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Orange Vista:

A Development Manager Plays Quarterback

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This Cornell University Real Estate Case was prepared to stimulate analysis and discussion in undergraduate and graduate real estate courses. While the case is drawn from a range of actual experiences, it is not intended to illustrate correct or incorrect applications.

Orange Vista:

A Development Manager Plays Quarterback

ABSTRACT

This case tells the story of a newly founded development management company, Palisades Real Estate (PRE), which takes over a challenging residential development project on behalf of its owner. The project is plagued by several onerous developer obligations and outstanding entitlements that have complicated the owner's exit ambitions, which has led the owner to seek the expertise of a highly talented development management firm that can guide the project to a successful conclusion. After agreeing to a risky compensation structure that defers much of its compensation to the sale of the project, PRE undertakes a complex assortment of restructuring efforts in order to make the project feasible, including the renegotiation of a development agreement, the pursuit of difficult permits, and arrangements for phasing and bond financing. Led by one of its principals, Hal Orin, PRE demonstrates what development managers can do when they're at the top of their game, and the value that they can add to even the most seemingly doomed projects. The case provides an opportunity for students to learn about what development managers do, how they add value, and how they are compensated.

This case study incorporates the following real-estate themes and issues:

Development Management

Value Creation in Real Estate

Entitlements

Bond Financing

Development Agreements

Exit Strategies

Orange Vista:
A Development Manager Plays Quarterback

By: Daniel Kuhlman and H. Pike Oliver

"Sure, luck means a lot in football. Not having a good quarterback is bad luck."

- Don Shula, former National Football League coach

Early one morning in the spring of 1996, the principals of Palisades Real Estate (PRE) sat around the conference table in their San Francisco office with the principals of Strategic Real Estate Group (SREG), who had recently engaged PRE as development manager for the Orange Vista project, a 531-acre property that SREG owned in Anaheim Hills, California. SREG had acquired the notes to the property at auction, and had subsequently taken title to the asset with the original intention of quickly reselling it to a multi-family developer. Unfortunately, a combination of depressed market conditions and a challenging set of requirements imposed by the municipality had foiled SREG's exit ambitions. Thus, it soon searched for a skilled development manager that could rescue the project and facilitate a favorable outcome by taking over the project on its behalf. That's where PRE came in.

The Orange Vista project became PRE's chance to demonstrate what it offered to the marketplace. After a dreadful few years, the real estate market in California was beginning to recover, and there would be bountiful business opportunities for a firm that had a proof of concept for adding extraordinary value to distressed projects. Hal Orin would lead the PRE team in analyzing the opportunity and deciding how they could turn an embattled project into a success story. PRE had agreed on a compensation structure that provided little revenue to the company until it achieved a successful exit. It was a risky approach for a new development management company, but one that had the potential to be extremely lucrative for PRE if things went well.

PRE had just received an offer to purchase from a potential buyer who was prepared to pay far more money, far earlier for the project that either PRE or SREG had ever imagined. PRE had just led the successful renegotiation of a pivotal development agreement with the municipality, and had secured several key entitlement arrangements. With the project well positioned for vertical development, the parties were eager to proceed with the build-out, however the unexpected offer to purchase suddenly presented an opportunity for an early exit. When and how SREG ultimately sold the asset would have major implications for PRE. As the team discussed the potential sale, Orin stared at PRE's latest bank statement, which lay over top of the site plan for the project.

Palisades Real Estate

PRE was a newly formed real estate development and land management company. The company was wholly owned and operated by its three principals: Kevin Sanders, Jessica Millhouse, and Hal Orin. The three PRE principals collectively had over 40 years of experience working in real estate development. They had all met in the early 1980s when they were all working as senior executives for Pacific Holdings, a subsidiary of Chicago-

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based Jepson Development. While they were with Pacific Holdings, the company managed and entitled projects with an aggregate market value of over $1 billion. The projects were located throughout California, with a concentration in Orange and Marin Counties.

The three partners had always harbored entrepreneurial ambitions, and in 1994 they decided that it was time to finally make the leap. While at Jepson, they gained experience and trust working together and were confident that they had the knowledge and skill-sets necessary to thrive as development management specialists in a geography that they knew like the back of their hands. What they were missing, however, was the personal capital or investors necessary to finance large-scale projects on their own. Especially with single-family developments, the initial capital outlay required to purchase land and shepherd a project to a successful exit was so significant that only the largest developers were able to foot the bill themselves without additional outside investment.

Each of the three PRE principals had an equal stake in decision-making for the company, but it was Orin who was taking the lead with the Orange Vista project. Orin had a varied background and a robust skill-set. Prior to co-founding PRE and working with large master-planned community developers, he had worked for municipal and state government agencies, including the City of New York and the Governor's Office of Planning and Research in California. This experience also equipped Orin with an extensive network of relationships - relationships that would become very important years later when he made the move into real estate development.

When they left Pacific Holdings, Sanders, Millhouse, and Orin were given severance packages sizeable enough to leave them with an adequate personal financial cushion and start-up capital to get PRE up and running before their first contracts were secured. However, as the days ticked on and their initial start-up funds began to run low, they became increasingly eager to get their first project underway so that they could generate some much needed revenue. The question soon became what kind of compensation model they should pursue, and how they could intelligently balance risk and reward in the capacity of development manager. Their approach to compensation, and how they executed on their first few projects would have significant implications for the future of their company.

The Strategic Real Estate Group

SREG was a newly organized private equity group founded by a number of former Wall Street executives. Although the partners of SREG had formidable expertise in finance, they had relatively limited real estate experience. What they did have going for them, though, was a considerable war chest of capital. Through investors and affiliates, SREG had a significant amount of financing options and industry contacts.

SREG had recently purchased the notes for the Orange Vista land through an auction process for $10 million. When SREG first purchased the notes, it was part of a larger strategy to acquire distressed real estate debt at a discount, take title to the assets and then quickly exit each investment by selling the assets at a considerable premium. In some cases, SREG would complete a limited amount of development work, and in other cases it would see projects through the build-out stage - if in either case such work was accretive to its returns. SREG had found success with the strategy elsewhere in the United States, and had recently set up an office in California where it expected to be able to increase its deal making velocity. SREG had a fairly small operational capacity, so it often sought to contract out most aspects of its projects to other companies with the resources, development expertise, and market knowledge that it lacked internally.

In addition to the Orange Vista land, SREG was also the owner of three additional ground-up development projects in California, namely: Sudden Meadow, Blue Marlin Keys, and Booth Gardens. Sudden Meadow was a 233-acre residential development in the

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Trabuco Canyon area of Orange County. The project would have to work its way through the entitlement process, as SREG attempted to rezone the land from manufacturing to single-family, with plans calling for a total of 318 units at completion. Blue Marlin Keys was a project in the San Francisco area that SREG would have to work through rezoning and entitlements for. The plan for Blue Marlin Keys was a single-family development anchored by a championship golf course. Finally, Booth Gardens was comprised of a 55-acre parcel in the city of Oceanside, located just north of San Diego. The site was planned and entitled for a total of 93 single-family lots, but the geographic features of the site had stalled development and required alterations to the original site plans. At the time that SREG contacted PRE about the Orange Vista project, SREG had not yet selected a firm to provide development management assistance for these other projects.

The Market

From 1940 to 1970, the population of Orange County increased from 130,000 to over 1.4 million. Most of the families in the area were moving into newly constructed single-family homes in the rapidly growing number of planned unit developments (PUDs) and larger master planned communities (MPCs) scattered throughout the county. PUDs and MPCs were first developed in Southern California as a way to the tap the new demand for single-family homes on a larger scale. What set these new developments apart from traditional subdivisions were their size, unified architectural designs, and inclusion of parks and other amenities (which were typically provided by the developer on behalf of the residents). In general, PUDs and MPCs aimed to create a holistic suburban environment through a unified development plan.

Like many other regions in the United States, Southern California had experienced a real estate boom in the late 1980s. New single-family housing developments were being built rapidly throughout the region, with most homes selling almost immediately upon being placed on the market. However, in the early 1990s the market turned ugly and the effects of a substantial recession were soon felt throughout Southern California. The aggressive development that had characterized the market in the 1980s all but ground to a halt, and home sales fell significantly. In the early 1990s developers and investors alike were attempting to ride out the recession, with many adopting the mantra, "survive 'till 95". From 1990 to 1993, there were a total of 500,000 jobs lost across California, a good portion of which were highly paid aerospace industry workers. The future of the area's economy remained uncertain, with even more uncertainty surrounding what would be the main industries in the area going forward and what type of workforce these industries would employ.

By the fall of 1994, economic indicators were starting point to a recovery on the horizon. SREG knew that successful development strategies sought to position the opening of the project at the top of the market cycle, which often meant that planning and pre-development activities needed to commence when the market was still depressed. A national recovery seemed likely, but Southern California often operated on cycles not fully syncopated with that of the U.S. economy as a whole. For investors like SREG, favorable market timing was crucial.

Project History

The Orange Vista site was a 531-acre parcel of land located in Orange County, California; 20 miles south of Los Angeles in the City of Orange (see **Exhibit A – Site Map**). Like the majority of the land in Orange County, the Orange Vista site was originally used for agricultural production. The neighborhood of Anaheim Hills—the community in which

Orange Vista was located—was formerly part of a large ranch, which employed the hilly landscape for a combination of cattle grazing and avocado farming. With the post-war boom is residential development, the ranch was sold in the early 1970s to Texaco Ventures, with the intent that it be developed into a master-planned community. Texaco Ventures developed a number of housing developments on the land, fully building-out the majority of its land holdings by the early 1980s.

The Orange Vista parcels, which comprised the last of Texaco Holdings' undeveloped land, were sold in the early 1980s to a large developer, Avro Companies, which intended to develop a project comprised of detached single-family homes. Avro ran into financial troubles in the mid-1980s, which led to it selling the land again to another developer, Baja Development, in 1987.

During the multiple ownership iterations over the previous decade and a half, work had been progressing to ensure that the site had the necessary city and county approvals to ready it for development. The first step in this process occurred in 1984 when the owners at the time submitted a request to the City of Orange requesting that it amend its general plan to allow the completion of the project. The 1984 request to the planning commission was met with opposition both from those sitting on the commission, and also from community members. The main concerns that were voiced were based on the increase in density, access to the site, and the continued preservation of open space and existing trail uses on the land. With continued debate and discussion throughout the second half of the 1980s, the developer (by this this point the project had been sold to Baja) and the municipality finally reached a consensus, and a 15-year development agreement was signed in 1988, with a Specific Plan for the site soon approved by the City of Orange in 1990.

With past projects, SREG liked to maintain flexibility with its assets, by either reselling undeveloped land if it found the right buyer, or by developing the land itself should that option yield more robust returns. For the Orange Vista project, SREG targeted at least a 20% return, which it felt that it could reasonably expect on its initial investment of $10 million, plus any other costs that accumulated up to the date of sale.

When SREG initially took control of the Orange Vista land in January 1992, its investment strategy was still fairly inchoate, but it felt the need to move quickly on the deal before another investor purchased the notes at such an attractive discount. Having an understanding of what comparable projects in the area were yielding, the managers at SREG knew that if they were able to obtain the notes at SREG's offer price, they would be able to articulate a more refined investment strategy once SREG had taken title to the asset. They also knew that given the anemia of the market at the time, SREG would need to hold the property for a minimum of two years before it could look to sell or proceed to development, once market conditions (hopefully) improved.

Two years had passed and SREG was starting to get anxious about its inability thus far to generate momentum for the project. With the market still relatively depressed, SREG had not yet made any progress towards starting development besides some initial meetings with the municipality's planning department. In the course of those meetings, the SREG managers were told that while the municipality was eager to see development get underway on the Orange Vista site, it would look for the developer to share in the cost of several infrastructure improvements, the cost of which was estimated to be significantly higher than anything else that SREG had experienced with any of its other projects. SREG quickly found that given its outsider status in California and its limited development expertise, it would find dealing with the municipality to be extremely challenging. SREG was unsure as to how to handle these complex negotiations, and to what extent it might be being taken advantage of.

Even though it had purchased the land entirely with cash, and was thus not paying any debt servicing costs, ownership of the land still came with some fixed costs, and those costs were starting to eat into its potential return on the project, not to mention the opportunity cost of tying up the capital. SREG had been receiving an annual property tax bill of $161,000, and had been paying approximately $1,000 per year for property insurance and $3,000 for basic property management fees. This resulted in a total per year expenditure of $165,000 just to hold the land (see **Exhibit B - To-Date Financials**).

In addition to assessing development opportunities for the site, SREG had also begun informally entering into talks with other developers who might be interested in purchasing the land on an undeveloped basis. SREG's first serious attempt to sell the Orange Vista site resulted in an offer of approximately $12 million, which was much lower than it had initially hoped for. With no other favorable offers presented to it, SREG soon realized that its initial plan of quickly flipping the land was likely too optimistic, and thus it decided to explore other options that might help it to achieve its targeted return. It was clear that in order to truly realize the underlying value of the property, some entitlement work and renegotiation with the municipality had to be pursued. These were not easy things to accomplish, and SREG's principals felt that they were in way over their heads. In order to better assess SREG's options, given that it appeared that it would be holding the asset longer than it had originally anticipated, the principals decided to engage a professional development management firm to either develop the site itself, or complete a significant number of the predevelopment and entitlement tasks that were preconditions to development. Through these value-adding activities, SREG hoped that it could carve a path to an exit that would facilitate a sales price that was much more closely aligned with its initial expectations.

The Call

The opportunity for PRE to bid on the Orange Vista project arose rather serendipitously. One evening at an Urban Land Institute event, Stephen Fogarty, one of Orin's close colleagues from the California Planning Roundtable (an organization that Orin founded), struck up a conversation with Roger Dunne, one of SREG's investment officers. Dunne casually mentioned how disappointed they had been with the Orange Vista project, and how happy they would be to see someone who really knew California real estate development resurrect it. "I have just the man for you!", said Fogarty. He spent the next twenty minutes describing some of the projects that Orin had worked on, and how he had recently founded PRE with Sanders and Millhouse. Dunne was intrigued and asked Fogarty for Orin's telephone number.

Two days later, Orin received a call from Dunne. Dunne told him the story of how SREG came to acquire the asset, and about how its development intentions had been unexpectedly stymied. Orin was quite familiar with the site already. Projects of its scale rarely went unnoticed, especially in a close-knit community like the California real estate industry. Orin considered the project, even given the current economic conditions, one that had a significant potential.

As he was listening to Dunne describe the project, Orin jotted down some initial calculations to better assess its potential. He was told, for example, that the specific plan for the site had initially allowed for 3,000 single-family detached units, but that the allowable lot count had recently been reduced to only 1,800. This meant (ignoring for the moment the costs SREG had already sunk in pre-development and tax expenses) that SREG's current cost-per-lot for the development was around $5,500.

Orin knew that in the area, finished lots[1] in a development like Orange Vista could easily be sold to homebuilders for per lot prices that ranged from $80,000 to $120,000. On the other hand, based on comparables that he had reviewed, Orin though that if the same lots were instead further developed and sold directly to homebuyers instead, it was not

[1] "Finished lots", also known as "shovel-ready", were lots that had all grading, sewer, road, and entitlements completed and were ready to begin unit construction.

unreasonable to expect that a completed unit in the Orange Vista development could be expected to sell for as high as $350,000 (see **Exhibit C- Comparable Properties**). Quickly multiplying out the potential sales price for either finished lots or for completed units, Orin figured that the project had a wide margin in which to make the project profitable. But these lots were far from finished, and there were still a significant number of unknowns surrounding additional costs that would need to be covered. Regardless of the current unknowns, the project piqued Orin's interest and as the call concluded, Dunne invited him to prepare a bid submission to assume development management responsibilities for the site. "Show us what you've got", said Dunne.

After getting off of the telephone with Dunne, Orin called a meeting with his partners. They too were familiar with the site and its history. Many real estate development professionals were curious about the site's future, as it represented an excellent market opportunity under the right circumstances, although concerns remained about some of the physical restrictions and entitlement uncertainties. As the three PRE principals discussed the project, questions abounded. SREG was certainly sanguine about the opportunities for development at the site, but did current market conditions support optimism? And could they really overcome the outstanding issues with the municipality?

The Development Management Game

As Orin and his partners founded PRE, they began to consider different revenue models and the role that they could play in the various development projects that they were assigned to. There were a wide variety of compensation models and roles that a development manager could arrange with an owner. It was largely a matter of negotiation, and the circumstances specific to each individual project dictated what was most appropriate (and lucrative) for a development manager. The appropriate compensation structure was dependent on a mix of variables, including the appetite that the development manager had for risk. It was often the entrepreneurial, creative companies who structured the best development management relationships – relationships where interests were aligned and where the development manager was properly incentivized to add the most value possible to the project.

Many development managers at the time focused on the "fee development" model, whereby they would manage many aspects of the development process and would be compensated with a fee that would typically be based on a formula or mechanism agreed to by the parties in advance. The fee development model could take various forms; however fees were typically in the range of 5% to 10 % of total project costs, depending on the nature of the project and intensity of management. It was not uncommon for development management contracts to also include compensation bonuses that were paid on top of flat fees, typically when certain predetermined performance milestones were accomplished. Additionally, fee development contracts would often contain stipulations guaranteeing either straight amount or percentage bonuses should the development manager meet certain pre-defined performance criteria.

There was often tremendous potential upside for development managers who adopted compensation models whereby they shared in profits for a project (for example the profit derived from the sale of future cash flow), but also assumed significant risks. With the Orange Vista project, since it was still unknown whether SREG would fully develop the site, or simply work through some of the pre-development activities and then resell the land, a compensation structure that paid a percentage of total project costs to the development manager brought with it additional risks, as the actual project costs would vary significantly depending on the final strategy that SREG decided to employ.

Regardless of the compensation structure employed, development managers had to earn that compensation. The role of a development manager could vary dramatically depending on the project; it could encompass a remarkably broad scope of responsibly in some instances, and a relatively narrow scope of responsibility in others. The best development managers were often those who were effectively an extension of the owners – trusted representatives who understood their clients and were always one step ahead of them.

Most often, development managers were responsible for completing the majority of the pre-development activities, for example by conducting market analyses and feasibility studies, maintaining a project budget and pro forma, negotiating with financing institutions, overseeing design work, hiring contractors, applying for permits, and working through the municipal approval process. As projects moved from pre-development to the construction phase, development manger responsibilities typically grew to include overseeing design and construction, reporting progress back to investors and lenders, continuing to ensure compliance with municipal codes and planning agreements, and beginning marketing and sales. Once construction was completed, development managers were often still engaged to oversee the sales and marketing efforts and to ensure that any final approvals from the municipality and other regulatory authorities were obtained (for example, and most notably for residential projects, certificates of occupancy).

In the case of projects where no vertical construction took place, but rather only entitlements (and perhaps servicing) occurred prior to an exit, development managers were often responsible for all of the same predevelopment activities as development managers who guided projects through construction, but were also responsible to concurrently market the undeveloped land to potential buyers. For projects where the development manager was merely responsible for the pre-development and initial site preparation work, the entitlement and approvals process was even more critical to their success and ultimate profit, as in the predevelopment stage, effectively negotiating approvals was what provided the development manager with the greatest potential to add value to the project.

PRE and SREG spoke at length about the potential compensation structures that they could arrange, and the potential scope of PRE's responsibilities. Given its lack of development expertise, SREG expected PRE to take on a considerable amount of responsibility, with PRE being tasked with pursuing all necessary entitlements, conducting underwriting, market analysis and a wide range of other matters. In the end, two alternative compensation models were offered to PRE by SREG for consideration. The first option would see a fixed fee of $16,000 per month paid to PRE, together with expense reimbursements. The second option would see PRE paid an initial $30,000 retainer (paid as a one-time upfront payment when the contracts were signed), and a tiered share of the project's exit price in which PRE would receive 2% of the first $20 million of the sales price, 4% of the next $20 million, and 8% of all of the sales proceeds above $40 million.

The two options gave the PRE principals a lot to think about. They owned a fledgling company in desperate need of revenue to cover their operational costs and provide a decent income stream for them as individuals. It was very tempting to just take the first option since it would at least "keep the lights on". But Orin emphasized his faith in the project, and in the PRE team, and insisted that PRE should avoid the temptation of reliable monthly revenue and instead position itself to participate in what could very well be a lucrative backend. Choosing to accept the retainer and percentage of the final sale also came with risks. While they all felt strongly about the project's potential, they were also painfully aware of their company's dimming financial situation, and were not exactly eager to spend much more of their personal incomes to keep PRE afloat. With some soul searching, PRE's principals decided to proceed with the compensation structure that would give them a piece of the exit, citing that they were confident enough in the site, the market, and, most importantly, themselves, as noted by Orin:

"Throughout a project like this, I often have to remind myself that I'm not the one who owns the project, because my natural tendency is to take the ball and run with it. With most of the day-to-day activities my work mirrors that of an owner-developer 100% and I really like this. I got into this industry because I like to work hard to add value to my projects and, at the end of the day; I really enjoy seeing my projects be successful. Knowing that I am going to expel all this effort, I thought why not go for the risky strategy. I trust in my own competency and that of my partners and I was certain we'd be able to make this project a huge success."

In Need of a Game Plan

As soon as the development management agreement was signed, Olin quickly got to work on the Orange Vista project. There were a number of issues to solve if PRE was going to make it a success. For example, the exactions that the municipality was requiring the developer to undertake were devastating to the project's economics. Exactions were not uncommon when developing large projects in California - in 1978 California voters had passed Proposition 13, which capped the rate that municipalities could charge residents for property taxes, which was traditionally the largest revenue source for local governments. To make up for this revenue restriction, municipalities began relying more heavily on direct development fees and zoning requirements to cover expenses that would traditionally been paid for out of their own budgets. But the exactions for the Orange Vista project seemed especially draconian, and SREG couldn't imagine how to make the project work while these onerous costs hung over its head like a dark cloud.

Specifically for the Orange Vista site, the planning commission was requiring that the developer, at the developer's expense, include a 4-acre park, preserve ridgelines along the top of the site, create of a trail system with access to the regional trail network, maintain a 1.5 million gallon water reservoir, and pay a number of one-time direct development fees. Additionally, to address concerns about access to the site, the development agreement and Specific Plan required that the developer build-out the remaining stretch of Orange Avenue, together with east and west collector loops, the majority of the cost of which would be covered by the developer (see **Exhibit D- Orange Vista Ave Plan Map**). The Orange Avenue extension and collector loops were the most costly additional requirement to be added and the one that the developers were least comfortable with accepting. As the planning commission had approved the final requirements, the Orange Avenue extension requirement would mean that the entire 3-mile, 4-lane stretch would need to be completed prior to the first lot at Orange Vista being sold. Based on his underwriting, Orin felt that it was not unreasonable to assume that the total cost of these items would be at minimum $82 million upon completion (see **Exhibit E – Detailed Non-Housing Development Project Cost Estimates**).

SREG also knew that it needed to renegotiate the development agreement with the municipality. What the former owner had considered to be an acceptable development agreement now looked like an insurmountable obstacle to SREG, and it was clear that in order to make the project feasible, it would need to be renegotiated. Both the development agreement and the Specific Plan represented significant deviations from the original development strategy put forth in 1984 - for example the reduction of the allowable unit count to 1,800 units at build-out. With this lowered unit count, the Planning Commission believed that it would be possible to cluster development in the center of the site, which would keep significant tracts of undeveloped land in-tact, while concurrently keeping densities low. The original request in 1984 proposed that a total of 3,000 residential units be built, allowing for a higher density development on the site - with the goal that such density could ensure the preservation of open space. The owners at the time, Baja Development, hoped that this request would allay the concerns of the planning commission and the community that some of the last remaining natural land in the area be preserved, while at the same time fitting enough units on the site to ensure the project's profitability.

While Orin and his partners had yet to fully calculate the financial impact of all of these responsibilities and restrictions, it was already clear that a number of the plan's components had to be fundamentally restructured in order to turn the project around and make it viable. The vision and management of that restructuring process was where Orin and his colleagues could truly prove their worth.

Playing Quarterback

On November 1st 1994, Orin gathered his partners in a room and started to write out PRE's goals for the project on a white board. "The way I see it, we have three main objectives to accomplish. One, we have to renegotiate the development agreement. Two, we have to secure the necessary wetlands permits from the feds. Three, we have to find a way to finance and effectively manage the Planning Commission's required improvements, because if we don't get creative, those costs will sink this project."

Orin needed to propose a development strategy that would take into account the municipality's concerns and the development history, while at the same time focus on financial feasibility. Orin soon arranged a meeting with the planning officials, one of whom - Brian Taylor - he had worked with on numerous development projects in the past. Over the course of the next few weeks, Orin worked tirelessly with the Planning Commission to arrange for amendments to the development agreement that would facilitate the project being turned around. It was an exhausting process, with Orin spending many late nights pouring over data and preparing detailed rebuttals for each issue that he expected the Planning Commission to push back on. It was a task that would call upon all of his, and his partners' collective experience.

In renegotiating the development agreement, Orin sought to enable SREG to phase the project, which was a strategy that Orin had orchestrated for other projects in the past. While Orin did have some reservations about the 1,800-unit limit, he was more concerned with the development agreement's omission of any mention of phasing opportunities. Rarely with a development of Orange Vista's size would the entire project be completed at once. More often, developers would deliver in the project in two or more phases in order to spread some of capital costs over a wider time horizon, giving the developer the opportunity to test some of its assumptions about price points and product types before committing to a full development schedule.

In addition to the unit phasing, Orin felt that an opportunity might exist to phase some of the Planning Commission's development requirements as well. This, he thought, would alleviate some of the costs by allowing SREG to pay for future phases of the road and park costs with revenues from the unit sales of the first phases. Orin's initial calculations had shown that with 1,800 units there still was significant opportunity for profit. Although the reduction in allowable unit count was onerous, Orin advised SREG that it was not a battle that they needed to fight; firstly because a large portion of the site was undevelopable due to a steep incline, and secondly because his market assessment concluded that market trends dictated that it was actually about the right number of units anyways, given the newfound desire by buyers for larger lot sizes.

Orin proposed that SREG phase the development of the project into two sections: east and west. The phasing that Orin had in mind would apply both to the lot and unit development, as well as the extra site development fees. In the first phase, they would complete the first section of Orange Avenue, the park, and the water reservoir, plus a total of 550 finished and developed lots. While there were still risks inherent with this plan, Orin felt that it would reduce some of the financial costs borne by SREG at the project's outset, as well as leave SREG with an exit strategy after the completion of the first phase, whereby it could consider selling the remaining portion of the development as either raw land, or finished lots to another developer.

Through his tireless efforts, Orin was able to negotiate a phasing arrangement with the municipality on behalf of SREG that would enable SREG to build a total of 550 units in the first phase of the project, with the substantial completion of the west section of Orange Avenue, the park, and the water reservoir being required prior to the first sale of the first unit. In the second phase of the project, SREG would be allowed to build 650 additional units, and would be required to complete the remaining portions of Orange Avenue at the same time.

During his renegotiation of the development agreement, Orin also resolved an important view shed issue that had been making the site layout difficult to arrange. While Orin was confident that even with the reduced lot count he would still be able to make the project pencil financially, what he and his architects were less sure of was how they would fit the units on the site, while orienting the development such that the ridgeline view was preserved. Additionally, the municipality was standing firm on its demand that development be clustered in the center of the site. After what seemed like an endless series of negotiations, Orin was finally able to get the planning board to agree to allow for a denser layout, with construction primarily concentrated at the bottom of the site close to Orange Avenue. This design, Orin argued, would both make the municipality happy and also decrease the overall construction costs for SREG.

Orin's skillful maneuvering throughout the project illustrated a recurring theme in development management – that relationships were exceptionally important. As noted by Orin,

> *"Some folks, real estate finance folks especially, often underestimate the value that firms like ours offer through our local and regional relationships. Although technical expertise is important in a development manager, that's really just the entry fee. The real value is added though the relationships that we have throughout planning agencies, municipalities, state and federal governments and regulators, and just as importantly consultants. It's not just the fact that we have them, its how we utilize them – tactfully, ethically and in the best interests of the owner. It isn't easy to get things developed in California, especially when it comes to entitlements, and it isn't getting any easier. In making the pitch for what we bring to the table, I can't overestimate how valuable those relationships are and how far they go towards overcoming obstacles."*

Orin also attended to securing a wetlands permit for the site. As it was laid out, a portion of what Orin saw as the prime developable area on site was situated on what had been designated as a wetlands area. A federal law passed in the 1970s placed strict restrictions on development in these areas, as they were seen as crucial components healthy watersheds and key tools to help with storm water management. When Orin first spoke to government officials about the issue, they said that this was a point on which they would not be able to negotiate, and that he would have to determine a site layout that met the other density and view shed requirements, while avoiding any areas designated as wetlands. This was a problem, however, because after lengthy discussions with his architect, he could not figure out a way to orient the development in a manner that met these requirements. On past projects, Orin had managed to get special permits that allowed development on wetland parcels as long as other areas on the site were set aside for wetland use (e.g. storm water retention ponds, drainage swales, etc.), so he pressed on in an effort to find a solution. Eventually he found success, as after weeks of negotiations with municipal officials and environmental engineers, Orin was finally able to secure permits that allowed for development on the wetlands areas. In exchange for the permits, SREG agreed to create a total of 4.5 acres of wetlands areas on the site. This would add an additional $300,000 to the development budget, but without these permits the project was, in his mind, all but impossible so he considered this an acceptable price to pay.

With the development agreement successfully renegotiated and wetlands permits secured, Orin turned to the topic of trying to cushion the financial blow of the exactions. Exactions were considered to be a necessary cost of doing business in California, but Orin felt that even with the proposed phasing there was no way that he would be able to structure the deal such that they could cover the entire $82 million in improvement costs and fees, while still making the project profitable. There were, however, other tools that developers often utilized that could help to defray the impact of onerous development fees and site improvements – one of which was bond financing. On past projects, Orin had been able to negotiate tax increment financing (TIF) agreements. He would use the proceeds from the TIF issuance to cover some of the initial site preparation and off-site development charges. Broadly speaking, TIFs were financing structures through which cities would borrow against future increases in the tax base of an area to fund development activities.

Orin knew that it was unrealistic to expect TIF financing to pay for all of the site improvements, but he thought that if SREG were able to partner with the municipality and negotiate a TIF package to help lower some of the non-development costs, the project may become more feasible. In the end, Orin arranged for the issuance of a municipal bond to cover a portion of the development costs totaling $21.5 million total for both phases. The bond would be issued by the municipality and would be repaid over a 30-year period through a portion of the increased property tax revenues that the development would generate. In its agreement, the municipality stipulated that the bond revenue only be used for road and other public infrastructure improvements.

It hadn't been easy, but Orin was able to accomplish all of PRE's objectives and put the project back on track. But there was still plenty of work left to do. Now SREG had to start building out the project, and try to find an exit on favorable terms.

Kick The Field Goal, Or Go For It?

Orin and his partners looked forward to the build-out of the project. Much of the most challenging work was behind them, and now they could focus on the fun part – building something tangible. But suddenly in April of 1996, Orin received a telephone call from Red Hawk Companies (Red Hawk), a medium-sized California developer who had already successfully developed a number of similar master planned communities in southern California. Red Hawk had become aware of the strategic changes that PRE was able to make to turn the Orange Vista project around, and was intrigued by the prospect of taking over the reins by purchasing the property and proceeding with the build-out work. Red Hawk's President, Manuel Reese, was amazed at how quickly and effectively PRE had transformed the prospects for Orange Vista and immediately began proposing purchase terms. Through a series of subsequent conversations, he proposed to purchase both of the phases of the project, including all of the site improvements that had already been completed, for a total value just over $50 million.

PRE had spent just 15 months on the project (and, at the proposed closing date, would have spent just 17 months on the project), so the opportunity certainly took Orin and his partners by surprise. Orin had expected that PRE would be involved in Orange Vista for the next several years and the Red Hawk proposal suddenly changed everything. Not in his wildest imagination would he have expected a company like Red Hawk to step up so quickly and to offer what were—objectively speaking—extremely generous purchase terms. Of course, it was ultimately up to SREG, not PRE, to decide whether to accept the proposal and sell the project, so Orin called a meeting for the next day with SREG's team to speak about the proposed deal. He spent virtually that whole night modeling out different financial scenarios, updating market analysis, tweaking the term sheet and otherwise preparing for what was a crucial meeting.

Orin brought SREG's executives into PRE's conference room and described the situation. Orin wanted to make sure that before the SREG executives made any decisions, they understood what their options were and appreciated the extent of the potential future profits that they might be giving up by selling at such an early stage. Orin certainly wasn't trying to dissuade SREG from selling, but he thought that it was important that PRE look out for SREG's best interests by keeping it fully informed. Even though the sales price was way higher than the principals of SREG ever thought they would achieve with the investment, there was reason to believe that the build-out would be equally, if not even more profitable. By this point, everyone on PRE's and SREG's teams had started to feel the market turning around, and were becoming more and more confident with the sales projections that Orin had worked so hard to convince the group of during the early weeks of PRE's management term.

But ultimately, the allure of the payday prevailed. After the meeting Orin recalled, "even as I was doing my best to explain what potential lay ahead, I could see the gears in their heads already tuning, mulling over where they would next invest these earnings." Two hours later it was decided that SREG would execute on the sale, subject to some minor adjustments to the term sheet that Orin had proposed. Orin shook the SREG executives hands, congratulating them and leading them out the door. He then walked back to his office, pulled out his calculator, and punched the keys enthusiastically as he determined what this all meant for PRE and its financial position (he had refrained from running the numbers the previous day because he didn't want it to distract him while he advised SREG). With the last keystroke, he glanced at the screen, and smiled from ear to ear.

Exhibit A

Site Map

Exhibit B

To-Date Financials

Orange Vista			
	1992	1993	1994 (est.)
Land Acquisition	$10,000,000	$0	$0
Property Taxes	$161,000	$161,000	$161,000
Insurance	$1,000	$1,000	$1,000
Management Fees	$3,000	$3,000	$3,000
Total	**$10,165,000**	**$165,000**	**$165,000**

Exhibit C

Competitive Properties

Competitive Developments			
Name	Vista Peak	Orange Canyon	The Cascades
Location	Brea, CA	Yorba Linda, CA	Laguna Woods, CA
Year Completed	1989	1991	1987
Unit Mix	3 and 4 Bedroom detached single family.	2,3, and 4 bedroom detached single family.	2 and 3 bedroom detached single family.
Development Size	75 units	150 units	65 units
Sales Range	$225,000-$310,000	$195,000-$275,000	$295,000-$350,000

Exhibit D

Orange Ave Plan Map

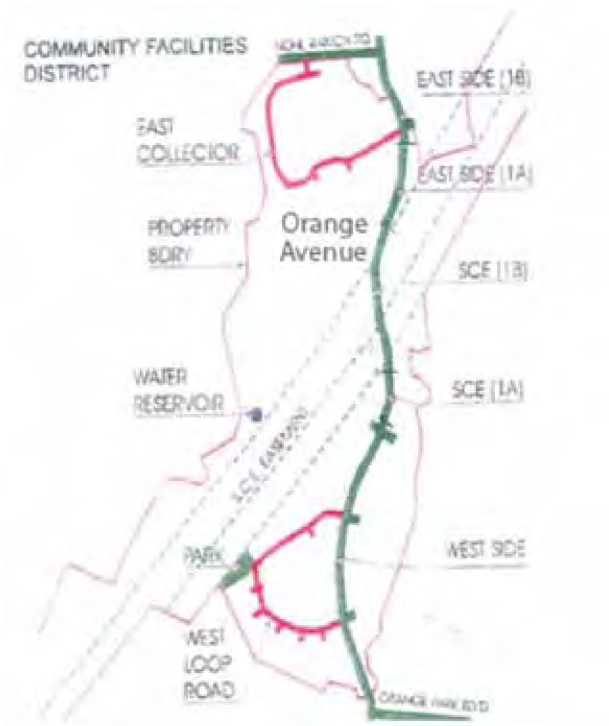

Exhibit E

Detailed Non-Housing
Development Project Cost
Estimates

Orange Avenue	
West Section	$24,120,500
East Section	$28,120,500
Final Connections	$6,300,000
Total- Orange Vista	**$58,541,000**

Collector Roads	
West Collector	$2,500,000
East Collector	$3,500,000
Total- Collectors	**$6,000,000**

Other Site Costs	
Parks and Trails	$1,500,000
Water Reservoir	$3,500,000
Total- Other	**$5,000,000**

Fees	
City Sewer Connection Fee	$75,000
Sanitation District Fee	$2,350,000
Major Thoroughfare/ Bridge Fee	$2,501,000
Transportation System Improvement Fee	$418,000
Water Meters	$150,000
Park Acquisition Fee	$2,310,000
Police Facility Fee	$355,000
Fire Facility Fee	$450,000
Drainage Assessment Fee	$4,150,000
Total	**$12,759,000**
Total All Costs:	**$82,300,000**