



ARE 528 REAL ESTATE MANAGEMENT



Real Estate Management

Economics of Real Estate

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Outline



Real Estate Management

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Introduction 1/3

Real Estate Management

- ❖ The professional property manager must understand real estate economics if clients' properties are to be administrated successfully.
- ❖ Real estate represents the largest single segment of the nation's wealth. It has been estimated that two-thirds of the country's wealth is composed of land, land improvements, land resources; and it is this wealth that attracts investors.
- ❖ Real estate is a major influence in the total economy. In addition to the real estate business, it has an overwhelming influence on the mortgage banking and saving and loan industries, life insurance and construction industries, and the building trades.



Introduction 2/3

Real Estate Management

- ❖ If this construction industry experiences a recession, the economy as a whole will falter. When housing starts decrease, the sale of consumer goods to furnish these houses also decrease. The result is a national economic slowdown.
- ❖ Equally important, in many countries, real estate is the tax basis of local governments.
- ❖ Because of its versatility, real estate is recognized by economists and business leaders as a key force in assuring national prosperity.



Introduction 3/3



Real Estate Management

- ❖ During the slack times, real estate can stimulate the national economy. When business is moving too rapidly, real estate controls are employed to slow down the economy, i.e., through a tight money market and higher interest rates.



Real estate market 1/5



Real Estate Management

- ❖ A *market* is best defined as a meeting of people for the purpose of trading through private purchase or sale,
- ❖ Thus, a success in any business requires familiarity with the market in that particular field.
- ❖ The successful property manager, then, must understand the nature of the real estate market, be able to recognize market trends, and know what makes a market strong or weak.
- ❖ A direct relationship exists between the real estate market and the operation of income property.



Real estate market 2/5



Real Estate Management

- ❖ Renting is selling, just as land brokerage is selling. Since the property manager's sale (i.e., renting or leasing) generally does not involve title transfer to a new owner, and because space must be resold as it become available, the property manager's interest in the real estate market is actually greater than the real estate broker's.
- ❖ Although real estate may be purchased either for use or investment, the occupants of a property-as apposed to its owner-are the ultimate users.
- ❖ Economically, then, real estate may be classified as a consumer good rather than a capital good.
- ❖ The economic wellbeing of the real estate industry depends more on consumer conditions than on capital markets.



Real estate market 3/5



Real Estate Management

- ❖ To support the above point, because people use buildings, people determine real estate values.
- ❖ This relationship depends not only on the number of people but also on their purchasing power, state of mind, social status, and, in some cases, why they are present at the location of the property.
- ❖ A multistory building would have no value in the center of the Sahara desert, little value in a small town, a fair value in a small city, but it would be worth a fortune on New York's Park avenue.
- ❖ The value would differ not because of the land under the building but because of the effect of people on the earning power of the land.



Real estate market 4/5

Real Estate Management

- ❖ Consequently, since the value of real estate depends on its location, value must be considered principally on a local level.
- ❖ Real estate markets are subject to 11 factors. Six of these may be termed factors of cause, and the other five factors of effects.
- ❖ The factors of cause are more important, because they bring about major developments in the real estate market.
- ❖ Factors of effect are lesser, but still valuable, indicators of the same economic conditions.
- ❖ Complete knowledge of these factors is essential to an appraisal of real estate conditions and the trends they may produce.



Real estate market 5/5

Real Estate Management

- ❖ Information concerning all of these factors should be compiled on a regular basis. Five factors of cause and four factors of effect depend on local data; only two are national in scope.



Factors of causes

Real Estate Management

❖ The six influences on the real estate market are:

1. *Supply and Value of Money.*
2. *Occupancy.*
3. *Rental price level.*
4. *Local eviction suits.*
5. *Employment level.*
6. *Family formation.*



Factors of causes- *Supply and Value of Money* 1/1

Real Estate Management

❖ The six influences on the real estate market are:

1. *Supply and Value of Money.*

❖ The purchasing power of the dollar or any currency and its availability for real estate transactions is important in setting the tone of property markets.

❖ The influences of cost, availability, and value of money are sufficiently important to the price, value, and earning power of real estate.

❖ Thus, a further study of the effect of money will be discussed later.



Factors of causes- *Occupancy* 1/11

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy.*

❖ The law of supply and demand operates as surely in the real estate industry as in any other commodity market.

❖ Therefore, the total number of units available for occupancy (supply) and the number of tenants who are able to pay the current rent level for these units (demand) must be considered in a study of the real estate market.

❖ One fallacy concerning real estate is that there is a normal vacancy level for each property type.



Factors of causes- *Occupancy* 2/11

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

❖ It once was believed that real estate, on the average, would be unoccupied ten percent of the time.

❖ Recently, the normal vacancy level was set at five percent.

❖ However vacancy is in a constant state of flux, so the concept of normal vacancy level is suspect.



Factors of causes- *Occupancy* 3/11

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

❖ In applying the law of supply and demand to real property, managers must recognize that there are two distinct types of oversupply that may result in increased vacancies:

1- Technical oversupply

2- Economic oversupply



Factors of causes - *Occupancy* 4/11

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

❖ Technical oversupply arises when there are more property units in a given community than there are consumers for them.

❖ It seems that technical oversupply exists only in isolated communities in which a declining population produce the condition.

❖ Economic oversupply, on the other hand, is caused entirely by the inability to pay current rents. This condition occurred during the depression.



Factors of causes- *Occupancy 5/11*

Real Estate Management

- ❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

- ❖ Within this context, the term “shortage” can also be explained.
- ❖ Technical shortage exists when there are more consumers than units.
- ❖ Economic shortage exists when there are more able-to-buy consumers than units.
- ❖ Since the real estate is affected by the number of applicable units available, an inventory study should be given substantial weight in analyzing the market.



Factors of causes- *Occupancy 6/11*

Real Estate Management

- ❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

- ❖ However, the property manager’s knowledge of occupancy should be based on a study of occupancy trends rather than current status.
- ❖ Occupancy levels are never stationary: they fluctuate up or down.
- ❖ Which way and how fast they move have a direct bearing on the property manager’s planning and merchandising policies.
- ❖ Occupancy levels and their movement are a significant concern of management.



Factors of causes- *Occupancy* 7/11

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

- ❖ An upward trend indicates a strong market.
- ❖ while a downward trend indicates weakness.
- ❖ In any case, the public - not the manager - sets the tone of the market. The public will be a ware of this though rent advertising and “for rent’ sale.
- ❖ Noting these indications, consumers resist rent increases or make greater demands for services at renewal time (decorating and equipment).
- ❖ Property managers and owners must cope with the situation the best they can.



Factors of causes- *Occupancy* 8/11

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

- ❖ In period of high occupancy, during these times, managers raise rents, tighten negotiations, and reduce optional services.
- ❖ These conditions present two rules:
 1. Rental market decline is directly proportional to the renting public’s awareness of increasing vacancy.
 2. A corollary rule is that in periods of increasing occupancy, rent reductions due to high vacancy are terminated when the public becomes conscious of the changing trend.



Factors of causes- *Occupancy 9/11*

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

- ❖ While the emphasis here is on residential property, these theories apply to all types of properties, commercial and industrial as well.
- ❖ In other words, high occupancy always implies market strength, and low occupancy suggests weakness.
- ❖ Occupancy data is of fundamental importance to market analysis. Thus, the manager must maintain a systematic record of its trend on a quarterly basis at least.



Factors of causes- *Occupancy 10/11*

Real Estate Management

❖ The six influences on the real estate market are:

2. *Occupancy (continued)*

- ❖ Several sources of occupancy data are available in studying the local housing situation.
- ❖ Using statistics of census periods, for example the U.S. Department of Commerce issues a report which lists vacancies by region for both homes owned and rental accommodations.
- ❖ Also, data on office building occupancy is provided annually by the Building Owners and Managers Association (BOMA).



Factors of causes- *Occupancy 11/11*

Real Estate Management

❖ The six influences on the real estate market are:

2. Occupancy (continued)

❖ Store occupancy is relatively easy to estimate, since vacancies are obvious.

❖ Other sources of data include:

❖ local power companies, which can provide the ratio of idle meters to total units; and

❖ a property manager's own vacancy statistics, which indicate the kind and trend of occupancy.



Factors of causes- *Rental level 1/5*

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❖ The six influences on the real estate market are:

3. Rental level

❖ While occupancy shows the relationship between supply and demand at the current rental level, rental price level shows the economic strength of the existing real estate situation.

❖ Rental price cannot be controlled. It moves upward and downward in response to supply and demand.

❖ There are two types of rent raises

1- Nuisance raises

2- Economic raises



Factors of causes - *Rental level*

2/5



Real Estate Management

❖ The six influences on the real estate market are:

3. *Rental level (continued)*

- ❖ A nuisance raises is an adjustment based on the property manager's appraisal of the amount a tenant will pay to avoid the expense, discomfort, and inconvenience of moving.
- ❖ Rather, it is an estimate based on familiarity with local conditions.
- ❖ The manager being in the position of determining the fairness of the actual increase.



Factors of causes- *Rental level* 3/5



Real Estate Management

❖ The six influences on the real estate market are:

3. *Rental level (continued)*

- ❖ An economic rent raise is based on the existence of shortage and requires exploration of two questions:
 - 1- When does the market reach the point of shortage required for economic rent raises?
 - 2- How is the level of rents to be related to consumer income?
- ❖ Another lesson can be learned; that is, there is no fixed relationship between the level of residential rents and family income.



Factors of causes- *Rental level 4/5*

Real Estate Management

- ❖ The six influences on the real estate market are:

3. *Rental level (continued)*

- ❖ Rent is essentially an independent factor, governed by its own law of supply and demand and fluctuating with occupancy trends.
- ❖ The fact remains that the scale of rentals may be raised (maybe 25 to 40 percent of family income) whenever shortage appear.
- ❖ However, such provisions serve only as palliatives, since real rents still depend on the occupancy trend.



Factors of causes- *Rental level 5/5*

Real Estate Management

- ❖ The six influences on the real estate market are:

3. *Rental level (continued)*

- ❖ Sources of data, for property manager can be though
- ❖ Public statistics(collected by the Decennial Census of Housing) on rental rates paid by occupants.
- ❖ Individual statistics (also may be useful in spotting trends) the manager and the other properties managers analyze the data they have and find the averages and the trends.
- ❖ Managers also might analyze rental rates given in classified advertisements.



Factors of causes - *Local Eviction Suits*

1/2



Real Estate Management

- ❖ The six influences on the real estate market are:

4. *Local Eviction Suits*

- ❖ Tenant credit is important in market analysis because, when tenants become delinquent in their rent payments, they do so in relation to current economic conditions.
- ❖ Most tenants pay rents promptly, except when economic conditions produce layoffs and rising prices.
- ❖ A monthly check on eviction suits filed by landlords because of tenants' failure to pay rent is a reliable indication of tenant credit.



Factors of causes - *Local Eviction Suits*

2/2



Real Estate Management

- ❖ The six influences on the real estate market are:

4. *Local Eviction Suits (continued)*

- ❖ The manager should be aware that not all eviction suits are because of rent not paid.
- ❖ Statistics on eviction suits are maintained by the local courts in which these suits are filed.
- ❖ The number of cases should be recorded monthly, since this is a reliable indicator of local tenant credit.



Factors of causes- *Employment Level* 1/4

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❖ The six influences on the real estate market are:

5. *Employment Level*

❖ A market analysis should incorporate those statistics that identify trends of consumer spending.

❖ The real estate analyst must answer at least three questions:

1- How many consumers are in the able- to- buy category?

2- What is the trend of their earnings?

3- How do they feel about spending versus saving?



Factors of causes- *Employment Level* 2/4

Real Estate Management

❖ The six influences on the real estate market are:

5. *Employment Level (continued)*

❖ Monthly statistics issued by the U. S. Department of Labor are most important in answering the first question.

❖ These statistics disclose (by geographical distribution) the total number of people available for work, the number of persons currently employed, and the ratio of the unemployed to the total labor force.

❖ By comparing these data with the latest census data, a manager may determine the number of housing units per employed person and draw accurate inferences about housing demand.



Factors of causes- *Employment Level* 3/4

Real Estate Management

❖ The six influences on the real estate market are:

5. *Employment Level (continued)*

- ❖ Also, information about the number of people collecting unemployment insurance and other forms of public assistance indicate consumer strength or weakness.
- ❖ In answer to the second question, consumer gross purchasing power can be estimated from trends in consumer income by using statistics and compare that with the consumer price index.
- ❖ Consumer savings are another indication of consumer attitudes.
- ❖ In times of declining public confidence, consumers save more and spend less as protection against an uncertain future.



Factors of causes- *Employment Level* 4/4

Real Estate Management

❖ The six influences on the real estate market are:

5. *Employment Level (continued)*

- ❖ These actions are reflected in all rental markets, including commercial, industrial, and residential.
- ❖ The professional who gathers and utilizes these data will be ahead of competitors on market information and will earn respect from both clients and colleagues.
- ❖ Appropriate data may be obtained from local employment offices of the U.S. Department of Labor.
- ❖ Information regarding public assistance programs is available from municipal, county, and state welfare agencies and from the U.S Department of Health and Human Services.



Factors of causes - *Family Formation* 1/2

Real Estate Management

- ❖ The six influences on the real estate market are:

6. *Family Formation*

It is basically concern the social issues which effect the life styles in a country

- ❖ Formerly, the number of marriage licenses indicated the formation of family units of some permanence, predictable as to size, growth, and composition.
- ❖ In recent years, the Bureau of the Census has applied the term *household* to all persons who occupy a *housing unit*, that is, an apartment, a group of rooms, or a room that constitutes “separate living quarters”.



Factors of causes- *Family Formation* 2/2

Real Estate Management

- ❖ The six influences on the real estate market are:

6. *Family Formation (continued)*

- ❖ A household includes related family members and all unrelated persons, if any, such as lodgers, foster children, wards, or employees who share the housing unit.
- ❖ A person living alone or a group of unrelated persons sharing the same housing unit also is considered a household.
- ❖ Following Census Bureau data will give indicators about the sizes of the units needed in the future.



Factors of Effect



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- ❖ The five factors of effect are widely accepted indices of real estate conditions; which are:
 1. *Foreclosures*
 2. *Mortgage volume*
 3. *Building activity*
 4. *Real estate sales*
 5. *Real estate securities*



Factors of Effect



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- ❖ Two views emerge on measuring the strength or weakness of the real estate market.
- ❖ One estimates that level of activity in real estate is the key to understanding the fluctuations in its values.
- ❖ The other view claims activity in itself is unimportant and that other factors (those of effect) must be considered for a broader perspective.



Factors of Effect- *Foreclosures*

1/3



Real Estate Management

1. *Foreclosures*

- ❖ An increase in the number of mortgage foreclosures indicates an inability of real estate to pay its debts.
- ❖ Mortgage holders file suit against debtors only when interest and principal payments are delinquent, usually because the mortgaged property or the owner cannot earn sufficient money to make payment.
- ❖ A study of foreclosures, then, will confirm trends already observed from studying the factors of cause.



Factors of Effect- *Foreclosures*

2/3



Real Estate Management

1. *Foreclosures (continued)*

- ❖ In other words, when occupancy and rental levels decrease and the purchasing power of the dollar increases, when there are fewer marriages and more tenants are evicted, it is clear that real estate is losing its earning power.
- ❖ This loss of earning power leads first to unpaid debts, then to creditors taking legal action, i.e., foreclosures.
- ❖ Statistics on the number or dollar volume of foreclosures are not universally available.



Factors of Effect- *Foreclosures*

3/3



Real Estate Management

1. *Foreclosures (continued)*

- ❖ This information may be obtained, however, from the courts, possibly a local agency (e.g., a title agency), or legal journals.
- ❖ The lack of foreclosures does not guarantee prosperity. However it shows that real estate is paying its debts. Possibly because lenders prolong the periods of the debts payment.



Factors of Effect- *Mortgage*

1/2



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2. *Mortgage Volume*

- ❖ Most loans reflect the lender's confidence in the borrower, in the security offered as collateral, or both.
- ❖ Loans made on real estate are no exception.
- ❖ Lenders must believe that the real estate is sound, that it will retain or increase its value, and that it can earn enough to ensure repayment of the loan.
- ❖ Increases in mortgage lending indicate confidence in the safety and desirability of real estate, but they do not create improved real estate conditions.



Factors of Effect - *Foreclosures*

2/2

Real Estate Management

2. *Mortgage Volume (continued)*

- ❖ When the trend is downward and the factors of cause are unfavorable, mortgage volume will be lower, fewer lenders having the confidence to make loans.
- ❖ Mortgage lending is adversely affected by rising interest rates; this was apparent in 1974 and again in 1979.
- ❖ In most counties, statistics are gathered on the number and dollar value of the monthly trust deed entries.
- ❖ If this information is not released by public authorities, it may be compiled and made available by savings and loan associations and mortgage bankers.



Factors of Effect – *Building Activity*

1/2

Real Estate Management

3. *Building Activity*

- ❖ In spite of the emphasis placed on construction as a factor in real estate prosperity, it cannot be considered a cause.
- ❖ Rather, it is a measure of the financial potential of vacant land.
- ❖ Large-scale building depresses the real estate market by introducing new supply and reducing the scarcity factor; this is true for both commercial and residential space.
- ❖ A high volume of building, therefore, may precede slack periods unless it is matched by a corresponding increase in demand.



Factors of Effect - *Real Estate Securities*

1/2

Real Estate Management

5. *Real Estate Securities*

- ❖ A security is an evidence of debt or ownership either given, deposited, or pledged in fulfillment of an obligation.
- ❖ A mortgage is a debt secured by real properties.
- ❖ RS securities refer to common or preferred stocks in corporation owning real properties, bond secured by RS, certificates of beneficial interest in RS ownership or debt.



Factors of Effect - *Real Estate Securities*

2/2

Real Estate Management

5. *Real Estate Securities (Continued)*

- ❖ Virtually all real estate investment securities are backed by large residential properties.
- ❖ The marketability and price fluctuation of securities are more changeable than the properties behind them.
- ❖ While real estate security prices do not cause property values to rise and fall, their price level does reflect changes in real estate value.



Real Estate Cycle

1/3

Real Estate Management

- ❖ Roy Wenzlick, a well-known real estate economist of the early 1930s. Wrote a book entitled *The Coming Boom in Real Estate*. He theorized that real estate activity experience peak-and-valley cycle every 17 to 20 years.
- ❖ This theory is based on historical records and under the assumption that the government is not managing the economy.
- ❖ Real estate still operates in cycles.
- ❖ The statistics of RS sales, mortgage lending, and new construction disclose periods of high activity followed by years in which it is markedly lower.

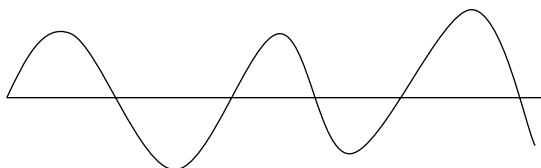


Real Estate Cycle

2/3

Real Estate Management

- ❖ But with government control, these cycles are shorter and the amplitude greater.
- ❖ The cycle is represented by a series of waves represent rises above normal activity and drops below it.



- ❖ When on the down side, real estate is in trouble:



Real Estate Cycle

3/3



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- ❖ Unemployment is on the rise, vacancy is increasing, rental and mortgage delinquency are edging up, real estate sales are off in number as well as price, new building is down, and family formation is on the wane.
- ❖ The reverse is true during recovery; two of the first indications are increasing employment and higher occupancy levels.



Real Estate and Money



Real Estate Management

- ❖ Money- its availability, cost, and value- is a deciding factor in the desirability of real estate as an investment.
- ❖ The monetary influence on real estate markets are so important that the property manager must have a basic knowledge of the history, nature, and function of money.



Real Estate and Money- *History of Money* 1/6



Real Estate Management

1. *History of Money*

- ❖ Any universally valued commodity used as a medium of exchange can be described as money as long as it is durable, scarce, and available. Gold met these requirements admirably. And it was used in ancient times.
- ❖ During the Industrial Revolution with its greater mobility and broader supply of goods, the problem of transporting gold arose.
- ❖ As a solution, goldsmiths stored this metal then issued receipts, or chits, for it.
- ❖ Chits issued by reputable goldsmiths were accepted as legal tender in lieu of the actual gold.



Real Estate and Money- *History of Money* 2/6



Real Estate Management

1. *History of Money (continued)*

- ❖ However, it was necessary to establish a world-wide unit of value against which individual currencies could be measured.
- ❖ In 1816, England established the gold standard, which meant that the government guaranteed that for each currency unit issued, a certain weight of actual gold had been stored in its vaults, so that on demand the holder of the currency could redeem paper money for gold.
- ❖ In colonial times, the English-speaking people called the Spanish peso the dollar. U.S. has adapted the dollar.



Real Estate and Money- *History of Money* 3/6

Real Estate Management

1. *History of Money (continued)*

- ❖ The Coinage Act of 1792 specified that dollars were valued at either 24.75 ounces of fine gold or 371.15 of fine silver.
- ❖ The first coins were minted in 1794.
- ❖ In 1837, and until the passage of the Gold Reserve Act of 1934, the standard was changed to one thirty-fifth of a troy ounce of gold.
- ❖ Under the Gold Reserve Act, citizens were prohibited from owning gold money, and the nation's currency was no longer redeemable in the precious metal.



Real Estate and Money- *History of Money* 4/6

Real Estate Management

1. *History of Money (continued)*

- ❖ At that time, both the United States and England abandoned the gold standard.
- ❖ Before that, a number of countries (including Russia, France, and Germany) had devalued their currencies by failing to maintain specified reserves.
- ❖ Instead, they printed fiat money (money not backed by gold or silver), which resulted in inflation.
- ❖ Political pressure on Britain and the U.S. to increase their money supplies resulted from the theories of John Maynard Keynes, an English economist.



Real Estate and Money- *History of Money* 5/6

Real Estate Management

1. *History of Money (continued)*

- ❖ According to Keynes, government could reverse the downward trend of its economy through spending programs.
- ❖ This spending would revive industry and commerce, restore general prosperity, and relieve unemployment.
- ❖ Keynes's followers believed that, once prosperity had been restored, government could gain its investment by increasing taxes on the accelerated volume of business and trade.
- ❖ Franklin Roosevelt adopted this theory in his economic policies.



Real Estate and Money- *History of Money* 6/6

Real Estate Management

1. *History of Money (continued)*

- ❖ Between 1942 & 1946, the federal deficit in U.S.A. totaled \$176.3 billion.
- ❖ In spite of this enormous expenditure, the U.S. dollar at the close of the war was the strongest monetary unit in the world.
- ❖ Out of this came the unprecedented largess of Marshall Plan, which provided massive aid to the recently defeated enemy as well as other foreign assistance programs.
- ❖ After 30 years, the need for the dollar was internationally weakened because of a negative balance of trade and domestic inflation due to import of oil and government over spending.



Real Estate and Money- *Inflation 1/2*

Real Estate Management

2. *Inflation*

- ❖ The terms inflation and deflation describe the relationship between money and goods.
- ❖ Inflation occurs when the money supply increase in relation to goods
- ❖ Deflation occurs when money declines in quantity and goods are comparatively scarce.
- ❖ In the late 1970s, the supply of money rose much faster than the supply of goods for two reasons.



Real Estate and Money- *Inflation 2/2*

Real Estate Management

2. *Inflation (continued)*

- ❖ First, the nation could not produce enough oil at home to meet its needs and was forced to import large quantities.
- ❖ Second, the government was spending money faster than it was being collected through tax revenues.
- ❖ Political pressure for welfare, education, health care, and disaster relief caused the government to create credit and currency in large amounts, further undermining confidence in the dollar.
- ❖ The consequence was inflation, and it reached an annual rate of more than 13% by 1979.



3. Real Estate as an Investment

- ❖ People acquire real estate for one of two reasons
 - 1- for use and occupancy.
 - 2- as an investment

- ❖ Considered as an investment, real estate is one vehicle for preserving wealth and providing an ongoing return.

- ❖ Alternatives for real estate investment include bonds, stocks, commodities, annuities, and other investment options.
(in terms of higher yield or appreciation of capital)



3. Real Estate as an Investment (continued)

- ❖ The problem that the dollars today are never in a deflationary state; they only grow cheaper.

- ❖ Until inflation is defeated, the best method of preserving wealth is to store it in property, either real or personal (gold, jewels, art works); in other words, to get "off" the dollar.

- ❖ The price and value of income property is controlled by the operation of money markets.

- ❖ Monetary criteria (interest rate), rather than real estate factors, control the value of income property.



3. Real Estate as an Investment (continued)

- ❖ For this reason, the impact of inflation must be weighed in making an investment decision.

- ❖ Assume an apartment complex cost \$3 million to build and was financed on a \$2.6 million mortgage (for long term) when one-bedroom unit rates were \$150.Ten years later, its one bedroom units were renting for \$275.

- ❖ If all the operating ratios remain the same, the debt is reduced proportionately by inflation alone.



3. Real Estate as an Investment (continued)

- ❖ It is believed that so long as values are based on money, the impact of inflation on real estate activity will be great.

- ❖ Based on these conditions, the investor should consider four questions:
 - a. What are the trends of money?
 - b. What will it cost to borrow money (interest rate)?
 - c. What % of the purchase price can be borrowed (leverage)?
 - d. How long should the loan be extended?



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3. *Real Estate as an Investment (continued)*

a. *Money Value Trends*

- ❖ **Month-to-month change in money values can be observed in government statistical reports covering consumer prices, producer prices for finished goods, prices received and paid by farmers, the money supply, and fluctuations in the interest rate.**

- ❖ **However, it is extremely difficult to project these statistics into longer-term future trends.**

- ❖ **Mainly ,due to government's intervention in economic affairs. and especially over spending for citizens economic benefits which will result in budget deficit and inflation.**



Real Estate Management

3. *Real Estate as an Investment (continued)*

a. *Money Value Trends*

- ❖ **Two predictions may affect money values.**

- ❖ **First, is that inflation can be brought under reasonable control by the government, despite complication presented by the energy crisis.**

- ❖ **Second prediction, is that inflation will continue to worsen until there is a monetary crisis which may force the government to change the currency values.**

- ❖ **Those people who own real or personal property, free and clear of dept, will continue to own it, but its value will be determined by the market in relation to the new currency.**



Real Estate and Money- *Money cost Trends*

1/2

Real Estate Management

3. Real Estate as an Investment (continued)

b. Money Cost Trends

- ❖ An economic student at a major university concluded in a thesis on interest rates that no one could predict fluctuations accurately.
- ❖ This conclusion seems justifiable, as there is no agreement whether interest rates will rise or fall from current levels.
- ❖ The property manager should be familiar with the arguments supporting increase or decrease in interest rate in order to make informed decision when problems arise.



Real Estate and Money- *Money cost Trends*

2/2

Real Estate Management

3. Real Estate as an Investment (continued)

b. Money Cost Trends (continued)

- ❖ The supply of and the demand for money actually determine interest rates.
- ❖ The experts do agree on at least one point: high interest rates discourage real estate activity.



Real Estate and Money- *Liberality of Lenders* 1/2

3. Real Estate as an Investment (continued)

c. Liberality of Lenders

- ❖ Lending terms become more liberal in recent years
- ❖ Since the early 1930s, loans for single-family houses have been affected by loan insurance because of government policy to encourage home ownership.
- ❖ The amount and terms of loans are determined by existing financial conditions and the real estate market.
- ❖ On other hand, during periods of above-normal vacancy, increasing foreclosures, and falling rent, lenders are conservative.



Real Estate and Money- *Liberality of Lenders* 2/2

3. Real Estate as an Investment (continued)

c. Liberality of Lenders (continued)

- ❖ The highest volume of loans was reached when both the real estate industry and the general economy prospered.
- ❖ Before arranging financing, the real estate manager should be aware of current economic conditions, remembering that the higher the loan-to-value ratio, the greater the potential profit to a borrower in an inflationary period.



Real Estate and Money- *Length of Term*

Real Estate Management

3. Real Estate as an Investment (continued)

d. Length of Term

- ❖ The average person is not well informed on the subject of loans and debt service payments.
- ❖ Because of the loan, the person may pay double the original amount.
- ❖ When mortgage interest rates were low, there was an advantage in making the lowest possible down payment and carrying the highest possible mortgage.
- ❖ However, with a mortgage interest rate in double figures and a monthly payment requirements in amortization, there is little likelihood of benefiting from long-term debt.



Real Estate Money Supply 1/2

Real Estate Management

- ❖ Some economists believe that forecasting business conditions requires close scrutiny of the nation's money supply (defined as the total amount of currency outstanding plus the total number of demand deposits in all of the nation's banks).
- ❖ The Federal Reserve Bank controls the money supply and thus is an important factor in the national economy.
- ❖ Real estate activity also is influenced by its own money supply.
- ❖ Real estate activity is stimulated when funds are available at reasonable rates.



Real Estate Money Supply

2/2

Real Estate Management

- ❖ A number of sources supply money for real estate. The main ones are:

1. *Saving and Loan Associations*
2. *Banks and Bank Holding Companies*
3. *Mortgage Banking Firms*
4. *Real Estate Investment Trusts*
5. *Corporate Conglomerates*
6. *Syndicates and Limited Partnerships*
7. *Pension Funds*
8. *Government*



Real Estate Money Supply- *Saving and Loan Associations*

Real Estate Management

1. *Saving and Loan Associations*

- ❖ Saving and loan associations are a major source of real estate capital.
- ❖ Because they rely almost entirely on the saving of the American people for the source of their funds, saving and loan associations respond to change in saving habits.
- ❖ Also they are affected by the competitive situation in the savings market.



Real Estate Money Supply- *Banks and Bank Holding Companies 1/2*

Real Estate Management

2. Banks and Bank Holding Companies

- ❖ Commercial banks traditionally have operated mortgage loan departments in conjunction with their saving departments, so they could offer mortgage to savers and retain their business.

- ❖ In addition, these banks make construction loans on income property once other lenders have committed to providing permanent financing.

- ❖ In the 1960s, the mortgage banking field was an important acquisition.



Real Estate Money Supply- *Banks and Bank Holding Companies 2/2*

Real Estate Management

2. Banks and Bank Holding Companies (continued)

- ❖ In the following ten years, most of the leading mortgage banking firms were bought by the numerous bank holding companies.

- ❖ The increase in the real estate money supply, from these sources, totaled countless millions of dollars.



Real Estate Money Supply- *Mortgage Banking Firms*

Real Estate Management

3. *Mortgage Banking Firms*

- ❖ Certain firms are in business as mortgage brokers, principally for life and other insurance companies that have large investment in real estate mortgage.
- ❖ These firms can place funds in long-term loans (20years and above), they are important sources of home and income-property loans.
- ❖ With the accelerating inflation of recant years, many life insurance companies protect themselves against loss of real capital from fixed-dollar loans through a practice known as “ a piece of the action”, i.e., participation in the ownership of the properties on which they are making loans.



Real Estate Money Supply- *Real Estate Investment Trusts*

Real Estate Management

4. *Real Estate Investment Trusts*

- ❖ The Real Estate Investment Trust Act resulted in the establishment of many real estate investment trusts (REITs) in the 1960s.
- ❖ They have advantage of tax relief for the investors in these banks.
- ❖ Public experience with REITs was disastrous, as had been the case with real estate bonds a generation earlier. (exaggerated estimates of earning)



Real Estate Money Supply- *Corporate Conglomerates*



5. *Corporate Conglomerates*

- ❖ Corporation in the industrial, commercial, and financial fields expand their operation into real estate.
- ❖ Because of lack of experience in RS, most companies withdraw from these investments.



Real Estate Money Supply- *Syndicates and Limited Partnerships*



6. *Syndicates and Limited Partnerships*

- ❖ Tax shelters for individuals have become popular protection from federal income taxes.
- ❖ Financial and real estate experts discovered that partnerships and syndicates, which act as conduits to pass tax benefits through to individual investors, could be extremely profitable.
- ❖ This option offered much higher after-tax yields than other forms of investment.



Real Estate Money Supply- *Pension Funds*

7. *Pension Funds*

- ❖ Just starting to have an impact on the real estate money supply are pension funds.
- ❖ Which hold assets for the payment of pensions to corporate and government employees and members of unions and other groups.
- ❖ These assets can be invested in long-term holding.
- ❖ However, largely as a result of a disappointing stock market, these institutions have begun to consider real estate. Especially conservative RS such as commercial centers.



Real Estate Money Supply- *Government*

8. *Government*

- ❖ The government has a major control in stimulating RS activity through control of money supply and housing programs.



Real Estate Management

THANKS