Environmental Assessment of REITs

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Environment

Overview

- What's a REIT?
- Typical REIT Environmental Assessments
- Non-Issues
- Deal Breakers
- RBC's definition of high and low significance
- What to look for
- Mitigants
- Case Studies

What's a REIT?

- REIT – Real Estate Investment Trusts
- A trust that holds hotels, office towers, retirement homes, shopping centres, apartment buildings and other income producing property as well as commercial mortgage backed securities
- Income trusts are attractive because they do not pay corporate income tax – taxable in hands of unit holder, provide monthly or quarterly distributions and opportunity to participate in upside of trust unit appreciation.

Typical REIT Environmental Assessments

- Ten or more properties with an aggregate value in excess of $20 million.
- Quality of some reports questionable.
- Quality of some consultants that prepared. reports even more questionable.
- Usually very short time allowed for assessment.
- Main issues is to establish what is material and what is not.

Non-Issues

- Asbestos
- Lead based paint
- PCBs
- ASTs
- USTs (unless numerous)
- Water damage and mould
- Stigma

Deal Breakers

- Age of report
- Poor quality reports
- Non-disclosure
- Litigation
- Material contamination

High Significance

- Effect on Revenue >1%
- Compliance issues > 5 significant issues
- General – inaction on unacceptable times virtually certain to result in or allow continuation of very negative impacts. Senior level action required

High Significance (Continued)

- Risk of prosecution of corporate officers/directors – Expected or probable
- Reputational damage – Sustained national negative media coverage- front page or business section
- Regulatory relations – Written threat of revocation or imposition of limitation on license

Low Significance

- Expected fines/legal costs $100 to $250K
- Effect on revenue ¼ to ½%
- 1-2 significant compliance issues
- Reputational damage – negative media coverage in region (state/province)
- Regulatory identified problems with licensing restrictions

What to Look For

- Quality of Consultant
- Bank Exposure (Loan amount)
- LTV
- Litigation Risks
- Overall Environmental Quality of Property Portfolio

Mitigants

- ✓ Removal of one or more properties from the pool
- ✓ Further assessment
- ✓ Insurance

Insurance

Spreading risk over a property portfolio makes insurance premium relatively cheap.

Insurance primarily to cover the unknowns (up to a point) or what the consultant missed.

Case Study 1

- 12 Prestigious Hotel Properties built in late1800's early 1900's in several Canadian Provinces
- All had mould, asbestos and lead base paint issues
- Estimated $100,000 per hotel for asbestos and $50,000 for mould (roofs to be replaced or repaired)
- Total cost $1.8 million
- On $100 million acqusition – not material

Case Study 2

20 Maritime properties

Shopping centres, strip malls.

In Maritimes, natural gas generally unavailable thus many businesses heated by fuel oil

On two of the properties off site hydrocarbon contamination issues identified with these properties identified as the source

Encouraged account manager to drop the two properties with off site issues from portfolio.

Informed that this was not possible

Case Studies 2 (continued)

Based on value of other 18 properties the banks exposure to entire portfolio of 60% LTV and undertaking by client to indemnify bank for any environmental issues related to portfolio we agreed to proceed

Summary

Determining what is “material” and what is not is the key.

To a consultant everything is key and to a vendor everything is not.

Our role is to be the judge

Thank You