

NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
PART IV - FINAL EXAMINATION – JUNE 2010
REAL ESTATE INVESTMENT AND FINANCE [CFI 4205]
TIME ALLOWED: 3 HOURS

Instructions to Candidates

Answer **Section A** and **three (3)** questions from **Section B**

SECTION A [40 marks]

Question 1

What is the market value of each of the following properties given their annual net operating incomes and capitalization rates? [4 marks]

<u>Property</u>	<u>NOI</u>	<u>Capitalization Rate%</u>
A	\$16,850	10.0
B	3,100	8.5
C	4,800	11.25
D	13,300	12.2

Question 2

Adam and Ankel are evaluating an investment in a condominium close to the campus of the University at Riverside. Adam has determined that the following numbers seem realistic.

Purchase price:	\$65,000
Sale price in one year:	\$69,000
Holding period:	1 year
Rents over period:	\$5,500

Ankel has found a savings and loan which will lend them \$50,000 at an interest rate of 13%. Their alternative is to finance the entire \$65,000 out of their savings. (taxes, maintenance and other expenses are assumed to be zero.)

- (a) What is the holding period rate of return if (i) they use all equity, and (ii) they use the loan? [4 marks]
- (b) Redo a. above, assuming the property can be sold only for \$65,000. [4 marks]
- (c) Compare a. and b. in terms of leverage. [2 marks]

Question 3

What is the net present value of a property, which has the following after-tax cash flows:
[3 marks]

Original required investment = \$18,000
Cash flows, years 1 to 5 = 2,000 per year
Net sale proceeds at end of years (after all fees, etc.)= \$19,500
Discount rate = 12%

Question 4

Anita is an individual taxpayer who has gross income of \$90,000. Anita actively manages her investment in the condominium. Based on the following condominium investment income statement, reconstruct the income statement to after-tax cash flows. Assume a tax rate of 28%. There was \$2,000 paid in principal over the year. [8 marks]

Gross rental income	\$25,000
Operating expenses	
Dues	\$3,200
Maintenance	600
Interest	21,000
Depreciation	16,000
Promotion and advertising	200
Property taxes	2,500
Profit or (loss)	(\$18,500)

Question 5

Suppose you are estimating the value of a shopping center by the income capitalization approach. You have determined that the gross rental income will be \$225,000 each year and that the operating expenses will equal \$35,000 each year. A similar center in the same area recently sold for \$2,850,000. You consulted the selling broker and learnt that the property was expected to have net income for the year of \$175,000 after operating expenses of \$27,500.

Explain the logic behind the net income capitalization technique and use the technique to calculate the estimated value of the subject property (show the calculations). [5 marks]

Question 6

Langa says, “I just added a fireplace to the living room of my house in Killarney West, Bulawayo. I had the house appraised before I added the fireplace and the value was \$225,000. The fireplace cost me \$75,000, but I’m sure I’ll get that money back with a good rate of return when I sell the house someday.” What principle of appraisal has Langa ignored?
[5 marks]

Question 7

- a) What is the difference between investment value and market value?
[2½ marks]
- b) Why is highest and best use analysis important in estimating market value?
[2½ marks]

SECTION B [60 marks]

Question 8

Briefly illustrate each of the following approaches to real estate market valuation and indicate in each case the type of property suitable for an approach :

- a. Cost approach [7 marks]
b. Comparative sales approach [7 marks]
c. Income approach [9 marks]

Question 9

Briefly explain the basic structure and investment considerations associated with a real estate investment trust (REIT). What are the three basic types of REITs? [14, 6marks]

Question 10

Describe how real estate investment objectives are set and how the features of real estate are analyzed in determining real estate value. [20 marks]

Question 11

Assume you have inherited a large sum of money and wish to use part of it to make a real estate investment. Would you invest in income property or speculative property? Why? Describe the key characteristics of the income or speculative property on which you would focus your search. [20 marks]

Question 12

Discuss the differences between a real estate space market and the real estate asset market? [20 marks]