BNA, INC.

Environmental Due Diligence Guide

REPORT

An Insider's Perspective

'Tsunami of Information' From Increased Environmental, Energy Due Diligence

Changes in building codes, state regulations, and voluntary standards related to energy efficiency are requiring more rigorous environmental and energy due diligence that will result in a "tsunami of information," an environmental risk and association management director told BNA May 3.

According to Dean Jeffery Telego with the Alexandria, Va.-based Environmental Bankers Association and RTM Communications Inc., part of this data collection phenomenon is the result of the commercial real estate market collapse and the ensuing debt and credit crisis that continues to plague economic recovery. Previously, the industry relied too heavily on "commoditized" environmental due diligence for loan originations in the commercial mortgage-backed securities market. Lenders now are demanding increased diligence across the board, Telego said.

"It is also the market and regulatory drivers calling for energy efficiency that have brought on energy disclosure and labeling requirements by states and local governments and from industry practitioners who in February through ASTM passed an energy data collection standard [E2797-11] to capture energy use and cost information to assist in the benchmarking of energy efficient buildings," Telego said (20 EDDG 9, 2/17/11).

Refined Diligence Process

"The environmental risk market has refined its due diligence processes throughout the transaction or loan life cycle, especially in the pre- and post-foreclosure of distressed assets," Telego said. "At the same time, emerging energy labeling requirements for buildings are adding yet another layer of increased diligence."

The collapse of the commercial real estate market also has added to the already high number of brownfield properties and other environmentally distressed assets. "This is over and above the increase of surplus industrial properties that manifested as a result of a downturned economy," Telego said. Now, both property owners and lenders are looking at the green retrofit market as a way to bring back value to these distressed assets.

Considering these factors, Telego said, the gathering of energy efficiency information for both existing and new buildings has become an essential part of due diligence, he said. "You can call it sustainability, but I like to call environmental risk management and sustainability all good risk management."

As the market evolves to encompass energy efficiency data collection, Telego explained that the environmental professional, environmental engineer, and auditor disciplines are taking on a different look. It is critical that the parties conducting the inquiry are operating as a team in an integrated fashion "to ensure that both risk and opportunity are being captured from energy efficiency data collected," Telego emphasized.

Need to Raise the Bar for EPs

"There is currently a call in the marketplace for improvement in the qualifications/licensing of environmental professionals." Because due diligence practices rely so directly and heavily on the judgment of environmental professionals, it is critical to set minimum criteria in a way that will ensure best practices are being integrated into due diligence, particularly as energy efficiency data collection and benchmarking are becoming critical pieces of diligence practices. For example, property condition assessments (PCAs) now need to consider green building features. "What kind of energy consultant or engineer is best to be conducting the energy audit and collecting that data?"

Telego cautioned that in coming up with more rigorous requirements for environmental professionals conducting environmental and energy assessments, it is important not to exclude qualified individuals who may not have particular degrees or licenses. "The bar needs to be raised a bit but in a way that does not exclude the professionals who, based on their long-term experience, are able to do this."

The parties conducting PCAs need to look at energy efficiency in different ways. ''There needs to be a more integrated function that includes an appraiser and an environmental professional until each person gains the qualifications to conduct both environmental and energy assessments,'' Telego said.

Return on Investment

Why is this so critical? Telego notes that 75 percent of all building stock was built before 1989. He also notes the abundance of distressed assets in the market with $350 billion in loans due this year. ''Looking at the wealth of properties needing to be refinanced between now and 2014, we are addressing $1.3 trillion in commercial real estate that need to be refinanced or default and go into foreclosure. When we bring these properties back into the fold, we will be looking at energy efficiency retrofits to achieve increased net operating revenue and ROI.''

Telego believes the ASTM's standard on building energy performance (E2797-11) is key to this energy efficiency data collection process.

''If you have a borrower who has an energy efficient building, they are a better credit risk down the road due to the increased value of green buildings.'' In particular, Telego said the model green lease being rolled out in New York City is a perfect example of how green buildings will result in a better return on investment than traditional building stock (20 EDDG 25, 4/21/11). ''This movement of green leasing and sharing the benefits of energy efficiency with tenants is going to take off. This is only the tip of the iceberg of what we are going to see moving forward.''

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