MONEY 101 EDUCATION

12.08 How can Sally sell her bond?

BOND A			BOND B	
Interest Rate	5%		Interest Rate	8%
Term	15 years%		Term	10 years

Sally purchased Bond A with a face value of $10,000

The Bond term was 15 years

The Bond interest rate was 5% - so she will receive $500 annually

At the end of the 15 years, she will get back the face value $10,000

	Year 1 - what an investor pays	Interest Income	Net cash Outlay
Year 1	$ (10,000)	$ 500	
Year 2		$ 500	
Year 3		$ 500	
Year 4		$ 500	
Year 5		$ 500	
	$ (10,000)	$ 2,500	$ (7,500)

CHALLENGE:

Five years p she has earned a total of $2,500 in interest

However she now has a need for cash - she wants to sell her bond.
Unfortunately since that time interest rates have risen

If someone was going to buy a similar bond, they would earn 8% interest.

Therefore an investor could make more interest by buying a new bond, rather than Sally's bond.

What can Sally do to attract a buyer to buy her bond?

THE NEXT TEN YEARS SALLY"S BOND WILL EARN			**A NEW BOND WOULD EARN**		
Year 6	$ 500		Year 1	$ 800	
Year 7	$ 500		Year 2	$ 800	
Year 8	$ 500		Year 3	$ 800	
Year 9	$ 500		Year 4	$ 800	
Year 10	$ 500		Year 5	$ 800	
Year 11	$ 500		Year 6	$ 800	
Year 12	$ 500		Year 7	$ 800	
Year 13	$ 500		Year 8	$ 800	
Year 14	$ 500		Year 9	$ 800	
Year 15	$ 500		Year 10	$ 800	
INTEREST EARNED	$ -	$ 5,000		$ -	$ 8,000

ANSWER - Sally can DISCOUNT her bond by $3,000

THUS THE NEW OWNER WOULD DO THE SAME IF THEY BOUGHT SALLY'S BOND OR THE NEW BOND

	PURCHASE & REDEMPTION OF BOND	INTEREST		PURCHASE & REDEMPTION OF BOND	INTEREST	
Year 6	$ (7,000)	$ 500		Year 1	$ (10,000)	$ 800	
Year 7		$ 500		Year 2		$ 800	
Year 8		$ 500		Year 3		$ 800	
Year 9		$ 500		Year 4		$ 800	
Year 10		$ 500		Year 5		$ 800	
Year 11		$ 500		Year 6		$ 800	
Year 12		$ 500		Year 7		$ 800	
Year 13		$ 500		Year 8		$ 800	
Year 14		$ 500		Year 9		$ 800	
Year 15	$ 10,000	$ 500		Year 10	$ 10,000	$ 800	
TOTAL EARNED	$ 3,000	$ 5,000	$ 8,000		$ -	$ 8,000	$ 8,000