Chapter 14 Multiple Choice Questions

1. In a financial decision making framework, ______ can be defined as uncertainty about the rate of return an investment will provide over the holding period.
   a. risk  
   b. annuity  
   c. discounting  
   d. compounding

2. ______ is defined as uncertainty arising from changing economic conditions that affect an investment’s ability to generate returns.
   a. Business risk  
   b. Financial risk  
   c. Purchasing power risk  
   d. Liquidity risk

3. ______ is defined as uncertainty arising from the possibility of defaulting on borrowed funds used to finance an investment.
   a. Business risk  
   b. Financial risk  
   c. Purchasing power risk  
   d. Liquidity risk

4. ______ is defined as the possibility of loss resulting from not being able to convert an asset into cash quickly should the need arise.
   a. Business risk  
   b. Financial risk  
   c. Purchasing power risk  
   d. Liquidity risk

5. Given a fully amortizing mortgage, which of the following is true?
   a. A higher interest rate results in lower periodic payments.  
   b. A longer term results in larger periodic payments.  
   c. As the loan term increases, the amortization rate decreases.  
   d. Higher interest rates result in higher amortization rates.
6. Which of the following is **not** a characteristic of risk?
   a. The greater the uncertainty, the greater the risk.
   b. The greater the potential risk, the greater the potential return investors will expect.
   c. The later the cash flows are expected to be received, the greater the risk.
   d. The shorter the expected holding period, the greater the risk.

7. _______ risk, the risk of having to sell an asset at a lower than market price if you must sell it quickly, is present in real estate.
   a. Purchasing power  
   b. Business  
   c. Liquidity  
   d. Financial

8. To reduce the risk to the **borrower**, adjustable rate mortgages typically have
   a. an interest rate cap.  
   b. a wraparound clause.  
   c. a prepayment clause.  
   d. negative amortization.

9. The value of money to be received in the future is _______ the value of the same amount of money in hand today.
   a. higher than  
   b. lower than  
   c. the same as  
   d. None of the above

10. The concept of compound interest refers to
    a. the process of gradually retiring a debt through periodic payments of principal and interest.
    b. the process of servicing a debt with regular interest payments, followed by a lump sum payment of principal and interest at the end of the loan term.
    c. the process of converting future lump sums and annuities into present values at a stated interest rate.
    d. the process of earning interest on an original amount, plus interest on interest previously earned.
11. An investor has an opportunity to purchase an investment that will provide $11,000 at the end of three years, and $50,000 at the end of five years. If the property is expected to be sold at the end of the sixth year for $100,000 and the investor requires a 12% rate of return, what amount should he or she pay for the investment today?
   a. $161,000
   b. $50,663
   c. $81,568
   d. $86,864

12. Julie wishes to begin making monthly deposits into a savings account that earns 5% interest annually. If she intends to have saved $8,500 by the end of 3 years, how much must she deposit each month?
   a. $219
   b. $236
   c. $474
   d. $225

13. Suppose an investor buys a property today for $70,000. If it increases in value by 10% each year, what will it be worth at the end of three years?
   a. $77,000
   b. $84,700
   c. $93,170
   d. none of the above

14. Suppose an investor expects to sell a property two years from now for $84,700. If the investor requires a 10% rate of return, how much is that property worth to the investor today?
   a. $70,000
   b. $77,000
   c. $84,700
   d. $93,170

15. You are buying a $62,000 house for 10% down, with the rest financed at 11 3/4% for 30 years with fixed monthly payments. You must pay 2 points for the loan. What is your monthly loan payment?
   a. $551.62
   b. $577.42
   c. $563.25
   d. $574.52
16. Use the information from the previous problem. At the end of 4 years, you sell the house. How much do you owe on the loan?
   a. $53,641  
   b. $54,772 
   c. $54,180  
   d. $55,868

17. John Jones is buying a house for $100,000. John can get a loan for 95% of the purchase price at 8% with monthly payments for a 25-year term. What would his payments be if he borrows under these terms?
   a. $620.67  
   b. $771.81 
   c. $733.23  
   d. $718.56

18. You have made 60 monthly payments of $500 at 8.5% annual interest. You have 300 payments left on the loan. If you sell the house and must pay off this loan, how much do you owe the lender?
   a. $18,000  
   b. $62,094 
   c. $24,371  
   d. $65,027