Call for Evidence
Energy Efficient buildings: Portfolio framework to increase lending for energy renovations

European Mortgage Federation-European Covered Bond Council (EMF-ECBC) Response

5 November 2024

Key recommendations:

1. **Leveraging on existing initiatives:** It is vital that a future voluntary portfolio framework is consistent with existing legislation, and recognises and builds upon existing market-led initiatives, in particular the Energy Efficient Mortgage Label and the Covered Bond Label.
2. **Access to data in line with the GDPR:** Priority should be given to removing obstacles which prevent banks from accessing public databases providing information on building energy performance (such as the EPC).
3. **Public support schemes:** In order to promote the further development of the green/energy efficient mortgage market and loan products specifically for vulnerable households (as per Article 17(1) EPBD), it would be necessary for the European Commission to make EU resources available to market participants.
4. **Strategic Partnerships:** A future voluntary portfolio framework should promote partnerships between banks and construction and/or renovation companies, allowing both parties to the agreement to offer advantageous solutions (including types of financing offered) to building owners.
5. **Dedicated prudential treatment:** It would also be appropriate to consider introducing a dedicated prudential treatment for green/energy efficient mortgages. Existing EEMI correlation analysis, which will be extended under DeliverEEM, points to a significant negative correlation between building energy performance and credit risk (PD).
6. **Definition of energy efficiency:** Consideration should be given to setting the definition of 'best in class' at 30%, which will be key to further unlocking mortgage finance in support of the Renovation Wave.

Introduction

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC) is a pioneer in energy efficiency and energy efficiency financing, having launched the Energy Efficiency Mortgages Initiative (EEMI) in 2015. The EEMI's efforts to date have delivered several key results in efforts to scale-up energy efficient mortgages over an accelerated timeframe, including the Energy Efficient Mortgage Label (EEML) and the 'greening' of the Covered Bond Label, consumer research, value chain analysis, pioneering analysis into the correlation between building energy performance and credit risk, to name but a few, combined with a committed network of more than 700 stakeholders.

Energy Efficient Mortgage Label: A robust response to the EPBD's voluntary portfolio framework

The EMF-ECBC strongly believes that industry-led initiatives such as EEML, and its accompanying Harmonised Disclosure Template (HDT) and the Covered Bond Label and its Harmonised Transparency Template (HTT) are already laying the foundations for better and faster data collection and reporting and equipping lenders and issuers with the necessary tools to enhance their understanding of building energy efficiency, helping them to scale-up their financing of the renovation of the existing building stock and tailor their financial products accordingly, thereby responding to the rationale of the EPBD's portfolio framework for voluntary use by financial institutions.

As a quality benchmark for consumers, lenders, investors and regulatory and supervisory authorities, the EEML, in particular, is intended to increase confidence in energy efficient mortgages and consumer loan products, catalyse consumer demand, and enhance transparency regarding the energy profile of lenders' portfolios, driving efforts to improve the quality of assets. The EEML also offers transparency on portfolios of energy efficient loans, supporting their inclusion in green covered bonds and securitisation, driving a virtuous financing and funding circle, whilst facilitating better performance evaluation, providing greater clarity on climate risks and resilience and supporting investor due diligence. A further core objective of the EEML is to ensure that loan portfolios are closely aligned with key regulatory frameworks, as well as international equivalents.

EEMI Ecosystem: A comprehensive, integrated approach to further scaling up energy efficient mortgage markets

Complementing these developments, the EMF-ECBC, with the support of its Members and extensive network, is continuing its journey started in 2015 with the EEMI and embedding these efforts to scale-up energy efficient mortgages into a broader integrated ecosystem by way of a new EU co-funded project: Delivering the Energy Efficient Mortgage Ecosystem (DeliverEEM).

DeliverEEM aims to respond to the Renovation Wave challenge by further scaling up and accelerating the allocation of private finance to energy efficiency investment through an innovative, integrated Energy Efficient Mortgage ecosystem. Indeed, research to date indicates that developing the energy efficient mortgage market at the scale and pace needed to support the Renovation Wave goes far beyond the product itself and will be contingent on the deployment of an integrated ecosystem of tailored products, strategic partnerships and optimised market interventions that deliver a seamless end-to-end customer journey.

DeliverEEM is committed to supporting the EU's decarbonisation targets by building on the groundwork laid down by the EEMI. This approach aligns with the objectives outlined in the EPBD, which recognises the essential role of financial institutions in overcoming barriers related to upfront costs, risk perceptions, and the fragmentation of demand among building owners.

1. Comprehensive De-Risking of EE Investments

DeliverEEM will place particular emphasis on addressing the perceived complexity of and de-risking energy efficiency investments, thereby unlocking the full potential of energy efficient mortgages through correctly evaluated risk profiles, supporting investor due diligence and appropriate regulatory treatment.

To this end, the Project will review and extend the existing EEMI correlation analysis between building energy performance and credit risk, by extending its scope beyond the focus to date on the impact on probability of borrower default to the impact on property value and therefore loss-given-default. This analysis will be underpinned by analysis of the stratification of the building stock, including the 15% best in class, across a sample of countries. A framework for advanced scenario analysis will provide lenders with the tools to better understand the impact of current and future climate-related events on their loan and bond portfolios and plan accordingly, while strategic partnerships with the insurance sector will provide an additional set of de-risking tools linked to physical risk of the collateral and credit risk of the borrower and renovation contractor.

2. Embedding ESG factors in Property Valuation

From early in the EEMI, property valuation and valuers' ability to reflect the impact of energy efficiency on building characteristics and form a judgement allowing a risk reduction or an increase in the value of the asset for the loan were recognised as a cornerstone of the energy efficient mortgage proposition and business case. Several years on, the relevance of ESG factors from a valuation perspective has increased significantly, with recognition of the positive impact of energy efficiency on value which could influence lending behaviour, as well as the potential for climate-related and environmental risks to negatively affect values, presenting risks for financial institutions.

Articulating the impact of ESG factors in property valuations is therefore fundamental. With this in mind, DeliverEEM will review, update and extend the scope of the existing EEMI Valuation Checklist & Guidance to better reflect the dynamics described above and ensure that valuers are as well-equipped as possible to embed ESG considerations in their property valuations. The Project will also create education and training material for valuers and financial clients and organise webinars and workshops to support capacity building.

3. Optimising Financial Operating Models with an ESG Focus

DeliverEEM will work alongside banks to support them in accelerating the transformation and enhancement of their business models and strategies, by optimising ESG financial operating models, thereby further contributing to the unlocking of the potential of the mortgage and covered bond markets. To this end, the Project will support the design of decarbonisation pathway blueprints and further reinforce market-led ESG-related data collection and disclosure through the EEM Label and the Covered Bond Label to facilitate compliance with the regulatory reporting requirements of the Sustainable Finance agenda.

4. Fostering SME Participation in the Renovation Supply Chain and enhancing Financial Risk Mitigation

An integral element of the EEM ecosystem is a mechanism to connect consumers and financial institutions with accredited, qualified suppliers to deliver high quality building renovation and guaranteed savings as part of a seamless customer journey, which will also, together with a flow of data, support better financial and risk assessment and therefore financial product offerings by financial institutions.

DeliverEEM will therefore promote SME integration into the EEM ecosystem by offering targeted and tailored pathways for their ESG alignment, access to finance, and marketplace inclusion. This collaborative approach strengthens the supply chain, mitigates risk, and ensures that renovation projects meet both quality and sustainability standards.

5. Putting Consumers at the Heart of the Climate Transition

Finally, DeliverEEM will prioritise consumer engagement through consumer research, behavioural mapping and analysis, on the basis of which the Project will develop tools and guidance for financial institutions to design products that resonate with consumer needs, thereby bolstering demand for energy efficient renovations. This approach complements the EPBD's goal of creating renovation opportunities accessible to all segments of society.

Preliminary Recommendations

By prioritising the scaling-up of energy efficient mortgages through the EEML and an integrated ecosystem approach, DeliverEEM and the broader EEMI align with the EU's myriad efforts to achieve its ambitious building decarbonisation targets for 2050, not least through the EPBD, as well as with broader efforts to deepen the single market and enhance the competitiveness of the Union. Indeed, the EEMI is intended to act as a CMU-aligned market compass, designing and deploying blueprints and action plans based on cooperation between private market stakeholders and public authorities, which will deliver long-lasting, concrete and transformative market action in support of economic growth, job creation and the climate transition.

Against the background outlined above and moving forward, the EMF-ECBC would like to highlight the following in the context of designing a future voluntary portfolio framework:

1. **Leveraging on existing legislative and market-led initiatives:** It is vital that a future voluntary framework is consistent with existing reporting legislation, which already requires. In practice, all major credit institutions with portfolios of exposures to real estate to report figures on energy efficiency, set targets, and implement mitigating measures. In the same vein, the EMF-ECBC advocates for a voluntary framework that recognises and builds upon existing market-led initiatives, in particular the EEML and its HDT and the Covered Bond Label and its HTT, which have identified a proportionate and relevant set of data points which are aligned with relevant legislative requirements, as described above. This approach will allow financial institutions to leverage the considerable progress already made through market-led efforts to unlock private finance in support of the EU's climate and energy targets. In developing a voluntary portfolio framework, it is also important to strike the right balance between ambition and realism. Indeed, such a framework should take into account that the information available to financial institutions on building energy performance, particularly the case for single-family houses, is currently based on estimates, given that on average only a relatively small number of buildings in Europe has an Energy Performance Certificate (EPC). In this respect, emphasis should be placed on simplifying the process for obtaining an EPC in order to increase the number of buildings with a certificate.
2. **Access to data in line with the GDPR:** Priority should be given to removing obstacles which prevent banks from accessing public databases providing information on building energy performance (such as the EPC). Indeed, national legislation limits access to building energy performance data in some countries. This would allow for a proper classification of loans as green/energy efficient mortgages and the application of discounts/incentives under banks' internal credit policies.
3. **Public support schemes:** In order to promote the further development of the green/energy efficient mortgage market and loan products specifically for vulnerable households (as per Article 17(1) EPBD), it would be necessary for the European Commission to make EU resources available to market participants. Indeed, it would be appropriate to adopt public support schemes at loan level (e.g. in the form of guarantees, grants) targeted at the most vulnerable and homeowners that do not have high-value buildings (i.e. the cost benefit is not there) and based on the market best practices of each Member State, which are already well known to businesses and financial sector.
4. **Strategic Partnerships:** The EEMI has placed significant emphasis on strategic partnerships through the energy efficient mortgages ecosystem that deliver optimised results for all market participants, in particular consumers, as described above. With this in mind, the EMF-ECBC believes that a future voluntary portfolio framework could reinforce these efforts, by promoting partnerships between banks and construction and/or renovation companies, allowing both parties to the agreement to offer advantageous solutions (including types of financing offered) to building owners, taking into account the provisions of the Mortgage Credit Directive (MCD) in terms of credit intermediation/promotion. Such partnerships could facilitate information availability about

financial opportunities offered by banks to support sustainable investments. There is also a need for educational and training initiatives, in partnership with public authorities. These initiatives should focus on increasing customer awareness of the importance of energy renovation, as well as the financial instruments available, including their characteristics and conditions related to supporting such investments.

5. **Dedicated prudential treatment for green/energy efficient mortgages:** We would also like to take this opportunity to note that, as per the European Commission's mandate to the European Banking Authority under Article 501c CRR, it would also be appropriate to consider introducing a dedicated prudential treatment for green/energy efficient mortgage loans. Indeed, the correlation analysis outlined above points to a significant negative correlation between building energy performance and probability of default. Preliminary research suggests a similar correlation exists between building energy performance and property value, and therefore LGD, and this correlation will be further explored through DeliverEEM.
6. **Definition of energy efficiency:** We would like to take this opportunity to highlight that the '15% best in class' concept is complex for building/homeowners to understand. From an energy efficiency perspective, the energy performance levels for the top 15% are expected to become more stringent over time, meaning that a customer may receive a discount linked to an green/energy efficient mortgage which may be removed at a later stage when the building is no longer in the top 15%, and giving rise to concerns from lenders about green-washing. Consideration should be given to setting the definition of 'best in class' at 30%, which will be key to further unlocking mortgage finance in support of the Renovation Wave.

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