

Chapter 31

Real Estate Crowdfunding: 2015 and Beyond

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ABSTRACT

Like a juggernaut, “crowdfunding” has hit the media, the financial markets and the common narrative by storm. Incipient in many ways, the intermediation of financing transactions online has become a billion-dollar industry. As technology has advanced, even recreated, industries, there seems none more primed than “finance”, an inherently information business. By creating improved efficiency, both art and science of finance are enriched. A 21st century vestige of the 1980’s syndication business, real estate seems to be enjoying the fruits of the crowd, with \$1 billion of property financings conducted online in 2014, with an expected \$2.5 billion this year. For sponsors and investors, there appears legitimacy to the online approach, underscored by the level of venture capital now finding home in this burgeoning sector. Yet, like its progenitor, might real estate crowdfinance find legislative, regulatory, and practical headwinds, stunting its progress? Still early, with business models, scalability and sustainability still suspect, the current momentum seems promising.

WELCOME THE CROWD

While coined as a term only a few years ago, “crowdfunding” certainly has taken the markets by storm. Now in its pubescent period, the investment and financing methodology of aggregating small amounts of capital through online interactive platforms now accounts for billions of dollars (or Euros or Yen) in capital formation and a breadth of new investment opportunities for global participants. Gaining visibility in non-securities based fundraising, *ala* perquisite platforms such as Kickstarter and IndieGoGo, the power of technology to efficiently expose private investment offerings is creating a changed landscape for existing (and largely analog) financiers and intermediaries. This is particularly the case within the real estate realm. 2014 was a breakout year for real estate crowdfunding, with over \$1 billion being infused into property-related investments through a hundred or so platforms, with an expected 250%

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growth this current year (2015) (Massolution, 2015). Whether the growth of real estate crowdfunding is a function of discerning and executing a new and improved way of intermediating capital providers with capital users, or rather taking advantage of an opportune moment as swelling regulatory and legislative oversight hampers the commercial banking mother lode, it does appear that the market, as of now, shall be characterized by exceptional progress. But we do remain judicious in our view of the quality and expanse of such advancement, and core to this view, is the sustainability of the underlying crowdfunding business model, particularly for real estate.

IF THERE'S A HISTORY, THERE'S NO MYSTERY

As I commented in the 2015 Massolution Real Estate Crowdfunding Industry Report, what we are witnessing is largely a 21st century manifestation of the real estate syndication model heavily utilized during the 1980s, at least for commercial real estate endeavors. Working either as a principal or as an intermediary, groups would raise funds from “syndicates” of accredited investors through the private placement of limited partnership offerings, with proceeds being used to acquire, rehabilitate, construct, or reposition commercial or multi-family real property. In the effort to aggregate such funds, the “syndicator” or say, sponsor, would prepare a placement memorandum, sometimes consisting of hundreds of pages, which it would provide individual investors generally by snail mail, and then “dial for dollars”. Participant investment sizes were set at a level to induce broad participation, but not so low to the extent of creating a “herding cats” phenomenon. The verbal exchange between fundraising sponsor and prospective investors tended to be laborious, as many of the questions or comments were redundant from investor to investor, regardless the size of a particular investment commitment, whether \$25,000 or \$250,000. Telling the same story time and again, was a characteristic of the syndication process. And then there was the monitoring of who received a book, what the nature of the conversation was and finally allocating time to complete the one-on-one sales process. Post fundraise, the communication between sponsor and investors was equally arduous, layering more paper, snail mail, and repetitive repartee.

Enter crowdfunding, or more explicitly, the analog nature of fundraising communication between sponsor and investors going digital. Rather than authoring a paperback tome, crowdfunding platforms expose dozens if not thousands of investors simultaneously to an investment proposition through engaging and informative websites, with customer relationship management (CRM) systems to support both outreach and ongoing investor management. Simply, this has become the process of telling the story singularly to a plurality, underscoring the efficiency of digital communications. Consider the cost and time savings of creating a single digital copy and allowing through invited online access compared to the mailing out 500 individual books, and then following up on each. And yes, pursuant to securities regulations, each of the old style books were to be manually numbered and controlled. Further imagine if such “book” required an amendment or introducing an update in the project. The efforts and costs to distribute what needed to be shared for informed investment decision making drastically have been reduced. This has wide ranging implications: in reducing the cost of intermediation, smaller transactions might be economically “syndicated”, as one can only assess so much in intermediation fees so as not to severely impact investable funds, nor gouge the economics in the end for the investor.

Another aspect of online syndication is that a broader audience can be reached. There has been nomenclature applied here, such as the “democratization” of investing, which respectfully has a semblance of truth. Reducing the cost of intermediation, and specifically on a per investor basis, smaller minimum

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