

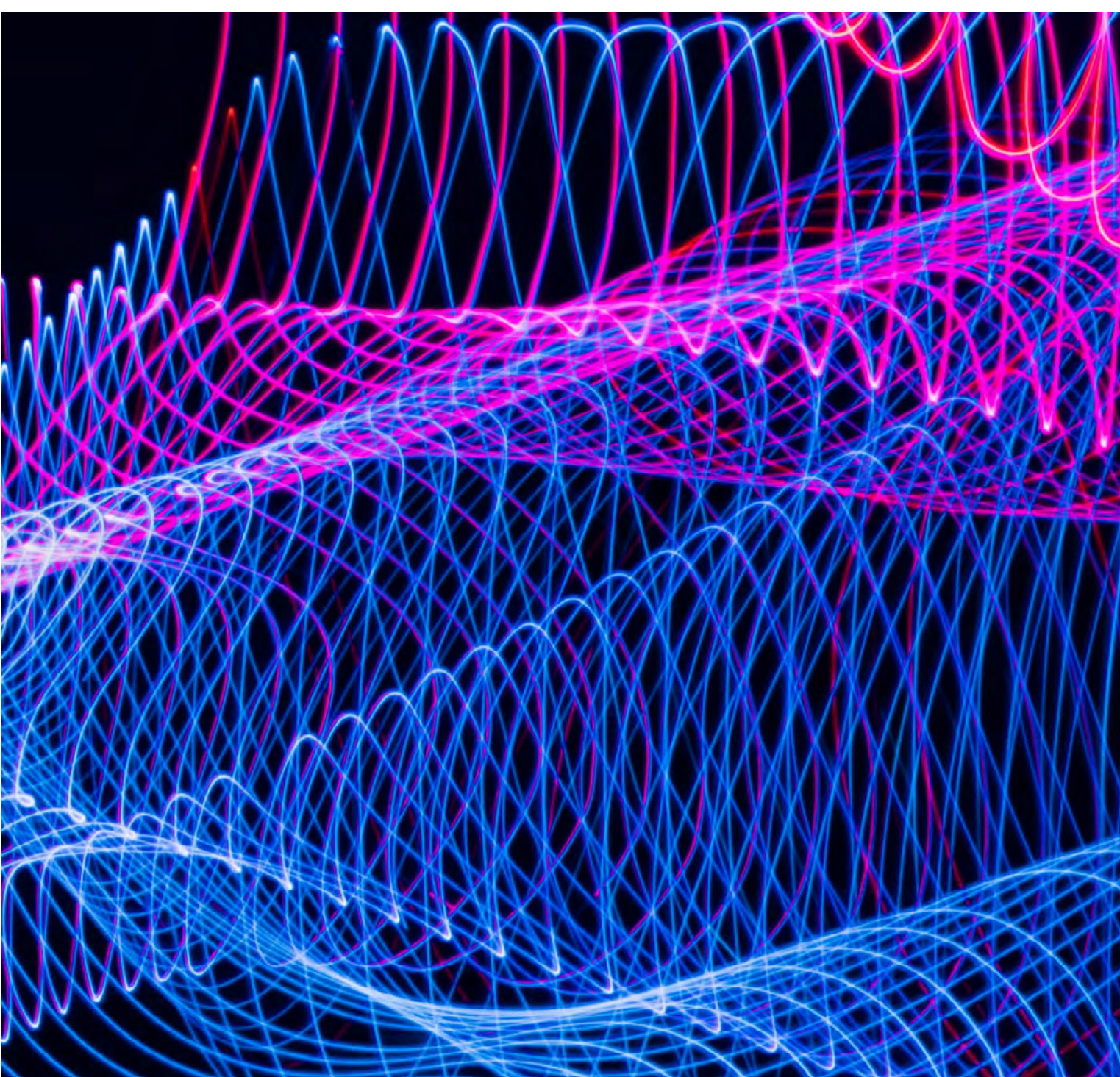
Advantages, Challenges and the Process of Tokenizing Real Estate

BLOCKCHAIN PRACTICE GROUP

Our firm is at the forefront of asset tokenization revolution

We advise clients from a wide variety of industries regarding the process of tokenizing different asset classes, including real estate, funds, operating businesses and luxury assets.

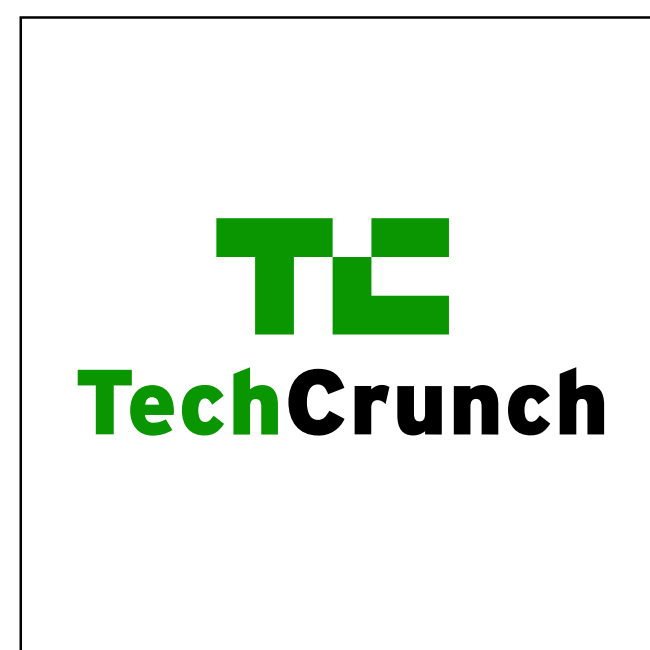
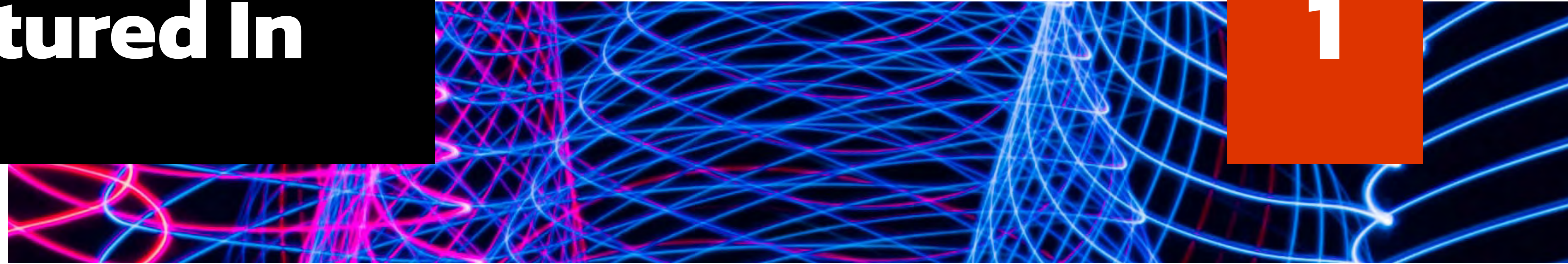
Our clients — blockchain startups, individual investors, funds, family offices, real estate owners/operators, art collectors, high net worth individuals and FinTech firms.



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1



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Topics

1

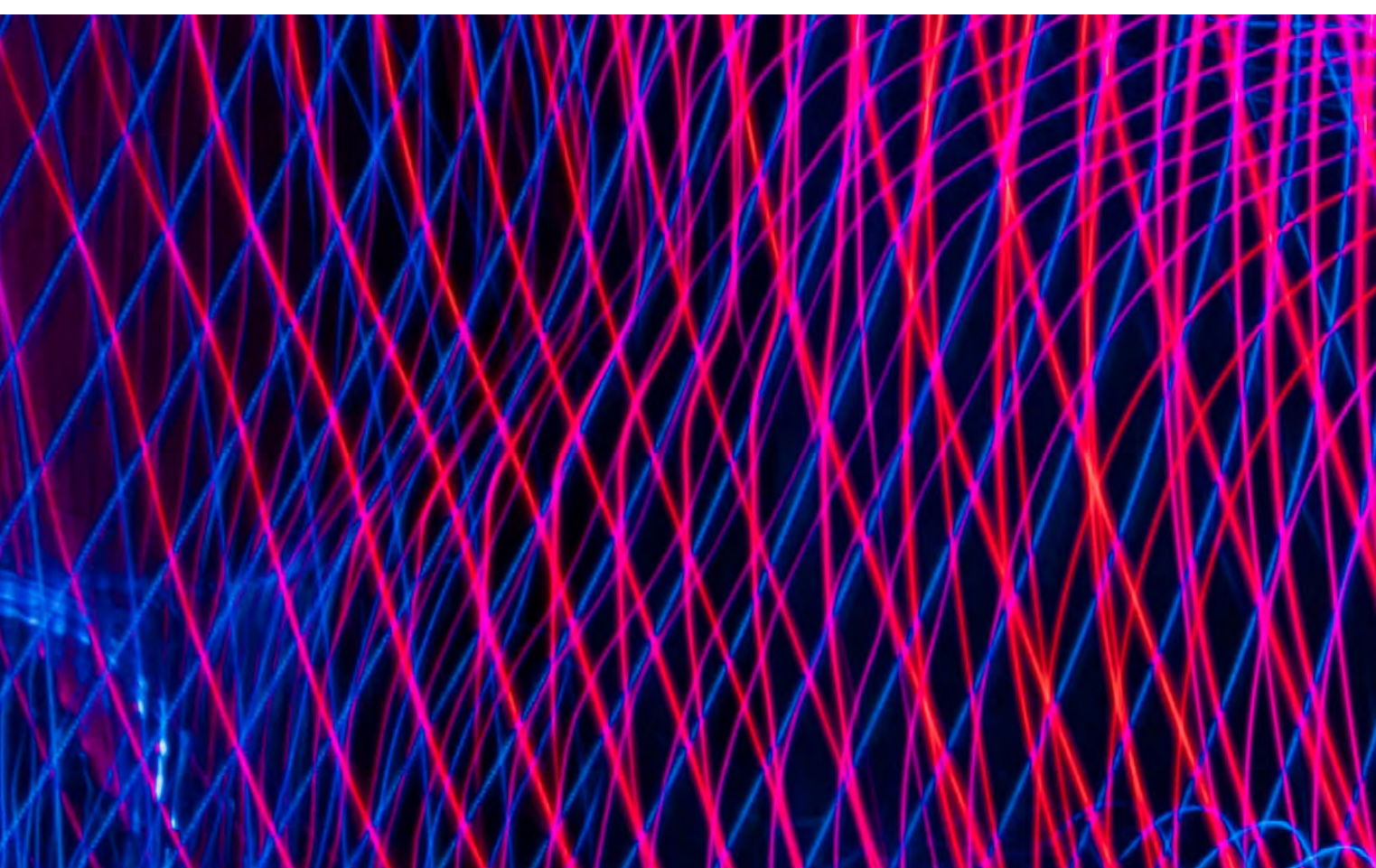
Why tokenize real estate?

2

Key considerations of a real estate tokenization strategy

3

How to tokenize a real estate project: practical steps & cases



Real Estate Tokenization & STOs

Tokenization

Process of creating a digital asset (token) to represent ownership of an interest in real estate, either directly or indirectly.

Real estate tokenization will involve forming a type of digital security and digital security offering (STO).

STOs

STO is a new method of financing real estate projects, key legal component of tokenization.

STO is an offering of digital securities implemented on a blockchain in compliance with US securities laws and regulations.

Why Tokenize Real Estate?

Liquidity, Management & Control

**Access to capital
on a global scale**

**Fractionalization
of ownership**

**Access to assets with traditionally
high barriers to entry**

**Reduction of
operating costs**

**Retention of control over
management decisions**

**Simplified investor
communications and management**

**Assets attractive to both
traditional and crypto investors**

Types of Tokenized R/E Interest

1

Ownership of an underlying real **asset**.

2

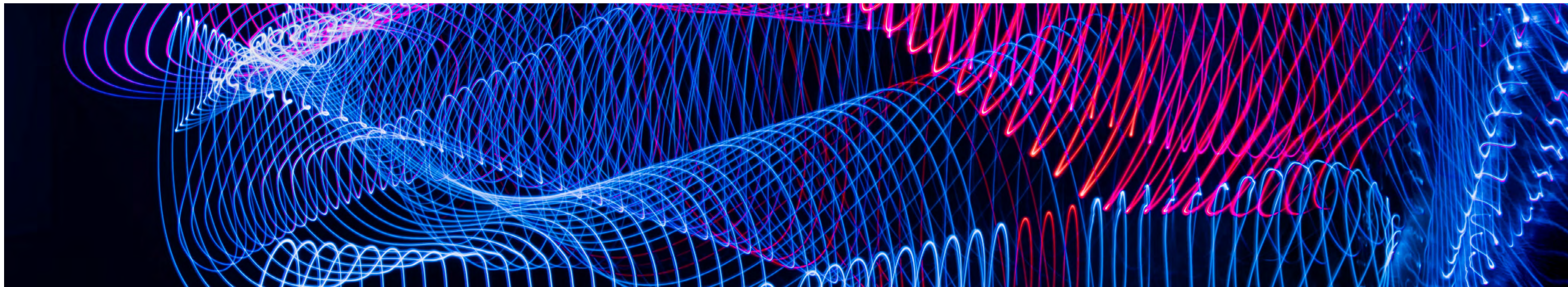
Equity interest in a legal entity that owns a real asset.

3

Interest in a **debt** secured by a real asset.

4

Right to share in **profits** arising from use of a real asset.



Key Considerations: Regulations

U.S. Securities Regulations

- Registered vs. exempt offering.
- Accreditation.
- Secondary trading compliance and cap table restrictions.
- Necessary disclosures.

Broker-Dealer Regulations

- Marketing.
- Advisors.
- Finders.
- Team compensation.

Anti-Money Laundering Regulations

- KYC/AML checks.

Global Securities Regulations

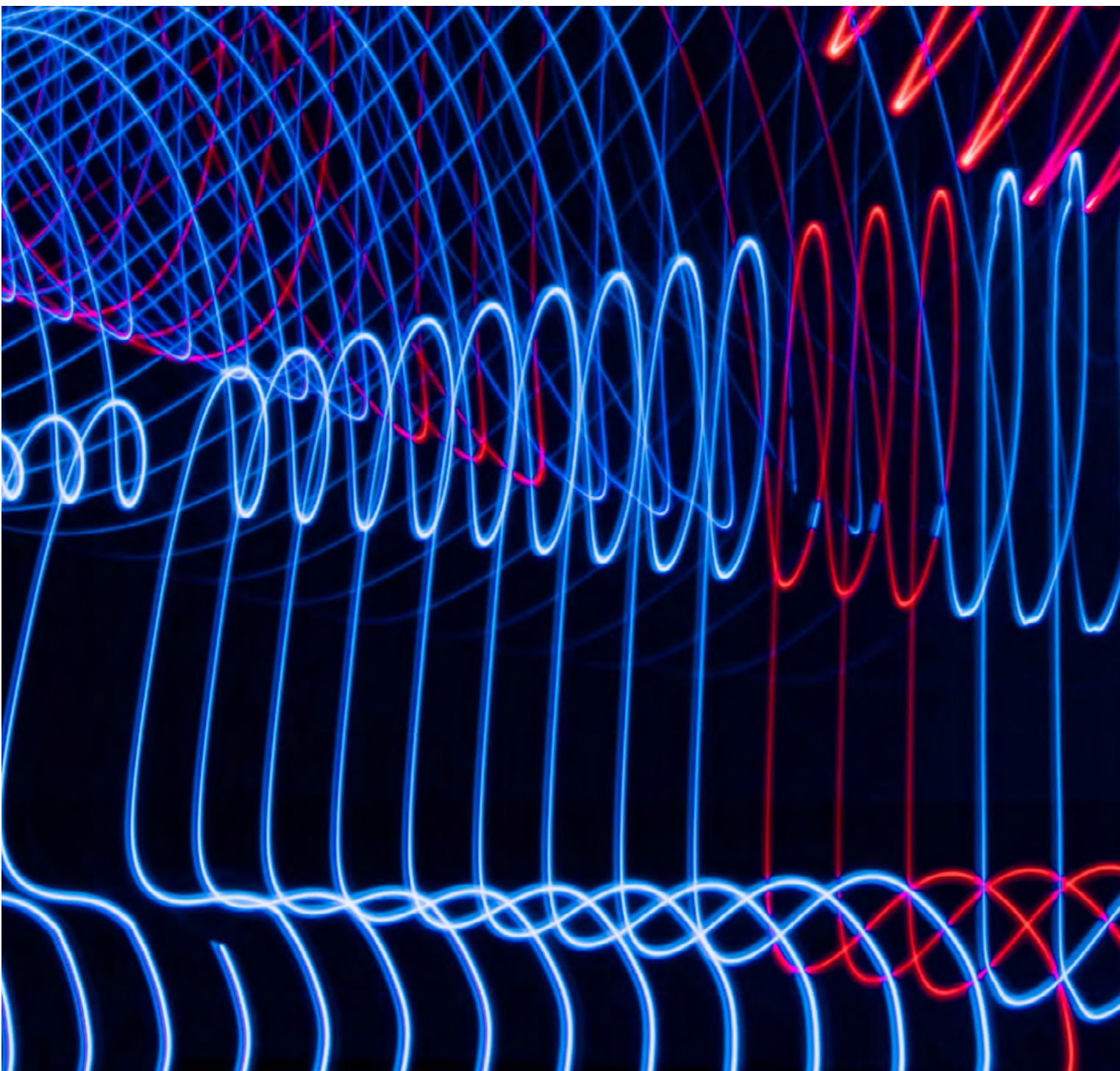
Sale of Digital Securities in the US

General rule: you must register a security with the SEC before you can offer or sell it.

Consequence of selling unregistered securities: strict liability.

However: even if a token is a security, it may qualify for an exemption from registration.

As a practical matter, there is usually no need to register because you can almost always structure a STO to qualify for an exemption.



Most Commonly Used Exemptions

1

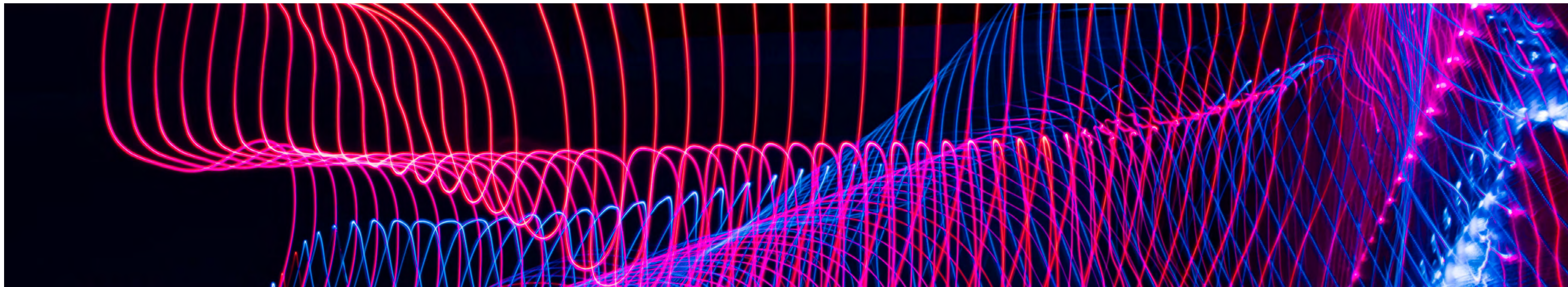
Regulation CF

2

**506(c) under
Reg. D + Reg. S**

3

Regulation A+

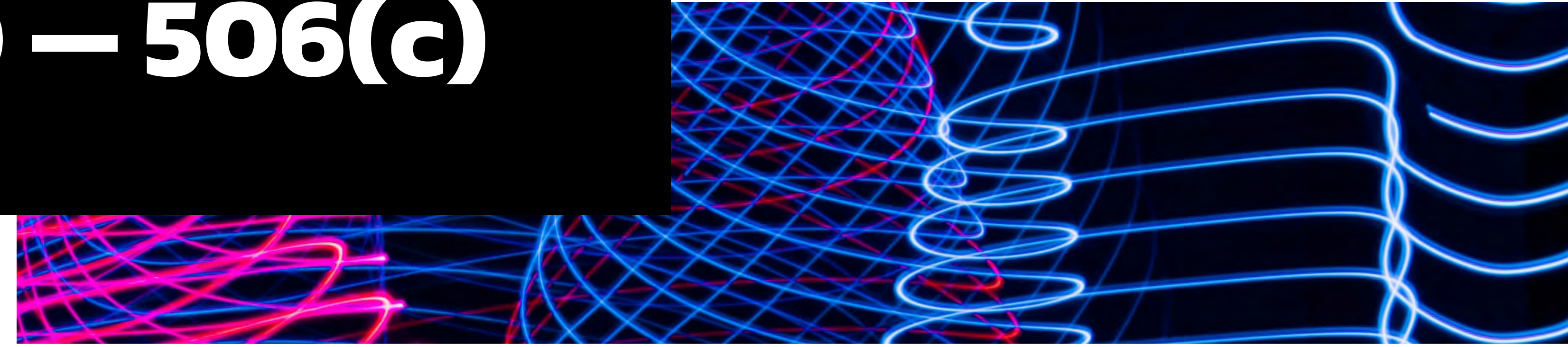


Regulation

Crowdfunding enables eligible companies to offer and sell traditional and tokenized securities through crowdfunding. The funding group must be incorporated into the US and must primarily do business in the US or Canada.

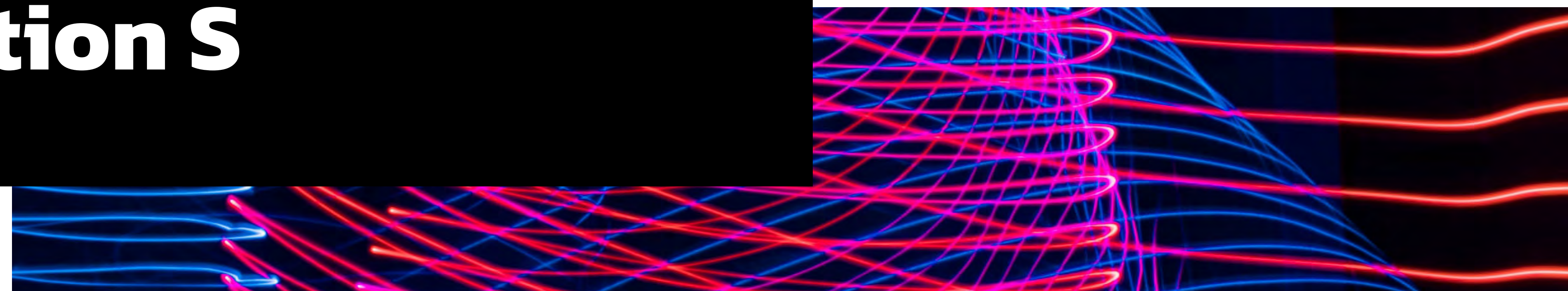
The rules

- Permit a company to raise a maximum aggregate amount of \$5 million from US and non-US retail and accredited investors.
- Tokenized Reg. CF securities can be traded on regulated ATS platforms one (1) year after the issuance date.
- Require all transactions under Regulation Crowdfunding to take place online through an SEC-registered intermediary, either a broker-dealer or a funding portal.
- Require disclosure of information in filings with the Commission and to investors and the intermediary facilitating the offering.



Overview of Reg. D — Rule 506(c)

- No restrictions on advertising—general solicitation is permitted.
- No prospectus required (although issuers generally release a PPM).
- Issuers can raise an unlimited amount of funds.
- No financial reporting requirements for the issuer.
- Only accredited investors may participate in the sale.
- State securities laws are pre-empted (no need to seek registration or exemption on a state level).
- Purchasers cannot transfer their securities for one year (subject to certain exceptions).
- Form D must be filed with the SEC 15 days after the first sale.



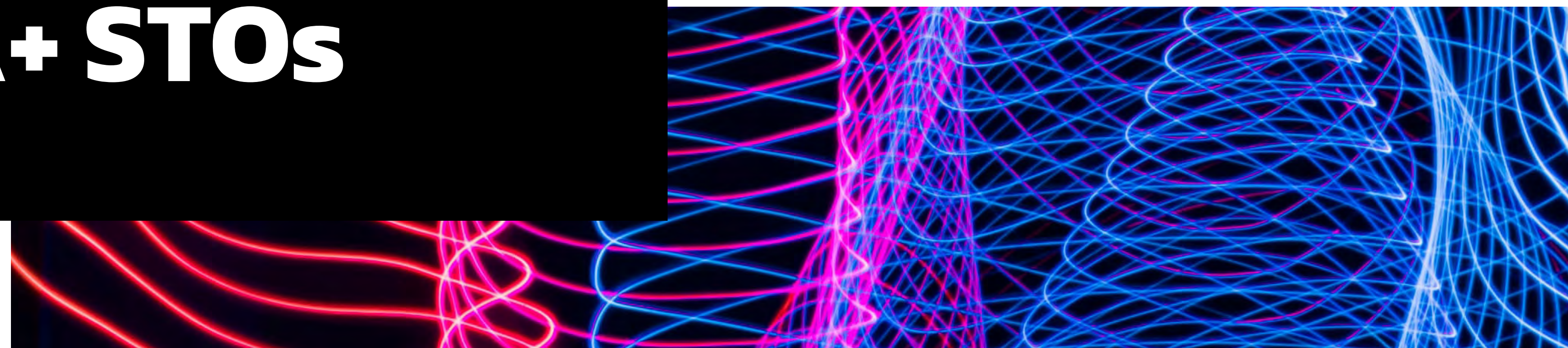
Overview

Rule 901 says that “offers and sales that occur outside the United States” don’t have to be registered.

Beware! The SEC has never clearly explained when an offer and sale occur outside the United States, so you shouldn’t rely on Rule 901 alone.

Fortunately, Rule 903 provides a safe harbor — if an offer and sale satisfy the following requirements, they are deemed to occur outside the United States:

- Offer and sale made in an offshore transaction.
- No directed selling efforts are made in the United States.
- Certain other requirements described in 903(b) are satisfied.



Overview

- The exemption allows U.S. and Canadian companies to publicly advertise investment opportunities from an unlimited number of unaccredited investors.
- Reg. A+ STOs must be qualified by the SEC by filing compliant Form 1-A.
- Immediate liquidity opportunity for investors as Reg. A+ securities are freely tradable and may be listed on ATS platforms.
- Accept investments from both accredited and non-accredited investors.
- Two offering size levels are available:
 - Tier 1 offerings of up to \$20 million over a rolling 12-month period.
 - Tier 2 offerings of up to \$75 million over a rolling 12-month period.
- The ability of selling security holders to participate in the offering, known as secondary sales.
- Equity securities, debt securities, securities convertible into or exchangeable into equity interests, guarantees of these securities may be offered and sold in a Reg A+ offering.

Key Considerations: Technology

Securities law compliance measures must be discussed with experienced attorneys and implemented in life — usually by a tokenization platform.

All of the key tokenization practices must be maintained by a chosen tokenization platform, including:

- KYC/AML/Accreditation process.
- Token issuance with a compliance protocol.
- Maintaining cap table.
- Secondary trading integration.
- Reporting and investor management.

Additional Considerations

**Asset
type**

**Current corporate
structure**

**Type of interest
to be tokenized**

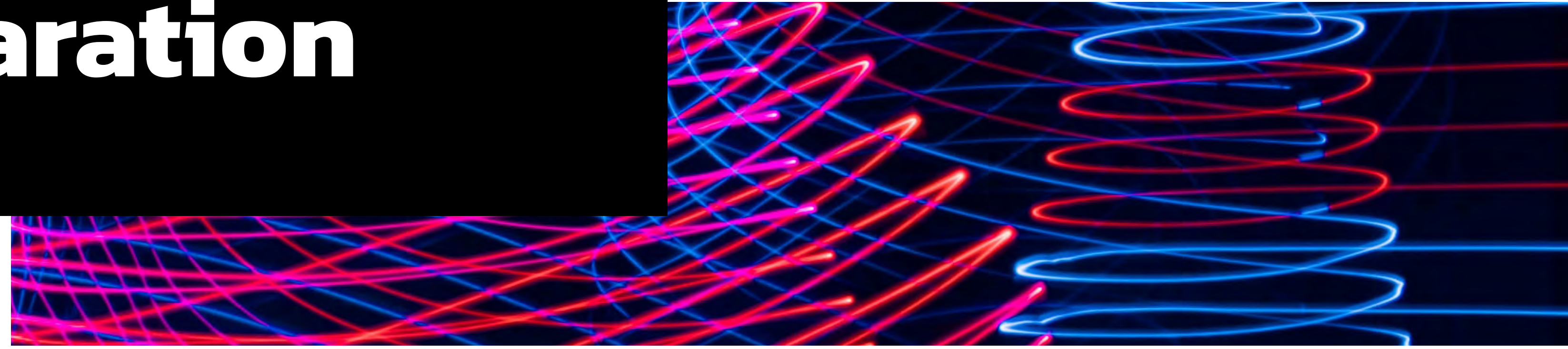
**US and global
tax compliance**

**Multijurisdictional (multi-regimen)
treatment of tokens**

**Tokenization
ratio**

**Location
(real estate situs)**

Stage 1: Preparation

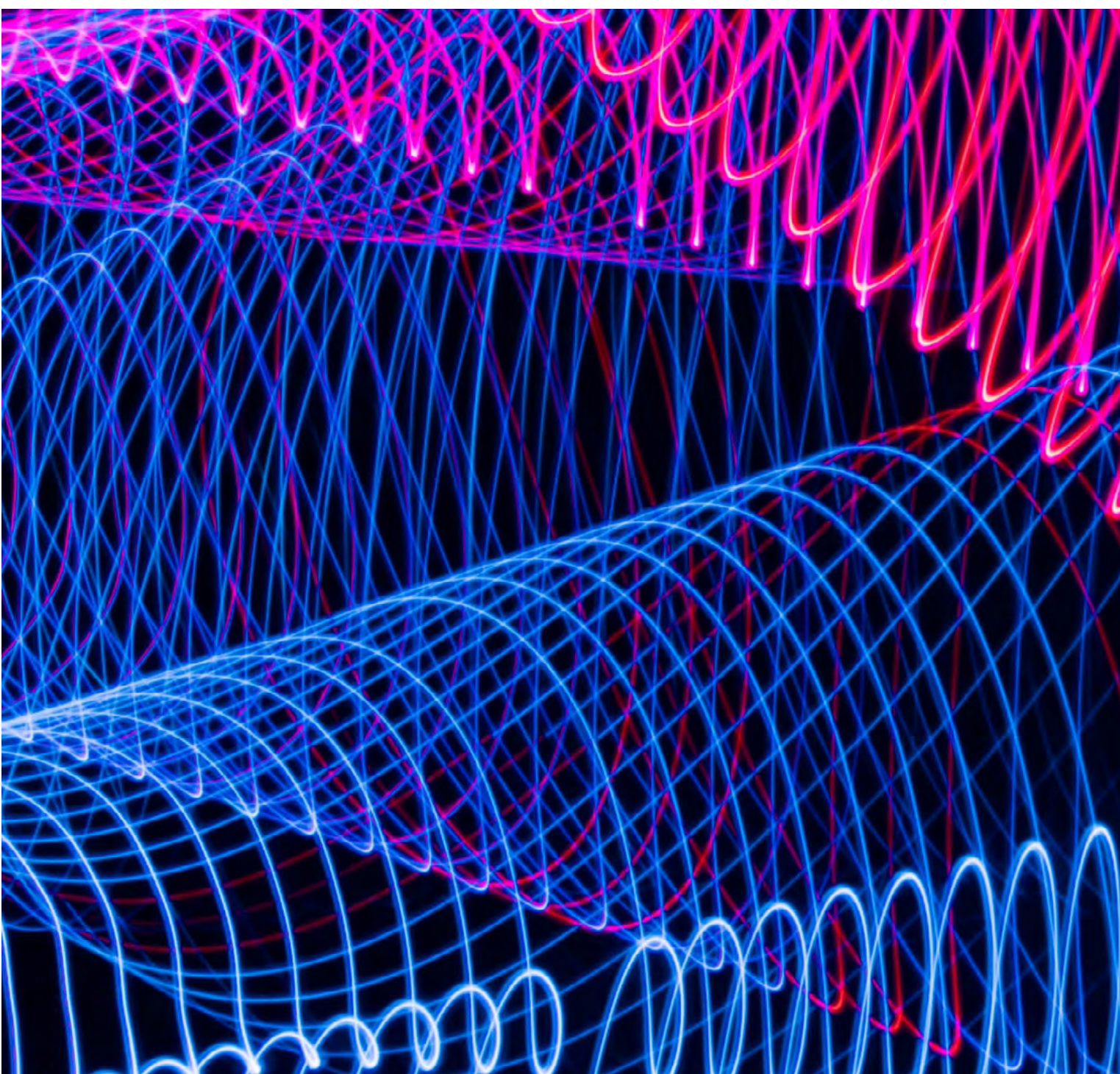


What's involved? At a minimum

- Determination and implementation of the corporate structure, offering structure & token features.
- Valuation and financials.
- Preparation of a private placement memorandum, token purchase agreement/subscription agreement & necessary questionnaires.
- Contracting with providers (tokenization platform, etc.).
- Whitelisting (advance AML/KYC/investor accreditation).
- Compliance with marketing restrictions.
- Takes 4–8 weeks to launch Reg. CF and Reg. D/S STOs.
- Takes 3–5 months to launch Reg. A+ STO.

Offering Terms and Disclosures

- Company overview, projections, financials and risks.
- Rights attached to a token (e.g., common/preferred equity, distributions, profit-sharing, management/voting rights).
- Buyback / redemption rights.
- Transfer restrictions.
- Token price/soft cap/hard cap.
- Accepted currencies and conversion rates.
- Use of proceeds.
- Management team.



Stage 2: Token Sale

1

KYC/AML/
Accreditation.

2

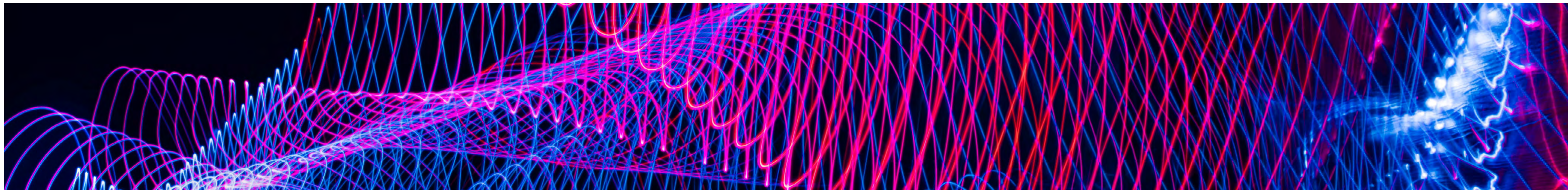
Implementing
sales/returns/
burns transfer
restrictions on
smart contracts.

3

Collection
and custody
of crypto/fiat.

4

Issuance of tokens
(compliant with
regulations).



Stage 3: Life Cycle

1

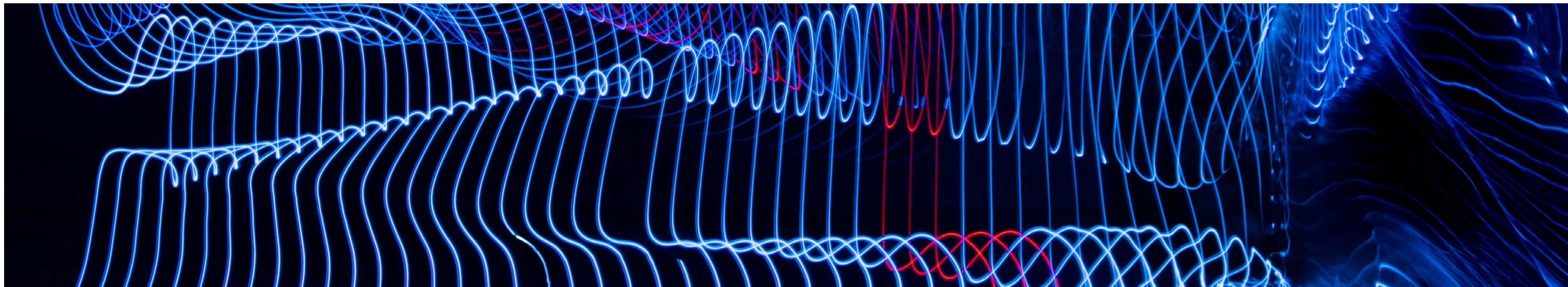
**Communications
with investors**

2

**Cap table
management**

3

**Secondary trading
& anti-flowback**



Additional Considerations to be Aware of

Singapore, Malaysia, Gibraltar and Hong Kong are actively developing markets for security tokens; this presents additional fundraising opportunities for issuers of US STO securities.

In choosing an ATS, there are factors such as offering density and built-in blockchain interoperability protocols with other ATS platforms. Depending on the asset and offering size, it may make sense to list on multiple ATS platforms (e.g., listing an offering on ATS platforms in New York and Singapore).

Additional Considerations to be Aware of

STO issuers can choose to work with multi-national broker-dealers to attract international investors, opening another investment pool that is not available in traditional real estate. A massive benefit of tokenization is the ability to raise capital through international investors, creating new markets and greater opportunities for STO sponsors.

There are tight-knit consortiums of broker-dealers and ATS, which could be an opportunity for efficiency gains. It is important to conduct thorough due diligence before choosing a broker-dealer and ATS because making the wrong choice could lead to the expensive process of burning and switching tokens.

The St. Regis Aspen Resort



Source: marriott.co.uk

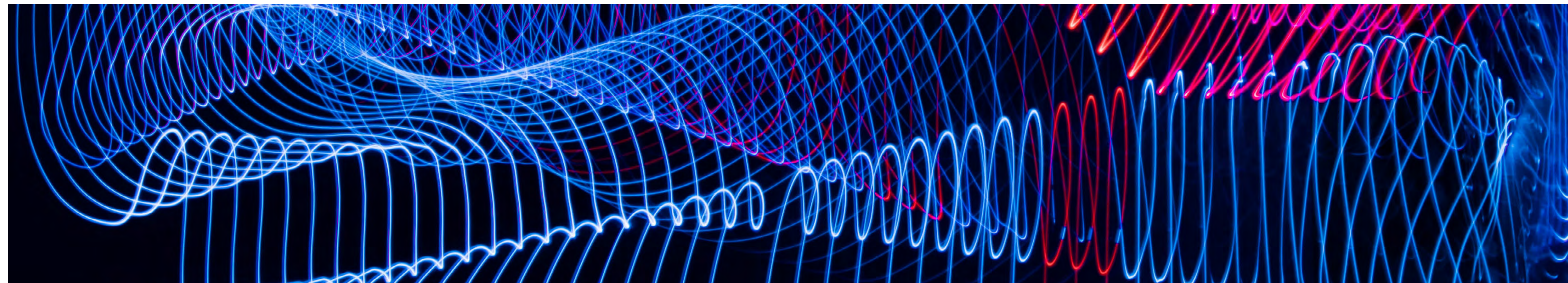
- Reg D — Rule 506(c).
- STO financing: up to \$18,000,000.
- Tokens represent 18.9% indirect ownership in the St. Regis Aspen Resort through ownership in the corporation (to be qualified as REIT) that acts as the GP and LP in the operating partnership that owns the asset — St. Regis Resort.
- Tokens represent common shares in REIT with voting rights (tokenized common equity).

Disclaimer

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