Chapter 15 Multiple Choice Questions

1. Amortization is the
   a. practice of charging interest on a loan.
   b. process of gradually retiring a debt by periodic payments.
   c. compounding of interest.
   d. use of debt to enhance the rate of return.

2. When a mortgage loan with level periodic payments has been completely repaid by the maturity date, it is said to be
   a. capitalized.
   b. reamortized.
   c. depreciated.
   d. fully amortized.

3. Loans made for a stated term on which interest payments are due periodically but whose principal is not repaid until the end of the term are called _______ loans.
   a. amortized
   b. depreciated
   c. adjustable
   d. interest-only term

4. Which of the following statements does not apply to employing the amortization method of repaying a mortgage loan? The amount of the
   a. interest payment decreases each period.
   b. payment applied to principal repayment decreases each period.
   c. payment applied to principal reduction increases each period.
   d. interest is based on the remaining principal.

5. How many discount points are necessary to raise the yield of a 12% loan with 360 monthly payments of $514.30 to 12.42%? (hint - find the present value of the annuity under each interest rate then examine the difference!)
   a. 1
   b. 3
   c. 2
   d. 4
6. A buyer can afford no more than $500 per month in payments. The most favorable loan available in the market is a 30 year loan at 10%. What is the maximum affordable house with a 10% down payment?

   a. $55,000  
   b. $63,306  
   c. $59,975  
   d. $69,636

7. Bill and nine of his friends each contributed $10,000 to form a real investment group. The group then purchased a small retail center for $350,000 using an interest-only loan for $250,000 at 10% annual interest. At the end of one year, the building was sold for $410,000. What is the rate of return on Bill’s investment?

   a. 60%  
   b. 17%  
   c. 35%  
   d. 15%

8. A lender makes a $90,000 mortgage at 9% interest with monthly payments for 25 years. How much principal will be repaid during the fourth year of the loan?

   a. $7,749  
   b. $1,314  
   c. $1,376  
   d. $7,787

9. A real estate investment is expected to return to its owner $3,500 per year for 16 years after expenses. At the end of year 16, the property is expected to be sold for $49,000. Assuming the required rate of return is 14% for investments with this degree of risk, what is the net present value of this property if the purchase price is $28,000 today?

   a. ($51)  
   b. $27,949  
   c. ($90)  
   d. $27,210

10. In the previous problem, which statement best describes the internal rate of return (IRR) of the investment?

    a. The IRR is greater than 14%  
    b. The IRR is less than 14%  
    c. The IRR may be less than or greater than 14%  
    d. The IRR is zero
Information for the next two questions:

Consider an adjustable rate mortgage of $90,000 with a maturity of 30 years and monthly payments. At the end of each year, the interest rate is adjusted to become two percentage points above the index. There is an annual cap of 300 basis points (3%), and a lifetime cap of 500 basis points (5%). In the first year the contract rate is 7%, with no teaser. In year two, the index rate is 9%.

11. What is the contract rate in year two?
   a. 8%
   b. 10%
   c. 9%
   d. 11%

12. What monthly payment is called for in year two?
   a. $786
   b. $795
   c. $599
   d. $648

13. If the initial contract rate on an ARM is 6%, the second year contract rate is 9%, the margin is 2%, the life of the loan cap is 5%, and the annual cap is 3%, what is the contract rate for year three if the index is 9%?
   a. 13%
   b. 12%
   c. 8%
   d. 11%

Consider the following information for the next two questions regarding an ARM loan:

The index for year one is 6%, the margin is 2%, the lifetime cap is 6%, the annual cap is 2%, and the first-year-only teaser is 1%.

14. What is the first year contract rate?
   a. 6%
   b. 7%
   c. 8%
   d. 12%
15. The maximum interest rate allowable during the life of the mortgage is
   a. 12%.
   b. 13%.
   c. 14%.
   d. There is no maximum

16. A borrower is offered a mortgage loan for $100,000 with an interest rate of 10% and a 30-year amortization period with monthly payments. The origination fee is 1% of the loan and the lender charges two discount points. What is the effective interest rate?
   a. 10%
   b. 9%
   c. 10.37%
   d. 10.24%

17. A __________ mortgage has mortgage payments reestablished once during the life of the loan.
   a. two-step
   b. adjustable rate
   c. fixed rate
   d. variable rate

18. Two-step mortgages are attractive to
   a. borrowers who expect to own the property for the entire length of the loan.
   b. low-risk borrowers.
   c. borrowers who do not qualify for other loan types.
   d. borrowers who don’t expect to own the property for the entire length of the loan.