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Cities as Assets

Abstract:
We extend the canonical CARA-Gaussian overlapping-generation asset pricing model to include location decisions and real estate pricing. Agents differ in city-specific productivity levels and in their ability to keep up with technological innovations. They choose where to live and how much to invest in housing and stocks. We consider two types of frictions: labor income is not insurable and housing consumption has to take place where the agent works. We characterize the equilibrium (location decisions, investment decisions, and real estate prices) as a function of catch-up coefficients, namely the effect on different cohorts of productivity shocks. We use the model to discuss home bias in portfolio allocation and the hump-shape pattern of home and stock ownership over the life-cycle. The model yields predictions with regards to the (mis)allocation of talents across cities.