**Chapter 1**

**EXERCISE 1.1**

**CONCEPT QUESTIONS**

1. a) 7%; the higher the interest rate, the more interest that will be paid on a loan;  b) 150 days; the longer is the term of a loan, the more interest that will be paid on a  loan; c) ordinary interest
2. 5%; the higher the interest rate, the faster a given investment    will grow to a given accumulated value after a given amount of  time
3. 6%; the lower the interest rate, the more that will be needed to be invested in order to accumulate to a given amount after a given term

**EXERCISES**

1. a)

b)

c)

d)

1. a)

b)

c)

d)

1. a)

b)

c)



At exact interest

1. Exact time = (365 – 138) + 98 = 325 days

Exact interest



|  |  |  |  |
| --- | --- | --- | --- |
| Dates | # of days | Balance | Interest |
| January 1 –March 1 | 59 | 1000 |  |
| March 1 – March 31 | 30 | 900 | March 31 pay $28.28 |
| March 31 –April 17 | 17 | 900 |  |
| April 17 – June 30 | 74 | 600 | June 30 pay $19.63 |
| June 30 – July 12 | 12 | 600 |  |
| July 12–August 20 | 39 | 400 |  |
| August 20–Sept. 30 | 41 | 300 | Sept. 30 pay $11.54 |
| Sept. 30-October 18 | 18 | 300 | October 18 pay $1.78 |
|  | | |  |
| Total interest paid = 28.28 + 19.63 + 11.54 + 1.78 = $61.23 | | | |

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| --- | --- | --- | --- | --- |
| Interest Period | #of days | Balance | Rate | Interest |
| Feb.3-Feb.11 | 8 | 50 000 | 6% |  |
|  |  |  |  | Feb. 11 Interest $65.75 |
| Feb.11-Feb.20 | 9 | 50 000 | 6% |  |
| Feb.20-March 11 | 19 | 40 000 | 6% |  |
|  |  |  |  | March 11 interest $198.90 |
|  |  |  |  |  |
| March 11-March 20 | 9 | 40 000 | 6% |  |
| March 20-April 1 | 12 | 30 000 | 6% |  |
| April 1 –April 11 | 10 | 30 000 | 7% |  |
|  |  |  |  | April 11 interest $175.89 |
| April 11-April 20 | 9 | 30 000 | 7% |  |
| April 20-May 1 | 11 | 15 000 | 7% |  |
| May 1-May11 | 10 | 15 000 | 6.5% |  |
|  |  |  |  | May 11 interest $110.13 |
| May 11- May 20 | 9 | 15 000 | 6.5% |  |
|  |  |  |  | May 20 interest = $24.04 |

Total interest paid $574.71

1. Consider a $100 amount. Then *P* = 98, *I* = 2, *t* = and
3. a)

b) Interest on loan =

Savings =

1. a) *S* =

= 5000 + 162.50 = $5162.50

b) *S* =

**EXERCISE 1.2**

**CONCEPT QUESTIONS**

1. 9%, the higher the interest rate, the lower the present value
2. 150 days; the larger (smaller) the term, the lower (higher) the present value
3. legal due date = due date + 3 days of grace
4. There is no difference (remember, there are no three days of grace added to regular bank loans, only for promissory notes)

**EXERCISES**

1. Maturity date is February 6

Maturity value = $3000.00

Discount period = 67 days

Proceeds

1. Maturity date is November 3

Maturity value = 1200[1 + (0.055) ()]= $1211.39

Discount period = 27 days

Proceeds

1. Maturity date is June 27

Maturity value = 500[1 + (0.07) ()]= $518.70

Discount period = 185 days

Proceeds

1. Maturity date is April 7

Maturity value = $4000.00

Discount period = 37 days

Proceeds

1. a) Maturity value = 2000[1 + (0.13)()]= $2066.25

Proceeds

b)

c) Bank’s profit =

*P*

Investor’s profit = 5006.24 – 5000 = $6.42

Bank’s profit = 5108.29 – 5006.24 = $102.05

*P*

1. Maturity date is 123 days after October 17,2020, i.e. February 17, 2021

Maturity value = 5000[1 + (0.075) ()]= $5126.37

Proceeds

1. Proceeds

Profit

1. Needs 97% of 2000 = $1940.00

= $1960.09

1. Maturity date is 123 days after June 8, 2020, i.e. October 9, 2020

Maturity value = $1532.86

a) *P*

b)

c) Banks profit =

1. a) = $3333.33

b) = $3333.42

where 10 months after July 31 is May 31, which is 304 days

1. a) Loan 1: = $1245.06

Loan 2: = $1418.25 → total = $2663.31

b) Loan 1: = $1244.59

Loan 2: = $1417.88 → total = $2662.47

**EXERCISE 1.3**

**CONCEPT QUESTIONS**

1. False: $3000 only when *r* = 0%.
2. a) A dated value is a value of a debt or payment made on a particular date;

b) An equivalent dated value is the value of a debt or payment that has been accumulated or discounted from the date it is made to another (focal) date;

c) A focal date is a specific point in time selected to compare the dated values of sets of payments.

1. A debt of $500 due in 6 months means that $500 is due in 6 months and already includes any interest; a debt of $500 due in 6 months with interest means the $500 does not include interest; you have to calculate the accumulated value of the $500 at the end of 6 months by calculating 500[1 + *r* (6/12)].

**EXERCISES**

1. = $1190.86
2. 38.60



94







1. a)

= $1153.68

b)

c)

1. First Debt

Second Debt

1. a)

b)



1. At the end of the 6 months:

At the end of 3 months:

1. At the present time:

At the end of 2 years

1. Maturity value of loan 1 = Maturity value of loan 2 =

Equivalent single payment made at the end of 180 days:  
*X* = +

14. At the present time:

At the end of 3 months:

At the end of 6 months:

At the end of 9 months:

**EXERCISE 1.4**

1. a) Declining Balance Method:

End of 3 months balance

End of 7 months balance

End of year balance

b) Merchant’s Rule:

Balance due

1. a) Declining Balance Method:

August 17/20 Balance

November 20/20 Balance

February 2/21 Balance

April 18/21 Balance

b) Merchant’s Rule: Balance due on April 18, 2021

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1. a) Declining Balance Method:

End of 2 months balance

End of 4 months balance

End of 6 months balance

b) Merchant’s Rule: Balance due

1. a) Declining Balance Method:

April 12 Balance

Note that interest from April 12 to August 10 is larger than $20

)

October 3 Balance

December 15 Balance

b) Merchant’s Rule:

Balance due on December 15

1. End of 2 months balance

Note that interest for the next 4 months and is larger than the partial payment of $30.00 ( )

End of 8 months balance

End of 12 months balance

1. a) Declining Balance Method:

August 16 balance

Note that interest due on Nov 19 is smaller than partial payment of $40

Thus, Nov 19 Balance

Jan 9 Balance

Mar 20 Balance

b) Merchant’s Rule:

Balance due on March 20

**EXERCISE 1.5**

**CONCEPT QUESTIONS**

1. Lower
2. Higher
3. a) the loan with the simple interest rate; borrower would receive $2000, while the borrower would receive less than $2000 for the loan with the simple discount rate;  b) the loan with the simple discount rate

**EXERCISES**

1. a) ]―1

b) ]

1. a) ]

b) ]―1

c)

1. ; Thus,
2. Maturity value

Discount

2. Maturity date of the 1st note is August 4

Interest due on the 1st note

Maturity date of the 2nd note is November 7

It is due to be paid in 245 days.

1. ; Thus,

1. a) Mar 13 to Sep 2

b)

c)

1. a)Canada: = $4957.36

USA: = $4956.40

b)Canada: = $4978.44

USA: =$4978.04

c) Canada: = 3.88%

USA: = 3.98%

1. a) → Solves for *r* = 4.65%

b) Sept 9, 2020 to Jan 25, 2021 is 138 days and

Jan 25, 2021 to Sept 8, 2021 is 226 days.

1. → Solves for
2. = 2.33%
3. a) Apr 25 to Aug 16

b)

c)

**REVIEW EXERCISE 1.6**

1. a)

b)

1. Ordinary interest:

Exact interest:

1. a)

b) Interest on loan

Savings

1. a)

b) Interest on loan

Savings

1. + 500

1. Merchant’s Rule:

Declining Balance Method:

October 27/20 Balance

January 7/21 Balance

May 1/21 Balance

1. a) Equation of value at the end of 6 months:

b) Equation of value at the present time:

1. Merchant’s Rule

On October 31:

Declining Balance Method:

July 17 balance

September 29 balance

October 31 balance

1. a)

b)

c)

1. Maturity date: August 12, 2020

Maturity value

1. Prasad’s profit
2. Bank’s profit

1. Bank’s profit

The answer is different from c) since in c), the note was assumed to be paid back on the maturity date, while in d), the note was assumed to be paid back 3 days earlier on the due date. The rate of return is higher despite losing 3 days of interest because getting the note paid back three days earlier is more valuable to the bank than receiving the extra 3 days of interest.

1. Maturity value
2. Bank will receive

Discount

1. Interest due on the first note

Face value of the second note

1. Assume last payment in X days

1. Exact time =

Banker's Rule: $1475.00

Exact interest:

Difference =

1. At present time :

At the end of 12 months

Difference

1. Maturity Value

Proceeds

1. a) At the end of 8 months:

b) At the end of 8 months:

**Case Study 1** – Promissory Notes

a) Maturity Value of note

20 days

Proceeds

30 days

Proceeds

40 days

Proceeds

50 days

Proceeds

Jerry should sell the note to Bank One sometime between 30 days and 40 days from now.

b) The exact time the note should be sold in order for the proceeds to be $400,000:

Which solves for *t* = 34.875 days

If Jerry sells the note to Bank One after 35 days, he will receive $400,000 (actually, he will

get a bit more than $400,000).

c) If the bank uses *d* = 12%,

Which solves for *t* = 35.965 days

Jerry should sell the note to Bank One after 36 days.

**Case Study 2** – Student Loans

The grace period is May 1 to October 31. From May 1 to September 15 is 258 – 121 = 137 days at 2.5% + 2.5% = 5%, while September 15 to October 31 (inclusive) is 304 – 258 + 1 = 47 days at 3.0% + 2.5% = 5.50%.

The accrued interest at the end of the grace period is

*I* = 12 500(0.05)(137/365) + 12 500(0.055)(47/365) = $323.12

The loan balance on October 31 is 12 500 + 323.12 = 12 823.12

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Days | Interest Rate | Interest ($) | Accrued Interest | Monthly Payment | Principal Portion | Outstanding Balance |
| Nov 1 | -- | -- | -- | -- | -- | -- | 12 823.12 |
| Nov 30 | 30 | 5.50 | 57.97 | 57.97 | 200.00 | 142.03 | 12 681.09 |
| Dec 31 | 31 | 5.50 | 59.24 | 59.24 | 200.00 | 140.76 | 12 540.33 |
| Jan 19 | 19 | 5.50 | 35.90 | 35.90 |  |  |  |
| Jan 31 | 12 | 5.75 | 23.71 | 59.61 | 200.00 | 140.39 | 12 399.94 |
| Feb 28 | 28 | 5.75 | 54.70 | 54.70 | 200.00 | 145.30 | 12 254.64 |

**Case Study 3** – Solving for a simple interest rate

a) Set up an equation of value, using the end of 12 months as the focal date:

220[1 + *i* ] = 20[1 + *i* (11/12)] + 20[1 + *i* (10/12)] + … + 20[1 + *i* (1/12)] + 20

220 + 220*i* = 20(12) + *i* (1 + 2 + … + 11)/12

220 + 220*i* = 240 + *i* (66/12)

*i*

b) Set up an equation of value, using the end of 6 months as the focal date:

220[1 + *i*(6/12) ] = 40[1 + *i* (5/12)] + 40[1 + *i* (4/12)] + … + 40[1 + *i* (1/12)] + 40

220 + 110*i* = 40(6) + *i* (1 + 2 + … + 5)/12

220 + 110*i* = 240 + *i* (15/12)

*i*