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The value of a phase one environmental site assessment during an acquisition or a foreclosure

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During the last real estate cycle where prices appeared to appreciate daily, many lenders and investors were required to move quickly. Transactions were at an all time high and competition fierce. In any industry, this kind of pressure can lead to mistakes. The environmental due diligence industry is no different. Purchasers feeling the pressure of a back-up bid for more money may have waived their right to a phase one because of the time required or accepted a lesser product such as a database report in lieu of a complete phase one Environmental Site Assessment (ESA). Many of these environmental issues may go undiscovered as long as the borrower is paying their loan on-time. Bank acquisitions may compound the problem as executives do not typically look at what type of environmental report is in the loan folders. Did the institution being acquired require full phase one assessments on all loans? Did the amount of the loan, type of asset (multifamily vs. commercial), and time frame allotted before closing play a role in the type of due diligence conducted by the lender to evaluate the environmental risk.

These days there is a more cautious approach to buying or financing commercial real estate especially when potential environmental issues such as on-site dry-cleaning operations or buried tanks arise. Lenders have become more cautious these days requiring more phase two investigations. Non-performing loans can become more complicated for the lender if an environmental issue exists. If the lender realizes that there is no environmental report in the folder, what they can represent to a potential buyer is limited. That can open the door for additional investigation such as soil and groundwater testing or more generically referred to as the "phase two" which can delay the sale of the property. If an environmental issue is discovered, there may be regulatory notification required in which the lender may need to manage or even pay for remediation. The severity of the situation is also going to cause the buyer to re-think the price he is willing to pay for the property. Depending on the age of the report and it comprehensiveness, the lender may need to order an updated report or new one from their approved vendor list to help better determine if any environmental issues exist prior to foreclosing. These steps take time and money and the bank generally pays the fee during a foreclosure as opposed to passing it along to the borrower. The ASSTM 1527-05 All Appropriate Inquiry standards provide certain protections as long as the report meets the protocols of the standard.

Purchasers are also taking a closer look at the potential environmental impacts than ever before. The theory of "I am getting it for a good price" does not resonate as it once did with buyer's more understanding of these costly environmental issues. A purchase price a few dollars below market can never make up for the potential cleanup cost, regulatory supervision, site disruption involved and potential law suits from tenants and neighboring property owners. Since 1994 the American Society of Testing Materials (ASTM) has provided the industry with standards on how to conduct a phase one assessment. These standards have been amended several times with the latest version being issued in 2006 as the 1527-05 standard. In 2006, Congress and the Federal Environmental Protection Agency (EPA) issued the All Appropriate Inquiry (AAI) rule which is the most comprehensive standard to date and offers purchaser's some protection from cleanup liability. The rule has ten key changes from the previous standard that must be adhered to in order to qualify for the protection. The process of buying commercial property can require a lot of out of pocket expense including legal fees, title insurance, appraisal, etc. The value of an environmental site assessment should not be overlooked.

This is the best time to understand the potential environmental impacts without the burden of the remediation lying at the feet of the purchaser or lender.

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