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Buying The Farm– Part II

A farmer must effectively work with the seller to buy farmland for the agreed-upon purchase price. Part II of this Guide focuses on (i) the elements of a Purchase and Sale Agreement, (ii) the investigation "due diligence" process that every farmer should undertake, and (iii) the deed and other acquisition closing documents, and (iv) the closing.

The Purchase and Sale Agreement

After the landowner accepts an offer to buy farmland, the next step is for the parties to negotiate and enter into an agreement for the purchase and sale of the property (a "Purchase and Sale Agreement"). The Purchase and Sale Agreement is a legally enforceable agreement that sets forth the terms of the purchase. Common terms addressed in a Purchase and Sale Agreement include:

- whether any deposit is due from the buyer of the farmland upon signing the Purchase and Sale Agreement,
- the length and nature of the investigation "due diligence period" the buyer has in order to inspect the farmland,
- the representations and warranties that buyer and seller make with respect to the farmland and that otherwise the sale is being made on a "buyer beware" basis,
- conditions that need to be satisfied by buyer and seller before completion of the sale,
- the purchase price and the allocation of closing costs between buyer and seller, and
- the closing process, including which closing documents are required to be delivered by each party.

Each of these terms are discussed in greater detail below.

The Deposit:

Typically, the owner of the farmland will require a "good faith deposit" of money that is due from the buyer when signing the Purchase and Sale Agreement. The amount of the deposit is often based on a certain percentage of the purchase price and is applied against the purchase price at the closing. It is in the buyer's best interest to require that the deposit is held with a third-party escrow agent as opposed to with the seller.

The Purchase and Sale Agreement will also state which party receives the deposit in the event the Purchase and Sale Agreement the sale does not go through. In most cases, the deposit will be returned to the buyer if

(i) the buyer terminates the Purchase and Sale Agreement during the due diligence period, usually based on information acquired during inspection of the farmland;

(ii) the Purchase and Sale Agreement is terminated due to an unsatisfied condition to closing (for example, obtaining a loan) and a party wishes to terminate the Purchase and Sale Agreement; or

(iii) the Purchase and Sale Agreement is terminated due to a default of the seller of the farmland under the Purchase and Sale Agreement (for example, an untrue representation or warranty or failure to transfer the property in the condition required by the Purchase and Sale Agreement at the closing).

The Due Diligence Period:

The Purchase and Sale Agreement will specify the time period that the buyer has to inspect the farmland and conduct due diligence. If the buyer does not complete due diligence in that time, the deposit typically becomes non-refundable. During the due diligence period, the buyer should thoroughly inspect the property to ensure they are comfortable with proceeding with the purchase and/or identify conditions that need to be addressed before the acquisition of the property can move forward. During this period the farmer should confirm the determinations it made prior to submitting an offer. See below for a more fulsome explanation of the due diligence process.

"Buyer Beware" Sale; Representations and Warranties:

The Purchase and Sale Agreement will typically provide that, except for representations and warranties expressly made by the seller, the buyer bears the risk of any issues with the property. Representations and warranties should be drafted and negotiated by an attorney and should include matters relating to the seller and the farmland that would be difficult for the buyer to investigate themselves. For example, a seller may represent that they have no knowledge of any ongoing lawsuits with respect to the farmland and will be liable (the "warranty") if the representation proves to be untrue. Other examples of matters that may be worth having the seller provide representations on include matters relating to the environmental condition of the property, the working condition of any equipment or facilities, and that no other party has a right to purchase the farmland.

Closing Conditions:

The Purchase and Sale Agreement typical sets out a list of conditions that must be satisfied by the seller in order for the purchase to take place. If the conditions are not met (satisfied), then buyer is not obligated to close the transaction.

Closing conditions should be tailored to include any matters that are specific to the farmland in order to get the buyer comfortable with closing on the farmland. Closing conditions may include:

- performance by seller of its obligations under the Purchase and Sale Agreement, which may include, for example, removing certain liens from the public record, paying off existing debt, paying all due and payable taxes, and completing certain required repairs on the farmland or removing old or abandoned equipment.

- delivery by seller of the Deed and other closing documents at closing, and

- delivery of a title insurance policy insuring the buyer's ownership of the farmland.

Unless specifically negotiated, there are typically no conditions to seller's obligation to perform.

The Purchase Price and Closing Cost Allocations:

Core to the Purchase and Sale Agreement is the purchase price and the allocation of taxes, utilities, operating expenses and closing costs. The Purchase and Sale Agreement should state the purchase price and any alternative payment structures (for example, if the purchase price will be paid in installments or includes seller financing).

Additionally, the Purchase and Sale Agreement should set forth the process for allocating taxes, utility and operating expenses between the buyer and seller. This is especially important for obligations that are paid infrequently, such as real estate taxes and water. Typically the seller is responsible for all expenses belonging to its period of ownership and buyer is responsible for all expenses after it takes title to the farmland. Certain post-closing obligations may be negotiated in order to ensure these costs items are reconciled or "trued up" to the extent the initial allocations were based on estimates or were incorrect.

The Purchase and Sale Agreement should also specify which closing costs are the sole responsibility of seller, which are the sole responsibility buyer, and which are shared. Typical closing costs include transfer taxes, recording fees, title insurance and survey costs, diligence costs, and escrow fees. This allocation is always negotiable, but is often based on custom of the state where the farmland is located.

The Closing Process:

Finally, the Purchase and Sale Agreement should specify the process of how, when and where the closing will occur. It is customary that closing will occur a certain number of days after buyer's due diligence period expires. If the parties are using a third-party escrow agent to handle the transaction, then the Purchase and Sale Agreement will specify that the buyer will deliver the purchase price and the closing documents to the escrow agent and that the seller will deliver the Deed and the remaining closing documents to the escrow agent, who will then consummate the closing.

> ***Takeaway:*** Negotiation of a Purchase and Sale Agreement is an integral part of fee acquisition of farmland as it sets forth the legal rights and obligations of the parties and the process for closing on the farmland. It is recommended to work with an experienced attorney to properly draft and negotiate the Agreement, who will be well-versed in these provisions and will likely use form documents that they are familiar with. If you are concerned about legal fees, the Legal Food Hub can help match you with an attorney at low or no cost.

DUE DILIGENCE

Perhaps the most important aspect of land purchase is the due diligence or inspection process. The scope of diligence may vary depending on the size of the transaction. Various aspects of the due diligence typically are carried out by different people based on their skills and knowledge, including the buyer/farmer, farmer's lawyer and other professional consultants.

Typical farmland acquisition diligence includes:

Physical Diligence:

The farmer should physically tour the farmland to ensure the farmland is useful for its intended operations. On larger transactions or if particular diligence issues arise, the farmer could engage engineers and other consultants to determine the levels of risk through tests, studies, and analyses.

- The buyer should specifically inspect the conditions of the land (i.e. soil quality, irrigation and water drainage and erosion) before committing to purchase the farmland in order to make sure the farmland is appropriate for the farmer's use (e.g., for crops and livestock). The buyer should also check field history, specifically, the historic pesticide use if the farmer plans on organic farming, or the historic herbicide use if the farmer plans on pasturing.

- The buyer should also inspect the facilities and infrastructure on the farmland by taking a close look at the fencing, buildings, pastures, lakes, ponds, wells, and roadways of the property. Determination should be made whether the facilities are in good repair or if they will need fixed or upgraded and whether the existing facilities, plumbing, and electricity will meet the farmer's needs or if new infrastructure is needed.

Title and Survey Matters:

Every buyer should obtain a title commitment that commits a title insurance provider to issuing a title insurance owner's policy at the closing of the sale. Typically, the buyer's attorney will coordinate with a title insurance provider to handle this process. From a diligence perspective, the title commitment is important because its sets forth the legal description of the farmland and the rights of others to use the farmland.

- Typical rights of others include covenants, conditions and restrictions, and easements (for example, for utilities or access rights). Particular attention should be paid to conservation easements which can set forth limitations on uses of the farmland.

- The title commitment will also disclose any liens associated with the farmland.

- The farmer should also confirm the flood zone of the farmland, which is of particular importance to a farmland owner.

- Finally, particular attention should be paid to any carve-outs to the farmer's ownership of gas, mineral, and wind rights associated with the farmland (in other words, confirming that those rights are not severed from the farmland).

Zoning Diligence:

Farmers looking to purchase farmland should confirm that the farmland complies with the local zoning code. Particular attention should be paid to the permitted use of the property to ensure the area is zoned for farmland and compliance with ordinances regarding physical structures on the farmland (for example, with respect to setback, density, and building height).

Environmental/Geotechnical Diligence:

Similar to zoning diligence, farmers should also ensure there are no environmental issues at or around the farmland, such as lead contamination. Environmental issues could potentially prevent using the land for agriculture and bring unwanted cost and liability to the new owner. If particular issues arise from review that warrant a deeper scope of diligence, the farmer could consult with professionals to determine the environmental makeup of the farmland and risks involved. In addition, farmers should consult with their attorney about the possibility of engaging geotechnical engineers to conduct tests, studies and analyses of the farmland with respect to such factors like soil quality, water rights and drainage, and other factors that affect the suitability of the farmland for farming operations.

Other Diligence Matters:

Other matters that farmers should review may involve operational matters like existing leases or service contracts relating to the farmland and whether there are any warranties relating to the farmland that will all be assigned to the farmer at the closing, or terminated at closing at the request of the farmer.

> ***Takeaway:*** Buyers should leave no stone unturned and explore all avenues of the diligence process to ensure the farmland is suitable for its needs and avoid surprises. For larger transactions, it is highly recommended that farmers engage skilled third-party consultants to assist in the diligence process.

The Deeds and Other Closing Documents

The Purchase and Sale Agreement will set forth the closing documents that the seller and buyer are obligated to deliver at the closing. The vital document is the Deed, which legally transfers fee title ownership from the seller to the buyer.

Other important closing documents that should not be disregarded and can include:

- *Bill of Sale* – this assigns the seller's right to personal property associated with the farmland to the buyer.
- *Assignment of Leases and Contracts* – this assigns seller's right to leases and contracts associated with the farmland to the buyer.
- *Assignment of Intangible Property* – this assigns seller's right to intangible property (for example – trademarks, licenses, permits and approvals) associated with the farmland to the buyer.

While the buyer should be familiar with these documents, the buyer's attorney will handle drafting and negotiation of the Deed and the remainder of the closing documents.

> ***Takeaway:*** The Deed is the operative document that the farmer will receive in exchange for the purchase price. Potential buyers of farmland should work with an experienced real estate attorney, who will handle preparation of the Deed and closing documents.

The Closing

If the parties are using an escrow agent to handle the transaction (which will likely be a real estate attorney), then the Purchase and Sale Agreement will specify that the buyer will deliver the cash and the closing documents to the escrow agent and that the seller will deliver the Deed and the remainder of the closing documents to the escrow agent. The escrow agent will then confirm that it has the cash, the Deed, and the other closing documents, and will then obtain the parties' authorization to close the transaction. In closing the transaction, the escrow agent will record the Deed and deliver the cash to the seller. The title company will then issue the title insurance owner's policy to the buyer, insuring the farmer's fee title ownership of the farmland.

An alternative to an escrow closing is an in-person "sit-down" closing in which all parties necessary to close the sale will be present at one location to coordinate the closing steps.

Summary

At this point, you did it. You successfully navigated the legal, business and financial requirements to farm ownership and have now officially "Bought the Farm."

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Looking for legal help?
Contact the Legal Food Hub to see if you qualify for ***free*** *legal assistance!*
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