

Underwriting the Renovation Wave with Mortgage Portfolio Standards for Energy Efficiency

Executive Summary for Policymakers

Urgent action is required to find €2.75 trillion over the next ten years to upgrade Europe's buildings and bring the building sector in line with the goals of the Paris Climate Agreement. €2.75 trillion is considerably larger than the combined EU budget and Recovery and Resilience Facility. It is also too big for national member state budgets and public banks. More than this, European residential buildings, which are worth €17 trillion, represent around half of European wealth and are home to 220 million households, are underperforming, and are not being renovated at the speed and depth required.

Banks hold €7 trillion of European mortgages and nearly a third of their non-financial lending is backed by property assets. In recent years, these banks have been starting to unlock the benefits and opportunities energy efficiency offers to strengthen the quality of their loan portfolios, foster stronger client relationships, and enhance their sustainability performance. Furthermore, sustainable banking leaders have identified the date when they will have upgraded all of the homes they lend against to EU Energy Performance Certificate grade "A". This report showcases some of these practices and develops a portfolio mechanism for inclusion in the review of EU Directives to make Europe fit to deliver 55% greenhouse gas emissions reductions by 2030 in the building sector.

This report introduces a new regulatory mechanism - a Mortgage Portfolio Standard - which can better align EU mortgage lenders, and mortgaged properties, with the Paris Climate Agreement. Like fleet emissions standards for millions of cars and trucks, a mortgage portfolio standard would require the energy performance of a bank's portfolio of financed buildings to meet specific targets by specific dates aligned with the Paris Agreement. While exact timings and targets will depend upon the location of the buildings and the starting point for the bank's portfolio, mortgage portfolio standards would add resilience to banks' balance sheets, boost energy efficient and smart building renovations, and help deliver the renovation wave and Europe's broader climate goals.

This is nothing if not timely. The introduction of portfolio standards for mortgage lenders is supported by historically upgraded public support to renovation, through the "Renovate flagship" of the Next Generation EU initiative, and from associated national and EU funds. This will support fair and broad access to necessary renovation finance, grants to the energy poor and thereby unlock all the benefits which come with deep renovation for the 35-70 million European households that need these by 2030.



Never has there been greater pressure on financial institutions to address climate risks and align their lending practices with the Paris Agreement. With just 8% of leading bank balance sheets currently aligned with the green thresholds defined by the EU Taxonomy, there is a very long way to go. Mortgages are a considerable part of those aggregated balance sheets, and the mortgage process and relationship is a strong rationalising influence on the otherwise highly fragmented buildings market.

In this context, this report proposes the development of a Mortgage Portfolio Standard (MPS) in the current review of the European Energy Performance of Buildings Directive, supported by information requirements in to-be climate-alignment EU financial regulation. Evidence for this approach is provided by drawing on US and European best practices that were used to promote renewable energy and low emissions vehicles, respectively. This evidence was amplified through stakeholder interviews and validated through a review of existing research and the mapping of aligned climate reporting and financial initiatives.

The reality is that mortgage lenders are largely absent from the coverage of the Energy Efficiency and the Energy Performance of Buildings Directives. Equally, buildings – despite being Europe’s most valuable asset class – are also largely absent from EU financial regulations. The silo-centric regulatory approach of the past relating to finance, climate and buildings cannot endure in a European Union whose 2030 climate ambition is aligned with the Paris Agreement.

In an EU with stronger energy performance data and information transparency obligations and with the upcoming introduction of mandatory minimum energy performance standards (MEPS) for existing buildings, there must be a clear alignment between buildings and financial sector stakeholders to deliver renovation wave targets fairly and without risk of civic backlash. An initial rush of public grants provided through recovery funds will quickly run dry, and private sector actors will need to pick-up the remaining 90% of building renovations.

Mortgage lenders are the single most powerful and most impacted stakeholder group in the decarbonisation of Europe’s buildings. A well-designed Mortgage Portfolio Standard supported by technical assistance and public guarantees to facilitate additional property backed renovation lending to homeowners from all sections of society can engage with the over 50 million banking customers via their existing mortgage relationships, and new ones, to deliver the EU Renovation Wave.

The current EU Commission fit-for-55 review of climate relevant directives, coupled with a historic level of public investment to build back better from COVID is the right time to implicate financial actors in the buildings renovation challenge. Private sector, and owner-led renovation investments are key to the delivery of the EU Green Deal and using fit-for-55 regulations to align mortgage lenders with the renovation wave is both timely and critical to its success.

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