

A person in a dark suit is handing a set of keys to another person whose hand is visible on the right. The scene is set on a desk with various office supplies: a clipboard with papers, a calculator, paper clips, and colorful sticky notes. The background is softly blurred, showing a window with greenery outside.

# Understanding Your Options: *Three Types of Tenant Option to Purchase That May Be Included in Commercial Leases*

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# **UNDERSTANDING YOUR OPTIONS: THREE TYPES OF TENANT OPTION TO PURCHASE THAT MAY BE INCLUDED IN COMMERCIAL LEASES**

*Written by Caroline R. Nichols, Esq. – 5/23/18*

Many landlords are reluctant to grant tenant option to purchase in a lease agreement. That's because the options may disincentivize other potential buyers or cause delays in the landlord's negotiation of a sale. Still, landlords may grant options to purchase to attract large, creditworthy tenants, particularly if they are the property's sole occupant. Tenants can protect their right to continue to use and occupy leased property if their landlord seeks to sell it by:

- Seeking to negotiate a provision that any sale must be subject to the tenant's lease; or
- Seeking to negotiate an option to purchase the property from the landlord.

## *Landlord Considerations*

Before granting any type of option, your landlord must determine whether consent of any third parties is required. These may include their lender or any of the other tenants. If your landlord has the authority to grant the option, they should negotiate the following key points with you:

- the type of option;
- the time period in which you may exercise the option;
- whether any conditions must be satisfied in order for you to exercise the option;



- the mechanism for determining the purchase price if you exercise the option;
- the timing of the closing if you exercise the option; and
- dispute resolution procedures in the event a dispute arises out of you exercising the option.

### *Tenant Options*

Tenant options to purchase are typically structured as:

1. a unilateral option to purchase that you may exercise at your discretion;
2. a right of first offer option that you may exercise if your landlord decides to sell the property; or
3. a right of first refusal option that provides you with the right to purchase the property on terms that your landlord has negotiated with a third party.

### *Option 1: Unilateral Option To Purchase*

This option is almost exclusively for your benefit as the tenant. It provides the right to purchase the property at a pre-determined price at any time during the option period. And that is regardless of whether your landlord is interested in selling the property.

So to protect against changing market conditions, landlords that grant unilateral options typically seek to set the option price above current market prices. They also insist on a short window in which the tenant can exercise the option. Tenants may exercise right of first offer options, and right of first refusal options, only if a landlord decides to sell the property on the market.

### *Option 2: Right Of First Offer Option To Purchase*

Requires your landlord to notify you of the intent to sell the property. After that, they must negotiate in good faith to sell the property to you before offering the property for sale to third parties.

### *Option 3: Right Of First Refusal Option To Purchase*

Requires your landlord to present to you the material terms of any agreement to sell the property that they have negotiated with a third-party.

The second and third options better protect the landlord from a forced sale, and give them the benefit of increasing property values. However, third parties frequently are reluctant to invest time and resources in negotiating a purchase if a tenant has a right first refusal in a lease agreement. That is because the option can deprive the third party of the benefit of their bargain.

Your landlord may grant you any of these types of options in the lease agreement, or it may be a separate option agreement. You may negotiate the right to record a Memorandum of Option in the public records. This puts the public on notice of the tenant's option rights.

Ultimately, in negotiating any type of option, you and your landlord should consider the long term goals for the property. That includes the type of events that should trigger your option rights as tenant.

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