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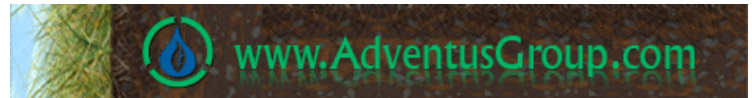
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California's Bona Fide Ground Tenant Model: The Start of a Nationwide Trend?

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Background of Problem: In the wake of the recent economic downturn, Brownfields deals are more difficult than ever. With a glut of non-contaminated properties throughout most urban areas, the added stigma of contamination makes it even less likely that a property will be sold and developed. Many holders of contaminated properties are finding it difficult, if not impossible, to find buyers for their properties, even if the property price is discounted significantly. And the list of vacant or underutilized, contaminated ("Brownfield") sites continues to grow, especially as more and more non-renewed auto dealerships and local factories shut down.

Given this disheartening marketplace for Brownfield transactions, the need for creative new solutions is greater than ever. This is true especially as we see an increased focus on transit-oriented development and other Smart Growth initiatives. In order for these critical local developments to proceed, innovative Brownfields strategies must be employed.

Bona Fide Ground Tenant Model: In the midst of these economic woes, many property owners, cities and redevelopment agencies may find relief from a new "Bona Fide Ground Tenant" concept recently enacted into law in California. This new concept is known in California simply as SB 989, or the Bona Fide Ground Tenant (or "BF Ground Tenant") Model, and it relies on utilizing long-term ground leases (25 years or more) to jump-start Brownfield redevelopment projects.

For those of you who are thinking that maybe you need not read further, that this article just doesn't apply to you because you (or your clients, as the case may be) don't do Brownfield projects under long-term ground leases, you might be surprised. You may well determine that this new BF Ground Tenant model is just the tool you need to jumpstart development at one or more of your projects. In particular, this tool allows Brownfield property owners to generate income from otherwise non-saleable properties, to significantly speed up the development timeline at such properties, and to secure investor funding long before site characterization has been completed.

To begin, let's set forth the basics of the concept. In the late Summer of 2006, the California legislature passed Senate Bill 989, which was signed by Governor Schwarzenegger and became law on January 1, 2007. That law allows for the bifurcation of cleanup between surface soil contamination issues and those deeper soil, groundwater and offsite migration issues. Put simply, in most cases, SB 989 allows a developer to focus solely on remediation of near-surface soil (and soil vapor issues), and to receive full liability relief (in the form of a statutory immunity from the State of California) for itself, its lenders and its successors, for any other contamination issues at or emanating from the site. The main hitch: the developer must not take actual ownership (title) to the property; the developer must acquire its development rights and build its project under a long-term ground lease, instead.

There is a growing nationwide consensus that this bifurcated cleanup approach makes good sense. Developers like the idea because focusing only on near-surface contamination can significantly reduce a developer's environmental cleanup exposure. Property owners like the idea because this bifurcated approach can attract site assessment, remediation and development dollars to properties and projects where the environmental risks would otherwise be too high. Even environmental groups can support a bifurcated cleanup approach, especially since (under the BF Ground Tenant approach) the property owner remains on the hook for the deep soil, groundwater and offsite migration issues.



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BF Ground Tenant Scenarios: The beauty of the BF Ground Tenant model is that it can be employed beneficially in numerous contexts. The obvious situation is the case where a nasty regional groundwater plume or other deep soil (or otherwise migrating contaminant plume) issue makes it untenable for anyone to purchase the site or sites which would otherwise be the subject of redevelopment. In that instance, redevelopment is often stymied by the fact that a prospective purchaser of any of the properties which overlay the regional plume may find itself stuck with a financially devastating environmental cleanup liability. This is especially true in situations where cleanup of the regional plume has not yet begun, and where uncertainty abounds because the regulators are still contemplating the scope of required cleanup efforts, who to pursue to pay for cleanup and whether there will be enough deep pocket PRPs to handle the totality of the remediation work.

If a BF Ground Tenant model were utilized at such sites, a developer would still be required to take care of remediating any shallow surface soil issues, and any other vapor intrusion issues, but would otherwise likely be issued a State-backed immunity from liability for the deeper soil and groundwater issues, as well as any offsite migration issues. This would allow development to occur in these regional contaminant plume areas, since the major environmental impediment to development - the risk that a developer would ultimately be saddled with astronomical cleanup costs - has been removed.

This situation has commonplace applicability to proposed developments in untold numbers of communities throughout the country. Large regional plumes, including the recent emergence of a perchlorate plume problem, can be found in most major metropolitan areas.

A second fairly obvious use for the BF Ground Tenant model is the situation where very little is known about the scope of environmental contamination at a proposed development site. In such circumstances, property owners are often reluctant to test the property and to risk becoming part of an environmental cleanup enforcement action, and developers are concerned about spending significant up-front investigation costs and then having to back out of the project if the cleanup costs are determined to be so excessive that the contemplated development is financially unfeasible. To remedy these concerns, the owner and the prospective developer could draft a purchase agreement that has a ground lease option which would only be utilized as a liability "back-stop" if environmental conditions encountered during escrow are excessive. In such a circumstance, the developer could still move forward with the site acquisition (under a ground lease instead of a fee title purchase) and proceed with the development. At a later date, and once the deep contaminant plume issues have been resolved and property ownership is no longer a huge liability, the developer could then execute his "purchase option," and convert from a leasehold to fee title ownership.

Importantly for many projects, the BF Ground Tenant model can significantly speed up the development process at Brownfield sites. Under California's program, for example, a developer (or even a city or redevelopment agency) could decide to take down a property, under a long-term ground lease, just to jump-start the entitlement process (and, possibly, qualify for loan or grant monies) while the site is being cleaned up. At that point, in most cases, the BF Ground Tenant will merely need to remediate surface soil (and soil vapor) issues and then a State-backed immunity, which would extend to lenders and successors, will be issued. At many Brownfield projects this approach would allow entitlement work, lender financing, and even site construction and buildout to occur many months, and perhaps years, earlier than under traditional Brownfield development models. And remember, using this tool to expedite the development process does not mean that the project must continue forward under the long-term ground lease model. This ground lease construct can be used merely as a preliminary step to jumpstart the project, with the developer converting to a fee title purchase at the appropriate time.

The Beginning of a Nationwide Trend: It is believed by the authors that the time is now ripe for states across the country to develop ground lease models similar to the one developed in California. In the recent past, the real estate market was what many would call "white-hot." Under those frenzied circumstances much of the demand/supply for real estate was based on the idea that a property could always be resold, at a substantial profit, within two or three years of acquisition. This often resulted in the exteriorization of the long-term hold, income-producing strategies of the past and, instead, the strategy of "flipping" properties (and projects) became the new rule of the day. This artificially buoyed real estate marketplace created unrealistically high

expectations in the minds of property owners (even those holding contaminated properties), and created few incentives for the use of income-producing long-term ground lease models.

The recession has changed all of that. Property owners are finding substantially deflated sales prices, across-the-board, and developers and investors are finding that they must revert back to the old conventional income-producing models for real estate, especially for commercial real estate, if their investments are to be viable. Under this more traditional construct, the long-term ground lease is once again in favor.

And for many of those property owners that are stuck holding true "Brownfield" properties (i.e., those that are vacant or severely underutilized because of contamination issues), the noose is tightening. No longer can those Brownfield property owners rely on the idea that they will be able to merely "flip" their sites at a tidy profit, without addressing contamination issues. Many of these property owners now realize that they will likely be holding these properties for a long, long time, unless and until they begin addressing contamination issues. Moreover, many of these sites are (or soon will) face regulators who will force site cleanup to occur.

For Brownfield property owners, the problem is obvious. By definition, these Brownfield properties do not produce much, if any, income, and they certainly do not typically earn enough money to pay for the cleanup costs the property owner must incur. And, unless and until contamination issues are addressed and even resolved, the properties are not likely to be saleable.

This is where the BF Ground Tenant model comes into play. Brownfield property owners that cannot sell their properties may still be able to generate income by entering into long-term ground leases, instead. By using the BF Ground Tenant model, many of these property owners could still attract developers by being able to offer them the bifurcated cleanup and State-backed immunity approach provided by the BF Ground Tenant model. This approach might be especially attractive for cities and redevelopment agencies as they are looking for more and more tools to attract developers to environmentally blighted areas of their communities.

Many states already have Bona Fide Purchaser laws which already significantly limit the liability of a truly innocent new owner for the contamination caused by its predecessors. However, even in States with laws like those it is believed that a BF Ground Tenant concept could still be beneficial. Some other states, like Michigan, also have significant tenant protections and may be able to utilize existing laws to pursue similar BF Ground Tenant models.

It would be a major boon in many of these states to have the ability at Brownfield projects to immediately bifurcate cleanup issues and to obtain an unequivocal State-backed immunity once the surface soil (and surface vapor) contamination issues are resolved. Additionally, the very issuance of a formal State-backed immunity, which also runs to lenders and successors, would make Brownfields projects much easier to finance and to insure.

Follow-up Efforts for interested stakeholders in other states : It is the firm belief of the authors that most states in this country would benefit from some form of BF Ground Tenant protection. In that vein, the authors have formed a nationwide team of experts who are reaching out to state and local Brownfields coordinators and other Brownfields stakeholders throughout the country to provide advice and assistance in establishing such legislative initiatives. For more information, please contact one or more of the authors of this article. Kevin Daehnke can be reached directly at KDaehnke@DaehnkeCruz.com or by cell, at (949) 632-2239.

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