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The Rise of Nearshoring in Mexico and its Real Estate Considerations.

Submitted By:

Jorge R. Ojeda
Cacheaux, Cavazos & Newton
Edificio VA0 2 -David Alfaro Siqueiros
No. 104, Int. 1505 Colonia Valle Oriente
San Pedro Garza Garcia, Mexico C.P. 66269
Email: jojeda@ccn-law.com.mx
Tel: +52 81 8363 9099
Website: www.ccn-law.com/
Attorney Bio

Abel Quezada
Cacheaux, Cavazos & Newton
Edificio VA0 2 -David Alfaro Siqueiros No. 104, Int. 1505 Colonia Valle Oriente
San Pedro Garza Garcia, Mexico C.P. 66269
Website: www.ccn-law.com/
Attorney Bio

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CCN
Cacheaux Cavazos & Newton
Attorneys / Abogados

The coronavirus pandemic, the U.S.-China trade war, and the war in Ukraine have accelerated the transformation of the world's global supply chains. These developments have prompted organizations to search for a closer, more reliable supply chain that is less dependent on transoceanic transportation.

In the particular case of North America, the almost 2,000 miles of land on the Southern border have made Mexico one of the favorite places for nearshoring, and all signs indicate that this is just beginning. Despite having its own unique historical and legal complexities, Mexico has remained a consistent choice for foreign investment in the region which serves the North American consumer market.

In terms of real estate leases or acquisitions, we would like to point out the following considerations for foreign companies choosing Mexico as a nearshoring option:

1. Location.

Even though Mexico has a wide range of options for industrial sites located throughout the country, a specific location plays a key role in the acquisition or lease of real estate. Industrial sites located in the northern states of Nuevo León, Tamaulipas, Coahuila, or Chihuahua, are usually good options for exports to Texas and the American Midwest, whereas locations in Baja California (Tijuana and Mexicali) are usually better suited for exports to the west coast.

Companies should also consider locating close to clusters of companies located throughout Mexico with a specific regional reputation for certain types of manufacturing processes for logistic purposes.

2. Availability.

The Mexican industrial real estate market is the largest in Latin America and offers a great deal of real estate diversity in terms of location, purpose, and investment options. With the latest wave of companies choosing Mexico as a nearshoring option, industrial developers are investing in the center and southern parts of the country to keep up with the growing demand. Some companies are even choosing the Yucatan peninsula for its proximity to Florida and the U.S. Gulf Coast region.

3. Transportation Infrastructure.

Connections with roads, ports, and railroads are an important consideration for companies setting up manufacturing operations in Mexico and the attendant reduction of costs and risks associated with transatlantic supply.

4. Availability of Services.

Feasibility reports for water, electricity, gas, and telecommunications services are essential aspects to review and consider for the acquisition or leasing of real estate in Mexico. Water and electricity services could be an issue depending on the state or city and their availability according to the demand, as many cities in Mexico have significant unprecedented growth rates. Alternatives, such as clean energy and self-sufficient systems, are also often sought by companies. Proper due diligence and review of costs associated to bring infrastructure as needed are key factors to keep in mind.

5. Environment.

In real estate transactions such as a purchase/sale or lease, one of the sensitive issues to review, as in any other place, is to carry out proper environmental studies to confirm that the site is free of contamination when received and when surrendered back to a lessor or new buyer. The objective is to avoid the need for possible environmental remediation of the site.

Companies should also be aware of environmental aspects when acquiring companies with prior operations, as environmental liability always follows the party responsible for causing it.

6. Private Property and Communal Land.

Mexican companies with 100% foreign investment may acquire a fee-simple title of property everywhere in Mexico for industrial activities. Proper due diligence is fundamental, from the title/ownership, to the feasibility to operate the specific industrial activity intended.

It is important to keep in mind that in Mexico a type of communal land called Ejido exists, and around 51% of the land in Mexico is subject to such status. It is possible to acquire Ejido land following several administrative procedures. If the project requires land that is located in Ejido land, specialized due diligence and review are fundamental.

7. Acquisition Tax and Property Tax.

When buying real estate in Mexico the buyer must pay the Rest Estate Acquisition Tax (ISAI). These tax rates differ in each Mexican state but they usually range between 2% and 5% of the greater value between the tax value of the property or acquisition price. In some states and depending on the investment project, companies can obtain a partial discount on this tax.

Another applicable tax is the Property Tax (predial) which is usually quite low in comparison to the US and is calculated based on the tax value, size, and location of the property, and normally is less than 0.5% of the tax value of the property. Most municipalities offer a discount if the entire year is paid in January and February of each calendar year.

8. Permits.

Considering most land in Mexico is regulated by municipal, state, and federal urban planning laws, companies must make sure the desired site is compatible with their operations. Feasibility permits exist for light industrial use, heavy industrial use, and warehouse activities, among others. Failure to comply with such regulations could result in the closure of operations of a company.

Other relevant permits depend on the companies' operations but could include wastewater discharge permits, hazardous material transportation, and storage permits, among others.

The review of the environmental implications of a project is fundamental, especially if the project requires significant energy or water services, or it is an environmentally sensitive operation.

9. Government Incentives.

Exceptions are made for major projects where large investments and generation of employment are involved. In general terms, government incentives are low in Mexico. In some states, administrative support for the project is all you may obtain.

Unfortunately, in most cases, economic incentives and their administrations do not justify the time and efforts to obtain such.

Governments compete every day to attract investment to their respective states, thus government incentives on certain taxes (such as Property Taxes as mentioned above) or property offers are always on the table and should be sought by companies looking into Mexico as a nearshoring option.

10. Process of acquisition.

The legal process of acquiring real property in Mexico requires the involvement of a Notary Public. The deed of the property is a buy-sale agreement signed by the parties through the Notary Public who is responsible for the withholding and payment of applicable taxes, as well as its registration in the applicable Public Registry of Property.

Notary Publics in Mexico are attorneys with an additional license. They review the current deed of the property and the registration status in the Public Registry of Property. It is important to mention that Notaries do not act as title insurance companies. Therefore, if a buyer is interested in title insurance, few companies are offering such a product in Mexico.

Based on the above, additional due diligence on the title, from the one carried out by a Notary Public, is advisable in projects with substantial investment.

Overall, nearshoring will continue to be a trend as long as the global issues noted herein persist. Clearly, Mexico continues to be a reliable option for foreign investment. We hope the description and information above is useful.