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# Taking Advantage of Brownfields Tax Credits

Underused incentives turn contaminated land into opportunities

**A**lthough there is currently no national tax-incentive program for brownfields renewal in place, many states still offer valuable incentives or tax credits that encourage the remediation of contaminated lands. Mortgage originators and others involved in commercial property development should review the eligibility requirements of programs in their specific states, as a brownfields tax credit (BTC) can open up additional financing avenues or collateralization sources for sites that may have been considered out of reach because of their current levels of contamination.

Including tax credits in the developer's toolbox is a prudent financial choice. Because it helps to reform blighted property into usable and useful land — and benefits the environment by cleaning up toxins that could eventually impact nearby properties — it also serves a valuable social function. In addition, the surrounding neighborhood may be enhanced by the remediation, driving up property values and community pride.

## History

The Environmental Protection Agency (EPA) initiated the Brownfields Program in 1995. At the time, the EPA defined a brownfield as a property for which the expansion, redevelopment or reuse “may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant.” Given this definition, brownfield properties could include anything from former industrial sites and abandoned gas stations to dumps and illegal residential drug labs.

The mission of the program, according to the EPA, is “designed to empower states, communities, and other stakeholders in

economic redevelopment to work together in a timely manner to prevent, assess, safely clean up, and sustainably reuse brownfields.”

Stemming from this program, the Brownfields Tax Incentive was originally enacted in 1997. This tax incentive was meant to further encourage brownfields remediation by allowing environmental cleanup costs to be fully deducted in the year they were incurred, rather than capitalized and spread over time. A major improvement to the law took place in 2006 when it was expanded to include petroleum cleanups, which allowed properties that had once hosted gas stations or those that still housed underground storage tanks to become viable for development and reuse.

Unfortunately, the incentive was never written as a long-term law, and although it was extended several times, it lapsed in December 2011 after Congress did not extend the brownfields-expensing tax incentive when it passed the American Taxpayer Relief Act of 2012. As with many laws that contain sunset provisions, the continued uncertainty of whether the law would be extended caused the incentive program to not be taken advantage of as fully as possible.

## States and brownfields

Fortunately, many states adopted their own brownfields incentive or tax-credit programs, varying only slightly in most cases from the national incentive program. Many of these programs have been renewed and are actively encouraging brownfields development.

States have also worked to add flexibility to the rules and eligibility requirements for environmental remediation issues, especially because without available tax

credits, many contaminated properties would not be considered for redevelopment purposes, given the enormous costs inherent in some cleanups.

Cost remains a significant deterrent for developers, even after factoring in the tax-credit benefits, because brownfields tax credits are generally made subsequent to a cleanup, requiring the responsible party to have the resources upfront to effectuate a cleanup. State tax credits are rarely available as a source of equity, unlike certain federal tax credits.

In Massachusetts, however, the BTC program has a two-tier credit. In the first tier, a 50 percent tax credit is awarded to eligible sites when either a permanent solution is achieved — which is documented when a Response Action Outcome (RAO) Statement is filed with the state's Department of Environmental Protection — or when a Remedy Operation Status (ROS) has been achieved on the property.

The second tier makes a 25 percent tax credit available to sites that have achieved an RAO, but have had an Activity and Use Limitation (AUL) imposed on the land. An AUL is a legal document recorded with the Registry of Deeds that is required for

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land that has been remediated to an extent that there are conditions that must be maintained in order for the property to remain of “no significant risk” to those on or around it.

In practice, AULs are often used by landowners who are required by law to remediate their property but don’t wish to incur the costs necessary to achieve a permanent solution without restrictions. These landowners will pursue an AUL cleanup made to industrial-use standards, which limits the use of the property to commercial and industrial enterprises only. In Massachusetts (as well as other states), the state government recognizes that brownfields that achieve the status of the soil being safe for some use — even with limitations and maintenance requirements — is preferable to leaving contaminated land undeveloped.

### Case study

A recent case study illustrates how BTCs can be used to overcome financial obstacles encountered when a seemingly safe property is determined to be a brownfield.

In Canton, Mass., a developer purchased a property that was later contaminated because it was down-gradient from a contaminated site. The developer’s intent was to build a 56-unit rental apartment complex on the property. Once the contamination was discovered, the developer was obligated by law to remediate that contamination.

The unanticipated need for \$1 million in remediation expenses to clean up the property could have derailed the project, but the availability and use of tax credits performed a vital function in stabilizing the property. Initially, the developer planned on incorporating the costs into the construction loan under the category of development costs, intending to pass on the expense to the property’s eventual tenants through increased rental rates.

Before doing this, however, the developer learned about the BTC program in Massachusetts, and together with his tax-credit specialists, licensed site practitioner and environmental lawyer, the developer prepared and submitted a BTC application to the Massachusetts Department of Revenue, which awarded him nearly \$500,000 in tax credits. The developer’s team monetized the tax credits and used the net proceeds toward project construction and completion costs, as well as debt reduction. As a result, the apartment complex is now fully rented out and is a viable, healthy community for its residents, who did not have to incur the burden of higher rents to offset the remediation expenses.

In this case and others like it, the developer’s use of the available BTC program is significant because the completed project has added to the community’s inventory of rental property, buttressed the community’s tax base and created jobs in an area where previously only a vacant,

contaminated site existed. Without the BTC, the property likely would not have been developed and instead would have remained a vacant site bedeviled by groundwater and soil contamination.

### Outlook

Despite the successful outcome in this particular case, BTCs have not been taken advantage of as much as possible in Massachusetts, perhaps because of concerns in the past year that the tax-credit program would expire. The state’s 2014 fiscal-year budget, however, includes a provision that extends this tax credit for five more years, through 2018.

Ideally, this Massachusetts tax-credit program and other programs like it will remain in place for a number of years, and more and more mortgage professionals, developers and landowners will take advantage of them. The credits will require flexibility and ongoing education, however.

As states extend and amend their BTC programs, changes in eligibility, timing and requirements to apply for the tax credits have been enacted. At the same time, efforts have been made to provide additional clarity, transferability, expansion or — in some cases — restrictions. Learning about and staying on top of these tax-credit programs may seem daunting, but this should not discourage developers from considering contaminated properties as sites for redevelopment. ●