



Simplifying CRE Finance Through Blockchain Technology

By Nick Ward

I recently read about the last Blockbuster store open in America. As fond memories of renting video games and movies on the weekend started to surface, I couldn't help but think how the once beloved company got to this point. A bevy of reasons exist, but one of the most telling is that Blockbuster didn't adapt its business model to the emergence of the internet. Specifically, Blockbuster didn't ask itself how it could utilize this new tool to its advantage. As a result, it was left in the dust as others did.

Blockbuster serves to remind us of why it is important to follow emerging technologies and ask, "How can this technology solve problems my business faces?" A great example is blockchain—a technology that has continued to capture headlines and threatens to disrupt every industry. Today I will explore the possibilities of blockchain effect on the commercial real estate industry.

Blockchain is a digitized, distributed ledger that immutably records and shares information to its network. The blockchain also creates an environment for strangers to transact with each other without establishing trust in one another first. Until recently, blockchain was known as the technology powering bitcoin. However, numerous industries have begun exploring blockchain-based applications for their business. These applications include: smart contracts, property rights, medical records, supply chain management and many others. For a deeper dive into what blockchain is and how it works, please check out our *e-book*. Blockchain is positioned to change the way we do business in the commercial real estate sector.

How Can Blockchain Serve the CRE Industry?

The idea is to review areas of the CRE industry and identify where we can gain efficiencies through the blockchain. Some existing challenges in the industry include:

- Inefficient property search process due to fragmented data
- Time-consuming due diligence process due to paper-driven and predominantly offline record keeping
- Record-keeping issues over titles that result in high costs related to title insurance, fraud risks and required diligence in the clearing process
- Inefficient, expensive and limiting financing mechanisms
- Need a large amount of capital to transact in the industry

Digitizing Data and Titles

Every real estate transaction goes through the multiple listing service (MLS), which provides information including, location, property features, rental rates, appraisals and more. The data found here is fragmented, often times outdated and can be difficult for people who aren't real estate professionals to access and interpret.

Additionally, these services often require a subscription, adding to the many costs associated with real estate deals. A blockchain-based MLS would result in accurate, secure, data that is quickly accessible to anyone at a lower cost. Even in 2018, the majority of title information remains stored at the local levels and is offline (paper).

According to the American Land Title Association, in nearly all real estate transactions there is at least one title defect that must be corrected before transferring the title. Additionally, in 25 percent of transactions, title professionals need to take extraordinary action to fix title defects that could impact the buyer's ownership. Using a blockchain, a digital title could be created and include the property's history, location and title details. This would save money on both the buyer's and seller's end. This also would save banks money and time because they typically duplicate title due diligence efforts in the case of mortgage financing.

Smart Contracts

Smart contracts have been on the minds of computer scientists and cryptographers since Nick Szabo introduced the idea in 1994. With the emergence of blockchain, smart contracts are becoming a reality. A smart contract is essentially a contract that is converted to computer code, stored and supervised onto a blockchain. The idea is to have the terms of a contract coded into the software and then once the terms are met, the contract will execute itself, transferring the assets in the detail to the correct parties.

One possibility in the CRE sector is to have a smart contract implemented in lease agreements. The key terms of the agreement are converted to code and recorded on the blockchain via a smart contract. The smart contract will initiate payment of rent through a bitcoin wallet or bank account at a specified time each month (or however frequent the terms dictate). Meridio, a Brooklyn, New York-based company is taking the idea of real estate on blockchain even further than digitizing records. It wants to allow for online sales of fractional shares of residential or commercial real estate properties. This would open the door to investors of all income ranges, giving them an opportunity to own fractions of property they normally wouldn't be able to purchase outright. It could also save the costs of the traditional route of opening up and crowdfunding limited liability companies. If the property was rented out, a smart contract could be written to distribute income to all owners of the property.

Looking Ahead

According to a 2016 World Economic Survey, respondents believe that at least 10 percent of the global GDP information will be stored on a blockchain in 10 years. Property is one of the largest asset classes in the world at approximately \$190 trillion in residential and commercial real estate. Obviously, much work needs to be done to see the above points become reality. That being said, localities in New York, Illinois and Vermont have begun experimenting with placing titles on a blockchain. If you don't want to be Blockbuster, here are some action items to keep in mind:

- Do your research—blockchain is complex and still in its infancy as a technology
- Educate yourself on the topic and keep track of its application as it is used more frequently
- Identify areas in which the blockchain can solve problems for your real estate business
- Look for opportunities to experiment with blockchain and smart contracts; identify where it can create the most value

Do you have questions about blockchain? Please contact Nick Ward at 440-449-6800 or nward@skodaminotti.com.