

Real Estate Derivatives

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PRRES UTS Sydney 20 January 2009

On the pulse of
the property world



Why the initial difficulties in the UK? ... the problems

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- A lack of knowledge
 - Real Estate people about derivatives
 - Derivative people about Real Estate
- Index availability
- Timing of past pushes and strong one-way capital flows
- The Life Fund ‘Catch 22’
 - “The market is illiquid so life funds can’t invest in derivatives... and ... because life funds can’t invest in derivatives, the market is illiquid”*
- Lack of clarity over tax treatment
 - Which regime, capital or income?
- A mismatch of knowledge and utility?
 - ‘all property’ contracts for multi-asset decisions
 - The link made through property fund managers
- Mandates

The advantages of going 'synthetic'?

...for UK property investors

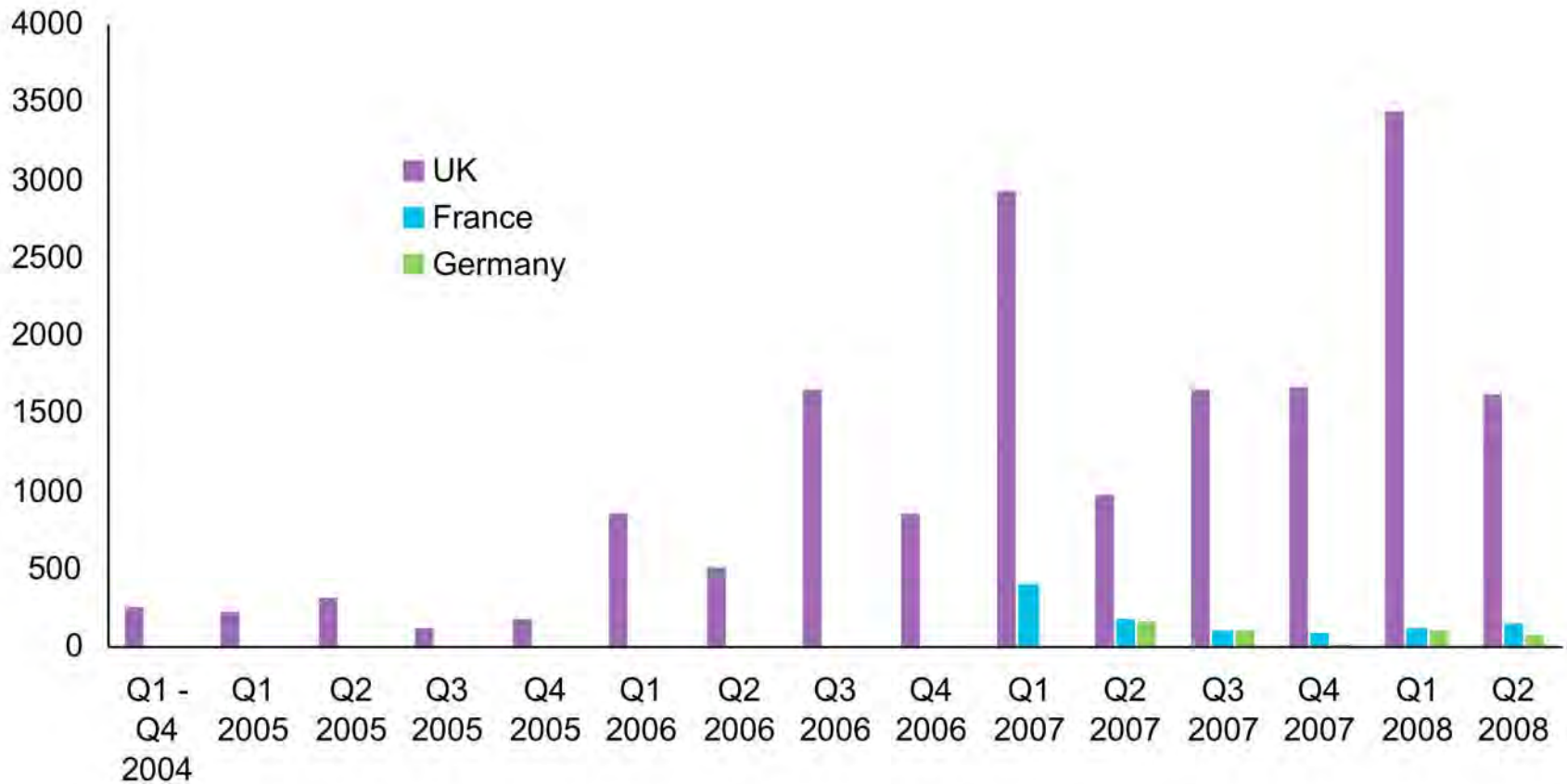
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- Speed
 - Hours versus months
- Reduced cost
 - 1% versus 10%
- 'Accuracy'
 - Target allocation levels
- Flexibility
 - Moving in and out of real estate, sectors and segments
- Lack of hassle
 - Less people involved in the chain

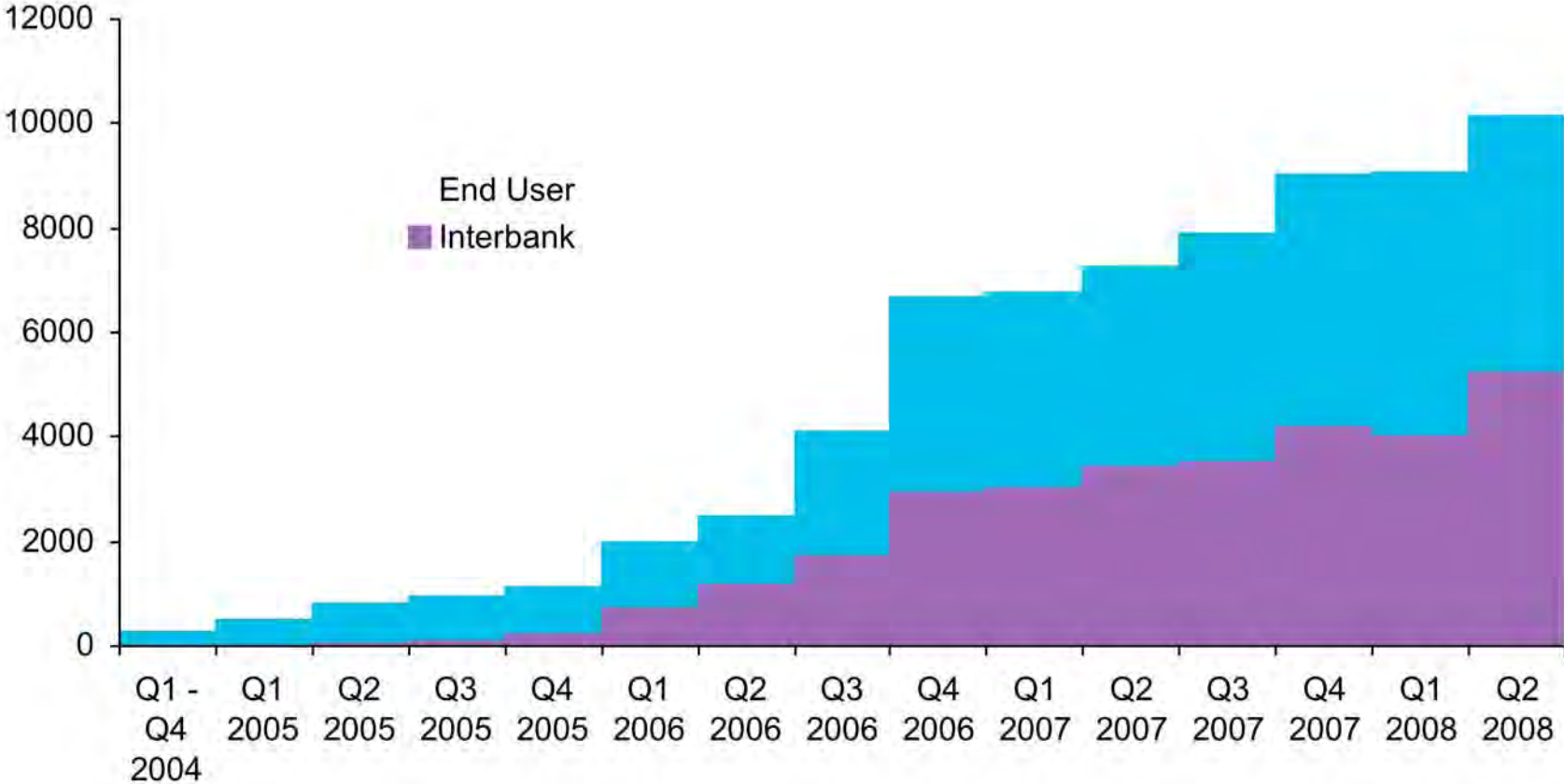
Notional Traded £m

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UK Interbank vs End User Outstanding Notional £m

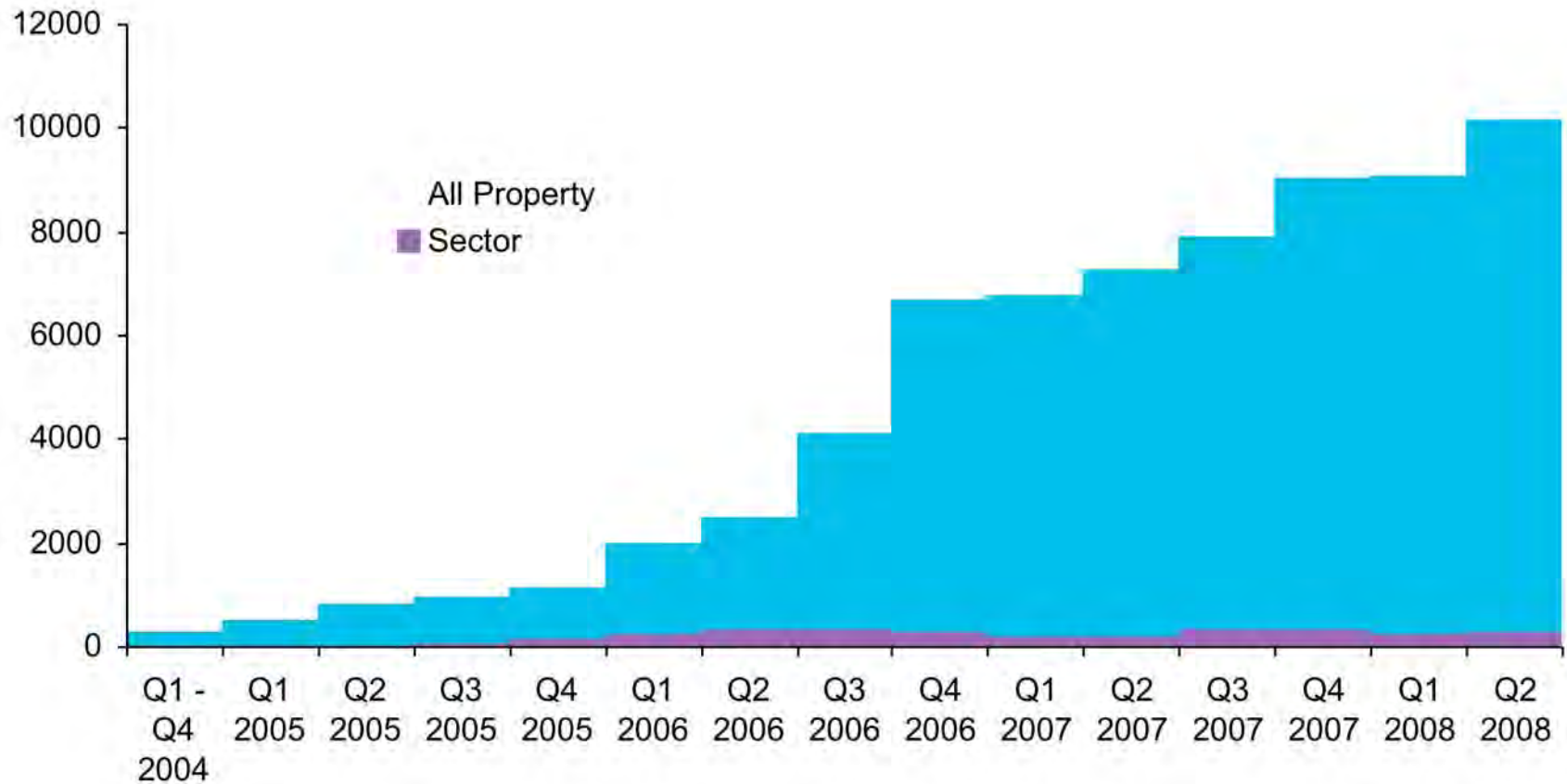
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UK Sector vs All Property

Outstanding Notional £m

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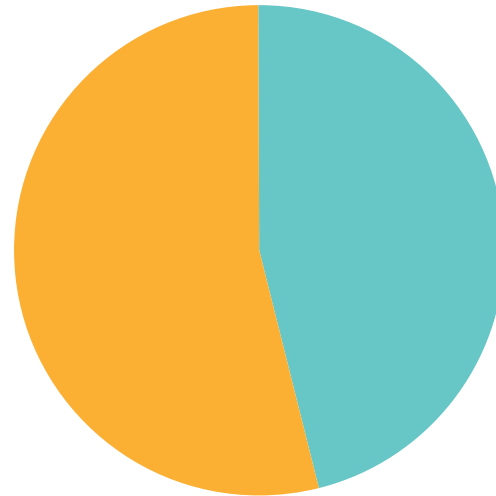


Survey respondents

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£ 31.4 bn
Managers
(54%)



£26.7 bn
Owners
(46%)

- Sent to 100 IPD contributors
- Replies representing £58 bn of capital
- 48% of the IPD UK Universe

Readiness Survey – Main Points

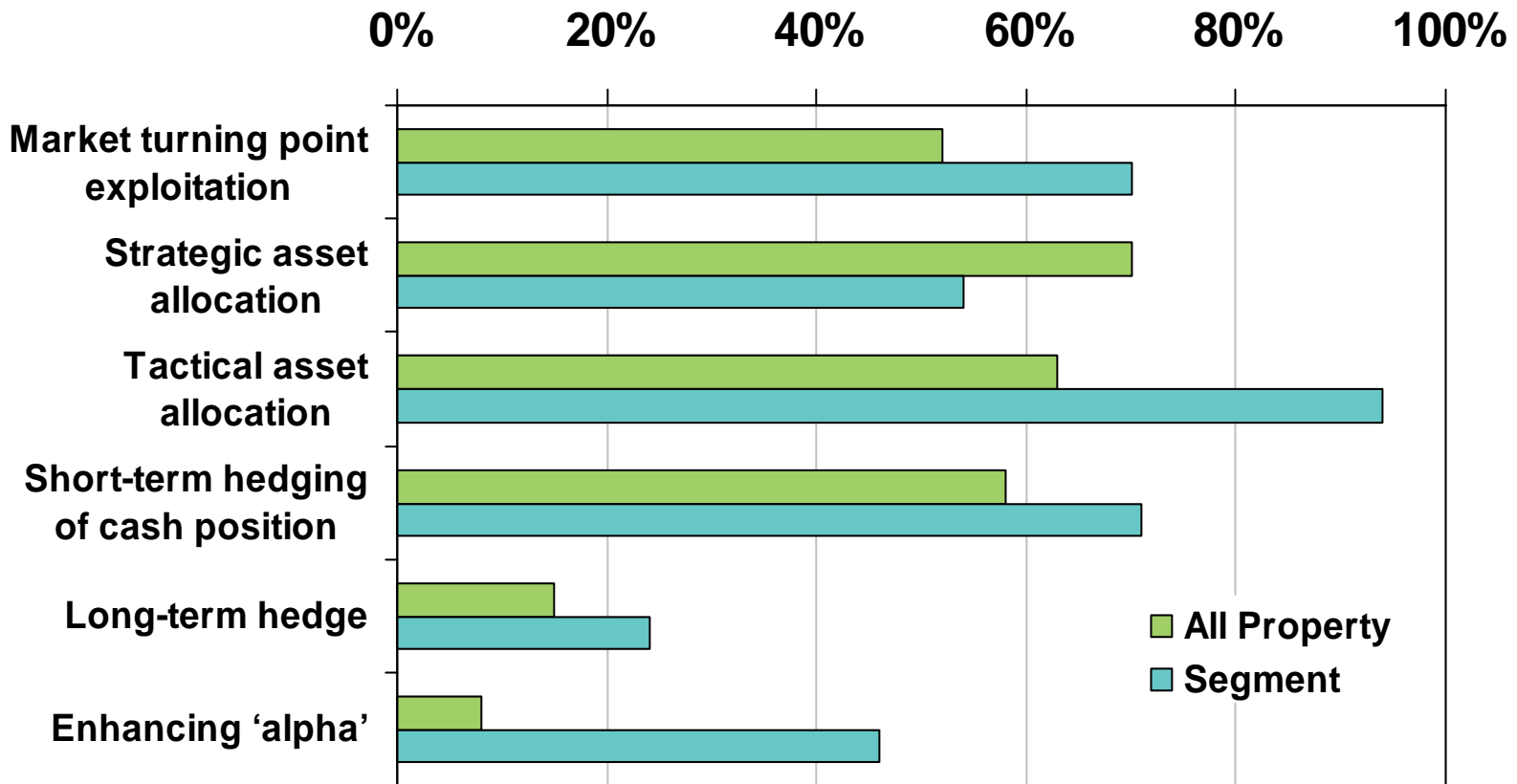
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- Investors feel they know about derivatives and are highly supportive of the market
- Keen to go beyond 'all property' contracts
- 3 out of 4 have a mandate to trade and the vast majority of the rest are willing to recommend their use
- Main concern – liquidity

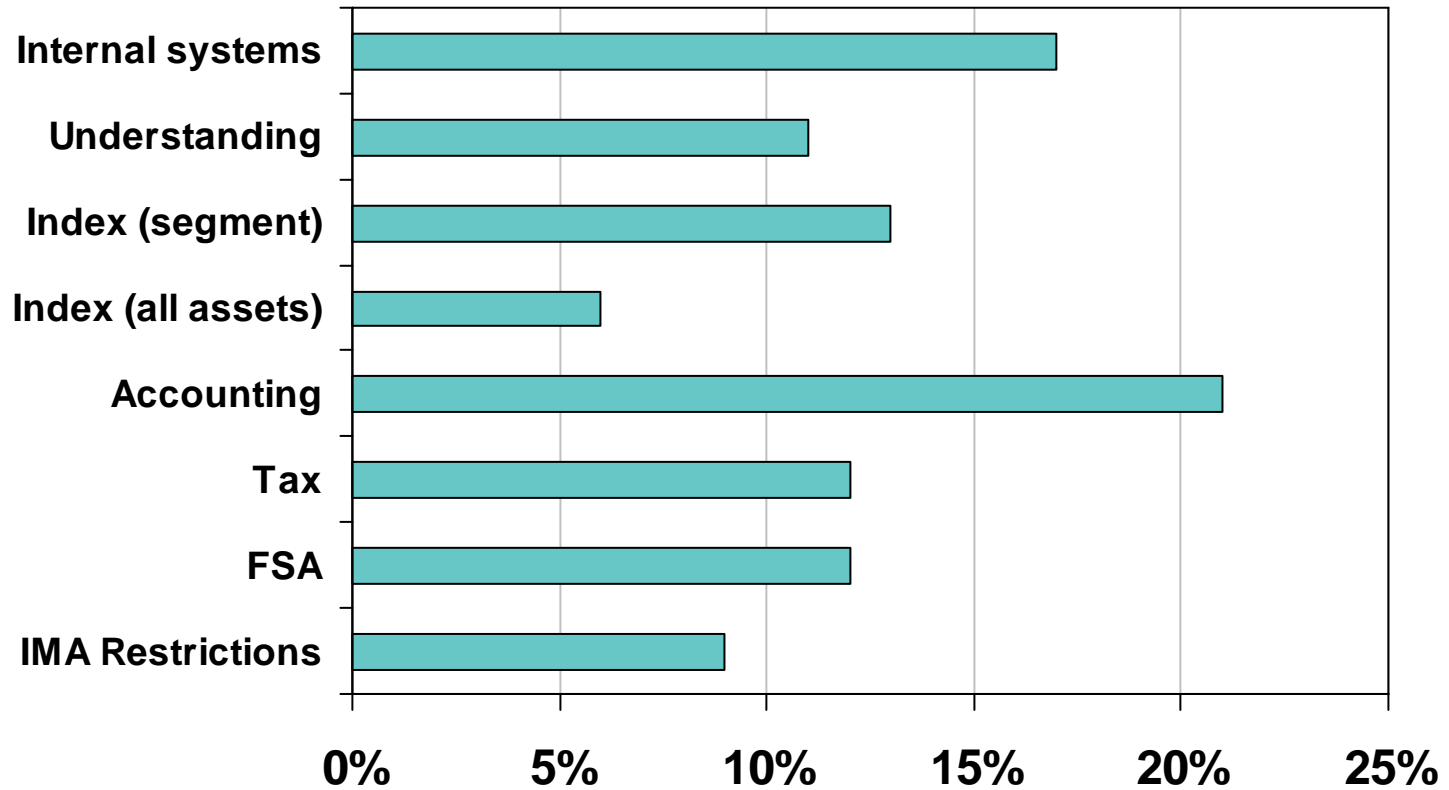
Main Uses of Property Derivatives

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Remaining Barriers to using derivatives

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The Australian Experience

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2006 Exuberance

2007 Practicalities

2008 Ready, Get Set,

CRASH

2009 ?

The Australian Experience

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Other Observations

“Catch 22”

Tertiary Education

Trust Confidence



A question for discussion

In the current Economic Climate does anyone think that there is a role for Property Derivatives this year in their portfolio or investment strategies?

Futures Curves.

Exploiting inadequate knowledge

Thank you for your time

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Example of recent CD deal

... Prudential & British Land

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Buyer	Agent	Seller
The British Land Company plc £20m	<p data-bbox="706 451 1087 482"><i>Pay IPD All Property Index</i></p> <p data-bbox="734 582 1024 672">Euro Hypo & Deutsche Bank</p> <p data-bbox="630 768 1163 799"><i>Pay Interest Rate (LIBOR + Premium)</i></p>	Prudential Prop. Investment Managers £20m

- Maturity of 3 years with annual settlement
- The agent charges a small fee on the notional value of the contract

The UK experience

... A potted history

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- Early 1980s – era of PINCs, SPOTs & SAPCOs
- Since the 1990s – four attempts to establish an index based derivatives market based on IPD indices
 - London FOX 1991 x
 - Property Index Forwards (PIFs) 1994 +
 - Real Estate Index Markets (REIMs) 1998 +
 - Property Index Certificates (PICs) 1999 +
- Other attempts
 - Abbey National plc residential derivative based on Halifax residential price index