Why the Future of Real Estate Fundraising is Online
How Crowdfunding is Changing Capital Sourcing
# Table of Contents

1. **Executive Summary**
   - Page 3

2. **I. Benefits of Raising Capital via Real Estate Crowdfunding**
   - Page 4

3. **II. The Regulatory Environment**
   - Page 5

4. **III. How Real Estate Crowdfunding Fits into the Capital Stack**
   - Page 6

5. **IV. Crowdfunding in Action: A Sample Project**
   - Page 7

6. **Appendix I: How to Crowdfund Your Next Real Estate Deal**
   - Page 8

7. **Appendix II: Is Your Project a Fit for Crowdfunding?**
   - Page 9

8. **About Fundrise**
   - Page 10
Executive Summary

Crowdfunding – the sourcing of capital from individuals through the Internet – is permanently engrained in the business lexicon of the United States.

The efficiency of Internet marketplaces coupled with the passage of the Jumpstart Our Business Startups (JOBS) Act in 2012, which relaxed securities regulations restricting general solicitation of private placement investments, has created tremendous opportunity to radically change the way entrepreneurs raise capital – starting in consumer products, venture capital, and now, real estate.

Until recently, crowdfunding was limited to donation-based raises, most notably on platforms like Kickstarter and Indiegogo, where the investor was restricted from receiving any type of monetary gain from the success of a product.

Peer-to-peer lending and equity crowdfunding, or the offering of equity- or debt-based securities to the crowd, has soared in recent years. In 2013 alone, $2.2 billion in capital was raised via equity crowdfunding.1

The real estate industry has quickly become an early adopter - and beneficiary - of equity crowdfunding. More than 190 real estate investment offerings were crowdfunded by 150 real estate sponsors between April 2013 and September 2014, resulting in more than $110 million of real estate debt and equity capital raised.2

Despite its rapid growth, the real estate crowdfunding industry is young. It is estimated that there are more than 50,000 real estate companies in the United States. So far, less than one percent of them have used crowdfunding as a vehicle to provide capital.

As the industry evolves, crowdfunding will continue to become a more viable, mainstream funding source for real estate companies.

Leading real estate crowdfunding platform, Fundrise, our thought partner for this paper, recently announced that they will begin to offer Guaranteed Pre-Funding, which means that sponsors can have a project pre-funded prior to being posted for investment from the crowd, receiving capital within 10 days.

This is a revolutionary shift which will make crowdfunding an even faster, more efficient, competitive source of capital.

Fundrise has cracked the code for crowdfunding largely because of its principals’ experience in urban development and their long involvement in traditional real estate funding.

“After we did our first few deals, where we were the developer and the platform, real estate companies started reaching out to us and saying ‘I have the same issue, I’d like to find an investor base that better understands my deals and manage the whole process online,’” says Dan Miller, co-founder and president of Fundrise.

GlobeSt.com is committed to keeping a close eye on this market and its participants. In this paper we provide an overview of the crowdfunding landscape and describe some of the early trends we have seen emerge.

“Real estate crowdfunding fills the hole in the capital markets for funding below the radar of traditional institutional sources that typically don’t look at deals smaller than $5-10M.”

—Dan Miller
President and Co-Founder
Fundrise

2: Crowdfund Insider: September 27, 2014

—Steve Lubetkin
Custom Content Editor
GlobeSt.com
I. Benefits of Raising Capital via Real Estate Crowdfunding

KEY BENEFITS FOR REAL ESTATE COMPANIES INCLUDE:

Lower Cost: New technology cuts out traditional middlemen and reduces the amount of time required to originate and underwrite a project, reducing the overall cost of capital.

Access to a Marketplace: Today most groups raise capital through only a handful of sources. Crowdfunding platforms can connect companies to tens of thousands of investors and lenders ranging from individuals to large institutions, creating the first true marketplace for real estate capital.

Flexible & Efficient: Companies can access funding across the entire capital stack for a wide variety of projects, often with more creative terms not available from traditional lenders or equity providers.

The Social Network: Tapping into the broader marketplace of investors creates a level of exposure not available through traditional funding. Companies can build their brand and over time a network of loyal investors.

Fundrise Exclusive - Guaranteed Pre-Funding: The one drawback associated with crowdfunding is that funding is not guaranteed. Companies are forced to rely on a “best efforts” approach where the amount and timing of funding is unknown. This uncertainty is a challenge for high-quality groups working on major projects.

Fundrise has solved this challenge by providing Guaranteed Pre-Funding for qualified deals. By doing so, real estate companies get the benefits of crowdfunding without the drawbacks.

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*These are benefits of the Fundrise platform and are not necessarily found with other crowdfunding platforms.

"Real estate crowdfunding drives invaluable marketing for real estate companies, particularly those who are developing branded assets or looking to develop a new base of investors."

— *GlobeSt.com*, July 25, 2014
II. The Regulatory Environment

Raising capital through real estate crowdfunding requires an understanding of the relevant regulations through which fundraising can be done. Below are the key definitions to understand related to the regulation of real estate crowdfunding.

**Accredited Investor:**
- An individual with a net worth or joint net worth with a spouse that exceeds $1 million, excluding the value (and any related indebtedness) of a primary residence.
- An individual with an annual income that exceeds $200,000 in the past two years or a joint annual income with a spouse exceeding $300,000 for those years, and a reasonable expectation of the same income level in the current year.

*Note: Most online crowdfunding investments are limited to accredited investors.*

**Regulation D Private Placements:**
Rule 506 of Regulation D permits raises of unlimited amounts from accredited investors without registering a public sale through the SEC, as it is assumed that accredited investors are able to bear the burden of investment decisions without SEC review.

**Public Regulation A Offerings:**
Regulation A allows unaccredited investors to purchase small offerings of securities that do not exceed $5 million in a 12-month period. These securities require an offering statement to be qualified with the SEC, which results in time-consuming and costly review by the SEC. A Regulation A offering needs to be registered in each individual state where potential investors reside, limiting access to most Reg A offerings.*

**Regulation A+:**
Regulation A+ is the SEC’s proposed revision of the current Regulation A. Some of the major proposed changes include:
- State law preemption, meaning once the SEC qualifies an offering, it can be offered anywhere in the US.
- An increase in the maximum offering amount from $5 million to $50 million.
- Modernization of the filing and review process, a major change from the current system, which requires hand delivering 7 paper copies of a filing to the SEC.

While Regulation A+ requires a more in-depth SEC review process, the proposed exemption permits much more money to be raised — specifically with regard to when audited financials are first required ($500K for Regulation A Crowdfunding, $5 million for Regulation A+).

**Title III Regulation Crowdfunding:**
- Outlined in the 2012 JOBS Act, Title III created an SEC registration exemption which, when implemented, will enable issuers to engage in crowdfunding equity offerings to the general investing public.
- Title III highlights:
  - $1 million offering limit
  - Issuers must disseminate an SEC-filed offering statement to prospective investors
  - No SEC review or clearance required for offering statement
  - Simultaneous Regulation D offerings are permitted

*Fact: In 2011, 19 Regulation A offerings were filed. Only one was qualified by the SEC, a revival of the musical Godspell. Only three Regulation A offerings have been done for real estate.*
III. How Real Estate Crowdfunding Fits into the Capital Stack

Part of the appeal of crowdfunding is its flexibility -- the ability to fit into many kinds of financing structures, for both small balance deals and investment-grade properties. Since 2010, real estate developers have crowdfunded over 200 projects, ranging from small acquisitions and rehabs to ground-up developments with over $100 million in total project capitalization.

A real estate company can access funding across the capital stack for virtually any type of project. Instead of going to a bank, private equity fund, mezzanine debt provider, or limited partners, sponsors can use crowdfunding to fund an entire deal.

DEBT
- **Senior Secured Debt:** Best for boutique commercial projects and single-family housing that requires more flexibility and speed than a bank.
- **Mezzanine Debt:** An effective tool for additional leverage in tight credit environments, crowdfunding provides the same benefits as a traditional mezzanine debt provider.
- **Blended Senior + Mezzanine Debt:** Some firms, including Fundrise, will provide nearly the entire capital stack, reducing costs and increasing speed. The portal provides a senior loan at 60-70% of cost with a junior mezzanine loan at 15-20% of cost, resulting in 80-90% of total project cost from one source.

EQUITY
- **Common Equity:** More appropriate for sophisticated investors; increase your investor base. Crowdfund traditional limited partnership equity in large portions, and leverage the social aspect of a building owned by the community.
- **Preferred Equity:** Cash out sponsor equity or limited partner equity for acquisitions or working capital while increasing leverage and hitting IRR targets faster. Retain more ownership on the back end.

See Appendix II for Fundrise parameters for partner real estate companies.
IV. Crowdfunding In Action: A Sample Project

30-UNIT MODERN INDUSTRIAL CONDO DEVELOPMENT
WASHINGTON, DC

XYZ Development has raised $19.75M for the acquisition and renovation of a 37,500 SF factory building into 30 large industrial lofts over a 24-month timeline.

The planned units are expected to range between 1,255-1,670 SF, with high-end luxury finishes. Based on comparable properties in the area, projected sales for each unit are between $475/SF and $500/SF.

This investment has a gross annual projected return of 14% over a 3-year period with an annualized 7% paid current on a quarterly basis and the additional annualized 7% accrued. All accrued returns are to be paid out at the end of the investment term.

- Under 30 Days from Term Sheet Signing to Closing
- Closed Alongside Senior Loan
- 3 Feature Stories in Prominent Publications
APPENDIX I: How to Crowdfund Your Next Real Estate Deal

1 Vet the platform.
   - What other real estate companies has the platform worked with?
   - What sort of terms have they negotiated? Look into the due diligence process. Does the platform seem to know about real estate underwriting?
   - How much information are you provided on their process?

2 Make sure your product fits within a platform’s parameters.
   - It’s important to understand if a platform is focused on equity vs. debt / development vs. value-add vs. stabilized assets / commercial vs. residential.

3 Guaranteed Funding vs. Best Efforts vs. Posting Platform?
   - Is the platform using Best Efforts Crowdfunding, meaning that a sponsor receives whatever funds are raised on the platform during the raise? Or, is there Guaranteed Pre-Funding, where a platform will fund the investment in its entirety and open it up to individual investors at a later date? Or, do they act as a Posting Platform, without performing due diligence or handling investor relations?

4 Know the regulations.
   - While all platforms “crowdfund real estate investment”, not all platforms provide the same access to investment opportunities.

5 Prepare and submit an Investment Package.
   - Using a crowdfunding platform means accessing an enormous network of individuals, professional investors, and institutions for capital. They will want to perform their due diligence and understand your firm’s financial position. Transparency is key.
**APPENDIX II:**

Is Your Project a Fit for Crowdfunding?

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<thead>
<tr>
<th></th>
<th>Senior Secured Debt</th>
<th>Mezzanine Debt/Preferred Equity</th>
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</thead>
<tbody>
<tr>
<td><strong>8-14%</strong> ANNUAL INTEREST RATE</td>
<td></td>
<td><strong>10-18%</strong> ANNUAL INTEREST RATE</td>
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<tr>
<td>Max Loan-to-Cost</td>
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<td>85%</td>
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<tr>
<td>Maturity</td>
<td>12, 36, 60 or 84 mo.</td>
<td>12, 36 or 60 mo.</td>
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<td>Size</td>
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<td>$500K-$10M</td>
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<td>Time to Close</td>
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<tr>
<td>Primary Use</td>
<td>Acquisition, Construction</td>
<td>Acquisition, Value-Add</td>
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</table>

*These terms are unique to the Fundrise platform.*
About Fundrise

Fundrise is the leading real estate crowdfunding platform. Founded in 2010 by developers and brothers Ben Miller and Dan Miller, Fundrise was the first site to successfully crowdfund an online equity offering for a real estate property. Based in Washington, D.C. with offices in New York and San Francisco, Fundrise has brought real estate to the mainstream.

Fundrise offers both debt and preferred equity products primarily targeted at small to mid-market value-add development in core urban markets. Often times, Fundrise provides financing to projects that require greater flexibility or do not fit in “traditional” institutional boxes. Fundrise works with strong sponsors in major metro markets with consistent track records of high performance.

For more information on Fundrise, visit www.fundrise.com, or email contact@fundrise.com.

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