

Environmental Challenges

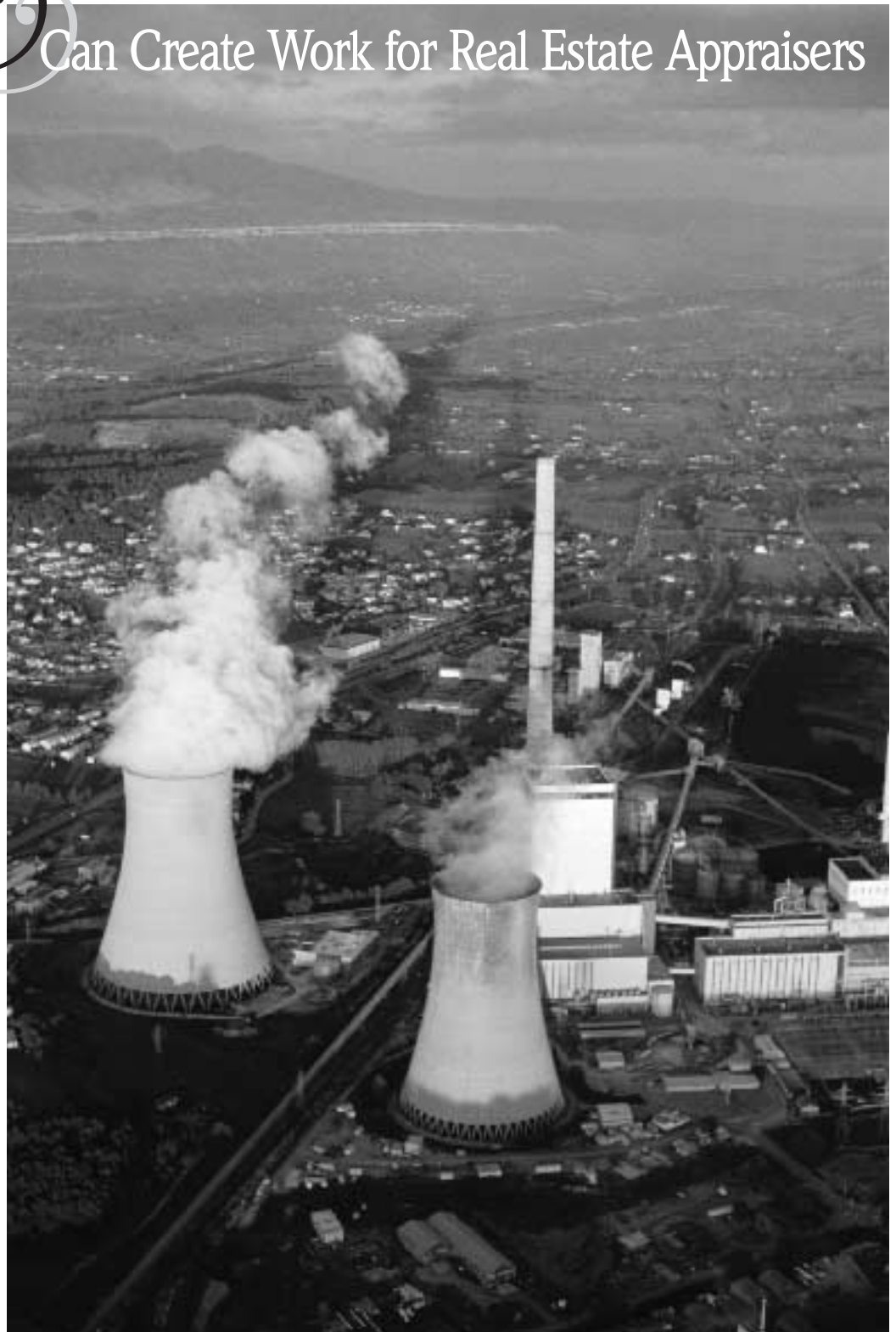
Can Create Work for Real Estate Appraisers

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With the onset of the new millennium, the need to balance economy and ecology has become an integral part of business decisions that will ensure the planet's sustainability. Earlier practices developed during the industrial revolution permitted the ferocious exploitation of the earth without regard to environmental degradation.

Since the 1960s, professions of all kinds have responded to this change. It is now commonplace to describe some of these specialists as "environmental" attorneys, engineers, health and safety experts and scientists. Real estate appraisers also have a role to play in this megatrend. This article discusses the current legal and regulatory environmental pressures on appraisers and the resultant opportunities.

Challenges

The First Quarter 1999 issue of *Valuation Insights & Perspectives* featured an article on this subject by David W. Craig, MAI, CRE, titled "The Environmentally Impacted Property Assignment: The best approach is a good defense." In the article, he describes three environmental situations in which appraisers can find themselves:

- where a property has a problem that is not obvious and the appraiser is uninformed;
- where there is a problem, the extent of which is unknown; and
- where the appraiser is aware of remediation steps and estimated costs for cleanup.

In all cases, Craig says, "it is important to attempt to place yourself in the position defined as the 'innocent landowner defense' where the appraiser would have no 'reason to know' of a site's contamination."

In the first scenario, he discusses how it is the appraiser's responsibility to make appropriate inquiries and observations regarding any known environmental problems and to "make note that this was done in the report."

In the second instance, he discusses the appraisal of a property as if unimpacted by environmental damages; compliance with Standards Rule 2-1(c) of the Uniform Standards of Professional Appraisal Practice (USPAP) covering "disclosure of this extraordinary assumption;" Appraisal Institute Guide Note 8, which addresses treatment of hazardous substances; and the need to retain qualified environmental professionals as due diligence.

He explains in the third case about increased environmental awareness in the marketplace, liability issues,

stigma, the potential unreliability of cost-of-cure estimates vis-à-vis diminution in value and possible remediation, and alternative uses for contaminated properties such as landfills and brownfields. The Comprehensive Environmental Response, Compensation and Liability Act (also known as Superfund) made potentially responsible parties (PRPs) liable for environmental cleanup costs whether or not they caused the contamination.

The Superfund Amendment and Reauthorization Act made PRPs liable for all costs unless they are eligible for the innocent land-owner/purchaser defense. In order to avoid liability, those doing environmental work must support that the pollution was caused by a third party, the property was acquired after the fact, they had no actual or constructive knowledge of the problem and that due care was exercised. Due care is defined as "all appropriate inquiry." HR 2787 defines all appropriate inquiry as a "Phase One Environmental Site Assessment" performed by an environmental professional.

Appraisers Not Immune

According to Craig, "the Superfund sets forth items that would take an appraiser out of the 'innocent landowner defense.' These are the following: specialized knowledge, knowledge of a recent price significantly below market value, ignoring reasonably ascertainable information and/or disregarding contaminants which could be detected by appropriate inspection."

Federal agencies have also addressed appraisers' environmental responsibilities. Fannie Mae says the "appraiser has a responsibility to note in the appraisal report any adverse conditions that were observed during the inspection of the subject property or report any information that he or she became aware of through the normal research involved in performing an appraisal."

According to Freddie Mac, "ignorance is not acceptable" and the "appraiser must consider any known contaminated sites or hazardous substances that affect the subject property or the neighborhood." The U.S. Department of Housing and Urban Development has stated that, "there are a number of environmental factors that by law and/or regulation must be considered by every appraiser and underwriter on every property."

Lenders are subject to corresponding requirements. The Office of Thrift Supervision warned member institutions of the dangers of environmentally contaminated properties and requires lenders to establish due diligence in all real estate transactions. →

The Federal Deposit Insurance Corporation requires banks to develop and implement an Environmental Risk Management Program for all types of transactions, including residential and commercial real estate loans and trust operations.

Appraisers are Excellent Candidates

There is growing demand by industry and consumers to determine if properties are environmentally safe at a reasonable cost. Having properties inspected by highly trained environmental engineers or assessors can satisfy these needs. However, these services can cost a great deal of money. Also, the number of these professionals is so small that they cannot handle the amount of inspections that will likely need to be performed in the foreseeable future. Appraisers can fill some of this gap in the market

Retaining a properly trained and certified Environmental Risk Screener (ERS) is one solution, although real estate appraisers are excellent candidates for this work. They already analyze on-site information and are trained to interpret real estate data from national, regional, local and neighborhood sources.

Certified screeners are qualified to screen properties to identify potential environmental risks. Several national environmental database firms provide practitioners one-stop shopping for public environmental disclosures in communities throughout the nation. Public agencies and associations can also be contacted individually.

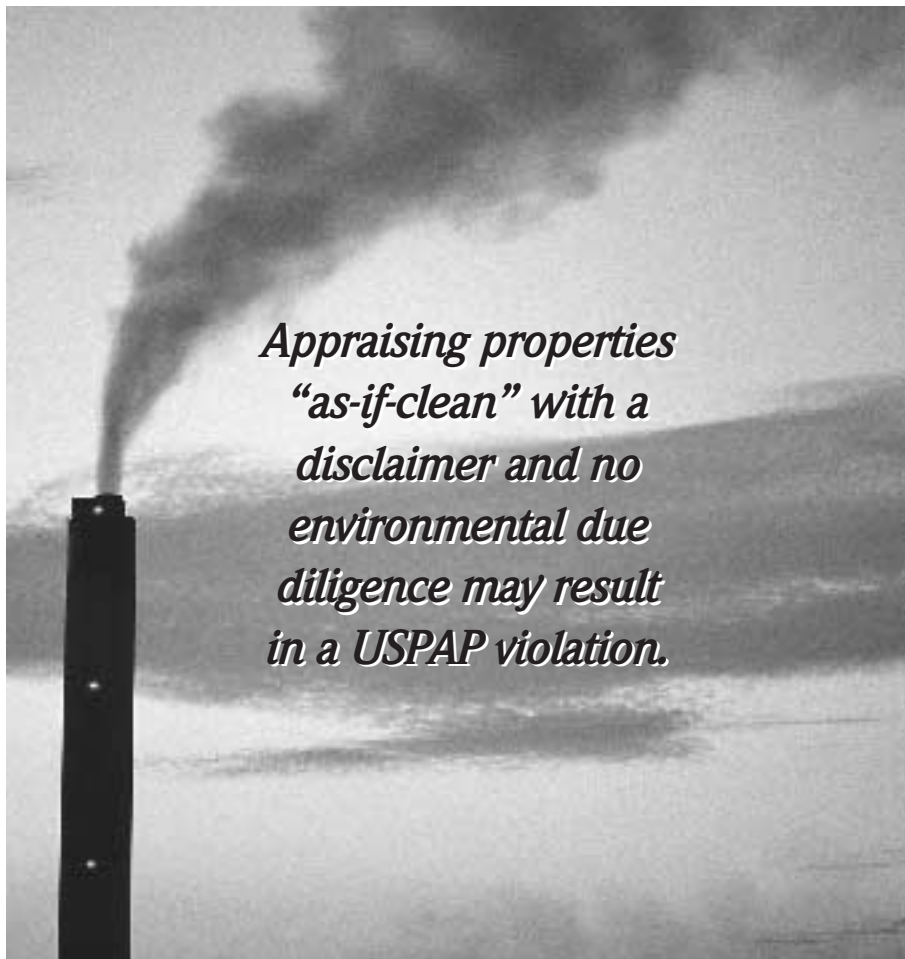
The screen is typically limited to an on-site above-grade visual inspection to identify apparent indications that the property may have some environmental problems. Items screened for include

asbestos, polychlorinated biphenyls (PCBs), formaldehyde, lead, air pollutants, radon and contamination in underground storage tanks, waste disposal, waste sites and other hazards. Depending on clients' desires screening may also be expanded to include a records and regulatory review and personal interviews. It has been used for both residential and commercial properties.

However, given increasing consumer awareness of home-related environmental health and safety issues and recent Federal Housing Administration initiatives, the demand for this service is expected to increase in the months and years ahead. Residential practitioners are well suited to add this service to their menu.

Users must be aware that not all problems may be apparent. It is better to report these problems rather than nothing at all, which is often the only course available for those who do not want to pay for a very expensive study. The extremes of requiring either an engineer's/assessor's report or no report at all are not satisfactory. Usage of ERSs and increased awareness of their services can provide the protection needed by buyers, sellers, lenders and others with an interest in the property.

Environmental due diligence needs can also be satisfied by retaining a properly trained and certified Environmental Risk Assessor (ERA) to perform Phase One Environmental Site Assessments (ESAs). The ERA has completed advanced training and is qualified to perform complex assessments on commercial, industrial, agricultural and special purpose properties. This involves evaluation of the present and past condition of the site and likelihood of a spillage, discharge, seepage, uncontrolled loss or filtration of a hazardous substance. The steps include a site investigation, neighborhood search, records and regulatory review and personal interviews. If the Phase One ESA uncovers the possibility of contamination, or suggests that a release may have occurred, a Phase



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Two ESA is recommended. There is no testing in the Phase One process.

The Phase Two ESA is a technical study designed to deny or confirm the presence of hazardous substances. It is performed by environmental professionals with understanding and knowledge of analytical and sampling processes and often entails complex on-site environmental sampling and laboratory analysis.

Most states require licensing for those working with radon, lead, underground storage tanks, hazardous materials and asbestos. Many designated ERSs and ERAs have aligned with other qualified specialists to provide competent services. Others have pursued licensing.

The Phase Three ESA is performed to determine the rate, degree and extent of contamination and to evaluate the potential impact on health and safety. Investigations can be quite complex and may involve soil, groundwater, surface water, air and relevant hydrologic and geologic information.

Remediation and cost estimates typically take place during the Phase Three process.

Develop a Skill Set

It is clear that appraisers face potential environmental liabilities in the normal course of their professional practices. To summarize Craig's article, appraisers are not generally considered environmental experts. Nonetheless, they must support the innocent landowner defense to produce a credible report on which users can rely. This requires at least awareness of environmental hazards. Appraising properties "as-if-clean" with a disclaimer and no environmental due diligence may result in a USPAP violation, dangerous exposure and potentially disastrous financial liability.

Real estate appraisers now have the opportunity to develop the skills and expertise necessary to avoid environmental liability in their existing work and to provide additional career-building services to their clients. Transaction Screens and Phase One ESAs are the best ways to treat environmental issues as

a constructive part of the real estate transaction process, rather than as an obstacle to be overcome later. ■

Steven Levine has been involved with NAERA since its inception in 1988 and has been its Executive Vice President since 1995. He began studying environmental damages to properties during the Times Beach, Mo., disaster of 1982.

Mr. Levine has served as a consultant to federal and state agencies in developing and presenting real estate training programs. He has a bachelor's degree in political science from the University of Cincinnati and has studied government and public administration at the George Washington University.

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