

# **The Potential Impact of Raising Capital to complete Property Developments Project/ Real Estate through Tokenization**

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**Tokenization:** the process of creating a virtual token that would represent ownership of a type of real estate asset (Vanessa Jane, Blockchain App Factory)

## **Tokenization and Real Estate**

FinTech innovation is meant to bring more significant efficiency, higher security, and lower costs to the financial industry, among which tokenization messengers are revolutionizing real estate products for a new digital world.

Tokenization is a fast-growing concept in the financial industry which enables investment in the form of digital tokens backed by real world securities or assets. For the purposes of this paper, “tokenization” will be utilized as an overall depiction of the most common way of moving conventional non-advanced protections to a mechanical structure utilizing blockchain innovation. “Tokenized securities” will be used to describe digital investment products with the characteristics and functions of securities. “Security tokens” will be used to describe the form in which tokenized securities are issued to purchasers.

At the center of tokenization is blockchain innovation, a sort of dispersed record that gets indistinguishable information across an organization of approved partners. Rather than a unified data set, there is no weak link for information put away on the blockchain than a suitable data set, and unapproved admittance to or adjustment of data is nearly unimaginable. Utilizing blockchain innovation's solid, unchanging characteristics, tokenization works with advanced fragmentary proprietorship with secure exchange records and quick settlement processes.

## **Tokenization**

Tokenization is the most common way of trading sensitive information for nonsensitive data called "tokens" that can be utilized in a data set or inner framework bringing it into scope.

Albeit the tokens are disconnected qualities, they hold specific components of the first information—ordinarily length or format—so they can be utilized for continuous business activities. The first sensitive data is then securely stored outside of the association's internal systems.

In contrast to encrypted data, tokenized information is undecipherable and irreversible. This differentiation is especially significant: Because there is no numerical connection between the token and its unique number, tokens can't be called back to their unique structure without the presence of extra, independently stored data. Therefore, a break of a tokenized environment won't present a security threat to the original sensitive data.

## **Advantages of Tokenization**

### **Flexibility**

The above elements enable flexibility in investment fractionalization enables flexible portfolio construction and diversification; operational efficiency and reduced settlement times which allow faster transfer of investment interests; and data transparency brings updated information for investment analysis

### **Fractionalization**

For assets that traditionally have large upfront capital requirements, tokenization lowers the barriers to entry for investment by enabling interests in the asset to be more readily divided across a wider pool of contributors, democratizing access to the asset.

Fractional ownership is securely managed by a digital register of members (ROM) on blockchain. New financial products could be distributed to a wider pool of investors at a lower per unit cost, with a fee structure inclusive of an access premium for the previously inaccessible investment opportunity.

### **Information Transparency**

Blockchain as a distributed ledger technology is known for its immutability and resistance to cyber-attacks, as data is distributed across a network of participating nodes as opposed to a single centralized database. While transaction information is made trackable and visible on blockchain, data anonymity of blockchain transactions are preserved by cryptographic hashes.

### **Functional proficiency**

Smart contracts are programmable actions on the blockchain that facilitate the automation of processes such as compliance checks, investor whitelisting, and post-issuance matters including dividend distribution. Smart contracts also enable the programming of tokens with unique qualities, such that characteristics of each share

class and customizable fee structures could be created for tokenized assets at a relatively low operational cost.

### **Decreased Settlement Time**

Transactions in tokenized products can be settled almost instantly, unlike the days or weeks that it can sometimes take to settle traditional finance transactions.

## Impact of Real Estate Tokenizing

Real estate tokenizing offers several advantages and opportunities, for the most part through fractionalization of properties. However, as the real estate market has been framed by and is overwhelmed by enormous players, the actual demand for fractionalization is low in practice.

A low demand in a conservative market creates challenges for real estate tokenizing, which relies on the conversion to blockchain innovation.

Especially when establishments and other enormous players might lose the mystery and huge scope of benefits because of a more transparent market.

One of the problems is the scalability problem, a limited capability of the blockchain network to handle large amounts of transaction data on its platform in a short span of time. As the use of real estate tokenizing and blockchain technology in general increases, the efficiency risk will decrease.

Another problem is the management of the property, partly caused by the fact that the deed is not transferred.

One solution to the management issue is to assign the property to an organization, a real estate firm. However, then investors invest in a property company, like in the first quadrant of the four quadrants of real estate capital markets, rather than in a property. In addition, this requires a minimum volume of properties in order to be profitable.

Another solution is third-party issuer, who issues real estate tokens and manages the tokenized properties. However, this creates limitations and dependency on the third-party issuer, which is a paradox since one of the main ideas with real estate tokenizing is to outsource third parties. Another paradox is the liquidity difficulties. While real estate tokenizing aims to solve liquidity issues, low liquidity increases the value of tokens according to token valuation theory.

The fact that the deed is not transferred also creates other problems, for example in debt financing. When investing in real estate tokens, the investors buy equities in an unlevered special purpose vehicle that represents the property. The special purpose vehicle is the actual tokenized asset. However, as the deed does not follow the investor, there is no security for the debt financier. As such, there is a financing risk which is one of the most crucial factors in real estate investments. Furthermore, there is a risk for fraud as investors need to verify that the tokenized special purpose vehicle actually holds the property. Accordingly, data still needs to be verified manually, reducing automatization benefits from asset management.

Another problem is the legal classification of real estate tokens. It is discussed whether a real estate token is a digital representation of a property or a financial derivative of a property. For example, the empirical characteristics in this study indicate that the real estate token indexes are more similar to the S&P 500 than to the housing index.

Consequently, tokens may qualify as a financial product, requiring more extensive frameworks and regulations, reducing the benefits against the traditional equity market.

Furthermore, it is relevant to ask whether the real estate industry and the public desire a liquid and volatile real estate market with uncertain trading to NAV. Accordingly, real estate tokens entail a single-asset vehicle risk for non-professional investors

## **Conclusion**

Real estate tokenizing is an interesting phenomenon with the potential to change the entire real estate industry. From the perspective of investors, the most central benefits are fractionalization and efficiency in the transactions process. Through fractionalization, the access to properties and customizability in the acquisition of a property portfolio is increased. Furthermore, the required capital for direct real estate investments is reduced. Through blockchain technology, reliable property information is structured and easily accessed. Thus, reducing agent costs and creating an efficient transaction process. Altogether, the attributes aim to increase the liquidity in real estate investments, potentially resulting in a liquidity premium and new structured products.

From the perspective of asset managers, the most central benefits are automation and efficiency in asset management. Through blockchain technology and smart contracts, transfers of dividend and ownership are automatically executed, increasing the efficiency in asset management.