***Statement of Charles Bartsch***
***Senior Policy Analyst for Economic Development***
***Northeast-Midwest Institute***

***on***
***Brownfield Financing and Tax Incentive Issues***

***before the***
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***Committee on Ways and Means***
***Subcommittee on Oversight***

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Mr. Chairman and members of the Oversight Subcommittee, thank you for the opportunitiy to testify about the financing issues affecting the productive reuse of older, often contaminated industrial and commercial sites. I am Charles Bartsch, senior economic development policy analyst at the Northeast-Midwest Institute. Since 1991, the Institute — working closely with the bi-partisan Northeast-Midwest Congressional Coalition, currently chaired by Reps. Bob Franks and Marty Meehan — has examined the relationship between environmental contamination and economic development. At that time, we recognized the severity and potentially devastating impact of neglected brownfield sites on long-established communities with a legacy of manufacturing. Both organizations began to identify case examples where environmental and redevelopment obstacles had been successfully addressed. The issue has come a long way since then; as this hearing underscores, many Members have worked hard this year to bring brownfields to the Congressional front burner.

The Institute has analyzed site reuse activities in more than 50 jurisdictions — large cities like Pittsburgh, Chicago, Dallas, Los Angeles, Seattle, and Cleveland; mid-sized cities like Buffalo, Kansas City, Sacremento, and Worcester; and small towns like Meadville, Pennsylvania, Glen Cove, New York, and Wyandotte, Michigan. Our research has indicated that, while the problems surrounding reuse of contaminated sites are critical ones in the nation's traditional industrial centers, they are by no means confined to such communities. The issue of brownfields is widespread, having surfaced in every state across the country, and in numerous small towns as well as most large cities. To meet it, communities need practical tools and approaches with broad applicability and appeal.

***What are the key issues surrounding brownfield sites?*** Successsful brownfield reuse projects must overcome several critical barriers, which have been well documented. These include the lack of process certainty and finality; liability concerns; added expenses of environmental cleanup; and lack of redevelopment financing resources available for brownfield projects.

The brownfield issue has evolved over the past few years, as states and communities have gained more familiarity with the environmental aspects of brownfield situations, and it has taken on more of an economic development urgency in most places; cost and financing have emerged as the common, predominant concerns that prospective site users must address. The procedural and legal steps needed to address brownfield barriers — testing, acquiring, cleaning, and redeveloping contaminated older sites — can be complicated, expensive, and time-consuming.

In practice, the brownfield reuse issue boils down to one of simple dollars and cents. In one scenario, a developer can acquire an untouched greenfield site, probably in a new industrial or business park far from the central city, and build a facility to suit with minimal fuss. Or, that same developer can acquire a previously used site in an old, often abandoned central city industrial district. The latter site, almost assuredly a brownfield, is probably available at little or no cost. However, the developer will then need to spend time and money having it tested to determine exactly what substances it might contain, spend time and money cleaning it up and preparing it for construction, spend months pleading with bankers to lend on it, and likely spend more time and money for additional documentation and site monitoring. According to case studies from Cleveland and elsewhere, in fact, total site costs per acre for long-time industrial sites in inner city areas can be quadruple those of a site of the same size in a new exurban development.

***What is the real-dollar impact of this contamination?*** Cleaning up contamination adds to the cost of any reuse project, often significantly. In fact, in most areas adequate financing to carry out both cleanup and redevelopment activities is not available at affordable costs. This drives development to greenfield locations in undeveloped areas, away from established economic and population centers. The mere presence of contamination has increased lending costs — more than three-fold in real dollar terms since 1980, according to some bankers. More time and staff work is required to put financial packages together, and prospective borrowers must pay for environmental assesments and more detailed appraisals — before they even begin the cleanup process.

This undermines efforts to revive brownfield sites in two ways. On one hand, higher transaction costs can make loans prohibitively expensive to obtain, particularly for small business owners or prospective purchasers with no collateral other than the site itself. On the other hand, depending on the extent and type of contamination, cleanup costs often exceed $50,000 and may top $1 million or more. While new insurance products can help guard against costly surprises during the remediation process, they do

not reduce the initial costs. And these up-front expenses are not easily recovered as part of the normal course of doing business, placing brownfield sites and facilities at a tremendous competive disadvantage with greenfield locations.

Clearly, financing gaps are a primary deterrent to reuse. However, the public sector can do much to help balance the playing field between greenfield and brownfield sites. Creatively designed and carefully targeted incentives and assistance can help advance cleanup and reuse activities and achieve significant community benefits.

***How has Congress addressed critical financing issues?*** Members from both parties began exploring ways to address specific financing barriers to brownfield development back in the 104th Congress. At that time, the link between environmental concerns and real estate markets and financing emerged, making it clear that new approaches would be needed to address this issue. Several Members of this Oversight Subcommittee were active early on; in the 104th Congress, for example, Rep. Coyne first advanced his proposal (HR 2846) to establish tax credits to offset site remediation expenses. In mid-1995, Rep. Weller co-sponsored Mr. English's bill (HR 1799) proposing two types of tax incentives to encourage cleanup of contaminated sites. Chairman Houghton co-sponsored a bill in early 1996 (HR 2919) to allow brownfield cleanup costs to be deducted from income in the year such costs occur — the forerunner of the existing brownfield expensing incentive.

In the 105th Congress, Members introduced nearly 30 different bills dealing with some aspect of the brownfield financing or re-development processes. These efforts laid a good foundation for the ongoing consideration of legislative answers to complex brownfield questions in the 106th Congress; Members of both parties have introduced nearly a dozen bills already this session. This activity cuts across many committees and transcends party and ideology; bills offered by both Republicans and Democrats have similar — often identical — objectives and approaches. Conceptually, there is a lot of agreement on ways to meet critical brownfield process and financing needs.

Over the past five years, Congress has recognized that no single approach fits the financing needs of all brownfield projects, which vary by project situation, type of developer, level and type of contamination, and needed rate of return. In general, bills to support brownfield financing have fallen into one of three broad categories:

- *process related initiatives*, to offer further protection to prospective purchasers and adjoining landowners, which can play a critical role in determining whether brownfield redevelopment financing is secured;

- *direct capital support efforts*, typically taking the form of grants for site assessment, planning, and to capitalize revolving loan funds for actual site cleanups themselves — activities usually not financed by private sources; and

- *tax incentives*, which can help attract affordable private investment and provide a cash-flow cushion for companies undertaking brownfield reuse projects.

In August, 1997, Congress approved a potentially significant brownfield tax incentive, which is just now starting to work its way into the redevelopment process. Known as the brownfield expensing provision, it allows new owners of brownfield sites to write site clean-up costs off their taxes in the year they incur them, rather than having to capitalize them over a longer period of time. This quicker cost recovery is intended to help level the economic playing field between brownfield and greenfield sites, which don't have to bear such costs. Currently, the expensing incentive — scheduled to sunset at the end of 2000 — is the focus of a couple of bills.

***What role have tax incentives played in brownfield reuse?*** Incentives focused on brownfield sites have similar objectives to traditional tax incentives for economic development purposes — they aim to overcome capital market imperfections and channel economic activity to achieve greater public benefits. Incentive programs can enhance a project's cash flow, by allowing revenue to be used for site cleanup and redevelopment activities, rather than for taxes or other purposes. This, in turn, can help a project's financial look in the eye of a lender. Tax incentives focused on environmental cleanup and reuse could help level the economic playing field between old brownfield sites and new greenfield locations.

At the state level, tax incentives have played a major role in strategies to promote brownfield reuse, and they show how federal efforts could enhance site redevelopment. About 22 states have some sort of brownfield tax incentive or credit initiative in place, notably the following.

- Ohio is working to level one aspect of the site selection playing field by offering a state franchise or income tax credit for Phase I and II assessment and cleanup costs. Site owners can claim the lesser of 10 percent or $500,000 for these purposes.

- Illinois provides a 25 percent income tax credit of up to $150,000 per site, available to developers who spend at least $100,000 to restore contaminated sites, and these credits are transferable to new owners. Florida offers a 35 percent credit, up to $250,00 per site, which also is transferable.

- New Jersey brownfield site owners in designated Environmental Opportunity Zones can negotiate with local communities and arrange to use some of their annual property tax levy to cover up to 75 percent of their site clean-up costs, instead of paying it to local tax coffers.

- Missouri's brownfield redevelopment program offers a flexible "menu" of tax incentives, based on new investment and job creation, up to 100 percent of remediation costs.

In addition, Pennsylvania this year enacted its Keystone Opportunity Zone programs, in which all taxes may be forgiven for up to 12 years. And, Massachusetts this year joined Wisconsin in offering remediation tax credits of up to 50 percent of cleanup costs.

These programs, in combination with other public-sector brownfield incentives, have started to tally some encouraging results, according to a Northeast-Midwest Institute survey of state program managers. For example, Missouri has approved $16.5 million in tax credits for 13 sites — on which new business activity has created 2,000 jobs. Ohio's efforts have brought more than 1,400 acres of brownfields back to productive use, creating about 7,100 jobs. Michigan's extensive brownfield incentive programs point to $459 million in new private investment, including 750 housing units, that have generated nearly 5,500 jobs. Pennsylvania's program has encouraged cleanup of some 7,000 acres in 60 of the state's 67 counties, leading to nearly 15,000 new jobs at more than 300 sites. Colorado attributes more than 6,200 jobs and 2,800 residential units to the 146 sites that have gone through the state's voluntary cleanup program.

***Why has the federal brownfield expensing provision gotten so little use so far?*** Initially, EPA and Treasury had estimated that the $1.5 billion in tax expenditure authority the 1997 law provided would be used at 30,000 sites over the three-year life of the incentive. However, only a couple of dozen sites have used the brownfield expensing incentive as of summer, 1999. There are several key reasons for this.

Initially, federal agencies were slow to market the incentive, and may have misjudged the willingness and ability of the private development market to make an effort to understand how it could work and the benefits it could bring to a project's bottom line. Although EPA and HUD made ample information on poverty and locational eligibility available to the public — including GIS maps and census tract data — many in the private development industry were skeptical because they perceived the credit as featuring complicated and cumbersome qualification and targeting requirements that could trip them up. Essentially, the real estate developers viewed as key players in brownfield reuse and prime target beneficiaries of this incentive simply do not operate in terms of census tracts and poverty levels, and the education process is taking a long time. In addition, it took a long time for developers to get comfortable with the notion that EPA actually wanted to be their ally in brownfield endeavors; their long-held views of the agency as adversary were slow to change. Many developers were reluctant to approach EPA and state environmental agencies to pursue the expensing incentive.

Now, the incentive's sunset date poses a deterrent to more widespread use. The closer we get to the end of December, 2000 — when cleanups need to be completed to qualify — and the expiration of the credit, the less likely developers will attempt to use it. Local economic development officials are concerned that not enough time remains now to bring projects through the brownfield acquisition/cleanup/redevelopment phases in time for new users to take advantage of the incentive. This makes them hesitant to promote its use, even though it could play an important role in making specific sites more viable candidates for reuse. Similarly, even though more private developers now have a grasp of the incentive and its benefits, they are reluctant at this time to factor it into their project's financial calculations — brownfield redevelopment, especially on a large scale, is a complicated process, and they are concerned that an unforseen delay in their project schedule will push them past the sunset date, and that they will have to forfeit the benefits they had anticipated.

In addition, private developers have noted that a couple of specific provisions of the expensing incentive also inhibit its use. One concerns lessors of facilities; while lease holders are technically eligible to take advantage of the incentive, in practice they are discouraged from using it because the law does not mention a specific length of lease term — which leads to uncertainty and discourages use. The law could be clarified to specify that new site users who opted for a long-term lease, say 30 years, would qualify for the incentive if they cleaned up the site they leased, even if they did not take title. This could encourage more private redevelopment activity on publicly owned sites.

A second provision that deters use of the expensing provision is the requirement that the recapture of incentive value be taxed as ordinary income. It discourages developers who will not be the end-users (such as those converting sites to retail or commercial use) from taking on brownfield sites. Since their business is real estate development and subsequent sale, this provision mitigates the benefits that the incentive brings. An alternative would be to tax the recapture as capital gains income, or allowing the incentive to be transferable to a new owner (as several states do), so that the developer could retain some of the value through its reflection in the purchase price.

***Why should the incentive be retained and made permanent?*** Clearly, the incentive has great potential and needs to be extended permanently, so that this tool can be better used to restore brownfields to productive, tax- and job-generating uses.

- For purposes of both planning and comfort, developers and investors need the certainty that permanence will bring. Given the length of time that it can take to get large-scale, multi-year projects underway and completed, permanence means that developer can count on the incentive, even if unanticipated delays slow down the redevelopment process.

- The brownfield expensing incentive is one of the few redevelopment tools that focus on the private-sector side of the reuse equation, and provide help in meeting cleanup costs — the number one financing need at most brownfield sites.

- After a slow start, federal agencies' technical assistance and outreach capabilities — such as site and census tract maps and support for state agency staff — are now in place to promote and implement the program.

***To close***, let me reiterate that site assessment and cleanup require financial resources that many firms lack and find difficult to secure. And without financing, brownfield reuse projects can not go forward, further undermining efforts to revive distressed, older industrial areas. The combined efforts of the public and private sectors will be needed to move properties into the realm of economic viability, and ultimately bring prosperity back to them. Therefore, Members of Congress are to be commended for their willingness to consider and promote different approaches to the complex issue of brownfield finance. While much attention is given to state and local initiatives, it is the federal government — whose programs, policies, and regulations form the foundation on which many state and local financing incentives are based — that must play a strong role if private financing for brownfield redevelopment is to become more widely available.

Thank you for the opportunity to speak, and I look forward to your questions.