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Environment

White-elephant properties turned around with cash and expertise

by Gary D. Beers

As a result of increased environmental regulation, potential environmental liability and restricted lending practices for contaminated "white elephant" properties, many owners are stuck with large commercial properties that are contaminated.

Several savvy investors have developed expertise in hunting down unmarketable properties and working with the owner to bring the property into the market and complete a sale. While the specifics on how this is accomplished vary, there are some general guidelines used by investors.

Approach

First, the difference between the current and potential market value of the property should be large enough to provide a good potential return to the investors working with the owner, as well as to the owner.

Typically, properties with a potential market value in the $2 million to $8 million range and a present value of less than 60 percent of this potential value are likely candidates for near-term turnaround projects.

Second, a likely purchaser and mortgage institution must be identified. While a specific purchaser may not be identified immediately, the near-term sale of the property must be a sound assumption. The groundwork for financing the property for the new owner is typically done through the contacts of the investor.

At this point, the investor will obtain an option to buy the property. With this position of equitable ownership, the investor has control of the real estate asset and a position to implement the next phase, with the cooperation of the current owners.

Third, the environmental contamination problem at the property is characterized in terms of regulatory agency perspective, of existing lender perspective and technical factors.

An attractive situation for the investor is when the regulatory agency and lender want the problem moved toward a practical solution and are willing to work, towards that goal. Often, the property owner wants the same end, but lacks financial capability.

At this point, the investor will have experts review the technical aspects of the environmental problem, including the need, scope and proposed costs for additional work. The investor can then begin a detailed selection process for the appropriate environmental consultants.

The emphasis in this approach is on engaging several small firms, each with specific expertise and first-hand knowledge of a particular regulatory agency. With an understanding of the agency's information needs and decision-making process, each retained firm is able to "fast-track" the project through the review and approval process.

Fourth, the plans for converting the white-elephant property into a marketable property are completed, and the necessary legal arrangements between the owner and the investor are signed.

Typically, this arrangement addresses the money to be invested in the project by the investor and the distribution of the net gain when the improved property is sold. While the investor will look for a sizeable portion of this added value, there will be a reasonable portion for the owner.

Further, instruments of understanding are completed with environmental agencies, the existing lender and others who may have contributed to the property's environmental problem.

The latter type of agreement can be critical to the eventual sale of the property. For example, prior owner/operators at the property may agree to indemnify future owners if the problem is resolved through the investor's approach and financial support.

Fifth, the agreed upon plans are funded and implemented.

Example

While the details of an example of the above approach cannot be revealed for reasons of client confidentiality, a limited description is provided of a turnaround in another state.

A vacant 5-acre parcel located in an light-industrial and urban area had been leased by a major firm for oil well development. Since the closure of the wells, the landowners had discovered petroleum contamination of the surface and subsurface soils in limited areas of the property.

The major firm wanted to continue the lease and avoid further discovery into the magnitude of the environmental problem, while the landowners wanted to sell the commercial property for development. The owners lacked financial resources to pursue the major firm or to investigate the extent of the problem.

After initial screening of the various components of the problems associated with the property, the investor took an option to buy the real estate for approximately $700,000. After interviewing 30 to 50 environmental consulting firms, several were chosen and a soil remediation approach was selected.

Next, negotiations were conducted with the major firm concerning expenditure of investor's funds to clean up the property in exchange for an indemnity clause by major firm for future owners of the property.

With this foundation in place, the investor financed the remediation of the property and continued negotiations with two other parties. First, the property owners were assured that their environmental liability exposure would be restricted and not be a significant residual of the sale. Second, discussions were held with the local municipality about options for future land uses at the property.

Agreement was reached that the property would be suitable for an automobile parking mall to support adjacent commercial development. In about one year, this white-elephant property had been converted into marketable real estate which sold for a price in the $2 million to $3 million range.

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