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Mental Accounting and False Reference Points in Real Estate Investment Decision Making

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Abstract

This study examines a number of behavioral finance issues as they relate to real estate investments. We find a statistically significant degree of mental accounting at all points throughout the disposition effect curve when holding a real estate investment in isolation versus holding the asset as part of a mixed-asset portfolio. We also identify four distinct disposition curve shapes beyond the traditional “S-shaped” curve, where investors are more willing to sell an asset that is in the gains domain. Furthermore, we conclude that an investor's willingness to sell jumps by the greatest amount when going from zero return into profitable territory. Finally, this false reference point does take into consideration transaction costs.

Keywords:

Notes

1. They might well even become risk seeking in their betting patterns with “house money” (see Ali [1977], McGlothlin [1956]).

2. It is necessary to specify the maximization function as an absolute value because, as demonstrated in Table 2, the willingness to sell can decrease or increase as the return on the asset increases.

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