Right of First Offer and Right of First Refusal

A landowner may not be ready to sell their property but may be willing—if and when they are ready to sell—to provide an organization with the opportunity to purchase the property before it is sold to another. The opportunity more specifically may be for the organization to accept or make an offer on the property before it is placed on the market, to negotiate with the owner before it is exposed to the market, or to match the offer of a third-party buyer after the property has been on the market. To legally commit to providing one or more of these opportunities, the owner grants the organization a right of first offer or right of first refusal.

Creating Opportunity

Organizations often encounter situations where they want to purchase a particular property but the owners have no interest in selling. Some owners may never want to sell or want to leave such matters to their heirs. Owners may tell an organization that they will be sure to contact the organization if they ever consider selling, but experience suggests that such assurances should not inspire confidence: when owners eventually come around to selling, they may have forgotten conversations of years passed or think it not worth the trouble of reaching out to what they perceive as a cash-strapped organization.

A grant by the owners to the organization of a right of first offer or right of first refusal to purchase the property can provide the organization certainty that it will have some opportunity to vie for the property if and when the owners (or their heirs) contemplate a sale.

A **right of first offer** requires the owners to offer the property, on terms of their choosing, to the person who holds the right (called the "holder" or "grantee") *before* offering the property to others. Alternatively, a right of first offer can be structured to have the holder, upon notice from the owners that they are interested in selling, make the first offer. A **right of first negotiation**, which does not stand alone but which may be appended to a right of first offer, goes one step further and requires the owners to negotiate with the holder in good faith for some period of time. A **right of first refusal** allows the holder the right, *after* offers are solicited from others, to match any offer that the owners are willing to accept. These rights are often combined so that the holder has the first opportunity to act on owners' interest in selling and the assurance that, if the owners' initial expectations regarding the property's value are unrealistic (that is, before the property is placed on the market), there is still the opportunity to match a price offered by a third-party buyer after the property has been exposed to the market.

Both a right of first offer (with or without negotiation) and a right of first refusal provide to an organization the guarantee of an opportunity to purchase a property. The discussions that lead to owners granting a right of first offer or right of first refusal may also provide a second benefit—serving to break the ice with an owner; this may be a first step toward building a relationship that eventually leads to more concrete and creative arrangements for the conservation of the property.

Model Documents

WeConservePA has published at the WeConservePA.org library a number of guides and model documents (accompanied by expansive commentaries) to help organizations obtain commitments from owners regarding the potential future sale of their property interests. Publications include:

- The *Model Grant of Purchase Option* is used to establish the right of an organization to purchase property for a fixed or ascertainable price at a fixed time. The guide *Purchase Options* discusses a number of circumstances in which a purchase option can be a useful tool for organizations, whether the subject is a land or conservation easement acquisition.
- The *Model Grant of Right of First Offer* provides a tool for establishing both a right of first offer and a right of first negotiation for the benefit of an organization.
- The *Model Grant of Right of First Refusal* provides a tool for establishing a right of a first refusal for the benefit of an organization.

Comparison of Tools

Organizations interested in acquiring land from owners not presently interested in selling can respond to owners' concerns more readily and with greater versatility if they are familiar with the real estate tools suited for this circumstance.

Example. The organization has identified, as a top conservation priority, acquisition of a tract owned by a conservation-minded family. The goal of the organization is to add the land to its adjacent preserve. The owners are good stewards of the land but have no interest in selling at present; nor are they likely to want to sell while they are healthy and still enjoying the land, deferring such matters involving mortality to the future, most likely to their estate and heirs.

Strategies. If acquisition is not a possibility, at least in the short term, what other strategies may be advanced by the land trust?

- **Conservation easement.** A conservation easement protecting the land's natural and scenic resources is a worthwhile step but does not achieve the ultimate goal of incorporating the land into the preserve.
- **Purchase option.** A purchase option granted to the organization may be a possibility. As discussed in the guide *Purchase Options*, the purchase option is triggered at a specific time (in this case a remote date such as that of the death of the owners) and at a specific, or ascertainable, price (in this case, fair value established by a future appraisal because the time for exercise of the option is likely far in the future).
- **Right of first offer.** If the owners do not want to commit to a purchase price established by an unknown appraiser, the right of first offer may provide the organization some protection against a hasty sale to a third party without its knowledge. In this example, the holder's exercise of their right of first offer will be triggered under the same circumstances as the purchase option. The difference is in how the purchase price is determined: appraisal for the purchase option versus the owners' discretion at the future date for the right of first offer. The right of first offer is discussed in this guide and in the commentary to the *Model Grant of Right of First Offer*.
- **Right of first refusal.** The right of first refusal is triggered just before the property is to be sold to a third party. The purchase price is firm (the same price offered by the third party) but the right to purchase must be exercised quickly by the organization without any time for negotiation. The right of first refusal is discussed in this guide and in the commentary to the *Model Grant of Right of First Refusal*.

Right of First Offer

Owners are often willing to accommodate a right of first offer because the detriment to them is minimal. All they have to do is notify the holder, before they list the property for sale, of the terms they are willing to accept. The offered terms do not have to be reasonable or comparable to market. The right of first offer alone (without the addition of a right of first negotiation, described below) is a "take it or leave it" proposition—there is no obligation on the part of the owners to consider a counterproposal. If the offer is not accepted within the agreed upon response time, then the owners can move forward with their marketing plan without any further need to deal with the holder.

Alternatively, the right of first offer can be structured to have the holder, upon notice from the owners that the owners are interested in selling, make the first offer. This configuration likewise places minimal burden on the owners. Owners are under no obligation to accept the holder's offer; their only inconvenience is having to provide notice to the holder and wait the specified period of time for holder to make an offer before placing the property on the market.

The principal advantage to an organization of holding a right of first offer is that the organization will be alerted when the property will soon be available for purchase. The owners may not offer or be willing to accept a reasonable offer without first experiencing how potential buyers respond to a listing of the property on the real estate market. Even so, the organization has the opportunity, before the property is marketed, to build a relationship with the owners. The organization can educate the owners on conservation strategies that may benefit them or be of interest to them, whether or not the organization is in a position to purchase. Additionally, the organization can prepare for making a better-informed offer that the owners may take more seriously after the property has been exposed to the reality of the market.

Example. The owners want to leave all of their options open should they ever want, or need, to sell their property. On the other hand, their preferred purchaser, all else being equal, is the organization and they have told the organization they have every intention of giving them an opportunity to buy before listing the property.

Right of First Negotiation

A right of first negotiation is not a stand-alone right but an add-on to the right of first offer. The purpose is to provide time after an initial offer is rejected for counterproposals to be made and, if possible, for the holder to reach agreement with the owners before others can make competing offers.

The grant of first offer will establish the amount of time allowed for negotiation. A reasonable period for negotiation may be 30 days and often up to 90. The *Model Grant of Right of First Offer* provides that both parties will negotiate in good faith during the negotiation period. If the owners and the holder do not come to terms within the negotiation period, there is no further obligation on the part of the owners (unless the holder also holds a right of first refusal).

Example. The owners' offered sales price is, in the opinion of the organization, well above its market value. A right of first negotiation appended to the right of first offer allows the organization time to organize a responsible and responsive counteroffer based on market information and an analysis of physical and legal constraints on the property's developability.

Right of First Refusal

A right of first refusal is triggered only after the owners have successfully marketed the property. The owners must hold off accepting a satisfactory offer received from a third party during the acceptance period specified in the grant of right of first refusal so that the holder can decide whether to match it. The owners will want this acceptance period to be considerably shorter than the time period for a response to a first offer because, unlike the first offer, the first refusal creates a risk that a third-party buyer will withdraw a satisfactory offer if the owners can't respond promptly. A prospective buyer typically gives the seller only a few days to accept an offer. If the right of first refusal's acceptance period is longer than the decision period allowed to the owner by the third-party buyer, the owner risks losing a satisfactory sale due to the holder not matching the third party's offer and the third-party buyer choosing not to extend their offer.

The grant of a first refusal may be attractive to those owners who, all other considerations being equal, would prefer a sale to the organization soliciting the right of first refusal.

Example. An elderly owner prefers his land to be acquired by the organization upon his death but without any detriment to the value of his estate. He could grant a purchase option that would give the organization the right to acquire the land at its value established by the appraisal for estate tax purposes, but he suspects that the appraised value established for those purposes may be on the low side of comparable values. Instead, he proposes a right of first refusal triggered when the estate is about to sell to a third party, who is likely to be a residential developer.

An organization will need time to analyze the real estate offer made by the third-party buyer to the owner and, if the details are satisfactory, obtain necessary internal approval. The organization probably will need time to obtain financing as well. However, as explained, the owner granting a right of first refusal is likely to want to be sure that the time allowed to the organization to respond is short. Combining a right of first refusal with a right of first offer (and negotiation) can ameliorate this serious time constraint.

Grant of all Three Rights is Optimal

Optimally, an organization will obtain from the owners rights of first offer, negotiation, and refusal—an opportunity for a first offer to be made and considered with sufficient time to negotiate a mutually acceptable transaction followed by a right of first refusal if the negotiation is unsuccessful. The logic is straightforward:

- Many owners have unrealistic expectations regarding the market value of their property, resulting in their first offer to the organization being unacceptably over-priced. Agreement may be unlikely at this juncture but the organization benefits by knowing that the property is soon to be marketed for sale.
- The right of first negotiation provides the organization the opportunity to respond with a realistic offer—and explain the reasoning behind the offer—before potentially losing the property to another bidder on the open market. Even if agreement is not reached, the organization has had the opportunity to (1) build a relationship with the owners that may lead to successful future negotiations after the property has been exposed to the market; (2) educate the owners on a range of conservation options; and (3) better familiarize itself with the property.
- The warning that the property will be marketed for sale provided by the right of first offer combined with the time provided by the right of first negotiation places the organization in a much better position to prepare for and make a quick decision to accept or reject terms offered to it as a result of a right of first refusal.

Example. The organization obtains from the owners both a grant of first offer using the default provisions of the *Model Grant of Right of First Offer* and a grant of first refusal using default provisions of the Model Grant of Right of First Refusal. Years later the organization receives notice from the owners of their intent to sell the property:

- The organization has thirty days to decide whether to accept the owners' offer; plus
- The organization has thirty days to offer a counterproposal and continue negotiations; and

- If negotiations fail to result in a sale, the organization may continue its due diligence investigations and pursuit of funding sources as the owners engage in marketing the property; and
- Thus, if the organization has used the time to organize itself, it may be in a position to issue a quick (and properly authorized) response when the right of first refusal is triggered.

Implementation

In Writing and Recorded

A prudent organization will want the owners' promises regarding a right of first offer or right of first refusal to be both in writing and in recordable form:

- An oral promise is of doubtful enforceability under Pennsylvania law.
- *If the written promise isn't recorded*, then, if the owners subsequently sell the property to a third party without the owners honoring their commitment to the organization, the third party takes the property free of any duty to the organization. In other words, the third-party buyers have no obligation to honor a promise made by the owners.

Careful Drafting

Grants of rights of first offer, negotiation, and refusal must be carefully negotiated and drafted to achieve the desired outcome. The organization must *ask for exactly what it wants.* If it simply requests a right of first refusal, that is what it will get—a right to match an offer, likely within a time period that is far too short to make a prudent decision. If it requests a right of first offer and does not clarify that it wants the offer followed by a period of good faith negotiation and a right of first refusal, it will likely ultimately receive an offer that demands too much for the property with no opportunity to negotiate and no guarantee that the owners will come back to the organization once market realities realign the owners' expectations.

The *Model Grant of Right of First Offer* and *Model Grant of Right of First Refusal* provide templates for establishing rights for the holder and, together with their respective commentaries, provide the user with guides to key issues that need to be resolved when establishing these rights.

Prior Liens

The organization will lose its rights under grants of first offer and first refusal if all three of these conditions are present:

1. There are prior liens on the property;
2. No subordination or other appropriate agreement has been obtained from the lien holder to recognize the rights of the organization; and
3. Foreclosure subsequently occurs.

However, if the risk of foreclosure is low and the organization is paying little, if anything, for the rights, the owners are unlikely to be willing to obtain subordination given the difficulty involved. As such, an organization may reasonably conclude that the low risks and costs do not merit pursuit of subordination.

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