Woosley's Guest Column in Triad Business Journal: "How to Buy (or Not Buy) Contaminated Property"

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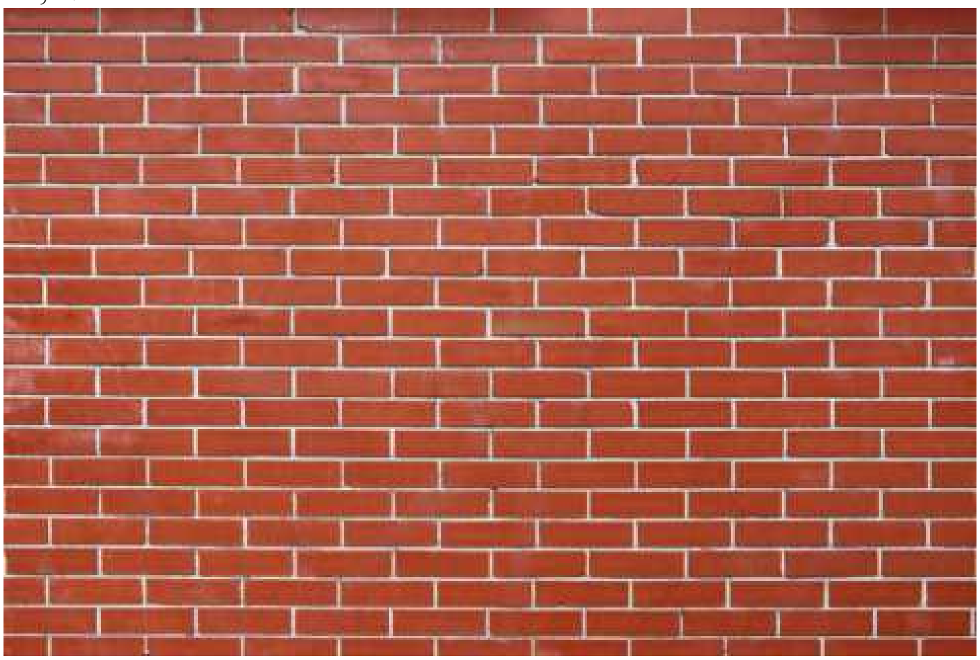

As the economy recovers, will you consider expanding your company's business? Relocate to a larger facility, or build a new facility? Expand to a neighboring property? Open a new branch?

If you consider buying or leasing real property, my advice is: Do your environmental due diligence, and do it early.

Contaminated sites are common. Chances are, if a property has been developed in the past, there is a risk of contamination, especially in downtown or industrial areas. The Department of Environment and Natural Resources (usually called DENR) has identified about 1,900 hazardous sites, 700 old landfills, and 40,000 storage tank incident sites, and estimates 1,500 contaminated dry cleaning sites across the state.

The environmental risks

There are three risks associated with buying (or leasing) contaminated property.

Cleanup Risk: There is a risk of liability to the government for site clean-up, natural resource damages, fines and penalties.

Damages Risk: The contamination often will migrate with the groundwater to adjacent properties, and there is a risk of liability to neighbors injured by using contaminated water or whose property values have decreased because of the contamination.

Business Risk: There is a risk the buyer or lessee may not be able to use or develop the property as planned, or obtain financing for development, or resell the property down the road.

Environmental laws can be draconian and counterintuitive. One who buys a contaminated property may be liable for cleanup, even though the buyer did not cause the contamination, and may end up owning a property with environmental liabilities that far exceed its value. So, you have strong incentives to investigate what you are buying.

Yet buyers often leave environmental issues to the last minute or, worse, ignore them entirely. This is penny wise and pound foolish. Hire a competent consulting firm, investigate the environmental condition of the property, get any legal advice you need, and consciously evaluate the risk.

Manage the risk

The simplest way to avoid the risks is to refuse to buy the property. But I suggest*Do not automatically scratch a property off your list just because it is contaminated.*

In some cases, the environmental risk may be minimal, not sufficient cancel the purchase. Or, the business deal may be so good as to justify taking some environmental risk.

There are several mechanisms to manage the risks, including insurance, escrows, and indemnities. Another effective way to manage risk can be a Brownfields Agreement with the State.

A property buyer is eligible to apply under the Brownfields Program if:

1. the property is abandoned, idled, or underused,
2. development at the property is hindered by contamination,
3. the buyer did not contribute to the contamination,
4. the buyer intends to buy the property to develop it, and
5. the development provides benefit to the public.

If a buyer qualifies and signs a Brownfields Agreement with DENR, the essential bargain is this: the buyer will invest capital to develop the property, make the property safe for the developed use, and provide a public benefit; in return, the State promises liability protection to the buyer and will not require additional cleanup, beyond what the Agreement requires.

The good. The Brownfields Agreement addresses two risks of buying contaminated property. It addresses the Cleanup Risk by defining the buyer's (limited) cleanup liability. It addresses the Business Risk by providing cleanup liability protection to the buyer, its lender, and future buyers and lenders. Lenders often are unwilling to finance purchase or development without protection from environmental liability. A Brownfields Agreement generally precludes unlimited cleanup liability and makes a contaminated property more readily developable and more easily transferable.

DENR believes its Brownfields Agreement also protects the buyer from liability to the federal government under federal law. But this is a gray area that must be assessed based on the facts of your case.

A Brownfields Agreement also entitles the buyer to a property tax exclusion on property improvements for five years. This tax exclusion is intended to offset some costs incurred by the buyer to implement the Agreement.

The bad. There are potential shortcomings to the Brownfields Program. First, the Program does not apply to all contaminated sites. If the only contamination is petroleum released from an underground storage tank, the property is not eligible. This is a quirk of North Carolina environmental laws; this kind of contamination is governed by a separate cleanup program.

Second, the process can be a lengthy one. It has become a popular program among developers and businesspeople, and there is insufficient staff to move sites through the process in a timely manner. It may be years from the time of application until an Agreement is signed. However, a recently established pilot program fast-tracks sites for an additional fee.

Third, a Brownfields Agreement does not address all environmental risk – it does not reduce the risk of liability to third parties. The buyer must assess and manage the Damages Risk separately.

Fourth, depending on the property, the proposed use, and the environmental data, a Brownfields Agreement may require further assessment and cleanup, use restrictions, and protection measures that allows DENR to conclude the property is safe for the proposed use. And some of these requirements may be essentially perpetual.

Fifth, the liability protection is conditional. A Brownfields Agreement allows DENR to “reopen” the site and require more investigation or cleanup in some circumstances: for example, if property use changes or if new data show the contaminants are more harmful than previously thought.

A Brownfields Agreement helps manage risk, but it is not perfect protection. Each case is different; each property requires its own assessment to determine the risks and the best methods to manage them.

The creative. The prototypical brownfields site is an old industrial facility, urban, abandoned, and deteriorating. The contamination resulted from years of industrial operations and imperfect waste disposal practices.

But there are opportunities to be creative in qualifying properties for the Brownfields Program. The Program staff views its role as a collaborative partner with property buyers in making contaminated properties safe for reuse while protecting public health and the environment. The staff has interpreted the brownfields statute liberally to make the Program as widely available as possible.

One example: A contaminated property may be eligible even if it is not abandoned. A brownfields site includes “underused” property where “expansion” is hindered by contamination. Thus, a currently operating facility may be eligible if it is not at full capacity and the buyer intends to undertake a bona fide expansion. But since an expansion implies continuing the current operations, the staff will review the site carefully to ensure the buyer does not cause additional contamination.

Another example: Most applicants are buyers, but a person who intends to sell a contaminated property for development also is eligible. Thus, the current property owner is eligible if the owner and property meet all Program requirements – including the requirement that the owner did not contribute to the contamination on the property. This can be difficult to prove, and the staff will review such a site carefully to ensure the owner has not undertaken contamination-causing activities.

Conclusion

Do your environmental due diligence before you buy or lease real property. If you determine the property may be contaminated, do not reflexively look elsewhere. While there are risks to buying contaminated property, often they can be minimized sufficiently – through tools such as escrows, indemnities, insurance, and the Brownfields Program – to justify the purchase if the property is a good business deal.