

Making Gas Station Loans in Michigan

Even in the current economy, gas station properties continue to turn over. Lenders have an option to make a loan on a gas station property, but what of the inherent environmental concerns? Some lenders choose to simply not enter this arena. Others do so but with caution.

A gas station loan applicant often approaches the lender with a "closure" (report), and with the comment that the site is therefore "clean". The closure report generally indicates that the station had a release of petroleum from the underground storage tank system in the past but that an environmental consultant has written a closure report for that incident. In Michigan, qualified consultants can complete a closure without the involvement or review by the Michigan Department of Environmental Quality. Some closure reports are more reliable than others.

But, despite the closure, the property is rarely "clean". Most closures merely indicate that there are no known petroleum compounds from the release that exceed the maximum concentrations that are allowable for the property, given restrictions to the deed or other restrictions on property use.

In addition, a closure report typically only addresses one or more releases of petroleum from underground storage tanks. It does not substitute for a Phase I environmental site assessment that fully examines past property use and other potential contamination issues, including previous underground storage tank systems located in other areas of the property as well as releases of contaminants from automobile service operations.

Starting Point

If a lender makes a loan of \$300,000 on a property worth \$2,000,000, no further assessment may be required. It's hard to imagine an environmental concern that would jeopardize a loan with that amount of equity. However, in general, a Phase I environmental site assessment, an updated Phase I or Yeoman Group's Gas Station

Environmental Risk Assessment is required – even if there is a leaking underground storage tank closure report. These site assessment services provide a more comprehensive study of the property. At times, current site soil or groundwater data (Phase II environmental assessment) is required as well (some groundwater sampling is included in the Yeoman Gas Station Environmental Risk Assessment).

Analysis

The word on the street is that “all gas station properties are contaminated”. In our experience, this is not true. We routinely encounter newer, well-run stations that have no site contamination. In these situations, all that may be required for a loan is assurance that the UST system is properly insured, maintained and monitored. As an example of required maintenance, steel tanks with cathodic protection need the cathodic system physically inspected every three years. Other systems require tank tightness testing on a regular basis.

Having said that, it is not uncommon for a gas station to be contaminated, often from historical rather than current operations. While the appropriate response in a loan scenario is site and loan specific, and beyond the scope of this article, some possible loan actions are noted below:

- If the loan involves a purchase by the Borrower and the contamination is first noted during the site assessment, a report of a release of contaminants is generally required. If the Seller's UST system insurance company responds to the release, it may be safe to proceed with the loan.
- If the loan involves a purchase and the contamination was previously known and reported, the cost to "close" the site may be an appropriate number to use to devalue the given appraised value. (It is rare that appraisers will consider environmental issues.) Once a conservative number is assigned to cleanup or closure, if the loan-to-value is still within lender guidelines, it may be safe to proceed with the loan.

- If the loan is a refinance and the site is known to be contaminated, the valuation approach noted above may still be applicable. Devaluation options are not necessarily limited to the prospective future costs to close or cleanup the site. Other methods may be useful, including the cost to "stay in compliance with regulations". This approach involves estimating the yearly fees to monitor the site until such time as closure may be achieved and then calculating the net present value of these total costs.

All too often, in Michigan, a lender will require a Baseline Environmental Assessment (BEA) for a contaminated gas station, believing that the BEA is protective of the loan. A truly protective BEA is of necessity a category "S" BEA – meaning that petroleum contaminates the site and that in the future petroleum will be used on the property. If the gas station has double-walled underground storage tanks (USTs) and double-walled product piping, a BEA is, under current regulations, generally feasible. However, if the USTs are single-walled, even coated or lined, but are not double-walled, a BEA is generally a very expensive and often futile exercise. Unfortunately, consultants in Michigan will often knowingly write a deficient BEA – to help their client get the loan – but with the provision that the BEA not be submitted to the Michigan Department of Environmental Quality for a determination of adequacy. The BEA process then becomes merely a tool to get a loan but provides no substantive protection to Borrower and no protection for the lender.

Conclusion

Prior to a gas station loan, the lender must consider the cost and effort that will be required to make the loan, the potential ability of the lender to foreclose upon the property and the resale value of the property after foreclosure. The most critical issue is usually the construction of the USTs and piping. If both are double-walled, the lender may be in good stead once devaluation is considered for any site contamination. On the other hand, if the UST system is not double-walled, the lender may not be able to foreclose without incurring liability for cleanup. While there may be some scenarios where a loan can be made on a gas station with a single-walled system, the lender is

forewarned that they will be accepting significant risk and that the results may not be worth the effort.

Yeoman Group is very experienced in gas station lending as well as in valuation of contaminated properties. We stand by to help.