

STEP 3

ARRANGING AN OPTION AGREEMENT

This guide explains what an option agreement is and how it can be useful to a community group with an interest in a particular asset. It also covers some of the main issues you should consider when entering into such an arrangement.

THIS SHOULD NOT BE TAKEN AS SPECIFIC ADVICE FOR YOUR PROJECT. AS WITH ALL CONTRACTUAL AGREEMENTS, IT IS ADVISED THAT COMMUNITY GROUPS TAKE LEGAL ADVICE BEFORE ENTERING INTO ANY OPTION AGREEMENT.



AN OPTION AGREEMENT CAN BE USEFUL FOR YOUR COMMUNITY GROUP IN A NUMBER OF WAYS:

- **IF YOU WANT TO TIE THE SELLER IN TO A PROPOSED DEAL BUT ARE NOT IN A POSITION TO BUY IMMEDIATELY.**
- **TO GIVE YOU THE FLEXIBILITY TO EXERCISE THE OPTION AT ANY TIME WITHIN THE SPECIFIED TIME PERIOD, OR IF YOU WANT TO, PASS UP THE OPPORTUNITY.**
- **IN EFFECT AN OPTION AGREEMENT BUYS TIME - TO RAISE FINANCE, TO OBTAIN PLANNING CONSENT, GAIN AGREEMENT FROM OTHER PARTIES, OR TO FULLY INVESTIGATE THE FEASIBILITY OF A PURCHASE.**

WHAT IS AN OPTION AGREEMENT?

An option agreement is a contract between the owner of a property and a potential buyer, giving the buyer the right to serve notice upon the seller to sell the property either at an agreed price or at its market value. Often, the purchaser will pay the seller a fee for entering into an option agreement.

A community body interested in registering an interest in land through the Community Right to Buy Provisions of the Land Reform (Scotland) Act 2003 or Community Empowerment (Scotland) Act 2015 – to secure a right to buy if the owner offers the property for sale – may wish to consider the merits of using an option agreement.

ELEMENTS TO AN OPTION AGREEMENT

An option agreement will usually contain the following:

- The names and addresses of both parties
- A detailed description and plan of the property land
- The price to be paid to the landowner to enter into the option agreement – the “option fee”
- The “exercise price” - the cost of the land or property if the option is exercised
- The last date by which the option must be exercised (after which the agreement will lapse)

WHEN CAN THEY BE USED BY COMMUNITY GROUPS?

Option agreements can be a useful tool when looking to purchase property for example where:

- The current owner of a property is willing to sell to the community but concerned by the length of time it can take for a community to be in a position to make an offer. An option agreement sets out a definitive timescale - and can also provide for an up-front payment as an incentive to the owner to create the opportunity.
- Your community body requires time to put together a funding package for a property acquisition and/or its subsequent development .
- Planning permission for the development of a site has yet to be applied for - you may wish to secure an option before investing resources into making an application for permission.
- A potential development site is sub-divided amongst several different owners and there is no guarantee that all of them will sell. Your community could assemble the development site gradually by acquiring options over each parcel of land.
- Your community already owns a piece of land and anticipates that your project may extend to adjacent land in the future. Under this circumstance an option can be exercised when the prospect becomes a reality.
- Vacant possession of the site is not yet available (i.e. the site is still occupied by a third party) but your community wishes to secure the ability to purchase it when it does become available.



WHAT COSTS ARE ASSOCIATED WITH OPTION AGREEMENTS?

There are two financial elements associated with option agreements: the cost of entering into the agreement - the “option fee” and the actual amount to be paid for the land when the option right is exercised:

Option fee

How much you will need to offer to pay the existing owner of a property to enter into an option agreement will depend upon the specific property and the circumstances. Where a site has development potential (such as the proposed development of housing on agricultural land) the option fee can be significant. However in other circumstances there may be a more modest or no option fee involved.

Exercise price

When the option is exercised, a further sum of money - the land acquisition price - will require to be paid to the potential buyer.

This amount can be:

- The property’s market value at the time when the option agreement was entered into. From a community perspective this is probably the preferred method as agreeing and including the purchase price in the option agreement document at the outset gives you a definitive value and fundraising target – something that many funding bodies will also require.
- The property’s market value at the time when the option is exercised. Given that the exercise date may be a number of years after the option agreement is entered into, the market value may have increased in the intervening period.
- For cases involving development land, a price based upon the development value of the site when the option is exercised. This price will be modified to take account of purchaser’s costs such as professional fees, costs associated with obtaining planning permission and the developer’s profit.

Note that it is important that market value must always be independently assessed by a qualified valuer (see ‘Instructing a valuation’).

WHAT ARE THE ADVANTAGES/DISADVANTAGES OF USING AN OPTION AGREEMENT RATHER THAN THE LEGISLATION?

An option agreement in some ways has a similar effect to a registered community interest in a property under the Community Right to Buy provisions of the legislation. It secures, for your community, an ability to purchase land at some point in the future. However there are some key differences:

- An option agreement can only be used if the current owner wishes to sell land or property to your community. However, once an option agreement is entered into, you can activate the right to purchase the property at any point during the set time period.
- If the relevant process is gone through successfully, you can register a Community Right to Buy over land or buildings irrespective of the wishes of the landowner.
- Some property owners see the registering of a community interest as a reduction in their rights as owners so, in some instances, the process can be perceived as confrontational. An option agreement, which is voluntarily entered into by both parties, achieves a similar outcome through a negotiated, non-regulatory process.
- Entering into an option agreement with a willing landowner is relatively simpler and a less complex process than using the provisions of the legislation. However an option fee may need to be paid.

FOR FURTHER INFORMATION PLEASE SEE

www.hie.co.uk/ten-steps

or contact us on community.assets@hie.co.uk

