Making Mortgages Energy Efficient?

Scoping research into the accreditation of financial products that promote sustainable energy use

Report to the Energy Efficiency Partnership for Homes (Home Purchase and Finance Group)

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Disclaimer

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CONTENTS

EXECUTIVE SUMMARY

Buying a home is a time when the new owner is typically planning home improvements, borrowing money at relatively low cost, and expecting to stay put for a while after the move. This home-buying transaction therefore represents an 'ideal opportunity' to persuade or entice the new owner to make energy efficiency improvements, supported by low cost mortgage borrowing, with a reasonable period for the householder to enjoy the resulting fuel bill savings.

With 1.4 million such transactions in the UK each year, realising this ideal opportunity more frequently could have a significant beneficial impact on the energy performance of the UK housing stock and hence on carbon dioxide emissions.

This study set out to explore the potential for an accreditation scheme for financial products promoting sustainable energy use to help achieve this impact. The study identified that, while three mortgage providers do offer these products, there is no evidence that a wider market for such products yet exists amongst the larger mortgage providers or the majority of home-buyers. The study's authors concluded that the market is not yet ready for an accreditation scheme.

In the light of this, the study looks more widely at the UK housing market and explores how the financing of home buying could combine with other efforts to give energy efficiency a higher profile. It analyses experience overseas and outlines some basic conditions that a mortgage which promoted sustainable energy might need to meet to engage home buyers. Finally, the study identifies a range of associated initiatives and developments which could pave the way to shift home-buyers and mortgage providers more towards realising the 'ideal opportunity'.

Towards an energy efficient mortgage? A six point plan of action

Our research has shown that we are faced with an indifferent home-buyer and a mortgage market largely unconvinced by the commercial potential of promoting sustainable energy use in their products. Changing this will require concerted effort to tackle this consumer indifference and to bring to the market competitively priced mainstream mortgage products which make it simple and enticing for the home-buyer to take action to improve sustainable energy use.

This approach gives rise to a 'six point plan' as recommendations to the Energy Efficiency Partnership for Homes to:

- Raise the profile of energy efficiency much more significantly within the Home Condition Report (HCR) (and in the Home Information Pack more generally)
- Ensure the communication of energy efficiency advice in the HCR is potent and motivating
- Outline the basic building blocks of mortgage products which would promote sustainable energy use
- Develop a programme of support which entices major mortgage providers to test the market with a high profile pilot in conjunction with the Energy Saving Trust or some other agency which provides 'accreditation by association'
- Look at the potential for involving energy suppliers in the delivery of energy saving measures (with explicit explanation of their energy saving obligations)
- Identify and pursue further policy measures (eg changes to stamp duty, focus on energy performance in regulations governing the provision of mortgage advice) which could create further motivation and incentives to improve energy efficiency in the newly-purchased home.

No single measure in this six-point-plan is likely to achieve a 'breakthrough'. Improving the HCR is unlikely to secure action unless the opportunities exist (prominently) to borrow the cost of energy saving measures and organise their installation. But such opportunities to borrow are unlikely to emerge without significant action to stimulate home-buyer interest and raise the priority of energy efficiency within their home improvement plans.

However, in combination these six measures could begin to realise the opportunity to improve energy efficiency that currently lies dormant in the majority of the 1.4 million home purchase transactions which take place every year in the UK.

- **Existing products promoting sustainable energy use: UK and overseas**

There are three financial institutions who currently provide mortgages in the UK which have a connection with the promotion of sustainable energy use: the Co-operative Bank; the Norwich and Peterborough Building Society (N&P), and; the Ecology Building Society.

These are welcome initiatives. The Co-operative Bank and N&P provide one-off energy advice as a stimulus to consumer action, though they both found limitations on what they could offer on a commercially viable basis to follow up this advice. This advice provision is similar to the energy advice which will be a compulsory element of the Home Condition Report (HCR) from 2007 onwards.

In the case of the Ecology BS, it limits its lending to ‘eco’ new build and renovation of derelict property and so has only limited applicability to the main UK housing market.

In other countries, notably the US, Canada and Australia, mortgages have been developed (usually with the involvement of a government agency) which more actively promote and incentivise the take up of energy efficiency improvements as part of the mortgage structure. These typically include:

- an energy survey which identifies accurately the measures the home-buyer could cost-effectively make to improve the energy efficiency of the home
- a provision to borrow a certain amount above and beyond normal loan-to-value and income multiplier rules to fund the measures identified in the survey
- an incentive to make the improvements within a given period of time (eg through a reduction in interest rate once evidence of completion is provided).

As with the UK products, these overseas examples are not particularly prevalent in their home markets. Nonetheless they have features which make them more likely to be successful in securing energy efficiency improvements from their customers than the products currently available in the UK. However, such products are very unlikely to emerge ‘naturally’ and at scale in the UK mortgage market as it currently stands.

- **The views of the mainstream mortgage providers**

Interviews with the three top mortgage providers in the UK found a shared and strong sense that there was not currently a market for financial products which promote sustainable energy use. They point to the predominant market focus on price (i.e. interest rate) and limited customer interest in other product features, particularly if they increase costs.

The forthcoming introduction of the energy advice element of the HCR was not considered sufficient to change this, though each provider is seeking to increase the level of advice and information on sustainability issues which they make available to customers as a matter of course.

In the absence of either a strong market pull based on demonstrable customer demand or a clear and specific regulatory push, it is extremely unlikely that major mortgage providers will be leading the development of mortgage products which promote sustainable energy use.

- **Understanding the home-buyer’s perspective**

The ‘ideal opportunity’ described here presumes an interested, well-informed and attentive home-buyer and a mortgage market featuring products which make it simple for the home-buyer to act. The reality is very different.

Home-buyers are generally not considering the energy performance of their next home and they are not looking for sustainable energy ‘bells and whistles’ in their mortgage product. They also demonstrate a more general disinterest in sustainable energy combined with:

- a lack of confidence in the quoted costs and savings from specific energy improvements
- a lack of trust in the delivery channels for the proposed energy efficiency measures (energy suppliers and insulation contractors)
- limited motivation to give energy efficiency priority over other home improvements.

The potential for the new HCR to change this situation should not be over-stated. While a welcome development, the energy efficiency advice will be in Section H of the HCR and the HCR is one of a number of elements of the Home Information Pack. In this context, there is a reasonable probability that the energy efficiency advice will be drowned out by the noise of all of the other information.

A six point plan of action

Our research has shown that we are faced with an indifferent home-buyer and a mortgage market largely unconvinced by the commercial potential of promoting sustainable energy use in their products. Changing this will require concerted effort to tackle this consumer indifference and to bring to the market competitively priced mainstream mortgage products which make it simple and enticing for the home-buyer to take action to improve sustainable energy use.

This approach gives rise to a 'six point plan' as recommendations to the Energy Efficiency Partnership for Homes. This is outlined in the box on page 4

1 INTRODUCTION

The point when someone buys a home represents, in theory, an ideal opportunity for them to consider improving the energy performance of their new dwelling. This is because:

- the new owner will typically be planning home improvements (providing an opportunity for energy efficiency improvements to feature in their plans)
- the new owner is, in most cases, borrowing to buy and improve the home, with potential therefore to borrow additional money at the same time to pay for energy efficiency improvements (thus reducing the hassle of arranging further credit for such measures at some point in the future)
- the new owner will generally expect to stay in their new home for a reasonable period (enabling them to benefit fully from any fuel bill savings achieved by improved energy performance)

This opportunity exists some 1.4 million times each year in the UK – as homes change hands – representing a significant potential for securing energy efficiency improvements in the UK housing stock; improvements which are otherwise proving quite difficult to secure.

This study was commissioned from the Centre for Sustainable Energy (CSE) by the Home Purchase and Finance Group of the Energy Efficiency Partnership for Homes to consider how the financial products market might combine with forthcoming requirements for point-of-sale home energy performance information to increase the likelihood that this 'ideal opportunity' is more frequently realised.. Specifically, the group was interested in how an accreditation scheme could be developed which would provide confidence in, and build a market for, financial products which promote sustainable energy use.

However, in the course of the study it became clear that, from the varied perspectives of home-buyers and mortgage providers, the 'ideal opportunity' outlined above looks rather different.

There are only a handful of products currently available from three of the smaller mortgage providers which actively promote sustainable energy use. These are welcome initiatives. However, larger mortgage providers see no market for such products, perceiving that energy efficiency plays no active role at all in home-buying decisions, mortgage selection, or short-term improvement plans.

And, in spite of what they might say in market research surveys, actual home-buyer behaviour shows that, within all their plans for their new homes, they pay practically no attention to energy efficiency improvement opportunities. The obstacles to realising the 'ideal opportunity' are much more significant than those which could be addressed at this stage by an accreditation scheme – as overseas experience reveals.

This study set out to explore the potential for an accreditation scheme for financial products promoting sustainable energy use. The study identified that, while three of the smaller mortgage providers do offer these products, there is no evidence that a wider market for such products yet exists amongst the larger mortgage providers or the majority of home-buyers. The study's authors concluded that the market is not yet ready for an accreditation scheme.

The study therefore looks more widely at the UK housing market and explores how the financing of home buying could combine with other efforts to give energy efficiency a higher profile. It analyses experience overseas and outlines some basic conditions which a mortgage which promoted sustainable energy might need to meet to engage home buyers. Finally, the study identifies a range of associated initiatives and developments which could pave the way to shift home-buyers and mortgage providers more towards realising the 'ideal opportunity' and thus securing the potentially significant financial and environmental benefits of doing so.

2 BACKGROUND TO THE STUDY

Since 1 January 2001, all new homes in the UK must display their home energy efficiency rating (calculated using the Standard Assessment Procedure for Energy Rating of Dwellings, or SAP). This regulation was designed to give prospective buyers and first occupiers an idea of the energy efficiency of the home and to promote energy efficiency as a factor in the buying decision.

Although this has possibly achieved some increase in awareness of home energy efficiency standards amongst buyers of new homes, the biggest challenge from an energy efficiency perspective remains securing improvements in the existing housing stock. To do this householders need to be informed, motivated and assisted to make home energy improvements – something which is potentially more likely to be achieved at a time when they are already thinking about home finance and/or home improvements.

There are some 1.4 million domestic property transactions in the UK each year. And from 2007, all domestic properties changing hands will have to come with a Home Information Pack (or ‘Sellers Pack’), which will include a mandatory Home Condition Report (HCR) which will, in turn, include an energy efficiency assessment of the property detailing cost effective measures to improve its energy performance.

In theory, this offers a huge opportunity to engage householders in thinking about home energy improvements and to develop new financial products which simplify their financing and installation.

In an ideal world, when future home buyers, armed with the HCR, select a mortgage or home loan, they should be able to:

a) access financial products that assist them in making appropriate home energy improvements to their properties as identified in the HCR;
b) choose from a selection of financial products to find one to suit their particular needs;
c) distinguish between the various claims made about the sustainable energy impacts achieved by financial products.

Currently there are no independent schemes for achieving (c) or checking that (a) is genuinely helpful and accurate. There is therefore potentially a risk that home buyers could be misled or confused by products. Such a situation would justify the development of an accreditation scheme to help customers to distinguish the genuinely useful and effective products and to support accredited providers in marketing their schemes.

It was in this context – of a forthcoming change to the type of information available to a home-buyer at the time of purchase and the potential for confusion amongst consumers about energy saving claims made by competing products– that the Energy Efficiency Partnership for Homes' Home Purchase and Finance Group commissioned this study to scope out such an accreditation scheme.

At the outset of the project, it was assumed that there were products in the market which endeavoured to promote sustainable energy use. These included products from three mortgage providers: The Co-operative Bank, the Norwich and Peterborough Building Society and the Ecology Building Society. It was also assumed that the forthcoming improvement in energy-related information in the HCR would potentially tempt more providers into the market with their own products.

As we shall see, closer inspection of the existing products and discussion with the three main mortgage providers in the UK show that these assumptions need to be revisited.

3 STUDY METHODOLOGY

The study had four components

- desk research into current home purchase and finance industries

- review of existing and prospective energy-related financial products and the views of mortgage providers of the potential market for such products

- review of existing accreditation schemes – both within the UK for other products and services and overseas for energy efficient mortgages – to assess the appropriateness of adopting their approach for mortgages

- development of proposals to bring energy efficiency more explicitly into the home-buying and mortgage market

As mentioned in the Introduction, the original intention for the study had been to draw up specific proposals for a UK accreditation scheme for mortgages which promote sustainable energy use. The evidence drawn from the first three research activities outlined above revealed the need to take a broader view of appropriate measures other than accreditation schemes at this stage in the market's development.

This section describes the activity undertaken for each element.

3.1 Desk Research into current home purchase and finance industries

Using data from the mortgage industry (eg Council of Mortgage Lenders – CML), the Bank of England and the Office of National Statistics, the project team built a picture of the UK housing market and the associated finance, including:

- numbers of homes changing hands each year
- numbers of first time mortgages and frequency of remortgaging
- numbers of home loans issued and their types
- how often people move.

The team reviewed CML surveys and various attitudinal studies by Halifax, Commission for the Built Environment and WWF to assess the extent to which energy efficiency or broader environmental issues play a part in choice of home or choice of mortgage product or provider. The project team also reviewed recent work which CSE has undertaken into consumer attitudes to energy efficiency for Ofgem and *energywatch*. This enabled a reasonably rounded picture of the home-buyer's perspective (and the place of energy efficiency within that) to be drawn.

Finally, the team examined developments in terms of the Home Information Pack and the anticipated role of energy performance information and energy advice within the HCR.

3.2 Review & assessment of existing & prospective energy-related financial products

The project team reviewed the mortgage and remortage markets, equity release products and home loans for evidence of products which promoted sustainable energy use. This produced a short list of just three mortgage products which had features related to this purpose.

The team then conducted semi-structured telephone interviews with providers of each of the specific products identified to establish:

- the drivers for offering the product
- the detail of its operation and administration
- how the product has been adapted to respond to customers needs
- customer uptake
- how successful they have been in encouraging the uptake of home energy improvements (and how such information is monitored)
- likely changes in the products or new products which might result from the introduction of the HCR
- their view on the benefits of some form of accreditation scheme for products that promote sustainable energy use.

Such interviews were held with Norwich and Peterborough Building Society, Ecology Building Society and the Co-operative Bank. The project team also assessed these products in terms of their likely attractiveness to home-buyers in relation to the wider mortgage market and the extent to which they were likely to encourage customers to achieve more sustainable energy use.

Interviews were also held with representatives of larger mortgage providers – Abbey, HBOS (Halifax) and Nationwide (which between them represent nearly half of the UK mortgage market). These interviews – for which it was often difficult for the institutions to identify an appropriate spokesperson – sought views on the potential role of energy efficiency in the mortgage market, the general level of interest for developing new financial products linked to the HCR, and perspectives on the merits of an accreditation scheme linked to sustainable energy.

3.3 Review of existing accreditation and endorsement schemes

There are no existing accreditation schemes in the UK for financial products that promote sustainable energy or wider sustainability objectives. The Ethical Investors' Group and a number of other ethical financial advisors categorise and provide information to consumers on mortgages and other financial products based on social and environmental criteria. However, there is no evidence that advisors measure or monitor the claims and performance of any products against any standardised criteria.

The project team therefore examined overseas experience – from the US, Australia, Canada, the Netherlands and Germany – to see if it could offer models or lessons from which the UK could learn. This process included telephone interviews and/or email exchanges with key people involved in the schemes in each of the countries.

In addition, the project team undertook a brief review of a selection of other accreditation schemes for different products and services – particularly for financial services and for energy efficiency or other sustainability products or services. These included:

- the CAT Standard for mortgages
- "Energy Efficiency Recommended" and EU energy labels for white goods
- the Eco-homes and BREEAM accreditation systems for new homes and non-domestic buildings (in terms of scheme set-up, management and operation)
- Ofgem's processes for approving energy efficiency measure included within EEC schemes
- the new Minimum Standards for Energy Advice Code of Practice
- the EU eco-label
- FTSE4Good
- the 'raising quality standards' mark scheme for life insurance, pensions and ISAs, accredited by the Pensions Protection Investments Accreditation Board (PPIAB).

There are elements of these accreditation schemes which may potentially be applicable in future to a system to accredit mortgages which promote sustainable energy. However, bearing in mind the changing emphasis of the study as it progressed, these were not examined in more detail here. They remain to be examined in more detail in any future development of an accreditation scheme.

3.4 Developing proposals for bringing sustainable energy into the home-buying and mortgage market

As mentioned in the Introduction, the original intention for the study had been to draw up specific proposals for a UK accreditation scheme for mortgages which promote sustainable energy use. The evidence drawn from the first three research activities outlined above revealed the need to take a broader view of appropriate measures other than accreditation schemes at this stage in the market's development.

The focus therefore moved to using existing knowledge and examples from overseas to identify the characteristics of a mortgage product which has the potential to stimulate and support home-buyer investment in improving the energy performance of their new dwelling.

The project team considered what might be required to create a significant market for such a product. The team also examined the aspects of such products which any future accreditation scheme would need to address. This process took into account the views of existing product providers gained through the interviews described above.

3.5 Defining 'promoting sustainable energy use'

This study is about financial products which 'promote sustainable energy use'. It would therefore be useful to define 'sustainable energy use'. This can be defined in accordance with an energy 'hierarchy' which promotes, in order of environmental priority and cost-effectiveness: reduced demand for energy services; improved efficiency in the delivery of energy services, and; the use of low carbon and renewable energy sources to supply some or all of the remaining energy demand.

In the context of financial products such as mortgages to promote sustainable energy use, this will therefore principally relate to products which promote improved energy efficiency and, possibly, the installation of buildings integrated renewables or micro-CHP.

4 SETTING THE SCENE: THE UK MORTGAGE MARKET

4.1 The volume and nature of UK domestic mortgage transactions

Approximately 1.4 million homes are bought and sold each year, with buyers borrowing approximately £24 billion a month to finance these moves or to remortgage their existing homes.

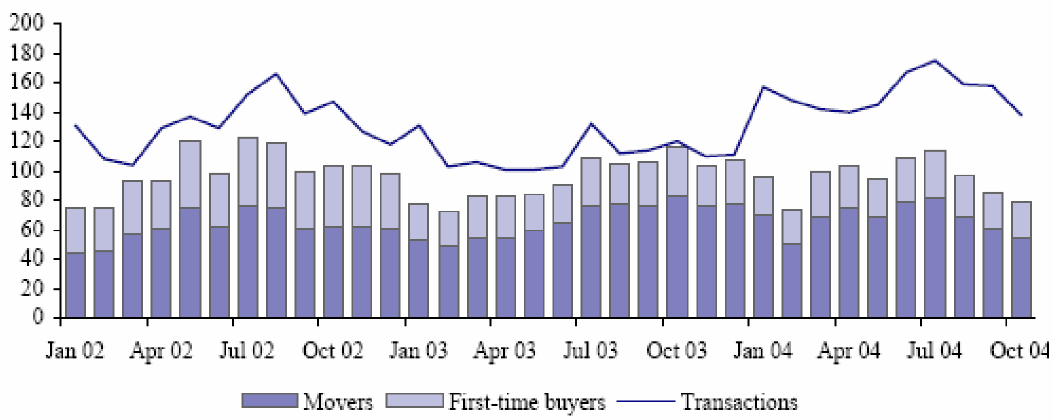
Table 1: Forecast summary

	2002	2003	2004	2005
House price growth, fourth quarter, year-on-year % change	26.4	15.4	8	6
Property transactions, 000's	1,585	1,340	1,360	1,395
Gross advances, £bn,	218	269	284	287
Net advances, £bn,	78	96	102	106
Further advances, £bn	13.1	18.4	11.9	10.0
First-time-buyers, % of loans for house purchase	38	30	29	29
Remortgages, % of gross advances	34	42	41	35
Arrears, 3-6 months, number of loans at end of period	81,340	54,000	60,000	65,000
Possessions, number in period	11,970	7,200	8,500	11,000
Base rates, fourth quarter, %	4.0	3.7	4.5	4.7

Source: Bank of England, CML

Table 1 shows the trend in property transactions in England, Wales and Northern Ireland from 2002 to 2004 years with projections for 2005. Approximately 1.4 million property transactions are expected in 2005, with a further 150,000 transactions expected in Scotland. A total of £287 billion is expected to` be advanced to finance these transactions and for remortgages (35% of total) on existing properties.

Chart 1: Transactions, split by mover and first-time buyer, 000s

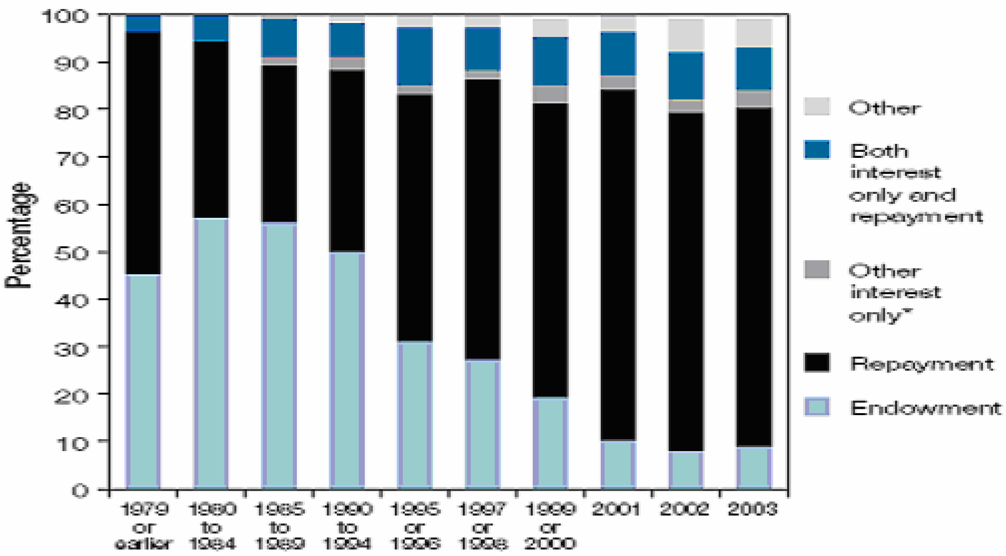


Source: Inland Revenue, Survey of Mortgage Lenders CML.
Notes: The level of transactions recorded by the Inland Revenue in 2004 may have overstated actual activity because of some accounting adjustments in the first quarter

Chart 1 shows the numbers of first-time buyers (FTB) and movers during 2002–2004. There were consistently more movers than FTBs, typically at least twice as many in any given month. Most participants in the housing market are therefore experienced home owners with experience of paying fuel bills and maintaining a property.

The type of mortgage dominating home purchases has changed over the last 15 years. Interest-only mortgages where the capital repayment was due to be made via an endowment policy – so called endowment mortgages – peaked in popularity in the mid 1980s, representing more than half of the market. However, the product has not lived up to expectations in terms of capital growth and subsequently has become less popular. As Chart 2 shows, repayment mortgages are currently the most popular types with 75% of the total mortgage market (2004 data).

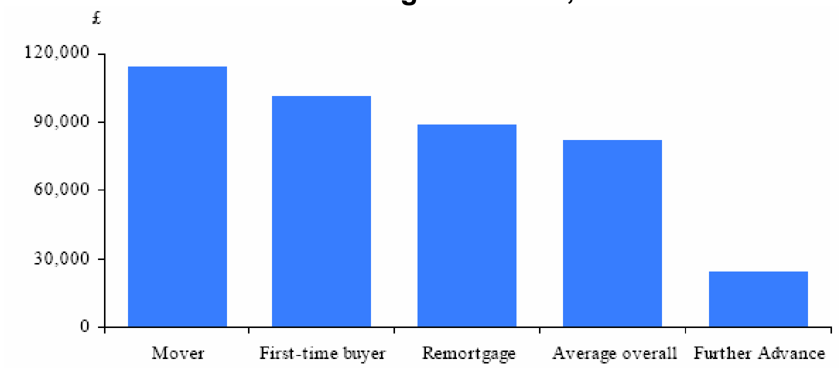
Chart 2: Type of mortgage by year bought



*includes Pension, ISA & Unit Trust mortgages

Chart 3 below shows the average size of mortgage taken out in 2004, for different mortgage types, A typical mortgage in 2004 would be in the region of £100–110K - and represent a loan to value ratio (LTV i.e. the amount of money borrowed against the value of the property) of between 0.9 and 0.95. Mortgage providers will typically lend for 25 years and, on various approaches, an amount of 3 times main salary plus second salary (the income multiplier).

Chart 3: Average loan size, 2004

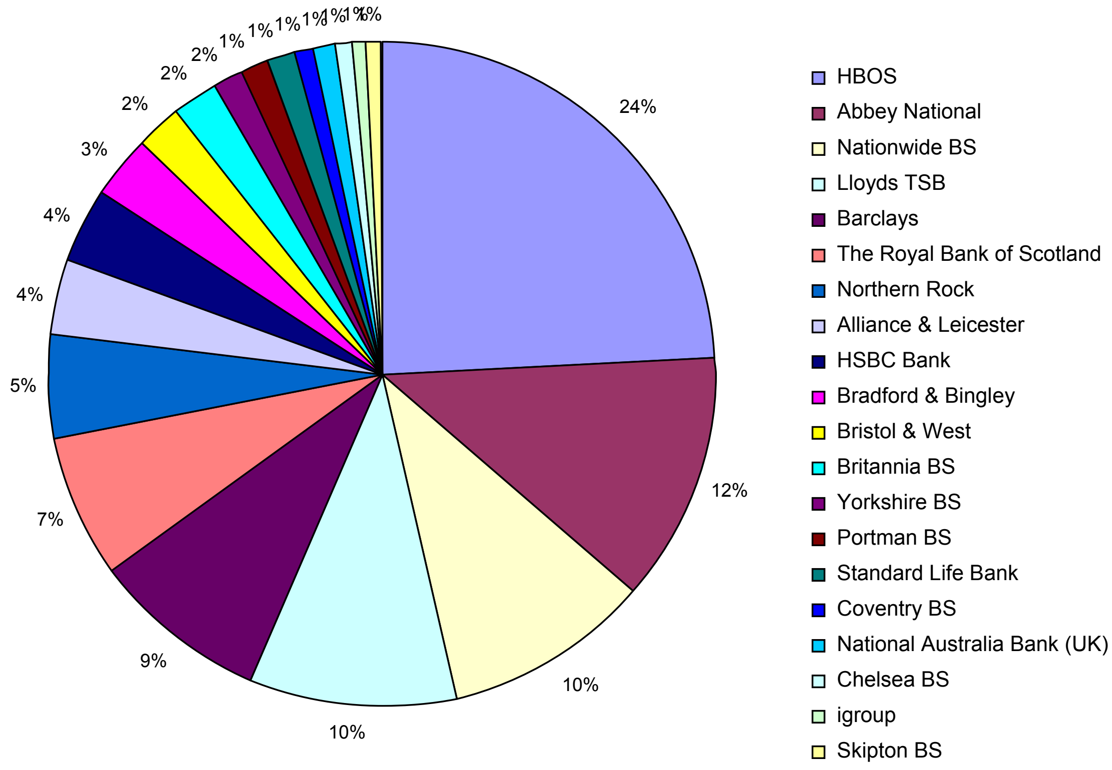


Source: Survey of Mortgage Lending, CML

It is important to recognise that, with house prices continuing to rise, these industry standards are being stretched to enable people to borrow enough to afford the homes. This potentially has implications for the extent to which people have either the financial space or inclination to borrow additional money to invest in energy efficiency improvements – even if they do 'pay back' with lower fuel bills.

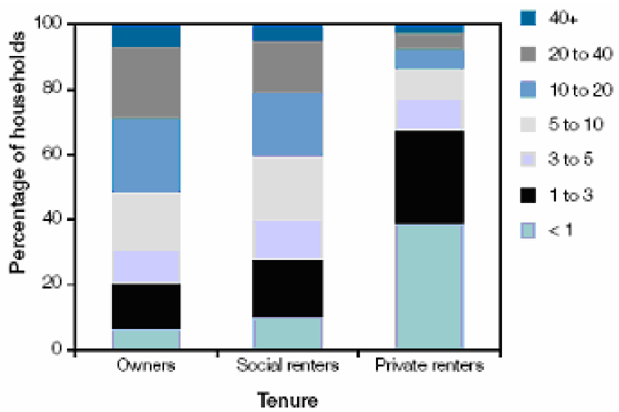
The main mortgage providers in 2004 are shown in Chart 4 below.

Chart 4: How the UK mortgage market divides



Another factor to consider in the context of mortgages and energy efficiency improvements is how often people move house. As Chart 5 shows, people can be expected to move on average once every 12 – 15 years, with slightly more than half of owner occupiers living in the same home for more than 10 years. In other words, while some homes might change hands more than once in the next 10 years, it can be expected that between **40 - 50% of all existing homes are likely to change ownership in the next 10 years.**

Chart 5: Length of residence by tenure: 2003-04



4.2 Home-buyer perspectives of the housing and mortgage markets – and related energy and environmental issues

The Council of Mortgage Lenders undertakes an annual survey of consumer views of mortgages. Its 2003 survey showed that the interest rate dominates their choice of mortgage and mortgage provider:

- The main factor that influenced consumer choice of their present mortgage lender was the interest rate (31%). Other reasons were: professional advice (28%); lender prepared to offer amount required (15%); another type of account held with lender (14%), and; convenience of location (11%).
- 45% of all mortgage-holders' total household income exceeds £30K. Less than one in six (15%) of all mortgage holders' total household income is less than £17,499
- A fifth of mortgage-holders changed their mortgage lender since first taking out their mortgage.
- Another fifth of mortgage-holders increased their borrowing against mortgage – with more amongst social classes AB (upper middle class) (25%) and those aged 35–44 (24%). People who increased their borrowing saw it as a relatively low cost means of raising capital.
- On average, mortgage-holders have held their current mortgage for 5 years.
- 37% of mortgages held are on a variable rate and 34% are fixed rate. 9% of people have a variable rate which is reviewed annually and 6% have a discounted interest rate for a specified period.
- The most common type of mortgage that people would most prefer to take out tomorrow would be one with interest rate fixed for more than 5 years (26%). 22% would prefer a fixed rate mortgage for less then 5 years and 15% said they would prefer a variable mortgage rate.

The Halifax and New Homes Marketing Board undertook a survey of consumer attitudes towards new homes and found increasing popularity for new homes and some attention to energy ratings provided with the new homes:

- 28% of those questioned in exit polls (from home viewings) said they would only consider buying a new home.
- 38% of respondents said that adequate information was given to them by the builder with respect to the energy rating of the home, though more wanted the information; 57% of people said that it was important or very important to them to be informed about the energy rating of their new home.

In spite of the requirement for energy ratings, very few people questioned in the survey said they had been told about how the house was built, why certain materials had been used, what energy ratings the home had, how it was insulated or even where the meter boxes were located. They also revealed that the detailed 'facts and figures' about the homes available in brochures were only consulted much later in the process, effectively after the purchase decision had been made.

These findings reinforce the survey results reported by a 2003 NHER study into SAP ratings in new homes (the standard assessment procedure for energy rating domestic properties) – which showed that:

- 98% of sample sites failed to comply with building regulations by not displaying SAP ratings within their unsold properties
- just one site out of 50 had a significant proportion of homes clearly displaying the SAP ratings where they should be placed.

A Gallop survey in 2000 reported in the NHER study found that 70% of consumers would be willing to pay more for energy efficient homes and the same proportion want to see energy ratings on all homes.

A more detailed study of consumer attitudes to the built environment was undertaken in 2004 by CABE (Commission for Architecture and the Built Environment), HBOS plc (the parent company of Halifax) and WWF. Focusing on sustainability issues, the survey found that:

- 87% of buyers want to know if their homes are environmentally friendly
- 84% will pay 2% extra on the purchase price for an eco home
- 66% of buyers say they are not given adequate information about the technical specifications of a new home
- in order of importance, people considered as eco-friendly factors; improved levels of energy efficiency, lower running costs, enhanced air quality and daylight, use of low allergy and environmentally friendly material and water efficiency
- the public want the sort of information promised by the Government's [then] planned Home Seller's Information Pack.

These market research results would indicate an interest in sustainability issues in housing amongst the home-owning public and some understanding of the importance of energy efficiency in this context.

4.3 The basis for a belief in the potential for energy efficient mortgages

In combination, the scale of turnover of the housing market and the apparent interest and willingness of home-buyers to consider energy rating information (and pay more for eco-friendly features of which energy efficiency is valued most) provides the foundation for the belief that there might be a market for financial products which promote sustainable energy use.

However, as outlined below (sections 4.2 and 6), this foundation does not fare well in the eyes of the mainstream mortgage providers interviewed for this study who see little sign of this market.

Nor does it reflect a rounded view of the home-buyer’s perspective which places energy efficiency not within an answer to a market research question on sustainability but within the broader context of their home-buying decisions and attitudes to energy efficiency.

4.4 Understanding the banking basics: the myth of ‘low interest’ loans

Before reviewing the existing mortgage products promoting sustainable energy use in some way, it is valuable to address a myth which seems to be prevalent within some sections of the energy efficiency community.

In recent years, a number of energy efficiency commentators and experts have suggested – often ‘in passing’ – that banks and building societies should provide low interest loans for energy efficiency improvements. This suggestion is driven principally by market research which shows that people claim that the lack of low cost credit is one of the reasons why they are not doing more to improve the energy efficiency of their homes.

However, this ‘low interest loan’ approach demonstrates a fundamental misunderstanding of the financial services industry. It assumes banks and building societies have some source of ‘low interest’ money they can lend out at such preferential rates – and they don’t.

At a very simple level, banks and building societies lend to home-buyers the money which savers have deposited with them. The money they earn in interest on the loans pays for the interests banks pay on savers' deposits (after a small margin of perhaps 2% to cover administrative costs and provide the profit expected by shareholders).

Banks and building societies will therefore only have 'low interest' money to lend to home-buyers or home-improvers if some of their depositors are prepared to accept 'low interest' deposit rates (or Government or some other agency is prepared to subsidise the interest payments). It is therefore not reasonable to expect the banks or building societies themselves (or their savers) to make a loss on such loans.

Of course, this does not mean that they could not decide to provide discounts or preferential rates in order to attract new customers, as frequently occurs in the normal course of business. They would just have to be convinced that such discounts would secure enough new business to make it worth their while. As we shall see, it is not obvious that the banks and building societies are considering discounts for energy efficiency investment in such a light.

5 EXISTING 'GREEN' MORTGAGES: PRODUCT ANALYSIS & EVALUATION

The project team undertook an extensive review of products available in the financial sector – from mortgages to home loans and equity release schemes. Only three mortgage providers were found which have developed products which have a connection with the promotion of sustainable energy use: the Ecology Building Society; the Norwich and Peterborough Building Society, and; the Co-operative Bank.

The relevant products and approaches of each provider are outlined below with further background details provided from interviews. The products are then evaluated in terms of the extent to which they are considered likely to encourage customers to achieve more sustainable energy use.

It should be said at the outset of this section that, simply by making products available in the market which do more than other mortgage products to promote sustainable energy use, these providers have been breaking new ground. Their experiences and the limits they have encountered on what can realistically and viably be delivered in the current market are important to understanding the opportunities and priorities for future market development.

5.1 The Co-operative Bank

- **The product**

All Co-operative Bank mortgages are badged as 'environmentally responsible' as part of the Bank's overall approach to sustainability within its product offerings. The mortgages have two primary attributes relating to sustainable energy:

- All home purchases (not re-mortgages) include a free home energy efficiency report including a SAP rating, in conjunction with the valuation. This details how energy efficient a house is, and how money can be saved via various energy savings measures.

- The Bank undertakes to 'offset' 20% of all carbon dioxide emissions arising as a result of household electricity and gas consumption. Based on current government targets for emission reductions, this has been equated to a tonne of carbon dioxide per year.

To meet this 'offsetting' undertaking, the bank makes a payment every year, for as long as the mortgage is held, to Climate Care, an organisation dedicated to helping tackle global warming. In 2004, the total payment was £250,000 which contributed to Climate Care's programme to restore more than 50 hectares of rainforest in Kibale, Uganda. As the project continues, the Bank expects its contributions to focus less on absorbing emissions through tree planting and more on reducing emissions through energy efficiency and renewables projects. This includes introduction and promotion of biofuels and biomass stoves in Africa.

In addition, customers will also receive the Bank's customer magazine (which gives ideas on sustainable house improvements) and a new home-movers pack is being launched which will include discount offers on environmentally-related products and the promotion of a 'green' electricity tariff.

- **The rationale for the product, its marketing and pricing**

This product was introduced in 2002 to fit with the Bank's public commitment to sustainability and its associated strategy of being a market leader in ethical banking. In 2003 the Bank had a 0.3% (and rapidly growing) share of the UK mortgage market and is by far the largest of the three providers detailed here.

The product is marketed as a competitively-priced mortgage with environmentally responsible features, and advertising frequently appears in periodicals with high ‘green’ readership.

The product is priced competitively (fixed rate of 4.89% for three years or 4.99% fixed for five years – at July 2005) compared with mainstream mortgages and occasionally it appears in ‘good buy’ listings in money advice magazines and newspapers.

- **Evaluation of its role in promoting sustainable energy use**

The Co-operative Bank sees the promotion of action on sustainable energy as only one part of the ethical aims of its mortgages. It is likely that, through the provision of the home energy efficiency report, the mortgages do have a limited effect in encouraging householders to take action, though no link is made between the report and the terms of the mortgage itself. When the HCR includes the energy report as a matter of course, however, this aspect of the mortgage will do no more than that required by regulations.

There is clearly some merit in offsetting the home-buyer’s carbon emissions through investment by the Bank in emission reduction schemes elsewhere. However, there are critics who suggest that this approach may have the effect of reducing the incentive for the household to reduce their own emissions through improved efficiency.

- **Further information and possible future developments**

The Bank has contemplated offering preferential terms (discount mortgages) to energy efficient housing but felt that, in practice, this would lead to preferential support for new housing stock, as these are much more likely to be built to high energy efficiency specifications and so felt it would be wrong to judge by a SAP rating. Additional concerns about the proportions of new housing being built on green field sites led to the dropping of this concept.

The Bank is also interested in financing renewable energy installations in customers’ homes, but has found generally that people looking to invest in technologies like solar thermal water heating or photovoltaics are not looking to borrow. They would nonetheless be interested in including lending for such technologies in any future product development and accreditation scheme.

The Bank is very aware that the introduction of the HCR will negate the ‘added value’ of the current energy efficiency rating it offers. It also considers it important to balance the provision of a competitively priced product with at least some sustainability features against the potential cost of adding in additional features. The Bank is currently exploring a range of options for future development of their approach.

5.2 The Norwich and Peterborough Building Society

- **The product**

The Norwich and Peterborough Building Society (N&P) offers a ‘Carbon Neutral’ mortgage for all new properties with a SAP rating of at least 100 and for customers that ‘want to make their properties more energy efficient’. These mortgages can be transferred between properties provided that the new property has an appropriate SAP rating.

N&P’s green mortgage range includes:

- A 1% discount off N&P’s standard variable rate for four years for energy efficient new homes
- A 0.75% discount off N&P’s standard variable rate for four years for secondhand homes with £500 cashback towards energy efficiency improvements and a free home energy rating report and advice.

Both products are also available with fixed rate options.

In addition, 8 new trees are planted by Future Forests Ltd each year for the first five years of the mortgage term. This is designed to make the house 'carbon neutral' by offsetting the emissions from the property against the rate of carbon absorption by the new trees. The trees are planted in new forests being created by Future Forests in East Anglia and Lincolnshire. Customers wishing to continue with the scheme after the initial five years can do so by paying Future Forests £4 for every new tree.

- **The rationale for the product, its marketing and pricing**

The N&P says that it is offering this product for two principal reasons: a perception that there was a gap in the market with no one offering anything similar, and; simply because the institution feels ethically it is “the right thing to do”. They included new build because they wish to encourage developers to build homes that are more energy efficient than required by building regulations.

The building society is very pleased with product uptake although it was not prepared to provide details. 'Anecdotally' customers have come them already knowing of their green mortgages. N&P see them as evolving products and plan to continue offering them.

- **Evaluation of its role in promoting sustainable energy use**

The approach taken by N&P of providing free energy advice and detailed recommendations for improvements does provide the home-buyer with an opportunity to act. However, as with the Co-operative Bank’s mortgage, this advice is not linked to the terms of the mortgage.

N&P’s green mortgages are not the cheapest deals on the market but are competitively priced and obviously have the additional energy-related features. Bearing in mind the cost savings currently available by buying a cheaper mortgage product, N&P has to work hard to sell the advantages of choosing a green mortgage to potential customers. The costs of delivering the extra features, such as the carbon offsetting, create some commercial limits on the potential to reduce prices to stimulate further customer interest.

The carbon offsetting is potentially an attraction but, as mentioned above, some would argue that this may have the opposite effect of undermining motivation for reducing carbon emissions, even with the efforts of N&P to promote energy efficiency.

- **Further information and possible future developments**

The new HCR has not apparently been considered yet in relation to the development of this product. However, the N&P is keen to encourage customers to act more responsibly in environmental terms.

5.3 The Ecology Building Society

- **The product**

The Ecology Building Society is one of the UK’s smallest building societies (its loan book is less than 2.5% of the size of that of the Co-operative Bank), but it has a very specific niche for its mortgage product. It only offers mortgages for those interested in energy efficient or ‘eco’ new-build or renovation of derelict properties. It only lends to those with an active interest in such improvements and it polices quite closely its mortgagees' ecological performance. They therefore only provide home mortgages for:

- properties including derelict and disused buildings that are being restored, old houses in need of renovation: They specialise in mortgages for the renovation/conversion of dilapidated and derelict property, bringing it back into use for owner occupation - a form of recycling, reducing the need for new build
- new homes built with recycled or sustainable materials; they lend for eco-self build where there is a lower impact on the environment. For example, they will consider timber property and some forms of non standard construction such as earth sheltered dwellings, cob and straw bale construction. They also lend on back to back terraces, organic farms and smallholdings
- homes which will be made as energy efficient as possible: encouraging borrowers to consider reduced energy use (e.g. high levels of insulation and renewable energy, such as solar and wind power) reduced pollution and eco-friendly materials (e.g. reclaimed wood, stone, brick, slate etc.)

Each mortgage applicant is provided with a copy of The Green Building Bible (GBB), produced by the Association for Environment Conscious Building (AECB). The GBB includes a directory of members and useful articles, including information on energy saving. They also plan to provide simple fact-sheets on eco-renovation/eco-self build, produced in association with the AECB.

- **The rationale for the product, its marketing and pricing**

The Ecology Building Society's mortgage epitomises its ecological principles. It has a very specific market – of building renovators and self-builders. It markets to them through specialist and 'deep green' publications. Many of its customers are working on projects rejected by other lenders.

Many customers arrive following recommendation of existing members and from intermediaries. They are listed on the main green information directories and advertise in mortgage and building magazines as well as green publications. Ecology differentiates from other lenders on its flexible approach, specialist knowledge and ethos rather than on its rate.

That said, it's pricing is reasonably keen in the market (particularly bearing in mind the nature of its specific niche), with an emphasis on stability. Providing borrowers maintain their account satisfactorily and complete all agreed repairs/improvements, after two years they will qualify for a loyalty discount of 0.25% below the prevailing standard variable interest rate (currently 6.3%) until the end of their mortgage term. They were recently ranked fifth in the ten year category of the What Mortgage Awards Best Value Lenders for 2005.

- **Evaluation of its role in promoting sustainable energy use**

The Ecology's approach of policing the building renovation and improvements being undertaken by its mortgagees and the advice and support it offers clearly helps to promote sustainable energy use, particularly in the context of broader ecological building methods. However, the product is not available for 'normal' existing housing and its focus on the motivations and interests of its customers will tend to ensure that it is generally working with people who have already taken up the ecological and energy saving message.

- **Further information and possible future developments**

The Ecology is considering changes to its mortgage product in light of the future introduction of the Home Condition Report.

5.4 An overview of the existing products

To summarise the products currently on the market which have some element relating sustainable energy, we have:

- one competitively priced product which does a little to promote sustainable energy use but does not go beyond what will be compulsory in the new HCR;
- one product which does only a little bit more but currently at a relatively high price, and;
- one encouraging and supportive product which is not available to most home-buyers

On this evaluation, it is difficult to conclude that there are any financial products currently on the market which would have a significant impact on the customer's approach to sustainable energy use. In Section 9 we will return to this issue and attempt to outline a financially robust product which might achieve this objective. Before that, we'll examine further the potential market.

6 THE VIEWS OF THE MAINSTREAM MORTGAGE PROVIDERS

The products outlined in Section 5 represent less than 0.3% of the UK mortgage market. The project team therefore approached the three largest mortgage lenders – Halifax (HBOS), Abbey and Nationwide – to assess their perspectives of the market and the potential for products which promote sustainable energy use.

6.1 HBOS including Halifax (24% of UK mortgage market)

The HBOS group has looked at the possibility of developing green products and services including green mortgages. They conducted customer research as an organisation to tailor their products to consumer demands and have worked with the WWF '1 Million Sustainable Homes' project and Insight investment fund managers. The conclusion was that they felt the niche market for green mortgages was being met already and therefore there was no business case for going down this route as well.

In their view, the public will always say they are concerned with green issues but these issues actually have very little relevance when it comes to finances. The finer details of cost of the mortgage are what matters. They have doubts that there is – or will be – a market for financial products that promote sustainable energy and the viability of an accreditation scheme would depend on convincing evidence to demonstrate such a market.

HBOS will be revisiting the issue regularly and it is interested in how to respond effectively to what it sees as increasing external pressure on sustainability and environmental awareness. They acknowledge that the forthcoming introduction of the HCR is likely to affect the products they are offering, but no decisions have been taken as yet as to how this will be taken on board and whether it will be viewed as a risk or an opportunity.

HBOS was also asked about the potential for adopting an approach from the US in which lending for energy efficiency improvements is allowed above and beyond normal income multipliers (on the basis that the improvements create their own 'income' from fuel bill savings). HBOS' view is that, in the current housing market, the multipliers are already extremely high and there was little additional room for manoeuvre.

6.2 Abbey (12% of UK mortgage market)

The Abbey has not considered offering mortgages tailored to environmental issues or sustainable energy specifically. Its standard Home Buyer's Report already includes a section on energy efficiency which is intended to make customers aware of potential improvements that could be made. No follow up is carried out on this and no extra money is made available in the mortgage to assist in implementation of the recommendations.

They expect to examine the implications of the HCR but feel that their existing Home Buyers Report, while it does not provide a SAP rating, does cover the energy efficiency angle quite effectively. The company representative communicated a strong sense that this issue was not on its radar at present and they do not perceive a market for 'green mortgages'.

6.3 Nationwide Building Society (10% of UK mortgage market)

The Nationwide actively promotes energy efficiency through a prominently displayed guide on their website 'Money-saving ways to an eco-friendly home'. It includes links to the Energy Saving Trust website, energy efficiency advice centre telephone contact details, and links to green energy websites.

The site (in place since September 2004) gives advice on energy saving measures, related costs and savings and then suggests financing these improvements through home loans.

However, the Nationwide's financial products themselves do not incorporate any environmental features. The building society has looked into the possibility of offering a product along the lines of a green mortgage but their general strategy is to provide products that suit the masses and feel this is very much a niche market. They have no intention of introducing such a product in the near future.

It is felt that the Home Condition Report will sway the market somewhat and also that the energy efficiency commitment on energy suppliers (EEC) and related promotions will further increase awareness of issues of energy efficiency. The new HCR could affect individual property values, but the Nationwide already offers additional borrowing schemes for general home improvements and does not intend to tailor them any more specifically to energy efficiency.

The existence of an accreditation scheme for financial products that promote sustainable energy would probably encourage them to reinvestigate the issue but they have a strong feeling that this is a niche market.

6.4 Conclusions from the mainstream

The three major mortgage providers interviewed share a strong sense that there is not yet a market for financial products which promote sustainable energy use. Providers which have looked at its potential have concluded that the current niche is not likely to hit the mainstream. They point to customer focus on the price of their mortgage which overwhelms other factors in the product purchasing decision (confirmed also by the CML survey reported in Section 4.2). The forthcoming introduction of the HCR does not seem to be significantly altering this perspective.

In the absence of either a strong market pull based on demonstrable customer demand or a clear and specific regulatory push, it is very unlikely that major mortgage providers will be leading the development of mortgage products which promote sustainable energy use.

7 LESSONS FROM OVERSEAS: ACCREDITATION WITHOUT MARKET DEVELOPMENT

If there are only a handful of products in the UK which promote sustainable energy use and the largest mortgage providers are shunning the concept, is there experience from overseas which can help point the way to product and market development? The answer is ‘yes’ to product development but ‘no’ to market development.

In most cases, development has been led by or supported by government agencies. Clearly there are differences between countries in relation to the nature of both the housing market and the mortgage market. Nevertheless, there are ideas and approaches applied overseas which may have application to the UK.

7.1 The US experience

The most interesting mortgage products for encouraging energy efficiency in existing housing have emerged in the US, generally from programmes or institutions targeting lending on low income first time buyers, disadvantaged neighbourhoods or special interest groups (such as veterans).

- **Existing homes**

Under the U.S. Department of Housing and Urban Development (HUD), the Federal Housing Authority (FHA) insures mortgage and home improvement loans, through its approved lenders, for borrowers who would not otherwise qualify for conventional loans on affordable terms, such as some first-time home buyers and some residents of disadvantaged neighbourhoods. The FHA has established Energy Improvement Mortgages (EIMs) and Energy Efficiency Mortgages (EEMs).

- The EIM is specifically focused on identifying and financing energy efficiency improvements in new or existing homes. The cost of the improvements – identified in a home energy rating – can be included in a borrower's mortgage if their total cost is less than the total dollar value of the energy that will be saved during their useful life.
  The cost of the improvements that may be eligible for financing as part of the HUD mortgage is either 5% of the property's value (not to exceed $8,000) or $4,000 – whichever is greater.

- The EEM allows the lender to stretch the borrower’s debt-to-income ratio outside normal guidelines on the basis that the fuel bill savings will meet the additional mortgage costs.

The U.S. Department of Veterans Affairs (VA) guarantees mortgage loans for veterans with active duty service and qualified reservists. Its EEM can be used to purchase or refinance a home along with the cost of making energy-efficient improvements. To cover the cost of the improvements, the loan amount can be increased to meet 100% of the cost of the energy improvements subject to the following conditions:

- Up to $3,000 based solely on documented costs
- Up to $6,000 if the increase in the mortgage payment is offset by the expected reduction in utility costs
- Final LTV may exceed 100% appraised value if energy improvement measures have positive cash flow
- All improvements identified by home energy rating as having a combined cost-effectiveness and they must be installed within 180 days.

Various other institutions set up to improve the affordability of home-ownership by setting guidelines for lenders and mortgaging companies for qualifying customers for mortgages (eg Fannie Mae and Freddie Mac) take a similar approach. Key features of these US products are:

- the energy efficiency measures are expected (and assessed) to produce fuel bill savings which cover the cost of the borrowing used to install them
- the extra borrowing sits outside conventional guidelines for both LTV and debt-to-income ratios
- there can be a time limit by when the measures must be installed.

- **New homes**

There are also products in the US to encourage the purchase of new energy efficient homes – most notably those associated with the Energy Star qualified homes programme. Energy Star is a long-standing national scheme (sponsored by the US Department of Energy and the US Environmental Protection Agency) to promote energy efficiency to reduce atmospheric pollution and save money.

Its new homes programme requires new homes to be at least 30% more energy efficient than homes built to the 1993 national Model Energy Code (a "model" national standard for residential energy efficiency) or 15% more efficient than the state energy code, whichever is more rigorous. These savings are based on heating, cooling, and hot water energy use.

There is an associated Energy Star mortgage criteria which provides loans for qualifying new homes. Mortgage providers meeting these standards can use the logo, give customers access to an accredited network of builders, and the potential for a borrower to qualify for a larger loan – up to 5% of the value of the home ($8,000 max) – by stretching the borrower’s debt-to-income ratio by up to 4%.

- **Degree of market penetration**

These products and programmes, while impressive, represent only a tiny proportion of total US mortgage activity. In the year 2000, the FHA programme, for example, insured fewer than 30,000 EEMs. Moreover, anecdotal evidence from the US indicates that the products have little or no profile within the mortgage market. For example, an environmental lobbyist based in Colorado reported that she was unaware of the products and the issue had not been raised during her search for a suitable mortgage product. Other contacts buying houses in upstate New York had never come across the EEMs.

7.2 Energy Efficient Mortgages for new homes in Canada and Australia

In both Canada and Australia, there are schemes to provide mortgages for buying new homes which set high energy efficiency standards.

- **Canada**

Canada’s national housing agency, the Canada Mortgage and Housing Corporation (CMHC), offers a 10% refund on its mortgage loan insurance premium when a borrower buys or builds an energy-efficient home. To qualify for CMHC’s premium refund, its energy efficiency must be rated using Natural Resources Canada EnerGuide for Houses rating system and meet certain minimum requirements. For new construction, an EnerGuide for New Houses energy adviser must rate the building plans before the home is built.

The Yukon Housing Corporation's Green Mortgage Program provides reduced interest rate mortgages for customers if they buy or build a home (or have one built for them) that meets or exceeds the Yukon Housing Corporation's prescribed energy efficiency rating. It is also possible to qualify by upgrading an existing home to the prescribed rating. Clients can borrow up to a maximum of $200,000.

- **Australia**

There are several products – though no accreditation system – for green mortgages in Australia. They have in common a general requirement for the home to attain a five-star nationwide Housing Energy Rating Scheme (NatHERS). A 5-Star rating indicates that the house has achieved a high level of energy efficiency, and will require minimum levels of heating and cooling to be comfortable in winter and summer. The minimum required level under the new building code legislation is for a 4 star rating.

Typically, these are for new-build homes and at least two companies (Bendigo Bank and The Green Home Loan Company) are offering a small discount (0.25-0.5%) off the major bank rates for qualifying homes.

The Bendigo Bank's Green Home Loan is specifically targeted at customers who want to purchase or build an energy efficient home. The qualification criteria varies by state relevant to the climate of the region i.e. in one state north facing living areas and insulation are vital and in others water efficiencies are of more importance. The product was developed to reward customers who want to make a positive contribution to the environment.

The customer, having received a 5 star energy rating for the property, is then put in touch with the assessor so that they can learn more about how they can adopt certain building principles to make their home more energy efficient. The bank is not able to monitor its contribution within the Australian home energy market.

Uptake has been lower than expected but there has been a high uptake of their Green Loans which enable customers to purchase a variety of environmentally friendly products ranging from renewable energy systems and petrol/electric hypbrid cars, to insulation and energy efficient white goods.

In Queensland, the Maleny and District Community Credit Union has developed the Cool Home Loan. This is being offered at a 'significant discount' to their normal home loan rate and this has been partly made possible due to the support received from the Cool Communities initiative, the Queensland Conservation Council and the Australian Greenhouse Office. To qualify for this loan, houses have to meet the mandatory criteria of "Anything but electric hot water" - e.g. Solar or Instant Gas. Then they must meet 4 of the remaining 9 energy saving criteria:

- Water efficient fittings (dual flush toilets, AAA rated shower roses)
- Eaves not < 600mm on eastern and western walls
- Roof insulated (Minimum Australian Standards)
- Walls insulated (Minimum Australian Standards)
- Ceiling insulated (Minimum Australian Standards)
- Connected to Earths Choice Electricity
- Windows tinted on eastern and western walls
- External awnings or shadings over windows on eastern and western walls
- Solar PV panels

As in the US, these are interesting products which clearly promote sustainable energy use. However, also like the US, these represent a tiny proportion of the overall mortgage market.

- **Germany**

The green bank, UmweltBank, connects the environmental performance of the house with the interest rate it charges on its mortgages. The more points the mortgagee achieves on a checklist the less interest s/he has to pay up to a maximum reduction of 0.45 percentage points. In addition, the bank reports the reduction in the customer's environmental impact as part of its company environmental reporting.

- **The Netherlands**

Since the early 1990s there have been several governmental incentives to stimulate Sustainable Building in the Netherlands. Beside legislative measures and non-legislative standards, financial instruments, like subsidies and fiscal measures, have been implemented.

The Dutch Green Financing Scheme provides a favourable mortgage for building projects with improved environmental performance. It is an incentive by the Dutch Government to stimulate sustainable building. Housing projects in the Netherlands that show a significantly better environmental performance than required by law are supported by a favourable mortgage.

Home Owners who want to request a green loan need to prove that their project meets the requirement profile for Green Financing. The requirement profile is an easy to use checklist and provides a practical instrument to measure sustainability. By dividing the requirements in compulsory and optional criteria, the system creates room for individual solutions. The Green mortgage is limited to a maximum loan of € 34,000 and fixed over a period of 10 years. Usually the green mortgage accompanies a conventional mortgage. For new building projects the foundation costs (without V.A.T.) must be below € 181,818.

To obtain a green loan the private or commercial investor sends his requests to a Bank which offers Green Funding. The Bank hands the request over to NOVEM (executive governmental institution), who checks if the building meets the green requirements. If this is the case, NOVEM gives a Green Declaration on behalf of VROM (Department of Spatial Planning and Environment) that grants participation in the green funding system.

Depending on several aspects, e.g. type of loan, current interest rates, income tax, participation of investors, the green loan results in a 1-2% lower interest rate than a regular mortgage.

For investors in a Green Fund this means a 1-2% lower dividend. To balance this gap and make the participation in a green fund attractive for investors, dividends from green loans are excluded from income tax.

Instead of targeting the environmentally idealistic consumer, the system also looks at consumers who are not (in the first place) willing to take a high financial risk for the implementation of sustainable aspects.

The amount of projects for which a green loan has been requested has grown gradually but participation is still lower than the total amount of projects for which a green mortgage has been reserved. Reasons for the low degree of participation are felt to be the insufficient recognition of the system and the competitive situation with alternative funding, e.g. recently introduced social funds or other favourable financing offers. Uncertainty about tax incentives and continuity of the program influences the attractiveness of the system.

8 UNDERSTANDING THE HOME-BUYER'S PERSPECTIVE

In order to understand the role which an accredited energy efficient mortgage could make in realising the 'ideal opportunity' represented by home buying, it is vital to understand the perspective of the home-buyer in more detail. A scheme or product founded on a poor understanding will fail to find customers and/or fail to stimulate more sustainable energy use. This requires an assessment of the home-buyer's perspective of both the housing and mortgage markets and their perspective of energy efficiency in general.

- **Other priorities crowd out consideration of energy performance**

The estate agent's mantra of 'Location, location, location' is used to explain their customers' priorities when buying a house. While price is clearly also a consideration, this is heavily related to location. In reality, home-buyers tend not to have lots of different homes they want to buy which they must choose between – just lots of homes to view before they find one they like and can afford.

While it is comforting to think that consumers might take the energy performance of a property into account (which, in theory, the new Home Information Pack will enable them to do), it is highly unlikely that this will influence the choice of home since other factors weigh so heavily on the purchasing decision.

To the estate agent's mantra, one could introduce a new mantra for the mortgage market based on consumer surveys of 'interest rate, professional advice, lending me what I need'. The CML survey reported in Section 4.2 regularly identifies these factors as key determinates of choice in the mortgage market.

In the context of their home-buying and mortgage-choosing decisions, the home-buyer has little interest in the energy efficiency of the dwelling being purchased and almost no interest in the sustainable energy product attributes being offered by mortgage companies (particularly if it unduly increases the cost of the mortgage). This is the perception expressed by the three largest mortgage providers as reported in Section 6.

- **Lack of emphasis on energy efficiency in the Home Information Pack**

So can the new HCR change this and bring energy efficiency more into a home-buyer's consideration of his or her home improvement plans or mortgage choices?

To answer this it is important to consider the reality of the new HCR and not to overstate its potential role to raise awareness of energy efficiency. The new HCR will not be dominated by energy efficiency information. Moreover, within the Home Information Pack, the HCR will be but one feature. The Home Information Pack will contain:

- Terms of sale
- Evidence of Title
- Standard searches
- Planning consents and building control certificates
- Property information and fixtures and fittings forms
- Copies of guarantees and warranties
- Draft contract
- Home Condition Report.

Within this, the HCR will provide impartial and reliable information on all aspects of the condition of the property (including structural soundness). One of many sections – Section H – will be an assessment of the energy efficiency of the property and the potential for improvement.

In this context for the full Home Information Pack, the potential is very high for the energy efficiency rating and advice to be drowned out in the noise of all the other information, most of which is of much more significance to consumers during the home purchase process.

- **Lack of consumer interest in energy efficiency**

Research undertaken by CSE and others has consistently shown a low level of public interest in, and engagement with, energy efficiency. Focus group work undertaken for Ofgem revealed reasonable knowledge of energy saving measures amongst energy consumers. However, this was combined with a high level of indifference to the subject and significant distrust of the current principal delivery channels for energy saving measures – energy suppliers (Roberts, Humphries and Hyldon 2004).

Being unaware of the energy saving obligations placed on suppliers, people are suspicious of energy saving offers from energy companies which make their money from selling energy. Consumers are therefore not ready to engage with an energy supplier and contractor market which has undermined public trust and confidence by historic mis-selling.

The Ofgem research also reinforced findings by the Energy Saving Trust's own market research; householders think energy saving measures are much more expensive to install than they actually are (and people have low levels of confidence in the claimed savings). This undermines faith in the validity and robustness of information indicating quick paybacks; it also raises doubts about the trustworthiness of offers which are priced significantly lower than people expect to pay.

- **The implications of the home-buyer's perspective**

The missing ingredients for home-buyers are therefore not just information about appropriate energy saving measures for a home (which the HCR should provide), but also:

- confidence in the quoted costs and predicted savings
- trust in the delivery channels for the proposed improvements, and
- motivation to give them priority over other possible home improvements and/or uses for the money

And, before any of these ingredients are added, the home-buyer must find, read and be convinced by Section H of the Home Condition Report within the Home Information Pack.

This requires a change of focus in attempts to realise the 'ideal opportunity' to secure energy efficiency improvements to the UK's existing housing stock at the point when homes change hands and home-buyers have plans for home improvements and access to relatively low cost capital.

This change of focus is examined in Section 9 below.

9 TOWARDS AN ENERGY EFFICIENT MORTGAGE? PROPOSALS FOR A CHANGE OF FOCUS

We are faced with an indifferent home-buyer and a mainstream mortgage market unconvinced by the commercial potential of promoting sustainable energy use in their products. This is not a situation in which the primary tool to secure change is a new accreditation scheme.

Instead the focus should be on measures which can tackle the indifference and start to create interest and confidence amongst home-buyers in improving their newly purchased home to achieve sustainable energy use.

These measures to tackle the indifference almost certainly include the high profile provision of mortgages which explicitly support and encourage energy efficiency improvements. In order to create such a profile, this would require the involvement of at least one of the major providers.

There is a chicken-egg question here – it seems clear from the interviews undertaken for this study that we are not going to see a major mortgage provider bringing a product to market until there is clear evidence that it will attract sufficient mortgage business of home-buyers to justify the cost of product development, marketing and delivery. This is a basic commercial reality of the mortgage market which is not always acknowledged by the energy efficiency community. (An accreditation scheme will not overcome these commercial realities).

Therefore, there is a need to focus policy effort also on developing more supportive (and commercially attractive) ways to secure the involvement of mainstream mortgage providers in testing the ground with mortgage products which actively and explicitly promote sustainable energy use.

This approach gives rise to a ‘six point plan’ to:

- Raise the profile of energy efficiency much more significantly within the HCR (and the Home Information Pack more generally)
- Ensure the communication of energy efficiency information in the HCR is potent and motivating
- Outline the basic building blocks of mortgage products which would promote sustainable energy use
- Develop a programme of support which encourages mortgage providers to test the market with high profile pilot in conjunction with the Energy Saving Trust or some other agency which provides ‘accreditation by association’.
- Look at the potential for involving energy suppliers in the delivery of energy saving measures (with explicit explanation of their energy saving obligations)
- Identify and pursue further policy measures (eg changes to stamp duty, focus on energy performance in regulations governing the provision of mortgage advice) which could create further motivation and incentives to improve energy efficiency in the newly-purchased home

If these measures succeed and product take-up is good and effective in terms of promoting sustainable energy use, then attention can turn to establishing a more formal accreditation scheme.

Each of these elements is examined in more detail below (though the first two are addressed together).

9.1 Raising the profile of energy efficiency within the HCR and giving it some potency

As detailed in Section 8, the energy efficiency section of the HCR is likely to be drowned out in the noise created by all of the other contents of both the HCR and the Home Information Pack more generally.

If the priority given to energy efficiency in the home buying process is to rise, then more must be done to ensure the energy information in the Home Information Pack is high profile and potent, reflecting more explicitly the ongoing financial impact of failing to install recommended measures.

Various approaches should be tested in focus groups – within the context of the entire Home Information Pack rather than just Section H of the HCR.

It may, for example, be relevant to give high profile to the cost of fuel bills over the anticipated ownership of the home (10 years?) with and without action to follow recommended actions to improve energy efficiency. This would emphasise the value in taking action and, particularly in taking such action sooner rather than later. It would also highlight not only the payback but the ongoing savings once the cost of measures has been met by fuel bill savings.

It makes sense to ensure the approach taken dovetails with – and refers to – the free and independent energy advice provided by the EST's national network of energy efficiency advice centres.

9.2 An energy efficiency recommended mortgage?

We recommend that any mortgage which genuinely promotes sustainable energy use needs to provide advice, information, and financial incentives to encourage home-buyers to undertake a range of energy saving measures identified at the point of survey.

Borrowing from some of the approaches taken overseas, this approach might include:

- An energy survey which identifies carefully the measures a household could cost-effectively make to improve the energy efficiency of the home
- Mortgage conditions which identify these improvement measures which, when completed and evidenced within a fixed period (say 1 year), would trigger a small but meaningful reduction in interest rate.
- Links to approved and quality-checked contractors (potential via energy suppliers to help them meet their EEC targets – see 9.4 below)
- Stipulation that all measures and advice provision are provided to nationally recognised standards (eg CHESS for heating systems, Code of Practice standards for energy advice etc).
- Ability to borrow up to £10,000 (or a set % of total advance) above and beyond LTV and income multiplier rules, to fund energy efficiency improvements identified in the mortgage conditions.

The product will have to compete in the mainstream market and so will need to be very keenly priced once improvements have been made and the discount has been applied. It would be dangerous to assume that home-buyers will value these benefits sufficiently to pay extra at this stage in the market transformation.

As outlined below, it is anticipated that such a product is very unlikely to emerge 'naturally' and at scale in the mortgage market as it currently stands. It will therefore require the intervention (and financial support) of a third party (eg the Energy Saving Trust) at the early 'trial' stage while the market is tested and, hopefully (if combined with other measures described in the six point plan) proved.

In designing and delivering this product for trial, care should be taken to ensure that home-buyers are not subjected to misleading claims (e.g. exaggerating the savings resulting from a particular measure), offered poor value for money products (e.g. energy improvement measures at inflated prices) and bad or incomplete advice (e.g. promoting renewable energy products such as solar panels ahead of standard more cost-effective insulation measures). These will be issues for a later accreditation scheme but for now the involvement of the Energy Saving Trust should ensure appropriate public endorsement and sufficient consumer protection.

9.3 Bringing mainstream mortgage providers into this new market

As explained above, without the mainstream mortgage providers there will not be a significant market for mortgages which promote sustainable energy use. Yet, the mainstream mortgage providers interviewed for this study are clear that they are not going to enter this market until such time as there is evidence of the commercial viability of such products.

There is therefore a strong case for some limited government funding and support to break through this log-jam. The funding would remove some of the commercial risk for mortgage providers to develop and test such a product on a significant enough scale to see if it really can help to transform this market. A trial would need to 'feel' as if the product was part of mainstream provision, which might justify an intensive focus on marketing in a particular area or region.

Without this pump-priming, it is highly unlikely that mortgages which promote sustainable energy use will have a significant role in the market for the foreseeable future. With the financial support, there is a chance that mortgage providers will be able to demonstrate the broader viability and 'marketability' of these products and the case for more widespread introduction could be made.

In parallel, additional support could also be provided to all existing mortgage providers in the form of a tool kit of information, details of existing activities (eg energy supplier EEC programmes), marketing support, and advice referral details. Provided by energy efficiency experts but with input from mortgage providers to ensure it 'goes with the grain' of their activities, such a toolkit would help to improve their understanding of this relatively specialist and technical field and perhaps create opportunities for effective new partnerships in future.

9.4 Involving energy suppliers in the home purchasing process and the delivery of recommended improvements

Energy suppliers have challenging targets to save energy in UK homes. They therefore have an interest in securing householder interest and finding low cost delivery channels for energy saving measures. They may well be potential partners for mortgage providers to deliver a comprehensive advice and installation service for the energy efficiency improvements identified in the HCR (and financed within the mortgage).

Clearly, this will only be fruitful if mortgage providers are interested in developing this market and energy suppliers can sense a cost-effective means of achieving their EEC targets. That should be achieved by other measures outlined here.

The Energy Saving Trust or the Energy Efficiency Partnership for Homes could play a role as a 'broker' between mortgage providers and energy suppliers to identify mutual interests and potential for joint product development (with support outlined under Section 9.3).

9.5 Further policy measures to incentivise energy improvements in home-buying

There are additional policies which could be introduced to create further motivation and incentives within the housing and mortgage markets to support energy efficiency improvements. The most relevant to the housing market would be to create a link between the rate of stamp duty and the energy efficiency of the dwelling, with a rebate for energy efficiency improvements made within, say, one year of purchase.

This would be unlikely to transform people's property choices but it could provide a significant additional financial incentive for people to improve energy efficiency once they've moved in to their property of choice. (A private members bill regarding this was introduced to the House of Commons on January 12th with second reading on April 8th)

The introduction of compulsory energy ratings as part of the HCR makes such a scheme administratively possible. Scaled appropriately (i.e. higher stamp duty for more inefficient properties), the measure could be fiscally neutral and create a genuine incentive for early action by the new owners of a home.

Since mortgage purchasing is increasingly undertaken through brokers and advisers, there would be merit in examining the potential for regulations governing the provision of such mortgage advice to include consideration of the energy performance of a home.

9.6 Conclusion

This study has explored the current state of the housing and mortgage markets and the indifferent home-buyer therein. It concludes that an accreditation scheme for financial products which promote sustainable energy use would do little to stimulate wider provision or greater consumer interest..

However, there is potential to change the housing and mortgage markets and challenge the indifference which is blocking effective action.

No single measure in the six-point-plan is likely to achieve 'breakthrough'. Improving the HCR is unlikely to secure action unless the opportunities exist (prominently) to borrow the cost of energy saving measures and organise their installation. But such opportunities to borrow are unlikely to emerge without significant action to stimulate home-buyer interest and raise the priority of energy efficiency within their home improvement plans.

However, in combination these six measures could begin to realise the opportunity to improve energy efficiency that currently lies dormant in the 1.4 million home purchase transactions which take place every year in the UK.

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