CONSIDERING FORECLOSURE?

YEOMAN GROUP routinely receives requests for guidance from lenders regarding foreclosure. The following represents common questions and concerns when looking at foreclosing on a property. For additional information please see the article titled “Foreclosure Timing” found in the available Yeoman Group articles for download or call our office at (248) 349.8363 to discuss your property with an Environmental Risk Specialist.

1. Why is pre-foreclosure environmental due diligence so important, especially for community banks?

Upon foreclosure the bank becomes the owner and is liable for site cleanup unless they take appropriate steps to protect themselves. Even If shortly after foreclosure they sell the property, they remain in the chain of title and are often seen as the “deep pocket” easy target for cleanup response. If they foreclose without due diligence and unknowingly take title to contaminated property, they may face a large financial loss. Large banks often have large loan loss reserve funds to cover these situations and can take significant hits. Smaller banks may not be able to withstand much in the way of loss.

2. Is a full Phase I always necessary, or can the lender get away with a transaction screen?

Only a Phase I renders any legal protection. A lender would be hard pressed to explain a subsequent loss to their shareholders if they did not perform a Phase I prior to foreclosure. However, in all reality, an ASTM transaction screen or another “smart look” at the property that targets the realistic environmental threats to that type of property may render the same valuable information as a Phase I. It is the lender’s choice.

3. How should a Phase I conducted pre-foreclosure differ from a Phase I conducted pre-purchase?

The content of the Phase I is the same. The procedures may be more difficult in that there is often an adversarial relationship with the site owner – making site visit and owner and tenant interviews sometimes impossible. Therefore, it is best to start the Phase I as soon as it appears that the loan may be in jeopardy and before tensions rise.

4. Does a pre-foreclosure Phase I cost more than a traditional Phase I?

Generally Phase I's are lump sum contracts with the consultant and the prices are the same, although the pre-foreclosure Phase I may be more difficult for the consultant.

5. What non-scope items should be included and why?

Non-scope items correspond to the specific property type and do not change due to the nature of the transaction. For example, asbestos- containing materials and mold are very important for multi-family properties – both pre-loan and pre-foreclosure. If a property Phase I was preformed pre-loan, then some of the non-scope items should have been resolved and would not be needed pre-foreclosure.

6. When should pre-foreclosure due diligence be conducted?

As soon as the lender sees that a loan is in potential trouble. As stated above, by the time a fight begins between lender and borrower, the Phase I becomes more difficult. In some situations, the consultant is not allowed on the property for site reconnaissance by the borrower prior to Sheriff's sale and during the following redemption period.

7. Are small banks generally aware of what might trigger the loss of secured creditor exemptions?

No. This area of the law is very obscure. Small banks and credit unions are generally unaware of how their secured creditor protections may be lost. The also often believe that if due diligence was done pre-loan, that nothing is required pre-foreclosure. Much too often, they turn to fee advice from environmental consultants and engineers and therefore do not get professional legal advice.

8. Do Phase I results typically change lenders' foreclosure decisions? If so, how?

Yes. In today's environment, the value of the secured property may be near or less than the outstanding balance of the mortgage. Lenders have to think carefully about the costs that will be incurred and the expected recovery upon sale of the property. Often, when a Phase I reveals for the first time that the property is contaminated, and therefore of much less value than thought, a lender will forego foreclosure and pursue other possible avenues to retrieve the balance of the loan.

9. Do community banks handle pre-foreclosure due diligence differently than big banks do?

Lenders, whether large or small, are all over the board on how they proceed with environmental due diligence prior to foreclosure. There is just no consistency.

10. What can be done to resolve site access issues? What if the EP can't get access?

This is a question that I would like to explore. Most attorneys indicate that the lender and consultant should not do site reconnaissance without the permission of the borrower. Vague questions of trespass and interference with business are thrown about. However, the mortgage documents generally, specifically allow the lender to visit for these purposes. It is likely that, if the site visit does not interfere with business, that the site visit is lawful. In addition, it may be possible to get a court order to perform the site visit, even accompanied by a marshal if necessary. In most real world situations, if the EP cannot get site access, they visit the surrounding properties and view the site from off-site, use aerial photographs and put the failure to visit in the report as a limitation. They then have to render an opinion as to the effect of that limitation.

11. Anything else community banks should know about pre-foreclosure environmental due diligence?

Keep in mind that the Phase I may only be the first required step and that expensive Phase II soil borings and other work may be required before they have an appropriate picture of the status of the property. The best way to avoid these workout environmental issues is to have the borrower perform proper environmental due diligence before the loan is made.