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“Homeowners consistently overestimate the value of their homes.”

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IF YOU’VE EVER house-hunted, you’ve probably got a sense that real estate purchases don’t represent consumers at their most rational. Did you like a house or apartment more, or less, depending on whether it was sunny the day you saw it? Chances are, you did.

Buying a house isn’t the same as buying a stock, an air conditioner or even a car. It’s not just a product with pluses and minuses—good school system versus small kitchen, new roof versus longer commute. A house represents the kind of life you want to live. And given its cost, a house and the value it gains or loses represent in a very concrete way the life you will be *able* to live. Thus, it’s both unsurprising and disturbing to realize our judgment about real estate is susceptible to many of the foolish forces that affect so many other consumer decisions—and in some ways, it may even be more affected.

Research by Michael Seiler, a professor at Old Dominion University, has found that both men and women (though particularly men) are susceptible to the attractiveness of a female real estate agent. The more attractive the agent, the more the buyer is willing to pay. What’s more, superficial things like a room painted an ugly color can make people less

likely to buy a house—even though fixing such a problem is as cheap as a couple cans of paint.

What’s more troublesome, though, is how attached our minds get to the perceived values of our houses. In one study, economists David Genesove and Christopher Mayer looked at the spectacular bust in condominium prices in Boston in the early 1990s. When a market goes south—as the national housing market did

recently—standard economics tells us that sellers should recalibrate their expectations and behavior, knowing they’ll have to sell for less.

Of course, this isn’t how our brains work. Instead, we’re susceptible to loss aversion—the mental quirk by which we feel losses much more sharply than we feel equivalent gains. So we set the price of our property not by what the market will bear, but by what we paid and what we feel we “have to” get out. People who bought at or near the peak of the Boston condo boom listed their properties for around 35 percent more than those who had bought lower. Consequently, those overpriced properties sat on the market; fewer than 30 percent had sold after 180 days. Another wrinkle: Owners who also lived in the units exhibited about twice as much loss aversion as people who had bought them as investment properties. A home, it seems, makes us more irrational than a house.

It doesn’t take a boom or bust to trigger this phenomenon: A more recent paper finds that homeowners consistently overestimate the value of their homes by 5 to 10 percent. The only cure for this seems to be buying one’s home during a slump; in fact, these buyers may underestimate their home’s value. Buyers getting in now, then, may be at a cognitive advantage for years to come. Boom buyers, meanwhile, have to come to terms not just with economic losses, but with psychological losses and regret. ☺



HOME IS WHERE THE HEAD IS

Research shows that consumers struggle to stay rational when buying or selling homes. Some examples:

The New Curb Appeal: It’s not just the paint job—the more attractive the real-estate agent showing a house, the more the buyer is willing to pay.

Refusing to Lose: People who buy homes near the peak of a boom tend to list them at high prices, even if that means they don’t sell. Blame it on “loss aversion,” which makes us acutely feel and fear losses.

Mine’s Better: Homeowners consistently overestimate the value of their homes by 5 to 10 percent. The only group that’s an exception: those who bought during a slump.

👉 **Ryan Sager’s Money & Your Mind appears twice a month at SmartMoney.com.**