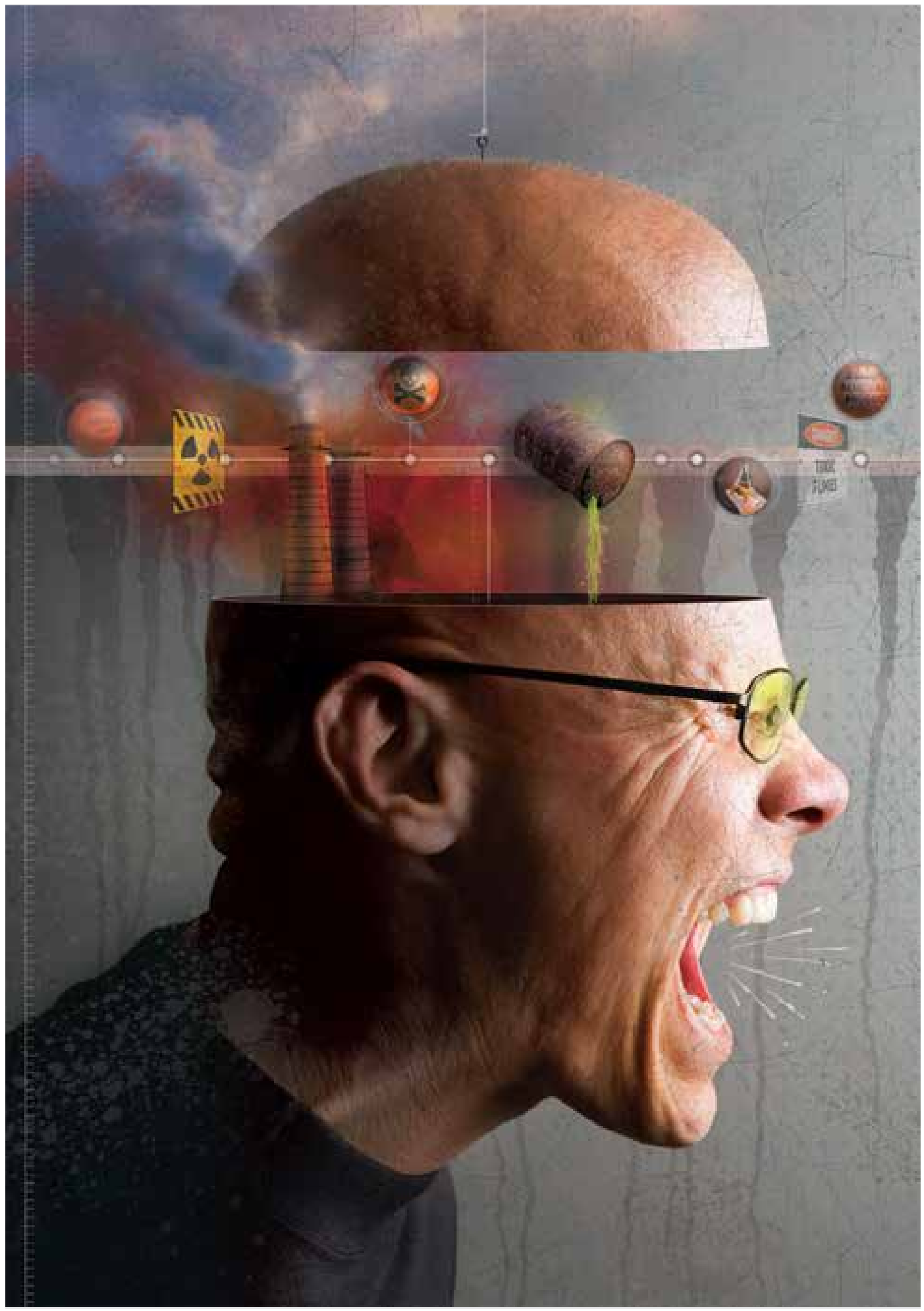
Alleviate Lending Headaches

Knowing a property's environmental history can be critical to closing deals

By D. Lynn Howells



There is no bigger headache for a broker or a property owner than getting a loan approved but then losing funding over an environmental issue. What can brokers do to protect their deals from this kind of risk? What can their clients do to make sure they don't end up with a building that can't be financed? How can both parties get these deals back on track? These are all good questions that should run through a broker's mind. The answers come from delving into the property's history.

Researching a commercial property to determine if it has a checkered environmental history starts with pre-purchase due diligence. As the adviser and professional in the mortgage process, you, the broker, need to help your borrower ask the right questions and make sure the buyer has a complete understanding of the property's prior uses.

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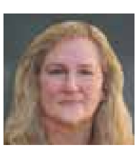

D. Lynn Howells is an underwriter at APEX Mortgage Corp. as well as a geologist and former environmental consultant. APEX is a nonconforming national lender that specializes in small-balance commercial mortgages ($25,000 to $1 million). APEX excels in understanding the income and credit issues faced by many self-employed borrowers. Learn more about APEX at apexmtg.com. Reach Howells at (800) 262-2739, ext. 227, or lhowells@apexmtg.com.

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Property-use issues can arise from a use that existed many years ago, often from a commercial use 20 to 40 years ago that involved underground storage tanks. This can be anything from a heating-oil tank to a chemical storage tank, such as gasoline or diesel fuel. Now, after decades — and several owners — no one knows the details about any such tanks and/or their removal.

It's not enough to know that a tank has been removed. You need to know how it was removed and what testing and site remediation was done. This includes obtaining a full understanding of any ongoing testing or monitoring that may be occurring on the property. If the removal happened years ago, this can become an even greater challenge.

Mitigating risk

To mitigate the risk of an environmental issue killing your deal, you need to start by getting an environmental history report. Numerous services provide these reports and they aren't that expensive. This report will disclose prior uses and any reported environmental issues related to the property. It will also tell you if the site ever had any registered storage tanks.

Equally important to the lender involved, the report will describe environmental issues that impacted nearby properties. This is important because you may not be able to finance a property that is adjacent to a contaminated property or is down grade from a property that had an incident. Once this report is reviewed, you have overcome the first environmental hurdle, but you're not done.

As part of property inspections that are common to any commercial purchase, brokers and buyers need to require that the inspector look for indications of environmental issues. Not only does this include the easily visible things, like storage drums or operations that involve chemicals or solvents, but also things like old feed pipes.

Today, it is not uncommon to find commercial buildings that are currently heated by gas, but were once heated by oil. If that's the case, there may be feed lines from the old tank, so it is important for the inspector to look for these and inform the broker and buyer of any found on the property. Environmental issues can be like a loose thread: Once you start pulling, you never know what will unravel.

If you get a clean property-history report and your inspection does not discover any issues, you should be home free. If you find an issue through either of these due-diligence processes, however, then further action is required.

Risk tolerance

If you do find an environmental issue on a property while working on a purchase loan or refinance, there are two things you should do as a broker. First, you need to understand your lender's tolerance for environmental risk. Second, you need to collect information about the property and overload your lender with it.

Different lenders have different levels of comfort with environmental risk. As the broker, you need to know what properties are on your lender's ineligible collateral list. Check to see if your preferred lender will finance properties that have active tanks or ones that actively use hazardous materials.

Remember that oil from your car's engine is toxic and can contaminate the soil or water at a property. This means it's not just gas stations that present a risk. Active uses like auto repair, transportation companies, auto body, car washes and more are all possible excluded properties. The same goes for properties where chemicals are used for stripping or coating materials.

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If you know what your lender will tolerate, you will save time and avoid rejections. There are lenders that accept all of these property types. You just need to search for them. This may force you to look beyond conventional lenders to find a specialty lender that can fund your deal. Many of these property types fit into the sweet spot of small-balance commercial lenders.

Information overload

The other thing that will help close transactions on properties that appear to have environmental issues is information. If a tank was removed from a property before the strict guidelines that exist today were in place, for example, you, as the broker, will need to become creative. You may need to track down prior owners to obtain paperwork or reports on the removal.

To aid in information retrieval, you can reach out to service providers that specialize in environmental issues. These vendors offer a variety of services, many of which are less expensive and/or less time-consuming alternatives to the Phase 1 or Phase 2 environmental studies that your lender may be suggesting.

If you want to know if an underground storage tank still exists on a property, for example, you can start with a magnetic survey or ground-penetrating radar survey of the property. This allows the vendor to detect the presence of various subsurface anomalies, such as metal or fiberglass tanks, pipes or disposal pits, even when these are currently under concrete or paving.

The results of this test and a conversation with the lender can often save your client the cost of a more detailed study. When a lender does require a Phase 1 study, make sure that both you and your client understand what is involved, what the costs are and how much more a Phase 2 study will cost.

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These reports can be expensive, depending on the extent of the work, but may be required by certain lenders. If you are working with a lender that requires a Phase 1 on all deals, build that into your cost analysis when comparing your client's financing options. This might be the time to think outside the box and look at alternative lenders.

Don't let this process scare you. A lot of conventional lenders require a Phase 1 on most commercial transactions and never need a Phase 2. Remember, knowledge is power. The more you know about how your lender looks at environmental risk and about the process, the better you will be at getting your clients the financing they need.

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Sometimes it is impossible to quantify the exact extent of a commercial property's level of environmental risk. Sometimes the cost of evaluating the existing risk is disproportionate to the transaction size. Sometimes the nature of your client's business is such that environmental risk is a part of everyday life.

When these situations exist, you need to direct your borrower to a lender that will look at the entire picture, evaluate the risks and the rewards of funding your transaction and make a decision to move forward. This is when you need to pull from your deep pool of nonconventional lenders and find one that fits. Unless a property is currently contaminated (and glowing in the dark), there is most likely a lender out there that can fund your transaction. ■