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# Windham Negotiation: Confidential Information for the Abbott Executor

## *Overview*

In this simulation you are seeking to sell some real estate at the best terms that you can negotiate. Price is an important element in maximizing value, but other issues may be significant, as well. The other key parties know some of the following information, but some is known only to you. Read this case carefully so that you can craft an effective strategy.

## *Background*

The local probate court has appointed you as the executor of Edwin Abbott's estate. In this role, you have a legal duty to gather all of the late Mr. Abbott's property, sell it for full market value, pay any debts and taxes, and then distribute the net proceeds to his charitable beneficiary. Your professional fee is set by a standard schedule.

Abbott died recently at age 96, leaving all his property to the Windham County Public Library; he had no close relatives. He had relatively little money or personal effects, but did have title to 75 acres of land and the old farmhouse in which he lived for many years. The only other structure on the property is a small barn.

The firm that you hired to appraise the real estate reported that the land has little agricultural value. Moreover, you could not sell the entire property for more than \$600,000 as a vacation home or a hobby farm. The house itself has some rustic charm, but needs repair. The appraiser concluded that the real estate is much more valuable for new home sites. Approximately 30 house lots could be created if the land were subdivided under the existing 2-acre zoning regulation. (The remaining acres would be devoted to new access roads and the like.)

Using a figure of \$40,000 per potential lot and assessing the existing farmhouse at \$200,000, the appraiser calculated the value of the entire property to be \$1,400,000. Actually, you felt that figure might be conservative, but you welcomed it, as it gives you some flexibility in negotiating a sale. You next listed the property with a real estate broker who confirmed your own impression, and who urged you to seek \$1,695,000 for the property. "You can always lower the price later," she said, "if there aren't any inquiries." There has been some interest, in fact, but no concrete offers.

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Professor Michael Wheeler prepared this simulation as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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At this point, you have two promising prospects. The first, Barkley Homes, is a prominent residential developer from the eastern part of the state. Barkley has indicated that it is prepared to make a written offer, but wants to discuss it with you. You are pleased to do so, as that will give you a chance to try to negotiate more favorable terms, whatever Barkley's initial offer may be.

The other potential buyer is Davis Stables, a business several miles from the Abbott farm. They board and train horses, offer riding lessons, and have a growing tack shop.<sup>1</sup> They currently lease about one hundred acres from a local bank, but a big resort developer is rumored to be buying that location. You have not yet really negotiated with the Davis people, though they are aware of your asking price of \$1,695,000. They did inspect the property, however, and looked carefully at the farmhouse and barn.

Privately, you are hoping to obtain a price in excess of \$1,500,000. While you do not want to be rigid, you believe that the property is worth at least that amount, probably more.<sup>2</sup> Specifically, your appraiser did not take into account the fact that Windham Township's zoning board is considering a new "cluster regulation." If enacted, this new law would allow developers to build homes on smaller lots in return for dedicating a corresponding amount of open space to public use. Cluster development would save Barkley significant infrastructure costs (roads, sewer, and utilities) and probably enhance the market value of the new homes. Your broker believes that passage of the cluster law would increase the value of the land by about 50 percent.<sup>3</sup> Local officials have cautioned you, however, that passage of the new law is not a certainty. The odds are probably about 80/20 that the new law will be enacted.

If Barkley Homes is not aware of the cluster proposal, you should explain how it increases the potential value of the land. As an experienced development firm, they should certainly understand this. (In fact, that may explain their interest in the Abbott property.) Similarly, if Davis Stables continues to pursue a deal you can leverage the cluster proposal as possibly increasing the property's value. Do not be surprised if either party, especially Barkley Homes, tries to play down this factor. They might argue, for example, that clustering would not add much market value. Or they might claim to be pessimistic that the law will pass soon enough to do them any good. They will try to value the land according to the limited development options that are available today, instead of the more flexible alternatives that soon may be in place.

In arranging your upcoming discussion, Barkley Homes itself raised another issue, namely whether a deal might be structured to include some seller-financing. Seller-financing would mean that Barkley would pay some of the agreed price immediately and the balance in installments, with interest, over time. While such deals are not uncommon, the fact that you are representing an estate with a charitable beneficiary complicates matters.

You consulted with the trustees of the library. Somewhat to your surprise, they said that they would accept some seller-financing if it were necessary to make a deal. They stipulated that a package from Barkley Homes, Davis Stables, or any other buyer must meet the following conditions:

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<sup>1</sup> "Tack" means riding gear—saddles, hard-hats, etc.—as well as other equestrian items.

<sup>2</sup> The probate court will review the appraisal and your ultimate accounting before settling the estate and approving your fee. The court would likely criticize you if you sold the real estate for less than its apparent worth. Indeed, you would be personally liable for any deficiency if you sold the property for less than full value.

<sup>3</sup> A 50 percent increase in the value of the land would raise the value of the entire parcel to about \$2,000,000 (namely, 30 times \$60,000 for each house lot and \$200,000 for the existing homestead).

- first, at least half of the negotiated price would have to be paid in cash;
- second, the balance must be paid in ten equal annual installments with floating interest at least 1.5 points over the prime lending rate; and
- third, the purchaser would have to secure the note with a mortgage on the land.

All other things being equal, you and the trustees would still prefer to do a straight cash deal. Thus, to figure your own trade-offs, you will *treat any amount that is financed as worth 10 percent less than if it were paid immediately* (even though any purchaser would have to pay interest). In short, agreeing to seller-financing diminishes the value of the deal for you.<sup>4</sup>

You reported the library's terms to Barkley's representative, and plan to do the same for Davis Stables, should they make a similar inquiry. Barkley's representative neither accepted nor rejected the trustee's proposal but instead said, "It would be much easier to come to agreement if you could cut that interest rate and perhaps increase the term." You stated flatly that you have no authority to do so—which is, in fact, the truth. Ideally, you would like a straight cash deal. As a practical matter, if you have to provide financing, you would prefer to have as much of the purchase price paid immediately. In no event can you agree to finance more than 50% of the deal. Your overriding goal is to maximize the value of the deal that you reach.

Another complication arose yesterday. You received a call from Stephanie Abbott, a second cousin of the late Edwin Abbott, who had heard that the property might be sold to a developer. Because of her sentimental attachment to the place, she offered \$300,000 for her relative's house, the barn, along with a few adjoining acres. You are intrigued by her offer, of course, as it is much more than the \$200,000 calculated by your appraiser. But carving out the homestead obviously would diminish the overall size (and value) of the property. It would be shortsighted on your part to maximize the proceeds from the farmhouse if that reduced the total value of the real estate. You thus told Stephanie Abbott that you would keep her offer in mind but that you had to deal with other parties first.

Finally, timing of the sale is critically important. You simply cannot sign a purchase and sale agreement with either Barkley Homes or Davis Stables unless it includes a "closing date" within the next thirty days.<sup>5</sup> You want to be sure that the purchaser is firmly committed to acquiring the property. As an executor, you cannot afford to take the chance that interest rates will rise and the real estate market will soften.

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<sup>4</sup> Thus, agreeing to finance \$100,000 is equivalent accepting \$90,000 in cash today. As a result, you must refuse to provide financing if the purchase price is only \$1,500,000. Here is why: the \$750,000 down payment would be worth full value, of course, but you would regard the balance as worth somewhat less, specifically, \$675,000 (that is, 90% of \$750,000). Thus, if you agree to finance half the deal, the minimum purchase price you could accept would be \$1,578,947. (The \$789,474 in cash would be worth full value, but the installments would be worth only \$710,526—90 percent of \$789,474; when added, the down payment and installments would be equivalent to \$1,500,000 in immediate cash.) Fortunately, you do not need calculator to compare possible deals. As a useful rule of thumb, you should not agree to finance half of the purchase price unless you are able to negotiate an amount that is more than 5 percent higher than Barkley would pay in straight cash. The more money you get up front, of course, the higher the value of the deal.

<sup>5</sup> "Closing" means the formal transfer of title in exchange for the agreed payment. The thirty days should be sufficient for Barkley Homes to confirm your legal title to the property, and to make whatever financial arrangements are necessary, whether with you or some other lender.

## Your Assignment

As to the choice between selling the Abbott farm to either Barkley Homes or Davis Stables, you are truly indifferent. Indeed, by law, you must be solely concerned with maximizing the economic value of the estate. You should make a deal with whichever party ultimately makes the better offer. Likewise, you should consider selling the farmhouse to Stephanie Abbott only if it enhances the value of the entire deal. Finally, remember that timing is important. You cannot sign a purchase and sale agreement with Barkley Homes or Davis Stables unless it includes a “closing date” within the next thirty days.<sup>6</sup>

Think hard about your negotiation strategy, now that you have two potential purchasers. You should certainly talk to each of them at least once before rushing into any deal.

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