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### Brownfields: How to Spot and Avoid the Risks

MAY 09, 2007 -- Apartment companies can be faced with open-ended liabilities if they purchased a brownfield property unknowingly or if their property is situated next to one. Environmental appraisal experts Rudy R. Robinson III, MAI, managing partner, and Scott R. Lucas, senior associate, Austin Valuation Consultants, speak to Keat Foong, executive editor, MHN, to explain what brownfields are and offer advice on how multi-housing owners can protect themselves legally against this form of environmental liability. All the same, owning a brownfield is not the end of the world. Robinson and Lucas also offer insight into how apartment owners can work with brownfields -- indeed, even purchase them -- and how they are appraised.

**MHN:** What is the definition of a "brownfield" and what are some of the "brownfield" conditions that can be present on a site or on the site of an existing and occupied apartment property?

**Robinson/Lucas:** Per the EPA, a brownfield means "real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant."

You can find the full legal definition at <http://epa.gov/brownfields/glossary.htm>. The Dictionary of Real Estate Appraisal defines a brownfield as "an industrial or commercial site that is abandoned or underused because it suffers from real or perceived continuing contamination."

## Reports and Analysis

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MAY 09, 2007 -- Case Study: Adaptive Reuse Attracts Green-Conscious Buyers in Seattle; and Brownfields: How to Spot and Avoid the Risks

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MAY 01, 2007 -- The term "high rise" takes on added meaning in the Big Apple, a city that is synonymous with "the high life." Another round of record year-end bonuses on Wall Street continues to propel real estate sales prices upward in the city. And on the other end of the cost spectrum, Mayor Michael Bloomberg remains committed to creating affordable housing in New York City, even though the popular 80/20 financing subsidy has become over-taxed and the 421-a tax abatement program may be drastically curtailed by the state legislature.

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Just about any type of contamination might affect an apartment complex or the site for one: petroleum products, heavy metals like lead and mercury, ethylene compounds (dry-cleaning solvents), asbestos, mold, etc.

It's important to understand that an apartment property need not be the source of the contamination or even contaminated itself in order to be a brownfield. An apartment property adjacent to a gas station known to have leaking underground storage tanks might be classified as a brownfield if the migration of contamination onto the apartment property is imminent or probable, even if the property is clean at the moment. The key is the potential for restrictions on future development, not the contamination itself.

**MHN:** In an article you co-authored that was published in The Appraisal Journal, you described the plight of an apartment property that was found to contain brownfield contamination. Even the lender did not want to foreclose on the property. Was it practical for the new owner to remediate the situation and redevelop the property?

**Robinson/Lucas:** Yes, but not immediately. The apartment complex in question was found to have been built over an abandoned landfill, and methane from the landfill was discovered to be seeping into many first-floor units at potentially explosive levels. The state environmental agency subsequently forced over 1,000 residents to vacate the property with 48 hours notice. The landfill created additional problems with foundational stability and waste seeping into a creek and toward the Colorado River.

Because of the potential for many third-party lawsuits and uncertainty over whether the property could ever be salvaged, my firm advised the primary lender (our client in a 1991 appraisal) not to foreclose. That lender eventually dissolved, and a subordinate lender purchased the property. Still, the property could not be remediated without the passage of a new state law permitting permanent structures over landfills, and the new owner had to enroll the property in the state's Voluntary Cleanup Program in order to limit future liabilities from state action.

Also, the local apartment market was in terrible condition in the early 1990s; not until the middle part of the decade did rents and occupancies improve enough to make redevelopment feasible. The property was not redeveloped until

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1999, so it sat empty for eight years between tenants.

**MHN:** What are the considerations for apartment developers who may want to calculate whether to redevelop a brownfield?

**Robinson/Lucas:** Can the developer get a loan on the property, and at what terms relative to a typical loan?

- Can the developer get insurance on the property, and will it require a special environmental policy?
- Will the property be subject to use restrictions such as prohibitions on using portions of the site or digging below a certain depth?
- Will the redevelopment require deed recordation of the contamination, and will leasing agents be required to inform potential tenants of the prior or residual contamination?
- What will the remediation cost, and what are the long-term liabilities might the developer face?
- Will the property's post-remediation value exceed the combined cost of the property acquisition and redevelopment?

**MHN:** How likely are brownfield conditions to be found in existing apartment properties? What is faced by apartment properties if they are found to be contaminated, and what recourse do they have if any?

**Robinson/Lucas:** Not highly likely, in general, but much more likely in older properties and ones located in predominately industrial neighborhoods with factories, refineries, waste facilities, dry cleaners, etc. Prior uses of the apartment property also have a great effect on the probability of being a brownfield.

Purchasers who unknowingly purchase a brownfield site need to seek legal assistance as soon as possible. The basic premise of property law is if you've bought a property, you're responsible for it, even if a prior owner was responsible for the contamination. Owners can face local, state and federal actions and third-party lawsuits

that create open-ended liabilities.

Purchasers can seek redress through negotiations with the seller or through the courts, but of course, litigation is costly and victory is never assured. The seller might declare bankruptcy or be "judgment proof" due to lack of money and assets. Also, a statute of limitations might cut off the possibility of a lawsuit-instigated recovery.

The key to avoiding such a nightmare scenario is performing due diligence prior to purchasing the property. A competent environmental engineer is needed to research the possibility of contamination on a site.

**MHN:** How do you appraise a brownfield site?

**Robinson/Lucas:** The basic formula is as follows:

"As Is" Market Value = Unimpaired Market Value – Costs To Cure – Stigma

The Unimpaired Market Value is the value of the property assuming it has already been remediated and is ready for leasing. In essence, the unimpaired value assumes the problem never existed.

Costs to cure include all the hard and soft costs to remediate the property.

The Dictionary of Real Estate Appraisal defines stigma as "an adverse public perception regarding a property; the identification of a property with some type of opprobrium (environmental contamination, a grisly crime), which exacts a penalty on the marketability of the property and hence its value."

In the case of an apartment property, stigma may include the risk that the property will have to offer below-market rents to gain tenants, or that occupancy may not approach market levels. It also includes the extra entrepreneurial profit required to accept the responsibility of ownership of a site that was previously contaminated and may still have residual contamination.

Stigma can vary over time. It may decline and eventually disappear over time depending on the situation. Sometimes stigma is long-term or even permanent.

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