

2027 CFA® Exam Prep

IFT Mock Exams

Level III

Mock Exam 1: Session 2

PRIVATE MARKETS PATHWAY

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Exam 1 Session 2

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Start time: 2:00 PM

End time: 4:12 PM

QUESTION 1**TOPIC: PRIVATE MARKETS****THE TOTAL POINT VALUE OF THIS QUESTION SET IS 12 POINTS**

The Parak River Bridge project of an emerging market country costs USD 2.5 billion. The Public Works Department (PWD) of the federal government, under the Ministry of Works, has successfully completed the RFP process for the design, construction, financing, and operation of the new bridge, and awarded the contract. The project is co-sponsored by the IFC, which provides both technical support and debt financing, and EDCon, a private investor, manager, and equity provider. Parak Bridge Limited (PBL) was established as the project company and concessionaire, with PWD serving as the grantor for the 20 year term, with ownership and control transferred to PWD at the end.

PBL will hold a 20-year concession under which it will receive periodic toll payments upon completion of the bridge. PBL Project Financing Plan is shown in Exhibit 1 and Exhibit 2.

Exhibit 1

Equity Financing is 45% of cost	USD 1,125,000,000
40% from EDCon, and the remaining 60% from other equity investors drawn in three stages.	
Equity drawdown:	
Initial:	USD 562,500,000
One year:	USD 281,250,000
Two years:	USD 281,250,000
GP performance fees upon completion are 10% of returns above a 14% hurdle.	

Exhibit 2

Debt Financing is 55% of cost	USD 1,375,000,000
International Finance Corporation (IFC) senior secured loan	USD 350,000,000 • 6% annual interest • Fully disbursed at the end of Year 2 linked to project milestones • Accrued interest is capitalized in Year 3 and paid in Year 4 on full balance outstanding. • Loan is repaid in 12 equal annual installments comprising principal and interest payments starting in Year 5
Senior syndicated secured bank loan—Term Loan A	USD 600,000,000

	8% annual interest paid annually on the balance outstanding • Fully disbursed at the end of Year 3 • Full balance outstanding for three years, with principal amortization in four equal annual tranches thereafter
Secured Bank loan ECA guaranteed	USD200,000,000 • 7% annual interest paid annually on outstanding balance • Fully disbursed at the end of Year 3 • Interest is paid on full balance outstanding for 10 years, with full (bullet) loan repayment at maturity. • Insured by developed market ECA against political and commercial risks; secured by equipment financed under loan agreement
Junior construction and development loan	USD 225,000,000 • 10% annual interest accrued on outstanding balance • Immediate disbursal upon project initiation and equity drawdown • Capitalized interest and principal are paid in four equal installments starting at the end of Year 14.

*Senior loans are secured by PBL project assets

**Junior loan has subordinated claims to PBL project assets.

In its first full year of operation, Parak Bridge Limited, based on varying proportions of multi class commercial vehicles, freight traffic, passenger cars, and vans, expects to earn an average net cash flow from operations of 252,500,000.

1.1. Calculate the outstanding debt and the DSCR for the first full year of operation (Year 4) of the PBL project.

1.2 Determine whether the GP will be paid the performance fee equal to 10% of the equity dividend rate in excess of the 14% hurdle rate based on the first full year of PBL's operation. (Ignore management fees.) **Justify** your response.

QUESTION 2**TOPIC: PORTFOLIO CONSTRUCTION****THE TOTAL POINT VALUE OF THIS QUESTION SET IS 12 POINTS**

Theo Radcliff works as an investment adviser for institutional investors at JD Warren, an investment management company. Radcliff meets with Karen Santiago, the CFO of Network Solutions (NS), to discuss the company's DB pension plan investments. NS is solely responsible for funding its Defined Benefit (DB) plan by making annual contributions. Santiago asks Radcliff to compare NS's DB plan with its two main competitors, Tyler Technologies (TT) and Munis Support (MS). Radcliff collects the following financial data and pension plan characteristics for the three companies.

	NS	TT	MS
Sales	21,000,000	38,000,000	29,500,000
Profit margin	29%	35%	35%
Projected benefit obligations	23,500,000	34,000,000	27,600,000
Long term debt-to-capital ratio	47%	43%	53%
Provision allowing lump-sum distribution	YES	YES	NO
Provision allowing early retirement	NO	YES	NO
Proportion of active lives as a percent of total participants	43%	28%	64%
Plan funded status	Deficit	Surplus	Surplus

Radcliff also has an endowment among his clientele associated with the University of Brussels (UB).

- The endowment currently has a planned time horizon until 2037.
- The endowment's investment returns are tax-exempt.
- UB currently receives enough funds from the endowment to meet its spending needs, and in recent years, it has had a budget surplus.
- UB's board is confident that it could raise funds through donor contributions, if necessary.

JD Warren manages a large fund for Hassler Insurance Corp (HIC), a non-life insurance company.

- The timing and amount of claims are uncertain, but HIC has a policy of settling all its liabilities within 3 years.
- The return requirement for HIC is calculated every year based on its forecast for expected claims, capital market expectations, and the market value of its portfolios.

David Ernst, president of JD Warren, asks Radcliff to review the IPSs of both the endowment and HIC.

Radcliff is approached by Safeway International (SI), a US-based company that operates a DB pension plan for its employees. SI is profitable, with a sound balance sheet and lower debt ratios than its peers. Its DB pension plan is in surplus. The company's percentage ratio of active employees to retired employees is 75%/25%. The average age of its employees is 39 years, and the workforce is stable. SI's management aims to maintain the plan's funded status (pension surplus) relative to its liabilities and intends to cease contributions to the plan in the next two years. However, after 2 years, it will make the necessary contributions if needed.

The plan maintains an asset allocation of 30% in US equities, 10% in emerging market equities, and 60% in US fixed income. The fixed-income allocations consist of 40% in US Treasury bonds and 20% in cash and short-term Treasury bills. However, the expected returns of both equities and fixed income are below long-term averages. As a result, SI's management is considering investing in alternatives. After reviewing the expected returns of various asset classes, Radcliff recommends the following asset allocation to SI.

Exhibit 1

Asset Class	Recommended Asset Allocation	Expected Long-Term (10-Year) Annual Return
Cash and US T-bills	5%	0.5%
US equities	20%	5.0%
Emerging market equities	5%	6.0%
US Treasury Bonds	30%	3.0%
Private Debt	20%	7.0%
Hedge Funds	20%	9.0%

2.1 Determine which company's pension plan has the highest risk tolerance based on:

- Financial status/profitability.
- Plan features.

Justify each response with one reason.

2.2 Compare each of the following components of HIC's IPS and UB Endowment's IPS:

- i. Risk tolerance.
- ii. Liquidity requirement.

Justify each response with two reasons.

2.3 Determine the investment horizon (short-term or long-term)/risk tolerance and the liquidity needs (high, low) of the DB plan. **Justify** each response.

- Investment horizon– short term, long term
- Risk Tolerance – higher, lower
- Liquidity needs – high, low

2.4 Determine the *most likely* effect (increase, decrease, no change) on the SI DB pension plan's funded status because of the recommended asset allocation. **Justify** your response with two reasons.

- Increase
- Decrease
- No change

QUESTION 3**TOPIC: ECONOMICS****THE TOTAL POINT VALUE OF THIS QUESTION SET IS 12 POINTS**

Tony Roth, senior analyst at Wellington Asset Management, and his team are preparing capital market expectations for the following year. Roth employs quantitative models that incorporate exchange rates, interest rates, commodity prices, and/or policy variables. These models use estimated past data to forecast the future with consistency. Mike Winston, a junior analyst in Roth's team, relies on leading indicators because they provide quick information about upcoming changes in economic activity, inflation, interest rates, and security prices.

Using his approach and Winston's analysis, Roth determines the current phase of a country's business cycle.

Exhibit 1
Predictions of Business Cycle Phase

	Country Y (Developed market)	Country T (Emerging market)
Cycle Phase	Slowdown	Early expansion

Roth has to analyze the effects of inflation on different asset classes, the path of nominal interest rates, and each country's potential monetary response in the current phase. He also considers the timing of the country's economy's entry into the next business cycle. After assessing Country Y, Roth makes the following notes:

- Monetary policy has been tight for Country Y, while fiscal policies have been loose. Expected inflation is within range.
- The current yield curve for Country Y is flat. Inflation is rising. Money market rates are procyclical, adjusting in response to expected inflation, reflecting economic slowdown conditions.

Roth observes Country T's government policies and finds that it is not expected to increase transfer payments or introduce a more progressive tax regime.

3.1 Identify two strengths of each forecasting approach that have likely appealed to each analyst.

- Econometric modeling approach
- Leading economic indicator–LEI approach