

## 15

THE REAL ESTATE MARKET  
AND ANALYSIS

## 1 LEARNING OBJECTIVES

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

- 3 ■ Describe the physical and economic characteristics of real estate.
- 4 ■ Identify the factors that influence supply and demand for real estate.
- 5 ■ Distinguish among ways of interpreting market conditions and demonstrate understanding of the differ-
- 6 ent market indicators.

## 7 KEY TERMS

buyer's market  
demand  
household

seller's market  
situs

supply  
vacancy rate

## 8 INTRODUCTION

9 The word *market* has many meanings, depending on usage. It can mean a place where  
10 farmers and tradespeople display their produce and products for buyers. It can mean a  
11 place where securities are exchanged, such as the commodities market or the stock mar-  
12 ket. Regardless of difference in form, the basic principles of market operation hold true  
13 for all. A market can function only when sellers and buyers interact. Many markets use  
14 intermediaries to facilitate activity between seller and buyer, and the real estate market is  
15 one such market.

16 **15.1 PHYSICAL AND ECONOMIC CHARACTERISTICS OF REAL ESTATE**

17 There are physical and economic characteristics of the real estate market that set it  
18 apart from other markets.

19 **Physical Characteristics of Real Estate**

20 **Immobility of Real Estate.** The geographic location of real estate is fixed. Because of the  
21 immobility of real estate, location largely influences the value of real estate. Real estate  
22 value is heavily influenced by changes in the surrounding area.

1 **Land Is Indestructible (Durable).** Land's indestructibility refers to the durability of the  
 2 land and its fixed location. Land cannot be destroyed. An appraiser, when applying the  
 3 cost approach to valuation, does not depreciate the land; only the structure. The physical  
 4 structures (improvements) on the land are relatively stable and long term; however, over  
 5 time the improvements can become obsolete and deteriorate.

6 Land's indestructibility is the reason property insurance protects the owner's buildings  
 7 and other man-made improvements; property insurance does not cover the land value—  
 8 even in times of catastrophe the land will survive. Flood insurance is issued on the con-  
 9 tents and the structure, not the land. Investments in real estate tend to be long term,  
 10 primarily due to the immobility and indestructibility of the land.

11 **Real Estate Is Unique.** No two tracts of land are identical. Real estate is not standard-  
 12 ized. Real estate, therefore, is unique or *nonhomogeneous* because even two lots side by side  
 13 have different geographic locations.

#### 14 **Economic Characteristics of Real Estate**

15 **Government Controls Influence the Market.** Government controls influence the market  
 16 through zoning, building codes, taxes, monetary policy, and so forth.

17 **Relationship Between Supply, Demand, and Price.** In the real estate market, supply and  
 18 demand interact to affect property prices. In any marketplace, supply and demand are  
 19 continually adjusting; this causes changes in the price of real estate. When the supply  
 20 increases relative to demand, prices go down. When demand increases relative to supply,  
 21 prices go up.

22 **The Market Is Slow to Respond to Change in Supply and Demand.** Design, land acquisi-  
 23 tion, site preparation, and construction phases of real estate are time-consuming. For this  
 24 reason, when the equilibrium between supply and demand is upset, it can be years before  
 25 the imbalance is corrected.

26 **Area Preference.** *Situs* refers to prospective buyers' preference for certain area. Area  
 27 preference, and therefore the property's location, is considered the most important eco-  
 28 nomic characteristic of real estate. One of the top considerations of families with K-12  
 29 age children is school zones. Subdivisions in preferred school zones demand higher prices  
 30 compared with other subdivisions. So goes the saying: location, location, location!

#### **Practice Questions**

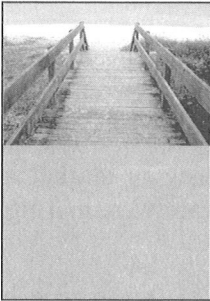
1. List the physical characteristics of real estate.
  1. Land is \_\_\_\_\_
  2. Land is \_\_\_\_\_
  3. Land is \_\_\_\_\_
2. When the supply increases relative to demand, prices go \_\_\_\_\_.
3. When demand increases relative to supply, prices go \_\_\_\_\_.
4. The premium paid for location preference is \_\_\_\_\_.

## 15.2 SUPPLY AND DEMAND FACTORS

A study of markets and their operations reveals several factors that influence supply and demand.

### Supply

**Supply** is the amount and type of real estate available for sale or rent at differing price levels in a given real estate market. The variables that influence supply are listed in the following text box.



### VARIABLES THAT INFLUENCE SUPPLY

- Availability of skilled labor
- Availability of construction loans and financing
- Availability of land
- Availability of materials

**Availability of Skilled Labor.** Numerous skilled laborers, such as carpenters, roofers, and electricians, are required for construction. The availability and cost of labor depend on such things as unemployment rates, skill levels required, and the influence of foreign labor. When an area is growing rapidly, the growth usually is characterized by much construction with resulting high employment in the construction industry. These conditions cause competition for labor and its cost increases.

**Availability of Construction Loans and Financing.** New construction is directly related to the availability of construction loans and short-term financing. As money becomes more available and less expensive, more speculative homes will be built, increasing the available supply of housing. The same is true for commercial development.

**Availability of Land.** Although land seems physically plentiful, the supply of the type and location of land most in demand is always scarce. Two factors influence the availability of land: (1) the scarcity of readily usable land and (2) the regulations affecting its use and cost of development.

**Availability of Materials.** The availability of construction materials influences the supply of new housing. In the late 1970s and early 1980s, the construction industry nationwide was severely crippled by a shortage of drywall. Drywall couldn't be found anywhere. New construction was stalled, and construction costs spiraled.

### Demand

**Demand** is the desire and ability to purchase or rent goods and services. In real estate, demand is the amount and type of real estate desired for purchase or rent in a given market at a given period of time. The variables that influence demand are listed in the text box that follows.



19

## VARIABLES THAT INFLUENCE DEMAND

- Price of real estate
- Population numbers and household composition
- Income of consumers
- Availability of mortgage credit
- Consumer taste or preferences

1 **Price of Real Estate.** There is an inverse relationship between price and the demand for  
2 real estate. When prices rise, demand goes down. When prices decrease, demand goes up.

3 **Population Numbers and Household Composition.** The demand for dwelling space  
4 depends on both the population and composition of households in every market area.  
5 Mere population size does not provide sufficient information for accurately estimating the  
6 demand for dwelling space, nor does a count of households.

7 Modern lifestyles, changes in economic conditions, and reduced family size have  
8 caused the household to become the basis for most population analysis. A **household**, as  
9 defined by the U.S. Census Bureau, is any person or group of persons occupying a sepa-  
10 rate housing space. Thus, a household may be a single person living in a rented apart-  
11 ment, a married couple with four children living in their own home in the suburbs, or  
12 two unmarried adults living in a condominium near the city center. Each constitutes a  
13 household.

14 Just before the end of the 19th century, 100 dwelling units housed 490 people, due  
15 to the average size of households at that time (4.9 persons). The most recent census  
16 reveals that the decreased size of the average household (about 2.58 people per household)  
17 requires approximately 190 dwelling units to house 490 people. The change in average  
18 household size alone has therefore caused a 90% increase in demand. Those who study  
19 population trends believe that a further reduction in average household size will occur.  
20 This again will change the demand for housing, not only in numbers of units but also in  
21 size of dwellings. *Demographics* refers to the characteristics of the population: age distri-  
22 bution, family size, and population movements. Demographics affect not only the total  
23 demand for real estate but also the type of housing demanded.

24 The 2020 U.S. Census is available at [https://www.census.gov/programs-surveys/  
25 decennial-census/decade.2020.html](https://www.census.gov/programs-surveys/decennial-census/decade.2020.html).

### WEBLINK



26 For valuable information on economic indicators, visit [https://www.census.gov/  
27 economic-indicators/](https://www.census.gov/economic-indicators/). Data concerning construction spending, new home sales, and hous-  
28 ing starts are updated regularly.

29 **Income of Consumers.** Whereas change in price is inversely related to change in demand,  
30 income is directly related to demand. As individual income increases, so does demand for  
31 dwelling space. Any change in local employment numbers or salary-wage levels causes a  
32 change in demand for dwelling space and related loan considerations.

33 **Availability of Mortgage Credit.** The availability and cost of mortgage credit has been  
34 called the barometer of the real estate market. Because the typical purchase of residential  
35 property involves two or three times the buyer's annual net income, it is easy to under-  
36 stand why a large number of homebuyers use credit to arrange the purchase. If a potential  
37 homebuyer can afford the monthly mortgage payments (principal and interest), plus prop-  
38 erty taxes and hazard insurance, the total cost of the house is of secondary importance.

1 The amortized (principal) portion of a monthly payment can be increased or decreased  
2 by (1) the amount of the down payment made on the property and (2) the term of the  
3 loan. Both of these have a direct bearing on demand for housing.

4 When a *tight money market* develops and interest rates rise, a corresponding drop is  
5 reflected in housing demand because the amount of money needed to make monthly mort-  
6 gage payments increases. For example, a \$90,000 mortgage loan at 7% interest for a period  
7 of 30 years requires a monthly payment of \$598.77, not including taxes and insurance.  
8 The same amount of money for the same period of time but at 9% interest requires a  
9 monthly payment of \$724.16, an additional \$125.39 per month. An increase in mortgage  
10 interest rates of even 1% causes a definite drop in demand for housing.

11 **Consumer Tastes or Preferences.** Another factor related to demand concerns changing  
12 consumer tastes or preferences. Different architectural designs are sometimes introduced  
13 into the residential market and may enjoy brief periods of popularity. Generally speaking,  
14 however, enduring changes in consumer tastes occur slowly, over extended time periods.  
15 In recent years, the “green movement” has consumers preferring energy-efficient homes.  
16 Whatever style and type of house the buying public prefers at a given time is the type  
17 of dwelling that will be built more often than others, until a new demand creates a new  
18 preference.

19 Changes in demand for condominiums or second homes for vacation purposes also  
20 reflect changes in consumer preferences. For years, *empty nesters* (those parents whose  
21 children are grown and have moved away) continued to live in the same house where  
22 they had reared their children, although it was then entirely too large for their needs as  
23 a couple. The numerous chores of the homeowner related to maintenance, repairs, and  
24 grounds upkeep were often a joy but sometimes too physically demanding. The advent of  
25 condominiums and other forms of smaller, maintenance-free housing units offered a solu-  
26 tion to these empty nesters and other small families.

### Practice Questions

5. \_\_\_\_\_ is the amount and type of real estate available for sale or rent at  
differing price levels in a given real estate market.
6. \_\_\_\_\_ is the desire and ability to purchase or rent goods and services.

## 15.3 INTERPRETING MARKET CONDITIONS

28 **Price Levels.** The changes in price levels of home sales is an indicator of new housing  
29 supply and demand for certain price ranges.

30 Price and supply are inversely (oppositely) related. When supply goes down, prices go  
31 up (more buyers competing for fewer homes). The supply and demand equilibrium is upset  
32 by excess demand (more buyers than supply) and a **seller's market** develops.

33 When supply goes up, prices go down (fewer buyers are competing for a bigger supply  
34 of homes for sale). The supply and demand equilibrium is upset by excess supply (more  
35 houses for sale than potential buyers), and a **buyer's market** develops.

### Market Indicators

37 **Price Levels and Building Permits.** Changes in price levels of home sales and the num-  
38 ber of building permits issued for a given period of time are indicators of new housing  
39 supply and demand for certain price ranges.

1 **Vacancy Rates.** A vacancy rate is the percentage of rental units that are not occu-  
 2 pied. Vacancy rates are one indicator of demand for housing in a certain market area. An  
 3 increase in vacancy rates in rental housing indicates a surplus of housing space. A 5%  
 4 vacancy rate (95% occupancy rate) is usually considered indicative of a healthy housing  
 5 market. As the occupancy rate increases, rental rates tend to increase, and apartment  
 6 dwellers who have been waiting to buy homes of their own start looking at houses for sale  
 7 and moving out of apartments. This causes increased apartment vacancies and eventually  
 8 a drop in rents, as well as a halt in construction of new apartments. One of the first indica-  
 9 tions of a revived real estate market is an increase in rental occupancies that cannot be  
 10 attributed to reduced rents or giveaway programs. High occupancy rates lead to increased  
 11 rents. Increased rents lead to new construction and a revived real estate market.

12 **Sales Volume.** Sales associates can collect information on the number and prices of  
 13 homes sold during the recent past. Data on the number of houses sold and the sale price  
 14 of each are available from county public records. From MLS data, licensees can extract  
 15 information on how many sales occurred, the approximate sale prices, where the proper-  
 16 ties sold were located, and the types of houses.

17 A database system arranged by subdivision, by streets, or alphabetically can be of great  
 18 value in building a current sales data file. A large-scale map of a town or those areas of a  
 19 city where interest is high can become a valuable tool to pinpoint areas of greatest activity  
 20 and to forecast direction of growth. When a sale is reported in a publication, a color-coded  
 21 "pin" can be placed on the map in the database to indicate price range and location of  
 22 property. A glance at such a map shows where most sales are occurring and the general  
 23 price ranges. Direction and rate of growth also can be estimated from a sales data map.

## 24 Calculating Occupancy and Vacancy Rates

25 To calculate the occupancy rate, divide the number of occupied units by the total  
 26 number of units in the building.

### Formula: Occupancy Rate

$$\text{occupied units} \div \text{total units} = \text{occupancy rate}$$

27 **EXAMPLE:** Assume that 200 apartments are rented in a 250-unit apartment build-  
 28 ing. What is the building's occupancy rate?

29  $200 \text{ rented units} \div 250 \text{ total units} = .80 \text{ or } 80\% \text{ occupancy rate}$

30 To calculate the vacancy rate, divide the number of vacant units by the total number  
 31 of units in the building.

### Formula: Vacancy Rate

$$\text{vacant units} \div \text{total units} = \text{vacancy rate}$$

32 **EXAMPLE:** What is the building's vacancy rate if 225 units are rented in a 300-unit  
 33 apartment building?

34  $300 \text{ total units} - 225 \text{ rented units} = 75 \text{ vacant units}$

35  $75 \text{ vacant units} \div 300 \text{ total units} = .25 \text{ or } 25\% \text{ vacancy rate}$

## Practice Questions

7. A \_\_\_\_\_ market exists when demand exceeds supply.
8. Price and demand are \_\_\_\_\_ related.

9. A 400-unit apartment building currently has 350 units occupied. What is the building's vacancy rate?
10. There are 180 apartments rented in a 225-unit apartment building. What is the building's occupancy rate?

## 15.4 SUMMARY OF IMPORTANT POINTS

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- 1
- 2 ■ Physical characteristics of the real estate market are that (1) real estate is  
3 immobile; (2) land is indestructible (durable); and (3) real estate is unique  
4 (nonhomogeneous).
- 5 ■ Economic characteristics of real estate include (1) government controls influenc-  
6 ing the market through zoning, building codes, and taxes; (2) the market's slow  
7 response to change in supply and demand; (3) area preference (*situs*) influencing  
8 the price buyers are willing to pay; and (4) supply and demand interacting to  
9 affect property prices.
- 10 ■ *Supply* is the amount and type of real estate available for sale or rent at differ-  
11 ing price levels in a given real estate market. Variables that influence supply are  
12 availability of labor, availability of construction loans and financing, availability  
13 of land, and availability of materials.
- 14 ■ *Demand* is the desire and ability to purchase or rent goods and services. Variables  
15 that influence demand are price of real estate, population numbers and house-  
16 hold composition, income of consumers, availability of mortgage credit, and  
17 consumer taste or preferences.
- 18 ■ *Situs* refers to prospective buyers' preference for a certain area.
- 19 ■ A buyer's market occurs when the supply and demand equilibrium is upset by  
20 excess supply (supply exceeds demand).
- 21 ■ A seller's market occurs when the supply and demand equilibrium is upset with  
22 excess demand (demand exceeds supply).
- 23 ■ A vacancy rate is the percentage of unoccupied rental units.

# UNIT 15 EXAM

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1. The economic characteristic that refers to preference for a certain location owing to various factors such as climate, employment outlook, public schools, and so forth is called
  - a. highest and best use.
  - b. vacancy rates.
  - c. sales volume.
  - d. situs.
2. Which characteristic does NOT describe the real estate market?
  - a. Land is indestructible.
  - b. The market is quick to respond to changes in supply and demand.
  - c. Real estate is heterogeneous.
  - d. Real estate is immobile.
3. Which statement is FALSE regarding the relationship between price and demand?
  - a. An increase in price causes a decrease in demand.
  - b. A decrease in price causes an increase in demand.
  - c. There is an inverse relationship between price and demand.
  - d. An increase in price causes an increase in demand.
4. Some 280 apartments are rented in a 350-unit apartment building. What is the building's occupancy rate?
  - a. .20
  - b. .70
  - c. .80
  - d. .85
5. Which statement is NOT associated with the economic concept of demand?
  - a. Demand is the desire and ability to purchase or lease goods and services.
  - b. Changes in price cause an inverse change in demand.
  - c. Consumer preferences influence demand.
  - d. The availability of building materials influences demand.
6. When the equilibrium of the real estate market is upset by an excess supply,
  - a. builder activity increases in response to the need.
  - b. a seller's market exists.
  - c. a buyer's market exists.
  - d. demand decreases.
7. One person or a group of persons occupying a separate housing space is technically defined as a
  - a. unit.
  - b. household.
  - c. family.
  - d. multiple ownership unit.
8. The uniqueness of real estate is also called land's
  - a. immobility.
  - b. nonhomogeneity.
  - c. indestructibility.
  - d. fixed location.
9. The durability of land refers to land's
  - a. immobility.
  - b. homogeneity.
  - c. indestructibility.
  - d. situs.
10. Factors affecting the supply side of the real estate market do NOT include the availability of
  - a. land.
  - b. skilled labor.
  - c. material.
  - d. mortgage credit.