

# Housing derivatives market draws pro investment crowd

## Broker addresses questions about futures trading in real estate

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By [Stephen Bedikian](#)



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*Since May 2006, the Chicago Mercantile Exchange has offered futures contracts and options based on the S&P/Case-Shiller U.S. National Home Price Index. Futures and options currently are traded on indices for a composite index, and the 10 markets included in that composite are: Boston, Chicago, Denver, Las Vegas, Los Angeles, Miami, New York, San Diego, San Francisco and Washington, D.C.*

*The following is an interview with Fritz Siebel, director of property derivatives at Tradition Financial Services. TFS is an executing broker of CME housing futures and OTC housing swaps and options for longer trade durations.*

**Q: How accurate have these markets been in predicting future housing-price levels over the last year? Do they tend to be overly pessimistic or optimistic?**

A: The futures contracts have an overall good predictive quality to them. While the futures contracts called the housing market lower since last summer, the L.A. and Miami one-year futures overshot the actual lower index results.

**Q: How quickly is the market growing for property derivatives in the United States? Do you look at contract volume, open interest or other metrics?**

A: Last year, the housing derivatives markets had a strong growth experience. CME housing futures and options volume grew steadily month-on-month. This year, we have seen a slight decline in housing futures volume, an increase in housing options volume and the first OTC housing forwards trades. The OTC trades were for four- and five-year durations. This year, we will see multiyear extensions to the housing futures markets and more OTC housing transactions.

**Q: Who are the primary market participants for property derivatives in the United States? Are they real estate developers, brokers or investors?**

A: Right now, the housing derivatives market is a mix of professional investors, asset managers and investment banks. From time to time housing developers trade a derivatives structure for hedging purposes. There are also an increasing number of mortgage lending institutions making their first trades. For commercial real estate derivatives, we are seeing trading interests from banks, direct property owners and investors, hedge funds, pension funds and insurance companies.

**Q: Should real estate brokerage companies look at this market as a way to hedge future commission revenues against housing-price declines? Southwest Airlines hedges itself against fuel-price increases to protect its future profitability. Would that be a good analogy for brokers, albeit on a smaller scale?**

A: Real estate brokerage companies should certainly know everything about these markets. The larger brokers have daily/weekly housing market intelligence that can be mined for speculative or defensive purposes in the housing derivatives markets.

**Q: Should homeowners consider using housing-price futures and options to protect themselves against price declines? Do you expect new financial products to be developed for less sophisticated investors?**

A: The housing derivatives markets are intended for professional investors only. These are sophisticated products -- trading of all such futures, securities, options and other derivative instruments entails significant risks, which can result in substantial financial loss. Such risks should be fully understood prior to trading. We do expect off-the-shelf homeowner products like home-value insurance policies, equity-participation mortgages and first-house savings accounts to meet

homeowner needs.

**Q: Have commercial property derivatives markets evolved more rapidly than residential property derivatives markets?**

A: In a sense, yes. In 2004, European commercial real estate derivatives trading started. This year it is forecast that cumulative notional value since 2004 is expected to be over GBP 15 billion [British Pounds Sterling] by 2007 year-end. This year, the U.S. commercial real estate market started in earnest and will probably exceed the U.S. housing derivatives market by year-end. We attribute this rapid growth to the spillover from the European experience.

**Q: How does the U.S. property derivatives market compare to the U.K. and other European markets? Are they more or less developed? Do they offer any guide for U.S. market development?**

A: The U.S. housing derivatives market will become a profound market. With our uniform indexation and a \$22 trillion asset base, the growth will be steady and consistent. On the commercial real estate derivatives side, since the whole country is available for trading at once, there is much discovery underway in how the market moves from national index trading to more granular regional and MSA trading. The main guide that the U.S. receives from European is that there is great demand for these products. We are seeing investors from Latin America, Europe and Asia looking for U.S. housing and real estate "beta" through the derivatives markets.

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