

I was excited about buying a condo in Cabo San Lucas, Mexico. It is a charming town with a walkable downtown, breathtaking natural beauty, is in the path of demographic migration, has a new Costco, and plenty of signs of growth. The cost of real estate is comparable to Spokane; i.e., a real bargain compared to other warm-weather places. I had heard of people who got into trouble in Punta Banda, near Ensenada, but there it sounded like the built on leased land and believed a builder when they shouldn't have.

I am a lawyer and thought I knew what I was doing. But I got burned badly on one of my deals, along with several others. I didn't realize that escrow agents in Mexico are not bonded. See www.americaalvarez.com for details on that sad story.

It is very high risk buying in Mexico. We, as Americans, are spoiled in having so many protections that a transfer of title can be easily handled by a title company. I now own five condos in Mexico, and have learned something new in each deal. My list of risks and things to consider if you are contemplating buying anything in Mexico is below.

But first, a word about Fideicomisos. You may have heard something about how you can't own land directly in border zones. This problem is easily solved through the use of Fideicomisos, bank trusts. These are similar to U.S. revocable trusts, the beneficiary has the ability to sell the property at any time, and if the beneficiary dies, title transfers to a substitute beneficiary. The reason for this is historical, and has to do with what happened in Texas. Basically, the trusts say that if you invoke the protection of your foreign government (and try to succeed from Mexico), you lose your property. My theory as to why Fideicomisos are still around is because they generate a lot of revenue for the banks.

Now, here is the list, which continues to grow over time:

1. The agents are not licensed or bonded. Anyone can sell and many so called agents, while members of the local MLS, do not know the market very well. Some do not know or do not care if properties they are selling have title problems. If you send a down payment to an agent, the agent could disappear with your money and you'd have little recourse. Even if it is a U.S. name franchise, if there is a problem, they will likely claim that it is a different entity in Mexico. This sort of emptying of the escrow account has happened before. A Coldwell Banker franchisee in Los Cabos named Lulu Jacobsen is accused of having emptied out her account and fleeing to the U.S. The boxer, Oscar de La Hoya, filed a suit against the U.S. Coldwell Banker and is seeking to hold them responsible since Lulu had a questionable past, yet was given a franchise. Hiring a private investigator to find them, getting a judgment, and finding assets can easily cost more than the down payment you lost so there is little point pursuing them. A Coldwell Banker franchisee in Ensenada is accused of having sold property involved in a title dispute, without proper building permits.

2. A sizable percentage of the properties have title problems. You have to get title insurance. Even if you ask for title insurance and pay for it, you might not ever receive a policy. It is possible for a seller to sell a "promise to make a promise" in Spanish and you'll never know you are getting a property with title problems. Be very careful. The escrow agents get recommended by the real estate agents, and the real estate agents and the escrow agents who they recommend have every incentive to make sure your cash gets disbursed, regardless of any title issues.

3. Just like with trinkets, you have to bargain. Asking price is not necessarily close to true market value. Asking price could be double true market value. There are MLS "sold" books but the agents do not report any data. You can hire an escrow agent to search public records for neighboring properties, or similar units in a condo complex, but you will have to pay for the service. Expect to pay \$200 or so for a search (you have to bargain, of course). But it may be worth it if you are not familiar with a market. You will have to convert pesos into dollars using the exchange rate in place at the time. Also, many values are underreported, as I will discuss below.

4. Standard real estate commission is 10%. There are big savings to be made by avoiding properties that are on the MLS. But you need the advice of someone who knows the market. And you need a lawyer to draft the papers and help with the closing. But you need a lawyer anyway.

5. Escrow agents are not bonded. They could empty out their escrow account and flee. This has happened before in Los Cabos (America Alvarez). You need to use U.S. escrow. Fidelity Title in New York and Steward Title in Houston offer escrow services. They will hold your money in a U.S. account until funds are to be disbursed based on the terms of your offer. Many Mexican escrow agents or real estate agents have U.S. accounts, but these accounts are usually set up to allow them to easily transfer funds into associated Mexican accounts. Don't feel safe just because the person you are dealing with has a U.S. account.

6. The closing process is complicated and expensive. Foreigners buying near the coast or border have to get a foreign investment permit, and have to hold title through a bank trust (Fideicomiso). Buyers have to pay a transfer tax that is a percentage of the total value of the transaction. There is an annual fee for the services of the trustee, about \$300-500 per year. The amount of the annual fee is set in your trust documents so make sure your closing agent shops around. My experience has been that Scotiabank-Inverlat is a bit cheaper than HSBC, the latter being the trustee that most people seem to use. It takes at least 2 months to get possession and four months to a year before you get your actual Trust. The Trust system is relatively new and there is ambiguity in the law over whether you can renew after 100 years. A Fideicomiso contract is for 50 years initially, and then is automatically renewable, presumably at a higher yearly fee. The question, then, is how many times can it be renewed? Of course, you can sell within the 100 years, and may not live more than 100 years, so that doesn't bother me.

7. Some people put title in corporations to avoid the bank fee and because they feel more secure having a title instead of having title in a trust. A foreigner can set up a Mexican corporation. You only need two shareholders and one can be a U.S. LLC. You cannot own a house that you live in using a Mexican corporation. There is ambiguity in the law as to whether you can own residential rental real estate in a Mexican corporation if you don't live in it. My accountant told me that the Mexican tax authorities watch you more carefully if you have a corporation, so I did not use a corporation. I have, however, made it a goal to eventually obtain Mexican citizenship, which is possible after holding an FM3 for five years (more on visas later), so I can get rid of these annual trust fees. But I will have to pay the stiff transfer taxes if I ever achieve this goal. A U.S. LLC can be the beneficiary of a Fideicomiso, and that is how I set up my first condo, but I later learned that a U.S. LLC is not permitted to conduct business in Mexico and cannot open a Mexican bank account. These are the types of things where if you ask two people for advice, you'll get two different answers. My personal view is that it is too complicated to use a U.S. LLC. So think carefully how you are going to hold title before you even make an offer.

8. Many people in Mexico view income tax as optional, and nobody likes to give receipts. You need official receipts "Facturas" if you are going to take itemized deductions (which you have to do if you use a Mexican company to hold title to your property). If you pay tax as an individual, there is a blind deduction option to paying income tax, which is the easiest approach. You need to get a Mexican tax ID or the renter is supposed to withhold the tax for you and submit it to the government, which is not likely to happen. To get a Mexican tax ID, you have to claim you are a Mexican resident.

9. If you stay 183 days, you are a Mexican resident for tax purposes and subject to Mexican income tax on your worldwide income.

10. If you do have income in Mexico, you are supposed to pay estimated taxes every month. Be prepared to get lousy information from your property manager with respect to income and expenses. Don't expect anyone to give you receipts for anything. Tax rules in Mexico change very frequently.

11. It is hard to get money out of Mexico. One way I've figured out to do it is via ATM card. Bank drafts are too expensive. It isn't that the currency is unconvertible; it is just that their mail system doesn't work. The locals don't trust the mail so are not inclined to mail things of value. Also, since it is an all cash society, the managers are unlikely to put the money in their own accounts and issue checks to you. There is a culture of avoiding taxes and avoiding recorded transactions. If you had a big project, you could do bank wires for \$10 or so, but a trip to the bank can take an hour. You could DHL a bank draft, but then you pay \$30 or so for the DHL, plus a couple of bucks for the bank draft. It is more of a transaction cost issue than anything. By using the ATM card approach, my manager can deposit cash in my account, quick line to the teller instead of a longer wait for a special service. And I can take it out here with the only transaction cost being the ATM fees. I also have checks from my Mexican bank account but didn't realize that you can't use them until you activate them. Which you have to do down there in person. There is some way to do it by phone but I haven't figured that out. I am missing some password. You have to make sure your Mexican bank balance doesn't go above \$10,000 or you have to report the foreign bank account to the IRS.

12. There is no problem getting money from the U.S. to Mexico. There are some banks that will let you automatically transfer funds from a U.S. account to a Mexican account. California Commerce bank offered that service. You can also use Western Union for a small service fee each transaction (about \$20).

13. To open a Mexican bank account, you first need an FM3 visa and a Mexican light bill. You can get the FM3 from a Mexican consulate with three month's of bank statements showing above some amount (around \$1000) deposited each month. You need to give them your U.S. passport for a day. You also need photos without glasses (they don't tell you that until you get there) and you need to pay in cash. I've been told that you need this visa to own property in Mexico according to the law or you are an illegal immigrant and have no rights in the event of a legal dispute. It is easier to enter and leave on a tourist visa than on an FM3. With an FM3, you need to get a re-entry permit from immigration each time you leave. They might hassle you, ask you what you were doing in the country, and try to get you to admit you were working illegally so they can charge a fine or extract a bribe. But you can enter the country more quickly on an FM3 and avoid the long lines in the airport. They are presently sending FM3 holders to the Mexican Citizen line.

14. You have to repeat the FM3 process when you arrive in Mexico and register with local immigration. You basically need the same documents all over again. Or you can pay a fine a year later.

15. To get the utilities changed to your name(which you need to do to open a bank account), you need a full copy of your trust documents and the photo page of your FM3 and an old light bill from the previous owner(or at least their name or the address). Of course, it can take 3 months to a year to get your trust documents.

16. If you have any title problems, it can take years to get it cleared. Make sure you hire an attorney to help you get clean title. Ask the seller if they have U.S. title insurance and if they have their Fideicomiso. If the seller doesn't have their Fideicomiso, there is a reason why, usually some title problem. That doesn't stop the sellers and agents from selling you something. If the seller has a Fideicomiso, that is not a guarantee that they have clean title. There could be liens on the property.

17. You have to renew your visa in the exact same town year after year. There is a lot of corruption in the Immigration department. The easiest way to renew a visa is to hire a lawyer and pay \$200. Otherwise they will send you away multiple times asking for documents that don't exist(like three month's of Mexican bank statements showing a certain deposit every month--you can't go back in time to get it).

18. You now have a foreign trust, you have to file special documents with the IRS that no accountant knows about, form 3520 and 3520A. If you don't do it in time(and it isn't the normal tax deadline),the penalties can be pretty drastic.

19. Mexican tax laws change all the time. Capital gains tax wasn't too bad if you were a resident for a couple of years before you sold. But that exemption is no longer there. Capital gains taxes are huge. Your capital gains taxes go down the longer you own a place.

20. Transaction costs are huge. There is a big transfer tax. Expect to pay at least 7k in closing fees. And don't expect to get that back when you sell. Only buy if you are planning to hold long term. Or to flip before closing.

21. People used to underreport values for this reason, seller would pay less capital gains tax, buyer would pay less transfer tax. But the government has caught on. If you do this, or allow the seller to do this, you will get stiffed with the seller's capital gains. If the seller doesn't pay their capital gains, for any reason, you have to pay it. So you have to modify the contract to say seller doesn't get any money until they pay their capital gains taxes. Need an attorney to do that for you. Watch out for properties with title in a LLC or corporation, you can be sure you will get stuck paying the seller's capital gain taxes if you just buy shares of the company. If it is an offshore corporation, that brings into question the seller's ethics. Even if your offer says that capital gains taxes are to be paid by seller, this doesn't protect you. This is where the attorney can help. A document prepared later in the process, "letter of instructions" should say that funds don't get disbursed to seller until capital gains taxes are paid. Put that in the offer too, that no funds are to be disbursed to seller until capital gains taxes are paid. Make sure the attorney agrees that the capital gains taxes have been resolved before funds are disbursed to the seller.

22. There is a rich history of re-socializing property. Watch out for Ejidos (communal farming land). In case of any dispute, the agrarian judge always rules in favor of the Ejido. In the Puerta Banda story in Ensenada, there were rumors of corruption, maps being redrawn, etc.

23. The court system is slow, inefficient, and sometimes corrupt. If you get in a dispute, don't expect any recourse in the courts without paying and paying and waiting and waiting. Nobody cares if an American loses their money. The criminal law system will not help you either unless you pay a prosecutor to investigate.

24. It is risky to use developer financing or any Mexican financing. Typical contracts say the developer keeps title until you pay everything off. If they go bankrupt in the meantime, you can lose everything. With bank financing, it can take years to get liens removed after you have made your last payment.

25. Insist on U.S. escrow, and hire an attorney in advance. It is well worth the money. You are spending \$7000 on closing costs. An extra \$1000 for an attorney is not that much. Just make sure they are competent. A lot of properties have title problems. Make sure you get title insurance. Make sure your attorney examines the condition of the title and looks at the commitment for title insurance before any funds get distributed to the seller. Put that requirement right in the offer.

26. Make sure that the escrow agent verifies that condo association fees are current, utilities bills are current, and property taxes are current.

27. If you want to actually use the condo yourself, you will need to find a manager who is willing to do short term rentals. These are very hard to find. Short term rentals do not work as well as long month leases in terms of cash flow, because of substantial vacancies and competition with hotels and timeshares, which are sometimes overbuilt. You will probably have to go through a couple of managers before you find one who is competent AND good at finding renters. The most successful owners are actively involved in finding renters for their own properties. Some managers may be tempted to not provide you with all the income they receive. Be aware that managers usually charge a higher percentage for short term rentals. Be aware that Mexican income taxes are generally based on gross income. With short term rentals, you will have a higher gross income but higher expenses, typically leading to higher income tax than with short term rentals.

28. Be aware that it can be hard to sell in Mexico. Because agents often set the asking price too high, pendencies can be long.

29. Make low offers and be patient. You'd be surprised. A lot of owners are elderly, just want out badly for whatever reason (e.g., strong negative cash flow due to high condo association fees), and capital gains isn't that important to them. Some properties are owned by U.S. children who have inherited the property. They get tired of the huge condo fees and other fees. It is "found" money to them and they just want to unload the albatross. For my first condo, which I bought a couple of years ago, I talked to an owner who said that she paid \$50k five years previous, but that some were going for \$60k. I offered 35k and my offer got accepted. My last one, two years later, same complex, I offered 35k and settled at 38k.

30. Make property managers and condo association managers your first source of information, not real estate agents. Don't waste your time with agents who can't tell you what prior sold prices have been (most of them don't know). The

managers often will also help you find a condo at a reduced commission. No license is required to sell real estate in Mexico. The real estate agents are not legal experts and will not guarantee you clean title. But they are very competitive because a commission is very big money.

31. Be aware that if anyone steals money from you, the prosecutors will not do anything for you. You have to pay to get the government to file criminal charges against anyone. Be aware that some people there have a feeling of "we have so little, you have so much."

32. Don't use a short "offer to purchase" form supplied by a real estate agent. Those typically only protect their commission. Get a lawyer to draft a "pro-buyer" offer form for you. Make sure to address that the recorded value will be the actual contract value, that no funds will be disbursed to seller until you or your attorney are satisfied that capital gains taxes have been paid from escrowed funds and that clean title is available, and that unit will be sold as shown, with no furniture removed. Also, put in the offer that no funds are to be disbursed until your lawyer has reviewed and approved of the preliminary commitment for title insurance. I have never seen a real estate agent form that addresses these issues.

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