



DEEPAK MALHOTRA

Hamilton Real Estate:

Confidential Role Information for the CEO of Estate One (BUYER)

You are the CEO of Estate One, a mid-sized real estate developing company that invests primarily in residential properties. You are the premier real estate developer in the region and virtually all of your properties are developed for the construction of luxury condominiums. You have been with Estate One since its founding twenty years ago and you have a reputation for finding and maximizing value in the deals that you negotiate. You hope that you live up to this reputation in your upcoming negotiation with the Executive Vice President of Pearl Investments.

Pearl Investments recently announced its decision to sell a large piece of property in the town of Hamilton. Hamilton is a mid-sized town at the outskirts of a large metropolitan area. Estate One is interested in purchasing this property and you have contacted the Executive VP at Pearl Investments to make your intentions known. Pearl Investments seems genuinely interested in speaking with you, but they have made it clear that the negotiation needs to take place immediately. If no agreement is reached in your negotiations this week, they will take their business elsewhere. You can only presume that this means they have another offer with a strict deadline, but then again, they might simply be posturing.

Even if Pearl Investments does have other offers, you have no way of knowing what those offers might be. How much a potential buyer will pay for the Hamilton property depends on a number of factors, including the buyer's ability to pay, their degree of desperation, and the planned use for the property. Each of these factors is critical. For example, your experts have estimated that if the land were developed for commercial use (e.g., a set of office buildings), the land might be worth 1.5 to 2 times as much as if it were developed for residential use (e.g., apartment buildings).

While property value would be maximized if the land were developed for commercial use, there is probably no interest for the property among commercial developers. The reason is that the zoning laws in Hamilton do not allow for commercial development of the property. While there has been some talk among local politicians of allowing commercial development in Hamilton over the last few years, no action has been taken. As a result, Hamilton has fallen off the radar for commercial developers. You expect that if Pearl Investments has any offer at all, it will be from someone interested in developing the land for residential use.

While Estate One deals almost exclusively with residential properties, your plans for the Hamilton property are not for residential construction. Instead, you see this purchase as an ideal opportunity

Professor Deepak Malhotra prepared this exercise as the basis for class discussion.

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to make inroads into the commercial real estate industry. There are a number of reasons for this. First, and most importantly, you have strong and extensive political ties in the local government of Hamilton and you have been carefully monitoring the public discourse related to proposed changes in zoning laws. As a result you are probably among the first to know that rezoning to allow commercial development in Hamilton is only months away from becoming a reality. Second, you believe that the opportunity to enter the commercial real estate industry cheaply (no other commercial builder is likely to be bidding for the Hamilton property) is too good to pass up. Finally, while you have dabbled in commercial real estate before, your prior investments in this industry have been smaller and have had more conservative risk profiles. Hamilton will allow you to make a grand entrance in the market. In short, you are seeking to purchase the Hamilton property for commercial development, and you are absolutely certain that zoning laws will change to allow this to happen.

Over the last few weeks your team has worked to assess exactly how much the property is worth to you if you put it to commercial use. Your analysts have calculated that the value of the property for commercial use can vary widely. Estate One may find itself on the lower end of this range due to lack of expertise in commercial development. On the other hand, Estate One is the premier developer in the region and has long-standing relationships with local contractors. This translates into significant cost savings. Taking into account the various factors particular to Estate One, your analysts have calculated that the property is worth \$66 million in the hands of Estate One if you put the land to commercial use. In other words, if you are able to purchase the land for less than \$66 million, you will make a profit on the purchase. If you pay \$66 million, you will break even.

If you are unable to negotiate the purchase of the Hamilton property, you will take the funds set aside for this project and invest them in a residential real estate venture where you expect to make \$6 million in profit.

Pearl Investments wants to try and negotiate an agreement as soon as possible. Fortunately, you are fully prepared to begin discussions immediately. Indeed, you were probably late in approaching Pearl Investments because you were waiting to get a firm answer regarding rezoning to allow commercial development, and because your analysts needed the extra time to work through the intricacies of appraising the property for commercial use. Fortunately, the property was still available. In your discussion with Pearl Investments, you were careful to sound confident and enthusiastic about your interest in the real estate, but you did not talk specifics regarding your analysis, your appraisal, or your plans.

Here is what you know about Pearl Investments: Pearl Investments is a holding company that specializes in real estate investments. They have recently started to divest land and property in a number of regions. The property in Hamilton may be among the largest pieces of property they are in the process of selling. The Executive Vice President of Pearl Investments will be negotiating the sale of the property. Pearl Investments is not a competitor of yours.

You will be meeting with the Executive VP shortly. If you are ever going to purchase the Hamilton property, it will have to be now. To prepare for the negotiation, you have collected as much information and data as possible. The following information is public knowledge, and you are sure that the Executive VP of Pearl Investments also has this information.

Pearl Investments purchased the Hamilton property seven years ago at a price of \$27 million.

Since the purchase, land value in the town of Hamilton has increased substantially. An evaluation of the sale prices of 4 somewhat comparable properties that have been recently sold in the area suggests that the Hamilton property could be worth between \$36 million and \$44 million. This assumes that the land is developed for residential use.

If the land is used for the construction of luxury condominiums instead of apartment buildings, it is probably worth an additional 20%.

Your goal in this negotiation is to get the best price possible for Estate One. The only issue that you are to negotiate is price.