Retrofit funding propositions

Short report

FEBRUARY 2021

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1 INTRODUCTION

This roundtable was organised as part of the UK Green Building Council's Accelerator Cities programme, with the support of EIT Climate-KIC, and the Green Finance Institute's Coalition for the Energy Efficiency of Buildings, to explore the opportunities for partnerships between local and combined authorities and the finance community to drive retrofit at scale.

This paper summarises those discussions and sets out recommended next steps.

2 SUMMARY

The roundtable confirmed a shared commitment to the net zero agenda and to collaboration between local and combined authorities and the finance community.

It identified the need for a deeper, local understanding of the market, both from the perspective of individual homes and homeowners and at a regional level. This will enable the appropriate design and scaling-up of new and existing funding models for all circumstances.

The social housing sector can act as a foundation of long-term programmes to stimulate all aspects of the market. This includes providing opportunities for the aggregation of projects and therefore delivery and financing at scale.

There is a clear role for local and combined authorities in this process if their resource challenges can be addressed as a key part of the process.

We recommend a series of design labs to take the discussions forward by outlining and then piloting individual and coordinated financial and delivery mechanisms, in collaboration with initiatives in the green built environment and finance sectors.

3 BACKGROUND

There is growing consensus of the importance of retrofitting homes in achieving net zero as well as providing jobs and healthier, more comfortable, and affordable homes. This is recognised in emerging government policy including the recent 10-point plan commitments on buildings[1], £2bn Green Homes Grant scheme[2] and Minimum Energy Efficiency Standards (MEES) consultation[3].

Alongside further and sustained government commitment, there is a recognised need for local and regional coordination, alongside a significant amount of public and private finance. It is estimated that £8.66bn of government investment per year for four years from 2020-2024 could unlock a cumulative total of around £71.95bn of private capital investment in that timeframe in existing and emerging financial products.[4]

This roundtable explored the relationship between these three elements, building on the ongoing collaborative work of the UK Green Building Council and Green Finance Institute.

UK Green Building Council, Accelerator Cities (Accelerator Cities)[5]

This programme is designed to support and enable both local and combined authorities to take action on home retrofit, run by UKGBC and partners, with co-funding from EIT Climate-KIC. It includes a 'Playbook'[6] to support the development of local and regional strategies and finance represents a key pillar, alongside stimulating demand and the supply chain.

Green Finance Institute, Coalition for the Energy Efficiency of Buildings (CEEB)[7]

The Coalition for the Energy Efficiency of Buildings (CEEB) was established by the Green Finance Institute, with support from E3G, as its flagship coalition in December 2019. Made up of more than 200 individual members from a diverse range of sectors, the CEEB's remit is to develop the market for financing a net-zero carbon and climate-resilient built environment in the UK, initially by catalysing the widescale retrofitting of residential buildings. The demonstration projects (CEEB demonstrators) presented in their report 'Financing energy efficient buildings: the path to retrofit at scale'[8] and 'Financing zero carbon heat: turning up the dial on investment'[9] show the elements that a coordinated approach to finance would include.

3.1 Local authority perspective

George Munson of Leeds City Council is a member of both Accelerator Cities and the CEEB and provided the following summary:

- Resource: There is a significant variation in 'capacity' across local authorities including their knowledge, skills, and access to data, but they almost all suffer an acute lack of resource.
- Commitment: Despite this lack of resource, there is a commitment to playing a leading role in tackling climate change, inequality and improving the quality of life for their communities; with a recognition that retrofit is key to each of these.
- Role: Currently, local authority projects are necessarily focused on existing funding and they are keen therefore to act as a catalyst by leveraging their influence and existing programmes to stretch public funding and social housing budgets, potentially acting as conduit or provider of finance, whilst recognising different appetites for risk.
- Challenge: Government policy is generally piecemeal and stop-start, without a recognition that to deliver programmes in many communities, a package of support for all tenures is required to enable whole streets or whole communities to be improved cost-effectively.
- Strengths: Local authorities have a deep understanding of their areas in terms of the housing stock and communities who live in them and are therefore ideally placed to design and facilitate cross tenure programmes.

3.2 Investor perspective

Emma Harvey of the Green Finance Institute chaired the roundtable and provided the following summary:

- The Green Finance agenda: Consists of 'Greening Finance' that pertains to reporting and disclosure, and 'Financing Green' which focuses on mobilising capital toward environmentally positive outcomes.
- Innovative products: Green Finance requires cross-sector collaboration to develop innovative financial products, customer engagement and education, and in the context of this roundtable can be understood as being aimed at either consumers or local authorities.
- Barriers to mainstream investment: In addition to the wider barriers to retrofit at scale, there are those specific to finance which include:
  - The challenge of offering attractive funding solutions to homeowners, while delivering commercial returns to lenders and investors.
  - Limited scale of both the market and individual projects, which can stymie the development of new financial products.
  - Perceived technology risk for products and services that do not have a long track record.
  - Sections 56 and 75 of the Consumer Credit Act which places liability with finance providers where contracts are unfulfilled.
  - A lack of consistent, long-term government policy.

4 DISCUSSION POINTS

The roundtable generated the following discussions:

4.1 Shared commitments to net zero

There are clear commitments from the finance community that align with the climate emergencies declared by local and combined authorities.

Both groups recognised the opportunity to collaborate to unlock the barriers to retrofit and are keen to work together to co-create solutions.

A local authority led approach can help overcome competition concerns for the finance community.

4.2 Understanding the retrofit market

There is a need to differentiate between income levels and motivations of different householders, housing types and tenures, as well as understanding the different tiers of decision making at homeowner, organisational and regional levels.

This will allow the design and coordination of programmes and associated finance, to cover all circumstances, initially targeted at the social housing and ‘able to pay’ sectors which are considered ‘ready’, subject to an adequate supply chain.

This design and coordination should include optimising the level of retrofit we require across the housing stock to achieve net zero, as it has a dramatic impact on the economics. In Leeds alone this could be the difference between £10bn and £16bn of investment when comparing Part L of the Building Regulations and the Enerphit Standard respectively[10].

The ‘Optimised Retrofit’ project is a Welsh Government funded collaboration between Sero and 68 partners, including 26 social housing providers. It is developing ‘Pathways to Zero’ that will allow all homes to achieve their lowest possible carbon footprint through a combination of fabric improvements, low carbon technology and intelligent building controls[11].

4.3 Utilising existing financial products

There are well established financial products that support investment into other sectors that, for the right business cases, could be applied to the retrofit market.

There are clear roadmaps for how these can be developed, although these require an understanding of the gap highlighted by UK100[12] between available finance and investible models. This includes addressing the issue raised by UK100, that there is a lack of resource and development capital in local and combined authorities available to develop these investible models.

For example, the bond markets are well-established in the UK and gross capital issuance by UK residents stood at £35.8 billion in November 2020[13]. The debt capital markets can provide borrowing over 30-40 years, with public issuances typically benchmarking above £250 million and private placements from £25 million upwards. By comparison, standard corporate loans typically provide financing for 5-15 years.

There are opportunities to utilise bespoke delivery vehicles (e.g. joint ventures and special purpose vehicles), blend private and public capital (e.g. guarantees and cornerstone investment) and also to aggregate projects to provide access to more sophisticated financial products.

4.4 Innovating new financial solutions

It is important to recognise that some emerging financial products have experienced very low uptake, primarily driven by low homeowner demand for retrofits.

An appropriate product needs to be available to consumers, and there is also a collective responsibility to develop the underlying business models and raise awareness and the aspirational nature of retrofit.

There is a key role for regulatory drivers in the form of fiscal incentives and policy levers, such as increasing minimum energy efficiency standards for the private rented sector. In Wales, the government has set a mandatory target of EPC A by 2030 for all tenures.

Local authority and community investment through the likes of Community Municipal Investments can have a dual benefit[14]. This product can deliver community wealth building, while also raising awareness that can drive behaviour change and encourage the demand for home retrofit.

4.5 Coordination for scale

One of the key questions was: 'How do we create a delivery mechanism for bringing it all together?'.

There was a shared view that joined up, regional and local authority level strategies are the answer, with finance as a key pillar.

These should include blended funding models that bring together public and private capital, which can enable attractive funding options for homeowners and landlords.

Neighbourhood-based approaches that initially build on social housing programmes could provide a valuable environment for developing and testing blended funding approaches, as well as unlocking the necessary scale for accessing the capital markets.

A recent review of the West Yorkshire Combined Authority's 'Better Homes Yorkshire' framework agreement recommended a regional loan scheme for retrofit. Some local authorities already act as loan provider, for example through schemes like Lendology[15] and Sheffield City Council's Energy Repayment Loans[16]. This could provide an element of a blended funding model, and may require partnerships with financial institutions in order to provide capital and manage risk.

It is important that local authority officers from multiple departments are included from an early stage to help design approaches that are robust from all perspectives.

Underpinning all aspects of the discussion was a clear emphasis on the role of Quality Assurance as a shared opportunity between local authorities, finance providers and householders.

5 OPPORTUNITIES FOR COLLABORATION

The workshop confirmed that a collaborative approach between the finance community and local and combined authorities can play a critical role in a holistic approach to overcoming the overlapping barriers in coordination, demand, supply, and finance.

This approach can unlock the multiple positive impacts of retrofit including an important focus on addressing fuel poverty, improving public health and providing other social value.

The UK Green Building Council Accelerator Cities Playbook[17] has identified the elements necessary for successful city and region-wide strategies and provides an illustration of the opportunities for collaboration with the finance community.

The Green Finance Institute's CEEB has published several reports[18] that outline a portfolio of commercially-viable and environmentally impactful financial mechanisms that draw on cross-sectoral collaboration. The CEEB members are actively bringing to market these solutions.

5.1 National policy

There is growing consensus on the need for ambitious, coordinated and consistent government policy to tackle retrofit. Collaboration between the different sectors such as this joint Green Finance Institute and UK Green Building Council initiative, and the active participation of the finance community and local and combined authorities, can provide confidence for national policy makers.

National Retrofit Strategy: The Green Finance Institute and UK Green Building Council have both supported calls by the Construction Leadership Council for a National Retrofit Strategy which includes a central role for finance[19].

5.2 Regional strategies and coalitions

Many regions are now developing multi-stakeholder initiatives to develop and deliver regional strategies, drawing upon all perspectives and sharing knowledge, skills and resource. The finance community can play an important role in these networks.

Case study: The Greater Manchester Combined Authority, Retrofit Accelerator is being led by the University of Salford and draws in partners including businesses, housing providers and other organisations[20]. The GMCA strategy is summarised in Part 1 of the UKGBC Retrofit Playbook[21].

5.3 Development capital

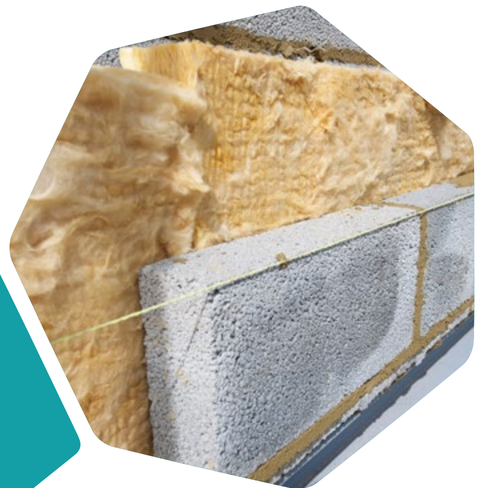
The workshop echoed the findings of the UKGBC Accelerator Cities project, on the acute resource gap in local and combined authorities, which creates a challenge for them playing an active role in project development, beyond local authority portfolios or where there is direct project finance. The experience of the finance community can be invaluable in demonstrating how seed funding can provide the resource and development capital to kick start regional programmes, which can be recovered across the projects as they subsequently develop.

Case study: The UK100 campaign Financing Local Energy proposes a National Net-Zero Development bank and demonstrates that £5bn of government development capital could unlock £100bn of private investment, a model that could be explored at a regional level[22].

5.4 Quality assurance

A sound base of technical standards is required for risk management in both the finance sector and local and combined authorities. Working together to develop consistent quality assurance approaches such as PAS2035, helps to reduce the barriers to product development and assist with scaling-up viable solutions. Insurance, performance contracts and guarantees are potential enablers of increased private investment into the sector.

Case study: Metered Energy Savings is a demonstration project under development by the Green Finance Institute's CEEB. This project aims to create a standardised energy savings calculation methodology to deliver rich data on real-time energy savings over the lifetime of a retrofitted building[23].



5.5 Social housing sector

Local authorities are often Registered Social Landlords with their own housing portfolios and in any case, along with combined authorities, possess strong working relationships with others. Significant emphasis is being placed on addressing fuel poverty within emerging government funding packages such as the Local Authority Delivery Scheme (LADS) within the Green Homes Grant scheme and the Social Housing Decarbonisation Fund. This government investment and the emerging decarbonisation commitments from the sector offer an ideal platform to develop business and finance models, capable of aggregation and acting as a foundation to catalyse the rest of the market.

Case study: Sustainability Linked Bonds such as those recently issued by Clarion Housing and arranged by Natwest Markets, HSBC and Santander, open up opportunities for low interest rates and long-term capital to fund retrofit programmes[24].

5.6 Private ownership sector

Privately owned properties represent the largest and most challenging sector to retrofit, due to the breadth of the barriers including low levels of consumer awareness, the 'hassle factor', access to attractive finance and limited trust in the supply chain. Emerging one-stop-shop models are aimed at removing a lot of the barriers to retrofit, and the provision of compelling financial products will be an essential factor in achieving scale in this market across all tenures. This includes green rental agreements developed for the private rented sector being applied in the social housing and commercial sectors.

Case study: Green Mortgages such as those provided by Ecology[25], Barclays[26] and Nationwide[27] that offer preferential interest rates on borrowing for retrofit activities or to purchase energy efficient homes.

Case study: Property Assessed Clean Energy products provide long-term capital for retrofit projects, with the unique characteristic that the finance remains with the property, rather than the property owner, when the original homeowner decides to move property. [28].

Case study: Green rental agreements with an 'Energy Alignment Clause' enable social and private sector landlords to recover the cost of a retrofit, based on the predicted energy savings, and minimises the landlord-tenant split incentive[29].

5.7 Neighbourhood-based approach, blended funding models and financial coordinators

The workshop discussed the opportunity presented by neighbourhood-based approaches, where social housing schemes can act as a foundation for engaging with all homeowners in a neighbourhood by presenting a blend of funding options to suit all tenure types and financial circumstances. This would leverage grant funding by combining them with emerging financial products and require a degree of financial advice and coordination.

Case study: A neighbourhood-based approach was adopted by the Leeds Group Repair Schemes where energy efficiency measures were included in a wider regeneration project and successfully engaged with 100% of property owners across all tenure types.

Case study: A financial coordinator role is provided by Lendology alongside their regulated service of managing loan facilities provided by local authorities for home upgrades. They also signpost homeowners to alternative sources of finance[30].

5.8 Regional financing for retrofit

Local and combined authorities are exploring their role in all aspects of driving retrofit at scale including the role of regional financing. The source and structure of the finance that supports each of the above elements will depend on the role that individual local and combined authorities are comfortable in playing. Developing a range of approaches that balance the associated risk and reward, will allow all regions to act as either facilitator, coordinator or providers of different elements of the finance mix.

Case study: Community Municipal Investments such as those developed by Abundance Investments provide a low cost and longer-term form of borrowing for local authorities available to retail and therefore community investors and are capable of enabling direct investment by local authorities[31].



6 RECOMMENDED NEXT STEPS

The participants demonstrated a clear commitment to support the retrofit agenda and strong ambition to deliver real-economy outcomes in this sector.

We propose a series of 3 design labs, aimed at complementing the Green Finance Institute's CEEB, that bring together the shared expertise of local and regional authorities, the finance community and other stakeholder representatives.

These will involve the following key elements with a view to developing prototypes for piloting:

1: Review housing stock data and the economics of retrofit with a view to developing business cases for social housing and the blended funding models necessary for the private sector.

2: Explore the elements of regional retrofit strategies, existing financial mechanisms and the CEEB demonstrators to identify the opportunities for cross-sectoral collaboration.

3: Outline priority opportunities and agree an approach to supporting pilot projects including collaboration with all stakeholder groups and advocacy to central government.

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ACKNOWLEDGEMENTS

We would like to thank the individuals from each of these organisations who have contributed their time, insights and feedback, in their personal capacities, to strengthen the quality of this report.

Abundance Investment

Barnsley Metropolitan Borough Council

Centre for Innovation and Energy Demand, University of Sussex

Devon County Council

Ecology Building Society

Green Finance Institute

Hull City Council

Leeds City Council

Legal & General Investment Management Ltd Nationwide Building Society

NatWest Group

Otley Energy

Royal Borough of Kensington and Chelsea

Sefton Council

Shropshire Council

St Helens Council

Swan Housing Association

West Midlands Combined Authority

West Yorkshire Combined Authority

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With special thanks to:

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