EPISODE 532

[INTRODUCTION]

[00:00:00] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

[0:00:24.1] WS: This is your daily Real Estate Syndication show. I'm your host Whitney Sewell. Today, our guest is Mark Roderick. Thanks for being on the show again, Mark.

[0:00:33.3] MR: Thank you very much for having me again, particularly, once you have me, most people don't invite me back.

[0:00:40.7] WS: We make some exceptions, right?

No, Mark, pleasure to have you back. And if you remember, if you've been listening to this show for a while, we had Mark as a guest on show number WS188. I would encourage you to go back and listen to that. I know we talked about some capital raising issues and how to pay capital raisers at that time and different ways to do that legally and make sure you're staying out of jail.

But a little about Mark though, just in case you haven't heard that show or heard of him. He's a crowdfunding attorney who has represented entrepreneur and their businesses successfully for more than 25 years. Represents companies across a wide range of industries, including technology, real estate and healthcare industries. He writes lectures on topics of raising money from investors, franchising laws and business contracts.

Mark, thank you again for your time being willing to share your expertise with the listeners. I know that just recently, this SEC, to make some new proposals, they're going to shake up the crowdfunding industry a little bit, that's something that myself and the listeners need to be on top of and need to understand so I'm looking forward to this conversation but get us started a little bit with what's happening right now.

[0:01:53.2] MR: Well, it is actually a very exciting time in the world of crowdfunding, you know? I'm sure every one of your listeners, in preparation for this show, listened to my previous shows. They know all about the basics of crowdfunding.

But the basics again, there were three kinds of crowdfunding called Title II, Title III, and Title IV. Title III is just for accredited investors which generally means wealthier people. And Title IV like a mini public offering, you can raise up to 50 million dollars but you have to register with the SEC. It's terrific but it's a lot more time consuming and expensive.

They had this little Title III, this little step child, unlike anything we've ever had in American securities laws before where companies could raise up to a million dollars per year. But with lots and lots of restrictions including restrictions on how much each investor could invest.

So, very restrictive rules that limited many investors including accredited investors. Limited, you know, maybe you could invest $5,000 in a deal or sometimes $3,000. That's not just in one deal, that's in every – an aggregate of all the deals you invest in for 12 months period. You could have someone who thinks of herself as a pretty well off, you know, middle class American. And these rules are telling her, "You can invest the maximum of $5,000 in all the deals for the whole year." And that is you know, that's a very small amount of money.

The Title III market in particular was very disappointing, had been very disappointing since its introduction in 2016, it's incredible, four years ago, amazing time flies. In contrast, the Title II world, the world of accredited investors only, particularly in the real estate space was just and still is, just taking off, very successful.

Title IV has been a little slow out of the gate but still successful. The SEC in its wisdom and that is not sarcastic as you're going to see. The SEC made some very significant changes so I wrote a blogpost recently as you know, I write this blog with a list of the changes so I won't bother repeating all of them.

But I will talk about a couple that are really good and really important. And those couple are this: One, for Title III offering's, the SEC raised the limit for the company from a million dollars a year to five million dollars a year. As you know, the world of million raising a million dollars to world raising five million dollars is an enormous leap in terms of the number of American companies who could take advantage of that.

In particular, I might add, for real estate companies, a real estate project that requires less than a million dollars of equity is a pretty small project. A real estate project that requires five million dollars of equity, man, there are a bunch of those projects and a bunch of really good projects. So, that leap from a million to five million is very significant. But by itself, it probably wouldn't have meant much.

The second complementary change that the SEC made, and this made perfect sense is to say that in Title III, accredited investors have no limit as to the amount they can invest. Non-accredited investors still do. But accredited investors do not and that is consistent with sort of the overall regulatory framework that governs small companies raising capital. It had been a glaring inconsistency that in Title III, accredited investors had these limits imposed on them.

You know, one of the tenets – The reason we have a difference between accredited, non-accredited investors, it's been a tenet of American securities laws since they were created in the 1930s that rich people can take care of themselves. They don't need the government protecting them. And that's actually worked out pretty well.

But in Title III, up until now, we've had the government putting its arms around his shoulders even of accredited investors and saying, "You know, we don't want you to make a bad decision here. You might want to invest $25,000 or 50,000 or more, but we the government are telling you; you can only invest 7,500."

That was a glaring inconsistency that is now a been eliminated and when you think about it, companies raising money, however much that number is, you've got to convince a certain number of people to invest.

When everyone, including accredited investors, everyone was limited to saying average of a $5,000 check, it's hard to raise even a million dollars, much less, five million dollars, if you're limited to $5,000 checks. Do the math, that's really hard.

So, this change of allowing taking sort of, taking the limits off accredited investors and increasing the total that you can raise from one to five million, man, that makes the Title III market so much more vibrant. When you drill right down, what does it mean? It means that Title III funding portals, you know? The many broker-dealers that sell these deals, they can finally make money. They can earn commissions, you know on up to five million dollars. It's been a real challenge in Title III with the current investor limits and with the million-dollar overall limit, as well as all the other rules, these companies just couldn't make money. They couldn't make a profit. It's too difficult.

They were resorting to tricks and gimmicks, sort of, it just. You know, if there's not enough money there at the market. Markets don't thrive unless there's an ability to earn a decent profit. And these changes, those two together are going to make the market thrive.

So Title III, as I say, it used to be a poor step child, it is now going to become very popular because even like if you're a Title II portal, a Title II real estate portal, real estate's very high, you know, you had no interest in Title III previously, tiny dollars, lots of rules. But now, you're going to seriously consider adding a Title III portal to your total, sort of, product mix because now, you get to bring in some smaller companies and you get to bring in some smaller investors.

The smaller investors might not have much money now and they might still be limited. But the example that I often use, this is like Mercedes Benz, right? You go into Mercedes show room. They've got the $125,000 car. It also got a $35,000 car. Why? It's not because they're going to make money selling the $35,000 car. It's because they want to draw customers of all demographics into their showroom, "Come look at this $35,000 car." Because eventually, those customers are going to buy the $75,000 car. I mean, that's the idea.

And so, this is exactly like that. You're expanding your product mix to bring more investors into the showroom and that is just – to someone like me, who is so evangelical about crowdfunding and you know, making capital accessible to more people and more places and making great deals more accessible to ordinary American investors rather than just a super wealthy, this is like a symphony music to my ears. Because it has really going to expand the market and bring it to more and more people.

That was quite a long answer.

[0:11:24.3] WS: No, it's good. Tell me, you know, talking about Title II, Title III, Title IV, that's not a term that we hear very often on the show. You know, tell the listener like when does that come into account? When we're talking about titles as supposed to different types of capital raising or –

[0:11:43.3] MR: Crowdfunding, used to be illegal for 80 years after enactment of the American securities laws in the 1930s. One thing every securities lawyer like me knew is that if you are selling an interest in a private company, like a private real estate syndication or a small company, you cannot advertise, right? You cannot advertise.

Well, the JOBS Act, signed into law by President Obama in 2012, changed that rule and introduced what we call equity crowdfunding. Now, for the first time in American history, you can advertise small deals, private deals. And of course, what that means, in the age of the Internet is that you can raise capital online. I mean, that's what I always say to people who are just getting into the space. Fortunately, there are lots of complicated legal rules because then, people have to hire me to explain them.

But the big picture which your generation understands immediately, it's just the Internet. You know, we use the Internet for everything, you might have met your wife using the Internet. We use the Internet for everything and crowdfunding means we can use it to raise capital which seems perfectly natural to your generation.

But to older generations, this was like a big deal. Anyway, the JOBS Act was a law, you know, passed by congress, signed by the president, in the United States laws, when they're wrong, are separated into pieces and it just so happens that the pieces of American laws are called titles, it's like a chapter. I could call it a chapter. But they happen to be called titles.

The JOBS Act of 2012 had a bunch of titles and the different kinds of crowdfunding, one kind is in Title II of the JOBS Act. The other is entitled three of the JOBS Act, the other is titled four of the JOBS Act.

So that's why to impress people at cocktail parties, we say Title II, Title III, Title IV.

[0:13:56.5] WS: Tell me how Title III is going to change or could change how we in the real estate syndication business might change how we operate or how will it change it?

[0:14:08.4] MR: Well, with these recent changes, you know the proposals, the SEC proposals that haven't come into effect yet, it makes it easier to syndicate real estate deals and –

[0:14:21.9] WS: Even if I am not a broker-dealer?

[0:14:23.7] MR: That is the point.

So, the last time I was on your show, we were talking about paying commissions, paying what amounts to commissions. To people who were not licensed to receive them. Finders, that whole world of finders. And the SEC has actually been cracking down recently on illegally paying people commissions for not broker-dealers and therefore not entitled to receive them.

And there is so much activity in the real estate world. So much time is spent trying to get these rules and create these different structures. So, if you are a Title III funding portal and I'll just say what I mean by that. So, one of the characteristics of Title III, is that like a company if you had a real estate deal and you wanted to syndicator, you could not use Title III crowdfunding and by just creating your own website. Only funding portals, companies that are registered as such with the SEC and FINRA can sell Title III offerings, okay?

It's a – you used the right word a few minutes ago broker-dealer, funding port is like a funding portal is like mini broker-dealer. And the great thing about funding portals is once you go through the process and you get your bronze star that says funding portal, you can now legally charge commissions. So, on all those real estate deals where people are raising up to $5 million wa-lah, the need for finders disappears.

The SEC has created a legal way to pay commissions, pay and receive commissions. So, you're going to see, I mean I'm already seeing a lot more funding portals being created to do real estate. Funding portals, Title III funding portals. Because wow, we can get commissions on deals up to $5 million. So yeah, I think it is going to change the landscape considerably. There are going to be – you know right now there is something like 60 funding portals or something of all kinds and I think there are going to be hundreds now.

[0:16:47.1] WS: Wow. Okay so will that, you know for the operator that's over here doing a 150-unit deals or whatever syndicating real estate, are they still going – Do you still see them raising capital the same way they always have from their list of investors through a 506(b) or (c) or do you see them like connecting somehow with some type of company that has a portal like this?

[0:17:09.7] MR: Well, it is a great question. I think they will do both because as you know real estate operators will take capital however, they can get it. But I do think that portals will be created. In the Title II world, okay you don't need funding portals. There is no legal rule but the place where the big money is being raised in Title II is on the established website, RealCrowd, CrowdStreet, those folks are raising tons of money. It's their business, right?

They attract hundreds of thousands of investors and maybe in the future millions. And so when you are the real estate operator I mean that is where the capital is –

[0:17:56.2] WS: Yeah, and that's accredited only for Title II, right?

[0:17:59.3] MR: That's right. So, I think in the smaller deal space now that they have changed these rules, I think the same thing is going to happen. Someone like you could create a funding portal. And you could attract, you would literally attract tens of thousands or hundreds of thousands of investors. And if the investors are there, the operators are knocking on your door. So, I think that's what's going to happen.

[0:18:27.1] WS: So, is creating a portal something I should personally look into or somebody that –

[0:18:31.4] MR: You should.

[0:18:32.0] WS: I should okay.

[0:18:33.2] MR: Yeah and you know a month ago I would have said, "No Title III, it is the wrong side of the tracks. It is scrapping the bottom of the barrel," but now absolutely.

[0:18:43.9] WS: Where do we even begin? What does that look like?

[0:18:47.3] MR: Well, it is a pretty easy process. You form a company. You register with the SEC – a very simple right – it is not an application. It is just a registration and then the harder part is you have to apply to be a member of FINRA. And FINRA has a lot of rules but it is just a process. It is just some application process. If you said, "Yeah this sounds interesting to me, Mark," you could be up and running as a funding portal 90 days from now.

[0:19:19.8] WS: I wouldn't have guessed that.

[0:19:21.6] MR: So it's big, it is big news.

[0:19:24.2] WS: Very, very interesting.

What are the setbacks or what is the downside or any downsides that we haven't talked about as far as I said, "Okay Mark, let's pursue this portal thing." What is going to be the downside?

[0:19:34.7] MR: Great. See you have a business mind, right? You saw, "Yeah this is great possibility but wait a second, what am I missing?"

So, there are two things, dealing with FINRA can be a pain for a small company. You know FINRA is created to regulate big broker-dealers. And FINRA and they would admit this just has a hard time dealing with you know, little funding portals, one or two- or three-man funding portals. So, the regulatory apparatus is outsized for the subject matter, for the little deals being regulated. So that's a drawback.

And then the advertising of deals that you are permitted under Title III is more restrictive than you are used to dealing with, okay? If you are used to just the normal private syndication world including 506(b), 506(c), you are used to just advertising all kinds of stuff and target IRR's this. And in the world of FINRA and therefore Title III, your advertisements have to be much more circumspect. I think that is the honest answer. Those are the two drawbacks.

But I am sure that the upside of being able to charge commissions legally on $5 million deals is going to far outweigh those downsides. And to tell you the truth, I think the next improvement the SEC makes, will probably have to do with making those advertising restrictions a little bit less restrictive because they are kind of silly in some ways.

[0:21:23.8] WS: Regarding 506(b) and (c) and how we can or can't advertise?

[0:21:28.2] MR: The restrictions in Title III. The restrictions only apply to Title III. In Title II, rule 506(c) you know my trick question when I am moderating a panel of lawyers at a conference is to say, "What kind of advertising can you not do in 506(c)?" And everyone goes "Hmm." And then I say, "That is a trick question because the answer is nothing." You can do anything in rule 506(c) and that is not the case today in Title III.

[0:22:01.6] WS: But you see that changing?

[0:22:03.5] MR: I do. Yeah, just because some of those restrictions are truly silly. I mean you got to bear in mind Title III as I said is a brand-new animal and many, many very conscientious people were and continue to be concerned that jadey operators would use Title III to steal money from widows and orphans. And I mean that is a legitimate concern that's why Title III started out so restrictive.

But in fact, there has been no stealing in Title III. There's been no fraud. I mean there had been a lot of bad companies but that's – there had been a lot of good companies. But we simply have not seen the really bad behavior that people were concerned with and that's why the SEC now feels free to kind of loosen it up a little because, "Hey, it's been okay. It's been fraud-free," and I think it will continue to be fraud-free and so they will loosen it up further.

[0:23:14.9] WS: Mark, we're about out of time unfortunately but any other big changes we need to speak to before we had to go?

[0:23:21.9] MR: You know there are changes to some of the other rules, for example Title IV, which is also known as regulation A, you're going to be able to raise up to $75 million now as opposed to $50 million and a bunch of miscellaneous changes. But the ones that we have talked about absolutely are the most important taken together.

And anyone interested in knowing about the others can take a quick look at my blog, which has them all and also has the links to the actual SEC rules.

[0:23:57.7] WS: Well before you tell us about where to find your blog, tell us how you like to give back?

[0:24:02.6] MR: Funny you should ask that because 10 minutes before I came on your show, one of the founder of one of the major real estate crowdfunding websites reached out to me and they are going to put together a crowdfunding fund to provide assistance for doctors and nurses and first responders in the coronavirus crisis.

[0:24:30.7] WS: Wow.

[0:24:32.1] MR: Which is wonderful. And he asked me if I would be willing to do the legal work pro-bono and I said, "Absolutely." Crowdfunding is about communities helping one another. So, this is a perfect opportunity for someone like me to use what I know to help those who God knows deserve it.

[0:24:57.9] WS: Yeah, that sounds like a great opportunity. Well I appreciate you sharing that and giving back in that way Mark. And I appreciate you just being willing to get on the show and share with all of the listeners and myself and just breaking down Title II, III and IV, which you know most of us don't understand or how that breaks down like that. And the changes in Title III that could potentially affect us in a big way in the near future.

But you know this blog sounds very interesting Mark and I just want to be sure and tell the listeners how they can get in touch with you and where they can find that?

[0:25:27.9] MR: Well, the blog is at crowdfundattny.com. So crowd fund and then the abbreviation for attorney dot com and all my contact information is there and send an email as with most of us these days. That is the best way to contact me.

[END OF INTERVIEW]

[0:25:48.6] WS: Don't go yet, thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcast out there. You can also go to the Real Estate Syndication Show on Facebook so you can connect with me and we can also receive feedback and your questions there that you want me to answer on the show.

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[OUTRO]

[0:26:28.9] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Life Bridge Capital, making a difference one investor and one child at a time.

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