



CHAMBERS
Global Practice Guides

Real Estate

Mexico – Law & Practice

Contributed by

Haynes and Boone, SC

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MEXICO

LAW AND PRACTICE:

p.3

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The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

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MEXICO LAW AND PRACTICE

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automotive, banking and finance, consumer products and retail, real estate and hospitality, construction, food and beverage, healthcare, infrastructure/projects, technology, telecommunications, shipping and transportation, manufacturing, mining and water. The firm's legal professionals are highly experienced in cross-border and domestic transactions in various legal practice areas, including antitrust, corporate and capital markets, banking and finance, bankruptcy, environmental, M&A, intellectual property, private equity, maritime/shipping finance, real estate, franchise and distribution, energy, tax, and arbitration and litigation.

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1. General

1.1 Main Sources of Law

The United Mexican States ("Mexico") is a federal republic composed of 32 states, each of which is composed of several municipalities. The federal government is comprised of three branches: executive, legislative and judicial. The head of the executive branch is the President, who is elected by popular vote for a six-year term (with no re-election). Legislative power is vested in the Chamber of Deputies and the Senate. The judicial branch consists of a Supreme Court of Justice, Circuit Courts and District Courts. Each of the 32 states has its own constitution and local laws and regulations, as well as its own executive, legislative and judicial authorities. The head of the state executive branch is the Governor of the relevant state. The legislative branch consists of the Chamber of Deputies and the judicial power is exercised by the local courts.

Mexico follows a civil law system that is based on the Continental European legal tradition stemming from Roman law and Napoleonic principles. Under this system, the laws of the land are largely codified in written statutes enacted by federal or local congress, as the case may be.

Sources of law derive from the three different levels of governmental jurisdictions – the Federation, the states and the municipalities.

The main sources of Mexican real estate law are the Mexican Federal Constitution, the Federal Civil Code, the Federal Commerce Code, the General Foreign Investments Law, the Federal Consumer Protection Law, Federal and State Environmental Laws, State Urban Development and Zoning Laws and Regulations, State Condominium Laws, Municipal Development and Zoning Programmes and Construction Regulations, customs, jurisprudence or case laws, general law principles and legal doctrine.

1.2 Main Market Trends and Deals

The main trends in the Mexican real estate market have been the development of mixed-use projects, industrial transactions which include acquisitions, leases and development of industrial parks, the development of apartments for rent product or so-called “multifamily” real estate projects, the acquisition and consolidation of real estate portfolios by Mexican REITs (*Fibras*), particularly by Fibra UNO, Terrafina and Fibra Danhos, and the incorporation and public offering of *Certificados de Capital de Desarrollo* (CKDs) as a source of capital for the development of real estate projects. In the hotel and resort industry there has been a large consolidation of hotel brands, ie the acquisition by Marriott of Starwood Hotels and the acquisition by Accor of the Fairmont, Raffles and Swissotel brands.

1.3 Proposals for Reform

Probably the most relevant reforms and amendments to laws are those currently being reviewed and discussed at the Mexico City Legislative Assembly, which include the new constitution for Mexico City, the new Housing Law and certain modifications to the Mexico City Urban Development Law as follows:

- modifications to Articles 41, 41 *bis* and 42 of the Mexico City Urban Development Law, which are intended to add requirements when requesting a change of zoning and densities applicable to Mexico City properties (including approval of the neighbourhood committee), which will make more burdensome the process to obtain zoning change; however, this does not imply limiting, restricting or modifying current zoning and densities granted to lots. This proposal was submitted before the Legislative body on 22 September 2015; and
- modification to the Mexico City Urban Development Law to provide that any High-Impact Construction will require a high-impact construction licence (which as a condition for its issuance will require the prior consent of the neighbourhood committee). This proposal was submitted before the Legislative body on 1 December 2015. This reform implies empowering the neighbours to approve construction licences for projects that will have a high impact on the current infrastructure of neighbourhoods, a situation that will put at risk the ability of developers to obtain construction licences for large-scale developments.

With respect to the aforementioned proposals, their current approval status is the following: the proposal indicated in the first point above is being reviewed by the first of four review commissions, any of which may make changes or comments to the proposal and if so, that proposal will need to be revised and the entire process must start all over again. If the process is followed with no obstacles, at least another 12 to 18 months will be needed to approve such a law. The proposal indicated in the second point above is being reviewed by the

second of four commissions. As indicated above, any of these commissions may make changes to or comments on the proposal and if so, that proposal will need to be revised and the entire process must begin all over again. If the process is followed with no obstacles, at least another six to 12 months will be needed to approve such a law. However, note that for the application of such amendments, the Construction Rules and Regulations of Mexico City will need to be amended to include the concept of a high-impact construction licence; the proposal of such an amendment (which is estimated to include the amendment of 27 articles of the Regulations) has not been concluded. Even if the amendments to the Construction Regulations are approved by the Mayor of Mexico City under a fast-track process, this will take at least two to three additional months after the approval of the Urban Development Law amendments.

With respect to the new Housing Law, the proposal includes a concept that is currently being discussed. This legal precept contemplates that any capital gains from the sale of a house that is due to the infrastructure provided by the City will be in the favour of the Mexico City government. Deputies of the Mexico City Legislative Assembly have indicated that the intention of that legal precept is not to create an additional tax on the property; therefore this term has been removed as proposed and will be clarified. The Housing Law proposal has already been approved with some clarifications and proposed modifications, including a request for clarification of the “capital gains” concept included therein.

2. Sale and Purchase

2.1 Categories of Property Rights

Generally, non-public land in Mexico falls into one of three categories: private property, *ejido* property and “communal” property. The owners of each type of land possess different rights to use, enjoy and transfer their property, as outlined below:

Private Property

Private property is owned by individuals or legal entities for their own exploitation and use. Private property rights are conveyed, in most cases, through sales contracts or trust agreements. Conveyances of title are recorded before the Public Registry of Property in the appropriate jurisdiction. Although there are some exceptions, such as subsoil rights, private property, generally, has no limitation on domain.

The most common property rights that are acquired in private property are: fee simple rights (full ownership) and usufruct rights (ie rights to use and enjoy the property but which do not include disposition rights). In addition to the above, a very common way to acquire real property in Mexico is through a trust, the background of which is the following:

as far back as 1937, the Federal Government recognised that the outdated protective constitutional restriction against foreign ownership could cause substantial harm to the economic development of the Restricted Zone. Under the Mexican Constitution, foreign individuals and legal entities may not hold legal title to any real estate in Mexico which is located within 100 kilometres from the border or 50 kilometres from the coastline (the “Restricted Zone”). Hence, on 29 April 1971, President Luis Echeverria issued a decree, clearly setting forth the rules according to which foreigners could obtain exclusive and absolute use and enjoyment of real estate located within the Restricted Zone. The provisions of the Presidential Decree of 29 April 1971 were, with certain modifications and additions, incorporated into the Foreign Investments Law (“FIL”). The FIL provides that the Ministry of Foreign Affairs may authorise a Mexican banking institution to acquire title over real estate located within the Restricted Zone, as trustee of a trust (*fideicomiso*) which would have a foreigner as the absolute beneficiary. Nowadays, the Trust structure is not only used as a mechanism for foreigners to acquire land in the so-called Restricted Zone, but as a collateral mechanism to secure repayment in financing transactions or as a source of funding and public offering of real estate projects (ie Mexican REITs or *Fibras*).

Ejido Property

Ejido property is land granted by the Mexican government to individuals for agricultural and farming purposes. *Ejid*os are structured as communities. They have internal administration and surveillance boards, respectively known as the “Comisariado Ejidal” and the “Comite de Vigilancia”. *Ejido* property may exist either for the exclusive use of an individual beneficiary in the form of *ejido* parcels, or for the mutual benefit of the *ejido* community in the form of *ejido* community parcels. Individuals have possession rights over their *ejido* parcels but not ownership rights. Only Mexican individuals who are members of the *ejido* community or Mexican individuals living in the neighbourhood may acquire possession rights over the *ejido* parcels. Also, *ejido* property may be subject to usufruct in favour of third parties. Notwithstanding the aforementioned, through a lengthy procedure, an *ejido* parcel may be released from the *ejido* property regime and converted into a private property regime. All *ejido* property is recorded before the National Agrarian Registry. In the event of release from the *ejido* regime, the land would be registered before the Public Registry of Property in the appropriate jurisdiction.

Communal Property

Communal property shares virtually all characteristics of *ejido* property, with the exception that there are no exclusive parcels for individual beneficiaries. Instead, all parcels belong to the community for its common use and enjoyment. The liberation of communal property to a private property regime also involves a lengthy procedure.

2.2 Laws Applicable to Transfer of Title

Real estate transactions in Mexico are subject primarily and generally to civil law as opposed to commercial law. Civil law is within the jurisdiction of the states, where each state has its own Civil Code, while commercial law falls under federal jurisdiction, governed primarily by the Federal Code of Commerce. There is substantial uniformity among the different civil codes and related statutes of the states, especially with respect to the conveyance of real estate.

In addition to the above, a specialised law called the Federal Consumer Protection Law applies to the conveyance of title of residential units from developers to end users and to the conveyance of timeshare products from developers and timeshare operators to end users, and the law provides for a set of protective covenants in favour of end users, including the requirement that any purchase and sale agreement of residential units and timeshare units must be approved by, and recorded at, the Consumer Protection Bureau.

2.3 Effecting Lawful and Proper Transfer of Title

All of the civil codes of the states require that any contract whereby an interest in real estate is conveyed or otherwise affected be formalised through a notarial public instrument (*escritura pública*) and recorded before the corresponding Registry of Property (normally in the city or municipality where the real estate is located). A civil law notary public is a quasi-public official who is vested with authority to attest to the veracity of the legal transactions formalised before him or her.

In addition to the formalisation in a public instrument, real estate transactions (ie acquisitions, mortgages, easements and, in some states, leases for terms greater than five years, etc) are required to be recorded in the Public Registry of Property. Thus, the status of title to a property may be verified through a search of such public records. Also, the Registry must, upon request, issue a “Certificate of Liens”, which reflects the identity of the holder of title and whether the property is subject to any liens or other real or personal interests (when the latter are subject to being recorded).

Although title insurance is available in Mexico it is only common when a US institutional investor is involved in the transaction.

2.4 Real Estate Due Diligence

Due diligence in real estate transactions will typically include a title search at the Public Registry of the Property and title opinion by legal counsel. Such a search and opinion would cover issues such as the following:

- legal ownership;
- limitations on the use of property as dictated by any applicable zoning ordinances;

- pending claims against the property by third parties or liens of record;
- labour claims, limitations or requirements which may be contained in any restrictive covenants of record;
- agrarian or “*ejido*” interests;
- municipal assessments for public improvements and property taxes, street or municipal improvement dedications;
- unpaid utility charges;
- non-conforming uses pursuant to restrictive covenants not of record;
- zoning and densities allowances;
- discrepancies, conflicts or shortages in area or boundary lines;
- encroachments and any overlapping of improvements; and
- rights of third parties in possession.

In the light of the above, the legal counsel’s title search and opinion should be required to cover not only the records in the Public Registry of Property, but also the elements necessary to ascertain that none of the above potential risks is present.

In addition to the above, obtaining of the following certificates and performance of the following studies will also be customary: obtaining of certificate of non-liens and encumbrances, certificate of non-indebtedness of property taxes and water utilities, power and telephone feasibility letters, zoning certificates, and the performance of land surveys and Phase 1 and Phase 2 environmental studies.

2.5 Typical Representations and Warranties

Typical representations and warranties granted by sellers on an asset real estate transaction will include organisation and good standing of the seller, legal representation and faculties, good and marketable ownership and possession, no liens and encumbrances other than permitted encumbrances, no knowledge of structural or material hidden defects, no knowledge of environmental contamination, no condemnation proceedings or eminent domain proceedings of any kind pending or, to the knowledge of the seller, threatened against the property, compliance with laws, compliance with property taxes and utility services fees and availability of services and infrastructure and no tax debts. There are some statutory warranties that, although not provided for in contracts, are granted by law, such as legal title and hidden defects warranties. Legal title remedies have no statute of limitations and hidden defects remedies have a statute of limitations from six to 12 months. The parties may agree in the contract larger statute of limitations terms.

With respect to fundamental representations (ie legal representation and faculties and good and marketable ownership and possession), buyers’ remedies will include recovery of the full amount of the price paid plus damages and losses. With respect to other types of representations, remedies

are usually limited to claim of damages and losses. It is also typical to include in Mexican purchase and sale contracts a specific penalty amount in the event of default to reflect the amount of damages and losses that would be caused in the event of default (usually from 10% to 30% of the contract value).

2.6 Important Areas of Law for Investors

The most important areas of law to take into consideration will be those related to legal title and possession of the property, whether there are *ejido* backgrounds on the property to confirm that due process was followed to convert *ejido* property into the private property regime, taxes that will be triggered upon acquisition of the real estate and upon the future sale of the property, any restrictions that may be applicable to the acquisition, zoning and density programmes and regulations applicable to the real property, and environmental matters.

2.7 Soil Pollution or Environmental Contamination

Purchase and sale transactions of real properties polluted with hazardous materials (including asbestos) are required to be approved by the Federal environmental authority *Secretaría de Medio Ambiente y Recursos Naturales* (SEMARNAT). The purpose of this authorisation is, among others, to indicate which party (seller or buyer) will be responsible for remediation and which remediation actions will be undertaken. In the absence of that approval, SEMARNAT could make either the buyer or seller responsible for the remediation of any contamination with hazardous materials, despite any agreement in this regard entered into by and between the buyer and seller.

2.8 Permitted Uses of Real Estate under Zoning or Planning Law

In most of the states in Mexico, the buyer will be able to obtain a zoning certificate for the property, and the certificate will indicate zoning, density and allowances for use for the property, as well as certain restrictions such as height and floor level, the required free or permeable area, and parking requirements, among others. However, a buyer will not be able to confirm that a specific real estate project will be able to be built on a piece of land until such time as a construction licence is obtained at a municipal level. The most common development agreements executed with the relevant public authorities that will facilitate the development of a project are those entered into for the creation or improvement of existing urban infrastructure (ie development, improvement and/or maintenance of public parks and recreational areas, street lighting, and, in general, improvement of street infrastructure, improvement of water and sewage infrastructure, and improvement of power infrastructure, among others).

2.9 Condemnation, Expropriation or Compulsory Purchase

It is possible for the taking of land, condemnation, expropriation or compulsory purchase by the government to happen. The two main processes contemplated in Mexican law are:

- expropriation due to a public cause; and
- domain expiry due to a crime committed in the real property.

Expropriation due to public cause is resolved through a Presidential decree, which is published in Mexico's Official Gazette. The affected owners may appeal that Presidential decree within the next 15 business days from its publication. If the appeal is resolved in favour of the Nation, the Mexican government will pay an indemnification to the owner based on an appraisal carried out by a Federal agency and will immediately take control over the expropriated asset.

The legal action to enforce domain expiry due to a crime committed in the real property may be exercised by a federal or local prosecutor, with respect to real property where crimes related to organised delinquency, crimes against public health, kidnapping, car robbery and "white slavery" have been committed. The domain expiry due to a crime committed in a real property must be resolved by a competent court.

2.10 Taxes Applicable to a Transaction

Typical taxes and fees in an asset transaction are:

- property transfer taxes which, depending on the state, are in a range from 2% to 5% of the transaction value;
- Public Registry of the Property recordation fees, which usually are in an amount equal to approximately 1% of the transaction value;
- value added tax in a 16% rate on the value of the construction only (except for real estate assets with a residential use, where no value added tax is triggered); and
- capital gains taxes (income taxes). On a general basis, profits from the sale of a real estate asset would be subject to tax at a 30% rate for corporations and a maximum 35% for individuals. If the seller is an individual and the real estate asset is their habitual residence, the sale could be partially or totally exempted from income tax.

Except for capital gains or income taxes which are paid by the seller, all other taxes and recordation fees are paid by the buyer.

In an equity transaction (purchase and sale of shares) as opposed to an asset transaction, no property transfer taxes, recordation fees and value added taxes are triggered. The only tax that will be triggered is the income tax on the capital gain. If the seller is a Mexican entity, a 30% tax rate will be applicable; if it is a Mexican individual, the applicable

tax rate could be up to 35%. If the seller is a foreigner, the income obtained will be taxed at a 25% rate on the gross income or 35% on the gain, depending on certain requirements. Depending on the tax residency of the final seller, a Tax Treaty might grant some benefits.

In the event of a partial ownership transfer, applicable taxes will be triggered only on the portion that has been transferred.

2.11 Legal Restrictions on Foreign Investors

Under the Mexican Constitution, foreign individuals and legal entities may not hold legal title to any real estate in Mexico which is located within 100 kilometres from the border or 50 kilometres from the coastline, in the so-called Restricted Zone.

Mexican law permits the acquisition of domain or title over land by foreigners outside of the Restricted Zone. Foreigners may acquire direct title over real estate outside of the Restricted Zone by obtaining a special permit from the Ministry of Foreign Relationships and by agreeing to what is known as the "Calvo Clause", which implies waiving its rights to request the protection of a foreign government with respect to the foreigner's real estate assets located in Mexico in the event of a claim.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisition and development of real estate is traditionally financed through loans. Commercial and development banks (domestic and foreign) are the largest players in the Mexican real estate loan market. However, there is a rising number of CKD funds (a type of high-return fund that raises capital from the public at large, mainly from regulated pension funds and insurance companies) and *Fibras* (REIT-like productive real estate funds that also raise capital from the public at large, also mainly from regulated pension funds and insurance companies), that invest in real estate through mezzanine, quasi-equity, and other high-yield real estate loans.

3.2 Typical Security Created by Commercial Investors

Lenders typically utilise the following arrangements to secure the borrower's payment obligations:

- **Mortgages:** These are still the most common means of security in Mexico for real estate financing transactions, and they must be granted in a contract executed before a notary public and recorded before the Public Registry of Property with jurisdiction over the place where the real estate is located.

- **Guarantee or collateral trusts:** Loans to Mexican borrowers or to non-Mexican borrowers that have real estate assets in Mexico can also be secured by means of a guarantee trust. In a guarantee trust, title to the assets which secure the loan (ie real estate, equipment, inventories, etc) in Mexico is conveyed by the borrower to a Mexican bank acting as trustee (in that capacity, the “Trustee”) under a guarantee trust agreement. The Trustee holds title of the real property for the exclusive purpose of securing compliance by the borrower with its loan obligations, until such time as the loan obligations are extinguished (by payment or otherwise). In the event of default, the lender has the right to cause the Trustee to sell out the assets to satisfy the debt, through a non-judicial auction process, for which most rules can be freely agreed upon by the parties in the guarantee trust agreement.
- **Collateral over rents:** In retail, offices and industrial real estate financing transactions, collateral over lease payments has become quite prevalent. Also, collateral over rents is also a common element in financing structures for a multifamily type of product (ie apartments for rent). Collateral over rent proceeds is usually structured through an administration and a source of payment trust is executed with a Mexican bank or through a pledge structure.
- **Collateral over sale proceeds:** In residential real estate financing transactions, collateral of proceeds from the sale of residential units is also customary. Collateral over sale proceeds is also usually structured through an administration and a source of payment trust is executed with a Mexican bank or through a pledge structure.
- **Collateral over hotel and resort proceeds:** In resort financing transactions, as additional security, the Mexican developer or operator often will create collateral over the proceeds from the operation of the resort in favour of the lender.
- **Assignment of performance bonds:** In construction projects, the borrower will often assign performance bonds obtained by the general contractor and subcontractors, in favour of the lender.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate to foreign lenders. Security mechanisms over real estate are available equally to foreign and local lenders. However, in the case of a foreign lender, deed in lieu of foreclosure would require a trust structure if the property is located within 100 kilometres from the border or 50 kilometres from the coastline or prior authorisation of the Ministry of Foreign Affairs if the property is located in any other area within Mexico.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Taxes or fees, such as documentary taxes, registration fees and notaries’ fees, may be paid on the granting and enforce-

ment of security over real estate. Mortgages and guarantee trusts over real property must be granted in a contract executed before a notary public and must be recorded before the corresponding Public Registry of Property. In the case of a guarantee or collateral trust, those also have to be registered in the Mexican electronic registry of liens on personal property and transfers of receivables (*Registro Único de Garantías Mobiliarias*, or *RUG*). Notarial fees vary, but normally they are in the 0.5% to a 1% range. Recordation fees in most of the states are fixed at a relatively low amount per event, but in some states they can be up to 1% of the mortgage value. If the security mechanism is a collateral trust, the trustee fees will also apply. On enforcement, taxes and fees are borne by the person acquiring the real property; these taxes and fees are recordation fees, notary fees and property transfer taxes (from 2% to 5% of the property value, depending on the state). Also, the execution of the guarantee might trigger a capital gains income tax to be levied on the guarantor and if the person acquiring the property is an individual, the individual may be subject to a capital gains tax if the price paid for the real property is 10% or more lower than its current appraised value.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Any entity must comply with requirements set forth in its bylaws to grant collateral. It is not uncommon for company bylaws to require approval from the board of directors or partners’ meeting. In the case of mortgages and collateral trusts securing third-party obligations (that is, obligations not of the grantor), a mortgage or trust conveyance is voidable if the grantor did not receive fair consideration, nor benefit from inherent value tantamount to fair consideration, and if the mortgage was created or the conveyance made within the clawback period of insolvency of the mortgagor or transferor.

3.6 Formalities When a Borrower is in Default

There are no particular formalities required or obstacles to be overcome before the lender is able to enforce its security over real estate against the defaulting borrower. In most cases, (i) the foreclosure of a mortgage requires that a special expedited judicial procedure be undertaken, and (ii) the foreclosure of a collateral trust requires that a non-judicial auction process be undertaken with the Trustee. One of the main challenges during foreclosure through a non-judicial procedure is recovering possession over the real property, which usually requires engaging a judicial procedure.

When a real estate asset is subject to a mortgage or a collateral trust arrangement, the effect is that the asset is isolated to be auctioned for the benefit of the secured lender in the case of breach of the secured obligation, out of the legal reach of other creditors, effective against third parties even while the grantor is subject to a bankruptcy procedure. In order

to achieve the above, it is important to comply with creation and publicity requirements of real estate liens, which are the creation through a public instrument executed before a Notary Public and recordation before the corresponding Public Registry of Property. In the case of guarantee or collateral trust, which in addition to the real estate includes personal property (such as rent and sales proceeds), these also have to be registered in the Mexican electronic registry of liens on personal property and transfers of receivables (*Registro Único de Garantías Mobiliarias*, or RUG).

3.7 Subordinating Existing Debt to Newly Created Debt

Existing secured debt can become subordinated to newly created debt by an agreement by the lenders, which is duly formalised before a Notary Public and recorded before the corresponding Public Registry of the Property and, in the case of a guarantee or collateral that also includes personal property (such as rents and sales proceeds), also registered in the Mexican electronic registry of liens on personal property and transfers of receivables (*Registro Único de Garantías Mobiliarias*, or RUG). The authorisation by the existing lender is relevant for these purposes.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over a real property contaminated by hazardous materials is not liable for the pollution due to the mere fact of holding or enforcing that security. However, owners and possessors of a real property polluted by hazardous materials may become liable vis-à-vis environmental authorities for such contamination. Accordingly, if a creditor becomes the owner of contaminated real property through deed in lieu of foreclosure, it will become jointly liable for that contamination.

3.9 Effects of Borrower Becoming Insolvent

If a security interest created over real property to secure the grantor's own obligation is duly formalised and recorded before the corresponding Public Registry of Property and, in the case of a guarantee or collateral trust that also includes personal property (such as rents and sales proceeds), duly registered in the Mexican electronic registry of liens on personal property and transfers of receivables (*Registro Único de Garantías Mobiliarias*, or RUG), it will not be voidable if the borrower becomes insolvent (albeit foreclosure thereunder will have to be undertaken within and pursuant to the rules of *concurso mercantil* proceedings). If a security interest is created to secure obligations of a third party, even if properly formalised and registered, that security interest is voidable if the grantor did not receive fair consideration, or inherent value tantamount to fair consideration, in exchange for granting the security interest.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Urban development planning and zoning are regulated on state and municipal levels. State governments usually have a Ministry of Urban Development in charge of implementing and enforcing urban development plans and regulations which include strategic planning and zoning for all regions within a state. Urban development plans and regulations are proposed by the executive governmental branch of each state and approved by the respective legislative body of each state. In addition or in supplement to urban development plans, environmental programmes and plans may also be issued and implemented by the Ministries of Environment of each state. At a municipal level, municipalities typically issue zoning programmes and municipal development plans which detail further the uses, densities and other construction allowances and restrictions applicable to each one of the lots within a municipality.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The design, appearance and method of construction of new buildings or the refurbishment of an existing building are regulated on a municipal level. Regulations related to design, appearance and method of construction are usually contained in construction regulations and Mexican official norms, which are enforced by public works bureaus or offices of each one of the municipalities.

4.3 Regulatory Authorities

Urban development planning and zoning are regulated on state and municipal levels. Ministries of Urban Development of each state are in charge of implementing and enforcing urban development plans and regulations, which include strategic planning and zoning for all regions within a state. Municipal public works bureaus or offices are also in charge of implementing and enforcing municipal zoning and construction regulations. Zoning allowances or restrictions usually include: specific uses allowed on the property, height or levels of construction allowance and restrictions, maximum construction surface, setback requirements, free area requirements, and parking space requirements. Also, restrictions may include protection of certain constructions that are deemed to have an artistic or historical value, which cannot be modified, altered and/or demolished without prior written authorisation by the competent authorities.

4.4 Obtaining Entitlements to Develop a New Project

Processes may vary from one state to another or from one municipality to another but, in general terms, the process is as follows:

The first step contemplates obtaining a zoning certificate from the respective state governmental office which, in general terms, will outline the construction allowances and restrictions applicable to a specific lot. Thereafter, in certain states, the owner/developer will obtain a use of land licence or equivalent licence that will approve, from a zoning perspective, the project to be carried out at the property. The owner/developer will need to prepare and present environmental and urban impact studies for approval by the respective state governmental authorities, who will provide detailed information on the project to be performed at the real property, an analysis of the impact that such a project will have on the environment and on the currently existing city infrastructure (mainly transit, power, water and sewage) and a proposal of mitigation measures. Different state and municipality offices in charge of the various environmental and infrastructure matters will have to approve the urban and environmental impact studies and will approve the mitigation measures or order additional or different mitigation measures. In certain states (including Mexico City), during this process the sign-off from the neighbourhood committee will be required. Simultaneously, the owner/developer will have to obtain power and water and sewage feasibility letters from the governmental offices in charge of providing those services. Upon completion of all of the above, the owner/developer will apply and obtain the respective construction licence. At substantial completion of the construction, the owner/developer will file a construction termination notice and will obtain the respective occupancy permit (including the respective civil protection/fire service authorisation). As one of the requirements to obtain occupancy authorisation, all environmental and urban impact mitigation measures imposed by competent authorities must be fulfilled by the time the occupancy application is filed. Depending on the uses and operation of the respective construction facilities, an operating licence may also be required.

4.5 Right of Appeal Against an Authority's Decision

In the event of a full or partial denial or rejection of a development, construction or zoning application, the applicant may present revision recourse before the same administrative governmental body or may present an appeal claim before a judicial court of appeals.

4.6 Agreements With Local or Governmental Authorities

The most common agreements executed with relevant public authorities that will facilitate the obtaining development of a project are those entered towards the creation or improvement of existing urban infrastructure (ie development, improvement and/or maintenance of public parks and recreational areas, street lighting and general improvement of street infrastructure, improvement of water and sewage infrastructure, and improvement of power infrastructure,

among others). Also, in certain states including Mexico City, it is legally feasible to acquire density rights from competent authorities or to transfer density rights from one lot to another lot through a private agreement executed by the respective owners and approved by the competent authority.

4.7 Enforcement of Restrictions on Development and Designated Use

First of all, competent authorities will not issue a construction licence or an occupancy permit if the respective real estate project does not comply with applicable laws, regulations and programmes. Each state and municipality has its own verification and inspection units that are in charge of inspecting and verifying that a real estate project complies with construction, development and zoning legal statutes. In the event that an inspection and verification unit detects a violation or breach of a construction, development and/or zoning legal statute, it may, through an appropriate administrative procedure followed before a competent authority, impose any of the following remediation measures: demolishing, restoring and/or replacing a specific construction, the construction of additional elements as may be required (ie parking spaces), the temporary or permanent closure of the premises, and the imposition of fines and economic sanctions.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The main entities available to investors to hold real estate assets in Mexico are:

- Limited Liability Company (*sociedad de responsabilidad limitada* – “SRL”; or *sociedad de responsabilidad limitada de capital variable* – “SRL de CV”): These entities offer some characteristics of a corporation, such as the liability of the equity holders being limited to their capital contribution, and some characteristics of a partnership, such as the equity interest not being represented by a stock certificate and not being freely transferable. Operated much like a partnership, this form offers limited liability similar to the corporate form. This is a preferred vehicle for US limited liability companies investing in Mexico since it is a pass-through entity for US tax purposes.
- Corporation (*sociedad anónima* – “SA”; or *sociedad anónima de capital variable* – “SA de CV”); hereinafter collectively referred to as “Corporation(s)”: The Mexican Corporation is the closest equivalent in Mexican law to a US corporation. There is a variant of this Corporation, which is the Investment Promoting Corporation (*sociedad anónima promotora de inversión* – “SAPI”; or *sociedad anónima promotora de inversión de capital variable* – “SAPI de CV”), which allows for more flexibility on the regulation of equity

contributions and distributions to shareholders and on the regulation and stipulation of transfer rights of shareholders' equity stake allowing the stipulation of drag-along, tag-along and other similar transfer rights.

- **Trusts:** A Mexican trust is a business arrangement structured with a Mexican bank where the bank holds title to real estate for the sole benefit of the designated trust beneficiaries. The trust is not an entity per se and when the activities performed under such a trust are passive activities (ie rental income), the trust is transparent for all tax effects. Under this scenario, the trust is a preferred structure for persons with special tax regimes (ie pension funds and individuals).
- **Real Estate Investment Trusts (REITs or Mexican *Fibras*) and *Certificados de Capital de Desarrollo* (CKDs):** A Mexican *Fibra* is a trust arrangement structured with a Mexican bank. A CKD can be structured either as a corporation or as a trust. Mexican *Fibras* and CKDs are real estate investment vehicles with a special tax-friendly regime. They are also financial products that allow investors to acquire real estate indirectly through capital markets.

5.2 Main Features of the Constitution of Each Type of Entity

Limited Liability Companies, Corporations and any other type of commercial company must be incorporated before a Mexican Notary Public. The bylaws and articles of incorporation are formalised in a notarial instrument and filed for recordation before the Public Registry of the Commerce with jurisdiction over the place where the corporate domicile of the entity is located. The corporate name of the entity must be previously approved by the Ministry of Economy. If there is foreign investment in the entity, the entity must be recorded before the National Registry of Foreign Investments.

A trust is a contract that is executed with a Mexican bank. When the trust patrimony is real estate, the trust must be formalised in a notarial instrument and filed for recordation before the Public Registry of the Property with jurisdiction over the place where the real property is located.

5.3 Minimum Capital Requirement

There are no minimum capital requirements for setting up each type of entity used to invest in real estate.

5.4 Applicable Governance Requirements

The supreme governing body of a Limited Liability Company or a Corporation is the partners' or shareholders' meeting, respectively. The management of a Limited Liability Company or a Corporation may be vested in one or more directors (or managers in the case of the Limited Liability Company). Whenever two or more directors are entrusted with the management of a Limited Liability Company or Corporation, they must act as a board of directors (or board

of managers in the case of the Limited Liability Company). The board of directors or the board of managers may appoint one or more general or special managers. Such an appointment is revocable at any time by the board of directors/managers or by the shareholders.

Trusts are usually governed by the decisions of the trust beneficiaries or the decisions of a technical committee whose members are designated by the trust beneficiaries.

5.5 Annual Entity Maintenance and Accounting Compliance

For any entity used to invest in real estate in Mexico, it will be necessary to maintain accounting books and records and to file monthly, quarterly and annual tax returns. Such activities will entail contracting an accountant or an accounting firm whose costs may vary depending on the quality standards of the firm being contracting for such purposes. In addition to those costs, in the case of investments made through a Mexican bank trust, an annual administrative fee to the Mexican bank trustee will apply.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The main arrangements that Mexican law recognises that allow a person, company or other organisation to occupy and use real estate for a limited period of time without buying it are the lease agreement, the gratuitous bailment agreement (lease without payment consideration), and the usufruct which provides similar rights as the lease arrangement but with the difference that the usufruct is a proper rem right that may be granted on a permanent basis. In addition to the above, Mexican law includes the farming lease agreement by means of which the owner of land leases a lot to a farmer to sow and harvest during a specific season.

6.2 Types of Commercial Leases

Mexican law distinguishes different types of leases depending on:

- the duration (undefined term versus specific termination date);
- the type of real estate being leased (rural versus urban land); and
- the use of the real property (residential, industrial or commercial).

Market-wise, different types of lease structures may be encountered, among which the most common are the gross lease, the net lease, the triple-net lease, the ground lease and the sale and leaseback structures.

6.3 Regulation of Rents or Lease Terms

The will of the parties is the supreme rule in Mexican contracts. In this respect, the parties may freely negotiate the terms of the agreement except for a few mandatory law provisions that may not be waived by the parties, ie maximum lease terms and health and safety conditions of residential units being leased. If there is a lack of agreement by the parties on certain lease matters, the provisions of the Civil Code applicable to the state where the leased property is located will apply on a supplementary basis.

6.4 Typical Terms of a Lease

Length of lease term

The length of the lease term depends on the type of property been leased. For residential leases, the market standard is one year subject to an additional one-year renewal. For retail or shopping centre leases, the standard is from two to 15 years, depending on the size of the real property and the investment made by the tenant, also subject to multiple renewal options. For office leases, the standard is from three years and up to 15 years, also subject to different renewal options. Finally, leases for industrial facilities are probably those with a longer term, which can go up to 20 years. Civil Codes for each state provide for mandatory maximum lease terms, which are usually ten years for residential properties and 20 years for commercial and industrial facilities.

Maintenance and repair of the real estate actually occupied by the tenant

Maintenance and minor repair due to day-to-day use are usually borne by the tenant. Hidden defects and structural element repairs are usually borne by the landlord.

Frequency of rent payments

The standard is that the payments are made on a monthly basis.

6.5 Rent Variation

The rent payable remains the same for as long as the lease lasts.

6.6 Determination of New Rent

Usually, the rent is increased every year to reflect inflation using the US Consumer Price Index (CPI) if the lease is denominated in US dollars, or using the Mexican CPI if the lease is denominated in Mexican pesos.

In the event of lease term renewals, usually the rent is increased based on (i) inflation using the US CPI if the lease is denominated in US dollars, or using the Mexican CPI if the lease is denominated in Mexican pesos; or (ii) fair market value determined through an appraisal procedure agreed by the parties by means of which other current rents for similar properties are compared with the current rent of the leased premises.

6.7 Payment of VAT

VAT is triggered on lease rents at a 16% rate except for residential leases where no VAT applies. If the residential unit is leased with furniture, VAT will be triggered with respect to the rent value of the leased furniture.

6.8 Costs Payable by Tenant at Start of Lease

In addition to the rent, other costs that the tenant pays are a common area maintenance fee, connection and consumption fees of utilities, including telephone and telecommunications, power, water and sewage, and HVAC. A certain number of parking spaces are included within the lease rent, but depending on availability, the tenant may pay for additional parking capability. Also, in certain types of leases (triple-net), the tenant is also responsible for paying property taxes. In shopping centre leases, (i) advertising and marketing fees are to be borne by the tenant; and (ii) key money is also customary.

6.9 Payment of Maintenance and Repair

Usually, the cost of maintenance and repair of common areas is included in the common area maintenance fee that must be paid by each one of the tenants.

6.10 Payment of Utilities and Telecommunications

Usually, tenants are required to contract utilities separately with third-party suppliers, including telephone, telecommunications and power. In those cases, tenants pay the cost of connection and consumption directly to the third-party suppliers. With respect to common infrastructure and services granted by the developer or owner to all tenants, those services are paid by each one of them, based on consumption or based on the percentage that their leased premises represent with respect to the total area within the relevant real estate compound.

6.11 Insuring the Real Estate That is Subject to the Lease

The tenant usually assumes the cost for contracting general liability for damages to third-party property and persons, business interruption, all-risk property insurance insuring the leased property for its replacement value, and the personal property of the tenant.

In some cases, the landlord is the one who assumes the cost for contracting all-risk property insurance insuring the leased property. The developer and property manager contracts all-risk property insurance insuring common areas of the real estate compound, with the costs shared by all tenants as common area maintenance fees.

6.12 Restrictions on Use of Real Estate

Usually, the landlord contractually imposes restrictions on how a tenant can use a leased property. Those restrictions are mainly related to the zoning allowances and legal uses

permitted in the leased property, but they also can include restrictions related to storage and handling of hazardous materials, hours of operations, remodelling or altering of the property, and use and operation of common elements. The retail and shopping centre leases' restrictions can be even more burdensome, such as the limitation of activities that can be performed and goods and services that can be sold in order to avoid competition with other tenants or the prohibition on closing or suspending activities ("going-dark" clause), situations which can hinder the proper operation of the shopping centre. Legal restrictions and prohibitions are normally related to zoning regulations and regulations related to the operation of public commercial establishments.

6.13 Tenant's Ability to Alter and Improve Real Estate

The tenant is usually permitted to carry out without the prior owner's written consent remodelling or adaptation works of an "ornamental" and "decorative" nature. However, any such repair, improvement or alteration of a structural nature, or that alters facades, walls, ceiling, carpet infrastructure and common elements, must be previously approved by the landlord. The tenant may be required to remove any removable improvements made at the leased property at termination of the lease before vacating the premises. Any such work must comply with internal construction regulations by the real property manager and with local laws and regulations.

6.14 Specific Regulations

Lease arrangements are regulated by each state's civil codes. In general terms, lease provisions apply to all type of leases; however, there are some specific provisions applicable to the different categories of real estate, especially with respect to the minimum and maximum term of the leases, and required health and safety conditions, among others.

6.15 Effect of Tenant's Insolvency

Tenant insolvency and bankruptcy is usually an event of default that gives rise to an early termination remedy in favour of the landlord. In order to avoid default due to an insolvency situation, landlords usually request tenants to grant a guarantee that contemplates either a bond issued by an authorised bonding company, a corporate guarantee or a joint obligor from an entity with better financial credentials than the tenant.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

The typical guarantees requested by the landlord under a lease agreement to secure tenant obligations thereunder include: (i) a security deposit in an amount equal to one to three months' rent; (ii) a performance bond issued by an authorised bonding company; and/or (iii) a corporate guarantee from a related third party or a joint obligor with better financial credentials than the tenant.

6.17 Right to Occupy after Termination or Expiration of a Lease

The tenant may only continue occupying the leased property after termination of the lease if the lease agreement provides for an extension period right or if the landlord so authorises in writing. Otherwise, the tenant will be unlawfully occupying the leased premises and will be subject to penalties. In order to achieve timely and proper vacation of the leased premises by the tenant, the landlord must include proper contractual provisions in that regard, backed up by proper guarantees (ie a performance bond, corporate guarantee or joint obligor). Usual contractual stipulations in this regard provide that, in the event that the tenant continues to occupy the premises after lease termination, the tenant will be obliged to pay an amount equal from 50% to 100% of the rent over the monthly rent payment.

6.18 Right to Terminate Lease

Usual events of default by the tenant that give the landlord a right to terminate the agreement are:

- if the lessee does not pay, on time, two or more rent payments or common area maintenance fees, or if it does not promptly pay any expense that it is required to incur;
- default on lease assignment and sublease restrictions;
- default on environmental and hazardous materials provisions;
- closure of the premises due to lessee default on laws and regulations;
- alteration and/or modification of structural elements of the leases premises without lessor consent;
- the use of the premises for uses other than those permitted under the contract;
- bankruptcy and insolvency of lessee;
- other special events of default in shopping centre leases may include: (a) a "going-dark" clause, which is the suspension of the activities and operations of the lease in the leased premises; and (b) a default with non-compete provisions.

Usual events of default by the landlord that give the tenant a right to terminate the agreement are:

- if leased premises close for reasons attributable to the lessor, and that closure is not remedied during a reasonable period of time;
- failure of the landlord to make structural repairs to the property;
- failure of the landlord to obtain and deliver to the lessee zoning and building occupancy permits;
- if the landlord does not deliver the leased premises on time;
- other special events of default in shopping centre leases may include: (a) default on co-tenancy requirements (anchor lease agreements usually provide for a minimum percentage of other premises opened and operating during the

lease term); and (b) default on non-compete and radius restrictions (anchor lease agreements usually provide for a restriction on developers opening premises to be leased to competitors within a radius closed to the leased premises).

Other events that may give the parties a right to terminate the agreement are damages or destruction to the leased premises due to Acts of God or *force majeure* events or in the event of condemnation of the premises or expropriation by authorities.

6.19 Forced Eviction

A tenant can be evicted from the property in certain events of default. Most of the states provide for summary judicial eviction procedures, which may take from three to eight months to complete.

6.20 Termination by Third Party

The lease agreement can be terminated by an authority in the event of expropriation due to a public cause or in the event of domain expiry due to a crime committed in the real property.

The expropriation due to a public cause is resolved through a Presidential decree, which is published in Mexico's Official Gazette. The affected owners may appeal that Presidential decree within the next 15 business days from its publication. If the appeal is resolved in favour of the Nation, the Mexican government will pay an indemnification to the owner based on an appraisal carried out by a Federal agency, and will immediately take control over the expropriated asset. In certain lease agreements, the landlord and the tenant agree to share to some extent the indemnification payment.

The legal action to enforce domain expiry due to a crime committed in the real property may be exercised by a Federal or local prosecutor, with respect to real property where crimes related to organised delinquency, crimes against public health, kidnapping, car robbery and "white slavery" have been committed. The domain expiry due to a crime committed in a real property must be resolved by a competent court. Depending on whether the landlord or tenant is responsible for these actions, the responsible party will have to indemnify the other party.

Depending on certain conditions (ie lease term and/or lease amount), in certain states lease agreements must be recorded before the Public Registry of the Property to produce effects against third parties. Therefore, in the absence of such recordation, a bona fide third-party buyer may claim termination of the lease agreement before a court.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The common structures used to price construction projects are unitary prices, fixed prices and lump sums.

7.2 Assigning Responsibility for the Design and Construction of a Project

Usually, the architect is responsible for the design of the project, including that the design complies with applicable codes, programmes, laws and regulations and the general contractor is responsible for the overall construction of the project according to the design plans and description outlines provided by the owner. In the event of a contingency in which the liability is due to a design error, the responsibility will be allocated to the architect; however, if the liability is due to a construction error, the responsibility will be allocated to the general contractor.

7.3 Management of Construction Risk

There are different devices and contractual and legal figures to manage construction risks. Usually, architects, contractors and subcontractors are obliged to provide performance and hidden defect bonds as well as general liability insurances and professional liability insurances. Performance bonds and insurances will be in full force and effect during the full construction stage and hidden defects bonds usually remain valid for a one-year period after final completion and delivery of the construction to the owner. The owner usually withholds 5% to 10% from each instalment from the general contractor to cover any work deficiencies and/or work delays. Withholdings and retentions are released upon substantial and final completion of the project. Architects, contractors and subcontractors are usually subject to penalties in favour of the owner in the event of default or delay in compliance with their obligations, as well as subject to general indemnification provisions in favour of the owner. The statute of limitations for general civil liability is two years and for general contractual defaults it is ten years from each event.

7.4 Management of Schedule-Related Risk

The contractor is obliged to perform and complete construction within a milestone schedule and substantial and final completion dates agreed by the parties in the respective construction contract. Contractor payments are subject to construction progress. In the event that the contractor has not reached a milestone, the owner is entitled to retain payment until that milestone has been completed. In addition to such retention, the owner usually withholds from 5% to 10% from each instalment to the general contractor to cover any work deficiencies and/or work delays. Withholdings and retentions are released upon substantial and final completion of the project. Additionally, if the contractor does not comply

with substantial and/or final completion of the project on the dates agreed for such events in the respective construction contract, the contractor will be subject to daily delay penalties to be paid to the owner. Also, the owner has the right to remedy defaults from the contractor and to be compensated for any amounts incurred for those purposes from any amounts owed to the contractor or, if such amounts are insufficient, to request payment from the contractor.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The most common guarantees in Mexican construction contracts are: advance payment bonds which guarantee the correct use of any advance payment made from owner to contractors; performance bonds which guarantee full compliance of contractors' obligations during the full construction stage; and hidden defects bonds which guarantee repair and replacement of any hidden defects detected after final completion (usually valid for a one-year term after final completion and delivery to the owner).

7.6 Liens or Encumbrances in the Event of Non-Payment

Liens for mechanics and workmen are not available in Mexico.

7.7 Requirements Before Use or Inhabitation

Before the occupancy of any newly developed and constructed real estate project, it will be necessary to file a construction termination notice and to obtain the relevant occupancy permit (including the respective civil protection/fire service authorisation). Depending on the uses and operation of the respective construction facilities, an operating licence may also be required.

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8. Tax

8.1 VAT

VAT will be triggered upon the sale of construction at a 16% tax rate, except for residential construction. The seller will be the taxpayer (however, the tax due will be collected from the purchaser). Transfer of land is not subject to VAT.

8.2 Mitigation of Tax Liability

There are certain structures to be put in place in order to reduce the valuation of the real estate portfolio, which could reduce the tax liability on acquisitions. However, this might impact the tax basis for further disposals of the assets and might trigger income tax for the buyer. Also, property transfer taxes may be deferred to a later stage by the use of trust structures upon compliance with certain tax requirements.

8.3 Municipal Taxes

No municipal taxes on the occupation of business premises apply. However, certain activities on premises may be subject to the obtaining of operating licences that will require payment of governmental fees upon issuance.

8.4 Income Tax Withholding for Foreign Investors

Foreign investors will be taxed if they receive (i) dividends (at a 10% rate; if a treaty is applied, this rate could be lowered), (ii) capital gains from the sale of shares in which the issuer has a 50% or greater value deriving from real estate, or (iii) gains deriving from the sale of real estate (25% on the gross sale or 35% on the net sale, subject to compliance with certain requirements). It is customary that the withholding is applied by the Mexican payer. There may be tax treaty benefits that could be granted to the foreign investors.

Be aware that, in the acquisition of real estate, if the price paid is more than 10% lower than its appraisal value, the difference between the purchase price and the appraisal value would be considered as taxable income in the hands of the foreign seller, subject to a 25% tax rate.

Rental income is also taxed at 25% on the gross income. Under certain tax treaties, there is a possibility to compute the tax on a net basis if certain requirements are met.

8.5 Tax Benefits

The purchase price and other related expenses (ie notary fees etc) might be considered as a deductible item subject to a yearly depreciation of a maximum of 5%. There are certain stimuli which grant accelerated depreciation to specific sectors.