A River Runs Through It: The JOBS Act’s Course Through Crowdfunding, Towards Stable Returns on Investment in Real Estate

Devin Finlayson

Follow this and additional works at: https://digitalcommons.pepperdine.edu/naalj

Part of the Administrative Law Commons, and the Property Law and Real Estate Commons

Recommended Citation
Available at: https://digitalcommons.pepperdine.edu/naalj/vol37/iss2/7

This Comment is brought to you for free and open access by the School of Law at Pepperdine Digital Commons. It has been accepted for inclusion in Journal of the National Association of Administrative Law Judiciary by an authorized editor of Pepperdine Digital Commons. For more information, please contact josias.bartram@pepperdine.edu, anna.speth@pepperdine.edu.
A River Runs Through It: The JOBS Act’s Course Through Crowdfunding, Towards Stable Returns on Investment in Real Estate

By Devin Finlayson

I. INTRODUCTION ................................................................. 816
II. HISTORY ............................................................................ 818
   A. Early Forms of Crowdfunding ...................................... 818
   B. Modern Crowdfunding Sites ...................................... 822
   C. Crowdfunding vs. Equity Investing ............................. 824
III. THE JOBS ACT ................................................................. 825
   A. Title III of the JOBS Act ............................................ 828
      1. Fundamental Layout of Title III ............................... 828
      2. Pros and Cons of Title III ........................................ 831
   B. Title IV of the JOBS Act ............................................ 832
      1. Tier I Offerings ..................................................... 835
      2. Tier II Offerings ................................................... 835
      3. Differences Between Tier I and Tier II Offerings ....... 836
      4. Pros and Cons of Title IV ....................................... 838
IV. DIFFERENCES BETWEEN TITLE III AND IV ...................... 840
V. REAL ESTATE CROWDFUNDING ........................................... 845
VI. PREDICTION ................................................................. 848
   A. How Real Estate Crowdfunding Affects the Real Estate Market ............................................. 848
   B. Potential Problems .................................................... 852
   C. Further Amendments that Should be Made ................. 854
      1. Increase Funding Cap on Title III ......................... 855
      2. Allow “Testing the Waters” for Title III Crowdfunding .......................................................... 855
      3. Loosen Title IV, Tier I Blue Sky Regulations .......... 856
VII. CONCLUSION ................................................................. 856
I. INTRODUCTION

Crowdfunding has become a simple and effective way for small startups to obtain funding, raise awareness, and gauge future interest in their products. It is thought of by most as a modern invention; however, crowdfunding has a long history that dates back to the early 18th century. While traditional crowdfunding may be older than we realize, real estate crowdfunding is still in its infancy.

Until recently, securities law prevented the average person from making capital investments in companies for an equity stake.¹ This restricted crowdfunding by only allowing these companies to offer “rewards” in exchange for monetary contributions to their causes.² This, and other restrictions, which further regulated the ways in which companies could raise capital through crowdfunding, meant that crowdfunding was not a viable option for large scale investing, especially in real estate.³ Recent changes in crowdfunding and investing regulations, however, have opened the door to the real estate market by allowing significantly larger amounts of capital to be raised via crowdfunding websites from non-accredited investors.⁴


Nonetheless, although changes in securities regulations have made crowdfunding a viable option for real estate developers and Real Estate Investment Trusts (REITs) to source capital, will they be enough to make it an attractive option?

This Article examines the recent changes in regulations under the Jumpstart Our Business Startups (JOBS) Act as they relate to the real estate market and makes predictions about what their effect will be on the real estate industry as a whole. Section II of this Article covers the history of crowdfunding dating back to the early 18th century, and includes a brief summary about crowdfunding. Section III of this Article dives into the history of the JOBS Act, its initial effect on crowdfunding, and the intricacies of Titles III and IV within it. Titles III and IV of the JOBS Act were the first major changes made to crowdfunding regulations that allowed for the entry of real estate investors into the crowdfunding world. Section IV is dedicated to comparing and contrasting Titles III and IV, and revealing more of their pros and cons. Section V examines real estate investment as a whole. Section V will cover everything from real estate investing before Title IV’s adoption, to the problems that still exist with Title IV real estate crowdfunding. Lastly, Section VI presents predictions as to how the real estate market in general will be affected by crowdfunding and whether it will become a regular tool for large-scale real estate developers going forward.


See infra Section II and accompanying notes 13–80.

See infra Section III and accompanying notes 81–190.

Id.

See infra Section IV and accompanying notes 191–223.

See infra Section V and accompanying notes 224–247.

Id.

See infra Section VI and accompanying notes 248–292.
II. HISTORY

Before talking about the history of crowdfunding, understanding crowdfunding itself is essential. Crowdfunding is defined as "the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet."\(^{13}\) Essentially, anyone who has money to invest can do so by contributing amounts as small as $10 to a particular project. This allows entrepreneurs the opportunity to raise potentially millions of dollars, because crowdfunding expands the pool of potential investors outside of "the traditional circle of owners, relatives, and venture capitalists."\(^{14}\) In the modern era, crowdfunding links investors and entrepreneurs through the use of the large networks created by social media sites.\(^{15}\)

A. Early Forms of Crowdfunding

When people hear the term crowdfunding, they may instantly think of sites such as Kickstarter, Indiegogo, or GoFundMe, where popular products such as the Pebble Smart-Watch (which earned $20 million through 80,000 contributors on Kickstarter)\(^ {16}\) or Oculus Rift (which was funded via Kickstarter and eventually bought by Facebook for $2 billion) started as just ideas or prototypes.\(^ {17}\) However, what most people fail to realize is that crowdfunding has roots that date back to as far as the 18th century.\(^ {18}\)

The earliest known form of crowdfunding is the practice known as praenumeration; common in Germany in the 1700s.\(^ {19}\)


\(^{15}\) *Id.*

\(^{16}\) *Id.*

\(^{17}\) *Oculus Rift History – How It All Started*, RIFT INFO (May 18, 2015), http://riftinfo.com/oculus-rift-history-how-it-all-started.


\(^{19}\) *Id.*
Praenumeration was essentially a subscription model used by authors to raise money for publication before their book had actually been published.\textsuperscript{20} The author would propose the planned book to potential buyers, usually offering it at a discounted price, before its publication to raise the money needed to print the book.\textsuperscript{21} This method was popular amongst magazine publishers as a way to gauge the number of future subscribers.\textsuperscript{22} Johan Heinrich Zedler employed the praenumeration method in 1728 when he announced that he would be writing a series of works about Martin Luther.\textsuperscript{23} Zedler announced the project at the Leipzig Easter Fair, stating that the first volume would be ready by the next fair the following year.\textsuperscript{24} Zedler used the payments he got from the announcement of each following volume to help pay the bills from the previous volumes.\textsuperscript{25} Like crowdfunding, praenumeration took small payments from many contributors to help fund a business venture.\textsuperscript{26}

War bonds are another historical method of crowdfunding.\textsuperscript{27} There is an extensive history of governmental bodies needing to borrow money to fund wars.\textsuperscript{28} As early as 1812, governments began issuing war bonds to help raise money to cover the cost of wars.\textsuperscript{29} Initially, these bonds did not resemble crowdfunding until about World War I (WWI), when they were offered to the public for

\textsuperscript{20} \textit{Id.}
\textsuperscript{21} \textit{Id.}
\textsuperscript{22} \textit{Id.}
\textsuperscript{23} \textit{Id.}
\textsuperscript{24} \textit{Id.}
\textsuperscript{26} Corsten, \textit{supra} note 18, at 81.
\textsuperscript{27} See generally Ernest Ludlow Bogart, \textit{DIRECT AND INDIRECT COSTS OF THE GREAT WORLD WAR} (David Kinley, 2d ed. 1919).
\textsuperscript{28} \textit{Id.}
purchase. In 1914, Austria and Hungary began financing their involvement in WWI through the sale of war bonds in amounts as low as 100 Kronen. These first bonds paid a return of about 5% over a five-year term to the purchaser of the bond. At some point, these war bonds were even offered to children. These bonds were popular because they offered a set return with little to no risk. Even though people do not necessarily purchase war bonds because of their interest in financing wars, this practice still resembles crowdfunding because it solicits the public for many small contributions to fund massive ventures.

Even the Statue of Liberty was crowdfunded. In 1885, the Statue of Liberty sat in New York “in pieces, awaiting assembly.” The only thing holding New York back from erecting this massive gift from France was the $250,000 (equivalent to about $6.4 million today) needed to construct the monumental granite base for the structure. When the task force assigned to raise the money fell short by more than a third of the requisite amount, the city of New York could not afford to pay for the remainder. Offers from other cities to pay for the base in return for the statue’s relocation did not seem viable, and it appeared as though the project was hopeless. Ultimately, the statue was saved by the fundraising campaign of

31 Bogart, supra note 27, at 239. 1 Krona was worth approximately $0.268 around 1914, which would mean that 100 Kronen would be worth approximately $26.80 in 2017. Id.; www.usinflationcalculator.com.
32 Bogart, supra note 27, at 239.
35 Id.
37 Id.
38 Id.
39 Id.
40 Id.
Joseph Pulitzer, founder of the *New York World Newspaper.*\(^{41}\) Pulitzer launched a campaign in his newspaper soliciting help from the citizens of New York.\(^{42}\) In just five months, Pulitzer raised $101,091 from over 160,000 people, “including young children, businessmen, street cleaners[,] and politicians, with more than three-quarters of the donations amounting to less than a dollar.”\(^{43}\) The amount raised was enough to cover the remaining $100,000 needed to construct the base, with little to spare.\(^{44}\) Pulitzer’s 1885 *Newspaper* campaign closely resembled a modern crowdfunding campaign in many ways,\(^{45}\) including continual updates and a running tally showing every donation to the fund.\(^{46}\)

Modern crowdfunding started to take shape in the early 1990s through the music and arts industries when U.S. fans of the British rock band Marillion desired that the band do a U.S. tour.\(^{47}\) Without any actual involvement by the band itself, U.S. fans started an internet campaign to underwrite a U.S. tour.\(^{48}\) In 1997, such fans successfully raised $60,000 and got their U.S. tour.\(^{49}\) The campaign was so successful that the band itself later used similar campaigns to crowdfund subsequent albums.\(^{50}\) Also in 1997, a similar situation occurred in the film industry. Mark Tapio Kines, a small independent writer and director, was working on a feature film titled *Foreign*

---

\(^{41}\) *Id.*

\(^{42}\) *Id.*

\(^{43}\) *Id.*

\(^{44}\) *Id.*

\(^{45}\) See generally *id.*

\(^{46}\) *Id.*


\(^{48}\) See Golemis, *supra* note 47.

\(^{49}\) *Marillion Fans to the Rescue*, *supra* note 47.

\(^{50}\) *Id.*
Correspondents.51 Without the funds to complete the film, Kines started an internet campaign in 1997.52 The campaign raised over $125,000 from as few as twenty-five investors and Kines was able to complete the film.53

B. Modern Crowdfunding Sites

Campaigns such as those led by Kines and Marillion helped pave the way for the modern crowdfunding arena—one ruled by websites like Kickstarter and Indiegogo, which make use of massive social networking sites to advertise campaigns and reach a broader spectrum of potential investors.54 The pioneer of the modern crowdfunding world was ArtistShare.55 In 2003, Brian Camileo founded ArtistShare as a way for music lovers to be more involved in the music making process.56 Camileo saw the way illegal downloading was affecting the music industry and envisioned a new way in which artists could be compensated directly by their fans.57 ArtistShare acted like a record label for artists and allowed them to raise money for recording albums that would only be offered online.58 For example, artists would post their ideas for an album on the ArtistShare website and interested fans could contribute as much or as little as they wanted in return for various “rewards,” including access to the album upon completion.59 In 2004, Maria Schneider’s

52 Id.
53 Id.
56 Id.
57 Can You Spare a Quarter, supra note 54.
58 Cole, supra note 55.
59 Id.
ArtistShare-funded album, *Concert in the Garden*, was nominated for four Grammy awards and ultimately won the Grammy for “Best Large Jazz Ensemble Album,” becoming the first album to win a Grammy without being available in retail stores. To date, ArtistShare artists have won ten Grammy awards and have twenty-nine total Grammy nominations.

Although other individuals, including music artists, had completed successful crowdfunding campaigns via the internet, ArtistShare was the first to offer a viable platform whereby any artists could launch their own crowdfunding campaigns to fund their projects. As the public began to see ArtistShare’s success in the music industry, it became evident that this type of platform could be scaled to fund campaigns for any endeavor. Accordingly, in 2008, Slava Rubin, Danae Ringelmann, and Eric Schell founded the popular crowdfunding site Indiegogo, which piggybacked off the success of ArtistShare. The idea for Indiegogo was sparked after Rubin’s father died from cancer. After and because of his father’s death, Rubin realized that “there was no efficient way to raise money for bone marrow cancer research . . . .” Accordingly, Rubin founded Indiegogo as a crowdfunding platform from which individuals could create funds for anything they were passionate about (including cancer research) and other individuals could contribute money to the funds. To date, Indiegogo has raised over $950 million from more than 650,000 projects throughout 223 countries. Indiegogo works as “a launchpad for entrepreneurial ideas,” offering individuals the opportunity to raise funds for any number of ventures in exchange for various rewards determined by

---

60 Id.
62 Id.
63 Id.
64 *Can You Spare a Quarter*, *supra* note 54.
65 Id.
66 Id.
67 Id.
the fundraiser. Most of the site's users seek to raise funds for inventions, product launches, movie productions, and other similar endeavors.

In 2009, Kickstarter, Indiegogo's biggest rival, was founded. Kickstarter, like Indiegogo, offers a platform for raising funds for a variety of different ventures, including those concerning technology, films, music, video games, stage shows, journalism, food-related projects, and almost anything else. Kickstarter has quickly become the leader in the crowdfunding space—raising money in numbers that dwarf those of Indiegogo. Kickstarter is home to some of the most renowned crowdfunding ventures, including the Pebble Smart Watch, Oculus Rift, and Soylent. Kickstarter and Indiegogo have almost identical functions, but Kickstarter has a few more restrictions than Indiegogo.

C. Crowdfunding vs. Equity Investing

Historically, crowdfunding has differed drastically from equity investing. Traditionally, to invest in a business for an equity share,

69 Id.
70 Id.
73 See Christopher M. Olenik, Crowdfunding Comparison 2017: Kickstarter vs. Indiegogo (May 16, 2017), https://medium.com/crowdfunding-marketing-news-tips-advice/crowdfunding-comparison-2017-kickstarter-vs-indiegogo-d0a9041659f5. While it is difficult to get a great comparison of the stats because Indiegogo does not release much information to the public, at the time the above-mentioned article was written the top ten grossing campaigns on Kickstarter had raised $108,866,609, while the top ten grossing campaigns on Indiegogo had raised only $43,256,927. Id.
75 See Olenik, supra note 73.
investors had to be accredited.\textsuperscript{76} This meant that the average person was prohibited from investing in business ventures unless they earned more than a certain amount of money per year or had a net worth higher than a specified value (i.e., $200,000 a year or a net worth of more than $1 million).\textsuperscript{77} Crowdfunding sites like Kickstarter circumvent these regulations by letting people “invest” in ventures, but instead of trading capital for equity, they offer “rewards” for various levels of capital donated.\textsuperscript{78} Rewards can be anything from personalized thank-you notes from the product’s creators, to the first production models of the finished product.\textsuperscript{79} While this form of crowdfunding can be highly beneficial to the business owners because it offers them a way to raise funds without relinquishing any share in the business, it gives little incentive for investors to donate anything higher than the value of the product itself.

Nonetheless, this all changed with the introduction of Title III of the JOBS Act, which opened the doors of equity investing to non-accredited investors via “funding portals.”\textsuperscript{80}

III. THE JOBS ACT

As previously noted, the JOBS Act is short for the Jumpstart Our Business Startups Act.\textsuperscript{81} The JOBS Act started as a conglomeration of bills passed by Congress in 2011 that were aimed at boosting domestic economic development.\textsuperscript{82} In March 2012, House Leader

\textsuperscript{76} Cowley, supra note 1.

\textsuperscript{77} Id. This net worth figure does not include a person’s primary residence as an asset. 17 C.F.R. § 230.501 (2017). Further, any indebtedness secured by a person’s primary residence that is greater than the fair market value of that residence is counted against their net worth. Id.

\textsuperscript{78} Miller, supra note 2.


\textsuperscript{81} Id.

Eric Cantor combined those bills with additional measures and introduced the legislation as the JOBS Act. After various revisions and debate, the final bill passed through the Senate on March 22, 2012 and the House on March 27, 2012. On April 5, 2012, President Barack Obama signed the JOBS Act into law. The JOBS Act was designed to loosen securities regulations to encourage the starting and funding of small U.S. businesses. When signed, the JOBS Act was comprised of six proposed titles, each with its own purpose and regulations.

Proponents of crowdfunding were immediately excited by the JOBS Act because it promised to make the world of early-stage investing accessible to the general public. The most important titles of the Act regarding crowdfunding, are Titles III and IV. Title III was proposed in 2013, and was aimed specifically at allowing non-accredited investors to participate in equity crowdfunding. Title IV was proposed shortly thereafter, and was focused on allowing small companies in their growth stages to raise capital from any type of investor (accredited or non-accredited) without needing to officially go public. Both proposed titles had potentially massive implications for the crowdfunding world. If enacted as proposed, the two titles


85 JOBS Act, supra note 80.


87 Id.


90 Segarra, supra note 4. Going public is another term for holding a public offering, or an IPO. See infra note 136.

91 See Barnett, Democratizes, supra note 4.
would essentially have allowed any American citizen to contribute funds to a startup company in exchange for equity—something that was previously impossible.\textsuperscript{92} However, by the end of 2015, when the finished rules of both titles had finally been adopted, it became clear that the effects were not going to be as monumental as anticipated.\textsuperscript{93} While the final rules of both titles were major steps in the right direction and granted access to non-accredited investors, each was just slightly too restrictive to be a viable fundraising option for most startups.\textsuperscript{94}

One of the most hopeful industries that was disappointed by the final adoption of Titles III and IV was the real estate industry.\textsuperscript{95} Real estate crowdfunding was popularized in 2013 after the passage of Title II (Regulation D), which allowed companies to finally solicit their equity offerings to accredited investors after an eighty-year ban.\textsuperscript{96} Afterwards, real estate crowdfunding sites like Fundrise and Realty Mogul popped up, offering private investors the opportunity to invest in individual real estate projects by contributing as little as $1,000 dollars.\textsuperscript{97} These sites desperately anticipated the passing of Titles III and IV.\textsuperscript{98} They hoped the Titles would open up such investment opportunities to the general public and give developers access to a much larger pool of potential capital.\textsuperscript{99} The final adoption

\begin{itemize}
  \item \textsuperscript{92} Id.
  \item \textsuperscript{93} Id.
  \item \textsuperscript{95} Id.; see also JD Alois, \textit{OneVest Co-Founder Criticizes Title III Equity Crowdfunding in Open Letter}, CROWDFUND INSIDER, (May 4, 2016), https://www.crowdfundinsider.com/2016/05/85165-onevest-co-founder-criticizes-title-iii-equity-crowdfunding-in-open-letter/ [hereinafter Alois, \textit{OneVest}].
  \item \textsuperscript{97} Nav Athwal, \textit{How Crowdfunding Has Changed Real Estate Investing}, FORBES (Dec. 2, 2015), http://www.forbes.com/sites/navathwal/2015/12/02/how-crowdfunding-has-changed-real-estate-investing/#6308e2a18d8e [hereinafter Athwal, \textit{Changed}].
  \item \textsuperscript{98} Id.
  \item \textsuperscript{99} Id.
\end{itemize}
of the rules, however, did not afford the level of access that many hoped for.

A. Title III of the JOBS Act

Title III of the JOBS Act was the first regulation that proposed to open the doors of equity investing to the average person.\textsuperscript{100} As noted previously, before the enactment of the JOBS Act, only accredited investors were allowed to receive equity in exchange for capital.\textsuperscript{101} Title III was proposed in October 2013\textsuperscript{102} and focused specifically on crowdfunding.\textsuperscript{103} The title’s promise was to allow small companies to raise up to a particular amount of money each year from non-accredited investors if done through “funding portals,” otherwise known as crowdfunding sites, along with various other criteria.\textsuperscript{104} At the end of 2015, Title III’s final rules were adopted and went into effect on May 16, 2016.\textsuperscript{105} The idea of Title III left crowdfunding sites and startups drooling over the potentially huge new source of funding, but many have been critical of the Securities and Exchange Commission’s (SEC) final execution of the title.\textsuperscript{106}

1. Fundamental Layout of Title III

Officially, Title III adds Section 4(a)(6) to the Securities Act of 1933.\textsuperscript{107} Section 4(a)(6) relieves many American citizens of the investor accreditation requirements for crowdfunding transactions set

---

\textsuperscript{100} Id.

\textsuperscript{101} See Cowley, supra note 1.

\textsuperscript{102} Segarra, supra note 4.

\textsuperscript{103} Id.

\textsuperscript{104} Id.


\textsuperscript{106} Hobey, supra note 3; see also Alois, OneVest, supra note 95.

out previously in §5.\textsuperscript{108} What this means is that anyone can purchase securities from a company, but not without first meeting the title’s requirements. Title III requirements can be broken down into two types: (1) requirements for investors; and (2) requirements for fundraisers.\textsuperscript{109}

As for the fundraisers themselves, there are a number of complex and intricate rules that must be followed in order to raise capital through crowdfunding;\textsuperscript{110} however, the basic rules for fundraisers are outlined as follows. First, the company must be a U.S. company, and all investments must be made online through a “crowdfunding portal” (i.e., a crowdfunding website).\textsuperscript{111} Second, the amount raised by the issuer\textsuperscript{112} of the equity, as measured on a rolling twelve-month period, cannot be greater than $1 million.\textsuperscript{113} In other words, companies cannot use crowdfunding to raise more than $1 million in any given year. Third, before starting the campaign, companies must file a Form C and submit financial statements.\textsuperscript{114} Those financial statements have to be audited, reviewed by a public accountant, or revised by the company’s CFO.\textsuperscript{115} The requisite review of financial statements depends on how much the company is looking to raise.\textsuperscript{116}

\textsuperscript{108} See Alois, OneVest, supra note 95. Section 5 sets forth the accreditation requirements that investors must make over $200,000 a year and have a net worth of more than $1 million. The Securities Act of 1933 § 5, 15 U.S.C. § 77c(d) (2012).
\textsuperscript{109} Crowdfunding, supra note 105.
\textsuperscript{110} Id.
\textsuperscript{111} Id. The SEC doesn’t provide much information as to exactly what a U.S., company means (i.e. domiciled in the U.S., founded in the U.S., principle place of business in the U.S.). It simply states that certain companies are not eligible for Title III crowdfunding, and among those it lists “non-U.S.” companies. Id.
\textsuperscript{112} The “issuer” of equity is the company looking to sell its shares. See id. In other words, it is the company looking to run the crowdfunding campaign in this context. Id.
\textsuperscript{113} Id.
\textsuperscript{114} Id.
\textsuperscript{115} Id.
\textsuperscript{116} Id. For example, companies offering $107,000 or less must have the company’s financial statements and certain tax information certified by the principal executive officer. Id. Companies offering more than $107,000, but no more than $535,000 must provide financial statements reviewed by an independent public accountant. Id. Finally, companies offering more than $535,000 are broken up into two groups. Id. Those that are raising funds through crowdfunding for the first time must provide financial statements reviewed by an independent public
Fourth, and possibly one of the biggest requirements, companies raising crowdfunded capital are subject to strict solicitation rules.\textsuperscript{117} Essentially, no solicitation of the company’s offering may occur before filing Form C.\textsuperscript{118} Even after advertisement, the offer is severely limited.\textsuperscript{119} Fifth, the issuers of securities and crowdfunding sites must disclose particular information about the offer to potential investors.\textsuperscript{120} Lastly, companies that run successful crowdfunding campaigns are required to report financial information annually.\textsuperscript{121}

In contrast, investors must abide by significantly less strict regulations. First, individual investments from non-accredited investors in all issuers during a rolling twelve-month period are limited to the following restrictions\textsuperscript{122}: (1) If the net worth or annual income of the investor is less than $100,000, the investor is limited to a maximum investment of either $2,000 or 5% of the lesser of the investor’s annual income or net worth, whichever total is larger;\textsuperscript{123} (2) If the net worth or annual income of the investor is $100,000 or more, the investor is limited to a maximum investment of 10% of the investor’s annual income or net worth, whichever is greater.\textsuperscript{124} Furthermore, the aggregate amount of securities sold to a single investor through all crowdfunding offerings cannot exceed $100,000.\textsuperscript{125}

\textsuperscript{117} Id.
\textsuperscript{118} Id. The term “solicitation” is simply a fancy way to say “advertising,” and “offering” refers to the company’s offering of their stock in exchange for money. Id. In other words, a company cannot advertise that they will be making an offering of stocks through crowdfunding until they have filed Form C. Id.
\textsuperscript{119} Id.
\textsuperscript{120} Id.
\textsuperscript{121} Id.
\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{124} Id.
\textsuperscript{125} Id.
2. Pros and Cons of Title III

Despite receiving significant criticism, Title III represents a great progress over the antiquated securities regulations prohibiting unqualified investors from exchanging money for equity when they so desired.\(^\text{126}\) The most obvious advantage of Title III is the instant accessibility to everyday Americans to small scale venture capitalism. With the economy regaining its color, a massive surge of small businesses and technology startups has emerged, creating a uniquely entrepreneurial spirit within our nation. Such is demonstrated by the rapid popularization of television shows like Shark Tank and The Profit.\(^\text{127}\) It is evident that a huge number of Americans want to be a part of this buzzing culture and claim their stake in the American Dream;\(^\text{128}\) however, due mostly to financial conditions, this was essentially impossible before the adoption of Title III.\(^\text{129}\)

Many criticize the move towards more liberal securities regulations because they fear that those below the line of financial conditions necessary to be an accredited investor will make uninformed investment decisions, ultimately resulting in the adoption of stricter regulations.\(^\text{130}\) It is obvious, however, that the drafters of


\(^{128}\) Id.


Title III had this in mind when shaping the regulation.\textsuperscript{131} By allowing anyone to invest, but setting funding limits based on income\textsuperscript{132}, Title III is still able to protect the unwise from their own ignorance and make sure that they do not squander a large portion of their income on a potentially risky investment.\textsuperscript{133} Furthermore, Title III’s stringent disclosure requirements help the uneducated investor to avoid making a regretful decision.\textsuperscript{134}

\textbf{B. Title IV of the JOBS Act}

Title III was a major push in the right direction for non-accredited equity investing from Title II. However, when the SEC released the final rules for Title III, most were disappointed by the $1 million limit on non-accredited funds.\textsuperscript{135} As stated previously, the $1

\url{https://corpgov.law.harvard.edu/2012/03/26/the-jobs-act-an-investor-protection-disaster-waiting-to-happen/}.

\textsuperscript{131} See Amy Wan, \textit{Title III Crowdfunding Became Legal on May 16: What It Does & What’s Still Lacking,} CROWDFUND INSIDER (May 17, 2016), https://www.crowdfundinsider.com/2016/05/85696-title-iii-crowdfunding-became-legal-on-may-16-what-it-does-whats-still-lacking/. Wan notes that the SEC may have added too much protection for small investors stating that “the SEC’s zealous concerns over small investor protection resulted in unrealistically high regulatory burdens that would disincentivize any company from using the regulation, except as a last resort.” \textit{Id. See also} David Price, \textit{SEC’s NEW JOBS ACT TITLE III CROWDFUNDING RULES: OVERVIEW AND FIRST THOUGHTS, CROWD EXPERT} (2015), \url{http://crowdexpert.com/articles/new_jobs_act_titleiii_rules_overview_first_thoughts/}. Price believes that “[t]he final rules are also very protective of investors, setting investment caps on the LESSER of income and net worth thresholds, when the initial proposal was based on the greater.” \textit{Id.}

\textsuperscript{132} See Crowdfunding, supra note 105.

\textsuperscript{133} See supra note 131.

\textsuperscript{134} See Crowdfunding, supra note 105. Specifically note section 3(b) outlining the offering statement disclosure requirements. \textit{See also} Alicia Robb, \textit{The Potential and Perils of Title III Crowdfunding,} FORBES (Sept. 20, 2016), https://www.forbes.com/sites/kauffman/2016/09/20/the-potential-and-perils-of-title-iii-crowdfunding/#a872fa316082. Robb notes other attempts to protect unaccredited investors inherent in Title III stating that “[t]he SEC assumes non-accredited investors are unsophisticated investors, and has tasked the crowdfunding portals with educating these investors prior to accepting investments on their platforms.” \textit{Id.}

\textsuperscript{135} See Chance Barnett, \textit{Why Title III of the JOBS Act Will Disappoint Entrepreneurs,} FORBES (May 13, 2016),
million limit made larger startups and pre-IPO corporations feel like crowdfunding still was not worth it.\textsuperscript{136} Many of these concerns were addressed with the passage of Title IV, which finally brings a workable set of regulations that address some of the concerns raised with Title III. Most notably, Title IV addresses the frustratingly low funding limit under Title III, which some feel will allow the general public to enter the world of equity investing.\textsuperscript{137} However, Title IV is also not without its own criticisms.

Title IV is commonly referred to as “Regulation A+.”\textsuperscript{138} It was adopted and took effect in June 2015,\textsuperscript{139} with slight modifications made in October 2015.\textsuperscript{140} Like Title III, Title IV has a slew of requirements of which, unfortunately, cannot be as easily categorized as Title III.\textsuperscript{141} Title IV replaces the single offering limit approach used in Title III\textsuperscript{142} and introduces two offering tiers: (1) Tier 1; and (2) Tier 2.\textsuperscript{143} These two tiers each allow for different amounts of capital to be raised depending on the tier chosen by a company and have their own distinct requirements.\textsuperscript{144}


\textsuperscript{136} IPO stands for Initial Public Offering (IPO). An IPO is when corporations offer equity in their company, in the form of stock, to the general public for the first time. Stock in these companies before an IPO or “pre-IPO” is essentially restricted to the founders and accredited investors that make early investments. Corporations use IPOs as a way to raise capital in order to further finance the business. See Adam Hayes, IPO Basics: What is an IPO?, INVESTOPEDIA, https://www.investopedia.com/university/ipo/ipo.asp (last visited Nov. 9, 2017).

\textsuperscript{137} See Barnett, Democratizes, supra note 4.

\textsuperscript{138} Id.


\textsuperscript{141} See generally Regulation A, supra note 139.

\textsuperscript{142} See generally supra Section III and accompanying notes 81–190.

\textsuperscript{143} See Regulation A, supra note 139.

\textsuperscript{144} Id.
However, both tiers are subject to a few basic shared rules. First, to be eligible for Title IV funding, the company must be a U.S. or Canada based company.\textsuperscript{145} However, it is important to note that not all U.S. or Canada based companies are eligible for Title IV fundraising; there are other limitations as well.\textsuperscript{146} For example even U.S. and Canada based companies cannot already be subject to the SEC’s reporting requirements, cannot be investment companies,\textsuperscript{147} cannot be planning to engage in a merger or acquisition, must have a specific business plan or purpose, must not be a public company,\textsuperscript{148} and cannot own stock in other companies.\textsuperscript{149} Also, before being able to raise any funds, all companies looking to make a Title IV offering must register with and be approved by the SEC. Further, not all securities are eligible for trade under Regulation A+.\textsuperscript{151} For example, Title IV allows for the trade of debt securities, but not asset backed securities. Title IV prohibits the sale of asset-backed securities\textsuperscript{153} or the issuance of any fractional undivided interests in oil, gas, or mineral rights.\textsuperscript{154} Additional requirements will depend on which tier companies choose.

\textsuperscript{145} Id. Unlike title III which does not define what it means to be a U.S. based company, Title IV clarifies that eligible companies must have their principle place of business in the U.S. or Canada. Id.

\textsuperscript{146} Id.

\textsuperscript{147} Investment companies are generally ones “that primarily invest or trade in securities and/or offer their own securities to the public,” like hedge funds. See Investment Company Act of 1940, INVESTOPIA, https://www.investopedia.com/terms/i/investmentcompanyact.asp (last visited Nov. 9, 2017).

\textsuperscript{148} A public company is one that has offered stock to the public through an IPO. See Public Company, INVESTOPIA, https://www.investopedia.com/terms/p/publiccompany.asp (last visited Nov. 9, 2017); see also Hayes, supra note 130 (defining what IPO means).

\textsuperscript{149} See Regulation A, supra note 139.

\textsuperscript{150} Id.

\textsuperscript{151} Id.

\textsuperscript{152} Id.

\textsuperscript{153} Id.

\textsuperscript{154} Id.
1. Tier I Offerings

Companies that choose Tier 1 are allowed to raise up to $20 million within a rolling twelve-month period. These funds can be raised from anyone, including non-accredited investors, with no limits on the amounts non-accredited investors are allowed to invest. Further, companies making a Tier 1 offering are required to disclose financial statement information that has been reviewed by an accountant. A Tier 1 offering does not have any audit or SEC reporting requirements, however, all Tier 1 offerings are still subject to the respective state laws in the states where the trades take place.

2. Tier II Offerings

In Tier 2 offerings, up to $50 million is allowed to be raised within a twelve-month period. Again, these funds can be raised from both accredited and non-accredited investors, however, there are limits on the amounts non-accredited investors can invest in a Tier 2 offering. Specifically, non-accredited investors are limited to investing either 10% of their net worth or 10% of their annual income per offering, whichever is greater. Moreover, Tier 2 offerings require the companies making the offering to disclose lengthy audited financial statement information to investors and require ongoing in-depth reporting to the SEC after a successful offering has been completed. However, Blue Sky laws, which will be covered in detail in the next section, are preempted, meaning that companies do not have to comply with individual state laws under Tier 2.

---

155 Id.
156 Id.
157 Id.
158 Id.
159 Id.
160 Id.
161 Id.
162 Id.
163 Id.
164 Id.
3. Differences Between Tier I and Tier II Offerings

If not immediately obvious, there are major differences between a Tier 1 and a Tier 2 offering, with the most apparent being the $30 million difference in the funding caps.\(^{165}\) It is important to note, however, that companies seeking to make a Title IV offering do not necessarily have to choose their tier based solely on the amount they want to raise.\(^{166}\) For example, a company that wishes to raise only $10 million does not have to choose Tier 1 just because it has a lower funding cap.\(^{167}\) A company seeking to raise even just $2 million could choose Tier 1 or Tier 2 depending on which most suitably fits the company’s business plans.\(^{168}\)

Besides the funding cap, there is also a difference in the individual investment limits.\(^{169}\) While both Tiers allow investments from non-accredited investors, Tier 1 is unlike Tier 2 in that it does not limit how much those non-accredited investors can invest.\(^{170}\) This might be a major incentive for companies to choose Tier 1 over Tier 2 because companies might be able to generate a larger “crowd” to fund from if non-accredited investors know they are not limited in their investments.\(^ {171} \)

The next difference between Tier 1 and Tier 2 offerings is the disclosure and reporting requirements. As previously stated, Tier 1 only requires disclosure of financial information that has been reviewed by an accountant, whereas Tier 2 requires disclosure of much more in-depth financial information which must have been

\(^{165}\) Id.

\(^{166}\) See generally id.

\(^{167}\) Id.


\(^{170}\) Regulation A, supra note 139.

audited. Further, Tier 1 does not require any further or ongoing reporting to the SEC after the funding campaign has completed. On the other hand, Tier 2 requires both annual and semi-annual reporting and reports whenever major changes occur within the company. These disclosure and reporting requirements might be further incentive to choose Tier 1 over Tier 2 because the necessary auditing requirements and continued reporting can be expensive, invasive, and very time consuming for a company.

The last major difference, and arguably the most impactful one, is the difference in state law requirements. As noted previously, Tier 2 implements Blue Sky law preemption. Blue Sky laws are the individual state laws that regulate securities exchanges. This is extremely important because without Blue Sky law preemption, a company making a securities offer would have to make sure that it complies with a state’s securities laws in every state where it exchanges. Given that the SEC adopted crowdfunding as a fundraising method under Title IV, and crowdfunding takes place over the internet (i.e., from any state), any company that wishes to use crowdfunding under Tier 1 would need to ensure compliance in all fifty states. This will likely be one of the largest contributing factors to companies trying to decide between the two offering tiers because having to ensure compliance in every state will be a material financial burden.

---

172 Regulation A, supra note 139.
173 Id.
174 Id.
176 Regulation A, supra note 139.
178 Id.
179 See Regulation A, supra note 139.
In the end, companies will have to weigh the pros and cons of each tier to make their decisions. While state law preemption under Tier 2 is enticing, a company will have to decide whether the benefits are worth the added disclosure and reporting requirements, or whether potential investors will be deterred by the non-accredited investment limit. The following table demonstrates the differences between the two tiers:

<table>
<thead>
<tr>
<th>Reg A – Tier 1</th>
<th>Reg A – Tier 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maximum Offering</strong></td>
<td>$20,000,000</td>
</tr>
<tr>
<td><strong>Investor Types</strong></td>
<td>All, including non-accredited investors</td>
</tr>
<tr>
<td><strong>Individual Investment Limits</strong></td>
<td>None</td>
</tr>
<tr>
<td><strong>General Solicitation</strong></td>
<td>Unrestricted</td>
</tr>
<tr>
<td><strong>Offering Documents</strong></td>
<td>SEC Review and State Review</td>
</tr>
<tr>
<td><strong>State Pre-emption</strong></td>
<td>No, Coordinated State Review</td>
</tr>
<tr>
<td><strong>Financial Disclosures</strong></td>
<td>Reviewed Financials (certain states might require audits)</td>
</tr>
<tr>
<td><strong>Ongoing Disclosures</strong></td>
<td>No Ongoing Public Financial Reporting</td>
</tr>
<tr>
<td><strong>Ability to Terminate Ongoing Reporting Requirements</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Transfer Restrictions</strong></td>
<td>None</td>
</tr>
</tbody>
</table>

4. Pros and Cons of Title III

The two-tiered make up of Title IV makes it difficult to analyze its pros and cons because each tier has its own set of pros and cons. The most clear benefit of Title IV in general is its large funding cap. Allowing companies to raise up to $50 million dollars through crowdfunding opens up many doors to startups. As noted in Section II above regarding the history of crowdfunding, it was not unheard of for an exceptional crowdfunding campaign to raise tens of million dollars from sites like Kickstarter, which do not offer “investors” any

---

equity in the company. It is not farfetched to imagine that allowing these companies to offer ownership in the company instead of “rewards” would bring an even larger pool of investors, potentially increasing crowdfunding campaigns way beyond their current averages.

It is not uncommon to hear a Title IV offering being referred to as a “mini-IPO.” This nickname was given because Title IV essentially gives smaller startups the ability to make a public offering without all of the stringent requirements that arise when going public. This is another pro of Title IV: Title IV allows smaller companies the opportunity to raise capital just as they might with a public offering and without all the hoops they would otherwise have to jump through.

This point coincides with one of the cons of Title IV. Companies using a Title IV offering solely as a “mini-IPO” will have to face the fact that while their stock can be sold, it has very limited liquidity. Therefore, there is no market for such securities to be resold or traded like stocks of a publicly traded company. This can be bad because potential investors often value liquidity, as the more liquid an investment or security is, the easier it is to make a quick exit when the company’s value suddenly drops. Arguably, this should not be a problem for long-term, experienced investors; however, much of

---

183 Mini-IPO, supra note 181.
184 Id.
185 Id.
186 Id.
189 Id. High liquidity is sought after for the ability to make a quick exit; however, a lot of long term experienced investors are not interested in quickly dumping their assets or securities and are more comfortable purchasing assets or securities with low liquidity for that reason. See generally id.
the appeal of a Title IV offering is drawing from an investor pool that has been increased because of the introduction of non-accredited investors. In other words, many of the new investors welcomed by Title IV will be inexperienced and will be investing smaller amounts. These tend to be the groups that value liquidity most and may affect how willing they are to take risks in smaller companies.190

IV. DIFFERENCES BETWEEN TITLE III AND IV

Because Titles III and IV both allow investments by non-accredited investors and allow the use of crowdfunding sites to fundraise, it is easy to make the assumption that they address the same issue but differ only in their funding caps. One could easily presume that if a company is unable to make use of Title III, because it wishes to raise more than $1 million via crowdfunding, that it can simply take advantage of Title IV and raise up to $50 million. However, these assumptions could not be further from the truth. Title III and Title IV differ completely in their applications and types of companies that make use of them.

The first major difference between Titles III and IV are the types of companies that each is geared towards.191 Title III, which is aimed specifically at crowdfunding, for example, was drafted around the small startup looking for initial seed funding.192 Startups in the seed funding stage are typically companies that are in the prototype phase, meaning usually that they are trying to fund production of the first models of their product.193 Title IV, however, is geared towards growth startups.194 These are startups that are usually past the seed

---

190 Id.

191 Compare Crowdfunding, supra note 105 (laying out the rules of Title III offerings), with Regulation A, supra note 139 (laying out the rules of a Title IV offering).


194 See Mini-IPO, supra note 181.
funding stage and are into the post-production stage whereby they generally have a product on the market, but are looking for funds to scale growth rapidly.\textsuperscript{195}

The second major difference between Titles III and IV are each’s various approval and reporting requirements.\textsuperscript{196} Title III does not require any kind of pre-approval or clearance from the SEC before funds may be raised.\textsuperscript{197} Yet, it does require filing of a Form \textquotedblright and disclosure of corporate information, including financial statements, to investors.\textsuperscript{198} Furthermore, Title III requires ongoing annual reporting.\textsuperscript{199} Title IV, on the other hand, requires pre-clearance by the SEC.\textsuperscript{200} Companies wishing to raise funds under Title IV have to file an extensive offering statement with the SEC and “are only permitted to begin selling securities . . . once the offering statement has been qualified by the Commission.”\textsuperscript{201} Moreover, Title IV only requires ongoing reporting for companies that choose to offer under Tier 2.\textsuperscript{202} Reporting under a Tier 2 offering, however, is much more demanding than Title III’s annual reporting in that a Tier 2 offering requires annual, semi-annual, and current (when there are major changes) reporting.\textsuperscript{203}

The third major difference between Titles III and IV are each’s solicitation regulations. Title II disposed of an eighty-year-old solicitation rule that prohibited early stage private companies from publicly advertising offerings to potential investors.\textsuperscript{204} After its passage, title II opened the door for these companies to “raise investment funding publicly- using sites like Facebook or Twitter to

\textsuperscript{196} See supra note 191.
\textsuperscript{197} Crowdfunding, supra note 105.
\textsuperscript{198} Id.
\textsuperscript{199} Id.
\textsuperscript{200} Regulation A, supra note 139.
\textsuperscript{201} Id.
\textsuperscript{202} Id.
\textsuperscript{203} Id.
\textsuperscript{204} See SEC Votes to Lift 80 Year Old Ban on General Solicitation, SEEDINVEST (July 10, 2013), https://www.seedinvest.com/blog/jobs-act/sec-votes-to-lift-80-year-old-ban-on-general.
help spread the word."  However, Title II does not apply to Titles III and IV in the same way. Title IV allows companies to "test the waters," meaning they can advertise their equity offers to potential investors to gauge the market before going through the hassle of filing an offering statement with and receiving approval from the SEC. Title III, however, does not afford this luxury to offerors. No solicitation can occur before filing Form C and even after doing so, solicitation is limited. Such solicitation is limited in that Title III issuers may only advertise their offers in the form of a notice that directs investors to the crowdfunding site and gives very limited details about the terms of the offer. However, issuers can advertise as they please and communicate with potential investors about the offer on the crowdfunding site itself.

The last major difference between Title III and Title IV, which encompasses most of the other differences discussed previously, is the difference in costs. While it should be noted that issuing under both titles is very expensive, generally, Title IV offers are considerably more expensive than Title III offers. Notwithstanding, Title III crowdfunding has various expenses, the largest of which is typically the crowdfunding portal success fee. Successful crowdfunding campaigns are usually charged a fee – from the crowdfunding portal used to raise the funds – of 7%-10% of the

207 See Stephenson, supra note 177.
208 Crowdfund, supra note 105.
209 Id.
210 Id.
211 Id.
212 See supra note 191; see also CHART, supra note 206.
213 Id.
214 See Barnett, Disappoint, supra note 135.
total amount raised. To put this into perspective, a company that raises $1 million would be charged a fee ranging from $70,000 to $100,000 alone. On top of this are the various compliance costs which will vary depending on the amount raised. For example, companies raising between $100,000 and $500,000 are required to have their finances reviewed by public accountants (which could cost between $1,500 and $18,000), whereas companies raising $500,000 to $1 million must undergo a full audit which can cost anywhere between $2,500 to $30,000. This means that a successful Title III crowdfunding campaign could cost as little as $7,000 to $20,000, but could easily cost as much as $70,000 to $100,000 for companies looking to raise up to the $1 million limit. The following chart demonstrates the differences in costs described.

<table>
<thead>
<tr>
<th>Offerings of $100,000 or less</th>
<th>Offerings of more than $100,000, but not more than $500,000</th>
<th>Offerings of more than $500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fees paid to the intermediary</td>
<td>$2,500 – $7,500</td>
<td>$37,500 – $56,250</td>
</tr>
<tr>
<td>Costs per issuer for preparation and filing of Form C for each offering and related compliance costs</td>
<td>$2,500</td>
<td>$5,000 – $20,000</td>
</tr>
<tr>
<td>Costs per issuer for preparation and filing of annual report on Form C-AR and related compliance costs</td>
<td>$1,667</td>
<td>$3,333 – $13,333</td>
</tr>
<tr>
<td>Costs per issuer for review or audit of financial statements</td>
<td>Not required</td>
<td>$2,500 – $30,000 (for first-time issuers raising more than $500,000 but not more than $1,000,000)</td>
</tr>
</tbody>
</table>

---

215 Id.
216 Id.
217 Id.
219 Barnett, Disappoint, supra note 135.
220 Final Rules, supra note 218.
Title IV Regulation A+ fundraising generally is even more costly than Title III due to the cumbersome federal qualification requirements, potential state requirements, and ongoing reporting associated with Tier 2. Therefore, because of the additional reporting required under Tier 2, those offers are generally going to be the most expensive. Tier 1 offers will range in costs from about $25,000.00 to $75,000.00, whereas Tier 2 offers will range from about $75,000 to $150,000.00, plus an additional $60,000.00 or so in costs for ongoing reporting. I have created the following chart to better demonstrate the cost differences between both tiers:

<table>
<thead>
<tr>
<th></th>
<th>Tier 1</th>
<th>Tier 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Costs</td>
<td>$25,000-$75,000</td>
<td>$75,000-$150,000</td>
</tr>
<tr>
<td>Additional Costs</td>
<td>$0</td>
<td>~$60,000</td>
</tr>
</tbody>
</table>

(estimated cost of ongoing reporting)

All of these differences are taken into consideration by companies hoping to raise capital and tap into the non-accredited investor pool. For example, a company may wish to raise funds via crowdfunding and concurrently have a goal of raising more than $1 million in capital. In this scenario, Title III funding may not be a good option for them because of the $1 million funding limit. In another example, a company may not want to raise more than $1 million, but like the idea of being able to test the waters before committing considerable amounts of time and money to an extended registration statement process. Another possibility is that a company is in its post-production stage and looking to scale rapidly by raising more than $1 million, but worried about whether the large cost of a Title IV offer is worth the risk of not meeting its funding goal. These are all considerations and problems that a startup looking to involve non-accredited investors may face when deciding which type of fundraising it should offer.

---

221 See Bevilacqua, supra note 175; see also Disappoint, supra note 186.

222 See Bevilacqua, supra note 175.

223 Id.
V. REAL ESTATE CROWD FUNDING

The JOBS Act is not limited one specific type of crowdfunding, but real estate crowdfunding easily became one of the most viable forms of investing under the JOBS Act because it brought a new level of accessibility to a notoriously closed-off area of investing.224 Also, real estate investments (particularly commercial real estate investments225) tend to be more stable and can yield higher percentages of returns than investing in something like the stock market.226 These considerations make real estate crowdfunding attractive to non-accredited individuals looking to start investing their money.227 Further, the eligibility restrictions placed on Titles III and IV that will keep many major companies away from crowdfunding (i.e., foreign corporations, investment companies, companies owning stock in other companies) will not affect real estate crowdfunding greatly.228 The proposal of Titles III and IV gave many in the real estate industry hope that this untapped pool of investment-hungry individuals would bring new money into the market to fund more


225 Commercial real estate investments usually involve investments in large buildings used for office or retail space, or rental residences with many units. Residential real estate investments usually involve family residences or multi-family residences with only a few units. Commercial real estate investments are generally more long term and focus on properties that generate recurring income (usually rent from commercial tenants) rather than residential investments which usually focus more on quick profits generated from flipping the home. See Athwal, Permanently, supra note 224; Matt Larson, Pros and Cons of Investing in Commercial Real Estate, NOLo, https://www.nolo.com/legal-encyclopedia/pros-cons-investing-commercial-real-estate.html (last visited Nov. 9, 2017); Tony Guerra, Commercial Vs. Residential Real Estate Investing, SFGATE, http://homeguides.sfgate.com/commercial-vs-residential-real-estate-investing-59968.html (last visited Nov. 9, 2017).

226 Athwal, Permanently, supra note 224.

227 See generally id.

228 See generally Crowdfunding, supra note 105; Regulation A, supra note 139.
projects. Still, even with the passage of Titles III and IV, non-accredited investors are still not able to fully take part in real estate crowdfunding to the extent desired.

Real estate crowdfunding provides three types of investment opportunities: (1) equity investments; (2) debt investments; and (3) REITs. Equity investments are generally private investments in return for equity in an individual piece of real estate or development. Debt investments are generally investments in loans, which tend to be less risky, but yield lower returns. Both types of investments have unique benefits. Gene Barash, Vice President of Business Development for real estate crowdfunding site RealtyMogul, stated that:

[E]quity investments in real estate offers investors the potential for strong cash flow from rents and appreciation if the property increases in value. Debt investments in real estate offer investors the opportunity to realize regular cash flow from loan payments and down-side protection from the secured nature of debt investments.

Finally, real estate crowdfunding offers investments in REITs which are pools of money held in trusts which are then used to purchase a diverse real estate portfolio, including equity and debt purchases. Typically, even today, non-accredited investors do not have access to equity and debt investments through crowdfunding sites. Even though Title III makes using crowdfunding to raise capital for real estate debt and equity investments possible for non-accredited

---

229 See Athwal, Permanently, supra note 224.
230 Id.
233 Id.
234 Email Interview with Gene Barash, Vice President of Business Development, Realty Mogul (Feb. 4, 2016).
235 Id.
236 See Frequently Asked Questions, supra note 231.
investors, its $1 million funding cap makes it virtually infeasible to do so.\(^{237}\) Most expected investments in properties and developments lie in the range of tens of millions of dollars.\(^{238}\) Hypothetically, real estate crowdfunding issuers could raise some of the money from accredited investors, and the remaining $1 million could be raised from non-accredited investors. However, this would likely be costly and more of a hassle than it is worth.\(^{239}\) Furthermore, Titles III and IV provide for ways to exchange money for equity in a company, not individual properties.\(^{240}\) Nonetheless, individual real estate properties and developments are not technically companies and usually these developers are not looking to give away any equity in their business.\(^{241}\) For these reasons, most real estate crowdfunding sites offer non-accredited investors the ability to invest in some sort of crowdfunded private REIT that is not publicly traded.\(^{242}\) These REITs are set up as separate limited liability corporations which allow the issuers to meet the criteria of Title IV without having to give up equity in the actual real estate company.\(^{243}\)

Although it is true that these non-accredited investors may simply invest in publicly traded or other non-traded REITs,\(^{244}\) according to Mr. Barash, crowdfunded REITs "have all the benefits of traditional public non-traded REITs, with the additional advantage of efficiencies gained through technology that result in a lower fees to clients."\(^{245}\) Mr. Barash noted that crowdfunded REITs typically enjoy fees of only about 3% compared to fees of traditional REITs, which range from 7%-15%.\(^{246}\) In his words, "[t]he benefit of lower fees means that a client has ninety-seven cents of every dollar

\(^{237}\) McBride, supra note 171.

\(^{238}\) Id.

\(^{239}\) Barnett, Disappoints, supra note 135.

\(^{240}\) See Frequently Asked Questions, supra note 231.

\(^{241}\) Id.

\(^{242}\) See, e.g., Jenkins, supra note 5; Frequently Asked Questions, supra note 231.

\(^{243}\) Id.

\(^{244}\) Id.

\(^{245}\) Interview with Barash, supra note 234.

\(^{246}\) Id.
invested go toward their investment, instead of only eighty-five cents of every dollar going towards their investment."

VI. Predictions

A. How Real Estate Crowdfunding Affects the Real Estate Market

Undoubtedly, the introduction of a materially new form of investment into any market will produce both short and long-term implications. Even the real estate market will not be impervious to such implications. However, with real estate crowdfunding still in its infancy, such implications are relatively unknown. One can only speculate at this point, but it is likely that real estate crowdfunding will mean easier access to real estate investing for the average American. This easier access will create greater awareness about crowdfunding’s viability as a good alternative to other forms of investing, such as in the stock market.

Already, this effect can be seen through the media’s coverage of flipping homes and foreclosure sale investments. TV shows like “Flip or Flop,” in which a young couple buys run-down homes, renovates them and, then sells them for a profit, or “Income Property,” in which the host helps young home owners “turn part of their home into a money maker,” are all over television as of late and are insanely popular. Furthermore, advertisements for

---

247 Id.
249 *See Shows A-Z*, HGTV (Feb. 5, 2016), http://www.hgtv.com/shows/shows-a-z. (noting the massive amount of television shows involving flipping homes just on one channel alone).
252 On the television station HGTV, there are 24 different programs about flipping houses, not to mention the other shows about other forms of real estate investment. *See Shows A-Z*, supra note 249.
253 Despite some personal drama between the two hosts that left many viewers disappointed, Flip or Flop continues to pull massive ratings numbers, even pulling more viewers than popular sports games. 'FLIP OR FLOP'
how-to guides on flipping homes or investing in real estate offering huge returns are commonly found on the internet and radio. These examples demonstrate that there is already a growing interest amongst the general population in real estate as an actual investment, not just as a living solution. The introduction of real estate crowdfunding to the general public will push this interest further into the heart of America because suddenly, making larger real estate investments will become more feasible for the average American.

As stated previously, until the passage of the JOBS Act, major investments, including major real estate investments, were off limits to non-accredited investors. While it is true that anyone could purchase a property and rent it, flip it, or sell it for more money, the average person does not have the kind of liquid capital on hand to do so. In other words, the everyday person looking to invest some of his or her disposable income does not have enough cash just laying around to purchase a whole property on a whim. With real estate crowdfunding, instead of requiring enough liquidity to purchase a second property in order to flip it and rent it out, almost anyone can contribute as little as $1,000 to commercial real estate investments.

---


254 A quick Google search for “house flipping” turned up a multitude of sites offering “how to guides”, insight, and advice on house flipping. Furthermore, the majority of the sites were also cluttered with advertisements offering further knowledge and information, through the purchase of books and programs. See, e.g., Heather Levin, Flipping Houses for Profit – Tips for How to Flip a House, MONEY CRASHERS (Feb. 5, 2017), http://www.moneycrashers.com/five-tips-for-effectively-flipping-a-house/; Lisa Smith, 5 Mistakes That Make House Flipping a Flop, INVESTOPEDIA (Nov. 23, 2015), http://www.investopedia.com/articles/mortgages-real-estate/08/house-flip.asp; Nathan Pyles, House Flipping in 2017: 5 Tips to Help You Turn a Profit, HOUSE FLIP MENTOR (Sept. 12, 2016), http://www.houseflipmentor.com/house-flipping-tips-for-2017/.

255 See generally, Athwal, Changed, supra note 97.

256 See generally Kristin McFarland, Why Real Estate Could Be a Better Investment Than Stocks, U.S. NEWS (Aug. 20, 2015), http://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/2015/08/20/why-real-estate-could-be-a-better-investment-than-stocks. Purchasing an investment property often requires an initial investment of over $100,000 in down payment and repairs alone; this initial required liquidity is what keeps most people away. Id.
which are often more attractive than traditional investments available to the public.\footnote{See Athwal, Permanently, supra note 224.}

Why can real estate investments be more attractive than investing in stocks?\footnote{See McFarland, supra note 256.} To start, investments in real estate, especially commercial real estate, tend to be more stable than investments in the stock market.\footnote{Id.} While the stock market has the potential to offer large returns on investments, it can be particularly volatile. Stock prices are known to rise and fall rapidly which can be disconcerting to less experienced investors. Commercial real estate, on the other hand, generally experiences less volatility in price, making it a safer choice for new investors.\footnote{Id.} Similarly, as another benefit aside from appreciation, investors can also expect consistent returns from rental income, which provides consistent cash flow into the investors’ pockets. This is compared to the inconsistent and sometimes nonexistent dividends provide by stocks.\footnote{Id.} Furthermore, real estate offers comparable returns to stocks, appealing tax benefits, and is almost immune to inflation.\footnote{See Brandon Turner, 6 Advantages of Real Estate Investing for Savvy Entrepreneurs, Entrepreneur (Sep. 23, 2015), https://www.entrepreneur.com/article/250677.}

As crowdfunding continues to reveal investment benefits, more and more people will begin to contribute funds to real estate investments. The more people invest in the real estate market, the more money the market will gain as a whole. Overall, this means more and more development projects will be started. More development will be necessary as recent trends show a greater number of younger individuals and families moving into city centers for work, but seeking more affordable metropolitan options by populating cities like Austin, Texas and Raleigh, North Carolina.\footnote{See Sam Frizzell, The New American Dream Is Living in a City, Not Owning a House in the Suburbs, TIME (April 25, 2014), http://time.com/72281/american-housing/; see also Joel Kotkin, America’s Next Great Metropolis Is Taking Shape In Texas, Forbes (Oct. 13, 2016), https://www.forbes.com/sites/joelkotkin/2016/10/13/the-next-great-american-metropolis-is-taking-shape-in-texas/#1c1dc291e2fb.}
These cities will need to further develop their metropolitan areas to accommodate the influx of residents. This development further improves the economy as a whole. More development projects mean more jobs, and more jobs tend to lead to higher gross domestic product (GDP) and lower unemployment rates.\textsuperscript{264} Additionally, more development also tends to bring about improved communities, raising the overall property values of the surrounding communities.\textsuperscript{265} Lastly, increased property values will, in turn, mean higher returns on investments.\textsuperscript{266}

An often-overlooked impact that real estate crowdfunding is already having on real estate investments is increased transparency about the investments themselves.\textsuperscript{267} Traditionally, many investors knew very little about the properties they invested in and often trusted the word of others that they perceived as more knowledgeable


\textsuperscript{266} See generally Marc Davis, How To Calculate ROI For Real Estate Investments, INVESTOPEDIA (Feb. 3, 2017), https://www.investopedia.com/articles/basics/11/calculate-roi-real-estate-investments.asp.

\textsuperscript{267} See Daniel Kelly, 7 Reasons You Should Consider Real Estate Crowdfunding, PEERREALTY (March 31, 2015), https://peerrealty.com/blog/7-reasons-you-should-consider-real-estate-crowdfunding (stating that “crowdfunding allows for much greater transparency and control over asset selection and location” compared to traditional real estate investing); Sterling White, 4 Crowdfunding Benefits All Real Estate Investors Should Consider, BIGGERPOCKETS, https://www.biggerpockets.com/renewsblog/2016/04/13/crowdfunding-benefits-real-estate/ (last visited Nov. 9, 2017) (stating that “one of the major upsides of real estate crowdfunding . . . is transparency”); Turner, supra note 262.
(generally friends and acquaintances). As for the affect that real estate crowdfunding has had, Nav Athwal, founder and CEO of a real estate crowdfunding platform called RealtyShares, states:

Crowdfunding platforms, on the other hand, generally operate with a goal of offering investors as much detail about an investment as possible. Property investments are typically vetted beforehand and investors have a broad range of information available to help guide their investment decisions. Investors have the ability to view their holdings online to see how well a particular property is doing.

Essentially, Athwal is saying that the increased detail generally offered by crowdfunding platforms coupled with investments being carefully selected will lead to more sound investments overall.

B. Potential Problems

As the old saying goes “what goes up, must come down.” This is true for real estate crowdfunding. Just as there are many potential positive impacts on the real estate market, there are also a few potential negative impacts it may have. One of the potential consequences that real estate crowdfunding may have is an increased possibility for inexperienced investors to get hurt financially. Like any investment, there is an inherent level of risk involved with real estate investments. It appears that the SEC strategically restricted the amounts that non-accredited investors could invest to keep from investing in things like large-scale real estate investments, because it wanted to protect those who were most susceptible to that risk. By opening the doors to those non-accredited investors, there is the potential that non-accredited investors will make poor decisions or just lack the disposable income for investment. Further, a poor investment has a greater impact on a non-accredited individual’s

---

268 Turner, supra note 262.
269 Athwal, Changed, supra note 97.
270 Id.
271 Id.
272 See generally Pricco, supra note 131.
financial situation as compared to an accredited investor with a large amount of disposable income. Additionally, it follows logically that an overall increase in investments will necessarily mean more bad investments as well. This could be anything from improperly managed REITs, to increased fraud, to poorly built properties.

Another potential impact that real estate crowdfunding could create in the future is over-production. It was stated previously that increasing development would benefit the economy overall;\textsuperscript{273} however, there is a point at which over-development can do more harm than good. Too much attention to investment and development or focusing on the wrong kinds of development, out of greedy motives (i.e., only building luxury properties because they yield higher returns when lower income housing is more of a necessity) could result in an oversupply with a lack of demand.\textsuperscript{274} This phenomenon has been seen in places like China, where the government emphasized real estate development to create jobs and temporarily boosted GDP numbers, and greedy developers focused their efforts on expensive luxury apartment complexes.\textsuperscript{275} China’s infamous “ghost cities” are a prime example of what happens when too much money is thrown at real estate development, and the wrong kinds of development.\textsuperscript{276} A quick Google search for “China ghost cities” reveals a huge number of sources documenting the surreal

\textsuperscript{273} See supra note 265 (citing to sources demonstrating how increasing development can increase overall property values).


effects of overdevelopment in China. There are entire cities in China filled with brand new luxury high-rise apartment complexes, expansive malls, gorgeous parks, statutes, and monuments that are all completely abandoned – or yet, were never filled. It is mostly a result of China’s rapid emergence as a growing economy and their desire to increase domestic production. The problem is not that there are not enough people to fill the abandoned cities; the problem is that the people looking for places to live could not afford to live in these towns. While it is highly unlikely that something as innocent as real estate crowdfunding and the passage of looser investing regulations would cause a similar result in the United States, it stands as a cautionary tale demonstrating the dangers associated with overproduction.

C. Further Amendments that Should be Made

Real estate crowdfunding was not the purpose behind the adoption of Titles III and IV, but it has proven to be a strong new option for young investors to invest in, and for real estate developers to fund new projects. Nevertheless, there are still many improvements that could be made to both Titles that would improve crowdfunding in general, but especially for real estate investments.

---

277 Searching these terms on Google gave the following top results in order. See, e.g., Mallonee, supra note 275; Kenneth Rapoza, What Will Become of China’s Ghost Cities?, FORBES (Jul. 20, 2015), http://www.forbes.com/sites/kmrapoza/2015/07/20/what-will-become-of-chinas-ghost-cities/#266eb9eb751b; Wade Shepard, China’s Largest Ghost City Is Now Almost Full – But There’s A Twist, FORBES (Apr. 23, 2016), http://www.forbes.com/sites/wadeshepard/2016/04/23/chinas-largest-ghost-city-is-now-90-full-but-theres-a-twist/#1a30b07776f4 (The authors sarcastic use of the word “almost,” in the title references the fact there is an occupancy now of 100,000 people in a city built for over 500,000, and the “twist” is that the city’s recent applications for official recognition just happens to leave out the massive chunk of the city that remains unpopulated).

278 See generally Mallonee, supra note 275; Rapoza, supra note 277.

279 See Mallonee, supra note 275.

280 Id.

281 See generally id.

282 See generally supra note 224.
1. Increase Funding Cap on Title III

The most obvious amendment needed for the JOBS Act to truly be beneficial to the real estate industry is an increase to the $1 million dollar per year crowdfunding limit. Title III has the potential to be a major benefit to the real estate market because it is generally cheaper for companies to run a campaign, but the funding cap essentially eliminates it as a profitable investment strategy within the real estate industry. 283 This is because the most profitable real estate investments tend to be commercial developments; 284 these developments, however, often cost tens of millions of dollars, making a Title III offering infeasible. Most critics suggest that the next step in improving the regulation should be to increase the funding cap to $5M million. While this is still not as high as would be desired for a profitable commercial real estate investment, it would at least make non-accredited real estate equity investing feasible by allowing companies to raise a portion of their capital through crowdfunding. 285 until the regulation is loosened further.

2. Allow “Testing the Waters” for Title III Crowdfunding

One of the major drawbacks of Title III is the inability to solicit offers to potential investors outside of the crowdfunding portal. 286 There does not appear to be any reason to abolish solicitation rules under Titles II and IV, but keep them under Title III. Even though a Title III offering is a considerably cheaper option, many would-be issuers in the real estate market are dissuaded by the inability to gauge market receptiveness of their offer. 287 Issuers want to be able

---

283 See Barnett, Disappoint, supra note 135.
284 See Athwal, Permanently, supra note 224.
286 Crowdfunding, supra note 105.
287 See Wan, supra note 131. Wan addresses the impact of adding the ability to “test the waters” to Title III stating: “Given that companies must brace themselves for the scenario in which they cannot cover transaction costs or loss money as a result of not having raised enough funds, the ability to gauge investor interest upfront may save a number of issuers from being in the red on day one (and may encourage other companies to boldly steam forward).” Id.
to perceive the general public’s acceptance of the offer before spending large amounts of time and money.\footnote{See generally id.} Many will avoid the risk of complying with the Title III regulations only to find out that their investment was not well received and did not meet their funding goal.\footnote{Id.} Abolishing solicitation rules under Title III would greatly improve its viability.

3. Loosen Title IV, Tier I Blue Sky Regulations

Title IV adopted crowdfunding as a means of offering securities to raise funds under its regulations,\footnote{Initially, crowdfunding was not included as a method for issuers to offer securities under Title IV of the JOBS Act. It was later revised, however, to include crowdfunding on October 30th, 2015. \textit{See Press Release: SEC Adopts Rules to Permit Crowdfunding}. U.S. SECURITIES AND EXCHANGE COMMISSION (Oct. 30, 2015), https://www.sec.gov/news/pressrelease/2015-249.html.} but the requirements under Tier 1 and Tier 2 do not seem logical. Tier 2, which generally has stricter requirements because of the higher funding cap, also has the benefit of Blue Sky law preemption, which is less strict than the Tier 1 requirement that offers comply with individual state regulations.\footnote{Regulation A, supra note 139.} Again, Blue Sky laws are the individual state laws that regulate securities exchanges. Without Blue Sky law preemption, a company making a securities offer would have to make sure that they comply in every state that they exchange which would basically mean every state for online crowdfunding campaigns.\footnote{Fast Answers, supra note 177.} It does not seem logical to require more stringent restrictions on compliance and reporting for Tier II, but then relax on something so major like state law preemption.

VII. CONCLUSION

Although crowdfunding has roots dating back to the 18\textsuperscript{th} century, with improvements in technology and globalization, it has truly sprouted in recent years. As equity crowdfunding becomes more commonplace, it is likely that we will begin to see its involvement in
more and more industries. For now, however, it is clear that it is a novel and challenging issue to the SEC, as they attempt to grapple with its unforeseen short-term and long-term consequences. Real estate crowdfunding is evidently a prime application of the crowdfunding platform; however, as shown throughout this article, real estate presents its own particular set of issues that do not mesh particularly well with the SEC’s current crowdfunding regulations.

The JOBS Act is a major improvement from the traditional and outdated investment regulations that would have made real estate crowdfunding almost impossible only a few years ago; but, Titles III and IV will require some alterations to take real estate crowdfunding from its current state as a viable investment alternative, to a preferred investment choice. Most notably, the SEC should raise the Title III $1 million funding cap, allow Title III offerings to “test the waters,” and institute Blue Sky preemption for both Title IV Tiers. It is likely that these changes are already on the SEC’s mind, but with equity crowdfunding still in its infancy (and all of its potential effects unknown), it is understandable that the SEC is opening investment crowdfunding up gradually.

There is exciting potential in the impact that crowdfunding may have on the real estate market as the regulations continue to loosen over time. Increased transparency and awareness will likely boost nationwide development, causing a domino effect that will ultimately improve the overall economy and potentially increase returns on investments for investors. Like all unknowns, real estate crowdfunding could have some negative consequences, most notably the increased risk of loss to unexperienced investors and the potential for overdevelopment; however, the benefits here seem to greatly outweigh the potential negatives.

It will be interesting to see how continued development from the legislature will direct crowdfunding’s flow through the real estate industry in the coming years. If an average American is looking for ways to invest his or her disposable income, I would say grab a raft and hop on the real estate crowdfunding stream. If it continues to flow along its current path, the average American is likely to find smooth sailing to high returns on investments in the near future.