

# **Michigan SBA Lender's Conference Environmental Considerations II**

## **Baseline Environmental Assessments, Brownfield Redevelopment Projects and SBA Policy Exceptions Case Studies**



**Presented by  
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March 20, 2009**



# Environmental Due Diligence

**Historical Inquiry Conducted when  
Financing, Foreclosing, or Purchasing,  
Commercial Real Estate.**



**Due diligence attempts to establish innocent land owner  
defense, assess environmental liabilities and quantify  
risks associated with the property.**

**Derived from Comprehensive Environmental Response,  
Compensation and Liability Act (CERCLA) at the  
Federal Level and Part 201 of P.A. 451 at State Level .  
Attempts to avoid liability for cleanup**



# FDIC Rules on Environmental Policy

- Environmental contamination and its associated liability can have a significant effect on the value of real estate collateral. It is also possible for a lending institution to be held directly liable for environmental cleanup of real property collateral acquired by the institution.
- Institutions should have in place appropriate safeguards and controls to limit exposure to potential environmental liability associated with real property held as collateral. The environmental risk program should be tailored to the needs of the institution.
- As part of its environmental risk analysis of any particular extension of credit, lender should evaluate whether it is appropriate or necessary to require the borrower to perform an evaluation that meets the standards and practices of the EPA All Appropriate Inquiry.

# Appraisal Considerations

- Should appraisals account for environmental liabilities ?
- Can liabilities arbitrarily be accounted for by a set percent reduction in appraised value ?
- How many of your appraisals have an environmental disclaimer ?



# Common Environmental Due Diligence Tools, Definitions and Acronyms

- Transaction Screen – Limited Historical Research Including a Database, City Directories and Sanborn Map Review.
- Phase I Environmental Site Assessment (ESA) – Extensive Historical Research Including a Database, City Directories, Sanborn Map Review, Municipal, State and Federal Records Review, Aerial Photos, Adjoining Land Use, Utility Connections, etc.
- All Appropriate Inquiry – (AAI) defines Phase I ESA process for innocent land owner defense.
- Environmental Professional (EP) – those qualified to conduct AAI Phase I ESAs.
- Phase II ESA – physical collection of soil and/or groundwater samples for chemical analysis.
- Baseline Environmental Assessments (BEA) – Phase II results summarized in MDEQ recommended format to obtain liability protection – must be completed in 45 days of purchase, occupancy or foreclosure.  
Affirmed – MDEQ reviews and opines.  
Disclosure – MDEQ issues letter of acknowledgement of receipt.
- Due Care – provisions to ensure safety of general public at sites of known contamination.
- Phase III – Remediation – cleanup/removal of contaminated soil and/or groundwater.
- Vapor Intrusion Condition – site is in close proximity to contamination that could affect indoor air quality.



# All Appropriate Inquiry (AAI) Defined by the EPA

- All Appropriate Inquiry (AAI) Defined by the EPA
  - Effective November 1, 2006.
  - Defines what level of environmental due diligence is necessary for AAI;
    - Phase I ESA required for New Purchases
    - Eliminates Transaction Screens (New purchase only)
  - Establishes credentials necessary to be “Environmental Professional”.
  - Will result in increased prices for Phase I ESAs.
  - Shelf life of Phase I ESA shortened to 1 year, if AAI/ASTM 1527-05 compliant.
  - No updates on pre AAI Phase I ESAs (2000 standard and older).
  - No updates after 1 year.
  - Updates only AAI compliant between 6-months to a year.

**Required for Baseline Environmental Assessments in Michigan  
and Brownfield Redevelopment Projects**



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# Due Diligence Options

1st Step - Determine if there are  
Recognized Environmental Conditions (RECs)



## **Options based upon Transaction - There is no Correlation to Loan Value and Environmental Risk.**

**Site Specific Environmental Risk Evaluation:** \$250 to \$1,200 Completed to meet specific bank risk requirements, and the scope of work can vary greatly. Can be as limited as the review of databases, or up to a full Phase I level historical and records search. Completed in one to weeks - applicable for all types of properties. Does not meet All Appropriate Inquiry (AAI) standard and is usually completed for a refinance transaction, when no innocent landowner or other liability protections are available for the borrower. **May satisfy Transaction Screen requirements for SBA approval. Typically used for Bank Re-Finance.**

**Transaction Screen:** \$700 to \$1,000 Consists of a specific Scope of Work, and is completed in accordance with the ASTM Standard for Transaction Screens (E-1528-06). Completed in one to two weeks - applicable for all types of properties. Does not meet AAI, and is typically completed when no innocent landowner defense or other liability protections are available for the User.

**Phase I Environmental Site Assessment (ESA):** \$1,800 to \$2,500 Must be used to obtain liability protections under State and/or Federal Laws. Includes site visit, significant research into history of subject property and nearby properties. Completed in two to four weeks - applicable to all types of property. Should be completed in accordance with AAI or ASTM Standard 1527-2005.

**If no RECs are identified - Due Diligence is complete!**

# SBA Policy – Where to start ?

- Questionnaire – loans < \$150,000 not listed NAICS – if further investigation concluded by EP must obtain a Transaction Screen. If further investigation concluded by EP
- Historical Records Review with EP opinion – loans > \$150,000 if elevated or high risk Phase I ESA required
- Transaction Screen
- Phase I ESA – NAICS match for environmentally sensitive industries.

# Other SBA requirements

- Gas Stations require Phase I ESA completed with PE or PG oversight.
- All Dry Cleaners with operations older than 5 years required to conduct a Phase II ESA.
- If Phase I ESA recommends further investigation, the lender or CDC must proceed.

# What if 1<sup>st</sup> Step of Due Diligence Identifies RECS?

## Phase II Environmental Assessment Investigates RECs

- Required for new purchases/foreclosures, to qualify for innocent landowner protections
- Includes soil and groundwater sampling at the locations most likely to be contaminated (i.e., former underground storage tank location, drums, dry well location, etc.) and geophysical surveys if orphan USTs are suspected.

**If no contamination is discovered by Phase II ESA Due Diligence is complete!**



# If Contamination is Detected or Orphan USTs are revealed

- Compare to applicable cleanup criteria:
  - *Drinking Water*- if groundwater present
  - *Soil Inhalation to Indoor Air* if under a building
  - *Direct Contact* - if no groundwater present (under a parking lot, etc.)
- If applicable cleanup criteria are not exceeded, Due Diligence may be complete!
- Site may still be eligible for BEA with limited due care provisions.
- If orphan USTs are identified they must be properly removed or closed in place in accordance with Part 211 of P.A. 451.



# If contamination is detected:

- Compare to applicable cleanup criteria:
  - *Drinking Water*- if groundwater present,
  - *Soil Inhalation to Indoor Air* if under a building,
  - *Direct Contact* - if no groundwater present (under a parking lot, etc.)

**If applicable cleanup criteria are not exceeded Due Diligence may be complete!**



Photo Courtesy of USEPA



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# What if Contamination is Detected and Applicable Cleanup Criteria is Exceeded?

## Options for New Purchasers/Foreclosures:

- 1) Conduct limited soil and groundwater cleanup and obtain a site closure or,
- 2) Conduct a Baseline Environmental Assessment (BEA)
  - Category N - no chemicals stored (typical in foreclosures)
  - Category D - different chemicals stored
  - Category S - same chemicals stored

## Other issues:

- “As Is” clauses could shift liability back to buyers
- Due Care Plan preparation and implementation
- BEA and Due Care petition to the State of Michigan - DEQ
- **SBA Policy Exception requires affirmation of BEAs. Many banks also require. This can be difficult (costly) with Category D or S BEAs.**



**Removal of Contamination**



**In- situ Remediation**

# BEA-Due Care Issues



With a well prepared BEA, new owner is not liable for existing contamination, however they must exercise *Due Care* :

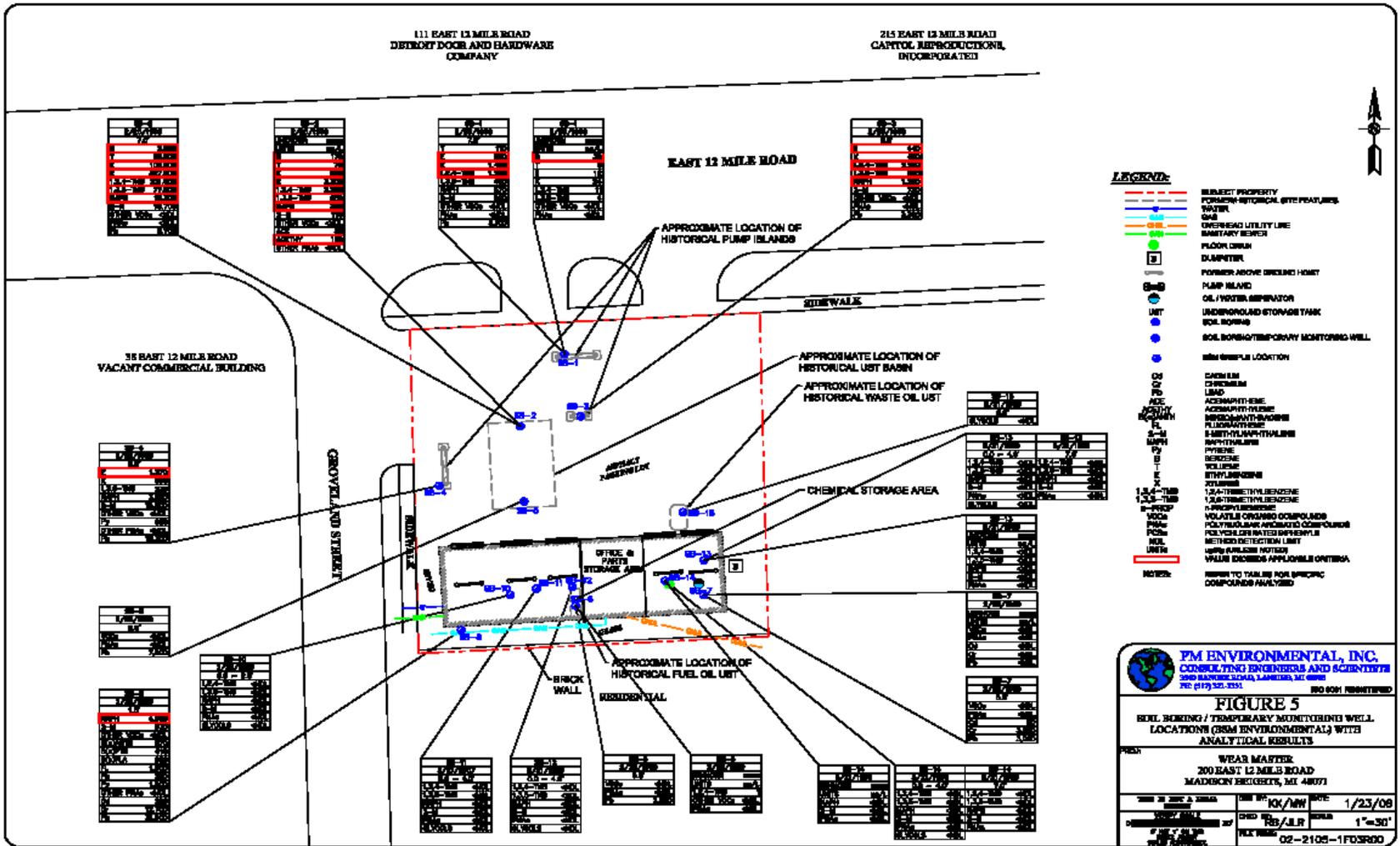
- Cannot *exacerbate* the contamination
- Must prevent unacceptable *exposure* to contaminants,
- Must take *reasonable precaution* against acts of third parties.
- Could lose liability protection if *Due Care* obligations not met

## Examples of *Due Care*:

- Not constructing a building over high levels of contaminants that could volatilize into the building,
- Not constructing a storm water retention pond over an area of high contamination,
- Not excavating contaminated soils without prior testing, etc.

# SBA Policy Exception Case Study - Category S

## Baseline for an existing Automotive Repair Facility





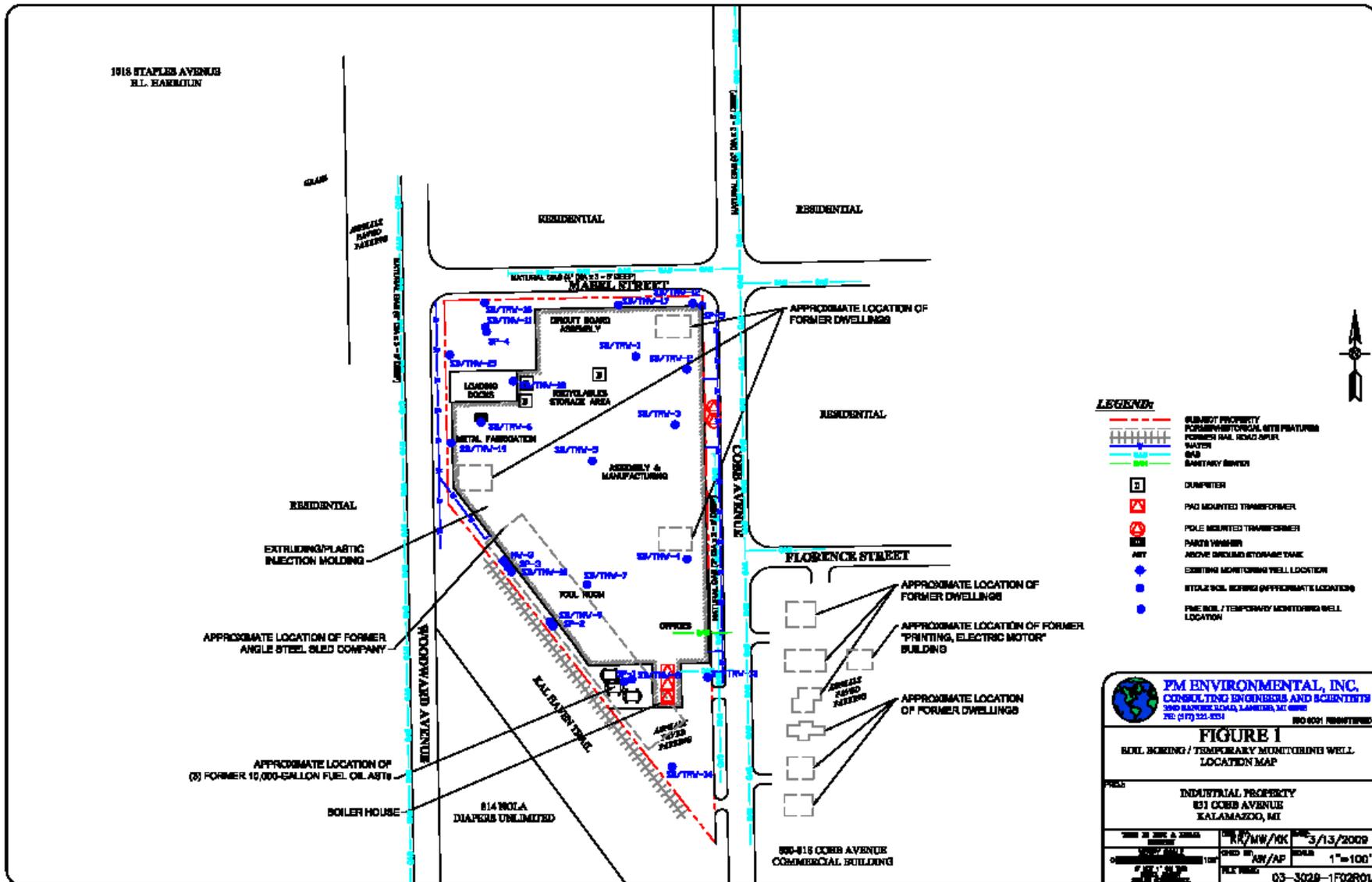
# **Affirmation on Baseline Environmental Assessment Petition for the Automotive Repair Facility**

“No Further Action”. If a CDC obtains a “no further action letter” or “closure letter” from a Governmental Entity stating that no further Remediation or monitoring of Contamination previously found is required, approval or disbursement may be considered.

# Glass Circuit Board and Braided Cable Component Manufacturer Due Care Plan Affirmation

- PME was retained to complete additional follow-up work to cure deficiencies noted by the Michigan Department of Environmental Quality (MDEQ) associated with a Section 7A Compliance Analysis (Due Care Plan). Based upon the “facility” (i.e. contaminated) status of the site, as identified in the Category-S Baseline Environmental Assessment (BEA) prepared for the site by an environmental consultant. The MDEQ and SBA required that a Due Care Plan be prepared for the site to outline the necessary operational activities that must be undertaken to ensure that unacceptable exposures do not occur to building occupants in association with soil and groundwater contamination at the site.
- The BEA prepared identified arsenic contamination in soil above the Part 201 Residential Direct Contact (dermal contact) Cleanup Criteria. No other contaminants were identified above the most restrictive Part 201 Generic Cleanup Criteria. However, the MDEQ requested (based upon a review of historical site data) that additional investigation be completed to verify current contaminant concentrations beneath the building foundation, and to determine whether contaminants may be present that could volatilize to indoor air (i.e., pose an inhalation hazard to building occupants).
- PME then completed additional investigation activities at the site that consisted of the advancement of 19 soil borings, including interior and exterior borings, and the collection of soil and groundwater samples for analytes requested by the MDEQ (volatiles, semi volatiles, and metals). The analytical indicated the presence of chlorinated solvent impact in soil that appears to be associated with historical degreasing activities and/or chemical storage. The general extent of soil and groundwater impact within the boundaries of the site have been determined, which was one of the main requests made by the MDEQ.
- Based upon the current industrial use of the site and the lack of a drinking water well, the soil and groundwater impact should not affect the use of the property and will not require significant engineering and/or institutional controls to prevent or mitigate potential human exposure. The main obligations in association with the site will be to not install drinking water wells, maintain a health and safety plan at the site, provide notices of migration of contamination (i.e., based upon the presence of soil and/or groundwater contamination at the property boundaries), provide notices to area utilities regarding the presence of arsenic impact in soil, and to not undertake activities that would cause exacerbation of the existing soil and/or groundwater contamination (i.e., not moving impacted soils or groundwater from one portion of the site to another, or offsite without characterization, etc.).

# Glass Circuit Board and Braided Cable Component Manufacturer Due Care Plan Affirmation



# SBA Policy Escrow Case Study for Proposed Car Wash – Vacant Land

- The central portion of the subject property historically contained gasoline dispensing operations and service garage from 1959 until 1974. Two (2) 9,000-gallon USTs and one (1) 6,000-gallon UST were installed in 1959 and removed in 1974.
- The central portion of the subject property was formerly occupied by an automotive service garage from 1959 until 1974.
- PME was unable to determine the historical waste oil storage practices for the former automotive service repair garage. The potential exists for orphan USTs to be present on the property and/or for a release to have occurred from the systems.
- The northern portion of the subject property was historically occupied by a factory from approximately 1915 until the mid 1990s, with the likely use of hazardous substances and/or petroleum products.
- The southern portion of the subject property was historically occupied by a trucking company in the 1920s. A portion of the former building was identified as “fuel” with likely vehicle repair activities and fueling operations.
- A heating oil tank was identified for the former building located at 6422 Gratiot (historic property address). The tank is identified as 220-gallons, installed in 1947 and was likely an above ground storage tank (AST).



# SBA Policy Exception

**SBA will rely upon one or more of the following factors when deciding to disburse before completion of Remediation or monitoring;**

**“Minimal Contamination”** If the extent of Contamination and cost of Remediation are de minimis in relation to the value of the Property and/or the resources of the Person responsible for Remediation, and the Remediation is projected to be completed within one year, approval or disbursement may be considered. The CDC should identify the Environmental Professional that will supervise the Remediation and discuss: (a) the nature of the Contamination; (b) the reliability of the Remediation estimates; (c) the projected completion date; and (d) the duration of ongoing monitoring.

**Escrow Account** If an escrow account is available which (a) equals a minimum of 150 percent of the total estimated cost of required Remediation and (b) is controlled by a 7(a) lender or first mortgage holder in a 504 loan as trustee, approval or disbursement may be considered. The Governmental Entity must concur with the Remediation’s scope. The Loan Authorization and escrow agreement for the escrow account must ensure that escrow funds will only be used for Remediation costs. Depending upon the circumstances, an escrow account with more than 150 percent of the estimated costs of Remediation may be appropriate. Any remaining funds in the account may not be released to the borrower until the appropriate “closure letter” or “no further action letter” is received or, in the case of monitoring, when all monitoring wells related to the Property have been decommissioned.

# SBA Policy Exception

<u>TASK</u>	<u>COST</u>
Excavate up to 100 cubic yards of non hazardous arsenic impacted soils, backfill the excavation and replace asphalt	\$7,500
Oversee removal of soil, collect soil samples, Staff Scientist, PID Meter, Support Vehicle and sampling supplies	\$750
Chemical analysis of six (6) samples for VOCs	\$450
Chemical analysis of six (6) samples for PNAs	\$450
Chemical analysis of six (6) samples for VOCs and PNAs	\$900
Data evaluation, project management, MDEQ correspondence, drafting, report preparation	<u>\$750</u>
<b>Total Lump Sum Cost</b>	<b>\$10,800</b>
For purposes of allocating adequate funds to escrow, multiply above total by a factor of <b>1.5</b> :	<b>\$16,200</b>

# What is a Potential Brownfield Site ?

- **Contaminated** – Concentrations of regulated chemicals are present in the soil or groundwater above the residential cleanup criteria
- **Blighted** – Abandoned and declared a public nuisance based on local code or ordinance, dangerous to children, utilities disconnected, unsuitable soil conditions due to previous development, etc.
- **Functionally Obsolete** – Property is unable to adequately perform the function for which it was intended due to substantial loss in value from factors such as overcapacity, changes in technology, deficiencies or superadequacies in design.



# Contaminated



# Blighted



# Abandoned



# New Amendments as of 12-2007 to the Michigan Brownfield Act ( Act 381)

- The brownfield reimbursement program has been extended through December 31, 2012.
- All communities now may reimburse the costs of demolition and asbestos and lead abatement on all contaminated, functionally obsolete or blighted properties. Previously, this benefit was limited to Michigan's 103 "core communities."
- Site eligibility may now be triggered by the past burial of demolition debris, such as improperly backfilled basements, thereby facilitating more urban redevelopment.
- Costs incurred for initial environmental investigations conducted before completion of the formal brownfield plan adoption process may now be reimbursed with a full complement of taxes (including school taxes), enabling developers to more thoroughly investigate potential redevelopment projects.
- Reimbursement is allowed for environmental activities that go beyond the limited "Due Care" responsibilities that typically apply to developers, enabling developers to create more long-term environmental benefits at brownfield sites and enhance the marketability of redeveloped property.
- The ability to use tax increment financing to pay interest to developers who advance the costs of reimbursable activities has been clarified, enhancing the financing potential of brownfield reimbursement.
- Environmental insurance, architectural, and legal fees can be reimbursed.
- The costs of developing brownfield plans can be reimbursed.

# House Bill 5511 – Passed March 20, 2008

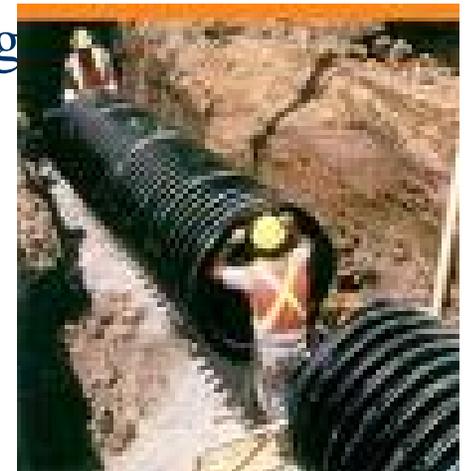
- Immediately and permanently increases brownfield tax credits from their current rate of 10 percent to 12.5 percent.
- Provides credits of up to 20 percent for projects located in urban development areas that increase density of multi-story projects, promote mixed-use development and walkable communities, encourage sustainable development and address underserved areas. After 2010, these credits will reduce to 15 percent.
- Provides a cash refund option of 85 percent of the amount of the credit.
- Increases the number of large MBT credits available in any given year from \$30,000,000 to \$40,000,000.

SBA encourages the redevelopment of brownfields, and SBA loan guarantee available to small businesses interested in locating on revitalized brown



# Examples of Activities Eligible for Reimbursement

- Brownfield Plan Preparation
- Phase I and II Environmental Site Assessments
- Baseline Environmental Assessments
- Asbestos/Hazardous Material Abatement and Demolition
- Due Care Plan preparation and implementation
- Remedial Activities: soil removal and groundwater treatment
- Engineering controls – vapor barriers, epoxy coating floors, containment structures, etc.
- Infrastructure improvements
- Reasonable Project Planning and Professional Fees





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# How does Tax Increment Financing (TIF) Work ?

- Increased tax revenue from the new development generate the tax increment, which is reimbursed to the owner/developer over a period of time from the municipality.
- Re-imburement is for recovery of eligible expenses and can be assigned to a lender or sold as an investment article



# TIF Example



- Abandoned Industrial Building with an SEV of \$186,440 (market value of \$372,880) in a municipality with millage rate of 23 mills = Current Annual Tax bill of \$4,288.
- Developer invests \$375,000 resulting in a new SEV \$373,940 ( $1/2$  of \$375,000 = \$187,500 + \$186,440 = \$373,940) = Annual Tax bill of \$8,600

# TIF Re-imbusement

- Borrower incurs \$124,775 in eligible costs including Phase I, Phase II and BEA, Brownfield Preparation, paving, landscaping, and partial demolition.
- Incremental difference is  $\$8,600 - \$4,288 = \$4,312/\text{year}$ .  $\$124,775/\$4,312 = 28$  years to recover costs.
- The owner/developer or tenants pay new taxes which are reimbursed to the owner/developer



# Michigan Business Tax Credit

**Developer and tenant invest \$500,000 not including land cost. Can include soft costs (i.e. architectural, engineering, etc.)**

**Also includes all renovations, carpet, lighting, window blinds, HVAC system, IT hardware/software, equipment, office furniture, telecom equipment, vehicles, etc. ( cannot include items that are eligible reimbursement from TIF – no double dipping)**

**Brownfield Status opens eligibility for a 12.5% credit on Michigan Business Tax.**

**Borrower nets \$62,500 tax credit**

**Total TIF and MBT - \$124,775 reimbursement (TIF) plus \$62,500 (MBT tax credit)= \$187,275. In this example it is 24% Return on Investment.**



## **Completed Brownfield Redevelopment PM Environmental, Inc. - Detroit Regional Office**



**TIF Reimbursable ~ \$124,775 and  
MBT of \$62,500 = 24% ROI**

**4080 W. Eleven Mile Road,  
Berkley, MI  
Completed October 2008**

# LEED - Leadership in Environmental and Energy Design



- U.S. Green Building Council.
- Ratings of certified, silver, gold and platinum.
- Point scale based upon demonstration and documentation of innovative design in energy and environmental.
- Adds increased value to building (~6-8 %).



# Other Economic Development Incentives

## Federal Historic Preservation Tax Credit

- A 20% credit on qualified expenditures for rehabilitation of historic commercial or rental residential properties.
- Properties must be either listed individually or be a contributing building in a district on the National Register of historic places.
- The rehabilitation work must follow the “*Secretary of the Interior’s Standards for Rehabilitation*” in order to qualify for the tax credit.
- After the rehabilitation, the historic building must be used as an income-producing property for at least five years.

## Federal Pre-1936 Building Tax Credit

- 10% credit on investment value based on rehabilitation. Used on buildings put into service before 1936, but not eligible for 20% credit.
- Rehabilitation expenses must exceed the property’s basis. Residential use not allowed.
- Limitations on building changes are much less restrictive than 20% credits.



# Other Economic Development Incentives

## Michigan Historic Preservation Tax Credit

- A 25% credit (5% if used in conjunction with the Federal Historic Credit, 15% if used in conjunction with Federal Pre-1936) on “qualified rehabilitation expenditures.”
- Work must be conducted and certified as consistent with the “*Secretary of the Interior’s Standards for Rehabilitation*” for Historic Preservation.
- Usually requires designation as a historical district.

## Federal Low Income Housing Tax Credits

- Program works by providing investor equity, thus reducing the amount of debt service on a project, allowing for lower rents to be charged to tenants while still producing positive cash flow.
- The program provides a dollar-for-dollar reduction in tax liability for owners (and partners).
- Credits offered in 4% and 9% increments.
  - 4% for new construction with Federal subsidies (i.e., tax-exempt bonds);
  - 4% credit for acquisition of existing buildings which are substantially rehabilitated; and
  - 9% for new construction/rehabilitation expenditures with out Federal subsidies.



# Other Economic Development Incentives

## Michigan Obsolete Property Tax Exemption

- A 100% abatement of non-school real property taxes on new value (i.e., improvements) from rehabilitation of a **commercial or rental residential building** located in a “core Community.”
- Abatement may last up to 12 years.
- Property must be contaminated, functionally obsolete or blighted.
- Must be in an OPRA district and should have an approved certificate before making improvements.

## Michigan Commercial Property Tax Exemption

- A 100% abatement of non-school real property taxes on new value (i.e., improvements) from rehabilitation of a **commercial or multi-family** building.
- Abatement may last up to 10 years.
- Property must be within a Commercial Rehabilitation District of not less than 3 acres in size (if downtown area, can be less than 3).



# Other Economic Development Incentives

## Michigan Neighborhood Enterprise Zones (NEZ)

- Rehabilitation value must be greater than \$5,000. Unit's true cash value can not exceed \$80,000 prior to rehab or construction.
- District must be established and an exemption certificate applied for before any permits are issued.
- Certificates may be approved for 15 years (17 years if historic tax credits used) and are transferable.
- For rehab projects, abatement of real property taxes on the improvements (i.e., freezes taxes at their pre-rehab level).
- For new construction projects, reduces the total property rate ½ of the statewide average rate (approximately 17 mills for owner-occupied property).

## Other Zone Programs

- Renaissance Zone (RZ) -. Michigan's version of a tax-free enterprise zones. Exempt from all but debt millage portion of real and personal property taxes, allocated portion of business taxes, city and state income taxes for residents of zone, and utility taxes. 15 years duration.
- Renewal Community (RC) (Northeast Detroit) allows for a Commercial Revitalization Deduction.
- Empowerment Zone (EZ) – only employment tax credits remain (through 2012), all other benefits expired December 31, 2004.



# Other Economic Development Incentives

## MEGA Retention Tax Credits

- Make new capital investment equal to \$50,000 or more per retained job at the facility. Examples: construction, acquisition of the company, purchase of a building or machinery and equipment.
- Certify without credits and infusion of new capital investment, the facility is at risk of closing with work and jobs leaving Michigan. Must retain not fewer than 50 jobs
- Must pay at least 150 % of the Federal Minimum Wage for each retained job.

## MEGA Standard and Rural Job Creation Tax Credits

- A refundable tax credit against the MBT to companies expanding or relocating operations into Michigan.
- Eligible entities are those engaged in manufacturing, mining, wholesale and trade, film and digital media, office operations, and some tourism projects.
- Standard MEGA tax credits are available to companies creating at least 50 new jobs by the first year of the credit.
- Rural MEGA tax credits available to companies in counties with populations of less than 90,000. Requires creation of 5 new jobs the first year and 25 jobs by the fifth year of the credit.



# Risk Analysis From Banker's Perspective



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**Presented by**  
**PM Environmental, Inc.**  
**Steve Price**  
**Vice President**  
**March 20, 2009**



**Michigan SBA Lender's  
Conference Environmental  
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# “Risk Analysis 101” - The Bank’s Perspective

- Bank’s secure real estate as collateral for one reason: So that in the event of default/foreclosure, the bank can recover outstanding loan balance and cover other carrying costs associated with taking a property back.





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# Property Valuation

- The appraised value used in determining loan amounts is typically based upon the highest and best use value.
- Therefore, it is very important that this value is maintained over the life of the loan, and remains in the event of default.



# Environmental Factors Affecting Highest and Best Use Value

- Elevated contamination above an applicable use criteria (i.e. Residential, Commercial, Industrial), which could limit the type of operations that can occur on the property.
- Typically include the following criteria exceedances:
  1. Soil Saturation (C<sub>sat</sub>)
  2. Soil or Groundwater Volatilization to Indoor Air
  3. Soil or Groundwater Direct Contact



# Environmental Factors Affecting Highest and Best Use Value

Contaminant levels above use criteria can:

1. Limit marketability if a Category D or S BEA needs to be completed for a new purchaser
2. Lead to limited use of property, which affects marketability
3. Lead to expensive engineering controls and/or remediation/closure costs to comply with Due Care obligations under P.A. 451 part 20107a



# Default Scenario for the Bank

- Considered new purchaser under State and Federal law
- Must complete their own environmental due diligence (Phase I, II BEA) to be protected from environmental liability (even if due diligence was completed by the borrower on the front end of the loan)
- Will be a Category N BEA, as the bank will not “operate” the property with hazardous materials
- Have same Due Care obligations under part 20107a as any other new purchaser (may be limited, however, as no operations would occur)



# Potential Property Value Reductions

- Cost reduction for engineering controls (i.e. epoxy coating floors, paving or other cover, containment structures, etc.)
- Costs to remove USTs and other unwanted structures/equipment
- Stigma of “contaminated” property



# Value/Cost Considerations



- Potential value reductions and costs associated with foreclosure and potential Due Care must be considered at the front end of a loan.
- Could lead to reduction in Loan to Value.
- Could require securing additional collateral to support requested loan amount.



# Non-Default Cost Issues for Borrowers

- Costs to complete remediation and/or closure
- Costs for long term environmental monitoring
- Costs for maintaining engineering controls to maintain compliance with Due Care obligations
- All could adversely affect loan dept service





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# New Purchase vs. Refinance

- New purchasers qualify for BEA protection, therefore, it's important they complete due diligence up front
- Borrower's who are refinancing generally can not complete BEAs (unless there is an entity change that can be protected). Therefore, the Bank's environmental policy and risk tolerance usually drives the scope of the investigation



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## Revised SBA SOP 50 10 5(A)

The U.S. Small Business Administration's revised SOP 50-150(5) became effective August 1, 2008, and was again revised in 2009. The 2009 revision (SOP 50 10 5(A)) became effective March 1, 2009.

As part of the revisions, environmental requirements were also modified which include more environmental due diligence for certain high risk properties.



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## Revised SBA SOP 50 10 5(A)

**The first step in the process is to identify the North American Industrial Classification System (NAICS) code for the property (for current and past use).**

- If the NAICS code is an environmentally sensitive industry (as identified in Appendix 4 of the SOP), a Phase I ESA must be completed.
- If not, then less due diligence is required, including the completion of an Environmental Questionnaire (for loans <\$150,000),
- For Loan >\$150,000, the Environmental Questionnaire and a Records Search with Risk Assessment is required.



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# Revised SBA SOP 50 10 5(A)

## Investigation Results:

- If the Environmental Questionnaire (i.e. loans <\$150,000) reveals that further investigation is warranted, then a Transaction Screen must be completed at a minimum.
- If the Records Search with Risk Assessment (i.e. loans >\$150,000) concludes that the property is an “elevated risk” or high risk” for contamination, then a Phase I must be completed.
- If the Transaction Screen concludes further investigation is necessary, then a Phase I will be required.
- If the Phase I recommends additional investigation (i.e. Phase II), then in most cases, the Phase II will be required.
- If contamination is found, the EP must document:
  1. Whether the contamination quantities exceed the reportable or actionable levels;
  2. Whether remediation is required;
  3. Estimate remediation costs;
  4. Projected completion date of remediation.



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## Revised SBA SOP 50 10 5(A)

### **Subparagraph G of the SOP “Approval and Disbursement of Loans When There is Contamination or Remediation at the Property”**

- Identifies circumstances where disbursement may be appropriate on contaminated property where remediation is not yet complete and/or where No Further Action status has not yet been achieved with the Regulatory agency.

**If the EP conducting any of the above due diligence tools indicates that no further investigation is warranted, the lender must then submit the results of the investigation to the SBA with recommendations and seek SBA’s concurrence.**



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# Revised SBA SOP 50 10 5(A)

## Gas Stations (Appendix 5)

- The current SOP (i.e. 2009 revision) requires that a Phase I ESA be completed on all gas stations, regardless of age. The Phase I must be completed by an Environmental Professional who holds a current Professional Engineer's or Professional Geologist's license, and has the equivalent of three years of relevant experience.
- Investigation must include testing of all USTs, lines and related equipment by an independent contractor using methodology acceptable to the Governmental agency with oversight authority.
- All leaking or otherwise defective equipment , systems, containment devises, etc., must be replaced or repaired prior to disbursement.
- Testing must have been completed within the last 12 months



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Another 2009 modification includes the requirement of a Phase II ESA for all dry cleaners which have had on-site dry cleaning operations for over five years. Other than these changes, it does not appear that any other modifications to the due diligence process were made in the 2009 revisions.

For all Phase I reports that identify RECs, a Phase II will be required to assess the RECs. If contamination is discovered above applicable cleanup criteria, regulatory closure or an equivalent “No Further Action” letter will be required prior to closing the loan. In Michigan, an Affirmed BEA is equivalent to an NFA for a new purchaser. The SBA will allow loan closings prior to achieving regulatory closure or NFA in certain circumstances which are outlined in Subparagraph G (pages 187-190 of the SOP (7a loans) and pages 282-285 for 504 loans), and pages 326-327 (Appendix 5) for gas stations.

It is very important that the bank and borrower understand exactly what environmental due diligence the SBA will require early on in the transaction, so that timing and cost considerations can be made. This is where a consultant well practiced in the SBA policy is very beneficial in getting the deal to close.