



# Underwriting the Renovation Wave with Mortgage Portfolio Standards for Energy Efficiency

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This is a summary of the [report](#) about launching Mortgage Portfolio Standards (MPS) in Europe to unlock private finance to renovate European buildings. The 2021 work is based on policy analysis and expert engagement in buildings, technology, and finance.

## EUROPE FACES A BUILDINGS' RENOVATION CRISIS

The EU faces a renovation crisis. Currently, renovations of energy-inefficient buildings are too few and do not unlock enough energy savings. As the EU upgrades its energy and climate policies to meet its 2030 climate targets in the path to climate neutrality by 2050, increasing buildings' energy efficiency is a central component of climate action.

In addition, with \$130 trillion commitments at COP26<sup>1</sup> (GFANZ), there has never been greater pressure on financial institutions to address climate risks and align their lending practices with the Paris Agreement. Mortgage lenders are certainly the single most powerful stakeholder group in the decarbonisation of Europe's buildings, yet they remain largely absent from the coverage of -the key European framework policies- the Energy Efficiency (EED) and the Energy Performance of Buildings Directives (EPBD).

Hence, we propose the urgent introduction of Mortgage Portfolio Standards (MPS) for energy efficiency in the current fit-for-55 package of EU legislation. Portfolio standards have been tried and tested to regulate vehicle fleet emissions and build renewables, and now its power can be directed at buildings renovations. A portfolio standard will better align EU mortgage lenders, and mortgaged properties, with the Paris Climate Agreement, and unlock the potential of banks and mortgage lenders in accelerating the EU's Renovation Wave with their 50+ million European homeowner clients.

## EUROPEAN BUILDINGS AND THEIR ECONOMIC AND ENVIRONMENTAL RELEVANCE

Home to 220 million<sup>2</sup> households, European residential buildings' worth is estimated at €17 trillion, approximately over half of European stored wealth.

Some two thirds of buildings in the EU were built at a time when energy efficiency requirements were limited, or non-existent. Buildings are responsible for around 40% of the EU's energy consumption<sup>3</sup>, and 36% of its energy-related greenhouse gas emissions<sup>4</sup>. Yet, only 1%<sup>5</sup> of buildings are renovated each year, and just one fifth (meaning 0.2% per annum) of these renovations are considered deep renovations (reducing 60% or more of energy demand).

The effects of climate change are also undoubtedly threatening the value of European buildings and the health of their occupants.

In light of current and expected regulation, considerable investments are required to increase their efficiency and resilience, and to reduce their emissions. In turn, these investments would protect buildings' long-term value, and effectively reduce the climate and transition risks of their physical or regulatory stranding.

## REGULATORY CONTEXT TO FOSTER ENERGY EFFICIENCY AND TO DELIVER TARGETS

Launched by the European Commission in late 2020, the Renovation Wave strategy aims to improve the energy performance of 35 million buildings by more

<sup>1</sup> GFANZ. (2021). *Amount of finance committed to achieving 1.5°C now at scale needed to deliver the transition*. [Website]. Retrieved from <https://www.gfanzero.com/press/amount-of-finance-committed-to-achieving-1-5c-now-at-scale-needed-to-deliver-the-transition/>  
<sup>2</sup> European Commission. (2021). *The future of cities*. [Website]. Retrieved from <https://urban.jrc.ec.europa.eu/the-future-of-cities/affordable-housing#the-chapter>

<sup>3</sup> European Commission. (2020). *In focus: Energy efficiency in buildings*. [Website]. Retrieved from [https://ec.europa.eu/info/news/focus-energy-efficiency-buildings-2020-feb-17\\_en](https://ec.europa.eu/info/news/focus-energy-efficiency-buildings-2020-feb-17_en)  
<sup>4</sup> Ibid.  
<sup>5</sup> SHREC project. (2021). *Renovation Wave Strategy targets European buildings*. [Website]. <https://www.interregeurope.eu/shrec/news/news-article/10397/renovation-wave-strategy-targets-european-buildings/>



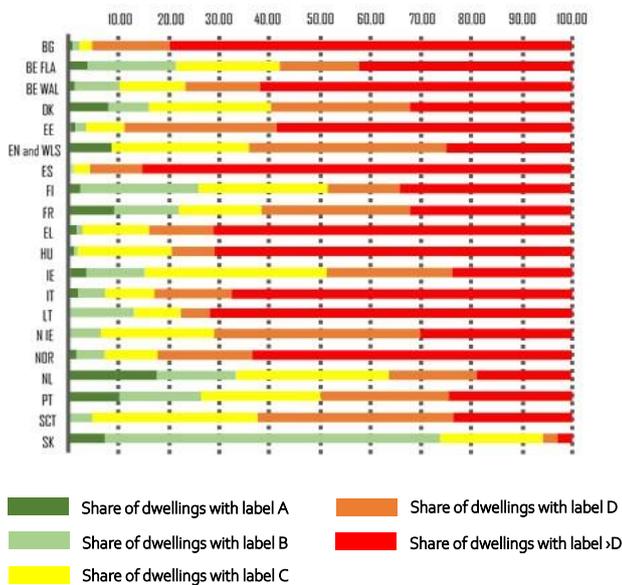
than doubling renovation rates over the next decade to cut emissions, boost a sustainable economic recovery, and drastically reduce energy poverty. Meeting this<sup>6</sup> renovation target would require €275 billion<sup>7</sup> invested per annum. This figure is about five times the 2019 total European buildings energy efficiency investment of €57 billion, reported by the IEA<sup>8</sup>.

Delivering this wave of buildings renovations and the new 2030 targets is a complex task which requires the revision of the EED, the EPBD, and the Mortgage Credit Directive (MCD). It also calls for revisions to the Energy Performance Certificate framework, as well as the introduction of mandatory minimum energy performance standards (MEPS) for all existing buildings.

### MORTGAGE BANKS AND THEIR UNIQUE RELATIONSHIP WITH CUSTOMERS AND ENERGY EFFICIENCY

Mortgage lenders are arguably the single major common stakeholder in the decarbonisation of over 50 million European buildings. With €7 trillion<sup>9</sup> of mortgages lent to homeowners, these lenders are a key and underutilised channel to promote renovation and help green mortgage portfolios in line with banks' commitments to the Paris Agreement.

#### EU Distribution of EPC Label Ratings (%)<sup>10</sup>



<sup>6</sup> European Commission. (2021). *Questions and Answers on the Renovation Wave*. Retrieved from [Website]. [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_20\\_1836](https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1836)

<sup>7</sup> Ibid.

<sup>8</sup> IEA Energy Efficiency 2020: <https://www.iea.org/reports/energy-efficiency-2020/energy-efficiency-in-2019>

<sup>9</sup> EeMAP. (2018). *Creating an Energy Efficient Mortgage for Europe Towards a New Market Standard*. Retrieved from <https://bit.ly/3FtdZ8m>

Energy Performance Certificates (EPCs) are a rating scheme summarising the energy efficiency of buildings, and are an essential part of renovation efforts. EPCs first emerged in 2002 and are a static record, largely based upon a combination of observed, estimated and asset-rated data, making them an imperfect response to the general lack of physical building energy performance data. EPCs increase the visibility of energy use, particularly during sale or rental transactions when a renovation may occur.

### WHAT IS A MORTGAGE PORTFOLIO STANDARD?

*A Mortgage Portfolio Standard is regulatory mechanism requiring banks to pledge to work with their clients to increase the energy performance of the buildings which back their mortgages along a science-based trajectory.*

Portfolio standards are proven regulatory tools that have been deployed in reducing energy and transport emissions. In Europe, fleet portfolio emissions standards<sup>11</sup> are expected to reduce car and van emissions by 15% by 2025 (and over 30% by 2030). In the US, renewable portfolio standards are responsible for around half of the growth in renewable energy production (82 GW).

Learning from these two successful approaches, a mortgage portfolio standard, coupled with technical assistance and public guarantees, would provide a clear alignment of interests and resources to guiding the transition of the highly disaggregated building sectors, and deliver the EU Renovation Wave.

### KEY DESIGN ELEMENTS FOR MORTGAGE PORTFOLIOS

- **MPS would target a 2050 whole portfolio final destination with interim steps** to allow for long-term renovations and upgrade planning and financing by owners and finance providers alike;
- **MPS targets would be aligned with a Paris Agreement trajectory**, with a stable, ramp-up over time and no sudden or uncertain shifts;

<sup>10</sup> X-tendo. (2021). *Energy Performance Certificates Assessing their Status and Potential*. [https://x-tendo.eu/wp-content/uploads/2020/05/X-TENDO-REPORT\\_FINAL\\_pages.pdf](https://x-tendo.eu/wp-content/uploads/2020/05/X-TENDO-REPORT_FINAL_pages.pdf)

<sup>11</sup> European Commission. (2021). *CO<sub>2</sub> emission performance standards for cars and vans (2020 onwards)*. Retrieved from [https://ec.europa.eu/clima/policies/transport/vehicles/regulation\\_en](https://ec.europa.eu/clima/policies/transport/vehicles/regulation_en)

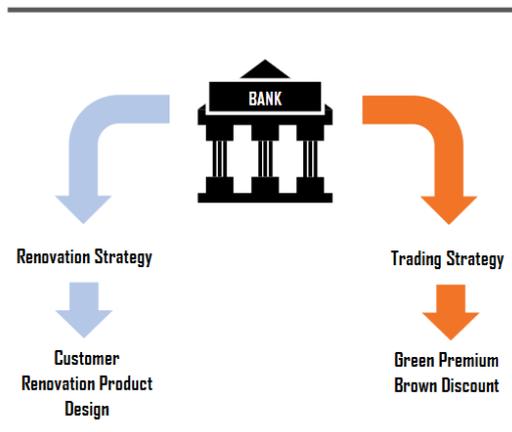


- **MPS covers all mortgage lenders and mortgage debt holders** (as regulated parties), including final holders of mortgages housed in special purpose vehicles, securitisation companies and other intermediate bodies;
- **MPS can rely on verified real energy or direct emissions data** from the property or an EPC as a proxy; and
- **MPS rules would include non-compliance penalties** on those entities that fail to meet their stated goals.

## MPS COMPLIANCE TO ACTIVELY PROMOTE ENGAGEMENT WITH HOMEOWNERS

Lenders looking to “green” their mortgages through MPS have two compliance strategies:

1. **“Renovation compliance route”**, renovate each building backing a mortgage in alignment with EU Taxonomy.
2. **“Trading-based compliance route”**, they could sell their mortgages lent against low EPC rated properties and acquire those lent against highly energy efficient buildings.

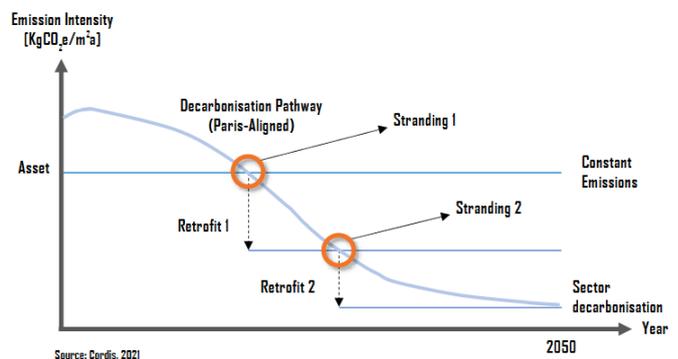


The “trading” strategy would – however - deliver increased incentives for working with clients to renovate their homes, and create a virtuous cycle as fewer buyers are found. MPS can align financial institutions’ interests with EU climate and energy targets and the Paris Agreement via:

- a. **The billions of euros of fees** that can be made through working with clients to borrow-to- renovate, as well as the evidence which shows that green property is worth more, and that owners of energy efficient homes are less likely to exhibit arrears or defaults in their mortgages.
- b. **Increased costs of non-renovation:** Unless renovated, aside from higher operational costs, buildings are at increasing risk of becoming stranded by new regulations, such as MEPS, taxes and ever-growing climate risks<sup>12</sup>.

Compliance with MPS also has a technology dimension where banks will need tools to set and track precise portfolio targets aligned with the Paris Agreement. In the case of commercial real estate, and larger buildings, the Carbon Risk Real Estate Monitor (“CRREM”) is an example of an easy-to-use pathway tool for science-aligned decarbonising, and reducing stranding risks<sup>13</sup>. CRREM is used by managers owning upwards of €300 billion worth of property covering a total of 5 million square metres.

## Defining a Paris-aligned MPS trajectory for a building and a mortgage portfolio



## CONCRETE MPS EXAMPLES

With a loan portfolio of EUR 185 billion<sup>14</sup> for residential and commercial property (2/3 of its balance sheet), Dutch bank ABN AMRO finances over 10% of the buildings in the Netherlands. By 2030 the bank intends for its commercial real estate and entire residential mortgage portfolios, and branch network to have an “A” weighted average energy performance label. The bank has partnered with the Partnership for Carbon Accounting

<sup>12</sup> UNEP. (2021). *Buildings and Climate Change Adaptation: A Call to Action*. [Website]. Retrieved from <https://globalabc.org/resources/publications/buildings-and-climate-change-adaptation-call-action>

<sup>13</sup> These are aligned with the Paris Climate Goals of limiting global temperature rise to 2°C, with ambition towards 1.5°C. Sourced from: GRESB. (2021). *Carbon Risk Real Estate Monitor (CRREM)*. [Website]. Retrieved from <https://gresb.com/carbon-risk-real-estate-monitor/>

<sup>14</sup> ABN AMRO. (2017). *ABN AMRO helps clients improve the sustainability of their homes*. Retrieved from <https://www.abnamro.com/en/newsroom/press-releases/2017/abn-amro-helps-clients-improve-the-sustainability-of-their-homes.html>



Financials (PCAF) to assess the carbon intensity and the necessary measures for each building. Its interim goal for 2025 is for the bank's real estate portfolio to have a "C" label.

The United Kingdom is evaluating the improvement of the energy performance of home through lenders through two regulatory proposals: Firstly, mandatory disclosure of energy performance for all registered mortgage lenders on their websites and to Gov't on an annual basis, and secondly, that UK lenders should voluntarily agree to meet an average MPS of EPC level C by 2030.

The UK Government recognises the unique position that lenders have to influence their clients' perspective on energy performance at critical trigger points such as home purchase, renovation, or re-mortgage. Moreover, UK lenders are developing a renovation market as a way of reducing the risk of homes becoming stranded assets as minimum energy performance standards become stricter. The UK government also promotes a TrustMark scheme banks can use where businesses are vetted to meet required standards and are required to provide robust consumer and financial protection.

## INTRODUCING MPS IN EU REGULATION

Portfolio mandates have been included in articles 5 (for utilities) and 7 (for public buildings) in the Energy Efficiency Directive (EED). We believe that MPS can be included in a revised Article 10 of the Energy Performance of Buildings Directive (EPBD), where the EC can require Member States to mandate MPS to manage transition risk in real estate lending and within EU mortgage portfolios:

*“Article 10.8 Member States shall require all mortgages lenders to implement mortgage portfolio standards to align the energy and emissions performance of their financed buildings portfolio with the Paris Agreement”*

Mortgage portfolio standards would clearly align with the EU Taxonomy, and other EU financial regulation to accelerate banks proactive engagement in buildings renovation. Further, the MCD can require a duty of information and advice from lenders on building energy performance (articles 13 and 14). This would make the borrower aware of any climate or transition risks in respect of the property,

and provide the borrower access to an estimate of a Paris-compliant deep renovation.

Mortgage portfolio standards can be referenced by the European Banking Authority (EBA) as a facilitating element of the promotion of increasing Green Asset Ratios (GAR). A GAR is envisioned by the EBA to cover all lending including to SMEs, households, local governments, municipalities and cover loans, advances, debt securities, equity instruments and repossessed real estate collateral. The publication of GAR for financial institutions will demonstrate the alignment of lenders' activities with the EU Taxonomy<sup>15</sup>. As over three quarters of EU bank Taxonomy-relevant lending is not yet aligned with the Paris Agreement, MPS is the ideal tool for banks to also address the GAR transition.

## CONCLUSIONS

The building sector is trying to “self-organise” in the face of increasing EU climate ambition and the opportunity to capitalise on cost effectively saving energy, improving performance, and delivering local jobs through renovations.

When applied by banks to their tens of millions of mortgages, existing mortgage portfolio standards are already driving transparency and rapid change for those green leaders who are already voluntarily using them. Mortgage portfolio standards work efficiently and they are a missing element that can bring lenders behind and to underwrite the delivery of the EU's Renovation Wave. In sum:

- **MPS will align mortgage lenders with the EU Green Deal and Renovation Wave strategy.**
- **MPS can address 50 million homeowners immediately.**
- **MPS will accelerate financed offers to the low hanging fruit for energy efficient renovations.**
- **MPS is a structured way for banks to manage climate transition risk in their mortgage portfolio.**

<sup>15</sup> EBA. (2021). *EBA/Rep/2021/03*. Retrieved from <https://bit.ly/3k6naMa>

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