



Outsourced Risk Management Solutions LLC

**Due Diligence.** *Done Simply. Done Right.*



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# Best Practices in Environmental Risk Management and SBA Updates

# — ORMS Overview —

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## **National provider of environmental risk management with over 30 years due diligence/risk experience.**

- Founded by an environmental risk management professional in 2009.
- Serve hundreds of lenders (including CDCs and 7A lenders) by providing the tools needed to develop and manage environmental policies and procedures that help close deals quickly.
- ORMS serves as an extension of our lender clients.
- We help hire and evaluate consultants that understand the risks they are investigating.
- Members of CT Real Estate Finance Association, RMA, Environmental Bankers Association , NADCO, NAGGL.
- ORMS was founded with SBA lenders, credit unions, community and regional banks as its primary focus.
- ORMS helps lenders do more risk management in a cost-effective manner by outsourcing the environmental risk management process.

# — Key Differentiators

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- We serve as your “virtual” environmental risk manager via costs typically passed through to your borrowers.
- We DO NOT do Phase I’s, Phase II’s or other field work.
- ORMS helps lenders order, review, and make decisions on environmental reports and information.
- We use the information available to help you make decisions as well as a professional opinion, recommendation and consultation after review.
- ORMS is set up to be a business advisor with our clients, not a product-driven company.
- Extensive national network of environmental professionals

## FAMOUS LAST WORDS:

**"I know enough  
to be dangerous"**



Outsourced Risk Management Solutions

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# — Current Trends in Lending and CRE —

- Pressure from regulators (FDIC and SBA)
- Real estate is slow due to interest rates and lenders reducing CRE exposure
- SBA continues to fill in the void
- ASTM Standards for Phase I's (ASTM 1527-21) and TSA (1528-22)
- Lenders updating environmental/appraisal policies
  - More levels/forms of due diligence than ever before on more loans
- Foreclosures?
- General interest of having best practices in place.

# — Similarities between Environmental — and Appraisals

- Lenders/BDOs often “hate” us both;
- Get done at the end of a loan (once all the “important” stuff is already done and usually at the same time as the closing date is being scheduled)
- Somewhat outside the deal
- Checkbox mentality
- Critical for collateral valuation

# — Impact of Lender Size/Resources —

## Regional & National Lenders

- Resources in place to understand environmental issues on the property
  - Screen for lower-risk loans
  - Have staff/internal resources to manage environmental risk

## Community Banks/Credit Unions

- No on-staff environmental expertise (typically)
- Not as sophisticated with regard to environmental issues or due diligence options available
- Often rely only on environmental questionnaires and/or proceed without accurate knowledge of environmental condition of property
- ***Rely on external guidance to dictate their practices***

# — Policy vs. Procedure

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## **POLICY**

- Used for formal lender documents
- Required per regulations and typically very definition focused
- Used to balance risk for a lender

## **PROCEDURE**

- “How” the policy gets executed
- Should be simple, easy to follow and well publicized
- Usually includes a risk matrix that is shared throughout organization
- Roadmap for the lender to adhere to the policy
- Must be communicated clearly to make day-to-day operations smooth

# — Common Commercial Issues —

Underground Storage Tanks (UST)	Gas Stations
Fuel Oil Tanks	Dry Cleaners
Spills	Lead/Asbestos/PCBs
Storage/disposal of Haz Waste	Radon
Vapor Intrusion	Storm Water Runoff
Mold	Superfund

# Vapor Intrusion



# — Environmental Due Diligence Options —

- Environmental questionnaire (EQ)
- Environmental Screening Product (i.e. ORMS EnviroFlash)
- Desktop due diligence (Desktop Review/RSRA)
- Transaction Screen Assessment (TSA)
- Phase I Environmental Site Assessments
- Phase II, III, Remediation, etc.
- Environmental Insurance
- Indemnification Agreements
- Escrow Funds
- Others

# — Report Types

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- ***ORMS EnviroFlash™*** – current data review and opinion designed for low risk loans
- ***ORMS Desktop Review (RSRA)*** – current data + historical research + opinion
- ***ORMS Property File Review - Phase I Reviews/3<sup>rd</sup> Party Reviews of Information***
- ***Phase I Procurement/ Assistance***
- ***SBA Environmental Reviews***
- ***Appraisal Reviews***
- ***Policy Development and Evaluation***
- ***Training Programs***
- ***Assistance with selection of environmental consultants on behalf of clients***

# — Environmental Due Diligence Products —

## ➤ Environmental Questionnaire

- Should be required unless this process was or will be duplicated during the Transaction Screen or Phase I ESA process
- Must be completed by a knowledgeable party
  - Typically the borrower, seller, or Relationship Manager in coordination with a knowledgeable party

## ➤ Environmental Screening Report/ ORMS EnviroFlash™

- Ideally, will include an evaluation by an environmental professional. Without the opinion, it has limitations, not always easy to figure out how to mitigate findings?

# — Environmental Due Diligence Products —

## ➤ Desktop Review

- A review of current environmental records, along with historical information similar to the information used in a Phase I.
- Questionnaire

## ➤ Transaction Screen

- Follows ASTM E1528-22 (updated from 2014)

## ➤ Phase I ESA

- Follows ASTM E1527-21 (updated from 2013)
- EPA's AAI Rule protection for E1527-13 expires in December. All Phase I's should be to this standard by then.

# – SBA Environmental Due Diligence Policy

## 2 levels of Environmental Due Diligence for SBA

### 1. Phase I – for high risk properties

- If property type/use matches the list of NAICS codes for Environmentally Sensitive Conditions

### 2. Records Search with Risk Assessment – low risk properties

- Includes a search of the government databases (compliant with AAI);
- A search of historical use records, and;
- ***A risk assessment by an environmental professional determining whether the site is “High”, “Elevated” or “Low” risk***

# — Sample Environmental Matrix

Loan Type	<\$250K	\$250K < \$500K	>\$500,000
<b>New Loan – Low Risk</b>	<ul style="list-style-type: none"> <li>Site Screen Report</li> </ul>	<ul style="list-style-type: none"> <li>Desktop Review (RSRA)</li> </ul>	<ul style="list-style-type: none"> <li>Phase I Report</li> </ul>
<b>New Loan - High Risk</b>	<ul style="list-style-type: none"> <li>Phase I Report</li> </ul>	<ul style="list-style-type: none"> <li>Phase I Report</li> </ul>	<ul style="list-style-type: none"> <li>Phase I Report</li> </ul>
<b>Renewals - Low Risk</b> <small>(Term renewals apply to loans with initial terms 3 years or greater)</small>	<ul style="list-style-type: none"> <li>Site Screen Report</li> </ul>	<ul style="list-style-type: none"> <li>Site Screen Report</li> </ul>	<ul style="list-style-type: none"> <li>Site Screen Report</li> <li>Review of existing Phase I report (if available)</li> </ul>
<b>Renewals - High Risk</b> <small>(Term renewals apply to loans with initial terms 3 years or greater)</small>	<ul style="list-style-type: none"> <li>Site Screen Report</li> <li>Review of existing Phase I report (if available)</li> <li>Phase I (Case by case basis)</li> </ul>	<ul style="list-style-type: none"> <li>Site Screen Report</li> <li>Review of existing Phase I report (if available)</li> <li>Phase I (Case by case basis)</li> </ul>	<ul style="list-style-type: none"> <li>Site Screen Report</li> <li>Review of existing Phase I report (if available)</li> <li>Phase I (Case by case basis)</li> </ul>
<b>Multi-Family</b>	<ul style="list-style-type: none"> <li>Site Screen Report</li> <li>Lead Paint Test (if necessary)</li> <li>Oil tank status check</li> <li>If constructed prior to 1980, lead paint and asbestos evaluation required)</li> </ul>	<ul style="list-style-type: none"> <li>Desktop Review (RSRA)</li> <li>Lead Paint Test (if necessary)</li> <li>Oil tank status check</li> <li>If constructed prior to 1980, lead paint and asbestos evaluation required)</li> </ul>	<ul style="list-style-type: none"> <li>Phase I Report</li> <li>Lead Paint Test (if necessary)</li> <li>Oil tank status check</li> <li>If constructed prior to 1980, lead paint and asbestos evaluation required)</li> </ul>
<b>1-4 Family Residential</b>	<ul style="list-style-type: none"> <li>Limited Site Screen Report</li> </ul>	<ul style="list-style-type: none"> <li>Limited Site Screen Report</li> </ul>	<ul style="list-style-type: none"> <li>Limited Site Screen Report</li> </ul>

# — SBA Top Issues —

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- There is a new SOP as of August 1, 2023 – SOP 50 10 7
- ASTM Updates
  - Phase I = ASTM 1527-21
  - Transaction Screen Assessment – 1528-22
    - New EQ required
- Lead Assessments – must be less than 1 year old and follow HUD standards
- 504 vs. 7a – same rules but PLP only knows if things were done correctly at foreclosure
- SBA has been much more particular about the nuances with the due diligence process and noting deficiencies
- Environmental not required on collateral used as additional collateral
  - Lenders are using lower levels of due diligence to make sure the collateral is clean.

# — SBA Top Issues —

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- You CAN close loans with contamination
- Dry Cleaners on site – Phase II required including vapor, soil and groundwater testing
- Gas Stations – typically requires more investigation if older than 20 years old and no testing
  - Compliance statements
- State specific issues – CT, MA, NJ, OH
  - Make sure consultants that are doing the work understand the nuances within those states or it could lead to problems for you and/or your borrowers
- Mitigating Factors – formerly Section G, then E.6, now E.5.

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# SBA Overview Slides

# — SOP 50 10 6 Updates —

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- **RSRA Threshold moved to \$250,000**
- **Clarification language for Day Care Facilities**
- **Merged Environmental Guidance together**
- **Sections and Appendices changed**

# — SOP 50 10 6 & 7 Updates —

- **Phase I reports are good for 1 year now (but not for liquidations)**
  - *The time period for PLPs is the date upon which the lender, using its delegated authority, makes their internal decisions on the adequacy of the environmental investigation.*
- **RSRA** – need to include the data that is relied upon
- **Dry Cleaners** – always require a Phase I and II (no more 5 year “window”)
- **Reliance Letter** - is altered slightly but there is language specifically stating it cannot be modified at all.
- **E&O Insurance** - must be for the time period of the report
- **The time limit of insurance is waived.**
- **NAICS Codes** revised to limit a few of the industries
- It is still up to PLPs to make the decision of whether the environmental is good or not.

# False Statements Certification

SOP 50 10 6

Appendix 4: Definitions - Environmental

loan. Environmental Questionnaires must be completed or reviewed by a Lender that has made at least one site visit to the Property and a good faith effort to conduct an interview with the current owner or operator of the Property. An Environmental Professional may, but is not required to, assist with the responses to the questionnaire. An Environmental Questionnaire may be considered if it was completed up to 1 year prior to submission. The current owner or operator of the Property must sign the Environmental Questionnaire. If the current owner or operator of the Property will not sign the Environmental Questionnaire it cannot be used and lender must then, at a minimum, obtain a Transaction Screen.



An acceptable Environmental Questionnaire must include, in addition to the required areas of inquiry listed below, the following language with respect to false statements: “The undersigned owner(s) and/or operator(s) acknowledge(s) and agree(s) that intentionally falsifying or concealing any material fact with regard to the subject matter of this Environmental Questionnaire may, in addition to other penalties, result in prosecution under applicable law including 18 U.S.C. section 1001.”

# Mitigating Factors

- a) Indemnification
- b) Completed Remediation
- c) No Further Action
- d) Minimal Contamination with Minimal Remediation
- e) Clean-up Funds
- f) Escrow Account
- g) Groundwater Contamination Originating from Another Site
- h) Additional or Substitute Collateral
- i) Other Factors

# Special Use Facilities – Child-Occupied Facilities

- “Child-Occupied Facilities” constructed prior to 1978 that are visited regularly by the same child under 6 years of age must undergo a lead risk assessment for lead-based paint and lead in the drinking water, and any risk of lead exposure must be sufficiently minimized.

## Special Use Facilities - Drycleaners

- On-site dry cleaners which may have utilized tetrachloroethylene (PCE) and trichloroethylene (TCE) and/or petroleum-based solvents in the course of their business operations, may present significant clean-up costs. As such, a Phase I and Phase II are required.
- Vapor Intrusion testing should be conducted if warranted by the circumstances or recommended by the Environmental Professional.

## Special Use Facilities – Gas Station Loans

- Environmental Investigation Requirements for Gas Stations are set forth in detail in Appendix 7 and always begin with a Phase I.
- Environmental Investigation results:
  - Property is not contaminated – Submit results to the SBA.
  - Property is contaminated – Lender may either decline the loan or follow the requirements set forth for approval and disbursement of loans when there is contamination and remediation at the property *provided that at a minimum, the SBA Indemnification Agreement must always be obtained and signed by the seller.*

# Gas Station Equipment Testing

- SBA requires that the EP to determine whether or not the gas station is in compliance with all state requirements, if any, pertaining to tank and equipment testing and provide documentation of this.
- All leaking or other defective equipment must be replaced or repaired prior to disbursement:
  - Any provision in the purchase and sale agreement that allows the seller to avoid repair (e.g., credit towards the purchase price or a lump sum payment) is not acceptable
- A loan may not be disbursed unless full compliance is achieved.

# Appeal Process and Exceptions to Policy

- The SBA has an appeals process.
- Appeals, including exceptions to environmental policy, are reviewed by the Environmental Committee.
- Lenders and CDCs that believe that a decision rendered by SBA is inconsistent with the SOP, or who seek an exception to policy, may appeal to the committee by sending a copy of the decision, supporting documentation and an explanation to [EnvironmentalAppeals@sba.gov](mailto:EnvironmentalAppeals@sba.gov)

## Common Errors on Environmental Submissions to SBA

- Reliance Letters
  - Not using the most current version.
  - Modifications to the letter.
- Section E.5 Factors for Contaminated Properties
  - Not submitting a Section E.5 analysis.
  - Not specifying one of the SOP mitigating factors.
  - Submitting insufficient analysis of the recommended mitigating factor. Please address the criteria listed in the SOP for the specific factor.
  - Leaving out the discussion of collateral value in a Section E.5 analysis.
  - Recommending “Minimal contamination with minimum remediation” as a mitigating factor for properties with a long history of contamination and remediation.

# Common Errors on Environmental Submissions to SBA

- Submittal Issues
  - Submitting locked or scanned pdf reports that are not searchable.
  - Resubmitting previously submitted documents. Please submit only the items requested.
  - Submitting a single pdf document that has all the files but does not contain an index for the location of pertinent items like a NFA letter etc.
  - Reports that are not dated or do not have a day, .i.e. May 2018 rather than May 15, 2018.
- Miscellaneous
  - Conducting vapor sampling without also addressing potential soil and groundwater contamination.
  - For child-occupied facilities, not testing all taps, faucets, and fountains likely to be used as a source of drinking water.
  - Not including a tank testing compliance statement in a Phase I Assessment for an active gas station.

# Tips

## Vapor Issues

1. Phase I recommends investigation of soil, groundwater and soil vapor, Phase II only includes soil vapor sampling.
  - *Tip: Provide a **detailed explanation** in the Phase II why no soil or GW sampling conducted (GW depth, bedrock, prior sampling, etc).*
2. Phase I only recommends soil vapor sampling.
  - *Tip: Include a **detailed explanation** in the Phase I Assessment why no soil or GW sampling is recommended.*
3. Vague statement regarding liability from groundwater migration from offsite.
  - *Tip: Provide specific reference to local regulations or laws.*

# Sample SBA Policy Matrix

	<b><i>Minimum Due Diligence Requirements</i></b>	
<b><i>Real Estate Loan Type</i></b>	<b>&lt;\$250K</b>	<b>\$250K &lt; \$5MM</b>
<b>Low Risk Loans</b>	Questionnaire	RSRA/TSA
<b>High Risk* Loans – NAICS Codes</b>	Phase I	Phase I
<b>Gas Station</b>	Phase I + Evidence of UST Compliance	Phase I + Evidence of UST Compliance
<b>Dry Cleaners</b>	Phase I and Phase II	Phase I and Phase II
<b>Special Use Facilities (i.e. Daycare)</b>	More specific requirements (i.e. Lead Paint Testing, Lead in Drinking Water, etc)	More specific requirements (i.e. Lead Paint Testing, Lead in Drinking Water, etc)

# — Gas Stations

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- ***A Phase I Environmental Site Assessment should always be obtained if the business sells, supplies, or dispenses fuel, gasoline, or heating oil, even if the NAICS code for the business is not identified on the list of environmentally sensitive industries.***
- ***The EP must include a determination whether or not the gas stations is in compliance with all regulatory requirements, pertaining to tank and equipment testing. Must include documentation supporting the EP's determination of compliance.***
- ***For contaminated gas stations, at a minimum, the SBA Indemnification Agreement must always be obtained and signed by the seller.***

# — Dry Cleaners (for SBA Loans) —

- *If a property is a dry cleaning facility **and has been in operation for more than 5 years**, a Phase I and Phase II Environmental Site Assessment are required.*

The Phase II Environmental Site Assessment must be conducted by a Professional Engineer (PE) or a Registered Geologist (RG)

# – Special Use Properties/Child Care Facilities

- *If a property is a daycare center, child care center, nursery school or a residential care facility occupied by children and the date of construction is prior to 1978, a lead risk assessment (for lead based paint) and testing for lead in drinking water are required.*
- *Lead testing needs to be a year or less old.*
- *Make sure the lead tests meet the HUD requirements and hire someone that understands this.*

# — Environmental Best Practices —

- Have as much control of the process as possible
- Tell the property operators that a Phase I is being done so you don't surprise/anger them.
- Make sure your consultants understand the states they are doing the work in (CT, MA, NJ, OH, MI – all have state specific issues)
- Collect as much information (i.e. all previous Phase I's, Phase II's, UST removal reports, etc.) that is available UP FRONT...reduces the time to get to the “finish line”.

# — Environmental Best Practices —

- Gas stations and dry cleaners sites undergoing remediation WILL take longer to get approval.
- Obtain current and former property uses (i.e. NAICS Codes) as soon as possible
- Make sure reports are correct

# — Best Practices/Takeaways —

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- Create and follow environmental policies and procedures;
- Use commitment fees from borrowers to cover the costs of the due diligence;
- At a minimum, obtain an environmental questionnaire and some form of government environmental records for each commercial transaction;
- Different types of properties require different levels of due diligence;
- ***Start the process as early as possible to allow enough time for evaluation and follow-up work that may be required.***
- ***Work with a company or expert that has experience in this area and consider outsourcing the review process similar to other functions that are not “core-competencies” of the bank .***

# It's Risk Management



How Much and How Long?

## FAMOUS LAST WORDS:

**"I know enough  
to be dangerous"**



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# Questions?



**Outsourced Risk Management Solutions LLC**