

EPA's New (Phase I ESA) Standard for Commercial Property Effective November 1, 2006

Regulatory Background

Owner(s) of contaminated property can be sued by the Environmental Protection Agency through the Comprehensive Environmental Response and Liability Act (CERCLA). This can include the current property owner regardless of when or how the contamination occurred. Liability limits were included in CERCLA for innocent landowners who can demonstrate that **all appropriate inquiry** into the previous ownership and uses of the property was completed prior to their acquisition.

What is a Phase I ESA?

Until recently, the accepted practice for conducting **all appropriate inquiry** was a **Phase I Environmental Site Assessment (ESA)**, as established in ASTM E 1527, revision 1997 or 2000. In general, this process incorporates four components: 1) a visual site inspection; 2) a review of environmental databases and historical records; 3) interviews with past and present occupants/owners; and 4) a written findings report.



However, wide discrepancies have been noted between reports, consultants, opinions and even the scope of the assessment. This begs the question of whether or not the assessment would hold up in court and would it actually protect the property owner from CERCLA liability?

Revised All Appropriate Inquiry / Phase I Standard

To address this problem and following several years of comments, reviews and revisions, the EPA issued their final rule for commercial property purchasers seeking to obtain protection from CERCLA (Superfund) liability. The new *All Appropriate Inquiry (AAI) Standard* will go into effect on November 1, 2006. Accordingly, ASTM updated the Phase I ESA process E 1527, revision 2005 to be consistent with the ruling.

The new standard clarifies regulatory language and requires additional research. It also establishes the qualifications required of the Environmental Professional (EP) completing the inquiry. Anyone who relies on a Phase I ESA must ensure the EP meets these qualifications. Lenders should employ a review process for reports that are provided by clients to ensure they comply with the new rule.

Should Banks Review their Policy with Respect to the EPA's New Standard?

Many financial institutions employ "risk screening" practices for commercial real estate loans to determine if there are environmental concerns. The level of investigation is dependent on the type of property and size of the loan. This practice oftentimes appoints the loan officer or even the borrower to identify suspect environmental red flags. Because most loan officers are not trained to characterize environmental conditions, potential sources of contaminants (on and off-site) may be overlooked. Conclusions drawn from this type of evaluation may lead to a false sense of security for both parties. There is no protection for the borrower under CERCLA and the lender may be left with worthless collateral.

Reliance on outdated Phase I ESA reports can also be dangerous. To ensure recent activity in the vicinity of the target property is accounted for, such as releases, groundwater contamination, leaking underground storage tanks and Brownfields sites, the EPA requires a Phase I ESA within 6 months of the transaction.

Phase I ESA's should not be viewed as a potential obstacle in the loan process, but rather an asset to the client and the institution. From the bank's perspective - without a Phase I ESA, there is no way to determine the true value of commercial property. From the client's perspective - while a bank may be willing to charge-off (due to contamination) a non performing receivable, the client may not be financially able to recover from the consequences. Phase I ESA's performed by a qualified environmental professional eliminate these risks.

Impacts to Property Developers and Prospective Buyers

Successful developers dedicate research to infrastructure, economic indicators, traffic flow, zoning and land use restrictions on all commercial property. A lender determines a borrower's ability to pay, intent to repay and the value of the collateral. Environmental due diligence should be incorporated in these processes and can be completed so as not delay the deal. CERCLA protection is only one of many environmental aspects. In addition to a Phase I ESA, buyers and lenders should be aware of suspect jurisdictional wetlands, asbestos containing building materials, historical/archaeological features, topography and soil type.



Impacts to Environmental Consultants

It has been estimated that around 20% of consultants currently conducting Phase I ESA's do not meet the EPA's definition of a qualified EP. The new rule defines an "Environmental Professional" (EP) as one who is a registered engineer or geologist with 3 years full-time experience or who holds a college degree in environmental sciences with at least 5 years full-time experience. EP's are also held accountable for omissions in data and subsequent conclusions under the new standard. In essence, EP's must be prepared to justify their opinion with data in the event of a lawsuit. This will most likely cause the price of Phase I ESA's to increase, due to more liability placed on the EP.

What to do with Contaminated Property?

In 2002, the Brownfields initiative was passed to encourage redevelopment of stigmatized property. Tax incentives are now available to interested parties who agree to assess, monitor and remediate contaminated property. These parties are also eligible for CERCLA/Superfund liability protection, assuming all agreement terms are met.

While expanding the balloon of available protection, the Brownfields initiative also increased the risks associated with commercial property transactions. For example, *contiguous property owners* are now identified in CERCLA. Even if a release did not occur directly on the (contiguous) property or by property occupants, cleanup from off-site migration can be left to the contiguous property owner. The process of conducting all appropriate inquiry includes an evaluation of surrounding properties to determine the likeliness of adverse impact from off-site activities.

Compliance Centre

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