Doris Barrell, GRI, DREI

FIFTEENTH EDITION

ESSENTIALS OF REAL ESTATE FINANCE

Dearborn™
Real Estate Education

Essentials of Real Estate Finance

Fifteenth Edition

Doris Barrell, GRI, DREI

President: Dr. Andrew Temte
Executive Director, Real Estate Education: Melissa Kleeman-Moy
Development Editor: Jennifer Brandt

ESSENTIALS OF REAL ESTATE FINANCE FIFTEENTH EDITION

Published by DF Institute, Inc., d/b/a Dearborn Real Estate Education
332 Front St. S., Suite 501
La Crosse, WI 54601

Printed in the United States of America

ISBN: 978-1-4754-6207-4

CONTENTS

Preface vi

UNIT 1
The Nature and Cycle of Real Estate Finance 1
Learning Objectives 1
Key Terms 1
Introduction 1
The Nature of Real Estate Finance 2
Mortgage Lending Activities 5
Real Estate Cycles 10
Summary 16
Review Questions 18

UNIT 2
Money and the Monetary System 21
Learning Objectives 21
Key Terms 21
Introduction 21
The Federal Reserve System (the Fed) 22
Instruments of Credit Policy 26
The U.S. Treasury 31
The Federal Deposit Insurance Corporation and Federal Home Loan Bank 34
Summary 36
Review Questions 37

UNIT 3
Additional Government Influence 39
Learning Objectives 39
Key Terms 39
Introduction 39
U.S. Department of Housing and Urban Development 40
Significant Federal Legislation 46
Local, State, and Agricultural Lending Programs 49
Summary 52
Review Questions 54

UNIT 4
The Secondary Mortgage Market 57
Learning Objectives 57
Key Terms 57
Introduction 57
Overview of the Secondary Market Participants 58
Fannie Mae 62
Freddie Mac 67
Other Secondary Market Participants 69
Summary 72
Review Questions 73

UNIT 5
Sources of Funds: Institutional, Noninstitutional, and Other Lenders 75
Learning Objectives 75
Key Terms 75
Introduction 75
Institutional and Noninstitutional Lenders 76
Mortgage Brokers and Bankers 81
Real Estate Trusts and Bonds 84
Private and Foreign Investors in Real Estate 90
Summary 92
Review Questions 94

UNIT 6
Instruments of Real Estate Finance 97
Learning Objectives 97
Key Terms 97
Introduction 97
Encumbrances and Liens on a Property 98
Basic Real Estate Finance Instruments 99
Contract for Deed (Land Contract) 108
Junior Finance Instruments 109
Special Provisions in Mortgage Lending Instruments 112
Summary 116
Review Questions 118

UNIT 7
Real Estate Financing Programs 121
Learning Objectives 121
Key Terms 121
Introduction 122
Interest 122
Types of Mortgage Loans 126
Conventional Conforming Loans 132
Private Mortgage Insurance 136
Refinancing 138
Impact of the Subprime Market 140
Subprime and Predatory Lending 141
Variations in Formats 144
Participation Agreements 149
Tax Impacts in Mortgage Lending 152
Summary 155
Review Questions 156

UNIT 8
Government Loans 159
Learning Objectives 159
Key Terms 159
Introduction 159
FHA-Insured Loan Program 160
Qualifying For an FHA-Insured Loan 166
Calculating a Payment for an FHA-Insured Loan 168

VA Loan Guarantee Program 174
VA Loan Processes for Assumption and Release of Liability 180
Summary 183
Review Questions 184

UNIT 9
Processing Real Estate Loans 187
Learning Objectives 187
Key Terms 187
Introduction 187
Qualifying the Borrower 188
Impact of Credit Scoring 194
Data Verification 195
Qualifying the Collateral 202
Qualifying the Title 210
Closing the Loan 212
Summary 214
Review Questions 216

UNIT 10
Defaults and Foreclosures 219
Learning Objectives 219
Key Terms 219
Introduction 219
Defaults 221
Adjustments and Modifications to Avoid Foreclosure 223
The Foreclosure Process 226
Alternatives to the Judicial Foreclosure Process 230
Deficiency Judgments 232
Tax Impacts of Foreclosure 232
Summary 233
Review Questions 235

Appendix A: Loan Estimate 237
Appendix B: Closing Disclosure 240
Appendix C: Promissory Note Secured by Deed of Trust 245
Appendix D: Note & Deed of Trust Purchase Agreement 247
Appendix E: Note & Mortgage Purchase Agreement 257
Appendix F: Fixed/Adjustable Rate Note 267
Appendix G: Uniform Residential Loan Application 272
Appendix H: Request for Verification of Deposit 277
Appendix I: Request for Verification of Employment 278
Appendix J: Sample Credit Report 279
Appendix K: Uniform Residential Appraisal Report 283
Answer Key 289
Glossary 295
Index 304

PREFACE

Welcome to the intriguing and exciting world of real estate finance. The past 10 years have seen tremendous changes in the real estate financing market. New programs seemed to appear almost daily as everyone from those in the Oval Office to the local corner bank worked to keep homeowners from losing their homes to foreclosure.

In October 2008, Congress passed the first of the rescue bills aimed at easing the great credit crunch that was brought about by the burst bubble of the burgeoning real estate markets of the early part of this century. The new bill directed $700 billion to help lenders dispose of their worthless defaulted loans and to restart their lending activities. Over the next three years, the government created numerous programs designed to assist homeowners at risk of foreclosure due to increased monthly payments and unemployment. The recovery, now in process, is again based on long-term, fixed-interest-rate loans made to qualified borrowers financing reasonably evaluated real estate properties.

Although loans can still be secured through the internet, underwriters will be screening these loans carefully to make sure the borrowers have verifiable credit histories, and the collateral properties are evaluated accurately. Nothing-down, interest-only, and variations of subprime loans are no longer acceptable. Lenders must now adhere carefully to the underwriters' requirements to sell their real estate loans in secondary markets.

To a great extent, the U.S. economy depends on the ability of many individuals to comprehend and use real estate finance. Each participant does not need to know everything about all phases of financing real estate, but those who do understand the process are more likely to achieve success.

People have depended, in ever-increasing numbers, on banks, thrift institutions, and life insurance companies to lend them the dollars with which to buy a piece of America. Some bought large pieces, and some grouped together to buy even larger ones—but most people just bought the little piece they call home.

In this new edition, you will find numerous revisions and additions that reflect the many changes that have occurred in the real estate financial market in recent years. The most commonly used forms have been moved to the appendices, including the new Loan Estimate and Closing Disclosure forms, which were mandated for use on October 3, 2015. Of course, there will always be new changes, especially as the market slowly works its way out of the overwhelming foreclosure problem. It is critically important for instructors and students to keep up to date with their own research. The websites listed in each unit provide excellent resources.

Doris Barrell

IN MEMORIAM

On October 2, 2014, the world of real estate lost one of its finest educators, practitioners, and authors. Dr. David S. Sirota passed away in Green Valley, Arizona, where he had enjoyed several years of retirement with his wife, Roslyn. His influence on thousands of students can never be fully measured, and he will be greatly missed by his many friends, former students, and colleagues throughout the real estate industry.

ACKNOWLEDGMENTS

Dr. David S. Sirota had a combined 40 years of field experience as a real estate agent, broker, appraiser, and consultant, plus an academic background culminating in a PhD from the University of Arizona in Area Development. He has said, "To be extraordinarily successful, it's not enough to know how the system works, but why it does. Then you can be in a position to utilize it for your own highest benefits."

Dr. Sirota taught real estate subjects at the University of Arizona in Tucson, the University of Nebraska in Omaha, Eastern Michigan University in Ypsilanti, National University in San Diego, and California State University in Fullerton. He held the Real Estate Chair at Nebraska and was a visiting professor at the University of Hawaii. He was involved as a consultant in the development of a congregate care center in Green Valley, Arizona, and acted in a consultant capacity for individuals and developers. He was a founding member of the Real Estate Educators Association, securing one of its first DREI designations. Dr. Sirota was also the author of *Essentials of Real Estate Investment* and coauthor of *California Real Estate Finance*.

Doris Barrell, GRI, DREI, has been in the real estate business for over 30 years, working first for a builder-developer, next as a general brokerage agent, and then for nine years as managing broker for a 60-agent office in Alexandria, Virginia. She became a full-time instructor in 1996, bringing her wealth of real-life experience into the classroom, where she taught courses in finance, agency, fair housing, ethics, and legislative issues.

In addition to *Essentials of Real Estate Finance*, Ms. Barrell is the author of *Real Estate Finance Today*; *Ethics in Today's Real Estate World*; *Know the Code*; and *Everyday Ethics in Real Estate*. She is the coauthor of *Reaching Out: The Financial Power of Niche Marketing* and *Fundamentals of Marketing for the Real Estate Professional*. She is also the consulting editor for *Reverse Mortgages* and *Virginia Practice and Law*. She also served as a teaching consultant to the International Real Property Foundation, bringing real estate education to countries in Eastern Europe and Southeast Asia for over 10 years. Ms. Barrell recently retired "with honors" from NeighborWorks® America, where she prepared course materials and taught classes at NeighborWorks® Training Institute locations throughout the United States. She also developed the Expanding Housing Opportunities course for NAR, which she taught in addition to Train the Trainer classes for NAR instructors. She continues to edit and write real estate courses, most recently an introductory course for real estate brokerage for entrepreneurs in Cuba.

CONTRIBUTORS

Our gratitude must begin with the many students who have insisted through the years, "Teachers, you should write that down." To them, we say, "Thank you for supplying the necessary motivation."

For their contribution to earlier editions of the text, thanks are extended to Joseph L. Barrett, associate professor, Essex Community College; Bruce Baughman; W. Frazier Bell, Piedmont Virginia Community College; George Bell, DREI, George Bell Productions, Ltd.; Robert J. Bond; John Bonin, NeighborWorks® America National Faculty; Lynn Brown, PhD, professor, Jacksonville State University; Thomas Cary, real estate instructor/coordinator, Wadena Technical Institute; Andrij W. Chornodolsky, MA, CMA Valuation, LLC; Kelly W. Cassidy; Maurice Clifton, GRI, DREI, ERA West Wind-Boise; Gerald R. Cortesi, Triton College; Richard D. Cowan, North Carolina Academy of Real Estate; Dr. Arthur Cox, University of Northern Iowa; Lee Dillenbeck, real estate coordinator, Elgin Community College; Barbara Drisko, Real Estate Training and Education Services (RETES); Ed Elmer, Denver Financial

Group; Calvin Ferraro, GRI, Coldwell Banker Real Estate; Gloria Fisher, Senior Loan Officer, Source One Mortgage Services, Green Valley, Arizona; Donald A. Gabriel; Bill Gallagher, DREI, GRI, CCDS, CBR, Mingle School of Real Estate; Arlyne Geschwender; Gerald N. Harris, Asheville Professional School of Real Estate; Janet Heller, Berks Real Estate Institute; Carl Hemmeler III, Columbus State Community College; Steve Hummel, Ohio University–Chillicothe; Carl M. Hyatt; John Jeddeloh; Glenn Jurgens; F. Jeffery Keil, J. Sargeants Reynolds Community College; Mike Keller; John W. Killough, Blue Ridge Community College; Rick Knowles, Capital Real Estate Training; Melvin S. Lang, National Institute of Real Estate; Craig Larabee, Director, Larabee School of Real Estate and Insurance; "Doc" Blanchard LeNoir, PhD, Cedar Valley College; Thomas E. LoDolce, Financial Estate Institute; Lucy Loughhead; Laurie S. MacDougal, Laurmac Learning Center, Inc.; Jon C. McBride, Wake Technical Community College; Justin H. McCarthy, Minneapolis Technical Institute; Colin F. McGowan, Frederick Academy of Real Estate; Timothy C. Meline, Iowa Realty Company, Inc.; Stephen C. Messner; T. Gregory Morton; William E. Nix, UCLA Extension; Henry J. Olivieri, Jr., Real Estate Education Company; Charles E. Orcutt, Jr., attorney at law and adjunct faculty, Babson College; Nick J. Petra, CFP, CRB, Priority One Education Systems; Paul R. Pope, Real Estate Education Consultant, University Programs, Inc.; Dr. Wade R. Ragas, University of New Orleans; Mike Rieder, Gold Coast School of Real Estate, A Gimelstob Company; John F. Rodgers III, Catonsville Community College; Jerome D. Rutledge, North Texas Commercial Association of Realtors®; Nancy Seago, GRI, Nancy Seago Seminars; Charles V. Sederstrom III, Randall School of Real Estate; Dan South, Columbus State Community College; Paul C. and Margaret E. Sprencz; Ronald Stark, Northwest Mississippi Community College; Phyllis Tonne, Dayton Area Board of Realtors®, Audrey May Van Vliet, Academy of Real Estate Education, Inc.; Richard Zemelka, Maplewood Area JVS Branch, John Carroll University; and Roger Zimmerman, faculty, Polaris Career Center and Cuyahoga Community College.

UNIT 1

The Nature and Cycle of Real Estate Finance

LEARNING OBJECTIVES

When you have completed this unit, you will be able to

- **define** and **illustrate** the concepts of collateralization, hypothecation, and leverage;
- **discuss** mortgage lending activities, including the financial crisis and plans to stimulate the U.S. economy; and
- **name** important factors that affect real estate cycles, including the impact of the financial crisis.

KEY TERMS

American Recovery and Reinvestment Act of 2009 (ARRA)
American Taxpayer Relief Act of 2012 (ATRA)
baby boomers
collateral
Consumer Financial Protection Bureau (CFPB)
disintermediation
echo boomers
equitable title
Generation X
Home Affordable Modification Program (HAMP)
Home Affordable Refinance Program (HARP)
hypothecation
leverage
millennials
mortgage-backed securities (MBSs)
Mortgage Forgiveness Debt Relief Act of 2007
primary market
real estate cycle
robo-signing
secondary market
short sale
subprime market
Taxpayer Relief Act of 1997 (TRA '97)
Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

INTRODUCTION

There is no getting away from real estate: We farm on it, live on it, work on it, build on it, fly away from and return to it, and ultimately are buried in it. No one can question the importance of real estate in our lives.

Complementing its physical importance is the economic impact of real estate on our lifestyles. The industrial and commercial activities of the nation are completely dependent on the land and its natural resources for their very existence. Our society cannot function without food, lumber, minerals, water, and other parts and products of our land.

Many of us are involved, either directly or indirectly, in some activity concerning real estate. Salespersons, brokers, farmers, miners, engineers, surveyors, land planners, homebuilders, furniture manufacturers, and paint purveyors—all these people and more depend on real estate and its use for their livelihood. Millions of persons are engaged directly in construction activities in the United States, with literally millions more providing them with the materials and peripheral services essential to their work.

Nowhere is the economic impact of the real estate market better shown than during the economic crisis that began in 2007. As the overall real estate market began to decline and it became impossible for many people to sell or refinance their homes, the rate of foreclosures all over the country began to climb.

The overall picture remained grim until 2012 when the housing market began to show some signs of renewal in many parts of the country. With the exception of the "sand belt"—Florida, Arizona, and Nevada—and the states affected by Hurricane Sandy, the rate of disclosures began a decline that continued into 2013 and 2014. This was partially because of a higher acceptance of short sales by lenders. The rate of decline continued through 2015 and 2016 and reached below pre-recession levels in 2017. Unlike recoveries from previous recessions, the employment rate has remained low, but there has been a gradual increase in the number of housing starts, which is an essential element of the overall economic picture.

THE NATURE OF REAL ESTATE FINANCE

Introduction

The construction industry is vital to our country's economic well-being and thus is important in real estate finance. Any changes in its activities soon affect everyone. A building slowdown results in layoffs and cutbacks, while increased activity stimulates production and services in the many areas associated with the industry. Little construction is undertaken that is not first financed by loans secured from the various sources of money for real estate finance. In fact, most real estate activities rely on the availability of borrowed funds.

The popular saying "as goes the construction industry, so goes the economy" was illustrated in the economic crisis that began with the downturn in the housing market in 2007. The number of housing starts kept falling, especially for new single-family homes. The first hopeful signs of a return to safe financial ground were not seen until 2013–2014 when single-family building began to slowly increase and multifamily starts actually reached their highest level since 1998.[1]

The Harvard *State of the Nation's Housing Report 2016* continues to show slow but steady improvement in the number of housing starts, an increase in sales prices, and a decline in delinquency rates throughout most of the country. One factor that has limited housing starts is the falloff in household growth. New households are being formed at half the normal rate as economic conditions make it difficult for young adults to live on their own and for

1. Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing Report 2013," *Joint Center for Housing Studies*, www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2013.pdf1. (accessed October 28, 2014).

immigrants to purchase new homes. With the economy nearing full employment and incomes beginning to climb, it is anticipated that household growth will continue to improve.

An important factor in the housing recovery is the continued drive of the rental market. More than one-third of households chose to rent in 2015, although surveys show that home ownership is still very much a part of the American dream.

Credit System Economy

We all recognize that our society is *credit oriented*. We postpone paying for our personal property purchases by using credit cards and charge accounts. Credit expands our ability to own goods that in turn enhance our lives.

The credit concept of enjoying the use of an object while still paying for it is the basis of real estate finance. Financing a real estate purchase involves borrowing large sums of money and usually requires a long time to repay the loan. Instead of revolving charge accounts or 90-day credit loans for hundreds of dollars, real estate involves loans of thousands of dollars, repayable for up to 40 years.

The long-term nature of real estate loans complements the holding profile of the major financial lenders. Furthermore, the systematic repayment of real estate loans, usually in regular monthly amounts, creates the rhythm that enables lenders to collect savings and redistribute funds to implement continued economic growth.

However, this rhythm can be interrupted when there is a prolonged period of **disintermediation**—that is, when more funds are withdrawn from financial institutions than are being deposited. This results in a net loss of deposits, a cutback in lending, and a slowdown in the economy. There is continuous, vigorous competition for the use of money among individuals, industry, and government. That is why we need the Federal Reserve (the Fed) and the secondary markets to redistribute funds nationally and provide a constant flow of cash.

Financing Relationships

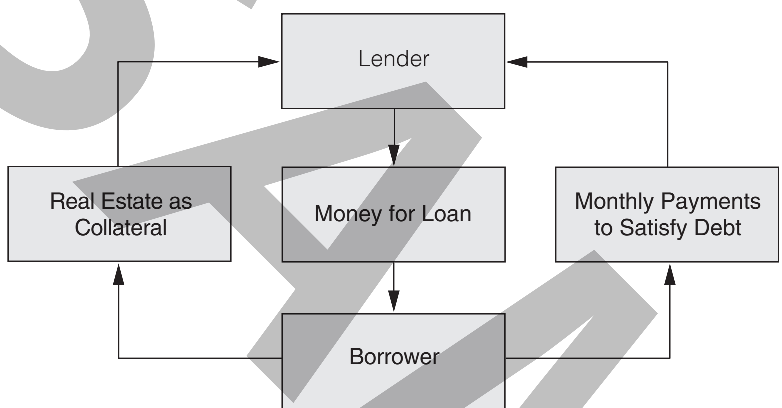
The nature of the financing relationship can be described in three ways. In its simplest form, real estate finance involves pledging real property as **collateral** to back up a promise to repay a loan. As illustrated in Figure 1.1, a building and the land on which it stands are pledged to a lender as the borrower's guarantee that the terms of a loan contract will be satisfied. If a borrower defaults on repayment promises, the lender is legally able to foreclose on the real estate and sell it to try to recoup the loan balance.

There are two main types of security instruments used in real property: a mortgage and a deed of trust. A mortgage is a two-party instrument between the mortgagor (borrower) and the mortgagee (lender). The deed of trust is a three-party instrument between the trustor (borrower), beneficiary (lender), and a disinterested third party known as a trustee. The trustor conveys title to the trustee for the benefit of the beneficiary. The title remains in the trust until the debt has been satisfied. State laws determine the type of instrument to be used. Along with the pledge of a security instrument, the title interest is determined. In a title theory state, the mortgage conveys ownership to the mortgagee (lender), known as legal title, and the mortgagor (borrower) has **equitable title**. Once the mortgagor pays the debt in full, the legal title is passed from the mortgagee to the mortgagor.

However, in a lien theory state, the mortgagor or trustor (borrower) has equitable title to the property and the mortgagee or beneficiary (lender) has a lien on the property. The trustee in a deed of trust may hold either the legal title or the promissory note; therefore, the trustor would have both legal and equitable title. This is sometimes called modified lien theory.

There will be more on mortgages and deeds of trust in Unit 6.

FIGURE 1.1: Financing Real Estate with Collateral



Until the borrower repays the lender in full, the real estate is the borrower's collateral or security that the debt will be repaid.

Hypothecation means to pledge real or personal property as security for a debt. A tenant may pledge leasehold rights as collateral for a loan. A lender may pledge rights in a receivable mortgage, deed of trust, or contract for deed as collateral for another loan. A life tenant can acquire a loan on beneficial rights as well as remainder rights. A farmer can pledge unharvested crops as collateral for a loan. In each of these cases, and others of similar design, the borrower retains possession, control, and use of the collateral but capitalizes on its value by borrowing against it.

Leverage is the third way to describe real estate finance. Leverage is the use of a proportionately small amount of money to secure a large loan for the purchase of a property. Buyers invest a portion of their money as a down payment and then leverage by borrowing the balance needed toward the full purchase price.

The quality and quantity of leverage are important topics. Buyers may be asked to invest 3, 5, 10, or even 20% of the purchase price before being eligible to borrow the balance. As a result of tightened qualifying standards resulting from the financial crisis, today's buyers may be asked to provide a much larger down payment than in the past. The minimum down payment for most conventional loans today is 5%, although FHA remains at 3.5%. The degree of leverage depends on the specific situation and the type of loan desired. These varying cash requirements dramatically affect a buyer's ability to purchase property. The use of leverage to purchase investment property generally increases the return on cash invested to an amount substantially higher than paying all cash.

MORTGAGE LENDING ACTIVITIES

The Primary and Secondary Mortgage Market

Underlying and forming the foundation for mortgage lending is the concept of savings. These savings are loaned to borrowers from whom additional earnings are produced for the lenders in the form of interest. These earnings are then used in part to pay interest to the savers on their deposits.

Most loans for real estate are made by financial institutions designed to hold individuals' savings until they are withdrawn. These primary market institutions include the following, among others:

- Commercial banks
- Savings banks
- Life insurance companies
- Credit unions

The loans originated by the primary market lenders are then packaged and sold to the secondary market, which includes the following:

- Fannie Mae
- Freddie Mac
- Ginnie Mae
- Federal Home Loan Bank
- Private investors

Scope of Mortgage Lending

The scope of the mortgage lending activities of various sources of funds is shown in Figure 1.2.

FIGURE 1.2: Mortgage Debt Outstanding, End of Q4 2016 (Millions of Dollars)

By Type of Property	
1–4 family residence	$10,205,280
Multifamily residence	1,186,655
Nonfarm, nonresidential	2,614,809
Farm	224,400
Total	$14,231,544

By Type of Holder	
Major financial institutions	$5,084,031
Federal & related agencies	5,146,936
Mortgage pools & trusts	2,836,628
Individuals & other	1,223,950
Total	$14,291,545

Source: www.federalreserve.gov

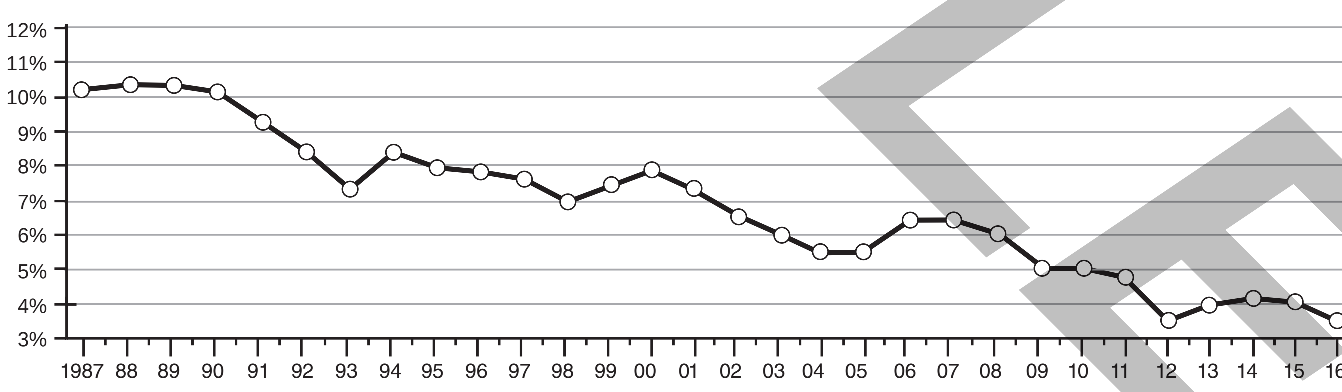
The total amount of mortgage loans outstanding at the end of 2016 was more than $14 trillion, back to the 2009 total of $14 trillion. Notice that almost 75% of all loans made are for one-family to four-family residential properties, a dramatic testimony to the importance of housing in the real estate market.

The price of real estate fluctuates over time, depending on changing market conditions. Most buyers do not have the cash required for real estate purchases. They must borrow to complete their acquisitions. If the sources for these loans were to be limited to any large extent, fewer properties would be developed and fewer would be sold. Shortages of funds for mortgage lending affect every level of the construction industry, with serious ramifications throughout the total national economy.

Interest Rates

In the late 1980s, interest rates on real estate loans were at double-digit levels, as shown in Figure 1.3. This effectively eliminated a major portion of the participants in the real estate market. To meet this emergency, wide-ranging creative financing arrangements were invented to allow market continuity. These arrangements included partnerships between lenders and borrowers (called participation financing, which is used mostly in commercial real estate), variable-interest-rate loans, and variable-payment loans, all designed to relieve borrowers' burdens and permit lenders to stay in business. As the decade progressed, interest rates fell almost as rapidly as they had risen, and the demand for basic fixed-rate mortgages returned. This reduction in interest rates, to between 6 and 8%, resulted in a sharply increased demand for mortgage refinancing, and the focus of the lenders shifted from loans for purchasing property to loans for refinancing existing high-interest, adjustable-rate, and fixed-rate loans. In addition, relatively low interest rates fueled a sharp rise in real estate activity. As interest rates continued to drop in the second decade of the 2000s and there were more loan modifications with the lower interest rates, lenders were again swamped with refinancing requests. Midway through 2014, the average interest rate for a fixed-rate, 30-year mortgage was slightly over 4%.

FIGURE 1.3: 30-Year Fixed-Rate Mortgage Interest Rates



Source: www.freddiemac.com

Financial Crisis

In the late 1990s and early 2000s, the **subprime market** more than doubled offering higher qualifying ratios, hybrid ARMs with artificially low initial payment schedules, and more liberal qualifying standards. Fannie Mae and Freddie Mac conforming loans also became available in many different forms using liberal qualifying standards and long-term risky loan products.

As the overall housing market boom began to decline in 2006, the subprime market was the first to crash, but by 2007, Fannie Mae and Freddie Mac were also in trouble. Borrowers found themselves unable to pay their sharply increased mortgage payments as adjustable-rate mortgages began to reset at higher rates. Refinancing was no longer an option because housing values were declining, and the slow market made it very difficult to sell. By 2007, more than 1% of all households were facing foreclosure, with projections of at least 3% by 2010. A Mortgage Bankers Association survey in August 2008 showed that 9.2% of all U.S. mortgages were either delinquent or in foreclosure. By September 2009, the number had risen to 14.4%. On a more optimistic note, in April 2010, RealtyTrac® reported a 2% drop in foreclosures from the previous year, the first annual decline in five years.

The decline continued in 2011 but was mainly attributed to the slowdown in the way many lenders handled foreclosure documentation after being criticized for taking shortcuts such as **robo-signing** (in which a bank official signs thousands of documents without verifying the information). As the banks began to move past these problems, the rate of foreclosures began to once again increase. According to financial analysts from CoreLogic, as of June 30, 2011, 22.5% of U.S. homeowners were "underwater" (i.e., they owed more than their house was worth) on their mortgage. The *U.S. Foreclosure Market Report*, published by RealtyTrac®, showed that one in every 213 U.S. housing units had a foreclosure filing in the third quarter of 2011.

The National Association of REALTORS® forecast for 2013 showed that the shadow inventory (i.e., houses that were delinquent or in foreclosure) represented about one-third of the market in 2010 and 2011. This number dropped to about 25% in 2012 and was projected to fall to single digits by 2014. In the January 10, 2014, issue of *REALTOR Magazine*, Mark Fleming, CEO of CoreLogic, was quoted as saying that the shadow inventory, which is also called the "pending supply," had fallen to its lowest level since August 2008, down 24% from the previous year.

By 2015, the foreclosure rate was down by 20%, reaching its lowest point since 2006. ATOMM Data Solutions, curator of the nation's largest fused property database, released its first quarter, 2017, U.S. Foreclosure Market Report, which showed foreclosure activity below pre-recession levels nationwide and in 102 out of 216 metropolitan statistical areas (MSAs). MSAs showing the highest percentages of improvement are Los Angeles, Dallas, Houston, Miami, and Atlanta. The MSAs still showing higher than pre-recession averages are New York, Chicago, Philadelphia, Washington, D.C., and Boston. Contrary to the national trend, the District of Columbia and 12 states continue to show a year-over-year increase in foreclosures. The ones with the highest percentages are New Jersey, Oklahoma, Louisiana, Connecticut, and Arizona.

The National Mortgage Settlement, announced in February 2012, is believed to have played a major role in the drop in the number of foreclosures. This was a joint state/federal settlement with five of the largest mortgage servicers in the country: Ally/GMAC, Bank of America, CitiMortgage, JPMorgan Chase, and Wells Fargo. The settlement, which provided nearly $25 billion in relief to distressed borrowers and direct payments to states and the federal government, was the largest multistate settlement since the tobacco settlement in 1998.

Another major factor in the reduction of foreclosures was the growing acceptance by lenders of short sales. After careful analysis, many lenders realized that accepting a determined loss from a **short sale**, in which the lender accepts less than the actual payment due, could result in a lesser amount of loss than carrying the property through foreclosure with limited prospects for resale.

Plans for Stimulus to the Ailing U.S. Economy

On February 17, 2009, President Barack Obama signed into law the **American Recovery and Reinvestment Act of 2009** (stimulus bill), also called ARRA. Important components of the act included federal tax cuts, expansion of unemployment benefits and other social welfare provisions, and domestic spending in education, health care, and infrastructure. Some of the credits and provisions of the act that were due to expire at the end of 2010 were extended by the Tax Relief and Job Creation Act of 2010 and again later by the American Taxpayer Relief Act of 2012. The Mortgage Forgiveness Debt Relief Act of 2007 and the deduction for mortgage insurance premiums were further extended to 2017.

On February 18, 2009, Obama announced his Homeowner Affordability and Stability Plan, which included the Making Home Affordable (MHA) program. The MHA program offered assistance to seven to nine million homeowners making a good-faith effort to make their mortgage payments through loan modification or refinancing. The **Home Affordable Modification Program** (HAMP), a key component of the MHA initiative, was extended through December 2016, when it was discontinued.

The original HAMP actions taken included

- expanding the Fannie Mae, Freddie Mac, and FHA loans limits to $729,750;
- launching a $23.5 billion Housing Finance Agencies Initiative to help state and local housing finance agencies;
- supporting the first-time homebuyer tax credit; and
- providing more than $5 billion in support for affordable rental housing through low-income housing tax credit programs and $2 billion in additional support for the Neighborhood Stabilization Program (NSP) to restore neighborhoods hardest hit by concentrated foreclosures.

On February 19, 2010, the government announced the $1.5 billion Hardest Hit Fund for state housing financing agencies (HFAs) in the nation's hardest-hit housing markets ($600 million more was added on March 29, 2010, for an additional five HFAs).

In April 2010, enhancements were made to HAMP. The program modifications expand flexibility for mortgage servicers and originators to assist more unemployed homeowners and those who owe more on their mortgage than the home is worth because of large declines in home values in their local market. This second chance was anticipated to help three to four million struggling homeowners in 2012. The **Home Affordable Refinance Program** (HARP) provides refinancing assistance for some homeowners who are not eligible for HAMP. This program has been extended to December 31, 2018.

In July 2010, Obama signed into law the **Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)**. This lengthy piece of legislation contains many provisions that were expected to restore responsibility and accountability to the financial system. Title III of the act abolished the Office of Thrift Supervision, transferring its power of holding companies to the Federal Reserve, state savings associations to the FDIC, and other thrifts to the Office of the Comptroller of the Currency. The amount of deposits insured by the FDIC and the National Credit Union Share Insurance Fund was permanently increased to $250,000.

Title X of the act established the Bureau of Consumer Financial Protection, also called the **Consumer Financial Protection Bureau** (CFPB). The CFPB is housed within the Federal Reserve but operates independently. Its mission is to set rules and regulations for any business that provides financial services for consumers. The CFPB will be discussed in more detail in Unit 3.

For more information on the Dodd-Frank law, see http://banking.senate.gov/public.

For more information on the CFPB, see www.cfpb.gov.

Local Markets

Real estate is a local market in that it is fixed in place. It is impossible to move a parcel of land. As a result, any activities are done to and on the property. A building is constructed on the lot. Utilities are brought to the property and taxes are imposed on it. A real estate loan is made *on* a property, usually by a local lender or the local representative of a national lender.

The activities of the local real estate market, especially as they influence property values, are vital to the activities of the local real estate lenders. Regional, national, and international economic and political events have an indirect effect on specific real property values. However, the immediate impact of local activities on individual properties most directly affects their value.

For example, police power decisions involving zoning regulations can dramatically raise individual property values, while just as dramatically lowering neighborhood property values. Political decisions concerned with community growth or no-growth policies, pollution controls, building standards, and the preservation of coastline and wildlife habitats can significantly alter a community's economic balance and property values.

In times of economic distress, as evidenced by high interest rates and/or unemployment, local financial institutions decrease their mortgage-lending activities. This decrease adds to the downward cycle. In good times, their lending activities increase to serve the growing demand.

National Markets

When the demand for mortgage money is great, local lenders may deplete available funds. In an economic slump, these lenders may not have any safe outlets for their excess funds. A national mortgage market was developed to balance these trends.

Fannie Mae, Freddie Mac, and Ginnie Mae are the major participants in a viable national market for real estate mortgages. They, and other groups of investors, are collectively known as the **secondary market**. Loans created by local lenders, thrifts, banks, mortgage bankers, and others, known as the **primary market**, are purchased by these "second" owners who, in turn, often package these loans into mortgage pools. Proportionate ownership of these mortgage pools is then sold to investors in the form of securities called **mortgage-backed securities** (MBSs).

In this manner, the secondary mortgage market participants act to stabilize the real estate market by shifting funds from capital-excess areas to capital-deficient areas. Although they were originally designed to provide safe investments for the purchasers of their securities, recently this has not necessarily been the case. The purchase of packages of "junk" loans that were not a safe investment was a major contributing factor to the economic crisis that started in 2007. There will be more about MBSs and CMOs (collateralized mortgage obligatons) in Unit 4.

REAL ESTATE CYCLES

Introduction

The ups and downs of real estate activities are described as **real estate cycles**. The word *cycle* implies the recurrence of events in a somewhat regular pattern. By studying past real estate market activities, researchers can develop prognoses for future investment plans.

Supply and Demand

Real estate cycles are affected by many variables, all of which, either directly or indirectly, are influenced by the economic forces of supply and demand. Real estate cycles can be short term or long term. In the short-term cycle, the general business conditions that produce the earnings needed to create an effective demand usually trigger the real estate market's activity. In a growth area where business is good and demand is higher than the available supply of real estate, the prices of properties available for sale increase. This active demand generally encourages more building, and the supply of real estate tends to increase until there is a surplus. When the supply exceeds the demand, prices decrease. Any new construction becomes economically unsound. The cycle repeats itself as soon as the demand again exceeds the supply.

IN PRACTICE

An elderly couple lives in a small town. They have decided to sell their home of 34 years and move to a retirement community. Unfortunately, the local factory, the only real business in town, recently closed its doors, putting 300 people out of work. Most of the families who worked there have to relocate because there are no jobs available in the immediate area, even at lower salaries.

Even though the couple isn't directly affected by the factory shutdown, they will suffer the effects of a declining real estate cycle. Their home is now one of many on the market at a time when there are very few potential buyers. The price they will be able to get for their property today is much less than they could have expected a year ago.

Another variable affecting the short-term real estate cycle is the supply of money for financing. Tight money circumstances develop when competitive drains on the money supply occur or the Fed takes certain actions to restrict the supply of money. The two largest competitors for savings are the federal government, with its gargantuan budgetary commitments, and industry, which taps the money markets to finance additional inventory or plant expansion. Any continuing deficits in its budget force the government into the borrowing market, reducing funds available for real estate finance.

In the short term, the market responds to current economic conditions, while in the long term, the time variables associated with real estate development prevail. It takes time to put a real estate project on the ground. From the creation of the idea to the acquisition of the land; through its possible rezoning, engineering, and preparation; during its construction, promotion, and sales, years sometimes pass. During this interval, the markets are fluctuating, and the developer may not achieve the anticipated profit.

Short-term real estate cycles generally run from 3 years to 5 years. In the long term, they generally run from 10 years to 15 years. The ability to examine the causes of the cycles and to forecast their movements in order to anticipate the markets is important to a real estate investor's success.

Population Characteristics

An important factor involved in making real estate development decisions is the makeup of this country's population and how it changes over time. Both financial investors in commercial real estate and real estate professionals in the residential market need to be aware of changing demographics in their local area in order to provide a solid basis for marketing planning. Census information continues to show that the majority of U.S. households are in officially designated metropolitan areas, and mostly in the suburbs.

The number of homeowner households has increased from a range of 75 million in 2007 up to approximately 117 million in 2016. Single-person households now account for over one-third of the market. The number of rental households has steadily increased from 2007 to the present, with more than 36% today. This increase is attributed to two factors: (1) the number of households in foreclosure has forced many into renting, and (2) tightened qualifying standards have made it more difficult to obtain a home mortgage loan. Ironically, the national Housing Affordability Index (a measure of how many households with median income can afford a house of median price) reached an all-time high in 2013, and has remained in the 160–180 range throughout 2016; however, the tighter lending standards still make it difficult to obtain a loan.

Harvard's *State of the Nation's Housing Report 2013* anticipated that in 2015, minorities would make up 36% of U.S. households with 46% in the 25–34 age group. The 2016 report indicates that the 2013 projections were right on track. This group represents half of first-time homebuyers. The 2016 U.S. Census Bureau reports a slight increase in ownership by white and Hispanic persons, a slight drop by African Americans, and approximately the same percentages for all other races. The **millennials** (those born between 1985 and 2004) have been making a slow start due to unemployment and the burden of student loans, but they are expected to start making a move toward home ownership as they approach age 30. The 2016 Harvard report shows that presently, 50% of those aged 20–24, 27% of those aged 25–29, and 15% of those aged 30–34 still live at home. The Harvard report estimates household growth in the 2015–2025 decade of between 11 million and 13 million, surprisingly, with a large share of domestic growth with those aged 70 or older. Minorities are expected to account for 75% of household growth in this decade. This would be in line with the annual averages from the 1980s, 1990s, and 2000s.

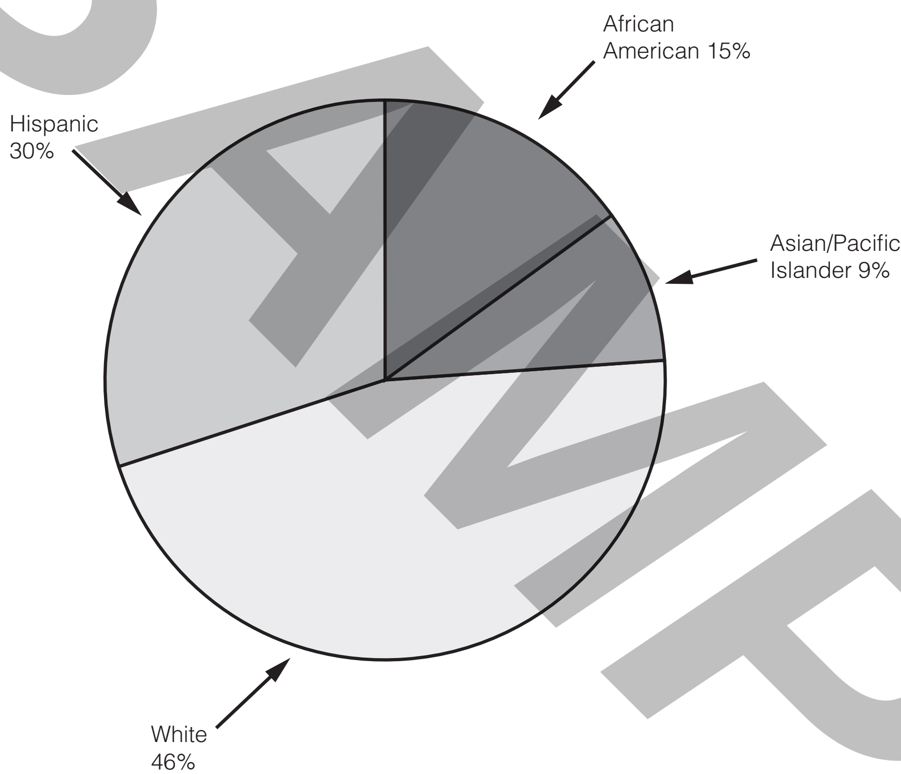
Who Is Buying What

The U.S. Census Bureau description of a median home's dimensions has enlarged slightly over the last decade and in 2015, set a new record of 2,467 square feet, with at least six rooms, four of which are bedrooms. More than half have three or more bathrooms. Two-thirds of these households have no children younger than 18. More than 30 million persons live alone. The median house value in 2016 was $222,400 ($229,100 for new construction). Median household income was $53,700 (still lower than any pre-recession level).

According to the 2016 census, the population of the United States is 316,128,839. (The census.gov website keeps a daily tally, with the population as of May 2, 2017, showing as 324,972,067.). This represents around a 10% increase since 2000. The percentage of the female population continues to be slightly higher than male, with the rate of growth faster in the older age groups. The median age increased from 35.3 in 2000 to 42.9 in 2013. Maine has the highest median age of 43.9, with Florida having the highest percentage of the population over 65 at 18.5%. Utah remained the state with the lowest median age of 30.2, largely due to the high percentage (8.8%) of the population under the age of 5.

A 2004 interim report published by the U.S. Census Bureau projected a new total population in 2050 of 420 million, distributed as shown in Figure 1.4. These numbers may all be less, however, as a result of a potential drop in the number of persons immigrating over the next four decades.

FIGURE 1.4: Projected U.S. Population in 2050



Source: U.S. Census Bureau

Minorities were expected to make up one-third of the U.S. population by 2016 and were originally expected to account for more than two-thirds of the net increase in households between 2010 and 2020. However, the economic crisis created a decline in the national homeownership rate from a high of 69% in 2004 to 63.9% in 2016 and also impacted the number of new immigration households. The total number of foreign-born households, which continuously increased in the past, actually started to decline in 2007.

The 2004 projections may change by a few percentage points in 2050, but are expected to follow roughly the same pattern. A more recent study of the distribution of the population by race and Hispanic origin showed the following percentages for the year 2060.

FIGURE 1.5: Projected U.S. Population in 2060

Non-Hispanic:	
White	43.6
Black	13.0
Asian	9.1
Other	.8
Two+ races	4.9
Hispanic	28.6

The crossover year for the majority/minority is projected to be 2044.

An Aging Population

Our population is also aging. The 78 million **baby boomers** born between 1946 and 1964 are creating a middle-age bulge in population demographics. Unlike the previous generation, boomers are living longer and healthier lives and many continue to work at least part time past the typical retirement age because of the erosion of retirement savings and the loss of acquired home equity. This generation tends to "age in place" and may look to making improvements or modifications in order to remain in their present home or to demand more services and amenities designed for senior citizens in one of the many independent or assisted living options. Harvard's *State of the Nation's Housing Report 2016* indicates that the number of households over age 70 will increase by 13 million by 2025.

The next age group, those born between 1965 and 1979, often called **Generation X**, tend to marry later, have a higher divorce rate, and a lower remarriage rate, making the single-person household the fastest-growing household type. According to the Harvard study, persons living alone are expected to account for 36% of household growth between 2010 and 2020.

Then there are the **echo boomers**, those born in the 1980s and early 1990s. There are five million more of them than their parents' generation. They should be just entering their most productive buying years but are inhibited by current economic conditions, and a large percentage of them continue, or have returned, to live at home. In general, they tend to be interested in green and environmentally friendly types of housing. The **millennials** (born between 1985 and 2004) overlap with the echo boomers. They are expected to form at least 2 million new households over the next few years, resulting in a projected 40 million in 2025.

Earlier Census Bureau charts showed our population divided as follows:

- Married couple household: 51.7%
- Two or more people, nonfamily: 6.1%
- Female householder, other family: 12.2%
- Male householder, other family: 4.2%
- Single householder, nonfamily: 25.8%

In 2016, Census Bureau charts show married households at 50%, nonfamily households at 35%, and other family households at 15%. Approximately 32,000 households are one-person, family households average 3+ members, while all other households average 2.5 members.

Social Attitudes

Changing social attitudes also influence real estate cycles. Historically, fast growth was the goal of many U.S. communities, and some even favor this approach today. Local governments often offer concessions to induce industry to move to their towns. Nevertheless, many communities promote an attitude of planned growth, legally limiting new construction activities to satisfy voters' demands.

Throughout the United States today, many communities are striving for "smart growth," with proper planning a prerequisite for allowing new development. A "no growth" policy leads to a downturn in the economy, but rampant "overgrowth" leaves communities lacking in schools, police and fire protection, and adequate transportation. There is also a growing concern today for energy conservation and other environmental issues.

Tax Issues

The constantly changing federal income tax structure also affects real estate cycles. In 1986 Congress imposed dramatic restrictions on the use of excess losses from real estate investments to shelter other income under the Tax Reform Act of 1986 (TRA '86). Special treatment for capital gains and excessive depreciation deductions were also introduced.

Effective May 7, 1997, Congress again fine-tuned the income tax laws by passing the **Taxpayer Relief Act of 1997** (TRA '97), providing homeowners with broad exemptions from capital gains taxes on profits made from the sale of personal residences. Replacing the one-time exemption of $125,000 for sellers older than age 55, TRA '97 exempts up to $500,000 of profits from taxes for a married couple filing jointly (or up to $250,000 for a single person) who have lived in the property as a primary residence for more than two years in the five years previous to the sale.

TRA '97 eliminated the necessity to purchase another residence at a price equal to or higher than that of sold property. It also eliminated keeping records of repairs, additions, or other changes to the sold property's tax basis unless the gain from the sale exceeds the exemptions. These tax benefits may be taken every two years, and Internal Revenue Service (IRS) regulations now stipulate that if the property meets the entire exclusion, the transaction need not be reported at all.

Investors in real estate received additional benefits from TRA '97. The long-term maximum capital gains tax rate was reduced to 15% (5% for investors in the 10% and 15% income brackets, later reduced to 0%). The depreciation recapture tax on the amount that has been depreciated over the years is charged at 25%. Note that the property must be held a minimum of 12 months. In 2001, this rate dropped to 18% (8% for those in the 15% tax bracket) for assets acquired after January 2001 and held for five years or longer.

The reduced 15% tax rate on qualified dividends and long-term capital gains was scheduled to expire in 2008 but was extended through 2010 and again through 2012. From 2008 to 2012, the tax rate was 0% for those in the 10% and 15% tax brackets. After 2012, dividends are taxed at the taxpayer's ordinary income tax rate, and the long-term capital gains tax rate is 20% (10% for those in the 15% tax bracket). Also after 2012, the qualified five-year 18% capital gains rate (8% for taxpayers in the 15% tax bracket) was reinstated.

The **Mortgage Forgiveness Debt Relief Act of 2007** provided a benefit for homeowners who had lost a home to foreclosure or through a short sale. In the past, the IRS counted any write-off amount on a loan as taxable income to the borrower. Under this act, any income realized as a result of modification of the terms of the mortgage such as recasting of the loan for a lesser amount, or as a result of foreclosure on a principal residence, or in a short sale was not counted as income. The act was extended through the end of 2013.

American Taxpayer Relief Act of 2012

The **American Taxpayer Relief Act of 2012** (ATRA) was signed into law on January 2, 2013. The bill extended the mortgage debt cancellation relief that had been granted under the Mortgage Forgiveness Debt Relief Act of 2007 through 2013. The act also extended the deduction for mortgage insurance premiums for tax filers making less than $110,000. Both extensions expired January 1, 2014, but have been extended through 2017. It has been suggested that the slight drop in the number of short sales in 2014 may be due to the uncertainty over the debt relief. The tax credit for energy-efficient improvements has been limited to 10% up to $200 for windows, and up to $500 for doors.

Current tax rates were extended for households earning less than $450,000 or $400,000 for individual filers. For households earning more than these limits, tax rates reverted to 2003 numbers, resulting in taxpayers in the highest income bracket paying at a rate of 39.5%, up from 35%. The income limits may be adjusted annually.

The tax rate on capital gains remains the same, at 15%, for most households, with an increase to 20% for the higher income bracket. The exclusion from taxes for gains on a principal residence remains the same unless the sellers are in the higher income bracket.

A key change in estate tax is the requirement that estates be taxed at a top rate of 40%, with the first $5 million in value exempted for individual estates and $10 million for family estates.

For more information, see the IRS website at www.irs.gov.

Property Value Fluctuations

Although some properties display a character of their own and run counter to prevailing trends, most properties are carried along in a cyclical action. Generally, in the long run, most real property values rise. In the short run, property values rise and fall.

In the past, the stabilizing influences of Fannie Mae, Freddie Mac, and Ginnie Mae calmed some of the volatile short-term reactions of localized booms and busts. At the same time, the financial management policies of the Federal Reserve and the U.S. Treasury largely soothed long-term reactions to these cycles. These latter federal government agencies were expected to control the supply of money in circulation. The financial crisis that began in 2007 challenged every aspect of mortgage financing from the federal government to the local bank on the corner.

Traditional real estate cycles can be moderated by better market information and by increasing openness about real estate dealings, financing, and new construction.

The following four key groups are largely responsible for providing this important market information:

- Bond analysts and rating agencies submit highly detailed information to investors who participate in mortgage-backed securities.
- Real estate investment trust (REIT) analysts provide full disclosure of the data in the field that now controls a substantial percentage of the commercial real estate market.

- Bank and insurance analysts publish essential underwriting market data.
- Information providers on the internet act as important sources of the vast amount of data available.

Impact of the Financial Crisis

After years of spectacular growth in the single-family housing market with concomitant increases in property values, the housing market boom came to an abrupt halt in mid-2008. Upon the discovery that lenders all over the country had issued thousands of subprime loans to unqualified borrowers on properties with super-inflated values, the financial markets froze and stopped making loans.

Even Fannie Mae and Freddie Mac were caught up in the lending disaster, having purchased thousands of "worthless" loans that they bundled and sold to international investors. The federal government stepped in to rescue these government-sponsored enterprises from bankruptcy, confiscating their assets and firing managers.

Now in conservatorship under the Federal Housing Finance Agency (FHFA), Fannie Mae and Freddie Mac have reinstated their basic standards, which real estate lenders must carefully observe if they wish to sell their new loans to these secondary market operators. The tighter qualifying standards drove many potential borrowers to government-owned or guaranteed loans. FHA became the primary lender for low-down-payment loans, accounting for 80% of the market in 2012. USDA Section 502 guarantees for homes in rural areas have also increased significantly. In 2014, a new cycle began as more private investment returned to the real estate financing market. The percentage of conventional loans sold to Fannie Mae and Freddie Mac continues to rise and the percentage of FHA loans is decreasing slightly. Discussion continues on the future of Fannie Mae and Freddie Mac, but the FHFA expects business as usual for at least a few more years.

SUMMARY

Millions of persons are involved in some form of activity related to real estate. When flourishing, the construction industry directly employs millions of people. Innumerable additional workers are engaged in providing this industry its materials and peripheral services.

Most real estate activities are financed. Monies accumulated by thrifts, banks, life insurance companies, pension funds, and other formal financial intermediaries are loaned to builders and developers to finance their projects. Other loans are made to buyers of already existing structures, thus providing the financial institutions a continuing opportunity for investments of their entrusted funds. These investments produce returns and new funds available for loans to stimulate additional growth.

These financing activities are based on the simple premise of real estate being pledged as collateral to guarantee the repayment of a loan. An owner of a property borrows money from a lender and executes a promise to repay this loan under agreed-upon terms and conditions. The real estate is pledged as collateral to back up this promise. The borrower continues to be able to possess and use the collateral real estate during the term of the loan. The ability to maintain control of the property while borrowing against it is called hypothecation. It is also a manifestation of leverage, by which a small amount of money can provide the means for securing a large loan for the purchase of property. If the promise to repay the loan is broken, the lender can acquire the collateral and sell it to recover the investment.

Generally, the majority of loans on real estate are made by local financing institutions, using deposits accumulated by persons in the community. However, a national market for real estate finance operates under the auspices of Fannie Mae, Freddie Mac, Ginnie Mae, the Federal Home Loan Bank, and private investors. These agencies provide a secondary market for buying and selling mortgages on a national level.

The overall cycle of real estate economics and finance is modified by the forces of supply and demand. Excess demand normally leads to increased production until excess supply reverses the cycle. Mirroring these forces of supply and demand is the availability of money for financing at reasonable costs. Other variables that affect real estate cycles include population changes in terms of numbers, age, and social attitudes; changes in political attitudes governing community growth policies; and changes in the federal income tax structure.

Complementing the secondary market activities that balance national level mortgage loan funding sources are the much broader controls exercised by the Federal Reserve (the Fed) and the U.S. Treasury. By controlling the amounts of money in circulation and the cost of securing mortgage funds, these agencies attempt to balance the fluctuations of the national money market.

The general decline in the housing market in 2006 started the domino effect of people unable to sell or refinance their homes and going into foreclosure. Purchases of packages of "junk" loans led to further financial collapse on the secondary market. Hopefully, the housing market will be able to lead the road to economic recovery over the next decade.

Internet Resources

- Fannie Mae—www.fanniemae.com
- Federal Housing Finance Agency—www.fhfa.gov
- Freddie Mac—www.freddiemac.com
- Ginnie Mae—www.ginniemae.gov
- Internal Revenue Service—www.irs.gov
- Joint Center for Housing Studies of Harvard University—www.jchs.harvard.edu
- RealtyTrac®—www.realtytrac.com
- U.S. Census Bureau—www.census.gov

REVIEW QUESTIONS

1. The economic well-being of the United States would be substantially affected by a slowdown in which industry?
   A. Farm
   B. Steel
   C. Construction
   D. Garment

2. A financial institution experiencing disintermediation is *BEST* described as
   A. a form of dispute resolution.
   B. more funds being withdrawn than deposited.
   C. an involuntary stock takeover.
   D. an excess of subprime loans.

3. A situation where the borrower retains possession of the property while the lender has a security interest is called
   A. disintermediation.
   B. collateral.
   C. hypothecation.
   D. leverage.

4. A buyer makes a very small down payment and borrows the balance needed to purchase real property. This is called using
   A. leverage.
   B. collateral.
   C. hypothecation.
   D. equitable title.

5. The largest holders of mortgage loan debt for one- to four-family units are
   A. major financial institutions.
   B. mortgage pools and trusts.
   C. individuals and others.
   D. federal and related agencies.

6. Which activity would have the *MOST* impact on property values in a moderately sized Midwestern city?
   A. Crash of the Japanese stock market
   B. Decline in the Nasdaq stock exchange
   C. Closing of the largest factory in the city
   D. Extensive hurricane damage in the South

7. According to the U.S. Census Bureau, the largest percentage of households today are
   A. married couples.
   B. female heads of household.
   C. two unrelated persons.
   D. single people.

8. A city is experiencing a 28% growth in population this year as a result of three new industries moving into the area. Based on supply and demand, this population growth will *MOST* likely lead to
   A. a decrease in home prices.
   B. an increase in home prices.
   C. an increase in property taxes.
   D. a decrease in property taxes.

9. The population demographics of the United States are changing in all categories *EXCEPT*
   A. an increase in Asian and Hispanic households.
   B. baby boomers retiring.
   C. a higher number of elderly households.
   D. a higher birth rate.

10. To qualify for the $500,000 exemption from capital gains tax on the sale of their home, a couple must have done which of the following?
    A. Lived there the two years before selling
    B. Lived there an aggregate of two years out of the past five years
    C. Lived there two years plus be at least 55 years old
    D. Never used the residence as a rental property

11. A new real estate cycle begins when
    A. demand exceeds supply.
    B. supply exceeds demand.
    C. supply and demand are equal.
    D. interest rates decrease.

12. Short-term real estate cycles typically run
    A. 1–3 years.
    B. 3–5 years.
    C. 5–7 years.
    D. 7–10 years.

13. Making a deposit into a credit union account is an example of investing in
    A. a local market.
    B. a secondary market.
    C. a primary market.
    D. a national market.

14. All of the following government programs have the potential to lower a homeowner's monthly mortgage payment *EXCEPT*
    A. the Making Home Affordable Program.
    B. the Home Affordable Modification Program.
    C. the Home Affordable Refinance Program.
    D. the Dodd-Frank Act.

15. Which of the following is a primary market financial institution?
    A. Commercial bank
    B. Savings association
    C. Credit union
    D. All of these

Build Your Successful Career with Dearborn™ Real Estate Education

Essentials of Real Estate Investment

The Language of Real Estate

Real Estate and Taxes: What Every Agent Should Know

Understanding 1031 Tax-Free Exchanges

ESSENTIALS OF REAL ESTATE FINANCE

FIFTEENTH EDITION

Essentials of Real Estate Finance is a classic text that has trained over 100,000 real estate professionals. With accessible language and plenty of examples, illustrations, and other learning tools throughout each unit, this exciting new edition provides in-depth and easy-to-understand coverage of the real estate finance industry.

Features:

- In Practice and For Example sections throughout each unit help you connect the principles in the book to real-life scenarios.
- Unit review questions with answers and detailed rationales in the back of the book allow you to quiz yourself and measure your understanding of the material.
- Key terms at the beginning of each unit and unit summaries at the end keep you engaged and help you focus on the most important information.
- A comprehensive glossary provides definitions for every key term in the book.
- Internet resources at the end of each unit direct you to the best places to find more information online.

Dearborn™
Real Estate Education

332 Front Street South, Suite 501
La Crosse, WI 54601
www.dearborn.com, 800.972.2220

For comments or queries about this product, please email us at *contentinquiries@dearborn.com.*

ISBN: 978-1-4754-6207-4

9 781475 462074