



REAL ESTATE INVESTMENTS AS SECURITIES

Your interest in a real estate investment may begin with a trusted family member, friend, neighbor or business associate who approaches you to talk about some impressive financial gains. An advertisement in a popular newspaper or online service catches your eye with a promise of guaranteed returns secured by an interest in a piece of real estate.

What you may not realize is that some of these investment opportunities may be unregistered securities or worse yet—scams. Whether a real estate investment is a security or not is not always easy to determine and depends upon the unique facts and circumstances of the transaction and not on what a promoter calls the investment product.

How do I know if what I am buying is a security?

A general rule of thumb with which to start is that if you as the investor are not in control of the real estate transaction and are expecting a return on your money, the transaction probably involves a security. Because the investment may involve a chunk of your life savings, consider consulting with an attorney knowledgeable in securities law to provide a legal interpretation for you and evaluate any exemptions claimed by the promoter. By law, the Commission's Securities Division cannot provide legal advice to the public.

Understand the Investment: Ask Questions!

The lure of large financial gains from a real estate investment opportunity may be enticing, but take your time, ask the right questions and verify before you buy. Most importantly, understand the investment and what it entails. If you don't understand, ask questions. If the promoter gives you nebulous answers and you still don't understand, don't invest.

Here are some important questions to consider before signing on the dotted line:

- ✓ *Are you buying an interest in real estate or in an entity that is buying or financing real estate?*

A promoter may "package" real property or loans on real property with service agreements—property management, rent or debt collection, foreclosure services—that the promoter will provide you. The promoter, not the investor, will make decisions regarding the management of the real estate or the real estate loan. If you are buying a "package" and you will not have active control over or management of the real property or the loan, then you are probably buying an "investment contract," which is a security.

- ✓ *Are you buying real estate that you can control?*

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✓ *Are you investing in a deed of trust?*

Although commonly called a deed of trust investment, the product that the promoter is selling is a promissory note secured by a deed of trust on real estate. The law exempts from registration requirements the sale of a note secured by a mortgage or deed of trust on real estate, but if the note and deed of trust are “packaged” with other services the promoter will provide to you, then the “package” you are buying is likely an investment contract. The investment contract would not be exempt from registration.

Watch for Red Flags of Fraud

A real estate investment opportunity may only be good as the person and the company who are standing behind it. Here are some warning signs that the investment opportunity may not be legitimate:

1. **A salesperson without a securities registration or valid exemption from registration.**

Having a real estate or insurance license does not qualify an individual to sell securities. Contact the Commission’s Securities Division to determine the license status of the promoter and product and if there is any disciplinary history—even if it is with someone you know and trust.

2. **A company without verifiable or audited financial information.**

Beware if the company’s representatives emphasize their luxurious lifestyle and not objective financial information that has been audited according to acceptable accounting standards. Request written information that fully explains the investment, such as a prospectus or offering circular. The documentation should contain enough clear and accurate information to allow you or your financial adviser to evaluate the company’s financial health and the particulars of the investment.

3. **A deal with guaranteed returns and little to no risk.**

Promoters may claim the investment has little risk since it is secured by a deed of trust, but such investments are rarely without risk. For example, the promoters may fail to record the deed of trust for the investors’ collateral or the total amount of funds secured by the deeds of trust may far exceed the value of the property. Remember, all investments involve some form of risk—the higher the rate of return, the higher the risk of financial loss. Only invest what you can afford to lose.

4. **A limited time period to make a decision.**

Scams are often presented as a once-in-a-lifetime opportunity and promoters usually require an investor to make a quick decision before the opportunity is gone. When it comes to your investment dollars, this high-pressure sales tactic is a warning sign of a possible scam. Having the appropriate amount of time is crucial for a thorough background check on the promoter and product. This investigative process is known as “due diligence.”

5. **An opportunity that sounds too good to be true.**

The lure of wealth sometimes blinds potential investors with greed. Vet the investment opportunity with an objective third party such as an accountant, financial professional or attorney, someone not associated with the transaction and without a hefty commission at stake.

Before buying any real estate investment opportunity, verify the licensure status of the product and promoter by contacting the Arizona Corporation Commission's Securities Division at **602-542-0662** or toll free in Arizona at **1-866-VERIFY-9 (837-4399)** and speak with the Investigator on Duty to verify whether the person is registered or licensed and has a disciplinary history.

Remember, the fact that a particular investment is registered, or exempt from registration, is not a guarantee as to how that investment will perform or if it's appropriate for your financial situation. To determine if the investment is appropriate for you in terms of risk and return, seek the assistance from an accountant, attorney or independent adviser.

Free Investor Resources

*For more information on wise investing and other investment products, visit the Investor Resource Center, **www.azinvestor.gov**. To request a presentation for your group call the Investor Education Coordinator at 602-542-0428 or email at **info@azinvestor.gov**.*