

Financial Real Estate Finance Exam 2006

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Published 2014

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Geltner, David, and Tod McGrath. 11.431J Real Estate Finance and Investment, Fall 2006. (MIT OpenCourseWare: Massachusetts Institute of Technology), <http://ocw.mit.edu/courses/urban-studies-and-planning/11-431j-real-estate-finance-and-investment-fall-2006> (Accessed 1 May, 2014). License: Creative Commons BY-NC-SA

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1. Real Estate Finance Exam 2006

- Part I: Multiple Choice (36 points, 3 points each).
- Part II: Definitions (12 points, 4 points each).
- Part III: Short Answer Questions (20 points, 10 points each question):
- Part IV: Longer Problems (20 points, 10 points each)
- Part V. Required Problem (20 points)
- Part VI: Extra-credit question.

4. Chapter: Part I: Multiple Choice (36 points, 3 points each).

1. Part I: Multiple Choice (36 points, 3 points each). Questions

4.1.1. A property has a McDonalds restaurant on it, which can earn \$50,000...

Author: David Geltner

A property has a McDonalds restaurant on it, which can earn \$50,000 per year. In any other use (including another brand of restaurant), the most it can earn is \$40,000 per year. Assuming a discount rate of 10% and constant cash flow in perpetuity, what is the "investment value" of this property to McDonalds, and what is its "market value"?

Please choose only one answer:

- Both investment value and market value are \$400,000.
- Both investment value and market value are \$500,000.
- Investment value is \$400,000 and market value is \$500,000.
- Investment value is \$500,000 and market value is \$400,000.

Check the answer of this question online at QuizOver.com:

Question: [A property has a McDonalds restaurant on by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/a-property-has-a-mcdonalds-restaurant-on-by-prof-david-geltner?pdf=1505>

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4.1.2. Suppose the riskfree rate of return is 3%, and the expected total r...

Author: David Geltner

Suppose the riskfree rate of return is 3%, and the expected total return on the property free & clear is 7%, and you have a target total expected return of 11%. Assuming you can borrow at the riskfree rate, what Loan/Value ratio must you obtain for this real estate investment to meet your target expected return?

Please choose only one answer:

- 0%
- 25%
- 50%
- 75%
- 80%

Check the answer of this question online at QuizOver.com:

Question: [Suppose the riskfree rate of return is by Prof. David Geltner @MIT](#)

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Interactive Question:

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4.1.3. An investor believes that a certain property is worth \$10,000,000. ...

Author: David Geltner

An investor believes that a certain property is worth \$10,000,000. The seller refuses to sell it for that amount, but has offered to provide a 5-year interest-only loan for \$5,000,000 at 4% interest (annual payments at the ends of the years, first payment due in one year). Market interest rates on such a loan are currently 6.5%. How much should the investor be willing to pay for the property from an investment value perspective (taking the loan deal) if the investor faces a 30% marginal income tax rate? (Ch15)

Please choose only one answer:

- \$10,000,000
- \$10,383,588
- \$10,403,023
- \$10,519,460
- Insufficient information to answer the question.

Check the answer of this question online at [QuizOver.com](http://www.quizover.com):

Question: [An investor believes that a certain property by Prof. David Geltner](http://www.quizover.com/question/an-investor-believes-that-a-certain-property-by-prof-david-geltner?pdf=1505)

Flashcards:

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Interactive Question:

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4.1.4. Consider a 20-year (monthly-payment), 8%, \$80,000 mortgage with 2 p...

Author: David Geltner

Consider a 20-year (monthly-payment), 8%, \$80,000 mortgage with 2 points prepaid interest up front. What is the yield to maturity?

Please choose only one answer:

- 8.00%
- 8.12%
- 8.20%
- 8.27%

Check the answer of this question online at [QuizOver.com](http://www.quizover.com):

Question: [Consider a 20-year monthly-payment 8 80 by Prof. David Geltner @MIT](#)

Flashcards:

<http://www.quizover.com/flashcards/consider-a-20-year-monthly-payment-8-80-by-prof-david-geltner-mit?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/consider-a-20-year-monthly-payment-8-80-by-prof-david-geltner-mit?pdf=1505>

4.1.5. Consider an 8.5% loan amortizing at a 25-year rate with monthly pay...

Author: David Geltner

Consider an 8.5% loan amortizing at a 25-year rate with monthly payments. What is the maximum amount that can be loaned on a property whose net operating income (NOI) is \$500,000 per year, if the underwriting criteria specify a debt service coverage ratio (DCR) no less than 125%?

Please choose only one answer:

- \$2,789,406
- \$3,409,091
- \$3,844,614
- \$4,000,000
- \$4,139,619

Check the answer of this question online at QuizOver.com:

Question: [Consider an 8.5 loan amortizing at a 25 by Prof. David Geltner @MIT](#)

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Interactive Question:

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4.1.6. For the same property as above, suppose the underwriting criteria i...

Author: David Geltner

For the same property as above, suppose the underwriting criteria is a maximum loan/value ratio (LTV) of 75%, and we estimate property value by direct capitalization using a rate of 11% on the stated NOI. By this criterion what is the maximum loan amount?

Please choose only one answer:

- \$2,789,406
- \$3,409,091
- \$3,844,614
- \$4,000,000
- \$4,139,619

Check the answer of this question online at QuizOver.com:

Question: [For the same property as above suppose the by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/for-the-same-property-as-above-suppose-the-by-prof-david-geltner?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/for-the-same-property-as-above-suppose-the-by-prof-david-geltner?pdf=1505>

4.1.7. Suppose a construction project anticipates end-of-month draws of \$4...

Author: David Geltner

Suppose a construction project anticipates end-of-month draws of \$400,000, \$300,000, and \$600,000 consecutively.

What will be the balance owed at the end of the third month if the interest on the loan is 7% per annum (nominal annual rate, compounded monthly), and no payments of either principal or interest are required during the construction period?

Please choose only one answer:

- \$1,306,430.
- \$1,314,051.
- \$1,378,960.
- Cannot be computed with the information given.

Check the answer of this question online at QuizOver.com:

Question: [Suppose a construction project anticipates by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/suppose-a-construction-project-anticipates-by-prof-david-geltner?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/suppose-a-construction-project-anticipates-by-prof-david-geltner?pdf=1505>

4.1.8. Consider the investment evaluation of a real estate development in ...

Author: David Geltner

Consider the investment evaluation of a real estate development in which the property to be built is projected to reach stabilized occupancy at the end of Year 2 (two years from the time the investment decision must be made and construction will begin).

The project is speculative in that there are no leases signed as of Time Zero (the present, when the investment decision must be made).

The property level opportunity cost of capital is considered to be 9% for stabilized investments, and 10% for assets not yet stabilized (lease-up investments).

Which of the following is true?

Please choose only one answer:

- Property level before-tax cash flows beyond Year 2 should be discounted back to the end of Year 2 at 9%, and the projected stabilized asset value as of the end of Year 2 should be discounted two years to Time Zero at 10%.
- Property level before-tax cash flows beyond Year 2 should be discounted back to the end of Year 2 at 10%, and the projected stabilized asset value as of the end of Year 2 should be discounted two years to Time Zero at 9%.
- Property level before-tax cash flows beyond Year 2 should be discounted all the way back to Time Zero at the 10% rate.
- Property level before-tax cash flows beyond Year 2 should be discounted all the way back to Time Zero at the 9% rate.

Check the answer of this question online at QuizOver.com:

Question: [Consider the investment evaluation of a by Prof. David Geltner @MIT](#)

Flashcards:

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Interactive Question:

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4.1.9. The opportunity cost of capital (discount rate) applicable on an un...

Author: David Geltner

The opportunity cost of capital (discount rate) applicable on an unlevered basis to assets that are not yet leased up ("speculative built properties") is best described as:

Please choose only one answer:

- Usually about 50 to 200 basis-points above the OCC for the same property with stabilized occupancy, based in part on analysis of the "interlease" discount rate implied in the property market.
- Usually about 300 to 500 basis-points above the OCC for the same property with stabilized occupancy, based in part on analysis of the "interlease" discount rate implied in the property market.
- Usually about 50 to 200 basis-points below the OCC for the same property with stabilized occupancy, based on the typical upward slope of the yield curve in the bond market, because lease-up is near term.
- Usually about 300 to 500 basis-points below the OCC for the same property with stabilized occupancy, based on the typical upward slope of the yield curve in the bond market, because lease-up is near term.

Check the answer of this question online at QuizOver.com:

Question: [The opportunity cost of capital discount by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/the-opportunity-cost-of-capital-discount-by-prof-david-geltner?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/the-opportunity-cost-of-capital-discount-by-prof-david-geltner?pdf=1505>

4.1.10. All of the following are typical types of real options found in dev...

Author: David Geltner

All of the following are typical types of real options found in development projects or developable land ownership, except:

Please choose only one answer:

- The wait option
- The phasing option
- The switch option
- The refinance option

Check the answer of this question online at [QuizOver.com](http://www.quizover.com):

Question: [All of the following are typical types of by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/all-of-the-following-are-typical-types-of-by-prof-david-geltner?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/all-of-the-following-are-typical-types-of-by-prof-david-geltner?pdf=1505>

4.1.11. All of the following must be known (or assumed) in order to rigorou...

Author: David Geltner

All of the following must be known (or assumed) in order to rigorously derive the real option value of a land parcel or development option, except:

Please choose only one answer:

- The current value of the underlying asset (the built property value, V_0)
- The opportunity cost of capital (OCC) of the underlying asset (rV)
- The volatility of the underlying asset (s)
- The payout rate (or current income yield rate) of the underlying asset (yV)

Check the answer of this question online at QuizOver.com:

Question: [All of the following must be known or assumed by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/all-of-the-following-must-be-known-or-assumed-by-prof-david-geltner?pdf=1505>

Interactive Question:

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4.1.12. The replicating portfolio of a development option (land) consists of:

Author: David Geltner

The replicating portfolio of a development option (land) consists of:

Please choose only one answer:

- A long position in an asset like the stabilized building to be built and a short position (borrowing) in a riskless bond.
- A short position in an asset like the stabilized building to be built and a long position (lending) in a riskless bond.
- Long positions in both the stabilized building and a bond.
- Short positions in both the stabilized building and a bond.

Check the answer of this question online at QuizOver.com:

Question: [The replicating portfolio of a development by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/the-replicating-portfolio-of-a-development-by-prof-david-geltner?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/the-replicating-portfolio-of-a-development-by-prof-david-geltner?pdf=1505>

4. Chapter: Part II: Definitions (12 points, 4 points each).

1. Part II: Definitions (12 points, 4 points each). Questions

4.1.1. Phased risk regimes (in development projects):

Author: David Geltner

Provide a complete definition of each term or phrase in the space below each.

Answer in a single, clear sentence. (You may provide a single example or formula to clarify your answer if necessary.) Only define the subject term; do not add extraneous material in your answer. Write legibly; no credit will be given for writing we cannot decipher.

Phased risk regimes (in development projects):

Check the answer of this question online at QuizOver.com:

Question: [Phased risk regimes in development projects Provide a complete definition](#)

Flashcards:

<http://www.quizover.com/flashcards/phased-risk-regimes-in-development-projects-provide-a-complete-definit?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/phased-risk-regimes-in-development-projects-provide-a-complete-definit?pdf=1505>

4.1.2. Back-door feasibility analysis:

Author: David Geltner

Provide a complete definition of each term or phrase in the space below each.

Answer in a single, clear sentence. (You may provide a single example or formula to clarify your answer if necessary.) Only define the subject term; do not add extraneous material in your answer. Write legibly; no credit will be given for writing we cannot decipher.

Back-door feasibility analysis:

Check the answer of this question online at QuizOver.com:

Question: [Back-door feasibility analysis Provide a complete definition of each](#)

Flashcards:

<http://www.quizover.com/flashcards/back-door-feasibility-analysis-provide-a-complete-definition-of-each?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/back-door-feasibility-analysis-provide-a-complete-definition-of-each?pdf=1505>

4.1.3. Promote (hurdle and preferred return):

Author: David Geltner

Provide a complete definition of each term or phrase in the space below each.

Answer in a single, clear sentence. (You may provide a single example or formula to clarify your answer if necessary.) Only define the subject term; do not add extraneous material in your answer. Write legibly; no credit will be given for writing we cannot decipher.

Promote (hurdle and preferred return):

Check the answer of this question online at QuizOver.com:

Question: [Promote hurdle and preferred return Provide a complete definition](#)

Flashcards:

<http://www.quizover.com/flashcards/promote-hurdle-and-preferred-return-provide-a-complete-definition?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/promote-hurdle-and-preferred-return-provide-a-complete-definition?pdf=1505>

4. Chapter: Part III: Short Answer Questions (20 points, 10 points each question):

1. Part III: Short Answer Questions (20 points, 10 points each question): Questions

4.1.1. What are the major line items in the operating budget of a developm...

Author: David Geltner

Choose 2 out of the 3 questions below, and answer each question in the space provided below that question.

Please be sure it is clear to us which question you DON'T want to be graded.

If the TA cannot figure it out, we will grade only the first four.

What are the major line items in the operating budget of a development project, and why might it make sense for such a budget to consider only a single year's operation of the building?

Check the answer of this question online at QuizOver.com:

Question: [What are the major line items in the operating Choose 2 out of 3](#)

Flashcards:

<http://www.quizover.com/flashcards/what-are-the-major-line-items-in-the-operating-choose-2-out-of-3?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/what-are-the-major-line-items-in-the-operating-choose-2-out-of-3?pdf=1505>

4.1.2. Why is it that construction loans are almost always used to finance...

Author: David Geltner

Choose 2 out of the 3 questions below, and answer each question in the space provided below that question.

Please be sure it is clear to us which question you DON'T want to be graded.

If the TA cannot figure it out, we will grade only the first four.

Why is it that construction loans are almost always used to finance all or most of the construction costs in a development investment, even when the investor has plenty of cash that could be used to pay for construction?

Check the answer of this question online at QuizOver.com:

Question: [Why is it that construction loans are almost Choose 2 out of the](#)

Flashcards:

<http://www.quizover.com/flashcards/why-is-it-that-construction-loans-are-almost-choose-2-out-of-the?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/why-is-it-that-construction-loans-are-almost-choose-2-out-of-the?pdf=1505>

4.1.3. Is it appropriate, and if so, why is it appropriate, to apply a ris...

Author: David Geltner

Choose 2 out of the 3 questions below, and answer each question in the space provided below that question.

Please be sure it is clear to us which question you DON'T want to be graded.

If the TA cannot figure it out, we will grade only the first four.

Is it appropriate, and if so, why is it appropriate, to apply a riskless or nearly riskless OCC to construction cost cash flows in the typical development project?

Check the answer of this question online at QuizOver.com:

Question: [Is it appropriate and if so why is it appropriate Choose 2 out of](#)

Flashcards:

<http://www.quizover.com/flashcards/is-it-appropriate-and-if-so-why-is-it-appropriate-choose-2-out-of?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/is-it-appropriate-and-if-so-why-is-it-appropriate-choose-2-out-of?pdf=1505>

4. Chapter: Part IV: Longer Problems (20 points, 10 points each)

1. Part IV: Longer Problems (20 points, 10 points each) Questions

4.1.1. Based on the following information, develop a front door "Simple Fi...

Author: David Geltner

Choose 2 out of the following three questions and answer in the space provided on the page.

Indicate clearly which questions we should grade or we will grade the first two.

- * 40,000 NRSF office building project.
- * Acquisition & construction cost = \$1,500,000;
- * Estimated operating costs (to landlord) = \$100,000/yr.
- * Projected stabilized occupancy = 95%.
- * Permanent loan available on completion @ 9% (interest-only loan) with 130% debt service coverage requirement on the net operating income, and 75% maximum loan-to-value ratio.

Show your work.

Based on the following information, develop a front door "Simple Financial Feasibility Analysis" (SFFA) for this project estimating the required minimum market gross rent per SF that will support development.

Check the answer of this question online at QuizOver.com:

Question: [Based on the following information develop Choose 2 out of three](#)

Flashcards:

<http://www.quizover.com/flashcards/based-on-the-following-information-develop-choose-2-out-of-three?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/based-on-the-following-information-develop-choose-2-out-of-three?pdf=1505>

4.1.2. A lender and a developer combine to undertake a development with an...

Author: David Geltner

Choose 2 out of the following three questions and answer in the space provided on the page.

Indicate clearly which questions we should grade or we will grade the first two.

[table]

Year ;0 ; 1; 2; 3; 4

Project net cash flows ;(\$10,000); \$1,000; \$1,000; \$1,000; \$11,000

[/table]

Construction is instantaneous at time 0, and the lender will provide \$8,000,000 to cover all construction costs at that time zero after

the developer has purchased the land for \$2,000,000 (assume both occur simultaneously at time 0).

The loan is a "mini-perm" loan for four years at a 6% interest rate,

with the loan's principal balance to be retired starting in year 1 based on priority access to all available project cash flow.

A lender and a developer combine to undertake a development with an expected 4-year holding period, and the following projected net cash flows (in thousands), including both land purchase and construction at time 0.

Check the answer of this question online at QuizOver.com:

Question: [A lender and a developer combine to undertake Choose 2 out of the](#)

Flashcards:

<http://www.quizover.com/flashcards/a-lender-and-a-developer-combine-to-undertake-choose-2-out-of-the?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/a-lender-and-a-developer-combine-to-undertake-choose-2-out-of-the?pdf=1505>

4. Chapter: Part V. Required Problem (20 points)

1. Part V. Required Problem (20 points) Questions

4.1.1. In the following situation:

[table]

;Today (time 0) ; Next Year (Yr...

Author: David Geltner

In the following situation:

[table]

;Today (time 0) ; Next Year (Yr.1) ;

Probability ; 100% ; 50% ; 50%

Value of Developed Property ; \$1000; \$700; \$1300

Development Cost (exclu land); \$800 ; \$800; \$800

[/table]

Suppose no further value after next year, construction is instantaneous, the riskfree interest rate is 4%, the expected return (OCC) on unlevered investments in developed property is 7.5%, what is the value today of the land? And should development be undertaken now or should you wait.

Check the answer of this question online at QuizOver.com:

Question: [In the following situation table Today time by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/in-the-following-situation-table-today-time-by-prof-david-geltner?pdf=1505>

Interactive Question:

<http://www.quizover.com/question/in-the-following-situation-table-today-time-by-prof-david-geltner?pdf=1505>

4. Chapter: Part VI: Extra-credit question.

1. Part VI: Extra-credit question. Questions

4.1.1. Earn up to 5 points extra credit. It can help you but not hurt you....

Author: David Geltner

Earn up to 5 points extra credit. It can help you but not hurt you.

Describe the call option model of land value. What is the "underlying asset" in this model?

What is the "exercise price"? What is the typical maturity of the land development option?

Check the answer of this question online at QuizOver.com:

Question: [Earn up to 5 points extra credit. It can by Prof. David Geltner](#)

Flashcards:

<http://www.quizover.com/flashcards/earn-up-to-5-points-extra-credit-it-can-by-prof-david-geltner?pdf=1505>

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