

## **Due Diligence for Brownfield Opportunities**

### **Introduction**

In a recent survey of corporate real estate executives, 85% of the respondents indicated that Workforce Availability was one of the most important factors in selecting a new location. Especially for labor-intensive industries, the move to greenfield sites located farther and farther from sizable labor pools has made the task of securing sufficient numbers of qualified employees increasingly difficult. Executives are often turning to “close-in” sites to assure adequate labor pools from which to draw their workforce. Thus, among developers and those charged with locating new facilities, there is a newfound realization that previously used sites can be attractive—and in some cases even more attractive than traditional greenfield sites. But, as is true with all “bargains,” the true finds go to those who do their homework. This article will briefly describe some of the major legislative changes that have made these sites more attractive, and the steps a prudent locator should undertake to assure that the benefits of brownfield sites are not outweighed by unpleasant surprises.

### **The Dark Past—Legislative and Financing Hurdles**

The Environmental Protection Agency (EPA) defines a brownfield as “an abandoned, idled, or underutilized industrial or commercial facility where expansion or redevelopment is complicated by real or perceived environmental contamination.” However, there is a growing realization that many of these sites do not pose any threat to human health and safety, and can be returned to economic usefulness with minimal investment. Spurred by this new awareness, Federal, state, and local governments have undertaken an unprecedented effort to reform environmental laws to encourage the redevelopment of these brownfield properties. To comprehend the magnitude of this change and its potential impact, it is important to understand the evolution of environmental regulation.

In the past, potential brownfield redevelopment was prevented in large part because of one factor—fear of the unknown! To a large extent, this fear was well founded. The original focus of CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act) was supposed to be on identifying and correcting sites that posed the most severe immediate threat to human health. Superfund was created to facilitate the cleanup of hazardous environmental contamination by providing “rapid response” funds and to worry about recovering the expenses later.

To facilitate timely reimbursement of the fund, the government was not required to engage in the time-consuming process of determining who was most responsible—either in an environmental or a legal sense. Rather, the government was allowed to send the bill to any of a broad range of potential polluters or landowners—current or previous—collectively known as Potentially Responsible Parties (PRP’s). The identified PRP was then left to search out other PRP’s, and to fight out the allocation of liability.

Over the years, the original intent of rapid cleanup and subsequent reimbursement became clouded in the rush to assess blame. Finger pointing became more than just a mere exercise since subsequent purchasers could now face the threat of unlimited liability for past contamination—even if they had no role in its creation. One attorney likened this to “jailing the buyer of a gun used by its former owner to shoot someone.” It was this perceived threat of potential lurking liability, sometimes well after the fact, which led to reluctance to even consider brownfield redevelopment—a massive departure from the original legislative intent!

### **New Approaches—New Potential**

Eventually, even the EPA recognized the draconian nature of these unintended results and worked throughout the 90’s to refocus on the original goal of rapid cleanup of the most dangerous sites. Although well intentioned and clearly in the right direction, these attempts did not go far enough to assuage the fears of potential developers. Further exacerbating the situation, lenders faced a number of disincentives when they considered

funding the redevelopment of contaminated sites. In one American Bankers Association survey in the late 90's, more than 60% of the banks admitted denying loans because of "environmental concerns." Originally, CERCLA exempted banks and other lending sources from liability provided that: 1). they did not actively participate in the management of the facility and 2). they held title only to protect their security interest. Lending institutions' uneasiness came from the ongoing litigation regarding the interpretation of nearly every word in these exemptions. Congress finally acted to reiterate EPA's intentions and exempt lenders once and for all with the Asset Conservation, Lender Liability and Deposit Insurance Act of 1996.

But they weren't done—and the news got even better! The Taxpayer Relief Act of 1997 eliminated the IRS requirement to capitalize cleanup costs over the life of the property, and rather, allowed the costs to be expensed in the year in which they occurred. Originally, to qualify, the land had to meet certain geographic or demographic requirements. Now, with revisions that became effective in December 2000, the property must simply be held for "the production of income" or in the taxpayers' inventory and hazardous substances must be present or potentially present.

To even further facilitate brownfield redevelopment, EPA adopted a number of additional provisions to address sustainable reuse of brownfields and to resolve developers' other ongoing concerns. In the Brownfield Economic Redevelopment Initiative, the EPA established grants of up to \$200,000 to local governments for redevelopment pilot projects. In addition, the Initiative funded training programs in environmental remediation for residents of these pilot areas affected by contamination.

And perhaps most importantly, the EPA empowered states to enter into negotiated agreements with developers that largely absolved developers or purchasers from further liability, often in the form of a "no further action" letter or a "certificate of completion" from the State, provided they conducted cleanup projects in accordance with their agreements. More than 35 States now have these voluntary cleanup programs (VCPs). The degree of protection from future State enforcement action at the site varies from

program to program. However, in a technical sense, none of the programs guarantee protection from federal EPA action, although the policy to accept state action is explicitly stated and has, to date, been followed.

As technology has matured and understanding of potential health threats has increased, the contamination at more and more sites is being viewed as manageable. Cleanup standards crafted specifically for an individual site, taking into account the physical characteristics and the surrounding areas, have also simplified remediation. In the past, if site cleanup was required, the only means to eliminate the threat of subsequent legal action was to perform the most stringent cleanup scientifically possible. These generalized standards, rather than site-specific standards, often led to astronomical cleanup costs. Now, with an ever-increasing understanding of methods of protecting humans from numerous sources and methods of contamination—whether skin contact, inhalation, ingestion, groundwater, or others—increasing levels of contamination (often measured in parts per billion) are recognized as posing no significant threat.

Furthermore, an increasing number of states are now basing clean-up standards on the intended use of the restored property. In Illinois and a number of other states, standards are being developed using a Tiered Approach to Corrective Action Objectives (“TACO”). Simply, if the site is being reclaimed for a Day Care Center, then the highest attainable cleanup standards should, and do, apply. On the other hand, if the brownfield was an industrial site and is being reclaimed for use as an industrial site, the first priority is to make sure that the contamination is not spreading, and poses no threat to water supplies or adjoining land. Then, with these assurances, construction is allowed to take place provided that it enhances (and in some cases, merely preserves) these safeguards.

### **The Steps**

If a site appears to offer proximity to labor supplies, needed infrastructure, and an attractive price, the magnitude of contamination and the necessary cleanup must be determined through an Environmental Assessment.

As shown in the following chart, the Assessments are categorized into three levels based on the scope and findings of the investigation:

**Environmental Audits**

<b>Type</b>	<b>Method</b>	<b>Purpose</b>
<b>Phase I</b>	Review of historical land records and governmental environmental records	To determine if a previous use or user is <u>likely</u> to have caused contamination. Also, to determine if governmental agencies (federal, state, or local) are aware of any prior contamination incidents.
<b>Phase II</b>	Limited sampling of soil and groundwater	To determine the nature and extent of existing contamination, if any.
<b>Phase III</b>	Comprehensive evaluation of the magnitude and severity of contamination present on the site.	To determine the appropriate remediation technique, and to accurately assess the potential cost.

Phase I audits are the simplest and generally involve a search of existing land records to determine past owners and uses, as well as existing environmental records to assure that the potential has not been previously identified as having problems. A Phase I audit can usually be performed for between \$1,000 and \$5,000. Many lenders now routinely require a Phase I audit of a prospective purchase or lease as a minimum level of due diligence.

If a Phase I audit indicates a previous use or owner that could contaminate the property, a Phase II audit should be performed. At this stage, actual soil and groundwater samples are taken to determine if contamination exists; and if so, the type and extent of contamination. If levels of contamination are found which exceed state or federal Environmental Guidelines, then a Phase III audit must be performed to quantify the

extent of the contamination and to determine the steps necessary to rectify it. However, Phase III audit findings may not be as onerous as once imagined. As one expert noted, “flawed ain’t necessarily fatal.”

As the legislation and public perception of contaminated properties have evolved, so too have cleanup technologies. These technologies range from the amazingly simple to the amazingly complex. Cleanups can be as simple as planting cottonwood trees to aspirate subterranean contamination or spreading molasses waste on the ground to stimulate the growth of pollution-eating bacteria, or as complex as injecting the site with massive amounts of electricity to melt the underlying soil and turn it into a glass-like containment chamber. Thus, many forms and degrees of contamination can be addressed through technologies that represent an insignificant portion of the land acquisition and development costs, and still render the site a “bargain.”

## **Conclusions**

No one would suggest that every brownfield site is a candidate for redevelopment, nor that redevelopment of a brownfield is right for every project. However, with the increasingly-favorable legislative and financial climate surrounding them, brownfields may yield strategic locations with existing infrastructure in the midst of ample labor supplies on sites that otherwise would have been underutilized or vacant for years!

### **BIO**

Jim is a Senior Consultant with The Wadley-Donovan Group, a Grubb & Ellis Company. In addition to a law degree with concentrations in Environmental and Real Estate law, he holds an MBA. As part of Grubb & Ellis's commitment to become a global real estate advisory firm, the Wadley-Donovan Group provides corporate location consulting services. In an increasing number of assignments, previously developed sites have provided an attractive alternative to greenfield sites, farther and farther from labor pools.