

Are Environmental Audits Needed on Ranches? Perspective of a Banker

Keith E. Kelley

Farm Credit of North Florida, ACA
Alachua, Florida

Environmental Risk Management

Two key concepts are employed by most lenders in this process:

(1) Due Diligence Investigation Due diligence means gathering the necessary and sufficient information so that a well informed decision can be made. As applied to environmental risks, it means the lender takes the appropriate steps to:

- identify actual or potential environmental problems on the borrower's property or in the borrower's business;
- evaluate the nature and severity of the problem; and
- appropriately address the problems in the credit analysis and loan structuring process.

The due diligence investigation is the means by which the lender gathers information, makes a credit decision and structures the lending transaction.

The investigation may serve as the basis for the innocent landowner defense in the event of title transfer. It is also an integral part of the risk classification process.

Due diligence is an incremental process. However, knowledge of the presence of hazardous substances which has been obtained as a result of due diligence investigation does not necessarily preclude the ability of a lender to invoke the security interest exemption under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

Thus, as an investigation uncovers potential hazards, additional investigation may be required to document the existence or absence of an actual hazard. This investigative duty is imposed by Law.

(2) Risk Classification—Definition It is important for the lender to understand that almost any industrial business presents an environmental risk. Even if chemicals are not manufactured or used in the production cycle, solvents, cleaners and paints may have been used to maintain the facilities, asbestos may have been used for insulation, and large quantities of toxic wastes and used lubricants may have been disposed.

Many experts also consider any type of agricultural property to be at risk environmentally. The use of chemical fertilizers, herbicides and pesticides, petroleum products, and the presence of animal waste on the farm contribute to the high potential for environmental problems on many farm properties.

Certain agricultural activities pose greater risk than others. In addition, differing soil types, groundwater characteristics and other geological characteristics mean that similar activities on different properties may have widely differing levels of risk.

Identifying the environmental risk potential of an individual property is part of the overall credit analysis.

Classifying the Property Information gathered during the due diligence investigation will be used to classify a property according to the relative risk of environmental problems that may exist on the property. The appropriate environmental risk management practices to be used when structuring the lending transaction can be determined according to the classification.

The following provides some general characteristics of low, medium and high risk properties.

Low Risk Property:

Present and historical agricultural or residential uses only; and

- an apparent absence of environmental hazards and facilities which might create environmental hazards; and
- a responsible attitude of the borrower toward environmental regulations.

Examples: Residential properties or agricultural properties without apparent hazards.

Medium Risk Property:

Present and historical agricultural, residential or industrial uses, where

- potential hazardous facilities are present, but well maintained and tested;
- visual inspection reveals no apparent environmental releases;
- hazardous materials are handled in a responsible manner with proper permits, licenses, and safeguards; and
- there is no record of noticing by environmental enforcement agencies, or satisfactory corrective actions have been taken to remedy problems.

For properties with discontinued industrial uses, investigation has identified the specific industry as one that does not normally involve the manufacture or use of hazardous materials and no apparent release is noted upon visual inspection. However, any former industrial site whose former practices cannot be documented with a high degree of specificity should possibly be treated as a high risk.

Examples: Well maintained, properly permitted properties where inspection reveals no apparent environmental releases. Could include the following:

- Shop or equipment maintenance facility
- Processing, mixing or packaging facility
- Dairy
- Confined livestock
- Poultry
- Laboratory, research, or veterinary facilities
- Aboveground or underground storage tanks
- Sewage or waste water treatment facility

- Irrigation equipment or tile drainage
- Well, cistern, or developed spring
- Commercial or large scale pesticide application operation
- Incinerator or industrial driers (other than grain drying)
- Bulk solid or liquid (including fuel) loading or transfer facility
- Natural or man-made pond, lake, lagoon, river, stream, swamp, wetland, reservoir, impoundment
- Pesticide application equipment and chemical inventory
- Mining (sand, gravel, clay, borrow, etc.) or oil and gas development
- Trash dumps, pits, old barrels, junk cars
- Landing strip
- Industrial/manufacturing facility
- Sewage sludge application

High Risk Property:

Present and historical agricultural or industrial uses where there is

- evidence of improper, unlawful, or irresponsible management of environmentally sensitive materials, facilities or practices; or
- visible signs of hazardous substance releases;
- a casual attitude on the part of the borrower or operator regarding handling, storage, use, or disposal of hazardous substances; or
- current or chronic notice by environmental enforcement agencies; or
- listing on, or effect from a site listed on federal or state priority list.

For properties with discontinued industrial uses, investigation has identified the specific industry as one that would have been expected to manufacture or use hazardous materials, or evidence of possible release is noted upon visual inspection.

Examples: Any medium risk property (above) where there is evidence or suspicion of environmental abuse or carelessness.

Environmental Assessment & Audit

The procedures used to perform the due diligence investigation and risk classification may vary from bank to bank.

Environmental Assessment This is the initial review of a property or business for the purpose of determining the elements of environmental risk. The assessment can be done by the lender or an environmental professional. The information reviewed in an assessment will be similar to that required to complete a Phase I audit (see below). It will provide sufficient information to allow for an environmental risk classification of the property or business and enable the lender to recommend further action.

Environmental Audit An environmental audit is conducted by an environmental professional. There are three levels of audit.

A **Phase I Audit** will include research into the past and present use of a property or business; research into compliance or violation of environmental statutes and regulations; a site inspection to discover or verify the existence of potential hazards and make recommendations for further investigation as appropriate.

A **Phase II Audit** would be conducted in addition to a Phase I audit. The scope of a Phase II audit is to be based upon the Phase I recommendation and could include well testing, soil sampling, and analysis of waste products stored on the site. The Phase II audit can be used to develop preliminary estimates of the need for and cost of remediation.

In a **Phase III Audit**, the consulting firm prepares a remediation program that includes construction documents. These documents detail the scope of work and are the basis for contracting out the cleanup. They also specify the regulatory agencies to contact and the permits to obtain. In addition, these documents will estimate the cost of the work and the time involved in completing it, including the time required to obtain the necessary permits. The audit firm's role in the inspection and supervision of the process will also be discussed.

The current policy of Farm Credit of North Florida, ACA places the responsibility of the environmental assessment on the account officer and appraiser as outlined below.

The Account Officer will:

- inform the borrower that the lender has established certain criteria and practices dealing with environmental risk;
- have borrower complete the Environmental Hazards Assessment, form ENV-1 (Exhibit "A");
- become sufficiently familiar with the borrower's business in order to be aware of the use of hazardous materials in his operation;
- notify the appraiser of any environmental hazard known or suspected to exist, or disclosed by the borrower or any other source on real property offered as security;
- ensure that environmental risks are considered as part of the credit analysis;
- determine the level of environmental risk analysis required in connection with a loan.

Low Risk Operation:

- Document the apparent absence of potential hazards and hazardous facilities
- Verify proper registration as licensed chemical applicator under state requirements if applicable.

Medium Risk Operation:

- Consider requiring borrower to hire outside experts to conduct an environmental audit and to assist with cost and risk estimates.
- Document existence and condition of well managed and maintained facilities, structures, and practices for handling hazardous materials.
- Document compliance with any environmental statutes and regulations.
- Request copies of environmental tests done by the borrower.
- Consider the possibilities that future remediation or cleanup may be required and evaluate any

impact those cleanup costs might have on the borrower's debt repayment capacity.

- Consider the advantages and disadvantages of correcting any actual or potential problems immediately.

High Risk Operation:

- Require the borrower to employ outside experts to conduct an environmental audit and to assist with cost and risk estimates as appropriate.
- Evaluate the existence of and/or potential for hazardous waste releases.
- Estimate potential remediation or cleanup costs.
- Evaluate the impact of remediation or cleanup costs on the borrower's debt servicing capacity.
- Include borrower testing, remediation or cleanup covenants as needed in the borrower's loan agreement.
- Include appropriate environmental representations, warranties, covenants, and indemnifications in the loan documents.

The Appraiser will:

- (1) Upon instruction from the account officer,

review and verify the Environmental Hazards Assessment, form ENV-1, by conducting a site inspection.

- (2) Complete the Appraiser's Environmental Supplement, form ENV-2 (Exhibit "B") to document (recognizing that the appraiser is not an expert on hazardous waste contamination) the existence of hazards discovered or disclosed and the presence and condition of potentially hazardous structures, facilities, and practices which are observed during the routine appraisal process.

If, through investigation, suspected environmental hazards are discovered, the appraiser will immediately notify the credit officer responsible for the loan.

Conclusion

Environmental risk management is an important element in the analysis of a loan. Environmental problems can impact a borrower's repayment ability as well as collateral values. Our experience has been that cattlemen tend to be good stewards of the land and they are sincere about the preservation of the land and environment around them.

EXHIBIT "A"
ENVIRONMENTAL HAZARDS ASSESSMENT
 PLEASE PRINT OR TYPE

This form is to be completed by The Loan Applicant or The Undersigned to provide The Lender with information on whether there is any environment contamination on the property offered as collateral or otherwise owned or operated by The Undersigned.

NAME(S) OF UNDERSIGNED _____

ADDRESSES _____

This form applies to: () all of the subject property; or () to _____ tract. If this form will not apply to all of the subject property, please complete a separate ENV-1 for each tract.

(COMPLETE ALL OF SECTION I AND OTHER SECTIONS AS DIRECTED) Tract # or Name _____

- I.**
1. Have any of the following ever been buried, dumped, stored, or disposed of either in or on the land, surface waters or in building(s) on any of the undersigned's property:

	YES	NO
Liquid or Solid Waste (including fill, trash, deceased livestock, crankcase oil, abandoned vehicle/equipment or garbage of any kind)	___	___
Chemical or Industrial Waste	___	___
Sludge from waste water treatment plants	___	___
Waste oil/petroleum products	___	___
Other hazardous material	___	___
If yes, provide details _____		

 2. Are you aware of any contamination of soil, streams, ponds, or groundwater caused by the disposal/ or storage of such substances?
 YES _____; NO _____.

 3. Do you obtain your drinking water from a well? YES _____; NO _____. If yes, have you ever submitted a sample of the well water for testing? If yes, provide the approximate year(s) that the samples were tested and the results. _____

 4. A. Have you received notice from any governmental authority concerning any toxic or hazardous material on the property?
 YES _____; NO _____. If yes, explain: _____

 - B. Are there any existing, potential or past environmental hazards which have not been addressed in the previous questions? (Ex. - Contaminated wells, past manufacturing or industrial site, asbestos, radon, PCB's, urea formaldehyde insulation, or unexplained features, etc.)
 YES _____; NO _____. If yes, explain: _____

 5. Are pesticides, herbicides, or fertilizers being stored or will they be stored, used, or disposed on the property?
 YES _____; NO _____. If yes, complete Section II.

 6. Does the pledged property contain above or underground storage tanks (other than water)?
 YES _____; NO _____. If yes, complete Section III.

 7. Are there any dairy, poultry, cattle, or other animal feeding operation on the property?
 YES _____; NO _____. If yes, complete Section IV.

 8. Is there a vegetable or fruit packing operation on the property?
 YES _____; NO _____. If yes, complete Section V.

 9. Has (or will there be) municipal sewage sludge been applied to the property?
 YES _____; NO _____. If yes, complete Section VI.

II. HANDLING OF FERTILIZERS, HERBICIDES AND PESTICIDES:

- A. Please explain (1) where the products are/ or will be stored, (2) the length of time these products are/ or will be generally stored, (3) a description of the containers in which these products are/ or will be stored, and (4) whether these chemicals will be used in the production of crops in the future.

INDICATE Pest/Herb/Fer	WHERE STORED	LENGTH OF STORAGE	CONTAINER DESCRIPTION	CROP PRODUCTION (YES/NO)

- B. Are containers and unused portions of herbicides, pesticides, or fertilizers discarded in a manner consistent with the disposal instructions on the pesticide label?
 YES _____; NO _____. If no, explain: _____
- C. Is each emptied pesticide container tripled rinsed before the container is disposed?
 YES _____; NO _____. If no, explain: _____

- D. Has any part of the property been used to mix, discharge, or washdown equipment to apply pesticides, herbicides, or fertilizers either by aerial (crop dusting) or ground application? YES _____; NO _____. If yes, describe the location of the property.

- E. If the answer to (D) is yes, answer the following: Is the waste water from the washdown of the application equipment discharged into any surface waters such as a stream, pond, ditch, or lagoon? YES _____; NO _____. If yes, describe the location of the property and a description of the body of water into which it flows.

III. UNDERGROUND AND ABOVE GROUND STORAGE TANKS

- A. Number of tanks: _____ Number of gallons held by each tank: _____ Age of tank(s): _____

- B. Kind of substance stored: _____
- C. Use of tanks: _____
_____ commercial (agriculture) _____ noncommercial (residential) _____ other
- D. Have all of the tanks described in Question (A) been properly registered? YES _____; NO _____. If no, explain why not.

- E. Have the underground storage tanks been tested to ascertain if any leaks have occurred? YES _____; NO _____.
If yes, what were the results? _____
- F. Have you had any leaks from any storage tanks? YES _____; NO _____. If yes, please specify the month and year the leak was discovered, the kind of substance leaked (Example: petroleum) and the estimated volume of substance leaked, if known.

	OCCURANCE 1	OCCURANCE 2
Month & Year		
Substance Leaked ..		
Volume Leaked		

IV. ANIMAL OPERATIONS

- A. _____ Dairy _____ Poultry _____ Cattle _____ Other (please specify) _____
- B. Please specify the kind of waste management system you employ:
 holding tank holding pond stacking pads
 lagoon land application other (please specify) _____
- C. Do you have any of the following permits for the waste disposal system?
 Permit to Construct a Waste Treatment System
 Permit to Operate a Waste Disposal System
 National Pollutant Discharge Elimination System (NPDES) Permit for Intermittent Discharges of Water Runoff into Surface Water (creeks, streams, ponds, etc.)
 Other _____

V. VEGETABLE OR FRUIT PACKING OPERATIONS

- A. Please specify kind: _____
- B. Is the waste from the packing operation discharged into a no-discharge lagoon? YES _____; NO _____.
If no, please describe where the waste water is discharged. _____
- C. Do you have any of the following permits for waste water discharge?
 NO-DISCHARGE/Land-Application Permit
 A National Pollutant Discharge Elimination System (NPDES Permit) to discharge into surface water.

VI. SLUDGE APPLICATION

Has the property ever been used to spread sludge or for the disposal of other commercial or industrial wastes? If so, list the type of waste, identify area involved and give permit number.

VII. CERTIFICATION/RECERTIFICATION

I hereby certify that the foregoing is a true and accurate account of any environmental hazards connected with the operations of the undersigned.

Signature _____	Date _____

EXHIBIT "B"

APPRAISER'S ENVIRONMENTAL SUPPLEMENT

Borrower/Applicant Name: _____ Loan No.: _____

This form applies to: () all of the subject property, or () to no. _____ of _____ tracts only. If this form will not apply to all tracts, please complete a separate ENV-2 for each tract.

APPRAISER VERIFICATION

Check one box only—

Verification of information contained in Environmental Hazards Assessment, form ENV-1.

Based on an inspection and other relevant inquiry, the undersigned subject to limiting conditions below has determined that the environmental conditions and information disclosed in the Environmental Hazards Assessment, form ENV-1, dated _____, accurately and adequately reflect the conditions observed on the subject property.

If checked, STOP HERE. Sign and date form.

Information provided supplemental to Environmental Hazards Assessment, form ENV-1.

Based on an inspection of the subject property and other relevant inquiry, the appraiser submits the information below to amend, clarify or supplement environmental information contained in the Environmental Hazards Assessment, form ENV-1, dated _____, for the following ENV-1 topics:

(check applicable topics)

- Regulatory Compliance
- Pesticide, Fertilizer, and Herbicides Application and Use
- Material Use, Storage and Disposal
- Surface and Ground Water Quality
- Storage Tanks
- Animal Operations
- Vegetable or Fruit Packing Operation
- Other

Details: (use attachments if necessary)

Appraiser _____

Date _____

Appraiser _____

Date _____

Appraiser _____

Date _____

Appraiser _____

Date _____