

## The Environmental Corner

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### Navigating The Environmental Due Diligence Process In SBA Lending

If you are currently considering purchasing a commercial property, expanding your existing business, or are in the market to sell your current business or commercial property, you have likely considered the lending opportunities available in today's challenging economy. Borrowing options became limited as small business and business banking lending came to a near grinding halt in 2008. In September of this year, 13 major U.S. banks pledged to increase government-backed Small Business Administration (SBA) small business lending by \$20 billion over the next three years in an attempt to stimulate the economy. In addition, local banks, regional banks, and even credit unions have begun taking advantage of SBA loan programs as a means of extending lending options to small business owners. If you choose to secure financing through an SBA loan program, you may face challenging environmental due diligence and environmental

investigation requirements for your business venture.

Environmental due diligence requirements are typically mandated and driven by policies adopted by your lending institution. Not all lending institutions have set guidelines for managing risk through environmental due diligence policies; however, if you are considering a loan guaranteed by the SBA, lenders must follow, at a minimum, the environmental requirements set forth in SBA policy. Many of these

loans will be administered through the SBA's 7(a) lender and Certified Development Company (CDC) loan programs. To protect the lender and SBA interests, applicants for these loans are required to fulfill federally mandated due diligence obligations to meet the requirements of eligibility for receiving funds guaranteed through these programs.

The SBA's environmental investigation requirements consist of a

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tiered approach in which higher risk properties such as gas stations or dry-cleaners must undergo more thorough due diligence activities including completing a Phase I Environmental Site Assessment (ESA) and possibly a Phase II ESA, whereas lower risk properties such as commercial office buildings may only undergo an environmental screening process. The screening tools include an Environmental Questionnaire, a review of regulatory and historical records (called a Records Search with Risk Assessment or “RSRA”), and/or an environmental Transaction Screen. These requirements are outlined in SBA Standard Operating Procedure (SOP) 50 10 5(D), which requires lenders to compare the North American Industry Classification System (NAICS) code for current and past users of the property against a list of 58 NAICS codes the SBA identified as environmentally sensitive industries. If there is a match to an environmentally sensitive NAICS code, a Phase I ESA is required at a minimum.

A Phase I ESA consists of an assessment and identification of potential and/or existing environmental concerns on a property through a process of conducting a site inspection, reviewing historical use records for the property and surrounding properties, reviewing regulatory records for the site and surrounding properties, and interviewing site owners and operators. The Phase I ESA must be conducted in compliance with the U.S. EPA’s All Appropriate Inquiry rule by an Environmental Professional (EP), which includes

Professional Engineers and Licensed Professional Geologists.

The findings of a Phase I ESA may necessitate a Phase II ESA to determine if contamination is present that may impact the value and impose liability to interested parties, including the lending institution extending the loan. The scope of the Phase II ESA will be developed based on site-specific conditions but may include subsurface soil and groundwater sampling and analysis. In the case of SBA guidelines, if the Phase I ESA concludes further investigation is necessary, the lender or CDC must proceed as recommended by the Environmental Professional or, alternatively, submit the results to the SBA and seek concurrence for not following the Environmental Professional’s recommendation, providing rationale for the rare instance when an exception to the due diligence process may be warranted.

Dry cleaners are also identified as environmentally sensitive properties with specific requirements for environmental investigations under SBA regulations. If a dry cleaner operated on a property for less than five (5) years, the process begins with a Phase I ESA, like other environmentally sensitive industries. However, if a dry cleaner operated on the property for more than five (5) years, both Phase I and Phase II ESAs are required. If contamination or on-going remediation is discovered during the due diligence process, the SBA will not approve a loan for the property unless the risk associated with the contamination is adequately addressed. The SBA identifies

eight (8) mitigating circumstances in which it would consider approving a loan despite ongoing remediation or contamination. These include obtaining a “no further action” letter, qualifying for government funding or reimbursement of cleanup costs, securing indemnification by a third party through SBA indemnification agreements, or escrowing 150 percent of the estimated cleanup cost, among others.

Although the SBA will not require a full-scale environmental investigation in every property purchase or business loan, the degree of investigation will depend upon the risk of contamination. Before you venture into the prospect of securing a loan guaranteed by the SBA, be sure you are working with a lender and a qualified environmental professional who are familiar with navigating the complicated and ever-changing nuances of the SBA environmental due diligence and investigation process. It could be the underlying factor in a successful small business lending transaction.