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Beyond Due Diligence

by Michael Stephan, Managing Director of iFunded.

Crowd investments from online platforms are among the fastest growing investment segments in Germany's real estate industry. This new investment vehicle is taking root as a viable alternative to mutual funds. However, purchasing subordinate always harbours some risk. Just recently, the first developer of a project funded by crowd investment went into insolvency. It is for now unclear whether investors will receive a refund.

While online platforms can only act as brokers, as they are not legally permitted to assume the function of an investment advisor, it is crucial to convey trust in the products being offered. Therefore, developers must be carefully selected and vetted. I will attempt to shed light on some key steps suppliers of online crowd investment opportunities can take to minimize risk, while maintaining a high level of transparency towards clients.

Often, the level of reliability of a planned project will become apparent with an initial check. The developer's track record is an important measure of competence, giving reference on projects they have completed in the past. Another crucial factor is the individual financial engagement. Only if the developer is prepared to invest their own equity, making them potentially liable, can one be sure of their commitment to the project and reimbursement to investors. There should also be absolute clarity about the legal circumstances of the development firm and its company structure.

In most cases, dubious offers will be combed out almost immediately, be it because of unrealistic scheduling or a lack of knowledge about the project's prospective type of usage. After all, a record of twenty realised residential projects does not guarantee the professional handling of a retail park modernisation.

Supposing all fundamental factors appear sound: What is to say that a project plan that seems realistic and well thought out will not prove unsustainable eventually? Any platform must therefore check all prospective expenses for plausibility. Building costs will be subject to the same level of inspection as projections of future proceeds. To make sure that any project will suit market requirements, any platform must consult real estate experts and examine whether the developer's estimates are realistic. In any case, the assessment of projects chosen for the portfolio should lie within company expertise. Cooperation with established property assessment firms is always advisable as they usually have a wealth of research data at their disposal.

Any project should be evaluated according to standards similar to those a bank may consult in the process of lending. Ideally, projects will undergo assessment twice: Once by the platform deciding whether to add them to their portfolio and once by any bank that is approached for credit.

Create transparency for investors

Another crucial step is to clearly and transparently display the information gathered to potential investors. After all, private investors are not privy to project documentation – also, the terminology used may be quite challenging for laymen. While investors are naturally advised to personally research platforms and project developers, platforms themselves must also do their best to present important information in a user-friendly format. When doing so, crowd investment platforms should go beyond conventional forecasting of a project.

One way to present information accessibly would be to use a points-based system which foresees various risk factors. In a renovation project, for example, an established prime location could be presented next to an elevated vacancy rate in the building. In the same way, the development risk of a third-tier location could be offset by the excellent track record of the respective developer. Bringing all these factors together, a platform would be able to display a range of risk categories.

Ongoing assessments, even beyond the funding phase

The success of a crowd investment project is not primarily decided by whether financing is fully realised. Results will only become visible during the reimbursement phase. Even though platforms act as brokers, supervision of a project should therefore continue beyond the funding period. This includes establishing contractual reporting obligations for developers which could help to recognise possible negative results or even insolvency early on. On this basis, platforms can then swiftly act and seek dialogue with developers and investors.

To date, real estate-related crowd investments have often been associated with subordinated loans. This is, however, not the only possible investment method. Bearer bonds or other securities can also be issued. Due to their clearly defined stipulations, using these bonds can further increase transparency. In the future, equity investment in a project developer could be another alternative.

Investors need a reliable and neutral foundation on which to base their decisions. Despite their intermediary role, platforms should actively communicate that broad diversification remains the most important factor in crowd investment. After all, the unique feature of the digital investment platform is the opportunity to spread one’s funds across a wide range of projects.

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iFunded opens the world of real estate to any interested investor. It is a smart, digital platform, that brings private investors together with leading professional investors in the real estate industry for joint projects. This enables iFunded investors access to exclusive project financing, which was previously reserved for institutional investors. https://ifunded.de/