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| BSA response  Environmental Audit Committee Inquiry into Energy Efficiency  Restricted  June 2020 |
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# Introduction

The Building Societies Association (BSA) represents all 43 UK building societies, as well as 6 credit unions. Building societies have total assets of nearly £430 billion and, together with their subsidiaries, hold residential mortgages over £335 billion, 23% of the total outstanding in the UK. They hold over £295 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies account for 39% of all cash ISA balances. They employ approximately 42,500 full and part-time staff and operate through approximately 1,470 branches.

The BSA welcomes the opportunity to respond to the Environmental Audit Committee's inquiry into the Energy Efficiency of Existing Homes. We have limited our responses to areas where our members have an interest.

**Are the Government’s targets on residential energy efficiency still appropriate to achieve its ambition to reach net zero emissions by 2050?**

The BSA recognises the importance of improving the energy efficiency of the UK's homes in order to bring down carbon emissions and meet the UK's climate change targets. As mortgage lenders, building societies have a clear interest in good-quality housing. Tackling climate change also has the secondary benefit to building societies of reducing the likelihood of severe weather events such as flooding which can damage homes and potentially affect a lender's mortgage security.

However, there is also a danger in moving too quickly and harming the consumers who could be left behind. Any transition to a low-carbon economy must be a just one. As such the BSA believes that the ambition shown in the Government's targets is about right. Our key message to the Committee is that there needs to be a balance between achieving high levels of energy efficiency and the costs to consumers of upgrading their homes. This needs to be a gradual path rather than a 'big bang'. We feel that current targets, though challenging, respect this balance but there must be a clear path from Government, set out at the earliest opportunity, so that costs to industry and consumers can be managed over time.

To take the example of the current energy efficient requirements in the private rented sector, the Government expects the cost of upgrading a home from F or G[[1]](#footnote-0) to the minimum E rating to be around £1,200 on average. The cap on costs is set relatively high – meaning landlords can only apply for an exemption if the work costs more than £3,500. Using the Government's estimate that the average upgrade would save around £180 a year in energy costs, it would take almost 20 years for a landlord paying just under the £3,500 threshold to make their expenditure back in savings for their tenants. While this work would likely add value to the property if the landlord sells in the meantime, or at least preserve its value as a rental asset, it is nonetheless a significant up-front cost for which there is a split-incentive in that the landlord does not directly receive the energy saving benefit.

It is also important to note how far the UK has come in the last twenty years or so. As the English Housing Survey notes:

'In 1996, a higher proportion of private rented homes (39%) were in F or G bands compared with the proportion of owner occupied (30%) and social rented (20%) homes. By 2016, the proportions of the tenures in F or G bands had decreased to 7%, 5% and 1%, respectively.'

To an extent energy efficiency improvements will continue to happen 'naturally' with advancements in technology such as better boilers and adoption of solar panels and improved building and retrofitting methods, such as the use of Modern Methods of Construction.

There have also been advances in reducing fuel poverty, as noted in the Clean Growth Strategy:

'In particular, progress has been made to upgrade the homes of those living in fuel poverty: the number of fuel poor households in England living in homes at energy efficiency rating E or below reduced from 1.8 million in 2010 to 920,000 in 2015'[[2]](#footnote-1)

Where we would like to see Government go further is in announcing a firm timetable and any incentives for consumers to improve energy efficiency, or fines if they don't, so that lead-in times can be managed. As buy-to-let lenders, building societies have to assess the risk of some of the landlords they lend to not being able to rent out properties if they do not meet the energy efficiency standards. They can work with landlords to anticipate any change if they are aware far enough in advance, but this becomes more challenging the shorter the timeframe.

In addition to the Minimum Energy Efficiency Standards, the aim in the Clean Growth Strategy for *as many homes as possible* to be EPC Band C by 2035 extends this risk beyond the private rented sector, though it is unclear whether the Government intends to introduce fines for non-compliance in the owner-occupied sector. In any case, although building societies are aware of the Government's aspirations for energy efficiency it will be difficult to quantify the impact of these policy proposals until there is a clear timetable and understanding of their scope and any incentives or sanctions for landlords and homeowners to comply.

As a final point, the BSA also has an ongoing work-stream looking at Modern Methods of Construction (MMC) which offers the potential to produce more energy efficient housing stock in the future. We are involved in the Ministry of Housing's MMC Working Group and see great promise in MMC for improving energy efficiency through factory design and precision engineering making it easier to produce homes to high standards such as Passivhaus.

**What are the potential risks and opportunities of bringing forward the Government’s energy efficiency target?**

A clear positive effect of bringing forward targets will be making the energy performance of a home a much more prominent driver in people's decisions on which home to buy. This in turn should help to grow the supply chain for retrofit works and increase demand for energy efficient homes.

There will be clear opportunities for the businesses in moving towards a low-carbon economy. There are likely to be SME builder jobs created by firms carrying out retrofit and in transitioning trades such as boiler engineers towards heat pump installation and renewables. The Trustmark Retrofit framework also requires a significant increase in the numbers of qualified EPC assessors and retrofit coordinators. There is a significant need for investment in training and skills in these areas. A net zero economy could also lend itself to high-tech jobs in creating low carbon technologies such as moving the energy grid away from gas.

Unfortunately we can also foresee significant negative effects on the house sales market if requirements are brought in too quickly with little time to prepare.

Firstly, there is a risk of 'stranded assets' with homes where it is not technically feasible to retrofit the fabric of the home with the result that in extreme cases these may need to be demolished and rebuilt unless there are appropriate exemptions.

Secondly, if a homeowner cannot afford to carry out the works needed to meet the Government target, and cannot find a willing buyer then there is a risk of people being stuck in a home they are unable to sell.

Thirdly, the proposals could have a disproportionate effect on first-time buyers who tend to borrow at higher loan-to-values.

Finally, we can see a risk of negative equity. For example, if a borrower has a high loan-to-value mortgage when energy efficiency requirements come in, their equity will in theory be eroded by the cost of the works from day one. Should they fall into payment difficulty and the lender is required to repossess then the borrower could owe more than the home is worth preworks, unless there is an exemption from meeting the target for a mortgagee in possession. There is a question whether lenders will also need to hold more capital against such loans, making it more expensive to lend and potentially leading to a lack of finance for energy inefficient homes.

**Should Government targets for energy efficiency be legislated for, and if so, what difference would this make?**

Legislation could be a useful tool if it requires Government to account to Parliament for progress on energy efficiency targets. This would likely drive greater focus and investment of resources into tackling the issue. However, the BSA believes legislators need to be careful that any law does not become a blunt tool with potentially serious unintended consequences for consumers, as outlined above. Rather than consumer-facing legislation it may be more productive for any legislative tools to require the Government to set out a timetable of the phases for tightening up energy efficiency requirements through regulations.

**How effective is the EPC rating at measuring energy efficiency? Are there any alternative methodologies that could be used? What are the challenges for rural areas?**

The BSA provided policy input and two of our members were involved in a consortium which undertook the LENDERS project seeking to better reflect household energy costs in mortgages applications.[[3]](#footnote-2) While the BSA is certainly supportive of measures to improve energy efficiency, we did have some concerns that incorporating the EPC into the mortgage process in the way LENDERS suggested would not provide the behavioural nudge the Government is looking for.

One of our key concerns was around the accuracy of EPCs and the gap between predicted energy use and actual performance. The Government has since consulted[[4]](#footnote-3) on improving EPC data quality and we will follow the outcome with interest.

**Is the £5 million Green Home Finance Innovation Fund enough to stimulate the market for and drive action from the banks to encourage owner occupiers to improve the energy efficiency of their homes?**

**What policy and/or regulation could supplement it?**

The Green Home Finance Innovation Fund was a good first step in encouraging lenders including banks and building societies to think through how they would create a green mortgage proposition. One of our members, Monmouthshire Building Society, has been successful in receiving funding from the competition.

The BSA is aware that the Green Finance Strategy suggests that lenders should be required to help customers improve the energy efficiency of their homes. We are yet to see the consultation paper but have been in conversation with Government about how this proposal would work in practice and the unintended consequences it could have, particularly if lenders were driven to be selective about which homes to lend against based on their energy efficiency.

There are barriers to overcome with regards to integrating energy efficiency into the mortgage lending process, including:

* Collation of the EPC ratings of homes in the mortgage book is not currently prioritised by most lenders. There is currently little incentive to do so, though this is changing with the Prudential Regulation Authority’s drive for lenders to better understand the transition risks they face[[5]](#footnote-4). While lenders are aware that Government will tighten regulations on rented homes, the ‘pathway to zero’ for residential homes is currently unclear. More visibility of this roadmap is needed to drive investment into understanding EPC data;
* The market around mortgage valuations is currently a low-cost, largely commoditised process which prioritises quick completion to reduce the time to mortgage offer. There is a reluctance by lenders to pay for extra services and a reduced number of skills in the valuation sector to understand the energy efficiency of buildings and the impact on valuations;
* A common understanding is required by the consumer, lender and valuer on the work that can be completed on a property that impacts energy efficiency and by how much. Additionally it is important to understand the order in which this work should be undertaken and what the energy efficiency benefit of each piece of work will be.
* Technology could be used to provide a plan for the consumer which highlights the energy efficiency opportunity but currently there is no market leader in this area.

In terms of other policy options and regulation, there may be opportunities with Help to Buy equity loan being wound down from 2021, to create a ‘Help to Green’ scheme which would provide equity loans for creating home improvements. A similar scheme already operates in Scotland.

As a sector building societies are looking at energy efficiency as part of a sector led taskforce, including representatives from 20 of our members. We are also working with the Green Finance Institute on the following projects:

* ‘*Energy performance and property value’* explores the relationship between energy performance and property valuations, supporting the financial case for retrofitting homes.
* ‘*Trustmark ‘Call to Action’ platform’* supports customers through the full retrofit journey: identifying improvements, sources of funding and finally linking homeowners into a reputable supply chain.
* ‘*Heat as a Service’* by [Sero Homes](https://www.serohomes.com/) (a zero-carbon builder) which uses technology to lower the carbon-intensity of heat.
* *’Building Renovation Passports’* presents the current sustainability performance of homes and offers homeowners an overview of potential improvement measures that could be taken to improve energy efficiency.

These projects are pilots to test how the big picture target of tackling building energy efficiency can be broken down and delivered in practice.

**What additional policy interventions are needed for social housing, leaseholders, landlords and tenants?**

The BSA agrees that the private-rented sector should be the initial priority for efforts to drive energy efficiency. As the English Housing Survey notes, of the 1.1 million homes with F or G ratings, 28% were in the private rented sector compared to their 20% tenure share.[[6]](#footnote-5)

There is an opportunity now to reflect on the current MEES which came into play in April 2018. The BSA is not aware of any significant difficulties for building societies with properties in their buy-to-let books failing to meet the current requirements – though the proportion of properties in the lowest F or G categories is small at around 6%.[[7]](#footnote-6) It may also be that tenancies have not come up for renewal or that these cases will come to light when domestic properties with existing tenancies are required to meet the MEES in 2020.

As stated earlier the Government's own estimates suggest that the average cost for landlords to upgrade a property from an F or G-rating will be £1,200 on average, capped at £3,500[[8]](#footnote-7). This could be quite a significant cost for a landlord to bear and some may choose to sell the property to an owner-occupier rather than bear the cost. The Government's aim for as many private-rented homes as possible to have a C rating or above by 2030, as expressed in the Clean Growth Strategy, will certainly be more challenging – given that around two-thirds of the UK's homes have an EPC rating below C according to our calculations set out in the table earlier in this paper.

There may be a role for building societies to finance energy efficiency improvements via a further advance on the mortgage. The rationale would be that energy efficiency should add value to the property, therefore making it better mortgage security for the lender, particularly if the landlord plans to repay their buy-to-let mortgage by selling the property in the future.

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|  | www.bsa.org.uk  The Building Societies Association (BSA) is the voice of the UK’s building societies and also  represents a number of credit unions.  We fulfil two key roles. We provide our members with information to help them run their  businesses. We also represent their interests to audiences including the Financial Conduct  Authority, Prudential Regulation Authority and other regulators, the Government and  Parliament, the Bank of England, the media and other opinion formers,  and the general public.  Our members have total assets of over £420 billion, and account for 23%  of the UK mortgage market and 19% of the UK savings market. |

1. <https://www.gov.uk/government/news/energy-upgrades-for-coldest-privately-rented-homes-to-save-billpayers-180-a-year> [↑](#footnote-ref-0)
2. <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/700496/clean-growth-strategy-correction-april-2018.pdf> P. 75 [↑](#footnote-ref-1)
3. <https://www.ukgbc.org/wp-content/uploads/2017/09/Lenders_Core_Report_1.pdf> [↑](#footnote-ref-2)
4. <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/729853/epcs-call-for-evidence.pdf> [↑](#footnote-ref-3)
5. <https://www.bankofengland.co.uk/prudential-regulation/letter/2020/managing-the-financial-risks-from-climate-change> [↑](#footnote-ref-4)
6. <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/724339/Energy_efficiency_2016.pdf> p. 4 [↑](#footnote-ref-5)
7. <https://www.gov.uk/government/news/energy-upgrades-for-coldest-privately-rented-homes-to-save-billpayers-180-a-year> [↑](#footnote-ref-6)
8. Ibid. [↑](#footnote-ref-7)