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Lance Johnstone: Developing 3000 North Broad

It was April, 2007 and Lance Johnstone and Corey Galloway were meeting, as they often did, at the Rainbow Cafe, a small coffee shop in North Philadelphia. The two men were reviewing the latest piece of news that threatened to derail their real estate development a few blocks north, at 3000 North Broad Street. Johnstone was a former NFL defensive end, who had played 5 seasons with the Minnesota Vikings and 6 with the Oakland Raiders. He had participated in an executive education program for NFL Players at Harvard Business School in 2005, where he had met Galloway, the proprietor of a business consulting firm in New York. Johnstone had been interested in real estate development for several years, and was seriously looking at property near his hometown, in downtown Philadelphia. He was particularly drawn to the area near Temple University, his alma mater, which suffered from a shortage of student housing.

Shortly after returning from HBS in the spring of 2005, Johnstone purchased the parcel of property at 3000 North Broad Street for \$185,000, with the intention of developing residential housing. He called his new friend Galloway, who agreed to help in return for some of the upside and a small retainer, and the two began working on developing a business case, working through the zoning and regulatory hurdles, obtaining financing, and purchasing the adjacent parcel of property from the city of Philadelphia. By early 2007, they had a fairly solid plan, approved by the city, as well as a general contractor on board, and a bank loan of \$1.9 million which, together with \$800,000 or so in funds Johnstone was prepared to commit, would cover the projected total cost of the project of \$2,700,000. This included a \$2,075,000 construction budget, "soft" costs of \$368,000 and the land (\$257,000, including the additional adjacent lots purchased from the city). Initially, Johnstone had very ambitious plans to pursue a \$20 million-plus development, but after looking at the numbers and discussing the project with Galloway, they agreed to pursue a pilot project and use this 3000 North Broad as the foundation for Johnstone's pursuit of later, more significant developments.

In April of 2007, however, the plan was dealt a blow when the bank pulled out of the loan commitment, citing the general contractor's ("GC") inability to pull together a detailed back-up for the capital budget they were loaning against. The men had worked to line up another bank, and had received a commitment from Clarion National Bank – but for only \$1.7 million, rather than the \$1.9 million the Franklin Federal Bank had committed. A few weeks later, the project was dealt another blow when the "final" construction budget came in at \$2,500,000, or \$425,000 higher than originally

Senior Lecturer Michael J. Roberts and Professor Nabil N. El-Hage prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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planned. Over the next week, the men scrambled to work with the contractor to try to get the budget back to a viable number, and succeeded in lowering it to \$2,200,000.

Thus, with the revised construction budget and the lower loan, the men now faced an equity financing requirement of \$1,125,000, or \$325,000 higher than originally anticipated.

Johnstone and Galloway faced a choice. In Johnstone's words: "We can pull the plug, or try to make this work." The funding gap has gone from \$800,000 which I was prepared to fill, to well over \$1 million, which I am not. We need to decide whether the project still makes financial sense at these investment levels, and if so, whether to raise more money from outside equity investors – with whom we have had some discussions – or continue on without the money we need in hopes of getting all the pieces to fall in place at the end. Galloway described more fully what this last option entailed:

The bank has said they'd be willing to go to \$1.9 million if we can "prove" that the financial projections are realistic - the evidence they want to see is a signed lease at the rental rates we are forecasting. Similarly, the contract we have with the GC calls for a 10% "holdback" on the contract until a certificate of occupancy is issued – basically when the project is done. By then we will have signed leases and some deposits. So, if we proceed on the current basis, we can make up this \$325,000 shortfall with a combination of the holdback – which we won't have to pay until we have some deposits, and the additional \$200,000 we will get from the bank.

Background: Lance Johnstone

Johnstone grew up in Philadelphia, and went to Temple University, a short distance from his family home. He played linebacker in college, earning All Big East honors and was a second round draft pick, joining the Raiders, who were then in the process of moving from LA to Oakland. Johnstone realized that – even if successful - he would need to plan for his post-playing career: "I always thought that the NFL was more like a Head-start as opposed to the end-game." When he lived in Oakland, Johnstone made a few small real estate investments: "I would buy a house in need of some work, do the work, live in it for a while, then sell it – I did that twice in Oakland and then again in Minnesota after I was traded to the Vikings in 2001." After 5 years with the Vikings, Johnstone was considering retiring, but was picked up for one more year by the Raiders, and went back to Oakland. "By then, my knee was giving me problems. I was playing hurt, and by the end of 2006, I knew I didn't want to play anymore." Johnstone retired at the conclusion of the 2006 season.

Johnstone had continued to return to Philadelphia in the off season to see his family, and believed there was a real opportunity to invest in real estate development projects near Temple.

Pursuing a Project in Philadelphia

In 2002 and 2003, with retirement on the horizon, Johnstone seriously turned his attention to finding a project in Philadelphia that he could develop. "I walked up and down the street near Temple, writing down addresses, looking up the owners, talking to people at Temple about their plans." Johnstone tried this approach for a couple of years, and had a few leads. Invariably, however, once mini-camps and training camps started up, all momentum would be lost as he turned his energies back to football.