

## AIRE Lunch, Learn & Lead: Crowdfunding in Commercial Real Estate

February 10<sup>th</sup>, 2014

On Tuesday, February 10<sup>th</sup>, John Picchiotti, COO – Brokerage with NAI Hiffman, moderated AIRE's latest panel discussion on crowdfunding in commercial real estate. A summary of the panel is below.

### Speakers:

**Anthony Zeoli** – Attorney, Ginsberg Jacobs LLC

**Kevin Brennan** – Vice President of Acquisitions, Brennan Investment Group

**David Brown** – Partner, Nixon Peabody, LLP

**Scott McKibben** – Managing Principal, Brennan Investment Group

**Picchiotti** – About a year ago I noticed the issue of crowdfunding while reading a NAIOP magazine but I didn't know anything about it so I did a little research. I brought it up to our brokers at NAI Hiffman, letting them know it should probably be something you put on your radar.

We are now seeing credible sources of capital using crowdfunding to fund their projects. This is where we see technology and real estate intersecting yet again.

**Zeoli** – Crowdfunding basically is a way to get smaller pieces of financing from a larger multitude of people. Normally, clients see large amounts of money from a small amount of people.

Kickstarter is a completely different than what we are talking about today. Think of Kickstarter as pre-selling products. In return, you get either a product or some sort of recognition or discount, and that is an entirely different form of crowdfunding. What we are talking about today is debt and equity, investment, crowdfunding.

Crowdfunding is not a new thing; it's actually one of the oldest forms of financing. The Statue of Liberty was one of the first crowdfunded projects. They were about \$300,000 short of it not coming to America until a group of high-net-worth individuals in New York got together to contribute the necessary funds needed.

Generally, crowdfunding will not have a controlling interest, or voting rights, so as an owner you won't have to deal with each individual constantly calling you for an update on their investment.

**Picchiotti** – Dave, could you briefly give us a couple of the terms and concepts of crowdfunding?

**Brown** – Why are we even talking about crowdfunding? Well because traditionally it's been difficult, time consuming, and expensive to raise money from private investors. Traditionally you are going to go to a credited investor, but what we are trying to do here with crowdfunding is say "is there a way to broaden the base?"

We aren't yet at the point where we would see a company looking for funding go out to anybody, any adult that wanted to put in some money, and ask if they would like to invest. On a national basis, the government is about 2-3 years behind and working on the rules and regulations. I wouldn't hold your breath on this.

Also, I don't know if you want to have a bunch of people putting in \$1,000 each because I guarantee you'll be having the person who invested \$1,000 calling you up just as much as the guy who put in \$100,000.

**Picchiotti** – Scott and Kevin, could you tell us why you've chose to go with a crowdfunding vehicle to raise funds as opposed to traditional equity raises, and how you've gone about that process?

**McKibben** – We've done a lot of different deals with a variety of equity sources, but we were starting to get to the point where we felt like we were spread thin. We have a person at Brennan that directs our investment strategy and he reached out to some groups like Realty Mogul and Fundrise. We ultimately chose Realty Mogul since they seemed like one of the leaders in this industry.

It was a little bit of a slow learning process at first, but we found a deal in Indianapolis for a multi-tenant flex building. When First Industrial found out that we were doing crowdfunding, they initially got a little freaked out that we didn't have the money. We assured them that we had fully raised the money, relieving any questions.

The beauty of working with Realty Mogul was that we only work with credited investors, and they may have 50 investors, but we are only dealing with and receiving calls from one person at Realty Mogul. They deal with all the administrative stuff. We've found working with them to be beneficial, and it really seems like this an avenue that is holding up quite a bit.

**Brennan** – One thing I wanted to point out, stepping back and looking at the process, was that Realty Mogul and Fundrise put an emphasis on who the sponsor is. We have a number of different equity partners, all with different appetites, and there was a void in some of the opportunities we saw where a lot of institutions don't want to play around with something that is so management intensive. So for deals like that, Realty Mogul is a great solution.

**Picchiotti** – In your investments, will you use all equity through crowdfunding? Or is there a debt portion?

**McKibben** – Generally it's a pretty typical capital stack.

**Brennan** – 100% of the equity is on the LP side, so we, as part of the deal with Realty Mogul, co-invest as we do with any of our other partners.

**McKibben** – One big fear we had early on was whether they would come up with the money when we had to close, and that's why we already had the money ready. Realty Mogul will get the commitment for money coming in, but they don't have a fund to back it up. Fundrise is a little different. We haven't worked with them, but what I'm told is that they have a fund behind them that will guarantee the committed amount, which is a huge difference than Realty Mogul.

**Zeoli** – In the market, debt is perceived as a safer investment for investors because you have an ongoing flow of payments. In terms of the funds, I believe Realty Mogul does have access to funds backing its commitments. From a developer perspective they are seeing this as a one-stop shop. It's definitely not just a source for the individual credit investors, but also for a lot of institutional money because they are seeing the potential for investment through these crowdfunding portals.

**Picchiotti** – What is the transparency with crowdfunding? You have private investments, on one side, where you know what you have going in, and then you have publicly traded REITs which have quarterly calls and are giving a lot of feedback. Where does crowdfunding fit in that spectrum?

**Brown** – If we are talking about a public REIT they are pumping out reports and other filings every year. In the crowdfunding space it really comes down to what your documents provide for, what level of disclosure you have, and if you have to follow any of the guidelines the portal may have. The short answer is that it's going to vary a lot.

**Picchiotti** – As an investor, how easy is it for them to get out of their investment?

**McKibben** – The liquidity on these deals are like any other real estate deal. A lot of times we give a window of when we could sell a property, but market conditions could warrant holding on to the property, or selling it sooner than expected.

**Zeoli** – That goes back to my point earlier why debt is perceived as a safer investment because it has more liquidity.

**Picchiotti** – What are the risks with crowdfunding you have considered?

**Brennan** – When we first started talking about it internally in our office, the first couple of concerns were we don't want 50 people knocking on our door asking why a tenant vacated. The good thing with Realty Mogul is that it is one entity that you are dealing with, so that's a plus from our side. As far as risks go, this is speculative investment no matter how you look at it. It's not any different than putting your own money into any other real estate. I know people bring up the idea of liquidity, but it's a different vehicle than investing in a liquid stock or equity.

**Brown** – From the legal side, I've represented developers on the front end of raising money, but also making a phone call when an investor says "how could we have lost money." The documentation is full of these annoying risk factors, that we know nobody reads, but are there for times like this to cover the developer, and show that they have given full disclosure. I think this holds true for crowdfunding deals or raising money only for credited investors in a traditional sense.