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ECONOMIC VIEW

A Reality Check for Home Sellers

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People who refuse to sell their houses for less than they paid for them are violating a cardinal rule of the market: stuff is worth what it's worth.

ECONOMISTS and other humans don't always see eye to eye. "Economists tend to think people are crazy because they won't sell their houses for less than they paid for them — and people think economists are crazy for thinking things exactly like that," said Professor Christopher Mayer, director of the Paul Milstein Center for Real Estate at Columbia Business School and an authority on real estate economics.

With house prices falling in many markets around the nation, this particular quirk of the human psyche might end up costing the economy a great deal, Professor Mayer says.

Classical economics can't explain this behavior. That's because people who refuse to sell their houses for less than they paid for them are violating a cardinal rule of the market: stuff is worth what it's worth. It doesn't matter what you paid for it. But when Professor Mayer and his co-author, David Genesove, a professor of economics at the Hebrew University in Jerusalem, studied the Boston condominium market in the 1990s — scene of one of the biggest real estate busts in recent American memory — the actual patterns of human behavior did not seem to follow the standard rules at all.

From 1989 to 1992, prices in Boston fell sharply, with condominium prices dropping as much as 40 percent. For a great many of those who bought condominiums during that period, selling could be done only at a significant loss. And, basically, many people refused to sell.

Their study, "Loss Aversion and Seller Behavior: Evidence From the Housing Market," appeared in The Quarterly Journal of Economics in November 2001. The professors gathered data on almost 6,000 Boston condominium listings from 1991 to 1997 and showed that for

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essentially identical condominiums, people who had bought at the peak and were facing a loss generally listed their properties for significantly more than those who had bought at a time when prices were lower.

Properties listed above the market price just sat there. In the Boston market over all, sellers listed their properties for an average of 35 percent above the expected sale price, and less than 30 percent of the properties sold in fewer than 180 days. In other words, much of the market went into a deep freeze as many people held out for market prices that no one would reasonably pay.

In classical economics, that's not supposed to happen, but the episode did comport with the behavioral economics theory of loss aversion: people have a visceral — some might say "irrational" — hatred of losing money. They try to avoid doing so, even when it goes against their own best interests.

Move ahead to September 2007. Many regions may be starting down a path like that of Boston's market freeze of the 1990s. Wherever prices decline, look for lots of sellers holding out for unrealistic prices in a vain attempt to recoup their losses. It's a hang-up that people have, and it can cause big problems. A number of houses with high prices just sit on the market while everyone waits.

One source of difficulty arises from a basic fact of real estate economics: about half of home purchases are by people moving within a metropolitan area. If sellers can't sell their houses because they want too much for them, they also can't become buyers of new homes.

"The buyers and the sellers are the same people in this market," Professor Mayer said. "So if the sellers price so high that they, effectively, put themselves out of the market, it shows up on the buying side, too."

He notes that economists at the Federal Reserve and elsewhere keep close tabs on this kind of behavior because the purchases of durable goods like furniture, appliances and televisions tend to run hand in hand with home purchases — and durables have a disproportionate influence on the business cycle. Further, because the freezing of the housing market makes it harder for people to move, it reduces the likelihood that they can quickly relocate for higher-paying jobs. Dysfunction in the housing market can spill over into the job market, too.

So by being hung up about whether your condominium will sell for what you paid for it, you aren't just driving yourself crazy trying to get a buyer. You may be threatening the very performance of the economy and driving up the unemployment rate — provided that many others behave in a similar way.

What is to be done? **Well, if you are holding out for an above-market price to recoup your losses, perhaps you would do well to hear the advice that Professor Mayer gives his own family members.**

"If you want to sell your house then you list it at the market price and you sell it," he said. "If you don't really want to sell then don't put it on the market. But don't *say* you want to sell and then set the price so high that you spend the year cleaning up every morning, having people walk through your living room and look in your medicine cabinets and reject you. That's just painful — and expensive."

His research offers a simple lesson for everyone out there waiting for a high price to push them back into the black: Get real.

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