

OPTION CONTRACTS OVER LAND

Option contracts can exist over most assets, including land, money and shares. Our concern is one over land.

Call options & put options

It may be a **call option** where the buyer has a right (but not the obligation) to buy the land from the seller, or a **put option** where the seller has a right (but not the obligation) to sell the land to the buyer. So, in a call option the buyer has a choice whether to exercise the right and compel the seller to sell, or not. The reverse operates in a put option: the seller has a choice whether to exercise the right and compel the buyer to buy, or not.

Call options over land are the more common so this paper will assume a call option.

A conditional sale agreement is a different legal creature from an option. In an option there is no agreement to buy and sell, but rather a promise that if (and only if) the option holder exercises the option, the parties will then agree to buy and sell. In a conditional sale agreement there is agreement to buy and sell, albeit that the sale may yet be defeated if a condition is not fulfilled.

In practice, professional investors and property developers may ask a landowner for a call option so they can plan ahead knowing that, if they exercise the option, they can buy the land. The landowner does not know however whether the option will be exercised.

Things to consider

There is no standard form option contract and in preparing a contract you might consider these matters:

Parties: The landowner will be the seller (or "grantor"); the other party will be the buyer (or "option holder")

Land: The land must be specified, usually by its title identifier. Some special cases:

- if an option is over only part of an allotment, planning laws will likely require a formal re-subdivision of the land before a settlement can occur
- if an option is over 2 or more allotments, can the option be exercised over less than

all of them (and, if yes, can the option be exercised more than once until all the allotments are taken)?

- if the option will not extend to any particular existing fixtures or improvements on the land, the contract must give details
- if the option will not extend to any growing crops, the contract must say so
- if the option will extend to water rights used with the land, the contract must give details.

Fee: The landowner has no assurance that the option will be exercised and the land be sold. But while the option exists, the landowner cannot sell the land to a third party. So merely by granting the option the landowner is limiting its freedom, and is usually compensated by being paid an up front fee. That fee is usually non-refundable and, if the option is exercised, not counted towards the price payable for the land.

Period: The starting date and finishing date must be specified. The option lapses if the buyer does not exercise the option on or before the finishing date.

Conditions precedent to the grant of the option: The grant of the option might be made conditional upon some thing happening or not happening. For example, maybe a third party has a prior right to buy the land, and the grant of the option is conditional upon the third party waiving that right.

Conditions precedent to the exercise of the option: Perhaps the option cannot be exercised unless something happens, or doesn't happen. For example, if the plan is for the buyer to community title the land and the seller to then buy back one or more of the community lots, the exercise of the option might be conditional upon the buyer first obtaining planning consent for the plan of community division.

Exercise of the option: The contract will require the buyer to notify the seller, within the option period, that the option is exercised. That notice should be in writing (or by email). To avoid legal uncertainty where a notice is mailed during the option period but delivered to the seller after the option period, it is wise to specify that to be effective a notice must be actually received by the seller during the option period. If local law allows

a buyer of land to “cool off” after contracting to buy, the option contract might require a formal waiver of that right to accompany an exercise of the option.

Caveat: In law, the buyer most likely can lodge at the Titles Office a caveat over the land, even before the option is exercised. A caveat may be “permissive” (so it allows later registrations on the title, but subject to the caveator’s claim) or “absolute” (forbidding all later registrations). The Titles Office is a public record and if the seller is uncomfortable with the grant of the option appearing on the record, the contract might forbid the buyer from lodging a caveat, at least until the option is exercised.

Assignment: In law, the buyer most likely can assign to a third party the benefit of the option. This is not uncommon in practice. If the seller is uncomfortable with the option being assignable, the contract must prohibit an assignment. To be fully effective, a prohibition against assignment must be drafted with care.

Stamp duty: The option contract most likely attracts stamp duty. The amount of duty will depend on the option fee and/or any shortfall between the market value of the land and (if the option is exercised) the price payable to buy the land.

Sale Agreement: If the option is exercised, the parties then agree to buy and sell the land. But on what terms of sale? To ensure a legally binding agreement to buy and sell, the option contract should:

- annex a form of sale agreement
- say that, if and when the option is exercised, a sale agreement between the parties in that form then exists
- give instructions on how any blanks in that form are to be filled in, for example:
 - the date of the sale agreement should be the date the option is exercised
 - how the price (if not fixed) should be worked out
 - how the date for settlement should be worked out.

It is common for an option contract to say that after the option is exercised, a party must prepare, sign and then exchange with the other party the form of sale agreement. [A deposit on the price might also change hands at that time.] This is for

convenience, so the parties can thereafter ignore the (now defunct) option contract and focus on the sale agreement.

There is however a legal risk that a failure by either or both parties to exchange a sale agreement will be interpreted as a lack of intention to be legally bound. So it is wise for the option contract to be clear that a failure to exchange a sale agreement does not affect the validity of the sale agreement that the option contract takes to exist on the exercise of the option.

Price: The price payable (if the option is exercised) may be fixed for all time, or be variable during the option period. The legal requirement is that the price be known, or be ascertainable. A landowner who is concerned about the price being too low (the buyer then taking a quick profit) might negotiate an “escalator clause” where the price increases by reference to the profit the buyer makes in assigning the option or on-selling the land itself.

Disclosure notice: If local law obliges a seller of land to give a buyer a disclosure document, the option contract might require that to be done in the period between the date the option is exercised and settlement day under the sale agreement.

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