Real Estate Crowdfunding: A Look Back, A Look Ahead

February 4, 2016 | By Rick Pollack, Vice President, and Eric Willett, Associate

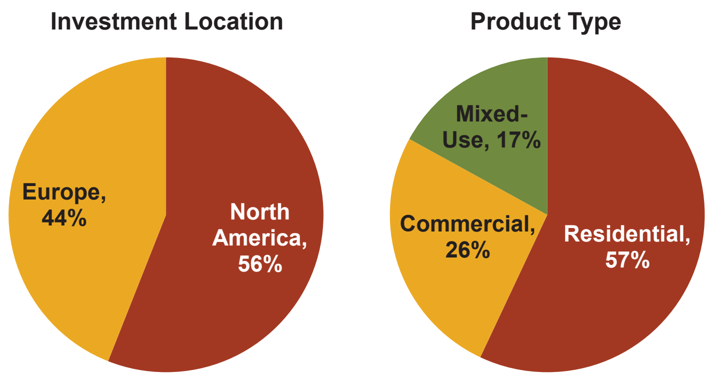
Crowdfunding as a source of capital for real estate investments is now entering its fourth year of existence within the United States. During that period, a host of companies have entered the market, capitalizing on evolving regulations that allow platforms to increasingly solicit the general public for investment. The industry's performance in 2015 and its increasing mainstream acceptance point to sustained future growth as it continues to mature.

Crowdfunded investment first emerged with the passage of the Jumpstart Our Business Startups ("JOBS") Act in 2012. Prior to the law's passage, sponsors were not allowed to solicit investment widely; general promotion of investments through various media, including the Internet, were prohibited. The law removed this restriction, allowing sponsors to use "broad based advertising" to attract accredited investors.[1]

In the ensuing years, real estate crowdfunding platforms have proliferated in the United States. Industry observers track upwards of 50 firms of varying stature and size that offer real estate crowdfunding services.[2] These platforms facilitate investment across all product types and geographies.

In 2014, industry researcher Massolution tracked $570 million in crowdfunded investments in North America. While crowdfunding platforms have gained popularity internationally, North America remains the principal source of real estate crowdfunding, capturing 56% of investment in 2014 and an estimated 54% in 2015. Funds raised through crowdfunding platforms have primarily financed residential developments (57% of total investments), but investments have also targeted commercial (26%) and mixed-use (17%) developments.[3] These crowdfunded investments in real estate are roughly evenly split between debt and equity.[4] While final data is not yet available, Massolution estimates that real estate crowdfunding grew to $1.4 billion in North America in 2015, and surpassed $2.5 billion globally.

Distribution of Crowdfunded Real Estate Capital, 2014



Source: Massolution

Among the most prominent projects of 2015 that was partially financed by crowdfunding is 3 World Trade Center. The construction of 3 WTC, at a total cost of $2.49 billion, was financed by $1.6 billion in tax-exempt bonds issued by the New York Liberty Development Corp.[5] The bond offering was restricted to qualified institutional buyers at a minimum denomination of $100,000. However, in February 2015, $2 million of the $1.6 billion in bonds was offered to accredited

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[1] John H. Vogel, Jr. and Benjamin S. Moll, "Crowdfunding for Real Estate," *The Real Estate Finance Journal* (Fall 2014): 5.
[2] "Top 100+ Real Estate Crowdfunding Sites," last modified 2015, http://www.therealestatecrowdfundingreview.com/#!top-100-sites-ranked-and-reviewed/c1lhw.
[3] Duncan MacDonald-Korth, Neha Manaktala, and Sebastian Artlieb, "Democratising Finance: Digital Real Estate Investment Demystified 2015," *DealIndex*, https://dealindex.co/research.html.
[4] Samantha Goins, "Real Estate Crowdfunding: Alternative Finance Sector Report," *intelligent partnership*, October 2014, http://www.altfi.com/downloads/real-estate-crowdfunding-report.pdf.
[5] David M. Levitt, "Crowdfunding Comes to Manhattan's World Trade Center," *BloombergBusiness*, January 27, 2015, http://www.bloomberg.com/news/articles/2015-01-27/crowdfunding-comes-to-manhattan-s-world-trade-center.

investors through the Fundrise platform. Minimum denominations were lowered to $5,000. The Fundrise offering sold out and was one of several crowdfunding transactions that garnered significant media attention, increasing interest from the broader investor universe.

Looking ahead to 2016, it is likely that crowdfunding as a source of capital for real estate investments will continue its dramatic growth and make greater inroads into the financing of selected core assets. Indeed, natural growth is likely to be magnified by the impacts of major regulatory changes.

Crowdfunding investments have historically only been available to accredited investors, defined as individuals with net worth greater than $1 million, annual individual income greater than $200,000 per year, or household income greater than $300,000 per year. However, in October 2015, the Securities and Exchange Commission finalized additional regulations for crowdfunded investments. The regulations, pursuant to the JOBS Act, permit crowdfunding platforms to solicit up to $1 million per project from unaccredited investors. Unaccredited investors will be restricted in the magnitude of their investment: households with income under $100,000 will be able to invest the greater of $2,000 or 5% of their net worth or annual income; households with income greater than $100,000 will be able to invest the lesser of $100,000 or 10% of their net worth or annual income. These regulatory changes will dramatically increase the population that is easily able to invest in crowdfunded real estate projects, as only 3% of the U.S. population, or fewer than 10 million persons, qualify as accredited investors.[6] The regulations, which take effect this month, could propel real estate crowdfunding volumes to new highs.

Despite the increasing media attention and the regulatory expansion, even the most optimistic calculations of crowdfunding volume in 2015 place it at less than one-quarter of one percent of total real estate investment. In high-profile projects, the role of crowdfunding is largely token, with the developments almost wholly funded through traditional financing sources. A notable exception is the work of Prodigy Network, which has financed several large properties in New York City with approximately $40 million in crowdfunded equity. The regulatory changes taking effect in February are unlikely to substantially alter this dynamic, particularly given the $1 million per project cap on contributions from unaccredited investors.

The high level of interest in crowdfunded products suggests that there is substantial demand for alternative investments in real estate. To date, the larger platforms have consistently sold out most offerings quickly. The crowdfunding sector's consistent growth over the past few years suggests that the platforms have staying power. Moreover, the uptick in volatility in the equity markets, the continued low returns on fixed income investments, and the expansion of the investor pool are likely to increase the demand for crowdfunded real estate in 2016.

Article and research prepared by Rick Pollack, Vice President, and Eric Willett, Associate.

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[6] Elizabeth Scharpf, "Only 3% of Americans are legally allowed to invest in start-ups," *Quartz*, June 22, 2015, http://qz.com/431198/this-is-not-a-typo-only-3-of-americans-are-legally-allowed-to-invest-in-start-ups/.