ALTERNATIVE INVESTING

Confronting Information Asymmetries: Evidence from Real Estate Markets

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This article examines the importance of asymmetric information in commercial real estate markets in the U.S. Using indirect information variables and exogenous variation in the quality of property tax assessments to characterize high and low asymmetric information environments, we find strong evidence that asymmetric information is significant in the commercial property market. Not all the mechanisms suggested by theory, however, are used to resolve these information issues.

We observe striking and clear evidence of limited participation, selecting offering and market segmentation. We find weak evidence that financial structure is used to allay information concerns. In effect, we find that in equilibrium, informed agents trade with each other, avoid trade with identifiable experts, and avoid selling properties that are particularly difficult to evaluate. In this context, signaling using financial structure is superfluous and is typically not employed.

Our approach differs from earlier empirical work in that we conduct direct tests of some of the fundamental implications of information theory using a novel and exogenous information measure based on the quality of property tax assessments.

This article shows that in responding to information disparities, economic agents first take direct action by not purchasing assets about when they are uninformed, focusing on assets that are easier to evaluate, and avoiding trades with the identifiably informed. Extending these results suggests that one might be cautious about regarding static financial structure choices as a device for minimizing information asymmetries, as this seems of second-order importance to limited participation, selective offering and market segmentation.