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Modeling the behavior of real asset prices

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Abstract

Recently there has been much research treating housing and other real assets as financial claims, primarily in order to value their derivative assets, such as mortgages and mortgage-backed securities. Real asset prices are then typically modeled as a lognormal process, in the same manner that has traditionally been applied to firm value. The service flow or implicit value of a house is thus considered, in analogy with stock dividends, to be a fixed proportion of the fluctuating house price. We consider the appropriateness of this formulation and draw some distinctions between real assets, such as a house, and investment enterprises, such as a firm. We then propose an alternative method of formulating the service flow and the price of real assets which seems more appropriate to the economic characteristic of such assets.



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