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On 1st July 2010 Peter Sceats & Associates took over the consultancy aspects of Tradition Property.

It is Peter's view the property derivative market has huge potential which is why Peter Sceats & Associates is now independently active in the market as a consultant or contractor on matters such as:

360 degree PD setup service
Modelling & Quantitative Analysis
Education & Training in PD
Outsourced Middle & Back Office
Front Office Advisory
PD Product Design & Marketing
Residential Forward Values and Derivatives
General Consulting on PD

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- **Changes Advent Commercial Property Derivatives**

Two key legislative changes in 2003 have cleared the way for a commercial property derivatives market in the UK. To summarise, companies can include property derivatives in their solvency calculations and capital losses can be offset against tax. Thus a key obstacle to development of the PD market was removed

- In Q4-04 Deutsche Bank and Eurohypo arranged the first/landmark commercial property swaps deal

- Around this time Abbey (now Santander) pioneered residential property derivatives

- 1990's First property derivatives trade but the "futures" form of derivative is not the right choice. Abbey trades first Halifax deals as a test
- 2004 Modern phase begins, landmark UK resi and UK commercial property derivative trades
- 2006 First UK commercial property sector trades and first US resi
- 2007 First French, German, Australian, Japanese, Swiss and Italian trades. First US commercial trades
- 2008 First Canadian and Spanish trades

- **Derivative** : in this case simply a term meaning a trade "other than" and/or "deriving from" a regular physical buy/sell
- **4 Basic Types** :
    - modern priced options
    - swaps
    - forward physicals
    - futures (regulated) or website market (non-reg)

- **Swap** : financially settled transaction pricing against an agreed index.
- **Futures** : Usually physical forwards traded on a centralised exchange operating under the scrutiny of a government agency acting as regulator
- **Option** : the right, but not the obligation to buy (or sell) a commodity at a pre-agreed price and time (note: describes a 'long' option)
- **Forward** : physically delivered 'lots' traded for future dates

So What is an HPI Swap?

An HPI Swap is an exchange of a fixed rate and floating rate.

The fixed is the price you traded at, the floating is the chosen Halifax House Price Index HPI.

Basically the movement in the HPI after you traded determines whether you made or lost money

A PD is “on-paper” agreement between two companies where the parties agree to compensate one another subject to the price movement of a chosen market index.

A swap agreement needs:

A buyer	
A seller	
An index	Halifax HPI (NSA)
An agreed exposure	£25 Mio
A duration/tenure	Cal-11 (the calendar year of 2011)
Settlement dates	Annually
A legal framework	ISDA

And suitable credit and counterparty approval.

Hedging Basics

- The derivative market is something that can protect property investment
- The derivative market can increase property market participant's trading alternatives
- The derivative market is another tool for the trading toolbox
- It has potential as an escape route when a "physical" trade goes wrong
- The derivative market itself is not likely to destroy value for end-users if it is used sensibly and strictly as a hedge
- The derivative market itself won't lose money for end-users, but a set of poor trading decisions deployed on it, might
- It is possible to 'design-in' profitability in the set-up that prepares a company for trading in the derivative market

- Hedging – swings… roundabouts...
- **What you lose on the physical, you gain on the derivative.**
- If the “Alpha PropCo” invested in a London property portfolio during 2010 and average prices fell by 4%, that’s reduced income…
- **If “Beta PropCo” invested in a London a London property portfolio during 2010 but also sold a property derivative that generated income if returns fell – that would be good. Wouldn’t it?**
- The money made on the property derivative goes to compensate for the reduced income on the property portfolio

- AlphaPropCo owns a property portfolio. This means they are "long" property
- To dampen (or eliminate) the effect of falling property returns they could sell a property derivative.
- A "short" (having sold) PD increases in value in a falling market
- The profit made from the PD goes to subsidise the effect of falling property returns
- This is hedging

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A non-hedged portfolio looks like this…

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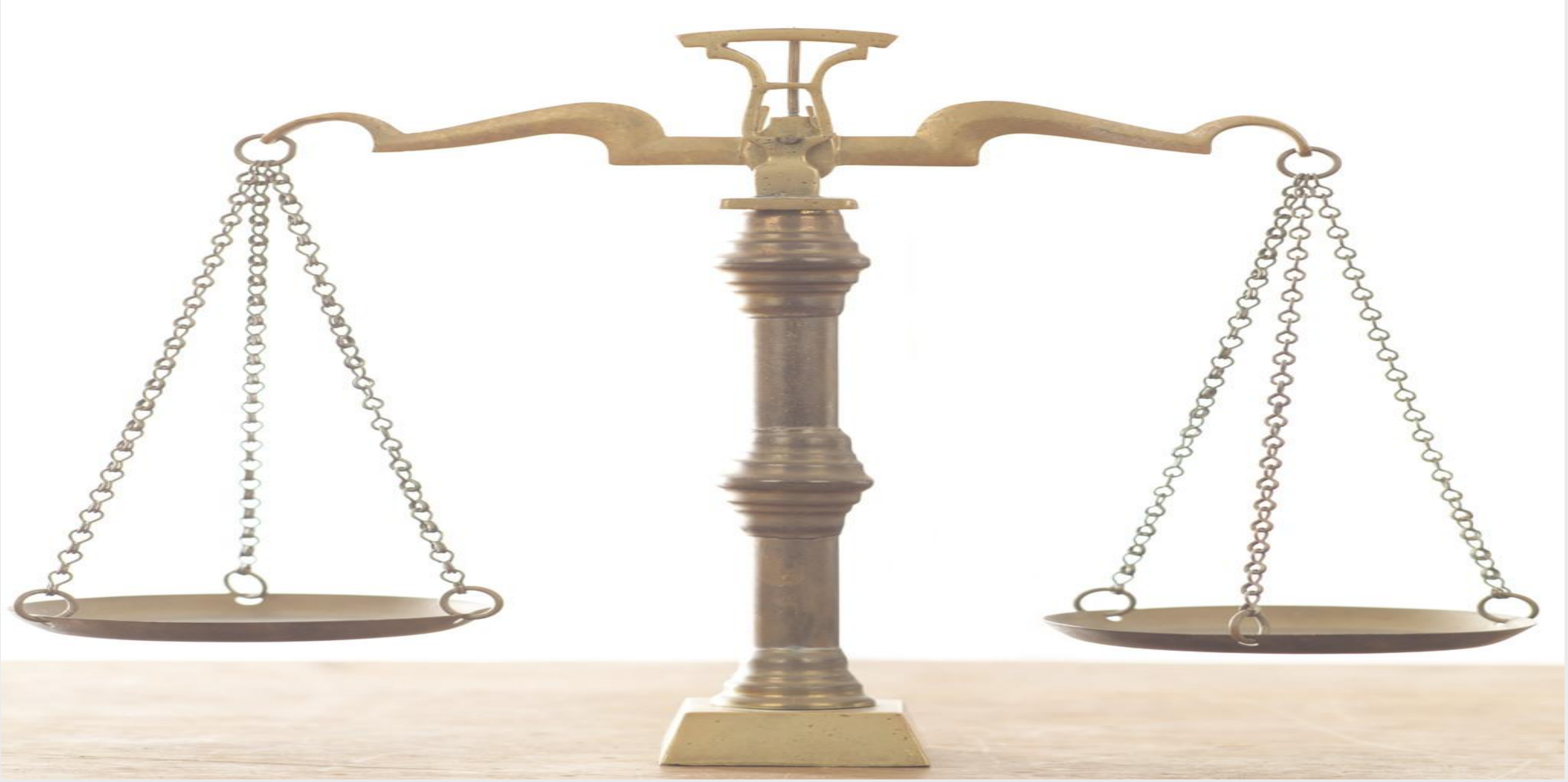

A hedged portfolio looks like this…

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Speculation

BetaTradeCo know very little about owning and operating property but are great at math and used to trading equities, interest rates and inflation.

BetaTradeCo think residential property has bottomed out and prices will rise.

BetaTradeCo buys a 5 year £25mio HPI swap at 88.50 (so 11.50 below the current value).

BetaTradeCo are now long “virtual houses” and if they are right about the direction of UK residential property prices will make money in a rising market.

Remember virtual houses are sometimes cheaper to buy or build than real ones and easier to sell...

How Propcos use PD

Investment

Propcos buy PD when they want exposure to the market but can't find or don't want the physical real estate

Hedging

Going short swaps to generate income in a down market is the classic asset hedge

Gearing Tool

Selling swaps to lighten physical exposure to facilitate more access to debt

Peter Sceats & Associates: Forecasting the UK House Price

Year	PD Market Forecast	% Terms	Cash Terms
2010	94.50	-5.50	£154,639
2011	87.50	-12.50	£143,184
2012	88.50	-11.50	£144,821
2013	92.50	-7.50	£151,366
2014	95.50	-4.50	£156,275
2015	99.50	-0.50	£162,821
2016	105.00	5.00	£171,821
2017	108.00	8.00	£176,730
2018	111.00	11.00	£181,639
2019	114.00	14.00	£186,548
2020	132.00	32.00	£216,003
2021	155.00	55.00	£253,640

£163,639 Halifax HPI (NSA)

Raw PD market data kindly supplied by Tullet Prebon

Since 2005 around 500 people from 180 different companies acquired a foundation in property derivative markets from Workshop: PROPERTY DERIVATIVE. From July 1st 2010 it became a product of Peter Sceats & Associates. It is now delivered privately in the boardrooms of clients.

Workshop: PROPERTY DERIVATIVE

the education product helping define the global property derivative markets

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