

The importance of a legal due diligence when acquiring a commercial farm in South Africa

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A common transaction structure that is utilised by a purchaser to acquire a commercial farm in South Africa is to purchase the business as a going concern as opposed to purchasing the shares in the company which owns the farming enterprise.

However, regardless of the transaction structure which a purchaser may seek to implement, it is important to conduct a thorough due diligence into the business and affairs of the farming business, before concluding a sale agreement.

Sale agreements for the acquisition of a commercial farm should be drafted by attorneys with experience in these types of transactions and having regard to any issues or risks identified during the due diligence.

Purchasers should be cautious about signing a standard template offer to purchase immovable property as these do not cater for the types of issues which arise when purchasing a commercial farm.

What is a legal due diligence

The legal due diligence can be equated to a type of audit of the business and affairs of the farming enterprise and it assists a prospective purchaser in identifying any material legal risks, issues, non-compliances or liabilities ("material issues") associated with the farming enterprise before they proceed to purchase the farming enterprise.

If these material issues are overlooked at the time of concluding the sale contract, it can lead to significant losses or disputes for the purchaser in the future.

Identifying these material issues can inform the basis on which purchasers negotiate their purchase transaction and can lead to a reduction in the purchase price or assist the purchaser in negotiating that the seller rectifies these matters before implementing the sale or that the seller provides adequate security for such matters for a period of time after the sale is implemented.

It is therefore pivotal that an appropriate due diligence investigation be conducted on the farming enterprise to identify any material issues associated with the farming enterprise.

Matters which should be investigated when purchasing a farming enterprise

Whilst every farming enterprise is different to another, the types of matters that should typically be investigated during a legal due diligence are similar.

The following list is a high-level overview of some of the matters that should be considered.

The title deed of the farm

A conveyancer's certificate is usually obtained to shed light on any encumbrances that may be registered against the title deed of the property. This ensures that the seller is lawfully entitled to sell the farm to the purchaser and that there are not any restrictions applicable to the intended sale.

Typical encumbrances that should be looked out for include mortgage bonds, pre-emptive rights, and servitudes in favour of neighbouring properties or other persons or governmental authorities.

It is also prudent for purchasers to appoint a land surveyor to carry out a cadastral survey of the property to identify any irregularities regarding, amongst other things, the true size of the property, the location of its boundaries, and the location of servitudes on the property.

Water rights

Water is essential for the success of every farming enterprise. It is important to investigate the nature and extent of the lawful water use rights that exist in relation to the farm and whether any required water licences are in place, in order to verify that the owner of the property is lawfully entitled to extract and/or use water for the farming activities being conducted on the property.

If there are material issues identified concerning the extent of the water use rights associated with the property, this could translate to significant losses for a purchaser if it were only determined after it became owner that the permitted water use rights are significantly less than what the purchaser assumed them to be.

Therefore, a qualified water consultant should be consulted to investigate the water use rights associated with the farm.

Liquor licences

Where a purchaser is considering the acquisition of a wine farm, or a farm with a restaurant which serves liquor, it is important to consider whether the seller has the appropriate liquor licences in place and whether such liquor licences comply with all applicable laws relating to the production and/or sale of liquor on the premises.

If the purchaser intends to continue producing and/or selling alcohol on the farm, it will need to obtain its own liquor licence/s or arrange for the transfer of the existing liquor licence/s from the seller.

Zoning and land use rights

The property must also be appropriately zoned for its intended use. Where the purchaser intends to run a guest house on the farm in addition to the farming operations, it would need to ensure that the appropriate consent use for such facilities is in place or will need to apply for such approval after it becomes the owner.

It should also, for example, be determined whether the buildings on the property have been built in terms of building plans approved by the local municipality.

In this regard, a town planning consultant should be appointed to assist with identifying any risks from a zoning and land use perspective.

Environmental considerations

Certain activities being conducted on a farm may require specific environmental authorisations. Moreover, certain environmental authorisations are required for certain structures to be erected on a property i.e. where these are conducted within a certain distance of a watercourse.

Where structures have been erected without such authorisation having first been obtained, or where a property owner conducts certain activities on the property without the appropriate environmental authorisation, significant fines and penalties could be imposed and the relevant authority may require that the structure be demolished or that the activity cease which can impact on the purchaser's intended use of the farm in the future.

It may however be possible that the appropriate authorisation for such structures and activities be applied for and obtained *ex post facto*.

Plant breeders' rights

Various forms of intellectual property may be relevant in a proposed sale. For example, plant breeders' rights protect the creators of new plant varieties and it becomes important to verify whether any plant breeders' rights are associated with the orchards and vineyards on a farm and to provide for appropriate agreements to assign such rights to the purchaser with the consent of the holder of the plant breeders' rights.

Another form of intellectual property to consider is whether copyright that is used by the seller (for example, copyright in labels used on wine bottles) has been assigned to the seller by the creators of the label designs in the first place (i.e., whether the seller is lawfully entitled to use and sell such copyright).

Mineral resources

Mineral rights in South Africa vest in the people of South Africa, with the State as the custodian who is tasked with administering prospecting or mining rights.

It is important to verify whether any person has any right to prospect or mine minerals on the property in question.

Terroir condition

Terroir is a combination of factors, including climate, soil, and elevation, that can influence the quality of crops. It is important to assess the terroir condition of the farm to determine its suitability for the intended use, for example, farming vineyards for wine production versus table grapes or other kinds of fruit or vegetables.

A specialist consultant who has expertise in analysing the abovementioned factors is often appointed to provide an assessment of the suitability of the terroir for farming of particular types of crops.

Farmworkers and other persons residing on the farm

South African law places high importance on securing the rights of occupants of rural land to continue residing there.

It is therefore important for a purchaser to determine the number and identity of occupants that permanently reside on the farm and obtain advice on the legal protections that these occupants are afforded in regard to their right of residence on the farm.

Contracts in respect of the farming business

An assessment of the contracts that apply to the farming enterprise should be conducted.

Specifically, purchasers will seek to identify the contracts which they consider to be critical for the successful operation of the farming business and to seek to obtain the consent of the counter parties to these contracts for the assignment of these contracts to the purchaser as part of the sale transaction.

Conclusion

When considering the acquisition of a commercial farm, it is important that purchasers engage the services of experienced legal advisors who can conduct an appropriate due diligence on the farming enterprise and who can engage and instruct specialist consultants who can advise on the specific matters discussed above which often arise in these types of transactions.



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