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Do I Need a Phase I Environmental Site Assessment When Buying Commercial Property in Illinois?

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Real Estate

When buying commercial property in Chicago, or elsewhere in Illinois, many investors ask whether a Phase I Environmental Site Assessment (Phase I) is required. Often times, yes, a Phase I is required.

A Phase I is not required to purchase a commercial property. However, it is required by most commercial lenders and is often recommended to help limit buyer liability via the “innocent landowner” or “bona fide prospective purchaser” defenses commonly present in state and federal environmental laws.

What Is a Phase I Environmental Site Assessment?

A Phase I Environmental Site Assessment (Phase I) is a report that evaluates whether a commercial property may be contaminated by hazardous substances, based on a records review, a site inspection, and interviews. Most Phase I reports follow the industry standard ASTM E1527-21, which is designed to satisfy (or help satisfy) federal and state defenses.

These defenses are important because environmental risk is one of the few issues that can exceed the property’s purchase price and follow the buyer after closing. Environmental liability from hazardous substances can:

- Attach to current owners, regardless of fault
- Pierce entity structures
- Trigger six- or seven-figure cleanup obligations

What Is the Innocent Landowner Defense?

The innocent landowner defense (and related protections like the “bona fide prospective purchaser” defense) protect a buyer from environmental cleanup liability if contamination existed before purchase and the buyer did not know (and had no reason to know) about it at closing. The exact requirements vary but generally are centered around doing the right due diligence before closing, and a Phase I is usually the starting point.

Can I Use My Lender’s Report?

Many new buyers mistakenly believe that reviewing their lender’s report is sufficient. While it is often possible to share a report with your lender, each Phase I environmental report is specifically certified to a party. Without a certification, a report loses most of its value. Some lenders will add a buyer to their report. Some lenders are willing to be added to a buyer’s report. Some lenders refuse to share the reports altogether. If the report provider does not certify that the buyer may rely on the report, a buyer can lose out on an innocent landowner defense.

Can a Phase I Kill a Deal?

A Phase I will rarely kill a deal, but it can change the deal in big ways. If issues are found, a buyer may look to:

- terminate during due diligence,
- renegotiate price or terms,
- require seller remediation, or
- proceed with a Phase II investigation.

Early discovery protects buyers from post-closing surprises.

Skipping a Phase I can expose Illinois buyers to cleanup liability under federal and state environmental laws even if they did not cause the contamination. Environmental liability can be difficult to contain through entity structuring, and cleanup costs can exceed the purchase price (especially if contamination affects redevelopment or triggers regulatory involvement). For many small and mid-market investors, a Phase I is the most practical way to:

- identify red flags early,
- preserve legal defenses,
- protect financing options, and
- avoid inheriting open-ended risk.

FAQ:

- **How do I incorporate a Phase I into my next commercial real estate purchase?** Budget for a Phase I Environmental Site Assessment in your next purchase. A Gould & Ratner real estate attorney can assist you with locating a provider that meets your timing and budget.
- **How do I coordinate a Phase I with my lender?** Communicate with your lender early. Ask if your lender is comfortable using your report. If your lender wants to use their own report, ask them to be added as a reliance party to their report.
- **What is the difference between a Phase I and Phase II?** A Phase I is non-invasive (records, visual inspection, interviews). A Phase II includes invasive sampling/testing to confirm whether contamination exists and to evaluate scope and risk.

Aaron Whyte is a Chicago multifamily real estate attorney focused on helping first-time and growing investors buy apartment buildings and small-to-mid-size multifamily assets across the City of Chicago and Cook County. He advises buyers on purchase agreements, due diligence, leasing risk, title/survey, zoning and closing execution to help deals close smoothly and avoid post-closing surprises. Contact Aaron at awhyte@gouldratner.com.