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Looking at Leases: Part 3
Right of First Refusal

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Generally only of the length of the lease is considered when thinking about the land security that leases ensure. While some leases may have longer terms than others, this is still a relatively short-term solution to landbase security. With the right planning, however, a lease can be a tool that provides your operation the opportunity to secure its landbase for generations to come.

Zachary Benjamin, a partner at Costello, Cooney & Fearon PLLC, has extensive experience in business and estate planning for agricultural business. "Rights of first refusal and purchase options are vital components of agricultural lease agreements," Benjamin says. "With an ever-shrinking available landbase, having assurances that you are able to protect your interests in land utilized in your operation is vital. These rights also ensure that the tenant does not unexpectedly lose its interest in land due to an unexpected offer by a third-party."

Julie Richardson, an attorney with Van Erden Richardson, PLLC, explains:

> "A right of first refusal and a first option to purchase are two different mechanisms. The right of first refusal requires that the land owner, or landlord, provide the tenant with notice of any purchase offer received from a third-party. The tenant must then match the terms of the third-party offer and may then purchase the property. Generally, when the right of first refusal language is included in the lease agreement, terms are included giving the tenant a certain amount of time to respond to the landlord upon receiving notice of a third-party offer. This is often 15 days and sometimes as much as 30 days. The right of first refusal rarely includes more specific information since the tenant is simply matching terms of an outside purchase offer and the terms of that third-party offer become the terms of the purchase.
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> In contrast, a first option to purchase puts the control in the tenant's hands and enables the tenant to decide when he would like to purchase the land. The first option to purchase language in a lease includes more details on the purchase than the right of first refusal because in this case, the tenant is not matching an offer from a third-party, but purchasing the property on their own terms. Therefore, the option to purchase in the lease agreement includes terms such as purchase price, payment terms, closing documents to be provided by seller/purchaser and closing timeframe. The option language in the lease may also have a specific timeframe within which it can be exercised, i.e. not before five years from the commencement date of the lease or must be prior to 10 years from the commencement date of the lease. Determining purchase

price is, of course, done differently in each transaction. However, in many instances, the parties look to similar sales in the area or appraised value. Because a first option to purchase takes the control away from the landlord, it is not as commonly seen in leases as landowners are not as comfortable with this.

Inclusion of either the right of first refusal or the first option to purchase as a term of a lease agreement is always beneficial to the tenant because it allows the opportunity to purchase the land, but does not require a purchase if the tenant is unable to do so at a certain point in time. This provides some security to the tenant that the land may be available to purchase in the future, if the terms are met.

This becomes increasingly important upon a death of the landlord where the tenant finds himself suddenly working with several family members that may not understand agriculture nor feel the same way the original landlord did. It is not uncommon to see a death of a landowner and shortly thereafter a sale to a third-party purchaser, instead of the tenant working the land. It is difficult to say why the family members of the deceased person would do this, but including the right of first refusal or first option to purchase in a lease agreement may prevent this from happening.

It is not uncommon for a farm to have a lease agreement even when the landowner is a member of the operating entity. Even in this case, it is beneficial to include a right of first refusal or first option to purchase in that lease agreement. This helps to secure the land for the operating entity if there is a future issue between the member-landowner and the operating entity or other members. Similarly, this protects the operating entity if the member-landowner passes away leaving family members to handle this land, as addressed above."

Lease agreements, and all of the options that can be built into them, are an integral part of securing the use of vital assets to your business's operation. Making it a priority today to work with an attorney to get well-written leases in place with both internal and external landlords has tremendous payoff potential for the future success of your farming operation.