

A Survey into the Use of Derivatives by Australian Property Funds

Chyi Lin Lee

School of Economics and Finance, University of Western Sydney, Locked Bag 1797,
Penrith South D.C. 1797, Australia.

Email: chyilin.lee@uws.edu.au

Paper submission for presentation at

The 16th Pacific Rim Real Estate Society Conference

Wellington, New Zealand

24th-27th January 2010

(Acknowledgment:

The author would like to thank the anonymous referee who provided helpful and constructive comments. The author also would like to acknowledge the financial support from the UWS Seed Research Grant (20531-82547)).

A Survey into the Use of Derivatives by Australian Property Funds

Abstract

Derivatives have gained an increasing attention by academics and practitioners in recent years. However, there is relatively little evidence on the patterns of use and the property funds' attitudes with respect to derivatives. Therefore, this study seeks to address this shortfall and aims to examine the usage of derivatives by property funds in Australia. A survey of Australian property fund managers was undertaken. The results show that different types of property funds have dissimilar patterns of derivatives use. Besides, the results also reveal that large property funds are more likely to use derivatives. The motivation factors and risk factors for using derivatives are also identified. In addition, significant differences are found between the perceptions of derivative users and non-users. The findings have offered some insights into the knowledge base of property investors towards derivatives.

Keywords: Derivatives, property funds, motivation factors, risk factors and Australia.

1.0 INTRODUCTION

Extensive studies on financial assets, commodities and foreign exchange derivatives have demonstrated that derivatives are valuable asset management tools. Derivative is a security between two or more parties, and the value of a derivative contract is determined by its underlying asset. Variety forms of derivatives are available such as options, forwards, futures and swaps¹. Nowadays, derivatives have become one of the basic banking businesses (Sinkey and Carter, 2000). Most importantly, derivatives have been widely used by financial companies, non-financial firms and insurance companies (Bodnar *et al.*, 1996, Sinkey and Carter, 2000, Ceuster *et al.*, 2003).

Despite the global financial crisis, the global listed derivatives achieved double digit growth rate (13.7%) with 17.7 billion contracts in 2008. Importantly, the Asian-Pacific listed derivatives market accounted for around 28% of the total global trading volume in 2008. This figure was ahead the European listed derivatives market (23.61%) and just behind North America (Burghardt and Acworth, 2009).

(Insert Figure 1)

Numerous Asia-Pacific derivatives exchanges are also on the list of the world's top 25 derivatives exchanges. As depicted in Table 1, the Korea Exchange appeared as the largest derivatives exchanges in Asia-Pacific with the total volume of 2.865 billion contracts in 2008. The Australian listed derivatives market was also one of the top 10

¹ The mechanics of the various derivatives are discussed extensively by Clayton (2007).

derivatives exchanges in the region and it was ranked as the 21st in the world with 94.8 million contracts.

(Insert Table 1)

In response to the tremendous growth of derivatives globally, property derivatives have also been introduced in the US, Europe and Australia in recent years. Since the emergence of property derivatives, the use of property derivatives is also growing at a rapid pace, particularly in the U.K. The total volume of property derivatives traded in the U.K. reached £11.2 billion. Importantly, the total notional of trades executed in the fourth quarter of 2008 has increased over fivefold than the total transaction values at the end of 2005 (IPD, 2009). In Australia, similar rapid growth in REIT futures was also evident. The trading volume of Australian REIT futures has increased dramatically from 109,593 lots in 2006 to 256,322 lots in 2008(ASX, 2009b). Ong and Ng (2009) have pointed out the advantages of using property derivatives by property investors such as hedging financial risk and enhancing liquidity of property investments. Moreover, institutional investors have also agreed that property derivatives would also help investors in managing the liquidity risk and the risk of lacking reliable valuation data in property investment (Dhar and Goetzmann, 2005, Clayton, 2007).

Extensive finance studies have largely concentrated on the use of derivatives by financial firms, non-financial firms and insurers. Up till now, however, there is little evidence on the extent and nature of derivatives that are used by property funds. Two exceptions are Horng and Wei (1999) and Ertugrul *et al.* (2008). Both studies focus in

REITs, while the use of derivatives among unlisted property funds has been largely ignored. In Australia, REITs are the largest and most successful indirect properties, whereas unlisted property trusts and property securities funds are also major players in the Australian property fund industry.

With an increasing acceptance of property derivatives and significance of property funds in Australia, it is critically important to assess the extent of derivatives used by property fund managers and their perceptions towards derivatives, to enable more informed and practical investment decision-making regarding the role of derivatives in property fund management. The purpose of this study is to examine the usage of derivatives by property funds in Australia and the perceptions of property fund managers towards derivatives. The motivating factors and obstacles for employing derivatives are also examined.

The contributions of this paper are threefold. Firstly, this study is one of the limited studies to shed some light on the extent of derivatives that are used by the property fund industry. In contrast to Horng and Wei (1999) and Ertugrul *et al.* (2008), REITs and unlisted property funds are included in this study in relation to the significance of these funds in the Australian property market. Secondly, this study is probably the first attempt to ascertain management perceptions about the usefulness of derivatives and their role in fund management. Importantly, Geltner and Fisher (2007) have highlighted the issue of insufficient understanding of derivatives by property investors. In other words, the findings from previous studies in non-property companies would not necessarily be generalised into a property context. More importantly, Bodnar *et al.* (1996) and Ceuster *et al.* (2000) found a sector effect in which the use of derivatives

is strongly subject to sectors. Thus, it is crucial to understand property fund managers' perception towards derivatives. Thirdly, the use of derivatives in the Australian property funds context is examined for the first time. The findings from the study provide some insight into property funds' decision for using derivatives and their attitudes towards derivatives.

The remainder of this paper is organised as follows. The significance of property funds in Australia is discussed in Section 2. The next section reviews the related literature in derivatives. Data and methodology of this study are examined in Section 4. The results are reported and discussed in Section 5. The last section concludes the paper.

2.0 SIGNIFICANCE OF PROPERTY FUNDS

Australia is one of the largest indirect property markets in the world. In 2007, the Australian securitised property market was ranked as the 4th largest world's securitised real estate market (RREEF, 2007). Australian property funds have dominated the Australian direct commercial property market. It is estimated that 70%-80% commercial properties are institutionally owned by property funds (JLL, 2008).

Numerous indirect property investment vehicles are available in Australia such as REITs, unlisted property trusts, property securities funds and property syndicates. The REIT market is the largest indirect property sector in Australia, representing 54.5% of the total assets of Australian property funds (PIR, 2009). Australian REITs are also

the second largest REIT market in the world with a market capitalisation of AUD\$136 billion (AME, 2007). Moreover, unlisted property trusts, wholesale property funds and property securitised funds also play a significant role in the Australian property fund industry. These funds contributed almost 44.5% of the total assets of Australian property funds with 4025 commercial properties in their portfolios (PIR, 2009).

Like the stock market, Australian property funds have been significantly affected by the global financial crisis. As demonstrated by Table 2, in 2008, massive losses were observed in the REIT and stock markets. Besides, a downward trend was also evident in direct properties and unlisted property funds. Figure 2 presents the rolling risk analyses for direct properties, REITs and unlisted property funds using three-year windows over Q4:2002-Q4:2008. Apparently, rapid increases of the volatilities for these assets were found since Q3:2007, particularly in the Australian REIT market.

(Insert Table 2 and Figure 2)

More importantly, the increasing level of cross border property investment is also evident in recent years. The amount of global cross border property investment activities increased over fourfold in 2007 to US\$225 billion (RREEF, 2008). As discussed by Newell and MacIntosh (2007), as December 2006, 63% of Australian LPTs had international property in their portfolios. Importantly, 13 LPTs appeared 100% international real estate in their portfolios.

Apparent increases in price volatility and international property investment activities in the Australian property market, developments in the range and complexity of tools

such as derivatives, available to manage financial risks are deserved by institutional investors. As a result, it is essential to understand the extent to which derivatives are used by property funds and the perceptions of property fund managers towards derivatives.

3.0 LITERATURE REVIEW

Many studies have demonstrated that derivatives are widely used by financial and non-financial companies, insurance companies and multinational companies. For instance, Nance *et al.* (1993) found that derivatives were employed by 104 firms out of the 169 firms in their sample. The results also documented that reducing expected liabilities and transaction costs, as well as agency problems are important factors in affecting firm's hedging decision. Additionally, they also documented that size is an important determinant for the usage level of derivatives. This is attributed to the information and transaction cost scale of economies in which large companies are more likely to hire managers with expertise in setting up a hedging program and pay lower transaction costs for hedging instruments. Mian (1996) also demonstrated that larger firms are more likely to use derivatives. Bodner *et al.* (1996) surveyed US non-financial firms about the use of derivatives. The results showed that less than half US non-financial firms employ derivatives. Besides, they also found the presence of sector effect. Interestingly, the use of derivatives is greater for large firms in the commodity and manufacturing sectors. Additionally, the results also demonstrated that "hedging for the cash flows" is the main reason for these firms to employ derivatives.

Geczy *et al.* (1997) have also provided similar evidence from the top 500 companies in the US in which larger firms and firms with greater growth opportunities and tighter financial constraints are more likely to use currency derivatives, suggesting that firms use derivatives to reduce the volatility of their firm's cash flows or earnings. They also found a positive link between R&D expenditures and the use of derivatives. More recently, Heaney and Winata (2005) showed there are significant differences between large and small firms for derivatives transactions. Specifically, 3 variables, namely R&D, director shareholding and market-to-book ratios, are significant in explaining the derivatives usage of large firms but not for small firms. In Europe, Ceuster *et al.* (2000) found that large non-financial companies focus relatively more on the reduction of volatility in cash flows rather than earnings.

Hoyt (1989) has offered the evidence that larger life insurers are more likely to use derivatives in comparison to smaller life insurers. Additionally, the results also suggested that futures users strongly believe that the financial risk of their companies can be reduced with a proper use of financial futures. Besides, the survey demonstrated that educating management for using financial futures is the most significant obstacle. A survey of property insurers by Bouzouita and Young (1998) indicated that hedging financial risk is the main reason for property/casualty insurers to use financial derivatives. The results also revealed the difference between users and non-users in terms of the perceptions of financial derivatives. Interestingly, lacking of qualified personnel is a major problem for non-users to implement the hedging program via derivatives. Nonetheless, derivative users tend to disagree with this statement.

In Australia, derivatives were employed by around 75% of the top 500 Australian listed companies (Nguyen and Faff, 2003, Benson and Oliver, 2004). Benson and Oliver (2004) have presented evidence of the reduction in cash flow volatility and earnings volatility are key motivating factors for these firms to use derivatives. Nguyen and Faff (2002, 2003) also showed that derivatives are used with a view to enhance the firm's value. Specifically, the results showed that a firm's leverage, size and liquidity are important determinants of derivatives usage.

In the real estate literature, Horng and Wei (1999) have exhibited that larger equity REITs and mortgage REITs have greater level of derivatives usage. The results also demonstrated the differences between mortgage REITs and equity REITs for using derivatives. Mortgage REITs tend to increase their hedging activities when they exposure to higher prepayment risk, while equity REITs are more concern with interest rate risk and it is the most important factor for them to use derivatives. Comparable results are illustrated by Ertugrul *et al.* (2008) in which REITs that use derivatives are larger. Nevertheless, the results also suggested that the derivatives usage is greater for smaller REITs once the hedging program is in place. A strong positive relationship between the use of derivatives and institutional ownership has also been identified, suggesting that the hedging practice via derivatives is preferred by institutional investors.

In summary, derivatives are widely employed by non-property firms and size is related to the usage level of derivatives by many companies. Additionally, hedging the volatility of cash flow is the main factor for using derivatives. However, little

study has been placed on property funds, particularly unlisted property funds. Besides, the use of property derivatives by property funds has also been largely ignored.

4.0 DATA AND METHODOLOGY

Since public data on the derivatives usage by unlisted property funds are difficult to be obtained, a questionnaire was designed to examine the extent and the perceptions of property fund managers towards derivatives. A survey has been viewed as the most effective way to assess the perceptions of human (Rogelberg and Stanton, 2007). Thus, the survey of property fund managers would provide a fuller understanding of institutional property investors' attitudes in relation to the use of derivatives in their fund management.

A total of 264 property funds were identified from the Australian Property Funds Industry Survey 2008 report and the ASX website (www.asx.com.au). Mortgage funds (72 funds) were excluded from this survey due to the fact that this study only focuses on equity property funds. 3 property funds declined to participate and 11 funds without complete mailing addresses or contact person. In turn, this resulted in a total of 178 samples with complete corresponding information being used in this analysis. A pilot test with small number of funds was conducted in May 2009. This was followed by minor changes before the questionnaire was distributed. 53 respondents responded to the survey, with the survey response rate being 30%.² This rate is quite comparable to the response rates reported by other derivatives studies in

² Non-response bias was examined by comparing the responses of early and late respondents. No significant variation is found in results, suggesting that the non-response bias is unlikely to be a cause for concern.

non-property companies such as Ceuster *et al.* (2000; 21.9%) and Benson and Oliver (2004; 23%).

This survey addressed a range of issues, but largely focused on the derivatives usage of property funds and motivating factors, as well as impediments for using derivatives. The survey was conducted during June-July 2009 and the questionnaires were distributed to property fund managers that based throughout Australia via mail or email. Most questionnaires were sent to the respondents who are at the level of “Managing Director” or “General Manager” or “Fund Manager”. Funds which had not responded within a month were sent a follow up letter. Their responses were analysed with frequency analysis and cross tabulation analysis.

5.0 RESULTS AND DISCUSSION

The Use Pattern of Derivatives by Property Funds

As depicted in Table 3, almost 80% of property funds employ derivatives, exceeding the findings from the top 500 Australian companies that are found by Nguyen and Faff (2003) and Benson and Oliver (2004). More importantly, more than 85% of REITs and property securities funds stated that they are derivative users, suggesting that derivatives are not relatively new products for property fund managers. In fact, derivatives have been widely employed by Australian property funds. Table 4 compares the derivative instruments that are used by property fund managers. The results indicate that the most frequently used derivatives instruments among property

fund managers are swaps (52%). It is followed by forwards (40%) and futures (21%). The pattern is not consistent with the findings of previous studies in non-property companies (Benson and Oliver, 2004) in which options only play a marginal role, reflecting that property funds have quite different patterns of derivatives use in comparison to non-property companies.

(Insert Tables 3 and 4)

Table 5 reports the types of derivatives that are utilised by property funds. Derivatives based on interest rate are the most popular financial derivatives among property funds. This is attributed to the volatile interest rate movement in recent years. Rising interest rates prior to the global financial crisis and the sharp decline afterward have been a major concern for property fund managers. Therefore, derivative contract based on interest rate appears as a desired product to minimise the interest rate risk. Interestingly, compared to the findings of Australian top 200 companies by Berkman *et al.* (1997), property funds in Australia are more concerned with the interest rate risk in which the interest rate derivatives usage is greater for those funds. The results in Table 5 also indicate that derivatives based on foreign currency are other common used derivatives. Specifically, 40% of property funds use currency derivatives. Nonetheless, less than 10% of respondents used stock- and property-based derivatives. This can be explained by the unpopularity of these derivatives. It should be noted that the trading volumes of interest rate derivatives are considerably larger than property and stock derivatives (ASX, 2009a).

(Insert Table 5)

Table 6 provides an insight into the patterns of derivatives use among different types of property funds. It is noteworthy that more than half of REITs, unlisted wholesale property funds and property syndicates use derivatives based on interest rates, while less than one third of property securities funds employ interest rate derivatives. The results also exhibit that property securities fund managers are being heavy users of foreign currency derivatives as 86% of these funds utilised derivatives based on foreign currency. One of the possible explanations is these funds have large international property portfolios. More importantly, property funds with and without international property are significant different in terms of the use of foreign currency derivatives with a statistically significant chi-square coefficient at 1% level³.

(Insert Table 6)

Another important point that has emerged from Table 6 is the greater level of property derivatives usage by property securitised funds in which more than half property securities funds use property derivatives, whereas no similar evidence is found for other property funds. Although derivatives based on direct and indirect properties are available in Australia, REIT futures and options (indirect property derivatives) are the largest property derivative markets in Australia. Importantly, REIT futures and options are more applicable derivative products for property securities funds compared with other property funds. This could explain the low usage of property derivatives among other property funds.

³ The results are available from the author

Property securitised funds also appeared as heavy stock derivatives users. It is attributed to many property securities funds are required to outperform stock indices. As pointed out by Lee *et al.* (2008), stock indices are commonly used as the benchmarks for property securities funds. Hence, property securities funds would use stock derivatives to hedge the market risk. Higher liquidity of stock derivatives in comparison to property derivatives could be another plausible reason. As discussed by Newell and Tan (2004), the transaction volume of stock futures is considerably higher than property futures in Australia.

An investigation of size effect was also performed to assess the presence of size effect in the Australian property fund industry. Specifically, property funds were classified into three groups (Small, Medium and Big) based on their total assets. The results are reported in Table 7.

(Insert Table 7)

As it can be seen from Table 7, derivatives are utilised by almost 90% of large property funds, whereas only 53% small property funds use derivatives. Importantly, the positive and statistically significant F-ratio (4.370) and chi-square statistic (7.855), with the probability level of 1% have further reinforced the statement, meaning that the use of derivatives is sensitive to the size of the fund. The presence of size effect provides some indirect support to previous studies such as Nancy *et al.* (1993) in which the derivative hedging program is easier to be implemented by larger companies with reference to the scale of economies.

In short, there are significant differences in terms of the derivatives usage patterns by different types of property funds. Specifically, property securities funds and REITs are more likely to use derivatives in comparison to unlisted property funds. Besides, derivative contracts based on property and foreign currency are more frequently used by property securities funds. Additionally, the linkage between the size of a property fund and the use of derivatives is also demonstrated.

Motivating Factors and Impediments of using Derivatives

Previous section has provided some insights into the use of derivatives among property funds in Australia. This section attempts to understand the attitudes of property fund managers towards the use of derivatives. Table 8 compares the perceptions of derivative users and non-users towards derivatives. Property funds are currently using derivatives were asked to indicate which of the factors are valuable for using derivatives. Non-users were asked to indicate which of the factors that will potentially be valuable for employing derivatives. Respondents are allowed to choose all factors that are applicable.

(Insert Table 8)

The three most important issues regarding the use of derivatives are to “reduce cash flow volatility”, “hedge against the foreign currency risk” and “reduce earning volatility”. On the other hand, the three least important factors for using derivatives are to “quickly adjust sector weighting”, “allow the company to move into higher yielding assets” and “trade for profits”. In other words, hedging rather than trading for

profits is the main reason for property funds to use derivatives. Although the top 3 important factors are quite comparable to the findings from previous studies, other often cited reasons by non-property companies, such as enhancing the firm's value and adjusted sector allocation, are less agreed by property fund managers. Interestingly, hedging currency risk was ranked the least important factor by property insurers, although it has been viewed as the second most important factor by property funds. This highlights the importance of treating property funds and non-property funds heterogeneously, reflecting that previous findings from non-property firms could not be totally translated into property funds.

Some variations in ranking between users and non-users are also evident from Table 8. The most frequently stated factor for using derivatives by users is to reduce the cash flow volatility. The second most common factor is to reduce earning volatility. Interestingly, fewer non-users indicated that these factors are potentially valuable for them to use derivatives. For non-users, the effectiveness of hedging the foreign currency risk is the most important factor that will encourage them to use derivatives. Interestingly, none of the non-users agreed that the use of derivatives can facilitate their risk management in which derivatives could be used to manage the market risk more effectively by altering their risk positions, whereas 46% of users agreed with this statement. Another interesting observation is almost 20% of derivative users agreed that derivatives can increase the liquidity of the investment portfolio, while this factor is also reckoned by few users (2.5%). To shed more light on the differences between users and non-users, a chi-square test was performed. A positive and statistically significant chi-square statistics for the factors of "to manage the market risk", "to reduce cash flow volatility", "to reduce earning volatility" and "to increase

the liquidity of the investment portfolio” confirmed the significant differences between the responses of users and non-users for these factors, indicating that users and non-users have different perceptions towards derivatives.

(Insert Table 9)

Both users and non-users were also asked with questions regarding problems of implementing and administering the use of derivatives. The results are reported in Table 9. Development of internal control and review systems is the only problem that was ranked as the important factor by both users and non-users. Non-users have significantly more problems with the issue of lacking qualified personnel to implement the hedging practice via derivatives than users. Interestingly, this factor was viewed as the most critical issue for non-users. Nevertheless, users do not recognise it is an important issue. The scale of economies can be the plausible explanation for this divergence. As pointed out by Table 7, large property funds are more likely to use derivatives as they afford to hire the expertise in setting up the hedging program. Therefore, lacking of qualified personnel is more significant for non-users as many of them are smaller property funds. Complicated accounting procedures were ranked as the most serious problem by users, although non-users of derivatives are less agreed with this statement. Since non-users have never used derivatives before, it is not surprising that they are not fully aware with the accounting issues in relation to derivatives. Besides, a higher percentage of non-users listed regulatory restrictions as a major concern comparing to users.

Another important observation from Table 9 is derivative users did not score these 7 difficulties as highly as non-users, although the chi-square statistics are insignificant. This indicates that property funds with currently using derivatives are comfortable with the use of derivatives where they already have the expertise and experience in dealing with derivatives and are quite familiar with derivatives.

In summary, the attitudes of property funds towards derivatives are different between those funds that used derivatives and those that do not. More specifically, they have somewhat divergent opinions on motivating factors for using derivatives. Non-users also scored the risk factors for using derivatives much higher than users, although the chi-square statistics are not statistically significant.

6.0 CONCLUSIONS

In recent years, the pattern of derivatives usage by non-property firms has become a topic of considerable interest to regulators and investors, although little study has been done in the property funds context. Importantly, the existing literature and evidence concerning derivatives do not necessarily generalise into property funds since many property funds are unlisted. Therefore, this study aims to examine the derivatives usage by property funds, and to determine the motivating factors and risk factors for using derivatives.

There are several important findings from this study. Firstly, almost 80% of Australian property funds are derivative users, suggesting that derivatives are not

relatively new products for property funds. Secondly, there are some variations in terms of the use of derivatives by different types of funds. Specifically, the greater levels of derivative usage are found for property securities funds and REITs. Besides, large property funds are more likely to use derivatives than small funds. Thirdly, derivatives are used for a range of different purposes. In general, hedging instead of speculation is the main motivating factor for derivatives transactions. However, derivative users and non-users have divergent attitudes towards derivatives.

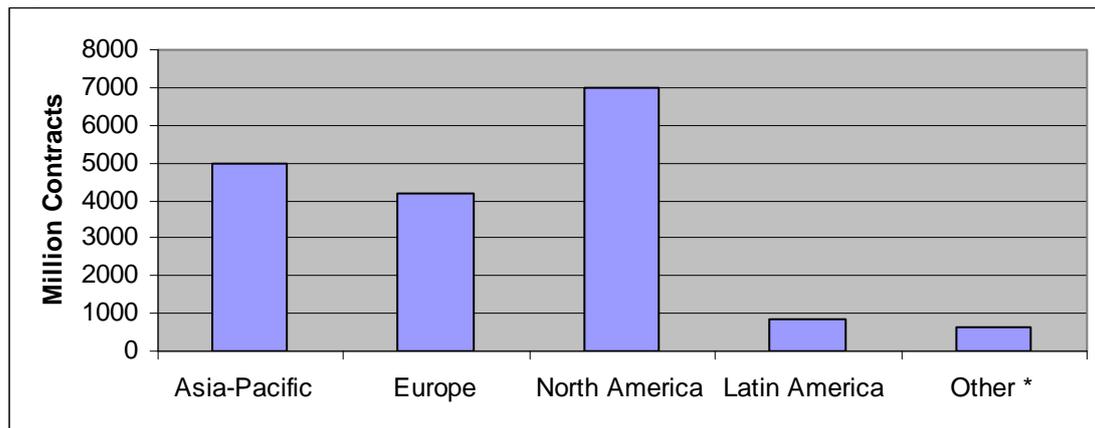
Finally, these results have improved the knowledge base on the use of derivatives by property funds. Given property companies have different patterns of derivatives usage and divergent attitudes towards derivatives in comparison to non-property companies, practitioners and academics should be cautious with this difference and an in-depth study in the property context in relation to derivatives, particularly property derivatives is therefore a worthwhile task for future study.

References

- AME (2007) Global Property Securities Research. London, AME Capital, 1-8.
- ASX (2009a) Monthly SFE Trading Report for July 2009. Sydney, Australian Securities Exchange,
- ASX (2009b) S&P/ASX 200 A-REIT Index Futures. Sydney, Australian Securities Exchange,
- Benson, K. & Oliver, B. (2004) Management Motivation for Using Financial Derivatives in Australia. *Australian Journal of Management*, 29 (2), 225-242.
- Berkman, H., Bradbury, M. E., Hancock, P. & Innes, C. (1997) An Analysis of Disclosures of Derivative Financial Instruments in Australia and New Zealand. *Accounting Forum* 21 (2), 207-228.
- Bodnar, G. M., Hayt, G. S. & Marston, R. C. (1996) 1995 Wharton Survey of Derivatives Usage by US Non-financial Firms. *Financial Management* 25 (4), 113-133.
- Bouzouita, R. & Young, A. J. (1998) Property/Casualty Insurers' Use of Financial Derivatives. *CPCU Journal*, 51 (2), 114-119.
- Burghardt, G. & Acworth, W. (2009) Annual Volume Survey: 2008 A Wild Ride. *Futures Industry*, (March 2009), 16-29.
- Ceuster, M. D., Flanagan, L., Hodgson, A. & Tahir, M. I. (2003) Determinants of Derivative Usage in the Life and General Insurance Industry: The Australian Evidence. *Review of Pacific Basin Financial Markets and Policies*, 6 (4), 405-431.

- Ceuster, M. J. K. D., Durinck, E., Laveren, E. & Lodewyckx, J. (2000) A Survey into the Use of Derivatives by Large Non-financial Firms Operating in Belgium. *European Financial Management*, 6 (3), 301-318.
- Clayton, J. (2007) Commercial Real Estate Derivatives: The Developing U.S. Market. *Real Estate Issues*, (Fall 2007), 33-40.
- Dhar, R. & Goetzmann, W. N. (2005) Institutional Perspectives on Real Estate Investing: The Role of Risk and Uncertainty. PREA Research,
- Ertugrul, M., Sezer, O. & Sirmans, C. F. (2008) Financial Leverage, CEO Compensation, and Corporate Hedging: Evidence from Real Estate Investment Trusts. *Journal of Real Estate Finance and Economics*, 36 53-80.
- Geczy, C., Minton, B. A. & Schrand, J. C. (1997) Why Firms Use Currency Derivatives. *Journal of Finance*, 52 (4), 1323-1353.
- Geltner, D. & Fisher, J. (2007) Pricing and Index Considerations in Commercial Real Estate Derivatives. *Journal of Portfolio Management*, (Special Issue 2007), 99-118.
- Heaney, R. & Winata, H. (2005) Use of Derivatives by Australian Companies. *Pacific-Basin Finance Journal*, 13 (4), 411-430.
- Horng, Y.-S. & Wei, P. (1999) An Empirical Study of Derivatives Use in the REIT Industry. *Real Estate Economics*, 27 (3), 561-586.
- Hoyt, R. E. (1989) Use of Financial Futures by Life Insurers *The Journal of Risk and Insurance*, 56 (4), 740-748
- IPD (2009) IPD / IPF UK Trade Volume Report. London, IPD,
- JLL (2008) Investment Case for Australia. Sydney, Jones Lang LaSalle, 1-27.
- Lee, C. L., Reed, R. & Robinson, J. (2008) An Investigation on the Risk Perceptions of Australian Property Fund Managers. *Pacific Rim Property Research Journal*, 14 (2), 199-221.
- Mian, S. L. (1996) Evidence on Corporate Hedging Policy. *Journal of Financial and Quantitative Analysis*, 31 419-439.
- Nance, D. R., Smith, C. W. & Smithson, C. W. (1993) On the Determinants of Corporate Hedging. *Journal of Finance*, 48 (1), 267-284.
- Newell, G. & MacIntosh, I. (2007) Currency Risk Management Practices by Australian Listed Property Trusts. *Pacific Rim Property Research Journal*, 13 (2), 213-233.
- Newell, G. & Tan, Y. K. (2004) The Development and Performance of Listed Property Trust Futures. *Pacific Rim Property Research Journal*, 10 (2), 132-145.
- Nguyen, H. & Faff, R. (2002) On the Determinants of Derivative Usage by Australian Companies. *Australian Journal of Management*, 27 (1), 1-24.
- Nguyen, H. & Faff, R. (2003) Further Evidence on the Corporate Use of Derivatives in Australia: The Case of Foreign Currency and Interest Rate Instruments. *Australian Journal of Management*, 28 (3), 307-317.
- Ong, S. E. & Ng, K. H. (2009) Developing the Real Estate Derivative Market for Singapore: Issues and Challenges. *Journal of Property Investment and Finance*, 27 (4), 425-432.
- PIR (2009) Australian Property Funds Industry Survey 2009. Melbourne, Property Investment Research 1-203.
- Rogelberg, S. G. & Stanton, J. M. (2007) Introduction: Understanding and Dealing with Organizational Survey Nonresponse. *Organizational Research Methods*, 10 (2), 195-209.
- RREEF (2007) Global Real Estate Securities. London, RREEF Real Estate Research,
- RREEF (2008) Global Real Estate Investment and Performance 2007 and 2008. London, RREEF Real Estate Research, 1-36.
- Sinkey, J. F. & Carter, D. A. (2000) Evidence on the Financial Characteristics of Banks that do and do not Use Derivatives. *The Quarterly Review of Economics and Finance*, 40 (4), 431-449.

Figure 1: Global Listed Derivatives Volume: 2008



Source: *Futures Industry Association (2009)*

Note: * includes South Africa, Turkey, Israel and Dubai

Table 1: Top 25 Derivatives Exchanges: Trading Volume (Contracts): 2008

Rank	Exchange	2008
1	CME Group	3,277,645,351
2	Eurex	3,172,704,773
3	Korea Exchange	2,865,482,319
4	NYSE Euronext	1,675,791,242
5	Chicago Board Options Exchange	1,194,516,467
6	BM&F Bovespa	741,889,113
7	Nasdaq OMX Group	722,107,905
8	National Stock Exchange of India	590,151,288
9	JSE South Africa	513,584,004
10	Dalian Commodity Exchange	313,217,957
11	Russian Trading Systems Stock Exchange	238,220,708
12	Intercontinental Exchange	234,414,538
13	Zhengzhou Commodity Exchange	222,557,134
14	Boston Options Exchange	178,650,541
15	Osaka Securities Exchange	163,689,348
16	Shanghai Futures Exchange	140,263,185
17	Taiwan Futures Exchange	136,719,777
18	Moscow Interbank Currency Exchange	131,905,458
19	London Metal Exchange	113,215,299
20	Hong Kong Exchanges & Clearing	105,006,736
21	Australian Securities Exchange	94,775,920
	Sydney Futures Exchange	74,605,556
	Australian Stock Exchange	20,170,364
	A-REIT futures	256,322
22	Multi Commodity Exchange of India	94,310,610
23	Tel-Aviv Stock Exchange	92,574,042
24	Mercado Espanol de Opciones y Futuros Financieros	83,416,762
25	Mexican Derivatives Exchange	70,143,690

Source: *Adopted from ASX (2009) and Futures Industry Association (2009)*

Note: the figures are based on the number of futures and options traded and/or cleared

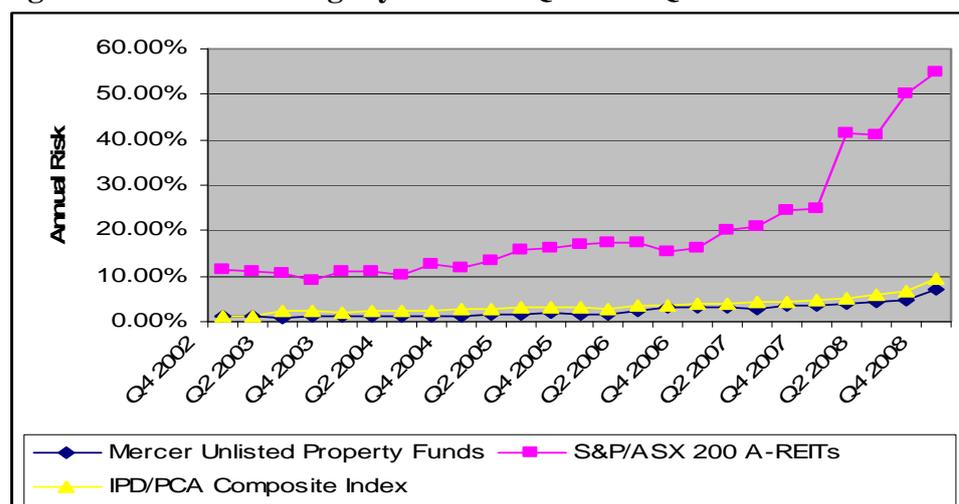
Table 2: Asset Class Performance Analysis: December 2008 (Annualised Return)

Market	1Y	3Y	5Y
Share (ASX All Ordinaries)	-40.4% (4)	-4.2% (4)	6.3% (3)
Direct Property (Australian Composite Property)*	-0.3% (3)	12.2% (2)	12.7% (2)
A-REITs (S&P/ASX LPT 300)	-55.3% (5)	-18.1% (5)	-3.9% (5)
Unlisted Property Funds (Mercer Unlisted Property Funds)	9.4% (2)	14.9% (1)	13.7% (1)
Bonds (UBA Australia Composite All Maturities)	10.3% (1)	6.1% (3)	6.0% (4)

Source: IPD/PCA (2009)

Note: Parenthesis shows the rank and (*) Australian Composite Property return is represented by the IPD/Property Council Investment Performance Index.

Figure 2: Annual Rolling 3-year Risk: Q4:2002-Q4:2008



Sources: Author's calculation based on the data from DataStream and IPD Australia

Table 3: Derivatives Usage by Organisations

Organisation	Derivative Users	Non-users of Derivatives	Total
REITs	32.7%	3.8%	36.5%
Unlisted Wholesale Property Funds	17.3%	7.7%	25.0%
Unlisted Retail Property Funds	9.6%	3.8%	13.5%
Property Syndicates	3.8%	1.9%	5.8%
Property Securities Funds	11.5%	1.9%	13.5%
Others	3.8%	1.9%	5.8%
Total	78.8%	21.2%	100.0%

Table 4: Derivative Instruments

Derivative Instruments	Usage Percentage
Swaps	63.5%
Forwards	30.8%
Futures	21.2%
Options	17.3%
Others	1.9%

Table 5: Types of Derivatives

Types of Derivatives	Usage Percentage
Foreign currency	40.4%
Fixed income assets including interest rate	51.9%
Stocks	9.6%
Properties	9.6%
Others	3.8%

Table 6: Types of Derivatives by Organisations

Organisation	Foreign currency	Interest rate	Stock	Property
REITs	36.8%	57.9%	5.3%	0.0%
Unlisted Wholesale Property Funds	46.2%	53.8%	15.4%	7.7%
Unlisted Retail Property Funds	28.6%	42.9%	0.0%	0.0%
Property Syndicates	0.0%	66.7%	0.0%	0.0%
Property Securities Funds	85.7%	28.6%	28.6%	57.1%
Others	0.0%	66.7%	0.0%	0.0%
Total	40.4%	51.9%	9.6%	9.6%

Table 7: The Usage of Derivatives by Size

Group	Derivative Users	Non-Users of Derivatives
Small	52.9%	47.1%
Medium	87.5%	12.5%
Large	88.9%	11.1%
Chi-square coefficient	7.855***	

Notes: *, **, *** denotes significant at 10%, 5% and 1% respectively

Table 8: Motivating Factors for Using Derivatives

Response	Derivative Users	Non-Users of Derivatives	Total	Chi-square
To hedge against the foreign currency risk	48.8%	36.4%	46.2%	0.538
To manage the market risk more effectively by altering the risk positions	46.3%	0.0%	36.5%	8.033***
To reduce cash flow volatility	70.7%	27.3%	61.5%	6.921***
To reduce earning volatility	51.2%	18.2%	44.2%	3.838**
To trade for profits	4.9%	9.1%	5.8%	0.283
To increase the liquidity of the investment portfolio	2.4%	18.2%	5.8%	3.954**
To quickly adjust sector weighting	2.4%	0.0%	1.9%	0.274
To hedge against the depreciation of fixed-income assets as interest rates rises	14.6%	18.2%	15.4%	0.084
To allow the company to move into higher yielding assets	4.9%	0.0%	3.8%	0.558

Notes: *, **, *** denotes significant at 10%, 5% and 1% respectively

Table 9: Obstacles for Using Derivatives

Response	Derivative Users	Non-Users of Derivatives	Total	Chi-square
Resistance from the Board of Directors	14.6%	18.2%	15.4%	0.084
Lack of qualified personnel to implement the program	14.6%	63.6%	25.0%	11.107***
Development of internal control and review systems	34.1%	54.5%	38.5%	1.525
Educating management in the use of financial derivatives	17.1%	36.4%	21.2%	1.935
Regulatory restrictions	14.6%	36.4%	19.2%	2.637
Complicated accounting procedures	39.0%	27.3%	36.5%	0.517
Not considered as a popular tool	7.3%	18.2%	9.6%	1.178

Notes: *, **, *** denotes significant at 10%, 5% and 1% respectively