GAZING AT THE GREEN LIGHT: THE LEGAL AND BUSINESS ASPECTS OF REAL PROPERTY INVESTMENT IN CUBA

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The toppling of the Berlin Wall sparked tremendous changes, but few could have predicted that its fall would mark the beginning of a real estate boom. From Europe to Asia, a different kind of "domino effect" occurred in which property values in one Communist country after the other skyrocketed over the ensuing decade.[1] In Estonia, for instance, the average price in Euros per square meter of an apartment[2] in the capital city of Tallinn increased from 300 € ($400 USD) to 2000 € ($2600 USD) between 1997 and 2007.[3] On the other side of the globe, Vietnam's annual GDP growth reached nearly 10%, and in 2007 saw more than $18 billion in Foreign Direct Investment (FDI)—much of which naturally went towards real estate development and passive investment.[4] As developers, investors, attorneys and builders struggle with the current global real estate recession, it might behoove them to consider positioning themselves to capitalize on the potential explosive growth of perhaps the last former Soviet satellite nation. By reflecting both on its turbulent past as well as its complex present, this paper sets out to analyze the undeniable allure of real property investment in Cuba.

A BRIEF HISTORY OF PROPERTY OWNERSHIP IN CUBA

The history of property ownership in Cuba is inextricably linked to the history of the nation itself. For several hundred years, starting around 1500, the island was colonized by European imperialists—predominately Spanish.[5] The conquistadors built city fortifications, palaces and developed the island's urban core.[6] This rule lasted until 1899, when Havana's suburbs were expanded and opulent modernist architecture emerged.[7] The first half of the 20th century was dominated by American influence: in 1959, five U.S. sugar companies controlled more than two million acres in Cuba and foreigners owned about 75 percent of arable land.[8] However, all of this changed that same year when Fidel Castro's government nationalized most private property and prohibited land development by U.S. citizens as well as land specula-

1. *Real Estate Financing in Estonia*, Edited by David, Richard M. (Paul Varul Law Firm). *World Finance*. Fall 2007.
2. The equivalent in the US to a freehold condominium.
3. *Statistics Estonia*. As cited in *House Prices Plunge in Estonia*. *Global Property Guide.* January 17, 2009.
4. *Between Hanoi and Havana.* Castañeda, Jorge. *Newsweek*. Aug 4, 2008.
5. *Flirting with Capitalism: Rebuilding Havana will require not only foreign investment, but also a government committed to creating a healthy city.* Rosenau, W. Paul; Fenske, Paul and Gilderbloom, John. *Urban Land*. October 2002. 98, 98–103.
6. *Id.*
7. *Id.*
8. *Id.*

tion of any kind.[9] In post-revolution Cuba, only the Castro regime was permitted to develop land; real estate development shifted away from the sale of housing and land for profit towards construction of utilitarian development at low cost.[10] (This policy shift is perhaps best exemplified by the National Schools of the Arts, which were built under Castro's regime on what were then the grounds of the most exclusive golf course in Cuba—the Havana Country Club—a playground of the wealthy, appropriated as an intellectual center for the future.)[11]

Moscow—whose Cold War commanders viewed the island just 90 miles from U.S. soil as a key military base—subsidized Havana for nearly 30 years. However, this relative stability effectively ended with the fall of the Berlin wall in 1989, a collapse which not only spawned the birth of a new Europe, but also forced the Cuban economy into tremendous upheaval.[12] The steady stream of subsidies care of Mother Russia came to a grinding halt and marked a watershed moment in Cuban history. According to Brian Latell, former U.S. government National Intelligence Officer for Latin America from 1990–1994, Castro was forced to make a difficult decision: cling to or compromise "previously sacred revolutionary principles to maintain absolute power."[13] Arguably, one such "sacred" sacrifice was the Government of Cuba's (GOC) turning to the industry that made Havana known in the 1950s as "Latin Las Vegas": tourism. The GOC, in an attempt to attract foreign currency and buoy the sinking economy, sought to form numerous joint ventures (JVs) with Canadian, Spanish and Italian firms to build hotels, airports, and infrastructure.[14] As if to imply the temporary nature of these projects, the GOC proclaimed this era as the "Special Period."[15] The tactic paid off and by 2001, 29 JVs with a combined value of $1.1 billion operated in Cuba's tourism sector.[16] JVs still occur today between the GOC and foreign investors, although the Cuban economy currently struggles to match its economic strength under the Soviet regime.[17]

REAL PROPERTY IN CUBA TODAY

The baseline authority that governs real property in Cuba is the Cuban Constitution. According to Article 15 of the Constitution, virtually all land in Cuba is "Socialist state property, which is the property of the entire people."[18] But for a few narrow exceptions, all land is owned by the GOC; this includes the subsoil, mines, mineral, plant and animal resources, forests, waters and "means of communications."[19] In addition, Art. 15(b) states that all means of production—sugar mills, factories, banks and "economic facilities" nationalized "from the imperialist landholders" fall under this large umbrella.[20] As alluded to previously, there a few exceptions. According to Pedro Freyre, Co-Chair of the Global Practice Group at Akerman Senterfitt law firm, Cubans, in effect, cannot own land but for "a few very narrow carve-outs for agricultural cooperatives…everyone else is a tenant of the state and possesses the property

9. *Id.*

10. *Id.*

11. Burnham, Bonnie. Lecturer for panel entitled, *Cuba on the Brink: The Next Great Development Opportunity*. Held at the *Urban Land Institute's 2008 Fall Meeting*. Miami, Florida.

12. *After Fidel: Raúl Castro and the Future of Cuba's Revolution.* Latell, Brian. Palgrave MacMillan: 2005 239, 1–275.

13. *Id.*

14. *Flirting with Capitalism.* 98, 98–103.

15. *Id.*

16. *Id.*, 99.

17. *Id.*

18. Cuban Const. (1992) art. 15 § a http://www.cubaverdad.net/cuban_constitution_english.htm

19. Cuban Const. (1992) art. 15 § a

20. Cuban Const. (1992) art. 15 § b

as a life estate."[21] Art. 19, in fact, states that "small farmers" have the right to legal ownership of their lands "necessary for the exploitation of their land, as prescribed by law."[22] While the Constitution allows farmers to "sell their lands, swap them or transfer them for another title," this may only be done where that sale is to the GOC or to other small farmers and "without detriment to the preferential right of the state to the purchase of the land while paying a fair price."[23] Further, Art. 19 bans any land leases, mortgages or other acts which "entail a lien on the land" or "cessation to private individuals" of the small farmer's rights to that land.[24] In sum, the GOC is unequivocal in its message to prospective Cuban real estate investors: think again. However, taking a broader view of what it means to "invest" in Cuban real estate, there remain additional opportunities for Cubans to participate in this sector.

WHO MAY INVEST IN CUBAN REAL ESTATE?

1. Opportunities for Cubans

Exchange System: In the United States, the §1031–tax deferred exchange enables the savvy real estate owner to defer capital gains taxes by effectively applying proceeds from the sale of one property towards the purchase price of a subsequent property.[25] Investors privy to the power of this law make use of it on a regular basis. While this is a useful tool, obviously this is not the only means by which one can transact real estate in the U.S. Imagine, however, that it were; that is Cuba today.

Through *permuta,* homeowners may exchange homes for tenancy so long as they obtain government approval and the properties—a bit like the requirements of a §1031–exchange—are of "like kind or on a like basis."[26] The Government recognizes these transactions through a formal process codified by regulations. The parties seeking to trade must overcome Art. 15(a), which prohibits the transfer of property ownership "to natural persons or legal entities *save for exceptional cases* in which the partial or total transfer of an economic objective is carried out for the development of the country."[27]

Logistically, however, these exchanges take on a very informal nature.[28] Notwithstanding the casual manner of the Saturday morning exchange, transactions often become complex webs. A 1983 film, *Se Permuta*, portrays how elaborate the Cuban property exchange system can get: a mother wishing to get her daughter away from a boyfriend she dislikes organizes a multipronged property swap that will result in the daughter moving from a tiny apartment into a spacious colonial-era house.[29] Although exchanges may be blessed by the GOC at its discretion, issues naturally arise where one motivated "seller" wishes to exchange a property that is not "like kind." We take for granted the power of capital as the universal equalizer in the West; in Cuba, the use of hard currency to balance unequal real property deals is illegal.[30] In reality, however, most property exchanges amongst Cubans involve swapping for a larger or smaller property, in which case it may be necessary at times to include cash or other personal property to

21. Interview with Pedro Freyre (Co-Chair of Akerman Senterfitt law firm's Global Practice Group based out of Miami): April 16, 2009. 11:45am–12:45pm PST.

22. Cuban Const. (1992) art. 19

23. *Id*.

24. *Id*.

25. 26 USC §1031. *Exchange of property held for productive use or investment*.

26. *Id*.

27. Cuban Const. (1992) art. 15 § b

28. Each Saturday morning, hundreds of people gather on the *Paseo del Prado* in central Havana in the hopes of finding someone willing to swap homes.

29. *The Black Market: Cuba Burns with Real Estate Fever on the Sly*. Lacey, Marc. *International Herald Tribune*. January 28, 2008.

30. Cuban Const. (1992) art. 15 § a

equalize the transaction.[31] Many continue to execute such illegal trades, as demand for property outweighs fear of imprisonment in Cuba's real property "Black Market."

Casas Particulares & Paladares: Another legitimate opportunity for a Cuban to profit from real property is the *casa particular*.[32] The GOC grants licenses to qualified families to operate their homes or *casas* as hostels or in a *particular* manner. *Casas particulares* are usually rooms in apartment buildings from the 1950s and are roughly equivalent to the bed & breakfast. Similarly, licensed residents may prepare meals to be served to paying customers who often dine in the living rooms of the owner's homes. These homes-turned-restaurants are known as *paladares*, where an individual may literally operate a restaurant within his or her own living room.[33] For both the *paladar* and the *casa particular*, however, the GOC tightly monitors all entrepreneurial activities and imposes hefty taxes for this privilege.[34]

The Black Market: As stated earlier, the Cuban Constitution forbids a citizen from using cash payments to equalize an otherwise inequitable property swap.[35] Yet in practice, capital is often used to bridge the gap: thus, swapping a less desirable property for something more attractive generally means "parting with several thousand dollars."[36] According to the *International Herald Tribune,* "the underground property market is thriving in Havana and prices are on the rise with as much as $50,000 changing hands."[37] Speculators want to get a hold of historic homes with the expectation that private property will once again be the norm in the country. "It's a good time to invest," one anonymous trader said. "If you have family [in Florida], $20,000 is nothing, and you can get a good place here. If change comes, and we all expect it, then you're set."[38] With President Obama's recent loosening of curbs on remittances—or monies a Cuban-American, such as a wealthy Floridian, may send to his or her relative in Cuba—one can imagine the incredible temptation for such speculation.[39]

2. Opportunities for Foreigners

Development Opportunities: Today, there are opportunities for non-nationals—e.g. Europeans, Canadians, Chinese, and Russians—to participate in real property in Cuba although there are "very limited opportunities for development and investments."[40] For several decades, there were not even limited opportunities; however, in 1995, shortly after the Soviet Union's collapse and subsequent cutting off of economic ties with the island, the GOC passed Law No. 77 (*The Foreign Investment Act*), that significantly expanded the financial collaboration between Cuba and Western European/Canadian governments.[41] Property ownership, income tax exemption and the transfer of real estate for business was suddenly a possibility.[42] In "exceptional cases," the state even granted themselves the right to transfer property

31. *The Black Market: Cuba Burns with Real Estate Fever on the Sly*.

32. *Id*.

33. *Cuba Libre? Uncertainty and controversy build as Cubans anticipate economic reforms following Fidel Castro's resignation.* Mehaffy, Michael. *Urban Land*. March, 2008. 102, 101–105.

34. *Id*.

35. Cuban Const. (1992) art. 19

36. *Cuba's Black Market Housing Boom.* Pressly, Linda. *BBC Radio: "Crossing Continents."* January 2, 2009.

37. *The Black Market: Cuba Burns with Real Estate Fever on the Sly*.

38. *Cuba's Black Market Housing Boom.*

39. *Cuban-Americans Favor Obama's Shift in Policy*, Harwood, John. *New York Times*. April 20, 2009.

40. Freyre, Pedro A (Co-Chair, Akerman Senterfitt's Global Practice Group). Lecturer for panel entitled, *Cuba on the Brink: The Next Great Development Opportunity*. Held at the *Urban Land Institute's 2008 Fall Meeting*. Miami, Florida.

41. *Toward a Culture of Nature*. Stricker, Pamela. Lexington Books: 2007. 75, 1–149.

42. *Flirting with Capitalism.* 100, 98–103.

rights to foreign nationals.[43] Regarding expropriation (the seizing of property by the GOC) under Law No. 77, except where necessary for "public utility," foreign investors were protected against the seizing of lands, and even in those circumstances they were guaranteed compensation akin to eminent domain laws in the United States.[44]

At first blush, it seems that *The Foreign Investment Act* provides a foreign investor with several options.[45] (See Table 1) However, as with any system, what is *de facto* and what is *de jure* may not always converge. A foreign investor may technically be permitted to own 100% of a development project (see "Wholly-owned Foreign Company," *supra*), but the rule of thumb is the GOC joint venture ("Joint Venture," *supra*).[46] The GOC's desire to generate revenue from its nationalized land base is what motivates it to form the JV with the capital-rich, land-starved foreign investor.[47] Perhaps a more typical arrangement in which a foreign investor joint ventures with the GOC for a real estate development project would look more like Figure 1.[48]

Figure 1. Possible Structure of Real Estate Deal

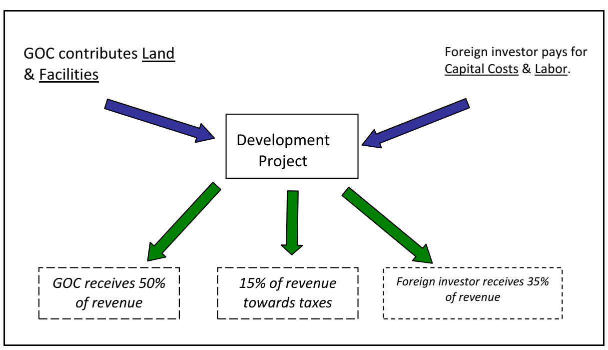

Table 1. Possible Structure of Real Estate Deal

Foreign investors may participate in Cuban Real Property in three ways:

1. **Separate Entity/Joint Venture:** Foreign investors from a Cuban commercial company and JV between themselves and national investors.
2. **International Economic Association contracts:** Foreign investors participate in individual contracts between themselves and national investors in which a joint venture is formed but one without the "establishment of a legal entity distinct from the parties."
3. **Wholly-owned Foreign Company:** Foreign investors from a commercial entity capitalized by their foreign capital and without the involvement of any national investor.

Under the arrangement in Figure 1, the GOC still owns the land, thus, a willing foreign developer's primary pecuniary motivation would be cash flow. In this regard, the GOC clearly wishes to promote development for productivity's sake and discourage land speculation. Perhaps recognizing that most developers would be deterred by such an arrangement, the GOC permits the foreign investor to repatriate 100 percent of his after-tax profits.[49] The ability to return hard capital provides at least a modicum of risk mitigation against the highly unpredictable nature of this "Frontier Market" investment.

There are several examples of the above arrangement currently at play in Cuba. For instance, a Cuban-Canadian joint venture called VanCuba Holdings, S.A., contracted to build 11 hotels where the GOC contributed land as its 50 percent share of the project,

43. *Id.*
44. *Toward a Culture of Nature*. 89, 1–149.
45. Art. 2, Law No. 77 (*Toward a Culture of Nature*. 87, 1–149).
46. *Cuba Today and Tomorrow: Reinventing Socialism*. Azicri, Max. University Press of Florida: 2000. 220, 1–416.
47. *Id.*
48. *Cuba's Hesitant Dance with Economic Freedom*. DeYoung, Karen. *International Herald Tribune*. July 25, 2000. *Indian Tractors, Cuban Cigars*, Chronicle Staff. *Latin Business Chronicle*. March 6, 2009.
49. *Id.*

while the Canadian partner had to pony up $400 million.[50] Unfortunately, establishing a fair appraisal method of the land's value is no easy task. (In situations where the land value is below 50% of the value of the capital and labor costs, some developers have been able to get the Central Bank of Cuba to cover the difference by lending at low interest rates to the Cuban counterpart.[51])

One foreign company that has emerged as the market leader in JVs with the GOC is *Sol Melía*. This Spanish hotel chain currently runs 22 facilities with about 40,000 rooms from coastal areas such as Varadero, Cayo Guillermo, Cayo Coco, Cayo Largo as well as in Havana and other cities throughout the island.[52] Just to give some perspective on the relative magnitude of *Sol Melía's* investment, in 1999 there were 30,000 rooms in *the entire country* of Cuba.[53]

Passive Investment Opportunities: Foreign investors not wishing to develop the property but still participate in investment in Cuban land may also have options. As in many Communist nations, "ownership" takes the form of a transferable long-term land lease (e.g., 50 or 99 years).[54] An example of one such investment opportunity is the Carbonera Club, part of the Cuban Golf Resorts, a joint venture of UK based Esencia Hotels & Resorts Ltd and GOC-owned Palmares. The Carbonera Club project will combine the design talents of an award-winning team of PGADC golf course designers, Spanish architect Rafael de la Hoz, Italian architectural firm OneWorks, elite Spa managers Six Senses and UK designer Terence Conran.[55]

The Carbonera Club, when built, will include a hotel and spa, a beach and water sports club, a tennis club, an eighteen-hole golf course and use of the Varadero Yacht Club, and will consist of 720 properties consisting of private villas, one, two and three bedroom apartments and Conran residences spread over 170 hectares on the north coast of Cuba.[56] The project is located approximately 40 miles from Havana.

In researching this project, I happened upon another such opportunity near the infamous Guantanamo, Cuba. The ad was for 24,000 acres of "Sugar Estates"; the asking price, $48,000,000.[57] Although the ad states, "the successful transaction will convey clear title and eliminate conflicts with any government transactions," a foreign investor permitted to participate in such need be extremely cautious.[58] This ad serves as a good opportunity to discuss a particular kind of danger in real estate investment in a frontier market like Cuba—uncertainty of title—as well as to examine additional significant real property laws.

OTHER IMPORTANT REAL PROPERTY LAWS

Land Use

A project is made or lost at the hands of those with authority over plan approval. In Cuba, it is no exception. If the developer can get his business vehicle—e.g., a joint venture with the GOC—approved by the Ministry of Foreign Investment, that Ministry in

50. *Id.*

51. *Id.*

52. *Granma Internacional*. March 18, 2004; *Toward a Culture of Nature*. 89, 1–149.

53. *Id.*

54. *Id.*

55. *Carbonera Club Opens Application Phase for New Vacation Resort in Cuba*. Sequin, Rob. *Havana Journal*. November 24, 2008.

56. *Id.*

57. *Property Description*: "Two prime sugar cane producing estates. Each property totals approximately 12,000 acres located near Guantanamo Bay, Cuba. Over the period 1950–1958 one estate produced an annual average of 184K tons of raw sugar and 617K gallons of black strap. The average price of comparable U.S. sugar producing agricultural land is approximately $9,000 to $10,000 U.S. dollars per acre. The asking price of $2,000 U.S. dollars per acre is calculated to consider the geopolitical circumstances and condition of the physical plant. Estates may be sold separately or together. Minimum is: $24,000,000.00 U.S. Dollars for each estate. Will consider reduction for purchase of both."

58. *Id.*

turn will submit the project to the Ministry of Science, Technology and the Environment (CITMA).[59] CITMA will then determine if an environmental impact assessment (EIA) needs to be undertaken. If deemed necessary—and 1/3 of all projects proposed to the Cuban inspection and environmental control agency typically require it—an EIA need be undertaken upon siting of a project.[60]

A developer should note that North American land use regulation differs "notably" from its Cuban counterpart, according to W. Paul Rosenau, principal of EKISTICS Town Planning, Inc., a Canadian company involved in development work in Cuba.[61] There is little consistency in standards or previously allowed exceptions.[62] Like many developing nations, all things become "negotiable." Rosenau advises the GOC enact Havana's "comprehensive land use, zoning, and master servicing plan before further 'market-driven' real estate development occurs."[63] With this in place, Rosenau adds, there is no reason Havana cannot become a "sustainable" city for the inhabitants, landscape, culture and "commerce that provides its future prosperity."[64] Until that time, however, the developer experienced in the political arena will have a far greater chance of success especially when it comes to negotiations with the GOC and CITMA.

Zoning

Due to the abundance of development opportunities along the coastline of the island, the GOC passed Decree-Law No. 212 in 2000.[65] Required setbacks, per the law, are stipulated as follows: 20 meters from beaches, coastal cliffs or "river mouths" and 40 meters from beaches with sandbar or dunes, low coasts, or "fragile coastal zones."[66] In the end, it seems foreign investment in Cuba can be profitable if one understands the somewhat byzantine rules. (As one Canadian tourist consultant remarked: "Doing business in Cuba is a license to print money for Canadians."[67]) However, the pragmatic international real estate investor must weigh those potential gains against several key risks: unclear title, political capriciousness and currency volatility.

RISKS PARTICULAR TO FOREIGN INVESTMENT IN CUBA

Third-party Creditor's Rights

Regardless of whether a foreign investor decides to make a passive investment or partake in a joint venture development project with the GOC, he or she will have to face a very unpleasant fact: someone other than the seller may have a rightful claim to that land. After the collapse of Soviet rule and subsequent reinstating of private property rights throughout Europe, third parties emerged from the proverbial woodwork to demand their rights be recognized.[68] Unfortunately, many of these claimants emerged *after* a foreign investor had purchased the property from the current tenant.[69] There is little doubt similar challenges will occur in Cuba, where an alleged $2

59. *Toward a Culture of Nature*. 90, 1–149.

60. *Id*.

61. *Flirting with Capitalism.* 101, 98–103.

62. *Id*.

63. *Id*.

64. *Id*., 103.

65. *Toward a Culture of Nature*. 91, 1–149.

66. Art. 4, § 1 Decree-Law 212, 2000

67. *Flirting with Capitalism.* 98, 98–103.

68. *Restitution of Property in Cuba: Lessons Learned from Eastern Europe*, Harper, G. Douglas. Article published in *Cuba in Transition*. http://lanic.utexas.edu/project/asce/publications/proceedings/annex2.pdf

69. *Id*.

billion[70] worth of US-owned land was expropriated in 1959 from Americans who lost businesses and land in "the largest uncompensated taking of U.S.-owned properties ever."[71] As an attempt at making such claimants whole, in 1972 the United States Foreign Claims Settlement Commission (created pursuant to 22 USC 1622) permitted those believing to have rightful ownership to confiscated Cuban property an opportunity to submit claims.[72]

Disgruntled former land owners submitted nearly 10,000 claims to the Commission.[73] The Commission, to determine the value of the claims, took into account: "the basis of valuation most appropriate to the property…including but not limited to, (i) fair market value, (ii) book value, (iii) going concern value, or (iv) cost of replacement."[74] To compensate these individuals,[75] the Commission determined that the GOC would incur debt equivalent to the values determined case-by-case according to the aforementioned criteria. As of 1991, the GOC owed nearly $8 billion to these claimants.[76] In reality, the odds of a post-Castro GOC paying off this debt are slim. The more than 5,000 U.S. citizens and 898 companies that have pending claims with the U.S. Foreign Claims Settlement Commission are unlikely to be made whole by the GOC.[77] This is particularly important as many embittered former Cuban land owners will likely seek compensation—if not the land itself—in the event of a shift in private property rights.

The likelihood of a tsunami of claims for confiscated property made by unknown third party creditors following a post-Embargo Cuba is great. Mr. Freyre points out that what may compound matters is that it is unclear whether an individual who had legal title to a property *prior* to 1959 but who was permitted by the Castro regime to remain in that same home and continues to live there today has a title "grandfathered or by operation of law they are living in state property."[78] Jaime Suchlicki, director of the University of Miami's Institute for Cuban and Cuban-American Studies, astutely predicts that "any future government in Cuba is going to have to recognize private property and do something about the property that was confiscated."[79] (As an aside, Suchlicki believes the lawyers will "make a fortune" from the impending tidal wave of lawsuits associated with American companies and Cuban companies battling over land title.)[80] The takeaway is that any potential investor needs to perform extraordinary due diligence (or possess a Herculean risk appetite) before taking the plunge. Or, perhaps, to follow the advice of Robert C. Helander, Esq., former Managing Partner at Kaye, Scholer law firm in New York and head of their Latin America/Emerging Markets group: "investors might be wise to buy the rights of former owners to avoid problems in the future."[81]

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70. 22 USC 1643(b)

71. *How to Invest in Cuban Real Estate—Wait*. Eaton, Tracey. *The Dallas Morning News*. February 22, 2005.

72. *Id*.

73. *Id*.

74. *Id*.

75. It is interesting to note that OfficeMax, Inc. holds what has been the largest single U.S. claim against the GOC for confiscated property via its ownership of a majority stake in Cuban Electric Co., the main pre-Castro electricity system. *Businesses Hold Few Hopes of More Trade Soon*, Dade, Corey. *The Wall Street Journal*. February 20, 2008.

76. *Options for Retiring Cuba's External Debt*. Lasaga, Manuel. *La Sociedad Económica*. Pg. 2. March 4, 1993.

77. *Property Bonanza Awaits Investors in Post-Castro Era*. Eaton, Tracey. *CubaNews* (Newsletter). April 2005. Pg 14 of 16. Citing *CubaNews,* February 2005, pages 1 and 8–9.

78. Interview with Pedro Freyre: April 16, 2009. 11:45am–12:45pm PST.

79. *Property Bonanza Awaits Investors in Post-Castro Era*. 14, 1–16.

80. *Id*.

81. *Creditors' Rights: Claims against Cuban Confiscated Assets*. Helander, Robert C. 42, 37–44. As published in *Investing in Cuba: Problems and Prospects*. Edited by Suchlicki, Jaime & Jorge, Antonio. Transaction Publishers: 1994. 42, 1–176.

Political Capriciousness

There is a joke amongst foreign developers in China: why be upset when discovering a disadvantageous law passed at breakfast, when it will likely be amended by supper. The same may be said of Cuba today. The foreign investor need be acutely aware of the political uncertainty of the GOC. An ostensible lack of legal protection has dissuaded several established developers from carrying out large-scale, sophisticated projects.[82] As a result, the GOC has had to accept much smaller projects by less-experienced developers willing to trade high risks for lower rewards.[83] The higher risk is clearly associated with the unpredictable nature of the GOC's decision-making.

Take the "Havana Palace" project as a prime example. This 73–unit condominium building with pool and garage was nearing completion in the upscale Miramar section of the Cuban capital.[84] Designed to be sold to foreigners with business interests in Cuba, or those merely looking for a Caribbean *pied-a-terre*, it was one of 17 projects being built under a joint venture construction program authorized by the Cuban government in 1997.[85] However, just before the project was to be completed, the GOC suddenly prohibited any foreigner from buying the units.[86] A similar project in the area—the Monte Carlo Palace—had experienced a 30 percent increase in profits from re-sales with original starting sales prices at a whopping $1450 per square foot.[87] Perhaps sensing an opportunity to capture some of those riches, the Ministry of Foreign Investment and Economic Cooperation said all but a handful of the approximately 2,300 units in the foreign-financed initiative would be purchased by the government and then rented to approved foreign visitors.[88] What is particularly alarming is that the developer was not consulted and suffered significant losses due to this unexpected breach.[89] Accustomed to a different kind of political system, it is unlikely the developer built in such contingencies in his pro forma. In short, anyone interested in participating in a Cuban real property venture need expect the presence of a predictably unpredictable political regime.

THE DOUBLE-EDGED SWORD OF CURRENCY VOLATILITY

Unlike the two aforementioned risks, currency volatility can actually work to the investor's advantage. "Location, location, location" may be the bromide of choice for all domestic real estate investors, but when it comes to investing in real estate on foreign soil, "exchange rates, exchange rates, exchange rates," may be the proper mantra. The following two hypothetical investments illustrate the double-edged sword nature of currency volatility:

Property X: A high rise Shanghai condo is purchased in 2002 for $1 million USD (or 8.3 million RMB). By 2009, on currency appreciation alone, it would be worth $1.21 million or 21% more in value. In this scenario, a property could be sold for 10% less than the purchase price and still yield a double-digit gross profit.

Property Y: A high rise London flat is bought in spring of 2008 for $1 million USD (or 500,000 GBP). Based on currency depreciation alone, it would be worth $700,000 less one year later and would require the seller to offload the property at least 42% higher than original purchase price just to break even.

82. *Flirting with Capitalism.* 102, 98–103.
83. *Id.*
84. *Id.*
85. *Id.*
86. *Cuba's Hesitant Dance with Economic Freedom.*
87. *Flirting with Capitalism.* 102, 98–103.
88. *Id.*
89. *Id.*

Of course, both above scenarios assume a conversion and repatriation of funds in USD.[90] Unless one must repatriate funds—e.g., to service a debt or distribute profits—it may not be necessary to convert from the local currency to USD. However, lacking this flexibility may deter many an investor from speculating in the foreign investment. Of course, as Professor Kenneth Froot of Harvard Business School points out, currency hedges may be available for added protection but will increase transaction costs.[91]

Understanding currency fluctuations is likewise important for the foreign real estate developer participating in a joint venture with the GOC. The profitability of the foreign investment—for instance, a hotel resort outside Havana—may depend heavily on the currency in which revenues are earned and expenses are paid. Typically, hard currency is earned by the JV, and imported inputs (e.g., construction materials) are purchased from those earnings.[92] The remaining proceeds are then used to buy domestically supplied inputs (e.g., labor) and to allocate the profit to the GOC and foreign partners.[93] The JV must pay its domestic expenses in the local currency of pesos at a negotiated exchange rate.[94] Ultimately, these negotiated rates can make or break an investment's returns.

In short, there are several risks associated with investing in a volatile frontier market such as Cuba. Some of these risks would be found in any international real estate investment. Whether the participant is investing passively by purchasing condominium units in an existing development or is participating in a joint venture with the GOC, the key risk associated with Cuba is uncertainty. The next section explores the possibilities of change in Cuba and specifically seeks to determine if this future will mean more or less certainty.

FINAL THOUGHTS: THE ENGINE OF FUTURE RETURNS?

Until major reforms are made in Cuba by the GOC and US politicians, US citizens will be banned from participating in real property opportunities and Cubans and other foreigners will have very limited access. However, if specific reforms are made, the likelihood of an investor experiencing returns akin to Estonia or Vietnam may be very high. The primary driver of that development will be the same engine that the Castros jumpstarted during the "Special Period" to prevent their economy from collapsing: tourism.

In April 2009, in addition to removing ceilings on remittances, President Obama lifted restrictions on travel for Cuban-Americans wishing to visit relatives on the island.[95] This was an important move and one that might signal further policy changes. If Obama enacts a law to allow *all* US citizens to travel to Cuba, the impact on Cuban tourism numbers may be startling. In fact, some speculate that were the Embargo and accompanying travel ban removed, Cuban tourism numbers would increase *six-fold* from approximately 2 million per annum to 12 million.[96] This increase may seem far-fetched; however, when you consider the proximity of Cuba to popular tourist destinations such as Cancun (approx. 100 miles), Jamaica (approx. 100 miles) and the Florida Keys (approx. 90 miles), you realize that this prediction may

90. (1) Based on spot rate of 6.83 RMB to $1.00 USD. (2) Historical exchange rates of RMB at 6.85 to $1.00 USD as of March 17, 2009 vs. 8.28 to $1.00 USD in March 2002. (3) Historical exchange rate of GBP:USD at approximately $2.00 USD to £1.00 as of March 17, 2008 vs. $1.40 USD to £1.00 on March 17, 2009.

91. Froot, K. A. "Currency Hedging Over Long Horizons." Working Paper, No. 4355, National Bureau of Economic Research, 1993 (Featured in the NBER Digest, October 1993.)

92. *Foreign Investment Opportunities in Cuba: Evaluating the Risks*. Jorge, Antonio & Cruz, Robert David. 30, 17–42. As published in *Investing in Cuba: Problems and Prospects*. Edited by Suchlicki, Jaime & Jorge, Antonio. Transaction Publishers: 1994. 30, 1–176.

93. *Id.*

94. *Id.*

95. *Cuban-Americans Favor Obama's Shift in Policy.*

96. *Flirting with Capitalism.* 102, 98–103.

have some merit. Naturally, general economic growth—including real property appreciation—may follow.

CONCLUSION

Walking along the beach last night
who do you think I spy?
A girl with ebony fire eyes.
Soft and low do she cry.
Now what could be such a source of pain?
I so boldly inquire.
Pointing finger Havana way,
these three words which transpire:
She told me that only in Miami
is Cuba so far away.[97]

We are at a very intriguing crossroads. Cuba-US relations could turn dramatically positive over the next few years, stay the same, or grow increasingly sour even after lo these many years. As this paper explores, there are signs or "objective manifestations," as Pedro Freyre describes them, of positive changes. The GOC, however, struggles with its future identity. Since taking over for his brother, Raúl Castro has visited Russia, China and Vietnam.[98] Naturally, he has touted the similarities between his ambitions for Cuba and Vietnam's own stance: "moving toward a market economy that provides a higher standard of living for its people without relinquishing an iota of power embedded in one-party rule."[99] Yet, perhaps—subconsciously or otherwise—he knows that for Cuba to progress in the 21st century it can follow a path like Vietnam's. Interestingly, Cuba and Vietnam were 64th and 62nd respectively in terms of GDP in 1994 after the fall of the Soviet empire.[100] Today, Vietnam's economy is growing at a torrid pace of 8 percent annually, and in 2007 saw more than $18 billion in FDI—one of the highest totals in the world as a percentage of GDP.[101] Will Raúl seek to follow Vietnam's lead and bury the hatchet as so many have done who suffered in the "American War"?[102]

Were legislation passed allowing ownership of private property in Cuba, the vast majority of American developers and property investors would likely still hesitate. However, with the high levels of risk associated with domestic investments on US soil, commensurate returns become all the more appealing even for frontier markets. In other words, were one to have the same risk developing land in Riverside, California as in Havana, Cuba, but expected returns being tenfold with the latter, the appeal of investing in Cuba becomes that much greater. Philip T. Fitzgerald, managing director for emerging markets at Los Angeles-based Paladin Realty Partners LLC, recently said: "The U.S. is now an emerging market."[103] If U.S. real estate begins to have the risk associated with emerging markets but the modest returns associated with safer investments, how might that impact the kinds of risks investors might make? Take Blackstone for instance: the Private Equity group recently closed a $10.9 billion dollar fund in 2008 with a significant portion earmarked for "global investing."[104] Since going public, pressure for growth by Wall Street has likely caused the Blackstone executives to consider more than U.S.-distressed real estate assets. In April of 2009, their stock was down 90% from its IPO price of $35 back in the company's heyday of 2007.[105] When you consider the ostensible demand for housing that Cuba has today, as well as the dire need for significant infrastructure improvements, the island is a potentially viable play.

97. *Only In Miami,* Lyrics by Midler, Bette. Atlantic Records. 1993.

98. *Between Hanoi And Havana.* Castañeda, Jorge. *Newsweek*. Aug 4, 2008.

99. *Cuba's Diplomatic Paradox*, Castañeda, Jorge. *The Wall Street Journal*, December 27, 2008.

100. *CIA World Factbook*. http://www.theodora.com/wfb/1994/vietnam/vietnam_economy.html

101. *Between Hanoi And Havana.*

102. "American War": how many of the Vietnamese people refer to the "Vietnam War."

103. *U.S. is Now an Emerging Market*, Karp, Jonathan; Hudson, Kris and Troijanovski, Anton. *The Wall Street Journal*, October 29, 2008.

104. *Blackstone Raises a $10.9 Billion Fund*, *The Wall Street Journal*, April 1, 2008.

105. http://www.marketwatch.com/quotes/bx

Blackstone may have to keep its powder dry for some time. For it should be understood that a transition from mortal enemies to bosom buddies does not take days. Truthfully, it may take decades. A casual stroll down the *Malecón*, which borders the Havana coastline, will provide one views of hundreds of gleeful kids playing stickball in the streets. But the tourist is shielded from the underlying animosities inculcated over decades of anti-Westerner indoctrination coupled with a kind of inevitable envy or distaste for all that the West might represent: hyper commercialism, environmental destruction, greed, severe class differences, imperialism, exploitation, racism and the like. Communism even with its countless flaws has proven that it can educate its people: Cubans are literate, accustomed to quality medical care and able to contemplate complex ideas. It is not unusual for a bus driver to debate abstruse political concepts. This same bus driver—intellectually curious but lacking a more lucrative marketable skill—may find himself a lost man in a post-embargo Cuba as he is habitually subjected to throngs of drunken tourists accustomed to a different set of cultural norms.

Like our hypothetical bus driver, those first few brave American real estate developers and investors who seek to build a new Cuba will struggle. For they will have to overcome a kind of invisible force that pervades every crumbling building sited on multi-million dollar beachfront property along the *Malecón.* That force of resistance emerges against the developer's yearn to see a Starbucks on every corner and a Wal-Mart on the outskirts of every new subdivision. The temptation will be to make Cuba into Florida, Havana into Miami. But American developers and GOC urban planners alike will both have to balance the increasingly more serious need for infrastructure and housing against the threat of destruction of a pristine coastline and cities chock full of exquisite architectural gems. That modern development effectively halted in 1959 and changed little over the ensuing 50 years left us "in effect with a much more interesting, pristine environment than we would have had."[106] Bonnie Burnham, President of the World Monuments Fund, argues by a funny kind of twist of fate, the *lack* of funds necessary for developers to turn Havana into Miami was what prevented such a transformation not necessarily a lack of desire for better housing.[107]

As the song goes, only in Miami, just 230 miles apart, is Havana "so far away." Today, it is "so far away" ideologically, economically, culturally. This is, perhaps, the strange intrigue that we have with our neighbor. There are nations that call themselves democratic, capitalistic, allies of the United States, yet they are thousands of miles away. Time zones and distances can place strains on otherwise strong business relationships. However, like Jay Gatsby, staring fondly at the blinking green light of the island of West Egg, we stare off at Cuba and wonder what may be. We stare out past the Florida Keys or from the shores of New Orleans and wonder if one day that invisible bridge will exist that will be built on a bridge of communication and the free exchange of ideas and commerce. And the millions of us who are removed from the macro decisions of policymakers and politicians, wonder when this bridge will be built because we know that once it is erected the likelihood of real property opportunities will be incredible. And like Gatsby, we, as Americans stare out at Cuba and believe "in the green light, the orgiastic future that year by year recedes before us," while, perhaps, simultaneously, others gaze fondly in our direction standing on the shores of an island not so far away.[108]

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106. Burnham, Bonnie. Lecturer for panel entitled, *Cuba on the Brink: The Next Great Development Opportunity*. Held at the *Urban Land Institute's 2008 Fall Meeting*. Miami, Florida.

107. *Id*.

108. *The Great Gatsby*, Fitzgerald, F. Scott. Scribner: 1925. 20, 186.