

Residential PACE Moderates, While Commercial PACE Expands

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Morningstar Perspective

At Information Management Network's Investors' ABS East Conference in Miami on Sept. 24, panelists discussed the current state of the property assessed clean energy market. While the residential PACE sector has moderated in the wake of consumer protection laws California enacted in 2017, recent activity from a couple of major originators has occurred.

Shawn Rose, director at Deutsche Bank, thinks the decrease in origination volume may not necessarily be attributed to a drop in qualifying borrowers, resulting from the newly imposed ability-to-repay, or ATR, rules. He instead speculated that fewer contractors were pitching PACE as a financing mechanism because processing times have substantially lengthened, going from minutes to weeks, in some instances. Rose noted that residential PACE originations in Florida may pick up as more homeowners consider PACE for storm hardening measures for their homes.

Uncertainty at the federal level has also muddied the waters because the Consumer Financial Protection Bureau has solicited information regarding residential PACE as it considers imposing regulations as part of the Economic Growth, Regulatory Relief, and Consumer Protection Act. David Sykes, partner at Chapman and Cutler, LLP, referenced section 307 of the Act, which amends the Truth in Lending Act and mandates that the CFPB promulgate ATR regulations to PACE financings. The CFPB solicited comments earlier this year and is reviewing the comments. Stephanie Mah, vice president at Morningstar Credit Ratings, LLC, noted that the rating agency considers increasing consumer protection measures as generally credit positive because they serve to strengthen the underlying collateral in PACE securitizations by improving underwriting guidelines based on a property owner's ability to repay.

While residential PACE volume has stalled, panelists were optimistic about the growth potential ahead for commercial PACE. Lain Gutierrez, CEO at CleanFund Commercial PACE Capital, remarked that he sees new construction and gut rehabs driving a lot of interest on the commercial side. Gutierrez said that while lender's consent continues to be a challenge, it's much easier to obtain in new construction and gut rehab projects because the senior lender is sitting at the same table with the borrower right at the onset of the project. Even though PACE financing for new construction is not yet allowable under existing legislation in New York City, Susan Morth, CEO of Energize NY PACE, expects to see that change in June 2020. On the heels of the New York City Council passing the Climate Mobilization Act, a set of bills aimed at mitigating the effects of greenhouse gas emissions from city buildings, Morth has seen a lot of interest from around a dozen different capital providers.

Overall, panelists remained positive in their outlook for PACE. Rose noted that while we may not see residential PACE volume reach the same historic heights as in prior years, the sector will adjust to the new framework and originations will bounce back. While commercial PACE has been slower getting out of the gate and is roughly only one-fifth the size of residential PACE in terms of cumulative originations, there is enormous growth potential on the commercial side as more states and local municipalities pass PACE-enabling legislation. In addition, Gutierrez said that new construction commercial PACE deals tend to be much larger in terms of dollar volume and more seamless since there is no lender consent question mark. At the same time, Mah remarked that growth may also stem from the demand side of the equation as investors look to meet their sustainable investing goals.

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