

REPORT

DATE ISSUED: October 10, 2009

REPORT NO: HCR09-098

ATTENTION: Chair and Members of the San Diego Housing Commission
For the Agenda of October 16, 2009

SUBJECT: Authorize and Ratify Termination of Purchase and Sale Agreement for the
Acquisition of Chollas Creek Villas

REQUESTED ACTION: (1) Authorize the President and CEO or designee to take all necessary actions and to execute all documents necessary to terminate the Purchase and Sale Agreement for the acquisition of the Chollas Creek Villas Project for failure of the Seller to satisfy certain conditions of the applicable agreements. (2) Ratify all acts taken by the Commission and General Counsel to effectuate the termination of the San Diego Housing Commission's (SDHC) proposed acquisition of Chollas Creek Villas Condominium property located at 4805 Castana Street, San Diego, California 92102 (the "Property") in accordance with the terms of the applicable agreements.

STAFF RECOMMENDATION:

Recommendations: (1) Authorize the President and CEO or designee to take all necessary actions and to execute all documents necessary to terminate the Purchase and Sale Agreement, including without limitation the cancellation of the escrow, recoupment of funds deposited into escrow, etc.; and (2) Ratify all acts taken by the Commission and General Counsel to effectuate the termination of the Purchase and Sale Agreement for the subject property and cancellation of escrow and recoupment of funds.

BACKGROUND:

On March 24, 2009, the SDHC entered into a Purchase and Sale Agreement for the purchase of the Property for a total acquisition cost not to exceed \$8.6 million from Chollas Creek 31 LLC, after approval of the same by both the Board of Commissioners of the Commission and the Housing Authority of the City of San Diego. Additionally, SDHC amended the fiscal year 2009 SDHC budget transferring \$6,112,478 million of SDHC Local Units funds from the Reserves for development to Rental Housing Development site acquisition/housing development for the acquisition of Chollas Creek Villas.

Chollas Creek 31 LLC (the "Developer") is the owner of the Property. The property is a proposed thirty-one (31) unit detached project, comprised of twenty-seven (27) row homes and four (4) detached conventional built homes. The property is located on the corner of Charles Lewis Way and 49th Street, San Diego, California 92102 ("Property"). The site area is 1.55 acre or 67,518 square feet gross. All thirty-one (31) homes are mapped as condominiums, but were to be rentals under SDHC permanent ownership with rents of all units to be restricted at 65 percent AMI levels and occupancy restricted to those households earning 80% or less of AMI at initial occupancy. The Property includes a common area greenbelt and parking. The 27 row homes have 1,606 square feet of living area with three bedrooms and three baths each. The four (4) conventional detached homes are to have 2,086 square feet of living area with four bedrooms and three baths each.

The Chollas Creek Villas condominium property sales were suspended due to a continued down turn in the residential market, prior to closing on the sale of any individual units. As a result, a notice of default and election to sell under the deed of trust securing the construction loan from Pomona Financial Services, Inc. ("PFF" which was acquired by US Bank) was issued. PFF/US Bank agreed that in the event the SDHC purchases the Property, all construction loan defaults will be cured and PFF/US Bank will continue funding the construction loan.

During the construction process, the Commission's staff noticed large cracks in the stucco of some of the finished homes in addition to separation of the soil and concrete along the walkway between the homes and the retaining wall, ground fissures, flatwork cracks and separations, etc. An independent geotechnical engineering firm, TerraPacific Consultants Inc., was engaged, by General Counsel on behalf of the Commission, to research the issues and to perform soils testing and analysis. A copy of the Geotechnical Evaluation of Reinforced Segmental Retaining Wall, dated September 4, 2009 (the "Geotechnical Report"), prepared by TerraPacific Consultants, Inc., is attached. The report is detailed and summarizes the geotechnical evaluation of the reinforced segmental retaining wall system located along the northern border of the new residential housing development.

The report includes a summary of the findings, as follows:

"In summary, the wall system has not been constructed in conformance with project plans and specifications. Additionally, the surcharge loading used for the design of the wall system was inadequate. Non-compliance with project plans/specifications and deficiencies in the wall design have resulted in a completed wall system that does not possess adequate stability and will likely continue to deform without enacting repairs. Our findings and opinions, including conceptual repair recommendations, are discussed in more detail in the following report."

The report concluded on page 6:

"These issues have resulted in inadequate factors of safety for the walls under both static and seismic loading conditions."

Notices were provided to the Developer and U.S. Bank with respect to: (i) that certain Purchase and Sale Agreement and Escrow Instructions (31 Residential Units) dated March 24, 2009, by and between Chollas Creek 31, LLC, and the SDHC (collectively with the Implementation Agreement and Second Implementation Agreement, both by and between Chollas Creek 31, LLC, and the SDHC, the "Purchase Agreement"); and (ii) that certain Tri-Party Agreement dated March 24, 2009, by and between SDHC, Chollas Creek 31, LLC, and U.S. Bank National Association ("Tri-Party Agreement").

Section 6(b) of the Purchase Agreement provides in pertinent part that:

If any of the conditions set forth in this Section 6(b) are not satisfied, or waived on or before the Closing Date, then Purchaser shall serve written notice of the failed condition to Seller, at which point Seller shall have thirty (30) days to cure the failed condition. If Seller cures the failed condition during such thirty (30) day period, the Closing shall

proceed as set forth in this Agreement. If Seller fails to cure the failed condition during such thirty (30) day period, then this Agreement may be unilaterally terminated by Purchaser.

One of the conditions set forth in Section 6(b) of the Purchase Agreement requires "Substantial Completion" of the Project. Section 4(e) of the Purchase Agreement sets out the requirements that must be satisfied for "Substantial Completion" to occur. Section 4(e) requires, among other things, that the Project be substantially completed in accordance with the Plans and Specifications and that SDHC's independent third party consultant review and verify completion of the Project.

Section 7 of the Purchase Agreement sets forth representations and warranties of the Developer, which the Developer represented were true, correct and complete as of the date of the Purchase Agreement and would also be true, correct and complete as of the Closing Date.

In Section 7(c)(4) the Developer, represented and warranted to the SDHC that:

All laws, ordinances, rules, codes, requirements and regulations of all governmental agencies, bodies or subdivisions thereof, that are applicable to the Property or the construction at the Property, will have been complied with, and Seller has not received notice of any kind from any governmental authority of any fire, zoning, health and safety, building code, Applicable Environmental Law, or other federal, state, or local violation of law with respect to the Property or any portion thereof, nor is Seller aware of any threat of such notice.

In Section 7(g) the Developer, represented and warranted to the SDHC, among other things, that:

Seller represents and warrants, effective as of the Closing Date, that the Project has been constructed in a good and workmanlike manner free from any and all Construction Defects. Seller represents and warrants that effective as of the Closing Date, and for the Warranty Period: (i) all of the Project will have been constructed and installed in accordance with applicable codes, laws, ordinances, rules, regulations, permits and approvals and have been completed in a professional and workmanlike manner free and clear from all Construction Defects and will be in good operating condition and repair ... the structural components, foundations, roofs, walls, and fixtures are in good operation and repair free and clear from all faults and defects, and structural components, foundations and roofs are free from leaks ... Seller further represents and warrants that during the Warranty Period there will be no defects or inadequacies in the Property that might adversely affect the insurability of the same or that might cause an increase in the insurance premium therefore ... Seller acknowledges and agrees that Purchaser is purchasing the Property upon Seller's express representation and warranty, that the Property has been constructed in a good, workmanlike and defect-free condition and in full and complete compliance with the Plans and Specifications and with all applicable codes. Purchaser is purchasing the Property solely in reliance on Seller's representations of fitness and express warranties.

The Geotechnical Report sets forth numerous conditions at the Property and Project that violate one or more of the above-referenced sections of the Purchase Agreement, provided, however, the foregoing is not intended to be an exhaustive list of the sections of the Purchase Agreement or the Tri-Party Agreement that have been breached by the Developer. Notice was given by Christensen & Spath, LLP, General Counsel, on behalf of the SDHC to the Developer, and U.S. Bank National Association, pursuant to Sections 6(b) and 15 of the Purchase Agreement on September 8, 2009, that the Developer had thirty (30) days to cure the defects at the Property and Project described in the Geotechnical Report. The Developer was informed that if all of the defects described in the Geotechnical Report were not cured during such thirty (30) day period, then the SDHC would be unilaterally terminating the Purchase Agreement forthwith and without further notice to Developer, or U.S. Bank National Association. On October 9, 2009, the 30 day period expired, without the Developer curing the serious defects at the site. On October 10, 2009, the Commission will provide unilateral notice of cancellation of the escrow to the escrow holder and will request the return of all of the funds that the Commission has deposited into escrow.

The Tri-Party Agreement does not require the SDHC to provide a notice of a default to Chollas Creek 31, LLC, U.S. Bank National Association, or any other person. However, in an abundance of caution this notice of default was also provided U.S. Bank, pursuant to the provisions of the Tri-Party Agreement.

The notices sent indicated that they did not contain an exhaustive list of all known or unknown defects at the Property or the Project or all known or unknown breaches or defaults by the Developer or U.S. Bank National Association under the Purchase Agreement or the Tri-Party Agreement. By providing the notice, the SDHC stated that it was not waiving any rights or remedies whatsoever under the Purchase Agreement or the Tri-Party Agreement. By providing the notice, the SDHC also stated that it was not agreeing that remedying all of the defects described in the Geotechnical Report to the satisfaction of the SDHC during the applicable time period will cause the Property or the Project to be in the condition required by the Purchase Agreement [defect free] or that the same will cure any other default or breach by the Developer or U.S. Bank National Association under the Purchase Agreement or the Tri-Party Agreement.

As stated above, on September 8, 2009, a Notice of Failed Condition and 30-Day Notice to Cure was sent to the Developer and the lender. Prior to that, on July 13, 2009, the General Counsel for the Commission notified the Developer in writing of the potential issues at the site concerning the retaining wall system. On August 24, 2009, Debbie Ruane of the Commission gave further notice of issues at the site. More recently, on September 29, 2009, General Counsel for the Commission notified the Developer and U.S. Bank, in writing, of its failure to substantially complete the project as required under the purchase and sale agreement on or before September 29, 2009. Further on September 30, 2009, the General Counsel for the Commission provided further notices to the Developer and U.S. Bank pursuant to the terms of the Agreement. Finally, on October 10, 2009, notice was provided that the soils remediation recommended by the geotechnical expert for the Commission has not been completed to the satisfaction of the Commission. The Commission will be providing the Developer and U.S. Bank with written notice that the Commission is unilaterally terminating the Purchase Agreement as provided for therein for failure to cure defaults in the terms of the Agreement, specifically constructing the project in

a defect free condition and in accordance with applicable plans and specification and applicable codes and regulations.

SDHC Budget Analysis

The SDHC made deposits of its own funds to meet the property's initial capital investment requirements into escrow. After the escrow is cancelled and the deposits are returned to the Commission and budget amendment will be processed to the Housing Authority to reflect the return of these funds.

Escrow

An escrow account was opened at Chicago Title and \$4,000,000 of deposits were made by the Commission into escrow as required by the terms of the Purchase and Sale Agreement.

The escrow on these units requires the return of any deposit placed into escrow upon the notice from the Commission to the escrow holder of a failure of a condition to timely close escrow and for any uncured breach by the Seller under the terms of the Purchase and Sale Agreement. In order to be able to close, the Commission's geotechnical expert must review the project and determine that it has been completed in a good and workmanlike manner and defect free condition. As referenced above, the geotechnical expert for the Commission is unable to make such a determination, based upon its work at the site as referenced in the September 4, 2009 report and the additional review of September 29, 2009, which was issued after a meeting between the Developer, U.S. Bank and their respective geotechnical consultants, those originally involved in the design and monitoring of the construction.

FISCAL CONSIDERATIONS: All funds deposited into escrow are required to be returned to SDHC.

PREVIOUS COUNCIL and/or COMMITTEE and/or SELECTION COMMITTEE ACTION:

Both the SDHC Board and Housing Authority approved entering into the Purchase and Sale Agreement prior to its execution in March of 2009.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

The Chollas Creek Villas project no. 6896 was presented to City Council on January 24, 2006 and to other government entities as follows:

- Southeastern Economic Development Corporation (SEDC): On December 3, 2004, SEDC completed the review and recommended approval of the plans for the proposed residential development (31 for-sale units) identified as the Chollas Creek Villas located within the Central Imperial Redevelopment Project Area.
- Community Planning Group (CPG): On March 21, 2005, the Encanto Neighborhoods CPG voted 6-4-1 to recommend approval, with recommendations.
- Planning Commission (PC): On November 17, 2005, the PC voted 6-0 to recommend approval of the project. The PC placed the project on the consent agenda and voted unanimously to recommend the City Council to approve staff's recommendations.

ENVIRONMENTAL REVIEW: On January 24, 2006, by resolution number 301197, the City of San Diego certified the information contained in Mitigated Negative Declaration (MND) No. 6896. The cancellation of the escrow and termination of the Purchase and Sale Agreement for an uncured default by the Seller is not a project within the meaning of CEQA.

KEY STAKEHOLDERS & PROJECTED IMPACTS:

The Council Offices for the district within which the project is located has been informed of this action. In addition, after this matter is acted upon by the Housing Commission, the Housing Authority will be given notice of the action under the provisions of San Diego Municipal Code to allow it to review this action, should it choose to do so. It should be noted, however, that all administrative actions are delegated to the Commission. In addition, Section 17(p) of the Purchase and Sale Agreement provides:

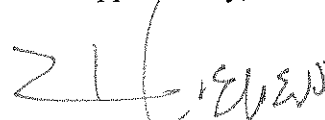
“Where this Agreement refers to an action or approval of Purchaser, it shall mean the approval of the President and CEO of the San Diego Housing Commission, or designee, unless otherwise provided.”

Respectfully submitted,



Deborah Ruane
Director of Acquisitions
Real Estate Development

Approved by,



D. Lawrence Clemens
Senior Vice President
Real Estate Development

Attachments:

1. Geotechnical Evaluation of Reinforced Segmental Retaining Wall, dated September 4, 2009 prepared by Terra Pacific Consultants, Inc. on file in the offices of the Housing Commission.

Hard copies are available for review during business hours at the Housing Commission offices at 1122 Broadway, San Diego, CA 92101, Main Lobby and at the Office of the City Clerk, 202 C Street, San Diego, CA 92101. You may review complete docket materials on the SDHC website at www.sdhc.org.