

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 alien 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. You need to remember that some things stay the same. Don't leave your common sense at home.

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.

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 owner who's owned it for generations, and because it's 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 have an attorney, and 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. I've pored over sale contracts, familiarized myself with development approvals...and been able to advise would-be developers on the permitting process in particular locations.

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

1. Hire a local attorney
2. Buy title insurance
3. Check the sale contract
4. Check the title deed
5. Check permits and approvals
6. Check access
7. Check infrastructure essentials
8. Check the developer's background
9. Check the master plan
10. Check the CCRs and HOAs
11. Investigate tax issues and wills
12. Use approved escrow services

Step #1: Hire a good, local, in-country attorney Your US 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 an in-country attorney.

Your local attorney should work for you—and only for you. He should not represent anyone else in the transaction. That may sound like a given...but in many countries, an attorney can legally represent both sides in a 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 instructing you to do, the whole process could quickly become a nightmare.

You should be aware that while the US and Canada have common law, in most of the rest of the world civil law applies. Civil law is very black and white. There's no pleading for fairness...you are either right or wrong. Some terms may sound similar but will mean something very different. Joint tenancy with rights of survivorship is one. You may have used it to avoid probate if one partner dies, back home, but it does not apply in civil law. It can be confused with tenants in common, which does apply in civil law—but means you will have probate if one partner dies. Be very clear explaining to your attorney exactly what you are trying to achieve.

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.

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...but the seller or your attorney won't remind you to purchase title insurance. You need to add it to your 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)—up to the point when you buy 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, there are so-called Sandinista exclusions on some policies. The Sandinista government confiscated land in the 1980s, and not all of the original landowners have been compensated.

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 overseas. Believe me, 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.

Step #3: Check the Sale Contract You may get a sale contract or purchase agreement in English—but it's the contract that is in the language of the country that you are buying in, that is legally binding, whether that be Spanish or Portuguese or French. If you have a dispute with the seller, if you need to go to court, then the version in the language of the country will be the one that you use. Have your attorney translate the sale contract for you, and read it yourself. 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 current 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 developer 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 developer paying off the portion of his mortgage related to your property. For that reason, if a developer has a mortgage, check how he proposes to pay it off, and how that affects your title. 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.

Check any price adjustments. 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).

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 property owner.

Check if your title is registered or possessory. In some countries, they can seem similar. 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. You cannot get mortgage financing on a possessory property, either.

Check the title chain. If it includes a *co-operativa* or confiscation, or was formerly *ejido* 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. 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 ask your attorney to investigate thoroughly.

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 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 with an established company like First American Title Insurance—an approved escrow. Otherwise, you could find that the development does not get the green light and you may find it tough to get your money back.

In some countries, you can see 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. Have your attorney check for you, and ideally get the seller to legalize the property before you buy it.

Step # 6: Check Access 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.

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?
- 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?
- Will it be overground or underground?

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.

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 I have visited is snail's speed back in the UK, where I lived.

You can try to cover yourself by ensuring that your contract has firm timelines, standards and commitments for the essentials. Some developers will allow you to escrow a portion of the purchase price until they are completed.

Step #8: Check the Developer's Background 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 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. 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-storey house next-door...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.

Are the CCRs and HOAs tied into the property deed? Are they 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 Tax issues and wills Discuss with your attorney the best way to hold your property overseas. 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...do you want to hold it long-term, sell it before completion, or use it for rental income?

Ask what happens if you die (not a pleasant subject, I know, but it needs to be broached). You may need to have two wills, one in the country you are buying in, and one back home. If you are a couple, how would the death of one partner affect the property ownership?

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 escrow services at that stage, and we mean approved escrow services, such as those offered by First American Title Insurance. Developers and attorneys will have escrow accounts, but they are often no more than a separate bank account in the developer's or attorney's name.

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

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