

# Advanced Finance Test

Spring 2005 – Robert Rooks

1. Real Property that is held for investment, more specifically, property that is held for use in trade, or investment, is entitled to preferential treatment for tax purposes. This means that when the property is sold the gain is taxed at;
  - a. **Long Term Capital Gains rates.**
  - b. Short Term Capital Gains rates
  - c. Normal rates according to total income.
  - d. Special dealer rates.
  
2. When loans are more desirable investments than other loans. The desirability of a loan is classed as the type of paper that it is considered to be. These classifications are normally;
  - a. **A, B, C, and D paper**
  - b. According to risk factors R-1, R-2, R-3, R-4 etc.
  - c. Priority A, Priority B, Priority C, etc.
  - d. Sections, as in Section 1 paper, Section 2 paper.
  
3. Lenders specialize in certain types of loans. This should lead you to;
  - a. Go to a mortgage banker for most loans
  - b. **Try and find the loan you need from a lender who specializes in that type of loan**
  - c. Search the internet for lenders
  - d. Commercial banks normally have the greatest selection of loans.
  
4. Loans are classified according to risk. The most desirable loan for most lenders is;
  - a. Single family home loans
  - b. Loans on small shopping centers
  - c. **Single family, owner occupied, home loans**
  - d. Large commercial loans
  
5. The most common loans used today are;
  - a. **Fully amortized loans with monthly payments**
  - b. Interest only loans with monthly payments
  - c. Partial interest loans with monthly payments
  - d. Interest only loans with quarterly payments

6. A Loan constant is;
- The amount of money necessary to amortize one dollar, at a given interest rate, for a given period of time.**
  - Interest rate for a given period of time
  - The amount of the monthly payment
  - The interest rate on the loan often called the Nominal Rate
7. Some loans are written as though fully amortized, but they have a due date preceding the date the loan would be fully amortized. These loans are normally referred to as;
- Bullet loans
  - Loans with “Balloon Payments”
  - Partially amortized loans
  - All of the above**
8. When a loan has a payment that is insufficient to pay the interest due they are called;
- Negative Amortization Loans**
  - Not-fully amortized loans
  - Reverse Equity loans
  - Partial loans
9. Adjustable Rate loans can be powerful tools. Many people avoid them because;
- They are hard to get
  - The adjustments are too great and too often
  - The payor can end up paying the loan off before it is due
  - The uncertainty the borrower feels exists.**
10. Adjustable rate loans use a financial index to determine the monthly interest rate on the loan. One example of a financial index is;
- Consumer Price Index (CPI)
  - The Federal Adjustable Funds Index (FAFI)
  - The Eleventh District Monthly Cost of Funds Index (CFI)**
  - FHA Monthly Cost of Funds Indicator (FMCFI)
11. Normally an adjustable rate loan is desirable because;
- It will be paid off sooner than a fixed rate loan
  - The monthly payment will be less initially**
  - The borrower can put less down
  - There are only eleven payments each year

12. One beneficial quality of the Adjustable Rate Mortgage today is;
- The rate never goes up
  - The payment cannot increase more than 2% annually
  - The borrower can qualify for a greater loan**
  - These loans are always amortized in fifteen years
13. Acceleration clauses in loans mean that at the happening of a pre-stated event;
- Payments have to be made more quickly than agreed
  - The loan becomes due and payable**
  - The interest rate will increase at a pre-determined amount
  - The borrower can borrow additional amounts of money, increasing the face amount of the loan
14. Interest Rate Buy Downs are normally considered to be a ratio of 6 to 1. What does this mean?
- Someone would have to pay 6% of the face value of the loan to reduce the annual interest rate 1%.**
  - The borrower can pay six payments in advance and reduce the annual interest rate by 1%
  - The borrower will have to borrow 6% more and pay it to the lender to lower the effective interest rate 1%
  - The lender will lower the interest rate 1% if the borrower has a 6A Credit Rating
15. The stated interest rate, or the face interest rate on a loan is often referred to as;
- The Effective Rate
  - The Internal Rate of Return
  - The Actual Rate
  - The Nominal Rate**
16. The loan to value is;
- A ratio of the property value to the market value
  - A ratio of the loan to the current market value of the property**
  - A ratio of all the loans in a model sampling of properties, against the total value of the properties involved in the study
  - Always 70% of the value of the property

17. When lenders restrict the “Loan to Value” ratio on properties, it is a common practice to increase the LTV by;
- Selling part of the land to raise cash
  - Having the seller carry a 2<sup>nd</sup> Trust Deed or Mortgage**
  - Leasing the property instead of purchasing. (Lease Option)
  - Sub-dividing the property.
18. The mortgage business can be looked at from the standpoint of three positions, or three primary participants.
- The borrower, the arranger, and the investor**
  - The borrower, the loan servicer, and the bank
  - The bank, the underwriter, and the appraiser
  - The escrow company, the borrower, and the appraiser
19. The borrower’s primary concern with a loan is;
- The desirability of the purchase and their ability to handle the monthly payment**
  - The total cost of the loan, points, appraisal fees, etc., and the monthly payment
  - The points charged, the interest rate, the length of the loan, and the quality of their purchase
  - The relationship with the lender, the servicing of the loan, the length of the loan, and the interest rate
20. The borrower has many interest rates involved in any loan they get. Which of the following are rates that a borrower would be most concerned with?
- The Overall Rate, and the Internal Rate of Return
  - The Effective Interest Rate, and the Annual Percentage Rate
  - The After Tax Rate, and the Effective Rate
  - The Nominal Rate, and the Annual Percentage Rate**
21. Most interest paid on real property loans can be;
- Depreciated over the life of the loan
  - Deducted annually, creating a tax savings**
  - Added to the tax basis of the property
  - Deducted from taxes owed, annually
22. The term “Amortized” most clearly indicates that;
- The loan is gradually, but sporadically, being reduced
  - Part of each payment is interest and part of each payment is principal**
  - The loan will last for a certain period of time
  - The loan will be reduced annually

23. The formula for the “Present Value” value of money is;
- a.  $\frac{1}{(1+i)^n}$
  - b.  $(1+i)^n$
  - c.  $(1+i)^n - 1$
  - d.  $1 - (1+i)^n$
24. The average, long term, appreciation rate in Southern California is;
- a. **5% Annually**
  - b. 1% Monthly
  - c. 10% Annually
  - d. 2% Annually
25. If a property currently has a 70% loan in the amount of \$700,000, the market value of the property will be;
- a. \$ 910,000
  - b. \$2,330,000
  - c. \$1,190,000
  - d. **\$1,000,000**
26. If a property has a \$700,000 loan, and the current market value of the property is \$1,000,000, the property is said to have a “Loan to Value Ratio” (LTV) of;
- a. 30%
  - b. **70%**
  - c. 130%
  - d. 142.8%
27. The Annual Percentage Rate (APR) is;
- a. The same as the Nominal Rate
  - b. **Is an attempt to measure all the costs of that loan as an interest rate**
  - c. Is the true rate of that loan
  - d. Was created to standardize loans

28. Loans have many benefits to buyers. One loan benefit for buyers is;
- a. Makes commodities that would normally be difficult or impossible to purchase attainable.
  - b. Allows consumers to purchase immediately, commodities that would take many years of savings to obtain.
  - c. Allows the consumer to purchase appreciating, long term, commodities at today's prices for immediate use
  - d. All of the above**
29. The "Arranger" of loans would include;
- a. Mortgage brokers
  - b. Mortgage bankers
  - c. Institutional lenders
  - d. All of the above**
30. The "Arranger" of loans is normally paid by;
- a. The seller
  - b. The buyer**
  - c. Through loan points charged up front
  - d. By the Federal National Mortgage Association
31. Some Arrangers of loans create additional income by;
- a. Servicing the loans for a fee
  - b. Selling the servicing rights on loans that they create or are servicing
  - c. Discounting and selling portfolio loans
  - d. All of the above**
32. In California most loans are arranged through Mortgage Brokers. Mortgage Brokers currently arrange what percentage of California loans?
- a. 25%
  - b. 75%
  - c. 50%
  - d. 66%**
33. Mortgage Brokers are;
- a. Real Estate Brokers who arrange loans**
  - b. Licensed by the Department of Real Property Lending (DRPL)
  - c. Licensed by the Department of Corporation
  - d. Licenses are not required to do Mortgage Brokering

34. Most loan funds for real estate loans come from;
- Savings accounts
  - Bonds, retirement funds, and mutual funds**
  - The Federal Government
  - Bonds sold by the State of California
35. The largest buyers of packaged or warehoused loans are;
- The Federal Government
  - Insurance companies
  - The stock market
  - Fannie Mae & Freddie Mac**
36. A marginal tax bracket is a numerical percentage that indicates;
- How much of the next dollar of tax deduction will save in taxes
  - How much of the next dollar of earnings will be paid in taxes
  - How much money the tax payer is earning
  - Both a and b are correct**
37. A tax deduction differs from a tax credit in what respect?
- Tax credits are dollar saved per dollars of credit, tax deductions save a percentage of the deduction**
  - Tax credits and tax deductions are the same thing
  - Tax deductions save one dollar for each dollar of deduction, tax credits save a percentage of each dollar of tax credit
  - Tax credits are good for real estate earnings, tax deductions are used for ordinary income
38. When an asset appreciates in value it indicates that;
- A tax write off has been created
  - The face value of the asset has increased**
  - The loan has decreased while the face value of the asset has remained the same
  - The improvements have created a write off
39. When we want to impress a buyer of an owner occupied home with their real loan payment on real estate assets, we have to make the buyer aware of;
- Cash flow and tax savings
  - Tax savings and equity build-up
  - Tax savings, equity build-up, and appreciation**
  - Tax savings, equity build-up, appreciation and cash flow.

40. The formula for the future value of money is;
- $\frac{1}{(1+i)^n}$
  - $(1+i)^n$**
  - $(1+i)^n - 1$
  - $1 - (1+i)^n$
41. The final investor in the loan process is;
- The person or entity that actually makes the funds available for lending**
  - The Mortgage Banker
  - The Mortgage Broker
  - The bank or lending institution
42. Investors invest in loans for many reasons one reason is;
- Income to live on or reinvest
  - Preservation of capital
  - Relative safety with a moderately high return
  - All of the above are good reasons**
43. The investor of loans is taxed on;
- The Principal part of the payment
  - The Principal and Interest part of the payment
  - There are no taxes on income generated from loan investments
  - Interest part of the payment only**
44. Returns from loans are often calculated after first estimating
- The after tax return
  - The after inflation return
  - Both the after tax and after inflation return**
  - The annual percentage rate
45. Using the “Rule of 72”, if rents are increasing 5% annually, how long will it be until a renters rent doubles?
- 8 Years
  - 14 Years and 5 Months**
  - 12 Years
  - 14 Years

46. There is an important relationship between time and the value of money. That relationship underlines this fact;
- a. \$1 in one year is worth \$1
  - b. \$1 today is worth \$1**
  - c. \$1 in five years is without value
  - d. \$1 in five years is worth 20¢
47. Time value of money has to do with two main concepts;
- a. Present Value and Future Value**
  - b. Annuities
  - c. Savings plans
  - d. Retirement accounts
48. When money is earning interest we become concerned with two types of interest. These two types of interest are;
- a. Simple Interest and Compound Interest**
  - b. Periodic Interest and Static Interest
  - c. Actual Interest and Perceived Interest
  - d. Before Tax Interest and After Tax Interest
49. Interest can be calculated from the:
- a. Beginning of a period
  - b. End of the period
  - c. In the middle of a period
  - d. Either the beginning or the End of a period**
50. The main difference between Compound Interest and Simple Interest is;
- a. Interest is, or is not charged on interest**
  - b. Compound interest has to be charged at the beginning of the period
  - c/ Simple interest earns interest on interest
  - d. Compound Interest means that the interest is not earned on interest that has already been earned
51. Money placed in a savings account begins to earn interest immediately. This is an example of a;
- a. A begin financial problem**
  - b. An end financial problem
  - c. A simple interest financial problem
  - d. A non-accruing financial problem

52. Regarding real estate loans the interest is due at the;
- Beginning of the period
  - At the end of the period**
  - Payoff of the loan
  - End of the year
53. A loan compounding period is;
- The point in time when the interest is calculated**
  - The point in time when the interest is due
  - The point in time when the payment is made
  - The point in time when the loan is due
54. Compounding periods occur;
- Only at the end of each month
  - Only at the end of each day
  - Only annually
  - Any agreed upon period of time**
55. The rule of 72 means;
- You can't legally charge more than 72% interest without breaking the usury laws
  - Is a method of economically checking the feasibility of improvements and repairs
  - You can divide any interest rate into 72 to determine how long it will take to double the original amount of money**
  - Both b and c are correct
56. The payments on amortized real estate loans can be determined by using;
- A financial calculator
  - Amortization tables
  - A loan constant
  - Any of the above**
57. The preferred method of finding loan payments, equity build-up, principal paid, interest paid, future loan balances is;
- Financial tables such as the "Blue Book".
  - Financial Calculators**
  - Logarithms
  - Formulas contained in the "Six Functions of One Dollar".

58. The “Internal Rate of Return” is used, primarily, to determine a usable interest rate on.
- All loans
  - Uneven Cash Flows**
  - Amortized loans with equal periodic payments
  - Interest only loans
59. Three contemporary and archaic methods of measuring the returns on investments are;
- Actuary Tables, Annual Percentage Rates, Simple Interest Rates
  - Simple Interest Rates, Financial Management Rate of Return, Average Annual Interest Rate
  - Internal Rate of Return, Nominal Rate, Annual Percentage Rate
  - Average Annual Interest Rate, Effective Rate, Simple Interest Rate**
60. Real Estate has several tax benefits. The main areas of tax benefits involved in real estate are;
- Depreciation Deductions, Interest Deductions, Property Tax Deductions**
  - Depreciation Deductions, Property Tax Deductions, Cash Flow Deductions
  - Vacancy Deductions, Expense Deductions, Net Operating Income Deduction
  - Interest Deduction, Real Property Tax Deduction, Land Depreciation Deduction
61. Income tax benefits occur at three primary junctures during the ownership of real property. Those three junctures are;
- Prior to acquisition, during acquisition, after acquisition
  - upon acquisition, during ownership, upon disposition**
  - Upon acquisition, while filing taxes, when calculating improvements and repairs
  - Upon acquisition, when considering improvements, upon disposition
62. Familiarization with real estate taxation is beneficial, even critical for real estate licensees, and appraisers for;
- More prudent and profitable property management
  - Better understanding of tax consequences upon disposition of property
  - For a better understanding of the profitable use of the IRC 1031 tax deferred exchange, normal sales, and the installment sale
  - All of the above**
63. The three basic types of income are;
- Regular Income, Investment Income, and Portfolio Income
  - Normal Income, Other Income, Portfolio Income
  - Passive Income, Active Income, and Regular Income
  - Active Income, Passive Income, and Portfolio Income**

64. Real estate income for investors is classified as;
- Normal Income
  - Passive Income**
  - Active Income
  - Portfolio Income
65. Upon the sale of real property the taxable gain involved in that sale is treated as;
- Long or Short Term Capital Gains Income**
  - Active Income
  - Regular Income
  - Portfolio Income
66. Capital Gains Income normally gets preferential tax treatment. Preferential tax treatment means;
- If the asset was held for more than one year the Federal Tax Rate is reduced to from 15% to 20% and the California State Rate is reduced to 5.5%
  - If the asset was held for less than one year the gain is treated as ordinary income
  - If held for more than two years the Federal Rate is 15% and the State Rate is 3%
  - Both a and b are correct**
67. Income producing properties produce four areas of return that are considered critical in the analysis of the investment;
- Cash Flow, Depreciation, Tax Write Off, and Equity Build-Up
  - Cash Flow, Tax Savings, Equity Build-Up, and Appreciation**
  - Cash Flow, Tax Savings, After Tax Cash Flow, Before Sale Equity
  - After Tax Cash Flow, Appreciation, Equity Build-Up, Expenses as a Write Off
68. Gross Rent Multipliers can be annual or monthly. Gross Rent Multipliers are;
- A numbers that when multiplied by the Gross Scheduled Income will indicate the buildings value.**
  - A number that when multiplied against the Net Operating Income will give the building value
  - A number that when divided by the buildings value will give the Net Operating Income
  - A number that when divided by the value of the building will give the capitalization rate

69. Capitalization Rates are a percentage that;
- a. When multiplied against the Net Operating Income gives the buildings value
  - b. A number that when multiplied against the buildings value will give the Net Operating Income
  - c. When divided into the Net Operating Income give the buildings value
  - d. **Both b and c are correct**
70. The 1% Rule is a tool or shortcut used to estimate the value created by a cash flow. Which of the following are true?
- a. If a rent was raised from \$1,000 to \$1,100, the building would increase \$10,000
  - b. If you decided to put air conditioning in each apartment in an apartment building at a cost of \$700 per each unit, and because of the air conditioning you could raise the rents \$7, the air conditioning would pay for itself
  - c. If you had the land to add two more apartment units at a cost of \$100,000, you would have to get \$500 per unit for the construction to be economically feasible
  - d. **All of the above are correct**
71. After Tax Cash Flow (ATCF) is;
- a. The cash received after the sale of a building
  - b. The net operating income after the depreciation has been deducted
  - c. The cash received from a refinance
  - d. **The cash flow and the annual tax savings**
72. Gross Equity is;
- a. **The difference between the Market Value, the loan balance, and the expenses of sale**
  - b. The difference between the Market Value, the loan balance, the expenses of sale, and any taxes due on the gain from the sale
  - c. The difference between the Sales Price, and the expenses of sale
  - d. The difference between the Market Value and the loan balance
73. The term “Net Equity “ normally refers to;
- a. **The difference between the Market Value, the loan balance, and the expenses of sale**
  - b. The difference between the Market Value, the loan balance, the expenses of sale, and any taxes due on the gain from the sale
  - c. The difference between the Sales Price, and the expenses of sale
  - d. The difference between the Market Value and the loan balance

74. After Tax Net Equity refers to;
- a. The difference between the Market Value, the loan balance, and the expenses of sale
  - b. The difference between the Market Value, the loan balance, the expenses of sale, and any taxes due on the gain from the sale**
  - c. The difference between the Sales Price, and the expenses of sale
  - d. The difference between the Market Value, the loan balance, the expenses of sale, and any taxes that are due because of realized gain.
75. Home owners have some annual tax benefits. Home owner's benefits are less than the tax benefits of income producing property owners. Home owner's tax deductions are normally limited to;
- a. Interest on the loans on that property
  - b. Interest on loans, and real property taxes.**
  - c. Depreciation, real property taxes, and interest on loans on that property
  - d. Expenses of maintenance, interest on loans, depreciation, and real property taxes
76. Homeowners are entitled to a "Tax Exemption". This exemption amounts to;
- a. \$250,000 for individuals or \$500,000 for married couples, if they have lived in the property for two of the last five years.**
  - b. \$250,000 per couple, if they have lived in the property for two of the last five years.
  - c. \$500,000 for any owners who have lived in the property for the past two years.
  - d. \$500,000 for any owners who have lived in the property for the past five years.
77. The homeowners initial payment of principal and interest, with insurance and real property taxes, but considering tax benefits;
- a. The payments on their loans after taxes are greater than the basic loan payment
  - b. The payments on their loans are usually lower than the basic payment, even with taxes and insurance**
  - c. The payments on their loan is normally equal to the principal and interest, even after taxes and insurance.
  - d. The payments on their loan is normally slightly higher than the Principal and Interest, the tax savings covers part of the real property taxes and most of the insurance

The following questions are based on this information;

You purchase a four-plex as follows;

Gross Scheduled Income	\$48,000				
Vacancy Factor 2%	(\$ 960)				
Gross Operating Income	\$47,040				
Expenses of Operation 25%	(\$12,000)				
Net Operating Income	\$35,040				
New 1 <sup>st</sup> Trust Deed	<u>(\$33,930)</u>	=		\$425,000 @7%, amortized 30 years	
Cash Flow	\$ 1,110				
Total Loans	-	-	-	-	\$425,000
Cash Down Payment 30%					<u>\$185,000</u>
Purchase Price of Four Plex					\$610,000

78. Based on this information the Gross Rent Multiplier is;

- a. 12.97 Times Gross
- b. 12.71 Times Gross**
- c. 17.41 Times Gross
- d. 14.28 Times Gross

79. According to this information the Capitalization Rate is;

- a. 6.193%
- b. 7.87%
- c. 7.71%
- d. 5.744%**

80. According to this information the Cost Per Unit is;

- a. \$106,250
- b. \$152,500**
- c. \$ 46,250
- d. \$160,000

81. Based on this information the Cash on Cash is;

- a. 0.6%**
- b. 6.14%
- c. 18.94%
- d. 25.95%

82. Based on the capitalization rate of 5.75%, if the rents were increased to show a Gross Scheduled Income of \$52,000, the vacancy factor was still 2%, and the expenses of operation remained 25%, the buildings value would;
- a. Increase by \$ 50,174
  - b. Increase to \$660,174**
  - c. Increase to \$677,000
  - d. Both a and b are correct
83. 99.9999% of 1031 Tax Deferred Exchanges are;
- a. Two way exchanges
  - b. Three way exchanges**
  - c. Multiple use property exchanges
  - d. Four way, or more, exchanges
84. There are three parties in the Three Way Exchange. Those parties are;
- a. The buyer, The Seller, and the Appraiser
  - b. Two Buyers, and the Exchanger
  - c. A Seller, a Buyer, and an Exchanger**
  - d. A Seller and Two Exchangers
85. In the Tax Deferred Exchange, we speak of “Concurrent Closings”, concurrent closings mean that all of the properties close at approximately;
- a. The same time**
  - b. Within 72 hours
  - c. Not later than one month
  - d. That week
86. In the 1031 Tax Deferred Exchange the “Delayed Close is permitted today. The “Delayed Close” means;
- a. Concurrent closings are not necessary
  - b. The downleg property, the exchanger’s property, can close before the upleg property. (“The exchanged into property”)
  - c. The downleg can close before the upleg, but on the same day
  - d. Both a and b are correct**

87. The “Delayed Exchange” differs from the “Delayed Close” in what respect?
- a. In the Delayed Close. The exchanger has not identified the upleg (exchanged into property) when the downleg (exchanged out of property) closes. In the Delayed Exchange, the upleg has been identified and closes soon after the downleg. However, there is not a concurrent closing.
  - b. In the Delayed Exchange. The exchanger has not identified the upleg (exchanged into property) when the downleg (exchanged out of property) closes. In the Delayed Close the upleg has been identified and closes soon after the downleg. However, there is not a concurrent closing.**
  - c. In the Delayed close the exchanger will have placed funds with an accommodator until the upleg is found. Whereas, in the Delayed Exchange an accommodator is never used.
  - d. The “Delayed Exchange” is preferable to the “Delayed Close”.
88. The Delayed Exchange is permitted today. In the Delayed Exchange the Exchanger has guidelines that have to be met to insure that a valid exchange has taken place.
- a. The Delayed Exchange must close within 180 days of finding the upleg property, there may be a one time 45 day extension.
  - b. The upleg property must be identified within 180 days of the close of the downleg, and title must be in the name of the exchanger within 45 days of the identification of the upleg.
  - c. In the Delayed Exchange the exchanger has to identify the upleg property within 45 days of the close of the downleg property, and close escrow on the upleg property within 180 days of the close, but before filing their next tax return.**
  - d. The upleg property has to be identified within 45 days of the close of the downleg, and title must pass within 90 days of the close of the downleg, but before the exchanger files their next tax return.
89. “Like Kind Property” is referred to in the 1031 Tax Deferred Exchange. Like kind means;
- a. A farm for a farm, commercial property for commercial property, residential income for residential income
  - b. Intent is the key here, if you are exchanging for property held in trade or business the exchange is valid. This would most nearly mean real property for real property, but not for a personal residence.**
  - c. Like kind has to do with intent. If the property is held for investment it is like kind. Simply stated you can exchange a four-plex for a Mercedes Benz as long as your intent is to own the car with a future profit in mind.
  - d. Like kind means your personal residence for another personal residence, your income property for more income property.

90. Two terms that we often confuse are “Mortgage Relief” and “Excess of Mortgage Over Basis”. These two terms are associated as follows;
- a. Excess of Mortgage Over Basis is always with the Tax Deferred Exchange, Mortgage Relief is always with the Installment Sale
  - b. Mortgage Relief is when a debt is forgiven because it was paid off by someone else. Excess of Mortgage Over Basis indicates that the seller has refinanced the property or used an accelerated method of depreciation.
  - c. Excess of Mortgage Over Basis is when the Mortgage is greater than the Adjusted Tax Basis of the property; Mortgage relief is simply when we pay a loan off.
  - d. **Excess of Mortgage Over Basis is always with the Installment Sale; Mortgage Relief is always with the Tax Deferred Exchange**
91. The “Even or Up Rules” we learned in the 1031 Tax Deferred Exchange Techniques simply stated are;
- a. We have to exchange into the same square footage, or greater, of property and improvement as we have exchanged out of.
  - b. The tax basis, square footage, and the loans on the exchanged into building have to be equal to or greater than the tax basis, square footage, and loans of the building we exchanged out of.
  - c. The income of the building we exchange into has to be equal to or greater than the income from the building we exchanged out of.
  - d. **To have a totally tax deferred exchange we must keep the dollar value of the property that we exchange into equal to or greater than the property we exchanged out of, and we must keep the loan in the upleg property equal to or greater than the loan on the building we exchanged out of**
92. When the “Even or Up Rules” are not adhered to, all is forgiven if;
- a. **Cash in an equal or greater amount is added to the exchange.**
  - b. We offset the difference with a larger loan
  - c. The square footage of the upleg property is greater than the square footage of the downleg property.
  - d. There is no way to avoid penalty when these rules are broken.
93. The Installment Method of reporting taxes, called The Installment Sale occurs when;
- a. The seller doesn’t have enough cash at close of escrow to pay the taxes. The Internal Revenue Service sets up a payment plan for them called the Installment Method.
  - b. The seller sells a trust deed or mortgage that they have carried on real property that they have sold.
  - c. **The seller of a property carries all or some of the loans on the property.**
  - d. This is a method of reporting sales used by “dealers” a dealer being classified as a person or entity that sells eight or more parcels of real property a year.

94. The Installment Sale is a method of selling property that defers the payment of taxes on gain from the principal proceeds that the seller has not received. The real advantage in the Installment Sale is that;
- That the seller can create an annuity, or an additional income pool
  - The seller can achieve a higher selling price
  - The seller is earning interest on money that they would have paid in taxes
  - All of the above are true**
95. If the seller in an installment sale is forced to foreclose on the property they were carrying the installment notes on;
- The deferred taxes will become immediately due and payable
  - The tax basis will be stepped up to fair market value at the time of the foreclosure; they could resell the property and have no gain at all**
  - They will realize a taxable profit on the foreclosure
  - The foreclosure will make the installment sale null and void and trigger an accelerated depreciation problem that could involve substantial fines and penalties
96. The Gross Profit Ratio is a percentage created by dividing the Gross Profit by the Contract Price. The Gross Profit Ratio is a percentage that when multiplied against any principal received by the seller;
- Indicates the method of reporting the installment sale
  - Indicates the amount of principal that is subject to taxation**
  - Indicates the remaining balance on the loans
  - Indicates the time remaining until the loans are fully amortized
97. The interest part of any payments received by the seller in the installment sale;
- Are taxed at ordinary rates**
  - Are subject to Long Term Capital Gains treatment
  - Are subject to the Gross Profit Ratio
  - Escape taxes because of the structure of the installment sale.
98. When selling a parcel of real property a lower down payment will have the immediate effect of;
- Scaring people away because they think something is wrong
  - Attracting more potential buyers**
  - Lowering the price of the property
  - Lengthening the marketing time

99. When selling a parcel of real property, offering a lower interest rate on a trust deed that the seller offers to carry on the parcel will;
- a. Create an annuity for the buyer
  - b. Increase the value of the property
  - c. Increase the interest of buyers
  - d. **All of the above**
100. Inflation has an effect on trust deeds and notes that sellers carry on buildings. When inflation is increasing;
- a. The face value of the note and the payments have greater purchasing power
  - b. Inflation has very little effect on loans and loan payments
  - c. **The face value of the note and the payments on the note are considered to have less purchasing power**
  - d. Inflation's affect on loan payments is minimal; the affect on the principal is catastrophic

Robert Rooks 4/16/2004

## Answers with Explanations

1. d. Apply to a different lender.  
It is common when lenders cannot make a loan or don't understand how to package the loan to blame the borrower or the property. If in fact the value is there, and if loans are available then you have to make certain that you are trying to get the loan from a lender who is familiar with that type of loan, and has made that type of loan before.
2. a. Mortgage notes and trust deeds are referred to by their desirability. The most desirable is A Paper, this includes Trust Deeds and Mortgages that the investor feels has the least likelihood of turning into a bad investment. The next most desirable would be B Paper and so on. You can find an investor for most paper, A, B, C, and D the interest rate will be higher the further the note is in the alphabet, but there are investors.
3. b. The more difficult it is to find an investor for a trust deed or mortgage, the more important it is that you are searching for the investor in the right place. Find a lender who makes the type of loan that you or your buyer are trying to get.
4. c. The loan that investors think, and statistics prove, are the most secure are loans on owner occupied single family homes.
5. a. The most common loans are fully amortized loans with equal monthly installments.
6. a. The loan constant is a number that indicates the periodic payment on \$1, \$100, or more commonly \$1,000, at a given rate for a stated period of time. The periodic payment can be for a year, or a month, or a quarter. Normally the periodic payment today is monthly.  
For example the **monthly loan constant** on a 9.5% loan, amortized for 30 years, and payable in equal monthly installments, would be 0.008409. This constant would equal the monthly payment on \$1, each month, to completely amortize the \$1 over a thirty year period. Normally, in real estate practice, we use a constant on \$1,000. That constant would be  $0.008409 \times \$1000 = \$8.41$ . This \$8.41 would be the monthly payment on \$1,000 for thirty years at 9.5% to completely amortize, pay off, the \$1,000. If we were getting a \$300,000 loan we could divide the \$300,000 by \$1,000 and come up with the fact that there are 300, \$1,000 bills in a \$300,000 loan. Then,  $300 \times \$8.41 = \$2,522.56$  per month to completely amortize \$300,000 in thirty years.  
In real estate practice today we would simply use a financial calculator and quickly come up with a loan constant or the actual monthly payment for whatever amount of money represented by the loan, at the given interest rate, for the stated period.

7. d. All of the above would be the best answer.
- a. is correct because a loan with a large payoff before the loan is fully amortized is like having a gun at your head. You may or may not be able to get a loan at the time the loan is due, thus “bullet loan”.
  - b. is a good answer because a large payment due in the middle of a loan is also called a balloon payment.
  - c. is a good answer because a loan with a large payment do wouldn't be a fully amortized loan, so it would have to be a negative amortization loan, an interest only loan, or a partially amortized loan.
8. a. Negative amortized loan would be the best answer.