



ENVIRONMENTAL DUE DILIGENCE:

IGNORING A PROPERTY'S PAST IS A COSTLY MISTAKE

by Amy Drescher

As a professional with many years of lending experience, Bob Chambers, a commercial lender with a small Midwestern bank, knows that environmental screening is an important part of the due-diligence process. Due diligence helps to confirm the value of property used as collateral for a loan. And failure to investigate a site's potential for environmental contamination can leave a bank exposed to significant liability. During a credit risk analysis, Chambers routinely orders a government records check report on the property. This report provides a map of the property and

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the surrounding area along with “hits” (and supporting data) of any properties listed in federal, state and local databases such as the National Priority List (Superfund), the leaking underground storage tank list (LUST), and more. In one case involving a strip mall in Indianapolis, satisfied that a government records check report turned up nothing significant, Mr. Chambers approved the loan.

Months later, during development, soil contamination was discovered at the site. The bank footed the \$65,000 cleanup bill. Why wasn't the leaking underground tank discovered during the site investigation? Because Mr. Chambers overlooked a critical component of the due-diligence process: the historical investigation. Had he reviewed historical city directories and Sanborn® maps, he would have uncovered the presence of a gas station on the property in the 1950s and 1960s. Furthermore, Mr. Chambers could have consulted a readily available database of old gas stations and dry cleaners which would have revealed multiple hits on the target property's street *and* adjoining streets.

The importance of historical research

“Historical information is extremely important,” said Cal McNeill, vice president of Commercial Real Estate Lending with The First National Bank of Bryan in Bryan, Texas. “This information will reveal the majority of issues that create or cause environmental problems and cost. The immediate danger for a leak or spill is not as great as one that occurred years ago and has been left alone.” A banker in California, who wishes to remain anonymous, agrees. “I deal with the preforeclosure aspect of properties, and consider the historical record critical in the decision-making process as to whether we foreclose on a property and take title.” Offers vice president of Environmental Risk Management Jay Wilttrout, with TCF Bank in Minneapolis, “Historical research is an essential piece of the environmental due-diligence process. Put it this way: You're nuts if you don't do it.”

There is a wide range in the level of environmental due diligence a bank performs, from a simple borrower questionnaire to a full Phase I typically performed in accordance with ASTM Standard E 1527-00. (The Phase I includes an investigation of federal, state and local government records on the property and surrounding area, research into the property's prior uses including past tenants, a site inspection, and interviews with the current owner and occupants of the property and local government

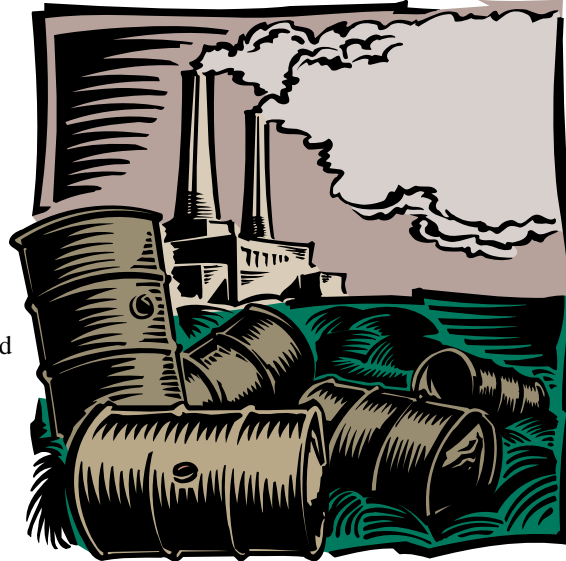
officials.) While historical research is essential to environmental due diligence at every level, *it is a requirement* of ASTM E 1527-00. The standard states that a property's history must be reviewed “back to 1940 or the first developed use, whichever is earlier.” To comply, eight standard

historical sources — including fire insurance maps (Sanborns and the like), city directories, aerial photographs, topographic maps, building department records, property tax files, recorded land title records and zoning/land use records — should be checked. It is important to note that other entities, such as Freddie Mac, FDIC, and SBA also publish environmental screening guidelines, many of which consider due diligence incomplete without a historical investigation.

Many bankers learn about the importance of historical research the hard way. “One property had to be cleaned before

we could make the loan, but many others were foreclosures. They were cleaned up at the bank's expense,” said Mr. McNeill. Adds the California banker, “We foreclosed on a cattle ranch that had cattle dip tanks — the cleanup bill was \$7 million. We found an old gas station with a closure letter from the state agency to be heavily contaminated after we foreclosed and did some digging. And, an old farm that once had an airstrip was highly contaminated because the airplane had been used for dusting operations.” Robert Bickford, a vice president of Commercial Real Estate and a construction loan specialist for Summit Bank in Oakland, California, has also dealt with the consequences of environmental contamination. “While managing a portfolio in Southern California, one site turned out to be contaminated. The customer walked away and it cost the bank \$500,000 on the loan and \$2,500,000 for cleanup. This is why I am very careful with environmental issues today,” he said.

Of course, it is better to learn about problems sooner rather than later. “There have been occasions when we have refused to take title when historical records indicate a high-risk usage in the past, and have avoided the problem by selling the note or using a receiver to transfer the property,” said the California banker. Assistant vice president, environmental analyst Rimmer de Vries, with TCF National Bank in Ann Arbor, Michigan, adds, “We have found many different contamination problems in the course of our historical reviews. Sanborn maps have turned up old plating shops and dry cleaners, city directories have revealed dry cleaners, and aerials have shown dumps, fill,



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excavation and outside storage. Contamination can cost time and money.”

The threat of contamination is no small consideration. According to the National Association of Local Government Environmental Professionals, there are currently between 150,000 and 200,000 underground storage tanks nationwide that contain hazardous substances capable of contaminating groundwater and soil. According to the General Accounting Office, due to limited funding and infrequent inspections, only 89 percent of USTs currently meet federal standards, and only 71 percent are operated and maintained properly.

Arm yourself with knowledge

The message is clear: If you don't research a site's history up front, you increase your potential risk exposure down the road. Armed only with current property information, it is all but impossible to make an informed decision regarding that property's environmental risk. Yet if you're new to historical research, how do you begin? You can always hire an expert. Environmental consultants are trained to perform site assessments and have experience researching and interpreting historical sources. But if you want to do the research yourself, or get a better understanding of your consultant's findings, start by reading the ASTM standard (www.astm.org) for Phase I environmental site assessments. First developed in 1993 by a group of environmental consultants, attorneys, bankers and others involved in ESAs, and revised twice since then, ASTM's standard is now widely recognized as *the* industry standard for conducting a Phase I. You should also read any other environmental due-diligence standards that your bank follows.

Next, become familiar with ASTM's standard historical sources, including where to find them, what information they contain, and how to interpret them. Historical reports and products can either be ordered from environmental risk management information companies, or you can conduct your own research at local libraries or town offices. Aerial photos are available from many sources and can be found in both public and private collections. Currently, there are no historical map Web sites on the Internet, although in the past five years there have been efforts by private companies and government agencies to provide historical resources over the Web. The task is no small order, however, as there are millions of pages, maps and photos of all areas of the United States that need to be scanned and uploaded, and the cost will run into the millions.

“As far as historical sources go, no single source is better than another,” says Hank Burnham, a historical researcher. “However, the nature of the property must be considered before conducting historical research. Sanborn maps and city directories are fundamental to any historical research on an urban property. Topographic maps and aerial photographs are also useful and should be used when

available, but they do not provide the up-close site view that a Sanborn map provides or the documented site uses provided by a city directory. You may see a building on an aerial photograph, but the city directory and the Sanborn map can tell you what was going on in that building and on that property — factors that are of critical importance for an



ESA in an urban area. On the other hand, for rural properties, Sanborn maps and city directories seldom provide the coverage needed to document the property's past use(s) to the level required by the ASTM standard. For rural sites, aerial photographs and historical topographic maps are more likely to come closest to providing a property's true history. In the historical context, however, most properties are a mix of urban and rural and, if possible, all resources should be consulted.”

Researching effectively

If you perform historical searches yourself, knowing how to locate data is critical. With every historical source, it is important to understand the limitations and factor them into the investigation. For example, with Sanborn maps, researching the map index by town name could be risky. If a town name is not in the index, it does not necessarily mean that there are no maps available for that town. It is possible, for instance, that the maps may be listed under another town name. Furthermore, exercise caution if you use the Library of Congress collection of Sanborns. The town index is incomplete and includes only those maps found in the Library of Congress collection — about 70 percent of the total Sanborn collection in existence. City directory research can also be tricky. Published since the late 1800s, these directories can generally be found if you know your site's city or outlying city area, as several cities were usually published together. In the mid-1950s, however, several companies published suburban area directories, making the

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research a bit trickier. For example, a site in Forest Park, Georgia will never be located researching the city itself; it can only be found using the Fulton County, Georgia directories in more recent years and Atlanta Suburban directories in earlier years. Complicating city directory research further, it is quite common for street names to change.

When reviewing historical topographic maps and aerial photos, it is critical to look at bordering counties. Cartographers produced topos by placing a grid over the entire United States; therefore, it is not uncommon to have a site located on the edge of a map quadrant, necessitating a review of adjacent quadrants to better understand the nature of the use of surrounding properties. Also, the names of the quadrants do not always represent the name of the city. A site in Miami may be found on Miami, South Miami, Miami Southwest or Hialeah quadrants. Likewise, names of quadrants change over the years; a site in Atlanta on the Bolton quadrant in 1954 would be on the Northwest Atlanta quadrant in 1983. For aerial photography research, it is important to note that most indices are countywide, and there is almost always overlap from county to county for areas close to a border. If you're not familiar with historical researching, until you become proficient it is best to hire an expert to ensure you're not leaving anything out.

The challenge of doing it right

Most environmental consultants check all sources whenever possible. Sometimes, however, data availability can be a problem. Anthony Buonicore, CEO of an environmental consulting firm, and former chairman of the ASTM E 50.02.06 Phase I/Transaction Screen task group (he participated in the development of the first ASTM site assessment standards and each subsequent revision), notes, "The intent of the standard is that the consultant use as many of the sources as necessary to determine the past uses of the property. However, if any standard historical source is not reasonably ascertainable (i.e., not publicly available, practically reviewable or available within reasonable time for reasonable cost), or if past experience with the source suggests that it is not likely to provide any useful information, then that specific standard historical source does not have to be researched. In such a case, data failure exists with respect to this standard historical source. If all

reasonably ascertainable and potentially useful standard historical sources have been researched, and the property's prior use history is still not clear, the consultant is not required to continue the historical records investigation."

Additionally, most consultants check records at five-year intervals, a timeframe that is acceptable under ASTM guidelines. Said Mr. Buonicore, "There is confusion in what the standard allows as a gap or interval for identifying a property's past uses. The standard says that it is not necessary to review sources at less than approximately five-year intervals. For example, if the property had one use in 1970 and another use in 1975, it would not be necessary to check for a third use in the intervening period. The problem faced by the industry is with multitenant properties, such as shopping centers. While the ASTM standard allows approximately five-year intervals, many types of tenants, including dry cleaners, may have existed within the "approximately five-year interval." This has been the source of much litigation and confusion with respect to the ASTM standard. Thus far, the consensus appears to be that if a client requests a Phase I be performed in accordance with the ASTM standard, the "approximately five-year interval" holds.

What next?

If historical research indicates that there are, or have been, underground or aboveground storage tanks on or near the property, it is important to consider the tanks' age, construction, status and what kind(s) of substances were stored. It is also important to determine whether leak-detection equipment has been installed, whether testing has been done (and, if so, what the results were), and whether there is a history of leaks or spills from the tanks. Additionally, if the site was a former dry cleaner, gas station, photo development site, or other operation that makes use of hazardous chemicals, it is important to investigate further to identify the potential environmental risk. As well, land that appears to have been filled should also be scrutinized. (If you're unsure whether to drop a property from your portfolio, it may be prudent to engage the services of a trained, licensed environmental professional.) Lastly, consider the level of risk your bank is willing to tolerate and factor that into the equation.

If historical reviews aren't yet a part of your due diligence process, it is time to add them. As many banks have learned the hard way, a timely look into the past can save you a fortune in the future. ▲



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