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Maintaining Viability of Environmental Due Diligence Reports

Consider this scenario: You are the lead sales broker on a large commercial real estate M&A transaction and the deal's primary lender has requested copies of Phase I Environmental Site Assessments (ESAs) for the 80 properties in the portfolio as a precondition to issuing a loan commitment for financing the transaction. In the final days leading up to the scheduled closing at the end of the month, you check with the seller's attorney who mentions that the latest Phase I ESAs for the properties were prepared around 15 years ago when the properties were first acquired and may no longer satisfy the [ASTM E2790-20 Standard Guide for Identifying and Complying with Continuing Obligations](#) and all appropriate inquiry and innocent landowner liability protection requirements. This leaves ten business days to secure updated Phase I ESAs, submit them to the bank and obtain the loan commitment. Further complicating this is the possibility of the lender requiring a large escrow for several properties based on the historic presence of unresolved Recognized Environmental Conditions (RECs) that several of the earlier Phase I ESAs identified.

Fortunately, another one of the firm's brokers utilized an environmental consulting firm last year for a similar transaction that has availability to complete updated Phase I ESAs and prepare the reports within the upcoming week, but will require an inspection of the property despite being in the middle of a pandemic. The firm also mentions that the prior Phase I ESAs for the properties by the seller no longer fulfill the current ASTM minimum requirements (ASTM E1527-13) based on a number of changes to the ASTM scope since the last reports were prepared.

Shelf Life of Environmental Site Assessments

Phase I ESAs older than 180 days, but less than one year of the date of purchase or the date of the intended transaction, no longer satisfy certain ASTM E1527-13 requirements and must be updated. Specifically, the update must include: (i) new interviews with owners, operators and occupants; (ii) updated searches for recorded environmental cleanup liens; (iii) updated reviews of federal, tribal, state and local government records; (iv) a new visual inspection of the property and adjoining properties; and (v) a declaration by the environmental professional responsible for the assessment or update. Phase I ESAs older than one year require that a new Phase I ESA be performed.

Key Terms and Anticipated Revisions

Since the time the previous reports were issued, revisions to the current ASTM standard for Phase I's (E1527-13) identified a new term (Controlled Recognized Environmental Condition [CREC]). In a previous whitepaper presented by AWAC Services Company, a member company of Allied World, titled "[Phase I Environmental Site Assessments – Limitations, Variability and Data Gaps: Are They Really Telling You](#)

Everything You Want to Know? Identification and Consistency in Interpreting the REC Findings Among Clients and Consultants”, readers were introduced to the importance of key environmental terms included in ASTM E1527-13 Phase I reports:

- Recognized Environmental Condition [REC] - *“...the presence or likely presence of any hazardous substances or petroleum products in, on, or at a property: (1) due to any release to the environment; (2) under conditions indicative of a release to the environment; or (3) under conditions that pose a material threat of a future release to the environment.”*
- Historical Recognized Environmental Condition [HREC] - *“...a past release of any hazardous substances or petroleum products that has occurred in connection with the property and has been addressed to the satisfaction of the applicable regulatory authority or meeting unrestricted residential use criteria established by a regulatory authority, without subjecting the property to any required controls.”*
- Controlled Recognized Environmental Condition [CREC] - a new term, which is defined as follows: *“...a REC resulting from a past release of hazardous substances or petroleum products that has been addressed to the satisfaction of the applicable regulatory authority (e.g., as evidenced by the issuance of a NFA letter or equivalent, or meeting risk-based criteria established by regulatory authority), with hazardous substances or petroleum products allowed to remain in place subject to the implementation of required controls (e.g., property use restrictions, AULs, institutional controls, or engineering controls).”*
- De Minimis Condition - A condition that does not represent a threat to human health or the environment; AND not be subject to enforcement action if brought to the attention of regulatory agency. Common examples of a de minimis condition are:
 - Poor housekeeping
 - Small incidental spills

Bona Fide Prospective Purchaser and All Appropriate Inquiries (AAI) “Final Rule”

Effective November 1, 2006, the process for assessing properties for the presence or potential presence of environmental contamination was published in 40 CFR Part 312. Under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), persons may be held strictly liable for cleaning up hazardous substances if they currently own, operate or owned or operated a facility at time of disposal, without regard to fault or negligence. A person may qualify as a bona fide prospective purchaser if such person made *“...all appropriate inquiries into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices.”* Knowledge of contamination resulting from all appropriate inquiries would not generally preclude this liability protection. A person must make all appropriate inquiries on or before the date of purchase and the facility must have been purchased after January 11, 2002. If a person wants to claim under the CERCLA Innocent Landowner Defense that they had no reason to know about the presence of contaminants, they must have undertaken all appropriate inquiries into previous ownership and uses of the property, prior to the acquisition of the property. Obtaining new or updated ASTM E1527-13 Phase I ESAs will allow the purchaser to satisfy the AAI requirement needed to maintain the innocent landowner defense, provided they also fulfill the Environmental Protection Agency (EPA)’s threshold and continuing obligations requirements further specified in the statute.

Vapor Encroachment

Prior to the recent amendment, ASTM had been silent on vapor intrusion. The current ASTM E1527-13 standard acknowledged the vapor pathway in the “migration” definition. If there are soil or groundwater impacts by volatile organic compounds (VOCs) that are not identified as a REC (e.g., they are de minimis or offsite and considered unlikely to impact the subject property), then an environmental professional must evaluate whether or not vapor migration could be considered a REC. This evaluation may not include modeling or sampling, rather, the environmental professional uses judgment based on the source, migration pathways and existing/future property development to evaluate the potential for migration in, on or at a potentially affected property. In summary, vapor migration must now be considered no differently than contaminated groundwater migration in the Phase I ESA.

Typical Non-Scope ASTM Items

Typical non-scope ASTM items may include the following:

- Asbestos-containing building materials
- Biological agents
- Cultural and historic resources
- Ecological resources
- Endangered species
- Health and safety
- Indoor air
- Industrial hygiene
- Lead-based paint
- Lead-in-drinking water
- Mold
- Radon
- Regulatory compliance
- Wetlands

Fannie Mae/Freddie Mac lending requirements are also consistent with ASTM E1527-13 but also require incorporating the following scope inclusions:

- Phase I ESAs performed for **Fannie Mae** require radon testing for properties located in USEPA Radon Zone 1 (i.e. counties that have a predicted average indoor radon screening level greater than 4 pCi/L [pico curies per liter]).
- Phase I ESAs performed for **Freddie Mac** require the following:
 - A larger search radii for environmental databases
 - Radon testing on all properties
 - Asbestos sampling for structures built pre-1978 (minimum of 12 samples)
 - Lead-in-water sampling, if property is not connected to a municipal portable water supply system
 - Polychlorinated biphenyl (PCB) determination in transformers, hydraulic systems, elevators, etc., which can be accomplished via notification from the owner of the equipment, labeling or sampling

Forthcoming ASTM E1527-21 Scope Changes

Every eight years, ASTM standards expire and are reevaluated by the Phase I ESA subcommittee with some sections subjected to undergo periodic revision. This latest revision will occur for ASTM E1527-13 on December 31, 2021 as it “sunssets” and the new standard, ASTM E1527-21, is finalized and published in 2021. Key changes to the ASTM E1527 standard are anticipated to include:

- Clarifications to the HREC and CREC definitions.
- Expansion of historical research to adjoining properties. The current version of the standard specifically requires historical research of the subject property, but the updated standard may require a more robust investigation of adjoining properties and the surrounding area.
- Non-scope considerations may be modified to reference emerging contaminants, especially perfluoroalkyl substances (PFAS).

Phase I ESAs during the COVID-19 Era

The COVID-19 crisis has led to many questions on how to assess the environmental condition of a subject asset and whether or not the Phase I ESA report is still useful given certain restrictions that are in place during COVID-19. Many states and localities promulgated stay-at-home orders prohibiting all but “essential activities” as health and safety precautions for protection of the public. Though each state is different and must be analyzed as such, a number of these restrictions provide lists of industries or activities that are essential and therefore exempt from shelter-in-place mandates. If your state or locality allows for a Phase I ESA, common sense efforts should be taken to minimize personal contact before, during and after site assessments. To the extent possible, spaces to be viewed by the consultant should be cleared of people up to three or more days prior to arrival. If this is not possible, then the consultant may seek to restrict the walk-through to vacant or limited use areas of the facility. As a result of these restrictions, deviations to normal operating procedures will incur. Existing federal regulations and the industry standards governing Phase I ESAs provide for identification of data gaps encountered during environmental investigations. Persons relying on Phase I ESA due diligence can expect to encounter potential additions to these traditional data gaps being attributed to the COVID-19 disruption including limited or no access to interior areas; inability to locate and interview key personnel; and inability to access regulatory records or obtain Freedom of Information Act responses from government agencies due to staffing reductions and office closures. These data gaps must be documented and evaluated within the context of the Phase I ESA findings. If identified, the usefulness of the assessment will depend on the particular use for which it’s intended. For example, if you are looking to rely on the Phase I ESA for securing lender financing requirements, the relevance of data gaps likely will depend on the specific bank or lending institution requirements and some may require more information than usual as they struggle to manage risk. If you are looking for protection from CERCLA liability, that path is still being tested within the statutory framework. While the EPA announced in March 2020 that it may exercise discretion in enforcing specific instances of noncompliance with some environmental laws, at this time, it is not yet clear what, if any relief will be provided through CERCLA’s innocent landowner and lender liability requirements.

Recommended Best Practices and Educational Resources

Overcoming challenges inherent in delaying environmental due diligence and causing disruptions in M&A transactions can be costly, so it is critical that owners and purchasers of commercial real estate are mindful

to adhere to current ASTM Phase I ESA standards to ensure that lender specifications, innocent landowner and bona fide prospective purchaser protections remain viable. It is not uncommon for environmental consultants to impose a 25-50% surcharge for expedited report delivery, so regularly updating Phase I ESAs can actually result in cost savings for preventing extended transactional costs or incurring surcharges to expedite delivery dates. In instances where historical Phase I ESAs included the identification of RECs, it is prudent to consider options in advance for how best to resolve those RECs. Steps for conducting reconnaissance sampling and comparing the analytical results to applicable regulatory standards guidance levels could be implemented to resolve the RECs and achieve no further action, thereby avoiding potential escrow. Alternately, the purchase of environmental liability insurance could provide liability protection to the seller or buyer for future cleanup or for third-party bodily injury and property damage claims.

Addressing data gaps associated with COVID-19 or other access restricted limitations can be addressed using conventional and innovative approaches such as off-hour scheduling, relying on the use of virtual inspections through laptops, phones or tablets, or physical barriers such as glass partition inspections between the occupied and common areas. Summer Gell, a Principal at Partner Engineering and Science, Inc. and others have prepared a [whitepaper](#) that provides additional information regarding the challenges posed with performing a Phase I ESA during the COVID-19 pandemic.

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