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The dog days of August and due diligence: Real estate is elastic and will come back stronger

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As the economy drags along trying to find the bottom so does the environmental due diligence industry. Many firms that entered into the business during a period of robust lending found that business was plentiful for all. Since the melt down which began in late 2007 and collapsed in 2008 with the fall of several major Wall Street Institutions, the due diligence industry has been in free fall as well. Firms are consolidating, laying off senior staff members or simply going out of business. Land America which became a nationwide provider of due diligence reports declared bankruptcy in the spring of this year. Their main focus was clients that originated commercial mortgage backed securities (CMBS) deals which were originated from coast to coast by Wall Street firms. To give some perspective to the severity of the decline, in 2007 there was $230 billion of real estate loans originated through the commercial mortgage back securities (CMBS). In 2008, $12 billion worth of deals were brought to market. The latest figure from June of 2009 indicated less than 1 billion was brought to market to be securitized. This steep decline in which firms were forced to adjust cannot even be described as a decline in the market but a sheer cliff. As firms expanded to meet the needs of their clients, so did the expenses. Many larger firms which grew into these expenses happily to serve their client's appetite, were not prepared for such a drop in volume at such a rapid pace. Not only were due diligence firms impacted but appraisers, attorneys, title companies, etc. Basically anyone and everyone who made their living from the lending community have suffered.

The decline is not only on the national level, local due diligence firms are feeling the pinch as well. Many local banks are on the sidelines or working out non-performing loans vs originating new ones. Real estate is a cyclical industry and this type of turmoil has been felt a few times over the past two decades. In the late 1980s, the condominium and co-op market got over heated and many people and lending institutions had similar losses. This may be one of the reasons why many lenders are on the sidelines right now. The main difference from that decline to the one we are experiencing today, is that the term due diligence had not yet found its niche. Phase one environmental site assessments (ESAs) did not exist in the late '80s. The American Society of Testing Materials (ASTM) published their first environmental standards in 1994. Property Condition Assessments (PCAs) and plan and cost reviews of construction projects were not an everyday requirement of lenders. This means many more firms and individuals are affected now than in previous downturns in the real estate market.

All of the news is not bad. The Small Business Administration (SBA) has been more active in the second quarter of 2009. They streamlined the environmental process in 2008 and there are requirements ranging from database with review, transaction screens to full phase one assessments depending on preliminary findings or based on the code classification that the property is designated. On sites such as gasoline stations and dry-cleaning operations, which are on the list of environmentally sensitive industries will require a full ESA assessment to the All Appropriate Inquiry (AAI) parameters. Private investors have also been raising capital in anticipation of buying distressed properties which will require due diligence firms to assist them. In addition, lenders are foreclosing on properties and requiring new or updated environmental reports to help guide through any environmental issues that may exist. So as August becomes September and we move from the first half of a dismal real estate year into the home stretch of 2009 perhaps some of the issues that have plagued the country as well as real estate will improve. As we have seen in the past, real estate is elastic and always comes back stronger. Hopefully that elasticity will kick in sooner rather than later.

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