

SAMPLE SECOND EXAMINATION  
REAL 204/804

This is a sample of what a second in my class looks like. It is slightly shorter than an actual exam. Please be sure to read each question carefully before you begin to write. I **will not read** anything that is not in the space provided after each question so be sure to complete your answer in that space. For the multiple choice: if you choose the right answer and write nothing, you get all of the points. If you choose the wrong answer, but write a valuable comment you may get some of the points. If you choose the right answer but write an erroneous comment, you get none of the points.

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**Question 1-45 points**

Henry Issac Potter (whom everyone calls “Hip”) and Helen Olivia Phillips (whom everyone calls “Hop”) were business partners in their real estate company “Hip Hop Realty”. Hip Hop specializes in finding underperforming assets, acquiring them at somewhat distressed prices, turning them around and then selling (this process has been called the “Hip Hop Flip”). For each deal they form a single asset LLC to acquire, own and manage the property.

One day while reading the Sheriff’s sale notices in the paper Hip comes across a gem of property. It is a partially occupied suburban office building. The notice says it is being sold “subject a mortgage lien from Gangsta Bank in the amount of \$2,000,000”. After doing their due diligence Hip Hop determines that the property is worth \$4,000,000 and plan on bidding on it at the sale. In the meantime they form an LLC (Bottomfeeder, LLC) and capitalize it by selling membership interests to their wealthy friends from the recoding industry. From 10 friends they raise \$1,500,000. In addition, Hop’s brother (who has always been secretly jealous of his sister’s wealth and success) empties out his bank account, and scrapes together \$5,000 and demands to buy into the LLC. Hop reluctantly agrees.

Their next stop is their friendly neighborhood lender, Thug Savings and Loan. Thug agrees to loan Bottomfeeder LLC \$1,500,000, 7% (fixed) interest, 4 year term (15 year amortization resulting in a balloon due at end of loan term) to acquire the property on the following conditions:

1. Loan is secured by a mortgage on the property
2. Loan is full recourse
3. Both Hop and Hip execute a guaranty and surety agreement for any deficiency
4. Prepayment premium (due whether prepayment is voluntary or involuntary) is based on yield maintenance provision based on comparable US Treasury obligations.
5. Commencement of foreclosure proceedings by Gangsta constitutes a default on the Thug loan.

Hip and Hop go to the Sheriff’s sale and acquire the property in the name of Bottomfeeder, LLC for \$2,000,000 (net of taxes and sheriff’s costs) subject to the Gangsta lien. They pay for the property using the \$1,500,000 loan from Thug and \$500,000 from Bottomfeeder equity.

Unfortunately, things don’t work out the way Hip and Hop had hoped. Six months later they are having a very difficult time leasing the open space. As a matter of fact, one of the two remaining tenants has just given notice that they will vacate their space at the end of the lease term in two months. They meet with Gangsta to see if Gangsta will forego principal and interest payments for 3 months and extend the term of their for 3 months. Gangsta says they will respond within a week.

When Thug finds out about this workout arrangement they call a default on the Thug loan. In their demand letter to Bottomfeeder Thug asserts:

1. The workout with Gangsta constitutes a loss of priority for the entire Gangsta loan.
2. Hip and Hop have personal liability for the entire Thug loan because it is full recourse

At the end of the week Gangsta informs Hip and Hop that they agree to the workout arrangement. Unfortunately, by this point Hip and Hop have given up. They offer to give Gangsta a deed-in-lieu and call it day (assume on this day the value of the property is \$2,500,000). As if all of this was not bad enough they receive a notice from the Securities and Exchange Commission asserting they violated federal securities laws by selling unregistered securities.

Should Gangsta accept the deed-in lieu? (15 points) Who has lien priority, Gangsta or Thug? (10 points) Do Hip and Hop have personal liability because the loan is full recourse? (10 points) Did Bottomfeeder violate federal securities laws? (10 points)

**Question 2-5 points each**

A. You are a developer applying for a construction loan. In the loan commitment there is a requirement for a 15% retainage:

- a) This means that each draw will be 85% of the requested amount
- b) This means that you must make a 15% equity infusion
- c) This means that if the loan gets out of balance you must contribute 15% of the re-balancing
- d) This means that you will be guaranteeing 15% of the loan

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B. Peter owns a large parcel of vacant land. He sees development occurring all around him but believes that land values will continue to show strong increases for at least 15-20 years. When Anna approaches him with an offer to purchase Peter instead offers to lease her the land for 15 years and allows her to develop it as a strip mall. When Anna's Lender requests that Peter join his fee to Anna's leasehold mortgage Peter:

- a) should refuse because foreclosure on the leasehold mortgage would likewise foreclose on his ownership interest
- b) should refuse because this would mean he could not take a depreciation deduction on the value of the improvements over the life of the lease term
- c) should refuse because under the merger doctrine he cannot hold both the lease and the mortgage interest
- d) should refuse unless the improvements revert to the owner at the end of the ground lease.

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C. Don owns an office building in midtown Manhattan. He bought it for \$50 million (total cost of land and improvements). For federal income tax purposes Don:

- a) may accelerate the depreciation over 10 years to produce paper losses
- b) can only take a depreciation deduction if the value of the property should decline
- c) can only depreciate the portion of the purchase price attributable to the improvements
- d) can only take the depreciation deduction if he sets up the transaction as a sale/leaseback

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D. In a securitized pool the lowest tranche

- a) has the lowest yield because it gets paid first
- b) is sometimes referred to as the “first loss piece”
- c) is secured by the subordinated debt structure
- d) is given the highest rating by the rating agencies

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E. Colin moves into an apartment. He brings his beloved dog Tanner. He knows about (but conveniently ignores) the clause in his lease that says no pets are allowed in the building. Graham, his neighbor, was recently threatened with eviction because he had brought his dog Murphy. Now with Murphy gone Graham wants Colin to get rid of Tanner. Graham sues Colin for breach of quiet enjoyment (Tanner does have some barking issues.....)

- a) Graham will win his suit as the lease clearly prohibits pets
- b) Graham will lose his suit as he cannot sue Colin for breach of quiet enjoyment
- c) Graham will only win if he can show provable (not speculative damages)
- d) Graham will win only if he can prove constructive eviction due to Tanner’s noise

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F. Angela, the Architect, draws up a site plan for a new office development. Diego, the developer uses this site plan when he applies for a construction loan. Diego got the loan and the bank filed a mortgage to secure the loan. However halfway through the construction Diego stopped paying the people working on the project. If Diego’s plumber files a mechanic’s lien, this lien:

- a) Has priority from the date of Angela’s drawing because mechanics’ liens relate back

- b) Has priority over all other liens because mechanics' liens have super priority
- c) Has priority behind the mortgage because construction mortgages always have first priority
- d) Has its priority determined by how this state's mechanics' lien law defines when work "commences"

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G. Food-So-Low, a discount supermarket chain, is about to sign a lease for a store in a new shopping center. The lease contains the following clause:

Tenant agrees not to open another store within 3 miles of this location. If Tenant should open another store within 3 miles Landlord may either 1) declare a default and accelerate all rents due to the end of the lease term and terminate this lease or 2) triple base rent due under this lease while continuing to impose percentage rent as determined under this lease.

This clause:

- a) is a valid radius clause
- b) is a valid "going dark" clause
- c) is a valid exclusive clause
- d) is a valid use clause

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H. In conjunction with making mortgage loans Big Lender routinely requires borrowers to sign an Assignment of Rents and Leases. One of its borrowers, Wimpy, was continually late in making monthly principal and interest payments. However, Big Lender never called a default. One day Big Lender decided to enforce its rights under the Assignment and told all of Wimpy's tenants that they should make their monthly rent payments to Big Lender, not to Wimpy. Big Lender did not, however, declare a default.

- a) Big Lender was entitled to do this because Wimpy had signed the Assignment
- b) Big Lender can only do this if they set up a strong lock box for the rent payments
- c) Big Lender cannot do this because the Assignment is contingent upon declaring a default
- d) Big Lender cannot do this because they did not take possession of the property

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