

Options

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You may not have run into them, but options to purchase exist. What do you need to know about them, and why?

An option to purchase exists when an owner conveys to another the right to purchase the property (options to lease also exists, but to keep this article to its customary size, we will talk about options to purchase). The written option spells out how and when it may be triggered. Some options may be exercised at any time the buyer elects. Options may be restricted so that they may only be exercised within a specified window of time. Other options allow the optionee (purchaser) to match any offers to purchase submitted by bona fide buyers. The latter are generally referred to as rights of first refusal.

As with any contract, options must be supported by consideration. Consideration is anything of value and for that reason most options are purchased for a stated sum. A mere promise to allow another to purchase that is not supported by consideration will not be enforceable.

A recorded option is a lien against the property. To be enforced against the rest of the world, it should be recorded at the office of the recorder of deeds for the county in which the property is located. If the option is not recorded, a bona fide purchaser without knowledge of the option's existence, will have priority over the optionee.

What does all this mean for you? Consider the following. A group of surgeons practicing at a local hospital decided they would open a surgical suite where minor procedures could be performed. Instead of splitting fees with the hospital, the doctors would be able to retain all fees charged and thus experience a substantial gain in income. A building was located for purchasers and an offer submitted. They buyers were aware that the property was tenant occupied and were also aware that the lease would expire five months from the signing of the agreement. The doctors were actually pleased by the delay as it would enable them to engage architects, contractors and order the specialized supplies and furnishings that would be necessary. This they did at a cost of approximately \$100,000.

As the day for settlement approached, the buyer agent, one who generally practices in the residential field, sent the last recorded deed to the title company and ordered the search necessary for settlement. When the title report came back it indicated that there existed a right of first refusal held by a former owner of the property (at the time the former owner sold it, he retained a right of first refusal). The former owner decided to exercise his option to repurchase and the doctors were without a landing place! Considering that the doctors had spent \$100,000 preparing themselves for the move, they did not just chalk this up as a learning experience; rather, they brought suit against the buyer agent.

You might be asking why the seller hadn't brought this to the attention of his listing agent who would have determined the optionee's intent before listing and marketing the property at expense to the listing agent. You might also be asking whether the listing broker is entitled to a commission given that the sale of the property occurred during the term of the listing

broker's contract. And what about the buyer agent, now a defendant; does she also have any hope of recovery or salvation?

Sellers forget. Options may have been negotiated years and decades ago. Sellers may possess property without interference from the optionee and may have long since forgotten its existence. Also, it is not uncommon, for a owners of property subject to easements to die and leave their heirs, who have no indication of the option's existence, with its ownership.

As for the listing broker, there is a good argument that a fee is owed. The typical listing agreement as an exclusive right to sell where the commission is earned upon the sale of the property regardless of who it is that procures the buyer. Further, sale would not have taken place (the option would not have been exercised) unless a bona fide purchaser was procured who made an offer for the optionee to match. Had the seller in the above example thought about it, the seller would have likely asked the listing broker to exclude sale to the optionee from the listing agreement.

For those residential agents who will occasionally take the commercial listing and may use the standard commercial listing agreement, beware. While it too provides that a fee is earned if the property is leased or sold, it does not provide how much the fee is if leased and how much if sold, that information must be added. In one case I am familiar with, the broker intended to sell the property and only completed what the commission would be if the property was sold. The listing agent set about locating a buyer, and did so. Only after the seller agreed, in writing, to the purchase price (this was done in a letter of intent and not an agreement of sale) the existing tenant exercised an option to re-let the property. The broker who procured the buyer was concerned that because he did not indicate a commission in the event the property was leased he would be without remedy. Fortunately, the listing agreement includes a seller representation that the seller has the ability to sell the property (which was not the case here because of the tenant's option). The broker also argued that the lease would not have been extended but for the broker having procured a willing buyer.

Buyer agents extend efforts to bring buyers to a property that is available for purchase which may be frustrated by the exercise of an option. How can a buyer agent determine whether an option exists? Even asking the seller (through the listing broker) may not yield an accurate response because, as I mentioned above, there are owners who are unaware of the option's existence. A title search will reveal a recorded option. But how many buyer agents are going to search titles before they take their buyers to view it? For this reason, it will occasionally happen that a property is subject to the lien of another's option in which case a buyer will get their deposit back together with title costs and other expenses that may have been incurred. Check the agreement of sale because seller who cannot convey marketable title may only have to reimburse buyers some of the expenses incurred rather than all (check the title clause of the agreement of sale).

Another consideration is the advice you give to an owner who may be considering granting an option. How marketable is the seller's property if buyers are aware that despite their offers, another will have the option to "steal the property?" If your client is considering granting an option, do you really want to take that listing? You will be obligated to assure that purchasers and their agents are made aware of the existence of the option as soon as reasonably

practicable. Also, you will want to make sure that if the option is exercised, you will be paid. While the listing agreement may provide for your payment, having to chase the seller into court is not all that attractive.

Lastly selling agents, assure that the title search is ordered as soon as reasonably practicable after the agreement of sale is executed. Why? Consider the case involving the doctors who spent \$100,000 between execution of the agreement their learning that title was encumbered by an option. Most buyers will not be spending this kind of money, but they may be selling their existing home or making other significant plans in the belief that they have secured a property for purchase. Further, many title defects can be cured given sufficient time. Sufficient time does not exist when the title defect is discovered days or weeks before closing. For this and other reasons, you will eventually conclude that ordering the title search at the outset is the new norm.

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