

The Benefits to Secured Parties of Real Estate Transactions in Mexico

MEXICO'S LAW OF TRUSTS AND MORTGAGES may afford lenders and creditors the opportunity to enter into a loan transaction governed by California law but secured by Mexican real estate under favorable provisions that are not available for Californian real estate collateral. To understand the benefits of securing credit transactions with real estate in Mexico, lenders and borrowers should consider 1) how to structure a real property secured transaction governed by Mexican law, 2) what remedies would be available in the event of default and how these remedies would be exercised, and 3) how the structure and remedies compare with their counterparts in California.

In California, the preferred form of securing a credit transaction with real property is the deed of trust. Mortgages, while still in existence, have fallen into disuse. By contrast, in Mexico mortgages (*hipotecas*) and guaranty trusts (*fideicomisos de garantía*) are equally preferred forms of securing a credit transaction.

The widespread use of mortgages in Mexico is evidenced by Mexico's production of a third of the total number of mortgages generated in Latin America (with Brazil generating another third)¹ and by Mexico's recent receipt of \$1 billion to promote efficient mortgage markets as part of a \$2.5 billion, 10-year conditional credit line for investment projects approved by the Inter-American Development Bank.²

A mortgage in Mexico is a contract under which the mortgagor grants to the mortgagee the right to sell, upon breach of a secured obligation, certain real property owned by the mortgagor and to be paid with the proceeds of the sale.³ The *hipoteca* requires the same formalities as a grant of real property, which include the signing of the deed or *escritura* before a notary public and the recording of the deed in the local public registry.⁴ A proper mortgage will enjoy priority over a subsequent transfer or conveyance of the mortgaged asset. California law is similar.⁵ Under both legal systems, the mortgagee holds a lien on the real property (but not title or possession) that gives the mortgagee the right to sell the property to satisfy the debt upon maturity or default.

There are substantial differences between mortgages in California and Mexico. First, a mortgagor in Mexico has no right of redemption, which is one of the major drawbacks for mortgagees under California law.⁶ A second difference is the ease with which a creditor in Mexico may obtain a deficiency judgment. In California, provided that a deficiency is not waived or prohibited and a debtor is personally liable for the debt, a creditor must file for a deficiency judgment within three months following the date of the foreclosure sale and after a hearing on the fair value of the real property on the date of sale.⁷

By contrast, a creditor secured by a Mexican mortgage is not required to undertake a separate proceeding to obtain a deficiency judgment. Mexican courts have ruled that the purpose of foreclosing on a mortgaged asset is to cover the indebtedness and, as a result, it would be contrary to judicial efficiency to send the creditor to a new process when the proceeds of the sale fail to cover the debt. Accordingly, when there is a deficiency, mortgagees should be able to execute on other assets of the debtor as part of the same foreclosure procedure.⁸

Obtaining a deficiency judgment in Mexico is thus simpler and faster than in California.

Fideicomisos de garantía

Guaranty trusts are used widely in Mexico as an alternative to mortgages. Some of the factors that should be taken into consideration to determine which is the better instrument in a specific transaction are:

- 1) The fees and costs charged by a trustee in a guaranty trust agreement, which are not applicable in a mortgage.
- 2) The convenience of a nonjudicial sale of the trust assets versus the need to pursue a judicial sale of the mortgaged assets in case of default.
- 3) The ability to partially "release" certain trust assets in proportion to the reduction of the debt versus the nondivisibility of the mortgaged assets, which make a partial release unavailable (except when an express agreement as to the portion of the credit applicable to each property applies to individualized properties).⁹
- 4) The flexibility of the guaranty trust agreement for additional business or commercial purposes, such as the development of a resort project, the subsequent sale of the individual units created within a multi-unit or fractional project, and the reinvestment of the sale proceeds.
- 5) The ability to include personal property, such as rents or sale proceeds, as part of the trust assets.
- 6) The power of the mortgagor to sell the mortgaged assets or further encumber the mortgaged assets by granting a junior lien on the same which, unless the parties agree otherwise, cannot be achieved if a guaranty trust is used, because the legal owner is the trustee.

The Mexican guaranty trust was created in 2000 with amendments to commercial and tax law that were enhanced, or "polished," in 2003. Mexico's *Congreso* endeavored to reduce transaction costs and interest rates, increase the type of guarantees available under Mexican law, motivate lenders to enter into credit transactions to help boost the economy of Mexico, increase commercial competition among trustees, protect collateral, and lower collection risks.¹⁰ The result is an instrument more favorable than its predecessor to a beneficiary in the event of default.

From a practical standpoint, Mexican courts consider the trustee to be the legal owner of the assets because legal title to the trust assets is transferred to the trustee to secure the performance of contractual obligations. Thus, the trust assets, together with the beneficiary's right to request a sale in case of default, are not affected if the debtor is the subject of a bankruptcy proceeding, becomes insolvent, or is sued by any creditor.¹¹ This is a powerful advantage for creditors in comparison to California law.

The transfer of ownership described above also protects trust beneficiaries from debtor's acts. Once the trust agreement is executed

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and title to the assets has been transferred to the trust, the debtor loses the power and authority to convey or encumber the trust assets (unless the trust agreement expressly provides otherwise).¹²

Other differences between a California deed of trust and a Mexican *fideicomiso* relate to the entity that may act as trustee and the scope of the trustee's responsibilities. Under California law, the trustee under a deed of trust is not a true trustee, is not subject to the general rules governing trusts, and has the limited function of reconveying the property to the settlor if the loan is repaid or to conduct a trustee sale in case of default.¹³ In Mexico, on the other hand, only entities authorized by law—mainly financial institutions—can act as trustees.¹⁴ They generally play a more active role and are highly regulated by the general law of trusts.

Furthermore, beneficiaries under a Mexican guaranty trust have the right to file a claim for any deficiency. By contrast, California law provides, "[N]o judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property or an estate for years therein hereafter executed in any case in which the real property or estate for years therein has been sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust."¹⁵

With regard to the nonjudicial foreclosure process, Mexican law provides, "[I]n a guaranty trust, the parties may agree on the form in which the trustee shall proceed to the nonjudicial sale of the rights or assets in trust."¹⁶ This ability to regulate the form in which the trustee shall proceed is applicable only if, at the time in which the guaranty trust agreement is entered into, the parties agree to the following terms: 1) the trustee shall initiate the nonjudicial foreclosure upon receiving a written communication requesting that the assets be sold and the events of default of the secured obligations are specified, 2) the trustee shall send a copy of the written communication to the debtor, who may oppose the sale only if any outstanding amount is paid and the debtor shows that no event of default has occurred, 3) in the event that the debtor is not able to prove performance of its obligations, the trustee may proceed to the nonjudicial sale of the trust assets, according to the terms and conditions of the trust agreement, and 4) the time frame in which the above-mentioned activities shall occur.

In the event that the parties to a guaranty trust failed to specify the process for a trustee sale or if the process, as set forth in the trust agreement, failed to meet the requirements of the law, the lender, upon breach of the guaranteed obligation, will have to file a lawsuit (*demanda*) in the state court having jurisdiction over the assets. If the lawsuit is properly

filed, the court will order full payment of the amounts due and provide that, if full payment is not made, the assets or possession thereof shall be delivered to the lender until they are sold. If the debtor (or whoever is in possession of the assets) refuses to deliver possession of the assets, the court may impose a fine, evict the debtor, or order the debtor's arrest for up to 36 hours. The lawsuit will then have to be served upon the debtor, who has five days to respond. Upon receipt of the debtor's response, the parties will be granted a probatory period during which both may offer evidence to support their claims and defenses. At the end of the probatory period, the court will study the case and issue a final judgment.

If the plaintiff prevails, it will be able to proceed to sell the assets or take legal title. If the value of the trust assets is insufficient to cover the amount due, the trust beneficiary may take legal action to collect the deficiency. Any motion or appeal related to the trustee sale will not suspend the nonjudicial foreclosure procedure.¹⁷

Although many similarities exist between mortgages and trusts in Mexico and California, Mexican law is in many ways more beneficial to secured parties. Accordingly, borrowers who own or have access to Mexican real estate should seriously consider offering, and lenders should seriously consider accepting, property in Mexico as collateral in properly structured Mexican *hipotecas* and *fideicomisos de garantía* as security for loan transactions in California. ■

¹ See <http://www.cnnexpansion.com/economia/2009/08/28/mexico-lidera-en-mercado-hipotecario>.

² See <http://www.iadb.org/news/detail.cfm?id=5554>.

³ Código Civil Federal [C.C.F.] [Civil Code for the Federal District] art. 2893 [hereinafter C.C.F.].

⁴ C.C.F. arts. 2320, 2917.

⁵ See CIV. CODE §2920.

⁶ In California, the right of redemption is codified under Civil Code §2903 and §2905.

⁷ CODE CIV. PROC. §726b.

⁸ Suprema Corte de Justicia de la Nación [Supreme Court] Semanario Judicial de la Federación [Judicial Weekly of the Federation] Registro No. 362267 [hereinafter Supreme Court Judicial Weekly].

⁹ See C.C.F. art. 2912.

¹⁰ Press release issued by the Ministry of Finance and Public Credit on Apr. 23, 2003 (on file with author).

¹¹ Supreme Court Judicial Weekly Registro No. 199312.

¹² Supreme Court Judicial Weekly Registro No. 241918.

¹³ ROGER BERNHARDT, CALIFORNIA MORTGAGE AND DEED OF TRUST PRACTICE §1:35 (3d ed. 2008).

¹⁴ With guaranty trusts, entities may include credit institutions, insurance companies, brokerage firms, and credit unions.

¹⁵ CODE CIV. PROC. §580d.

¹⁶ Ley General de Títulos y Operaciones de Crédito [General Law of Negotiable Instruments and Credit Transactions] art. 403.

¹⁷ See Código de Comercio [Commerce Code] art. 1414 bis 20.

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