



By **Eric Kieselbach**
President
Phase One Inc.

Follow the Wise Steps of Due Diligence

To secure funding for clients, know how lenders make environmental assessments

Today's economy is in a fragile state, with commercial property foreclosures and short sales becoming ever more common. Given the economic slowdown, mortgage lenders may take this time to evaluate their environmental due-diligence needs for loans before the economy picks up again. For many lenders, the time is right to examine their environmental due-diligence program — either because it needs updating, because a formal program has never been implemented or because the costs of the current program have inhibited the success rate of loan approvals.

Updated policies mean many lenders are considering a new, all-inclusive stepwise program for environmental due-diligence. Although this type of program can be customized for each lender, commercial mortgage brokers should be familiar with the most-common approaches to a stepwise program so they can guide clients through the process efficiently and secure funding for their deals.

The stepwise program

A stepwise approach is a program that provides environmental due-diligence in incremental steps. It begins with the environmental risk-summary report, which is a quick screening. The second step is an environmental database report to get additional environmental risk details on the property and the surrounding area. The third step is a records search with risk-assessment report or a transaction-screen report, providing a review of historical and current site uses and the environmental database report. The last two steps are the Phase I environmental site assessment and Phase II site assessment. At any point, the lender may skip to an appropriate step.

Typically, companies that use this approach will discount the cost of any of the prior reports ordered from the cost of subsequent reports completed for the loan transaction, with the exception of a Phase II environmental site assessment. This report often is property-specific, and its scope of work is designed to address the recognized environmental conditions identified in a Phase I environmental site assessment.

Environmental risk summary

The environmental risk-summary report is a quick, one-page report that provides the environmental risk for a specific property and the surrounding properties. This report displays a map with the site location and the surrounding site locations within a quarter-mile radius that have been identified on environmental regulatory databases. The map has colored triangles representing the level of environmental risk associated with specific locations.

Often, the loan process will start with the involved parties unaware that there are any environmental risks associated with the collateral property. This quick summary report alerts the lender to any identified environmental risks that may be associated with the property, thus allowing preparation for a potential delay earlier in the transaction. It is typically free; some companies may charge a small fee, however. This report does not meet any specific standards and should be used only as a screening tool.

Environmental database report

The environmental database report is a computer-generated federal, state and regional one-mile regulatory database search used to determine whether the

collateral property is listed on a regulatory agency environmental database and to identify regulatory-listed sites of concern within a one-mile radius.

In general, these databases list known or suspected hazardous-waste generators, release sites, landfills, authorized disposal sites, sites with registered or leaking underground storage tanks and sites currently under investigation for known or suspected environmental violations. The agency databases vary among states and regions and always meet or exceed the requirements of ASTM International.

Details of listed sites are presented in this report, and the lender will receive a computer analysis of the environmental risks. The environmental database report provides multiple maps that display various shapes representing sites that are listed in the government regulatory agencies' databases. This report is tailored for financial institutions, and lenders may use it to determine whether moving forward with the loan is ideal. This report often is produced within 30 minutes and delivered via e-mail; it provides information that is beneficial to the progression and success of the loan. It typically costs \$70 to \$100.

continued >>

Eric Kieselbach is the president of Phase One Inc. and Environmental Record Search. He was one of the environmental consultants selected to work with the U.S. Small Business Administration's environmental lawyers to develop environmental due-diligence policies for 504 and 7(a) commercial loans. For more than 20 years, Kieselbach has striven to provide his clients with the best environmental advice they can receive for any transaction nationwide. Contact him at (800) 524-8877 or erick@phasei.com.

<< continued

Records search

The next step in an environmental due-diligence program can go one of two ways. According to the loan's size and the different standards to which it must adhere, lenders may decide to order a records search with risk-assessment report or a transaction-screen report.

The records search with risk-assessment report was designed to meet the U.S. Small Business Administration's environmental due-diligence policy requirements for 504 and 7(a) loans for environmentally non-sensitive properties where the loan value is greater than \$150,000. This report also may be used when the loan value is less than or equal to \$150,000 if the property is environmentally nonsensitive but the environmental questionnaire indicates further investigation. In the past, a transaction screen was required.

Many commercial lenders have adopted the records search with risk assessment as part of their environmental due-diligence, but it does not replace a transaction screen. The records search with risk assessment determines if a property is at high risk, elevated risk or low risk for environmental contamination. The environmental risk is based on the property's historical uses, as well as a review of the one-mile regulatory environmental database records search. If the property is determined to be at elevated or high risk, further environmental investigation may be required. This report typically is done in three business days and ranges from \$299 to \$700.

Transaction screen

Instead of the records search with risk assessment, a transaction-screen assessment may be indicated. This report is ASTM Standard E 1528-06 compliant and provides environmental due-diligence for small loans for environmentally nonsensitive properties.

The transaction screen includes:

- **A site inspection with digital photo documentation** of the site visit;
- **A review of the computer-generated, one-mile radius regulatory records** research document;

- **A review of historical city directories**, if readily available or ascertainable;
- **A review of questionnaires completed by the owner and tenant**;
- **A review of the questionnaire completed by the person completing the site inspection**; and
- **A recommendation** if further investigation is required.

The entire report is reviewed by an environmental professional as defined by the Environmental Protection Agency's (EPA's) All Appropriate Inquiry rule. Companies that offer this program often provide a second option for this report, the electronic transaction-screen assessment. ASTM standards for this are the same as a regular transaction-screen assessment; the only difference is the site walk/observer questionnaire is completed by a lender representative or a real estate professional.

The transaction screen is specifically geared toward certain types of properties: commercial, residential and vacant land. Commercial properties are office buildings and retail stores. Residential properties include projects such as housing tracts, apartment complexes, senior-housing facilities and daycare facilities. Vacant land is simply undeveloped land.

A transaction-screen assessment costs significantly less than a Phase I environmental site assessment, and ranges from \$750 to \$950. An electronic transaction-screen assessment costs \$399 to \$700. These reports usually take 10 business days to complete.

Phase I assessment

A Phase I environmental site assessment is the predominant environmental due-diligence tool used for evaluating the risk associated with real estate properties or portfolios. A Phase I report should comply with ASTM and EPA standards.

A Phase I environmental site assessment includes all the components of the environmental database report, records search with risk assessment and transaction-screen assessment. It also includes a review of regulatory agencies' records and any environmental liens, additional

historical research and interviews, and reviews of data gaps and geological or hydrological information. The report identifies if there are any recognized environmental conditions associated with the collateral property and is signed by an environmental professional. Conclusions and recommendations, if necessary, are provided.

A report should be completed in 10 to 15 business days, and the average cost is \$1,800 to \$2,100. The cost may increase significantly for larger, more-complex properties.

Phase II assessment

When a Phase I environmental site assessment identifies a possible environmental condition for a property, a Phase II environmental site assessment is warranted. It includes further investigation to determine if there is a recognized environmental condition.

The areas typically investigated involve the subsurface soil or groundwater and may be investigated by collecting soil samples, soil gas samples and even groundwater samples. These are collected to determine if there is any environmental contamination present. Sometimes the initial Phase II assessment's results will indicate that there is no environmental contamination. Consequently, the recognized environmental condition identified in the Phase I assessment is eliminated, and the loan can move forward. Other times, the results of the initial Phase II assessment will indicate there is environmental contamination and further sampling is required to characterize and delineate the area of environmental contamination. The assessment also can recommend remediation activities to rectify the situation.

A Phase II assessment typically takes 15 to 20 days, including on-site drilling or sampling activities, laboratory analysis and completing a written report.

Benefits

A stepwise program to environmental due-diligence provides cost and time savings and reduces environmental risk. Although

continued >>

<< continued

these benefits apply primarily to the lender, a more efficient due diligence process means loan applications move more

efficiently through the system — a benefit to commercial mortgage brokers and their clients.

Knowing the stepwise program will help brokers prepare their clients for all that is involved in environmental due-diligence. ●
