Theoretical Analysis of the Liquidity Risk of the Property: Using Bargaining Theory

By Dr. Shunichi Maekawa
Meikai University, Faculty of Real Estate Science
8 Akemi, Urayasu, Chiba, 278-8550, Japan

Abstract

The purpose of this paper is to examine theoretically the liquidity risk of the property using bargaining theory, in the case where the property owner searches the buyer, exhibiting the listing price in the property market, and bargains with him who may buy the property for the listing price.

We defined that the liquidity risk consists of the liquidity cost and the uncertainty of the transaction price. According to the bargaining model, in the general, the expected profit of the transaction in the actual property market is smaller than that in perfect competitive market, because of the searching cost and the bargaining cost in the actual property market. Therefore, the liquidity cost can be defined as its difference.

And according to the bargaining model, the transaction prices in the actual property market are more volatile, because each player has to bargain with the counterpart player with the incomplete information in imperfect competitive market and each player's reaction is relatively slow. Therefore a property owner's listing price may be volatile.

1. Introduction

If the property market is perfect, the property owner can immediately sell the property to a buyer for a reasonable price whenever he wants to sell it. However, the property market is imperfect, it takes much time for the property owner to search the counterpart player in the bargaining and to conclude the bargaining with him because of the limited number of buyers and imperfect information about counterpart players, and the property owner has to spend much money for the search and the bargaining. Also, transaction prices of the properties at the time would be volatile because of the volatility of each player's reservation price and the incomplete information about the counterpart player in the bargaining.

Therefore, in the actual property market, the property owner's expected profit of