REALTY MOGUL

Crowdfunding for real estate

# Quick Stats

Updated August, 2013

## **Private Real Estate Investing:** A Look at Current Market Rates for Real Estate Syndications

**Realty Mogul** is a marketplace for accredited investors to pool money online and buy shares of pre-vetted real estate investments; it is crowdfunding for real estate. After review of over $375 million of real property across 32 unique private placements, we have begun to see common themes and seek to provide data on such themes as well as current market rates for private real estate placements.

### MACRO STATS[1]

- Over the four year period from 2009 – 2012, aggregate capital raised for real estate private placements accounted for $63 billion, excluding capital raised under private equity and hedge fund indicators.
- In the same four year period, there were 5,617 separate Reg D offerings for real estate. In 2012, there were 1,900 separate Reg D offerings for real estate.
- The median offering size for real estate offerings was $2.3 million while the average was $15 million.
- Over 47,000 investors participated in private real estate placements in 2012. The average number of investors in a real estate syndication was 25 in 2012, compared to a median of 7 investors.

### SURVEY SPECIFIC STATS

- Over half of the transactions surveyed (19 out of 32 or 59%) are structured as preferred equity.
- In the data surveyed, the average preferred return to investors is 8.5% and ranges from 5.0% on the low end to 12.0% on the high end.
- The most commonly found preferred return is 8.0%, which we found in 9 of the 19 transactions (47%) with preferred returns.
- Of the transactions surveyed, the most favorable promote to investors was 80/20 (80% to investor, 20% to sponsor) while the least favorable promote to investors was 50/50.
- Greater than 80% (26 out of 32) of the transactions provide for a promote structure.
- The average promote across all transactions was 67/33 (67% to investors, 33% to sponsor).
- 62% of transactions (16 out of 26) had promotes between 70/30 and 80/20.
- Over two-thirds of the transactions surveyed (25 out of 32 or 78%) are structured with an acquisition fee.
- In the data we surveyed, the acquisition fee ranges from 0.59% to 5.00% and averages 1.79%. The most common acquisition fee is 1.00%, which we found in 8 of the 25 transactions (32%).
- Less than one-third of the total transactions surveyed (10 out of 32 or 31%) are structured with an asset management fee.
- In the data we surveyed, asset management fees ranged from 0.50% to 4.00% and averaged 1.85%.
- Property management fees are standard in almost every private real estate transaction and range from 2.25% on the low end to 8.5% on the high end.
- Disposition fees were not common in the set of private real estate transactions surveyed. However, for the transactions that did include this fee, the disposition fee averaged 2.25% and ranged from 0.5% to 6.0%.



1 Bauguess, Scott and Ivanov, Vladimir; "Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009- 2012"; July 2013.

**About the Survey Data**: In total, 32 different real estate private placements were surveyed from 25 disparate privately held real estate investment companies. The average total property capitalization was $11.7 million. All of the transactions were actively raising capital in the 11-month period from September 2012 to

# **Private Real Estate Investing:** A Look at Current Market Rates and Trends for Real Estate Syndications

**AUGUST 2013**


**REALTY MOGUL, CO.**

www.realtymogul.com


## ABSTRACT


Realty Mogul is a marketplace for accredited investors to pool money online and buy shares of pre-vetted real estate investments; it is crowdfunding for real estate. At www.realtymogul.com, we have received hundreds of requests to finance a variety of real estate transactions from a variety of sponsors. After review of over $375 million of real property across 32 unique private placements, we have begun to see common themes and seek to provide data on such themes as well as current market rates for private real estate placements.

Until now, this data has not been aggregated and provided publicly. One benefit of the new "crowdfunding" investment model is the availability of information and the tremendous amounts of transparency that can be disseminated to the market. At Realty Mogul, the concept of transparency is core to our culture and is part of the reason we have compiled this report. The following report is broken into two sections*:*

I. *An Introduction To Private Real Estate Syndications, Private Placements and Regulation D,* and
II. *Six Themes Surrounding Private Real Estate Transactions*


## AUDIENCE

This report is intended for both investors interested in private real estate investing as well as privately owned real estate companies ("sponsors" or "operators") looking to conduct real estate syndications with outside investors.

## SUMMARY OF MAIN FINDINGS

- The private real estate market continues to grow alongside the growth of Regulation D offerings for all private transactions.
- Over the four year period from 2009 – 2012, aggregate capital raised for real estate private placements that were reported accounted for $63 billion, excluding capital raised under private equity and hedge fund indicators.
- In 2012, there were 1,900 separate Reg D offerings for real estate specifically.
- Real estate private placements typically afford investors the opportunity to earn a preferred return and a promote through a preferred equity structure.
- In the data surveyed, the average preferred return to investors is 8.5% and ranges from 5.0% on the low end to 12.0% on the high end.
- It is common for sponsors to charge an acquisition fee with the most common acquisition fee being 1.0%.
- In the majority of transactions surveyed, asset management fees were not charged. When they are charged, they tend to be charged by sponsors who are not assuming day-to-day management of the properties.
- Property management fees are standard in almost every private real estate transaction and range from 2.25% on the low end to 8.5% on the high end.
- Disposition fees were not common in the set of private real estate transactions surveyed. However, for the transactions that did include this fee, the disposition fee averaged 2.25% and ranged from 0.5% to 6.0%.

## I. An Introduction To Private Real Estate Syndications, Private Placements and Regulation D

*What is real estate syndication?*

Real estate syndication is "crowdfunding for real estate" before crowdfunding for real estate ever existed. In its most simple form, both syndication and crowdfunding involve pooling capital with other individuals for a common purpose or a common goal. In real estate, that common purpose is the purchase of a real property, a physical building you can see and touch.

The difference between real estate syndication and crowdfunding is introducing the internet as a distribution vehicle and the use of technology to allow a wider range of investors to contribute capital to a real estate transaction. While syndications have historically been completed offline, crowdfunding is facilitated largely through online means, allowing investors to invest in real estate from the comfort of their living room and the convenience of their smartphone or iPad.

*What is a real estate private placement?*

A private placement is a funding round that is not a public offering but offered through private means, historically to a select group of individuals. With the introduction of crowdfunding to real estate investing, more and more investors have access to these transactions. These private placements, however, are still private (i.e., not public offerings like an IPO). Although these private placements are subject to securities laws, namely the Securities Act of 1933, these securities are typically exempt from registration with the Securities and Exchange Commission ("SEC"). The most common exemption used in real estate is Regulation D 506.

*What is a Regulation D 506 transaction?*

A Regulation D 506 transaction ("Reg D 506") is a private offering of securities. You can compare this to a public offering of securities when a company issues stock on an exchange, like the New York Stock Exchange. Not every company is in the right stage to go public, but since these companies still need to raise capital, many of these companies utilize Reg D 506 as a financing mechanism. With a Reg D 506 transaction, the following rules apply:

- The company that is raising money can raise an unlimited amount of money.
- The company cannot market the securities to the general public[1].

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[1] *Note:* This piece of the legislation is subject to change as a result of Title II of the JOBS act that received a 4:1 vote by the SEC in July, 2013 allowing for marketing for private transactions for the first time in 80 years. This new legislation is supposed to be in effect by September, 2013.

- The securities that are sold are “restricted” so they cannot be resold during the first year.
- The company must sell the securities to “accredited investors”[2] .
- When securities are sold to non-accredited investors, there are additional regulations and disclosures that are required.
- A Form D must be filed in every state where there is an investor.

Reg D 506 transactions help small companies since the regulatory requirements are much less onerous than when filing for a public offering.

*How do Reg D 506 transactions apply in real estate?*

Reg D 506 transactions apply in real estate the same way they apply for all other companies. In most real estate transactions, there is a new LLC or a new Limited Partnership opened for each property or each fund. By using the Reg D 506 exemption, that LLC can raise money from groups of investors within the confines of the law.

*Why do people engage in real estate syndication?*

Access to deal flow is the biggest reason investors participate in real estate syndication or crowdfunding for real estate. Not every investor has the time to search and underwrite hundreds of properties to find a gem to acquire. Since there are thousands of real estate companies all over the United States who do this for a living, getting involved through real estate syndication enables investors to access this deal flow and gives them the ability to invest in real estate without the hassles of property management.

*Who is involved with a real estate syndication?*

1. The first ingredient for a real estate syndication is a “syndicator” or “sponsor”. This individual or company is in charge of finding, acquiring and managing the real estate. They have a history of real estate experience and the ability to underwrite and complete due diligence on the real estate.

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[2] An “Accredited Investor” generally includes wealthy individuals and organizations such as banks, insurance companies, significant charities, some corporations, endowments, and retirement plans.

In the United States, for an individual to be considered an accredited investor, he or she must have a net worth of at least one million US dollars, not including the value of one's primary residence or have income of at least $200,000 each year for the last two years (or $300,000 together with his or her spouse if married) and have the expectation to make the same amount in the current year.

2. The other party is the investors. These are the individuals who invest with the syndicator and own a percentage of the real estate as a result. They get all the benefits of property ownership, but they are not involved with acquiring the property, arranging financing (if there is a loan on the property) and day-to-day management of the property.
3. In many transactions, there is a third party, the Joint Venture ("JV")/Equity partner. This JV partner typically has access to a large number of investors and serves as a conduit between the syndicator and the investors. In addition to help with financing, the JV partner may help the syndicator with asset management, reporting, communications and tax documentation

## II. Six Themes Surrounding Private Real Estate Transactions

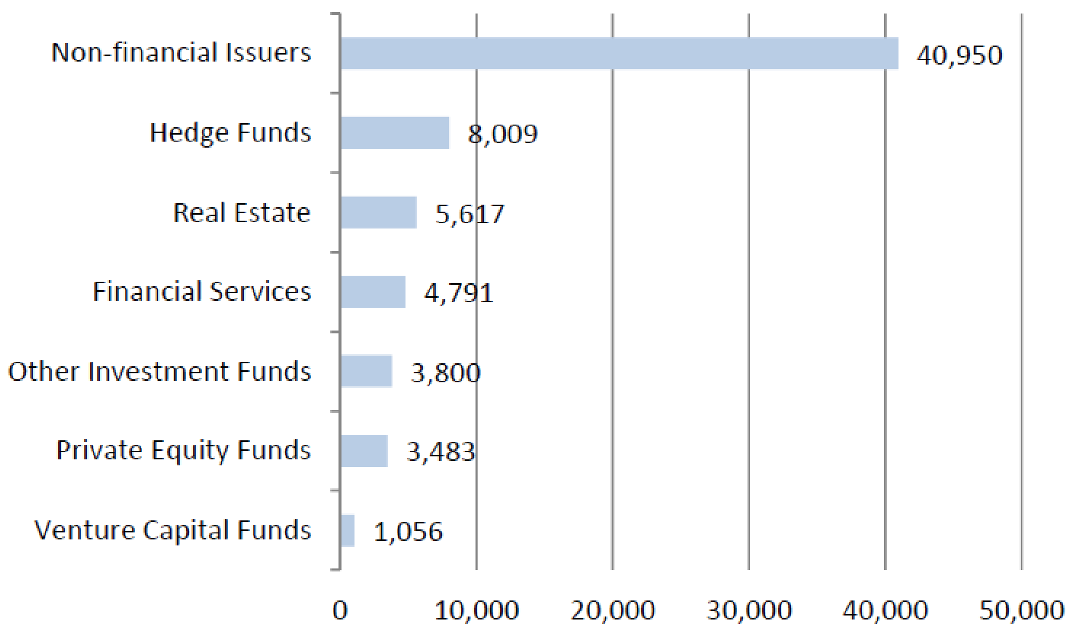
1. **The private real estate market continues to grow alongside the growth of Regulation D offerings for all private transactions.**[3]

In 2012, Regulation D accounted for $903 billion in capital raised compared to $863 billion in 2011.

*Note: Because there was historically no regulatory requirement when a Regulation D filing was closed, the amount of capital raised through Regulation D offerings is likely considerably larger than reported.*

In 2012, there were 1,900 separate Reg D offerings for real estate specifically. In the four year period from 2009 – 2012, there were 5,617 separate Reg D offerings for real estate specifically. Compared to the broader Reg D environment, real estate accounts for the third largest number of new offerings during the period.

***Number of initial (new) offerings during the period 2009-2012 by issuer type***[4]




[3] Bauguess, Scott and Ivanov, Vladimir; "Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009- 2012"; July 2013

[4] Bauguess, Scott and Ivanov, Vladimir; "Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009- 2012"; July 2013

In 2012, $20 billion in real estate was reported to be sold through Regulation D. Assuming that $20 billion accounts for 60% of the market (due to the fact that companies are not reporting their total capital raised as there is no regulatory requirement to do so), we believe real estate accounted for more like $33 billion in 2012. This excludes capital being raised for real estate by private equity firms raising separate private equity funds or hedge funds (presumably they filed as a private equity firm as opposed to a real estate firm).

Over the course of 2009 – 2012, aggregate capital raised for real estate private placements that were reported accounted for $63 billion.

While the median offering size of Regulation D offerings is $1.5 million, the median offering size for real estate offerings was slightly larger at $2.3 million. The average offering size, however, for Regulation D offerings was $30 million while the average for real estate specifically was $15 million.

In 2012, more than 234,000 investors participated in Regulation D offerings. In real estate specifically, 47,135 investors participated in 2012. The average number of investors in a real estate syndication was 25 in 2012, compared to a median of 7 investors.

2. **Real estate private placements typically afford investors the opportunity to earn a preferred return and a promote through a preferred equity structure.**

Preferred equity is often described as a hybrid security that combines elements of a debt security and an equity security. A preferred equity structure typically consists of 1) a preferred return, which acts similar to an interest payment and 2) a promote, which is split between the sponsor and the investor using a pre-determined formula.

To the extent that the preferred return provides regular dividends (similar to an interest payment), it is similar to debt, the difference being that investors are not in a secured position against the property like a loan. To the extent that investors participate in the profit generated from the investment through a promote, it is similar to equity.

Before the sponsor is paid on the transaction (excluding fees, discussed later), the investor receives their preferred return each year. Many times, this preferred return is paid quarterly and is compounded. For example, if a transaction had a preferred return of 8% and the property only provided for a 7% return in the first two years, the investors would accrue that additional 1% (8% minus 7%) for two years (2% total) and those returns would be provided to the investor before the promote structure came into effect.

The promote allows investors to share in any additional cash flow from rents above and beyond the preferred return and share in any appreciation from the property when the investment is sold. An example of a promote structure is 60/40, meaning 60% of the additional cash flows from operating the property, above and beyond the preferred return, and 60% of the gain when the property is sold is provided to the investors with the remaining 40% provided to the sponsor.

***Statistics on Preferred Return***

- Over half of the transactions surveyed (19 out of 32 or 59%) are structured as preferred equity.
- In the data surveyed, the average preferred return to investors is 8.5% and ranges from 5.0% on the low end to 12.0% on the high end.
- The most commonly found preferred return is 8.0%, which we found in 9 of the 19 transactions (47%) with preferred returns.

***Statistics on Promote***

- Greater than 80% (26 out of 32) of the transactions provide for a promote structure.
- Of the transactions surveyed, the most favorable promote to investors was 80/20 (80% to investor, 20% to sponsor) while the least favorable promote to investors was 50/50.
- The average promote across all transactions was 67/33 (67% to investors, 33% to sponsor).
- 62% of transactions (16 out of 26) had promotes between 70/30 and 80/20

3. **It is common for sponsors to charge an acquisition fee**

Acquisition fees are paid to the sponsor for completing the sourcing and diligence work necessary to find and acquire a real estate transaction. These fees are usually paid once escrow is originally closed on the investment. The acquisition fee is usually calculated as a percentage of the purchase price and typically declines as the purchase price increases. It is usually included as a closing cost for the transaction.

- Over two-thirds of the transactions surveyed (25 out of 32 or 78%) are structured with an acquisition fee.
- In the data we surveyed, the acquisition fee ranges from 0.59% to 5.00% and averages 1.79%. The most common acquisition fee is 1.00%, which we found in 8 of the 25 transactions (32%) with an acquisition fee.
    - The 5% acquisition fee was a single outlier and appears to be well outside the range of market indicators.

4. **Asset management fees tend to be charged by sponsors who are not assuming day-to-day management of the properties.**

Asset management fees are paid to the sponsor for managing the investment on behalf of the investor group. These fees are on-going and paid before any distributions are made to investors.

Asset management fees are typically calculated as a percentage of revenue (Gross Potential Revenue or Effective Gross Income).

- Less than one-third of the total transactions surveyed (10 out of 32 or 31%) are structured with an asset management fee.
- In the data we surveyed, asset management fees ranged from 0.50% to 4.00% and averaged 1.85%. We found that this fee was largely dependent on the size of each transaction – the larger the transaction, the smaller the percentage will be due to the larger nominal amount.

5. **Property management fees are standard in almost every private real estate transaction.**

Property management fees are paid to the company that is managing the property's day-to-day operations. If the sponsor is assuming these duties, many times their compensation is paid to a wholly-owned subsidiary that is the sponsor's property management company, and they are compensated for these responsibilities through that entity. If the sponsor is not vertically integrated as a property management company, these fees are paid to a third party property management firm for assuming day-to-day operational duties.

Property management fees are typically calculated as a percentage of revenue (Gross Potential Revenue or Effective Gross Income).

- All the transactions surveyed are structured with a property management fee.
- In the data we surveyed, property management fees ranged from 2.25% to 8.50% and averaged 4.05%. The minimum and maximum fees we found both appeared to be outliers, as the majority of property management fees ranged between 3.00% to 6.00% - 3.00% for larger properties and up to 6.00% for smaller acquisitions.

6. **Disposition fees are not common in the private real estate transactions surveyed**

Disposition fees are sometimes paid to the sponsor for completing the work necessary to sell a property. These fees are usually paid when the property is sold.

The disposition fee is usually calculated as a percentage of the sale price, and the percentage typically declines as the sale price increases. This fee is taken out of sale proceeds prior to any distributions to investors.

- In the data we surveyed, the disposition fee was not a common component, found in 19% (6 of 32) transactions.
- Disposition fees ranged from 0.50% on the low end to 6.00% on the high end.
    - Neither of these appear to be within the range of market indicators.

## Appendix: Survey Data:

In total, 32 different real estate private placements were surveyed from 25 disparate privately held real estate investment companies. The average total deal capitalization was $11.7 million.

Property types included in the analysis are multi-family, retail, self-storage, office and student housing.

All of the transactions were actively raising capital in the 11-month period from September 2012 to July 2013.