CHUKA   **UNIVERSITY**

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE
AND BACHELOR OF COOPERATIVE MANAGEMENT

BCOM 338: REAL ESTATE FINANCE

STREAMS: BCOM Y3S2   **TIME: 2 HOURS**

DAY/DATE: WEDNESDAY 08/04/2020   **2.30 P.M. – 4.30 P.M.**

INSTRUCTIONS:
- **Answer question ONE and any other TWO.**

QUESTION ONE

(a)   An investor in real estate has several alternatives to consider that would lead to maximized returns. State and explain the different alternatives of investing in real estate.
                                                                                            (10 marks)

(b)   One of the reasons of investing in real estate is because of the control an investor has over property. Discuss how control is actualized.   (6 marks)

(c)   Giving reasons, explain why real estate is considered to have lower liquidity. (6 marks)

(d)   An originator packages 1,000 fixed rate loans of Sh. 200,000 each with the same maturity and contract rate of interest (assume 40 years and 1% p.m.). It then issues 200 million in bonds have a minimum denomination of Sh. 40,000. The interest rate on the bonds is 10% p.a.
If an investor buys 3 bonds and at the end of the 1st month all mortgagors, remit their payment.

Required;

Calculate the amount that will be remitted to the investor of the mortgage backed
        bond at end of the first month.   (8 marks)

QUESTION TWO

(a)   Discuss the real estate system and the 3 major components of the system. (6 marks)

(b)   Clearly explain the different types of taxes charged on real estate property. (6 marks)

(c)   An investor purchased a property that has potential gross income of Sh. 180,000. The vacancy loss is 12% and has expenses as follows; utilities 12,000, repairs 25,000 salaries 35,000. Further the investor purchased the building with a loan of Sh. 500,000 making a down payment of 25% and financing the rest with a mortgage at 8% p.a. interest maturity in 15 years. The amount of depreciation charged on the building is Sh. 8,400. Tax rate is 30%

        Required; calculate

        (i)   Net operating income.   (8 marks)

        (ii)   Annual mortgage payment.   (2 marks)

        (iii)   After tax cashflow in year 1.   (3 marks)

QUESTION THREE

(a)   You are considering to invest in a real property that has a net operating income of Sh. 150,000 for 4 years. At the end of the 4th year the Net Operating Income is expected to grow by 6% indefinitely. The investor intends to sell property after 6 years at market
value. The risk free rate is 7% and risks premium is 7%

        Required; calculate

        (i)   The terminal cap rate

        (ii)   How much would the property sell for after 6 years?

        (iii)   What is the property worth today?

        (iv)   Calculate the current cap rate   (12 marks)

(b)   In the real estate industry investors identify various significant factors that tell of supply and demand of various property types. State and explain any 4 of these factors. (8 marks)

QUESTION FOUR

(a)   Using an illustration, describe the secondary mortgage market and how it works.
                                                                                        (8 marks)

(b)   An owner of office property expects to receive cashflow as follows; 180,000, 220,000, 252,000, 128, 000 and 280, 000. Determine the present value of the office property at a discount rate 12%. If the property costs Sh. 450,000.

     (i)   Advise the investor on whether or not to invest in the property.   (4 marks)

     (ii)   Explain the benefits of investing in real estate investment trusts.   (8 marks)