

Real Estate Finance Exam 2 Practice

1. If your business needs 9,000 useable sq. feet of space in a large multi-tenant office building and the building has a "load factor" of 10% what is the "rentable" sq. footage you will need? Ch9

$$9,000 \times (1 + 10\%) = 9,900$$

- (A) 8,182
- (B) 9,000
- ☒ (C) 9,900
- (D) 9,999

2. Many retail tenants demand a clause in their lease that prevents the landlord from renting space in the shopping center to one of their competitors. This clause is referred to as a(n): Ch9

- (A) Kick-out clause
- (B) Option clause
- ☒ (C) Exclusivity clause
- (D) Co-tenancy clause
- (E) Santa clause

CONSIDER WHAT THE
WRONG ANSWERS ARE
(EXCEPT (C))

3. In a typical real estate proforma, the most important line item is an estimation of property cash flow before debt service. This line item on a real estate proforma is usually referred to as: Ch9

- (A) Potential gross income
- (B) Effective gross income
- ☒ (C) Net operating income
- (D) Before-tax cash flow

4. In which of the following types of multi-tenant property, would an owner/investor be most concerned about tenant mix? Ch9

- (A) Office
- ☒ (B) Retail
- (C) Industrial
- (D) Apartment

5. Which of the following lease clauses shifts risk to the tenant? Ch9

- (A) Rent amount clause
- (B) Signage clause
- ☒ (C) Expense recovery clause
- (D) Co-tenancy clause
- (E) Tiger clause

EXPENSE PASS-THRU PROTECTS LANDLORD
FROM RISING COSTS

6. You have a building with expected first year NOI of \$122,000. You've applied for a mortgage where the lender requires a minimum debt coverage ratio of 1.2 (applied to first year NOI). What would be the (maximum) estimated monthly mortgage payment you could afford (rounded)? Ch10

- (A) \$5,200
(B) \$8,470
(C) \$10,170
(D) \$12,200

$$\frac{122,000}{1.2} = 101,667 \text{ ANNUALLY} \div 12 = 8472 \text{ MONTH}$$

PROFORMA

Year	1	2	3
NOI	\$82,000	\$84,460	\$86,994
Debt Service	74,839	74,839	74,839
Cash flow (before tax)	\$7,161	\$9,621	\$12,155
Resale in year 3			853,368
Less mortgage balance			-574,599
Total cash flow to equity	\$7,161	\$9,621	\$290,923
Present Value of each cash flow (to equity) @ 15%	[\$6,227 + \$7,275 + \$191,287]		

7. Consider the table above for a hypothetical income property that is available for purchase with a \$604,200 loan. Using the principles of *mortgage equity capitalization* (or equity CF analysis – where equity position is valued separately from debt), what is the estimated total property value (rounded to the nearest \$100)? Ch10

- (A) \$622,800
(B) \$809,000
(C) \$863,200
(D) \$914,700

BALANCE SHEET	
SOLVE FOR ASSETS	DEBT: 604,200
	EQUITY: 204,890
808,939	808,939

8. Considering the same table, if your commercial broker told you that current "cap rates" for this kind of building were 9%, what value would he/she be suggesting the building was worth (rounded to nearest \$100)? Ch10

- (A) \$683,800
(B) \$715,300
(C) \$863,200
(D) \$911,100

ONLY RELEVANT NUMBER IS NOI,

$$\frac{NOI}{CAPRATE} = \frac{82,000}{.09} = 911,111$$

9. When analyzing a real estate project (unleveraged), investors often calculate the IRR (internal rate of return) on a series of cash flows. Which one of the following inputs is NOT required to calculate this? Ch10

- (A) Purchase Price (or investment amount) CF
(B) Required rate of return
(C) Sales Price at end of Holding Period CF
(D) Annual (or periodic) cash flows CF

YOU NEED ALL CFS FOR IRR

"r" IS NOT REQ'D

10. Real estate executives refer to lots of financial rates, including those mentioned below. If you are thinking about investing in a "leveraged" real estate deal, which one of these is likely to be most important to you? Ch10

- (A) Going-in cap rate
(B) Going-out cap rate
(C) Overall (free and clear) property return rate
(D) Equity (investment) yield rate (aka cash on cash return)

ALL IMPORTANT

(D) IS YOUR ACTUAL CASH ON CASH RETURN

11. A property that produces an annual NOI of 90,000 was purchased for \$1,200,000. Debt service for the year was \$76,000 of which \$73,400 was interest and the remainder was principal. Annual depreciation is \$38,095. Ignoring capital improvements (capex), what is the taxable income? Ch11

- (A) \$16,600
(B) - \$21,495
(C) - \$24,095
(D) - \$97,495

NOI 90,000
Less Dep'n (38,095)
Less Interest (73,400)
TAXABLE (21,495) TAXABLE LOSS

12. In the above example, assume you sell the property after 1 year of ownership for \$1,300,000. How much tax on the gain would be payable if marginal ordinary rates are 36%, capital gain rates are 15% and depreciation recapture rates are 25%? (Ignore taxable income calculated in prior question). Ch11

- (A) \$22,714
(B) \$24,524
(C) \$34,524
(D) \$38,534

1.3 100,000 CAPGAIN X 15% = 15,000
1.2 38,095 DEPN RECAP X 25% = 9,524
24,524

13. You are evaluating a potential purchase of an income producing property without debt. You have completed a proforma which shows the following data (the last two of which were properly calculated using Excel formulas).

"r" = Discount rate: 16%

PV \$5,000,000 (PV of future CFs) USING "r"

IRR: 14.249% (using actual asking price)

IRR < "r" THUS BAD DEAL
OUR VALUATION = 5,000,000
THEY MUST BE ASKING MORE

Which of the following statements is consistent with your work? Ch11.

- (A) The discount rate is unreasonably low - OPINION
(B) The NPV on this property is positive NO. OPPOSITE IS TRUE
(C) The "asking price" for this property is too high
(D) The property looks financially viable. NO.

14. Describe the meaning of "going out cap rate" as that term is used in real estate proforma analysis. Ch11

- (A) Same as internal rate of return, calculated once final sales price is known
- (B) Same as "cap rate" as that term is used in general conversation
- (C) Same as "Loan constant" which can be used to capitalize an income stream
- ☒ (D) Same as "going in cap rate" conceptually, but determined for use at a future time

15. All other things being equal, which of the following best describes the effects of positive financial leverage on an investment's risk-return characteristics? Ch12

- (A) Lower expected return, lower risk
- (B) Lower expected return, higher risk
- ☒ (C) Higher expected return, higher risk
- (D) Higher expected return, lower risk
- (E) Risk-return characteristics have no role in investment decision making

16. A lender requires a 1.30 debt coverage ratio as a minimum. If the net operating income of a property is \$45,500, what annual amount of debt service would be acceptable? Ch12

- (A) \$35,000 or higher
- ☒ (B) \$35,000 or lower — IF YOU BORROW LESS OR GET LOWER RATE, LENDER WILL BE COMFORTABLE. 35,000 IS A MAX GIVEN C.F.
- (C) \$59,150 or higher
- (D) \$59,150 or lower

17. If you were negotiating with a lender for a \$10 million real estate loan and considering different types of loan structures, which of the following loans would you expect to have the highest first-year debt service? Ch12

- (A) Accrual loan (negative am)
- ☒ (B) Conventional amortizing loan — TYPICAL. ALL OTHER 'ALTERNATIVES' ARE STRUCTURED TO REDUCE DEBT SERVICE
- (C) Interest only loan
- (D) Participation loan

18. A lender has quoted you some financing with the following terms: 8.5%, 30 year amortization, 10 year term, 75% LTV, 1.25 DCR. You are looking at buying a well leased building at its appraised value of \$9,200,000 with verifiable NOI of \$692,000. What is the maximum amount (rounded) you will likely be able to borrow? (Assume monthly payments, and that the NOI calculation has included a reserve for capital expenditures and needs no further adjustments) Ch11

- ☒ (A) \$6,000,000
- (B) \$6,450,000
- (C) \$6,900,000
- (D) \$7,210,000

LOWER OF (A) or (B) MUST MEET BOTH TESTS

(A) DCR TEST

NOI

$$\frac{692,000}{1.25}$$

553,600 ANNUAL

$$\div 12m$$

46,133 MAX PMT

$$N=360 \quad 1/Y=8.5 \div 12 \quad PMT=46,133 \quad CPT \quad PV=5,999,808$$

(B) LTV TEST

$$9,200,000 \times .75$$

$$= 6,900,000$$

19. Which of the following legal entities is least likely to be used to own a real estate income property (with the unique exception of a REIT)? Ch18

- ☒ (A) Corporation
- (B) Limited Partnership
- (C) Limited Liability Company (LLC)
- (D) S-Corporation

WHY?

DOUBLE TAXATION

20. The Internal Revenue Service wants to be sure that abuses do not occur in allocating tax attributes in a partnership or LLC legal form. The primary principle here is: Ch18

- (A) Book versus tax adjustments
- (B) Capital formation
- ☒ (C) Substantial Economic Effect
- (D) Enforcement

← JUST AN IMPORTANT PHRASE

21. In real estate deals, the best definition of the concept of a joint venture would be: Ch18

- ☒ (A) Two or more parties to come together in any rational way to execute a business plan
- (B) A money partner plans to insure he gets his capital back
- (C) A developer or deal sponsor plans to raise capital very inexpensively
- (D) Two developers agree to develop a deal together without capital

22. A "Reg. D" offering is: Ch18

- (A) The same as an IPO (initial public offering)
- (B) A tax requirements under regulation D of the Internal Revenue Code
- ☒ (C) A money raising proposal restricted to wealthy or sophisticated investors
- (D) A bankruptcy filing by a developer who has defaulted on his loans

GENERALLY CALLED
"ACCREDITED
INVESTORS"

23. A real estate sponsor often attempts to structure a deal with investors such that the sponsor receives a greater interest in future cash flow than their investment would otherwise dictate, especially if the project performs well. This special right is often referred to as: Ch18

- (A) The hurdle
- ☒ (B) The promote
- (C) The cap rate
- (D) The pref

← ALSO 'CARRIED INTEREST' or 'SWEAT EQUITY'

