

Real Estate Investment Opportunities in Cuba

by

Jason Lawrence Addison

Bachelor of Commerce
Finance & Real Estate
McGill University
1994

Civil Engineering Technology
Project Management
Dawson College
1992

Submitted to the Department of Urban Studies and Planning
in Partial Fulfillment of the Requirements for the Degree of
Master of Science in Real Estate Development at the
Massachusetts Institute of Technology

July 1996

[September 1996]

© Jason L. Addison 1996

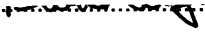
The author hereby grants to M.I.T. permission to reproduce and to
distribute publicly copies of this document in whole or in part.

Signature of
Author.....



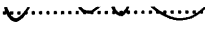
Jason Lawrence Addison
Department of Urban Studies and Planning
July 31, 1996

Certified
by.....



Blake Eagle
Chairman, MIT Center for Real Estate
Thesis Supervisor

Accepted
by.....



Professor William Wheaton
Director, MIT Center for Real Estate

Interdepartmental Degree Program in Real Estate Development

MASSACHUSETTS INSTITUTE
OF TECHNOLOGY

SEP 16 1996

Rotch

LIBRARIES

REAL ESTATE INVESTMENT OPPORTUNITIES IN CUBA

by

Jason Lawrence Addison

Abstract

Cuba is one of today's controversial topics discussed within circles of real estate developers and investors. However, due to a seemingly everlasting embargo and recent toughening of sanctions imposed by the US, including the signing of the controversial Helms-Burton Law, many would be investors are being held at bay. This and other events have created opportunities for nations such as Canada, and those within the European Community and Latin America to test the water before what many believe will be a tidal wave of participants following the inevitable normalization of relations between the US and Cuba.

Recently adopted, and proposed, political and economic reforms within Cuba have made significant inroads in attracting foreign interest. It appears these reforms offer new opportunities to western participants who are considering real estate joint ventures. The feasibility of these opportunities will be explored through an analysis of real estate development versus the inevitable constraints imposed by a steep learning curve described by Dr. Raul Brito Salvador, Director of Negotiation for the Gran Caribe Hotel Group and Joint Professor of Commercial Law at the University of Havana, in his attestation that the real estate industry is a very recent discovery in Cuba, and which they are now learning and trying to develop at the same time. Through research conducted to date, feedback has led me to conclude that the Republic of Cuba has a limited real estate professional capacity. This impression has been formed through discussions with authorities on foreign investment in Cuba including: Cuban policy-makers, officials of Cuban companies, ministers and vice ministers, Cuban and American based lawyers and economists, North American real estate and hospitality advisors, foreign corporations in Cuba, and academics from the University of Havana, and abroad.

Therefore, an in-depth study of Cuba's real estate industry, placing the emphasis on a comparative of capitalistic and Cuban approaches, will provide the framework for discussion of what real estate joint ventures as well as 100% foreign-held ventures have to offer to foreign participants. This paper will identify the investment process, including procurement of necessary governmental approvals. Drawing from research in Cuba, this study will illustrate the logistics associated with establishing and operating joint ventures in Cuba.

It will be my primary objective to address the following questions within the body of my master thesis: Within the frame-work of the existing investment and development process in Cuba, why have real estate joint ventures become popular? What incentives exist to attract foreign real estate developers to Cuba? What do joint ventures offer both the Cuban and foreign partners? What reforms have been adopted to encourage foreign investment, and are they sufficient to meet their objectives? To a foreign real estate developer, what are the specific problems associated with completing a real estate project in Cuba?

Research on this topic began in November 1995, while field-research began in May 1996, with three intensive visits to Cuba to conduct interviews with policy-makers, academics, political figures, high-ranking officials of Cuban companies authorized to form joint ventures with foreign entities, independent lawyers and consultants, and persons involved in the planning of urban development in Cuba. A significant amount of information has been collected through contacts made at: the "***American Business and the Cuban Economy Conference***," held at Harvard University, December 14, 1995; the "***US / Latin American Hotel & Resort Development Conference***," held in Costa Rica from January 29-31, 1996; the "***Real Estate and Investment Opportunities in Latin America and the Caribbean***," sponsored by the Urban Land Institute in Miami on March 4-5, 1996; the "***International Property Markets Conference***" sponsored by MIPIM in Cannes, France, March 14-17; and the "***Corporate Counsel Cuba Conference***," sponsored by the Cuba Report,

March 29-31, 1996, in Boca Raton. From May 7-9, I participated as a guest-speaker on real estate issues related to Cuba at the "***Foreign Investment and Economic Development in Cuba Conference***," held in Havana, co-sponsored by McGill University and the University of Havana. During my visits to Cuba in May, June and July, I collected both quantitative and qualitative data from State agencies, Ministries, research facilities, the University of Havana, and foreign enterprises doing business in Cuba.

Acknowledgments

This paper would not have been possible without the cooperation and support of many people in Cuba. Special thanks go to the people of Wilton Properties, at their offices in Havana and Vancouver, Canada. Their financial support, and assistance in arranging interviews and other logistics was paramount in the success of this paper. For sharing their trials and tribulations on how joint ventures have materialized, I would like to thank Raul Brito Salvador, Miguel Solano, Ricardo Nunez Fernandez, Roberto Brier Rivero, Miguel Martin Pérez and Mario Travieso Garcia. It is their relentless pursuit of new challenges that has provided a frame-work to this unexplored territory. Finally, I would like to thank Marie-Pascale for her uncompromising support and encouragement.

Table of Contents

ABSTRACT.....	1
ACKNOWLEDGMENTS.....	4
TABLE OF CONTENTS.....	5
CHAPTER ONE.....	6
Introduction	
Statistics	
Brief Historical Overview	
Key Stages in Cuban Development	
CHAPTER TWO.....	15
The Impact Of The US Trade Embargo And Helms-Burton Law On Cuba’s Economy	
The US Trade Embargo	
The Helms-Burton Law and its Effects	
Economic Impact	
CHAPTER THREE.....	23
An Overview Of The Cuban Real Estate Market	
Historical Perspective	
Development Activity Over the Past 35 Years	
Residential Real Estate Market	
Commercial Real Estate Market	
Tourism-Related Real Estate	
Status of Cuban Real Estate Markets Summarized	
CHAPTER FOUR.....	35
Cuban Laws Governing Real Estate	
Historical Account	
Land Valuation	
Legislative Process	
Foreign Investment Laws	
Approval Process	
Economic Impact of Foreign Investment Laws	
CHAPTER FIVE.....	45
Real Estate Investment Climate for Foreign Investors in Cuba	
Autonomous State Agencies Authorized To Form Joint Ventures In Real Estate	
Laws Governing Joint Ventures	
Management & Labor Issues	
Profits, Taxes & Insurance Issues	
Case Studies	
Foreign Investment in the Tourism Sector	
Example of a Joint Venture Structure	
CHAPTER SIX.....	58
Conclusions & Recommendations	
The Real Estate Investment Climate in Cuba	
APPENDICES.....	68
BIBLIOGRAPHY.....	72

Chapter One
Introduction

Statistics

Cuba is the largest island in the Caribbean and the seventh largest in the world. Over 775 miles (1,250 km) in length, the island tapers from 118 miles (190 km) wide at its eastern head to 19 miles (30 km) at its western tail. Including the Isle of Youth and some 1,600 islets and cays, Cuba has an area of 42,827 square miles (110,992 km), about the size of Florida. Shaped like an alligator, its "spine" is no more than 90 miles (148 km) from Florida's Key West. The Bahamas float along its north-eastern coast. Mexico lies 131 miles (210 km) to the west, and the island's nearest Antillian neighbor, Haiti, is just 48 miles (77 km) to the east.

High mountain ranges, sub-tropical forest, deserts and savannah offer a variety of landscapes and the entire island is ringed by nearly 300 beautiful sandy beaches, numerous coral cays and large secluded bays. Havana, in the north-west, is the country's capital city and Santiago de Cuba on the island's south coast is its second city. The island has a subtropical climate, with a mean annual temperature of 77°F (25°C).

Cuba has a total population of around 11 million, with a median age of 26. Nearly 8 million Cubans are urban dwellers - living in Havana (2.1 million), Santiago de Cuba (420,000) Camaguey (286,000), Holguin (233,000) and smaller provincial cities. The following figures provide a comparative analysis of Cuba with the US.

Comparing Cuba and the USA

Source: CIA on the Internet

Cuba's labor force: 3.8 million, 61% male	US labor force: 132 million, 54% male
Average education: 10th grade	Average education: 12.7 years
One in 15 graduated from college	One in 6 graduated from college
One in 8 has a vocational/technical degree	One in 25 has a vocational/technical degree
Doctors: One for every 270 citizens	Doctors: One for every 400 citizens
Nurses: One for every 160 citizens	Nurses: One for every 100 citizens
Health care: 100% state paid	Health care: 46% state paid
Average monthly professional salary: 400 pesos, (\$16, at 25 pesos to \$1 street rate)	Monthly professional salary: \$2,720
Life expectancy: 75.6 years	Life expectancy: 75.6 years

Brief Historical Overview

In the 500 years since Columbus set foot on Cuba there have been several waves of Spanish adventurers who arrived on Cuba's shores expecting to make their fortunes and who decimated the indigenous population. These local Indians were replaced by a work-force of black slaves from the African continent which, over several centuries, mingled with the Spanish colonists to form the mixed race that are today's Cubans. By 1868, Cubans were eager to end Spanish colonial rule, igniting the Ten Years War with Spain. The war ended in a stalemate after taking some 200,000 lives. In 1895, the Second War of Independence erupted. By 1898, Washington had decided that Cuba was crucial to their country's strategic interest, looking for a justifiable excuse to intervene. The pretext for intervention by the US came on February 15, when the *USS Maine* - a battleship sent to protect American interests - mysteriously blew up in Havana Harbor, killing 260 people.

Following the Spanish-American War, Spanish colonization gave way to the United States, which instead of handing over to local nationalists, the US set up a military government to administer Cuba from 1898 to 1902, when independence was declared. Although US Congress passed an amendment to assure the world that they were not claiming sovereignty in Cuba, worried that radicals would take over an independent Cuba, it was widely believed that Cubans had traded one set of colonial masters for another. The US eventually agreed to withdraw its troops in exchange for

guarantees, under the negotiated Platt Amendment, that Cuba would remain an American protectorate. In 1902, Cuba began its compromised freedom only to be interrupted by American intervention on several occasions over the next several years. From 1906 to 1909 the US Congress reinstated US military rule, protecting over US\$100 million that had been invested over the same period.

The outstanding feature of Cuba's economy from the turn of this century was its dependence on sugar exports. The sugar industry employed more than one quarter of the labor force, occupied over 50 percent of the cultivated land and accounted for 80 percent of Cuban exports. Cuba's economic viability was dependent almost entirely on the US. During and immediately following World Wars I and II, Cuba experienced unprecedented economic growth. This was primarily due to the US focusing its production on the war effort and therefore causing the domestic production of sugar to fall. Supplying the US with sugar was Cuba's primary source of foreign receipts. As both the supply and price of exported sugar increased, a trade surplus with the US fueled an investment into machinery and real estate that would later shape the physical and economic infrastructure of Cuba.

Throughout the first half of the twentieth century, elections were regularly fraudulent, and corruption was rife. The spiraling decadence of Havana was aided and abetted by a series of increasingly corrupt, brutal and authoritarian regimes.¹ President Gerardo Machado's thirteen year reign of terror on those who dared oppose the regime ended in 1933 when a general strike was called; Machado hopped on a plane to Miami, supposedly carrying five revolvers and as many sacks of gold. In the ensuing chaos, Fulgencio Batista, a "persuasive talker" and colonel in the Cuban army, emerged as the dominant figure in Cuban politics.

¹ Bell, B. "*Insight Guides: Cuba*", Singapore: Hofer Press Pte Ltd, 1995

In 1934, comfortable with the direction of Cuban politics, the US government rescinded the Platt Amendment that guaranteed its power of intervention, instead the 47 square mile Guantanamo Bay US Naval Base on Cuba's south-east coast was re-negotiated and leased to them in perpetuity. Batista managed the government through a string of puppet presidents until he was elected as president in 1940. Batista returned to power, after a brief hiatus with a bloodless coup in 1952.

The prohibition years were the catalyst to American Mafia influence over Cuban domestic politics. It became evident in 1938 when Batista invited Meyer Lansky, the Jewish godfather from Miami, to take over operations of two casinos and a racetrack. Later in 1953, Batista would appoint Lansky as his personal adviser on gambling reform. The Mafia saw this as an opportune way of earning cash receipts in a perfectly legal arrangement. Meanwhile, as Cuba evolved into the playground for the American tourist, exploitation of labor became prevalent. Educated Cubans gave up their careers as doctors and engineers for much more lucrative work as croupiers.

Under Batista, a small elite enjoyed a luxurious lifestyle, while the majority of the rural population endured appalling poverty. Many Cubans were disgusted with the levels of corruption, seeing Cubans sleeping on the sidewalks outside the opulent Mafia-run casinos. Few Cubans had running water, electricity, or access to health care and education. In 1953, a young lawyer named Fidel Rul Castro concluded that an armed uprising was the only way to end the dictator's reign. A successful Revolution would eliminate the corruption, oppression, and inequality.

In 1953, the Rebel Army, seeing themselves as warriors of the common people, set out to infiltrate the country with their revolutionary ideas. On January 1, 1959, following several years of guerrilla attacks on Batista's army, Castro began his victory drive across Cuba. The Revolution's objective was best summarized in a statement made by Fidel Castro on February 10, 1959.

"I think this is one of the lands with the greatest natural wealth. The thing is that at the present time the sugar mills have certain advantages. Within five months we will have those advantages. They [the foreign owners] think that we are a small nation and perhaps a cowardly one. They think that, faced with the enormous

power of the country from which they come [the US], we will have to give in to their whims and insolence; they think we are fools and that we are going to do foolish things. A few have all the privileges, while the others, the vast majority, have all the misery. The worker is the main creator of wealth, not the capitalist sitting in a comfortable office on Wall Street. The Revolution will end all that."

In the spring of 1959, Castro declared himself the prime minister of Cuba.

The Castro regime inherited all the problems of a static economy (of some five million people). Throughout the 1950s, the balance of payments with the US showed a negative figure on Cuba's side of \$1.0 billion. Foreign investments and almost total foreign trade was with the US. Limited by US imposed quotas, about 50% of Cuba's annual sugar production was sold to the US, resulting in Cuba having received more income from the US than it did from the world market. The elimination of quotas would have resulted in the US having to pay the lower world prices for sugar. This would have eliminated domestic production in the US, a production that received a high subsidy. Cuba would then have sold to the US not 3 million but 7 million tons, and the world price would have fallen significantly, due to the elimination of inefficient and expensive producers. The US had significant control over Cuba's economic destiny through its holdings within Cuba and through its powerful influence over the price of sugar. As it was apparent Castro did not have the same agenda as his predecessor, Batista, the US began to feel compromised.

Oil exploration by large American oil companies (some \$25 million invested over twenty years) showed signs of considerable future potential in 1955 when production rose to 300,000 barrels a day. In 1959, the Castro government created a Cuban Institute of Petroleum (INRA), setting the government's share of any oil at 60 percent, based on the value of production at the source. The government reserved the right to acquire all or part of the oil production, given its oil imports at \$50 million per year. The foreign companies, unable to accept these measures, ceased all operations. Cuba then nationalized the oil companies in 1960, placing Cuba on a collision course with the US.²

² Gilbert, Roger, "*Cuba's Economy and the United States*", Essay, Montreal, 1996

In 1960, the governments of the Soviet Union and Cuba arrived at a long-term commercial agreement guaranteeing the security of the Cuban economy from the unfavorable consequences of the fluctuations of the price of sugar on the world market and from the economic influence of US monopolies. Cuba had spent on the purchase of US products not only all its income derived from sales to the US but also 20% more. In the agreement struck with the Soviet government, Cuba had to spend the bulk of the income derived from sales to the Soviet Union on Soviet products, however, this resulted in Cuba possessing a favorable amount of dollars in its balance of payments with the Soviet Union. The trade surplus amounted to 20% of the total value of its exports to that country.³ With a significant improvement over the trade agreement Cuba had with the US, Cuba would begin its climb from a static economy to a short lived economic prosperity.

Prior to the Revolution, Americans controlled 90% of the public utilities, owned over 40% of the sugar industry and 165 major companies. The beginning years of the Castro government saw a redistribution of the wealth through confiscation and expropriation of foreign owned industries and property. These maneuvers resulted in the US imposing a trade embargo, severing economic and political ties with Cuba. Whether the embargo was economically motivated and/or intended to address the interest of national security, has been hotly debated during the past three decades. The extent of dislocation to Cuba's economy was catastrophic. The lack of spare parts for machinery, automobiles, trucks and rail transport, and a significant drop in tourism, gave Castro no alternative but to turn to the Soviet Union as an economic ally.

Key Stages in Cuban Development

In more recent times, the situation within Cuba can be illuminated through four stages of the Cuban Revolutionary Project: the initial period which gave rise to a model of socialist self-government (1960-1970); a period of assimilation and partial adoption of the Soviet socialist model (1971-1985); a period in which the attempt was made to redefine its own model based on new guidelines (1985-

³ Franqui, Carlos, *Family Portrait With Fidel*, New York: Random House, Inc., 1984

1990); and the present period of internal reorganization which aims at providing for Cuba's re-entry into the international economy (1991-present).⁴

The initial period saw the creation of a low-income housing program, free health care and education available to all. The Soviet Union provided economic and military support that measured in the billions. During the 1970s, Cuba built roads throughout the countryside and built low-rental apartments. By the early 1980s, Cuba's productivity, health care, social services and education began deteriorating. Discontent among Cubans led to over 125,000 Cubans fleeing in 1980 for the US. By the late 1980s, Cuba had accumulated several billion dollars in debt to the Soviet Union.

In the early 1990's, many observers spoke of the imminent collapse of the Cuban Revolution. In 1991, with the breakdown of the Eastern Communist block, political and economic relations between Cuba and its former allies were abruptly and drastically cut back. Cuba was no longer receiving shipments of oil priced far below OPEC prices. It could no longer sell its sugar at inflated prices, and the financial aid that represented one-half of all Soviet aid to the third world had all but dried up. The early 1990s witnessed food rationing, and regular occurring black-outs. During the summer of 1995, an additional 35,000 Cubans fled to the US. Within a complex global situation, Cuba has had to face an unprecedented economic crisis, one which forced a comprehensive reorganization of its domestic production with its reintegration into the international economy.

As it had been determined in 1989, before the collapse of the Eastern block, close to 85% of the Cuban trade was carried out with this group of countries, but by 1993 the Soviet Union (COMECON nations) accounted for only 20% of Cuban trade. Importation of oil alone decreased from 13 million

⁴ Gonzalez, Elena Diaz, "*The Quality of Life in Cuba's Special Period: Examining the Life of US Policies*", FLASCO-CUBA, 1995, pg. 12

tons in 1989 to 6 million in 1992. From 1989 to 1993, GDP declined from a base level of 100% to 65% respectively.⁵

On account of the US blockade, there is no longer an alternative market available that can offset the loss. In April 1994, vice-president Carlos Lage told an exiles' conference that the US embargo has cost Cuba \$41 billion since 1962. Faced with this situation, the Cuban leadership declared the "Special Period in Times of Peace," by implementing measures to respond to the new situation and to prepare for any possible foreign attack. "*Cuba will no longer become dependent on one trading partner, rather it will diversify and distribute trade over several countries, limiting bi-lateral trade to 30 percent with any one nation.*"⁶

Since 1991, Cuba has given priority to economic management and the development of a mixed economy based on the promotion of foreign capital investments, cooperatives and mixed enterprises. Under this strategy, which had been anticipated by Foreign Investment Law No. 50 adopted on February 15, 1982, and endorsed and expanded in 1992, and more recently in September of 1995, as Foreign Investment Law No. 77, Cuba is offering certain advantages to foreign investors, including free remittance of profits abroad and/or tax-free gross profits. Prior to 1982, foreign investment was not permitted under Cuban law, and the lack of guarantees and incentives made it unappealing to foreign investors until these issues were finally addressed in 1992 and in 1995.

Cuba began seeking foreign association in the areas considered most useful to its national interests such as tourism, basic industry, iron and steel machinery, materials for construction, textiles,

⁵ In the speech of Alfonso Casanova, Vice Minister of the Economy, at the McGill University & University of Havana co-sponsored workshop on Foreign Investment and Economic Development in Cuba, Havana, Cuba, May 7-9, 1996

⁶ Alfonso Casanova, Vice Minister of the Economy

agriculture, pharmaceuticals, mining of natural resources, and petroleum prospecting. The objective was to reactivate economic production by stimulating the injection of foreign capital.

This paper, politically neutral, will analyze the evolution of laws and policies towards property markets in Cuba, focusing primarily on what opportunities exist for the foreign real estate developer / investor considering today's economic, legal, political and social environments.

Chapter Two

The Impact Of The US Trade Embargo And Helms-Burton Law On Foreign Investment

The US Trade Embargo

In 1960, the US began to see Castro as a threat and began applying economic and political pressure. Castro responded in January 1961 with the expulsion of 11 US diplomats. In April 1961, under the support of the Kennedy Administration, a US CIA-trained brigade of 1,500 mercenaries, mostly Cuban exiles from Miami, landed at Playa Giron (Bay of Pigs), failing to instigate a coup against Castro. Within weeks the two countries severed diplomatic relations, and the US imposed an economic blockade.

In December of that year, to the surprise of many, Castro declared, "I am a Marxist-Leninist and shall be until the day I die." As a support for the new socialist Cuba, the Soviet leader Nikita Khrushchev supplied Castro with economic aid and shipped nuclear weapons to the island for defense. This action triggered the *Cuban Missile Crisis*, whereby the US and the Soviet Union came face to face over what might have evolved into World War III. After the US threatened to bomb Cuba, the Soviets reluctantly pulled out their nuclear weapons. However: the damage had been done, and in 1963, President Kennedy imposed the *Trading with the Enemy Act*, which tightened the blockade and disallowed all personal and most commercial contact between the two countries.

The economic consequences for Cuba have recently been quantified at a cost of \$41 billion. The social repercussions are as severe. An example of the embargo's economic impact includes Castro's attempt to lessen the country's dependency on the sugar industry, by diversifying the economy through industrialization. This attempt failed primarily due to the US blockade limiting the import of industrial equipment, thus resulting in sugar becoming the main driver of the economy once again. The embargo has also prevented hundreds of thousands of American tourists from visiting Cuba. This had a substantial impact on tourism revenues since Americans have traditionally made up the lion's share of tourist visitors to the Caribbean.

It was the tourism sector that became the first recipient of recently permitted foreign investment. Tourism related real estate investment has witnessed the greatest foreign participation of all real estate product types, however, the future potential of Cuba's tourism industry will remain limited as long as the embargo is in place. An independent study conducted by *Price Waterhouse* projected a significant impact on tourist visits to Cuba upon normalization between the US and Cuba. Table 4 quantifies the number of visitors to Cuba under three scenarios. Scenario A assumes the status quo remains in place over the next five years, showing the total number of projected hotel rooms. Scenario B shows what might occur if the US were to lift the travel restrictions while maintaining the embargo. Scenario B indicates a significant number of new hotel rooms would need to be added to the *status quo* projections of Scenario A. Scenario C shows how many hotel rooms might be required with the embargo completely lifted. The conclusion drawn from these projections reveal a significant lost opportunity while the embargo remains in place.

Table 4

Scenarios for Projected Room Supply

Number of Rooms / Scenario	1996	1997	1998	1999	2000
Scenario A	20,900	23,800	27,000	30,600	34,600
Scenario B	24,300	28,100	33,800	40,200	47,400
Scenario C	33,100	41,100	50,200	58,000	66,500

Source: 1994 Price Waterhouse Report on Cuba's Tourism

Currently, the US Treasury Department's Embargo regulations apply to persons subject to the jurisdiction of the United States. This includes any individual, wherever located, who is a citizen or resident of the US, and any corporation, partnership, association or organization, wherever organized or conducting business, that is owned or controlled by US residents or corporations. The regulations prohibit any dealings with Cuba, any Cuban national, and any Specially Designated National of Cuba. Specially Designated Nationals of Cuba operating in the US are subject to criminal prosecution. US individuals or organizations who violate the regulations by transacting business with them are also subject to criminal prosecution or civil monetary penalties.

In order to further cripple Cuba's economy and force the collapse of the current regime, the US has recently imposed laws to dissuade nations from trading and doing business with Cuba. Today, a foreign investor from a country other than the US, may be subject to the laws of the US. US imposed extraterritorial laws require the investor to be especially prudent in his planning of any business association in Cuba as to avoid repercussions related to the sanctions and prohibitions contained in the *Act of 1996* ("Helms-Burton Law"), as well as the *1963 Cuban Assets Control Regulations*, and the *1992 Torricelli Cuban Democracy Act* and *the Cuban Liberty and Democratic Solidarity* (Libertad). The recent acts of 1992 forbid foreign subsidiaries of American firms from conducting business with Cuba.

The Helms-Burton Law and its Effects

In light of recent events, an in-depth analysis of the Helms-Burton Law and its impact on foreign investment in Cuba will be alluded to. On February 24, 1996, the Cuban air force shot down two unarmed civilian aircraft killing four American civilians who were involved in anti-Communist leaflet dropping campaigns. Two weeks later, the bill was passed by the US Senate voting 74-22 and the House voting 336-86. President Clinton, who had originally intended to veto the bill, changed his strategy and signed the bills into law on March 12, 1996, in direct response to the aggressive actions of Cuba.

The Helms/Burton Law gives the President the right to delay any action for a period of six months, the most damaging being that which permits a claimant to sue the American based subsidiary of a foreign company that is profiting from nationalized property in Cuba. However, the right to delay may be viewed as a deferral of the inevitable for as long as the law is active. The law applies only to commercial property worth in excess of \$50,000, thus excluding thousands of claims for private homes. This inclusion of private homes, however, is conditional upon the following: as of March 12, 1996, the claim on the property must be held by a US national and must have been certified under

the *International Claims Settlement Act of 1948*; or if any American-owned property is occupied by an official of the Cuban government or ruling political party.

For US courts to have jurisdiction, the foreign companies profiting from nationalized property of claimants (a sample of registered claimants can be seen in Table 3) must also hold assets in the US that could be targeted for lawsuits.⁷ In the case where the Helms-Burton Law applies, it would be preferable that none of the foreign investor's subsidiaries or affiliates conducting business in the US be directly or indirectly involved in Cuba. Therefore, to mitigate the risk one should create a new entity whose sole business purpose is to deal strictly with Cuba. A potential disadvantage of this approach is that the entity may be singled out thus making it more susceptible to attracting the "Specially Designated National of Cuba" status. However, as alluded to above, the designation should only apply to the joint venture itself and to any entities it owns or controls, and not to the corporation by whom it is owned or controlled.

Incorporating a new entity dedicated to Cuban business may limit the foreign investor's liability under the Helms-Burton Law; however, it is not clear how corporate law may impact a suit. For example, under Canadian corporate law, the liabilities of such corporation would not normally extend to its parent company, subject to any contractual provisions to the contrary. However, some years ago *Rio Algom's* US subsidiary was held liable for sins of *Rio Algom Limited*, an Ontario Corporation, pertaining to a worldwide uranium cartel. The US subsidiary had no involvement in the cartel yet it was treated not as a separate legal entity but as an operating division of *Rio Algom Limited*.

To give the reader some indication of the magnitude of the claims, Table 3 alludes to the largest claimants. Today, the claimants total 5,911 companies and individuals, whose claims, \$1.8 billion in all, were officially registered in 1970. At 6% per year simple interest, those claims now total \$7.3

⁷ The Economist, Journal, "Scarecrow", April 13, 1996

billion. This figure may be disputed, since the official book value of US investments in 1958 were approximately \$1 billion. The Cuban-American claims are less organized; their claims have never been adjudicated, and therefore, may be hard to prove. During the due diligence process, it is imperative that these records are examined so that the foreign investor is aware of whether his investment is subject to such a claim.

Table 3

Major US Certified Claims of Persons Against Cuba for Expropriated Property

US Company	Certified Claims (US\$000,000)	% of All Claims	Collective % of All Claims
Boise Cascade	279.30	15.50	15.50
ITT	130.70	7.26	22.76
Borden	97.40	5.40	28.16
United Brands	85.10	5.00	33.16
Amstar	81.00	4.70	37.88
Exxon	71.60	3.90	41.85
Texaco	50.10	2.78	44.63
Freeport Minerals	33.00	1.83	46.46
Coca-Cola	27.50	1.52	47.98
Lone Star Industries	24.90	1.38	49.36
Colgate-Palmolive	14.50	.80	50.16
Atlantic Richfield	10.20	.56	50.72
Uniroyal	9.60	.53	51.25
Woolworth	9.20	.51	51.76
Continental Group	8.90	.49	52.25
Firestone Tire	8.30	.46	52.71
International Harvester	8.30	.46	53.17
Owens-Illinois	8.10	.45	53.62
General Motors	7.70	.42	54.04
Chase Manhattan Bank	7.50	.41	54.45
Citicorp	6.20	.34	54.79
Esmark	6.00	.33	55.12
First National Bank of Boston	5.90	.32	55.44
General Electric	5.90	.32	55.76
Libby, McNiell & Libby	5.70	.31	56.07
Goodyear Tire	5.10	.28	56.35
Proctor & Gamble	5.00	.27	56.62
Sears, Roebuck	3.70	.20	57.00
Reynolds Metals	3.40	.18	57.18
Sherwin-Williams	3.40	.18	100.00
Others	776.80	43.15	100.00
Total	US\$1,800.00	100.00%	100.00%

Source: US Foreign Claims Settlement Commission

As of mid-1996, Cuba has settled with several countries, including Canada, Spain, Britain and Switzerland. A final settlement involving 1,455 claimants resident in Spain, recently accepted payments from the Spanish government, which were to be reimbursed by Cuba in cash and goods. Officials say Havana is willing to negotiate US claims if they are weighted against the cost of economic damage to Cuba arising from the US embargo.

The threat of some significant suits, based on new investments or expansion of existing ones, is very real. *Lone Star Cement*, a Connecticut firm, could challenge a big Mexican company, *CEMEX*, which it says operates a confiscated cement works. *Texaco*, which has its Latin American headquarters in Miami, might pursue a claim against operators of what were once its refineries. Another large claim could be against a Canadian mining company, *Sherritt*, which operates a confiscated nickel mine. In June of 1995, *Sherritt Inc.*, a natural resource conglomerate, became the first major Canadian company to be put on the list of "Specially Designated Nationals of Cuba". The designation by the US Treasury Department essentially means that Washington considers *Sherritt's* Venture in Cuba to be under the effective control of the Cuban Government. Where 50% ownership by the Cuban Government can be sufficient to invoke this designation, it has been stated by legal counsel at the Office of Foreign Assets Control in Washington that the ownership interest could be less than 50% and still result in designation, if Cuba was found to have effective control over the joint venture through such provisions as appointing board directors or making key business decisions. The ban placed on *Sherritt's* joint ventures with Cuba does not apply to the overall company, since it is not explicit within the Regulations that such designation would adversely affect the holding company of the joint venture undertaking. *Sherritt's* other operations are free to engage in any US business dealings.

In July 1996, Clinton exercised the six month moratorium, whereby American claimants will not be entitled to sue the American based subsidiary of the foreign firm profiting from nationalized property.

However, designated senior executives and immediate family members from both *Sherritt* and *CEMEX* are now prohibited from entering the US.

Both Canada and Mexico have stepped up their opposition to the Helms-Burton Law. Aside from filing a complaint against the Helms-Burton Act under the North American Free Trade Agreement (NAFTA), Canada plans to introduce legislation allowing Canadian companies to countersue American companies in Canadian courts. This legislation will be held back until the US Presidential elections in November 1996, giving President Clinton a chance to use his discretionary authority.⁸ European, Asian and other Latin American nations have recently stated their unhappiness with the Helms-Burton Law. With all the International pressure against the Helms-Burton Law, foreign companies having completed or planning to do business in Cuba may begin to feel less restricted.

Economic Impact

Regardless of international opposition, the Helms/Burton Law has been effective in achieving its primary objective, that of discouraging foreign investment into Cuba. The ambiguities within the law, and the uncertainty of whether it will be applied in full, have significantly slowed the rate of investment into Cuba since its signing in on March 12, 1996. Many foreign investors who planned to commit funds within Cuba are currently taking a back seat, awaiting the outcome of the November 1996 US Presidential elections, and its impact on the US government's policy towards Cuba. Many of these foreign investors have business interests in the US, such as *CEMEX* from Mexico and the *Melia Hotel* chain from Spain, both of whom have assets in the US that may be subject to reprisal. Meanwhile, investors who have already committed funds have pursued projects that have broken ground, but have drastically reduced the rate in which new capital is injected. This has been accomplished through phasing or down-sizing their Cuban project.

⁸ New York Times, June 17, 1996

As it is difficult to quantify, the enactment of the Helms-Burton Law has certainly had some impact on Cuba's economic recovery. However, on July 24, 1996, Cuba's Vice President Carlos Lage announced that Cuba's latest GDP results were up 9.6% for the first half of 1996 over the same period last year, despite the Helms-Burton Law. Improved sugar and nickel production, and tourism revenues were reported to have been the cause. The sugar and nickel producing sectors of the economy have not been affected by the Helms-Burton Law, although the Law is expected to have had a measurable impact on the hotel sector. Today, we have insufficient data to draw a conclusion, other than surmising that tourism demand has no correlation with the Law. There is indication however, that the hotel sector will experience difficulty in attracting new capital, since more than 50% of the new hotel stock relies heavily on foreign capital, most of which will come from international hotel chains that have stakes in the US. If the tourism sector is to sustain its growth, capital will have to be sourced from foreign entities other than those in the hotel industry. The Ministry of Tourism has projected that an average of 5,065 new rooms each year over the next five years are needed to meet the anticipated demand.

As a matter of caution, the foreign investor should perform in due diligence an investigation of prior ownership of any property through Cuban Land Registries and historical records, and compare the results with the list of certified claims published by the *Cuban Claims Program* of the United States Foreign Claims Settlement Commission. The investor should be aware that records and registries may be outdated, whereby claims lists are frequently reopened. If he can satisfy himself that he is dealing with property free of any claims, he will likely not be subject to the extraterritorial law of the US.

Chapter Three ***An Overview Of The Cuban Real Estate Market***

Historical Perspective

During and immediately following US military rule at the turn of the century, American investment in Cuba began to take-off. The power and influence of the American greenback facilitated the acquisition of land at bargain prices. Mini colonies for American immigrants began popping up in places as diverse as the Isle of Youth and the north coast of Camaguey. Profits earned from sugar production fueled the most significant development booms that occurred during and immediately following World Wars I and II.

Tourism related real estate development became popular in the 1940s and 1950s. In 1953, under Batista, visas were waived for visiting Americans, and all new hotels were granted tax-free status sparking a development boom that saw Havana's hotel rooms double in six years. Dozens of mansions were built in Varadero (85 miles or 140 km from Havana), along with golf courses, gambling casinos and hotels. While in Vedado and Miramar, suburbs of Havana, vacation homes and mansions were being erected on every street corner. Havana had become the playground for the American tourist with its casinos and live entertainment in its opulent hotels. Once Castro's government was in place, the policy towards tourism became inhospitable. Within the first few years the casinos and nightclubs closed, and the hotels were designated as vacation retreats for privileged workers.

Development Activity Over the Past 35 Years

Under Batista, 70 percent of the land was owned by 8 percent of the landowners. In the early 1950s, the World Bank (IBRD) suggested agrarian reform, i.e. the buying of idle land or taxing it in order to diversify the economy through promoting the highest and best use of the land. In 1960, Castro's government passed an agrarian reform act, quite different from that suggested by the

IBRD, limiting private land ownership. The housing laws that would come into force over the following 35 years would all reflect the principals of the agrarian reform act of 1960.

Since 1963, Cuba saw no foreign investment in real estate up until 1988. In fact, all development in both infrastructure and real estate was funded internally and by the COMECON nations. Development of housing was driven both by the demand and financial capacity of the government. All housing that was built during this period by the government was predominantly low-rent apartments. There has been absolutely no speculative development, and no need to build new office or commercial stock, since the supply of space vacated following the Revolution has far exceeded the demand. Any office and retail space left unoccupied by government agencies and departments were later occupied by families in need of housing. The number and type of new institutional buildings over the past three decades reflect the political objectives of a socialist society. With the technical and financial support of the Soviet Union, Cuba's defense infrastructure developed into the most powerful military force in Latin America. The Cuban government has built an average of 4,700 housing units per year over the last ten years. However, in the last two decades, capital constraints have led to a current housing shortage of over a half a million units.⁹

Large infrastructure projects were undertaken between 1965 and 1990 with the technical and financial assistance of the former Soviet Union. Projects such as airports, deep water seaports, electric and water treatment plants, and a highway and road network comprised of 21,118 miles (33,985 km), of which 13,727 miles (22,091 km) are paved. A rail system, built at the turn of the century, consists of 9,270 miles (14,918 km) of track. Most of the rail network is utilized by government run farms as well as by recently formed farming cooperatives. In fact, Cuba maintains one of the Caribbean's two remaining passenger railroads. Cuba also has five international, and nine domestic airports in operation.¹⁰

⁹ In the speech of Teo Babun, Cuba analyst, at the Americas Conference Corporation sponsored, "First Annual Corporate Counsel Cuba Conference", Boca Raton, FL, March 29-31, 1996

¹⁰ In the speech of Teo Babun's

Residential Real Estate Market

An examination of current real estate development activity with foreign participation will provide an indication of the real estate sector(s) that offer the most opportunity.

In 1995, a circular was distributed to the diplomatic corps from the *National Housing Institute* announcing the formation of the *Cuban Property Association Ltd.* to sell new apartments to foreigners, " in freely convertible currency, with full ownership by foreign residents seeking temporary or permanent residency in the country." The enclosed questionnaire asked the recipients to indicate their preferences from a range of prices, sizes and facilities, presumably with the motive to display to potential foreign partners that demand existed. The outcome was the formation of *Real Inmobiliaria S.A.* established by the *Pastor Group* based in Monte Carlo, and the Cuban company *Lares S.A.*, a subsidiary of *Cubalse*. The foreign partner, the *Pastor Group*, being the prime source of capital, as in all real estate joint ventures.

Real Inmobiliaria S.A. was the first real estate joint venture of its kind since the Revolution. Building is expected to break ground in mid-1996, following the formation of a temporary joint venture construction company. It will be comprised of 600 residential condominiums priced between \$110 and \$140 per square foot. The project will be phased and built at multiple locations in Miramar. The plan is to build 15 blocks of two to five bedroom condos four to five stories high. The deal was structured as a 15-year renewable agreement to manage the condominiums. The first phase of development includes 350 units to be built on several sites in the Miramar district, where the joint venture has secured land from the government for an average price of \$42 per square foot or \$450 per square meter. A recent announcement in the April 26, 1996 issue of the "Les Echos," a daily newspaper in France, stated that 80% of the condos in phase one of the development have been reserved to date.

Cuban law does not permit Cuban nationals to purchase real estate; rather, the government facilitates exchanges of property between Cubans. Therefore, the market for residential development for profit is limited to foreigners. Foreigners, who are permitted to buy these condos, may have temporary or permanent residency status, or simply hold a tourist card. However, as residents, they must obtain permission with at least 72 hours advance notice to the government to leave Cuba. An additional inconvenience forbids condo owners from purchasing an automobile, thus requiring owners to rely on taxis or car rentals that are significantly more expensive than in North America.¹¹ To be granted permission to buy a car or to bring one from abroad, owners must go through an approval process that begins with applying to the Chamber of Commerce.¹² Finally, owners should not expect to have the same freedoms afforded to them in their own countries.

The *Real Inmobiliaria S.A.* project is the only residential development approved to date. Negotiations for the project began in the early 1990's. This proves how important it is to gain the trust and confidence of senior government officials. A 50% share of the project was promised to the Pastor Group despite the law at that time which limited foreign participation to 49%. The final approval, however, was granted four months after the enactment of the new foreign investment law, which has no limitation on foreign participation

The government's priority is to spread new residential development over several sites, therefore, improving and potentially adding value to neighboring properties, as well as complimenting the social surroundings.¹³ The residential units are to be built on several non-adjacent sites, allocated by Cuba's Institute of Physical Planning. The project approval was therefore conditional upon this objective being adhered to by the joint venture.

¹¹ Interview with Roger Mailhot, Commercial Counselor with the Canadian Embassy, in Havana on June 11, 1996

¹² Interview with Alberto Tutor, Director of Negotiations at the Ministry of Foreign Investment and Economic Collaboration, in Havana on July 2, 1996

¹³ Interview with Manuel Pereda, Manager of Residential and Office leasing for Cubalse Real Estate Company, in Havana on July 4, 1996

Commercial Real Estate Market

Shopping for items such as clothing and small luxury items is limited to stores in hotels and at a few locations in city and town centers, and in even fewer locations for durable goods such as furniture and appliances. In September 1993, Decree Law No. 141 was passed allowing Cuban citizens to work for themselves in a variety of professions including operating restaurants from their homes. Currently, there are approximately 600 Paladars (privately operated restaurants by licensed individuals), 300 of which are located in Havana, are restricted to twelve seats and no advertising beyond their premises. To date they represent the only competition for state controlled restaurants, except for Pizza Nova, a Canadian restaurant chain, that recently formed a joint venture to operate three restaurants in Cuba, conditional upon locating in or adjacent to hotel properties catering to foreigner tourists. Pierre Cardin's luxury restaurant chain "Maxims", may become the first exception to that rule, since it is currently negotiating with authorities to open its thirteenth worldwide location, in the Miramar district, home to foreign diplomats and foreign business persons.

A sample study of the prices at a number of stores in Havana, Miramar, and Varadero, revealed that durables are priced on average 25-40% higher than in the US. Prices of perishable items, where choice of brand is non-existent, were on average 240% higher than in the US. The cost of importing these goods include a 30 percent import tariff, however, as this charge is not uncommon in industrialized nations, there is most definitely a substantial mark-up on the items which account for the huge disparity in prices. Cuba also relies on imports for such food products as red meats, milk products, vegetable oil, staples, as well as many non-perishable food products. The government's monopoly on retail allows it to control prices and therefore benefit with dollar receipts from products with inelastic demand.

During this "Special Period" the market for durables and luxury items are primarily foreigners affiliated with the embassies, businesses, or tourism. The majority of working Cubans have very little disposable income after spending their monthly salaries, which average 193 pesos (\$8), on

essentials such as food and lodging. Meat in the market costs 28 pesos per pound, and black beans 9 pesos. However, it is estimated that approximately 800,000 Cubans have access to US\$ to supplement their peso denominated salaries. This would be from either tourism related activities, remittances from family abroad, black market activities, or from privately run businesses permitted since 1993. However, access to dollars only permits the average Cuban family to maintain their standard of living as experienced prior to the collapse of the former Soviet Union. This may include the ability to purchase clothing, cleaning products, and other household goods. When considering these factors, we must conclude that a commercial retail market is not sustainable without foreign consumption. As the foreign consumer represents a small percentage of the potential consumer market, we must ask ourselves whether speculative, or build-to-suit commercial development is economically feasible.

The Cuban government now permits commercial development. Due to their monopolistic control over the commercial sector, state and autonomous state agencies (Cuban companies), are the only prospective tenants. Therefore, a market demand driven rental rate is non-existent. This poses a substantial risk to the developer, since his project would be dependent on what the government or Cuban company is willing to pay, a true tenant's market.

As for office development, the situation of demand and supply is quite different than that with retail space. The current office stock is lacking the ability to support the needs of technically sophisticated businesses. Its obsolescence is due to deficiencies in capital needed to improve the telecommunication infrastructure of the island. Offices have for the most part been occupied by government agencies simply lacking funds to improve the space. Today, hundreds of foreign companies, doing business in Cuba, demand space that can support their daily operating functions. Most foreign businesses have their offices combined with residences in older homes, located mostly in the Miramar district of Havana. The current office market for foreigners is estimated at

500,000 sq.ft. (46,464 sq.m.).¹⁴ The Cuban state company, *Cubalse*, is the island's landlord to foreign entities. *Cubalse* has a mandate to relocate the office tenants to new office developments, thus freeing up residential space. These facts and figures can help us quantify the existing demand of modern office space.

In June of 1995, *Habaguanex S.A.*, a Cuban company mandated to restore Old Havana, formed a joint venture with the Spanish Bank, *Argentaria*. The 51-49% joint venture created *AUREA LA INMOBILIARIA*, a 145,877 sq.ft. (13,552 sq.m.) office redevelopment, plus 46,717 sq.ft. (4,340 sq.m.) of indoor parking in an adjacent building. The *AUREA* project will be elaborated upon in chapter 4. In April 1996, a deal signed by *Lares S.A.* with an Israeli group, *Monte Barreto*, to build a 1,614,640 sq.ft. (150,000 sq.m.) complex of offices, stores and indoor parking in the Miramar district of Havana, was announced. The total project is estimated at \$100 million.¹⁵

Since the market for office tenants depend on foreign businesses, this market will soon be flooded with excess office space. The economic feasibility of new office development will be purely speculative. Therefore, this sector essentially has no opportunity to exploit.

Tourism-Related Real Estate

Christopher Columbus might well be considered Cuba's first tourist as he was the first non-primitive foreigner to set foot on the island. In his diary, Columbus's initial entry for Cuba described the country's splendor, a sentiment which has been repeated down through the last five centuries by a succession of visitors. However, the tourism industry did not really discover Cuba until the early 1940s when visitors from the US began enjoying the country's pleasant climate, attractive beaches and luxuriant countryside. Prior to the overthrow of the Batista regime by Fidel Castro and the

¹⁴ Interview with Alex Klip, Vice President of CubaLink Canada Ltd, Real Estate Consulting, in Boca Raton, FL, on March 30, 1996

¹⁵ Interview with Alberto Tutor, Director of Negotiations at the Ministry of Foreign Investment and Economic Collaboration, in Havana on July 2, 1996

establishment of a socialist Cuban Republic in 1959, the island played host to many thousands of tourists from the US. These comprised the majority of Cuba’s tourists and tended to treat the country, and especially Havana, as an offshore playground. The State, and particularly Batista, in collusion with Mafioso organizations from the US, exploited US tourism at the expense of the Cuban population and the country. Statistics prove how popular Cuba was with the US visitor although the pre-Revolutionary official figures probably do not reflect the exact number of tourists and business-related visitors entering Cuba at that time.

US tourism represented 90% of the tourists who visited Cuba from the late 1940s to the late 1950s. In 1959, two months after Batista’s overthrow, the Cuban government passed Law 270 “proclaiming the people’s full right to enjoy all the beaches”, where previously, beaches catering to foreigners were off-limits to Cuban nationals. For many years since the Revolution, the only kind of tourists welcomed were solidarity brigades from the Soviet Union and other sympathetic countries. Thus, Cuba’s tourism has suffered considerably, rallying only in recent years following the discovery of the country by European tourists and the increase in visitors from Canada. During the period prior to the collapse of the Soviet Union, the number of visitors from socialist countries had steadily increased. Between 1963 and 1975, the island received only about 3,000 foreign visitors a year. The figures in Table 2 reveal that the number of visitors to Cuba recovered spectacularly, even without the support of US tourism. Following the formation of the Cuban Communist Party in 1965 an increasing proportion of total arrivals consisted of visitors from socialist countries. This position started to change as the proportion of leisure visitors from socialist countries dropped from 179,699 in 1986 to just 37,000 in 1989.

Table 2
Visitor Arrivals to Cuba, 1957-1989

1957	1974	1975	1980	1985	1986	1987	1988	1989
272,226	12,000	39,727	51,054	192,179	238,300	275,700	298,600	314,900

Source: Cuba’s Ministry of Tourism (MINTUR)

The tables and graphs in Appendix A summarize published information about tourist arrivals by origin, arrival projections and revenues for the period 1987-1995 including the year 2000. Appendix B, a comparative analysis between Cuba, the Caribbean and the World, reveals figures that warrant serious consideration for new tourism related developments with foreign participation. The availability of comprehensive data is unique to this industry. Reliability of these figures, however, may be questionable, since a 1994 *Price Waterhouse* report revealed discrepancies between its own findings and those of Cuba's Ministry of Tourism (MINTUR). Faithfully collected data on tourism began as recently as 1990, which may explain why the implementation of data collection and reporting practices have wrinkles to be ironed out.

MINTUR has struggled with inaccurate data in the past, but now that several self-sustaining Cuban companies control the stock of hotel rooms, their financial records are considered reliable and they accurately reflect the industry's economic viability. As tourism has become Cuba's second-biggest earner of hard currency after sugar, MINTUR is responsible for reporting the industry's financial performance. Profits are often funneled to other sectors of the government, leaving very little to be reinvested in new stock and the refurbishment of existing stock. It is estimated that over 50% of the projected new stock will require foreign capital. Therefore, significant opportunity exists for foreign participation.

A number of international hotel companies have entered the Cuban market since 1990 (see Chapter 5). Those pioneering companies are not necessarily household names and may not have the marketing prowess of leading international hotel companies, but they are nevertheless well known to lodging-industry experts. Renewed interest in Cuba's tourism sector can be further substantiated by a summary of the statistics in Appendices A and B. The World Tourism Organization (WTO) reported that Cuba placed 14th for receptions in the Caribbean area and 12th in gross receipts in 1995. Ten years earlier, in 1985, the comparable figures put Cuba 24th in the number of tourists and 23rd in receipts. Cuba's share of Caribbean visitors has gone from 2.9% in

1990 to 5% in 1995. In 1995, Cuba had the highest growth rate in the Americas for the number of tourist visits, up 19.6% to 738,000, from a year earlier. In fact, the result exceeded MINTUR's projection of 700,000. Cuba also ranked fourth in tourist dollars received in the Caribbean, up 10.9% from 1994 to \$943 million.¹⁶

Assuming the status quo in regards to the US embargo, the graphs in Appendix C were constructed with figures from an independent study conducted at the end of 1994 by Price Waterhouse. Over the next five years, hotel rooms that meet international standard (the equivalent to 2 to 5 star lodging) are expected to grow at an annual compounded rate of 12%, based on conservative estimates of projected arrivals seen in Graph 2 of Appendix C. The 1995 year-end inventory of international standard rooms was approximately 20,900. At a constant 60% occupancy rate, there is an anticipated demand that will support an inventory of 34,600 rooms by the end of the year 2,000. This translates into a demand of 2,740 rooms per year over the next five years. However, MINTUR projects a need of 49,556 rooms by the year 2,000 as seen in Appendix A. MINTUR's figures conclude that 5,065 new rooms per year will be required to meet anticipated demand. To reach 49,556 rooms by the year 2,000, a study was performed to determine the cost of infrastructure (transportation, water, sewer, electricity, telecommunications) required to support the new development. A total budget of \$160 million has been allocated to execute this task.¹⁷ The figures from both MINTUR's and the independent study by Price Waterhouse imply that there exists substantial opportunity for foreign investment.

Currently, there are 142 deals related to tourism development being negotiated. These include port restoration to accommodate cruise ships, hotel and resort development, as well as the restoration of old hotels. Since the signing of the Helms/Burton Law on March 12, 1996, there have been three new joint ventures approved. Eight regions have been prioritized for future hotel development, as

¹⁶ World Tourism Organization's 1995 Preliminary Results on Caribbean Tourism Statistics

¹⁷ Interview with Eduardo De la Vega, Vice Minister of Tourism, in Havana on June 12, 1996

seen in Appendix A. A condition imposed by MINTUR is that any joint venture proposing to develop in one of the three mature regions, 1,2 or 7, must agree to develop simultaneously in one of the remaining five relatively virgin regions. In 1994, Cuba's Institute of Physical Planning prepared a Tourism Master Plan that sets Cuba's potential room capacity at 150,160, including rooms for domestic tourism. Currently, the stock of rooms for domestic tourism stands at 14,000.¹⁸ Over eighty percent of this potential capacity is slated for international tourism.

One of the most opportune modes of visiting Cuba is by private yacht. Each year from the west coast of Florida down through the Gulf of Mexico and across the Straits of Florida along the northern coast of Cuba and up into the Bahamas, travel some 260,000 private yachts carrying some 2.5 million passengers and crew.¹⁹ Respecting the laws imposed by the embargo, this mode of visiting Cuba is restricted to non-Americans, and to those craft that will not call on American soil for a period of six months following their call at a Cuban port. However, the potential of traffic stopping at Cuban ports along its northern shores is significant, and will be substantial upon the normalization of relations between the US and Cuba.

There also exists an international airport within the vicinity of each of the eight prioritized regions facilitating reasonable access. *Cubana de Aviacion*, Cuba's national airline, flies scheduled and charter routes between Havana and other cities in the Americas and Europe. Several other airlines also fly to Cuba, including: *Air Canada*, *Mexicana*, Venezuela's *Viasa*, Spain's *Iberia*, *Aeroflot* from Moscow, *LTU International Airways* from Germany, and *Martinair* from Amsterdam.

In conclusion to tourism related real estate, the facts and figures indicate significant opportunities for foreign participation. In late 1995, MINTUR sponsored an international marketing campaign

¹⁸ Interview with Eduardo De la Vega, Vice Minister of Tourism, in Havana on June 12, 1996

¹⁹ Interview with Mundi Gilbert, Director of Planning/Design/Construction of the Melia Group, Hotel Developers and Operators, in Montreal on June 7, 1996

targeting several markets throughout Canada and Europe. The result was an astounding 45% increase in tourist visits in the first quarter of 1996 over the same period in 1995.

Status of Cuban Real Estate Markets Summarized

The current demand for office and residential space has a positive correlation as well as a low ceiling of opportunity, since new housing slated for development through joint ventures with foreign participation will be built for foreigners possessing hard currency, those who are related to businesses opening offices in Cuba, as well as those linked to the embassies and diplomatic corps. Joint ventures currently slated to develop office and residential projects are associated with foreign entities that are relatively small size investors with no dealings on American soil. The potential for commercial retail development is non-existent, due primarily to the limited purchasing power by Cuban nationals. The limited merchandise currently available are brought to market by government agencies that have a monopoly on commercial retail activities. As a result, commercial real estate development has little or no economic feasibility under the current situation. The lifting of the embargo would facilitate the importation of American products; however, since the Cuban government will continue to control retail activity up until they permit competition, commercial retail development will continue to offer no economic incentive to the foreign investor. Tourism related real estate development is least effected by Cuba's economic crisis. Today, as Cuba's second leading earner of foreign receipts, tourism will continue to be respected as a strong dollar earner and continue to possess the ability to attract foreign capital.

Chapter Four

Cuban Laws Governing Real Estate

Historical Account

Real Estate Law has experienced several transitions throughout the years since the Revolution. From 1960 to 1974, 140,000 housing units vacated by emigrants were confiscated. These homes were used for public purposes, such as schools, clinics, offices, and museums, or rented to families in need of housing. Relatives that could establish that they had been resident of such dwellings for a statutory minimum period could inherit them. As at June 1996, approximately 90% of Cuba's current housing stock was privately owned, although owners do not necessarily own the freehold of the land on which their homes stand.²⁰

The 1960 Urban Reform Law gave leaseholders the usufruct of their homes. It also allowed existing landlords to retain their main home plus a second home for holiday use. Under this law, foreign nationals and émigrés had three options when exiting Cuba in regards to releasing their real estate assets: (i) to simply donate the asset to the Revolution; (ii) to sell the asset to the government at a predetermined price based on the social cost as opposed to the true cost; (iii) to be released through expropriation of the foreign owned land and business. Most chose the third option in the hopes that the expropriation of their property would not be permanent, rather, it would be returned to them upon the departure of the Castro government.

The 1984 Housing Law gave some 480,000 rent-payers the opportunity to buy their homes. The 1988 Housing Law restricted house sales on the open market, and made clear that home ownership rights are inheritable. Houses may be sold at prices determined by the government or traded. Trading a home can be facilitated by simply transferring the outstanding debt obligation, owed to Cuba's National Bank, to the next property. The following is an illustration of a typical exchange where the owner of home #1 wishes to move to home #2.

²⁰ Interview with Ricardo Nunez, Urban Economist at the Center of Integral Planning for the Capital, in Havana on May 10, 1996, June 10, 1996 and June 14, 1996

home #1 value	home #2 value
\$30,000	\$20,000
paid to date	regardless of amount paid to date
\$15,000	\$15,000
balance owed to bank	balance owed to bank
\$15,000	\$15,000

Home values are determined by consideration of the social costs and benefits rather than by market demand or replacement cost. As can be seen in the above illustration, regardless of the value of the home, the originally contracted debt obligation moves with the owner, not with the property.

Land Valuation

The Cuban Ministry of Finance and Prices (Ministerio de Hacienda y Precios) is responsible for valuing real estate. In Cuba, policy dictates that the use of the land constitutes neither sale nor rent but nonetheless forms part of the original capital contribution of the Cuban partner to the joint venture. As hereinafter described, land tenure constitutes in effect a right granted by the State to the Cuban partner who can benefit from the use of the land for a period of time defined by the objectives of the joint venture (25 to 50 years depending on circumstances).

The three common standard approaches used in determining land value, including market comparison, replacement cost, and income capitalization approach, are not practiced in Cuba. A real estate market, as we know it in North America, does not exist in Cuba, since land is not bought and sold in an open market. The application of the market comparison approach is eliminated due to the inexistence of a real estate market in Cuba. The lack of cost data renders the replacement cost approach invalid. The income capitalization approach, however, would be the most reliable technique.

Following the introduction of such principles of appraisal at the "Workshop on Real Estate Development and Derivation of Land Value", organized by the Center of Integral Planning for the

Capital, in Havana on May 28, 1996, Cuban officials showed little interest in applying them.²¹ Since it is the objective of the government to attract foreign capital to domestic real estate development, the current administration considers that its methodology carries sufficient flexibility and subjectivity to land valuation, a conventionality which officials would prefer not to compromise. Whether their reasoning produces results is another question.

When determining land value of a Cuban development project with foreign participation, rather the following Cuban methodology applies. Land valuation takes into consideration locational advantages/disadvantage, infrastructure support, buildability and right of use. These attributes are investigated by the Department of Physical Planning in order to derive a coefficient that is assigned to the property under consideration. This is compounded by the Ministry of Finance and Prices imposing criteria of its own, resulting in a value at variance from the common principles of appraisal.

When land tenure is under consideration, a determinate period should negatively impact the value of land. The Ministry of Finance and Prices does not agree with this. It reasons that value can be determined for a specified period much the same as freehold land value. A survey of comparable property values in Mexico, Jamaica, Venezuela, Barbados, and the Dominican Republic is used as a source to calculate Cuban land value. The Ministry of Finance and Prices reasons that a property on the beach in Cuba has the same value as a property, for instance, on the beach in the Dominican Republic, and therefore, such value represents a fair capital contribution towards the joint venture by the Cuban partner. It also claims that "*Upon becoming property, the land will not devalue with time but, on the contrary, it will continuously increase. It is, thereby, deemed necessary to account for this fact in the calculation of land use.*"²²

²¹ Interview with Ricardo Nunez, Urban Economist at the Center of Integral Planning for the Capital, in Havana on May 10, 1996, June 10, 1996 and June 14, 1996

²² This analysis is drawn from a composite of literature and interviews with officials authorized and having access to the data and methodology on land valuation.

Obviously the Cuban claim is based on different criteria, since freehold land in Mexico, Jamaica, etc., cannot be compared with Cuba's limited time-use restriction. Furthermore, other country factors, such as political and economical influences, play significant roles in land value derivation. Moreover, international land market values have been subject to fluctuations; therefore, the Cuban market can hardly escape that reality in the long term.

Legislative Process

To understand the legislation process and how the government impacts the investment decision, the following briefly defines the current government structure. Cuba is administered by the Municipal, Provincial and National Assemblies of the People's Power, whose delegates are nominated in coordination with the neighborhood Committees for the Defense of the Revolution (CDR) and elected by popular ballot from a single voting list. The National Assembly elects the Council of State, the supreme governing body, which in turn selects the Executive Committee of the Council of Ministers. Fidel Castro Ruz is President of both these Councils and head of the Communist Party of Cuba (PCC), the country's highest policy-making body. The PCC sets economic and political guidelines and determines how they should be implemented through the organs of the People's Power.

Foreign Investment Laws

Before 1982, foreign investors were not permitted to participate in business activities in Cuba. Thirteen years after the promulgation of Decree-Law 50, the first law to allow and govern foreign investment, a team of jurists (organized in 1994) was mandated to formulate proposed regulations to accompany the new Foreign Investment Law. For this purpose, similar legislation was studied, mainly that of China, Vietnam, and some Latin American countries. Also studied in depth were the experiences derived from Decree-Law 50 of 1982. On September 5, 1995, the National Assembly culminated an almost two year process of Cuba's re-examination of its Decree Law No. 50, and

created the Foreign Investment Act (Law Number 77, trans. Editora Politica, 1995). Hereinafter called Law 77, it opens by stating:

In today's world, without the existence of the Socialist block, with a globalizing world economy and strong hegemonistic tendencies in the economic, political and military fields, Cuba, in order to preserve its accomplishments despite the fierce blockade to which it is subjected... can benefit from foreign investment, on the basis of the strictest respect for national independence and sovereignty...

Under Law 77, foreign investment may be authorized in all sectors, excluding the population's health, educational, and Armed Forces institutions, with the exception of the Armed Forces commercial divisions.

According to the new law, foreign investment shall adopt one of the following forms: a) Joint venture; b) International economic association contract; or c) Totally foreign capital company. For the purpose of this study, the joint venture will be the only form of foreign investment analyzed as it is the sole method of investing in real estate in the present and foreseeable future.

If the new law reflects an enthusiastic attempt to balance the interests of the State while encouraging foreign investment, it misses some critical elements. This is indicative of the body of law in Cuba where, for example, no corporate law exists, leaving the business community to rely on the Spanish Civil Code of 1885, and Law 77, for its direction.

A critical problem with Law 77 is a) its lack of well defined terms of reference; b) the absence of sanctions or penalties for failure to comply with the law and c) conditions of approvals by either the foreign investor or Cuban government. It is stated that foreign investors within Cuban national territory enjoy full protection and their assets cannot be expropriated, except in the interest of society, and in accordance with the Constitution; however current legislation provides for

indemnification in freely convertible currency according to the commercial value of the asset.²³ Additionally, sixteen countries have signed international agreements covering the mutual promotion and protection of investments in Cuba, while 25 others are in negotiation.²⁴ The value of the asset in dispute is to be determined either by mutual agreement or by an internationally recognized evaluator agreed to by all the parties.

Law 77 also codifies the approval process for foreign investments. It is expected that this will streamline the process of negotiating and obtaining final approval. A decision on the approval is to be made within 60 days from the date of a written request. The foreign investment must be authorized by the Executive Committee of the Council of Ministers or a Commission of the Executive Committee which will issue a resolution approving the foreign investment. The main provisions in relation to the setting up of the joint venture, for example, capital structure and exemption from taxes, will be included in this resolution. There is no prescribed format dictating the contents of the resolution and its contents are therefore the result of negotiation between the parties of the joint venture and the government. Therefore, the joint venture may be required to use, as a template, agreements which have been approved in the past in order to facilitate a timely response from the Cuban government.

It is a principle of the government that the case by case approval of foreign investments, specifically by the Council of Ministers or by the Commission designated for this, must be for the economic and social benefit of the country.

“The Socialist state property comprises sugar mills, factories, chief means of transportation and all their enterprises, banks and facilities that have been expropriated from former landholders; factories, enterprises, economic facilities and scientific, social, cultural and sports centers, present

²³ Article 3 of Law 77 and Articles 23 and 25 of the Constitution of the Republic of Cuba

²⁴ In the speech of Raul Torres

or future, excluding lands belonging to small farmers or cooperatives; the sub-soil; mines; natural resources; forests; waters and communications. Property ownership may not be transferred to natural persons or legal entities, save for exceptional cases in which the partial or total transfer of an economic objective (freehold interest), is carried out for the development of the country and does not affect the political, social and economic foundations of the state, prior to approval by the Executive Committee of the Council of Ministers.”²⁵ To date, a freehold interest has not been granted to a joint venture.

Raul Taladrid, the Deputy Minister of Foreign Investment, said with a laugh that he does not understand this compulsion to own, rather than have the use of, property. Surely businessmen do not really care about that? Following the interpretation of the laws governing the sale or leasing of real estate by foreigners, and from observation of how these laws have been applied, I conclude that outside of the exceptional case, the government is not prepared to give foreigners a right it does not extend to Cubans. Therefore, the opportunity to invest in property would be structured as follows. The original contracted period for the use of land (usufruct), may be for up to 50 years. The original contract may then be extended by 50% of the original lease period, upon the mutual consent of the partners. Therefore, the maximum period of usufruct could be for 75 years.²⁶

Laws concerning foreign real estate investment may seem somewhat ambiguous. The fact that real estate investment is a recent discovery for Cuba explains why the laws do not address all of the issues of concern to the seasoned real estate investor, such as property taxes, depreciation, land tenure, and mortgages. Cuba has taken steps, for the most part unilaterally, to address these issues in drafting of a new real estate law. This law is expected to be adopted sometime within the next two years. Expertise from abroad has been consulted, however on a small scale, since the capitalistic approach to business conflicts with the ideologies of Cuba’s socialist structure.

²⁵ Article 15 of the Constitution of the Republic of Cuba

²⁶ Article 4.1 of Decree-Law 50, and Article 225 of Law No. 59

Approval Process

There is now a two-tier approval process based on the type and size of the real estate investment. The Executive Committee of the Council of Ministers has the exclusive power to authorize investments over \$10 million, and where state property rights are transferred. Whereas, a government commission designated by the Executive Committee may authorize an investment which does not fall under the aforementioned categories. The foreigner must first consult with the Ministry of Foreign Investment and Economic Collaboration (MINFEC). MINFEC will advise the foreigner of the possible Cuban companies authorized to form joint ventures. Once the foreign investor decides on an authorized Cuban company to create a joint venture, the tentative partners must seek approval from several departments and Ministries before submitting the final endorsed proposal to the Executive Committee of the Council of Ministers.

The partners must propose a site and use of the development. Only if the proposed project is related to tourism, must the partners first consult with the Ministry of Tourism (MINTUR). MINTUR will provide a list of potential sites and conditions that must be complied with. The next step would be to perform in due diligence an investigation of prior ownership of the property through Cuban Land Registries and historical records, and compare the results with the list of certified claims published by the *Cuban Claims Program* of the United States Foreign Claims Settlement Commission. The next step would be to present the preliminary conceptual plan to the Institute of Physical Planning, who will investigate the feasibility of the project, in terms of infrastructure support, and then assign a coefficient to the property. Once again, if the project is related to tourism, MINTUR must endorse the business plan and the partnership agreement. Both the business plan and the partnership agreement must then be submitted to the Ministry of Finance and Prices (MINFP) along with the coefficient supplied by the Institute of Physical Planning. At the same time, both the business plan and the partnership agreement must also be submitted to the Ministries of Labor, Economic Planning, Science and Technology (for environmental purposes), and the National Bank of Cuba. As it is the responsibility of MINFP to assign a value to the land, a

process of negotiation may follow, whereby the partners must support the deduced land value alluded to in the business plan. The most difficult hurdle in realizing a joint venture is settling on the land value. Once the business plan and the partnership agreement receive their endorsements, a package that includes the joint venture agreement, article of association of the company, article of association of the foreign partner, and the business plan are then submitted to the Executive Committee of the Council of Ministers who have 60 days to review the proposal. Finally, with their approval, the company must then be incorporated before a Public Notary, and registered at the Registry of Economic Associations. If the partners fail to receive endorsement by one of the aforementioned Ministries or departments, they must refine the proposal and revisit the approval process. This process can easily consume eight to ten months, however, the duration should be considered reasonable when compared to North American standards.

Economic Impact of Foreign Investment Laws

In 1991 there were a mere 20 joint ventures facilitated by "Decree Law 50: The Cuban Joint Venture Law," between the Cuban state and foreign capitalists. As of May 1996, there were 203 economic associations including joint venture enterprises registered and operating in 34 different sectors of the economy. During 1995, \$140 million were realized in tax revenues and other government revenues directly related to these enterprises, representing 3% of GDP. The top five sectors receiving foreign capital were: 1) Nickel Mining, 2) Oil Exploration, 3) Tourism, 4) Light Industry, 5) Food Industry.²⁷

More than \$5 billion in announced foreign investment have been promised to Cuba under its new open-door policy, and several hundred million of that has been committed to date. On July 1, 1996, the largest single foreign investment commitment of \$370 million was signed between a Canadian

²⁷ In the speech of Raul Torres, Group Negotiator for the Ministry of Foreign Investment, at the McGill University & University of Havana co-sponsored workshop on Foreign Investment and Economic Development in Cuba, Havana, Cuba, May 7-9, 1996

firm and a Cuban state agency. Table 1 shows the breakdown by country of announced and committed capital investments.

Table 1
Investment in Cuban Enterprises by Country
(millions of dollars)

Country	Announced	Committed	% of Total
Mexico	2,256	250	33.9
Canada	1,111	100	13.6
Australia	500	0	0
South Africa	400	15	0.02
Spain	350	125	17.0
Netherlands	300	40	5.4
Brazil	150	20	2.7
Chile	100	15	0.020
Italy	97	87	11.8
United Kingdom	75	50	6.8
Venezuela	50	3	0.004
Russia	25	2	0.003
Israel	22	7	0.009
France	15	10	0.014
Germany	10	2	0.003
China	10	5	0.007
Sweden	10	1	0.001
Honduras	7	1	0.001
Dominican Republic	5	1	0.001
Jamaica	2	1	0.001
Japan	2	.5	0.0007
Greece	2	.5	0.0007
Panama	2	.5	0.0007
Uruguay	.5	.3	0.0004
Austria	.5	.1	0.0001
Total	\$5,502.0	\$736.9	100

Source: Statistics compiled by US - Cuba Trade and Economic Council from the media, other public sources, and discussions with company representatives, non-Cuban government officials, and Cuba-based enterprise managers and government officials.

Chapter Five

Real Estate Investment Climate for Foreign Investors in Cuba

Autonomous State Agencies Authorized To Form Joint Ventures In Real Estate

Several Cuban companies have been granted the authority by the Executive Committee of the Council of Ministers to seek and enter into joint ventures for the purpose of developing real estate. Criteria for authorization has not been disclosed. These companies include *Habaguanex*, *Cubalse*, *Eproyiv*, *Inmobiliaria Caribe*, and several hotel chains including *Cubanacan*, *Gran Caribe*, *Horizontes*, and *Gaviota*. Approved joint ventures as of June 1996, include the participation of: *Habaguanex*, *Cubalse*, *Cubanacan*, and *Gran Caribe*.

Habaguanex, was formed in January 1994 by the Administrative Office in Control of Historic Havana. The founder and President, Eusebio Leal, and Vice President Miguel Martin, have made it their primary mission to improve, restore and redevelop hotels, offices and commercial space within the district of Old Havana. To date, *Habaguanex* has established joint ventures with four foreign entities, three of which are small hotel projects, and the fourth is the country's first office redevelopment joint venture slated to be completed by August of 1996. The office redevelopment joint venture was created with a Spanish Bank and is called *AUREA LA INMOBILIARIA*.

Habaguanex projects that by the end of 1996, 145,877 sq.ft. (13,552 sq.m.) of office space and 60 hotel rooms, with foreign joint venture partners, will be introduced onto the market. By the year 2,000, an additional 400 of approximately 700 rooms expected to be added to the current stock, are anticipated to have foreign participation. Currently, *Habaguanex* is negotiating with a consortium of Spanish, English and Italian investors to redevelop some office space that will be significantly larger than the *AUREA* project.²⁸ The consortium's objective is to have assurance that there currently exists sufficient demand to economically justify this project.

²⁸ Interviews with Miguel Martin, President of Habaguanex S.A. Real Estate Development Company, in Havana on June 13, 1996 and July 3, 1996

Cubalse is a Cuban company originally formed by the Ministry of Foreign Affairs to govern and manage the housing and office stock leased to diplomats in the early 1960's. By the mid 1980's, *Cubalse* began providing office and residential space to foreign businesses doing business in Cuba, following the adoption of Law No. 50 facilitating foreign investment and participation. Today, *Cubalse* has two departments, one handling the diplomatic body, and the other handling the foreign businesses. In late 1995, *Cubalse* formed a subsidiary called *Lares S.A.*, to participate in all real estate joint ventures with foreign entities. In January of 1996, *Lares S.A.* formed Cuba's first residential development joint venture, since the Revolution, with the *Pastor Group* from Monte Carlo. This joint venture is called *REAL INMOBILIARIA S.A.*. In April 1996, *Lares'* second joint venture was with an Israeli group called *Monte Barreto*, created to construct 1,615,000 sq.ft. (150,000 sq.m.) of office, commercial and indoor parking in the Miramar district of Havana. Currently, *Lares S.A.* is negotiating with six foreign parties interested in building residential and or office projects in Cuba, in and outside of Havana.²⁹

Cubanacan is Cuba's largest hotel chain and tourism agency formed by the Ministry of Tourism in August of 1987 to facilitate the first hotel joint ventures with foreign partners. *Cubanacan* is the most recognized hotel chain in Cuba amongst tourism wholesalers abroad, thus, resulting in a consistent augmenting stream of business since its inception. Cuba's first hotel joint venture, *Cubacan S.A.*, was created in November of 1987, with a Spanish group. Their objective was to build three hotels in Varadero, a total of 1,580 rooms. As of June 1996, a total of twelve joint ventures have been approved, with eleven more in the negotiation stage. *Cubanacan* has built only hotels in joint ventures with foreign partners, however, today they are negotiating with an Italian group to build residential condominiums on the north east coast, 45 minutes from Holguin Airport. Several International hotel operators are managing *Cubanacan* hotels, including *Delta Hotels* from Canada,

²⁹ Interview with Manuel Pereda, Manager of Residential and Office leasing for Cubalse Real Estate Company, in Havana on July 4, 1996

Melia Hotels from Spain, *Golden Tulip* from Holland, *LTI International Hotels* from Germany, and *Commonwealth Hospitality* from Canada.³⁰

Gran Caribe is a hotel chain that has 32 four and five star hotels located in nine different regions of Cuba. *Gran Caribe* also has exclusivity over three of the most popular entertainment spots with historic significance in Havana: the Tropicana Cabaret, the Floridita and Bodegita del Medio restaurants. Several of their popular hotels are managed by some international hotel operators such as *Accord Hotels* of France, *Trype Hotels* and *Ibero Star Hotels* of Spain, *Kawama Caribbean Hotels*, and *Venta Club Hotels*. *Gran Caribe's* objective is to redevelop its older stock and develop a new product in the four and five star range. Currently, *Gran Caribe* has a monopoly over future development in Cayo Largo, a tourist destination on a cay off the southern coast of Cuba, with its own domestic airport which can accommodate direct flights from abroad. *Gran Caribe* recently signed a joint venture deal with *Wilton Properties* from Canada to build 4,200 new rooms, approved July 1, 1996. This joint venture, called *VANCUBA*, is expected to invest US\$370 million over the next ten years.³¹

Laws Governing Joint Ventures

Decree-Law 50, passed in 1982, limited foreign participation to 49%, except in extraordinary circumstances. Therefore, since 1982, foreigners conducting business in Cuba had to do so through either an economic association or a joint venture with a Cuban entity as stipulated in the Law. The extent of foreign participation under the new Law 77 is more flexible and will allow participation of foreign investment of up to 100%. Unfortunately, policy overrides the law, and no one is likely to see any businesses wholly-owned by foreigners, since it is the explicit intention of the Cuban government to maintain significant participation in all foreign investments. Therefore,

³⁰ Interview with Miguel Solano, Director of Negotiations and Advisor to the President of Cubanacan Hotel Group, in Havana on June 12, 1996

³¹ Interview with Brito Salvador, Chief Negotiator for Gran Caribe Hotel Group, in Havana on May 8, 1996 and July 1, 1996

foreign participation is limited to 50% of any joint venture. Under normal circumstances, the expected time to have a joint venture approved and registered, may average six months.

A joint venture can be financed through either the contribution of cash or assets in return for nominal shares. The partners may also make loans to the joint venture or obtain the loans from a lending institution. The capital contribution of the foreign investor may be in the form of: (i) freely convertible currency; (ii) machinery, equipment or other physical or tangible goods; (iii) intellectual property rights and other rights over intangible goods; (iv) property rights over personal items and real estate, and other rights such as usufruct and surface rights. As for the methodology to evaluate the contribution, an economic evaluation of the business proposal including values of the non-cash contributions must be submitted to the Ministry of Foreign Investment and Economic Cooperation.³²

The use of land constitutes a right granted by the State to the Cuban partner in the joint venture. The joint venture project can benefit from the use of the allocated lands for a specified period of time defined in the objectives of the joint venture. The use of the land constitutes neither sale nor rent; rather, it forms part of the original capital contribution of the Cuban partner to the joint venture. It differs from land lease in that there is no annual rent to be paid. As indicated above, the value of the land contribution to the project becomes part of the total capital contribution to the joint venture.

The rights of the shareholders do not differ much from those of North American shareholders.³³ However, since there exists no written law addressing corporate issues regarding the collection of taxes, as of July 1996, the treatment of shareholders may be subject to changes once these laws are adopted. These laws are currently being drafted, and are expected to be in practice within the next two years.

³² Article 19 of Law 77

³³ Articles 152 to 174 of the Commerce Code

The Cuban joint venture has limited liability in that “the responsibility of the partners in a stock company vis-à-vis the obligations and losses incurred, is restricted to the funds they contributed or committed themselves to contribute to the common assets.” Furthermore, “the corporate assets, made up of the capital stock and accumulated benefits, are held liable for the obligations undertaken in running and managing the company by a legally authorized person and in the manner stipulated in the deed of incorporation, by laws or regulations.”³⁴

As for an exit strategy, the foreign partner must comply with the investment. This law states that, “At any moment, subject to the consent of all parties, the foreign investor may sell or transfer its total or partial share of the company to the State, Cuban partner or any third party, subject to government authorization. The seller will receive the corresponding price in freely convertible currency.”³⁵ In the sale of any shares or assets, the government also retains the right of first refusal, whereby the government may choose to buy the interest at the corresponding price offered by the Cuban partner or any third party. As for government authorization as to whom the foreign partner intends to sell their interest, the government’s primary concern is that the buyer is considered socially acceptable (no criminal past), and has sufficient capital resources.³⁶

The design and construction firms in charge of implementing any project must be Cuban; however, it is permitted that both technical and specialized support from a foreign entity be sourced. The creation of a Temporary Union of Construction Firms (TUCF), or temporary joint venture for the purpose of constructing the project, is also permitted. In all real estate joint ventures to date, practice reveals that a TUCF has been applied. As for the design and supervision of the project, both local and foreign firms typically work together, where their union is strengthened by the outlined contributions of each partner.

³⁴ Articles 153 & 154 of the Commerce Code

³⁵ Article 6.1 of Law 77

³⁶ Interview with Roberto Brier, Lawyer with Consultores Asociados S.A., in Havana on June 13, 1996

Management & Labor Issues

The management of the joint venture is governed by the partnership agreement and the articles of association. Among joint ventures practicing to date, management is facilitated through periodic board of directors and shareholders meetings. Cuban law does not contain specific provisions governing management structure or the power of directors. The president and vice-presidents of the joint venture must be appointed by the board of directors. The joint venture parties must include provisions in the articles of association governing the appointment and removal of directors, as well as what constitutes a majority ruling. Normally, the president would be rotated every one to three years. At a predetermined schedule, elections will be held, and upon the mutual consent of all the partners, a president (Cuban or Foreign) may, in fact, be reelected. The workers in joint ventures, as a rule, are Cubans or foreigners permanently residing in Cuba. However, high level administrative positions or posts of a technical nature may be occupied by foreigners who are not permanent residents. One critical condition requires Cuban participation in the administration or joint administration of the joint venture. In practice, however, the day-to-day decision-making of a joint venture will be taken by the president who may be a representative of the foreign partner.³⁷

A joint venture company cannot hire Cuban workers directly. They must be hired by Cuban intermediary employment agencies and subcontracted to the joint venture. Many foreigners hoped that the new law would amend the labor regulations to allow the joint venture to hire workers directly. Although there was much discussion of this in the Cuban National Assembly, it did not occur - except in "exceptional cases", the new law maintains the existing practice of using the Cuban intermediary employment agencies. It remains to be seen how the "exceptional cases" will be interpreted.

The joint venture must pay directly to the employment agency for the services of the work force. The employment agency is then responsible for paying the workers their salaries. Practice and law

³⁷ Article 13, Law 77

stipulate that the joint venture pays the employment agency in dollars, whereas, the employment agency must then pay the workers in pesos, at the official exchange rate of 1 peso to 1 US\$. Wages are to be determined by existing legislation except in the case of Cuban managerial personnel whose salaries will be set by agreement between the partners. With regard to incentive payments, the joint venture may be authorized to create an "economic stimulus fund," paid out of earned profits, at an amount mutually agreed upon between the partners.³⁸ This economic incentive provision has only been explicitly stated in law since September of 1995.

In the case where the joint venture finds it necessary to relieve a worker from his/her post, it can request that the employment agency replace that worker. However, any indemnification to which the worker is entitled, is to be determined by the authorities, and may be the responsibility of the joint venture.

Profits, Taxes & Insurance Issues

The joint venture is required to use freely convertible currency in all its transactions and operations. The repatriation of after-tax profits out of Cuba is free of restrictions and taxes. The terms of the partnership agreement dictate how the profits are distributed. Profits are usually paid out by way of dividend. The joint venture may, if it is expressed in the partnership agreement, open a bank account abroad or within Cuba. An important condition of the joint venture is the requirement to build up a reserve fund to cover contingencies. This could amount to 5% of annual profits until the reserve amounts to 15% of the paid up capital stock of the company.

The only tax on the formation of the joint venture is a US\$500 fee payable to the Chamber of Commerce upon the registration of a company, however, the joint venture is subject to a profit tax. The law stipulates the method for calculating profit tax as well as deductible items. Interest payments on loans, expenses incurred in refurbishing facilities on lease or under usufruct, fixed

³⁸ Article 41 of Decree Law 50

asset depreciation, losses, all can reduce taxable profits. There exists favorable depreciation rates for buildings used in the tourist industry. Profit tax is charged at the flat rate of 30% regardless of the level or type of profit. Whereas, in a totally foreign owned company, the tax is 35%.³⁹ Sources within the committee drafting the new Tax Law claim that the percentage of taxes will not change for foreign investors; only the process on which it will be collected may be amended and written into law.⁴⁰ The Real Estate Law that is currently being drafted will affect the foreign buyers of condominiums and tenants of office space, since a property tax will likely be applied for the use of services such as water and sewer.⁴¹

The Ministry of Finance and Prices is empowered to temporarily exempt, either in full or in part, joint ventures from profits tax, tariffs and other custom duties. There are no taxes on a joint venture's assets or turnover. Current practice indicates that the joint venture receives a tax holiday for the specified period projected in order to recover 100% of the capital invested.⁴² The range is from 4 to 9 years for hotel and office projects, averaging 7 years for hotel and 9 years for office. These figures come from discussions with high level officials in charge of negotiating such joint ventures; however, it must be noted that each case may result in a different outcome due to the influences of the partners and relevant Ministries.

The tax rate for just the utilization of the labor force is 11% of the pay roll, and the social security contribution is 14%. However, in a 100% foreign owned enterprise, the utilization of the labor force tax rate increases to 25%. Therefore, the total payroll tax rate in a joint venture is 25%.⁴³

³⁹ Article 39 of Law 77, Resolution 35/95, and Resolution 22/83

⁴⁰ Interview with Alberto Tutor, Director of Negotiations at the Ministry of Foreign Investment and Economic Collaboration, in Havana on July 2, 1996

⁴¹ Interview with Roberto Brier, Lawyer with Consultores Asociados S.A., in Havana on June 13, 1996

⁴² Article 43 of Law 77

⁴³ Article 39 of Law 77

Joint ventures have the ability to import materials and equipment, if and when the prices, quality and delivery terms are better than those available in the Cuban market. The State will authorize a Customs and Excise Duty exemption on building materials and equipment to be used exclusively in connection with construction and equipping of hotel, residential and office projects. As of June 1, 1996, and as announced by the Ministries of Finance and Prices and Foreign Trade, reductions to customs duties to a new ceiling of 30% will favor the entry into the country of goods which are not produced on the island, in particular raw materials and foodstuffs.

Insurance is an issue of concern to developers and investors alike. The Cuban government has taken steps to protect these interests. The Cuban enterprise for International Insurance (*ESICUBA*) has been given the priority rights for contracting insurance against hazards, as established by the Ministry of Finance and Prices. The insurance is applicable to hotel and non-hotel facilities completed or in the construction phase, and until their operations begin. The cost will also be borne by the joint venture. Unfortunately, bonding, which is to ensure the completion of the project, is not available through *ESICUBA*, or any other organization within Cuba. The case of the *Melia Cohiba Hotel* which took some seven years to construct, was plagued from the beginning with problems that could have been avoided through such a protection plan. The result was the dissolution of the foreign participation and costly overruns carried on the shoulders of the cash strapped Cuban partner.

Case Studies

Foreign Investment in the Tourism Sector

The following paragraphs identify some of the international players participating in Cuba's tourism sector. The first real estate joint venture project since the Revolution, was the \$26 million, 607-room *Hotel Sol Palmeras*, opening in 1990. This was a 50-50 partnership, despite Decree-Law 50 49% limit on foreign participation, between *Cubanacan*, a Cuban autonomous state tourism agency, and Spain's *Cubacan*, a privately held company. The joint venture term was signed for 25 years with an

option to extend to 50 years. The operator and part owner (8%), is *Spain's Grupo Sol Melia*, Europe's second largest hotel chain. The 500-room *Melia Varadero Hotel* built in 1992 for \$34 million was the second deal that came to fruition by the same joint venture partners. Today, *Grupo Sol Melia* is a part-owner or manager of six luxury hotels in Cuba, with *Cubanacan*, their real estate arm, owning 50% of most of these properties with *Cubanacan*.

The portfolio of hotels are amongst the most profitable in the entire *Melia* chain of over 170 worldwide. Carlos Martinez, General Manager of the *Melia Varadero Hotel*, claims that their Cuban hotels are averaging over 80% occupancy levels and that the *Sol Palmeras* is their most profitable worldwide. The *Sol Palmeras* has paid almost no taxes, and experiences labor costs of 15% of operating costs compared with the industry's average labor cost of 35% to 45%.⁴⁴ *Grupo Sol Melia* plans to double its stake in Cuba over the next two years. Recently, *Grupo Sol Melia* has negotiated partnership agreements with Cuba's *Gaviota Hotel* group. Plans include building six new resort properties.

In early 1996, *Guitart Hotels* and *Cubanacan* began a 50/50 joint venture to restore *the Havana Libre*, a hotel in the center of Havana-Vedado. The controversial split between *Guitart* and *Cubanacan* was allegedly valued at US\$6.6 million. Today, *Trype Hotels* of Spain has acquired *Guitart's* interests. The construction of the *Melia Cohiba Hotel* in Havana-Vedado took some seven years. Sources within *Cubanacan* claim that their original Spanish partner split into two groups, neither having the capacity to fulfill their financial commitment to complete the hotel. Finally, after sourcing the capital for the hotel on their own, *Cubanacan* brought *Grupo Sol Melia* in to begin operating the hotel in February of 1995. The *Melia Cohiba Hotel* earned US\$18.7 million during its first ten months of operations, US\$3 million more than projected. Spanish manager, Carlos Villota,

⁴⁴ Interview with Marcelo Montenegro, former General Manager for Delta Hotels in Cuba, in Toronto on May 5, 1996

predicts earnings of US\$23 million in 1996. Room rates range from \$150 to \$400 per night in the five star facility.

In late 1995, Italian investors opened a \$7 million cruise-ship terminal in Havana's harbor; where the first passengers disembarked two weeks before Christmas 1995. Currently, only one cruise ship calls at Cuban Ports once per week. There are several factors limiting the number of ships calling on Cuban ports, including the toughening of the blockade specified by the Torricelli Law (October 1992). Under this law, ships that enter Cuba are forbidden to arrive in US ports for six months after a previous arrival in Cuba. Additional requirements imposed by Cuba's Ministry of Tourism include: (i) a minimum of three Cuban ports must be included in the itinerary, (ii) a minimum of 30% of the ship's passengers must stay for at least one week on the mainland prior to or following the cruise, (iii) and a negotiated number of Cubans must be employed aboard the cruise ship. These conditions limit the economic viability of cruise ship traffic, and therefore, any dependence on significant tourist traffic from this mode may be unrealistic.

The *Horizontes* hotel chain reports an increase in earnings in 1995 of 144%, and *Gaviota*, Cuba's smallest tourism group, reported earnings ahead by 60%.⁴⁵ *Gaviota* has ambitious expansion plans: two new hotels scheduled for completion in 1996, with 570 rooms between them; several more hotels at the planning or negotiation stage, and plans to refurbish the Varadero marina. Most, if not all of these projects will involve joint ventures.

Example Of A Joint Venture Structure

On July 1, 1996, the largest real estate joint venture was approved by the Executive Committee of the Council of Ministers, and signed by all parties. *Wilton Properties* of Canada and *Gran Caribe* of Cuba formed a joint venture called *VANCUBA*. *VANCUBA* will develop 4,200 rooms, in the four and five star categories, over the next five years. These hotels will be developed in several regions

⁴⁵ Havana Asset Management Limited, "Cuba Investment Report", March 1996

including: one in Havana, five in Jibacoa, three in Cayo Largo, and two on the Isle of Youth. The first phase, to begin in 1996, will include 500 rooms in Jibacoa and 250 rooms in Cayo Largo. The total cost of the developments are estimated at \$370 million.⁴⁶

The land value contribution to each project varied across regions, however, on average it ranged from 12 to 20 percent of the total development cost. The mature regions, Havana and Cayo Largo, had land values assigned to them in the 20 to 30 percent range. Whereas, in the relatively virgin regions, land values represented 10 to 15 percent.⁴⁷ To put these figures into perspective, 1990 data collected in both the US and the United Kingdom revealed that the land value for premium sites represented on average 12 to 13 percent of four and five star hotel development costs.⁴⁸

The business plans for each of these projects indicate capital recovery periods of between 6 and 9 years. A tax exemption coincides with these periods, so as to allow the investor(s) to recover 100 percent of their capital tax free. *VANCUBA* has been set up as a holding company with a 50-50 interest. A subsidiary will be created to develop each project just prior to its inception. *Gran Caribe* will retain a 50 percent interest in each subsidiary, however, in the event that a third party were to participate in a subsidiary, *Wilton's* interest in that subsidiary must be diluted.

Prior to the inception of a subsidiary, *VANCUBA* must prepare a feasibility study and submit it to the Executive Committee of the Council of Ministers for approval. Since land constitutes a right granted by the State to the Cuban partner through which the same can benefit from the use of the land for a specified period of time, the term of the subsidiary must coincide with the term of the land. For each project the original term of the land lease is for 50 years with an option to extend to 75 years. The term of the lease begins only after the incorporation of the subsidiary. Therefore, the option on the

⁴⁶ Interview with Walter Berukoff, President of Wilton Properties Inc., in Quebec on April 21, 1996

⁴⁷ Interview with Brito Salvador, Chief Negotiator for Gran Caribe Hotel Group, in Havana on May 8, 1996 and July 1, 1996

⁴⁸ Hospitality Valuation Services International, "Hotel Development Costs: United States Vs. United Kingdom", International Real Estate Journal, Volume 18, Issue 4

parcels of land for each of the projects has been assigned a date by which time *VANCUBA* must exercise its option, or risk losing the parcel to another developer. As referred to above, the eleven hotels must all break ground within five years.

VANCUBA is typical of a real estate joint venture that plans to develop more than one project on more than one site. In the event that the joint venture plans to build only one project, it would be unnecessary to create a holding company, rather, the creation of a single company would suffice.

Chapter Six
Conclusions & Recommendations

The Real Estate Investment Climate In Cuba

Cuba's leading economic strategist, Vice President Carlos Lage, had this to say in the wake of the signing of the Helms-Burton Law: " The law, which includes provisions allowing US citizens to sue foreign firms "trafficking" in expropriated property, would be hard to apply and has been widely criticized abroad, but it has been effective in scaring away some foreign firms." Confiscated homes, offices, hotels, and other commercial premises, could be the subject of claims by Cuban-Americans and pre-Revolution American owners. However, current owners will inevitably make counter-claims based on purchases made in the interim.

In the short term, the new US legislation may temporarily cut off the flow of foreign capital. The most obvious result is that hopes for early normalization of relations between Cuba and the US have been eliminated. Given a second term, Clinton might have encouraged a gradual easing of the embargo, regarding free trade as a stronger influence for political and economic change than economic reprisals. Some analysts have argued that Castro's hold on power will fade once the embargo is removed; also in the interim, the previous loosening of US travel restrictions had no doubt allowed a number of Cuban-Americans hostile to the government and bent on sedition to slip into Cuba. Whether the act of destroying the exiles' planes was calculated to delay an early lifting of the US embargo is unknown, but the crisis has certainly resulted in a tightening of political control in Cuba.

Whatever the short term domestic political repercussions, economic liberalization is still on the agenda. Cubans have tasted the fruits of previous liberalizing measures and their expectations are rising. The reformers have taken a back seat for the time being, but discussions with vice ministers and academics at the "*Foreign Investment and Economic Development in Cuba Conference,*" held in Havana May 7-9, 1996, have confirmed that further important reforms are under discussion. As

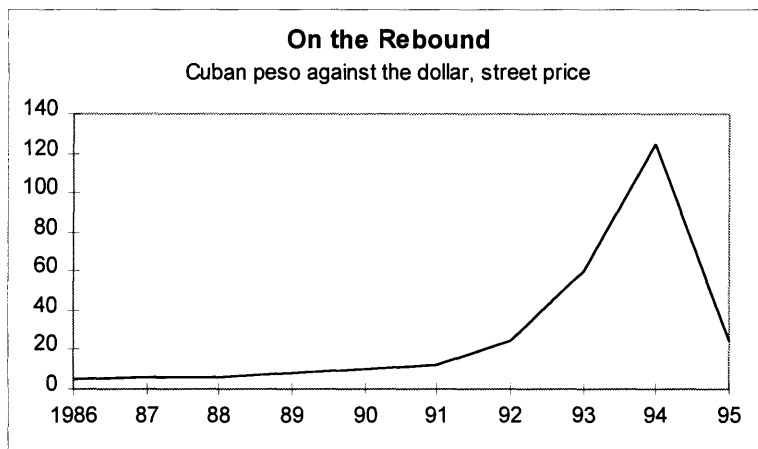
for political risk, Fidel Castro himself recently stated, " The only political risk in Cuba is the threat that Cuba becomes capitalistic overnight."

Political or country risk, is often determined through the observation of the country's historical trends and current environment in respect to how events impact the country's social and economic stability. Political instability is not the result of underdevelopment but the cause of underdevelopment. The origin of Cuba's problem is economic in nature. Due to Cuba's authoritarian top-down political system, it has experienced limited organized opposition. When disaffection is apparent among such a significant groups as the student elite, the government often opts for appeasement and concessions rather than confrontation. The investment community, including financial institutions, will typically apply a methodology to measure political/country risk. The Royal Bank of Canada, Canada's largest bank, has determined through its own methodology that Cuba is ranked too high a risk to be lending to Canadian companies planning to business there.⁴⁹ Much of Cuba's economic future may depend on its ability to normalize its relations with the US. This remains a factor of uncertainty, given the overtones of the Helms-Burton Law.

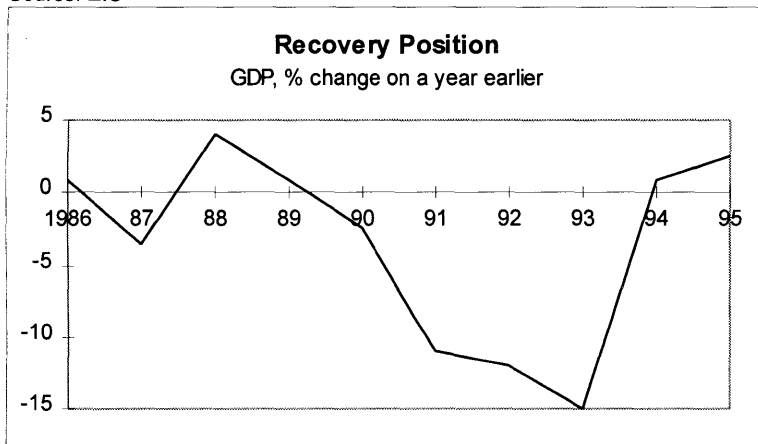
Major political factors that have impacted the business decision in Cuba today, include the unpredictability of governmental policies. An example of where policy over rides law is with Law 77 which explicitly permits up to 100% foreign ownership of land and or business, however, practice reveals that to date approval of foreign investments have been for a maximum of 50% foreign participation. The results from interviews with officials from several companies authorized to do business with foreign entities have been consistent in that these companies all require the maintenance of a minimum of 50% Cuban participation. A policy to limit development along the sea to hotel projects, has also been reconsidered for exceptional cases.

⁴⁹ Interview with Bill Jandrisits, Group Head & Senior Industry Analyst Real Estate & Infrastructure Financing for the Royal Bank's Multinational Lending Unit, in Boston on June 4, 1996

Dealing with foreign debt will be one of Cuba's biggest obstacles to sustaining an economic recovery. Cuba's access to capital hinges on reducing its debt and complying with the *International Monetary Fund (IMF)*. Excluding the former Socialist block, China, Vietnam, and North Korea, Cuba's foreign debt stood at \$9.2 billion at the end of 1995. However, progress has been made in cutting the budget deficit from 33.5% of GDP in 1993 to less than the 5% maximum required by the *IMF* in 1995.⁵⁰ The following traditional indicators convey Cuba's economic recovery.



Source: EIU



Source: EIU

In 1994, Cuba slashed its budget deficit by nearly 75%, bringing it to 3.6% of GDP in 1995. This was achieved mainly by increasing duties on cigarettes, alcohol and petrol and by reducing by nearly 50% subsidies to money-losing state enterprises. Observers both inside and outside Cuba now agree that the economy grew by 2.5% in 1995. Officials expect that additional cuts in 1996 will

⁵⁰ Economic Intelligence Unit (EIU)

reduce the deficit by another 25%. On July 24, 1996, vice president Carlos Lage reported better than expected tobacco crops, tourist visits, nickel production, and a significantly improved sugar harvest over 1995, resulting in a 9.6% increase in the GDP over the first half of 1995. These results are indicative of Cuba's economic recovery.

All of the above is expected to have a significant and positive impact upon Cuba's ability to gain access to capital, or be better heard by the *Paris Club* and *London Club* with respect to debt re-negotiation. In addition, Banco Nacional de Cuba (National Bank of Cuba), appears to be dedicated to a reorganization of the Cuban banking system to separate the central and commercial banking functions.⁵¹ Other signs of credit improvement include the recent announcement that Spain's export risk insurance agency *CESCE* has decided to grant three-year coverage to the island, thus encouraging Spanish banks to increase their lines of credit. France also recently announced that it will increase its line of credit to \$155 million from \$140 million last year. The improved Spanish and French credits have not yet been echoed elsewhere in Europe.⁵²

In Cuba's economy where dependency on foreign receipts is paramount, efforts to revitalize its economy and participate in the new international economy are under way. Although the volume of Cuban trade has not increased since 1989, the participation of Latin America countries, Canada, and the European Community has grown substantially. This is the direct result of newly authorized reforms over the last several years including flexibility in joint ventures, economic associations, free trade zones, autonomous enterprises, cooperative production agreements, third party marketing and management agreements, and an overhaul of the domestic economy with the promotion of private entrepreneurs. These actions are indicative of a country moving towards capitalism, however, the fact that Cuba is highly suspicious of foreign capital, indicates that Cuba will continue to maintain strict control over their hybrid economy.

⁵¹ Interview with Mercedes Lopez, Director of FINSA, Financial Institution, in Havana on June 12, 1996

⁵² Cuba Business, March 1996, pg. 3

The effectiveness of the work force in a capitalistic sense is another consideration. In Cuba, the work-force is one that is highly educated by most standards. However, an educated work-force is one thing, a motivated work-force is quite another. Due to the restriction of material incentives, and control over salaries by the Ministry of Labor and Social Benefits, the salary ceiling is reached rapidly by comparison to capitalist societies. A recent graduate may expect to earn 200 pesos (\$8) per month, whereas a doctor with a specialization would earn between 400 (\$16) and 450 pesos (\$18), regardless of experience. A high-ranking politician or government official will typically earn 400 to 450 pesos per month. In the tourism sector, the cost to a joint venture per employee averages \$450 to \$475 per month, including social benefits; however, the employee is paid by the government employment agency which collects the dollar salary and pays the employee on average 250 to 350 pesos. One must consider that upon a normalization with the US, and a continued integration into the international economy, extremely low labor costs that make a hotel project economically viable today, may become less lucrative as salaries move upward due to external pressures. Furthermore, under the current regime the effectiveness of distribution systems and the reliability and quality of supplies has proven to be inconsistent. These are risks that must be measured prior to taking an investment decision. Depending on the investor's risk aversion, a project's expected risk premium begins to add up.

In today's climate, are there real estate investment opportunities in Cuba?

The *Real Inmobiliaria* residential project, and the *AUREA* office project, both referred to in Chapter 3 could be economically feasible under existing Cuban Legislation; however, until the new property and tax laws are introduced, both currently in their initial draft stage, it will be difficult to judge how far the government is willing to go. Following the announcement of the *Real Inmobiliaria* condominium joint venture in January 1996, official sources were quoted as saying that the aim was to build housing and office space for a market that is "self-restricting". "The policy is not to sell existing buildings but to sell buildings planned for construction in the future," says Ricardo Nunez, Urban Economist at the Department of Comprehensive Development for the City of Havana.

However, as the quantifiable demand exists for new residential and office space, it is difficult to foresee a future opportunity in these sectors as supply will soon surpass demand upon the completion of the *AUREA*, *Real Inmobiliaria*, and first phases of the *Monte Barreto* office project.

The viable sector for real estate investment is tourism, since demand is less dependent upon the internal economy and political infrastructure. The tourism sector has proven profitable to the few players who have been participating since the early 90's. Future projections and past trends all point towards a significant demand and supply disequilibrium. Cuba's ability to provide the capital needed to keep up with the demand on its own, is considerably strained. Therefore, taking into account the facts and figures alluded to within this report, hotel development continues to be at present and in the foreseeable future, the most opportunistic product for foreign real estate investment.

Within the framework of the existing investment and development process in Cuba, why have real estate joint ventures become popular?

Policy dictates that joint ventures are the only investment vehicle that facilitates foreign participation in a real estate development project.

What incentives exist to attract foreign real estate developers to Cuba?

Incentives include a tax holiday for the joint venture until such time that 100% of the initial capital is recovered. In the short term, the ability to earn over 20% after tax returns on hotel development, with unlimited upside potential upon normalization between the US and Cuba, is nearly twice the typical returns realized in Europe and North America.⁵³

⁵³ Cooper, Marc, "A Conflict of Interest", *World Business*, May/June 1996, pg. 20, and in an interview with Eduardo De la Vega, Vice Minister of Tourism, in Havana on June 12, 1996, and in an interview with Mundi Gilbert, Director of Planning/Design/Construction of the Melia Group, Hotel Developers and Operators, in Montreal on June 7, 1996

What do joint ventures offer both the Cuban and foreign partners?

The joint venture relationship facilitates the development of real estate which the Cuban partner is financially incapable of pursuing alone. Development of high quality real estate product continues to be constrained by lack of capital available for construction, and the lack of in-country development expertise. These barriers can be profitably exploited by forming a joint venture with a foreign entity that possesses capital, development expertise, property management skills and experience in building real estate in emerging markets. The foreign partner will seek a qualified local joint venture partner who will benefit the development by assisting in locating and acquiring control over attractive sites, assisting in procuring required government approvals, and providing knowledge of local construction methods and contractors.

What reforms have been adopted to encourage foreign investment, and are they sufficient to meet their objectives?

Prior to September 1995, there was no constitutional or statutory guarantee under Cuban law against expropriation of any foreign investment without due process and compensation. Flexibility has been added to the new law of September 1995, whereby foreign participation is no longer limited to 49%. Cuba also guarantees foreign investors the right to remit exclusively through the *Banco Nacional de Cuba* all dividends and net earnings derived from their Cuban investments.

As a foreign real estate developer, what are the specific problems associated with completing a real estate project in Cuba?

The negotiation process is time consuming but not necessarily unique to Cuba; however, the approval process requires the joint venture to pass through many more agencies than in a North American system. The requirement of the joint venture to simultaneously develop a hotel project in a relatively unproved virgin region similar to the originally proposed project in a mature region, can add significant risk to the economic viability of the joint venture. The procurement of materials and skilled labor have caused logistical nightmares on most all joint venture projects developed to date.

Over 50% of construction materials must be imported due to lack of quality or availability in Cuba. Scheduling is a phenomenon not recognized in Cuba. Many things can go wrong, whether a shipment is delayed, or a wall is erected in the wrong place. *Working drawings* is a concept that does not exist in the Spanish language nor in Cuba. Finally, construction typically takes up to twice the time it normally does in North America, despite the fact that the construction season is not interrupted by snow or freezing temperatures.

When considering a 100% foreign owned enterprise in Cuba, there exists obvious disincentives. These include the tax treatment of the 100% foreign owned enterprise versus the joint venture. For example, the flat rate profit tax increases to 35% from 30% for the joint venture, and the utilization of the labor force tax rate increases to 25% from 11%. Other disincentives include the unlikelyhood of convincing the Executive Committee of the Council of Ministers that a 100% foreign owned enterprise can be economically and socially beneficial to the Cuban people. Therefore, when considering entering the new Cuban real estate market, a joint venture is the advisable routes.

The opportunities to realize returns comparable with those in capitalistic countries, such as the US and Canada, as alluded to in this report, do exist. However, expected risk premiums that are realized in other business sectors such as in mining, agriculture and manufacturing are, in fact, non-existent in speculative real estate development.⁵⁴ This is due primarily to the relatively high cost and definitive period of use of a project's land component. Today's foreign real estate investors are hoping for a lifting of the US embargo to cover and potentially exceed the expected risk premium's shortfall of pursuing a real estate investment in Cuba.

Following the adoption of Foreign Investment Law 77, in September 1995, two to three real estate developer/investors per week, from small to large, began investigating the real estate investment opportunities. Since March 12, 1996, following the signing of the Helms-Burton Law, this number

⁵⁴ Interview with Patrice Merrin Best, Vice president Corporate Affairs, Sherritt Inc., in May, 1996

trickled down to two to three per month.⁵⁵ For example, *Trizec*, a large Canadian based real estate company with 80% of its assets in the US, spent three months investigating the opportunities, concluding that the risks were too high with Helms-Burton in the air. Officially, the Cuban government claims that interest has picked up since March 12. This may in fact be true, however, the number of ongoing negotiations does not reflect the number of joint ventures that come to fruition. As alluded in the body of this report, only a handful of joint ventures have been signed to date and fewer have broken ground.

Despite both the embargo and the Helms/Burton Law, if economic reforms continue and a clear and concise process to facilitate foreign investment into real estate activities are written into formal legislation, where law governs over policy, Cuba may prove to be a fertile real estate investment opportunity into the next century. However, as Cuban officials watched the socioeconomic breakdown of the former COMECON nations, they believed it was the result of going too far too fast and losing control of the reform process. Therefore, Cuba, not likely to experiment politically in the midst of an economic crisis, will wait until after the crisis before contemplating further significant reforms. As referred to earlier in this chapter, the economic recovery is moving ahead, and at this pace is certain to pull Cuba out of its "Special Period" in the not so distant future. This will inevitably lead to the adoption of the laws referred to in the body of this report, including the creation and passing of a real estate law governing mortgages, property taxes, fee simple ownership of land and the renewal of property management contracts, all of which impact the investment decision-making process.

Meanwhile, by the time American firms are permitted to do business in Cuba, Canadians, Europeans and Latin Americans will hope to have tied up the mineral rights, the power companies, the telephones, the hotels, the sugar mills, and anything else that seems ripe for the picking. They

⁵⁵ Interview with Ricardo Nunez, Urban Economist at the Center of Integral Planning for the Capital, in Havana on May 10, 1996, June 10, 1996 and June 14, 1996

will be the first foreign investors in Cuba, which will become a magnet for American tourists and the US dollar once normalization of relations with the US occurs. Today, it is apparent that foreign investors from other nations are banking on normalization, so that they may benefit in the unlimited upside driven by the expected tidal wave of activity. There are two questions to consider, however; (i) When will Americans have unrestricted access to Cuba? (ii) Will the lifting of the embargo usher in reform to a freer economic system? As Cuba has slowly adopted market reforms, one thing is certain, it has already gone too far to backtrack.

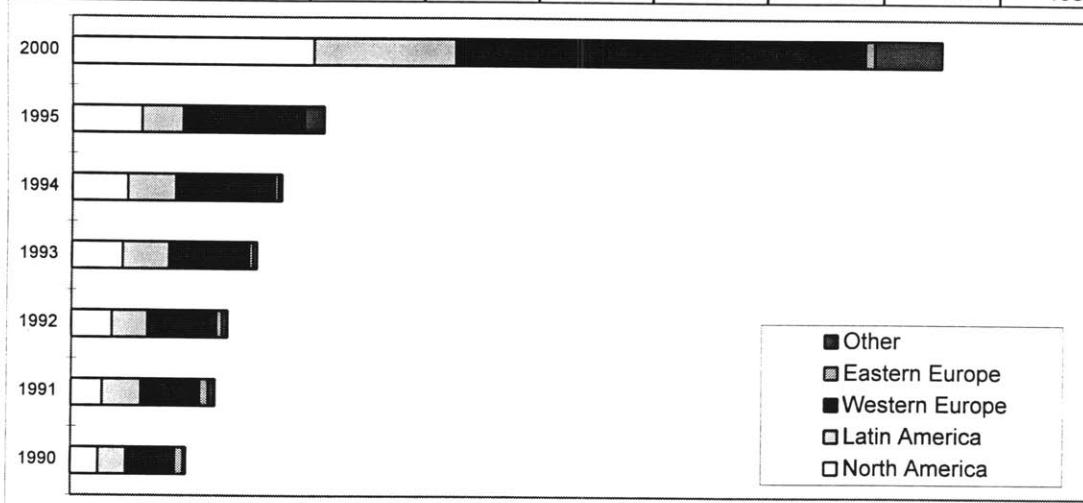
In light of recent events, it may be many more years before normalization between the US and Cuba occurs. Therefore, a relatively risk-adverse real estate investor must consider any projects' current economic feasibility while factoring in the appropriate country risks, rather than expecting a normalization.

Appendix A

Selected Indicators of International Tourism

(Source: MINTUR)

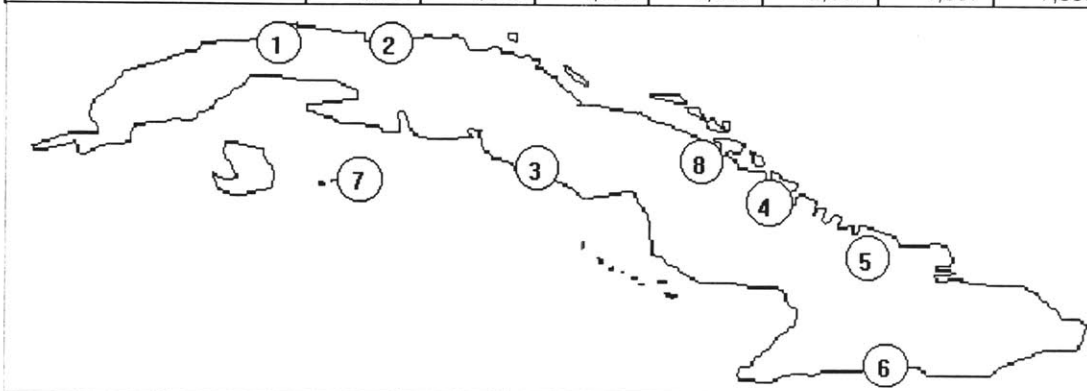
	REAL						Forecast 2000
	1990	1991	1992	1993	1994	1995	
Visitors Received (,000)	340.3	424.0	460.6	546.0	619.2	741.7	2,551.0
North America	81.8	92.3	120.3	151.1	164.9	206.4	709.9
Latin America	82.0	115.0	105.8	136.9	141.4	121.0	416.2
Western Europe	143.4	171.2	200.7	234.5	290.6	349.4	1,201.7
Eastern Europe	25.4	25.6	17.7	11.6	11.5	8.0	27.5
Other	7.7	19.9	16.1	11.9	10.8	56.9	195.7



Average Stay (days)	8.7	8.7	9.1	9.6	9.1	8.7	7.6
Tourist-days (,000)	2,949.7	3,678.9	4,181.1	5,221.9	5,656.1	6,461.0	19,504.4

Total Revenues (US\$ mill.)	243.4	387.4	567.0	720.0	850.0	1,100.0	3,120.7
US\$ / Tourist-day	82.52	105.30	135.61	137.88	150.28	170.25	160.00

Rooms (one) *	12,866	16,638	18,662	22,139	23,254	24,233	49,556
1 Havana	4,197	4,936	6,624	6,690	7,318	7,664	10,664
2 Varadero	4,145	5,614	5,622	6,641	7,151	7,273	14,773
3 Southern Coast	432	669	632	1,192	1,192	1,374	1,874
4 North of Camagüey	449	739	739	952	952	1,343	2,343
5 North of Holguín	816	1,079	1,043	1,000	1,235	1,594	2,594
6 South of Oriente	868	1,455	1,505	1,643	1,567	1,737	2,489
7 Canarreos	264	308	308	554	554	560	1,310
8 North of Ciego de Ávila				458	678	821	5,621
9 Other	1,695	1,838	2,189	3,009	2,607	1,867	7,888



* Excludes approximately 1600 rooms operated by Islazul for domestic tourism, which during the period 1996-2000 could be refurbished and added to the inventory serving international tourism, which could also be increased if other non-hotel lodging alternatives are included.
Data for the year 2000 are calculated at 60% occupancy rate.

Appendix B

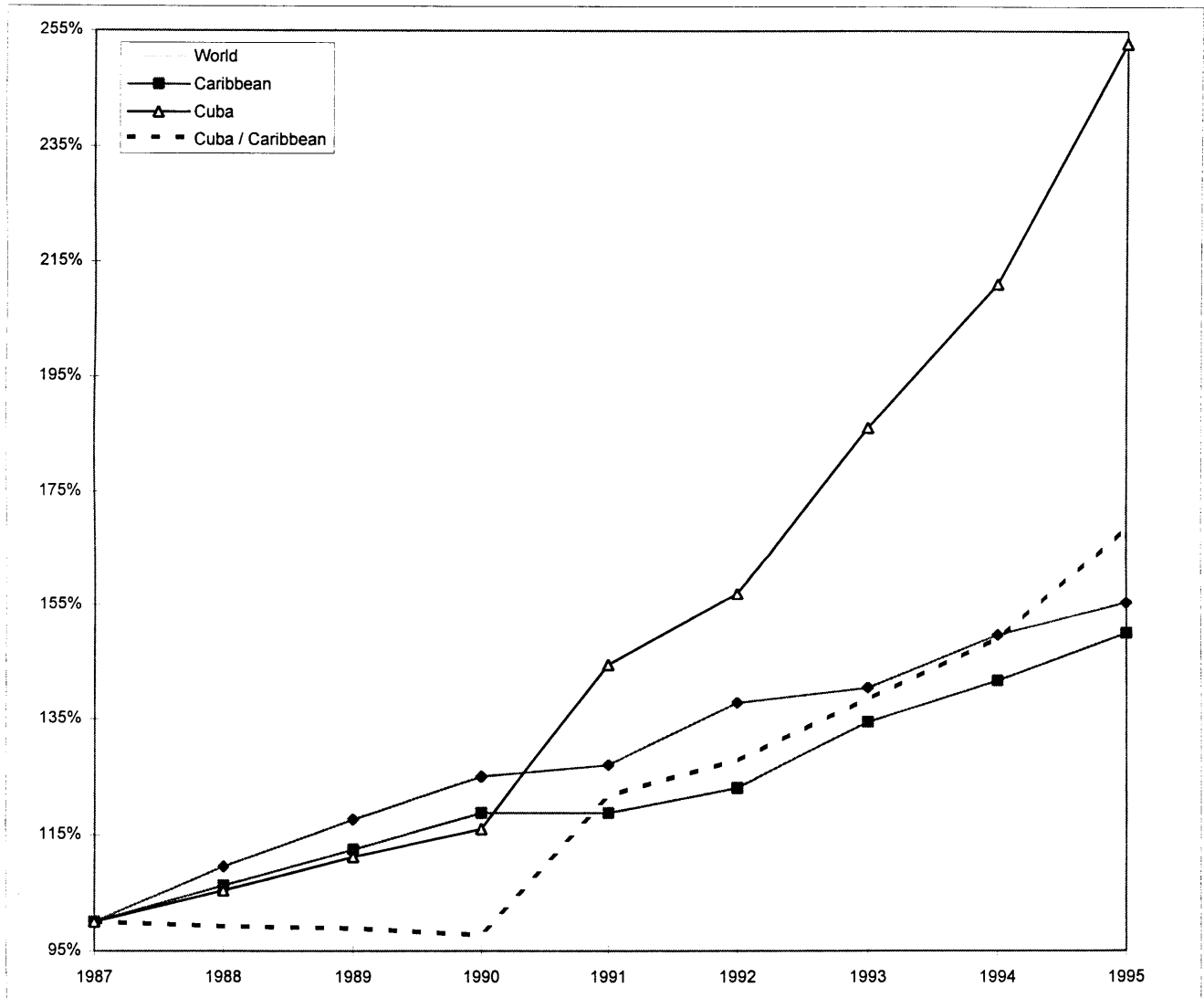
Arrivals

(Source: WTO)

Year	World		Caribbean		Cuba		Cuba / Caribbean	
	Millions	Change	Millions	Change	Thousands	Change	%	Change
1987	364.9	100.0%	9.6	100.0%	293.4	100.0%	3.06%	100.0%
1988	399.7	109.5%	10.2	106.3%	309.2	105.4%	3.03%	99.2%
1989	429.2	117.6%	10.8	112.5%	326.3	111.2%	3.02%	98.9%
1990	455.8	124.9%	11.4	118.8%	340.3	116.0%	2.99%	97.7%
1991	463.1	126.9%	11.4	118.8%	424.0	144.5%	3.72%	121.7%
1992	502.9	137.8%	11.8	122.9%	460.6	157.0%	3.90%	127.7%
1993	512.5	140.4%	12.9	134.4%	546.0	186.1%	4.23%	138.5%
1994	546.3	149.7%	13.6	141.7%	619.2	211.0%	4.55%	149.0%
1995	567.0	155.4%	14.4	150.0%	741.7	252.8%	5.15%	168.5%

Average Yearly Increase

1987-1990	7.7%	5.9%	5.1%	-0.8%
1990-1995	4.5%	4.8%	16.9%	11.5%



Appendix B cont'd

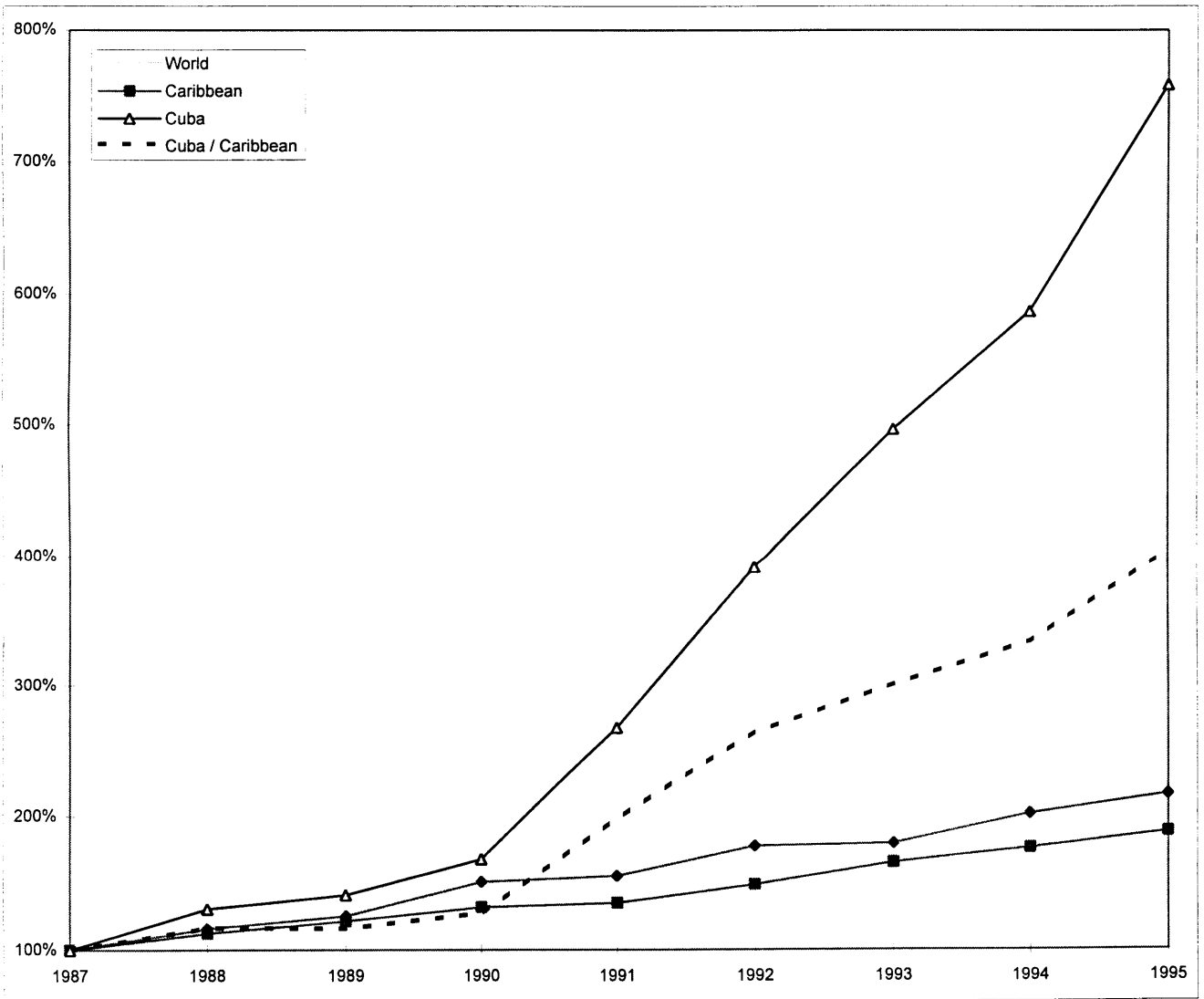
Revenues

(Source: WTO)

Year	World		Caribbean		Cuba		Cuba / Caribbean	
	Billions	Change	Billions	Change	Millions	Change	%	Change
1987	172.4	100.0%	6.6	100.0%	145.0	100.0%	2.20%	100.0%
1988	199.5	115.7%	7.4	112.1%	189.0	130.3%	2.55%	116.3%
1989	215.6	125.1%	8.0	121.2%	204.0	140.7%	2.55%	116.1%
1990	260.0	150.8%	8.7	131.8%	243.4	167.9%	2.80%	127.3%
1991	267.5	155.2%	8.9	134.8%	387.4	267.2%	4.35%	198.1%
1992	305.9	177.4%	9.8	148.5%	567.0	391.0%	5.79%	263.3%
1993	309.1	179.3%	10.9	165.2%	720.0	496.6%	6.61%	300.7%
1994	347.0	201.3%	11.6	175.8%	850.0	586.2%	7.33%	333.5%
1995	372.0	215.8%	12.4	187.9%	1,100.0	758.6%	8.87%	403.8%

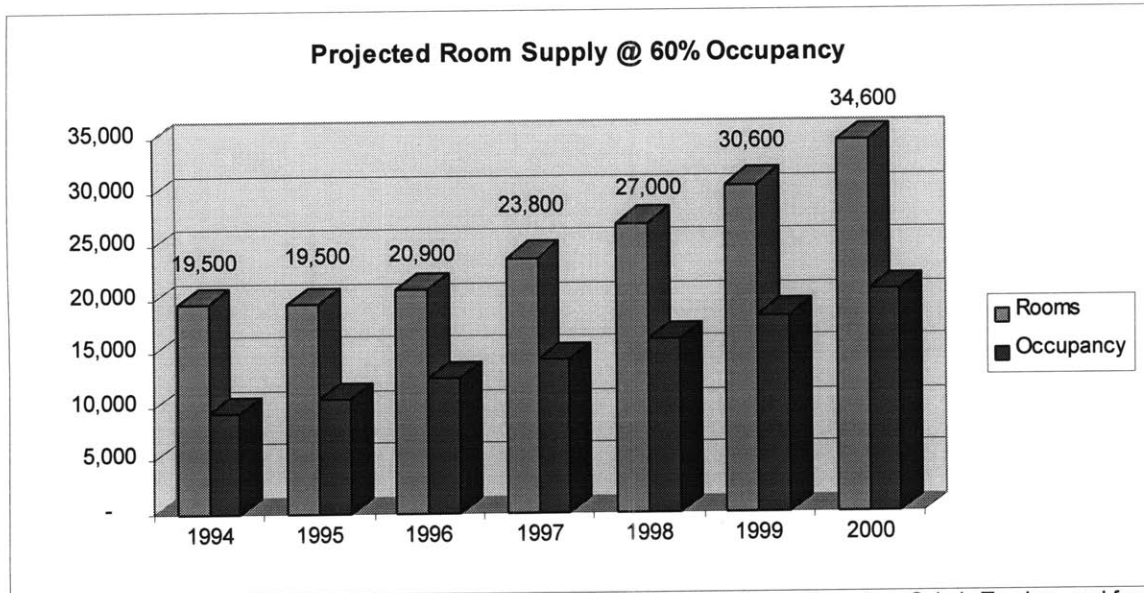
Average Yearly Increase

1987-1990		14.7%		9.6%		18.8%		8.4%
1990-1995		7.4%		7.3%		35.2%		26.0%



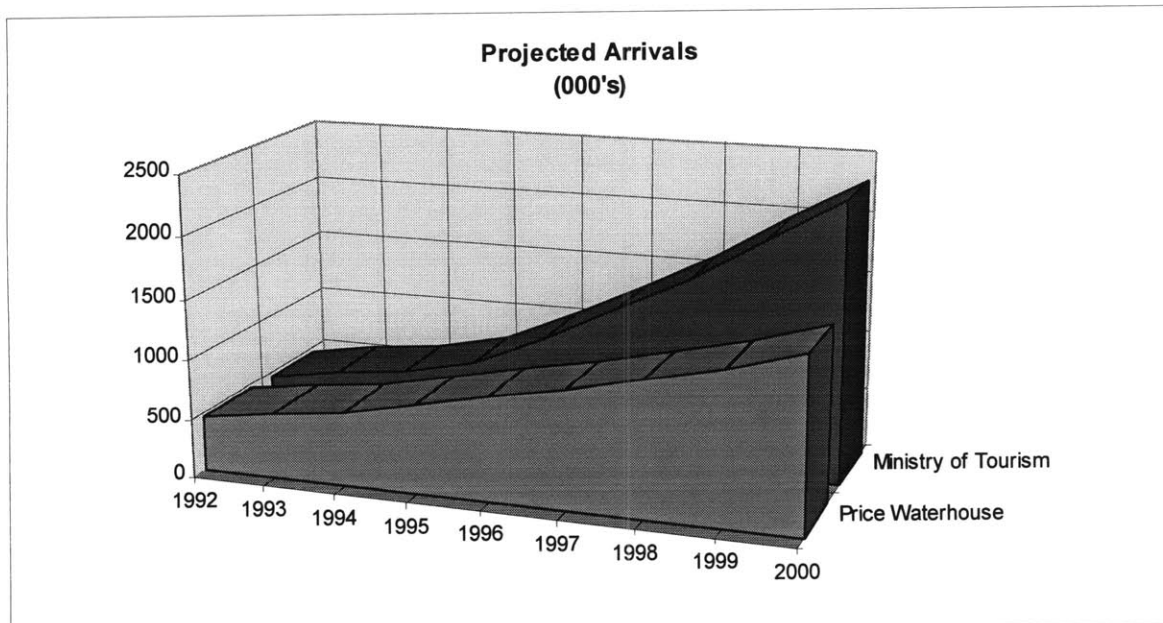
Appendix C

Graph 1



Source: Constructed from information from the December 1994 Price Waterhouse Report on Cuba's Tourism, and from published reports from MINTUR.

Graph 2



Source: Constructed from information from the December 1994 Price Waterhouse Report on Cuba's Tourism, and from published reports from MINTUR.

Bibliography

Books

- Bell, B. *"Insight Guides: Cuba"*, Singapore: Hofer Press Pte Ltd, 1995
- Brier, R. *"Legal Profile of Foreign Investment in Cuba"*, Havana: Consultores Asociados, S.A., 1995
- Franqui, Carlos, *"Family Portrait With Fidel"*, New York: Random House, Inc., 1984
- Jenkins, G. and Haines, L. *"Cuba: Prospects for Reform, Trade and Investment"*, New York: The Economist Intelligence Unit, 1994

Articles, Reports & Papers

- Berman, Scott, *"The Challenge of Cuban Tourism"*, The Cornell H.R.A. Quarterly, June 1994
- Cooper, Marc, *"A Conflict of Interest"*, World Business, May/June 1996, pg. 20
- "Cuba Business", March 1996, pg. 3
- Cuba Publications Inc., Miami, "The Cuba Report", Volume 4 Numbers 6,8,9
- The Economist, Journal, *"Heroic Illusions: A Survey of Cuba"*, April 6, 1996
- The Economist, Journal, *"Scarecrow"*, April 13, 1996
- Escobar, S.R. and Travieso-Diaz, M.F. *"Cuba's Transition to a Free-Market Democracy: A Survey of Required Changes to Laws and Legal Institutions"*, Duke Journal of Comparative & International Law [Vol. 5:379] 1994
- Falk, Pamela, *"Eye on Cuba"*, Foreign Affairs, US, March/April 1996, pg. 14
- Gilbert, Roger, *"Cuba's Economy and the United States"*, Essay, Montreal, 1996
- Gonzalez, Elena Diaz, *"The Quality of Life in Cuba's Special Period: Examining the Life of US Policies"*, FLASCO-CUBA, 1995, pg. 12
- Havana Asset Management Limited, "Cuba Investment Report", March 1996
- Helewa, Sami, *"Fidel Castro's Treasure Island"*, The G7 Report Money Trade & Investment, Volume 4 Number 6
- Hospitality Valuation Services International, *"Hotel Development Costs: United States Vs. United Kingdom"*, International Real Estate Journal, Volume 18, Issue 4
- Kaplowitz, D.R. *"The Cuban Market Opportunities and Barriers"*, Cuba Research Associates, Spring 1995
- Morris, Nomi, *"Can Cuba Change?"*, Maclean's Business Journal, Canada, January 15, 1996, pg. 16

The Miami Herald Publishing Company, "CUBANEWS", Volume 4, Numbers 1-6

Price Waterhouse, Toronto, "An Assessment of Tourism Developments and Opportunities in Cuba", December 1994

Smith, Wayne, "Cuba's Long Reform", Foreign Affairs, US, March/April 1996, pg. 99

Wells, Jennifer, "Business Moves In", Maclean's Business Journal, Canada, January 15, 1996, pg. 22

Whisenand, James, "Cuba: An Economic Frontier", Global Law & Business, March 1996, pg. 59

The World Tourism Organization (WTO), "Report on Caribbean Tourism Statistics", 1995 Preliminary Results

Transcripts of Workshops & Conferences

Americas Conference Corporation, "First Annual Corporate Counsel Cuba Conference", Boca Raton, FL, March 29-31, 1996

Center of Integral Planning for the Capital, "Workshop on Real Estate Development and Derivation of Land Value", Havana, Cuba, May 28, 1996

The David Rockefeller Center for Latin American Studies, Harvard University, "American Business and the Cuban Economy", Cambridge, MA, December 14, 1995

Ecklein Communications, Inc., "US / Latin American Hotel & Resort Development Conference", San Jose, Costa Rica, January 29-31, 1996

McGill University & University of Havana, Workshop on Foreign Investment and Economic Development in Cuba, Havana, Cuba, May 7-9, 1996

ULI Professional Development Seminar, "Real Estate and Investment Opportunities in Latin America", Miami, FL, March 4-5, 1996

Legal References

Cuban Laws:

Law Number 77, Cuba's Foreign Investment Act of 1995

Constitution of the Republic of Cuba, Latest modification on July 12 of 1992

Decree Number 50, Cuba's Foreign Investment Law, 1982

US Laws:

Helms-Burton Legislation, US, March 12, 1996

Title III of Cuban Liberty and Democratic Solidarity Act of 1995

Revised full text of Cuban Liberty and Democratic Solidarity Act as of April 1996

The Cuban Democracy Act of 1992, US Legislation

Cuban Assets Control Regulations, 31 CFR, Part 515 (7-1-94 Edition)

Trading With the Enemy Act of 1963, US Legislation

Interviews

Alfonso, Abilio. Manager of Internal Economic Investments at Cubanacan Corporation, in Havana on June 12, 1996

Brier, Roberto. Lawyer with Consultores Asociados S.A., in Havana on June 13, 1996

Berukoff, Walter. President of Wilton Properties Inc., in Quebec on April 21, 1996

De la Vega, Eduardo. Vice Minister of Tourism, in Havana on June 12, 1996

Gilbert, Mundi. Director of Planning/Design/Construction of the Melia Group, Hotel Developers and Operators, in Montreal on June 7, 1996

Gonzalez, Enrique. Group Negotiator for Habaguanex S.A. Real Estate Development Company, in Havana on May 10, 1996

Jandrisits, Bill. Group Head & Senior Industry Analyst Real Estate & Infrastructure Financing for the Royal Bank's Multinational Lending Unit, in Boston on June 4, 1996

Kavulich, John. President of U.S.-Cuba Trade and Economic Council, Inc., in Cambridge, MA, on December 14, 1995

Kim, John. Lawyer with Burns Solicitors Internacional in Collaboration with Rado Y Asociados, in Havana on May 9, 1996

Klip, Alex. Vice President of CubaLink Canada Ltd, Real Estate Consulting, in Boca Raton, FL, on March 30, 1996

Krinsky, Michael. Lawyer representing Cuba, with the Law Firm Rabinowitz, Boudin, Standard, Krinsky & Lieberman, P.C., in Cambridge, MA, on December 14, 1995

Leal, Eusebio. City Historian of Havana, and Chairman of Habaguanex S.A. Real Estate Development Company, in Havana on May 10, 1996

Lopez, Mercedes. Director of FINSA, Financial Institution, in Havana on June 12, 1996

Mailhot, Roger. Commercial Counselor with the Canadian Embassy, in Havana on June 11, 1996

Martin, Miguel. President of Habaguanex S.A. Real Estate Development Company, in Havana on June 13, 1996 and July 3, 1996

Merrin Best, Patrice. Vice president Corporate Affairs, Sherritt Inc., in May, 1996

Mollinedo, Jorge. Director of Negotiation for Eproyiv Real Estate, Architecture and Engineering Company, on June 14, 1996

Montavos, Ileana. Director of Information at the Chamber of Commerce, in Havana on June 11, 1996

Montenegro, Marcelo. Former General Manager for Delta Hotels in Cuba, in Toronto on May 5, 1996

Nunez, Ricardo. Urban Economist at the Center of Integral Planning for the Capital, in Havana on May 10, 1996, June 10, 1996 and June 14, 1996

Orozco, Javier. Director of Corporate Intelligence at Cubanacan Corporation, in Havana on June 11, 1996

Pereda, Manuel. Manager of Residential and Office leasing for Cubalse Real Estate Company, in Havana on July 4, 1996

Salvador, Brito. Chief Negotiator for Gran Caribe Hotel Group, in Havana on May 8, 1996 and July 1, 1996

Scott, Peter. Chief Executive of Havana based Beta Funds Limited, in Boca Raton, FL, on March 30, 1996

Solano, Miguel. Director of Negotiations and Advisor to the President of Cubanacan Hotel Group, in Havana on June 12, 1996

Suddaby, Charles. Partner at The Economic Planning Group of Tourism and Management Consultants, in Toronto on January 5, 1996 and in Boca Raton, FL, on March 30, 1996

Travieso, Mario. General Manager of Inversiones Caribe S.A. Real Estate Services, in Havana on May 6, 1996 and June 11, 1996

Tutor, Alberto. Director of Negotiations at the Ministry of Foreign Investment and Economic Collaboration, in Havana on July 2, 1996