BISNOW

Crowdfunding Industry Tries To Restore Confidence In Wake Of Nightingale Fraud Allegations

August 15, 2023

Scandal has rocked the real estate crowdfunding industry over the past month, after Nightingale CEO Elie Schwartz was accused of walking away with tens of millions raised from small-time investors on the CrowdStreet platform.

It's a black eye for the industry — which has only existed for about a decade — and it has prompted some of CrowdStreet's competitors to soothe their own customers by reassuring them they are more protected from possible fraud than the hundreds of investors who lost money by investing in Nightingale deals through CrowdStreet.

"This has been a challenging few weeks in the online real estate investing realm," RealtyMogul told investors in a letter published on Reddit last month. "While we have no comment on [the Nightingale] incident, we are saddened and concerned whenever investors in our industry face adversity."

Nightingale raised roughly $63M on the platform last year to acquire an office complex in Atlanta and renovate another office building in Miami Beach, but the company never closed on the deals. After months of delays and a lack of communication, an independent manager was appointed to take over the entities created for the deals.

Last month, that manager, Anna Phillips, said less than $130K combined was in the two entities' accounts, and the vast majority of the funding was missing. On

Friday, Phillips said forensic accountants had traced roughly $40M to accounts affiliated with Schwartz.

While CrowdStreet isn't accused of committing fraud — unlike Schwartz and Nightingale, which are now under investigation by the Department of Justice and the Securities and Exchange Commission — many of the nearly 700 investors who had their money misappropriated have raised questions about why there weren't more controls in place at CrowdStreet to prevent such an act.

The biggest sticking point comes down to the fact that the equity raised on CrowdStreet had been sent directly to accounts controlled by the sponsors, even before deals closed.

“The idea that someone in that position would just commit such blatant fraud was shocking,” EquityMultiple CEO Charles Clinton, whose real estate crowdfunding platform has funded about $4.4B in projects, told Bisnow. "I was also very surprised about the escrow arrangement. That was the other thing that jumped out.”

EquityMultiple also issued a letter last month, similar to RealtyMogul, highlighting the differences between its policies and CrowdStreet's.

"In light of the news that the largest investment funded to date by Crowdstreet is embroiled in potential fraud, I want to take the opportunity to remind you of what makes EquityMultiple different," Clinton wrote in the letter.

Both Los Angeles-based RealtyMogul and New York-based EquityMultiple's letters highlighted the platform's use of third-party escrow services, as well as the fact that they are registered investment advisers with the SEC.

Clinton said he doubted the Nightingale scandal would turn into an existential threat for the real estate crowdfunding industry, but acknowledged it could be damaging. He said he has heard from a few investors who have shared fears over crowdfunding's security.

“Financial services and fraud are unfortunately a natural pairing, and given that our industry is still newer and on a growth curve, anything that could hurt the reputation could hurt its growth,” Clinton said.

Investors might be scared now, as with any kind of fraud in financial services, but the impact won't be permanent, Clinton added.

“In the last three or four weeks that things have been unfolding, we've seen no disruption at all,” he said.

RealtyMogul declined to make anyone available for an interview.

Ian Ippolito, an independent real estate investor who has invested in other CrowdStreet deals but not Nightingale’s funds, said he wasn't surprised by allegations of fraud.

“From the beginning, this deal had problems all over it, and improprieties,” Ippolito said. “They were not disclosing things that they were required to under law. They weren't disclosing their losses, which is a big, big no-no. It looked impressive from the numbers, but I thought at the beginning, ‘I'm not touching this deal.’”

“It's a bit of a Wild West out there,” Ippolito added. "Some people will say, it's fine, these are accredited investors that can take the loss. But when you talk to these investors, they're angry. They're very, very angry. It didn't work the way they expected it to, and nobody likes to lose money.”

Ippolito said while CrowdStreet will probably suffer, the real estate crowdfunding industry will bounce back. On Tuesday, just weeks after the Nightingale scandal came to light, reports indicated that asset manager Yieldstreet could purchase Cadre in a deal that would value the platform at as much as $100M, according to The Information. That would be a steep drop from its $800M valuation in 2017.

Major corporate investments aside, individuals have become accustomed to real estate crowdfunding as an option for investing their money.

“There's just so many of these deals going out, and there's just so much capital that people are looking to deploy that I don't see it stopping,” Ippolito said.

The U.S. crowdfunding industry as a whole is forecast to expand from $1.67B in 2022 and is expected to expand at a compound annual growth rate of 16.7% from 2023 to 2030, Grand View Research reports. Real estate is a major component of the industry, along with tech, media, healthcare and food and beverage.

That is also despite the fact that this kind of fraud will happen again, Ippolito said.

“Sadly, it's going to happen again,” Ippolito said. “These marketplaces don't have any duties to do any due diligence. I mean, they say they do, but they basically do minimum due diligence to protect themselves.

“I would love to see some new regulatory action, but I don't know if it's going to happen,” Ippolito said. “What's needed is better rules on disclosures. [Nightingale] continued to raise money for months from these investors while they weren't disclosing the losses.”

Not long after the Nightingale scandal came to light, CrowdStreet CEO Tore Steen exited the company. In a statement published by Crowdfund Insider last week, CrowdStreet defended its due diligence process.

“Importantly, CrowdStreet has consistently followed a detailed due diligence process and does with all deals and sponsors, including Nightingale,” CrowdStreet stated.

"Nightingale provided references from notable institutions, including KKR, Citibank, Wafra Capital Partners, ICER Properties, and DRA Advisors,” the statement said. “Our review and vetting process did not give us cause for concern with Elie Schwartz, Nightingale, or these deals, which went through their own due diligence process.”

CrowdStreet also said it is launching its first offering utilizing CrowdStreet Capital, a FINRA-registered broker-dealer.

A CrowdStreet spokesperson said in an email to Bisnow the platform adds to existing sponsor due diligence via various means, such as assessing a sponsor's aggregate portfolio risk, requiring audited financial statements and implementing anti-money laundering screening. It said all investor funds would be placed in escrow accounts moving forward.

“CrowdStreet has evolved its business model as a licensed broker dealer acting in the best interests of our investors,” the spokesperson wrote.

Sponsors vary in quality, StarPoint Properties Senior Analyst of Capital Markets & Acquisitions Taylor Trautloff said, stressing that investors need to look at the sponsor itself to make sure they have the track record they say they have.

Her company has raised funding on crowdfunding platforms for commercial property developments in Phoenix and Denver.

“At the end of the day, the risk still lies with the sponsor. The crowdfunding platforms, I think, can only do so much,” Trautloff said.

The original article can be found here.