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Bankers
Association



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A dense, close-up photograph of numerous pink roses, filling the entire page below the title. The roses are in various stages of bloom, with some showing deep pink and others lighter shades.

Everything's Coming
Up Roses

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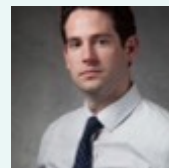
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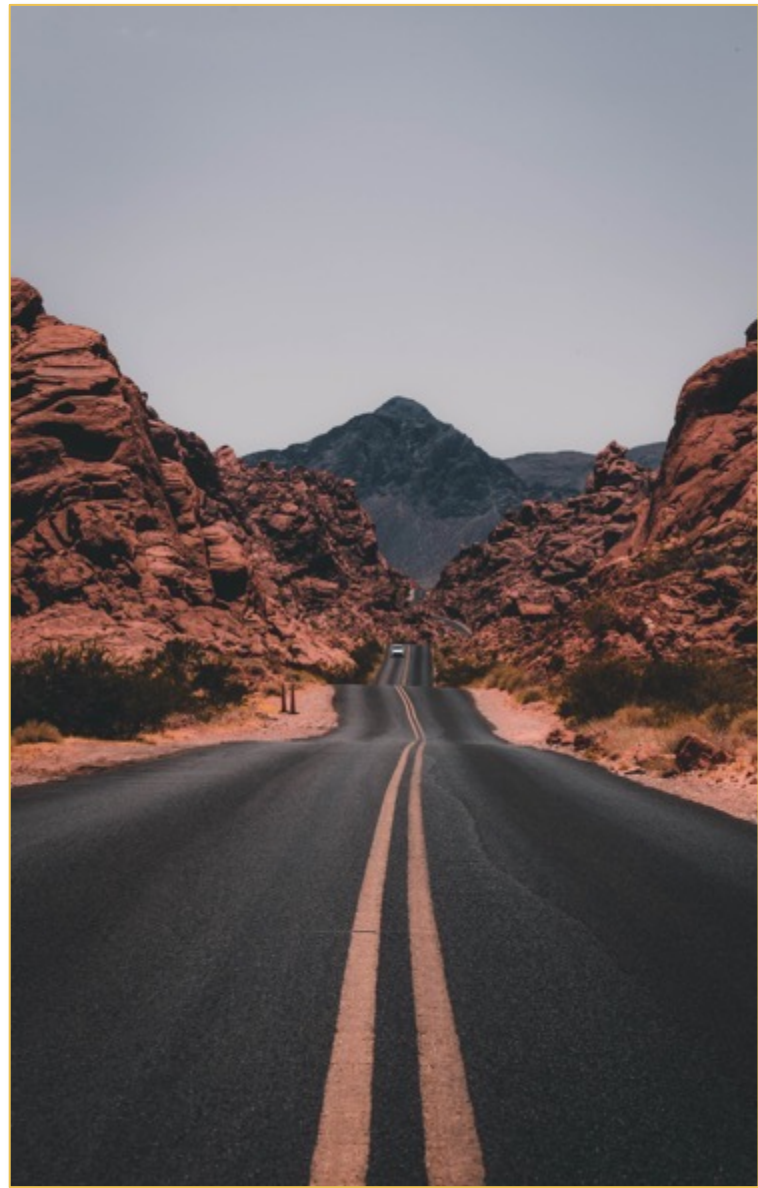


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Environmental Bankers Association!*

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Welcome Back – It's Been Too Long!

A Message from the President



EBA President

David Lambert, Wells Fargo Bank

Twenty-eight months ago I was sitting on a balcony overlooking the Gulf of Mexico enjoying a week-long break from work, when I received a number of texts from co-workers asking “have you heard the news...” I reluctantly logged into email and found a flurry of emails indicating until further notice, I was strictly prohibited from entering my office. My thoughts went straight to practical matters. Surely, I will be able to pick up my docking station and other essentials. We will be back soon, right? What perishable items are in my snack drawer?

In the following weeks and months, it became clear that the world had changed. I was denied access to the office to pick up essentials. My favorite restaurant closed. I now owned masks in assorted colors and materials. Personal travel plans were canceled. The EBA Board of Governors canceled the 2020 Summer Conference in Charlotte. Personal interaction with friends and colleagues were limited to Zoom meetings. Through it all, I still had my favorite coffee shop at the end of the morning walk to provide a sense of normalcy. But then I got kicked out of the coffee shop after an unmasked man insulted me for wearing a mask – apparently, I was too candid when conveying feedback to him. My in-person human interaction had just been reduced by a third. This was the turning point when I started longing for the world to return to normal, or some semblance thereof.

To this day, I have stepped foot in my office only once because of a move from Dallas to Denver, which required approval from the highest levels of the bank. As we made plans to return, my office in Denver was sacrificed to a lease amnesty program. As a result, full time telecommuting is my new normal.

The point being, lack of true human interaction profoundly affected me, and others who have shared similar experiences. Knowing the tight-knit EBA family will be together again in Charlotte feels like a light at the end of the tunnel, a source of hope that the world is returning to normal, and an opportunity to celebrate!

We have a great conference planned under Rita Wiggin's leadership! Many volunteers and sponsors have contributed to ensure that there will be an excellent mix of industry leading educational content and social engagement. Take a moment to reflect on how lucky we are to be together and take advantage of the opportunity.

Damn glad to see you again!

David Lambert
EBA President



The Near-Term Outlook: Growing Uncertainty Triggers 2Q Reset of Forecast

Dianne P. Crocker, Lightbox



After a strong start to the year, the second quarter delivered a subtle change in sentiment across commercial real estate lending amid somewhat confusing economic barometers. The market is adjusting to the impact of persistent inflation stemming from the war in Ukraine and the first increases in interest rates from the Fed in decades. Yet there is no shortage of debt and equity capital looking for a home in the U.S. commercial real estate, and property fundamentals are still largely positive. Activity across LightBox's platforms in the environmental due diligence, valuation, lending, and investment sectors points to positive momentum approaching mid-year, but with some early trends worth noting, including a recent thinning of the buyer pool. There is growing talk of a late-year market correction, triggering an urgency to close loans at still-low rates. Due to the growing headwinds of previous months, many forecasters ratcheted down their previously rosy expectations for this calendar year. The market is in for interesting times as the next few quarters play out, and there is no shortage of things to watch. Below I summarize emerging concerns and their impact on shifting near-term expectations as we head into the second half of 2022:

1. The Two I's: Inflation and Interest Rates

You can't talk about how 2022 is shaping up without paying attention to inflation and interest rates. The market impact of the Ukraine conflict has been growing inflation, and in response, the Federal Reserve is moving more aggressively than it might otherwise have to tighten monetary policy. The early May rate move was the largest since 2000, in response to escalating inflationary pressures, and more are planned for the coming months. The delicate balancing act is whether the Fed can effectively reduce inflation without triggering a recession. The market can expect steadily rising interest rates for the foreseeable future. The good news is that despite the run up, interest rates remain at historic lows, at least for the time being. Real estate is largely viewed as a hedge against inflation, and the outlook for investment in Europe raises the probability that capital flows into the U.S. will increase, a positive for real estate.

2. Higher Rates Pressure Lender Underwriting

There was a record flow of debt capital to commercial real estate investments in the U.S. in 2021, and the universe of lenders had largely returned to pre-pandemic conditions. CMBS lenders, after a COVID-driven retreat from the market, reverted to roughly 20% of new commercial originations by year-end, followed by regional/local banks with 19% of all new loans, and investor-driven lenders with 13%. Economic recovery continues to be reflected in lower delinquency rates with the overall CMBS rate declining from 4% at peak of COVID to only 1.5% currently.

Based on the most recent data from the MBA, first quarter commercial and multifamily mortgage loan originations increased 72% in the first quarter of 2022 compared to the same period last year. Consistent with seasonality trends, originations during the first three months of 2022 year were 39% lower than the fourth quarter of 2021. Industrial and multifamily still draw the strongest interest although other asset classes (e.g., hotel and retail) that were harder hit by the health crisis are starting to attract more attention.

One recent impact of the increases in interest rates this year is that borrowers are rushing to lock in today's low rates. The result is an urgency by commercial real estate lenders to complete environmental due diligence, appraisals and other underwriting before the rate lock expires. As rising interest rates increase the cost of capital, it exerts downward pressure on property prices. More and more investors are expecting a market correction by the third or fourth quarter simply because property prices can't keep rising as much as they have been indefinitely. Due to these changes in the financing landscape, there is more scrutiny in underwriting, including more of a focus on a property's operating costs, revenue forecasts, and future pricing assumptions.



3. Investment Growing at Moderating Pace

Like commercial property lending, investment deal-making set records in 2021, and that momentum continued through the first quarter. By the end of March, commercial property sales climbed at double-digit rates from a year prior despite the uncertainty surrounding the Ukraine conflict, interest rates and inflation. Individual asset sales grew in the first quarter, according to Real Capital Analytics, at a 58% year-on-year rate. By the end of April, however, the numbers reflected a softening of activity, closing the first four months with a slight decline below activity from January-April of 2021. One month alone doesn't establish a trend so it will be interesting to see what 2Q'22 data shows. It seems likely, however, that given the timeframe it takes to close a real estate deal, 1Q data reflects market confidence from the start of the year that may be starting to wane considering current market uncertainty. Growth rates are also normalizing post-pandemic to more traditional levels year-on-year after the double-digit recovery rates experienced immediately following the pandemic.

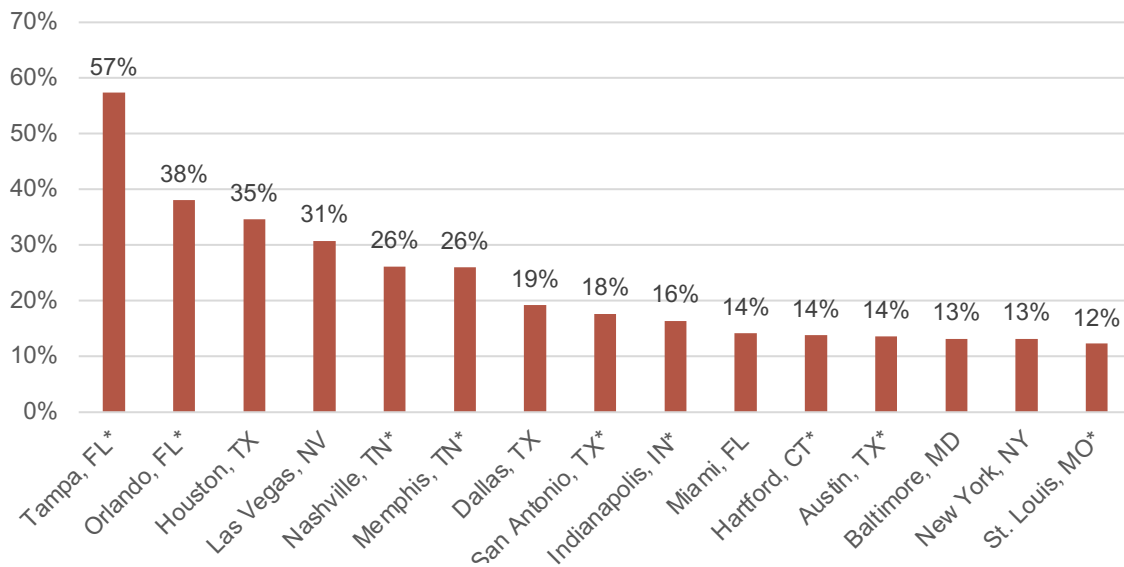
Market barometers from LightBox's RCM platform also reveal several recent trends worth noting. Given the still-healthy fundamentals, the number of listings coming onto market continued to rise through the end of April, but the buyer pool is beginning to thin as evidenced by the number of interested parties performing due diligence. This suggests a market with more emphasis on selling than buying—perhaps reflective of the recent increases in interest rates making debt capital more expensive for borrowers. Growing uncertainty in the market may also be spurring sellers to list properties now rather than waiting until later in the year when market conditions may be less favorable.

4. Secondary Metros, Technology Hubs Drive Growth

Based on the latest data from the LightBox ScoreKeeper model, one trend established in 2021 that continues through the latest quarter is the strength and interest in commercial property in smaller, secondary markets. The LightBox ScoreKeeper model tracks trends in the volume of environmental due diligence across the U.S., and its output is widely viewed as an early indicator for where commercial real estate investment activity is increasing—or losing steam.

As a result of the health crisis driving development, corporate headquarters, and population growth into small cities, growth in property due diligence activity is above industry benchmarks in metros like Tampa, Orlando, and Houston. The accompanying graph shows an analysis of Phase I ESA activity over the past two quarters (1Q'22 and 4Q'21 vs. corresponding quarters of prior years) in the 50 largest commercial real estate markets of the U.S. The 15 cities highlighted in the graph outperformed the average 6% growth in due diligence activity across the top 50 metros. Interestingly, four of the fastest-growing metros are in Texas (Houston, Dallas, San Antonio, and Austin), and three are in Florida (Tampa, Orlando, and Miami). Also notable is that 9 of the 15 strongest metros are smaller, secondary metros (denoted with an * in the accompanying graph). Nashville and Austin continue to lead the list of strong emerging cities that are competing with more traditional magnets for top technology talent, business headquarters and development dollars.

15 Highest-Growth Markets for CRE Due Diligence: (past 2 quarters vs. prior year)



* denotes a secondary metro

Source: Lightbox ScoreKeeper model, 1Q22.

5. Forecasts for 2H22 Downgraded Amid Growing Risks

As the result of changing market conditions in the first four months of the year, the lines were redrawn on a number of 2022 forecasts. Among them were the MBA's forecast for commercial and multifamily originations this year. Initially the MBA's 2022 forecast made headlines with the prediction that origination volumes this year would break \$1 trillion for the first time. Instead, in mid-April, the association downgraded that bullish forecast slightly to \$895 billion. Longer term, the MBA is forecasting that loan production will rise 6% to \$945 billion. The Urban Land Institute also recently dialed back its forecast for commercial property deals, now predicting a slight 5% contraction to \$800 billion for 2022.

Against the tapestry of growing uncertainty, it is not surprising that commercial real estate lenders and investors are becoming more cautious. If market volatility takes root, sellers could pull back to the sidelines to take a wait-and-see approach until rates and uncertainty stabilize.

Another recent change that has implications for the lending and investment market is that as borrowing costs increase in today's rising-rate environment, investors will seek lower prices (i.e., higher cap rates to meet their target IRRs). Given how aggressively many asset classes have been priced in recent quarters, it is not surprising that a market correction is widely expected later this year, particularly with in-demand properties like multifamily and industrial.

With interest rates increasing and a slowdown in the rate of price increases, as well as the growing uncertainty, it is critical that lenders exercise caution in their underwriting and make sure that assumptions about property expenses, rent growth and other market conditions are reasonable given the shifting sands of the recent quarter. Assumptions should reflect the likelihood that future price increases and rent growth will likely temper compared to the robust growth of the past few years.

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The outcome of the war in Ukraine remains unclear and the timing is uncertain, which complicates the economic outlook. The balance between inflation and interest rates remains largely unsettled, and an important dynamic to watch in coming quarters. Capital markets could be in for some interesting times.

For the second half of 2022, persistent economic and political uncertainty seem likely to continue, and with it—a growing risk of recession. Barring any unforeseen market disruption or an unexpectedly dramatic rise in interest rates, the trajectory of the commercial property market over the near term is still largely positive, just not as strong as 2021 was. There is an urgency taking root as lenders and investors sense the need to complete deals sooner rather than later in case market barometers lose momentum. The challenges of today's market are exerting intense pressure on environmental consultants, appraisers and PCA providers to complete their assessments quickly and accurately, especially given the growing reliance on interest rate locks. As a result, speed and efficiency continue to be key differentiating factors in lenders' procurement decisions. Important forces to watch in the coming quarters are the pace of property deals, the timing and magnitude of rate increases, and a flattening of the property pricing curve. Until then, underwriting should reflect the growing caution in the market, and assumptions should be tested under various scenarios to ensure prudent decision-making appropriate for today's uncertain climate.





Dianne Crocker is the Principal Analyst at Lightbox, a leading technology provider of due diligence, risk management, location intelligence and workflow solutions to consultants, lenders, appraisers, brokers and other stakeholders in CRE transactions. She is a highly respected expert on commercial real estate market trends and forecasting; property due diligence and risk management; and technology trends. With more than 20 years' experience in the commercial real estate industry, she has analyzed the market through three cyclical downturns. Globe St. Real Estate Forum recently recognized Dianne among their 2022 Women of Influence based on career achievements, community outreach and mentorship within the industry. She was also selected by Connect Media as one of ten national winners of the 2020 Women in Real Estate Awards, which honors the achievements and inspirational stories of women who have reached respected positions of leadership and play key mentorship roles for others. She is also a co-founder of the Developing Leader mentoring program, now in its third year of connecting young environmental professionals in the consulting and lending sectors with veteran mentors.

Dianne is a passionate member of CREW Boston, currently serving as her chapter's Delegate to the global organization, CREW Network, and as a member of CREW Network's Industry Research Committee.

IN PART III – WINTER IS COMING: Lender Considerations for Foreclosure Environmental Due Diligence

*John Thomas Rybak, Lizz Barringer Lagomarsino, Bill Tryon, Jimmy Kirkland,
Brenna Durden, Jessica Crutchfield, and Kathryn Peacock*

Introduction:

This is part three of a three-part series on the unique world of pre-foreclosure environmental due diligence. Due diligence conducted before foreclosure, deed-in-lieu, or other action to take ownership of a property can be substantially different from pre-loan investigations since ownership of the property could lead to direct liability for undiscovered issues as well as impact on the lender's ability to recover loan funds. Depending on the lender's risk appetite and exit strategy, the issues addressed, depth of investigation, information collected, and recommended actions, pre-foreclosure due diligence may bear little resemblance to pre-loan due diligence.

A market downturn has been anticipated for the past several years however, at this point in 2022 we have not yet seen significant levels of distress, but many economists are beginning to predict an increase of distressed assets in 2022, particularly in the retail sectors. According to an article published by Reuters in May of 2022, the Federal Reserve's recent rate increase, implemented with the goal of taming inflation, may potentially steer the economy into recession. The article cites worsening credit risks since the Ukraine crisis and notes that JP Morgan Chase & Co, Goldman Sachs, and Citigroup combined have put aside \$3.36 billion in credit loss reserves in the first quarter of 2022; in contrast to the past year, in which lenders released billions in reserves after losses related to COVID -19 failed to materialize.

With an increase in foreclosures potentially on the horizon, a quick review of pre-foreclosure due diligence may help lenders consider options and develop strategies to avoid direct liabilities while maximizing the recovery of loan funds. In this article, we begin with discussion of foreclosure environmental due diligence, but continue with discussion of other due diligence during foreclosure that can help lenders to avoid direct liability and maximize the recovered loan funds.





Why is pre-foreclosure due diligence important? - Three factors frequently drive due diligence during the loan workout process.

- Lenders can experience direct liabilities that exceed the property value. Environmental cleanup costs are a common example; however, injuries to occupants, exposure to asbestos containing materials, lead based paint, radon, mold, and similar concerns can be equally significant.
- Conditions may also exist which reduce the lender's ability to recover on the debt. For example, regulatory fines for failure to maintain stormwater management systems, costs to wind down existing operations, dispose of hazardous substances, complete construction, or comply with regulatory requirements can eat into the proceeds of a foreclosure sale.
- Finally, out of pocket cost the lender could experience after taking ownership of the property can eat into the lender's ability to recover loan funds. The disposal of hazardous materials left behind by the borrower, repair or correction of defects and deterioration at the property, failure to comply with permit obligations, etc. can add up quickly.

Policies - First, it's important to review and refine policies for pre-foreclosure investigation and post foreclosure marketing and management of properties. Simply ordering an off-the-shelf environmental site assessment before foreclosure, for example, may not fully satisfy the lender's needs. Policies should address exit strategies, direct liabilities, risk-specific due diligence objectives, who will order and review reports, whether previous reports or reports provided by the borrower will be acceptable, when and how information may be shared following foreclosure, and much more. The development of pre foreclosure policies could warrant another article in-itself, but the key here is to develop and implement a robust program to help control direct liabilities and maximize loan recoveries.

Understand the Property - Once pre-foreclosure due diligence is triggered, it is important to work closely with the workout officer, to understand the property boundaries and improvements, obtain all prior due diligence, review memos, and loan approvals, and verify objectives and exit strategy for the property. Will the property continue to operate as a going concern, or will it be shuttered? Are both scenarios possible? Does the lender want to stay out of the chain of title? Will there be a receiver involved? Will continued environmental oversight be needed?

Once these items are addressed, the due diligence process can begin. For this article, we begin with a discussion of Phase I and other environmental due diligence items, followed by a discussion of additional investigations that can help lenders maximize the recovery of loan funds.

Phase I Scope of Work for Foreclosure Environmental Due Diligence

The scope for a Phase I Environmental Site Assessment is ASTM 1527, which has been designed to satisfy EPA requirements for All Appropriate Inquiries (AAI) in order to qualify for defenses to CERCLA liability. Because the impacts on the ability to recover the loan funds are not limited to CERCLA; however, lenders may not be primarily concerned with AAI compliance during foreclosure. The secured creditor exemption protects lenders from CERCLA liabilities after foreclosure as long as they try to sell as quickly as possible to recoup expenses. But if this doesn't happen, they could lose their CERCLA protection, particularly if the lender participates in the management of the property. In addition, anyone buying the property from the lender does not benefit from the secured creditor exemption, which can make it difficult for lenders to recover the full amount of the loan if contamination is discovered.

As a result, a standard Phase I ESA may miss key issues important to the lender when taking title to a property. Modification of the typical, pre-loan scope of work can help lenders capture these issues. Some common considerations are listed below:

User Responsibilities - When the lender is not relying solely on the secured creditor exemption to avoid CERCLA liabilities, their own process should document steps required to satisfy user responsibilities required by the AAI rule. Lenders sometimes include research of environmental liens as part of pre-foreclosure ESAs to help satisfy these requirements.

Consultant Qualifications - The ASTM practice establishes minimum requirements for the environmental professional. To help assure the quality of pre-foreclosure assessments, though, the lender may want to establish additional requirements for the individual performing site reconnaissance, as well as enhanced experience for the environmental professional.

Depth of Investigations – In accordance with the ASTM practice, investigations are not intended to be exhaustive, and focus on the identification of obvious conditions. No investigation can rule out the potential for undiscovered issues, but it is not uncommon for lenders to ask consultants to dig a little deeper and consider less obvious risks prior to foreclosure.

Documentation - the inclusion of documentation in the Phase I report can help the lender understand and manage risks before and after foreclosure. For example, a typical ESA may not include full copies of prior Phase II investigations or closure letters; but this information can be critical to management of the property after foreclosure as well as efforts to sell the property.

Recommendations - The ASTM Practice does not require the inclusion of recommendations in ESA reports and provides no guidance on how recommendations should be developed. If you ask for recommendations, be sure to discuss your objectives and risk appetite with your consultant early on. Ideally, the lender should have a clear understanding of their own objectives to make sure that recommendations developed by the consultant are consistent with their concerns and risk appetite. Some lenders prefer recommendations to be provided under separate cover to improve their flexibility in managing and sale of the property, but either way discussion of recommendations prior to finalization can help to avoid recommendations that are not critical to the pre-foreclosure analysis or identification of immediate actions following foreclosure.

Items that are not included in the standard ASTM scope of work may also represent a significant ongoing financial burden and liability risk. Expansion of the scope of work to go above and beyond ASTM and AAI can help lenders to screen for significant issues. The following table provides a summary of non-ASTM items, and the potential risk they carry, that are sometimes included in the pre-foreclosure scope of environmental assessment.

Environmental Scope Considerations for Foreclosure Phase I ESAs

Environmental Issue	Potential Risks
Compliance	Regulatory fees for violations associated with expired permits including stormwater permits, hazardous waste storage, and disposal permits.
Hazardous Materials Inventory (Approximate)	The post-foreclosure disposal and management of hazardous materials can represent a significant cost and risk of long-term liability. Identification of the location and approximate quantities of hazardous materials during the ESA can enable the lender to require borrower removal of materials prior to foreclosure and will assist in the management of materials that remain in place.
Underground Storage Tanks (USTs) and Aboveground Storage Tanks (ASTs)	Costs to place USTs and ASTs temporarily out of service in addition to costs associated with out of compliance USTs can be significant and include removing remaining fuel, capping product lines, pumps, manways, and other ancillary equipment. Additionally, costs associated with upgrading USTs that do not meet current standards can be incurred.
Asbestos and Lead Based Paint	Costs associated with assessing and potentially abating asbestos containing materials and painted surfaces in poor condition that provide a danger to human health in addition to ongoing costs associated with any asbestos and lead-based paint management plans
Moisture and Mold Assessments	Costs associated with assessing and potentially abating moisture and mold impacted building materials, in addition to costs associated with identifying and remedying the source of water intrusion coupled with ongoing costs associated with any management plans.
Radon	If the property is in a high-risk radon zone and is occupied by sensitive receptors such as residents and/or daycares, costs for radon assessments can be significant. Existing radon mitigation systems are costly to maintain and require that utilities are not disrupted during the foreclosure process.
Equipment Containing Petroleum Products	Large industrial manufacturing equipment can contain large amounts of chemicals and other hazardous materials. If equipment is not properly decommissioned before the property is vacated, releases can occur that can be costly to remediate.

Equipment Containing Petroleum Products	Large industrial manufacturing equipment can contain large amounts of chemicals and other hazardous materials. If equipment is not properly decommissioned before the property is vacated, releases can occur that can be costly to remediate.
Stormwater Management	Properties under construction are frequently subject to permitting for stormwater management to comply with the Clean Water Act. Failure to comply with the permits can result in significant fines as well as requirements to correct damage to bodies of water that may be affected. Responsibilities under these permits transfer with property ownership. As a result, the lender may become directly liable for compliance with permit requirements after foreclosure.
Vacated Properties	Vacant buildings and properties are susceptible to environmental, security, and maintenance concerns if not appropriately managed following foreclosure. Any vacated areas should be appropriately secured to prevent vandalism, unauthorized habitation, theft of saleable building materials, unauthorized storage/dumping, a release of on-site chemical materials, or improper use of the site such as for a clandestine drug lab. It is also important that routine inspections be conducted to manage any concerns in a timely manner, such as water intrusion and the resulting potential for mold growth.

Quality and Process Management

Engaging a consultant that you trust and with whom you have a close working relationship is integral to managing the foreclosure process. Your consultant is an extension of your own operations. Having a close relationship with your consultant is key to making sure that your scope of work is met, and risk tolerance is understood.

Implementing a clear process to deliver accurate information to your consultant along with communication of expectations is vital to ensure the process goes smoothly. At the onset of the project, it is important to provide:

- A clear understanding of the lender's expectations and risk appetite
- Accurate information on property boundaries, parcel, and improvements, along with current and planned use of the property, and planned workout options
- All prior EDD (appraisals, environmental, property condition and title reports, surveys, property maps, insurance, etc.)
- Accurate contact information for contact, attorney, workout staff etc.
- An open communication line to the ERM department for questions and to resolve problems

Confidentiality is of utmost importance during the foreclosure process. Oftentimes, tenants are not aware of the property's status, therefore, consultants should be instructed on exactly what and *what not* to reveal in their communications with the site contact and during the site visit – they may need a good “cover story”. The tenant and/or borrower may not be aware of the reason for the Phase I ESA, and you don't want your borrower's first notice of possible foreclosure to come from your consultant.

It can also be helpful to provide your consultant with guidance to be able to answer challenging questions during the site assessment. The more you share expectations with consultants at the beginning of the process, the less problem management you will need to do on the back end when you are scarce on time and resources. Questions that consultants often want guidance on in foreclosure situations are:

- What do I say to on-site contacts about why we are here, and do they know about the potential foreclosure?
- What do I do if the site contact will not let me to go inside the buildings?
- Do you have an expanded scope of work that addresses compliance., permit maintenance, waste disposal, etc.?
- Is there a chain of command for questions, who are the appropriate people to contact and to not contact?

Access to the property is another common challenge. It is not uncommon for borrowers to be unresponsive or uncooperative. Many banks want their consultants to document all communications or attempts. Avoid settling for site assessments that don't include interior access. If the interior is not inspected, critical issues could be missed. In these situations, the lender may want to seek legal counsel to assist with access.

Phase II ESA and Remedial Cost Considerations

Phase II investigations before foreclosure can be appropriate when the ESA determines that a release is likely to have occurred. Additional investigation may also be needed to supplement due diligence performed and limited environmental risks identified prior to loan origination. The prior evaluations may have been based on a few sampling locations. In a foreclosure scenario it is important to review existing Phase II reports to evaluate whether additional certainty is desirable.

- **Authority to Perform Phase II** - the lender is likely to have authority to perform Phase II work under an agreement; however, Phase II is an intrusive investigation, and the borrower may not be a cooperative party for many reasons. It may be necessary to work through legal counsel to assure permitted access to perform the work.
- **Scope of Work** - Phase II ESA performed during foreclosure can be far more extensive than investigations performed before a loan is made. When a Phase II ESA is recommended to address likely releases at a property, it is important to conduct a focused investigation that will allow the lender to evaluate risks as well as manage and sell the property. Depending on the lender's appetite for risk, this can require the collection of more samples than would normally be the case. When a release has been identified, the collection of these additional samples can also support development of a remedial cost estimates to helpful under understand the magnitude of the risk.
- **Recommendations** - For reasons discussed elsewhere in this article (or in parts 1 and 2), lenders sometimes require consultants to provide recommendations under separate cover.

Remedial Cost Estimates - When contamination is discovered, it may also be useful to approximate the magnitude of cleanup costs. As with recommendations, obtaining this information under separate cover help to protect the lender. Based on phase two results, an experienced consultant may be able to provide an order of magnitude estimate of cleanup costs, but the development of a Remedial Cost Estimate can help to narrow the range of expected costs.

Other Things to Consider

A wide range of additional diligence can also help lenders to maximize loan recoveries and limit direct liabilities. A complete catalogue of possible due diligence could fill a book, but a few of the most common issues and types of assessment are listed below. These issues are sometimes combined with the Phase I or other reports, e.g., inclusion of asbestos in a Phase I ESA; however, it may be prudent to obtain focused reports under separate cover to simplify post-foreclosure activities and improve the control of information.

Property Condition Assessment (PCA) - The physical condition of a property has an obvious impact on marketability and value. At foreclosure, it is not uncommon to discover that a borrower has delayed maintenance and repairs, which may significantly impact the property value and can result in rapid deterioration of the improvements. ASTM has published guidance for property condition assessments. Unlike the ASTM standard practice for Phase I environmental site assessments; however, rather than providing a specific scope of work which is applicable in all circumstances, the property condition standard is published as guidance for the baseline assessment of property condition and is most useful in assisting clients to define a scope of work to address their unique concerns. When conducting pre-foreclosure due diligence, it can be appropriate to eliminate the evaluation of some commonly added elements to focus on specific concerns.

Reserve Estimates - Though it is not required by the standard, most property condition assessments include an estimate of major system replacements anticipated for some number of years in the future; most commonly for a period of 5 – 12 years. This information can impact the marketability and value of the property and is not particularly useful in the pre-foreclosure analysis. This can commonly be eliminated from pre-foreclosure reports.

Natural Hazard Exposure - Another common addition to property condition assessments is the evaluation of exposure to natural hazards. The discussion of flood, earthquake, and wind zones can be useful prior to loan origination, but adds little to the pre-foreclosure decisions.

At the same time, it can be useful to expand other elements of the work:

Extent of Observations - The ASTM guide provides suggestions regarding the percentage of the property to be observed during the assessment. For example, the observation of multifamily units is typically limited to 10%. The guide also limits observations to readily observable conditions, which may mean that some conditions are not identified or evaluated. A long list of activity limitations is also included in the guide. To make sure their most important considerations are addressed, Lenders may want to discuss these limitations with the consultant to agree on any adjustments to the baseline scope of assessments.

Specialists – Property buyers sometimes include an evaluation of high dollar or high-risk items by specialists. The general condition of roofs, mechanical systems, elevators, and buildings facades, for example, will be evaluated by a generalist during the property condition assessment; but inspection of existing systems by consultants who specialize in those systems will provide a more reliable evaluation. This can be especially important when concerns are known to exist but can also help to avoid surprises that may affect the lender's ability to recover loan funds. Larger facilities may warrant assessment by one or more specialists.

Recommendations - The ASTM guide requires the inclusion of recommendations in PCA reports but does not provide guidance on how those recommendations should be developed. The objective of a pre foreclosure property condition assessment may be substantially different from other acquisition assessments. Ideally, the lender should have a clear understanding of their own objectives to make sure that recommendations developed by the consultant are consistent with their concerns and risk appetite. Discussion of recommendations prior to finalization can help to avoid recommendations that are not critical to the pre-foreclosure analysis or identification of immediate actions following foreclosure.

Cost Estimates - In accordance with the guide, the consultant may develop order of magnitude estimates for recommended activities. Depending on the objectives of the report, lenders may benefit from more precise estimates that will require additional time and effort of the consultant and could even require the solicitation of bids. Rather than modification of the scope of work to reflect more precise costs, it is generally more practical to further evaluate costs for high-budget items as a follow up to the property condition assessment.

Accessibility - A screening for accessibility concerns is frequently added to the property condition assessment, but it is important to be aware that this is an extremely limited review. A more complete assessment involves the review of regulatory requirements, existing records, review of plans, and evaluation of the property by a specialist. At a Federal level the Americans with Disabilities Act and Fair Housing Act require properties to conform to certain criteria, but some jurisdictions have established additional requirements. Accessibility represents both reputational and financial risk for the lender. Owning a property that doesn't meet accessibility standards, even for a short time following foreclosure, can expose the lender to reputational risk. Costs to correct deficiencies also represent a direct reduction of market value.



Investigation of the following issues can also provide useful information before foreclosure. It can be tempting to include these in the scope of property condition assessment or environmental site assessment; however, as indicated above including the findings in a single report may not be in the lender's best interest. By engaging a consultant to conduct one site visit, but produce multiple reports on different topics, the lender can achieve better control of the resulting information.


Mold and Moisture investigations - Screening for mold and moisture conditions is sometimes added to the Phase I scope of work. When combined with another scope; however, addition to the property condition assessment is likely to provide better information since field observations for the PCA will generally be completed by someone with greater knowledge of building issues. In any case, the property condition assessment will identify moisture concerns within the context of the ASTM guide, but it is important to remember that the ASTM guide describes a minimum scope of work which may not be adequate to fully identify and characterize related concerns. Additional assurance can also be achieved by completion of a separate investigation in accordance with ASTM Standard Guide E3026-15 for the evaluation of Readily Observable Moisture Affected Materials and Conditions Conducive to Elevated Moisture in Commercial Buildings.

Safety Concerns - ASTM guidance expressly excludes the evaluation of safety concerns as part of the property condition assessment. The evaluation of safety concerns is important to limit direct liabilities for injuries during the term of ownership by the lender, inclusion of this work in the property condition assessment it's strongly discouraged. Since there is no standardized since there is no standardized scope of work for the evaluation of safety concerns, lenders should work with their consultant to develop a scope of investigations to protect their interests during ownership.

Seismic Risk Assessment – Seismic the reports included in the file should be reviewed to identify issues that may be of particular concern. For example, building stability issues identified in a seismic risk assessment will not always prevent a lender from moving forward with a loan, but if an earthquake occurs during the lender's ownership of the property, full or partial collapse of the building could result in claims for damage and even loss of life – especially if the lender took no steps to correct a known vulnerability. When no seismic report was performed prior to making the loan, a current investigation can help to inform foreclosure decisions.

Balcony and Facade Inspections – Many jurisdictions require periodic inspection of balconies and building facades. The related scope of work and reporting requirements are typically established by existing regulation and will vary among jurisdictions. It can be useful to ask the property condition consultant to comment on such laws; however, a separate report and more detailed inspection are likely to be required.



A vertical photograph on the left side of the page shows a person from behind, walking across a narrow suspension bridge. The bridge has a wooden plank deck and metal mesh railings. It stretches into a dense, lush green forest. The person is wearing a blue shirt, light-colored pants, and a backpack.

Resilience and Energy Efficiency - These are important issues that are more commonly addressed during underwriting of new loans. These reports can be interesting before foreclosure but could be essential to favorable sale of the property so should be considered on a case-by-case basis.

What Next?

By investigating critical issues before foreclosure, lenders can greatly improve their chances of maximizing the recovery of loan funds. Anticipating risks, developing an exit strategy, establishing clear objectives for investigations, and communicating extensively with your consultants and workout team will make a huge difference in the process.

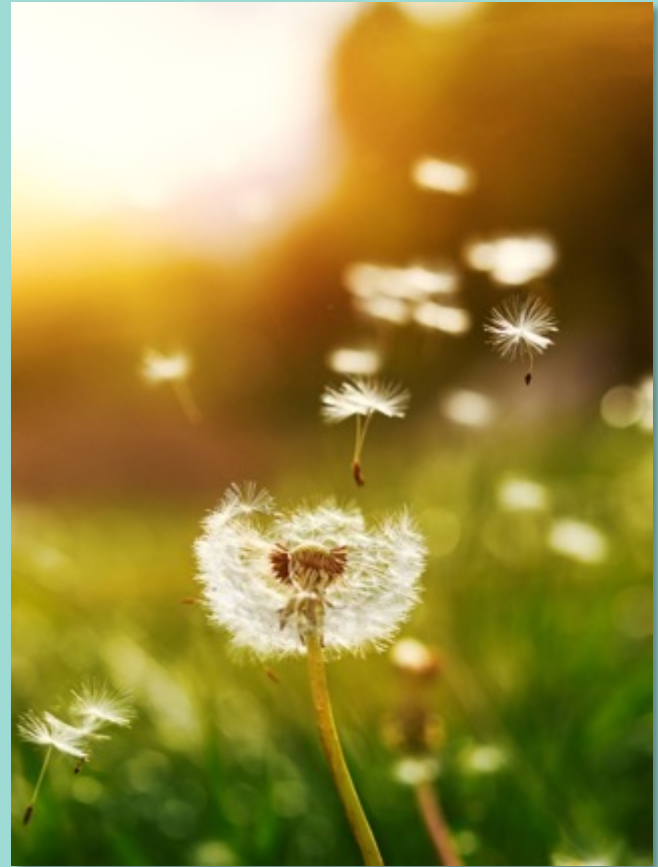
Many lenders and affiliates in the Environmental Bankers Association have significant experience with the investigation of properties prior to foreclosure. One of the greatest values of EBA membership is the ability to reach out to this seasoned team to talk through issues and concerns. If you would like to talk through issues and develop a robust program for the pre foreclosure evaluation of properties and operations, feel free to connect with one of us or reach out to other EBA contacts or management.

What Do Climate Disclosures have to do with Due Diligence?

Trends for Environmental Risk Managers

Dianne Phillips, Holland & Knight

Climate risk and climate disclosures have dominated the news recently. It has become harder and harder to keep track of all the moving pieces, and even more difficult to understand the implications for lender Environmental Risk Managers (ERMs). At a macro level, ERMs know that incorporating climate risk into their portfolio of risk management tools will become increasingly more important, but given the current state of the myriad proposals many are at a loss for how to get started as a practical matter. Much depends on the specific approach adopted by financial institution leadership. Similar to the Biden administration's whole-of-government approach, financial institutions are considering and implementing organization-wide approaches. Most of the climate disclosure proposals, and the climate risk evaluations, encourage institution-level analysis. These plans are being crafted at the highest levels of organizations, and will likely be implemented from the top down. Following the trends and their impact on due diligence will become increasingly important for ERMs and the customers they serve.



Much of the news has been focused on the Security and Exchange Commission's (SEC) proposed rule that would require registrants (publicly-traded companies) to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. Published in March 2022 and currently undergoing public comment, the proposed rule changes would require these companies to disclose information about how any climate-related risks have had or are likely to have a material impact on its business and which may manifest over the short-, medium-, or long-term. For companies that already conduct scenario analysis, have developed transition plans, or publicly set climate-related targets or goals, the proposed amendments would require certain disclosures about those activities as well. The proposed rules also would require a company to disclose information about its direct greenhouse gas (GHG) emissions (Scope 1) and indirect emissions from purchased electricity or other forms of energy (Scope 2). In addition, certain companies would be required to disclose GHG emissions from upstream and downstream activities in its value chain (Scope 3), if material or if the company has set a GHG emissions target or goal that includes Scope 3 emissions.

For ERMs, Scope 3 emissions implicate customer-focused environmental due diligence and underwriting processes. However, to date, very few ERMs have included emissions disclosure as part of their environmental due diligence checklist. That may change as more and more data and tools become available and more stakeholders require this information for regulatory reporting. One such tool currently available is published by the Partnership for Carbon Accounting Financials (PCAF). Measuring financed emissions as the starting point to managing risks and identifying opportunities associated with greenhouse gas emissions is PCAF's goal and they offer a number of tools currently used by many financial institutions. Another potential tool for individual buildings or commercial real estate portfolios is the Energy Star Portfolio Manager, part of the Energy Star program to encourage energy efficiency run by the U.S. Environmental Protection Agency. Becoming familiar with these tools, and others like it, will help ERMs assemble relevant data if called upon as part of a financial institution's climate disclosure and climate risk program.

While only the largest financial institutions which are publicly traded will be subject to SEC rules, climate disclosures and climate risk analyses are being proposed by other regulatory bodies including the Office of the Comptroller of Currency (OCC), an independent bureau within the Treasury Department, and the Federal Deposit Insurance Corporation (FDIC). Moreover, the Financial Stability Oversight Council (FSOC), established by the Dodd-Frank Wall Street Reform and Consumer Protection Act, similarly views climate risk as an emerging threat to the U.S. financial system as described in their 2021 Report on Climate-Related Financial Risk. That report lays out a number of recommendations which will be important to follow. Several international bodies have proposed guidance as well. For example, more than 200 U.S. financial services companies publicly support the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations, a framework for more effective climate-related disclosures created by the Financial Stability Board, an international body that monitors the global financial system.

While a detailed description of these initiatives is beyond the scope of this article, the framework outlined by the OCC and FDIC is illustrative. Specifically, on December 16, 2021, the OCC, in OCC Bulletin 2021-62, issued a draft framework for financial institutions with more than \$100 billion in assets, outlining principles on incorporating climate risk into their strategic planning. Finding that banks are likely to be affected by both the physical risks and transition risks associated with climate change (referred to in the draft principles as climate-related financial risks), the OCC proposed a framework to help banks analyze those risks. More recently, on April 4, 2022, the Federal Deposit Insurance Corporation (FDIC) published a notice of proposed policy statement and request for comment which includes many of the same principles as the OCC guidance. Both policies focus on entity-level risk analysis of both physical risk and transition risk including suggestions for governance, strategic planning, policy implementation, risk management, data collection and reporting, and scenario analysis.

As a reminder, physical risks refer to the harm to people and property arising from acute, climate-related events, such as hurricanes, wildfires, floods, and heatwaves, and chronic shifts in climate, including higher average temperatures, changes in precipitation patterns, sea level rise, and ocean acidification. Transition risks refer to stresses to certain banks or sectors arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change. For ERMs conducting due diligence, the focus is typically on physical risks which may arise in the course of environmental due diligence related to customer collateral.

The OCC draft principles suggest a framework for the entire organization, but emphasize the need for data, risk measurement, and reporting. Specifically, OCC recommends the following:

Management should incorporate climate-related financial risk information into the bank's internal reporting, monitoring, and escalation processes to facilitate timely and sound decision-making across the bank. Effective risk data aggregation and reporting capabilities allow management to capture and report material and emerging climate-related financial risk exposures, segmented or stratified by physical and transition risks, based upon the complexity and types of exposures. Data, risk measurement, modeling methodologies, and reporting continue to evolve at a rapid pace; management should monitor these developments and incorporate them into their climate risk management as warranted.

OCC also urges banks to consider what specific climate-related data, metrics, tools, and models from borrowers do banks need to identify, measure, and monitor in order to control their own climate-related financial risks. Key questions posed include the following: How do banks currently obtain this information? What gaps and other concerns are there with respect to these data, metrics, tools, or models? These questions can be informed by ERM's who could play a significant role in assuring proper data, metrics and models are utilized. ERM's are typically trained in environmental sciences and are familiar with the principles underlying climate data, metrics and models. Becoming familiar with the various climate models, government resources, and publicly-available data, as well as the growing number of private vendors offering such services will be important for an ERM's expanded role.

If ERM's begin to plan for climate-related due diligence the way they have been planning for PFAS and emerging contaminant due diligence, they can start to build their knowledge base. Starting with a comprehensive checklist for borrowers, supplemented by online databases, will be important to build-out climate-related environmental due diligence which captures the physical risk reporting requirements likely to be imposed in the future. It is not too early to begin that process.



SEC Rules: Impact on Lenders

Tony Liou and Jeff Polasek, Partner Engineering and Science



SEC's Climate Disclosure Proposal Impact on Lenders

The SEC released its climate-related disclosure requirements proposal on March 21st. The proposed rules would require public companies, including many banks, to disclose both their climate-related risks along with how they will mitigate those risks, as well as their greenhouse gas (GHG) emissions. The disclosure requirements, if adopted, would provide investors information around climate-related risks that may pose financial risks to companies and help them make investment decisions. While some companies are already disclosing similar information according to their Environmental, Social, and Governance policies, the SEC rules would make it mandatory for public companies and standardize the practice.

Proposed Disclosure Requirements

Climate-Related Risks

Public companies will need to disclose all identified climate-related risks (physical and transitional risks) that may have material impacts on the business and their consolidated financial statements, including short, medium, and long-term risks. Companies will also need to disclose how those risks may affect their business model, strategy, and outlook. The SEC rules would affect the entire business, so lenders will need to report on the climate-related risks associated with their corporate assets as well as loans. While some banks have begun to analyze climate hazards and their potential effects on their loans and assets, many have not begun to collect this data or do not understand the scope of work involved.

Physical climate-related risks refer to risks from climate change, such as flooding, fires, and sea level rise. Analysis of these risks are based on the property's historical data and regional climate data, while property-specific risks need to take into account the condition of the property itself, and whether there are any resilience measures in place. An example of a property resilience measure -- if a property is located in a potential flood zone due to sea-level rise, are the energy generators and mechanical equipment relocated in an above grade location rather than the basement?

Currently, one challenge to analyzing climate-related risks is the lack of standardization in measuring the severity of climate hazards and how potential damages are calculated. ASTM is currently developing a scale to measure climate hazards for the Standard Guide for Property Resilience Assessments, which would resolve the issue when it is published. Despite this challenge, there are reputable climate hazard data reports available that can be used to assess risks to properties. Lenders can and should start gathering climate risk data now, along with site-specific data for individual assets, which will be necessary when evaluating risks. And some lenders are doing just that. Currently, the most common practice is performing one of two “tiers” of climate risk analysis during due diligence, much like it is done for environmental due diligence: 1) assessment of the regional climate hazards in the area that a property is located, or 2) assessing the regional climate hazards *plus* a site visit to evaluate property specific risks, resilience measures already in-place, and additional resilience measures needed to mitigate those risks.

In addition to evaluating climate-related risks, public companies will also need to disclose how they plan to manage the risks, and how the processes are integrated into its overall risk management system. If the company has adopted a transition plan, they will need to provide a description of the plan with relevant metrics and targets.



GHG Emissions, Targets, and Goals

In addition to climate-related disclosures, the proposed rules would also require companies to report on their GHG emissions for the most recent completed fiscal year. While companies with ESG policies or those that have committed to net-zero goals would already have begun collecting and reporting this data, the SEC rules would make GHG emissions reporting a standard practice. Reporting would be required for at least the first two out of three scopes of emissions, as defined by the EPA: Scope 1 consists of direct emissions from owned or controlled sources; Scope 2 includes indirect emissions from the generation of electricity, or heating and cooling that are purchased by the company. For lenders, Scopes 1 and 2 would include the emissions emitted by their owned corporate assets.

The SEC would also require reporting of Scope 3 emissions if they are material to the company, or if the company has set a GHG emissions reduction target that includes Scope 3 emissions. EPA defines Scope 3 as indirect emissions that occur within a company's value chain. For lenders, Scope 3 emissions would likely mean reporting on the emissions data of any loans and collateral properties.

If a lender has set GHG reduction goals, they would also be required to provide information about the measures they are taking to reduce emissions and their timeframe to getting to those targets.

While companies still have some time before filing even after the rules are adopted--the first compliance year for Scope 1 and Scope 2 would be for fiscal year 2023 (filed in 2024) for large accelerated filers, and Scope 3 would be due for fiscal year 2024 (filed in 2025)—those who have not reported on GHG emissions in the past should investigate the varied emissions sources they have and ensure that they are ready with the data when reporting time comes. While reporting requirements for Scope 3 emissions remain to be determined, lenders can and should begin gathering data for Scope 1 and 2 emissions.

Fortunately, lenders would not need to gather all this data themselves, since third-party consultants can help gather the data, assist with the reporting, and provide recommendations to help lower GHG emissions.

The Next Step

The SEC rules are not finalized yet, but the trend is clear. The Net Zero Asset Managers Initiative, which launched in December 2020 and currently has 128 signatories—overseeing \$43 trillion in assets—is committed to supporting net zero greenhouse gas emissions by 2050 or sooner. Companies are setting ESG and property resilience goals as investors demand this information to make their investment decisions. Though lenders may not need to commit to the same goals, setting targets to address climate-related risks and developing policies and processes to mitigate those risks will be advantageous in the long-run.

Present-day investors and borrowers are scrutinizing lenders' ESG strategies to determine with whom they want to do business. Lenders at the forefront of ESG can strengthen their public trust, stay ahead of the upcoming regulatory requirements, and have significant growth opportunity. Multiple articles/interviews conducted within the last year have indicated that most lender CEOs believe their future growth will largely be determined by their ability to anticipate and navigate the shift to a low-carbon, clean technology economy.

Finally, as lenders move forward to develop an ESG policy, they should understand their current ESG baseline, have an understanding of regulatory expectations, understand that ESG risks are real and relevant and should be evaluated as part of the credit and valuation risk, and develop an ESG strategy that is integrated into the lender's overall business strategies.

Authors:

Jeff Polasek currently serves as a National Client Manager and Principal at Partner Engineering and Science, Inc. providing solutions to clients' due diligence needs. Mr. Polasek has over 26 years of experience in the real estate due diligence industry. He is responsible for ensuring consistency, quality, and on-time delivery of due diligence and engineering services provided by Partner. Mr. Polasek holds a Bachelor of Science from the University of Texas and a Master of Science from Texas A&M University.

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Tony Liou



Jeff Polasek

Best Practices in SBA Environmental Due Diligence

Derek Ezovski, Outsourced Risk Management Solutions

The U.S. Small Business Administration continues to be a very popular source of funding for small businesses and commercial real estate transactions. The SBA guaranteed and funded [over \\$44 billion in loans to small businesses in fiscal 2021](#) in the form of 7(a), 504 and microloans.

While SBA loans are a fantastic option for small businesses that may not qualify for a conventional loan, the agency requires a level of due diligence that often differs from those of the typical lender.

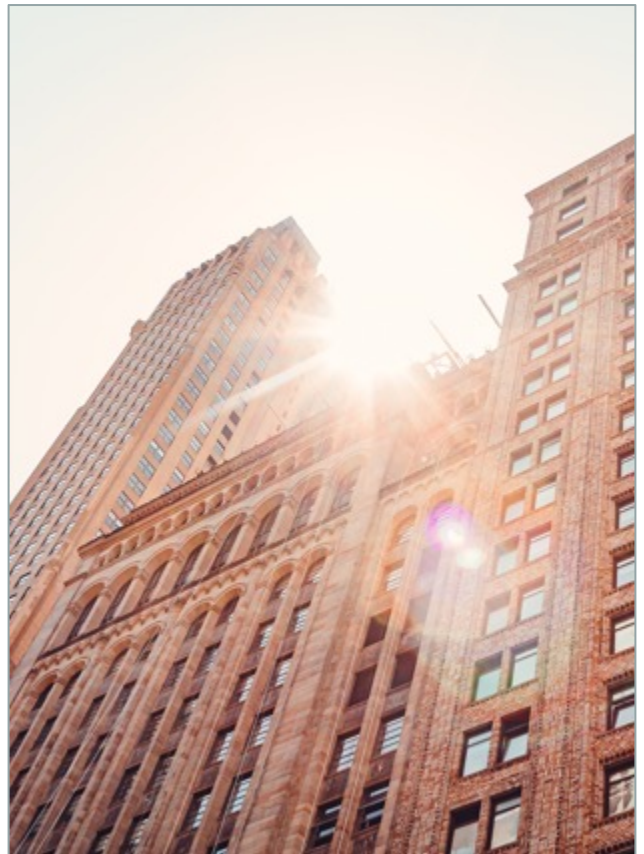
Why SBA lending?

SBA loans offer a number of compelling advantages over conventional lending. For one, they are often a great fit for new or niche market businesses that may not have yet developed a track record of success in their industry.



SBA loans also offer more flexible borrowing terms under certain circumstances. For example, whereas lenders typically offer a five-year loan on a conventional basis, through an SBA 7(a) loan, borrowers can qualify for a term up to 10 years, allowing them to preserve precious cash flow needed to cover payroll, rent and other operational expenses as they grow.

For lenders, the benefits are obvious. Depending on the specific program, the SBA offers guarantees of 50 -85%, as long as proper due diligence and reporting are completed and certain criteria are met. SBA loans can be an important part of a healthy commercial loan portfolio—enabling lenders to grow their interest income without adding undue risk. Because SBA lending is an important tool for supporting marginalized and traditionally underserved populations, these loans can also help lenders comply with Community Reinvestment Act (CRA) requirements while creating or preserving jobs in their home communities.



SBA loans have rigorous due diligence requirements

For lenders new to SBA lending, it's important to recognize some key differences with conventional lending before you dive in head first. Although it's always important to follow proper pre-lending due diligence with any commercial loan, the SBA has its own unique requirements, particularly around environmental due diligence. Any misstep can result in a possible loss of guarantee. Take note of the following, all of which are covered in the agency's latest standard operating procedures, [SOP 50 10 6](#), effective October 1, 2020.

- **Phase I and Phase II Environmental Site Assessments (ESAs)** must be performed by an Environmental Professional, and must be accompanied by a Reliance Letter, which **cannot** be altered in any way.
- **Phase I ESAs can be used for up to one year.** After that time, you must obtain an updated site assessment.
- Phase Is must also include an **opinion by the Environmental Professional** as to whether any Recognized Environmental Conditions (RECs) are present, along with a conclusion as to the level of risk present at the site and recommended next steps.
- Specialized properties including **gas stations, dry cleaners, and childcare facilities** have more rigorous environmental due diligence requirements, which may include additional investigations.
- If contamination is determined to be present on a **gas station property that includes a change in ownership**, the lender is required to obtain an SBA environmental indemnity agreement or an exception from the environmental committee.

- It's important to recognize that a **“no further action” letter** provided by the responsible government entity does not automatically resolve due diligence concerns. Future remediation may be necessary, depending on the specific circumstances.
- All **insurance policies** submitted as part of the SBA approval package must include the time period that the report was completed.
- **All property addresses must match** in the SBA loan package.
- Currently, **pre-approvals are not allowed**; credits must be approved by the SBA's Sacramento Loan Processing Center (SLPC) before environmental reports can be submitted for approval.
- Participants in the **Preferred Lender Program (PLP)** should follow the SOP just like participants in the 504/CDC program. Because PLP lenders are authorized to make their own lending decisions, this added responsibility means that a failure to follow proper due diligence protocols can put the guarantee at risk.



As professional risk management consultants, we strongly recommend SBA lenders review, understand, and consult the full SOP and stay up to date on all environmental and collateral valuation provisions and requirements. We also recommend consulting outside risk management professionals for help with navigating and interpreting the latest guidance.

SBA guaranteed loans offer banks and credit unions a flexible and low-risk way to support their small business borrowers. If you haven't yet explored SBA lending, now is a great time to acquaint yourself with this beneficial program.



Derek Ezovski is the President of Outsourced Risk Management Solutions LLC (ORMS), a leading environmental risk management firm. A recognized expert in the field of risk management, Derek has presented to many leading industry organizations, including the Risk Management Association (RMA); Independent Community Bankers of America (ICBA); National Association of Government Guaranteed Lenders (NAGGL); and the Environmental Bankers Association (EBA). Derek can be reached at 877.407.ORMS or via email at dezovski@orms.com.



PFAS CORNER



Terrifying Nightmares on Small Maine Farms

(not a Stephen King Novel)

Victor DeTroy, AEI Consultants



Stephen King, Maine's most famous resident, couldn't have written a more horrific script. Around the state, small farmers are waking up to a living nightmare. Is it a bloodthirsty clown hiding under their zucchini leaves? Is it a giant rabid dog chewing their apple trees? Is it a head of cabbage that looks eerily similar to Jack Nicholson's face?

Worse. It's PFAS.

It all started when Fred Stone, a third-generation dairy farmer in the small town of Arundel Maine discovered that there were extraordinarily high levels of PFAS in his cow's milk. Turns out that biosolid sludges had been spread at his farm for nearly 20 years and the hay that the cows were eating was contaminating them with PFAS. The single PFAS chemical of highest concern was identified to be PFOS.

This prompted the Maine Department of Agriculture to start testing all Maine-produced fluid pasteurized milk for the single chemical PFOS. Maine is one of the few states that has screening levels for different PFAS in dairy and meat products.

Adam Nordell and Johanna Davis, a young couple in Unity Maine, started a small organic farm in 2014 called Songbird Farm. Business was booming until they were alerted in fall of 2021 that there was a deer advisory in the area. Hunters were told not eat the deer in the greater Fairfield area due to the detection of elevated levels of PFAS in liver and tissue of several deer. It turns out that due to the historical spreading of biosolid sludges on fields in the area had contaminated the plants and soil. The contamination had passed on to the deer.

Adam and Johanna were also alerted that their farm was on a state database where biosolids had been historically spread. They voluntarily tested their soil, a spinach crop, and groundwater and found that elevated levels of PFAS were present in all three (with groundwater 400 times higher than Maine state guidelines). Their land is now essentially worthless.

Sadly, these cases are becoming more common. Over 700 potentially contaminated have been identified in the small state of Maine alone.



The Maine legislature is working on relief funding for these farms; however, help is often too little and too late for some. Fred Stone was forced to euthanize his entire herd of dairy cows, undergo multiple efforts to clean his land, and in the end still failed to bring the levels of PFOS in his milk to acceptable levels. The State of Maine Legislature bill [LD 2013](#) proposed by the [house and](#) passed on April 7, 2022, would set up an advisory committee and fund of \$100 million to pay for testing, remediation, health assistance, and a buyout program of contaminated land. The fate of that bill seems uncertain and is currently designated as “dead” in the Maine Senate.

Spreading of biosolids has a curious history. Wastewater plants would historically discharge wastes into the ocean. However, in 1972, with the passage of the Clean Water Act, Marine Protection, Research and Sanctuaries Act, and the Federal Water Pollution Control Act Amendments, there was a shift that pushed sludges from our oceans to our farms. This shift was further solidified in 1977 and 1987 with Clean Water Act amendments and in 1988 with the Ocean Dumping Ban Act that outright prohibited the dumping of wastewater sludges into the ocean.

Clean Water Act amendments and in 1988 with the Ocean Dumping Ban Act that outright prohibited the dumping of wastewater sludges into the ocean.

On March 22, 1993, the EPA enacted “The Standards for the Use or Disposal of Sewage Sludge” under 40 CFR (Title 40, Code of Federal Regulations) Part 503 Biosolids Rule (Part 503 Rule). This became known as the “503 rule” and it created incentives for the “beneficial use of biosolids.” The idea was that biosolid sludge could now be used “safely” for agricultural uses. The 503 rule did establish requirements for testing biosolids for pathogens, metals, and nutrients. It was considered a win-win at the time. Wastewater treatment facilities were getting rid of their sludge for next to nothing and farms were getting free fertilizer.

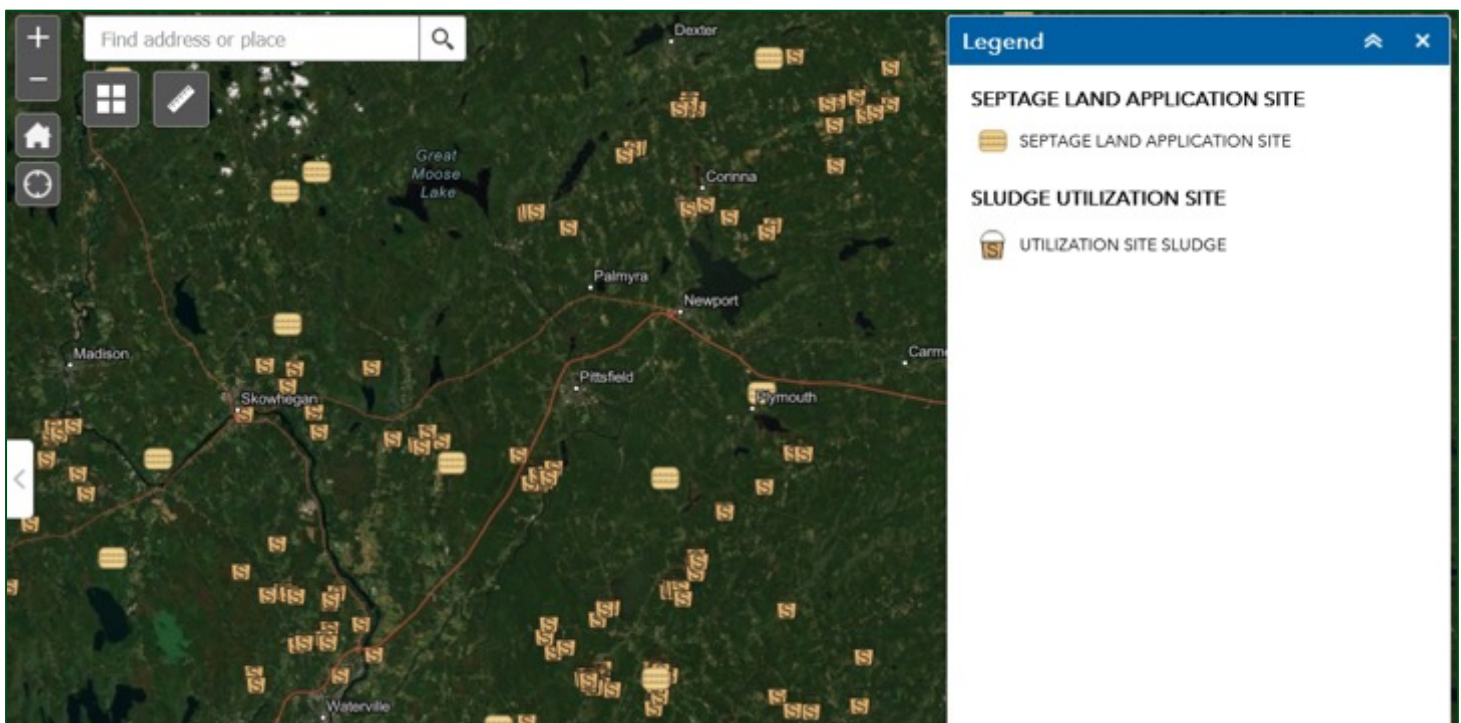
Biosolid spreading is still happening to this very day. Until the practice of biosolid spreading is halted, the fight against PFAS in our food could be a Sisyphean task. Maine bill [LD 1911](#) proposed to ban the land application of biosolid sludges, and was signed into law by the governor on April 20, 2022. These sludges would have to remain in landfills. Critics of the bill included landfills and wastewater treatment plants. The application of biosolid wastes are incredibly advantageous for landfills and wastewater treatment plants. They provide a cheap way to dispose of these sludges. One surprising group of critics are some local plant nurseries that appear to have been utilizing sludges for cheap soils and fertilizers. So just a note to all you gardening hobbyists out there, be careful where you buy your soil!

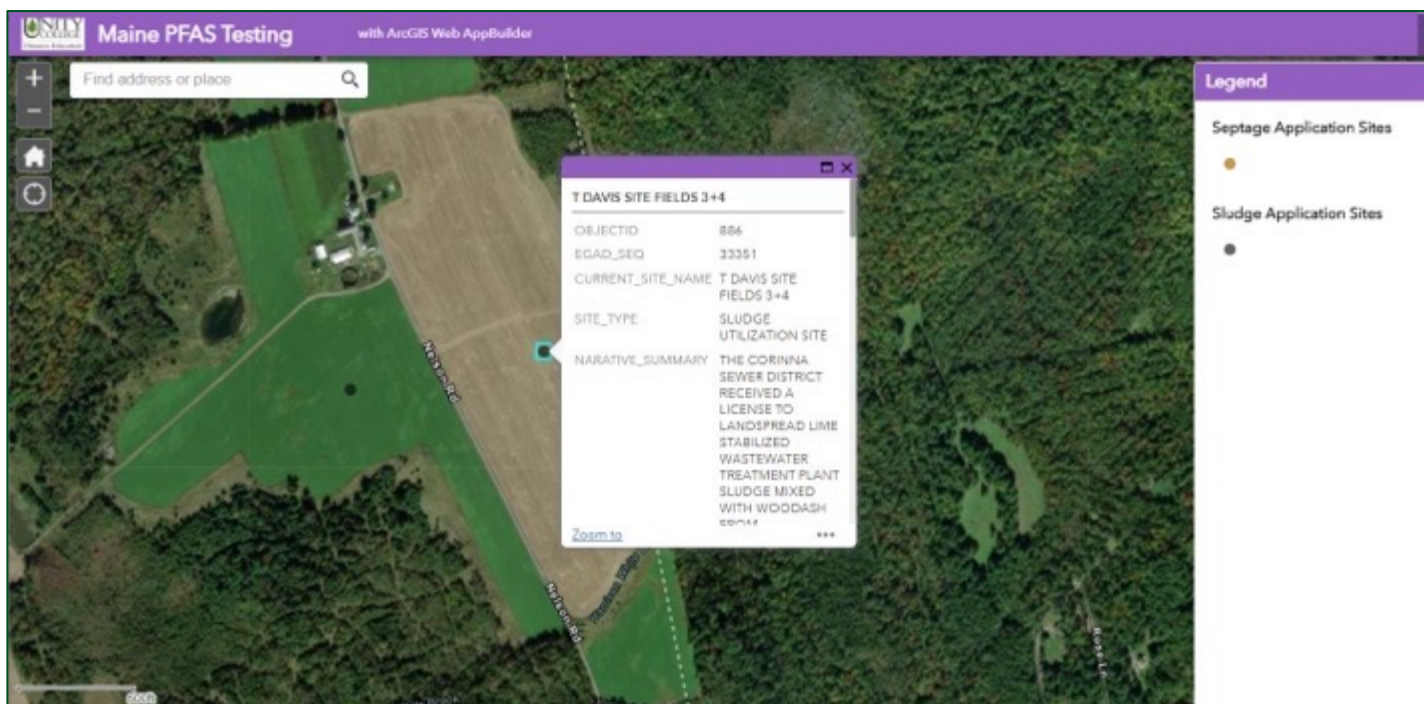
From a lending and risk assessment perspective. It will be increasingly critical to assess potential biosolid application at properties, particularly sites where agriculture is the main source of income. An asset could dramatically lose value with a single PFAS test result.

In the state of Maine, assessing the risk of past biosolid spreading is becoming more feasible with the mapping and databases that have been established. Furthermore, Maine is a small state with fewer waste water treatment facilities. Thus, tracking biosolid application is not as much of a herculean task as tracking down all of the land application permits in states like California and Texas.

Biosolid application might be the sleeping monster in the PFAS saga. While everybody's head is turned looking at groundwater contaminated by military bases and airports, biosolid sludge is like the goo monster slowly oozing into our fields of vegetables. It creeps into our farms and before we know it, it's everywhere in the grocery store. It's not coming for us... it's already here. Just make sure you keep the eyes on the back of your head open.

For my fellow nerds that want to dig deeper, here's the Maine biosolid map:





Things I Wish I Knew When I First Started as an Environmental Risk Manager

Ruxandra Niculescu, GSI, with anonymous contributions by Lenders

The job of an Environmental Risk Manager (or equal job requirement position) would be so much easier if they were handed a list of “Things to Know” from their predecessor. However, not only does that rarely happen, but in many cases, there is no predecessor. People find themselves stepping into (or sometimes being *pushed* into) the role of managing environmental risk, and they have no road map and no way of knowing what pitfalls they might encounter.



The following is a list of questions posed to ERMs from lending institutions of varying sizes. We have pooled their answers in the hopes that it helps anyone recently stepping into this role, and we're sure there might even be a few things for the veterans. The individuals have been kept anonymous, and only answers pertinent to the survey are being released here.

What makes your job easier now, that would have been useful to know when you first started?

Lender 1: When I first started sheer energy was my ‘go to’ superpower. It did not matter how much I had to do. I would have the endurance to plow through. While I still have the ability to muster up yesterday’s sheer energy, I have a new superpower today. It’s called ‘planning’.

Look at the calendar every Friday afternoon to know what is coming up the next week. Then, looking again on Monday morning to remember what you saw on Friday. We have *so much* on our calendars - deadlines, meetings, etcetera - that it is hard to get it all done. It is draining. Planning ahead, organizing, and taking the time to review your plans is critical to being effective and reducing stress levels.

Continuously working on larger initiatives is important. Don’t put them off. Incremental steps of progress are like compound interest. It may not look like much at first, but little by little it makes a big difference so don’t put the bid projects off.

Lender 2: My job has become quite a bit easier by being involved in the EBA and having the ability to talk to lots of people from all parts of the country with all sorts of backgrounds. Someone is always willing to take a call, or answer an email and give you some advice, insight, or background. And that includes all members of the organization: bankers, consultants, attorneys, regulatory agencies, and database providers. There is always someone you can talk to if you have a question about pretty much anything in this industry. That's been an invaluable resource for me.

Lender 3:

- If possible, keep your internal review memo to one page – don't bury the lead and just stick to the facts.
- Just tell the Banker what is required to close the loan (action items) – don't beat around the bush. The Banker will respect you more in the long run.
- Always review draft reports, but do not provide sign-off or approval until you receive the final version.
- Don't get hung up on reliance letters – it's a waste of time.
- Last, but not least – be up front, honest and provide realistic expectations

Did you have any “why did no one tell me this?” moments early on or even now? (e.g.: regional differences related to environmental regulations, permitting/reporting requirements, SBA pitfalls, etc.)

Lender 2: It's really hard to know what you don't know. There are so many differences with regulatory agency requirements across the various states-it takes some research to figure it out. And I've found I'm learning on-the-fly a lot! I tell myself regularly “buckle-up buttercup!” or “it's going be a bump-ee ride!” and then hang on for dear life! Just remember, things settle down eventually.

Lender 3: Yes:

- Is this loan an acquisition (purchase), owner-occupied property (seller is the borrower)?
- What is the future use of the site (as is or demolition of the building)?
- Is this a participation? who is the agent and the participating banks?

Is there anything you simply cannot gloss over that might have saved you grief early on?

Lender 1: The importance of looking beyond what is obvious in the due diligence firms and finding consultants who are passionate about identifying risk and solving problems. Many firms complete Phase I reports, and call themselves quality firms, but don't really strive for excellence and to put client's needs at the top of their priorities. Looking back, I spent a lot of time listening to what a firm's marketing team would tell me, or the enthusiasm a firm would have to work with my company.

Hundreds of firms have pitched me on why they would be the best choice for my company. How they are better, work faster, are cheaper, or have some other tangible edge over the competition. Only once in my three decades working for a lender, did a consultant actually ask what our needs were. After 30 years in the business, someone asked about us, instead of telling me about them. She listened to what my team's needs were and whether or not she could add value in meeting those needs. A multitude of other firms were selling me on 'why' them. From my perspective, the value of our relationship mattered more to her than the volume of our relationship. That was refreshing.

It is likely that you will encounter only a couple of firms in your career are consistently exceeding the minimum standards, with a passion to solve your problems. If only I could get the wasted time back with so many other firms trying to win business based on what 'they' thought we needed.

Lender 2: Don't gloss over a bad report. Be honest and tell the appropriate person your concerns as early in the process as you can. Be prepared to do additional work on your own to fill in the gaps, if your policy allows for that. And don't hesitate to tell your internal bank partners that you know other consultants who do better work and that you prefer working with them.

Lender 3: Make sure you take your vacation.

What have you learned over the years that you wish someone would have given you a heads up about or provided you with a list of "do this before signing off on the deal"?

Lender 1: Communicate with your clients. Get the full story of the transaction.

For environmental risk management teams, the client is the banker and/or credit teams. Find out about the transaction. Is it a purchase or refinance? Will they continue with the current use, or redevelop the site?

The more you know them better you can help them by identifying the risk, and communicating with them on how to further investigate or mitigate those risks. They need your expertise to effectively do their jobs.

On tougher deals, don't let them just read about it in your review memo. Recognize that you have the opportunity to be a resource, to help them understand the type and magnitude of the risk. Don't shy away from communication, even if you fear you may bring news they don't want to hear.

It's our job to communicate the risks, and their job to decide the next steps in the proposed loan process. When you develop relationships like this, you empower your clients to make better business decisions.

Lender 2: Have an open mind, ask questions and listen.

I wish I'd known I'd be wearing a black hat when I started environmental consulting in 1999. I wish I had known I was going to continue wearing the black hat when I moved into environmental risk for banks. Ha! Is there an online course to learn how to deliver bad news to people who don't want to hear it? I want that class, then and now!

Lender 3:

- Maintain a file of annual memorable reviews
- Don't speculate or guess when making a judgement call – you can only rely on the available information provided by the Banker. (Garbage in and garbage out).

We hope you've learned something from our members. EBA is a mix of many individuals, at varying levels of their careers and we can all learn from each other. As you progress in your career, don't hesitate to tap into the resources available through EBA. As one of our members said, they often reach out to ask questions to EBA members directly, and that is what we strive to provide: the resources to keep getting better.

If you have experiences you'd like to share, that you think are valuable, please reach out. We want to keep helping our community grow, and never feel like they are stuck on an island with no one to help.



COMMITTEE ROUND-UP



The EBA has several committees meeting regularly. In fact, it is due to our volunteer members who dedicate their time, talent, and expertise, that most of the EBA's content exists, including this Journal.



All EBA members are invited to join these open committees and get involved! Contact eba@envirobank.org to learn more.

Conference Committee

Plans the EBA conference agenda and conference experience.

2022 Chair: Rita Wiggins, First Bank

Content Committee

Plans and organizes EBA educational content, including webinar planning and execution, and recommended topics for conference sessions

2022 Chair: Georgina Dannatt, Bank of the West

DEI Committee

Identifies and organizes opportunities we can make EBA and our industry more diverse, equitable, and inclusive.

2022 Chair: Lori McKinnon, Zions First National Bank

Gives Back Committee

Identifies and organizes opportunities where our members can make an impact through contributions to charitable organizations.

2022 Chair: Mike McGeehan, EBI Consulting

Membership Committee

Builds connections with members to ensure they're making the most of their EBA membership, as well as identifies and makes initial outreach to future members.

2022 Chair: Onamia Chun, First Citizens Bank

Journal Committee

Collects, writes, edits, and assembles articles our members contribute to our 2x annual publication.

2022 Chair: Ruxandra Niculescu, GSI



Environmental Bankers Association



Questions, concerns or feedback?
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