MOORE Intelligence

DEMOCRATISING PROPERTY INVESTMENT

Tokenisation driving trillion dollar investment revolution

A digital real estate revolution is spreading across the world as property specialists increasingly 'tokenise' assets to improve liquidity in the world's most valuable asset class and make real estate investment easier, cheaper and more efficient.

Real estate tokenisation is the latest advance in 'PropTech' and is fuelled by growing adoption of blockchain technology and the emergence of new digital asset trading platforms that have created new ways to buy and sell property.

"Tokenisation may be at a relatively early stage but it is absolutely going to be a disrupter in global property markets," says Dan Natale, Moore Global's leader of real estate and construction. "It has potential to lower the cost of capital, increase the pool of potential investors and increase liquidity.

"Whether widespread adoption is three or five years away, now is the time to gain a clear understanding of both potential benefits as well as hurdles and risks. Tokenisation is driving innovation on many levels – it could lead to the launch of new financial products as well as the emergence of a new breed of property investors."

The total value of the world's real estate is $280 trillion, dwarfing the value of other major asset classes. Properties from Shanghai office blocks to Texan malls and shares in Real Estate Investment Trusts (REITs) feature in investment portfolios worldwide as a means of diversifying risk, storing wealth, achieving capital appreciation and generating income.

However, a long-held frustration for investors is that property is a relatively illiquid asset class.

This presents challenges for investors looking to access new opportunities or divest assets at an optimum time and price, says Natale, managing partner of Segal LLP in Toronto. The emergence of new secondary markets for digital property assets holds the promise of increased liquidity.

> "Tokenisation is driving innovation on many levels – new financial products and a new breed of property investors."
>
> **Dan Natale, Leader, Moore real estate group**

So far, experts reckon that only a fraction of the global real estate market has been tokenised.

Fragmented development of digital asset trading platforms together with the numbers of new players entering the market, and the absence of centralised reporting of deals, complicate efforts to assess total current value.

However, based just on the value of deals made public in recent years, tokenisation already accounts for billions of dollars worth of digital property assets being traded annually and the value of individual deals is generally increasing.

Natale says it could take time for a critical mass of institutions to invest with confidence in tokenised real estate. However, if even just 0.5% of the total $280 trillion global property market were tokenised in the next five years, it would become a $1.4 trillion market.

Moore property experts report that institutional investors still largely remain on the sidelines because they want to see how the market develops and are seeking greater clarity from a regulatory perspective.

Currently there are no global standards and approaches to regulation vary across jurisdictions but new guidance is being issued by regulators in several leading financial markets. Topics addressed include custody of digital assets, audit and disclosure and regulation of digital asset trading platforms.

Lori Stein, partner at Canadian law firm Osler, Hoskin & Harcourt LLP, says that financial market regulators are looking at digital assets through different lenses. Some in Asia and Europe regard digital assets as new financial instruments outside the regulatory perimeter whereas North American regulators consider many of them to be securities with a digital wrapper.

“Ultimately, we expect that similar investor protections will be put in place globally but they will have got there by very different routes,” says Stein. “Once that happens, local markets may begin to interact with each other and bring robustness and liquidity that will really be the game changer.”

$280 trillion

The total value of the world’s real estate

Noah Buxton, who leads the blockchain and digital assets practice of Armanino LLP, a member of Moore North America, believes that tokenisation is not significantly different in principle from conventional property investment. "We need to refocus people on what we are really talking about which is putting a digital wrapper around a current recognised legal structure and regime.

"Regulators or jurisdictions care about protecting markets and they care about protecting consumers. Everything that's happening in the US is directed at upholding those two fundamental principles."

He regards real estate tokenisation as the "inevitable" next chapter in blockchain's disruption of capital markets – and property markets in particular – which fits with a forecast by the World Economic Forum that 10% of global GDP could be stored on blockchain by 2027.

Buxton's view is also supported by Fidelity's 2021 Institutional Investors Digital Asset survey of more than 1,800 investors in the US, Europe and Asia. It included institutions, high net worth individuals, family offices and hedge funds and found that more than 70% plan to buy or invest in digital assets in the near future. Of those who plan to do so, more than 90% expect to have an allocation in their portfolio by 2026.

David Walker, managing partner of Moore Cayman, is an auditor and a specialist in cryptocurrency-focused funds, digital assets and so-called cryptoassets. He says that from an audit perspective, adding digital assets to a portfolio can be advantageous as blockchain technology can make transactions more transparent and trackable. This is because data is encrypted, stored and exchanged securely in blocks distributed and updated simultaneously across a network of computers, rather than stored centrally.

Accounting tasks in relation to tokenised assets require expert understanding of distributed ledger technology and Walker says blockchain platforms can actually give auditors a higher degree of confidence in data accuracy than in conventional property deals. Tokenisation cuts out the need for intermediaries and promises to significantly shorten the time taken to settle deals but still requires robust due diligence.

Moore experts say the track record of property firms seeking to raise capital has to be scrutinised, valuations checked and there must be full disclosure of key financial information to investors before and after investing.

"We are really talking about putting a digital wrapper around a current recognised legal structure and regime."

Noah Buxton, United States

Tokenisation has potential to drive down transactional costs and improve efficiency via the use of 'smart contracts' which can replace copious paperwork and laborious administration.

They can be programmed to automate actions such as dividend distributions or the release of financial data to investors.

As trading in digital property assets evolves there have been some failures as well as many successes. For example, this year US crowdfunding platform Prodigy Network filed for bankruptcy and faces several investor lawsuits, collapsing even as rivals went from strength to strength.

Investors may have concerns over cyber security when dealing in digital assets. Theoretically, decentralised data storage and encryption make it harder for blockchain data to be hacked, stolen or used for fraudulent purposes. However, no network is completely impregnable and hackers stole $3.8 billion in 2020 in 122 cyber attacks.

Another potential issue is that investors are given an individual private cryptographic key to access their token. Unlike a computer password it cannot be reset if it is lost, meaning owners cannot access their investments unless they have a digital custody solution in place.

While the future pace of institutional adoption is unclear and hurdles and challenges remain, it is clear that momentum has grown since 2018 when the luxury St Regis hotel in Aspen, Colorado blazed a trail as the world's first real estate tokenisation deal.

The project, led by New York-based asset owner and manager Elevated Returns, raised $18 million from the sale of digital tokens in the form of 'Aspen Coins' to individual investors – who also received a cash rebate on spending in the hotel.

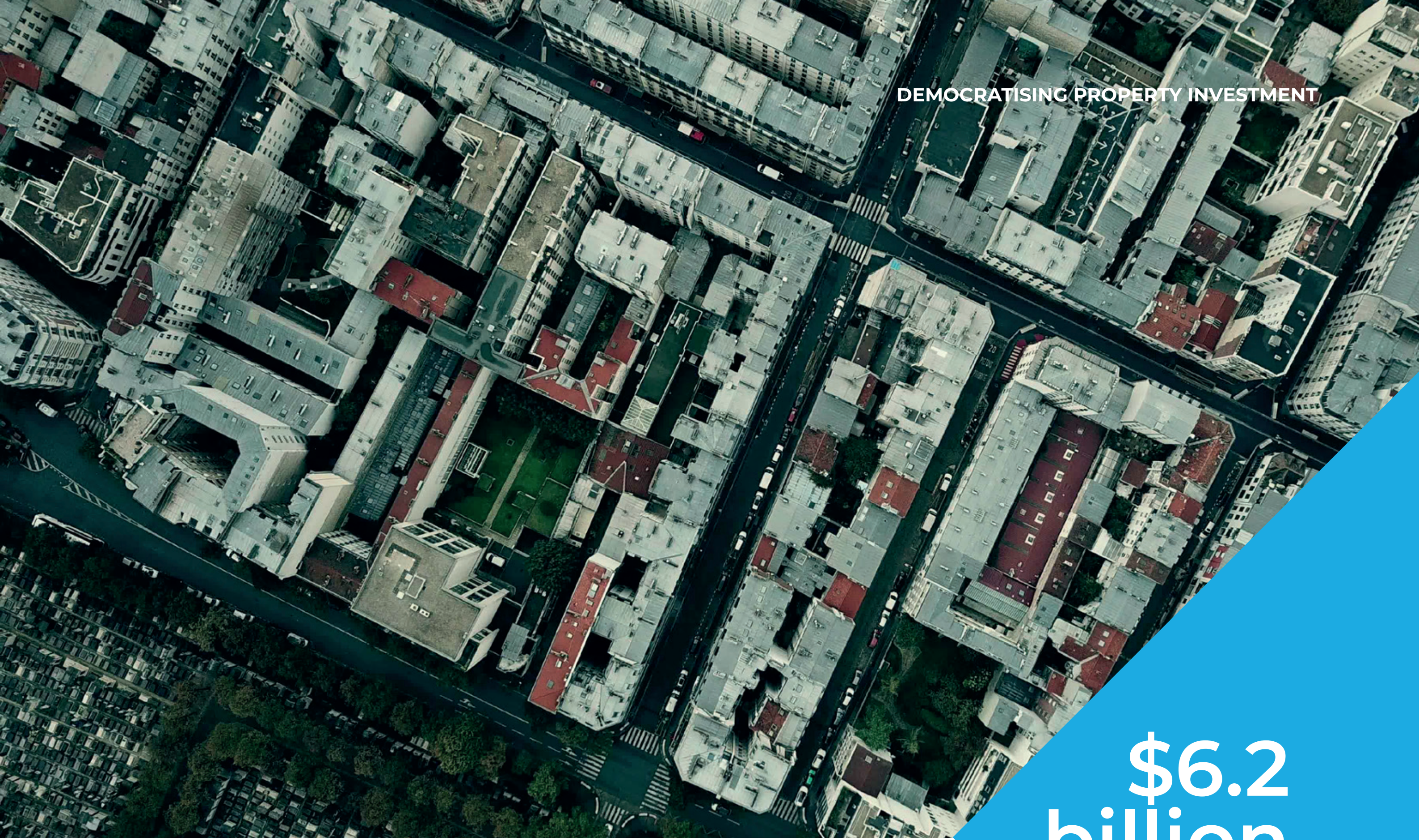
The world's first tokenisation deal may never have happened if the owner had proceeded with an earlier plan for an IPO (initial public offering) which would have marked the first single asset REIT to trade on a US stock exchange. It was cancelled amid disagreements over valuation and a conviction by Elevated Returns that tokenisation could raise capital at a lower cost and more efficiently than a stock market listing, and generate greater liquidity.

"Adding digital assets to a portfolio can be advantageous as blockchain technology can make transactions more transparent and trackable."

David Walker, Cayman

$18 million

Raised in St Regis Aspen resort tokenisation deal



$6.2 billion

of property to be tokenised by US firm RedSwan

Since then, tokenisation deals have been struck and digital asset trading platforms launched in at least 15 countries. There is a growing pipeline of property assets slated for tokenisation around the world and new trading platforms are rapidly emerging, with many targeting players in the real estate sector.

The United States, Hong Kong, Singapore, and Dubai are among a dynamic group of early adopters while Switzerland, Germany and the UK have emerged as European pioneers.

There have been a flurry of international joint ventures announced as fintechs, real estate developers, property owners and digital asset experts team up to tokenise pipelines of properties.

Assets tokenised range from residential blocks to retail, office, leisure and hospitality developments. They include a parking lot in Slovenia, residential property in Paris and Seville, a luxury London hotel and a community school in the New York borough of Queens.

The United States is in the vanguard, with a number of firms jockeying for leadership in the emerging investment space. They include RedSwan, a Texas-based real estate marketplace which has already tokenised $2.2 billion worth of property and plans to tokenise $4 billion more. Property tokenised so far includes residential developments in Texas, California and New York and a hemp farm in Canada.

In Europe, deals are more prevalent in countries where regulators have given the green light to key aspects of digital asset investing.

In Germany, for example, financial regulator BaFin approved distribution of the country's first regulated tokenised real estate bond.

Also, Bauwens Group, one of the country's biggest real estate developers has made a strategic investment in asset tokenisation firm Fundament as part of a partnership which will see Bauwens begin to tokenise a portion of its €6.7 billion property portfolio.

Meanwhile in the UK, the Financial Conduct Authority (FCA) authorised Archax as the country's first regulated digital securities exchange and custodian. That will enable digital issuances from across the world to trade on an FCA-authorised secondary market for the first time.

The Middle East is a hotbed of activity: high net worth investors are pursuing both local and overseas tokenisation deals and a new partnership has been formed to create the region's first real estate tokenisation platform.

Some investors are also turning to locations with attractive investment and tax regimes such as the Cayman Islands to domicile new digital real estate investment funds.

At this stage it remains unclear which type of digital real estate asset – or indeed fund – will prove most attractive to retail and institutional clients.

Real estate tokenisation began with a single 'trophy asset' in Colorado and there are a number of new projects based around a single asset such as a luxury hotel or upmarket apartment building. However, some experts believe that this form of investment is better suited to groups of assets such as those held in REITs.

Andrew Baum, director of the Future of Real Estate Initiative at Oxford University's Said Business School, believes tokenisation of single real estate assets is a stepping stone to the development of tokenised REIT funds. His view is that tokenisation has the greatest chance of success where an established structure is in place and there is evidence of demand for fractional ownership.

Individual investors have embraced tokenisation more readily than institutional investors, welcoming a chance to participate in deals that previously were off-limits because barriers to entry were too high. Of course, they do not face the same compliance issues and fiduciary duties as institutional investors.

Raising capital by conventional means is rarely a rapid or straightforward process for property businesses seeking an IPO or fund managers launching a REIT.

It can take in excess of a year, associated costs run to millions of dollars and can be physically and mentally exhausting. One well-known UK fund manager attended 497 meetings to raise $900 million for a new property fund – an average of $1.8 million raised per meeting.

That is hardly a model of efficient capital raising and Moore's Dan Natale says it illustrates why the property investment market is ripe for transformation.

"Tokenisation is an emerging trend with potential to become a mega trend. There are challenges to overcome and uncertainties to resolve but we are just beginning to glimpse the multiple benefits it could deliver in future."

"Tokenisation is an emerging trend with potential to become a mega trend"

Dan Natale, Canada

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