Farm Management

Promise is no protection for tenant

Country Counsel

By ROBERT MOORE

ACCORDING to Ohio State University surveys, about half of all farmland in Ohio is leased. Many of the landlords leasing land are elderly, and their heirs are far removed from the land.

The landlord may know or suspect that upon his or her death, the heirs will sell the farm to the highest bidder. However, the landlord may have a long relationship with the tenant and would prefer the tenant have an opportunity to buy the farm.

Many tenants have been promised the opportunity to buy the farm when the landlord dies, but the heirs of the landlord do not honor the promise. What options are available to the landlord and tenant?

Right of first refusal

A right of first refusal is a contract between landlord and tenant in which the tenant buys the right to have an opportunity to buy the farm. The right to buy the farm is triggered prior to the land being conveyed to another person. It should be drafted to ensure that it survives the death of the landlord. Before the heirs can sell the land, the ROFR requires them to offer the land to the tenant. The ROFR protects the tenant with little inconvenience to the landlord.

The ROFR is triggered by a sale, gift or inheritance of the land. One challenge with the ROFR is determining the purchase price. One option is to give the tenant the right to buy the farm at the appraised value when the ROFR is triggered. Another option is to use the appraised value but allow the tenant to buy at a discount, perhaps 10%. The price can be established at the time the ROFR is signed, but this option is very risky because the land could increase or decrease greatly in value after the ROFR is signed.

Long-term lease

The landlord can grant a long-term lease on the land. This strategy does not guarantee that the tenant will have an opportunity to buy the land, but it is better than having nothing in place. If the landlord passes away while the lease is in place, the tenant becomes the most likely buyer of the land.

For example, the landlord signs a 10-year lease with the tenant. In the fifth year of the lease, the landlord dies. The tenant still has five years remaining on the lease. The remaining term on the lease will make it difficult for the heirs to sell the land to anyone other than the tenant.

Obviously, this strategy only works if the landlord dies with a significant amount of time left on the lease. If the landlord survives the lease, it provides no protection for the tenant.

Purchase option in will or trust

The landlord can provide an opportunity for the tenant to buy the farm in his or her will or trust. This strategy has two primary issues.

First, the landlord can change the will or trust at anytime. The tenant will only know if he or she has an option to buy the land when the landlord dies.

Second, will the tenant be able to enforce such a provision? If the tenant is not an heir or beneficiary, he or she has no right to even see the will or trust. If the executor or trustee refuses to honor the wishes of the landlord, the tenant may not have an opportunity to even enforce the sale provision.

To get around this issue, the landlord can make the tenant a beneficiary. For example, the landlord bequeaths $100 to the tenant and an opportunity to buy their farm in the will or trust. Now, the tenant is a beneficiary entitled to enforce the terms of the will or trust.

Sell during lifetime

The landlord can always sell the land to the tenant. However, many landlords are reluctant to sell because of the capital gains tax. The sale can be structured with installment payments to spread the capital gains tax out over several years, but the tax will ultimately be paid one way or another.

These are just a few strategies that can be taken by the landlord and tenant to make sure the tenant has an opportunity to buy the farm. A mere promise by the landlord to the tenant has no legal effect and provides absolutely no protection to the tenant.

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