



(Knowledge for Development)

**KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS**

2021/2022 ACADEMIC YEAR

**FOURTH YEAR SECOND SEMESTER
MAIN EXAMINATION**

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCF446E

COURSE TITLE: REAL ESTATE FINANCE

DATE: 5TH SEPTEMBER, 2022

TIME: 2.00PM - 4.00PM

INSTRUCTIONS TO CANDIDATES

1. Answer Question One in Section A and Any other TWO (2) Questions in Section B
2. Question **one** carries **30** marks and each of the other two questions carry **20** marks each.

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

This Paper Consists of 6 Printed Pages. Please Turn Over.

QUESTION ONE – COMPULSORY

a) Compare between the following terms as used in real estate finance:

- Real property and personal property [2 marks]
- Leasehold and easement [2 marks]
- Space markets and capital markets [2 marks]
- Gross absorption and net absorption of real estate demand [2 marks]

b) Location is of paramount importance. The right property in the right location will always command a high value. Justify this assertion with reference to four location features. [8 marks]

c) The various forms of capital used to finance real estate investment can be arranged along a continuum ranging from the two extremes of (pure) debt and (pure) equity.

Using four points, justify for the preference of debt over equity finance.

[8 marks]

d) Evamba Limited has entered into a new lease, which includes a commitment to spend Kshs200, 000 on internal rearrangements to the premises. A loan has been arranged at an interest rate of 7 per cent to be repaid at the end of three years. Calculate the amount due at that time by computing year by year amounts. [4 marks]

e) Evaluate how the Kenyan government has embraced the Environmental, Social and Governance (ESG) as an emerging trend in real estate.

[2 marks]

QUESTION TWO

a) Propose four exogenous drivers of the demand for real estate. [8 marks]

b) Property investment has its own peculiarities. Assess the main features that are unique to property investment. [12 marks]

QUESTION THREE

a) Tujenge contractors own a freehold office building recently let at a market rent of Kshs 30,000 per annum. The rent will be reviewed at the end of five years. You are asked to indicate the present value of the first five years' income at a discount rate of 6 per cent. [5 marks]

- b) At any point in time, the real estate market may not be at demand-supply equilibrium. Evaluate three causes of market inefficiencies in demand and supply of real estates. **[9 marks]**
- c) Examine three unique characteristics of financial analysis of real property investments. **[6 marks]**

QUESTION FOUR

- a) Using valuation of real estates theory, assess the difference between price and value. **[4 marks]**
- b) Corporations can either lease or own space needed in business operations and may conduct lease-versus-own analysis to decide which option is superior. Evaluate five factors that can affect the decision of lease or ownership of real estate property. **[10 marks]**
- c) Exel Real Properties Ltd has a net operating income of Kshs115,000 per year from their office rental building located at the CBD of Bungoma town. Equity bank is willing to advance them a loan of Kshs 800,000 with an interest rate of 10 percent per annum. The tax rate is 20 percent and the required after-tax rate of return is 14 percent. You are required to compute the value this building. **[6 marks]**

QUESTION FIVE

- a) Maarifa Real Estates have office apartments in Milimani area of Bungoma town. Their Accountant has presented to you the following analysis of Net Operating Income for the year ending 31st December 2021.

	Kshs	Kshs
Gross income	700,000	
Less: vacant house	- 20,000	
Net rental income		680,000
Income from provision of water		70,000
Other income		16,000
Total Gross income		766,000
Operating expenses		
i) General administrative expenses		
Management fees	26,000	

Office supplies	4,500	
Legal and accounting fees	1,400	
Advertising	2,000	
Total Gen. and administrative exp.		33,900
ii) Repairs and maintenance		
Repair of floor	69,000	
Contract services	5,000	
Painting	4,900	
Ground work and landscaping	4,700	
Total repairs and maintenance costs		83,600
iii) Salaries and payroll		
Office staff salaries	33,700	
PAYE	9,100	
Payroll maintenance costs	22,000	
Total salaries and payroll costs		64,800
iv) Utilities		
Kenya Power	82,500	
Water and sewer services	54,500	
Telephone	9,700	
Generator power	20,000	
Total utilities		166,700
v) Other expenses		
Insurance	19,000	
KRA Rental tax expense	38,000	
Total other expenses		57,000
Total operating expenses		406,000
Net operating income		360,000

You are provided with the following further information:

- i) The sales price/ fair market value is Kshs 8,000,000
- ii) Maarifa has a secured bank loan plus interest that was outstanding of Kshs 6,500,000
- iii) The building sits on 5,000 square feet plot.
- iv) The rental income is earned evenly throughout the year.

Required:

The management is concerned about the financial health of the apartments and would like you to carry out the following analysis:

- i) Capitalization rate [2 marks]
- ii) Debt service coverage ratio [2 marks]
- iii) Operating efficiency ratio [2 marks]

- iv) Gross rent multiplier and opportunity cost should Maarifa decide to sell the building [2 marks]
- b) Assess various types of risk that must be considered when evaluating real estate investment alternatives. [12 marks]