



Environmental Risk Management in Commercial Lending

Establishing Risk Tolerance, Management and Mitigation Strategies

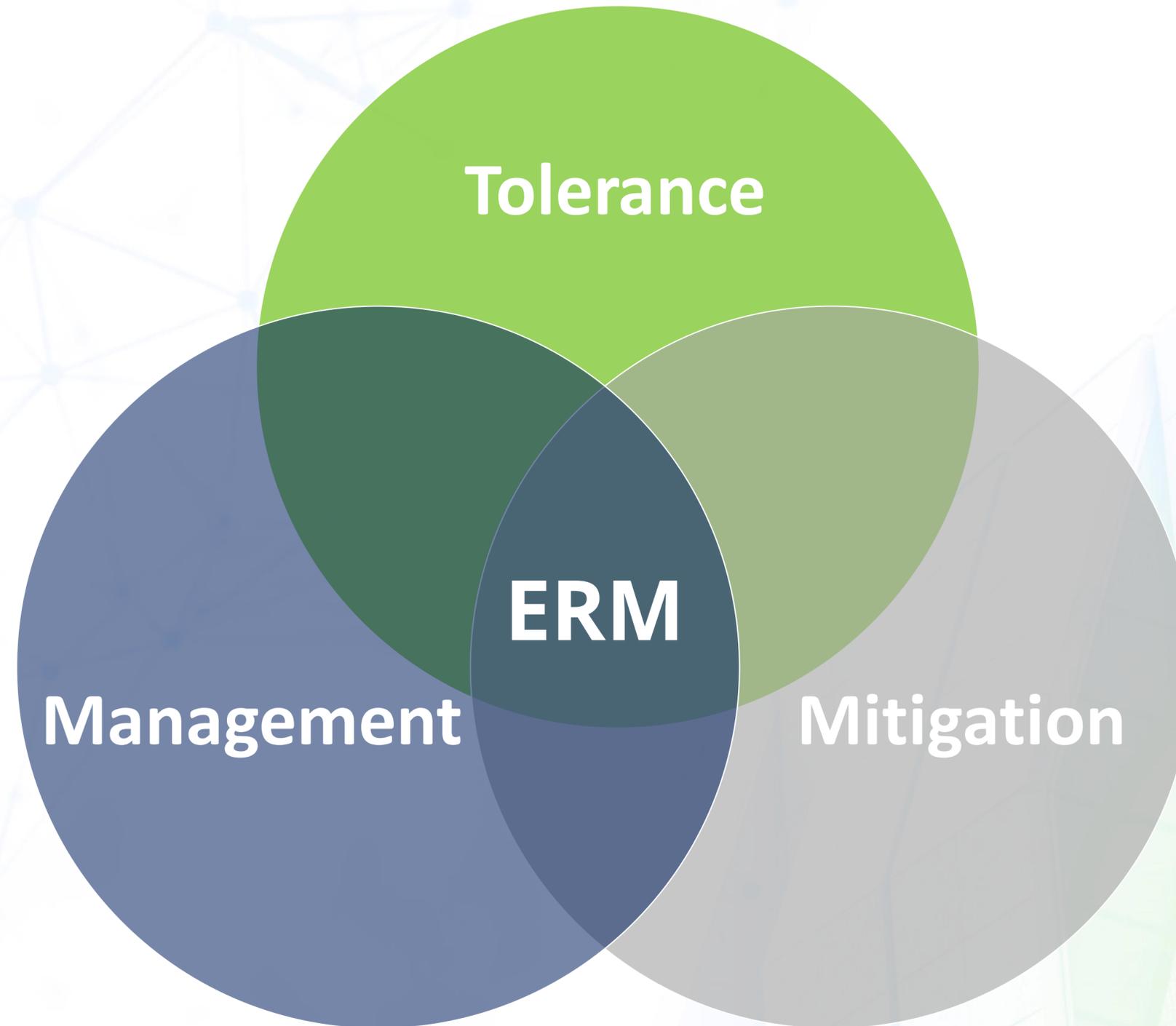
Presented by:

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Housekeeping

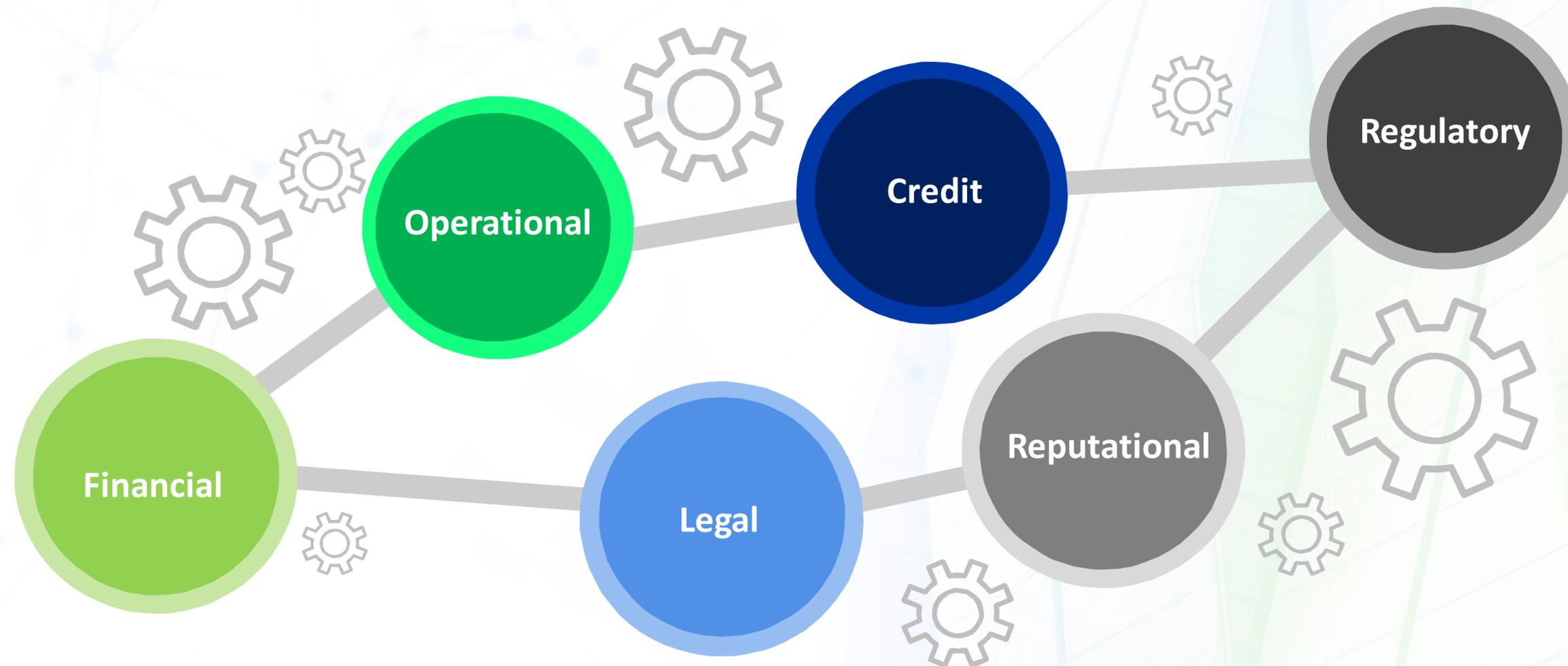
- Q&A
- Presentation materials/recording
- Session 3
Risk Evaluation Tools, Analysis and Documentation
August 30, 11 am Pacific/2 pm Eastern





risk noun

- 1 : possibility of loss or injury : PERIL
- 2 : someone or something that creates or suggests a hazard
- 3 **a** : the chance of loss or the perils to the subject matter of an insurance contract
also : the degree of probability of such loss
b : a person or thing that is a specified hazard to an insurer
c : an insurance hazard from a specified cause or source
- 4 : the chance that an investment (such as a stock or commodity) will lose value



tolerance noun

- 1 : capacity to endure pain or hardship
- 2 : the allowable deviation from a standard

Acceptable

Collateral presents acceptable risk based initial screening parameters.



Questionable

Collateral presents unquantified risk based initial screening parameters.



Unacceptable

Collateral presents unacceptable risk based initial screening parameters.



Ambiguity leads to confusion.

Confusion leads to inconsistency.

Inconsistency leads to exceptions.

Exceptions lead to audit flags.

Common Issues & Contaminants

Gasoline Station

Common Issues

- USTs (current & former)
- Multiple Tank Beds
- Site Reconfiguration
- Auto Repair

Likely Contaminants

- Total Petroleum Hydrocarbons (TPH)
- PAHs
- SVOCs
- VOCs
- Metals

Auto Repair

Common Issues

- USTs /ASTs
- Drum Storage
- Housekeeping
- Waste Handling, Storage & Disposal
- Hydraulic Lifts
- Oil/Water Separators

Likely Contaminants

- TPH
- PAHs
- SVOCs
- VOCs
- Metals

Dry Cleaners

Common Issues

- Solvent Use
- Waste Handling, Storage & Disposal

Likely Contaminants

- VOCs
- SVOCs
- PAHs

Manufacturing

Common Issues

- Industrial Processes
- Waste Handling, Storage & Disposal
- Wastewater Treatment Lagoons
- Septic Systems, Cesspools
- Oil/Water Separators
- Drums
- Landfilling

Likely Contaminants

- TPH
- PAHs
- SVOCs
- VOCs
- Metals, RCRA 8 & PP13

Agricultural

Common Issues

- Agricultural Wells
- Waste Handling, Storage & Disposal
- Equipment Maintenance
- Equipment Fueling
- Application of Crop Chemicals
- Landfilling

Likely Contaminants

- TPH
- PAHs
- SVOCs
- VOCs
- Metals, RCRA 8 & PP13

Where Do You Stand?



Bulk Chemical Waste Storage/ Poor Material Handling



Staining/Poor Housekeeping



Septic Systems, Wells & Floor Drains at High-Risk Properties



Inadequate Tank Documentation



Unresolved Regulatory Issues



Compliance Violations

management noun

- 1 : the act or art of managing : the conducting or supervising of something (such as a business)
- 2 : judicious use of means to accomplish an end

Informed Decisions

Matrix

Policy

Exceptions

mitigation noun

- 1 : the act of mitigating something or the state of being mitigated : the process or result of making something less severe, dangerous, painful, harsh, or damaging

Mitigation tools are a credit decision.

Financial

- Escrow
- Liquidity
- Lending Cap
- Loan Type

Collateral

- Alternative Collateral
- Unsecured/Secured
- Negative Pledge
- Abundance of Caution

Legal

- Indemnification
 - Financial Strength of Indemnitor
 - Transferability
 - Third Party Claims

Regulatory

- No Further Action
 - Incident Specific
 - Conditions of Closure
- Cleanup Agreements
 - Remedial Action Plan
 - Budget

Insurance

- Additional Insured v. Mortgagee
- Duration of Policy
- Maintenance of Policy (escrow renewal premium for life of loan?)
- Transferability

Considerations by Transaction Type



- **New Loan**
 - What risks can the purchaser be liable for if not investigated prior to closing?
- **Refinance**
 - Are there any significant risks that should be addressed before new money is advanced?
- **Construction**
 - Does the construction budget include a dedicated line item for addressing environmental concerns at the property?
 - What is the basis for the figure? Proposed scope of work with associated fees? "Guesstimate"?
 - Is there a clear Materials Management Plan in place that outlines how contaminated materials are handled if encountered?
- **Non-Real-Estate-Secured, Abundance of Caution, Negative Pledge**
 - Be clear about requirements in event value is assigned to the property.

Considerations by Transaction Type (cont'd)



- **Leases**

- Carefully read the lease agreement provisions regarding Environmental Liability.
- What is the likelihood the borrower can impact the property?
- Is it possible that a previous tenant may have impacted the site prior to the borrower's tenancy?

- **SBA Lending**

- 7a v. 504

- **Participations and Syndications**

- Participants are responsible for making their own underwriting decisions.
- Deferring to the Lead Bank is not sufficient.

- **Foreclosures**

- Was due diligence performed at loan origination? If yes, what was the outcome?
- Is the site a high-risk property use?
- Is the borrower cooperating? Full-access is needed to adequately investigate site and qualify for AAI.
- Is there a risk of contamination?

Potential Mitigation Strategies

- **Escrow**
 - Can the seller or borrower set aside funds in escrow until the environmental issues are resolved?
- **Loan-To-Value**
 - Can the LTV be capped to limit exposure?
- **Alternative Collateral**
 - Does the borrower have alternative or supplemental collateral to further offset the potential environmental risks?
- **Environmental Insurance**
 - Can the Bank be named as Mortgagee or Additional Insured?
- **Client Experience & Business Knowledge***
 - Does the borrower have adequate experience in managing their environmental risks? (in-house environmental officer, proper budget, etc.)
- **Indemnification Agreement***
 - Is an acceptable Indemnification Agreement available?
- **No Further Action Letter**
 - Limiting conditions?

Indemnification Agreements Considerations

- **Financial strength of the Indemnitor**
Escrowed funds may need to be considered.
- **Transferability**
Ideally should extend sufficiently to cover the sale of the property in the event of foreclosure.
- **Third-party claims**
Should cover exposure due to potential third party lawsuits.
- **Time restrictions**
Beware that a time restriction does not limit ability to claim indemnified status.
- **Restrictive conditions**
Can the agreement be easily annulled due to restrictions on property?

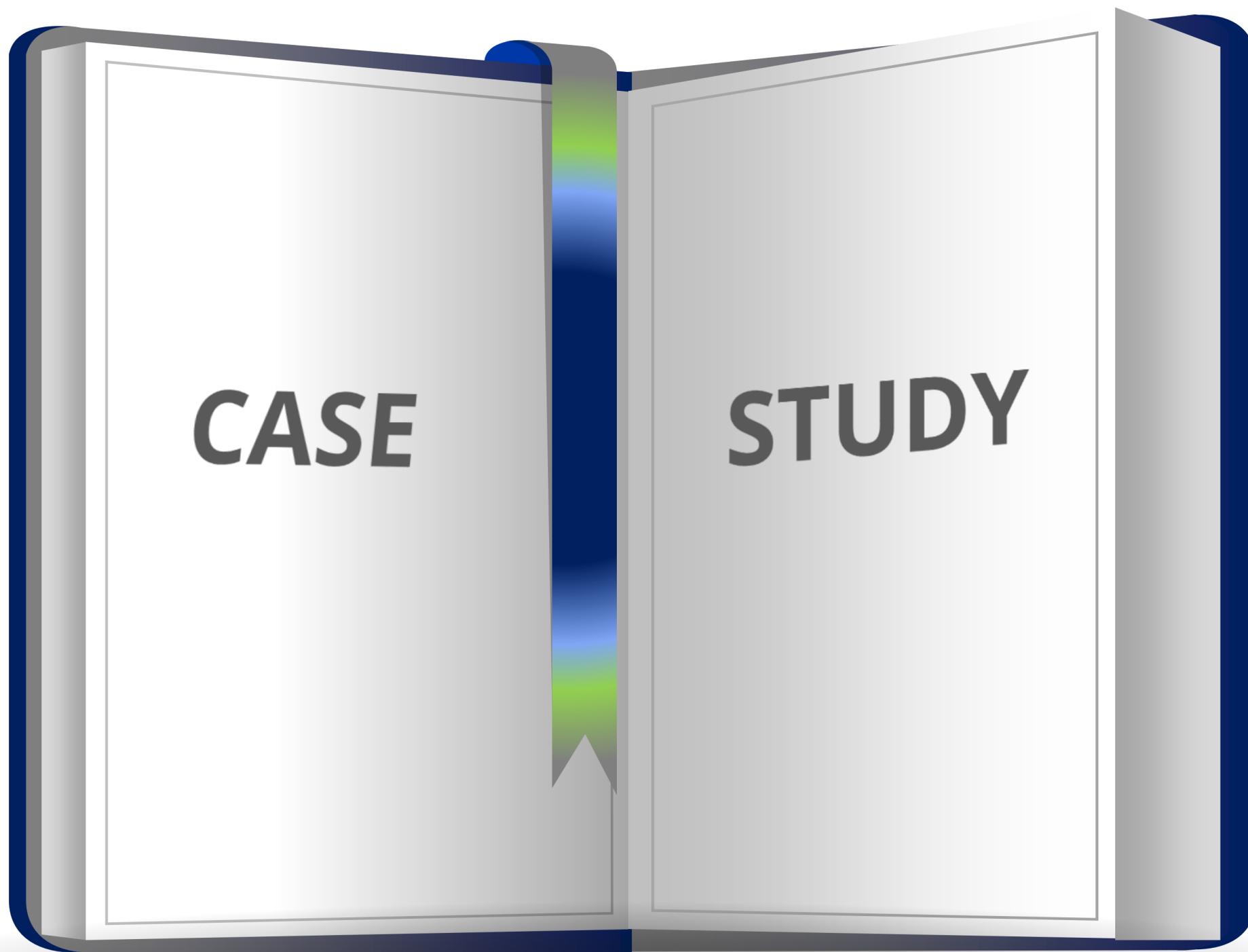
Cleanup Fund Considerations

- **Eligibility does not guarantee funding**
- **Solvency of the fund**
Has the fund gone bankrupt? How often?
- **Funding criteria & prioritization**
Will your collateral realistically be remediated?
- **Out-of-pocket expenditures**
Are there any shared costs between the property owner and the agency?
- **Transferability**
Does the funding continue with property transfer?

No Further Action Letter - True or False



- Issued to specific releases/incidents only
- **True**
- Guarantee the case will never be reopened.
- **False**
Cases can be reopened at the discretion of the regulatory agencies.
- Guarantee no contamination is present onsite.
- **False**
NFA is often granted with contamination left on-site; sometimes above regulatory standards resulting in Deed Restrictions.
- Do not guarantee additional work won't be required in the future.
- **True**
- May be subject to limitations or conditions.
- **True**
NFA may be conditional upon several factors. Most commonly, a requirement to abandon monitoring wells within 30 days of the letter.
- Endure any changes in property use.
- **False**
There are different regulatory standards for different property uses. If a site was granted NFA as an industrial site, but is to be redeveloped into a residential property, additional work may be required.



CASE

STUDY

Sample Client Documentation Request

Gas Stations

Documents to request from Client:

- Copies of previous Phase I ESA reports
- If ongoing remediation is under way at any sites, copies of
 - Most recent sampling results
 - Remedial Action Plan or other remedial action documents
- Most recent Line Tightness Testing results
- Most recent Tank Tightness Testing results (may include Veeder-Root or other monitoring system CSLD pass/fail results)
- Proof of current tank registrations/permits
- Proof of current compliance with financial assurance mechanism (i.e. receipt for payment into tank fund, tank insurance, etc.)
- Proof of tank insurance, if any



Sample Client Engagement Questions

Gas Stations

Information to request from Client:

- Does the company have a dedicated environmental compliance officer or contracted third-party to manage environmental regulatory obligations?
- General operating costs
 - Expenditures for basic environmental compliance/permitting (not including remediation) over the last 5 years
 - Projected expenditure for basic compliance/permitting (not including remediation) for the next 5 years
- Remedial action costs
- Are remedial action costs accounted for in the annual operating budget?
 - Expenditure on remediation activities over the last 5 years
 - Projected expenditure for remediation over the next 5 years
 - How many stations have active releases



Sample Lending Considerations

Gas Stations

Lending considerations:

- Are compliance/permitting costs adequately accounted for in the operating budget?
- Are remedial action costs adequately accounted for in the operating budget?
 - What are the anticipated remedial action costs based on?
 - Is there adequate supporting documentation for the anticipated remediation expenditure (for example, average of historical annual expenditures, written estimate from a third-party consultant, etc.)
- Potential costs for taking title to the properties (not including remedial action obligations) in the event of foreclosure
 - Registration of tanks
 - Evacuation of tank product, securing of station perimeter, pumps, etc.
 - Tank removal costs in the event they are inactive for too long.





Define your tolerance.

Manage through policy and matrix.

Identify your mitigation strategy.

Document your rationale using facts.

Be consistent.

Attend our final webinar!

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QUESTIONS?

Next Session:

Risk Evaluation Tools, Analysis and Documentation
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THANK YOU

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