



Environmental due diligence: A crucial part of the development process - by Michele Pincus

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Planning for environmental due diligence is crucial in identifying the potential risks before entering into a real estate transaction. This helps either side to the transaction anticipate and correct problems that may affect the purchase/sale price and lessens demands for reductions in price or substantial escrows to cover potential liabilities.

A significant part of assessing the physical state of the real property, whether it is vacant or improved, includes consideration of environmental conditions. Determining whether there are any environmental issues affecting the property is an important part of protecting prospective property owners from potential liability for environmental contamination discovered now or in the future. The nature and extent of the required environmental due diligence is shaped by the current and historic uses of the property as well as its location and the laws/regulations to which it is subject.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) establishes a determination of liability for hazardous substances found on a property. CERCLA authorizes the fining of property owners and requires the removal of hazardous materials at the expense of the owner regardless of the current property owner's responsibility for causing the hazardous condition. CERCLA, and the subsequent legislation, established the All Appropriate Inquiry (AAI) rule - a process for innocent landowners and bona fide prospective purchasers to protect themselves from environmental liability by meeting certain criteria. The industry standard for meeting the AAI Rule is the Phase I Environmental Site Assessment (Phase I ESA). A Phase I ESA, the backbone of environmental investigations and due diligence assessments, is performed to aid purchasers in defining the environmental quality of the property.

As part of the Phase I ESA, a qualified environmental professional examines the environmental history of a subject property, including a review of its property records, research on the land's past uses, interviews with current and prior owners and occupants of the site, inspection of the site, and a review of the site's current operations and conditions. In addition, a Phase I ESA includes review of regulatory environmental records, files, and database reviews, identification of Recognized Environmental Conditions (RECs), Historical RECs (HRECs), and Controlled RECs (CRECs), as well as other conditions indicative of potential environmental impact and financial liability. Finally, a Phase I ESA includes recommendations regarding the overall findings of the assessment,

By conducting the due diligence assessment consistent with the AAI rule, potential purchasers may alleviate costly environmental liabilities and resultant regulatory enforcement including investigation, remediation and monitoring, fines and/or other civil actions. Note that the Phase I ESA is essentially a 'paper' study. Although the environmental professional will identify Recognized Environmental Conditions (RECs), if present, the extent of potential risk from the RECs will not be quantified. A Phase II ESA may be warranted as a result of the findings in a Phase I and can quantify the identified risk. The Phase II may include a sampling investigation to confirm or deny the presence of contaminants in the soil, groundwater or soil vapor. Depending on the findings of the Phase II there may be a need for site remediation or further examination of identified issues.

By "uncovering" environmental contamination, a potential property owner is providing the documentary evidence of historic or ongoing contamination, prior to ownership of the property or business. With this information in hand, a purchaser can request that the owner remediate these conditions prior to purchase or can utilize this information as a financial consideration of the real estate transaction.

As an additional factor, assessing existing buildings for business environmental risks including asbestos, mold and lead-based paint are important to determine the overall potential cost liabilities associated with the site. Asbestos, lead and mold are non-scope considerations in the Phase I process so remember to consider these as additional potential liabilities. When engaging a consultant to assess the environmental condition of a property, make sure the company is reputable and, at a minimum, follows the appropriate ASTM standards.

In summary, an effective environmental due diligence process supports the real estate transaction and protects the potential property owner. The investment in environmental due diligence is well worth the price to avoid devastating financial liability.

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