

7. **ENVIRONMENTAL CONSIDERATIONS:**

Disbursement of loans approved prior to the effective date of this SOP may follow either the policies detailed herein or the policies from Notice 5000-494. SBA requires an investigation and assessment of the environmental risk on all primary collateral offered as security for any loan or debenture that the Agency is asked to guaranty in order that the risks of environmental contamination can be assessed and addressed. A lender may require its own environmental investigation of any additional collateral at its discretion.

a. **What Are The Risks of Environmental Contamination?**

- (1) The costs of remediation could impair the borrower's ability to repay the loan.
- (2) The value and marketability of the property could be diminished. If the borrower defaults, SBA might have to abandon the property to avoid liability or accept a lower than expected price.
- (3) The SBA potentially could be liable for environmental clean-up costs and third-party damage claims arising from environmental contamination if it takes title to contaminated property as a result of foreclosure proceedings or if it exercises operational control over the site.
- (4) If a government agency cleans a site, it may be able to file a lien for recovery of its costs which may be superior to SBA's lien.

b. **Definitions**

- * (1) **Environmental Investigation** - An investigation to help ascertain whether and the degree to which a property is subject to environmental contamination. An Environmental Investigation may include one or more of the following: an Environmental Questionnaire, Transactional Screen Analysis, Phase I Audit, and Phase II Audit, as these terms are defined below.

- (2) **Environmental Questionnaire** - A written form asking specific environmentally-related questions about the property which requires a visual inspection to complete the form. The lender or its agent must fill it out after conducting an interview with the current owner or operator of the site and the current owner or operator of the site must sign it. The lender may use SBA's form or its own form if it includes all of the information included in SBA's questionnaire.

* **Use of an environmental questionnaire consistent with the standard issued by the American Society for Testing and Materials is satisfactory to SBA.**

- (3) **Environmental Records Review** - A review of the files of the regulatory agency (defined below) related to environmental permits, reported contamination, and the storage, generation, transportation, use, or release of environmentally harmful substances at the site or at nearby properties. These records may be available from the appropriate governmental agencies, and there are commercial services available to obtain this information, including several on the Internet. The Environmental Records Review must include, at a minimum, the following databases and minimum search distances to the subject property:

Governmental Record	Approximate Minimum Search Distance
Federal NPL site list	property and 1.0 miles
Federal CERCLIS list	property and .5 miles
Federal RCRA TSD Facilities list	property and 1.0 miles
Federal RCRA Generators List	property and adjoining properties
Federal ERNS list	property
State equivalent of NPL List	property and 1.0 miles
State equivalent to CERCLIS list	property and 1.0 miles
State landfill and solid waste Disposal Site list	property and .5 miles
State leaking Underground Storage Tanks (LUST or LPST) list	property and .5 miles
State registered Underground Storage Tanks (UST/AST or PST) list	property and adjoining properties

- (4) **Historical Records** - A second component of the Environmental Records Review consist of such items as: Aerial Photographs that show the development and activities on the subject property and surrounding areas; Fire Insurance Maps that indicate the uses of the subject property and surrounding areas; local fire, health, or environmental departments public records that show the uses of the subject property and surrounding areas; and any other records which could provide insight into the uses of the subject property and surrounding areas such as zoning records, building permits, property tax reports, and land title records.
- (5) **Lender** - refers to banks, non-bank lenders, and certified development companies.
- (6) **Monitoring** - A physical sampling of soil or groundwater to determine the continued presence or quantity of environmental contamination.
- (7) **No Further Action Letter** - A statement issued by the regulatory agency declaring that no further remediation or monitoring of contamination previously found is required.
- * (8) **Phase I Audit** - An investigation and written report by an environmental professional or contractor (see sub-paragraph l of this paragraph), regarding the history and use of the property, which determines the potential existence of environmental contaminants. At a minimum, a Phase I Audit must contain all of the following elements:
- (a) A visual inspection of the site and adjacent properties;
 - (b) An Environmental Records Review;
 - (c) On-site review of available environmental records and interviews with the current owner and (if different) operator of the site and others with knowledge about operations on the site and on adjacent sites, such as the previous owner and (if different) operator of the site, and owners or operators of neighboring sites; and
 - (d) A conclusion by the contractor that performs the audit either: (i) that the risk of contamination at the site is so minimal that no further investigation is warranted; or (ii) that there is risk sufficient to warrant additional investigation.

- (9) **Phase II Audit** - An investigation and written report conducted by an environmental professional involving testing for actual contamination which relies on laboratory testing of samples extracted from potentially contaminated locations (buildings, soil or groundwater) to determine whether and to what extent actual contamination exists.
- (10) **Primary Collateral**
- (a) The project site that is acquired or improved through the loan proceeds; and
 - (b) Any business real property to be taken as collateral when it represents over 50 percent of the total collateral value.
- (11) **Reasonable and Prudent Belief That There Is No Risk of Contamination**
A belief based on existing information and prudent lending standards that past business or agricultural operations at the Primary Collateral site or on adjacent sites are unlikely to have resulted in contamination at the site. Such a determination would not be reasonable if:
- (a) There is insufficient knowledge about past or current business or agricultural operations at the site or adjacent sites to be able to reach such conclusion; or
 - (b) Past or current business or agricultural operations at the site or adjacent sites are likely to have involved the use of (i) chemicals in such quantities as would be subject to regulation by environmental authorities or (ii) aboveground or underground storage tanks. Likelihood of contamination may arise from the known business operations at the site or typical industry practices of any business which operated at the site or adjacent sites.
- (12) **Regulatory Agency** - The local, State, or Federal agency with authority to enforce environmental laws regarding use of hazardous materials or cleanup of environmental contamination at the primary collateral site.
- (13) **Remediation** - Any action to clean-up or remove contamination from soil at a site or groundwater under a site.

- (14) **Transactional Screening Analysis ("TSA")** - A review and written report which includes the following.
- (a) A visual inspection of the site being offered as collateral by a person trained to determine whether conditions at a site are indicative of potential environmental contamination or adverse environmental conditions. The person conducting this inspection may be an employee of the lender or its agent, but cannot be an employee of, or under contract with, the seller, the borrower or any other party that will benefit financially from the loan. The lender must use prudent lender standards in choosing or accepting the qualifications of the person conducting the inspection.
 - (b) The completion of an Environmental Questionnaire.
 - (c) An Environmental Records Review.
 - (d) A recommendation by the lender or its agent either: (i) that the risk of contamination at the site is so minimal that no further investigation is warranted; or (ii) that there is risk sufficient to warrant additional investigation.

c. **Environmental Investigation Requirements**

Environmental investigation is part of the due diligence required of lenders.

- (1) **Except for loans of \$25,000 or less, there must be an Environmental Investigation for all business loan applications secured by Primary Collateral. The results of this Environmental Investigation must be sent to SBA.**
- (2) Due diligence and prudent lending practice require a lender to pursue more in depth investigation when an investigation method indicates a risk of environmental contamination. The **type** of Environmental Investigation to be performed varies with the **amount of the risks** described in **Sub-paragraph A** of this paragraph which might result from any contamination that might be present. The greater the risk, the more in depth should be the investigation.

- (3) **If a loan application is for \$25,000 or less**, no Environmental Investigation is required if the borrower certifies in writing that he or she has no knowledge of any past or present contamination at the site and lender has no information to the contrary.

d. The Steps of an Environmental Investigation

Depending on the circumstances, the Environmental Investigation can begin with an Environmental Questionnaire, Transactional Screening Analysis, Phase I Audit or Phase II Audit.

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- (1) The **Environmental Investigation** may **begin with an Environmental Questionnaire** when any of the following five conditions exists:
 - (a) There has been **no business or agricultural operations** on the property;
 - (b) The collateral is part of a multi-unit building or complex;
 - (c) A **Phase I Audit** has been completed within 1 year of the loan application indicating that the risk of contamination at the site is so minimal that no further investigation is warranted;
 - (d) A Phase I Audit has been completed within one year indicating the presence of contamination and: (i) the Regulatory Agency has determined that no remediation or monitoring is necessary, or that remediation and monitoring has been completed; or (ii) an adequate indemnification agreement exists; or
 - (e) There is a "Reasonable and Prudent Belief That There Is No Risk of Contamination" as specifically defined in subparagraph b. (11) of this paragraph. If this belief does not exist, a TSA would be appropriate [see sub-paragraph d. (2) of this paragraph].

If the **Environmental Questionnaire or other information available** indicates a risk of environmental contamination, the loan cannot be disbursed. Therefore, further investigation such as **a TSA or Phase I Audit will be required.**

- * (2) The **Environmental Investigation may begin with a TSA** when the lender, or CDC for 504 loans, is unable to conclude that there is a Reasonable and Prudent Belief That There Is No Risk of Contamination, based on the due-diligence it has already completed.

If the TSA indicates a risk of environmental contamination, the lender should either decline the loan or require a Phase I Audit prior to any disbursement.

- * (3) The Environmental Investigation may begin with a **Phase I Audit** when the lender, or **CDC for 504 loans**, has a reasonable belief that, based on existing information and prudent lending standards, the **Primary Collateral site is likely to have been contaminated from past business operations at the site or adjacent sites**. The likelihood of such contamination may arise from the known business operations at the site or adjacent sites, or from the typical industry practices of the business or businesses which operated at the site or adjacent sites.

If the Phase I Audit indicates more than minimal risk of environmental contamination, the loan officer must either decline the loan or require a Phase II Audit to determine whether there is actual contamination.

- (4) A **Phase II Audit** may be used when:
- (a) A **Phase I Audit reveals** more than **a minimal risk** of environmental contamination; and/or
 - (b) A Phase II Audit will ultimately be needed and **the Phase I Audit** would be an **unnecessary expense**.

If an applicant cannot or will not obtain a Phase I or II audit when one is required, you may not approve or disburse the loan.

If a **Phase II Audit indicates that contamination exists**, the Audit must state: (i) **whether the quantity exceeds the reportable or actionable levels for that contaminant established by the responsible Regulatory Agency;**

(ii) whether environmental remediation or monitoring of conditions will be necessary; and (iii) a general estimate of the remediation or monitoring costs.

- e. What is the **Timing** for the Environmental Investigation?

A lender should initiate an Environmental Investigation **as soon as it receives any application** to be secured by Primary Collateral. The lender should get an understanding of the environmental issues surrounding any Primary Collateral before it applies to SBA for a guarantee. The lender must submit the results of its Environmental Investigation to the SBA office processing the application, prior to disbursement. SBA will approve disbursement based on the results of the Investigation it receives.

- f. **Legal Responsibilities**

The SBA loan processing personnel must obtain field counsel concurrence in their determination of the adequacy of an Environmental Investigation and whether the risk from contamination is sufficiently minimized to allow disbursement.

- g. What **Actions Can Be Taken When Contamination is Present?**

If the Environmental Investigation indicates potential contamination, the lender should attempt to minimize the risks discussed in paragraph A from any such contamination before submitting the guarantee request to SBA. The processing office may approve the loan, with appropriate conditions, if it determines that the risk from potential environmental contamination is sufficiently minimized so that disbursement would be appropriate relying upon the factors below and in sub-paragraphs 7h and 7i of this paragraph.

If the lender cannot minimize such risks sufficiently before it applies to SBA, the processing office may approve the loan, with appropriate conditions, if there is a reasonable expectation that the risks can be minimized sufficiently under the guidelines and relying upon the factors below and in sub-paragraphs 7h and 7i of this paragraph.

- * A lender must submit documentation with its guarantee request of the actions taken and factors relied upon to minimize any such risk. If a lender does not submit this documentation with the guarantee request, it must do so prior to

disbursement. In either case, the SBA processing office must concur that the risks have been sufficiently minimized. (PLP lenders & PCLP CDCs do not have to submit such documentation or obtain SBA's concurrence - see sub-paragraph k of this paragraph).

The SBA processing office may approve disbursement if the contamination issue is resolved in any of the following ways:

- (1) The amount of contamination present is less than the minimum "state action levels" set by the Regulatory Agencies and no remediation will be necessary under law;
- (2) The Regulatory Agency has issued a "No Further Action" letter;
- (3) There is adequate indemnification as discussed in this paragraph 7h; or
- (4) Guided by the factors discussed in this paragraph 7i, disbursement is appropriate before completion of any necessary remediation or monitoring.

h. **Indemnification Agreements**

* A loan may be disbursed if the seller (or another party) possesses sufficient financial resources to cover the cost of completing remediation and signs an indemnification agreement which provides adequate protection to SBA and the lender. A standard indemnification agreement that field offices and lenders may use without authorization from Headquarters is included in appendix 7.

If the indemnifying party will not sign this standard agreement, but is willing to negotiate a different agreement, the processing office must refer the matter to the AA/FA who will consult with the Associate General Counsel for Litigation in determining its acceptability.

* Attempt to obtain an indemnification agreement before considering the factors in this paragraph 7i.

i. **Disbursement Before Completion of Clean-Up**

The SBA office which processed and approved the loan considers and provides approval for the initial disbursement of this loan prior to the completion of remediation or monitoring (in the absence of a "no further action" letter or indemnification agreement) if, and only if, it is satisfied that the risks from any contamination or potential contamination as detailed in sub-paragraph A of this paragraph have been sufficiently minimized. The SBA will rely upon one or more of the following factors when deciding to disburse before completion of remediation or monitoring:

Proximity? RP Cleaning Up? Possible that past activities on-site may have contributed or co-mingle?

- (1) If the Regulatory Agency has affirmed in writing that remediation is complete but additional monitoring is required, **approval may be granted after obtaining the monitoring results for the first year and a written opinion from a qualified environmental professional** that the results show no unacceptable increase in contamination since remediation.
- (2) Federal statutes limit the liability of lenders for contamination if the lender does not participate in the management of the site and moves promptly to sell the property after foreclosure. However, state law may hold the lender liable. If state law does limit environmental liability of lenders, field counsel should consult with the Associate General Counsel for Litigation in making the determination that the law adequately protects SBA. In order to do so, state law should:
 - (a) **Protect private lenders** and governmental entities;
 - (b) **Apply to the contaminants** found at the site;
 - (c) **Allow a lender to foreclose** without creating liability; and/or
 - (d) **Define specific circumstances** under which a lender would be liable (for example a precise explanation of "not participating in management").

- (3) If there is a satisfactory agreement or "comfort letter" from the Regulatory Agency stipulating that lender, SBA, and future purchasers would not be liable for specified contamination at the site, disbursement may be appropriate. This letter or agreement must be approved by an official authorized to bind the Regulatory Agency to its content.
- (4) If the extent of contamination and cost of remediation is minimal in relation to the value of the property and/or the resources of the party responsible for remediation, approval, or disbursement may be considered if remediation is projected to be completed within a year. A discussion of the reliability of the remediation estimates and projected completion date should include:
- the contractor's experience,
 - the lender's confidence in or past experience with the contractor, and
 - the nature of the contamination.

This factor would be more appropriate for contamination affecting the soil, given the complexities of groundwater contamination.

- (5) If the State in which the site is located has a fund to reimburse remediation costs and SBA is adequately protected, approval or disbursement may be considered. Any conditions of remediation that might preclude reimbursement, and the financial capability of the fund should be addressed. Written assurance from the responsible Regulatory Agency that the fund will apply to the specific site may be necessary.
- (6) If an escrow account is available which equals 110 percent of the total estimated cost (in the bid or contract) of required remediation, controlled by the 7(a) lender or first mortgage holder in a 504 loan as trustee, approval or disbursement may be justified. The lender's role as trustee of this account is not to control or manage the property to be remediated, but solely to release funds from the escrow account upon the satisfactory completion of work by the contractor performing the remediation and/or monitoring.

The authorization must ensure that funds will only be used for costs of cleanup and remediation until the appropriate "No Further Action" letter is received. The Regulatory Agency must concur with the scope of

remediation and the cost estimate should be reviewed for reasonableness including a discussion of the contractor's experience.

- (7) If the borrower obtains a bond or insurance equal to 110 percent of the total estimated cost (in the bid or contract) of remediation, approval or disbursement may be considered. You must be satisfied that the borrower's cash flow is sufficient to complete the remediation and repay outstanding debt. The Regulatory Agency must concur with the scope of remediation and the cost estimate should be reviewed for reasonableness including a discussion of the contractor's experience.
- (8) If groundwater contamination on the site is shown to have come from nearby property, approval may be considered if:
 - (a) Another party with sufficient resources is performing remediation and is willing to provide indemnification and the Regulatory Agency concurs with the remedial action;
 - (b) The State has a written policy that it will not hold an owner or operator of property responsible for contamination from another site; or
 - (c) The Regulatory Agency provides satisfactory written assurance that it will not hold the borrower, lender, SBA, or any future purchaser liable for the contamination.
- (9) Additional or substitute collateral, or equity contribution, sufficient to overcome the potential loss due to contamination is available.

The lender must consider the six information items referenced in paragraph K when making a recommendation under this paragraph for approval or initial disbursement. Lenders should forward their justification for approval and/or disbursement to the SBA processing office responsible for making the approval/declination decision on the request for financial assistance.

j. **Submission of Environmental Investigation to SBA**

When SBA approves a loan with the condition that initial disbursement can not occur without SBA's approval, the results of the lender's Environmental Investigation must be reviewed by the SBA office which processed the

application. The lender must submit sufficient justification for disbursement to SBA, based upon one or more of the factors referenced in sub-paragraphs 7g, 7h, or 7i of this paragraph. Upon SBA approval, the lender may disburse the loan.

k. **Responsibilities of the Processing Office to Approve Initial Disbursement**

The SBA processing office makes the determination for initial disbursement in the absence of a no further action letter or indemnification agreement, based upon the results of an Environmental Investigation which has justification based on one or more of the nine factors referenced in paragraph 7I above. The SBA will consider:

- * (1) How the factors of this paragraph 7i relied upon sufficiently protect SBA from the risks resulting from contamination;

NOTE: There may be factors other than the nine referenced above which can be acceptable to SBA, but reliance upon any such factor not previously referenced requires clearance from the AA/FA (this includes PLP and PCLP/CDC lenders).

- (2) Nature and extent of contamination present (referring to relevant pages in the Phase I or Phase II Audit);
- (3) The status of remediation and monitoring;
- (4) Relevant environmental reports;
- (5) Correspondence from the Regulatory Agency regarding current conditions at the site; and
- (6) Amount of loan.

If a processing office has any questions regarding the application of any of the factors the lender chooses to use in a specific case, it should consult with SBA field counsel or the Associate General Counsel for Litigation. If the processing office is not sure that disbursement is appropriate in a particular case, based upon the justification provided by the lender, it should submit a recommendation regarding disbursement to the AA/FA, who will make a decision with the concurrence of the Associate General Counsel for Litigation.

The processing office's recommendation shall include the supportive documentation of the six items referenced above, and analysis of same plus other relevant information and the recommendation of SBA field counsel.

- * 1. **Criteria for Selecting an Environmental Professional/Contractor**
- (1) Environmental audits must be performed or approved by contractor personnel with adequate expertise and independence. Such expertise is evidenced by:
 - (a) A **license to conduct such an audit by the State** in which the audit will take place;
 - (b) At least **5 years experience** in conducting environmental audits;
 - (c) An **advanced degree** in engineering, environmental sciences, or geology **and at least 2 years** of direct experience in conducting environmental audits; or
 - (d) Sufficient prior, satisfactory **experience with the 7(a) lender or first mortgage holder on a 504** in conducting reliable and technically sound audits.
 - (2) In addition, a **Phase I or II Audit must be conducted by a firm** that is impartial, **with no conflict of interest** in the transaction. Lender must obtain the responses from the auditor to the following information:
 - (a) Name and address of the contractor;
 - (b) Name and title of the person performing the audit plus a statement of how long the person has been performing environmental assessments and the education and training the person has received;
 - (c) The recognized environmental standards to be used in the audit;
 - (d) Any present or prior affiliation of the contractor with the seller or purchaser of the property;

- (e) A description of the contractor's liability insurance; and
- (f) A certification under 18 U.S.C. § 1001 that the information provided is true and correct.

The lender must include the responses to these questions made by the contractor when submitting a Phase I or Phase II audit as part of the justification for approval or disbursement.

m. **PLP and PCLP Authority**

- (1) The **PLP lenders and PCLP/CDCs** are delegated the authority to internally make the decisions regarding environmental risk which are reserved for the processing SBA office. Therefore, these Lenders may not disburse any loan unless the Environmental Investigation has been performed in accordance with this paragraph and, if there is a risk of environmental contamination; disbursement can be justified under the guidelines detailed in paragraphs 7H, 7I, and/or 7G.
- (2) These lenders are subject to the same Environmental Investigation requirements as all other Lenders.
- (3) Lenders must retain all documentation utilized to justify their approval and disbursement decisions in their file for review or audit by SBA.

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- (4) The PLP lenders and PCLP CDCs may consult with SBA field counsel regarding state or local environmental laws.

n. **Environmental Loan Authorization Conditions**

The following loan authorization conditions are required for both 7(a) and 504 loans that will be secured by primary collateral to address the risk associated with Environmental Issues.

(1) **For Loans Over \$25,000**

* For 7(a) loans, insert "Lender may not disburse this loan" and for 504 loans insert "CDC may not issue debenture to fund this loan" until it has:

- (a) **Completed the review** for potential environmental contamination required in this SOP (Environmental Investigation) on each business real property site that is:
- (i) **acquired or improved with proceeds** from this loan, or
 - (ii) **taken as collateral if the site represents over 50 percent** of the value of all collateral securing this loan; **and**

* (b) **Sufficiently minimized the risk** from any adverse environmental findings discovered in the Environmental Investigation, or otherwise, in accordance with Subpart A, Chapter 5, paragraph 7 (Environmental Conditions) of this SOP.

(2) **Use the Following Paragraph When Lender has not completed** the Environmental Investigation Prior to Issuance of Authorization

* The lender must submit the results of the Environmental Investigation to the SBA field office for SBA approval prior to disbursement. If the lender or SBA determines from the Environmental Investigation that there is potential environmental contamination, [for 7(a) loans, insert] "Lender may not disburse the loan", and [for 504 loans insert] "CDC may not issue debenture to fund a loan" until SBA is satisfied that the risk has been sufficiently minimized. Adverse environmental findings may lead to [For 7(a) insert] cancellation of the SBA guaranty, [for 504 insert] "withdrawal of a 504 authorization."

OPEN OPTION: If the Environmental Investigation submitted with the application reveals risks of environmental contamination, and approval is still appropriate, the loan officer should add authorization conditions in accordance with the Agency's Environmental Policy per this SOP in consultation with counsel.

(3) **For Loans \$25,000 or Less**

Lender may disburse the loan **without an Environmental Investigation** under this SOP if:

- (a) Borrower certifies in writing that the borrower has no knowledge of any past or present contamination at the site; and
- (b) Lender has no information to the contrary.

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(4) **For All Loans**

The **SBA will hold Lender responsible** for any losses or liability caused **by failure to comply** with SBA environmental requirements.

o. **Questions on SBA's Environmental Policy**

Questions on SBA's Environmental Policy for the Office of Financial Assistance **should be E-Mailed**, not phoned, to "**SOP-5010**" with the subject heading of "**Environmental**". Since the issues surrounding environmental risk assessment can be complicated, it is best to provide a best time for a discussion and the appropriate phone number of inquirer.