CHAPTER 1:
economics 101

Learning Objectives

At the basic root core definition, economics is really just the study of human behaviors. Economics is also the study of goods, services, productions, consumptions, and the underlying reasons why people are so willing to transfer their wealth in order to obtain these goods or services. The real estate profession is one of the main hubs which drive the U.S. economy while creating potentially the highest percentage of wealth for a high percentage of Americans.

Economics is the study of money, land, labor, investments, income, job production, taxes, individual well-being, and governmental expenditures. Upon completion of this section, the student will learn about the origins of economic strategies, various economic theories, and about how real estate values are created both for the subject property as well as for the neighboring regions.

"Formal education will make you a living; self-education will make you a fortune."

Jim Rohn

key terms

- Boom/Bust
- Bubble State
- Clayton Act
- Communism
- Communist Manifesto
- Credit Crisis
- Economic Obsolescence
- Economics of Assemblage
- Economics of Subdividing
- Economies of Scale
- Elastic/Inelastic
- Equilibrium Point
- Federal Trade Commission (FTC)
- Federal Trade Commission Act
- Imperfect Competition
- Leverage
- Marginal Propensity to Consume
- Marginal Propensity to Save
- Market Price
- Monopoly
- Monopsony
- Multiplier Effects
- Oligopoly
- Perfect Competition
- Principle of Change
- Principle of Progression
- Principle of Regression
- Shadow Inventory
- Sherman Act
- Socialism
- Theory of Filtering Down

Microeconomics and Macroeconomics

Microeconomics studies the actions of individuals and various industries within a society such as the relationships between buyers, sellers, borrowers, and lenders. Macroeconomics, in turn, focuses more on the economic activity of an entire nation, continent, or even the world's overall economy.

To simplify, microeconomics is akin to using a microscope to study a smaller segment of the economy such as local housing trends in one town or city while macroeconomics is more like trying to observe a larger region with a telescope. Some real estate agents prefer to focus more on local trends while other agents may prefer to follow national or international trends which may later impact their local markets. Either way, both microeconomics and macroeconomics affect us all in whichever profession we decide to work.

"Economics is the study of people in the ordinary business of life."

- Alfred Marshall, Principles of economics; an introductory volume (London: Macmillan, 1890)

"Economics is the science which studies human behavior as a relationship between given ends and scarce means which have alternative uses."

- Lionel Robbins, An Essay on the Nature and Significance of Economic Science (London: MacMillan, 1932)

"Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people."

- Paul A. Samuelson, Economics (New York: McGraw-Hill, 1948)

The Supply and Demand Seesaw

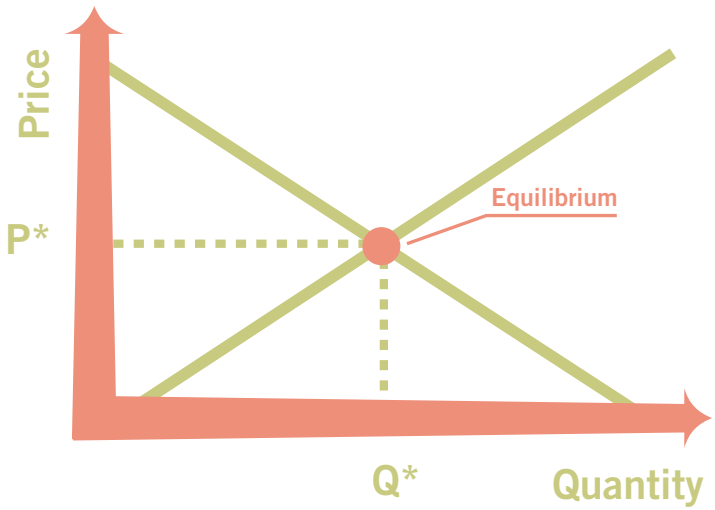
The value of an asset such as a single-family home is subjective. Value is based upon the perceptions, interests, demands, and access to cash or cash-like assets for the parties involved. The final price of an asset is known as the equilibrium point or compromised middle ground, somewhere between the maximum price willing to be paid by a motivated buyer and the minimum price willing to be sold by a seller.

The Law of Supply: This microeconomic theory states that as a price of a specific good or service increases, the quantity of the same good or service will increase as well so that suppliers can attempt to maximize their profits. Conversely, falling price typically leads to falling production.

The Law of Demand: The opposing microeconomic theory, with all other factors being equal, is that as the price of a good or service increases, the consumer demand for the same good or service will decrease. This inverse movement to one another between price and demand is akin to the direction of a seesaw at a local playground. Conversely, falling price leads to increasing demand.

Price Equilibrium Point: The price point where market supply and demand balance one another out. This is akin to visualizing a balanced and level seesaw with two children of equal weight sitting on opposing sides. In a free market society, the state of equilibrium is established at a price resulting in a sufficient quantity of a specific good or service which satisfies the demand from buyers at that same price.

Equilibrium is also known as the **market price** point where the demand and supply lines intersect on a chart with demand, supply, price, and quantity.



Real Estate Economics – Supply, Demand, and Market Prices

Real estate is an imperfect marketplace, where the supply and demand doesn't always meet in a perfect equilibrium point, either locally, statewide, or nationally.

The moving price trends for real estate assets are not just based upon the equilibrium point reached between supply and demand. Increasing and decreasing demand for real estate assets, such as single-family homes or multi-family apartment buildings, are directly impacted by the available supply of properties in the region of interest, the access to affordable third-party money supplies from places like local banks or mortgage brokerage firms, interest rate directions, and inflation or deflation trends with the national economy and primary currency such as the U.S. dollar.

Few investments today are perceived as a better hedge against inflation than real estate. Historically, the median price of a home has consistently averaged at or above the reported governmental rates of inflation on a fairly consistent basis throughout both boom and bust housing and economic cycles over most of the past century. However, there have been exceptions to this rule that "home values always go skyward" in recent years.

A 50-Year Snapshot of Median Home Prices Nationally

January 1963 - $17,200
January 1973 - $29,900
January 1983 - $73,500
January 1993 - $118,000
January 2003 - $181,700
January 2013 - $170,600

(Sources: U.S. Census Bureau and the National Association of REALTORS®)

Buying Power and Real Estate: Per the CPI (Consumer Price Index) inflation calculator, $1 in 1950 later had the same purchasing or buying power fifty years later as $7.15 in the year 2000. Thanks to a weakening dollar and increasing levels of inflation over time, these numbers equate to about 4% annual inflation rates during this same time span.

Inflation is a hidden form of taxation which adversely impacts and reduces a person's overall wealth if one does not purchase inflation hedged assets like real estate.

Consumer Price Index:

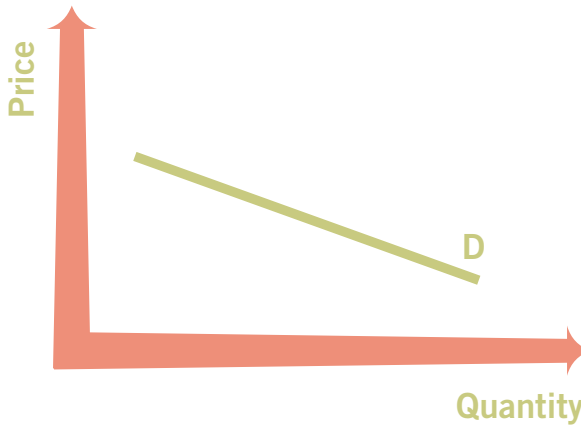
Lumbleau.com/resourses/CPI-inflation-calculator

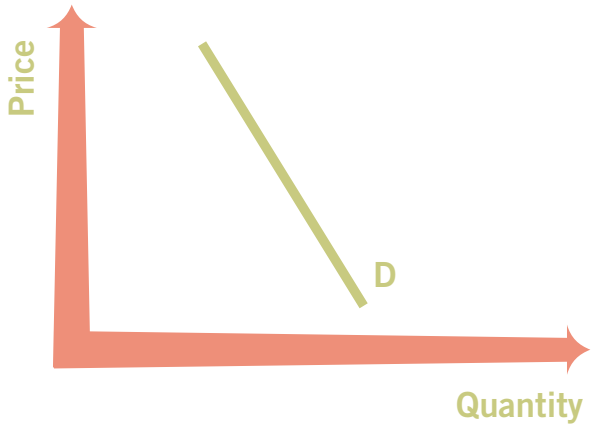
Elasticity of Supply and Demand: The degree of responsiveness or reaction from buyers to a change of price is described as elasticity. An **elastic** housing market is one in which a 5% price drop for a specific listed home may rapidly increase demand from motivated home buyers in the region while creating multiple offers at or above the new listing price. In this housing price adjustment example, a relatively small price adjustment downward leads to a significant increase in buyer demand.

An **inelastic** real estate asset, good, or service is one in which a change in price may have little to no impact on current or future buyer demand. An example of an inelastic real estate asset is raw land out in the middle of the desert with no access to water and other utilities, streets, or populated communities within 50 miles.

Elasticity can be visualized as a rubber band which snaps forward in a positive direction; inelasticity can be visualized as a rope which doesn't snap back as quickly.

An elastic curve for a home or other good or service on a chart will be more horizontal or flat. The more horizontal chart line represents how just relatively small price changes can lead to a tremendous increase in demand or quantity consumed of any product type. An inelastic curve, conversely, will be viewed as a more vertical chart.





Housing Economics and Local Neighborhoods: At the most basic level of economics and housing prices, the available supply of perceived affordable homes and recently sold similar homes within a specific neighborhood or zip code region provides buyers and sellers with good starting points where homes should be priced. Sales comps in the same neighborhood for homes with near identical square footage ranges for both the homes and land sizes may establish the potential buying or selling price ranges.

Both distressed properties (e.g., foreclosures, bank sales) and non-distressed home sales at record-setting high prices can be either a person's worst or best sales comp directly impacting the local neighborhood owner's values. Neighborhoods full of large numbers of foreclosed properties selling for 25%+ below the most recent current market value at local trustee sale auctions, or from very motivated sellers trying to save some equity, will directly impact neighboring home values either positively or negatively.

The Credit Crisis Housing Demand and Supply Case Study

During the near depths of the credit crisis back in 2008, there were an estimated 3.8 million homes for sale either on local MLS (Multiple Listing Service) or other online notification systems created to market towards the general public. In 2008, and for several years thereafter, there might have been an additional several million **shadow inventory** homes potentially for sale which were not publicly listed for sale. A shadow inventory home can be defined as a mortgaged property with 90+ days of payment delinquencies and properties foreclosed upon by a bank or mortgage loan servicing company but not yet fixed up and not listed online for sale to the general public.

Home prices between 2008 and 2010 fell dramatically in many regions; especially in **bubble state** regions like California, Arizona, Nevada, and Florida. Each region experienced some of the highest double-digit annual price percentage gains in the boom years before the housing and financial markets began to weaken in 2008. Experienced individuals, or institutional buyers with all cash, were quite aware of the glut of available homes, regardless of whether they were formally listed for sale, to purchase from motivated individual or institutional sellers like banks, mortgage loan service companies, or hedge funds.

Prices began to rapidly fall in California neighborhoods with the highest percentage of distressed or foreclosed properties partly because the available supply of homes for sale far exceeded the number of qualified buyers with access to cash. Home prices later stabilized and improved once the available supply of distressed and non-distressed homes for sale declined and the number of qualified individual or institutional buyers increased.

Key Housing Statistic:

According to the National Association of REALTORS®, 4,940,000 existing homes were sold in 2014. An additional 437,000 newly constructed homes were sold in 2014, per the U.S. Census Bureau, for a grand total of 5,377,000 home sales in 2014. In many regions, like many prime coastal California regions, the number of qualified buyers exceeds the amount of available listed homes which, in turn, has led to rampant price appreciation in recent years.

Consumer Price Index:
Lumbleau.com/resources/consumer-price-index

Key Housing Statistics

According to the 2013 American Housing Survey, there are an estimated 115 million occupied housing units in the United States. The typical owner-occupied home was built back in 1976 while the typical non-owner occupied rental home was built in 1973. The median home size is close to 1,500 square feet. The typical homeowner is 55 years of age and has lived in the same residence for an average of 14 years. 65.2% of families owned their primary residence in 2013, per the Federal Reserve's Survey of Consumer Finances report.

The Terms of Economics

Capitalism: Individuals in a capitalistic society usually own and control the land, property structures, household furnishings, cars, boats, and other types of private property or chattel. Additionally, members of a capitalistic nation typically have the right to choose their short-term jobs or long-term professions or occupations that allow them to generate their own income sources as an employee or as a self-employed individual such as a licensed real estate agent, restaurant owner, or a retail store operator.

Capitalism allows people with business goals to pursue those dreams by way of strategies such as education and/or starting up their own new businesses for so long as they have enough of their own direct or indirect access to startup capital. In many cases, the same individual is free to pursue their business ideas with minimal government interference except for things like permit or tax fees related to the business ventures. Under this type of national economic system, the individual has the maximum number of personal choices in life.

Once businesses are established, truly capitalistic markets are supposed to be somewhat balanced between buyers, sellers, and fellow business owners that work in the same competitive fields. In capitalistic theory, it is ruled by perfect competition more so than imperfect competition. The shortest definition of perfect competition is that there are at least a matching number of buyers and sellers for a specific product like a new television or smartphone and where no single or multiple sellers or buyers can directly influence the prices for these same products.

With the field of real estate, it is quite challenging to sell identical products because there are so many different variations of properties and real estate services offered to the general public. These products and services can include one-bedroom condominium units in crowded metropolitan regions that are priced at $200,000 in midwestern regions to $50 million-dollar mansions on the sand in prime coastal regions that have 15 bedrooms and 10 baths in the home. With both properties, the types of buyers and sellers will vary significantly just like the properties.

One of the early giants and biggest influencers of the capitalism movement was Adam Smith. He was best known for his economic book entitled The Wealth of Nations that was published in 1776. The book was published in the same year of the Declaration of Independence (July 4, 1776) and near the dawn of the Industrial Revolution. Mr. Smith argued for market competition that was fair and balanced, free trade, and solid morality in the private enterprise with "limited government influence" in the private sector. Smith thought that the government should

focus on the establishment of law and justice while also providing for education and basic infrastructure such as roads and bridges.

Imperfect Competition is more often seen in places with economies that are based upon socialism or communism beliefs and leadership. One of the quickest ways to define imperfect competition is an economic environment where there are few sellers and qualified buyers with various types of seemingly unrelated products that aren't too like one another. Imperfect competition can be seen in nations with the following economic models:

Monopoly: One seller exists for the sale of a unique product or service, or one seller dominates the marketplace. In many cases, there is just one seller of the product or service that may end up being the local or national government. In the field of health care, there may only be one seller of medical services or medicines available to the general public at any given time. People with severe health problems at the time may be willing to pay just about any price to receive treatment because their life could depend upon it.

Ironically, the creation of monopolies in a certain business sector can be an extreme result of free market capitalism. Sometimes, the lack of just minimal governmental restrictions coupled with positive economic cycles that encourage business growth leads to the absolute dominance of a market sector for one company. If one company is the only business in town that provides reasonably priced air conditioning systems partly since they build them using cheap labor in a foreign nation by way of an efficient assembly system, then no other local companies can compete with their cheap and efficient labor, marketing, distribution, and employee systems. As a result, the free market capitalism system works so well that a monopoly is created.

Antitrust Laws: The first antitrust law created in the U.S. was named the **Sherman Act**. It was passed by Congress in 1890. Described as a "comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade." Two other major types of antitrust laws were passed after the Sherman Act over the next few decades. These acts included the **Federal Trade Commission Act**, which established the **Federal Trade Commission (FTC)**, and the **Clayton Act**.

These same three core antitrust laws make up the bulk of anti-competition laws here in the U.S. The main antitrust laws were written with the intent to limit or ban perceived unlawful mergers and other types of business practices by attempting to protect the competition process for both buyers and sellers of goods and services. Their intent was to make sure that businesses had strong incentives like the avoidance of significant fines or years of prison time for the company executives so that companies would operate efficiently, keep prices within reasonable levels, and product or service quality as high as possible for consumers. If the two largest companies in the U.S. merged with each other for the sale of something like a dishwasher, then they might unfairly dominate the American dishwasher industry because no competitor could match their market dominance.

The Sherman Act outlaws "every contract, combination, or conspiracy in restraint of trade," and any "monopolization, attempted monopolization, or conspiracy or combination to monopolize." It would later be decided by the courts on whether a business was acting fairly

or not. The Sherman Act imposed and allowed courts to assess significant fines for individual owners up to $1 million and as high as $100 million fines for larger corporations. In addition, individual owners or corporate executives could face upwards of up to 10 years in prison.

The Federal Trade Commission Act was designed with the intent to ban "unfair methods of competition" and "unfair or deceptive acts or practices." The U.S. Supreme Court has ruled that any and all violations of the Sherman Act also automatically and simultaneously violates the Federal Trade Commission Act. Yet, only the Federal Trade Commission (FTC) can bring legal claims against potential antitrust violators under the Federal Trade Commission Act.

The Clayton Act covers additional business practices that aren't necessarily covered under the Sherman Act. These possible antitrust violation activities can include "mergers and interlocking directorates" (as defined by the FTC) where one person is on the board of directors for two separate competing businesses while making decisions that impact the direction of both firms. Section 7 of the Clayton Act includes the banning of mergers and acquisitions where the effect "may be substantially to lessen competition, or to tend to create a monopoly."

The Clayton Act allows people who feel violated by anti-competitive type business behaviors or methods to sue for upwards of triple damages for actions deemed unlawful under the Clayton Act or Sherman Act. The Clayton Act also allows injured parties to seek a court order prohibiting the anti-competitive and monopolistic actions in the very near future. In addition to these federal statutes that prohibit monopolies, the vast majority of states have antitrust laws that can be enforced by state attorney generals or private individual plaintiffs.

Oligopoly: A type of economy where there are just a few sellers of a specific type of product or service. Many times, the local or national government will represent one of these powerful sellers. A perceived oligopoly example might include a telecommunications or wireless business that only has one other major competitor in a city, county, state, or nation. In each market region, both main sellers of these high-tech services set their high prices almost identical to their main competitor since they both know at the time that they control the marketplace and that consumers really only have two choices to choose from. This way, both sellers are able to maintain the highest profit margins for their owners and shareholders.

Monopsony: A monopsony can also be referred to as a "buyer's monopoly" in that one or just a few large, powerful, and wealthy buyers truly dictate and control the direction of the market partly by driving prices downward since they have minimal competition from other buyers for the same goods or services. One single buyer may act as a single purchaser from multiple seller firms prior to driving down prices as these sellers compete to match the buyer's increasing demands for the lowest prices and highest quality options.

Sadly, many sellers end up giving up their decent profit margins and product quality in their "race towards the bottom" with the other competing sellers in order to entice the buyer to purchase their products or services. Effectively, buyers in a monopsony lose any real power that they once had in traditional supply and demand economic theories or situations.

Socialism: The economic theory of socialism is a concept that individuals shouldn't have ownership of land, capital or money sources, business ownership or industry. Instead, the

society or whole community should collectively own and control properties, goods, and the production and distribution of these goods, assets, or services. In some ideally perceived socialistic national theories, all members of the society share equally in the amount of work performed and the benefits received by their fruits of their labor. Yet in reality, these envisioned utopia (*"a place of ideal perfection, especially in laws, government, and social conditions"* - Merriam-Webster dictionary) situations rarely happen in real-life scenarios.

Socialism originated a few decades before the completion of the *Communist Manifesto* by Karl Marx and Friedrich Engels. Some of the most influential socialist leaders included Henri de Saint-Simon (1760 - 1825) who developed somewhat of a utopian socialism in spite of being an avid fan of the pro-capitalism leader Adam Smith. Other early socialist revolution movement leaders included Robert Owen (1771 - 1858), Charles Fourier (1772 - 1837), Pierre Leroux (1797 - 1871), and Pierre-Joseph Proudhon (1809 - 1865) who was possibly best known for declaring that "property is theft."

Many of these early socialist economists pushed the ideology that included a fair distribution of wealth opportunities, a sense of solidarity and pride among the working class, improved working conditions, and the shared ownership of productive resources used in work such as land and manufacturing equipment. Some of the early pioneers in the socialist movement wanted the state to take a central or primary role in the governance of production and distribution of goods and services to the general public.

Under socialistic beliefs, there is really not as much motivation for workers to strive towards working hard and excelling at their jobs because there really isn't much of an additional benefit to a dedicated and diligent worker as seen with overtime pay and promotions in more capitalistic nations. Socialism is also defined as a political movement for the establishment of these socialistic rules, doctrine, and laws. A socialistic government plays a significant role in providing for their citizens' needs such as providing them free education and health care. Many times, it is the political leaders who really have more control and ownership of the assets as opposed to society as a whole.

Socialists can be either supportive or against free market commerce and profit-making business activities. Some socialist movements may seek the ultimate goal of full-blown revolution and the abolition of social classes while others may offer more pragmatic options such as universal healthcare as seen more recently in the U.S. and/or universal pension funds for all citizens. Interestingly, the Social Security system in the U.S. for elder Americans closer to their retirement years is more of a socialist policy than a truly unabashedly capitalist fund. Some socialist leaders may run for election, and others may govern their nation as authoritarians or dictators somewhat like the regime of President Hugo Chávez in Venezuela.

The early origins of socialism and communism date back to economists and social theorists like Friedrich Engels (1820 - 1895) who was born in the Prussian region. Some parts of Prussia would later be united under the leadership of Germany while other regions of Prussia were absorbed by the Soviet Union after the former Soviet leader named Joseph Stalin incorporated the northern portion of East Prussia into the Soviet Union. Friedrich Engels was thought to be one of the main economists and social strategists who first developed modern socialistic

theory during the late 18th century back when he advocated the complete elimination of production methods that were based on traditional supply and demand, fair competition, and other types of capitalistic strategies.

Communism: Karl Marx (1818 - 1883) was also a Prussian-born economist, philosopher, political theorist, and revolutionary socialist was the original basis for the phrase "Marxism" or "Marxist" beliefs. To Karl Marx, socialism was a lower form of communism. Marx publicly stated that he thought that socialism was too close and just a short, intermediary step away from communism as opposed to capitalism. As such, Mr. Marx thought that communism was the next logical step forward for socialist nations.

Partly due to the influence of Engels and Marx after connecting in Prussia, more and more nations across Europe and Asia began considering and embracing first the concept of socialism before later thinking about a switch to communism. The two largest nations that embraced communism were the Soviet Union and Mainland China. Engels and Marx worked on the *Communist Manifesto, Das Kapital,* and *The German Ideology* (1845) pamphlets and books together. Shortly before working together more often, Engels solely wrote and published work entitled *The Condition of the Working Class in England* that later became one of the classics in Marx's field of specialty.

America's first experience with socialism began shortly after the Pilgrims arrived from England around 1620. Initially, the Pilgrims decided as a majority that they would plant a community garden in their local regions where they could all share the literal and figurative fruits of their labor as well as vegetables equally. Sadly, not many of the local residents wanted to work in the community gardens and do their fair share of planting and weeding.

As a result of lack of interest by the local citizens to assist with the community garden, the gardens were not very healthy and produced very few decent crops for the residents to share and eat. These poor crops, in turn, led to hunger the following winter. By 1623, the Pilgrim colony was facing severe starvation. Due to the failure of the community gardens, it was decided by the Plymouth Colony leaders that a more capitalistic system of assigning plots of land to individuals and families in proportion to their household size would then allow them to keep the fruits and vegetables for themselves on their privately held plots of land.

Governor William Bradford (1590 - 1657), the listed founder and longtime governor of the original Plymouth Colony settlement, was quoted as follows in regard to his account of the successful transition from socialism to capitalism as it related to gardening:

"All this while no supply was heard of, neither knew when they might expect any. So they began to think how they might raise as much corn as they could, and obtain a better crop than they had done, that they might not still thus languish in misery. At length, after much debate of things, the Governor (with the advice of the chiefest amongst them) gave way that they should set corn every man for his own particular, and in that regard trust to themselves; in all other things to go on in the general way as before. And so assigned to every family a parcel of land, according to the proportion of their number, for that end, only for present use (but made no division for inheritance) and ranged all boys and youth under some family. This had very

good success, for it made all hands very industrious, so as much more corn was planted than otherwise would have been by any means the Governor or any other could use, and saved him a great deal of trouble, and gave far better content. The women now went willingly into the field, and took their little ones with them to set corn; which before would allege weakness and inability; whom to have compelled would have been thought great tyranny and oppression.

The experience that was had in this common course and condition, tried sundry years and that amongst godly and sober men, may well evince the vanity of that conceit of Plato's and other ancients applauded by some of later times; that the taking away of property and bringing in community into a commonwealth would make them happy and flourishing; as if they were wiser than God. For this community (so far as it was) was found to breed much confusion and discontent and retard much employment that would have been to their benefit and comfort. For the young men, that were most able and fit for labour and service, did repine that they should spend their time and strength to work for other men's wives and children without any recompense. The strong, or man of parts, had no more in division of victuals and clothes than he that was weak and not able to do a quarter the other could; this was thought injustice. The aged and graver men to be ranked and equalized in labours and victuals, clothes, etc., with the meaner and younger sort, thought it some indignity and disrespect unto them. And for men's wives to be commanded to do service for other men, as dressing their meat, washing their clothes, etc., they deemed it a kind of slavery, neither could many husbands well brook it. Upon the point all being to have alike, and all to do alike, they thought themselves in the like condition, and one as good as another; and so, if it did not cut off those relations that God hath set amongst men, yet it did at least much diminish and take off the mutual respects that should be preserved amongst them. And would have been worse if they had been men of another condition. Let none object this is men's corruption, and nothing to the course itself. I answer, seeing all men have this corruption in them, God in His wisdom saw another course fitter for them."

(Source: Bradford, William. Of Plymouth Plantation, 1620--1647)

Communist Manifesto

1. **The Overthrow of Capitalism:** This meant a Revolution to overthrow a capitalist or friendlier socialism-controlled government. However, the typical new approach has usually been to infiltrate the news media, take control of education while programming the indoctrinated students to believe in the communistic system, and take over most or all political parties prior to grabbing full control of the government. Once a group has control of their government, they then can change laws at will which will later lead to a communist state.

2. **The Abolition of Private Property:** The individual citizen cannot own his land, home, car, capital sources, or other types of personal property or chattel. Under communism, the ownership or control of real or personal property is not determined by the individual or the local community as seen with some socialistic nations. Rather, the control and ownership of assets and production is assumed by the national government. The communist state decides what items people can use, where they can live, and where they will work as the individual citizen has few rights.

3. **The Elimination of the Family as a Social Unit:** The communists prefer the abolition of all classes as well as family structures that could work together later to overthrow them. The Soviet Union back in 1917 was the first place in the world to offer no-fault divorce options. In spite of the cordial sounding "no fault" (or blameless) description, it transfers more power over to the state to control families. The British legal doctrine of parens patriae ("the state is the parent") is also followed globally in various courts and closely follows communistic beginnings. To this day in the 21st century, many family court systems around the world still follow these same no-fault beliefs that once originated from communism.

4. **The overthrow of all governments.** (In practice, the USSR did have a government; a Communist Government.)

5. **The establishment of a communist order** with communal ownership of property in a classless, stateless society.

Chapter Summary

Individuals in a capitalistic society usually own and control the land, property structures, household furnishings, cars, boats, and other types of private property or chattel. Once businesses are established, truly capitalistic markets are supposed to be somewhat balanced between buyers, sellers, and fellow business owners that work in the same competitive fields. In capitalistic theory, it is ruled by **perfect competition** more so than imperfect competition. The shortest definition of perfect competition is that there are at least a matching number of buyers and sellers for a specific product like a new television or smartphone and where no single or multiple sellers or buyers can directly influence the prices for these same products.

Antitrust Laws: The first antitrust law created in the U.S. was named the **Sherman Act.** It was passed by Congress in 1890. Described as a "comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade." Two other major types of antitrust laws were passed after the Sherman Act over the next few decades. These acts included the **Federal Trade Commission Act,** which established the F**ederal Trade Commission (FTC)**, and the **Clayton Act**.

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The Elasticity of Supply and Demand: An elastic housing market region may positively snap back or a listed home may sell quickly, somewhat like a rubber band with minor price changes. Inelastic housing markets don't rebound as quickly with price reductions.

Property values are directly impacted positively or negatively by way of external factors such as declining neighborhoods, crime, increasing unemployment rates, and internal factors such as functional obsolescence of older and outdated homes with just one bathroom.

Inflation hurts the purchasing power of a person's local currency such as the

dollar. When the purchasing power of the dollar declines, then consumers can buy far fewer goods and services. Real estate, in turn, has proven to be an exceptional hedge against inflation by way of appreciating in value consistently over time either at or above the annual reported rates of inflation.

Microeconomics is akin to the study of economic activity directly impacting individuals and businesses under a microscope at the more local level.

Macroeconomics, on the other hand, is akin to using a much larger telescope to better focus on the economic activities of a specific country, or even the entire world, as a direct result of fiscal and monetary policies enacted by governments and central banks.

Market prices for goods, services, or assets are established by the intersection of the law of demand and the law of supply. Values are subjective and originate within the eye of the beholder based upon a buyer or seller's personal perspectives and needs. This figurative intersection between demand and supply is called a price equilibrium point. It can be visualized as a balanced seesaw at the local playground.

Monopoly: One seller exists for the sale of a unique product or service, or one seller dominants the marketplace.

Monopsony: A monopsony can also be referred to as a "buyer's monopoly" in that one or just a few large, powerful, and wealthy buyers truly dictate and control the direction of the market partly by driving prices downward since they have minimal competition from other buyers for the same goods or services.

Oligopoly: A type of economy where there are just a few sellers of a specific type of product or service

The **principle of progression** is an economic theory in which the purchase of a smaller home benefits by being surrounded by newer, updated, and larger homes in the same neighborhood. Conversely, the principle of regression can be defined as owning the biggest home on the block and having these same smaller and older homes bring down the value of the largest and nicest homes partly due to recent sales comps.

Socialism: The economic theory of socialism is a concept that individuals shouldn't have ownership of land, capital or money sources, business ownership or industry. Instead, the society or whole community should collectively own and control properties, goods, and the production and distribution of these goods, assets, or services. In some ideally perceived socialistic national theories, all members of the society share equally in the amount of work performed and the benefits received by their fruits of their labor.

Glossary

Boom/Bust: The rapid upward (boom) and downward (bust) movement of the business cycle or general economy.

Bubble State: States like California, Arizona, Nevada, and Florida which had experienced some of the highest double-digit annual price percentage gains prior to the credit crisis of 2008.

Clayton Act: Antitrust Act of 1914 that further defined and added antitrust regulations developed in the 1890 Sherman Act.

Communism: A society of common ownership without social classes, money and state.

Communist Manifesto: An 1848 booklet written by Karl Marx and Friedrich Engels on communism and the problems of a capitalist society.

Credit Crisis: The 2008-2012 global financial crisis. The sudden tightening of credit and reduction of loans from banks caused by inappropriate and careless lending.

Economic Obsolescence: Real estate properties are more likely to be torn down prior to them being worn down or by way of functional obsolescence (i.e., outdated home design such as a home with only one bathroom). A property that is falling apart due to age or poor maintenance is usually associated with internal control and management of the same property. With economic obsolescence, the decline of property values is typically associated with external factors such as high rates of crime in the immediate neighboring region, chemical plants built nearby which are causing noise and environmental pollution, and even weather or flooding factors. Since economic obsolescence is related to external forces or matters outside of the subject property, the economic theory states that it cannot be cured or improved.

Economics of Assemblage: The real estate valuation theory in which the assembling or combining of two or more lots can create a much higher value for the property owner. In some ways, it is both an opposite and similar theory to economics of subdivision. In urban communities which lack buildable land supply, the assemblage strategy is highly favored by many investors and developers.

In older, urban regions, the highest and best use for two adjacent residentially zoned lots is to be rezoned as higher density multi-family apartment units. Many builders or developers will seek out two or more vacant or fully built residential lots to rezone the sites through the local Planning and Zoning Department and later build an apartment building with 30 to 100+ units. In some cases, the new value of zoning and usage changes can increase the property value 10-fold or higher due to the economics of assemblage.

Economics of Subdividing: This real estate economic theory states that there are more buyers for smaller parcels of land and properties partly since these same subdivided properties are more affordable. From a seller or developer's perspective, the profit margins are usually much higher to subdivide a large piece of land such as a 10-acre site into a site with 60 smaller subdivided lots at 6 lots per acre (43,560 square feet per acre or approximately 7,000+ sq. ft. per subdivided lot).

Economies of Scale: The economic theory of producing greater returns by way of spreading fixed costs over a larger number of units or assets like subdivided lots. The production of automobiles on early car assembly lines developed by the Ford Motor Company in the early 20th century is one of the better examples of economies of scale. Modern-day big box retail stores are another example where their massive size and efficient product distribution and transportation systems make it very challenging for small "Mom and Pop" retail stores from competing with them. The subdivision of lots is another exceptional example of using economies of scale in the real estate profession.

Elastic/Inelastic: A market condition in which a small change in price of a real estate asset, good, or service may have a big impact (elastic) on marketability, or little to no impact (inelastic) on current or future buyer demand.

Equilibrium Point: The price point where market supply and demand balance one another out.

Federal Trade Commission (FTC): Developed by the Federal Trade Commission Act of 1914 to promote consumer protection and prevent anticompetitive business practices such as monopolies.

Federal Trade Commission Act: A 1914 law signed by Woodrow Wilson to outlaw unfair business practices.

Imperfect Competition: Where buyers and sellers can determine the price of a specific product. If there are few sellers and many buyers, prices will be driven up.

Leverage: One of the best things about buying real estate is the ability to use third party sources of capital from places such as banks, mortgage brokers, private money firms, hedge funds, equity funds, and even from crowdfunding platforms for real estate. One of the main benefits of buying a home using leverage capital (i.e., 95% loan to value FHA mortgage loans) is that the property owner gets to keep all of the potential future appreciation gains using just a relatively small amount of personal equity like a 5% cash down payment.

In inflationary and boom economic periods of time, the theory of leverage can create tremendous amounts of annual returns. For example, a $100,000 home purchased with 5% down can appreciate 5% per year. So, the $5,000 cash down payment at the purchase is creating $5,000 in annual appreciation (5% of $100,000 purchase price) returns, in this example, which is effectively a 100% return on investment each subsequent year (excluding mortgage payments, utilities, repairs, etc.).

Marginal Propensity to Consume: When people believe that the economy will prosper or boom in the near term, they are more likely to spend and invest their cash. The increased demand for assets, goods, and services can later lead to increasing prices as well.

Marginal Propensity to Save: If a person perceives near term negative financial or economic futures, busts, or economic downturns, then he or she is more likely to save a higher percentage of cash as liquid savings. When less money is spent, then prices of assets, goods, and services may later fall as well.

Market Price: The economic price of goods or services offered for sale in a marketplace. Also known as the equilibrium point.

Monopoly: Where an individual or company has no competition in supplying a certain product or service.

Monopsony: Where there is only one buyer and multiple sellers for a particular good or service and prices will be reduced for the lack of demand.

Multiplier Effects: The measurement of an anticipated future return of investment as compared to the dollars invested. A significant change in the positive value of an asset, good, or service can be created by adding a relatively small amount of capital or making relatively minor changes. For example, as it pertains to real estate, an investor may add $20,000 in new additions to a kitchen which later adds another $80,000 in property value. This can be viewed as a 4 to 1 or 400% cash-on-cash return by way of the multiplier effects.

Oligopoly: Few or limited sellers for a particular goods or services which limits supplies and increases prices.

Perfect Competition: A matching number of buyers and sellers for a specific product and buyers and sellers cannot directly influence the prices for these products.

Principle of Change: The U.S. housing marketplace is very fluid and ever-changing. Both demand from buyers and products, like homes for sale by sellers, are not fixed or constant. Some months, buyer demand can be either significantly higher or lower than historical averages. Other times, home listing inventory numbers are much lower or higher than the norm. The fluctuation in the supply of houses, qualified buyers, and the equilibrium price point will eventually cause home prices to either increase, decrease, or not change much at all.

Principle of Progression: Few economic or financial trends impact the value of one's property more than the other properties adjacent to a homeowner's property. The economic and real estate valuation theory known as the principle of progression states that a property of lesser value, such as a fixer upper or the smallest home on the block, may be enhanced by way of adjacent higher valued and larger properties.

Principle of Regression: This valuation theory is the exact opposite to positive valuation trends found in the progression principle by way that quality properties can fall in value due to being surrounded by too many fixer uppers or smaller homes on the same block. With these economic and valuation theories, proximity and location are some of the keys to higher or lower values. The closest homes to a subject property will also most likely be used in real estate appraisal reports, which can be the primary basis used for market value in a real estate transaction.

Shadow Inventory: A shadow inventory home can be defined as a mortgaged property with 90+ days of payment delinquencies and properties foreclosed upon by a bank or mortgage loan servicing company not yet fixed up and not yet listed for sale to the general public.

Sherman Act: Antitrust legislation signed into law in 1890 by President Benjamin Harrison to encourage competition and outlaw monopolies to support consumers.

Socialism: An economic theory where individuals shouldn't have ownership of land, money, business ownership or industry. Instead, the society or whole community should collectively own and control properties, goods, and the production and distribution of these goods, assets, or services.

Theory of Filtering Down: The principle where housing tends to be passed downward to lower economic groups. During more prosperous economic times, the wealthier members of a local population base may choose to move up into newer and larger homes. Over time, there will be more affordable homes to purchase or rent for people not as financially well-off. In some communities, the least desirable homes later become vacant and severely rundown. They become obsolete and real estate developers tear them down to build new properties on the same land site.

chapter 1 quiz

1. Which type of economics theory or principle is more likely to study a town's economic numbers?

A. Macroeconomics
B. Microeconomics
C. The Law of Demand
D. Price Equilibrium Point

2. When the price of a good or service increases, what else tends to increase?

A. The quantity of the same good or service
B. The supply will decrease
C. The consumer demand
D. Both B and C

3. Which economic theory states that when the price of a good or service increases, so does the quantity?

A. Price Equilibrium Point
B. Law of Demand
C. Law of Supply
D. Law of Supply and Demand

4. What is another term for equilibrium?

A. Market Value
B. Market Price
C. Law of Supply and Demand
D. Macroeconomics

5. What are the approximate government-reported historical annual inflation rates since 1950?

A. 1%
B. 2%
C. 3%
D. 4%

chapter 1 quiz

6. What is elasticity?

A. The degree of measured responsiveness from buyers
B. The degree of reaction from buyers
C. Both A and B
D. A fluctuating currency value

7. What is an example for the principle of progression?

A. Social Progress
B. Financial Progress
C. Inflation
D. Buying a small home surrounded by larger homes

8. What is an example for the principle of regression?

A. Building a much larger home than neighboring properties
B. Deflation
C. Owning the smallest home on the block
D. Excessive governmental regulations

9. Who can provide leverage in a home purchase transaction?

A. Bank
B. Mortgage Broker
C. Seller by way of seller financing
D. All of the above

10. What is an example of a multiplier effect?

A. Compounded debt
B. Compounded interest
C. Adding a $20,000 upgrade to a kitchen which later equates to a $50,000 home price gain
D. 100% LTV financing