The Woodlands History

THE WOODLANDS, THE INSIDE STORY OF CREATING A BETTER HOMETOWN

Why George Mitchell Sold The Woodlands

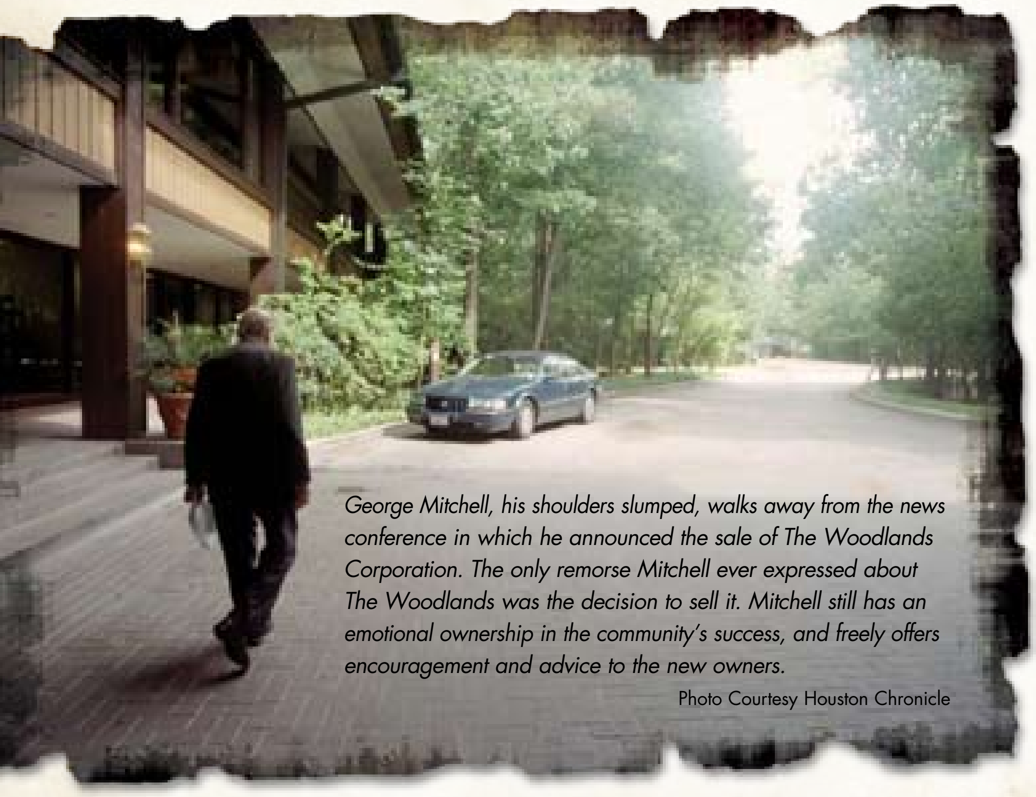
By Roger Galatas

By 1996, George Mitchell had been engaged in The Woodlands for a great portion of his professional career. He had acquired the land, fostered the development vision, assembled the development team, invested emotional capital and placed his personal wealth at risk to get the community underway and help it survive several very tough financial spots. The project had then moved into a profitable position and was nationally recognized as a development success, so why would he elect to sell it? In large measure because Wall Street did not fully value a public company that was half energy and half real estate with an individual shareholder, in this case, George Mitchell, holding about 50 percent of the corporate stock.

So in 1996, the board of directors of Mitchell Energy & Development Corp., parent company of The Woodlands Corp., insisted it was time to get out of either the land or energy business to enhance the value of the company. Mitchell went along with the decision, despite the fact he personally owned enough shares in the company to give him voting control of the board and might have been able to overrule that decision.

"I didn't want to sell The Woodlands," Mitchell said in a 2004 interview. "The Woodlands is a great project and I was very proud of it. And of course I had done a lot of work in energy, and they both were very exciting, very interesting. But I hated to sell The Woodlands, not only because it's more visible, but also it probably has a greater affect on (people) compared to what I accomplished in energy."

But at that time Mitchell could not sell the energy portion of Mitchell Energy & Development Corp. because of a number of lawsuits pending in Wise County in North Texas, the site of the major natural gas production that put this company in the big time and him on the list of the 400 richest Americans. The suits claimed that Mitchell's gas wells were polluting the water wells of many residents and demanded as much as $200 million in damages. Later, Mitchell prevailed in the suits as the courts found his company's activities were not responsible for any pollution. But in 1996, with those suits hanging over the company, the energy portion of Mitchell Energy was diminished in value. No one wants to buy a lawsuit. "I couldn't sell the energy company," Mitchell said. "So I had no choice but I had to sell The Woodlands."



George Mitchell, his shoulders slumped, walks away from the news conference in which he announced the sale of The Woodlands Corporation. The only remorse Mitchell ever expressed about The Woodlands was the decision to sell it. Mitchell still has an emotional ownership in the community's success, and freely offers encouragement and advice to the new owners.

Photo Courtesy Houston Chronicle

Mitchell, whose wealth was substantial, might have bought The Woodlands himself from Mitchell Energy. But there were severe constraints on doing so. Much of his wealth was tied up in stock of the company named for him. He would have had to sell enough stock to come up with the price – The Woodlands was sold for $543 million – or borrow against it. And while Mitchell remained quite active, he was not getting younger. He had 10 children. No one lives forever and dying in the United States without good estate planning meant much of his wealth could go to the U.S. government in estate taxes. Tying up a substantial part of his wealth in largely illiquid land just didn't make sense. Mitchell once told me that if he had been 50 years old in 1997 he would not have sold The Woodlands Corporation.

The company hired the investment bank, Goldman Sachs, to help evaluate the properties and implement a plan to dispose of company-owned real estate assets within The Woodlands. We had a large number of diverse assets – ranging from country clubs, a mortgage company, to a title company; undeveloped land to developed land to office buildings and retail centers. A host of these assets were subject to leases, contracts liens and loans. The properties outside

The Woodlands were also diverse but simpler in terms of ownership. We sold the non-Woodlands assets separately, not through a financial advisor but with our own resources using appraisers and industry standards to establish values.

The sale of non-Woodlands assets included 30,000 acres of timberland in Montgomery County, the San Luis Hotel in Galveston, several resort developments on the west end of Galveston Island and a 3,000-acre property near Steamboat Springs, Colorado, that Mitchell had hoped to develop into a resort community. We sold the non-Woodlands assets before we closed on The Woodlands.

While the other real estate assets were sold in multiple transactions to separate buyers, The Woodlands was a package deal. Its assets included:

- Approximately 14,000 acres of undeveloped land in the master planned community.
- The Woodlands Executive Conference Center Resort and The Woodlands Country Club with four golf courses.
- Total or partial interest in 1.4 million square feet of office space, a million square feet of research technology space and 2,300 apartments.
- Partial ownership of Mitchell Mortgage Company and Stewart Title Company of Montgomery County.
- Easement use fees and a realty sales operation.
- WoodTrace, a proposed 2,850 master-planned residential golf community in Northwest Houston.
- Certain financial assets, contracts and leases.
- The franchise value of a nationally recognized, successful master-planned community.
- An experienced team of professionals within The Woodlands Corporation.
- A going business with positive cash flow.

Goldman Sachs prepared a confidential memorandum offering The Woodlands for sale. It was released to potential buyers in March of 1997. It anticipated The Woodlands would be sold for cash, but also said a stock sale might be arranged, subject to favorable tax rulings and the financial strength of the acquiring entity. Following the bidding process one prospect would be chosen with whom it would negotiate.

The Crescent Real Estate Equities-Morgan Stanley partnership had the higher bid and it sent in a team of executives for the


Houston Chronicle

Mitchell selling The Woodlands

Partnership to buy community for $543 million in cash

George Mitchell's $543 million sale of The Woodlands Corporation is reported in the Houston Chronicle.

45-day due diligence period. That very short time of 45 days came from Mitchell. As the time approached for the closing, Crescent-Morgan Stanley identified a number of issues about deferred maintenance and other matters. They viewed those as a valid reason to either extend the period for due diligence or adjust the price. George Mitchell held the line. There would be neither. Mitchell didn't want to sell anyway and he was not about to reduce the price to accommodate the sale. Despite several calls from Crescent, the closing did occur at the original offer price and it closed within the time frame set forth in the agreement.

A good case can be made that George Mitchell sold The Woodlands at exactly the wrong time. The cash sale price was $545 million and the sale generated an after tax loss of $67 million for Mitchell Energy. Chalk up that loss to two significant reasons: (1) the sale occurred prematurely with respect to financial maturity of The Woodlands' assets. Subsequently reported profitable returns to Crescent and Morgan Stanley bear out this circumstance; and (2) George Mitchell's charitable nature and his belief that the community deserved contributions to make it a better place, such as the Cynthia Woods Mitchell Pavilion, funding and land grants to the Houston Area Research Center, the John Cooper School, the University Center and other institutions. These contributions (investments) by Mitchell created value that could be recovered over time from future sales, but no current income to the company and therefore added little value to the sale. But the loss generated by the sale of The Woodlands was more than offset by a significant increase in the market value of Mitchell Energy stock.

Upon the closing of the sale to Crescent-Morgan Stanley our management team had several objectives. We wanted to introduce the new owners to the community and reshape our operations to achieve their objectives. We felt we had to reassure the community that George Mitchell's vision was intact and reinforce our network of relationships with regulatory agencies, elected officials and community leaders. And finally we knew if we were going to accomplish these objectives we needed to establish our credibility with the new owners.

Crescent-Morgan Stanley kept most of the existing management team at The Woodlands when it completed the sale. The new owners put in place a financial bonus program for key employees who would stay for several years. This worked for a time, but gradually a number of key employees moved on. By late 2003, many positions were filled by new employees.

Change in the way The Woodlands operated did come, but gradually. Land use covenants, development plans, existing regulatory approvals, contracts with third parties and agreements with homebuilders and contractors required a measure of stability. Also Crescent and Morgan Stanley understood the value of George Mitchell's vision. They did not, necessarily, share his passion. They saw the Mitchell vision as a vehicle to achieve the financial goals of their investors and shareholders, but they chose a somewhat different approach to achieving it.

It was important for residents to understand that the sale of The Woodlands involved only its name and corporate assets, not the assets of the community such as the Pavilion or its governmental structure. These remained beyond the direct control of Crescent and Morgan Stanley. Residents continued to raise their families, buy and sell homes, educate their children and enjoy community amenities. Businesses continued without interruption. Community volunteers and the institutions

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they supported continued to weave the tapestry of community fabric just as they had done under the ownership of George Mitchell. This human element provided continuity as the company and its assets went from one owner to the other. Residents actually became more alert to even minor changes. They became more active protectors of George Mitchell's vision.

Even though the transition to new ownership had been challenging, Crescent and Morgan Stanley pursued development initiations already planned under the Mitchell ownership and launched new initiatives. Anadarko, Chevron/Phillips, U.S. Oncology and The Marriott Hotel and Convention Center opened in Town Center; The Woodlands Waterway® advanced as a major commercial amenity. The Carlton Woods Country Club opened; homes sales increased; new public schools opened and a new hospital was constructed. So, from a development standpoint, the community has made significant progress since the sale in 1997. Credit goes to the new owners, the team of company professionals and community leaders for the successful progress.

While I am convinced that had Crescent and Morgan Stanley started The Woodlands in 1974, instead of George Mitchell, it would have been a failure, it's equally clear that during their ownership starting in mid-1997 they were successful in creating value, generating a profitable cash flow and providing capital to advance elements of Mitchell's vision.

Editor's note: The Woodlands Development Company is currently owned by The Howard Hughes Corporation. This article marks the last in the series about the history of The Woodlands. A special thank-you to Roger Galatas for sharing his insight on the history of The Woodlands with The Woodlands Community Magazine.

Roger Galatas
Roger Galatas is the former president of The Woodlands Corporation and the author, with Jim Barlow, of the popular book, The Woodlands, The Inside Story of Creating a Better Hometown. *For more information, please visit www.rgiwoodlands.com.*

Correction: *Last month's* Name Game *article included a photo of event attendees, but not all were identified. The photo description should have read as follows:* In July 1983, the formal opening of Cochran's Crossing, the third residential village built in The Woodlands, was attended by Roger Galatas, Bill Cochran, Joel Deretchin, Rev. Don Gebert, Ed Lee, Montgomery County Commissioner Weldon Locke, George Mitchell, State Representative Jim Turner and Montgomery County Judge Jimmy Edwards. *The Woodlands Community Magazine regrets the error.*