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Year in review: real estate law Mexico

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All questions

Introduction

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

Public property is property that belongs to the Mexican nation, as a sovereign entity, by way of public or state-owned entities, which may be federal, local or municipal. It is generally regulated by:

1. the Constitution;
2. the National Goods General Law;
3. the Acquisitions, Leases and Services of the Public Sector Law; and
4. other applicable local laws or regulations.

All public real estate must be registered at the relevant Public Registry of Property and Commerce office. As a general rule, the property may not be sold, transferred or encumbered in any manner, unless a disincorporation procedure is followed for its sale or a concession is granted to allow its use and enjoyment.

Ejido property belongs to agrarian communities. It is granted by the government to members of local communities, mainly for agrarian or communal use, to develop productive or social activities. The ejido has full legal capacity of ownership of its own assets.[3] This was established in 1917 following the Mexican revolution. Ejido property is not considered public or private property; however, following further amendment to the original legislation, 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 are duly satisfied. This type of ownership is regulated by the Constitution, the Agrarian Law and other applicable local laws or regulations. All ejido property must be registered at the National Agrarian Registry Office as opposed to the Public Registry of Property and Commerce.

Private property is property that belongs to private parties, who can be domestic or foreign natural persons, companies or investment vehicles. Private ownership is regulated by the Constitution, the Federal Civil Code and various 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 Public Registry of Property and Commerce office.

The Public Registry of Property and Commerce is a public entity that publicises the legal status of goods and rights, including:

1. deed owners of real estate;
2. the easements, liens and encumbrances covering a particular piece of real estate; and
3. 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 duly registered with the relevant Registry office. The act of recording has 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, recording does not have the effect of creating or constituting the respective right.

The Registry is public, and any interested party can 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 over the piece of real estate. 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 at the Federal 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 have to use the laws of the state where the property is located when settling disputes.

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 in facilitating 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 are many options for grant financing and owning real estate properties through fintechs, infrastructure and real estate trusts and co-ownership structures exclusively created or involved in the real estate market.

Foreign investment

Article 27 of the Constitution provides that the Mexican nation owns the land and water located within national territory and that the Mexican nation has the right to transfer those ownership rights to individuals by creating private property. Although Section I of Article 27 grants only Mexican individuals and companies the right to acquire ownership of land and water, it also confers on the Mexican nation 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 return to the state.

Foreign individuals or companies may, subject to prior authorisations, 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 within the restricted zone, for residential purposes, may only do so through a special bank trust called a *fideicomiso*. By using this 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, and to sell or even inherit the rights to the premises.

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

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

Structuring the investment

The most common ways of owning or investing in real estate in Mexico are:

1. personally through a direct deed;
2. through the incorporation and use of a Mexican corporation; or
3. through hiring the services of a banking institution using a fideicomiso.

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

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 to ensure that 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.

Real estate ownership

i Planning

According to the Constitution, the government must take the measures necessary to:

1. arrange human settlements and to establish adequate provisions, uses, reserves and purposes for land, water resources and woodlands;
2. execute public works; and
3. 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 will 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 liability as a consequence of contamination and site remediation. Those responsible for site contamination are liable to pay reparation damages. Liability can entail joint and several responsibilities among prior owners.

If the land is contaminated with hazardous waste, it 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:

1. physical survey of the property and the surroundings properties;
2. on-site inspection to identify environmental damage;
3. review of the local geology and hydrology;
4. assessment of current and past practices of the property (particularly if hazardous materials or waste were managed at the site); and
5. 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 real estate ownership. It is important that the agreement clearly states whether the ownership 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 payable by the buyer of any real estate in Mexico. The rate may vary depending on the 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.

Nowadays, 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 non-bank financial institutions 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.

Almost all acquisition of real estate in Mexico must be formalised by executing a public deed before a notary public and registered with the relevant Registry office. The notary will search the background of the recorded real estate and perform an 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, recording and registration of the relevant security before the Registry office, and 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 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.

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 they 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:

1. the rent;
2. the period of the lease, since there will be improvements built for the sole purposes of the lease;
3. early termination;
4. guarantees;
5. initial deposit;
6. improvements;
7. return;
8. change of circumstances; and
9. 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 for five years and 'built to suit' lease transactions to provide for a minimum term of 10 years.

Developments in practice

Year in review

In light of certain events such as the covid-19 pandemic or structural damages cause by earthquakes, one of the most relevant aspects of real estate transactions that must be properly documented and regulated, and that 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 them.

Other key elements that must be carefully reviewed and analysed, especially in real estate developments that are located near the coastline, are granted federal concessions and archaeological sites.

In Mexico, federal concessions are normally granted either to use a beach front, adjacent to the real estate, or to obtain specific water volumes and use water wells. It is common among parties to include these concessions as part of the price to acquire or invest in certain real estate; however, these concessions are only granted by the government to specific persons, on a case-by-case basis, and the same could not be transferred or negotiated between private parties. A new owner or investor will have to apply for the concessions, to be granted, and the government is not obligated to grant concessions. Also, constructions are not permitted within the federal concession area, therefore any violation will result in fines and the confiscation of the assets.

Archaeological findings or sites are also an important element to consider concerning certain areas of the Mexican territory because, if there are findings within the perimeters of the real estate property, the corresponding authorities will be authorised to stop any real estate project or development and to determine the relevance of such findings and the continuance of the project.

Finally, another key element that needs to be carefully considered in the purchase of real estate, most importantly for the development of projects, is the availability of power supply and infrastructure, which may have a significant impact both on the cost and viability of the project.

Outlook and conclusions

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. Nearshoring has further activated the real estate industry, mainly regarding industrial developments. To obtain better returns, investors from all over the world find in Mexico a good option to invest and develop. Affordable prices, food, culture and weather also attract a lot of foreigners to experience living and retirement in Mexico. All this is possible because of the notable changes in our legal framework, including:

1. the multiple options in financing and leasing contracts;
2. 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;
3. the increase in second-home investments; and
4. 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, and has caused a shift in the areas of real estate development focus and, to some degree, in the power of negotiation between the parties, depending on the area and the type of real estate development that is the subject matter of negotiation.

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