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The Tokenisation of Real Estate

An important innovation and trend of the next few years will be the tokenisation of real estate. Tokens are an electronic – and blockchain enabled – expression of ownership. The use of tokens as distinct from money can democratise or widen the funding base of projects by decreasing dramatically the transaction costs of issuing, maintaining and publicising a syndicate. This presents some fabulous opportunities and real dangers to those putting capital to work.

The intrinsics of how real estate investments are made, how they are run and how investors are paid back are not changed either by blockchain or the use of tokens. Furthermore, although tokens are one step removed from *fiat* currency it is important to underline that the legislative structure remains very much in force in the crypto / technology / tokenised world. Contrary to the statements of some early adopting buccaneers, criticising sceptics on the sidelines or even lawmakers themselves the law is and always has been 'technology neutral'. This means that by whatever mechanism something is done if, for example, an entity is raising a syndicate or managing other people's money they remain subject to the relevant laws in the appropriate jurisdiction for these activities.

That said, the speed and the cheap cost with which capital can move in a more tokenised world should massively increase liquidity for all asset classes. As has been seen from last cycle with above average extension of liquidity real estate becomes a prime destination for excess liquidity – driving absolute capitalised rates down as well as at a rate that is unsustainable in the long run. In the short-term capital feeding frenzy that this environment creates, investors forget how illiquid real estate can become during the bad times. Since real estate is capital heavy this can be a very costly error.

How can such misallocation decisions be avoided? First, it remains to be seen whether tokens themselves can act as circuit-brakers to a stampeding market. Hitherto, large brokers of capital (banks and financial institutions) themselves have been part of systematic shocks of modern capitalism. It remains to be seen whether moving to a more statistically discrete (non-binomial) and non-contaminated investment blocks will become self-correcting. Secondly, like any powerful instruments to be used for good they need to be manned by people of good standing and ethical behaviour as both initial sponsors but also subsequent administrators. Alignment of interests is difficult enough in an established publicly listed company – how much more is the challenge when we are effectively talking about a self-policing a micro-bond? For example, effective control could be in the hands of a minority participant or an administrator whose interest in the free cash flow is non-existent in comparison to their above-the-line emoluments.

Time will tell of tokenisation in real estate turns into an organic and sustainable injection of liquidity or a micro (and retail led) version of, for example, the bond crash of the 1980s or the credit crisis of 2007/8. One thing we can tell for certain right now – no one is quite sure.

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