# Multifamily Market Commentary – July 2017

Over the past few years, crowdfunding is increasingly being used as a vehicle in financing multifamily properties and providing investment opportunities for less sophisticated investors. Simply put, crowdfunding is the practice of funding a project or venture by raising small increments of cash from a number of people, usually through a website. Most importantly, for certain types of crowdfunding, anyone can invest, not just high net worth individuals, institutional investors, or corporations. But these type of investments are quite illiquid. In fact, crowdfunding investors will likely be required to hold their investment for a period of time and will be limited in their ability to transfer their investment.

## Crowdfunding Overview

Crowdfunding received a boost from the Jumpstart Our Business Startups (JOBS) Act, which became law in 2012 and allows smaller investors to participate in funding startup entities. The initial purpose was to provide small businesses access to more capital by reducing regulatory requirements.

Since the passage of the JOBS Act, various rules have been adopted by the Securities and Exchange Commission ("SEC") permitting offerings to be advertised to smaller investors. These rules impose varying requirements on the businesses raising capital relating to, among other things, the maximum size of the offering, information that must be provided to regulators and to investors, and whether the deal can include investors who do not meet net worth or income tests.

## Crowdfunding Risks

Crowdfunding involves significant risks, some of which are noted below:

- Speculative. Investors need to be prepared to lose their entire investments.
- Illiquidity. Investors may be limited in their ability to resell their crowdfunding investment and may be required to hold the investment for an indefinite period of time.
- Limited disclosure. Information may be limited and may not be updated as frequently as in other types of investments.
- Possibility of fraud. There is no guarantee that crowdfunding investments will be immune from fraud.

## A Crowded Field for Real Estate Crowdfunding

There are many real estate crowdfunding platforms with various investment terms for investing. For example, minimum investment amounts appear to vary widely, from at least a $50,000 investment on one platform to another platform offering just a $10 minimum investment amount. In addition, investors may not have equity in the real estate but rather only share in the debt. Most real estate crowdfunding websites make it fairly easy to sign up for additional information, while others are already closed to new investors.

## Limited Crowdfunding Property Sales Information

Real Capital Analytics has been able to gather some information on property sales, but its reported crowdfunding investment activity may not be comprehensive due to these crowdfunding platforms investing as a general partner rather than as a stand-alone investor. In addition, real estate crowdfunding platforms often partner or co-invest with local developers and investor partners, making identification of crowdfunding-specific real estate transactions difficult.

That said, according to data compiled by Real Capital Analytics for properties valued at $2.5 million or higher, it is estimated that the largest annual real estate crowdfunding property sales transactions occurred in 2016, at $218.7 million, compared to an estimated $121.5 million in 2015, as seen in the table below.

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**Real Capital Analytics**
**Estimated Real Estate Crowdfunding Property Purchases by Year**

| Year | # Props | $ Volume |
|---|---|---|
| **2013** | 2 | $ 73.5 million |
| **2014** | 7 | $ 138.7 million |
| **2015** | 16 | $ 121.5 million |
| **2016** | 25 | $ 218.7 million |
| **YTD May 2017** | 4 | $ 75.1 million |

*Source: Real Capital Analytics*
*Note: Property sales of $2.5 million or higher. Also, crowdfunding investment activity may not be comprehensive due to these platforms investing as a general partner and often partnering with local developers/partners.*

## Fannie Mae and Multifamily Crowdfunding

Due to the increasing participation of crowdfunding platforms, Fannie Mae has specific guidelines for acquiring multifamily mortgages that include a crowdfunding equity position.

Fannie Mae's Multifamily underwriting guidelines state that any mortgage loan in which anyone with a direct or indirect equity interest in the borrower or any key principal that solicits financial contributions from the online community for capital funding and/or investment in real estate, or at any time during the term of the mortgage loan, is considered to be a crowdfunding investment.

As such, all multifamily loans with crowdfunding investments must be reviewed and approved by Fannie Mae prior to acquisition, and the lender does not have the authority to deliver the loan to Fannie Mae without such review. The following underwriting guidelines apply for all loans with crowdfunding:

- Crowdfunding investment requires a payoff, or it must have a redemption period, maturity date, trigger date, or similar mechanism requiring the repayment of the crowdfunding investment. This was designed to ensure the crowdfunding investment would have a term as long as the senior loan.
- The terms of the organizational documents of the borrower or any key principal do not allow or permit for any reason the crowdfunding equity to cause a direct or indirect change of control in the borrower or such key principal. This was drafted to ensure the crowdfunding entity could have no mechanism to gain control of the asset during the term of the senior loan.
- Changes of control for any reason to the crowdfunding investment (including changes of control for "bad boy" carve-outs or with later lender consent) are not acceptable.

Fannie Mae multifamily lenders are expected to work diligently to ensure the crowdfunded investments in their transactions are structured as passive limited liability equity.

## Multifamily Crowdfunding: Just the Beginning?

Crowdfunding investment for commercial real estate, including multifamily properties, is likely here to stay. With some real estate crowdfunding platforms offering various investment options, investor demand, especially from the average consumer, is likely to continue expanding.

Yet, commercial real estate remains a risky investment, and being a small part of a large community of investors can feel safer to those with little or no real estate experience. It remains to be seen how influential and expansive commercial real estate crowdfunding will be over the next few years.

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