

Inspect Your Properties Thoroughly

Investors can learn quite a bit from a recent environmental incident in New Jersey

By **Derek Ezovski**, vice president of lender services, Environmental Data Resources

FAVORABLE RISK AND RETURN RATIOS make commercial real estate an attractive option for many investors. When something goes wrong with a property, however, there can be disastrous consequences for everyone involved, including lenders and investors.

A recent occurrence at the Kiddie Kollege Day Care in southern New Jersey is just one of numerous examples. This past July, tests revealed that some children and employees at the center had been breathing levels of mercury vapors 27 times the regulatory limit. Unbeknownst to parents, the day care, which had been open for more than two years, was situated on land that once housed a thermometer factory.

This past August, the day care's owner, Jim Sullivan Inc., was ordered to pay \$500,000 toward site cleanup. Because of ongoing disputes over responsibility, the company not only refused to pay but also reportedly blocked access to the property until New Jersey officials intervened. Using public dollars, the New Jersey Department of Environmental Protection now is sampling soil and ground water.

A long chain of misunderstandings and a breakdown in communications throughout all parts of the due-diligence process in this case led to an environmental disaster and costly litigation. This worst-case scenario underscores that environmental research upfront into a property's past uses can prevent major headaches down the road. A half-hearted attempt at environmental scrutiny can impact how lucrative an investment will be for your borrowers.

Turn to the professionals

Commercial real estate investors can avoid a fate such as Sullivan's if they scrutinize every transaction — even if the property looks benign or an

official letter seems to indicate that it is clean.

While Sullivan himself says the sale of the Kiddie Kollege property is invalid because he did not know about the contamination, he could have avoided damage to his reputation — along with the hit to his wallet from escalating litigation costs and lost revenue from the site's operation — by conducting proper environmental due diligence upfront.

Before hiring an environmental professional, investors and lenders should check the professional's credentials. Many states do not have licensing requirements.

When considering whom to hire, it can be wise to steer clear of any unseasoned professionals. Experienced professionals have significant background in dealing with government agencies, which is a necessary part of many investigations. Further, a good environmental professional will be qualified to explain environmental-due-diligence options and costs in detail.

Conduct appropriate research

If investors in commercial real estate don't bring in an environmental professional early on, they at least should screen the property using environmental reports prepared by a commercial-database service. Many are available online. These reports will run the property through a host of databases, such as a state list of leaking underground storage tanks, and report on the findings.

Investors should also consider obtaining a historical-use report to identify what other types of businesses once occupied the property. If, for example, the site once housed a dry cleaner, it immediately sends up a red flag that the site has a high potential for pollution.



The area surrounding the property must be checked in reports, too, as contamination can migrate through soil and ground water. Information about nearby properties usually is included in standard commercial-database reports.

If preliminary reports turn up red flags, then investors can hire a qualified environmental professional, if they haven't done so already.

Understand the liability

When considering how much investigation the environmental professionals should conduct, investors should know what is needed to secure federal cleanup liability protection under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). Since this past November, investigations must conform to the new federal All Appropriate Inquiry (AAI) rule or the updated ASTM E 1527-05 Phase I environmental-site-assessment standard.

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Derek Ezovski is vice president of lender services for Environmental Data Resources. Before joining EDR, Ezovski worked for FleetBoston Financial and helped create the environmental policy for the bank's small-business-services division. Reach Ezovski at (800) 352-0050 or at dezovski@edrnet.com. To learn more about EDR, visit www.edrnet.com.

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If your investors fail to conduct the required environmental site assessment before purchasing the property, they cannot go back after the sale to seek federal cleanup-liability protection. Lenders, though, are protected from liability via secured creditor exemptions, unless they foreclose and take ownership of the property or do something that a court would construe as participating in the property's management.

Bill Wolfe, the New Jersey director of environmental-watchdog group Public Employees for Environmental Responsibility, further advises investors to go above and beyond liability-protection standards.

"Developers want to get breaks on state land," he says, "and there are a large number of sites, so they're sometimes fast-tracked. Yet as an investor, your money, credibility and public image are on the line.

"[Investors should] get the public involved from the outset, because if the public jumps in during the ninth inning, there's going to be an outcry. Save time and money in the negotiations by doing everything openly."



As urban sprawl continues and virgin land gets harder to find, states are making it easier for investors to put formerly contaminated sites back into use. While this provides myriad opportunities for investors, situations such as that at Kiddie Kollege question the adequacy of federal state oversight, the enforcement of laws governing brownfield redevelopment and the growing shift toward risk-based and voluntary cleanup.

When redeveloping a former industrial site, investors should look at the pitfalls as well as the opportunities. All parties should carefully weigh the risks involved in the reuse of former industrial and other potentially contaminated sites.

Ultimately, investors and lenders should view environmental due diligence as part of their business equation. In this way, the investors and the lender will understand the environmental and business risks at hand. **!**