property

Businesses with property assets can now manage their exposure to property through the use of property swaps without the considerable expense of actually buying and selling property.

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Property Derivative Specialist

The property derivative market is a relatively new market in an asset class which, historically, hasn't had a developed derivatives market. Given the significance of property as a 'real asset' it is of great interest to most companies that it is now possible to increase and decrease exposure to property without the expense of buying and selling their property assets.

In this case we look at a property development company with commercial property assets in South East England and a life assurance company with a UK property portfolio. The life assurance company, which is overweight in cash due to a lack of attractive properties, does not wish to see a drag on its asset management performance as a result of being under-invested in commercial property. It needs a solution to its asset allocation problem. The Property developer wants to maintain his long term exposure to UK commercial property but has a view that a slowdown in the retail sector might hit total returns on retail property and offices in the next 2 to 3 years.

Both parties can enter a 3 year total return property swap on the UK IPD* All Property Index. The insurance company pays a series of regular LIBOR based cash payments, plus a spread, to the property developer in return for the total performance of the Property Index. The property developer does the opposite with the effect of paying away the return on the property index for 3 years in return for receiving cash payments based on LIBOR, whilst continuing to own real property assets.

* Investment Property Databank

% Total Return (to June 2006) on IPD* Irish Property Index	Annualised Over		
	3 yrs	5 yrs	10 yrs
Retail	24.0	19.4	21.8
Office	14.2	8.7	19.4
Industrial	11.4	8.4	16.5
All property	17.2	12.0	19.9