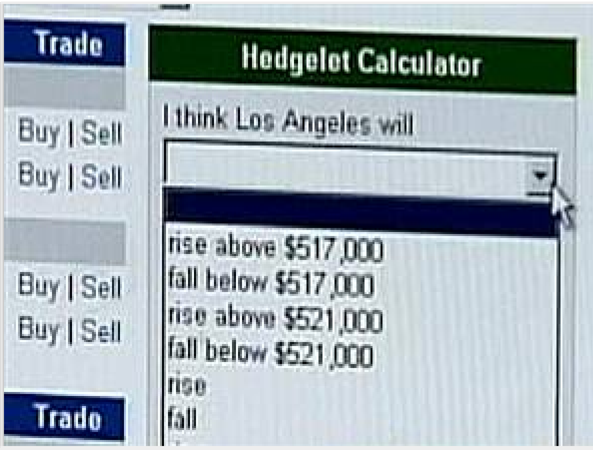
Hedging against a housing bubble

New market lets investors offset drop in home prices



A sure bet on real estate?
May 26: CNBC's Jane Wells reports on a futures market that lets investors hedge against a sharp drop in home prices.

CNBC

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Everyone wants to be in the housing market these days, but it's crazier than any market going. People are constantly talking about it, and with home prices marching seemingly ever higher, investors are finding ever more creative ways to play the market.

Just how creative? Starting today, a futures market called HedgeStreet.com, a U.S. government-designated online financial market, is offering home owners the opportunity to protect themselves against the uncertainties of the red-hot housing market.

The new service from HedgeStreet lets investors bet on the direction of home prices in six U.S. markets — Chicago, Los Angeles, Miami, New York, San Diego and San Francisco. The idea is to hedge against a housing bubble bursting, which in many of the nation's hottest housing markets would likely lead to a sudden drop in house prices. HedgeStreet lets individual investors buy and sell very small futures contracts called "hedgelets." Traders bet that median home prices in the designated housing markets will go up, or down, in three to six months time.

Say, for example, you live in Los Angeles. You can buy hedgelets to bet that prices in that city will drop. If they do, the money you make could help to offset the lost value in your home. Alternatively, you could buy contracts that bet prices will rise. If they do, you're looking at a win-win situation.

Hedgelets offer real estate investors the opportunity to take on more exposure in the housing market, or offset some of their exposure notes Russell Andersson, co-founder of Hedgestreet.com. They can also dip their toes into other geographies, he adds.

"You may live in Los Angeles, and be long Los Angeles real estate, but think there's an opportunity in Miami," said Andersson. Of course, for every investor who bets the right way, there's another one who bets the wrong way. And while this type of home price derivative product is new in the United States, it has been around for some time in the Untied Kingdom.

HedgeStreet offers all kinds of hedgelets, including ones that track employment rates and mortgage rates, and it plans to expand its housing price instruments to add new cities. The company launched last fall and is backed by venture capital.

At present, trading volume is small, but the company says it's doubling monthly. HedgeStreet is regulated by the Commodity Futures Trading Commission and monitored by the National Futures Association.

Meantime, the Chicago Mercantile Exchange, the nation's largest exchange for futures and options, is exploring various housing derivatives with macro securities research, although it has not set a date to launch them, and while derivatives are not for the faint of heart, or thin of wallet, they are perhaps just fun to watch as predictors.

And while many are speculating about whether the real estate market is a bubble waiting to burst, HedgeStreet trading on housing price contracts suggests the U.S. housing market will remain hot, at least into the second quarter.

Based on current trading in the six U.S. markets tracked by HedgeStreet, traders predict home prices will mostly rise in the second quarter compared to the first, rising over 6 percent in Los Angeles. But in New York traders expect home prices to drop by nearly a percentage point.