

MANSION

SPREAD SHEET | SANETTE TANAKA

WHEN MONEY DOESN'T ADD UP

'Money illusion' leads people to embrace real-estate gains at face value, even if reality turns them into a mirage



Home sellers, be warned—that attractive house price might be nothing more than an illusion. Many home buyers and sellers fall prey to the phenomenon of “money illusion,” says Lucy Ackert, professor of finance at Kennesaw State University in Kennesaw, Ga., who studied money illusion in residential real estate. Money illusion occurs when people think in terms of nominal values rather than real values—meaning, they consider the face value of money instead of its actual purchasing power.

In other words, homeowners who sell their home for a higher dollar amount than what they bought it for see themselves as coming out ahead—even if inflation eats the gains.

“Homeowners don’t think in

real terms. They think in nominal terms. Many people would prefer a situation where they have a real loss, than a real gain and nominal loss,” Prof. Ackert says.

Prof. Ackert and co-authors Bryan Church and Narayanan Jayaraman of the Scheller College of Business at Georgia Tech presented 141 homeowners in suburban Atlanta with four scenarios in October 2005, near the height of the housing bubble. The researchers then determined respondents’ propensity to fall prey to money illusion. Their study, “Is There a Link Between Money Illusion and Homeowners’ Expectations of Housing Prices?” was published in Real Estate Economics in May 2011.

Prof. Ackert noted that respondents weren’t disillusioned about the price of their house—77% had realistic expectations about their area’s home values. Most respon-



Anna Parini

DOLLAR DREAMS

Researchers described four scenarios to 141 homeowners in suburban Atlanta to measure how susceptible they were to money illusion:

**78%** recognized that real returns in income or earnings mean that people are better off, but...

**77%** believed that people are happier if they are ahead in nominal terms.

**77%** had realistic expectations about their area’s home values, but...

**45%** were not opposed to buying a house outside a family’s budget.

Source: Real Estate Economics, May 2011

dents also understood that a person is better off financially if real returns are higher.

But, in keeping with money illusion, people base happiness around nominal values—77% of respondents believed that a person is happier if they are better off in nominal terms, even if real returns decreased.

Why does nominal win out? Simply put, it’s easier to think that way, says Alan Cooke, a marketing professor at the University of Florida, who studies consumer decision-making.


“People tend to expend as little mental effort as necessary to make a particular decision. So, if you have the opportunity to consider things in nominal terms rather than real terms, that’s what people will focus on first,” says Prof. Cooke, adding that people will put more effort into making decisions that they see as more important.


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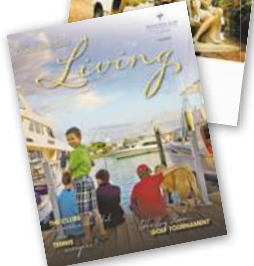
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