

# SECRETS OF AN ENVIRONMENTAL BANKER

*An environmental risk manager turned consultant tells all.*

Brian Mende

In the world of environmental due diligence, most of the real estate industry — property owners, brokers and consultants — pray to the same god: the bank's environmental risk manager. That was me for the past 8 years, serving as a senior environmental risk manager at Citibank before becoming a consultant again.

The first bit of sound advice received upon joining the ranks of the environmental risk managers is to understand the deal. This little tidbit was the basis of every evaluation conducted, and it became apparent that very few consultants understand this point. Secondly, it takes time to understand the intricacies of the job given the nature of the deals coupled with the challenging environmental issues.

First and foremost, environmental risk managers are part of the risk management team, in charge of not killing a deal (as some would believe), but quantifying the risks associated with a particular piece of property and providing sound advice to the credit managers. That is where a true understanding of the deal comes into play. Although many feel it's the environmental component that nixes deals, most, if not all, deals are done in by credit or appraisal issues with the environmental issues being the final nail in the coffin. To clarify the point, lenders are in business to close deals, provided they make sound business sense.

## TO CONTROL OR NOT TO CONTROL

Should borrowers and brokers engage Phase I Environmental Site Assessments on the front end or should they allow their lenders to order the environmental due diligence on the

back end? The answer is not so simple and should depend on the size and complexity of the project. As a general rule of thumb, let the financial institution control the Phase I process. I can honestly say I have seen my share of third-party reports that aren't worth the paper they are written on. These reports are difficult reads and provide incomplete or tough-to-find information. This requires more time to fully value the property and potential closing delays. The common denominator to these reports is that the one area on which they decided to save a few dollars was their environmental consultant under the guise that all Phase Is are alike. Wrong.

Most consulting firms are highly reputable and perform admirably. The problem arises because many consultants perform their work in accordance with the ASTM standard, but they fail to understand the nature of the deal. Consultants who work routinely for the same lenders get to know their clients' likes and dislikes, and start to understand the levels of risk tolerance acceptable to that institution.

## NO TWO LENDERS APPROACH ENVIRONMENTAL RISK THE SAME

Risk tolerance varies from bank to bank, and in very large financial institutions it varies considerably between business groups. Recently, a survey was conducted of bankers, consultants, lawyers and other environmental professionals through the Environmental Bankers Association (EBA) trying to define a recognized environmental condition (REC). The survey presented several site scenarios including dry cleaners, USTs, gas stations and a printing facility. To no one's surprise,

consultants were more conservative than bankers, a finding which supports the point above: few consultants fully understand the lenders and their approach to risk.

## THE ART OF THE DEAL FOR CONTAMINATED SITES

If you want to get a contaminated site financed, commit to the process. A thorough Phase I Environmental Site Assessment should find the potential RECs associated with the historical site uses. The Phase II Subsurface Investigation confirms the absence or presence of the subsurface contamination. If the Phase II finds contamination, then you are financing contaminated real estate, but don't give up.

First question: will your lender play ball? If your lender has not financed a contaminated property in the past 12 months, you should switch lenders. Educating and persuading a lender that does not have the tools to understand environmental risk is seldom successful.

Second question: how big is the release? A Phase III Subsurface Investigation attempts to quantify the vertical and horizontal extent of soil and groundwater contamination. The geologist or engineer will locate borings through what is believed to be the center of the plume to determine how deep the contaminants have migrated and will locate "step-out-borings" in each direction laterally to determine the width of the contaminant plume.

Third question: How much will it cost? If the Phase III successfully characterizes the plume, then the environmental engineer may be able to design a remedial cost estimate (RCE). RCEs are difficult without an approved reme-

dial action plan (RAP); however, most states have readily accessible guidelines in which to design and prepare a RAP. Generally, lenders will utilize a multiplier of 1.5 times the “reasonable worst case scenario” to factor into their credit risk guidelines.

## **BUSINESS RISK OR CERCLA LIABILITY PROTECTION**

The stated purpose of ASTM 1527-2005 is to provide the user with Protection under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) commonly referred to as Superfund, which was enacted by Congress in 1980. The great

irony is that banks don’t experience CERCLA liability when they write a loan. Banks are really interested in making a good credit risk decision, which begs the question: why do lenders feel bound by the ASTM 1527-2005 Standard? They are not.

ASTM 1527-2005 is one of two standards, along with the EPA’s All Appropriate Inquiries Rule, that govern the scope of Phase I Environmental Site Assessments. ASTM 1527-2005 standards include a non-intrusive evaluation of current and historical operations of the target property, including hazardous material use and storage, underground and aboveground storage tanks, geology and hydrogeology.

ASTM 1527 is a fine scope in environmental due diligence; however, it is better to work with lenders to design custom due-diligence products that will meet their credit needs.

In conclusion, the selection of a good consultant is critical. The consultant must understand the science of environmental risk management and also how the individual lenders think, how regulators think and how to assist you in getting deals done with integrity and in compliance with the requirements of all parties.

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