Crowdfunding as an Innovative Form of Collective Investment in Real Estate

Submitted 12/11/21, 1st revision 13/12/21, 2nd revision 12/01/22, accepted 20/03/22

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Abstract:

Purpose: The aim of the paper is to present the purpose and principles of real estate crowdfunding, as well as to outline its different forms (equity crowdfunding, debt crowdfunding and co-investment).

Methodology: This paper provides a comparative analysis of selected real estate crowdfunding platforms from around the world in terms of investment amounts, funding period, and return on investment, among others. The last part of the paper is devoted to assessing the development prospects for real estate crowdfunding as well as the opportunities and risks associated with the same. The paper uses the methods of literature analysis and criticism as well as the descriptive method.

Findings: The analysis showed that crowdfunding is gaining traction globally in real estate financing and has provided an opportunity to open up the real estate market to a wider range of investors.

Practical implications: The paper outlines the principles of real estate crowdfunding as well as the advantages and disadvantages of its various forms, which should be taken into account by investors who consider this form of investment. Crowdfunding platforms should be considered as a source of knowledge about planned investments. People interested in real estate crowdfunding can select, based on the information they have gathered, the form of investing their savings that will be most profitable for them.

Originality/Value: The paper presents new methods to use crowdfunding in the real estate industry, where in addition to fund pooling, project participants have the opportunity to make successful investments and generate more capital. This research contributes to the debate on how crowdfunding, which is associated with innovativeness, is changing the traditional real estate market.

Keywords: Crowdfunding, crowdinvesting, investment, real estate, real estate crowdfunding

JEL: G21, G23, E22.

Type of paper: Research article.

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1. Introduction

Real estate is considered the safest investment of capital, providing a hedge against both inflation and economic fluctuations. Real estate includes not only residential units, but also commercial premises, warehouses, tenement houses, office space and land, among others. The opportunities to profit from real estate ownership are virtually endless. They can be leased or kept for own use and then sold at a profit.

However, real estate investment has a significant barrier to entry due to the amount of capital needed. Households need to borrow larger and larger amounts to keep up with high real estate prices. As a result, the number of mortgage defaults has increased considerably in recent quarters (UBS Global Real Estate Bubble Index, 2021). Independent investors can participate in smaller projects, such as buying an apartment for rent or house flipping. The investment is profitable if the selling price exceeds the cost of purchasing, renovating and maintaining the property.

Following the 2008 crisis, real estate investment companies decided to allocate more “dispersed” funds to finance new projects, as many institutions lost the capital needed to finance real estate acquisitions in the market. It became evident that the model based on raising capital from the community is no worse than financing through large and well-known banks which by definition have substantial capital. Individual investors who wish to participate in larger projects can do so with other investors.

This form of collective real estate investment is referred to as real estate crowdfunding. This is one of specific and promising types of crowdfunding which allows raising relatively small amounts of money from investors in the online community whose number can nevertheless be substantial.

The aim of the paper is to present the purpose and principles of real estate crowdfunding, as well as to outline its different forms (equity crowdfunding, debt crowdfunding and co-investment). The paper uses the methods of literature analysis and criticism as well as the descriptive method.

2. Literature Review

There is currently a debate in the literature about the purposefulness, usefulness, and degree of risk associated with the use of crowdfunding in the real estate industry. Most researchers take the position that it is an important alternative source of raising funds for real estate investment projects (Gostkowska-Drzewiecka, 2016; Firek, 2017; Agrawal, Catalini, and Goldfarb, 2013) and seek new opportunities for its use in the industry.
3. Purpose of Study

As it was mentioned in the introduction, the main aim of the paper is to present the purpose and principles of real estate crowdfunding, as well as to outline its different forms. The analysis will focus on equity crowdfunding, debt crowdfunding and co-investment, i.e. forms of investment in which investors allocate their funds to buy, build or renovate a property. Once the business goal, e.g. a property sale or lease, has been met they can share the profits. Profit can include rent from a lease or income from a sale, or even a dividend or coupon.

4. Results

4.1 Real Estate Crowdfunding: Definition and Types of Investments

Crowdfunding is a type of raising and allocating capital for a specific venture in exchange for a certain benefit which involves a wide range of contributors, uses information and communication technologies, has a lower barrier to entry and better transaction terms than those imposed in the market (Król, 2013). The first definition of real estate crowdfunding in the context of academic research was formulated by Schweizer and Zhou who defined it as a form of financing in which a developer setting up a real estate project through a specialised online platform offers debt or equity instruments related to the company or project in order to attract a large group of investors (Schweizer and Zhou, 2016).

Thus, the purpose of real estate crowdfunding is the promotion of projects (investment offerings) through a specialised platform. The investors select those projects that meet their criteria. Table 1 shows the participants in real estate crowdfunding which include fund seekers, investors, and the crowdfunding platform.

Table 1. Real estate crowdfunding participants

<table>
<thead>
<tr>
<th>Participant</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund seeker (project initiator)</td>
<td>An individual or business entity seeking funds to finance a real estate project. The fund seeker benefits by raising funds to launch the project and by earning profit the project generates.</td>
</tr>
<tr>
<td>Investors</td>
<td>Individuals funding the project through the purchase of shares in the project. When the project is complete and the property is sold, the profit from the sale will be distributed to the shareholders.</td>
</tr>
<tr>
<td>Crowdfunding platform</td>
<td>An intermediary between the fund seeker and investors.</td>
</tr>
</tbody>
</table>


There are three basic types of investments in real estate crowdfunding, land acquisition, property development projects, and rental projects. Projects involving
the acquisition of land are carried out through special purpose vehicles. They generally acquire agricultural land that can be converted to land of a different use and subdivided into building plots. At the end of the investment period, i.e., usually after 5 years, the land is sold and the generated profit is distributed among the investors on a pro rata basis (Sharevestors, 2022).

Another type of investment is property development projects which are ventures run entirely by an experienced developer. The investor participates in the project directly and earns profits without committing their time. Crowdfunding participants acquire shares in the special purpose vehicle established to carry out the project. The developer agrees to buy back the shares from the investor at a predetermined price and on a specified date – upon completion of construction or upon sale of the property. Property development projects are medium-term (typically 12-24 months). They allow fully passive investors to achieve event double-digit returns while maintaining maximum security (Gostkowska-Drzewicka, 2016). Figure 1 shows a basic property development project scheme.

*Figure 1. Property development project scheme.*

![Property development project scheme](Source: Own work based on www.crowdangels.pl.)

In addition to collective investing in typically development projects, investments in already built and rented properties are also highly popular among investors. This type of rental projects involves purchasing well-situated commercial premises through a crowdinvesting platform. Leasing such premises to retail chains provides stable profit in the long term. The purpose of the established companies is to manage the assets whereas the rental profits can be used to purchase new properties. The rent from the lease of premises is paid to the shareholders on an ongoing and pro rata basis. The rate of return of such an investment model is 6-8% per year (Firek, 2017).

In addition to investing in property development and rental projects as discussed above, investors can also participate in peer-to-peer lending (crowdlending). Peer-to-peer lending is a form of crowdfunding commonly used in the real estate industry to raise funds for capital projects. In this model, a group of investors collectively lends a development company the amount of money it needs. This is carried out through an online platform, without the involvement of traditional financial institutions. This innovative form of lending is ideal for developers without an extensive portfolio, having difficulty raising funds from banks and non-banking companies. Peer-to-peer lending is one of the alternative ways to invest capital surplus. The borrower,
carrying out a real estate project, repays the loan on a predetermined date along with a set interest which is the investor's profit (Lehner, 2013).

The analysis conducted indicates that real estate crowdfunding may be considered a type of equity crowdfunding if the investor is offered shares in the financed real estate. It can also be considered an example of a debt crowdfunding if the real estate investment is debt-based. Registered online platforms operating in the most developed markets provide for both forms of investment, debt and equity, or are specialised only in debt or equity financing (Vogel and Moll, 2014).

4.1.1 Real estate crowdfunding platforms in Poland and worldwide

The first real estate crowdfunding platform was launched in 2010 (Goins, 2014), and in December 2015, there were as many as 214 such sites operating worldwide. As discussed in the previous section of this paper, a crowdfunding platform acts as an intermediary between the fund seeker and the investors. Real estate crowdfunding platforms give investors the opportunity to choose from a variety of property types, including private and commercial properties, in different locations, expected rate of return, and investment time frame.

There are various real estate crowdfunding models around the world, as well as more or less strict regulations. Usually, the function of a crowdfunding platform is limited to posting offerings and putting potential investors in touch with developers. Platforms do not collect funds from investors, nor are they responsible for the success of projects, although they may evaluate developers or the projects themselves. The platforms' revenue comes from fees charged to developers and sometimes to potential investors.

Choosing a crowdfunding platform and a project to invest in is not always an easy task. It is worth considering the type of real estate a given crowdfunding platform offers, whether investors are charged fees, the estimated payback period, the reliability of the platform – completed projects, opinions of other investors, anti-fraud measures in place to protect shareholders, ability to easily monitor the finances of the selected SPV, ability to divest early. Table 2 summarises the best real estate crowdfunding platforms in the world through 2022. The highest average return, ranging from 17% to 18%, is offered by the CrowdStreet and DiversyFund platforms.

<table>
<thead>
<tr>
<th>Platform</th>
<th>Fees</th>
<th>Minimum investment</th>
<th>Average annual returns</th>
<th>Total investor distributions</th>
<th>Accredited Investors only</th>
</tr>
</thead>
<tbody>
<tr>
<td>CrowdStreet</td>
<td>0.50% to 2.5% for CrowdStreet funds; other fees vary by offering</td>
<td>$25,000</td>
<td>17.3% as of 2021, depending on the investment</td>
<td>$220 million</td>
<td>Yes</td>
</tr>
</tbody>
</table>
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<table>
<thead>
<tr>
<th>Platform</th>
<th>Developer Fee</th>
<th>Minimum Investment</th>
<th>Annual Fee</th>
<th>Equity Multiple</th>
<th>Minimum Investment</th>
<th>Annual Fee</th>
<th>Investment Size</th>
<th>Accredited</th>
</tr>
</thead>
<tbody>
<tr>
<td>DiversyFund</td>
<td>2% to 8% developer fee</td>
<td>$500 depending on account level</td>
<td>17% to 18% historically, depending on the investment</td>
<td>$135 million</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EquityMultiple</td>
<td>1% on equity investments; other fees vary by offering</td>
<td>$10,000</td>
<td>16.8% historically</td>
<td>$126.7 million</td>
<td>Yes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fundrise</td>
<td>0.15% Advisory fee; 0.85% Asset management fee</td>
<td>$10 to $100,000, depending on account level</td>
<td>7.31% to 16.11%, from 2017 to 2021</td>
<td>$124 million+</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PeerStreet</td>
<td>Typically 1%</td>
<td>$1,000</td>
<td>2% - 9%</td>
<td>$225 million+</td>
<td>Yes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RealtyMogul</td>
<td>1% - 1.5%</td>
<td>$1,000</td>
<td>4.5% - 8%</td>
<td>$136 million</td>
<td>No.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


CrowdStreet is a private equity real estate investing platform that provides investors with direct access to individual commercial real estate investment opportunities, allowing them to view, compare and select offerings that meet their individual investment criteria. The platform was launched in 2014. Today, it is one of the largest markets for individual deals in the real estate investment market. The platform is best suited for accredited investors, investors willing to let their money sit for years, risk-tolerant investors, investors willing to do their own due diligence. (CrowdStreet, 2022).

DiversyFund was also launched in 2014 and is an online real estate investment platform offering private commercial real estate investments to non-accredited investors (or those with less than $1 million to invest). DiversyFund is fully automated. The main advantages of DiversyFund include: $500 minimum investment, no management fees, automated real-estate investment management and available to non-accredited investors. Disadvantages of the platform include: limited investment selection; only offers one REIT with assets in three states, must hold investments for at least five years, no IRAs, can't withdraw investments' earnings until the real estate assets, or properties, are sold (DiversyFund, 2022).

Real estate crowdfunding was initiated in Western Europe and the United States many years ago, however in Poland it is a relatively new method of investing. The most popular Polish real estate crowdfunding platforms include: CrowdRealEstate and Social Estate which offer various investment opportunities.

CrowdRealEstate is the first Polish platform that allows Polish real estate developers and investors to raise capital through debt crowdfunding. Investors lend their funds to develop various real estate – for sale or for rent – and ultimately they are paid back the invested capital plus interest. The platform was launched in 2019. It aims to
ensure that project initiators and investors can achieve mutual benefits in an atmosphere of investment security and mutual trust which is possible through effective project safeguards. By 2022, four projects had been completed – three in Warsaw and one in Dolnośląskie Province. The rate of return on CrowdRealEstate is 7% and interest is paid quarterly. All available projects are carried out in Poland. The minimum loan amount is PLN 1,000. In addition, investors contributing to certain projects are offered attractive discounts, e.g. for accommodation in a built hotel or for the purchase of an apartment (CrowdRealState, 2022).

**Table 3. Projects completed between 2019 and 2020 through the CrowdRealState platform.**

<table>
<thead>
<tr>
<th>Project (location)</th>
<th>Amount of funding</th>
<th>Funding period</th>
<th>Project value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxury house (Warsaw, Foksal Street)</td>
<td>PLN 9.75 million</td>
<td>18 months</td>
<td>PLN 18 million</td>
</tr>
<tr>
<td>Aparthotel (Warsaw, Puławska Street)</td>
<td>PLN 5.3 million</td>
<td>10 months</td>
<td>PLN 15 million</td>
</tr>
<tr>
<td>Luxury house (Warsaw, Wilanów District)</td>
<td>PLN 2.2 million</td>
<td>12 months</td>
<td>PLN 5.2 million</td>
</tr>
<tr>
<td>Land property (Retail Park, Dolnośląskie Province)</td>
<td>PLN 3.2 million</td>
<td>12 months</td>
<td>PLN 5 million</td>
</tr>
</tbody>
</table>

*Source: Own work based on www.crowdrealstate.pl.*

Social Estate is another Polish platform, but unlike the previous one, it focuses on real estate equity crowdfunding. Through the platform, backers can invest in commercial real estate. The average annual rate of return is 7%. The investor, being a shareholder, is entered into the National Court Register. Most of the projects involve the lease of premises for stores of well-known chains such as Biedronka, Żabka or Rossmann. Residential units are sometimes offered as well. The expected duration of such a rental project is generally between 5 and 15 years. However, one can exit the company early by redeeming the shares or selling them to another person (Social Estate, 2022).

In conclusion, the number of available crowdfunding platforms is growing year by year and each of these sites has different characteristics – that is why they need to be carefully analysed and compared. Crowdfunding platforms should be considered as a source of knowledge about planned investments. Potential backers select a project on the site that they want to invest in and later reap the benefits they were offered. Each offering describes in detail the model of business cooperation which specifies the level of risk, the projected rate of return and the amount of capital required.2

### 4.1.2 Opportunities and risks of real estate crowdfunding

According to the “Global Real Estate Crowdfunding Market Outlook 2028”, real estate crowdfunding will grow globally at an average annual rate of 33.4% from 2020 to 2028. Some forecasts suggest that the average annual growth rate in the value of real estate crowdfunding will be even higher. Globally, it could reach 58.3% between 2020 and 2027 (Global Real Estate Crowdfunding Market Outlook
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2028, 2021). The United States, which was the cradle of real estate crowdfunding, no longer plays the major role in terms of global investment value growth. Currently, 50% of global real estate crowdfunding takes place in Asia Pacific. This is owing to the Chinese economy which has become a global leader in crowdfunding (not just in real estate).

According to the research report, the global real estate crowdfunding market size and share was valued at USD 10.78 billion in 2021 and is expected to reach USD 250.62 billion by 2030, to grow at a CAGR of 45.6% during the forecast period. The real estate crowdfunding market experienced negative growth during the pandemic, however is expected to pick up in a short period of time once business resumes (Global Real Estate Crowdfunding Market Outlook 2028; 2021). Real estate crowdfunding investments have many advantages and disadvantages, as shown in Table 4.

Table 4. Main advantages and disadvantages of real estate crowdfunding

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small minimum investment; Becoming a shareholder in a company; Good annual rates of return; Record of completed projects; User-friendly application.</td>
<td>Problematic early divestment; Conflicts of interest of co-owners; Possible loss of capital if the developer's project fails; Profits dependent on market conditions.</td>
</tr>
</tbody>
</table>

Source: Own work based on crowdstreet.com, crowdrealstate.pl, diversyfund.com, sharevestors.com.

The greatest advantage of real estate crowdfunding is that it allows investors with little initial capital to enter the market. Real estate crowdfunding has thus provided an opportunity to open up the real estate market to a wider range of investors. With real estate crowdfunding, it is possible to invest in much larger projects, such as luxury apartment buildings or civic buildings, which also brings a higher rate of return. Until recently, such projects could not be carried out by investors who do not have enough capital. However, owing to real estate crowdfunding, this is changing (Gostkowska-Drzewicka, 2016).

Equity crowdfunding for real estate allows the investor to become a shareholder in companies that are responsible for real estate ventures, and thus a co-owner of properties. The investor obtains funds from either leasing the property or the capital gain from the sale of the property for a higher price. The returns on this type of investment can be very high, however they are also difficult to estimate in advance and involve a higher level of risk (Social Estate, 2022). Equity crowdfunding for real estate is offered by EvoEstate, as well as other platforms such as Reinvest24 and Rendity. In Poland, this type of crowdfunding is offered by the Social Estate platform.

In debt crowdfunding for real estate, the profit is limited to a predetermined interest rate and does not depend on the profit of the company to which the funds are lent.
The project period is specified in advance so investors know from the beginning when they can expect the principal and interest to be paid back. Compared to equity crowdfunding, debt crowdfunding is much less risky and easier to predict. However, even debt crowdfunding does not offer a risk-free investment. Top debt crowdfunding platforms include EvoEstate and EstateGuru. In Poland, this type of crowdfunding is offered by the CrowdRealEstate platform. As crowdfunding platforms ensure safe investment, those who are not familiar with the real estate market as they should be, e.g., to flip a house, may also decide to invest.

Real estate crowdfunding is a solution that offers a plethora of opportunities for investors with both small and large amounts of capital. The offerings of developers posted on the platforms are verified beforehand. Low deposit interest rates offered by banks and substantial risk associated with investing in capital markets encourage potential investors to seek alternative ways of increasing capital, and real estate crowdfunding seems to be a good solution.

However, it is not without its drawbacks. Since there is no direct contact between the project initiators and the investors, there is a risk of conflict of interest (if there are multiple owners). Due to the volatility of real estate market, a high rate of profit cannot be guaranteed. It is advisable to assume a longer investment period, of at least several years, to reduce the risk of a significant drop in property prices.

Before investing in crowdfunding, it is also a good practice to assess the feasibility of the established profit goals and the industry experience of the persons running the company. Furthermore, it is important whether small investors are granted the right to exercise control – for example, through participation in a supervisory board. Real estate crowdfunding is available to anyone, however proper investment knowledge is necessary (even though crowdfunding platforms provide extensive information about the project). The estimated rate of return presented may be overstated.

5. Conclusions

Based on the analysis, it may be concluded that crowdfunding is gaining traction globally in real estate financing and has provided an opportunity to open up the real estate market to a wider range of investors. This alternative project financing sector is projected to trend upward. It provides an opportunity to democratise access to the real estate market, especially to exclusive properties that most investors cannot afford today. Real estate crowdfunding allows smaller investors to finance large projects. The most important aspect is the elimination of the need to borrow from banks. It is a relatively safe investment of capital. However, like any other method of investing in real estate, it is not completely without risks that should always be taken into account.
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