

The Brave New World of Investment Crowdfunding in Illinois

by Anthony J. Zeoli

A FREEBORN & PETERS CLIENT ALERT

ABOUT THIS CLIENT ALERT:

As the author of the new Illinois Intrastate Crowdfunding Exemption, I am ecstatic to be able to announce that Illinois businesses are NOW able to raise up to \$4 million dollars, per year, from Illinois residents. This new law most certainly will be a game changer for Illinois businesses and Illinois investors. Here's what you should know about this opportunity.

As of January 1, 2016 the Illinois Intrastate Crowdfunding Exemption officially became effective. What does this mean you may ask? It means that Illinois businesses, entrepreneurs and real estate developers now have access to a new, and extremely powerful, tool to raise significant amounts of working and project capital. Not to mention giving Illinois residents the chance to earn above-average returns by investing in local projects and companies. Here's what you need to know:



The Basics

In the past, companies that needed growth or project funding had to seek out bank financing, angel investors or venture capital in order to get them to the next stage. If these types of funding can even be found, they are often costly to the company and/or require the company's owners to give up a significant amount of company equity or control.

Under the new law however, companies which are incorporated/organized in Illinois are now able to use "investment-based crowdfunding" to **raise up to \$4 million dollars a year from Illinois residents**, whether they qualify as "accredited"¹ investors or not. Put another way, Illinois companies who are looking for funding can now seek investment dollars from ANY Illinois resident (*individual or entity*); allowing the company to turn friends,

¹ The term "accredited investor" is defined in Section 501 of the Securities Act of 1933. Under this section an individual will qualify as "accredited" if he or she: (a) earned income that exceeded \$200,000 (or \$300,000 together with a spouse) in each of the prior two (2) years, AND reasonably expects the same for the current year; OR (b) has a net worth over \$1 million, either alone or together with a spouse (excluding the value of the person's primary residence).

neighbors, local residents and even customers into investors. Moreover, the required amount of return/control offered to attract such investors will, in general, be significantly more favorable to the company than under existing options.

What Is “Investment-Based Crowdfunding”?

Today the term “crowdfunding” can take on many contexts but it is, by definition, the practice of funding a project or venture by raising small amounts of money from a large number of people, most commonly via the Internet. The most commonly known type of crowdfunding campaigns are “rewards-based” campaigns (e.g. *Kickstarter, Indiegogo, etc.*) where people contribute money to a company/entrepreneur in exchange for a reward (e.g. *a t-shirt, one of the products to be made, etc.*). The Illinois Intrastate Crowdfunding Exemption on the other hand, involves “investment-based” crowdfunding. The difference is that in an “investment-based” crowdfunding campaign a contributing person will actually be making an INVESTMENT in the company seeking funds, not just getting a reward. Put simply, in “investment-based” crowdfunding a person will give money to a company in return for a piece of the action.

Companies That Qualify

Under the new exemption, an offering may be made only by a company:

- Formed in Illinois;
- Doing most of its business in Illinois²; and
- Which is not otherwise subject to disqualification (*pursuant to the rules of exemption*).

One point that should be noted is that the new exemption may be used by a company (i.e. a “special purpose vehicle” or “SPV”) specifically formed for the purposes of completing a particular project such as a real estate construction project. By using separate SPV’s, the developer seeking funds could potentially raise up to \$4 million dollars per project (i.e. *per SPV*).

Investors That Qualify:

An offering made under the new exemption would be open to ANY Illinois resident (*individual or entity*), whether they are an “accredited investor” OR “non-accredited investors.”³ The only difference is that “non-accredited” investors may only invest up to \$5,000 per year, per company⁴, whereas, there are no limits for accredited investors.

What Does It Cost?

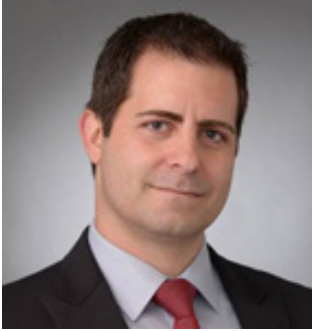
While it will vary, a good rule of thumb is that a crowdfunding campaign costs between 7 to 10 percent of the amount you expect to raise. This includes the expenses for preparing the offering materials, marketing it, and paying required portal fees. Some of these costs can be paid with the proceeds from the offering.

² Must meet the requirements of Rule 147 (17 CFR 230.147).

³ Any individual that does not otherwise meet one of these tests would be considered a “non-accredited” investor.

⁴ It should be noted that “non-accredited” investors are not capped on their overall annual level of investment, just their investment in any one particular company/offering in a given year.

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What Are The Benefits Of Crowdfunding Other Than Raising Capital?

Crowdfunding offers benefits to entrepreneurs and small businesses beyond simply the ability to raise capital, including:

- **Marketing.** Crowdfunding provides a source of brand loyalty and social marketing that just cannot be bought. It allows people to get behind a product/business that they truly have a connection to and, in turn, incentivizes them to tell the world about it. As a result, investors are quite literally paying businesses to advertise their products.
- **Positive Publicity and Community Support.** Crowdfunding can be a great way to give back to a particular local community, and/or get local residents involved, which can help generate local publicity and support.
- **Local Job Creation.** Under the new exemption, more Illinois investment dollars will be kept in Illinois and used to help small and emerging Illinois' businesses leading to increased local job creation.

This Sounds Great, How Do I Start?

The process of setting up an "investment-based crowdfunding" campaign under the new Illinois Intrastate Crowdfunding Exemption is relatively simple, especially in comparison to the requirements of some other available financing options. That being said, navigating the requirements of the new law can be tricky and it should not be undertaken without the assistance of qualified counsel.

This alert shares only the important basics to help you decide if an "investment-based" crowdfunding campaign is worth pursuing. If "investment-based crowdfunding" sounds like a good, low-cost, way to gain access to financing, then take the next step. You can contact me directly at 312-360-6798 or azeoli@freeborn.com. As the author of the exemption and a recognized crowdfunding expert, there really is no one more qualified to help you navigate the nuances of this new and unique way to fund your company's growth.

ABOUT FREEBORN & PETERS LLP

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