Analysis&Perspective

During the past two decades, many of the nation's urban areas experienced a dramatic decline in manufacturing and industrial activity. This industrial migration resulted not only in the loss of thousands of jobs, but has also left cities saddled with hundreds of thousands of acres of abandoned, deteriorating, and under-used industrial properties known as brownfields.[1]

Brownfields located in desirable locations can present good financial opportunities to sophisticated developers. However, buyers of contaminated property in economically depressed communities are likely to find they must take advantage of special federal, state, and local financial incentives in order to turn a profit.

This two-part article surveys the principal financing mechanisms available to developers for these properties. Part I, which appears below, discusses federal financing tools and private non-profit programs. Part II will discuss state and local initiatives.

FINANCING BROWNFIELDS DEVELOPMENT: Part I

BY LARRY SCHNAPF*

While many brownfields sites are contaminated with hazardous substances from prior uses, the contamination is usually not serious enough to require a cleanup under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)[2] or to undergo corrective action pursuant to the federal Resource Conservation and Recovery Act (RCRA).[3] Because of relatively low contamination levels and limited government resources, these are sites that are unlikely to become subject to enforcement activities.

Nevertheless, the mere perception of contamination has been an obstacle to brownfields redevelopment despite the fact that the cities in which these sites are located often have the advantages of a skilled work force, mass transportation, and other infrastructure benefits. Indeed, according to a U.S. General Accounting Office report,[4] the principal barrier to redevelopment of these former industrial properties has been the existence of state and federal environmental laws like CERCLA that impose strict and retroactive liability on owners and operators of contaminated properties.

It is ironic that the strict liability framework of these statutes, which was designed to foster prompt cleanups, is instead discouraging industrial remediation. The process of identifying and remediating sites contaminated with hazardous substances can be long and arduous. Often, total cleanup costs may not become known until well after the remediation process has begun. Faced with this uncertainty, developers hesitate to purchase these properties out of fear of becoming responsible for contamination caused by others.

Fear of liability, concern over reduced collateral values, and the effect that a cleanup will have on the ability of borrowers to repay their loans have also made lenders reluctant to provide redevelopment financing. Many corporations that own brownfields sites are warehousing these properties instead of placing them on the market. These companies have felt it is better to incur passive holding costs than to take the risk that contamination discovered by a potential buyer will draw atten-

[1] Community Development: Reuse of Urban Industrial Sites (GAO/RCED-95-172)(June, 1995).
[2] 42 U.S.C. 9601 et seq.
[3] 42 U.S.C. 6901 et seq.

Larry Schnapf is chair of the Environmental Law Department at the New York law firm of Pryor Cashman Sherman & Flynn. He is author of "Environmental Liability: Law and Strategy for Businesses and Corporations," published by Michie, and an adjunct professor at New York Law School where he teaches "Environmental Problems in Business Transactions."

[4] Superfund Barriers to Brownfields Redevelopment (GAO/RCED-96-125 (June 1996)).

  TXLR 0887-7394/98/$0+$1.00

tion to the sites and expose the owners to cleanup liability.

CERCLA provides an innocent landowner defense for owners that are not responsible for contamination at a site.[5] However, this defense is not available to most prospective owners of brownfields sites because it is available only to landowners who can show they did not know and had no reason to know the property was contaminated. To establish that they had no reason to know about the contamination, owners must have conducted an "appropriate inquiry" into a property's past uses consistent with "good commercial or customary practice."[6] Since a brownfields's prior industrial use will probably be enough to put a prospective owner on notice of the site's potential contamination, developers generally will not be able to assert this defense and avoid cleanup liability. Moreover, lenders usually require environmental site assessments (ESAs) before they will finance a transaction. If the ESA uncovers contamination, a prospective owner will be precluded from subsequently raising the defense. Even if an ESA fails to disclose contamination, the prospective purchaser will probably not be able to assert the innocent landowner defense for contamination that is discovered after the purchase because courts place the burden of proof on the purchaser. In such cases, courts will likely take the position that the contamination was not discovered because the new landowner failed to conduct an appropriate inquiry.[7]

To address these liability concerns, the Environmental Protection Agency has taken a number of administrative actions during the last two years to encourage the reuse of brownfields. First, EPA deleted approximately 25,000 sites from the CERCLA Information System (CERCLIS), a list of sites that have potential releases of hazardous substances.[8]

The EPA also issued a guidance document entitled "Final Policy Towards Owners of Property Containing Contaminated Aquifers."[9] This guidance policy states that if groundwater beneath a site was contaminated solely as a result of subsurface migration of hazardous substances from an off-site source, EPA will not require the landowner to take any remedial actions or reimburse the agency for any of its response costs provided the landowner did not cause, contribute to, or exacerbate the contamination. The existence of this guidance document has helped alleviate the fears of lenders.

The EPA also revised its "Guidance on Agreements With Prospective Purchasers of Contaminated Property."[10] Under this policy, EPA may enter into prospective purchaser agreements (PPA) covenanting not to sue the purchaser if the purchaser was not responsible for the contamination and the purchaser provides adequate consideration to the EPA.[11] These PPA can be an important tool in the hands of sophisticated prospective purchasers to narrow the risks posed by a transaction.[12] The PPA could also be used to enhance the marketability of the property by having the covenant not to sue extend to lenders and to any future successors or purchasers of the property.

In its guidance on "Land Use in the CERCLA Remedy Selection Process,"[13] EPA also announced a change in how it calculated the risks posed by a site. In the past, EPA would evaluate risk based on the assumption that the property would be used for residential purposes. This approach often overstated risk and resulted in stringent and costly cleanups. Under the new policy, EPA will now take the most reasonably anticipated land use into account and select the cleanup that is designed to eliminate only the risk posed by that anticipated use.[14]

Finally, EPA issued its "Policy on the Issuance of Comfort/Status Letters."[15] Under this policy, EPA will consider issuing "comfort letters" to parties seeking to purchase, develop, or operate brownfields indicating that the EPA will not pursue those parties for response costs associated with prior uses of the property. Regional EPA offices may issue these letters when there is a realistic perception or probability of superfund liabil-

[5] 42 U.S.C. 9601(35)(B).

[6] Id.

[7] See Schnapf, Environmental Liability: Law & Strategy for Businesses and Corporations, § 10.07 (Michie 1997).

[8] The CERCLIS list is distinguished from the National Priority List (NPL). While CERCLIS contains sites that are suspected of having releases, the NPL is the list of the nation's most seriously contaminated sites. The NPL contain approximately 1200 sites and is published as an appendix to the National Contingency Plan, 40 C.F.R. 300, a set of EPA regulations governing the cleanup of releases of hazardous substances and oil spills. Many sites were placed on the CERCLIS years ago when they were suspected of having contamination and remained on the list even when site investigations did not reveal significant contamination. However, the presence of a property on the CERCLIS often scares away developers and lenders concerned that the site could be required to be cleaned up.

[9] 60 F.R. 34790 (July 3, 1995).

[10] 60 F.R. 34792 (July 3, 1995).

[11] Only a handful of agreements were issued under the previous 1989 guidance policy primarily because that policy required EPA to receive substantial benefits either in the form of response actions or reimbursement of agency response costs in order to enter into these agreement. However, the 1995 guidance allows EPA to accept reduced direct benefits if there will be an indirect public benefit resulting from a prospective purchaser agreement. This could be the creation or retention of jobs, development of brownfields, creation of recreation areas, or improved services to the community. The EPA has issued approximately 35 PPA under the 1995 policy.

[12] For example, a prospective purchaser may not only be able to receive a covenant not to sue and contribution protection for contaminants existing at the site to be acquired but may also be able to negotiate a broader covenant that cutoffs liability for migration of the contaminants beyond the property. In addition, prospective purchasers could also seek to extend the covenant not to sue to include enforcement actions under § 7003 of RCRA as well as § § 106 and 107 of CERCLA.

[13] 60 F.R. 29595 (June 5, 1995).

[14] Local government and community groups have often lobbied for the more stringent residential cleanup standards because of a perception that the industrial-use remedy was not sufficiently protective and to avoid the imposition of long-term operation and maintenance (O & M) requirements which could restrict development and lower property values. Risk Assessment Process and Issues, GAO/T-RCED-93-74 (September 30, 1993). In addition, when EPA funds a cleanup, the states are required to pay for most of the O & M costs. The Government Accounting Office estimates that, on average, O & M will be required for thirty years and will cost $12 million. See Operations and Maintenance Activities will Require Billions of Dollars, GAO/RECD-95-259 (September 1995).

[15] (November 12, 1996). There are four kinds of comfort letters. The "No Previous Federal Superfund Interest Letter" indicates that the site has had no involvement with the federal superfund program. The "No Current Federal Superfund Interest Letter" is issued when the site was formerly on the CERCLIS or the NPL, or is located near a CERCLIS site. The "Federal Interest Letter," which discusses the applicability of the CERCLA program to the party requesting the letter, may be issued when EPA plans or is conducting a respond action at the site. The "State Action Letter" may be provided when the state has lead responsibility for response actions at a site.

ity, when the comfort letter will facilitate redevelopment, and when there are no other mechanisms to adequately address the parties' concern.

These administrative solutions bind only EPA and do address neither liability under state environmental laws nor liability to third parties such as other PRPs. Consequently, these administrative reforms have generally not provided sufficient incentive to encourage developers and lenders to redevelop brownfields. As a result, many states have enacted voluntary cleanup programs (VCP) in which prospective purchasers can enter into agreements with the state environmental agency limiting their liability. The VCPs can minimize investigation and remediation costs by allowing streamlined investigatory procedures and reduced governmental oversight. The VCPs also usually offer generic or pre-set risk-based cleanup standards that take future land use into account. This approach lessens remediation costs since the owners do not have to devote resources to develop site-specific cleanup standards and can often leave residual contamination in the soil or groundwater provided institutional controls such as use restrictions are employed to minimize the risk of exposure.[16] On the other hand, the presence of residual contamination can pose valuation problems to lenders.

Another important feature of the VCPs are that buyers will generally obtain a formal sign-off from the state in the form of a No Further Action (NFA) letter and/or a covenant not to sue. Some states will even grant the volunteers contribution protection insulating them from liability to third parties. The covenants not to sue usually also extend to a volunteer's lender as well as its successors and assigns.

These streamlined administrative approaches have not eliminated all of the major roadblocks to brownfields redevelopment since a cleanup will still have to be performed that may render the transaction financially unattractive to both the developer and its lender. Moreover, these agreements often contain reopeners for unknown environmental conditions and for contamination that migrates off-site. The uncertainty created by these reopeners is exacerbated by the fact that even where a state approves a cleanup under its VCP, there is no assurance that the federal government may not require an additional cleanup if it subsequently determines that the state approved cleanup does not meet federal standards. The EPA comfort letters are simply informational tools with no force of law. Without a binding commitment from EPA that it will not take any action at a site, many sellers remain unwilling to place their brownfields sites on the market. Because of the reopeners, many lenders are continuing to condition their loans on use of the traditional or residential cleanup standards that can greatly increase remediation costs.

Using the VCP program's streamlined investigation and cleanup procedures can be a dual-edged sword for prospective owners. The streamlined procedures often do not satisfy the requirements of the NCP. Thus, while a prospective owner may save on remediation costs, it will not be able to recover its cleanup costs from other PRPs under CERCLA or most state superfund programs, which require private parties to demonstrate compliance with the NCP before they can seek response cost reimbursement.

EPA has attempted to address this concern by entering into agreements with 11 states not to take enforcement actions for cleanups approved under the state VCPs. In addition, EPA recently issued a draft guidance document establishing the conditions under which EPA regional offices will refrain from taking enforcement actions or pursuing cost recovery at sites where there has been a VCP-approved cleanup.[17] However, the guidance was withdrawn by a November 1997 memo to the regions because many states said it would unduly restrict their VCP programs.

Brownfields located in desirable locations are more likely to be developed despite environmental concerns because the economics of the project may outweigh any remediation costs. Many of these prime properties remain deeply discounted because of their environmental conditions and present profitable opportunities to sophisticated developers who know how to use the tools created by the VCPs. Indeed, private investment groups known as "vulture funds" have been formed to purchase and remediate these properties. Because these properties are undervalued, these funds often are able to sell the properties at profits approaching 30 percent.

In contrast, environmental issues may be a major deterrent to brownfields redevelopment in economically depressed communities. For these marginally profitable properties, federal, state, and local financial incentives have begun to play an important role in the redevelopment of brownfields.

FEDERAL FINANCING TOOLS FOR BROWNFIELDS. Under the brownfields National Partnership Action Agenda, a number of federal agencies will invest approximately $300 million in brownfields communities and make an additional $165 million available in the form of loan guarantees.

I. EPA Brownfields Financing Programs. In addition to the administrative reforms that try to take brownfields out of the CERCLA process, the EPA has announced two financial assistance programs to facilitate the cleanup and reuse of brownfields sites.

[16] Common use restrictions include prohibiting use of on-site drinking water wells and restricting both the kinds of operations that may take place on the property. Installation of impervious surfaces that prevent exposure of contaminants is another form of institutional control.

[17] Final Draft Guidance on Developing Memoranda of Agreement Language Concerning State Voluntary Cleanup Programs, 62 F.R. 47495 (September 9, 1997)(subsequently withdrawn). Under this guidance document, EPA would have to determine that a state VCP meets certain minimum criteria such as providing adequate public participation, ensuring that cleanups are protective of human health and the environment, and that adequate enforcement mechanisms exist to ensure completion of response actions if a volunteer fails to satisfactorily complete a cleanup. The guidance also creates two tiers of sites and requires all sites to undergo a ranking to determine which tier applies. Properties where there has been a release of hazardous substances that exposes or is likely to expose humans to the contaminants or which impacts sensitive environments fall within Tier I. These will generally be sites that have a Hazardous Ranking System score above 28.5, those listed or proposed to be listed on the NPL or facilities undergoing a RCRA corrective action. Tier I sites will continue to be subject to federal action. EPA would refrain from exercising its enforcement authority for the less-contaminated sites comprising Tier II. Some state officials have complained that the criteria proposed by EPA would disqualify many sites from their VCPs and that the extensive screening protocols would prevent sites from moving quickly through the VCP process. Indeed, a GAO report indicated that most VCPs would admit sites that could qualify for the CERCLA program. State Voluntary Programs Provide Incentives to Encourage Cleanups, GAO/RCED (April, 1997).

  TXLR 0887-7394/98/$0+$1.00

A. Brownfields Assessment Demonstration Pilots. During the past two years, EPA has awarded 113 national and regional brownfields Assessment Demonstration Pilots (BADP) totaling nearly $20 million. The brownfields assessment pilots are funded under CERCLA § 104(d)(1) of and generally consist of $200,000 two-year grants.

BADP grants are used to test cleanup and redevelopment models, to identify and remove regulatory barriers to redevelopment without sacrificing environmental standards, and to help coordinate environmental cleanup and redevelopment efforts at federal, state, and local levels. The grants may not be used to pay for actual cleanups or other response activities associated with cleanups. Instead, they must be used for preliminary response activities such as identifying and inventory sites that have releases or threatened release of hazardous substances, conducting site assessments to evaluate the nature and extent of the contamination, and identifying or planning cleanup activities at the sites.

Another important restriction is that BADP grants may be used only at brownfields sites where there is an actual or threatened release of hazardous substances or a release or threatened release of pollutants or contaminants that presents an imminent and substantial danger to public health or welfare. BADP funds may not be used at sites that have been placed on the National Priorities List (NPL) nor may they be used for assessment activities at sites that are contaminated with petroleum products, which are excluded from the definition of hazardous substances under CERCLA. Sites containing petroleum co-mingled with other hazardous substances or contaminants such as a site containing used oil, is eligible for the brownfields assessment pilot program.

Private developers are not eligible for the BADP grants program. However, a private party interested in developing a particular property might try to have the site assessment activities funded by the BADP program by having a local government agency apply. Indeed, the BADP program has been used as an important source of start-up funds for a number of brownfields projects.

B. EPA Brownfields Cleanup Revolving Loan Fund. Unlike the BADP, the BRCLF may be used to fund cleanups of eligible brownfields sites.[18] BRCLF funds may not be used to conduct preliminary response activities such as site assessments to pay for non-environmental redevelopment activities such as construction of a new facility or marketing of a property.[19] However, up to 10 percent of the total loan may be used to cover administrative and cleanup response planning costs. In addition, EPA may authorize the lead agency to use up to 5 percent of the total award to pay administrative and legal costs such as loan processing, professional services, audit, legal fees and state program fees.[20]

For fiscal year 1997, the only brownfields sites that are eligible for the BRCLF program are BADP projects awarded prior to October 1995. Successful applicants, which must be local government entities, are designated the "lead agency" and are responsible for selecting site managers to supervise cleanups and for approving recipients for BRCLF grants.

Private parties may be borrowers under the BRCLF program so long as they are not PRPs. For example, a party who was a generator or transporter of hazardous substances that caused the contamination at a particular brownfields site may not be a borrower for that site.[21] However, an owner/operator of a brownfields site may be eligible to receive BRCLF grants if the lead agency determines that the owner/operator would fall under a statutory exemption from liability or that EPA would not pursue a CERCLA enforcement action against the party because of an administrative policy[22] (e.g., owners of property with contaminated aquifers where the contamination is coming from an off-site source).

There are a number of restrictions on how the BRCLF may be used. BRCLF funds may be used only at sites that are owned by government agencies or a quasi-public entity such as an industrial development agency. Eligible sites may also include properties to be acquired by an "innocent prospective purchaser" as well as other privately owned properties. However, in these cases, there must be a mechanism for recouping BRCLF expenditures such as through a guarantee from the owner or the imposition of a lien on the real property.[23]

There are a number of restrictions on how the BRCLF may be used. First, tLike the BADP program, the BRCLF program may be used only at brownfields sites where there has been a documented actual or threatened release of hazardous substances or where there is a release or threatened release of pollutants or contaminants which present an imminent and substantial danger to public health or welfare. The BRCLF may not be used to clean up sites contaminated with petroleum unless the petroleum is co-mingled with other hazardous substances or contaminants. The BRCLF may not be used at sites which have been listed or proposed to be listed on the NPL, at sites where a "removal" action was taken by a federal or state agency during the prior six months,[24] or at sites where a federal or state agency is planning or conducting a response or enforcement action.[25] Additional prohibited uses of the BRCLF include post-remedial operation and maintenance costs and the gathering of information for obtaining or complying with environmental permits, unless the permit is required as a part of the funded cleanup.[26] The cleanup activities must not only comply with state and federal environmental requirements but also qualify as a "removal" action. The borrower must also comply with the public participation requirements

[18] 62 F.R. 24915 (May 7, 1997).

[19] In a revolving loan, a sponsoring entity such as the EPA provides capitalization funds to a managing agent such as a municipality that is responsible for issuing the loans and ensuring they are used for the authorized purpose (i.e. brownfields cleanup). The revolving loan fund charges generally interest at a low rate. The loan repayments (principal plus interest) are used by the managing agent to make new loans for the same authorized purpose

[20] 62 F.R. at 24917.

[21] Id.

[22] Id.

[23] 62 F.R. at 24916.

[24] There are two kinds of cleanup or response actions that may be performed under the NCP. "Removal" actions are short-term measures such as removing drums, erecting fences, etc. that are designed to remove the source of the contamination. 40 C.F.R. 300.415. Removal actions may only be conducted for up to one year and may not exceed $2 million. "Remedial" actions are longer term measures that are designed to permanently eliminate the contamination causing the release of the hazardous substance. 40 C.F.R. 300.430.

[25] Id.

[26] Id.

of the NCP and meet all federal and state requirements for worker health and safety.

One of the primary drawbacks of this program is the limited size of the grants, which range from $200,000 to $400,000 per site. For many brownfields sites, this sum is simply inadequate to satisfactorily remediate the site.

II. Department of Housing and Urban Development. Redevelopment of brownfields is a critical element of HUD's National Urban Policy. HUD obtained an appropriation of $25 million for fiscal year 1998 for brownfields redevelopment and will give special priority to brownfields located in Empowerment Zones and Enterprise Communities (EZ/EC).[27] Indeed, 34 of the first 60 EPA BADF were awarded to EZ/EC.

It is important to remember that HUD's mandate is housing. As a result, most of the agency's brownfields-related financing has been to used turn brownfields sites into housing complexes. This limits the usefulness of the program since many brownfields sites are not suitable for residential development. Moreover, since residential cleanup standards are more stringent than industrial use standards, the HUD-sponsored cleanups can be more expensive than cleanups performed at commercial or multi-use properties. HUD has two programs that may be used to develop brownfields.

A. Community Development Block Grants (CDBG). Under the Housing and Community Development Act of 1974,[28] local governments can obtain CDBG funds to help finance the acquisition, construction, renovation or rehabilitation of privately owned buildings, properties and public facilities.[29] Many of the construction-related activities eligible for CDBG funding may also be used to clean up and redevelop brownfields. For example, Bridgeport, Connecticut, used $2 million in CDBG funds to finance the assessment and cleanup of a brownfields.

In addition, recipients of HUD assistance may request funding to perform environmental site assessments or impact statements for activities that could have a significant impact on the environment or when environmental conditions could have a significant impact on users of the project.[30] The kinds of issues that could require such a review include threats to air quality, contamination of drinking water, and disparate environmental impacts to residents of low income communities.[31] Under the Special Purpose Grants Program, funding also may be available to pay for the costs of environmental investigation to determine the environmental conditions of Department of Defense properties being transferred to local governments.[32]

Because many projects take more than one year to complete, communities often cannot use their CDBG allocations in one year. When this occurs, communities may accrue their allotments until the funds are needed or tap these funds on an interim basis to finance short-term, low-interest loans for projects that will create jobs. Developers and not-for-profit agencies may apply for these CDBG "float" loans, which may be used to help pay for remediation costs. Float loans may not be for more than two and one-half years.[33]

B. Section 108 Loan Guarantee Program. Another important HUD funding source is the § 108 loan guarantee program.[34] The loan guarantee program is also useful when the upfront expenses of a project are too large for a local government's annual CDBG allotment.

Under this program, the local government issues debentures that are guaranteed by HUD and pledges its future CDBG grants as collateral for the HUD guarantee. Loan proceeds may be used to finance a broad array of activities including (1) acquisition costs to buy or lease vacant or improved property; (2) clearance, demolition, removal and rehabilitation of buildings and improvements; (3) rehabilitation of buildings or construction of real property improvements carried out by public or non-profit organizations; and (4) site preparation including construction, repair or installation of infrastructure improvements, utilities and other public facilities.[35]

In 1996, HUD approved $50 million in § 108 loan guarantees to finance brownfields redevelopment activities in Chicago. These loan proceeds will be expended over a three-year period to acquire, remediate and redevelop abandoned industrial properties. The loan will be repaid using proceeds from the sale of the properties, tax incremental financing, interest earned on the loan balance, and settlements with PRPs.

III. Small Business Administration (SBA). The SBA provides financial assistance in the form of loans and loan guarantees to small businesses that are unable to secure financing on reasonable terms through normal lending channels.[36] To be eligible for SBA financial assistance, a small business must actively conduct operations for profit in the United States and must demonstrate that it has a need for credit, that it cannot obtain financing from non-federal sources on reasonable terms, and that funding is not available from any owner that holds 20 percent or more of the equity in the business.[37]

A small business may use SBA financing to purchase real estate for use in operating its business; make site improvements such as grading, landscaping, and the construction of streets and parking lots; construct new buildings or renovate or expand existing buildings; and acquire machinery and equipment.[38] Loan proceeds cannot be used to purchase real estate that will be held primarily for investment purposes.[39]

---

[27] Id. at Part 597. EZ/EC are economically-distressed urban areas receiving special federal tax treatment such as wage tax credits, accelerated depreciation, and tax-exempt facility bonds.

[28] 42 U.S.C. 5301 et seq.

[29] 24 C.F.R. Part 570.

[30] Id. at § 58.2.

[31] Id. at § 58.5.

[32] Id. at § 570.401(d)(6).

[33] Id. at § 570.301.

[34] 42 U.S.C. 5308.

[35] 24 C.F.R. 573.

[36] Because of variations within industry sectors, the SBA has developed size standards for determining program eligibility. 13 C.F.R. 121.201. These standards are established by SIC (Standard Industrial Classification) Code and vary according to business activity. For example, the SBA may use "annual receipts" to determine eligibility in some industries, but may look to the number of employees in others.

[37] 13 C.F.R. 120.100-102. The SBA requires such owners to use their personal resources to reduce the amount of the loan to be funded or guaranteed by the SBA when the owner's liquid assets exceed certain thresholds. The thresholds change depending on the size of the loan. Id. at § 120.102.

[38] 13 C.F.R. 120.120(a).

[39] Id. at 120.111. However, a holding company of the borrower may use the proceeds to acquire, improve, or renovate real or personal property that it leases to the borrower provided that (1) both the holding company and the operating company/borrower are each a small business that would independently qualify for the

  TXLR 0887-7394/98/$0+$1.00

There are two SBA lending programs best suited to help redevelop brownfields.

A. SBA 7(a) Loan Program. This is the primary lending program of the SBA.[40] The SBA will guarantee up to 80 percent for loans that are $100,000 or less and 75 percent of loans up to $750,000.[41] Direct loans under this program are limited to $150,000.[42] The term of a direct loan or a loan that is being guaranteed will generally be less than ten years unless the loan is used to finance real estate or personal property with a useful life exceeding ten years, in which case the maximum life of the loan will be 25 years.[43] The interest rate for loans with terms of less than seven years is the prime rate plus 2.25 percent while loans longer than seven years will carry an interest of prime plus 2.75 percent.[44]

In addition to the general purposes listed above, a borrower may use 7(a) loan proceeds to purchase inventory, supplies, raw materials, and working capital, as well as for consolidating, refinancing, or repaying debts.[45] The SBA is authorized to guarantee loans of up to $1 million to help small businesses plan, design, and install pollution control equipment such as air pollution control equipment and water treatment facilities.[46] It is also possible the program may be used to pay for the installation and operation of groundwater treatment systems to remediate contamination beneath a brownfields site.

B. SBA § 504 Certified Development Company (CDC). Under this program, not-for profit corporations known as Certified Development Companies are established to provide technical and financial assistance to small businesses located in designated geographical areas.[47] To qualify for the 504 program, a business must first meet the general SBA definition of a small business and have a tangible net worth of less than $6 million and an average net income of less than $2 million after taxes for the preceding two years.[48]

The financial assistance package consists of three parts. The first component is the 504 loan, which may not exceed 40 percent of the project costs. Another 50 percent must be financing from a private sector lender that is not guaranteed by the SBA. The remaining 10 percent must be an equity contribution by the borrower in the form of cash or property.[49] The total outstanding balance of all SBA financial assistance to the borrower and its affiliates generally cannot exceed $750,000.[50]

Project costs that may be paid with 504 funding include the acquisition of long-term, major fixed assets such as land, buildings, improvements, and machinery and equipment[51] The loan proceeds may also be used to pay for a variety of professional fees that are directly attributable and essential to the project. These include the costs of performing environmental site investigations and legal fees.[52] However, § 504 loans may not be used to pay for working capital, debt refinancing, or short-term fixed assets such as furniture, furnishings, and motor vehicles.[53]

IV. Community Redevelopment Act (CRA). This law requires regulated financial institutions to improve access to credit in low– and moderate-income neighborhoods where they are chartered.[54] In 1995, the CRA regulations were substantially amended to change the way lenders demonstrate compliance with CRA. Under the amended regulations, financial institutions can meet these tests by making loans that support community redevelopment. One of the qualifying activities is " loans to finance environmental cleanup or redevelopment of an industrial site as part of an effort to revitalize the low- or moderate-income community in which the property is located."[55] The author has not uncovered any instances of CRA-based brownfields financing. Nevertheless, this law could encourage lenders to finance brownfields redevelopment in low income neighborhoods.

V. Economic Development Agency (EDA). This agency provides financial assistance to local governments and public or private non-profit organizations to spur economic development. Earlier this year, EDA announced it would make $17 million available for brownfields redevelopment. There are three principal programs that may be used to fund brownfields redevelopment.

Under the Title I Public Works program,[56] EDA will provide financial assistance for projects located within designated Redevelopment Areas or Economic Development Centers. The financial assistance may be in the form of grants, loans, guarantees of loans issued by private banks, or the purchasing of debt. Recipients may use the financial assistance to purchase and develop land, facilities, and equipment for industrial or commercial uses including construction of new buildings; for rehabilitation of abandoned or unoccupied structures; and for the alteration, conversion, or enlargement of existing buildings. In addition to acquisition and development costs, the financial assistance may be used to secure working capital loans, guarantee rental payments, and satisfy liens against property intended to be developed.

The Title IX Economic Adjustment Assistance program[57] provides funding to communities that experience or may be reasonably foreseen to be about to experience severe economic dislocations or long-term economic deterioration as a result of actions of the federal government such as military base closings. To qualify, the local area must either (1) have experienced or anticipate a change in economic conditions from the loss of a significant number of permanent jobs relative to the area's employed labor force or (2) suffer from high unemployment, low per capita income, or failure

loan; (2) there is a lease between the two companies equal to the term of the loan that is subordinate to the SBA's lien and there is an assignment of the rent payable under the lease to the SBA; (3) each holder of 20 percent or more equity in both companies guarantees the loan; and (4) the operating company co-signs or guarantees the loan with the holding company.

[40] 13 C.F.R. 120.200-222 (Subpart B).
[41] Id. at § 120.210.
[42] Id. at § 120.211.
[43] Id. at § 120.212.
[44] Id. at § 120.214.
[45] Id. at § 120.120(b).
[46] Id. at § 120.370.
[47] Id. at § 120.800-.991(Subpart H).
[48] Id. at § 120.880.
[49] Id. at § 120.801.
[50] Id. at § 120.910-.931.
[51] Id. at § 120.882. The fixed assets financed under this program must generally have a useful life of at least ten years. Id. at § 120.120(b).
[52] Id. at § 120.882(c).
[53] Id. at § 120.884.
[54] 12 U.S.C. 2901(a) et seq.
[55] 60 F.R. 22160 fn.1 (May 4, 1995).
[56] 42 U.S.C.§ § 3131-3137.
[57] 42 U.S.C. § § 3241-3145.

to keep pace with national economic growth over a five year period.

FEDERAL TAX INCENTIVES. The Internal Revenue Code allows businesses to deduct remediation costs.[58] However, there has been some confusion as to whether the cleanup costs may be deducted as an expense in the year that the costs are incurred or whether they must be capitalized over the useful life of the contaminated property.[59] Under the Taxpayer Relief Act of 1997, owners of brownfields may now deduct "qualified remediation expenditures" in the year they are incurred or paid.

The term "qualified remediation expenditures" applies to costs paid or incurred in connection with the abatement or control of hazardous substances after August 5, 1997. It does not include costs to remediate petroleum contamination unless the petroleum is comingled with other hazardous wastes. It also does not apply to releases from products that are part of a building structure such as asbestos-containing materials nor releases into public drinking water supplies where the release is due to the deterioration of the system through ordinary use.[60]

The costs also must be associated with a "qualified contaminated site." To fall within this definition, a site must have had a release of hazardous substances, must be held by the taxpayer for use in a trade or business or to produce income, and must be located in a "targeted area."[61] A site that is listed or proposed to be listed on the NPL is not a "qualified contaminated site."

Taxpayers will not be allowed to treat remediation expenses as deductible expenses in the year they are incurred after December 31, 2000.[62] Remediation costs that are treated as deduction expenses are subject to recapture as ordinary income when the property is sold or disposed.[63]

[58] I.R.C. § 162.

[59] Compare Rev. Rule 94-38, 1994-1 C.B. 35 (holding soil remediation costs deductible as expenses but groundwater treatment expenditures to be capital expenditures) with TAM 9541005 (October 13, 1995)(requiring taxpayer to capitalize environmental investigation costs as well as consulting and legal costs) and TAM 9541005 (PLR 9627002)(January 1996)(revoking earlier TAM 9541005 ruling).

[60] I.R.C. § 198(d).

[61] I.R.C. § 198 (c)(1).

[62] I.R.C. § 198 (h).

NON-PROFIT FINANCING SOURCES. A number of non-profit organizations have been established to provide financial assistance to owners and developers of brownfield properties. These non-profits are usually capitalized from charitable foundations and can be used to fill financing gaps, particularly at marginally profitable properties expected to have a rate of return well below that required by most venture capital investment groups. They are also useful for brownfield sites that are suitable for mixed-use development, which ordinarily does not qualify for HUD financing.

Non-profit groups can play several roles in brownfield development. Those that provide access to funding for marginally-profitable sites can be a particularly important financing tool for sites where cleanup costs can be as much as 50 percent of a project and private lenders agree to finance only the non-cleanup phase of the project. The funding provided by the non-profit can be used as equity to perform the cleanup and reduce the lender's risk ratio. Some non-profits will provide developers 100 percent financing to pay for the costs of property acquisition, environmental assessments and remediation, and environmental insurance premiums. The loans may have a maturity of 18 months to 24 months with a single payment at the end of the loan term. Sometimes, the repayment date is tied to the length of the remediation period so that loan payments are not due until the remediation has been completed.

In other instances, the crucial barrier to redevelopment of a site may not be access to funding but uncertainty over cleanup costs. Many developers will not spend their own resources on an environmental site investigation when they fear an expensive cleanup will make the project impractical. In those cases, some non-profits will purchase an option on the property, perform the upfront investigatory work, and then negotiate a contingent assignable VCP agreement for cleaning up the site. If the cleanup costs reflected by the VCP agreement are acceptable to the developer, the non-profit will assign the developer both its option and the cleanup agreement.

[63] I.R.C. § 198 (e).

  TXLR 0887-7394/98/$0+$1.00