

Financing Real Estate Development on the Blockchain: A Hypothetical Case Study



Executive Summary

Traditional funding methods for real estate developments aren't always ideal. Lending is expensive and may be challenging to secure. Bringing Real Estate Funds on board usually implies conceding control of the development, and courting individual investors with an illiquid investment can be problematic.

Digital Security Offerings (DSOs) offer a new way to access capital. DSOs are compliant Private Offerings made on the blockchain. They enable access to a global pool of investors without sacrificing control. They are compliant with all securities laws and can offer liquidity to investors.

In addition, they greatly reduce operational costs and complexity by paying out distributions and managing cap tables on the blockchain. The following hypothetical case study showcases in detail why and how to access funds for real estate developments or asset acquisitions using DSOs. While the example provided is hypothetical, real funds are being raised through actual DSOs on the Securitize platform and already issued digital securities are being traded on regulated marketplaces using Securitize's DS Protocol every day.

REDev: Hypothetical Case Study

REDev is a leading real estate developer that focuses on developing and operating commercial properties in Northern California. The company incorporated in Delaware in 1994 and has steadily grown since then. It has focused primarily on developing mid-sized malls.

REDev was interested in pursuing an appealing new opportunity to develop a large mall in premium real estate in downtown San Jose, CA. However, this project would require a total investment of \$350 Million, significantly more than REDev was accustomed to funding via its regular channels.

After discussions with its usual lenders, REDev concluded that their typical 80% debt / 20% equity funding structure would be problematic in this case. The interest rates would be too high due to the unusually high loan amount. REDev therefore decided to only fund 40% of the development costs via loan in order to obtain favorable financing. However, this meant that REDev still had to fund \$210MM.

Typically REDev invests around 5% of the development costs and funds the remaining 15-20% of equity with investments from real estate funds. This has created some issues in the past since the interests of the funds and the developer weren't always aligned, and the funds were not shy about using their ownership stake to get their way. In this case however, funds would theoretically be required to contribute over 50% of the funding. REDev was concerned that it would be challenging to obtain this much funding from them, and that giving the funds a controlling stake in the project would further aggravate the potential misalignment between them.

REDev was intrigued by the recent success of Initial Coin Offerings (ICOs) and the apparent easy access to funds they provided. However, the regulatory uncertainty and the lack of any discernible "utility" in their offering quickly shut that door.

DSOs: The Digital Security Offering

Unhappy about the available financing options, REDev was approached with a new method of financing real estate developments: The Digital Security Offering (DSO). Like an ICO, the DSO promised to bring together access to funds and liquidity. But unlike an ICO, security tokens would not be required to have any utility in the company's operations. Rather, the digital securities would simply represent an ownership stake in

the development and rights to its future revenue streams in the same ways as traditional securities would. The DSO would also minimize the potential conflicts of interest with large funds as the investors would be less concentrated.

	Debt	Private Offering To Funds	ICO	DSO
Cost	High	Mid	Low	Low
Operational Savings	None	None	High	High
Liquidity	Low-Mid	Low	High	Mid-High*
Operational / Strategic Pressure	Low	High	Low	Low
Geography	Local	Local	Multiple	Multiple
Regulatory Uncertainty	Low	Low	High	Low-Mid

*Dependent on speed of security marketplace rollout

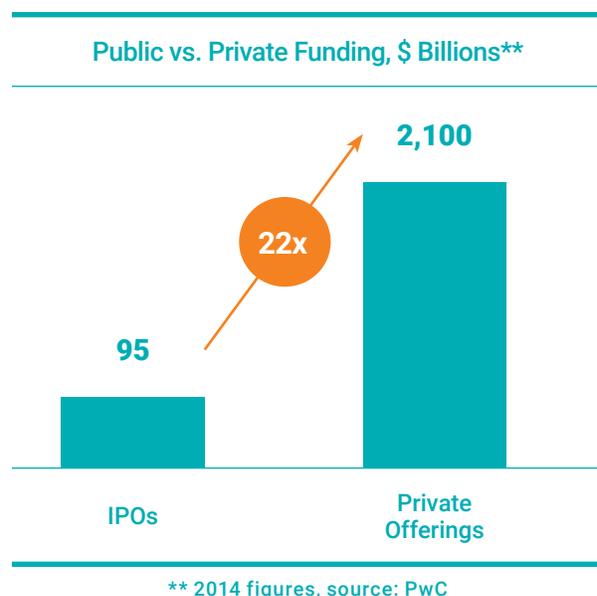
DSOs: The Digital Security Offering Cont'd

The main concern the company had with an DSO was that it was limited to only 2,000 accredited investors because this was a private, rather than a public offering. But this concern quickly dissipated when the company found that the private offering market in the US was 22X bigger than the public offering one.

Interested in the prospects of the DSO, REDev started looking into the process and costs involved. They quickly discovered that Digital Securities go far beyond just a digital representation of ownership. Since these tokens are instances of a smart contract running on a decentralized and trustless blockchain, it is possible to use them to perform certain actions in an automated and seamless manner.

REDev decided not only to access financing through an DSO, but to leverage the full power of blockchain by also using Digital Securities to distribute dividends to investors every month once the development became income producing, and to manage the company's cap table on a real-time basis as well.

This would be done globally, automatically, and on-chain, and would greatly reduce the operating and reporting costs for REDev.



DSO Process Overview

So How Do You Actually Do A DSO?

Working with Securitize, REDev followed a 3-step process for setting up, executing and managing its DSO:

STEP1: Pre-DSO

In the set-up phase, REDev focused on structuring the offering, creating or changing the required documentation, obtaining legal reviews for the process and setting up marketing activities.

STEP2: Issuance

The DSO itself consists of issuing the tokens, conducting KYC/AML/Accreditation processes for the investors, and managing the flow of capital and tokens between company and investors.

STEP3: Lifecycle Management

Once the tokens are issued, the investor lifecycle needs to be managed, including investor communications and secondary trading compliance.

DSO Process Overview

Timelines

Steps		Estimated Time	Responsible	Securitize Role	
STEP1: Pre-DSO	Company Charter	1 Week	Company, Counsel	Advise, Knowledge Sharing	Total Time From Kick-Off Until Issuance: 2-6 Months
	Offering Document	1 Month	Company, Counsel	Advise, Knowledge Sharing	
	Real-Estate Specific Setup	0-4 Weeks	Company, Counsel, Securitize Partners	Support	
	Marketing	3 Months	Company, Broker-Dealer	None	
STEP2: Issuance	KYC/AML/ Accreditation	Ongoing	Securitize	Lead	
	Token Issuance	1 Day	Securitize	Lead	
	Funding	1 Day	Securitize	Lead	
STEP3: Lifecycle Management	Ongoing Communications	Ongoing	Securitize, Company	Execution	
	Secondary Trading	Ongoing	Securitize	Lead	

STO Process Details

STEP 1: Pre-DSO

COMPANY CHARTER

Special Purpose Vehicle (SPV): Tokens represent an ownership stake in the SPV set-up to finance and manage the property development. REDev issued a total of 210,000,000 tokens, together representing 100% of the equity of the SPV. However, only 80% of these tokens would be sold in the raise, at a value of \$1.25 each. Consequently, the investors would jointly contribute \$210MM of financing in return for a 80% ownership stake in the project. The remaining 20% of the tokens remained in the hands of REDev, and the remaining \$140MM of funding was secured through a bank loan. The underlying shares were assigned a nominal value of \$0.001.

DSO DOCUMENTS

Next, REDev had to define the terms of the offering and reflect those terms, as well as some additional items, in their offering memorandum. The offering memorandum used for DSOs is substantially less comprehensive than the prospectus used for public offerings, **and includes:**

Company overview, risk and financials:

An overview of the company's business, its business risks and its financial reports.

Offering details:

In this case, REDev decided to conduct an DSO under Regulation D, Rule 506(c), since this allowed them to perform solicitation for their offering. The terms were:

Min. investment size:

\$210,000. This was done to ensure that valuable investor slots are not taken up by smaller investors.

Rights:

Tokenholders have no voting, tag-along or drag-along rights. Monthly distributions would be paid out to tokenholders in USD or EUR once the property becomes income-producing.

Obligations:

The company established the right to buy back the tokens in certain cases and to block them if investors do not complete their KYC/AML/Accreditation process or do not sign the Subscription Agreement.

Transfer rights:

Secondary trading is restricted to trades permitted by existing securities regulations.

Price:

A price of \$1.25 per token was set in order to facilitate the \$50MM raise.

Accepted currencies:

REDev decided to allow investors the flexibility to invest using USD, EUR, BTC or ETH.

Cap:

The limits set for the raise.

Closing date:

The date at which the offering ends.

Use of proceeds:

Proceeds were to be used exclusively for the purchase, development and operations of the property.

Legal disclaimers:

REDev engaged outside counsel to assist with drafting the standard Private Offering legal disclaimers along with some additional disclaimers relating to the token offering.

Subscription agreement:

During the DSO, investors may be required to sign the Subscription Agreement, which is a separate document that summarizes the terms of the investment and captures the investor consent to those terms.

STO Process Details

STEP 1: Pre-DSO

Cont'd

REAL-ESTATE SPECIFIC CHALLENGES

There are a series of considerations that may come up when setting up real estate investments, such as setting up SPVs, handling complex global taxational issue, ensuring compliance with investor count thresholds, or managing ongoing reporting including tracking project progress . Fortunately, all of these concerns were handled either on-chain using the Securitize platform or off-chain, leveraging Securitize's partners such as Slice.

MARKETING

Since Rule 506(c) allows for general solicitation, REDev created a marketing plan and set aside a budget for accredited investors. However, due to the cap on the number of investors, these marketing activities were more focused and cost-effective than those surrounding an ICO. Overall, REDev spent \$250,000 on marketing its offering, not including any fees paid to their broker dealer. REDev chose to use the white label Landing Page provided by Securitize in order to manage investor onboarding.

DSO Process Details

STEP 2: Issuance

KYC/AML/ACCREDITATION

DSOs are limited to accredited investors, or qualified investors in Europe. Working with Securitize, REDev seamlessly managed the KYC/AML/Accreditation process and created investor accounts on the platform for each investor that cleared the process.

TOKEN ISSUANCE

REDev used Securitize's standard smart contract that their counsel had confirmed already included all necessary global compliance requirements, such as limits on investor counts, lock-up periods, and flowback restrictions. The smart contract was then tweaked to facilitate the buy-back powers that REDev wanted.

FUNDING

The process of collecting funds from interested investors and distributing the issued tokens to investor wallets was handled end-to-end by Securitize, in compliance with the requirements defined in the set-up phase by REDev. In addition, since REDev preferred not to hold all the funds collected in BTC & ETH on their balance sheet, they opted to use the 3rd party custodian service that was offered on the Securitize platform.

DSO Process Details

STEP 3: Lifecycle Management

DSOs don't require anything resembling the ongoing effort associated with public offerings, but there are certain life cycle implications that must be addressed:

ONGOING COMMUNICATIONS

From time to time, REDev may need to communicate with investors. The details of these communications are generally defined in the offering memorandum and may include sharing periodic financial reports or certain event-triggered communications such as those involving buy-backs. REDev opted to use Securitize's community management solution in order to remove this concern.

SECONDARY TRADING

Restricted shares have certain limitations on secondary trading such as lock-up periods and caps on investor counts in different geographies. Managing these complexities can be quite daunting, but fortunately REDev's counsel confirmed that the secondary trading restrictions baked into the Securitize DS Protocol were fully compliant and adhered to current secondary trading regulations.

Conclusion

REDev completed its DSO in under 5 months, raising the full \$210MM hard cap, while maintaining a 20% direct ownership stake (far higher than their typical 5% direct ownership stake) in the development. With this funding in hand, REDev proceeded to acquire the land and start development.

REDev's tokens were programmed to automatically distribute proceeds, which made cash flow management and daily operations significantly simpler. If and when REDev decides to dispose of the property, liquidation proceeds will be paid out in the same way. REDev's tokens are scheduled to be listed on compliant securities marketplaces in the coming months, well before the lock-up periods expire.

This will ensure investors have full liquidity once they are legally permitted to trade in their holdings.

[**Request Demo**](#)

Questions?

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