

WEALTHFORGE SECURITIES

VIA ELECTRONIC MAIL

March 27, 2017

Joseph E. Price
Senior Vice President
FINRA
Corporate Financing/Advertising Review
pubcomm@finra.org

Re: Comment on Proposed Amendments to Rules Governing Communications with the Public

Dear Sir or Madam:

WealthForge Securities, LLC (“WealthForge”)¹ welcomes the opportunity to comment on the proposed amendments to the rules governing communications with the public (FINRA Rules 2210, 2241, and 3110), in particular request for comment 6.²

WealthForge primarily works in the private placement market, conducting offerings under the federal 506(b) and 506(c) exemptions. Since January 2014, WealthForge evaluated over 600 private placement offerings, accepted and administered more than 400 private placement offerings, of which, as of the date of this correspondence, 195 were securities of real estate funds or securities issued by special purpose entities (SPE) whose pooled assets were used for real estate related projects. As part of its private security offerings administration, WealthForge’s advertising review included many hundreds of public communication pieces regulated by FINRA Rule 2210; of which, the majority were for funds or Special Purpose Entities (“SPE”) directly related to real estate.

Request for Comment 6: Are there single investment products that operate like an asset allocation or other investment strategy for which performance projections might be appropriate?

Comment: Certain real estate backed products, particularly real estate funds that contain multiple and diverse real estate assets in the portfolio, may operate like an asset allocation or other investment strategy. An asset allocation into the private securities issued by a real estate development company may diversify an investor’s investment over many projects with different return expectations and different asset classes, and should be allowed to use performance projections in certain circumstances.

Background: Most issuers, who have engaged WealthForge, historically have not conducted previous securities transactions utilizing a broker-dealer. While no requirement exists for an issuer of private securities to utilize a broker-dealer, one reasonably concludes that in regard to regulatory oversight, investor protection, and market effectiveness, it is likely a better outcome for both the investor and the market if a private security offering were administered by FINRA registered and regulated broker-dealer. Based on our own research of the SEC’s Form D filings, most real estate related private security transactions do not utilize a broker-dealer – both in terms of the number of closed transactions and the dollar volume raised.

¹ WealthForge Securities, LLC is a registered broker-dealer with FINRA. Under its membership agreement WealthForge is licensed to sell private placements, engage in merger and acquisition advisory services, fairness opinions, underwriting and Reg A services.

² Regulatory Notice 17-06 (February 2017).

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Having evaluated hundreds of real estate private security offerings, WealthForge believes that there are real estate investment products, primarily investments into a diverse real estate fund, which would operate like an asset allocation or other investment strategy, for which performance projections should be allowed. Additionally, WealthForge believes that there is a reasonable approach that would also allow the use of projections for some other single investment products in specific cases.

Evaluating an offering based solely upon an expected internal rate of return (IRR) is unwise;³ however, industry participants use the IRR and cash-on-cash (CoC) attributes as part of their potential investment evaluation, and expect those attributes to be present in communications from the issuer. If it is true that potential investors expect to see IRR and/or CoC projections when evaluating real estate offerings, an expectation which is forbidden by FINRA's rules for offering materials distributed by a broker dealer and his associated representatives, other than an issuer prepared private placement memorandum, it is a deterrent for real estate private security issuers to allow their offerings to be administered by a SEC registered and FINRA member broker dealer. This self limiting outcome leaves investors without the protection afforded by a broker-dealer and the securities regulations, which they enforce.

This existing market force impediment is inconsistent with FINRA's mission to provide investor protection and to promote market integrity. The Firm expends significant effort to educate issuers on acceptable communication relying on FINRA's communications with the public rules. Consistently, throughout these discussions, real estate issuers are steadfast in their insistence that these rules unfairly put them at a competitive disadvantage in a market where anticipated IRR and CoC return are benchmarks used by sophisticated investors in evaluating the quality of offerings and which are prevalent if not prominent in the communications for private placements not administered by a registered broker-dealer.⁴

Absent a communications rules change by FINRA, which enables broker-dealer communications to be consistent with the market segment vernacular, these offerings are likely to continue principally outside the antiseptic light of the regulatory framework. Alternatively, an escalation in Securities and Exchange Commission enforcement actions targeting unregistered broker-dealer activities may create a market reality, different from today, where the cost of non-compliance for the private securities issuer may compel them to seek broker-dealers for their offering administration. An outcome where a private security offering administered by a broker-dealer is desired rather than circumvented, would be beneficial to both investor and market.

Funds with multiple assets

Real estate private security offerings occur in a spectrum from an SPE investing in a single fix and flip residence to large scale Delaware Statutory Trusts or non-public REITs. We contend that these real estate funds are essentially investment strategies and thus performance projections should be allowed.

³ Jason Wald, "Understanding Internal Rate of Return (IRR) in Real Estate Investing," CrowdStreet, available at <https://www.crowdstreet.com/education/article/what-internal-rate-return-irr/>; EquityMultiple, "The Limits of Internal Rate of Return for Real Estate Revenue," Equities.com, available at <https://www.equities.com/news/internal-rate-of-return-doesn-t-tell-everything-about-real-estate-revenue/>; "What IRR Can Tell Investors About Real Estate Investments," Realty Mogul, available at <https://www.realtymogul.com/resource-center/articles/what-irr-can-tell-investors-about-real-estate-investments>.

⁴ Current Offerings, CrowdStreet, available at https://app.crowdstreet.com/properties/?_ga=1.65168686.1067091199.1488487236; Offerings, RealCrowd, available at <https://www.realcrowd.com/offerings/>; Investment Opportunities, Carlton Crowdfund, available at <https://carltoncrowdfund.com/crowdfunding-deals/>; Origin Investments, Investments, available at <https://www.origininvestments.com/investments/>.

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A real estate investment fund containing multiple real estate assets should be considered an investment strategy because these funds typically consist of multiple distinct real estate assets, to meet a specific asset allocation goal, and the assets often have an income producing history, which serves as the basis of a reasonable hypothetical return illustration. For example; a fund holding multiple commercial real estate assets may specifically acquire assets in different markets executing a strategy to hedge against regional downturns, or a fund may choose to concentrate in a specific subset of commercial real estate such as hotels, franchises of restaurants or multi-family residential. Or, a fund may choose to be more specific in its investments and only invest as the general partner in other real estate funds. All are illustrative of options that a real estate fund may choose in the formation and allocation of its pooled capital. In each alternative, the underlying assets have historical income (rent rolls, occupancy rates, or historical contractual returns) on which to base an illustration that would be similar to investment allocation strategy within a specific sector.

Real Estate Private Security Offerings

Staff should allow hypothetical projections when those projections are based on historical returns from a specific asset. For example, a real estate fund holding specific assets may have experienced an average return of 7% per year for the last four years and anticipate that that return will continue based on a reasonable economic forecast. In that case, with proper disclosure that past performance does not guarantee future outcomes, and a robust investment risk disclosure, the fund should be able to communicate with potential subscribers what it believes is a reasonable and good faith expectation of future return. The projection would be based on demonstrated performance and, with proper disclosure, would be reasonable and informative to investors. Unlike many asset allocation or investment strategies, there are hard assets underlying these funds, principally real estate, which have verifiable worth, and, depending on the type of real estate, may produce regular income and a reasonable expectation that they will have appreciation over some horizon.

Staff should allow hypothetical CoC projections for offerings where projected performance is currently demonstrated. In the case of a fund's historical returns, the postulation is that it is reasonable to provide investors with a projection of potential returns when that projection is based on performance that is currently demonstrated. Investors in real estate utilize the CoC metric to calculate the cash income earned on the cash invested in a property. In some cases, a real estate fund's assets may already demonstrate an on-going CoC return for investors. In that case, the issuer should be allowed to advertise that return as historical and to project an on-going return based on that demonstrated performance. A stout disclosure set should accompany this projection, including the required "past performance does not guarantee future outcomes" and a description of the underlying assumptions, and calculation of the CoC number.

Conclusion

WealthForge Securities believes that FINRA's Advertising Department should permit the use of projections for certain real estate related private securities. In particular, FINRA should allow the use of IRR projections for real estate funds containing multiple assets, as they act more like an investment strategy than an individual security. Relatedly, FINRA should allow the use of projected IRR and projected CoC in circumstances where the security being sold is for a real estate fund with assets that have historical returns or are currently demonstrating an on-going cash-on-cash yield.

Sincerely,

WealthForge Securities LLC
CRD # 152550