Engaging Retail Lenders in Home Renovation

2023

Executive Summary

The most cost-effective way to reduce emissions, improve resilience, address energy poverty and reduce dependence on imported fossil fuels is to invest in energy efficiency. Investing to save energy creates local jobs, saves money, delivers longer and more healthy lives for fragile communities and provides the base of Europe's energy transition by placing energy efficiency first.

Buildings are in the spotlight because they are collectively the most significant energy users in Europe and are highly inefficient. As energy prices increase, and renovation receives more public financial support, the demand for energy efficiency investments is rising, and yet retrofit rates are still far below those anticipated by the EU Green Deal, or in most Member States' renovation plans.

"Lack of finance" is frequently cited by building owners and policymakers as one of the most important barriers to action, and yet **many banks offering finance for home renovations are underwhelmed by customer demand.** In a world where consumers are smothered in financing options for cars (hire purchase), white goods (0% interest, buy now & pay later) and many other competing investments, it's a surprise that so few attractive "point of sale" renovation finance options exist, and how little financial support would-be renovators have.

There are over one hundred thousand bank branches in the European Union and retail lenders process "millions of daily customer interactions[1]" online. **Over a quarter[2] of EU homes have a mortgage and this channel to discuss energy savings is underused. Lenders could offer and process the millions of energy renovation loans, or green mortgage top-ups, annually required to deliver the finance needed to upgrade and modernise the EU's buildings.** With limited public funding rightly being prioritised for the most needy, the EU's building renovation and energy efficiency targets will be wholly unachievable without the engagement and alignment of mortgage lenders. The required step-change in energy renovation rates will be impossible without mortgage lenders hosting informed and engaged dialogues with building owners on their energy performance and how to resolve this.

This report looks at the role of financial institutions in building renovation in Europe, through their sustainable finance and mortgage operations, and is supplemented by responses to a detailed 2023 sustainable finance questionnaire. The work approaches the offer of buildings' renovation finance through the prism of lenders' existing sustainable finance activities, climate risk management and decarbonisation commitments. Further, it provides **a new way of segmenting EU homeowners to improve the market's understanding of the need to offer different financial blends of public and private components to deliver a renovation wave**, and through that a resilient and energy secure and efficient housing stock.

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[1] EUSEW INTERACTIVE. (2023). *Fredrik Nilzen intervention in panel: Strengthening energy efficiency for the clean energy transition and energy independence*.[Website]. Retrieved from https://interactive.eusew.eu/eusew-2023/sessions/3305191a-6c82-44c1-802f-145d622bfdc5

[2] Statista. (2023). *Share of the population in European countries who are owner-occupants in 2021, with or without a mortgage*. [Website]. Retrieved from https://www.statista.com/statistics/957803/homeowners-with-and-without-an-outstanding-mortgage-in-eu-28-per-country/

European banks with net-zero targets[3], clear transition plans or science-based emissions reductions trajectories have already identified their mortgage books as containing material climate risks and opportunities. They have also seen the evidence that shows mortgage arrears and defaults in Europe decrease as property energy performance improves[4]. In fact, **over 30% of Europe's largest banks have already begun to implement a voluntary Mortgage Portfolio Standard** as a result of regulatory changes and to operationalise their overall climate targets, identify data gaps and provide a framework for action for renovation.

Lenders to buildings, their owners and occupants need better data. Fortunately a host of AI-powered, proxy-based, and innovative solutions are emerging to resolve these data gaps[5]. An ambitious recast of the EU Buildings Directive (EPBD) can introduce minimum energy performance standards, accelerate the uptake of Mortgage Portfolio Standards and help improve buildings data through improving Energy Performance Certificates (their quality, coverage and visibility), introducing building passports and digital logbooks, and requiring disclosure of embodied carbon emissions in the construction and renovation sectors.

Over 70% of EU homeowners own the homes they live in. The majority of these homeowners can borrow against their homes if they wish to improve their comfort and energy performance - and be paid back through energy savings and value increases. However, many of these homeowners do not meet the income, age or loan-to-value tests required to qualify for more mortgage debt. Private sector lenders therefore need public support to deliver attractive funding to these tens of millions of homeowners. This is potentially **a trillion euro opportunity where EU-level guarantees can be deployed with private capital to better serve the needs of an often older and precarious market segment** who need a new blended public-private financial instrument to renovate.

In 2023, the EU adopted an updated Energy Efficiency Directive that contains an economy-wide final energy consumption target which represents a 21% reduction by 2030 on 2021's actual energy use. Meeting this target will be historic and requires actions that are over and above what has gone before. Success will deliver significant economic and security benefits to countries, yet it cannot be met unless building renovation rates increase significantly. This is why **2023 also needs to see an ambitious agreement in the recast of the EU Buildings Directive (EPBD) that combines new standards with the financial resources to deliver the EU Renovation Wave**. The report concludes with four key recommendations to policymakers and financial institutions.

[3] NZBA Signatories commit to setting sectoral decarbonisation targets for 2030 or sooner in line with pathways that limit global warming to 1.5 degrees above pre-industrial averages. This includes residential and commercial real estate.
[4] European Commission, Directorate-General for Energy, *The quantitative relationship between energy efficiency improvements and lower probability of default of associated loans and increased value of the underlying assets – Final report on risk assessment*, Publications Office of the European Union, 2022, https://data.europa.eu/doi/10.2833/532126
[5] EEFIG. (2023). *Collecting and monitoring data on energy efficiency investments and financing across EU Member States and targeted economic sectors.* [Website]. Retrieved from https://op.europa.eu/en/publication-detail/-/publication/f8d98e5e-fdd2-11ed-a05c-01aa75ed71a1/language-en/format-PDF/source-287360293

This report recommends the recast EPBD strengthen the following four areas:

1	Member States need to establish minimum energy performance standards through a framework with clear and measurable interim targets to improve the energy performance of their commercial and residential buildings.	These must be established in line with the collective EU targets, and national energy and climate plans and buildings renovation strategies, with a focus on the worst-performing buildings.
2	Governments need to increase grant funded renovations to the energy poor and increase levels of technical and project development assistance to all residential segments. In addition, an EU-level guarantee facility should be made available to retail lenders engaging in providing home renovations to the elderly and homes with poor economics.	The launch of an EU Renovation Loan would immediately increase the resources available to Member States and offer specific tailored retrofit funding to homeowners unable to refinance or extend their mortgages for renovation. It will also level the playing field across the EU by helping resolve issues of scale, fiscal headroom and speed to market.
3	Mortgage lenders in the EU must play a more proactive role in unlocking the trillions of home equity stored in the buildings owned by their clients. By implementing a voluntary Mortgage Portfolio Standard, these lenders can more easily identify the low-hanging fruit and the climate risks in their property backed loans, and will be able to more efficiently deliver their own sustainable finance and net-zero commitments.	A Commission-led Delegated Act process can convene Europe's leading lenders and experts to build from the many existing best practices and help define technical standards and guidance to achieve these goals.
4	All necessary policy levers must ensure that more and better quality energy use and performance data is surfaced to the buildings renovation supply chain, and homeowners, to help residential and commercial buildings owners prioritise cost effective renovations, add value to their properties and reduce operating costs.	The complexity of renovation must be resolved by the contractors, financiers and trusted project managers. Digital logbooks, building renovation passports, AI, proxies and improved and advanced EPCs all have a role to play, but fundamentally building owners need support and simplicity. .

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