

New Policy for SBA Loans

LOS ANGELES -- On August 1, a new policy will go into effect which governs how lenders do environmental due diligence on all Small Business Administration (SBA) 504 and 7a loans, according to a prominent environmental consultant.

“The policy covers a great many topics, but one of the most significant areas of change is the SBA’s new more prescriptive environmental policy,” says Joe Derhake, principal of Partner Engineering and Science, Inc. “The most noteworthy changes include using NAICS Codes for determining when a Phase I is required, specific requirements for Gas Station due diligence and guidelines for screening low risk loans.”

According to Derhake, any collateral property currently or historically occupied by a business carrying one of the 58 enumerated NAICS Codes, such as *dry cleaner*, *gas station* or a *funeral home*, will now require a Phase I inspection. This creates the basic challenge of identifying the NAICS Codes for every tenant that has ever occupied the building. This could be especially challenging if the property is 50 years or older. Importantly, more environmental due diligence may be required if the precise use of the property is unknown.

The SBA also is pulling back from their long standing position as a primary guarantor of gas station loans. “The SBA will continue to make loans, but they will do so only if borrowers conduct robust environmental due diligence,” adds Derhake.

Under the new policy, all gas stations must have a Phase I plus a Compliance Audit. If a gas station is over five years old, then the SBA also requires a Phase II Subsurface Investigation. For a six-year old gas station, the borrower will need to pay for a Phase I Environmental Report, a Compliance Audit, and a Phase II Subsurface Investigation and allow six weeks for these reports to be completed. The borrower will be faced with \$7,000 to \$10,000 in environmental due diligence expenses—a substantial expense on small loans, according to Derhake.

If the loan is more than \$150,000 and the property is not associated with one of the listed NAICS codes, then the minimum due diligence product will be a Risk Assessment and Records Search, which is a risk assessment done by a third party environmental professional and must include a review of the following information:

- Borrower completed environmental questionnaire;
- Environmental Database;
- Available historical reverse telephone directories;
- Sanborn fire insurance maps;
- Historical tenant NAICS Codes and a risk assessment made by an environmental professional with errors and omissions insurance.

“One of the controversial parts of the standard is the requirement to have errors and omissions insurance, which lenders do not typically carry,” continues Derhake. “A strict interpretation would require that these reviews be done by third party consultants.”

“The SBA Guidelines, which also include such things as guidance on remedial cost estimates and required indemnity language of third party indemnifiers, are more prescriptive which makes setting policy easier, however, there are several changes in practices that the SBA is forcing on the industry that will only complicate the process,” concludes Derhake.

Los Angeles-based Partner ESI is a national environmental and LEED consulting firm focusing on real estate due diligence, building sciences, construction monitoring and environmental site remediation services.