

PROPERTY TAX ISSUES FOR BROWNFIELDS AND OTHER CONTAMINATED PROPERTIES

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INTRODUCTION

The authors discuss several valuation and property tax issues, including:

- Methods of appraising contaminated real estate and Brownfields;
- How future environmental liabilities can be amortized in a discounted cash flow analysis, thus reducing the value of the property and the property taxes owed;
- Programs for remediating mildly contaminated properties and Brownfields and reducing liabilities from owning them; and,
- Ways of reducing property taxes on Brownfields, remediated properties and properties used for pollution control.

THE BACKGROUND OF ENVIRONMENTAL LAW AND APPRAISAL

The environmental movement gained notoriety in the 1960s, but prolonged, nationwide attention to how environmental contamination affected people's homes and businesses really began with the Love Canal disaster in 1976. Later publicity focused on the health hazards of asbestos in buildings and lead in paint and gasoline. A wave of local, state and federal laws followed, banning some substances and more strictly regulating others. More importantly for appraisers and attorneys, these new laws provided a framework for the cleanup of already contaminated sites and the determination of which parties would have legal responsibility. Of course, these new laws did not magically eliminate contaminated sites, nor was consensus reached on who should pay for the cleanups. These issues are still the subjects of intense debate.

Laws enacted in the early 1980s such as the Federal Superfund were designed for the worst cases of contamination and most imminent threats to public health and ecology. While the public interest might have been served by government agencies "laying down the law" on the most egregious and recalcitrant offenders, this approach created a deeply adversarial relationship between the government and contaminated-property owners. Many of these owners were not responsible for the pollution and did not know about such pollution when they bought their properties. For problems that are more common but usually less serious – leaking underground storage tanks in gasoline stations, TCE spills in dry cleaning facilities – the punitive aspects of the law and the Superfund apparatus are overkill. State and federal government needed to create a less obtrusive system that would encourage remediation instead of litigation.

In recent years, Texas has enacted programs such as the Voluntary Cleanup Program (VCP) to facilitate remediation and reclamation of mildly contaminated sites. Other programs, which will be discussed below, include Brownfield Site Assessments (BSAs), the Innocent Owner/Operator Program (IOP), tax abatement for Pollution Control Properties and direct tax abatement for remediated sites. One goal of these programs is to foster a better relationship between private parties and enforcement agencies so that money is spent directly on remediation rather than legal fees. Another goal is to use the most recent scientific data to assess which contaminants present the most danger to the public. Less hazardous substances can be handled in a less costly and disruptive manner.

ENVIRONMENTAL LAW AND APPRAISAL METHODOLOGY

In the appraisal of an ordinary office building or plot of land, the appraiser has decades of industry experience on which to draw. The methodology is very straightforward and fairly rigid. The competent appraiser needs only to follow the guidelines in a careful, thorough manner in order to provide a worthwhile value estimate and other information to his or her client.

On the other hand, the valuation of contaminated real estate and Brownfields is still a relatively new field. The constantly shifting legal landscape presents unique problems. For example, during the 1980s, the public perceived asbestos-containing building materials to be an extremely serious health problem, which they are, but no differentiation was made between friable and non-friable asbestos. The demand was often for complete (and extremely expensive) abatement, regardless of whether the particular form of asbestos posed a serious health threat. Now, the public and market participants seem to have a better understanding of the risks involved. For example, asbestos-containing floor tile is usually covered with a new layer of tile rather than being removed. The cost is far less, and the difference in risk is negligible as long as the substances are not disturbed and the encapsulation is accompanied by an operation and maintenance program.

Just like the courts, lawyers and public at large, the appraisal community has differing opinions on how severely, if at all, some forms of contamination affect real property values. Appraisers have typically used the Income Approach or the Sales Comparison Approach to estimate the real property damages caused by contamination. In brief, the Income Approach involves estimating the market rent for a property, then dividing that rent by a capitalization rate to determine the property value. The Sales Comparison Approach involves finding properties similar to the subject properties that have sold recently, then adjusting for variations between those sales and the subject.

Some real estate appraisers and scholars favor the Income Approach. The basic method for contaminated properties is to determine the rental rate for the contaminated property and compare it to the rates of similar, uncontaminated properties. The difference in rental rates, once capitalized, provides the estimate of damages from the contamination. This technique is valid and can provide an easy-to-follow, mathematical quantification of environmental risk.

One of the most significant restraints on the application of this method is the lack of contaminated income property sales from which an impaired capitalization rate can be derived.

Unfortunately, the conclusions are infrequently substantiated by market data. The appraiser often finds no difference in the rental rates between contaminated and uncontaminated properties and determines that no damage has occurred. While this seems logical, the appraiser's mistake is to assume that the market is well informed and that the rental transactions meet the criteria of market value, when in fact they often do not. Despite the increased attention paid to environmental hazards, rarely is a community genuinely well informed of environmental risks associated with contaminants within their neighborhood. Even in Superfund sites, only limited objective information may be available to the public. Also, we have found examples of contaminated rental properties in close proximity to a Superfund site in which the owners knew of the contamination but did not inform the renter. Texas Property Codes §92.056, 92.0561, and 92.052 require landlords to notify tenants when there is a "condition that materially affects the physical health or safety of an ordinary tenant," but what is required of the landlord to determine such a condition is more ambiguous. In sum, an analysis considering only rental values might indicate no damages, whereas more careful scrutiny could indicate quite the opposite. The Income Approach is therefore often criticized as being strictly theoretical and lacking real world contact with the market.

The same problems occur in the Sales Comparison Approach. Some appraisers, finding no market transactions in the contaminated area, conclude that the subject property is unmarketable and property damages equal 100% of the unimpaired value. Once again, this seems superficially logical, but in truth, the lack of transactions is often the result of market confusion and the lack of sound data on which to base buying and selling decisions. The lack of data may also be related to something entirely unrelated, such as a general economic downturn (as occurred in the late 1980s in Texas). Conversely, we know of cases in which market activity in a contaminated area is robust with no apparent difference from other neighborhoods. We have often found that knowledge of contamination in the area is virtually non-existent, calling into question whether these transactions fit the criteria of a market sale with a fully informed and willing buyer and seller.

Either approach *can* be useful in determining the real property damages caused by contamination, but the analysis of the transactions involved must be much more thorough than a typical sales analysis. In our firm, we usually use a methodology known as the Case Studies Approach.

The Case Studies Approach has evolved as part of the Sales Comparison Approach in estimating diminution in property value of real estate that has been affected by contamination. As real estate professionals have gained more information and experience with environmentally impaired transactions, they have adjusted their biases away from absolute rejection of a property. Sellers of contaminated properties have developed mitigation solutions including indemnification agreements, separation of surface and subsurface rights, future remediation/liability escrow and ground leasing. As a result of these measures, a small but increasing number of data is emerging in the form of sales, financing and leasing of contaminated real estate.

Most of the data researched involves slightly-to-moderately contaminated properties. The sales of more severely contaminated communities, such as Superfund sites and adjacent properties, are scarce. The necessary research on them can be expensive and time-consuming to develop. Severely contaminated properties are the most rare; these sites usually have such a high risk of regulatory or third party liability that the current owners cannot or will not relinquish control. These properties may never sell on an arms-length basis to an informed, knowledgeable buyer because of pending litigation or enforcement proceedings.

While sales of mildly impaired properties are still infrequent, the authors are convinced by observations over the last ten years that sales are occurring more frequently. Reasons for this include market familiarity, the quantification of environmental risks and regulatory bodies offering responsible parties more relief from future prosecution and remedial action through Risk-Based Corrective Action (RBCA) closures.

The Case Studies Approach is a process of comparing contaminated sales that are similar to the subject property. From these comparisons, the appraiser attempts to develop an understanding of how actual buyers and sellers have reacted to the following factors:

- Discounts in selling price;
- Risk of regulatory enforcement and third party litigation;
- On-going and future monitoring, sampling, testing and other remediation liabilities;
- Structural controls such as deed recordation requirements;
- Medical monitoring costs and health claims or concerns; and,
- Seller and purchaser indemnification requirements related to future conveyances of the property and subsequent recontamination discoveries.

In order to apply the results of case study research to the property being appraised, the analyst must understand the nature and extent of the contaminants present. The most complicated assignments involve a team of consultants that may include geologists, hydrologists, professional engineers, toxicologists and medical and veterinary doctors.

The following are questions in the valuation assignment:

- What type of contaminants is involved? How are the contaminants characterized (hazardous or toxic waste, petroleum substances, non-hazardous waste, debris, etc.)?
- How large is the plume of contaminants and in what direction and speed is it moving? What are the principal sources and pathways of contamination (air, soil, groundwater)? What is the likelihood of subsequent discharges from the point source?
- Is the subject property currently contaminated or will it be invaded by contaminants in the foreseeable future? What type of testing, monitoring or surveillance work will be necessary to quantify the nature and extent of the contaminants present on site? Are there any pathways that could transport the contaminants to the surface?
- What are the public health risks?
- What has been the history of the complaints and problems generated against the responsible parties, including all the discharges, violations, fines, etc.?
- What is the potential for state or federal action? Who will be the target of the enforcement by the governmental agency? What are the environmental response costs and legal fees, if any, to the innocent landowner?
- If no governmental action will be taken and the responsible party will not remediate the site, what mitigation measures and structural controls must be implemented by the

property owner to increase or decrease the marketability of the property? How should the owner disclose this liability to third parties?

- If no action is taken, how long before the contaminants to reach a concentration below background or maximum contaminant level (MCL) assuming biodegradation is possible?
- What actions, if any, can the adjacent, innocent landowners take toward remediation of their site and at what cost of money and time? How will the post-remediation amount of contamination compare to background for properties in the area?
- In how many years will the subject site be remediated to background levels? Will deed recordation be required because remediation goals will not achieve background levels?

After the appraiser has assembled a group of contaminated case studies, he or she can develop some basic opinions.

1. Sites purchased with little-to-no concern of future reprisals by regulatory bodies or with a nominal, manageable remediation liability often command the smallest discounts. Purchasers of this type of property are unlikely to require a large stigma discount. This may be especially true when the contaminants have not moved off-site and the remediation effort will result in an effective, permanent cure such as a closure letter from the applicable enforcement agency upon completion of the remediation project.
2. Purchasers who manage similarly contaminated sites on a daily basis are less likely to negotiate large discounts on sites that will be continuously operated and exposed to future releases. A notable exception is major oil companies that are reluctant to purchase gasoline station sites that have been previously contaminated by on-site or off-site hydrocarbon contaminants until they have been remediated to below regulatory limits and closed. The dilemma for many purchasers of formerly contaminated real estate is that while a site may have been successfully remediated to the acceptance of state and federal regulations, it still may not satisfy mortgage lenders or subsequent purchasers. The result is that the property may never regain its mortgageability or original market value.
3. Sites sold without regulatory closure or with off-site migration problems sell for substantial discounts and many are not marketable at any price because the environmental and third party liabilities cannot be quantified.

4. Some properties in demand because of a scarcity of substitutes often sell for lesser discounts. In these cases, purchasers are compelled to work with the site owners in spite of the contamination problems.

The case studies suggest an appropriate discount in value for the subject property proportionate to the risks associated with the nature and extent of contaminants. The comparability of each case study is based on its similarity to the subject property's contamination problem. The contamination case studies may be drawn from diverse property types or land uses, but can still be applicable to a subject property for the purpose of estimating total diminution in value. The primary factor is not so much the quantity of data as the quality. When enough solid, supportable case studies that are analogous to the subject property have been developed, this approach can be the primary approach to quantify diminution in market value associated with owning contaminated real estate.

CONTAMINATION AND PROPERTY TAXES: SECTION 23.14 OF THE TEXAS PROPERTY TAX CODE

For large-scale operations such as landfills, incinerators and refineries, state and federally mandated environmental costs can exceed tens of millions of dollars. These costs can extend thirty years or more beyond the operating life of the property. Of primary importance is whether these costs can be amortized and deducted from the value of the facility. County appraisal districts have argued that these costs are strictly business expenses that cannot be deducted for property tax valuation purposes. We disagree. An example of a business expense is the malpractice insurance paid by a lawyer who is a tenant in an office building. The insurance cost does not affect the real estate; if the lawyer leaves the building, that cost goes with his firm. Conversely, although environmental costs are incurred because of a particular business activity, these costs accrue to the property itself - environmental costs cannot be transferred to a different property. Even if the property owner ceased or changed the business use of the site, most of these future costs would still have to be paid.

The State of Texas Property Tax Code § 23.14(b) states that *“in appraising real property that the chief appraiser knows is subject to an environmental response requirement, the present value of the estimated cost to the owner... is an appropriate element that reduces market value and shall be taken into consideration by the chief appraiser.”* [emphasis added]

Property owners do not always take advantage of this situation. Often, the owner has not explored this avenue of potential tax savings because of the negative publicity surrounding tax protests and litigation. The publicity can be especially negative when the property is not particularly welcome in the community in the first place. Another problem is that by drawing attention to his or her own potential environmental problems, the owner risks third party litigation from nearby property owners, environmental groups or government regulators. The owner must thoroughly evaluate the risks, costs and potential benefits of pursuing property tax relief under this section of the Tax Code. Such an evaluation would involve legal counsel, environmental engineers, accounting/finance personnel and real estate appraisers.

AMORTIZATION OF FUTURE ENVIRONMENTAL COSTS

As an example of what effect amortizing environmental costs has on property taxes, we present two discounted cash flow analyses of a fictional hazardous waste incinerator. For a variety of reasons, after what appeared to be a promising future at the beginning of the decade, this industry underwent drastic decline. Companies that spent hundreds of millions of dollars on one facility have faced huge operating losses or narrow positive margins that will never recoup the original construction costs. Thus, the opportunity to save on property taxes is of critical importance.

Large-scale projects such as hazardous waste incinerators and landfills have inherent environmental risks. Therefore, they come under much closer scrutiny by government agencies than a typical property and are subject to special environmental costs. These costs are described below:

Permitting costs: The costs of permitting acquisition and renewal over the life of the facility. For example, the initial permit for a hazardous waste incinerator in Texas is for ten years and subsequent permits last five years.

Closure costs: The costs associated with decontamination and removal of buildings, tanks, pipes, pumps, capping of landfills, etc., in a legal and environmentally sound manner.

Post-closure costs: The costs of monitoring the closed facility for environmental safety. Activities include monitoring of groundwater and soil, maintenance of drainage, security remediation activities and report preparation. In the case of landfills and hazardous waste incinerators, the post-closure period is thirty years.

The first spreadsheet displays the estimated value of the incinerator without considering environmental costs. For 2000, the plant is expected to gross \$35 million and net \$5 million. Revenues and operating expenses (not including property taxes) are expected to increase 3% annually. The operating discount rate is 15%, to which 2.5% was added to account for property taxes (assuming an assessed rate of \$2.50 per \$100 in value). The facility is expected to have a remaining economic life of 20 years. In this analysis, the facility has a value of approximately \$30,107,000. Based on this value, 2000 property taxes on the facility should be approximately \$753,000.

In the second evaluation, we have included the costs of permitting, closure and post-closure on an amortized basis. We have assumed that the cost of renewing the permit every five years is \$1 million, closure costs for 2000 are estimated at \$40 million and post-closure costs are \$20 million. The amortization costs for each item were estimated as follows:

Permit fees: Enough money must be saved each year to build up to \$1 million after five years. That money is then spent on the permit, and the process begins from zero. Using an earnings rate of 7% on the assumption that the money will be saved in a safe investment such as a U.S. Government bond, the annual amortization cost is \$162,515.

Closure costs: The \$40 million figure applies to what the costs would be if the facility were closed today, not in the future. Since we have assumed a 20-year remaining life, we must estimate the closure cost after 20 years. Assuming an inflation rate of 2.5%, that total cost is \$63,946,007. Then, using the same earnings rate of 7%, we calculate the annual amortization cost needed to build up to \$63,946,007 after 20 years. That annual amount is \$1,457,785.

Post-closure costs: These are calculated in the same fashion as closure costs with one exception. Because the post-closure money will be spent over a longer period after the facility is closed, interest can still be earned on the unspent money. For the \$20 million in post-closure costs, the annual amortization cost is \$452,243.

The sum of these three cost items is \$2,072,543 annually. Since the net operating income was only \$5 million without these costs, the effect on the value of the property is dramatic. The value estimate decreases from approximately \$30,107,000 to \$18,724,000, a decrease of 38%. Likewise, the estimate of what property taxes should be declines from \$753,000 to \$468,000. The annual net savings is \$285,000. Over the life of the facility, the net present value of the annual savings is over \$3 million.

**DISCOUNTED CASH FLOW ANALYSIS #1 – River City Hazardous Waste Incinerator
(no amortization of future environmental liabilities)**

Effective Date	Jan-1-2000
Expected Remaining Economic Life (Years)	20
Operations Discount Rate	15.0%
Property Tax Rate	2.5%
Effective Discount Rate	17.5%
Sinking Fund Earnings Rate (for Permit/Post-Closure Costs)	7.0%

Year	1 2000	2 2001	3 2002	4 2003	5 2004	6 2005
REVENUE	\$35,000,000	\$36,050,000	\$ 37,131,500	\$ 38,245,445	\$ 39,392,808	\$ 40,574,593
OPERATING EXPENSES	(30,000,000)	(30,900,000)	(31,827,000)	(32,781,810)	(33,765,264)	(34,778,222)
NET OPERATING INCOME	5,000,000	5,150,000	5,304,500	5,463,635	5,627,544	5,796,370
DISCOUNT RATE	0.8511	0.7243	0.6164	0.5246	0.4465	
PRESENT VALUE OF N.O.I.	\$ 4,255,319	\$ 3,730,195	\$ 3,269,873	\$ 2,866,357	\$ 2,512,636	
CUMULATIVE PRESENT VALUE OF N.O.I.	\$ 4,255,319	\$ 7,985,514	\$11,255,387	\$14,121,743	\$16,634,379	

CUMULATIVE PRESENT VALUE OF N.O.I.	\$ 16,634,379
VALUE OF FUTURE N.O.I. (REVERSION)	
N.O.I. in Year 6 (2003)	\$ 5,796,370
P.V. Annuity Factor (15 Years @ 17.5%)	5.2057
Discount Rate (5 Years @ 17.5%)	0.4465
	\$13,472,340
PRESENT VALUE OF FACILITY	\$30,106,719

PROPERTY TAXES FOR 2000	\$752,668
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**DISCOUNTED CASH FLOW ANALYSIS #2- River City Hazardous Waste Incinerator
(including amortization of environmental liabilities)**

Effective Date	Jan-1-2000
Expected Remaining Economic Life (Years)	20
Operations Discount Rate	15.0%
Property Tax Rate	2.5%
Effective Discount Rate	17.5%
Sinking Fund Earnings Rate (for Permit/Post-Closure Costs)	7.0%

Year	1 2000	2 2001	3 2002	4 2003	5 2004	6 2005
REVENUE	\$ 35,000,000	\$ 36,050,000	\$37,131,500	\$38,245,445	\$39,392,808	\$40,574,593
OPERATING EXPENSES	(30,000,000)	(30,900,000)	(31,827,000)	(32,781,810)	(33,765,264)	(34,778,222)
Permitting/Closure/Post-Closure Costs						
Amortization of Permit Costs	(162,515)	(162,515)	(162,515)	(162,515)	(162,515)	(162,515)
Amortization of Closure Costs	(1,457,785)	(1,457,785)	(1,457,785)	(1,457,785)	(1,457,785)	(1,457,785)
Amortization of Post-Closure Costs	(452,243)	(452,243)	(452,243)	(452,243)	(452,243)	(452,243)
TOTAL	(2,072,543)	(2,072,543)	(2,072,543)	(2,072,543)	(2,072,543)	(2,072,543)
NET OPERATING INCOME	2,927,457	3,077,457	3,231,957	3,391,092	3,555,001	3,723,828
DISCOUNT RATE	0.8511	0.7243	0.6164	0.5246	0.4465	
PRESENT VALUE OF N.O.I.	\$ 2,491,453	\$ 2,229,032	\$ 1,992,287	\$ 1,779,050	\$ 1,587,269	
CUMULATIVE PRESENT VALUE OF N.O.I.	\$ 2,491,453	\$ 4,720,485	\$ 6,712,772	\$ 8,491,822	\$10,079,091	

CUMULATIVE PRESENT VALUE OF N.O.I.	\$ 10,079,091
VALUE OF FUTURE N.O.I. (REVERSION)	
N.O.I. in Year 6 (2003)	\$ 3,723,828
P.V. Annuity Factor (15 Years @ 17.5%)	5.2057
Discount Rate (5 Years @ 17.5%)	0.4465
PRESENT VALUE OF FACILITY	\$ 8,655,187
PRESENT VALUE OF FACILITY	\$18,734,278

PROPERTY TAXES FOR 2000	\$468,357
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Annual savings when compared to DCF without amortization	\$284,311
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Present value of savings over life of facility	\$ 3,011,995
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Direct Abatement Of Ad Valorem Property Taxes

In 1997, the 75th Legislature of Texas passed Senate Bill 1596/House Bill 1239, which amended Texas Tax Code §312 to allow cities to grant property tax abatements for remediated properties. As you might guess, the bureaucratic obstacles for receiving such an abatement are high, but the benefits are substantial and worth pursuing.

As described in the Senate Bill analysis, the amendment “provides an incentive for the development of cleanup sites of contaminated areas by creating a four-year property tax incentive to eligible individuals that clean up and redevelop eligible properties subject to the Texas Voluntary Cleanup Program (VCP).” The sponsors believed that an additional incentive to the VCP was needed to spur remediation and redevelopment of contaminated property. The VCP is discussed in the following section.

To be eligible for tax abatement, the real property must pass four basic rules:

- The property must be located in a “reinvestment zone” as defined and created under Texas Tax Code § 312;
- The property must not be in an improvement project financed by tax increment bonds;
- The property must have received a Certificate of Completion from the Voluntary Cleanup Program (VCP) of the Texas Natural Resource Conservation Commission (TNRCC); and
- The property value must have been adversely affected by the release of a hazardous substance or contaminants according to the two preceding appraisals by the appraisal office.

Rule 1 covers the “reinvestment zone.” According to the Tax Code, the municipality in question does not merely grant an abatement; it must willingly enter such an agreement as it pertains to defined criteria for an abatement program. The property must be located within a “reinvestment zone” or “enterprise zone.” In general, a “reinvestment zone” is a neighborhood or sector specifically designated by a city as having “substandard, slum, or deteriorated structures, ... unsafe or unsanitary conditions,” and also “substantially arrest[s] or impair[s] the sound growth of the municipality creating the zone.” In this case, the property owner would need a property tax consultant and/or attorney to research the municipality’s involvement in the program and to determine the viability of the property meeting the city’s reinvestment criteria.

Rules 2 and 3 are relatively self-explanatory. Rule 2 prevents the “double dip” that would be created by granting tax abatements to a property already receiving similar benefits. Rule 3 prohibits the granting of abatements prior to the complete remediation of the property.

Rule 4 is especially significant, more for what it does not say than what it does say. Appraisal Districts, understandably, are loath to unilaterally grant reductions in property value even if the property is contaminated. County Appraisers and their superiors may feel that discounting properties for on-site contamination is poor public policy, especially when the property owner is principally responsible, even if such an opinion violates the spirit of Tax Code 23.14. The property owner must aggressively pursue a reduction in assessed value prior to or at least during the remediation process.

The governing body must enter into a formal tax abatement agreement with the owner of the Brownfield property.

Year of Agreement	Maximum Property Tax Abatement
Year 1	up to 100%
Year 2	up to 75%
Year 3	up to 50%
Year 4	up to 25%

As stated previously, the benefits of an abatement agreement can be substantial. To illustrate, we have created a hypothetical scenario to illustrate the potential tax savings of the agreement. Assume that the property is valued at \$1,000,000 by the local appraisal district, has met all the requirements of the Tax Code and its owner has reached an agreement with the city and county for the maximum abatement allowed by law. Also, assume that the property value will appreciate 5% per year and the tax rate will remain at a level of \$2.50 per \$100 of value. The following chart displays what the property taxes would be under the abatement agreement compared to the full assessment:

	Property Value	Tax rate per \$100 in value	Nominal Property Taxes	Abatement	Actual Taxes Paid
Year 1	\$1,000,000	\$2.50	\$25,000	100%	\$0
Year 2	1,050,000	2.50	26,250	75%	6,563
Year 3	1,102,500	2.50	27,563	50%	13,781
Year 4	1,157,625	2.50	28,941	25%	21,705
Sum of Property Taxes			\$107,753		\$42,049
Total Savings					\$65,704

The aggregate tax savings are worth 6.5% of the initial value of the property.

We should note that a municipality is under no obligation to grant the maximum abatement or any abatement at all. Numerous factors would come into play, including the city planning department's willingness to provide assistance in redevelopment, the location of the property within the city, the speed and type of redevelopment and the political climate.

In addition, while not directly related to property taxes, the Taxpayer Relief Act of 1997 (HR 2014) allows a taxpayer to expense, rather than amortize, certain environmental remediation expenditures in the taxable year in which it is paid. This Act applies to Brownfield redevelopment and ongoing concerns such as manufacturing plants. The Act is set to expire on December 31, 2000.

VOLUNTARY CLEANUP PROGRAM

The Voluntary Cleanup Program (VCP) is the primary program of the Brownfield Redevelopment Initiative. According to the TNRCC, it "provides incentives for properties with real and perceived contamination (Brownfields) to be investigated, cleaned, and redeveloped. An additional benefit is the sparing of outlying rural, 'greenfields.'"

The VCP's purpose is to streamline the remediation process by providing a clear, step-by-step framework for solving the environmental problems and legal issues affecting the site. The VCP intends to be more proactive and less punitive than earlier programs such as the State and Federal Superfund. In brief, the property owner must submit an application (along with \$1,000) describing the property and an environmental site assessment detailing the type and extent of contamination. Then, the applicant and TNRCC must agree on the remediation

process and the applicant must pay all TNRCC oversight costs. After completion of the cleanup, the owner or participating party receives a Certificate of Completion from the TNRCC stating that all non-responsible parties are released from all liability to the state for cleanup of areas covered by the certificate. Sites already under an enforcement order or pending action are not eligible.

As of May 18, 2000, the TNRCC has received 1,113 applications for the VCP. Four hundred and twenty (420) sites have been issued Certificates of Completion. As noted previously, the property owner must enter the VCP and receive a Certificate of Completion before applying for a reduction in property value with the County Appraisal District.

INNOCENT OWNER/OPERATOR PROGRAM

Related to the Voluntary Cleanup Program is the Innocent Owner/Operator Program (IOP). The IOP is designed to “provide a certificate to an innocent owner or operator... if their property has become contaminated as a result of a release or migration of contaminants from a source or sources not located on the property, and they did not cause or contribute to the source or sources of contamination,” according to the TNRCC. The property owner must submit an application fee of \$1,000 and a Site Investigation Report proving that the property owner was not responsible for and did not contribute to the contamination problem. In almost all cases, the Site Investigation Report requires soil and groundwater testing and analysis. Also, the applicant must notify adjacent landowners of the IOP application, and if a certificate is received, deed recordation is required.

While the IOP may be beneficial in terms of liability protection to the current landowner, by law the IOP certificate does *not* transfer to the new owner if the property is sold. Subsequent owners must submit a new application (including the fee) if they need such a certificate. In sum, the IOP offers limited liability protection, but the process can also be time-consuming and costly, and offers no protection for future owners. The property owner must weigh these costs and drawbacks with the potential benefits, which include immunity from State enforcement actions and perhaps a means of thwarting third-party lawsuits.

TAX RELIEF FOR POLLUTION CONTROL PROPERTIES

In 1993, voters passed a constitutional amendment that permitted property tax relief for properties used for pollution control. Title 30, Chapter 17 of the Texas Administrative Code permits a property owner to apply to the TNRCC for determining that his property and/or equipment is being used for pollution control purposes. If so, the owner may be entitled to a property tax break. According to the TNRCC, “the intent of this amendment is to ensure capital investments undertaken to comply with environmental mandates do not result in an increase in property taxes.”

Under a two-step process, the property owner applies to the TNRCC for a determination that the property or equipment in question is for pollution control. If a positive determination is made by the Executive Director, the owner may apply for a property tax reduction or exemption with the County Appraisal District.

The application fee is only \$50 if the property or equipment appears on a predefined list published by the TNRCC. For equipment or property not on the list, the fee ranges from \$1,000 to \$2,500 depending on whether the entire property is used for pollution control. Appendix B of “Use Determination of Pollution Control Property,” published by the TNRCC in October 1996, contains a lengthy list of acceptable property and equipment. The tax exemption for most items is 100%; other items range from 20% to 90%.

Properties and equipment not eligible for the tax relief include motor vehicles, residences, recreational facilities and parks. Also, property used in manufacturing pollution control devices or providing pollution control services to others is not eligible. The tax break applies to the actual use of such equipment and property, not merely its provision. Likewise, buffer zones, offices, and incidental equipment used as a commercial facility are not eligible.

Of the 4,111 applications reviewed by the TNRCC, only 47 have been rejected, primarily because the TNRCC determined the equipment or property in question was not pollution-preventing. One-third of the applications received were from chemical plants. Other common property types include gasoline service stations, electric and natural gas utility plants, oil refineries, manufacturing plants and bulk storage facilities. The most common type of equipment for which an exemption is requested is containment devices, followed by vapor

recovery systems, wastewater systems, stormwater segregation systems, flare modifications and scrubbers. Common property uses include landfills, injection wells, monitoring and recovery wells, waste storage, septic systems and recycling facilities. This section (11.319) does not apply to a facility, device, or method for the control of air, water, or pollution that was subject to tax abatement agreement executed before Jan. 1, 1994.

To date, the TNRCC has received application from 175 of the 254 counties in Texas. Nine counties account for one-half of the total application: Harris County leads the way (with nearly three times the applications of any other county), followed by Brazoria, Dallas, El Paso, Galveston, Jefferson, Nueces, Tarrant and Travis Counties.

BROWNFIELD SITE ASSESSMENTS

Brownfield Site Assessments (BSA) is a recently created adjunct to the Voluntary Cleanup Program. BSAs are federally financed and are performed and administered by the TNRCC.

BSAs apply to private property only when “property taxes [are] owed to the local government and... foreclosure for failure to pay those taxes is likely,” according to the 1999-2000 BSA Application. More often, the property is already owned by a local government entity. In either case, the property must ultimately serve a “long-term beneficial use by the local government or non-profit organization.” Hence, a property owner cannot use a publicly funded BSA for private gain, but the owner’s partnership with the government could prevent tax foreclosure and perhaps assuage his potential legal and environmental liabilities.

The property must meet other criteria to qualify for a BSA. The property must be abandoned, cannot be subject to state or federal environmental enforcement and may not be a permitted site under the Resource Conservation and Recovery Act (RCRA). In sum, the property should not present an immediate health or safety threat. Also, the local government must have targeted the property for redevelopment, perhaps as a reinvestment zone as described previously.

The benchmark of the BSA is a Phase I Environmental Assessment, an increasingly common feature of commercial property transactions. A Phase I Assessment does not include site testing, only documented research of prior contamination. It also incorporates a Lien Holder's Assessment to establish partial interests held by governments, financial institutions and other parties. The BSA provides research of local redevelopment incentives, infrastructure, prior attempts at redevelopment that failed, job creation and market development.

Given the restrictive criteria listed above, the BSA program clearly is intended for a select few properties and is not meant as a broad incentive for the private sector to remediate contaminated properties. But for the contaminated-property owner facing property tax foreclosure and without the means or wherewithal to redevelop his property, the BSA program could possibly resolve many of the owner's problems while benefiting the community.

INTERNET LINKS

A web page with these links and others can be found at:

<http://www.austinval.com/links.htm>

TNRCC Brownfield Redevelopment Initiative Home Page:

<http://www.tnrcc.state.tx.us./permitting/remed/vcp/brownfields.html>

TNRCC Voluntary Cleanup Program (includes links to Texas VCP News, guidance publications, Applications and Agreement forms, and examples of Certificates of Completion):

<http://www.tnrcc.state.tx.us./permitting/remed/vcp/index.html>

TNRCC Risk Reduction Program (for the VCP):

<http://www.tnrcc.state.tx.us./permitting/trrp.htm>

TNRCC Innocent Owner/Operator Program (includes Application forms and examples of Certificates):

<http://www.tnrcc.state.tx.us./permitting/remed/vcp/iop.html>

Property Tax Incentives for Pollution Control Properties:

<http://www.tnrcc.state.tx.us./exec/chieffeng/prop2/>

Property Tax Incentives for Brownfield Redevelopment:

<http://capitol.tlc.state.tx.us/statutes/codes/TX000046.html> (abatement agreements)

<http://capitol.tlc.state.tx.us/statutes/codes/TX000045.html> (redevelopment zones)

EPA Region 6 Brownfield Program:

<http://www.epa.gov/earth1r6/6sf/bfpages/sfbfhome.htm>

Federal Tax Incentives for Brownfield Redevelopment:

<http://www.epa.gov/swerosps/bf/html-doc/taxlaw2.htm>

City of Austin Brownfield Redevelopment Program:

<http://www.ci.austin.tx.us/sws/brownfields.htm>

City of Dallas Brownfield Redevelopment Program:

http://ci.dallas.tx.us/html/brownfields_.html

City of Fort Worth Economic Redevelopment Program:

<http://ci.fort-worth.tx.us/dem/brownfields.htm>

City of Houston Brownfield Redevelopment Program:

<http://www.gcr1.com/brownfields/>

City of San Antonio Brownfield Assessment Pilot:

<http://www.epa.gov/swerosps/bf/html-doc/sananton.htm>

City of Austin Brownfield Redevelopment Program:

<http://www.ci.austin.tx.us/sws/brownfields.htm>

Brownfield News:

<http://www.brownfieldnews.com/>

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