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Brownfields: The Hidden Gem Of The Retail Industry

- Craig J. Carbrey

The unifying theme throughout the retail industry over the past year has been a return to fundamentals. The lack of liquidity in the capital markets, coupled with a prevailing “wait and see” attitude among retail analysts, has taken many previously aggressive players out of the market and ushered in a more tempered approach to acquisitions, predicated upon investing in well located development opportunities in strong local markets.

But how can growth oriented retail developers and investors find these opportunities in an already crowded market? The answer for some has come in the form of brownfields, environmentally at-risk sites typically located in infill areas. When land is scarce, these sites, which are contaminated from previous use as landfills, power plants, junk yards and other environmentally hazardous practices, can sometimes prove to be the best opportunity for retail developers to acquire a strategically located land parcel within a thriving regional market. While the long-term advantages associated with these opportunities are often easy to perceive, making these properties economically feasible remains the preeminent challenge.

Brownfield Finance: A Two-Tiered Approach

While the vast potential of brownfield development is capable of enticing even the most conservative developers, tapping into this potential has proven infinitely more complicated, beginning with the financing. Many developers with the best of intentions have been derailed by an array of hidden risks and unexpected roadblocks. To circumvent these potential snags, employing a two-tiered approach to the financing strategy is needed.

Tier one encompasses the traditional credit camp, which focuses on the basic parameters involved in financing the deal. Obtaining the necessary financing for a brownfield requires a different financing strategy. Loans for brownfields typically have lower loan-to-cost (LTC) ratios than conventional deals and require a longer holding period. As a result, they require more cash, take more time and require capital designated for both construction and remediation. This creates the need for a lender with a keen understanding of this process, financing both remediation and construction concurrently, creating a full service brownfield finance model.

Tier two encompasses the environmental camp, which works separately to identify and address all of the environmental aspects of the property and works with the borrower to achieve the best possible set of circumstances.

Properly financing a brownfield property requires a comprehensive assessment of the potential risks associated with the property including challenges associated with regulatory issues, insurance requirements, environmental engineering and remediation strategies. This also includes searching for possible unknown contamination that could surface during remediation and drive up costs. This stage typically involves employing a consultant with a focused expertise in brownfields who can answer such key questions as:

- How far along in the clean-up process is the property?
- Has all of the necessary site investigation been completed?
- Have the proper regulatory parties been engaged for the clean-up process?
- Has the environmental remedy been approved by the regulating agency or been included in a voluntary clean-up program (VCP)?
- Has the proper environmental insurance been acquired to adequately mitigate risk?
- To what standards must the property be remediated?
- Are there institutional controls in place and what effect, if any, do they have on the value of the property?

Once the environmental areas have been addressed, the site's strategic location becomes a key factor. Currently, a great deal of the concern involving the overall vitality of the retail market is directly correlated to the turmoil in various housing markets located in fringe areas outside of major metropolitan areas, which were most affected by the mortgage crisis. The primary advantage to brownfield development is the ability to do infill development in an already strong retail market. These types of locations, which already boast a have base or existing consumers, often boast a 30 percent to 40 percent increase in volume over a suburban area and are precisely the areas in which many brownfield opportunities exist.

Transition Yields Opportunity

2007 was a year of transition in the brownfield industry. As with traditional retail investment, the market underwent a period of correction that correlated with the mortgage meltdown and subsequent credit crisis.

With the retail industry continuing to expand at a rapid pace early in the year, many investors and developers made plays for brownfield properties without doing the proper due diligence,

instead focusing solely on the positive momentum of the market. Land values have since regressed substantially and the brownfield opportunities that did not make sound economic sense (i.e. location, regulatory and remediation issues) began to fall by the wayside.

What emerged from this initial fallout presents an outstanding opportunity for the experienced players in 2008. We are now witnessing a number of contaminated properties in key strategic locations just waiting to be acquired. Many of the sites are the last remaining development opportunity in a strong commercial market, but have been passed up due to their environmental issues. With the fundamentals firmly in place, these types of properties could represent hidden gems in the midst of a highly unpredictable retail market.

While we now face a much more sober retail market, the potential for finding well-located brownfield properties remains high in markets ranging from the East Coast to the Midwest all the way to Hawaii. Furthermore, the correction in land values has made acquiring land parcels for retail projects much more financially feasible, with competition for available parcels now limited to a smaller pool of proven borrowers.

Experience Equates To Success

While the vast potential of brownfield development is high, one caveat remains: active players in today's market must have sound experience with brownfields and must undertake the proper due diligence on the property. Active players in the now streamlined brownfield market include brownfield equity funds, which continue to outstanding opportunities, greenfield developers, which have pulled back slightly but remain active in the business, and engineering companies, which have expanded their services to include development.

The brownfield market will always be characterized by a varied profile of borrowers across broad local markets with disparate business goals. However, with uncertainty gripping the retail market and well-located infill properties gaining prominence, tapping into the many opportunities associated with brownfield development remains synonymous with research, experience and sound economic practices. SCB

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