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A legal update from Dechert's Finance and Real Estate and Environmental Law Groups

The Impact of ASTM's New Vapor Intrusion Standard on Commercial Real Estate Lending

Although still a relatively recent concern, vapor intrusion has quickly come to the forefront of environmental issues which potentially affect commercial real estate transactions. Essentially, vapor intrusion occurs when vapors from volatile chemicals, including petroleum hydrocarbons, present in subsurface soils or groundwater enter buildings or structures through either the natural exchange of air or mechanical ventilation systems. Thus, for vapor intrusion to occur, two elements must be present: (i) impacts to soils or groundwater from volatile chemicals in proximity to buildings or structures on the property (in other words, a source of the vapors), and (ii) a means of entry into the building. Once inside a building, the chief concern with vapor intrusion is occupant exposure through inhalation, creating the potential for adverse health effects.

Both the EPA and numerous state environmental agencies have responded to growing concerns about the potential health effects of this exposure pathway with an increased focus on vapor intrusion in the investigation and remediation of contaminated sites. It is not merely newly discovered contaminated sites that are drawing the attention of regulators. Sites that previously received agency-approved closure due to low perceived human health risk are being reevaluated in the context of concern for the risk posed by vapor intrusion. In agreeing to allow sites to be closed with contamination remaining in place, even subject to institutional or engineering controls, the state and responsible party may have focused on the lack of a traditional exposure pathway, but not considered the vapor issue. The New York State Department of Environmental Conservation, for example, recently announced it would re-examine approximately 430 sites impacted with volatile organic compounds that had been remediated

before 2004 and received case closure.¹ Owners of sites where remediation has already been completed and a no further action letter issued by the appropriate authorities may now find themselves subject to additional investigation and/or cleanup responsibilities and potential liabilities.

Among the EPA and the states, however, there is no consistent approach to assessing the vapor intrusion risk or with respect to how it should be managed. As a result, ASTM, the industry standard-setting organization, recently released a new Standard Practice E 2600-08 to address the evaluation of vapor intrusion in the context of buying, selling, and financing commercial real estate. The asserted purpose of the new standard is to define "good commercial and customary practice in the United States of America for conducting a vapor intrusion assessment ("VIA") on a property parcel involved in a real estate transaction with respect to chemicals of concern . . . that may migrate as vapors into existing or planned structures on a property due to contaminated soil and groundwater on a property or within close proximity to the property."²

Under the current ASTM Phase I Environmental Site Assessment Standard E 1527-05, which outlines what has become the industry standard for initial environmental property-level diligence, vapor intrusion is not explicitly identified. This has led to some controversy in the literature over the relationship of the new Vapor Intrusion Standard Practice E 2600-08 to the existing ASTM Phase I

¹ Lawrence Schnapf, *Vapor Intrusion Basics*, The Practical Real Estate Lawyer, March 2006, at 17-8.

² See ASTM Standard. E 2600-08.

Standard E 1527-05; namely, is the risk of vapor intrusion addressed by ASTM's Phase I standard, or is it an out of scope issue?³ The new vapor intrusion standard provides on its face that it can be used to supplement a Phase I Environmental Site Assessment or can be performed independently.

From a lender's perspective, the key issue is not where an issue gets raised. Lenders must ensure that they are made aware of potential environmental issues and can evaluate whether such issues could have an impact on the use, condition, or value of the subject property; pose a risk of liability to the lender or its borrower; or affect the lender's exit strategy. Accordingly, the lender will want to make sure that the consultant conducting the environmental due diligence is tasked with notifying the lender of potential or actual vapor intrusion issues. As with most other environmental risks, the lender's need for additional information and further investigation of the issue will be a function of its risk-tolerance and the need for certainty taking into account the nature of the transaction and the contemplated use of the property. ASTM's new Vapor Intrusion Standard offers lenders a useful tool by which to further assess the risk of vapor intrusion associated with a particular property and to evaluate mitigation alternatives for this specific environmental risk.

ASTM Standard E 2600-08—A Brief Overview

ASTM Standard E 2600-08 prescribes a four-tiered process by which commercial real estate with a low risk of vapor intrusion can be screened out expeditiously, while properties with higher associated risks can be more fully evaluated and mitigation measures employed as necessary.

- **Tier 1 Screening Assessment:** As noted, this initial screening step can either supplement a

³ For further detail on this debate over the relationship between the existing ASTM Phase I standard and E 2600-08, see generally Christopher M. Roe, *New ASTM Standard Practice for Assessment of Vapor Intrusion In Real Estate Transactions: More Harm Than Good?* BNA'S ENVIRONMENTAL DUE DILIGENCE GUIDE, No. 193 (March 2008) and Derek Ezovski and Jeff Telego, *Commercial Lenders Welcome Guidance From New ASTM Standard for Vapor Intrusion*, Environmental Data Resources, Inc. (March 2008).

Phase I Environmental Site Assessment or stand on its own. This tier includes a collection of the same information as collected for a Phase I Environmental Site Assessment (including government and historical records as well as physical information on the property's location). This information is then evaluated to identify (i) if there are any known or suspect contaminated sites in the area of concern (the search distance will vary depending on whether the known or suspected contamination is a petroleum hydrocarbon or non-petroleum hydrocarbon) (the "search distance test"); (ii) whether any of the known or suspect contaminated sites in the area of concern may have released certain chemicals of concern (the "chemicals of concern test"); and (iii) whether a plume of contamination is close enough such that any resulting vapors could have a means of entrance into the buildings located on the property adversely affecting indoor air quality (the "plume test"). The Tier 1 Screening Assessment should result in a conclusion that vapor intrusion either is not a likely concern or that it cannot be eliminated as a concern meaning it is a potential vapor intrusion condition.

- **Tier 2 Screening:** If the potential for a vapor intrusion condition is identified at the Tier 1 level, a Tier 2 data collection can then take place, with both invasive and non-invasive components. The non-invasive portion of the review includes the review of any available and relevant Phase II reports, and the invasive portion may include soil, soil gas and/or groundwater sampling.
- **Tier 3 VIC Assessment:** If the potential for a vapor intrusion condition still cannot be eliminated as a result of the Tier 2 review, Tier 3 provides for more sophisticated testing options, including additional soil, soil gas and/or groundwater testing as well as indoor air concentration testing.
- **Tier 4 Mitigation:** Tier 4 is used to identify the various options for mitigation, whether necessary due to a confirmed risk or to be taken as a precaution. Mitigation can include institutional controls, such as deed restrictions; engineering controls, such as source removal or

treatment; and building designs which could include barriers and/or venting.

Numerous technical issues can complicate the four tiers outlined above. Inherent limitations in the currently available methods of air concentration modeling, sampling, and testing can all affect the reliability of results, producing either false positives or false negatives. Additionally, since many common household products such as cleaners, polishes, and adhesives contain chemicals identical to the relevant subsurface contaminants, it can be extremely difficult to discern actual instances of vapor intrusion as opposed to emission of similar vapors by such common household products.

Also, it should be noted that although a Tier 1 Screening Assessment may not cost more than several hundred dollars, a full vapor intrusion assessment, using the ASTM standard, even without mitigation is likely to cost in the thousands of dollars and can clearly require weeks to complete. However, given that the standard is so new, it is difficult to estimate the likely costs and time.

Key Lender Concerns where Financing Is Secured by Real Property Collateral

Where financing is secured, at least in part, by real property collateral, the issue of vapor intrusion requires lenders to be cognizant of the potential for significant exposure.

- **Lender liability:** For many years, case law created uncertainty about the circumstances in which a lender could be held liable as an “owner or operator” of contaminated real property under the Comprehensive Environmental Response, Compensation and Liability Act, as amended (“CERCLA”) or what is commonly known as the federal Superfund⁴. The Lender Liability Amendments⁵ to CERCLA now provide comfort that lenders are unlikely to have “owner or operator” liability for releases of hazardous substances on real property used as collateral,

⁴ 42 USC §9601 et seq.

⁵ Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996, Pub. L. 104-208, 110 Stat. 3009-462 (1996).

so long as the lender “merely holds an indicia of ownership and acts primarily to protect its security interest in a facility (for example, through foreclosure or post-foreclosure acts) but does not participate in the management of the facility prior to foreclosure.”⁶ (Many states have adopted similar, if not identical, lender liability protections with respect to state Superfund statutes.) It is critical, then, to avoid environmental liability that while the borrower is in possession of the real property encumbered by the security interest, lenders adequately insulate themselves from potential liabilities in this area by avoiding (i) undertaking responsibility for the handling or disposal of any hazardous substances, or (ii) more generally, exercising control over the property comparable to that of a manager with day-to-day decision making authority regarding environmental compliance.⁷ If vapor intrusion gives rise to state law tort claims for personal injury or property damage or claims under other federal, state, or local environmental laws, a lender’s exposure to liability may well depend on whether the applicable lender liability statute in that jurisdiction provides protection for lenders against common law tort or other actions.

- **Affect on the collateral:** Like many environmental issues, the presence of vapor intrusion or even the mere *potential* of vapor intrusion can impair the perceived or actual value of commercial real estate used as collateral. The property may not be suitable for all uses, such as multi-family, or only suitable with on-going remediation. The cost of remediation can be significant; thereby impairing the borrower’s ability to satisfy its loan obligations. The existence or potential for a vapor intrusion condition can also affect the lender’s ability to refinance or market the loan or sell the property in the event of a default.

⁶ 42 U.S.C. § 9601(20)(E).

⁷ Id. Lenders who foreclose on real property which has been impacted by releases of hazardous substances must also engage in appropriate conduct post-foreclosure to maintain the lender liability protections to Superfund liability.

- **Reputational risk:** There can also be negative reputational effects resulting from a lender's involvement in real estate transactions with environmental issues, especially those perceived as posing risks to human health, which effects cannot be minimized through statutory protections.

Proactively Addressing the Potential Risk of Vapor Intrusion

Regardless of whether an actual or potential vapor intrusion condition is identified as a result of an ASTM Phase I Environmental Site Assessment or an ASTM Vapor Intrusion Assessment, lenders should ensure that their due diligence efforts and loan documents adequately address the potential risk. Specifically, lenders should consider the following:

- **Due diligence.** The lender should determine whether the selected environmental professional performing the Phase I Environmental Site Assessment has included or will include the potential for vapor intrusion in its scope of work. If not, in consultation with the environmental professional and/or environmental counsel, the lender should consider whether vapor intrusion should be added to the scope. If a known or potential vapor intrusion condition is identified or cannot be eliminated, the lender, again in consultation with the environmental professional and/or environmental counsel, should consider whether a more comprehensive vapor intrusion assessment using the ASTM Standard Practice E2600-08 or other more tailored approach may be warranted.

■ Loan Documentation

- **Definitions.** The definition of "Environmental Liabilities" or any similar term in the loan documents should expressly refer to liabilities, including claims for personal injury and property damage, arising from vapor intrusion. Other environmental definitions in the loan documents such as the definitions for "Environmental Laws," "Releases," or "Remediation" should be reviewed to ensure that they extend to vapor intrusion conditions and mitigation.

- **Representations.** Lenders should consider including representations that require the borrower to disclose known contamination on or in close proximity to the property, known vapor intrusion conditions, and, if applicable, the existence and continued operation of any mitigation system.
- **Covenants.** If a potential or actual vapor intrusion condition is identified or confirmed during pre-finance due diligence which could pose a risk given the current or contemplated use of the property, the lender should consider including an assessment and mitigation covenant in the loan documents. Such a covenant would provide that the borrower shall be required to timely complete, if necessary and appropriate, a vapor intrusion assessment and mitigation that complies with applicable law and guidance documents in the relevant jurisdiction or, if no less stringent, with the ASTM Vapor Intrusion Assessment Standard Practice E 2600-08. The same covenant should be broad enough to address a potential or actual vapor intrusion condition which is discovered by the borrower during the life of the loan. Of course, the borrower should be obligated to notify the lender promptly upon acquiring knowledge of such condition. The lender should also consider whether to include provisions in loan documents requiring adequate reserves for any required vapor intrusion assessment and mitigation, and mechanisms (periodic certifications, etc.) allowing the lender to ensure compliance by the borrower over the life of the loan.

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In deciding whether or not to conduct a vapor intrusion assessment as per the new ASTM Standard E 2600-08, as with any environmental issue, lenders, borrowers and sellers of commercial real estate, alike must balance the need for certainty against their respective tolerances for risk. Undertaking a vapor intrusion assessment in accordance with the new ASTM Standard E 2600-08 will add costs and time to due diligence. Lenders and their advisors will need to consider whether the particular transaction and potential risks justify the expense and potential for delay. For lenders, unfortunately, this means that

there is no clear-cut, definitive rule as to when a lender should require existing or prospective borrowers to perform a more comprehensive vapor intrusion assessment in accordance with the new standard or otherwise—this decision can only be made on a case by case basis. If more certainty is needed, ASTM’s new Vapor Intrusion Standard provides a useful roadmap in evaluating and mitigating vapor intrusion conditions.

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