



So you want to crowdfund? Top 7 issues

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True crowdfunding (lots of small investors who are not accredited under SEC rules) has not yet started - the regulations proposed by the SEC are not yet finalized. However, the advertising rules for private placements have been relaxed by the SEC as long as the advertising is targeted to accredited investors. The New York attorney general has also issued guidance for sponsors of condo projects who want to attract investors who are interested in the option of taking title to a condo unit once the project is complete in lieu of a cash return on the investment. While this is not true crowdfunding, the press and most people call it crowdfunding. Because I've done several transactions and because I follow these issues and write about developments in the area, I have been repeatedly involved in conversations with clients about how to navigate the process. Here is my top issues list:

1. The biggest issue so far: sponsors can't use a broker or pay commission based compensation to a third party who finds the investor unless the broker is registered with the SEC as a securities broker/dealer. A mere real estate broker does not count. There are potential exemptions but they are fraught with uncertainty.
2. The sponsor needs to make Regulation D filings with the SEC and each state in which the sponsor is soliciting investors. While these submissions are not difficult, they are exhaustive and require specialized counsel.
3. To protect from fraud claims, the sponsor should make full disclosure of the risks of the deal. The exact form of the disclosure may vary from a full private placement memorandum to the delivery of various deal documents combined with the right assumption of the risks wording in the subscription agreement or LLC agreement.
4. The timing is tough. It's hard to arrange for the investments in the month or two a typical sponsor has to line up its equity before the closing of the acquisition.
5. Equity vs. debt? Most crowdfunding websites are offering debt, not equity, crowdfunding deals. Debt is much easier to explain to an investor since it does not involve risks like phantom income and potential dilution if additional capital is required. But debt does not underwrite as well with mortgage lenders for obvious reasons.
6. There are numerous crowdfunding websites up and running but so far, the deals actually closed through them seem small. Most just offer the sponsor a platform to place their deal - they don't actually work too hard to attract investors - it's up the sponsor to refer investors to the site. Other sites only place their own deals on the site.
7. The investors must be accredited investors (generally, \$200,000 of income (or \$300,000 with a spouse if married) for two years with expectation that the income will continue at that level or \$1 million of assets other than the investor's primary residence). In a change from prior law, the sponsor must take reasonable steps to verify the accredited status - the sponsor just can't take a

check the box statement from the investor.

Crowdfunding offers a new avenue for raising the capital needed for today's real estate deals but obstacles remain and the complications often seem endless.

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