



Independent Study IN IDAHO

Bus 262
Real Estate Finance

Independent Study in Idaho
University of Idaho North Campus Center
645 W. Pullman Road, Suite 203
PO Box 443225
Moscow, ID 83844-3225

Local: (208) 885-6641
Toll-free: (877) 464-3246
Fax: (208) 885-5738
indepst@uidaho.edu
<http://www.uidaho.edu/isi>

The University of Idaho in statewide cooperation with
Boise State University — Idaho State University
Lewis-Clark State College

Study Guide

Independent

Study IN IDAHO

PO Box 443225

Moscow ID 83844-3225

Self-paced study. Anytime. Anywhere!

Business 262 Real Estate Finance

University of Idaho
3 Semester-Hour Credits

Prepared by:
William Hatch
Real Estate Instructor
University of Idaho

2 – Bus 262
RV: 2/03; updated 2006
Copyright Independent Study in Idaho/SBOE

Table of Contents

Welcome!.....	1
Course Description.....	1
Prerequisites.....	1
Course Materials.....	1
Course Introduction.....	2
Course Objectives.....	2
Lessons.....	2
Exams.....	4
Grading.....	4
About the Course Developer.....	5
Contacting Your Instructor.....	5
Disability Support Services.....	5
Assignment Submission Log.....	6
Lesson 1: The Nature and Cycle of Real Estate Finance.....	8
Lesson 2: Money and the Monetary System.....	12
Lesson 3: Additional Government Activities.....	17
Lesson 4: Secondary Mortgage Market.....	26
Lesson 5: Sources of Funds: Fiduciaries.....	30
Lesson 6: Sources of Funds: Semifiduciary and Nonfiduciary.....	35
Lesson 7: Instruments of Real Estate Finance.....	39
Lesson 8: Conventional Loans.....	48
Lesson 9: FHA-Insured Loans.....	55
Lesson 10: VA-Guarantee Loans.....	61
Lesson 11: Processing Real Estate Loans.....	71
Lesson 12: Closing Real Estate Loans.....	81
Lesson 13: Real Estate Financing Programs.....	84
Lesson 14: Defaults and Foreclosures.....	95
Exam 1 Information: (Self-Administered) Covers Lessons 1–14.....	99
Lesson 15: <i>Self-Study</i> Realty Blue Book Financial Tables, Units 1–8.....	100
Exam 2 Information: (Self-Administered) Covers Lesson 15.....	111
Lesson 16: Financing Problem.....	112
Final Exam Information: (Comprehensive) Covers Lessons 1–16.....	113
Appendix and Forms Table of Contents.....	i
Appendix: Independent Study in Idaho Policies and Procedures.....	iii
See the Appendix for information on registration, lessons/exams, instructor contact, etc.	
Forms for Independent Study in Idaho	

Independent Study in Idaho

This course is offered by the University of Idaho.

Real Estate Finance

3 Semester-Hour Credits: UI

Welcome!

Whether you are a new or returning student, welcome to the Independent Study in Idaho (ISI) program. Before beginning this course, read the information provided below, including course description, prerequisites, required materials, course objectives, and information about lessons, exams, and grading.

Important!

As you read this section, you will see the following icon: 

Use this icon to direct yourself to the **Appendix** in the back of this study guide for essential registration information, Independent Study in Idaho policies and procedures, and forms you will need to successfully complete this course. You are responsible for understanding and following ISI policies and procedures.



Turn to the **Appendix** now. Familiarize yourself with the information in the *Registration* section, student responsibilities in *Academic Integrity*, and the necessary forms. If there is anything you do not understand, please contact the ISI office for clarification before starting your course.

Course Description

Analysis of sources and methods used in the financing of real estate property construction, development, and purchase. Real Estate Finance is certified by the Idaho Real Estate Commission for 45-clock hours. The hours can be used to meet continuing education requirements in Idaho and Washington, to meet requirements for broker licensing in Idaho or Washington, or as one of the 6 courses required to earn a Graduate Realtors® Institute designation in Idaho.

Prerequisites

Bus 261 (Real Estate), or a course in essentials of real estate.

Course Materials

Required Course Materials

- Sirota, David. *Essentials of Real Estate Finance*. 11th ed. Dearborn Real Estate Education, 2006. ISBN: 1-4195-2091-1.
- de Heer, Robert. *Realty Bluebook*, 33rd ed. Dearborn Real Estate Education, 2003, and *Financial Tables*, Dearborn Real Estate Education, 1995.

Independent Study in Idaho course materials are available for purchase at the University of Idaho Bookstore. Visit the UI Bookstore's Web site, <http://www.uidahobookstore.com>, select *Textbook, Independent Study* for a list of course materials. You may order online, by telephone, (208) 885-7334, or by e-mail to uibooks@uidaho.edu.

Independent Study in Idaho courses are updated and revised periodically. Ordering course materials from the UI Bookstore at the time of registration allows you to purchase the correct edition(s) of textbooks, study guides, and supplemental materials. If purchasing textbooks from another source, refer to the ISBN(s) for the textbook(s) listed for this course to ensure that you obtain the correct edition(s). If you have questions regarding the course materials you have ordered and received, contact the UI Bookstore.

Course Introduction

The Real Estate Finance course is designed to help consumers, business people and professional real estate agents understand basic real estate principles and trends in real estate financing.

The purchase, sale, and financing of real estate play a major role in the American economy. Every year millions of Americans borrow money to purchase homes and other property. Mortgage institutions currently hold over 5 trillion dollars in mortgage debt.

Informed citizens should have a working knowledge of how the mortgage industry works, since a home purchase is usually the largest and most complex financial commitment most of them will make during their lifetime.

Until the 1970s, only a few programs were available to finance real estate purchases. Pre-qualifying borrowers was relatively simple. In the late 1970s, interest rates increased dramatically. Only affluent American families could afford to purchase and finance homes in many areas of America. In response, many new types of loan programs were devised. Today consumers face a bewildering array of loan programs. Access to the Internet has increased consumer access to financing information, but the flood of information makes it difficult to pick out what is true and valuable from what is not true or valuable. In fact, the Internet has greatly increased the ability of con artists' to defraud unwary or unsophisticated consumers.

Course Objectives

1. The primary objective of this course is to understand basic real estate financing principles, types of lenders, how buyers are pre-qualified, and how loans are processed.
2. A secondary goal is to apply what students learn to practical problem solving, such as pre-qualifying the borrower, finding the right type of lender, negotiating loan terms and rates, and learning how loans are closed.

Lessons

Overview

Each lesson includes the following components:

- lesson objection
 - reading assignment
 - important terms
 - lecture
 - written assignment
1. In reading the Sirota, *Essentials of Real Estate Finance* text, preview each chapter briefly before reading. Begin by reading the introduction paragraph, turn through the pages noting subtitles and key words, then read the final summary paragraph. This provides you a basis for understanding what the author plans to teach you. Next, read the whole chapter. This method will increase your understanding and retention of the materials.

2. As you read each chapter, study the various charts, graphs, and examples. On page 6 of the Sirota text, for example, a chart shows 30-year fixed-rate mortgage interest rates from 1985 through 2005. As you can see, interest rates fell steadily from the mid-1980s through the 1990s and early years of the twenty-first century. This goes a long way towards explaining the economic boom during most of those years.
3. Another memory tool is briefly outlining the chapter. List key words and concepts. Then look them up in the glossary. Write a one or two line definition in your own words and then memorize a few definitions each day.
4. Read the questions at the end of each chapter of the textbook. Review the information given in the chapter and write a brief answer for yourself. Your answers will provide a good review for the final examination. The chapter quizzes that you mail in are based on these chapter questions.
5. Now you are ready to do the independent study course lessons in the Study Guide. Each lesson is divided into: 1) learning objectives with additional information and exercises, 2) a reading assignment, 3) a list of important terms, 4) a lecture, and 5) a written assignment that is to be sent to the instructor via Independent Study in Idaho office, or by email to the instructor and the Independent Study office, for correction (except for Lesson 15 which is a self study lesson, that you must complete but **do not** submit).
6. The Realty Blue Book's *Financial Tables* is a self-study text. You will need a simple calculator to do the arithmetic. You do not need a financial calculator, but it is a good idea to purchase one if you are, or plan to be, in real estate sales or financing. Good professional models include: the Hewlett-Packcard 10-B, HP 12-C, or one of Texas Instrument's Business Analyst series. I recommend you work out the problems in the Study Guide using the Financial Tables, then use a financial calculator to check your answers. This is a prudent business practice as well.
7. **Written Assignment**
To complete a written assignment, answer each multiple-choice question and write out the essay questions in your own words. You may quote from the texts, or from other sources, but use your own words as much as possible. In answering essay questions, write or type the question on a separate piece of paper, then answer the question. A quarter to half a page is sufficient.

For the multiple-choice questions, simply list the quiz number, the question number, then write or type your letter choice. For example:

Quiz No. 1	1.	B	4.	A
	2.	D	5.	C
	3.	C	Etc.....	

Study Hints

- Complete all assigned readings.
- Set a schedule allowing for completion of the course one month prior to your desired deadline. (An *Assignment Submission Log* is provided for this purpose.)



See the **Appendix** at the back of this study guide for essential *ISI policies on submitting lessons to your instructor*. See the letter sent in your registration packet for *your instructor's requirements: how to format and submit lessons; number of lessons you may submit at one time, and lesson guidelines*.

Exams

Overview

- You must wait for grades and comments on lessons prior to taking each subsequent exam.
- For your instructor’s exam guidelines, refer to the letter sent in your registration packet and the *Exam Information* sections in this study guide.

The examinations are a mixture of essay and multiple choice questions. Exams 1 and 2 are **self-administered**; you will need to request them from the ISI office. You will *not* need a proctor for these exams. The final exam (Exam 3) is must be proctored. See the exam request instructions below.

See *Grading* for specific information on exams, points, and percentages.

Choosing a Proctor/Scheduling Exams

All exams require a proctor unless an exam is self-administered.



See the **Appendix** for guidelines on *how to choose a proctor and schedule exams*.

Self-Administered Exams



See the **Appendix** and your course registration letter for important information on *self-administered exams*.

Grading

The final course grade will be based upon the following considerations.

Fourteen lessons from Sirota, *Essentials of Real*

Estate Finance:

Each chapter quiz is worth 20 points 280 Points

Examination 1 covers Sirota, Chapters 1-14
and the *Realty Bluebook* 100 Points

The **Finance Problem** 100 Points

Examination 2 covers the *Financial Tables* 100 Points

Examination 3 covers the whole course (Proctored) 200 Points

TOTAL POINTS 780 POINTS

A = 702 points or more

D = 468 points or more

B = 624 points or more

F = anything below 468 points

C = 546 points or more

Real estate licensees need a 30-clock hour certificate for license renewal in Washington.

To meet broker license requirements in Idaho or Washington there are two additional requirements.

- (1) The final examination (Examination 3) score must be a minimum of 70% and the overall course score 546 or better.
- (2) When the final examination is requested, also request that a 30-clock hour certificate be issued upon passing the final examination.

The final course grade is issued after **all** lessons and exams have been graded.



See the **Appendix** for information about *confidentiality of student grades, course completion and time considerations*, and *requesting a transcript*.

About the Course Developer

Your course developer, Dr. William Hatch, has over 28 years of real estate experience as a real estate broker in Idaho, Washington and Oregon. He has owned various private real estate schools. He is currently a state certified real estate instructor and a contract instructor for North Idaho College and the University of Idaho. He is also a self-employed technical writer for computerized distance learning courses in real estate, finance and insurance.

Contacting Your Instructor

You will receive *course and instructor contact information* in your registration packet.



See the **Appendix** for detailed information on *contacting your instructor*.

Disability Support Services



See the **Appendix** for *information on Disability Support Services (DSS)*.

Assignment Submission Log

Lesson	Chapter	Reading	Written Assignment	Date Submitted
1	1	Sirota, pp. 1-13	Study Guide Quiz 1	____
2	2	Sirota, pp. 14-31	Study Guide Quiz 2	____
3	3	Sirota, pp. 32-48	Study Guide Quiz 3	____
4	4	Sirota, pp. 49-75 Bluebook, pp. A25-29	Study Guide Quiz 4	____
5	5	Sirota, pp. 77-87 Bluebook, pp. A30-33	Study Guide Quiz 5	____
6	6	Sirota, pp. 88-102	Study Guide Quiz 6	____
7	7	Sirota, pp. 104-142 Bluebook, pp. A1-7	Study Guide Quiz 7	____
8	8	Sirota, pp. 144-162 Bluebook, pp. A8-15 & 48-69	Study Guide Quiz 8	____
9	9	Sirota, pp. 163-178 Bluebook, pp. A70-112	Study Guide Quiz 9	____
10	10	Sirota, pp. 179-190 Bluebook, pp. A113-155	Study Guide Quiz 10	____
11	11	Sirota, pp. 192-225 Bluebook, pp. A34-47	Study Guide Quiz 11	____
12	12	Sirota, pp. 226-240 Bluebook, pp. A156-167	Study Guide Quiz 12	____
13	14	Sirota, pp. 261-290 Realty Bluebook, A8-24	Study Guide Quiz 13	____
14	13	Sirota, pp. 241-259	Study Guide Quiz 14	____
It is time for you to request Exam 1 from ISI.				
15	Supplementary Lessons—Realty Blue Book, Financial Tables			
	Unit 1			____
	Unit 2			____
	Unit 3			____
	Unit 4			____
	Unit 5			____
	Unit 6			____
	Unit 7			____

Unit 8 _____

It is time for you to request Exam 2 from ISI.

16 Finance Problem (Field Trip) _____

It is time to make arrangements with your proctor to take the Final Exam.

Lesson 1

The Nature and Cycle of Real Estate Finance

Lesson Objectives

- 1-1 Explain the difference in the concepts of collateralization, hypothecation, and leverage.
- 1-2 Describe mortgage lending activities in this country.
- 1-3 Give examples of both local and national real estate markets.
- 1-4 List important factors which affect real estate cycles.
- 1-5 Discuss current activities in the local real estate financial market.

Reading Assignments

David Sirota, *Essentials of Real Estate Finance*, pp. 1-13

Important Terms

Business cycle	Equitable title	Leverage	Primary mortgage market
Collateral	FIRREA	Mortgage-backed securities (MBS)	Secondary mortgage market
Disintermediation	hypothecation		Thrift Industry

Lecture

Boom and Bust Cycles:

In *Essentials of Real Estate Finance*, the author discusses real estate cycles of boom and bust. These cycles are natural and inevitable. They can be national or local, or a combination. One city may have a booming real estate market with high employment, while 100 miles away another similar sized city may have a depressed market because a major employer has closed down. For example, in the 1970s, the Idaho real estate market suffered from an over supply of homes, low demand, and relatively low prices. In contrast, urban areas, such as southern California saw double digit increases in home prices every year.

Towards the end of the 1970s, large numbers of families in urban areas decided to sell their homes at inflated prices. Taking advantage of favorable federal tax rules on the sale of personal residences, they used their equities to purchase less expensive homes in rural states, such as Idaho. Many were attracted to Idaho because of relatively low home prices, low crime rates, less pollution and a more laid-back life style.

In 1981, I helped a married couple from southern California purchase a home in north Idaho. They had purchased a small tract home in 1969 for \$28,000 and sold it twelve years later for \$485,000! After expenses and sales costs, their capital gain was \$435,000. The potential capital gain tax was 28% or \$121,800. The tax alone was over four times what they paid for the house originally. To avoid the capital gain tax, federal tax law at the time required that they purchase a replacement home within two years for \$485,000 or more. The same kind of tract home in northern Idaho was worth about \$75,000. They purchased a stunning home for \$300,000 and paid federal and state taxes on part of their capital gain. They still had nearly \$70,000 in cash to invest in the stock market.

Attracted by rising prices, subdividers, developers and builders created hundreds of new residential subdivisions and thousands of new homes in Idaho. Sales remained strong until the early 1980s when

a national recession spread to Idaho. It lasted in Idaho from 1981-1986. The national recession was caused by a number of factors: high unemployment, high interest rates (12-18% for a 30 year mortgage by 1980) and a rapid increase in inflation that peaked at over 20% per annum by 1980. Normally high unemployment would be combined with low growth rates and low inflation. The recession defied most standard economic theories and economists coined a new term to describe it -- "Stagflation".

In 1985, long-term interest rates began a drop that continued throughout the 1990s and into the twenty-first century (see: Sirota, p. 6). The result was another boom cycle in real estate sales.

How is the real estate market today in your area? The factors to consider are the available housing supply, demand for housing, the level of business activity, population growth, characteristics of the population and interest rates. Social attitudes can also affect the market. In our story above, the California family moved north to raise their children in what they considered a less stressful, less polluted and less violent area. In purchasing their home, tax considerations dictated the purchase of a home that was probably too large for their needs. Today's tax laws allow a married couple, filing jointly, to avoid up to a \$500,000 capital gain. The long-term capital tax gain is lower too, only 20%. Today many buyers from higher priced areas still buy homes in Idaho, but many are retired and do not need large homes. They can purchase less expensive homes and invest the difference. In the 1990s, the alternative investment to real estate was the stock market. After the market crash in March 2000 and the following bear market, many now prefer to invest in second homes and rental property. The result is a boom in second home sales nationwide.

Written Assignment



Please read the **Appendix** in the back of this study guide for essential Independent Study in Idaho policies and procedures, and forms you will need to successfully complete this course. You are responsible for understanding and following ISI policies and procedures. If there is anything on these pages you do not understand, contact the ISI office for clarification. Before starting the written assignment for Lesson 1, see the letter sent in your registration packet for your instructor's contact information and requirements: **how to format and submit lessons, number of lessons you may submit at one time, and lesson guidelines.**

CHAPTER 1 QUIZ

Quiz Questions: 1 point for each correct multiple-choice question:

1. Which of the following is **NOT** a primary market financial institution?
 - a. Commercial bank
 - b. Savings association
 - c. Credit union
 - d. Fannie Mae

2. Which of the following is a definition of "collateral"?
 - a. A valuable asset
 - b. An item of value pledged as security for a loan
 - c. Cash on hand
 - d. Proof of a debt

3. The right of borrowers to remain in possession and control of property used as collateral for a mortgage loan is called:
 - a. pledging.
 - b. hypothecation.
 - c. equitable title.
 - d. leverage.
4. Long-term cycles in real estate generally run from:
 - a. three to five years.
 - b. five to 10 years.
 - c. 10 to 15 years.
 - d. 15 to 20 years.
5. All of the following are factors that affect the cycles of real estate **EXCEPT**:
 - a. the supply of money for financing.
 - b. population growth.
 - c. business activities.
 - d. the gross national debt.
6. A single woman has lived in her current home for four years. She plans to sell it. Under federal tax law, she will be exempt from capital gains tax on a profit up to:
 - a. \$500,000.
 - b. \$250,000.
 - c. She must pay capital gains tax because she has not lived in the home for five years.
 - d. She must be at least 55 years old to use the exemption.
7. The failure of many savings and loan associations in the 1980s led to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. An important part of FIRREA was the creation of the:
 - a. Department of Housing and Urban Development.
 - b. Office of Thrift Supervision.
 - c. Federal Deposit Insurance Corporation.
 - d. Federal Savings and Loan Insurance Corporation.
8. Disintermediation occurs when:
 - a. supply exceeds demand.
 - b. the nation's rate of savings declines.
 - c. healthy banks acquire failed savings institutions.
 - d. savings withdrawals exceed saving deposits.
9. The real estate cycle begins over when:
 - a. supply equals demand.
 - b. supply and demand are ignored.
 - c. supply exceeds demand.
 - d. demand exceeds supply.
10. When a purchaser relies on borrowed funds more than on equity this is know as:
 - a. hypothecation.
 - b. disintermediation.
 - c. collateralization.
 - d. leverage.

Essay Question: 10 points. Answer in two or three paragraphs in your own words:

Briefly describe the real estate market in your area based on (1) availability of housing, (2) financing and terms of financing, (3) population growth and characteristics, and (4) social attitudes towards types of housing.