How Should We Measure Residential Property Prices To Inform Policy Makers?

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Paper Abstract: The real estate sector plays an important role for the real economy, the financial system, financial stability and not least the monetary transmission process. However, unlike the case of residential property, official data on commercial property markets are hardly available. This asset class is usually defined through the intention to generate profit from its possession. The focus is thus more investment-oriented than in the case of owner-occupied residential property. Commercial objects are frequently categorised by their main forms of usage. Common clusters include: office property, retail property, industrial property and – if held for commercial purposes – residential property.

The IMF included commercial property prices in its Financial Soundness Indicator set (IMF 2006). In spite of this, due to limited data availability and methodological difficulties, official indicators on commercial property have hardly been published yet. The IMF and the Financial Stability Board brought up this issue again in their report on the financial crisis and information gaps to the G-20 finance ministers and central bank governors and recommended the collection of price indicators on commercial property (FSB 2009). As one result, an international conference on commercial property price indicators was jointly organised by the BIS, the ECB, Eurostat, the IMF and the OECD in June 2012 (ECB 2012). Eurostat envisaged the compilation of a "Handbook on Commercial Property Price Indicators" with the intention of defining the methodological framework for reconciling the efforts towards an indicator set at an international level, in order to eventually bridge the data gap. A workshop on this handbook was organized in September 2014.

This paper argues that, despite the quest for swiftly disseminated indicators, it is of utmost importance to set up a valid and reliable methodological framework first. The various data users make substantially different demands on the index concepts. These, in turn, need to be tailored for the distinctive purposes. For instance, investment performance indicators serve the specific purpose to provide a benchmark for investors and fund managers for commercial property investment portfolios. This is a very different purpose than measuring the price changes of commercial property. Therefore, the paper seeks to work out a stylised framework for assessing performance-based measures in comparison to price measures. We provide a simplified model which formally treats prices and performance indicators in a single, unified framework. This will

allow a better understanding of the links between the two indicators and, most particularly, the limitations of performance measurement. The analysis then turns to gauging the distortion that arises from treating performance based measures as price measures. Selected data uses are reviewed thereafter. The final section concludes and outlines the challenges ahead.