Contaminated properties as the new investment niche in tight real estate market

By Daniel Johnson - Environmental Business Institute

A growing number of California developers are realizing that getting their hands on a little dirt can really pay off — especially in tight real estate markets like San Diego that have land shortages and cap rates in the five to seven percent range for low-risk niches such as apartments.

There are at least 100,000 contaminated sites in California — with estimates of the fair market value in the hundreds of billions. While the risk and hard times may not appeal to every investor, the rate of return can be substantial. Several recent changes have made the risk much more manageable than it has ever been.

The acquisition of contaminated properties has become an investment niche for savvy developers looking for better rates of return. Buyers and lenders are looking closely at properties with environmental issues for solutions to reduce liability and increase protection for property owners and affordable insurance to adequately address environmental concerns that have become increasingly available.

Regulatory reforms & due diligence

State and federal regulatory reforms regarding the diligence have been tailored toward helping developers understand and minimize liabilities, while providing for property owners use and income tax planning.

The thinking behind the due diligence has historically been the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) as amended, the Resource Conservation and Recovery Act (RCRA), and state laws. A landmark in 1986 was the SARA Act, which added an additional to the original SARA bill of 1980.

CERCLA or Superfund, has established prohibitions and strict liability concerning places and abandoned hazardous waste sites, provides for clean-up and retroactive liability of persons responsible for release of hazardous waste at such sites, and established a trust fund to provide for clean-up when no responsible parties can be identified.

Superfund has always had an "eye on the amount of the "contaminant landowner defense" in proving that all appropriate inquiry into the previous ownership and use of the property be consistent with good environmental or customary practice.

Until months the criteria to qualify as an innocent landowner were uncertain at best. Fortunately, recent amendments to SARA have clarified what constitutes "all appropriate inquiry.

The amendments, which became effective in 2003, expand the American Society for Testing and Materials Standard Practice for Environmental Site Assessment. The amendments require the Environmental Protection Agency to adopt regulations within two years that establish standards for "appropriate inquiry." The EPA is currently working with multidisciplinary sites on this process.

Other liability clarifications, such as for "brownfield property owners" and "new EPA requirements" also are involved in the amendments, although their practical effects may be limited. These changes specifically provide for the purchase of a contaminated property, while limiting the liability if certain conditions are met.

Real estate developers looking to acquire contaminated properties, perpetuate due diligence processes thorough through required Phase I site assessment, which should meet or exceed the updated ASTM guidelines. A typical Phase I conducted by an environmental consultant includes site evaluations, interviews with title and officials, review reports and thorough analysis of the site and its environmental history.

Environmental insurance

Environmental insurance can cap liability to maximum liability recoveries from the balance sheet, thereby eliminating or reducing the risk to the buyer and minimizing costs and delays of the deal.

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Determining the best environmental insurance policy first requires an underwriter's judgment of environmental risk classification for a particular contaminated property, assesses the impact of potential property transaction increases, unknown or undeveloped environmental liabilities, as well as development of known, environmental liabilities.

There are also many major types of environmental insurance coverage:

- Cost containment has worked for anyone involved in remediating contaminated properties. A major uncertainty here is paying for defined clean-up costs. Instead, make the anticipated cost of cleanup, and provide a buffer above the expected cleanup costs. A remedial action plan is usually a prerequisite to obtain this type of coverage.

- Environmental Impact Liability coverage is the specific cover and limits that harm occurs. It is similar to the general insurance issued by insurers and requires some contingent coverage. A joint agreement is usually required to ensure that the parties agree to the joint agreement. It also includes the right to mitigating the extent of the contamination and cleaning up the site.

- Lenders Coverage is designed to protect lenders from loss of collateral value; the inability of the borrower to erosion of loan; and the liability of the environment on conditions on the environment and the site contamination. Lenders coverage might make lenders more willing to provide capital on contaminated properties.

- Prime investment sites

Sites with leaking underground storage tanks are excellent redevelopment candidate. Feasibility for leaking underground storage tanks can be reimbursed through a state cleanup fund or covered by environmental claims. Risk-averse investment may facilitate the redevelopment and cleaning of these sites.

- "Contaminated property" such as contaminated brownfield sites, also can be prime investment opportunities. Taking ownership of property located next to a brownfield, for example, a brownfield site, can provide additional investment from an adjacent site to the property and increase the price for developers of the subject site for commercial or residential purposes. A brownfield property can be sold under an "as is" condition and environmental assessment. In addition, almost all urban areas now encompass numerous brownfield properties. A brownfield property may be an empty lot, including obtaining a "certificate of compliance" from an environmental agency. This could facilitate the situation.

- Real estate investors carry their share of risks. Brownfield properties are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are truly "quarantine" areas that are at risk. Almost no real estate investors are true