

As commercial real estate transactions pick up, so do environmental questions - by Chuck Merritt



Chuck Merritt

When the current American Society of Testing Materials (ASTM) E1527-21 standard was universally adopted for use in February 2024, commercial real estate was at the low end of the business cycle (to put it gently), and therefore, not as many may have noticed the changes. With higher interest rates (beginning in the first quarter of 2023), government compliance regulations and tighter underwriting standards, many lenders put their “pencils down” for some time. Investors were worried about tariffs and the inability to find a lender at attractive rates for them to take some cash off the table so (by some estimates) commercial real estate transactions dropped by 45-76% depending on the asset class. In addition, the Federal Reserve’s reluctance to lower interest rates significantly, have left most investors feeling that higher borrowing environment (which is not historically terrible) is here to stay. Hopefully the trend begins upward in commercial real estate from both buying and lending perspective.

As outlined in previous ar-

ticles, many phase one reports being conducted under the new standard, are concluding with “additional investigation” recommended. For a buyer, this should be good news. Even if they don’t realize it when signing a contract, the additional requirements of the 1527-21 standard cover more items that if missed can be problematic in the future. A properly prepared phase one that meets the definition of All Appropriate Inquiry (AAI) provides legal protections under CERCLA law and innocent landowner defense. Attorneys preparing contracts will be familiar with this concept and ask for a due diligence period allowing a buyer to understand the potential environmental risks. Recognized Environmental Conditions (RECs) such as old, buried heating oil tanks at the “subject site or target property” are typically easy to establish and communicate within the Environmental Site Assessment (ESA). Additional time could then be requested to conduct more investigation at the property (IE: phase 2).

Utilizing the more recent ASTM-21 standard, the net is cast in a broader manner bringing into play, adjacent properties that may be next to the subject site or located nearby. Historical tenants that may have been overlooked utilizing previous standards will be called out more by the new standard. Buyers should heed these “red flags” as an opportunity to find out more about the property. This will be important for obtaining financing with a lending institution or selling the property in the future. There are still buy-

ers who may not understand this and abdicate their due diligence opportunity to a potential lender they are approaching for a loan. The lender will then typically hire a consultant off their “approved list” and that consultant is beholden to the lender who is their client.

Lenders are still a main user of environmental reports (especially during a refinance), whether it be a full-phase one ESA or a lesser product such as a Transaction Screen Assessment (TSA) which does not include all the bells and whistles and is generally less expensive. During the refinance of a property, a lender will engage with one of the firms on the approved list and with every new standard, different findings are a possibility from either a new consultant retained or in some cases the same consultant that prepared the report several years ago. Once that report is issued, lenders, borrowers, real estate brokers and mortgage consultants may suddenly have questions. The most common one is, “Why was this not flagged the last time we did a loan?” The environmental consultant has the responsibility of educating all stakeholders. Hopefully in a forum with everyone together at one time and go over why the new report has such recommendations. In some situations, consultants may be trying to “prove the negative” and comply with the current standard. An old listing in a city directory or other historical source does not necessarily correlate to an environmental problem, but additional investigation may be required to demonstrate such. As lenders tend to be con-

servative, and don’t want to take back property that may have an environmental issue, (no matter how unlikely) the trend has been towards additional investigation being required.

Vapor testing has become more popular over the past decade and can provide valuable information. The process is less invasive than bringing in a drill rig and coring down to get soil/groundwater samples, (although that may ultimately be required). However, setting up a few sampling canisters in strategic locations can be a good way to obtain data regarding any potentially dangerous vapors that may have been left behind from a perceived listing of concern such as a drycleaner, commercial printer or gasoline station to name a few.

Understanding the potential environmental conditions that may exist at a property as part of the new ASTM standard is important to get out in front as part of the due diligence process during an acquisition. Leaving enough time for both phase one (1) and two (2) investigation (if needed) is critical as well. Discussing the process with a potential lender can be beneficial since they may rely on internal and external advocates to review the reports. As refinances with lenders increase so will the number of questions borrowers and brokers will have regarding the findings of newly prepared environmental reports.

Chuck Merritt, LEED AP, is the president of Merritt Environmental Consulting Corp., Hauppauge, N.Y.