First Citizens Bank

Environmental & Engineering Due Diligence for the Bank

2025 CAVA RMA Commercial Lending School

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What is this class about?

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	Environmental 101 – What types of environmental risks are there?
	Our Purpose – Why do we need Environmental Due Diligence programs?
	Documentation – What documents does the bank need for review?
	Policy/Standards – What does an example of the bank's environmental policy look like?
	Roles & Responsibilities – What are the banker's and environmental department's roles in this?

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Environmental 101

What type of environmental risks are there?

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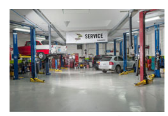
Types of Environmental Risk

Drycleaners


Auto Repair


Gas Stations


Orphan Tanks


Industrial/Manufacturing


Oil/Gas Wells


Embalming/Cremation

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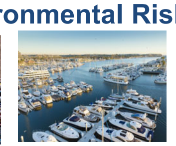
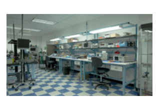
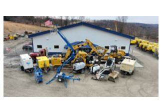
Types of Environmental Risk

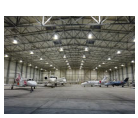

Golf Courses

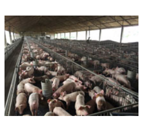

Waste Management


Marinas


Testing Laboratories


Equipment Rental


Airports/Hangars


Commercial Farming


Foundries

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Understanding How Contamination Migrates

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Our Purpose

Why do we need environmental due diligence programs?

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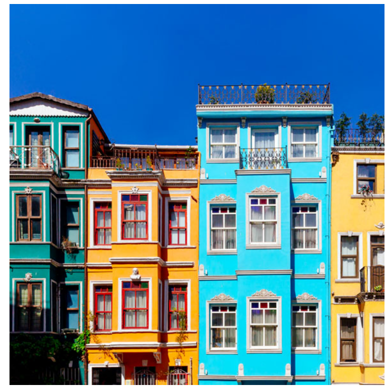
Why Due Diligence?

The bank measures the borrower's ability to repay the loan if funds must be diverted for environmental purposes

The bank also needs to ensure collateral value exceeds the market value of the loan if it defaults

Bottom Line: The most important thing the bank can do when taking a real estate loan is to conduct the appropriate environmental investigation before taking any security or ownership interest in the property.



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Why Do We Need an Environmental Due Diligence Program?

1	Purpose	The purpose of environmental due diligence is to evaluate the environmental liability and risk of a property, prior to lending on it.
2	Repayment	Environmental problems can affect our borrower's ability to repay the loan or use the site for its intended purpose.
3	Collateral Value	Environmental problems impact the collateral Value.
4	Liability	Environmental problems can have Legal implications to both the borrower and potentially the bank.
5	Construction Delays	On site contamination can impact a construction projects cost and timetable.
6	Transaction Exit	These issues can impact the banks' ability to exit the loan.

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Regulatory Agencies Responsible for Enforcement

Environmental Protection Agency (EPA)

Resource Conservation & Recovery Act (RCRA)

Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)

Clean Air Act (CAA)

Clean Water Act (CWA)

Toxic Substances Control Act (TSCA)

Occupational Safety and Health Administration (OSHA)

Asbestos, lead-based paint, chemical exposure, indoor air quality

State Regulatory Agencies

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Evolution of Environmental Risk

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RCRA (1976)

Covers the use, treatment, storage, and disposal of hazardous waste (substance meeting specific characteristics, or as a substance routinely produced by specific industries)

Enforcement is typically passed to state agencies, and some states may have stricter requirements

Compliance with RCRA is a key indicator in environmental due diligence

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Evolution of Environmental Risk

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CERCLA (1980)

What is it?

- Covers contamination resulting from release of hazardous materials to the environment
- Also known as "Superfund" because it created a trust fund of money to be used to clean up the most contaminated properties
- This prompted the banking industry to take steps to protect itself from environmental liability since this law can hold the bank responsible for cleanup of contaminated properties
- The courts and EPA have held banks liable for contamination through "potentially responsible parties" and "strict liability"
  - Includes past/present owners and operators as well as a party who accepts or arranges for disposal or treatment of hazardous substances
- Bank can become liable through chain of title by foreclosure and/or involvement through a lease or as a trustee or other fiduciary

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Liability

- **Strict liability** means that you have legal connection to the property even if you did not cause contamination, you are still liable
  - Liable for government cleanup costs, damage to natural resources, costs of certain health assessments, and performing cleanup where imminent and substantial endangerment are present
- **Defenses:** there are a limited number of defenses the bank and property owner can use against CERCLA liability including:
  - **Secured Creditor Safe Harbor Defense** which exempts the bank if it holds a security interest in real property to secure repayment of money or some other obligation, and it did not actually participate in decision making control over environmental compliance or management of the property; Foreclosing on a property won't result in liability if the bank takes reasonable steps to divest itself of the property quickly and on reasonable terms
  - **Innocent Landowner Defense**: entity can be exempt from liability if a Phase I ESA completed to all appropriate inquiries AAI compliance prior to purchase (must be dated within 180 days of purchase or updated), has no affiliation with liable party, complied with land use restrictions (if applicable), provides cooperation, assistance, and access to property, and takes reasonable steps to minimize contamination.

There are similar provisions in the Bona Fide Prospective Purchasers Defense and Contiguous Property Owners Defense.

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Documentation

What documents does the bank need for review?

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Environmental Questionnaire (non-intrusive)

- Completed by the Deal Team for real estate secured loans, including purchases and refi's, as a screening tool
- Internal bank document and can be tailored to your bank's needs
- Should include the following:
  - Transaction Summary (e.g., loan type, prior environmental reports, etc.)
  - Collateral Information (e.g., current/former property use, planned site use, hazardous material storage, etc.)

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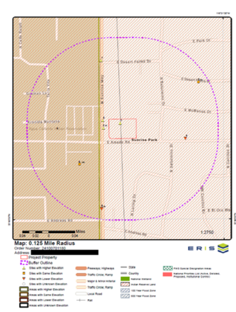
Desktop Database Reports (non-intrusive)



- Environmental listings within a 0.25-mile radius of the subject collateral
- Cheap - ~$75
  3 business days
- Typically completed on non-suspect property types with smaller loan size

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Records Search with Risk Assessment (non-intrusive)

- Mostly used for SBA loans, but can be used for non-SBA loans
- Provides a “Low Risk” or “High Risk” determination
- Costs ~$750; completed within 5-7 business days
- Typically completed on non-suspect property types

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Environmental Transaction Screen Assessment (non-intrusive)

- Less extensive option to a Phase I Environmental Site Assessment
- Cheaper and faster than a Phase I - ~$1,600; 10 business days
- Typically completed on smaller loan size

Site Visit, Environmental Questionnaire, Regulatory Database Report, and review of historical sources

Phase II can be recommended

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Phase I Environmental Site Assessments (non-intrusive)

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Phase II Environmental Site Assessments (intrusive)

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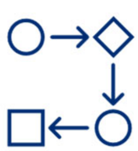
Policy/Standards

What does an example of the bank’s environmental policy look like?



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Risk Management Priorities

Area of Risk	Environmental Examples (all Commercial Transactions)
Human Health	1. Contamination with pathways to users of the site / neighbors 2. Very high-risk industries 3. Hazardous materials in buildings
Asset Value	1. Cleanup costs for known remediation liabilities 2. Contingent remediation liabilities or third-party liabilities, including product liability 3. Cost-to-cure noncompliant conditions or safety/health risks 4. Transition costs caused by new regulation
Transaction Exit	1. Transfer of owner/operator liabilities for cleanup and compliance 2. Guaranty programs/insurance limitations 3. Actions required by regulatory agencies when responsible parties cannot be found 4. Compliance obligations when taking over an operating business 5. Third party liability

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Levels of Due Diligence Example – Sample Matrix

Threshold	Property Use	Requirement
≤$3MM	Non-Suspect	Desktop Database Report
≤$3MM	Assumed Suspect	Environmental Transaction Screen
>$3MM to ≤$5MM	Non-Suspect	Records Search with Risk Assessment (RSRA)
>$3MM to ≤$5MM	Assumed Suspect	Environmental Transaction Screen
>$5MM	Any	Phase I Environmental Site Assessment (ESA)
Any loan amount	Known Suspect	Phase I ESA

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Vendors

- Most banks have an approved vendor list:
  - Conducts non-intrusive and intrusive onsite investigations
  - Conducts a bidding process based on approved scope of work designed by the bank's Environmental Risk Department
  - Fully understands the bank's risk tolerance
- Vendors must be managed in accordance with your bank's Third-Party Risk Management Policies with regular updates and quality control measures
- Reports provided by non-approved vendors can be subject to rejection

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Lending on Contaminated Properties

- If the bank takes contaminated property as collateral, there are several potential impacts:
  - Fines from non-compliance with regulations and:
    - Costs of cleanup
    - Can affect resale value or marketability
    - Increases the likelihood of borrower default due to losses
    - Reputational risk to the bank if they are held liable

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Know your bank's risk tolerance!

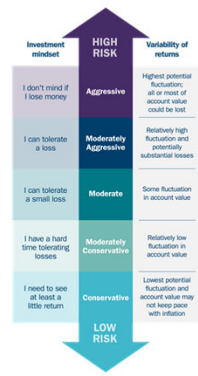
Risk tolerance is a measure of the degree of loss an investor is willing to endure within their portfolio

Stock volatility, market swings, economic or political events, and regulatory, or interest rate changes affect an investor's tolerance for risk

Age, investment goals, and income contribute to an investor's risk tolerance

An aggressive investor commonly has a higher risk tolerance and is willing to risk more money for the possibility of better, yet unknown, returns

A conservative investor commonly has a lower risk tolerance and seeks investments with guaranteed returns



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Roles/Responsibilities

What are the banker's and environmental department's roles in this?

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Environmental Department's Role

- Partner with bankers to reduce environmental risk to the bank
- Conduct a careful review of each new loan or modification
- Inform and educate bankers on environmental risk
- Improve the bank's service to clients

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Environmental Department's Responsibilities

- Identify potential environmental concerns that may affect the value, marketability, or the bank's ability to foreclose on the property, as well as issues that may affect the borrower's ability to repay the loan
- Determine if the bank has met its due diligence requirements and whether potential conflicts of interest exist
- Review environmental reports to determine if it adequately assesses the property and provides the information needed to determine the environmental risk to the bank
- Assisting the bank in determining if all reasonable steps have been taken to minimize the risk or loss and/or liability and ensuring the environmental condition of the property is satisfactory or whether additional investigation is recommended

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Banker's Role

- Partner with the Environmental Risk Department to reduce environmental risk to the bank
- Conduct a careful review of your Environmental department's risk review memos
- Inform and educate customers on environmental risk
- Improve the bank's service to clients

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Banker's Responsibilities

- Be familiar with the property you are lending on and the bank's risk tolerance
- Request previous environmental reports from the customer
- Use your bank's risk matrix to determine the level of due diligence needed
- Understand the risks involved in extending credit for real estate assets that have property conditions that may affect the property's value, life and safety of occupants, you bank's ability to exit a loan via foreclosure.

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Case Study

Small Group Activity

Let's see what you learned today!

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Group 1 Case Study

- Opportunity
  - New Loan request from Bill Borrower for $3.2MM
  - Property is currently vacant land
  - Proposed construction of a car dealership
- According to your sample matrix, what is the appropriate due diligence that should be completed?

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Group 2 Case Study

- Opportunity
  - Christy Customer has an existing loan with ABC Bank in the amount of $1.5MM, a bank in which your bank recently acquired
  - Due to ABC Bank's aggressive risk tolerance, no environmental due diligence was required or completed at origination
  - Christy Customer's loan is up for renewal, and she is requesting an increase of $1.2MM for renovations/upfit
  - Property currently operates as a dry-cleaning plant
- According to your sample matrix, what is the appropriate due diligence that should be completed?

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Group 3 Case Study

- Opportunity
  - Casey Client wants a new loan from your bank in the amount of $4.75MM
  - The loan will support demolition of current onsite buildings and new construction of a multi-tenant office complex
  - Property currently has unoccupied structures onsite which were reportedly part of a commercial farming operation
- According to your sample matrix, what is the appropriate due diligence that should be completed?

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Group 4 Case Study

- Opportunity
  - Steven Sponsor wants a new loan from your bank in the amount of $750M
  - The loan will support renovations/upfit of an existing residential apartment complex
- According to your sample matrix, what is the appropriate due diligence that should be completed?

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References

- Seventies 1970-79 | Environmental history
- The Father of Environmental Justice Exposes the Geography of Inequity | Scientific American
- Chapter 9: Uranium Milling and the Church Rock Disaster, "KILLING OUR OWN", 1982 (ratical.org)
- PM Environmental - Phase I ESA
- PM Environmental - Phase II ESA
- Resource Conservation and Recovery Act (RCRA) Laws and Regulations | US EPA
- Superfund: CERCLA Overview | US EPA

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