Mothballed No More

How Sarbanes-Oxley and FIN 47 are breathing new life into contaminated properties.

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The corporate practice of "mothballing" contaminated properties may be coming to an end. In December 2005, the Sarbanes-Oxley Act and Financial Accounting Standards Board (FASB) Interpretation No. 47 (FIN 47) took effect, forcing public companies to recognize cleanup or disposal costs associated with facilities or equipment, including facilities that have been taken out of service or "mothballed." Such facilities are fenced off as contaminated property indefinitely as a method to avoid clean-up costs.

A 1998 Environmental Protection Agency (EPA) study disclosed that 75 percent of publicly traded U.S. corporations surveyed violated the Security and Exchange Commission's (SEC) environmental financial debt accounting regulations. Many companies took a "don't ask, don't tell" position in the past and did not conduct environmental investigations, leading to the current increase in regulations and accountability.

Now with FIN 47, companies can decide to remediate or sell previously mothballed properties to avoid or lessen the blow of disclosure of any environmental liabilities in their financial statements. FIN 47 is an interpretation of Financial Accounting Standard 143 or Assets Retirement Obligation. The goal is to properly recognize and categorize environmental liabilities when they first occur rather than only when retired. There is a myriad of potential environmental liabilities covered, as spelled out in numerous federal and state environmental statues, laws and regulations. Examples of the federal level include Superfund, the Clean Air Act, RCRA or hazardous waste regulations, and underground storage tank regulations.

No single test determines whether to disclose or not to disclose material relating to environmental data in every situation. However, with the trend toward greater accountability of accounting practices by the SEC, and fines of up to $5 million and/or 20 years in prison, now is the time to take a closer look at all assets, including retired assets. The SEC is requiring more complete assessments of environmental liabilities and is also doing a better job of tracking these retired assets to insure compliance. Careful consideration about disclosure is needed to avoid public embarrassment and shareholder loss associated with accounting discrepancies, as well as fines, penalties and credit down-ratings.

Remediation

Some companies will seek outside advice on measuring environmental liability. The associated risks of brownfield development can hinder, or even kill, real estate deals. In high-risk situations, certain companies are choosing to team up with firms that offer risk transfer of impaired assets and liability. These firms offer real estate professionals protection against the risks associated with brownfield development. Such companies add value to impaired real estate by bringing a variety of risk-management strategies to bear, including insurance, guaranteed fixed price remediation programs, liability buy-outs, and other risk transfer mechanisms.

Factors to consider when assembling a remediation team include remediation experience, extent of contamination, types of contamination and available technologies. The team should include general counsel, accounting firms and an environmental consulting firm with a real estate client focus. The environmental consultant needs to be proficient in the evaluation of environmentally impaired assets, investigations, compliance auditing and monitoring, risk mitigation, remediation, due diligence and the support of acquisition and disposition of contaminated real estate. The environmental consultant can help develop and implement a strategy to identify, manage, mitigate and monitor contingent environmental liabilities. Additionally, the right environmental consulting firm can help transfer identified liabilities to reduce the impact to a company's ledgers.

Whereas some developers might otherwise have walked away from a risky but potentially lucrative investment, they now have the option of collaborating with firms that will assume full responsibility for potentially costly projects. By offering liability protection and transferable indemnification for future cleanup costs and third-party claims, risk transfer groups allow contaminated assets to more readily be transacted, financed, cleaned up and put back into productive use.

Troubled Assets

This also is an ideal time to divest from these troubled assets. Besides having many companies wanting to acquire contaminated real estate, the new All Appropriate Inquiry (AAI) standards (required by the "Brownfields Amendments") required EPA to define AAI. The standards are now completed, and they take affect in November 2006. AAI is a means to an end for the Brownfields Amendments of 2002, which offers enhanced Innocent Landowner liability protection, and new Bona Fide Prospective Purchaser and Contiguous Property Owner defenses. The Bona Fide Prospective Purchaser allows a buyer to knowingly purchase contaminated real estate and be protected against the environmental liability created prior to the purchase. For developers, these adjustments introduce new brownfield properties into the marketplace.

Some companies may elect to sell these assets so they will not have to increase the liability they are accruing. There are other factors to consider when selling, as it does not totally release companies of their environmental liabilities; but a sale does provide cash, eliminate on-going carrying charges and maintenance budgets for the properties and reduce future liabilities on the income statement. In the case of environmentally contaminated real estate, the liabilities do not drop away until the site is remediated, but the net effect is that reduced environmental liabilities will help shore up and preserve stock values and help protect against a credit down-rating of the company.

In short, companies are now routinely cleaning up and selling previously contaminated property more easily than in the past, thanks to new technologies and a new understanding of remediating contaminated properties. Many firms and local governments are now comfortable with acquiring properties with environmental liability and contamination because potential new values of property created after remediation drastically offset clean-up costs. These companies have an appetite for contaminated real estate and are chasing higher rates of return than are normally associated with typical real estate development.

With the proper mix of risk-mitigation strategies, Brownfields Amendments, All Appropriate Inquiry, and a buyer's market for contaminated real estate assets, a public company can finally start to get control of its contingent environmental liabilities. The Sarbanes-Oxley Act and FIN 47 create these opportunities for companies and developers to profit from previously contaminated property. SITE

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