THIS EXAMINATION CONSISTS OF 11 PAGES (including this page)
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THE UNIVERSITY OF BRITISH COLUMBIA
FACULTY OF LAW

FINAL EXAMINATION December 2014

LAW 447B
Topics in Commercial Law Corporate Finance/Financing Transactions

Section 001
Professor Fine

TOTAL MARKS: 100
TIME ALLOWED: 3.0 HOURS
THIS EXAM CONSISTS OF 7 QUESTIONS

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NOTE:

1. This is an open book exam and open notes examination. Candidates may make use of all reference material.

2. ANSWER ALL QUESTIONS.

THIS EXAMINATION CONSISTS OF 7 QUESTIONS
QUESTION ONE: 10 Marks

Preliminaries and Quick Definitions

(a) During the course we talked a lot about the terms and conditions included in loan documents. However, decisions need to be made by a lender before even entertaining a loan facility. Please list and BRIEFLY discuss the 5 C’s of credit decision-making.

(a1) A developer must first find a piece of land he wants to develop. His first consideration will be what the current permitted use of the land is; or what he thinks it can potentially be used for. In order to find out the answer to the use issue he will need to check with city hall on the _______________ of the land.

(b) As a general rule there will be at least two lenders in a typical project. These two lenders are called (1) ______ lender and (2) the _________ lender. Briefly explain their functions as lenders.

(c) The first document between a lender and developer will likely be the _________ letter. Please explain why the name of this document misleading.

(d) During the draw process for a development project the lender will send someone to inspect the physical property (amongst other steps) before the lender will make a project advance/draw to the borrower. This person is called the ______.

(e) Sometimes a municipality may allow the developer extra floor space and or relaxations for a project in return for the developer providing accouterments that may serve civic purposes. Please name some examples of what a developer may be asked to provide.

(f) There are two basic mechanisms a lender can choose in putting in place the person a Receiver. What are the ways and what is the title of said person depending on how he is installed?

(continued on next page)
(g) There is a cap on what interest rate a lender can charge for a loan. In addition to the face rate of interest name two other costs a lender may charge the borrower that may be included for the purposes of determining whether a lender is over the legal rate of interest that can be charged.

(h) Often when there are more than one lenders to a project the first lender may ask the secondary lender to execute a __________ agreement. Included in this agreement there will also more than likely be a term called a __________ clause. Briefly explain the purpose of this term.

(i) In addition to the lenders to a construction project there are also other participants. Please name two others in the “cast of characters” involved in a construction project.
QUESTION TWO: 10 Marks

Section 347 of the Criminal Code

Please answer the following questions related to s.347 of the Criminal Code of Canada

(a) What is the actual rate expressed on a per annum basis in the section at which number it becomes a criminal rate of interest?

(b) s. 347 of the Criminal Code was likely not directly intended to specifically target commercial lending commerce. What did we discuss was the real target of the legislation? What other amounts charged by the lender besides the face rate of interest will be included in the calculation to determine if s.347 has been breached. (You should be able to name at least 3).

(c) In the past courts have held that if s347 was breached a lender may be disentitled wholly to receiving any interest at all. However, in a series of Ontario cases which cases were ultimately referred to by the Supreme Court of Canada, a number of factors were isolated in deciding whether a lender could still receive interest in the face of a breach of s347. Please discuss these factors.

(d) There is a clause that is generally included in a lender’s document in the interest provision section of the contract in an attempt to alleviate any adverse consequences of breaching s.347. What is the explanatory heading of this clause and briefly explain its intent and operation.

(continued on next page)
(e) Do you think the law should provide for a maximum interest rate that can be contracted for between lenders and borrowers and why or why not. (Your opinion is being asked for) Finally, if a lender wants to have a return greater than the maximum allowable interest under s.347 briefly describe a method he can legally employ to obtain such a return.

QUESTION THREE: 10 Marks

Commitment Letters

(a) The commitment letter sets the tone for the relationship between a lender and borrower. One of the first steps is to adequately describe the parties to the contract as well as the purpose of the relationship (description of the project). Please discuss the importance of these seemingly obvious necessary terms. (Hint: they relate to consequences should post the commitment letter other parties become partners in the project with the borrower and to potential default consequences under the mortgage relating to the intended description of the purpose of the project).

(b) A commitment letter will always have, inter alia, conditions precedent before the lender will be required to fund. The list will vary depending on the type and nature of the project. However, there are many usual standard type conditions precedent that will almost always be in the list of conditions precedent, in particular when it is for a construction project. Please list at least 4 conditions precedent to funding that a lender will likely insist on and a brief discussion as to why a lender would insist on them. (Hint if you are totally stuck: We discussed that a lender may at some point have to “take over” a project and thus build it himself, albeit through a receiver. To do so the lender or its agent will need to be able to “step into the shoes” of the developer so may require amongst other things assignments of necessary matters).
(c) A commitment letter is often intended to survive through the entire relationship between the parties. Accordingly, the commitment letter will almost always be incorporated by reference into what document?
QUESTION FOUR: 20 Marks

Construction Mortgage

(a) If the parties are now operating under a construction mortgage it means that all the terms and conditions precedent in the commitment letter have been satisfied and the actual project is underway. Let us assume a $10,000,000 loan construction budget has been arranged and that the developer was required to have at all times a minimum of $1,000,000 of his own money in the project (i.e. he bought the original land for $1,000,000 with his own $ and the lender is loaning the rest to build the structure). Let us further assume the developer has in his budget an excavation cost of $1,000,000. Let us say he is one month into the project and that excavation was supposed to take two months and the cost budgeted to be evenly spread over the two months. He has incurred in month 1 $500,000 in excavation cost and wishes to submit a request (draw) to the lender so he can pay his sub trade excavator. Please describe the process which will be followed so that the developer/borrower can obtain his $500,000 from the lender. (Hint: this process is followed for each and every draw).

(b) Let us assume that our developer is now at the end of month two. All excavation is completed and it turns out that the excavation bill for the work done in month 2 is $520,000 for a total cost over the two months of $1,020,000 ($20,000 over budget). The original budget of the developer, which the lender based his approval upon, is now off side. List two alternate things the developer can do to deal with this situation to account for this $20,000 so he is still within the parameters of the over all budget and thus stay onside with his lender. (Hint: the budget itself was likely not inflexible). (continued on next page)
(c) Let us assume that the lender discovers a lien against the property at some point through the construction period. Why would a lender be reluctant to advance any further funds under his construction mortgage?

(d) Let us assume that part way through the construction of the structure it is destroyed by fire. What would the lender have likely have included in the construction mortgage (and the commitment letter) to assist him in protecting his security in such an event.

(e) In certain circumstances a lender may feel obliged to take the project away from the developer. The construction mortgage will often contain the right of the lender to “step right in” and take it over for breach of the contractual terms; making him a mortgagee in possession. If a mortgagee does not go through the courts but simply throws the developer off the site and takes it over himself through his contractual right to do so; what is one of the main risks the lender faces in proceeding in this manner.

(f) Let us assume that our budget of $10,000,000 turns out to be low. Let us further assume that the project is not finished and that there are liens on the property amounting to $2,000,000. Our construction lender has already advanced $9,000,000 prior to these liens being registered so the $9M ranks ahead of the liens. However, $2M more is required to finish the project so that it can be sold in order for the lender to get back his $9M. In addition, the developer/builder has disappeared. Discuss how the lender should proceed so that he can advance money to the project so it can be finished and be assured that this additional money will be secured in priority to the liens he has now discovered.
QUESTION FIVE: 10 Marks

Olympic Village and Sophia Development

During the year we discussed the situations that presented themselves in the course of these two projects. Please answer the following questions with respect to them:

(a) The two projects had many pre sales prior to construction and to finishing construction. What is the reason for a pre sale requirement and who most likely would have insisted that the developer obtain pre sales?

(b) A pre sales requirement can consist of one or more component elements. Please discuss.

(c) In the Sophia project what ultimately was the havoc caused by having so many pre sales?

(d) In respect of the Olympic Village, what was unusual about the purchase of the land component of the project? Who stood to gain the most by this circumstance?

(e) As you know, in the Sohpi project a “divorce” took place between the lender and the developer. What action did the lender take to manage the completion of the project? What was the dilemma faced by this person. What parties were being affected/most affected by the entire situation and how were they being affected.
(f) Dealing specifically with the pre sale purchasers in development projects, do you think there should be a mechanism for protecting their rights? If so, what method(s) do you think should/could be adopted to provide them with more rights?
QUESTION SIX:

COURSE MATERIAL: 20 Marks

Throughout the term we went through the various documents necessary between a developer/borrower and a lender in order to take an empty piece of land and turn it into a project of one type or another. Along the way we discussed issues and situations, which occur through the life of a project; how unseen difficulties can impact a borrower or lender and what can be done to minimize exposure to each party, etc.

Please discuss and outline what you learned in this course, if anything, about the practical as well as the legal considerations involved in the development/construction process. (This question, while there may be some overlap with your answers to the questions above, is meant to elicit a more general overall response to what you learned rather than the specifics of various issues which were covered in the exam).

QUESTION SEVEN: 20 Marks

You received two articles with this exam paper; "Development of Vancouver’s Olympic Village trapped in vicious, hollow circle and Sophia condo project falls into receivership.

Please pick one of the articles (please identify which one you have chosen) and discuss any practical, legal and general principles which you see at work in the article that we learned during the term. Also, discuss how this course (I hope!) helped you in understanding these articles more clearly. Also, during your discussion tie in your comments to one or all of the 5 C’s of credit granting.

END OF EXAMINATION
Development of Vancouver's Olympic Village trapped in vicious, hollow circle

FRANCES BULA
VANCOUVER — Special to The Globe and Mail
Published Thursday, Feb. 10 2011, 8:47 PM EST
Last updated Thursday, Aug. 23 2012, 5:02 PM EDT

The receivers for Vancouver's Olympic Village are looking to rent some condos - at a loss - to help fill up the project and make sure that retailers move in.

The 112-page plan, outlined by Ernst & Young and filed Thursday in B.C. Supreme Court, notes that one of the several reasons the marketing effort last year only attracted 30 buyers was because of the lack of shopping in the nine-block development.

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London Drugs, the Urban Fare grocery store, and a Mark James brew pub were supposed to be part of the Village's attractions.

Those spaces remain vacant and the receivers were warned that "if occupancy levels remained near the low levels, the major proposed tenants had advised the receiver that opening for business in their proposed location would not be feasible."

And, if the large stores don't come in, neither will the smaller ones, they noted.

As a result, the plan recommends renting out up to 127 of the higher-end condos (though none valued at over $1-million) even though Vancouver, which is on the hook for the $740-million owing on the project, is likely to see a loss. Not because the rents will be low. They won't be.

But, because of a complicated situation inherited from the previous private developers who didn't apply to stratify the units by the required deadline, the city will have to pay HST on the value of any condo that gets rented out. It would take 20 months of renting to recover that.
As well, those previously rented condos will likely sell for less at some future date or need to be refurbished in order to get a good sale price.

In spite of those "adverse considerations," the receiver's plan says it is worth it in order to accelerate occupancy at the Village.

The receivers envision seeing the Village 70 per cent occupied by the summer, compared to the 32 per cent it stood at in mid-November.

However, it's anticipated that it could take as long as three years to sell everything in the project. And the receiver says it has no prediction on whether the city will get back all of its money.

The rental issue is just one of the many complications the receiver has had to grapple with to come up with a plan for the Village, as the city tries to get back as much as possible on the money it is still owed for land and construction costs after the private developer, Millennium Development Corp., agreed to have it placed in receivership.

That plan currently envisions putting 230 of the condos up for sale through a marketing re-launch next week, with prices reduced about 30 per cent from what they were last May. The most expensive condos would be held off the market for now, while up to 127 might be rented.

Some of the other dilemmas:

* The prices needed to be reduced, but not so much that it would damage the equity of people who already bought in. So the plan emphasizes that the pricing due to be announced next week "is not intended to represent a 'fire sale' or drastic discount in order to accelerate sales." Instead, it says, the prices are meant to reflect actual market value.

* The market can't absorb all 480 units at once, so the receiver is holding back about 250 units. But that costs money. Not only does the city have to pay interest on the loan that goes unpaid while those condos sit empty, but it has to pay the strata fees on the empty units.

Besides figuring out future sales and rentals, the receivers have also had to deal with current problems - all of which are adding up to more bills for the city.

When the cold snap hit in December and the project's unusual capillary-mat system didn't function properly, the receiver had to arrange to have electric heaters delivered to some units as well as get the existing system repaired.

The heat also had to be turned up to a minimal level in some of the empty apartments in order to prevent the cold from permeating the occupied units. The receiver has had to hire extra security to make sure that the high number of vacant buildings and units are protected.
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Sophia condo project falls into receivership

Bill Eden, head of the company developing the upscale Sophia condominium project in Mount Pleasant, said municipal strike delays, labour costs and contractors who abandoned the job contributed to about $4 million in cost overruns that pushed the development into receivership.

BY THE VANCOUVER SUN  FEBRUARY 29, 2008

Bill Eden, head of the company developing the upscale Sophia condominium project in Mount Pleasant, said municipal strike delays, labour costs and contractors who abandoned the job contributed to about $4 million in cost overruns that pushed the development into receivership.

Eden, in an interview Thursday, said that while construction has halted on the 81-unit, eight-storey building, pre-sale buyers "are not at risk at all" of losing their units.

They do, however, face some uncertainty over whether they might be asked to shoulder some of the additional costs to bring the project to completion.

The court-appointed receiver, David Bowra of the Bowra Group, said he has just begun his assessment of the Sophia project and it is premature to speculate on whether pre-sale buyers will be asked to shoulder any additional costs.

He added that his intent is to convince the project's financiers that it makes more sense to bring the project -- which is 85 per cent built -- to completion rather than liquidating it as is.

However, if there's a gap between the financing and sales revenue, "We're going to have to find [the money] somewhere."

"My advice to purchasers would be to sit tight for the next week or so," Bowra said. He is due to make his recommendations to B.C. Supreme Court in the next week to 10 days.

Eden said he is cooperating with Bowra and hopes to come up with a proposal that "meets everybody's needs.

"[Buyers] can either get their deposit back or work with the ruling of the court."

Eden said advance sales on the Sophia project started in the fall of 2005, and 78 were sold relatively quickly at prices of about $400 to $425 per square foot.
Since then, Eden said market prices in the neighbourhood around Main St. and Sophia St. have risen, and on paper at least, the value of the units is up between $100,000 and $200,000.

"Everybody's made a lot of money on these units," he added.

As far as the Sophia's costs go, Eden said the problems started last October when he was hit with cost overruns totalling $2.2 million. He put up additional securities then, which he believed would get the project to the end of April.

However, within 60 days Eden said the project was hit with another $2 million in additional costs "we just couldn't handle. That's what put us into receivership."

A "variety of issues" pushed costs up, he added. Last summer's municipal strike caused delays that added to his interest costs on financing. In September, he told The Sun that interest was racking up at a rate of $300,000 per month.

He also faced extra inspection fees during the strike, lost a couple of his trade contractors, and had difficulty securing skilled workers.

In November, Eden blamed strike delays for cancelling two other condo projects before construction started.

The Sophia situation follows from another developer, Chandler Development Group Inc., being pushed into receivership on two high-profile projects, the 192-unit H+H project in Yaletown and the 108-unit Garden City building in Richmond.

Bowra is also the receiver in those cases, and said that while they faced some cost overruns, the receivership had more to do with the project financiers losing confidence in management of the development.

In his most recent report to B.C. Supreme Court, Bowra said the lenders on both buildings have agreed to finance completion of the projects, and the pre-sale buyers will be able to complete the purchases of their units at contract prices.

"Given the market conditions and the fact these people are in the money, I suspect the majority, if not all, will want to complete those transactions," he added.

However, in an interview Thursday, Bowra said about 22 units appear to have been pre-sold at prices significantly below prevailing market prices at the time, and he is seeking some direction from the court on how to handle those. He said some of the buyers were "related parties" to the developer.

Bowra was also the receiver appointed to last spring's high-profile failure of the Riverbend condominium project in Coquitlam, where the developer attempted to cancel pre-sale contracts to re-sell them at higher prices when construction costs exceeded the revenue from the contract prices.

But Bowra doesn't see a trend developing, noting that "there haven't been too many [failures]."
Peter Simpson, CEO of the Greater Vancouver Home Builders' Association, added that while the industry has strained under labour shortages and inflation of costs, the failures are still isolated cases.

"Over the last four years, there were 78,000 new homes and condominiums delivered at the price agreed upon without incident," he said.

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CONDO CONCERNS

Project: Sophia, Mount Pleasant,

Vancouver

Units: 81

Developer: Eden Group of Companies

Status: Being evaluated by the receiver.

Project: H+H Yaletown

Units: 192

Developer: Chandler Development Group Inc.

Status: Financing committed to complete, new disclosure statement being finalized.

Project: Garden City, Richmond

Developer: Chandler Development Group Inc.

Status: Financing committed to complete, new disclosure statement being finalized.

Source: Bowra Group receiver manager

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