Glossary

Accredited Investor Some regulations used by crowdfunding real estate sponsors and marketplaces restrict them from accepting funds from people who are not classified as "accredited investors." To be an accredited investor, one must have at least $200,000 of income for the past two years, with a reasonable likelihood of earning the same again in the current year ($300,000 if a married couple), or over $1 million of net worth, not including one's primary residence. This standard has not changed (much) since it was first set in 1982, at which time there were approximately 550,000 accredited investors in the United States. Today there are over 11 million who qualify as being accredited.

Alternative Investment Some people refer to real estate as an "alternative investment" distinct from "traditional investments," which are generally stocks, bonds, and cash.

Capital Any use of the term "capital" in real estate is synonymous with the term "money." It can be used to refer to debt of any kind or equity of any kind, or to both in unison.

Collateralized Debt Obligation (CDO) A structured financial product where cash-flow-generating assets are pooled together, tranched according to their risk profile, and then sold to investors. In the run-up to the Great Recession of 2008–2009, high-risk mortgage products that came to be known as "subprime" loans were skimmed off larger pools of mortgages. The resulting pools, in their entirety high-risk mortgages, were tranched and reclassified relative to each other, resulting in some receiving extremely high ratings consisting solely of subprime mortgages. Having such high ratings, they attracted conservative and institutional investors, creating considerable liquidity. Based as they were on high-risk mortgages but carrying the veneer of being highly rated, they contributed in part to the market's crash.

A. Gower, *Leaders of the Crowd*, https://doi.org/10.1007/978-3-030-00383-8

Debt Used by sponsors to reduce the amount of equity that they need in a project. Debt typically earns interest and takes no share in the profits of a deal—in contrast to equity. However, debt is usually secured by the property itself and has the highest priority when it comes time to be paid back; an institution or private lender to a sponsor who is getting no share of the profit will be the first person to be paid back and will have the greatest rights in the event the project falters. It is, therefore, the lowest risk component of the finance on a deal.

Development The process by which buildings or land are improved by adding value through construction or renovation. Someone who engages in developing real estate is said to be a developer or sponsor, and their projects, the "developments."

Due Diligence The process by which a sponsor will evaluate a project. It is an intensive phase of the development process that involves careful, systematic evaluation of all risks involved, the market, and all costs. It usually culminates in a financial analysis of the project where every assumption has been thoroughly vetted. Investors in crowdfunded deals do not need to do the due diligence themselves (what a relief!). Their role in protecting their interests, however, is to ensure that the sponsor has conducted project due diligence thoroughly by reviewing their work product.

Equity Equity is the money invested in a property that is designated to receive a share of the profits when the property sells or is leased. It is often paid at a minimum interest rate while the property is being developed or improved. This interest rate is called a preferred return. The equity in a transaction is paid back only after the debt is repaid. Consequently, there is a higher risk of nonpayment. The term "equity" can be used synonymously with the term "investment."

Funding Portal Funding portals are a new type of intermediary created by the JOBS Act that are exempt from the requirement to register as a broker but must register with the SEC and are regulated by FINRA (Financial Industry Regulatory Authority). They are online platforms where Regulation Crowdfunding (CF) transactions can take place and where non-accredited investors may also participate. The concept of the funding portal was to create a layer of investor protection through a third party or portal. The portal conducts some basic anti-fraud, money laundering, and terrorism screening on a deal before the public is granted access. These portals provide educational materials to investors but not investment advice; they make available information about entities raising capital, the issuer, but are not compensated based on the sales of securities sold, and though they do not take possession of investor funds or securities, they do facilitate the offer and sale of crowdfunding securities.

General Solicitation The process by which someone wishing to raise capital for their business or real estate deal can openly advertise to the public anywhere across any media. Previously it was primarily restricted only to those entities "going public" through an initial public offering (IPO), a heavily regulated option. The JOBS Act largely deregulated these restrictions; it is now far less onerous to solicit investment from the general public.

Impact Investment Impact investments are investments made with the intention to generate positive, measurable social and environmental impacts alongside a financial return.

Internal Rate of Return (IRR) The internal rate of return (IRR) is a measure of returns on an investment that considers the effect of time and allows comparisons to be made from one deal to another. The IRR is expressed as a percentage, a little like the way interest is expressed on a bank deposit—the average annual percentage return on an investment. However, it allows for very complicated scenarios to be compared.

Investment Property Investment property is any real estate that is purchased with a view to earning income either from rents or through adding value and selling the property at some point in the future. In short, if a piece of real estate is acquired that is geared to creating income or building wealth of some sort, then it is an investment property. One of the only kinds of real estate one might buy into that is not considered investment property is a person's primary residence, though historic preservation may also fall into this category.

Private Equity Fund A private equity fund is a company (of sorts) where the fund managers, a group of real estate professionals, raise money from institutional investors, pension funds, endowments, sovereign wealth funds, or high-net-worth individuals in order to make investments in real estate. These funds often have investment criteria that will include specific investment strategies and types of real estate (value-added hotels, for example, or maybe class-A apartments), and target returns. Private equity funds do not engage in real estate development themselves; they invest with developers directly and manage those investments on behalf of their institutional clients.

Real Estate Investment Trust A real estate investment trust (REIT) builds a portfolio of real estate properties according to its declared investment strategy and sells shares of itself to the public. Traded REITs, those for which there is a market for their shares, are exposed to general stock market volatility, so while they are collateralized by real estate, they behave in many ways similarly to stocks, rather than the underlying real estate upon which they are based.

Regulation A+—JOBS Act Title IV This has been called a "mini-IP" or "IPO light" because it provides simplified access to public markets for small companies. Issuers can raise capital from accredited and non-accredited investors alike. These mini-IPs are considerably less costly, less time-consuming, and require far lower reporting requirements than full IPOs. The regulation allows issuers to raise up to $50 million per year from both accredited and non-accredited investors through general solicitation, including over the Internet.

Regulation Crowdfunding—JOBS Act Title III Regulation Crowdfunding (Regulation CF) is the part of the JOBS Act most commonly associated with the concept of crowdfunding for three reasons; one, its name; two, it was designed to be inexpensive to implement and therefore accessible to the smallest of companies; and, three, it was open to everyone for investment.

Issuers using Regulation CF were originally permitted to raise up to $1 million every 12 months and to invest in any kind of real estate provided it is a direct investment in real estate rather than through a fund vehicle. Although general solicitation, that is, advertising, is permitted, it has to be conducted through a registered funding portal.

Regulation D, Rule 506(c)—JOBS Act Title II This regulation was an upgrade of the old, commonly used 506(b), which permitted sponsors to raise capital from investors with whom they had a pre-existing relationship. Becoming effective in September 2013, 506(c) eliminated the need for a pre-existing relationship—opening the doors to general solicitation or, more simply stated, permitted sponsors to advertise. This change increased the number of investors in any one deal to 2000 (accredited) investors, although some see this as being an artificial ceiling and that the regulations allow for an almost unlimited number of investors. 506(c) continues to require very little disclosure or ongoing reporting, as did its predecessor, although the SEC, in writing the rules following the passing of the Act, added some layers of complexity as to how an investor actually gets verified as being accredited.

Returns Any kind of payment that is made to an investor as a result of an investment in a real estate deal is considered a "return" of some sort. The terms that define this concept include return on investment (ROI), return on equity (ROE), cash on cash, rate of return, yield, and others. Unfortunately while these terms are often used in the industry, their definition is not consistently understood. Be sure to ask if in doubt.

Sponsor The sponsor is the person, or entity, who has taken upon themselves the responsibility of acquiring, developing, renovating, and/or managing a property. The sponsor will typically have full management decision authority and, with that, responsibility for ensuring things progress as planned. Other terms used synonymously with "sponsor" include "developer," "operator," and "principal."

Underwriting This is the process by which the extent of risk in a deal is measured, with a view to making an investment. The term is most often used to describe the process a lender will engage in to decide whether to extend credit to a borrower and, if so, how much.

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NUMBERS AND SYMBOLS

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