

The way ahead for the UK's green mortgage market

The Green Finance Institute looks at the evolution of this growing market to date and the innovation, policy and regulatory levers that will ensure it fulfils its promise





Introduction

The UK's nascent green mortgage market is showing signs that it is ready for lift off. Encouraged by the innovation of their peers in this space, eleven banks and building societies in the UK have launched green mortgage products since the beginning of 2020 alone.

The opportunity for lenders in this space is huge. The UK Committee on Climate Change has estimated that £250 billion needs to be invested in UK home upgrades by 2050, which means there is the potential for significant capital flows in green mortgages in the coming years. Meanwhile, there are other levers in play, with policy makers, NGOs and financial regulators increasingly demanding that lenders examine the energy efficiency of their mortgage portfolios.

Yet significant challenges remain, including a lack of demand from homeowners to undertake energy efficient retrofits on anything like the scale needed for the UK government to meet its goal of upgrading all UK homes to an EPC rating of C by 2035. With many green mortgages focusing on the small

number of properties that are already energy efficient, more mortgage products and other loans must target the retrofit market to fund the transformation of the UK's existing housing stock on the scale required.

This lack of demand and supply has created something of a chicken and egg problem. It's harder for lenders to create innovative new products without understanding the potential demand, while more homeowners are unlikely to retrofit their homes without a consistent

national policy framework that supports retrofits at scale and the availability of preferential financing to pay for them.

In this article, the Green Finance Institute (the Institute) will look at the evolution of the UK's green mortgage market to date, in both the retrofit and green build space, explore the market-led innovation that is currently underway, and the policy and regulatory support required to turn the residential mortgage funding currently trickling into this promising market into a flood. ■

The evolution of the market

Ecology Building Society became the first UK lender to offer green mortgages back in 2006, when it introduced its C-Change discount mortgages. Through this product, Ecology offers discounted mortgage rates to homeowners building or converting sustainable homes, or undertaking retrofits and energy improvements.

For sustainable homes and retrofits, the size of the discount that homeowners receive depends on the outcome once the project is completed. For retrofit discount mortgages, for

example, a 0.25% discount is applied to Ecology's standard variable rate for each Energy Performance Certificate (EPC) grade that the property improves. "We've been involved in initiatives since early 2000s to try to support the green mortgage market," says Paul Ellis, Ecology's CEO. "Our C-Change discounts try to drive behavioural changes by giving customers a price signal that improvements are worth doing." In total, Ecology originated £39.3 million of new green mortgages in 2020 and Ellis thinks that number will grow consistently over the next two years. ►►

► For a long time, Ecology was the UK's only green mortgage lender, until 2018, when Barclays launched its Green Home Mortgage, which gave buyers of new homes with EPC ratings of A or B a discounted interest rate on two-year and five-year fixed rate mortgages. It became the first high street bank to launch a green mortgage, and in doing so, demonstrated to other major mortgage lenders that structuring and launching a green mortgage was both possible and also commercially viable.

The following year, new government policies provided more support to the market. In July 2019, the UK government launched its Green Home Finance Innovation Fund competition, which awarded grants to three new green finance projects that incentivised energy efficiency retrofits in homes.

This was followed by the launch of the short-lived Green Home Grants Scheme, in September 2020, providing grants for

homeowners who made certain energy improvements to their homes. The scheme was a breakthrough for the market, as it reassured lenders that the amount of homeowners undertaking energy efficient retrofits of their homes would continue to grow, creating, in turn, increased demand for green mortgages and other retrofit loans.

The Green Finance Institute launched its Green Home Finance Principles in the same month, supported by a number of lenders and the Loan Market Association, which provide financial institutions with a consistent and transparent methodology for allocating finance towards retrofitting works in UK homes.

A combination of these drivers, plus competition from other lenders, led Nationwide Building Society, Newbury Building Society, Just Group, Saffron Building Society, NatWest and Monmouthshire Building Society to

introduce green mortgages in 2020, and more government initiatives soon followed. In November 2020, the UK government announced that companies would be mandated to report their climate risks, in line with the Task Force on Climate-related Financial Disclosures (TCFDs), by 2025.

The Bank of England has announced that it will begin climate-related stress tests on UK banks and insurers in June this year and in February 2021, the UK government's Department of Business, Energy and Industrial Strategy finished its consultation period on the proposed policy that UK lenders disclose the energy efficiency of their mortgage portfolios. Since the beginning of 2021, Paragon Bank, Foundation Home Loans, Kensington Mortgages, Santander and Halifax have all launched their first green mortgage products. ■

Today's green mortgage landscape

The table below shows the number of UK lenders that currently offer green mortgages today and the different types of product that are available. These are broadly divided between those that offer discount mortgage rates to customers building or buying homes that are highly energy efficient; and those that offer extra lines of credit, discounted mortgage rates or cash back on existing loans to homeowners that improve the energy efficiency of their homes.

A third flavour is Santander's EnergyFact home energy reports, introduced last month with Countrywide Surveying Services, available to customers that want to move their existing Santander mortgage to a new property or take on additional borrowing for home improvements on an existing mortgage. The EnergyFact reports show



what improvements homeowners can make to reduce their home's carbon footprint, the work needed to achieve this, and how they can save money on their energy bills, while making their home warmer.

For Santander, this is part of a strategy to improve the average EPC rating of its entire mortgage book, where 55% of its customers live in homes with an EPC rating of D. "The next 10 years will be critical to decarbonise the heating of UK buildings and green mortgage propositions that only target new-build homes with A or B EPC ratings are not going to move the needle," says Richard Hirst, Climate Change Strategy

Advisor at Santander. "The EnergyFact report aims to be more inclusive. Many of our mortgage customers can get a tailored assessment of how to improve their home." Eventually, Santander would like to use the bank's scale to negotiate better energy deals or retrofit prices for its customers.

All lenders interviewed for this article agreed that financing the transformation of the UK's existing housing stock through energy-efficient retrofits, rather than rewarding buyers for purchasing the very small number of existing homes that are already green, is going to be crucial to increase green mortgage volumes and reduce carbon emissions in the built environment. Only 3% of UK homes have an EPC rating of A or B, according to the latest quarterly release from the Ministry of Housing, Communities and Local Government, while the Climate Change Committee has found that 19 million UK homeowners live in properties with an EPC rating below C.

NatWest, which launched its first green mortgages last October, offering

Company Name	Product Name	Launch Year	Requirements of product					Eligibility and further information
			Discount to existing mortgage or new low-interest rate mortgage	Additional borrowing for existing customers	Energy Efficiency of property must be improved	Property bought must be energy efficient	Cashback	
Ecology Building Society	C-Change Discount	2006	✓		✓			<ul style="list-style-type: none">3 types: Energy Improvements Discount, Retrofit Discount, Sustainable Homes Discount.95% of their residential mortgage customers already eligible.Discount applied upon completion of the project.
	Energy Improvements Mortgage	2018; updated 2021	✓		✓			<ul style="list-style-type: none">Often accept projects that standard lenders may not.Discounts provided from the date evidence of energy improvement works are completed.If eligible, C-Change Discounts (above) can apply.
Barclays	Green Home Mortgage	2018	✓			✓		<ul style="list-style-type: none">Must be a new-build property (with an EPC A or B) from a select group of house builders.EPC or PEA must be submitted at the stage of application.
Nationwide Building Society	Green Additional Borrowing mortgage	March 2020		✓	✓			<ul style="list-style-type: none">Only available to existing customers.At least 50% of borrowing must be spent on energy efficiency improvements.
Newbury Building Society	GoGreen Further Advance	July 2020		✓	✓			<ul style="list-style-type: none">Available to existing borrowers to transfer their existing mortgage onto.At least 50% of borrowing must be spent on specific energy efficiency improvements.
Just Group	Green Lifetime Mortgage Feature	July 2020	✓		✓		✓	<ul style="list-style-type: none">Feature available for the 'Just For You Lifetime Mortgage 2.5 LTV' series.Reduces the standard interest rate by 0.10% for the duration of the loan.EPC must be submitted at the application stage. All customers will receive £50 cashback when the advance completes to contribute to cost of EPC.
Saffron Building Society	Retro Fit Mortgage	Sept. 2020	✓		✓			<ul style="list-style-type: none">Proof of energy efficiency upgrades (to minimum EPC E) required.If proved, customers will be given a discount on their monthly mortgage payments for the remainder of the two-year deal.
NatWest Group	Green Mortgages	Oct. 2020	✓			✓	✓	<ul style="list-style-type: none">£250 cashback paid to solicitor on day customer drawdowns mortgage.Valid EPC rating of A/B required.
EeMAP Initiative	Aim to develop an “energy efficient mortgage”	Ongoing	✓	✓	✓	✓		<ul style="list-style-type: none">An EU-wide market-led initiative intended to channel private capital into energy efficiency investments.
BNP Paribas	Green Mortgage	Since 2018						<ul style="list-style-type: none">Collaborating with E.ON to develop and pilot such a product, under the EeMAP Initiative umbrella.
Monmouthshire Building Society	Green Mortgage – under the VALUER project	Pilot launch 2020	✓			✓		<ul style="list-style-type: none">To pilot product in low-carbon Sero Homes' housing development Parc Eirin, South Wales.
Paragon Bank	Green further advance range	February 2021						<ul style="list-style-type: none">Four products for portfolio landlords who have applied and been accepted for a Green Homes Grant.All four products have no application fee, no product fee and include a free valuation.
Foundation Home Loans	Green Reward Mortgage	February 2021					✓	<ul style="list-style-type: none">Available to portfolio and non-portfolio landlords for their properties with an EPC C or above. Designed to reward landlords who have made environmentally-friendly choices.£750 cashback upon completion and a reduced 0.75% product fee.If work has been done, they can re-mortgage immediately rather than wait the usual 6 months.
Kensington Mortgages	eKo Cashback Mortgage	February 2021			✓		✓	<ul style="list-style-type: none">Available to all individuals across all properties in the UK.Evidenced increase of at least 10 Standard Assessment Procedure (SAP) points required to qualify.Up to 12 months to make the energy improvements and claim cashback reward.£1000 cash paid upon qualification. Also comes with free valuations, and free legal advice on remortgages.
Halifax	Green Living Reward	March 2021			✓		✓	<ul style="list-style-type: none">£500 cashback when homeowners make one or more eligible home improvements using a TrustMark registered supplier;Customers must have registered for the reward by 31st May 2021.Have created a home Energy Saving Tool for customers to create a personalised action plan for their homes.Existing customers and new customers all eligible.
Santander	EnergyFact Report	March 2021						<ul style="list-style-type: none">Santander, in partnership with Countrywide Surveying Services, has launched EnergyFact – a free, practical home energy report. The free report provides existing Santander mortgage customers with guidance to improve the energy efficiency of their home



- ▶ discounted interest rates and cash back to customers purchasing new homes with an EPC rating of A and B, plans to extend its range over the next couple of years. “We’re really pleased with the uptake in demand from customers since the launch and we want to also make this product available to customers remortgaging their home,” says Lloyd Cochrane, NatWest’s Director of Proposition, Home Buying and Ownership. “We also want to develop a product so people with existing mortgages can borrow more to make energy-efficient investments in their home.” He adds that the bank is also building a site for customers to receive a list of the top things they can do to save money and improve their carbon emissions based on their postcode.

Although Ecology Building Society has always funded retrofits, renovations and conversions, Ellis says that the building society has been making more loans that improve the existing housing stock over the last couple of years. It introduced a new variable rate renovation mortgage this February, offering deeper discounts to homeowners doing home renovations that improve the EPC rating of the property. The result is that Ecology has done as much lending in the first three months of 2021 on renovations as it did in the whole of last year.

Yet while the need to finance home retrofits is clearly there, for many green mortgage lenders, it’s still hard to assess the extent of customer demand. “Most people in the UK understand their next car or the one after that needs to be electric or a hybrid, but don’t have the same awareness that they need to make their home more energy efficient to reduce the carbon from their home in the same way,” says NatWest’s Cochrane. “Homeowners also need clarity on what the solutions are, with access to trained retrofit professionals that do work to required standards so that consumers have faith in the supply chain. These issues are interrelated. The finance can be there, but the demand and the capacity to fulfil retrofits isn’t yet.” ■

The current policy and regulatory landscape

The way to bolster demand and capacity in this market is through consistent, robust, long-term government policy and regulation, which is why many organisations viewed the cancellation of the Green Homes Grant Scheme last month as a step in the wrong direction. Although there were problems with the administration of the scheme, including a shortage of qualified contractors, the short-lived scheme did provide lenders with more certainty of demand and encouraged green mortgage innovation.

“The government’s decision to cancel the programme will have ripple effects across the sector, but we believe it’s a clear example to government that collaboration with all parts of the value chain is critical in the design and implementation of future grant schemes,” says Emma Harvey, Programme Director at the Green Finance Institute.

The 2019 Conservative manifesto committed over £9 billion of investment to retrofitting homes, so bringing more of that funding forward is now essential. The government’s announcement that public funding for the ‘able to pay’ housing market will be limited in future makes it even more critical for the private sector to deploy capital into the retrofit and green built space.

As Ellis points out, past government funding programmes that supported energy efficient homes have also been too short and aligned to annual budgets. Without the certainty of them continuing, it is hard for homeowners, and even contractors, to commit.

Ellis cites the example of the UK government’s Zero Carbon Homes plan, which would have made all new homes carbon neutral by 2016. The plan ended in 2015 and was replaced by the UK Future Homes Standard, which will ensure that new homes produce 75% to 80% less carbon, but won’t be enforced

until 2025. Ellis does not consider the Future Homes Standard to be equivalent to Zero Carbon Homes and would have preferred the former initiative to be retained. “We could have been building zero carbon homes now and developing the supply chain already, but that was abandoned,” he says. “Instead, we’re actually building homes now which we will have to retrofit to meet the Future Homes Standard.”

However, banking and building society members of the Institute’s Coalition for the Energy Efficiency of Buildings (CEEb) generally welcome the current government proposal that UK mortgage lenders disclose the EPC ratings of their portfolios as one of the positive long-term policy changes that are needed.

“It raises that EPC metric in the awareness of boards and will drive action throughout the industry,” says Cochrane, who adds that NatWest has an ambition for 50% of its mortgage book to have an EPC rating of C or above by 2030. These energy efficiency disclosures could also spur the creation of more innovative financial products to help homeowners retrofit their properties, whether those are green mortgages, unsecured retrofit loans or other products.

Nevertheless, there is concern that the imposition of target EPC ratings could have unintended consequences, potentially discouraging the improvement of properties with low EPC ratings and penalising the owners of those homes. “The concern is that this could drive poor practices from lenders, who start to cherry pick those borrowers with preferential EPC ratings,” says Mick Taylor, Head of Proposition Development, Regulation and Industry Liaison at Santander. “That would create a two-tier system where homeowners with lower ratings would find it harder to move to a new mortgage provider.”



► The outlook

There are many more steps the UK government could take to stimulate demand for retrofit financing, as outlined by the Coalition for the Energy Efficiency of Buildings (CEEB) in its report last May. Stamp duty that is linked to EPC ratings, where homeowners pay less for buying more energy efficient properties, or receive a stamp duty rebate for undertaking an energy efficient retrofit within a set period, is one idea.

Mandatory minimum energy efficiency standards, which already exist in the private rented sector, could be extended to the sale of owner occupied properties, where purchasers of properties that do not meet the standard could negotiate the property price to pay for the energy efficiency renovations they will subsequently have to perform. Removing or reducing VAT on energy efficiency measures could be another stimulus.

A concerted public awareness campaign would prompt more homeowners to recognise the opportunities to make energy efficient improvements to their homes. As the CEEB outlined in its March report, providing homeowners with bespoke Building Renovation Passports would enable them to identify and undertake the most impactful renovations on their property and access qualified contractors who can do the work. Early steps have been taken by the industry to develop these solutions, including Santander's EnergyFact report.

On the supply side, there are many steps that could stimulate the green mortgage market. A national loan guarantee scheme, an interest rate offsetting scheme, or favourable capital treatments for green mortgage loans, could all help banks and building societies offer more attractive interest rates to customers and boost loan volumes. More funding to support new product innovation, like the Green Home



Finance Innovation Fund, could help financial institutions that are also dealing with COVID -19 and the Libor and Brexit transitions address potential capacity constraints.

Beyond supportive policy and regulation, industry-wide standards must be applied throughout the green mortgage market to maintain its consistency and integrity and ensure that lenders do not greenwash mortgages for CSR benefits. The Institute's Green Home Finance Principles provide an important framework here, outlining how loan proceeds should be used, how improvements should be assessed, how funds should be managed, and how activity should be reported. The evolution of this market must produce a race to the top, both in standards and in innovation.

This will require collaboration between government and lenders, energy suppliers, retrofit contractors, homebuilders, and other stakeholders to share best practices and develop an ecosystem of providers that can finance and implement green home improvements at scale, and ensure those implementations are verified and measured.

"To comply with the Green Home Finance Principles, we need to validate how our funds are being used, then verify that the retrofit has resulted in an improvement to the energy efficiency of

that property," says Santander's Taylor. "That's a challenge that will require a collaborative approach across industries and where the Institute's Building Renovation Passport working group will be useful."

If these hurdles can be overcome and the right policies and regulations enforced, lenders see significant growth potential for this embryonic market over the next five years, with a wide variety of lenders, large and small, supporting a diverse range of products. As well as financing for new and existing green builds, retrofits and the provision of energy reports, more products could emerge that are sensitive to the wide range of environmental characteristics in UK properties and the many unique scenarios that homeowners experience.

Lenders willing to invest in product innovation, underwriting and the expansion of their green mortgage book today will play a key role in shaping what this young, exciting and critically important market will look like in years to come, and ultimately, the influence it will have on the decarbonisation of UK homes. ■

Q&A

with **Emma Harvey**, Programme Director, Green Finance Institute

Before joining the Green Finance Institute, Emma Harvey worked for several different divisions of Barclays Bank, and worked on the launch of the bank's pioneering Green Home Mortgage. She discusses below how the UK's green mortgage market has evolved since then and what further initiatives will support its growth.



How did Barclays' first green mortgage in 2018 influence the development of this market?

As the first major UK high street bank to bring an innovative product to market, the Barclays green mortgage created a ripple effect across the industry. It demonstrated that you can launch a green mortgage, offer customers a lower interest rate to support green choices, and verify a property's high-energy performance rating. Before the Barclays product, it was also challenging to point to market demand when developing a green mortgage. Now other organisations can see there is demand and a supply of green finance coming forward, which makes it easier for banking and financier members of the Coalition for the Energy Efficiency of Buildings to innovate.

Was it also important to demonstrate that green mortgages could be commercially viable?

Yes, because even a couple of years ago, there was the misnomer that 'green' meant a negative impact to the bottom line. Instead, we've seen green products in the retail space, and the capital and syndicated loan markets, which really do generate attractive returns.

Before we launched the Barclays' mortgage, research in the US had also demonstrated a link between energy efficiency and the probability of default on mortgages that were secured against those properties. Subsequently, the Bank of England has published research that verifies this correlation. That's important, because if the mortgage has a lower probability of default, the bank holds less capital against that loan, and can offer lower interest rates without eroding its return on equity. That can lead to a self-sustaining green mortgage market, where lower risk loans mean that lenders are able to offer lower pricing.

As the market grows, this benefit may wash itself out, because this correlation may be a socio-demographic indicator, rather than the result of people saving on their energy bills each month, but it's still an important trend to note.

What other factors, other than UK policy and regulation, could encourage the development of this market?

The work of the Coalition for the Energy Efficiency of Buildings at the Green Finance Institute has already catalysed and stimulated market-led innovation. Since it was established in 2019, its demonstration projects, developed with members, have shown that financial institutions can generate commercially attractive, risk-adjusted returns by financing the retrofit market. By bringing together 300 members, drawn from all sectors of the economy that support the retrofit value chain, it has also fostered cross-sector collaboration, which is critical, and ensured that the financial solutions it recommends work for all parties.

The EU Energy Efficiency Mortgages Initiative (EEMI) is also important because it was the first initiative to bring together multiple stakeholders to develop the energy efficient mortgage market. The end goal of the initiative is to establish an energy efficient mortgage securitization market across Europe. It also provides a very useful definition of what a green mortgage is, which the Institute's Green Home Finance Principles point to as one of the market's best practices.

What else can spur product innovation at lenders?

It's really important to gain buy-in at the senior level, while also empowering the bankers that develop these products. Financial institutions need to be ahead of demand for green mortgages, particularly to fund home retrofits, so that finance is not a barrier but rather an enabler when demand increases. There needs to be a culture of innovation and a willingness to try new ideas, in order to catalyse new financial solutions.

It's also about harnessing the enthusiasm of young bankers who are really passionate about climate and see a fantastic opportunity to do something good. That's why we see so many talented professionals in the early stages of their career moving into sustainable and green finance. Let's capture that enthusiasm and get it moving in the retrofit space. ■