



THE CITY OF SAN DIEGO
Redevelopment Agency's Report

DATE ISSUED: January 31, 2007

REPORT NO.: RA-07-3

ATTENTION: Honorable Chair and Members of the Redevelopment Agency
Docket of February 6, 2007

SUBJECT: Approving the Subordination of Affordability Covenants for the North Park
Condos ("La Boheme") Project

REQUESTED ACTIONS:

That the Redevelopment Agency:

- 1) Make a finding that an economically feasible alternative method of financing the affordable units on substantially comparable terms and conditions, but without subordination, is not reasonably available.
- 2) Authorize the Agency Executive Director or designee to take such actions as may be necessary in order to subordinate the Agency's affordability covenants and restrictions to the lien of the lender providing financing for the affordable units, but only upon receipt by the Agency Executive Director or designee of written commitments from such lender, reasonably designated to protect the Agency's investment in the event of default.

STAFF RECOMMENDATION:

Approve the requested actions.

SUMMARY:

On March 30, 2004, the Redevelopment Agency approved a Disposition and Development Agreement ("DDA") with Western Pacific Housing (a D.R. Horton company) for the North Park Condos project. The project, now substantially complete and marketed as "La Boheme", includes 224 condominium homes and 15,800 square feet of ground level commercial space. In conjunction with the approval of the DDA, the Redevelopment Agency authorized the expenditure of \$2,100,000 as a subsidy to 45 affordable condominiums among the total of 224. These 45 units are subject to recorded affordability restrictions defining both the maximum income of eligible buyers and the affordable sale price. Pursuant to the DDA, the Agency and D.R. Horton executed an Agreement Affecting Real Property, recorded on January 31, 2005, as amended by the First Amendment to the Agreement Affecting Real Property, recorded on September 16, 2006, that required D.R. Horton to append to the Grant Deed conveying the affordable units an Addendum to Grant Deed. The Addendum to Grant Deed, which is secured

by a Subordinate Deed of Trust, Security Agreement and Fixture Filing (With Assignment of Rents) (“Deed of Trust”), provides that the affordable unit that is the subject of the Grant Deed is conveyed by D.R. Horton subject to certain affordability restrictions and covenants. With limited exceptions, California Community Redevelopment Law (“CCRL”) requires that these affordability restrictions remain in place for the longest feasible period of time, but not less than 45 years. One exception to the 45-year term for affordability restrictions is defined in Section 33334.14 of the CCRL. This section permits Agencies to subordinate their recorded restrictions to a lender’s deed of trust subject to a finding by the Agency Board that “an economically feasible alternative method of financing, refinancing, or assisting the units or parcels on substantially comparable terms and conditions, but without subordination, is not reasonably available.” As the result of Agency subordination, initial lenders and purchasers of mortgage-backed securities are assured that foreclosure proceedings may be pursued without additional delays associated with third-party participation or the costs of qualifying new moderate-income buyers. Subordination of the Agency’s affordability restrictions does, however, expose Agency-subsidized units to conversion to market rate in the event of foreclosure or surrender of title in lieu of foreclosure.

D.R. Horton has advised Agency staff that it has been unsuccessful in securing a lender for the moderate-income condominium units within the La Boheme project due to lender objection to the Agency’s affordability covenants. While interested in making loans to moderate-income home buyers, all lenders contacted by D.R. Horton (including Countrywide Financial Corporation, Wells Fargo Bank, Bank of America, CitiMortgage, California Housing Finance Agency and Placer Sierra Bank/Bank of Orange County) have objected to provisions of the Agency’s recorded affordability restrictions that require the units to be sold at a price affordable to moderate income households following a foreclosure in which the lender takes title to the property. Attached hereto as Attachment No. 1 is D.R. Horton’s declaration that lenders have declined to provide financing on the affordable units without the subordination of the Agency’s affordability restrictions.

In an effort to determine whether all alternatives to subordination have been exhausted, Agency staff conducted discussions with staff of the Housing Commission and counsel for both agencies. Agency staff also engaged in discussions with representatives of Wells Fargo Bank – an institution that has historically participated in the financing of affordable housing units. These communications indicate that the foreclosure-surviving nature of the Agency’s affordability covenants are obstructing the financing of the moderate-income condominiums. The reason cited is an inability on the part of lenders to easily package such loans for re-sale to the secondary market for mortgage-backed securities. Further, while recent changes in the Fannie Mae insurance standards support the re-sale of price-restricted mortgages, the market for such securities has not yet developed. Consequently, staff concludes that an economically feasible alternative method of financing the units on substantially comparable terms and conditions without subordination is not immediately available and that it is necessary to subordinate the Agency’s affordability restrictions to the buyer’s mortgage lender as permitted in Section 33334.14 of the CCRL.

Should the Agency act to subordinate its affordability covenants as proposed by the developer, it would retain its rights under the DDA to cure conditions of default and take possession of

threatened affordable units to prevent foreclosure. Agency staff anticipates including a line item in the 2008 Agency budget for the North Park Project Area to provide funding for this purpose. In addition, any subordination agreement entered into between Agency and lender providing financing for the affordable units would include written commitments, such as the following, to protect the Agency's investment in the event of default: (i) a copy of all notices of default delivered to the affordable unit borrower by the lender shall be concurrently delivered to the Agency; (ii) the Agency shall be provided with an opportunity to cure any and all defaults on the lender's encumbrances prior to any foreclosure under the lender's encumbrances; and (iii) in the event that the Agency exercises its right to cure and takes title to the affordable unit, the lender will not accelerate the obligations of the affordable unit borrower by reason of the transfer of the title to the Agency. A copy of the form of Subordination Agreement between Agency and the lender is attached hereto as Attachment No. 2.

Based on the foregoing, staff recommends that the Agency take the following actions: (i) make a finding that an economically feasible alternative method of financing the affordable units on substantially comparable terms and conditions, but without subordination, is not reasonably available, and (ii) authorize the Agency Executive Director or designee to take such actions as may be necessary to subordinate to the lien of the lender the Agency's affordability covenants and restrictions contained in the Agency's Addendum to Grant Deed and Deed of Trust, but only upon receipt by the Agency Executive Director or designee of written commitments from such lender protecting the Agency's investment in the event of default.

FISCAL CONSIDERATIONS:

No new funding commitment is established with this action. It is anticipated, however, that the draft North Park Redevelopment Project Area Budget for FY 2008 and following years will include a request to authorize the expenditure of up to \$100,000 for the purpose of curing monetary default conditions associated with Agency-subsidized units within the Project Area. Proceeds from the resale of units following a default are anticipated to reimburse costs incurred by the Agency either partially or fully.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

On March 30, 2004, the City Council and Redevelopment Agency, at a joint public hearing, approved the Disposition and Development Agreement ("DDA") with Western Pacific Housing Corporation (a D.R. Horton company) for the North Park Condos ("La Boheme") project. On August 3, 2006, the 1st Implementation Agreement to the DDA amended Exhibit "B" to the Agreement Affecting Real Property to revise the schedule of affordable units. The 1st Implementation Agreement also substituted for the Agency's Addendum to Grant Deed and Subordinate Deed of Trust, documents authorizing the San Diego Housing Commission to monitor and enforce affordability restrictions for the units to be sold at prices affordable to households earning no more than 100% Area Median Income. These documents included a Promissory Note and associated Deeds of Trust, as well as a Declaration of Covenants, Conditions and Restrictions, Affordable Housing Agreement, and Right of First Refusal.

COMMUNITY PARTICIPATION & PUBLIC OUTREACH EFFORTS:

At its regular meeting on December 12, 2006, the North Park Project Area Committee (NPPAC) considered testimony from staff and D.R. Horton regarding the challenge of identifying a lender

willing to provide a forward commitment and funding for moderate-income mortgages. The NPPAC concluded that additional due diligence should be conducted to determine whether sufficient evidence is available to support a finding that an economically feasible alternative method of financing the units (on substantially comparable terms and conditions) is not reasonably available without subordination.

On January 9, 2007, the NPPAC considered additional information gathered since the December 12th meeting and adopted the following motion by a vote of 7 in favor, 0 opposed and 0 abstaining.

The NPPAC acknowledges that efforts by D.R. Horton and Agency staff have failed to identify an economically feasible alternative method of financing the units on substantially comparable terms and conditions without subordination and therefore recommends that the Agency Board adopt a resolution subordinating Agency's affordability covenants for the project pursuant to Section 33334.14 of the California Community Redevelopment Law, provided that the Redevelopment Agency have in place written procedures for the exercise of the Agency's right to cure defaults.

The Redevelopment Agency does not currently have an adopted policy for the resolution of defaults as recommended by the NPPAC. Staff anticipates that a draft policy can be prepared and presented for Agency consideration within 60 to 90 days. In order to permit the affordable units within the La Boheme project to be occupied prior to adoption of a comprehensive policy, the following procedures would be followed until a formal policy has been approved.

- Upon receipt of a Notice of Default recorded by a senior lien holder, the Redevelopment Agency will monitor the status of the loan to determine if it is brought current by the borrower within the 90-day period provided to borrowers by law.
- If the borrower fails to bring the loan current within 90 days and a Notice of Trustee's Sale is recorded by the lender, subject to the availability of funds authorized for such purpose within the North Park Project Area, the Agency Executive Director or designee shall make payments as necessary to reinstate the senior liens to forestall a foreclosure action by the senior lienholders. The Agency shall subsequently record a Notice of Default against the property on its behalf, and initiate foreclosure proceedings against the property in accordance with the laws governing such transactions. If such default is not cured within the statutory time period, the Agency Executive Director or designee shall take such action as is required by law to vacate the premises. Upon obtaining possession of the subject property, the Agency Executive Director or designee will make such repairs as deemed necessary to prepare the property for resale.
- The Redevelopment Agency will collaborate with the Housing Commission in computing the affordable sale price applicable to the property in conformance with the recorded affordability covenants and conduct a lottery among prospective buyers determined by the Housing Commission to be eligible with respect to income restrictions and qualified with respect to underwriting requirements.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

ROLE	FIRM	OWNERSHIP
Developer	D.R. Horton, Inc.	D.R. Horton, Inc. is a publicly traded corporation

Respectfully submitted,

Maureen Ostrye
Deputy Executive Director

Approved: James T. Waring
Assistant Executive Director

Attachments

1. Developer's Statement of Unavailability of Mortgage Financing
2. Form of Subordination Agreement