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Tokens as instruments for real estate investments?

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Introduction

When discussing tokenisation of real estate, it may be thought that, by the acquisition of tokens, real estate investment is accessible in a simple manner, particularly to investors with little capital.

Financing through the issuance of tokens undoubtedly corresponds to a trend and probably also to a need. In particular, the tokenisation of assets may increase the efficiency of a transaction and reduce its costs. However, with regard to real estate investment, it is important to make some reservations under the current legal framework in Switzerland.

Investment tokens and asset transfer

Investment tokens are, unlike payment tokens, not a means of payment but represent certain assets or parts of certain assets that exist outside of the blockchain. For example, such assets may include receivables, shares and bonds, as well as real properties.

By linking a token to an asset, from an economic perspective, the asset represented by the token is transferred when the token is assigned. From a legal perspective, however, it remains necessary to comply with the applicable rules of civil law in order to transfer the concerned asset.

Under the current law, the transfer of real estate requires a publicly notarised contract, whereby certain electronic public deeds are equivalent to the corresponding physical originals.⁽¹⁾ Neither the simple issuance or transfer of a token nor a smart contract can satisfy the formal requirement of a public notarisation.

In addition, an entry of the new owner in the land registry is required. Under the current law, this cannot validly be replaced by an investment token or by blockchain technology.

Direct and indirect investments

In connection with the tokenisation of real estate, the impression is sometimes conveyed that a broad investor base has the opportunity, with a small contribution, to acquire a share in a property. It is even said that tokenisation allows to invest directly in real estate and that the equity barrier can be bypassed.

This is a tempting prospect, as real estate investments and home ownership in Switzerland are still reserved to a minority, which will probably not change in the foreseeable future.

With a direct real estate investment, the investor is directly involved in handling the property, holds the property in sole ownership or in co-ownership or joint ownership together with other investors, and is registered as the owner in the land registry. In contrast, indirect investors participate in a separate legal entity, such as a company or a fund, that holds legal title in the property.

As mentioned above, investment tokens have limitations when it comes to the transfer of real estate. Moreover, according to the current legal situation, they cannot serve as a direct real estate investment – they do not bestow direct ownership of the underlying real estate, but only rights against the issuer of the token or a certain legal entity, such as a company or a fund. Accordingly, tokens can only represent certain assets, such as rights to a property. The value that the participants of the blockchain assign to a token, however high it may be, is not relevant to the legal position of the token holder.

The difference between direct and indirect investments is not only relevant from a legal point of view, but also from a practical perspective and for the purposes of risk calculation. For example, the direct owners must take care of the maintenance, management and leasing of the property, and they may bear a certain cluster risk. The transaction costs in connection with direct investments are usually rather high. Also, the direct owner is not exposed to any risks or possible legacy issues in connection with an intermediary company or a fund. In contrast, the indirect owner may be exposed to such risks. In the event of poor performance of the company or fund, the indirect owner cannot directly access the value of the real property – they can, however, diversify the property-related risks and also enjoy the benefit of lower entry hurdles and transaction costs.

Depending on the individual case, either direct or indirect investments may be more suitable. However, any investor should be aware of the differences and particulars relating to the two forms of investment, and, when holding a token, they cannot expect to hold a legal title in a property.

Non-Swiss token holders

Although tokens cannot enable direct real estate investments under current legislation, special questions may arise in the case of foreign owners of tokens.

The Federal Law on the Acquisition of Real Estate by Persons Abroad restricts the acquisition of certain real estate by foreigners, in particular capital investments in residential real estate.⁽²⁾ In this regard, the transfer of real property in the land registry is not the only

transaction that is subject to the legal restrictions. According to the principle of economic consideration, the relevant rules apply to any legal transaction that gives a person abroad the actual power of disposition over a property.

For persons abroad within the meaning of the Act, the acquisition of a token may be subject to legal restrictions, in particular, if it achieves the following:

- the participation in a company without legal personality whose actual purpose is the acquisition of real property;
- the acquisition of ownership or usufruct of:
 - a share in a real estate fund whose shares are not regularly traded on the market, or similar assets;
 - a share in a real estate SICAV (an investment company with variable capital) whose shares are not regularly traded on the market, or similar assets; and
 - a share in a legal entity whose actual purpose is the acquisition of real property, provided that the shares in this legal entity are not listed on a stock exchange in Switzerland;
- the creation or the exercise of a right of purchase, pre-emption or repurchase of real property or of a share within the meaning of the points above; and
- the acquisition of other rights that give the acquirer a position similar to that of the owner of a real property.

Comment

For direct real estate investments and corresponding trading via tokens and blockchain, not only the legal but also the technical prerequisites are lacking today.

From a legal point of view, comprehensive legal adjustments would be necessary, especially in contract law and with regard to the formal requirements of contracts, as well as with regard to public notarisations and the land registry.

A first step in the direction of more digitisation is the planned enactment of a Federal Act on the Creation of Electronic Public Deeds and Electronic Notarisations and, in connection with this, certain amendments to the Land Register Ordinance.⁽³⁾ The legislative process is still underway and the final version of the Act does not yet exist, but it is expected that it will take the step towards complete electronic notarisation. Current law does not provide for electronic originals of public deeds. This will also be introduced through the expansion of electronic public notarisation.

Blockchain solutions, however, are not yet envisaged. Therefore, there is still a long way to go before direct real estate investments and corresponding trading via tokens and blockchain can take place.

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Endnotes

(1) Ordinance on the Creation of Electronic Public Documents and Electronic Notarisations, SR 211.435.1.

(2) Federal Act on the Acquisition of Real Property by Persons Abroad, SR 211.412.41.

(3) The status of the projected bill is available [here](#).