PODCAST TRANSCRIPTION SESSION NO. 110-BEN MILLER

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Peter Renton: Today on the show, I'm delighted to welcome Ben Miller, he is the CEO and Co-Founder of Fundrise. Now I've been wanting to get Ben on the show for quite some time because Fundrise are one of the true pioneers in the marketplace lending space for real estate, they were doing real estate deals when pretty much every other platform wasn't even in existence and they really are a true pioneer so I wanted to get Ben on the show. We talk a lot about what Fundrise does, what makes them different, this unique focus they have on non-accredited individual investors so we talk about how they're able to do that, we talk about how they source deals. We also talk about their recent equity fundraise which they also did in a unique way. It was a fascinating interview and I hope you enjoy the show!

Welcome to the podcast, Ben.

Ben Miller: Thanks for having me.

Peter: Okay, so let's get started by giving the listeners a little bit of background about yourself, what you've done in your career prior to starting Fundrise.

Ben: Well prior to Fundrise, right before I was working at and president of a real estate development company in Washington, DC. We were let's say one of the largest retail mixed-use developers in the city; we built complex...fairly large scale real estate projects usually 250,000 sq ft. to a million sq ft. so in an urban context that can be pretty large. Before that, I worked at a tech startup and private equity fund so my background has been real estate, private equity tech since the late 90s actually.

Peter: Okay, so then you started in real estate and obviously Fundrise has been around for a long time. I think you're one of the oldest companies in the real estate space when it comes to the online space anyway. Tell us about how you got the idea for Fundrise and how you got started.

Ben: Yeah, so as I said we had these large real estate projects and so we had large private equity or private capital partners and in 2008/2009, when the financial market blew up, so did they.

Peter: Right:

Ben: The last thing I expected was these multibillion dollar fund partners to be the ones that had no money. (Peter laughs) So we spent a couple of years restructuring those deals. We bought some of them from the partners, it was a pretty hairy period and I came out of it being like, okay, I don't want to do that again and thinking about the system, thinking about the capital markets because as a real estate guy I was really just thinking about the real estate and I never really thought where does money come from, how does the money get into my projects, why does it exist the way it does?

One day, I was doing a small scale real estate deal in kind of an emerging market in DC, my brother and I were sort of like local developers here and it sort of dawned on me, what if we use the internet to raise the money for this deal as opposed to traditional. This was before the JOBS Act, before any idea, this is like the I guess history…the first real estate crowdfunding deal, it's 2011 and we're sitting there trying to convince SEC to let us do an online offering of a single real estate deal for $100 a share. They were sort of like what are you talking about, this is crazy, this idea of internet fundraising, I called it online syndication, was just this totally outrageous idea. People thought I was crazy, I'd go to real estate companies, you should do this, they'd say that's crazy, we're never going to do that.

Peter: Right.

Ben: And then by 2013, they started saying well that's not crazy, that's just novel (Peter laughs) and by 2014/2015, people started saying well, that's obvious.

Peter: Right, so yeah people came around eventually. So when did you actually do that very first deal, when did it close?

Ben: We were the real estate company, we built a web platform and then we got the securities side of the business all tied up together so bought the real estate in 2012 is when we did the offering, 2012 was when we launched it. We raised $325,000 from 175 people and I think it took us four months to do that.

Peter: Wow.

Ben: So I was like, oh my God, at the end of that, I was like man, that couldn't have been worth it...and now we raise that in like less than a day.

Peter: Right, right.

Ben: You know, we probably raise half a million, a million dollars a day at this point so it's like...there's a non linear nature to tech that's different than real estate. Real estate guys thought I was joking when I told them how much time and I effort I put in to raise $325,000.

Peter: Right, yeah, well there's certainly easier ways to have done that, but you were...you really have been a pioneer, I mean, trying to get this done. So you closed this deal then after the JOBS Act? Were you trying to do this before?

Ben: Before, before, we did it before. We cleared...we filed with SEC I think in 2011, but we didn't get…it might have taken us like a year, I can't remember exactly, maybe eight/nine months to get cleared by the SEC because they were critically skeptical of it when they first saw it. We actually hired the former Deputy Director of the SEC to help us shepherd it through the SEC so that helped us with some credibility and so right when we were doing this all of a sudden the JOBS Act comes out of…so people who were there, it really came out of nowhere, I mean, to me it was just, you know…it hit the House and the Senate and it flew through the House. I remember going up to the Hill trying to tell people this was a good idea and I remember people were just like, wow, something happened that was bipartisan and quick, it was unheard of. So that was 2012 when we sort of closed the deal…and the JOBS Act, it passed but it didn't get promulgated or effectuated for like a number of years thereafter.

Peter: Right, right. So I'm curious, you spent all this effort raising $325,000 and you decided to do it again. So clearly, you must have been pretty passionate, I imagine, about this. Was this all about trying to democratize your investor base because of what happened to you in the financial crisis or was this something that you just felt like...you felt really strongly that this was an idea whose time had come?

Ben: Yeah, so one thing that we focused on from the beginning and at times people thought we were a little bit like evangelical...we always wanted to be open to the full public, to the non-accredited investor too, the idea that...after we did this....it took a few years for the industry to catch on, I mean there's probably a hundred real estate crowdfunding sites now and I'd say 97 of them all do accredited, high net worth, institutional money. We've always been focused on the individual, the average investor, the everyday guy who generally doesn't get access to good investments because that's just not the way the system is built and that made it a lot harder.

I mean, the regulatory burden associated with doing this was a hundred times harder than doing it just for normal, high net worth accredited investors, but there's a saying in the securities world, they say that you either qualify the investor or you qualify the offering. And so most sites qualify the investor, qualified or accredited investor; we always qualify the offerings and so anybody can invest in them.

Peter: Right, so was your first offering non-accredited investors?

Ben: Yeah, public.

Peter: It was?

Ben: Yep, that's why it was so hard.

Peter: That's amazing. So, okay then...

Ben: It might have been the smallest public offering in history.

Peter: (laughs) Certainly for a long time, yes. Okay, so let's just talk a little bit about how...obviously now you've established your business, how has your company evolved since those early days? What's actually stayed the same and what has changed?

Ben: Oh my goodness, we've been doing this for five years so it's evolved a lot. We started out doing these individual deals and investors could come on the site and invest in individual deals, but there was a two-fold challenge we found with that. The regulatory burden for allowing the public to invest in an individual deal was sort of asymmetric, it just made sense to create more targeted portfolios and second is 99% of investors they are not real estate experts. I've spent 18 years in real estate and you're asking a lot of somebody to look at a real estate deal and really know the difference between a good one and one maybe that's not so good so we try to make it a little simpler and more diversified.

We moved from individual deals to these, what we call eREITs which are portfolios of real estate. The fundamental advantage of going through our system is that as a public investor, as an everyday investor, you can not get to the private market at private pricing, you only can get to the public markets and public pricing is generally a lot higher for the same asset. It can be 20, 30, 50, 100% higher because the public markets you have millions or tens of millions competing for the same purchase. It's way more efficient, way more transparent and that results in basically higher pricing and way more liquid.

It's one of the reasons why Lending Club and Prosper were successful early on is that it basically allowed an individual to transact in a private context, but as a public investor and so those yields can get bid down. They eventually got bid down by the institutional investor so they essentially became accepted by the public market. It's not a very deep space, you know, Lending Club and Proper hit ceilings on how much they could put out and keep their credit quality so one of the big values is being able to, as a public investor, invest in private assets at the same price, at the same basis, at the same terms as an institutional investor, as you know, a billion dollar fund.

Peter: Right, got it. Okay, so let's talk about the actual deals that you're doing. What part of the real estate market are you focused on and what part geographically and sort of what component, what sort of sub-asset class are you focused on?

Ben: Our approach has always been to be in the space that's too small for institutional investors and too big for individual investors. So if you're going to raise money for a real estate deal, if you're an individual, you're going to have a hard time raising more than a few million bucks.

Typically, it's $1, $2, $3 million is friends and family, above $1 or $2 million or $3 million, you start needing institutional money. Institutional money doesn't like to write checks…usually, they don't like to write checks less than $10 million, sometimes it's 20 so we try to stay between $3 to $15 million check size which is kind of an inefficient part of the marketplace for real estate and then we just play all over the capital stack.

We love to go where institutions don't want to go because the second institutions are there, big funds are there, it's going to price way lower. We've already seen some of our early kind of niches where we used to get a 14% interest rate from a mezz position on an apartment building. Now institutions are playing a lot more in, for example, construction mezz, those deals are now maybe now down to 12% so they just compress the returns. We always want to be ahead of the big guys because they just crush your returns.

Peter: Right, so in that..you sort of said $3 to $15 million range so are these primarily office buildings then, are they multi-family apartment complexes? What are the actual typical kinds of properties?

Ben: Yeah, we've been doing primarily residential; it's apartments, it's housing. I haven't been very bullish on office for years, I've done offices as a developer...I don't like office as a product but…and the housing side of the market, residential, apartments. There's a lot more stability there in a lot of small or medium size apartment buildings. So we've done equity in sort of what they call Class B, boring but really good assets where you can buy...we did a deal in Jacksonville, I think we're into it for $40,000 a door, a unit and we did some value add and then we took it to $60,000 a door and you can't build in Jacksonville for less than $120,000 an apartment unit, right. So you're half the replacement costs, you know, our current yield was like 8% and we think it appreciates some more, that's a great way to do real estate because you can get the sort of inflation protection of buying an asset below its true cost, below its cost to replace it and you can get the current cash flow from the rents. We've done that now for five years at Fundrise.

Peter: Okay, so then are you always investing in the equity piece? You're not providing lending capital?

Ben: No, no, we do up and down the capital stack because that might be....we do a lot of senior lending on housing, we do a lot of mezz or preferred equity which is like a senior to equity but junior to debt for different kinds of apartment projects. I'd say about two thirds to half of our business has been debt and it just depends a lot on the ground up underwriting.

Peter: Right.

Ben: Everything we do is ground up.

Peter: Okay then how are you sourcing these deals, where are you finding these properties?

Ben: Back in 2013/2014, there was a dearth of capital, there was not enough money in the market and there was a lot of deals and we would just get thousands of deals through our site and we'd pick one or two out of every probably hundreds. These days we have built out a more traditional network where we're in markets sourcing deals a lot through the traditional ways and just try to be in the market at slightly below the institutional players' radar and so we have 50 people now at the company so we have a team of people who, all they do is source and underwrite real estate deals.

Peter: Right, okay. So then I just want to clarify something. If you go to your homepage, it's a very investor focused website which is not that unusual, I'm guessing, but you say we just invented a whole new way to invest, introducing the first low cost private market investment advisor. Can you explain what you mean by that?

Ben: Yeah, so if you have a normal investment advisor maybe like a Betterment or Wealthfront or even Merrill Lynch, they're going to push you into stocks and bonds. That's how they allocate a normal investor's portfolio, it might be 70% stocks, 30% bonds, largely ETFs, mutual funds. Because of the way the markets work, you are not invested in any private assets because basically the definition of private asset is the public can't invest in it so it's been this barrier in the market that doesn't exist for institutional investors.

So Yale, for example, actually has 75% of their investments in the private market and 25% in the public market. The average investor who is institutional like a hedge fund, private equity fund, pension funds, they're going to be doing at least 25% alternatives, a multi-family office like some of the big ones, will definitely be heavily invested in private market assets. The individual, until recently, just didn't have access to it so we created a way to give them access to it and do it in a simple and guided approach that looks like how you invest in stocks and bonds, but puts you into an asset class that has historically outperformed stocks and bonds by a lot.

Peter: Okay, so that's sort of where...you're basically making it easy to understand and simple for the investor and that's where the advisory piece, I guess, comes in.

Ben: Yeah, we're technically a registered investment advisor...we are an advisor and we try to create these baskets for investors to get diversified so they can add diversification to their portfolio, make a one click heavily diversified investment and still get access to this generally higher return asset class that previously wasn't possible.

Peter: Right, so you mentioned earlier your eREITs. I want to dig into that a little bit and full disclosure, I actually do invest in your Income eREIT, I have been now since soon after it came out so it's almost a couple of years now. Tell us a little bit about the eREITs, how they work, what kind of returns they're getting and that sort of thing.

Ben: Yeah, the way the eREIT works is we qualify a real estate investment trust through the SEC so that we can allow the public to invest in it and then we find or source real estate, in this case debt, because the income eREIT is focused on debt-like products. We'll source them and originate them and place them directly into the Income REIT so just to contrast that for a second. If you look at most REITs who are public, they gather their portfolio in the private markets, maybe they'll gather a portfolio of a couple of million dollars and they'll take it public. When they take it public, when you take a company public you want to take it public at a higher price than you bought it so normally those companies price much higher and then that's how normally an investor buys a REIT.

So they buy a REIT essentially at retail rather than wholesale and they pay a markup and that markup, the street will call a liquidity premium. But if you're not going to sell that REIT let's say you're a five-year investment holder then you're paying a premium but you're not actually getting the value of it. So we created these REITs…we use electronic distribution that make it efficient, our upfront costs are like less than 1% now. A typical…even an IPO is going to be 7%/10% and so we have a very efficient way to use technology to get access to, in this case, the income REIT is debt products and that's why I think we have higher yield than you see normally in a REIT.

Peter: So can you share what sort of the historical yield has been on the eREITs?

Ben: Yeah, the Income REIT is a debt REIT so it has been at 10.5% or 11% since its inception. It's blended probably somewhere between 10.5% and 11% annual current dividends. The other REITs are either equity REITs or hybrid debt and equity and those I think are about a 8% dividend, maybe a little more, but they hold equity so a decent amount of the upside is in the appreciation and the exit of the real estate. Where does that end up....we obviously want it to be greater than the Income REIT, but it's...as a highly regulated organization, we try not to make too many forward looking projections here.

Peter: Sure, sure, understood.

Ben: But historically, sorry you asked a historical question. Historically, it's actually on our site, I think like a 12% return in like '14 and '15 and in '16 it came down a little bit. I think it went down to a little less than 9 because we did a lot of equity investments which pulled down our return a little bit because they have less upfront payoff.

Peter: Right, okay so can you give us some idea about the scale you're at today like what sort of dollar volume of funds that have been deployed...just give us some idea about where you're at.

Ben: We have invested in more than a quarter billion dollars of equity put out, we have about a billion plus of real estate, we have somewhere between 15,000 and 20,000 investors, and 150,000 users.

Peter: Okay, that is substantial. So I want to switch gears a little bit and talk about your equity fundraising because not only did you take the hard road when you started the company when you were doing property deals, you've also gone and done equity fundraising the Reg A+ way. I shouldn't say the hard way, but I guess it is a lot harder than raising money privately. So tell us about the...you had a successful fundraise, I believe, in Q1 of this year, can you tell us about how that process went and why you chose to go the Reg A+ route?

Ben: When we thought about raising another round and we did a Series A back in 2014 and we started looking at Series B. We basically came to the conclusion that our whole business is to allow the public individual, our user, to access essentially this private, previously inaccessible type investments. Or in other words, another way to think about it, we disintermediate sort of the private equity funds and a lot of the traditional Wall Street players who are investing pre-IPO, is another way to think about it. So for us to have that be our business and our mission to then turn around and raise venture money seemed a little bit incongruent.

So we started down that road, it took a little bit of time for the SEC to qualify RISE Companies which is our parent, but we basically said let's just take Fundrise itself public through the platform, let only our investors invest. You can't just show up and just buy shares in the tech company and so we did that. We started out by just saying, okay, who's interested, we created a reservation list and we ended up with something like 9,000 people on the list and that's just from our investor base and when we opened it, something like 2,000 people invested in less than 24 hours and we got oversubscribed. We had to reopen it again just to handle the unexpected demand and we ended up raising $15 million in that first go, but only really tapping a small part of our demand. So we sort of proved this hypothesis again of creating an alternative approach to fundraising, an alternative approach to investing that I just think is the future of finance.

Peter: Right, I think there's been more and more Reg A+ deals, they're not as many I don't think as what people expected when they came in, but I'm sure it gets easier the more people that do it and it makes perfect sense to me that you would go out...you clearly have a customer base or an investor base, shall we say, that believes in you and is willing to invest in your equity as well as in your deals.

So then I'm curious about what you're going to do as far as...where are you going to take this company, is this going to be....are you going to keep doing what you're doing, what's your vision for the future? I mean, you really have been a pioneer in so many ways, are you going to continue to push the envelope in new areas or are you just going to try and scale what you've got or a bit of both?

Ben: I think that we're Blackstone in the internet age. If Blackstone were to launch today, they would do it the way we're doing it and they would focus on a total tech solution. So over five years, say a mid-term horizon, to me raising money from pensions funds, raising money from endowments which is how every major private fund built their business is yesterday's threat. Pension funds are a melting ice cube that they are a consequence of the baby boomers retiring and that's why there are so many pensions funds, but as the baby boomers start to consume their retirement, the pension funds will start to shrink.

So if you're 30 years old, you're not thinking about a pension fund, that's a joke. You're going to be investing, you're going to be managing your money online and so that's where we're headed, that's where we put ourselves really well positioned basically to ride that trend and we're going to keep innovating around giving investors access to really interesting investments. We just launched a whole concept around housing for millennials in urban cities like LA and DC, you know, for sale housing like townhomes, and single family homes, and condos which are not REIT eligible, it's a whole different concept. So this is a mega trend and I think it's going to be enormous.

Peter: So maybe one day in the distant future we'll see Fundrise at a scale that Blackstone is at today then?

Ben: I mean what we hope is that Blackstone looks at us being like…it's kind of Walmart and Amazon, right?

Peter: (laughs)

Ben: Blackstone...it's like when I said to the real estate developers I raised $325,000. They thought I was joking and now they come to me for money. I mean, the non-linear nature of internet businesses always confounds and surprises the status quo players.

Peter: Right, there's many, many examples of that whether you go back to...the travel companies or Blockbuster or what have you, there has been many, many examples of that. Anyway, we're out of time, Ben, it was a fascinating conversation, I really appreciate you coming on the show today.

Ben: Thanks for having me.

Peter: See you.

So, to go through what Ben and his team at Fundrise have gone through, you've got to really be very passionate about the individual investor. You can tell just listening to Ben talk that he really is passionate about that. I think it's great because there really is so few opportunities for individual non-accredited investors outside of the stock and bond markets. If you want to invest in real estate and you're a non-accredited investor and you just got a couple thousand dollars to invest, there really are not that many options for you and Fundrise, having been a true pioneer in this space, I applaud them in doing that. I hope that we will see more companies go down this route of offering investments to non-accredited investors. I think it's really been a problem, I think, that the industry has suffered from and I feel like companies like Fundrise are making it easier, they're blazing a trail and I for one wish them all the best in expanding their business for non-accredited investors.

Anyway on that note, I will sign off. I very much appreciate your listening and I will catch you next time. Bye.

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(closing music)