

**SA422: HOUSING ECONOMICS AND FINANCE 2008/2009**  
**Seminar Problem Set 4 - Investment Decisions/Finance**  
**(Week 6, Thursday 13 November 11:30 – 12:45 in Room E304)**

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1. Clarify the relationship between the price of a dwelling and the rental income achievable from that dwelling in a perfect market
2. What is the effect on house prices of (i) a reduction in real interest rates; (ii) an increase in the demand for rented housing; and (iii) a change in expectations about levels of house building?
3. In a perfect market is an individual household indifferent between owning and renting?
4. A landlord wants advice on how she might decide whether or not to add an additional bathroom. The cost of the addition is £10,000. The interest rate is 5%. She can expect to get an additional £450 p.a. rent as a result.
  - (i) Should she do the investment?
  - (ii) If the additional rents were £440 should she do the investment?
  - (iii) What would be the position if the interest were 6% and
  - (iv) 4%?
5. Clarify what is meant by (i) debt, (ii) equity, (iii) gearing. How does a decline in the value of a property affect gearing and risk?
6. Define (i) a fixed interest rate mortgage and (ii) a variable interest rate mortgage. Under each system who bears the cost/risk of expected and unexpected changes in interest rates and inflation?