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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 1. Family financial goals should be   |  |  |  | | --- | --- | --- | |  | a. | very general in nature. | |  | b. | realistically attainable. | |  | c. | individually determined. | |  | d. | set once for a lifetime. | |  | e. | reserved for retirement planning. |  |  |  | | --- | --- | | *ANSWER:* | b |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | | 2. Effective financial plans should   |  |  |  |  | | --- | --- | --- | --- | |  |  | a. | consider your wants and needs. | |  |  | b. | consider your financial resources. | |  |  | c. | reflect your personality. | |  |  | d. | reflect your emotional reactions to money. | |  |  | e. | do all of these. |  |  |  | | --- | --- | | *ANSWER:* | e |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | | 3. Personal financial management is important because it   |  |  |  | | --- | --- | --- | |  | a. | controls inflation. | |  | b. | limits consumption. | |  | c. | uses money as an end. | |  | d. | makes personal financial goals easier to achieve. | |  | e. | lessens economic differences among individuals. |  |  |  | | --- | --- | | *ANSWER:* | d | | | |

4. The personal balance sheet describes a family's wealth

|  |  |  |
| --- | --- | --- |
|  | a. | at a certain point in time. |
|  | b. | as an annual summary. |
|  | c. | as a time period less than one year. |
|  | d. | at a future time. |
|  | e. | none of these |

|  |  |
| --- | --- |
| *ANSWER:* | a |

5. Mandy and Jeff have a net worth of $25,000 and total assets of $140,000. If their revolving credit and unpaid bills total $2,200, what are their total liabilities?

|  |  |  |
| --- | --- | --- |
|  | a. | $115,000 |
|  | b. | $140,000 |
|  | c. | $142,200 |
|  | d. | $165,000 |
|  | e. | $167,200 |

|  |  |
| --- | --- |
| *ANSWER:* | a |

6. You would not include \_\_\_\_ on an income and expense statement.

|  |  |  |
| --- | --- | --- |
|  | a. | the value of your stock portfolio |
|  | b. | taxes withheld |
|  | c. | utilities paid |
|  | d. | mortgage payments |
|  | e. | charitable payments |

|  |  |
| --- | --- |
| *ANSWER:* | a |

7. If your total liquid assets equal $50,000 and your total current debts equal $15,000, your current ratio is

|  |  |  |
| --- | --- | --- |
|  | a. | 30%. |
|  | b. | 70%. |
|  | c. | 143%. |
|  | d. | 233%. |
|  | e. | 333%. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

8. To determine how effectively the budget is working, you can compare it to

|  |  |  |
| --- | --- | --- |
|  | a. | the personal balance sheet. |
|  | b. | the income and expense statement. |
|  | c. | the record of actual income and expenses. |
|  | d. | the year-end financial statements. |
|  | e. | your financial goals. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

9. Michael and Sandy purchased a home for $100,000 five years ago. If it appreciated 6% annually, what is it worth today?

|  |  |  |
| --- | --- | --- |
|  | a. | $100,000 |
|  | b. | $106,000 |
|  | c. | $130,000 |
|  | d. | $133,823 |
|  | e. | $135,603 |

|  |  |
| --- | --- |
| *ANSWER:* | d |

10. . The stated interest rate on your account is 7.12% with interest paid semiannually. Your effective rate of interest will be

|  |  |  |
| --- | --- | --- |
|  | a. | lower than 7.12%. |
|  | b. | equal to 7.12%. |
|  | c. | greater than 7.12%. |
|  | d. | none of these. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

11 . \_\_\_\_ can be deducted on your salary tax payment.

|  |  |  |
| --- | --- | --- |
|  | a. | Rent payments |
|  | b. | Mortgage interest |
|  | c. | Homeowner's insurance |
|  | d. | Utility bills |
|  | e. | None of these |

|  |  |
| --- | --- |
| *ANSWER:* | b |

12 The seller of the house typically pays the

|  |  |  |
| --- | --- | --- |
|  | a. | loan application fee. |
|  | b. | real estate agent's commission. |
|  | c. | appraisal fee. |
|  | d. | Mortgage points. |
|  | e. | title search and insurance. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

13. \_\_\_\_ is a reason for preferring to rent rather than to buy.

|  |  |  |
| --- | --- | --- |
|  | a. | Flexibility |
|  | b. | No maintenance worries |
|  | c. | Lower monthly cash flows |
|  | d. | Down payment money better used elsewhere |
|  | e. | All of these |

|  |  |
| --- | --- |
| *ANSWER:* | e |

14. It is *not* a good idea to use credit to

|  |  |  |
| --- | --- | --- |
|  | a. | buy a home. |
|  | b. | live beyond one's means. |
|  | c. | spread payments within a budget. |
|  | d. | purchase expensive items. |
|  | e. | replace a check for small items. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

15. Clare's gross salary is $36,000 annually and her after-tax income is $28,800. What is Clare's maximum recommended monthly consumer credit payment?

|  |  |  |
| --- | --- | --- |
|  | a. | $600. |
|  | b. | $480. |
|  | c. | $450. |
|  | d. | $360. |
|  | e. | $200. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

16. A credit card can provide an interest-free loan if you

|  |  |  |
| --- | --- | --- |
|  | a. | pay for purchases within six months. |
|  | b. | pay the minimum payment. |
|  | c. | pay the entire balance on or before the due date. |
|  | d. | pay the previous balance by the due date. |
|  | e. | receive a cash advance. |

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| --- | --- |
| *ANSWER:* | c |

17. If your installment loan has a variable interest rate,

|  |  |  |
| --- | --- | --- |
|  | a. | the rate will remain the same over the life of the loan. |
|  | b. | the amount you borrowed will change with interest rates. |
|  | c. | you cannot accurately predict the total interest you will pay on the loan. |
|  | d. | you can calculate the total interest you will pay on the loan. |
|  | e. | none of these are true. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

1. A loan against the cash value of your life insurance policy would be characterized by

|  |  |  |
| --- | --- | --- |
|  | a. | increased death benefits to beneficiaries. |
|  | b. | increased premiums. |
|  | c. | unchanged death benefits available to beneficiaries. |
|  | d. | no specific repayment date. |
|  | e. | annual percentage rates higher than other sources. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

19. When the simple-interest method is used to determine finance charges, the interest is calculated based on the

|  |  |  |
| --- | --- | --- |
|  | a. | ending balance of the loan. |
|  | b. | average outstanding balance. |
|  | c. | actual loan balance outstanding. |
|  | d. | beginning balance of the loan. |
|  | e. | none of these. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

1. Insurance is a tool that can lessen \_\_\_\_ risk.

|  |  |  |
| --- | --- | --- |
|  | a. | social |
|  | b. | mental |
|  | c. | economic |
|  | d. | accident |
|  | e. | exposure |

|  |  |
| --- | --- |
| *ANSWER:* | c |

21. The needs analysis method of  determining the amount of life insurance considers

|  |  |  |
| --- | --- | --- |
|  | a. | needed income. |
|  | b. | debt liquidation. |
|  | c. | extra expenses if income producer dies. |
|  | d. | special needs of dependents. |
|  | e. | all of these. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

22. If the objective of your life insurance program is to get the greatest death protection now for your insurance dollars, you should choose \_\_\_\_ insurance.

|  |  |  |
| --- | --- | --- |
|  | a. | term |
|  | b. | universal |
|  | c. | limited pay |
|  | d. | industrial |
|  | e. | whole life |

|  |  |
| --- | --- |
| *ANSWER:* | a |

23. Terms of payment under your health insurance are governed by

|  |  |  |
| --- | --- | --- |
|  | a. | policy limits. |
|  | b. | deductibles. |
|  | c. | coordination of benefits. |
|  | d. | set maximums for types of services. |
|  | e. | all of the above. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

24. All of the following *except* a \_\_\_\_ are highly recommended for a long-term disability income policy.

|  |  |  |
| --- | --- | --- |
|  | a. | guaranteed renewable clause |
|  | b. | cost-of-living adjustment |
|  | c. | long duration of benefit |
|  | d. | short waiting period |
|  | e. | waiver of premium |

|  |  |
| --- | --- |
| *ANSWER:* | d |

25. Instructing your broker to buy a stock at a specified or lower price is a

|  |  |  |
| --- | --- | --- |
|  | a. | limit order. |
|  | b. | market order. |
|  | c. | margin order. |
|  | d. | regular order. |
|  | e. | stop order. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

26. At age 25, Julie invests $2,000 at an average rate of return of 6 percent. Approximately how much will Julie have by the time she is 65?

|  |  |  |
| --- | --- | --- |
|  | a. | $10,000 |
|  | b. | $100,000 |
|  | c. | $250,000 |
|  | d. | $309,000 |
|  | e. | $486,000 |

|  |  |
| --- | --- |
| *ANSWER:* | d |

Short Question

1. Jessica Wright has always been interested in stocks. She has decided to invest $2,000 once every year into an equity mutual fund that is expected to produce a return of 6 percent a year for the foreseeable future. Jessica is really curious how much money she can reasonably expect her investment to be worth in 20 years. What would you tell her?

Ans: It should be noted, that you are calculating this amount using an expected rate of return. Should the return be higher any given years, the value will be more. Should the return be lower any given years, the value will be less.

|  |  |  |
| --- | --- | --- |
| FV | = | $2,000 x 36.786 |
|  | = | $73,572 |

1. Sean and Amy Anderson have a home with an appraised value of $180,000 and a mortgage balance of only $90,000. Given that an S&L is willing to lend money at a loan-to-value ratio of 75 percent, how big a home equity credit line can Sean and Amy obtain?

Ans:

Current appraised value $180,000

First mortgage balance 90,000

Remaining value available for loan $ 90,000

If loan to equity is limited to 75%, most that could be loan is 75% or $180,000 = $135,000

Total available $135,000

First mortgage balance 90,000

Remaining value available for loan $ 45,000

1. Claire Gerber wants to buy 300 shares of Google, which is currently selling in the market for $537.34 a share. Rather than liquidate all her savings, she decides to borrow through her broker. Assume that the margin requirement on common stock is 50 percent. If the stock rises to $625 a share by over the next year, show the dollar profit and percentage return that Claire would earn if she makes the investment with 50 percent margin. Contrast these figures to what she’d make if she uses no margin.

Ans:

|  |  |  |
| --- | --- | --- |
|  | No Margin loan | With Margin loan 50% |
| Cash invested | 300 \* $537.34 = $161,202 | Only half, $80,601 |
| Sell stock, cash received | 300\* $625 = $187,500 | Same, $187,500 |
| Pay off margin |  | $187,500 - $80,601= $106,899 net cash received |
| Gain on stock | $187,500 – 161,202 = $26,298 | $106,899 – 80,801 = $26,098 |
| Return on stock | $26,298 / 161,202 = 16.3% | $26,098 / 80,601 = 32.4% |

1. Todd Kowalski is borrowing $10,000 for five years at 7 percent. Payments are made on a monthly basis, which are determined using the add-on method.

a. How much total interest will Chris pay on the loan if it is held for the full five-year term?

Ans:

Add-on = $10,000 \* 7% \* 5 years = $3,500, the total interest.

b. What are Chris’s monthly payments?

Ans:

Principal + interest = total payments, divided by 60 months = monthly payment

$10,000 + $3,500 = $13.500 / 60 = $225.00 per month.

c. How much higher are the monthly payments under the add-on method than under the simple interest method?

Ans:

Using simple interest, payments using Exhibit 7.6 for 7% over 60 months is $19.80 per thousand, or $198 for $10,000. Thus, add-on payments are $27 per month [$225 - $198] higher than simple interest.

Structural Question

1. Ho is in the process of taking a five-year loan of $50,000 with HSBC. The bank offers three payment options:
   1. Pay all of the interest (8% per year) and principal in one lump sum at the end of 5 years;
   2. Pay interest at the rate of 8% per year for 4 years and then a final payment of interest and principal at the end of the 5th year;
   3. Pay 5 equal payments at the end of each year inclusive of interest and part of the principal.
2. Under which of the three options will Ho pay the least interest and why?

Ans:

* Option 1: Principal and Interest Due at end

Payment at the end of year5 = FVn = PV x (1 + r)n

FV5 = $50,000 x (1+0.08)5

= $73,466.40

Interest paid = Total payment - Loan amount

Interest paid = $73,466.40 - $50,000 = $23,466.40

* Option 2: Interest-only Loan

Annual Interest Payment (Years 1-4) = $50,000 x 0.08 = $4,000

Interest paid = $4,000\*5 =$20,000

* Option 3: Amortized Loan.

To calculate the annual payment of principal and interest we can use the PV of an ordinary annuity equation and solve for the PMT value using n = 5; I = 8%; PV=$50,000.

PMT = $12,522.82

Total payments = 5\*$12,522.82 = $62,614.11

Interest paid = Total Payments - Loan Amount = $62,614.11-$50,000

Interest paid = $12,614.11

* So, the amortized loan is the one with the lowest interest expense, since it requires a higher annual payment, part of which reduces the unpaid balance on the loan and thus results in less interest being charged over the 5-year term.

1. Let’s say Ho decides to go with the amortized loan option and after having paid 2 payments decides to pay off the balance. Using an amortization schedule calculate his payoff amount.

Ans:

Amount of loan = $50,000; Interest rate = 8%; Term = 5 years; Annual payment = $12,522.82

Year Beg. Bal. Payment Interest Prin. Red. End Bal.

1 50,000.00 12,522.82 4,000.00 8,522.82 41,477.18

2 41,477.18 12,522.82 3,318.17 9,204.65 32,272.53

3 2,272.53 12,522.82 2,581.80 9,941.02 22,331.51

1. 22,331.51 12,522.82 1,786.52 10,736.30 11,595.21

5 11,595.21 12,522.82 927.62 11,595.21 0

The loan payoff amount at the end of 2 years is $32,272.53