MONOPOLY PRICES IN THE REAL ESTATE MARKET DEVELOPMENT AND WAYS TO ELIMINATE THEM

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Abstract. In the real estate market, there are examples of bilateral monopoly in special situations related to the position and the configuration of the property. Typical cases are the trading involving: extra ordinary properties that are taken away from the normal interactions between supply and demand; landlocked funds and/or residual surfaces that get a certain value only if connected to neighboring properties. A model that summarizes the framework within which supply and demand move and interacts is defined, in order to identify a possible break-even point of the respective utilities.

Keywords: break-even point, utility theory, real estate market, bilateral monopoly.

Introduction: When the property for sale is an asset not reproducible or non-replaceable (for example with reference to the use of a complementary properties1), to determine the trading price it is possible to assume that supply will be able to exercise bargaining monopoly power. It is true, however, that once the property placed on the market – due to the constraints imposed2, its location3, or its physical characteristics4,5 – the bargaining power of supply has to deal with a single interlocutor interested in buying property.

This is the hypothesis that defines the framework in which the model of interaction between supply and demand is developed for the definition of a likely trading price. This condition can be treated, with respect only to the phase of negotiation, as a scheme of bilateral monopoly.

In fact, in these conditions, the balance cannot be derived from an analysis conducted in terms of the marginal-productivity theory6,7, that is, building the curves of supply and demand, cost and marginal revenue. Since this is a property not replaceable or reproducible, within a quadrant that has the abscissa axis the quantity and on the ordinates the price, these curves would be infinitely rigid in quantity.[1]

They would be as vertical lines with opposite directions (upwards the supply, starting from the minimum price for the sale, down the demand, starting from the maximum price for the purchase).

The solution appears at first sight indeterminate; the only obvious statement concerns the possibility that the exchange takes place or not. That is, given the level of the maximum price that demand is willing to pay and the minimum price level that supply is willing to accept, an indispensable condition for the start of trading is that the first is greater than the second8. The equilibrium, i.e. the price fixed for the exchange, is then determined by non-economic factors such as the bargaining power, strategies, etc9. From these premises and based on assumptions about the behavior of supply and demand a model that defines a probable equilibrium has developed. The balance is sought by resorting to measures of the utilities arising from exchanges and identifying the likely break-even point.

With reference to the Italian traditional theory of appraisal10, it should be noted that in this case the estimate of the equilibrium price is not generally valid. It is rather the expression of a specifically judgment formulated in relation to: 1) the specific nature of the property, 2) the subjectivity of the actors, 3) the relationship between them and the asset, 4) and the different motivations that cause the exchange.[2]

Balance in the exchange:

The interest of the study is aimed at defining a probable equilibrium in a two-bargaining which is between a private entity interested in investing to enhance a particular property and another party willing to alienate it.

The exchange will be the result of negotiation between the parties, if they reach an agreement on the equivalence between the resource and a quantity of money. It is evident that this equivalence should be referred to two different utility functions that have different measurement scales. The one and the other party measures the utility derived from the exchange using the monetary parameter, but each gives to this parameter a different marginal utility in relation to his economic capacity.

The unknowns of the problem are initially three: the maximum price that demand is willing to pay (*PMaxD*), the minimum price that supply is willing to accept (*PMinO*) and the equilibrium price.

It is possible to define the first unknown building a financial analysis of the cash flows associated with the investment. In other words, you need to determine the value that can ensure the profit expected by the investor with regard to the intervention of exploitation, processing or union with other property. Placing *NPV* = 0, and finally setting the discount rate equivalent to the "opportunity cost" of the investment, the only unknown is the *PMaxD* (initial outlay for the purchase of property).

$$P_{MaxD} = \sum_{i=0}^{n} \left[\frac{R_i}{(1+r_d)^i} - \frac{C_i}{(1+r_d)^i} \right]$$

[3]

For the solution, namely to estimate the other two unknowns - the minimum price supply is willing to accept and the equilibrium price - has built a linear system involves two equations and two variables. The two equations both represent the condition that is the basis of the model: the equilibrium is defined by the break-even point of the weighted utilities of the two parties. This condition, however, is described with different approaches: one analytical the other graph. For each of the approaches are valid, the following hypothesis, but it should be noted, there is no interaction or relationship between them:

1. The first hypothesis involves a simplification of the mechanism that describes the real interaction between supply and demand. It requires not consider any non-economic factors that determine financial exchange; i.e. it is not brought into account an eventual thrust psycho-sociological that can induce a greater or lesser propensity to the exchange.

2. The second assumes the perfect symmetry of the information. Each of the two parties know the economic capacity of the other and is therefore able to measure its bargaining power, or more realistically, this information is known to the expert called upon to estimate the likely equilibrium price or to mediate between the parties.[4; 5]

Conclusions: The model defines the balance likely in a pattern of bilateral monopoly able to approximate the actual conditions characterizing the exchange of properties in the real estate market. It considers supply unable to achieve any profits by the property that in turn forces to support a cost of conservation. However, given its physical and qualitative characteristics, or the location of the property, supply and demand are both able to exercise bargaining monopoly power.

A number of assumptions that simplify the mechanism of interaction between supply and demand, the definition of the basic parameters used to represent the different bargaining power of the players involved in the exchange and an original formulation allow to give solution to a problem apparently indefinitely.

First step of the model is to determine the maximum limit of the range within which the price will be fixed eventually (maximum amount that demand is willing to pay). The lower limit of the same range (minimum amount that supply is willing to accept) together with the equilibrium price are the unknowns of a system of two linear equations. The writing of these equations is derived respectively from two types of approaches to the same problem (one analytical, the other graph): the breakeven point of the weighted utilities of the two actors involved (supply and demand).

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