

**California Real Estate Finance**  
**Chapter 2**  
**Money and the Monetary System**

**Chapter Purpose**

This chapter discusses the roles of the major Federal and California financing agencies as they control the supply and costs of money for real estate finance. The topics covered here expand the student's definition of monetary theory as it applies to realty finance.

Beginning with a definition of money and its uses and purposes, this chapter looks at the three major federal agencies, the Federal Reserve System, the United States Treasury and the Federal Home Loan Bank System and how they control the supply and costs of money. The interrelated attributes of supply and costs as they affect real estate financing funds are also examined. This chapter also examines the various state agencies established to oversee financial activities.

**Suggestions to the Instructor**

The effective presentation of the material in this chapter will vary with the instructor's background in money and banking. It is suggested that, where this background is limited, the presentation be enhanced by a team-teaching effort using someone well versed in the roles of these agencies.

Of significant interest to the students will be the Fed's open market activities, the impact of reserve requirements and the multiplier effects from the creation of new money based on the amount of monies not required to be held in reserve. The role of the Treasury in issuing short- and long-term government securities and attempting to manage the enormous national debt in the fact of continued annual deficits should be analyzed. Keep in mind that it creates competition (with the Fed) for available funds. The implication is that these funds might otherwise be available for real estate loans.

All practicing and potential real estate professionals must become familiar with the California finance agencies and their areas of activities.

**Learning Objectives**

Upon completion of this chapter, the student should be able to:

1. define money as a medium of exchange, a storehouse of purchasing power and a standard of value;
2. understand the effects of the supply and costs of money on funds available for financing real estate;

3. discuss the activities of the Federal Reserve System in establishing and enforcing the nation's monetary policies and supervising the nation's banking systems;
4. identify the role of the U.S. Treasury as this nation's fiscal manager in balancing the collection of income tax and social security receipts with the payments required for the expenses of the federal government;
5. describe the increased responsibilities of the Federal Deposit Insurance Corporation (FDIC) as it becomes the only government agency guaranteeing depositors in both banks and thrift;
6. recognize the operations of the Office of Thrift Supervision as it regulates the thrifts;
7. define discount rate and prime rate;
8. describe the various state agencies involved in regulating financial activities in California.

### **Presentation Outline**

- I. Introduction to Government's Role in Financing
  - A. What is money?
    1. Medium of exchange or means of payment
    2. Storehouse of purchasing power
    3. Standard of value
  - B. The Use of Paper Money
    1. Why federal government has a regulatory role in achieving economic stability
      - a. the goldsmiths
      - b. 1934 Gold Reserve Act
        - (1) replacement of gold standard with gold exchange standard
        - (2) no gold could be redeemed for money after 1934
      - c. in theory, manipulating supply and cost of money should work toward achieving economic balance
        - (1) results achieved by infusion of more money into economy
        - (2) results achieved when funds are withdrawn from circulation
    2. The supply and cost of money for real estate finance
      - a. the money supply
        - (1) M1 includes cash and checking accounts
        - (2) M2 adds savings accounts under \$100,000
        - (3) M3 adds savings accounts over \$100,000

- II. Federal Agencies Empowered to Use Tools for Controlling Supply and Cost of Money
  - A. The Federal Reserve System (Fed)
    - 1. Purpose—a central banking system
      - a. provides a rising standard of living through controlled growth of money and credit
        - (1) maintains sound credit conditions
        - (2) stimulates full employment
        - (3) stabilizes values
        - (4) raises levels of consumption
      - b. combats inflationary and deflationary pressures
      - c. serves as lender of last resort to prevent national liquidity crisis and financial panics
    - 2. Organization
      - a. twelve federal reserve districts
      - b. each district includes federal reserve bank
      - c. directed by board of governors
      - d. membership open to all federally chartered banks and thrifts
    - 3. Functions
      - a. issues currency (see dollar bills)
      - b. specifies reserve requirements
      - c. clears members' checks
      - d. establishes discount rates
        - (1) define discount and prime rates
        - (2) explain that lower discount rates lower mortgage rates
      - e. specifies the Federal Funds rate at which the Fed lends money to member banks
      - f. open market operations
        - (1) purchase and sale of government securities
        - (2) can compete with U.S. Treasury
        - (3) under direction of Federal Open Market Committee (FOMAC)
      - g. supervises Truth-In-Lending Act, Regulation Z
  - B. The U.S. Treasury
    - 1. Manages government fiscal operations
      - a. manages national debt
      - b. collects funds from federal income tax to pay costs of running government
      - c. balances annual deficit spending by borrowing funds in financial markets
        - (1) bills: less than a year
        - (2) notes: one to five years
        - (3) bonds: more than five years
      - d. collects and disburses social security payments

2. The Financial Institutions Reform, Recovery and Enforcement Act of 1989
  - a. supervised by the Treasury to recapitalize and consolidate the Federal Deposit Insurance System (FDIC)
  - b. eliminated the FSLIC
  - c. expanded the FDIC into the Deposit Insurance Fund (DIF) with its two subsidiaries, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF)
  - d. made the FDIC the supervisor of its member associations with the power to act as receiver or conservator for the purpose of reorganizing or liquidating failed financial institutions
- C. The Federal Home Loan Bank System (FHLB)
  1. Organized in 1932 to bring stability to the nation's savings and loan associations
  2. Organizations
    - a. twelve regional home loan district banks
    - b. directed by board of governors
    - c. currently supervised by the Office of Thrift Supervision (OTS), which is located in the U.S. Treasury (The OTS replaced the former Federal Home Loan Bank Board)
    - d. the Federal Housing Finance Board now supervises mortgage lending by the twelve district banks
    - e. membership is required by federally chartered thrifts but is open to others who qualify
  3. Functions
    - a. establishes reserve requirements
    - b. provides insurance for depositors through the FDIC
    - c. makes loans to member associations
    - d. purchases securities from members
    - e. regulates member activities

- III. California Financial Agencies
  - A. Department of Savings and Loans
  - B. California Housing Finance Agency
  - C. Department of Banking
  - D. Department of Insurance
  - E. Department of Corporations
  - F. Department of Real Estate