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On the Cutting Edge

Favorable Market Trends Driving Contaminated Property Transactions

Increased cooperation from regulators and a great deal of liquid capital in the market right now are driving a rise in contaminated property transactions, environmental professionals told Bloomberg BNA.

“There’s a lot of corporate cash out there to improve inventories, upgrade facilities, increase production, and make strategic acquisitions of other companies that complement organizations’ core business, and there’s improving activity going on right now, especially with certain market segments,” Jeff Telego, president of environmental risk management and consulting firm Risk Management Technologies in Alexandria, Va., said Aug. 29.

“Corporate surplus properties are starting to turn over, especially when the economic fundamentals work for the transaction,” Telego said. Correspondingly, “we’ve seen the environmental due diligence performed in these types of property transactions skyrocket.” Telego noted that “it’s a seller’s market for commercial and industrial property—we’ve seen an uptick in the number of transactions for mergers and acquisitions, brown-field transactions for infill, affordable housing, waterfront and port terminal activity and big box store redevelopment.”

The market also has seen an increase in lending for commercial and industrial loans because “the interest rates are so low, the cost of money is very competitive,” according to Telego. As a result, “we are seeing an increase in construction lending for both commercial and in-

dustrial projects including brown-field redevelopments,” he said.

Environmental Liability Transfers

Environmental concerns uncovered during the performance of due diligence at contaminated properties are being addressed more frequently through a mechanism known as environmental liability transfer (ELT). ELT refers to a financial and environmental risk management and risk transfer strategy for contaminated property transactions.

According to Telego, unlike in traditional transactions, a purchaser using ELT assumes the environmental liability accompanying the property, referred to as the ELT cost. The purchaser of the contaminated property uses financial and environmental due diligence and risk management tools to determine price to value. The market value of these properties can be determined by subtracting out investigative costs, assumed environmental liabilities, cost of any environmental insurance purchases, carry costs, repositioning costs and return on projected risk.

Telego went on to explain that “ELT is used when there is known contamination on the site in situations when the property acquisition can be right side up or upside down financially due to the contamination and appraised value of the assets.”

ELT is unique because the presence of contamination at the property being transferred is a given. In the majority of transactions where the buyer is unaware of environmental contamination at the site, conducting all appropriate inquiries and using the ASTM E1527-13 due diligence standard can be used as a defense to liability under the Comprehensive Environmental Response, Compensation, and Liability Act. “In an ELT transaction,” however, “environmental contamination

is a given—it is just the extent of the contamination and associated liability that needs to be determined against the asset value of the property and future use considerations,” Telego said.

ELT can be an effective method to ease the burdens of transferring contaminated property, but other risk transference tools also are commonly used.

Insurance to Manage Risk

“Environmental insurance is one of many effective risk transfer tools for indemnifying the prospective sellers and buyers of contaminated real property where there may be legacy environmental risk,” Telego continued.

Risks can include known and unknown contamination, hazardous substance constituents left on the property, natural resource damages assessments, or the potential for third-party personal injury or property damages. In the case of such third-party damages, insurance can be used instead of or in addition to corporate indemnifications, or compensating employees or agents of a company for liability personally incurred on the job.

When selling or acquiring properties with environmental liabilities, “I always recommend some form of environmental insurance, especially if there’s a concern that there is some level of residual contamination in the ground,” Telego said. “You want a combination of first-party and third-party liability coverage that looks at preexisting contamination and makes sure it doesn’t exceed the limits for the cleanup and also protects you from claims for injuries resulting from any contamination that may go off-site,” he said.

Attorney Abbi Cohen, a partner with Dechert LLP in Philadelphia, told Bloomberg BNA Sept. 5 that “insurance products have

changed—it's always smart to keep an eye out for new policies that may better address emerging remediation issues."

"The most common form of environmental insurance," Cohen said, still is the pollution legal liability policy. This policy provides protection and risk mitigation from a third party deep pocket, which "helps ease the fears of lenders related to how the costs of completing an environmental transfer will be met," she said.

PLL Insurance 'Most Effective'

Randall Jostes, president and CEO of Environmental Liability Transfer, Inc., a real estate acquisition and environmental liability transference and assumption firm, told Bloomberg BNA Sept. 9 that the pollution legal liability policy has "ultimately been the most effective type" of environmental insurance. According to Jostes, "it covers, in large part, all of the unknowns."

Jostes said the gradual refusal of insurance companies to offer cost cap environmental insurance, which had covered all expenditures over a known estimated cleanup cost, has harmed the ELT market. This type of policy was "not a good product from the insurer's perspective" because of the tendency of such cleanup projects to incur overrun costs, Jostes said.

But losing cost cap coverage "really chilled the transfer of properties."

"For the industry to expand again, companies need to see insurers coming back into the market with cost cap policies," Jostes said. One alternative in lieu of cost cap coverage for larger environmental liability transference companies with excess capital is to offer their balance sheets online rather than seek out environmental insurance coverage. "If there is a cost overrun, purchasers and sellers then have the assurance the company [handling the ELT] has the funds

available to cover any unknowns," he said.

Rising Regulatory Cooperation

Even with fewer insurance options available, Jostes has seen "tremendous cooperation from regulators who understand what's taking place and see the concrete benefits to the community."

"Regulators are really starting to embrace the concept" of using ELT, he said.

Initially, many regulators saw the use of ELT as a way "for polluters to get off the hook," Jostes said. "Now, they see transference as a method to get cleanup done quickly, efficiently and in a way designed to really make development happen at contaminated sites."

Vapor Intrusion a Game Changer

Traditionally, risk shifts from the seller to the buyer when regulators sign off with a no-further-action letter, Cohen said. Sometimes, however, "there is a recognition that a condition might be discovered in the future that could cause a risk of reopener—vapor intrusion is exactly that type of risk." Many deals didn't anticipate these conditions, so this new risk "changed the game," said Cohen.

"A major concern of industry now is the question, 'Is there ever a site that we can walk away from?'" Telego said. Transferring environmental liabilities along with a contaminated site that retains the risk of vapor intrusion is "a work in progress, and there are no absolutes," he said.

Jostes said his company also has encountered vapor intrusion concerns, but they "haven't really changed ELT's valuation strategy."

"Vapor intrusion abatement technology has proven successful—we know it works," Jostes said, so these issues "aren't really a barrier, more

just an extra cost to be considered" at the outset.

Certainty, Incentives Needed

"The end goal is to satisfy the regulators and otherwise meet applicable legal requirements in connection with the contamination so that you utilize the property for its highest and best use," Cohen said. To do so, companies need to "identify early on the interplay between the regulatory constraints on the remediation and the redevelopment demands," she said.

"Redevelopers must ask 'What type of closure do we need to obtain from regulators to confirm that we've satisfied the regulatory program?' The deal then needs to reflect the certainties and uncertainties associated with the project and that program," Cohen said. "The most efficient path is to get all the players involved in the process from the start to identify what each party needs in order to get the transaction accomplished."

Jostes said incentives, such as less regulatory push back and more grants and tax breaks, potentially would "open the floodgates of development."

The critical step, Jostes said, is getting to the point where the transfer of environmental liability is monitored and embraced by the entire regulatory community on a state and federal level. "As the regulatory community sees successful projects happening, they're going to be more inclined to say, 'We can do that here—let's see that in our state.'"

BY LOGAN L. HOLLERS

Telego, Cohen and Jostes are all featured speakers at the upcoming RTM Communications, Inc. conference. Bloomberg BNA is a sponsor. More information about the Oct. 7-9 conference is available at <http://www.rtmcomm.com/2014-Philly-Conference>.