

## **Environmental Risk Assessment Timing during Workout and Foreclosure of Commercial Properties in Michigan**

Foreclosure on a commercial property requires informed decision-making after carefully coordinated environmental due diligence. The lender must assess environmental concerns that could result in a diminution in the value of the collateral or that could create cleanup liability for the lender once the lender becomes the owner of the property.

For all loans, the initial step is to review the environmental due diligence that was performed prior to making the loan. The workout officer should not be surprised to find that the pre-loan due diligence did not rise to the level of a Phase I environmental site assessment (ESA). Since the lender will become owner of the property upon foreclosure, a full Phase I should be the standard prior to beginning the foreclosure process. Anything less than a Phase I should be an exception to policy.

Timing of the pre-foreclosure environmental due diligence can be tricky. It is best to perform the Phase I ESA when it first appears that the loan may be in jeopardy and when the Borrower is still cooperative. Once the loan relationship has soured, it may not be possible for the environmental consultant to gain access to the property. In many situations, such as the case with industrial properties, the inability to gain access to the property may preclude performance of a protective Phase I. There are types of property, however, where no chemicals are in use, and where the failure to view the interior of a building may not be fatally detrimental to the competence of the Phase I.

If it reveals no issues, the Phase I ESA should provide the lender with landowner liability protections to liability for cleanup of pre-existing and undiscovered contamination. This may seem a contradiction that there even could be pre-existing contamination on the property if the Phase I did not discover and report it. However, it is recognized that site assessments are not perfect and that even a Phase I done in accordance with recognized standards may not uncover all historic contamination. If the Phase I is performed competently, and contamination is later discovered, the lender will not have cleanup liability. This is considered the “innocent landowner defense” to cleanup liability.

If the Phase I does reveal potential environmental issues, called “recognized environmental conditions”, then there is no protection against cleanup liability. The lender may have pause to reconsider the property value or the wisdom of foreclosure. In many situations, it may also be appropriate for the lender to continue on to a Phase II ESA. Phase II ESA work generally includes intrusive soil and groundwater sampling. In addition, in appropriate situations, the lender should consider environmental issues that do not fall under the purview of a Phase I, such as asbestos, lead based paint, wetlands and radon.

If property contamination is noted, the lender may still foreclose, if it determines that is in its best interests. The Michigan Natural Resources and Environmental Protection Act provides that an owner (the lender) is not liable for cleanup of pre-existing contamination

if the owner conducts a baseline environmental assessment prior to or within 45 days after the earlier of the date of purchase, occupancy or foreclosure. Under the provisions of the Act, “foreclosure” means possession of a property by a lender on which it has foreclosed on a security interest (i.e. taking deed in lieu) or the expiration of a lawful redemption period, whichever occurs first.

The Michigan Department of Environmental Quality’s “Instructions for Preparing and Disclosing Baseline Environmental Assessments and Section 7a Compliance Analyses”, while neither statute nor rule, state that “in situations where a foreclosing lender is delayed in getting access to a property because of the foreclosure redemption process, the 45 day period will begin when the lender gains control over the property. The lender must fully document any delays attributable to the redemption process.” This implies that the BEA must be completed within 45 days after the Sheriff’s sale unless blocked in getting access to the property during the redemption period. This seems to be poorly worded. The law actually gives the lender 45 days after the end of redemption to conduct the BEA.

### **Summary**

To minimize the risk of environmental liability, a lender should consider the following guidelines during the workout and foreclosure process:

1. The initial step is to review the environmental assessment (if any) that was performed prior to making the loan.
2. Next, sit down with an environmental professional to chart a course of action. There may be situations where it becomes clear that the lender will not want to foreclose on the property.
3. Attempt to get the Borrower’s permission to access the property as soon as possible for a Phase I ESA (and Phase II if necessary).
4. However, whether or not site access is granted, the Phase I should be completed. If site access is not possible until after the end of the redemption period, then the lender should consider supplementing the Phase I with site reconnaissance at the end of redemption.
5. If there are “recognized environmental conditions” noted in the Phase I, it is important to start the Phase II ESA as soon as possible. If necessary, the Phase I, Phase II and BEA must be conducted within 45 days of the end of the redemption period. This is an extremely compressed period of time for these three actions to be performed.

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