

Property crowd funding position

Law



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Introduction

Crowdfunding is related to the precise practice of funding ventures by raising financial contribution from the mass population to suffice a specific purpose, via any type of mass media. Typically, the idea has been credited substantially to raise money for a specific reason, which has only augmented with the continuous developments in technology. In today's competitive world, people have become increasingly media savvy than previous eras. It is in this context that in the modern phenomenon, through crowdfunding, the idea switches around people, who are seeking funds for specific projects and purposes, with the help of mass media. There are three types of crowdfunding, which include donation, debt and equity. Donation crowdfunding is mostly related to noble causes, where most people decide to invest simply for they believe in the purpose of Crowdfunding. Similarly, debt crowdfunding is based on the concept of peer-to-peer lending process¹. In debt crowdfunding, the entire process revolves around lending money, wherein the investors expect to receive their interest on their invested amount and thus, gain profits. In this case of debt crowdfunding, along with the financial returns, investors also aim at gaining the benefit of contributing to the success of a particular purpose, which they believe as worthwhile. Additionally, in the case of equity crowdfunding, people invest in exchange for equity. Fundamentally, here the money is exchanged with the shares. Correspondingly, it can be stated that when the funding is successful, the community's share value goes up, and vice-versa². It is worth mentioning in this regard that both debt crowdfunding and equity crowdfunding can be related to property crowdfunding concepts, wherein investors tend to buy a <https://assignbuster.com/property-crowd-funding-position/>

real estate in order to sell it or let it out in order to obtain profits or returns. Aimed at elaborating on the context of property crowdfunding, the discussion henceforth will elaborate on two main themes, which are property or real estate and crowdfunding. In the view of today's competitive global business world, crowdfunding in real estate has emerged as a new investment option with secured high returns for many. It was following this augmentation in the rate of property crowdfunding that the Jumpstart Our Business Startups (JOBS) Act of 2012 was brought into effect in the US. This new rule was intended to allow all the investors from every income level to gain direct access to the real estate market with the help of crowdfunding. This Crowdfunding pattern followed the peer-to-peer lending procedure among other investment markets³.

In the recent past, taking the assistance of the internet media, there were various sites introduced for crowdfunding, such as, iFunding, CrowdStreet, Reality Mogul, and Fundrise. With these crowd-funding sites, the US Securities as well as Exchange commission attempted to explore the various ways to allow investors from all the income level to access the real estate market online. In this manner, crowdfunding generated an easy accessibility of vast networks of known and unknown people through social media websites, including, Facebook, LinkedIn and other relevant sites. Through such social media initiatives, real estate agents launched their new business and simultaneously attracted the investors as well. According to the new trend of business, crowdfunding has fuelled the tendency of entrepreneurship in real estate businesses by expanding the pool of investors from whom the funds can be raised for a better business prospect. This thought was beyond the traditional circle of owners along with venture

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capitalists⁴.

Thesis Statement

As mentioned prior, the theme of this paper emphasized the assumption that “ Real estate Crowdfunding creates better returns on investments”.

A ‘ The desire to invest and own commercial real estate though communally has prompted many to embrace property Crowdfunding’

In this competitive world, real estate business has certainly emerged as a significant investment deal for all the investors. As of now, as per the conception of the new regulation in Jumpstart Our Business Startups (JOBS) Act of 2012, investors are allowed from all the income levels to gain direct access to real estate market with the help of crowdfunding. In correspondence to the stated law, people from different income levels have shown interests in their investment in properties, which, on economical grounds, have accelerated wealth distribution and currency exchange in the global market. Moreover, this particular regulation has encouraged investments on mutual grounds, jointly with the other people, to enhance their property through crowdfunding⁵.

B ‘ Property Crowdfunding to numerous investors has become the present days Gold rush’

Fundamentally, in today’s date, real estate business has accrued considerable attention from the real estate businesses, in view of value addition by incurring limited points and hence, has arguably resulted to a scenario, similar to ‘ Gold Rush’ . To be specific, JOBS law allowed small and large investors to access the real estate market with only a limited amount of investment but assuring risk avert returns. Additionally, this law also helped to work directly to the real estate developers. Moreover, investors

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can also choose the projects of real estate according to their desired invested money. Besides, through direct regulation of real estate business, investors have been able to access the myriad projects as well. This situation clearly indicated that the choices as well as options were not any more a problem for investment business in real estate and hence, can be argued to have raise a ‘ Gold Rush’ like scenario in the domain 6.

C ‘ Presently, numerous SMEs prefer property crowdfunding as a way to overcome funding difficulties and increase their seed capital quickly’ According to Jumpstart Our Business Startups (JOBS) Act of 2012, investors from various income levels are allowed to invest, which also may cover SMEs. To be noted in this context, as per the perception of Commercial Real Estate Development Association, each of those investment policies has developed various platforms for its strategy. According to these policies, diverse investments towards all the accredited investors is possible, who meet specific requirements for their annual income. In contrast, property crowdfunding has opened a vast field of investment for many smaller investors as well. With this rule implemented and growing participation from the real estate agents, investors faced minimum funding difficulties in terms of investor’s net worth, along with other relevant criteria. Additionally, this situation also increased the tendency of investor’s seed capital too quickly augmenting the overall scope for capital distribution⁷.

D ‘ Compared to other different forms of investments, property crowdfunding does not necessitate day-to-day attention from their members, hence many referring it as lazy investing’

Crowdfunding has evidently provided and accredited investors with various opportunities in terms of their net worth and other relevant criteria. In this <https://assignbuster.com/property-crowd-funding-position/>

century, property crowdfunding was helpful to invest money through the internet as well. Arguably, property crowdfunding did not necessitate regular attention from its accredited members and therefore, increased the tendency or lazy investment that was quasi regulated, inadequate to completely rule out fraudulences. For instance, internet crowdfunding was too easy to access as well as free to join, wherein investors were also able to choose the projects of real estate according to their desired invested money. In addition, investors were allowed to access the myriad projects simultaneously, and thus, options and choices were not a problem at all for them. Investors also received all the updates and detailed track performances through internet at their own desk. Hence, for these typical characteristics of crowdfunding, it is often referred also as ‘ lazy investing’⁸.

Methodology

Research methodologies are commonly associated with strategies and measurements, which extend with each step from extensive detailed approaches including data collection, data analysis, as well as interpretation. With concern to the current study objectives, the selected research approach was identified as based on the nature of the research issue in concern. It is worth mentioning that mostly three types of research approaches are used for research purposes, viz. qualitative approach, quantitative approach, and the mixed approach of research. Qualitative research methodology is used to explore and develop the collected data as well as related variables for identified characteristics of research along with its problem areas⁹.

Correspondingly, quantitative research methodology is used for the measurements of those variables and collected data with the help of relevant instruments, which ultimately helped to analyze those relevant data

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using statistical procedures. In addition, mixed research methodology is used as a combined research approach of both the quantitative and qualitative research methods¹⁰.

To be concentrated in this particular study, the selected issue emphasized property crowdfunding trends in the current era among the various large and small sized investors. Thus, based on the research objective, qualitative and quantitative research approaches were selected for the collective data analysis in this study. To ensure collective information comprising this research study, reliable as well as up-to-date, it was essential to use the qualitative and quantitative research methodologies in combination. The research approach thus aimed to suffice the proper cause and effect functioning in the trend of property crowdfunding¹¹.

To gather information relevant for this particular research study, a secondary data collection method was utilized. Correspondingly, systematic reviews from varied scholarly articles were used to conduct this research study ensuring its internal viability as well as overall reliability. To conduct the data collection method in a more compact as well as reliable manner, and to determine the correct sources of collective data for this particular research study, particular steps were implemented¹². For the collection of relevant data for this research study, internet sources were used, comprising scholarly articles, e-journals, and statistical data related to the research subject, emphasizing the current trends in property crowdfunding. During this collection of related data, , all the articles gathered were filtered on the basis of the authority of authors, their competencies, reviews on those as well as journals, published within the recent five years. Another crucial criteria considered in the filtering of the considered secondary sources, <https://assignbuster.com/property-crowd-funding-position/>

information were must to be relevant to the main statement of thesis, along with other important criteria related to the thesis subject. These processes were conducted particularly on the grounds for reliability as well as viability of the collective data and further present a compact analysis of the collective information.

Literature Review

The term, ' crowdfunding' simply indicates to the collection of required funds from the crowd or mass or people. Theoretically asserting, it is the precise practice of funding a venture and thus, raising financial contribution from the mass population for a specific purpose, via any type of mass media.

According to the Bradford, the media most commonly utilized for crowdfunding is internet¹³. Historic rise of the process reflects it as similar to a revolution among investors irrespective of their sizes, as the market allowed return even on minimal funds. Potential from the end of investors, crowdfunding proved simultaneously beneficial for smaller entrepreneurs, with augmented scope for capital inflow and lesser legal hazards to attract the pool. According to Lawton & Marom, the basic concept of crowdfunding was however not new for the world. Politicians have been already collecting funds through small campaigns, commonly as donations from the public for generations to meet many ethical requirements of the society. Such a trend fundamentally had the essence of crowdfunding. However, in context to profit earning and enhancing capital flow in the business purposes, crowdfunding just presented itself. Gunter thus commented that, in today's competitive world, people are much more media savvy than they were in the previous eras¹⁴. Through crowdfunding, especially in the property market, the idea switches around people seeking funds, now able to project their

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purposes with the help of raising funds from the other investors. Bradford supported these facts as well as added that there were typically three types of most essential players within the property crowdfunding model¹⁵. These factors were, project initiators, project supporters, and the moderating platform. At the very beginning stage of such contracts, the initiators intended to propose a unique idea, which needed fund for its execution. In subsequence, project supporters are those who are interested in the purpose of the real estate project, showing their confidence to attract and build up a larger pool of investors. Additionally, the mediator of both of these initiators and supporters function on the moderating platform, which connected both the parties. As per the perception of Bradford and Gunter among many others, the main concept of crowdfunding was much clear, targeting better capital inflow in the real estate market¹⁶.

According to the Bradford, in the pre-purchase model of property crowdfunding, the investor investigates for the likely options of investments, but often does not decide to buy a stake in the company¹⁷. This type of transaction is deemed as basically, bound to the commitment to return the borrowed amount of money at regular intervals with assured predetermined interest rate of the company¹⁸. The reward-based model correspondingly reflects the idea that people decide to invest on the basis of exchange for a reward. Contextually, the equity model reflects the idea of a particular type of property crowdfunding, wherein a stake in the company is given to a group of people to obtain capital and finance the business. As part owners of the company, the investors stand to make a return on their investments with a share of the profits that the company manages to survive in the long run¹⁹.

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Emphasizing the same issue, Mollick, outlined the influential benefits of crowdfunding in the real estate business. At the onset, Mollick argued that “Crowdfunding can validate an existing prototype that’s working”. This particular statement implies that a small business can produce great customers, but have to face considerable challenges for capital collection in a sufficient manner. In this situation, crowdfunding tends to help these entrepreneurs to raise funds for business investment from the community and even from the global platform. Apparently, the stated prospects of crowdfunding indicate the large market to obtain capital and debt based investments. However, differences still persisted between the larger brands in the real estate market and the smaller ones, when concerning investors’ confidence to invest through crowdfunding. As argued by Mollick, big brands in the real estate market often used the property crowdfunding system of obtaining easy capital, taking the virtues of their brand value and recognition, which in turn augmented the trend of pre-selling of real estates in the market²⁰. Nevertheless, this in turn assisted smaller real estate companies as well, who could initiate the business with comparatively a minimum amount of capital, drawing a larger amount of the same from crowdfunding²¹.

Contextually, crowdfunding was able to generate a new set of relationships to form around companies and their investors. Additionally, crowdfunding has also been able to reduce confinement of new small-business investments in the market²². Besides the stated economic benefits crowdfunding led to better job creations. Aligned with these benefits, Verloop supported and commented that crowdfunding was more efficient than traditional fundraising. As compared to applying a loan or searching for accredited

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investors from own perception was difficult. In contrast, crowdfunding helped to generate successful campaigns for capital raising platform from the most eligible investors. This right platform was much more efficient as well as effective for any new investment in the real estate or any business as well. According to Macht & Weatherston , crowdfunding is commonly considered as a place to build traction, social proof, and validation in terms of investment business²³. Thus, through crowdfunding platform, potential investors reflected their interests in a particular project. Through this platform, a larger number of people could be attracted through media attention, wherein this social recognition would have proven helpful for any investment. In addition, it was an opportunity for crowd sourced brainstorming to refine any business investment idea as well as real estate investment towards a better decision-making direction²⁴.

Fundamentally, crowdfunding reflected various ideas and unique thoughts of different people about this particular investment idea that ultimately led these bundle of unique thoughts towards success. Crowdfunding also helps to gain early adopters and loyal advocates for any unique idea related to investments in properties. As previously mentioned, social recognition was important for businesses wherein investors believed in initiating ideas and services, which further motivated investors. Hence, by attracting a larger pool of capital inflow, real estate companies invested their money for longevity as well as long-term success in the real estate or any other investment business. Additionally, as asserted by Silverman, this process was building a positive vision towards the interest of investments among people, as it also permitted building a strong loyal relationship of trust. As well as it helped to double marketing and media exposure through new <https://assignbuster.com/property-crowd-funding-position/>

investment ideas related to the real estate business. As previously mentioned, media coverage was essential for recognition among the potential investors, for the investment business' future sustainability as well as future prospects. Through media coverage thus, crowdfunding accumulated a new path that captured new investor's interests and increased capital inflow within the market²⁵.

As can be inferred from the above discussion, Crowdfunding has grown into an excellent option for entrepreneurship as well as investment in the real estate to validate the business. Obtaining capital, as well as early adopters, to get the needed exposure for growth, were thus fulfilled by this potential platform named crowdfunding. Simultaneously, crowdfunding had some contrary characteristics, besides all of these discussed benefits. According to the Jarboe, crowdfunding has implicated “ plenty of lawsuits”, both for the fraud as well as for failures to return the assured sum to the investors²⁶. As on one hand, this implies that many crowdfunding investment seekers were unable to provide convenient as well as valuable feedbacks to their investors, most were seeking for the ‘ quick rich’ scheme through crowdfunding procedures, giving rise to unethical businesses in the sector. Jarboe also commented that, such type of investment business failures were predictable results for lawsuits by the investors, who attempted to recoup the invested money from the failed crowdfunding entity²⁷. Though crowdfunding represented a tremendous opportunity towards the investment business in property as well as other businesses for funding, there were more chances to fraud as well as failures.

Additionally, according to Tomczak & Brem, information on crowdfunding was highly asymmetric as they were susceptible for incompetence²⁸.

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Illustrative in this context, at times investors used to face considerable difficulties to obtain essential data for relevant decisions. Besides, investors also faced problems to understand risks associated with crowdfunding investments in the real estate business. On the other hand, Tomczak & Brem also commented that in the perception of crowdfunding, many unreliable ideas also get funded inhibiting investors' confidence to the process²⁹. This particular tendency evidently decreased the success potentials of crowdfunding investments³⁰. It is worth mentioning in this context that crowdfunding helped to attract investments in large volumes from small income level to large income of level investors. According to Tomczak & Brem, too much failure in crowdfunding investments, owing to the limited reliability on the same has pictured a negative blow as well as it has prompted regulatory tightening. In today's world, crowdfunding has increased its value in running investment business in manifold. It rather now presents a similar trend to that of the early 'gold-rush' involving small and large investors in real estate or property business. Entrepreneurs have accordingly become more eager to obtain funds through the mechanism and gain competitive benefits over the rivals. Therefore, it was essential for all the investors to invest with consciousness knowing about the venture capital, along with risks associated with equity funding³¹.

According to Harburg, Hui, Greenberg, & Gerber (2015), property crowdfunding platform might be risky for the investors as well as the initiators. Arguably, among the risks found according to the crowdfunding investment business, 'loose patent ownership' was one of those legal issues witnessed during business in investments. Tomczak & Brem (2013) further argued that through crowdfunding, initiators also faced the rise to lose their

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brand value, if the trust of the investors was shaken. It was with concern to these risks to the initiators and other involved in crowdfunding that the basic rule in United States legal program stated it clearly that registration of a business trademark should first avoid unnecessary legal issues. It is also noteworthy in this context that owing to the lack of a coherent and defined process to crowdfunding, investors as well as initiators often restrain from using the benefits of the channel, making it less vibrant as compared to its scope or potentials³².

In the view of Kuppuswamy & Bayus (2013), crowdfunding in real estate businesses is mostly based on investor's money and the initiator's unique idea. Therefore, here was a clear deviation of success, between all the investors and initiators. However, according to United States' business law, sharing success with so many associates was quite unlikely to follow all the proper business norms making it virtually almost impossible. In addition, as asserted by Faraj, Jarvenpaa, & Majchrzak (2011), the U. S. Securities and Exchange Commission (SEC) have been quite strict about the violation of security law when gathering funds through crowdfunding. Sometimes obligations along with caveats of the related project of Crowdfunding also remained unclear between investors and initiators. For instance, even if initiators provided ' non-equity' rewards to the investors, the law mentioned no specific regime about these particular criteria of sharing the equity that might in turn fuel money laundering activities through the process (Faraj, Jarvenpaa & Majchrzak, 2011).

According to EBA (2015), not all types of crowdfunding involve greater risks than any other property funding mechanism, although it presented a higher chance to face such issues or discrepancies. Crowdfunding can be a great

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source of investing capital for new ventures in real estate as well as other businesses, which also assured a degree of long-term sustainability. Considering the risk factors of crowdfunding, investments with the appropriate advices along with subjective responsibilities were needed from both the investors as well as the initiators. As asserted by Jarboe (2012), the JOBS law 2012 allowed investors from every income level to gain a direct access to the real estate market with the help of crowdfunding. This crowdfunding pattern can often be observed as reflected through the peer-to-peer lending procedure among other investment business markets. The US Securities and Exchange Commission thus explored the various ways to permit investors from almost every revenue level to access the real estate market. In this way, crowdfunding tends to generate easy accessibility of vast networks of known and unknown people as investors through social media and websites, such as Facebook, LinkedIn and other relevant sites. Through these means people were able to launch their new businesses and simultaneously attracted investors as well³³. Further, in the view of EBA (2015), according to the new trend of business, crowdfunding has developed the potentiality to increase entrepreneurship in real estate businesses by expanding its pool of investors through whom the funds can be raised for the business' future prospect. This thought was beyond the traditional circle of owners along with undertaking investors³⁴.

Asserted by Property Crowd (2015), in this competitive world, people were more attracted towards crowdfunding making it a phenomenon similar to 'gold rush'. As per the conception of this particular tendency, several trends were pictured. For instance, through this practice, vertical platforms were intended to focus on specialized market segments like, property or real

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estate. Crowdfunding has also been giving people a generalized platform for raising money. This typical pattern of publicity further proved helpful for the new specialized market segments. Another trend of crowdfunding was reflected by Silverman (2015), emphasizing the long-term support for the project based model ideas. In present time, a standard crowdfunding model involves one time fund drive for the particular project of an initiator. This type of situation builds a specific prototype as well as helps to demonstrate the market interest properly. It is worth mentioning in this context that crowdfunding campaigns are basically expensive to organize as well as promote and indicates towards long-term support for sustainability. This particular notion was again supported by Gu, Konana, Raghunathan, & Chen, stating that crowdfunding will increase its popularity rapidly with time as the global arena witnesses a rising number of potential investors. However, on a simultaneous note, it also increases the chances of money laundering and forgery as crowdfunding mostly is conducted through internet these days. Gu, Konana, Raghunathan, & Chen also discovered that crowdfunding can become a more efficient path to relate with the people. It is rather like an attempt to obtain returns in a risk avert manner within the short run period³⁵. It is also interesting to find thus that crowdfunding has evolved in new segments of markets as well as that it has gradually moved to develop a proper mechanism to ensure the money distribution along with other related relevant issues.

Recommendations & Implications

In view of the risk factors as well as other threats of failure in the crowdfunding investment in real estate, both the parties, i. e. the initiators and the investors must follow some recommended pathways. As the JOBS

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law 2012 allows all the investors from different income levels to gain a direct access to the real estate market with the help of crowdfunding, investors must focus on investing capital with professional advices along with subjective responsibility. Moreover, responsibility is also needed from the end of the initiators as well, when proposing the unique idea to the investors, highlighting on both its pros and cons. Furthermore, both the parties must share the responsibility towards legal issues related to crowdfunding investment in the real estate in order to avoid unnecessary risk factors³⁶. In the year 2014, the Investor Advisory Committee (IAC) of the Securities and Exchange Commission (SEC), held a meeting aimed at discussing way outs to eradicate the risk factors during crowdfunding in real estate investment business and attracting the attention of scholars as well as industrials towards the phenomenon. The IAC hence recommended specifically some proposed rules of Crowdfunding to ease the rule of SEC, which have been discussed as below³⁷.

Investment ‘ Limits

In the year 2012, according to JOBS law there was not limit to invest in crowdfunding. On the other hand, this situation specifically highlighted some difficulties within the crowdfunding procedure. However, according to the Investor Advisory Committee (IAC) new rule was proposed to set the investment limits. According to the new rule, both the investor’s income and net worth escalated to \$100, 000, and hence, the investors were provided with a relaxation to invest up to 5%. This 5% investment was summed up with the network or income, whichever constituted of the lower amount. On the other hand, if the total investment attained the summed up value for more than \$100, 000, the investors could subsidize up to 10% and the same

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would be applied to the lower amount of either income or net worth³⁸.

Strengthen Investment Limit Enforcement Mechanisms

To reduce the error in calculating investment limits through electronic calculations, property crowdfunding achieved minimal cost as well as in convenience to investors. Additionally, the Investor Advisory Committee (IAC) recommended to the Securities and Exchange Commission (SEC), supervising the effectiveness of this particular method to determine its process continuity as well as gearing the established of a stringent enforcement mechanism to control this arena³⁹.

Intermediary Obligations and Ability to Curate

The Investor Advisory Committee (IAC) acclaimed intermediary obligations to the dilution and liquidity of the invested capital. In addition, this obligation also included factors such as the size of offering, amount of investments, participation of individuals, along with record of security law violation. These criteria were resolved as well as protected through the new proposed regulation by IAC. Through this regulation, it was possible to require intermediaries to recognize homogeneous information about the failure rates, returns, along with other relevant information and facts straight through the funding portals of investors. These regulations also helped to evaluate the background records of investors as well as initiators related to the specific crowdfunding investment, so that any chances to money laundering could be avoided⁴⁰.

Education Materials

From the total process of investments to the ideas of business prospects, each phase of crowdfunding required a specific way to properly conduct the transactions. To maintain quality and proper conduction method, investors

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and initiators must therefore ensure some relevant degree according to the specific terms of business. The Investor Advisory Committee (IAC) thus recommended to the Securities and Exchange Commission (SEC) to take further strict measures and ensure the qualifications of the associated parties and materials, involved in the overall transaction⁴¹.

Conclusions

As previously mentioned, the objective of this study was to elaborate the real estate crowdfunding, assuming to create better returns on investments. In order to substantiate the objective of this study, a planned research methodology was implemented that involved specific research strategies and measurements, which extended with each stage from widespread detailed approaches comprised with data collection, data analysis, as well as interpretation. Data collection method for this specific research of crowdfunding in real estate was conducted through the combination of qualitative as well as quantitative approach using the secondary data sources. These data sources included scholarly articles, e-journals, and other online available reliable materials. Correspondingly, during the collection of relevant data, some basic norms were followed. At the onset, it was ensured that all the articles were filtering on the basis of authority of the authors, along with reviews as well as journals to be published only within the recent five years and no more than that to ensure that the information were relevant to the main statement of thesis.

The findings of the study proved that it was essential for the investors to invest capital with specialized and suitable advices along with subjective responsibility. To be specific, the study helped identifying that crowdfunding was becoming an increasing trend in the property investment field around <https://assignbuster.com/property-crowd-funding-position/>

the globe and offered wide prospects of wealth maximization and capital flow. However, on the contrary, it also presents the risks of money laundering and forgery owing to the limited involvement of legal restrictions into the domain. It was perhaps owing to the young nature of this process that legal inclusions have been negligible in this context. Suggestively thus, responsibility gets shared between initiators as well as the investors to ensure that the actual need of the process is sufficed benefiting both the parties rather than making one to suffer.

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