

Number 19

Me First! A Tenant's Right of First Refusal under the Landlord and Tenant Act 1987

The Landlord and Tenant Act 1987 ("the Act") should always be at the forefront of property owners' minds when planning to build or sell developments containing residential elements. It is particularly relevant where a developer plans to grant long leases of residential units intending to sell on the freehold reversion to an institutional investor.

What is the Right of First Refusal?

Where the owner of the reversion ("the interest") of any property (not just purpose built residential blocks) containing two or more residential units held on almost any sort of residential tenancy except for an assured shorthold ("qualifying tenants") wishes to sell or grant a lease out of his interest in the property or any part of it, he is legally obliged to offer the interest to the qualifying tenants of the property ("the First Refusal Offer") and only if they do not take the offer up can he sell it to a third party. The information contained in the First Refusal Offer and all subsequent negotiations relating to the offer are strictly regulated by the Act.

If the First Refusal Offer is not accepted, the owner may then sell to any third party within the next 12 months provided the interest is sold at or above the offer price contained in the First Refusal Offer and otherwise on corresponding terms. If the owner wishes to sell the interest on terms that are less beneficial to him than the terms contained in the First Refusal Offer he must first re-offer the interest to the qualifying tenants on those less beneficial terms.

Note: On a building with a retail unit on the ground floor and flats above the Act requires a lease of the retail unit to be offered first to the qualifying tenant.

What must be contained in the First Refusal Offer?

This must be made in the form of a Notice to each qualifying tenant and must:-

1. state the property and interest to be sold;
2. give the principal terms of such sale, including the price; and
3. inform the qualifying tenants that the Notice constitutes an offer to sell under the Act.

What happens once the First Refusal Offer has been made?

Once the First Refusal Offer has been served on the qualifying tenants, the owner cannot sell his interest until the period given in the First Refusal Offer for the qualifying tenants to reply has lapsed. This must be a minimum of two months. During this offer period the qualifying tenants have three options:-

1. Accept the offer. This requires more than 50% of the qualifying tenants to accept the offer in which case they must nominate a person (individual, company etc.) to purchase the interest and such nominated person must buy the interest within a set period of time.

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2. Where the qualifying tenants wish to purchase but on different terms, make a counter-offer. This goes beyond the ambit of this briefing but will result in further negotiations between the parties leading to an acceptance or rejection of the offer. If this situation arises further professional advice should be obtained.
3. Confirm they do not wish to proceed. Silence through the offer period operates as a refusal of the offer.

Note: There is no obligation on the Landlord to sell at any particular price and, even after the offer has been accepted by the qualifying tenants, the Landlord can at any time up to the formal exchange of contracts, withdraw his offer. There may be cost consequences and he will not be able to sell within 12 months of the withdrawal.

What happens if the owner fails to comply with the Act?

Failure to comply with the procedures set out in the Act is a Criminal Offence punishable by a maximum fine of £5,000.

In most cases the qualifying tenants will also have the statutory right to buy the interest from the purchaser at the same price paid by the purchaser and on the same terms. This could also result in the owner leaving himself open to further litigious action from the purchaser depending on the circumstances in each case.

This briefing summarises the main points of the first refusal system enforced by the Act. The legislation is complex and poorly drafted. Legal advice should be obtained at the start of any negotiation. There are implications as to the legal structure to be used for buildings, particularly mixed use buildings, to protect the commercial element from the operation of the Act.

For further information please contact a member of our property department.

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Readers are advised to take specific advice before acting in reliance on the matters set out in this briefing.

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