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## CROSS-BORDER REAL ESTATE PRACTICE

### WHAT IT IS AND WHAT YOU NEED TO KNOW

*By Terry A. Selzer*

Cross-border real estate practice sounds more exciting than just doing real estate, but what actually is it? Basically it involves a party from one country buying or leasing property in another country. A lawyer in such a transaction could represent a buyer, tenant, seller, landlord, bank, real estate broker, developer, architect, engineer, title insurance company, government entity, or other stakeholder. The buyer could be an individual, investment fund, asset-management company, or other entity. The property could be an existing building or land for development. Transactions may involve an individual seeking a vacation home in another country, a multinational corporation interested in acquiring land for establishing a factory or distribution center in a new jurisdiction, or a real estate investment fund seeking to acquire property in a country with higher yields than its own.

Cross-border real estate transactions can be fairly simple and straightforward, such as those involving one property with no legal restrictions preventing a foreign buyer from purchasing the property. The only differences may be the legal processes the foreign buyer is used to and language and cultural variations.

On the other hand, a cross-border real estate transaction may be extremely complicated, requiring the establishment of local companies, or for tax reasons a company in a third jurisdiction, and multiple agreements between multiple parties in multiple jurisdictions. The transaction may be done as a share deal rather than an asset deal. In a large project in Gdansk, Poland, for example, my firm completed several acquisitions of land for a Danish company as a share deal because under a local master plan an administrative land tax was imposed on all sales of land made within five years of the implementation of the plan. The foreign investor may enter into a joint venture with a local partner. The sales price may include share swaps or swaps of land plots. Additional

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# ABOUT THIS ISSUE

## Cross-Border Real Estate Transactions

*By Catherine M. Doll, Deputy Editor*

In this issue of *ILN*, we focus for the first time on the challenging and fascinating subject of cross-border real estate transactions. We bring to you articles covering Argentina, India, Mexico, Russia, and Sweden. We hope you enjoy them!

The necessity of addressing the problems of cross-border real estate transactions has been looming on the horizon for quite some time. The international nature of the world makes it paramount for attorneys to be familiar with the issues that can arise in cross-border real estate transactions, business and consumer alike, and to appreciate the challenges they may face when working in multiple jurisdictions and unfamiliar cultures.

Partly in response to this necessity, this past year the ABA formed a new committee, the Cross-Border Real Estate Practice Committee, with a goal of advancing the law in areas "relating to the regulation of inbound real estate investment; financing, mortgages, and security issues; harmonization of title registration and transfer requirements; title insurance issues; and other matters of substantive real estate law." More about the committee can be found on the Section's website at *www.abanet.org/intlaw*.

Despite its recent beginnings, committee members have contributed substantiality to the current issue. In our cover story, Terry Selzer, cochair of the committee, analyzes issues that may arise in cross-border real estate transactions, drawing upon his extensive experience in multijurisdictional transactions. The author poses a series of questions one must ask to successfully navigate in different legal and cultural environments.

In the next article, Anna Gray and Kenneth Gray introduce us to the three contract types one can choose from when investing in real estate in Russia and highlight the pros and cons of each type. Benjamin Rosen takes us to the other side of the globe and examines the challenges of foreclosing on cross-border loans in Mexico. The author points out that although in theory Mexican law appears clear on the foreclosure process, the reality of foreclosing in Mexico is much more complicated. Marcela Knaup brings us the fascinating world of investing in "vineyard estates" in Argentina and also familiarizes us with the wine real estate market of Argentina.

By contrast, Anil Jarial and Amruta Kelkar examine the problems of foreign direct investment in real estate and slum redevelopment projects in India. The authors offer an overview of the law dealing with foreign direct investment and acknowledge that the real estate market in India is still underdeveloped. To conclude we bring to you an article by Anders Forkman, who discusses the process of transfer of real property in Sweden.

Of special note is the submission from Michael Marriott, a 3L at UC Davis King Hall School of Law. This piece explores whether the International Criminal Court's jurisdiction can be expanded to become a universal jurisdiction.

As always, we welcome your articles, casenotes, and suggestions for upcoming issues. We hope you enjoy this issue of *ILN*, and we look forward to seeing you at upcoming ABA events. ✦

***Catherine M. Doll** (cmdoll@debevoise.com) is a partner at Debevoise & Plimpton in New York City.*

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# FORECLOSING ON CROSS-BORDER LOANS IN MEXICO

*By Benjamin C. Rosen*

One of the main issues confronting the financial sector worldwide as a result of the economic and real estate market troubles is how to deal with developers and homeowners alike who, due to unfavorable financial and market conditions, are unable to timely repay loans.

This issue is particularly acute with respect to foreclosing on cross-border loans in Mexico. A cross-border loan may be defined as either (a) a loan that originates in one country and is disbursed in another or (b) a loan that is executed under the laws of (or the lender is domiciled in) one country but secured by collateral located in another.

### To Foreclose or Not to Foreclose

Financial institutions and private lenders who have made cross-border loans in Mexico are faced with the following options when confronted with a delinquent borrower:

1. grant the borrower either a **forbearance** or a **deferment**
2. **restructure** the loan, so that, for example, interest and/or principal payment obligations are reduced, the term is extended, balloon payments are deferred, and/or the lender takes an equity interest in the project/property
3. threaten foreclosure or file for foreclosure then **negotiate a settlement** through which the borrower is given some sort of consideration for voluntarily "handing over the keys"
4. **foreclose**

Because of the well-known difficulties in foreclosing on loans and repossessing property in Mexico, and, in general, the perception that the Mexican judicial system is slow, unpredictable, and vulnerable to corruption, most lenders are opting for restructuring the loan, deferment, forbearance, or settlement.

Nevertheless, when confronted with a defaulting borrower in Mexico, it is advisable for lenders to look at all four options mentioned above and to weigh the pros and cons of each based on the specific circumstances. Indeed, the first step might be to grant a temporary forbearance, but if that does not work, then perhaps the parties will restructure the loan. And, only if both these attempts fail, might the lender decide to foreclose; and even then, he may end up settling by, for example, paying the debtor an agreed sum in exchange for voluntarily relinquishing his rights to the collateral.

In any case, before deciding on whether or at what point to foreclose, lenders are advised to consult with qualified Mexican legal counsel who can help them better understand (1) the type of Mexican security interest granted and the lender's right to foreclose under Mexican law, (2) the likelihood of success, (3) the estimated time to obtain a final binding judgment and to enforce the judgment, and (4) the estimated costs involved.

### The Foreclosure Process

Once the creditor ultimately decides to pursue foreclosure against a debtor in default, the first step will usually begin with a demand letter.

#### *The Demand Letter*

Mexican legal requirements for demanding payment under a promissory note or other debt instrument are much more formalistic than in the Unites States, and to ensure the demand letter will hold up in court, it will likely be necessary to grant local counsel a formal power of attorney to serve the demand letter personally and in the presence of a Mexican notary public or officer of the court. This formal demand letter is referred to under Mexican law as an *interpelacion*. Although a demand letter usually will not be necessary if foreclosure is sought under a guaranty trust, it is often advisable to serve one regardless in case the matter ultimately ends up in court.

#### *Mortgage vs. Guaranty Trust*

If the demand letter does not work, then the next step will depend on what type of security instrument is in place. The two most common ways of securing a loan with real

*Benjamin C. Rosen* (brosen@rosenlaw.com.mx) *specializes in real estate law and cross-border transactions in San Jose del Cabo, Mexico.*

 

property in Mexico are the mortgage and the guaranty trust.

A mortgage is an agreement whereby the debtor or a third-party obligor grants the creditor the right to collect an amount due via real property put up as collateral, which right may be exercised if the debtor breaches its obligations pursuant to the credit agreement or note. Mortgage agreements must be executed before a Mexican notary public and recorded in the public registry of property in Mexico. Once recorded, the "world is on notice" that the subject collateral has been encumbered to secure the payment of the debt referenced in the mortgage instrument.

> Borrowers wishing to stall or avoid administrative foreclosure often employ "legal maneuvers" that can result in delays in the foreclosure process.

On the other hand, a guaranty trust is an agreement whereby a debtor or third-party obligor (trustor/*fideicomitente*) transfers title to collateral to a Mexican trust institution (trustee/*fiduciario*) for the benefit of the creditor (beneficiary/*fideicomisario*). That is, instead of the debtor conserving title to the collateral and encumbering it in favor of the creditor, the trustee holds the temporary title to the property to secure the debtor's compliance of the debtor's obligations. Almost all trustees in Mexico are banks, and they must be authorized as such by the Mexican Banking and Securities Commission.

### *Foreclosing under a Guaranty Trust*

Guaranty trust agreements contemplate an administrative foreclosure process. This process is carried out by the trustee without the intervention of a judge and therefore is designed to be significantly more streamlined than foreclosing on a mortgage, which requires filing a lawsuit and obtaining a judgment. Every trust institution will have its own administrative foreclosure template to be included in the trust agreement. Nevertheless, lenders can negotiate the specific terms with the borrower, subject to approval of the trustee. For purposes of analysis, we have included below an example template, which establishes the following administrative foreclosure process:

1. The First (Guaranty) Beneficiary/Creditor ("Creditor") notifies the Trustee in writing, (a) indicating that Trustor/Debtor ("Debtor") has defaulted on one or more of the obligations guaranteed by the Trust, (b) specifying the events and causes of default, and (c) requesting the sale of the properties to satisfy the debt.

2. The Trustee, upon receipt of the notice, shall within two working days thereafter proceed to notify the Trustor/Borrower that (a) he is in default and (b) he has ten working days to:
   a. Submit the documents evidencing he has fully paid and/or complied with the guaranteed obligations;
   b. Present any document evidencing an extension; or
   c. Pay the total debt due.

3. If the Trustor/Borrower does not comply with the foregoing, the Trustee will initiate the foreclosure process by proceeding to sell the properties under the following terms:
   a. The initial sale price of the properties will be the commercial value determined by an expert appraiser selected by the First Beneficiary/Creditor;
   b. The Trustee will then, based on instructions from the First Beneficiary, either: (a) hire a realtor selected by the First Beneficiary to broker the sale of the properties at the appraised value; or (b) hold a public auction to sell the properties in the manner described below;
   c. If the First Beneficiary chooses to hire a realtor, the realtor will promote the sale of the collateral for at least 90 days. If the properties are not sold at the appraised value during this time, the First Beneficiary may instruct the Trustee and/or the realtor (as the case may be) to: (i) continue promoting the sale for up to four additional 90 day-periods, in each instance decreasing the appraised amount by 10%; and/or (ii) proceed with the auction;
   d. If the First Beneficiary elects to hold an auction (either from the outset or subsequently if selling through a realtor was unsuccessful), the auction shall stipulate a floor price of 80% of the appraised value;
   e. Should the properties not sell in the first auction,

 

a second auction shall be held, at a price equal to 20% less than the price of the first auction;

f. Should the properties not sell in the second auction, a third auction shall be held, at a price equal to 20% less than the price of the second auction;

g. Should the properties not sell in the third auction, the Trustee shall act upon the First Beneficiary's [unilateral] instructions (which instructions could include, e.g., a request to transfer the property definitively to the First Beneficiary or its assign in lieu of payment of the debt).

Despite the relatively quick and straightforward process, "legal maneuvers" of recalcitrant borrowers can result in unforeseen delays and risks in the foreclosure process. One of the tactics most commonly employed by borrowers wishing to stall or avoid administrative foreclosure involves filing a lawsuit to enjoin the trustee from transferring title without a court order. Although in theory this should not be possible because the trust will stipulate that a court order is not necessary, in practice, trustees are very risk averse, so as soon as they are sued, then tend to "freeze up" and refuse to do anything further without a court order, thereby rendering the administrative foreclosure process inoperative. The legal argument of the borrower in these cases is often that the trustee transferring the property to a third party without the judge's intervention is tantamount to depriving the borrower of property rights without due process of law and is therefore unconstitutional.

These arguments, however, are not always successful and usually require that the trustee has committed some sort of error in following the administrative foreclosure process outlined in the trust agreement or the trust agreement does not obligate the trustee to notify the borrower of the default and give him an opportunity to respond by showing he is not in default.

Moreover, borrowers considering "crossing the line" and refusing to abide by the agreement can be subject to a claim for damages, attorney's fees, and costs for filing a frivolous lawsuit or acting in bad faith. Indeed, although employing the tactics above (or others) will surely result in prolonging the foreclosure process, in almost all cases it will not change the ultimate outcome (all the borrower is doing is delaying the inevitable and incurring expenses in the meantime). In the end, then, borrowers choosing to fight foreclosure are doing so only with the goal of improving their negotiating position with the creditor, often with an eye toward forcing the lender to consider restructuring the debt or granting an extension or forbearance.

Despite the practical risks associated with foreclosing, if the borrower is willing to proceed in good faith and abide by the terms of the guaranty trust agreement, then indeed the process should be a quick and expeditious one. Accordingly, guaranty trusts have become quite the norm, particularly for cross-border lenders.

Six months to three years is a reasonable time-frame to achieve foreclosure under a guaranty trust, depending on whether and how much the borrower fights and how effectively the process is managed by the trustee and creditor.

### *Foreclosure of a Mortgage*

If the creditor has a mortgage and the debtor defaults, then to foreclose (assuming the mortgage has been properly granted before a notary public and recorded before the public registry of property in Mexico) the creditor must file a Special Mortgage Proceeding (*Juicio Especial Hipotecario*). Once the creditor obtains a judgment, the collateral will be sold at a judicial auction pursuant to the procedure established in the applicable civil procedure code.

The special mortgage foreclosure proceeding (from filing until judicial sale is final) may take between one and five years to complete, depending on the actions or legal maneuvers employed by the borrower's counsel.

**The Pledge: An Additional Layer of Security.** In addition to guaranty trusts and mortgages, many lenders are mandating that borrowers pledge their shares in the borrowing entity and/or the receivables/rents deriving from the collateral. The pledge may be the creditor, a third party, or the same trustee holding the collateral under the guaranty trust. If the later approach is taken, in the event of a default, not only can the creditor proceed to administratively foreclose on the real property collateral but also can instruct the trustee to deliver the shares of the debtor company, thereby giving the creditor control over the debtor and preventing the previous decision makers from challenging process.

In theory the pledge guaranty offers the creditor significant additional security, but in practice sometimes the creditor is faced with similar enforcement problems as those mentioned above (i.e., the borrower sues to enjoin the trustee from handing over the shares).

**Eviction and *Amparo*.** After the collateral has been sold or awarded to the judgment creditor—either pursuant to the terms of the guaranty trust or the mortgage—the party who was awarded title might still have to sue to evict a third party such as a lessee or laborers in possession.

Under the Mexican Constitution and federal *amparo* law, a private party may bring two types of *amparo* suits to enjoin an official state act (or omission):

1. an *amparo* appeal of a decision of a lower court (similar to a habeas corpus proceeding but not limited to cases in which the appellant is incarcerated or otherwise restrained of his liberty), which may be brought only after all other judicial or administrative remedies have been exhausted, called an *amparo directo*
2. a claim brought at the federal trial court level to enjoin the activity of an individual or body acting under color of law claimed to have violated the plaintiff's individual rights (akin to a civil rights claim to enjoin state action), called an *amparo indirecto*.

Furthermore, in some instances, the debtor who has lost his property will file an *amparo indirecto* to stay the enforcement of the new owner's title that arose out of the foreclosure process. That is, oftentimes debtors will lose the property either administratively (guaranty trust) or judicially (foreclosure trial, followed by judicial auction), and then still fight the case via an *amparo*, which may be filed to enjoin any state action alleged to violate a party's civil rights. For example, in the case of the guaranty trust, the debtor may claim that the administrative foreclosure violated his right to due process, thereby forcing the creditor to pursue judicial foreclosure notwithstanding the trust agreement. On the other hand, in the case of a mortgage where a default judgment has been rendered based on the defendant's failure to appear, the debtor may allege that he was not properly served, thereby nullifying the trial and requiring the creditor to begin the process anew. In both instances, the *amparo* is typically filed when the creditor/new owner attempts to take possession.

### Minimize Risks and Unknowns

Based on the foregoing, one can conclude that in theory Mexican law affords a relatively clear and expeditious foreclosure process, both under guaranty trust agreements and special mortgage foreclosure proceedings. However, in practice a significant gap often exists between foreclosing in theory and in reality. Accordingly, the time and expense involved in foreclosure in Mexico will vary significantly from case to case and from debtor to debtor.

To help minimize the risks and unknowns associated with foreclosure in Mexico, it is advisable to retain qualified Mexican legal counsel with experience not only in preparing cross-border loan documents, security instruments, and guaranties, but also in enforcing them. Once the debtor has defaulted, consider all options before proceeding to foreclose, including restructuring the loan, granting the borrower a deferment or forbearance, or negotiating a settlement through which the borrower is given some sort of consideration for voluntarily "handing over the keys." If foreclosure is inevitable, have a clearly mapped out legal strategy well in advance, taking into consideration possible moves by opposing counsel. ✦

 