Up on Cripple Creek, A New Kind of Gold

An obscure accounting rule, combined with a shortage of urban real estate, is creating a rush to reclaim contaminated land. Now one company that made its fortune in the gold-rush era is cashing in again.

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Along the western slopes of Pike's Peak in Colorado sits the legendary gold rush town of Cripple Creek, which spawned 500 mines and 21 million ounces of gold — more of the precious metal than was produced in the California and Alaska rushes combined. One of the five original ore processing plants serving the mines was the Golden Cycle Mill, built in 1906 on a 210-acre tract of land in the heart of what is now the picturesque city of Colorado Springs.

The mill was shuttered in 1949, and eventually the U.S. Environmental Protection Agency classified the surrounding land a "brownfield" site, which is an abandoned or under-utilized piece of contaminated real estate that requires extensive environmental cleanup before it can be sold or re-developed.

The Golden Cycle property is just one of the 400,000 brownfield sites that EPA estimates are in the United States. Cleanup of these sites will cost between $520 billion to $2 trillion, depending on final reuse plans, according to figures released by the EPA and the National Brownfields Association. To date, only $2.3 billion in capital has been raised to remediate brownfield sites, which means the potential cleanup and attendant redevelopment market is enormous.

That puts the mill, now owned by Gold Hill Mesa Development, at the crossroads of another potential rush — the rush to cleanup, and then redevelop, brownfield sites. Indeed, several market and financial factors are conspiring to push the redevelopment of contaminated land forward, not the least of which are a shortage of real estate near thriving city centers, and an obscure accounting rule known as FIN 47.

FIN 47, Accounting for Conditional Asset Retirement Obligations, is a new interpretation of the five-year-old accounting rule, FAS 143. Issued in December 2005, FIN 47 requires companies to disclose, and carry on their balance sheets, the future cleanup costs of brownfields and other polluted real estate.

Although most CFOs say the FIN 47 charges are immaterial, the potential environmental cleanup cost is now in plain site of directors and investors, who may think it is imprudent for a company to retain unproductive assets that are weighed down by liabilities that grow larger as facilities get older and closer to retirement.

Before FIN 47, many companies followed standard industry practices of either low-balling cleanup estimates, claiming that the future cost could not be estimated properly, or taking a "don't ask, don't tell" attitude. Indeed, pre-FIN 47, property sales, facility retirements, or discovery of contaminants were the only events that triggered the disclosure of the costs. So as long as companies put assets into semi-retirement and "mothballed" plants, balance sheets remained clean of these cleanup costs.

FIN 47 changed that, and several market constituents, notably those that see burgeoning market opportunities, are making noise. For example, in July, the American Bar Association's special committee on environmental disclosure issued a 26-page newsletter devoted to FAS 143 and FIN 47, underscoring legal issues that could form the basis of shareholder lawsuits.

Meanwhile, environmental engineering firm BLDI and Steve Goldberg, the head of accounting at Grand Valley State University in Michigan, are working on a FAS 143/FIN 47 study — due out in January — that examines FIN 47 disclosures, and assesses accounting firms and their response to the rule. The initial results "surprised me," noted BLDI President Joe Berlin, who says that, so far, there are fewer disclosures than he expected.

Berlin sees lots of sales of contaminated properties — banks advising companies on the sale or acquisition of contaminated properties often hire him as environmental engineer. He says there seems to be a "dramatic" disparity between the Big Four accounting firms, and the rest of the market, as audit managers at small national and regional accounting firms are paying little attention to FIN 47, claiming that the future liability cannot be accurately estimated.

Others are tracking the affects of FIN 47 as well. In March, consultancy Corporate Executive Board released a study on the impact of FIN 47, noting that companies are reporting disparate affects of the accounting rule. Consider the industrial manufacturing sector, says the study, in which United Technologies reports a $95 million FIN 47 charge, while Caterpillar simply calls its charge "immaterial."

Perhaps the most tenacious tracker of FIN 47 balance sheet affects is the frequently updated website of Advance Environmental Dimensions, which recently noted that in an August 4 regulatory filing, argri-business giant Archer Daniels Midland recorded a $9 million after tax charge related to FIN 47.

While a $9-million charge will almost always be immaterial to a $37-billion behemoth like ADM, investors and analysts still say they want assurance that companies adhere to disclosure rules, especially rules that put what used to be a financial footnote onto the balance sheet.

As a matter of best practice, CFOs should ensure that processes are in place to identify asset retirement obligations (AROs), and assess, measure, and report the fair value of the obligation according their own materiality determinations, counsels Kathryn Pavlovsky, a senior manager with Deloitte Advisory Services. She warns that inadequacies in the ARO processes could result in the assignment of control deficiencies, or result in the company being subject to other reporting risks.

The Advanced Environmental Dimensions website also lists companies that disclose misstatements and deficiencies in financial controls attributed to AROs. For instance, companies including US Neurosurgical, Waste Management, New Century Energy, and Millennium Chemical, have issued restatements blaming the adjustment on accounting errors related to AROs.

Insurers are also keeping close tabs on the ripple effects of the accounting rule. "FIN 47 is the divergence of accounting and legal professions," asserts Kenn Anderson, the central team leader for insurance broker Aon Environmental. "The $64,000 question is how to satisfy both masters." Anderson explains in the strictest sense, FIN 47 mandates that companies disclose the future cost of a *legal* clean-up obligation. But if the contamination remains unknown — or an estimate can't be calculated — some attorneys argue that the legal obligation does not exist.

Nevertheless, the number of clients asking about insurance quotes related to environmental remediation and "toxic torts," (shareholder lawsuits) has increased by about 20 percent since the beginning of the year, reckons Anderson. "More often than not, clients ask for help connecting the dots between the accounting side of the business and the risk management side."

The risk management answer is more straightforward than the legal one: It doesn't matter if the obligation is known or whether an estimate can be made, says Anderson. "If a company owned and operated and contaminated a site, they are responsible for cleanup." The risk management question is: "What do you do?," adds Anderson

After carrying the abandoned mill site on its books for 50 years, Gold Hill Mesa Partners decided to convert the property into a productive asset. In March, Gold Hill Mesa Partners signed a first-of-its-kind deal with newcomer Brownfields Capital, a specialty financing company that uses a patented bond-like debt instrument to replace "costly and dilutive equity," says James Harasimowicz, president and chief operating officer of Brownfields Capital.

The deal worked like this: Gold Hill Mesa Partners contributed the polluted property to a special purpose vehicle (or SPV), known as Gold Hill Mesa Development (GMHD). That erased the asset from the company's balance sheet, but Gold Hill Mesa Partners retained a stake in the SPV. Brownfields Capital issued a revolving debt facility for the entire life of the project, that is, for both the remediation and redevelopment of the site.

Traditionally, each phase of a brownfield redevelopment is permitted, planned, and financed separately, with different constituents — the property owner, developer, construction company, state and local officials, finance companies — all vying for the best deal for their particular stage. As a result, there is no way to identify the net present value of the completed project because too many disconnected entities are working on the project as a piecemeal endeavor, never financing the next stage until the previous stage is completed.

Because the GMHD was planned and funded from start to finish, the net present value of the "cleaned and developed" project could be determined, and was used as "bankable equity" to finance the work, explains Harasimowicz. What's more, because the redevelopment is tightly managed as a single project, capital is deployed more efficiently.

The GHMD project, which will result in a mixed residential/commercial development, produces a fixed-coupon return for bondholders. The aim is to create the highest residual value from the redevelopment as possible, so that bondholders receive a return in the 16 percent to 20 percent range, and the SPV's total cost of capital is less than 10 percent.

In essence, says Brownfields Capital founder and CEO Cheryl Hoffman, the project financing has the functionality of construction revolver with the virtues of corporate debt. GHMD received a 39-month term on a $19 million revolving debt facility, which has no recourse back to Gold Mesa Hill Partners.

Housing and retail stores will be built in stages, and the positive cash flows from the project will first pay off the loan principal and interest, and then be distributed to the equity holders of the SPV. Brownsfield Capital calculated that sales proceeds from the completed project would be $62 million, and that Gold Hill Mesa Partners will reap $27 million for their once-contaminated mill site.