Real Estate Principles 6th edition Ling Solutions Manual

SKU: 9781260013931-SOLUTIONS

CHAPTER 1
The Nature of Real Estate and Real Estate Markets

Test Problems

1. A market where tenants negotiate rent and other terms with property owners or their managers is referred to as a
   b. user market.

2. The market in which required rates of return on available investment opportunities are determined is referred to as the
   d. capital market.

3. The actions of local, state, and federal governments affect real estate values
   d. through all of the above.

4. What portion of households owns their house?
   b. approximately two-thirds

5. Of the following asset categories, which class has the greatest aggregate market value?
   d. nongovernment real estate

6. Storm water drainage systems are best described as
   b. improvements to the land.

7. Among the following four categories, which is the largest asset category in the portfolio of a typical U.S. household?
   a. housing

8. Real estate markets differ from other asset classes by having all of the following characteristics except
   d. homogeneous product.

9. Which of the following is *not* important to the location of commercial properties?
   c. access to schools

10. Which of the following attributes of a home are the most difficult to observe and value?
    c. location attributes

Study Questions

1. The term *real estate* can be used in three fundamental ways. List these three alternative uses or definitions.

   Solution: Real estate is most commonly defined as land and any improvements made to or on the land, including fixed structures and infrastructure components. The term is also used to describe the "bundle of rights" associated with the ownership and use of the physical characteristics of space and location. Finally, real estate may be described as the business activities related to the development, construction, acquisition, operation, and disposition of real property assets.

2. The U.S. represents about 6 percent of the earth's land service, or approximately 2.3 billion acres. Who actually owns this land? What is the distribution of this land among the various uses (e.g., developed land, federal, land, forest land).

   Solution: Developed land, consisting of residential, industrial, commercial, and institutional land, represents approximately 6 percent of the total land in the U.S. Federal lands and water areas occupy about 24 percent of the land; crop land and CRP land represent about 20 percent; and pasture land comprises about 6 percent of the land. Most of the remaining land is divided between range land and forest land, with each representing 21 percent of all U.S land.

3. Describe the value of U.S. real estate by comparing it to the values of other asset classes (e.g., stocks, bonds).

   Solution: As of 2018, real estate (including owner-occupied housing, but excluding real estate held by non-real estate corporations) was the second largest asset class in the U.S., valued at approximately $38.5 trillion. The value of publicly traded corporate equities at that time was $42.9 trillion. The value of mortgage debt (on all property types) was approximately $15.4 trillion. This is larger than the existing stock of both corporate and foreign bonds and just slightly less than the outstanding value of U.S. Treasury Securities.

4. How much of the wealth of a typical U.S. household is tied up in housing? How does this compare to the role that assets and investments play in the portfolios of U.S. households?

   Solution: Housing is the single largest asset in the typical U.S. household's portfolio, representing approximately 21 percent of household wealth in 2018. In comparison, the total value of corporate stocks and mutual fund shares represents 20 percent of household assets. Pension reserves, excluding stocks, represent 21 percent of household assets. Deposits and money market funds represent 11 percent of household assets.

5. Real estate assets and markets are unique when compared to other assets or markets. Discuss the primary ways that real estate markets are different from the markets for other asset that trade in well-developed public markets.

   Solution: Real estate is unlike other asset classes because it is heterogeneous and immobile. Real estate assets have unique and distinctive characteristics, such as age, building design, and location. Real estate is also immobile; therefore, location is an important attribute. Because real estate assets are heterogeneous and immobile, real estate markets are illiquid and localized. Potential users of real property and competing real estate are typically located in the same area or region. Additionally, real estate markets are highly segmented because of their heterogeneous nature. Therefore, potential users of a specific type of real property generally do not seek to substitute one property category for another. Finally, most real estate transactions are privately negotiated and have relatively high transaction costs.

6. Explain the role of government in real estate at the federal, state, and local level. Which has the most significant impact on real estate markets?

   Solution: Local government has the most influence on real estate markets. It affects the supply and cost of real estate through zoning and land use regulations, fees on new land development, and restrictive building codes. It also affects rental rates through the assessment of property taxes. Finally, local government affects the supply and quality of real estate through the provision of community infrastructure and through building codes. The Federal government influences real estate through income tax policy, housing subsidy programs, federal financial reporting requirements, fair housing laws, and disclosure laws. State government generally has the least influence on real estate. State government affects real estate through the licensing of real estate professionals, establishment of statewide building codes, the creation of fair housing and disclosure laws, and through numerous housing related subsides for low and moderate income households. In addition, the state may protect some environmentally sensitive lands from development.

7. Identify and describe the interaction of the three economic sectors that affect real estate value.

   Solution: The three economic sectors that influence real estate value are user markets, capital markets, and government. In real estate user markets, households and firms compete for physical location and space. This competition determines who will obtain the use of a specific property and how much will be paid for the use of this property. Capital markets provide the financial resources necessary for the development and acquisition of real estate assets. Real estate competes for resources against other investment opportunities in the capital market based on investor required rates of returns and risk considerations. Capital markets are segregated into two categories: equity interests and debt interests. Government influences the interaction between the user markets and capital markets through tax policy, regulations, provisions of services and infrastructure, subsidies and other means.

8. Real estate construction is a volatile process determined by the interaction of the user, capital, and property markets. What signals do real estate producers (i.e., developers) use to manage this process? What other factors affect the volatility of real estate production?

   Solution: When real estate market prices exceed the cost of production, this signals producers to build, or add additional supply. As the supply of real estate increases relative to demand, rental rates decline in the user market, which lowers property values and signals the real estate market to slow the production of real estate. Furthermore, shocks in the capital markets and the volatility of construction costs add to the volatility of real estate production. For example, higher interest rates adversely affect property values, all else equal, thereby reducing the attractiveness of new construction. Additionally, shortages of key building materials and organized labor disputes may contribute to the volatility of real estate production.

Author's Note: All presentation slides and instructor's manual material are based on material that the authors and other users have found useful in their classes. However, they have also edited them and supplemented them to support varied use. The intent is for the user to feel free to edit, add to, and prune as he or she sees fit. We hope this material provides a substantial starting point and serves you well!

Chapter 1

The Nature of Real Estate and Real Estate Markets

Chapter Overview

This chapter serves as an introduction to the fundamental concepts of real estate. Real estate is the single largest component of wealth in the global economy. The importance of real estate is highlighted in terms of its roles in the global and domestic economies, as well as its prominence in the investment portfolios of U.S. households. The distribution of U.S. land uses is also touched upon. In this chapter, a significant amount of attention is paid to differentiating real estate from other asset classes. The unique characteristics of real estate and real estate markets are introduced. These discussions should grab the interest of students and provide the essential background and motivation for the entire text.

Chapter Concepts

- Real Estate: Some Basic Definitions
- Real Estate and the Economy
- Real Estate Markets and Participants
- Characteristics of Real Estate Markets

Presentation Strategies

The primary purpose of presenting this chapter is to motivate the students to become interested in the subject matter and provide them with the necessary foundation upon which the remainder of the class will be built.

To make learning effective, it is helpful to have students relate their own experiences to the subject matter. If students have a strong background in finance, the instructor may want to emphasize the differentiation of real estate from other financial assets. If, however, the students are from urban planning programs or more general programs, a discussion of the importance of real estate (as reflected in Industry Issues 1-1) can help bolster their interests. In addition, regional and local residential real estate market conditions and events can be included in the discussion.

Since this chapter serves as an introduction to the entire textbook, students should also be informed of how later chapters are related to the concepts introduced here.

Presentation Outline

1. Real Estate: Some Basic Definitions

An introduction to real estate is presented in PPTs 3-6. The emphasis is first placed on the comparison of tangible and intangible assets. After introducing these concepts, the slides outline the three ways in which the term "real estate" can be interpreted; (1) as tangible assets (PPT 4), (2) as a bundle of property rights (PPT 5), and (3) as an industry and profession (PPT 6).

The initial focus is placed on the definition of real estate that students are most familiar with, real estate as a tangible asset. A discussion can be conducted to allow students to provide their own examples of real estate. PPT 4 is provided to emphasize this concept. Perhaps the instructor would like to include pictures of properties found within the local community that highlight the differences between raw land, improvements to the land, and improvements on the land.

The second definition introduces the legal side of real estate. Real estate can be defined as a bundle of property rights. This is an extremely important concept of which most students are not aware. Explaining real estate as a bundle of rights will be the focus of Chapter 2. PPT 5 is provided to introduce this concept.

Various real-estate professions are introduced in PPT 6. The instructor can highlight how real estate is an applied field, which means there are opportunities to work in this industry that span the spectrum of majors across the university.

PPT 3: Real Estate is Property
PPT 4: The Term "Real Estate" Used Three Ways (1. Real estate as a tangible asset)
PPT 5: The Term "Real Estate" Used Three Ways (2. Real estate as a bundle of rights)
PPT 6: The Term "Real Estate" Used Three Ways (3. Real estate as an industry and profession)

2. Real Estate and the Economy

The objective in this section is to underscore the significance of real estate in the overall economy (PPT 7.) This section begins by discussing the role of real estate in attracting foreign capital investment. It then analyzes U.S. land use distribution, the distribution of assets, and the distribution of household wealth.

The real estate facts/statistics provided in this chapter are impressive presentations by themselves, as shown in PPTs 8-11. Instructors can select from the large number of fact-based slides below according to the focus of the lecture. Always ask students about their general perceptions on these statistics before presenting the slides. Questions relating to students' personal or professional experiences can also be used to motivate the discussion of the importance of real estate.

PPT 7: Real Estate in the Economy PPT 8: Land Use in the United States: 2015 PPT 9: Aggregate Market Values of Selected Asset Categories: 2018: Q4 PPT 10: U.S. Household Wealth: 2018:Q4 PPT 11: Selected Household Assets as a Percentage of Total Assets

3. Real Estate Markets and Participants

Next is a discussion of the three main sectors of the real estate market: the User (Space) Market, the Capital Markets, and the Property Market. A general description of each market's features is provided. It is important for students to focus on the interaction between these sectors in determining real estate values. Particular focus is placed on the segmentation of the user market as well as an introduction to the four quadrants of real estate capital markets: private and public equity and debt markets.

The role of government is given additional attention within this section in terms of its impact on each of the main three sectors. Students should be informed that Chapter 4 will present more information on the role of local governments on land use policies, Chapter 12 will discuss state laws that govern operations in the real estate market, and Chapter 20 is focused on federal income taxes.

PPT 22 provides an illustration of how the three sectors of the real estate market, along with the government sector, interact to determine property values.

PPT 12: What Determines Real Estate Values? PPT 13: Space vs. Property vs. Capital Markets PPT 14: User Market: Demand and Supply PPT 15: Segmentation of User/Space Markets PPT 16: Segmentation of User Markets PPT 17: Capital Markets PPT 18: The Four Quadrants of Real Estate Capital Markets PPT 19: Public Capital Markets PPT 20: Private Capital Markets PPT 21: Property Markets PPT 22: Economy at Large

4. Characteristics of Real Estate Markets

The physical, economic and legal characteristics of real estate markets render them "imperfect", which, in turn, makes real estate pricing and valuation complex. First, real estate is heterogeneous in size, shape, material, style, structure, and quality. Moreover, location is another unique characteristic of real estate that is unparalleled by any other assets. Real estate is immobile. Thus, location can create monopolies in the real estate market. These location-related concepts are discussed in detail in Chapter 5. Lastly, the legal aspects of real estate further complicate its acquisition, ownership, disposition, and valuation.

An effective way of presenting this material is to draw comparisons to other markets and other economic goods. Depending on the background of the students, the stock market or a market of a consumption good (e.g., soft drinks or automobiles), can be used as a reference. The instructor can create an additional slide that compares and contrasts real estate market characteristics with the characteristics of these other assets. In summary, these characteristics of real estate and real estate markets are the reasons why we need a special course to study the uniqueness of the real estate market and its activities.