Engaging Retail Lenders in Home Renovation

2023

Conclusions and Recommendations

2023 is the year when EU Governments and citizens began to see that addressing the thermal quality and energy efficiency of buildings through renovation is the bedrock for the delivery of a fair and net-zero emissions economy in Europe. **As a vehicle, the recast EU Buildings Directive (EPBD) seeks to establish the regulatory frame to stimulate increased renovation investments through 2030**. This is the moment when mortgage lenders must identify the “low hanging fruit” of the worst performing buildings and support the offer of public and private finance solutions to turn an inefficient and uncomfortable home into a modern, comfortable and climate-friendly one.

Most EU financial institutions are aware that the collateral against which they provide mortgages is largely inefficient and will fall out of alignment with the net-zero emissions pathway at some point in the coming years. Leadership in offering renovations to mortgage clients has largely been among lenders with voluntary forms of Mortgage Portfolio Standards, Science-based emissions reduction targets or in countries with Minimum Energy Performance Standards. Unlike buying a new home, or car, the renovation process is more complex and execution is provided by a multitude of local contractors whose warranties and standards are all very different. **Financial institutions who have been able to make renovation finance programmes work have also been able to rely on supportive measures provided by standards, contractor accreditation, improving technologies (like heat pumps) and increasingly sophisticated measurement tools and AI.**

Like LEDs, wind and solar, the “whole package” of energy performance renovation is receiving more and more attention, heat-pump technology has finally started to gain traction and the business process efficiencies of a growing market are slowly becoming apparent. **Point of sale financing that packages public and private components to provide the best offer to homeowners is a critical element of successful renovation delivery, and some mortgage lenders are years into building leadership here.**

The financial institutions implementing climate risk and mitigation measures, portfolio by portfolio, understand the highly material risk of inaction in mortgages, and are aware that there is a limited window of opportunity to work with Governments to jointly address and deliver shared objectives. This provides a unique backdrop for more formal processes which bring together impacted organisations with experts and policymakers to co-develop voluntary and regulatory approaches which together can accelerate the delivery of energy savings to homeowners. As ever, in the case of the delivery of such solutions, there is no single measure that will have unique success and finance is not the only barrier - nor even sufficient to provoke action in many cases. However, without long-term confidence that building owners will be provided with attractive finance options for the kind of deep renovations that can transform a home, office or school, there will be insufficient momentum to build a wave, and the outcomes will resemble “business as usual”.

Business as usual renovation rates do not serve homeowners, governments nor the EU, as they leave buildings exposed to energy price shocks and keep the EU energetically unfit and vulnerable. **An ambitious recast Buildings Directive is a once in a decade opportunity for Europe, and it must contain the financial measures recommended in this report to enable millions of EU citizens to save energy and see the real benefits and impacts of the EU’s new energy and climate ambitions.**

Recommendations to Policymakers

1.

Member States must set national minimum energy performance standards that require building owners with the buildings that waste the most energy to renovate them in a given timeframe. This must be supported by committed, long-term public funding instruments and technical assistance.

In order to have a chance to double energy renovation rates, national buildings renovation strategies need to be complemented with a **mandatory regime that delivers specific minimum portfolio energy efficiency improvements across the whole building stock with targets for 2030, 2035 and 2040 horizons.** Within this, upgrades of the worst-performing buildings need to be specified as they will have the most impact on the overall efficiency of the whole building stock - or national portfolio.

Public funding and financial support is an essential and complementary component in delivering this and must be **consistently available, easy to access and tailored to the different segments of building owners and building types**. Recovery and resilience funds made available by the EU Commission have been helpful in stimulating building renovation, and yet access to them, availability for up-front project development costs, and payment terms can be improved to increase their uptake. These public **support facilities need to be permanent in nature**, and not restructured with each new Government, as renovation projects can take years to develop and execute.

2.

Introduce a new EU-level instrument to help tens of millions of homeowners who can renovate but don't have access to attractive finance

EU mortgage lenders believe that up to 20% of their current mortgage holders may not qualify for additional or extended mortgage loans. **Without a new public-private financial instrument, a trillion euros of renovations for tens of millions of EU homeowners are unlikely to proceed.** Public guarantees are an under-explored way to enable lenders to offer more energy renovation loans and to reduce their costs to customers. An EU Renovation Loan[1] is an innovative and newly proposed EU-enabled financial instrument that combines an EU-level guarantee with ECB green liquidity to offer tens of millions of "homes with poor economics" (including the elderly) affordable debt offered through local lenders to insulate their homes from sky-rocketing energy prices and transition risks.

With an EU Renovation Loan, homeowners would pay interest and capital repayments at sale, transfer or after 30 years with an interest rate that is set at the EU's borrowing rate, i.e. lower than the current retail market. **ERLs can be pledged against the €13 trillion of home equity identified in the EU and turn this home equity into energy savings and local jobs to relaunch the EU Renovation Wave**. At a time when energy prices have spiked up, and interest rates are rising, quickly unlocking just 10% of the €13 trillion of EU home equity, often in the hands of the older generations, will stimulate renovation jobs, increase resilience to price shocks, improve thermal comfort and lower their energy costs. **Bringing new financial instruments into the mix that are distributed via mortgage lenders to their most needy clients is a quick, and so far largely untested way, to boost the uptake of energy renovations.**

[1] Climate Strategy & Partners. (2022). *The EU Renovation Loan: a new instrument to fund the EU Renovation Wave*. Retrieved from https://www.climatestrategy.es/press/ERLReport03112022.pdf

3.

Position Mortgage Portfolio Standards as a voluntary tool for Member States to use to better engage mortgage lenders and increase National Buildings Renovation ambitions

European lenders' voluntary use of Mortgage Portfolio Standards as a risk-identification and compliance tool for net-zero targets has been developing well in recent years. **Over one third of the largest European banks are already using some form of mortgage portfolio target setting and compliance mechanism.** Given the extent of these voluntary practices, **the recast buildings directive should launch a delegated act process to help develop, widen and deepen these good practices.**

A Commission-led Delegated Act process can engage leading EU lenders, compare best practices and give confidence to Member States in the promotion of voluntary Mortgage Portfolio Standards. Tools that align mortgages with national buildings renovation and energy efficiency ambitions can be reviewed in a harmonised way across the EU and involve all types of mortgage holders (retail lenders, funds, insurance companies, special purpose vehicles, asset managers). Such a process could offer a standard set of variables that reference the National Climate and Energy Plans of the Member State where the building collateral is located, and help support a pathway to net-zero for each building.

The delegated act process can lever the data found in ECB reporting on Climate Stress Tests[2], manage climate risks and establish a reference order for baseline energy data including: real energy use, EPC, statistical informed proxy and other estimates. **Mortgage portfolio standard trajectories can also be reviewed against the baselines used in Member States buildings renovation action plans**, CRREM and the binding EU-wide energy efficiency targets established by the Energy Efficiency Directive.

Finally, **the delegated act process has intrinsic value** as it will bring lenders together with policymakers, experts and representatives from Member States to jointly develop a solid framework which aligns with and has the capacity to deliver the optimum outcomes for homeowners and delivers the benefits of an EU Renovation Wave.

[2] European Central Bank. (2022). *ECB report on good practices for climate stress testing*. Retrieved from https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202212_ECBreport_on_good_practices_for_CST~539227e0c1.en.pdf

4.

Promote pragmatic solutions to address the data quality and availability issues relating to EU buildings renovation

Currently, there are 29 methodologies used to rate EPCs in the European Union, and these vary greatly in each Member State[3]. There has also been a sector focus on delivering national databases to give visibility and enhance the integration of the data within EPCs and with the financial and renovation processes. **It is already common practice among lenders to use multiple data elements from different sources in their operations, and in the future it is likely that operational and energy data will be sourced directly from energy bills, via proxies and from both "Renovation Passports" and "Digital logbooks" that are components of the recast Buildings Directive (EPBD).**

Renovation passports are expected to offer a clear building-specific roadmap for deep renovations and thereby help owners and investors plan the best timing and scope for interventions. Digital building logbooks can become a common repository for all relevant building data, including data related to energy performance such as energy performance certificates, renovation passports and smart readiness indicators, as well as on the life-cycle GWP of materials and indoor environmental quality. The use of Digital logbooks and related data repositories is being developed in several Member States[4]. These approaches already provide valuable insights on data collection and management:

- Digital logbooks (e.g. Madaster, Eigenheim Manager, GebäudePass)
- Building renovation passports (E.g. P2E, iSFP, EPC+)
- Advanced EPCs (e.g. Portuguese EPC, Danish EPC, Estonian EPC)
- Initiatives under development (e.g. Electronic building ID, Le carnet numérique du logement, Brussels BRP, Wikihabitat)

It is anticipated that the EU Commission will adopt implementing acts to support the efficient functioning of digital building logbooks, and this process can also align with the delegated act to develop voluntary Mortgage Portfolio Standards. Through these processes, **common templates for data collection, data management and interoperability can be developed and links to existing databases will be useful, as well as a recognition of the role of AI and other forms of proxies.**

It may take years to improve and standardise EPC databases[5],[6] and yet the EU Renovation Wave, mortgage lenders and climate action does not have this time to wait. There are multi-stakeholder processes looking to automate greenhouse gas reporting for 5.5 million SMEs in the UK[7], and teams providing 3D-models that deliver EPC-proxies instantly[8] so that banks can quickly identify solid energy renovation prospects from among their clients. Easily shareable, accurate, and assurable data must form the basis of these new approaches and enable mortgage providers to identify the least efficient buildings, or those exposed to future minimum energy performance standards, and make renovation finance offers.

Media contact:

Mauricio Yrivarren
Senior Research Associate, Climate Strategy

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Paseo Recoletos, 5, Oficina 604, 28004, Madrid, Spain
Email: info@climatestrategy.es
Tel local: +34 91 576 4837 Tel UK: +44 (0) 20 7193 4807

Linkedin and @Climatest

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[4] iBRoad2EPC. (2022). *Setting Building Renovation Passports (BRPs) up for success Frameworks, measures and elements in support of stepwise deep renovation of the EU building stock*. [Presentation]. Retrieved from https://timepac.eu/wp-content/uploads/2022/01/TIMEPAC_Session_1_Alexander_Deliyannis-_GR.pdf
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