

# Entrepreneur Sees a Futures Market for Homeowners

Ralph Liu is trying to start an exchange for hedging real estate. Some say the challenge would be finding enough buyers, sellers.

By JOSH FRIEDMAN  
Times Staff Writer

Ralph Liu's first experience in real estate investing was every homeowner's nightmare.

After getting his Wharton School MBA and heading to work on Wall Street in 1987, he bought a condominium on New York's Upper East Side for \$220,000 — and then sold it seven years later for \$160,000.

"I made other people happy by selling at the bottom," the 44-year-old Taiwan native said with a chuckle.

Now, Liu hopes his new venture, **Advanced E-Financial Technologies Inc.'s** Real Estate Futures Index Exchange, will help other homeowners avoid a similar fate.

The Corona-based entrepreneur is trying to raise \$5 million in capital to launch what he calls the world's first residential real estate futures market, an online exchange that would allow homeowners to hedge their investment and others to speculate on price swings in ZIP Code-based housing indexes.

He hopes to begin a pilot program by the end of the year that would involve the trading of futures contracts tied to indexes of property values in three to five ZIP Codes. He wants to use Corona, Pasadena and Santa

Monica as the testing grounds. ers. But with the residential housing market in the U.S. worth an estimated \$13.6 trillion — and home prices continuing to soar in many areas — Liu believes the concept's time has come.

"Almost everybody has exposure to the housing market, but how can you hedge?" said Liu, who left Wall Street in the early 1990s to work in Asia for **Union Bank of Switzerland** and **Chase Manhattan** before founding a consulting and financial software firm, **Advanced Risk Management Solutions Ltd.**, which he later sold.

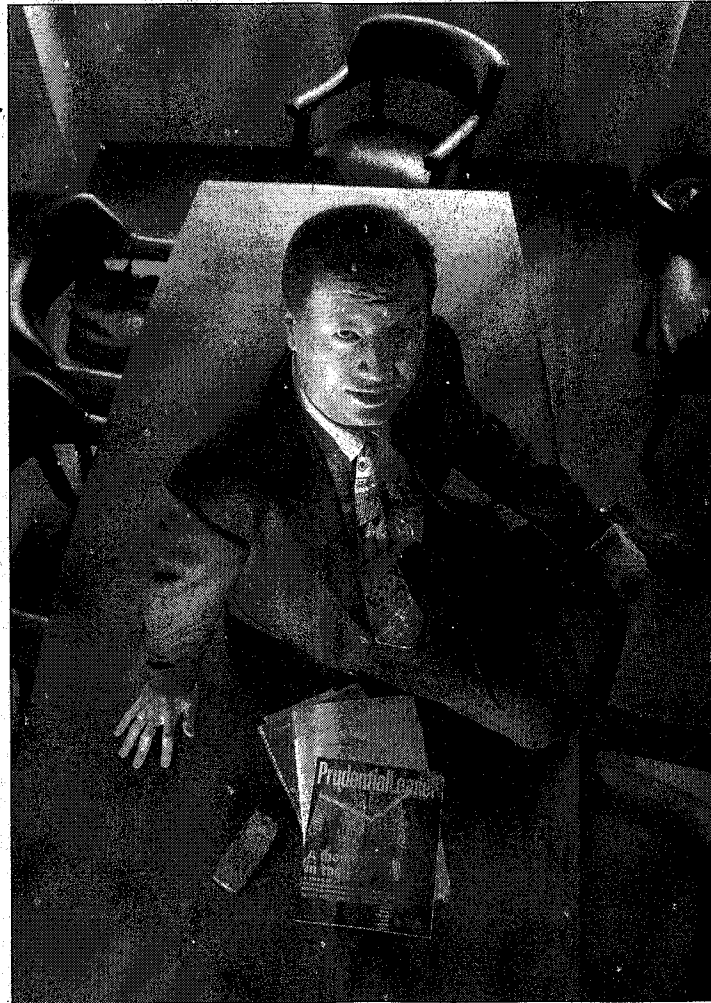
## How Futures Work

Futures contracts are agreements to buy or sell a specific amount of a commodity or other asset at a set price on a specific date. They have been available in the United States for almost 200 years and for seemingly any asset other than real estate. A farmer can use them to hedge against a drop in soybean prices, or a catalog jeweler to guard against a spike in gold.

Here's how Liu envisions bringing the same concept to real estate:

The owner of a 3,000-square-foot house with a mortgage of \$300,000 and a current value of \$405,000 wants to hedge her position. Say a housing index of her ZIP Code has a median value of \$135 per square foot — matching her home's value. She could sell 30 futures contracts (which would be sold in increments of 100 square feet) at that price.

If, over time, the ZIP Code index falls to \$120 per square foot, the homeowner would be up \$15 per square foot, or \$1,500 per contract, for a total of \$45,000 — offsetting the drop in her home's value (assuming it moves



MARK BOSTER/Los Angeles Times

**FIELD TESTING:** Ralph Liu wants to use Corona, Pasadena and Santa Monica as test sites for his planned futures market.

in sync with the index).

If the ZIP Code index in the example above were to rise to \$150 per square foot, the homeowner's futures contracts would be in the red by \$45,000, but that loss would be offset by the rise in the home's market price.

Either way, the only cost to

the homeowner would be commissions, which Liu estimates for the example above at \$375 upfront and \$25 per quarter (as contracts are updated). In other words, it would be like buying a form of insurance.

As Liu plans it, homes would provide the collateral for these

contracts, but there wouldn't be forced property sales to settle the futures. Contracts would be "marked to market" daily, which for speculators would entail putting up more money to cover paper losses.

(Liu provides more information on the mechanics at a Web site, [www.investorsally.com](http://www.investorsally.com).)

Liu, who returned to the U.S. in September 2001, has met with a handful of California venture capital firms and wealthy individuals who back start-ups, and none has committed.

Fund-raising is only one challenge.

The firm would need to obtain a license from the Commodity Futures Trading Commission, which regulates futures markets.

## Attracting Liquidity

Ultimately, the biggest hurdle if the exchange gets up and running could be to build a big enough base of futures buyers and sellers.

"It sounds innovative and interesting," said Cynthia Cain, director of planning and development at the National Futures Assn. in Chicago, a trade group and self-regulatory organization for the futures market. "But the challenge any new market faces is attracting enough liquidity."

Tom Skinner, the founder of Washington-based start-up **Real Liquidity**, whose government-backed pilot program has offered home equity protection contracts in Syracuse, N.Y., since September, is skeptical.

"I'm not too keen on the notion of using a ZIP Code-level index because you're not going to get liquidity," Skinner said. "In the L.A. area, for example, there are so many ZIP Codes. There

are not going to be enough buyers and sellers for each one."

The indexes, compiled by data trackers such as **Data-Quick Information Systems**, can fluctuate dramatically from quarter to quarter, Skinner said, especially when few homes are sold.

Real Liquidity, whose contracts cost 1.5% of a home's value, has sold about 50 policies so far, he said.

A homeowner is allowed to make a claim if he lives in his home for at least three years and his ZIP Code index falls. If he buys \$100,000 of protection at a cost of \$1,500 and the ZIP Code index drops 10%, he could make a \$10,000 claim when he sells.

Liu believes middlemen such as banks would use his futures contracts to offer an insurance-type product in the Real Liquidity vein.

"Although it's unclear whether there is any future for real estate futures, Liu's former colleagues say he has the knowledge and trading savvy to pull it off.

"I respect him not only as a trader but as a strategist with a market view," said James Pan, who co-manages a fixed-income hedge fund at **Seagate Global Advisors** in Redondo Beach.

When Pan and Liu worked in Asia during the 1990s — Pan for the agency that runs the Chinese central bank's foreign exchange reserve — Liu helped coach him about trading techniques.

Liu said there were several reasons earlier efforts to establish real estate futures never got off the ground, but he said that with today's widespread Internet use, thriving housing market and the wider dissemination of ZIP Code indexes such as those maintained by DataQuick, the time is right.