company, for both escrow services and title insurance, so as to protect your funds and your property both before, during and after your purchase;

Make sure the written sales documents state the full purchase price that you are paying for the real estate, otherwise you run the potential risk of violating the Mexican tax laws, and having possible tax complications and tax code violations when you later sell the property. A qualified lawyer, licensed in Mexico, can help explain this to you;

Ask about fees and expenses, of both your lawyer, real estate agent and other parties assisting you, as well as the required fees for filings, registrations and tax payments, etc. so that you can budget accordingly. Required government fees in Mexico tend to be higher than those in other countries such as the USA and Canada;

Use both the internet and later personal references for anyone that you might consider utilizing to help you in the transaction. While many people have been working successfully in the Los Cabos and

Baja Sur markets for many years, others are rather recent arrivals and may not know their way around as well as others.

## Conclusion

Buying real estate in Mexico can be a fun, exciting and profitable venture, if you utilize the services of qualified people and companies to help you achieve your goals. And remember, when it is all said and done, you'll have your own place to call home in paradise

## About the Author



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