Brigitte Unger and Joras Ferwerda

Money Laundering in the Real Estate Sector

Suspicious Properties

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Brigitte Unger
Professor of Public Sector Economics, Utrecht University School of Economics, the Netherlands

Joras Ferwerda
PhD candidate, Utrecht University School of Economics, the Netherlands

with a contribution from

Hans Nelen
Professor of Criminology, Maastricht University, the Netherlands

Luuk Ritzen
PhD student of Criminology, Maastricht University, the Netherlands

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About the Authors

Authors

Brigitte Unger is professor of public sector economics at Utrecht University School of Economics, the Netherlands. She has previously published two books with Edward Elgar on money laundering: *The Scale and Impact of Money Laundering* in 2007 and *The Economics of Money Laundering* together with Donato Masciandaro and Elöd Tákáts in the same year.

Joras Ferwerda is writing his PhD on money laundering at Utrecht University School of Economics, the Netherlands and was involved in previous studies on money laundering for the Dutch Ministry of Finance, the EU and the World Bank.

Contributors

Hans Nelen is professor of criminology at Maastricht University, the Netherlands.

Luuk Ritzen is a PhD student of criminology at Maastricht University, the Netherlands.

Abbreviations

BIBOB	Public Administration Probity in Decision-making
BSN	Social Security Number
BVR	Management Programme of Relations from the Tax Authorities Office
CBS	Statistics Netherlands
CIE	Criminal Intelligence Unit
DNB	Dutch National Bank
FATF	Financial Action Task Force
FEC	Financial Expertise Centre
FIOD-ECD	Dutch Financial Intelligence and Investigation Unit
FIU	Financial Intelligence Unit
GDP	Gross Domestic Product
GEFIS	Dutch Integral Fraud Identification System
OECD	Organisation for Economic Co-operation and Development
RIEC	Regional Intelligence and Expertise Centre
STR	Suspicious Transaction Report
TCSP	Trust and Company Service Provider
UNODC	United Nations Office on Drugs and Crime
VAT	Value Added Tax
VIC	Real Estate Intelligence Centre
VKC	Real Estate Knowledge Centre
WODC	Dutch Scientific Research Documentation Centre

Contents

1. Introduction

The real estate sector is a growing and fascinating market, not only for those who are fond of gorgeous properties in breathtaking locations or of the beautiful architecture of Frank Lloyd Wright, Gerrit Rietveld, Adolf Loos or I.M. Pei. It has become a magnet for people searching for profitable investment opportunities without even intending to set foot in one of these marvellous buildings. In addition, in combination with the subprime mortgage market, the real estate sector has also recently become a highly debated cause of the financial crisis. Notwithstanding all scandals and fascinating features, this book looks at the real estate sector from a different angle, namely as a prominent candidate for money laundering and criminal abuse.

Given the sector's economic importance in many countries, several studies have been made on criminal behaviour in the real estate sector (e.g. FATF/GAFI, 2007). Most prominent amongst them is the OECD (2006) report by the Centre for Tax Policy and Administration on tax fraud and money laundering vulnerabilities involving the real estate sector. It is based on a survey concerning key tax evasion and money laundering issues in which 18 countries participated: Argentina, Australia, Austria, Canada, Czech Republic, Denmark, Germany, Ireland, Japan, Mexico, the Netherlands, Norway, Portugal, Spain, Sweden, Turkey, the United Kingdom and the United States. The report concludes that, in most of the countries surveyed, the real estate sector is identified as a sector that is used to facilitate tax fraud and money laundering.

In the Netherlands, two detailed studies have been done by two government related research centers. These are the study of the Dutch Scientific Research Documentation Center (WODC) by Ferwerda et al. (2007), which gives a good overview of maleficent behaviour in the Dutch real estate sector, and the Financial Expertise Center (FEC) report of 2008 on money laundering techniques used in this sector.

However, so far there has been no systematic study on the importance and frequency of diverse maleficent behaviour constructions for money laundering in the real estate sector. How many of the real estate objects are suspicious? This book tries to use all available information to systematically identify and analyse criminal investments in the real estate sector. Though the data refer to the Netherlands, the method described can be used for other countries as well.

This book is the outcome of a study jointly financed by three Dutch ministries. The pioneering idea of the Dutch Ministry of Finance, Ministry of

Justice and Ministry of the Interior and Kingdom Relations to jointly finance a project that studies criminal investments in the real estate sector by combining the knowledge of the diverse ministries and by bringing together different academic disciplines, allowed us to compile a report on Criminal Investment in the Dutch Real Estate Sector in January 2010 (Unger et al., 2010). The Utrecht University School of Economics and Maastricht University engaged in a multidisciplinary project of economists and criminologists in cooperation with all three ministries to identify criminal investments in the Dutch real estate sector.

We would like to thank the pioneers of the three ministries and all of the members of the advisory board who gave considerable help and support to this project, especially for providing data access. In particular we want to thank Erik van Andel, Jan Glimmerveen and Brigitte Slot (Ministry of Finance) for their courage and drive to start this project. We are heavily indebted to the latter for her sharp intellect, communication skills and enthusiasm that greatly inspired and helped this project. We thank Paul van Voorst (Ministry of Justice) and Karel Schuurman (Ministry of the Interior and Kingdom Relations) for their involvement in work across ministries. We would like to thank Jaap Trouw for his assistance in this project, especially the data mining process and for making some of the graphs. Without Bernd Veldman from the Tax Administration Office Real Estate Knowledge Center (VKC), who himself is writing a PhD thesis on this topic, the study would not be what it is. Nico van Waarden helped to combine the large datasets at the Tax Administration Office (Belastingdienst). Arjen Cuijpers and Ruud Leijenaar from the Real Estate Intelligence Centre (VIC) helped in particular by quickly arranging workplaces at the centre and thus giving us the opportunity to make use of their intelligence facilities and sources. We thank Arjen Siegmann from the Finance department of the University of Amsterdam for his original idea of using unusual prices to identify conspicuous objects and for providing graphical support. We thank John Zdanowicz for his great idea of using unusual prices for identifying trade-based money laundering, which inspired this study. Aart Hordijk from the University of Maastricht was so kind to provide us his estimates of the real values of European real estate markets. We thank Jan Rijk and Luud Geerlings for providing us with data for the region of South Limburg. We thank Niels Laheij from the Research Intelligence Expertise Center Limburg and Grazielena Marcus from the municipality of Maastricht for preparing the essential data. Last but not least, we thank Martin Grimbergen of the Dutch Financial Intelligence Unit and Eugene Heijnen, Peter Vincent and Bert Stevens from the Police Limburg South for the granting of access to and the preparation of closed-source materials (Suspicious Transaction Reports and Police dataset Blue View). We thank Henk Polet from the Office of the Land Registry (Kadaster) for his support and the Mayor of Utrecht, Aleid Wolfsen, for his interest in the research and

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With this book we hope to show new ways of detecting crime, which can be used for establishing early warning systems. Based on a number of unusual characteristics of an object or transaction, such as an unusual price, strange ownership characteristics or unusual bank relations, we identify those objects that should be further investigated by the authorities because they might be related to money laundering or other criminal activities. We also calculate the probability that an object with certain characteristics is being abused by criminals. Needless to say, the assumption of innocence holds true as long as a building has not been identified by the police as being related to criminal abuse.

In Part One of this book we will first show the importance of the real estate sector for money laundering and criminal investments (Chapter 2) and then discuss the most typical money laundering constructions mentioned in the literature (Chapter 3). Chapter 4 describes the research method and derives objective indicators from the literature that could point to suspicious money laundering constructions. Chapter 5 describes the data collection. Chapter 6 shows the results of the data analysis and derives a list of 150 objects that we consider unusual, which is then mixed with a list of 50 seemingly normal objects as a control group. Chapter 7 investigates the results of this data analysis. Part Two of this publication is the criminological part of the study. Chapter 8 describes the criminological methods with which the list of 200 objects handed over by the economists was analysed, the results of this analysis are presented in Chapter 9. Chapter 10 gives the major findings of the criminologists. Part Three of this study consists of a statistical and econometric analysis of all of the data in order to determine the importance of the various indicators (Chapters 11, 12 and 13). Chapter 14 presents the major findings of this analysis. Chapter 15 gives some suggestions for further research and the whole study is summarized in Chapter 16.

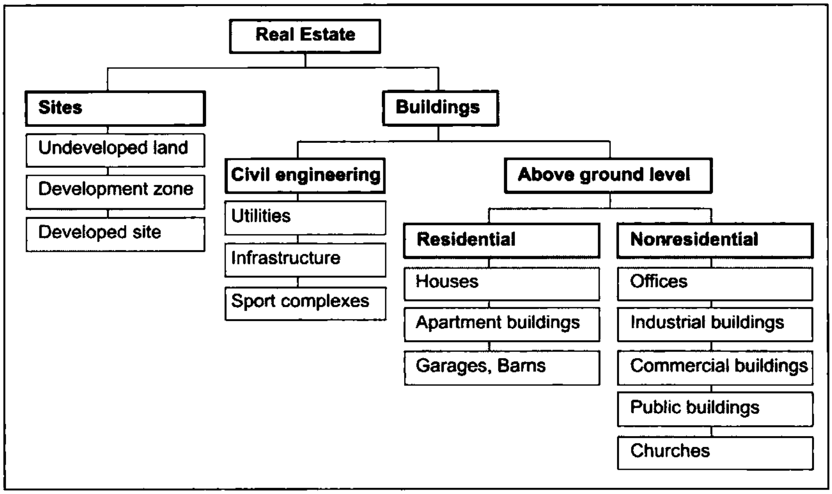
Part One
Economic Approach

2. The Real Estate Sector

Real estate can be perceived as a market, a sector or an industry, as an annual amount of transactions, as the total amount of physical objects being constructed or traded, as a means of providing shelter for living and for doing business, as the total value of wealth from these physical objects, and as investment opportunities and financial assets related to these physical objects. It can refer more to the real side of the economy such as the construction and trading of houses or to the financial side, such as the trade of real estate securities. International comparison over this encompassing market is rare, since every country has its own way of determining real estate values, has its own tax laws and instruments to determine the size and volume of this market and what belongs to real estate and its subcategories. Nevertheless, we were surprised to find no encompassing international comparative literature on a market, sector or industry which often amounts to more than 10 per cent of GDP in most countries. In the following we just want to give some definitions and sketchy numbers, which such an encompassing international comparison should systematically include.

The real estate sector comprises sites (plots of land) and buildings, where a distinction can be made between buildings above ground level and civil engineering. This distinction can differ slightly between countries and can have very different labels. In the Netherlands for example the first is called civil and utility buildings (BandU, burgerlijke en utiliteitsbouw) and the other ground, road and water buildings (GWW, grond-, weg- en waterbouw). In Germany the distinction is between Hochbau and Tiefbau. Buildings above ground level can be further divided into residential buildings (e.g. new and existing houses and apartments) and non-residential buildings wherein the latter comprise offices and other commercial buildings (e.g. shops, factory halls). In the Netherlands public buildings, such as government buildings and prisons, are explicitly added as a third category. Civil engineering comprises things like canals, tunnels, roads and dikes. Figure 2.1 gives a schematic overview over the types of real estate.

Figure 2.1 Different types of real estate



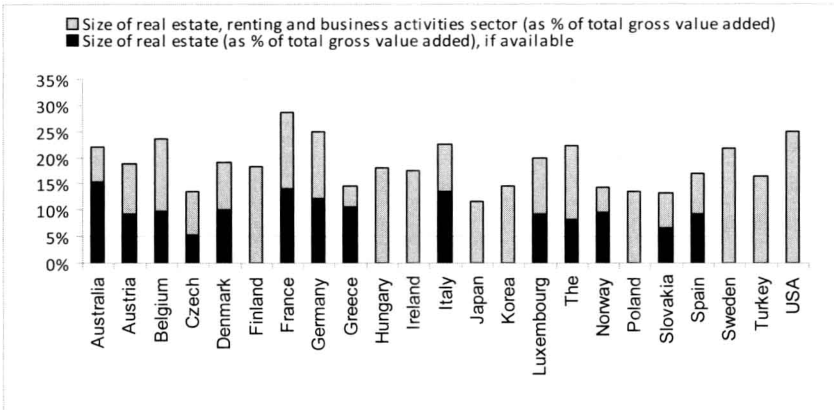
Source: Made by the authors, based on ZEW Mannheim (2009).

2.1. SIZE AND VOLUME OF THE REAL ESTATE SECTOR

The real estate sector is a sizeable market in many countries. Real estate activities contribute between 5 and 15 per cent to the total value added (and thus Gross Domestic Product) in most OECD countries.[1] In Germany, for example, the real estate market amounts to 12 per cent and is the second largest industry after production, and before retail and wholesale. In Italy it even amounts to 13 per cent of the GDP, in the UK to 7.5 per cent, and in Australia to 15 per cent. Figure 2.2 shows the relative size of the real estate sector (measured by gross value added in per cent of total gross value added) in many OECD countries. Including the renting and business activities this sector is even larger and amounts to about 20 per cent– 25 per cent of a country's gross domestic income. While data on the gross value added of the real estate sector including renting and business activities is available for all the countries below, data on the real estate sector alone are available only for some of them. They are indicated by dark-grey bars in Figure 2.2.

1 http://www.oecd.org/dataoecd/37/31/37664867.pdf

Figure 2.2 Relative size of the real estate sector (including renting and business activities) in OECD countries



Source: OECD Statistics from DSI Data Service and Information (2008), graph made by the authors.

The real estate market can be quantified as an industry that produces annual value added and thus contributes to the GDP, or as the total value of stocks or as the amount of tradable assets.

While the annual value added of the real estate market is published and can be compared internationally, the value of the stock of real estate is usually only estimated for some individual countries, as is the number or value of transactions. The data are hence not comparable and difficult to collect. Also, the OECD states that despite the fact that the number of property sales and property values could be estimated (in certain countries even from information stored in administrative/governmental bodies' databases) and that information available about transactions is normally higher than in other sectors, none of the countries have reported official figures or statistics. Hordijk (2008) shows that there is still a long way to go until international taxation and value estimation techniques will be comparable. Nevertheless, for our purpose, to demonstrate the large size of this sector and the large volume of transactions which might also include criminal transactions, the following data give an impressive picture. The total overall value of real estate assets in most European countries is more than three times as big as their GDP. Table 2.1 shows the total value of national real estate in most European countries. The largest real estate values can be found in Germany, the UK, France, Spain and the Netherlands.