

# **Beaches of Gold**

**Buying and Selling Real Estate in Mexico**

*John Fleming*

## Table of Contents

<i>Chapter I</i> Debunking Some Myths	5
<i>Chapter II</i> Some Unfamiliar Terms and Concepts	8
<i>Chapter III</i> American Attitudes	10
<i>Chapter IV</i> Culture and Business	12
<i>Chapter V</i> Differences between Real Estate in the U.S. and Mexico	16
<i>Chapter VI</i> Types of Ownership in Mexico	22
<i>Chapter VII</i> Contracts	26
<i>Chapter VIII</i> New Mechanisms for Buying Mexican Real Estate	30
<i>Chapter IX</i> Taxes	32
<i>Chapter X</i> Closing Costs	33
<i>Chapter XI</i> Rentals	37
<i>Chapter XII</i> Building in Los Cabos	38
<i>Chapter XIII</i> Obtaining an FM-3	40
<i>Chapter XIV</i> Forming a Mexican Corporation	41
<i>Chapter XV</i> To Sum Up	43
<i>Chapter XVI</i> Congratulations on Your New Home	45
Glossary	47

## 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](http://www.penasco.com), and in our paper, which was now also called [www.penasco.com](http://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*

Tucson, Arizona  
August 2002

This version of my book was adapted by Julie Kershner and Debra Dodson, of Prudential California Realty--Cabo Gold Division, from my original, so that it would be more appropriate for the Los Cabos area. I am glad they are disseminating a positive picture about Mexico--It is truly a Beach of Gold.

John Fleming  
Puerto Penasco, Sonora Mexico  
August 2003

## 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.**

**2. An American must have a Mexican partner (who has at least 51% ownership) in order to own real estate in Mexico.**

**3. A bank trust is a lease agreement.**

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

### **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. The entire Baja Peninsula is considered a "Restricted Zone".

Perhaps the main reason for establishing the restricted zone is that the Mexicans lost so much territory to the U.S. in the 19th century—about 1/3 of their country: Texas in 1845, and in 1848, through the treaty of Guadalupe Hidalgo, which ended the Mexican War, the territory that became California, Nevada, Utah, most of Arizona, and parts of New Mexico, Colorado, and Wyoming—a huge expanse (see map). The U.S. paid only \$15,000,000 for all this land. And in 1854 through the Gadsden Purchase the U.S. acquired the rest of what is now Arizona and New Mexico. It's not surprising that Mexico was a little nervous about allowing foreigners, especially Americans, to acquire any more land.



But old wounds heal, and now the U.S. and Mexico are significant trading partners in each other's economy. NAFTA has promoted good business relationships, but even before NAFTA, 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.

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 publico* 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 17 in the Baja Peninsula). 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/Fideicomso**

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 Los Cabos, 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.

U.S. Citizens should check with their Tax Accountant regarding IRS Forms 3520/3520A, involving Foreign Trusts. Currently, there is an incentive from the U.S. Government for filing this form.

## Chapter III

### American Attitudes

*Larry and Rita Marino had rented a beachfront condo in Cabo San Lucas 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.*

- 1. Party mentality.** 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.
- 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 person 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 Los Cabos, foreign individuals can purchase 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 XIV 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 to 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 deposited into a bonded, U.S. escrow account or with a title company. The seller does not receive any money from the transaction until closing.

## *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 Los Cabos there is a Multiple Listing Service, as well as Asociacion Mexicana de Profesionales Inmobiliarios-A.M.P.I, which works closely with National Association of Realtors-N.A.R.

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. and compare it with Mexican practices. The processes described here show the way I go about it, having been a real estate broker in Arizona for over 20 years. Of course individual transactions will vary, but these are fairly standard scenarios.

#### **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 is currently no specific government regulation of the real estate industry and no licensing requirement. This is ironic in a country that thrives on red tape and regulations. In Los Cabos, most of the people selling real estate are Americans, and their qualifications range from years of experience as brokers or agents to the ability to nail two boards together and put up a sign. However, in Los Cabos, the goal of the Multi List of Los Cabos and AMPI is to provide professional real estate services to its clients by implementing ongoing educational requirements for its members, background checks on new members, and promoting our Code of Ethics.

## **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, Asociacion Mexicana de Profesionales Inmobiliarios (AMPI), which promotes professional standards and ethical conduct. Until recently membership remained small, consisting of volunteers who were willing to work hard to raise the level of professionalism in real estate in Los Cabos. We have had a dramatic increase in our membership and a worthy responsibility has been placed on our shoulders. Committees are forming to provide educational courses, background checks and enforce the Code of Ethics.

## **Listing Agreements**

### U.S. and Mexico

In the U.S. and Mexico 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.

## **Multiple Listing Service**

### U.S. and Mexico

In the U.S. each MLS maintains a computerized database 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 the property and enter the data into the on-line system. Other members have access to the database through computer programs, so all members of the service can access information on all listed properties. In Los Cabos, the Multiple Listing Service works much the same as in the U.S. In addition, the general public can access the listings through [www.loscabosmls.com](http://www.loscabosmls.com).

## **Showing**

### U.S.

MLS members can lease or purchase keysafes, 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 no keysafes in Los Cabos, 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.

## **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. 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. Then 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 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 Los Cabos, most of the above procedures are taking place, with the exception of key safes. Signs are generally installed, unless CCR's (Codes, Covenants and Restrictions) prevent them.

## **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, which designates me as their agent. Then I go to the Multiple Listing Service's computer program and search for any and all 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 Los Cabos, the procedure is much the same, taking into account the fact that Los Cabos is a "Resort Community" and many properties are rented, so proper notification to the tenants must first be given. Most transactions are cash or developer financing. The money does not go directly to the sellers, but is deposited in a bonded, U.S. escrow account or with a title company.

## **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.

### 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 is always recommended as part of the transaction. Financing has been virtually unknown for real estate transactions in Mexico, which are usually done on a cash basis. Closing costs for the buyer in Los Cabos are substantial, between 5% to 7% 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 disbursed by the escrow company, usually by wire transfer once all the documents have been signed.

## **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 registered in the Public Registry Office and Catastrol 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 and title insurance are available.

## **Recommendations**

I would recommend that any foreigners who intend to buy property in Mexico, engage the services of a real estate professional affiliated with AMPI and always purchase title insurance.

## 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 and to Mexicans by birth, naturalized citizens, and Mexican companies. 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 ejidal 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 Procede (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 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.*

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.

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.

## **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.

## **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. 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.

## **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 Los Cabos 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 10-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 Mexico, 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.”

In both the U.S. and Mexico if sales are not properly processed and registered, it is questionable whether the buyers have valid titles. If buyers of residential property don't have a bank trust and haven't had their transaction processed by a notario, taxed, and registered, 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. Real estate agents and developers often use their own forms as preliminary documents to spell out amounts, dates, and expectations. Oral contracts involving real estate are not legal in Mexico or the United States.

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 country of Mexico 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.

### **Financing**

It can be extremely difficult to qualify for vacation home financing, as well as very expensive. Real estate loans offered in Mexico through U.S. banks are typically considered "unsecured" loans, as today there is no viable means to put a mortgage on the property. Qualifying for this type of loan is difficult, time consuming and usually expensive. On the flip side, currently, if a buyer is successful in obtaining a loan for property in Mexico, they will be rewarded with a Form 1099 Mortgage Interest Statement for use as a deduction on their U.S. Federal Income Tax.

### **Seller Financing**

Seller Financing is another means of obtaining a vacation home. Sellers often own properties free and clear, and appreciate the benefits of a long term payout with a higher interest rate than they may obtain on a traditional investment. Obtaining a credit report adds to the seller's peace of mind. Often, an uninvolved third party collects, records and distributes the funds, and holds the necessary title documents.

### **Home Equity Loan**

A home equity loan, on the buyer's primary dwelling is often the easiest and most affordable way to obtain the necessary funds to purchase a vacation home. In addition, a Form 1099 is usually provided.

Finally, fractional ownership, for instance with another family, is another option. A carefully worded contract with explicit shared-use and property-disposal clauses is an absolute necessity.

These are just a few examples of fairly typical financing arrangements. Creative financing arrangements are best left to a finance professional, and as always, it is best to consult an accountant and attorney to verify the appropriateness of the transaction.

## **Title Insurance**

It is now possible to get U.S. title insurance on some Mexican properties. While this costs more and takes longer, it is 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, and funds disbursed through escrow.

## **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 Los Cabos MLS is working diligently to make mandatory disclosure of sales prices and terms available to the agents. This will make it possible for real estate agents to do comparative market analysis and determine fairer and more consistent pricing.

## **Bank Trust /Fideicomiso**

The question many foreigners ask is, "Can I own property in Mexico?" The answer is, "Yes, you can!"

In 1970, a Presidential Resolution to the Mexican Constitution allowed foreign ownership of property in the restricted zones by way of a Bank Trust or Fideicomiso. Under the Bank Trust agreement (Fideicomiso), the foreign owner is able to purchase property in the restricted zones, such as the Baja, with the property held in trust by a Mexican Bank. As a beneficiary under the trust, a foreigner is then able to enjoy the same rights as a Mexican citizen owning property in Mexico.

Originally the trust was set for a 30-year period. However, In November 1993, the government announced an amendment to the trust law extending the term of the trust to 50 years. After the initial 30-year term, owners would be able to apply for renewal of the trust for a 50-year term. New trusts granted will be for 50 years. If the property is already in trust, the term remains at the original 30 years. Six months to a year before the expiration of the 30-year period, the owner would apply for a renewal. Upon approval, the renewal period would be 50 years.

The property owner has the obligation to pay the annual trust fees to the bank holding the trust on their property. Normal fees run between \$350 and \$550 U.S. annually, depending on the bank.

## 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

An extremely important part of the real estate transaction is understanding tax laws in Mexico. Capital Gains Tax is owed on the profit you receive when your property is sold. However, the actions you take when buying a home dictate your future tax consequences. Always register your property at the value you actually paid. Never record a lower value and always insure your construction has been manifested. Check with a tax professional to insure complete understanding of the tax laws and recent changes.

**Option 1: 35% of the net profit based on registered amount when purchased (There are deductions that apply)**

**Option 2: 25% of the gross sales amount with no deductions. There are several laws and procedures that can assist you to maximize your cost basis to reduce your net profit and lower your Capital Gains.**

## *Chapter X*

### **Closing Costs**

Closing costs can range from 5% to 7% of the purchase price of the property. These costs include title search, transfer taxes, government permits, and notary 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.

#### **Acquisition or Transfer Tax**

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

#### **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 \$ 440 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 \$1,200. 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 the trust. Fees generally range from \$350 to \$550. 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 \$400 and up 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. Buyers should recognize that there may be instances in which problems can not be cleared up and title insurance cannot be obtained. The good news is that as more and more title searches are done, a data base will be 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 \$5.00 to \$7.00 per \$1000.00 of the purchase price. The cost is usually included on the face of the policy. First American, Stewart and Fidelity Title Insurance Policies are available in Mexico.

## **Capital Gains Tax**

The seller's major cost, the Capital Gains Tax, according to the 2002 Tax Code, will be calculated as follows: 35% or of the net profit based on the "registered" amount when purchased (There are deductions that apply), OR 25% of the gross sales amount with no deductions. There are several laws and procedures that can assist you to maximize your cost basis to reduce your net profit and lower your Capital Gains. Capital Gains are paid by the seller to the Notary at closing.

## **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.

## **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 publico. His duty is to draft the deed and to confirm the validity of signatures. The persons signing before him must prove that they are who they say they are. The notary is also responsible for the calculation of buyer's and seller's taxes. His fees are based upon a rate schedule and are tied to the amount declared in the official appraisal. These fees range from \$1100, depending upon the declared value of the property.

## **IVA**

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

## **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.

## **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 square meter per year if the property is unimproved, about \$23 per square meter if it has improvements built on it. This assessment must also be brought current before the property can be sold. BUYER'S PURCHASING OCEANFRONT PROPERTIES ARE ADVISED TO OBTAIN THE CONCESSION FOR THE BEACH IN FRONT OF THEIR PROPERTY.

## **Apostille**

When a document is to be used in a foreign country, it may be necessary to authenticate the notarization or certification. Foreign countries often require documents to be authenticated before the documents will be accepted in the foreign jurisdiction. An “authentication” is an act which certifies the signature and the position of the official who has executed, issued or certified a copy of a document.

Since October 15, 1981, Mexico has been part of the 1961 Hague Convention abolishing the Requirement of Legalization for Foreign Public Documents. The Convention provides for the simplified certification of public (including notarized) documents to be used in countries that have joined the convention. Under the Hague Convention, signatory countries have agreed to recognize public documents issued by other signatory countries if those public documents are authenticated by the attachment of an internationally recognized form of authentication known as an “apostille”. The apostille insures that public documents issued in one signatory country will be recognized as valid in another signatory country.

The sole function of the apostille is to certify the authenticity of the signature on the document; the capacity in which the person signing the document acted; and the identify of any stamp or seal affixed to the document.

The Secretary of State for each state in the United States of America has the authority to prepare an Apostille for documents created within the state’s jurisdiction. All signatures must be acknowledged before a Notary Public prior to obtaining the Apostille.

## *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 in Mexico.

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 Los Cabos and on the Baja Peninsula, 15% in other parts of Mexico. A declaration must be filed 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 XIV 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.

## *Chapter XII*

### **Building in Los Cabos**

Over the years there have been many horror stories about the construction experience in Mexico. Projects began and sat there half finished for years. Materials were delivered to construction sites and disappeared. Time and cost overruns were the norm. Builders disappeared and so did funds. Fortunately, these conditions have changed dramatically in recent years. Buyers are now able to select from a variety of reputable builders and have their homes completed on time, on budget and to quality standards, equal to the best in the States.

In Los Cabos, there are building sites with views and settings unequalled elsewhere in the world. Where else can you enjoy sunrises, moonrise and fabulous sunsets over the Sea of Cortez? Watch whales and dolphins playing from your patio? Listen to the surf and smell fresh caught Dorado broiling on the BBQ. The offerings of such spectacular properties are truly unique to the developments of Los Cabos.

When considering the purchase of a building site, it may be helpful to ask your real estate agent to invite two or three different architect/builders to the lot to discuss your building ideas and to listen to their suggestions. They will often have ideas that you hadn't considered. At the same time, they will be happy to show you homes that they have completed and provide you with a list of satisfied clients so that you may check references. Once you have closed on the purchase of your lot, some architect/builders will create a preliminary design of your home at no cost.

The greatest value in lots is often realized in firm time offerings from developers. There are often significant pre-construction discounts. It is important to be sure that the infrastructure is in place and that the developers are not counting on sales to finance the infrastructure. That can be risky. Once an architect has been selected, plans and cost estimates will be prepared. Most builders will prepare a construction calendar that provides for progress payments as each phase of the work is completed. Architects are in constant communication with their clients through email. With the digital camera, they can email photos of completed work and discuss details, colors and change orders. It usually takes 8 months to a year to complete a home. Building costs for "top of the line" construction are in the area of \$170 per square foot. That price applies to the under roof portion, but includes all major appliances, pool, patios, decks and basic landscaping.

There are two other very important benefits to building your own home. First, it is the only way you can get your dream home exactly the way you want it. Also, the return on your investment is typically much higher. It is not uncommon to realize a 30% to 40% return on your investment when your home is complete.

## **Manifesting Your Construction**

It is important to register the costs of building your home. Receipts alone are not enough. If you have not manifested your construction, Mexico will not recognize your costs and you will not be able to use your expenses as a deduction when calculating Capital Gains tax. Manifesting is basically registering the amount of your construction or remodel to add to your cost basis.

Prior to construction, you should meet with your architect/builder to discuss the best method for payment. (See Chapter IX regarding Facturas).

Your architect/builder will assist you in obtaining a building permit. It is important to insure the permit is in the name of the Beneficiary named in your Trust. Also, the permit should represent the amount of the construction. Always register the permit at the cost of the construction. When complete, notice should be given stating the actual amount spent and that construction is complete.

In closing, contractors and sub-contractors must pay Social Security for all laborers and obtain a release letter.

## Chapter XIII

### FM-3 (Migratory Visa)

An FM-3 (Migratory Visa issued by Mexico) is not a proof of residency in Mexico, but a visa required in order to reside “in-country” and not as a tourist. Obtaining an FM-3 is currently a necessary step in avoiding or reducing your Capital Gains Tax. In addition, you are allowed a one-time exemption to bring household furniture and belongings into Mexico with no payment to customs.

You can apply for an FM-3 at the Mexican Consulate in your country, but as soon as you arrive in Mexico, you must register your new address at Immigration. You have 30 days to register. You can also apply for an FM-3 at the local Immigration Office.

The following are basic requirements for obtaining an FM-3, and subject to change.

- 1) Valid Passport (2 copies of all pages).
- 2) Original Tourist Card. If you drive down, it is important to obtain the Tourist Card in Tijuana. Tourist cards are not issued in Los Cabos, unless you arrive by airplane.
- 3) Copy of a utility bill showing your address in Mexico.
- 4) Copies of last 3 monthly bank statements as proof of your financial solvency. Bank accounts should be in your name and statements should come with the bank logo.
- 5) Open a bank account in Mexico as soon as you arrive, with a minimum of \$1,000 USD. The updated bank statements of this account will be required on every renewal of the FM-3.
- 6) Your copy of any documents as proof that you own property in Mexico. (All documents should be in your name).
- 7) Photos: 4 front and 4 right side. The size must be 4x4 cms, black and white on white background. Photos should be taken without eyeglasses, and with ears exposed.

The Immigration Department requires that you use the FM-3 each and every time you enter or leave Mexico.

## *Chapter XIV*

### **Forming a Mexican Corporation**

To establish a corporation, foreigners must have an FM-3, a document they need to work in Mexico. It must be renewed annually. An FM-3 is one of several documents that show a foreigner's immigration status in Mexico. There is also an FMT for tourists and an FM-2 for resident aliens. Anyone who wants to do business needs to obtain an FM-3. If you intend to establish a Mexican corporation, all the stockholders must have an FM-3.

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. 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); Department of Commerce, State Registry, a mandatory Chamber of Commerce (by industry), SIC code data base, Import/Export permit, and the Department of Immigration.

Additional permits are required specific to certain industries. All of the above, including permit fees, including the Notario's, usually come to around \$1,500 USD. Consulting fees for processing the paperwork and completing registries are additional.

## *Chapter XV*

### **To Sum Up...**

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

#### **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 also it will impair your judgement.

#### **Don't cut corners**

- ❑ Use a reputable real estate broker that is affiliated with AMPI
- ❑ Use a reputable attorney
- ❑ Use a bonded, U.S. escrow company 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
- ❑ Obtain your FM-3
- ❑ Always purchase Title Insurance
- ❑ Manifest your construction
- ❑ Don't put residential property in a corporation

#### **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 Los Cabos 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 Los Cabos are more expensive, but it is still possible for Americans and Canadians to buy properties that they could only dream of north of the border. There are still good deals in Los Cabos.

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.

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 three large American title companies that are selling Mexican title insurance to American buyers; there may be others. Private escrow companies are working with Notarios to streamline paperwork for real estate and business transactions. On the national level, President Fox has proposed establishing government-insured financing, similar to FHA, which would make it possible for many more Mexicans to own property. AMPI (Asociacion Mexicana de Profesionales Inmobiliarios), is establishing local affiliates throughout Mexico and promoting ethical standards.

Large commercial projects are attractive possibilities. Coastal land for condo development is available at affordable 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 federal government have opened their arms and invited us to come in. 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 pleasure in life.

## *Chapter XVI*

### **CONGRATULATIONS ON YOUR NEW HOME!!!!**

Here are some helpful tips that will make ownership a total delight in Los Cabos....

If you have a Spanish speaking friend who can help you, you will find the going much, much easier.

First, keep in mind that property taxes will be pro-rated at time of closing, and that you will receive a discount if you pay each year's taxes in January...remember also that you will not receive a statement, and you will have to go to Catastrol on Blvd. Mijares and pay the taxes in person, with a copy of the previous year's tax receipt.

An important thing to be aware of is that all utility bills may be paid at your bank as long as you pay them at least two days before the final due date on the bill. To prepay a utility bill, you must go to the utility company.

If you are fortunate enough to have a phone line already installed, it will be helpful if your Spanish speaking friend can call the phone company and get the phone in your name....if there is no phone line, be aware it make take two or three weeks to have a line installed. If you do not pay your phone bill on time, they will cut your service immediately and re-install it only after the bill is brought current. Again, it is possible to pre-pay your telephone bill.

Remember that the electric bill only comes every other month and unless you have the billing changed, it will remain in the name of the previous owner. And, be sure the bill is paid prior to the due date...the company will send out a worker the day after the final due date to disconnect your electricity if the bill is not paid.

The same information is true for your water bill and if the billing is in the name of a prior owner, be sure you know that name, especially if there is a general mail box in your complex and you must go there to get your bills. The water company will never shut your water off, however, each month the bill gets higher.

Each bank has pluses and minuses, i.e. at Bital, there is a line that winds around while you wait your turn. At Banamex, you can take a number and wait for your number to be called. Banks offer dollar accounts, peso accounts as well as ATM service. Don't close your bank account in the U.S., as Mexican checks are not accepted for payment in the U.S.

Be sure to investigate for the proper insurance coverage on your condo or home and its contents as well as on your auto. Check with someone local to determine which are the best companies from which to get quotes.

Now, enjoy your home and life in the paradise of Los Cabos!!!!!!!!!!

XVII

**Glossary**

<i>Apostille</i> . . . . .	government authentication
<i>Ayuntamiento</i> . . . . .	city council
<i>Desarrollo</i> . . . . .	development
<i>Ejido</i> . . . . .	a rural cooperative
<i>Ejiditario</i> . . . . .	member of an ejido
<i>Escritura</i> . . . . .	deed
<i>Factura</i> . . . . .	an official receipt
<i>Fideicomiso</i> . . . . .	bank trust
<i>Fraccionamiento</i> . . . . .	subdivision
<i>IVA (Impuesto sobre Valor Agregado)</i> . . . . .	value-added tax
<i>Notario publico</i> . . . . .	public notary
<i>Proyecto</i> . . . . .	project
<i>Secretaria de Infraestructura Urbana y Ecologia</i> . . . . .	Secretariat of Urban Infrastructure and Ecology
<i>Tanto de derecho</i> . . . . .	right of first refusal