

Going Through a Phase?

Knowledge of Fannie Mae's and Freddie Mac's environmental guidelines is key to multifamily-deal completion

By **Summer Gell**, principal, Partner Engineering and Science

DESPITE CONCERNS STEMMING from the credit crunch, bank closures, and the government conservatorship of Freddie Mac and Fannie Mae, the multifamily sector remains strong. In fact, these loans actually are producing profits for the former government-sponsored enterprises, helping them rebuild their capital reserves.

Further, many lenders believe that Fannie Mae and Freddie Mac will continue to originate and service multifamily loans, which is expected to keep this sector healthier than other realms of commercial real estate. As underwriting changes take the market back to more-historic norms, Fannie and Freddie may become dominant players in multifamily financing.

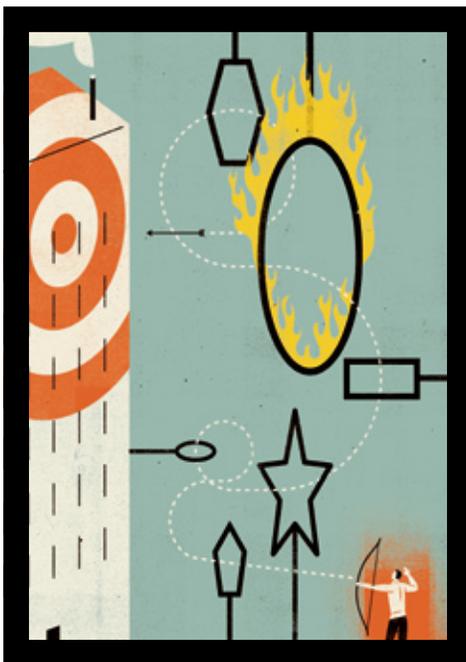
In fact, Freddie Mac recently announced that its 2008 multifamily-loan volume was \$24 billion, a more-than-10-percent increase from 2007. Fannie Mae reported its multifamily-loan volume was \$35.5 billion in '08.

With this in mind, mortgage brokers who help clients purchase and refinance multifamily properties would be well-served to understand their due-diligence needs when working with Fannie and Freddie. Each has different guidelines for third-party inspections and reports, most notably for Phase I environmental site assessments (ESAs).

Here's a breakdown of what Fannie's and Freddie's Phase I ESAs for multifamily properties should entail.

Inspection requirements

Fannie Mae's and Freddie Mac's Phase I standards are based on those of the American Society of Testing Materials (ASTM), with some modifications.



For the Phase I and property-condition assessment, Fannie and Freddie require visual inspection of 10 percent of a property's units, as well as 50 percent of any down units. These units should be randomly selected and spread across the property to allow for an accurate representation.

Inspectors likely will observe each room within the individual unit and may pay extra attention to the water-supply piping, water heaters, air supply and return vents, electrical wiring for outlets and light switches, windows, and appliances. In addition, the inspectors likely will view the property's exterior to note the overall condition of the building and roofing, surrounding drainage features, electrical transformers, and asphalt parking areas or carports.

In addition to the apartment units, the inspectors often observe the leasing offices, clubhouses, pool areas and other property amenities.

Areas of concern

Beyond the typical ASTM requirements for a Phase I assessment, Freddie Mac and Fannie Mae require addressing other concerns, including:

- **Radon:** This colorless, odorless gas is formed via radioactive decay of radium atoms. According to the U.S. Environmental Protection Agency (EPA), radon is the second-leading cause of lung cancer in the U.S.

The EPA has divided the country into three radon zones. Zone No. 1 comprises areas that have the highest potential for radon, with the average predicted indoor radon concentration exceeding the EPA action limit of 4 picocuries per liter. Zone No. 2 has moderate radon potential and Zone No. 3 has low potential. View the map at epa.gov/radon/zonemap.html.

Keep in mind, though, that the EPA has found properties with elevated levels of radon in all three zones. It therefore recommends site-specific testing to determine radon levels. The zone map also offers a valuable indication of the propensity of radon-gas accumulation in structures.

Freddie and Fannie require that ESAs determine if radon-gas accumulation is a potential concern for a property.

Sampling may be required. Environmental consultants vary widely on their method of sampling. Some place canisters in a minimum number of units, regardless of the EPA radon zone, while others only place canisters in Zone No. 1 areas.

The short-term test consists of setting out small canisters containing charcoal and a metal-screen covering. These canisters should be placed four to five feet off the ground and away from any vents or open windows to allow for accurate results. They must be open for 48 to 96 hours and then collected, properly sealed and returned to the laboratory for analysis.

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Illustration: Keith Negley

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It is important that the apartment units selected for radon testing maintain “closed house” conditions from 12 hours before the test until its completion. This means having no open windows for extended periods of time and only routine use of doors.

If the short-term test has results above the EPA action limit, then a longer test — which can range between three months and one year — is required. If results are all below the action level, no further assessment is required.

Sampling results will be included in the Phase I report and typically include any recommendations for additional testing or mitigation, if necessary.

■ **Asbestos:** This material had been used commonly as an acoustic insulator, for thermal insulation, for fire proofing and in other building materials. Because of the fibers’ microscopic size, airborne friable asbestos can be inhaled — and may result in a potential health risk. Continued exposure can increase the amount of fibers that remain in the lungs. Over time, fibers embedded in lung tissue may cause serious lung diseases including asbestosis, lung cancer or mesothelioma.

The Occupational Safety and Health Administration finds the installation of friable surfacing material and thermal-system insulation unlikely to contain asbestos-containing materials (ACMs) in buildings constructed after 1980. Freddie and Fannie require Phase I assessments to include an opinion about the potential for ACMs at the subject property.

Fannie Mae considers materials from 1979 or earlier to have potential ACMs; Freddie Mac, on the other hand, leaves this determination to individual consultants.

If consultants suspect ACMs, they must collect samples of friable material, which are materials that can be crushed easily by hand. These include pipe insulation and acoustic ceiling panels.

If consultants do not identify any friable or damaged materials, Fannie and Freddie will accept managing the identified suspect ACMs

within an operations-and-maintenance program implemented at the site.

Many states have licensing requirements for collecting asbestos samples, so it is important that the inspector have proper certification.

■ **Lead-based paint:** The Residential Lead-Based Paint Hazard Reduction Act of 1992 — also known as Title X — was designed to protect people from exposure to lead in paint, dust and soil. Section No. 1018 of this law mandates the disclosure of known information on lead-based paint and its hazards before the sale or lease of most housing built before 1978. Sellers, landlords and their agents are responsible for providing this information to the buyers or renters.

For properties built before 1978, Freddie Mac gives borrowers the option to either:

1. **Test for lead-based paint;** or
2. **Presume lead-based paint is present and implement an operations-and-maintenance program to manage the hazard in place.**

Regardless of borrowers’ action, environmental consultants must comment on the paint condition for all properties built before 1978. Lead-based-paint testing must meet Freddie Mac’s minimum standards.

Fannie Mae, on the other hand, mandates in-field screening of painted surfaces in buildings constructed before 1978, unless it gives the lender a waiver. The waiver allows the lender to assume that lead-based paint is present and to implement an operations-and-maintenance program. The in-field screening requirements include testing representative painted surfaces from 10 percent of units for a maximum of 30 samples.

■ **Lead in drinking water:** Neither Freddie Mac nor Fannie Mae requires sampling of drinking water for lead unless the property is connected to a private, nonmunicipal water supply. In those cases, drinking-water samples are required; however, neither agency specifies the number or method for collecting these samples.

When sampling is required, most consultants collect at least two or three drinking-water

samples from each representative source (e.g., via an initial draw, a 30-second flush and possibly a two-minute flush) for laboratory analysis. Analysis results should be included in the Phase I.

■ **Mold:** Mold can be found indoors and outdoors. Given enough moisture and organic material, it can grow and multiply. In large quantities, molds can cause allergic symptoms when inhaled or through the toxins they emit.

Fannie Mae does not specifically mention mold in its Phase I ESA requirements.

Freddie Mac, on the other hand, requires that environmental consultants investigate for mold-related hazards and report on all findings related to the evidence of mold, water intrusion and conditions that could lead to mold growth.

If inspectors identify moisture or mold issues, they must recommend identification and correction of the source of all water intrusion or leaks. They also must suggest remediation of the mold issues in accordance with EPA guidelines for cleanup and remediation.

If no evidence of water intrusion or mold growth is found, Freddie instead requires that a moisture-management-prevention plan be implemented for the property.

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There are many additional factors that brokers and their clients must consider when conducting a Fannie Mae or Freddie Mac Phase I environmental site assessment. Fannie and Freddie require completion of detailed environmental forms specific to each agency and loan program. Each also has its own precise inspection and reporting requirements.

Purchasers and refinancers are therefore encouraged to retain environmental consultants who not only are familiar with Fannie’s and Freddie’s requirements but also have actual experience with these programs. Brokers who understand the requirements and help clients find a qualified consultant can help make the environmental-due-diligence process run as smoothly as possible. 