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How can lenders make the most of their growing role in the Government's drive to cut household emissions?

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Overview

In June 2019, the UK government enshrined into law a target of reaching net zero carbon emissions by 2050. With homes in the UK accounting for 22% of greenhouse gas emissions, residential energy efficiency is a vital battleground in the fight against climate change.

Kamma's analysis of EPC data for all registered domestic properties in England & Wales however, shows that over the last 13 years, the national average EPC rating has risen just 3 SAP Points (from 61.8 to 64.7). This is a fight that needs new recruits, and mortgage lenders are about to find themselves conscripted for the frontline.

The Department for Business, Energy and Industrial Strategy (BEIS) has proposed a new set of policies that significantly increase the responsibility of lenders in improving the energy efficiency of housing stock.

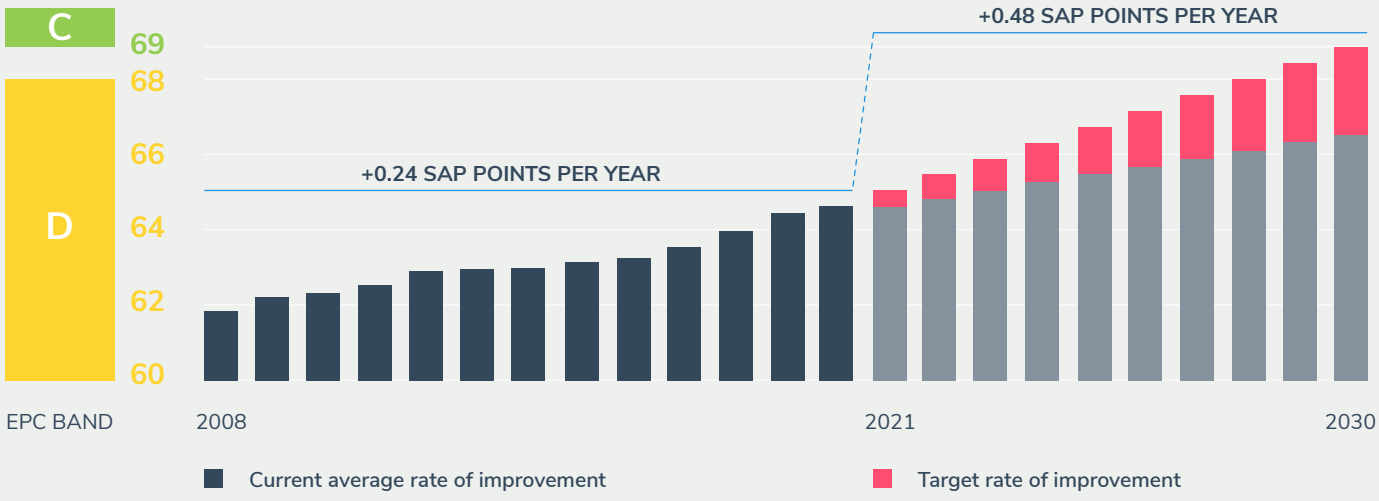
These include:

- Regularly disclosing the average energy efficiency performance of their books
- A published league table of lenders highlighting the comparative best and worst performers
- Lenders agreeing to reach the target of a back book average of EPC Band C (69 SAP points) by 2030.

Assuming a lender's back book performance is similar to the national benchmark, the government's proposed target means they will have to **double their rate of energy efficiency improvement** if they are to get to the target within 9 years. Not to mention the huge amount of investment that will be required to achieve this. Reaching an average of EPC Band C across all EPC-registered properties is currently projected to cost an eye-watering £48.3 billion.

Yet within this challenge there is opportunity: a burgeoning market for green finance products, growing public demand for sustainable housing, and a huge opportunity for brands to showcase their green credentials by acting to reduce the emissions of their customers. Those lenders able to get on the front foot and solve the technological challenge of delivering accurate and customisable analysis of energy performance across their mortgage book, will soon be leading the charge towards a greener future.

Lenders will need to double the current rate of improvement



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The consultation

The consultation, running November 2020-February 2021, 'Improving home energy performance through lenders' contains two key proposals:

1. Annual disclosure of back book-wide EPC data and the gross value of lending for energy performance improvement works

The scope of the disclosure would cover **all FCA-registered lenders** carrying out mortgage lending in England and Wales. To fulfil disclosure requirements, lenders would be expected to collect EPC data on their mortgage stock, gathering the following data at an individual property level:

- Building identifier / address information
- Existing EPC scores and ratings
- Potential EPC scores and ratings

With this data, BEIS proposes providing public comparisons between lenders, in the form of 'league tables', which would rank lenders' current average EPC ratings and value of lending for energy performance improvements.

In order to ensure lenders are providing relevant and reliable data, the government proposes introducing external audits and spot checks of sample data.

2. Lenders agreeing to meet a back book average of EPC Band C by 2030

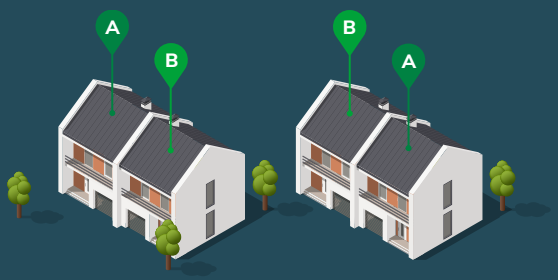
While the government states that their preferred approach is for targets to be agreed on a voluntary basis, the consultation also confirms that the "ultimate objective should be to transition to mandatory disclosure".

To meet this target, the homes within a lender's back book would be required to have a mean average SAP point score of at least 69.

The government anticipates that lenders will meet their back book energy performance target through:

- Incentivising homebuyers to make energy improvements through the provision of 'cashback' schemes
- Lower interest loans
- Awareness-driving campaigns

To increase compliance with any potential mandatory legislation, the consultation also suggests that financial penalties could be imposed for lenders that fail to meet statutory deadlines included in the policy.



“I think that the costs of any initiatives to increase EER [Energy Efficiency Ratio, a measure of household energy efficiency] need to be carefully considered and there needs to be wide acceptance from the whole community to support this.”

Chief Lending Officer, Landbay

60%

of homes in the UK are poorly insulated

£48.3bn

investment is required to reach an average of EPC Band C across England & Wales

The Energy Efficiency Investment Index

Not many people realise it but, across the UK, housing is the second largest emitter of carbon. Currently, around **60% of homes in the UK are poorly insulated**, achieving an EPC Band D or worse.

Reaching net zero means drastically reducing emissions from housing stock. How feasible then, is the proposed target of an average Band C by 2030? And where in the country will this prove hardest to achieve?

Across England & Wales, the average EPC score has risen just 3 SAP points over 13 years. Assuming a lender’s back book performance is comparable to the national benchmark the proposed target gives a lender just 9 years to increase their average score by 4.3 SAP Points.

Every EPC certificate comes with recommendations on improving the property’s score, along with associated costs. By averaging the total costs of improvement suggested, Kamma has calculated that raising the average for England & Wales up by just 1 SAP point would cost £11.2 billion. Raising the national average to Band C (69 SAP points) brings the total cost of investment to £48.3 billion.

As the Energy Efficiency Investment Index makes clear, the difference in SAP score also varies drastically from region to region. London leads the way on energy efficiency, with average SAP scores sitting at 66.4, just 2.6 points away from a Band C target, yet the sheer number of properties mean substantial investment is still required. Elsewhere in the UK, energy efficiency is much further off target. Wales, for example, is a considerable 6.5 points away from Band C. With just under 400,000 homes below the target level they still require around £2.5 billion in improvements.

Regardless of where lenders are focussed then, they face a challenge: either a large number of homes requiring smaller improvements, or a smaller number facing large scale upgrades. In either scenario sophisticated strategy is required, creating opportunities for smarter and faster moving enterprises, and challenges for those slow to adapt.

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The Energy Efficiency Investment Index

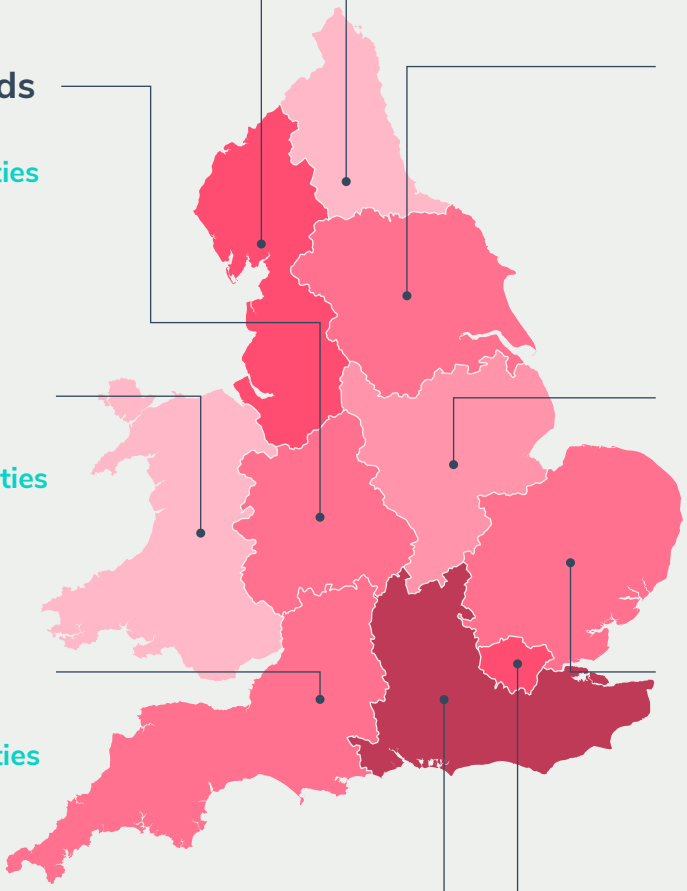
What will it cost to make each region energy efficient?

North West
4.9 SAP points
973,375 properties
£6.3bn

North East
3.7 SAP points
358,273 properties
£2.4bn

West Midlands
5.4 SAP points
746,783 properties
£4.7bn

Yorkshire & The Humber
5.5 SAP points
751,279 properties
£4.6bn



Wales
6.5 SAP points
396,785 properties
£2.5bn

East Midlands
4.7 SAP points
614,999 properties
£4bn

South West
4.6 SAP points
688,890 properties
£4.7bn

East of England
3.8 SAP points
733,431 properties
£5.1bn

South East
3.3 SAP points
1,045,836 properties
£7.4bn

London
2.6 SAP points
927,314 properties
£6.7bn

Number of SAP points required to reach an average of EPC Band C
Number of properties currently below EPC Band C
Projected investment required to reach an average of EPC Band C

Source: Kamma, MHCLG

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Delivering green growth

In any league table, the prestige available to first place is an order of magnitude higher than that available to second or third, whilst a robust and comparable approach to measurement will highlight poorer performers with a level of transparency not seen in the market before.

Lenders' green credentials are about to be put under the spotlight for an audience of green consumers to judge who to reward with their business. There are three steps to getting ahead in the race to the top of the table:

Deliver accurate and customisable analysis of the back book

Mitigate the risk of stranded assets

Win in the green finance market

Deliver accurate and customisable analysis of the back book

Although EPC data has been made "open" and freely available, integrating it with back book data is technically challenging. Disclosing back book-wide EPC performance means reconciling and matching the exact property, using the lender's mortgage information and the property in the EPC certificate data to deliver accurate information at scale. Whilst the government acknowledges that some lenders may be better equipped to deal with this, they also state that "other lenders do not have this capability" and will have to "overcome administrative and systems barriers" in order to fulfill obligations on EPC disclosure. Reconciling two large geographic data sets represents a myriad of issues. Resolving inconsistent and confusing address data, for example, with third-party datasets requires investment in geocoding technology, which is prohibitively expensive to buy and takes years to build.

Collecting clean, standardised data is an essential step in carrying out accurate analysis, which further informs strategy. Those lenders armed with accurate insights can use this information to segment, prioritise and target effectively, giving them an advantage both in the market, and in the fight against climate change. Lenders have been asked to respond quickly, and those that can rapidly surmount these technical obstacles will have a distinct advantage.

Mitigate the risk of stranded assets

There are risks associated with inaction in the face of climate change. In 2018, the Bank of England identified the energy performance of homes as one of the major climate 'transition risks' for banks. They highlighted a risk of stranded assets if landlords fail to respond to regulation on homes.

In January 2020, the Bank of England also published data that showed residential mortgages on energy-efficient properties (EPC Bands A–C) to be **18% less likely to be in arrears** than those against energy-inefficient properties (EPC Bands E–G).

Whilst this correlation shouldn't be interpreted as causal, it does suggest that the energy performance of a property is a relevant predictor of mortgage payment arrears and thus may increasingly become a factor in risk-adjusting the pricing of mortgages. Once back book data has been reconciled, and a clear picture has been delivered, lenders need to prioritise those parts of their back book most at risk and act quickly to offer attractive solutions. Improving the worst performers both mitigates the risk of stranded assets, and has the potential to deliver a large improvement in average EPC performance.

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Winning in the green finance market

One of the key proposals laid out by BEIS is that lenders must significantly open access to green finance products and incentivise homeowners to carry out energy efficiency improvements.

> "The existing relationships lenders have with their customers, often supported by a strong regional focus, provide a platform for lenders to develop green products that will encourage action from mortgagors by removing financial barriers and thereby help to unlock the value of improved energy performance."

Improving home energy performance through lenders, BEIS consultation, 18th November 2020

As previously mentioned, these products carry wider brand building benefits, as well as direct commercial returns. These multiple drivers have led to many lenders getting ahead of the curve (see below).

One point missed in the consultation, however, is the opportunity to win in markets beyond consumer-facing green finance products. As BlackRock's CEO Larry Fink recently articulated in his annual letter to CEOs:

> "We know that climate risk is investment risk. But we also believe the climate transition presents a historic investment opportunity... As more and more investors choose to tilt their investments towards sustainability-focused companies, the tectonic shift we are [already] seeing will accelerate further."

Larry Fink, CEO, Blackrock, 26th January 2021

Those able to harness the power of energy performance analytics across their backbooks have a huge opportunity to gain from this seismic shift towards sustainability from writing new business, introducing new products and partnerships to accessing cheaper liquidity through green securitisations. Delivering accurate and customisable analysis of the back book is not just the start of meeting a compliance or environmental imperative, it's an increasingly vital economic imperative too.

Nationwide Building Society

In February 2020, Nationwide Building Society offered £1 billion in low-interest loans to help borrowers buy energy efficient properties

RBS The Royal Bank of Scotland

In the same month, RBS announced that 50% of its mortgage book will have an EPC, or equivalent rating, of C or above by 2030.

BARCLAYS

Barclays announced that it successfully closed a £400m 'Green Bond' issue 27 October.

NatWest

NatWest launched its first ever Green Mortgage in November 2020, offering borrowers purchasing an energy efficient property a preferential interest rate. This came after 70% of its customers were concerned about climate change but were unclear on how to act.

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Inefficient housing stock, the growing risks of climate change and a burgeoning green finance market all provide lenders with huge incentives to act. The government has further proposed financial penalties for poor performance, compared to the rich commercial rewards for leaders in the category.

For those seeking leadership positions, accurate and customisable analysis of the back book is the logical first step. Without data on the energy efficiency of lender back books, the extent of the challenge is not yet clear. With so much at stake, early and accurate assessment is crucial to matching the size of response to the scale of the challenge. Being able to differentiate between properties with poor and high energy performance gives lenders an opportunity to segment, prioritise and target. Accurate data can act as a source of competitive intelligence and lead generation. Lenders can personalise both product and message to consumer and property profile.

Looking beyond their own customer base, accurate data also provides more options for lenders to package green securitisations. In this way leveraging EPC data achieves commercial, as well as societal and environmental objectives. Lenders are being asked to do more, but, in the process, have been given a rare opportunity to achieve the triple aims of driving new revenue growth and building a green brand whilst driving the nation towards a greener future. could personalise both product and message to consumer and property profile. Looking beyond their own customer base, accurate data also provides more options for lenders to package green securitisations. In this way leveraging EPC data could achieve the triple aim of driving new revenue growth and building a green brand whilst driving the nation towards a greener future.

“By doing what we have always done lenders won’t be able to improve the average EPC rating of properties in their mortgage portfolios, something different has to be done. Different financial products, different lending policies to incentivise customers to improve their properties.”

Chief Risk Officer,
Fleet Mortgages

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How can Kamma help?

Kamma is an industry leader in geospatial technology, providing trusted solutions to a wide range of lenders and real estate companies. Our unique technology is adept at reconciling large volumes of address data with multiple datasets and providing clear insights that drive business growth.

Our Energy Performance Product Suite is designed to put lenders in control, delivering a source of competitive advantage in the market and a transparent view on energy performance in the form of 'regulator-ready' reports.

Kamma Sweeper provides accurate and customisable analysis of the back book, segmented by risk category, geography and any other internal categories. This helps to automatically monitor and report on back book-wide energy performance, as well as identifying opportunities for targeted green product offerings. Sweeper reports are designed specifically with regulatory obligations and reporting in mind, while also providing key commercial analyses that help our clients to capitalise on high-growth opportunities.

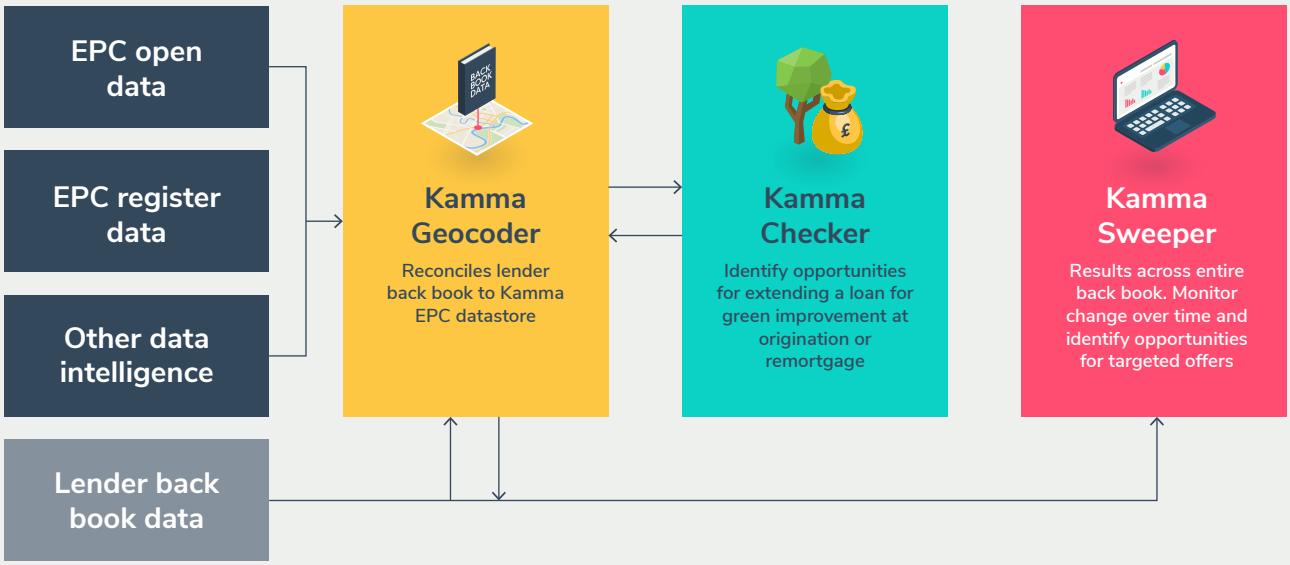
For originations and remortgages, Kamma Checker delivers complete transparency on a property's EPC status in real-time. At a click of a button, lenders can gain access to a property's current and historical EPC data, facilitating smarter lending decisions and opening up opportunities for green finance products.

With new challenges and further regulation on the horizon, banks have to adapt and evolve to beat the competition. Whilst the importance of tackling climate change is undeniable, the government's proposals on EPC present, in equal measure, some tough logistical obstacles as well as some truly promising commercial opportunities.

Kamma's Energy Performance product suite is built to minimise the operational burden, identify both risks and commercial opportunities and support swift decision-making, delivering a positive impact for both profit margins and the planet.

Contact us now to find out more about Kamma's Energy Performance services.

Data-driven lending



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Contact us now to find out more about Kamma's Energy Performance services

Get in touch

About Kamma

Kamma puts companies back in control of their compliance through data-driven technology solutions. They mine unstructured legislative information and harness AI to de-risk markets, deliver operational efficiencies, protect reputations and open up new revenue opportunities

Visit the site at
kammadata.com

Speak to the team
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Methodology

The EPC data analysed in this report was taken from MHCLG's Energy Performance of Buildings Data England and Wales, found at **https://epc.opendatacommunities.org/** and the analysis is accurate as of 12 January 2021. All industry quotes found in this article were taken from a survey carried out by Kamma, which ran from 18th January - 5th February 2020.National costings have been derived from the mid-points of total recommended energy efficiency improvements obtained directly from the EPC register. The average EPC score per year has been calculated by taking the mean average across all properties that had an active EPC certificate in that year.