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# LAND TRANSFER AND FINANCE IN MEXICO

MARCELLUS R. MEEK\*

Very few, if any, areas of Mexican law have caused as much confusion, or given rise to as many questions, as that of land ownership by persons other than Mexican nationals. The reason, of course, is the almost constant state of change and development that the law has undergone over many years and, particularly, the last few decades, up to and including the enactment of what is commonly known as the Foreign Investment Law of May 8, 1973.<sup>1</sup>

The purpose of this short paper is to present the state of the law concerning land ownership in Mexico as it exists in the year 1974, and perhaps detect some further trends in the development of the law, at least for the predictable future. We shall begin, then, with the posture of the law as it stands today, but will take an historical approach as an aid to discovering the pattern of the future.

The basic principles regulating and restricting land ownership in Mexico by foreigners are established in Paragraph I,<sup>2</sup> Article 27 of the Federal Constitution<sup>3</sup> which, by way of translation, reads as follows:

Only Mexicans by birth or by naturalization and Mexican companies shall have the right to acquire ownership of lands, waters and their accessions or to obtain concessions for exploitation of mines or waters. The state may grant the same right to foreigners, provided they agree before the Ministry of Foreign Affairs to be considered nationals with respect to such properties and not to invoke, therefore, the protection of their governments for anything referring thereto: under penalty, in case of breach of the agreement, of forfeiture in favor of the nation the properties they have acquired by virtue of the same. Within a zone of one hundred (100) kilometers [about 62 miles] from the borders and fifty (50) kilometers [about 31 miles] from the seacoasts, foreigners may not for any reason acquire direct ownership of lands and waters.

The agreement which this Article requires is the so-called "Calvo Clause,"<sup>4</sup> whereby a foreigner agrees not to invoke official assistance

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1. Law for the Promotion of Mexican Investment and to Regulate Foreign Investment, *Diario Oficial*, March 9, 1973.

2. Federal Constitution of the United States of Mexico, art. 27, para. I.

3. The current Mexican Constitution became effective on May 1, 1917.

4. The Calvo Clause takes its name from the Argentine diplomat and scholar,

from his home country in any questions arising from his ownership of land in Mexico. As provided by Article 27 of the Constitution, outside the zone referred to as the "prohibited zone", foreigners may be granted the same right to acquire property as Mexicans; provided, that they enter into an agreement with the Mexican government to consider themselves as Mexican nationals with respect to the realty and not to invoke the protection of their own government. Breach of this covenant will product forfeiture of the realty to the Mexican government.

Actually, the right of a foreigner to acquire real estate may not be considered as an absolute right, but as a product of the discretionary power of the government to grant the right stated in Article 27 of the Constitution recited above which reads ". . . The state may grant the same rights to foreigners . . ." Likewise, Article 73, Paragraph XVI of the Constitution vests in The Federal Congress the power to enact laws with respect to the legal status of foreigners, as well as to restrict private property rights, as may be required by the public interest. (These public interest requirements may be imposed on Mexicans as well.)

The restriction of land ownership by foreigners is, however, an absolute prohibition when the realty is located within the prohibited zone as stated by Article 27 to be within 100 kilometers from the land boundaries or 50 kilometers from the seacoasts.

As we shall observe, powers vested in the Federal Congress have been the basis for the enactment of other statutes regulating the basic principles set forth in the Constitution.

#### ACQUISITION OF LAND BY FOREIGN LEGAL ENTITIES

The Constitutional statement providing that the State may grant the same rights to acquire land everywhere outside the prohibited zone to foreigners as are granted to Mexicans, has been construed by the drafters of the Constitution and by the commentators as an authorization only to foreign individuals, thus, foreign companies may not acquire title to real property in Mexico. This is covered by Article 34 of the Nationality and Naturalization Statute in a chapter devoted to Rights and Obligations of Foreigners, which reads:

Foreign legal entities may not acquire ownership of lands, waters and their concessions, or obtain concessions for the exploitation of mines, waters or combustible minerals in the Mexican Republic, except in those case in which the laws expressly so provide.

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Carlos Calvo, who in the 19th century enunciated his doctrine against diplomatic protection whereby a foreigner could appeal to his home government when proper legal protection could not be secured by domestic remedies. Today many of the Latin American countries have implemented the Calvo doctrine.

Notwithstanding the exception referred to in the preceding translation, there is no specific statute providing for real estate acquisition by foreign legal entities. On the other hand, Article 6 of the Organic Law of Paragraph I, Article 27 of the Federal Constitution authorizes the conveyance of land to a foreign legal entity in cases of a judicial adjudication (e.g. forfeiture) or endowment; provided that within a period of five years, which period may be extended if considered necessary, the property will be transferred to a qualified purchaser of Mexican nationality.

As an interesting and rare exception to the above, The First National City Bank of New York, which, by the way, is the only foreign bank authorized to operate as a banking institution under conditions similar to those provided for Mexican banks, has been permitted on two occasions to acquire property rights in the real estate on which its banking facilities are located. This exception is an outgrowth of special powers granted under Article 10, Paragraph XI of the General Law of Credit Institutions and Auxiliary Organizations. They apply to credit institutions which have been granted concessions from the government to operate in conformity with the general principles set forth in Article 27 of the Constitution as it relates to authorized banking institutions.

Notwithstanding the prohibition against ownership, a foreign company may lease real estate for a term not exceeding ten years. Furthermore, there is no objection to the execution of a mortgage on Mexican land in favor of a foreign company and the subsequent *temporary* acquisition of title to the land on a foreclosure.

As will be seen later, foreign companies may participate in Mexican entities owning legal title to realty outside of the "prohibited zone," provided that such participation shall not exceed forty-nine percent (49%) when the Mexican company owns rural real estate.

#### ACQUISITION OF LAND BY FOREIGN INDIVIDUALS

Foreign individuals are, therefore, permitted to acquire land ownership outside of the "prohibited zone" but only subject to prior approval of the Ministry of Foreign Relations and the Ministry of Internal Affairs; and further provided that such individuals have the immigration status of either that of an "inmigrante" or "inmigrado."<sup>5</sup> An "inmigrado" is one who is a permanent resident after five years of being an "inmigrante." These provisions reveal the intention of the Mexican government that ownership of land by foreign individuals should be restricted to those who reside more or less permanently in the country. No such rights are granted to tourists, visitors and other

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5. First General Ruling of the Interministerial Commission, adopted on Sept. 3, 1947.

aliens residing in Mexico on a temporary basis.

Although permits to acquire land are freely and regularly issued to "inmigrados," the Ministry of Internal Affairs has the power to impose restrictions on all activities of "inmigrados;" hence, it may impose restrictions on the acquisition of land by them.<sup>6</sup>

"Inmigrantes" may acquire land only to the extent required and actually used for their dwelling and that of their dependents. In special cases, they may also be authorized to acquire other properties, shares or other rights, provided such transactions do not contradict the terms of their immigration visa. Further, each such acquisition is subject to the prior authorization of the Ministry of Internal Affairs and also the Ministry of External Affairs, if the acquisition is of real estate.<sup>7</sup>

Foreign individuals with immigration status other than that of "inmigrado" or "inmigrante" are not generally qualified to acquire real estate in Mexico.<sup>8</sup>

An exception to this rule is made in the case of acquisition by inheritance in which case the person may be authorized to receive title without having either "inmigrado" or "inmigrante" status; subject, however, to the condition that the property be conveyed to a qualified purchaser within a given period of time.<sup>9 10</sup>

These provisions are strictly enforced and violations thereof are sanctioned by forfeiture to the state in which the property concerned is located. In addition, notary publics, registrars and other officers who authorize or record such illegal conveyances are subject to suspension and fines.<sup>11</sup> Public officials and notaries are required to give notice to the Ministry of Internal Affairs of all acts, deeds and contracts which they authenticate to which foreigners are parties.<sup>12</sup> Failure to give such notice is subject to fines of varying amounts.<sup>13</sup>

Special mention should be made of the fact that the above provi-

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6. Regulations to the General Law of Population (Immigration Law), art. 67, sec. I.

7. *Id.* art. 14 in connection with art. 71 of the General Law of Population.

8. According to art. 14, sec. AI, of the Regulations to the General Law of Population, and the Emergency Presidential Decree of 1944, permits may be issued in exceptional cases to political refugees and students, whom according to the Law of Population are non-immigrants. In practice, this was rarely done and we know of none being issued since the war years.

9. Regulations, *supra* note 6, art. 14, sec. AV, and the Emergency Presidential Decree of 1944.

10. In practice this period is generally for two years.

11. Regulations to the Organic Law of Constitutional Article 27, para. I, and the Emergency Presidential Decree of 1944, arts. 5 & 6.

12. Regulations, *supra* note 6, art. 14, sec. BI.

13. General Law of Population, art. 109.

sions apply only to those alien individuals residing in or physically located in the territory of Mexico. Generally, the government has taken the position that the same requirements are not applicable to the execution of contracts by alien individuals not located in Mexico. For example, an alien not physically present in Mexico may acquire a mortgage or a beneficial interest in real property held in trust<sup>14</sup> or even acquire direct ownership of Mexican land so long as it is outside the "prohibited zone." Conversely, an alien temporarily in Mexico as a tourist or visitor may do none of these things.

#### ACQUISITION OF LAND BY MEXICAN LEGAL ENTITIES WITH FOREIGN EQUITY

By Mexican legal entities are meant those entities which are formed in accordance with the laws of Mexico and which have their legal domicile therein,<sup>15</sup> thus, foreign ownership of equity does not disturb a company's Mexican nationality.

Mexican companies whose articles of incorporation do not expressly prohibit the ownership of shares or other interests in the company by foreigners, will not be entitled to own real estate in the "prohibited zone."

Mexican companies with or without foreign shareholders must secure a permit from the Ministry of Foreign Affairs for each conveyance of real property. They usually encounter few obstacles when it is located outside the "prohibited zone," and the acquisition of the land is necessary to fulfill the company's purposes as stated in its Articles of Incorporation. In addition an agreement must be entered into with the government referred to earlier in pursuance of the "Calvo Clause."<sup>16</sup>

The same permit requirement applies to the execution of leases having a term exceeding ten years; trust agreements under which a company is the beneficiary; and to the acquisition of controlling interests in existing enterprises that deal in real property. Broad discretionary power is given to the Ministry of External Affairs to limit such permits to Mexican-controlled and managed companies.<sup>17</sup>

Prior to May 8, 1973, the practice of the Ministry was to issue such permits to Mexican companies regardless of the percentage of foreign ownership, but only on a showing of "proof that the real properties concerned were indispensable to the corporate purpose" of the company.<sup>18</sup> After that date, it is likely that (in applying the provisions

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14. Ruling issued by the Ministry of Internal Affairs, Sept. 24, 1962.

15. Nationality and Naturalization Statute, art. 5.

16. Organic Law of Constitutional Article 27, art. 2; also Regulations to the Organic Law of Constitutional Article 27, arts. 2 & 3.

17. Emergency Presidential Decree of 1944, art. 3.

18. Ninth General Ruling of the Interministerial Commission, adopted on March 24, 1949.

of the new Foreign Investment Law), the Ministry of External Affairs or the National Foreign Investments Commission will require a majority of Mexican participation, whenever the acquisition of land is deemed a new foreign investment even by already existing companies.<sup>19</sup>

#### RURAL PROPERTY FOR CORPORATE PURPOSES

Commercial stock companies are denied the right to acquire, possess or administer rural agricultural property. Rural land is defined as land located outside the limits of a city, town or village. A Mexican company desiring to acquire urban property will be likely to secure permission with ease, but, when rural land is involved, the company must present evidence (with its application for permit) that the land is essential to its corporate purpose.

The Ministry of External Affairs also requires a statement of consent from the governor of the state in which the land is located.<sup>20</sup>

#### RURAL PROPERTY FOR AGRICULTURAL PURPOSES

Acquisition of rural land for agricultural purposes is subject to special regulations relating both to ownership and to the surface area of land that may be held privately under the agrarian laws.

For historical reasons, and to prevent the concealment of the true ownership of rural land, commercial stock companies, even 100 percent owned by Mexicans, may not acquire, possess or administer rural agricultural properties.<sup>21</sup>

The prohibition applies to both stock corporations and limited partnerships with shares, but not to other commercial companies whose capital is not represented by stock (i.e., limited liability companies are not included in the prohibition, provided that their capital is owned at the least by a Mexican majority or by Mexican companies controlled by Mexican nationals).<sup>22</sup>

The maximum area of rural land that may be privately owned depends upon either the quality of the land or the use to which it is put. The maximum ranges from 100 hectares (247 acres) to 800 hectares (1,976 acres). Properties not exceeding such surface areas are called "small agricultural properties" and are not subject to expropriation for communal property purposes.<sup>23</sup>

#### COMMUNAL RURAL LAND ("EJIDO")

Communal rural land or "Ejido" is a parcel protected by the

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19. Foreign Investment Law, *supra* note 1, art. 12, sec. III.

20. Federal Constitution of the United State of Mexico, art. 27, para. 6, sec. IV.

21. *Id.*

22. Organic Law of Constitutional Article 27, art. 3; and Regulations to the Organic Law of Constitutional Article 27, art. 7, sec. I.

23. Agrarian Code of December 31, 1948.

agrarian code and which is dedicated to communal use by peasants. This land may not be conveyed, leased or mortgaged either to Mexican nationals or to foreigners; and any act or contract violating that prohibition is null and void.<sup>24</sup>

A prospective purchaser of rural land should not rely on an apparently valid deed, until he has searched the records in the local branch of the Department of Agrarian Affairs and the Federal Agrarian Register. Moreover, a statement of clear title from such agrarian authorities is advisable.

Having now discussed the earlier enacted laws and constitutional provisions which control or otherwise restrict the ownership of land in Mexico, we may proceed to a discussion of the most recent legislative enactment affecting land ownership in Mexico.

#### NEW FOREIGN INVESTMENT STATUTE

On May 8, 1973, the Foreign Investment Statute became effective. Among its features affecting the subject matter of this paper, is a provision to the effect that every Mexican company to be incorporated from that date forward should have at least 51 percent Mexican owned equity. That provision, of course, means that land holding companies are similarly limited.

The law has no retroactive effect, thus, Mexican companies 100 percent owned by foreign shareholders will not be subject to forced divestiture. It is likely, however, that when applying for any of the required permits, as, for instance, to change the present operations of an existing company, the government will no doubt continue to press for Mexicanization along present guidelines.

Provided the expansion of an existing Mexican enterprise does not involve new business, new fields of economic activity or new products, it seems to be clear that an expansion of existing operations will be permitted without express authorization and, therefore, without divesting equity to Mexican nationals.

#### THE PROHIBITED ZONE

As mentioned earlier, Article 27 of the Constitution specifically prohibits a foreigner from holding title to realty within the "prohibited zone." Foreigners, however, have in the past been able to enjoy the use of such property and acquire the equivalent of beneficial ownership thereof without openly violating this constitutional prohibition. This result, traditionally, has been accomplished through the use of nominee Mexican companies<sup>25</sup> or trusts.

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24. *Id.*

25. A Mexican company owned by foreigners is also prohibited from owning realty in the "prohibited zone," hence, nominees were employed to hold the stock.



The use of nominee companies or land holding companies even though neither expressly authorized nor prohibited, became the most common method for foreigners to hold an interest in land in the "prohibited zone," even in such well-known resort areas as Acapulco. It was the stated intention of the drafters of the Presidential Decree of April 30, 1971 to eliminate the various subterfuges that had been used to defeat or circumvent the spirit of the Constitutional principle. With respect to the use of a trust arrangement, the Decree provides that the trust may be handled only through Mexican financial institutions so authorized to act in accordance with the General Law of Credit Institutions and Organizations.

The essential requirement of any such arrangement is that legal title to the realty must vest in the trustee<sup>26</sup> and that any foreign beneficiaries thereof may not acquire *in rem* rights in the trust *res*. The Decree does not define the term "foreigner" or "foreign beneficiary," but we can assume that the definition included in the Regulations to Article 27 of the Constitution will also govern the interpretation of this legislation. This raises the possibility that foreign corporations will not be permitted to create, or become beneficiaries of a trust; since, as noted, foreign corporations (but not foreign individuals) cannot "participate" in Mexican entities holding legal title to realty within the prohibited zone. It has been our experience, however, that a beneficial interest in a private land trust has not been equated to equity participation in a commercial company. A foreign corporation may, therefore, be permitted to become the beneficiary of a real estate trust without violating Article 27 of the Constitution. Since the permission is discretionary, one cannot be certain that it will be granted where the beneficiary is a foreign corporation. Nevertheless, in the past, several such permits have been granted.

The Decree enumerates various other requirements attendant upon the use of a trust, as follows:

1. An application to create the trust must be submitted to an Inter-departmental Consultant Commission for its approval. This Commission is composed of representatives from the Ministries of Foreign Affairs, Interior, Treasury, Industry and Commerce, and from the Department of Tourism. The application will be considered in the light of the economic and social aspects of the proposed acquisition in accordance with standards which are vague enough to allow the Commission almost complete discretion to approve or reject the request.

2. Legal title to the realty must remain vested in the trustee during the trust term. The fact that legal title vests in the trustee will

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26. The trustee must be the financial institution.

not, however, preclude the certificate holders or the beneficiaries from managing the trust. Mexican trust jurisprudence contemplates instances where the trust instrument obligates the trustee to consult, and implement the decision of the trust beneficiaries. As the owner, the trustee will have the right to rent the realty, but only for terms not exceeding ten years. We assume that this ten year limitation applies to initial lease terms, and that they can be renewed for similar periods.

3. The trust may issue "certificates of participation" to evidence the equitable interest of the beneficiaries or others in the trust *res*.<sup>27</sup> The certificates of participation must be nominative or registered, and may be transferred only upon notification to, and approval of, the trustee. The certificates are not, however, amortizable over the term of the trust or otherwise.

4. The trust cannot last for more than thirty years. At the end of this period, the trustee must sell the realty to individuals or legal entities capable of owning realty within the "prohibited zone," i.e., Mexican citizens, Mexican owned or controlled companies, and presumably, another qualified trustee (but not the same beneficiaries).

5. Upon termination, the trustee must distribute its net earnings to the holders of the certificates of participation in proportion to their respective holdings. The net earnings of the trust might include rental income in addition to the proceeds from the sale of the realty upon its termination.

The use of a trust to acquire an interest in realty located within the "prohibited zone" has also now been regulated by the newly enacted Foreign Investment Law. In substance, this legislation incorporates all of the requirements and provisions set forth in the Presidential Decree of 1971. The Foreign Investment Law specifically requires, for example, that direct ownership vest in the trustee at all times,<sup>28</sup> that the term of the trust not exceed thirty years, and that the certificates of participation be nominative or registered and not amortizable over the term of the trust or otherwise.

The Foreign Investment Law adds, however, a significant requirement to the effect that the trust must be registered with, and approved by, the National Registry of Foreign Investments. The Registry is charged with reviewing any proposed transaction in the light of its social and economic value to Mexico. These standards are, of course, quite similar to the criteria used by the Interdepartmental

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27. In practice, however, fiduciary institutions will not issue certificates, unless the trust is intended to develop realty and to allow for public trading of the interests therein. Trustees will, instead, execute private land trusts.

28. The certificates of participation cannot, as a result, represent a direct allocation of the legal rights to the trust *res*.

Consultant Commission mentioned earlier. Failure to register with (and obtain the approval of) the National Registry of Foreign Investments will result in the unenforceability of the trust against the trustee; and, most likely, in the inability of the trustee to make distributions to the beneficiaries or certificate holders. It should be mentioned, too, that the Foreign Investment Law provides criminal penalties to aid the enforcement of its provisions.

#### FINANCING REAL ESTATE

##### A) *Secured Transactions*

The most widely used methods in real estate financing in Mexico are mortgages, conditional sales, and sales subject to rescission.

A mortgage, as defined by the Civil Code<sup>29</sup> is a guarantee *in rem* constituted on property which is not delivered to the creditor. The mortgage holder is given the right, in case of non-payment of the obligation, to be paid out of the value of the property.

Through a conditional sale, the seller retains the title until the purchaser has completed his payment obligations to the seller.<sup>30</sup>

A third method commonly used in Mexico is a sale subject to rescission, whereby title passes to the buyer but will revert to the seller upon the buyer's failure to pay one or more installments of the purchase price.<sup>31</sup>

Of these three methods, the first two have been more frequently used by financing institutions, when granting loans for real estate acquisitions. Even foreign credit institutions have used one or more of these methods in securing loans granted by them.

A fourth secured transaction device which is now commonly used in Mexican practice is the land trust. Through such a trust, the lender (who normally becomes the trustee) takes title to the property and holds it in trust for his own benefit. Depending upon the trust terms, if the borrower does not pay his debt, the trustee may declare that the property placed in trust has become his absolute property or sell it elsewhere.<sup>32</sup>

##### B) *Banking and Financing Institutions*

Mexican law makes a distinction between banks that receive deposits from the public (and that regularly make short term loans on a personal basis) and investment institutions that undertake

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29. Civil Code for the Federal District and Territories, art. 2893.

30. *Id.* art. 2312.

31. *Id.* art. 2310.

32. The trust is regulated by the Law of Credit Institutions and Organizations, effective since 1941.

credit operations for longer terms and for specific areas of financing.

Some of the types of institutions comprised in the second category are as follows:

i) *Savings Banks*—These banks engage in granting loans, guaranteed by mortgage, up to 15 years; but emphasis is placed upon the channeling of loans toward low cost housing.<sup>33</sup>

ii) *Finance Companies*—Their purpose is the financing of production and investment of capital. These companies may undertake any form of debit operations such as loans for housing, refinancing, mortgages, etc., but similarly, their main emphasis insofar as housing is concerned is the financing of low cost home construction. The housing to be constructed should fulfill all requirements to conform to the general government policies to the effect that loans by these institutions may only be granted to those persons (either individuals or companies) residing in Mexico.<sup>34</sup>

iii) *Mortgage Credit Companies*—This type of institution is authorized to engage in typical mortgage operations, that is, the financing of building and dwelling construction.

However, the Law provides a limit on the percentage of the loan vis-a-vis the total value of the property as follows:

a. Up to 30 percent when the construction is designated to house machinery or fixtures which represent more than half of the value of the property mortgaged.

b. Up to 30 percent when the construction can easily be modified.

c. Up to 70 percent when the credit is for the construction, acquisition or improvement of dwellings with a value not in excess of \$16,000.

d. Up to 80 percent when the credit is for the construction or acquisition of low cost dwellings.<sup>35</sup>

#### AVAILABILITY OF FINANCING FOR NON-MEXICANS

As a practical matter, it is fair to state that Mexican nationals are given preference in securing loans from financing institutions. This is not true, however, if the real estate is located in new suburban areas or resort developments, where sales and financing efforts are focused upon non-Mexican purchasers. The common practice for this purpose is to require from the borrower a down payment of approximately 20 percent of the aggregate cost and providing for equal pay-

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33. General Law of Credit Institutions and Organizations, arts. 18-24.

34. *Id.* arts. 26-33.

35. *Id.* arts. 34-39.

ments over a period of time ranging from five to ten (or more) years with interest of no less than one percent per month.

#### TITLE INSURANCE

While title insurance is a typical form of insurance originating in the United States, it is relatively unknown in Mexican practice. However, there are no legal impediments to its use in Mexico, provided that the title insurer be an insurance company authorized to do business in the country.

Conveyances of real estate are performed through a notary public and recorded in the public registry of property. As a general principle, registration of a notarial deed is the method used to evidence title under Mexican law. Of course, the title being transferred must have been validly obtained or granted and, therefore, all federal and local regulations (i.e., agrarian laws) complied with.

Historically, the number of challenged real estate titles has been insignificant, but there is always a risk present, especially in those states where the registries are not kept with the same accuracy as they are in major cities.

In conclusion, the acquisition of land in Mexico is not simple, even for Mexicans.