

# *Cuban Real Estate: The Next Boom?*

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The name *Cuba* conjures, for many, images of a country hostile to private real estate ownership. But those of us who have been to the island recently know that opportunities for private land ownership do exist, although they are limited. As far as Cuba is concerned, American investments in certain kinds of real estate are welcome, as are those of citizens of other nations who are willing to follow Cuban law and enter into working partnerships with Cuba's government.

### **Excuse Me; Did You Say Cuba?**

Cuba has changed its foreign investment laws to make the island more hospitable to investment from abroad. The introduction to 1993's Foreign Investment Law is a concise statement on the benefits of international business; it shows a softening of the socialistic government's stance on economic cooperation with capitalistic economies. Addressing the National Assembly of People's Power, Cuban president Ricardo Alarcon de Quesada said Cuba "... can benefit from foreign investment, on the basis of the strictest respect for national independence and sovereignty, given that such investment can be used in the introduction of innovative and advanced technology, the modernization of its industries, greater efficiency in production, the creation of new jobs, improvement in the quality of the products and services it offers, cost reduction, greater competitiveness abroad, and access to certain markets..."

Yet as far as *our* national government is concerned, until Congress lifts its long-standing trade embargo, American real estate ownership in Cuba will be limited to a select group of government and eleemosynary organizations carefully screened by the Treasury's foreign asset control division. For example, anticipating greater trade and diplomatic activity, the State Department recently renovated its downtown Havana quarters. Only one of the six floors is occupied, but the building sits ready for other potential occupants, "sucking air," as developers say.

Illinois interests also await an open Cuba. Recognizing the potential impact

of Cuban trade on the Illinois business community, in 1995 the Chicagoland Chamber of Commerce held "a non-political business conference focusing on the role of Illinois business in Cuba's post-embargo future." The conference was attended by sixty-five business professionals. "We don't often see that many people," noted Bob Lahey, director of the Chamber's World Trade Division.

When Cuba opens up, the real estate opportunities could equal those of Florida, California, the Colorado highlands, South Texas, and other 20<sup>th</sup> century boom locations. During the next decade, Illinois investors could easily be operating real estate developments in Cuba, designed by Illinois architects, built by Illinois engineers, and funded by Illinois lenders. Illinois Realtors® could be listing condominium units overlooking any of the more than 1,000 miles of Cuban beaches.

This article provides an analysis of the business environment for real estate investments in Cuba, moving from the US blockade to discussions of property rights, the growing tourist trade, the growth in foreign investment, and some unexpected sources of competition (such as the Cuban military, which is actively engaged in real estate development).

### **Cuba's Development Environment**

The US blockade is the overriding influence on business development in Cuba. Initiated in 1961, after several rounds of back and forth hostilities between the US and the Castro government, then strengthened by the Helms-Burton Act of 1996, the embargo makes it illegal for Americans to spend money in Cuba. It effectively blocks direct investments, although our countrymen can invest in foreign companies that do business in Cuba.

The Illinois business community is playing a key role in efforts to eliminate the blockade. Dwayne Andreas, the long-time CEO of Decatur agribusiness conglomerate Archer Daniels Midland, is a major figure in a US Chamber of Commerce advisory committee working to ease the embargo by permitting sales of food and medicine to the Cuban people.

Many observers believe that once restrictions on the sale of food and medicine to Cuba are lifted, the mere problems of defining food and medicinal products will lead to a quick termination of the entire embargo. Once it is lifted, Americans will be able to own property within the limits imposed by the Cuban government.

### **Property Rights**

Even though Cuba has a socialist government, its citizens own land, houses, and automobiles; and they have bank accounts. Moreover, many Cubans own their own businesses, under the provisions of a law that permits entrepreneurs to work "on their own account." Lands have titles that are recorded in a Registry of Properties, maintained by the Cuban government in the Ministry of Justice.

Under Cuba's post-revolution constitution, real estate can be owned by: small farmers; private citizens; cooperatives; the government; and political and social groups, such as labor unions, churches, and other non-governmental organizations dedicated to nonprofit activities. In terms of numbers, small farmers are the largest category of land owner, as a result of a strong agrarian reform movement following the revolution. Between June 1959 and February 1961, a total of 32,823 land titles were given to small farmers. In terms of total acreage, this group owns about 15% of all Cuban land; cooperatives own another 50%, and the rest belongs mostly to the state.

Certain kinds of real estate can be owned by foreigners under provisions of the Foreign Investment Law of 1993. As set forth in Article 16, paragraph 1, foreign investors can "acquire ownership and other property rights over that real estate." But these investments are limited to particular uses; as paragraph 2 of Article 16 specifies, "the investments in real estate discussed in the previous paragraph can be utilized for: a) housing and other structures destined for private residence or tourism activities of persons who are not residents in Cuba, b) housing or offices of foreign companies, and c) real estate development for use in tourism."

Most notably, foreign firms can not purchase land for agricultural production, extractive industries, or any other business not related to tourism. Further, foreign firms are prohibited from practicing law or medicine, or owning internal communications media. Moreover, all investments by foreign firms are subject to government approval. However, that approval is usually forthcoming when a project can be shown to be profitable, and to generate jobs. Available evidence shows that in dealing with foreign investors, Cuba's government is generally fair and honest.

In fact, Cuban laws are probably *less* restrictive, and certainly less complicated, than US regulations on foreign investment, simply because the Cubans have had only a decade of experience in this

Permuta has developed into a flourishing but clandestine housing market centered on a boulevard in Old Havana. Prices run from \$10,000 for small flats to \$50,000 for elegant mansions in Havana suburbs.

But while Permuta works for Cubans, it would work less well for foreigners, who are subject to constant surveillance. Foreigners attempting to subvert Cuban law can easily find themselves charged with "Economic Crimes Against the State," as was Robert Vesco, the fugitive American financier, who is now held in a Cuban prison hospital. Basically, under this law, it is illegal to trick the Cuban government. Most foreign real estate investors find it more convenient to build facilities for the tourist trade, which the government encourages and appreciates.

consultants have already conceptualized a "Pista de Piratas" (Pirate's Trail) that will take boaters around the island, stopping at small historic sugar ports (still functioning but largely abandoned, like small town ports in the riverine system of the American Midwest). Similarly, a "Pista de Pescadores" (Angler's Trail) will take boats through Cuba's archipelago of cays on the south coast, a string of islands larger than the Florida Keys. Intriguingly, in a post-embargo Cuba, large outboard boats will be able to travel from Miami to Central America with a three hour run through open ocean. American waterfront developers continue to monitor the political climate, hoping to build marinas and thereby join the growing foreign business community engaged in Cuban activities.

Increases in the number of foreign businesses operating in Cuba will drive the demand for improved real estate. Cuba now has 340 joint ventures with overseas companies. Foreigners have invested \$2 billion on the island in the last few years, with most of the money coming from Canada, France, Great Britain, Italy, Mexico, Netherlands, and Spain. Another 120 joint ventures are under review by Cuban officials, indicating accelerated future growth and an increased need both for commercial space and for housing to shelter foreign managers.

Yet the international private sector has not been alone in responding. In a manner quite unfamiliar to most Americans, military establishments in Latin America often own and operate businesses completely outside the realm of defense activities. Cuba's military is no exception; it is heavily involved in real estate development. Among the military's companies owning and operating real estate are Gaviota, which owns tourist facilities; Contrucciones ANTEX SA, a construction company that also owns real estate; and Agribusiness Sector, which owns a huge rural development project and agricultural holdings. The military establishment is no small player in Cuba's real estate development industry.

### Development Markets in Cuba

Currently, there are three potential Cuban markets for US real estate developers and sellers in a post-embargo environment. They are: 1) developing tourist facilities

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activity. Indeed, over the 1982-1992 decade, out of 76 capital associations with Brazilian, Canadian, French, Mexican, and Spanish corporations, there were no major legal disputes, and only one business was terminated: a Spanish-operated downtown discotheque. Yet while the *legal* problems are not as severe as some might expect, foreign investors complain about *business* practices: inertia, poor workmanship, poor communications, misunderstandings, personnel problems, and Cubans' inability to meet deadlines.

### Swapping Stories

Cuban law provides for real estate to be inherited, traded, or sold. However, when it is sold, the seller must first apply to the Ministry of Justice for permission to sell, and at that time the Ministry may elect to set the price. More importantly, it can undermine the transaction by electing to buy the property in the federal government's name. As a result, most homes are "traded," rather than sold, under a system called "Permuta." Under Permuta, buyers and sellers disguise sales as swaps, and pay unrecorded bonuses. With the arrival of the hard currency spent by foreigners,

### Tourist-Driven Growth

Tourism is the fastest growing sector of the Cuban economy, recently overtaking sugar as the major foreign exchange earner. Cuban statistics show that the number of visitors tripled from 340,000 to 1,004,000 between 1990 and 1996. As many as 2,000,000 visitors are hoped for by the end of the year 2000, although government tourism officials regularly issue overly optimistic projections. Even with two million visitors, Cuba would be far below the number enjoyed by the Bahamas, where ten million people come each year to bask in the sun, but the growth has garnered attention. Worried about an open Cuba's impact, Florida's state legislature commissioned a 1998 study, which found that the post-embargo Cuban tourist industry will cannibalize Florida's tourist trade. Expressing a different fear based on the same underlying belief, Cuba's Minister of Tourism (at a May 1998 press conference at the Annual Tourism Convention) voiced concern about the social impact of America's "spring breakers" on Cuban society.

Preparing for large numbers of boat borne tourists, Cuban planners and their

such as hotels, condominiums for foreign owners living outside Cuba, and recreational facilities such as marinas; 2) constructing commercial office space for foreign firms operating in Cuba; and 3) building housing for foreigners living in Cuba. Ultimately, in a restructured Cuba, US developers may be permitted to build housing for Cubans, although doing so is illegal under existing statutes. At this time, development of tourism facilities holds the most promise for US investors.

### *Developments Targeted for Tourists*

Tourist facilities in Cuba tend to be shore side developments. Of course, no Cuban lives more than fifty miles from an ocean, and with more than 1,000 miles of beaches the island is certainly the least developed in the Caribbean. In the past decade a number of tourist facilities were built, beginning with hotel construction and culminating in raising timeshare units.

American firms are already poised to serve the tourist market in post-embargo Cuba. In 1995, Days Inns of America announced that it had located twelve Cuban hotels to carry the Days Inn logo once the embargo has ended. Meanwhile, European and Latin American firms have been busy. In 1994, just after the Foreign Investment Law of 1993 took effect, European hotelier Climent Guiart signed agreements to build 3,000 rooms, mostly on the north Cuba coast. Weeks later, Austrian investors agreed to build a 1,000 room hotel on Cayo Sabinal; the government gave them the entire island in return for investing a billion Austrian schillings.

Extensive development is planned at Varadero ("the Shipyard") Beach, which is the Miami Beach of Cuba. With four five-star hotels, nineteen four-star hotels, and fourteen three-star hotels, Varadero is by far Cuba's largest destination resort complex. The government plans to triple hotel capacity, early in the 21<sup>st</sup> century, from 10,000 to 30,000 rooms. At that capacity, Varadero will rival Cancun and Miami, neither of which has much space to expand. Even then, large stretches of Varadero will remain undeveloped.

Not to be left behind, Canadian company VanCuba Holdings, SA, plans to invest \$400 million in 11 hotels, with a total of 4,200 rooms. Cubans will hold 50% interest in the company. Another

Canadian company has entered into a joint venture with the Cuban government to build 2,000 resort units; it will offer timeshares for the first time in Cuba. A timeshare unit will cost \$5,000 for a one week interval each year, while condos will start at \$200,000 (a price considerably higher than the government charges for comparable units sold to foreigners taking up permanent residence in Cuba).

### *Commercial Development Opportunities*

When Cuba shifted from an economy dominated by Soviet aid to an emerging market economy in the mid 1990s, there was virtually no commercial space available to house offices of companies seeking to do business there. Early on, executives converted hotel rooms to offices;

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indeed, the second floors of several hotels are still dedicated to commercial space. Recognizing this shortage, the Cuban government retrofitted and renovated homes on thoroughfares west of Havana in the Miramar district. It rented them through the state real estate operation Cubalese, and then began to enter into joint ventures with foreign corporations.

In 1995, the first non-tourism related project in Cuba began with the construction of an adaptive re-use project in old Havana. A joint venture was formed between a subsidiary of the Spanish banking group Argentaria and the Cuban tourism enterprise Habaguanew. The \$19 million project gutted the Lonja de Comercio building in Old Havana to accommodate new offices. Cuban government officials say that 250 such joint ventures with foreign entities are under negotiation, an indication of a sharply increased demand on the island for both housing and office space.

### *Housing Market for Foreigners in Cuba*

In Cuba, all consumer real estate is overseen by the National Housing Institute. Moreover, Decree Law 171, published on

May 16, 1997, prohibits apartment owners from renting to "representatives of organizations, firms, entities, or foreign countries accredited in the Republic of Cuba." Apartment owners may rent to tourists, or to other Cubans, but not to foreigners living in Cuba on a permanent basis. The effect of this ruling has been to make all foreigners living permanently in Cuba customers of Cubalese, a state-owned company that leases houses for \$1,000 to \$5,000 per month, a price that very few Cubans could afford.

However, in 1998, faced with a housing shortage so severe that foreign managers were threatening to live in Cancun or the Bahamas and commute to Cuba, the government relaxed its restrictions. In a news conference, Foreign Minister

Ibrahim Ferradaz announced the creation of five joint real estate enterprises, with a sixth under negotiation and thirty more under consideration by the ministry. In August of 1998, Real Inmobiliaria started pre-selling apartments at its Monte Carlo Palace project, at prices ranging from \$137.70 to \$171.90 per square foot.

### *The Domestic Housing Market*

The mass domestic housing market is theoretically off limits to foreign investors. Yet this market is so potentially lucrative, and the Cuban government has shown itself to be sufficiently flexible in meeting popular needs, that its dimensions should be explored. After nearly four decades of centralized planning that resulted in frequent delays and neglect, a lack of adequate housing has become one of Cuba's most acute social dilemmas. Part of the problem lies with the government's declared policy of giving priority to agricultural and industrial development at the expense of other economic sectors.

In the fourteen years preceding the revolution, the average construction rate was 3.5 dwellings per thousand inhabitants annually; between 1959 and 1982,

it was roughly half that level. As a result of the drop in construction, the housing supply declined dramatically. According to *Cuba: Handbook of Historical Statistics* (written by Susan Schroeder, Atlas Demographic, La Habana, 1995), dwelling units built annually per 1,000 in population numbered 2.84 in the 1921-1945 period, 3.50 in the 1946-1958 period, 1.09 in the 1959-1970 period, 1.83 in 1971-1982, and 0.14 in the years since for which information is available.

Although the population is growing slowly, it is still growing, at 1% per year. More importantly, *shifts* in Cuba's population have added to the housing problem. Moreover, the economy's deep slump in the past ten years has reduced the level of housing construction even further. From

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1987 to 1995, the government built only 11.2% of its planned 123,500 units. On a per capita basis, housing construction is only 4% of its 1946-1958 level. Even the Cuban government's own reports on housing reveal acute shortages, particularly in Havana. There in the capital, about 21,000 people live in sixty-eight government shelters, and another 210,000 live in "citadels" (buildings of one room apartments, whose occupants share community bathrooms and kitchens). With the large number of residences needing repair, three fourths of all Cubans live in substandard housing.

Indeed, housing conditions are equally poor in rural areas. In the countryside, more than 300,000 houses are "bohios," thatch-roofed huts used as living units. In some areas, schools are being converted into housing units, while "low consumption" housing is being constructed with a minimum of cement, iron, and wood. Similarly, "ecological settlements" consisting of primitive adobe huts are being built in some rural areas. Clearly, Cuba's masses could benefit from America's vast expertise in building and marketing housing for the working class.

### Conclusion

Whenever our country's trade embargo is lifted, as it surely will be, Cuba will present a wide range of investment opportunities for American investors. The island's economic opening may well be a regional real estate development opportunity to rival the most noteworthy booms in the history of American real estate markets. After the embargo ends, investors from the US will find a Cuban government reasonably hospitable to foreign investment, albeit very careful in its dealings with partners. Generally speaking, Cuba follows the rule of law, although the government has more authority than is true in most countries, particularly where matters of national economic security are concerned.

In the short run, the best development opportunities will be in destination resorts, followed by commercial office space for foreign companies doing business in Cuba, and then permanent residences for foreigners. In the longer run, the Cuban government may well open the mass housing market to foreign investors, to help stem the country's critical shortage of decent places for its people to live. In fact, because the Cuban government's attitudes have become increasingly flexible, the need for housing among Cuba's masses represents what may well be the most dramatic development opportunity for outside investors since the 1970s' resort construction boom. Still, caution is advised; some unknowns remain, and the knowns are not always reassuring. Furthermore, tight government control over real estate transactions dictates that an investor should expect to own a Cuban property for the very long haul. ■

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### Are Your Tickets Refundable?

Dr. Norvell warns in the accompanying article that, despite progress, investing in Cuba is not yet like committing funds in our domestic markets. In a June 28 front page piece, *Wall Street Journal* reporters Jose de Cordoba, Carlta Vitzthum, and Julian Beltrame tell of FirstKey, a Canadian engineering firm that lost \$9 million after committing to a \$500 million electricity project, on which Cuba's government later reneged, handing the Canadians' plans to a European rival. This reversal occurred despite involvement by Canada's government, which had itself committed seed money to the project. Canadian officials and business people apparently had seen the 1993 opening as a way to trump US companies restrained by the embargo and Helms-Burton. (The latter prevents both US and foreign companies from doing business with entities that make use of expropriated US assets in Cuba.)

The move to lure outside money to the island may have slowed in 1996, when Castro decided to discontinue liberalization beyond 1993's enactments. Yet *many* problems, cultural and physical, face those bold enough to undertake Cuban ventures. The country has high foreign debt, some already in default, and it lacks access to the IMF and World Bank. Reports tell of petty bureaucratic interference, of government spies in business offices, and of Cuban officials' refusal to respond to phone calls and faxes. The need to sustain relationships with people close to Castro necessitates picking up the tab for officials' costly travel and entertainment. And a nagging physical problem, not surprisingly, is a lack of reliable electrical power.

As in Norvell's report, the *Journal* tells of success stories; Canadian, Dutch, and Spanish investors speak favorably of past and current opportunities (though a major planned Canadian real estate investment has been scaled back considerably). A Spanish source surmised that FirstKey had hastily agreed to conditions that were impossible to meet, giving Cuba an excuse to back out, while a Dutch response was that the risks should have been understood. At least the risk side of the risk/return tradeoff seems to be alive and well in Castro's paradise.