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Coronavirus boosts relevance of sleepy home price futures; Las Vegas most vulnerable

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S&P/Case-Shiller Home Price Indices futures have been a lonely corner of activity for the CME Group over the past decade, perhaps as home values have been reliable gainers amid falling unemployment, growth in the number of households, and a dearth of available homes. Now, the abrupt shift in the US economic outlook might draw attention to the derivatives, according to one market maker.

John Dolan, a former CIO of Hyperion Brookfield Asset Management who has long advocated the futures contracts developed at the peak of the last real estate boom in 2006, is seeing a new opportunity to drum-up interest in them as the coronavirus (COVID-19) pandemic threatens to push the economy into recession and upend the benign housing environment.

Logic has turned Dolan's attention to a contract tied to home prices in Las Vegas, whose metropolitan statistical area is highly dependent on the hospitality and food service industries that are suffering badly as consumers avoid public spaces. Home prices were also on the minds of at least two SFVegas 2020 conference-goers who — huddled outside an ARIA Resort & Casino meeting room as financial markets were tanking on 24 February — bandied about futures as a way to protect their portfolios from a turn in real estate.

Indeed, "we've done a pivot," Dolan said.

"The tradeoff between the benefits of lower interest rates versus the loss of wealth from the stock market selloff and raised volatility will likely impact various cities in different ways," Dolan said. "Nowhere would I expect that uncertainty to be more pronounced than in Las Vegas."

Las Vegas home prices have been steady gainers since the trough in 2012, according to S&P/Case-Shiller Home Price Indices. The city's index value in November and December topped 195, the highest since December 2007 and within striking distance of the pre-financial crisis peak of 234.78 in August 2006.

So far there hasn’t been an increase in activity for the Las Vegas home price futures contract but fears over the carnage in what was a hot real estate market could change that, Dolan said. Just 38 futures contracts traded during February, though that brought the rolling 12-month tally of trades to 197 — the highest in five years, his data show.

In contemplating home prices, one should consider what has happened with the shares of the companies that dominate Las Vegas, Dolan said. Las Vegas Sands shares are down 46% since 21 February, while the stock of MGM Resorts International has lost nearly 80% of its value over the same period.

Fitch Ratings also raised a red flag on home prices this week.

In a report on Wednesday, Fitch analysts Jian Mao and Suzanne Mistretta noted that a further spread of coronavirus will slow home buying activity and possibly lead to a drop in home prices. Making matters worse, the analysts wrote, is that national home prices are 1.5% overvalued on a population-weighted average basis with about 18% of MSAs more than 10% overvalued. Las Vegas tops the pack with home prices 20%–24% overvalued, they wrote.

February 2021 S&P/Case-Shiller contract prices are consistent with a selloff in home prices for 2020, Dolan wrote in a blog post this week. Las Vegas’ contract anticipates a home price drop of 5.4% over the year, the most of any city linked to a contract, Dolan’s data show.

Dolan and an investor said GSE credit risk-transfer debt, the de facto replacement of the pre-crisis non-agency RMBS market until recently, may also see increased scrutiny because some bondholders have such little credit protection. As could be seen in the aftermath of Hurricane Harvey in 2017, it doesn’t take large CRT exposures to decimated areas to boost anticipated losses to lower mezzanine and subordinate CRT.

Fannie Mae’s CAS CRT issued in the past two years have relatively low exposures to Las Vegas, according to Recursion’s data platform. For example, Las Vegas MSA loans represent 1.1%, 1.4% and 1.2% of the reference pools for **CAS 2018-C03**, **CAS 2018-C04** and **CAS 2018-C05**, respectively, the data show.

In 2017, investors sold subordinate CRT linked to reference pools with just 1%–3% exposure to areas belted by the hurricane, as reported.

by Al Yoon

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