How to engage retail lenders in home renovation

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European mortgage lenders must align their real estate loans with their net-zero targets. The degree of Paris alignment of mortgage lending is, however, low and the rate of issuance of green mortgages is slow. This article provides insights and recommendations to EU policymakers of how the recast Energy Performance of Buildings Directive can change this.

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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 healthier lives for fragile communities and provides the base of Europe's energy transition by placing energy efficiency first.

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.

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" online. Over a quarter 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 neediest, 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.

European banks with net-zero targets, 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. 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. An ambitious recast of the EU Energy Performance of 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.

An ambitious recast Energy Performance of Buildings Directive is a once in a decade opportunity for Europe

2023 is the year when EU Governments and citizens began to see that addressing the thermal quality and energy efficiency of buildings through renovation is the bedrock for the delivery of a fair and net-zero emissions economy in Europe. As a vehicle, the recast EPBD seeks to establish the regulatory frame to stimulate increased renovation investments through 2030. This is the moment when mortgage lenders must identify the "low hanging fruit" of the worst performing buildings and support the offer of public and private finance solutions to turn an inefficient and uncomfortable home into a modern, comfortable and climate-friendly one.

Most EU financial institutions are aware that the collateral against which they provide mortgages is largely inefficient and will fall out of alignment with the net-zero emissions pathway at some point in the coming years. Leadership in offering renovations to mortgage clients has largely been among lenders with voluntary forms of Mortgage Portfolio Standards, Science-based emissions reduction targets or in countries with Minimum Energy Performance Standards. Unlike buying a new home, or car, the renovation process is more complex and execution is provided by a multitude of local contractors whose warranties and standards are all very different. Financial institutions who have been able to make renovation finance programmes work have also been able to rely on supportive measures provided by standards, contractor accreditation, improving technologies (like heat pumps) and increasingly sophisticated measurement tools and AI.

Like LEDs, wind and solar, the "whole package" of energy performance renovation is receiving more and more attention, heat-pump technology has finally started to gain traction and the business process efficiencies of a growing market are slowly becoming apparent. Point of sale financing that packages public and private components to provide the best offer to homeowners is a critical element of successful renovation delivery, and some mortgage lenders are years into building leadership here.

The financial institutions implementing climate risk and mitigation measures, portfolio by portfolio, understand the highly material risk of inaction in mortgages, and are aware that there is a limited window of opportunity to work with Governments to jointly address and deliver shared objectives. This provides a unique backdrop for more formal processes which bring together impacted organisations with experts and policymakers to co-develop voluntary and regulatory approaches which together can accelerate the delivery of energy savings to homeowners.

Business as usual renovation rates do not serve homeowners, governments nor the EU, as they leave buildings exposed to energy price shocks and keep the EU energetically unfit and vulnerable. An ambitious recast EPBD is a once in a decade opportunity for Europe, and it must contain the financial measures recommended in this report to enable millions of EU citizens to save energy and see the real benefits and impacts of the EU's new energy and climate ambitions. We conclude this article with four critical recommendations to EU policymakers. ■

To read more and a fuller analysis of the data behind these conclusions, please download our recent report via this link: https://www.climatestrategy.es/en/informes.php

Four critical recommendations to EU policymakers:

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.