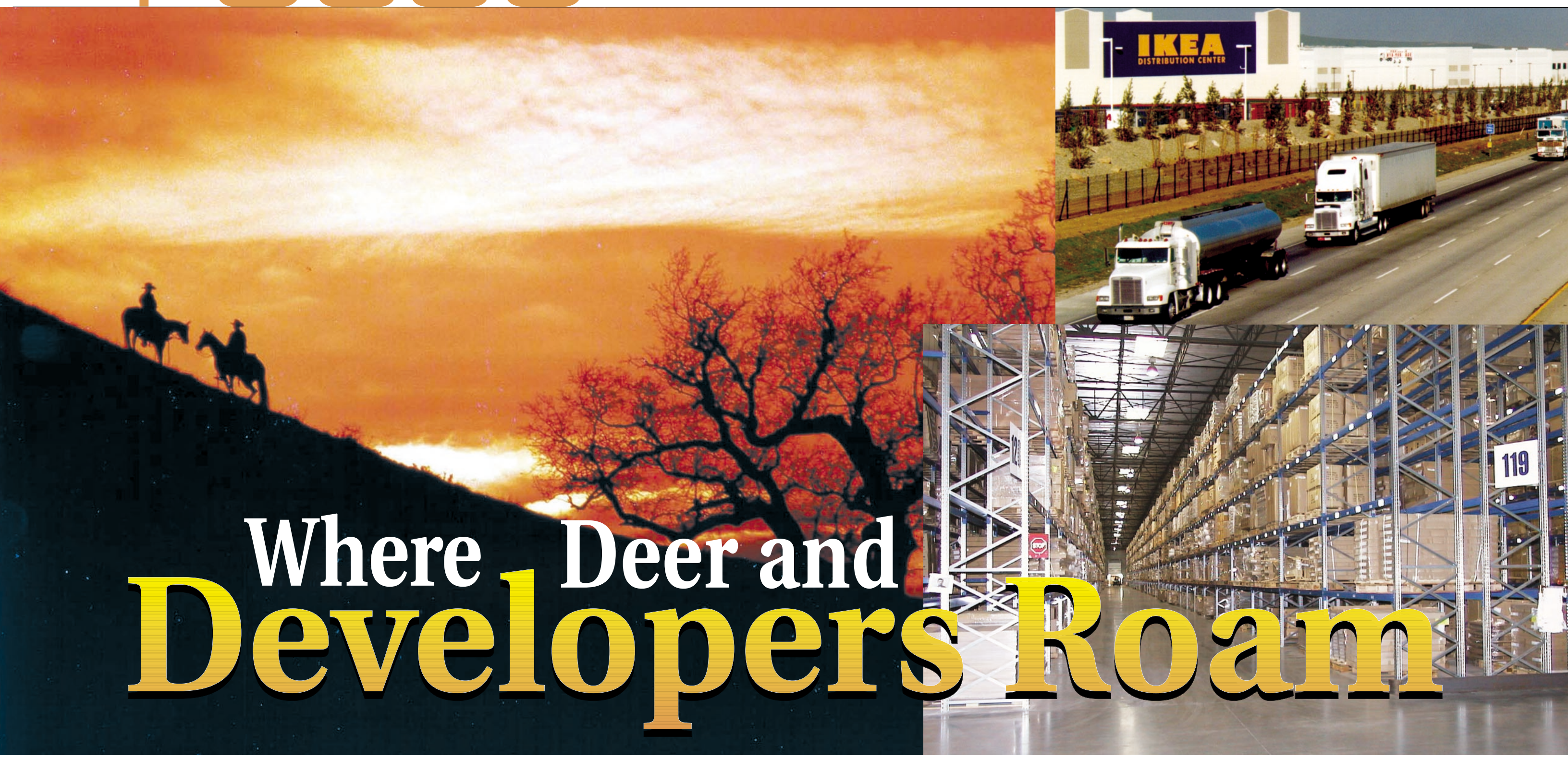

Where Deer and Developers Roam

By Cara L. Clinton

With its canyons, lakes and mountain views, Tejon Ranch, in California's Kern and Los Angeles Counties, has served as the backdrop for such picturesque films as "Braveheart." Those traveling local Interstate Five can spot cattle grazing on the 270,000-acre property–said to be the largest contiguous land holding in the state–which is also home to deer, antelope and wild boar. Yet harder to miss these days are the mammoth distribution and warehouse facilities rising within the ranch's Tejon Industrial Complex, a project that opened just north of the Los Angeles Basin in 1999 and has since put Tejon on the commercial real estate map. And with plans to add residential and resort communities to its mix, the property's owner, Tejon Ranch Co., expects to derive the bulk of its future income from bricks and mortar.

The publicly traded Lebec, CA-based company earned total revenues of $21.7 million in 2002, a rise from $19.1 million in 2001. This year, that growth curve has continued: for the quarter ending March 31, revenues were up 23% from the previous quarter to nearly $3 million. In Q2, that number went up to $3.5 million.

Year-over-year, the company did register a loss. Last month it announced a net loss of $414,000, or three cents per common share, diluted, over the same period a year earlier, when it racked up net income of $600,000, or four cents a common share, diluted. Total revenues for the first half of this year were nearly $6.6 million versus $7.2 million for the first six months of 2002. The company attributed the losses to a decline in real estate revenues and interest income.

A good portion of Tejon Ranch's earnings is derived from agriculture, the ranch's primary use since it was formed by Spanish land grants more than a century ago. Some 6,700 acres are still farmed, principally for wine grapes, pistachios, walnuts and almonds. In addition, notes Joe Drew, SVP of commercial and industrial development for Tejon Ranch Co., two cattle ranching operations have grazing leases for more than 200,000 acres. The company has also forged a major land conservation agreement with the Trust for Public Land to ensure that up to 100,000 acres remain undeveloped.

Nevertheless, as the ranch celebrates its 160th anniversary this year, it is in a transition phase, with a handful of large commercial projects on the horizon. Tejon Ranch Co.'s board of directors, including president and CEO Robert A. Stine, is making "limited strategic real estate development" one of its primary initiatives going forward, states Drew. "Times have changed," he explains, "and our state needs some of the real estate opportunities we can offer."

Those opportunities are also important for Tejon Ranch Co.'s shareholders. The company was acquired by a group of investors including the Times Mirror Co. in 1912. After 85 years, the Times Mirror Co. sold its 31% ownership to Third Avenue Value Fund and Carl Marks Management Co. in 1997. Tejon Ranch Co. began trading on the New York Stock Exchange in 1999, with its roughly 14.5 billion shares of common stock hitting a 52-week high of $33.30 in July and hovering around the $30 mark in the middle of last month.

"Because we are a publicly traded company, it is important for us to make sound decisions for our shareholders and to try and increase our value," says Drew. And due to the ranch's prime location, real estate is an obvious way to achieve that. The property's most southern border is 60 miles north of Los Angeles, and its northern border lies 15 miles east of Bakersfield, CA, allowing distributors to service the California markets and the 11 Western states surrounding it.

"The development we are considering is right on the industrial corridor," Drew explains. "California's lifeblood is Interstate Five

Clockwise from left: Although it is now focused on commercial real estate development, Tejon Ranch Co. has also signed an agreement with the Trust for Public Land to preserve up to 100,000 acres of its pristine habitat and wild lands; Ikea purchased an 80-acre land parcel in Tejon Industrial Complex for its Western North American distribution center in October 2000; and in January 2002, the home furnishings retailer opened the first 850,000 sf of the nearly 1.8-million-sf facility for business.

North and South, and we just happen to own a total of 16 miles on both sides of that." In addition, Highway 58, the extension of Interstate 40, runs through the northern tip of the ranch and straight into Bakersfield, giving truck drivers east-west access as well.

That location is precisely what made Tejon Ranch a logical site for Petro Travel Plaza, a truck maintenance and servicing facility that opened for business five years ago as the premier project in Tejon Industrial Complex's first component, TIC West. With its 30,000-sf main building, 12 lanes of diesel fueling and restaurant, the Travel Plaza, a JV with El Paso, TX-based Petro Stopping Centers, was a solution to a lack of services for truck drivers rumbling along the interstate, explains Barry Hibbard, VP of commercial and industrial marketing for Tejon Ranch Co. The company saw it as a cash generator, he says, "but we never realized that it would have quite the synergy that it does. It has proven to be an excellent driver of tenants to the complex because it solves issues they are having in other parts of the country and particularly in Southern California."

For example, since the Sept. 11, 2001 terrorist attacks, truck drivers are no longer allowed to park their rigs on the side of the road, explains Hibbard. If they are early for deliveries, they are forced to circle the area. Drivers making deliveries within Tejon Industrial Complex, however, can stop at the Petro Travel Plaza to relax and have a bite to eat, says Hibbard, which has led to greater efficiency.

Current amenities at Petro Travel Plaza include a Wendy's, Baskin-Robbins and Pizza Hut as well as proximity to a McDonald's and Starbuck's. In addition, Tejon Ranch signed a long-term lease in January of last year for the construction and operation of a 30,000-sf, 63-key Best Western hotel, which has since been completed.

That retail and hospitality base serves both traveling motorists and employees of tenants like Ikea, which opened the first 850,000 sf of its nearly 1.8-million-sf facility in TIC West in January 2002. Ikea Tejon Terminal is Ikea's Western North American distribution center, servicing an area that extends from Houston up to western Canada. The home furnishings retailer purchased an 80-acre plot from Tejon Ranch Co. in October 2000 for the building and tapped Pepper Construction of Irvine, CA as the GC. In the meantime, it will continue to operate facilities in Ontario, CA and Vancouver, Canada–but this is by far the company's largest Western outlet, notes Michael McNiff, store distribution manager for the new center.

"We needed room because of the expansion we're undergoing," notes McNiff, adding that Ikea plans to open at least five new stores in North America every year for the next 10 years. "This was a good deal all around. We can go to our southbound stores in LA and San Diego, north to the San Francisco area and Seattle and into Canada." Also important is the ranch's access to the ports of Los Angeles and Long Beach, CA, both a two-hour drive away.

Construction on the remainder of the Ikea project, or Phase II, is wrapped up, says McNiff, adding that the entire center should be up and running by next spring.

Also luring Ikea to Tejon Ranch, adds the distribution manager, is Kern County's sizable and relatively inexpensive labor force. In fact, Hibbard reports that the retailer had 13 applicants for every job opening at the new facility.

"Kern County has had an extremely high unemployment rate for years, and we are adding jobs with a multiplier effect–they create other service and government jobs," he says. Ikea's first phase alone created 150 jobs.

John DeGrinis, SVP in Colliers Seeley's Encino, CA office and broker for the Tejon Industrial Complex, says Kern County's unemployment rate was around 8% last month, compared to the national average of 6%. The rate in some communities 20 minutes north of the complex, where Tejon derives much of its labor, is close to a whopping 20%. Depending on the job, labor can be between \$3 and \$3.50 cheaper per hour in Tejon than it is in the highly industrial Inland Empire, adds DeGrinis.

"Kern County has been lacking diversification in the labor market, so by bringing major companies in here, we are changing the lives and potential for a lot of folks. People literally stand in line for these full-time jobs," Hibbard says.

Poised for economic growth, Kern County also offers other benefits to its business tenants, largely in terms of pricing. The county works with businesses to process permits in an average of six weeks and has no inventory, transaction or utility taxes. Land in Tejon Industrial Complex is trading at between \$2.50 and \$4 per sf, notes DeGrinis, whereas in areas like Valencia, CA, where there has been continued industrial growth, land is being swapped for \$10 to \$12 per sf. New product greater than 500,000 sf within TIC, he reports, commands asking rents in the low-to-high-20-cents range, compared to the Inland Empire, where rents are in the high-20- to low-30-cents range.

Hibbard is hopeful that all of those factors will help him lock in a new tenant for a facility in TIC West that was previously occupied by the bankrupt Daisytek International. The wholesale distributor of computer and office supplies inked a 15-year lease for half of a 650,909-sf spec facility that was developed in TIC by a JV between Tejon Industrial Corp. and DP Partners of Reno. At that time, it was estimated by economic forecasting company Gobar & Associates that Daisytek's presence would infuse \$55 million into the local economy. Daisytek vacated the property last month, but Hibbard says that interest in the building is strong and that, as of press time, he was "really close" to filling the empty space. Upon occupancy of all or part of the former Daisytek asset, he adds, another spec building of 606,000 sf will rise on an adjacent pad and could potentially be completed within five months.

All told, plans for TIC West encompass 350 acres and five million sf of development. This includes another 77 acres available for either build-to-suit or land sale transactions, notes Hibbard. "We have chased a couple of big build-to-suits. You can put 1.2 million sf on that pad," he says. "It's one of the bigger parcels that is fully available and ready to go in Southern California."

And the recent trend toward consolidation means the larger the plot, the better, explains DeGrinis. "Companies like Wal-Mart, Ikea

This 270,000-acre land parcel is a burgeoning industrial hub, with residential soon to follow. Still, its agricultural roots remain firmly planted.

and Home Depot have realized that the most important thing in their business is to get product from the manufacturer to the shelves in the most effective manner. Instead of having multiple warehouses around the country, they are going to have two or three, and that has driven a growth to much larger warehouses. Where 10 or 15 years ago, a big building would be 300,000 sf or 400,000 sf and a company had 12 or so of them around the country, we now see almost two-million-sf facilities as the norm for regional distribution operations."

On top of that, adds Hibbard, manufacturers are delaying the final packaging of their goods. "The manufacturer is trying to decide how to have the most flexibility to be able to meet the changing demands of the customer," he says. "They are postponing the final configuration and packaging of product until it gets to the warehouse, causing warehouses to get bigger and house more employees."

Both of those trends bode well for TIC East, the second part of the industrial complex, which will tout 1,100 acres and accommodate 15 million sf of development. Tejon Ranch received entitlements for this portion in March and inked an option agreement last month with San Francisco-based Catellus Development for build-to-suits on an 80-acre site. "They are paying us every month for the option to buy that dirt, which is then applicable to the purchase price of the dirt when we go out and find the first build-to-suit tenant," says Hibbard, who says the option agreement will likely convert into a joint venture. "Catellus is one of the better build-to-suit companies on the West Coast, so we hope to be able to get some high-profile tenant activity," says Hibbard. "With their expertise, strong capital and

"California's lifeblood is Interstate Five, and we own 16 miles on both sides of that."

JOE DREW
SVP, COMMERCIAL AND INDUSTRIAL DEVELOPMENT

ability to go after a deal, we might be able to secure a build-to-suit on the 80-acre site and then on other pads in the south end of the park, designed for monster buildings."

But Tejon Ranch Co. is also saving room for smaller-scale projects, particularly in TIC West, where a 38.5-acre plot has been designed for eight to 10 buildings in the 20,000-to-100,000-sf range. The company has identified some target industries, such as entertainment, that may benefit from assets of this size, says Hibbard. With the amount of filming that takes place on the ranch, facilities for storage and editing equipment are one option. Regional automotive distribution and aerospace storage facilities are other possibilities. In addition, plans are under way for another first-class travel center equivalent in size and scope to the one on the west side.

While there is no targeted build-out date for Tejon Industrial Complex, Hibbard estimates that current plans call for at least a 10-year development supply. The possibility exists for expansion beyond TIC East and West, but such growth will be contingent upon the success of the complex and the overall economy, he adds.

For now, Tejon Ranch Co. is focused on the advantages it has to work with in the near future. "We are not just selling off dirt to developers. We want to stay in these deals as a partner," says Hibbard. "We own 60% of the Petro Travel Center and the DP deal is a 50/50 partnership. Also, as the option agreement with Catellus unfolds, we will have the right to participate in those deals with them."

"We are not just selling off dirt to developers. We want to stay in these deals as a partner."

BARRY HIBBARD
VP, COMMERCIAL AND INDUSTRIAL MARKETING

And as the owner of such a large land holding, Tejon Ranch Co. can ensure that TIC remains purely industrial. "The fact that we own all of the dirt around the complex is key, because what is hurting areas like Ontario right now is the residential-industrial clash," explains Hibbard.

"We are not going to have homes adjacent to industrial facilities that run 24/7–that's what we are seeing in the Inland Empire," adds DeGrinis. "That's causing some significant constraints on growth."

That's not to say there's no residential planned for other areas of Tejon Ranch. More than 20 miles from TIC and 60 miles north of Los Angeles on the Kern County border at the junction of Interstate 5 and Highway 138, plans are being drawn for a 12,000-acre master-planned community currently in the entitlements stage. Centennial Founders, a JV between Tejon Ranch Co. and homebuilders Pardee Homes of Los Angeles, Standard Pacific Homes of Irvine, CA and Upland, CA-based Lewis Investments Co., will master plan the community. It will comprise 6,000 acres of open space and another 6,000 acres occupied by residential (split into seven villages), retail, schools and medical facilities, as well as a business district. Tejon Ranch Co. owns 50% of the project, while the remaining half is split between the three other partners. "We think this is the next logical place for some quality community," says Drew.

Approvals should take another three of four years to obtain, adds Drew, at which point construction will commence, one village at a time. The first home occupancies are slated for 2007.

A third concept being explored is Tejon Mountain Village, a world-class resort that would rise along the shores of Tejon Lake in southern Kern County. While still on the drawing board, the village should encompass a resort hotel with a golf course and residential areas allowing for plenty of open space, says Drew. "There won't be a row of cookie-cutter houses sitting anywhere," he adds.

Yet there's still a lot of work to be done. "If it does come together it will be built out over the next 20 years or so," Drew says. In fact, all three of the commercial real estate concepts under way at Tejon Ranch could take up to 30 years to complete. But the company's execs appear to be in no rush. "That's one of the advantages to being a 160-year-old start-up," says Hibbard. "We've owned the land, so the interest clock is not burning a hole in our pocket. We can afford to wait and do the right thing.

And they can only hope that the company's future decision-makers have the same mindset. "There is still 150,000 acres of the ranch that we don't have a vision for, and we don't believe you can predict every absolute use of this land," stresses Drew. "It will be up to subsequent generations of leaders and owners of the ranch to make those decisions." ◆

Reprinted with the permission from the September 2003 edition of Real Estate Forum