5

Real Estate Markets and Analysis

■ LEARNING OBJECTIVES

Students will be able to

1. understand and differentiate the difference between districts and neighborhoods.

2. understand the relationship of the four value forces as they relate to districts and neighborhoods.

3. understand and be able to identify the four stages in a neighborhood's life cycle.

4. understand the concept of market segmentation.

5. understand and explain the difference between efficient and inefficient markets, giving examples of each.

6. identify the three different types of market analysis.

7. identify the types and sources of data.

8. understand the basic steps in performing a market analysis.

9. understand the basic impact of federal monetary and fiscal policy with special emphasis on the three credit regulation devices used by the Federal Reserve to impact the price and supply of money.

10. understand and differentiate between money and capital markets, giving examples of each.

11. understand the basics of real estate finance including the basic terms, types of loans, and various forms of mortgages.

■ KEY TERMS

amortization	Federal Open Market	market study
buydowns	Committee (FOMC)	money markets
capital markets	fiscal policy	original loan amount
conclusion	growth	neighborhood
decline	inefficient market	payment
district	interest	points
efficient market	life cycle	reserve requirements
equity	loan-to-value (LTV) ratio	revitalization
feasibility study	market analysis	stability
federal discount rate	market segmentation	

■ INTRODUCTION

As we have already learned in this course, value influences can generally be broken down into the following four basic forces or categories:

1. Social

2. Economic

3. Physical/Environmental

4. Governmental

In recognizing these four forces, it is noted that the physical attributes of the real estate component of a particular property being appraised comprise only part of one of these four forces, that being physical/environmental. We have also learned that value is subjective in its nature rather than objective. With these two concepts in mind, it is obvious that value is significantly influenced by occurrences outside the property limits. The interaction of the four forces creates a "real estate market." This Chapter focuses on the identification and analysis of real estate markets, with consideration also accorded the influence of federal monetary and fiscal policy, as well as real estate finance, allowing the appraiser to proceed efficiently through the appraisal process.

P A R T   O N E   Districts and Neighborhoods

Recognizing that most factors that influence value occur outside of the actual real estate, the appraiser must undertake a study of the market factors that affect a certain parcel of real estate. Before doing this, however, the appraiser must identify the particular market in which the four forces interact to create value of a particular property. An understanding of districts and neighborhoods is essential for this task to be completed efficiently and thoroughly.

■ DISTRICT

A **district** is a group of *homogenous* land uses. The most obvious district with which most people are familiar is the immediate subdivision in which a family or individual lives. Most subdivisions are planned with the idea of grouping similar and compatible structures. Developers often seek to maintain congruity as to house styles, sizes, price ranges, and configuration.

There are, however, other types of districts. Many of us work in well-defined industrial districts. Consistent with residential subdivisions, an industrial district is composed of similar buildings on similar sites, with similar manufacturing or warehousing orientation.

Another example of a district would be a heavily developed corridor featuring strip commercial development. Here, the homogenous land uses are all retail in their character.

■ NEIGHBORHOOD

A **neighborhood** is a group of complementary land uses. Uses that would be complementary to a residential subdivision may include those destinations or places frequented by families or individuals living in the subdivision. Schools, shopping facilities, places of worship, and employment centers are all complementary to single-family usage.

The term used to describe the connecting of complementary uses to the homogenous land uses (district) is **linkage**. Linkage is the element that joins districts to complementary uses, creating neighborhoods. Linkages that would apply to a residential district (subdivision) would include nearby schools, shopping facilities, employment centers, and places of worship.

Linkages that would transform an industrial district into a neighborhood would include access routes to interstate highways, airports, other transportation facilities, residential areas that provide an employment base, and possibly financial services.

Linkages that transform a commercial district into a neighborhood would include transportation routes to wholesalers, nearby residential areas (customers), etc.

■ THE FOUR VALUE FORCES

Both neighborhoods and districts are influenced by the four value forces. The identification of a district or a neighborhood is usually based on the physical/environmental forces that affect value; however, it is quite common for one or more of the other three forces to be the most dominant determinant when identifying a district or neighborhood. The following are examples:

Social

Family composition
Community and neighborhood organizations
Cultural or ethnic groups

Economic

Income levels of residents
Development trends
Employment

Physical/Environmental

Topography
Subsurface (Rock, marsh, etc.)

Governmental

Zoning
School districts
Police and fire protection
Land use plan

Even though a district or neighborhood may be most clearly identifiable by a social, economic, or governmental force, the appraiser usually relates these forces to a specific area defined geographically.

> For example, a neighborhood may be most easily identifiable by the predominance of a particular age or occupational group such as young professionals; however, the appraiser would usually "frame" the defined district or neighborhood through street boundaries or other geographic means.

■ LIFE CYCLE

Neighborhoods and districts alike generally exist in one of four life cycle stages; these are growth, stability, decline, and revitalization.

Growth

Growth is typically the initial stage in a neighborhood or district's life cycle. This refers to the period in which the neighborhood or district is expanding and developing. An example would be a suburban bedroom community where numerous houses are being constructed, along with complementary schools, shopping facilities, and other uses. Compared to the other stages in the life cycle, the growth stage is usually fairly rapid.

Stability

After the growth stage, an area typically matures and grows at a slower rate. The **stability** stage in the life cycle may occur when it is no longer profitable to build, and/or the supply of vacant land is depleted.

Decline

When a neighborhood can no longer compete with other comparable neighborhoods, it usually enters the **decline** stage of its life cycle. Improvements may become functionally inadequate and lose market appeal, and maintenance levels frequently decrease.

Revitalization

After decline, a neighborhood or district sometimes shows **revitalization**, that is, it regains momentum or sees rebirth. Often, this occurs because of an area's proximity to employment or other conveniences. Many fringe areas around older downtown business districts are being revitalized. In a sense, a district or neighborhood such as this re-enters the "growth" stage of the life cycle.

When older structures are revitalized, with rehabilitation and renovation occurring, the area is said to be undergoing *gentrification*.

Sometimes, a neighborhood or district may go through a long, extended growth stage, then mature and stabilize, never going through the decline or revitalization stages. Stability may dominate the life cycle for many years, with the area never declining to the point that revitalization occurs.

■ MARKET SEGMENTATION

The act of distinguishing or delineating markets that the appraiser should consider in his data program is called **market segmentation**.

When appraising a typical, single-family residence, the market segmentation process may relate only to identifying the specific neighborhood in which the subject property is located, along with the comparable sales, rentals, and land sales.

Market segmentation can also become very complex. If an appraiser is involved in an appraisal of a limited market property, such as a food processing facility, cold storage warehouse, concrete plant, etc., the breadth of the market research may well be expanded to include several states, a region, and in some cases the entire United States. When market segmentation requires expansion of the research program into such a broad area, the appraiser should concentrate on cities, counties, or regions with economic characteristics similar to the area in which the subject is located.

> For example, an appraiser who is appraising a poultry processing plant in Georgia, may have to expand his data search into Arkansas as both states have significant poultry industries.

P A R T   T W O   Efficient/Inefficient Market

An **efficient market** is one that is characterized by goods or services that are easily produced and readily transferable, with a large number of buyers and sellers. An **inefficient market**, on the other hand, is just the opposite. Goods and services are not readily produced or easily transferable, with no readily identified group of buyers and sellers active in a particular marketplace. The differences between an efficient market and an inefficient market are illustrated in Table 5.1.

Based on these characteristics, described in Table 5.1, real estate tends to operate in an inefficient market. Often, real estate transactions are confidential, and limited information is available via public records, making the data collection and verification process crucial in real estate appraisal.

When a market is undersupplied, an extended time period is usually required to bring a particular type of real estate to the market for sale. Conversely, oversupplied conditions can occur because the time period required from initial conception to final delivery of real estate may encompass a number of years, and demand could possibly decline during the period that it takes to create the real estate product.

TABLE 5.1 ■ Contrasts of an Efficient Market and Inefficient Market

Characteristic	Efficient Market (stock market)	Inefficient Market (real estate)
Products	Homogeneous	Unique
Inventory of Buyers and Sellers	Large number	Few
Prices	Uniform/Stable/Low (most can afford)/ Quality Tends to Uniformity at a Set Price	Variable/Inconsistent/High (limited affordability)
Restrictions	Self Regulating/ Few Government Restrictions	Many Restrictions
Supply and Demand	Balanced (daily) due to competition	Often Unbalanced (for months/years)
Information/Intelligence	Fully Informed Participants	Limited Accurate Information
Organized Conduit	An Exchange	None
Goods	Readily Available/Consumed Quickly/ Supplied Easily/Transportable	Years to Consume/Months or Years to Supply/Immobile

Although technology has enhanced the marketability of real estate tremendously in recent years, most buyers still want to personally view the product they are buying, as well as a number of alternative properties. This activity is very time consuming, especially since the "shopping" time may well be restricted to weekends and other off work times.

All of these tendencies make real estate an inefficient market.

P A R T   T H R E E   Market Analysis

Market analysis is the study of a specific market. It is the collection and dissection of data and the conversion of that data to information that can be used for analysis and decision-making by an appraiser or analyst.

■ TYPES OF MARKET ANALYSIS

The following three types of market analysis are available:

1. Market study

2. Marketability study

3. Feasibility study

All are performed by appraisers either separately or as part of a complete appraisal.

Market Study

A **market study** is the analysis of an environment of buyers/sellers and/or landlords/tenants (lessors/lessees). A market study is not site specific. It usually relates to a certain property type or geographic area.

> For example, a bank may want a market study of a certain city or region indicating what the region's trends are related to housing. The bank may be interested as to whether the area is dominated by condominiums, detached starter homes, detached move-up homes, or estate homes. Based on this information, the bank could tailor its loan portfolio to the product type likely to be most successful in a particular area.

As a second example, a developer interested in developing a shopping center in a certain suburban area of a metropolitan community would likely want to know the origin of the potential customers. To perform this, a market study of the housing in the area may be performed. Based on this study, a developer could ascertain whether or not the area was growing, what the prevailing income levels were, whether or not there were families with children, or a wide variety of other informative data.

Marketability Study

A **marketability study** relates to a more specific product type within a defined market. A marketability study often addresses the time required to absorb a particular product, and the price or rent level at which that product would be accepted into the marketplace.

A marketability study is usually both site specific and property type specific. However, the appraiser usually begins with a broad market, then reduces this down to an individual submarket.

For example, if an appraiser is performing a marketability study to determine whether or not 30,000 square feet of minor tenant space in an anchored shopping center in a metropolitan suburban bedroom community would be absorbed in a reasonable period of time, the analysis may begin with a retail overview (supply and demand) of the overall metropolitan area. From here, the appraiser may study the county retail market, then focus on the immediate neighborhood or submarket.

A single-family residential subdivision developer may have recently acquired a 50-acre parcel. By studying demographic trends, income levels, and other factors, the developer may conclude that the most logical and probable use for the site is to subdivide the parcel into one-half acre lots with curvilinear subdivision streets and cul-de-sacs. The marketability study would give the developer an indication as to how long it would take to sell the lots, and at what general price level the lots would sell. A marketability study may also reveal that a subdivision amenity package (pool and tennis courts) is a necessity if a developer is expected to market more than 100 lots comprising a subdivision.

Another example would be an office developer considering constructing a speculative office building in the downtown area. A marketability analysis may indicate that the current market is oversupplied, with a five-year inventory remaining at current absorption levels. Based on the implied demand that is expected to be unmet five years hence, the office building developer may choose to postpone construction for three years so that a two-year construction period would coincide with the absorption of the excess space currently existing in inventory. Then, there should be demand when the office building is completed.

Feasibility Study

A **feasibility study** is simply a comparison of cost versus the value if the project is undertaken. If cost exceeds the value, the proposal is not feasible. If the value exceeds cost, the proposal is feasible.

Cost feasibility is incorporated into the highest and best use analysis, as subsequently discussed. There may be numerous feasible uses, but there is usually one that is most profitable, that ultimately being the highest and best use.

An example would be a builder who acquires a building lot for $30,000. His construction costs, including all hard and soft expenditures, may total $100,000. If the prevailing price range for similar houses in the neighborhood is $100,000 to $110,000, the builder's total investment of $130,000 indicates that this project is not feasible. On the other hand, if the prevailing price range is $140,000 to $160,000 for similar houses, the value obviously exceeds costs, leaving the developer with a profit for having undertaken the venture.

A feasibility study is of course property type as well as site specific.

■ TYPES AND SOURCES OF DATA

When proceeding through the data collection process, the appraiser should be aware of how to categorize all the information obtained. One general means is to classify the data by type and by source.

Types of Data

1. *General Data*—General data relates to collected information that would be appropriate for many properties. General data usually encompasses all of the four forces (social, economic, environmental/physical, and governmental).

   A demographic printout from a demographic service is an example of general data.

Other examples of general data include labor statistics, weather studies, transportation studies, etc.

2. *Specific Data*—This relates to information that is used directly in the analysis of the subject property. Specific data thus relates to the subject property itself as well as the comparables that will be used in the actual valuation process.

> For example, information on the subject itself would include site data such as legal description, survey, environmental report, etc. Information on the comparables may include data related to land sales similar to the subject site, sales of improved properties with improvements similar to the subject, and comparable rentals.

Sources of Data

1. *Secondary Data*—Secondary data encompasses publications and other sources of information that were prepared by someone other than the appraiser. Sources of secondary data may include chamber of commerce publications, census reports, rent studies, published sales data services, etc.

2. *Primary Data*—Primary data relates to information that was collected directly by the appraiser. Examples of primary data may include a sketch prepared by the appraiser based on actual building measurements, subject photographs, sales information procured directly by the appraiser, area rentals obtained directly by the appraiser, etc.

In the course of performing an appraisal, an appraiser usually starts with a variety of secondary data sources, then chooses the items that must be verified and/or inspected directly by the appraiser. When this step occurs, primary data may be produced from the secondary data source.

> For example, a multiple-listing service (MLS) sold book may be an example of secondary data, but when the sale is confirmed firsthand by the appraiser, then inspected and photographed by the appraiser, it then becomes primary data.

■ STEPS IN MARKET ANALYSIS

Market analysis includes an evaluation of the market boundaries and then of its supply and demand for one or more products.

Market Boundaries

Identifying the market area is the first step in market analysis. Although the boundaries may be more clearly defined by social, economic, or governmental factors, the **market boundaries** are usually identified by some geographical (physical/environmental) means. Geographical boundaries may include streets, rivers, lakes, rail lines, etc.

Establishing boundaries does not necessarily mean that the appraiser cannot go outside the boundaries for appropriate data.

> For example, there may be insufficient data within a specific residential subdivision for a meaningful application of the sales comparison approach. The appraiser may have to go to a nearby similar but geographically distinct subdivision for sales data.

Forces outside the subject site boundaries are called external forces or external economies, and thus, could include the market area, but would be outside the subject site itself.

In other instances, neighborhood boundaries may be more readily identifiable by linkages.

> For example, a resort destination may be more appropriately defined by the areas from which the buyers come. This may be statewide, regionwide, or even nation-wide. Because of this phenomenon, a resort community in Colorado may have as its direct competition a resort in Utah.

Supply

The existing inventory represents the most easily identifiable component of **supply**. There are other more subtle indications of supply, however, that must also be analyzed. Properties under construction, properties planned, or properties that are capable of being converted all represent supply alternatives. A study of housing permits in a certain geographic area could be a very valuable indicator of what the inventory may be several months hence. Most major developments such as office buildings, shopping centers, or industrial parks become known through public announcements.

Demand

Demand relates to occupancy and absorption of a particular product in the defined area. Occupancy is the count of the units that are physically occupied as of a certain period while absorption is best described as the change (positive or negative) of occupied units over a specified period of time.

In performing a demand analysis, the appraiser usually starts with a broad market, then continually condenses the analysis into a smaller, well-defined area.

For example, a proposed single-family subdivision in a certain census tract may require the appraiser to first consider population trends based on census data and county projections, household composition, and income levels. A census tract may be expected to add 500 households over the next five years, with the family composition indicating two children per household. This may well indicate demand for single-family detached dwellings.

If household income levels are $50,000, one could reasonably anticipate demand for detached single-family homes priced in the $100,000 to $125,000 range based on historic price levels/income earnings relationships. A more concentrated study of five subdivisions in the subject's immediate area may indicate that all the subdivisions are selling two to four houses per month within this identified price level. Assuming continuation of this demand and a proper supply, it may be concluded that the time is right to proceed with a single-family subdivision development on the subject site.

Conclusion

The **conclusion** of a market analysis reconciles or correlates the results of the supply and demand analysis in the identified market. This step is necessary for market studies as well as marketability studies.

P A R T   F O U R   Monetary and Fiscal Policy

When real property is sold, a defined interest in real estate is exchanged for a defined amount of money. Usually, the money exchanged is free to float in an open market, competing for other goods and services. Most of the time, a portion of the money used to acquire a real property comes from borrowed funds, most often from banks or other traditional lending institutions. Money should not be viewed as a fixed, static commodity, but rather one that is constantly changing in its availability and cost.

The United States operates on a fractional reserve banking system in which deposits are made to banks, and the banks lend from the deposits. Although most of the deposits are loaned to various customers, the banks are required to keep some of the deposits in reserve. Loans and reserves are directly influenced by federal monetary policy. The supply and cost of money in the United States is significantly affected by the Federal Reserve, commonly known as the Fed. This is not a direct part of the federal government; however, the President of the United States does appoint the Federal Reserve board members.

■ CREDIT REGULATION DEVICES

The Fed impacts the price (interest rate) and the supply of money in the three ways described on the following page. By affecting the price and supply, demand is also affected.

Federal Discount Rate

The **federal discount rate** is the rate at which member banks can borrow funds from the Fed to loan to other customers. Banks compete in the open market for deposits and must pay a certain level of interest. Banks also must charge customers higher rates than the rates being paid for deposits so that profit can be made. If the Fed lowers its discount rate, member banks are allowed to pass the savings onto customers through lower interest rates. This spurs economic demand since the cost of acquiring borrowed funds has been lessened. Conversely, if the discount rate is increased, credit tends to become tight, and economic activity declines. An economy that is expanding too rapidly may lead to inflationary conditions. The Fed is constantly trying to maintain a balance between economic growth through lowering rates and controlling inflation through raising rates.

Reserve Requirement

The **reserve requirement** is the percentage of deposits that must be retained by banks. If the reserve requirement is increased, credit tends to tighten. Because of the limited amount of available funds, interest rates tend to rise, and economic activity decreases. If the reserve requirement is lowered, more funds are made available for borrowers. Interest rates tend to come down, and economic expansion occurs. Again, a balance between economic expansion and inflation control is the ultimate goal of the Fed.

Federal Open Market Committee (FOMC)

The **Federal Open Market Committee (FOMC)** is the part of the Fed that buys and sells government securities. If the FOMC buys government securities, money flows into the economy, spurring economic expansion. If the FOMC sells securities, funds are funneled into the Fed from the general economy, and credit becomes scarce, increasing interest rates and decreasing economic activity.

All three of these mechanisms influence the money supply and the price of credit (interest). The most direct influence is the federal discount rate because many banks tie their prime lending rate to the discount rate. Discount rates are changed frequently during the year. Reserve requirements, on the other hand, have a lagging effect on the economy, but a change can have a powerful and long-term impact on the supply and demand for money. The FOMC buys and sells securities every business day. Although not immediately evident to the public, the effects are similar to the discount rate in that they are current and sometimes dramatic.

■ FISCAL POLICY

The government's management of revenues (taxes) and expenses (appropriations) is called **fiscal policy**. The United States fiscal policy is managed by the Office of Management and Budget (OMB). The budget management and fiscal spending also affect interest rates. Generally, the higher the amount of debt, the higher the inflation rate, which means the higher the interest rate. Conversely, the lower the debt amount for the nation, the lower the inflation rate and the lower the interest rate.

P A R T   F I V E   Money and Capital Markets

Money markets and capital markets are both sources of funds and differ only in the types of instruments and the maturities of these instruments. Money markets are financial instruments that have a maturity of less than one year; capital market instruments have maturities of more than one year. Money markets and capital markets are important because they both compete with real estate for investment dollars. Prevailing interest rates are a direct consequence of the activity in both of these markets. Interest rates also have a direct impact on the demand for real estate because real estate purchases usually involve the use of borrowed funds that are repaid with interest. When interest rates are down, demand for real estate tends to be up; when interest rates are up, demand tends to be down. Assuming a stable supply of a product, prices increase when demand increases, and prices decrease when demand decreases.

■ MONEY MARKETS

Money markets are financial vehicles with traditional maturities or investment periods of less than one year. Some examples of money market instruments are short-term certificates of deposit (a bank's CDs), federal funds (member banks' short-term borrowing from the Fed), Treasury bills (short term government securities), and commercial paper (corporate promissory notes). Money market instruments tend to influence short-term financing rates, such as loans for construction and/or development of real estate.

■ CAPITAL MARKETS

Capital markets include financial vehicles with usual maturities of more than one year. Examples of capital market instruments include bonds, stocks, mortgages, and deeds of trust. Capital market instruments tend to influence long-term financing rates, as well as required rates of return on real estate investments.

P A R T   S I X   Real Estate Finance

Real estate transfers usually involve the use of dollars as opposed to other assets. Also, most real estate acquisitions involve both the buyer's investment in the property as well as the use of borrowed funds for the balance. The buyer's contribution is called equity, whereas the borrowed money is called a mortgage. Mortgages are generally considered to be capital instruments because payback periods are usually 15 years or more.

■ MORTGAGE FINANCING TERMS

To understand the ramifications of mortgage financing, some basic terms must be understood.

Original Loan Amount

The **original loan amount** is the face amount of the original loan.

Equity

Equity is the down payment or the cash paid by the buyer.

Amortization

Amortization is the process of retiring a mortgage or debt over a specified time period. An amortization usually calls for the systematic repayment of principal plus interest at some specified rate.

Interest

Interest represents the money earned for the right to use capital. Mortgages in the United States are generally paid on a compound interest method in which interest is paid each month on the outstanding balance at the contractual interest rate.

Payment

Payment is also known as *debt service.* A payment on an amortizing mortgage is comprised of both interest and principal. Dividing the annual debt service by the original loan amount equates to the mortgage constant. For instance, if a mortgage payment is $1,300 per month, or $15,600 per year, and if the original loan amount was $200,000, the annual constant is .078 ($15,600 ÷ $200,000).

Loan-to-Value

The **loan-to-value (LTV)** ratio is a percentage of the original or proposed loan to the value of a property (loan amount ÷ property value). Mortgages are usually based on a loan-to-value concept that protects the lender from loaning too much on a property. If a lender has a program that loans 90 percent LTV, and the property value is $100,000, the maximum loan will be $90,000. The remaining $10,000 is derived from a down payment (equity) or some form of other financing.

Points

Points are prepaid interest to the lender and are calculated based on the loan amount. Each point is 1 percent of the loan amount. To qualify at a lower interest rate, a buyer might pay cash to the lender at closing (points). Assuming a buyer wants to prepay interest to buy down the rate on the mortgage in the first three years, it may cost two points on the $100,000 mortgage. The buyer's cost will be $2,000 ($100,000 × 0.02 = $2,000).

■ TYPES OF LOANS

Loans vary by region and the dynamics of the market. Traditionally, there were only 30-year self-amortizing loans available; in the 1980s, adjustable rate mortgages (ARMs) became popular; today, an array of mortgage programs are available, and new ones are announced frequently. The following loan programs are the most popular.

Fixed Rate Mortgages

In a *fixed rate mortgage*, the interest rate is fixed, usually for the term of the loan. Other programs are available in which the rate is fixed for five or seven years, then readjusted for the remainder of the term; the initial interest rate is less on these loans as the lender is committed only to the contractual rate for five or seven years versus being committed to the entire term.

Adjustable Rate Mortgages (ARMs)

An *adjustable rate mortgage (ARM)* is a loan in which the interest paid is based on a certain index (one year Treasury bill, for instance) plus a "spread" or amount over the index. An ARM might be 200 basis points (or 2.00%) over the 1-year T-bill. Assuming the one-year T-bill is 4.0%, the interest rate would be 6.0%. It adjusts on the anniversary of the loan to the then-current T-bill rate. ARMs typically have annual and lifetime "caps" that keep the mortgage within an acceptable range. A common program is a 2% annual cap and a 6% lifetime cap. In the example noted here, the highest it could go in Year 2 is 8.0%, then 10.0% in Year 3, and so on to a maximum of 12.0% over the life of the loan. Keep in mind, however, that the ARM "floats" with the indexed rate; the rate and payment could also decrease if the T-bill rate falls.

Buydowns

Buydowns are a variation of ARMS or fixed-rate mortgages, but interest is prepaid to lower the payments in the early years of the term. The interest is sometimes prepaid by the builder or developer in order for prospective homeowners to qualify.

■ FORMS OF MORTGAGES

There are various forms of mortgages available, such as conventional, insured, purchase money mortgages, and blanket, chattel, and package mortgages.

Conventional Mortgages

Conventional mortgages are the most common mortgage instruments and are available through mortgage bankers, banks, and savings and loan institutions. These types of mortgages are originated by these groups but are usually bought and sold by the following three entities:

1. FNMA (Federal National Mortgage Association)

2. FHLMC (Federal Home Loan Mortgage Corporation)

3. GNMA (Government National Mortgage Association)

This is known as the *secondary market* for mortgages. Because these are promissory notes secured by real estate, they have value which is based on the yield and the maturity date of the note. Due to the stringent requirements of these agencies/corporations, these loans and the mortgages, properties, appraisals, and documents that go along with them must fit certain criteria. Loans fitting their criteria are traded on the secondary market since they are backed by these groups. Loans not meeting their criteria are termed nonconventional loans. Nonconventional loans are also traded on the secondary market, but without the backing of FNMA, FHLMC, and GNMA, and are thus considered more risky.

Insured Loans

Insured loans are mortgages which include a guarantee or insurance to protect the lender in case of default by the borrower. The Federal Housing Authority (FHA) and the Department of Veterans Affairs (VA) both offer loan programs to qualifying individuals.

Blanket Mortgages

A *blanket mortgage* is a mortgage secured by a group of properties or a number of lots. Suppose a person owns ten rental houses; she may want a blanket mortgage on all ten homes, with one loan, one payment, and one lender.

Chattel Mortgages

A *chattel mortgage* is a loan for personal property and secured by personal property.

> For example, a restaurant owner may put a chattel mortgage on the restaurant equipment.

Package Mortgages

A *package mortgage* is a loan on both real and personal property. The same restaurant owner may put a package mortgage on the restaurant equipment and the real estate.

Purchase Money Mortgages

A *purchase money mortgage (PMM)* is a loan or note taken back by the seller and part of the purchase price. For instance, say Joe wants to buy a home and can qualify for a $90,000 mortgage at today's interest rates; he has $12,000 for a down payment and closing costs; closing costs are estimated to total $3,000; hence, he can afford a $99,000 home; he finds a home he likes and contracts to buy it at $110,000; to effect the sale, the seller could take back a PMM for $11,000 to make up the difference.

1. A group of complementary land uses is called a(n)
   a. area.
   b. neighborhood.
   c. district.
   d. region.

2. Which component does NOT comprise demand?
   a. Buyer/tenant profiles
   b. Occupancy
   c. Properties under construction
   d. Absorption

3. Which of the following is NOT a credit regulation device controlled by the Fed?
   a. Federal funds rate
   b. Prime rate
   c. Reserve requirements
   d. Federal Open Market Committee

4. Which of the following is a capital market instrument?
   a. Treasury bills
   b. Short-term bank CD
   c. Federal funds
   d. Mortgage

5. Which is the systematic reduction of debt over time?
   a. Points
   b. Payment
   c. Amortization
   d. Principal

6. A point equals which of the following?
   a. 1 percent of the interest
   b. 1 percent of the payments
   c. 1 percent of the value
   d. 1 percent of the loan amount

7. Which characteristic is indicative of an efficient market?
   a. Having a unique product
   b. Numerous governmental restrictions
   c. Often unbalanced supply and demand
   d. An organized exchange conduit

8. Which study examines the profitability of a proposed property?
   a. Feasibility study
   b. Market study
   c. Marketability study
   d. Trade area analysis

9. Which component does NOT comprise supply?
   a. Absorption
   b. Existing inventory
   c. Properties under construction
   d. Planned properties

10. Which body of government controls fiscal policy?
    a. Office of Management and Budget
    b. The President
    c. The Committee of Back-Slapping, Back-Stabbing Idiots (CBSBSI)
    d. Congress

11. Payments on an amortizing mortgage are comprised of
    a. Principal
    b. Utility costs
    c. Interest
    d. Both A and C

12. A mortgage in which the interest rate floats with an indexed rate is a(n)
    a. adjustable rate mortgage.
    b. package mortgage.
    c. fixed rate mortgage.
    d. buydown mortgage.

13. General data relates to what?
    a. All data gathered in the research process.
    b. The four forces on real estate—social, economic, physical/environmental, governmental
    c. Data relating to the subject property only.
    d. All primary and secondary data.

14. What is data that is gathered in the analysis of a certain property?
    a. Primary data
    b. General data
    c. Specific data
    d. Secondary data

15. Data that the appraiser personally collects is called
    a. specific data.
    b. general data.
    c. secondary data.
    d. primary data.