ABS Research

PACE Is Set to Take a Bite Out of the Big Apple

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Morningstar Perspective

As climate change concerns are increasingly taking center stage, state and local governments are passing measures that promote reductions in fossil fuel usage and encourage alternative energy efficiency initiatives. Historically, California has been at the forefront of addressing climate change concerns in the United States; however, in the past two months, New York City and New York state have each introduced legislation that presents the toughest emission reduction standards across the entire nation. As property owners strive to adhere to these new requirements, Morningstar Credit Ratings, LLC believes that property assessed clean energy programs could play a pivotal role in helping them become compliant. As they adopt these new measures, New York PACE assessments may appear in future securitized pools, thereby increasing geographic diversity.

40x30, 80x50 for New York City

On April 18, the New York City Council passed the Climate Mobilization Act, a set of bills aimed at improving the carbon footprint of New York City's buildings and mitigating the effects of greenhouse gas emissions from those structures. Two important components of the act support the development of PACE. Introduction 1253-C, also known as Local Law 97, mandates that the city achieve a 40% GHG emissions reduction over 2005 levels by 2030 and an 80% reduction by 2050, also known as "40x30, 80x50." While the details are still being worked out, a new group, called the Office of Building Energy and Emissions Performance, which falls under the existing Department of Buildings, will spearhead the development and implementation of the regulations.

The GHG emissions reduction requirements apply to commercial, industrial, institutional, and residential buildings over 25,000 square feet. However, buildings with rent regulations are exempt from the mandate because there was concern that property owners might raise rents, which is allowable when paying for major capital improvements. Other exemptions include city buildings, such as those managed by the city's health and hospital corporation, colleges under the City University of New York system, and institutions that fall under the Cultural Institutions Group. In advance of the new GHG emissions reduction requirements, building owners are urged to map out a strategy to be compliant.

Introduction 1252-A, also known as Local Law 96, is the PACE-enabling legislation that paves the way for building owners to use PACE financing to help them pay for renewable energy and energy efficiency retrofits. NYCEEC, New York City's commercial PACE administrator, anticipates financing becoming available to property owners by early 2020. The New York City Mayor's Office of Sustainability estimates that nearly 12,000 properties are likely to do some work to meet the new targets, with the overwhelming demand coming from multifamily dwellings. While the current legislation does not specifically allow PACE to be used for new construction projects, speakers at the Building Energy Exchange's recent Climate Mobilization Act seminar on July 17 indicated that they expect legislators to include an addendum soon to accommodate such projects.

New York State Follows Suit

Similarly, on June 19, the New York State legislature passed Senate Bill S6599, also known as the Climate Leadership and Community Protection Act, and Gov. Cuomo signed the bill into law on July 18. Its requirements are similar to those of the city's but are slightly more stringent over the longer term, with a requirement to reduce GHG emissions 40% by 2030 and 85% by 2050 over 1990 levels. In addition, the mandate also includes producing 70% of electricity from renewable sources, increasing energy efficiency from 2012 levels by 23%, and achieving a 100% reduction in the electricity sector's GHG emissions by 2040. Although the state passed PACE-enabling legislation in 2009, there is only one active C-PACE program, the Energy Improvement Corporation's Energize NY Finance Program. The new requirements of SB S6599 may serve as a catalyst to additional programs being created.

Geographical Expansion May Lead to More Diverse Underlying Pools

Morningstar's outstanding portfolio of residential PACE securitizations includes underlying assessments from California, Florida, and Missouri. Across C-PACE securitizations, the underlying assessments are more diverse from a geographical perspective but are heavily concentrated in a handful of states. Ohio, Connecticut, and California account for the top three states, representing nearly 60% of the underlying assessments, with the remaining 11 states having single-digit proportions. As New York becomes active in PACE, future securitizations may contain assessments from New York, which will help to further geographically diversify the underlying collateral. Indeed, attendees at the CMA seminar said that they expect New York to become the largest PACE market in the country.

New York Sets the PACE

While California was the birthplace of PACE, it looks like New York wants to be the pioneer in mandating the country's lowest emissions targets. Morningstar expects usage of PACE to increase, as property owners strive to meet these requirements and look for ways to finance these energy efficiency measures. We also believe this may translate to more diverse pools of securitized PACE assessments.