Idiosyncratic Risk in Returns to Housing *

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Is idiosyncratic risk priced in residential real estate markets? I examine this question using a novel micro-level data set covering the universe of housing transactions in major German cities over the past four decades. I show that properties with higher levels of idiosyncratic risk are sold at a discount and that total returns to housing increase with the level of idiosyncratic risk. Additionally, I also find that this measure of idiosyncratic risk is strongly correlated with the degree of standardization of the property- the less standardized the property, the more uncertain its value is, and therefore the lower the price. These findings are rationalized by the fact that less standardized properties have less liquid markets and are susceptible to more dispersion in private values.

Keywords: housing markets, household portfolios, asset returns
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