

PERSON OF THE WEEK: Edward Elanjan Talks Brownfield Lending

May 19, 2009

This week, MortgageOrb interviewed Edward Elanjan, executive vice president and chief financial officer at EnviroFinance Group LLC, a commercial mortgage lender specializing in financing the acquisition, remediation and redevelopment of contaminated land. Elanjan discusses the risks of brownfield lending, ways to mitigate those risks and why the public sector is getting involved with land remediation projects.

Q: Brownfield redevelopment is most closely associated with mixed-use projects, especially in recent years, but are these often very expensive projects still doable now? What other types of development are you seeing now with brownfield projects?

Edward Elanjan: Brownfield redevelopments that lend themselves to mixed-use projects generally have a larger footprint and require remediation to a much higher standard, which increases costs.

However, the cost of the land as-is generally reflects a discount from a comparably situated clean parcel. In other words, the cleanup cost is already priced in.

The reason we're seeing fewer multi-use projects now has more to do with the softness of the real estate market and oversupply of residential, office and retail space.

The result has been an influx of smaller deals with end uses targeted at segments where there is both demand and strong prospects for permanent financing. An example would be low-income rental housing that is eligible for federal, state or local support or subsidies on completion.

Q: Given that brownfield lending is inherently more risky than other types of lending, how do you ensure deal soundness?

Elanjan: Typically, the most substantial added risk to brownfield development is not the complexity of the cleanup, but the timing. Delays in obtaining regulatory approvals can put a project behind schedule, giving competitors valuable time to catch up.

To evaluate this risk, we look at the environmental team - primarily the engineer, attorney and project manager - and speak to the regulatory body that has jurisdiction over the cleanup.

A good developer is usually on top of this risk, and we are able to work through it with them. What really kills the deals today is the lack of a clear exit strategy, which is more of a function of the recession and the credit crunch.

Q: What role do communities and local governments typically play in these brownfield deals? Can we expect to see growing numbers of public-private partnerships?

Elanjan: Local communities can play a large role not only in granting entitlements, but by providing assistance through local financing programs, such as tax increment financing and housing authority bonds.

In the current environment, programs that partner the interests of the developer and the local community are vital to the economics. Fortunately, redeveloping a brownfield is usually a win-win.

Q: To what degree has the current green movement encouraged brownfield redevelopment? Has this momentum been enough to overcome the economic downturn?

Elanjan: The green movement is so broad that you have to address it in pieces. The current emphasis on renewable energy and energy-efficient buildings has no real connection to brownfield development.

However, the bigger green picture of conservation and reuse melds seamlessly with brownfield development. Many brownfields are infill opportunities located in city centers. Redeveloping these contaminated land parcels encourages urban growth and reduces the need for commuting, ultimately diminishing fuel usage.

Also, we like to think of redeveloping a contaminated site as the ultimate form of recycling, turning a site that previously had a negative effect on the environment into something that has a widespread positive impact on both the environment and society as a whole.

Q: What is your usual deal structure these days (leverage, interest rate, etc.)? How have parameters changed from the pre-credit crunch days? When do you anticipate a return to normality?

Elanjan: One of the first casualties of the financial meltdown was loan pricing. Nobody is comfortable pricing risk, particularly on an illiquid asset such as real estate. As a result, loan costs for riskier projects such as brownfields are now in double digits - often in the low teens.

As you might imagine, loan-to-value (LTV) ratios have come down as well. Getting above a 50% LTV is rare on a land deal. But the biggest hurdle is getting a good handle on value in a distressed market where comps often reflect fire sale prices, if they even exist at all.

While the Fed is predicting a recovery in late 2009, it will take sustained periods of job growth to get occupancy rates back to normal, retailers back to full health and housing inventories back down to normal levels.

I think we're still at least a year away, and we may not see leverage and terms like we did in 2006 for many, many years.