



MACHAKOS UNIVERSITY

University Examinations for 2017/2018 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

**FOURTH YEAR SECOND SEMESTER EXAMINATION FOR BACHELOR
COMMERCE (FINANCE OPTION)**

BAC 414: REAL ESTATE FINANCE

DATE: 6/12/2017

TIME: 2:00 – 4:00 PM

INSTRUCTIONS:

Answer Question One and Any Other Two Questions

QUESTION ONE (30 MARKS)

- (a) Explain the meaning of the term Estate and the rights associated with it. (3 marks)
- (b) Explain the meaning of taxes in default and its implications. (2 marks)
- (c) (i) X Corporation is evaluating an investment that will provide the following returns at the end of each of the following years:

Year	Sh.
1	9,000
2	6,000
3	4,000
4	8,000
5	(500)

The corporation believes that it should earn an annual interest of 15% on its investments. How much should it pay for this investment? (7 marks)

- (ii) An investor pays Sh.3,000 per month into a real estate investment which promises to pay an annual rate of interest of 10% compounded monthly. If he makes consecutive monthly payments for five years, how much will the amount accumulate to after that period? (4 marks)
- (iii) Assuming that an individual is considering an investment which will provide a series of annual cash receipts of Sh. 50,000 for a period of 5 years and that the desired rate is 5%, for the investment to be viable, how much should he source for? (4 marks)
- (d) Mr. brown made a 30 year mortgage loan five years ago for Sh.300,000 at nine percent interest per annum . He now wants to pay down the mortgage balance by Sh.50,000. (10 marks)
- Assuming that he pays down the balance, what would be the new monthly repayment for the remaining period?

QUESTION TWO (20 MARKS)

- (a) Briefly explain the various methods of mortgage adjustments. (6 marks)
- (b) Explain the factors to be considered when deciding whether to refinance a loan after interest rates have declined. (6 marks)
- (c) A potential homeowner has Sh.30,000 to invest in a Sh.140,000 home. He can obtain either a Sh.110,000 loan at 11% for 20 years or a Sh.90,000 loan at 10% for 20 years and a second mortgage of Sh.20,000 at 14% for 20 years.
- Which alternative should he choose, assuming he will be in the house for the whole loan term. (8 marks)

QUESTION THREE (20 MARKS)

- (a) Many mortgages do provide explicitly that a penalty can be paid by the borrower should he decide to prepay the loan. Explain the rationale for the penalty. (4 marks)
- (b) A borrower is faced with choosing between two loans. Loan A, is available for Sh.100,000 at 12% interest per annum for 30 years, with a 1% to be included in closing costs. Loan B, would be made for the same amount, but for 11.5% interest per annum for 25 years, with 3% to be included in the closing costs:
- (i) If the loan is repaid after three years, which loan would be a better choice? (8 marks)
- (ii) If it is repaid after five years, which loan would be a better choice? (8 marks)

QUESTION FOUR (20 MARKS)

- (a) Estimating the current market value of a piece of property is done through a process known as real estate appraisal, explain briefly the techniques that are used. (6 marks)
- (b) James wants to buy a property for Sh.90,000 and wants an 80 percent loan of the value of the property. A lender indicates that the loan can be obtained for 25 years at 13 percent interest. However, a loan origination fee of Sh.1,500 will also be necessary for James to obtain the loan.
- (i) How much will the lender actually disburse? (4 marks)
- (ii) What is the effective interest cost to the borrower, assuming that the mortgage is paid off after 25 years (full time)? (5 marks)
- (iii) If he pays off the loan after five years, what is the effective interest charge? Why is it different from (ii) above? (5 marks)

QUESTION FIVE (20 MARKS)

- (a) In real estate finance there are several general methodologies for determining value. Briefly explain them. (6 marks)
- (b) A mortgage loan for Sh.600,000 was to be paid in a period of 30 years at an interest rate of 12% compounded annually.
- (i) determine the closing balance of the loan after 5 years. (7 marks)
- (ii) Now that prevailing interest rates have gone down to 10% in another financial institution, determine how much a borrower should look for to ensure early repayment of the mortgage after five years. (7 marks)