Case Study 1:

'The Gherkin'

The iconic building at the heart of London's financial district seems in most respects to be a success story. 30 St Mary Axe (to give it its correct name) has 40 floors of fully-let office space, and is home to a number of prestigious and high-profile firms, including the highly-regarded business team of satellite broadcaster Sky News.

However, an in-depth look at the financing of the building reveals a depressing story. One of the firms who bought The Gherkin in 2006 was a German fund manager, IVG Private Funds, who financed part of the purchase with a loan denominated in Swiss Francs. The reason seemed logical enough – Swiss interest rates were lower than other comparable alternatives at the time. However, IVG did not have a readily available supply of Swiss Francs, so they relied on purchasing them in the market whenever an interest payment was due.

That was the root of the problem. As the global crisis worsened during the following years, many global investors switched to the Franc, raising its value sharply against other currencies. Between October 2007 and August 2011, the Franc strengthened by more than sixty percent against the Euro and, as IVG was only partially hedged, this represented a huge increase in their funding costs (as their purchases of expensive Francs required an ever-increasing amount of weakening Euros). This additional cost far outweighed the benefit of borrowing at Swiss interest rates.

That might have been the end of the story, but The Gherkin's owners had also entered into interest rate swap contracts with a number of mainly German banks. This strategy would have protected them if interest rates had risen, but instead the opposite happened – rates fell, leaving IVG and the other owners facing additional compensation payments to the banks with whom they had entered into the swaps.

The sorry story reached breaking point in late-July 2014, when the lenders called in the receivers and the Gherkin was put up for sale.

It is difficult to make a complete list of everything that went wrong, or of the mistakes that were made: relying on exchange rate forecasts, failing to identify even very basic risk exposures, entering into wrongly structured and inappropriate interest rate swap contracts, and so on. In many ways, this case provides an object lesson in what NOT to do when faced with market exposures of this kind.

To discuss how problems like this can be avoided, please e-mail us by clicking here.

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