NYU STERN

Center for Sustainable Business

Spring 2022 Sustainable Business Pitch Competition

Client: Wells Fargo

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Wells Fargo's Sustainability Commitments are aligned with the PACE program

As both the acceleration of climate change and the regulatory pressure to mitigate it intensify, Wells Fargo has reckoned with its emissions and set substantial commitments to address them.

To achieve net-zero greenhouse gas emissions by 2050, Wells Fargo will work with clients to help finance their emissions reduction efforts.

As part of the Climate Mobilization Act, and in concert with NYC's Local Law 97 which sets emissions caps and penalties on large buildings, PACE financing (Local Law 96) offers low-cost, low-interest loans for property owners to make sustainable capital improvements.

Participating in the program can help Wells Fargo to reach its ESG goals

To achieve net-zero greenhouse gas emissions by 2050, including financed emissions, Wells Fargo has committed to:

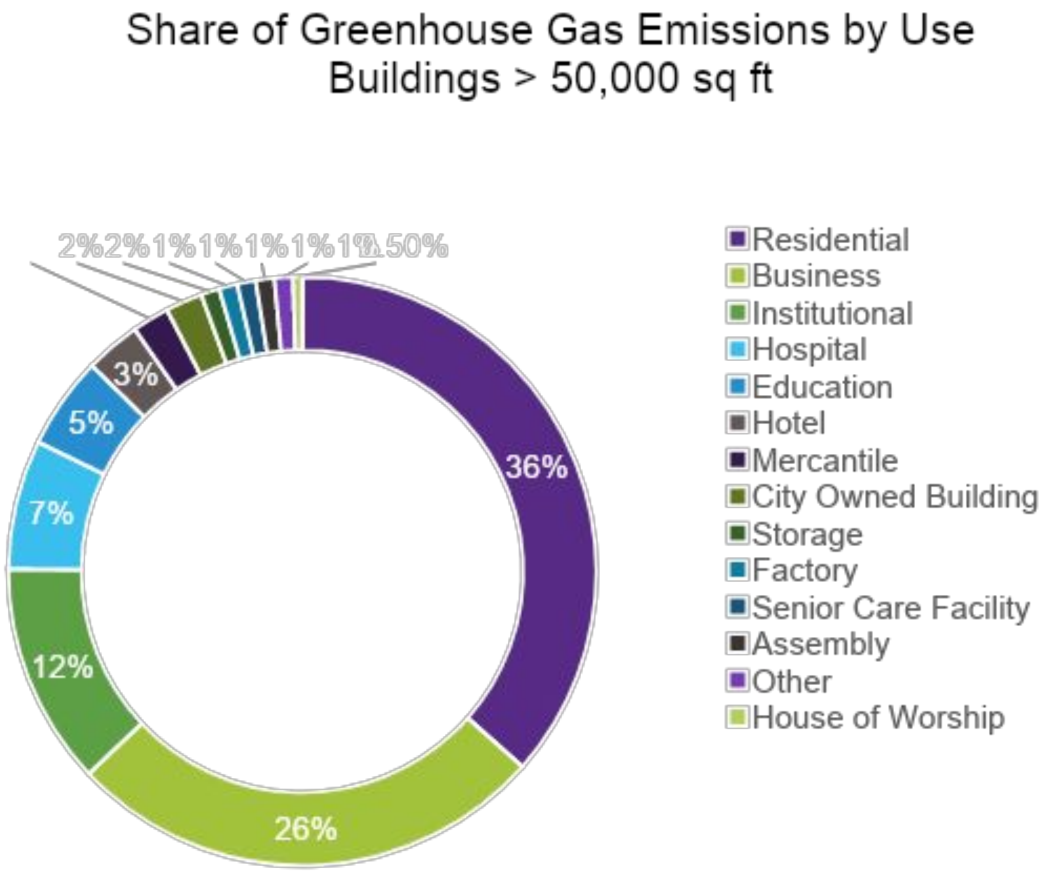
1. Working with clients to help finance their emissions reduction efforts….and advocate for policies the enable client transactions → PACE financing will help over 400 Wells Fargo borrowers make sustainable upgrades that reduce their carbon emissions.

2. Driving innovation and accelerating market-based solutions to the climate crisis → PACE creates opportunities for new lines of business in green financing.

3. Transparently disclosing our progress, including working to include all Scope 3, financed emissions → By supporting borrowers' emission reduction efforts, WF will reduce their reported Scope 3 emissions, which are increasingly demanded by investors.

4. Building strategic environmental and social risk management (ESRM) practices → Becoming a PACE loan originator will reduce risk by improving clients' ability to repay existing loans and increasing the value of the loan collateral.

Real estate accounts for 71% of NYC’s total emissions

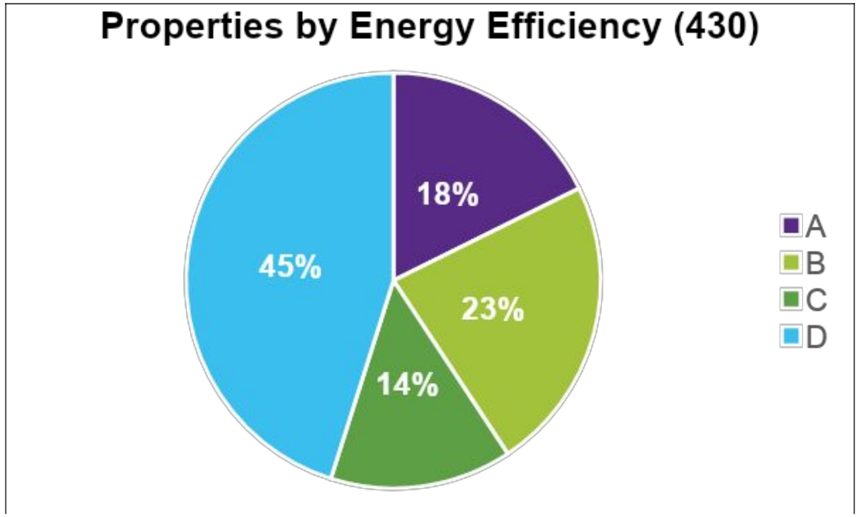


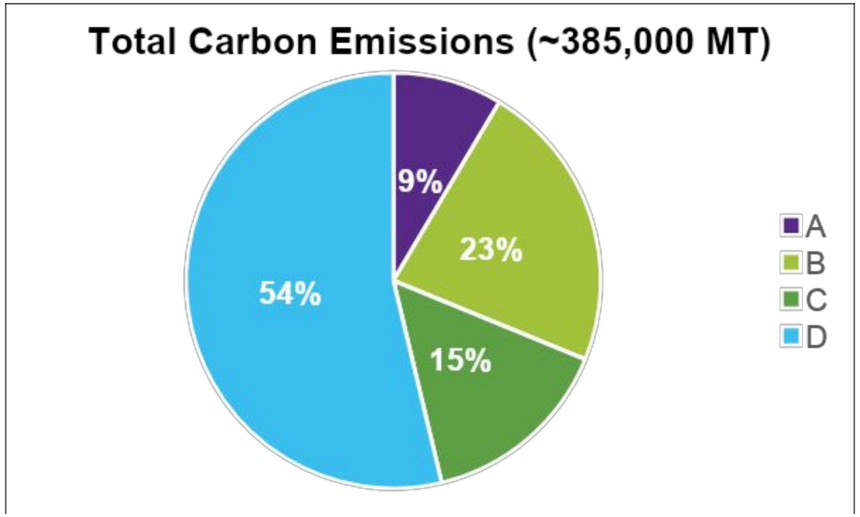
71% of NYC's greenhouse gas emissions are from buildings

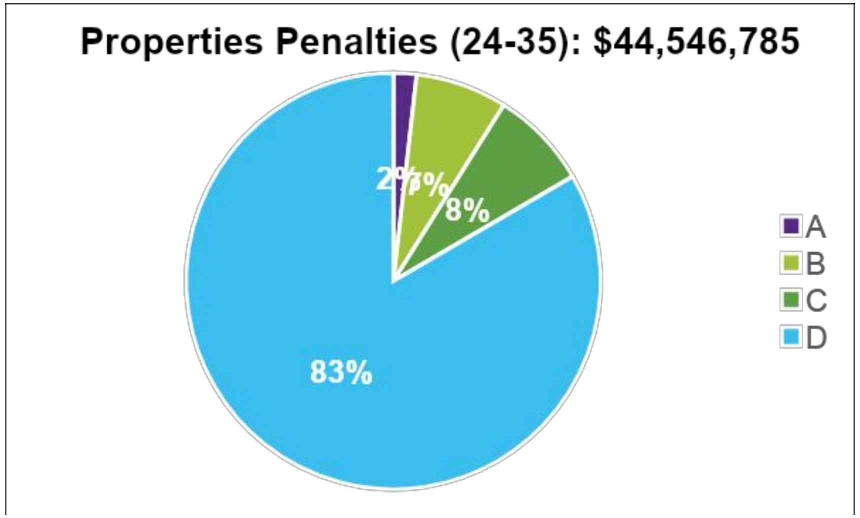
The NYC Climate Mobilization Act will reduce building emissions 40% by 2030

Source: New York City Council https://council.nyc.gov/data/green/

Nearly half of Wells Fargo’s portfolio are category D and are subject to significant penalties if emissions are not reduced







Not engaging with Local Law 97 & PACE exposes Wells Fargo to increased financial and reputational risks

Financial Risk:

<u>Overview:</u>

400+ Wells Fargo borrowers subject to penalties amounting to nearly $35 million starting in 2024.

- **Increase in loan defaults:** Penalties significantly impact borrower’s cash flows and ability to service existing debt
- **Lost business opportunities:** Significant penalties cause project delays and deter borrowers from investing in new projects

Reputational Risk:

<u>Overview:</u>

With growing emphasis on ESG reporting, regulators and investors are enforcing environmentally sustainable guidelines.

- **<u>Access to capital:</u>** With Scope 3 emissions reporting to be mandated by SEC, public and institutional investors expect companies to be more environmentally responsible.
- **<u>Competitive positioning:</u>** With J.P. Morgan and BofA making significant ESG commitments, Wells Fargo will need to keep pace with its competition.

Wells Fargo could benefit from the PACE program due to new business, improved underwriting, and enhanced branding

- **New Markets:** With PACE supporting legislation active in 38+ states, including California, Florida and New York, there is a massive national market opportunity.
- **Green Financing Products:** The PACE loan provides an opportunity to diversify Wells' product suite and build a robust Green Financing Platform, offering several cross-sell opportunities.

Underwriting

- **Improves borrower cash-flows:** With improved building energy efficiency, borrowers can achieve ~22% savings in utility and energy costs
- **Increases collateral value:** Retrofits improve property value and thereby reducing LTV ratios
- **Limited default exposure:** Knowledge and tools to monetize financial return on sustainability investments

Social Impact

- **ESG Commitments:** With a $500 billion commitment to sustainable financing by 2030, Wells Fargo could leverage the PACE program to reach this goal.
- **Access to capital:** With growing demand in the green bond securitization market, Wells Fargo could unlock additional sources of patient, long-term capital.

Case Study: Improved borrower cash-flow reduces default risk

Background: A property owner has an 18-unit, multifamily building and is ready to refinance and make some efficiency improvements. Working with a certified engineer, the owner, obtains an energy audit and plans to complete work that will cost $45,000 and will reduce the property's utility bills by 40 percent. The owner's loan officer provides two loan options: one, based on historical income, and a second taking into account the results of the energy audit and underwriting half of the projected savings.

Key Takeaway: Underwriting based on efficiency savings allows the property owner to support additional debt service and obtain sufficient financing to complete the desired efficiency projects.

Income	Historical	Energy Efficient
Effective Gross Income	$336,938	$336,938
Less Expenses:		
Water & Shower	$13,500	$10,800 (20% lower)
Heat	$17,550	$14,040 (20% lower)
Electric	$7,020	$5,616 (20% lower)
Other Expenses	$108,899	$108,899
NOI	**$189,969**	**$197,583**
Debt Service	$151,976	$158,067
Loan Amount	$2,293,470	$2,385,393
Property Value	$3,454,000	$3,592,000
LTV	66%	66%
DSCR	1.25	1.25
Per Unit	**$5,107**	

Wells Fargo can create a team and structure for PACE loans to simultaneously grow business and meet the firm’s ESG goals

A combined system of incentives and penalties will facilitate Wells Fargo’s green transition

Decarbonization Finance Team

- Establish PACE approval criteria, including loan-to-value ratios and accounting standards
- Capital improvement consulting to connect developers to sustainable suppliers and contractors
- LL97 compliance support

Carbon-anchored Loans and Mortgages

- Pitching PACE in mortgage refinancing conversations
- Offering temporary rate declines based on CO2 reduction

Portfolio Decarbonization

- Protect against high-emission projects with clauses in loans
- Establish a base, net-zero interest rate and then increase the rate based on projected emissions

Wells Fargo is well-positioned to deal with the minimal risks and challenges they may face

	PACE Loans and Lien Priority	Potential Lack of Customer Interest	Potential Regulatory Changes
Risk	PACE loans take lien priority, a risk for the mortgage holder in the event of a default.	Real estate industry has demonstrated minimal interest in PACE financing to date.	Will Eric Adams defang LL97 penalties and fail to pursue stronger environmental regulations?
Mitigant	Unique structure of PACE minimizes losses, and the upgrades improve the value of building, lowering default risk.	PACE can be leveraged to fuel demand as LL97 deadlines approach, potentially wining market share from competitors	With effects of Climate change accelerating, interest in sustainability among consumers, government, and industry is growing. Green buildings are the future, embrace them

The structure Wells Fargo creates for the PACE program can be scaled up for use with other green finance products, markets, and geographies

"Climate change is one of the most urgent environmental and social issues of our time, and Wells Fargo is committed to aligning our activities to support the goals of the Paris Agreement and to helping transition to a net zero carbon economy." - Charles Scharf, Wells Fargo CEO

Build on Wells Fargo's existing track record ($75B in financing provided to sustainable businesses from 2018-2020)

- With a $500B commitment to green financing, Wells Fargo should consider integrating PACE program with its green financing platform and offer PACE as part of its product suite

Implement features of PACE loan program in other sustainability initiatives

- Coordination by Decarbonization Finance Team
- Use of carrots and sticks to incentivize emissions reductions
- Educate customers about green financing options

Take credit for your good work!

- Stake out a first-mover advantage
- Enjoy the reputational upside as shareholders, employees, and other stakeholders take an increasing interest in sustainability

Appendix

Property Portfolio Review – Wells Fargo NYC