

## **Agricultural real estate due diligence**

### **INTRODUCTION**

As discussed in a previous article, trading of agricultural real estate in Poland is heavily regulated, especially in terms of characteristics of a prospective purchaser. Once it's determined that a potential purchaser qualifies to proceed with a real estate deal, several new obstacles appear on the way. They are capable of verifying certain parameters and legal or financial requirements concerning a plot of land themselves. At a certain stage, however, after identifying some basic risks, they need more specialized knowledge to properly assess the proposed deal. This is where relevant sectoral audits come into play, in particular - a legal due diligence report.

### **WHAT IS A REAL ESTATE AUDIT (REAL ESTATE DUE DILIGENCE)?**

There are five main types of a real estate audit (otherwise called real estate due diligence):

- 1) **technical** – concerning assessment of its current technical condition (all installations and utilities, access to infrastructure etc.) and investment prospects; in case of a land developed with buildings, it also includes a list of defects in their workmanship and operational defects, along with estimated costs for repairs and upgrades;
- 2) **environmental** – concerning geological and hydrogeological assessment of land (including contamination risks), analysis in terms of archeology and forestry protection, possible inclusion in protected "Natura 2000" areas or mining areas etc;
- 3) **management (operational)** – concerning the quality of up-to-date management of the property, including the scope of its insurance etc;
- 4) **financial and accounting** – concerning the correctness of the billing system for utilities, analysis of financing sources, tax obligations and their timely fulfillment etc;
- 5) **legal**.

A legal due diligence (the main focus of this article) is a type of legal audit meant to support a prospective land purchaser in identifying significant legal risks, liabilities and cases of non-compliance associated with acquiring real estate (so called "red flags"). It serves as an invaluable tool during contract negotiations, either allowing for adjusting the price of the land to its "defects" as well as properly securing the purchaser's interests in that regard or to be used as an incentive for the seller to deal with the identified problems before the closing of the transaction.

### **WHAT ARE THE SPECIFIC CONSIDERATIONS RELATING TO AGRICULTURAL REAL ESTATE DUE DILIGENCE?**

The specifics of each legal due diligence report depend on the nature of the particular real estate in question and on the economic activity that is supposed to be (or already is) conducted on that land. However, some of the most important typical issues to consider while preparing such a report for an agricultural real estate would be the following:

#### **1) Legal title to property and encumbrances**

The first part of the legal audit is to determine the nature of the seller's ownership of the land (or other title, such as perpetual usufruct). A "go-to place" for making these findings would be the land and mortgage register. Unfortunately, information available there might not be up-to-date or incomplete, therefore it is necessary to verify it with documents, mainly appropriate notary deeds, court rulings and administrative decisions provided by the seller. It has to be also borne in mind, that a prolonged,

unauthorized use of land can lead (in certain instances) to third parties acquiring enforceable ownership rights to the land or its parts by way of usucaption.

Next, it is essential to verify any interests to the land held by third parties, both in the form of property rights, such as easements or mortgages, and bond rights, such as leases or contractual rights of preemption. Preemptive rights might also stem directly from the statutory regulations – such as the Law on Formation of the Agricultural System (see the previous article). When it comes to existing agreements concerning the land, for example - as a rule, the new owner of the land by operation of law enters into the rights and obligations of the previous lessor. Therefore the agreements themselves need to be separately audited as well.

The land and mortgage register can also include information on pending enforcement proceedings relating to the land and certain enforceable claims, such as a claim for transfer of ownership in execution of a preliminary agreement concluded in the form of a notary deed. Once again, the information from the register might not be updated, therefore in each case it needs to be supported by the additional analysis of documents provided by the seller.

## **2) Inclusion in an agricultural farm**

The Civil Code defines an “agricultural farm” as agricultural real estate together with forest land, buildings and their parts, installations and livestock, if they constitute or may constitute an organized economic unit along with the rights bound with conducting an agricultural farm. In this context it is important to determine whether the real estate in question constitutes a part of such farm, and then – if the prospective purchaser would be interested in acquiring the whole such farm.

Under the provisions of Polish civil law, a party acquiring an agricultural farm shall be jointly and severally liable with an alienating party for the latter's obligations connected with conducting the farm, unless they did not know about these obligations at the moment of the acquisition, even though due diligence has been shown. Liability of the acquiring party shall be limited to the value of the acquired farm as it stood at the moment of the acquisition and in conformity with the prices as at the time of satisfying the creditor. Such liability may not be excluded or limited without the consent of the creditor.

## **3) Location**

The location of a particular plot of land is specifically important in the course of due diligence analysis. First of all, provisions of an existing zoning plan must be discussed in detail. Such plan determines the purpose for which the plot of land can be used (for example only agricultural) and other requirements that the potential purchaser-investor must meet when developing the land, such as building intensity ratio. Such analysis also allows to determine the potential directions of development of the area of interest. If there is no zoning plan adopted for the area in question – individual zoning decisions (if issued) must be studied.

Secondly, one must take a closer look at the plot's surroundings and the consequences flowing from the existing shape of its neighbourhood. For example, if a plot of land is situated nearby a national park or an airport, additional statutory restrictions in its usage and development possibilities apply.

## **4) Features of the land**

Another important step of the audit is an in-depth inspection of existing and needed utilities such as access to electricity, gas, telephone and sewer, as well as a proper access to a public road (direct or indirect – by way of a right of passage).

In some cases examination of water rights and obligations attached to the land might also prove crucial. As part of this analysis, special attention should be paid, among other things, to existing or potentially needed water permits, proper access to water sources (for example by way of a water drawing easement

or a water supply contract), legal status of water infrastructure existing on the land (wells, pipelines, drainage systems etc., also whether that infrastructure encroaches upon the neighbouring plots and whether it meets the minimally required technical and safety thresholds) or fees payable, such as a fee for constructing a water facility (for instance hydropower facilities or ponds designed for wastewater treatment) without a required water permit.

Moreover, if the land is (or is to be) developed with some sort of a processing facility, it is essential to inspect how the by-products of these activities are dealt with. For example, a dumping or pesticide storage areas pose significant soil and water contamination risks, therefore potential environmental liabilities must be properly addressed.

The due diligence report cannot stop on a "surface level" – it has to, quite literally, also dig a bit deeper, as some plots of land are naturally rich in mineable deposits such as salt, coal or hydrogen. Formally, it is the State Treasury that is the owner of these resources. Therefore, if a potential purchaser of land wishes to mine them, they need a special administrative permit (concession) to do so. As a part of the audit analysis, it needs to be verified whether any third party has been or is still exercising such rights of extraction of the natural resources on the land and on what conditions.

## **5) Buildings**

According to the Civil Code, as a rule, buildings erected on a plot of land and permanently attached to it (such as siloses, barns, garages etc.) are considered to be this land's component parts. In such case, their legal status and technical state (especially compliance with the provisions of construction law) require a separate analysis.

## **6) Intellectual property rights**

In the field of agribusiness intellectual property law might play an important role, especially when it comes to plant varieties harvested on the land. A plant variety right is an intellectual property right for the exclusive exploitation of a certain plant variety which can be granted both on national and on European Union level. Authorisation of a holder of such rights is required for, among other things, in respect of propagating material of the protected variety - production, reproduction and offering for sale. The legal protection also extends to the derived varieties and in some situations to the harvested material or products produced directly from that material.

In Poland this topic is governed by the Law on Legal Protection of Plant Varieties of 26 June 2003 and the registration system is administered by Research Center for Cultivar Testing. An official document called "Register of varieties protected by national Plant Breeders' Rights" consists of a list of protected varieties and their breeders. A breeder can grant a third party a license to exercise these rights for a fee.