Takeaways From ABS East

Optimism Around PACE Persists, Despite Low Issuance

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Morningstar Perspective

The tone of yesterday's ABS East panel on property assessed clean energy didn't cement itself until the very end. In his concluding remarks, Tim Condon, CFO of Ygrene Energy Fund, said that 2018 is a weird year to be optimistic about PACE, given the decline in issuance volume, but "there's very clearly a place for the PACE industry in terms of advancing public initiatives and providing a form of financing for consumers that makes better sense than other alternatives they would have." The sentiment from the other panelists also indicated that they believe PACE has an opportunity to grow and that the short-term dip in issuance volume doesn't mean interest in the asset is lacking.

Shawn Rose, a director at Deutsche Bank, estimated that PACE issuance so far this year is hovering around $795 million, and 2018 will likely conclude at a level well short of 2017's $1.5 billion and 2016's $1.7 billion. However, he said investors are interested in commercial PACE, where the energy-efficient improvements being financed are on commercial properties. Also, he expects the investor pool to expand to include Europe, but any issuers looking to enter the region will need to first comply with European risk-retention rules.

Legislation for consumer protections has legitimized the industry. California has been the leader in introducing and passing new legislation because that's where PACE first emerged, and new regulations are still coming in. Two California bills (Assembly Bill 2063 and Senate Bill 1087) are awaiting approval from Gov. Jerry Brown, according to Craig Braun, senior vice president and head of capital markets at Renovate America. Brown has until Sept. 30 to sign or veto the bills. However, in California, if the governor doesn't take action, the bills still go into effect. An example of one of the provisions in these bills is that income from a spouse or domestic partner will be considered when determining a property owner's ability to pay back the assessment.

However, Condon believes that the regulations have slowed residential PACE issuance volume, as originators try to be compliant and figure out the best approach, especially with requirements for contractor training hours in California that go into effect Jan. 1, 2019. To be proactive, Ygrene is going “directly to the consumer more because that resolves some of the issues around appropriate disclosure for customers if we can talk to them directly the first time.”

PACE has reached multiple milestones in its short lifespan. Despite previous private C-PACE deals, this year marks the first public C-PACE asset in the market--$115 million in underlying collateral that came from CleanFund Commercial PACE Capital, Inc. Greg Saunders, CEO of CleanFund, said that it was important to go public because the company wanted to give a large number of investors access to the deal. “It’s amazing. This is my fifth ABS conference. This is the first one where we really have any C-PACE securitizations to talk about. In the last 12 months, we’ve had three, and there’s another one coming as well. It’s really encouraging to see issuers tap into the capital markets.”

In addition, Morningstar Credit Ratings, LLC considers PACE assets to have low credit risk because of their nature. For example, Stephanie Mah, a director at Morningstar, explained that PACE assessments have an equal lien position with property taxes and are senior to the mortgage. They’re also not likely to be a significant financial burden to a property owner because they have a maximum lien-to-value ratio of only 15% and are paid over five to 30 years. She added that liens are generally not extinguishable through bankruptcy and are tied to the property, rather than the borrower. These are among the reasons Morningstar considers PACE to be low credit risk.

Using PACE assessments to finance energy-efficient projects has proven to be an effective strategy, and performance reflects this. Braun said data shows that PACE borrowers either pay on par or slightly better than the average consumer. This makes sense because those who utilize PACE now had to seek out information on the program and are more intent on lowering homeownership costs via these improvements.

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