

U.S. SBA's Environmental Policies and Procedures: Tip Sheet for Following SOP 50 10 5(C)

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This tip sheet is based on outreach to the environmental consultants and SBA lenders who have been implementing the agency's environmental policies in the field. There are a number of important differences between SBA required due diligence and typical operating practice. The purpose of this tip sheet is to foster a greater understanding of the SBA policy's requirement, as stated in the latest version, SOP 50 10 5(C).

The U.S. Small Business Administration's SOP 50 10 5(C) outlines the Environmental Policies and Procedures for lenders and Certified Development Companies (CDCs) necessary for participation in the SBA's lending programs. This environmental protocol applies to lenders participating in 7(a) loan programs—as well as to all 504 loans. The introduction of SOP 50 10 5 in 2008 was a significant development in that it provided lenders with a rigorous, tiered approach for environmental investigations whose type and depth would vary given the property's potential risk of contamination. The latest version, SOP 5010 5 (C), takes effect on October 1, 2010.

Just after the release of the original version of SOP 50 10 5, it was clear that the impact of the environmental policies would expand beyond the 7(a) and 504 loan programs. EDR's 2009 *Benchmarking Survey of Financial Institutions* revealed that 53% of SBA lenders expected their institutions to adopt the SBA's tiered approach to environmental due diligence for use on other types of loans as well (i.e., non-SBA loans). This is not surprising considering that its release coincided with increased regulator pressure on banks to have rigorous risk management policies in place for their commercial real estate lending. Its adoption also validated the SBA's approach of tailoring environmental investigations based on a property's current or past use.

1. Loan size does not determine whether a Phase I ESA is conducted.

In the past, it was quite common for bank policies to base the determination of whether

a particular commercial real estate loan warranted a Phase I ESA on the basis of loan size. One of the innovative aspects of the SBA's SOP was the recognition that a property's current or past use should dictate the level of environmental investigation conducted to assess its potential risk. There are three main triggers for a Phase I ESA in SOP 50 10 5(C) as follows:

- If there is a NAICS code match to an environmentally sensitive industry (Appendix 4); or
- If a Transaction Screen calls for further investigation; or
- If a Records Search with Risk Assessment concludes that the property has a "high risk" or "elevated risk" for contamination.

2. Current and former gas station properties warrant a set of unique requirements.

For NAICS code 447 (gas stations), the Environmental Investigation must begin with a Phase I ESA. In order to avoid lending on contaminated gas station sites, the SBA also defined more robust requirements for these types of properties. Although Appendix 5 clearly identifies "Environmental Investigation Requirements for Gas Station Loans," there is still not a widespread understanding in the market about these steps of the investigation and the higher level of effort it takes to meet them.

In addition to the Phase I ESA, there are also other steps that need to be followed (e.g., an analysis of all relevant environmental records concerning the property and adjoining properties, equipment testing, and a review of any Phase II sampling conducted on the property). Given the complexity of these sites, lenders should ensure that the Environmental Professionals used to perform assessments for gas station loans are familiar with Appendix 5, have professional experience conducting assessments on these unique types of properties and have a thorough understanding of how service stations and tank systems work. If a Phase II is conducted for a gas station site, it must be conducted by an independent EP who holds a current Professional Engineer's or Professional Geologist's license and has three years of relevant experience.

3. Lead risk assessments are mandatory for certain "special use facilities."

The SBA requires additional information on "special use facilities," such as property constructed prior to 1980 that will be used for daycare or child care centers or nursery schools (as well as residential care facilities). These properties must undergo a lead risk assessment to determine the presence of lead based paint as well as testing for lead in drinking water. The challenge in meeting these requirements lies in the fact that the SOP does not identify the specifics of what must be included in the lead risk assessments. It is difficult to do so, given the wide variety of state-level guidance documents that exist. Instead, lenders should rely on Environmental Professionals who are knowledgeable about applicable state guidelines and have the experience to develop an adequate scope for the lead risk assessment based on professional judgment.

4. Dry cleaners deserve special attention.

There are tens of thousands of properties in the United States that either are, or once were, used as on-site dry cleaning operations. Given the close correlation between the use of tetrachloroethene (PCE) and trichloroethene (TCE) for dry cleaning operations and the occurrence of potentially costly soil/groundwater contamination, the SBA policy has special provisions for loans on dry cleaner properties. For instance, for properties that have ever had dry cleaners in operation for more than five years, a Phase II environmental site assessment must be conducted by an Environmental Professional, in addition to the Phase I ESA. The Phase II must be conducted by an independent EP who holds a current Professional Engineer's or Professional Geologist's license and has three years of relevant experience.

5. Records Searches with Risk Assessments require Environmental Professionals.

A number of Environmental Professionals and lenders report that there is still an absence of knowledge regarding the Records Search



with Risk Assessment (RSRA) in the market, particularly at the CDC levels. In some cases, lenders are instead requesting a Transaction Screen because the CDC does not believe the SBA will accept anything less.

An RSRA (and an Environmental Questionnaire) is required for loans above \$150,000 on properties that did not trigger a NAICS code match to an environmentally sensitive industry. To comply with the RSRA requirements, a search of databases listed in the EPA's All Appropriate Inquiries rule, as well as a search of historical use records (e.g., aerial photography, city directories, reverse directories and/or fire insurance maps) pertaining to the property and adjoining properties are required. Then, the input of a qualified Environmental Professional is needed to make the determination of whether the property is either "low risk" or "elevated risk" or "high risk" for contamination. The SBA adopted the U.S. EPA's definition of "Environmental Professional" in the All Appropriate Inquiries rule (40 CFR Part 312) (see Tip 6 below). In doing so, the agency has, in effect, recognized that reviewing property records for potential environmental conditions is an extremely complex process that requires the input of a qualified Environmental Professional. The RSRA step cannot be satisfied if the individual who is providing the opinion does not have the education, training and years of field experience included in the federal definition of Environmental Professional.

6. Look for quality in Environmental Professionals.

In its AAI rule, the U.S. EPA established what has become a widely accepted set of specific education, training, and experience requirements necessary for an individual to demonstrate that he/she has the professional judgment needed to develop opinions about a property's potential for environmental risk.

Critical to meeting this definition—in addition to having the specified licensing or education requirements—is having the specified years of "relevant experience," which the EPA defined as:

"participation in the performance of environmental site assessments that may include envi-

ronmental analyses, investigations, and remediation which involve the understanding of surface and subsurface environmental conditions and the processes used to evaluate these conditions and for which professional judgment was used to develop opinions regarding conditions indicative of releases or threatened releases...to the subject property."

There are still questions in the industry about how lenders can determine if an Environmental Professional is qualified. At a minimum, lenders should compare a consultant's qualifications with the definition in SOP 50 10 5(C). It may also be prudent to ask consultants to provide a sample Phase I report conducted for an SBA loan and review it for quality and compliance with SOP 50 10 5(C). Be sure that they understand the most current version of the SBA's environmental policy guidelines, and are comfortable signing the Reliance Letter (see Tip 8 below).

7. Look for the Environmental Professional's opinion about further investigation in the Phase I.

SBA requires that all Phase I ESAs contain a conclusion by the Environmental Professional stating that either: (1) the risk of contamination at the property is so minimal that no further investigation is warranted; or (2) that there is risk sufficient to warrant additional investigation. (Then if further investigation is warranted, the Environmental Professional needs to include a detailed description of the recommendation.) Phase I ESA reports that are being submitted to the SBA for review do not always include this requisite statement about further investigation. It is critical that lenders make their consultants aware of this requirement to ensure timely processing of their loan documentation.

8. The Reliance Letter cannot be modified by the Environmental Professional.

All Transaction Screens, Phase I and Phase II environmental site assessment reports must be performed by an Environmental Professional and be accompanied by the Reliance Letter in Appendix 3. In practice, there have been Environmental Professionals who were uncom-

fortable with the terms of the Reliance Letter and modified the language before submitting to the SBA. According to the SBA's Environmental Committee, environmental professionals are not at liberty to do this. The Reliance Letter must be signed by the Environmental Professional who conducted the environmental investigation and must appear exactly as written in SOP 50 10 5(C). There is some confusion in the market regarding 504 loans. For these, it is the CDC (not the lender) that needs to be named on the Reliance Letter.

As an added note, given the wide adoption of the SBA's environmental policies in the marketplace, ASTM is currently evaluating whether the E1527-05 Phase I ESA standard needs to be revised to include better guidance language about the use of reliance letters for Phase I reports.

9. Do not overlook housekeeping measures.

The SOP defines a number of "housekeeping measures" (e.g., secondary containment, floor drain seals, monitoring well decommissioning) that the SBA may require on certain sites. Be sure your environmental consultants are aware that all recommendations made, no matter how general, must be implemented.

10. Lastly, stay current.

The SBA's Environmental Committee actively solicits input from lenders and Environmental Professionals so that necessary updates can be made to the environmental policy outlined in the SOP. Be sure you are working with the most current version, and as each new update is released, review the changes and incorporate them into your policy.

When in doubt, ask!

Outreach to the field suggests that there are still areas of uncertainty, in addition to those outlined above, regarding the application of the SBA's Environmental Policy. Any questions should be directed to local SBA field counsel for the area where the property is located.

For more information on the SBA policy and a flow chart of the required steps, visit www.edrnet.com/sba

