

Introduction

In the farming community, “lease-to-own” refers to certain methods to achieve land ownership. Purchasing a farm with conventional financing is simply not an option (or the best option) for many. “Lease-to-own” can be a more affordable approach to farm ownership.

It’s important to note that “lease-to-own” is not a legal document or principle. Rather, “lease-to-own” refers to strategies to gain ownership of a particular property at a future point via specific legal transactions between the property owner and the buyer.

This fact sheet outlines three ways farmers can achieve lease-to-own objectives, the legal nature of these arrangements, and issues farmers and landowners should consider before adopting them. When exploring or pursuing each of these strategies it’s important to work with an attorney on the legal procedures and language. If an attorney doesn’t draft the documents, his or her review can still alert individuals to potential problems.

Option to Purchase

Generally speaking, an option to purchase gives a buyer (who may also be a tenant) the right to trigger the sale of the property to that buyer-tenant according to specific procedures and within a specific timeframe. A landowner can grant a person the option to purchase a piece of

property even if the parties have no lease arrangement. This is often called an option contract.

In a farm lease with an option to purchase clause, an individual (the buyer-tenant) can obligate the landowner (the seller-landlord) into selling by drawing on the option. An option to purchase is generally written into a standard lease agreement, but in some situations, the lease and option to purchase are two separate documents. For example, a tenant and landlord may agree on an option to purchase after the lease has been signed. They don’t necessarily need to sign a new lease if they only need an option to purchase. Leases with an option to purchase included might be called a “lease-to-own” agreement. Legally speaking, however, the document is still a lease with an option to purchase clause included.

Options to purchase come with various contingencies, and there is no single best clause or document. Although there are some overarching legal standards, the parties have wide legal latitude to craft an option that accommodates their unique needs, concerns, and resources. The clause might occupy a couple sentences or several pages. Simplicity is not necessarily a wise objective. Purchasing property is not simple and a simple option to purchase may ignore very important issues.

At a minimum, an option to purchase clause in a lease should contain the following details:



1. **Description of the property subject to the option.** The property included in the option may or may not be the same as the leased premises. Parties should make sure to identify any buildings, equipment or other resources included in the option.
2. **Consideration given for option.** “Consideration” is a legal concept that means both parties gave and received something of value, and consideration makes a contract enforceable. If one party receives something for nothing, they received a gift which may be revoked. If the option to purchase is separate from the lease, it must have its own consideration to be enforceable. If the option to purchase is included in a lease, the recommended legal practice is for tenants to pay an extra one-time fee for the option.

The option clause should state the fee and that the parties agree it is adequate. The dollar value of the fee is not important so long as something of value is given. It could be nominal. Although additional consideration (in the form of an extra fee) is a best practice, a court would likely find that lease payments under a lease agreement including an option to purchase are consideration enough for the option.
3. **Duration of option period.** The document should describe exactly when the tenant may elect to use the option to purchase. Does the option begin and end on certain dates? Is the option available at any time during the lease?
4. **Terms of the option.** How is the option activated? How does the tenant let the landlord know that she intends to move forward with the purchase?
5. **Price of the property.** The tenant will need to know the purchase price of the property so she can make a decision about purchasing it. This may be as easy as stating a dollar value for the property right in the option to purchase clause or document. However, most parties will not choose this strategy because it is difficult to accurately forecast the value of a specific property. More likely, the price will be determined by an appraisal to be performed at the time that the option is exercised. Or, it could be determined by a formula. Regardless of what method the parties choose, the document should be very clear about how the price is determined.
6. **Timetable for acceptance or rejection of purchase price.** Where the purchase price depends on a formula or appraisal, the tenant might also want the ability to back out of the sale if the purchase price turns out to be unexpectedly high. If so, this right must be specified in the lease. The clause should detail how long the tenant has to make the decision after the price is set. Many tenants also want the purchase subject to the tenant’s ability to secure financing. This is what makes it an option to buy the land, rather than an obligation. The right starts as an option but becomes an obligation only after specific conditions are met. Tenants and landlords should pay special attention to these timeframes to ensure everyone has enough time to move the transaction forward as desired.
7. **Whether and how a portion of rent may go to the purchase.** Some options to purchase allow the tenant to assign a portion of each rental payment to the purchase price, if the tenant exercises the option. The option should fully describe the amount, if it’s held in escrow, how it applies to the purchase price, and if it’s returned should the option not be exercised. Farmers taking



advantage of this opportunity should work with an accountant or bookkeeper to make sure this is handled properly. The portion of rent that goes toward the purchase is considered an equity interest. This would be handled differently from rent by a court of law.

8. **Terms on which property is transferred if option is exercised.** Attorneys often recommend including many or most of the terms for the property sale right in the option to purchase. This makes things easier for the tenant because s/he knows exactly how the process will proceed and can evaluate if it's the right choice. Also the parties might have some incentive to complicate the transfer if the sale isn't in his or her best interest anymore, and including the terms can prevent complications.

A sample "option to purchase" document is available from Freelegalforms.uslegal.com. This example illustrates one way an option to purchase might describe items 1-5 above. (This is a sample, not an endorsement of this specific document.) Although the sample is presented as a stand-alone contract, the same provisions could be incorporated right into a lease. Because the sample is separate from a lease, it doesn't handle allocating a portion of the rent to the purchase price. Farmers and landowners wishing to outline the terms of the property transfer in advance should consult a sample "offer to purchase" agreement tailored to the state in which the farm property is located.

Right of First Refusal

A right of first refusal (ROFR) can be written into a lease agreement, although it can be a stand-alone legal document between a landowner and a prospective purchaser. Generally, a ROFR allows an individual would-be purchaser (in this case, the farmer-tenant) to intervene after a third party has offered to purchase the property. The individual usually has the

chance to buy the property on the terms the seller and the third party negotiated. ROFR clauses are highly variable. The seller may not need to find a third party purchaser first. The seller may simply offer the property for sale to the tenant/buyer at a specific price. If the buyer thinks the price is too high or the terms too onerous, the seller may look for a third party who will accept his or her terms.

The ROFR differs from the option to purchase in that the latter is pre-emptive: the buyer can choose to activate the option to purchase. With a right of first refusal, the individual usually has to wait for a third party to elect to buy the property or for the landowner to offer it for sale. Only then can the individual (tenant) step in to become the buyer.

ROFRs and options to purchase are alternatives; a lease should not include both.

Despite their differences, a ROFR contains some of the same elements as an option to purchase. The description of the property, consideration paid for the right, and the term (when it is in effect) of the right should all be listed in detail. A ROFR should also address the following details:

What is the nature of the ROFR? What exactly is the tenant receiving with this right? Is it the right to buy the property on the same exact terms that another third party has already negotiated with the seller? If not, does the seller assemble the terms and then offer it to the tenant? Can the tenant negotiate the terms, and if so, how? Is the seller required to offer the property at an established price or at a price determined by an agreed-upon formula? This section has enormous variation and need for detail depending on what the parties agree upon.

What is the timing of and how does the tenant exercise the ROFR? The parties need to clearly understand how the property owner will notify the tenant that he has decided to



sell and the right is now active. Then, the document should articulate exactly how long the tenant has to decide on the offer or re-negotiate terms as allowed. It may also need to state what the tenant/buyer must tender to exercise her right. For example, does the purchaser have to tender the full purchase price in cash or secure adequate financing by a specific date?

A sample right of first refusal document is available from Freelegalforms.uslegal.com. (This is a sample, not an endorsement of this specific document.) As with the option to purchase, this sample is very brief and doesn't go into detail on how the property will be transferred or any additional terms on the transfer that most buyers want in a real estate transaction. Farmers interested in more detail should consult a sample "offer to purchase" contract for the state in which the farmland is located.

Land Contract (also known as Contract for Deed)

In a land contract the buyer (in this case, the farmer-tenant) makes installment payments to the owner over a period of time. Once the final payment is made, legal title to the land is transferred to the buyer. The buyer (former tenant) now officially owns the land. Land contracts are popular for transferring property between family members. A land contract mimics lease-to-own in many ways, but they are not the same.

Sometimes the timeline of a land contract covers a very long period of time, similar to a mortgage—15, 25, or 30 years. A land contract is a way to initially finance a land sale without a traditional bank mortgage. However, often the parties agree on a balloon payment at a particular time—several years down the road—at which time the buyer must

pay in full. Ideally the farmer will have established a sufficiently profitable operation at that point to finance a conventional mortgage to cover the balloon payment.

Under this strategy, the buyer agrees to make monthly payments to the seller, generally without an initial down payment. The property is considered "sold" to the buyer in that the buyer holds most of the legal rights and responsibilities of an owner. However, full legal title to the property often does not pass until all or a significant number of monthly installment payments have been made. A land contract can be a good way to receive nearly all the rights and responsibilities of ownership without paying the full purchase price immediately.

A land contract often comes with risk. If the buyer defaults on (misses) a payment, the seller may be able to withhold title to the land because the buyer essentially defaulted or breached the contract. The buyer's equity in the payments made up to the point of default may be lost. Some legislatures and courts have made land contracts more equitable to the buyer. For example, the court system may require a land contract seller to go through the foreclosure process before evicting a defaulting buyer. In other states, sellers must return a portion of the monthly installments, if they exceeded the fair rental value of the property. Some courts may also consider the title to be transferred after a significant number (rather than all) of the payments have been made. These protections apply regardless of whether they are written into the land contract itself.

In many respects, a land contract has the same provisions as a standard farm lease. Land contracts look very similar to leases with an option to purchase provision that allocates a portion of the rent to a future purchase agreement. The parties may interact with each other in the same way: one party pays the other a monthly payment. Yet legally



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speaking, the two are different and the distinction matters on several levels. A land contract transfers nearly all the rights and responsibilities of ownership such as the right to mortgage the property, for example. By contrast, a lease transfers a legal right to use the land for a specific purpose. Responsibilities under a land contract may include taxes and assessments, for example; these are usually not the obligation of a tenant. A land contract and a lease may differ with respect to how court procedures are handled following a default.

Whether an agreement is a lease or a land contract is based on the parties' intention. Did the parties intend to transfer the rights of ownership (a land contract), or the right to possess and control the property without ownership (a lease)? The signed documents should reveal the parties' intentions. Did they call the document a lease or a land contract? Do the clauses in the lease show the intent to transfer ownership or just the right to use the land?

Farmers and landowners must make a conscious choice about whether the transaction is a lease or a land contract. The parties should back up that choice with a consistent document. Some parties make the mistake of putting "land contract" at the top of the document but write clauses that transfer only the right of possession, not ownership. A lease with an option to purchase won't be seen as a land contract in court.

USDA Land Contract Guarantee Program. The USDA Farm Service Agency's "Land Contract Guarantee Program" promotes land contract sales by addressing two landowner concerns. Landowners can elect a "Prompt Payment Guarantee" that protects landowners against the risk that the buyer will miss a monthly payment- a situation which might put the landowner's own finances at risk. In the

Prompt Payment Guarantee, the federal government through FSA will pay up to three monthly installments plus taxes and insurance if the buyer defaults.

Some landowners/sellers, especially those depending on the land to finance retirement, may be concerned that the land will decline in value. If the buyer defaults and the seller is returned a property with much less value, the individual's retirement financing is threatened. The "Standard Guarantee" program will provide the seller with up to 90% of the outstanding principle if the buyer defaults.

The Land Contract Guarantee Program is restricted to beginning farmers and properties sold for \$500,000 or less, among other requirements. Farmers and landowners should contact their local FSA office for more information.

For more information on writing a land contract, including a sample agreement and checklist of issues to consider, see [Farm Commons'](#) resource on drafting land contracts.

Land For Good ensures the future of farming in New England by putting more farmers more securely on more land. We educate, consult, innovate and advocate with and for farm seekers, established farmers, farmland owners, and communities to navigate the complex challenges of land access, tenure and transfer. For more resources and information, visit our toolbox at landforgood.org/toolbox. For help with leasing farmland, contact us at landforgood.org/contact.



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