# Crowdfunding Commercial Real Estate: Panacea or Path to Disaster?

## Description

As seen in the March 14, 2016 edition of the *Providence Business News.*

Much has been written about crowdfunding commercial real estate since the passage of the Jumpstart Our Business Start-ups Act of 2012 ("JOBS Act"). Websites such as Selequity, Fundrise, and Realty

Mogul have sprung up to provide what Selequity calls "the leading edge CRE investment platform." However, has crowdfunding been the panacea for developers and owners it was touted as being – and how have investors fared?Crowdfunding is seen as providing greater flexibility to CRE owners. Online investing websites claim that they benefit owners seeking access to capital, liquidity for sale adverse owners, and maintenance of control over a highly valued asset. Such sites also claim that they benefit new investors seeking to include CRE ownership in their asset mix without the need for specialized industry knowledge.

The founder and CEO of crowdfunding portal RealtyShares, Nav Athwal, wrote in the December 2, 2015, issue of Forbes that "real estate crowdfunding is rapidly reshaping the way individuals find and invest in properties… [and] has brought benefits not only for investors but also for real estate companies." There is some proof in the market place that crowdfunding a CRE project can work for real estate developers and owners. For example, the developers of a new extended stay project in New York City, the AKA United Nations, successfully used crowdfunding to fill gaps in financing the project's costs. However, is there any evidence to date that crowdfunding brings benefits to individual investors?

The very short history of crowdfunding and the web portals that promote it indicates that investors should only proceed with a firm grasp of the potential high risks. The United States Securities and Exchange Commission ("SEC") has yet to issue any regulations governing crowdfunding and the portals that raise equity from investors. However, there are already calls from consumer advocates calling for the SEC to investigate the portals, claiming that some are charging excessively high fees or are otherwise taking advantage of investors. It is certain that at some point the SEC will investigate crowdfunding and the portals that promote it. The results of any SEC investigation may include additional rules and regulations that could significantly alter the crowdfunding landscape. And, don't forget that additional rules and regulations will only be necessary if the SEC deems the current environment unfair to investors, which is not the ideal environment in which to invest!

Individual investor liquidity is also an evolving issue. Portals usually carry warnings that investments made through crowdfunding are made in private entities, and once made, the investor is a minority owner with no control over how his money is used. As a result, it is incumbent upon each investor to carefully consider the project's time frame as stated in the developer's business plan. Each investor must further consider her needs for the invested amount that she may have during that time frame as there will be no way to recover the invested money until the occurrence of one of the liquidity events set forth in the business plan. Although the JOBS Act requires that investors be accredited, the standards are based on net worth outside the value of a primary residence or a minimum annual income – neither of which guaranties any degree of sophistication in reading and understanding a business plan designed to entice people to part with their money. Until a secondary market develops CRE crowdfunding investors will be stuck with an illiquid share in a project that may or may not succeed.

One final risk that has not yet been fleshed out in the marketplace: what happens to an investor who places money for a project with a portal that fails? A corollary to that is what happens to the CRE developer or owner who has raised money through a portal that fails before releasing the money? The law is evolving very slowly with respect to CRE crowdfunding and is still largely undeveloped; one sure bet is that these scenarios will benefit only the law firms handling the resultant litigation.

Crowdfunding for commercial real estate projects thus may be both a panacea and a path to disaster, depending entirely on the project and the portal through which one invests. It is likely that as the market evolves, the SEC sets some rules, and the crowdfunding process matures, it will become a more common means of raising capital. However, until that time one can only urge the investor to pay heed to the Latin warning: caveat emptor.

**Date Created**
March 22, 2016