

STATEMENT  
OF  
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TO  
THE SUBCOMMITTEE ON WATER RESOURCES AND  
ENVIRONMENT  
OF THE COMMITTEE ON TRANSPORTATION AND  
INFRASTRUCTURE  
OF THE  
UNITED STATES HOUSE OF REPRESENTATIVES  
REGARDING  
**BUILDING A 21<sup>ST</sup> CENTURY INFRASTRUCTURE FOR AMERICA:  
Revitalizing American Communities Through the Brownfields  
Program**

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**Prologue**

Thank you for this opportunity to provide testimony to the Committee. I have been privileged to provide testimony on 5 previous occasions before various Congressional committees on the issues of revitalization of distressed real estate, brownfields and ways our government can further the public interests to encourage the private activity and investment in the betterment of our national communities. I am deeply honored to be invited to provide testimony about environmentally distressed properties.

I feel like there has never been a better time to create an infrastructure for more efficiently cleaning house in the area of Brownfields. Brownfields drain resources, are often negative tolls on taxpayers and detract from American's beauty. I include a number of suggested solutions for accelerating the cleanup of brownfields across the US in my testimony. When I established the US Conference of Mayors — Community Revitalization Initiative, a first-of-its-kind national public-private partnership to fast-track the revitalization of property in cities and towns across America using private capital in city's off-balance sheet transactions, I intended this model to be a national blue print. I have some concrete solutions for various areas of the capital stack related to brownfield remediation and redevelopment – from equity investors to lender – that would, in my opinion, greatly accelerate revitalization and could do so without spending a dime of taxpayer money. I would welcome the opportunity to meet with you and discuss these ideas and personally assist with implementation in the future.

I would like to preface my statement regarding revitalizing America's communities through the Brownfields Program by emphasizing that since the real estate crash in 2008, the redevelopment of brownfields sites came to a screeching halt in our nation. Brownfields are complicated, messy, laden with liability. In a post-crash world where budgets tightened, the real estate market contracted many magnitudes and even the carrying costs of holding "clean" land were often considered too high by many, brownfields, not surprisingly, have been virtually ignored by private investors and developers for the past 8 to 9 years. Given that almost no new public investment (and even less new private investment) has been deployed in brownfield reclamation and



redevelopment since the market crash in 2008, three things are clear: 1) the real estate market has as much or more to do with the acceleration or deceleration of brownfield cleanup and redevelopment as any government policy; 2) now that real estate market movements are starting to trend toward a healthier period, this is a very fine time to begin to examine the nation's brownfield program infrastructure and implement improvement and reauthorization to further reduce barriers to site development. We hope and expect market forces in the future to begin to make redevelopment economical for more brownfield sites across the nation; and 3) there are few case studies and data over the past 7 years that one can call upon to produce a sample size of meaningful analysis and I encourage the Members of this Committee to examine the larger data sample prior to 2008 when crafting legislation. My comments in this testimony necessarily draw upon the period of activity (pre-2008) rather than the relatively dormant last 8+ years.

I applaud this Committee's foresight in re-igniting the discussion of brownfields to plan for a future that can allow more site redevelopment to occur with fewer impediments. Your timing is excellent and I, along with our investment firm, Anka Funds, look forward to lending our resources to assist you, as called upon.

Before I begin, I would like to provide a little background about our experience as private sector investors in distressed properties.

#### **Anka Funds – Overview**

Anka Funds ([www.ankafunds.com](http://www.ankafunds.com)) is an investment firm headquartered in Raleigh, NC focused on niche, underserved opportunities that produce strong returns for its stakeholders and have a positive social or environmental impact. Anka Funds' platform includes a family of managed private equity funds, including Anka Residential Real Estate Dividend Fund I, Anka Residential Real Estate Dividend Fund II and Anka Residential Real Estate Dividend Fund III which actively acquire, pool and manage attractive properties which produce dividends for Anka investors, the Anka Sustainable Ventures Fund, which invests in the acceleration of companies with innovative products and technologies with central attributes that are environmentally or socially sustainable, the Anka Real Estate Opportunity Fund, which invests in undercapitalized, challenged or governmentally prioritized real estate assets during times when the market is supportive of such strategies.

#### **Anka Funds – History**

The principals of Anka have worked together since 2002, helping Cherokee Investment Partners and its affiliates invest opportunistically in, and sustainably manage distressed investments for, their various private equity funds. Cherokee is a real estate private equity family of funds focusing on the acquisition of distressed real estate that grew from \$250mm to \$2bn during the tenure of Anka's principals. At the time, Cherokee was the largest investor in the reclamation of brownfields sites and pioneered a new sector by applying expertise, creativity and resolve to sustainable redevelopment of properties after remediation. Following the market collapse in 2008, Anka principals spun out and



formed Anka Funds, an independent company to invest in attractive niche opportunities that fell beyond Cherokee's permitted investment criteria.

### **Anka Funds -- Track Record**

Anka has sourced, separately acquired and managed approximately 700 properties since its inception, in addition to its non-real estate investments. Most of these properties were distressed properties upon acquisition. The Principals of Anka have a long history working alongside mayors, governors and other officials on redevelopment projects that incorporate sustainable elements. The Anka team has collectively worked on well over \$10 billion of transactions across a wide array of industries. Anka's expertise is in buying housing from distressed sellers in areas and situations where there is little or no competition from traditional institutional capital. Anka's ability to systematically source and manage the buying, rehabbing and management process in these under-served areas has led to superior results, including, in core markets, 9% unlevered cash-on-cash yields (16%+ levered tax-equivalent yields) from rental operations<sup>1</sup> and 40% annual unlevered returns on investment on sold/realized investments<sup>2</sup> in core markets.

### **Anka Funds -- Mission and Philosophy**

Anka's mission is to create positive outcomes for both our investors and the communities and stakeholders that are touched by our projects and companies. Our investment philosophy is straightforward. We target transactions with significant upside potential but take a conservative approach with respect to making sure that our investors' capital and resources are protected in a downside situation. In doing so, we make sure that environmental responsibility, integrity and strong stakeholder relations are a vital part of everything we do. We set high standards for businesses in the area of environmental responsibility and believe that private entities can work in tandem with public institutions to reduce environmental impacts and efficiently accomplish both public and private objectives.

Our corporate philosophy is also straightforward. Anka believes that conducting business ethically and with integrity is vital to the success of the company. We are proud to steward the resources with which we are entrusted and embrace the role of fiduciary for our stakeholders. Our management team is constantly striving to uphold the highest professional standards, provide sound advice and align our interest with our partners. Our integrity builds trust and collaboration and creates a culture of openness and candor. Our reputation is our greatest asset and is molded by the way we act with partners, colleagues and the communities we serve. We strive not only to implement with our partners and stakeholders the best strategic decisions and investment of resources, but also aim to strengthen our relationships by promoting open communication. We value our stakeholders and understand that our business relationships provide us with important sources of proprietary investments.

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<sup>1</sup> As of 2014

<sup>2</sup> As of 2015, in core markets



## ***Introduction***

Historically, owners of contaminated real estate often focused resources on avoiding liability rather than site cleanup. The consequence was stagnating properties, economic malaise, eyesores, and conditions hazardous to health in otherwise growing urban neighborhoods. Secondary effects have been documented to include increased crime, lower tax revenues, job loss and surrounding blight.

Among the most historically popular tools used by sellers to avoid liabilities included variations on what has been termed “mothballing.” Corporate mothballing typically involved a legal team talented in producing endless delays, a chain-link fence, and techniques to continue token and inefficient “operations” with the objective of avoiding requisite environmental assessments and attendant regulatory scrutiny and enforcement actions. Owners have perceived that it is economically and “reputationally” preferable to avoid environmental testing and investigation, so as to delay the greater liability of having been legally “put on notice.” This pattern of owner response to environmentally contaminated properties ensured that the nation’s brownfield inventory ballooned.

As the true costs of these delays and mothballed sites have become apparent, the public and private sectors have worked together to create regulatory and financial mechanisms to revitalize brownfield sites. These stakeholders have effectuated important changes in court rulings, environmental laws, regulations and enforcement action, urbanization, insurance and availability of financing vehicles to address the cleanup and reuse of these brownfield properties. Both the public and private sectors maintain a strong interest in the cleanup of brownfields and their restoration to productive use.

Just as our nation required both sectors, working together, to produce the important brownfield reforms of the past several years, a similar partnership will continue to be important to ensure an acceleration of the rate of brownfield cleanups across the country.

My predecessor company was the nation’s largest and most experienced brownfield investor. We believed that without public-private partnerships, there could be little hope of reclaiming most of the sites that languish today.

Only those sites that are both trivially contaminated and situated in the most attractive real estate locations are sure bets to receive the attention of developers who may be willing to tackle projects with marginally increased risks and substantial rewards. Unfortunately, we believe the vast majority of US brownfield sites are both more complicated and less economically attractive; it is this majority that are unlikely to be addressed under current market forces...even if market forces continue an upward trend of increased demand for urban land.

I believe that the environmentally contaminated sites most plaguing this country are more often than not either those which would produce net losses for the investors, or those with



a risk-reward ratio that is significantly unattractive relative to commonplace, sprawl-producing greenfield development.

In either case, the problem stems from rational economic decisions based upon local market forces of supply and demand. If we are to concede that a wholesale, publicly funded cleanup of every contaminated site in the nation is not resource-feasible or easily implemented, we must innovate better ways to combine public and private resources to effectuate more cleanups more quickly.

The problem of brownfields can be greatly alleviated by creating a rational economic framework in which the private sector may operate, respond and be guided by well-considered, typically local, public decisions for prioritization of private-sector driven site cleanup. In an unsubsidized setting, market economics drive the cleanup decisions of these challenging sites. With public guidance, private forces can operate efficiently to produce revitalization in places where communities most need it, but where without such public incentive, revitalization may not occur.

Municipal officials and urban residents increasingly fight suburban sprawl by encouraging development of urban sites. Communities support redevelopment of in-fill sites they previously avoided due to uncertain or complicated environmental issues. Although challenges remain, federal, state and local governments and private groups have collaborated historically to explore creative ways to remediate environmentally impaired sites. I am proud to have participated actively in many such efforts.

Companies whose core business is not real estate asset management and remediation or brownfield redevelopment can maximize shareholder value and redeploy resources elsewhere by selling underutilized and environmentally impaired properties to brownfield developers with proven and successful track records. By carving out underutilized and environmentally impaired properties, companies improve their liquidity and reduce their liabilities, thereby strengthening both the left- and right-hand sides of their balance sheets.

When companies want to maintain the use of such property pending cleanup, sophisticated buyers can use structures such as sale-leaseback agreements, though these structures have not been fully vetted by the courts. Despite the risks, I see sale-leasebacks as a preemptive tool useful in the fight against what might otherwise become tomorrow's abandoned brownfields. By allowing non-intrusive cleanup to occur during a pre-determined lease-term, we are able to ensure that if the ongoing operation on the site were to depart, the site would have already been environmentally assessed, substantially remediated and in the hands of a community-friendly entity that is interested in seeing property revitalized for a future highest and best use. Best of all, the communities in which these "future brownfield sites" reside are benefited by locking in for the host communities the jobs and tax rates associated with the ongoing concern, in addition to the obvious and instant community and environmental benefits associated with the cleanup of a polluted site.



### ***Background - The Brownfield Market***

Even more so than the broader real estate market, the brownfield market is disaggregated and local in nature. Lack of reliable information makes it difficult to estimate accurately participants and market size. According to the Environmental Protection Agency (“EPA”) and the Office of Housing and Urban Development (“HUD”), approximately 500,000 industrial and commercial brownfields were estimated to exist in the United States. The EPA’s definition of brownfields includes only properties that have both environmental contamination and certain socioeconomic characteristics. Based on George Washington University research using EPA and HUD databases prior to the real estate crash, the value of this impaired real estate in the US exceeded \$600 billion in its then current condition.

Corporations own many brownfield sites. Many companies are consolidating operations and closing facilities, while mergers and acquisitions produce additional surplus sites. Government agencies, individuals and financial institutions that unknowingly purchased or foreclosed on brownfield sites also own these properties. Still, there are those sites that were acquired by entities aware of the existing environmental conditions and inspired by the prospect of an attractive return on investment, only to discover that the properties challenges were too difficult to overcome, given the entity’s limited track record in dealing with such properties.

Despite the significant increase in the number of brownfield redevelopments since the early 1990s (even considering the slowdown in redevelopments since 2008, as I mentioned earlier) the brownfield market continues to experience excess supply (National Brownfield Association – Market Report). The imbalance between supply and demand results from several factors, including brownfield redevelopment economics, environmental liability potential, capital source limitations available for redevelopment (especially for large redevelopment), capital cost, transaction complexity and market inefficiencies in matching buyers and sellers.

### ***Brownfield Redevelopment Economics***

Brownfield redevelopment is a unique real estate development type. The economic drivers are generally similar to those found in typical real estate/greenfield development, but environmental contamination introduces several hurdles to successful economic redevelopment.

On the revenue side, the future sale price (i.e., exit price) of the land is a function of the highest and best use of the “clean” real estate parcel. Highest and best use values the real estate in accordance with the use that, at the time of appraisal, is likely to produce the highest economic return. On the cost side, the expenses associated with brownfields redevelopment include the purchase price, closing costs, remediation and risk management costs, capital expenditure (e.g., infrastructure, building improvements), soft



costs (e.g., legal, rezoning, engineering and consulting) and sales costs (e.g., marketing and/or commissions).

Remediation cost (i.e., cleanup cost) is not the only hurdle associated with contaminated real estate; as important for the developer is the potentially larger environmental liability and the difficulty of finding debt project financing. Brownfield developers have difficulty using financial leverage (e.g. debt) because brownfield appraised value is generally low, and banks require lower loan-to-value ratios to protect themselves from the risk of having to own and manage stigmatized properties. As a result, the equity requirement for brownfield redevelopment is high. High equity requirements combined with increased expenses due to remediation costs often lead to greater risk with a possibility of lower return on investment. In 1998, the Urban Land Institute reported that average rate of return for brownfields was less than three percent, well below the rate of return for greenfields projects, which averaged at that time between 10 to 30 percent. Higher site development and financing costs, along with often significantly longer periods of time during which capital is invested (creating a riskier illiquid investment), are seen as factors contributing to the lower brownfields return rate. Low rates of return on investment combined with high project risk and complexity requiring niche areas of expertise constitute a significant impediment to private sector brownfield development financing.

Another hurdle specific to brownfield transactions is that other dilapidated sites frequently surround individual brownfield sites. Successful redevelopment of an individual brownfield site is often contingent upon developing a master plan for an entire area, which may require the development team to buy adjacent sites from multiple owners. The complexity of dealing with multiple sellers adds to the risk inherent in brownfield development projects. In some cases, buying additional surrounding parcels is the only way for the project to offer the potential to generate, on a blended basis, enough gain to offset the risks and costs associated with the core contaminated parcel(s). However, as more property is acquired on the perimeter of a contaminated site, the investor assumes greater assembly and market risks. For example, with a smaller, core contaminated parcel, a revitalization effort hinging on future market acceptance and absorption is less risky than investing in a geographic so large that the future transformed region would need to be significantly deeper to accommodate the newly created supply in the marketplace.

In spite of these challenges, our success in having cleaned up pollution on so many sites and those activities of others serves to strongly evidence that brownfield sites still have potential if broad community support exists to restore them, and creative development teams can structure the transactions to maximize the customarily low return. Brownfield investors and developers must think creatively about ways to complete a transaction that appears upside-down (i.e., higher cost than potential sale/exit value), using tools such as private equity funding, environmental insurance, public-private partnerships, Tax Increment Financing (“TIF”) and other public financing components. Public financing helps lower the capital cost and thereby increase returns. Simply put, public incentive for private activity is necessary to remediate and revitalize most of the thousands of





brownfield sites nationwide. Together, a private company can shoulder the investment and liability of clean up, while the host community receives the environmental benefits of a cleaned site and the community and economic benefits of revitalization.

## **Financing Brownfield Redevelopment**

Significant barriers prevent the remediation and redevelopment of the vast majority of this nation's brownfields. While Congress has made strides to address this problem with the passage of the Section 198 tax provisions in 1997, the passage of the 2002 brownfield law, the passage of the tax provisions waiving the unrelated business income tax penalties on qualified brownfield transaction to reduce unintended tax barriers for large tax-exempt institutions from investing in brownfield redevelopment (an idea I personally dreamed up soon after testifying before Congress in a prior year. I helped architect, write and win passage of this idea into federal law in 2004), there is still much that can and should be done.

In this section of my testimony, I will briefly address the underlying causes of the brownfield problem and the market dynamics that currently inhibit remediation and redevelopment.

I will then focus on two areas where I believe that Congress (as well as states and local governments) can have the biggest impact in encouraging brownfield revitalization: 1) creation of new financial incentives, and 2) other actions to encourage deployment of additional capital.

Finally, in this section of the testimony, I will provide a list of criteria that brownfield investors use to determine whether to remediate and redevelop a particular site. This list is critical since, I believe, it provides some insight to the direction the markets will head if Congress, the states, and/or local governments reauthorize the Brownfields Program and/or provide additional financial incentives and/or other actions to encourage deployment of additional investment capital in this field.

## ***Capital Sources and Cost***

### ***Background***

The last stock market decline contributed to an increase in capital flow to the real estate market asset class in 2002 - an increased rate that, while stunted starting in 2008, has continued to some extent to present day. Both individual and institutional investors (e.g., pension funds, endowments and foundations) have increased their portfolio real estate allocation target. The real estate allocation is largely comprised of class A office, hotel and development opportunities in strong markets. On the other side of the spectrum, "distressed" real estate receives significantly less allocation. Environmentally contaminated real estate is, for all practical purposes, non-existent in the division of the traditional, conservative, institutional real estate allocation.



Foreign institutions, particularly in Germany, have been increasing their investment in the U.S. real estate market (PricewaterhouseCoopers, 2003). As of September 2002, the total global real estate capital market was about \$4.63 trillion. Non-institutional and institutional investors represented about \$2.39 trillion and \$2.24 trillion respectively. Out of the \$2.24 trillion from institutional investors, \$402.8 billion (18%) was equity and \$1,841.4 billion (82%) was debt. The ability to attract such capital for a category of brownfield investments is driven by several factors, including the category's ability to diversify an institution's holdings, the possibility, if successful, to generate returns at least commensurate with what ordinary real estate investments might yield, there is a defined market in which there is no foreseeable shortage of deal flow and, perhaps in certain situations, an investor's particular interest in engaging in what may be deemed as "socially responsible" investing.

### *Equity*

A very small portion of the \$402.8 billion of real estate equity capital represents brownfield investment, due in part to the risk and illiquidity inherent in that investment class. When assessing the risk-return relationship for different types of real estate investment (e.g., core real estate, real estate securities, mezzanine investment, opportunistic investment, and brownfield redevelopment) brownfield redevelopment clearly falls within the upper range of the risk-return spectrum. One of the lessons of this data is that, if we wish to foster a more active private sector participation in the cleanup of our nation's polluted land, we have two levers to adjust. Either one can either lower the risk associated with tackling a brownfield project or increase the potential project return. Absent one or both of these factors, developers across America will follow the easy road: remaining content to make sizeable returns converting the next farmstead to suburban sprawl on that proverbial 'edge of town.' However, as my presence before this distinguished body suggests, there are successful and experienced brownfield equity investors with long track records that have developed the necessary risk management skills to navigate this otherwise risky business environment. Buyer track records and reputation are especially important when sellers seek a transfer of environmental risk and liability.

For small transactions, the number of brownfield equity investors is still limited, though it has been growing in recent years as regulatory changes have encouraged more redevelopment. For large transactions, the universe of brownfield equity players is even smaller, though legislation enacted last October served to promote the formation of larger pools of capital dedicated to the investment in brownfields (I will discuss this legislation in Part IV of my testimony). The main incentives for a seller to transact with equity players with large pools of institutional capital are easy to understand: the wherewithal and credibility, the ability to close without financing contingencies and the experience and track record of the equity investors experienced with large and complex transactions. When unforeseen liabilities arise, or costs spiral out of control (as they so commonly do), our experience is that such unbudgeted events have never been less than 200%. The ability to stand behind a project and write a check to cover such unforeseen events is something that can be reassuring to sellers, communities and investors alike. On the



other hand, institutional investors have fairly rigid return expectations, structural requirements and limited investment horizons, which are often hard to satisfy in many transactions.

The cost of investment equity for brownfields is higher than for greenfields due to the additional time, cost and legal risks assumed for brownfield redevelopment. To achieve a targeted internal rate of return (IRR), the longer the time horizon between the date of purchase and the date of sale of the property, the larger the required spread between the purchase and exit price. Historically, depending on the prevailing interest rate environment, prudent brownfield investors underwrite transactions to yield an IRR between 5-10% greater than a typical greenfield investor. By targeting a higher IRR, brownfield investors attempt to compensate for the historically lower rates of return actually realized on brownfield investments.

### *Debt*

Traditional redevelopment projects rely heavily on the use of debt to enhance investor IRRs and sometimes make seemingly economically unviable projects doable by virtue of time compression effect that use of debt affords an equity investor. Brownfield projects do not have this same luxury. The use of debt in the capital structure reduces the “blended” cost of capital and increases both project risk and the return on equity. Typically, development teams use debt when the project can generate a certain amount of cash flow (e.g., from existing building lease) to service interest payments. Debt cost varies from project to project and is highly dependent on the overall capital market at the time when debt financing is needed.

Conventional lenders are generally unwilling to provide debt during the times when it is needed most: i.e., before cleanup, rezoning and leasing or sale activity has been achieved. On occasion, certain lending groups have warmed to conditional participation in brownfield projects if there is sufficient equity in the project (the amount of equity depends on the overall risk profile of the project), the critical path to environmental closure is known and, perhaps, accomplished or nearly accomplished, and the equity partners/developers have the reputation, track record and risk management capabilities necessary to limit the downside risk. Without these conditions, lenders have been reluctant to lend funds on contaminated sites due to the potential liability, the relatively limited income stream in the short and medium term and the lack of marketability. In the construction lending context, where principal repayment takes months or a few years, lenders chiefly worry about the borrower’s collateral relative to contingencies in the construction budget for unknown site costs and whether the project has or can readily obtain takeout financing. Permanent lenders primarily worry about the borrower’s defaulting, which may require them to assume ownership of a stigmatized asset with questionable value.

### *Government Funding & Incentives*

As I will discuss more extensively in Parts III and IV of this testimony, government incentives can provide the necessary additional funding to encourage additional brownfield redevelopment. Local governments usually shy away from direct grants;



instead, tending to favor property tax incentives and Tax Increment Financing (TIF), especially for infrastructure costs like roads and utilities. Under TIF, the increased tax revenues generated by the redevelopment are used to pay off part of the redevelopment expenses. Federal and State Brownfield funds are sometimes available. More recently, some states are considering, or have passed, laws that authorize the establishment of a capital pool, drawn from future tax revenues, to serve as reimbursement of certain qualified remediation expenditures. Other programs offer low or zero interest debt financing for brownfield redevelopment. Occasionally, it may be worth exploring a special State or Federal appropriation to kick-start a remediation project. If the Federal Government is a responsible party for onsite contamination, then such appropriations are more likely.

It is unquestionably paradigmatic that the largest and, arguably, most important, brownfield projects in our nation require true public-private partnerships, allowing all stakeholders to leverage each another's resources to produce a winning result for all parties. I can think of several projects that would never have generated attention were it not for the willingness of public and private entities to brainstorm together creative ways to accomplish a shared goal.

### ***Impact of Court Rulings and Legislation***

U.S. Supreme Court rulings, as well as federal and state legislation, have helped private and institutional investors become more comfortable with investing capital to redevelop environmentally impaired properties. In 1998, the U.S. Supreme Court in *United States v. Bestfoods* (528 U.S. 810; 120 S. Ct. 42) clarified the Superfund liability for corporate parents. This case held a corporate parent responsible under CERCLA when (i) the corporate veil is pierced under traditional corporate law doctrines, or (ii) the corporate parent or shareholder directs the workings of, manages or conducts the affairs of a polluting facility. In 2002, the Small Business Liability Relief and Brownfields Revitalization Act increased funding and tax incentives to promote the cleanup and reuse of brownfield and helped clarify and limit the Superfund liability of owners and purchasers under certain conditions.

Furthermore, existing federal legislation has sought to utilize the nation's tax structure to provide incentives for the privately funded cleanup of brownfields. For example, Section 198 of the IRS Code, initially passed in 1997, and subsequently amended, provided a framework to encourage the cleanup of qualified contaminated sites by allowing an eligible taxpayer to immediately expense, rather than amortize, the costs of remediation. Other contaminated site tax legislative proposals have recently passed or are on the horizon.

### ***Brownfield Investment Key Criteria***



Location and real estate market are critically important. Ideal brownfield sites are in growth corridors within tier 1 or 2 urban markets with good access from a main highway, complemented by good visibility and strong demographics. In addition to the environmental impairment, a primary brownfields site has all the attributes of a good real estate development site. Due to prior use, many brownfield sites have industrial zoning, and the potential to rezone them for mixed-use residential/retail often increases their development value. To analyze whether a real estate transaction has potential for a private brownfield investment group, the starting point is a thorough understanding of the site's real estate fundamentals. Two of some of the most important analytical elements are the site's underlying market value (its value without the contamination and stigma) and time required/complexity involved to achieve a revitalized site (and hence, a financial exit). Typical brownfield site screening criteria are as follows:

#### *Capital Commitment*

The "ideal" size of capital commitment by private brownfield investors depends on the size of their available capital pool. Brownfield investors would prefer to commit amounts of capital in each transaction that reduces overall overhead. Well-capitalized brownfield investors often seek transactions that allow them to employ \$10 million or more, realizing that smaller projects can often require as much overhead as larger projects. The site size (number of acres or square feet) is irrelevant if the location does not dictate sufficient value. Multiple sites with a common owner sold as a portfolio can provide the desired critical mass of dollar value. On the flip side, smaller, more moderate site redevelopments can mitigate risk by freeing an investor from the political perils often associated with extremely large projects of any time – contaminated or not. Some of the most financially successful brownfield projects that I know are smaller and midsized projects that were less complicated politically and from a zoning perspective.

#### *Market*

Brownfield developers prefer properties in primary urban markets because they represent potentially higher real estate values and because market demands in those areas are more likely to enable prompt (or less risky) redeployment of the asset after cleanup.

#### *Location*

Location, despite the cliché into which it has evolved, is still a dominant factor in analyzing a site. Access to highways and infrastructure, visibility and future-use possibilities all combine to increase the value of sites.

#### *Environmental Cost, Schedule and Path to Closure*

By studying existing environmental documents including soil-boring results and groundwater well test results and by conducting other standard types of environmental and land use due diligence with the help of experienced and well-qualified technical and legal consultants, the brownfield investor usually can make a well-educated guess as to the extent of the required environmental clean-up. An added challenge is mapping out a remedial closure path that dovetails with future redevelopment plans for the site. In some cases, a seller does not know (and does not wish to know) whether, and to what extent, contamination is present on its property. Former manufacturing sites, for example, are



still contracted for sale without the benefit of accompanying Phase I and Phase II assessment reports.

*The Historic Preservation Model:*

I'd like to take a brief moment to comment on the tremendous success of historic preservation efforts in this country and to suggest that it could help inform our current discussion if we look to the underpinnings of that success.

In 1976, Congress created the Historic Preservation Tax Credit a tax credit equal to 20% of the amount spent by a taxpayer in a certified rehabilitation of a certified historic structure.

According to the National Park Service, since 1976, this tax credit and a related 10% historic rehabilitation tax credit have produced impressive results including:

- Rehabilitation of more than 32,000 historic properties
- Stimulation of more than \$33 billion in private investment
- Rehabilitation of more than 185,000 housing units and creation of 140,000 housing units of which over 75,000 are for low and moderate income families.

National Park Service, *Federal Historic Preservation Tax Incentives: Revitalizing America's Older Communities Through Private Investment* (2005).

While this federal model, on its own, deserves attention, I believe that one of the reasons that this model has been so successful is because of the synergy and complementary nature of the state historic preservation incentives and this federal tax credit.

If our goal is to encourage private developers to undertake projects that are underwater from a development perspective but that are above water from a public perspective, then it makes sense to me that we would look to create federal brownfield incentives that can complement state brownfield incentives that already exist.

In the field of historic preservation, our nation has seen great results by coupling a uniform federal tax credit with individual state initiatives tailored to meet local needs.

If we wish to enjoy a similar measure of success in the brownfield arena, I believe we should look to the historic preservation model as we examine the interplay between state and federal programs.

**Brownfield Solutions**

Given what we know about the causes of the brownfield problem, the market forces that both inhibit and encourage remediation and redevelopment, existing government



programs to encourage redevelopment, and criteria that the markets use to select particular sites for investment, how do we solve the overall problem? How do we move beyond our current situation where some sites are being remediated and redeveloped while literally hundreds of thousands of others continue to languish?

A friend once told me that for every complex, difficult problem, there's usually a simple solution – and it's usually wrong.

I think that's true for the brownfield issue, generally. If there were one simple solution, we probably would have found it and enacted it long ago.

On the one hand, the problem seems clear-cut: the costs associated with remediating and redeveloping a brownfield site must be outweighed, when adjusted for risk, by the potential economic reward from that transaction.

Viewed on that level, the solution becomes one of reducing costs and risks or increasing potential income.

On the other hand, the problem is much more complex. A few brownfield sites may be already economically “above water” – that is to say that without additional incentives, those sites will likely be revitalized at some point in time. Fear of unknowns or other risks may still drive most prospective developers of those sites away, but an objective analysis would suggest that the project is economically viable. Other sites are marginally “under water.” That is to say that with some coordinated efforts, focus, creativity and a modest economic push, the sites would likely be redeveloped within a reasonable period of time. And then there are sites in less attractive real estate markets and/or those with more substantial contamination. Those sites may be substantially under water and, without significant help, may never be cleaned up.

Viewed on this level, the solution becomes more multifaceted, requiring a mix of federal, state and local incentives to thoroughly attack the problem. Policymakers need to increasingly understand that the problem of brownfields is nuanced and solutions must be nuanced and targeted, as well. Some would prefer to focus attention on the graphical intersection of the most polluted sites and those with the lowest intrinsic real estate value, as these are the ones that most need the help of the public sector for reclamation to occur. Others would prefer to target sites that fall within the graphical intersection of the sites with both the most economic development potential and those that are most easily, quickly and cheaply revitalized. Perhaps the answer is a combination of those two views. Regardless of one's view, we would be doing our country a disservice by not understanding the market factors driving cleanups and crafting policies and programs that target those sites that are determined to be in most urgent need of redevelopment.

If we, as a country, really want to attack the brownfield issue on a nationwide basis, it is clear that we must create policies that will truly move the meter well beyond assessment assistance and expensing provisions—though such programs have been important and will continue to help move sites back into productive use. But, by now, it should be clear



to everyone involved that these programs are simply insufficient to drive most of the 500,000 to 1 million brownfield sites into revitalization.

The United States Environmental Protection Agency, in an analysis conducted with George Washington University, concluded that the remediation “costs for all of the brownfields located within the United States have been estimated to exceed \$650 billion,” and that, consequently, *“it is imperative that private capital be attracted to the redevelopment of brownfields.”*

I believe that it is on this front that the federal government can have the biggest impact. The challenge to the federal government should not be to create a new program that helps better characterize brownfield sites or that tries to create a larger role for federal agencies. The federal government’s challenge should be to look for bold, innovative ways to reduce barriers and create incentives to attract significant volumes of private capital to help remediate and redevelop our nation’s brownfields. The H.U.D. BEDI program, one of the focal points of past Administration’s efforts in brownfield economic incentives, is a creative, albeit currently defanged and in need of streamlined guidelines, example of the federal government’s creative path to leveraging private capital to clean-up and recycle America’s lands.

Given all of these tools at the state level, one might mistakenly think that we have the brownfield problem solved.

This brings us to the second main point that I would like to make here today: As critical as these state efforts are, federal assistance is essential if we are to see a significant portion of america’s brownfield sites revitalized in our lifetime.

In previous testimony to other distinguished Congressional bodies that I have been privileged to have been invited to address, I provided a detailed analysis of the economics that drive brownfield transactions and surveyed some of the barriers that exist that are preventing the remediation and redevelopment of the vast majority of this nation’s brownfields.

It is my basic assessment that the environmentally-contaminated sites most plaguing to this country are more often than not either those which would produce net losses for the investors, or those with a risk-reward ratio that is significantly unattractive relative to commonplace, sprawl-producing greenfield development. In either case, the problem stems from rational economic decisions based upon local market forces of supply and demand.

If we are to concede that a wholesale, publicly-funded cleanup of every contaminated site in the nation is not resource-feasible or easily implemented, we must create better ways to combine public and private resources to effectuate more cleanups more quickly.





The problem of brownfields can be greatly alleviated by creating a rational economic framework in which the private sector may operate, respond and be guided by well-considered, typically local, public decisions for prioritization of private-sector driven site cleanup.

In an unsubsidized setting, market economics drive the cleanup decisions of these challenging sites. With public guidance, private forces can operate efficiently to produce revitalization in places where communities most need it, but where without such public incentive, revitalization may not occur.

If one recognizes that public-private partnerships represent one of the only realistic hopes this country has to solve its brownfield problem, and if one recognizes the importance of the various state programs already in effect, the question then becomes: “Is the federal government a necessary partner on the public side of the equation?”

The answer to this question must be “yes” – at least today. I see a pathway, however, where one day the federal government’s partnership with the private sector will be reserved for a smaller group of sites. It will take very concerted leadership at the highest levels of the EPA and other agencies to make this happen, but it is doable and will not require large expenditures of taxpayer dollars. I would welcome the opportunity to discuss these ideas following this testimony.

It was published that of the between 450,000 and one million abandoned or underutilized brownfield sites in this country, only 16,000 sites (less than 4%) had been redeveloped or were in the process of redevelopment through state voluntary cleanup programs as of 2005.

In 2005, 2006 and 2009 I encouraged Congressional committees to think about sites as being “under water” or “above water.” A site that is under water is a site that the marketplace will not redevelop on its own given the cost of cleanup, the value of the property in a clean state, and various other factors (*e.g.*, risk, difficulty/cost of securing capital, cost of development, likely rate of return). A site that is above water is a site where the economics of redevelopment indicate that the site is likely to be cleaned up and revitalized by the private sector without government assistance.

Along this continuum there are some sites that are barely below water. These are sites that may be redeveloped during a favorable economic upturn or with a slight nudge from a state or local incentive program.

Unfortunately, most of the sites we think of as brownfields are further underwater – many considerably so. Without significant public assistance, these sites are unlikely to be remediated anytime soon by the private sector.

Which raises a critical point. These terms – under water and above water – take into account only what I’ll call for lack of a better term, “internal” costs of a developer. On the benefits side, they do not reflect the various public benefits that development would



bring, such as reduced risk from pollution, more jobs, a more pristine environment, or even increased property tax revenues. One mission of government, then, must be to focus particularly on those properties that are under water when looking at the internal costs, and above water when the externalities are considered. In this band of sites, government must do what it can to see that the external benefits are realized and that, if possible, the recipients of those benefits (*e.g.*, the municipality that would get increased property tax or sales tax revenue) help defray some of the costs (*e.g.*, through a TIF that will be paid off through those increased revenues). With less than 4% of the nation's brownfields having been cleaned up in the decade since EPA coined the term, "brownfield" and increased its focus in spurring brownfield development, it is clear that more needs to be done. And that increase needs to come not just at the state and local level, but federally as well.

Yet even with all of the state programs and even with the benefits that we have in this market place, the vast, vast majority of sites that I reviewed each year when market conditions allowed us to focus on brownfield investments showed that sites are still so far under water that, even in at the absolute peak of the real estate market boom in 2006, it was uneconomic to invest in most of their remediation and redevelopment.

In past years, my predecessor organization conducted an internal assessment to determine the number of sites that we had reviewed the two years prior and the number of sites that we had ultimately acquired. What we found was that we had reviewed over 450 sites for investment and that in the intervening two years, we had been able to invest in only 10. Critically, we had also reviewed publicly available information to determine whether others had invested in the sites that we had been forced to pass by. What we found was that other entities had invested in another 10 of the original 450 sites.

Consider these numbers for a moment. We reviewed 450 sites. In the next two years, we were able to invest in only 10 of the sites and other entities across the world opted to invest in only an additional 10 sites. That leaves 430 sites that were unable to attract investment because, from an "internal cost" perspective, they were too far underwater. And this is despite the state and federal Brownfield Programs that then existed at the time.

Given this, I think it is safe to assume that there are many hundreds of thousands of brownfield sites in America that will not be revitalized in our lifetimes even with the existing federal, state, and local programs working in tandem with the private sector to bring them back into productive use.

Clearly we must do more if we are to redevelop the hundreds of thousands of brownfield sites that blight our communities. Without additional federal involvement, these contaminated sites will continue to cause health and environmental problems, discourage economic development and encourage sprawl into the countryside.

An analysis prepared by the U.S. EPA and George Washington University in September of 2001 concluded that, "unfortunately, the cost of restoring brownfields to economic



viability may be beyond the capability of many state and local governments. Though remediation costs are always site-specific, total remediation costs for all of the brownfields located within the United States have been estimated to exceed \$650 billion.” U.S. Environmental Protection Agency, Office of Solid Waste and Emergency Response and The George Washington University, *Public Policies and Private Decisions Affecting the Redevelopment of Brownfields: An Analysis of Critical Factors, Relative Weights and Areal Differentials* (Sept. 2001).

Clearly, this is a challenge that is beyond the capacity of state and local governments. If we are to be successful, the federal government simply must be an active and significant partner in this effort to attract private investment to solve this problem in our lifetime.

Again, I thank you for your invitation to provide testimony to the distinguished Members of this Congressional committee and I repeat our interest and willingness to continue to serve as a resource to you and your colleagues as you do your good work.

**Contact Information:**

For more information regarding this testimony, or if there is a site or community area in need of our help or attention, please use the following contact information:

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## **BIOGRAPHY OF JONATHAN PHILIPS**

Jonathan Philips is a Managing Director and founding partner of Anka Funds, an investment platform that, through a family of managed private equity fund vehicles, opportunistically invests discretionary capital and expertise in niche real estate and sustainable venture programs. Mr. Philips helps oversee the management of Anka's portfolio of real estate assets and operating companies. While at Anka, Mr. Philips has sourced, underwritten, helped closed and managed over 650 separate transactions. Prior to Anka, was a Partner at Cherokee Investment Partners, a real estate private equity family of funds focusing on the acquisition of distressed real estate that grew from \$250mm to \$2bn during his tenure. In 2008 Anka spun out as an independent company of Cherokee Investment Partners so that Anka could take advantage of attractive niche opportunities that fell beyond Cherokee's permitted investment charter. Mr. joined Cherokee as one of a small handful of senior investment professionals during the deployment of \$250mm Fund II and assisted in catalyzing expansion of the Cherokee platform over the next 6+ years with Fund III (\$620mm), Fund IV (\$1.24b), CSS (\$200mm+), New Market Tax Credit vehicle (\$92mm) and the creation of the not-for-profit CGB entity. Mr. Philips helped lead the multi-award winning National Homebuilder Mainstream GreenHome, [www.mainstreamgreenhome.com](http://www.mainstreamgreenhome.com), a national educational showcase and the first LEED Platinum home in the Southeast home and helped establish the US Conference of Mayors — Community Revitalization Initiative, a first-of-its-kind national public-private partnership to fast-track the revitalization of property in cities and towns across America. Mr. Philips has provided expert testimony on distressed real estate and revitalization on five occasions in his career before the United States Congress and has served on a number of nonprofit boards. While living in New York City, Mr. Philips founded and ran several companies and spent time as a mergers and acquisitions and capital markets attorney with Davis Polk. He received his JD from the Yale Law School, where he was an Olin Fellow in Law and Economics, and his BA from the University of Virginia, where he graduated an Echols Scholar and with what was possibly the first double Highest Distinction awarded by the University. University of Virginia (BA); Yale Law School (JD). Bars: NY, NJ, NC

