OAK INVESTMENT MANAGEMENT GROUP

JULY (1) 2012: Real Estate and the Use and Misuse LIBOR

The London Inter Banking Overnight Rate is the rate at which willing banks lend to each other in the normal course of business. Hitherto this has been based on median quotes of a couple of dozen lending institutions. The fact that the data fed into this process has been manipulated is a relapse in ethical standards but also has real consequences on every sector of the economy.

Directly or indirectly the manipulation of LIBOR has affected almost every single financial instrument in the world. As a heavy user of financial instruments, real estate has suffered a great deal from this. All mortgages (commercial or residential) and swaps are linked to LIBOR or the European equivalent of EURIBOR. This means the sanctity of a reference point central to all bank lending has been compromised. By definition because LIBOR is a reference point, the economics of how this transactions have been working is a zero sum game. As a result, this means that banking institutions have directly benefited at the expense of all of their customers. Unlike overselling products, unscrupulous insurance protection and pushing imprudent LTV levels there are no extenuating circumstances in this episode of the banking saga.

It is such a massive issue no one in the media quite knows how to critique what happened. That the LIBOR manipulation might have affected the borrowing rate of the banks for their emergency facility is really only the very tip of the iceberg. It affects everything. To make this clear, theoretically if the banks had to repay all the proceeds that have accrued from the LIBOR manipulation there is no government on earth that would be able to bail them out.

Perhaps because of this all-encompassing nature of failure of honesty we are heading for some sort of compromise, as it is not feasible to have the clock turned back. So what reforms will emerge out of this and what are the implications for the real estate industry? First, there will be a great deal more law suits holding up the foreclosure of a mortgage and / or an enforcement of a charge on a property. This will add to the expense of investing in distressed real estate. Secondly, lawmakers will seek a more mechanical sampling of the borrowing rate. Although this is praiseworthy as an initiative, as ever with legislation it is doubtful it will make the system work better. The lending rate is not a machine but a test of people's willingness to borrow and lend to one another in the name of their respective institutions. Get rid of the 'people' from the equation and you will have a useless measure that does not correlate to what people will end up doing. Thirdly, this episode will only encourage the bunker mentality of bankers that will make them less open to issuing credit to their counter-parties as well as to their clients. This will further hamper liquidity in the wider market and slow down the lending and borrowing process, which broadly speaking will act as a drag on asset prices.

All in all this is a difficult time for banking, as well as real estate investing, which could be characterised as 'junior banking'. But if banking is to regain an honest broker status it needs to stop fiddling with the tills. No one should complain about reward for putting capital at risk. Reward for risk can always be justified, pick-pocketing cannot.

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