What You Need to Know About Put and Call Options

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Call Options

1. Call options are granted by the vendor of the property to a potential purchaser for an agreed fee.

2. The vendor is the "grantor" of the option and the potential purchaser is known as the "grantee" of the option.

3. The option fee is usually released to the vendor on the granting of the option.

4. The grantor and grantee also agree the price the grantee will pay for the purchase of the property if they exercise their option at the end of the call option period.

5. A call option **must have** a copy of the full contract for the sale of the land attached so that if the call option is exercised the terms on which the property is sold to the purchaser are agreed between the parties.

6. For the purchaser the date of the exercise of the option is time of the essence. One of the rare things that cannot be rectified at law is a failure to exercise an option on its terms or on time. Effectively if an option expires at 3pm on a certain day and the person exercising the option is delayed by 5 minutes the option **expires.** If that happens the vendor is free to renegotiate the terms with the potential purchaser.

7. Call options often contain a provision for an extension of the option period at the discretion of the grantee. This involves the payment of an additional fee to be released to the grantee. Generally, assume that the grantee will extend the call option period unless they have decided that the project is not financially viable or development consent will not be granted. It is best to load the amount of the extension fee so that the grantee will not extend as a matter of course unless the project does appear to be viable and they have what they often refer to as "imminent certainty" in respect of the development approval or other value they need to add to the property.

8. The grantee is most often a property developer who is looking to add value to the property by obtaining development consent whether in respect of the property on its own or as a part of a larger group of properties the developer is seeking to acquire.

9. Call options benefit the **purchaser**, as the **vendor is obligated** not to sell or do anything else with the property for the term of the option, or any extension of the option.

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10. The benefits to the vendor of the property are that the price the developer is willing to pay is usually higher than the property is worth in its current state.

11. The control as to whether to complete the sale proceeds or not is with the purchaser. At the end of the option period the developer decides whether to exercise the option and exchange contracts with the vendor to purchase the property.

12. **You do not have a binding agreement** for the sale of your property until contracts are **exchanged.** Therefore, if you grant a call option for the sale of your property **do not commit** to any purchase or other arrangement that is based on you receiving the moneys from your sale until the option is exercise and contracts have exchanged.

13. Development is a numbers game. When a developer prepares a feasibility to assist them to decide whether to undertake a project or not they calculate:
    - the price of the land; **plus**
    - the additional costs of purchase e.g. stamp duty, legal fees etc; **plus**
    - the costs of obtaining development approval, which includes a number of consultants such as architects, town planners, engineers, etc.. The cost to obtain development consent is approximately $250,000 for a small site to $1million and more for larger developments. The development costs increase depending how many stages are involved and become more expensive if the land is to be redeveloped; **plus**
    - the costs to hold the land from the time of completion of the purchase until the project is built and the individual properties are sold. Such costs include the costs of financing, rates, land tax etc; **plus**
    - the payment of contributions to Council which can include s94 contributions for future infrastructure and affordable housing; **plus**
    - the costs of construction; **plus**
    - the costs of selling the properties - agents' fees, marketing fees, legal fees etc; **plus**
    - taxes including capital gains tax and GST as the sale of new developments is subject to GST, but purchasers resist paying GST and so new developments are usually sold as a GST inclusive price.

    The developer calculates its expected profit and ultimately makes the decision whether to proceed with the development based on the amount they estimate for the sales of the finished product.

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14. When deciding whether to undertake a development a developer is looking to achieve about a 20% profit. One of the reasons this needs to be about 20'% is that there are so many variables that a 20% profit in a feasibility rarely achieves that amount in reality.

15. The benefits to the developer in entering into call options include that:
    - they are only committed to paying the option fee and not obligated to proceed if they cannot obtain development consent or add value to the property in some other way;
    - they know what that particular property will cost to buy. This is important because the only variable they can control is how much they pay for the land;
    - they have a commitment from the vendor whilst they are negotiating with other potential vendors;
    - they have the option period to investigate whether the project is economically viable;
    - the holding costs do not become their problem until after completion of the purchase, therefore, the longer they can delay completion the better for them; and
    - stamp duty is not payable until 3 months after the contracts for the purchase of the property are exchanged so they are deferring up to 5.5% of the cost.

16. Call Option agreements most often contain an agreement that the vendor will sign all necessary documents to enable the developer to obtain the relevant approvals. They also include a provision that the developer and its consultants may have reasonable access to the property to survey and undertake tests required for the development application or feasibility. If the developer wants to carry out any more invasive testing such as digging test holes for an environmental or geotechnical report, this should not be allowed unless you are indemnified against any damage or claim that results from those tests.
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17. **Never** give the developer access to carry out work on the property prior to settlement. It is all right to give them access to undertake surveys and other pre-development application enquiries but **do not** give them the occupation rights to the property. If you doubt this advice please see a Supreme Court case *J Cummins Pty Limited –v– F & D Bonaccorso Pty Limited [2014] NSWSC 1064.* **CLS Legal** acted for the **successful defendant** who had granted an option and allowed a developer access to refurbish their property during the option period. CLS Legal did not act for the owner of the land at the time they granted the option.

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18. It is a good idea, particularly if the purchaser owns the entire potential development site, to include a clause in the call option that provides that in the event the option is not exercised all of the developer's rights including copyright in the development application and associated reports transfer to the vendor.

19. If the developer obtains development consent but is unable or unwilling to exercise its option and purchase the property the consent remains in place until it expires, usually 5 years after it is granted. The property can then be sold with the approval although the vendor must be careful of any intellectual property right issues.

20. The terms of the option can contain a number of other clauses including such things as:
    - the purchase price increases if the grantee's development consent results in additions FSR;
    - the purchase price is indexed to reflect the percentage increases in property prices during the option period. This type of clause means that that the grantor's buying power is not reduced during the option period;
    - the purchase price includes the grantor acquiring a property or properties in the eventual development, however, this type of arrangement is fraught with difficulties;
    - the grantee is required to pay the grantor's legal costs;
    - if the property is being sold for a development site the vendor has the right to remove any of the existing structure or items e.g. plants on completion;
    - the grantor may remain in occupation after completion until the property is required for demolition; or
    - to satisfy any other concerns the grantor may have regarding the transaction.

21. All property developers have a certain appetite for risk. The most successful property developers always have a set of rules they apply to their decisions and rarely deviate from those rules. Some property developers have a greater appetite for risk and effectively are gamblers. **Be very wary** of a developer who will just offer any amount to secure a foothold to your property. If they do not seem concerned about the price, rather than abiding by the rules of sensible development they are hoping the price will increase. If you have any doubts about this read the facts in the Bonaccorso case referred to above.

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Put Option

22. The only way to have an agreement that is **binding on the purchaser** and provides it with the advantages of an option, particularly the deferment of the stamp duty, is by combining the call option with a **put option**.

23. The put option is granted in the same agreement as the call option and a separate nominal put option fee is payable. It is important that this put option fee is paid as a separate amount to the call option fee.

24. The put option is granted on the terms of the **same contract** as the call option.

25. The period for the exercise of the put option commences on the **expiration of the call option** period and is usually for a fairly short period of time.

26. During the put option period the vendor may exercise the put option which effectively requires the purchaser to enter into and complete the contract.

27. Accordingly, a put and call option is as effective as an **unconditional contract** for the sale of the property. The main difference being that the vendor can decide whether or not to "put" the purchaser and require the purchaser to complete. This would only happen in a rising market and in circumstances where the vendor believes a subsequent sale would result in a better price.

28. If the vendor decided not to exercise the put option it is entitled to retain the call option fee paid by the purchaser.

Contact us at CLS Legal at info@clslegal.com.au for further information regarding negotiating a put and call option deed, assistance with the sale or purchase of your property or if you have any questions about the contents of this document.

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