

TEJON RANCH CO  
Form 10-K  
March 01, 2019

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2018

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-07183

TEJON RANCH CO.

(Exact name of registrant as specified in its charter)

Delaware 77-0196136

(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

P.O. Box 1000, Lebec, California 93243

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (661) 248-3000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class Name of Exchange on Which Registered

Common Stock New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T ((§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer" "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of registrant's Common Stock, par value \$.50 per share, held by persons other than those who may be deemed to be affiliates of registrant on June 29, 2018 was \$517,801,604 based on the last reported sale price on the New York Stock Exchange as of the close of business on that date.

The number of the Company's outstanding shares of Common Stock on February 19, 2019 was 25,982,337.

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**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Stockholders relating to the directors and executive officers of the Company are incorporated by reference into Part III.

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## PART I

### Forward-Looking Statements

This annual report on Form 10-K contains forward-looking statements, including statements regarding strategic alliances, the almond, pistachio and grape industries, the future plantings of permanent crops, future yields and prices, and water availability for our crops and real estate operations, future prices, production and demand for oil and other minerals, future development of our property, future revenue and income of our jointly-owned travel plaza and other joint venture operations, potential losses to the Company as a result of pending environmental proceedings, the adequacy of future cash flows to fund our operations, market value risks associated with investment and risk management activities and with respect to inventory, accounts receivable and our own outstanding indebtedness and other future events and conditions. In some cases, these statements are identifiable through the use of words such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan,” “project,” “target,” “can,” “could,” “may,” “will,” “should,” “w similar expressions. In addition, any statements that refer to projections of our future financial performance, our anticipated growth, and trends in our business and other characterizations of future events or circumstances are forward-looking statements. We caution you not to place undue reliance on these forward-looking statements. These forward-looking statements are not a guarantee of future performances and are subject to assumptions and involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from any future results, performance, or achievement implied by such forward-looking statements. These risks, uncertainties and important factors include, but are not limited to, market and economic forces, availability of financing for land development activities, competition and success in obtaining various governmental approvals and entitlements for land development activities. No assurance can be given that the actual future results will not differ materially from the forward-looking statements that we make for a number of reasons including those described above and in Part I, Item 1A, “Risk Factors” of this report.

As used in this annual report on Form 10-K, references to the “Company,” “Tejon,” “TRC,” “we,” “us,” and “our” refer to Tejon Ranch Co. and its consolidated subsidiaries. The following discussion should be read in conjunction with the consolidated financial statements and the accompanying notes appearing elsewhere in this annual report on Form 10-K.

ITEM 1. BUSINESS

Company Overview

We are a diversified real estate development and agribusiness company committed to responsibly using our land and resources to meet the housing, employment, and lifestyle needs of Californians and create value for our shareholders. Current operations consist of land planning and entitlement, land development, commercial land sales and leasing, leasing of land for mineral royalties, water asset management and sales, grazing leases, farming, and ranch operations. These activities are performed through our five reporting segments:

Our prime asset is approximately 270,000 acres of contiguous, largely undeveloped land that, at its most southerly border, is 60 miles north of downtown Los Angeles and, at its most northerly border, is 15 miles east of Bakersfield. We create value by securing entitlements for our land, facilitating infrastructure development, strategic land planning, monetization of land through development and sales, and conservation in order to maximize the highest and best use for our land. We are involved in eight joint ventures, that either own, develop, and/or operate real estate properties. We enter into joint ventures as a means to facilitate the development of portions of our land.

### Business Objectives and Strategies

Our primary business objective is to maximize long-term shareholder value through the monetization of our land-based assets. A key element of our strategy is to entitle and then develop large-scale mixed use master planned residential and commercial/industrial real estate projects to serve the growing populations of Southern and Central California. Our mixed use master planned residential developments have been, or are in the process of being, approved or re-approved, to collectively include up to 34,783 housing units, and more than 35 million square feet of commercial space. We have obtained entitlements on Mountain Village at Tejon Ranch, or MV, and in litigation regarding the entitlements for Grapevine at Tejon Ranch, or Grapevine. During December 2018, the Los Angeles County Board of Supervisor voted in favor of our plan to develop Centennial at Tejon Ranch, or Centennial, taking an additional step toward approving the mixed use residential community. We are currently engaged in entitlement, construction, commercial sales and leasing at our fully operational commercial/industrial center Tejon Ranch Commerce Center, or TRCC. All of these efforts are supported by diverse revenue streams generated from other operations, including commercial real estate, farming, mineral resources, and our various joint ventures.



Percentage of Total Revenue<sup>1,2</sup> by Segment:

1. Real Estate includes equity in earnings of unconsolidated joint ventures.
2. Charts presented only include the segment revenues, other income components are excluded.

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The following table shows the revenues from continuing operations, segment profits and identifiable assets of each of our continuing segments for the last three years:

**FINANCIAL INFORMATION ABOUT SEGMENTS**

(Amounts in thousands of dollars)

|  | Year Ended December 31, |            |           |
|--|-------------------------|------------|-----------|
|  | 2018                    | 2017       | 2016      |
| Revenues and Other Income  |                         |            |           |
| Real Estate—Commercial/Industrial (1)  | \$8,970                 | \$9,001    | \$9,840   |
| Mineral Resources  | 14,395                  | 5,983      | 14,153    |
| Farming  | 18,563                  | 16,434     | 18,648    |
| Ranch operations   | 3,691                   | 3,837      | 3,338     |
| Segment revenues   | 45,619                  | 35,255     | 45,979    |
| Gain on sale of real estate  | —                       | —          | 1,044     |
| Investment income  | 1,344                   | 462        | 457       |
| Other loss   | (59 )                   | (275 )     | (581 )    |
| Revenues and other income  | \$46,904                | \$35,442   | \$46,899  |
| Equity in earnings of unconsolidated joint ventures                                      | 3,834                   | 4,227      | 7,098     |
| Total revenues and other income (2)  | \$50,738                | \$39,669   | \$53,997  |
| Segment Profits (Losses) and Net Income  |                         |            |           |
| Real Estate—Commercial/Industrial (1)  | \$2,724                 | \$2,472    | \$2,740   |
| Real Estate—Resort/Residential   | (1,530 )                | (1,955 )   | (1,630 )  |
| Mineral Resources  | 8,172                   | 3,019      | 6,357     |
| Farming  | 2,535                   | 233        | (25 )     |
| Ranch operations   | (1,760 )                | (1,574 )   | (2,396 )  |
| Segment profits (3)  | 10,141                  | 2,195      | 5,046     |
| Gain on sale of real estate  | —                       | —          | 1,044     |
| Investment income  | 1,344                   | 462        | 457       |
| Other loss   | (59 )                   | (275 )     | (581 )    |
| Corporate expenses   | (9,705 )                | (9,713 )   | (11,811 ) |
| Income (loss) from operations before equity in earnings of unconsolidated joint ventures | 1,721                   | (7,331 )   | (5,845 )  |
| Equity in earnings of unconsolidated joint ventures                                      | 3,834                   | 4,227      | 7,098     |
| Income (loss) before income taxes  | 5,555                   | (3,104 )   | 1,253     |
| Income tax expense (benefit)   | 1,320                   | (1,283 )   | 496       |
| Net income (loss)  | 4,235                   | (1,821 )   | 757       |
| Net loss attributable to non-controlling interest  | (20 )                   | (24 )      | (43 )     |
| Net income (loss) attributable to common stockholders                                    | \$4,255                 | \$(1,797 ) | \$800     |
| Identifiable Assets by Segment (4)   |                         |            |           |
| Real estate—commercial/industrial  | \$65,929                | \$63,065   | \$65,290  |
| Real estate—resort/residential   | 273,620                 | 258,697    | 243,963   |
| Mineral Resources  | 54,144                  | 48,305     | 45,066    |
| Farming  | 40,835                  | 36,317     | 36,895    |
| Ranch operations   | 2,973                   | 3,625      | 3,893     |
| Corporate  | 91,547                  | 108,190    | 44,434    |
| Total assets   | \$529,048               | \$518,199  | \$439,541 |

(1) Refer to Note 1, Summary of Significant Accounting Policies of the Notes to the Consolidated Financial Statements for discussion on impact of the adoption of ASU 2014-09 "Revenue with Contracts from Customers (Topic 606)" on the years ended December 31, 2017 and 2016.

(2) Refer to Note 16, Reporting Segments and Related Information of the Notes to the Consolidated Financial Statements for additional detail related to segment revenues.

(3) Segment profits are revenues less operating expenses, excluding investment income and expense, corporate expenses, equity in earnings of unconsolidated joint ventures, and income taxes.

(4) Total Assets by Segment include both assets directly identified with those operations and an allocable share of jointly used assets. Corporate assets consist of cash and cash equivalents, refundable and deferred income taxes, land, buildings and improvements.

### Real Estate Development Overview

Our real estate operations consist of the following activities: real estate development, commercial land sales and leasing, land planning and entitlement, and conservation.

Interstate 5, one of the nation's most heavily traveled freeways, brings in excess of 88,000 vehicles per day through our land, which includes 16 miles of Interstate 5 frontage on each side of the freeway and the commercial land surrounding three interchanges. The strategic plan for real estate focuses on development opportunities along the Interstate 5 and Highway 138 corridors, which includes TRCC in Kern County, Centennial, a mixed use master planned community on our land in Los Angeles County, MV, a resort and residential community in Kern County, and Grapevine, a mixed use master planned community on our land in Kern County. TRCC includes developments east and west of Interstate 5 at TRCC-East and TRCC-West, respectively.

The chart below is a continuum of the real estate development process highlighting each project's current status and key milestones to be met in moving through the real estate development process in California. During this process, we may experience delays arising from factors beyond our control. Such factors include litigation and a changing regulatory environment.

Our real estate activities within our commercial/industrial segment include: entitling, planning, and permitting of land for development; construction of infrastructure; the construction of pre-leased buildings; the construction of buildings to be leased or sold; and the sale of land to third parties for their own development. The commercial/industrial segment also includes activities related to communications leases, and landscape maintenance fees. Our real estate operations within our resort/residential segment at this time include costs for land entitlement, land planning and pre-construction engineering, and land stewardship and conservation activities.

## Operating Segments

### Real Estate - Commercial/Industrial

During 2018, approval for expansion of the Foreign Trade Zone (FTZ) was granted by the U.S. Department of Commerce. The expanded FTZ now covers all the industrial sites within TRCC, an area totaling 1,094 acres. The FTZ designation allows the user to secure the many benefits and cost reductions associated with streamlined movement of goods in and out of the zone. This FTZ designation is further supplemented by the Economic Development Incentive Policy, or EDIP, adopted by the Kern County Board of Supervisors. EDIP is aimed to expand and enhance the County's competitiveness by taking affirmative steps to attract new businesses and to encourage the growth and resilience of existing businesses. The EDIP provides incentives such as assistance in obtaining state tax incentives, building supporting infrastructure, and workforce development.

#### Construction:

During 2018, we formed TRC-MRC 3, a joint venture with Majestic Realty Co., or Majestic, a Los Angeles-based commercial/industrial developer, to pursue the development, construction, leasing, and management of a 579,040 square foot industrial building at TRCC-East. We anticipate construction completion and delivery of the space in the fourth quarter of 2019 to a tenant that has entered into a lease agreement occupying 67% of the total rentable space. We also began development on a new 4,900 square foot multi-tenant retail building at TRCC-East to further expand our footprint at TRCC. We anticipate completion of a dark shell, a commercial building with an unfinished interior, in the third quarter of 2019.

During 2017, our TRC-MRC 1 joint venture with Majestic completed the construction of a 480,480 square foot distribution facility. The facility was fully leased in 2018, with half of the space leased to Dollar General and the other half to SalonCentric, L'Oréal USA's professional salon distribution operation.

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The following is a summary of the Company's commercial, retail and industrial real estate developments as of December 31, 2018:

(\$ in thousands)

| Project                                       | Cost to Date | Estimated Cost to Complete | Total Estimated Cost at Completion | Estimated Completion Date |
|---|--------------|----------------------------|------------------------------------|---------------------------|
| Tejon Ranch Commerce Center                   | \$82,778     | \$ 74,358                  | \$ 157,136                         | TBD                       |
| Less: Reimbursements from TRPFFA <sup>1</sup> | 68,450       | 58,980                     | 127,430                            | TBD                       |
| TRCC Development Costs, net                   | \$ 14,328    | \$ 15,378                  | \$ 29,706                          |                           |

<sup>1</sup>The Tejon Ranch Public Facilities Financing Authority, or TRPFFA, is a joint powers authority formed by Kern County and Tejon-Castac Water District, or TCWD, to finance public infrastructure within the Company's Kern County developments. TRPFFA, through bond sales, will reimburse the Company for qualifying infrastructure costs at TRCC.

The following table summarizes total entitlements for TRCC as of December 31, 2018:

| (in square feet)            | Industrial             | Commercial           | Retail |
|-----------------------------|------------------------|----------------------|--------|
| Total entitlements received | 19,300,941             | 956,309              |        |
| Total entitlements used     | 4,717,629 <sup>1</sup> | 632,795 <sup>2</sup> |        |
| Entitlements available      | 14,004,272             | 318,614              |        |

<sup>1</sup>With the start of a 579,040 square foot building during the first quarter of

2019, total entitlements used subsequently increased to 5,296,669.

<sup>2</sup>With the start of a 4,900 square foot multi-tenant during the first quarter of

2019, total entitlements used subsequently increased to 637,695.



Commercial/industrial real estate sales:

The commercial/industrial real estate sales market is highly competitive, with competition throughout California. Our most direct regional competitors are in the Inland Empire, a large industrial area located 60 miles east of Los Angeles, which continues its expansion eastward beyond Riverside and San Bernardino into the Perris, Moreno Valley, and Beaumont regions of Southern California. We also face competition within Northern Los Angeles, which is comprised of the San Fernando Valley and Santa Clarita Valley along with areas north of us in the San Joaquin Valley of California. The principal factors of competition in this industry are price, availability of labor, proximity to the port complexes of Los Angeles and Long Beach and customer base. A potential disadvantage to our development strategy is our distance from the ports of Los Angeles and Long Beach in comparison to the warehouses and distribution centers located in the West Inland Empire. Strong demand for large distribution facilities is driving development farther east in a search for large entitled parcels.

During 2018, vacancy rates in the Inland Empire stayed flat at 3.9% compared to 3.7% in 2017. This industrial market continues to see available supply remain at historic low levels. Construction declined slightly during the fourth quarter with 20.5 million square feet under construction compared to 20.7 million in 2017. This new supply is currently meeting growing industrial demand. The low vacancy rates have led to a year-over-year increase in lease rates of 7.3% within the Inland Empire. As lease rates increase in the Inland Empire, we may begin to have greater pricing advantages due to our lower land basis.

During 2018, vacancy rates in the northern Los Angeles industrial market, which includes the San Fernando Valley and Santa Clarita Valley, approximated 1.6% compared to 1.7% in 2017. Rents have been increasing for the past six years and will likely continue to rise in future years as the vacancy rate is at historic lows and quality industrial space remains hard to find. During 2018, average asking rents increased 8.5% compared with 2017, which have surpassed the historical peak which was seen in late 2007. Industrial demand remains high and infill industrial demand remains higher still. Future quarters will likely see greater construction activity as rents hit new highs and vacancy rates are at historic lows. Demand for industrial space in this market will also continue to be driven by domestic and global consumption levels. As industrial vacancy rates are at historic lows, industrial users seeking larger spaces are having to go further north into neighboring Kern County and particularly, TRCC which has attracted increased attention as market conditions continue to tighten.

In 2018, the Los Angeles and Long Beach Port container traffic recorded its highest container total ever with 17.54 million Twenty-Foot Equivalent Units, or TEU's, up 3.8% from 2017. TEU is a measure of a ship's cargo carrying capacity. The dimensions of one TEU are equal to that of a standard shipping container measuring 20 feet long by 8 feet tall.

Joint Ventures:

During 2018, we formed TRC-MRC 3, a joint venture with Majestic to pursue the development, construction, leasing, and management of a 579,040 square foot industrial building on the Company's property at TRCC-East. We anticipate construction completion in 2019, and plan to deliver the space in the fourth quarter of 2019 to a tenant that has entered into a lease agreement to occupy 67% of this rentable space.

During 2016, we entered into a joint venture operating agreement with Majestic to pursue the development, construction, leasing, and management of a 480,480 square foot industrial building on the Company's property at TRCC-East. The facility was fully leased up in 2018, with half of the space leased to Dollar General and the other half to SalonCentric, L'Oréal USA's professional salon distribution operation. In addition, we entered into a second joint venture operating agreement with Majestic for the purchase of, ownership of, and management of a fully leased, 651,909 square foot industrial building located at TRCC-West.

Our joint venture with TravelCenters of America, or TA/Petro, owns and operates two travel and truck stop facilities, restaurants, and five separate gas stations with convenience stores within TRCC-West and TRCC-East.

We are involved in three joint ventures with Rockefeller Development Group, which includes the following: Five West Parcel LLC, which owns a 606,000 square foot building in TRCC-West that is fully leased to Dollar General, 18-19 West LLC, which owns 61.5 acres of land for future development within TRCC-West, and TRCC/Rock Outlet Center LLC, which operates the Outlets at Tejon.

Leasing:



Within our commercial/industrial segment, we lease land to various types of tenants. We currently lease land to two auto service stations with convenience stores, 13 fast-food operations, two full-service restaurants, a motel, an antique shop, and a post office.

In addition, the Company leases several microwave repeater locations, radio and cellular transmitter sites, fiber optic cable routes, and 32 acres of land to Pastoria Energy Facility, L.L.C., or PEF, for an electric power plant.

The following table summarizes information with respect to lease expirations for our consolidated entities as of December 31, 2018.

| Year of Lease Expiration | Number of Expiring Leases | RSF of Expiring Leases | Annualized Base Rent <sup>1</sup> | Percentage of Annual Minimum Rent |
|--------------------------|---------------------------|------------------------|-----------------------------------|-----------------------------------|
| 2019                     | 1                         | —                      | \$25                              | 0.43%                             |
| 2020                     | 3                         | 8,788                  | \$247                             | 4.24%                             |
| 2021                     | 6                         | 60,722                 | \$232                             | 3.98%                             |
| 2022                     | 4                         | 46,414                 | \$273                             | 4.69%                             |
| 2023                     | 5                         | 4,640                  | \$375                             | 6.44%                             |
| 2024                     | —                         | —                      | \$—                               | —%                                |
| 2025                     | 3                         | 57,320                 | \$300                             | 5.15%                             |
| 2026                     | 3                         | 4,645                  | \$257                             | 4.41%                             |
| 2027                     | 1                         | 1,801                  | \$62                              | 1.06%                             |
| 2028                     | 1                         | —                      | \$13                              | 0.22%                             |
| 2029 <sup>2</sup>        | 1                         | 1,394,000              | \$3,577                           | 61.42%                            |
| Thereafter               | 6                         | 195,915                | \$463                             | 7.95%                             |

1 - Annualized base rent is calculated as monthly base rent (cash basis) per the lease, as of the reporting period, multiplied by 12. Annualized base rent shown in thousands.

2 - This amount includes 32 acres of the PEF ground lease.

Three leases expired during the year-ended December 31, 2018. The leases were renewed in 2018 and represented less than 5% of annualized base rent.

Please refer to Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for information regarding our 2018 commercial/industrial activity.

#### Real Estate - Resort/Residential

Our resort/residential segment activities include land entitlement, land planning and pre-construction engineering, and land stewardship and conservation activities. We have three major resort/residential communities within this segment: MV, which has entitlement approvals and approved tentative tract map for the first four phases of residential development;

Centennial, which has zoning and land use designation within the Antelope Valley Area Plan, or AVAP, and the Los Angeles County General Plan, and is completing the specific plan process in LA County. The AVAP is designed to guide future development and conservation in the northern-most region of unincorporated Los Angeles County.

Centennial is included in the AVAP as part of the west Economic Opportunity Area, or EOA, where future development would be directed. In December 2018, the Los Angeles County Board of Supervisors' voted in favor of the LA County Specific Plan, taking an additional step toward approving the community; and

Grapevine, which is on land owned within Kern County received entitlement approvals in 2016. On December 11, 2018, the court ruled we have to amend our EIR by preparing supplemental environmental documentation to further analyze the Grapevine project's internal capture rate (ICR), which is the percent of vehicle trips remaining within the project. The supplemental environmental documentation will include updated traffic, air quality, greenhouse gas emissions, noise, public health and growth inducing impact analyses. As a part of the process Kern County will work with us to correct the EIR and re-approve the project. See Note 14, (Commitments and Contingencies) for further discussion.

The entitlement process precedes the regulatory approvals necessary for land development and routinely takes several years to complete. The Conservation Agreement we entered into with five major environmental organizations in 2008 is designed to minimize opposition from environmental groups to these projects and eliminate or reduce the time spent in litigation once governmental approvals are received. Litigation by environmental and other special interest groups have been a primary cause of delays and increased costs for real estate development projects in California.

As we embark on our mixed use master planned communities, we understand that it can take up to 25 years, or longer, to complete from commencement of construction. The entitlement process for development of property in California is complex, lengthy (spanning multiple years) and costly, involving numerous federal, state, and county regulatory approvals. We are unable to determine anticipated completion dates for our real estate development projects with certainty because the time for completion is heavily dependent on the regulatory approvals necessary for land development. Also, as a real estate developer, we are cognizant of the micro- and macro-economic factors that have a significant influence on the real estate sector. As a developer, one would be at an economic disadvantage to bring product to market with no willing or able buyers. This ebb and flow of the economy also plays into the timing of our completion date. Costs will also fluctuate over the life of these projects as a result of the cost of labor and raw materials and the timing of approvals and other activity. The uncertainty of estimated costs to completion is compounded by the potential impact of inflation, which will fluctuate with the equally uncertain completion dates for our projects.



#### Mountain Village at Tejon Ranch:

MV is planned to be an exclusive, low-density, resort-based community that will provide owners and guests with a wide variety of recreational opportunities, lodging and spa facilities, putting greens, a range of housing options, and other exclusive services and amenities that are designed to distinguish MV as the resort community of choice for the Southern California market. MV is being developed by Tejon Mountain Village LLC, or TMV LLC, a wholly owned subsidiary of the Company. MV encompasses 5,082 acres for a mixed use development to include housing, retail, and commercial components. MV is entitled for 3,450 homes, 160,000 square feet of commercial development, 750 hotel keys, and more than 21,335 acres of open space.

We are working toward delivering the first phase of the 160,000 square foot commercial center that we call Farm Village. Farm Village will serve as the commercial center and community gathering place for MV residents and visitors, as well as the gateway to MV. Farm Village will include fresh culinary offerings, artisan markets, boutique lodging, and an array of trails, gardens, and agriculture that will be intertwined to create the most unique, relaxing and “edu-taining” experience while fulfilling the needs of residents of MV. In January 2018, we obtained approval from Kern County on the first phase of the Farm Village.

During December 2017, the Company received approval of Tentative Tract Maps for the first four phases of residential units of MV.

In 2014, the Company acquired full ownership of TMV LLC through the purchase of DMB TMV LLC's interest in the former joint venture for \$70,000,000 in cash.

The Company's decision to obtain full ownership of MV reflects the Company's growth as a fully integrated real estate company and demonstrates our belief in the future success of the development.

MV is fully entitled and all necessary permits have been issued to begin development once the mapping process is complete. Timing of MV development in the coming years will be dependent on the strength of both the economy and the residential real estate market. In moving the project forward, we will focus on the preparation of engineering leading to the final map for the first phases of MV, consumer and market research studies and fine tuning of development business plans as well as defining the capital funding sources for this development. Over the next several years, we expect to explore funding opportunities for future development of MV. Such funding opportunities could come from a variety of sources, such as joint ventures with financial partners, debt financing, or the Company's issuance of common stock.

#### Centennial at Tejon Ranch:

The Centennial development is a mixed use master planned community development encompassing 12,323 acres of our land within Los Angeles County. Upon completion of Centennial, it is estimated that the community will include 19,333 homes and 10.1 million square feet of commercial development. Centennial will also incorporate business districts, schools, retail and entertainment centers, medical facilities and other commercial office and light industrial businesses that, when complete, will create a substantial number of jobs. Centennial is being developed by Centennial Founders, LLC, a consolidated joint venture in which we have a 83.50% ownership interest as of December 31, 2018. Centennial is envisioned to be an ecologically friendly and commercially viable development.

In December 2018, the Los Angeles County Board of Supervisors took action to approve the specific plan and development agreement for Centennial by a vote of 4-1. Upon final approval and finding of facts, the 19,333 residential units will be fully entitled and is expected to occur during the first half of 2019.

In 2016, Lewis Investment Company withdrew from the joint venture. The surviving members (TRC, TRI Pointe Homes and CalAtlantic) absorbed the equity of Lewis Investment Company based on their respective proportionate interest in the joint venture at the time of the withdrawal. In 2018, CalAtlantic also withdrew from the joint venture. The surviving members (TRC and TRI Pointe Homes, Inc.) absorbed the equity of CalAtlantic based on their respective proportionate interest in the joint venture at the time of the withdrawal. Both withdrawals were deemed an equity transaction between members and had no earnings impact to the Company.

During 2014, the Los Angeles County Board of Supervisors approved the AVAP. The AVAP is designed to guide future development and conservation in the northern-most region of unincorporated Los Angeles County. Centennial is included in the AVAP as part of the west Economic Opportunity Area, or EOA, where future development would be directed. This particular EOA is located along Highway 138 and encompasses the vast majority of Centennial's proposed boundaries. In June 2015, the Los Angeles County Board of Supervisors gave final approval for the AVAP.

The AVAP provides Centennial with land use designation and zoning for residential and commercial development.

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### Grapevine at Tejon Ranch:

Grapevine is a 15,315-acre development area located on the San Joaquin Valley floor area of our lands, adjacent to TRCC. The 2008 Conservation Agreement allows for the development of up to 12,400 acres in this area. We are currently focusing on 8,010 acres for a mixed use development to include housing, retail, and commercial industrial components. Grapevine has received approval for 12,000 homes, 5.1 million square feet for commercial development, and more than 3,367 acres of open space and parks. On December 6, 2016, the Kern County Board of Supervisors unanimously approved the specific plan and the Environmental Impact Report, or EIR, for the development of the Grapevine community, which included approval for land use designation, zoning and a development agreement. On December 11, 2018 the court ruled that portions of the EIR required corrections and ordered that the County rescind the Grapevine project approvals until such supplemental environmental analysis was completed. The Company will file new applications to re-entitle the Grapevine project (“re-entitlement”) in 2019. See Note 14, (Commitments and Contingencies) for further discussion.

The greatest competition for the Centennial and Grapevine communities will come from California developments in the Santa Clarita Valley, Lancaster, Palmdale, and Bakersfield. The developments in these areas will be providing similar housing product as our developments. The principal factors of competition in this industry are pricing of product, amenities offered, and location. We will attempt to differentiate our developments through our unique setting, land planning and different product offerings. MV will compete generally for discretionary dollars that consumers will allocate to recreational and residential homes.

The following is a summary of the Company's residential real estate developments as of December 31, 2018:

|  |                  |                |                    |             |
|--|------------------|----------------|--------------------|-------------|
| Community:                                   | Mountain Village | Grapevine      | Centennial         | Resort      |
| Location:                                    | Kern County      | Kern County    | Los Angeles County | Residential |
| Project Status <sup>1</sup> :                | Entitled         | Re-Entitlement | Pending Approval   | Total       |
| Entitlement Area (acres):                    | 26,417           | 8,010          | 12,323             | 46,750      |
| Housing Units:                               | 3,450            | 12,000         | 19,333             | 34,783      |
| Commercial Development (sqft) <sup>2</sup> : | 160,000          | 5,100,000      | 10,100,000         | 15,360,000  |
| Open Areas (acres):                          | 21,335           | 3,367          | 5,624              | 30,326      |
| Costs to Date <sup>3</sup> :                 | \$137,571        | \$31,175       | \$100,311          | \$269,057   |

(1) Estimated completion anticipated to be 25 years, or longer, from commencement of construction. To-date construction has not begun.

(2) MV also has approval for up to 750 lodging units and 350,000 square feet of facilities in support of two 18-hole golf courses.

(3) Total estimated project costs are difficult to accurately forecast with any certainty at this time due to finalization of entitlement and mapping processes, as well as final engineering for the developments, and capital funding structure selected. Dollars presented in thousands.

### Mineral Resources

Mineral resources consist of oil and gas royalties, rock and aggregate royalties, royalties from a cement operation leased to National Cement Company of California, Inc., or National, and the management of water assets and water infrastructure. We continue to look for opportunities to grow our mineral resource revenues through expansion of leasing and encouraging new exploration. Within our water assets, we are expanding our resources through new well drilling programs, while at the same time looking for opportunities to continue to purchase water as we have in the past. We look to sell excess water over our internal needs on a temporary basis until that water is needed by us in our real estate and agricultural operations.

We do not expect increased oil production in 2019 if prices remain at current levels. Water sales opportunities for 2019 will depend on rain and snowfall volume along with California State Water Project, or SWP, allocations. As of February 20, 2019, the 2019 SWP allocation is at 35% of entitled amounts.

We lease certain portions of our land to oil companies for the exploration and production of oil and gas. We however do not engage in any oil exploration or extraction activities. As of December 31, 2018, 10,332 acres were committed to producing oil and gas leases from which the operators produced and sold approximately 250,000 barrels of oil and 241,000 MCF (each MCF being 1,000 cubic feet) of dry gas during 2018. Our share of production, based upon average royalty rates during the last three years, has been 92, 99, and 114, barrels of oil per day for 2018, 2017, and

2016, respectively. There are 309 active oil wells located on the leased land as of December 31, 2018. Royalty rates on our leases averaged approximately 13% of oil production in 2018.



Estimates of oil and gas reserves on our properties are unknown to us. We do not make such estimates, and our lessees do not make information concerning reserves available to us.

We have approximately 2,000 acres under lease to National, for the purpose of manufacturing Portland cement from limestone deposits found on the leased acreage. National owns and operates a cement manufacturing plant on our property with a capacity of approximately 1,000,000 tons of cement per year. The amount of payment that we receive under the lease is based upon shipments from the cement plant, which increased during 2018 compared to 2017. The improvement in shipments is due to an increase in road construction activity as compared to the prior years. The term of this lease expires in 2026, but National has options to extend the term for successive periods of 20 and 19 years. Proceedings under environmental laws relating to the cement plant are in process. The Company is indemnified by the current and former tenants, and at this time, we have no cost related to the issues at the cement plant. See Item 3, “Legal Proceedings,” for a further discussion.

We also lease 521 acres to Granite Construction and Griffith Construction for the mining of rock and aggregate product that is used in construction of roads and bridges. The royalty revenues we receive under these leases are based upon the amount of product produced at these sites.

Our royalty interests are contractually defined and based on a percentage of production and are received in cash. Our royalty revenues fluctuate based on changes in the market prices for oil, natural gas, and rock and aggregate product, the inevitable decline in production of existing wells and quarries, and other factors affecting the third-party oil and natural gas exploration and production companies that operate on our lands including the cost of development and production.

In August 2015, we entered into a water sale agreement with PEF, our current lessee under a power plant lease. Beginning in 2016, PEF may purchase from us up to 2,000 acre-feet of water and from January 2017 through July 2030, PEF may purchase from us up to 3,500 acre feet of water per year, with an option to extend the term. PEF is under no obligation to purchase water from us in any year, but is required to pay us an annual option payment equal to 30% of the maximum annual payment. The price of the water under the agreement is \$1,120 per acre-foot of annual water in 2019, subject to 3% annual increases for the duration of the lease agreement. The Company's commitments to sell this water can be met through current water sources.

#### Farming Operations

In the San Joaquin Valley, we farm permanent crops including the following acreage: wine grapes—1,197; almonds—1,966 (1,214 in production and 752 not in production); and pistachios—1,062. We manage the farming of alfalfa and forage mix on 775 acres in the Antelope Valley, and we periodically lease 1,000 acres of land that is used for the growing of vegetables but also can be used for the development of permanent crops such as almonds.

We sell our farm commodities to several commercial buyers. As a producer of these commodities, we are in direct competition with other producers within the United States, or U.S., and throughout the world. Prices we receive for our commodities are determined by total industry production and demand levels. We attempt to improve price margins by producing high quality crops through proven cultural practices and by obtaining better prices through marketing arrangements with handlers.

Sales of our grape crop typically occur in the third and fourth quarters of the calendar year, while sales of our pistachio and almond crops also typically occur in the third and fourth quarter of the calendar year, but can occur up to a year or more after each crop is harvested.

In 2018, we sold 62% of our grape crop to one winery, 23% to a second winery and the remainder to two other customers. These sales are under long-term contracts ranging from one to 12 years. In 2018, our almonds were sold to various commercial buyers, with the largest buyer accounting for 54% of our almond revenues. We sold pistachios to three customers with the largest accounting for 73% of our pistachio revenues. We do not believe that we would be adversely affected by the loss of any or all of these large buyers because of the markets for these commodities, the large number of buyers that would be available to us, and the fact that the prices for these commodities do not vary based on the identity of the buyer or the size of the contract.

Our almond, pistachio, and wine grape crop sales are highly seasonal with a majority of our sales occurring during the third and fourth quarters. Nut and grape crop markets are particularly sensitive to the size of each year's world crop and the demand for those crops. Large crops in California and abroad can rapidly depress prices. Crop prices, especially almonds, are also adversely affected by a strong U.S. dollar which makes U.S. exports more expensive and

decreases demand for the products we produce. The low value of the U.S. dollar in prior years has helped to maintain strong almond prices in overseas markets, but we are now seeing this change as the U.S. dollar has strengthened against the Euro and Chinese Yuan in 2018 and the beginning of 2019. The full potential impact of an increasing U.S. dollar to our pricing and revenue is not known at this time. Additionally, increased tariffs from China and India which are major customers of almonds and pistachios, can make American products less competitive and push customers to switch to another producing country. In 2018, prices for almonds and pistachios have seen some decline due to the uncertainty surrounding trade tariffs.

Weather conditions could impact the number of tree and vine dormant hours, which are integral to tree and vine growth. We will not know the impact of current weather conditions on 2019 production until the early summer of 2019. Thus far, we have experienced heavier rain fall and colder temperatures during the 2018-2019 winter when compared to the 2017-2018 winter, which could positively impact 2019 production.

At this time the State Department of Water Resources has announced that the estimated water supply for 2019 will be at 35% of full entitlement. This allocation is expected to change based upon winter storms. The current 35% allocation of SWP water alone is not enough for us to farm our crops, but our additional water resources, such as groundwater and surface sources, and those of the water districts we are in, should allow us to have sufficient water for our farming needs. It is too early in the year to determine the impact of the 2019 water supplies and its impact on 2019 California crop production for almonds, pistachios, and wine grapes. See discussion of water contract entitlement and long-term outlook for water supply under Item 2, "Properties." Also see Note 6. (Long-Term Water Assets) of the Notes to Consolidated Financial Statements for additional information regarding our water assets.

#### Ranch Operations

Ranch operations consist of game management revenues and ancillary land uses such as grazing leases and filming. Within game management, we operate our High Desert Hunt Club, a premier upland bird hunting club. The High Desert Hunt Club offers over 6,400 acres and 35 hunting fields, each field providing different terrain and challenges. The hunting season runs from mid-October through March. We sell individual hunting packages as well as memberships.

Approximately 256,000 acres are used for two grazing leases, which account for 41% of total revenues from ranch operations at December 31, 2018.

Ranch operations also includes Hunt at Tejon, which offers a wide variety of guided big game hunts, including trophy Rocky Mountain elk, deer, turkey and wild pig. We offer guided hunts and memberships for both the Spring and Fall hunting seasons. At December 31, 2018, game management accounts for 37% of the total revenue from ranch operations.

In addition, the ranch operations segment is in charge of upkeep, maintenance, and security of all 270,000 acres of land.

#### General Environmental Regulation

Our operations are subject to federal, state, and local environmental laws and regulations including laws relating to water, air, solid waste, and hazardous substances. Although we believe that we are in material compliance with these requirements, there can be no assurance that we will not incur costs, penalties, and liabilities, including those relating to claims for damages to property or natural resources, resulting from our operations. Environmental liabilities may also arise from claims asserted by adjacent landowners or other third parties. We also expect continued legislation and regulatory development in the area of climate change and greenhouse gases. It is unclear as of this date how any such developments will affect our business. Enactment of new environmental laws or regulations, or changes in existing laws or regulations or the interpretation of these laws or regulations, might require expenditures in the future. We historically have not had material environmental liabilities.

#### Customers

During 2018, our PEF power plant lease accounted for 9% of total revenues. In 2017 and 2016, the PEF power plant lease generated 11% and 8% of our total revenues, respectively. No other customer represents 5% or more of our revenues in 2018 and 2017.

#### Organization

Tejon Ranch Co. is a Delaware corporation incorporated in 1987 to succeed the business operated as a California corporation since 1936.

#### Employees

At December 31, 2018, we had 122 full-time employees. We believe that we have good relations with our employees. We have adopted a Compliance with State and Federal Statutes, Rules and Regulations Reporting Policy that applies to all of our employees. Its receipt and review by each employee is documented and verified quarterly. None of our employees are covered by a collective bargaining agreement.



## Reports

We make available free of charge through our Internet website, [www.tejonranch.com](http://www.tejonranch.com), our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed or to be furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with or furnish it to the SEC. We also make available on our website our corporate governance guidelines, charters of our key Board of Directors' Committees (audit, compensation, nominating and corporate governance, and real estate), and our Code of Business Conduct and Ethics for Directors, Officers, and Employees. These items are also available in printed copy upon request. We intend to disclose in the future any amendments to our Code of Business Conduct and Ethics for Directors, Officers, and Employees, or waivers of such provisions granted to executive officers and directors, on the web site within four business days following the date of such amendment or waiver. Any document we file with the Securities and Exchange Commission, or SEC, may be inspected, without charge, at the SEC's website: <http://www.sec.gov>.

## Executive Officers of the Registrant

The following table shows each of our executive officers and the offices held as of March 1, 2019, the period the offices have been held, and the age of the executive officer.

| Name                 | Office   | Held since | Age |
|----------------------|--|------------|-----|
| Gregory S. Bielli    | President and Chief Executive Officer, Director                              | 2013       | 58  |
| Allen E. Lyda        | Executive Vice President and Chief Operating Officer and Corporate Treasurer | 2019       | 61  |
| Hugh McMahon         | Executive Vice President, Real Estate  | 2014       | 52  |
| Joseph N. Rentfro    | Executive Vice President, Real Estate  | 2015       | 50  |
| Robert D. Velasquez  | Senior Vice President, Finance, and Chief Financial Officer                  | 2019       | 52  |
| Michael R.W. Houston | Senior Vice President, General Counsel                                       | 2016       | 44  |

A description of present and prior positions with us, and business experience for the past five years is given below.

Mr. Bielli has been employed by the Company since September 2013. Mr. Bielli joined the Company as President and Chief Operating Officer and became President and Chief Executive Officer on December 17, 2013. Prior to joining the Company Mr. Bielli was President of Newland Communities' Western Region, a diversified real estate company, and was responsible for overseeing management of all operational aspects of Newland's real estate projects in the region. Mr. Bielli worked with Newland Communities from 2006 through August 2013.

Mr. Lyda has been employed by us since 1990, initially serving as Vice President, Finance and Treasurer. He was elected Assistant Secretary in 1995 and Chief Financial Officer in 1999. Mr. Lyda was promoted to Senior Vice President in 2008, and Executive Vice President in 2012. Mr. Lyda's title was subsequently changed in 2013 to Executive Vice President and Chief Financial Officer to more accurately describe the responsibilities of his office. On January 1, 2019, he was appointed to the role of Chief Operating Officer and ceased serving as the Company's Chief Financial Officer.

Mr. McMahon joined the Company in November 2001 as Director of Financial Analysis. In 2008, Mr. McMahon became Vice President of Commercial/Industrial Development and in December of 2014, was promoted to Senior Vice President of Commercial/Industrial Development and elected as an officer of the Company. In 2015, he was promoted to Executive Vice President. Mr. McMahon's title was subsequently changed to Executive Vice President, Real Estate.

Mr. Rentfro joined the Company on February 27, 2015 and was elected Executive Vice President of Real Estate on March 9, 2015. Mr. Rentfro's prior experiences involved development efforts for a number of major projects within the Emirate of Abu Dhabi in the United Arab Emirates. Notable developments include the Westin Abu Dhabi Golf Resort & Spa, Monte Carlo Beach Club-Saadiyat, Eastern Mangroves Resort and Residences, St. Regis Saadiyat Island Residences, and the Al Yamm and Al Sahel Villas at the Desert Islands Resort & Spa by Anantara. Prior to his work in the Middle East, Mr. Rentfro held executive positions at The St. Joe Company (NYSE: JOE), ascending ultimately to Regional Vice President and General Manager. There he led all efforts related to planning, design, entitlement, development, construction, asset management, marketing and sales for real estate operations within a 330,000-acre region along the Gulf Coast of Northwest Florida.



Mr. Velasquez joined the Company as Vice President of Finance of TRC in 2014. Mr. Velasquez's title was subsequently changed, in 2015, to Vice President of Finance and Chief Accounting Officer to more accurately describe the responsibilities of his office. Prior to joining TRC, Mr. Velasquez served as an Executive Director at Ernst & Young in their audit and assurance practice section. Mr. Velasquez worked with Ernst & Young from 1999 through 2014. Mr. Velasquez holds a B.S. in Business Administration – Option: Accounting from California State University, Los Angeles. Mr. Velasquez is a Certified Public Accountant in the state of California. On January 1, 2018 he was promoted to Senior Vice President, Finance and Chief Accounting Officer. On January 1, 2019, he was appointed Chief Financial Officer.

Mr. Houston joined the Company in May 2016 as the Senior Vice President, General Counsel. He previously worked for the City of Anaheim, where he served as City Attorney from 2013 through 2016. His background involves extensive experience in corporate governance, municipal law, real estate, land use and environmental issues. Prior to working for the City of Anaheim, he served as a partner for a Newport Beach, CA-based law firm of Cummins & White from 2011 to 2013, and prior to that, was a partner at Rutan & Tucker, LLP, Costa Mesa, CA.

#### ITEM 1A. RISK FACTORS

The risks and uncertainties described below are not the only ones facing the Company. If any of the following risks occur, our business, financial condition, results of operations or future prospects could be materially adversely affected. Our strategy, focused on more aggressive development of our land, involves significant risk and could result in operating losses. The risks that we describe in our public filings are not the only risks that we face. Additional risks and uncertainties not presently known to us, or that we currently consider immaterial, also may materially adversely affect our business, financial condition, and results of operations.

#### STRATEGIC RISKS

Strategic risk relates to the Company's future business plans and strategies, including the risks associated with the macro- and micro- environment in which we operate, including the demand for our products and services, the success of investments in our real estate development, technology and public policy.

Adverse changes in economic conditions in markets where we conduct our operations and where prospective purchasers of our future homes and commercial products live could reduce the demand for our products and, as a result, could adversely affect our business, results of operations, and financial condition. Adverse changes in economic conditions in markets where we conduct our operations and where prospective purchasers of our real estate products live have had and may in the future have a negative impact on our business. Adverse changes in employment levels, job growth, consumer confidence, interest rates, and population growth, or an oversupply of product for sale or lease may reduce demand and depress prices and cause buyers to cancel their purchase agreements. This, in turn, could adversely affect our results of operations and financial condition.

Higher interest rates and lack of available financing can have significant impacts on the real estate industry. Higher interest rates generally impact the real estate industry by making it harder for buyers to qualify for financing, which can lead to a decrease in the demand for residential, commercial or industrial sites. Any decrease in demand will negatively impact our proposed developments. Lack of available credit to finance real estate purchases can also negatively impact demand. Any downturn in the economy or consumer confidence can also be expected to result in reduced housing demand and slower industrial development, which would negatively impact the demand for land we are developing.

We are subject to various land use regulations and require governmental approvals and permits for our developments that could be denied. In planning and developing our land, we are subject to various local, state, and federal statutes, ordinances, rules and regulations concerning zoning, infrastructure design, subdivision of land, and construction. All of our new developments require amending existing general plan and zoning designations, so it is possible that our entitlement applications could be denied. In addition, the zoning that ultimately is approved could include density provisions that would limit the number of homes and other structures that could be built within the boundaries of a particular area, which could adversely impact the financial returns from a given project. Many states, cities and counties (including neighboring Ventura County) have in the past approved various “slow growth” or “urban limit line” measures. If that were to occur in the jurisdictions governing the Company’s land use, our future real estate development activities could be significantly adversely affected.





Third-party litigation could increase the time and cost of our development efforts. The land use approval processes we must follow to ultimately develop our projects have become increasingly complex. Moreover, the statutes, regulations and ordinances governing the approval processes provide third parties the opportunity to challenge the proposed plans and approvals. As a result, the prospect of third-party challenges to planned real estate developments provides additional uncertainties in real estate development planning and entitlements. Third-party challenges in the form of litigation could result in denial of the right to develop, or would, by their nature, adversely affect the length of time and the cost required to obtain the necessary approvals. In addition, adverse decisions arising from any litigation would increase the costs and length of time to obtain ultimate approval of a project and could adversely affect the design, scope, plans and profitability of a project.

We are subject to environmental regulations and opposition from environmental groups that could cause delays and increase the costs of our development efforts or preclude such development entirely. Environmental laws that apply to a given site can vary greatly according to the site's location and condition, present and former uses of the site, and the presence or absence of sensitive elements like wetlands and endangered species. Federal and state environmental laws also govern the construction and operation of our projects and require compliance with various environmental regulations, including analysis of the environmental impact of our projects and evaluation of our reduction in the projects' carbon footprint and greenhouse gas emissions. Environmental laws and conditions may result in delays, cause us to incur additional costs for compliance, mitigation and processing land use applications, or preclude development in specific areas. In addition, in California, third parties have the ability to file litigation challenging the approval of a project which they usually do by alleging inadequate disclosure and mitigation of the environmental impacts of the project. Certain groups opposed to development have made clear they intend to oppose our projects vigorously, so litigation challenging their approval is expected. Currently, the Grapevine entitlement approval has been opposed and litigation has been filed against the Company and Kern County, which is the approving governmental entity. The issues most commonly cited in opponents' public comments include the poor air quality of the San Joaquin Valley air basin, potential impacts of projects on the California condor and other species of concern, the potential for our lands to function as wildlife movement corridors, potential impacts of our projects on traffic and air quality in Los Angeles County, emissions of greenhouse gases, water availability and criticism of proposed development in rural areas as being "sprawl." In addition, California has a specific statutory and regulatory scheme intended to reduce greenhouse gas emissions in the state and efforts to enact federal legislation to address climate change concerns could require further reductions in our projects' carbon footprint in the future.

Until governmental entitlements are received, we will have a limited inventory of real estate. Each of our four current and planned real estate projects, TRCC, Centennial, MV, and Grapevine involve obtaining various governmental permits and/or entitlements. A delay in obtaining governmental approvals could lead to additional costs related to these developments and potentially lost opportunities for the sale of lots to developers and land users.

We are in competition with several other developments for customers and residents. Within our real estate activities, we are in direct competition for customers with other industrial sites in Northern, Central, and Southern California. We are also in competition with other highway interchange locations using Interstate 5 and State Route 99 for commercial leasing opportunities. Once they receive all necessary permits, approvals and entitlements, Centennial and Grapevine will ultimately compete with other residential housing options in the region, such as developments in the Santa Clarita Valley, Lancaster, Palmdale, and Bakersfield. MV will compete generally for discretionary dollars that consumers will allocate to recreation and second homes, so its competition will include a greater area and range of projects. Intense competition may decrease our sales and harm our results of operations.

Increases in taxes or government fees could increase our cost, and adverse changes in tax laws could reduce demand for homes in our future residential communities. Increases in real estate taxes and other local government fees, such as fees imposed on developers to fund schools, open space, and road improvements, could increase our costs and have an adverse effect on our operations. In addition, any changes to income tax laws that would reduce or eliminate tax deductions or incentives to homeowners, such as a change limiting the deductibility of real estate taxes or interest on home mortgages, could make housing less affordable or otherwise reduce the demand for housing, which in turn could reduce future sales.

Our developable land is concentrated entirely in California. All of our developable land is in California and our business is especially sensitive to the economic conditions within California. Any adverse change in the economic

climate of California, or our regions of that state, and any adverse change in the political or regulatory climate of California, or the counties where our land is located could adversely affect our real estate development activities. Ultimately, our ability to sell or lease lots may decline as a result of weak economic conditions or restrictive regulations.

We may encounter other risks that could impact our ability to develop our land. We may also encounter other difficulties in developing our land, including:

- Difficulty in securing adequate water resources for future developments;
- Natural risks, such as geological and soil problems, earthquakes, fire, heavy rains and flooding, and heavy winds;
- Shortages of qualified trades people;
- Reliance on local contractors, who may be inadequately capitalized;
- Shortages of materials; and
- Increases in the cost of materials.

A prolonged downturn in the real estate market or instability in the mortgage and commercial real estate financing industry, could have an adverse effect on our real estate business. Our residential housing projects, Centennial, MV, and Grapevine, are currently in the entitlement phase, permitting phase, or are fully entitled and waiting for development to begin. If a downturn in the real estate market or an instability in the mortgage and commercial real estate financing industry exists at the time these projects move into their development and marketing phases, our resort/residential business could be adversely affected. An excess supply of homes available due to foreclosures or the expectation of deflation in housing prices could also have a negative impact on our ability to sell our inventory when it becomes available. The inability of potential commercial/industrial clients to get adequate financing for the expansion of their businesses could lead to reduced lease revenues and sales of land within our industrial development.

#### OPERATIONAL RISKS

Operational risk relates to risks arising from external market factors that affect the operation of our businesses. It includes weather and other natural conditions; regulatory requirements; information management and data protection and security, including cybersecurity; supply chain and business disruption; and other risks, including human resources and reputation.

We are involved in a cyclical industry and are affected by changes in general and local economic conditions. The real estate development industry is cyclical and is significantly affected by changes in general and local economic conditions, including:

- Employment levels
- Availability of financing
- Interest rates
- Consumer confidence
- Demand for the developed product, whether residential or industrial
- Supply of similar product, whether residential or industrial

The process of development of a project begins and financial and other resources are committed long before a real estate project comes to market, which could occur at a time when the real estate market is depressed. It is also possible in a rural area like ours that no market for the project will develop as projected.

The inability of a client tenant to pay us rent could adversely affect our business. Our commercial revenues are derived primarily from rental payments and reimbursement of operating expenses under our leases. If our client tenants fail to make rental payments under their leases, our financial condition and cash flows could be adversely affected.

Our inability to renew leases or re-lease space on favorable terms as leases expire may significantly affect our business. Some of our revenues are derived from rental payments and reimbursement of operating expenses under our leases. If a client tenant experiences a downturn in its business or other types of financial distress, it may be unable to make timely payments under its lease. Also, if our client tenants terminate early or decide not to renew their leases, we may not be able to re-lease the space. Even if client tenants decide to renew or lease space, the terms of renewals or new leases, including the cost of any tenant improvements, concessions, and lease commissions, may be less favorable to us than current lease terms. Consequently, we could generate less cash flow from the affected properties than expected, which could negatively impact our business. We may have to divert cash flow generated by other properties to meet our debt service payments, if any, or to pay other expenses related to owning the affected properties.



We may experience increased operating costs, which may reduce profitability to the extent that we are unable to pass those costs on to client tenants. Our properties are subject to increases in operating expenses including insurance, property taxes, utilities, administrative costs, and other costs associated with security, landscaping, and repairs and maintenance of our properties. Our leases allow us to pass along real estate taxes, insurance, utilities, common area, and other operating expenses (including increases thereto) in addition to base rent. However, we cannot be certain that our client tenants will be able to bear the full burden of these higher costs, or that such increased costs will not lead them, or other prospective client tenants, to seek space elsewhere. If operating expenses increase, the availability of other comparable space in the markets we operate in may hinder or limit our ability to increase our rents, if operating expenses increase without a corresponding increase in revenues, our profitability could diminish.

If we experience shortages or increased costs of labor and supplies or other circumstances beyond our control, there could be delays or increased costs within our industrial development, which could adversely affect our operating results. Our ability to develop our current industrial development may be adversely affected by circumstances beyond our control including: work stoppages, labor disputes and shortages of qualified trades people; changes in laws relating to union organizing activity; and shortages, delays in availability, or fluctuations in prices of building materials. Any of these circumstances could give rise to delays in the start or completion of, or could increase the cost of, developing infrastructure and buildings within our industrial development. If any of the above happens, our operating results could be harmed.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects. Our future success depends, to a significant degree, on the efforts of our senior management. The loss of key personnel could materially and adversely affect our results of operations, financial condition, or our ability to pursue land development. Our success will also depend in part on our ability to attract and retain additional qualified management personnel.

Decreases in the market value of our investments in marketable securities could have an adverse impact on our results of operations. We have a significant amount of funds invested in marketable securities, the market value of which is subject to changes from period to period. Decreases in the market value of our marketable securities could have an adverse impact on our results of operations.

Volatile oil and natural gas prices could adversely affect our cash flows and results of operations. Our cash flows and results of operations are dependent in part on oil and natural gas prices, which are volatile. Oil and natural gas prices also impact the amount we receive for our mineral leases. Moreover, oil and natural gas prices depend on factors we cannot control, such as: changes in foreign and domestic supply and demand for oil and natural gas; actions by the Organization of Petroleum Exporting Countries; weather; political conditions in other oil-producing countries, including the possibilities of insurgency or war in such areas; prices of foreign exports; domestic and international drilling activity; price and availability of alternate fuel sources; the value of the U.S. dollar relative to other major currencies; the level and effect of trading in commodity markets; and the effect of worldwide energy conservation measures and governmental regulations. Any substantial or extended decline in the price of oil and gas could have a negative impact on our business, liquidity, financial condition and results of operations. Substantial or extended declines in future natural gas or crude oil prices would have a material adverse effect on our future business, financial condition, results of operations, cash flows, liquidity or ability to finance planned capital expenditures and commitments. Furthermore, substantial, extended decreases in natural gas and crude oil prices may cause us to delay development projects and could negatively impact our ability to borrow, our cost of capital and our ability to access capital markets, increase our costs under our revolving credit facility, and limit our ability to execute aspects of our business plans.

Our reserves and production will decline from their current levels. The rate of production from oil and natural gas properties generally decline as reserves are produced. Any decline in production or reserves could materially and adversely affect our future cash flow, liquidity and results of operations.

Water delivery and water availability continues to be a long-term concern within California. Any limitation of delivery of SWP water, limitations on our ability to move our water resources, and the absence of available reliable alternatives during drought periods could potentially cause permanent damage to orchards and vineyards and possibly impact future development opportunities.



Our future revenue and profitability related to our water resources will primarily be dependent on our ability to acquire and sell water assets. In light of the fact that our water resources represent a portion of our overall business at present, our long-term profitability will be affected by various factors, including the availability and timing of water resource acquisitions, regulatory approvals and permits associated with such acquisitions, transportation arrangements, and changing technology. We may also encounter unforeseen technical or other difficulties which could result in cost increases with respect to our water resources. Moreover, our profitability is significantly affected by changes in the market price of water. Future sales and prices of water may fluctuate widely as demand is affected by climatic, economic, demographic and technological factors as well as the relative strength of the residential, commercial, financial, and industrial real estate markets. The factors described above are not within our control. Terrorist attacks may have an adverse impact on our business and operating results and could decrease the value of our assets. Terrorist attacks, particularly those that may cause a decline in global economic activity could have a material adverse impact on our business, our operating results, and the market price of our common stock. Future terrorist attacks may result in declining economic activity, which could reduce the demand for and the value of our properties. To the extent that future terrorist attacks impact our client tenants, their businesses similarly could be adversely affected, including their ability to continue to honor their lease obligations.

Failure to maintain effective internal control over financial reporting could have a material adverse effect on our business, results of operations, financial condition, and stock price. Pursuant to the Sarbanes-Oxley Act of 2002, we are required to provide a report by management on internal control over financial reporting, including management's assessment of the effectiveness of internal control. Changes to our business will necessitate ongoing changes to our internal control systems and processes. Internal control over financial reporting may not prevent or detect misstatement because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business, results of operations, and financial condition could be materially harmed, and we could fail to meet our reporting obligations and there could be a material adverse effect on our stock price.

Information technology failures and data security breaches could harm our business. We use information technology and other computer resources to carry out important operational and marketing activities and to maintain our business records. These information technology systems are dependent upon global communications providers, web browsers, telephone systems and other aspects of the Internet infrastructure that have experienced security breaches, cyber-attacks, significant systems failures and electrical outages in the past. A material network breach in the security of our information technology systems could include the theft of customer, employee or company data. The release of confidential information as a result of a security breach may also lead to litigation or other proceedings against us by affected individuals or business partners, or by regulators, and the outcome of such proceedings, which could include penalties or fines, could have a significant negative impact on our business. We may also be required to incur significant costs to protect against damages caused by these information technology failures or security breaches in the future. However, we cannot provide assurance that a security breach, cyber-attack, data theft or other significant systems failure will not occur in the future, and such occurrences could have a material and adverse effect on our consolidated results of operations or financial position.

Increased cybersecurity requirements, vulnerabilities, threats and more sophisticated and targeted computer crime could pose a risk to our systems, networks, products, solutions, services and data. Increased global cybersecurity vulnerabilities, threats and more sophisticated and targeted cyber-related attacks pose a risk to the security of Tejon's and its customers', partners', suppliers' and third-party service providers' products, systems and networks and the confidentiality, availability and integrity of Tejon's and its customers' data. We remain potentially vulnerable to additional known or unknown threats despite our attempts to mitigate these risks. We also may have access to sensitive, confidential or personal data or information that is subject to privacy and security laws, regulations or customer-imposed controls. Our efforts to protect sensitive, confidential or personal data or information, may nonetheless leave us vulnerable to material security breaches, theft, misplaced or lost data, programming errors, employee errors and/or malfeasance that could potentially lead to the compromising of sensitive, confidential or

personal data or information, improper use of our systems, software solutions or networks, unauthorized access, use, disclosure, modification or destruction of information, production downtimes and operational disruptions. In addition, a cyber-related attack could result in other negative consequences, including damage to our reputation or competitiveness, remediation or increased protection costs, litigation or regulatory action.



Inflation can have a significant adverse effect on our operations. Inflation can have a major impact on our farming operations. The farming operations are most affected by escalating costs, unpredictable revenues and very high irrigation water costs. High fixed water costs related to our farm lands will continue to adversely affect earnings. Prices received for many of our products are dependent upon prevailing market conditions and commodity prices. Therefore, it is difficult for us to accurately predict revenue, just as we cannot pass on cost increases caused by general inflation, except to the extent reflected in market conditions and commodity prices.

Inflation can adversely impact our real estate operations, by increasing costs of material and labor as well as the cost of capital, which can impact operating margins. In an inflationary environment, we may not be able to increase prices at the same pace as the increase in inflation, which would further erode operating margins.

Government policies and regulations, particularly those affecting the agricultural sector and related industries, could adversely affect our operations and profitability. Agricultural commodity production and trade flows are significantly affected by government policies and regulations. Governmental policies affecting the agricultural industry, such as taxes, trade tariffs, duties, subsidies, import and export restrictions on commodities and commodity products, can influence industry profitability, the planting of certain crops, the location and size of crop production, whether unprocessed or processed commodity products are traded, and the volume and types of imports and exports. In addition, international trade disputes can adversely affect trade flows by limiting or disrupting trade between countries or regions. Future governmental policies, regulations or actions affecting our industry may adversely affect the supply of, demand for and prices of our products, restrict our ability to do business and cause our financial results to suffer.

#### FINANCIAL RISKS

Financial risk relates to our ability to meet financial obligations and mitigate exposure to broad market risks, including volatility in interest rates and commodity prices; credit risk; and liquidity risk, including risk related to our credit ratings and our availability and cost of funding. Credit risk is the risk of financial loss arising from a customer or counterparty failure to meet its contractual obligations. We face credit risk in our industrial businesses, as well as in our investing and leasing activities and derivative financial instruments activities. Liquidity risk refers to the potential inability to meet contractual or contingent financial obligations (whether on- or off-balance sheet) as they arise, and could potentially impact an institution's financial condition or overall safety and soundness.

Constriction of the credit markets or other adverse changes in capital market conditions could limit our ability to access capital and increase our cost of capital. During past economic downturns, we relied principally on positive operating cash flow, cash and investments, and equity offerings to meet current working capital needs, entitlement investment, and investment within our developments. Any slowdown in the economy could negatively impact our access to credit markets and may limit our sources of liquidity in the future and potentially increase our costs of capital.

We regularly assess our projected capital requirements to fund future growth in our business, repay our debt obligations, and support our other general corporate and operational needs, and we regularly evaluate our opportunities to raise additional capital. As market conditions permit, we may issue new equity securities through the public capital markets, enter new joint ventures, or obtain additional bank financing to fund our projected capital requirements or provide additional liquidity. Adverse changes in economic, or capital market conditions could negatively affect our business, liquidity and financial results.

Our business model is very dependent on transactions with strategic partners. We may not be able to successfully (1) attract desirable strategic partners; (2) complete agreements with strategic partners; and/or (3) manage relationships with strategic partners going forward, any of which could adversely affect our business. A key to our development and value creation strategies has been the use of joint ventures and strategic relationships. These joint venture partners bring development experience, industry expertise, financial resources, financing capabilities, brand recognition and credibility or other competitive assets.

A complicating factor in any joint venture is that strategic partners may have economic or business interests or goals that are inconsistent with ours or that are influenced by factors related to our business. These competing interests lead to the difficult challenges of successfully managing the relationship and communication between strategic partners and monitoring the execution of the partnership plan. We may also be subject to adverse business consequences if the market reputation or financial position of the strategic partner deteriorates. If we cannot successfully execute transactions with strategic partners, our business could be adversely affected.



Inability to comply with long-term debt covenants, restrictions or limitations could adversely affect our financial condition. Our ability to meet our debt service and other obligations and the financial covenants under our credit facility will depend, in part, upon our future financial performance. Our future results are subject to the risks and uncertainties described in this report. Our revenues and earnings vary with the level of general economic activity in the markets we serve and the level of commodity prices related to our farming and mineral resource activities. The factors that affect our ability to generate cash can also affect our ability to raise additional funds for these purposes through the addition of debt, the sale of equity, refinancing existing debt, or the sale of assets.

Our credit facility contains financial covenants requiring the maintenance of a maximum total liabilities to tangible net worth not greater than .75 to 1 at each quarter end, a debt service coverage ratio not less than 1.25 to 1.00, and a minimum level of liquidity of \$20,000,000, including any unused portion of our revolving credit facility. A failure to comply with these requirements could allow the lending bank to terminate the availability of funds under our revolving credit facility and/or cause any outstanding borrowings to become due and payable prior to maturity.

Uncertainty relating to the LIBOR calculation process and potential phasing out of LIBOR in the future may adversely affect the value of any outstanding debt instruments. National and international regulators and law enforcement agencies have conducted investigations into a number of rates or indices known as “reference rates.” Actions by such regulators and law enforcement agencies may result in changes to the manner in which certain reference rates are determined, their discontinuance, or the establishment of alternative reference rates. In particular, on July 27, 2017, the Chief Executive of the U.K. Financial Conduct Authority (the “FCA”), which regulates LIBOR, announced that the FCA will no longer persuade or compel banks to submit rates for the calculation of LIBOR after 2021. Such announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. As a result, it appears highly likely that LIBOR will be discontinued or modified by 2021.

At this time, it is not possible to predict the effect that these developments, any discontinuance, modification or other reforms to LIBOR or any other reference rate, or the establishment of alternative reference rates may have on LIBOR, other benchmarks, or LIBOR-based debt instruments. Uncertainty as to the nature of such potential discontinuance, modification, alternative reference rates or other reforms may materially adversely affect the trading market for securities linked to such benchmarks. Furthermore, the use of alternative reference rates or other reforms could cause the interest rate calculated for the LIBOR-based debt instruments to be materially different than expected. Lastly, we may need to renegotiate any credit agreements extending beyond 2021 that utilize LIBOR as a factor in determining the interest rate to replace LIBOR with the new standard that is established. There is currently no definitive information regarding the future utilization of LIBOR or of any particular replacement rate. As such, potential effect of any such event on our business, financial condition and results of operations cannot yet be determined.

#### MARKET RISKS

Market risk relates to the functioning of the marketplace. Many factors affect market function; investor anticipation, shocks in other markets, and anything that limits the efficient functioning of the marketplace. Market risks can affect the price of our Common Stock.

Only a limited market exists for our Common Stock, which could lead to price volatility. The limited trading market for our Common Stock may cause fluctuations in the market value of our Common Stock to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market of our Common Stock.

Concentrated ownership of our Common Stock creates a risk of sudden change in our share price. As of March 1, 2019, directors and members of our executive management team beneficially owned or controlled approximately 19.8% of our Common Stock. Investors who purchase our Common Stock may be subject to certain risks due to the concentrated ownership of our Common Stock. The sale by any of our large shareholders of a significant portion of that shareholder’s holdings could have a material adverse effect on the market price of our Common Stock. In addition, the registration and sale of any significant number of additional shares of our Common Stock will have the immediate effect of increasing the public float of our Common Stock and any such increase may cause the market price of our Common Stock to decline or fluctuate significantly.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.



## ITEM 2. PROPERTIES

### Land

Our approximately 270,000 acres include portions of the San Joaquin Valley, portions of the Tehachapi Mountains and portions of the western end of the Antelope Valley. Each of our five reporting segments use various portions of this land. A number of key transportation and utility facilities cross our land, including Interstate 5, California Highways 58, 138 and 223, the California Aqueduct (which brings water from Northern California), and various transmission lines for electricity, oil, natural gas and communication systems. Our corporate offices are located on our property.

Approximately 247,000 acres of our land are located in Kern County, California. The Kern County general plan, or the “General Plan,” for this land contemplates continued commercial, resource utilization, farming, grazing and other agricultural uses, as well as certain new developments and uses, including residential and recreational facilities. While the General Plan is intended to provide guidelines for land use and development, it is subject to amendment to accommodate changing circumstances and needs. We have three major master planned real estate projects in Kern County: MV, TRCC and Grapevine.

The remainder of our land, approximately 23,000 acres, is in Los Angeles County. This area is accessible from Interstate 5 via Highway 138. Los Angeles County has adopted general plan policies that contemplate future residential development of portions of this land, subject to further assessments of environmental and infrastructure constraints. In December 2018, the Los Angeles County Board of Supervisors took action to approve the specific plan and development agreement for Centennial on 12,323 acres of this land by a vote of 4-1. Upon final approval and finding of facts, the 19,333 residential units will be fully entitled. This is expected to occur during the first half of 2019. See Item 1, “Business—Real Estate Development Overview.”

Portions of our land consist of mountainous terrain, much of which is not presently served by paved roads or by utility or water lines. Much of this property is included within the Conservation Agreement we entered into with five of the major environmental organizations in June 2008. As we receive entitlement approvals over the life span of our developments we will dedicate conservation easements on 145,000 acres of this land, which will preclude future development of the land. This acreage includes many of the most environmentally sensitive areas of our property and is home to many plant and wildlife species whose environments will remain undisturbed.

Any significant development on our currently undeveloped land would involve the construction of roads, utilities and other expensive infrastructure and would have to be done in a manner that accommodates a number of environmental concerns, including endangered species, wetlands issues, and greenhouse gas emissions. Accommodating these environmental concerns, could possibly limit development of portions of the land or result in substantial delays or certain changes to the scope of development in order to obtain governmental approval.

### Water Operations

Our existing long-term water contracts with the Wheeler Ridge-Maricopa Water Storage District, or WRMWSD, provide for water entitlements and deliveries from the SWP, to our agricultural and municipal/industrial operations in the San Joaquin Valley. The terms of these contracts extend to 2035. Under the contracts, we are entitled to annual water for 5,496 acres of land, or 15,547 acre-feet of water subject to SWP allocations, which is adequate for our present farming operations. It is assumed, that at the end of the current contract period all water contracts will be extended for approximately the same amount of annual water.

In addition to the WRMWSD contract water entitlements, we have an additional water entitlement from the SWP sufficient to service a substantial amount of future residential and/or commercial development in Kern County. TCWD, a local water district serving our land in the district and land we have sold in TRCC, has 5,749 acre-feet of SWP entitlement (also called Table A amount), subject to SWP allocations. In addition, TCWD has 52,547 acre-feet of water stored in Kern County water banks. Both the entitlement and the banked water are the subject of a long-term water supply contract extending to 2035 between TCWD and the Company. TCWD is the water supplier to TRCC, and will be the principal water supplier for any significant mixed use development in MV. TCWD will also be the water district that provides services to Grapevine.

We have a 150-acre water bank consisting of nine ponds on our land in southern Kern County. Water is pumped into these ponds and then percolates into underground aquifers. Since 2006, we have banked 35,793 acre-feet of water from the Antelope Valley-East Kern Water Agency, or AVEK, which has been pumped from the California aqueduct

and is currently retained in this water bank. We anticipate adding additional water to the water bank in the future, as water is available. In 2010 we began participating with AVEK in a water-banking program and we have 13,033 acre-feet of water to our credit in this program.

Over time we have also purchased water for our future use or sale. In 2008 we purchased 8,393 acre-feet of transferable water and in 2009 we purchased an additional 6,393 acre-feet of transferable water, all of which has been placed in our water bank.

We also have secured SWP entitlement under long-term SWP water contracts within the Tulare Lake Basin Water Storage District and the Dudley-Ridge Water District, totaling 3,444 acre-feet of SWP entitlement annually, subject to SWP allocations. These contracts extend through 2035. On November 6, 2013, the Company completed the acquisition of a water purchase agreement that will allow and require the Company to purchase 6,693 acre-feet of water each year from the Nickel Family, LLC, or Nickel, through the Kern County Water Agency.

The initial term of the water purchase agreement with Nickel runs through 2044 and includes a Company option to extend the contract for an additional 35 years. This contract allows us to purchase water each year. The purchase cost of water in 2018 was \$738 per acre-foot. Purchase costs are subject to annual cost increases based on the greater of the consumer price index and 3%, resulting in a 2019 purchase cost of \$769 per acre-foot.

The water purchased will ultimately be used in the development of the Company's land for commercial/industrial development, residential development, and farming. Interim uses may include the sale of portions of this water to third party users on an annual basis until the water is fully used for the Company's internal uses.

During 2018, SWP allocations were 30% of contract levels, and WRMWSD was able to supply us with water from various sources that when combined with our water sources provided sufficient water to meet our farming and real estate demands. In some years, there is also sufficient runoff from local mountain streams to allow us to capture some of this water in reservoirs and utilize it to offset some of the SWP water. In years where the supply of water is sufficient, both WRMWSD and TCWD are able to bank (percolate into underground aquifers) some of their excess supplies for future use. At this time, Wheeler Ridge expects to be able to deliver our entire contract water entitlement in any year that the SWP allocations exceed 30% by drawing on its ground water wells and water banking assets. Based on historical records of water availability, we do not believe we have material problems with our water supply. However, if SWP allocations are less than 30% of our entitlement in any year, or if shortages continue for a sustained period of several years, then WRMWSD may not be able to deliver 100% of our entitlement and we will have to rely on our own ground water sources, mountain stream runoff, water transfer from other sources, and water banking assets to supply the needs of our farming and development activities. Water from these sources may be more expensive than SWP water because of pumping costs and/or transfer costs. A 35% preliminary SWP water allocation has been made by the California Department of Water Resources, or DWR, for 2019. The current 35% allocation of SWP water is not enough for us to farm our crops, but our additional water resources, such as groundwater and surface sources, and those of the water districts we are in, should allow us to have sufficient water for our farming needs for the next year. All SWP water contracts require annual payments related to the fixed and variable costs of the SWP and each water district, whether or not water is used or available. WRMWSD and TCWD contracts also establish a lien on benefited land.

Portions of our property also have available groundwater, which we believe would be sufficient to supply commercial development in the Interstate 5 corridor and support current agricultural operations. Ground water in the Antelope Valley Basin is the subject of litigation. See Item 3, "Legal Proceedings," for additional information about this litigation. Please refer to "Note 14 (Commitments and Contingencies)" for further discussion.

A new development with respect to groundwater is the Sustainable Groundwater Management Act, or SGMA, which became effective January 1, 2015. For the water districts in which the Company participates in the San Joaquin Valley, Groundwater Sustainability Plans are to be developed by 2020 and 2022. Through these plans it will have to be demonstrated to the satisfaction of the Department of Water Resources, that the basins are "sustainable" and in balance by 2040, which could ultimately lead to restrictions on the use of groundwater. The Company's lands are located in the White Wolf Basin, which is a basin that is currently not over-drafted, so there is no anticipation at this time of any restriction related to manageable uses of ground water. However, the Company's lands are in relatively good condition because of the diverse inventory of surface water supplies and banked water that the Company has access to as mentioned above.

There have been many environmental challenges regarding the movement of SWP water through the Sacramento Delta. Operation of the Delta pumps are of primary importance to the California water system because these pumps are part of the system that moves water from Northern California to Southern California. Biological Opinions, or BO, issued by the U.S. Fish and Wildlife Service and National Marine Fisheries Service in 2008 and 2009 contain restrictions on pumping from the Delta. These BOs are being challenged in the courts by both water agencies and environmental groups, which challenges were for the most part unsuccessful. There are many groups, governmental

and private, working together to develop a solution in the future to mitigate the curtailment of water from the Delta. Historic SWP restrictions on the right to use agricultural water entitlement for municipal purposes were removed in 1995. For this purpose, "municipal" use includes residential and industrial use. Therefore, although only 2,000 of TCWD's 5,749 acre-feet of entitlement are labeled for municipal use, there is no practical restriction on TCWD's ability to deliver the remaining water to residential or commercial/industrial developments.



#### Other Activities

TRPFFA is a joint powers authority formed by Kern County and TCWD to finance public infrastructure within the Company's Kern County developments. TRPFFA has created two Community Facilities Districts, or CFDs, the West CFD and the East CFD. The West CFD has placed liens on 420 acres of the Company's land to secure payment of special taxes related to \$28,620,000 of bond debt sold by TRPFFA for TRCC-West. The East CFD has placed liens on 1,931 acres of the Company's land to secure payments of special taxes related to \$55,000,000 of bond debt sold by TRPFFA for TRCC-East. At TRCC-West, the West CFD has no additional bond debt approved for issuance. At TRCC-East, the East CFD has \$65,000,000 of additional bond debt authorized by TRPFFA. Proceeds from the sales of these bonds are to reimburse the Company for public infrastructure related to TRCC-East. As of December 31, 2018, \$4,180,000 is available under the currently issued East CFD bonds for reimbursement on qualifying infrastructure improvements.

We paid \$2,570,000 and \$2,578,000 in special taxes related to the CFDs in 2018 and 2017, respectively. As development continues to occur at TRCC, new owners of land and new lease tenants, through triple net leases, will bear an increasing portion of the assessed special tax. It is expected that we will have special tax payments in 2019 of \$2,570,000, but this could change in the future based on the amount of bonds outstanding within each CFD and the amount of taxes paid by other owners and tenants. The assessment of each individual property sold or leased is not determinable at this time because it is based on the current tax rate and the assessed value of the property at the time of sale or on its assessed value at the time it is leased to a third-party. Accordingly, the Company is not required to recognize an obligation at December 31, 2018.

#### ITEM 3. LEGAL PROCEEDINGS

The Company is involved in various legal matters arising out of its operations in the normal course of business. None of these matters are expected, individually or in the aggregate, to have a material adverse effect on the Company. For a discussion of legal proceedings, see Note 14 (Commitments and Contingencies) of the Notes to the Consolidated Financial Statements.

#### ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

## PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND  
5. ISSUER PURCHASES OF EQUITY SECURITIES

The following table shows the high and low sale prices for our Common Stock, which trades under the symbol TRC on the New York Stock Exchange, for each calendar quarter during the last two years:

|         | 2018    |         | 2017    |         |
|---------|---------|---------|---------|---------|
| Quarter | High    | Low     | High    | Low     |
| First   | \$24.58 | \$20.21 | \$26.04 | \$20.58 |
| Second  | \$26.25 | \$22.43 | \$24.18 | \$19.90 |
| Third   | \$24.57 | \$21.17 | \$21.94 | \$19.67 |
| Fourth  | \$21.82 | \$16.04 | \$22.81 | \$18.59 |

As of February 19, 2019, there were 292 registered owners of record of our Common Stock.

No cash dividends were paid in 2018 or 2017 and at this time there is no intention of paying cash dividends in the future.

On October 13, 2014, the Tejon Ranchcorp, a subsidiary of the Company, entered into an Amended and Restated Credit Agreement, a Term Note and a Revolving Line of Credit Note. This credit facility contains customary negative covenants that limit the ability of the Company to, among other things, pay dividends or repurchase stock to the extent that immediately following any such dividend or repurchase of stock, total liabilities divided by tangible net worth (Stockholders Equity) is not greater than 0.75 to 1.0.

For information regarding equity compensation plans pursuant to Item 201(d) of Regulation S-K, please see Item 11, "Executive Compensation" and Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" of this Form 10-K, below.

The annual stockholder performance graph will be provided separately in our annual report to stockholders.

## ITEM 6. SELECTED FINANCIAL DATA

|  | 2018      | 2017      | 2016      | 2015      | 2014      |
|--|-----------|-----------|-----------|-----------|-----------|
| Total revenues, including investment and other income <sup>1</sup>                       | \$46,904  | \$35,442  | \$46,899  | \$52,056  | \$52,291  |
| Income (loss) from operations before equity in earnings of unconsolidated joint ventures | \$1,721   | \$(7,331) | \$(5,845) | \$(2,287) | \$3,165   |
| Equity in earnings of unconsolidated joint ventures                                      | \$3,834   | \$4,227   | \$7,098   | \$6,324   | \$5,294   |
| Net income (loss)  | \$4,235   | \$(1,821) | \$757     | \$2,912   | \$5,762   |
| Net (loss) income attributable to noncontrolling interests                               | \$(20)    | \$(24)    | \$(43)    | \$(38)    | \$107     |
| Net income (loss) attributable to common stockholders                                    | \$4,255   | \$(1,797) | \$800     | \$2,950   | \$5,655   |
| Total assets   | \$529,048 | \$518,199 | \$439,541 | \$431,919 | \$431,923 |
| Long-term debt   | \$65,915  | \$69,959  | \$73,867  | \$74,215  | \$74,459  |
| Equity   | \$434,672 | \$426,810 | \$334,709 | \$331,308 | \$324,333 |
| Net income (loss) per share attributable to common stockholders, diluted                 | \$0.16    | \$(0.08)  | \$0.04    | \$0.14    | \$0.27    |

<sup>1</sup>Refer to Note 1, Summary of Significant Accounting Policies of the Notes to the Consolidated Financial Statements for discussion on impact of the adoption of ASU 2014-09 "Revenue with Contracts from Customers (Topic 606)" on the years ended December 31, 2017 and 2016.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

See Part I, "Forward-Looking Statements" for our cautionary statement regarding forward-looking information.

This discussion and analysis is based on, should be read together with, and is qualified in its entirety by, the consolidated financial statements and notes thereto included in Item 15(a)1 of this Form 10-K, beginning at page F-1. It also should be read in conjunction with the disclosure under "Forward-Looking Statements" in Part 1 of this Form 10-K. When this report uses the words "we," "us," "our," "Tejon," "TRC," and the "Company," they refer to Tejon Ranch Co. its subsidiaries, unless the context otherwise requires. References herein to fiscal year refer to our fiscal years ended or ending December 31.

### OVERVIEW

#### Our Business

We are a diversified real estate development and agribusiness company committed to responsibly using our land and resources to meet the housing, employment, and lifestyle needs of Californians and to create value for our shareholders. In support of these objectives, we have been investing in land planning and entitlement activities for new industrial and residential land developments and in infrastructure improvements within our active industrial development. Our prime asset is approximately 270,000 acres of contiguous, largely undeveloped land that, at its most southerly border, is 60 miles north of Los Angeles and, at its most northerly border, is 15 miles east of Bakersfield. Our business model is designed to create value through the entitlement and development of land for commercial/industrial and resort/residential uses while at the same time protecting significant portions of our land for conservation purposes. We operate our business near one of the country's largest population centers, which is expected to continue to grow well into the future.

We currently operate in five reporting segments: commercial/industrial real estate development; resort/residential real estate development; mineral resources; farming; and ranch operations.

Our commercial/industrial real estate development segment generates revenues from building, land lease activities, and land and building sales. The primary commercial/industrial development is TRCC. The resort/residential real estate development segment is actively involved in the land entitlement and development process internally and through a joint venture. Within our resort/residential segment, the three active mixed use master plan developments are MV, Centennial, and Grapevine. Our mineral resources segment generates revenues from oil and gas royalty leases, rock and aggregate mining leases, a lease with National Cement and sales of water. The farming segment produces revenues from the sale of wine grapes, almonds, and pistachios. Lastly, the ranch operation segment consists of game management revenues and ancillary land uses such as grazing leases and filming.

#### Financial Highlights

For 2018, net income attributable to common stockholders was \$4,255,000 compared to net loss attributed to common stockholders of \$1,797,000 in 2017. Factors driving the change include an increase in mineral resource revenues of \$8,412,000 resulting from more sales opportunities for water in 2018 when compared to 2017, and an increase in farming revenues of \$2,129,000 resulting from improved pistachio sales. From an expense perspective, expenses increased \$2,410,000 mainly as a result of an increase in costs of \$3,100,000 stemming from increased water sales. For 2017, net loss attributable to common stockholders was \$1,797,000 compared to net income attributed to common stockholders of \$800,000 in 2016. Factors driving the change include: a decline in farming revenues of \$2,214,000 resulting from a decline in pistachio production in excess of 2,200,000 pounds, a decline in mineral resource revenues of \$8,170,000 resulting from decreased sales opportunities for water in 2017 when compared to 2016, and a decrease in income from unconsolidated joint ventures of \$2,871,000. In addition, 2016 included a land sale to a third party of \$1,039,000, whereas 2017 did not have any land sales. From an expense perspective, expenses decreased \$10,282,000 as a result of reduced water sales and our staff rightsizing initiatives.

For the year ended December 31, 2018, we had no material lease renewals.



During 2019, we will continue to invest funds toward the achievement of entitlements, permits, and maps for our land and for master project infrastructure and vertical development within our active commercial and industrial development. Securing entitlements for our land is a long, arduous process that can take several years and often involves litigation. During the next few years, our net income will fluctuate from year-to-year based upon, among other factors, commodity prices, production within our farming segment, the timing of land sales and the leasing of land and/or industrial space within our industrial developments, and equity in earnings realized from our unconsolidated joint ventures.

This Management's Discussion and Analysis of Financial Condition and Results of Operations provides a narrative discussion of our results of operations. It contains the results of operations for each operating segment of the business and is followed by a discussion of our financial position. It is useful to read the business segment information in conjunction with Note 16 (Reporting Segments and Related Information) of the Notes to Consolidated Financial Statements.

#### Critical Accounting Policies

The preparation of our consolidated financial statements in accordance with generally accepted accounting principles in the United States, or GAAP, requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We consider an accounting estimate to be critical if: (1) the accounting estimate requires us to make assumptions about matters that were highly uncertain at the time the accounting estimate was made, and (2) changes in the estimates that are likely to occur from period to period, or use of different estimates that we reasonably could have used in the current period, would have a material impact on our financial condition or results of operations. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, impairment of long-lived assets, capitalization of costs, allocation of costs related to land sales and leases, stock compensation, our future ability to utilize deferred tax assets, and defined benefit retirement plans. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and the Audit Committee has reviewed the foregoing disclosure. In addition, there are other items within our financial statements that require estimation, but are not deemed critical as defined above. Changes in estimates used in these and other items could have a material impact on our financial statements. See also Note 1 (Summary of Significant Accounting Policies) of the Notes to Consolidated Financial Statements, which discusses accounting policies that we have selected from acceptable alternatives.

We believe the following critical accounting policies reflect our more significant judgments and estimates used in the preparation of the consolidated financial statements:

**Revenue Recognition** – The Company's revenue is primarily derived from lease revenue from our rental portfolio, royalty revenue from mineral leases, sales of farm crops, sales of water, and land sales. Revenue from leases with rent concessions or fixed escalations is recognized on a straight-line basis over the initial term of the related lease unless there is a considerable risk as to collectability. The financial terms of leases are contractually defined. Lease revenue is not accrued when a tenant vacates the premises and ceases to make rent payments or files for bankruptcy. Royalty revenues are contractually defined as to the percentage of royalty and are tied to production and market prices. Our royalty arrangements generally require payment on a monthly basis with the payment based on the previous month's activity. We accrue monthly royalty revenues based upon estimates and adjust to actual as we receive payments.

From time to time the Company sells easements over its land. The easements are either in the form of rights of access granted for such things as utility corridors or are in the form of conservation easements that generally require the Company to divest its rights to commercially develop a portion of its land, but do not result in a change in ownership of the land or restrict the Company from continuing other revenue generating activities on the land. Sales of conservation easements are accounted for in accordance with the five-step model under Accounting Standards Codification Topic 606, or ASC 606. The five-step model requires that we (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, including variable consideration to the extent that it is probable that a significant future reversal will not occur, (iv) allocate the

transaction price to the respective performance obligations in the contract, and (v) recognize revenue when (or as) we satisfy the performance obligation. Since conservation easements generally do not impose any significant continuing performance obligations on the Company, revenue from conservation easement sales are generally recognized in the period the sale has closed and consideration has been received.

In recognizing revenue from land sales, the Company follows ASC 606 to achieve the core principle that an entity recognizes revenue to depict the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of ASC 606 on January 1, 2018 impacted our accounting for land sales. Upon the adoption of ASC 606, for any future land sales with multiple performance obligations, the standard generally requires the Company to allocate the transaction price to the performance obligations in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis) not total costs.

At the time farm crops are harvested, contracted, and delivered to buyers and revenues can be estimated, revenues are recognized and any related inventoried costs are expensed, which traditionally occurs during the third and fourth quarters of each year. It is not unusual for portions of our almond or pistachio crop to be sold in the year following the harvest. Orchard (almond and pistachio) revenues are based upon the contract settlement price or estimated selling price, whereas vineyard revenues are typically recognized at the contracted selling price. Estimated prices for orchard crops are based upon the quoted estimate of what the final market price will be by marketers and handlers of the orchard crops. These market price estimates are updated through the crop payment cycle as new information is received as to the final settlement price for the crop sold. These estimates are adjusted to actual upon receipt of final payment for the crop. This method of recognizing revenues on the sale of orchard crops is a standard practice within the agribusiness community.

Actual final crop selling prices are not determined for several months following the close of our fiscal year due to supply and demand fluctuations within the orchard crop markets. Adjustments for differences between original estimates and actual revenues received are recorded during the period in which such amounts become known.

**Capitalization of Costs** - The Company capitalizes direct construction and development costs, including predevelopment costs, interest, property taxes, insurance, and indirect project costs that are clearly associated with the acquisition, development, or construction of a project. Costs currently capitalized that in the future would be related to any abandoned development opportunities will be written off if we determine such costs do not provide any future benefits. Should development activity decrease, a portion of interest, property taxes, and insurance costs would no longer be eligible for capitalization, and would be expensed as incurred.

**Allocation of Costs Related to Land Sales and Leases** – When we sell or lease land within one of our real estate developments, as we are currently doing within TRCC, and we have not completed all infrastructure development related to the total project, we determine the appropriate costs of sales for the sold land and the timing of recognition of the sale. In the calculation of cost of sales or allocations to leased land, we use estimates and forecasts to determine total costs at completion of the development project. These estimates of final development costs can change as conditions in the market and costs of construction change.

In preparing these estimates, we use internal budgets, forecasts, and engineering reports to help us estimate future costs related to infrastructure that has not been completed. These estimates become more accurate as the development proceeds forward, due to historical cost numbers and to the continued refinement of the development plan. These estimates are updated periodically throughout the year so that, at the ultimate completion of development, all costs have been allocated. Any increases to our estimates in future years will negatively impact net profits and liquidity due to an increased need for funds to complete development. If, however, this estimate decreases, net profits as well as liquidity will improve.

We believe that the estimates used related to cost of sales and allocations to leased land are critical accounting estimates and will become even more significant as we continue to move forward as a real estate development company. The estimates used are very susceptible to change from period to period, due to the fact that they require management to make assumptions about costs of construction, absorption of product, and timing of project completion, and changes to these estimates could have a material impact on the recognition of profits from the sale of land within our developments.

**Impairment of Long-Lived Assets** – We evaluate our property and equipment and development projects for impairment when events or changes in circumstances indicate that the carrying value of assets contained in our financial statements may not be recoverable. The impairment calculation compares the carrying value of the asset to the asset's estimated future cash flows (undiscounted). If the estimated future cash flows are less than the carrying value of the asset, we calculate an impairment loss. The impairment loss calculation compares the carrying value of the asset to the

asset's estimated fair value, which may be based on estimated future cash flows (discounted). We recognize an impairment loss equal to the amount by which the asset's carrying value exceeds the asset's estimated fair value. If we recognize an impairment loss, the adjusted carrying amount of the asset will be its new cost basis. For a depreciable long-lived asset, the new cost basis will be depreciated (amortized) over the remaining useful life of that asset.

Restoration of a previously recognized impairment loss is prohibited.

We currently operate in five reporting segments: commercial/industrial real estate development, resort/residential real estate development, mineral resources, farming, and ranch operations. At this time, there are no assets within any of our reporting segments that we believe are at risk of being impaired due to market conditions nor have we identified any impairment indicators.



We believe that the accounting estimate related to asset impairment is a critical accounting estimate because it is very susceptible to change from period to period; it requires management to make assumptions about future prices, production, and costs, and the potential impact of a loss from impairment could be material to our earnings. Management's assumptions regarding future cash flows from real estate developments and farming operations have fluctuated in the past due to changes in prices, absorption, production and costs and are expected to continue to do so in the future as market conditions change.

In estimating future prices, absorption, production, and costs, we use our internal forecasts and business plans. We develop our forecasts based on recent sales data, historical absorption and production data, input from marketing consultants, as well as discussions with commercial real estate brokers and potential purchasers of our farming products.

If actual results are not consistent with our assumptions and judgments used in estimating future cash flows and asset fair values, we may be exposed to impairment losses that could be material to our results of operations.

**Defined Benefit Retirement Plans** – The plan obligations and related assets of our defined benefit retirement plan are presented in Note 15 (Retirement Plans) of the Notes to Consolidated Financial Statements. Plan assets, which consist primarily of marketable equity and debt instruments, are valued using level one and level two indicators, which are quoted prices in active markets and quoted prices for similar types of assets in active markets for the investments. Pension benefit obligations and the related effects on operations are calculated using actuarial models. The estimation of our pension obligations, costs and liabilities requires that we make use of estimates of present value of the projected future payments to all participants, taking into consideration the likelihood of potential future events such as salary increases and demographic experience. These assumptions may have an effect on the amount and timing of future contributions.

The assumptions used in developing the required estimates include the following key factors:

- Discount rates;
- Retirement rates;
- Expected contributions;
- Inflation;
- Expected return on plan assets; and
- Mortality rates.

The discount rate enables us to state expected future cash flows at a present value on the measurement date. In determining the discount rate, the Company utilizes the yield on high-quality, fixed-income investments currently available with maturities corresponding to the anticipated timing of the benefit payments. To determine the expected long-term rate of return on pension plan assets, we consider the current and expected asset allocations, as well as historical and expected returns on various categories of plan assets. At December 31, 2018, the weighted-average actuarial assumption of the Company's defined benefit plan consisted of a discount rate of 4.2% and a long-term rate of return on plan assets of 7.5%. For the years beginning with 2017, there are no assumed salary increase factors included in the plan assumptions due to the plan being amended to freeze future benefits. The effects of actual results differing from our assumptions and the effects of changing assumptions are recognized as a component of other comprehensive income, net of tax. Amounts recognized in accumulated other comprehensive income are adjusted as they are subsequently recognized as components of net periodic benefit cost. If we were to assume a 50-basis point change in the discount rate used, our projected benefit obligation would change approximately \$700,000.

**Stock-Based Compensation** - We apply the recognition and measurement principles of ASC 718, "Compensation – Stock Compensation" in accounting for long-term stock-based incentive plans. Our stock-based compensation plans include both restricted stock units and restricted stock grants. We have not issued any stock options to employees or directors since January 2003, and our 2018 financial statements do not reflect any compensation expenses for stock options. All stock options issued in the past have been exercised or forfeited.

We make stock awards to employees based upon time-based criteria and through the achievement of performance-related objectives. Performance-related objectives are either stratified into threshold, target, and maximum goals or based on the achievement of a milestone event. These stock awards are currently being expensed over the expected vesting period based on each performance criterion. We make estimates as to the number of shares that will actually be granted based upon estimated ranges of success in meeting the defined performance measures. If

our estimates of performance shares vesting were to change by 25%, stock compensation expense would increase or decrease by approximately \$725,000 depending on whether the change in estimate increased or decreased shares vesting.

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See Note 11. (Stock Compensation - Restricted Stock and Performance Share Grants), of the Notes to Consolidated Financial Statement for total 2018 stock compensation expense related to stock grants.

Fair Value Measurements – The Financial Accounting Standards Board's, or FASB, authoritative guidance for fair value measurements of certain financial instruments defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Fair value is defined as the exchange (exit) price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This guidance establishes a three-level hierarchy for fair value measurements based upon the inputs to the valuation of an asset or liability.

Observable inputs are those which can be easily seen by market participants while unobservable inputs are generally developed internally, utilizing management's estimates and assumptions:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is determined from quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, or by model-based techniques in which all significant inputs are observable in the market.

Level 3 – Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on our own estimates about the assumptions that market participants would use to value the asset or liability.

When available, we use quoted market prices in active markets to determine fair value. We consider the principal market and nonperformance risk associated with our counterparties when determining the fair value measurement.

Fair value measurements are used for marketable securities, investments within the pension plan and hedging instruments.

#### Recent Accounting Pronouncements

For discussion of recent accounting pronouncements, see Note 1 (Summary of Significant Accounting Policies) of the Notes to Consolidated Financial Statements.

### Results of Operations by Segment

We evaluate the performance of our reporting segments separately to monitor the different factors affecting financial results. Each reporting segment is subject to review and evaluation as we monitor current market conditions, market opportunities, and available resources. The performance of each reporting segment is discussed below:

#### Real Estate – Commercial/Industrial

During 2018, commercial/industrial segment revenues decreased \$31,000, or 0.3%, from \$9,001,000 in 2017 to \$8,970,000. The reduction was primarily attributable to land sale revenues of \$73,000 in 2017, whereas we did not have any land sales in 2018.

Commercial/industrial real estate segment expenses decreased \$283,000, or 4.3%, from \$6,529,000 in 2017 to \$6,246,000 in 2018. During 2018, payroll, overhead, stock compensation and bonuses decreased \$887,000, due to reassignment of resources within the Company, while professional services also decreased \$194,000. The above reductions were partially offset by increases in TCWD fixed water assessments of \$727,000 and fees of \$107,000. TCWD's higher water assessment taxes were a result of declining TCWD water sales to third parties outside of the district.

During 2017, commercial/industrial segment revenues decreased \$839,000, or 9%, from \$9,840,000 in 2016 to \$9,001,000 in 2017. The decrease was driven by a land sale in 2016 of \$1,039,000 versus land sales of \$73,000 in 2017. The decline was offset by a \$242,000 increase in lease revenues from the Pastoria Energy Facility. Please refer to Note 1 (Summary of Significant Accounting Policies) of the Notes to the Consolidated Financial Statements for further discussion on adopting ASC 606, and its impact on the recognition of land sales revenue in 2017 and 2016. Commercial/industrial real estate segment expenses decreased \$571,000, or 8%, from \$7,100,000 in 2016 to \$6,529,000 during 2017. During 2017, payroll, overhead, and bonuses decreased \$269,000 as a result of our staff rightsizing. Also contributing to the decrease were reductions in professional services and repairs and maintenance costs of \$149,000 and \$153,000 respectively.

The logistics operators currently located within TRCC have demonstrated success in serving all of California and the western region of the United States, and we are building from their success in our marketing efforts. We will continue to focus our marketing strategy for TRCC-East and TRCC-West on the significant labor and logistical benefits of our site, the pro-business approach of Kern County, and the demonstrated success of the current tenants and owners within our development. Our strategy fits within the logistics model that many companies are using, which favors large, centralized distribution facilities which have been strategically located to maximize the balance of inbound and outbound efficiencies, rather than a number of decentralized smaller distribution centers. The world class logistics operators located within TRCC have demonstrated success through utilization of this model. With access to markets of over 40 million people for next-day delivery service, they are also demonstrating success with e-commerce fulfillment. We believe that our ability to provide fully-entitled, shovel-ready land parcels to support buildings of any size, especially buildings 1.0 million square feet or larger, can provide us with a potential marketing advantage in the future. We are also expanding our marketing efforts to include industrial users in the Santa Clarita Valley of northern Los Angeles County, and the northern part of the San Fernando Valley due to the limited availability of new product and high real estate costs in these locations. Tenants in these geographic areas are typically users of relatively smaller facilities. In pursuit of such opportunities, the Company is in process of constructing a 579,040 square foot distribution facility with Majestic. The Company and Majestic have successfully leased 67% of this distribution facility prior to its completion, with the tenant taking occupancy in Q4 of 2019. This new construction is building on the success in 2018 of fully leasing a 480,000 square foot building in a partnership with Majestic.

A potential disadvantage to our development strategy is our distance from the ports of Los Angeles and Long Beach in comparison to the warehouse/distribution centers located in the Inland Empire, a large industrial area located east of Los Angeles, which continues its expansion eastward beyond Riverside and San Bernardino, to include Perris, Moreno Valley, and Beaumont. As development in the Inland Empire continues to move east and farther away from the ports, our potential disadvantage of our distance from the ports is being mitigated. Strong demand for large distribution facilities is driving development farther east in a search for large entitled parcels.

During 2018, vacancy rates in the Inland Empire stayed flat at 3.9% compared to 3.7% in 2017. This industrial market continues to see available supply remain at historic low levels. Construction declined slightly during the fourth quarter with 20.5 million square feet under construction compared to 20.7 million in 2017. This new supply is currently meeting growing industrial demand. The low vacancy rates have led to a year-over-year increase in lease rates of 7.3% within the Inland Empire. As lease rates increase in the Inland Empire, we may begin to have greater pricing advantages due to our lower land basis.

During 2018, vacancy rates in the northern Los Angeles industrial market, which includes the San Fernando Valley and Santa Clarita Valley, approximated 1.6%. Rents have been increasing for the past six years and will likely continue to rise in future years as the vacancy rate is at historic lows and quality industrial space remains hard to find. During 2018, average asking rents increased 8.5% compared with 2017, which have surpassed the historical peak which was seen in late 2007. Industrial demand remains high and infill industrial demand remains higher still. Future quarters will likely see greater construction activity as rents hit new highs and vacancy rates are at historic lows. Demand for industrial space in this market will also continue to be driven by domestic and global consumption levels. As industrial vacancy rates are at historic lows, industrial users seeking larger spaces are having to go further north into neighboring Kern County and particularly, the TRCC which has attracted increased attention as market conditions continue to tighten.

In 2018, the Los Angeles and Long Beach Port container traffic recorded its highest container total ever with 17.54 million Twenty-Foot Equivalent Units, or TEU's, up 3.8% from 2017. TEU is a measure of a ship's cargo carrying capacity. The dimensions of one TEU are equal to that of a standard shipping container measuring 20 feet long by 8 feet tall.

We expect the commercial/industrial segment to continue to experience costs, net of amounts capitalized, primarily related to professional service fees, marketing costs, commissions, planning costs, and staffing costs as we continue to pursue development opportunities. These costs are expected to remain consistent with current levels of expense with any variability in the future tied to specific absorption transactions in any given year.

The actual timing and completion of development is difficult to predict due to the uncertainties of the market.

Infrastructure development and marketing activities and costs could continue over several years as we develop our

land holdings. We will also continue to evaluate land resources to determine the highest and best uses for our land holdings. Future sales of land are dependent on market circumstances and specific opportunities. Our goal in the future is to increase land value and create future revenue growth through planning and development of commercial and industrial properties.

#### Real Estate – Resort/Residential

We are in the preliminary stages of development; hence, no revenues are attributed to this segment for these reporting periods.

In 2018, resort/residential segment expenses decreased \$425,000 to \$1,530,000, or 22%, when compared to \$1,955,000 in 2017. The reassignment of resources within the Company translated to increases in qualifying costs, including payroll and overhead costs within resort/residential which in turn translated to an increase in costs being capitalized into our real estate development projects by \$250,000 when compared to 2017. In addition, we experienced savings in professional services of \$163,000 in 2018.

In 2017, resort/residential segment expenses increased \$325,000 primarily due to reduced capitalization of payroll and overhead costs that in the prior years were identified to be incremental to our mixed use master plan development projects.

Our resort/residential segment activities include land entitlement, land planning and pre-construction engineering and conservation activities. We have three major resort/residential communities within this segment: Centennial, Grapevine, and MV.

For Centennial, the Board of Supervisors in December 2018, by a vote of 4-1, affirmed the recommendation of the Los Angeles County Regional Planning Commission and Department of Regional Planning that Centennial be approved.

For Grapevine, we are currently working with Kern County to defend litigation related to the approved EIR. For a more complete discussion of the litigation and approval process, please see Note 14 (Commitments and Contingencies) to the Notes to Consolidated Financial Statements.

For MV, we have a fully entitled project and received approval of Tentative Tract Map 1 for our first four phases of development. The timing of MV development in the coming years will be dependent on the strength of both the economy and the real estate market including both primary and second home markets. In moving the project forward, we will focus on the preparation of engineering leading to the final map for the first phases of MV, consumer and market research studies and fine tuning of development business plans as well as defining the possible capital funding sources for this development. We also obtained approval on the Farm Village commercial site plan from Kern County. Farm Village will serve as the commercial center and community gathering place for MV residents and visitors as well as the gateway to MV.

The resort/residential segment will continue to incur costs in the future related to professional service fees, public relations costs, and staffing costs as we continue forward with entitlement and permitting activities for the above communities and continue to meet our obligations under the Conservation Agreement. We expect these expenses to remain consistent with current years cost in the near term and only begin to increase as we move into the development phase of each project in the future. The actual timing and completion of entitlement-related activities and the beginning of development is difficult to predict due to the uncertainties of the approval process, the possibility of litigation upon approval of our entitlements in the future, and the status of the economy. We will also continue to evaluate land resources to determine the highest and best use for our land holdings. Our long-term goal through this process is to increase the value of our land and create future revenue opportunities through resort and residential development.

We are continuously monitoring the markets in order to identify the appropriate time in the future to begin infrastructure improvements and lot sales. Our long-term business plan of developing the communities of MV, Centennial, and Grapevine remains unchanged. As the California economy continues to improve we believe the perception of land values will also begin to improve and the long-term fundamentals that support housing demand in our region, primarily California population growth and household formation will also improve. California also has a significant documented housing shortage, which we believe our communities will help ease as the population base within California continues to grow.

See Item 1, “Business – Real Estate Development Overview” for a further discussion of real estate development activities.

## Mineral Resources

|   | 2018      | 2017      | 2016      |
|---|-----------|-----------|-----------|
| Oil and gas                                     |           |           |           |
| Oil production (barrels)                        | 250,000   | 263,000   | 301,000   |
| Average price per barrel                        | \$67.00   | \$45.00   | \$37.00   |
| Blended royalty rate                            | 13.4 %    | 13.7 %    | 13.7 %    |
| Natural gas production (millions of cubic feet) | 241,000   | 209,000   | 238,000   |
| Average price per thousand cubic feet           | \$0.76    | \$0.74    | \$0.56    |
| Blended royalty rate                            | 13.4 %    | 14.5 %    | 14.4 %    |
| Water   |           |           |           |
| Water sold in acre-feet                         | 9,442     | 939       | 7,285     |
| Average price per acre-feet                     | \$968     | \$1,181   | \$1,317   |
| Cement  |           |           |           |
| Tons sold                                       | 1,154,000 | 1,063,000 | 909,000   |
| Average price per ton                           | \$1.47    | \$1.52    | \$1.41    |
| Rock/Aggregate                                  |           |           |           |
| Tons sold                                       | 1,168,000 | 1,222,000 | 1,397,000 |
| Average price per ton                           | \$0.98    | \$0.88    | \$0.85    |



2018 Operational Highlights:

Revenues from our mineral resources segment increased \$8,412,000, or 141%, to \$14,395,000 in 2018 when compared to \$5,983,000 in 2017. This increase was primarily attributed to water sales of \$9,142,000 in 2018, representing a \$7,888,000 increase over last year, as a result of moderate drought conditions in Kern County. The improved water sales accordingly increased mineral resources expenses largely due to the cost of sales of water by \$3,259,000.

We experienced improvements for oil and gas royalties as a result of improved oil prices. Please refer to above table for current and historical production volume and pricing.

2017 Operational Highlights:

Revenues from our mineral resources segment decreased \$8,170,000, or 58%, to \$5,983,000 in 2017 compared to \$14,153,000 in 2016. During the 2016/2017 winter, California experienced above normal rain fall and snow levels, resulting in a reduction in water market activity throughout the state, adversely impacting water sales opportunities. This resulted in an \$8,347,000 decline in water sales. The reduced water sales accordingly decreased mineral resources expenses associated with the cost of sales of water by \$4,832,000.

We experienced improvements in cement production as a result of increased demand and pricing during 2017 compared to 2016. The improvement in shipments was due to an increase in road construction activity as compared to the prior years.

Despite falling production, we experienced improvements for oil and gas royalties as a result of improved oil prices. Please refer to above table for current and historical production volume and pricing.

Although oil prices improved throughout 2018, we currently expect our largest tenant, California Resources Corporation, or CRC, to continue its program of producing from current active wells at lower levels with no near-term intent to begin new drilling programs until oil prices reach higher levels. CRC has approved permits and drill sites on our land and has delayed the start of drilling as it evaluates the market. A positive aspect of our lease with CRC is that the approved drill sites are in an area of the ranch where the development and production costs are moderate due to the depths being drilled. During 2017, CRC executed a new exploration lease with us covering 1,524 acres. Thus far in 2019, oil prices are within 10% of West Texas Intermediate pricing.

Since we only receive royalties based on tenant production and market prices and do not produce oil, we do not have information as to the potential size of oil reserves.

Our royalty revenues are contractually defined and based on a percentage of production and are received in cash. Royalty revenues fluctuate based on changes in market price for oil, gas, rock and aggregate, and Portland cement. In addition, royalty revenue is impacted by new production, the inevitable decline in production in existing wells, and rock and limestone quarries, and the cost of development and production.

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Farming

| (\$ in thousands)                | December 31, 2018 |                            |               | December 31, 2017 |                            |               | Change   |                            |               |
|----------------------------------|-------------------|----------------------------|---------------|-------------------|----------------------------|---------------|----------|----------------------------|---------------|
|                                  | Revenue           | Quantity Sold <sup>2</sup> | Average Price | Revenue           | Quantity Sold <sup>2</sup> | Average Price | Revenue  | Quantity Sold <sup>2</sup> | Average Price |
| ALMONDS (lbs.)                   |                   |                            |               |                   |                            |               |          |                            |               |
| Current year crop                | \$4,476           | 1,717                      | \$ 2.61       | \$5,221           | 2,033                      | \$ 2.57       | \$(745 ) | (316 )                     | \$ 0.04       |
| Prior crop years                 | 1,234             | 412                        | \$ 3.00       | 729               | 315                        | 2.31          | 505      | 97                         | 0.69          |
| Prior crop price adjustment      | —                 |                            |               | 352               |                            |               | (352 )   |                            |               |
| Signing bonus                    | 34                |                            |               | 25                |                            |               | 9        |                            |               |
| Subtotal Almonds <sup>1</sup>    | \$5,744           | 2,129                      | \$ 2.68       | \$6,327           | 2,348                      | \$ 2.53       | \$(583 ) | (219 )                     | \$ 0.15       |
| PISTACHIOS (lbs.)                |                   |                            |               |                   |                            |               |          |                            |               |
| Current year crop                | \$7,251           | 3,615                      | \$ 2.01       | \$1,288           | 643                        | \$ 2.00       | \$5,963  | 2,972                      | \$ 0.01       |
| Prior crop years                 | 518               | 120                        | 4.32          | 1,007             | 247                        | 4.08          | (489 )   | (127 )                     | 0.24          |
| Prior crop price adjustment      | 111               |                            |               | 1,452             |                            |               | (1,341 ) |                            |               |
| Crop Insurance                   | —                 |                            |               | 776               |                            |               | (776 )   |                            |               |
| Subtotal Pistachios <sup>1</sup> | \$7,880           | 3,735                      | \$ 2.08       |                   |                            |               |          |                            |               |