ALUPE UNIVERSITY COLLEGE
... Bastion of Knowledge...
P. O.Box 845-50400 Busia(K)
principal@auc.ac.ke
Tel: +254 741 217 185
+254 736 044 469
off Busia-Malaba road

OFFICE OF THE DEPUTY PRINCIPAL

ACADEMICS, RESEARCH AND STUDENTS' AFFAIRS

UNIVERSITY EXAMINATIONS

2019 /2020 ACADEMIC YEAR

4TH YEAR 1st SEMESTER REGULAR EXAMINATION

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 411

COURSE TITLE: REAL ESTATE FINANCE

DATE: Friday 12TH March 2021 **TIME: 2.00-5.00 PM**

INSTRUCTION TO CANDIDATES

- **SEE INSIDE**

PLEASE TURN OVER

INSTRUCTIONS ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

a) Name the two general methods of title assurance and briefly describe each. Which would you recommend to a friend purchasing a home? Why? (6 marks)

b) Determine the equal end of the year payment necessary to amortize fully a Sh.600,000, 10% loan over 4 years. Assume payment is to be rendered semi-annually, draw the loan amortization schedule (8 marks)

c) What is meant by mortgage foreclosure, and what alternatives are there to such action? ,(8 marks)

d) What is a Real Estate Investment Trust ,(8 marks)

e) Ms. Brown purchased a property consisting of one acre of land and a building for sh.100,000 five years ago. She obtained an sh.80,000 mortgage loan from ABC Bank at that time. The building was very old and Ms. Brown has just had it torn down. She now wants to build a new building. Ms. Brown hopes to finance construction with ABC Bank and will call them soon to discuss financing the new project. How will ABC Bank evaluate the possibility of making another loan to Ms. Brown? (8 marks)

QUESTION TWO (20 MARKS)

a) An interest only ARM is made for sh.200,000 for 30 years. The start rate is 5 percent and the borrower will make monthly interest only payments for 3 years. Payments thereafter must be sufficient to fully amortize the loan at maturity.

i. If the borrower makes interest only payments for 3 years, what will payments be? (4 marks)

ii. Assume that at the end of year 3, the reset rate is 6 percent. The borrower must now make payments so as to fully amortize the loan. What will payments be? (4 marks)

b) A price level adjusted mortgage (PLAM) is made with the following terms: Amount sh.95,000 Initial interest rate 4 percent Term 30 years Points 6 percent Payments to be reset at the beginning of each year. Assuming inflation is expected to increase at the rate of 6 percent per year for the next five years:

i. Compute the payments at the beginning of each year. (8marks)

ii. What is the loan balance at the end of the fifth year? (4 Marks)

QUESTION THREE (20 MARKS)

a) A fully amortizing mortgage loan is made for sh.100,000 at 6 percent interest for 30 years. Determine payments for each of the periods i to iv below if interest is accured:

i. Monthly. (3marks)

ii. Quarterly. (3marks)

iii. Annually. (3marks)

iv. Weekly. (3marks)

b) A 30-year fully amortizing mortgage loan was made 10 years ago for sh.75,000 at 6 percent interest. The borrower would like to prepay the mortgage balance by sh.10,000.

i. Assuming he can reduce his monthly mortgage payments, what is the new mortgage payment? (4 marks)

ii. Assuming the loan maturity is shortened and using the original monthly payments, what is the new loan maturity? (4 marks)

QUESTION FOUR (20 MARKS)

a) How do inflationary expectations influence interest rates on mortgage loans? (5marks)

b) A basic ARM is made for sh.400,000 at an initial interest rate of 6 percent for 30 years with an annual reset date. The borrower believes that the interest rate at the beginning of year 2 will increase to 7 percent.

i. Assuming that a fully amortizing loan is made, what will monthly payments be during year 1? (3 marks)

ii. Based on (i) what will the loan balance be at the end of year 1? (3 marks)

iii. Given that the interest rate is expected to be 7 percent at the beginning of year 2, what will monthly payments be during year 2? (3 marks)

iv. What will be the loan balance at the end of year 2? (3 marks)

v. What would be the monthly payments in year 1 if they are to be interest only? (3 marks)

QUESTION FIVE (20 MARKS)

a) What is the difference between interest rate risk and default risk? (4 marks)

b) A fully amortizing mortgage loan is made for sh.100,000 at 6 percent interest for 20 years.

i. Calculate the monthly payment for a constant payment mortgage CPM loan. (3 marks)

ii. What will the total of payments be for the entire 20-year period? Of this total, how much will be interest? (3 marks)

iii. Assume the loan is repaid at the end of 8 years. What will be the outstanding balance? How much total interest will have been collected by then? (4 marks)

iv. The borrower now chooses to reduce the loan balance by sh.5,000 at the end of year 8.

(1) What will be the new loan maturity assuming that loan payments are not reduced? (4 marks)

(2) Assume the loan maturity will not be reduced. What will the new payments be? (2 marks)

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