UK FINANCE

Building a market for energy efficiency

UK Finance response to the BEIS call for evidence

January 2018

Introduction

UK Finance is a trade association formed in July 2017 to represent the finance and banking industry operating in the UK. It represents around 250 firms in the UK providing credit, banking, markets and payment-related services. The new organisation brings together most of the activities previously carried out by the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

In addition to representing residential mortgage lenders, UK Finance members also lend to support the social housing/ RSL sectors across the UK nations. We welcome the opportunity to provide this submission to the BEIS Call for Evidence on building of a market for energy efficiency.

General comments

Lenders support in principle affordable measures that can help customers to reduce household energy costs.

Against the backdrop of the need for government and the EU to address climate change issues and the role of reduced carbon emissions from housing in tackling this, we recognise and understand that it is timely now for the UK government to consider a range of proposals that might build and sustain a viable market for energy efficiency in relation to the UK housing markets.

The Call for Evidence raises a range of proposals and issues for mortgage lenders. Our comments here are intended to inform the development of more detailed formal consultation proposals.

The proposals and options in the Call for Evidence appear to be based on a range of assumptions including:

- That lenders have a beneficial interest in the "value" of energy efficiency including in relation to reduced potential for customer default, increased values of security properties and the potential for reduced capital costs/ capital requirements for lending on energy efficient properties
- That lenders have a role in promoting energy efficiency to both existing and new customers as part of ongoing customer relationship management, and new lending decisions
- That lenders should be tasked to improve the efficiency (or support efficiency improvements) of properties on which they lend, and that this could be effectively achieved by voluntary or mandatory targets.

We are not wholly persuaded, at this stage, that there is overall industry acceptance of such assumptions or that they should be regarded as "true" in all cases. We suggest that issues such as property value, mortgage affordability and the potential for default are influenced by such a range of factors that it might not be readily possible to isolate energy efficiency as a factor of material influence.

We also suggest that conduct and prudential regulation issues will weigh on the potential for mortgage lenders to have a greater role in this area. Further consideration of aspects of the proposals in the Call for Evidence should include deeper engagement with and input from both the FCA and the PRA, as well as regulators in Europe.

Although we have reflected views from some of our members, we expect individual lenders will respond to market opportunities for energy efficiency according to their appetite for business and risk in this area.

We would also point out that, as the trade body for lenders, the role of UK Finance is not in market building, however we can and will work to support a policy and regulatory environment that is conducive to lenders wishing to pursue opportunities in this area.

Aspects of the proposals in the Call for Evidence relate to work that is already underway as part of the LENDERS project, and we pick up on this in our specific comments, below.

This response should be considered in conjunction with our views on the related [Call for Evidence on the reform of the Green Deal Framework](#).

Specific comments

We have responded questions in the Call for Evidence that relate most directly to the interests of our members.

Barriers to market growth and incentives (Section 3)

Do you agree with our assessment of the current barriers to market growth? (Question 5)

Our preliminary comments about the extent to which mortgage lenders are beneficiaries of energy efficiency "value", and the link between efficiency and house price values are relevant here.

Otherwise, and particularly in relation to supply side barriers, we agree that issues around quality and consistency of data still need to be fully addressed. Issues here relate particularly to, for example, the LENDERS project and development of a robust methodology for calculating levels of savings from installation of measures that might be factored in to mortgage affordability assessments.

Are there other barriers that you think we should be addressing? (Question 6)

For lenders who might wish to be more commercially active in responding to opportunities in an expanded market for energy efficiency, particularly in offering financial or mortgage/ mortgage-related products, there are both conduct and prudential regulatory challenges that would need to be fully understood and addressed by government and the regulators both in the UK and Europe.

Do you think there are any other important lessons to learn from past attempts to stimulate the market? (Question 7)

The experience of the Green Deal and Green Deal marketplace was that complexity and bureaucracy stifled consumer interest, innovation and dynamism. We would caution, however, that there remains a need for consistency and standards, for example, in relation to the development of products, measures and consumer protection, and we have commented more specifically on issues such as these in our separate but related response to the Call for Evidence on reforming the Green Deal Framework.

Are there any barriers preventing business models for energy efficiency that have developed in other countries from also developing in the UK? (Question 9)

Yes, regulation. We are aware of the cautionary approach of capital regulators, whether in Europe or internationally, in consideration of a possible "green supporting factor" in relation to capital requirements. The experience in Europe of the related SME supporting factor is pertinent in this regard. Developments and approaches in the UK towards *Building a Market* will need to be consistent and compliant with those applying in the EU, particularly when considering issues around capital requirements for "green mortgages" or related financial products.

Proposed approach (Section 4)

Do you agree with the set of proposed principles for guiding our approach? (Question 10)

Yes, the principles seem sensible provided they are applied in a way that supports consumer choice. The principles should also operate in a way that does not impinge on lender commercial decisions (appetite and risk); and in a way that does not distort the operation of the market and the valuation of properties or types of properties.

Do you agree that the policy areas we have set out are the correct ones to focus on? (Question 11)

Again, our preliminary comments about lenders as beneficiaries of energy efficiency "value" and the role of lenders in an expanded market for energy efficiency refer. Otherwise, yes, we agree broadly with the policy areas identified for focus. From the perspective of lenders, the focus on data is welcome, including in the context of the work of the LENDERS project and building an evidence base for consistent modelling of energy savings.

Demand side measures (Section 5)

Developing new methods for financing energy efficiency: Fiscal levers; design of incentives; barriers to financial institutions; trials and government assistance (Questions 12, 13, 15, 16, 17)

There are advantages and disadvantages to the different approaches/ fiscal levers identified, and each would need to be evaluated according to its merits. From the perspective of consumers, issues including availability, delivery, and communication will be key to success.

From the perspective of lenders, some types of incentives (such as low rate further advances) would need reduced capital costs to ensure viability. The capital regulation issues already highlighted would come into play here. On the possibility that SMEs might also be encouraged to enter the market for energy efficiency, there could be further capital regulation issues arising from both the Basel/ EU "SME supporting factor" and any equivalent "Green supporting factor":

Conduct regulation issues could also arise in relation to customer affordability of additional borrowing and the overall impact on customer debt. There could also be regulatory issues in relation to second charge loans and how these interact with any first charge mortgage and its affordability assessment. Issues such as these mean that product development and delivery is likely to be complex for lenders. We expect both conduct and capital regulators would need to be fully engaged by government in agreeing the overall types of incentives it might wish to see in the market and their overall structure and design. Broad "template" incentives within which lenders could develop competitive offers that are compliant with regulation, could be a useful way forward.

In terms of trials of ideas/ incentives, we suggest these should be small scale initially and that regulators are involved e.g. via the FCA regulatory sandbox, noting that competition for acceptance to the sandbox is strong. Due account should be taken of the resource implications for lenders of product development, even for a limited trial. Resource requirements would need to be ranked against competing business and system development priorities.

Price signals to encourage homeowners to prioritise energy efficiency (Questions 19-22)

In our view, the most effective price signals for consumers are likely to be around areas in which they are required to make significant transactional/ property-related expenditure via taxation – so SDLT and council tax. We would caution, however, that interventions in areas such as these could risk distorting the housing market both in relation to transaction volumes at price bands/ property types and possibly geographic areas. There could be unintended consequences in terms of impact on consumer choice and market competition for properties. Factors such as this should be fully modelled and understood before any interventions are made.

Improving awareness of energy efficiency products and technologies, their benefits and advice to consumers (Questions 23-26)

On linking installation of energy efficiency measures and property values, we strongly suggest that RICS be included and engaged here, if not already.

In the development of earlier initiatives, such as Green Deal and RHI, we have stated that different measures will impact different properties in different ways, including through a range of variables such as lifespan, maintenance, visual impact, physical impact, and operation in-use. For example, more intrusive measures to the structure/ appearance of the property (external or internal solid wall insulation; solar PV/ heat pumps; connection to district heating) are likely to have a greater impact on property value and market appeal. In addition, from the perspective of lenders, we have flagged other issues that still need to be considered when developing interventions and products in the context of *Building a Market*. These include issues about ownership of measures (e.g. district heating plant installed in the property); liability for measures that might pass to the lender on taking possession (e.g. responsibility for Green Deal Plan payments); and potential for installed measures and related responsibilities to make onward disposal from lender possession more complex or protracted.

Supply side measures (Section 6)

Creating the conditions so that those who derive value from energy efficiency can be key players in the market (Questions 31-34)

The questions here are particularly relevant to lenders. Again, our preliminary comments about lenders as beneficiaries of energy efficiency "value", and the role of lenders in an expanded market for energy efficiency refer.

Similarly, we also underline again that there would need to be up-front clarity about solutions to regulatory challenges and issues in both conduct and prudential regulation before lenders could be comfortable to begin exploring commercial opportunities in any expanded market for energy efficiency.

In relation to **Question 31** about lenders' plans for improving the way they factor energy efficiency into lending decisions, this raises the work of the LENDERS project and related work on data and methodology for calculating savings. We are aware that work by Nationwide Building Society in this area by way of follow-up to the LENDERS project work pointed to only modest/ limited increases in the level of borrowing that might be available to customers.

We suggest that, before government reaches a firm policy position on the desirability of a LENDERS-based methodology for assessing energy costs/ savings, more work needs to be done to ensure any such methodology is consistently robust and accurate and that its outputs demonstrate sufficient potential increases in levels of additional borrowing to customers as to justify the likely significant resource and systems implications to lenders of changing their existing affordability calculators.

In any event, it might be that forthcoming developments in open banking and smart metering could short-circuit the need for a bespoke modelled calculator of the type envisaged by LENDERS and that, via these other routes, lenders will be able to have a far more detailed understanding of actual energy costs that could be factored into existing mortgage affordability assessments.

In relation to **Question 32**, about the possibility of lenders committing to voluntary targets for improving the average energy efficiency of properties they lend to, we do not consider it appropriate or desirable to move to a targets-based approach (voluntary or otherwise). Improving energy performance of homes is fundamentally not the core business of mortgage lenders, and such improvements are a matter for consumer choice. We are concerned that the use of targets could have market distorting effects, particularly for new lending and could lead to lenders being effectively compelled to increase new (or newer) build lending (on properties which are more likely to be more efficient in the first place), and this would also have impacts in terms of distorting exposures and rated risk. Further, it is likely that the operation of targets (and associated reporting on these) could be burdensome and costly and could also bring issues with lower-performing properties being blighted.

In relation to **Questions 33 & 34**, on lender development of more accurate modelling of energy bill savings and "green mortgages", the issue of modelling savings is the same as in Question 31, above. Again, we suggest that a more effective solution to the challenges here could be in technological developments via open banking and smart metering that will allow tailored assessment of actual energy costs to be included in existing mortgage affordability calculators without the need for developing potentially complex and costly new calculator elements. In terms of willingness to lend "green mortgages", we suggest again that issues around capital regulation from Europe (the possible "Green supporting factor") would need to be addressed and applied in the UK context before lenders could confidently respond to new business opportunities in any expanding market for energy efficiency.

Enabling innovative energy efficiency products and services

Although we have not responded to the specific questions (35-37), we expect that due account will be taken of the outcome of the Hackitt building regulations review post-Grenfell. We suggest also that there could be a degree of consumer "rejection" of wall insulation systems in the aftermath of the disaster and this could present additional barriers to uptake, particularly of (external and internal) solid wall insultation. In this regard, we would not expect government policy and market interventions to operate in a way that steers consumers to measures they might not want. It might be that there could be a need to "rehabilitate" the reputation of wall insulation systems and we suggest it might take some time yet for consumers to accept such measures, going forward.

Improving data to open-up the market for investment (Questions 38 & 39)

Our responses to earlier questions on data refer. Open banking and smart meter data could be key to unlocking many of the challenges to accurately assessing actual energy use before and after installation of efficiency measures.

Improving supply chain capacity

Although we have not responded to the specific questions (40-42), our response to the related Call for Evidence on the reform of the Green Deal framework refers. In that context, and in the context of *Building a Market*, issues around quality, consumer protection and redress continue to be key and we suggest a strong focus be maintained on issues such as these in line with the work of Each Home Counts and the single Quality Mark.

Next steps and contact

We are ready to engage further as appropriate through the work of the BEIS Green Finance Task Force. In the meantime, to discuss this submission further, please contact John.Marr@ukfinance.org.uk