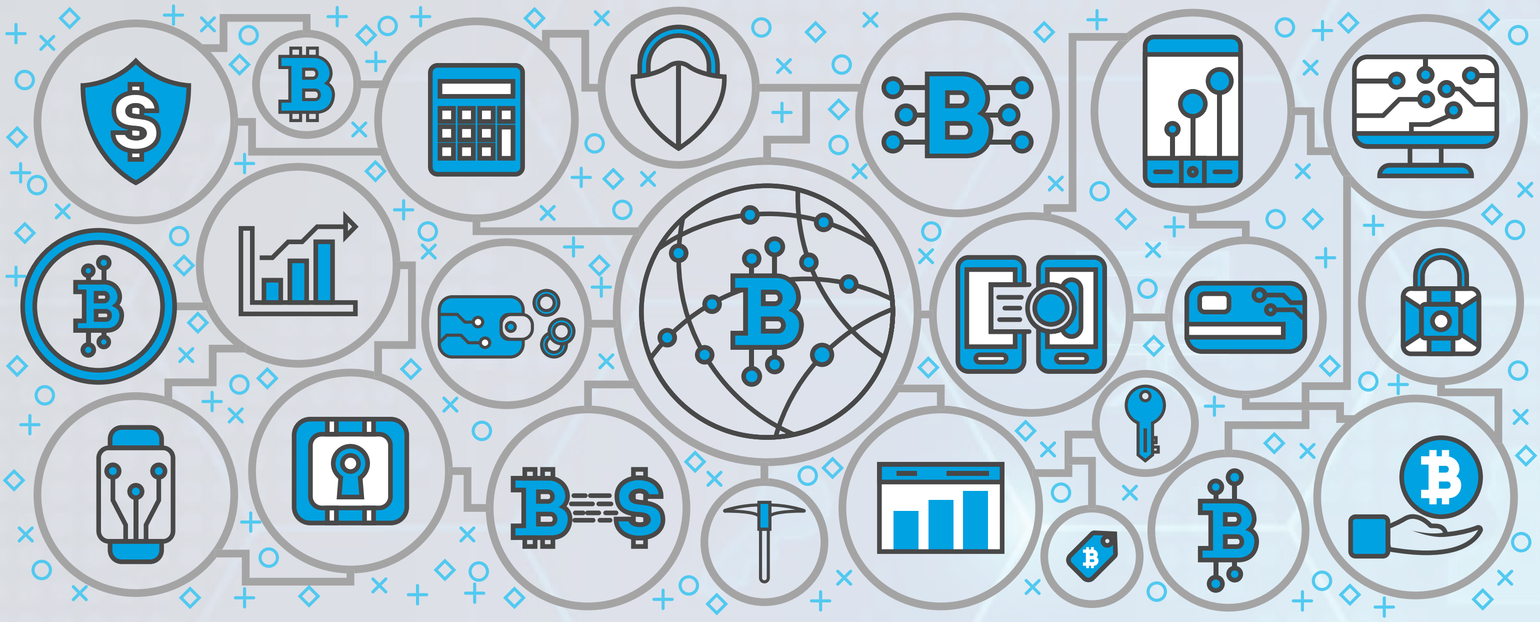

Tokenising Real Estate

The recent introduction of security tokens means retail investors will have direct access to different commercial real estate asset types.

– By Philip Pang

I recently had the pleasure of attending a number of blockchain conferences, where I met with some start-ups who are looking to 'Tokenise Real Estate'. The idea is to solve some of the key problems investors and property developers face when investing in commercial real estate, primarily the limited access, the fees imposed by third parties, and the lack of transparency and liquidity.

The way people hold and transfer assets may change dramatically in the near future. Whether it's real estate, equity, derivatives, commodities, art or even debt, the ownership on these assets may be recorded on a distributed ledger (blockchain) and represented by security tokens. The importance of blockchain is made evident by the opinion of 800 executives and IT experts at the World Economic Forum, 50% of whom said they believe more than 10% of the global GDP will be stored in blockchain by 2025.

> *A key principle for security tokens is to fractionalise assets such as real estate and allow these investments to become more liquid.*

The recent introduction of security tokens has gained a huge interest in the blockchain space. Unlike utility tokens, which provide its holders access to an application, a product, or a service and are used in token sales and initial coin offerings; security tokens derive their value from real assets. A key principle for security tokens is to fractionalise assets such as real estate and allow these investments to become more liquid. Essentially security tokens are an investment contract, like stocks, bonds, and private equity investments, and are considered a 'security' if there is an expectation of profits from the investment (e.g., price appreciation, revenue share, dividends, etc.).

Advantages of a security token

Historically, commercial real estate investments have only been accessible to high-net-worth investors, property developers, real estate funds, and institutional investors. The premise of security tokens will give retail investors direct access to different commercial real estate asset types while benefiting from any dividends (rental income) and price appreciation. Additionally, property developers can raise capital from a new class of investors - retail investors, who could co-invest with reputable property developers. Currently, real estate investment can't be easily transferred from one party to the next because the system is slow, expensive, and tedious. Blockchain technology will hopefully create secondary markets for registered securities on Security Token Exchanges. In Asia, few firms are building the infrastructure which will allow investors to exchange real estate ownership as easy as it is to trade common stocks.

> *"The main problem with issuing security tokens is that it's an early technology which is trying to enter a highly regulated environment."*

Disadvantages with security tokens

The main problem with issuing security tokens is that it's an early technology which is trying to enter a highly regulated environment. Now there are too many uncertainties of how the technology would work in the real world, coupled with the current lack of liquidity in secondary markets, and not to mention the fact that security token exchanges are just being built. Additionally, some countries' regulators prohibit the sale of securities to independent, retail investors (as a part of their investor-protection policies), so investors need to carefully examine security-token offerings to find out whether they are allowed to participate.

Security tokens and the real estate landscape

In New York, Fluidity (the team behind Airswap), a company providing technology services to registered broker-dealers, partnered with Propellr Securities, to tokenise the first residential development which was recently appraised for US$30 million. Propellr is a FINRA-registered broker-dealer which uses its financial and capital markets expertise to offer and sell traditional and tokenised securities under what is known as Reg D rule 506(c), meaning that the issuer must take reasonable steps to verify that every investor is accredited.

A key value proposition these firms see in the tokenisation of real estate assets is, they don't require a bank or third party to be involved in the financing of the project. Tokens represent the debt which can be traded as private securities. If the token holders sell the shares, the purchaser can preserve the token on the blockchain, or "cash out", thereby dissolving these tokens altogether. This theoretically would produce more liquidity in a notoriously illiquid market.

That said, we are in the beginning stages of 'tokenising real estate', and for this concept to truly bring value to investors and property developers, collaboration between incumbent real estate firms, blockchain developers, lawyers, and certainly regulatory bodies, is key to move the technology forward in a compliant and efficient manner.

If you would like to know more about PropTech, blockchain, cryptocurrencies and the impact these technologies will have in the real estate industry, contact Philip Pang at philip.pang@colliers.com

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