Why should companies focus on Real Estate fintech startups?

Technology startups seem to be here to stay.

Rapid advancements in technology have lowered entry barriers for tech start-ups. Over the past 15 years, the cost of establishing an internet-based startup has plummeted from $3 million in the 1990s to just $300 today,[6] causing them to become more synonymous with disruption and innovation.

This has also meant exponential growth in the real estate sector. Globally, real estate fintech start ups increased by 18% from 246 in 2008 to 1,372 by 2017.[7] In the same period, cumulative investments soared from $2.2 billion to $31.3 billion.[8]

While venture capital (VC) remains the dominant funding source, there is substantial capital flow from non-VC investors as well, including REITs, established real estate services companies and investors, private equity firms and high net worth individuals.

In the five-year period between 2011 and 2016, funding from non-VC sources for real estate tech startups increased at a compound annual growth rate (CAGR) of 72.4% to $2.4 billion in 2016.[9] And there is an all-time record funding of $3.4 billion YTD, as of July 25, 2017[10].

Globally, real estate fintech startups increased by 18% from 246 in 2008 to 1,372 by 2017.

6. "Disrupting the Disruptors: Startup Accelerators Feel Pressure to Evolve", Knowledge@Wharton, University of Pennsylvania, July 28, 2016, http://knowledge.wharton.upenn.edu/article/why-startup-accelerators-are-feeling-pressure-to-evolve/.
7. Venture Scanner database, data as of July 31, 2017.
8. Ibid.
9. Ibid.
10. Ibid.

See the NUMPERSPEAK chart over for more details.

We categorise real estate (RE) tech startups into two groups – RE operations and RE fintechs.

- **RE operations –** The operations-related tech startups focus on the core real estate business such as property search, leasing, facility management, smart building technologies, and home services.
- **RE fintechs –** Our focus area of discussion, are enabling financing and investments in real estate. They offer diverse services and solutions such as real estate transaction services, digital lending platforms for construction and real estate owners and lenders, online real estate investments options for individuals, or investments in single-family homes for institutional investors.

The general notion was that startups would threaten incumbent real estate companies. Certainly with the help of technology, they absolutely offer innovative solutions and enhanced user experience at a relatively lower cost, faster pace, and user friendly environment. However our research shows that while they were initially thought to be a competitive threat, they have been more about changing the pace of innovation than taking the place of the incumbents.

Take the case of startups that directly compete with REITs by providing online investment avenues for individuals to invest in commercial real estate in the US.[11] Also called eREITs, their solutions combine the features of nontraded REITs and crowdfunding, with lower fees.[12] But unlike traditional crowdfunding ventures, eREITs offer multiple and diversified asset lending services.

Large crowdfunding firms, such as Fundrise and RealtyMogul, have been key proponents of eREITs so far.[13] Even companies such as RealtyShares provide similar investment opportunities in the Construction and Real Estate sector as they seek to potentially compete with traditional REITs. As such, RE Fintech startups comprise only 5% of the overall global real estate tech start-up space by investments, having raised $1.4 billion to date. But they are certainly disrupting traditional business models.[14]

But this is not just an overseas story with investment and innovation in Australia. Examples include BlochExchange and BrickX (fractionalised property trading platforms) and the emergence of foreign entrants into the local market, such as Purple Bricks, challenging traditional residential real estate agents.

How to benefit from RE fintechs?

There are many ways in which traditional real estate companies can benefit from the solutions offered by RE fintech firms. They can provide platforms that can expand and diversify the lender base and enable more individuals and institutions to get exposure to real estate.

This is especially useful for US-based companies, which face a challenging financing environment, where traditional lenders such as banks are tightening lending standards and CMBS issuances remain well below their historical highs due to the implementation of the new regulations following the 2008 financial crisis. In light of the fact that the global online lending industry is expected to grow from $40 billion in 2016 to more than $1 trillion in the next five years, the growth in construction and real estate financing may very well be led by these RE fintechs.[15]

Where should companies start?

Traditional real estate companies can benefit by engaging with these startups in different ways. Companies can make choices based on their investing capacity, the utility of a startup's services, their need for financing, and so forth. As end users, real estate companies can leverage some of the online services and solutions for key property-related decisions.

Companies can also access capital by using the innovative funding and investing platforms that RE fintechs have to offer. Alternately, they could also partner with the RE fintechs to help meet their financing and investment needs. Finally, real estate companies can invest in the RE fintechs and benefit through their growth.

RE fintechs' services

Construction and real estate owners, developers, and investors can use RE fintech platforms for a variety of services – including leasing, acquisition, disposition decisions, and managing the underwriting process, and accessing detailed financial models for property financing.

The most obvious and key benefits would be efficiency and convenience, as these online and sharable solutions have the capability to provide analysis faster, more cheaply, and efficiently.[16] As an example, Assess+RE provides cloud-based services such as property level valuation models and related financial analysis.[17]

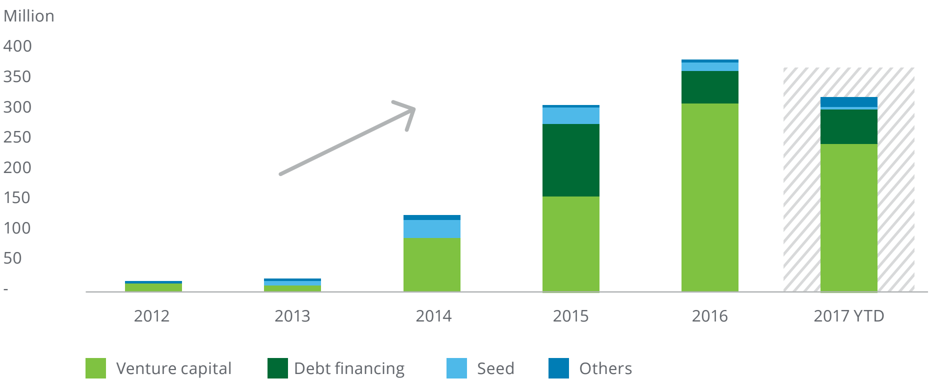
11. Fundrise website https://fundrise.com/, accessed on August 4, 2017.
12. Ibid.
13. Fundrise website https://fundrise.com/; RealtyMogul website https://www.realtymogul.com/, accessed on August 4, 2017.
14. Venture Scanner database, data as of July 25, 2017.
15. Beth Mattson-Teig, "How is the CRE Industry Adapting to the Emergence of Fintech Solutions?," National Real Estate Investor, April 25, 2017.
16. Assess+RE website https://www.assessre.com/index.html, accessed on August 4, 2017.
17. Ibid.

NUMBERSPEAK #2

Number of tech startups: Overall – 1372; RE fintechs – 177
Investments: Overall – $31.3 billion; RE Fintechs – $1.4 billion

RE fintech startups continue to receive increased funding each year, dominated by VC investors

Yearly investments in RE fintechs by investor type*



Prominent RE fintech models

1. Digital lending platforms for CRE owners and lenders
2. Online RE investments solutions for individuals
3. Commercial and residential investment options for institutional investors
4. Property transaction services.

Top 5 RE fintechs

1. Money 360
2. Cadre
3. RealtyShares
4. Fundrise
5. Scalable.

*Based on total investment received**

**Analysis based on Venture Scanner data as of July 25, 2017*

Source: Venture Scanner; Deloitte Center for Financial Services Analysis.

Partner: Construction and Real Estate owners, operators, and developers can collaborate with these startups to raise equity, secure joint venture partners, or even sell their properties by getting access to accredited and institutional investors. Cadre, with US $133.3 million in funding, is one such platform that helps connect owners, operators, and investors.[18,19]

Owners can also partner with startups to finance projects and obtain loan offers from a diverse set of lenders including banks, private equity, and crowdfunders. For instance, digital lending marketplaces, such as StackSource, help connect Construction and Real Estate owners and lenders.[20]

Invest: Real Estate companies that have a fair understanding of the startup business, substantial funds, and the appropriate risk appetite can invest in fintechs with a good value proposition. Such a route could bring relevance to existing business or beef up future strategy as well as gain knowledge of the technology and other intellectual properties of the startup. In some instances, real estate companies may want to create value for the startup by lending their expertise and/or relationships, or even contribute to their business by being customers for the products or services of the startup.

The bottom line

Almost every day there are new headlines about digital initiatives, digital incubators, innovation teams, acquisitions or collaboration with nimble fintech firms. Startups are constantly incubating new ideas as they continue to increase in size and services. Traditional real estate companies can learn from and in many cases benefit from collaborating with fintech startups. As they do it will cause a reassessment of their engagement approach given fintechs flatter and more nimble style of operations. All approaches will only stand organisations in good stead as they embrace the exponentially changing future.

18. Cadre website https://cadre.com/partnering, accessed on August 4, 2017.
19. Venture Scanner database, data as of September 7, 2017.
20. Beth Mattson-Teig, "How is the CRE Industry Adapting to the Emergence of Fintech Solutions?," National Real Estate Investor, April 25, 2017.

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