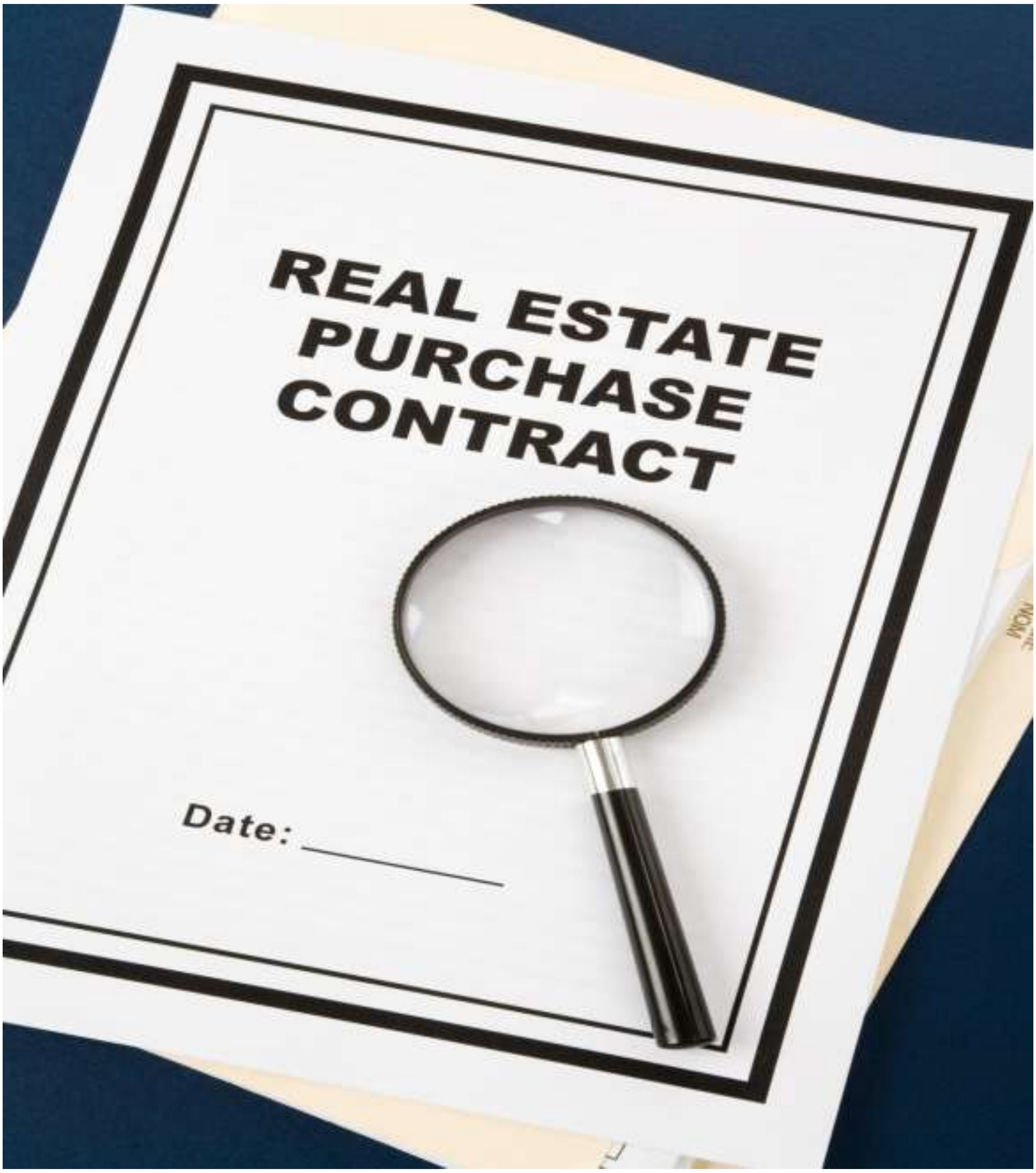
How to Due Diligence Your Overseas Property



A Pathfinder Special Report

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Dear Reader,

There's something about buying a property overseas. The purchase process is so different to the one back home...you don't speak the language... and it's all so exciting and full of possibilities. It's easy to get caught up in the buying process, and it's very easy to get carried away.

I don't know whether it's the sun, the rum, or a heady combination of both, but many people take risks when buying a property overseas that they would never take when buying back home. You need to remember not to leave your common sense at the airport...

Sure, you've met a guy in a bar who tells you that he can show you this great piece of land, that's a sound investment. He knows the seller who's owned it for generations, and just for you, he'll negotiate a special price. He has a friend who is the best attorney in town, who can do your due diligence for you, for a special price. Your newfound friend tells you that the land needs a permit before you can build your home...but you won't have to wait months for that, because he has a cousin in the planning department who can help...for a special price. That's the way things work in a foreign country, right?

You wouldn't buy a property back home this way. You'd hire an attorney, work with a broker you'd worked with before, or who come with recommendations from friends and family. You'd do your own due diligence, and you'd comply with all the local laws and systems that regulate property ownership.

So why do things differently overseas? You should do the same due diligence, and exercise the same caution, that you would when buying back home.

I spent my first fifteen months with Pathfinder scrutinizing the paperwork for developments in Central and South America. In the last six years, I've pored over sale contracts, familiarized myself with development approvals…to the extent that I've been able to advise would-be developers on the permitting process in particular locations.

To help you do your due diligence, I've compiled the following checklist you should follow with all your overseas property purchases. I've broken it down into a 12 step guide that's easy to follow.

But before we get started, there is one major difference when buying overseas that you should know about. It's the legal system. In most of Canada and the U.S., the legal system is common law. But in most of the rest of the world (and especially in Latin America) the legal system is civil law. And the two are very different.

Common law is warm and fuzzy, with lots of gray areas. In a common law country, if you agreed to purchase a pre-construction condo and didn't get what you thought you would on delivery (no ocean view, a cheaper kitchen, less floor space), you'd probably withhold a portion of the purchase price and go to court. In court, you'd plead your case, argue for forgiveness ("I didn't close on my condo because the developer didn't deliver the kitchen he promised") and reach a compromise.

Not so in a civil law country. Civil law is very black and white. You're either right or you're wrong. If you don't close on your condo, you're automatically in default, and the developer can keep the condo and any monies you have paid to date. It doesn't matter why you didn't close. If you're unhappy, you close on the condo, and then take the developer to court…which is likely to be a long, difficult process.

For that reason, in a civil law country you need to make sure that your purchase/sale contract is watertight and covers all the possible worst-case scenarios *before* you sign on the dotted line. It's incredibly difficult to rectify problems afterwards.

And you should understand too that legal terms don't automatically carry through from common to civil law. A classic example is buying as joint tenants with rights of survivorship in a common law country. What you are trying to cover is the scenario where something happens to one of you -and you want the remaining partner to inherit the property without the need to go to court.

If you say joint tenants to your civil law attorney, he may think you mean tenants in common, as there is no definition of joint tenants with rights of survivorship in civil law. Tenants in common is very similar—but has one big difference. A remaining partner will need to go to court to inherit. It does not happen automatically. So, explain clearly what you are trying to achieve to your civil law attorney: don't just quote legal terms from back home at him. Tell him specifically: we are buying as partners, and want to ensure that if one of us dies, the surviving partner inherits the property automatically without the need to go to court.

And now, on to the twelve-step process.

Step #1: Hire a good, local, in-country attorney Your U.S. or Canada-based attorney may work wonders for you, but he is not likely to be familiar with the intricacies of buying a property in your chosen country. You need a local, in-country attorney.

Your local attorney should work for you—and only for you. That may sound like a given, but in many countries, an attorney can legally represent both sides in a transaction. It's not seen as a conflict of interest. So make sure that you're the only person your attorney is representing in the transaction.

Your attorney should be bilingual. It's going to be tricky enough getting to grips with a different buying process. If you can't understand what your attorney is advising you to do, or he isn't clear on your instructions, the whole process could quickly become a nightmare.

Don't take a seller's word for it: have your attorney check everything that they tell you regarding the property.

Also, have your contract translated and read it carefully yourself. Ask your attorney to explain anything you don't understand. Your attorney may not explain a clause that is normal procedure in his country—but it may be very different to how you'd do things back home.

Try to use an attorney who specializes in real estate.

If you are unsure how to find a good local attorney, do what you would do back home. Ask friends, family or colleagues if they have bought property in that country, and if so, which attorney they used. Failing that, First American Title Insurance has a list of approved attorneys they work with in foreign countries. You can ask for their list of approved attorneys in Costa Rica, for example.

Step #2: Buy Title Insurance You purchase it back home as a normal part of the buying transaction—so why not purchase it for your overseas property? Perhaps because it's taken for granted as part of the buying process back home, you might not think of it. With an overseas purchase, the seller or your attorney won't remind you to purchase title insurance. They'll probably try to put you off, telling you it's not available, it's too expensive, and their property registry system is so good, you don't need it. Stick to your guns. Add buying title insurance to your "must-do" checklist.

Title insurance is available in most countries through companies like First American Title Insurance, and it's affordable. It gives you peace of mind. Having a commitment to title insurance in place before making your final payment on a property ensures that you are paying the owner, and that the title is good.

Title insurance covers defects in title, property taxes, boundary disputes, hidden defects (fraud, forgery, and unknown heirs)—anything that is not known to you at the time you are buying the property. You may ask why you need it, if you have a title checked by an attorney and/or a notary. Well, I recall speaking to one attorney, who said that he had the local notary check all the documents related to a property—but that he then went to the property himself and spoke with the neighbors to see if anyone thought they had rights to the property, if there was a secret lovechild who could come to light and claim their portion...things that a notary search would not uncover. Attorneys and notaries are human, too—and can make mistakes.

Not all title insurance policies are equal. Check your cover carefully. Make sure you understand what is covered - and what isn't.

Check exclusions in your title insurance cover, which can vary from country to country. In Nicaragua, the Sandinista government confiscated land in the 1980s, and not all of the original landowners have been compensated. Your worst-case scenario here is an uncompensated owner turning up and laying claim to your property. But I've seen so-called Sandinista exclusions in some title insurance policies that specifically stated they wouldn't cover that. Know what the worst-case scenarios for your property are, and then ensure that your title insurance will cover you for them.

With title insurance, you are covered for events that have happened up to the point when you purchased the property. Anything that you are aware of at the time of purchase is not covered. Future events—and that includes political risk—are also not covered.

Title insurance is a one-off payment, and lasts as long as you (or your heirs) own the property. In the case of a claim, First American covers defense costs and/or actual loss. If someone challenges your title, based on a past event—forgery of documents, fraud, someone selling a property who was not entitled to do so—then First American has a duty to defend that title. They either cover your defense costs--or they pay you your actual loss if they made a mistake, up to the amount of the policy. If they defend, they hire a local attorney, and monitor the litigation. Court cases can be lengthy and complicated overseas. It's easier when someone else handles that for you.

You can get a commitment to title insurance on pre-construction property. It does have to be renewed every 6 months, though.

Developers often have master title insurance policies already in place on their land, and that is a good sign. You still need to get individual title insurance though—a developer's title insurance covers them as an owner, not you. Once they sell you a home site, a lot, or a condo, it's no longer covered by their master title insurance policy.

If a developer doesn't have a master title policy, ask why. Sometimes they simply don't bother. They may be dealing with local buyers, who don't ask for title insurance. Maybe they just plain don't know about it. Sometimes there are more sinister reasons…so it is worthwhile checking.

In some countries, there is a gap between closing and getting the property title registered in your name. In that situation, you should buy gap title insurance.

Step #3: Check the Sale Contract You may get a sale contract or purchase agreement in English—but it's the contract in the language of the country that you are buying in that is legally binding, whether that is Spanish or Portuguese or French. If you have a dispute with the seller, or if you need to go to court, then the version in the language of the country will be the one that you use. So get the Spanish or Portuguese or French version of the contract and have your attorney translate it for you. Ask your attorney to explain any clauses or terms that you are not sure of.

Check that the property details, description and price are correct. Check that the seller's name matches the name on the title deed.

Your attorney can check that your sale contract/purchase agreement gives you title, free and clear, on closing. Surprisingly, sometimes the contracts don't. I have seen a few that give you possession of a condo in a block, and the keys, but not the actual registered title...the seller simply stated that he would register it at some point (with an undefined time period).

I've also seen a few that gave title but did not include a mechanism for the seller paying off the portion of his mortgage related to your property. For that reason, if a seller has a mortgage, check how he proposes to pay it off, and how that affects your title. And make sure that there are no outstanding taxes or liens on the property.

Unfair penalty clauses are an issue with contracts, too. If a seller has clauses stipulating exactly what will happen if you are in default, and applies financial penalties, you should have the same, if the seller is in default. Some standard developer contracts for pre-construction property state that if you as a buyer default for any reason (including making a late payment even if it's only by a few days), you will lose whatever monies you have paid to date. I have even seen one where they not only kept your money, but imposed a fine on top. That's all well and good…but you should have clauses that protect you equally if the seller is in default.

Your attorney will explain how much are you paying for the property in total, and in what currency. He'll go over deposits, and stage payments, and explain inflation adjustments and balloon payments.

Check any price adjustments for pre-construction properties. In some countries, developers have an over-ride clause stating that if condo or home construction costs increase during the build period, they can charge an additional fee, based on a percentage of the property's purchase price. That percentage can be as high as 10%...so if you agreed a purchase price of $100,000 for your condo, you could end up paying $110,000.

The additional fee is payable on closing in countries such as Panama, and developers are supposed to prove that construction costs have actually risen, using government figures and statistics.

In Brazil, the adjustment is monthly, if you are making monthly payments to the developer during the construction period. The adjustment in Brazil relates to the pending balance, not on monies already paid. If you have developer financing on the balance of the purchase price after completion, there is a monthly adjustment for that, too. These adjustments are linked to government-produced indices (INCC during the construction, and IPGM afterwards).

Your attorney can see if the sale contract has a mechanism for fault fixing. If you buy a property (especially if it's new) is there a period when the seller is still responsible for a leaking roof, or faulty wiring? Make sure you know your rights under the terms of the contract.

Step #4: Check the Title Deed Your attorney will check the title chain in the registry. In some countries the registry is online, while in others it is a case of leafing through physical documents. Sometimes your attorney will need to use a notary public to check the documents. From that title check, your attorney should be able to tell you the current registered owner and value, the boundaries, previous sales and transfers, whether there are any liens or mortgages or taxes outstanding on the property, and if there are any annotations such as rights of way, etc. Make sure that your seller is the registered property owner.

Check if your title is registered or possessory. We only recommend you buy titled property.

You can live in a Rights of Possession property, record your claim to it and you can sell it. There is a difference, however. Registered title means you own the land. Possession means you have the right to occupy the property, until someone with a better claim to it turns up. If that happens, you could lose the land and the money you paid for it. You cannot get mortgage financing on a possessory property, either.

Check the title chain. If it includes a confiscation, or was formerly a *co-operativa* or *ejido* land (shared or communal land), your attorney will have to do extra checks to make sure that the title is clear and all transfers were done correctly.

Beachfront and border properties should be checked carefully. Most overseas countries have a section of the beach related to the high-water mark where you cannot legally own a property, it's publicly owned. You may see concession land in this section of the beach. It's a form of lease granted by the local government. It's not a secure lease with rights of renewal, limits on how much you pay or an appeals board if things go wrong. You often can't buy a concession lease as a foreigner. And usually you can't own a residential property in a concession zone – it's restricted to tourism and business ventures (a B&B or beach bar, for example).

Foreign buyers are usually not allowed to own property that borders a neighboring country, either. The distances for these zones are not standardized, but vary from country to country.

In some countries, particularly in Asia, foreigners cannot legally own property outright. There are ways round this, but not all are legal. Ask your attorney to investigate thoroughly.

Some countries restrict what foreigners can buy. They may not allow you to buy large land parcels. You might have to buy a property of a minimum value or have to build within a short timeframe if you buy a lot. Or you may need a letter from the government to show that the property is cleared for sale (in Nicaragua, this is known as a letter of no objection). Again, check this out with your attorney.

Step #5: Check the Permits and Approvals They're becoming more difficult to get, and more expensive. There's quite a range of them, and they vary from country to country. The standard ones are environmental, water, construction, and municipal permits.

Have your in-country attorney check to make sure that your seller/developer has all the permits and approvals he needs to comply with current regulations.

Many countries require developments to have developmental and environmental pre-approval before they can legally market or sell a property. That process can take up to two years, and until pre-approval is granted the developer cannot legally start selling—or construction.

You could say that you are happy to wait for one last permit to be granted to a developer or seller but make sure that your money is escrowed if so, and by escrow I mean an approved escrow with an established company like First American Title Insurance. Otherwise, you could find that the development does not get the green light and you may find it tough to get your money back.

It's not just pre-construction property. In some countries, you can see finished houses for sale that have either never applied for planning approval or had initial approval but subsequently added an extra unapproved bedroom or garage. This is particularly true in rural areas. Sometimes you only need to pay a fine or tax to get retrospective approval. But you could risk losing the property or having to remove the upgrades and additions. Ideally you should get the seller to get all the permits and approvals needed before you buy it.

Step # 6: Get a Survey/Check Access You should get a proper survey done to legally establish your boundaries. This is particularly important with older properties, where boundary markers noted in the deed may have changed. It's also important when buying large land parcels. You'll pay a price per acre or per hectare. And you want to know that you're getting each and every acre or hectare you're paying for.

On the topic of land, if you plan on farming, growing crops or cultivating vines, do a soil analysis to see if the soil is suitable to do that. Seek expert advice if you plan on farming as a business to make sure your plans are viable in the area you're buying in. Ask about climate, frost, water availability, infrastructure, etc.

How do you get to your property? If it is via a right-of-way through someone else's property, that needs to be stated in the deed. Similarly, has anyone else got rights of way through your property? Both of these scenarios can be checked by your attorney.

If you're buying land for farming, you should hire an expert to carry out soil analysis tests to make sure you can grow grapes or wheat or whatever you plan on using the land for.

Side Notes: Check if the property you're buying already has squatters. If so, ask the owner to remove them legally before you close the sale. If you're buying a property with existing tenants or employees (a caretaker, say) then the seller should terminate his contract with them and pay them off in full (rent deposits, salary, sick pay, etc.). Get your attorney to draw up a new contract if you want to keep the tenants or employees on.

Step #7: Check Infrastructure Essentials These are the services that you can't live without, and you should ask the seller as many questions as you need to ask to feel comfortable before proceeding with the sale.

Water:

- Is there a source of potable water on the property?
- What's the water pressure?
- What's the purity?
- If there isn't a mains supply, who will drill a well? If it is you, how deep will you have to drill—and how much will that cost?
- If there isn't water already on the property, make finding it a condition of sale. No water=no sale.
- How is waste treatment being handled?—and does it comply with local regulations?
- Will there be a municipal system, a system put in place by the developer, or will you need to put in a septic tank?
- If a septic tank, check local regulations to see how much you will have to spend (some environmentally-sensitive areas require a very high-tech, and very expensive, tank).

Electricity:

- Is it in place…if not, what timeframe are you looking at? In rural Latin America, it can take a long time to get hooked up
- Will it be overground or underground?
- Don't assume with electric (or telephone or water) services that a meter on the wall or wiring means you have a supply. Check with local supply companies to make sure the property is connected
- How reliable is the service - will you need a back-up generator?

Roads:

- Are roads and pavements already in place?
- If not, when will they be…and what standard will they be? Remember, developers often leave roads until last, as road surfaces can be damaged by heavy construction equipment.

Remember, you can ask for roads and utilities to meet a timeframe and certain standards in your contract when buying pre-construction. In many locations, you can't get a lot titled until it has some level of infrastructure. <u>If that's the case, don't pay in full for the property upfront</u>. Close only when the infrastructure's installed, and you can get the property title transferred to you.

If **high-speed internet** is an absolute necessity for your job or your business, check that it is available in your area (preferably with a service provider). Ask what the speed is in MB (megabytes). "High speed" or broadband internet in some countries overseas is as slow as dial-up in some parts of Europe and the US.

<u>Step #8: Check the Developer's Background</u> If dealing with a pre-construction development, ask if your developer has developed before. If so, where, and what was the finished development like. Can he provide you with written testimonials from previous buyers?

How is your developer financing the project? If he has loans or mortgages, how is he proposing to pay them off? If he is committed to repaying those *before* he starts construction that is not the ideal situation for you.

Does he need money from sales to finance the project? How likely is he to achieve that sales level in the current market? Bank financing often kicks in when a developer has sold 20-80% of the project. That percentage is decided by the bank, based on a number of factors, including the developer's track record, and the market he is operating in. Banks are becoming more cautious in the current economic downturn, and tightening lending restrictions. Obviously, it is preferable for you if the developer will start construction when he is 20% sold rather than 80%.

Most developers do not build themselves. They hire a construction company. What is their background and record? Can you see some of their finished projects to see if you are happy with quality of their work?

See if the developer has insurance that covers him in the event that his constructor goes bankrupt or can't complete the work or fails to complete it satisfactorily. Insurance still means a delay waiting for the funds to re-start construction, but it’s better than the alternative of a half-finished project.

Step #9: Check the Master Plan With pre-construction developments make sure that amenities promised in the master plan are in writing in your contract, if possible, with timelines and standards... the swimming pool, the clubhouse and landscaping. Imagine how you would feel if you only got some or all of those promised amenities…a small pool rather than the Olympic-size one, or no pool at all. Amenities are usually the last items installed in developments, and the first that suffer if a developer is running short of cash.

If the developer has reserved areas or green space, see if they will be preserved, or used for future development. Similarly, if there’s empty land next to the property find out what plans are in place for it.

Check the local municipal developmental plan (if there is one) and see if roads, or factories, are planned nearby. Ask what local zoning regulations allow. Similarly, check out the local area...is there a municipal dump close by, or a truck park, close to your new home?

Step #10: Check the CCRs/HOAs With the CCR’s (Covenants, Conditions and Restrictions), make sure there is nothing you can’t live with.

Keeping certain pets may go against CCR rules. Working from home usually carries restrictions, related to the type of work you do. See what standard of maintenance you are obliged to carry out on the exterior of your property--and what remodeling is allowed.

Perhaps subleasing your property, for vacation rentals, interests you. Check that the CCRs allow that.

Make sure too that the rules are tight enough that what your neighbors do won’t adversely affect you. If you don’t want a purple three-story house tight next to your fence...chickens in the neighbor’s yard waking you in the early hours...check those CCRs. I've seen all of those in developments without strict CCRs.

Who will manage the HOA (Home Owner's Association) initially? If it is the developer, when is the handover date? What are the projected monthly dues? Can the HOA enforce collection? One development I saw had roads and pavements in terrible condition, with potholes and badly worn surfaces. Maintenance was impossible as owners did not pay their monthly dues and the CCRs had no mechanism for enforcing payment.

Who will manage the HOA finances? What checks and balances are there for ensuring that funds are managed correctly? Around 20-25% of your monthly dues should go into a reserve fund, for covering major problems (replacing an elevator in a condo tower, or roads in a private community, say).

On the upside, CCRs are often the only form of zoning you’ll have in Latin America. They can help preserve the value of your home. If you don’t want the house next door turning into a nightclub…or a neighbor building a shack in the vacant lot across the street…you’ll feel more comfortable in a community with CCRs.

Make sure that the CCRs and HOAs are tied into the property deed and enforceable against future owners if the current owner sells. Don’t assume that because CCRs are in your deed that they are enforceable. They must also be set up under a proper statutory regime that varies country by country.

Step #11: Investigate Ownership, Tax issues and Wills Discuss with your attorney and tax advisor the best way to hold your property overseas. You need to decide before you buy what you will use the property for. Is it a vacation home, a main residence or a rental vehicle?

Whether you hold the property in the name of an individual or a corporation, for example, is dictated by your personal circumstances and what your plans are for the property. You might want it to hold it in a corporation to pay lower taxes on rental income…or in your name to qualify for a residency visa.

In larger countries like Brazil, Argentina and Mexico, taxes can vary from state to state. You should ask your attorney to outline all the taxes that apply in the state you're buying in.

Ask what happens if you die. If you are a couple, how would the death of one partner affect the property ownership? You may need to have two wills, one in the country you are buying in and one back home. If you do, make each attorney aware of the existence of both wills.

Step #12: Use Approved Escrow Services You are almost at the end of the checklist, and probably ready to start making payments to the seller. We advise that you use approved escrow services at that stage, such as those offered by First American Title Insurance. Developers and attorneys will have escrow accounts, but they are often no more than a bank account in the developer's or attorney's name.

Escrow services give you full control over when your money is paid and who it is paid to. You can add all kinds of terms and conditions – only releasing the money when title is in your name, all permits are in place, etc.

Finally, remember that buying a property overseas is exciting, and potentially one of the most profitable investments you can make. You just need to do your homework, and make sure it's the best possible deal for you.

Margaret Summerfield