

Real Estate Investment Analysis
Fall 2002

Midterm 2 Review Practice Problems

Dr. Stanley D. Longhofer
T 7:05-9:45

- 1) Walter owns an office building that he purchased several years ago for \$3.5 million, including transaction costs. He has claimed total (cumulative) depreciation (cost recovery allowances) of \$360,000. He has made no capital improvements during his holding period.

The prospective buyer has offered Walter \$5 million for the property to be paid as follows: The buyer will pay \$500,000 cash immediately and assume Walter's existing \$2.5 million mortgage. The remaining \$2 million will be paid in two annual installments including both principal and interest at 8 percent.

If Walter accepts this offer and incurs \$250,000 of sales costs, what will be the resultant increase in his taxable income in the year of the transaction and in each of the three succeeding years, assuming he uses the installment method of reporting the sale?

- 2) George, owns rental property worth \$750,000 and subject to a mortgage of \$200,000. His adjusted tax basis in the property is \$300,000. He trades with Gerald for a like-kind property worth \$500,000, which is subject to a mortgage balance of \$100,000. Each party takes title subject to existing mortgages. If necessary, either party will put up cash to balance the equities.
- a) How much cash must be put up by whom to balance the equities?
 - b) How much total boot has George received?
 - c) What is George's realized, recognized, and deferred gain from this transaction?
 - d) What is George's substitute basis in his new property?