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ARTICLES

Familiarity Bias and Perceived Future Home Price Movements

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Abstract

This study empirically confirms the existence of the status quo deviation aversion hypothesis, but not increasing status quo deviation aversion, in people who own their primary residence. The examination was conducted in the 20 Case-Shiller Metropolitan Statistical Areas across the country. The results are systemic and do not vary substantially by demographic characteristics. However, variations are noted with different levels of real estate knowledge, income, purchase motive, relative home tenure, and excess relative housing risk.

Keywords:

Familiarity bias | Behavioral real estate | Status quo deviation aversion | Increasing status quo deviation aversion

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Notes

1. Thaler [1993] refers to “behavioral” finance (real estate) as “open-minded” finance (real estate). It can no longer be ignored that not all market participants behave with 100% rationality 100% of the time. In a more definitive statement, Shleifer [2000] concludes that people's deviations from rationality are pervasive and systematic.

2. It can be counter-argued that an independent appraiser will provide an objective evaluation of the property thus nullifying the drawback of a homeowner's familiarity bias. However, appraisals are only measures of current values. Appraisals are not forward looking and do not incorporate future expected risk and return. This is something the homeowner needs to assess in order to make intelligent sell or refinance/mortgage choice decisions.

3. It is important to note that familiarity bias is not just a problem that affects an individual homeowner in isolation. When it becomes commonplace, contagion may set in and influence market conditions and outcomes for the entire U.S. economy, even those homeowners not subject to such biases (Harding, Rosenblatt, and Yao [2009], Lin, Rosenblatt, and Yao [2009], Rogers and Winter [2009], Immergluck and Smith [2006]).

4. All of the above are potential pitfalls associated with errors in risk assessment. We leave it to future studies to directly link these errors to transaction-based market biases in decision making.

5. The return on homes in large MSAs is not materially different from the return on homes in small MSAs. Only price levels are notably different.

6. Case and Shiller [2003] suggest the increased use of surveys in behavioral research. However, Toshino and Suto [2004] criticize many past behavioral studies because the concepts are tested in an experimental setting with students as the convenience

sample. Our study conforms to both these ideals. It is a survey that does not suffer from convenient student sample problems.

7. The need to augment an existing database or create a new dataset through the use of a survey is common in behavioral financial research because surgical precision is often needed to ferret out the idiosyncrasies of behavioral biases and natural laboratories for doing so are few and far between (Baker and Nofsinger [2002]). See recent studies such as Grinblatt and Keloharju [2009], Kumar [2009], and Kaustia, Alho, and Puttonen [2008].

8. http://www.sca.isr.umich.edu/

9. Collected weather related variables include the amount of rainfall, temperature, dew point, humidity, barometric pressure, wind speed, wind direction, wind gusts, visibility, and various weather conditions such as clear sky, scattered clouds, partly cloudy, mostly cloudy, overcast, haze, fog, light drizzle, light rain, heavy rain, light thunderstorms, thunderstorms, and dust storms.

10. This number compares with the University of Michigan surveys that utilize a sample of roughly 500.

11. Examples of consumption words include “family, comfort, warm, safe, welcoming, and relaxing,” while investment words include “money, upkeep, return, mortgage payments, investment, and equity.” If at least one word from both lists is used, the observation is classified as both consumption and investment.

12. Unfortunately, we have no way of properly differentiating between true knowledge and the self-reported level of knowledge we ask about on the survey. That is, a humble true expert in real estate might self-evaluate his knowledge of real estate to be a 7 on the scale from 1 to 9, when in fact it is a 9. Conversely, an overconfident, or arrogant, person might self-report a value of 7 when the reality is that their true knowledge should be rated a 5 (average knowledge). In the design of the test instrument, we considered asking several real estate general knowledge questions. A quiz on real estate is a better way to ascertain true real estate knowledge. However, respondents completed this survey in the comfort of their own homes on their computer. Having the Internet at one's disposal would have likely done more to bias the variable than improve it. One potential solution is to try to control for the “Wikipedia Effect” (Chira, Adams, and Thornton [2008]) by standardizing the total time it took to complete the

survey—a variable we have full data for down to the second. However, we find survey completion times vary tremendously and are not associated with response patterns to the variables included in our sample. This variable is best measured by having respondents take a proctored quiz without outside resources, but gathering 500 homeowners in an auditorium is an unlikely scenario.

13. Byrnes, Miller, and Schafer [1999], Harris, Jenkins, and Glaser [2006], and Powell, Schubert, and Gysler [2001] also find that gender differences are model-specific. Therefore, it is difficult to make accurate ex ante predictions as it relates to gender.

14. The theory supporting the inclusion of this term is further explained in Keller et al. [2005].

15. In a large sample like ours, we can offer no rational explanation for why people should systematically believe their home will perform better than homes across the street.

16. We also test using the Case-Shiller index. However, while Case-Shiller is calculated for the MSA and the overall country (a 10-city and a 20-city index), it is not calculated for each state. For both consistency and to avoid spatial aggregation issues, we use the Freddie Mac CMHPI return and volatility throughout our regression analyses.

17. We do not include macro-economic variables in the neighborhood regressions because data at such a micro level are not available. For example, returns to one's house relative to the returns that accrue to each neighborhood are understandably not readily available.

18. All aggregate data was gathered from http://www.ce–nsus.gov/hhes/www/housing/hvs/historic/index.html

19. A paired-samples T-test reveals that the increase in not statistically significant. The t-statistic is 1.255 and the corresponding p-value is only 0.210.

20. In addition to the results shown here, we also estimated the model controlling for respondent fixed effects. Specifically, 19 dummy variables were included to represent the 20 MSA from which all respondents hail. The results are not sensitive to the inclusion of these nonsignificant dummy variables.

21. The results are not sensitive to the substitution of a GLS procedure like the Cochrane-Orcutt method of accounting for correlation in the residuals.

22. We acknowledge that since the level of real estate knowledge is self-assessed, we could also be capturing a measure of overconfidence to some degree.

23. Relative income (personal income divided by the median income within the MSA) was also considered based on the work by Kumar [2009]. Results between income and relative income are qualitatively similar.

24. Although not reported, consistent with Massa and Simonov [2006], we also considered AGE2 in one specification to try to capture a non-linear relationship. This variable was not significant.

25. We also created a dummy variable to test for “sunny” weather (not just for bad weather) in case the weather effect is asymmetric. The sunny dummy variable is not significant.

26. Woodcock and Custovic [1998] share that people in industrialized countries spend 93% of their time indoors. It has been suggested that our null weather result might be a function of people not being affected by weather because they remain inside most of the time. However, Keller et al. [2005] find that the effects of weather are extremely consistent across groups who spend their time outdoors versus indoors. As such, we discount this as a likely explanation of our null weather finding.

27. Even though a full year has yet to pass, we performed a preliminary analysis to determine if respondents were correct in their assessment that their homes, as proxied by MSA, performed better than the rest of the state and country. Our weighted results show slight underperformance. We further segmented by those reporting relative home appreciation values above 5 versus below 5. The above 5 group did perform slightly better. However, both groups were still slightly negative.

28. In the case isolating responses within the 5 category, it is not possible to perform T-Tests because there is no variation in the responses.

29. Two additional neighborhood regressions were estimated after splitting the sample for responses strictly above 5 and strictly below 5. The results are not materially different from the regression reported in Table 3 and are therefore suppressed for the sake of brevity. Note that it is not possible to perform a regression for the only 5 category as there is no variation in the dependent variable.

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