

COMMON EXAMINATION FOR HOUSE AGENTS

PAPER 3

PROFESSIONAL PRACTICE AND MANAGEMENT

Wednesday, 9 Jan 2008

2 ½ hours

100 marks

Instructions:

1. Answer any **5 (FIVE)** out of 8 questions.
(You must not provide answers to more than 5 questions.)
2. Each question carries 20 marks.

Failure to comply with the above instructions may result in loss of marks.

Question 1

Each part of this question carries two (2) marks. You are required to indicate the most appropriate answer for each part of this question in the answer script. No marks will be given if the answer is not clearly indicated. If more than one answer is given to any part, no marks will be awarded for that part.

- (I) Consider the following: (i) no central trading place; (ii) high transaction costs; (iii) continuous capital appreciation; (iv) costless information.

The characteristics of a real estate market include

- (A) (i) and (ii) only.
(B) (i) and (iv) only.
(C) (ii) and (iv) only.
(D) None of the above answers.
- (II) Consider the following features of an intermediate terrace house: (i) number of storeys; (ii) freehold or 99-year leasehold tenure; (iii) land area; (iv) state of maintenance of the property. The expected market rent of the property will be affected by
- (A) (i), (ii), and (iii) only.
(B) (i), (ii), and (iv) only.
(C) (i), (iii), and (iv) only.
(D) None of the above answers.

- (III) The highest and best use of a vacant residential site is not affected by
- (A) Any height restrictions that may be imposed on the site.
 - (B) The land area.
 - (C) The neighbourhood characteristics.
 - (D) None of the above answers.
- (IV) Consider the following statements: (i) Professional standards are established to protect consumers' interest through a combination of statute laws and code of conduct. (ii) Ethical standards are limited to those prescribed by common law. (iii) Besides exercising due diligence in the performance of his duties, a real estate agent is also expected to be a stakeholder of his client's monies.
- (A) Statement (i) is correct while the other 2 statements are incorrect.
 - (B) Statement (ii) is correct while the other 2 statements are incorrect.
 - (C) Statement (iii) is correct while the other 2 statements are incorrect.
 - (D) None of the above answers.
- (V) Consider the following: (i) indivisibility; (ii) positive sentiments about the property market; (iii) purchasing power; (iv) immobility.

In order for demand to be effective, it must be accompanied by

- (A) (i) and (ii) only.
- (B) (ii), and (iii) only.
- (C) (iii) only.
- (D) None of the above answers.

- (VI) Mr. Tan is currently 67 years old and owns a freehold apartment. He plans to use the property to yield him a monthly income under a reverse mortgage. Under such a scheme, the monthly income receivable by him would not be affected by
- (A) The age of the property.
 - (B) The floor area of the property.
 - (C) The number of beneficiaries in his will.
 - (D) None of the above answers.
- (VII) Messrs AKC Ltd receives cash of \$3,500 for services rendered to a client. The firm pays cash of \$1,500 to purchase stationery.

The following accounting entries are made to reflect the said transactions:

- (i) A debit entry of \$3,500 for the cash account and a credit entry of \$3,500 for the revenue account.
- (ii) A debit entry of \$1,500 for the stationery account and a credit entry of \$1,500 for the cash account.

- (A) (i) and (ii) are both correct.
 - (B) (i) and (ii) are both incorrect.
 - (C) (i) is correct but (ii) is incorrect.
 - (D) (i) is incorrect but (ii) is correct.
- (VIII) During the initial stage of the upswing phase of the real estate cycle, one would not expect to see
- (A) Low interest rate.
 - (B) Tightening of credit.
 - (C) Increased demand.
 - (D) Low unemployment rate.

(IX) Consider the following:

- (i) A real estate agent highlights to potential buyers that while the property is relatively cool during December and January, it receives the afternoon sun directly during the hot months of the year.
- (ii) A real estate agent informs potential buyers that the owner is prepared to accept as low as 90% of the asking price because the vendor faces urgent financial pressure to dispose the property.
- (iii) A real estate agent advises a very keen potential purchaser that mortgage payment should typically not exceed 30% of monthly income.

A breach of business and professional ethics is evident in

- (A) (i) only.
- (B) (ii) only.
- (C) (iii) only.
- (D) None of the above answers.

(X) Consider the following: (i) date of valuation; (ii) the property will be sold via auction; (iii) a bank has indicated that it will advance a loan capped at 80% of valuation.

In deciding on the most appropriate valuation method to estimate the open market value of the property, a valuer should take into consideration

- (A) (i) and (ii) only.
- (B) (i) and (iii) only.
- (C) (ii) and (iii) only.
- (D) None of the above answers.

(20 marks)

Question 2

- (a) During 2007, prices of high-end private homes appreciated by much more than those of mass-market private homes. Discuss the factors that could account for the different price trends in these two market segments during the said period. (12 marks)
- (b) Identify four (4) errors in the following financial statement and explain why they are deemed as errors.

LLC Real Estate Agency Private Limited Balance Sheet 1 Jan 2007 to 31 Dec 2007			
Assets		Liabilities	
Cash	\$9,000	Interest expense	\$2,560
Utility Expense	\$5,000	Office Furniture	\$8,780
Computers	\$8,900	Accounts receivable	\$4,800
Accounts payable	\$5,200		
Equity	\$9,860		

(8 marks)

Question 3

- (a) Mr. Cheong is evaluating the purchase of an office unit at a price of \$1,550,000. His preliminary calculations based on the said asking price, expected future cash flows over a holding period of 5 years, and a discount rate of 8.5% per year indicate a Net Present Value of \$14,560.
- (i) If he pays less than \$1,550,000 for the property, would the Internal Rate of Return be lower than 8.5% per annum? Why?

(5 marks)

- (ii) If his required rate of return is 8% per year, is it advisable for him to buy the property for more than \$1,550,000? Why?

(5 marks)

- (b) Real estate is often perceived as a "high-risk" asset. Enumerate and explain the various sources of risk associated with real estate investments.

(10 marks)

Question 4

Write short notes on the following:

- (a) Time Value of Money in the DCF Approach.
- (b) Elasticity of Supply in the Short and Long Run.
- (c) Loan-to-Value Ratio.
- (d) Functional Obsolescence.

(20 marks)

Question 5

- (a) Mr. Wang was appointed as the sole agent in the sale of a 15-year-old terrace house in Upper Thomson. The seller told him privately that the motivation for selling the house was triggered by bad "Feng Shui" given that the house was facing a T-junction. Mr. Ong, a potential buyer, enquired about the reason behind the sale. Mr. Wang replied that the seller was planning to relocate closer to his eldest daughter's home in Upper Bukit Timah. The property was eventually sold to Mr. Ong.

Has Mr. Wang breached any Code of Conduct and Ethics? Give reasons to support your answer.

(6 marks)

- (b) Priority Realty Ltd has advertised in the press as follows: "We have the largest team of sales personnel to meet all your needs. Last year, we chalked in the highest number of sales, as much as 25% above that of our nearest competitor."

Has this advertisement breached any Code of Conduct and Ethics? Why?

(6 marks)

- (c) Explain why the Cost Approach and Profits Method are not used for the valuation of HDB resale flats.

(8 marks)

Question 6

Mr. Lee is considering the purchase of a semi-detached bungalow as an investment. The freehold property has a land area of 220 sq m and a built-up floor area of 210 sq m. A comparable property with the same land area but a larger built-up floor area of 235 sq m has recently been leased at \$5,500 per month unfurnished. Under the said lease, the landlord is responsible for property outgoings such as property tax and fire insurance. Outgoings typically constitute about 13% of the unfurnished rent.

- (a) Estimate the unfurnished monthly rent of the subject property.
- (b) The initial yield of such properties is around 2.5% per year. Estimate the open market value of the subject property.
- (c) A friend of Mr. Lee advised him that unless the expected capital appreciation of the property is more than 5% per year the proposed investment is not an attractive proposition. Is this a sound investment advice? Give reasons to support your answer.

(6 marks)

- (d) Mr. Lee is not sure whether he should invest all his savings of \$1 million in the property or obtain a higher bank loan to finance the purchase of the property. He has also heard that a leveraged investment is also a "double-edged sword." How you would advise him on this matter?

(8 marks)

Question 7

- (a) Dr. Chin plans to rent a unit in a shopping centre to set up a medical practice. A vacant unit with a floor area of 47 sq m on the third storey is available for \$185 per sq m per month, exclusive of service charges. Another vacant unit with an area of 53 sq m on the second storey is available for \$180 per sq m per month, exclusive of service charges.

Dr. Chin feels that the asking rent of \$185 per sq m per month on the third storey is excessive when compared to the asking rent of \$180 per sq m per month on the second storey. Explain to him by listing four (4) characteristics of these 2 shopping units that could account for the variation in their asking rents.

(8 marks)

- (b) Discuss how real estate agents could avoid or pre-empt situations involving conflict of interests.

(12 marks)

Question 8

Each part of this question carries two (2) marks. You are required to indicate the most appropriate answer for each part of this question in the answer script. No marks will be given if the answer is not clearly indicated. If more than one answer is given to any part, no marks will be awarded for that part.

- (I) Which one of the following statements is incorrect?
- (A) After purchasing a plot of land, Mr. Lee is currently constructing a house on it. He can withdraw his CPF savings to pay for the land and construction cost after the issuance of a Temporary Occupation Permit for the house.
 - (B) The open market value of a property can be determined using data on the owner's asking price and offer prices by potential buyers.
 - (C) The assumption of "going concern" is one of the accounting conventions guiding the preparation of financial statements.
 - (D) Valuation of real estate is also conducted for purposes related to fire insurance, property taxation, and land acquisition.
- (II) Consider the following statements about an apartment that was completed in 1974: (i) The property does not suffer from physical obsolescence given that regular and periodic maintenance has been carried out to the premises. (ii) The property does not suffer from functional obsolescence because there is an increasing trend to encourage conservation of older properties.
- (A) Both statements are correct.
 - (B) Both statements are incorrect.
 - (C) Statement (i) is correct, but statement (ii) is incorrect.
 - (D) Statement (ii) is correct, but statement (i) is incorrect.

- (III) Consider the following: (i) high land cost for real estate development; (ii) 7-year period between the peak and trough of a real estate cycle; (iii) long construction period of a project.

The factors that could explain why the demand for private residential properties is elastic are

- (A) (i) and (ii) only.
- (B) (i) and (iii) only.
- (C) (ii) and (iii) only.
- (D) None of the above answers.

- (IV) Consider the following statements:

- (i) The principle of "Caveat Emptor" places a fiduciary duty on the seller's agent to negotiate for the highest price.
- (ii) The principle of "Caveat Emptor" absolves the seller's agent from any responsibility if the property is eventually sold at less than 95% of the reserve price.

- (A) Both statements are correct.
- (B) Both statements are incorrect.
- (C) Statement (i) is correct, but statement (ii) is incorrect.
- (D) Statement (ii) is correct, but statement (i) is incorrect.

(V) Mr. Tan calculates the Internal Rate of Return (IRR) of a proposed investment to be 20% per year. Consider the following statements:

- (i) The payback period is 5 years, calculated as the reciprocal of the IRR.
- (ii) Given a payback period of 5 years and an IRR of 20%, the initial yield is 4%.

- (A) Statement (i) is correct while statement (ii) is incorrect.
- (B) Statement (ii) is correct while statement (i) is incorrect.
- (C) Both statements are correct.
- (D) Both statements are incorrect.

(VI) Which one of the following statements is correct?

- (A) The open market value of an office unit is affected by whether the property is vacant or owner-occupied.
- (B) In evaluating the loan-to-value ratio of a residential property the bank will take into consideration the age of the applicant.
- (C) Among other issues, the code of conduct and ethics also prescribes a schedule of commissions to ensure that each firm will cover their cost of operations.
- (D) Durability, heterogeneity and immobility are factors influencing the highest and best use of a vacant commercial site.

(VII) The demand for office space is not likely to be influenced by the

- (A) growth rate of the economy.
- (B) employment growth rate.
- (C) number of tourist arrivals.
- (D) All of the above answers.

(VIII) Which one of the following statements is correct?

- (A) Accrual-basis accounting ensures that a firm always has sufficient cash to meet its obligations.
- (B) The residual method of valuation is often used to value commercial properties whenever there is a lack of rental transactions.
- (C) The "separate entity" concept ensures that revenue is recorded only upon receipt of cash for services rendered by the firm.
- (D) A leveraged investment is exposed to financial risk brought about by interest rate movements.

(IX) The Net Present Value concept

- (A) ignores the time value of money of all cash flows received after 5 years from the acquisition date of the investment.
- (B) generally ignores the debt-equity ratio of an investment.
- (C) considers only revenue received during the first 10 years of the investment.
- (D) None of the above answers.

(X) The availability of mortgage loans has a huge impact on the demand for real estate because

- (A) the supply of real estate is inelastic.
- (B) the property market is subjected to cyclical uncertainties of boom and bust.
- (C) properties are indivisible, heterogeneous and immobile.
- (D) None of the above answers.

(20 marks)

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