Real Estate Crowdfunding
What's the Buzz?

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Ready for the next big thing on the internet? Maybe it is real estate "crowdfunding." In the past, investors interested in real estate faced a daunting mission as they embarked on the quest to place their funds. Direct investment in a project involved establishing special connections with developers or financial intermediaries and large sums. Small investors could not muster the funds nor identify projects to participate in lending to specific real estate projects.

Real estate investment trusts did allow small investors to access real estate but only indirectly through portfolios of properties. Crowdfunding aims to change that model to accommodate small investments by a broad array of individuals in either real estate lending or equity ownership for specific properties.

Title III of the JOBS Act became law in April 2012. Although the title sounds like a stimulus measure designed to create new jobs, the Jumpstart Our Business Startups (JOBS) Act actually sought to encourage funding for small businesses. Title III of the act addressed so-called crowdfunding and new Security and Exchange Commission (SEC) rules unleashed internet-based crowdfunding sites for business on May 16, 2016.

The Takeaway

Touted as an innovation in efficiency in real estate finance, crowdfunding may become a big success. On the other hand, it may be an inglorious disaster. Only time will tell.

These provisions promise to provide ventures access to funding from large numbers of ordinary investors. The idea is to allow a crowd of small investors access to transactions previously reserved to accredited investors (those with incomes exceeding $200,000 for several years or more than $1 million in net worth excluding equity in a home). Where traditional real estate investments normally require large amounts from each party to the deal, crowdfunding allows a large number of investors to fund a small part of the deal. Some platforms accept investments as small as $1,000.

Bringing Creativity to Life

Crowdfunding traces its origins to Ireland where Jonathan Swift, the author of "A Modest Proposal," founded a fund in the early 1700s to provide loans to low-income families. Through the years, the approach has encompassed mass donations to various causes as well as loans and funding for public projects, even supporting a tour by the British rock group Marillion in 1997.

Perhaps inspired by that success, ArtistShare (https://www.artistshare.com/v4/) launched a platform to allow the public to fund projects for musicians in return for specified rewards. That success in turn inspired a number of other sites, including Kickstarter (https://www.kickstarter.com/), which focuses on "bringing creative projects to life," everything from movies to technology and food. The JOBS Act sought to open these creative internet forces to business expansion.

LendingClub, a crowdfunding site that links borrowers with investors, began in 2007. Instead of real estate, LendingClub focuses on consumer loans to individuals. The platform proved so successful that it launched an initial public offering in 2015 with a $15 share price. Shares immediately escalated, but then a shakeup resulted in the CEO's resignation, sparking SEC and Justice Department investigations. Threatened lawsuits initiated a roller-coaster ride to the current share prices in the $5 to $6 range, highlighting the risky nature of this business.

Undeterred by the LendingClub problems, Goldman Sachs launched an online direct lending site named "Marcus by Goldman Sachs" as an online platform offering unsecured personal loans in October 2016. This foray into internet lending, while not funded by the crowd, signals confidence in the approach to making online personal loans available on a broad basis.

Crowdfunding came to real estate following the financial meltdown in 2008 when some sites began to provide capital to borrowers locked out of traditional lending sources. However, since the SEC rule change enacted in 2016, real estate crowdfunding is blossoming into a bewildering array of platforms, each focused on bringing prospective real estate project principals together with borrowers across the nation in an industry historically known for its local focus.

Sharing the Wealth

Time-honored paths to real estate investing led through country clubs, alumni associations, and other social entities where deals happened. These projects normally

Tier 1: Best of the Best

These sites have it all: High transparency, co-investment, pre-funding, high-volume, average to low fees, excellent bankruptcy protection and strong venture capital backing.

None	No site has all these features yet, but we hope that will change by the time of our next review.

Tier 2: All-Stars

These sites are all extremely strong in the majority of the fundamentals that are most important to investors.

1	Peer Street
*2	Real Crowd
*2	Realty Mogul
*2	Realty Shares
5	Acquire Real Estate
*6	LendingHome
*6	Roofstock
8	Patch of Land

These sites are tied, and tied sites are shown in alphabetical order.

Tier 3: Contenders

These sites are a step below the previous tier, but still have one or more key/strong features that makes them worthy of consideration.

9	FundThatFlip
10	1031 Crowdfunding
11	Crowd Street
12	City Funders
13	Early Shares

Tier 4: Up-And-Coming

These sites may be missing certain features and/or are not quite as polished as competitors. However, each one has some sort of promise or potential for the future. We look forward to watching how these sites evolve in this very young and exciting industry.

14	Equity Multiple
15	Peer Realty
16	DiversyFund
17	Crowd Flipr
18	Groundbreaker
19	Prodigy Network
20	Full Capital Stack
21	Carlton Crowdfund
22	ShareStates
23	TripleNetZeroDebt
24	Money 360

Tier 5: The Challenged

These sites have or have had a legal or financial challenge to deal with.

*25	Fundrise
*25	iFunding

All Challenged are ranked equally

required piles of cash to finance. Borrowers faced limited possibilities when seeking funds. Crowdfunding strives to make access to funds and lucrative investments more accessible at lower cost.

Various online portals focus on financing, including debt and/or equity investments for specific properties in scattered locations. Currently, the crowdfunding industry is in its infancy with limited historical records. Nevertheless, crowdfunding for real estate has sparked interest among tech-savvy would-be investors who can choose from a dizzying number of sites offering opportunities. This explosion of initiatives may signal the beginning of a revolution in how real estate deals happen or they may foreshadow an implosion. Those possibilities suggest that uncertainty abounds.

One site that has attempted to impose some order on the abundance of platforms is The Real-Estate Crowdfunding Review (http://www.therealestatecrowdfundingreview.com/), which provides a free ranking of the top 100 sites. It was founded by Ian Ippolito, a self-described "serial tech entrepreneur." Tech-oriented and skeptical of traditional investment wisdom, he narrowly escaped disaster when advised to invest in stocks in 2008, just before the crash. More cautious after that experience, he looked for alternative investment opportunities.

Playing by SEC Rules

The review is the result of his experience when the quest led him to crowdfunding. It offers his take on industry players.

It has information on each of the more than 100 listed platforms for the top 25 ranked firms with links to the websites. The review provides the most complete analysis of sites currently online. However, as Ippolito insists, ". . . I'm just an investor and not a financial, tax, or legal advisor. Everything I post on the site is purely my own opinion."

Crowdfunding for real estate comes under the purview of the SEC. To protect individual investors from unacceptable levels of risk, SEC rules define the nature of this funding mechanism. Specifically, an investor must use an intermediary to access this market. That intermediary must be a broker-dealer or funding portal that has registered with the SEC and is a member of the Financial Industry Regulatory Authority.

Risky Business Investing

An investor must open an account with the intermediary to invest. Peer Street platform (https://www.peerstreet.com/) touts returns ranging from 6 to 12 percent for investments ranging from six to 24 months at loan-to-value ratios of 75 percent or less. Those generous returns in the recent economic environment with rock bottom interest rates suggest that although they are potentially lucrative, the loans are risky. In fact, the SEC notes that these are "early-stage ventures" that are speculative in nature and further warns ". . . there is no guarantee that crowdfunding investments will be immune from fraud."

In *Investor Bulletin: Crowdfunding for Investors,* the SEC insists that, "You should be able to afford and be prepared to lose your entire investment (https://www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding-.html). In fact, the bulletin specifies limits to the amount an investor can invest depending on annual income and net worth levels.

A potential investor should be prepared to spend time investigating real estate crowdfunding in general, the particular portal chosen, and the properties offered before committing to any investment.

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