Alternative Investments.

1)	Which of the following are advantages that have been yielded as a result of the involvement of venture capitalists in the financing process? I. At times, it is the venture capitalist that is charged with building up an effective management team to run the underlying company. II. Venture capitalists bring a business focus to a company that may only have a product focus. III. Since venture capitalists usually execute the business plan, companies have a greater chance at success. IV. The indirect benefits from venture financing are largely the result of the multiplier effect in combination with the rising income levels of the employees who work for these start-up companies. A) I and III only B) II, III and IV only C) II and IV only D) I, II and IV only
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2)	Which of the following statements does not represent a disadvantage of owning a REIT? A) The tax sheltering effects of depreciation are not passed through to the unit holders. B) REITs may result in higher taxes to an individual relative to a similar risk investment that pays less income. C) REITs have limited growth prospects. D) Since the underlying asset is still real estate, REITs are still illiquid relative to stocks.
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3)	Which of the following statements are true with respect to investing in commodity related securities? I. Commodity related securities are often a good hedge against inflation. II. A collateralized commodity futures position is created by simultaneously longing the futures contract and shorting the underlying asset. III. The objective of a collateralized commodity futures position is to generate a rate of risk-free return that is slightly higher than that offered by Treasury bills. IV. Stocks of companies operating in commodity industries are not as correlated to the underlying commodities as, say, a futures on the same commodity would be. A) I, II, III and IV B) I and IV only C) II, III and IV only D) I, II and III only
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4)	Which of the following statements are true with respect to hedge funds? I. Short squeeze risk arises when short sellers are forced to cover their short positions during a period where the price of the underlying asset rises sharply. II. Survivorship bias largely explains why hedge fund indexes produce a higher return and lower risk levels than traditional equity indexes. III. Hedge funds generally have a low but negative correlation with traditional equity indexes. IV. Most hedge fund fee structures ensure that managers only take moderate levels of risk. A) I and II only B) I and IV only C) II, III and IV only D) I, II and III only
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5)	Which of the following is a way/are ways to resolve agency conflicts that may exist in the venture capital industry? I. Entrepreneurs will generally insist on a clause in their contract so that the venture capitalist will not abandon its ties with the firm prematurely. II. Investors should look for venture capitalists that generally have a low carried interest on their pool of funds. III. Investors should avoid venture pools that have a finite life fund structure. IV. Investors should avoid venture funds that allow the manager to partake in self-dealing activities. A) II only B) III and IV only C) I, III and IV only D) I and IV only
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6)	Under the income capitalization approach to valuing real estate, which of the following definitions for net operating income is not true? A) Net operating income is measured after capital expenditures. B) Net operating income is measured before income taxes but after interest expense. C) Net operating income is measured before interest expense. D) Net operating income is measured after property taxes.
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7)	All of the following statements are true with respect to the various ways that equity investments may be classified except: A) Sector investing should be deemed as a complementary strategy to a well established portfolio. B) From a U.S. investor point of view, international investing implies purchasing stocks domiciled all over the world, including the U.S. C) Indexing is a type of passive investment strategy. D) Purchasing only stocks that exhibit a low P/E ratio is a form of "style" investing.
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8)	Which of the following statements is untrue with respect to the various real estate valuation techniques? A) A cost approach involves an estimation as to how much it would cost to construct the existing property using current construction cost figures. Then, an amount is deducted to account for the functional depreciation of the existing property. B) A comparative sales approach looks at similar properties that were recently sold in the community, and using that price as a base, an amount is deducted to account for the functional depreciation of the existing property. C) Using the cost approach, once an estimate is formed of the real estate structure, it is added on to the value of the land in order to come up with a total value for the entire property. D) The cost approach is a lot more subjective than the comparative sales approach.
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9)	Which of the following statements with respect to venture capital financing during an expansion phase is (are) true? I. Expansion phase financing is aimed toward companies with a product that is commercially viable but that is produced on a small scale. II. Companies with a very high growth rate in sales will mostly be able to finance their growth through internally generated funds. III. Third stage financing is aimed toward assisting the underlying company to gain a sufficient share of its market. IV. Bridge financing is the loan a venture capitalist will make just before mainstream commercial banks begin to consider making loans to these start-up companies. A) II and IV only B) I and III only C) I and II only D) I only
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10) Which of the following is not a determinant of demand for real estate?

A) The demographic breakdown in the local community, including age and income distribution
B) The elasticity of builders to expand their developments and build more properties
C) Availability and cost of mortgage financing
D) The state of the economy in the local market

11) Which of the following statements does not accurately explain the impact of demographics on the supply and demand for real estate?

A) Psychographic profiles simply means that properties that have certain characteristics which are desirable by the largest influx of people will experience a greater price appreciation.
B) If the fastest growing segment of the local population is made up of retired individuals, then the values of real estate properties such as detached homes may decline as this group downsizes or moves out to other communities in order to live their retirement years.
C) If the fastest growing segment of the local population is made up of 25-35 year olds, then real estate values will decline, since this age group is far from its peak earning years.
D) As employment opportunities grow in a community, the influx of new workers will almost always cause the values of real estate properties to appreciate.

12) Which of the following statements with respect to investment companies is (are) true?

I. Shares of a closed-end fund may only be bought from the issuing company.
II. Load funds sell at a premium over the fund's NAV. However, they may only be redeemed at the fund's NAV.
III. Load funds are generally bought through brokers.
IV. If an investment company implements a 12b-1 charge into the mutual fund, then the management fee may be eliminated.

A) II and IV only
B) II and III only
C) III only
D) I and II only

13) Which of the following statements with respect to the diversification effects of venture funds is (are) true?

I. Venture capital returns tend to be highly correlated with publicly-traded small capitalization stocks.
II. Venture capital returns tend to be negatively correlated with bonds.
III. The more diversified a venture capital fund is, the more correlated it will be with the public market.
IV. Most companies in a venture fund will have a very high degree of systematic risk.

A) I and III only
B) I and IV only
C) IV only
D) II and III only

14) A property that originally cost $750,000 and that is being depreciated over an eight-year period using straight line depreciation has the following information:

Net Income	$65,000	Mortgage Principal Payment	$32,000
Increase in A/c Payable	$12,000	Increase in Uncollectibkle Rents	$8,000
Capital Costs	$17,000		

What is the amount of after-tax cash flow that will accrue to the owner of this property?

(a) $89,750 (b) $20,000
(c) $113,750 (d) $147,750

15) Which of the following statements with respect to passive real estate investments is (are) true?
I. REITs are most beneficial to institutions that prefer to diversify their real estate exposure.
II. REIT managers may only use the capital raised through the issuance of the trust units in order to buy properties.
III. Instead of acquiring properties, mortgage REITs simply make out real estate loans.
IV. In the U.S., REITs do not have to pay taxes on their profits if they pay out at least 75% of their income to shareholders by way of dividends.

A) II, III and IV only
B) III only
C) I and IV only
D) I only

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16) Which of the following is neither an objective nor a constraint when it comes to investing in real estate?
A) The correlation of real estate returns to other asset classes such as stocks and bonds
B) The amount of liquidity that the investor requires
C) The amount of financing that the investor can get other than his or her own equity
D) The amount of risk that the real estate investor is willing to take

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17) Which of the following statements about leverage is incorrect?
A) Positive leverage occurs when the return on the real estate asset (before financing costs and taxes) exceeds the after-tax cost of the mortgage.
B) Positive leverage occurs when the return on the real estate asset (before financing costs and taxes) exceeds the pretax cost of the mortgage.
C) Positive leverage implies that the return on the investor's equity will always be greater than the return on the asset itself.
D) With negative leverage, it is possible to have a losing return on equity, even though the underlying asset may have a positive net operating income.

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18) Which of the following statements with respect to the performance of investment funds is (are) true?

I. Closed-end funds usually trade at a discount to their net asset value in order to take into account potential taxes that may result from the unrealized capital gains.
II. Empirical studies have shown that there is very little correlation between past performance and future performance for a fund.
III. Studies have found that only about a third of investment funds have performed better than the market on a risk adjusted basis.
IV. For open-end mutual funds, the supply and demand imbalances for the units may sometimes lead to a unit price that is different from the fund's NAV.
A) I, II and IV only
B) II only
C) I, II and III only
D) III and IV only

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19) Which of the following statements is not true when it comes to performing a valuation analysis for a property?

A) A comparable sales approach may be used to evaluate an investment property whose fortunes will largely depend on the unique circumstances of the investor.
B) While in theory all valuation methods should lead to the same market value for a property, in practice the results will vary greatly depending on which valuation model is used.
C) A fair market value analysis can be performed by using the comparable sales approach or the cost approach.
D) For properties that are unique in nature, using the discounted cash flow method would yield more meaningful results than the cost approach.

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20)	Which of the following statements with respect to factors that influence the risk and return characteristics of a venture fund is (are) true? I. The degree of diversification within a sector specific venture fund will dramatically impact the fund's risk. II. Historically, venture capital funds have generated much higher rates of return after periods of low fund flows into the industry. III. Generally, firms that have had venture capitalist backing performed no better after an IPO than firms that did not have similar backing. IV. The geographical area in which a fund specializes could have a dramatic impact on the fund's risk and return. A) I, II, III and IV B) I and IV only C) II and IV only D) I and III only

<u>Alternative Investment</u>

1)	**A**	**B**	**C**	**D**	**11)**	**A**	**B**	**C**	**D**
2)	**A**	**B**	**C**	**D**	**12)**	**A**	**B**	**C**	**D**
3)	**A**	**B**	**C**	**D**	**13)**	**A**	**B**	**C**	**D**
4)	**A**	**B**	**C**	**D**	**14)**	**A**	**B**	**C**	**D**
5)	**A**	**B**	**C**	**D**	**15)**	**A**	**B**	**C**	**D**
6)	**A**	**B**	**C**	**D**	**16)**	**A**	**B**	**C**	**D**
7)	**A**	**B**	**C**	**D**	**17)**	**A**	**B**	**C**	**D**
8)	**A**	**B**	**C**	**D**	**18)**	**A**	**B**	**C**	**D**
9)	**A**	**B**	**C**	**D**	**19)**	**A**	**B**	**C**	**D**
10)	**A**	**B**	**C**	**D**	**20)**	**A**	**B**	**C**	**D**

Answers

1) D 2) D 3) B 4) A 5) D 6) B 7) B 8) B 9) B 10) B	11) C 12) B 13) A 14) C 15) B 16) A 17) A 18) C 19) A 20) C

Explanations

1)	The Right Answer is **D**. **Explanation:** Choice III is incorrect because it is the managers running the company who will end up executing the business plan. The venture capitalist, on the other hand, will in most cases take on an advisory role.
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2)	The Right Answer is **D**. **Explanation:** Actually, REITs trade on major stock exchanges; therefore, they are just as liquid as the majority of the stocks listed on the exchanges. The reason why REITs have limited growth prospects is because they cannot retain more than 5% of their income. Furthermore, from an investor point of view, because dividends are taxed at a higher rate than capital gains, a REIT will result in higher taxes than a similar risk investment which pays a lower income, and thus consequently, a relatively higher amount of capital gains.
	. .
3)	The Right Answer is **B**. **Explanation:** Choices II and III are incorrect because a collateralized commodity futures position is created by simultaneously longing the futures contract and purchasing the same amount in Treasury bills. Therefore, return comes from both the long position in the futures and the interest from the T-bill.
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4)	The Right Answer is **A**. **Explanation:** Choice III is incorrect because hedge funds generally have a low but positive correlation with traditional equity indexes. Choice IV is incorrect: since most hedge fund fee structures incorporate a bonus feature that is tied to the absolute level of performance of the fund, most managers are induced to take higher absolute levels of risk.
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5)	The Right Answer is **D**. **Explanation:** Choice II is incorrect because a low carried interest suggests that the venture capitalist is scrambling for funds or perhaps does not possess a decent track record. Carried interest is the primary motivation for the venture capitalist to perform optimally. The absence or reduction of this incentive might suggest otherwise. Choice III is incorrect because a finite life fund structure would release an investor from making contributions to the venture pool if the fund manager does not meet some pre-existing goals.
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6)	The Right Answer is **B**. **Explanation:** When valuing an entire property, and not just the equity portion in the property, we have to discount all the cash flows that would be available not just to the property owner, but to the creditors as well. Therefore, net operating income is measured before any interest charges are deducted.
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7) The Right Answer is **B**.
Explanation: Global investing is the proper definition for investing in stocks from all over the world. International investing generally involves investing in securities domiciled outside of the investor's home country.

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8) The Right Answer is **B**.
Explanation: The comparative sales approach accounts for depreciation by choosing a comparative property that has depreciated in a similar fashion to the existing property. Functional depreciation is more often used when evaluating a property using the cost approach.

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9) The Right Answer is **B**.
Explanation: Choice II is incorrect. In fact, companies with a very high growth rate in sales will require a lot more funds in order to invest in more assets and to meet working capital requirements. Choice IV is incorrect because bridge financing is really designed to equip the underlying company just as it issues its shares to the public.

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10) The Right Answer is **B**.
Explanation: "The elasticity of builders to expand" is nothing more than a cleverly worded version of the concept "elasticity of supply". Clearly then, this is a supply factor.

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11) The Right Answer is **C**.
Explanation: While it is true that the earning levels for the 25-35 age group is far below where it will be during the peak years, the availability of mortgage financing fills in any gap between how much this group earns and how much local housing costs.

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12) The Right Answer is **B**.
Explanation: Choice I is not entirely true. At first, the company issues closed-end units; however, the shares may be traded among shareholders afterwards without affecting the issuing company. Choice IV is incorrect because a management fee will always be charged, regardless of what the additional charges may be.

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13) The Right Answer is **A**.
Explanation: Choice II is incorrect because there is hardly any correlation between venture funds and bonds. Choice IV is incorrect because most companies backed by venture capital have a very low degree of association with the markets, thus having a very low systematic risk. On the other hand, the unique nature of each company results in a very high degree of unsystematic risk associated with their returns

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14) The Right Answer is **C**
Explanation:

$$\begin{aligned} FCF_{EQUITY} &= [NI] + [DEP] - \begin{bmatrix}\text{Mortgage}\\ \text{Principal}\\ \text{Payment}\end{bmatrix} - \begin{bmatrix}\text{Increase in}\\ \text{Uncollectible}\\ \text{Rents}\end{bmatrix} + \begin{bmatrix}\text{Increase in}\\ \text{Accounts}\\ \text{Payable}\end{bmatrix} - \begin{bmatrix}\text{Capital}\\ \text{Expenses}\end{bmatrix} \\ &= 65{,}000 + 93{,}750^* - 32{,}000 - 8{,}000 + 12{,}000 - 17{,}000 \\ &= 113{,}750 \end{aligned}$$

$$^*\text{Note: Depreciation} = \frac{750{,}000}{8} = 93{,}750$$

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15) The Right Answer is **B**.
Explanation: Choice I is incorrect because REITs were primarily constructed to suit the needs of small investors who wanted to have real estate exposure but did not have the financial resources to buy properties outright. Choice II is incorrect because REIT managers may also finance their acquisitions through the issuance of debt.

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16)	The Right Answer is **A**. **Explanation:** When investing in real estate, an investor must decide how much risk he or she is willing to take and how much liquidity he or she will need. This will determine the types of real estate investments that will be most suitable for the investor. Because real estate investing requires large amounts of capital, an investor's ability to raise capital will be a constraint as to what kinds of properties will be affordable. The correlation of real estate with other asset classes is important, but that does not constitute an objective or a constraint
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17)	The Right Answer is **A**. **Explanation:** When looking at leverage, we have to compare the net operating income with interest charges; however, both of these are before-tax items.
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18)	The Right Answer is **C** **Explanation:** Choice IV is incorrect because open-ended funds do not trade on exchanges. Instead, the fund companies issue as many units as needed in order to fulfill demand. Therefore, supply always equals demand, and the unit price of a mutual fund will always equal its NAV.
	. .
19)	The Right Answer is **A**. **Explanation:** A comparable sales approach is most appropriate when there are many properties that are similar to the property in question. Therefore, when it comes to a unique property or a unique situation, using the discounted cash flow method would yield much more reliable figures.
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20)	The Right Answer is **C**. **Explanation:** Choice I is not really true. For diversification to be effective, it must involve an investment into various sectors. Therefore, no matter how many companies a sector fund may have, the fact that all the companies are in the same sector means that fund risk will really not be reduced that much. Choice III is incorrect because, in general, firms that have had venture capitalist backing perform much better after an IPO than firms that have not had similar backing.