



Hunt Corp. Commercial Real Estate Q&A: Environmental reports

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Q: We have made an offer to purchase a building. Our broker insisted that it was made “subject to environmental.” What exactly does that mean?

A: When purchasing any real estate, one of the most critical items to research is the environmental condition of the property. There are several critical reasons that a comprehensive environmental report must be done, not the least of which is the fact that nearly every lender will mandate such a report. More importantly, however, the law makes you responsible for the environmental condition of the property, whether you contaminated it or not! Therefore, this environmental report **MUST** be done properly. With current environmental laws, the failure to protect yourself with a comprehensive report could be more expensive than the entire acquisition cost of the project.

Environmental reviews are broken down into two parts. A Phase I report involves researching the historical uses of the property as well as walking through the potential site conducting a visual inspection. A certified environmental engineer will look for discolored concrete, new patches of concrete or asphalt that might indicate the removal of underground tanks (USTs.) He will also be looking for other environmental concerns, such as 55 gallon drums. If there are “positive” results (a good report is “negative” for signs of environmental contamination), then more active testing is required, and this is called a Phase II inspection. This might include soil, groundwater or similar testing. So, when you negotiate the contract of sale, make sure that you have the right to conduct a Phase I inspection, with further rights to a Phase II inspection if the Phase I is positive in any way.

The priority after signing a contract is to hire a reputable environmental firm to do a Phase I survey of the property. A lender will typically have a list of approved environmental companies, so make sure you have that list before hiring an engineer. It is good practice to interview at least two companies and request proposals from both of them. When hiring the firm, it is a good idea to let the principals know if they find information that will cause the need to do some physical work (a Phase II), their company will not be handling that component of the work. This will avoid the situation where your environmental engineer is incentivized to find issues. You want to avoid being in a position where you and your consultant have different goals. To further complicate matters, the seller also has conflicting goals and may not want you to go on an unlimited “fishing expedition.”

Current environmental law makes the purchaser responsible for uncovering any existing

environmental contamination prior to purchasing the property. The stakes are very high, since responsibility can be personal, as well as “joint and several.” I once had a client who was quite interested in purchasing an industrial building, but after our initial inspection, I remembered that there was a Superfund site in the immediate area. I hired an environmental engineer to access all the public information and give me a verbal report. He called me to say, “I would not hesitate to lease the property, but there is no way in the world that I would put my name in the chain of title.” Obviously, my client and I walked away from this potential purchase.

This is a good illustration of why environmental homework is a must. Many older sites have cost millions of dollars to remediate, so carefully follow the above steps to ensure a successful purchase.

Do you have a question regarding commercial real estate? Email your question to Commercial Real Estate Q & A, at email@huntcorp.com for possible inclusion in a future column.

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