

## ABS Research

# Tornado Activity Has Likely Had a Limited Impact on PACE

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### Morningstar Perspective

A flurry of tornadoes passed through several U.S. states at the end of last month, leaving behind a vast trail of destruction, particularly in Ohio and Kansas, where both commercial and residential properties suffered extreme damages. Morningstar Credit Ratings, LLC examined the exposure in our commercial PACE portfolio and found a roughly 53% concentration in the states that were recently hit by tornadoes and expects limited impact on the transactions, along with mixed implications for the PACE industry. Furthermore, we believe that an increase in natural disasters might also present opportunities for PACE expansion.

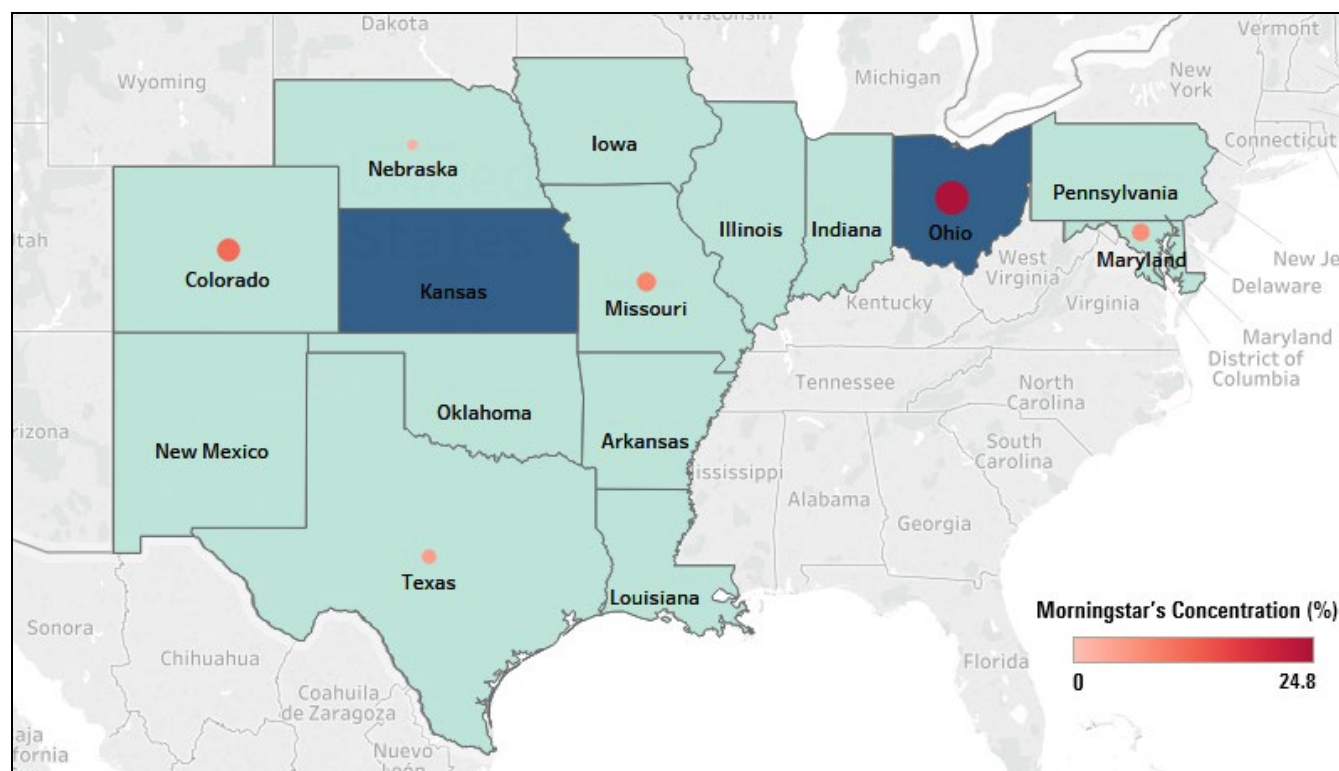
Across the states recently hit by tornadoes, Ohio accounts for the largest share of the underlying properties in C-PACE securitizations we rate, at 24.8%, with the city of Dayton experiencing significant damages. Dayton is in Montgomery County, which accounts for 4.4% of our overall portfolio. A strong tornado also struck Kansas in May, and a state of emergency was declared for the region. However, our rated portfolio does not currently have any exposure in Kansas because the state has not yet passed PACE-enabling legislation. Exposure in residential PACE programs is negligible because only California, Florida, and Missouri have active R-PACE programs.

### Morningstar's C-PACE Exposure in the States Recently Hit by Tornadoes

State	%
Ohio	24.8
Colorado	8.4
Missouri	7.4
Maryland	5.9
Texas	4.3
Nebraska	2.2

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## Morningstar Concentration in Areas of Recent Tornado Activity



Sources: NOAA, Morningstar

Ohio has four active C-PACE programs, according to PACENation, an industry nonprofit organization dedicated to advancing PACE programs. Dayton, which suffered colossal damage from the recent tornado activity, is a participant in C-PACE through Ohio PACE, which is run by the Greater Cincinnati Energy Alliance. The GCEA is a nonprofit organization devoted to creating energy-related economic development programs to support energy efficiency and renewable energy projects.

According to the National Oceanic and Atmospheric Administration, tornado activity across the United States has ramped up significantly this year, with almost 750 tornadoes reported in the months of April and May alone, compared with around 300 during the same period last year. The months from April through July have typically been considered the peak season for tornadoes in the U.S., and it was no exception this time round.

A major part of the Midwest has been prone to tornadoes, earning it the moniker of "Tornado Alley." The definition of territories included has expanded over the years. While Tornado Alley initially included Kansas, Nebraska, Oklahoma, South Dakota, and Texas, severe tornadoes have also touched down in Illinois, Indiana, Iowa, Minnesota, Missouri, Ohio, and Wisconsin. Each of the states has C-PACE programs in differing stages of development, as can be seen in the table on page three. The exposure across our R-PACE portfolio is negligible, with only a 0.4% concentration in Missouri.

**PACE Programs Across States Experiencing Tornado Activity in 2019**

State	PACE Program Status	Active PACE Program	
Arkansas	Active	Arkansas Advanced Energy Equity Program (A2E2)	■
Colorado	Active	Colorado C-PACE	■
Illinois	In development	-	■
Indiana	N/A	-	■
Iowa	N/A	-	■
Kansas	N/A	-	■
Louisiana	N/A	-	■
Maryland	Active	MD PACE	■
		Montgomery County PACE	■
Minnesota	Active	MinnPACE / St. Paul Port Authority	■
		Southwest Regional Development Commission (SRDC)	■
Missouri	Active	Missouri Clean Energy District	■
		Missouri Energy Savings Program (MO-ESP)	■
		Set the PACE St. Louis	■
		Show Me PACE	■
Nebraska	Active	Omaha PACE	■
New Mexico	PACE-enabled	-	■
Ohio	Active	Columbus Region Energy Fund PACE	■
		Northeast Ohio Public Energy Council (NOPEC)	■
		Ohio PACE	■
		Toledo-Lucas County Port Authority / Betterbuildings Challenge	■
Oklahoma	PACE-enabled	-	■
Pennsylvania	In development	-	■
South Dakota	N/A	-	■
Texas	Active	Lone Star PACE	■
		Texas PACE Authority	■
Wisconsin	Active	Milwaukee PACE	■
		PACE Wisconsin	■

Source: PACENation

■ Null ■ Commercial ■ Residential/Commercial

Morningstar does not expect overall loan defaults to surge over the long term because insurance will likely help businesses to avoid interruptions and cover the gap in service. However, we do not rule out a short-term rise in delinquencies during the post calamities payment cycle because of the sheer property devastation that these tornadoes may bring. In addition, refinancing could also be a second potential problem for properties whose value might drop as a result of such calamities. While governments are still assessing the extent of the recent damage, we have yet to see the exact impact on properties. To date, there have not been any C-PACE delinquencies reported in our portfolio.

While recognizing that heightened tornado activity creates worries for property owners, the increase in occurrence of natural disasters also presents a growth opportunity for the PACE market. As property owner interest in taking proactive measures to avoid future damages by upgrading their buildings with various enhancements increases, they will likely turn to PACE to help them finance such measures, which include resiliency to seismic damage, modifying landscape to minimize water flow, bolstering backup power sources, installing high-impact windows and doors, and installing wind- or fire-resistant roofing.

Indeed, Morningstar published a research report in September of last year addressing this topic, titled [Natural Disaster Retrofitting Is Likely to Drive PACE Growth](#). Often, legislation can be a catalyst to future PACE-funded retrofits as property owners seek to make their properties more resilient to natural disasters. For example, California legislators have required seismic resiliency in certain buildings and have promoted other resiliency measures such as fire hardening efforts.

Morningstar expects to see wider use of PACE programs as more states enact PACE legislation, helping property owners to outfit their buildings to better withstand these extreme weather occurrences. As more and more counties start sponsoring such resilience programs, the scope and demand for PACE assessments is likely to increase.

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