**Real Estate Finance II**

**Homework 1**

**Chapters 16 & 17**

**Below are 33 multiple choice questions, each worth 3 points. Highlight the answer you think most correct.**

Chapter 16 Financing Project Development

True False

1. One of the risks of project development is “project risks,” which are the result of unexpected changes in general market conditions affecting the supply and demand for space. (F)
2. In general, developers must get a construction loan before they can line up permanent (long-term) financing that will be used once the project is complete and being operated with tenants. (F)
3. A bullet loan is a construction loan that, in effect, becomes permanent financing when construction is complete. (T)
4. Holdbacks are used by construction lenders to be sure that a developer has met all of his or her obligations before all of the funds from the construction loan are given to the developer. (T)
5. The demand for retail space should be examined in terms of the characteristics of the tenants demand in a given market. (T)
6. Construction loans provide the money to construct a building and are usually provided by life insurance companies or pensions funds. (F)
7. Permanent loans provide the money for a single permanent mortgage loan and are usually provided by commercial banks or mortgage banking companies. (F)
8. Commitments for construction financing are usually contingent on commitments for permanent financing. (T)

Multiple Choice

1. A standby commitment is: (B)
   1. A way to increase NOI for projects with large debt service obligations
   2. An agreement by a lender to provide permanent financing for a property once construction is complete
   3. Another term for a construction loan
   4. The same thing as a take-out loan commitment
2. Which of the following is one reason that construction lenders typically prefer the cost approach to valuation over the income approach? (A)
   1. The cost approach provides a more conservative estimate of value
   2. The cost approach provides a more optimistic estimate of value
   3. The cost approach is a good indication of the expected value of an income-producing property once construction is complete and it has been leased-up
   4. The cost approach is a better estimate of actual market value of the project

|  |  |  |
| --- | --- | --- |
| Units | 275 | 300 |
|  |  |  |
| Gross Revenue | $3,267,000 | $3,564,000 |
| Vacancy | 163,350 | 178,200 |
| Expenses | 1,143,450 | 1,247,400 |
| Net Operating Income | $1,960,200 | $2,138,400 |
|  |  |  |
| Cost | $22,000,000 | $22,800,000 |

1. Consider the table above. An investor-developer demands a return of at least 9 percent on cost. Which of the following statements is TRUE based on the information above? (C)
   1. Neither project produces a sufficient expected return
   2. The 275 unit project produces a sufficient return, but the 300 unit project does not
   3. The 300 unit project produces a sufficient return, but the 275 unit project does not
   4. Both projects produce sufficient return, but the 275 unit project produces a higher return than the 300 unit project
2. Which of the following is the usual progression for a real estate development project? (B)

(A) Land acquisition, completion, management, sale, construction

(B) Land acquisition, construction, completion, management, sale

(C) Land acquisition, construction, completion, sale, management

(D) Land acquisition, management, construction, completion, sale

1. Which of the following is a “soft cost” of construction? (A)

(A) The cost of the architectural drawings

(B) The cost of pouring the foundation

(C) The cost of erecting the building

(D) The cost of finishing the interior space

1. Permanent funding commitments usually contain many funding contingencies. Which of the following typically is NOT one of those contingencies? (A)

(A) Approval of all prospective leases

(B) Approval of design changes or building material substitution

(C) Provisions for gap financing

(D) Minimum rent-up requirements

1. Mini-perm loans usually refer to financing: (D)

(A) At local coffers

(B) For lease-up period

(C) For construction and all subsequent periods

(D) For construction, lease-up, and one or two subsequent years

1. The MOST common method of distributing funds provided by a construction loan is a: (C)

(A) Single lump sum of money at the closing of the loan

(B) Single lump sum of money at the end of the construction project to reimburse the developer for the project’s expenses and profit

(C) Series of payments throughout the construction project to reimburse the developer for costs incurred since the previous payment

(D) Series of payments throughout the construction project to reimburse the developer for anticipated expenses in the upcoming period

1. In comparison to permanent financing, the rates and rate variability for a construction loan would be: (B)

Interest Rates Interest Rate Variability

(A) High Steady

(B) High Fluctuating

(C) Low Steady

(D) Low Fluctuating

1. Interest on a construction loan is usually paid: (D)

(A) Up front at the beginning of the loan

(B) Periodically over the life of the loan

(C) In quarterly installments over the life of the loan

(D) At the end of the loan

Chapter 17: Financing Land Development Projects

True/False

1. Option contracts are used to reserve a parcel of land so that it will not be sold to someone else, while the developer does preliminary analysis of the site. (T)
2. Lenders typically insist on a loan repayment rate that equal to the rate for which parcels are expected to sell. (F)
3. The release price is the dollar amount of a loan that must be repaid when a lot is sold. (T)
4. A feasibility study analyzes whether a tract can be purchased and developed profitably. (T)
5. An option contract does not preclude the landowner from selling the property to someone else after the expiration date. (T)
6. The release schedule refers to a schedule of expiring leases for existing tenants. (F)
7. By using an option contract, a developer may profit from an appreciation in the property’s value over the option period. (T)
8. In most instances, a developer’s repayment rate is set so that the development loan will be repaid at the exact point that 100% of total project revenue is realized. (F)

**MULTIPLE CHOICE**

|  |  |
| --- | --- |
| Total sales revenue | $10,000,000 |
| Less: Development cost | 6,000,000 |
| Less: Land asking price | 1,000,000 |
| Potential gross profit | $3,000,000 |
| Less: Admin., legal, commissions, etc. | 1,500,000 |
| Potential net profit | $1,500,000 |

1. Consider the feasibility study shown in the table above. What is the return on total cost for the proposed project? (A)
   1. 15.0%
   2. 17.6%
   3. 21.4%
   4. 150.0%
2. Refer to the information in the previous question. You have been advised that sales revenues may be 10 percent lower and/or development costs may be 10 percent higher. Performing a sensitivity analysis, you conclude: (A)
   1. A 10 percent decrease in sales revenues would have a bigger impact on returns than a 10 percent increase in development costs
   2. A 10 percent increase in development costs would have a bigger impact on returns than a 10 percent decrease in sales revenues
   3. A 10 percent increase in development costs and a 10 percent decrease in sales revenues would have opposite impacts on returns, canceling each other out and having no impact on returns
   4. Both factors would have such a small impact, that there is no reason to be concerned about either a 10 percent increase in development costs or a 10 percent decrease in sales revenues

|  |  |  |
| --- | --- | --- |
| Month | Construction Draw | Sales Revenue |
| 1 | $200,000 |  |
| 2 | 150,000 |  |
| 3 | 75,000 |  |
| 4 | 25,000 | $600,000 |
|  |  |  |
| Total | $450,000 | $600,000 |
| Present value @ 12% | $441,883 | $576,588 |

1. Consider the table above, which summarizes monthly construction draws and sales revenues. What is the percent of lot sales revenue that needs to be used to repay the loan? (C)
   1. 4.0%
   2. 75.0%
   3. 76.6%
   4. 33.3%
2. The land development industry is best characterized by which of the following statements? (B)

(A) The land development industry is dominated by relatively few national competitors

(B) The land development industry is highly fragmented, localized, and extremely competitive

(C) Land development and project development are synonymous

(D) The production technologies and market risks involved in land development are essentially the same as those in project development

1. Which of the following is the MOST LIKELY sequence of events in the land development process? (C)

(A) Inspect site, perform feasibility analysis, implement marketing program, purchase land and begin construction of improvements

(B) Inspect site, purchase land and begin construction of improvements, perform feasibility analysis, implement marketing program

(C) Inspect site, perform feasibility analysis, purchase land and begin construction of improvements, implement marketing program

(D) Purchase land, perform feasibility analysis, perform preliminary market study, begin construction of improvements, implement marketing program

1. Generally, which of the following is FALSE regarding an option contract? (C)

(A) An option contract allows the developer to perform a preliminary market study and feasibility analysis

(B) If the developer decides to purchase a property, the price of an option is applied towards the price of the property

(C) If the developer decides not to purchase the property, the landowner will refund any money paid for the option

(D) An option contract provides the developer with the assurance that a property will not be sold over the course of the option period

1. Each parcel of land in a new development is selling for $15,000 and the total project revenue is estimated to be $5,000,000. The project lender has stated that the loan should be paid off when 80% of the total project revenue has been earned. The total loan amount is $3,500,000. What is the release price for each parcel? (B)

(A) $8,400

(B) $13,215

(C) $18,750

(D) None of the above