THE REAL ESTATE LAW REVIEW

TWELFTH EDITION

Editor
John Nevin

THE LAWREVIEWS

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PREFACE

This time last year the world's focus was still on the covid-19 pandemic as the dominant issue affecting us all. Tragically, just as we were starting to see light at the end of the tunnel, the much-hoped-for fresh start was stopped in its tracks by the war in Ukraine. The past 12 months have been dominated by war in Eastern Europe and the ensuing global humanitarian, economic and political fallout. The stability and certainty craved by all currently remains a distant hope.

Following on from COP26 in Glasgow, this year the focus was on Sharm El Sheikh for COP27. Once again, some key world leaders were notable by their absence and there remains the sense that more could and should have been achieved. This year, a further focus was acknowledging the developed world's contribution to the climate problem, and a new loss and damage fund was agreed upon to help meet the climate change costs suffered by the world's poorer nations. It has been accepted that something needs to be done, and that includes in the property industry. The built environment accounts for at least 25 per cent of the UK's greenhouse gas emissions, and significant changes are necessary if net zero targets are to be met. To date, the focus has been on high-profile new developments with eye-catching environmental, social and governance credentials. How to deal with the much larger stock of older, lower-value and underperforming buildings remains a bigger challenge.

A great deal has happened since the first edition of *The Real Estate Law Review* appeared in 2012; Brexit seems but a distant memory, as a pandemic was swiftly followed by war in Europe and a cost of living crisis. These have truly been unprecedented times. This 12th edition of *The Real Estate Law Review* will, perhaps more than ever, continue to prove its worth by giving readers an invaluable overview of how key markets across the globe operate and how they react to major world events. The covid-19 pandemic and the war in Ukraine have both served as stark reminders that it is not possible to look at domestic markets in isolation. Investors and their advisers need to understand real estate assets in the context of global events, and *The Real Estate Law Review* continues to help its readers to do just that.

This edition extends to 25 key jurisdictions around the world, and I am very grateful to all the distinguished practitioners for their insightful contributions. Each chapter has been updated to highlight key developments and their effects on the relevant domestic market. Together, the chapters offer a helpful and accessible overview of the global real estate market. Overseas investors are key influencers in most markets, and it is vital that practitioners are able to advise on a particular deal in the light of an understanding of their client's own jurisdiction.

Covid-19 has not gone away but we have learned to live with it. The pandemic's legacy will be its lasting effect on how we live, work and play, and on each and every aspect of the global real estate market. More immediate headwinds include the very real risk of a long and deep recession, soaring inflation, rising interest rates, the withdrawal of government lockdown support, failing consumer confidence, increasing costs, a critical shortage of labour and materials as well as ongoing supply chain problems. On a more positive note, the property industry has traditionally proved to be resilient, and covid-19 demonstrated its ability to adapt to difficult and challenging times. The United Kingdom will be anxious to maintain its position at the top of global shopping lists as investors look for relatively safe havens for their investment capital. London and the regions seem certain to remain attractive to overseas investors looking for investment opportunities, both in the traditional real estate investment markets and also the rapidly evolving alternative asset sectors. The next few years will undoubtedly be challenging as we continue on the journey to recovery, but opportunities will arise, and real estate will remain a key part of global investment strategies. Knowledge of the global real estate markets will prove key to identifying and making the most of buying opportunities.

Once again, I wish to express my deep and sincere thanks to all my fellow contributors to this 12th edition of *The Real Estate Law Review*. I would also like to thank the members of *The Law Review* team for their sterling efforts in coordinating the contributions and compiling this edition. Finally, I wish everyone the very best of health for 2023 and beyond.

John Nevin
Slaughter and May
London
February 2023

Chapter 19

MEXICO

Alfredo Chávez and Joaquín Alcalá[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Mexico is a civil law country in which ownership of real estate can be categorised as public property, 'ejido' property or private property. It is regulated, in general, by the Mexican Political Constitution (Constitution)[2] and the federal and local laws that derive from those laws, such as the civil code of each Mexican state.

Public property is property that belongs to the nation as a sovereign entity by way of public or government entities, which may be federal, local or municipal. It is generally regulated by the Constitution; the Acquisitions, Leases and Services of the Public Sector Law; and by different applicable local laws or regulations. All public real estate must be registered at the relevant Public Registry of Property and Commerce (Registry) office. As a general rule, the property may not be sold, transferred or encumbered in any manner.

Ejido property is property that belongs to the agrarian communities. It is granted by the government to members of local communities, mainly for agrarian or communitarian use. The ejido has legal capacity of ownership of its own assets.[3] This was established in 1917 as a result of the Mexican revolution. Ejido property is not considered public or private property; however, following further amendment to the original law, ejido property can now be converted into private property and transferred to third parties (other than 'ejidatarios' or members of the ejido of which the land is originally a part), provided that all the legal requirements to do so are satisfied. This type of ownership is regulated by the Constitution, the Agrarian Law and different applicable local laws or regulations. All ejido property must be registered at the National Agrarian Registry Office as opposed to the Registry.

Private property is property that belongs to private parties, who can be national or foreign natural persons, companies or investment vehicles. Private ownership is regulated by the Constitution, the Federal Civil Code and different local laws and applicable regulations, including the civil code of the specific state in which the property is located. All private real estate must be registered at the relevant Registry office.

The Registry is a government entity that publicises the legal status of goods and rights, including deed owners of real estate; the easements, liens and encumbrances covering a particular piece of real estate; and any other limitations on ownership regarding real estate.

For the transfer of ownership or a lien on real estate to be effective against third parties, the transfer or lien must be registered with the relevant Registry office. The recordation has

1 Alfredo Chávez is a partner and Joaquín Alcalá is an associate at Gonzalez Calvillo.
2 Article 27 of the Mexican Political Constitution.
3 Article 9 of the Agrarian Law.

a declarative effect, which means that it announces the existence of rights over real estate; however, in specific states and circumstances, such as in the state of Quintana Roo, the recordation does not have the effect of creating or constituting the respective right.

The Registry is public, and any party interested could obtain information about a particular piece of real estate to review the chain of title, the actual status of the property, liens or any other encumbrances. If the real estate is not registered, legal ownership will not be accredited before third parties, who may claim a better right in the event of transfer or the placement of liens or encumbrances.

There is a general legal principle in the Civil Code that rules that real estate transactions are usually governed by the applicable law of the place where the real estate is located, although the parties are free to agree to be subject to the jurisdiction of other courts, such as those of the domicile of the parties, who would, upon settling any dispute, have to use the laws of the state where the property is located.

II OVERVIEW OF REAL ESTATE ACTIVITY

Mainly because of its geographical location, climate, economy and social situation, Mexico has been selected by many as a good place to live, retire or invest – the real estate sector being one of the preferred ways to invest. Notwithstanding global or complex local scenarios, foreign and local developers have demonstrated their confidence in the local economy by steadily increasing their participation in the construction of resorts and residential, industrial and commercial properties in Mexico. This confidence is a key reason why a significant number of foreign and local banking institutions, real estate funds and trusts are including Mexican real estate as part of their portfolios.

According to Mordor Intelligence:

> *The Mexican residential real estate industry is growing due to young people demanding a place to live. The housing demand projected for the next few years will be driven by people under 30 years (representing 55% of the country's population). . . . Access to financing has become an indispensable component of the Mexican residential market, with public institutions and private banks having a key role.*[4]

Technological development has been one of the most important factors to facilitate new ways of investing in the real estate sector in Mexico, as in other countries. New financial management policies proposed by the government have encouraged the introduction of new financing and credit underwriting structures, as well as the development of a new credit culture, resulting in an open interest by investors to participate in Mexican real estate finance and development projects. As at the time of writing, there have been more options to grant financing and to own real estate properties through fintechs, infrastructure and real estate trusts, and co-ownership structures exclusively created or involved in the real estate market.

4 'Residential Real Estate Market in Mexico - Growth, Trends, Covid 19 Impact and Forecasts (2022-2027)', Mordor Intelligence.

III FOREIGN INVESTMENT

Article 27 of the Constitution provides that the state owns the land and water located within national territory and that the state has the right to transfer those ownership rights to individuals by creating private property. Although Section I of the article grants only Mexican individuals and companies the right to acquire ownership of land and water, it also confers on the state the power to grant the same right to foreigners, provided that the foreigners agree before the Ministry of Foreign Affairs to consider themselves as Mexican nationals in respect of the acquired ownership and not to invoke the protection of their country of origin in respect of the same. If the covenant is breached, all rights to the ownership shall return to the state.

Foreign individuals or companies may directly own land in Mexico, with the exception of land in the 'restricted zone', as defined in Article 27 of the Constitution. The restricted zone encompasses the area within 100km of any national border and within 50km of the coastline. Foreign individuals or companies and Mexican companies that are 100 per cent owned by foreigners that want to purchase real estate, for residential purposes, within the restricted zone must do so through a special bank trust called a 'fideicomiso'. By using such vehicle, the banking institution will act as trustee, and the trust will retain the ownership title of the real estate, granting to the foreigner all beneficiary rights for it to be able to use and enjoy the premises, sell or even inherit the rights to it.

Another option to consider is that Mexican companies with 100 per cent foreign capital may own real estate directly in the restricted zone for other non-residential purposes, allowing foreign investors to acquire real estate and develop.

Notwithstanding the foregoing, there are other restrictions to be aware of when trying to acquire property for agrarian, livestock and forestry purposes.

IV STRUCTURING THE INVESTMENT

The most common ways of owning or investing in real estate in Mexico are through a direct deed, through the incorporation and use of a Mexican corporation, or through hiring the services of a banking institution using a fideicomiso.

Although several structures have been implemented when investing in real estate projects in Mexico, incorporated limited liability companies and variable trust structures are the methods that have been preferred.

Real estate trusts are also commonly known as property investment management trusts and real estate investment trusts. They can be used to acquire, develop and sell real estate, issue securities, perform mortgages, act as escrow and secure payments, among other things.

Structuring a trust can be challenging and elevate the costs of a transaction. Investors will usually try to be part of the technical committee so that they ensure they are well represented and informed timely of the trust's decisions or actions, as such decisions or actions could present a problem in structures or transactions in which a large number of investors or participants are involved.

Real estate assets can be acquired directly by the trust or transferred to the trust, with a reversal right in favour of the person that owns the real estate, to avoid paying transfer taxes and secure the transaction until all intended purposes are met.

Apart from the advantage of deferring transfer taxes by implementing the reversal right, the usual taxes and service fees should be paid.

V REAL ESTATE OWNERSHIP

i Planning

According to the Constitution, the government shall take the measures necessary to arrange human settlements and to establish adequate provisions, uses, reserves and purposes for land, water resources and woodlands to execute public works and to plan and rule the creation, conservation, improvement and growth of urban centres. Depending on the location of the real estate, one or more urban development plans may be applicable. These plans may be local, regional or for a specific zone, taking into consideration the activities and the background of the places where the plans shall be applied. In respect of preparation, the federal regulations regarding natural protected areas must be considered.

Permits for the construction, development or improvement of real estate must be issued by local governments.

It is therefore of the utmost importance that prior to the acquisition of any real estate, developers clearly identify the permitted uses for the land and the density availability for the actual development of the land.

ii Environment

Mexican Environmental Legislation contemplates responsibility as a consequence of contamination and site remediation. Those responsible for site contamination are liable to pay reparation damages. Such liability can entail joint and several responsibilities among prior owners.

If the land is contaminated with hazardous waste, that land cannot be sold or transferred without the approval of the Ministry of Environment and Natural Resources. If the property has been abandoned and no owner or possessor can be found, the Ministry of Environment and Natural Resources, in coordination with the governments of the local states or municipalities, is entitled to carry out actions to execute remediation programmes.

In Mexico, environmental studies typically comprise the following activities:

a physical survey of the property and the surroundings properties;
b on-site inspection to identify environmental damage;
c review of the local geology and hydrology;
d assessment of current and past practices of the property (particularly if hazardous materials or waste were managed at the site); and
e review of the records of local, state and federal regulations.

A detailed review of a site that further evaluates suspected environmental damage and the extent of surface and subsurface contamination is administered. The review is used to confirm any environmental liabilities that may arise.

iii Tax

The most important tax implications to be considered upon acquisition of real estate through an 'agreement upon construction' are the real estate transfer tax and the value added tax (VAT). The real estate transfer tax is payable by the buyer upon acquisition of the property. It is important that the agreement clearly states whether the property actually transfers to the buyer upon construction or before. The applicable tax rate used by the local tax authority to calculate the real estate transfer tax may vary from state to state in Mexico.

Transfer of ownership of real estate improvements will be subject to VAT at a rate of 16 per cent on the value of the improvements. The seller may also be required to pay taxes upon transfer of the real estate, including income tax.

The local transfer tax is a tax payable by the buyer of any real estate in Mexico. The rate may vary depending on the particular state where the real estate is located. Upon acquisition of real estate, the buyer will be further obliged to pay property tax, with the amount being based on the value assigned to the property by the local tax authorities. The tax may be paid either annually or in bimonthly increments. A seller is required to be up to date with its tax payments to be able to sell.

iv Finance and security

Almost all commercial banks in Mexico grant commercial financing so that clients can acquire real estate, normally using the same property as a guarantee until it is fully paid. Some other financial structures are also available, particularly in the form of bank trusts or other assets as backup guarantees.

In recent times, non-bank financial institutions such as fintechs are a good option to obtain financing or as investors. They are usually licensed to profit from interest rates in loans directed at specific sectors or for specific types of activities, such as housing, consumer and small business lending, or other assets finance. Most of them obtain all their funds through investors' equity; national, foreign or development bank loans; or the Mexican capital markets.

As in other countries, there is also the option to use the service of a title insurance company with a presence in Mexico to avoid any possible future ownership issues. Once a title company is involved in the process, it usually conducts an independent due diligence process to find out the risks, if any, of insuring the property in question.

Notwithstanding the foregoing, it is important to mention that almost any acquisition of real estate in Mexico must be formalised by a notary public and registered within the relevant Registry office. To do so, the notary will search the backgrounds of the real estate that are recorded and will perform the same investigation procedure.

Typically, notaries charge a percentage of the purchase price of the real estate for their services; however, the fees are duly regulated and subject to negotiation.

The most common securities in real estate transactions include the incorporation of land mortgages, recordation and registration of the relevant security before the Registry office, and the grants under applicable laws that are available under a specific enforcement procedure that intends to make the execution process for lenders upon execution faster and more economical as result of a default under the main credit.

The second most commonly used method to secure financing over real estate involves the use of fideicomisos and involves specifically transferring ownership of the real estate to a trustee (generally a bank) to secure obligations under financing. This allows for control of the actual ownership and transfer thereof to be held by the bank, which can subsequently transfer the real estate to the lender in the event of a default using a special, faster process.

VI LEASES OF BUSINESS PREMISES

The execution of lease agreements is another alternative to establishing a presence in Mexico without acquiring real estate. Lease agreements are highly flexible and can be negotiated using standard terms and conditions, as long as the same are permitted by law.

In commercial leasing, it is relatively common to require a landlord to construct improvements on the property and lease both the improvements and the land collectively.

A right of first refusal for the tenant under a lease agreement is mandatory under law; however, the terms and conditions relating to the right of first refusal are normally contained within the corresponding lease agreement and can be waived.

Some of the most important points to consider when negotiating a lease agreement are:

a the rent;

b the period of the lease, since there will be improvements built for the sole purposes of the lease;

c early termination;

d guarantees;

e initial deposit;

f improvements;

g return;

h change of circumstances; and

i *force majeure*, or acts of God and jurisdiction (jurisdiction usually being held by the place where the real estate is located).

It is customary for commercial spaces to be leased within five years and 'built to suit' lease transactions to provide for a minimum term of 10 years.

VII DEVELOPMENTS IN PRACTICE

In light of the covid-19 pandemic, one of the most relevant aspects in real estate transactions that must be properly documented and regulated, and which used to be documented and regulated in a very general manner in real estate-related contracts, concerns unforeseeable changes in circumstances, and acts of God and *force majeure*, regardless of the position (creditor or debtor, a tenant or landlord, etc.) a party holds in the contractual relationship.

In this regard, Mexican law allows for *force majeure* provisions to be waived by mutual written consent of the parties and, in general, documented in a manner that properly reflects the intent of the parties. For example, a creditor in the contractual relationship may seek to waive pandemics from consideration of *force majeure*, and a debtor may seek an express exception of compliance of its contractual obligations or documentation of those obligations in an intermediate structure that attempts to balance the parties' positions. Careful attention to those clauses will reduce future litigation associated with those clauses.

VIII OUTLOOK AND CONCLUSIONS

The covid-19 pandemic undoubtedly had a great impact on real estate relationships and in real estate development around the world, including Mexico. In Mexico, there have been notable changes, including the need to restructure financing and leasing contracts; repurposing of the use of commercial real estate to adapt to the increase in digital commerce activities while maintaining a balance with physical retail activity; the increase in second-home investments; and the need to recognise and incorporate factors such as those in relation to digital nomads.

The foregoing has further impacted the pricing and availability of real estate products in all areas, from residential to industrial, as well as caused a shift in the areas of real estate development focus and, to some degree, a shift in the power of negotiation between the parties, depending on the area and the type of real estate development subject matter of the negotiation.

While these changes have occurred and are clearly recognised by the market, Mexico remains a country with a high potential for real estate investment in all areas and types of real estate, as well as a secure legal framework.

Appendix 1

ABOUT THE AUTHORS

ALFREDO CHÁVEZ

Gonzalez Calvillo

Alfredo Chávez is a leading practitioner in the fields of real estate and project development investment. He provides legal and business advice to multinational and Mexican companies in all types of corporate transactions. Alfredo's work includes active representation of diverse clients from a wide variety of industries in multimillion-dollar transactions and investments in the areas of real estate, energy, electricity generation, structuring of foreign investment, franchise, compliance, money laundering, data privacy and projects for their consolidation in Mexico.

JOAQUÍN ALCALÁ

Gonzalez Calvillo

Joaquín Alcalá has advised and represented both domestic and foreign companies for more than 25 years in everything related to the establishment and operation of their business operations in Mexico, as well as in the structuring and negotiation of various international transactions. He has extensive experience in the corporate, mergers and acquisitions and real estate practice areas.

GONZALEZ CALVILLO

Montes Urales 632
Lomas de Chapultepec
Mexico City 11000
Mexico
Tel: +52 55 5202 7622
achavez@gcsc.com.mx
jalcala@gcsc.com.mx
www.gcsc.com.mx

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