ON THE HOUSE: HOW ANONYMOUS COMPANIES ARE USED TO LAUNDER MONEY IN U.S. REAL ESTATE

23 SEPTEMBER 2020

Alongside the world's worst COVID-19 death rates, the United States is facing an impending economic recession following the first wave of the pandemic. But, while millions of Americans struggle to stay afloat amid record job losses[1], there is a sector that seems strangely unaffected by the post-pandemic economic fallout: Real estate purchases.[2] Alarmingly, in the U.S., there are few regulations and checks of who is purchasing homes. As a result, housing remains a key vehicle for criminals looking to stash cash, launder money, and buy up homes in a tight market.

In the wake of the 2008 recession, the U.S. real estate sector demonstrated its potential to cataclysmically affect the rest of the world's markets: The recession led to a loss of more than $2 trillion in global economic growth.[3] Fast forward to 2020 and the U.S. housing market stands once again on a precipitous edge — this time, thanks to the COVID-19 pandemic. As income inequality rises, combined with rising housing costs[4] and a fall in supply,[5] the need for affordable housing is at an all-time high.[6]

While there is a confluence of factors underlying the cause of the housing crisis, the use of anonymous shell companies plays an important role. These companies provide a legal smokescreen for potential criminal or shady activities. Unfortunately, unlike the United Kingdom and all 27 European member states, no U.S. state requires company owners to disclose their identity, so these anonymous shell companies can operate like any other business.

Real estate has long been a preferred vehicle for money laundering. All too often, the proceeds of crime and corruption is used to purchase homes. Once the real estate is re-sold, the capital involved becomes legally acquired. The trick is to mask where the money comes from: Criminal networks do this by setting up anonymous companies to hide their connection to the purchase of the property. This briefing reveals the scope and seriousness of this problem and makes recommendations for what must be done to fix it.

Given that the obscure nature of anonymous companies makes investigating them extremely difficult, the cases presented here represent an indicative – not exhaustive – list of the ways in which company secrecy linked to property purchases leads to abuse.

THE HOUSING CRISIS

In 2008, the recession was driven by declining standards in mortgage underwriting, which forced families to foreclose and homes to stand empty. The housing market of 2020 looks remarkably different. Rather than too many houses, there is now a decrease in supply of existing homes for sale and an increasing consumer preference for brand-new homes. As a result, sales of newly built homes rose faster in June 2020 than any month since 2005.[7] This "hot market" signals a historic undersupply of single-family and multifamily houses for those who need housing most.[8]

To make matters worse, the U.S. Census Bureau has found that nearly half of all renters in the U.S. are rent burdened (spending more than 30 percent of their monthly income on rent).[9] The problem has been getting worse: in every year since 2001, median rents have grown more than renters' incomes.[10] While the real estate market has mostly recovered since the crash,[11] incomes have not[12], thus adding to the burden.[13] With the added strain of the COVID-19 pandemic, The Aspen Institute estimates that between 15 and 20 million renters will be at risk of eviction by December 2020.[14]

While families are under pressure to keep up with payments to stay in their homes, a swath of shell-owned properties go unoccupied. This problem influences housing prices across the country. At the ends of Miami Beach, more than half of beachfront properties lie empty.[15] On the west coast, San Francisco and Los Angeles have similar vacancy issues.[16] Half the homes in Oceanside, San Diego are currently unlived-in.[17] In New York City, there are eight blocks from Central Park to Lenox Hill that are nearly 40 percent unoccupied. [18] While we don't know exactly how many anonymous shell companies are used daily to purchase real estate, the New York Times estimated in 2015 (based on figures from the property data service First American Data Tree) that nearly half of purchases of residential real estate over $5 million were made by shell companies. [19]

As the cases below demonstrate, bad actors or wealthy speculators can use anonymous companies to bid up prices on properties and then use them as a "bank" rather than a home — all without identifying who they are[20] or where the money came from to purchase the property. Limited Liability Companies (LLCs) shield property owners from personal liability while obscuring their identities. In some cases, anonymity also enables money laundering, and it can mean that tenants struggle to hold landlords accountable, cities fail to fight graft, and that researchers can't answer basic questions about the housing market.

THE U.S.'S ANONYMOUS COMPANY PROBLEM

The World Bank found that the U.S. was the preferred destination for corrupt politicians from around the world to set up companies to move or hide dirty money, and that this is "especially troubling given the huge number of legal entities formed in the United States each year – around ten times more than in all forty-one tax haven jurisdictions combined."[21]

In most countries, including the U.S., real estate ownership is anonymous, meaning ownership is usually tracked at the legal and not the beneficial ownership level. In other words, companies used to purchase properties are not required to disclose their true, living owners. This makes identifying potential money laundering risks extremely difficult for law enforcement. Regardless of what you want to use an anonymous company for, it is too easy to set up an anonymous company in the U.S.

A study found that out of sixty countries sampled worldwide, only Kenya makes it easier than the U.S. to set up a company without disclosing who the owners are.[22] This study also demonstrated how little time it takes to find a U.S. corporate service provider willing to set up a company with anonymous owners. Even when inquiries came from clients that were similar to a front for terrorism or for those that should have raised a corruption risk, clients were on-boarded.[23] The evidence suggests that company service providers are not interested in who you are or what you might be doing, and current U.S. laws do not require them to be. You have to provide less information to obtain a library card than incorporate a company in every U.S. state.[24]

REAL ESTATE PROFESSIONALS

In addition to corporate service providers, other real estate professionals—such as brokers and agents—are currently exempted from the due diligence requirements of others in the financial sector.[25] The USA PATRIOT Act of 2001 contains provisions requiring those involved in real estate closings to perform due diligence on their customers, but these real estate professionals were ultimately granted a temporary exemption which was never lifted. A 2016 study by the U.S. National Association of Realtors found seventy-three percent of purchases by international clients were made in cash.[26]

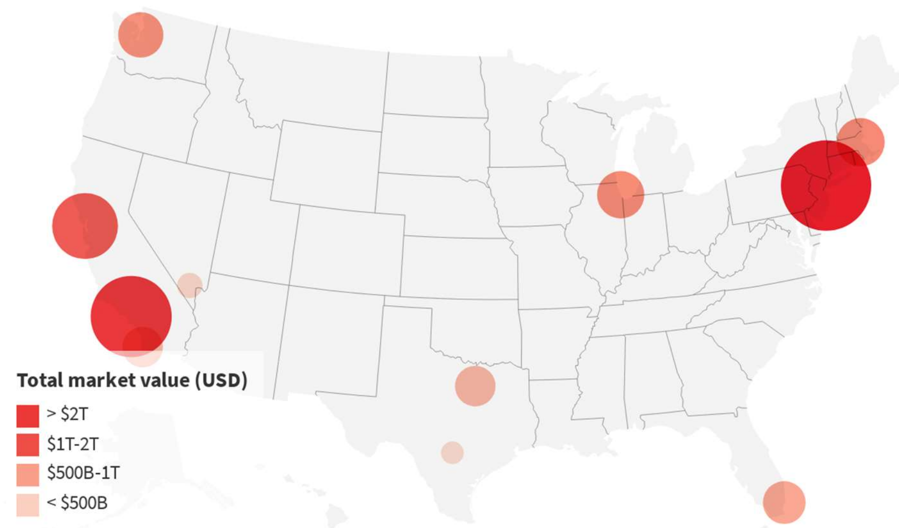
GEOGRAPHIC TARGETING ORDERS

This dynamic of secrecy and lack of accountability creates particular risks for cash purchases. The Treasury Department's Financial Crimes Enforcement (FinCEN) has since January 2016 managed a pilot real estate ownership collection program using a tool called a Geographic Targeting Order (GTO). Under 31 USC § 5326, FinCEN may impose temporary reporting requirements on businesses in a defined geographic area on certain transactions involving currency, monetary instruments, or wire transfers. FinCEN has renewed the orders every six months, with the most recent renewal occurring in May 2020.[27] Under the program, title insurance companies must report to FinCEN the beneficial owners of legal entities used to purchase residential real estate without mortgage financing above certain dollar thresholds in covered counties.[28]

Over time, FinCEN has expanded the scope of the program. It began by covering Manhattan, Brooklyn, and Miami and now includes counties in the Boston; Chicago; Dallas-Fort Worth; Honolulu; Las Vegas; Los Angeles; Miami; New York City; San Antonio; San Diego; San Francisco; and Seattle metropolitan areas.[29] The monetary threshold for reporting was lowered in November 2018 to purchases over $300,000 for all counties.[30]

GEOGRAPHIC TARGETING ORDERS COVER REAL ESTATE MARKET WORTH TRILLIONS

Since January 2016, the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) requires U.S. title insurance companies to identify the natural persons behind shell companies used in all-cash purchases of residential real estate. These "Geographic Targeting Orders" (GTOs) cover certain counties within 12 major U.S. metropolitan areas with a combined real estate market value of approximately $12 trillion dollars.



Home values listed by Zillow as of January 2020. The City and County of Honolulu is also covered by the GTO.

Figure 1 Source: *World Property Journal (2020)*

In August 2017, following the roll out and implementation of the GTOs, FinCEN announced that about 30% of the transactions under the pilot program involved a beneficial owner or purchaser representative that was also the subject of a previous Suspicious Activity Report (SAR)[31]—corroborating FinCEN concerns about this segment of the market, where anonymous shell companies are used to purchase luxury property via all-cash transactions. .

A 2018 academic working paper studying the FinCEN pilot program in Miami found surprisingly robust effects on buyer behavior.[32] These include a seventy percent decline in all-cash purchases by legal entities and an estimated four percent annualized price decline in luxury residential properties in covered counties directly caused by the program. The authors attribute these effects to a sharp drop-off in anonymity-seeking buyers.

While expanding and renewing the GTOs has caused some positive reverberations in the real estate market, the breadth and range of the cases below demonstrate the urgent need for swift, effective action to stop abusive behavior by anonymous company owners and their professional enablers. Lack of accountability across the sector sends a clear signal to those wishing to launder illicit money that the U.S. real estate market is open for business. While those who seek to exploit the U.S. financial system stream in, average renters and homeowners continue to struggle.

Momentum is building, but the U.S. needs a policy solution that will solve the problem full stop. To increase corporate transparency in the

U.S. real estate sector the U.S. Government must agree new rules that do the following:

- Collect and make public information about all of the company's real, human owners (otherwise known as "beneficial owners") and define those "beneficial owners" as a real human being, not another company or a nominee (someone who is listed as the owner on behalf of another person);

- Repeal the 'temporary' U.S. Treasury Department exemption under the USA Patriot Act of 2001 and to require all reporting entities involved in real estate transactions to conduct due diligence on customers. This should include real estate agents and other relevant individuals or entities, such as lawyers and law firms, accountants, notaries, mortgage lenders and other corporate service providers who engage in the buying and selling of real estate.

- Expand the FinCEN Geographic Targeting Orders covering residential property nationwide and make them permanent. Conduct a study on the risks posed by commercial real estate.

CASE STUDY #1: FLIPPING FOR DRUG MONEY

We've all seen shows on home improvement networks that follow a savvy investor or a relatable neighbor as they purchase a house that looks nearly irreparable. Construction costs add up, problems arise, but just when it looks like the problems will boil over, it's finally transformed inside and out and they flip the property for a healthy profit. There's genuine skill in turning these houses around—not to mention plenty of money to make in the process.

But one Las Vegas-based real estate agent, Luis Eduardo Rodriguez, allegedly took flipping houses to a whole new level, and it wasn't for earning a legitimate profit.[33]

In an effort to help a global drug cartel with ties to Italy, Mexico, and Spain launder its money into the U.S., Rodriguez is accused of utilizing his stature in the Las Vegas real estate industry—along with the ease of corporate anonymity that Nevada and other U.S. states provide—to purchase homes, renovate them, and then re-sell them on the housing market. He hid his connection to the crimes through a network of anonymously-owned shell companies, none of which could be traced back to him on paper. He flipped at least three houses for the drug cartel in a few months of 2016 alone.

Throughout the U.S., you can purchase a home with an anonymous shell company, often never being required to disclose who is really behind it, and he used this fact to his advantage. Along with his intimate knowledge of the real estate market, this anonymity allowed him to fund a drug cartel that has allegedly trafficked hundreds of kilograms of heroin, cocaine, and other narcotics.[34] He even recruited someone with no ties to the drug cartel to serve as an "administrator" of an anonymous shell company, distancing him from the operation further, while adding a layer of legitimacy to the company's structure. Ultimately, these flips helped perpetuate a drug ring moving millions of dollars.

Rodriguez pleaded guilty to drug smuggling charges in 2008[35] and is facing charges for laundering money including via real estate.[36] He faces up to 20 years in prison on the charges contained in the criminal complaint—the case is being handled by the Southern District of New York Office's Money Laundering and Asset Forfeiture Unit and at the time of writing was still ongoing.

CASE STUDY #2: YOU'RE A WINNER!

Everyone's dreamt of the knock on the door. You hear a loud "congratulations!" There's a man with a video camera and another one in a suit handing you a giant check with lots of zeros.

One New York-based fraudster, Tully Lovisa, allegedly created a scheme similar to the well-known Publishers Clearinghouse Sweepstakes and prayed upon everyone's desire to hear that knock on the door to perpetuate a $30 million mail-order prize scam.[37] His direct mail campaign would often intentionally target elderly individuals and claim they had won prizes; all they needed to do was pay delivery or processing fees.

Taking advantage of the hidden anonymity that shell companies provide, he and his co-defendants used a half-dozen shell companies with nominee owners in the US and post office boxes in the Netherlands to create a seamless scheme.

But it wasn't always so seamless.

Lovisa was actually sanctioned by federal courts after the the Federal Trade Commission (FTC) brought an enforcement action against him for similar schemes in 2010. Despite this injunction,

REAL ESTATE CASE STUDIES

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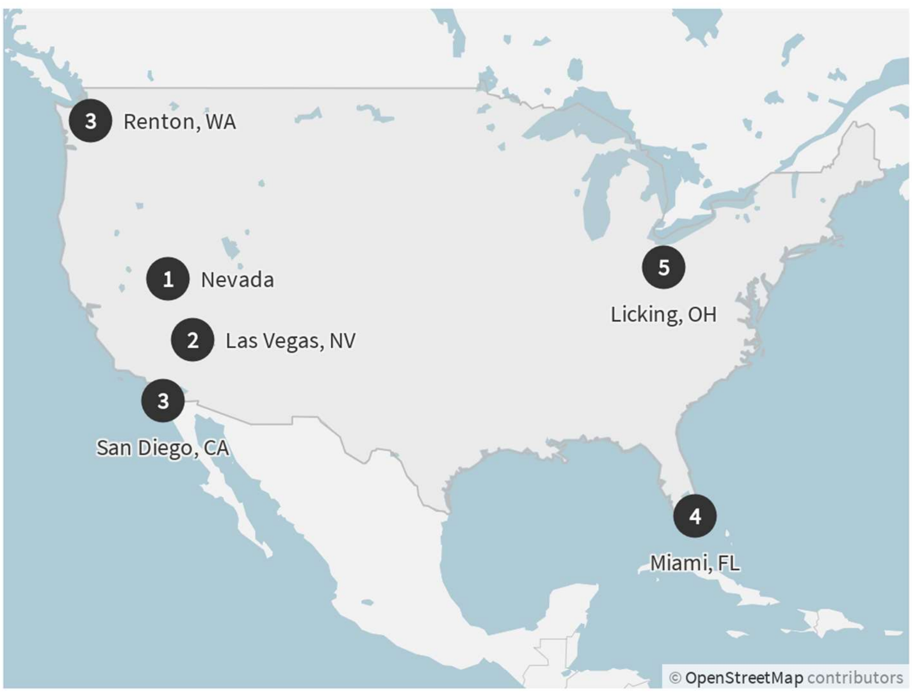

Properties involved in money laundering schemes:

1. At least 3 properties in Nevada being flipped in an effort to help a global drug cartel.
2. A house on Dreamcatcher Ave. in Las Vegas, Nevada, used by a fraudster.
3. Properties in Renton, Washington; Rancho Cucamonga, California; and La Jolla, California manipulated by industry insiders.
4. An apartment in the Porsche Design Tower in Miami, Florida, connected to a billion dollar bribery scheme.
5. 48 acres of land for a mansion in Licking County, Ohio, linked to an offshore anonymous company in Belize.

he continued, and even ramped up, the prize fraud, using shell companies to conceal his connection, and a slew of co-defendants for more than six years.

All of this is fairly standard for the corrupt and criminal, but there is one trick he had up his sleeve that showed just how much anonymous companies in the real estate sector can help evade the arms of the law. In 2012, as part of an FTC enforcement action, the fraudster was ordered to sell a Las Vegas home and hand the proceeds over to the FTC—he had to figure out a way to at least keep his hands on the money from the sale of the home.

To do this, he first manipulated real estate listings to inform the FTC he only received two offers on the house. Ultimately, they approved the sale to one individual, who was actually being organized to purchase the house by the defendant himself.

Here's the kicker—right before closing, the purchase rights of the property were transferred to a Panamanian company that was secretly controlled by him. This enabled him to evade the FTC sanctions and still control the real estate property. Ultimately, he sold it on the open market for over half-a-million dollars, nearly $400,000 more than the original "sale" that the FTC was aware about.

Lovisa pleaded guilty to wire fraud and conspiracy to commit mail fraud in October 2018.[38]

CASE STUDY #3: INDUSTRY INSIDERS

Map Data © 2020 Google

Map Data © 2020 Google

Clarence Roland III had a wealth of knowledge about the real estate industry, having spent 17 years as a mortgage broker. In 2009, Roland allegedly decided to team up with a former client, Arlando Jacobs, to game the mortgage system by filing fraudulent property deeds and fake mortgage liens.[39]

In order to defraud mortgage holders, Roland and Jacobs would allegedly fabricate documents to cause property records to show that the original mortgage holder's interest in the property was eliminated. Then, they would allegedly transfer the ownership of the property to shell companies ultimately controlled by Roland and Jacobs.[40]

But the scheme didn't stop there.

The duo allegedly then misrepresented that the shell companies had mortgage liens on the real properties and omitted their interest. Once the property was sold, the fake mortgage lien would be paid off using the seller's proceeds.

While this complex scheme was difficult enough to trace, it was made even more so by the alleged use of shell companies and lax beneficial ownership disclosure requirements. For one of their largest single fraud transactions, Roland and Jacobs allegedly created a shell company in Oklahoma to complete the transfer of USD$685,000 in stolen funds. The company listed an alias as the registered agent, the only person required to be named on incorporation documents in Oklahoma, and many other states in the US. In total, the defendants allegedly made nearly USD$4 million profit from the scheme.[41]

Roland and Jacobs allegedly used at least fourteen shell companies to help them perpetrate the mortgage fraud in Nevada, Oklahoma, and Texas.

Roland faces trial in January 2021.[42]

CASE STUDY #4: THE VENEZUELA CONNECTION

Photo by John Parra/Getty Images for Porsche Design

Large-scale corruption often spans national borders, and the US$1.2 billion bribery scheme that engulfed Venezuelan state-owned oil company Petróleos de Venezuela, S.A. (PDVSA) is no different. Former Executive Director of PDVSA Abraham Edgardo Ortega, who pleaded guilty to money laundering charges in October 2018,[43] and his co-defendants used the ability to incorporate anonymous companies in the US to funnel ill-gotten proceeds into the US, some through real estate transactions.

In his plea agreement, Ortega disclosed how he took at least US$12 million in bribes during his tenure at PDVSA, roughly US$5 million to give priority loans to a French company and a Russian bank, and another US$7 million to participate in the larger embezzlement scheme.[44]

But once they had their millions, Ortega and his co-defendants needed to find a way to "clean" the money.

In order to move the money into the U.S., Ortega and his partners worked with several professional money launderers to create false-investment schemes that ultimately drew money out of an investment fund, rather than into it. Some of the money was then used to purchase real estate in the US.[45]

In recorded conversations, Ortega and his co-defendant Carmelo Antonio Urdaneta discuss the possibility of purchasing a luxury apartment in Miami to funnel some of their proceeds. However, there was a small problem—the realtor they were working with advised them that purchasing an apartment via a shell company might get flagged during a "pre-closing" questionnaire, which could ultimately trigger an investigation by the Treasury Department's Financial Crimes Enforcement Network (FinCEN).

In order to escape this detection, Ortega's partner, Urdaneta, allegedly discussed creating a new shell company with his wife listed as the beneficial owner. But rather than keep the property for himself, Urdaneta wanted to transfer it to his money launderer as partial payment for his services. To complete the transfer, according to property and court records, Urdaneta formed a company in Florida, Paladium Real Estate Group LLC, in May 2016 and listed his wife as owner, and, later Amparan's wife was added as a manager. Then, in September 2017, after the closing was complete, Urdaneta's wife was removed from the company roles. This left the company and property in the hands of Urdaneta's partner, with his fees settled, and more importantly, no FinCEN investigation in sight.

Urdaneta, Ortega, and their co-defendants allegedly purchased at least 12 properties in total in Florida and Panama with their ill-gotten gains.[46]

Ortega has pleaded guilty to conspiracy to commit money laundering. His sentencing is set for November 2020.[47]

CASE STUDY #5: FROM BELIZE TO OHIO

Ponzi schemes have been helping the corrupt line their pockets for nearly a century — the name dates back to the 1920s when Charles Ponzi set up get-rich-quick investment schemes in which he paid early investors out of the money provided by later investors. But what wasn't so common in its nascent stage was a prominent role for real estate, shell companies, and an opaque financial system.

Ponzi schemes are still running rampant, but are now often enabled by weak financial regulations.

Hedge fund manager Jonathan D. Davey was convicted in 2013 by a grand jury for helping to collect over US$11 million of a US$40 million Ponzi scheme that robbed would-be investors from North Carolina, Virginia, and Ohio.[48] After the first scheme began to collapse, Davey and his co-defendants set up a Ponzi scheme that collected a further US$5 million that was used to pay investors of the first scheme as well as themselves.[49]

Davey and his co-defendants even created a website that claimed to show investors their returns. Towards the end of their heist, the website showed nearly US$120 million, when the actual value was less than US$1 million.

But once Davey had secured his own profits, he needed somewhere to hide it.

He set up a network of shell companies, which helped him evade taxes and launder the proceeds of the Ponzi scheme. As is seen in many other high profile money laundering cases, one of the most foolproof ways to clean your money for safekeeping is to put it into real estate, and this is exactly what Davey attempted to do.

After collecting his ill-gotten gains, Davey opened an offshore anonymous company in Belize to ultimately move the money into the U.S. to build a mansion in Ohio. With money stolen from his "clients", Davey purchased 48 acres of land and ordered US$3.3 million of construction costs — including an opulent driveway that could heat and melt snow.

However, the shell company in Belize was just one piece of the puzzle.

According to the indictment, Davey then created a Delaware-based corporation to be the owner of the mansion. This Delaware corporation was in turn owned by the Belize-based company, creating a web of ownership that hid Davey's identity from the property's records.

By the time Davey and his co-defendants were caught, they had stolen money from more than 400 victims.[50] Davey was convicted by jury trial in 2013 of conspiracy to commit securities fraud, wire fraud, money laundering, and tax evasion.[51]

CONCLUSION & RECOMMENDATIONS

These cases are just the tip of the iceberg, and without urgent intervention, anonymous companies will continue to undercut and disadvantage ordinary Americans looking for housing. At the same time, the impact of the COVID-19 pandemic, insufficient supply, and now the shutdown of new construction in much of the country is exacerbating the crisis. With this in mind, there is an urgent need for swift, effective action to curb the use of anonymous companies and their professional enablers.

Momentum is building, but the U.S. needs a policy solution that will solve the problem full stop. To increase corporate transparency in the U.S. real estate sector the U.S. Government must agree new rules that do the following:

- Collect and make public information about all U.S. companies' "beneficial owners" and define those "beneficial owner" as the real human beings that own and control the company, not another company or a nominee (someone who is listed as the owner on behalf of another person);

- Require all reporting entities involved in real estate transactions to conduct due diligence on customers by repealing the 'temporary' U.S. Treasury Department exemption under the USA Patriot Act of 2001. This should include real estate agents and other relevant individuals or entities, such as lawyers and law firms, accountants, notaries, mortgage lenders and other corporate service providers who engage in the buying and selling of real estate.

- Expand the FinCEN Geographic Targeting Orders covering residential property nationwide and make them permanent. The Department of Treasury should also conduct a study on the risks posed by commercial real estate.

Without these reforms, America will continue to hurdle towards a housing crisis, made worse by the COVID-19 pandemic and related shutdowns and layoffs.[52] As everyday Americans continue to struggle with finding affordable housing or making rent on time, anonymously-owned companies and their owners are allowed to operate without impunity and use the U.S. as a safe haven for ill-gotten gains. Lower-wage workers in particular will bear the brunt of this crisis – especially as they are the most likely to have incurred a loss of income due to the pandemic.[53] Addressing the affordable housing crisis in the US will require tackling the systems that allow fraudsters to use property to potentially launder billions. Congress and any future administration must act swiftly or face the consequences of another housing meltdown.

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