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# Real Estate

**Mexico – Law and Practice**

Creel, García-Cuéllar, Aiza y Enríquez, S.C.

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# MEXICO

**LAW AND PRACTICE:** p.3

Contributed by Creel, García-Cuéllar, Aiza y Enríquez, S.C.

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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**Creel, García-Cuéllar, Aiza y Enríquez, S.C.** is a leading full-service corporate law firm with an unwavering commitment to excellence. The firm has an established reputation for delivering creative, specialised and responsive legal advice on the most complex and innovative matters in Mexico for the most sophisticated and demanding clients. Our practice is based on the philosophy that a client is best served by legal advice designed to anticipate and avoid problems, rather than to respond to them. Our goal is to be the law firm of choice for clients with the most demanding transactions and projects, endeavouring to become a strategic service-provider by offering the type of legal advice that gives clients certainty and peace of mind. Our Real Estate practice group advises multinational and domestic developers, promoters, tourism and hospitality companies, and investors (including international real estate funds, Mexican CKD's and FIBRAs). Our Real Estate lawyers are experts in the Mexican legal and regulatory aspects of direct or structured investments in, or strategic acquisitions of, real property in the industrial, retail, commercial, tourism and leisure, residential and urban sectors. The entire team at Creel, García-Cuéllar, Aiza y Enríquez has contributed to this chapter.

## 1. General

### 1.1 Main Sources of Law

Mexico is a civil law country composed of 31 states and Mexico City, regulated by federal, state and municipal statutes (ie, codes, laws and regulations). The main statutes that govern the tenure, transfer, development and use of real estate in Mexico include: i) at a federal level, the Constitution, the Federal Civil Code, the Federal Civil Procedures Code, the Agrarian Law, the General Law on Federal Property, the Foreign Investment Law, and Federal environmental laws, among others; and ii) at a state and municipal level, state civil codes and state civil procedures codes, state tax code, urban development and construction laws and regulations and local environmental legislation, among others.

### 1.2 Main Market Trends and Deals

Over the last 12 months, the Mexican real estate market has continued to expand with investment on mixed-use projects; the investment by CKDs and private equity funds in industrial portfolios; and the creation of Mexican REITs (FIBRAS), as well as the consolidation and growth of existing ones through the purchase and sale of large portfolios of retail, industrial and housing properties, like Fibra Terrafina or FIBRA Uno's acquisition of a retail portfolio. The hospitality market has continued to experience important control changes, like RLH Properties' acquisition of the controlling interest in the Rosewood, Fairmont, Banyan Tree and Andaz Hotels all located in Mayakoba, Quintana Roo. The offices or business market went through an important comeback with innovating companies such as WeWork, and commercial leases becoming even more sophisticated with institutional clients like Tesla expanding its business throughout the country. Another particularity of the past 12 months has been the interest in properties with an agrarian background, located in several states within Mexico and necessary for the development of important industrial projects.

### 1.3 Proposals for Reform

There is currently a proposal to enact the General Law for the Harmonisation and Equating of the Property, Entities and Cadastral Public Registries. Enacting and enforcing this could change the way in which real property is registered in Mexico. Currently, many local public registries are inefficient due to a lack of technology, unqualified personnel and differences with cadastral records, among other things. Today's public registries' response time is often long and unpredictable and this new law, if enforced, could represent a significant improvement in the public registries' operation.

The new law mainly proposes to: i) update all properties' records through an electronic system in co-ordination with the cadastral registry; ii) establish a process to register properties faster and easier; and iii) create an online system for consultation on properties' information and records.

This law was approved by the Senate in December 2017 and it is expected to be ratified by the Camara de Diputados (House of Representatives) in the next legislative period.

## 2. Sale and Purchase

### 2.1 Categories of Property Rights

Real estate tenure in Mexico is based on either in rem rights (with reference to a thing [property]) or in personam rights (with reference to a person). Rights in rem include fee simple rights over real estate (ie, ownership rights held in perpetuity), and rights which limit ownership over real estate (ie, liens, mortgages, easements or usufructs). On the other hand, rights in personam refer to the use and enjoyment of a property by someone as a result of a contract and include, among others, lease agreements and gratuitous bailments (comodato).

### 2.2 Laws Applicable to Transfer of Title

The most important statutes that apply to transfers of title in Mexico are, at a federal level, the Constitution, the Foreign Investment Law, the Federal Civil Code, the Agrarian Law, the General Law on Federal Property and federal environ-

mental laws. At a state and municipal level, transfers of title are regulated mainly by state civil codes, the state tax code, urban development and construction laws and regulations, local condominium legislation, and local environmental regulations. In addition to the above statutes, the Federal Consumer Protection Law regulates the transfer of residential units, timeshare and fractional ownership units.

### 2.3 Effecting Lawful and Proper Transfer of Title

In order for any transfer of title or creation of a lien on real estate to be effective vis-à-vis third parties, it must be recorded before the Public Registry of Property (PRP) where the relevant property is located. However, such recordation is just for publicity matters and does not create or constitute a right over the property (except in the State of Quintana Roo, in which the recordation before the PRP creates per se the right over a property). Therefore, and with the exception of properties located in the State of Quintana Roo, the relevant rights and obligations related to the property are binding and enforceable between the parties by virtue of an agreement among them, regardless of the recordation before the PRP. Nevertheless, and even when transfer agreements are binding and enforceable between parties, title to the property is enforceable vis-à-vis third parties when the parties execute the conveyance deed before a notary public and the deed is recorded before the corresponding PRP.

Title insurance is available in Mexico for buyers and lenders, and it is often requested by foreign and institutional investors.

### 2.4 Real Estate Due Diligence

The legal due diligence that is carried out in connection with real properties varies depending on: i) the land use or nature of the real estate involved in a transaction (ie, commercial, retail, industrial or residential properties); and ii) the conditions/nature of the purchasers (ie, institutional investors, foreign or Mexican individuals or entities, etc). Notwithstanding, the main aspects of legal due diligence is always the chain of title and recorded encumbrances and information related with the properties. Considering that real estate transactions have to be recorded before the PRP to be enforceable vis-à-vis third parties, the registry normally contains plenty of very useful information regarding the chain of title of a property. Moreover, the review of documentation related with the "entitlements" (land use, zoning, etc) of properties is also a must.

In addition, the performance of technical studies such as American Land Title Association (ALTA) type surveys and Phase I and II environmental reports have become tools commonly used by purchasers and their counsel to assess the conditions of real estate. The average due diligence lasts between 30 to 90 days, depending on the availability of information.

### 2.5 Typical Representations and Warranties

Typical representations and warranties of a seller include power and authority; title to the property; non-existence of liens, encumbrances or any other limitations of title; and compliance with laws, permits, property tax, water duties and environmental laws. On the other hand, typical representations and warranties of a buyer include power and authority and sufficiency of funds. A seller's warranties made before a notary public are provided under statute; however, more recently it has not been typical for sellers of real estate to represent or warrant the general state of a building, especially if the buyer carried out a long and thorough due diligence.

Under Mexican law and in case of dispossession, the buyer may claim the payment of damages and lost profit. The statute of limitations for dispossession claims is a maximum of ten years, which the parties may agree to shorten. For other seller's misrepresentations, an indemnity clause subject to basket or deductible, cap and survivability is generally provided in a purchase and sale agreement.

### 2.6 Important Areas of Law for Investors

The most relevant areas of law to consider are foreign investment and corporate law with respect to the buying entity or vehicle. With respect to the acquisition of real property, the state civil code, local zoning and land use, urban development and construction, tax and environmental laws and regulations must be considered.

### 2.7 Soil Pollution or Environmental Contamination

Under applicable Mexican law, the owners and possessors of sites with soil contamination are jointly and severally liable for their remediation, regardless of any actions such owners and possessors may have against the contaminating party and aside of any liability the contaminating party may have. Environmental liability in Mexico may be of a civil, administrative or criminal nature, depending on a variety of factors.

### 2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer may ascertain the permitted uses of a real estate by: i) reviewing the local statutes, such as the local urban development laws, the municipal zoning and land use regulations and the local urban development programmes and plans; in Mexico City, land use is determined in the General Urban Development Program which in turn regulates the urban development programmes of each neighbourhood or Delegaciones. The same structure works in the rest of the states of Mexico, where there is a State Urban Development Plan which regulates all land use and zoning in the relevant state and is then used to create municipal urban development plans; and/or ii) requesting a Land Use and Zoning Certificate (which name varies from state to state) for the property, which describes the permitted land use.

It is not customary to enter into an agreement with the authorities for specific projects; what it is typically done is to request from the local authorities the Land Use and Zoning Certificate and then, if the owner or developer wishes to use the land differently from that determined by the local authorities in such Certificate (based on the relevant urban development plan or programme), a change of land use can be requested to the local authorities, who will analyse the possibility of approving such a change (which if authorised may be subject to certain conditions). Otherwise, development agreements may be entered into with public authorities for public infrastructure projects such as public parks, sidewalks or public lightning, for example.

### 2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation is legally possible in Mexico pursuant to the Expropriation Law if and when the competent Federal Ministry declares that, under the provisions of Article 1 of the Expropriation Law, there is a public purpose for the expropriation. After the Ministry's declaration of the public purpose the President issues and publishes in the Official Federal Gazette an expropriation decree, authorising the temporary or definitive land-taking. The owners of the land and other affected parties are then notified of the expropriation and of the commercial appraisal value at which they will be indemnified. The affected parties may challenge the amount of the indemnification, and may also, through legal recourse called Amparo, challenge the expropriation decree.

### 2.10 Taxes Applicable to a Transaction

The taxes and main duties and fees involved in the acquisition of real estate are transfer tax, value-added tax (VAT, if applicable), income tax, registration duties and notary public fees.

Real estate transfer tax is payable by any buyer (individuals or entities) who acquires real estate either directly (asset deal) or indirectly (assignment of trust beneficiary rights [which for tax and duties purposes has the same effect as any direct conveyance of a real estate asset] or merger of companies). The rate varies from state to state but it is generally between 2% and 5%, and applied to the highest value between the appraisal value, the transaction value and/or the cadastral value assigned by the local tax authorities.

VAT, at a rate of 16%, is payable by any buyer (but collected by a seller and remitted to the competent tax authorities) in the direct or indirect (assignment of trust beneficiary rights or merger of companies) acquisition of constructions or improvements dedicated to other purposes different from residential. The transfer of ownership of land, as well as of constructions or improvements dedicated to residential purposes, is exempt of VAT.

Income tax is payable by a seller and is determined based on the seller's gain for the sale of real property. The corresponding rate is of 30% for Mexican entities, and for individuals the maximum rate is 35%. If the seller is not a Mexican resident for tax purposes, the applicable income tax rate would be 25% of the gross amount or 35% of the gain received by the foreign resident.

Registration duties are customarily paid by the purchaser (whether or not he/it is a Mexican resident for tax purposes) in order for the relevant Public Registry of Property to record the real estate conveyance deed, the assignment of trust beneficiary rights deed or any other public instrument formalising any rights related to real estate property (ie, a mortgage or security trust on real property). Registration duties are generally equal to a percentage of the real estate purchase price (or, in the case of the registration of a security interest on real property, the value of the loan being secured), subject to a cap.

Notary public fees are paid by the purchaser to the notary public who formalised the transaction and the amount varies from state to state. Generally speaking, the notary public charges service fees based on a fixed progressive quota which is a percentage of the total transaction value (as the value increases, the quota for services rendered by the notary decreases). For example, in Mexico City such percentage varies between 0.327% to 1.125% of the transaction value.

An equity transaction does not trigger transfer tax, notary public fees and registration duties and is exempt for VAT purposes.

The transfer of shares or equity interest in a corporation or in a partnership (depending on the treatment of such partnership) could trigger income tax in Mexico (even if there is not a change of control).

If the corporation is a Mexican resident entity, the transfer of shares/equity interest by a non-Mexican shareholder would trigger income tax at 25% on the gross income or 35% on the net gain, after certain requirements are satisfied. Tax treaties may provide certain tax benefits.

The transfer of shares/equity interest of a non-Mexican resident entity by a non-Mexican shareholder also triggers income tax in Mexico to the extent the book value of those non-Mexican shares derives more than 50% from real estate located in Mexico. Tax rates are also 25% on the gross income or 35% on the net gain (after certain requirements are satisfied) and tax treaties may also provide certain tax benefits.

### 2.11 Legal Restrictions on Foreign Investors

Regardless of the intended use or purpose of real estate property, foreign individuals or foreign companies may not acquire direct ownership over real estate located within the so-called "Restricted Zone" (a strip of land of 100 kilometres [deep] along the Mexican borders, and 50 kilometres [deep] along the Mexican seashore). Mexican entities with foreign investment may not acquire direct ownership over real estate located in the Restricted Zone and intended for residential purposes or uses; however, if the intended purpose or use of the property is not residential, direct acquisition is permitted and only a notice thereof should be filed with the Foreign Affairs Ministry.

Notwithstanding, foreign entities or individuals may acquire indirect ownership over real estate within the Restricted Zone, by means of a trust agreement, where a Mexican bank acts as a trustee and the foreigner is the sole beneficiary of all rights and obligations thereunder. The formation of a restricted zone trust agreement requires prior authorisation from the Ministry of Foreign Affairs (Secretaría de Relaciones Exteriores).

## 3. Real Estate Finance

### 3.1 Financing Acquisitions of Commercial Real Estate

Most real estate acquisitions are financed by secured debt finance. Depending on the types of guarantees sought, financing can also be structured through subordinated debt schemes for large real estate portfolios.

### 3.2 Typical Security Created by Commercial Investors

The most common security structures to secure real estate financings are either through a mortgage or a security trust agreement, which may include, in addition to the real estate property, cash flow from the underlying assets and/or project, relevant agreements (leases) and insurance policies.

Under a security trust agreement, the settlor (borrower or guarantor) transfers the title to the property in favour of a trustee (typically a Mexican banking institution) to secure the payment of secured obligations in favour of the lender (the first place beneficiary). The settlor, however, retains a secondary beneficial interest in the collateral so that, upon satisfaction of the secured obligations, legal title to the collateral reverts back to it.

A security trust agreement has certain unique advantages, such as the ability to agree and provide for an extra-judicial foreclosure procedure and certain insolvency benefits. Legal title to the collateral is transferred to the trustee as trust property. Therefore, in the event of insolvency of the settlor (assuming it is a Mexican entity) the collateral held by the trustee under the security trust agreement should not be co-mingled with the settlor's assets.

Sale and leaseback transactions are also commonly used.

### 3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate in favour of, or on repayments made to, foreign lenders. However, in the event that proceedings are brought in Mexico seeking performance of the obligations of the borrower, pursuant to Mexican Monetary Law, the borrower may discharge its respective obligations by paying any sums due in a currency other than Mexican peso or in Mexican peso at the rate of exchange prevailing in Mexico and fixed and published by the Banco de México in the Official Gazette of the Federation on the date preceding the date of payment.

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

There are no documentary taxes in Mexico.

Registration fees (which vary from state to state) are payable because, under Mexican law, all security over real estate must be registered at the applicable Public Registry of Property where the real estate is located. In most cases, registration fees are capped by local authorities but in other cases it may be a percentage based on the secured amount. Finally, in some other cases and in certain jurisdictions, additional taxes or fees may apply on registration and/or enforcement of security over real estate.

In most cases the granting and/or enforcing of a security over real estate must be granted before a notary public. Notarial fees vary and depend on the type of security interest created and/or enforced. Generally, notarial fees are capped to a certain amount, however in some other cases fees may depend on the value of the transaction.

Finally, in the event of enforcement, real estate transfer and income taxes will be triggered.

### 3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no legal rules or requirements before an entity can give valid real estate security, as long as the entity includes in its corporate purpose the ability to grant security over its real estate assets.

### 3.6 Formalities When a Borrower Is in Default

If a borrower is in default, formalities or obstacles depend on whether or not a security trust or mortgage is implemented. A security trust agreement typically provides that upon the occurrence of the default of a borrower under the financing

documentation, the beneficiary may request from the trustee the sale of the collateral by means of an extrajudicial foreclosure procedure. If an extrajudicial foreclosure procedure is not contemplated, then a security trust may be enforced through a special judicial procedure set forth in the Commerce Code. On the other hand, a mortgage agreement must be enforced through a special judicial foreclosure proceeding, which varies from state to state.

In addition, both the security trust holding the real estate and the mortgage agreement must be registered in the Public Registry of Property of the place where the real estate is located in order to be effective against third parties. Such recordation before the relevant Public Registry of Property, sets forth the priority of a lender over other registered creditors (the security first recorded has legal preference over other securities recorded afterwards).

### 3.7 Subordinating Existing Debt to Newly Created Debt

Subordination of an existing secured debt depends on the collateral rules governing priority. For instance, in a Pledge Without Transfer of Possession split liens are limited by law and typically collateral is granted to one pledgee (acting as agent on behalf of the secured parties), thus priority is usually agreed by means of an intercreditor agreement.

### 3.8 Lenders' Liability Under Environmental Laws

A lender can be liable under environmental laws due to the fact that under Mexican law, holders and/or possessors of real estate with contaminated soil are liable for remedial actions regardless of their responsibility in the contamination.

### 3.9 Effects of Borrower Becoming Insolvent

The commencement of an insolvency process (ie, the filing of an insolvency petition) does not have any effect on a lender's rights to enforce its loan or any security or guarantee; however, the court could issue injunctions to prevent the dilapidation of the insolvency estate, such as stays on foreclosures. Once a judgment is issued by the court adjudicating an insolvent company (ie, in concurso mercantil), a stay is automatically imposed against any creditor action, and lenders are no longer able to continue any enforcement proceedings initiated prior to the insolvency judgment, or initiate new claims seeking enforcement of their loans or their respective collateral.

Upon the issuance of an insolvency judgment:

- all unsecured peso-denominated claims are converted into Unidades de Inversión (UDIs), and interest thereon ceases to accrue on such claims;
- all unsecured claims denominated in a foreign currency are converted into Mexican peso and subsequently into UDIs, and interest thereon ceases to accrue on such claims; and
- all secured claims are maintained in the agreed currency, and ordinary (but not default) interest thereon continues to accrue up to the value of the respective collateral.

The insolvency judgment also initiates the concurso mercantil stage of the Mexican insolvency process, in which a mediator determines the creditors of the insolvent company to be recognised in the insolvency proceeding. During this stage, creditors are allowed to file proofs of claim to get their claims recognised by the mediator. The final recognised creditors in an insolvency proceeding are determined by the courts in a creditor recognition judgment.

Generally, creditors that are recognised as secured creditors in an insolvency proceeding have the option of either subscribing a creditors' arrangement with the rest of the creditors of the company; or commencing or reinstituting a foreclosure proceeding with respect to its respective collateral, with the prior approval of the courts.

Lenders should always bear the following matters in mind in the event a borrower, security provider or guarantor becomes insolvent.

- Secured creditors have certain privileges over unsecured creditors, including the option to continue foreclosure of their respective collateral with court approval. In addition, there are certain security interests in Mexico that could potentially prevent a lender from having to appear in an insolvency proceeding of a borrower, security provider or guarantor. For example, a security trust agreement in Mexico requires the borrower to transfer actual legal title to the collateral in favour of the trustee for the benefit of the lender. In an insolvency scenario, the Mexican insolvency law contemplates a separation action to have the court acknowledge that title to such assets is actually held by a third-party trustee, and not the insolvent entity.
- As in any other jurisdictions, fraudulent conveyance is a concern for any lender. Generally, transactions entered into with the intent to defraud creditors, gratuitous transactions, transactions that are entered into outside of market terms or for unfair consideration, or payments of undue debt, may be deemed to constitute fraudulent conveyance under Mexican laws, and may be annulled by the courts. In addition, increases of collateral and payments in-kind that were not originally contemplated in the respective loan documents constitute presumptions of fraudulent conveyance. Therefore, lenders should always make sure that the financing is negotiated and entered into on an arm's-length basis, and that the collateral (including potential increases thereto) and forms or payment are agreed from the outset in the respective loan documents.

## 4. Planning and Zoning

### 4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The Mexican Government has, at all times, the right to:

- organise human settlements and establish adequate uses and make better allocations of lands, water bodies and forests;
- order public works and plan the establishment and growth of population centres;
- divide large extensions of land;
- preserve and restore environmental balance; and
- prevent the devastation of natural resources and/or damages to property in detriment of society.

Therefore, and further to such Constitutional right, but in compliance with applicable law, governmental authorities may impose restrictions on private property for strategic planning and zoning purposes. For example, federal or local environmental authorities may declare certain extensions of land, which may include private property, as natural protected areas, which declaration will result in the imposition of certain protective measures that restrict an owner's use or exploitation of their property.

Legislative controls are set forth: i) on a state level, through the State Urban Development Ministries which issues the local Urban Development Programs or Plans, and through the State Environmental Ministries; and ii) on a municipal level through the Municipal Urban Development Ministries, who issue the Municipal Urban Development Plans. In Mexico City, each administrative authority or Delegación issues its Urban Development Programme.

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

In Mexico, any construction of new buildings or remodelling of existing ones must be previously authorised by the local authorities through a construction licence (whose name varies from state to state). Through such authorisation the governmental authorities impose restrictions based, among other things, on the density, landscape and civil protection provisions set forth in each local construction law and regulations, in the urban development programmes and plans and in the local civil protection laws and regulations. Typical restrictions include: constructing in a manner that affects the view or the property of adjoining owners; and building or conducting a business that is not permitted by law or that may affect the health or security of others. One example is in Mexico City, given the city's exposure to earthquakes, local statutes provide for specific construction requirements and materials to be used in order to guarantee a building's safety and survival in case of earthquakes.

### 4.3 Regulatory Authorities

On a federal level, the authority responsible for regulating the development and use of real estate is the Ministry of Agrarian, Territorial and Urban Development, and the statutes are the General Law for Human Settlement, Territorial Organisation and Urban Development, the Agrarian Law and the National Urban Development Program.

In each state the authority is the State Urban Development Ministry which issues the state urban development programme (Mexico City) or plan (the other Mexican states).

On a municipal level (for all states other than Mexico City), the Municipal Urban Development Ministries issues the municipal urban development plans. In Mexico City, each administrative authority or Delegación, issues its urban development programme, applicable just in the relevant Delegación.

Restrictions are typically imposed through the issuance of the relevant construction licence, the land use certificate and the civil protection authorisation, and are related to specific land use and permitted activities for each parcel, construction height, health and safety measures and materials, special protected areas or historic, artistic or archaeological sites.

### 4.4 Obtaining Entitlements to Develop a New Project

In order to be able to carry out a new project or major refurbishment, the owner of a property should obtain a licence (the name of which varies from state to state) for the construction, demolition and/or remodelling of a real estate. Such an application is filed before the local authorities attaching, among other documents (which also vary from state to state), evidence of the title to the property, the land use and zoning certificate, architectural plans, environmental and urban impact assessments, information on the individual responsible to carry out the relevant works, and duties' payment receipt.

Depending on the purpose and location of the project, obtaining governmental concessions may also be necessary for the full development of a specific project. For example, a water concession for the use of underground water, or a beach concession for the instalment of a palapa on the beach, may be necessary for a hotel project.

Third parties, which are not directly affected by the project, have no right to participate or object to the granting of a construction licence; in any event, affected third parties cannot object to the construction licence but rather to the permitted use of land.

### 4.5 Right of Appeal Against an Authority's Decision

In Mexico the right to request that authorities review, rectify or further clarify the terms and conditions in which a construction licence was granted exists.

### 4.6 Agreements with Local or Governmental Authorities

It is not necessary or customary to enter into agreements with local authorities to facilitate a development project. However, with respect to utilities and depending on the size, location and purpose of the project (residential projects are different from, for example, hotel projects), it may be necessary to enter into agreements with the relevant suppliers and authorities such as the Federal Electricity Commission, or the local water authority (whose name varies from state to state), or to obtain a concession, for example, from the National Water Commission in order to exploit underground water.

### 4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development and land use is are enforced through the imposition of sanctions which are different in each state and depend on the nature/relevance of the breach. The most common sanctions consist of the imposition of an economic fine against the developer and/or the director responsible of the works (who may even be sanctioned with the removal of his or her licence to act as Works Director). Temporary or definitive partial or total suspension of activities, or partial or total demolition of the works are also sanctions that may be considered by the authorities.

## 5. Investment Vehicles

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

Investors may hold real estate assets through commercial/civil entities or trusts. With respect to commercial/civil entities there are no specific advantages from which investors might benefit in choosing one or the other for real estate investment. The most common entities in Mexico for real estate investment are Stock Corporations, Limited Liability Companies and the Investment Promotion Stock Corporations (SAPIs).

On the other hand and depending on several factors - such as the type of transaction, the type of real estate property, or the purpose of such real estate property, among others - investors may prefer to enter into a trust agreement rather than buy property through a commercial entity. For example: where there are several investors participating in the transaction, the investment rules could more easily be determined through the trust mechanics rather than by means of a corporation's by-laws which shall comply with the minimum requirements set forth in the General Law for Commercial Companies and in the Securities Market Law, as well as with the rights to protect minority shareholders/partners. On the contrary, trusts are not required to follow a minimum quorum for decision-making processes and consequently are more flexible in setting tight or lax governance requirements. Another advantage of the trust agreement as compared to a commercial entity is that title to the real estate being held by the trust, can indirectly be transferred to third parties through the assignment of trust beneficiary rights which does not entail any of the corporate liabilities typical of a corporate equity interest sale.

### 5.2 Main Features of the Constitution of Each Type of Entity

The main features for entities used to invest in real estate include:

For Stock Corporations and SAPIs, there shall be no fewer than two shareholders, each of whom shall subscribe to at least one share. At least 20% of each share value payable in cash must be paid on the date of incorporation and each share value payable partially or totally in kind, must be fully paid upon incorporation of the company.

A Limited Liability Company requires a minimum of two and a maximum of 50 partners, and at least 50% of each partnership interest value must have actually been paid on the date of incorporation.

All commercial entities should be incorporated before a notary public.

Under Mexican law, a real estate holding trust is an agreement that should be entered into before a Mexican notary public and recorded before the applicable Public Registry of Property. For its formation, a trust requires a settlor, a trustee (a Mexican banking institution), a trust beneficiary, and the assets or personal property to be contributed into the trust's estate.

### 5.3 Minimum Capital Requirement

In Mexico there are no minimum capital requirements to set up a Stock Corporation, a Limited Liability Company, a SAPI or a real estate holding trust.

### 5.4 Applicable Governance Requirements

The Shareholders' Meeting is the supreme authority for both Stock Corporations and SAPIs. Shareholders' Meetings are held in the corporate domicile.

The management of a Stock Corporation may be entrusted to a board of directors (integrated by at least two members) or to a sole administrator. The management of a SAPI may

only be entrusted to a board of directors appointed by the shareholders, with the understanding that the members of such a board may or may not be shareholders. Directors must prepare and submit an annual report to the Shareholders' Meeting, including:

- details of an entity's operations during the last fiscal year, policies observed and, where applicable, major existing projects;
- accounting policies, criteria and information on which financial statements are based;
- financial statements; and
- any additional information required to clarify and complete the above.

Surveillance of Stock Corporations and SAPIs shall be entrusted to one or more statutory auditors, who may or may not be shareholders (but shall not be employees or directors), and who will be appointed by the shareholders' meeting. Statutory auditors normally do not participate in the daily operations of the entities, but provide surveillance over management in order to verify the lawfulness of all corporate acts. Statutory auditors are typically local accountants.

As to a Limited Liability Company, the Partner's Meeting is the supreme authority and meets at least once a year in the corporate domicile. The management is vested in one sole manager or in a board of managers who may or may not be partners. Unlike a Stock Corporation or SAPI, the appointment of a surveillance body for a Limited Liability Company is not mandatory; nevertheless, corporate by-laws may provide for the appointment of a statutory auditor or the integration of a surveillance committee.

Finally, concerning title-holding trusts, applicable laws do not provide for a mandatory technical committee; however, if a technical committee is to be created, the beneficiaries shall provide, inter alia:

- such body's obligations;
- the number of members;
- the voting procedure, establishment quorum and voting quorum (including supermajority decisions, if applicable) to be followed in the technical committee sessions; and
- guidelines to provide written instructions by the technical committee to the trustee.

### 5.5 Annual Entity Maintenance and Accounting Compliance

All real estate investment entities shall be incorporated before a notary public and registered in the corresponding commercial public registry. Entities are also required to keep accounting books and to file monthly, quarterly or annual tax returns. For such activities it is necessary to retain an accountant or an accounting firm, of which costs vary from firm to firm. The creation of a title-holding trust also requires the payment of a notary public's fees and of public registry of property recordation fees, which is generally equal to a percentage of the real estate value, subject to a cap. A one-time acceptance fee and an annual administration fee shall be paid to the trustee, which is set independently by each banking institution based on market standards.

## 6. Commercial Leases

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

Mexican law provides for lease agreements which allow temporary (subject to the maximum legal terms) use and enjoyment of a third party's property in exchange for rent, and gratuitous bailments which allow for the temporary (unless otherwise provided in the relevant agreement, the gratuitous bailment may end when the beneficiary dies or upon request from the owner, made at any time during the term of the agreement) rent-free use of another person's property. Additionally, there is the so-called usufruct, which allows the use, enjoyment and exploitation of another person's property. Since the usufruct is a propter rem right, different from the lease and the gratuitous bailment which are rights in personam, the usufruct beneficiary has the right, among others, to exploit and profit from the property (receive rents), and the usufruct agreement must be granted before a notary public and recorded before the relevant Public Registry of Property. Unless a specific term is settled in the agreement, the usufruct lasts until the beneficiary's death. Finally, another propter rem right which exists only in the State of Nuevo León, is known as a surface right which basically consists of the right to plant and harvest in someone else's property for a maximum term of 30 years. Such a surface right can be charged or granted for free and the relevant agreement should be granted before a notary public and recorded in the applicable Public Registry of Property.

### 6.2 Types of Commercial Leases

Regardless of the fact that leases are regulated in Mexico on a state-by-state basis, all leases are distinguished in Mexico in consideration of their length and the use and purpose of the leased property (housing, office, industrial, retail, agrarian). Within such legal differences, commercial leases in Mexico are normally structured as gross or net leases, triple-net or sale and leaseback agreements.

### 6.3 Regulation of Rents or Lease Terms

Mexican law is based on the will-of-the-parties principle, under which parties may freely negotiate and agree on lease terms subject to the provisions of the Civil Code corresponding to the state where the property is located. If the parties omit to determine specific rights or obligations, the

provisions of the relevant Civil Code (including the Federal Civil Code) shall apply.

### 6.4 Typical Terms of a Lease

Lease terms are regulated on a state-by-state basis according to each state's Civil Code. In general terms, commercial leases shall not exceed a term of 20 years.

Leases are locally regulated on a state-by-state basis, however, in general terms, a tenant is in charge of the daily maintenance and repairs related to the normal use of the property while the landlord is responsible for hidden-defects, major or structural repairs.

In Mexico, rent is normally paid on a monthly basis.

### 6.5 Rent Variation

The market standard in Mexico is for rent to be increased annually based on different factors, of which the most common is the Consumer's Price Index (CPI).

### 6.6 Determination of New Rent

During the term of a lease, rent is most commonly increased using the increase of the CPI as a reference. If rent is established in US dollars, parties may use the US CPI and if the rent is determined in Mexican peso, normally parties refer to the Mexican CPI. For lease renewals, parties may choose to set the new rent based on either the CPI or fair market value by comparing the leased property to similar properties in the area.

### 6.7 Payment of VAT

Leases trigger VAT at a rate of 16% (unless the real estate is for housing purposes, without furniture), which should be withheld by a tenant, as long as they are a Mexican tax resident. In cases where a furnished property for housing purposes is leased, VAT will be triggered but only with respect to the proportion of the rent corresponding to the furniture.

### 6.8 Costs Payable by Tenant at Start of Lease

In addition to rent, tenants normally pay the monthly maintenance or condominium owners' association fee corresponding to the common areas, and the monthly bills for utility services, such as electrical power, water service, telephone, internet, cable-TV and HVAC. Depending on each property's management, tenants may also have to pay an independent amount for parking spaces. In retail or shopping centre leases it is also customary for tenants to pay key money (one-time payment), and a share of the shopping centre's advertising and marketing costs. Finally, in some triple-net leases, tenants are also bound to pay the relevant property tax.

### 6.9 Payment of Maintenance and Repair

The maintenance and repairs for common areas is normally paid by all tenants through a monthly maintenance fee set forth in proportion to the size of a leased property with respect to the total surface area of a building or complex.

### 6.10 Payment of Utilities and Telecommunications

Normally, each tenant in a property is required to enter into separate agreements with each utility supplier in which case, each tenant will pay, directly to the relevant supplier, not only the connection fees but also its consumption costs. In the case of common utilities used jointly by several or all tenants, each tenant normally pays their consumption share or the amount proportionate to the size of its leased property with respect to the total surface area of a building or complex.

### 6.11 Insuring the Real Estate That Is Subject to the Lease

Tenants of residential properties do not normally pay or have any insurance. In connection with other types of properties and depending on the business or activities to be carried out therein, tenants usually pay for general liability insurance to cover any damages to a third-party's property and persons, and for business interruption insurance. All-risk property insurance is sometimes paid by tenants and other times by the landlord.

It is also customary for the property manager to get all-risk property insurance for common areas, the cost of which is then shared by the tenants through the payment of their maintenance fee.

### 6.12 Restrictions on Use of Real Estate

From a statutory point of view, tenants' use of a leased property is limited by the permitted land use and applicable environmental, civil protection and health and safety regulations. From a contractual perspective, it is restricted by the lease terms and any condominium regulations. In the leasing of commercial spaces further restrictions may apply, for example, with regards to the disposal of hazardous materials, opening hours, prohibition to suspend activities or prohibition of certain activities or goods that cannot be offered in order to avoid competing with other tenants.

### 6.13 Tenant's Ability to Alter and Improve Real Estate

As a general rule, all improvements or alterations to a leased property carried out by a tenant should first be approved by the landlord, unless anything to the contrary is established in the lease agreement. In the lease agreement, it is customary to allow the tenant to carry out minor decorative alterations which, upon termination of the lease and at landlord's sole discretion, shall be removed without damaging the property or shall be left for the benefit of the landlord free of charge.

### 6.14 Specific Regulations

Regardless of the fact that in Mexico leases are regulated on a state-by-state basis, all leases are distinguished in Mexico in consideration of their length and the use and purpose of a leased property (housing, office, industrial, retail, agrarian). Each state civil code provides for different lease terms depending on whether the lease is for residential, commercial or industrial purposes. Additionally, and depending on the activities to be carried out in a leased property, environmental, civil protection or health and safety regulations may also apply.

### 6.15 Effect of Tenant's Insolvency

A tenant's insolvency under general contract terms may result in early termination of a lease and the payment to the landlord of any indemnity provided for in the lease (ie, liquidated damages or damages and lost profit). Additionally, pursuant to the applicable law, tenants may be evicted from a leased property and the corresponding lease may be terminated, among other reasons, for a tenant's default in the payment of two or more rent payments (after ten business days lapse since the date the landlord notified the tenant of the default)

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

For commercial or industrial leases, in addition to the security deposit, tenants usually provide a surety bond (fianza) issued by a third party (such as a parent company) or by an authorised financial institution, or a joint obligor with sufficient capital to guarantee a tenant's obligations under the lease.

### 6.17 Right to Occupy After Termination or Expiration of a Lease

Upon termination of a lease a tenant may continue using the leased property as long as the landlord does not oppose such further use. In this case, the lease will continue for an indefinite period of time with the tenant paying the rent that applies pursuant to lease terms) and either party has the right to terminate the agreement with notice delivered to the other party 30 business days in advance.

In the lease agreement the landlord may establish a high rent increase or a very high penalty in case the tenant does not leave on the originally agreed date.

### 6.18 Right to Terminate Lease

The usual events of default of a tenant include:

- non-payment of two or more monthly rents or maintenance fees;
- using the property for any uses not permitted under the lease or under applicable laws;
- storing or using hazardous substances without the landlord's approval and/or without the applicable permits;
- not obtaining legally required functioning permits and licences;
- breaching any applicable laws and regulations;
- not having the agreed upon insurance policies;
- defaulting the lease's assignment or sublease restrictions;
- not operating or closing the commercial space for a period of time longer than that established in the agreement; and
- breaching non-compete provisions.

The usual events of default of a landlord include:

- not carrying out necessary or structural repairs;
- breach of the quiet enjoyment right of a tenant;
- if the premises are closed for a cause imputable to the landlord;
- if the premises are not delivered to the tenant on time and due to a cause imputable to the landlord; and
- breach of co-tenancy or non-compete provisions.

Under Mexican law early termination of a lease also occurs due to the destruction or loss of the premises due to acts of God or expropriation.

### 6.19 Forced Eviction

Pursuant to applicable laws, tenants may be evicted from a leased property and the corresponding lease may be terminated upon breach of any obligation under the lease. However, this right is normally exercised for material breaches such as a tenant's default in the payment of two or more rent payments (after ten business days lapse since the date the landlord notified the tenant of the default), for criminal activity (including unlawful weapon possession) or violating community and/or condominium regulations. The length of the eviction process is different in each state; however, in most states an eviction trial lasts between five to 12 months.

### 6.20 Termination by Third Party

Expropriation or domain extinction of a property claimed by a governmental authority may cause the early termination of a lease.

Expropriation of a property occurs when the competent authority declares that under the provisions of Article 1 of the Expropriation Law, there is a public purpose for the expropriation. After the Ministry's declaration of public profit, the President issues and publishes in the Official Federal Gazette an expropriation decree authorising the temporary or definitive land taking. The owners of the land and other affected parties are then notified of the expropriation and of the commercial appraisal value of which they will be indemnified. The affected parties may challenge the amount of the indemnification, and may also, through a legal recourse called Amparo, challenge the expropriation decree. If provided in

the lease agreement, the landlord may share part of such indemnity with the tenant.

Domain extinction occurs when a crime, normally related to drug trafficking, against public health, kidnapping, white slavery or money laundering has been committed at a property. Domain extinction legal action is exercised by a federal or local prosecutor and is resolved in court. The lease agreement shall provide for indemnity in favour of the affected party in case the lease is terminated early due to an extinction of domain action.

## 7. Construction

### 7.1 Common Structures Used to Price Construction Projects

Construction projects are commonly priced as lump sums or based on a fixed price.

### 7.2 Assigning Responsibility for the Design and Construction of a Project

An architect is responsible for the design of a project and such design's compliance with applicable laws, regulations and programs, such as environmental, construction, zoning and civil protection statutes. The architect is also bound to verify the works' progress and confirm that the construction was carried out in accordance with the architectural project. On the other hand, the contractor (led by a Works Director) is the party responsible for carrying out the construction and developing works in compliance with applicable laws and regulations. In the case of damages caused due to a design error the architect shall be liable; however, if the damages were caused due to a construction mistake, then the contractor shall be responsible.

### 7.3 Management of Construction Risk

Construction risk is managed first of all through the general liability and professional liability insurance policies of an architect, the contractor and the subcontractor. Additionally, under applicable laws, the architect, the contractor and subcontractor are liable for hidden defects for a minimum period of six months (which can be extended in the relevant agreement) counted as of the date of delivery of the construction.

Construction risk is also managed through indemnities set forth in each agreement, and through a reserve fund provided for in the construction works agreement entered into with the contractor, which is basically a withholding of a percentage of each contractor's instalments to guarantee the contractor's compliance with the terms of the agreement. The general statute of limitations for contractual defaults is ten years.

### 7.4 Management of Schedule-Related Risk

It has become more and more common to set forth in construction works agreements a payments calendar based on the construction progress and fulfilment of milestones. In the case of delays, an owner may be entitled to the payment of daily liquidated damages. It is also customary to provide for a reserve fund in favour of the owner, which is basically a right to withhold a percentage of each contractor's instalments to guarantee the contractor's compliance with the terms and the calendar set forth in the agreement.

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

Performance bonds (fianza) and the obligation to repair or replace any hidden defects are the most common guarantees given to property owners to ensure a contractor's performance. In some cases, a joint obligor is also offered by the contractor.

### 7.6 Liens or Encumbrances in the Event of Non-Payment

In Mexico contractors and/or designers are not allowed to lien or encumber a property in the event of non-payment.

### 7.7 Requirements Before Use or Inhabitation

An occupancy certificate (which name varies from state to state) must be obtained prior to the occupancy of any new construction or of any property that has had a change of land use being officially approved. Such occupancy certificate is issued once the competent authority verifies that the property complies with applicable laws and regulations.

## 8. Tax

### 8.1 VAT

The transfer of real estate (other than plots of land or constructions destined for housing purposes) is subject to VAT at a rate of 16%. A seller triggers the VAT which shall be collected from the buyer. The buyer may credit the VAT borne to the extent that he/it meets the requirements provided for in the VAT Law. The sale of properties and constructions used for residential purposes is exempt from VAT.

### 8.2 Mitigation of Tax Liability

Unless non-Mexican tax residents acquire real estate for free or below the 10% of the real estate appraisal value, no federal taxes are triggered for acquiring real estate portfolios located in Mexico. However, and even though the buyer is not the taxpayer, he/it bears the input VAT.

With respect to local taxes, the tax liability of acquiring a real estate in Mexico may vary depending on the state and municipality where the real estate is located. Generally, the tax liability cost may include:

- real estate transfer tax which is triggered by the buyer and is paid on the highest value of the property among the authorised appraisal, the cadastral value, or the actual consideration paid, at a rate between 2% to 5%. This tax is triggered in any transaction conveying property (ie, donation, contribution to a trust, spin-off or mergers, among others). REITs are a common method to mitigate transfer tax, since FIBRAs allow to defer the transfer tax resulting from the contribution into the FIBRA, until the transfer of the real estate takes place, to the extent that the trustors/beneficiaries receive public trust certificates (CBFIS) in exchange of their contribution. Nevertheless and in order to apply for the tax benefits an investor must meet certain substantial and formal requirements;
- notarial fees which are equal to a percentage of the value of the transaction. There is no common method to mitigate this cost; and
- registration duties, which could be a fixed fee or a progressive rate based on the real estate purchase price. There is no common method to mitigate this cost.

### 8.3 Municipal Taxes

Municipal taxes vary from municipality to municipality. For example, the Mexico City Tax Code does not tax the occupation of business premises; however, real estate owners (ie, plots of land and/or constructions) are bound to pay a local tax called property tax (impuesto predial) which shall be calculated multiplying the applicable tariff to the cadastral value of the property. The property's cadastral value has different manners to be determined, depending largely upon the location, use of the property and how it was acquired. The property tax shall be paid to the local tax authorities on a bi-monthly basis. As to exemptions, among other particular cases and pursuant to the Mexico City Tax Code, public governmental owners, foreign governmental owners and international organisations are exempt from the property tax payment. Additionally, the Mexico City Tax Code provides for some property tax reductions (ie, yearly advanced payment, low-cost homes, artistic or historic real estate and real estate used for religion, education and public benefit activities purposes, etc).

### 8.4 Income Tax Withholding for Foreign Investors

There is income tax withholding in Mexico for foreign investors. Because the leased real estate is located in Mexico, rental income tax withholding occurs at a rate of 25% on the gross proceeds. If the tenant is a Mexican tax resident or has a permanent establishment in Mexico for tax purposes, such a tenant is the withholding party. On the contrary, if a non-Mexican tax resident invests through a Mexican tax resident entity, then the Mexican entity triggers the income tax at a rate of 30%. Leases also trigger VAT at a rate of 16% (unless the real estate is used for housing purposes, without furniture), which should be withheld by the tenant as long as it is a Mexican tax resident.

Applicable double taxation treaties may provide income tax relief for a landlord, to the extent that the requirements provided therein and in the Mexican Tax Law are met. In accordance to the Mexico-US Double Tax Treaty, non-Mexican tax residents may elect to compute the tax on such income on a net basis, as if such income was attributable to a permanent establishment in Mexico.

Foreign pension and retirement funds and their subsidiaries where pension funds directly or indirectly participate (the indirect investment is limited to a two-tier structure), are not taxed in Mexico in the proportion of the pension fund's participation with respect to, among others, income arising from granting temporary use or enjoyment of land or constructions located in Mexico.

Taxation of disposition gains or income tax occurs at a rate of 25% on the gross proceeds, which should be withheld by the buyer (as long as it is a Mexican tax resident or it has a permanent establishment in Mexico). Alternatively, the income tax rate may be of 35% on the net gain basis, to the extent the taxpayer meets the requirements provided for in the Tax Law. Foreign investors should estimate the gain as if they were Mexican tax resident individuals. If the non-Mexican tax resident invests through a Mexican tax-resident entity, the Mexican entity triggers the income tax at a rate of 30% on the net gain basis. Except for plots of land or constructions used for housing purposes, disposition of properties located in Mexico are taxable at a rate of 16% for VAT purposes, which should be withheld by the buyer, as long as it is a Mexican tax-resident.

Additionally, under the tax law it is considered to be a Mexican source of income when a non-Mexican resident transfers shares of an entity whose value comes from more than 50% of real estate located in Mexico. In this case, the income tax rate is of 25% on the gross proceeds or 35% on the net gain basis, provided certain requirements are satisfied.

Applicable double taxation treaties might provide tax relief, to the extent that the requirements provided therein and in the Mexican Tax Law are met.

To the extent certain requirements are satisfied, foreign pensions funds and their subsidiaries where such foreign pensions funds participate are exempt with respect to capital gains taxation.

### 8.5 Tax Benefits

The Tax Law does not provide for a tax benefit for foreign investors owning real estate. However, foreign investors that invest in Mexican real estate may estimate the income tax on a net gain basis, to the extent they satisfy the requirements provided for in the Mexican Tax Law. In this case, the gain should be estimated as if the foreign investors

were Mexican individuals. This means that the gain shall be computed reducing some applicable deductions from the income received. Mexican Income Tax Law does not allow for non-Mexican tax residents to deduct the depreciation of constructions.

In a case where a real estate investment is made by a non-Mexican resident through a Mexican entity (SPV), the construction's value (excluding land) may be deducted, based on the depreciation percentages established in the Mexican Income Tax Law (depreciation under straight line method, adjusted for inflation) at an annual rate of 5% (applicable rate in 2018).

If some requirements are met, there are other tax benefits for Mexican entities such as:

- accelerated VAT refunds for the acquisition of new assets;
- expenses incurred in connection with long-term agreements for the construction of buildings, may be deductible based on an estimation related to the yearly received income;
- deduction of the land or plot used for real estate projects in the year it was acquired; and
- FIBRAS which provide tax benefits to their trustors/beneficiaries (ie, the deferral of income tax triggered by the beneficiaries as a result of the contribution of real estate into the trust; tax exemption for the transfer of the CBFIS held by non-Mexican tax residents; non-filing of trust's monthly advanced returns, among others.)

### 8.6 Key Provisions in the Federal Tax Reform Legislation

No recent tax reform in Mexico has been published that affects real estate investments from the US.

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