Long-duration housing-price derivatives debut

Housing futures contracts to extend out five years

Monday, August 13, 2007

By Stephen Bedikian

Stephen Bedikian

The Chicago Mercantile Exchange last week announced that housing futures and options contracts based on the S&P/Case-Shiller U.S. National Home Price and Composite Indices would be extended out to five years. Trading of these contracts is scheduled to begin on Sept. 17.

Contract months extending out 18 months will be listed on a quarterly cycle of February, May, August and November. Contracts listed 19 to 36 months out will be available on a biannual schedule of May and November contracts. An annual November listing schedule will apply to contracts listed 37 to 60 months out into the future.

The CME began listing housing futures and options in May 2006. The 10 cities include Boston, Chicago, Denver, Las Vegas, Los Angeles, Miami, New York City, San Diego, San Francisco and Washington, D.C., in addition to the composite index containing all 10 cities.

These short-duration contracts have been very thinly traded compared to mature markets like commodities and foreign exchange. The slow growth has been due to the fact that residential real estate is often a long-term investment. Property developers, builders and other investors need tools that allow them to hedge risk over multiyear periods. The contracts initially listed in May 2006 only had durations of up to 12 months.

Fritz Seibel, director of property derivatives at Tradition Financial Services, "expects the U.S. housing futures market to trade in a two- to three-year forward 'sweet spot' that reflects the natural timetable of housing. This sweet spot allows for a change in the equilibrium of the housing market (changes in housing inventory, starts, permits, sales, demographics, credit, etc.) to manifest itself in housing pricing. It is as if the spot market for housing is some two years in the future at any given time. These future prices will be discovered through trading."

For real estate pessimists who want to speculate on an extended downturn in the market, these contracts provide a vehicle as well. Residential real estate markets, unlike stock markets, are often characterized as "sticky downwards." If homeowners don't get offers they like, many choose to simply take their home off the market until demand firms up and prices rise.

As a result, real estate slumps can last for extended periods of time. For example, the last major downturn in the Los Angeles market lasted nearly six years, beginning in June 1990 and continuing until March 1996. During that period the market declined just over 27 percent.

Stephen Bedikian is a partner at Real IQ Consulting (www.realiq.com), which provides real estate strategy consulting and lead analytics services. He can be reached by phone at: 310.871.3737 or by e-mail: sbedikian@realiq.com.

***

What's your opinion? Send your Letter to the Editor to opinion@inman.com.

Copyright 2007 Inman News