

## Q&A

### COMMERCIAL REAL ESTATE Question of the Month

## Rights of First Refusal

**Q:** *We are negotiating a commercial lease with a prospective landlord and have asked for a right of first refusal to purchase the building. He declined, but offered us a right of first offering instead. What exactly is the difference?*

**A:** A right of first refusal is a contractual right, giving you the option to purchase the building before it can be sold to a third party. An option is the right to exercise something, but not the obligation to do so. In your case, you have asked for the right to purchase the building that you lease in the event that the landlord is prepared to sell it to someone else, but you are not obligated to do so. Most often, this right can be exercised at the same price that the third party was prepared to pay. A right of first refusal is often a reasonable request, particularly if you are making a substantial investment in building improvements.

Your prospective landlord is offering you something completely different with a right of first offering. What he is offering is basically the right to negotiate. When and if he decides to sell, he is agreeing to offer it to you first. Thereafter, he may come to an agreement with you, or simply come to an agreement with someone else after he has offered it to you. I won't say that a right of first offering is meaningless, but you will truly have little recourse if you are offered the building and then are out-negotiated by a third party.

In the real world, many landlords

would naturally talk to their tenant as a potential purchaser before anyone else, so that a first right of offering is merely a statement of the obvious. The tenant knows the value or condition of the property, and may have invested large amounts of money in improvements, so from the landlord's point of view, the tenant should be willing to pay the highest price. The landlord may also be able to avoid marketing costs and a brokerage fee by working directly with his tenant.

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Why might a landlord not want to grant a right of first refusal? After all, if he is going to sell the building anyway, why not to you, the tenant? One reason might be that the landlord is contemplating something other than an "arm's length" transaction. As an example, he might wish to eventually

transfer the title within the family for estate purposes. Another reason is that it is very difficult to market a property for sale that is encumbered with a right of first refusal. Neither potential buyers nor their brokers really want to spend the time negotiating on a property that can be swept away at the last minute by an existing tenant after the negotiations have been completed. In addition, the broker may have a claim for a brokerage if he has produced a buyer, "ready, willing and able" to purchase the property, whether his potential buyer closed on the property or not.

So what does this mean in your present situation? It means you have to look closely at how important it is that you eventually own the property. A normal transfer of property title does not void your lease rights, so one solution is to ask for a lease term plus options to renew that satisfactorily allow you to amortize your start-up costs and protect your interests. If property ownership is critical, you will have to stand your ground in lease negotiations for a right of first refusal, or even better, an option to purchase at a pre-determined price. If the landlord is adamant, you must be prepared to move on to another alternative. A right of first offering is not a satisfactory substitute.



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