

# CHAPTER 2: PROPERTY, REAL ESTATE MARKETS, GOVERNMENT, MONEY AND FINANCE

## LAST CHAPTER REVIEW

The first chapter gave you an overview of how the book is arranged and how history has influenced present day customs, usage and laws in California. Then the types of properties that are managed in the specialized area of real estate called property management were reviewed. The basic benefits of owning different types of properties were also presented, to help property managers better match the owner with the appropriate type of property. You read brief accounts of today's organized, professional property management associations.

## CHAPTER OVERVIEW

In this chapter you learn about the different phases of a property's life cycle so this knowledge may be used for effective asset management. The effective age of a property may be extended with professional property management or shortened with deferred maintenance.

The strength of the real estate market is vital to the successful management of property. This includes knowledge about population, demographics, and political and social trends. The income and value depend a great deal on specific events that occur within the real estate market. The property manager needs to pay careful attention to the various factors that affect the market and the various indications of market strengths, weaknesses and changes.

Government policies and activities, at state, regional and local levels greatly influence and have a major impact on the real estate market as it affects real property. The property manager must see the relationship and consequences of the pace of the national economic growth and the amount of available international investment dollars. The global economy affects the viability for specific projects that the property manager proposes to an investor, manages for an investor, develops for themselves or others, and builds to create wealth.

Investors have alternatives. Money may be invested in non-real estate investments that make less capital available for real estate investments. Money is used as to purchase other goods and services and is treated as a commodity. The cost and availability of money affects real estate value, financing and the sources of that financing.

## Student Learning Outcomes:

As a result of studying this chapter, the student will be able to:

- Recognize the different phases of the life cycle of a property and describe income and expenses projected outcomes as a result of a particular phase.
- Define and describe the factors that determine the value of property.
- Differentiate value among residential, non-residential, agricultural, commercial and industrial property.
- Analyze how government influences, economics and politics affects a property being managed.
- Discuss the international, national, regional, local aspects that affect property management.

## 2.1 THE LIFE CYCLES OF REAL PROPERTY

**Initiation.** The initiation phase of the life cycle is the creative period when the most choices are available and the most questions must be answered. This is the phase that includes obtaining commitments for funding the project and meeting with architects, surveyors, contractors and decorators and designers. The property manager must be able to accurately predict the performance of a project at this point. The construction or rehab is just beginning and capital expenditures are large.

**Introduction.** The introductory phase is the period when the operating expenses are at their highest. Pre-sale advertising, lease-up fees, bonuses and move-in incentives are major expenses. A high level of property management expertise is required to decrease losses from expenditures that net little results, and to avoid poor marketing that leads to prolonged vacancies. Property management ensures that this phase is kept to the shortest time period as is possible.

**Growth.** The growth phase is the period of time from the first move-in to the break-even point of the financial operations of the building. The income increase the most during this phase, when the property manager's projected rent-up schedules are met. This phase should proceed on a specific, pre-designed program, reviewed regularly with all staff members to ensure support and adherence to the projected targets and goals for the project.

**Maturity.** The maturity phase lasts the longest. This period is when stable income flows meet on-going operational costs. This phase can be extended for many years with careful attention to complete on-going maintenance programs, tenant education and personnel training. Adhering to long-range ownership goals enhances the performance of a building in the maturity phase.

**Decline.** The decline phase of a building's life is when the majority of the building's components are so old that they are obsolete. Rehabilitation can be done only if the potential income would offset the high cost of modernization. These buildings usually attract tenants who are willing to give up amenities in exchange for lower rents. As the building continues to decline, it attracts even poorer tenants. Maintenance expenses are very high during this phase. Schematics, expertise and replacement parts are often lacking, so repairs are rarely possible at a reasonable cost.

**Demise.** The demise phase is that stage in a building's life where the value of the raw land far exceeds the cost to maintain the existing structure with its current use. The property's income cannot meet its expenses. When one pipe is repaired, the next crumbles. The quality of tenants willing to live in these structures may add to the extra cost of keeping these old buildings in place. Overcrowding is common. The "slumlord" building that may be pictured in the news is generally in this phase. The highest and best use of the land is no longer the present structure and the current usage.

Redevelopment agencies specialize in areas where demise-phase structures exist. Rezoning, special loans to build and other incentives are often available for these non-profitable properties.

## 2.2 FACTORS AFFECTING THE REAL ESTATE MARKET

Like most other commodities, a property's value is affected by the supply of and demand for real estate in the marketplace. Thus, a property manager must understand the real estate market to maximize a property's value and income. There is a direct relationship between the value of a property and its ability to earn income. When determining the value of property (i.e., setting rental rates), there are several factors the property manager should consider, especially for the residential rental real estate market: (1) money supply, (2) occupancy rates, (3) rental prices, (4) employment level and (5) family unit formation. Non-residential, agricultural markets would be

affected by (a) demand for the crop, (2) crop production, (3) water shares, rainfall and similar costs of production. Non-residential commercial markets are more influenced by (1) business formations and business failures, (2) industry trends, including international markets, (3) competition and labor costs, (4) cost of production, such as utility and energy consumption costs, and (5) green factors such as environmental issues. These factors, in turn, influence the outward signs of strength in the real estate industry: (1) foreclosures rates, (2) mortgage volume and interest rates, (3) building activity, (4) sales activity. Some of these factors are discussed below.

The various measurements of the real estate market are watched vigilantly by differing organizations. For example, housing starts are watched closely by the U.S. Department of Commerce, while private mortgage insurers and the FHA and VA keep careful track of mortgage foreclosure rates. The real estate sales figures are watched by industry organizations, such as the National Association of Realtors® and the Mortgage Bankers Association®.

**Supply side economics.** The greater the supply of the item and the less the demand for the item, the less the value; the less the supply and the greater the demand, the greater the value.

How much the dollar is worth and how available it is for use in real estate transactions has an obvious impact on the value of property. If people had to pay all cash for property, as was the predominate method of land purchases from the beginning of this country until less than 100 years ago, the cost would be lower. Today, if few people are willing to invest their money in real estate, the value of real estate will decline. Conversely, when people do not favor alternative investments, due to higher risk or safer returns, the value of real estate increases when there are more buyers than properties that are available in the marketplace.

The total number of units available for occupancy in the area and the total number of potential tenants able to pay rent for those units also affects the real estate market, referred to as the occupancy rate. Occupancy levels are constantly fluctuating. The direction and speed in which they are moving will have a significant impact on the property manager's operating and merchandising policies.

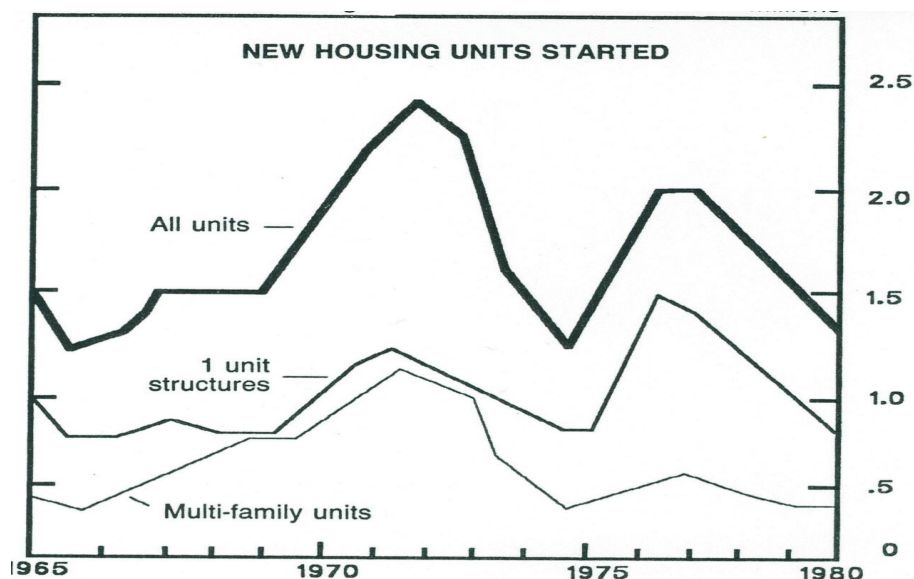
Another supply side economic factor when studying residential properties are the issues surrounding family size and lifestyle. Family size has a great deal to do with the value of particular residential units. Assume that the average family size is three (two adults and one child). In these circumstances, five-bedroom units will have little appeal and two-bedroom units will be very attractive. Therefore, the two-bedroom units will command a higher price per square foot than the five-bedroom units. It is important that the property manager be aware of the nationwide trend toward smaller and even single person households and also any peculiarities in local family size trends. In California, larger family units are more common due to the large immigrant population, and higher rental rates that often cause unrelated persons to cohabitate to reduce their living expenses, called doubling up.

The basic rules of supply and demand apply to rental properties much the same way as the affects on the real estate sales market. A basic demand side would include the turnover rate, which is the frequency with which new tenants move into and out of a unit. High rates add wear and tear to the premises and increase maintenance expenses, advertising costs, and frequently indicate the need for training of a leasing agent. Another demand side factor is the absorption rate, which is the rate at which new units are rented from the time they become available in the market. When managing an existing building that is in direct competition with new construction vacant units, different strategies would need to be utilized.

**Demand side economics.** One of the strongest demand side economic factors is local employment. The property manager should be aware of where local tenants work and the projected local employment trend. If a potential tenant can afford higher rents but is seeking lower rents to save funds towards a car purchase or a home purchase, a unit may get priced out of the market. The basic questions the property manager will want to answer are:

- 1) How many tenants are in the able-to-rent-at-the-current-rate category?
- 2) What is the trend of their spending (up or down) versus saving?
- 3) Are local industries expanding, experiencing lay offs or moving out of area?

Generally, an increase in population, which has been a constant on a long-term basis in California, means higher rents, which increase property values. New employment opportunities generate increased immigration (both foreign and domestic) and with an increased population there is increased demand. Increased demand causes a rise in the rental rates. In turn, as the income increases, so does the value of the building. The higher the rental income and the higher the net operating income, the higher the value of the building. The higher the building value, the more opportunity investors have to make profits. Builders can more easily attract investors. As rents and building values increase, more housing units are constructed. As more units enter the market, there is more competition for tenants. Competition makes the market price decrease, and the cycle continues. The following figure shows the enormous variation in the number of units started over a period of covering 1965 to 1980. These new units built in 1965, 1971-72 and 1976 are now considered as being part of the large inventory that is more than 30 to 40 years old.



In summary, since the real estate market is affected by the number of comparable units available, the property manager will want to determine the occupancy trend, the vacancy rate and absorption rate for his or her particular locale and property. If the trend is towards rising occupancy levels, the value of the units will increase. As space becomes even more scarce it increases in value. It is during these times that managers raise rents and can upgrade the tenant mix and building character. On the other hand, if there is a growing vacancy rate, the value of the vacant units will decrease. In period of high vacancy, the public is likely to resist rent increases and/or make more demands for services or repairs at renewal time.

The property manager must also look at local construction. If there is little or no building activity, or an area has strong no-growth or slow-growth proponents, rent levels will rise as the demand for existing space increases. Conversely, if over-building occurs, the result is technical oversupply and rents will be lower. During the mid-1980's, a good portion of high-rise office space and many small, strip shopping centers were vacant because too many of these projects were built. Overbuilding causes lower occupancy rates until the demand can catch up with the supply. For example, federally assisted housing units declined from over 200,000 in 1980 to only about 25,000 in 1987 for new construction. There has been a sharp drop by the U.S. Department of Housing and Urban Development (HUD), by about 75%, that removed vast numbers of high-demand units from the market place that has disrupted many households.

Current rental rates are evidence of the economic strength of the existing real estate market. Rental rates move up and down in response to supply and demand (occupancy). A residential property manager can discover rental trends by using the Bureau of Labor statistics on rents paid for residential properties. Non-residential property managers can read commercial or industrial association reports to obtain general rent levels. A property manager may also survey the properties that he or she is managing to determine the average monthly rent per unit or the price per square foot. Statistics kept by individual property managers can also be combined with those of other managers in the area to get a broader perspective. Rental rates given in classified ads can also be examined. These methods give a manager a basic idea of rental trends.

**Foreclosure rates.** When real estate investments can no longer pay for themselves, foreclosure rates increase. Most foreclosures occur because the property is no longer generating enough income to meet the loan payments. Increased expenses, high vacancy rates, or increasing interest rates may cause this, from a variable rate loan or simply over-encumbering the property. An increase in the foreclosure rate is a sign of weakness in the real estate market. However, single-family residence foreclosures increase the demand for rentals.

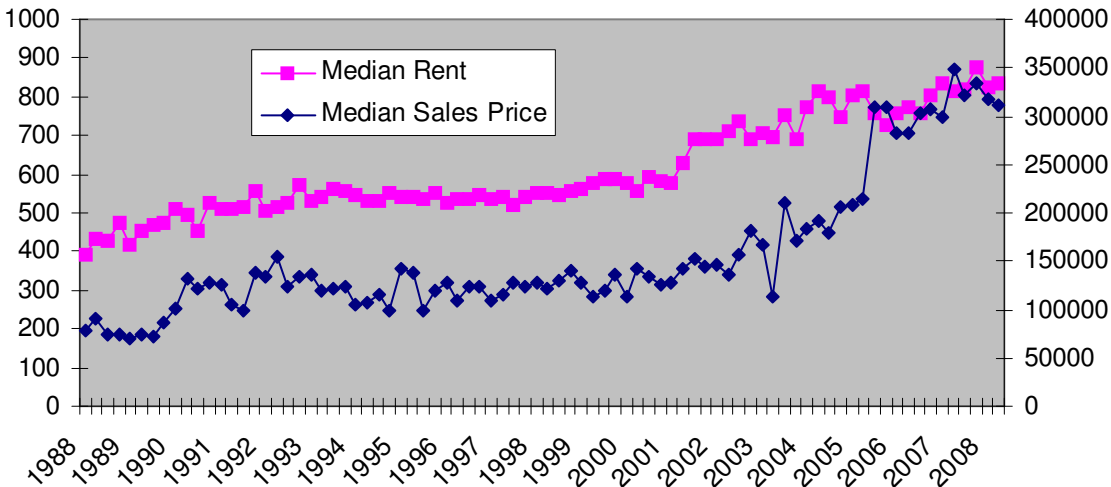
**Loan activity.** When loan activity increases, this is a sign that both borrowers and lenders have confidence in the real estate market. Borrowers believe that the property will generate more money than it costs to buy it, and lenders believe that the value of the property is high enough and stable enough to support the loan amount.

Loan volume is also directly tied to interest rates. If rates are low, more borrowers can qualify for the loan payments. As more people purchase homes, vacancy rates tend to increase, especially in the high-rent, luxury apartments.

**Building activity.** The availability and cost of construction funds and the projected demand for future units determines income property building activity. Increased building activity does not necessarily bode well for the real estate market. If there is too much building activity, an oversupply results and property values stop increasing often with a decrease in rental rates. On the other hand, if there is too little building activity, a shortage results and property values and rental rates increase. The latter is the most frequent in the California real estate market.

**Sales activity.** Brisk real estate sales indicates confidence in the real estate market. It also ensures the liquidity of real estate holdings, further increasing their appeal to investors. The price of homes, volume of sales, and future housing supply all affect the demand for rental housing. The next graph indicates the median asking rent for the West and the median asking sales price for the same U.S. region, using quarterly results from 1988 to 2008. Sales prices go up and down more drastic over time, while rents have a tendency to have a constant, gradual rise over time, with fewer peaks and valleys.

## Median Rent vs. Median Sales Price



## 2.3 GOVERNMENT, ECONOMICS AND POLITICS

Local government policies, state and regional activities, the pace of the national economic growth, and the amount of available international investment dollars, as discussed above, affect the real estate market. All of these factors affect the performance of a specific property. To be a successful property manager, you must consider each of these factors as you analyze each property and project future performance.

### Government

**The National Housing Goal** is to provide decent, safe and sanitary housing for Americans. For example, overcrowding is addressed in the Space and Occupancy Standards of the Uniform Housing Code (Health & Safety Code 17922). These Occupancy Standards are enforced by ten Commissioners appointed by the Governor (with the approval of the Senate). The Commission uses the Uniform Housing Code as a guide. A portion of the Housing Code States:

"Every dwelling unit shall have at least one room which shall have not less than 150 square feet of floor area. Where more than two persons occupy a room used for sleeping purposes the required floor area shall be increased at the rate of 50 square feet for each occupant in excess of two."

As the California market adjusts to the increase in population and demand for housing, so does the government. Harsh conditions, such as dramatically increasing rents, poor sanitation, and inhabitable premises all encourage government involvement. Because of the high demand, landlords often establish nuisance rent raises without fear of vacancy. Some landlords even evict existing tenants to make units available for new occupants at higher rents. Rents are sometimes charged on a per-person basis to achieve a maximum price. Overcrowding is often the last resort for those who cannot afford the high rental rates. To help ease the effects of these conditions, local health and safety officers, planning and zoning departments, fire departments and local officials have assumed the role of enforcing the National Housing Goal.

The general rule-of-thumb is that the limitation should be at least as liberal as two-per-bedroom-plus-one. Those managers trying to use occupancy limitations to discriminate against

families with children, however, are investigated by the California Department of Fair Employment & Housing, authorized by Civil Code Section 51 of the Unruh Civil Rights Act.

The government is the largest single landlord in the United States. State, federal and county governments all have significant property holdings. They directly own and operate, or indirectly contribute to more rental programs than any other single residential owner. They often hire private property management firms to handle the daily operations of the building management.

Governmental agencies typically insist on using their own, government-approved management agreements and rules of operations and force the owner to comply with these mandatory, unilateral clauses than are often subject to subjective interpretation and not clearly defined within the law.

Public assistance programs limit the rental rate based upon number of bedrooms, unit size, and family size. The rent is often set at a percentage of the county average. Thus if only 75% or 80% of the county average is the set rent amount, the landlord would be offering the unit at lower than market rent and be subject to higher governmental constraints and requirements for the unit. Schedules determine the amount of rent the tenant can be expected to pay. The tenant must pay his or her share or the rent separately and the Housing Authority pays its portion, separately. In the event of default, a landlord must proceed with the eviction process in the same manner as non-public assistance tenants.

Most government involvement in the rental market, however, is not through direct property ownership. The government's biggest role is through their approved programs:

The National Housing Act of 1934: created the Federal Housing Administration (FHA), which was given the authority to insure mortgage loans for housing and home improvements.

The United States Housing Act of 1937: established the Public Housing Authority, and set up loan programs and annual contributions to local public housing agencies for low-rent housing and slum clearance.

The Housing Act of 1949: provided federal assistance to local agencies for slum clearance, urban redevelopment and construction of low-rent public housing; and new rural housing programs.

The Housing and Urban Development Act of 1965: created the U.S. Department of Housing and Urban Development (HUD) to stimulate housing development.

The Housing and Community Development Act of 1974: authorized Section 8 housing assistance program through block grant programs.

**Rent control** affects the projected performance of any project. Critics claim rent controls place the government's burden of supporting the poor on the shoulders of private property owners. Rent control decreases incentives to purchase, maintain and upgrade private property. In addition, critics feel they have lost another constitutional right when the ability to charge fair market rents is taken away from landlords by the government, a form of government price-fixing. Rent control ordinances have greatly changed since the mandated World War II precedents. Some areas have eliminated rent control. Most have modified the ordinance. Some have vacancy decontrol provisions that allow the unit rent to move up to local market rents of at least 80% of average county rents when a vacancy occurs, then the unit goes back under rent control at that rent level, termed re-control. Some ordinances allow for rent increases based upon a percentage of the CPI increase while others use a set formula as a percentage increase.

The intent of rent control is to make property available for rent at reasonable rates when there is a shortage of available space. It may not, however, be effective because artificially low rent may increase demand and discourage new construction and the necessary maintenance on existing properties.

## GOVERNMENT INFLUENCES ON MONEY

The value of the dollar fluctuates, depending on general economic conditions. A prime factor in the value of money and its availability for real estate lending is government influences in monitoring, reacting to, and handling economic trends. The government has been involved in the economic affairs of the nation for a long time. At various times in history, the government has implemented different economic policies, each with its own effect on the economy, and in turn, on the real estate market.

At the time of the American Revolution, Adam Smith described a laissez-faire economy -- the economy was run by individuals motivated by profit. This freely competitive market would force the most efficient allocation of scarce available resources and would work most effectively without government interference. However, the United States faced successive periods of recession, suffered unemployment, and had to face the issues of the homeless, poor, and elderly. Towards the end of The Great Depression, John Keynes challenged the traditional economic theory by advocating that some government interference was necessary to balance the economy, to offset the peaks and valleys of the natural economic cycles. In recent years, Milton Friedman has stressed that if the money supply increased at a rate equal to the real growth in the gross national product (GNP), inflation could be kept under control.

**Government policies.** Over the years, the public has come to expect, even to rely on, some government control to help prevent economic disaster (even though this contradicts the free enterprise system). The government uses two policy tools to this end: monetary policy and fiscal policy. Monetary policy refers to the government's control of the money supply: increasing or decreasing the supply of money can help counteract recession, unemployment, and inflation. Fiscal policy refers to the government's ability to collect taxes, spend money, and borrow money to counteract recession, unemployment and inflation. The effect of these policies will stimulate or slow economic activity.

**The Federal Reserve** is the primary government regulator in monetary policy activities. The Fed's role is to regulate the supply of money and credit so the nation can have economic growth with acceptable levels of unemployment and inflation. The Fed controls the supply of money and credit in three ways:

- a. setting reserve requirements
- b. setting federal discount rates, and
- c. engaging in open market operations

Not all banks are members of the Federal Reserve Board, even though the majority are those institutions that are part of the Federal Reserve System are called member banks. When the Fed changes the reserve requirements it greatly influences the economy because the reserve requirement is the percentage of deposits that commercial banks are required to maintain on deposit.

The original purpose of the reserve requirement was to help avert financial panic by giving depositors some confidence that their deposits were safe and accessible. The reserve requirement protects depositors by ensuring that enough funds are available to meet unusual customer demand.

The reserve requirement also enables the Fed to exercise some control over the growth of credit. By increasing the reserve requirement, the Fed can reduce the amount of money that banks have available to lend. On the other hand, a reduction in reserve requirements frees more money for investment or lending by banks. An increase in the reserve requirement, then, tends to decrease available loan funds and increase interest rates. Conversely, a decrease in the reserve requirement tends to increase funds available for lending and to decrease interest rates.

Federal discount rates are the interest rates charged by Federal Reserve Banks on loans to its member banks. Increasing the discount rate usually results in the banks charging higher interest rates to their customers, since they have to charge more interest on the money they lend if they have to pay more interest on the money they borrow.

The Fed also buys and sells government securities. These sales are called open market operations. They are the primary method relied upon by the Fed to control the money supply, and with the money supply, inflation and interest rates. When the Fed purchases government securities from the public, the money supply is increased (there is more money in circulation). When the Fed sells government securities, the money supply is decreased (the investors who buy the securities have less money to invest in other areas).

**The United States Treasury** is the primary actor in fiscal policy operations. As the nation's fiscal manager, the Treasury is responsible for managing the government's finances, including the national debt. Treasury funds come from a number of sources, but the largest source is personal and business income tax.

When federal income is less than federal expenditures, a shortfall called a federal deficit occurs. When there is a deficit, the Treasury covers the shortfall by issuing interest-bearing securities to investors. By doing so, the government is actually borrowing money from the private sector. The more money the government borrows, the less there is for investment in real estate or other areas.

Taxation is another important tool of fiscal policy. Lower tax rates mean that taxpayers have more funds for lending and investing. High tax rates mean that taxpayers not only have fewer funds to invest, but that they will be more likely to invest in tax-exempt securities instead of real estate.

The Treasury Department also oversees the US Printing Office, which has the power to increase the amount of the nation's money. This act typically decreases the value of the dollar and can spur inflation. This affects real estate investments by affecting the cost and availability of loan funds.

## CURRENT PROBLEMS

The balancing of economic growth and inflation is not any easy task for government. As market conditions change, the government must quickly act or react to the fluctuations. While on the one hand, the government relies on economic growth to help lessen the looming federal deficit, continued economic growth also fuels inflation. But fighting inflation often requires higher interest rates, which in turn increases the value of the dollar, adding to the problem of the trade deficit.

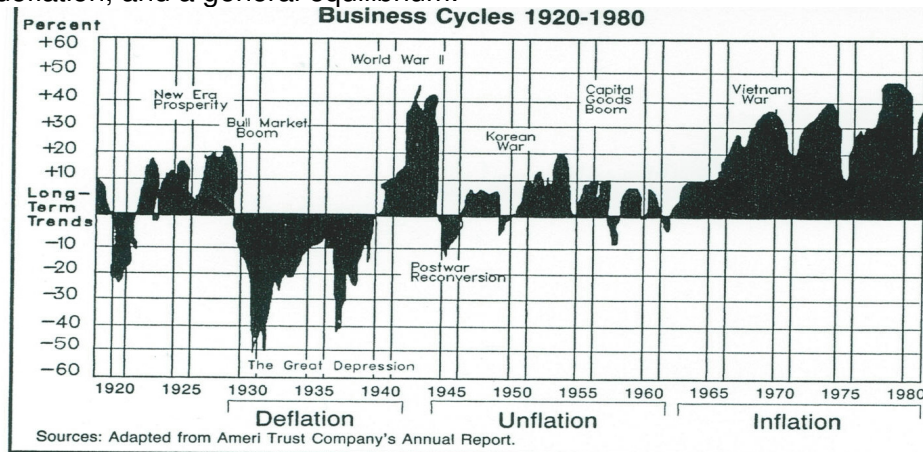
**Inflation** is an abnormal increase in the volume of money and credit resulting in a substantial and continuing rise in the general price level. Inflation affects real estate in many ways. It makes loan repayment worth less, so lenders raise interest rates as a hedge against future revenues. Increased interest rates make it more difficult for buyers to qualify for loans, reducing housing demand. A decrease in homebuyers means increased demand for rentals, forcing rental rates higher. Increased rents cause more vacancies on the top-end rental units, and overcrowding on lower-end rental units. If vacancies continue, foreclosures increase on the more expensive units. The poor especially suffer because lower-income units become more difficult to find.

Inflation also has a harsh effect on lending institutions. Customers, fearing a decrease in the value of the money, take their money out of savings accounts and invest it in other markets offering higher returns. This is referred to as disintermediation, and decreases the amount of money available for mortgage loans, further increasing interest rates. Inflation also causes the

cost of construction materials to increase, making new construction even more expensive for investors and driving smaller investors out of the real estate market.

**Disintermediation** is when people withdrawal of funds from banks for investment in other instruments that offer higher yields, e.g., government securities.

As you can see, the real estate market is closely interrelated to the general business economy of the nation. For example, the general collapse in the real estate market in 1928 spurred on the Great Depression (which began in 1929). A recession or depression, called deflation is prevalent where there is a shortage of available money. A look at the general business cycle shows periods of inflation, deflation, and a general equilibrium.



As fears of inflation creep over the U.S. economy, California is already experiencing inflation in the real estate market. The national inflation rate is expected to remain moderate for a time (under 6%), but California construction and sales prices are increasing far above the national average. Four of the top ten most costly housing areas in the nation for homes are in California: Orange County (3rd), San Francisco (4th), Los Angeles (7th) and San Diego (8th).

**Arbitrage.** In finance and economics, the term arbitrage is used when a person, called an arbitrageur, takes advantage of a price differential between two or more similar financial instruments on different markets. It exists as a result of market inefficiencies, such as real estate. The idea is to capitalize on the imbalance between items, and to take the profit from using the differences. It is possible when one of these conditions is met: (1) the same asset (apartment rent) does not trade at the same price on all markets (i.e., one apartment rents for a different amount than another apartment unit in the same area); or, (2) Two assets with identical cash flows do not trade at the same price (i.e. a duplex in a high-rent area has annual income of \$48,000 and a four-plex in a low-rent area has \$48,000 annual income—the nicer area will be more highly desired by most investors and to obtain the property, one investor will bid more money than another, just to have that property, whereas in a poorer area the investor stops bidding when the annual income meets the desired capitalized rate of return desired); or (3) An asset with a known price in the future does not today trade at its future price discounted interest rate (i.e. A property that goes from rent control to decontrol at a future specified time due to ordinance expiration that produces much higher current market rental rates would have an instant increase in price over the current known price.) However, arbitrage is not simply buying in one market and selling in another for a higher price at a later date. The transactions must occur simultaneously, which does not happen in even the fastest escrow period. Some investors speak of arbitrage when buying a building with existing lower rents than the area, bringing the rents up to current market rates, then immediately

re-selling the property for a profit. This process would take months to occur because of the escrow period to purchase the property, the time to give tenants legal notice of rent increases, and the time to obtain a new buyer who will pay market price for the new market rents and the time to close that escrow. The speed at which prices converge is a measure of market efficiency. Arbitrage reduces price discrimination by encouraging people to rent when an apartment is lower than other surrounding vacant units, and move when rents are raised. People tend to buy when the price is low and resell when the price is high. When leverage, or borrowed money is used, the risks of such transactions become greater for people trying to “flip” properties.

**Time value of money.** The value of the dollar rises and falls over time in the economy. This may be due to the difference in value against foreign currencies, such as again the Euro. At other times the value may alter due to internal inflationary issues. The question to ask when making investments is if the dollar given today in a transaction will be worth 96 cents or \$1.04 a year from today. If you can time the investment where you borrow funds to purchase income property, and pay back the loan on deflated funds with inflationary rents, then your timing was great and you used money to optimize your return. Conversely, if you borrow funds and get stuck with an inflationary, adjustable loan pay back, and if rents cannot be adjusted upward to cover the increase loan payment, then you have a financial crisis. It may even worsen if, when a unit becomes vacant, that you can only fill the vacancy with a rent rate that is lower than the previous tenant was paying. This is often coupled with increased expenses, such as utility costs, which are often tied to inflationary price increases, especially if they are tied to rising oil prices. The investor who does not study economic trends would be well to invest in the expertise of a professional property manager, at least on a consultation basis, to obtain current economic trends and to seek advise on positioning for the projected future market.

## Economics

Basic real estate economics draws from general economic theories indicating that the general business cycles tend to last over normal fluctuating periods of time. For example, a period of economic recession is when rent rates decline due to lack of income and ability to afford current expenses, including housing. Evictions and non-paying tenants become a more frequent occurrence. An economic recovery is when rents rise because business expands, jobs are good and wages are in line with housing expenses. An economic depression is when rents are projected to decline due to the inability for people to earn income to afford rents and delinquencies and evictions increase. Units stay vacant longer and tend to rent for less with new occupants. This may be offset as overcrowding, called doubling up, comes into play. Often more people are paying the same amount of rent that the unit received before the depression. Economic prosperity is when the highest rents may be obtained. This is a period when high-end tenants leave rental units and purchase homes or a condominium.

Economic activity tends to fluctuate by segments of the market. Some are more stable, while others are more volatile. National and international events influence economic activity in each market. In the past, stocks and bonds offer an array of investment amenities. Stock investors were predominately either seeking short-term profits with easy access to their funds, or seeking stable yields to add to a well-diversified portfolio of investments. Bonds attract investors seeking good interest rates with fixed returns, little or no management, and less risk. Conservative, long-term returns are expected from the bond market.

**The international market.** The speed of communications has made the world shrink in terms of financial markets. A shout in one corner of the globe can be heard and responded to immediately in a local market. Global economies are so intertwined that their individual

independence in the 1990's is questionable. Nowhere is this more apparent than in California, especially in California's real estate markets.

California property management interacts with markets in every part of the world. The fluctuation in the price of the dollar valued against foreign currencies now affects the price of local income properties. And of course, the price of homes affects demand in the rental market.

Example:

In the late 1970's, when the U.S. dollar lost value due to inflation, the demand for housing rose as people invested in real property as a hedge against inflation. This caused the price of residential property to increase. The price increase was passed along to tenants in the form of economic rent raises. All phases of property management reacted to this shift in the market. These same recurring conditions cause some investors and property managers to rely on this historical perspective to project that future rents will be increasing in the near future as the foreclosure and sub-prime meltdown factors stabilize into an economy much like that of the late 1970's.

The growing world population also affects the demand for housing in local California markets. The United States has a growing population, but is still relatively less densely populated than many countries with less than 15% of the world's population. However, the United States has a very large portion of the more inhabited total land area (approximately 3.6 million square miles) that falls under private ownership, much of which is income-producing property. As the world's population increases, political unrest, poor economic conditions and overcrowding in other countries increases immigration to the United States. The need for housing accommodations multiplies at an ever-increasing rate in the clamor for more room.

The cities San Diego, Sacramento, San Francisco, and Los Angeles are all "new" cities in comparison to the larger cities in the rest of the world: Paris, London, Tokyo, or Cairo. Their youthful image of being less set in their ways, more adaptable to change, and more flexible in opportunities increases their attraction to immigrants, making them the destination for large numbers of new citizens.

**The national market.** From 1926 to 1966, the rural population in the U.S. decreased from 120.7 to 107.1 million when over 50% of the United States population began living in an urban environment. By 1980, this figure had grown to 70%. The United States was building 342 dwellings per 1,000 people by 1970. Twenty-six million more housing units had been added by 1980.

California has been the benefactor to the new urban population, providing many job opportunities, a desirable climate, and popular lifestyle. A slowing in the national economy increases the demand for California housing as more people move to California to find jobs in a bigger marketplace.

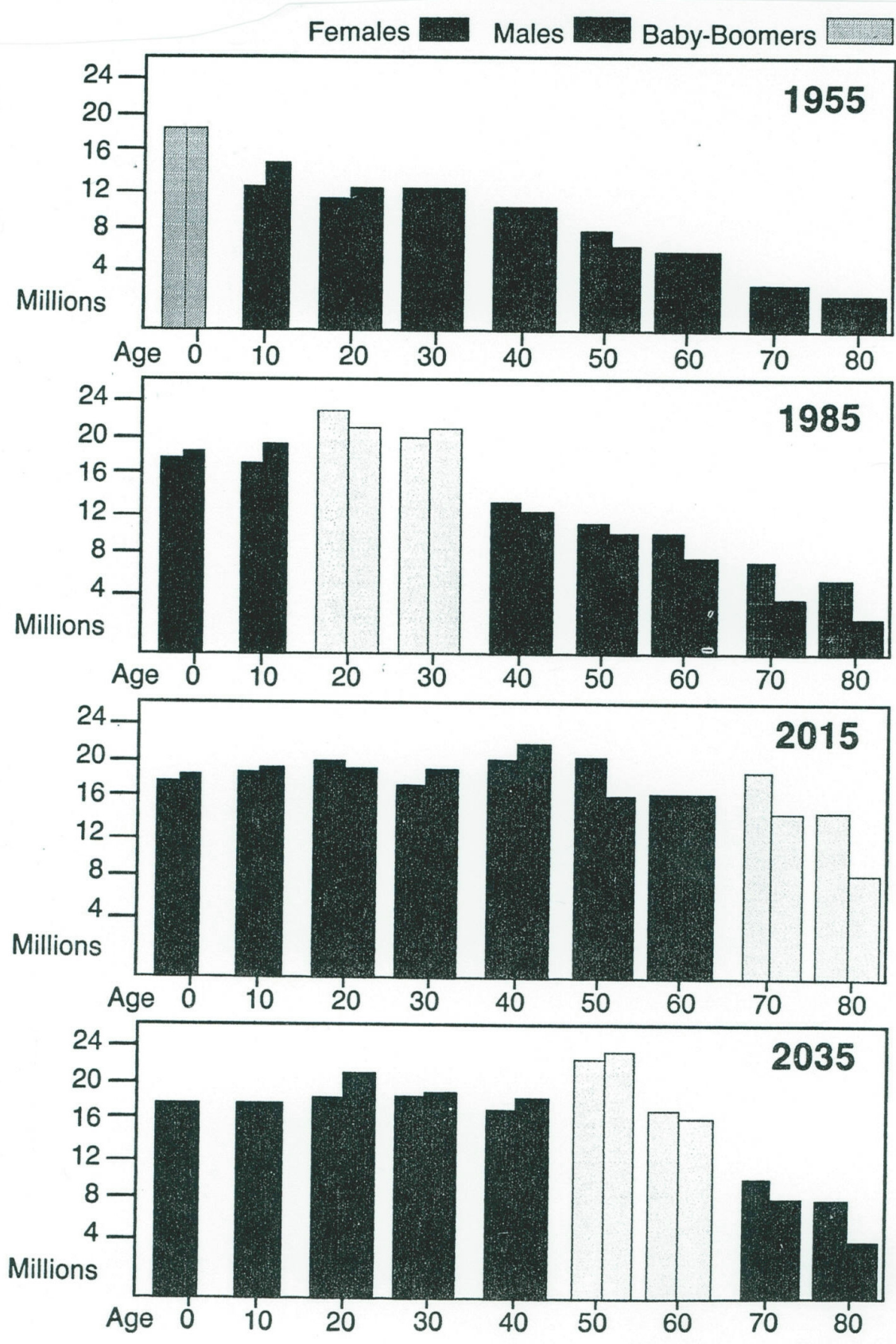
The demand for housing is directly related to the composition of the population. The charts below show the national age composition for 1955, 1985, 2015 and 2035. The largest and fastest growing segment of the national population is between ages 20 and 39. This age group has the highest demand for rental housing. Those under 20 tend to live with their parents; the 40 and over tend to own their own homes. Never before has the national rental market been stronger, and California in one of the strongest rental markets within this group.

The national economy also greatly influences California's investment property market. The cost of investment capital in California is affected by competition for the national supply of available dollars. The rate of national economic growth (measured by Gross National Product) influences the demand for commercial units in particular employment-base areas.

Population growth varies greatly across the county. Northeastern cities of the United States are growing very modestly. From 1980 to 1987, New York City grew 3% and Chicago grew 2.7%. Due to weather, lifestyle, and more-affordable housing, Texas grew at the fastest pace between 1980 and 1987, with Houston increasing by 18.3% and the Dallas/Fort Worth region increasing by 30.4%. (Growth in Texas was the result of recovery from the earlier oil-crunch layoffs.) Over the past 20 years, the demographics and population migration patterns have continued to change.

**The local market.** A property manager who is familiar with local conditions can raise current rents without causing a vacancy, based upon the theory that the tenant will stay and pay the increase rather than bother with the trouble and expense of moving, referred to as a nuisance rent raise. Conversely, even with the shortage of available units, some areas have a relatively high amount of vacancies, due to economic oversupply.

Economic oversupply is the inability of tenants to afford the current rents. Affordable housing is still well beyond the means of many renters. Between 1974 and 1983, the total number of residential units priced at under \$300 per month declined by nearly one million units. As rents have increase seven-fold, the situation has not decreased. Builders have little or no incentives to construct lower-rental rate units. Thus, the building you manage may be in an area where there is a high demand for housing but little ability to pay for it.



## POLITICS

**State activity.** In 1983, the rental business became the third largest industry in California, ranking behind only tourism and agriculture. By 1985 renter households made up 45%, and the rental housing market was valued in the billions. Over the next decade demand for California housing exceeded 100%, causing rents to rise. Total California population is about 39 million in 2009, where tenants have reached over 50% of California households. The projected population is expected to be 66 million by 2020. This translates to a high number of Californians employed in the rental housing business, valued in the hundreds of billions. The sheer number of registered voters who are tenants requires legislatures to work with tenant groups to try to solve the housing issues unique to California, such as overcrowding, habitability and rent control. For example, virtually all mobile home parks in California fall under some form of rent control that was voted in by the tenants who are registered to vote where the park is located. Even if the property owner lived in the same location, the owner would be only one vote against rent control as compared to all the votes of the residents.

Demographics are vital to successfully managing property. An individual's age group and total income bears a direct relationship to the amount of rent he or she can afford. For instance, people pay more for housing between the time they leave home, usually under the age of 25, and at the age of 35 than at any other time in their life. Then, between age 35 and 45, housing expenditures drops behind the cost of eating food away from home, and again drops into third place by age 45, when health care costs move into first place.

**Regional activity.** The Sacramento and San Diego regions are projected to be the fastest growing large economic regions in California. The Greater Los Angeles economic region, however, holds the dominant status on the basis of solid job growth. Additional jobs create greater demand for housing in these areas, stripping existing supply, and driving existing prices even higher.

There are, however, many regional factors to counterbalance an assumption of automatic rent increases. Within each region are pockets of less desirable areas, necessitating rent adjustments. For example, many multi-family properties are located in areas predominantly under some kind of public assistance programs, which limits the maximum rents. Also, commercial properties located near an airport or railway command higher rents than properties within the same region without close proximity to these means of transportation. By determining the area's population composition, developers and planners can better forecast the demand for different sizes of units.

For example: In California's auto oriented society, there is a healthy market for units having two bedrooms, two bathrooms, and a four-car garage. In New York, which relies heavily on subway, bus and public transportation alternatives, most properties do not accommodate any parking facility. On the other hand, the demographics in many regions indicate a need for several smaller-sized bedrooms to accommodate larger family sizes.

In reviewing regional activity, the property manager must also look at local construction. If there is little or no building activity, or an area has strong no-growth or slow-growth proponents, rent levels will rise as the demand for existing space increases. Conversely, if over-building occurs, the result is technical oversupply and rents will be lower. During the mid-1980's, a good portion of high-rise office space and many small, strip shopping centers were vacant because too many of these projects were built. Overbuilding causes lower occupancy rates until the demand can catch up with the supply.

In California, regional growth has been consistently healthy due mainly to the diversified employment base. San Francisco population grew 10.6% between 1980 and 1987, a phenomenal rate. But even this growth rate is dwarfed in comparison to the southern California rate. Long Beach/Los Angeles grew 14.1%; Anaheim/Santa Ana grew 14.6%; and Oxnard/Ventura increased by 18.9%. The Riverside/San Bernardino region grew the most, at 35.2%, making Southern California's overall total growth 17.3% from 1980 to 1987.

Most of these 13.5 million additional people rent when they first come to California (paying high southern California prices) until they locate the neighborhood they want to live in. This pattern is reflected in California's homeownership statistics, which are lower than the national average. However, as these new residents accumulate wealth, many more potential buyers will be entering the housing market. In the meantime, these regions lack affordable rental units. To ease the burden of high rents and utilities, many families double up, increasing the ratio of number of people per unit.

**Rent control** affects the projected performance of any project. Critics claim rent controls place the government's burden of supporting the poor on the shoulders of private property owners. Rent control decreases incentives to purchase, maintain and upgrade private property. In addition, critics feel they have lost another constitutional right when the ability to charge fair market rents is taken away from landlords by the government, a form of government price-fixing.

Single-family residences are usually exempt from rent controls. On the other hand, almost all mobile home communities in California fall under rent control ordinances. Individual cities, such as Santa Barbara and West Los Angeles, often have some form of rent control or a rent review board covering apartments. Some hotel units are subject to control. 1988 real estate legislation prohibits public entities from enacting or enforcing rent controls on specific commercial property. The prudent property manager must check not only present rent control conditions, but anticipated conditions as well.

**Limited growth.** Proponents of limiting growth in California communities use different methods to accomplish the same ends. Under the provisions of the Williamson Act, agricultural preserves are established and property tax incentives make it beneficial to keep the property undeveloped. Some local governments use zoning to prohibit growth. Ordinances require minimum lot sizes of 1 acre, 5 acres, or up to 60 acres per single family home. Utility moratoriums are used when communities reach their limits on water supply or sewage disposal capacity. Some areas charge very large developer fees, or require the donation of large public lands as part of their approval process. Also, any resident can file suit against a developer to halt the construction on the grounds that the environmental review was inadequate.

#### Example

Petaluma, about 40 miles north of San Francisco, is California's most famous case. A 25% increase in population occurred in a two-year period. Anticipating increased property values, many investors and property managers purchased additional property to develop income-producing properties. However, to slow the unprecedented growth, the city established explicit quotas on the number of new building permits that could be issued each year (not to exceed 500 dwelling units per year). Eight to twelve percent of these units were to be low- and moderate-income units. Each dwelling unit was thought to represent about three people. Many of the investors/developers were stopped in their tracks and their capital tied up for years to come because of these restrictions.

## 2.4 MONEY AND NON-REAL ESTATE INVESTMENTS

Even in the earliest days of civilization, there was a need to exchange one item for another. Ancient peoples developed the barter system, which varied depending on the needs of the people and the era. Today, tenants exchange money for housing accommodations. Investors exchange their capital for an expectation of a future return. Property managers exchange their services for a fee or commission.

In our society, money is the major medium of exchange. It goes by many names, from the colloquial to the formal: gravy, wampum, dough, wad, bucks, bread; or, funds, capital, interest, return, yield; or, payment, salary, wages, profits; or, gold, silver, cash, currency, checks, bills, notes, legal tender. In other countries, it may be called: dinar, peso, franc, rupee, lira, or pound. Whatever its name, money is the commodity that is easily exchanged.

Money is needed as the backbone of real estate finance to fund various phases for a property. Money is the profit goal for most investors. All of these factors affect the performance of a specific property. To be a successful property manager, you must consider each of these factors as you analyze each property and project future performance.

**The free market.** Since 1973, the exchange value of the dollar and most other currencies has been determined in the free market. If demand for a currency rises, so does its price in relation to the currency of other countries. The value of the dollar affects the number of people who are willing to invest in it. Volatile exchange rates fuel speculation, which in turn affects international investments (both positively and negatively).

As with stocks, bonds, and futures, the dollar vies for investor attention. Up until the mid-1980's, the dollar's value was on the increase. Between 1980 and November 1985, the dollar's value rose more than 40% against other major currencies. This strength hurt United States manufacturers, as consumers began to buy less expensive foreign-made goods. As the United States continued to import more goods to meet consumer demand, it exported fewer. (U.S. goods were too expensive on foreign markets.) A trade deficit developed. Industrial output fell, meaning lower tax revenues, and a higher federal deficit, which can fuel a tax increase.

More recently, the value of the dollar has declined significantly. Although a devalued dollar sounds dangerous, it has had advantageous consequences for the general economy. A lower dollar has made American-made products more competitive; consumers (both foreign and domestic) are buying more U.S. products than before. This means fewer imports and more exports. The trade deficit decreases, and industrial output rises. More tax dollars are collected, which lowers the federal deficit. As both the federal deficit and trade deficit decrease, economists become more optimistic, encouraging even more economic growth. As economic growth increases, investors have more faith in the dollar and, as they begin to invest in it, the dollar's value begins to rise.

**Government influences.** Aside from the free market system, various government agencies affect the value of the dollar. The Federal Reserve has a great deal of influence on the value of the dollar. To lower the dollar's value, the Fed can expand the money supply. This action brings down interest rates, and makes the dollar less attractive for foreigners to own. Domestic goods become more competitive. Exports and sales at home make the economy busier, which produces more revenues for tax collectors and reduces the size of the budget deficit. On the other hand, to increase the value of the dollar, the Fed can raise discount rates and reserve requirements and decrease the supply of the money.

**Foreign investment affects on U.S. real estate and money.** The value of the dollar, and its effect on investment, has a significant impact on real estate management. In the past, investor

confidence in U.S. markets by foreigners was due to higher yields in the U.S. than abroad, fewer profitable enterprises available in their home country, and the safety of U.S. investment due to political stability. In the past, the U.S. financial instruments (mortgage backed securities) provided higher yields and were more stable than those abroad.

**Competition.** The real estate market must compete against other types of investments funds: stock, bonds, futures, gold, etc. One primary advantage of some types of competing investments is their liquidity. For instance, stocks are generally considered to be more liquid than real estate because the investor can sell them quickly for cash. For example, if an investor owns a property currently valued at \$484,000 that has an unpaid loan amount of only \$237,000, the equity of \$147,000 would take 30, 60, 90 days or more to obtain, less the costs of sale, including commission. If that same investor had \$150,000 in stocks, their stockbroker could sell the entire portfolio, deduct the costs to sale and their commission, and transfer the funds to the owner within 24 hours from when the order to sell was communicated. Both transaction probably have tax consequence that are not taken into consideration in this discussion. However, the ability to readily turn an investment into cash is always one consideration for most investors.

Economic activity tends to fluctuate to different degrees in various segments of the market. Some are more stable while others are more volatile. Non-real estate markets are more international, using U.S. currency as its foundation. Funds flow into and out of Euro-dollar deposits, time deposits, savings deposits, checking accounts, and T-bills or CDs. These funds move through the US markets as investments in stocks, bonds, and in the commodities. Stocks and bonds offer an array of investment amenities. Typically, the stock market has two types of investors: those seeking short-term profits and desiring easy access to their funds, and those seeking stable yields to add to a well diversified portfolio of investments.

Bonds, however, attract investors seeking good interest rates with fixed returns, little or no management, and less risk. Conservative, long-term returns are expected from the bond market. The gold, silver, and precious metals markets have quick, dramatic fluctuations in returns. This is also true of the futures markets.

During periods of inflation or unsure politics (e.g., the period immediately after a presidential election), investors often move their holdings out of banks and savings & loans and into precious metals, art, antiques, and real estate. Money becomes a bad investment, as its value is likely to decline due to temporary instability. On the other hand, precious metals, real estate and other more limited resources skyrocket in price. When public confidence returns, their prices level off or decline and money becomes a good investment again (e.g., savings deposits, CDs, bonds). If inflation continues unchecked, however, and the prices of tangible goods continue to rise, these goods become more desirable as long-term hedges against inflation. This was the case with real estate in the late 70's, and expected again by 2010, when real estate values escalated rapidly.

**Sources of money for real estate.** Real estate requires the consistent availability of long-term money. When funds are scarce and interest rates rise, the real estate market slows. But when long-term moderate-rate financing is available, activity picks up.

The importance of finance to the real estate market is due to the fact that most real estate activity is based upon leverage. Leverage is the use of borrowed money to increase the investors return on a property. The investor pays only a small portion of the purchase price, but gets a return on the whole property, not just the portion actually paid for by the investor.

Leverage is using a small amount of your own money to make a major real estate purchase, but getting the returns on the whole value of the property, not just the portion paid for. Leverage requires the use of financing.

### Example

a \$75,000 gain on a \$5,000 investment using \$95,000 leverage.

1985:	\$5,000 cash down payment	1990: \$175,000 sales price
	\$95,000 new loan	\$ 93,000 loan balance
	\$100,000 purchase price	\$ 82,000 equity
	\$5,000 original cash investment	
	\$2,000 principal reduction payments	
	\$75,000 gain	

Property managers often become responsible for managing property with financial problems. The property manager must be able to analyze the underlying loan obligations in the hopes of restructuring the financing so as to turn around the building's performance. This may involve evaluating overall interest rates or payment schedules, and examining the possibility of using acquired equity. The property manager must know where to obtain funds in the marketplace when they're needed, at the best rates and under the best terms. By knowing which institutions offer the best program for a particular property, the property manager can enhance the performance of that property.

## 2.5 Real Estate Finance

**Types of lenders.** California real estate markets are dependent on the ready supply of available money. Money, or loan funds, can be obtained from institutional or non-institutional lenders. Institutional lenders include savings & loans, commercial banks, and life insurance companies. Non-institutional lenders include mortgage companies, private parties, REITS, credit unions, and syndications and partnerships. Each has its own characteristics, which will be discussed below.

### LOAN ANALYSIS

Every property is considered on an individual basis, and each lender will carefully examine all the facts about a particular property before deciding whether to make a loan and how much the loan amount should be.

The amount of funds necessary to make the monthly loan payment is called the debt service (DS). This amount may be interest only, or a combination of principal and interest and may be a combination of different loans (i.e., first, second or third trust deed). The monthly obligation is determined by the terms of the note. The payment may be impounded and include payments to the lender for reserves for taxes and insurance.

A prudent lender will underwrite the loan so that there is sufficient income, after expenses, to pay the debt service. The amount of available funds required by the lender will be based on the lender's analysis of the risk. At a minimum, lenders are presently requiring that there be at least \$1.10 of net income for every \$1.00 of debt service.

### LOAN PACKAGE REQUIREMENTS

When submitting a loan for approval, the following items must be included:

### BORROWER INFORMATION.

The operating statement for the subject property must show the past two years and the present year-to-date figures. A current rent schedule, certified by the borrower showing each occupant's name, unit number, unit type, rent, rental agreement type, expiration date and utilities

furnished by the borrower is also required. If it is a leasehold property, a recorded copy of the ground lease is requested. Of course, an appraisal by an approved appraiser qualified is also necessary.

## INSTITUTIONAL LENDERS

**Thrift institutions.** Formerly known as savings and loans, thrift institutions get their funds primarily from depositors that are primarily seeking long-term savings deposits, such as CD's. They primarily make long-term real estate loans at rates higher than they pay their depositors, thus operating at a profit since they are less influenced by liquidity. These institutions are either state- or federally chartered. The majority of their loans are used for residential real estate, mostly in single-family units, but also in multi-family and mobile homes.

**Commercial banks** remain one of the largest sources of investment funds in the country today. As their name implies, they are oriented towards commercial lending activities. Commercial banks are also state- or federally-chartered and their main source of funds is also customer deposits. Commercial banks serve a vital role in the real estate market because of their ability to make short-term real estate loans. Their short-term financing sustains the construction industry. They also are a major source of long-term, large commercial property loans, as well as medium range business loans. In addition, they are a widely used source of junior liens and homeowner equity loans.

**Life insurance companies** obtain funds from life insurance premiums paid by customers. These funds are mostly long-term and thus life insurance companies are mainly interested in large, long-term loans. They often lend money for the development of new housing subdivisions and very large commercial shopping centers, office buildings and industrial complexes. Their funds are usually channeled through intermediaries (loan correspondents or mortgage companies). The real estate projects financed by life insurance companies are almost always under the watchful eye of a professional property manager, who may be a direct employee of the borrower, or an outside consultant.

## NON-INSTITUTIONAL LENDERS

**Mortgage companies** work on a fee basis and are paid according to the amount of work they perform. The services they offer include loan origination, and processing, closing, and servicing the loan after closing. Servicing a loan includes collecting the payments and forwarding them to the lender. Mortgage companies get their loan funds from life insurance companies, banks, savings & loans, or other companies. Pooled funds and pension funds often enter the California real estate market through mortgage companies. Some mortgage companies loan their own funds, and are thus referred to as a mortgage banker. A mortgage company may loan its own funds for an attractive but risky project that an institutional lender would turn down, thus filling a gap in the market.

**Private lenders** make direct loans, or loans placed through an intermediary. Although private lenders are not limited to any type of loan, they seem to concentrate on making junior loans. A seller carrying back a portion of the purchase price is making a junior loan, which may be a second, third or fourth trust deed that is recorded against the property that is used for collateral. In California, investors who want no liability, management or maintenance associated with the actual real property frequently seek these purchase money trust deeds that are secured by real property out. These investors are primarily seeking a return on their investment.

Many private investors often sell these loans to other investors at a discount at some time during the loan and prior to the due date. The loan amounts are typically small and are for a relatively short period of time. Often, property managers use a second loan to fund building rehabilitation or to recast loans on projects with existing second, third, or fourth loans. More flexible payment plans, interest rates, prepayment penalties, late fees, and due dates are typical of this type of loan.

**Real estate investment trusts (REIT)** are comprised of a group small investors who pool their funds together to raise venture capital for real estate transactions. The popularity of REITs depends largely upon current tax laws and public favor, but they have become more common in recent years. Some REITs have stabilized their offerings to the extent that their shares are now traded on some stock exchanges. Their portfolios tend to be more diversified in loan types and investment projects.

**Credit unions** are also made up of the pooled funds of small investors and are like a specialized REIT in that they usually make loans only in their local real estate markets. Associations, employee groups, or organizations deposit and use their funds as a checking account. The credit union invests the deposits, often in real estate, to make a higher yield on the funds than it pays its depositors.

**Syndications and partnerships** are special types of real estate investors. Their funds come directly from the members or partners. They often handle a project from its inception to completion - including funding the construction loan, long-term funding, and on-going management of the property. Their popularity is tied to the current tax laws. Often, their performance falls short of expectations because the participants may lack the necessary expertise in property development and management. However, they remain viable sources of funds and many syndications or partnerships now include a CPM or other professional property manager.

## EXERCISE:

1. You will be given a description of an investor in Chapter 3 and will need to prepare a comprehensive Management Plan as described in Chapter 4. Part of that report will include your specifically describing the phase of the property in the life cycle of a building. Review the various criteria for each phase to assist your future recall of each type.
2. Describe the local real estate income product markets by using Internet searches. Show the web site and the asking price and rental income property (residential, non-residential, agricultural, commercial and industrial property) that is to support that price. Determine if it makes economic sense to purchase the property based upon the income generated and explain your conclusion.
3. Outline and explain the primary governmental issues involved in the local rental market. Cite your source.
4. Using an Internet search, locate rates of returns for real estate investments and for non-real estate investments, such as bonds, stocks and commodities investments for a period covering at least 20 years. Briefly compare and contrast returns, using graphs or charts where it will enhance the explanation. Data sources must be indicated along with web addresses.
5. Use an Internet search to find city rent control ordinances that are located in at least three different California counties. Cite the web address, source and list the similarities and differences.

## CHAPTER 2 QUIZ

1. Local property management in California interacts with markets:
  - a. internationally
  - b. nationally
  - c. statewide
  - d. All of the above
  
2. Property managers study population trends to determine building rents in relation to:
  - a. supply
  - b. demand
  - c. cause and effect
  - d. liquidity
  
3. When population decreases, which oversupply results?
  - a. Technical
  - b. Economic
  - c. Legislative
  - d. Projected
  
4. The main reason for property management needs in urban areas is due to population increases caused by California's climate, lifestyle and:
  - a. investment capital
  - b. rent rates
  - c. home prices
  - d. job opportunities
  
5. Persons spending the most of their total income for housing are aged:
  - a. under 30
  - b. 30 - 45
  - c. 45 - 55
  - d. 55 - 65
  
6. When tenants cannot afford the current rental rates, it is a case of:
  - a. technical oversupply
  - b. economic oversupply
  - c. economic phenomena
  - d. economic enterprise
  
7. According to critics, rent controls discourage:
  - a. construction
  - b. remodeling
  - c. tenant mobility
  - d. All of the above
  
8. An economic rent raise:
  - a. occurs when a landlord tests the market
  - b. is usually a very small rent increase
  - c. is based on fair market rents when a few units are available
  - d. where it costs the tenant more to move than stay and pay the increased rent.

9. Which of the following is NOT a common method to limit growth?
  - a. Restricting building permits on multi-family units
  - b. Imposing utility moratoriums
  - c. Setting minimum acreage requirements for single family residences
  - d. Subsidize property managers to compensate them for not raising rents
  
10. The National Housing Goal is to provide for all Americans housing that is decent:
  - a. and that complies with the Uniform Housing Code
  - b. under public assistance programs
  - c. and safe and sanitary
  - d. and affordable
  
11. The phase of a building's life when the most choices must be made is called the:
  - a. initiation
  - b. growth
  - c. introduction
  - d. demise
  
12. When comparing real estate investment to stocks, stocks are thought to be:
  - a. harder to manage
  - b. greater tax deductions under IRS codes
  - c. require an investment of smaller amounts of cash
  - d. harder to sell, less liquid and have higher costs to sell expenses
  
13. Government activity in the rental market tends to:
  - a. increase the availability of affordable units
  - b. regulate habitability, equal housing opportunity and rental rates
  - c. allow owners freedom on rent levels and security deposits that may be collected
  - d. allow landlords to charge higher rents and receive regular rent increases
  
14. When the landlord raises the rent \$25 per month on a unit paying \$2500 a month rent, it is:
  - a. technical oversupply
  - b. nuisance rent raise
  - c. economic oversupply
  - d. turnover rate
  
15. The government affects the California real estate market by:
  - a. Housing Authority programs
  - b. Redevelopment Agency loans
  - c. Federal Reserve Board actions
  - d. All of the above
  
16. An asset capable of being easily converted to cash is considered:
  - a. money
  - b. liquid
  - c. leveraged
  - d. disintermediation

17. Which is a non-institutional lender:
- a. Savings and loan
  - b. Commercial bank
  - c. Mortgage company
  - d. Life Insurance company
18. Inflation affects California real estate by increasing:
- a. overcrowding and doubling up on the demand side for rentals
  - b. rental rates for properties where the supply side is limited
  - c. vacancies when rents increase faster than people's ability to pay
  - d. all of the above
19. Since floating exchange rates began in 1973, the dollar has:
- a. sharply increased, nearly doubling
  - b. bounced with many fluctuations
  - c. remained as a constant stable
  - d. drastically declined
20. Which of the following is not a way in which the Fed controls the supply of money and credit:
- a. regulating the fiscal policy to offset disintermediation
  - b. setting reserve requirements
  - c. engaging in open market operations
  - d. setting federal discount rates