European Parliament

Understanding money laundering through real estate transactions

SUMMARY

Money laundering through real estate transactions integrates black funds into the legal economy while providing a safe investment. It allows criminals to enjoy assets and derived funds having camouflaged the origin of the money used for payment.

A number of techniques are used, namely cash or opaque financing schemes, overvalued or undervalued prices, and non-transparent companies and trusts or third parties that act as legal owners. Among the possible indicators are geographical features (such as the distance between the property and the buyer and their actual geographical centre of interest). In order to assess the existence of a money-laundering risk, concrete assessments of transactions and a customer's situation provide indications that help raise red flags and trigger reporting obligations.

The anti-money-laundering recommendations set out by the international Financial Action Task Force (FAFT) are implemented in the European Union (EU) by means of coordinated provisions (chiefly the Anti-money-laundering Directive). Customer due diligence and reporting of suspicious transactions are tools to address money laundering. Real estate transactions involve both non-financial and financial sector parties operating under different legal requirements. Yet, reporting of suspicious transactions in real estate is limited, leaving ample room for improvement.

Improvement is all the more necessary inasmuch as money laundering in general, and in the real estate sector in particular, has a major socio-economic impact, the magnitude of which is difficult to quantify. Awareness is however growing as a result not least of high profile examples of money laundering through real estate in a number of EU cities.

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Real estate: a haven for money launderers?

Abuse of the real estate sector (property in the form of land or buildings) has long been described as one of the oldest known ways to launder ill-gotten gains. Real estate is as attractive to criminals as it is to any investor (prices being generally stable and likely to appreciate over time) and is also functional (the property can be used as a second home or rented out, generating income). Real estate also provides a veneer of respectability, legitimacy and normality. This applies to both residential and commercial properties as part of a reliable and profitable investment strategy.

Real estate transactions can involve large sums and are subject to more limited scrutiny with regard to money-laundering risks than financial sector transactions, as non-financial sector rules are much more limited.[1]

Some illustrative snapshots

This is a worldwide phenomenon,[2] with plentiful examples from Canada, the United States, Australia and New Zealand to the European Union, Africa, Asia and Middle East.[3] The transactions used for money laundering mainly concern houses and buildings, but any form of immovable property can be used to this end, for instance vineyards.

Some textbook cases, such as those for instance in Vancouver[4] or London, highlight striking features such as:

- discrepancy between the usual income and wealth of the owner and the property: in some cases, the most expensive properties in the city are owned by individuals with no income or wealth that would allow them to purchase such a property;
- an anonymous owner, as a result of recourse either to a third party or to companies, trusts or similar arrangements;
- a property's underestimated or overvalued price;
- the indication by a country that there is a risk of money laundering by its citizens in another country.[5]

Real estate in the money laundering cycle

Money laundering is the process used to camouflage the illegal origin of funds generated by illicit or criminal activities. By successfully laundering the proceeds of criminal activities, the illicit gains can be enjoyed without fear of their being confiscated. In real estate, money laundering involves using such funds to pay for the transaction (predicate offence of money laundering). Real estate plays a role (mainly) in the third and final stage of the money-laundering cycle, after the placement and the layering phases.

Placement consists of moving funds directly associated with a crime and introducing them into the financial system (e.g. breaking up large amounts into small deposits or purchasing financial instruments such as money orders). **Layering** is then designed to hide the trail and hinder pursuit by distancing the illegal proceeds from the source of the funds, using layers of financial transactions.

Purchasing real property is one way to **integrate** black money into the legal economy, while also returning the illegally derived proceeds to the criminals concerned. In addition, when sold or rented, real property provides what appears to be a legitimate source of income.

Addressing the misuse of real estate for money laundering

Identifying the misuse of real estate to launder money

Reports based on surveys provide for a typology of the basic techniques used for laundering money through the real estate sector. The Organisation for Economic Co-operation and Development (OECD) published two in two consecutive years: the 2007 FATF report 'Money laundering and

terrorist financing through the real estate sector' and the 2008 OECD report 'Real estate sector: Tax fraud and money laundering vulnerabilities'.[6]

Examples of real estate money laundering display some or all of the following features:

- complex loans or credit finance (used as a cover for laundering money, their repayment can be used to mix illicit and legitimate funds, black and legal money);
- non-financial professionals;
- corporate vehicles;
- manipulation of the appraisal or valuation of a property (undervaluation, overvaluation and successive sales at higher values);
- monetary instruments;
- mortgage schemes;
- investment schemes and financial institutions.

To complement this typology, other features can serve as specific indicators of real estate money laundering, such as:

- recourse to third parties by customers (sellers and buyer) for concealment of ownership;
- unusual income (e.g. no income, or inconsistency between income and standard of living), unusual rise in financial means, unusual possession or use of assets, or unusual debt (e.g. mortgage with low income or unidentified lender) on the part of the legal owner;
- use of front companies, shell companies, trusts and company structures, allowing the criminal not to appear as the real owner;
- rental income to legitimise illicit funds (either with rental funds provided by the criminals for the tenants to legitimise illicit funds, or renting the property to a third party they use as the legal owner);
- property renovations and improvements using illicit funds that increase the value of the property, which is then sold at a higher price;
- consideration of geographical elements.

In short, these techniques and indicators highlight the **unusual nature** of the transaction compared with a normal situation, pointing to a possible suspicious transaction.

Mitigating risks and detecting suspicious transactions

The challenge is to spot the money laundering behind the real estate transaction. Possible indicators of money laundering (red flags) help risk-based assessment. Guidance has been established as a tool for the sector at both global and national levels. Professional representative bodies have also developed implementing tools.

The process demands familiarity with the normal conduct of business so as to be able to identify unusual or suspicious patterns relating to customer risk, transaction risk or geographical risk (these are sometimes clustered in pairs, geographical aspects being added to the first two risk types). A number of questions need to be asked before, depending on the answer, the transaction can be found to be suspicious and reporting obligations triggered.

Customer risk relates primarily to the buyer, but concerns may broaden to include the seller and any other persons intervening in the transaction. The ability to identify the real purchaser and ascertain whether involvement of third parties or a corporation obscures the owner's identity (without a legitimate business explanation) is central to ascertaining customer risk.

Customer risk also covers purchases involving high-ranking foreign officials or their families, who require specific attention either as politically exposed persons (PEPs) or because of specific international provisions, such as sanctions.

The **transaction risk** relates to a variety of elements regarding for instance the type of property, successive transactions, under- or overvaluation, mismatch between buyer and property, and financing risks relating to the source of funds, use of cash or use of complex loans. Concerns can be aroused as a result for example of a lack of interest in obtaining a better price, or a buyer purchasing property without viewing it, or with no visible interest in its characteristics. In short, this relates to the concern that the transaction does not appear to make professional or commercial sense.

Geographical risk can relate to both the property and the buyer. The first question is whether the location of the property matches the location of the buyer and the seller. Then the question arises as to whether they are located in a jurisdiction with weak anti-money-laundering regimes, that supports or funds terrorism or that displays a high degree of corruption. The same questions apply to the origin of the funds.

Another scrutiny-raising factor can be a large unexplained geographical distance between the location of the property and that of the buyer.

Tackling the problem: a work in progress

Anti-money-laundering framework and real estate

Some of the features and concepts that are relevant to understanding the anti-money-laundering (AML) framework in relation to real estate are set out below.

Anti-money-laundering framework

The [FATF](#) is an intergovernmental body whose objective is to set standards for the development and promotion of national and international policies to combat money laundering and terrorist financing. Its recommendations increase transparency and enable countries to take successful action against the illicit use of their financial systems. FAFT recommendations are intended to be implemented in countries' legal texts. The recommendations were last [updated](#) in 2012.

In the European Union, the first anti-money-laundering framework dates back to the 1990s. It has been revised constantly in order to mitigate risks relating to money laundering and terrorist financing. It encompasses: [Directive (EU) 2015/849](#) of 20 May 2015 on preventing the use of the financial system for money laundering or terrorist financing (the fourth AML directive) – as amended by [Directive (EU) 2018/843](#) of 30 May 2018[7] – and [Regulation (EU) 2015/847](#) on information accompanying transfers of funds, which makes fund transfers more transparent, thereby helping law enforcement authorities to track down terrorists and criminals. The EU's money laundering rules set minimum requirements, leaving Member States free to impose stricter requirements if they consider it necessary to do so according to the risk.

Geographically targeted approach

As the use of [real estate for laundering money](#) is concentrated in a number of geographical areas, targeted questions can generate matches. This is the case in the US where real estate geographic targeting orders ([GTOs](#)) made in 2016 and renewed in 2018 have been issued by the US Financial Crimes Enforcement Network ([FINCEN](#)) for a number of geographical locations, with varied monetary thresholds for each area. Some of these require the identification of the natural persons behind companies used to pay all cash for luxury residential real properties.

This looks like a well-targeted tool, but a geographically targeted tool bears the risk of the [phenomenon moving](#) to other areas beyond its reach.

Real estate gatekeepers and the risk-based approach

Two FATF documents, the report on Money laundering and terrorist financing through the real estate sector and the Guidance on the risk-based approach for real estate agents, issued in 2007 and 2008 respectively, address the real estate sector's vulnerability to money laundering.

Gatekeepers in real estate transactions are a wide range of professionals governed by different regulations and anti-money-laundering obligations, who to varying extents have an obligation to assess risks and, if need be, report them.

In updated Recommendation 22, the real estate sector belongs to the designated non-financial businesses and professions (DNFBP) category. DNFBPs are required to run customer due diligence checks based on risk assessment and record-keeping requirements. This includes real estate agents involved in transactions for their clients concerning the buying and selling of real estate and also lawyers when preparing or carrying out such transactions for their clients. To this end, guidance can help gatekeepers to identify risks and implement obligations. Among the gatekeepers, the financial sector also has a role to play when it is involved in the transaction. This role is important but should not be over-relied upon, as not all transactions pass through a financial sector intermediary, especially in the case of cash transactions. The legal professions have a particular role to play, as they sometimes provide advice on structures and contracts relating to transactions and can be involved in conveyancing.

In order to apply a **risk-based approach** to detecting and if need be reporting suspicious transactions, there is a need to ascertain the true identity of each customer by running a customer due diligence (CDD) / know your customer process (i.e. identifying and verifying the identity of clients, monitoring transactions and reporting suspicious transactions).

This spans from the simple identification and verification of the identity of clients (in the case of real estate transactions, the vendor, the purchaser and any other parties involved) to the more complex identification of the beneficial owner. Identifying the beneficial owner,[8] who may be shielded either behind a third party acting as legal owner or behind a corporate vehicle, such as a company (a shell company for instance), a trust or a similar vehicle.

Suspicious transaction reporting (STR) must take place when there is suspicion or reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing. Financial institutions are obliged to report, and the non-financial sector has the same or a similar obligation in a series of transactions defined in the recommendations.

Still a lot to be done?

A number of shortcomings in anti-money-laundering practices have been identified.[9] A 2017 European Commission report on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities[10] puts forward recommendations (that predate the adoption of the fifth AML directive and implementation of the provisions of the fourth AML directive). The report takes stock of the fact that 'the real estate sector is also exposed to significant [money laundering] risks, due to the variety of professionals involved in real estate transactions (real estate agents, credit institutions, notaries and lawyers)'.

With this in mind, a number of critical assessments have been made by specialised NGOs, starting with Transparency International, whose recommendations[11] call for an overhaul of money-laundering measures on a global scale and for proper enforcement. The recommendations are based on the following essential elements:

Ability to **identify the owner of the real estate**:

- introducing public beneficial ownership transparency for companies owning properties in a Member State and inserting some (minimum) requirements and

checks on foreign companies prior to having access to the real estate market, so as to tackle money laundering risks;

- ensuring identification of the beneficial owners of legal entities, trusts and other legal arrangements; and
- introducing a geographically comprehensive public register of beneficial ownership (overseas territories and specific status territories such as the United Kingdom Crown Dependencies);

Coverage of **all professionals involved** in real estate transactions:

- ensuring 'fit and proper' tests for professionals engaging in real estate transactions, and proper and consistent supervision of professionals involved in real estate with regard to money-laundering risks, as well as enforcement of the rules;
- addressing globally the inadequate coverage of anti-money-laundering provisions, extending due diligence requirements to the full range of non-financial professionals and businesses that might be involved in the buying and selling of real estate;
- ensuring sanctions in case of non-compliance, and sanctions for involvement in money laundering schemes;

Proper implementation of anti-money-laundering requirements **(preventing getaways)**:

- ensuring that due diligence checks are undertaken, either by financial institutions or by the non-financial sector when financial institutions are not involved (problem of cash transactions going unnoticed). This involves lawyers and real estate professionals in particular;
- ensuring submission of suspicious transaction reports (STRs) globally where there are reasonable grounds to suspect that the transaction is related to money laundering;
- conducting adequate checks on politically exposed persons and their associates, including national PEPs;

Reaction to cases of properties bought with laundered money:

- strengthening enforcement action (starting with the proceeds of corruption), using existing tools such as unexplained wealth orders and national equivalent provisions;
- ensuring a rapid reaction to trace stolen assets.

The recommendations also call for adequate resources for the authorities responsible for tackling money laundering and corruption.

Real estate money-laundering impact

Money-laundering impact on the legal economy

As with any non-recorded phenomena, an assessment of the scope of money laundering can only yield estimated amounts. There are limited reliable sources. Data on illicit financial flows[12] and money laundering are made available by the World Bank,[13] the OECD and the United Nations Office on Drugs and Crime (UNODC). There are some estimates on geographical areas that provide for some quantitative assessment. The 2011 UNODC report estimating illicit financial flows indicated that money laundered globally in one year could represent between 2 % and 5 % of global gross domestic product (GDP).[14] Although these figures vary, even the lower estimate underlines the significance of the problem.

As regards the quantification of tax fraud and money-laundering risks associated with the real estate sector, the 2008 OECD report Real estate sector: Tax fraud and money laundering vulnerabilities, based on a 2006 survey covering 18 countries, reported that none of the countries had reported official figures or statistics.

Another indication of the scale of money laundering via real estate is the share of real estate in criminal assets confiscated, which was estimated at 30 % between 2011 and 2013. Some studies have shown that real estate is considered a safe investment by criminals when it comes to laundering money.

The socio-economic effects of criminal financial flows on the legal economy and society are enormous. They cover the following elements: distortions in resource allocation from high-yielding investments to investments that run a low risk of detection, distortion of prices, notably in the real estate sector, unfair competition, risks of supplanting licit activities, negative impact on direct foreign investment, corruption, risks of real sector volatility, and strengthening of skewed income.

Trickle-down effect on real estate

Distortions of real estate prices and the concentration on limited sectors may have an impact beyond those areas and lead to increases in real estate prices, thus pricing people with legal sources of funds out of the market. Driving up the prices of real estate reduces housing affordability, something that has been witnessed in several cities in both developed and developing countries. This impacts not only those people rendered unable to purchase housing but also renters. In both cases, this can affect decisions about where to live, among other factors, resulting in a change of neighbourhood and the related displacement of less affluent households. Data on house prices are available for the EU (Eurostat data).

The contribution of foreign real estate investment to the growth in house prices is visible for a number of locations in the world. Upward and downward house price fluctuations and a shortage of affordable housing and offices can foster opportunities for foreign investment. Yet this does not necessarily correlate with money laundering. As for the impact of money laundering on real estate, there may be suspicions but there are no data. Indicators are found in high prices including payment in excess of value (not as such an indicator of money laundering but clearly one of luxury home prices and industry-pleasing).

Impact in the European Union

Examples are provided below for several EU Member States on the basis of publicly available information (press and reports when they exist). Some countries' situations are more often reported in the press and documented in specialised reporting. Yet as such, this is not an indicator of the greater scale of the problem in those countries, and conversely when no coverage or report is available, this does not indicate that the country is immune from such practices or from vulnerabilities to money laundering in the real estate sector.

In the **Czech Republic**, there have been reports in the press of cases of the existence of money laundering in real estate as well as the large number of properties bought by foreigners, with a high proportion from the same country.

The same goes for **France** where there are cases of money laundering through real estate, with undervaluation of real estate prices, recourse to opaque ownership, and opaque financing schemes, all typical of money laundering.[15] The press has reported the limited number of suspicious transactions reported, and the marginal improvement in real estate professionals' contribution to the fight against money laundering though real estate. There have also been several press reports that the phenomenon is not limited to luxury properties, but includes other immovable properties, such as vineyards.

In an investigation launched in September 2015 by the French public prosecutor's office and coordinated by Eurojust and Europol, a vast and complex money-laundering network in six Member States (Denmark, Germany, Estonia, Spain, Latvia and Lithuania) and in offshore financial centres outside Europe (Hong Kong and Singapore) included a number of real estate properties bought with the laundered proceeds of illegal activity.

In **Finland**, a €3.5 million money-laundering case was reported concerning island purchases in the south-west archipelago of Finland and under investigation.

Growing concern in **Germany** was reported in 2018, with a particular focus on Berlin, where prices are fast increasing, causing concern for renters and potential buyers. This triggered consideration of the idea of locking out foreign investors from Berlin real estate. There are a number of articles reporting a link with illicit money and seizures of related properties, and cases reported and investigated by the German financial investigation unit (FIU). The number of suspicious transactions reported by real estate agents is also limited. Real estate had already been identified as one of a number of individual economic sectors carrying money-laundering risks. A recent report on real estate money-laundering vulnerability provides an assessment of the magnitude of foreign money of unclear origin laundered into German real estate in 2017 (about €30 billion) and a description of the phenomenon.

Cases have also been reported by the press regarding **Greece**, while other specific features of the Greek real estate market show real estate prices can outweigh those outlined in the contract prices. A study considered the housing sector as well as the professions involved as being at high risk of money laundering. Golden visas also have a real estate impact, yet as such they are not linked to money laundering. Some cases have been investigated in the context of residence permission in an EU country.

In the **Netherlands**, a study Estimating money laundering risks shows that risks exist in real estate, with few concrete examples being reported. There are reported cases relating to organised crime and massive investment in new or planned residential housing projects, as well as in restaurants, through the use of private non-bank loans. In one older case, a real estate agency acting as a money 'laundromat' was prosecuted (for laundering money of criminal origin on behalf of dozens of its customers). Special attention to the growing influence of organised crime in the property market, in particular its grip on property formally owned by non-profit organisations and/or associations, has also been reported in the context of the seizure of illegally obtained assets.

In **Portugal**, the press and specialised reports highlight the existence of money laundering through real estate, with a link to the resident permit programme and its requirement to invest in the country. A number of beneficiaries of the programme may have acquired properties using laundered funds.

The issue has been found to be of particular importance in the **United Kingdom** and in particular in **London**. An inquiry on foreign home ownership was launched by London's mayor in 2016, with political follow-up. A number of reports provide a factual assessment of the role of overseas investors in the London new-build residential market and on the true effects of foreign investment on the UK property market. A July 2017 House of Commons Library briefing on Foreign investment in UK residential property provides data on the scale of overseas investment in housing and on property owned by overseas companies, and lists key issues associated with foreign ownership.

> ### Golden visa
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> Citizenship by investment (CBI) and residency by investment (RBI) schemes, often referred to as 'golden visas', are national schemes designed to attract foreign investment. Some of these schemes offer residency or citizenship rights in exchange for a sizeable investment, including real estate investment.
>
> Concerns about money laundering arise when the beneficiaries happen to be using illicit money for the purchase of real estate.

As regards quantitative data, the 2015 Transparency International report on Corruption on your doorstep and the 2017 Faulty Towers report provide an assessment of the scale of the problem.[16] They refer to the data of a 2016 Business innovation and skill survey indicating that between 2004 and 2014, 'over £180m worth of property in the UK has been investigated by UK law enforcement as suspected proceeds of corruption. Moreover, over 75 % of these properties use offshore corporate ownership. This is believed to be the tip of the iceberg in terms of the scale of the proceeds

of corruption invested in UK property through offshore companies'. The survey also details the location of the offshore company owners of a larger number of properties and draws a map of the city that highlights the boroughs most affected. According to Transparency International UK, the second report 'assessed 14 new landmark London developments, worth at least £1.6 billion. It found 4 in 10 of the homes in these developments have been sold to investors from high corruption risk countries or those hiding behind anonymous companies. Less than a quarter had been bought by buyers based in the UK'.

A public register requiring overseas companies that own or buy property in the UK to provide details of their ultimate owners is expected to be in place by 2021.

MAIN REFERENCES

FAFT, Money laundering and terrorist financing through the real estate sector, FATF/OECD, 2007.

FAFT, Guidance on the risk-based approach for real estate agents, FATF/OECD, 2008.

OECD, Real estate sector: tax fraud and money laundering vulnerabilities, 2007.

OECD, Money laundering awareness handbook for tax examiners and tax auditors, 2009.

ENDNOTES

[1] As one press article puts it: 'probably the most advantageous aspect of buying real estate is that reporting requirements for suspicious activity are almost non-existent, particularly compared to banks and financial institutions, which are legally required to blow the whistle on anything that looks fishy' (US local news online).

[2] See also F. Teichmann, 'Twelve methods of money laundering', *Journal of money laundering control*, 2017, Vol. 20, Issue 2, pp130-137.

[3] For an illustration of this widespread concern, see: Money laundering and real estate – Why the real estate sector should prepare for regulation, Acuity, 2018.

[4] This situation triggered the adoption of a speculation tax.

[5] Canada has been identified 'as a country that [China] wishes to target for recovering the proceeds of Chinese corruption' in FAFT, Anti-money laundering and counter-terrorist financing measures: Canada mutual evaluation report, September 2016, footnote 10, p.16.

[6] Similar analyses have been made globally, see for instance the 2008 FINCEN Suspected money laundering in the residential real estate industry and the Australian government's strategic analysis on Money laundering through real estate.

[7] A consolidated version is available in Eur-lex.

[8] The beneficial owner 'refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement'. On the initiative of the G20, work is ongoing to establish A global framework for tracing beneficial ownership.

[9] Prior to the implementation of the most recent changes in the EU AML framework. For all of them, only limited experience has been gained so far to assess the provisions.

[10] Article 6 of Directive (EU) 2015/849 requires the Commission to draw up, by 26 June 2017, a report identifying, analysing and evaluating money laundering and terrorism financing risks at Union level.

[11] Recommendations in the 2017 Faulty Towers report focus specifically on the London property market. The report also includes a specific recommendation to introduce more transparent regarding off-plan property purchases (buying from plans before the property has been built). The 2018 Towards better AML practice – real estate scoping paper is not based on a specific geographical area.

[12] According to the World Bank Group's response to illicit financial flows, the term 'Illicit financial flows (…) generally refers to cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred, or used that crosses borders. This falls into three main areas: the acts themselves are illegal (e.g. corruption, tax evasion); or the funds are the results of illegal acts (e.g. smuggling and trafficking in minerals, wildlife, drugs, and people); or the funds are used for illegal purposes (e.g. financing of organised crime)'.

[13]   In the World Bank Group's response to illicit financial flows: a stocktaking (dated March 22, 2016), a range of figures is quoted and the report states that 'While these estimates are difficult to verify (and are not always consistent), they indicate that the amounts involved are significant and pose widespread problems'.

[14]   Estimating illicit financial flows resulting from drug trafficking and other transnational organised crimes Research report, in 1988, p.7.

[15]   For more information, see M. Feferman and Y. Pelosi, L'immobilier face au blanchiment et au financement du terrorisme, RICS, Edition PC, December 2017.

[16]   Statistics included in the report are based on data available at the time of the preparation of the report.

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