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Brownfields: An Entrepreneur's Perspective

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I. INTRODUCTION

With some 400,000 sites nationwide, brownfields remediation and redevelopment is one of today's hottest environmental and real estate topics. It is hard to pick up the daily newspaper or mail without seeing an article, a newly proposed piece of legislation, a conference brochure or an advertisement about some aspect of brownfields activity. Indeed, in the February 1997 issue of this newsletter, a detailed summary is given of New York's brownfields efforts in an article entitled, "The Department of Environmental Conservation's Voluntary Remedial Program." To complement that earlier piece, this article provides a brief background on the evolution of brownfields remediation and development, the track record to date of the brownfields business and finally, a few words of caution about brownfields legislation and regulation.

First, some brief background. Brownfields, or environmentally impaired properties, are not new. Environmental engineers, consultants and lawyers have been struggling with them since the early days of the federal Superfund program. Real estate brokers and lenders have been buying and (mostly) selling them, and entrepreneurs and others with high risk thresholds have been quietly investing in, remediating and redeveloping them for years. So, why has everyone else suddenly gotten so interested in them?

There are several reasons.

1. As the federal Superfund program and state hazardous waste cleanup programs have matured, there has been a collective realization that there is not enough money today, nor will there be in the foreseeable future, for government to remediate all of the environmentally impaired sites across the country. In addition, litigation of and by potentially responsible parties has proven

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Ian S. Tattenbaum, "Renewal for the 1990s: An Analysis of New York City Redevelopment Programs in Light of Title I of the United States Housing Act of 1949," 6 *N.Y.U. Envtl. L.J.* 220 (1997).

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to be costly and time consuming, with little to show as final results for clean-up of properties.

2. In response to this realization, governments at the state and federal levels have put in place a number of incentives to lure the private sector into the brownfields arena. Use-based cleanup standards, no further action letters, covenants not to sue, prospective purchaser agreements, comfort letters, voluntary cleanup programs, tax subsidies, low interest loans and outright grants have all been developed and employed in a barrage of efforts to attract players to the brownfields game.

3. There has been an inefficiency in the real estate market with respect to environmentally impaired sites. Liable and anxious sellers, few buyers and risk adverse lenders and insurers have led to financial yields ranging from the high teens to the mid-thirties and higher. In the most advantageous situations, buyers have been able to purchase sites for steep discounts, remediate for lesser amounts than originally anticipated and sell to third parties for near-market values, resulting in returns far in excess of traditional real estate transactions.

4. Money is everywhere. Wall Street firms, real estate investment trusts, pension and investment funds and wealthy individuals, to name but a few, are flush with money to invest as a result of the extended bull market.

5. Urban renewal is back in the news. Examples abound of cities and older industrial and commercial centers being restored, renovated, overhauled, razed and rebuilt. To slow suburban sprawl and save green space, abandoned and derelict properties are being brought back to productive use.

6. Communities have become increasingly adept at attracting jobs. Community leaders seize on brownfields opportunities both to capitalize on available government grants and loans for site investigation and remediation, and to lure businesses with the prospect of land, facilities, or both at lower-than-market prices. Together with tax breaks, special utility rate packages and other economic development programs, these incentives have begun to entice businesses to look seriously at brownfields as they relocate or expand their operations.

7. Potential buyers and their advisors have become more sophisticated about environmental risk. We are approaching the 20th anniversary of the federal Superfund and state hazardous waste cleanup programs. With the collective experience of agencies, environmental engineers and consultants, lawyers and owners gained through the bruising cleanup battles of the 1980s and early 1990s, there is now a great deal that is known (and to a degree, predictable) about a wide range of contamination scenarios. With this knowledge in hand, remediation costs are more accurately calculated, extensive cleanup surprises are smaller in scope and hence, risk is more willingly taken by buyers.

8. Insurance is once again available, and, increasingly, of real substance. Policies can be purchased that provide protection against remediation cost overruns (so-called cost cap coverage), changes in law and regulation (which might require additional cleanup after the original remediation has been completed), discovery of contamination previously unknown to the buyer, new pollution incidents, business interruption due to environmental incidents, and government and third-party lawsuits. Terms are typically five or ten years, with some being as long as fifteen years, with coverage limits as high as $100 million in the aggregate. The long drought following the pollution exclusion provisions introduced into policies in the mid-1980s is at an end.

9. State and federal environmental agencies have become more flexible in their interpretation of laws and regulations, and less adversarial in their dealings with owners, particularly those who have no responsibility for site contamination. In the early years of hazardous waste cleanup programs, virtually no flexibility was permitted in the regulatory review and oversight of remediation activities. If such flexibility were shown, or if any differences were demonstrated in the treatment of responsible parties because of varying site conditions, regulators were faced with the prospect of having to defend their actions before contentious legislative and Congressional hearings. With the realization and program responses discussed respectively in items 1 and 2, above, a changed attitude and approach is being taken by elected and regulatory officials.

10. Securities and Exchange Commission disclosure requirements and bank reserve requirements are forcing publicly owned companies to be more forthcoming about environmental problems and, importantly, to account for them on financial statements. Such requirements are resulting in a more concerted effort by officials in these companies to clean up and dispose of their environmentally impaired properties in order to get them off the books, to free up monies for more productive use and, importantly, to guard against, or

repair, poor images associated with being publicly portrayed as insensitive to the environment.

11. Outsourcing is in vogue throughout corporate America. Along with virtually every other aspect or corporate operations, real estate functions are increasingly being managed by third party firms. More and more, firms include in-house or associated environmental investigation and remediation capabilities.

Together, these factors have resulted in the establishment of a number of stand-alone firms, as well as several subsidiaries of real estate and environmental and engineering consulting firms, devoted solely to buying, remediating and redeveloping or selling brownfields. While too early to determine whether or not this is a new industry in its infancy or just a passing fad, there are a number of key components that have emerged as necessary to the success of such efforts.

II. COMPONENTS OF SUCCESS

First and foremost is location, location, location. Obvious though it may seem, it is important to remember that these are real estate plays. Thus, successful purchasers of environmentally impaired real estate must have internal or networked expertise in real estate investment and acquisition.

A close second is environmental expertise. Once it is determined that the property in question has good real estate value when clean, it is necessary to understand the nature and extent of the environmental problems at the site. This capability is crucial not only from a technical point of view, but also from a regulatory standpoint. It is one thing to know everything about the environmental issues at a site, it is quite another to be able to secure the necessary governmental permits and approvals to clean up the site and to link them to a redevelopment plan.

The third component of success is risk management/insurance capability. If the environmental issues can be defined and quantified, and a cleanup plan developed with an upper bound on costs, then insurance can be secured witch caps those costs. This is known as Remediation Stop Loss insurance. In addition, Environmental Asset Liability (EAL) insurance can be obtained which protects buyers and sellers from, for example, the costs associated with the discovery of new or unknown contamination, changes in law or regulation and third party liability claims. Knowledge is power, and once a property has been characterized properly, environmental risk becomes no different than any other type of execution risk (e.g., zoning, entitlements and parcelization).

The fourth component is the area of planning/redevelopment. What is the highest and best use for the site? While this is tied closely to real estate expertise, it goes beyond it to the formulation of a conceptual plan for the new use, and most importantly, to the ability to tie together remediation and redevelopment activities on the site. To the degree that the two can be linked, there is good potential for cost savings on the remediation side of the ledger. For example, instead of capping an area of contamination with large quantities of clay and topsoil which must be purchased and transported to the site, the asphalt of a parking lot or the concrete slab of a building foundation may be appropriate substitutes, thereby transferring remediation costs to development costs.

Fifth, community relations can make or break a deal. Despite what may have been years of degradation and neglect, site planning and implementation are most often of deep-seated interest to a community. Failure to recognize this can place even a good project at great risk of failure. Like any other real estate development project, the earlier contact is made with local officials, residents and special interest groups, and the more they are brought into the entire process, the better the project will be and the greater its chance of success.

Sixth and finally, adequate financial backing must be secured. This goes without saying for any real estate project, but it is particularly important in the brownfields arena because of concerns by sellers about residual liability that may come back to haunt them if buyers are unable to complete a project and the responsibility for cleanup is returned to the seller.

These, then, are the key ingredients for a successful brownfields program. Environmental engineering and consulting firms and law firms can play a significant role in the process by identifying opportunities for their clients to dispose of what otherwise are thought of as albatrosses. By allying themselves with brownfields purchasers, or bringing these sites to the attention of such purchasers, firms are serving their clients and helping to bring the sites back to productive use and returning them to the tax rolls. More importantly, what may appear on the surface to result in the ultimate loss of clients and, hence, additional revenues, may instead result in repositioned opportunities.

Where potential conflicts of interest can be addressed, purchasers of brownfields often use the same firms to continue cleanup work on a site, but even better, they often are willing to develop incentives for firms to be quicker and more efficient in the cleanup by providing the opportunity to become a financial partner in the transaction. Such arrangements are structured in various fashions depending on the situation, but they offer the potential for a firm to earn far more than fees-for-services can provide. This opportunity for firms is particularly important given the shake-out that has been taking place in the industry over the past few years as governmental enforcement programs have slackened and hence, the pace of remediation activities has slowed.

III. HURDLES

So, what is the track record to date of companies solely in the brownfields business? I have no hard numbers, but from being in the fields for two years or more and from talking to people in the business and going to meetings and conferences, it appears that there is less than meets the eye, or, there is more smoke than fire.

Significant hurdles must be overcome. First is simply getting a deal closed. Deals are being consummated, but they are few in number and they are complicated and time-consuming. Transactions are not often occurring in the classic real estate

sense of a seller selling to a buyer, who in turn remediates and redevelops the site. Instead, a business expands its own operations, does a sale leaseback or sells to another business. In these instances the brownfields company does not end up as a majority owner of the equity, but simply provides environmental and risk management services for a fee or, in some instances, for a small slice of the transaction.

Second, too often deals are caught up in traditional developmental delays of planning approval, permitting, financing, construction, etc. If these deals simply become a more complicated real estate development effort, the brownfields craze is doomed to die out quickly. In short, local support, in the form of more efficient bureaucracies and a willingness to make brownfields redevelopment a priority, is crucial.

Third, and related to the second, many communities have not yet come around to a way of thinking that efficiently and effectively tackles the problems of contaminated properties. Either old stereotypes prevail regarding responsible parties (and, unfortunately at times, regarding new, innocent owners), or there is a general lack of knowledge about changes in law and regulation and about opportunities that exist to help create financial incentives for potential buyers. Other problems include community leaders who, believing they have financial leverage with buyers, reach too far and end up killing a transaction.

Fourth and finally, sureness of process is critical in a deal. If environmental authorities cannot provide a firm timetable for remediation review and approval, equity financing will dry up. It does not matter whether it is six months, a year or three years, it needs to be a firm timetable that can be used to construct financial models for equity sources.

IV. POINTS OF CONCERN

Before closing, and writing as a former regulator, it is important to raise two points of concern as brownfields remediation and redevelopment incentives continue to be proposed and put in place by law and regulation. First, although perhaps easily addressed, programs must be established to ensure that classification exception areas[1] and deed restrictions will be recorded in a fashion that does not allow the accidental or convenient neglect of them ten, twenty, fifty or more years from now. Efforts need to be redoubled to make very clear any deed notices that are required after the cleanup of a site. Perhaps consideration should be given to some standardization of notice on a state-by-state basis.

Second, in the zeal to protect innocent buyers and in the rush to develop more competitive incentive packages, states are tinkering with environmental liability in ways that, at best, may only make the brownfields remediation process more complicated and drawn out, and at worst, may unwittingly create new loopholes for truly responsible parties to escape environmental liability. There are a lot of very smart attorneys representing clients with very big environmental liabilities, who are still willing to spend a great deal of money trying to escape or significantly reduce their liabilities. There needs to be real vigilance to ensure that loopholes are avoided that could allow those responsible parties to wriggle free. Too often, it is not potential buyers, but instead, people representing currently responsible parties that are more vigorously promoting liability-limiting brownfields laws and regulations.

Most brownfields law and regulations have provisions whereby if a cleanup is completed voluntarily according to an agency-approved remedial action plan, the agency will provide a letter acknowledging that the volunteer has cleaned the site according to the approved plan, and has been granted a release from liability for past contamination. For both the approved plan and the release, however, there are reopener provisions, no protection from other laws which may be applicable to the site and no protection from third party personal or property damage claims. This is the case with the New York State Department of Environmental Conservation's voluntary remedial program, the liability protection provisions for which are only a matter of policy, not statute.

These liability protection laws, regulations and policies can result in protracted negotiations between the volunteer and the agency over the language of the cleanup plan, the acknowledgment letter and the release provision, thereby adding to the time and legal expense of the real estate transaction. In addition, with the reopener provisions and potential for third party damage claims, the liability protection provided is not very strong. The smart investor will heed the admonition, "buyer beware." With only a partial release in hand, and with the knowledge that what the government gives, the government can take away, a buyer is well advised to secure the additional protection provided by today's environmental insurance policies.

In the worst cases, competition between states for ratables will result in new laws that try harder and harder to protect innocent purchasers of brownfields. This may cause situations where the risk of governments being stuck with paying for additional cleanup costs is increased to a point that might be of a real concern to voters and taxpayers if those risks were clearly articulated and understood. Even though a cleanup today may seem comprehensive by today's standards, how can assurances be given that improvements in scientific understanding of fate and transport issues for chemicals will not result in new knowledge which calls into question the previously completed cleanup? For example, today most of the focus in remediation is on receptors associated with cancer. However, there is increasing evidence that with rising incidence of asthma (particularly in children) and reproductive abnormalities, other receptors should be examined. If we later learn that those receptors are indeed an issue and a previously approved remediation plan is re-opened, who will pay for the work when the innocent purchaser is off the hook and the seller is long gone or otherwise has dispersed his or her assets? Government will be left with the problem, and either taxpayers will pay the bill, or a new round of Superfund-type legislation will be introduced and fought over. We will have come full circle.

An unlikely scenario? Perhaps. But if such provisions were in place 20 years ago, the discovery of the many toxic waste sites in this country would have led to even greater government

expenditures than have been made to date, and the few sites that have been remediated might still be laying fallow.

With use-based cleanup standards and environmental insurance policies, there is little need for releases from liability to be granted by governmental agencies. If environmental liability is given as the reason a transaction is stalled, it likely is more because of a very conservative buyer or one that is unaware of the environmental insurance that is available in the marketplace today. Indeed, if government really wanted to provide incentives, it would focus on issues of transportation and site access, workforce training, tax incentives and other such issues that impede the redevelopment of brownfields. The polluter pays principle, promulgated in the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), is hard, perhaps even onerous at times, on responsible parties. However, it is a principle that has resulted in the cleanup of many sites by the private sector, and not by taxpayers. To give up or significantly dilute it in brownfields programs may be dollar wise and pound foolish.

Despite the concerns raised in this article, opportunities abound in the brownfields arena if you have staying power, if you have patient money and if you are able to persevere though a difficult regulatory/redevelopment path. Brownfields may not always result in a windfall, but they can provide a good financial return and a real contribution to urban renewal.

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[1] A Classification Exception Area, or CEA, is a New Jersey regulatory designation available where ground water is not used as drinking water source, thus enabling the responsible party, in certain circumstances, to avoid a cleanup of the ground water by removing the source of contamination, then monitoring the ground water at periodic intervals to determine if pollution is being abated through natural attenuation.

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