

Crowdfunding for Real Estate

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The purpose of this article is to describe how crowdfunding works, the different approaches that crowdfunding Web sites have taken, some of the early real estate deals that have been funded through crowdfunding, the advantages and disadvantages of raising equity through the crowd, and potential implications for the real estate industry if crowdfunding becomes a significant source of capital.

An old adage about real estate partnerships goes something like this: “at the beginning of an investment, the general partner brings experience and the limited partners bring money. At the end, the roles are sometimes reversed.” The history of real estate is filled with scandals from sales of Florida swamp land to con men selling properties they do not own. Thus, our first reaction on learning about sponsors using crowdfunding to finance real estate investment was one of deep skepticism. Crowdfunding seemed custom made for sleazy promoters to take advantage of naïve investors. Why would reputable real estate firms with dependable financial backers go through the headaches of bringing the general public into their deals?

The counter argument is that crowdfunding is a disruptive technology. Raising equity for real estate investments is inefficient, lacks transparency and tends to be time consuming and expensive. Technology and the Internet thrive in markets with these characteristics. Ten years ago, many of us were dubious about buying items on the

Internet like clothing or shoes. Today it is hard to think of an item that we would hesitate to buy online. Even when it comes to spending significant sums or renting out our personal property, we trust Web sites like Trip Advisor and Airbnb to provide reliable advice and connect us with trustworthy individuals.

Two recent developments have elevated the profile and potential for raising money for private, real estate investments through crowdfunding. The first is the Jumpstart Our Business Startup Act or JOBS Act which President Barack Obama signed into law on April 5, 2012. This bill changes key provisions in securities law to allow sponsors to raise capital from the general public utilizing broad based advertising (what the SEC calls “general solicitation”). The second development has been the injection of over \$50 million from venture capitalists and strategic partners into the leading real estate Web sites that facilitate crowdfunding.

Will crowdfunding become a significant

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factor in the real estate industry? Will it lead to greater uniformity in the way fees are assessed and deals are structured? Or will crowdfunding become discredited by a series of scandals? All three scenarios are possible. The purpose of this article is to describe how crowdfunding works, some of the different approaches that crowdfunding Web sites have taken, some of the early deals that have been funded through crowdfunding, the advantages and disadvantages of raising equity this way and some potential implications for the real estate industry if crowdfunding becomes a significant source of capital.

General Crowdfunding Background

The Oxford Dictionary defines crowdfunding as, “the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet.”¹ The Internet can greatly decrease the cost of pooling small investments and allowing individuals to target specific opportunities. KIVA, for example, allows investors to loan money to small entrepreneurs in Africa and around the world in increments as small as \$25. In eight years, it has raised and made loans totaling \$574 million.

In 2008, the use of crowdfunding expanded from primarily funding nonprofit ventures to funding small, for profit ventures. IndieGoGo and Kickstarter began raising money for new ventures to develop things like high tech products or new music albums. Since securities law, at that time, made it difficult for individuals backing these projects to receive a financial return, backers of the projects typically receive an advanced copy of the product or a t-shirt. Typical projects sponsored by Kickstarter and IndieGoGo include films, books, music, art, services and high

tech products. Kickstarter and IndieGoGo have funded more than 200,000 projects with nearly \$1 billion in capital.

Today there are about 500 crowdfunding Web sites² which rely broadly on one of two models to raise capital: donation/reward-based or investment-based funding. Political campaigns, charitable organizations and some entrepreneurs have relied on the donation and reward-based crowdfunding model to raise capital to fund projects or run campaigns. Under this model, backers either donate money to support a cause or receive a pre-determined reward for their capital. The donation and reward-based crowdfunding model is the platform used by Kickstarter and IndieGoGo and many of the more established crowdfunding Web sites.

The second model is investment-based where the Web site creates a marketplace where investors can choose from a variety of potential investments. Under this model, investors expect to receive a market rate of return on the capital they invest. Before the JOBS Act, it was very difficult to raise private equity using crowdfunding because of the Security and Exchange rules about general solicitation. As Jonathan Axelrad, a partner at the Goodwin Procter law firm explained:

For many decades, emerging companies and private investment funds generally had only two choices when seeking to issue securities: a fully registered public offering, or a private offering ‘not involving any public offering.’ The Jumpstart Our Business Startups Act (JOBS Act) created a third path. It directs the U.S. Securities and Exchange Commission (SEC) to adopt new rules. Under Rule 506(c), the prohibition against general solicitation is eliminated . . . so long as securities are issued only to accredited investors.³

Real Estate Crowdfunding 101

Much of the early success in real estate crowdfunding focused on making loans on

small residential properties. Accredited individuals would fund a Limited Liability Corporation (LLC) which would then make a loan to an individual or small real estate company to fix up and sell a residential property. These loans are typically first mortgages, which are backed by a personal guarantee from the developer, and matured in six months to 18 months. There are several real estate crowdfunding sites that currently offer their investors this type of investment including: Realty Mogul, Realty Shares, iFunding, and Patch of Land. In our examination of several of these deals, investors expect an annual interest rate between 7% and 10% and return of capital upon maturity.

As crowdfunding for real estate has gained greater acceptance, the emphasis has shifted from this kind of niche lending to raising equity, mezzanine financing and debt for larger commercial properties and multifamily investments. There are at least 10 crowdfunding sites that have successfully raised equity capital for real estate sponsors from accredited investors. To date, most of the real estate Web sites have followed a two-step approach which begins with finding credible real estate sponsors. Crowdfunding platforms like Realty Mogul, Fundrise, Real Crowd, iFunding, and Realty Shares look for real estate sponsors that have previously raised capital through private syndications. These crowdfunding Web sites emphasize their ability to find outstanding sponsors and perform careful due diligence on these sponsors.

If a sponsor makes it through this screening process, they are allowed to present deals for potential investment. The second step is that some crowdfunding sites use their internal staff to do property level due diligence. In our discussions with sponsors,

we learned that the leading Web sites have developed their own underwriting models, do financial stress testing and have set up investment committees to approve the investments. Only investments that survive this vetting process are listed on the Web site.

Each investment that is listed generally contains the information one would expect in an institutional investment committee memo. The memo and other attachments discuss: the location, the market, historical financials, underwriting assumptions, sponsor track record, risks and exit strategy. For some deals, the crowdfunding sites hold webinars or conference calls to introduce the sponsor and the deal to investors who are registered on the Web site and are interested in the property.

In most of the deals that we reviewed, the sponsor allocated only a portion of the limited partnership equity to the crowdfunding platform. For example if a sponsor needs to raise \$3 million in capital to fund an acquisition, it may raise \$2 million from its own network of investors and allocate the remaining \$1 million to be raised by the crowdfunding site.

When a potential investor, who is registered on one of the crowdfunding Web sites, decides to participate in a particular deal, they can download and sign the legal paperwork and then send their payment to an escrow account through an online portal. The typical investment listed on a crowdfunding platform has a "reserve" or minimum amount of capital that it must raise. If the reserve amount is not raised, the money held in the escrow account is refunded to the investors.

If sufficient capital is raised, the crowdfunding sites invest the money in one of two

ways. Some sites, including Realty Mogul, iFunding, and Realty Shares, set up a special purpose entity, which then invests in the partnership or whatever legal entity owns the property. Essentially all the crowd fund investors act as a single limited partner. Nav Athwal, the founder and CEO of RealtyShare, commented that pooling investor capital this way, "greatly reduces the burden to the sponsor because the sponsor doesn't have to manage many small investors and leaves that to us."⁴ Other sites, including Real Crowd, Prodigy Network, and Fundrise simply allow investors to invest directly in the partnership or Limited Liability Corporation that holds title to the property as if each investor were like any other limited partner.

Advantages of Using Crowdfunding to Invest in Commercial Real Estate

1. Greater Transparency

Perhaps the greatest benefit of crowdfunding for real estate investments is in creating greater transparency for both the investors and sponsors. By screening and presenting multiple potential investments, investors receive better information about what kinds of investments are available and can compare the fee structures in each partnership. Most equity real estate private placements are structured with a preferred return, which is the amount that investors are entitled to before the sponsor begins to share in the cash flow and appreciation. According to RealtyMogul in its survey of \$1 billion of private placements, the preferred returns ranged from 7% to 12% with an average of 8.35%. In the past, most investors only saw a limited number of private, real estate offerings and therefore had a hard time figuring out if they are getting an appropriate preferred return. Similarly in its survey,⁵ RealtyMogul found the following data about fees:

- The most favorable promote to investors was 80%/20% (80% to the investors, 20% to the sponsor) while the least favorable was 50%/50%. The average promote across all the transactions was 72%/28%.
- Three fourths of the transactions surveyed were structured with an acquisition fee. The acquisition fee ranged from 0.59% to 5% and averaged 1.73%.
- Asset management fees ranged from 0.5% to 5% and averaged 1.88%. Property management fees ranged from 1.25% to 8.5% with an average slightly below 4%.

The success of a real estate investment depends on lots of things like the skill of the sponsor and the quality and location of the property. However, creating transparency so that investors can compare investments and compare deal structures is a great boon and a healthy step forward for the historically opaque real estate industry. Over time, we hope that crowdfunding Web sites will force sponsors to report fee structures and investment results in a standardized way so that investors can make apples-to-apples comparisons.

2. More Investors and Smaller Minimums

Most private real estate partnerships purchase a single property. According to RealtyMogul the median real estate, private equity deal size in 2012 was \$2.3 million.⁶ Finding and explaining these offerings to potential investors is time consuming. So most sponsors set relatively large minimum investments. The average, private real estate partnership had seven investors.⁷ By present-

ing the materials online rather than in person means that these offerings can be viewed by thousands of potential investors. Sponsors can lower the minimum investment and include more investors. It is noteworthy that only 47,000 people made investments in private real estate equity partnerships in 2012.⁸ According to the Securities and Exchange Commission, in the United States there are about 8.3 million accredited investors, so crowdfunding could potentially, greatly expand the investor pool. And once the rules are finalized, non-accredited investors will also be able to invest.

3. Lower Fees

Most of the crowdfunding sites emphasize that crowdfunding enables more money to go into the property than investments in private REITs and private partnerships. Part of the reason is that the Web sites charge substantially lower fees for raising capital than the brokers and financial advisers who are paid as much as 10% of the capital raised. To cite one example of the fees currently being charged by private REITs, Brent Hunsberger claims that the "Georgia-based Wells REIT II Inc., raised \$6 billion from investors since 2004. But it used only about \$4.7 billion to buy real estate, according to the company's latest quarterly financial report." One of the benefits of the transparency described above is that by explicitly detailing all investment fees there is a high likelihood that competition will drive down the fees.

4. Benefits of Having Local Investors

There are advantages to having local investors involved in real estate projects. They can provide sponsors with suggestions about what is and is not acceptable in their community. If the project needs regulatory approval, local investors can sometimes help

in rallying local support and appearing at community meetings. Once the project is operational, they serve as an extra set of eyes on the project and can steer customers to the property, especially if it is a hotel, apartment building or retail establishment.

5. Enhanced Reporting and Accountability

Because crowdfunding platforms are primarily focused on providing information, they should be able to provide individuals with high quality information in a timely and easy to understand format. In terms of accountability, an interesting analogy is the rating system on the Web site eBay. People who sell goods on eBay worry a great deal about their ratings and reputation. As the crowdfunding industry gains scale, it should become easier for investors to obtain objective information about the track record of different sponsors and greater uniformity in the way returns are calculated and reported.

Disadvantages

1. Investors Overestimate Their Expertise

Crowdfunding Web sites promote the idea that because all of us interact with real estate, we have the expertise to select good investments. They also claim that knowing the specific property in which your money is being invested reduces the risk. These concepts directly contradict what many financial advisers, like Mark Severs at Morgan Stanley, recommend. Severs stresses the importance of diversification and believes that investors are generally better off investing in indexes and mutual funds rather than in individual stocks or individual properties. Most experienced real estate investors have learned that investing in real estate requires

significant expertise that goes well beyond the knowledge acquired by working in an office or shopping at retail stores. Theoretically, an investor could hire a real estate expert to examine the leases, physical attributes, valuation and market competition for a property in which they want to invest, but that would add significantly to the cost.

2. Unrealistic Projections

In looking at some of the prospective investments on the crowdfunding web sites, we were struck by what seemed like very high returns. In many cases, sponsors advertised internal rates of return of 19% to 22%. The emphasis seemed to be on eye catching returns rather than risk-adjusted returns. In the current investment environment, these returns seem optimistic. Even when it came to investments in first mortgage debt the investments advertised returns of 8% to 10%. Since banks are currently making construction and acquisition loans at 4% to 5%, it is puzzling that investors are able to earn a 400 basis point premium, unless the quality of the credit is low, the time horizon is very short and/ or the risk is very high. Many investors expecting outsized returns are likely to be disappointed.

3. Lack of a Personal Relationship to the Project Sponsor and to Other Investors

The key to successful real estate investing is selecting the right general partner with properly aligned incentives. When a sponsor raises money from “family and friends,” the personal relationship with the investors adds an extra incentive to treat the investors fairly. In crowdfunding, the sponsor does not know his or her investors. Over the course of the investment, the sponsor will make hundreds of decisions that impact the returns to the

limited partners. Conflicts of interest are inevitable, such as the decision about whether to renew an existing lease or look for a new tenant and earn a lease commission.

Megan Hammond, who is the managing director of the real assets portfolio for the Dartmouth endowment, highlighted the importance of having like-minded, limited partners. When an investment gets in trouble, she pointed out, the investors need to work collaboratively, whether that means investing more money or replacing the general partner. If investors have different expectations, time horizons, expertise and financial capability, agreeing on a workout plan or funding a capital call can become a nightmare.

The Players

In trying to understand the current state of real estate crowdfunding, we looked at seven of the most successful crowdfunding Web sites. We selected them based on: the number of deals completed, estimated equity raised for real estate investment, overall visibility and total venture capital invested in the sites to further develop their platforms. While there are currently over 30 sites attempting to raise equity or debt capital for various real estate transactions, these seven Web sites are on the cutting edge and provide a good overview of the current state of the industry.

The revenue models for these seven crowdfunding sites differ in interesting ways. Some sites charge a fee to the sponsors for the use of their technology and asset management platform. Others charge sponsors based on the amount of capital raised or for the due diligence costs to list a deal. Some Web sites charge investors a percentage of their quarterly distributed cash flow as an annual asset management fee or for using their technology. How these sites will ulti-

mately create a sustainable business will undoubtedly change when and if they achieve a substantial scale.

All seven Web sites are willing to list investments anywhere in the United States. Similarly they all draw investors from across the United States and some even welcome non U.S. citizens. To invest on most of these sites, an investor must be accredited, meaning that he or she has over \$1 million in liquid

net worth, earns over \$200,000 annually or meets some of the other requirements under Regulation D of the Security and Exchange Commission rules.⁹ As Chart A indicates there are substantial differences between these seven web sites, especially in terms of the minimum investment required for a person to invest in one of the properties listed on their Web site.

Chart A

Platform (Name on the Web-site)	Type of Property and Type of Investment	Sponsor	Type of Investor	# of Deals Done	Equity Raised (Estimate)	Minimum Investment	Amount of Investor-Sponsor Interaction
Fundrise	Commercial & Residential Equity & Debt	External	Accredited Non-accredited	19	\$10M ¹⁰	\$100 ¹¹	Medium
Prodigy	Commercial Equity	Internal	Accredited, Foreign	5	\$250M ¹²	\$100,000	High
Realty Mogul	Commercial & Residential Equity & Debt	External	Accredited	67 ¹³	\$19M ¹⁴	\$5,000	Low
iFunding	Commercial & Residential /Equity & Debt	External & Internal	Accredited	18	\$26M	\$5,000	Low
Ground-floor	Residential/Debt	External	Non-accredited	5	\$0.25M	\$100	Low
Realty Shares	Commercial & Residential Equity & Debt	External	Accredited	33	\$8M	\$5,000	Low
RealCrowd	Commercial/Equity	Broker	Accredited	8	\$3M	\$25,000	High

Fundrise

Fundrise was founded in 2010 with the goal of “democratizing local investment” and allowing non-accredited local investors to “build their own city.” Today, the platform provides a range of private real estate investments for accredited investors. It also offers

some real estate investments for non-accredited investors who qualify as local investors.¹⁵ Fundrise recently raised \$31 million of venture capital from the Collaborative Fund and Renren, a large social networking company based in China. Other investors in Fundrise include prominent real estate execu-

tives of Silverstein Properties, Rising Realty Partners, the Ackman-Ziff Real Estate Group, and Loopnet.

Prodigy

Prodigy is a New York based company that raises money only for its own deals. Prodigy's founder and CEO is Rodrigo Nino, a native of Columbia. It first came to prominence marketing the Trump SoHo hotel condominium. Recently Prodigy shifted its focus from U.S. investors to international investors. It raised \$171.8 million of equity from 3,100 investors to build a 66-story tower in Bogota, Columbia. Of all the crowdfunding Web sites we studied, Prodigy seems to have the highest profile properties.

Realty Mogul

Realty Mogul refers to itself as "a marketplace for accredited investors to pool money online and buy shares of pre-screened real estate investments."¹⁶ Investors on Realty Mogul's platform invest directly into a newly formed entity controlled by Realty Mogul. All interaction between the sponsor and investors is filtered through Realty Mogul. Thus far, Realty Mogul has offered a mix of equity investments in commercial deals with experienced sponsors and debt investments on residential "fix and flips." Realty Mogul has raised \$9 million of venture capital in a round led by Canaan Partners.

Realty Shares

Realty Shares is an online investment platform attempting to become "the E*TRADE of private real estate." The site contains a mix of equity investments on commercial properties and peer-to-peer lending on residential "flips." Investors pool capital into funds that hold an interest in a specific,

private real estate investment. Realty Shares is backed by General Catalyst Partners, 500 Startups, and Greg Framke (former COO of E*Trade).

iFunding

iFunding's platform currently appears to utilize a similar business model as Realty Mogul and Realty Shares. The Web site focuses primarily on equity investments in residential "fix and flips," but has completed a few commercial deals. It recently partnered with one of its sponsors, who is building a \$250 million condominium project in New York. So far iFunding has raised \$7 million of equity for this condominium project and hopes to raise an additional \$48 million.¹⁷ Former New York Governor David Paterson recently joined the staff at iFunding.

Groundfloor

Groundfloor is a peer-to-peer lending site for small residential, development projects based in the Raleigh-Durham Research Triangle. The site has successfully raised capital from non-accredited investors in Georgia and anticipates using other intra-state crowdfunding exemptions to solicit interest from investors in Arizona, Illinois, Massachusetts, and Virginia. Groundfloor closed its first round of funding with Bandwidth Labs and the American Underground.

RealCrowd

RealCrowd allows real estate operating companies to post information about their projects and connect to accredited investors who invest directly with the sponsor alongside their existing limited partners. The sponsors that raise capital through RealCrowd are responsible for vetting the investors to ensure that they are accredited and for cor-

responding directly with investors. The site has raised \$1.6 million in a seed round from Data Collective, Y Combinator Partner Garry Tan, Reddit co-founder and author Alexis Ohanian, and a collection of real estate and wealth managers.

Two Representative Deals

In writing this article, we reviewed more than 30 deals that have raised money or are currently raising money through one of the crowdfunding platforms. These deals ranged from first mortgages for “fix and flip” residential projects to equity stakes in large commercial properties. The variety of investments gave us the sense that these Web sites are trying out lots of ideas to see what works.

In one deal that received considerable investor interest, Real Crowd raised \$400,000 for Atlas Real Estate Partners, a New York City based investment firm. The \$400,000 of equity was roughly a quarter of the total equity. Atlas used this money to acquire Fort Davis Center, a 44,147 square foot, 100% leased office/retail center located in Washington, D.C.

Fort Davis Center is in an up-and-coming neighborhood of Washington D.C and is anchored by the Department of Human Services, which occupies 59% of the property. The acquisition was financed with a 10-year fixed-rate CMBS loan. Atlas structured this investment so that investors receive an 8% preferred return and then a share of additional cash flow and residual profits on sale or refinancing. Overall, Atlas projects that investors will receive an overall return in the teens.

When asked why they decided to use crowdfunding to raise part of their equity,

vice president of investment Joe Stampone said, “We easily could have raised the capital from our existing investor base, but by using crowdfunding we are branding ourselves as a forward thinking group and as thought leaders in the industry.” Further, when discussing the process of raising capital online, Stampone “found Real Crowd very easy to use because the site connects us directly with potential investors. We chose that site because we wanted access to high-net worth investors with whom we could develop long-term relationships.”

Another example of a property where a crowdfunding site raised the required equity capital was the Hard Rock Hotel in Palm Springs. Realty Mogul raised \$1.56 million in equity to recapitalize this property. The current owner, Kittridge Hotels & Resorts sought the capital in order to recoup some of its initial investment and to make improvements to the property like upgrading the swimming pool. The deal is structured as an 8% preferred return with excess cash flow and residual proceeds split 80% to investors and 20% to the sponsor. The sponsor projects a 16% total return over a five-year hold.

In analyzing this hotel investment several aspects of the underwriting stood out. It appears to be highly leveraged with at least a 75% loan to value ratio including mezzanine debt. Over the five years, the sponsor projects that the REVPAR, (or “Revenue per Available Room,” a common hotel revenue metric) will increase by 38% from \$111 per available room per night to about \$154 per available room per night. One other interesting aspect of the deal is that Realty Mogul has built in some special perks for investors: “In addition to sharing in the income from the hotel through quarterly rental payments and any appreciation of the hotel when it is

eventually sold, investors will receive a Hard Rock Hotel Palm Springs Owners Card," which entitles investors to discounts on stays, room upgrades, dining credit and special treatment at the pool.¹⁸

Regulatory Issues

The Jumpstart Our Business Act (JOBS) Act was signed into law on April 5, 2012. The SEC is currently writing and circulating key rules. But the JOBS Act is already having an impact by allowing crowdfunding Web sites to broadly publicize their private equity investments. Until the SEC completes its rulemaking, most crowdfunding Web sites are only making their investments available to accredited investors.¹⁹ Once the SEC rules are finalized, non-accredited investors will also be able to participate in these crowd-funded investments.

The two parts of the JOBS Act that most directly govern crowdfunding are Title II and Title III.

Title II

Previously, the SEC provided real estate sponsors an exemption from full registration of its securities when they did a "private placement" (Rule 506B under Regulation D). Sponsors were able to raise as much money from as many accredited investors as they wanted as well as 35 "sophisticated" investors who were not accredited. Nonetheless, this rule prohibited general solicitation in private securities offerings regardless of the type of investor. Sponsors therefore could not advertise their deals publicly through newspaper ads, television or radio commercials, public seminars, or unrestricted Web sites. Sponsors generally put numbers on each private placement offering and kept detailed records of each individual who received a copy of this material.

Based on the JOBS Act and the new rule 506C sponsors can still raise unlimited amounts of money from accredited investors and can now use broad based advertising like their Web sites to generate interest. However, under rule 506C of the JOBS Act, the sponsors now have more responsibility in ensuring that their investors meet the accredited investor criteria. Under the old rules, all that was required of the sponsor was that their investors check a box stating that they are accredited. Under the new rules, the crowdfunding Web sites are required to obtain additional proof of eligibility.

Title III

Title III of the JOBS Act focuses on the rules allowing non-accredited individuals to invest in crowd-funded offerings. The SEC is currently finalizing these rules and seeking comments from the public. For crowdfunding Web sites part of the motivation for including non-accredited investors is to broaden their investor base. Many of these Web sites also assert that people should be able to invest in properties in their local communities. Crowdfunding makes it possible for investors to put as little as \$100 into a private equity investment. Before the JOBS Act and the ability to solicit investments through the Internet, it would have been cost prohibitive to allow such small investments.

Crowdfunding Web sites like Fundrise and Groundfloor are not waiting for the SEC rulemaking to accommodate non-accredited, local investors. Both make some of their investments available to non-accredited investors by raising capital through Regulation A or through intrastate crowdfunding laws. A number of states have enacted statutes favorable to crowdfunding and a number of additional states are seriously considering passing similar measures.

Conclusion

It will be interesting to see how crowdfunding evolves over the next few years. While there are advantages to investing in real estate with people you know, the Bernie Madoff scandal is the latest examples of how “face to face” relationships do not necessarily protect investors. Apparently, Bernie Madoff did not even know how to use the Internet. In contrast, most of the leading crowdfunding Web sites have hired people with considerable real estate experience to screen investments and sponsors. It may, in fact, be more difficult for con men to commit fraud through the leading web sites with the transparency and written documentation that is required. Furthermore, the combination of crowdfunding and social media may drive poor performing sponsors out of the market relatively quickly.

On the other hand, inexperienced investors may not fully understand the risks. Naïve investors are easily lead to believe that because a building is tangible their downside is protected. The reality is that many of the real estate investments we reviewed were opportunistic with high leverage and/ or significant leasing challenges. Investors could easily lose their whole investment. Many of the investments that we looked at projected very high internal rates of return. In today’s real estate environment it may be possible to achieve these returns, but only with high risk investments.

Bill Poorvu, emeritus professor at Harvard Business School, points out a subtle but important tension between quality control and earning fees from transactions. Since these Web sites earn fees based on the volume of transactions there will be pressure, as there was in underwriting commercial mortgage backed securities, to allow the standards to

slip. In a similar vein, he noted that “in the early stages the seven groups mentioned in this article, seem to be fairly responsible. But if this approach gets more traction it may attract less reputable players.” Professor Poorvu also guessed that crowdfunding “will work better with existing properties than development deals.” The amount of equity in development deals “is often hard to pin down.”

It is interesting to note, where crowdfunding has taken hold. As one might expect, in the United States, many early adopters are located in Silicon Valley. But interestingly, the largest crowdfunding investment, as described earlier, was made in Bogota, Colombia.²⁰ For countries like Colombia where the capital markets are less developed and where there are fewer options for investors who want to put money into commercial real estate, crowdfunding may gain traction quickly. Similarly, for international investors, crowdfunding may be an attractive way to invest in U.S. real estate.

For those who are optimistic, the Lending Club provides an interesting analogy. Lending Club started in 2007 and does peer to peer lending, enabling investors to make unsecured personal loans to prescreened borrowers. In the first year, the Web site made \$4.8 million in loans. In the first three months of 2014 it raised and made \$781 million in loans and topped \$4 billion in loans since inception.²¹

Arthur Segel, the Poorvu family professor of management practice at Harvard Business School, recently ran a program for 180 seasoned real estate professionals. After doing a session about crowdfunding for real estate he asked the audience if they thought it would work. “Everyone under 40 thought it would work,” according to Segel, “and every-

one over 40 believed it would not work.” Time will tell.

NOTES:

¹http://www.oxforddictionaries.com/us/definition/american_english/crowdfunding.

²<http://www.forbes.com/sites/ryanaldbeck/2013/06/23/crowdfunding-trends-which-crowdfundin-g-sites-will-survive/>.

³Slide show by Jonathan Axelrad, Partner, Goodwin Procter: <http://www.goodwinprocter.com/~media/691FFF61D0A549E9AC55242CB6CCFCE6.pdf>.

⁴<http://astudentoftherealestategame.com/my-updated-thoughts-on-crowdfunding-for-real-estate-and-a-n-interview-with-realtyshares/#more-8452>.

⁵Realty Mogul survey of private real estate syndications: <https://www.realtymogul.com/sites/default/files/A%20Look%20at%20Current%20Market%20Rates%20and%20Trends%20for%20Real%20Estate%20Syndications.pdf>.

⁶Realty Mogul survey of private real estate syndications: <https://www.realtymogul.com/sites/default/files/A%20Look%20at%20Current%20Market%20Rates%20and%20Trends%20for%20Real%20Estate%20Syndications.pdf>.

⁷Realty Mogul survey of private real estate syndications: <https://www.realtymogul.com/sites/default/files/A%20Look%20at%20Current%20Market%20Rates%20and%20Trends%20for%20Real%20Estate%20Syndications.pdf>.

⁸Barguess, Scott and Vladimir Ivanov, Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012.

⁹According to Investopedia, “Accredited Investor is a term used by the Securities and Exchange Commission (SEC) under Regulation D to refer to investors who are financially sophisticated and have a reduced need for the protection provided by certain government filings. Accredited investors include individuals, banks,

insurance companies, employee benefit plans, and trusts. In order for an individual to qualify as an accredited investor, he or she must accomplish at least one of the following:

1) earn an individual income of more than \$200,000 per year, or a joint income of \$300,000, in each of the last two years and expect to reasonably maintain the same level of income.

2) have a net worth exceeding \$1 million, either individually or jointly with his or her spouse.

3) be a general partner, executive officer, director or a related combination thereof for the issuer of a security being offered. An employee benefit plan or a trust can be qualified as accredited investors if its total assets are in excess of \$5 million.

¹⁰https://s3.amazonaws.com/fundrise-content/website-documents/fundrise_marketing_onepager_interactive.pdf.

¹¹Using Regulation A offerings.

¹²The majority of this amount was raised for projects outside of the United States.

¹³<https://www.realtymogul.com/statistics>.

¹⁴<https://www.realtymogul.com/statistics>.

¹⁵<https://www.realtymogul.com/help>.

¹⁶<https://www.realtymogul.com/help>.

¹⁷<http://www.rew-online.com/2014/01/07/ifunding-to-build-250-million-condo-tower-on-fulton-street/>.

¹⁸<https://www.realtymogul.com/investment-opportunity/16570>.

¹⁹See *supra* for accredited investor criteria.

²⁰Max Raskin, “Crowdfunding for Real Estate: Buy a Slide of a Skyscraper,” Bloomberg Businessweek, January 24, 2013.

²¹Lending Club Web site: <https://www.lendingclub.com/>.