

**SEPTEMBER**

**2007**

**KEVIN F. JURSKINSKI, ESQ.**  
**COMMERCIAL LEASE NEWSLETTERS**

**Part II: Options to Purchase and First Right of Refusals in a Lease.**

This is the second part of a discussion on options contained in commercial leases. This second part addresses First Right of Refusal and Option to Purchase.

**I. Options to Purchase or First Right of Refusal.**

Occasionally, the Landlord and Tenant, as part of the lease negotiations, agree to an Option to Purchase or First Right of Refusal as to the lease premises. There is a distinction between these two commercial rights.

An Option to Purchase sets an Option Price at a specific sum certain which would allow the Tenant to buy the subject real property on an agreed upon price with specific terms and conditions or alternatively, on an Option Price with a verifiable method to establish a value. (An appraised value by a MAI Appraiser or a blended value of two appraisers, one selected by the Landlord or the Tenant or a verifiable procedure or formula which could be enforced by a Trier of Fact). The preference however, would be to have a specific sum certain purchase price for an Option to Purchase together with all material terms and conditions of the purchase price, inclusive of the manner and method of exercising the option, the date of closing and the specific procedure to be utilized in allocation of closing expenses and alike, between the Landlord as seller and Tenant as buyer.

**II. Options to Purchase-Method to Exercise.**

The Option to Purchase should be drafted in clear, unambiguous terms providing for all essential terms of the purchase. The Option to Purchase should also contain a specific method for the Tenant to exercise the Option in writing with such Option Notice identifying these essential terms of the Purchase.

### **III. First Right of Refusal.**

Although similar to an Option to Purchase the First Right of Refusal essentially allows the Tenant the Contractual Right to purchase the property under the same terms and conditions under which the Landlord would be selling the property to a third party purchaser based upon a bona fide written proposal from the Landlord.

The distinction between an Option to Purchase and a First Right of Refusal is that in the latter, the Tenant can not force or elect the purchase of the property, as could the Tenant with a specific identifiable Option to Purchase. In a First Right of Refusal a Tenant gets the opportunity to purchase the property in the event that the Landlord receives a legitimate prospective contract from a bona fide purchaser.

### **IV. Pros and Cons of a First Right of Refusal-Landlord**

The First Right of Refusal is a two edged sword for both the Landlord and Tenant. As far as the Landlord is concerned it does encourage the prospective Tenant to purchase the property, but may also negatively impact the Landlord's ability to negotiate a lease. Generally, in a commercial lease deals, certain prospective purchasers might shy away from negotiating if they know that their very best deal that they negotiated, could be subject to a review and acceptance by the Tenant who could negate the prospective purchaser's efforts in negotiations and purchase the property to the Tenant's benefit. This affectively allows the Tenant to step into the shoes of the prospective buyer, who may have negotiated an outstanding purchase price for the subject property only to see the Tenant reap the benefits.

In addition, a First Right of Refusal often ends up chilling prospective purchasers interested in buying the property which may correspondingly make it harder for the Landlord to have a specific and set format to dispose of the property based upon the fact that any prospective contract is contingent upon the Tenant's waiver and relinquishment of its rights.

### **V. First Right of Refusal Pros and Cons for Tenant.**

The First Right of Refusal, as above indicated, has positive and negative implications for the Landlord. The First Right of Refusal has some positive and negative implications for the Tenant. The Tenant must be wary of the time periods and the manner and method to exercise the First Right of Refusal.

Often times the Tenant is induced into entering into a lease agreement with the understanding that the Tenant would have the right to purchase the subject property since the Tenant may be making substantial and significant improvements to the property based upon the Tenants belief that they would have the First Right of Refusal to buy the property.

If the First Right of Refusal is written so that the Tenant is required to exercise the First Right of Refusal with minimal notification, or on terms and conditions which might not be able to be met by the Tenant, the Tenant can end up relying upon a First Right of Refusal and making leasehold expenditures with no real bona fide right to purchase the property.

An example of this is in the event that the First Right of Refusal requires the Tenant to waive their rights to purchase the property without an adequate amount of notice. By way of example of a less than desirable First Right of Refusal for a Tenant, which could prejudice a Tenant, is the following:

**“Landlord and Tenant acknowledge and agree that in the event that Landlord receives a bona fide written contract for sale and purchase for the real property that Landlord will provide Tenant with written notice of such written offer to purchase. Upon receipt of such notice, Tenant shall have seven (7) days from the receipt of such notice (exclusive of the date of notice) to advise Landlord that Tenant will exercise Tenant’s First Right of Refusal to acquire the subject property under the same terms and conditions of the proposed offer for sale and purchase.”**

In such circumstances a Tenant might be faced with having to close on an all cash purchase on short notice which under certain circumstances might prevent the Tenant from exercising the Right, even though with adequate time to close, the Tenant might have chosen to accept the offer.

By way of example; if the purchase price was \$1,000,000.00 with a cash closing the Tenant nonetheless, might be able to obtain financing and still pay “cash” at closing if the Tenant had enough time to arrange for the closing. However, without adequate time to exercise its rights it might be unable to do so under such circumstances as above set forth and be forced to waive and relinquish any First Right of Refusal and possibly walk away from substantial and significant lease hold improvements.

An appropriately drafted First Right of Refusal for the Tenant should allow adequate time for exercising the Option on First Right of Refusal. In addition, a properly drafted First Right of Refusal should also provide that the Landlord is required to provide the Tenant with a renewed opportunity to exercise the First Right of Refusal if there was a material change in the third party offer after the Tenant failed on election to waive its exercise of the First Right of Refusal on the original contract terms.

In summary, the fundamental concept of accurate contractual language needs to be applied to Options to Renew, Options to Purchase and First Right of Refusals contained in Commercial Leases.