

A Green Light for Brownfields

Creativity pays off when entering the growing brownfield niche

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As published in Scotsman Guide's Commercial Edition, October 2009.

A series of regulatory, environmental and financial factors have made brownfield lending -- once viewed as the ultimate niche development discipline -- more mainstream.

Brownfields are environmentally contaminated properties, such as former industrial sites, gas stations or dry cleaners, and often are in prime infill locations. Because of substantial liability risks, regulatory hurdles and unforeseen costs that can stem from uncertain project timelines, brownfield lending historically has been inherently riskier than other types of lending. Now, however, developers and lenders are showing greater interest in these properties.

Commercial mortgage brokers looking to break into the brownfield-lending niche must understand the major factors helping to stoke interest in these properties, as well as what obstacles their clients must still overcome.

Why the shift?

For years, regulators relied on conservative, standard-based criteria (e.g., drinking-water standards) and required sites to be remediated to near-pristine levels -- often an enormous hindrance to any brownfield project. As regulators became more comfortable with the idea that it is nearly impossible to reduce the concentration of any contaminant down to a level near zero, however, they started adopting risk-based cleanup-assessment models in which the property's future use determined the level of required remediation.

The U.S. Environmental Protection Agency's Risk Assessment Guidance for Superfund is one of the earliest documents to describe methodology for conducting site-specific risk assessment. Many states have developed their own guidance, likely based on this methodology. With this guidance, regulators can employ scientifically defensible cleanup and marry development with remediation.

Brownfields also have gotten a boost from the green-building movement. The idea of turning contaminated properties that were once the dregs of a community into clean, profitable developments typifies the values of sustainability and smart economic growth.

Regulators, in turn, are more likely to streamline approvals for projects that carry a green dividend in today's market. Brownfield projects that contribute to various smart-growth city initiatives -- remediating a dilapidated gas-station site and building an affordable-housing complex, for example -- carry much more weight in city municipalities today than in years past.

Obstacles still exist

Like other property niches, brownfield redevelopment is tied to what's going on in the economy and the real estate market. Lenders are waiting on the sidelines for the market to stabilize and are generally reticent to engage in any high-risk transaction in today's economy.

Consequently, from equity and lending perspectives, there are fewer capital sources for brownfield-redevelopment projects, which typically depend on either private-lending capital or traditional private-public financial partnerships. As such, it can be extremely difficult for brokers to get deals done and for many of their clients' remediation or redevelopment efforts to reach completion.

Furthermore, "golden egg" projects -- i.e., contaminated properties that have low cleanup costs and high land value -- are increasingly harder to come by. Brokers may therefore see their developer clients taking on more-challenging projects than they might have considered previously.

Often, the biggest obstacle in getting financing for brownfield projects is establishing a sound exit strategy. Brokers and their clients, along with all other parties in the brownfield-redevelopment process, must understand that obtaining financing in poor market conditions is still predicated on basic real estate investment criteria, the most important of which is the land's proposed use after redevelopment. In other words, the property's end use must make sense.

Also, projects that address demand and have strong prospects for permanent financing have a better chance at funding than those that may not make sense in today's market. For example, a project that transforms a dilapidated factory into affordable housing is likely to receive a Federal Housing Administration construction loan upon completion.

The good news

Despite the market slowdown, there is good news for brokers wishing to break into the brownfield-lending industry.

For one, municipalities increasingly look at brownfield-redevelopment projects more favorably because they recognize that they're economic drivers for communities. By encouraging smarter land use, creating jobs and building healthier communities, brownfields have an inherent economic dividend.

Another positive sign is that environmental-lending institutions are in relatively good shape and are still active in the market. Although credit markets are tight, many developers view the market slump as a prime opportunity to buy brownfield properties, obtain government assessments and cleanup funds, and prep the properties for redevelopment upon market recovery.

Additionally, public funding -- such as tax credits, bonds and other incentives -- are more readily available for brownfield projects that make economic sense. Tax-increment financing (TIF), for example, enables cities to finance debt for new development projects by setting aside future tax revenues

within a defined district for debt repayment. Cities, in turn, can use TIF revenues to reimburse developers for costs related to site preparation, which significantly alleviates the burden on city budgets. Currently, TIF is hard to come by, however, because the compression of real estate values has eroded the source of repayment.

Ultimately, brokers will see that creativity is the key difference between successful brownfield redevelopment and a property that continues to be underused. Innovative financing, cleanup and redevelopment solutions must be designed to address a property's specific challenges.



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