

ATTACHMENT B

FEDERAL PROGRAMS

1. Federal Assistance Programs

The 1989 Catalog of Federal Domestic Assistance lists over 850 financial assistance programs, over 200 non-financial assistance programs, and about 50 combined assistance programs. These programs do not include federal tax credits or federal tax deductions. From the information in the Catalog, and without examining each program's regulations, it is not possible to identify how many of these programs include direct or indirect assistance related to building construction, repair, maintenance, and use. However, the 1989 Catalog lists programs by functional area, with the following being noteworthy in relation to buildings:

Housing/Construction and Rehabilitation	-	44 programs
Community Development/Construction, Renewal, and Operations	-	45 programs
Community Development/Historic Preservation	-	20 programs
Education/Educational Facilities	-	20 programs
Employment, Labor, and Training/Facilities Planning, Construction, and Equipment	-	10 programs
Energy/Facilities and Equipment	-	6 programs
Health/Facility Loans and Insurance/Facility Planning and Construction	-	36 programs
Regional Development/Land Acquisition and Rehabilitation and Facilities Construction	-	6 programs
Disaster Prevention and Relief/Emergency Preparedness, Civil Defense	-	23 programs

There is duplication in these functional listings, and some of the programs listed may not actually assist facilities.

It is assumed that each federal assistance program:

- o was created in response to a functionally articulated problem;
- o enjoyed sufficient political support to bring it into being; and
- o is implemented through a particular set of statutes and regulations.

2. Some Federal Incentive Programs Related to Existing Buildings

2.1 Housing

Housing incentive programs are among the oldest and most entrenched federal assistance programs. Not even listed as federal domestic assistance, the tax deductibility of interest on mortgages and more recently home equity loans is an incentive serving a long-standing policy of encouraging home ownership, which is

assumed to bring with it social stability, environmental maintenance, and other broad benefits. Federal mortgage guarantees can be viewed in a similar light.

A more recent federal incentive program for housing is the low income housing tax credit program which under current law is to expire at the end of 1990. Under this program, investors in qualified low income housing projects receive tax credits. To qualify, a housing project must include 40% of tenants at 60% of the median income, or 10% at 40% of the median income. The project must be kept in this usage for at least 15 years. Substantial rehabilitation, defined as the investment of at least \$3,000 per unit, can also qualify. The credit amounts to 9% of the basis for new construction and 4% for rehabilitation. Affordable housing advocates have viewed this program as a major incentive.

As the building stock has gotten older and cities and neighborhoods have become dilapidated, government policies have evolved which emphasize building maintenance, repair, and rehabilitation, and neighborhood improvement, frequently combined with the long-standing policy of encouraging home ownership. Incentive programs have been developed by the Department of Housing and Urban Development to achieve these policies. In general, there are externalities to building rehabilitation which exceed those benefits which accrue to the private owner. Since these externalities are shared by the community at large, the financial assistance is the mechanism for assuring that they are paid for by the beneficiaries.

A current program, which reflects a policy of increasing the supply of affordable rented housing, is the Rental Rehabilitation program. Here, federal funds are granted to State and local governments to be used in locally developed programs. It is described in the Catalog of Federal Domestic Assistance as follows:

OBJECTIVES: *To increase the supply of standard rental housing units affordable to lower income families. This is achieved by (1) supplying government funds to States and units of local governments to support the rehabilitation of existing residential rental units, and (2) providing rental housing assistance to lower income families to enable them to afford the rents of units in projects assisted with program funds or find alternative housing.*

TYPES OF ASSISTANCE: *Formula Grants*

USES AND USE RESTRICTIONS: *For use by eligible grantees for rehabilitation of privately owned, primarily residential rental property, to be made available to lower income tenants. Rehabilitation subsidy for each project generally limited to a range from \$5,000 to \$8,500 per unit depending upon number of bedrooms, or 50 percent of rehabilitation costs, whichever is less. The maximum per unit subsidy remains at \$5000 for a zero bedroom unit, but has been increased to \$6500 for a one bedroom unit, \$7500 for a two bedroom unit and \$8500 for a three or more bedroom unit by the Housing and Community Development Act of 1987 (Public Law 100-242).*

Rental Rehabilitation grants have dropped from about \$206 million in FY88 to \$150 million estimated for FY90.

A recent program which has been evidently terminated is the Section 312 Rehabilitation Loans program. Here, federal funds are loaned to property owners at below market interest to encourage rehabilitation. It is described in the Catalog of Federal Domestic Assistance as follows:

OBJECTIVES: *To promote the revitalization of neighborhoods providing funds for rehabilitation of residential, non-residential and mixed use property in areas determined to be eligible by local governments for activities under either the Community Development Block Grant, Urban Development Action Grant, or Section 810 Urban Homesteading areas.*

TYPES OF ASSISTANCE: *Direct Loans.*

USES AND USE RESTRICTIONS: *These loans may be used to finance the rehabilitation of property located in federally assisted Community Development Block Grant (CDBG) areas, Urban Development Action Grant (UDAG) Areas and Section 810 Urban Homesteading areas. Properties, at a minimum, must be brought up to local code standards. Loans are made at three percent to persons at or below 80 percent of the area median income who live in the single family (1-4 units) property to be rehabilitated, and for higher income persons, the interest rate will be equal to the market yield on outstanding marketable securities of the United States with comparable terms. For all other types of property the rate is also equal to the yield on these marketable securities. The program is administered by the local government or its designee.*

The linkages of Section 312 to CDBG, UDAG, and Section 810 are designed to assure that the various interrelated policy objectives are met. Section 312 loans dropped from over \$100 million in FY88 to about \$20 million in FY89, and estimated at 0 in FY90.

2.2 Energy Conservation

Following the energy crisis of the 1970s, a government policy of energy conservation was enunciated. Various incentive programs were developed. One encountered in the course of this study consisted of federal grants to hospitals for use in retrofitting buildings for energy conservation. The institutions were required to invest at least 50% of the cost from their own funds. The institutions' motivation to do so was that their investment was paid back over a period of 5-10 years in energy cost savings, with the payback starting with the completion of the work. (Note that no such payback can currently be realized for seismic strengthening.) At the same time, the government's goal of conserving a scarce resource was being achieved. The program is no longer in effect. (Several persons active in hospital facility management have indicated that today hospitals would look for a 3-year payback to make similar investments. This may be explained as higher discounting of future benefits due to the rapid rate of change in medical technology.)

2.3 Historic Preservation

Historic preservation developed as a national policy and was enacted by Congress in 1966 (National Historic Preservation Act). Federal policy in this area is guided by the Advisory Council on Historic Preservation, and it enjoys a reasonably broad base of local and national support, which at the national level is channelled through, and articulated by, the National Trust for Historic Preservation.

Federal incentives for historic preservation were created by the Tax Reform Act of 1976, which initiated various incentives for rehabilitation including tax credit. The highest credits (25%) were given to certified rehabilitation of historic structures. Owners' costs of rehabilitating historic buildings qualify for the credit when the

rehabilitation work conforms with the Secretary of the Interior's Standards for Rehabilitation and Guidelines for Rehabilitating Historic Buildings.

The Economic Recovery Act of 1981 enhanced this program. Between 1981 and 1984 approximately 3,200 rehabilitation projects valued at over \$2 billion were approved for the credit. Underlying this policy, and supporting the expenditure of public funds (in the form of foregone tax payments) is that local communities ultimately will realize a benefit in the form of growth of economic base, tax base, and improved neighborhoods. This in turn assumes that there is a potential public demand for space in historic buildings.

There is some reason to believe that the latter benefits may not be universal and may be subject to local market differences. At least two communities studied under this project, Charleston, SC and Lowell, MA, are prime examples of communities which have thrived economically in the past 10 years. Their relative prosperity and development is attributable, at least in part, to the historic preservation tax credit. However, in at least one community, Kansas City, MO, some observers have stated that the credit led to distortions in the downtown real estate market. Many historic buildings were rehabilitated with the benefit of the credit and now continue to experience the highest vacancy rates in Kansas City, when adjacent new buildings are nearly fully occupied.

The impact of the historic preservation tax credit on historic rehabilitation has been weakened significantly by the Tax Reform Act of 1986. The income tax rate has been reduced, making all investments aimed at reducing tax liability less attractive. The credit itself was reduced to 20%. Depreciation periods were increased. Capital gains tax was effectively increased, and eligibility for use of the credit has been effectively limited.

A report of the National Trust for Historic Preservation, Tax Incentives for Rehabilitating Historic Buildings, Fiscal Year 1987 Analysis, concludes that the effect of the 1986 act has been to "reduce both the benefits of investment and the pool of those who can take advantage of those benefits."

2.4 Other Assistance Programs

Federal programs created in pursuance of policies such as economic development, business development, or job creation may have a direct or indirect impact on buildings, because most economic activities take place in buildings. Some examples of this are Small Business Administration (SBA) loans and guarantees.

The major federal community and economic development program is the Community Development Block Grant (CDBG) program. CDBG has three national, legislatively established objectives:

- o benefitting low and moderate income persons,
- o preventing or eliminating slums and blight, and
- o meeting urgent community development needs.

There are three CDBG programs:

- o CDBG Entitlement Program, whose grantees are all central cities of metropolitan areas, all other cities with populations of 50,000 or more, and urban counties.

- o State CDBG, whose grantees are 48 States and Puerto Rico, with funds used for the non-entitled areas.
- o HUD-Administered Small Cities Program, whose grantees are the non-entitled areas of the other two States.

Grantees use the funds to accomplish a broad range of activities which meet one or more of the three objectives.

In FY 1981 the CDBG Entitlement Program amounted to about \$2.7 billion. In 1982 it dropped to about \$2.4 billion where it remained through 1985. In 1986 it dropped to \$2.053 billion, and in 1988 to \$1.973 billion. In 1989 it was back up to slightly over \$2 billion. Estimated for 1990 is \$1.915 billion. In 1988 the funds were planned to be spent as follows:

Housing related:	36%
Public facilities and improvements:	19%
Economic development:	13%
Administration and planning:	13%
Public services:	10%
Acquisition and clearance:	5%
Other:	4%

The State CDBG and HUD-Administered Small Cities programs have had the following recent funding history:

1981:	\$926 million
1982-84:	\$1,020 million (each year)
1985:	\$1,023 million
1986:	\$880 million
1987:	\$883 million
1988:	\$845 million
1989:	\$880 million (estimated)
1990:	\$821 million (estimated)

In 1988 the funds were planned by the States to be spent as follows:

Public facilities:	48%
Housing:	36%
Economic development:	14%
Other:	2%

ATTACHMENT C

Thrift Bulletin

Handbook: Thrift Activities
Subjects: Lending Risk Assessment

Section: 210
TB 16

February 6, 1989

Environmental Risk and Liability

Summary: This Bulletin addresses the potential risks and liabilities that thrift institutions can incur as a result of adverse environmental factors. It also contains guidelines for the development of policies of reasonable due diligence to protect institutions against financial risks created by such factors.

For Further Information Contact.

The FHLBank District in which you are located or the Policy Analysis Division of the Office of Regulatory Activities, Washington, DC.

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Introduction

Environmentally related hazards can be a source of high risk and potential liability to an insured institution or service corporation in connection with its mortgage or commercial loans and real estate investments. Potential environmental problems may exist in a myriad of forms such as asbestos insulation, underground storage tanks, surface impoundments, septic tank systems or oil and gas wells.

Thrift problems with pollution and hazardous waste contamination have grown as Federal, state and local governments have passed comprehensive environmental regulations and laws imposing liabilities on landowners and others for cleaning up the environment. Thrifts must be aware of and concerned with regulations that impose clean-up liability on an absolute or strict liability basis, particularly when governments have the right to assign liability to persons or entities no longer holding title to the property.

Potential Risks And Liabilities To Institutions

There are at least eight basic categories of risk that an association can face as a result of environmentally contaminated property. These include:

1. The risk that the collateral for a real estate loan or property to be acquired may be drastically reduced in value after discovery of the existence of hazardous waste contamination.
2. The risk that the borrower cannot repay the loan if the borrower must also pay for the cost of cleaning up the contaminated property. The cost for cleanup in many cases can be significant and may exceed the institution's encumbrance on the property.
3. The risk that a mortgage loan may lose priority to a cleanup lien imposed under the laws of those states that require super priority liens for the cost of clean-up. In each of these super lien states, a lien granted to the state securing the cost of cleaning up hazardous waste contamination may have priority over a lender's mortgage.
4. The risk that a lender may be liable to the extent of any credit extended to any debtor who has operated property containing hazardous wastes, has generated such waste, or has transported it in an improper manner. This risk extends to all creditors, not just those who hold as collateral the property containing the hazardous waste.
5. The risk that the thrift may become directly liable for the cost of cleaning up a site if it forecloses on a contaminated property or becomes involved in the management of a company that owns or operates a contaminated facility, or is involved in decisions pertaining to the disposal of toxic or hazardous waste.
6. The risk that a lender may not be able to pursue its foreclosure remedies and may have no practical alternative but to give up its loan security, and the right to recover on the loan itself. This could lead to charging off the loan balance.
7. The risk that the borrower does not maintain collateral or property with an environmental risk potential in an environmentally sound manner.
8. The risk that, aside from the statutory liabilities that can be imposed for toxic waste contamination, there is also potential liability for personal injury or property damage.

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To address these potential risks and liabilities, thrifts should develop internal underwriting and risk management procedures and revise their mortgages, guarantees, indemnities, contracts, and other loan documents to protect themselves against potential environmental hazards and to maintain the value of their loans and real estate investments.

Purpose Of Environmental Risk Policy

The most expeditious means by which a thrift institution may commence protective action against potential environmental risks and liabilities is to develop and implement a written environmental risk policy. Such a policy will serve several critical purposes. It will:

1. establish a level of due diligence in all real estate transactions;
2. establish a means of identifying excessive environmental risk in properties being considered as collateral or for acquisition, or in properties being analyzed prior to foreclosure, or to meet standards set by buyers in the secondary market;
3. minimize environmental contamination of the borrower's property through the life of the loan by alerting institution staff to a potential problem property and providing for collateral monitoring and periodic property inspections throughout the loan term.
4. establish guidelines for a satisfactory inquiry into the uses of property and for other protective actions as needed to qualify for the "innocent landowner"¹ defense in the event that it acquires, through foreclosure or otherwise, a contaminated property that it could not have reasonably known to be contaminated; and

5. support the institution's adherence to the principles of safety and soundness.

Environmental Risk Policy Components

The following are essential components in an institution's environmental risk policy:

1. A stated assessment of potential environmental problems and liabilities. (i.e., an acknowledgment of the risks cited under "Potential Risks and Liabilities to Institutions" (pgs. 1 & 2)) and a declaration that a policy of due diligence is adopted to protect the institution from such risks.
2. A requirement that loan applicants provide information on environmental matters pertaining to their business and facilities. Institutions should develop a form covering specific questions to which applicants respond. The questions should request information concerning past, present or proposed uses of the proposed collateral, potential hazards, insurance availability for the property as it pertains to environmental matters, and contacts by any Federal, state or local government agencies concerning environmental matters that must be resolved in order to obtain business and environmental permits.
3. A requirement that an acquiring institution, in a purchase or participation loan, ensure that adequate due diligence regarding environmental risk matters has been met by the lead lender and a requirement that all loans sold to Freddie Mac or Fannie Mae meet with the environmental due diligence standards imposed by those agencies.
4. A requirement that all loan requests, in which the proposed

real property collateral has a higher environmental risk potential than other types of real property, have a Phase I Environmental Risk Report (See Appendix) prepared for the institution prior to approval of the loan.

Most one-to-four family residential properties will not need a Phase I Environmental Risk Report. If cursory property inspections or records research, however, disclose a high potential for environmental risk, then Phase I reports are likely necessary.

Examples of properties that should have a Phase I Environmental Risk Report include:

- a. Proposed construction properties (other than a proposed individual one-to-four family residential property).
- b. Industrial properties and properties on industrially zoned land.
- c. Properties located close to industrial areas.
- d. Properties that include or are close to an existing or former gas station site.
- e. Commercial properties that include an automotive repair facility or a dry cleaning establishment where the work is done on the premises.
- f. Properties adjacent to railroad tracks or underground pipelines (excluding one-to-four family residential properties).

¹ an exemption from liability for an innocent landowner who acquires property unaware of the presence of hazardous material. The landowner must not have conducted, permitted or contributed to the release of hazardous substances and must have had, after appropriate inquiry, no knowledge of the pollution at the time the property was acquired.

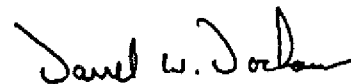
- g. Properties that have served as or are close to a refuse or waste disposal site.
 - h. Properties where the past uses or the surrounding uses include the storage of or usage of hazardous or toxic substances (e.g., pesticides).
 - i. Properties suspected of containing asbestos material that is or may be friable (easily crumbled or crushed into powder and capable of being absorbed into the environment).
 - j. Properties where the emanation of radon gas from the soil may result in detrimental health effects to building occupants. (Institutions may need to consult with qualified environmental firms regarding the seriousness of radon problems in specific areas.)
 - k. Residential properties where there are known hazardous conditions on or in the property's immediate vicinity: where Superfund sites² exist within a one mile radius; where the site is in close proximity to oil and gas production; where there is asbestos within the building structure; where the site is a corner lot property (and is known to have been previously used as a gas station locale); or where the historic use of the property prior to its residential zoning is cause for concern.
5. The designation by the institution's board of directors or senior management of one or more qualified staff persons as the association's "designated environmental risk analyst(s)". These staff members should receive special training through courses or seminars in reviewing and interpreting environmental risk reports for the institution, and should assist in the development of the institution's environmental risk policy.
 6. Criteria for the selection and retention of a roster of qualified environmental experts retained for risk analysis reports. The association should confirm that the organization or individual has appropriate education, training and experience. The consultant should not be affiliated with the buyer or seller of the property nor with a firm engaged in any business that might present a conflict of interest.
 7. A requirement that it will be the loan officer's responsibility (after consultation with the designated environmental risk analyst) to order the Phase I Environmental Risk Report on the subject property as needed. Guidelines regarding environmental risk reports follow:
 - a. The association must be the client on the environmental risk report. This provision will maximize the likelihood that the institution will receive an objective report that discloses all of the pertinent facts.
 - b. The institution should only use environmental risk auditors from its approved roster.
 - c. The loan officer, with assistance from the institution's designated environmental risk analyst, should have the responsibility to review the outside environmental audit reports and judge the conclusions of the report after consulting with any environmental risk resources considered necessary. Final acceptance of environmental risk reports and decisions concerning the information in the report should be made by the institution's senior management.
 8. A requirement that appraisal reports fully disclose the findings and take into consideration any environmental risk factors and related costs identified in environmental risk reports.
 9. A requirement that any potential environmental problems noted in an environmental risk report be considered by the institution's required approval authority and senior management before the loan is approved or the property is purchased.
 10. Criteria for determining the circumstances in which loan requests may be declined due to environmental factors. Some reasons for declining loans based on environmental factors are:
 - a. The structure is built over a sanitary landfill or other solid, hazardous or municipal waste disposal site.
 - b. There are materials containing friable asbestos or substantial amounts of non-friable asbestos that cannot be safely encapsulated or removed or will not be routinely inspected and maintained by the borrower.
 - c. There is evidence of spills or soil or groundwater contamination on or around the loan applicant's properties.

² Sites identified by the Environmental Protection Agency (EPA) from which hazardous substance releases occurred or from which releases could occur (e.g., abandoned hazardous waste dumps and chemical spills). The EPA is authorized to undertake removal or remedial actions at such sites.

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- d. There is documented soil or groundwater contamination on the subject property and:
 - i. physical constraints posed by the site specific geology, geohydrology or subsurface structure render corrective actions technically impossible; or
 - ii. constraints render treatment processes or disposal options prohibitively expensive, i.e., beyond the financial capabilities of the current owner; or
 - iii. environmental hazards or potential hazards exceed the value of the land or the requested loan amount; or
 - iv. potentially responsible parties are unwilling or financially incapable of instituting corrective actions on neighboring properties.
 - e. There is laboratory analysis of soil and groundwater samples that indicates they exceed action levels established by government agencies.
 - f. There is polychlorinated biphenyls (PCB) contamination where:
 - i. physical constraints posed by the site specific geology, geohydrology or subsurface structure render corrective actions technically impossible; or
 - ii. constraints render treatment processes or disposal options prohibitively expensive (i.e., beyond the financial capabilities of the current owner).
 - g. There are radon levels above acceptable standards that can only be corrected through large capital improvements or extensive ongoing maintenance programs that are beyond the financial or technical capability of the borrower.
 - h. There are conditions that represent violations of applicable local, state or Federal environmental or public health statutes and laws.
 - i. The properties are currently the subject of environmental or public health litigation or administrative action from private parties or public officials.
11. Procedures for reviewing collateral before completion of foreclosure procedures or acceptance of a deed in lieu of foreclosure. The procedures may include, but should not be limited to:
- a. A review of the existing loan file (including site inspection, leases, reports and completion of an environmental checklist).
 - b. A review of the loan documents and any subsequent modifications.
 - c. A determination as to whether any guarantees or indemnities were obtained on the loan.
 - d. A determination as to whether the borrower has any environmental impairment insurance or other applicable insurance that could be utilized for an environmental hazard claim.
 - e. A review of the current tenants and real property uses.
 - f. Procurement of a Phase I Environmental Risk Report if conditions suggest it is necessary.
12. An acknowledgement of the importance of coordination and cooperation among the institution's loan origination department, its loan servicing department, its designated environmental risk analyst, its legal counsel, and its appraisers, to carry out the environmental risk policy and to enlist the help of environmental specialists and applicable government agencies in this endeavor.



— Carrel W. Dochow, Executive Director

The following is a brief description of the various types of environmental risk reports that institutions may need to employ.

1. A Phase I Environmental Risk Report is a qualitative assessment of the property. A typical Phase I Report includes, but is not limited to:

- a. A historical review of the use and improvements made to the subject site.
- b. A review of building, zoning, planning, sewer, water, fire, environmental and other department records that would have information on or have an interest in the property and neighboring sites.
- c. A review of the Department of Health Services, Solid Waste Management Board, Regional Water Quality Control Board, Air Quality Management District, and other Boards or Agencies records and files whose actions may affect the subject property and neighboring properties.
- d. An investigation of the subject property and neighboring properties with regard to the Environmental Protection Agency's National Priority List or Comprehensive Environmental Response Compensation and Liability Information System (CERCLIS) list and similar state lists.
- e. An inspection of the site and all improvements with particular attention to the use of hazardous materials in the structures or operating equipment.
- f. A verification as to whether present or past owners or tenants have stored, created or discharged hazardous materials or waste, and review of whether appropriate procedures, safeguards, permits and notices are in place.
- g. An analysis of old aerial photographs to determine the construction or destruction of buildings and the existence of ponds and disposal areas on the property over time.
- h. Interviews with neighbors to determine prior uses of the subject property (if appropriate and only if deemed acceptable by the parties involved in the transaction). Confidentiality must be recognized.
- i. A review of building records and a visual inspection of the building(s) to determine if asbestos-containing building materials may be present.
- j. A review of scientific literature to determine the potential existence of radon in the soil.
- k. A written report summarizing the findings.

2. Phase II Environmental Risk Report

A Phase II Report is performed if "red flags" are apparent to the lender or if they are disclosed during the Phase I investigation. This report consists of all Phase I activities plus combinations of the following field tests and activities.

- a. Testing of underground storage tanks for content and integrity.
- b. Soil gas analysis to identify the potential for petroleum hydrocarbons and volatile organic compounds such as industrial solvents and dry cleaning chemicals.
- c. Bulk soil sampling.
- d. Groundwater sampling if groundwater may be impacted by land activities.
- e. Limited surface water sampling if there is a pond, lagoon or stream on the property.
- f. A comprehensive review of the regional and local geology to determine the pathways leaked chemicals would follow in the event of a spill or leak.
- g. A list of individual groundwater wells or subsurface water bodies that may be affected by a spill or leak.
- h. A comprehensive inspection of the building for asbestos-containing building materials. This should include collecting and analyzing samples of the building material for friable asbestos. It is strongly recommended that inspections be performed by EPA-certified inspectors and analyses be completed according to EPA guidelines.
- i. If no listed hazardous materials or waste are found, an appropriate verification should be provided.
- j. A written report summarizing the finding.

3. Phase III Environmental Risk Report

A Phase III Environmental Risk Report is much more detailed and consists of all of the Phase I and Phase II activities in addition to involved soils, water and air quality analyses. As in a Phase I and Phase II Report, a Phase III Report also includes a written report summarizing the findings of the investigation.

Based upon the Phase I, Phase II or Phase III report results, subsequent steps regarding further assessment, corrective action or preventative programs should be submitted. This should include gross cost estimates for correcting any discovered contamination

Institutions should not hesitate to contact environmental firms and question the principal investigator for the project regarding observations, conclusions and recommendations made in the environmental assessment reports.