

**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
Richmond Division**

In re:)	
)	
PROSPECT HOMES OF RICHMOND, INC.)	Case No. 09-33528-KRH
)	Chapter 11
Debtor.)	
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DECLARATION OF JOSEPH R. AUDI OF PROSPECT HOMES OF RICHMOND, INC., IN SUPPORT OF CHAPTER 11 PETITION AND FIRST DAY PLEADINGS

I, Joseph R. Audi, being duly sworn, depose and say:

1. I am the President and 100% shareholder of Prospect Homes of Richmond, Inc. (the “Debtor” or the “Company”), a subchapter S corporation incorporated under the law of the Commonwealth of Virginia. I am authorized to submit this Declaration in support of the Debtor’s chapter 11 petition and the first day pleadings described herein.

2. I founded the company in 1988 and am familiar with the Debtor’s day-to-day operations, business affairs, and books and records. I have also reviewed the Debtor’s “First Day Motions and Orders” and am familiar with the facts alleged therein and relief requested. I have personal knowledge of the facts, circumstances and other matters set forth in the First Day Motions and Orders and in this Declaration or have gained knowledge of such matters from the Company’s officers or employees that report to me in the ordinary course of my responsibilities. If called as a witness, I would testify thereto and as follows:

A. Introduction

3. On June 2, 2009 (the “Petition Date”), the Debtor commenced a bankruptcy case

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by filing a petition for relief in this Court under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”).

4. The Company is a residential homebuilder based in Henrico County, Virginia and has built several thousand homes in the Central Virginia region since its inception in 1988. Today, the Company is in the process of building and selling single family detached homes and town homes in 18 different communities at prices ranging from \$150,000 to \$500,000 or more. The Company has consistently been a top five builder in terms of unit sales in the Richmond market for the last ten years. The Company has long been regarded as a high quality builder and over the years has won numerous awards for its design and build quality including many Gold and Silver Awards in the annual Richmond Parade of Homes.

5. In addition, the Company owns a number of Limited Liability Companies that engage in the acquisition and development of land for sale as residential lots. Prospect has affiliates that engage in land acquisition and development and real estate related services for its homebuilding and land development operations.

6. After several years of growing revenues and record profits, the residential homebuilding industry took a severe downward turn in 2007 which continues through today. Across the country and the Central Virginia market, unit sales dropped dramatically, home prices fell and record profits turned to records losses. During 2008, the entire mortgage market froze for a period of time. While conventional mortgages under the government sponsored programs are readily available today, the higher loan to value and sub-Prime mortgages that were available to assist first time and marginal buyers in prior years are simply no longer available. Job losses in the greater Richmond market have added substantial resale home inventory to the local market, increased unemployment and decreased prospective homebuyers’ sense of security.

7. The Debtor has felt the impact of this difficult business environment. In 2007, the Debtor sold approximately 190 homes for total sales revenues of almost \$60,000,000. In 2008, sales dropped 40%, in line with total home sales in the local market and the company failed to make a profit.

8. In response to reduce sales and profitability, the company and I, personally, have taken aggressive measures to reduce expenses, manage cash flow and reduce debt. As President, I have not taken a regular salary most of the last 2 years. Staffing levels of the Company have been reduced by almost 70% since the beginning of 2008 and overhead expenses have been reduced by over 60% in the 12 months prior to Petition Date. In addition, the Debtor's debt was reduced by over \$11,000,000 (25%) since early 2008.

9. Prior to the Petition Date, the Debtor has been engaged in frequent communications with its lenders, informing them of its turnaround efforts and long-term strategy.

B. The Chapter 11 Case

10. Notwithstanding the Company's efforts, it was forced to commence a chapter 11 proceeding to attempt to restore positive financial performance and continue its turnaround efforts. In large part, the filing is due to four factors, all of which contributed to the liquidity crisis that prevented the Company from completing its turnaround goals outside of a court proceeding: (i) inability to obtain necessary lending to complete construction of current projects; (ii) decreased liquidity; (iii) decreased demand; and (iv) judgments and liens impairing the ability to market and sell properties.

C. Objectives of the Chapter 11 Filing

11. The Company commenced this chapter 11 case to restructure promptly and

efficiently the Company's capital structure, reduce house and lot inventory, reduce debt and streamline business operations related to sales of properties. In that regard, the Company has commenced this case with the immediate goal of obtaining three significant types of relief designed to meet its long-term turnaround and financial performance objectives: (i) approval of adequate postpetition financing to ensure a smooth transition into chapter 11; (ii) authorization to sell property of the estate; and (iii) elimination of unnecessary expenses through rejection of certain executory contracts.

MOTIONS AND ORDERS

12. In furtherance of its restructuring objectives, the Company is filing concurrently herewith a number of first day motions (the "First Day Motions") and proposed orders (the "Proposed Orders"), each listed on the attached Exhibit A, and respectfully requests that the Court consider entering the Proposed Orders and/or granting the relief sought in such First Day Motions. I have reviewed each of the First Day Motions and Proposed Orders and the facts set forth therein are true and correct to the best of my knowledge, information and belief, with appropriate reliance on corporate officers and advisors. Moreover, I conclude that the relief sought in each of the First Day Motions and Proposed Orders (a) is vital to enable the Debtor to make the transition to, and operate in, chapter 11 with a minimum interruption or disruption to the Debtor's business or loss of productivity or value; (b) constitutes a critical element in achieving the Debtor's successful reorganization; and (c) ensures that the Company complies with applicable non-bankruptcy law, to the extent such law remains applicable in a chapter 11 proceeding.

A. Administrative Motions

13. The Company will file four administrative motions, which (i) request a first day

hearing on June 4, 2009 to consider the relief requested in each of the Motions, (ii) seek approval of case management procedures, (iii) request an extension of time for the filing of the Company's schedules and its statement of financial affairs, and (iv) request a waiver of the requirements of Bankruptcy Code section 342(c) and Bankruptcy Rules 1005 and 2002(n), all as more fully set forth in items 1 through 4 on Exhibit A hereto.

B. Motion to Authorize Payment of Employee Obligations

14. The Company will file a motion seeking authority to continue paying various employee obligations, as set forth in item 5 on Exhibit A hereto.

15. To minimize the personal hardship that the Employees will suffer if prepetition Employee-related obligations are not paid when due, and to maintain Employee morale during this critical time, it is important to pay and/or perform, as applicable, among other employee related obligations: (i) prepetition obligations to current employees and to continue certain non-working day policies, employee benefit plans and employee programs, (ii) reimburse Employees for prepetition expenses incurred by the Employees on behalf of the Company, and (iii) pay all related prepetition withholdings and payroll-related taxes.

C. Motions to Authorize Payment of Other Critical Business Expenditures.

16. Taxes. The Company will file a motion seeking authority to make critical business expenditures on account of sales, use, trust fund and other taxes (as set forth in item 6 on Exhibit A hereto). In the ordinary course of business, the Company incurs various taxes, including state and local taxes (the "Taxes"). Prior to the Petition Date, the Company was, for the most part, current on its obligations with respect to these Taxes.

17. Insurance. The Company will file a motion seeking authority to maintain various Insurance Policies (as set forth in item 7 on Exhibit A hereto). Maintenance of insurance

coverage under the various Insurance Policies is essential to the operation of the Company's business and is required under the United States Trustee's Operating Guidelines for Chapter 11 Cases and state laws.

D. Motion to Approve Debtor-in-Possession Financing.

18. The Company will also file a motion for interim and final orders authorizing postpetition financing ("DIP Financing") (as set forth in item 8 on Exhibit A hereto). The proposed DIP Financing consists of two notes in the amounts of \$50,000 and \$1,500,000. For the reasons set forth in the Motion and below, it is essential that the Court approve this motion.

19. As discussed above, the Company has experienced operating losses resulting from several factors resulting in decreased liquidity. The Debtor has an immediate need to access the DIP Financing in order to permit, among other things, the orderly continuation of the operation of its business and the completion of the restructuring process.

20. The Company accordingly has decided, in the exercise of its sound business judgment, that the proposal for DIP Financing by myself and J. R. Audi LLC represented the most favorable opportunity under the circumstances and best address the Company's working capital needs. Accordingly, entry into the DIP Financing will afford the Company valuable additional time pursue its goals through reorganization. The Company concludes that entry into the DIP Financing is in the best interests of the Debtor's bankruptcy estate, the Debtor's creditors and other parties' interest. I request that the Court authorize the Company to enter into the DIP Financing and immediately be permitted to receive funds under it as soon as the final documentation is complete.

E. Motion to Authorize Rejection of Certain Executory Contracts

21. As set forth in item 9 on Exhibit A hereto, the Company seeks authority to reject

executory contracts. Rejection of the executory contracts will discontinue the Company's obligation to the counterparties and save the Company's bankruptcy estate considerable costs.

F. Motion to Authorize Debtor to Sell Property of the Estate

22. As set forth in item 10 on Exhibit A hereto, the Company seeks authority to sell certain property of the estate free and clear of all liens, claims, encumbrances and interests, with such liens, claims, encumbrances and interests to attach to the proceeds of such sale. The contract on the Property establishes that time is of the essence and if the sale does not close timely, the Debtor will be required to return the Buyer's deposit and will have to remarket the Property for sale at an additional cost to the Debtor's estate. If the relief requested is not granted, there will be immediate and irreparable harm to the Debtor's estate.

I swear under penalty of perjury that the facts, circumstances and other matters set forth in the First Day Motions, as well as the foregoing, is true and correct to the best of my knowledge, information, and belief, with appropriate reliance on the Company's officers, employees and advisors.

Dated: June 4, 2009

PROSPECT HOMES OF RICHMOND, INC.,
Debtor and Debtor in Possession

/s/ Joseph R. Audi
Joseph R. Audi
President

EXHIBIT A

1. Debtor's Motion for the Entry of an Order Pursuant to Bankruptcy Code Section 105 and Local Bankruptcy Rule 9013-1(N) for an Order Setting and Expedited Hearing on "First Day" Motions

2. Motion of Debtor for Order Pursuant to Bankruptcy Code Sections 102 and 105, Bankruptcy Rules 2002 and 9002, and Local Bankruptcy Rules 2002-1 and 9013-1 Establishing Certain Notice, Case Management and Administrative Procedures

3. Motion of Debtor for Entry of an Order Pursuant to Bankruptcy Rule 1007(c) and Local Bankruptcy Rule 1007-1 Extending Time for the Debtor to File its Schedules of Assets and Liabilities and its Statement of Financial Affairs

4. Motion of Debtor for Order Waiving Requirements of Bankruptcy Code Section 342(c) and Federal Rules of Bankruptcy Procedure 1005 and 2002(n)

5. Motion of Debtor for Order Pursuant to Bankruptcy Code Sections 105(a), 506(a), 507(a)(8), 541, and 1129 and Bankruptcy Rule 6003 Authorizing the Debtor to Pay Prepetition Sales, Use, Trust Fund and Other Taxes and Related Obligations

6. Motion of Debtor for Order Pursuant to Bankruptcy Code Sections 105, 363, 1107, and 1108 and Bankruptcy Rule 6003 Authorizing the Debtor to Maintain Insurance Policies, Pay Insurance Obligations, and Renew Insurance Policies

7. Debtor's Motion for Order Pursuant to Bankruptcy Code Section 364(c) and Bankruptcy Rules 2002 and 4001 Authorizing Debtor to Incur Postpetition Secured Indebtedness

8. Motion of Debtor for Entry of an Order Pursuant to Bankruptcy Code Sections 105(a) and 365(a) and Bankruptcy Rule 6006 Authorizing Rejection of Executory Contracts Effective as of the Petition Date

9. Motion of Debtor for Order Pursuant to Bankruptcy Code Sections 363 and Bankruptcy Rules 6003, 6004 and 9014 Authorizing Debtors to Sell Property of the Estate and to Reduce Applicable Notice Periods Related Thereto