

THE CYNICS GUIDE TO CROWDFUNDING

Real estate is perhaps one of the greatest wealth creation tools. You don't need a fancy degree and you can participate in several different ways. With the advent of crowdfunded real estate, never before has it been easier to invest in deals with less money.

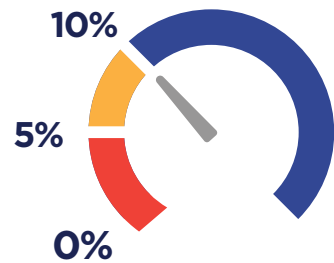
That lower barrier to entry, though, is widely seen as a siren call for fraudsters to take advantage of the less-sophisticated. This blueprint will keep you from being fleeced.

1 HOW MUCH IS THE OPERATOR, THE PERSON MANAGING THE DEAL, INVESTING PERSONALLY?

Where is this money coming from? Is it actually theirs, or is it from family and friends?

The operator having their own money in the deal says that they have an alignment of interest with you as the investor. **Where is their alignment of interest with you?** There isn't one. Financially speaking, if you get hurt, they should get hurt, too.

Never take advice from someone who doesn't have skin in the game or doesn't have to live with the consequences. You will lose every time.



2 FEES. IS THERE A HUGE UPFRONT FEE OR LOAD?

Funds and deals that use this model are set up to make their Promoters or Operators rich, not their investors. They're in it for the fees, not the performance, and they don't have an alignment of interest with you (see #1).

3 HOW WILL YOU GET TAKEN OUT? WHAT IS THE EXIT STRATEGY?

Believe it or not, many Operators will not have this in mind. In commercial real estate, **there are only two exit strategies: a sale or a refinance.** Is your Operator financially qualified to get refinanced out of the deal? How long before you will be taken out of your deal and get your investment back?

4 HOW MANY SMALLER INVESTORS DO THEY HAVE? THE CYNICS GUIDE TO CROWDFUNDING

This could be an indication that the Operator may have dropped his minimum investment in a desperate attempt to raise funds.

Generally, if there are more smaller investors, as evidenced by smaller minimum investments of say less than \$5,000 or \$10,000, this may mean that those investors are unsophisticated and do not understand that this is an illiquid investment. Then that means that your Operator may have to focus his time on getting those smaller, needier investors cashed out by raising money from others rather than doing what he or she should be doing, which is managing your deal.

5 WHERE DOES YOUR MONEY GO?

You may think it's to buy a piece of real estate; however, that may not be the case. Where in the Capital Structure are you? Are you debt (safe), equity (riskier, but more upside) or something else? **Steer clear of "cash flow notes" and "cash flow certificates" as they are basically IOUs that are not secured by anything.**

Ask your Operator: "How am I secured?" Then keep quiet as he or she explains. If you want to go crazy, ask them "Where in the *capital structure* will my investment be?"

6 WHAT IS YOUR OPERATOR'S EXPERIENCE?

Ah, résumé can be embellished and those who are not experienced real estate investors are almost certainly impressed by throwing names around of Fortune 500 companies. However, being a real estate entrepreneur is just that. Being an entrepreneur with no nets. No company middle management to hide behind. Has this Operator managed, as a principal, an investment similar to this one? **Have they ever laid in a pool of their**

own sweat before? What is their track record? Or are they expecting you to be the stupid money to fund their first deal that they will make lots of mistakes on?

Where is the asset located? It should be within 20 minutes of where your Operator lives. Otherwise they will go broke, or worse yet, incur the travel fees to you to manage that far away asset.

7 ARE THEY OVERPAYING FOR THE ASSET?

Real estate becomes the most popular asset class at exactly the wrong time, which is when prices are going up. If your Operator isn't using any of his own money, what does he care if he overpays or not?

However, most buyers and investors will be easily seduced by not the Current Net Operating Income, but rather the *Pro Forma* Net Operating Income, which is **essentially a lie.** Any experienced multifamily Operator will tell you it is impossible to get 10% rent increases year over year when a majority of Americans have seen their paychecks grow smaller.

People who buy off the pro forma are losers as they will lose your money faster than you can say "Exit Strategy", as in you won't have one...

Ask them how they valued this deal? Is it based on recently sold assets of similar size and unit numbers? Then be quiet. You'll learn more here about your Operator than you probably want to know.

8 HOW MUCH LEVERAGE ARE THEY USING?

Leverage is good, sometimes. If your Operator is using too much, then they are probably trying to use that juice to make a marginal deal look like a home run. Debt can amply help your returns, if used carefully, and can absolutely destroy you when the markets go down.

WHAT OTHER ASSETS DOES

9 YOUR OPERATOR CURRENTLY HAVE?

This is similar to #5 but could be more lethal. Do they have a portfolio of "legacy assets" that they are using your money to pay off other investors or expenses related to those bad apples? This occurs much more often that you can imagine. Putting good money after bad is not a winning investment.

10 DO THEY HAVE PARTNERS?

If so, how do they all know each other? Do they all live in the same town or vicinity? The best case scenario is that they have worked together on real estate transactions for years. Maybe they took some time off and decided to bring the band back together again for one last show, or the opportunities are ripe, etc. Those are the good management and operating teams you want.

The last thing you want are a bunch of folks who are "friends" who really don't know each other. They don't know each other's financial position and experience. **Husband and wife teams are red flags too...**

If they are truly partners, they will have an Operating Agreement that will dictate who does what, when and if a breakup occurs, who does what and who gets what out of the divorce. **If a partnership breakup happens, you'll almost never know about it until it's too late.**

Investors may be putting most of their life's savings into these deals. Real estate historically has been full of scams, but now it has neared perfection. Use this checklist to ask the hard questions to the deal's Promoter or Operator before you invest. Then use your gut to measure if this is something you should be involved in or not.

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