Kahr Notes

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1..Opening Shot

Welcome to another issue of Kahr Notes.

This issue, I have an interview on a subject that is dear to my heart, and my consulting practice - the remediation of environmentally contaminated properties. I've personally done a lot of work with brownfield redevelopment and one of the more complex issues that one comes across is how to financially model the impacts of tax incentives and other government programs on a potential project.

My interview subject for this issue, Bart Higgins, just completed one of the best studies I've seen on brownfield redevelopment from a financial perspective. It's not just a policy paper; it actually shows what the impact of the newly enacted New York State Brownfield Tax Credit will have in encouraging new development.

The study can also be downloaded from the Kahr Real Estate web site at:

http://www.kahrrealestate.com/Publications.shtml

The links to download the study are listed under Volume 3, Number 4 of Kahr Notes.

Also, as mentioned in last issue, the New York State Department of Environmental

Conservation is sponsoring a workshop on Brownfield Real Estate Development for not-for-profit and government personnel. I'm one of the workshop leaders and welcome everyone who can attend to do so.

The first will be held on March 7th at the Newman Library, Baruch College in Manhattan, and there is an additional one on 3/16 in Syracuse. If you're interested, you can read about it in my last issue of Kahr Notes, which is here:

http://www.kahrrealestate.com/KahrNotesvolume3issue3.shtml

I look forward to seeing at least a few of you in person shortly.

Regards,

Joshua Kahr
Editor/Publisher, Kahr Notes

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2. Argus Class on 3/22... Spread the word and take the class for free!

For every colleague you refer that signs up for my class, I'll take $55 off the cost of you attending. There is no cap to this promotion, so if you refer 10 people that sign up, you can take my class for free. If you've already taken my class and can't use the discount, you can pass it onto a friend.

The class is only $550 and runs for four evenings over four weeks (12 hours of class time). All attendees leave my class with both a good working knowledge of the software and the tools to master it. To ensure a quality experience, the class is capped to only 12 people.

All attendees also receive a copy of my 150 page training manual. This manual is the product of over four years of teaching Argus at leading universities and corporations. It is the only manual of its kind and covers both the software and the important related financial issues. Think of it as a crash course in the only real estate finance you really need to know.

The next class starts on 3/22. You can read more about the course, and sign up at:

http://www.kahrrealestate.com/argustraining.shtml

If you have any questions about the class, please e-mail me at josh@kahrrealestate.com or call me at (646) 286-0128.

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KN: Today, I'm sitting here with Bart Higgins, marketing and business development consultant. Welcome to Kahr Notes.

BH: Thanks Josh.

KN: So, let's start with the basics. Why don't you tell the readers a little about yourself, and then we'll dig into the main topic for today - the study that you recently completed on brownfield redevelopment in New York City. Tell us about your education, background, and what experience you've had in real estate.

BH: My career in real estate started in 1995 when I began working for Wired Magazine and Wired Online as the National Director of Facilities. I continued in the commercial office business as the Real Estate Planning Manager for The Industry Standard and in

1999 helped to start up the West Coast office of A+I Design Corporation, a New York based architecture firm specializing in commercial office design, where I worked as the Director of New Business Development. Based on a desire to get more deeply involved in urban renewal and new development projects I decided to attend the Columbia University Masters in Real Estate Development Program and received my degree in the fall of 2004. I have operated Higgins and Associates, which is my own marketing and business development consulting business, since 2002 and have had the privilege of working with companies such as Pompei A.D., M.A. Design, L&M Equity, Miller Development, The Newman Real Estate Institute, DWL Development and Friendster.

KN: OK. I've read your study on brownfield redevelopment in New York, which is why I invited you to speak with us today. This is a unique project that you completed, but before we jump into the heart of the study, how did you become interested in brownfields?

BH: Columbia University's Masters in Real Estate Development Program is an accelerated 1 year degree and therefore a large part of the education is focused on student's independent thesis work. I viewed this as a great opportunity to exercise my social interests in urban renewal and a discontinuation of suburban expansion. I decided to build my work around real estate development opportunities in urban areas that could benefit local communities by providing increased tax revenue, jobs, housing, and services.

My preliminary investigation into potential topics led me to the conclusion that one of the primary barriers to development in urban centers like New York City is the lack of developable land. This fact seems to be a little ironic when you stand on the western shore of the East river and see Brooklyn's vastly underutilized waterfront staring back at you. Why is it that some of the best real estate in America is sitting idle while developers are fighting like cats and dogs for land? When looking at these properties I found that in many cases zoning issues were major barriers to development but an even greater detriment to their viability was the fact that their historic industrial use had left them encumbered by contamination.

A brownfield, by definition, is real property, the expansion, redevelopment, or reuse of which is complicated by the presence of potential presence of hazardous substance, pollutant, or contaminant. Historically the private development community has shied away from these properties because of the inherent issues of liability, and cleanup costs. This factor has left federal and state government with the insurmountable task of dealing with the issue and as a result we've been left with a substantial amount of underutilized land in urban areas that often blights surrounding neighborhoods and limits the development of housing and jobs.

KN: What caught my eye about your work is that it's more than just a policy paper; it tries to bridge the gap between theory and finance of brownfields.

BH: It's and interesting point actually. The theory of cleaning up brownfields and putting them back in to service is pretty straight forward. If you look at the impact that the existence of contaminated property has on suburban expansion you can easily see how viable the theory of redevelopment and cleanup is. The United States Environmental Protection Agency has recently estimated that there are between 500,000 and one million brownfield sites in America today and that the vast majority of these contaminated properties lie within America's urban landscape.

A distressing symptom of the problems created by these underutilized sites is the continuation of concentric suburban expansion away from our city centers into our nation's quickly disappearing greenfields. Urban sprawl is one of the greatest planning concerns facing our nation today, the inefficiency or suburban expansions strains our infrastructure, decentralizes our tax base, disrupts our environment, and increases our reliance on fossil fuels. If we focus on redeveloping these sights rather than simply mothballing them and moving out from the urban centers in search of clean land to build on we can kill two birds with one stone, we can revitalize the reconnect the fabric of urban communities and we can protect our rural land. The President of the United States said while signing The Small Business Liability Relief and Brownfields Revitalization act in 2002, that for every acre of redeveloped urban brownfield land, we save four and a half acres of open space.

So there you have it, the theory of cleaning up brownfields is easy, what is hard is figuring out how to make it happen. That is where you have to begin thinking about finance. Developers have traditionally shied away from contaminated urban properties out of fear over the excessive regulation that has historically controlled them or because of the fear of getting involved in a property ownership and cleanup situation that could lead to perpetual litigation and liability issues. Private developers are market driven business people who have to focus on the financial returns of their investments. Contaminated properties are huge financial risks from a cleanup and from a marketing standpoint and historically have a significantly lower return for investors than clean properties due to the cost of clean up and the uncertainties of liability. Efforts to require cleanup by the Primary Responsible Parties, otherwise known as PRP's, take years and years and costs government vast sums of money in legal fees. On the other hand, the idea of requiring the public to fund cleanups for damage done by private parties is hard for taxpayers to swallow. The best way to put these properties back in to service is to find a way to make redevelopment profitable for the private development community.

The Federal Government set the stage for greater involvement from the private development community with the 2002 Small Business Liability Relief and Brownfield Revitalization Act which dramatically limits liability for purchasers of contaminated land. This bill did much to provide incentive for communities and non profit organization however, for the private development community state legislation has a much greater potential for impact on project profitability. In 2003, Governor Pataki signed into New York law the Brownfield Cleanup Program which enacted sweeping reforms and incentives to brownfield cleanup. Strangely enough, New York State was one of the last states to enact such a law, even though we had a significant industrial history.

The bill does even more that the Federal Act to limit liability and also sets up a defined system for creating cleanup standards, remediation plans, and time tables for project review and in so doing dramatically reduces the uncertainties associated with brownfield projects. The program's biggest incentive to private developers, however, is the issuance of $135 million in tax credits for brownfield projects. These credits have the potential to dramatically increase the financial returns of brownfield redevelopment projects.

KN: That brings us to the heart of why I picked this study for discussion. Explain how you went about examining the impact of the Brownfield Tax Credit.

BH: The majority of my work focused on the impact that the New York State Brownfield Cleanup Program and the Brownfield Tax Credit will have on the private development community. The new tax credit program doesn't go in to effect until April of 2005 so I was forced to speculate and to predict the impact it will have for developers. To my dismay, I wasn't able to find any existing predictive models for how the credit will work so I had to create them on my own. Not having anything to base your work on is never easy but it does leave a lot of room for interpretation. I decided that the best way to explain how the new Tax Credit could work would be to define an area of New York that could benefit from the program and then create some hypothetical redevelopment projects that would utilize the credit. By taking this approach I was able to see how the credit applied to different types of asset classes and how these redevelopment projects could affect the neighborhoods that surround them. When it came to choosing properties, it was difficult to gather historic information because few people were willing to openly identify their buildings as having environmental issues. In most cases, I had to spend a lot of time combing through historic Sanborn Maps to determine what properties had been used for in the past and then make assumptions about what contaminates might exist today.

KN: Where else did you find the resources you needed to complete this project? Did you rely heavily on interviews or was there any other published information that helped you? As you mentioned, it's not as if most people would be very open about advertising environmental issues. Also, did you reach out to the public or private real estate community more?

BH: Brownfields are a hot topic right now so people are very open to discussing what they know and what they have experienced in the field. The EPA proved to be one of the greatest resources for historical information on contamination in America and regulation at the Federal Level. I was amazed at their openness in speaking with me about the project and at their interest in helping me to develop an appropriate focus. They are incredibly dedicated people who truly believe in the benefits of involving the private development community in the cleanup of contaminated properties.

Another great source of information was the local brokerage community. Brokers always have their ears to the ground and are always aware of coming trends in the market. Everyone I spoke with, especially John Rienertson of CB Richard Ellis in Long Island City, was incredibly helpful and knowledgeable on the subject. They often seemed to know more about how Federal and State Laws were affecting developers and land owners than the lawmakers did. Another great thing about working with brokers is that they know their territories inside and out and have endless knowledge of property history and use.

The New York State Department of Environmental Protection is in charge of overseeing the Brownfield Cleanup Program and was and obvious information resource for my project. Unfortunately, due to the enormous workload they are dealing with as a result of the new BCP program they weren't able to speak with me directly. The program and the tax credit issue has created such a surge of interest here in New York that their staff simply didn't have the time to meet with me. Luckily, their website was incredibly in depth and had a detailed description of program details. I was also able to supplement much of the information I needed from them regarding the tax credit program with the New York State Bar Associations interpretation and review of the program.

I was very lucky to have the opportunity to interview Terry Wolfram of Cherokee Investment Partners about the issues of liability and Environmental Insurance. Cherokee is well known in the environmental remediation business and has had significant success investing in the redevelopment of contaminated properties. They are also currently undertaking a large cleanup and redevelopment project in New Jersey.

During all of my research, one name continued to come up as the most knowledgeable person on the topic of brownfield development. Barry Hersh, of Baruch College, is the chair of the Developer's Group for the national Brownfield Association and a Board Member of Partnership for Sustainable Brownfields Redevelopment. Barry was of incredible help to me and went out of his way to assist me in figuring out how to test the viability and impact of the proposed brownfield tax credit. At the time that I was writing my thesis Barry was putting together an analytical report on brownfield redevelopment for the City of New York. We were able to combine our efforts and I believe both projects benefited from it.

KN: Why are there brownfields in such a rich city as NYC? You'd think that with real estate values being so high, the private market would have had excellent success in cleaning up the sites.

BH: It's important to recognize that not all brownfield sites are toxic waste dumps or large chemical manufacturing plants. The majority are actually old gas stations, or dry cleaners, or even buildings with asbestos issues. Every city in America is faced with the issue of cleaning up these sights.

In areas like Manhattan where property value is so high and the profitability of what is built is equally great, the issue of contamination is not a limiting factor. Developers don't fear the risk of cleanup cost because the profits of the developments easily outweigh the cost. Brownfields exist in New York primarily in areas where the market hasn't driven the return of development to high levels.

What we found was that there are areas in New York with very high concentrations of brownfield sites and sites that we assume are contaminated based on their historic use. In the case of Long Island City, which I used as a case study for my thesis, the economy of the area had been industrially based since before the turn of the century. In the early 1900's, Long Island City was the most industrialized city in America and as a result nearly every piece of land has at one time or another been use for the production or storage of some kind of hazardous substance. Because of the historic use, the assumed contamination that comes along with that use and restrictive zoning to protect the industrial economy the area has remained primarily industrial. The contaminated properties that exist there are never cleaned up because their use has never changed. In fact, most brownfield sites only show up on the radar when there is a change of ownership or a change of use.

As the market has begun to change and industrial properties are less productive and profitable than residential or mixed use properties, many areas that have high concentrations of brownfield sites have been rezoned to allow for redevelopment. It is only then that the long standing issue of contamination becomes a development issue. This is true in Long Island City but the market has yet to drive project returns high enough in the area to outweigh the costs and liabilities of getting involved in a brownfield project. It is in these areas that the new Brownfield Cleanup Program and the Brownfield Tax Credits will have the greatest potential for initiating cleanup of sites by the private development community. Allowing a high enough return on investment is the best way to involve the private community and tax credits will do just that in transitional markets such as Long Island City.

KN: What's the history of the brownfield tax credit? Are there other Federal, State, or Local programs that we should be aware of?

BH: In 1997, the Federal Government signed in to law the Taxpayer Relief Act, the act included a tax incentive for private developers who would take on the burden of cleanup and redevelopment of urban and rural brownfields. The idea was to allow private parties who remediate contaminated land to deduct all environmental cleanup costs in the year that they are incurred rather than having to capitalize the costs over a number of subsequent years. The cost of the tax incentive was approximately $300 million in annual tax revenue, the tax incentive was expected to leverage $3.4 billion in private investment and return 8,000 brownfields to productive use.

At the state level, New York was one of the latest in the brownfield cleanup game but to their credit the new New York State Brownfield Cleanup Program is easily the most progressive in the nation and is offering the most significant financial tax incentive of any state.

By far, the most significant and most talked about component of the BCP legislation is the proposed issuance of $135 million in annual tax credits to provide financial incentive to private parties who take part in the cleanup of brownfields. The act offers a variety of tax credit opportunities for developers including bonuses for developments that take place in areas designated as Environmental Zones or En-Zones where were chosen by the DEC as areas with the greatest opportunity to benefit from brownfield redevelopment.

An applicant to the BCP program who completes required site remediation outlined in a written agreement with the DEC (Brownfield Cleanup Agreement) will be granted a Certificate of Completion which entitles the applicant to the tax credits created by the program. These credits are available to Volunteers and Participants as long as they adhere to the provisions of the Brownfield Cleanup Agreement. A developer has the ability to significantly increase the returns of a project through the use of these credits and is likely to have a much easier time gaining financing from outside sources with their guarantee.

The new legislation creates three new State income tax credits, one based on development costs, one on liability insurance costs, and another based on the number of jobs a project can bring to a community. All of these credits will allow a developer to reduce the amount of income tax from project earnings on a dollar for dollar basis. The law allows for these credits to reduce taxes to the minimum which is zero in New York. An interesting and compelling component of the BCP tax credits is that they are "refundable" which means that any unused credit will be treated as an overpayment of taxes. This overpayment is repaid to the taxpayer after the taxpayers return is filed which has the potential to provide a very lucrative incentive.

KN: That's amazing. I almost can't believe that any government would ever make a tax credit "refundable" if you couldn't use it. Typically, tax credits are carried over from year to year; it's not like the government just cuts you a check if you can't use the tax credit. Well, this brownfield tax credit sounds like it is extremely important for redevelopment in New York State. What has the impact been so far of the credit?

BH: Well, the impact of the tax credit won't be seen for quite some time. The act goes into effect this April and that translates in to 2006 for tax payers. What is known at this point is that there has been a huge amount of interest in applying for the BCP program.

The way the law was originally written left many holes in the program and didn't allow for proper oversight by the DEP. A major concern was that large projects would use up the entire $135 million dollar fund and leave little for smaller and in many cases more significant projects. Another important concern is the refundability of the credits. Offering to reduce a developers tax burden is one thing but paying out large sums of money as credit refunds will make a substantial dent the in the State's bank account. The DEP has revised the program to eliminate many of these issues but there is still large scale apprehension from the development community about how the system will actually work.

It is very important to note that one of the provisions of the tax credit incentive is the potential for recapture. This recapture can be triggered by a revocation by the DEC of the Certification of Completion due to findings of noncompliance. There is also a trigger for disposal of the property. The developer is expected to hold the remediated property for at least 12 years in order to avoid a recapture of a portion of his tax credits. This fact significantly limits the opportunity provided to developers and in my view should be eliminated from the provisions of the program. The object of the tax credit program is to clean up property and to put it back in to use so the state can create housing, jobs, and tax revenue. A developer should not be forced to hold on to a project for 12 years once they have taken on the burden of cleaning it up. This factor also limits the ability to develop condominium housing which is something that the state needs dramatically more of.

KN: To conclude, over all would you say that the redevelopment of brownfields is an important issue for cities and urban areas?

BH: Absolutely! Due to lack of regulation in the last century our cities are full of contaminated land which has added dramatically to a continued trend of suburban expansion. The task of cleaning all of these sites up and putting them back in to economic use is insurmountable for our government to handle on its own. The best way to get the job done is enlist the services of the private development community. I like to look at the example of affordable housing. Look at how affective the private development community has been at building affordable housing in America. They build this type of housing better, cheaper, and more efficiently than public agencies ever could and the only reason that they are involved is because of the government's creation of an affordable housing tax credit program that offered a system of profitability. By making these projects profitable with tax credits affordable housing has become a competitive industry in the United States and is in many ways a jewel in the crown of the development industry. I think that the same can be true for brownfield redevelopment if we continue to refine the tax credit system and allow to private industry to take over the cleanup process.

KN: Thanks for your time, Bart. This has been very interesting.

BH: Thank you.

To contact Bart Higgins regarding this report or real estate consulting services, please use barthiggins@hotmail.com or 646.344.9272.