

Digitizing Demand: Is Tokenization on the Horizon for Commercial Real Estate?



Back in 2018, things seemed to be taking an interesting turn for the real estate world. For the first time, a major sale of equity in a real estate asset happened through a process of ‘tokenization’, as buyers purchased a stake in the St. Regis Aspen Resort through an offering called Aspen Digital.

Since then, there have been numerous other contenders in the tokenization space, but most of these seem to have gained limited traction. Of course, the world has changed in some significant ways over that period, and many other disruptors to the real estate space have risen to prominence in the wake of those changes.

The question that remains for commercial real estate (CRE) is: What role will tokenization play in the future?

A Tokenization Primer

For those who need a refresher, ‘tokenization’ is the process of subdividing or ‘fractionalizing’ an asset into tokens stored on a blockchain. What this does in practical terms is that it allows investors (and sellers) to easily trade portions of value in a specific property.

So, in the St. Regis example touched on above, around USD 18 million of the property’s value was converted to tokens, representing only a fraction of its overall valuation at the time.

Clear Advantages

The obvious benefit of being able to break a real estate asset down into smaller ‘token’ parts like this is that it increases liquidity, making it easier for investors to buy in at lower cost.

This in turn opens the door for a more democratic investing process where people who might otherwise not have access to commercial real estate investments can participate in the market. And, unlike REITs (Real Estate Investment Trusts), those investors can even choose which specific buildings and projects they want to invest in and control their own stake in that property.

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Storing tokenized assets on a blockchain also means that transaction histories and data can't be altered. This makes the whole process of ownership and sale completely transparent, creating what blockchain aficionados call a 'trustless' environment where everyone has access to the same, immutable records.

Regulatory Concerns

Despite the potential that tokenized real estate holds, it's worth noting that at present there's still a great deal of regulatory uncertainty around the technology. As Christina Mkrtychyan writing for USC Gould Law sums up:

"Uncertainty about regulation poses the most significant hurdle to real estate tokenization. Because tokenization is a relatively new investment form, regulators have yet to establish a clear and consistent framework to follow. While some regulators view real estate tokens as securities, others categorize them as real property investments."

Mkrtychyan adds that a lack of public awareness about tokenization, and the perception of blockchain-based technology as inherently volatile, are additional challenges the space will need to overcome before wider adoption takes place.

PropTech Projections

Despite these challenges, there are several real estate and investment startups forging ahead with tokenization. In many cases, these companies are betting on a massive shakeup of not only the real estate sector but the larger financial system as well.

Dan Natale, leader of real estate and construction at accounting firm Moore Global, puts it like this: "Tokenization may be at a relatively early stage but it is absolutely going to be a disrupter in global property markets. It has potential to lower the cost of capital, increase the pool of potential investors and increase liquidity."

Natale adds that if "just 0.5%" of the USD 280 trillion global property market was to be tokenized in the next five years, the market would be valued at USD 1.4 trillion.

Taking the Long View

For the real estate sector, the reality at present is that tokenization still has some way to go before it makes a dent in the CRE market. That said, we are already seeing startups like Red Swan making a splash, and the US is one of the leading markets for new tokenization initiatives.

Whether the technology can overcome regulatory hurdles in the long run, and deliver on its promises in the process, still needs to be seen. What remains true, however, is that for the savvy real estate professional, it pays to keep a finger on the pulse of new opportunity and pay heed to new ideas that just might be "the next big thing."