
Office of the Inspector General

Audit Report

Acquisition of Contaminated Property

Federal Highway Administration

Report Number: R6-FH-7-002

Date Issued: October 21, 1996





**U.S. Department of
Transportation**

Memorandum

Office of the Secretary
of Transportation

Office of the Inspector General

ACTION: Report on Acquisition
of Contaminated Property, FHWA
Report Number: R6-FH-7-002

October 21, 1996

Lawrence H. Weintrob
Assistant Inspector General for Auditing

JA-1

Federal Highway Administrator

I am providing this report for your information and use. The Federal Highway Administration (FHWA) comments of September 19, 1996, on our June 14, 1996, draft report were considered in preparing this report. A synopsis of the report follows this memorandum.

FHWA generally concurred in the recommendations, and proposed alternative wording for one recommendation. The FHWA suggested wording was acceptable. We revised the report accordingly. Although FHWA stated it generally concurred in the recommendations, FHWA did not identify specific actions taken or planned, and also did not provide estimated completion dates for implementing the recommendations. As required by Department of Transportation Order 8000.1C, please provide this information within 60 days.

I appreciate the cooperation and assistance of FHWA and state officials. Please call John Meche at (817) 978-3545, or me at (202) 366-1992, if you have questions concerning this report.

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Transportation

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Objectives

Our objectives were to determine whether the Federal Highway Administration (FHWA) ensured states (i) conducted appropriate environmental studies during project planning and right-of-way acquisitions, (ii) considered contamination when appraising property, and (iii) identified responsible parties for environmental remediation.

Conclusion

FHWA did not always ensure states acquired contaminated property in accordance with Federal guidelines. We found states acquired property without (i) adequately investigating for contamination, (ii) considering contamination in assessing property value, or (iii) holding property owners responsible for cleanup cost. Consequently, FHWA participated in inflated prices for contaminated property, and in cleanup cost that should have been paid by property owners or states.

Monetary Impact

FHWA participated in inflated prices for 20 contaminated properties audited, and about \$390,000 of cleanup cost. The full monetary impact could not be established because states had not determined total cleanup cost on some properties, or the impact of contamination on fair-market value.

Recommendations

We recommend the FHWA Administrator incorporate provisions in project agreements which require states to (i) adequately investigate project sites for contamination, (ii) obtain sufficient information on contamination and cleanup cost if avoidance is not feasible, (iii) attempt to secure property owner clean up of contaminated sites prior to acquisition, (iv) adjust fair-market value for the "stigma effect" of contamination, (v) seek recovery of cleanup cost, (vi) keep a separate accounting of cleanup cost incurred on each Federal project and periodically report on cost-recovery actions, and (vii) give prior notification to FHWA before using Federal funds for cleanup of contaminated property.

SYNOPSIS



U.S. Department of
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We also recommend FHWA deny Federal participation in cleanup cost when states do not comply with Federal guidelines.

Management Position

FHWA generally concurred in the recommendations, but believes the report fails to support the assumption that FHWA is not currently following its guidance.

Office of Inspector General Comments

Our report presents recurring incidents showing states were not complying with Federal policy concerning the acquisition of property with contamination. Yet, FHWA participated in the acquisition or cleanup without specific assurances from the states that Federal-aid highway funds were used as a last resort.

SYNOPSIS

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I. INTRODUCTION

Background

The Federal Highway Administration (FHWA) responsibility to protect the environment while providing highway transportation facilities is contained in the National Environmental Policy Act of 1969 (NEPA), as amended. Title 23, Code of Federal Regulations, Part 771, establishes FHWA policies and procedures for implementing NEPA. When states propose highway projects for FHWA funding, NEPA requires states to determine environmental impact, and establish measures to mitigate damages before proceeding with right-of-way acquisition or construction. When acquiring property with Federal participation, states also are required to comply with the Relocation Assistance and Real Property Acquisition Policies Act (Uniform Act).

The Transportation Research Board, in a 1993 study entitled Hazardous Wastes in Highway Rights-of-Way stated:

. . . hazardous wastes are frequently encountered and potentially present in nearly all DOT projects. . . .

During Fiscal Year (FY) 1993 and FY 1994, FHWA participated in about 60,000 parcel acquisitions for over 5,000 highway projects. The total cost was about \$2 billion. About \$586 million was for projects in the State of California.

Objectives, Scope, and Methodology

Our objectives were to determine whether FHWA ensured states (i) conducted appropriate environmental studies during project planning and right-of-way acquisitions, (ii) considered contamination when appraising property, and (iii) identified responsible parties for environmental remediation. The audit was conducted at FHWA Office of Environment and Planning, Office of Right-of-Way in Washington, D. C., and FHWA Regions 1, 6, and 9. We also visited state highway departments in Austin, Texas; Baton Rouge, Louisiana; Sacramento and Oakland, California; Santa Fe, New Mexico; and Trenton, New Jersey. We interviewed officials from FHWA, state highway agencies, and state auditors. We judgmentally selected and reviewed files on 97 acquisitions in five states. The audit was conducted between January and November 1995 in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

Management Controls

We reviewed Federal environmental laws, FHWA implementing regulations, and FHWA and state guidelines for acquiring potentially contaminated property. We also evaluated FHWA management controls for ensuring states take appropriate actions to mitigate damage to the environment. The management control weaknesses we identified are discussed in Part II of this report.

Prior Audit Coverage

This was the first FHWA-wide assessment by the Office of Inspector General of acquisition of contaminated property. During our audit of land acquisition in FHWA Region 6 (Report R6-FH-4-010, April 8, 1994), we found states acquired right-of-way property without considering contamination in assessing property value or holding property owners responsible for remediation cost. The results are summarized in this report.

II. FINDING AND RECOMMENDATIONS

Finding. Acquisition of Contaminated Property

States acquired right-of-way property without (i) adequately investigating for contamination, (ii) considering contamination in assessing property value, or (iii) holding property owners responsible for cleanup cost. This occurred because FHWA project agreements did not clearly establish state accountability for acquiring contaminated property, and FHWA did not always limit its participation when states failed to comply with Federal policy. Consequently, FHWA participated in inflated prices for contaminated property, and in cleanup cost that should have been paid by property owners or states.

Discussion

Title 23, Code of Federal Regulations, Part 771, requires FHWA and state highway agencies to investigate the potential environmental impact of highway projects, and identify measures necessary to mitigate adverse impacts. On August 12, 1988, FHWA issued guidance to states for acquiring property that potentially contains hazardous substances. FHWA stated:

This guidance is intended to provide a framework around which effective processes for dealing with hazardous substances/wastes can be built.

Because of the complexity of most hazardous substance/waste issues and the severity of cost overruns and project delays associated with late discovery of such materials, FHWA strongly endorses the . . . procedures to help identify and avoid hazardous waste sites. . . .

Property Acquisitions

Right-of-way acquisitions, in four of the five states audited, did not adequately address Federal concerns with acquiring contaminated property. Only the State of New Mexico consistently (i) tested property before acquisition to identify contamination, (ii) avoided contaminated sites, and (iii) held property owners responsible for cleanup cost when acquisition was required.

In the other four states, files for 25 of the 86 acquisitions showed properties contained contamination. For five acquisitions, the states reduced fair-market value by estimated cleanup cost, or required property owners to clean up the

contamination, as required by Federal policy. The states acquired the remaining 20 properties for about \$24 million.

Identification of Contaminated Properties

States acquired right-of-way for 16 of the 20 acquisitions without adequately investigating for contamination. FHWA policy states:

Keys to success in dealing with hazardous waste sites are early identification and assessment of all potential right-of-way properties which could be contaminated with hazardous substances/wastes. . . . Again, avoidance is stressed . . . unless the risks of proceeding with contaminated property can be justified.

If site avoidance is not feasible, the additional investigation and sampling/testing plan should proceed to obtain sufficient information to characterize the site, the type and extent of contamination, and develop alternative treatment/cleanup/disposal measures with associated costs.

. . . in those cases where the SHA [State Highway Agency] failed to adequately investigate project site conditions, FHWA's participation in handling the conditions encountered may be limited. (Bracketed data added.)

In one state, we found state law prohibited soil tests without property owners' permission. In other states, right-of-way officials failed to comply with FHWA guidance. To illustrate, a 1994 internal state audit found 5 of 39 parcels tested were appraised and acquired before hazardous waste investigations were completed. We found similar problems. For example:

A property was adjacent to an active railroad yard for 90 years, and two other properties on the environmental monitoring and cleanup lists. In February 1994, the state obtained permission from the owner to perform soil tests to identify contamination. However, in January 1995, before soil tests were performed, the state acquired the property. In February 1995, the tests were performed which confirmed the property was heavily contaminated.

Adjustment of Fair-Market Value for Contamination

State right-of-way officials acquired 17 contaminated properties without adjusting fair-market value for estimated cleanup costs or considering the impact of contamination on property values. A 1992 FHWA study, The Effects of Contamination on the Market Value of Property, found the "stigma effect" of contaminated property, even after cleanup, can reduce property values by 21 to 94 percent. The August 1988 FHWA guidance states:

Necessary cleanup or waste disposal costs are normally reflected in a property's salability, and thus, in the market value. Therefore, in appraising such property for Federal-aid purposes, the impact of any hazardous substances/wastes affecting the property and the level of treatment needed to control/cleanup the property needs to be considered and reflected in the appraised market value. . .

The Uniform Appraisal Standards for Federal Land Acquisitions states:

Under established law the criterion for just compensation is the fair market value of the property at the time of the taking . . it is improper to estimate the market value of a property assuming it is free of contamination when there is evidence, by the past use of the property... that contamination may exist.

Uniform Standards of Professional Appraisal Practice Advisory Opinion G-9 states:

The value of an interest in . . . contaminated real estate may not be measurable by simply deducting the remediation or compliance cost estimate from the estimated value . . including any positive or negative impact on marketability (stigma) and the possibility of change in highest and best use.

For 14 acquisitions, costing about \$17 million, the files included evidence the properties were potentially contaminated, but appraisal reports contained no adjustment for cleanup, or for the "stigma effect" of contamination. For example:

On June 20, 1994, the state purchased property for \$4.8 million. Before the acquisition, the state knew the property contained two active monitoring wells designed to detect the presence of groundwater contamination. During 1990 and 1993, these wells recorded

concentrations of tetrachloroethane and trichloroethene, suspected carcinogenics, which significantly exceeded state safety levels. In March 1994, the property was appraised "as if environmentally clean," with no adjustment.

For three acquisitions, costing about \$2 million, appraisal reports recognized the properties were contaminated, and cleanup cost was estimated at \$71,000. Contrary to Federal policy, state right-of-way officials did not make the adjustments. In one case, right-of-way officials improperly cited a state law which relieved property owners from paying cleanup cost. Files for the other acquisitions did not show why no adjustment was made.

State officials were not aware the remaining three acquisitions were contaminated at time of purchase. Consequently, no adjustment was made. The contamination was discovered after construction started.

Recovery of Cleanup Cost

States did not always initiate recovery action for cleanup cost. The FHWA guidance states:

Federal-aid highway funds, as a general rule, should only be used as a last resort to cleanup or dispose of hazardous substances/wastes located on proposed or existing project sites.

A FHWA manual, Hazardous Waste: Impacts on Highway Project Development, Construction, and Maintenance states:

Under current FHWA policies, cost recovery must be undertaken as a condition of federal participation when the SHA cannot avoid a hazardous waste site and the owner cannot clean up the contamination. . .

Cost recovery in general involves those activities undertaken by a SHA to seek reimbursement from a land owner or other entity for all costs incurred by the SHA to cleanup contaminated right-of-way which could not be cleaned up by the previous owner prior to acquisition of the property by the SHA.

For 4 of 20 contaminated properties, the states specifically billed Federal-aid projects about \$390,000 for cleanup cost, but the states did not initiate recovery action against previous owners or other parties responsible for the

contamination. Additional cleanup cost for the 20 acquisitions was estimated by state officials to be at least \$1.4 million. However, actual cleanup cost could be substantially higher. To illustrate, for one acquisition in remediation, a state official advised us the cleanup cost will run into ". . . millions of dollars . . ." if the state is required to remove all contaminated and hazardous material.

Acceptance of Cleanup Cost

FHWA participated in hazardous waste cleanup without ensuring the states met conditions for Federal participation. FHWA guidance states Federal-aid highway funds can participate in cleanup when:

The FHWA and SHA knowingly agree to accept the responsibility of others for the cleanup and/or disposal of hazardous substances/wastes from a Federal-aid project in order to expedite the completion of a much needed project, with the understanding that the necessary efforts will be pursued to recover the costs of cleanup and/or disposal from the responsible parties and that any costs recovered will be promptly credited to eligible work items. (Underscoring added.)

We found, in at least seven acquisitions, cleanup cost was hidden among construction cost, either as work items in the original contract or as contract change orders. In one state, four construction contracts included \$10 million of cleanup cost. FHWA did not require the states to separately report the amount of Federal funds spent for cleanup. In fact, this information was not readily available at the states.

Although FHWA participation in cleanup cost was conditioned on the states pursuing cost recoveries and crediting those recoveries to eligible cost items, FHWA did not require states to report on the status of cost recovery actions. Consequently, FHWA did not know whether states lived up to their part of the agreements.

Compliance with Federal Guidelines

FHWA has known since 1991 that states have not diligently identified contaminated properties or held property owners responsible for cleanup cost. In a September 1991 memorandum to all FHWA regional counsels, the FHWA Environmental and Right-of-Way Law Branch recognized possible difficulties in recovering the Federal share of cleanup cost from responsible

parties when the state had already received a portion of its cost from FHWA. The memorandum stated:

It appears this possible problem might be avoided if the project agreement included . . . a provision requiring the State to use its best efforts to seek recovery of its clean-up costs from any responsible parties as a condition of Federal participation in such costs. Inclusion of such a provision in the project agreement would also serve to enforce the State's obligation to seek recovery from responsible parties.

FHWA has not added the suggested provision to the project agreement. Moreover, FHWA has not required states, as a matter of policy, to demonstrate to FHWA's satisfaction that the states used their "best efforts" to avoid contaminated property or recover cleanup cost. Due to diminishing Federal resources and a congressionally-mandated shift of program oversight responsibilities to state highway agencies, it is appropriate, in our opinion, for FHWA to incorporate specific state accountability concerning contaminated property in project agreements.

Recommendations

We recommend the Federal Highway Administrator:

1. Incorporate provisions in project agreements, depending on the type of project, which require states to:
 - Adequately investigate project sites for contamination and, if feasible, avoid acquisition of contaminated property.
 - If avoidance of contaminated property is not feasible, obtain sufficient information on the type and extent of contamination and cleanup cost.
 - Attempt to secure property owner clean up of contaminated sites prior to acquisition.
 - Adjust fair-market value for the "stigma effect" of contamination on property values.
 - Seek recovery of cleanup cost from responsible parties.

- Keep a separate accounting of cleanup cost incurred on each Federal project and periodically report on cost-recovery actions.
 - Give prior notification to FHWA before using Federal funds for cleanup of contaminated property.
2. Deny Federal participation in cleanup cost when states do not comply with Federal guidelines with respect to acquisition of contaminated property.

Management Response

FHWA generally concurred in the recommendations, but believes the report fails to support the assumption that FHWA is not currently following its guidance. FHWA stated:

- The report does not recognize that our guidance provides for a great deal of flexibility for the states to make overall cost-based decisions which consider acceptable risk as opposed to other factors not mentioned in the report. . . . One such alternative may be the acquisition and mitigation of a particular site when the costs of project delay, administrative overhead, and other factors outweigh the alternative.
- While it may be desirable to get property owners to clean up contaminated sites before acquisition, it may not be possible to require them to do so. . . . We would suggest that rather than using the word 'require,' it may be more appropriate to reword this provision as follows: 'Attempt to secure property owner clean up of contaminated sites prior to acquisition.'

The complete text of management comments is the appendix to this report.

Office of Inspector General Comments

Although FHWA generally concurred in the recommendations, it did not identify specific actions taken or planned. FHWA also did not provide estimated completion dates as required by DOT Order 8000.1C. We request this information be provided within 60 days.

We agree FHWA guidance provides for a great deal of flexibility for the states, and such flexibility is necessary. However, our report presents recurring incidents showing states were not complying with Federal policy concerning

the acquisition of property with contamination. Yet, FHWA participated in the acquisition or cleanup without specific assurances from the states that Federal-aid highway funds were used as a last resort.

We recognize that it may not always be possible to "require" property owners to clean up contaminated sites before acquisition. The alternative wording suggested by FHWA for the recommendation was acceptable. We revised the report accordingly.

MAJOR CONTRIBUTORS TO THIS REPORT

These individuals participated in the Audit of Acquisition of Contaminated Property, Federal Highway Administration.

John L. Meche	Regional Manager, Region VI
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Evelyn H. Norris	Administrative Support



U.S. Department
of Transportation

**Federal Highway
Administration**

Memorandum

Subject: INFORMATION: Federal Highway Administration
(FHWA) Comments on Office of Inspector General (OIG)
Draft Report on Acquisition of Contaminated Property

Date: September 19, 1996

From: Associate Administrator for Administration

Reply to
Attn. of: HMS-11

To: Mr. Lawrence H. Weintrob
Deputy Assistant Inspector General for Auditing (JA-2)

The FHWA generally concurs with the OIG's recommendations. However, we believe the report fails to support the assumption that FHWA is not currently following its guidance. The report does not recognize that our guidance provides for a great deal of flexibility for the States to make overall cost-based decisions which consider acceptable risk as opposed to other factors not mentioned in the report. For example, our guidance allows States to consider proceeding with alternatives other than avoidance when justified by sufficient experience or procedures and when such alternatives present limited risk. One such alternative may be the acquisition and mitigation of a particular site when the costs of project delay, administrative overhead, and other factors outweigh the alternative.

The third provision of recommendation 1 reads: "Require property owners, whenever possible, to clean up contaminated property before the state acquires it." While it may be desirable to get property owners to clean up contaminated sites before acquisition, it may not be possible to require them to do so. A property owner may simply reject the State's offer, moving the acquisition into the hands of the court and eminent domain proceedings. Should this occur, the courts have been traditionally concerned with the amount of just compensation due the property owner and not pre-acquisition agency procedure. We would suggest that rather than using the word "require," it may be more appropriate to reword this provision as follows: "*Attempt to secure property owner clean up of contaminated sites prior to acquisition.*"

We appreciate the opportunity to comment on the report, and especially appreciate your patience during the comment process.

George S. Moore, Jr.