

# As Residential PACE Slows, Commercial PACE Has Momentum

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**Morningstar Perspective**

At Information Management Network's Green & SRI Investing Symposium on April 9, Joseph Lau, Managing Director at Lord Capital LLC led the Quickening the PACE panel, with a discussion on recent trends across R-PACE and C-PACE. While the R-PACE sector continues to experience headwinds on the heels of increased consumer protection measures, the commercial PACE sector has momentum after reaching new milestones in 2018.

James Vergara, Managing Director at PACEfunding LLC noted that 2018 R-PACE new origination volume was down by as much as 50% off prior-year levels. Considering the longer processing times, customers are looking to other unsecured loans to finance property upgrades. Craig Braun of Renovate America Inc. concurred, citing a "hassle factor," whereby contractors do not want to spend inordinate amounts of time explaining PACE as a financing mechanism after already spending an hour pitching the potential property enhancement. It's interesting to note, however, that Renovate has not seen a drop in borrowers qualifying for PACE as a result of ability-to-pay rules, which California enacted last year. Indeed, Braun said, "Average FICO scores have only declined by a marginal amount, by about 10 points."

Panelists noted that while volume will likely not reach the historic heights that we have seen in years past, driven by the residential side, PACE continues to serve a public policy good. Given new building requirements, such as the California Building Standards Commission approving mandatory solar installation on new residential properties starting in 2020 and the Los Angeles City Council's Ordinance requiring seismic resiliency efforts, there will be strong demand for financing such improvements. In addition, California's Senate Bill 465 was amended to allow community facilities districts to use PACE as a financing alternative for fire-hardening efforts.

In contrast to residential, commercial PACE has good momentum with increasing origination volume and other milestones, including the first single asset C-PACE securitization (Petros PACE Finance) and the first 144A C-PACE securitization (CleanFund Commercial PACE Capital) coming to market in 2018. Mansoor Ghori of Petros PACE Finance, LLC has a positive outlook on C-PACE, given its growing pipeline. Ghori noted the concentration in C-PACE originations, with 80% of volume occurring in six states and Ohio surprisingly accounting for 20% of PACE liens, at roughly \$200 million.

Stephanie Mah, vice president at Morningstar Credit Ratings, LLC, agreed that the commercial side will drive much of the growth across PACE this year, with new construction and resiliency leading the way. Mah said, "As the green bond market has evolved and market participants have become more comfortable with the asset class, attention has expanded from solely climate change concerns to conversations regarding resiliency."

The panel closed with participants' outlook on developments outside the U.S. Europe has a 2020 pilot in place where it will roll out first in Catalonia, Spain and then across Europe. Canada is also seeing progress, specifically in Alberta, where PACE legislation was recently passed. Each region is likely looking to the U.S. as a model because PACE has experienced solid growth here.

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