

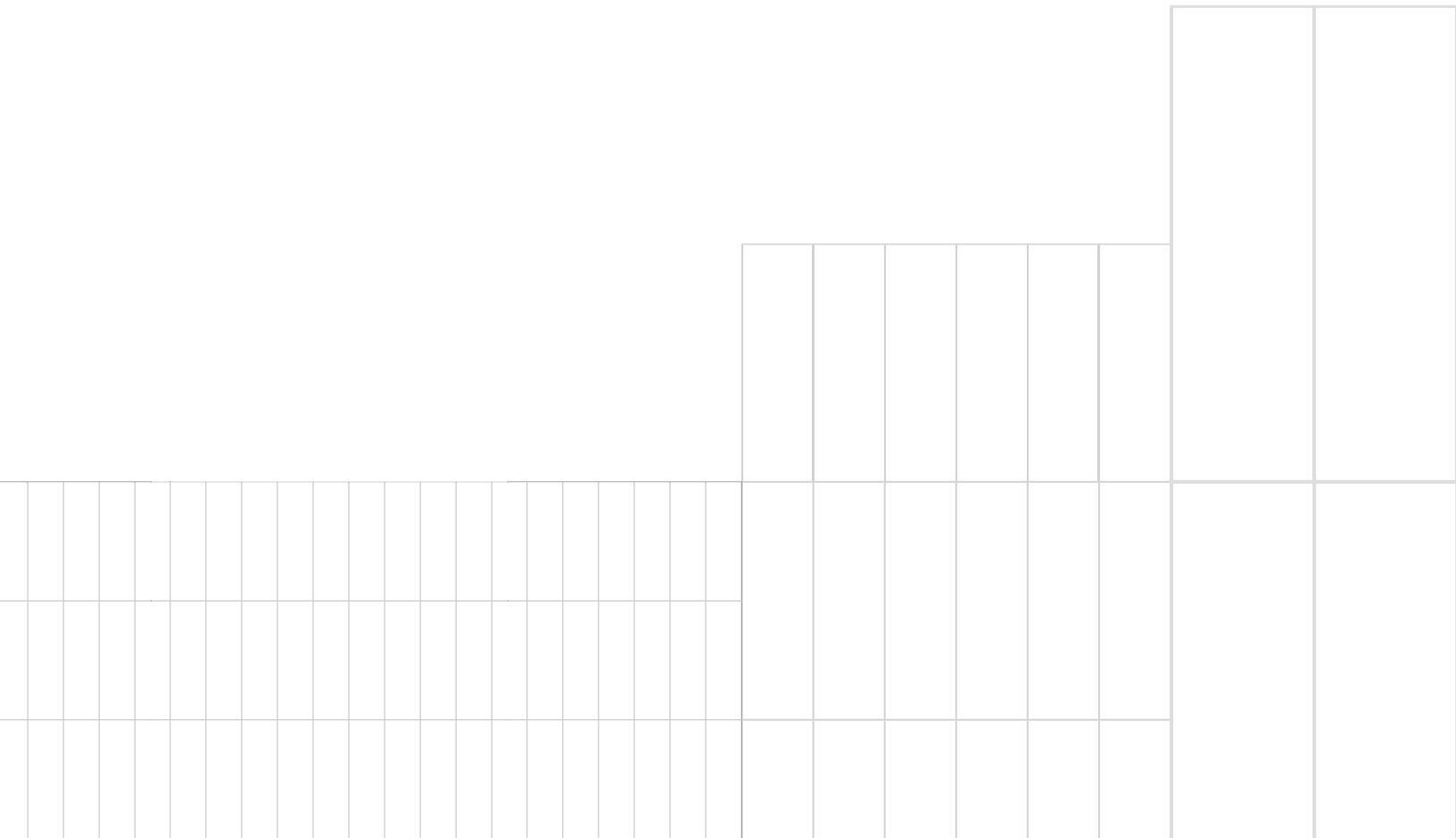
**Bloomberg
Environment**

Expert Insight Panel:

Private Risk Financing for Environmental Remediation

April 19, 2018

1:30 pm



Private Risk Financing for Environmental Remediation

The Environmental Protection Agency, through its Superfund Task Force, has indicated that the agency will be focusing on streamlining and expediting cleanup and reuse of contaminated sites, with a major emphasis on involving private parties and encouraging private investment.

This session will explore the costs and benefits of several private risk funding approaches for site cleanups, such as: litigating old general liability insurance policies, purchasing pollution legal liability and cost cap insurance, and incorporating environmental liability transfer and guaranteed fixed priced remediation strategies at sites. The session will provide an overview of common terms and conditions associated with the various options, the market and providers for each of these options, and their potential role in transactions through real-life case studies.

Speaker:



Brad Maurer

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Brad Maurer, J.D., CPCU of American Risk Management Resources LLC, is an environmental risk management and insurance executive with over 25 years of experience. His practice focuses on environmental risk management advisory services and as an expert witness/advisor for pollution claims disputes on both commercial general liability as well as environmental insurance policies. Maurer has been an environmental insurance underwriting and brokerage executive for a total of 20 years and has intimate experience in the trade and practices of both functions. In addition, he has been in-house counsel for an engineering consulting firm and a brownfield development firm with extensive transactional experience in drafting and executing environmental insurance policies, engineering services contracts, GFPR contracts, and real estate purchase/sale/lease agreements. He can be reached at maurer@armr.net.

Moderator:



Sylvia Carignan

Reporter, Bloomberg Environment,
Arlington, VA

Sylvia Carignan is a reporter at Bloomberg Environment who covers the Environmental Protection Agency's Superfund program, brownfields, waste, the agency's Science Advisory Board, and pipeline safety. She previously wrote about environmental and social issues for The Washington Post, Washington D.C.'s NPR station, and the Frederick News-Post in Maryland. Sylvia graduated from American University with a bachelor's degree in journalism.

Superfund Site Redevelopment: A Brownfield Approach to Financing Environmental Remediation Costs for Site Reuse

By Brad Maurer

The Environmental Protection Agency, through its Superfund Task Force, has declared that the agency has prioritized streamlining and expediting cleanup and reuse of the most contaminated sites in the country, known as National Priorities List (NPL) sites, with a major emphasis on involving private parties and encouraging private investment.

NPL site designation was once a popular way for affected communities to secure federal funding for the remediation of sites in their locale that have been abandoned. However, upon the expiration of Superfund earmarked tax funding in 1995, the program has suffered from little general funding.

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA or “Superfund”) established strict, joint, several, and retroactive liability for the remediation of released hazardous substances. Based upon a “polluter pays” principal wherein “potential responsible parties” (PRPs) pay for response costs, the Superfund law empowers the EPA to identify PRPs and compel their contribution to the costs of site remediation at NPL sites. With insufficient levels of earmarked tax revenue funding for NPL site response costs, the EPA relies primarily upon PRP contributions to fund NPL site remediation. PRP litigation, both with the EPA and amongst themselves, has significantly delayed the complete remediation and subsequent delisting of NPL sites. To date, there are 1,341 NPL sites with 55 more proposed; only 399 NPL sites have ever been removed or “delisted” from the NPL since the advent of the Superfund law.

Now, the Trump administration seeks to streamline the delisting of NPL sites by encouraging their reuse.

This initiative will more likely succeed if NPL site redevelopment is encouraged in the same manner as the redevelopment of brownfields.

For the last 25 years, there has been a wave of initiatives both at the federal and state levels to address brownfields – former industrial or commercial sites where future use is affected by real or perceived environmental contamination. Most brownfields do not rate high enough on the human health or environmental threat scale to be NPL-listed for federal funding. However, state environmental and economic development agencies have recognized that brownfield redevelopment has the twofold effect of curing contamination issues while at the same time spurring economic development. The EPA has recognized the value of redeveloping brownfields and offers financial and technical assistance to identify them through assessment and cleanup grants, revolving loan funds, and areawide planning grants pursuant to the 2002 Small Business Liability Relief and Brownfields Revitalization Act.

Brownfield initiative programs have three common elements:

- 1) Statutory liability relief for successful remediation,
- 2) Use of voluntary cleanup programs and expedited governmental approvals for remedial actions to shorten remediation periods, and
- 3) Funding to identify brownfield sites and bridge the financing gap between cleanup costs and property market value.

It has been recognized at the federal level that investment in brownfields pays a high rate of return: \$16 of private investment resulted from every \$1 of government money expended. Some state programs experience an even higher rate of return. With a burgeoning economy and increased demand for real estate, it is time to merge the two initiatives and apply a brownfields approach to Superfund site redevelopment.

Superfund Designation Adds a Level of Complexity to Site Redevelopment

With few exceptions, NPL sites often are not redeveloped. NPL site redevelopment is akin to brownfield redevelopment from a real estate development perspective, but it differs in some significant ways, making it more challenging:

- 1) *Level of Contamination.* A site can be designated as a brownfield site by the mere perception of environmental contamination. NPL sites have significant contamination.
- 2) *The Regulatory Program.* A brownfield site is easily placed into a state voluntary cleanup program, whereas Superfund sites are bound by the federal process, which requires much greater agency oversight and longer remediation periods.
- 3) *Different Nature of Responsible Parties.* Brownfield sites usually have few responsible parties, while NPL sites tend to have many. Also, while brownfields typically are owned by the party responsible for implementing the cleanup, the NPL PRPs often have no current ownership interest in the property.

A brownfield redevelopment approach can be applied to NPL sites but only if it addresses these additional complexities.

Viability of a Redevelopment Project: Real Estate Market Factors

Any property can be remediated to the point where the land is safe for reuse, but a key lesson learned

in brownfield redevelopment is that the real estate market ultimately determines access to private investment for a property. To be a candidate for redevelopment and private investment, a Superfund site must be located where there is market demand for the land. Properties in areas of high real estate demand will garner greater private interest and require less public assistance than those in less desirable areas, irrespective of contamination levels at a property. Therefore, a Superfund site in a depressed real estate area will not attract private investment, even if it is fully remediated. This is the hard truth that many brownfield programs have experienced. Where no private investment is available, the government must decide whether it wants to subsidize the cleanup to either create a public asset or use the property as an opportunity to stimulate the local real estate market and attract private investment to the area for nearby projects.

Redevelopment Financing: Public? Private? Or Both?

In any real estate development, there are different project phases that require funding:

- 1) Property acquisition,
- 2) Zoning and entitlements,
- 3) Site development, and
- 4) Vertical construction.

Traditional real estate development funding comes from private investors, developers, commercial lenders, and, to some extent, government economic development agencies. In the context of Superfund and brownfields, remediation costs must be factored in.

At most brownfield sites, the remediation costs are low enough to be absorbed by traditional financing, such as private equity and commercial lending. Where traditional financing is insufficient for brownfield remediation costs, government funding has at times been available to keep developers from scuttling a development,

either through brownfield program grants, low interest loans, or creative local funding such as Tax Increment Funding (TIF). TIFs are public subsidies paid for by local municipalities or economic development agencies for infrastructure necessary for a development. TIF financing derives its borrowing capacity from committing all normal yearly future real estate tax increases associated with the redeveloped parcels. TIF funding arrangements are available for Superfund sites from the local agencies, and, at times, state brownfield grant funding also may be available.

Value Extracted From the Property

In the brownfield context, redevelopment typically transforms low-value industrial land to higher value commercial or residential land. The mere re-zoning of the property can increase its value. This increase in property value is a source of equity that can be leveraged for remediation and development costs. The owner of a brownfield site typically is the main responsible party and has a direct financial interest in its development and value appreciation. The owner can either leverage its increased equity that results from remediation and rezoning to fund its remediation obligations or contractually transfer the remediation costs to a brownfield redeveloper, who is willing to accept these costs for the higher valued land that will result.

In the Superfund context, however, PRPs often are former, not current owners and therefore may not gain from its sale. In addition, Superfund remediation costs tend to be significantly higher than those for typical brownfields and often far exceed the value of the land. Therefore, to attract PRP participation in NPL site redevelopment, there must be an incentive. A share in the increased land value can be just that. For example, if an NPL site's current land value as an industrial site is \$2 million, but its land value as commercial/mixed use is \$10 million, the \$8 million difference can be applied in some percentage toward the necessary response costs. This decrease in the PRP's contribution liability can be a persuasive incentive and allow the PRP to partner with the redeveloper in executing the necessary remediation.

Why Should PRPs Fund Superfund Site Redevelopment?

CERCLA was enacted to remediate highly contaminated properties, but it did not focus on reuse or redevelopment of those properties post-cleanup. Arguably, PRP liability for response costs is limited to the actions consistent with the National Contingency Plan (NCP). The NCP provides that response costs are necessary to address:

- Threats to human or animal populations,
- Contamination of drinking water supplies or sensitive ecosystems,
- High levels of hazardous substances in soils,
- Weather conditions that may cause migration or release of hazardous substances,
- Threat of fire or explosion, or
- Other significant factors affecting public health or the environment.

While actions consistent with the NCP may address health risks for what is typically the site's industrial use, additional remediation may be necessary to prepare a site for commercial or residential use.

Due to the significant cleanup costs at these sites, PRPs normally stand little to gain by accelerating the remediation of Superfund sites for which they are liable. In fact, most PRPs would rather delay remediation expenditures until they are completely necessary. A brownfield approach to cleanup and redevelopment can change this attitude if the stakeholders leverage some of the successful strategies implemented at those sites. Some key benefits of that approach are:

- 1) *Redevelopment attracts private and public investment to efficiently remediate the property.* Time is money in real estate development, and remediation efforts at development projects are designed to be both cost-effective and timely.

Brownfield redevelopment projects focus on the most cost-effective end-use-based cleanup (e.g. industrial, commercial, or residential) to prepare the property for future use in a predictable time frame. The aim is to complete the remediation with redevelopment in mind so construction may begin in a time frame that conforms to real estate market demand. This expediency in developing an NPL site like brownfields may accelerate PRP expenditures, but it reduces the ultimate net costs to PRPs by eliminating years of costly monitoring and investigation activities that occur while NPL sites are idle.

- 2) *Redevelopment ultimately “closes” the remediation issue.* In the Superfund context, NPL delisting traditionally takes a very long period of time – sometimes as much as 30 years. Redevelopment sets remediation goals that are defined by end use and a time frame to achieve them.
- 3) *Long-term remediation elements can be funded from the property’s revenue as an operating cost.* In many cases, cleanup remedies implemented at sites can result in continuing efforts such as groundwater monitoring, groundwater treatment, or vapor extraction and treatment that have associated long-term costs. Redevelopment of a contaminated property creates cash flow that can fund these ongoing efforts and often can be classified by the end user as an operational expense.

The key to PRP funding is understanding that their liability for response costs, although it may be large, is limited. To interact and partner with PRPs and their insurers at a Superfund site redevelopment, it is important to define the difference between CERCLA-related response cost liability and the additional remediation costs, if any, that are necessary to redevelop the site beyond its former use. There often are additional remediation costs attributable to a change in land use. For example, an NPL site that is zoned industrial may be re-zoned as commercial.

That change in use will require a more robust remediation than before and may increase costs significantly. The PRPs will only agree to fund those costs necessary to a standard of completion that was applicable to its use at the time it was contaminated. Understanding CERCLA liability for PRPs and its limits is important to negotiate reasonable PRP contributions towards an NPL site development.

The Role of the Nonresponsible Party: The “Bona Fide Prospective Purchaser”

Under CERCLA, a “Bona Fide Prospective Purchaser” (BFPP) can take title to a Superfund site with statutory liability protection. While an agreement is not necessary for BFPP status, it often is wise to engage the EPA to settle liability for any existing liens on the property and formalize future interaction with the agency. Once in control of the Superfund site title, the BFPP typically takes the lead role in site remediation to ensure it conforms with the desired end use of the property. A BFPP can act as an organizer of PRP contributions as they relate to CERCLA liability and as the clearinghouse to discern between necessary response costs and redevelopment-based remediation costs.

Some key benefits of a BFPP becoming involved in an NPL site development include: coordinating with the regulating agencies, directing and implementing the site remediation plan, and establishing protections for the property’s future use. Most remediation projects are risk-based, meaning cleanup levels are tied to a property’s intended reuse, and will often result in residual contamination at the property. In this scenario, PRPs benefit from the forgone costs of removing all contamination, but, in exchange, must rely on the BFPP’s responsible management of site. The BFPP can manage the risk of this residual contamination in several ways:

- 1) Ensure the proper installation and maintenance of engineering controls,
- 2) Responsibly monitor the efficacy of engineering controls through periodic sampling and analysis, and

- 3) Maintain financial assurance for remediation efficacy and personal injury protection providing proper capital reserves and purchasing insurance to leverage those reserves.

Remediation Cost Defining Arrangements

Superfund sites share the same major challenge as brownfields – defining the cost of environmental remediation. Every development has an estimated rate of return to attract investors and lenders. Environmental remediation costs in a development pro-forma are notoriously difficult to estimate – even more so with Superfund sites. This is another area in which developers of Superfund sites can utilize some of the mechanisms that have been successfully employed by brownfield developers to hedge their remediation cost investment.

The risk that environmental costs will exceed their estimate is a major challenge to redevelopment. Risk-capital markets have arisen to offset cost escalation risks in the brownfield market. Such mechanisms are available for Superfund sites as well and are outlined below.

Guaranteed Fixed Price Remediation (GFPR)

There are companies, mostly environmental remediation firms, that will agree to complete site remediation for a fixed price. The GFPR company will analyze site conditions and the expected remediation outcome. After modeling several cost outcomes, the company will generate a reliable remedial cost estimate and add a premium to that value for taking the risk to arrive at a “fixed price.”

These arrangements are offered via complex and varied agreements but fall into two main categories: 1) GFPR for a set scope of activities and 2) GFPR for a set remedial outcome (e.g. a “no further action” determination.) The latter is riskier and will command a higher premium, while the former leaves the site owner with the risk that the set scope of activities fails to achieve the desired remedial outcome.

Environmental Liability Transfer (ELT)

A new breed of companies has arisen that actively seeks to purchase contaminated properties. Often used as an exit-strategy for contaminated site owners, ELT companies possess both technical remediation and real estate development expertise. In the Superfund redevelopment context, an ELT company may act as a “straw man” to acquire the site, remediate it, and even perform preliminary land development in preparation for sale to the ultimate developer.

Environmental Impairment Liability Insurance (EIL)

Another lesson learned in Brownfield development is that most government liability protections surround liability for remediation but do not protect developers from personal injury liability that may arise from the property’s neighbors or future occupants. The EIL market for Brownfields is robust and will underwrite insurance policies that insure against the fortuitous risks of both brownfield and Superfund site development, including:

- 1) Personal injury claims of bodily injury or property damage arising from the release of pollutants on, at, or emanating from the project location,
- 2) Remediation of undiscovered contamination that is found during the project’s construction; and
- 3) “Reopener” exposure from the risk that a completed remedy somehow fails in the future to remain protective of human health and the environment and the costs to correct it.

EIL policies have other available coverages and insure both past and future pollutant releases. They are available for multi-year periods, up to 10 years currently, and the market has substantial capacity to offer up to \$250 million on a single project. EIL policies often have been used to attract investors and lenders to brownfield sites who fear the substantial unknown risk of tort liability presented by the properties’ tainted pasts and propensity to leave residual contamination onsite.

Cost Cap Insurance

Once a widely offered product, the cost cap insurance market has returned but with only two significant insurers at the time of this article. Cost cap insurance pays for remediation costs that exceed the combined value of the expected remediation costs from a set scope of work (e.g. the remedial action plan) and a “buffer” amount akin to a deductible which is typically between 20% to 30% of expected remediation costs. These policies typically provide an extra 100% of remediation funding above the expected remediation cost value and this “buffer.” For example, a \$5 million remediation project can be insured for \$5 million that will be available to fund additional project costs once project costs exceed \$6 million (i.e. the \$5 million expected costs plus the 20% or \$1 million “buffer”). Premiums rates of 15% of the expected cost are typical. GFPR companies often employ this insurance to hedge their exposure.

Conclusion

EPA's Superfund Task Force has made NPL site delisting and redevelopment a priority. Once thought unfathomable, the redevelopment and productive reuse of Superfund sites is now plausible given the successes of the brownfield approach to cleanup and redevelopment and the private financing and risk management options available in the market that can be utilized to cleanup and redevelop Superfund sites.

The last 38 years of the Superfund program and related litigation has entrenched many PRPs in a mode of glacial progress towards site cleanup as they attempt to minimize current day costs. Redevelopment requires timely remediation to ensure that developers and investors can deliver their projects in sync with real estate demand. Decreased total remediation costs and resolution of liability are the key incentives for PRPs to rethink their approach. If brownfield concepts of public/private financing and partnerships, as well as efficient risk-based remediation can be successfully implemented at Superfund sites, PRPs will benefit from the financial success of the project and as such, will remain incentivized to clean up and redevelop their legacy properties.

With the EPA's new Superfund Task Force and NPL redevelopment initiative, PRPs may have a unique opportunity to transition from being long-term stewards of contaminated Superfund sites into motivated partners, invested in the completion of a site's cleanup and subsequent redevelopment. Together, the EPA, PRPs, BFPPs, and the communities surrounding Superfund/NPL sites, have the collective opportunity to remediate significant environmental contamination, ameliorate certain PRP liabilities, create and extract value from, and return these former blights back into the economy.

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