



BOXALL BATTLES

PHASE 4 – SECOND LAWYER-CLIENT MEETING

Information for Keith Nelson

You have confirmed that your sister and your mother have retained attorneys to represent them against you. That could be good: maybe their lawyers will talk sense into them.

Your lawyer requested that you and the BoxAll CFO put together a package of BoxAll financial statements from the last ten years. He explained that, while it might seem ridiculous, your sister and mother are legally entitled to see these documents. You weren't happy about it but complied promptly, sending your lawyer the last ten years of BoxAll financial statements. These show BoxAll revenues and expenses, including executive salaries and any loans extended to BoxAll, as well as interest paid on loans. You assume they are reviewing the documents with an accountant.

After sending them, you had a Zoom call with your lawyer to discuss any questions about the financials, and what the lawyer was authorized to communicate to the other side.

You assume they will complain about your \$3 million loan to BoxAll five years ago, from your own funds, with interest at 8%. Since then, BoxAll has paid you interest and principal of approximately \$300,000 per year. (\$240,000 was all interest the first year, and then the company started paying down the principal too.)

You explained why this loan should not have been a surprise and its benefit to BoxAll. As Dianne and her lawyer will surely point out, at the time the loan was made, banks were advertising commercially interest rates were in the 4-5% range. It was a teaser. You don't what business could have gotten a loan at those rates – maybe Procter & Gamble. BoxAll was no P&G. The company's overall financials weren't great at the time; that's why the company needed a loan. BoxAll's banker said they wouldn't lend at a rate lower than 10% without personal guarantees and mortgages on the homes of BoxAll shareholders. You remember explaining this at the annual dinner meeting. Neither Dianne nor your mother were willing to provide personal guarantees or mortgages. So, you decided to loan the company \$3 million from your own money at an interest rate lower than the bank had quoted.

It's petty for them to complain about an 8% vs. 5% rate paid to you, given the rate of return in BoxAll value it enabled. With that \$3 million loan, BoxAll made phenomenally successful investments that have already created value many times over. This wouldn't have been possible if you hadn't taken the loan risk with your personal funds.

Regarding the 4% BoxAll allocation, you adamantly explained (and want you lawyer to tell them) that you weren't trying to cheat Dianne by asking their mother to allocate 3% of BoxAll to him and 1% to Dianne. You explicitly told your mother that any difference in monetary value should be made up with other assets – property or cash reserves. You were worried that a 50/50 split would mean unresolvable future conflict. That would only diminish BoxAll's value and thus harm everyone's financial interests. Your mother seemed to understand and agreed that conflict would continue to tear the family apart. Based on what's happening, you now assume your mother didn't really understand or, more likely, she forgot and never conveyed it to Dianne. You remain committed to carrying out your father' intent that you and your sister share equally in the financial value of BoxAll and the other holdings.

You asked your lawyer to communicate all of this to Dianne and your mother through their lawyers. Once they understand it, perhaps they will be open to negotiating a resolution.

On the topic of litigation ugliness. While you will listen to your lawyer's explanation of theoretical legal claims your sister and mother might file, you aren't worried about that. You did absolutely nothing wrong. You expect the lawyer will provide an estimate of legal fees (or any other fees), but that's not your main concern. You can afford whatever the fees will be. But you know litigation is a pointless waste of money that could be put to better use.

More important and more costly is the litigation's potential impact on BoxAll's valuation for future buyers. You are in your 60's and would like to retire sooner rather than later. Litigation – any fight over decision-making control – could scare away buyers. Or buyers might demand a sharp reduction in the valuation multiplier – reducing BoxAll's value by as much as 20%, or more. That's just a rough guess. BoxAll is worth a good deal of money now, with \$10 million in net profits in recent years. BoxAll's new patents and large long-term contracts suggest profits will only go up. So, if your sister and mother insist on litigating, they will be hurting their own financial interests as much as yours. They should see that!

Dealing with the Property

As you explained to your lawyer at the outset, your father's commercial real estate property is held by the Nelson Family Trust. You are the Trust's Successor (after your father) and Managing Trustee. Each Trust property is professionally managed, with annual income going back into the Trust.

The Trust provides that your mother is its primary beneficiary as long as she lives. Upon her death, the properties are to be divided equally between you and Dianne (as contingent beneficiaries). At that point, you and Diane are free to agree on allocation of properties and transfer titles accordingly. The Trust provides that if you and Diane cannot agree within a year after your mother's passing, then unallocated properties will be sold, and proceeds divided equally.

In the meantime, you oversee the management contracts for each property and authorize significant maintenance expenditures, etc. The management companies retained are known to be highly professional. You have been scrupulous about this oversight role. Ever since your father's death, you've made sure that Dianne and your mother are copied on emails attaching financial statements.

Given that your mother is physically healthy, resolving the property allocation isn't urgent. On the other hand, the current conflict with Dianne and your mother makes it wise to settle any future property questions now. You are ready and willing to deal, and to have the properties appraised. The cost of appraisals should be paid out of the Trust (which has plenty of cash in reserve).

If, in the end, all the properties were sold and the proceeds divided, that would be okay. However, if you could, you would like to have title to some of the properties, for sentimental and tax reasons.

You will provide some or all the following information to your lawyer, if and only if Dianne and your mother are agreeable to negotiating the eventual property allocation now.

Shortly after your father's death, you had a real estate agency do quick appraisals of the properties' values for tax and estate purposes. Your sister and mother should already have copies of this valuation schedule (without your comments or stated preferences). If not, you would provide it, through the lawyers.

Fresh appraisals would be appropriate. The properties' current dollar values are higher than five years ago, as commercial property values have increased since then. Still, if their relative values are about the same, the earlier appraisals can serve as the basis for negotiation about allocation.

Leaving aside the appraisals, you have somewhat different analysis and preferences among the various properties. In other words, you would "pay" more or less than the stated value – or at least count them as more or less valuable in negotiating about allocation between you and Dianne. The appraiser's valuations of each property are listed below, along with your comments about how the way *you* subjectively value each of them.

1) Compass Road Nelson Car Wash - \$3 million (land & equipment with profit multiplier)

This car wash has high and steady customer volume. It benefits from a location close to local playing fields, a nature center, a church, a gas station, and an ice rink. You suspect the former appraisal of \$3 million is still about right.

You have no sentimental attachment to this car wash, and no other reason to give it more value than \$3 million in a negotiation with your sister.

2) Dexter Road Nelson Car Wash - \$2 million (land & equipment with profit multiplier)

The Dexter Road car wash is not highly profitable. Its \$2 million dollar valuation is due to its location on a large lot, with good highway access. In fact, you value this property at far more than \$2 million. You believe it will be worth as much as \$5 million because it's quite close to BoxAll and to the airport. If you owned the property, you might develop it as a warehouse or supplementary production facility, and later sell or lease it to a new BoxAll owner or to another business that would value proximity to the airport.

3) Exeter Street Strip Mall - \$3 million (land and buildings with profit multiplier)

While you don't view the earlier appraisal as obviously wrong, you see this property as difficult to value because of its location. It's relatively close to the city center, but no one knows if that area of the city will generate more commercial activity in the near future. It's hard to say whether the volume of foot traffic or car traffic will go up or down, or whether the city's public transit routes will reach that area. The tenants are all on long term leases, but they are all small businesses, not national chains. So, if their businesses don't remain profitable, they won't be able to pay the rent. Bottom line: \$3 million might be right. But that's not a firm estimate. It could be worth anywhere from \$2-4 million.

4) Fairview Street Strip Mall - \$5 million (land and buildings with profit multiplier)



What was the appraiser was thinking when he put a \$5 million dollar price tag on this strip mall? It's not worth nearly that much. Perhaps the high valuation was prompted by its location across the road from a very large regional mall/shopping center, and the numerous eateries by the property. Unfortunately, since your father's passing, the larger regional mall has gone into receivership. It is all but shuttered; the anchor stores have closed. On this property's side of the road, the eateries have either closed or converted to drive-throughs.

The management company has been struggling to collect rents, and three of the six business tenants have indicated they don't plan to renew their leases over the next few years. You are quite certain that an updated appraisal (or a conversation with the property management company) would confirm it has probably lost at least half of its value. To reap real profits, you would need a refocused business plan and, no doubt, substantial investment in the property. Frankly, the location is pretty far from where you live. You have no interest in spending time or effort thinking about a new business plan or overseeing a further investment there. Given all this, you value this property at no more than what you guess you could sell it for on today's open market -- \$1-2 million.

5) Garnet Apartment Building - \$6 million (land and buildings with profit multiplier)

You think this valuation is about right. While the Garnet is a grand old building, it's not in the new "hotter" areas of town. The Garnet apartments have benefitted from unit-by-unit renovation and cosmetic work over the past ten years. With your approval, the management company oversaw this work between leases, enabling it to command at top dollar rent for the area. The tenant demographics trend toward empty nesters so there's not much turnover.

You have no attachment to this property. It's not far from your residence, making it easy to stop by to check that common spaces are clean and well maintained. You doubt a new appraisal would be appreciably different from the earlier one – about \$6 million.

6) Hoover Apartment Building - \$5 million (land and buildings with profit multiplier)

The Hoover Apartment building has been assessed at a lower value because its per unit rental averages are lower. Each unit is reasonably large, but finishings and appliances are low-cost and outdated. Many units' layouts are inefficient and awkward. With some renovation and investment, much higher rents could be charged. Or the building could easily be turned into condominiums without

bumping into local legal restrictions. For that reason, you would value it at closer to \$8 million.

7) Ibid Apartment Building- \$8 million (land and buildings with profit multiplier)

Bottom line: you want this building to stay on your side of the ledger. Based on standard property valuation methods, the \$8 million appraised value is about right. Even if it's not an architectural wonder, it's a prominent building in the area. The tenants are a mix of empty nesters, young professionals, and a good many medical students, residents, or researchers. While turnover is higher than optimal, at least the medical folks stay for several years. (And there's always a doctor in the house.)

You see only an upside for this property because of its phenomenal location. It would be attractive as a senior assisted living facility because of its proximity to area hospitals. At some point, the university or one of the hospitals might seek to buy it (at top dollar) for use as medical offices or expanded research or treatment facilities. If that happens, the value will go up. You want to hold this one, and you would count it (internally) at significantly more than \$8 million.

In addition to the real estate, the Nelson Family Trust now has about \$4 million in cash reserves. That is likely to increase between now and when your mother passes away. There should be no dispute about dividing it in half or using it to offset imbalance in the value of the properties as agreed upon between you and your sister. (Note that, for each property, the management companies maintain modest cash reserves to cover normal operational expenses, repair, and maintenance. However, the Trust would have to fund any sizeable investments for significant repurposing or construction. These would be subject to your approval as Successor Trustee.)

As you will explain to your lawyer, you are open to negotiating with Dianne (through her lawyer) about the future allocation of these properties. You both know that, upon your mother's death, the Trust gives you both equal rights to the properties. Absent agreement on how to divide them, they are to be sold and the proceeds split evenly.

You don't have to do this now. You can wait. But given that you and your sister are entangled in the conflict over BoxAll, you would like to suggest getting it over and done with. Then you'd never have to fight again. What a relief!