HW 9 Horizon Value 1

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Passed solution review

A project involved initial construction costs of $2.5 million. The annual rate of economic depreciation for that construction class is 0.008. The project is expected to terminate in 25 years. The expected annual rate of inflation is 0.025.

a. Estimate the horizon value at time t=25 owing to the remaining value of this asset.

$V_0 = 2.5$ million $d = .8\%$ $T = 25$ $m = 2.5$

$2.5(1-(.008))^{25} = 2.05$ million

b. If the real discount rate is 0.035, what is the present value of the horizon value from (a)?

$(2.05/(1.035)^{25}) = .8675$ million