

Editorial: Real estate, investment decisions and behavioural finance

Journal of
Property
Investment &
Finance

265

The core of what we teach on real estate investment programmes remains rooted in corporate finance and, at the heart of that, is some idea of market equilibrium, where prices converge to fundamental levels as a result of the actions of rational, utility-maximising agents. Of course, we caveat that with cautions about the nature of commercial real estate markets – it's a private market with information asymmetry, costly and noisy information and heterogeneous assets, the limits to arbitrage and so forth. Yet, there is still an embedded idea that in the long run, rational decisions will win out, mispricing will be reversed and investors will move towards rational portfolio holdings.

That idea and those core theories also underpin much of the real estate investment and finance research in mainstream journals – they shape our projects and research questions and the way that we approach research problems – even when we are critiquing those very theories. Anomalies are failures to conform to the expectations driven by those corporate finance theories. Mispricing assumes there is (or should have been) a correct price somewhere.

When we observe market practice (assuming that we *do* observe market practice and do not remain in our ivory towers) doubts surely should set in. Finance 101 tells our graduates that the starting point for capital budgeting decisions should be discounted cash flow and that NPV is superior to IRR. Yet IRR dominates NPV and rules of thumb and heuristic metrics are everywhere. We teach them to focus on systematic risk: they micro-adjust their property yields. Asset values rise up to levels that cannot be explained by rational models and then crash back down. Funds leverage up at the top of the market.

One response to this comes from critical social science, rejecting rational utility frames and emphasising power and class relations – particularly in the concept of financialization. My concern with this literature is that much of it seems to replace the idea of a representative agent with the equally abstract concept of a representative financial capitalist, with little room for nuance, difference or what drives the individual actors in that market. However, that's not my focus here.

The other main response has come from behavioural finance and behavioural economics, where individual behaviour and information processing deviate from the rational utility, full-information models of traditional corporate finance, arguably with systematic impacts on market outcomes. This work has generated many insights into market practice and, while initially resisted, is increasingly featured in mainstream finance journals and in more specialist field outlets such as *JPIF*. In many ways, the specialist journals provided an early platform for behavioural finance, paving the way for acceptance in the mainstream.

Much of the behavioural work in real estate markets claims a lineage from Kahneman and Tversky and their co-workers, with prospect theory pointing to the importance of framing, risk-aversion, anchoring and other influences that change the nature of decision-making. Much of this rests on a dual processing model of thinking (where intuitive, heuristic decisions interact with more measured analytic processes). Elsewhere [1], I have argued that too much of this work presents a misleadingly incomplete view of mainstream financial economics and ignores much of the behavioural insights already there in the foundational work (behavioural factors feature in Adam Smith and are important in Keynes). Here, I want to pose a different question: Is prospect theory the best starting point for considering *corporate* decision-making?

The insights from prospect theory apply very much to *individual* decision-making and much of the best work comes from consumer and retail markets (including major financial decisions such as house purchase or investment allocations). There has been a shift, too, in more recent research, to moving beyond the identification of “biases” to exploring the channels that cause and sustain those biases, the psychological and cognitive origins – at the



Journal of Property Investment &
Finance
Vol. 43 No. 3, 2025
pp. 265-267
© Emerald Publishing Limited
e-ISSN: 1470-2002
p-ISSN: 1463-578X
DOI 10.1108/JPIF-04-2025-241

2025 American Finance Association conference, this was being dubbed Behavioural Finance 3.0, although this seemed to encompass many different directions from brain scanning experiments through to mathematical models of political polarisation.

How applicable is it, though, in professional investment markets? Individual decision-makers are set within an institutional structure, with colleagues, reporting lines, rules, clients and performance measurement, and they must make repeated decisions within that framework. Those making sub-optimal decisions should not thrive in competitive markets. If those individual behavioural traits are to have a systematic impact on market outcomes, then we need to understand the mechanisms that allow that to happen – which means looking in detail at *firm-level* decision-making, structures, recruitment, incentives and interactions.

Aspects of the commercial real estate industry would make an excellent case study for such work. Given the large lot sizes, it is largely a market for professional investors and advisors, yet its nature as a private market creates information uncertainty and noisy signals. Many of the firms active in the market are relatively small, creating more scope for individual agency, with powerful individuals driving investment decisions less encumbered by rule-driven processes. Yet, there are global advisory firms and major institutional and private equity funds operating, which one might expect would lead to arbitrage in mispriced markets. What, then, might drive deviation from expected rational investment behaviour?

What might such a research programme look like? There are many possible routes, none of them simple or, necessarily, easy to publish. A starting point might be to chronicle the processes that occur within firms and funds. As an example, what actually happens in investment committees? To what extent do the quantitative appraisals that we teach drive the decisions and to what extent do individuals and heuristics override the models? Equally, what are the processes by which assets come to investment committees? Where are they sourced, what are the filters applied to exclude assets and how do those filters get set and amended? This becomes particularly important when a fund pivots from one strategy to another – what underpins that switch and who drives it?

In a sense, this points to a focus on learning processes within (and across) firms and the way in which information is sourced and processed. There are a number of avenues here suggested by the behavioural and cognitive literature about the way that information, ideas and views are transmitted within social and business networks, which include the role and importance of strong and charismatic leaders (influencers!), models of information cascades and the concept of rational inattention. This last is potentially promising since it moves from the standard Grossman and Stiglitz idea that information is costly to one where information is plentiful but attention time is limited – so decision-makers focus on signals that reinforce their prior beliefs and discount others, in a form of confirmation bias. These ideas have been applied in financial economics with some success and link also to a growing literature on polarisation [2]. From where do real estate professionals source their ideas? This is a separate question from where they source their data, their comparables and their benchmarks.

If one accepts that individual beliefs and attitudes play an important role in the making of decisions and the framing of investment strategies, then this might point to the role of personality. Again, there is some literature to guide research from the corporate finance world that links the attitudes of managers to corporate decisions. This literature also suggests that finance professionals have different psychological profiles than the general public: more competitive, more optimistic and less risk-averse, scoring higher on the psychopathy scales (less truthful, more selfish and less caring) [3]. Would this hold for real estate professionals? Almost certainly! This literature also links to research on overconfidence, which brings us back to a Kahneman and Tversky framework. What channels cause this psychological differentiation? It could be self-selection (that is the choice of industry by the job seeker), it could be imprinting (accepting and being conditioned by the views and practices prevalent in the firm or fund, with promotion and retention a function of holding such views) or it could be selection – by firm leaders selecting new workers “in their image” or even formalised through,

for example, psychometric testing. Research in this area would be difficult and sensitive but potentially very rich.

Research along these lines would also augment studies examining deviation from expected behaviour under rational utility models, either from natural experiments or from direct experiments and survey work. I emphasise “augment”. These are parallel research lines. But so too is that larger body of work that seeks to model the dynamics of markets, pricing processes, factor risk and so forth. If I were to critique the behavioural literature in real estate, it would be that too much of it presents behavioural finance as mutually exclusive to mainstream corporate finance (this is still truer of the financialisation literature). They should be complementary, providing us with a richer and more nuanced understanding of decision-making processes in real estate markets.

Colin Lizieri

Emeritus Professor of Real Estate Finance, The University of Cambridge, Cambridge, UK

Notes

1. Lizieri, C. (2024) Individuals, Beliefs and Decision-Making in Commercial Real Estate Markets: Some Reflections from the Past, *Journal of Property Investment and Finance*, 42,1, 120–130.
2. For a review, see Maćkowiak, B., Matějka, F. and Wiederholt, M. (2023) Rational Inattention, A Review, *Journal of Economic Literature*, 61, 226–273; for a contribution to the polarisation literature, see Nimark, K. and Sundaresan, S. (2019) Inattention and Belief Polarization, *Journal of Economic Theory*, 180, 203–228.
3. For example, Graham, J., Harvey, C. and Puri, M. (2013) Managerial Attitudes and Corporate Actions, *Journal of Financial Economics*, 109, 103–121; Holmén, M., Holzmeister, F., Kirchler, M., Stefan, M. and Wengström, E. (2023), economic preferences and personality traits among finance professionals and the general population, *Economic Journal*, 133, 2949–2977.