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When Should You Invest in a Condominium?
Making Investment Timing Decisions Based on an Income Capitalization Criteria

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Abstract

In this paper we provide a framework for determining the optimal holding time of an investment in condominiums and developed real estate projects in general. We first estimate a fundamentals based linear regression model to forecast the current rent of a condominium. The forecasts from the regression, occupancy rates, expenses, and capitalization rates then provide us with an estimated appraisal value of any particular condominium in the downtown Tokyo area. This estimated appraisal value is compared to the market price to assess whether the property is undervalued. We then assume that the dynamics of the condominium value is governed by a Ho-Lee type model and provide a simple numerical example. We obtain the future condominium value via a Monte Carlo simulation and derive the probability that the condominium value will exceed a particular target value. The probabilities provide us with benchmark information for the investor in timing their investment decision.

Key Words: Income Capitalization, Monte-Carlo, Optimal Hitting Time

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