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Will the Brownfields Bloom?

By Bennett Voyles

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Twenty-five years ago, the country was dotted with over 450,000 sites too contaminated with chemicals and other industrial waste to build on. Today, there are still hundreds of thousands of brownfields, but specialized developers say they're getting much easier to redevelop.

"Five years ago, few people touched [brownfields]," recalls Robert Colangelo, CEO of the National Brownfield Association and owner of Chicago-based Terravita Development, which redevelops surplus corporate brownfield properties. "Now, they're becoming closer to mainstream, but they're not there yet."

After years of gradually accelerating growth, brownfield redevelopment may be on the verge of a kind of slow-motion boom. "Deal flow has been tremendous. I think it's fair to say that we have only scratched the tip of the iceberg in terms of the opportunities," says Todd Davis, CEO of Hemisphere Development, a Cleveland redevelopment firm.

Rising land values have increased the potential demand for brownfield property. At the same time, observers expect regulatory and accounting pressure will encourage more companies to unload their contaminated land.

Jay Biggins, managing partner of Stadtmauer Bailkin Biggins, a Princeton, N.J.-based consulting firm that advises on large-scale economic development projects including brownfields, notes that many public companies have long had their impaired properties locked up "in a kind of accounting limbo." Today, he says the requirements of Sarbanes-Oxley and Financial Accounting Standards Board Rule 47 (FASB) are prodding companies into dealing with the problems.

The new rules require companies to list and quantify potential environmental liabilities as balance sheet items, creating an urgent need to dispose of this nearly forgotten land. "We're seeing companies turning their attention to properties that haven't received significant managerial attention in many years," Biggins says.

The old habits of fencing and forgetting such messes are dying hard, experts say, and many owners have yet to take action. "We in the environmental industry are waiting for it to really jump," says David Oldow, vice president of facilities underwriting and industry relations for XL Insurance, an environmental insurer.

"Many of us thought that FASB and Sarbanes-Oxley would really flood the market with properties, but companies still are being very cautious," says Don Eisen, executive managing director for Cushman & Wakefield in East Rutherford, N.J. He adds that there are rumors that many major companies may act soon.

Biggins says his firm is advising a few companies now on the issue. Others say it takes time for companies to understand the new requirements and make a decision. "It takes a while for these things to percolate through," says Kevin Matthews, director of government relations for AIG Environmental, another large insurance provider for brownfield developers.

But Eisen of Cushman & Wakefield is less certain that FASB and Sarbanes-Oxley will actually lead companies to sell off their brownfields. Brownfield owners can never entirely escape their liability, he says, even if they do sell their property.

"The big elephant in the corner of this room is called finality. There is no finality when you sell a brownfield site ... you are never off the hook with brownfields. You can insure it. You can clean it up. You can do the best possible job. It doesn't matter. You're not off the hook," Eisen insists.



Specialty development

At the moment, only a handful of developers work full-time rehabbing contaminated land. Yet even if the numbers are small, the niche is already far from a simple ecosystem. Among developers who dedicate themselves to brownfields, a number of specialized business models have already evolved.

Some firms handle only large, difficult cases that give them access to government clean-up grants and incentives. Others buy risky sites, offer to take on the company's legal liability, and clean up and flip prepared sites. Still others take on both cleanup and vertical development.

The sites themselves can vary almost as much, from the small and relatively simple, such as old gas station or corner dry cleaners, to former industrial parks.

For big deals, the contamination can almost be matched by the legal tangles, according to Cynthia Brooks, CEO of the Greenfield Environmental Trust Group, an environmental development and consulting firm based in Chestnut Hill, Mass.

Sometimes simply buying the property can be difficult. For example, on one of Brooks' biggest projects, half of the 245-acre industrial park called Industri-plex in Woburn, Mass., took four years to close. Home to pesticide, munitions and leather-related manufacturing since 1853, the industrial park had been rated by the EPA as the fifth-most contaminated site in the country.

The project began in 1995, but between land-use restrictions, land-use controls, restrictive covenants, liability waivers, and the need to coordinate private capital with \$50 million in new public infrastructure, the first parcel didn't sell until 1999, according to Brooks. "The deal was absolutely painful and protracted. You can't imagine what went into the transaction itself," Brooks recalls.

Brownfields get easier

Developing on toxic land is inherently risky work, but brownfield redevelopers say it's getting easier, as the technical, legal, and financial infrastructure keeps getting stronger.

Beyond a number of technical advances, science, state and federal regulators have designed requirements that now better calibrate the level of cleanup required with the eventual use of the property, making remediation costs more manageable. Federal and state agencies offer grants, loans, and tax abatements for the most difficult cases. State and federal laws now cap or shield new owners from potential liability on older properties.

In addition, major insurers offer environmental liability insurance to provide some measure of protection against the nearly unlimited downside risks, if a cleanup project is not entirely successful.

Although AIG doesn't track policies written specifically on brownfields, Matthews of AIG Environmental, says demand for environmental liability policies seems to be growing at about 10% a year.

Cash for trash

In the current climate, developers say it's easier to find a lender for a brownfield project today than in the past. "The combination of the insurance protection and the liability reform protections that are afforded to investors really has increased the number of opportunities to move forward on financing," says Brooks of Greenfield Environmental.

While the biggest and most sophisticated banks reportedly dominate brownfield loans — Bank of America and Comerica are two names often cited — a few specialized debt and equity lenders have also grown up to meet the demand.

Jeff Telego, executive director of the Environmental Bankers Association, estimates that there is about \$3 billion in private equity money invested in the sector. Cherokee Investment Partners, a private equity lender, may be the largest. A number of states have also set up revolving loan funds for cleanup operations.

Specialized debt providers are the latest arrivals to the scene. The California Environmental Redevelopment Fund (CERF), a small, five-year-old private consortium, began as a vehicle for seven California banks to park some Community Reinvestment Act money, but the consortium turned out to be surprisingly profitable. The Sacramento-based lender provides bridge loans to get developers through the remediation phase of a project.

CERF President Peter Hollingworth says he is now looking to expand the consortium into a national enterprise. While CERF USA is starting small — the specialty lender is backed by \$40 million from an equity investor, and plans to borrow \$100 million in debt — Hollingworth wants to grow it much larger over the next five years. The goal: Hollingworth says he's shooting for \$1 billion.

Funding these kinds of deals requires a different mindset than a traditional lender, according to Hollingworth. "Most lenders are into risk avoidance," the Sacramento-based bank executive says. "We're into risk management."

An important part of lending on these deals, Hollingworth says, involves "sculpting" insurance policies in such a way that the risks

are highly circumscribed. Such environmental policies provide a cap on losses if cleanup costs are underestimated or if more contamination is found unexpectedly, making it easier for lenders to loan on a limited set of risks.

With so many brownfield risks now limited and quantifiable, more large investors are finding their way to brownfields. Colangelo of the brownfield association says that in the past most lenders would not entertain making a loan on a contaminated site. Now, he says they are more likely to deal with brownfield projects — but at a price.

Simpler, but not simple

Although deal making may be getting easier, developers say brownfield deals are still laborious. They're costly projects, according to Michael Nachamkin, senior vice president and northeast regional director for ProLogis, the Denver-based global distribution center giant. They also require a lot of developer expertise.

In New Jersey, for example, "You have to understand all the environmental laws, you have to understand insurance, and you have to understand wetlands and [state environmental] mitigation plans."

Developers say brownfield developments often take two or three times as long to complete as a conventional project. Nachamkin says a large deal that takes a year as a greenfield can take up to four or five years to develop on a brownfield site. Beyond extensive environmental due diligence, the number of stakeholders can be daunting.

Like affordable housing projects, which often are cobbled together with funding and financing from multiple sources, the most serious brownfield developments require multiple sources of financing to stay profitable. Davis of Hemisphere says his firm often uses up to seven different layers of financing, including public and private sources, in a single transaction.

All that may be a time-consuming nuisance, but it has a bright side: Kevin Noell, CEO of Meridian Development in San Diego, says that while working on his first brownfield seven years ago, he realized that the difficulty also gave him a competitive advantage. "These sites are headaches and we sell aspirin," he says.

Davis notes that brownfield developers haven't had much new competition. "We have not been overwhelmed by a variety of new entrants into this area because the deals are hard. Most developers aren't patient enough to do this," he says.

That may change. A number of large REITs and other real estate companies are also learning how to develop brownfields. ProLogis, for example, has now completed two projects in California — a 43-acre and 600,000 sq. ft. campus for the U.S. Air Force in El Segundo. In addition, it has completed a 206-acre residential development in Hercules (Bay Area), according to a ProLogis spokeswoman.

And that's only the beginning: ProLogis is working on seven other brownfield projects, in California and New Jersey, more than 1,300 acres. Most of that land is being developed for industrial use.

Seeing green

How much opportunity lies ahead? The Environmental Protection Agency estimates that there are about 450,000 brownfield sites around the country. That's a lot of contaminated land, but not all of those sites will be economical to develop, experts say, even with various government incentives. Some sites, says Hemisphere's Davis, "should just be viewed as cleanup projects."

Even so, Davis is confident that there's a lot of opportunity ahead. "I firmly believe that there is more opportunity than we can address in our lifetime," he says.

Biggins, the site consultant, is not so sure whether the supply of poisoned land is inexhaustible. "It's anybody's guess," he says. "It is the real estate trend du jour, and it looks like it has legs," he says. "However, in many states the most significant brownfield opportunities already are being pursued by multiple developers, so the chances of finding undiscovered investment opportunities are declining."

Bennett Voyles is a New York-based writer.


U.S. BROWNFIELDS EMERGE AS MASSIVE, UNTAPPED RESOURCE

- There are more than 450,000 brownfields around the country, properties whose expansion or reuse may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant.
- As much as \$2 trillion of U.S. real estate may be undervalued due to the presence of contamination.
- 5 million acres of that may be abandoned industrial property in urban areas.
- Environmental hazards are estimated to be present at 20% to 50% of all industrial real estate properties.

- For every acre of brownfield property that's reclaimed, 4.5 acres of green space are preserved.

Sources: EPA, National Brownfield Association, Environmental Law Institute

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