

# **Due Diligence**

Presented by:

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.     **Introduction**

Once the purchase agreement is signed and purchaser applies for financing, the lender will begin its due diligence process on both the property and the purchaser. This section covers the most important due diligence items regarding the property being acquired. Due diligence for the lender is crucial as the property will be the most significant security for the repayment of the loan.

**B.     Lien Searches**

Broadly defined, a lien is any encumbrance against an item of property that secures a debt or other obligation. At early common law the lien was a possessory right, meaning the lienholder had a right to retain possession of the property pending performance of the obligation. Modern liens generally no longer retain this possessory quality, but rather allow the lienholder a right to proceed against the property in order to recover on the obligation. Liens can be voluntarily created by contract, or involuntarily created through operation of law. Examples of involuntary liens include tax liens and judgment liens. A common voluntary lien is the Mechanic's Lien, covered in § VII, *infra*.

Federal tax liens are filed in the office of the county recorder of the county in which the property is located. State tax liens are recorded with the office of the secretary of state, and can be searched in the same manner as UCC records. Other liens are filed in either the office of the county recorder, the office of the secretary of state, or both. The title commitment, covered below, will indicate the existence of any lien shown by public records. For more information on liens and lien searches, see § IV(G), *infra*, on UCC Searches, and § VII, *infra*, on Mechanics Liens and Mortgage Foreclosures.

**C.     Title Commitment**

The title commitment is the initial document issued by the title company that sets out the title company's conclusions as to the status of the title. The commitment also states the terms on which the insurer will issue the final policy. The seller usually provides a title commitment to the purchaser within ten days of the execution of the purchase agreement. The title commitment will reveal to the lender if there are title issues that need to be corrected before closing and if there are title issues on which the lender may want to obtain additional title coverage.

The commitment consists of (1) a pre-printed cover, (2) Conditions and Stipulations of the contract between the underwriter and the customer, (3) Schedules A and B exceptions, and (4) all relevant attachments, such as easement maps or surveys.

### **1. Schedule A**

Schedule A of the commitment sets forth basic information such as:

- The effective date of the commitment
- The estate or interest covered by the commitment
- The name of the vestee of the estate or interest
- A description of the land referred to in the commitment
- The name of the proposed insured
- The type and amount of each policy to be insured
- The title company's file number

### **2. Schedule B**

Perhaps the most important component of the title commitment, Schedule B lists all exceptions to coverage under the policy. Exceptions are of two (2) types: general and special.

General exceptions usually appear on all commitments. There five standard general exceptions:

- rights or claims of parties in possession not shown by the public records
- encroachments, overlaps, boundary line disputes, and any other matters which would be disclosed by an accurate survey or inspection of the premises
- Easements, or claim of easements, not shown by the public records
- Any liens, or right to a lien, for services, labor, or material not shown by the public records
- Matters first occurring after the effective date of the policy and prior to the creation of the interest to be insured

Special Exceptions typically include items which must be addressed and corrected before issuance of the policy, or else the policy will exclude coverage of the items. Special exceptions often include:

- unpaid taxes or assessments
- existing mortgages
- adverse claims
- defects in description or vesting of title
- defective access or lack of access to property
- any other judgments, liens, easements, restrictions, covenants, conditions, or other encumbrances unique to the property

### **C. Zoning Letters**

Zoning letters represent an important part of the real estate transactions process. A zoning letter is essentially a statement from the local municipal zoning authority (or other governmental body with jurisdiction over the property) indicating the current zoning classification for the property, and stating that the purchaser's intended use of the property is allowed under the current zoning classification.

In order to be assured of complete compliance with any zoning regulations, an attorney will need to determine which governmental body/ies have jurisdiction over the property, and whether there are any additional requirements for local approval of intended uses. Once the attorney has determined which body/ies have jurisdiction, the attorney should acquire a zoning letter, zoning report, zoning certification or some other zoning document memorializing certain information. Regardless of the title of the document, the bottom-line requirement is to get a written statement from the zoning authority clearly describing the property and its current zoning classification, and confirming that such zoning classification specifically permits the purchaser's intended use of the property.

#### **D. Environmental Assessments (Phase I and II)**

Like a certificate of title, an environmental site assessment looks to past events to convey information regarding the present condition of the real estate. To this end, an environmental consulting firm should be hired to look for any past commercial or industrial activities or events that may have contaminated or otherwise affected the site. These searches are conducted through a “Phase I” environmental site assessment and a “Phase II” environmental site assessment.<sup>1</sup>

##### **1. “Phase I” Environmental Assessment**

The “Phase I” investigation is designed to reveal any potential for contamination on the site. In a “Phase I” investigation, an environmental consulting firm can provide an assessment of the activities of the property’s prior owners. The assessment can also include a look at the activities of current and prior owners of neighboring sites. Typically, the Phase I assessment

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<sup>1</sup> See generally ASTM E1527-05 “Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process;” ATSM E1903-97 (2002) “Standard Guide for Environmental Site Assessments: Phase II Environmental Site Assessment Process.” Available at [www.astm.org](http://www.astm.org), and a copy of which is included in the appendix.

also involves a visual observation of the property, in an effort to observe any features that may point to the presence of potentially hazardous materials such as storage tanks or disposal zones.

*See 25 Minn. Prac. § 9.20(a).*

The requirements of the assessment are flexible, and will vary with the circumstances. Real estate with a long history of industrial use will require a thorough and rigorous assessment, while a previously undeveloped site will require very little assessment. The purpose of the “Phase I” assessment is to determine whether the real estate is subject to recognized environmental conditions, i.e. the presence or likely presence of any hazardous substances or petroleum products on a property under conditions that indicate an existing release, a past release, or a material threat of a release of any hazardous substances or petroleum products into structures on the property or into the ground, ground water, or surface water of the property. As such, the process consists of the following:

- Property Records Review
- Visual Inspection
- Interviews with Current and Past Owners
- Interviews With Local Government Officials

If the Phase I assessment demonstrates any signs of contamination, the lender should engage the environmental consulting firm to perform a “Phase II” assessment.

## **2. “Phase II” Environmental Assessment**

The primary objectives of conducting a Phase II assessment are to evaluate the recognized environmental conditions identified in the Phase I assessment for the purpose of providing sufficient information regarding the nature and extent of contamination to assist in making informed business decisions about the property; and where applicable, providing the

level of knowledge necessary to satisfy the innocent purchaser defense under the Comprehensive Environmental Response, Compensation and Liability Act, (“CERCLA”). A Phase II assessment actually includes a physical inspection of the site, such as soil boring or groundwater sampling, in an attempt to ascertain with more certainty whether contamination has occurred.

*See 25 Minn. Prac. § 9.20(a).*

Again, the standards for a Phase II assessment are flexible and depend upon the scope of the users objectives. The mere confirmation of contamination or the preliminary indication of the extent and magnitude of contamination may be sufficient for the purposes of many users. If a user desires a more complete characterization of the environmental condition of the property, further assessment may be undertaken. Accordingly, the assessment may require multiple iterations, or may be subject to termination at the point where sufficient data have been generated. At the completion of a Phase II assessment, the environmental professional should be able to conclude, at a minimum, that either:

- (a) the assessment has provided sufficient information to render a professional opinion that there is no reasonable basis to suspect the presence of hazardous substances or petroleum products at the property associated with the recognized environmental conditions under assessment; or
- (b) the assessment has confirmed the presence of hazardous substances or petroleum products at the property under conditions that indicate disposal or release.

If the data generated is insufficient to support either of the above propositions, additional iterations of the assessment may be required.

The assessment is intended to identify recognized environmental conditions and develop technically sound data. It is not intended to satisfy the level of inquiry that may be necessary to support remedial solutions for a site.

## **E. Survey and Boundary Issues**

A mortgage and a security agreement must contain a legal description of the real estate that secures the commercial loan. Where title insurance provides a legal description of the land, a survey is a different kind of insurance. A survey can be used to confirm that the legal description of the real estate accurately depicts the real estate contemplated in the transaction. A survey can also provide a detailed account of existing conditions on the real estate.

The American Land Title Association (“ALTA”) has set standards for surveys, as well as titles, and a surveyor’s work generally conforms to these standards. The surveyor will address the most basic of issues, such as a boundary lines. The boundary line survey assures the lender that the structures securing their transactions are actually on the borrower’s property. The surveyor will also address complicated issues, such as the conditions that exist on the property. With larger structures and properties, the lender will benefit from the survey’s visual depiction of how municipal codes or ordinances have placed conditions on the real estate. For example, the survey may be able to reveal conditions on setbacks, parking spaces, or utilities more accurately and clearly than a legal, textual description. Other conditions that are important to be aware of are the existence and location of any easements or riparian interests on the property. The surveyor should draw attention to all such conditions.

Once the survey is complete, the attorneys should compare the survey with the legal descriptions of the real estate. Specifically, the attorneys should look for any ambiguous or erroneous legal descriptions. The attorney will also want to assess whether there are any conditions that may prevent the buyer from conducting their intended business. The diligent lawyer should also become aware of any prior surveys on the real estate, and check to see whether prior surveys conflict with the present survey.

In attending to the red tape, the survey certification form should be checked to ensure that it is addressed to all required parties, that it is signed, current, and in the required form. Finally, the survey certification form should be attached to the current title commitment.

While a survey may be relied upon even if it contains errors, there is a two-year statute of limitations on survey errors, except for where fraud is involved. Minn. Stat. § 541.052. Attorneys will also want to maintain the survey certification by keeping it up to date and accurate, and call the insurance company and/or surveyor to update or recertify the survey as needed.

#### **F. Appraisal**

It is axiomatic that an appraisal must take place before a lender will issue funds for the purchase of real property. The purpose of the appraisal is to verify that the subject property has a market value commensurate with the loan amount. The appraisal also serves the function of allowing the lender to evaluate the subject property when deciding whether to issue a loan. Because the appraisal is an important component of the real estate deal, the appraisal should be performed by an appraiser with professional certification or other credentials establishing the appraiser's competence.<sup>2</sup> Finally, to avoid the appearance of any "taint" to the appraisal process, the appraisal should be initiated by the lender.

The first step of any appraisal is a site inspection to verify the condition of the property. Following inspection, the appraiser will prepare a written appraisal estimating the value of the property. Typically, the appraiser will use one (or more) of three standard methods for estimating the value of the property, depending on the type and location of the property. The

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<sup>2</sup> The Appraisal Standards Board of the Appraisal Foundation promulgates the Uniform Standards of Professional Appraisal Practice, commonly known as "USPAP". This document, recognized by Congress as the generally accepted appraisal standard, covers appraisal valuations of real property, personal property, and business or intangible assets. The USPAP can be purchased at [www.appraisalfoundation.org](http://www.appraisalfoundation.org).

three methods are (1) the Sales Comparison Approach; (2) the Cost Approach; and (3) the Income Approach.

### **1. The Sales Comparison Approach**

The sales comparison approach is the most common and reliable method for estimating the market value of residential real estate. This approach utilizes an analysis of the selling price of comparable properties within the geographic area closely surrounding the subject property. This provides a close approximation of the “going rate” for similar property in the area. A property is considered comparable if it closely resembles the subject property in terms of design and layout, square footage, lot size, quality of construction, age, physical condition, number of rooms, and other physical characteristics. In an attempt to control for differences in property characteristics, appraisers will include standardized adjustments to the selling prices for variations in these criteria. For example, a standard dollars per square foot calculation will be utilized to adjust for differences in the square footage of the subject property and the comparable property.

A sales comparison analysis generally involves three sets of data. First, the appraiser will research the range of asking prices for all comparable properties in the neighborhood. Second, the appraiser will research the selling price for all comparable properties recently sold in the neighborhood. Finally, the appraiser will perform a detailed comparative analysis of the subject property and several comparable properties, making adjustments for variations in property characteristics. Based on these data sets, the appraiser will determine the estimated market value of the subject property.

### **2. The Cost Approach**

The cost approach utilizes a projection of the total cost to fabricate an exact replica of the subject property. Because the cost approach does not take into consideration “real world” factors such as rental income potential or comparable sales figures, it is typically considered a secondary method of appraisal for both residential and commercial property. However, this approach is valuable as it can serve as a control for inconsistencies in the other methods.

The cost approach involves a calculation of the value of the land, plus the cost of reconstructing any improvements, less any depreciation to the improvements present on the subject property. Although this is a logical method of determining the value of a property, it is subject to several limitations. For instances, although the method is fairly reliable for newer properties, changes in building techniques and materials make it less reliable for older buildings. Additionally, unique and costly improvements to a property do not always translate into an equivalent increase in market value.

### **3. The Income Approach**

The income approach, also called the income capitalization approach, is most appropriate in the context of transactions involving income generating commercial property. This method involves an estimate of the value of property in relation to the income that the property produces. Appraisers generally determine the monthly or yearly net income generated by the property, and multiply that figure by a standard income multiplier to determine the estimated value of the property. This method is especially preferable for commercial properties that have unique characteristics or other income generating features that render the property unsuitable for the sales comparison or cost approach.

## **G. UCC Article 9 Searches**

### **1. Why is Article 9 Important in the Real Estate Lending Context?**

Article 9 of the Uniform Commercial Code, (“UCC”), governs the creation and perfection of valid security interests in personal property in Minnesota. Article 9 is important in the real estate lending context because many real property loan transactions involve a lender taking security interests in personal property (such as furnishings, fixtures and equipment) as well as a mortgage on the real property. The provisions of Article 9 must be followed both with respect to the creation and perfection of a security interest in personal property, and also the enforcement of any default in the underlying loan documents and foreclosure upon the personal property. Thus, some key concepts in the Article 9 context include: (a) attachment, (b) perfection, (c) priority, and (d) enforcement after default.

#### **a. Attachment**

A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the attachment. Minn. Stat. § 336.9-203(a). Subject to certain exceptions, a security interest is enforceable against the debtor and third parties with respect to the collateral only if: (1) value has been given; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and (3) one of the following conditions is met:

- a. the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;
- b. the collateral is not a certificated security and is in the possession of the secured party...pursuant to the debtor's security agreement;
- c. the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party...pursuant to the debtor's security agreement; or
- d. the collateral is deposit accounts, electronic chattel paper, investment property, letter of credit rights, or electronic documents, and the secured party has control...pursuant to the security agreement.

Minn. Stat. § 336.9-203(b).

A security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors. Minn. Stat. § 336.9-201. Additionally, a security agreement may create or provide for a security interest in after-acquired collateral and may provide that collateral secures future advances or other value, whether or not the advances are given pursuant to the commitment (**NOTE: remember that a security interest does not become enforceable until value is given**). Minn. Stat. § 336.9-204.

### **b. Perfection**

A security interest is perfected if it has attached and all of the applicable requirements for perfection...have been satisfied. Minn. Stat. § 336.9-308. In the great majority of cases, perfection of a security interest is accomplished by either filing a financing statement **or** by the secured party having “control” over the collateral.

#### **i. Perfection by Filing a Financing Statement**

Communication of a record to a filing office and tender of the filing fee, or acceptance of the record by the filing office, constitutes filing. Minn. Stat. § 336.9-516. The appropriate filing office for an interest in fixtures or timber to be cut is the office where the mortgage on real property is recorded (i.e., in Minnesota, the county recorder). Minn. Stat. § 336.9-501. For all other interests, the financial statement should be filed with the central filing system operated by the office of the Secretary of State. *Id.*

In order to be sufficient, a financing statement must (1) provide the name of the debtor; (2) provide the name of the secured party; (3) indicate the collateral covered by the financing statement; and (4) real-property related financing statements must indicate that it covers the type of collateral (as-extracted collateral, timber cut or fixtures), that it is to be filed in the real estate

records, contains a legal description of the real property and the name of the owner of the real property. Minn. Stat. § 336.9-502. If the debtor is a registered organization, the public name of the organization must be listed; a trade name only is insufficient. Minn. Stat. § 336.9-503. The indication of Collateral is sufficient if it (A) contains a description of the collateral which reasonably identifies it; or (B) indicates that it covers all assets or all personal property of the debtor. Minn. Stat. § 336.9-504.

Minor errors and omissions are acceptable. However, a financing statement that fails to sufficiently identify the debtor is seriously misleading and is insufficient. Minn. Stat. § 336.9-506. A properly filed financing statement remains valid even if the collateral is sold or disposed of. Minn. Stat. § 336.9-507. Additionally, a financing statement may be amended by filing an amendment, or terminated by filing a termination statement. Minn. Stat. §§ 336.9-512 - 336.9-513.

### **ii. Perfection by Control**

The other means of perfecting a security interest is by “control.” If an equity interest is being pledged and is evidenced on a certificate, the secured party should hold the original certificate to have “control.” A security interest in a letter of credit or deposit account may be perfected only by control. Minn. Stat. § 336.9-312. A security interest in investment property, electronic chattel paper, or electronic documents may be perfected by control. Minn. Stat. §§ 336.9-312, 336.9-314.

### **c. Priority**

“Priority” refers to the order of secured creditors’ rights in collateral when multiple security interests have been created with respect to the collateral. The general rule is that the first creditor to file is the first in priority. Minn. Stat. § 336.9-322. However, a **key exception** to

this rule comes in the case of investment property. A security interest in investment property perfected by control **takes priority over** a security interest in investment property perfected by filing (Again, get control of the certificate). Minn. Stat. § 336.9-328.

With respect to future advances, the security interest arises when the first advance is made; future advances can be “tacked” to the date of the original advance. Minn. Stat. § 336.9-323. Finally, a possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise. Minn. Stat. § 336.9-333.

#### **d. Enforcement after Default**

After a default, a secured party may reduce its claim to judgment or foreclose upon the collateral. Minn. Stat. § 336.9-601 (**PRACTICE TIP:** Send a written notice of default prior to commencing an action to recover the collateral.) A secured party may notify the account debtor to make payment directly to secured party. Minn Stat. § 336.9-607. Furthermore, after a default the secured party can enter upon real property and remove the fixtures, but must reimburse the debtor for any injury caused by the removal. Minn. Stat. § 336.9-604. In any event, proceeds are applied in the following order: (1) the reasonable expenses of collection and enforcement; (2) the satisfaction of obligations secured by the security interest; and (3) the satisfaction of any subordinate obligations. Minn. Stat. § 336.9-608.

Additionally, a secured party may take possession of the collateral after default. Minn. Stat. § 336.9-609. The secured party may take possession and dispose of collateral at debtor's premises without removal, may proceed pursuant to judicial process (replevin action), and may require the debtor to assemble the collateral and make it available to the secured party at a place TBD by the secured party. *Id.* Once possession is acquired, the secured party may dispose of the collateral in a number of ways. The secured party may sell the collateral, and the secured

party may purchase the collateral at sale. Minn. Stat. § 336.9-610. However, the secured party must notify the debtor and any secondary obligor of the disposition, as well as any others with claims against the collateral who request notice. *Id.* The secured party can retain the collateral in full or partial satisfaction of the obligation **only if** no objections are received. Minn. Stat. § 336.9-620. (**PRACTICE TIP:** Move quickly to enforce your rights in secured collateral; in many cases a bankruptcy filing might be imminent and other creditors will want to tie up the collateral in order to satisfy obligations owed to them.)

## **2. The Mechanics of an Article 9 Search**

Because UCC filings are maintained by the Minnesota Secretary of State, a UCC Article 9 search is performed through the UCC division of the Secretary of State's office. The search can be done either through a legal courier service, or by establishing a pre-paid account on the Secretary of State's website. In either case, the Secretary of State's office does not provide expedited orders for UCC documents, so the turn-around time is about one week.

### **a. Using a Legal Courier**

There are several reliable legal courier companies that regularly perform UCC document requests from the Secretary of State. You will need to provide them with the name of the company or individual you want searched. They will then submit a request for the relevant documents, and the Secretary of State will send the results back by mail, typically in about a week. As mentioned above, the Secretary of State does not accept expedited orders for UCC searches, so the courier cannot get the results from the Secretary of State over the counter.

The cost of the search with copies of the accompanying filing documents is \$20.00, in addition to any fees charged by the courier company. For a reduced fee, you can also run the search without any accompanying filing documents, in which case you will get a printout that

indicates the name of the secured party, the date of filing, the anticipated date of termination of the filing, the filing number and any other filings that are associated with the original, such as amendments and/or terminations. However, this printout will only indicate the identity of a secured party, not the collateral associated with the security interest. In order to acquire this information, it is necessary to order copies of the accompanying filing documents. Therefore, it may save time to order the search with the accompanying documents.

**b. Using a Prepay Account**

An Article 9 search can also be conducted by setting up a prepay account with the Secretary of State's website. One of the advantages of this method is avoiding the additional courier fees incurred by having the courier submit the request for you. Also, prepay accounts generally diminish the turn-around time associated with receiving documents. Details for setting up the account are available on the website.

Once you have established a prepay account, you can log on to the fee-based portion of the Secretary of State website and conduct a debtor name search for \$5.00. There is an on-line form to input the debtor name, either company or individual, and an optional address. Starting with the debtor name search is a good first step as it is cheap and immediate. If there are no results (no filings have been recorded for that debtor name), then you have a strong indication that there are no outstanding security interests. On the other hand, if there are filings against the debtor, the results of the debtor name search will have some basic filing information, such as the debtor name, the filing date of the interest, any anticipated termination date, and the filing number.

Once you have acquired the UCC filing numbers via the debtor name search, you can retrieve some additional information for free by looking up the filings by number. This will give

you a little more information, such as the secured party name, but not the collateral description. In order to get the full description, you will need to order copies of the filing documents from the Secretary of State for \$20.00, which can be done using the prepay account. It will take about a week to get the search results with copies back from the Secretary of State. Again, in order to save time and conduct an adequately thorough search, it may be a good idea to order the complete search with filing documents at the outset.

### **c. Practical Advice for Conducting an Article 9 Search**

The results of a search can vary depending on the search terms that are provided to the courier or input on-line. Leaving off addresses and using the simplest form of the company name or individual name will broaden the scope of the search, correcting for variations in the filing documents and ensuring complete results. The following examples help to illustrate this point:

- Omit corporate entity designations:
  - Rather than searching for “Acme Widget Company, LLC” search for “Acme Widget Company,” leaving off the entity designation.
  - Errors can be made regarding company names – adding an entity designation will limit the search results to companies with that designation.
  - Thus, if “Acme Widget Company, LLC” changes to “Acme Widget Company, Inc.” the search results will be incomplete.
- Omit middle initials and other personal designations:
  - Rather than searching for John C. Smith, Jr., search for John Smith and leave out the middle initial and the “Jr.”
  - A search for John C. Smith, Jr., won’t get any results for John C. Smith, or John Smith
- Leave the address field blank:
  - Rather than providing the current address, do not provide any address information.
  - Debtors can change addresses over time. Entering the current address can limit the search results and exclude results for any other addresses the debtor used in the past.

Broadening the search results will correct for variations associated with UCC filings, generating the most complete results. Although the search will likely be over-inclusive, a

determination can be made, based on the documents, as to whether a given UCC filing pertains to the relevant debtor.

# **Appendix**

## **Exhibit A – Phase I Environmental Site Assessment Process**

E1527-05 Standard Practice for Environmental Site Assessments:  
Phase I Environmental Site Assessment Process

### **1. Scope**

1.1 *Purpose*--The purpose of this practice is to define good commercial and customary practice in the United States of America for conducting an environmental site assessment of a parcel of commercial real estate with respect to the range of contaminants within the scope of Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) (42 U.S.C. 9601) and petroleum products. As such, this practice is intended to permit a user to satisfy one of the requirements to qualify for the innocent landowner, contiguous property owner, or bona fide prospective purchaser limitations on CERCLA liability (hereinafter, the "landowner liability protections," or "LLPs"): that is, the practice that constitutes "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice" as defined at 42 U.S.C. 9601(35)(B). (See for an outline of CERCLA's liability and defense provisions.) Controlled substances are not included within the scope of this standard. Persons conducting an environmental site assessment as part of an EPA Brownfields Assessment and Characterization Grant awarded under CERCLA 42 U.S.C. 9604(k)(2)(B) must include controlled substances as defined in the Controlled Substances Act (21 U.S.C. 802) within the scope of the assessment investigations to the extent directed in the terms and conditions of the specific grant or cooperative agreement. Additionally, an evaluation of business environmental risk associated with a parcel of commercial real estate may necessitate investigation beyond that identified in this practice (see Sections 1.3 and 13).

1.1.1 *Recognized Environmental Conditions*--In defining a standard of good commercial and customary practice for conducting an environmental site assessment of a parcel of property, the goal of the processes established by this practice is to identify recognized environmental conditions. The term recognized environmental conditions means the presence or likely presence of any hazardous substances or petroleum products on a property under conditions that indicate an existing release, a past release, or a material threat of a release of any hazardous substances or petroleum products into structures on the property or into the ground, ground water, or surface water of the property. The term includes hazardous substances or petroleum products even under conditions in compliance with laws. The term is not intended to include de minimis conditions that generally do not present a threat to human health or the environment and that generally would not be the subject of an enforcement action if brought to the attention of appropriate governmental agencies. Conditions determined to be de minimis are not recognized environmental conditions.

1.1.2 *Petroleum Products*--Petroleum products are included within the scope of this practice because they are of concern with respect to many parcels of commercial real estate and current

custom and usage is to include an inquiry into the presence of petroleum products when doing an environmental site assessment of commercial real estate. Inclusion of petroleum products within the scope of this practice is not based upon the applicability, if any, of CERCLA to petroleum products. (See X1.7 for discussion of petroleum exclusion to CERCLA liability.)

**1.1.3 CERCLA Requirements Other Than Appropriate Inquiry**--This practice does not address whether requirements in addition to all appropriate inquiry have been met in order to qualify for the LLPs (for example, the duties specified in 42 U.S.C. 9607(b)(3)(a) and (b) and cited in Appendix X1, including the continuing obligation not to impede the integrity and effectiveness of activity and use limitations (AULs), or the duty to take reasonable steps to prevent releases, or the duty to comply with legally required release reporting obligations).

**1.1.4 Other Federal, State, and Local Environmental Laws**--This practice does not address requirements of any state or local laws or of any federal laws other than the all appropriate inquiry provisions of the LLPs. Users are cautioned that federal, state, and local laws may impose environmental assessment obligations that are beyond the scope of this practice. Users should also be aware that there are likely to be other legal obligations with regard to hazardous substances or petroleum products discovered on the property that are not addressed in this practice and that may pose risks of civil and/or criminal sanctions for non-compliance.

**1.1.5 Documentation**--The scope of this practice includes research and reporting requirements that support the user's ability to qualify for the LLPs. As such, sufficient documentation of all sources, records, and resources utilized in conducting the inquiry required by this practice must be provided in the written report (refer to 8.1.8 and 12.2).

**1.2 Objectives**--Objectives guiding the development of this practice are (1) to synthesize and put in writing good commercial and customary practice for environmental site assessments for commercial real estate, (2) to facilitate high quality, standardized environmental site assessments, (3) to ensure that the standard of all appropriate inquiry is practical and reasonable, and (4) to clarify an industry standard for all appropriate inquiry in an effort to guide legal interpretation of the LLPs.

**1.3 Considerations Beyond Scope**--The use of this practice is strictly limited to the scope set forth in this section. Section of this practice identifies, for informational purposes, certain environmental conditions (not an all-inclusive list) that may exist on a property that are beyond the scope of this practice but may warrant consideration by parties to a commercial real estate transaction. The need to include an investigation of any such conditions in the environmental professional's scope of services should be evaluated based upon, among other factors, the nature of the property and the reasons for performing the assessment (for example, a more comprehensive evaluation of business environmental risk) and should be agreed upon between the user and environmental professional as additional services beyond the scope of this practice prior to initiation of the environmental site assessment process.

**1.4 Organization of This Practice**--This practice has thirteen sections and four appendixes. Section 1 is the Scope. Section 3 is Referenced Documents. Section , Termnninology, has definitions of terms not unique to this practice, descriptions of terms unique to this practice, and acronyms. Section is Significance and Use of this practice. Section provides discussion regarding activity and use limitations. Section describes User's Responsibilities. Sections are the main body

of the Phase I Environmental Site Assessment, including evaluation and report preparation. Section provides additional information regarding non-scope considerations (see ). The appendixes are included for information and are not part of the procedures prescribed in this practice. explains the liability and defense provisions of CERCLA that will assist the user in understanding the user's responsibilities under CERCLA; it also contains other important information regarding CERCLA, the Brownfields Amendments, and this practice. provides the definition of the environmental professional responsible for the Phase I Environmental Site Assessment, as required in the "All Appropriate Inquiry" Final Rule (40 C.F.R. Part 312). provides an optional User Questionnaire to assist the user and the environmental professional in gathering information from the user that may be material to identifying recognized environmental conditions. provides a recommended table of contents and report format for a Phase I Environmental Site Assessment.

This standard does not purport to address all of the safety concerns, if any, associated with its use. It is the responsibility of the user of this standard to establish appropriate safety and health practices and determine the applicability of regulatory limitations prior to use.

1.5 This practice offers a set of instructions for performing one or more specific operations. This document cannot replace education or experience and should be used in conjunction with professional judgment. Not all aspects of this practice may be applicable in all circumstances. This ASTM standard is not intended to represent or replace the standard of care by which the adequacy of a given professional service must be judged, nor should this document be applied without consideration of a project's many unique aspects. The word "Standard" in the title means only that the document has been approved through the ASTM consensus process.

## **Exhibit B – Phase II Environmental Site Assessment Process**

E1903-97(2002) Standard Guide for Environmental Site Assessments:  
Phase II Environmental Site Assessment Process

### **1. Scope**

1.1 This guide covers a framework for employing good commercial and customary practices in conducting a Phase II environmental site assessment (ESA) of a parcel of commercial property with respect to the potential presence of a range of contaminants which are within the scope of CERCLA as well as petroleum products.

1.1.1 This guide is intended to provide practical procedural guidance for the continuation of an assessment conducted in accordance with the most recent edition of Practice E 1527 or E 1528, or both. Practice E 1527 is the practice for conducting Phase I ESAs for a parcel of commercial property and Practice E 1528 is the transaction screen practice. Both practices define a process that is intended to constitute "all appropriate inquiry into the previous ownership and uses of a property" to determine whether hazardous substances or petroleum products have been disposed or released there in order to satisfy one element of the innocent purchaser defense to CERCLA liability.

1.1.2 Because this guide for conducting Phase II ESAs describes a process for further evaluating a parcel of commercial property with recognized environmental conditions, as defined in Practices E 1527 and E 1528, users of this guide should understand the requirements and limitations of those practices. It is strongly recommended that the user refer to and apply the guide in concert with Practices E 1527 and E 1528.

1.1.3 This guide has multiple purposes. It is intended to provide assistance to users in satisfying the appropriate inquiry element of CERCLA's innocent purchaser defense, as defined in 42 U.S.C. § 9601(35)(B), where a previous assessment satisfying that element identified recognized environmental conditions. This guide also is intended to assist a user in gathering reliable information about a property's environmental conditions to guide the user's business decisions. However, this guide does not purport to include the level of specificity required of technical standards that govern full characterization of a site's environmental conditions.

1.2 *Objectives*—The primary objectives of conducting a Phase II ESA are to evaluate the recognized environmental conditions identified in the Phase I ESA or transaction screen process for the purpose of providing sufficient information regarding the nature and extent of contamination to assist in making informed business decisions about the property; and where applicable, providing the level of knowledge necessary to satisfy the innocent purchaser defense under CERCLA.

1.2.1 To achieve these objectives, it may be appropriate to perform more than a single iteration of assessment. The guide fosters an iterative approach to Phase II assessments and allows the user to terminate the Phase II ESA at the point where sufficient data have been generated to meet the user's objectives.

1.2.2 At the completion of a Phase II ESA, the environmental professional should be able to conclude, at a minimum, that either (a) the ESA has provided sufficient information to render a professional opinion that there is no reasonable basis to suspect the presence of hazardous substances or petroleum products at the property associated with the recognized environmental conditions under assessment, or (b) the ESA has confirmed the presence of hazardous substances or petroleum products at the property under conditions that indicate disposal or release. If the information developed in the ESA is insufficient for the environmental professional to reach either of these conclusions, the environmental professional may recommend additional iterations of assessment if warranted to meet the objectives of the user. If the environmental professional reasonably suspects that unconfirmed hazardous substance or petroleum releases remain but concludes that further reasonable assessment is not expected to provide additional information of significant value, he may recommend that further assessment is not warranted. In such circumstances, the recommendation for no further assessment should be accompanied by an explanation why a reasonable suspicion of releases remains and why further reasonable assessment is not warranted. Depending upon the work scope, the environmental professional may also be able to provide guidance on the nature and extent of contamination in order to assist the user in making business decisions regarding the property.

1.2.3 This guide is intended to provide guidance for assessing recognized environmental conditions and developing technically sound data. It is not intended to satisfy the level of inquiry that may be necessary to support remedial solutions for a site. For further discussion of the use of this guide, refer to Section on Significance and Use.

1.3 *Needs of the User*—Establishing the innocent purchaser defense may not be a realistic objective in some instances. Accordingly, the extent of assessment is based on the business objectives of the user as well as the degree of uncertainty acceptable to the user. In either case, the primary purpose of a Phase II ESA conducted in accordance with this guide is to assess and evaluate the recognized environmental conditions identified in the Phase I ESA or Transaction Screen Process.

1.3.1 The mere confirmation of contamination or the preliminary indication of the extent and magnitude of contamination may be sufficient for the purposes of many users. If a user desires a more complete characterization of the environmental condition of the property, further assessment may be undertaken. However, this guide should not be construed to require multiple iterations of assessments in all cases, either to establish the innocent purchaser defense or to meet other objectives. Many Phase II ESAs may in fact be restricted to only a single round of assessment, whatever the extent of contamination, if any, that might be revealed.

1.4 *Limitations*—The use of this guide is related to the scope as set forth in Section 1. For information purposes, Section 12 of this guide contains a non-exhaustive list of certain environmental conditions that are beyond the scope of this guide but that may warrant consideration by parties to a commercial property transaction. This guide provides an approach that may be employed to assess the environmental conditions listed in Section 12. Reference also should be made to 4.1.

1.5 *Organization of This Guide*—This guide has twelve sections and one appendix. Section 1 is the Scope section. Section 2 is Referenced Documents. Section 3, Terminology, contains definitions of terms and acronyms used in this guide. Section 4 is Significance and Use of this

guide. Section 5 is Contracting Considerations. Sections 6-11 constitute the main body of the Phase II Environmental Site Assessment guide and include objectives (see Section 6), developing the scope of work (see Section 7), assessment activities (see Section 8), evaluation of data (see Section 9), interpretation of results (see Section 10) and recommended report preparation (see Section 11). Section 12 provides additional information regarding non-scope considerations. provides a sample table of contents and report format for a written Phase II Environmental Site Assessment Report.