

# Environmental due diligence: How much are you willing to spend? - by Chuck Merritt



**Chuck Merritt**

This is the conversation consultants and clients buying commercial real estate are having on a regular basis. As I have stated in previous articles, the Phase 1 Environmental Site Assessment (ESA) is a roadmap to understanding what environmental concerns may be presented as part of the due diligence process. For a buyer, the American Society of Testing Materials (ASTM) environmental standard adopted in February of 2024 is a good thing as it casts a broader net than the previous ASTM standards and provides an opportunity to investigate the property. This is referred to as the Phase 2 investigation. So, how much should you spend?

Before we answer that question, we should think about who the stakeholders are once the commissioned ESA report indicates there are Recognized Environmental Conditions (REC's). If a buyer hired the consultant, they have the discretion of doing nothing recommended in the ESA. I have seen this decision many times over the decades and include reasons such as a feeling that the price is too good to pass on or the seller will

not allow Phase 2 and they buy it anyway. Some buyers may opt to spend a minimal amount of money depending on their expectations of the report that will follow. I am not going to couch the definition of "minimal" in a real estate industry that ranges in value from a few hundred thousand to billion-dollar "trophy buildings".

There are potentially three different medias associated with each property to be tested which include soil, groundwater and air. Traditionally, the soil and groundwater at a property is what consultants were concerned about in which data could be garnered from a day at the property with some drilling equipment. Soil samples would be collected and depending on many factors (including the information in the phase one or "road map" report) analyzed by a laboratory for a host of compounds. Soil samples are a good identifier of things that may have occurred at the property.

Ground water samples help identify what may have occurred at a property as well as at neighboring properties that "migrated" onto the subject site. However, this data may be harder to collect based on geological challenges such as the depth, refusal that may be encountered and naturally occurring features such as bedrock that is expensive and time-consuming to drill through.

The third media consist of vapors that may have encroached onto the property or intruded into the building impacting the air quality. Within phase one ESA, terms like vapor encroachment condition (VEC) and vapor intrusion condition (VIC) are more common as

consultants investigate the property and neighboring ones. In terms of cost, we have worked for investors that try to limit the scope and cost while others, want a Cadillac scope that includes testing all the media available with a "leave no stone unturned" approach.

Since many of these acquisitions seek financing, you should also think about that other stakeholder, "the lender". With many forms of debt available, there are also many levels of environmental due diligence that may be required. Will your lender accept a buyer's Phase 1 or will they require their own from a local or perhaps national firm. How long will that take? Does that lender have the capacity to review the phase one internally or will they enlist the services of an environmental consultant or attorney? Will that entity agree with the phase one findings? Make no mistake about it, phase one ESA's are a subjective document. However, as a buyer once you have made the decision to conduct additional investigation (Phase 2), things become clearer for all stakeholders.

The "road map" phase one ESA is now a powerful tool in designing the Phase 2 scope of work. Historical maps and aerial photographs can help depict past tenants and operators that may need further investigation. The site reconnaissance may have located a fill or vent line at a building that ceased using oil but never addressed the underground storage tank (UST) and not visible on historical maps/photos. Database records and local agency files conducted through Freedom of Information Law (FOIL) could potentially provide

documents about a former on-site sanitary system that may be a concern. These are all pieces of the puzzle in developing the appropriate scope.

Many times, consultants are hired by developers looking to build on a particular site. In older cities with very little open land available, often this involves purchasing an existing structure or several structures that will accommodate the new vision of the property. Vetting those parcels for environmental concerns will be very important. When excavating soil, the developer needs to know what compounds are present to establish which disposal facility will accept the soil and the cost from that facility. This scope of investigation tends to be more expensive.

With the new ASTM standards, there is a greater emphasis on conducting a Phase 2 investigation to fully vet a property being purchased. The more a buyer is willing to do within that scope, the better the data they will receive. This will also benefit the lending looking to make the loan and save time. Without outlining what expensive or inexpensive is regarding the cost of a properly scoped Phase 2, I will make this one analogy. If the asset being purchased is \$1 million, spending \$10,000 on a Phase 2 represents 1% of the purchase price. So, how much are you willing to spend to better understand what may lurk under the property you are buying?

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