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Question of the Month: Crowdfunding - Catalyst for bringing real estate investing to the masses?

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Kickstarter, the crowdfunding investment portal, saw investors pledge over $1 billion in equity capital to more than 140,000 different fundraisers by the end of 2013. The success of Kickstarter and other crowdfunding portals may lead to significant changes in the way real estate development firms and real estate fund sponsors raise funds for the equity tranche of a project's capital stack - imagine, for example, having the ability to "test the waters" for projects with quick, online capital fundraising efforts before signing on the dotted line for a project's debt component. The crowdfunding model may also provide investors with unprecedented access to a diverse universe of real estate investments, with only a fraction of the capital commitment needed to participate. Investors and sponsors alike may also be empowered to use crowdfunding to participate in "passion projects" such as historic preservation, open space conservation, and neighborhood-improvement campaigns.

Section 302(c) of the Jumpstart Our Business Startups Act (JOBS Act) required that the Securities and Exchange Commission (SEC) issue final rules governing Crowdfunding activities no later than 270 days after the date of the JOBS Act's enactment, or by December 31, 2012. The SEC failed to meet the deadline imposed by Section 302(c), and the date the SEC is expected to issue its final rules governing crowdfunding is still four to seven months away. While the SEC has received substantial input during the ongoing public comment period of its Section 302(c) rulemaking, the SEC's final rules are still expected to include the general crowdfunding guidelines set forth in Section 302 of the JOBS Act itself. These general guidelines include the following:

Privately-held companies are allowed to use government-registered Internet "funding portals" to raise capital from investors, including unaccredited investors.

There is a yearly aggregate limit on the amount an investor may invest in crowdfunding offerings, which is tied to the investor's net worth or annual income (e.g., (i) $2,000 or 5% (whichever is greater) for an investor earning (or worth) up to $100,000; and (ii) $100,000 or 10% (whichever is less) for an investor earning (or worth) $100,000 or more).

The amount of capital a company can raise annually under the Crowdfunding exemption is limited to $1 million; also, a company looking to raise between $100,000 and $500,000 must provide reviewed financials (and audited financials for capital raises in excess of $500,000).

The crowdfunding model has already been replicated in real estate, with sites like realtyshares.com, fundrise.com, realtymogul.com, ifunding.com and prodigynetworks.com which have seen an increase in traffic as investors once again turn their eyes toward real estate. These portals have been growing notwithstanding the lack of final rules issued by the SEC. Supporters of its role in real estate investments argue that Crowdfunding will revolutionize the way commercial real estate projects attract equity to their capital while altering the demographics of their target investors by removing many of the traditional barriers to entry. Due to concerns about the myriad "unknowns" that have persisted with respect to the timing, reach and ultimate enforcement of the SEC's final rules, many of these pioneering crowdfunding portals have limited access to the real estate investment opportunities featured on their sites solely to accredited investors. To qualify as an accredited investor you generally need to have income of over $200,000 ($300,000 for joint filers) for the two previous years, plus a reasonable expectation of the same in the current year, or a net worth of $1, million (excluding your primary residence). But with the SEC poised to issue its final rules in a matter of months, we may be seeing an opening of the floodgates on real estate investments by unaccredited investors.

Daniel Meyer, Esq. is a member of Partridge Snow & Hahn, LLP's real estate and corporate groups, Providence, R.I.