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6 RULES TO INVESTING IN TROPICAL REAL ESTATE

Follow These Simple Steps To ENSURE You're Investing Not Speculating

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Tropical Real Estate Not Always Paradise

The Six Rule of Investing in Tropical Real Estate

Become an informed investor instead of an excited and emotional speculator.

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Due to the high Canadian dollar, the shrinking market in the US and the huge commissions that are paid to promoters, Canadians are currently being inundated with sales pitches for tropical real estate

And let's be honest, in the midst of another long, cold Canadian winter, the idea of owning recreational property in a tropical paradise is quite easy to be drawn into.

This dream can quickly become a financial nightmare if an investor does not follow the critical 6 Rules to Investing in Tropical Real Estate. Buying out of the country requires substantially more due diligence than buying in Canada, and sadly most people do substantially less.

I have almost 20 years of experience with business and real estate in tropical countries and during that time I have seen just about everything, from outright fraudulent developers selling Canadians a dream (and NEVER intending to complete the project) to individuals flying down doing their OWN homework and finding the perfect retirement property. The difference in every case is in the homework that the buyer completed. From this experience I have developed the **6 Rules To Investing in Tropical Real Estate.**

Let's set the stage.

Tropical real estate is a true emotional sell and has proven to be the easiest real estate sale on earth. Combine this easy sale with the HUGE commissions that are paid to the promoters in Canada and you have a situation ripe for abuse. And unlike Canadian real estate, it is unregulated, there is no dispute resolution process, there is often limited land title guarantees and the contracts can't be signed in Canada due to the developers/promoters trying to do the deals without scrutiny.

What is So Alluring About Throwing Money Away?

Tropical real estate has some obvious draws (warmth, holiday mind-set) however one of the top reasons people justify buying this type of real estate is because saying ***"I own Real Estate in Costa Rica "*** sounds cool when you tell your friends and family. It's like name dropping – only it's country dropping. Imagine that, we can allow our egos to justify a property purchase. That does NOT make it a good investment.

The second reason we see people buying this type of real estate is the ***"Grass is Greener"*** Syndrome. Anything 'far away' has an appeal – but it is absolutely critical that you do even MORE due diligence than if it was in your own country.

Tropical real estate purchasing and owning is completely different to what we all know in Canada. And because of that there are very specific rules that we all need to follow BEFORE we sign on the dotted line.

Rule One: Go there not just once, but twice. *Don't Sign Until You Fly*

Never buy property at a distance, especially in another country, without seeing it for yourself. You work hard for your money in Canada, why would you throw your money at a potential property without knowing the reality behind the dream?

The important steps are to make sure you visit the region at least twice, once in the high season and once in the low season. In many counties there is a VAST difference in accessibility (flights, bus travel etc), demand (tropical storm season or too hot) and open amenities (often times half the businesses are shut down during low season).

Imagine if you were from outside of Canada and you were thinking of investing in a summer cottage area. You visited only in the summer time, you saw an area teeming with life, the economic activity would be obvious, the rentals would be hard to find and it would feel like an amazing place to park your money. However, you would only be getting half the picture. If you took the time to visit in November or February, you would start to see the other side of the reality: Huge snow-banks, most businesses shut for the season, very limited number of visitors, potentially difficult access. Your view would now start to change closer to reality, you wouldn't be caught up in the "Holiday Feel" that drives people to buy and you would then start to analyze the facts.

Combine these realities with the property being located in a tropical second or third world country with different laws and customs and you will quickly see why visiting at least twice, at different times of the year is critical. The reason time-share and vacation property sales people locate themselves in the heart of tropical tourist country is they understand the whole "Holiday Mind-set" psychology that makes a holidayer enjoying the weather an easy target.

If the promoter tells you that you don't have to visit to check out the property or the region, you have to ask yourself, what are they hiding? Why don't they want you to do your due diligence?

What To Do During The Visits

When you visit, there are certain steps you should take to complete your due diligence.

A. Feel free to tell the promoter/developer that you are coming but only tell them this the first time (you might get a free hotel stay out of it) The next time you go do not pre-warn them, book somewhere else and just show up at the site to see what's really going on behind the scenes. Bring your camera, you might be shocked at what you find when they're not prepared for your visit.

B. Check out the location and closeness to local amenities, airport, restaurants, stores, water, etc. A three hour bus ride from the airport is NOT compelling to potential renters/tourists. Check out what the water is like, is it good for tourists (or something you would feel comfortable swimming in)? Are there a lot of attractions/restaurants, stores nearby? How about a medical clinic, what are the medical service options?

Be wary of promised local improvements such as a new airport unless you see actual construction underway. In Tropical countries, I have seen the same airport 'rumour' being announced 10 times in 10 years and still no real work has been completed.

C. Visit a local realtor to see if a property you are considering was quoted to you in local or "foreign" pricing. Sure it may look inexpensive, based on our North American perception but only by visiting will you know if it truly is a deal or not. The difference between local pricing and 'foreigner' pricing is often substantial. There is a reason that such massive commissions are paid to the promoters in Canada. It is because the mark-up on the property sale price is so high. Properties being sold in Canada at $50,000 per acre has been bought for less than $5,000. That is amazing mark-up… and you won't know about it until you start speaking with a trusted local real estate person, visiting properties for sale and checking out the competition.

Rule Two: Always check out the competition on both fronts

Bring Realism and Skepticism - not blind enthusiasm

"Make sure you're buying not because it is cheap but because it has potential." Part of any due diligence is investigating what else is out there. Discover what your competition may be and what other opportunities you can uncover that may be cheaper or provide better return.

There are two types of competition you will want to check out.

Competition #1

Other projects or properties in the region… or even in other better countries or regions

Before a sophisticated investor buys any piece of property they check out what else is for sale out there. The question I ask is, why do so many people NOT do this when looking at tropical real estate? The answer quite clearly is because of laziness and blind excitement, neither of which leads to good investment decisions.

In order to ensure you don't get caught in this trap, or get seduced by an apparent bargain, you should always check out other available properties. If it is for investment, check out other geographic regions as well. Look for the best potential combination of cash flow (rental income) and capital appreciation.

> ### Sophisticated Investor Insight
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> When looking at the proformas for comparable properties take a look for 'Resort Fees' that are often charged over and above other operating expenses. Watch for this as a hidden profit centre for promoters or developers not discussed in presentations. How will this affect your bottom line?

Once again, once you have finished your investigations on the internet (Google will become your friend), then get on a plane and visit, find out what is real (see Rule #1 above), have fun with it, make it an adventure as well as a due diligence trip. Make sure that the area is appealing to you, so that it is appealing to your potential visitors/renters/vacationers.

Competition #2

Other projects vying for your potential renters or vacationers

If you are expecting your property to eventually produce revenue, you MUST know what else is out there and who your competition is for your revenue generating renters. In order to do this properly, you must put yourself in the role of the potential tourist, they are now using google.com more often than not to start their vacation search, so that's exactly where you must start. Get on the internet and start searching for properties for rent in your area. Find out what the prices are, what the availability is, what amenities they're providing, then compare these to what your expectations are.

Often times you will see, when a tropical property is being sold to North American investors, a projected rental rate that is completely unrealistic based on market comparables. There is often no account for high and low season, they are often quoted at 'rack rate' a rate in the industry that no one ever pays. Only by playing the role of tourist would you know what's real in the market.

Make sure your potential property would look compelling (financially, accessibility and amenities wise.) if you were a tourist planning a trip to the area. Remember, generally tourist often only have a week or two, so they want amenities, ease of access good pricing.

If the flights is long with lots of connections or the trip from the airport is brutal, what are the chances of getting a returning visitor. Not very good. You want to know that people would be willing to do these trips. You'll also want to see (by going there twice before buying) whether you want to go there often or not yourself. Dream vs reality.

Look at the reality to cut through any 'dream assumptions' you may have.

Sophisticated Investor Insight
Wild Rides of Currency Fluctuations

Remember, you are always at the whim of the currency markets, so make sure that you investigate that side of the equation. Find out how the currency performs. Ask these questions as a start:

- Is it floating or is it pegged to the US dollar?
- If it is pegged to the US dollar, do you believe that the dollar will strengthen? If the US dollar continues downwards, will the currency change to a floating currency or adjust to their internal conversion rate?
- If it is floating – Is the local economy strong enough to support the current level of the currency? What do you expect the currency to do against the Canadian dollar during the time you own your property?
- In both cases, how will the fluctuations affect your cash flow and the willingness to travel to that country?
- Can your investment value or potential income drop dramatically when their currency fluctuates?

Remember, there is a reason that these countries are economically called second and third world

Rule Three: Know the property laws of the country

This is critical. If you don't know the property laws you're playing with fire.

The first step in this rule is to find out what restrictions are put on a foreign property holder. This should include investigations into:

- What is the Maximum Length you can stay in the country? Do you need a Visa to do business (i.e buying real estate) in the country? If Yes, what type, how easy is it to get and how long does it last?
- Ownership must be Held?
- What are the squatters' Rights Laws?
- What appropriation rights do the many levels of government hold in the region?
- Do locals appreciate or disapprove of foreigners buying up their properties? What types of problems can that lead to?

Even after this investigation, it's important that you investigate how stable the government system is. If the government changes is it likely that some of these foreigner rights will change along with it?

Make yourself aware of the property laws, the zoning requirements. Especially look at the 'deforestation' rules if you are buying a lot to build upon. Don't assume that what occurs here in Canada will lookk anything like what occurs in another country.

Rule Four: Always have your own legal representation in the target country

The best way to deal with Rule 3 is by following Rule 4. Every contract you sign must be reviewed by an unattached, outside expert familiar with local laws. The best case scenario is that they are located in the country you are thinking of buying in. This legal expert must not have anything to do with the property or the development promoter and must be very proficient in property transactions with foreigners.

What you will find is that the property contracts are quite different than your typical MLS offer. Although they may look the same, so that you are made to feel comfortable with the process, many clauses we are familiar with in Canada are actually unenforceable in some other countries so you cannot just transfer your Canadian thinking to a foreign country.

Find out, from your independent legal advisor, what right you have if the developer or promoter does not perform. What is the dispute resolution process, what would the costs be and would you have to be present in the local court to bring an action?

Land Title Considerations

The land titles registry, in many of these countries, is not as sophisticated, or as accurate as we have come to expect here in North America. You want to ask key questions to ensure that you are well protected in the transaction such as:

- **How is Title usually held in that country?**
- What is the historic accuracy of their process?
- **Do you get the equivalent of a site survey or Real Property Report? Is the info on this document confirmed by a government agency?**
- What is the title dispute resolution process?
- **What are the restrictions for use on the property's title?**
- What are the zoning rules?
- **Are there Historic or Indigenous Rights Issues? (this is becoming an increasingly more common issue that you do NOT want to be the target of.)**
- Can you hold the title as a Canadian or does a local have to 'hold' the title in trust?
- **If in 'trust' who do you know that you TRULY trust with your money and investment in the country?**
- Who holds the deposits and in which country are they held during the purchase process?
- **How do you get your deposits back if you need to?**

Knowledgeable and independent legal advise is going to be critical in all of your transactions whether in Canada or in a tropical country. Do NOT take this transaction lightly, make sure you have a strong team around you who has nothing to do with the promoter or vendor and has extensive knowledge of the local laws and how they can affect you.

For instance, many people do not know that in some countries there are squatter rights laws that allow a squatter to move into or onto your property and if they stay there for a set period of time (often only a few months) you lose the right to move them off. They can even erect make-shift buildings on your property.

In other countries, there are laws where the government has limited the size (diameter) of trees you can cut down on your property. Therefore, if you are not careful, and you buy a building lot with these certain sized trees scattered on it, you may have just bought your self a nice camping plot that you will never be able to build on due to the location of the trees.

Don't fool yourself, get the expert on your side early in the transaction.

Sophisticated Investor Insight
Financing Options

Real estate is such a great investment due to the leverage that banks provide you. When buying outside of Canada, you must find out what your financing options are and what types of interest rates you can expect to be paying.

Often times it is not as simple as it seems, and you will see many a promoter telling you to go get a Canadian line of credit to buy the property. What they forget is that you must service this debt (so there had better be cash flow) and you are now really putting your self at increased risk because you are borrowing Canadian dollars to buy a property based on another currency.

Find out what financing is available in the country the property is located and find out what their underlying interest rate is, and you will soon find out what their central bank thinks of their economy and currency.

Rule Five: Dig into the tax implications – *How will the profits be treated?*

That's right, tax issues follow you wherever you go. An important component of any investment is in the tax planning. It is critical that you understand the tax implications of buying, owning and operating a property outside of Canada. How will this purchase affect you in Canada and in the country where the property is located.

Is there a tax treaty between Canada and the country? How will profits (income and capital gains) be taxed in both places and what effect does the time you spend in each country have? When money is being transferred many countries insist on a tax hold-back. In other words, when profits are being transferred to a foreigner, it is the obligation of the management company / developer to send a portion of that profit to the government who will hold it until all proper tax filings are done at the end of the year. This can take a big bite out of your profits.

Property taxes are also an issue that are often overlooked. Find out if you are going to be paying substantially more property taxes because you are from out of the country. In many cases, the local's property taxes are substantially less than that paid by foreigners. (same thing with utility rates). Ensure that you are analyzing the cash flow based on the foreigner taxes, not the local.

In addition to the tax issues, it is important that you fully understand that if you will be renting out your property you must know how the property management company will conduct the finances and how money will be transferred to you. Will it be sent by wire, cheque, or do you have to open a foreign bank account? Can this cash flow be expected monthly?

Other key questions are: What rights do you have to get your money out if the property or the management company doesn't perform? What occurs when there is a deficit in the cash flow? How will you be transferring the funds to the management company?

When buying any property at a distance you are in essence putting all of your cash in the hands of a second party. What is your trust level with them? What experience do they have with foreign investors? Do you believe that they will be treating your money as if it was their own?

Rule Six: Know exactly what you are buying

Do you TRULY know what you are buying? Is it a real estate investment, or a security with a real estate foundation? Many unsophisticated investors buy into projects believing that they are buying a real estate investment, when in fact they are simply pooling their money in a security (partnership, LP or share) that happens to use real estate as the base for the profits. There is a massive difference between this and a real estate investment where you are in control.

The key thing to consider with any property is can you own it, move in, rent it, or sell when you want? This is the true definition of a real estate investment. Whenever there are restrictions that limit your ability to make a profit if the developer/manager doesn't do their job, you are adding more risk and it is less of a true real estate investment. If you do not have control you may get stuck with a dead investment. If you have control, in worst case scenarios you can sell it on the open market to try and get some of your money back.

That is why you see so many time-shares for sale by those who bought them at a dinner meeting… they bought into the dream but never did their homework on what they were buying. Then, when reality hit, they were stuck with something completely different than what they expected.

Another key issue when you are buying in a tropical country is whether you can hold the title as a Canadian or does a local have to hold the title in trust? In many cases, foreign ownership of property is limited to certain geographic zones unless title is held by someone in the country 'in trust' for you. Well, ask yourself; "How many people do I know in that country who I am willing to trust with my hard earned money?" Can the trustee, legally, take control of the property? Often times the answer is "yes."

Find out the local title dispute resolution process. Ask the key question… are there any historic or indigenous peoples rights issues? Something you do not want to get caught up in.

A key to any real estate deal being profitable is your ability to get out quickly and easily when you need to, so consider your exit options. Could you sell it on the open market or are your sales restricted by price, title, financing or other encumbrances?

By following these 6 Rules To Investing In Tropical Real Estate you can do well with a purchase of tropical real estate. However, you MUST do the homework in order to protect yourself and make sure you are investing, not just blindly speculating. If you're not willing to do the work, and you blindly believe the promoter's pitch, you might as well play the slot machines.

A promise of quick riches is such an alluring sales pitch, people look for ways to justify to themselves why they should buy. Don't get caught up in the dream, this is you and your family's hard earned money. Make the dream a reality by asking the tough questions. And in ALL cases make sure you are visiting the area at least twice before you sign on the dotted line.

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