

Welcome to Mexico



About Mexico

Officially United Mexican States, republic (1995 est. pop. 93,986,000), 753,665 sq mi (1,952,500 sq km), S North America. It borders on the United States in the north, on the Gulf of Mexico (including its arm, the Bay of Campeche) and the Caribbean Sea in the east, on Belize and Guatemala in the southeast, and

on the Pacific Ocean in the south and west. Mexico is divided into 31 states and the Federal District, which includes most of the country's capital and largest city, Mexico City.

Land

Most of Mexico is highland or mountainous and less than 15% of the land is arable; about 25% of the country is forested. Most of the Yucatán peninsula and the Isthmus of Tehuantepec in the southeast is lowland, and there are low-lying strips of land along the Gulf of Mexico, the Pacific Ocean, and the Gulf of California

In the south the deserts yield to the broad, shallow lakes of a region, comprising the Valley of Mexico, known as the Anáhuac and famous for its rich cultural heritage. South of the Anáhuac, which includes Mexico City, is a chain of extinct volcanoes, including Citlaltépetl , or Orizaba (18,700 ft/5,700 m, the highest point in Mexico), Popocatépetl , and Iztaccihuatl . To the south are jumbled masses of mountains and the Sierra Madre del Sur.

People

The great majority of the population are of mixed Spanish and indigenous descent and speak Spanish, the official language, as their first language. Various Mayan dialects are also spoken. Since 1920 the population of Mexico has had a very high rate of growth, almost entirely the result of natural increase; from 1940 to 1990 the population grew from 19.6 million to 81.1 million.

Below is a book that I wrote about investing in Mexico--Hope you find it interesting.

Beaches of Gold

Buying and Selling Real Estate in Mexico

John Fleming

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Introduction

My wife Margaret and I have been going to Puerto Peñasco (Rocky Point), Sonora for over 30 years. As the nearest beach community to Tucson and Phoenix, it has been a magnet for vacationing Arizonans since the 1920's. When we drove down in the late 60's and early 70's, we usually took all our food and supplies with us and went directly to the beach. To get there over the sandy roads, we had to let air out of our tires and then drive fast without stopping or else we would get stuck in the sand. We camped on the beach and stayed there; we saw very little of the town and learned virtually nothing about Mexican culture.

In 1994, with the passage of the North American Free Trade Agreement (NAFTA), this changed. Puerto Peñasco, which had been a fishing village for decades, had "fished out" most of the nearby waters, and so it was being encouraged by the government to phase out the fishing industry and begin to promote tourism. The number of restaurants and hotels began to increase dramatically, and developers started buying up land for large projects. The town's economy came alive; property owners began building new homes and renovating old ones. Growth was evident everywhere.

I have been a real estate broker in Tucson for over 20 years, and Margaret has been an agent. When we made a trip to Puerto Peñasco in 1994 after a gap of several years, we saw opportunities everywhere for real estate development, as well as tourism. We began to publish a one-page flyer with information about the community, which we distributed to real estate agents in Tucson. We met some Mexican people in Puerto Peñasco who became our friends, helped us buy property, and encouraged us to get involved in business.

One thing led to another, and we soon expanded our one-page flyer to a 4-page tabloid newspaper called optimistically *El Futuro*. We set up a marketing corporation and hired a local manager, Romeo Torres. The paper increased in size as we sold more ads. We met more Mexicans, made more friends, and learned more about the culture. It was enjoyable, educational,

and enriching.

At first I was hesitant to get into the real estate business in Puerto Peñasco because it wasn't well-regulated, and its reputation wasn't that good; there were some developers and agents operating without full knowledge of, or compliance with, the Mexican legal system. But I did start trying to learn the mechanisms of Mexican real estate. After 5 or 6 years, I decided maybe I knew enough to advertise openly for business. So we began putting ads for our real estate company, El Gato Negro, on our web site, www.penasco.com, and in our paper, which was now also called www.penasco.com. Margaret and I began teaching classes on buying and selling property in Mexico at a real estate school in Tucson. Romeo became our local Puerto Peñasco agent, discovering in himself a real liking and aptitude for real estate.

Americans trying to buy and sell real estate in Puerto Peñasco often have unrealistic expectations based on what they are used to. It is a severe culture shock for them to go from a big city to a small town, from long-distance high-tech communication to a direct face to face model of doing business, from computerized organization of data to boxes of paper files. Puerto Peñasco has moved rapidly into the electronic age within the last few years, but it is still a small town in many ways.

The information presented in this book is based on what I have learned from consulting with other professionals and from my own experience, which has been only in Puerto Peñasco. But I believe you will find it substantially true for Mexico in general. Much of what I now know has been internalized to the point that it's difficult to document precisely the contributions of others, but I want to thank especially the following people for their part in my education: Linda Neil for information on history, closing costs, and legal procedures; Armando Ramirez for helping me understand the Mexican legal system; Mitch Creekmore for the history and practice of title insurance; Bruce Greenberg for knowledge of appraisals; Rolando Ballesteros for the background of the ejido; José Amate for legal and title procedures; and Francisco Manzo Taylor for information on the title guaranty trust.

John Fleming
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Chapter I

Debunking Some Myths

If you go to Mexico, enjoy the beautiful sandy beaches, and experience an intense desire to have your own property there, you have a lot in common with many other Americans and Canadians. Buying property in Mexico can be a good investment, financially as well as emotionally, since Norteamericanos, as the Mexicans call us, enjoy approximately six times as much buying power in Mexico as in their home countries. Recent changes in the economy suggest that this may even be a conservative estimate. But many foreigners are afraid to buy property in Mexico. Often their fears are based on stories they've heard at third hand, or confusions between past history and present practice.

Here are some of the myths I hear most often, followed by an explanation of the facts of each situation.

1. Foreigners can't own real estate in Mexico.

NOT TRUE. In most of Mexico, Americans, or any other foreigners can own land outright with what's called fee simple title, the same kind we have in the United States. Only in the restricted zone—50 km. (31.05 miles) from the ocean and 100 km. (62.1 miles) from the borders—is it true that foreigners can't hold fee simple title. Puerto Peñasco is in that area, so these limitations apply.

Mexicans wanted to encourage foreign investment in their country, so in 1971 they developed the bank trust (*fideicomiso*) as a way for foreigners to buy residential property in the restricted area. I'll explain the bank trust more fully in Chapter II.

2. Americans can't own real estate unless they have a Mexican partner.

NOT TRUE. It used to be that for a partnership or corporation, foreigners had to have Mexican partners who owned at least 51% interest. This is no longer the case. Under the new Foreign Investment Law of 1993, a Mexican corporation—like ours—can be owned 100% by foreigners, and the corporation can buy and own any property with fee simple title, as long as its use is non-residential.

3. A bank trust is a lease agreement.

NOT TRUE. Under a bank trust the beneficiary (buyer) has all the rights of ownership: the right to buy, sell, lease, use, bequeath, improve, transfer, and encumber. A lease grants only the right to use. If a lessee makes improvements, such as building a house, on the property, that house belongs to the landlord. Nor can the lessee sell the property or borrow money on it. In Puerto Peñasco there have been in the past many long-term lease agreements for land. Before 1971 the Bank Trust was not available, and leasing was the only option for Americans. Apparently some of them were confused about the difference between a long-term lease and ownership; thus they built homes and made improvements on the land they were leasing. Under Mexican law, a lease must be renewed at least every 10 years. After the Bank Trust was initiated, some leases expired and the landlords declined to renew, which was their legal right. The tenants then lost the houses they had built. This frightened other Americans, who thought that their compatriots had had their ownership rights taken away, when in fact they had never possessed such rights. In many cases, however, the former lessees were able to regularize their situations by purchasing the property under a bank trust.

4. The Mexican government can take away foreigners' property at any time.

NOT TRUE. The bank trust is established by the government and gives foreigners the same rights of ownership as Mexican citizens. The only difference is that they never receive the actual fee simple title. It is held in trust for them by a bank.

When first established, the term of a bank trust was for 30 years only. In 1989 it was made renewable for another 30, and in 1993 the term was extended to 50 years, renewable for another 50. Not long ago the U.S. media featured a group of Americans in Baja California who complained that they were being "evicted" from their property. They had "purchased" homes in an upscale development in 1986.

What had happened was that a certain group of landowners got their boundary lines redrawn, then "sold" the land thus acquired to an unscrupulous American developer, who built the homes and offered them for sale to other Americans. These buyers went ahead with their purchases even though many had been warned that the developer's title to the land was in dispute and that litigation was pending. The courts eventually decided in favor of the Mexican landowners, and the Americans were dispossessed. In the U.S. it was reported that "the Mexican government" had taken away their land. In fact, it was simply the law being enforced.

A similar thing happened in Cholla Bay, a small fishing village just north of Puerto Peñasco, which grew up haphazardly before regulations were in place. Its spontaneous growth was part of its charm, but also the root of many problems. Before the bank trust was available, vacationers had to lease their land from Mexican owners. They often put up little fishing shacks; then gradually they built larger houses on land that they didn't own. Some of them believed that their land was in the Federal Maritime Terrestrial Zone, which extends back 20 meters from the high tide line, and belongs to the Mexican government. They stopped paying rent to the landowners. Years later, after a lengthy lawsuit, a Mexican court ruled that they had been on private land all along and thus owed thousands of dollars in back rents. Then the Mexican owners decided not to renew some of the leases for non-payment of rent. Although the Americans were outraged, the property owners were entirely within their rights. Again it was a case of the law being enforced.

The Phoenix and Tucson papers from time to time have published negative stories dealing with the alleged injustices to a few Americans in Cholla Bay. Most of these stories have been ill-informed and one-sided. In any country, including the United States, title discrepancies exist, lawsuits get filed, and in some rare cases, buyers lose property. Some Americans, I have noticed, have an irrational fear that the Mexican government can take away property at any time for any reason. This is absolutely not true. Other Americans are incredibly gullible and will pay over money to almost anyone if they believe they are getting a bargain. Rather than fearing the Mexican government, foreign buyers would do better to be wary of unscrupulous developers like the ones mentioned earlier.

Chapter II

Some Unfamiliar Terms and Concepts

Mexico has a complex and complete legal system and a court system based on models that go back for centuries. It is a civil law system, based on statutes, unlike that of the U.S., which is a common law system, based on precedents. Common law tends to be more flexible in its interpretation. Many U.S. and Canadian citizens have a very poor understanding of how the Mexican legal system works and make assumptions about the process of buying real estate that can lead to costly and troublesome errors. In order to understand Mexican real estate, we have to gain some familiarity with certain aspects of it that are unknown north of the border.

Notario

A *notario público* in Mexico is not the same as a notary public in the United States, although the names sound alike. In the U.S. anyone who can post a bond can pay a fee and become a notary public. But a *notario* in Mexico has to have practiced law for at least 5 years and must pass a very difficult examination. I hear that it's as bad as a bar exam and CPA exam rolled into one.

Notarios are appointed for life by the governors of each state, and there are very few of them (only 2 in Puerto Peñasco). In accordance with the Roman legal system, the *notario's* certification gives authenticity to legal acts and documents, such as contracts. He or she is a legal expert who can give advice to parties on how to comply with the law in whatever they wish to do, but can not litigate. *Notarios* close real estate transactions, in which their function is a combination of real estate lawyer and tax collector. Many other important legal transactions, such as forming corporations, must also be finalized before a *notario*.

In a real estate transaction, the *notario* investigates all aspects of the property—orders appraisals (city and state), checks to make sure the title is clear, draws up all the documents for the transaction, and calculates the taxes, which are based on the appraisals. The official contract of sale is drawn up, not by the buyer and seller or their agents, but by the *notario*. It is then recorded with the city registry. The buyers get a certified copy of the title for their records. Since the *notario* represents the government, buyers should hire their own real estate agents or lawyers if they need representation.

Bank Trust (Fideicomiso)

When a foreigner buys property in the restricted zone (100 kilometers, or 62.1 miles, from the border and 50 kilometers, or 31.05 miles, from the coast), which includes Puerto Peñasco, title to the real property is transferred to a Mexican bank, which holds it in trust for the foreign buyer as the beneficiary. Foreign buyers, however, have all the rights of ownership. What they own under a bank trust is the right of ownership rather than the real estate itself. It is good to be aware of this legal distinction, although in practice it makes virtually no difference. The beneficiaries of a bank trust may buy, sell, lease, use, bequeath, improve, transfer, and encumber the property.

It may help in understanding the bank trust to compare it with the deed of trust, a type of instrument used in the U.S. as security for loans. People who buy homes for cash receive their titles right away. But the majority don't buy for cash.

Under a deed of trust the buyer of a house has only "equitable title," or an equity interest, with the right to use but only a restricted right to sell, until the loan is paid off, after which the owner receives the actual fee simple title. Until then it is held by a trustee, usually a bank or title company. In Mexico the bank trust is also held by a trustee, the only difference being that the buyer never receives the actual title. Realistically, many homeowners in the U.S. never receive title to their properties either, because they sell or refinance their homes long before the 30-year term of their loan is complete.

At the time a foreigner chooses a piece of real estate, the bank will be instructed to purchase the land as trustee and seek the permit to do so from the Ministry of Foreign Affairs. The beneficiary of the trust has full use and enjoyment of the property. The bank, as trustee, is responsible to the government and sees that the terms of the trust are fulfilled, assuming the technical, legal, and administrative supervision of the agreement for the purchaser's protection, and charging an annual fee.

Initially, the trust was created for a 30-year term. At the expiration of the term, the trustee had to sell the property to a qualified buyer, another trust, or a Mexican citizen, and deliver the net proceeds to the beneficiary, thereby terminating the trust. On May 16, 1989, the government announced that all trusts would be extended for an additional 30 years with presentation of proper and timely applications. The new Foreign Investment Law of 1993 increased the trust's term to 50 years with 50-year renewals permitted.

Chapter III

American Attitudes

Jim Beam and three of his buddies were drinking in a bar one night and had the brilliant idea of driving their quads across the border and setting up a business in Puerto Peñasco renting them. So one Friday they drove across, parked their vehicles on the beach, and put up a sign saying, "RENTALS, \$25/HOUR." Business was a little slow at first, so two of them decided to take a ride down the beach. Unfortunately they had been drinking a lot of beer and were not very steady drivers. They rolled over the quads, putting both the vehicles and themselves out of commission. While they were being treated, Jim rented another quad to a guy on the beach, who took off and never came back. The fourth quad was confiscated because Jim and his friends had no corporation and hence no legal status to do business in Mexico.

This is an (only slightly) exaggerated situation, but I have met many, many Americans who seem to feel that they are on vacation as soon as they cross the border. This greatly hinders their ability to conduct any sort of business transaction.

Larry and Rita Marino had rented a beachfront condo in Puerto Peñasco for several

years. They decided to see if they could buy one. The owner of the one next door happened to be there one weekend when they were and told them he'd like to sell. The price was right, and they agreed to buy it. Rita asked when they could meet with a notario to close the transaction. The owner said, "Oh, we don't have to do that. It costs too much. Just give me the money and I'll hand over the title. That's how it's done in Mexico." Three months later Larry and Rita returned and found their condo occupied by another family who claimed to have bought it from the same owner. He had returned to the U.S. and could not be located.

I have found that there are several attitudes that cause problems for Americans who are trying to do business or buy property in Mexico:

1. Party mentality. "It should be possible to go on vacation in Puerto Peñasco and make some money on the side." Not likely. Jim and his friends made the mistake of trying to mix vacation with business.
2. Greed. "Great bargains in Mexico can be picked up like shells on the beach." Not true. They can be found, but it takes time and effort to make a sound investment.
3. Ignorance. "That's the way it's done in Mexico." Not if it's done right. People who say this are usually trying to cut corners. Buyers should always check the details of proposed transactions or engage a reputable professional to check for them.

Larry and Rita gave money for the purchase of property to a complete stranger without an office or an established business. They allowed their greed to overcome their business sense and failed to follow proper procedure or even to find out what the proper procedure was.

Buying Property in Mexico

If you are an American or Canadian wanting to buy property in Mexico, here are some tips for you.

1. When you arrive in Mexico, turn off your vacation attitude and turn on your business brain. You will do better if you aren't distracted by Margaritas and fun.
2. When buying property, do it right. In Puerto Peñasco foreign individuals can purchase residential property with a bank trust. A Mexican corporation can own property outright, but only for business purposes. These are the only two legal ways of doing it. (See Chapter XIII for information on forming a corporation.)

Chapter IV

Culture and Business

Many of us have had our lives enriched by the contact with another culture. Doing business between two countries can also be interesting and profitable. But there are times when misunderstandings can occur as a result of cultural differences.

Business Relationships

Two businessmen were trying to put together a transaction. The Mexican—we'll call him José—was to visit the office of the American, whom we'll call Sam. Sam invited José to come between 4:00 and 5:00 on a certain day, expecting that they would talk for an hour, and then, if all went well, arrange to get together again. This was Sam's usual way of operating.

What José understood was that he was to arrive at any time between 4:00 and 5:00 and that the two of them would spend some time getting to know one another, perhaps going out for a drink and maybe even having dinner together. That's how it would have been done in Mexico, where the ending time of an appointment would not be specified. So José arrived at 4:45, ready for a leisurely conversation.

Sam was annoyed because he had made another appointment for 5:00 and only had 15 minutes to talk to José. He felt that José was inexcusably rude to have arrived so late. José was taken aback that Sam was so abrupt with him, hurrying him away after only a few minutes. Sam had seemed so friendly when they made the appointment; José couldn't understand why he had apparently changed his mind about wanting to do business together and was now so rude.

Time

Americans believe that time is money. Most of our metaphors for time are financial. We make time, spend time, save time,

gain or lose time, and waste time. Real estate contracts in Arizona have a standard clause, "Time is of the essence of this contract." Simply put, this means that the parties to the transactions should do their parts as quickly as possible. We feel that if a business transaction takes more time than anticipated, we are losing money.

Mexicans think of time differently. A Mexican friend said to me once, "Time is free." Mexicans seem to feel that time is always there, like sand on the beach. Therefore there's no hurry about getting things done. Americans see this as a "mañana" attitude and find it very exasperating. For example, José saw no reason to arrive at his appointment exactly at 4:00, but Sam thought of the 45 minutes between 4:00 and 4:45 as wasted time and hence wasted money. Obviously there were deep differences in what each man expected from the other, which caused a promising transaction to go sour when they weren't fulfilled.

Schedules

A more trivial difference that can still cause some frustration is the matter of daily schedules. In the U.S. most offices open at 8:00 and close at 5:00. Lunch hour is from 12:00 to 1:00. Americans like to leave work early enough that they can spend the evening with their families. In Mexico, the afternoon meal is the one spent with families. Mexican businesses usually open later, take a 2- or 3-hour lunch break, and then stay open in the evenings. So let's suppose that Sam needed to get in touch with José in Mexico. He got to his office one morning at 8:00 and tried to call José, only to find his office not open yet. So he turned to something else on his agenda. Returning to the office after lunch he remembered José and again tried to call. This time José was on his lunch hour. Sam tried again at 3:00 and left a message for José to call him. When José got back to his office he didn't have a chance to call Sam right away, but at 6:30 he tried and was told Sam had left for the day. Next morning at 10:00 he called again, but Sam was in conference, and when José called back at 12:10, Sam had gone out for lunch. And so it went.

Attitudes

Mexicans often find U.S. business people impatient and pushy. They tend to want things done now. Mexicans are more willing to wait, to come back, to try again the next day or the next week. These feelings are tied to cultural concepts of the proper way to get from Point A to Point B.

Americans value directness. It's obvious to them that a straight line is the most efficient pathway. They may start by telling a joke or talking about the weather for a few minutes, but when doing a transaction, they generally like to get down to business right away.

Mexicans value relationships more than directness. They appreciate courtesy and subtlety. Their approach to a business transaction is to get to know the person they are dealing with, and perhaps his or her family as well. So it may take several meetings to arrive at the point of beginning to negotiate. Americans do a lot of their business on the telephone, since it saves the time and trouble of a face-to-face meeting. I myself will often spend half an hour or an hour talking to a potential client or a business associate on the phone, and I find that I can pretty well size up a person this way.

Mexicans, on the other hand, often seem reluctant to do business on the telephone. They apparently feel that unless they can look someone in the eye, a conversation has no real validity. This is probably related to the value they place on personal relationships. Or maybe the high price of telephone service in Mexico is why they seem to want to get off the phone in a hurry.

As an example of the value Mexicans place on courtesy, consider that if José asked Sam to do something and Sam couldn't do it, he would tell José NO right away. But José could never be so abrupt. If Sam asked him to do something he couldn't, José would consider it more polite to say yes and not do it than to refuse outright. Another Mexican would understand this and not expect it, but Sam would believe José meant to do it and would feel let down when he didn't. Or José might simply give no answer. This would perhaps cause Sam to see him as evasive and would generate distrust.

Obviously awareness of these differing cultural expectations can help all of us to understand each other better and thus do business more effectively.

Hacienda or Castle?

In Mexico huge imposing edifices are often located right next to small run-down homes or corner businesses. Americans, accustomed to measuring everything against their own customs as the norm, may see this as unwarranted laxity in zoning laws. Actually it reflects differences in our respective cultural attitudes toward land and home.

In the American tradition, which is based on British models, homeowners see their house as a

miniature castle seated in its own park. The land is thus very much a part of the estate, extending outward from the house into the neighborhood. And so we impose zoning ordinances and deed restrictions to keep our buildings in a given area as homogeneous as possible.

In the Mexican tradition, based on Spanish models, the park is inside the wall. The hacienda, a walled courtyard surrounded by a house, is an indoor-outdoor living area. Mexican homeowners apparently see real estate as extending from the walls inward, instead of from the walls outward as their American counterparts do. And so what's outside has less relevance.

Another possible reason for the difference in attitude is that Americans tend to see their homes as investments. In fact, a home is typically the American family's only investment. And so they look upon the character of the neighborhood as something that affects their home's value and hence the value of their investment. Mexicans, on the other hand, tend to see their home as a place to live, a retreat where they can shut out business concerns and enjoy their families.

Attitudes toward Title

Mexico puts great emphasis on original documents. Since copy machines are relatively recent as standard office equipment, the reason for this is easy to see. As an Arizona real estate broker, I know the importance of having original signatures on legal documents. I always used to have my clients sign multiple copies. But now faxed and photocopied signatures are being accepted as original in the U.S.

Not so in Mexico. A legal transaction must be finalized by the parties' signing before a notario. This guarantees the genuineness of the signatures.

Many Mexicans, I have found, thus believe that the title document is the legal title, and that if they have it in their possession, they have title. I may discover during the process of a transaction that a seller says she has title to a certain property, when what she has is a title document which may have her mother's or husband's or sister's name on it. Perhaps this is partly a linguistic problem. It might be better to ask, "Who is the legal owner of this property?" instead of "Who has the title?"

Earnest Money

In the U.S. it is customary for buyers to offer a sum of money along with an offer to purchase as a guarantee of their good faith. This sum is usually deposited into a broker's trust account or with an escrow company. The seller does not receive any money from the transaction until closing.

In Mexico, since there is no escrow as such, buyers often give earnest money directly to the sellers. If Americans are buying from Mexicans, this difference in expectations can cause problems. (See Chapter V for further discussion of real estate procedures.)

Chapter V

Differences between Real Estate in the U.S. and Mexico

The purchase of real estate in Mexico is not the same as in the U.S. Unfortunately many problems have arisen from the fact that Americans don't realize this. Foreigners often naively expect that buying a property in Mexico is just like buying one at home. Mexican sellers don't know what Americans are used to and are puzzled by some of their expectations. In some cities in Mexico there are Multiple Listing Services and organizations of real estate professionals, and this is true in Puerto Peñasco. Until recently, however, real estate, as an industry, has not been regulated.

I thought it might be educational for both Americans and Mexicans for me to describe the real estate industry and the process of a typical home sale in the U.S., as I go about it, having been a real estate broker in Arizona for over 25 years, and compare it with Mexican practices, as I have observed them in Puerto Peñasco. These practices are in the process of changing, but there is still some carryover from older small-town ways of doing things. In the past properties could be sold with a handshake because everybody knew everybody and knew whom they could trust.

Licensing

U.S.

In the U.S. real estate agents and brokers must be licensed. Regulations differ in detail from state to state, but are similar in intent. In Arizona each office has a designated broker who is

legally responsible for all transactions. Agents are responsible to the broker. To get a license, agents must undergo a criminal check, take a prescribed number of hours of course work, and pass an exam. To become a broker in Arizona, an agent must have been active for at least three years, take more required course work, and pass another, much more difficult, exam. Every two years agents and brokers take more hours of required course work to renew their licenses. Other states have similar educational requirements. Brokers are audited regularly by the state Real Estate Commission, and those found guilty of illegal or unethical practices can be fined substantial amounts, have their licenses revoked or suspended, and have criminal charges pressed against them.

Mexico

In Mexico there has been until recently no specific government regulation of the real estate industry and no licensing requirement. In Puerto Peñasco most of the people selling real estate are Americans, and their qualifications range from years of experience as brokers or agents to no experience whatsoever. Now the state of Sonora has instituted a requirement that all persons engaged in real estate brokerage, whether Mexicans or foreigners, must get a license by demonstrating their qualifications, undergoing a criminal check, and providing documentation of their legal status in the country. A course called the *diplomado*, which leads to licensing, is being offered for agents. It consists of over 100 hours of instruction in Spanish (though an interpreter is provided). This licensing program is intended to provide more accountability for clients and more protection for the public.

REALTOR® Associations

U.S.

In the U.S. the National Association of REALTORS® and affiliated local REALTOR® Associations promote professional standards among their members by offering courses, seminars, and printed materials to help the member agents. Local Associations of REALTORS® cooperate to sell real estate. Realizing that they can best serve their clients by advertising their properties to as many other agents as possible, they operate a Multiple Listing Service (MLS), which is an agreement among member real estate companies and agents that they will cooperate with each other in listing properties for sale, showing each other's properties, and sharing commissions. This organization, because of its large membership, also has political influence.

Mexico

Mexico has a national professional association, Asociación Mexicana de Profesionales Inmobiliarios (AMPI), which promotes professional standards and ethical conduct. Its membership consists of not only real estate agents, but appraisers, builders, and other real estate-related businesses.

In Puerto Peñasco there is a very active local organization called the Puerto Peñasco Association of Real Estate Agents (PPAREA) which was started in 2002, 4 years before the local AMPI chapter was organized. It is based on REALTOR® associations in the U.S. and has its own Multiple Listing Service, Policies and Procedures, and contracts and forms to be used in all kinds of transactions. Margaret and I were instrumental in starting this association, going from office to office to persuade agents to join. Since then we have served in various leadership roles in the organization.

Listing Agreements

U.S.

Most cities in the U.S. have what's called a Multiple Listing Service (MLS). This is a group of real estate offices who contract to share listings and commissions. When sellers list a property for sale with any one of the members of MLS, they are agreeing that any of the other member agents can also sell it and receive a commission. The contractual agreement is between seller and real estate broker, and between broker and other brokers. It has been a typical arrangement until fairly recently.

In the U.S. sellers usually sign what is called an Exclusive Listing Agreement, which means they are obligated to pay the agreed-upon commission to the listing broker, no matter who sells the property—the listing agent, another agent, or even the sellers themselves. The amount of the commission, which is negotiable, is included in the price of the property.

Mexico

Historically many Mexican listings have been what in the U.S. we call pocket listings. There is no signed contract between the seller and the real estate agent, and a sign on a property does not mean that the real estate agent actually has a listing. The seller just says, in effect, "If you find someone who wants this property, you have my permission to sell it." The agent says, in effect, "OK, I'll put this in my pocket and if I hear of anyone who wants to buy it, I'll let you know."

Even though the agent usually puts up a sign, the pocket listing can do a disservice to the seller because the agent has little motivation to advertise the property further and will probably not attract many buyers. The PPAREA now requires that all listings in its MLS must be exclusive; however there are still many pocket listings out there.

Multiple Listing Service

U.S.

In the U.S. each MLS maintains a computerized data base of properties listed for sale by all its members. When agents list a property, they fill out a form that includes a great deal of information about it and enter the data into the system. Other members have access to the data base through computer programs. So all members of the service can find out whatever they want about all listed properties. Recently, through a new electronic device similar to a Palm Pilot, agents can now access this information while out with their clients.

Mexico

Since 2002 there has been an MLS in Puerto Peñasco, but many properties still are not listed through it. If they are not, it is difficult to get information about properties or even to find out what properties are for sale. If a client wants, for example, a 3-bedroom house on the beach, the agent will have to rely on an informal network of contacts or perhaps drive down all the beaches in the area and count **For Sale** signs. While a search may not be totally comprehensive, the PPAREA MLS has made the situation much better than it has been, and it is steadily improving. There is now a solid foundation to build on.

Showing

U.S.

MLS members can lease or purchase key safes, which they usually use on homes listed for sale. Keys to the property are placed inside a key safe hung on the door, and agents have special keys that are programmed to open it. This keeps the sellers' homes secure but provides access for member agents.

Mexico

There are few key safes in Puerto Peñasco, so agents for buyers have to find sellers or caretakers and get the keys from them to show a property. Since many sellers are not full-time residents, it may be difficult to locate someone who has a key. More and more offices are putting their own key safes on properties, but this is not yet a standard practice.

Commissions

U.S.

The standard practice in the U.S. for sharing commissions is as follows: at closing the company that has listed the property for sale receives a percentage (usually 50%) of the commission agreed upon; the company that brings the offer from the buyer receives the balance (usually 50%). Each company then shares further, giving the individual agent a percentage (usually at least 50%) of its share.

Here's how it might work in practice. Let's say a house is listed by Henry Smith of Happy Realty for \$100,000 with a commission of 7%. Martha Baker of Felix Realty brings in a full-price offer from the buyers, which is accepted. When the transaction is closed, Happy Realty will receive \$3,500 and will give Henry a check for \$1,750. Felix Realty will receive \$3,500 and give Martha \$1,750. This sharing procedure is part of the contract between the companies, but the percentages will differ in each case because they are all negotiable.

Mexico

In the past in Mexico there has been no standard practice for paying commissions. Many sellers believe that they can set a price on their property that does not include a commission, expecting either that the buyers will pay it or that their listing agents will increase the asking price to make sure they receive a commission. Without a cooperative agreement to share commissions, the details of each transaction have to be negotiated individually. However, through the PPAREA MLS, agents who belong to the association can be assured of receiving the commission mutually agreed upon. Another difference from American practice is that since the government charges a value-added tax (IVA) of 10%, many companies add this to the amount of the commission they charge.

Selling

U.S.

When I work with sellers in the U.S., I start by doing a comparative market analysis on the computer to see what comparable homes have sold for in the recent past. Then I visit the sellers in their home for a counseling session. They show me around the house, pointing out all its best features and any problems that may exist. They are legally obligated, as I am, to tell prospective buyers about any defects they are aware of. I have the sellers sign an exclusive listing contract and fill out a disclosure form giving information about the property. Now I enter all the data into the MLS computer system. I get a set of keys from the sellers and put them in a key safe so that other Realtors can have access to the house. I put up a sign and advertise the property for sale. When a buyers' agent brings in an offer, I discuss it with the sellers and they either accept it, reject it, or write a counter-offer. Typically buyers and sellers do not meet and do not discuss prices and terms except through their agents.

Mexico

In Puerto Peñasco some of this procedure takes place, but often foreign sellers are not in town, and much of the counseling happens over the phone or by e-mail. Technology has made all this much easier. Because Mexico has not has a real estate industry as such until very recently, Mexican sellers are often reluctant to sign listing agreements, although agents typically put up a sign anyway. It is not unheard of for sellers, following Mexican custom, to ask agents for an advance payment on their sale or a bonus for signing a contract. This is not recommended.

Buying

U.S.

My first step when working with buyers is to sit down and counsel with them for an hour or two. I typically ask them to sign a buyer's brokerage agreement (See Chapter VIII). I also ask them for a statement of qualification from a loan company if they are planning to finance the purchase. Then I go to the Multiple Listing Service's computer program and search for any houses in the right price range and the desired area. I narrow down the possibilities to 10 or 12 properties. I preview them and eliminate any that are not suitable. Then I take the buyers out to see them. I note their reactions to each one so that I will know what not to show them if any future visits are necessary. Very often buyers find the house they want on their first trip. If not, I repeat the process until they do.

The next step is for the buyers to make an offer. In most transactions a large part of the money will be financed and so the offer is contingent upon the buyers' obtaining that financing. When they make an offer, the buyers have to include what is called earnest money, a substantial sum to indicate that their offer is serious. The money does not go directly to the sellers, but is deposited in the broker's trust account or with an escrow company.

Mexico

In Mexico the counseling process is, or should be, even more important than in the U.S. Buyer's brokerage is strongly recommended. (See Chapter VIII.) American buyers must realize that agents may need more time than in the U.S. to find suitable properties for them to look at. When an offer is accepted, Mexican sellers may expect buyers to give earnest money directly to them, which is shocking to American buyers who are used to the practice of no money changing hands until the final closing of the transaction.

Mortgage companies and mortgage brokers were virtually non-existent until a few years ago, and there was no secondary mortgage market. Thus financing was the province of the banks, which charged extremely high interest, effectively making financing impossible for a large part of the public. Nor was there proper securitization for loans; lenders could not foreclose and get their money back without going through a long judicial process, such as we had 75 years ago in the U.S. Financing for Mexican real estate is still not as readily available as it is in the U.S. but it is becoming more widespread, although it still takes longer and has less favorable terms on the whole.

Escrow and Closing

U.S.

After acceptance of the offer, the contract and the earnest money are deposited with an escrow service, a neutral third party that will process the entire transaction. Usually escrow is handled by

a title insurance company, which will check to make sure the title is valid and can be transferred free of any clouds or liens and encumbrances. All closing costs, including taxes, are calculated by the escrow company and itemized on the closing documents. After all of the paperwork necessary has been received from both buyers and sellers, they will go in to the escrow company, and sign everything required. Usually buyers and sellers go separately on the same day. The buyers deposit a cashier's check for the required amount. After the transaction is recorded (usually the next day), the sellers receive their check for the full price minus the costs of the sale and any liens that were outstanding. The real estate companies get their commission checks. The buyers get the keys to their new property, signifying official possession. Typically buyers write only one check, and the escrow company makes out checks for all the expenses of the sale.

Mexico

In Mexico real estate transactions are finalized before a *notario*. It should be remembered that he is not a representative of either buyer or seller, but represents the government of the state. The Mexican Constitution provides that foreigners who purchase Mexican property must agree to consider themselves as nationals before the Foreign Ministry. They must agree to adhere to the laws of Mexico and not to invoke the protection of their own government.

The practice of title insurance is relatively new in Mexico and not usually part of the transaction. The *notario* will check the current title but often does not go back to the original and all subsequent owners, and so buyers cannot be absolutely sure that their title is free of clouds or liens.

Financing has been virtually unknown for real estate transactions in Mexico, which are usually done on a cash basis, although this is in the process of changing. Closing costs in Mexico are substantial, sometimes as much as 20% or 30% of the cost of the property.

Often buyers and sellers meet with the *notario* at the same time to sign all the required documents, but the transfer of money to the sellers does not take place in front of the *notario*. It is handled outside by the buyers or their agents.

Unlike in the U.S., buyers may have to write several different checks--to the seller, to an insurance company, to an appraiser, to the *notario*, to the state. Sellers may also have to write several checks--to their agents, to the notario, to the government for taxes.

Escrow was an unknown concept in Mexico until very recently. *Notarios* handle some of the same functions that escrow companies do in the U.S. But they never keep clients' money, and although they collect their fees and the money to pay the required taxes, they don't pay other expenses for the parties. Now there are some escrow services available, mostly through American title companies, but they have not been used extensively. Partly this is because they are very expensive, and closing costs are already high.

Recording

U.S.

In the U.S. real estate transactions are recorded with county offices in the county where the sale takes place. This gives valid notice to the public of the sale. A transaction is not considered closed until it is recorded.

Mexico

Exactly the same concept has force in Mexico. Transactions are recorded in the Public Registry Office of the municipality in which the property is located.

Problems can arise when foreign buyers do not obtain an individual bank trust, but leave their property in the name of a developer. They may be told that there is a Master Trust for the entire development, but this is not sufficient to give them a legal remedy in case the seller defaults. They should wait to buy property until they can be assured that individual bank trusts are available.

Recommendations

I would recommend that any foreigners who intend to buy property in Mexico engage the services of a buyer's broker. Buyers' agents represent and are paid by the buyers, thus making it easier for them to obtain information about properties for sale and give better service to their clients. This concept has gained favor in the U.S. in recent years, and it seems even more appropriate in Mexico when buyers are dealing with a different language, a different culture, and a different legal system. (See Chapter VIII for more about buyer's brokerage.)

Chapter VI

Types of Ownership in Mexico

The Mexican Constitution vests ownership of all land, water, natural resources, and airspace in the Mexican nation. Therefore, land ownership is limited to surface rights. Mexico's constitution restricts or prohibits direct foreign ownership of land in the prohibited zones, which includes 100 kilometers along the border, 50 kilometers along the coast, and all of Baja California. (See Chapter II)

In Mexico there are four types of property:

A. Original property of the Mexican Nation, which consists of Parks, Forests, Volcanos, Marshlands, etc.

B. Property of the Mexican Nation by Decree (Article 27 of the Mexican Constitution of 1917), which consists of Minerals, Water, Oil, and the Federal Maritime Terrestrial Zone, a strip of land 20 meters back from the high tide zone along all the coasts. These all belong to the Mexican government, although concessions can be obtained for their use.

C. Social properties, which are either Communal or Ejidal. Communal properties are government lands—often the town squares and area surrounding a rural village, possession of which was established in pre-Hispanic times. These properties are not generally offered for sale. Ejidal properties were established in Article 27 of the Mexican Constitution of 1917 as an outcome of the revolution and represent probably 50% of all the land in the country. I'll discuss these properties in further detail later.

D. Private Property, which is like private property anywhere, and can be bought, sold, inherited, acquired by gift, or awarded by judicial decree. Many private properties are owned jointly by family members (*co-propiedad*). These are generally old titles with many, many heirs. Let's say that a Mexican bought a 2,000 acre ranch in 1850 and it has remained in the family. By now there may be 250 owners. *Co-propiedad* is private property, but certain steps must be taken to give legal title. If, say, a great-great-great-grandson wanted to sell such a property, he would have to obtain permission from the other 249 co-owners to sell; each has the right of first refusal. Or the property could be subdivided and title issued to each co-owner, but this is a costly procedure.

Ejidos

Ejidos (pronounced ay-hee-does) represent a unique type of property ownership unknown in the U.S. and Canada. Many foreign investors have run into trouble because of their lack of understanding of the *ejido* system, often enough to derail their entire projects. As you will see from the description that follows, trying to purchase *ejido* property can be extremely complex and time-consuming.

The word *ejido* is from the Latin *exitus* (exit), because in Spanish colonial times small Indian communities were located near the exits of large towns. These *ejidos* were villages surrounded by plots worked by individual peasant farmers, and they continued in operation through the period of the Revolution and the early years of the Mexican Republic.

In 1917 hundreds of millions of acres from the original Spanish land grants were expropriated by the government and classified as "*ejidal*." They were granted to communities for farming and ranching purposes, and registered as such with the National Agrarian Registry. The communities did not own the property, but were only entitled to use and work the land. If they did not, title could be revoked. Rights of usage passed from father to son, but could not be rented or sold. In 1936 a different kind of *ejido* came into being when the government, under President Lázaro Cárdenas, seized many large haciendas and began distributing the land to thousands of rural families, 49,000,000 acres by 1940. Approximately 1/3 of the population received land under this program. Many of these *ejidos* were organized as collective farms. The members of the collectives, called *ejiditarios*, had no absolute property rights, since the federal government retained ownership of the land. It is estimated that about one-fifth of the arable land in Mexico belonged to *ejidos* at this time.

In January of 1992, Article 27 of the Mexican Constitution was amended, and a new Agrarian Law was enacted, to permit the lease or sale of an *ejido* property. With these changes, the *ejidos* can now own the properties previously granted under the former Agrarian Law. They must go through a process known as *El PROCEDURE* (the procedure).

The *ejido* as a legal entity is governed by an *asamblea* (similar to a shareholders meeting) and administered by a board consisting of a president, a secretary, and a treasurer. Each member of the *ejido* has voting rights with regard to the use of the property, but all the real estate is owned by the *ejido* as a whole. The members, meeting as the governing body, are empowered to grant property rights for each parcel.

The real property of the *ejidos* is divided into three categories:

- Individual parcels
- Property for community development
- Property for common use

Individual parcels are those which have been assigned to each *ejiditario* through certificates issued and approved by the National Agrarian Registry. Neither the *ejido* assembly nor the *ejidal* commissioners may use these properties without the written consent of the title holders. These *ejiditarios* do not have fee simple ownership. They have the right to use a parcel exclusively, bequeath it to a family member, grant the usage to others, rent it, or transfer it.

Once an *ejido* property has been conveyed by the *asamblea* to a member, he or she can cancel its registration, have the parcel converted into private property, and register it as such. Then, and only then, can the property be leased or sold.

Privatizing *ejido* lands is a long process. An *ejiditario* may not sell his or her land to an outsider until the entire *ejidal* group goes through *El PROCEDURE* (The Procedure), a seven-step process that may take as much as five years to accomplish. After the *ejiditario* finally receives a deed, he or she may in turn sell to third parties, but only after notification to other family members, then to those who have worked the property for more than one year, then to other *ejiditarios* in the group, neighbors, and the *ejidal* government. These parties all have the right of first refusal, similar to *co-propiedad*. If they can't meet the terms of the sale within 30 days, they lose their right of first refusal. If the procedure is not carried out correctly, any transfer to a third party may be declared null and void.

Property for community development or human settlement includes such areas as the city center, school sites, and recreational facilities. These properties cannot be sold or mortgaged.

Properties for common use are those that are neither community property nor individual parcels. They cannot be sold or mortgaged, but under the new Agrarian Law, *ejidos* can enter into joint venture agreements with partnerships or corporations, mercantile societies, or civil associations. Such agreements must be approved by the Agrarian Reform Department and then also approved by the entire *ejidal* group. Prior authorization from the governing body is also required for leasing these properties. If the agreement is dissolved, the *ejido* can get back the property.

Problems can occur when American investors don't understand the complexities of the *ejido* system. A clear title can't be obtained on an individual lot unless the former *ejiditario* has gone through the privatization procedure. Another type of problem is exemplified by a potential client of mine. The parcel he wanted to buy had a valid title, but he found that there was still common use property owned by the *ejido* between the sea and what he thought was a beachfront lot, and the *asamblea* was planning to put up a taco stand on it.

Buyers also need to realize, when trying to buy the entire property of an *ejido*, that every member must privatize his or her individual lot before it can be transferred. To buy the community property requires the consent of the governing body. Aside from the practical difficulty of getting 40 or 50 or 75 persons to agree on anything, there is the logistical problem of notifying them of the meeting and getting them to vote. Since most of the *ejido* land in and around Puerto Peñasco is undeveloped, the owners do not live on their lots and must be sought out elsewhere. And then there will always be a few who can't be located. Some buyers have bought land from *ejidos*, thinking they had a valid sale; then suddenly an *ejiditario* has appeared, claiming that he or she never received notification of the meeting, or wasn't able to vote, and this is sufficient to throw a cloud on the title.

All these problems can be solved, but it takes research, legal advice, patience, organizational skills, and a great deal of time to get the job done. Prospective buyers should retain the services of a reputable real estate agent and/or a Mexican lawyer to check out legal details for them, obtain title insurance, and close their transactions through a *notario*.

Chapter VII

Contracts

I am often consulted by fellow Americans when they have problems with purchases they have

made. Unfortunately, they usually don't consult me until after their transactions have taken place. Here is an example:

Jane and Ted Arvey found what they thought was an excellent bargain on an RV park outside of Puerto Peñasco. The price was right, and the American real estate agent they bought it from assured them that they would have lots of business as soon as the season started. The contract was in Spanish, which they didn't understand, but the agent, who didn't know Spanish either, explained that it was a standard purchase contract granting them title to the property. The season came, but no business. Frustrated, Jane and Ted went to a Mexican lawyer and found out that what they had was only a lease on property that belonged to a Mexican landowner.

The moral of this tale is: be sure you know what you are signing. If you can't read Spanish, get someone to translate your contract, preferably a translator who is government-approved. Buying or selling property is too important to accept the word of a person anxious to take your money and make a profit. In every transaction I have done in Mexico, the *notario* has always explained everything in the contract; it was his or her legal obligation to make sure I understood.

There is some question about whether a contract in English is valid in Mexico. It may be enforceable if both parties to the transaction know English, but the legal language of the country is Spanish, and a contract in that language will always take precedence.

Many of the purchases Americans make are problematic because the contracts they sign are imperfect. So let me review some details about contract law, which has fascinated me all these years.

A legal real estate contract has 5 necessary parts:

- Competent parties
- Lawful objective
- Offer and acceptance
- Legal description of the property
- Consideration

Competent Parties

This is usually defined as "being of legal age and sound mind." The intent is to insure that buyers and sellers are capable of understanding what they are promising. So a child or a retarded person would not be considered competent. In some cases a person under the influence of an excessive amount of drugs or alcohol or a mental illness might also be deemed incompetent. In Mexico another factor comes into play—language. A person who doesn't understand Spanish, the legal language of the country, no matter how mature or intelligent, is not competent in any practical sense. Jane and Ted are examples.

Lawful Objective

This means that contracts can be voided if it is discovered that the intent has been to set up a drug business, a house of prostitution, or some other illegal operation. If one doesn't own a property, it can't be lawful to try to sell it. Yet this is done all the time.

In Arizona in the early 1960's many dishonest developers sold lots in fictional subdivisions, often sight unseen, to investors in other locations. Some of these lots turned out to be nonexistent, or under water, or 50 miles from any infrastructure. The practice was such a scandal that it resulted in a number of statutes being enacted that now regulate real estate in Arizona very stringently. The governments of Puerto Peñasco and of Sonora are working to develop similar regulations. (See Chapter XII for more information on Mexican subdivisions.)

Offer and Acceptance

In practical terms, this means that a contract must be signed by both parties. It sounds elementary, but several years ago a friend of mine was threatened with a lawsuit by a company which claimed that he had agreed to buy a certain service. When I examined his contract, I found that while he had actually signed it before changing his mind, the company offering the service for sale had only a printed name on the contract, and no signature from an official representative. Thus it was not legally binding. A contract must also have a date when it takes effect and usually specifies the place where it is signed.

Legal Description

Legal descriptions can take several different forms. In the U.S. metes and bounds, lot and block, and government survey are all used. In Puerto Peñasco the first two are also used, but whatever the method, the key is that the property must be readily identifiable. So a specific street address in a specific community may be sufficient even if it doesn't take the prescribed form.

But not too long ago I saw a contract for a property in Las Conchas (a residential development in Puerto Peñasco) that was identified only as Lot 1 of Section 2 in Sonora, Mexico. I contend that this could not be a valid legal description since there might be Lot 1 of Section 2 in any number of cities in Sonora, perhaps even in another part of Puerto Peñasco.

In Mexico what Americans call a block is called a *manzana*. In the legal description it is customary to identify the lots to the north, south, east, and west of the subject property, with their length in meters, and to specify the square meterage of the entire property.

Consideration

Consideration accompanies a contract as an evidence of good faith. Although it can take the form of a promissory note, another piece of property, an item of value like a car or boat, or even such an intangible as "love and affection," it usually means money.

Protection with Contracts

When I was a boy in a small town in Minnesota, I knew adults who said proudly, "My word is as good as my bond." This meant that if they promised to do something, it wasn't necessary to sign a document. The security was in the size of the community, where everyone knew everyone, and reputation was all-important.

When Puerto Peñasco was a small fishing village, the same attitude prevailed. Transactions could be consummated with a handshake—no need for a written contract. But when Americans started coming in and buying real estate from Mexicans, the situation changed. Not only did sellers and buyers not know each other, but they were often operating on a whole different set of expectations and assumptions. Problems were sure to arise.

When I became a real estate agent in Tucson in 1978, the standard purchase contract was only 1 page long. Almost half of it was blank for us to fill in our own details. Now Arizona has a 9-page contract that covers (or attempts to cover) every possible contingency. There are no more blank spaces, just boxes to check. The community is bigger; people know each other less and less; there are more dark places for dishonest people to hide; hence there's less trust, and more safeguards are necessary.

John Doe knows that his word is good, but Richard Roe, who never met him, doesn't. And so Richard demands a signed contract for any business negotiations he has with John. John may then feel insulted because Richard is implying that he is a person who can't be trusted. Richard is actually implying nothing of the sort. He just doesn't know whether John is trustworthy or not, and so is taking steps to protect himself. The value of a written contract is that it is clear and enforceable, whereas interpretation of spoken words is always flexible.

I've run into situations in Puerto Peñasco, where people think their honor is being questioned when I ask for a written contract. I wish I could convince them that I'm not trying to insult them. I just want to do things in a businesslike way—for everybody's protection. Mikhail Gorbachev's motto seems appropriate: "Trust, but verify."

Let's look at some examples that show how lack of contracts can be damaging.

Howard and Maud Jones, an American couple, ask Ernesto Gonzalez to find them a house to buy in Puerto Peñasco. They tell him they will pay him \$1000 for helping them buy the property. Ernesto spends several weeks intensively looking for properties and finds several that meet the Joneses' needs, which he takes them out to see. The Joneses say they'll think about it and get back to him. A few days later Ernesto finds out that they have bought one of the properties directly from the owner, so he gets nothing for his trouble.

Pablo Garcia tells Dora Smith that a friend of his has a house he will sell for \$40,000. Dora agrees to buy it and gives Pablo \$5,000 as a down payment. Two weeks later, Pablo tells Dora the price has gone up to \$43,000. Dora agrees to pay the increased price. Several weeks later when Dora comes in with the money, ready to close the transaction, Pablo says the price is now \$48,000. Dora gets angry and says she won't buy. She asks for her \$5,000 back. Pablo says he will get her a check. He doesn't do so. Weeks go by. Finally, when Dora threatens legal action, Pablo gives her a check. It comes back marked "Not Sufficient Funds."

In both these cases there's obviously a lack of honesty involved. But, without a contract, even perfectly honorable people can find themselves in awkward situations. Consider the following scenario, with variations:

Arnulfo agrees to sell Bill a certain lot. The price is \$90,000 pesos, and the exchange

rate is 9:1, which is \$10,000 in American dollars. As a down payment, Bill gives Arnulfo \$1,000, which he uses to pay taxes due on the lot.

Here are some possible ways things could go wrong without either party's intending to injure or defraud the other:

Misunderstanding

At the time of closing the transaction, Bill gives Arnulfo \$9,000. Arnulfo says the amount due is \$10,000. Bill says, "But I already gave you \$1,000." Arnulfo says, "That was to pay the taxes; it wasn't part of the purchase price."

Different Expectations

1. Bill makes it a condition of buying the property that Arnulfo clear off a large quantity of trash that has been dumped on it. Three weeks go by, and Arnulfo hasn't yet cleared off the lot. Bill decides that since he hasn't performed, the agreement is dead. Arnulfo says, "But I wasn't going to go to all the trouble and expense of clearing off the lot until you paid me the rest of the money." Bill says, "I wasn't going to pay you until the lot was cleared off."

2. At the time of closing the transaction, Bill is charged for the bank trust and the entire notario's fee. He asks, "Doesn't Arnulfo have to pay half of these fees?"

Changed Personal Circumstances

1. Arnulfo dies, leaving the lot to his brother, César, who decides he doesn't want to sell. Bill says, "Give me back my \$1,000." César says, "You made the agreement with Arnulfo, not me. I don't owe you anything."

2. Bill dies. His heir is his daughter, Denise. She refuses to go through with the transaction. Arnulfo has already spent \$1500 putting in an electrical pole.

Changed Economic Circumstances

The exchange rate changes to 10:1. Bill now wants to pay only \$9,000 in American dollars for the lot.

Changed Legal Circumstances

1. Arnulfo discovers that the lot is actually owned by him and his sister jointly. She lives hundreds of miles away. He pays for her transportation to come and sign the official documents. Meanwhile Bill gets tired of waiting, finds another lot, and buys it.

2. Arnulfo discovers that, due to a clerical error, the lot is registered to him as owner, but also to another unrelated person. He is therefore unable to sell at all. Bill asks for his \$1,000 back, but Arnulfo has already spent it.

In each of these cases one or the other party suffers a loss of money or time or both. If Arnulfo and Bill had had a written contract, with amounts, terms, and expectations all spelled out, these disasters could have been avoided.

I have seen contracts that are only personal agreements between individuals, lacking some of the essential components of a contract. Many are incomplete, inappropriate, or just plain sloppy. It would be a good idea for all potential buyers to read their contracts carefully, have them reviewed by a reputable real estate broker or attorney, and demand explanations or clarifications when necessary.

In both the U.S. and Mexico if sales are not properly processed and recorded, it is questionable whether the buyers have valid titles. If buyers of residential property in Mexico don't have a bank trust and haven't had their transaction processed by a *notario*, taxed, and recorded, the power of their ownership is diminished. If there are challenges to their rights of ownership, some of these questions may have to be decided in Mexican courts.

The contract drawn up by the *notario* in a real estate transaction is the official document that authorizes the transfer of property rights. But real estate agents and developers often use their own forms as preliminary documents to spell out amounts, dates, and expectations. PPAREA has developed a series of bilingual contracts and cost sheets, using the best ideas from both Mexican and U.S. practices. Hopefully, these will make real estate transactions easier because everyone will know exactly what to expect. (See Appendices)

Families know each other; close friends and small communities know each other; people brought up in the same culture have similar expectations. But nowadays we live in a global community. Differing cultures, economies, currencies, languages, and expectations make it more necessary than ever that we put everything in writing, so there will be no unpleasant surprises. This will preserve good will between people and their respective countries.

Chapter VIII

New Mechanisms for Buying Mexican Real Estate

The state of Sonora is attempting to accommodate foreign investors in the real estate industry. In concert with U.S. title companies, banks, and appraisers, it is simplifying the process of determining property values, which will make it easier for buyers to purchase property and for lenders to make loans.

Regularization

In 1990 the Sonoran state government decided to regularize the situation of Cholla Bay (see Chapter I), and since the bank trust was now available, Sonora started working with the original Mexican landowners and with the Cholla Bay residents to have them all become legal owners. By 1997 this was almost accomplished. About 90% of the residential units had bank trusts issued, and another 5% allowed themselves to be bought out. Apparently the great majority were satisfied with the regularization of their ownership.

Financing

Real estate loans have not been widely available in Mexico, although some large developments have provided their own financing. There are two main reasons for this. One is that lenders have had no feasible way of protecting their interest in the event of default. Judicial foreclosures have been available but because the courts were involved in the process, they could take years. But now an instrument called a title guaranty trust is becoming more widely used. The other is that title insurance has not been available, and banks have been unwilling to take the risk of lending without it. But now both these practices are becoming more widely used, and hence financing is more feasible.

Guaranty Trust

In the U.S., judicial foreclosure on a mortgage used to take up to two years. To remedy the problem, Arizona and California legislators designed the deed of trust, which speeded up the process and is now widely used. With a deed of trust, in case of default lenders can take back a property in 90 days. Now Mexico has a similar instrument called the title guaranty trust, which can be used both by Mexican banks and U.S. lenders for loans to U.S. citizens on Mexican properties. This is making real estate financing more available to citizens of both countries. The buyer and seller must designate a Mexican bank to act as trustee. If the buyer defaults on loan payments, the seller notifies the trustee, who has the authority to sell the property without resorting to a judicial sale. The process takes about 6 months. If buyers are obtaining financing from outside Mexico they are required to have title insurance in order to obtain a guaranty trust. Because of the greater ease of enforcement, guaranty trusts are expected to be more widely used than mortgages.

Title Insurance

It is now possible to get U.S. title insurance on some Mexican properties. While this costs more and takes longer, it may be worth it to American buyers to ensure peace of mind. Title searches in Mexico are usually done through a Mexican law firm. The attorneys verify the owner and search for liens, encumbrances, and anything else that could affect the title. Since Mexico's registries are not automated, this can be a lengthy process, taking approximately eight to ten weeks, as opposed to one to five days in the United States. After the search is completed, the Mexican law firm prepares its legal opinion of status of title, which will include owner of record, easements, liens, restrictions, and anything else pertinent to the property ownership. The closing of the transaction is done in the office of the notario.

Computerized Property Valuation

Access to public records is taken for granted in the U.S., but comparable sales are not readily available to the public in Mexico. The state of Sonora and the city of Puerto Peñasco are developing a public registry and a computerized system for recording data on property sales. Together with the PPAREA's MLS database, it is increasingly possible for real estate agents to do valid comparative market analyses and determine fairer and more

consistent pricing.

Buyer's Brokerage

The concept of buyer's brokerage is becoming increasingly familiar in the United States. To understand it fully, we need to go back and look at some history in the real estate industry there. Under the typical Multiple Listing Service (MLS) system, when sellers list a property for sale with any one of the members of MLS, they are agreeing that any of the other member agents can also sell it and receive a commission. The contractual agreement is between seller and real estate broker, and between broker and other brokers. It has been a typical arrangement until fairly recently.

What many buyers never realized was that under this system, the real estate agents who helped them buy property were actually sub-agents of the sellers' agent. Thus their primary loyalty was to the seller, not the buyer, no matter how helpful they were or how involved they became with the buyer. So sellers had one primary agent and a host of sub-agents representing their interests, but no one was officially representing the interests of the buyer, even though agents are ethically obligated to treat all parties fairly in a transaction.

The real estate community in the U.S. has become increasingly aware of the problem of lack of representation for the buyer and so in many places has instituted the practice of buyer's brokerage. Under this arrangement, buyers contract with an agent who agrees to represent their interests exclusively.

In Mexico buyer's brokerage is even more important than in the U.S. since purchasers are dealing with a different culture, a different language, a different legal system, and different expectations. I usually charge buyers 10% of the purchase price to represent them. This is not too much to pay, since representation educates them, protects them, and ensures a high level of service.

Chapter IX

Taxes

Income Tax

Mexico's tax law states that:

- Individuals who are residents of Mexico are obligated to register with Hacienda (the Mexican equivalent of IRS) and to report their income, regardless of the source.
- Individuals who are residents of a country outside Mexico must declare any income generated in Mexico.

It is not required to pay taxes in two countries on the same income. But taxes paid on Mexican income can in some cases be deductions on U.S. and Canadian returns. Check with your tax accountant to determine how to declare these foreign tax payments.

Facturas

In order for any authorized expense to be deductible, the taxpayer must obtain an official receipt which is known as a *factura*. This receipt must be printed by a government-authorized printer and contain the taxpayer ID number of the individual or company issuing the receipt. Be sure to ask for a *factura* when buying materials or hiring labor for property improvement. Some companies will charge a little more for a *factura*, but it is necessary to have them for calculating the amount of tax due on a sale of property or for use in the event of a tax audit.

Capital Gains Tax for Sellers

Capital gains tax (*impuesto sobre la renta*) is a large part of the closing costs on a real estate transaction. At the time of this writing, the foreigner who sells a property in Mexico must pay either 20% of the appraised value of the property at the time of the sale or 35% of the net profit on the sale, whichever is less. The amount is determined by having an official appraisal done for every real estate transaction. While the appraisal is not mandatory, notarios use it as a way to be fair and consistent.

If the seller elects to use the 20% figure, it is calculated on the basis of the appraisal done at the time of the sale. The 40% calculation is a bit more complicated.

AV1 = the appraised value at the time of purchase

AV2 = the appraised value at the time of sale

Imp = improvements made during ownership

C = costs of the sale (notario's fees, real estate commission, etc.)

TA = taxable amount
T = tax due

The formula then is:

$$\mathbf{AV2 - AV1 - Imp - C = TA \times 35\% = T}$$

When I first wrote this as an article in *El Futuro* (now www.penasco.com), I was trying to help my readers understand the two different ways of calculating these taxes. In order to do this I constructed two fictional scenarios in which American buyers had bought and then sold properties.

Case of Raymond and Susan Mason

Raymond and Susan Mason bought a property twelve years ago that was appraised for \$50,000. They have spent \$20,000 on improvements since then. The appraised selling price is \$300,000. The commission, notario's fees, and closing costs add up to \$30,000. If they elect to pay 20%, their tax will be \$60,000. Using the formula, they will have to pay \$80,000.

$$\mathbf{\$300,000 - \$50,000 - \$20,000 - \$30,000 = \$200,000 \times 35\% = \$70,000}$$

Therefore Ray and Sue will be better off using the 20% calculation.

Case of Bill and Marcia Brown

Bill and Marcia Brown bought a house 4 years ago for an appraised price of \$100,000. They have made \$30,000 worth of improvements, and their appraised selling price is \$250,000. Their sale costs are \$30,000. 20% of \$250,000 is \$50,000.

$$\mathbf{\$250,000 - \$100,000 - \$30,000 - \$30,000 = \$90,000 \times 35\% = \$31,500}$$

Bill and Marcia will be better off using the 35% calculation.

After this was published, I received a letter from Ing. Pablo de Garay y Coca, I.C., M.A.E., of the Mexican Institute of Cost Evaluation of Sonora, A.C. in which he pointed out to me that I had failed to take into consideration the following factors:

- Devaluation of the peso in 1993
- The effect of inflation
- The amount of depreciation of the property

He went on to say that the sellers would save more than \$20,000.00 if the calculations were done properly.

Obviously I oversimplified too much in trying to make my point, and I greatly appreciate his having taken the trouble to correct me.

It is clear to me from his analysis that calculating taxes is a complex matter that should be done by a professional. *Notarios* have computer programs that do the job of computing taxes, and they know that fiscal depreciation and inflation must be part of the computation. It might be a good idea, however, for buyers to have their own accountants.

Caution

Discrepancies and problems occur when false figures are used to try to avoid payment of taxes. Under-reporting the value of a piece of property is sometimes done in Mexico because it saves both the buyer and seller money in transaction taxes. Not only is this illegal, but it can result in catastrophically high capital gains taxes when the buyer subsequently decides to sell the property. Determining the real value of a piece of property, however, is not always easy. Appraisals must be formulated by professionals and supported by documentation, as required by the government.

Chapter X

Closing Costs

Closing costs can range from 7% to 30% (yes, 30%) of the total cost of the property. These costs include title search, transfer taxes, government permits, and *notario* fees, as well as the costs of bank trusts, title insurance, and real estate commissions. But it is essential to pay the necessary costs to obtain a registered title when buying property or trust rights to Mexican property. I have found it difficult to estimate exact closing costs, since they vary so widely from one

transaction to another. Some *notarios* apparently lump together some of the smaller fees and provide only a total amount due. Others itemize more carefully.

Acquisition or Transfer Tax

The buyer's major cost is the Property Transfer Tax, 2% of the value of the property, minus allowed deductions.

Official Appraisal

The appraisal is made by a government appointee, often an architect. The cost will range from \$250 to \$1,000 per parcel, depending upon the value of the property. It includes both the fees charged by the property tax department for authorizing the appraisal, and the fees for the appraiser's services.

Bank Trust

If the seller already has a bank trust on the property being purchased, the buyer will pay only the costs for assignment of the beneficial rights, bank transfer fees, and registration in the Foreign Investment Registry. The charge for registration is approximately \$350 and is required for all transfers of trust properties.

If the property is not under a bank trust, it will be necessary to acquire a permit from the Secretary of Foreign Relations to establish one. The application for the permit must indicate the proposed usage of the property. If the property is a vacant lot, the request should include a general development plan, the amount of money being invested, and the estimated time frame in which the investment will be made. A permit for a new 50 year trust is currently approximately \$1,120. It increases slightly on the first day of January and the first day of July of each year.

Bank Administration Fees

If title to the property is in a bank trust there will be annual fees for the administration of it. They will generally range from .05% to 1% of the value declared and be subject to reappraisal of the property each year or two. Banks generally do not send annual statements, so it is often necessary to request the bill for fees from the trustee bank each year and to pay on time to avoid penalties. The amount of the fee is generally mentioned in the trust document.

Title Search

A title search will generally cost from \$500 to \$3,000 and will show history of the property, any existing liens, easements, and other pertinent details. It is required for any type of institutional financing or title insurance. If a search has never been done, there will be no history of the property on file. Thus it may be necessary to go back through a great many transactions over the course of years, which can be a very expensive and time-consuming process. Older, commercial properties that have been subdivided, resubdivided, and transferred many times can be especially problematic. In Puerto Peñasco the records go back only to 1980. Those for prior years are stored in Caborca, and so a trip to that city may be necessary.

The most disconcerting factor about a title search is that it is almost impossible to predict how long it will take and how much it will cost. The legal firm which does the search will often ask for a deposit in advance.

Buyers should recognize that there may be instances in which problems cannot be cleared up and title insurance cannot be obtained. It's necessary to do the best you can and then hold your breath. The good news is that as more and more title searches are done, a data base is being built up that will make future searches easier and less expensive.

Title Insurance

Title insurance, now available through both Mexican and U.S. companies, generally will cost \$7.00 to \$7.50 per \$1000.00 of the purchase. The cost is usually included on the face of the policy.

Capital Gains Tax

The seller's major cost, the Capital Gains Tax is the lesser of 20% of the gross or 35% of the gain, minus the improvements made, commissions paid, and other allowable expenses. The formula is complicated, and the tax should be calculated both at the 20% and at the 35% levels in order to determine the lower amount. (See Chapter IX for more on this tax.)

Property Taxes

Property taxes must be brought current before the property can be sold. This usually means that taxes must be paid before the time of closing, not concurrently as in the United States. It may even necessitate an extra trip to Mexico for the sellers.

Federal Maritime Assessment

As mentioned in Chapter VI, the Federal Maritime Zone belongs to the Federal government and cannot be sold. But there is a fee for the concessions granted for its use. The cost is about \$7 per meter per year if the property is unimproved, about \$23 per meter if it has improvements built on it. This assessment must also be brought current before the property can be sold.

Settlement Costs

These fees are for services provided and include: supervision and coordination of permits, tax payments, and other details necessary to obtain full legal title. These fees are generally based upon the purchase price of the transaction.

Notario's Fees

All real estate transactions must be finalized before a Mexican *notario público*. His or her duty is to draft the deed and to confirm the validity of signatures. The persons signing before him or her must prove that they are who they say they are. The *notario* is also responsible for the calculation of buyer's and seller's taxes. *Notario's* fees are based upon a rate schedule and are tied to the amount declared in the official appraisal. These fees can range from \$500 to several thousand dollars depending upon the declared value of the property. They are usually shared by buyers and sellers.

IVA

IVA (*Impuesto sobre Valor Agregado*) is a value added tax, currently 10% of the value of goods and services in Puerto Peñasco. In other parts of Mexico it may be 15%. IVA must be paid on fees charged by the real estate agent, the *notario*, the appraiser, and any other professionals whose services are being used in the transaction.

Other Fees

Other, smaller fees that may be charged are (for buyers) Foreign Investment Filing Fee, *Apostille*, UCC Fee, Mexican Consul's Notarization, and Recording in the Public Registry, and (for sellers) Certificate of No Debt, Certificate of No Encumbrance, and Certification of Blueprint of Lot.

Real Estate Commission

Real estate agents in Mexico may charge anywhere from 5% to 10%. Typically this is paid by the seller, but if buyers are represented by a buyer's broker, they will pay him or her. I usually charge sellers 10% of the purchase price, but I share commissions with other real estate agents. If I am acting as a buyer's broker, I may also charge 10%, although this is negotiable. My reasoning is that buyers and sellers in the U.S. expect to pay something like 6% or 7%; therefore they should expect to pay more in Mexico where there is more work involved and more expertise necessary.

In general, because of certain fixed fees, the buyers' closing costs for a lower priced property will be a higher percentage of the purchase price than those for a higher priced property. I have found that closing costs for a \$50,000 property often will be about 20%. Those for a \$2,000,000 property may be as little as 7%.

Chapter XI

Rentals

Many Americans and Canadians come to Mexico, purchase a property, and then rent it out to others. Even if the foreigner lives in the property part of the year, any income must be declared, an official receipt provided to the tenant, and taxes paid.

The term "rental" carries two meanings in Mexican law. One is lodging. This is the type of service offered by hotels, in which the accommodations are furnished, the linens are changed, and the room is cleaned. The other is long-term rental, in which the owners provide the

accommodations but not the services associated with lodging.

It is not illegal for Americans to rent properties to others on a long-term basis. But failure to give tenants the legal receipts or to file the appropriate declaration with the tax authorities can result in penalties for tax evasion.

Some foreigners rent their vacation homes as lodgings, but do not have a corporation or pay taxes in Mexico. This is illegal, because they are in direct competition with hotels and other businesses that have to pay taxes for renting out lodgings. To provide lodging it is necessary to have a corporation, to be registered, and to pay taxes. Value Added Tax (IVA) is paid on all furnished houses, rooms in guest houses, hotel rooms, and commercial properties. It is 10% of the total rental amount in Puerto Peñasco and on the Baja Peninsula, 15% in other parts of Mexico. A declaration must be filed every three months and the appropriate tax paid by the person receiving the rental income. If potential property owners intend to do this, they should make their purchase in the name of their Mexican corporation. (See Chapter XIII for how to set up a Mexican corporation.)

The city and state governments have not in the past had adequate personnel to enforce the laws governing this practice, but now computerized systems are making it possible to exchange information between the U.S. and Mexico. Americans may not be able to evade these taxes for much longer.

Chapter XII

Establishing a Subdivision

Subdivision History

Americans have been vacationing in Puerto Peñasco since its beginning in the 1920's. But most of them came and went and did not buy property. The first large-scale influx of American buyers was in Cholla Bay, which has grown in a somewhat haphazard way over the course of the last several decades, with no oversight and lots of irregularities. There were problems because many Americans built houses on land they had leased, not purchased; or they had not obtained bank trusts; or they had violated Mexican laws or customs in other ways.

Then in the 1970's the subdivision of Las Conchas was started. From the beginning it had rules and restrictions aimed at avoiding some of the problems Cholla Bay had encountered. And, although there have been some difficulties, by and large it has done so. Deed restrictions and an active neighborhood association have kept the subdivision growing in an orderly fashion, thus enhancing values for the mostly American residents there to whom conformity in a residential community is a priority.

In the 1990's, with the phasing out of the fishing industry and the government promotion of tourism, Puerto Peñasco became home to a number of large planned residential developments. Some of these have been built already, but many are still in the planning stages, although lots have been sold based on their expectations. Nearly all of the developments have had problems with title, with government regulations, or with financial backing, causing delay in their planned openings.

Seller financing has been available for some of these developments, but many Americans have financed their vacation homes by taking out home equity loans on their property in the U.S., thus enabling them to pay cash in Mexico. Recently several American lending companies have made it possible for buyers of Mexican properties to finance their purchases. One key is the title guaranty trust, which has a foreclosure provision similar to the American deed of trust. With this instrument, lenders can now foreclose within 90 days and get their security back. Another key is title insurance, and this concept too is becoming more widely known in Mexico. Since it protects buyers and sellers alike, it is sure to be used increasingly in the future. It should be noted, however, that title insurance may be difficult to obtain in cases where past irregularities make it impossible to establish a clear chain of title. This is especially likely to occur with large commercial properties.

Appraisal is also coming to be an accepted practice. Without the computer data base American REALTORS® are used to, it used to be difficult to fix a fair price on properties, but the PPAREA MLS database is growing and providing more and more reliable information; also appraisers are building up their own databases, and the states of Arizona and Sonora are cooperating to facilitate computer access to property registries in both countries.

Developing a Subdivision

Mexican regulations are similar to those in the United States when it comes to the development of real estate projects. In 1976, the government of Mexico established the Human Settlement Law for the regularization of land development. Each

state in Mexico has its own corresponding law. In Sonora it is the Law of Urban Development for the State of Sonora, commonly referred to as Urban Development Law 101.

The procedure to authorize the development of a subdivision is specified by the Secretary of Urban Infrastructure and Ecology (SIUE) for the state of Sonora. Some developers (usually Americans) have run into trouble in Mexico by omitting some of the necessary steps. From what I have learned about subdivisions and some of the problems I've heard about, I am convinced of the importance of doing everything deliberately and in the right order, according to the Mexican legal system. Here is the recommended procedure.

First, establish a Mexican corporation. (See Chapter XIII.) Decide whether it is to be run by a single director or a board of directors.

Second, raise money and allot funds for the project. This is essential. Too many developments have stalled half-way through when they ran out of money. It is probably a good idea to sell shares of stock in the corporation so that the investors' money is securely tied up. Having someone pull out funds in the middle of a project can be a death blow.

Third, buy the property in the corporation's name. Obtain title insurance, if possible.

Fourth, consult a lawyer and a *notario* to start the process of creating a Master Bank Trust for the future subdivision.

Fifth, create the plans for a subdivision, apply for the necessary permits, and have them approved. This is a lengthy process, which goes as follows:

The developer obtains a land use license from the city council by submitting:

- an environmental impact study on the land to be developed
- deeds of ownership on the property
- a map that shows the location of the property in the community
- a plat map of the tract
- a draft or blueprint of the proposed development

The city council then presents the draft of the proposed project, along with the relevant documentation, to SIUE. Meanwhile, it presents the land use license and the plan of lots and blocks to the appropriate municipal agencies in order to facilitate the obtaining of water service, drainage, and electricity for the project. The developer receives initial approval for the intended subdivision from the city council.

Once initial authorization is granted, the developer submits a formal executive development plan, with documentation, to the city council, which presents the project again to SIUE with the calculations of water and sewer use for review, revision, and approval. Additionally, the city council submits the calculations for electrical usage and street lighting to Mexico's Federal Electricity Commission for its review and approval.

After a satisfactory review of the general project plan by the authorities, the developer signs a formal agreement with the municipal president, which lays out the obligations and the time frame estimated for completion of the proposed subdivision. The developer must donate 15% of the overall land area to the city, for common areas such as green belts and schools. After paying the required fees, the developer publishes the subdivision's approval in the *Official Bulletin*, giving notice to the public of the government's approval.

Lastly, the developer records the agreement in the Public Registry of Property along with a declaration of intent to develop the property. Copies go to the local tax assessor's office, the treasury department, and SIUE. A developer who wants to advertise in Arizona must also file a subdivision report with the Department of Real Estate, since real estate cannot be advertised for sale in Arizona unless this is done.

Sixth, after all permits have been approved and registered, put in the infrastructure: roads, water, and electricity, if not already in place.

Seventh, begin selling property in the subdivision with individual bank trusts for foreigners or deeds for Mexican citizens. Do not initiate any sales until all the required procedures have been complied with. It may take a year or more, but it must be done in order to avoid costly problems. Too many developments in Mexico have run into trouble because they started taking money from potential buyers without having legal title, without having completed the approval process, or without having individual bank trusts available.

Residential development in Sonora has made a significant change for the better in the last few years. Most developers are obtaining the necessary approvals before beginning construction and lot sales. I know of at least one development that has filed a subdivision plan with the Arizona Department of Real Estate. Following the recommended steps will minimize the risk to all concerned and increase the value of property in Puerto Peñasco.

Buying Property in a New Subdivision

Lots, condos, and homes in new subdivisions are typically sold by an on-site real estate agent

in Mexico as they are in the U.S. If buyers go around shopping for property without an agent, they may not realize that the site salesperson is representing the developer's interests only. Buyers should have their own agent, someone who represents their interests. This concept, called buyers' brokerage, is becoming increasingly popular in the U.S., not only for subdivision homes, but for resale properties as well. In Mexico it is even more important for buyers to have their own agents because the laws and practices are different from what they are used to. Moreover, many large developments have had their own problems with Mexican laws and regulations, and it is important for buyers to be aware of the potential for trouble. (See Chapter VIII for a fuller explanation of buyer's brokerage.)

Buyers should always ask developers if their subdivision has been approved and should ask for a copy of the published authorization. They should also ask if the property can be conveyed through a bank trust. If not, they should be wary of making any commitments or paying out any money.

Chapter XIII

Forming a Mexican Corporation

To establish a corporation, foreigners must have an FM3, a document they need to work in Mexico. It must be renewed annually. An FM3 is one of several documents that show a foreigner's immigration status in Mexico. There is also an FMT for tourists and an FM2 for resident aliens. Anyone who wants to do business needs to obtain an FM3. You don't need one just to come and spend up to six months in your own condominium or home or to pay taxes on your Mexican income. But if you open a Mexican bank account you will probably need one. And if you intend to establish a Mexican corporation, all the stockholders must have FM3s.

A Mexican corporation is a Mexican entity, even if the stockholders are all foreigners. There can be as few as two stockholders. Certain documents are required, such as bank statements, passport or visa, and photos. The corporation must have a physical address in Mexico (not a P.O. box), an accountant, a bank account, and proof of financial stability. There must be a minimum investment of \$50,000 pesos (about \$5,200 dollars). The corporation can be run by either one director, with power of attorney to make decisions, or a board of directors.

How to Establish a Mexican Corporation

The first step is to apply for a permit from the Department of Exterior Relations in which you register the name of your Mexican corporation. Three names for the company must be submitted. A computer search of those names is done to avoid duplicating an existing name. Approval of the company name, and a permit authorizing it, can be completed within a few days.

The next step is developing the articles of incorporation. This task requires the services of a *notario* (see Chapter II), who must draw up and record them. Mexican corporations require specific objectives, so be sure to list anything you might conceivably want to do. If you will be selling furniture, for example, include such objectives as interior design service, furniture repair, and sale of polish, cabinet hardware, cushions, draperies, and any other related products or services. It is very difficult and expensive to go back and add items once the corporation has been established.

Once the articles of incorporation are recorded in the public record, you need to obtain the necessary permits: Hacienda (federal tax), Dept. of Commerce, State Registry, a mandatory Chamber of Commerce (by industry), SIC code data base, Import/Export permit, and the Dept. of Immigration. Additional permits are required specific to certain industries. All of the above permit fees, including the notario's, usually come to around \$1,500. Consulting fees for processing the paperwork and completing registries are additional.

Chapter XIV

To Sum Up . . .

Here are some tips to guide you in your Mexican negotiations.

1. Don't be gullible

- If someone offers you a deal that seems too good to be true, it probably is.
- Don't assume that you can trust a salesperson just because he or she is an American.
- Be wary of anyone who tells you: "A master trust is sufficient," or "We will have bank trusts available in 6 months," or "Our legal title will be cleared up in 2 more weeks."

2. Don't try to mix business with pleasure

If you go to Mexico to negotiate, don't party. Not only will it waste your time, but it will impair your judgment.

3. Don't cut corners

- Use a reputable real estate broker. Sign a contract to have him or her represent you.
- Use a reputable attorney.
- Use a *notario* to close transactions.
- Comply with all legal requirements.
- Buy residential property only with an individual bank trust.
- Form a Mexican corporation to buy commercial property.
- Pay required taxes.

4. Be careful

- Do your homework beforehand. Investigate Web sites. Read published materials. Ask friends and acquaintances.
- Check out what you are told. Get second opinions.
- Be patient. Remember that making your investment or sale in Puerto Peñasco will probably take longer than a similar transaction in the U.S. Relax. Now is the time, while you're waiting, to have that beer or Margarita.

* * * * *

Investing in Mexican real estate doesn't have to be like dancing in quicksand. Mexico is a beautiful country with almost 6,000 miles of coastline, most of it still undeveloped. Real property is very affordable. I've seen houses overlooking the ocean south of Tijuana for \$150,000 that would cost \$3,000,000 in San Diego. Similar homes in Puerto Peñasco are somewhat more expensive, but still it is possible for Americans and Canadians to buy properties that they could only dream of north of the border.

Everyone wants to be on the beach or near the beach, but consider that excellent bargains can be had inland, as well. Living in a Mexican area can be an enriching experience. The Mexican people are wonderful—warm and welcoming, forgiving of our limited Spanish, and eager to share their culture with us. Getting to know them as neighbors is immensely rewarding.

For investors and developers, the coastline of Mexico is a new El Dorado. The climate for investment is better than it's ever been. The government is encouraging foreign investment, and the private sector is cooperating. I know of at least two large American title companies that are selling Mexican title insurance to American buyers; there may be others. American lenders are making loans for Mexican properties. Private escrow companies are working with *notarios* to streamline paperwork for real estate and business transactions. The government of Sonora is establishing real estate regulations and licensing. On the national level, government-insured financing, similar to FHA, will soon be available, which will make it possible for many more Mexicans to own property. The PPAREA locally and AMPI (Asociación Mexicana de Profesionales Inmobiliarios) nationally, organizations of real estate professionals, are promoting ethical standards for real estate agents.

Large commercial projects are attractive possibilities. Coastal land for condo developments is available at bargain basement prices. New technology, such as solar energy, desalinization systems, and windmills can provide infrastructure without drawing on the limited resources available in urban areas. Developers who do it right from start to finish, obtaining clear title and providing title insurance, financing, and bank trusts, will have a decided advantage over those who struggle with legal difficulties and then sit there, hoping that buyers will come in with cash.

The potential for making good real estate investments in Mexico is excellent. The state and the federal government have opened their arms and invited us to come in. There are, however, many pitfalls for inexperienced investors. It is important to go slowly, to become informed, to take care, and to comply with all the legal requirements. I believe that if you have digested the information in this book and follow the guidelines above, you can be enormously successful. You will have a sound investment that will add to your pleasure in life.

Glossary

Anteproyecto	draft or blueprint
Asamblea	shareholder's meeting
Ayuntamiento	city council
Desarollo.	development
Ejido	a rural cooperative
Ejiditario.	member of an ejido
Escritura	deed
Factura.	an official receipt
Fideicomiso	bank trust
Fraccionamiento.	subdivision
IVA (Impuesto sobre Valor Agregado)	value-added tax
Notario público	public notary
Proyecto	project
Secretaria de Infraestructura Urbana	Secretariat of Urban Infrastructure and Ecologia
Tanto de derecho.	right of first refusal

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