JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

E. Realtor Associations

5. "The Changing Structure of the Mortgage Market", 1968 Realtors Conference, No date or place given

I. Introductory comments
   A. Thank you for a repeat invitation
   B. Real estate education is improving--the brokers program in Madison in February, expansion of extension courses, introduction of real estate courses at Whitewater, growing enrollments at Waukesha and Madison technical colleges.
   C. The job today is to identify the factors which will affect the cost and supply of money, the pattern of lending, and new sources of money.

II. Since demand for mortgage money always exceeds supply, the first question is concerned with how much money will be available for real estate finance. Unlike the crunch of '65-66, when money often was not available at any price, today money is generally availble at a price except for low down payment conventionals.
   A. One likes to think that high interest rates are temporary, loan ratios will rise, and credit qualifications will become more relaxed. However, I do not believe that we will return to the old ways in the mortgage market for several reasons:
   B. First lending institutions have the same need to raise income and reduce costs as any other business. They will lend where the yield is highest and the cost of processing and collection is the lowest. The price of mortgage money has always lagged the price of money for consumer loans and industrial loans.
   C. Mortgage money is only one special sec tor of our total capital market. Despite the wealth of this country, we are in great need of capital for defense and government, for our own industrial development, for overseas development as well as for sheltering the coming expansion of our adult population. We will have less capital than we need and it will be rationed by interest rates.
   D. While your reaction may be that lenders are becoming greedy, the fact is that they are only intermediaries for savers. The interest cost of capital eventually relates back to the interest and financial services sought by savers.
      1. All capital comes from the decision to save out of current income or postponement of the use of prior savings.
      2. A rising cost of living means less current saving, a threat of inflation means conversion of past and future savings to hard goods, and institutional factors can lead to the transfer of funds from those institutions which make loans to those more inclined to make equity investments or consumer loans.
      3. The saver is now used to 5% or more on his savings and would not gracefully accept less; his representative,the lender, needs to control his credit costs and secure a higher interest lest he lose the confidence of the fickle saver.
   E. Therefore over the next five years there will only be temporary relief on the demands made on the money market. Presently industrial demands are slacking off and the next federal budget and urban development costs have yet to be felt. For the next six months or perhaps a year there will be some easing of residential credit but eventually I foresee home loans stabilizing somewhat above 7%, with 8% common for low down payment loans. Remember, lenders are grossing close to 8% on FHA 6 3/4% loans as a 6 or 7 point discount applies to loans which average less than 11 years before they are paid off.

F. So I predict there will be money but you can forget about the old norm of 6%.

G. However there will be some limit on the supply of money and here lies a hitch. Consider the residential loan market. The number of transactions times the average loan per transaction suggests the number of total dollars required. However the number of transactions increases as we create new property, replace old, and see our population become mobile.

1. At the same time price inflation has meant ~~met~~ more credit dollars to complete each real estate transaction. Thus the total number of transactions is rising at the same time dollars per transaction is rising so the need for money multiplies exponentially, that is geometrically.
2. However, price inflation can mean less ability or less willingness to save, more willingness to commit past and future savings to hard goods, and more inclination to transfer savings funds to those devices which give the highest yield and protection against price inflation.

H. Neither the consumer nor the mortgage lender can afford this pressure on the demand for money and so we already see certain forces at work which are not only changing the cost of shelter but the form and scale of housing development as well. In a couple of years the real estate broker will be forced to pursue marketing and lobbying practices designed to reduce the number of credit dollars required per transaction including:

1. Land-planning techniques which increase average density to lower site costs as is done with cluster plans, town houses, and planned unit development.
2. Significant reform of building codes to permit greater use of prefabricated home sections and industrial methods.to reduce cost of construction.
3. Better subdivision environments and lower construction costs will check inflation of prices of existing buildings.
4. Reduction of transaction cost for buyers and sellers by reform of marketing techniques, commission schedules, credit, and insurance ~~insruace~~ costs.
5. Increased use of multiple family cooperatives, comdominiums, and large scale full service real estate service organizations.

III. Real estate is the art of doing business with somebody else's money. To get that money you generally have to do business their way. The pattern of various institutional lenders is already changing to bring about significant changes in the brokerage business in the not too distant future. Look at what is happening:

A. Insurance companies
1. Many are withdrawing from residential single family home loans for better yields elsewhere.
2. To reduce transaction cost they want to lend on large-scale projects.
3. Commercial projects for development or rental purposes offers more opportunity for participation profit features.
4. Insurance companies are forming long-term partnerships, exchanging money for know-how, with proven local operators. The scale of the project increases permitting property management and merchandising to be done by salaried company men. The broker will be involved in a smaller percentage of transactions involving new projects unless he too can qualify as a partner in his area.

B. The mortgage banker
1. Has to make profit opportunities available in more areas of real estate and needs to capture a reliable source of funds.
2. Reliable access to funds requires either vertical integration with lenders or development of a market for mortgage securities among others than the insurance industry. The best mortgage b ankers will become

the risk capital real estate bankers of the future while those who live on servicing fees alone will die out.

C. Savings and loans
   1. Once these institutions served as capital bank for real estate but more ~~more~~ recently they have been pointing to more diversified consumer lending.
   2. With time there will be a merging of the S and L with consumer financing.
   3. The S and L must pursue higher yield consumer loans in order to maintain capacity to keep dividend rates equal to alternative bank and bond rates.
   4. The new generation of management has fewer roots in the old methods of doing business and tend to see themselves as thrift institutions for the savers rather than capital banks for borrowers.

D. Coops and Capital banks for urban areas
   1. In the tradition of the old savings and loan I expect modification of the credit union format to fit the place where you live rather than where you work by means of government stimulation and subsidy.
   2. These risk cooperatives are most likely for second mortgages and business opportunity loans in the core areas.
   3. These coops will also assist in insurance and general management counseling.

E. Banks and bank holding companies
   1. Packaging of construction, permanent financing, and front money through various holding company subdivisions.
   2. Real estate is in a large part a financial and administrative problem so that eventually banks will become involved through their trust department and through captive management and sales divisions of the holding company. These services will be offered coporate customers as part of a complete financial service package.

IV. By and large current trends in finance will adversely affect real estate brokerage by small brokerage offices because:

A. The man who has access to the big loan will make the big deal and that will tend to be the broker who operates from a mortgage banking group, a holding company group or as a partner of an insurance company.

B. Larger scale developments are more likely to have their own merchandising operations and mortgage loan credit lines and will be able to reduce transaction costs by means of exchanges, computerized procedures, and better market research which eliminates need for broker experience.

C. Little deals in the core may be handled more often by governmental agencies while big deals in the suburbs will be negotiated directly.

D. My father was in the paper box business. Once the money was made converting paper into boxes by making many little deals. Then the price of paper rose and stabilized and the money was in making paper and those who were only converters only broke even at best.

E. In my opinion the same kind of transition is taking place in real estate. For many years the money has been made in turning over properties, while the raw material of credit, was cheap and not highly regarded as profit.

   Today and tomorrow the money will be available to those with the raw materials, credit, necessary to make a deal.

F. For box makers the need for the raw material led to almost complete integration and consolidation of the industry. I foresee the same trend in real estate brokerage.
   1. Mortgage bankers, banks, and property developers will all offer complete real estate services with each having a captive source of credit.
   2. Independent brokers will specialize by property types and consolidate their operation to take advantage of EDP services and the opportunity to reduce overhead and hence commission rates.

3. To improve mortgage deals mortgages will begin to feature variable interest rates, bonus interest rates, or prepayment penalties which give lenders a greater interest in management skills of the invester. Lenders will take a greater interest in the operational ability of the developer and realtor.
4. In short brokers will be absorbed into our credit institutions or consent to credit instruments which give more revenue to the risk taker, the lender who will one day soon be firmly in the best bargaining position ever.

E. In the early days of real estate those who controled the water controlled the valley. Today those who control the liquid assets--credit pools-- will control the peaks and valleys of real estate btokerage.

F. For the broker the need is clear. Establish strong ties with a reliable source of credit and play it straight with them for bankers have long memories when they have bargaining position. The insurance industry has undergone a significant structural change from commission agent to salaried representatives in the mass merchandising fields of insurance, because transaction costs were high and consumer needs were clear. Shelter is a mass market with direct ties to retailing and credit. Transaction costs are high. The changing pattern of mortgage lending and the credit squeeze makes real estate brokerage vulnerable to invasion too.