EPISODE 101

[INTRODUCTION]

Mark Roderick (MR):

What the internet does is it weeds out inefficiencies. That's, you know, bypasses middlemen, bypasses experts. And so what it's really good at in the crowdfunding space is funding deals, as to which there would be limited information.

Tejas Gosai (TG):

Ladies and gentlemen, welcome to Real Estate Investor MBA. My name is Tejas Gosai, and I've had the honor of helping hundreds of investors achieve the American Dream by creating generational wealth through real estate. I've spent the past few years interviewing the most knowledgeable experts I could find in the business to cut your learning time and conquer the hardest subjects in the game. Check out [rei.mba](rei.mba), which my team and I have packed with over 75 interviews and free access to our real estate roadmap, webinars and publications. If you're listening, I am rooting for you. And you're already on your way to financial freedom. Cheers and happy hunting!

[INTERVIEW]

TG:

I love picking the guests on this program, I try to have the best and most knowledgeable experts to help me personally get through the times that we're in, sharpen your skills and rely on folks that have been through many cycles in real estate and have decades of experience. So that, us, while I'm in my 40s, can adapt to the crazy market that we're in.

Mark Roderick, we have a couple of similarities, which is great. He is a tax attorney who pulls capital legally and invests that capital in real estate to create returns for investors. I do the same thing. I went to law school, I'm not a practicing attorney, I do have my commercial real estate license. I am pooling capital with accredited investors, high net worth individuals, and investing in real estate. And I do this in the Lehigh Valley. It's where I live. My team and I have closed millions in this community specifically in multifamily over the past almost decade now. So it's great to have Mark on the program to share his knowledge, insight and how he keeps people legal in doing the same thing. So Mark began his career as a tax lawyer, he handled mergers and acquisitions for a very large company. And he considers himself a boring corporate and securities lawyer.

Since the Jobs Act of 2012, which we talk a lot about in detail, He has spent all of his time in the crowdfunding space. And today, he's one of the leading crowdfunding and fintech Lawyers in America, he regularly writes blogs that are widely received. And he offers a wealth of legal and practical information for portals and issuers. And we'll get into that in a bit. He speaks about crowdfunding at events across the country, and he represents industry participants across the country and the world as well. He is an evangelist about crowdfunding by making capital available to a broad spectrum of entrepreneurs and by making available to ordinary Americans the kind of investment previously limited to the very wealthy. Crowdfunding can reinvigorate American capitalism and begin to address the serious wealth and income inequality in our country. So he believes in this passionately, and he thinks that everyone is capable of taking part in real estate through a few specific avenues. I'm super excited to have him on the program. Enjoy.

[INTERVIEW]

TG: Mark, thanks so much for being here. I appreciate you taking the time out of your busy schedule. I just said a big intro about you. Welcome.

MR:
Thank you. Looking forward to our conversation.

TG:
You know, we were chatting about what we should talk about. I think, first, if you could just tell us a little bit about yourself, I want to cut right into what's happening now and some of the things you've seen with your clients.

MR:

Well, it was a bright blue day when I was born. And I'll tell you my whole personal background. Now I have been practicing law since about 1840. And I have represented during that old time entrepreneurs and their businesses in all the different kinds of stuff they do. And of course entrepreneurs, including real estate folks, are often looking for capital because this is capitalism. And you know, capital is the lifeblood of our economy. I mean, real estate folks, the joke is that you can meet someone in real estate who is not looking for capital and call 911 because he's probably not breathing. So I have done a ton of, you know, helping folks raise capital. So when the crowdfunding laws came on the horizon in 2012, I immediately said to myself, this is absolutely cool. And it's going to be transformative. Because crowdfunding is really for all the technical legal details. Crowdfunding is simple. It's just the internet coming to the capital formation industry, you know, in Amazon and various competitors and the dating industry match.com. But I mean, seriously, I mean, that's one of the best examples of what the internet does. In the past to raise capital, if you wanted to raise capital for your real estate project, for example, what would you do? Let's say this is your firsttimeout. I mean, there's no obvious way to start you. Call your accountant, call your friends, call your lawyer. If you grew up in a wealthy family, you asked your parents, friends, and family, you know, and start that whole quest, trying to meet people and getting introduced to people. It's so fun. Well, think of dating, you decide, okay, I'm gonna start dating Well, where do you start looking? You know, go to Starbucks or whatever, but it's exactly the same. And so what the internet does in both cases is it just so vastly increases your opportunities. On the investment side, you know, you can use crowdfunding to immediately connect, literally, with every prospective investor in the world. I'm sure that crowdfunding laws. And so anyway, so I realized that was just going to be transformative and exciting. I just started to do that. And started to write a blog.

TG:

Yeah, what did you do with your first project? How did you help on those first crowdfunding deal?

MR:

Well, that it's not okay. I was gonna say it's not that complicated. It is kind of complicated. But as soon as the word started to trickle out that there was this way, contrary to all prior laws, that there was this way that you could solicit investors publicly, you know, that has always been absolutely no before and now it becomes yes. And so people started to call me to understand how that worked. And to put those deals together for them, you know, those real estate syndications complying with all these new laws and all the different types of laws and so forth

TG:

And not go to jail and do it legally.

MR:

And not be sued. And I, I can't tell you how many people would call and say, No, that's not possible. You can't do that. Because of course, you know, that's what they were being told by the lawyers that they had (inaudible). I don't know, that guy if he's telling you, that's illegal. That's wrong. You're gonna go to jail. It has been transformative.

TG:

I'm a nerd about the law. So what exactly in the law changed? Was it just hey, you can't do this before now you can do this? Or was it a bunch of different laws that happened at one time?

MR:

Yes to both questions, even though they seem contradictory, and I will become as granular as you'd like. The law was the Jobs Act of 2012, which was signed into law I think, on April 5, 2012. And the Jobs Act created three different types of crowdfunding. The simplest, and the most spectacularly successful from a real estate perspective, was indeed, as to your first question, just a change. You couldn't do it before you could do it now. Most syndications, real estate syndications, previously, were done under SEC Rule 506 either only to accredited investors or to accredited plus 35 Non accredited. So rule 506 used to be the place where most real estate syndications happened. One of the rules under Rule 506 was no advertising period, don't do it, go to jail.

The Jobs Act simply changed that rule. And said that now we have two types of Rule 506 offerings, the old type is rule 506 B and all the same rules apply to that. But now we have rule 506 C, which says you can advertise and the only requirement is that you have to ensure, verify that all your investors are accredited. That was an example of you just you couldn't do before. And the law says, now you can do it. And, you know, thank you billion dollars of capital raised later that that has been spectacularly successful.

TG:

Thank you for sharing that. I do like the granular nature of that. It is important because of that whole staying out of jail thing. One day you couldn't do it one day you could that means the SEC changed and a lot of the rules behind that and consumer protections and some of those things, right?

MR:

Well, it amounted just to a simple new regulation issued by the SEC pursuant to that statute that says if you do this, namely, verify that your investors are accredited, that old rule, it was one of the subsections of Rule 502 that said no solicitation, that rule just doesn't apply then. It was flipping a switch.

TG:

It was a big switch then because from what you’re saying, it activated the internet. And then like speed.

MR:

Exactly. You got it. That's all it did. It said no internet before now you can use the internet.

TG:

Yeah, this whole gigantic infinite world opens up for you. (That's right.) And that's why we've seen so many changes just since 2012. It's not been that long. It's been 13 years. Let's get into that stuff. So people have been crowdfunding, you have been leading the charge keeping everybody legal. Tell me about some of the folks you've worked with recently. A lot of people are still afraid to pull investors into a deal or they're still afraid to do a deal with the environment. What's going on with your folks today?

MR:

Oh, my gosh. Yes, you're right. Some people, particularly in some areas of the country like Philadelphia, where I live there's almost no crowdfunding because it's the culture is just so you know, my grandfather wasn't allowed to do what I'm not doing it. But other areas of the country, most areas now, California was the leader. Texas, as you might guess, is has been another leader, Florida, New York. And the clientele, it's everybody. It's the largest syndicators. I mean, I can't tell you my clients' names because they're confidential, but some of the largest syndicators in the country are my clients and just their level of syndications has just gone through the roof. Down to small developers and everyone in between. But my clients have certainly done hundreds of millions of dollars.

TG:

Probably billions to this point. Let me talk about the smaller part of it first. I got this 10-unit property, I want to crowdsource it. It's a great deal. No one's ever seen anything like this. I come to Mark, can you help me? How do we do this?

MR:

Yeah, and the good news is, I can say yes, to part of the question. The bad news is, it's the part of the question that you're probably least interested in. So I will say, as I always do, I'm a boring corporate lawyer, I can absolutely make sure this is done legally with great, easy-to-understand documents and make sure you don't get yourself in any trouble and put all the right special provisions in your documents, you know, anticipating, in documents where you used to have poor investors and now you have 40 or 400 are very different and I give you all the right documents cool, and that's exciting to me. But what you're really asking is can you help me raise the money? And to that, my answer is no. I'm not an investment banker. And if you're a, have a long track record, you might be able to get on one of the top real estate crowdfunding sites to get your deal listed, like on Real Crowd or Crowd Street and have an excellent chance of raising a lot of money from their established investor base. At the other end, if you're just starting out, guess what, you are now in the digital marketing business. I have said since the beginning, crowdfunding is a marketing business. It is not, you put up a website, and suddenly everyone's beating on your door to write checks to you. It's not a build it and they will come. You need to advertise.

TG:

But you are building it so that we can take it to market, essentially.

MR:

Oh, yeah, I will build it. So it's absolutely ready for you to take it to market.

TG:

Let'stalk about that. So all right, yeah, I have this project. I know I'm going to be able to market this on Facebook, I have a small Facebook group or whatnot. So what do we do I show you the property. I tell you all the information, I pay you a retainer, and then you make sure I can go to market?

MR:

That's right. I do all this stuff. I really ended up giving you a set of legal documents that are appropriate for your ideal.

TG:

Granular I would I really want to know what documents, if you could share, you know, what keeps us legal?

MR:

I'll answer your question in a couple of different ways. Three documents in any real estate deal, or in almost any real estate deals is a subscription agreement and the limited liability company agreement, and the disclosure document, also known as a PPM, private placement memorandum, and each of those do have a certain purpose,more than happy to talk about, but it is it's the to stay out of jail. It was just using that as a rough metaphor, sort of, that's the most important thing. And that's the disclosure document. That is what you tell people about the deal, what you say, and also what you don't say, and how clearly you say it and how well you describe the risks of investing. Because, you know, what you don't want is your investors. Let's say the deal. I mean, if the deal triples in value, and everyone gets rich, no one ever complains. It turns out, you didn't need it, everyone's happy. But if the deal goes sideways, or South investors are unhappy, or maybe one of your original investors has died. And now that his son-in-law who's a personal lawyer is unhappy, and starts thinking about legal points. And so you the disclosure document is the main document that keeps people from suing you successfully after the fact if they, if they've lost money. And so that's it's a super important document.

The subscription agreement, it's also important it's the terms whereby they're buying their interest, their interest in your real estate project. And you have to be very careful.

TG:

For example, I'm going to put in $100,000. That gets me 25% or something.

MR:

Yeah, that's right. And that's the purchase agreement, where you're buying those shares. That's the subscription agreement. The disclosure document is what tells you all about the dea, upsides and downsides. And then the LLC agreement is what governs the actual operation of the enterprise. So it's what talks about, you know, the distribution waterfall, for example. Obviously very important to describe the distribution waterfall,

TG:

and just because people may not know that is the profits. (How the money comes out.) Yeah, and there's typically a percentage, it's like 80% to the investor 20% to the operator type thing.

MR:

Yeah, all different possibilities, you know, income kinds of deals and multifamily deals with, it's typical to have like a 7% preferred return to the investors and then maybe an 80/20 or 70/30 split, a development deal might not have talked about preferred returns, it might just talk about internal rates of return. So there's different kinds of distribution, waterfalls, but you'd be amazed how many in how many documents they're not described properly. That's bad. So it all has to work together. And I can put that all together, but you still have to sell your deal. That's why crowdfunding is a marketing business.

TG:

How about this? So I've talked to you, you put the documents together? Where do I file them? Or who do I tell? Or how do I make sure you know, with the doubt, Is there someplace I put it?

MR:

No, not not in Rule 506 C? Again, we, our whole conversation, so far has been about one of the three kinds of crowdfunding, it's the simplest and has been, by far the most successful Rule 506 C requires no government approval, and no even government filing, except you have to file a very simple piece of paper with the SEC, called a Form D says nothing about the offering really, it's just an informational tool.

TG:

File that with Mr. Edgar.

MR:

File that with Mr. Edgar and then you have to file a very simple notice in each state where one of your investors lives. But almost nothing. I mean, it's very, very straightforward. So one of the tenants of American securities laws is rich people can take care of themselves, and rich people and accredited investors have sort of historically coincided. So in Rule 506 C, by definition, it's only accredited investors, and therefore, the government takes a very, very hands-off approach. So you know, no filings, no approval. And so if you could, it's sort of wild, wild west, except, you know, you can get sued by your investors.

TG:

And, you know, I don't even think I told you this, you know this, but I run a private equity fund, everything you're saying is what I've done, the accredited investor portion, right, you're saying, hey, these consumers are different, and they're versed. What does it take to be an accredited investor? How do I, as somebody who's who's working with you? How do I make sure they're an accredited investor?

MR:

Well, the basic definition hasn't changed since 1982. That is a long time ago, 41 years now. And for an individual, it's the same as it was then it's $200,000 of income or 300,000, you and your significant other your spouse, or a million dollar net worth, without taking your primary residence into account. And so you can see, I mean, 40 years of inflation, you know, even gradual inflation. Back in 1982, earning $200,000 meant a heck of a lot more. I think it's the equivalent is like five or 600,000. The rules haven't changed. The SEC hasn't changed. A couple years ago, they modified the definition a little to include a few more people, like people who have certain FINRA licenses, have passed finger exams,

TG:

Series seven and stuff like that.

MR:

Stuff like that. But it's still, I think about 8% of the population is accredited, 7%. Something like that. And under the old syndications if you wanted to know if your investor was accredited, and you just ask her, “Are you accredited?” She says, “Yes,” you say, “Okay.” You can't do that anymore. Under 506 C, you have to either verify yourself, for example, by asking your investors to see their tax returns which investors don't want to share with you or you use a third party. The biggest player in that provider is a company called Verify Investor. (We use them.) You use them. That was started by a buddy of mine in (inaudible) law.

TG:

Really?

MR:

Oh, yeah. It’s a small world.

TG:

I would like to shake that man's hand and thank him.

MR:

Well, he sold the company. And the way it usually works, all the investor needs to do is to get a letter from a lawyer or accountant saying, Yep, she's accredited, and then you can rely on that. So it's a pretty straightforward process, you pay about $40 per investor, something like that.

TG:

And then that's the Wonka ticket, right? Because when you're, when you get that you can then go invest in any fund you want or any syndication, and then, you know, you're looking for good operators. Let's talk about that for a minute. So you obviously have some good operators and some national folks and some pretty big, big guys. Are they creating documentation for single properties? Like, you know, $50 million development? Is it for a group of properties? Can you share some of that?

MR:

It's both. Wealthy investors, as you probably know, in your, in your capacity, wealthy investors, many of them think that they're just as good at your business as you want. And they want to do their own due diligence on properties. So even if you've done, you know, a million multifamily projects or a million industrial projects, very wealthy institutional investors want to invest on a project-by-project basis, because they, they want to do their own due diligence. So I would say most of the market is single asset syndication.

TG:

Can you give me some examples? Just like size?

MR:

Well, it can be. It can be anything, I mean, you're not going to probably in crowdfunding. So this is kind of a deeper issue. But deals that, the sweet spot I would say these days is maybe you're raising a few million dollars of equity deals have been crowdfunded, raising $25 or $30 million of equity. So now you're talking about an asset, probably close to $100 million asset. Those have been crowdfunded and continue to be but most of the volume is that lower levels, and there's a reason for that. The reason is, so just to take sort of an extreme example, where crowdfunding has not been useful, is single-family homes. There. There's no successful crowdfunding of loans, mortgage loans for owner-occupied single-family homes. Why is that? It's because the market for those mortgages is already incredibly efficient. Where all the players big players have access to extremely granular information, you know, by zip code and, and, and all that. So, what I mean, what the internet does, is it weeds out inefficiencies. That's, you know, bypasses, middlemen, bypasses, experts. And so what it's really good at in the crowdfunding space is funding deals, as to which there would otherwise be limited information. A, a deal, you know, a $10 or $20 million deal in Austin or something that's not on anybody's radar or not on very many people's radar so crowdfunding can come in and make lots of people aware of that deal, and share information about it, make it a very efficient deal. If someone is building a $3 billion office tower in Manhattan. You don't need crowdfunding to make that an efficient deal. Because all the potential investors, you know, all the hedge funds, all the banks, they already know everything there is to know about that yield. You know, no one doesn't know who should know. And so crowdfunding isn't needed for those deals. I don't know. It's like, I'm just going to try to use a stupid match.com metaphor and to go back some years. You don't need Match to know who Camila Anderson is, right? But they do need to know that there's some eligible person who was in your city or something. It's a bad analogy but, the internet is about sharing information and creating efficiencies and the smaller market is just more appropriate for that reason.

TG:

I hate that we have to call time soon. But that's a good point to end on. The Internet is beautiful. Real estate is beautiful. You are putting a roof over people's heads. I think a lot of people think about multifamily, oh, I'm going to the bank every day with your tenants' checks. But we're taking care of people's families. That amount of money that's going towards the taxes is paying for a good school nearby. I think we would just forget that this is a very beautiful business. And you've done a lot. You've probably helped house, I don't know, tens of thousands of people at this point?

MR:

More than that I would certainly hope. Before we finish, I do want to make one point. Because we have been talking as these conversations always do because of the people asking the questions like you. You are a person interested in raising money and so you view this from one end of the telescope - the person raising money - what does the world look like, how do I use this new tool to do what I want to do? And that's the normal perspective. And lawyers and other experts in the field get hired by people like you to help them raise money. The key is the industry, the other benefit of the industry is the benefit to the investors. Again, match.com works both ways. Both people have to be looking. And so, investors, traditionally in this country, up until now, the best deals have been available only to very wealthy people. Family offices, institutions, okay. The rest of even the accredited investors, poor Americans, people haven't been able to get in these deals. You have to buy the Vanguard 500 index fund and just hope for the best. So the other great thing about crowdfunding, not only does it help people like you raise capital, it helps ordinary Americans have access to institutional quality investments. That's what makes it great. We have the income and net worth in equality to some degree. Crowdfunding allows us to address some of that. It makes great investments available to ordinary Americans. And if you think about it, it can only be successful if it does both. You can only attract investors if you're giving them something good. And it's giving investors something good that is itself an enormous social benefit.

TG:

I love that. That is beautiful and I don't think about it all the time. Luckily I have great investors and I get to see the other side of it. But just stating that is a reason to be in the business. You're providing a good, you are standing by that good, you're warrantying that good with your operation and your profitability and your knowledge and your lawyer because you need a mark.

MR:

I have clients who could have raised hundreds of millions of dollars but they made the decision, you know what, I want to make this investment available to ordinary Americans and they raised hundreds of millions of dollars from ordinary Americans and they got better terms, by the way, from the ordinary Americans than they did from the institution.

TG:

And those ordinary Americans are extraordinary Americans.

MR:

And they're wealthier now. It's a great thing. That's kind of why I'm so evangelical about crowdfunding.

TG:

I have everything to get a hold of Mark in the show notes. You want to share your website real quick?

MR:

Well, my blog, where there's a ton of information. It's called crowdfundingattorney.com. It couldn't be simpler than that.

TG:

Check it out. Word of knowledge. Mark, thank you so much. We'll check with you guys soon. Cheers.

[END OF INTERVIEW]

