






ENVIRONMENTAL DUE DILIGENCE

BY STEVE BERGSMAN | SPONSORED BY SIOR FOUNDATION





THE TREND TO FIND INFILL LOCATIONS FOR REDEVELOPMENT MEANS PERFORMING EXTENSIVE DUE DILIGENCE IS MORE IMPORTANT THAN EVER. IT IS RARE TO FIND AN INFILL LOCATION WITHOUT SOME ENVIRONMENTAL ISSUES, SO IT'S NECESSARY TO GET AHEAD OF THE PROBLEM, UNDERSTAND THE POTENTIAL SOLUTIONS, CREATE A TIMELINE, AND, IN NEGOTIATIONS, CONTROL THE NARRATIVE.

Over the past decade (or even longer) the trend line for new development has been to build within city limits or close enough to eliminate long commutes. This usually entails tearing down older structures or taking a second look at abandoned properties, and this almost always reveals prior contamination issues.

As Jeff Hoffman, SIOR, a principal with Cushman & Wakefield | The Boerke Company in Milwaukee, observes, "When you are talking about tearing down old buildings that are on properties developed in urban cores in the 1940s and 1950s, inevitably you are going to find some type of environmental challenges."

It is not just the older cities of the Midwest that have contamination issues. In Charlotte, N.C., Scott Hensley, SIOR, principal of Piedmont Properties | CORFAC International, reports that "Environmental concerns are on most of our deals. Our book of business is primarily heavy industrial and infill development. On infill, something almost always comes up because these sites had been industrial uses in the past."

While commercial brokers are not scientists or environmental engineers, they are often the key player in getting deals completed when there are environmental issues with a property because these transactions are complicated, involve outside consultants, and negotiations can go on for a very long time, resulting in someone needing to be the fulcrum. The most important buyer

concern for these types of properties is that once you own it, you are in the chain. This means further environmental issues become your problem. So the broker has to ameliorate that concern or discover an insurance against the liability. There are numerous ways to do that and the broker should know them all. Most importantly, the first step is always a very thorough due diligence.

The principal steps in these deals, says Hoffman, are to quantify the extent of the challenges and create processes and timelines to work through the obstacles. "You are a broker, not a scientist, but you have to understand what the official language is suggesting; what the projected path to get to environmental closure is going to be; to serve as a conduit to get the buyer, seller, consultants, and attorneys together; and to hash out who is going to be responsible for what. Everyone has to be on the same page. I've seen these things go on for years on end if there is not alignment between all the parties."

Without going too deeply into the environmental necessities to make a deal happen, the first step is Phase One, which is simply an assessment, where an environmental consultant will do a records search on the property and surrounding properties for reported releases, brownfield sites, contaminations, etc. They also do a reconnaissance or a walk of the site. There is not sub-surface investigation and generally, the buyer pays for this. The desired outcome is that no further assessment is required. If an issue

is detected, it's onto Phase Two. In Wisconsin, as an example, a Phase One costs about \$2,500, while the minimum cost for a Phase Two is \$10,000. Who pays for that is negotiable. If Phase Two determines chemicals are in the ground exceeding established Environmental Protection Agency (EPA) levels, then it gets complicated with expensive remediation now required as it involves things like monitoring wells, cap in place, or hauling off disrupted dirt.

Outside of Milwaukee, a turn-of-the-19th-Century coke processing site on Lake Michigan had been shuttered. The land was contaminated and the landscape looked like a post-apocalyptic wasteland. Various state and federal agencies were involved in a clean-up as it was a superfund site. It eventually was acquired by the Japanese company, Komatsu, which just broke ground on the land after completing two years of environmental remediation with the seller.

Chris Sheehan, SIOR, a senior vice president with Colliers International, El Segundo, Calif., works the Los Angeles metro area, where there is a famous area of underground pollution called the Omega Plume. It began with an industrial property in the city of Whittier that had a long history of chemicals being dumped into the soil. These chemicals became part of the ground water and the underground flow extended for four miles underneath tens of millions of square feet of prime industrial real estate and hundreds of

homes. As Sheehan notes, "You can still get a 'clean' Phase One or Phase Two for an individual property that was not a contributor to the plume, so an acquisition can be financeable."

However, it's important in these deals to take control of the process and use experienced consultants (it's helpful to have experienced buyers as well). For example, there are environmental consultants that have worked in this area who understand the market and should be used because, as Sheehan says, "You don't want the buyer or seller to get some inexperienced consultant coming in who needs to get up to speed, which can be expensive and time-consuming."

More importantly, he adds, the most efficient way to get a deal done here is to do as much due diligence upfront as possible, including an ALTA survey, property inspection report, and environmental review before taking the property to market.

"What you are hoping for is good news so and it shows no further action required," Sheehan says. "If there is a problem, then we recommend sellers try to figure out as much as they can about the problem—or even solve it—so they can control the narrative when taking it to market. If there is an open issue, then that creates an opportunity for the buyer to control the outcome of their own investigation, lengthening the time of the transaction or involving a price reduction."

Even with potential problems such as the Omega Plume, any dirt in Southern California has an attraction because land

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for industrial is so sparse. This means that at any given time, only about 1% of the entire market is available for new development.

Sheehan tells the story of a family that owned a construction yard in the Omega Plume area for 70 years. Even with surface environmental problems, Colliers had been calling on the site for 15 years, but the family had never been in a position to sell. In the meantime, just a block away, a new industrial building was erected. The family finally decided to sell, couldn't pull off a deal, and called Sheehan, who turned to a developer who had just built a block away from the construction yard and was familiar with the environmental challenges of the area. He successfully completed the transactions and a brand new, state-of-the-art 234,000 square foot distribution building is currently under construction on the site of the old construction yard.

Sometimes, it's just as important to walk away from a deal .

Hensley tells this story. He had a client who found an industrial truck and equipment maintenance facility that had a Phase One completed and a report that said no further investigation was required. Hensley went out to the property to do his own site-walk when he discovered an oil/water separator. He looked around and about 10 feet away was a white PVC pipe sticking out of the ground. Hensley grabbed a long stick and poked it down the pipe. When he pulled it up, he could see there was at least three to four feet of a used petroleum-type liquid down

"SOMETIMES, IT'S JUST AS IMPORTANT TO WALK AWAY FROM A DEAL."

below. After further investigation, it was discovered the oil/water separator had been installed incorrectly. The seller said he wasn't going to pay to have it properly installed as it had been working well for him for the past 20 years. Hensley explained that if the city or state came out and saw this contraption, the owner would be fined. The seller said he didn't care and was not going to fix the situation. Hensley responded, "We care and we are not interested in the property." Hensley's client walked away from the deal.

Finally, some states and metros have become more aggressive in trying to solve the problem of old industrial sites that might have a contamination problem. It's not unusual for state or local commissions to get involved in deals or inject monies into clean-ups.

In 1996, the city of Atlanta's Brownfields Program received its first grant from the EPA, which allowed it to identify, assess, and remediate brownfield sites throughout the city. Peyton McWhirter, SIOR, managing broker of McWhirter Realty Partners LLC, sits on the Atlanta Commercial Board of Realtors advisory board to the Brownfields Program. One of the board's goals was to identify sites in the Atlanta area. "This fund was giving grants to owners to pay for a Phase One and—if needed—a Phase Two, with the goal to clean-up sites that were inactive," says McWhirter.

He has also been involved with sites that included the Georgia Underground Storage Tank Fund, or GUST. The fund

allots money to remove underground tanks and monitor the ground for a period to time. "The ownership is still responsible for some of these costs, but ultimately the state helps the landlord through the process," McWhirter explains.

All these programs have been successful, McWhirter affirms. "People have been able to use these programs to get old industrial land and other types of properties back into production. The biggest concern is liabilities. These programs look to alleviate that liability for the purchaser."

McWhirter, for example, helped a buyer who desired a 15,000 square foot industrial building that had been constructed in the 1950s and adjoined a scrap yard. The structure was located in an older part of Atlanta, just south of downtown, which was transitioning from industrial to quasi-industrial and small office. This particular building—which had originally been industrial—had been acquired since and turned into an event facility. The potential new purchaser wanted the building for a recording studio. A Phase One turned up a surprise: there was an underground storage tank that had been forgotten about. This made the buyer nervous. Using the city's Brownfields Program, the tank was removed and the buyer received protection from possible future liability.

No pun intended, but the recording studio was built for a heavy metal band. ♥

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