GHJ GEORGE HAMILTON JONES Inc.
Real Estate Appraisers & Consultants

Stuart D. DuVall, MAI
Casey O. Jones, MAI

July 15, 2021

Omar Sandoval, Esq.
Woodruff, Spradlin & Smart
555 Anton Boulevard, Suite 1200
Costa Mesa, CA 92626

Re: Response to Integra Realty Resources "Comments and Conclusions" regarding the George Hamilton Jones, Inc. Appraisal Report of the Willowick Golf Course

Dear Mr. Sandoval:

I have reviewed the "Integra Comments and Conclusions" (pages 10–13) portion of an Appraisal Review submitted by Integra Realty Resources, dated June 15, 2021.

At your request, I have provided responses to the Integra comments. These are provided on the following pages.

Respectfully,

Casey Jones, MAI
(State Certified General Real Estate Appraiser No. AG041862)

George Hamilton Jones, Inc. • 717 Lido Park Drive, Suite D • Newport Beach, CA 92663
Phone (949) 673-6733 • Fax (949) 673-6924 • www.georgehamiltonjonesinc.com

Response to Integra Realty Resources Review
"Comments and Conclusion"

I was not given the entire Appraisal Review prepared by Integra Realty Resources. My comments are restricted to the "Integra Comments and Conclusions" section on numbered pages 10-13 that were provided.

<u>Section 1</u>:

Paragraph 2: The reviewer states that she finds it "interesting that the appraisal report does not:

1. Appear to adequately account for risk;
2. Adequately account for the time associated with entitlements;
3. Adequately account for the cost of obtaining entitlements."

This critique is not consistent with the empirical information, reasoning and analyses presented in the Appraisal Report.

In paragraph 1 of Section 1, the reviewer extracts a quote from the Appraisal Report that reads "…based on analysis of market evidence of entitlement experiences at comparable properties and discussions with private and public participants with wide experience in the entitlement process…"

This statement clearly sets out the fact that appraisal analysis was based on *market evidence* of actual development experiences with comparable properties. These are the five market data items presented in the sales comparison analysis of the report, and they certainly address, on a case by case basis, issues related to risk, timing and cost.

It is important to underscore that these data are not speculative. They do not provide an opinion of how entitlement might unfold, but, rather, provide empirical evidence of buyers' and sellers' perception of risk, the actual timing of the entitlement process and the burdens of cost. All of these elements - risk, timing and cost - are implicit in the price paid – the "meeting of the minds" of well-informed parties at a particular point in time and as a reflection of the specific entitlement status of the project. As such, these data are real-world examples of how this complex interplay of the above, and other forces, actually unfolded in open market conditions in various jurisdictions in the Southern California market area.

In Section 1.a.1., the reviewer states "that these sales basically sold as entitled." This statement is misleading, if not precisely inaccurate. As the reviewer outlines in subsequent paragraphs, in this particular market segment the price is typically "set" long before the property is fully entitled. This is done with the understanding that the buyer will incur the risk, time, cost and entrepreneurial effort in obtaining the entitlements. The price is based upon these assumptions – not as an entitled property, but as a property that must obtain entitlements, and the burden (risk, time, cost) is placed upon the buyer to do so.

As an example, compare Sale 2 and Sale 4. The price was set for Sale 2 in late 2016 in an unentitled condition. It was $18.74 per square foot. Sale 4, by contrast, sold as a fully entitled site with an "A" Tentative Tract Map in place less than a year later, in September 2017. This price was $34.20 per square foot.

The subject is considered to be in the condition of Sale 2 at the date of value. All the entitlement timing and cost, and the risks attendant thereto, lie in the future. The market's perception of the risk, timing and cost, is embedded in the price that is "set" in the Purchase and Sale Agreement (PSA).

The traditional understanding of a "fully entitled" property is that all entitlements have been put in place by a developer/owner who incurred risks, costs and effort – and would expect to make a profit on that entrepreneurial effort. When the property is then offered to the open market generally, the price reflects this enhancement above raw land value. (This was the case of Sale 4, which sold as "shovel ready.") However, in most instances in this market segment, the price that is "set" reflects the cost of the land, as unentitled or partially entitled, with the anticipation by both parties that those expenditures of entitlement will be necessary before physical development can commence.

As the market data in the report shows, it is standard industry practice that the price can be set years before the actual close of escrow/recorded sale. This marketing approach would reasonably be the case for the subject property. Therefore, the appraisal provides an opinion of market value that reflects the price that would be "set" at the date of value, in anticipation that the buyer would take on the burdens of entitlement, and that the "close", or "sale", would not occur until some future date.

The comparative analyses presented in the Appraisal Report addressed these issues by adjusting the data items to reflect the subject's condition as unentitled. As an example, Sale 1 had partial entitlements at the time of signing the PSA so a significant downward adjustment for the subject was made to reflect the time, effort and cost to get to that condition (3 years, in addition to the 3 years from PSA to close of escrow). It should also be noted that the broker estimated that the buyer (Toll Brothers) still incurred $10.M± in entitlement costs from the signing of PSA until close of sale, so the entitlement burdens were still considerable.

Sale 2 and 3 both were unentitled at the time of setting the price, which was approximately 4 and 7 years prior to the close of escrow, respectively. All costs were incurred by the buyer. This is directly comparable to the entitlement condition of the subject.

Details of the timing from setting the price to going through the entitlement process to the close of escrow is presented for each data item in the appraisal. The reviewer acknowledges as much in section 1.a. ii. ("hold the property for 3 – 7 years") so it is difficult to understand the critique in section 1. b. that "the appraisal does not consider the time associated with entitling the property." Again, all these elements are addressed in the sales comparison analysis where the adjustments between each sale data item and the subject are discussed.

Paragraph 3 of Section 1 states that "the report is written in a summary format." This is inaccurate. It is complete Appraisal Report consistent with professional standards. Sales 1 to 4 have approximately two pages of narrative discussion about the various factors considered in the comparative analysis. Sale 5 has a full page. Each data item is accompanied in the Addenda by detailed market data sheets. Not all adjustments were quantitative, some were qualitative.

It is acknowledged that the section at the end of Sale 2 regarding the affordable housing adjustment in the Appraisal Report is, upon review, poorly written, somewhat confusing and inaccurate. In fact, since in this phase of the analysis the subject is considered to be without the affordable housing requirement, an upward adjustment should have been made, not a downward adjustment. The appropriate downward adjustment for the subject's obligation that 15% of the residences should be available for affordable housing was made subsequently in the report (pages 55-63). A downward adjustment of approximately 18% was made at that point. The effect of this misstatement for Sale 2 on the ultimate value conclusion is de minimis.

Section 2:

This section of the review addresses concerns about the highest and best use of the subject 101.5-acre site. The reviewer critiqued a lack of detailed discussion of what development the City of Santa Ana would be supportive of. Our discussions with Steve Mendoza, Executive Director of the Community Development Agency of the City of Santa Ana, and Minh Thai, Executive Director of Planning and Building Safety for the City of Santa Ana, indicated that, as would be the case with any large in-fill site in an urban environment in Southern California, development approvals for the subject site would likely be influenced by a variety of factors that were unpredictable and, from their position, speculative, until presented and submitted to the review process.

This sentiment was confirmed by interviews with developers, brokers, planning department representatives from various jurisdictions, and other experienced professionals. This fundamental consensus regarding the reality of the development process was summarized and reported in the statement on page 28 of the Appraisal Report: "Market evidence indicates that a complex interplay of political, social, environmental, legal and economic forces ultimately shapes the character of a master planned community development. This knowledge would lead an experienced, well-informed investor to anticipate that protracted negotiations and give-and-take on a variety of issues is an inevitable part of the process necessary to obtain approvals for entitlement of a property like the subject."

The highest and best use analysis present in the Appraisal Report involves four pages of discussion, reasoning and empirical information reflecting these conditions. The proposed mix of uses on the subject was acknowledged to be speculative, as it must be, yet it was based upon analysis of the plans actually obtained in the market. These were the data presented in the report. This empirical information was coupled with discussions with parties involved in generating those plans. This shed light on the thinking and priorities of market participants and the strategies they used in achieving their ends. This knowledge assisted in providing insight into what might reasonably be developed at the subject property.[1]

The reviewer's statement that "while the appraisal recognizes that 10% of the site could be developed with commercial use, and 15% with an open space use, no

---

[1] One anecdote of the give-and-take process of entitlement was provided at the bottom of page 30, where the City of Whittier required a certain amount of commercial for tax revenue, but offset this by not requiring affordable housing and permitting greater density for the residential.

value was given to these components" indicates a misunderstanding of the comparative analysis process in the appraisal of properties of this type.

This valuation was done on a property-to-property basis of "whole" parcels, transferred in the open market and expressed in price per square foot and price per unit value indications. No allocation of value based on the sum of the parts within a proposed development project was offered or deemed appropriate because of the speculative nature of such an analysis and the number of assumptions required for such an allocation.

Section 3:

The reviewer's comments here are brief. Essentially the critique is that the analysis of the affordable housing requirement was presented in a "very summary format." The analysis actually covers nine (9) pages in the report and provides a great deal of source material including information from the California Housing and Community Development, the Orange County Utility Allowance Schedule, market data from 10 townhome projects as a basis for market sale price (in the Addenda Section of the report), as well as corresponding discussion and analysis.

The suggestion that it would have been preferrable to find "sales of land sold to low income housing developers" fails to take into account the actual burden placed on the developer for the physical construction of the low income housing. It is not merely the dedication of land that reduces the subject value. It also includes the costs of construction of improvements for which a "capped", non-market return is imposed by low-cost housing restrictions in terms of revenue. This is far different than the mere allocation of land.

Closing Comments by Appraiser:

These pages, in combination with a review of the Appraisal Report, will show that the issues of risk, timing and cost for the entitlement process were closely considered in the valuation of the subject property.

The Highest and Best Use of the property presented in the appraisal was based, in part, upon discussions with informed professionals in public agencies, active buyers and sellers participating in the development of land comparable to the subject, as well as experienced land brokers. Additionally, investigations of empirical evidence of actual development programs that were successfully achieved in the market were made and closely analyzed. These steps, in combination, produced a well-supported and reasonable proposed use for the subject property that was physically possible, legally permissible, appropriately supported, financially feasible, and that resulted in the maximally productive use of the land.

It should be further noted that the demand for residential housing has only accelerated in the months between the date of value and the date of this document. By example, the California Association of Realtors database indicates that the median price for existing homes in Orange County was $995,000 in February 2021 (date of value) and that the reported median home price for May 2021 was $1,100,000. This is a 10.5% increase in four months. This is not strictly a pandemic related phenomenon; the two year increase from May 2019 to May 2021 was 30.2%. There is little reasonable doubt that a 101.5-acre level, effectively vacant site in central Orange County would elicit tremendous demand from developers in the open market.

The analysis and reasoning supporting the deduction for the affordable housing component was laid out in nine pages with supporting empirical information and extensive discussion of the reasoning used in the analysis. This is considered to be consistent with professional appraisal practice and an appropriate scope of work for the assignment.