

## Chapter 2 Problems

### Problem 2-1

Jones only has the right to prepay the loan if there is a prepayment clause in the loan agreement that provides for early payment. Otherwise the lender has the right to collect the full amount of interest specified in the original loan agreement. Furthermore, if there is a prepayment clause, it may provide for a penalty if some or all of the loan is prepaid.

### Problem 2-2

Generally, in addition to the \$80,000 first lien, the lender also has first lien on any improvements made on land serving as security for the mortgage loan under the initial mortgage terms (see: after acquired property clause). In other words, depending provisions contained in the existing mortgage document, ABC Bank also probably has a first lien on the new building constructed by Mr. Smith, even though Mr. Smith built the building with his own funds. Whether Duce Bank is willing to provide \$16,000 in new financing may be problematic at this point. Mr. Smith should have approached Duce Bank before constructing a new building on land serving as security for the initial mortgage loan.

### Problem 2-3

Mrs. Brown has probably violated a covenant in the mortgage agreement (see: preservation and maintenance of the property) with ABC Bank by destroying part of the security held by ABC Bank. In other words, the land and building are part of the realty serving as security for the mortgage loan. By tearing down the building, she has, in essence, destroyed some of the security. The lender may give her notice that she has violated this covenant and is in default and call the remaining loan balance due immediately. Mrs. Brown should have notified the lender prior to the tear down. Let's hope that (1) the total value of the proposed new project far exceeds the outstanding loan balance, plus the cost of any new improvements and (2) that ABC Bank can be persuaded to finance the new project.