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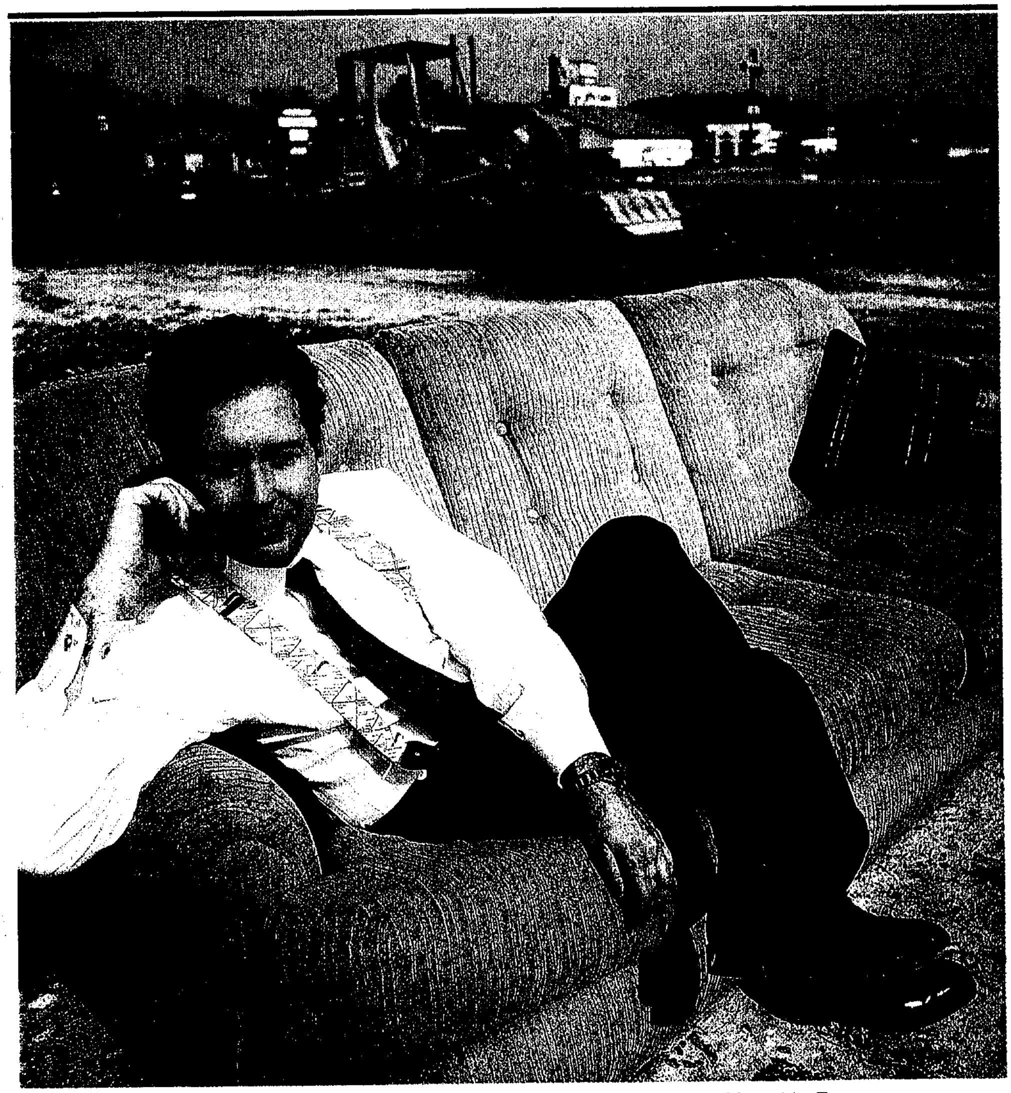
Real estate investors avoid properties that may be polluted. Ron Bruder thrives on the yucky stuff.

Pay dirt

By Carolyn T. Geer

FIFTY-YEAR-OLD entrepreneur Ronald Bruder should be beloved by environmentalists. Bruder has cleaned up 25 contaminated commercial sites, put the properties back on the tax rolls and earned enviable returns to boot. He and a handful of competitors are bringing much-needed common sense to the business of cleaning up polluted properties.

With master's degrees in finance and accounting, Bruder founded the Brookhill Group, a New York-based real estate redevelopment company, in 1977, when he was 29. He started out doing real estate development on



Dames & Moore/Brookhill's Ronald Bruder at the former Sycamore Square Mall in Memphis, Tenn.
Bringing common sense to the cleanup of polluted properties.

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a small scale in New York, Connecticut and Florida. As property prices mounted, smaller developers like Bruder were getting squeezed out. Only sites with environmental contamination—"brownfields" in trade lingo—remained cheap. These are sites that have been abandoned or neglected because of the risks—perceived or real—associated with developing them.

Making virtue out of necessity, Bruder decided to specialize in polluted property. Between 1993 and 1996 he bought half a dozen sites. He did it carefully. "We only bought properties where we could wrap our arms around the problem and clean it up," he says.

These are not government-designated Superfund sites. Superfund sites are disaster areas in every sense of the word. Litigation has brought the cleanup process to a virtual halt. In the 18 years since Superfund was set up, only 150 of the roughly 1,300 designated sites have been given a clean bill of health. More than $30 billion in public and private money has been spent on Superfund projects. Much of it has been pocketed by lawyers: A December 1994 General Accounting Office survey found that a third of big companies' Superfund costs went to legal fees.

Bruder avoids this kind of cleanup. Brownfields are moving right ahead because municipal land-use authorities have finally recognized that, contrary to what some environmentalists say, properties need not be absolutely pristine to be usable. "States are adopting what's called a use-based cleanup standard," says Bruder. "They're realizing that if the property isn't going to be used for housing or a day care center, but for some industrial or retail building, it only has to be so clean." That means removing 90% to 95% of the ground pollution instead of the 100% removal generally required by Superfund.

The slight lowering of standards makes far more sites practical for rehabilitation. The cost of removing the last 5% to 10% of contaminants on a site can equal half of the entire cleanup cost.

New Jersey passed a law in January that gives brownfields developers tax breaks based on cleanup costs, and cash credits for testing new remediation technologies. The law exempts developers from any new cleanup costs once state environmental authorities give their blessing, and it protects them from future private lawsuits. As a result, developers now have the confidence to move ahead with cleaning up brownfields in states like New Jersey.

Helping to make brownfields green again are new insurance products introduced during the past two years by American International Group, Reliance Group and others. If a cleanup ends up costing more than expected, the insurance covers the difference.

And thanks to accounting rules taking effect this year, corporations holding brownfield assets have a new incentive to get rid of them. Under the rules, public companies must fully disclose their environmental liabilities, and book reserves against them. William Russell, an environmental specialist at Coopers & Lybrand, says many properties will be coming on the market this year to avoid an accounting mess. Many will be available at bargain prices.

Anticipating this increase in supply, Bruder last year teamed with publicly traded Dames & Moore, a very large Los Angeles-based environmental engineering firm, to buy polluted property to clean up, redevelop and sell. An affiliate of Credit Suisse First Boston backed the venture with $190 million in debt financing. Typically, CS First Boston puts up 75% of a property's costs with a first mortgage. To date, Dames & Moore/Brookhill, a 50-50 joint venture, has purchased 29 sites.

The former Sycamore Square Mall in Memphis, Tenn. is an example of a deal Bruder did on his own. Bruder acquired it last year in foreclosure after purchasing the mortgage from the FDIC. The 120,000-square-foot shopping mall was built in 1984, anchored by a Levitz Furniture store. After the Levitz store closed in 1991, the mall foundered.

Leaky underground storage tanks from a former gas station on the property had contaminated the land. Since it was convenient to two major highways and a city bus stop, with lots of parking, Bruder figured the place could be used for commercial purposes even though it had flopped as a mall. So he negotiated with the oil company that had operated the gas station. The oil company agreed to pay for the cleanup and indemnify Brookhill against future liability related to the pollution.

Bruder proceeded to spend $3.5 million to raze the gas station and several fast-food joints on the property, reface and expand the main building and repave the parking lot. In June he leased the space to Omaha-based Sitel Corp., a teleservicing company, for use as a call center. Bruder has recouped his costs by remortgaging the property based on its enhanced revenue stream and has already turned down offers to sell out at a nice profit.

The Dames & Moore/Brookhill partnership made its biggest single purchase a year ago: 24 properties and mortgages in 12 states from the defunct Confederation Life Insurance Co. U.S. "These were the stepchildren in their portfolio," says Bruder.

Bruder has learned to move fast, avoiding the capital costs involved in holding properties for long periods. Take his 21,000-square-foot, two-story office building in Culver City, Calif. The building was in excellent condition, but the property had been contaminated by a leaky underground storage tank at an adjacent gas station. The purchase price, in March, was $1.3 million. After spending $150,000, Dames & Moore/Brookhill sold it in July for $1.7 million. That gave Bruder's outfit a more than 50% return on equity. "We work on small margins, and we move quickly," Bruder explains.

"A lot of the low-hanging fruit is gone," says Bruder of the business. But he thinks his expertise in the field and his ability to make a quick turn will give him plenty of opportunities, especially with 100,000 brownfield sites out there ripe for development.

Now why can't the government get smart and start handling Superfund cases as expeditiously? ■