**Corporate Finance**

**Tutorial**

**Homework:**

**Capital Budgeting and Leverage**

 **Debt Financing**

**Leasing**

Following are 25 questions, each worth four points. For the Multiple Choice questions, select the answer you think is most correct.

**Budgeting and Leverage: Chapter 18**

1) Which of the following is NOT one of the simplifying assumptions made for the three main methods of capital budgeting?

A) The firm pays out all earnings as dividends.

B) The project has average risk.

C) Corporate taxes are the only market imperfection.

D) The firm's debt-equity ratio is constant.

2) Which of the following methods are used in capital budgeting decisions?

A) WACC method

B) APV method

C) FTE method

D) All of the above are used in capital budgeting decisions.

3) The assumption that the firm's debt-equity ratio is constant means:

A) the firm's cost of capital will not fluctuate when it accepts a new project.

B) corporate taxes are the only imperfection.

C) the risk of its debt and equity will change when it accepts a new project.

D) the firm adjusts its leverage to maintain a constant debt-equity ratio in terms of book value.

4) Consider the following equation:

*rwacc = rE + rD*(1 - *τc*)

the term *E* in this equation is:

A) the dollar amount of equity.

B) the dollar amount of debt.

C) the required rate of return on debt.

D) the required rate of return on equity.

5) Consider the following equation:

*rwacc = rE + rD*(1 - *τc*)

the term *D* in this equation is:

A) the dollar amount of debt.

B) the required rate of return on equity.

C) the required rate of return on debt.

D) the dollar amount of equity.

6) Consider the following equation:

*rwacc = rE + rD*(1 - *τc*)

the term *rE* in this equation is:

A) the after tax required rate of return on debt.

B) the required rate of return on debt.

C) the required rate of return on equity.

D) the dollar amount of equity.

7) Consider the following equation:

*rwacc = rE + rD*(1 - *τc*)

the term *rD*(1 - *τc*) in this equation is:

A) the required rate of return on debt.

B) the dollar amount of equity.

C) the after tax required rate of return on debt.

D) the required rate of return on equity.

8) Consider the following equation:

*Dt = d × *

the term *Dt* in this equation is:

A) the firms target debt to value ratio.

B) the firms target debt to equity ratio.

C) the investment's debt capacity.

D) the dollar amount of debt outstanding at time t.

9) Consider the following equation:

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the term *d* in this equation is:

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C) the firms target debt to equity ratio.

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**Debt Financing: Chapter 24**

10) Treasury securities that are semiannual-paying coupon bonds with maturities longer than 10 years are called:

A) Treasury bonds.

B) TIPS.

C) Treasury bills.

D) Treasury notes.

11) Which of the following statements regarding municipal bonds is FALSE?

A) A single municipal bond issue will often contain a number of different maturity dates. Such issues are often called multi-muni bondsbecause the bonds are scheduled to mature over a multiple number of years.

B) Revenue bonds are where the local government pledges specific revenues generated by projects that were initially financed by the bond issue.

C) Municipal bonds are sometimes also referred to as tax-exempt bonds.

D) Bonds backed by the full faith and credit of a local government are known as general obligation bondsand are not as secure as bonds backed by the full faith and credit of the federal government.

12) Which of the following statements is FALSE?

A) Mortgage-backed securities, such as GNMAs, are pass-throughsecurities. That is, each security is backed by an underlying portfolio or poolof mortgages.

B) The Government National Mortgage Association (GNMA, or "Ginnie Mae") is an example of an enterprise; the Student Loan Marketing Association ("Sallie Mae") is an example of a government-sponsored agency.

C) Sovereign debt is debt issued by national governments.

D) Agency securitiesare issued by agencies of the U.S. government or by U.S. government sponsored enterprises.

13) Packaging a portfolio of financial securities and issuing an asset-backed security backed by this portfolio is known as:

A) asset securitization.

B) revenue securitization.

C) backup securitization.

D) payment securitization.

15) A(n) \_\_\_\_\_\_\_\_ cash flows come from the cash flows of underlying financial securities.

A) general obligation security's

B) revenue bond's

C) asset-backed security's

D) double-barreled bond's

16) The largest sector of the asset-backed security market is the \_\_\_\_\_\_\_\_ market.

A) collateralized debt obligation

B) mortgage-backed security

C) real property-backed security

D) double-barreled security

17) When banks resecuritize other asset-backed securities, the new asset-backed security is known as a:

A) mortgage-backed security.

B) double-barreled security.

C) collateralized debt obligation.

D) resecuritized security.

**Leasing: Debt By Another Name: Chapter 25**

18) Which of the following statements is FALSE?

A) Leasing allows the party best able to bear the risk to hold it. For example, small firms with a low tolerance for risk may prefer to lease rather than purchase assets.

B) When the lessor is the manufacturer, a lease in which the lessor bears the risk of the residual value can improve incentives and lower agency costs.

C) For leases in which the lessor retains a substantial interest in the asset's residual value, the lessee has more of an incentive to take proper care of an asset that is leased rather than purchased.

D) Whether they appear on the balance sheet or not, lease commitments are a liability for the firm.

***Use the information for the question(s) below.***

St. Martin's Hospital plans to purchase or lease a $2 million dollar CT scanner. If purchased, the CT scanner will be depreciated on a straight-line basis over five years, after which it will be worthless. If leased, the annual lease payments will be $500,000 per year for five years. St. Martin's borrowing cost is 8%, and its tax rate is 35%.

19) If St. Martin purchases the CT scanner, what is the amount of the lease-equivalent loan?

Hint: construct the FCF from leasing and buying.

20) Is St. Martin's better off leasing the CT scanner or financing the purchase of the CT scanner with a lease-equivalent loan and by how much is St Martin's better off?

Hint: construct the FCF from leasing and buying.

21) A lease that gives the lessee the option to purchase the asset at its fair market value at the termination of the lease is called a:

A) fair market value cap lease.

B) fair market value lease.

C) $1.00 out lease.

D) fixed price lease.

22) A lease where ownership of the asset transfers to the lessee at the end of the lease for a nominal cost is called a:

A) fair market value cap lease.

B) fixed price lease.

C) $1.00 out lease.

D) fair market value lease.

23) A lease where the lessee has the option to purchase the asset at the end of the lease for a set price that is set upfront in the lease contract is called a:

A) fixed price lease.

B) $1.00 out lease.

C) fair market value lease.

D) fair market value cap lease.

24) A lease where the lessee can purchase the asset at the minimum of its fair market value and a fixed price is called a:

A) $1.00 out lease.

B) fixed price lease.

C) fair market value lease.

D) fair market value cap lease.

*Use the information for the question(s) below.*

Suppose the purchase price of a bulldozer is $90,000, its residual value in four years is certain to be $15,000, and there is no risk that the lessee will default on the lease. Assume that capital markets are perfect and the risk-free interest rate is 6% APR with monthly compounding.

25) The monthly lease payments for a four year lease of the bulldozer are closest to:

A) $1870

B) $1825

C) $1750

D) $2115