



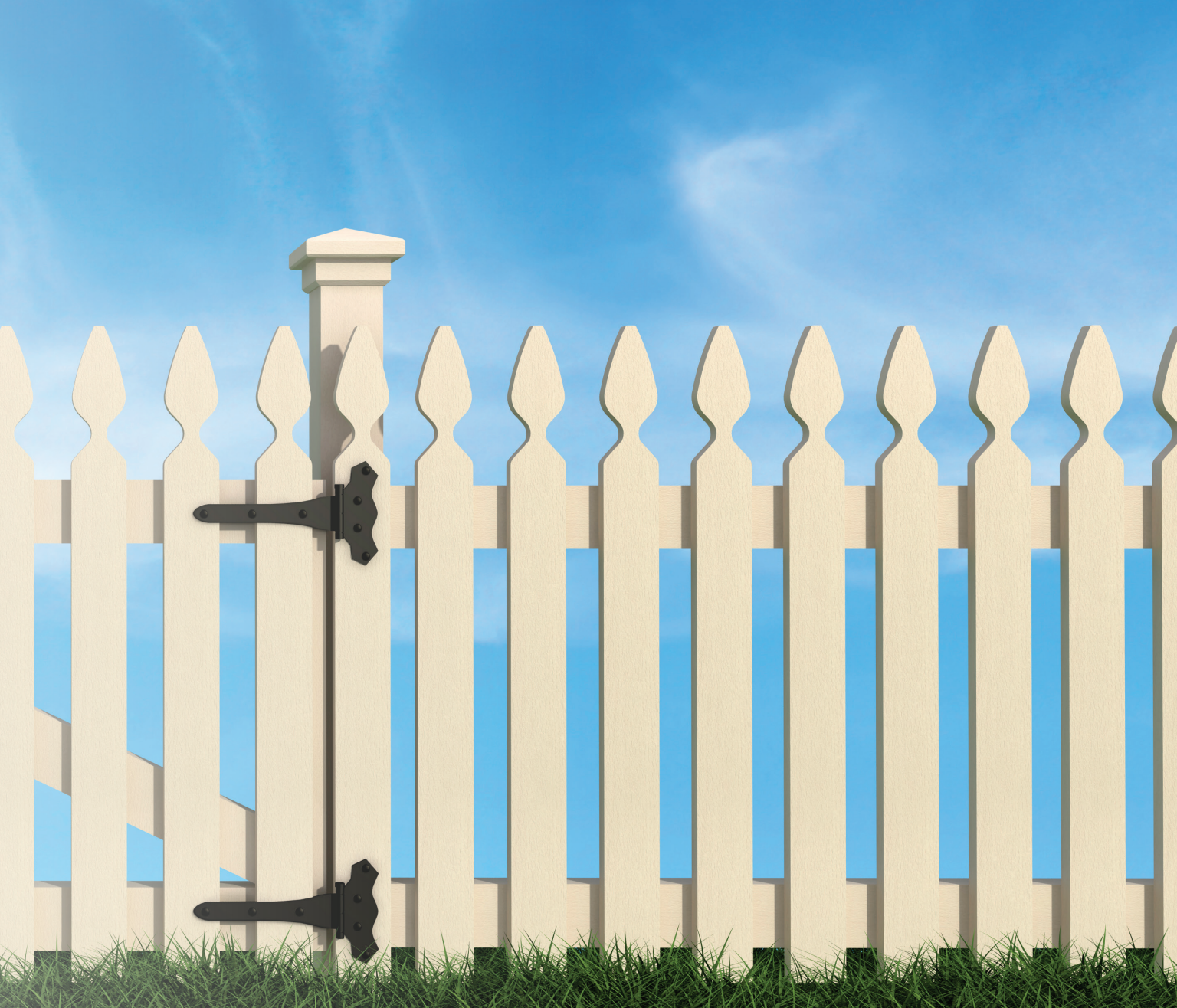
Residential Environmental Compliance in a Post Dodd-Frank Era

Technology has reduced the cost of residential environmental compliance, but the need for due diligence has never been greater. Now is a good time for lenders to revisit how they address residential property contamination issues in their lending practices.

BY JACK HUNTRESS AND JAMES D. HABERLEN

IN A POST Dodd-Frank era, the order of the day is consumer protection, disclosure, and transparency. New requirements are being introduced, and existing ones that may have been ignored are now being enforced. Chief among the agencies releasing and enforcing these regulations is the Consumer Financial Protection Bureau. In addition, Fannie Mae and Freddie Mac have ramped up scrutiny of the mortgages sold to them, resulting in increased loan ineligibility and repurchase risk for lenders.

For those working in residential lending, it is important to consider the new regulations in the context of traditional due diligence requirements, including credit checks, flood checks, and appraisals. For instance, since 1994, Fannie Mae has acknowledged the importance of reporting environmental contamination on a property during the appraisal process. Similarly, Freddie Mac and HUD request information about potential contamination on or near the subject property, also to be reported during the appraisal process. Unfortunately,



these requirements are not being enforced, which has led to unnecessary consumer health issues and lending risk.

For a number of important reasons, however, lenders may not be able to ignore these environmental requirements any longer. This article evaluates why change is likely. Specific attention is given to each of the following issues, with emphasis on their roles in supporting a shift to a stricter environmental practice:

- Growing public concern and regulatory scrutiny over vapor intrusion.
- Environmental requirements of Fannie Mae, Freddie Mac, and HUD.
- Tougher consumer protection and informed consent in the post Dodd-Frank era.
- Tightening of residential mortgage standards by Fannie

Mae and Freddie Mac.

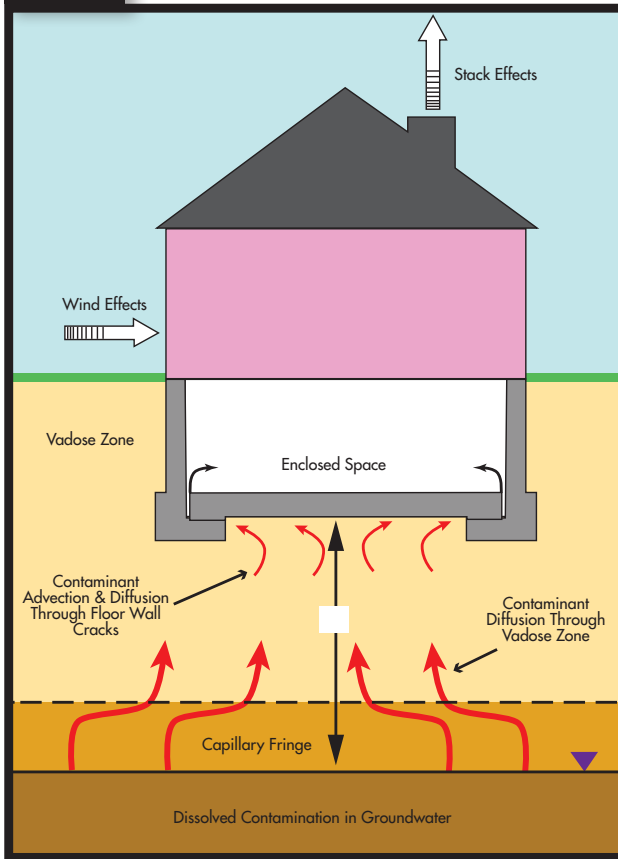
- Technological advances that now enable cost-effective solutions for complying with existing requirements.

Vapor Intrusion: The “Game Changer”

Lenders fortunate enough to have avoided environmental issues with residential property mortgages will now find vapor intrusion (VI) a powerful new driver for environmental screenings. VI occurs when volatile chemicals migrate from contaminated groundwater or soil into an overlying building. Figure 1 illustrates this risk in a conceptual model.

VI is fast becoming a “game changer” owing to the growing awareness of vapor-related risk, the potential health effects, and new federal and state guidance on managing VI risk—all of which point to a strong rationale for performing

Figure 1



Source: The Brownfields and Land Revitalization Technology Support Center (<http://www.brownfieldstsc.org>)

environmental screening as part of residential loan transactions. One reason why VI is of particular concern in residential properties is that, once a pathway is established into a building and vapors enter a home, occupants are unable to avoid exposure. Thus, VI is different from soil or groundwater contamination. In the case of the latter contaminations, people can limit their exposure by changing their behavior (for example, by avoiding tap water and not letting children play in backyards).

Although VI has been known as a risk since the 1990s, only in the past few years has science advanced enough for us to better understand the risks and the mitigation techniques. The U.S. Environmental Protection Agency (EPA) is also in the final stages of issuing updated VI guidance, and 33 states have already developed specific guidance to assess the potential for VI, largely following the EPA's lead.

Additionally, the American Society for Testing and Materials (ASTM), by updating both the standard for assessing vapor encroachment onto a property (E2600) and Phase I Environmental Site Assessments (E1527), is creating a market where vapor migration screening will become standard due diligence practice for commercial property, including multifamily (five or more units) residential properties.

Given the trend toward vapor migration screening

Lenders fortunate enough to have avoided environmental issues with residential property mortgages will now find vapor intrusion a powerful new driver for environmental screenings.

for commercial and multifamily properties, as well as the growing body of evidence on potential health risks, there is a compelling case for screening residential properties (single-family and multifamily up to four units) for VI risk, particularly for the following reasons:

- People typically spend more time in their homes than at their workplaces.
- Children are likely to be more sensitive than adults to the effects of contaminated air; the more time they spend in their homes, the more they are exposed.
- Most people live and spend more time in first-floor and basement settings (where VI risk is greatest) of residential properties than they do in commercial structures.
- Residential buildings usually do not have the airflow refreshing that commercial buildings are typically required to provide.

For residential properties, all these factors create an increased risk profile for exposure limits in situations where contaminated soil or groundwater may migrate to indoor air.

Following the pathways for exposure to contaminated soil and groundwater (such as water supply) has long been a logical way to find and mitigate contaminated properties, but the VI pathway, after being overlooked for years, is a recent addition to today's environmental risk audits of commercial real estate. Numerous plumes thought to be benign because residents drew on municipal water have reemerged as issues because of toxic vapors entering homes.

Pompton Lakes, New Jersey, offers just one of many VI cases around the country. It illustrates the issue of consumer protection and disclosure for homes sitting atop carcinogenic plumes of PCE and TCE, mostly caused by dry cleaning solvents. What is particularly noteworthy about the Pompton Lakes plume, which originated from a former industrial facility, is that information about the contamination was publicly available, yet was not disclosed to buyers and owners until after they learned of their exposure. Figure 2 depicts the Pompton Lakes plume that affected more than 400 homes. If detected early, VI risk can be mitigated rather easily and cost effectively.¹ Further, the principal mitigation technology is not unlike that for managing radon risk by a network of qualified contractors using reliable equipment.

As awareness of VI risk continues to grow and more is known about the health effects, the number of vapor cases continues to grow. New instances of VI are being discovered all the time, and previously overlooked sites are being reopened by state regulatory agencies. A broad summary of all known VI cases to date can be found in Appendix A of the Land Contamination and Residential Properties Summit Report.²

Fannie Mae, Freddie Mac, and HUD Requirements

Unlike multifamily and commercial properties, single-family residential transactions rarely involve any environmental due

diligence. This is somewhat surprising, given the multiple requirements calling for the reporting of land contamination information in residential property transactions.

Largely embedded in the appraisal process, environmental due diligence requirements have been on the books since as early as 1994, but the ability to fulfill these reporting requirements within reasonable time and cost constraints has only recently been developed. Prudent lenders are watching this changing landscape closely, especially those selling into the secondary market, as greater enforcement of these requirements could lead to loan ineligibility or even repurchase risk.

On the first page of the Uniform Residential Appraisal

Figure 2

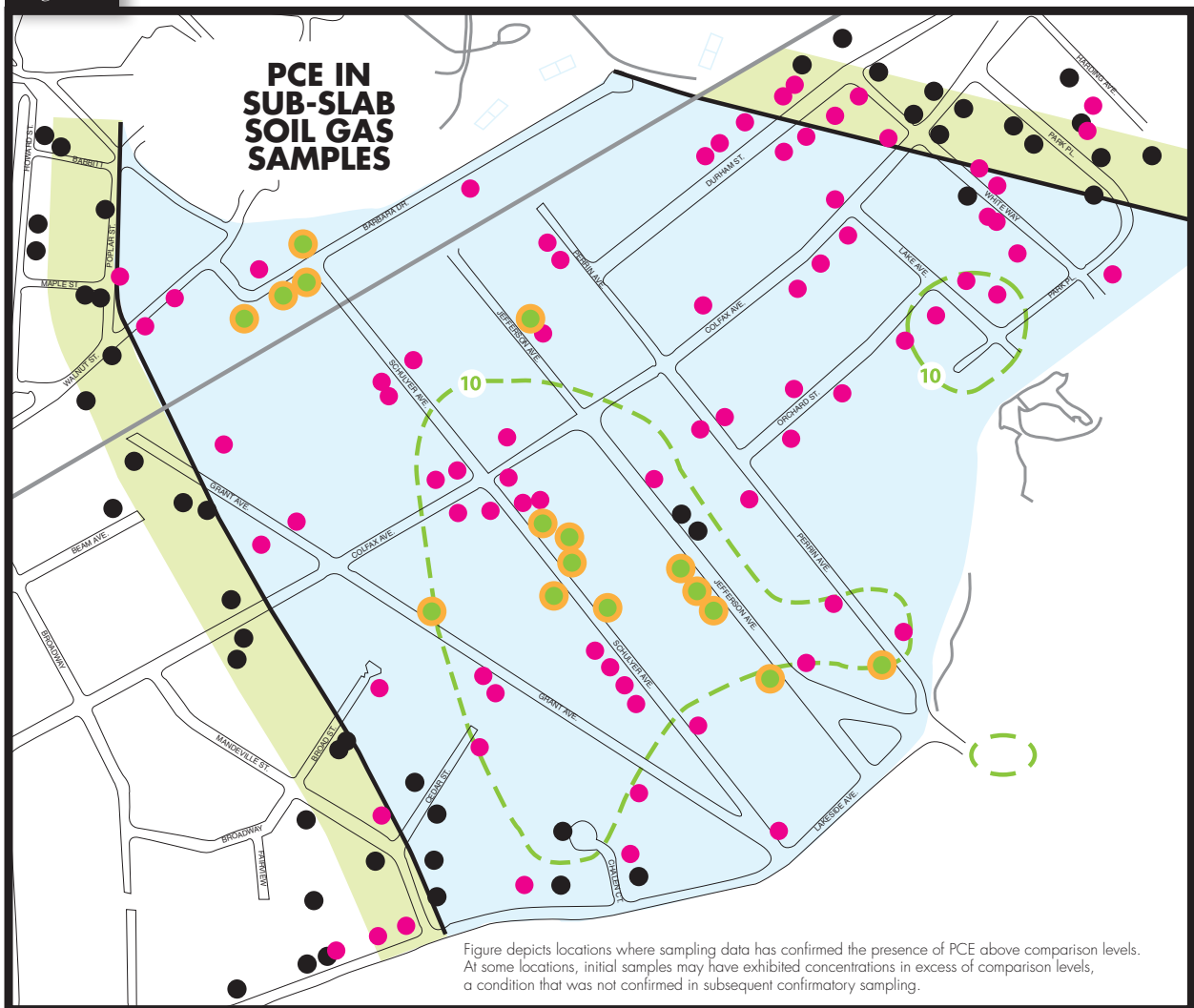


Figure depicts locations where sampling data has confirmed the presence of PCE above comparison levels. At some locations, initial samples may have exhibited concentrations in excess of comparison levels, a condition that was not confirmed in subsequent confirmatory sampling.

Source: Pompton Lakes Works (<http://www.pomptonlakesworks.com>)

Legend

- PCE in Sub-Slab Soil Gas ≥ 16 pg/m² (includes non-detections)
- PCE in Sub-Slab Soil Gas ≥ 16 pg/m²
- PCE in Sub-Slab Soil Gas $\geq 1,000$ pg/m²
- ⋯ PCE in Shallow Groundwater ≤ 10 pg/L

Figure 3

Environmental Risk Disclosure on the URAR

SITE	Utilities			Public			Other (describe)			Public			Other (describe)			Off-Site Improvements - Type		Public		Private			
	Electricity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Water	<input type="checkbox"/>	<input type="checkbox"/>	Street	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>				
Gas	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Sanitary/Sewer	<input type="checkbox"/>	<input type="checkbox"/>	Alley	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>					
FEMA Special Flood Hazard Area		<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	FEMA Flood Zone	FEMA Map#	FEMA Map Date															
Are the utilities and off-site improvements typical in the market area?															<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	If no, describe				
Are there any adverse site conditions or external factors (easements, environmental conditions, land uses, etc)?															<input type="checkbox"/>	Yes	<input type="checkbox"/>	No	If yes, describe				

Source: Fannie Mae (https://www.fanniemae.com/content/guide_form/1004.pdf)

Report (URAR), shown in Figure 3, the appraiser is asked to provide environmental information on a number of property- and area-related topics. The three mortgage agencies call for disclosure of this information in the Freddie Mac Single-Family Guide, the Fannie Mae Single-Family Selling Guide, and the HUD Valuation Analysis for Single-Family Dwellings and HUD FHA HOC Reference Guide.

The answer to the question on the form is typically one of the following responses: unknown, none apparent, or even, in some cases, N/A, even though the vast majority of this information is already publicly available on the Internet. The widespread lack of environmental information on these forms is simply not valid. Although only a small portion of homes are affected by any type of environmental condition, a recent study by Environmental Data Resources on 1,000 residential addresses nationwide revealed that 85% of properties had high-liability spill records within a half-mile radius. The benefits of assessing environmental contamination up front are many—but one of the most important is that, with accurate information in hand, buyers are able to make better decisions.

More information on how land contamination records play a role in the way property loans are transacted—and what it means for the lenders extending credit—is available from each of the following sources:³

- Uniform Standards of Professional Appraisal Practice (USPAP).
- Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).
- HUD Multifamily Standards.
- 24 CFR 200.926 (Appendix K).
- FDIC Guidelines for an Environmental Risk Program.
- Consumer Financial Protection Bureau (CFPB) Bulletin.
- OCC Environmental Risk Policy RE 213.
- International Valuation Guidance Note No. 7.

What has changed dramatically over the past 18 years is the ability to access this information and report on what is known about a property's potential for contamination. The Internet, mapping capabilities, and publicly accessible information have all played a significant role in this change, making information about a property's environmental profile easier to obtain than ever.

Consumer Protection and Informed Consent

In a post Dodd-Frank era, where information is just a few

mouse clicks away, environmental due diligence during the mortgage-lending process remains a policy of “don't ask, don't tell,” even though clear guidelines and regulations have existed since the early 1990s.

In mortgage lending, compliance, safety and soundness in lending operations, and consumer goodwill are all at stake when environmental risk goes undetected. With additional property intelligence to mitigate collateral risk, lenders can make more-informed lending decisions.

Although these requirements are largely associated with the appraisal process, it's not necessary that the information affect the value of the property. In cases where there is known contamination at or proximate to a property, the Uniform Standards of Professional Appraisal Practice (USPAP) recommend providing a true and accurate statement describing why the environmental contamination does not affect the value. The benefit to consumers is that the information is reported in a place that would be disclosed to them as part of the mortgage origination process.

Tightening Residential Mortgage Standards

In the residential mortgage community, the risk of liability stemming from undetected or unmitigated environmental dangers has not yet been fully embraced in an operational sense. It's handled on an exceptions basis, usually ending with the lender declining the loan application because of property ineligibility.

Given regulatory pressures to increase consumer protection, the use of environmental data early in the lending process is one way to mitigate the dangers by identifying any potential risk earlier in the process and mitigating the hazard as appropriate. Further, because of the marketplace shift to more residential properties being purchased by small investors, there is a new level of liability concern as these loans and properties have not traditionally been handled with the same rigor as standard commercial lending for multifamily residential properties, even though they are, in fact, “commercial operations.”

Additionally, the topic of environmental justice and the potential scrutiny of the Consumer Financial Protection Bureau⁴ are further drivers for environmental screening becoming part of the residential lending process. Currently, the CFPB, by way of the Dodd-Frank Act, has a mandate to issue rules governing real estate settlement-related functions that specifi-

cally include appraisals. Proactive risk mitigation is one of the hallmarks regulators look for when evaluating a financial institution's health, so efforts to tighten property-specific policies could help put a lender in good standing with regulators.

Technology Advancements

It's impossible to ignore the role of technology in property risk management. Advances in technology have made environmental assessments on all types of properties, including residential, easier than ever before. Admittedly, in the early 1990s, the costs and turnaround times of performing environmental reporting limited the use of environmental data in underwriting to only the largest commercial property transactions. Information on sites had to be gathered, mapped, and delivered, all of which cost hundreds of dollars and took days to complete.

In today's world, the Internet, cloud computing, e-mail, broadband, and high-speed wireless, along with many advances in database and mapping technologies, are providing a far different definition of what's possible and are changing the landscape for time and cost structures. For example, flood screening and detailed credit reporting can now be performed in less than a second at a cost of just dollars per transaction. Similarly, it's possible to conduct a quick environmental screening with the same parameters. As stated above, the definition of what constitutes reasonably ascertainable and "known" information has changed. Informed lenders are staying on top of these changes and revising their policies as the definition of "best practices" advances along with technology. These improvements ultimately will lead to better compliance with existing requirements.

An example of these requirements is the following statement from the Freddie Mac *Single-Family Seller/Service Guide*, Volume I, Section 44.15(i):

"The appraiser must consider any known contaminated sites or hazardous substances that affect the property or the neighborhood in which the property is located. The appraiser must also note the presence of contaminated sites or hazardous substances in the appraisal report, make appropriate adjustments to reflect any impact on market value, and comment on the effect they have on the marketability of the subject property:

Proximity of the property and/or its neighborhood to a contaminated site [and]

Proximity of the property to ground water contamination, chemical or petroleum spills, or other hazardous substances that are expected to impact the area for more than a year."

Specific Concerns for Residential Lenders

The concerns facing the residential lending community today fall into one of three broad areas: consumer health,

value diminution, and lender liability/risk. By looking at each of these, it's possible to explore the cause-and-effect dynamic hidden beneath the surface of status quo practices.

Consumer Health

Each year thousands of people have health-related issues connected to contaminated soil, air, or drinking water. The effects of this contamination can range from respiratory illness and external rashes to a variety of cancers from known carcinogens. Contaminants such as benzene (found in gasoline) or perchloroethylene (used in dry cleaning operations) are pervasive nationwide, along with hundreds of other contaminants used in manufacturing and business operations.

People may be exposed to health hazards when they breathe vapor intrusion in a home or steam in a shower; ingest contaminants directly (through drinking water) or indirectly (from eating vegetables); or have contact with contaminants on the skin or in a shower.

As mentioned above, contaminated soil and drinking water have long been considered risks to human health, but VI is a consumer health issue that has, to date, largely been overlooked. The simple but necessary act of breathing threatens constant exposure once a pathway has been established within a building.

Appliances, toys, vehicles, food, beauty aids, and other products are all subject to appropriate disclosure so that the consumer is well aware of the risk posed. Further, millions of dollars are spent annually investigating the risks and enforcing action against those who do not disclose as required. Homes are no different, especially those sold and backed by federally insured mortgages. Existing rules call for the identification of environmental hazards, and these hazards are expected to be mitigated before the borrower and lender enter into a mortgage agreement.

Best practices for performing risk screenings are evolving over time as awareness of environmental risk expands and technology allows for easier access to property risk information during loan transactions. For a better understanding, one needs look no further than the way in which flood risk has evolved over the past decade. Today, the growing awareness of VI risk, particularly in residential and multi-family properties, has elevated the importance of property due diligence and provides ample rationale for performing environmental risk screenings and disclosure.

Further, in February 2013, the EPA, HUD, and the White House Council on Environmental Quality announced a new initiative that encourages federal agencies to take preemptive actions that will help reduce the number of American homes with health and safety hazards.⁵ This action is a referendum on homes that cause health issues and, in turn, hold back the economy through lost days and increased medical costs. HUD Secretary Shaun Donovan announced the action, saying, "It is clear that unhealthy and unsafe

housing has an impact on the health of millions of people in the United States, which is why we must do everything we can to ensure that individuals and families have a healthy place to call home.”

Value Diminution

The appraisal community recognizes the drastic diminution in value that can occur when a property is environmentally contaminated or has a negative environmental stigma associated with it. When a property cannot be financed owing to an unmitigated environmental issue, the number of would-be buyers falls dramatically. When a case makes headlines (as Pompton Lakes did), the value diminution is even more intense. The reduced demand for damaged properties has a direct influence on market value.

In weak market conditions like those experienced since 2009, environmental impacts tend to be exacerbated. When property prices are depressed, the impact that an issue can have (expressed as a percentage of total value) is that much greater than during a period of higher property prices.

Lender Liability and Risk

There are numerous ways in which lenders are exposed to the risk of property contamination in residential lending practices. Although not all of them have historically been major concerns for lenders, they deserve renewed attention in today's era of increased disclosure and transparency. The potential risks of residential property contamination to a lender include the following:

- **Loan ineligibility or repurchase risk.** Lending practices are halted or hindered because the secondary market prohibits the sale of the loan or forces repurchase due to contamination.
- **Direct liability.** Issues arise from contaminated properties that the bank takes title to or sells (as part of REO dealings).⁶ The bank is, in fact, the gatekeeper, and consumers do rely on the bank to protect them.
- **Reputational risk.** Lenders are drawn into situations where homeowners are faced with contaminated soil, drinking water, or VI. Although the lender may not be directly liable for the exposure, it can certainly suffer reputational risk because of its inability or unwillingness to resolve the issue. Imagine the challenge if any one bank had been the primary lender to borrowers residing in the contaminated Pompton Lakes neighborhood.
- **Repayment risk.** Simply put, a borrower (or a family member) experiencing health issues can be at risk of nonpayment of the loan when confronted month after month with the hard choice of paying the mortgage on the contaminated family home or paying the doctors trying to nurse the borrower back to health.

Conclusion

The risky practice of overlooking land contamination infor-

mation as part of residential lending could well be on the cusp of change. In light of new enforcement initiatives and requirements, it's a good time for lenders to revisit how they address residential property contamination issues in their lending practices. Numerous environmental requirements in the appraisal process have existed for nearly two decades, but now new drivers on the VI and consumer-protection fronts are providing more pressure for enforcement. Further, technology advances have eliminated the once prohibitive cost and time constraints for performing such screenings up front.

The world of information disclosure is constantly evolving. What was impossible a decade ago is now a click away. Environmental land contamination information is both readily available and readily ascertainable in today's digital world. This effectively changes the definition of what is known at the time of a property transaction. It also has the potential to lower the public's exposure to public health risks and aligns with the EPA and HUD's reenergized focus on healthy homes.

Residential mortgage lenders would be well served to get ahead of this change and consider how they and their business partners can include environmental screening in their lending policies, improve their risk management practices, and reduce public exposure to contaminated soil, groundwater, and vapor. ❖



The authors are with Environmental Data Resources, where Jack Huntress is managing director, residential services, and James D. Haberlen is vice president, strategic client program. They can be reached at jhuntress@edrnet.com and jhaberlen@edrnet.com.

Notes

1. See "EPA Technical Documents and Tools Prepared to Support Guidance Development," U.S. Environmental Protection Agency. Available at <http://www.epa.gov/oswer/vaporintrusion/guidance.html/>.
2. See "Latest News for Environmental Consultants," Environmental Data Resources, Inc. Available at <http://www.edrnet.com/community/blogs/environmental-consultants/latest-news-for-environmental-consultants/2012/08>.
3. These sources are detailed in the Land Contamination and Residential Properties Summit Report. See <http://www.edrnet.com/community/blogs/environmental-consultants/latest-news-for-environmental-consultants/2012/08>.
4. See "Protecting Consumers from Irresponsible Mortgage Lending," Consumer Financial Protection Bureau, 2013. Available at <http://www.consumerfinance.gov/>.
5. For more on this new initiative, Advancing Healthy Housing: A Strategy for Action, see the press release "Federal Agencies Working to Make Homes Healthier," February 4, 2013. Available at <http://yosemite.epa.gov/opa/admpress.nsf/0/3e6188a2d58e2c0f85257b08004e66de>.
6. See "Bank Sues Contaminating Dry Cleaner's Owner," Oakpark.com, June 8, 2010. Available at <http://www.oakpark.com/News/Articles/6-8-2010/Bank-sues-contaminating-dry-cleaner-s-owner/>.