Don't be a victim of real-estate fraud

BY WAYNE KLEIN
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Limousines overflowing with investors seeking real-estate bargains are now trolling the streets of South Florida looking for properties to buy. An April study found that 11.5 percent of Florida mortgages are past due, and one in 26 are expected to be foreclosed. Is this a rare opportunity for investors or a harbinger of coming investment scams? How do real-estate investors avoid getting taken for a ride?


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Profiting from real-estate investments requires confronting the three major risks associated with these investments: the risk of fraud, the risk that an apparently legitimate investment is rigged against the investor and the risk that values may drop. Successful investors avoid the first two pitfalls, leaving only market risk.

Real-estate investment fraud is a huge problem. Five years ago, promoters created myriad fraud schemes to deceive investors wanting to profit from skyrocketing property values. Now that Florida property values have plummeted, we expect new scams to arise promising great profits by purchasing distressed properties. Investors will be solicited to pool their money to buy undervalued real estate. Sadly, many of these investment promoters will never buy any properties.

LICENSED BROKERS

Fraud losses can be avoided by dealing only with licensed securities brokers. Refuse to give money to anyone who claims that a securities license is not required. When money is given to someone else to make a profit, the securities laws apply. The seller needs to be licensed and must disclose the risks of the investment and its financial condition. Plus, if the broker is found to have lied, the brokerage firm must reimburse losses.

WHO ASSUMES RISK?

Even legitimate real estate investments are sometimes structured so the investor assumes most of the risks; the promoters profit regardless of how the investment performs. Brokerage firms earn most of their fees from structuring deals, not from owning them.

When making real-estate investments, carefully examine who bears the most risk. If the deal sponsor is not keeping a share of the risk, the sponsor has inadequate incentive to ensure the investment performs well. The hundreds of billions of dollars investors lost in subprime mortgage pools, structured investment vehicles and collateralized debt obligations were deals where the investors ended up with most of the risk.

CONDO HOTELS

Similarly, buyers of condo-hotel units are now discovering their investments were rigged against them. Sellers claimed that profits from renting out the rooms would pay for the cost of buying the room. But, when the economy soured, the hotel manager rented the hotel's rooms first, leaving the buyer with little of the expected income. Even when the investor's unit is rented, the high fees give most of the revenue to the hotel, not the investor.

Investors should expect to bear the risk of market fluctuations. They should not be victims of fraud or rigged investments. Holding title to property is one way to avoid the first two risks. Those who don't hold title but give their real-estate investment money to others must protect themselves against fraud and rigged investment deals.

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