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Move Over, Widgets

Real Estate Investments Come Of Age In Crowdfunding

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Ask anyone who follows innovation in cities like Boston, New York and San Francisco what topics are hot and it's likely most of them will say "crowdfunding." By now, sites like Kickstarter and IndieGoGo have launched many new products and ventures, and created dozens of loyal followers, often individual consumers who opt in early in exchange for loyalty perks instead of a stake in the business. Crowdfunding sites like these, known as "rewards" and "contribution" sites, were quickly followed by angel and venture capital investing sites. Now there's a new player on the crowdfunding scene: real estate.


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In real estate crowdfunding, providers and consumers of equity or debt capital can join to finance specific investments or investment entities. It has potential to redefine the way sponsors and investors access real estate capital markets.

It's still an emerging model, but, owing to its viability and growing popularity, it was a lively topic for a room of 150 real estate professionals attending last month's Real Disruption event hosted by ULI Boston and the MIT Alumni Association for the Center for Real Estate.

What Is Crowdfunding?

Crowdfunding involves the use of the Internet and social media to raise equity or debt capital, typically from a large number of investors, each of whom chooses to invest a relatively small amount. In the real estate world, crowdfunding can take two forms: private crowdfunding, through which private entities or sponsors seek to raise capital from high net worth individuals who qualify as "accredited investors," under regulations of the Securities and Exchange Commission (SEC); or public crowdfunding, through which public offerings registered with the SEC are marketed primarily to retail investors.

Private crowdfunding enables sponsors of "sub-institutional" property investments or small real estate investment pools to seek equity or debt capital while bypassing traditional intermediaries such as equity funds, investment banks or commercial lenders. There is potential for sponsors to access investment capital more cheaply and from a broader selection of investments. Public crowdfunding could enhance the capital-raising capabilities of companies that rely on retail capital, such as public non-traded REITs.

How Crowdfunding Has Changed The Landscape

Until recently, private equity capital could not be raised through the use of public advertising or solicitation. Real estate sponsors seeking to raise capital were limited to small "friends and family" offerings or forced to make use of licensed broker-dealer placement agents. Prospective investors did not have ready access to deal flow and were therefore effectively excluded from this segment of the capital markets.

This is all changing because of the federal Jumpstart Our Business Startups (JOBS) Act of 2012, which directed the SEC to remove the existing prohibition on general solicitatiaon and advertising in private placements as long as all purchasers qualify as "accredited investors." The SEC responded by adopting new Rule 506(c) of Regulation D under the Securities Act of 1933.

These changes, coupled with the growth of social media and the SEC's no-action position with respect to certain aspects of federal broker-dealer regulation, have given rise to a growing number of online crowdfunding platforms. Typically, these platforms manage the whole process – from posting and publicizing their investment offerings, to recruiting prospective investors, making documentation and due diligence materials available, providing a mechanism for investors to subscribe, and providing hosted sponsors with appropriate back-office support.

These private crowdfunding platforms, such as Real Crowd, potentially enable a much larger universe of sponsors and investments to access the private capital markets than before.

Another interesting development has been the rapid rise of peer-to-peer lending sites like LendingClub and Prosper. These sites, which began as platforms to raise capital from small investors to provide commercial loans to small businesses and startups, have been swamped by institutional capital. They are already a multi-billion dollar industry.

Where Are We Headed?

While gaining in popularity, there's more validation to be done. These platforms have not yet proven themselves capable of raising truly large amounts of capital. There are also concerns over the inability to police the quality of offerings. However, private investment offerings are likely to increase in size as specific platforms become better-known, proper quality controls are implemented and high net-worth individuals become more comfortable with the notion of investing online. The JOBS Act also provides for other crowdfunding mechanisms, for which regulations have not yet been finalized.

In addition to the public peer-to-peer lending sites, public crowdfunding platforms that provide access to equity capital are also beginning to appear. These platforms could, for example, enable public non-traded REIT "wholesalers" to bypass their traditional private broker-dealer sales forces to access retail investors directly. It remains to be seen whether traditional brokerage firms will also establish crowdfunding platforms to allow for their customers to invest online.

The bottom line: crowdfunding is here to stay. Whether you're an investor looking for a place to put capital or a developer seeking a boost to your proposed project, funds could be as close as a click of the mouse or a swipe of the tablet.

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