Metaverse real estate: Legal considerations in Canada

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Virtual parcels of land are being sold in the metaverse for astonishing amounts of money. In 2021, the largest metaverse platform transacted C$450 million in virtual land, with the biggest transaction closing in excess of C$5.5 million.[1] This article provides insight on metaverse real estate and the key legal considerations in Canada.

Transactional backbone of the metaverse:

As explained in our previous article on Key legal issues in the metaverse, the metaverse generally refers to a highly immersive and interconnected virtual world spanning multiple and potentially competing virtual platforms. The metaverse also uses a collection of technologies such as virtual reality technology, augmented reality technology, non-fungible tokens (NFTs) and digital commerce, working together to make user experience more streamlined and immersive. As the sector grows, investment increases as businesses try to stake a claim in emerging worlds. In 2021, private equity funding and venture capital reached $13 billion in investment in the metaverse.

Most metaverse platforms are public and built on a blockchain, to help enable the ownership and transaction of digital assets, such as NFTs. Many metaverse platforms integrate digital scarcity, which support the concept that “real” estate in the metaverse can be a lucrative investment. Virtual plots of land can be utilized in whatever manner the owner desires (within the terms of use or governance protocol of the platform), such as building a storefront, renting out the plot or developing a unique digital experience. The location of the virtual plot can impact the cost, which is also influenced by virtual landowners with adjacent properties. This was evident in the purchase of a virtual plot next to the “Snoopverse” which sold for U$450,000.[2]

Real estate transactions in the metaverse:

A metaverse platform can share many characteristics with the real world, such as physical constraints like gravity, scarcity of land and scarcity of assets.[3] On average, between November 2021 and January 2022 there were roughly 8000 land transactions per month in a particular metaverse platform, with the average transaction amounting to

C$16,500, and the highest transaction for a single virtual land plot closing at C$253,000.[4]

Interest and investment in virtual land has been on the rise as the metaverse continues to mature, not only from individual purchasers, but also large institutions. However, much like buying anything in the real world, there are risks that investors and businesses must consider:

Virtual land or a security?

Metaverse platforms are still in the early stages and are likely to experience issues as they mature. At the same time, regulatory bodies will react to the challenges arising from e-commerce within the metaverse. For example, the exchange and sale of NFTs including digital plots of “land” on a metaverse platform could be considered a real-world trade in securities if the underlying NFT is considered a security rather than a good. Consequently, core e-commerce business practices and steps taken relating to virtual real estate transactions in the metaverse may change if these transactions require a prospectus or a prospectus exemption.

There are unique challenges that virtual real estate transactions need to grapple with. For example, in the real world, purchasers of land do not have to worry about a developer suddenly creating more plots out of thin air because creating more land is not as simple as changing a line of code in a computer program. However, the risk of instantly creating more land is very real when it comes to virtual land. In some instances metaverse platforms can issue more “virtual" plots of land after many investors have already purchased virtual land. The issuance of additional “limited” NFT based virtual land plots would likely devalue already existing plots of virtual land, which were purchased with the expectation of a truly finite virtual land environment. These types of issues may attract additional regulatory oversight.

Real-world protections, virtual risks

Similarly, metaverse platforms lack the robust protections afforded by property laws in the real world. Physical real property is regulated by legislation and deeply rooted jurisprudence, these laws are enforced by government agencies with strong regulatory powers. Ownership is proven by a land registry, and those who own real-world real property have a bundle of well-defined rights to that property. For example, real property can not simply be taken away by a third party claimant, and even governments must go through an expropriation process that is subject to rules and limitations if they wish to expropriate. Likewise, land use and land regulation is tightly controlled by municipal and local authorities who must adhere to strict rules, with an eye to the overall needs of the broader community that the real property is located in.

Rules surrounding metaverse real estate are largely determined by the platforms themselves. Until governments and courts choose to regulate metaverse platforms more directly, those platforms can make whatever changes to virtual real estate that their terms of use allow. Further, it is an open question as to how metaverse platforms will determine the community interest or the best use of land, given the lack of historical case law, regulation or public accountability. Anyone investing in virtual real estate

should carefully analyze the terms in place in on each platform, and consider whether their ownership rights are adequately protected.

Compounding risks – mortgages in the metaverse:

The costs of virtual land in the metaverse are rising to and in some cases exceeding real property prices. With the rise in value, new financial products have quickly been created to meet demand for credit to purchase virtual land. Specifically, mortgage products are now available to assist in the purchase of virtual land in the metaverse. However, as with any financial product, there are associated risks which are compounded by the fact that regulations are not in place to protect consumers who wish to use such products. Individuals or businesses that decide to take on a "mortgage" to enter the virtual real estate market must be cognizant of the fact these types of mortgages are more properly characterized as a collateralized loan akin to trading securities on margin.

Virtual land mortgages are not only subject to the volatile nature of NFT-based assets, but also risk devaluation through dilution via the creation of new virtual land. Either of these circumstances, or even a combination of the two, can result in the value of the virtual land falling below the value of the mortgage, which is likely an event of default, even if payments are being made regularly.

An additional concern stems from mortgages executed under predatory lending practices. Affected businesses or individuals may have limited legal recourse given the unregulated nature of e-commerce in metaverse. As such, it is important to carefully evaluate how the regulatory landscape might adjust over time to address various domestic and international concerns relating to e-commerce and the transacting of virtual land in the metaverse.

Conclusion

It is clear that the metaverse is a highly volatile and speculative environment, which requires careful consideration before deciding to carry on business within it. Acquiring property and building a brand around virtual real estate will generate traditional as well as novel legal issues that require expert advice to navigate successfully. Businesses should seek to develop a fluid business plan and understand the legal risks before expanding into the metaverse, regardless of whether ownership of virtual real estate is part of that plan.

For more information on the Canadian commercial real estate legal considerations in the metaverse, please reach out to any of the key contacts listed below.

[1] Centre for Finance, Technology and Entrepreneurship, "Real Estate in the Metaverse" (2022) at 6, online (pdf): *Centre for Finance, Technology and Entrepreneurship*.

[2] *Ibid at 19*.

[3] *Centre for Finance, Technology and Entrepreneurship*, *Supra* note 1 at 6.

[4] *Ibid*.

By

Marin Leci, Julie Bogle

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BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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