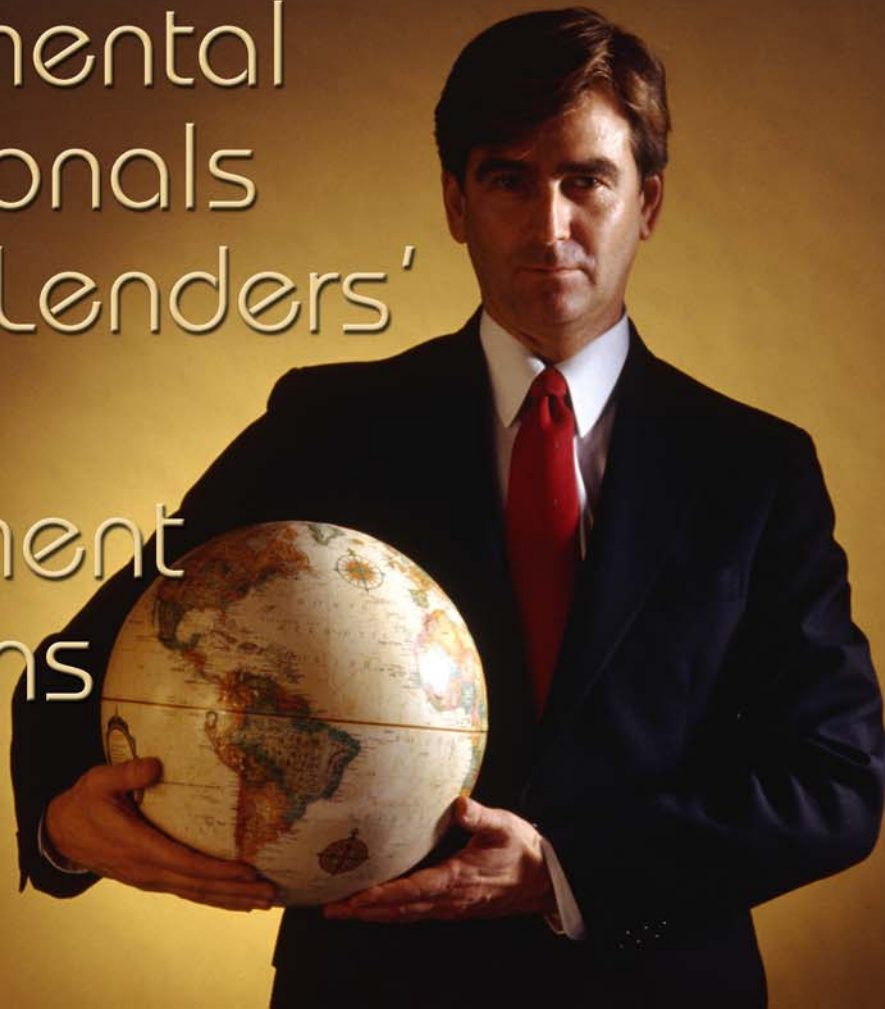


Environmental Professionals Answer Lenders' Top Site Assessment Questions



by Derek Ezovski

The environmental industry is in the throes of change. A new federal rule became effective November 1, 2006, and it is altering the scope of environmental due diligence conducted prior to property transactions. Today, compliance with EPA's new All Appropriate Inquiry rule is required to secure liability protection under the Comprehensive Environmental Response, Compensation and Liability Act. As expected, environmental professionals are undergoing a period of adjustment as they adapt to the new regulation, which differs from traditional industry practice in several significant respects.

Those who rely on environmental due diligence, a practice commonly referred to as a Phase I environmental site assessment, are also adjusting. In particular, lenders are starting to re-evaluate their environmental policies, especially after learning that agencies like the FDIC, the U.S. Small Business Administration and Standard and Poors will require compliance with the new protocol. However, for every lender that has already written the AAI rule into its environmental due-diligence policy, there is another that is unsure whether it's necessary. The decision for each lender will be a function of the institution's risk tolerance. To help lenders learn more about the AAI rule,

some of the country's leading environmental professionals—those who closely follow AAI's developments and who routinely advise their clients on environmental due-diligence best practices—shared their thoughts on conducting a Phase I today.

(Note: To qualify for CERCLA liability protection, either EPA's AAI rule or ASTM's newly updated E 1527-05 Phase I standard can be followed. ASTM, an international standards-setting organization, developed the previously accepted protocol for conducting Phase I environmental site assessments. EPA has determined that ASTM's newest update satisfies AAI.)

Environmental due diligence: Getting started *Do I need a Phase I for every transaction?*

Many lenders require a Phase I for every large-cap loan (i.e., above \$1 million) and for certain loans perceived as posing a high environmental risk. But, in scrutinizing their environmental due diligence policies in light of the new AAI rule, even the most risk-averse lenders are now asking themselves whether a Phase I is always necessary. Some consultants say yes. "Many lending institutions only

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require Phase I when a loan is of a certain dollar value. However, the lower-value loans often have the highest risk of default, which could result in the bank foreclosing on the site and having some accountability for potential contamination. Conducting a Phase I may identify contamination that would assist the bank in determining whether smaller-value loans with higher default potential are worth the risk,” says Matthew Neigh, an environmental professional in Rockville, MD.

Other consultants say, not so fast. “In my opinion, unless the financing entity needs it to ‘check a box,’ a Phase I isn’t always necessary,” says Ray Hendry, an environmental expert in Atlanta. “If the property has known environmental conditions, an adequate operational and environmental investigative history, regulatory oversight, and an experienced due diligence and underwriting team, then I don’t think a Phase I provides much useful information.”

But how can lenders tell whether a former environmental investigation is adequate? “At a minimum, an environmental professional or real estate or environmental legal counsel should perform a desktop review of existing documentation and, based upon the findings, determine an appropriate scope for further investigation, if warranted,” says Elizabeth Krol, P.G., a Hopkinton, MA-based environmental due-diligence expert.

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information must have been collected or updated to within one year of the property transaction, and certain elements (e.g., site visit, government records review, etc.) have only a 180-day shelf life. The thinking behind the stricter updating schedule, compared with the formerly accepted protocol, is that a property’s use, status, or its neighbor’s status could have changed since the site was last assessed.

What types of properties are generally associated with a high risk of contamination?

In making decisions about whether a Phase I investigation under AAI is warranted, past use is often a critical determinant, yet certain property types always merit closer inspection. Gas stations, industrial sites and retail centers with dry cleaners top the list. However, even some sites that might be considered benign, such as nurseries and agricultural land that has been sprayed with pesticides, can be associated with a high risk of contamination.

What qualifications and experience to look for in an environmental consultant?

Besides raising the bar for environmental site assessment research, the federal AAI rule set the first minimum qualifications for environmental professionals. This is driving scrutiny by lenders on the qualifications of their short-listed EPs. Although the rule allows for consultants who do not meet the definition to conduct an AAI-compliant Phase I provided they are under the supervision of someone who does, some lenders are adopting more stringent policies that require only qualified consultants to perform every element. “Look for an environmental degree, a PE license and ten years’ experience,” says David Robinson, PE, an environmental project manager in Buffalo, NY. But lenders should also hire someone with sufficient experience in the work they’re seeking to have done. Carol-Anne Taddeo, an environmental due-diligence expert in Westford, MA, says that someone could be an EP based on subsurface investigation field experience or remediation experience, but never have done a Phase I. She says lenders should ask for resumes and project summaries.

“Review reports by the firm for the proper documentation of data gaps required under the AAI rule and to determine the adequacy of historical research,” says Sean Dundon, an environmental professional in Portland, ME. “This is a good indication of whether the firm cuts corners or could put a lender at risk. If there are shortfalls in this area, question the quality of the entire document. Look for firms that understand your risk tolerance, the debt-to-equity ratio of the loan, and the potential magnitude (in cost) of any identified environmental impairments so you can work as a team.”

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The Phase I environmental site assessment

What are the components of a high quality Phase I?

Phase I ESAs can vary greatly in price, depth and scope. The old adage, ‘You get what you pay for,’ applies. Mr. Neigh says the biggest complaint he hears from Phase I users is that environmental consultants “identify issues and send an invoice” without giving an opinion about the implications of the issues they uncovered. Ben Strong, an environmental due-diligence expert in Weymouth, MA, agrees, and adds that the report should include, among other things, detailed information on historic property use and clear explanations as to why things are or are not considered recognized environmental conditions. This information is critical to rule out potential questions that may arise during a peer review of the report, he says.

“I’ve been involved on both sides of environmental transactions, i.e., buyer and seller,” says Mr. Hendry. “My experience is that an ASTM-compliant Phase I serves more as a ‘check box’ activity than truly generating an understanding of the nature and extent of the environmental problems on site. Typically, the focus of the Phase I is to find everything that could be a problem on the property, and thus areas that have to be investigated as a part of due diligence. On a property that has known environmental issues, this potentially exposes the buyer, seller, and the financing entity to excessive and unnecessary charges. This, coupled with a consultant who isn’t experienced in these types of transactions, can further drive up costs. A Phase I is necessary, but should be done by someone who can interpret the collected information, access and analyze that information, draw conclusions, and provide recommendations relative to the property’s conditions, its clean-up (if necessary), the transaction, and [remain] independent of the interests of the buyer and seller.”

What turnaround time can I expect for a typical Phase I ESA?

While EPs often lament that turnaround times are getting tighter, most say it takes a minimum of two weeks and as many as six weeks to complete an ASTM E 1527-05-compliant Phase I. Discussing the schedule up front can help avoid misunderstandings down the road; any change in the typical timeframe generally affects cost. Lenders in a hurry can help save time if they facilitate site access. Streamlining this path for the consultant can cut days to a week off the turnaround time, according to Ms. Taddeo.

Under what circumstances should a Phase I be expanded to include nonscope considerations such as mold or asbestos?

CERCLA liability protection is often not the primary driving force for having a Phase I conducted. For lenders, the primary concern has more to do with whether environmental issues will affect the property’s value or the borrower’s ability to repay the loan. As such, it is not uncommon for a Phase I’s scope to expand beyond CERCLA hazardous substances to include other environmental risks, like lead-based paint, asbestos and mold. The decision depends on how the client will use the Phase I report. Mr. Dundon offers, “If the borrower is repositioning the asset in any way and may have to excavate soil, dewater the site, renovate the site in a way that asbestos is impacted, or if the ESA can assist the borrower in identifying a property condition assessment issue such as mold, the Phase I scope should be expanded.”

Mr. Neigh advises the inclusion of nonscope considerations when the user of the Phase I report is also the user of the property, or if the lender is lending on a transaction that includes a construction loan or anticipates renovations/alterations to the existing subject property. “Although asbestos and other nonscope issues are not specified as considerations under CERCLA liability protection, the presence of asbestos, for instance, in a building may present a significant cost to the user of the Phase I under a renovation or redevelopment scenario. If asbestos is identified correctly and quantified during due diligence, these costs can be accounted for when evaluating the purchase of the site and whether the planned use is financially viable.”

Ms. Taddeo adds, “These concerns are primarily related to the ability to lease/occupy space, and, in the case of asbestos, where renovation or demolition is planned. Mold is more of a geographic concern, as it is more prevalent in more humid climates and in low-lying, flood-prone areas. Mold surveys are becoming common for buildings in these areas, and due to tenant concerns, in multifamily buildings, regardless of location. Asbestos is a

greater concern in older buildings; however, this is due more to its potential damaged condition. Asbestos is still legal for use in several building materials, and may be present in recent construction. The EPA requirement for a survey prior to renovation or demolition is not age-dependent for



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Environmental professionals answer lenders...

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this reason. If asbestos is present in a building in good condition, in most cases, it can be managed-in place. Generally, asbestos surveys are being requested in buildings constructed prior to 1981 (based on OSHA date for presumption that certain materials are asbestos-containing).”

Next steps

What can I expect if contamination is discovered during the Phase I?

The Phase I is complete, and an environmental condition has been uncovered. Time to panic? Not necessarily. Lenders in this situation do have options. “The first step is to quantify the potential cost to clean up the property, either through a rough estimate using what is known or, if greater certainty is needed, by conducting further investigation. Based on this information, the deal may proceed with funds in escrow for the clean-up, the loan may be delayed to allow clean-up to occur, or other options may be pursued. It is important for both lenders and consultants to understand whether there is a nondisclosure agreement in place should the loan not proceed. This would determine whether the borrower can be told of the release, potentially obligating it to report it to the state,” says Ms. Taddeo.

Get your consultant to help evaluate the business risk posed by the contamination, and make sure that evaluation includes information on whether the contamination is continuing, whether there is a reporting obligation to a regulatory agency, if that obligation has been met, and whether additional investigation is necessary, says Mr. Neigh. He also advises discussing what’s needed to obtain an estimate of remediation costs.

“In some cases, identification of on-site contamination may be a deal breaker; in others, the cost to address the issue is negotiated as part of the purchase price. Options include obtaining environmental insurance, establishing an escrow account to mitigate the problem, or perhaps obtaining a fixed-price remediation contract and negotiating the costs between buyer and seller,” says Ms. Krol. ▲



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