

# MODERN **REAL ESTATE** PRACTICE

21<sup>ST</sup>  
EDITION



Fillmore W. Galaty | Wellington J. Allaway | Robert C. Kyle  
Martha R. Williams, JD, Contributing Editor

**Dearborn**  
Real Estate Education

# Modern Real Estate Practice

21st Edition

Fillmore W. Galaty, Wellington J. Allaway, and Robert C. Kyle

Martha R. Williams, JD, Contributing Editor

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MODERN REAL ESTATE PRACTICE 21ST EDITION

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# ONLINE EXAM PRACTICE QUESTION BANK

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## **INCLUDED WITH YOUR BOOK!**

You receive access to hundreds of questions in an online question bank. This online exam practice tool allows you to create customized quizzes and exams from the hundreds of questions found in this book. Use the exam performance tracker in the online question bank to determine your preparedness for not only your final exam but also your state licensing exam!

SAMPLE

# PREFACE

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Since it first appeared in 1959, *Modern Real Estate Practice* has set the industry standard for real estate education. Whether preparing for a state licensing examination, fulfilling a college or university requirement, looking for specific guidance about buying or renting a home, buying an investment property, or simply expanding your understanding of this fascinating field, you can rely on *Modern Real Estate Practice*, the recognized authority for accurate and comprehensive information presented in a user-friendly format.

Just as today's real estate market is challenging and complex, today's real estate students are increasingly sophisticated and demand a high level of expertise and efficiency. This 21st edition of *Modern Real Estate Practice* meets those expectations. It provides the background in real estate principles that prepares students to practice the test-taking skills required by state licensing agencies. In response to the growing body of laws that govern the practice of real estate, this edition contains revisions and new features designed to make it an even more effective tool, no matter what your goal may be.

## SPECIAL FEATURES

This 21st edition of *Modern Real Estate Practice* retains the successful features developed for previous editions to reflect the rapid pace of change in the real estate industry.

### **Website**

*Modern Real Estate Practice* has a website dedicated exclusively to the text and its ancillary products. At [www.modernrealestatepractice.com](http://www.modernrealestatepractice.com), students and instructors have access to an assortment of study and teaching tools, including a question bank and Instructor Resource materials.

### **Quick math reference**

Inside the front and back covers of the book is a great time-saving reference tool: the most frequently used real estate math equations.

### **Math concepts**

Throughout the book, helpful math hints and answers to commonly asked math questions appear at point of use to help you understand examples in real estate that require math computations.

### **Math FAQs**

This section at the end of the book provides additional math hints and solutions to commonly asked math questions to help you understand basic math concepts and apply them to examples in real estate.

***In practice***

Throughout the text, there are examples of how the concepts discussed are carried out in everyday real estate practice.

***Directory of state licensing agencies***

An internet address for every state licensing agency is provided in the appendix. State real estate regulatory agencies typically provide links to state statutes, real estate regulations, required forms, and other useful information. When applicable statutes are provided at a different site, that address is provided as well.

***Other internet resources***

Throughout the text, *Modern Real Estate Practice* helps connect the student to internet resources by identifying relevant websites whenever appropriate. The student can access the many government and professional association websites that are continually expanded to provide historical, as well as current, information.

***Glossary***

The glossary features definitions of all key terms, as well as definitions of other important real estate terms used in the text. It also includes page references that indicate where the terms are defined or explained in the text.

***Margin notes***

Notes in the margins direct students' attention to important vocabulary terms, concepts, and study tips, as well as internet resources included in the text. The margin notes also help students locate issues for review and serve as memory prompts for more efficient and effective studying.

**UNIT FEATURES*****Learning objectives***

Each unit begins with a list of the unit goals that will help the reader anticipate the unit content.

***Key terms***

Key terms appear at the beginning of each unit. This feature not only alerts the student on the important vocabulary words that should be noted as the text is read but also helps the student to study and review.

***Key point reviews***

At the end of each unit is a summary of the most essential content covered in that unit.

### **Unit quizzes**

Demanding fact-pattern problems encourage students to not just memorize but to also understand and apply information. The answer key includes specific page references to the text.

The fundamental goal of *Modern Real Estate Practice, 21st Edition*, is to help readers understand the dynamics of the real estate industry by providing the critical information needed to pass a licensing examination, buy or sell property, or establish a real estate career.

### **A FINAL NOTE**

With the publication of *Modern Real Estate Practice, 21st Edition*, we think it is fair to consider the book a classic. For over six decades, this book has provided readers accurate and comprehensive real estate information, but we continue to ask, “What can we do to make a great book even better?”

With this edition, we continue to provide clear, concise content that complements the collective voice of the original authors, while emphasizing contemporary issues such as fair housing, client representation, financing, and the environment. The information provided here should be useful for prospective and current property owners and renters, as well as those considering a career in real estate.

Please let us know what you think of this edition by emailing us at [contentinquiries@dearborn.com](mailto:contentinquiries@dearborn.com).

Thank you for your help as you join the ranks of successful *Modern Real Estate Practice* users.

— The Publisher



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# ACKNOWLEDGMENTS

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Like a real estate transaction, this book is the product of teamwork and cooperation among professionals. We would like to express our gratitude and appreciation to the instructors and other real estate professionals whose invaluable suggestions and advice help *Modern Real Estate Practice* remain the industry's leading real estate text. Whether they responded to instructor surveys, provided reviews and suggestions for improving the previous edition, or reviewed the manuscript for this edition, the participation of these professionals—and their willingness to share their expertise—is greatly appreciated.

We would like to specially acknowledge contributing editor Martha R. Williams for her expertise and dedication while working on this edition. Martha received her juris doctor from the University of Texas, is an author and educator, and has practiced law in Texas and California. She is author or coauthor of *Fundamentals of Real Estate Appraisal*, *The Art of Real Estate Appraisal*, *How to Use the Uniform Residential Appraisal Report*, *California Mortgage Loan Brokerage*, *California Real Estate Principles*, other textbooks, and numerous electronic courses.

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Each new edition of *Modern Real Estate Practice* builds on earlier editions. We gratefully acknowledge the many real estate professionals and others who have contributed to prior editions of this book.

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# UNIT

## Introduction to the Real Estate Business

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › List the various careers available in the real estate industry.
- › Describe the different classifications and characteristics of real property and the types of housing available for purchase or rental.
- › Identify the major goal of fair housing laws.
- › Explain the factors of supply and demand in the real estate market.

### KEY TERMS

associate licensee  
broker  
fair housing

market  
real estate licensee  
sales associate

salesperson  
supply and demand

### OVERVIEW

Real estate transactions are taking place all around us, all the time. When a business that sells camping gear leases space in a shopping center, or the owner of an apartment building rents out a unit to a new tenant, it's a real estate transaction. The most common transaction is the purchase or rental of a home, whether by a first-time buyer, by someone seeking a larger or smaller place to live or a second home, or by an investor interested in the property's income-producing potential. Consumers of real estate services thus include buyers and sellers of homes, tenants and landlords, investors, and developers. Nearly everyone, at some time, is involved in a real estate transaction.

All this adds up to big business—simple as well as complex transactions that together involve trillions of dollars each year in the United States. The services of millions of highly trained individuals are required: attorneys, bankers, trust company representatives, abstract and title insurance company agents, architects, surveyors, accountants, tax experts, and many others, in addition to buyers and sellers. In most of these transactions, the people involved depend on the skills and knowledge of licensed real estate professionals.



## REAL ESTATE: A BUSINESS OF MANY SPECIALIZATIONS

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**Learning Objective:** List the various careers available in the real estate industry.

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Despite the size and complexity of the real estate business, many people think of it as a business of real estate brokers and real estate salespeople only. Actually, the real estate industry is much broader than that. Appraisal, property management, financing, subdivision and development, home inspection, counseling, and education are all separate businesses within the real estate field. To succeed in a complex industry, every real estate professional must have a basic knowledge of these specialized areas and how they impact the real estate industry.

### Brokerage

Real estate brokerage is the business of bringing people together in a real estate transaction. A licensed real estate broker acts as a point of contact between two or more people in negotiating the sale, purchase, or rental of property. A **broker** is defined as a person or company licensed to buy, sell, exchange, or lease real property for others and to charge a fee for these services. A licensed real estate **salesperson** is employed by or associated with the broker to perform brokerage activities on behalf of or for the broker, and may also be referred to as a **sales associate** or **associate licensee**.

A **real estate licensee** is a person who has satisfied the requirements of a licensing agency, as authorized by state legislation. The requirements typically include course hours or work experience and passing a state-mandated real estate exam. In some states, every real estate licensee is a broker, but only a managing broker may employ other licensees to act as sales associates, and the managing broker is responsible for the sales associates' conduct. Check the laws in your state to learn the terms used for licensees and the requirements for obtaining a license.

### Appraisal

*Appraisal* is the process of developing an opinion of a property's market value, based on established methods and the *appraiser's* professional judgment. Although brokers should have some understanding of the valuation process and, in some circumstances, may even be asked to estimate the price at which a property is likely to sell, lenders require a professional appraisal for most transactions. Appraisers must have detailed knowledge of the methods of valuation. For many federally related transactions (typically, those that involve a federal agency or federally chartered or insured lender), the appraiser must be licensed or certified by the state in which the property is located. Many states require appraisers to be licensed or certified even for transactions that are not federally related. The Appraisal Institute, [www.appraisalinstitute.org](http://www.appraisalinstitute.org), is the largest trade association of real estate appraisers.

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[www.appraisalinstitute.org](http://www.appraisalinstitute.org)

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### Property management

A *property manager* is a person or company hired to maintain and manage property on behalf of the property owner. By hiring a property manager, the owner is relieved of day-to-day management tasks, such as finding new tenants, collecting rents, finishing or altering space for tenants, ordering repairs, and generally maintaining the property. The scope of the manager's work depends on the terms of the management agreement—the employment contract between the owner and the manager. Whatever tasks are specified, the basic responsibility of the property manager is to protect the owner's investment and maximize the return on that

investment. Depending on the size of the property and/or the scope of the work required, the property manager may need a real estate license or a property management license that is issued by the state in which the property is located. The Building Owners and Managers Association International, [www.boma.org](http://www.boma.org), provides useful resources for both owners and managers.

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[www.boma.org](http://www.boma.org)

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## Financing

*Financing* is the business of providing the funds that make real estate sales transactions possible. Most sales are financed by a loan that is secured by a mortgage or deed of trust on the property purchased. Individuals involved in financing real estate may work in federally or state chartered banks or credit unions, as well as mortgage banking and mortgage brokerage companies. Federal law requires mortgage loan originators to qualify for the Nationwide Multistate Licensing System and registry (NMLS), found at <https://nationwidelicensingsystem.org>.

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<https://nationwidelicensingsystem.org>

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## Subdivision and development

*Subdivision* is the dividing of a single property into smaller parcels. *Development* involves preparation of a site and construction of structures or other improvements. These improvements may be either on-site or off-site. Off-site improvements, such as water lines and storm sewers, are made on public lands to serve the new development. On-site improvements, such as new homes or recreational amenities, are made on individual parcels. While subdivision and development normally are related, they are independent processes that can occur separately.

## Home inspection

*Home inspection* is a profession that combines a practitioner's interest in real estate with skills and training in the construction trades. Many states have recognized the importance of a thorough home inspection by a competent, well-trained inspector by instituting home inspector licensing requirements that include education, training, examinations, and ongoing coursework. The American Society of Home Inspectors, [www.homeinspector.org](http://www.homeinspector.org), is a trade group for home inspection professionals.

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[www.homeinspector.org](http://www.homeinspector.org)

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A professional home inspector conducts a thorough visual survey of a property's structure, systems, and site conditions and prepares an analytical report that is valuable to both purchasers and homeowners. The inspector examines the property from the chimney to the basement, being alert to deterioration, water intrusion, mechanical, or other observable problems. Often, the home inspection leads to a recommendation for additional examination when warranted by a property condition, such as evidence of mold damage or insect infestation. Cautious consumers, especially those who live in states in which *caveat emptor* (buyer beware) is the law, are relying more and more on the inspector's report to help them make purchase decisions. Frequently, a real estate sales contract will be contingent (conditioned) upon the inspector's report.

## Counseling

Counseling involves providing clients with competent independent advice based on sound professional judgment. A real estate counselor helps clients choose among the various alternatives involved in purchasing, leasing, using, or investing in property. A counselor's role is to furnish clients with the information needed to make informed decisions. Professional real estate counselors must have a high degree of industry expertise.

## Education

Real estate education is available to both practitioners and consumers. Colleges and universities, private schools, and trade organizations all conduct real estate courses and seminars covering topics from the principles of a prelicensing program to the technical aspects of tax and exchange law. State licensing laws establish the minimum educational requirements for obtaining—and keeping—a real estate license. Continuing education, usually required for license renewal, helps ensure that licensees keep their skills and knowledge current.

## Other areas

Many other professionals are involved in real estate, including lawyers who specialize in this area of practice, land-use planners employed by state and local agencies, and tax assessors.

# TYPES OF REAL PROPERTY

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**Learning Objective: Describe the different classifications and characteristics of real property and the types of housing available for purchase or rental.**

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Just as there are areas of specialization within the real estate industry, there are different types of property in which to specialize. Real estate can be classified as

### Six categories of real property

- Residential
- Commercial
- Mixed-use
- Industrial
- Agricultural
- Special purpose

- *residential*— all property used for single-family or multifamily housing, whether in urban, suburban, or rural areas;
- *commercial*— business property, including office space, shopping centers, stores, theaters, hotels, and parking facilities;
- *mixed-use*— property that allows for two or more commercial and residential uses in the same building;
- *industrial*— warehouses, factories, land in industrial districts, and power plants;
- *agricultural*— farms, timberland, ranches, and orchards; or
- *special purpose*— privately owned properties, such as places of worship, schools, and cemeteries, as well as publicly held properties, such as schools, municipal service buildings, and parks.

The market for each type of real property can be divided into three main functions: buying, selling, and leasing. The most frequently occurring type of real estate transaction is the sale or rental of a home or other residential property. We will mainly focus on residential, but other types of property transactions are mentioned as well.



## IN PRACTICE

Although it is possible for a single real estate firm or an individual real estate professional to perform all the services and handle all classes of property discussed here (unless restricted by a state's license law), this is rarely done. A variety of services may be available within the same real estate firm in small towns, but most firms and professionals specialize to some degree.

## TYPES OF HOUSING

Some housing types are innovative uses of real estate while also incorporating various ownership concepts. These different forms of housing respond to the demands of a diverse marketplace.

People buy homes for a variety of reasons. To many people, home ownership is a sign of financial stability. A home is an investment that can appreciate in value, especially over many years of ownership. Even when a loan is necessary to be able to afford the purchase of a home, the interest paid on the loan may be a useful deduction from federal income tax.

Financial constraints or personal preference lead many people to leasing rather than buying a home. Some like the flexibility offered by a lease, or the amenities offered by a housing development or neighborhood where renting is a viable alternative to a home purchase. Renting also means less initial financial commitment, making it possible to use funds for business investment or other purposes. Often, renting is a way to try out a new area before making a purchase.

The *single-family detached house* has been one of the most popular housing types, although it has been adapted in urban areas to take the form of the row house that may share a wall with an adjoining property. Often, multistory residences in cities like New York and Chicago have one or more separate living units on each floor, offering the possibility of an owner-occupied building that also provides rental income. The need for housing in many areas has also led to the popularity of the *accessory dwelling unit (ADU)* on a single-family house lot. When allowed, an ADU may be a garage conversion or a separately built unit.

The *apartment building* was the response to housing demand in crowded urban areas. Modern highrise structures can offer residents many amenities. In the suburbs, multifamily housing has taken advantage of greater availability of large tracts of affordable land. An *apartment complex* is made up of a group of apartment buildings with a varying number of units in each building. The buildings may be lowrise or highrise, and the complex may include storage areas, laundry and exercise facilities, parking, security, clubhouse, swimming pool, tennis court, and even a golf course.

The *condominium* is a popular form of residential ownership, offering the security of owning property without the exterior maintenance responsibilities of a house. A condominium owner owns an individual unit and also shares ownership with other unit owners of common facilities (called *common elements*), such as halls, elevators, reception area, laundry room, exercise room, main entrance security system, and surrounding grounds, which may include a swimming pool, clubhouse, tennis court, or other amenities. Management and maintenance of building exteriors and common facilities are provided by the governing association of homeowners, who typically make use of a management company and outside contractors, with expenses paid out of monthly *assessments* charged to owners. While condos are often apartment-style homes, this ownership form includes single-family and even commercial properties. Condominium units can be rented, if allowed under the terms of the governing documents.

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Condo = conventional ownership; deed

Co-op = proprietary lease

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A *cooperative* also has units that share common walls and facilities within a larger building. The owners do not own the units; instead, each owner owns shares in a corporation that holds title to the real estate. Each shareholder receives a *proprietary lease* to a specified unit in the building. Like condominium unit owners, cooperative shareholders pay their proportionate share of the building's expenses.

*Planned unit developments* (PUDs), sometimes called *master-planned communities*, might consist entirely of residences, but they can also serve to merge such diverse land uses as housing, recreation, and commercial units into one self-contained development. PUDs are planned under special zoning (permitted land use) ordinances. These ordinances often permit maximum use of open space by reducing lot sizes and street areas. An owner of a property in such a community does not have a direct ownership interest in the common areas. A community association is formed to maintain these areas, with fees for expenses collected from the owners. A PUD may be a small development of just a few homes or an entire planned community.

Highrise developments, sometimes called *mixed-use developments* (MUDs), combine office space, stores, theaters, and apartment units into a single vertical community. MUDs are usually self-contained and may offer restaurants, grocery stores, beauty parlors, barbershops, and other convenient features.

*Converted-use properties* are factories, warehouses, office buildings, hotels, schools, churches, and other structures that have been converted to residential use. Developers often find renovation of such properties more aesthetically and economically appealing than demolishing a perfectly sound structure to build something new. An abandoned warehouse may be transformed into luxury loft condominium units; an out-of-date hotel may be renovated to create an apartment building; and an unused factory may be recycled into living and work spaces for artists.

*Factory-built housing* was once the often-derided *mobile home*, the most temporary of residences. Today, what are termed *manufactured homes* are permanent installations built to federal specifications, providing principal residences or vacation homes. The relatively low production cost of construction in factories unaffected by the elements, coupled with the increased living space available in newer models, makes such homes an attractive option for both manufacturers and buyers. Increased sales have resulted in growing numbers of manufactured home parks that offer complete residential environments with permanent community facilities, as well as semi-permanent foundations and hookups for gas, water, and electricity.

Another type of factory-built housing is the *modular home* with components that are assembled at a building site on a prepared foundation. Workers finish the structure and connect plumbing and wiring. Entire developments can be built at a fraction of the time and cost of conventional stick-built construction.

One of the newest and most intriguing forms of housing is the 3D-printed home. 3D printing got its start as a way to create relatively small specialized items, such as dental implants, prosthetic limbs, and machine parts. At present, the size and expense of the equipment needed to produce a structure in a factory or on site makes it an intriguing choice for a small dwelling, possibly an ADU. As manufacturing costs are brought down, and the greatly reduced labor costs of such "additive manufacturing" become more pronounced, the 3D-printed home may become commonplace.

## FAIR HOUSING

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**Learning Objective: Identify the major goal of fair housing laws.**

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The decision to purchase or lease housing, and where to do it, should be based on an individual's preferences and finances. Too often, individuals have been denied the housing they prefer based on discriminating factors that should not be considered. At present, there are housing protections provided by federal and state governments, as well as some municipalities and other local governing bodies. Here, we provide a brief summary of current federal fair housing law.

The latest revision to federal fair housing legislation is known as the Fair Housing Act. The Fair Housing Act prohibits discrimination in the provision of housing and housing-related services (including lending) based on an individual's race, color, national origin, religion, sex, familial status, or disability.

The Fair Housing Act covers most housing. There are limited exemptions, such as owner-occupied buildings with no more than four units. The Fair Housing Act protects anyone who falls within one of the protected categories from discrimination in

- renting or buying a home,
- getting a mortgage,
- seeking housing assistance, or
- taking part in other housing-related activities.

There are even more protections for someone applying for federally assisted housing.

It is considered illegal discrimination to take into account an individual's race, color, national origin, religion, sex, familial status, or disability when making a decision to

- refuse to rent, sell, or negotiate for housing;
- set different terms or conditions in the sale or rental of housing;
- provide different housing services or facilities;
- falsely deny that housing is available;
- impose different sales prices or rental charges;
- use different qualifying criteria;
- evict a tenant or a tenant's guest;
- harass a person;
- fail or delay performance of maintenance or repairs;
- limit privileges, services, or facilities;
- assign a person to a particular building or neighborhood or section of a building or neighborhood;
- deny access to or membership in any multiple listing service or real estate brokers organization.



## THE REAL ESTATE MARKET

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**Learning Objective: Explain the factors of supply and demand in the real estate market.**

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A **market** exists when goods can be bought and sold. The function of a market is to provide a setting in which supply and demand can establish market value, making it advantageous for buyers and sellers to trade. Other considerations for a homebuyer include the tax benefits of home ownership.

### Supply and demand

Prices for goods and services in the market are established by the operation of **supply and demand**. The supply is the quantity of goods or services that can be sold at a given price. In the real estate market, the supply is made up of residential and commercial land and structures. Demand refers to the quantity of goods or services that consumers are willing and able to buy at a given price. In the real estate market, the number of homebuyers and businesses seeking to buy property can vary greatly depending on general economic conditions.

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When supply increases and demand remains stable, prices go down.

When demand increases and supply remains stable, prices go up

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When supply and demand are roughly balanced, prices are stable and there is neither inflation (prices increasing) or deflation (prices decreasing). When supply increases and demand fails to increase commensurately, prices go down; when demand increases and supply fails to increase sufficiently to satisfy that demand, prices go up. Greater supply means producers need to attract more buyers, so they lower prices. Greater demand means producers can raise their prices because buyers compete for the product.



### IN PRACTICE

In 30 years in real estate, broker B has seen supply and demand in action many times. When a computer retailer relocated its distribution center to B's town 10 years ago, more than 100 families were interested in the 60 houses for sale at the time. Those sellers received multiple offers, and most sold their homes for more than the asking prices. On the other hand, 10 years before that, when the nearby naval base closed and 500 civilian jobs were transferred to other parts of the country, it seemed that every other house in town was for sale. There were plenty of sales, but prices were lower than they had been in many years.

### Supply and demand in the real estate market

Two characteristics of real estate govern the way the market reacts to the pressures of supply and demand: uniqueness and immobility. *Uniqueness* means that, no matter how identical they may appear, no two parcels of real estate are ever exactly alike; each occupies its own unique geographic location. *Immobility* refers to the fact that property cannot be relocated to satisfy demand where supply is low, nor can buyers always relocate to areas with greater supply. For these reasons, real estate markets are local markets. Each geographic area has different types of real estate and different conditions that drive prices. In these well-defined areas, real estate offices can keep track of the types of property that are in demand, as well as the properties that are available to meet that demand.



## IN PRACTICE

Technological advances and market changes have enabled real estate professionals to track trends and conditions that affect their local markets. The internet, smartphones, and global positioning systems are just a few of an ever-expanding gallery of tools that help real estate practitioners stay on top of their markets.

Because of real estate's uniqueness and immobility, the market generally adjusts slowly to the forces of supply and demand. Though a home offered for sale can be withdrawn in response to low demand and high supply, it is just as likely that oversupply will result in lower prices. When supply is low, on the other hand, a high demand may not be met immediately because development and construction are lengthy processes. As a result, development tends to occur in uneven spurts of activity.

Even when supply and demand can be forecast with some accuracy, natural disasters such as hurricanes and earthquakes can disrupt market trends. Similarly, a sudden change in the national financial market, a local event such as a business closure, or a regional disruption caused by storm damage can dramatically disrupt a seemingly stable market.

### Factors affecting supply

#### Factors affecting real estate supply are

- labor force, construction, and material costs;
- government controls and financial policies; and
- local government factors.

Factors that tend to affect the supply side of the real estate market's supply and demand balance include labor force availability, construction and material costs, and governmental controls and financial policies.

#### ***Labor force, availability, and material costs***

A shortage of skilled labor or an increase in the cost of materials can decrease the amount of new construction. High transfer costs, such as taxes and construction permit fees, can also discourage development. Increased construction costs may be passed along to buyers and tenants in the form of higher sales prices and increased rents that can further slow the market.

#### ***Governmental controls and monetary policy***

The government's monetary policy can have a substantial impact on the real estate market. The Federal Reserve Board (the Fed) establishes a discount rate of interest for the money it lends to commercial banks. That discount rate has a direct impact on the interest rates the banks charge to borrowers, which in turn plays a significant part in people's ability to buy homes. The Federal Housing Administration (FHA), the Federal National Mortgage Association (Fannie Mae), and the Government National Mortgage Association (Ginnie Mae) can also affect the amount of money available to lenders for mortgage loans.

Even apart from financing concerns, virtually any government action has some effect on the real estate market. For instance, federal environmental regulations may increase or decrease the supply and value of land in a local market. Real estate taxation is one of the primary sources of revenue for local governments. Policies on taxation of real estate can have either positive or negative effects. While high taxes may deter homebuyers and investors, tax incentives may attract new businesses and industries and bring increased employment and expanded residential real estate markets.

Local governments also influence supply. Land-use controls, building codes, and zoning ordinances help shape the character of a community and control the use of land. Careful planning can help stabilize, and even increase, real estate values.

### Factors affecting real estate demand are

- population,
- demographics, and
- employment and wage levels.

## Factors affecting demand

Factors that tend to affect the demand side of the real estate market include population, demographics, and employment and wage levels.

### Population

Because shelter is a basic human need, the demand for housing grows with the population. Although the total population of the country continues to rise, the demand for real estate increases faster in some areas than in others. In some locations, growth has ceased altogether or the population has declined. This may be due to economic changes (such as business closings), social concerns (such as the quality of schools or a desire for more open space), or population changes (such as population shifts from colder to warmer climates). The result can be a drop in demand for real estate in one area, which may be matched by increased demand elsewhere.

### Demographics

The study and description of a population is called *demographics*. The population of a community is a major factor in determining the quantity and type of housing in that community. The number of occupants per household and their ages, the ratio of adults to children, the number of retirees, family income, and lifestyle are all demographic factors that contribute to the amount and type of housing needed.



### IN PRACTICE

*Niche marketing* is the phrase used to refer to the targeted marketing of specific demographic populations. For example, as baby boomers aged and began to look for retirement housing, their need or demand was considered a niche market. At the same time, fair housing laws prohibit discriminatory practices that work against protected classes of individuals.

### Employment and wage levels

Decisions about whether to buy or rent and how much to spend on housing are closely related to income. When job opportunities are scarce or wage levels low, demand for real estate usually drops. The market might, in fact, be affected drastically by a single major employer moving in or shutting down. Real estate professionals should stay informed about the business plans of local employers.

As you have seen, the real estate market depends on a variety of economic forces, such as interest rates and employment levels. To be successful, real estate professionals must follow economic trends and anticipate where those trends will lead. How people use their income depends on consumer confidence, which is based not only on perceived job security but also on the availability of credit and the impact of inflation. General trends in the economy, such as the availability of mortgage money and the rate of inflation, will influence people's spending decisions.

## Financial considerations for the homeowner

Purchasing a home can offer financial advantages to a buyer, provided the marketplace cooperates. First, if the property's value increases, an eventual sale of the property might bring in more money than the owner's purchase price. Second, as the total mortgage debt is reduced through monthly payments that include part of the principal owed, the owner's actual ownership interest in the property increases. The difference between the market value of the property and the amount still owed on it is the homeowner's **equity** in the property. The equity can be borrowed against in future or realized on a sale of the property. A homeowner's mortgage payments thus help to build personal net worth. The third financial advantage of home ownership may be the tax deductions available to the homeowner for mortgage interest and property tax, but only if those deductions total more than the amount of the applicable standard deduction and meet tax law stipulations. Finally, part of any profit made on the sale of a principal residence is not taxed at all.

### Tax deductions

Homeowners may deduct from their gross income some or all of the mortgage interest paid up to a certain point. For mortgages taken out after December 14, 2018, an individual may deduct interest on debt up to \$750,000. Loans in existence prior to that date are not affected, as long as they are not over \$1,000,000. If a loan was generated prior to that date and is refinanced, that interest is deductible as well, as long as the amount refinanced is not greater than the original loan amount. Finally, between January 1, 2018, and December 31, 2025, the interest on a second mortgage is no longer tax deductible. State and local real estate taxes can be used as an itemized deduction up to a limit of \$10,000. Homeowners may also deduct certain loan origination fees and loan discount points.

### Other tax benefits

When a married couple who file a joint tax return sell a principal residence, up to \$500,000 in profit (sales price minus purchase price) can be excluded from capital gains tax. A taxpayer who files singly is entitled to a \$250,000 exclusion. The exclusion may be used repeatedly, as long as the homeowner has both owned and occupied the property as the principal residence for at least two of the past five years.

A first-time homebuyer may make a penalty-free withdrawal from a tax-deferred individual retirement account (IRA) for the down payment on a home, although the withdrawal is still subject to income tax in that year. The limit on the withdrawal is \$10,000 and the amount withdrawn must be spent entirely within 120 days on a down payment to avoid any penalty.

Other tax incentives, such as a tax credit for part of the purchase price, also are offered by the federal government from time to time to encourage homebuying. In addition, many states have their own programs meant to encourage home ownership.

Real estate purchases purely for investment purposes (property that is not to be owner-occupied) offer their own tax and other incentives. Because tax laws are complex and subject to change, real estate professionals should recommend clients consult a competent tax professional for advice.

## KEY POINT REVIEW

**Real estate brokerage** is the business of bringing people together in a real estate transaction conducted by a **real estate broker** who is a person or company licensed to buy, sell, exchange, or lease real property for others for compensation. A **real estate salesperson (sales associate)** conducts brokerage activities on behalf of the broker.

**Appraisal** is the process of developing an opinion of a property's value (typically, market value) based on established methods and an appraiser's professional judgment. Licensing or certification is required for many federally related transactions, and many states require licensing or certification for other transactions as well.

**Property management** is conducted by a **property manager**, a person or company hired to maintain and manage property on behalf of the property owner. The property manager's scope of work depends on a **management agreement**, and the basic responsibility of the property manager is to protect the owner's investment while maximizing the owner's financial return.

**Financing** is the business of providing the funds that make real estate transactions possible through loans secured by a mortgage or deed of trust on the property. Funding may be provided by commercial banks, credit unions, mortgage bankers, and mortgage brokerage companies.

**Subdivision and development** involve splitting a single property into smaller parcels (subdividing) and constructing improvements on the land (development).

**Home inspection** is of interest to both purchasers and homeowners, and an inspection report will show results of a thorough survey of observable property conditions. A state license may be required of a home inspector.

**Real estate counseling** involves independent advice based on sound professional judgment regarding how to buy, sell, or invest in property.

Types of real property include **residential, commercial, mixed use, industrial, agricultural,** and **special purpose**, which can be privately or publically held.

**Discrimination** in the provision of housing and related services is prohibited by federal law.

The **real estate market** reflects the principle of **supply and demand**, influenced by the **uniqueness** and **immobility** of parcels of real estate. When the supply increases relative to demand, prices go down, and when demand increases relative to supply, prices go up.

The factors affecting the **supply** of real estate include labor force availability, construction and material costs, government controls (environmental restrictions, land use policies, building codes, zoning), and monetary policy that impacts interest rates and the money supply.

The factors affecting the **demand** for real estate include population, demographics, and employment and wage levels.

The buyer of a home can benefit from **tax deductions, exclusion of gain** on the sale of the home, and **tax credits**, when available.

# UNIT 1 QUIZ

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1. A professional opinion of a property's market value, based on established methods and using trained judgment, is performed by
  - A. a real estate attorney.
  - B. a real estate appraiser.
  - C. a real estate counselor.
  - D. a home inspector.
2. In general, when the supply of a commodity increases,
  - A. price tends to rise.
  - B. price tends to drop.
  - C. demand for it tends to rise.
  - D. demand for it tends to drop.
3. Which factor primarily affects supply in the real estate market?
  - A. Population
  - B. Demographics
  - C. Employment
  - D. Governmental monetary policy
4. Which factor is *MOST* likely to influence demand for real estate?
  - A. Number of real estate professionals in the area
  - B. Number of full-time real estate professionals in the area
  - C. Wage levels and employment opportunities
  - D. Price of new homes being built in the area
5. Property management, appraisal, financing, and development are all examples of
  - A. factors affecting demand.
  - B. specializations within the real estate industry.
  - C. non-real estate professions.
  - D. activities requiring broker management and supervision.
6. What type of federal law prohibits discrimination in the provision of housing and housing-related services (including lending) based on an individual's race, color, national origin, religion, sex, familial status, or disability?
  - A. Licensing
  - B. Lot size
  - C. Home ownership
  - D. Fair housing
7. A major manufacturer of automobiles announces that it will relocate one of its factories, along with 2,000 employees, to a small town. What effect will this announcement *MOST* likely have on the small town's housing market?
  - A. Houses will likely become less expensive.
  - B. Houses will likely become more expensive.
  - C. Because the announcement involves an issue of demographics, not of supply and demand, housing prices will stay the same.
  - D. The announcement involves an industrial property; residential housing will not be affected.
8. A real estate professional who has several years of experience in the industry decided to retire from actively marketing properties. Now this person helps clients choose among the various alternatives involved in purchasing, using, or investing in property. What is this person's profession?
  - A. Real estate counselor
  - B. Real estate appraiser
  - C. Real estate educator
  - D. Building inspector
9. Nationwide Multistate Licensing System and Registry was created to register
  - A. appraisers.
  - B. property managers.
  - C. home inspectors.
  - D. mortgage loan originators.
10. Schools would be considered part of which real estate classification?
  - A. Special purpose
  - B. Industrial
  - C. Commercial
  - D. Residential
11. When demand for a commodity decreases and supply remains the same,
  - A. price tends to rise.
  - B. price tends to fall.
  - C. price is not affected.
  - D. the market becomes stagnant.



12. Federal law specifically prohibits discrimination in the sale or rental of
  - A. all forms of real estate.
  - B. housing
  - C. commercial property.
  - D. industrial property.
13. The federal Fair Housing Act covers discrimination in
  - A. restaurants.
  - B. mortgage financing.
  - C. theaters.
  - D. automobile dealerships.
14. The splitting of a single property into smaller parcels is called
  - A. brokerage.
  - B. subdivision.
  - C. development.
  - D. management.
15. The supply of land is affected by
  - A. population.
  - B. demographics.
  - C. wage levels.
  - D. monetary policy.
16. The most important factor in determining how quickly the forces of supply and demand work is
  - A. a property's specific geographic location.
  - B. immobility of a property.
  - C. the property's price.
  - D. uniqueness of a property.
17. A person who performs a visual survey of a property structure and writes a report for a buyer is
  - A. an educator.
  - B. a home inspector.
  - C. an appraiser.
  - D. a property manager.
18. When it is sold in good condition, a school, church, or hotel may have value as
  - A. a converted-use property.
  - B. a burden on the local community.
  - C. farmland.
  - D. vacant land.
19. A person or company responsible for maintaining a client's property and maximizing the return on the client's investment is serving as
  - A. a rental agent.
  - B. a building maintenance specialist.
  - C. a property manager.
  - D. an investment counselor.
20. Detailed information about the age, education, behavior, and other characteristics of members of a population group is called
  - A. population analysis.
  - B. demographics.
  - C. family lifestyles.
  - D. household data.

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