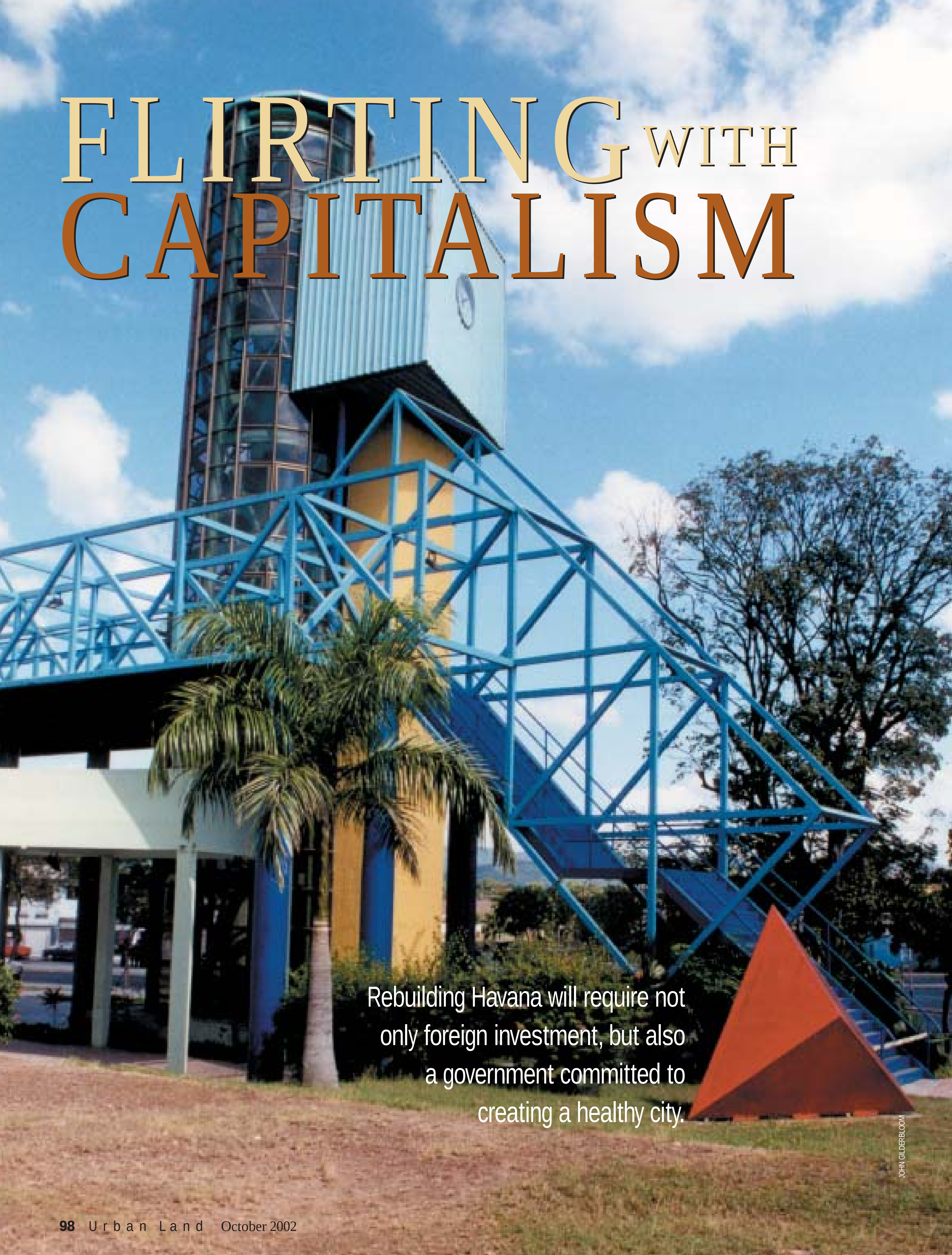
FLIRTING WITH CAPITALISM

Rebuilding Havana will require not only foreign investment, but also a government committed to creating a healthy city.



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To encourage foreign investment opportunities in Cuba, the Castro government passed Decree Law Number 77 in 1995, inviting foreign firms to enter into partnerships with Cuban-owned corporations. As the foreign investment opportunities in Cuba, including investment in real estate development, were broadened, the response was immediate. Within the first year, more than 30 proposals were being considered for 2,000 new apartments, townhouses, and homes in Havana alone. Many of these projects now have been completed or are under construction, while others have been caught in the moratorium imposed in 2000 on foreign land development. The completed projects, however, have begun to leave a significant mark on Havana's urban and social fabric.

Development often directly reflects a culture: it mirrors the society that built it. Havana's 500 years of urban development closely reflect the political periods that have governed the city. The colonial period, 1500 to 1889, saw the construction of the city's fortifications, palaces, and urban core, while the republican period, 1899 to 1959, saw the expansion of Havana's suburbs and the construction of its opulent modernist architecture. Following the 1959 overthrow of General Fulgencio Batista y Zaldivar, the revolutionary period, 1959 to 1989, significantly altered Cuba's urbanization and land development. In postrevolutionary Cuba, land development by U.S. citizens, who had created most of Havana's housing, was prohibited and land speculation forbidden. Development became the sole domain of the government. The goal was no longer the sale of housing for profit but the construction of utilitarian housing at the lowest cost.

The so-called special period, 1989 to the present, began when Cuba's economy collapsed with the 1989 downfall of the Soviet Union. The Cuban government turned to tourism as the primary means of generating much-needed foreign currency to buoy the economy. To attract tourism dollars, Cuba needed international partners. Government joint ventures were developed with Canadian, Spanish, and Italian firms to build the country's hotels, airports, and other sorely needed tourism infrastructure. By the early 1990s, large-scale foreign investment had become an accepted activity in Cuban resort and land development.

Postmodernism has begun to leave its mark on the Cuban landscape. Central Train Station in Santiago de Cuba (opposite page) is intended to complement Cuba's colonial period, 1500 to 1889, which began with the construction of military fortifications such as the Castillo de la Real Fuerza (at top of page) and colonial buildings in Old Havana's Plaza Vieja (second from top). A housing project in the Antonio Guiterras neighborhood (third from top) is typical of the prefabricated buildings constructed during the Soviet-influenced revolutionary years of 1959 to 1989. The cascading roof structure of the School of Music at the National Art Schools Complex in Havana (bottom) provides an example of postrevolutionary architecture.


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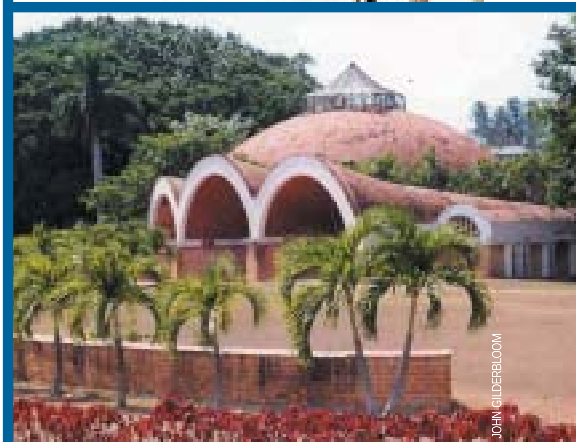
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Havana's largest real estate joint venture project with over 1.8 million square feet of commercial space, the Miramar Trade Center has been called by local developers "Havana's Canary Wharf."

By early 2001, 29 joint venture companies with a combined capital value of $1.1 billion were operating in Cuba's tourism sector; currently, 11,900 hotel rooms are in the design or development stages. Despite this construction boom, Cuba's Ministry of Tourism estimates a potential shortfall of 59,000 hotel rooms by 2010 under its medium-growth scenarios. With half of the Caribbean's land area and one-third of its population, Cuban officials consider the tourist industry still to be "80 percent untapped."

To attract international development capital, in the 1990s the Castro government undertook five significant initiatives that have launched Cuba's current experiment in market land development.

Fashioning the Legal Framework

In 1995, the Cuban government opened the country to foreign capital. Restrictions on foreign investment were lifted, allowing property ownership, income tax exemption, and the transfer of real estate for business. The Castro government also allowed the repatriation of dividends, profits, and foreign employee salaries in hard currency. The most radical departure from the socialist ideal was the state's power to transfer property rights in "exceptional cases" to foreign nationals. In 1995, foreign investment was allowed in all sectors of the economy, with the exception of the armed forces, community education, and health services. Under the Foreign Investment Act, investors were protected against expropriation except for reasons of public utility, and in those cases, they were guaranteed compensation.

Despite these advances, foreign ownership laws regarding real estate and mortgage lending continue to present major obstacles to land development ventures. The legal tenure of land and the issuance of a foreign firm's property certificates has yet to be resolved to the satisfaction of the development industry. Such legal uncertainty has prevented the formation of several business partnerships, requesting greater long-term vision, stability, and transparency. This lack of legal protection has served to dissuade established developers most able to carry out sophisticated, larger, economically sound projects. As a result, the Cuban government has had fewer strong proposals to evaluate, often having to accept smaller projects managed by less-experienced international developers who are willing to accept high investment risks.

A related problem is the uncertainty posed by Cuba's ever-changing legal landscape and political positioning regarding land development. Just recently, the government introduced a moratorium on new development and froze negotiations on approximately 30 projects that were "in the pipeline," resulting in big losses for developers. Without stability and trust in the government-led process, foreign investors are scared off by the inherent risks involved in large-scale developments. One major foreign investor stated, as reported in the *International Herald Tribune* on July 25, 2000: "There is a jerkiness in the way Cuba conducts business that makes investors nervous . . . . the regulatory framework is not there. When momentum is interrupted, it feels like you're going backward." One Cuban economist, who works inside the system and asked to remain anonymous, put it more boldly: "For a foreigner to want to go to a country and invest a large sum of money, the government has to be coherent. It can't say on the one hand it wants something and, on the other, its leader gives public speeches denouncing the international financing system." Such inconsistency shakes investor confidence and greatly affects the cost of doing business in Cuba. Consequently, investors expect internal rates of return to compensate for the greater inherent risks they must take.

Selling Government Land

A second initiative used to encourage development has been the country's nationalized land base. To generate revenue, the Cuban government uses land in place of capital as its contribution in joint venture projects. In the case of VanCuba Holdings, S.A., a Cuban-Canadian company contracted to build 11 hotels, Cuba contributed land as its 50 percent share of the project, while the Canadian partner was expected to invest $400 million. Such joint venture arrangements are common, particularly in real estate and tourism. With land as its principal contribution to international joint ventures, the government's method of land assessment has become a controversial issue. In the absence of an open real estate market, establishing the value of land to represent 50 percent of a joint venture's investment capital has been criticized as an exercise in "creative accounting." In cases where the value of the land is less than 50 percent, foreign partners often have been asked to assist their Cuban counterpart in obtaining credit from international banks. More recently, the credit to assure 50 percent Cuban participation is now offered at low interest rates directly from the Central Bank of Cuba.

The uncertainty surrounding Cuba's land tenure laws continues to discourage foreign investment. There is debate among Cuban planning and development experts concerning the pros and cons of introducing open land markets or maintaining the existing public management of land. Advocates of an open land market feel it is necessary to encourage land development and enable Cuba to benefit from linkages with the global economy. They argue that Cuba must continue to develop mechanisms for capturing publicly created land value to stimulate its economy.

Those arguing for a continuation of the current system, which does not permit the sale of land, point to Cuba's success in reducing economic disparity, promoting social services, and preserving its historic building stock. They refer to Latin America's recent experiences with free markets, which they claim has resulted in increased economic disparity, a lack of public social services, increased urban violence, land speculation, and growing environmental problems.

Creating Cuba Development Corporations

To respond to growing foreign investment interest, the Castro government has given greater autonomy to state enterprises involved in joint venture land development. The state-owned development corporations have been registered with Sociedad Anónima (S.A.) destinations, thereby enabling them to retain funds in other countries and to manage their own hard currency revenues. In return for these enhanced powers, S.A. firms must remit a monthly "dividend" to the government. Inmobiliaria CIMEX S.A. and Inmobiliaria Lares S.A. are two such state-owned companies primarily responsible for real estate investment in Cuba. While operating at arm's length from the government, Cuba's development corporations are legally committed to their foreign joint venture partners. Despite this, they are mired in conflicting interests, which are apparent in their land valuation methods, the often-opaque financial reporting procedures to government ministries, and the allegiance to changing government priorities.

Cutting the Regulatory Red Tape

Whether they are obtaining a license or seeking regulatory approvals, foreign companies operating in Cuba most commonly complain about the country's excessive bureaucracy. In response, the government has established a streamlined administrative process for foreign investments, known by the acronym ONINVEX. The National Office for Foreign Investment claims "quickness and professionalism in the foreign investment processes." It offers a single application form for permits, licenses, authorizations, certifications, registration, insurance, immigration permits, and banking arrangements.

While streamlined in process, the style of land use regulation differs notably from that of North American cities. In Cuba, legislation often is "enabling" rather than "definitive": the law and its regulations reflect development practice rather than planning theory. Officials are able to negotiate development regulations with little consistency in standards or previously allowed exceptions. In contrast, the zoning and land use regulations of North American cities are definitive. Such regulatory rigidness serves to provide consistent and transparent rules for real estate acquisition and development. The tools of zoning and comprehensive master plans guarantee the value of land, underpinning the successful functioning of an open real estate market. While lacking in transparency, the Cuban method of regulation results in all things being negotiable. Each new foreign investment application is assessed on its own merits with exceptions to almost every regulation possible. Understanding this practice is fundamental for the success

Havana's first residential real estate development project was Monte Carlo Palace in the Miramar neighborhood, which initially offered condominiums starting at $1,450 per square foot.

A joint venture project between the Cuban government and a Spanish developer, La Cecilia in Havana's Miramar neighborhood offers apartments with views over the Caribbean Sea, with prices starting at $81,000.

of any land development company doing business in Cuba.

Marketing Serviced Development Sites

Without adequate engineering budgets to maintain Havana's urban infrastructure, the government has adopted a policy of identifying development sites based largely on the presence of functioning services. Determining building sites for foreign land development initiatives, as well as for its own housing projects, has been determined largely by land requiring minimal "off-site" infrastructure improvements. As infrastructure is costly, the Havana neighborhood of Miramar has provided most of the development sites, owing simply to its intact roads and services. Consequently, this neighborhood has experienced a great deal of office, housing, and hotel development.

Although the government would prefer to manage large projects rather than numerous small ones, large projects require substantial infrastructure investment. Smaller infill projects therefore have become the norm. While larger projects would be able to finance infrastructure improvements on a city scale, they would run the risk of becoming exclusive enclaves, isolated from their surrounding community. The alternative may be for the government to look toward land in outlying areas, such as Celimar and Santa Maria Loma in Playas del Este, about 12 miles from Old Havana. Projects in those areas could be large enough to finance the building of their own infrastructure through a development cost charge program similar to the model used in Canada.

Does a Market Exist?

The lack of economic data and international publications addressing Cuba's current economy has resulted in a number of widespread misconceptions. Although Cuba has yet to achieve its pre-1989 standards of living, certain sectors present significant opportunities for foreign investment. With the number of visitors increasing from 340,000 in 1990 to nearly 1.8 million in 2001, Cuba has become one of the fastest-growing tourism destinations in the Caribbean. Cuba estimates a post-blockade scenario of 12 million visitors per year by 2010. With gross revenue in 2000 estimated at $2 billion, tourism represents nearly one-half of every dollar entering Cuba. Tourism revenues increased 23 percent each year during the 1990s, with the number of tourists increasing 19 percent. Cuba's tourism sector projects a continuing increase in visitors over the next ten years, particularly in the event that the United State lifts travel restrictions, allowing a free flow of American visitors to Cuba. (See "Cuba Calling," page 40, August 1999 *Urban Land*.)

Land Development Projects in Havana: What Has Transpired

The primary focus of foreign land development continues to be Havana's established neighborhoods, and in particular the neighborhood of Miramar. The past five years have witnessed the construction of nearly 30 condominium projects focused on Miramar's Quinta Avenida, or 5th Avenue.

The 1990 reforms to foreign investment have evidently been successful for both international and Cuban partners. Since opening its doors to foreign investment in 1995, Cuba claims to have received more than $2.5 billion in international capital. By creating an environment attractive to foreign investment, it has received a great deal of attention from both reputable multinational firms and less-than-reputable developers. The Castro government's challenge has been to weigh the economic benefits gained against the loss of control over portions of Havana's land base. A high-ranking government official from the Ministry of Tourism has stated that approximately 80 percent of the recent construction activity in Havana is related directly, or indirectly, to the tourist sector. State-owned land and buildings already committed to new resort and development projects in Cuba have been estimated to represent approximately $500 million.

According to Stephen Marshall, a British real estate agent based in Havana, government-run agencies have even been buying up some of the apartment units currently under construction in Miramar. This action is fueled by profits of more than 30 percent from resales in the Monte Carlo Palace. The initial selling price range for an apartment in the Monte Carlo Palace was $78,000 to $638,000, depending on size, floor, and view. The starting sales price per square foot was $1,450. Even with such extraordinary price tags, most of the projects already completed are well on their way to being sold out.

Recently completed through a joint venture between a Monaco developer and Inmobiliaria Lares, the Habana Palace sold its two penthouses for over $600,000 apiece before the property came on the market.

Is There a Future for Land Developers in Havana?

Having experimented in the unfamiliar waters of market-driven land development in the past decade, and possessing greater improved economic stability, how should Cuba proceed with "tapping" into the potential revenues that foreign land development in Cuba represents? In May 2000, the Cuban government froze 25 residential joint venture proposals under consideration by the Ministry of Foreign Investment. *The Washington Post* quoted the Cuban government as stating: "Approximately 2,300 units currently within the foreign-financed initiative would be purchased by the government." The exact reason for this action is not clear; rumors range from government panic over the inability to provide sewer and water services to complaints by Communist hardliners that the private ownership initiative had moved too fast. While official statements sought to reassure investors: "There is no change in foreign investment policy," additional statements seemed to reveal the government's true motives: "We are being more selective because the economic conditions of the country have improved," Cuba's first foray into real estate development appears to have been driven more by the immediate financial needs of the country than by a desire to introduce long-term reforms in land development policy.

From this foray, it has become clear that Havana requires a comprehensive land use, zoning, and master servicing plan before further "market-driven" real estate development occurs. Such a planning tool would enable the government to guide the redevelopment of specified areas through "upzoning" and densification. It would also identify areas to preserve as historic districts and valuable existing housing stock. In combination with a master servicing plan, such development-oriented planning would provide for the infrastructure needed for the planned rebuilding of Havana. With a comprehensive public policy, the cost of new infrastructure could be allocated to new development projects in the form of impact fees and development cost charges. These land planning mechanisms would allow the government to manage the future redevelopment of Havana according to a consistent, systematic plan—agreed to by all levels of government—that would provide definitive regulations for foreign development companies.

Having retreated temporarily from its joint venture with the foreign market in land development, the Cuban government today faces a series of difficult challenges. How should it manage market-driven land development, while fostering social equality? How should it resist the piecemeal sale of its land base for development, while seeking economic stability? How should it preserve Havana's 500 years of valuable built heritage, while pursuing a development model that should be profitable, equitable, and sustainable?

Cuba needs to chart a fresh course, before again launching into market real estate development. Reforms to its legal and regulatory framework need to be adopted to create certainty. Municipal master plans and servicing agreements need to be negotiated to provide coherence. A unified approach within government needs to be established to provide consistency. And finally, government patience needs to be cultivated to allow the returns of new development to mature into long-term economic stability and prosperity.

The rebuilding of Havana not only will require foreign investment, but also a government committed to restoring the city's physical, social, and environmental well-being. The government's greatest challenge will be to demonstrate the ability to balance the economic benefits of development with the social and ecological prosperity required for a healthy city. Havana can be a city that is sustainable—for the people that live in its neighborhoods, for the landscape that endows it, for the culture that enlivens it, and for the commerce that provides its future prosperity. ■

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