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Asset Pricing, Real Estate and Public Finance over the Crisis

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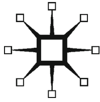

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Preface

The recent and continuing economic instability demonstrates how excessive financial innovation can cause a global crisis if investors are not able to correctly evaluate new financial instruments and business models adopted by financial intermediaries.

The real estate industry was the first sector affected by a price bubble driven by excessive demand for housing that pushed the price of real estate units above their fair values. Due to the high relevance of mortgage-backed securities (MBS) and collateralized bond obligations (CBOs) in financial intermediaries' balance sheets, the crisis spread across all the financial markets and the price of almost all assets was biased by the pessimistic views of investors and the lack of liquidity. Even bonds issued by governments with an excessive amount of debt were affected by a loss of investor confidence that caused a significant increase in the cost of capital and the probability of default of the issuer. In this new scenario, investors have been looking for the best criteria to measure the value of their investments independently with respect to any irrational market behaviour.

During the crisis, financial markets have shown the increasing role played by investor sentiment in the price definition mechanism and higher volatility of returns. In order to develop profitable investment strategies, investors have to consider the impact of qualitative data and news on the value of financial instruments.

The increasing risk of default of the Sovereign demonstrates lack of knowledge about their risk drivers and proves the usefulness of a more detailed analysis of issuer characteristics for selecting investment in the fixed income sector.

The trend of the real estate sector during recent years supports the thesis of the lack of transparency and quality in the information available in the direct investment market and demonstrates the usefulness of a more detailed evaluation procedure for selecting the best indirect investment.

This book is intended as a tool for policy makers, practitioners and scholars to understand and discuss the new issues related to value measurement in the financial markets. It looks separately at the asset management industry, Sovereign bonds and the real estate market. It is the result of extensive academic experience and strong theoretical and empirical work conducted by the authors, all engaged in research activities in their universities. Most contributors are participants in the PhD programme in Banking and Finance at the University of Rome 'Tor Vergata'.

Ideas and preliminary drafts of the papers relating to the research programmes from which this book was assembled have been presented and discussed in various academic workshops and international conferences. These include ADEIMF (2009, Palermo); AISRe (2011, Turin); European Real Estate Society (2010, Milan); Global Business Conference of Finance Research (2010, San Jose de Costarica); International Finance and Banking Society (2011, Rome); 5th International Symposium on Economic Theory, Policy and Applications (2010, Athens); 8th International Conference on Applied Financial Economics, (2011, Samos); 20th International 'Tor Vergata' Conference on Money, Banking and Finance (2011, Rome).

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Abbreviations

ADF	Augmented Dickey Fuller
AFIN	financial autonomy
AIC	Akaike Information Criterion
AIMP	fiscal autonomy
ANN	artificial neural network
ARIMA	Autoregressive Integrated Moving Average
B–L	Black and Litterman
BPN	back propagation neural network
Burke	Burke ratio
CAIC	Consistent Akaike Information Criterion
Calmar	Calmar ratio
CBO	collateralized bond obligation
CDS	credit default swap
CIG	conditional independence graph
CIU	Collective Investment Undertakings
CO	operating costs
CVAR Ratio	conditional value at risk ratio
DAG	directed acyclic graph
DARaP	Decile Average Risk adjusted Performance
DJIA	Dow Jones Industrial Average index
DW	Durbin Watson
E(RV)	expected recovery value
EAD	exposure at default
ECB	European Central Bank
ECM	Error Correction Mechanism
EGARCH	exponential generalized autoregressive conditional heteroskedasticity
EL	expected loss
ELR	expected loss rate
EMH	efficient market hypothesis
FDI	foreign direct investment
GARCH	generalized autoRegressive conditional heteroskedasticity
GDP	gross domestic product
GLS	generalized least squares
HIC	Hannan and Quinn test
I/B/E/S	Institutional Brokers' Estimate System
ICT	Information and Communication Technology
IDR	Issuer Default Rating
I.I.D.	independent and identically distribute

IMC	Investment Management Company
INDL	local debt per capita
IPO	initial public offering
IRR	internal rate of return
Kappa (n = 3)	Kappa corrected for skewness
Kappa (n = 4)	Kappa corrected for asymmetry
Ke	cost of equity
LAFP	loan arbitrage-free pricing
LGD	loss given default
LRG	local and regional governments
M	maturity
MACD	Moving Average Convergence and Divergence
MBS	mortgage backed securities
MCOR	current balance
MLP	multilayer perceptron
MPT	modern portfolio theory
MVAR ratio	modified value at risk ratio
PD	probability of default
PF	Project Finance
PILL	local GDP per capita
PMN	positive minus negative words in the news
RAROC	risk-adjusted return on capital
RE	real estate
REITs	real estate investment trusts
RMSE	root mean square error
ROA	Return on Asset
ROAS	Return on Absolute Shortfall
ROE	Return on Equity
ROPS	Return of Probability Shortfall
SALD	net borrowing respect to total revenues
SDEB	expenditure on loans repayment
SEC	Security Exchange Commission
Sharpe	Sharpe index
Sharpe	Omega Sharpe Omega ratio
SIC	Schwarz test
SING or SINT	spending on debt
SME	small and medium enterprises
Sortino	Sortino ratio
SSCA	Supervisory Slotting Criteria Approach
Sterling	Sterling ratio
SUR	seemingly unrelated regressions
SVAR	structural vector autoregression
TA	total assets
TEV	Tracking Error Volatility
TIT	internal transfer rate
UL	unexpected loss
VAR	Value at Risk ratio