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## Lenders: Do You Have These Critical Environmental Due Diligence Items on Your Checklist?



Environmental issues rarely result in liability for secured lenders thanks to legal protections laid out in the [Comprehensive Environmental Response, Compensation, and Liability Act \(CERCLA\)](#) and similar state laws. Still, lenders shouldn't ignore potential environmental hazards. Contamination can hamper a borrower's ability to repay the debt and decrease the value of collateral securing the loan.

To reduce risk, it's important to uncover any environmental issues prior to booking the loan—and then have a plan to address those concerns. But how far should the investigation go?

“For commercial properties, a Phase I environmental site assessment is the industry standard, although for long-term residential and other properties considered low risk, a transaction screen or just a desktop records search may be sufficient,” says Susan Phillips, an environmental attorney with Mintz Levin in Boston.

Phillips offers the following additional guidance with respect to the due diligence process:

**Choose the consultant wisely.** Phase I pricing is extremely competitive, but it can be ultimately costly to sacrifice quality for the lowest price. Lenders should insist on compliance with the current [ASTM Phase I standard E 1527-13](#), and resist any assertion that this effort is more expensive than using the prior standard. It is also advisable to negotiate the consultant’s boilerplate contract terms and conditions, which often limit liability to the price of the contract.

**Evaluate prior uses.** History is important. Current property use only tells part of the story, so reviewing historical records is critical. That innocent-seeming office building could once have housed an auto parts manufacturer.

Besides the obvious risks associated with known spills or contaminations, lenders should be aware of the implications of the [Connecticut Transfer Act \(Sections 22a-134 of the Connecticut General Statutes\)](#). Under this law, real property or business operations in which hazardous substances were generated are classified as “establishments.” Some common examples of historical uses where the law would apply are properties such as dry cleaners, auto body shops and businesses that store more than a specified level of hazardous waste.

When making a credit decision, whether a property has been deemed an “establishment” by the terms of the Connecticut Transfer Act becomes an issue of concern for commercial lenders in two ways:

1. It impacts the value of the property.
2. In the event of a loan default and subsequent foreclosure, such properties cannot be sold or transferred without following the specific guidelines and filing requirements of the Department of Energy and Environmental Protection (DEEP).

For any commercial real estate loan where prior uses may be questionable, the lender should ensure that the Phase I environmental investigation includes an assessment of the potential applicability of the Connecticut Transfer Act. This is important, as environmentally questionable prior uses can upend an otherwise highly desirable commercial real estate loan.

**Consider relying on someone else’s report.** Prospective commercial buyers will typically perform at least a Phase I assessment to uncover issues that can be negotiated with the seller, and where appropriate, lenders may be able to rely on those existing reports.

**NOTE:** Special thanks to [Susan Phillips](#) of [Mintz Levin](#), who shared her insights for this article.