

paragon

The rental sector energy challenge



Foreword

Minimising the negative impact that we have on the environment is one of the biggest challenges we face today.

Creating a sustainable future is something that is as important here in the UK as it is around the rest of the world and the Government has made a legally binding commitment to producing net zero carbon emissions by 2050.

Data published by the Business, Energy and Industrial Strategy Committee revealed that domestic properties account for approximately 30% of energy use and around 19% of greenhouse gas emissions in the UK. As a result, reducing the environmental impact of our dwellings is a key facet of the Government's strategy.

The private rented sector (PRS), with its estimated 5.5 million homes, is central to this goal.

The Government has proposed changes that it hopes will see PRS homes attain higher levels of energy efficiency than the current Minimum Energy Efficiency Standards regulations, which require all rented properties to achieve at least an 'E' Energy Performance Certificate (EPC) rating.

When first announced, the proposals stated that all properties let for new tenancies would need to achieve an EPC rating of C or above by 1 April 2025, extending to all let property by 2028. More recently, however, Leveling Up Secretary, Michael Gove, has said that the pace at which the PRS transitions to tougher energy efficiency standards should be relaxed.

While the need to build on the progress that has been made in improving the energy efficiency of PRS homes over the past decade is clear, it is widely acknowledged that the proposals pose a sizable challenge.

Government data shows that much of the improvement made to the profile of PRS stock, in terms of its sustainability, has resulted from the purchase of newer, more energy-efficient homes. This means that while the total proportion of privately rented homes has become greener, more work needs to be done to enhance the stock that already exists within the sector.

We surveyed over 1,000 landlords on different aspects of PRS sustainability. This has helped to ascertain landlord awareness of the proposals and their influence on buy-to-let business strategy, in addition to how Government and the mortgage industry can support the landlord community.

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For lenders and brokers, as well as the varied list of companies that operate in the growing green energy sector, opportunities exist in providing such support but it's more important than a business transaction. The PRS is an essential component of the UK's housing infrastructure so the challenge of making millions of homes fit for a sustainable future is an issue impacting a broad mix of stakeholders, not least the diverse population of tenants.

Recognising these wider social and economic implications, we are actively engaging with policymakers and working closely with industry partners to provide tailored finance solutions for those that need them, as well as education on what is a new world for many.



Richard Rowntree
Managing Director, Mortgages
Paragon Bank



How energy efficient are privately rented homes today?

Substantial improvements have been made to the energy performance of privately rented homes.

The number of properties with an Energy Performance Certificate of between A and C in England has risen by 165% over the past decade to 1.92 million. Additionally, homes rated D and E have fallen by 21% to 2.18 million, whilst those rated G – which is not legal under current rental legislation – have reduced to 54,000.

The PRS now outperforms the owner-occupied sector for energy performance, with 44.5% of stock between A and C, compared to 42.9% in owner-occupied homes. Lenders, including Paragon, have encouraged landlords to buy more energy efficient homes through preferential pricing, and the sector has made great strides over the past 10 years.

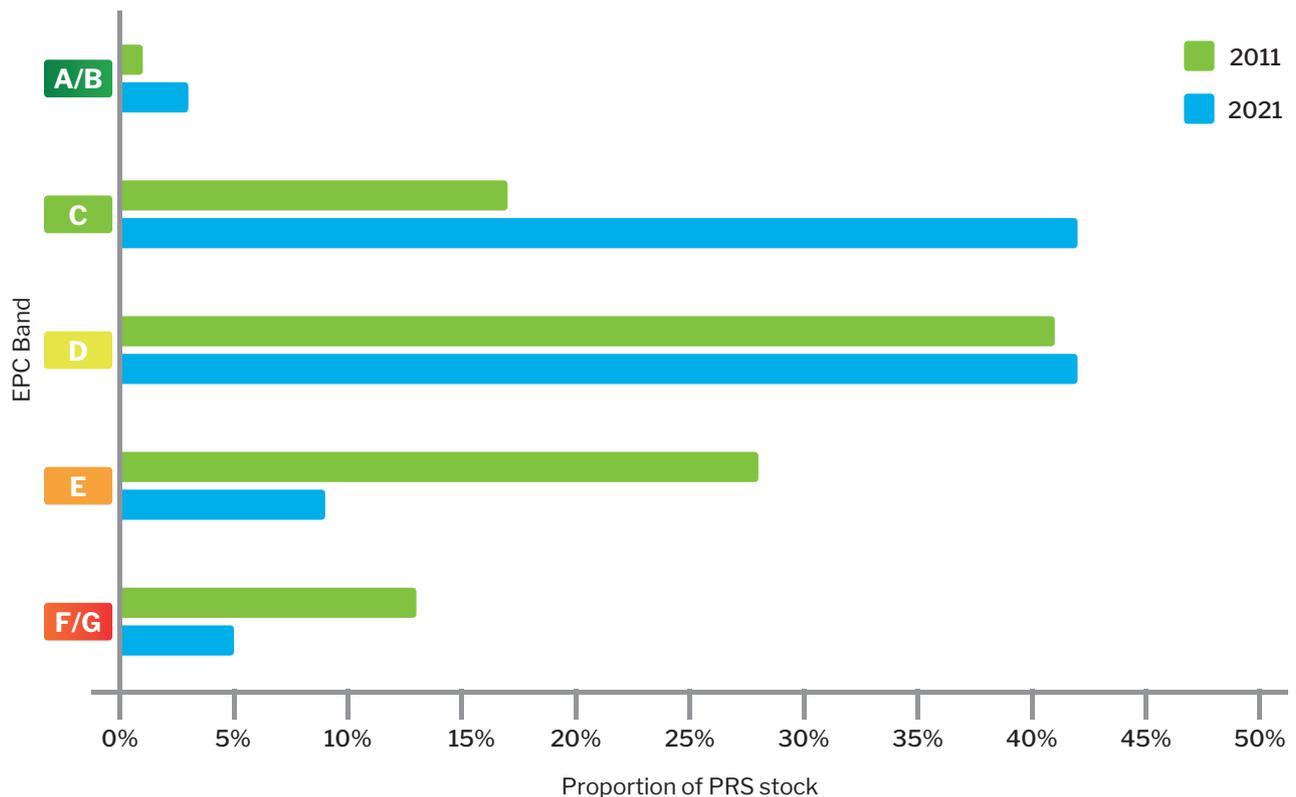
Between 2011 and 2021 the proportion of properties with EPC ratings of F or G fell from 12.9% to 4.9%.

Our research of 1,200 landlords showed over half (52%) have a property that needs a new EPC assessment before 2025, highlighting how there is potentially a requirement to update current understanding of the status of the country's housing stock in terms of its energy efficiency.



*The number of PRS properties with an Energy Performance Certificate of between A and C has risen by **165%** over the past decade to **1.92 million**.*

PRS energy efficiency rating bands – 2011 and 2021



Source: English Housing Survey, DLUHC

Tougher energy regulations on the horizon?

Since 2018, the Minimum Energy Efficiency Standard (MEES) Regulations have required all domestic private rented properties let on assured, regulated or domestic agricultural tenancies to have an EPC rating of E or above, unless not legally required to have an EPC.

Proposed changes

In 2020, the Government proposed new regulations that, if passed into law, would require greater energy efficiency for privately rented homes. These new requirements would result in all properties let under new tenancy agreements requiring an EPC of C or above from 2025. This would then extend to all PRS properties by 2028.

The PRS makes up roughly 19%, or 4.6 million, of households in England. With just under 60% of PRS housing rated below EPC C, around 2.5 million homes will require improvement to be rated EPC C or above by 2025/2028.

If the policy was introduced on 1 August 2023 and enforced from 1 April 2025, there would be 637 days to make the necessary upgrades.

If the policy had been confirmed on 1 August 2023, meeting the new standards outlined in the proposals would require 3,742 properties to be upgraded per day, more if we discount non-working days such as weekends and bank holidays.

The Government has not responded to the consultation two years after it closed but Levelling Up Secretary, Michael Gove, has recently added to speculation that the implementation dates will be delayed. The Secretary of State acknowledged the pressure being placed on the PRS in having to meet energy efficiency standards and stated that Government will give landlords a greater degree of breathing space.

*Meeting the new standards outlined in the proposals would require an **estimated 3,742 properties** to be upgraded per day, more if we discount non-working days such as weekends and bank holidays.*



Landlord awareness of proposals improving but inconsistent

Awareness of the proposed changes has improved but is inconsistent, and it is likely that inaccurate media reporting on the issue has contributed to some misunderstanding.

Over half of landlords surveyed by Paragon believe that all newly rented properties must achieve EPC band C or higher from 2025. A lower proportion, 37%, correctly noted that the changes are still currently proposals and the dates when they may come into effect are unknown.

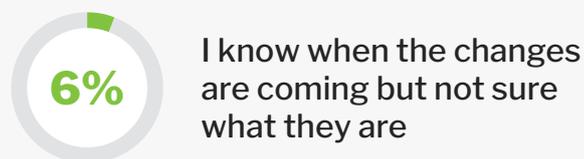
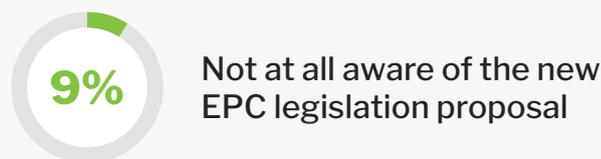
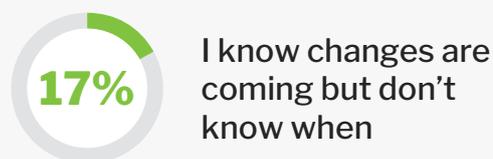
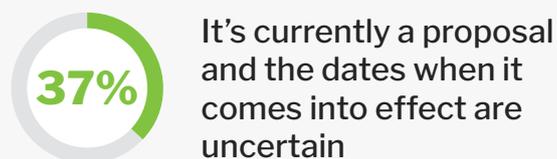
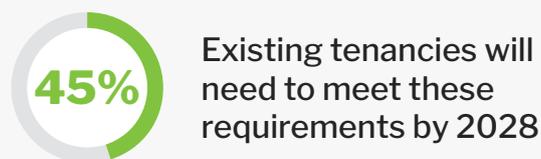
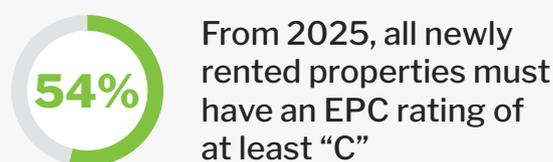
The media is likely to have the biggest influence on landlord understanding of proposed EPC regulations, with newspapers and television identified as the most common information sources.

This is closely followed by landlord membership bodies, such as the NRLA, and online landlord networking groups, cited as information sources by 36% and 30% of survey respondents respectively. This suggests an active landlord community that plays an important part in disseminating information on the issues facing the sector.

Landlord sources of EPC regulation information



Landlord awareness of proposed changes to EPC regulations



How landlords plan to adapt their portfolios to meet proposed requirements

With a varied understanding of the proposals and the implications for the sector, as well as a lack of clarity from Government, landlords are considering a range of approaches to ensure that their portfolios are compliant with any new laws on the horizon.

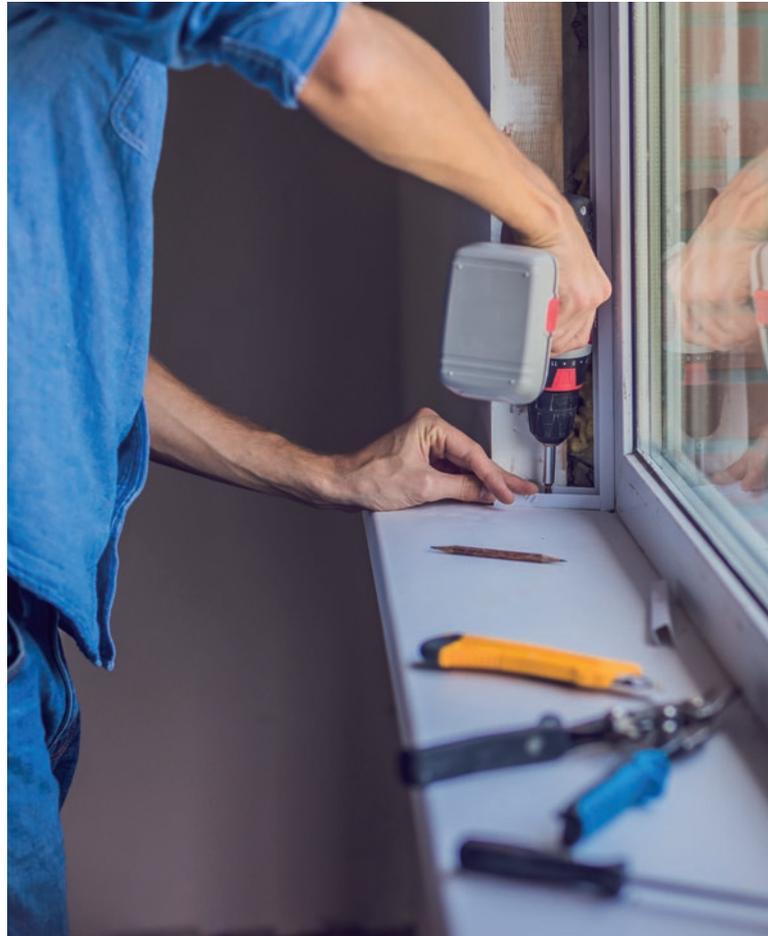
Just over one in five landlords (21%) don't yet know how they will respond to proposed new regulations.

Strategies for adapting portfolios

Most commonly, landlords plan to upgrade existing properties to achieve EPC C, chosen by 33% of respondents. This was followed by just over one in five landlords (21%) who don't yet know how they will respond to proposed new regulations.

A similar proportion, 19%, expect to upgrade some of their properties and sell others, while a further 15% anticipate selling all properties rated below EPC C.

Fewer than one in 10 plan to exit the PRS and just 3% plan to sell all properties rated EPC C or lower and replace them with homes rated A-C, the least popular approach.



How landlords plan to respond to proposed requirements



Upgrading existing properties in the portfolio to EPC rating C



Reduce my portfolio and sell all properties with an EPC below C



Don't know yet



None of the above as I plan to exit the market



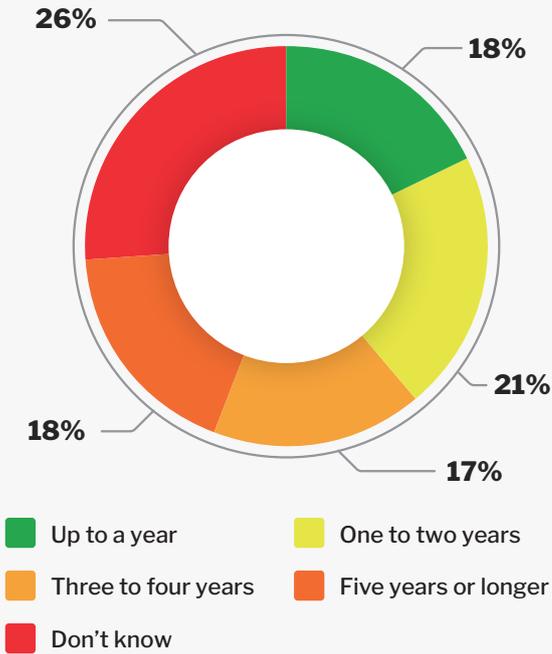
Upgrade some properties in the portfolio and sell some



Sell all properties with an EPC below C and replace them with A-C rated properties

Anticipated time to upgrade portfolios to EPC C

Around four in 10 landlords estimate that it would take up to two years to upgrade all their properties to EPC C, but nearly one in five thinks it would be longer than five years and a quarter don't know.



Anticipated property upgrades

The most common upgrades landlords expect to make to non-compliant properties are upgrading loft insulation and adding energy saving light bulbs. Draught-proofing, upgraded windows and better fabric insulation are also high on the list, but significant changes to the heating system or the introduction of solar panels are less popular.

How landlords plan to upgrade property



Loft insulation



Changing lightbulbs



Draught-proofing



Improving windows



Smart meters



Internal insulation



Cavity wall insulation



Water saving taps



External insulation



Floor insulation



Adding solar panels



Changing boiler to a heat pump

The valuers' view



David Hitches

Head of Property Risk
Paragon Bank

Our research suggests that loft insulation is becoming a popular energy efficiency measure considered amongst landlords. While we encourage efforts to improve the sustainability of homes in the PRS, we recommend that landlords seek specialist independent advice from experienced professionals on the most appropriate materials and practices. As the technology evolves it is important to carefully assess the products available and their suitability to the property.

Using loft insulation as an example, we are aware of concerns with earlier applications of spray foam because many have been found to lead to deterioration of the roof due to problems arising from condensation and lack of ventilation. In the event that spray foam needs to be removed, this can be difficult to achieve and can potentially require entire roof structures to be replaced.

While improvements have been made to address poor practices over the years, this is still work in progress. Therefore, in their consumer guide, RICS recommends that spray foam insulation should be designed and applied by an approved installer trained by the manufacturer, and in accordance with the manufacturer's recommended installation method, while ensuring compliance with appropriate guarantees. We would also advise any landlord looking to install spray foam insulation to check with their lender to see if the application will affect the overall mortgageability of their property.



Above: Example of spray foam insulation

Landlords adopt ‘wait and see’ approach, but proposals are already influencing behaviour

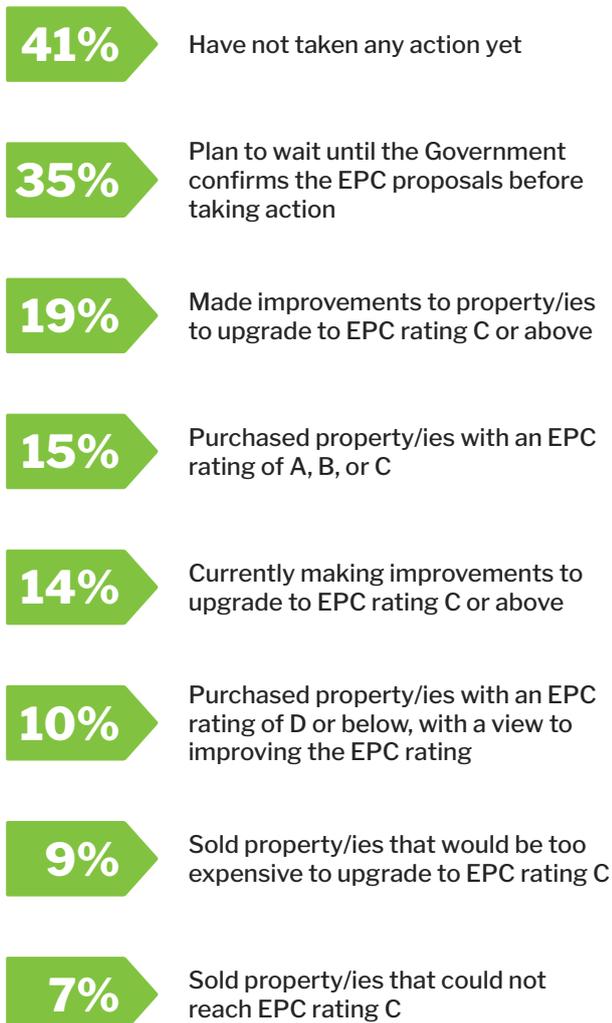
In the absence of clear direction from Government, it is unsurprising that many landlords have so far been reluctant to put their plans into action, with four in 10 stating this when asked what they have done in anticipation of the proposed legislative changes. Similarly, 35% plan to wait until any new EPC regulations are confirmed by Government.

Looking at those who have already taken some form of action, we see that just under one in five (19%) has enhanced property to achieve EPC rating C or above, and a further 14% are in the process of doing so. A similar proportion, 15%, of landlords have purchased properties that have EPC ratings of A-C, so already comply with proposed regulations.

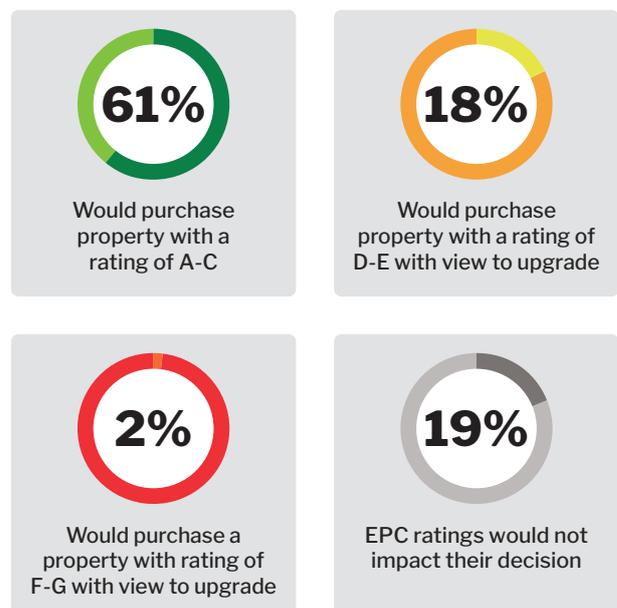
One in 10 landlords (10%) has purchased property rated EPC D or below, with a view to improving its energy efficiency. Similar proportions, 9% and 7% respectively, have divested in anticipation, either selling properties that would be too expensive to upgrade to EPC rating C or could not achieve that level of energy efficiency.

Looking forward, the proposals are having some influence on landlords’ purchase strategies, with 61% considering acquiring additional rental property seeking to purchase A-C rated homes. Just under one in five claimed they would acquire properties rated EPC D and improve and a similar proportion stated that the EPC rating had no bearing on their purchase decision.

Proposed EPC regulations – actions undertaken



How EPC ratings affect property purchase decisions



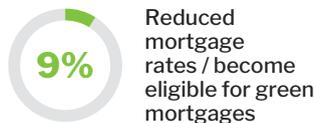
Property improvements deliver broader benefits

Improving the sustainability of portfolios, regardless of EPC regulations, has the potential to deliver a range of benefits.

The primary motivator for upgrading the energy performance of property was to attract better tenants, chosen by 38%. This was closely followed by reducing energy bills for tenants and increasing the capital value of the property, both selected by 35% of landlords.

Sustainability improvement motivators

THE TOP THREE



£276

The potential annual saving following upgrade of PRS properties to EPC C or above

Source: English Housing Survey Energy Report 2021-22

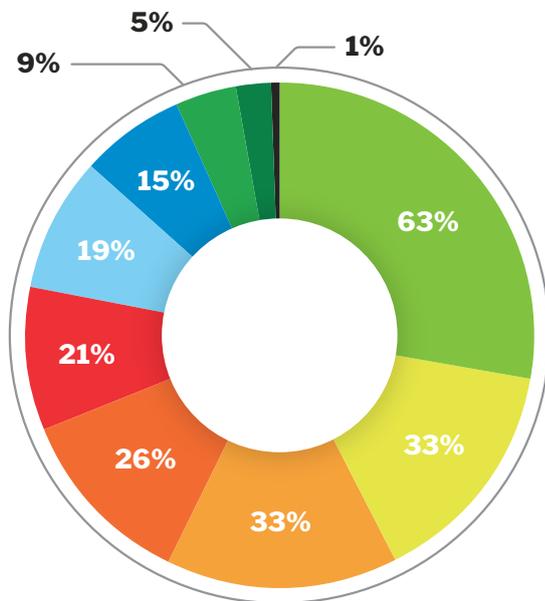


Barriers to improving energy efficiency of homes

Alongside the factors spurring sustainability enhancements, a number of barriers stand in the way for landlords. By far the most prevalent amongst landlords is the financial cost, chosen by 63%. Not wanting to disrupt tenants and the proposals not yet being passed into law were highlighted as barriers for 33% and 32% of landlords, respectively.

Frequent amongst 'Other' reasons were issues relating to the age and/or type of property, with concerns that it is not possible, or at least affordable, to improve the energy efficiency of older and listed buildings.

What are the main barriers stopping you from making improvements to EPC grade?



- High costs of reaching EPC rating C
- Not wanting to disrupt tenants
- Government proposals not made into law
- Lack of knowledge regarding what upgrades to make
- Availability of finance
- Availability of skilled tradespeople
- Other
- None of the above
- Availability of materials
- Property already exempt

THE TOP THREE



High costs



Not wanting to disrupt tenants



Government proposals not made into law

The financial cost of improving the EPC rating of PRS properties

Landlords were asked how much they would be willing to invest to bring homes up to EPC C over a five-year period. Of those who plan to make upgrades, almost seven in 10 (68%) would be willing to spend up to £5,000 per property, with the most common amounts being £2,000 and £5,000.

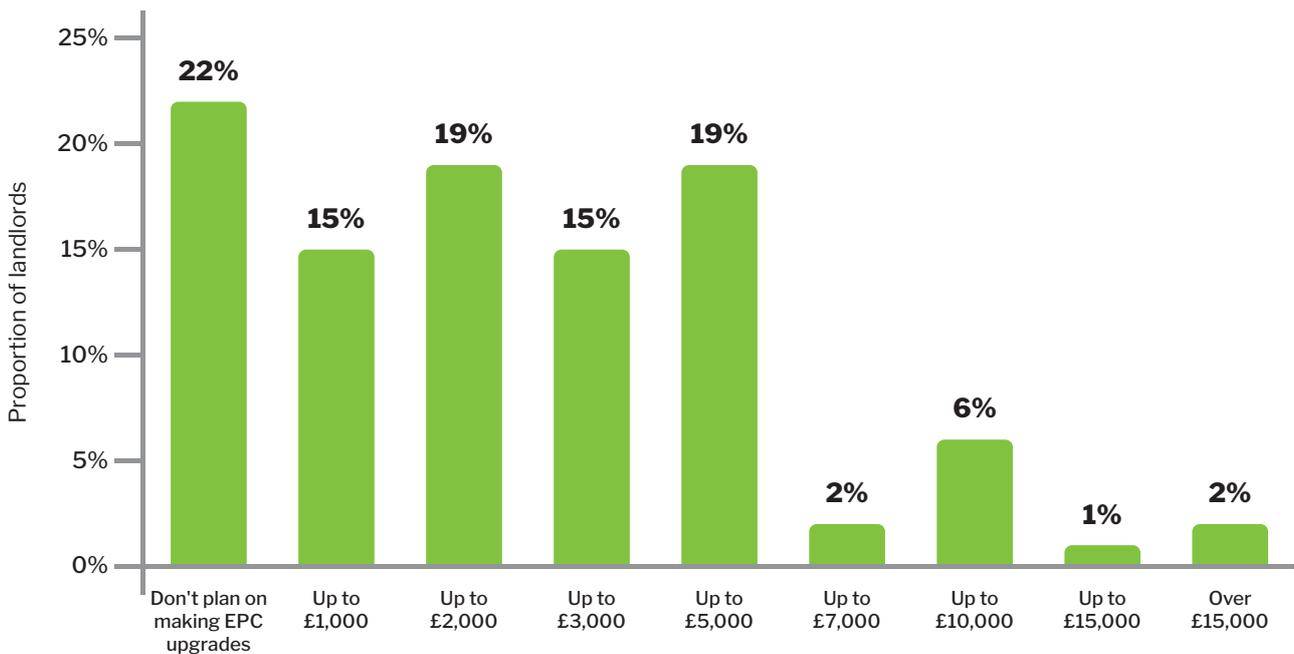
Nearly half of landlords plan to fund the cost of upgrading property from their savings, although a similar proportion also plan to increase the rent. Approximately 13% said they would sell a property to fund the works across the rest of their portfolio.

£7,737

the average estimated cost to improve a home to EPC band C

Source: English Housing Survey Energy Report 2021-22

Willingness to invest - by amount



Anticipated sources of funding



Supporting landlords to make changes



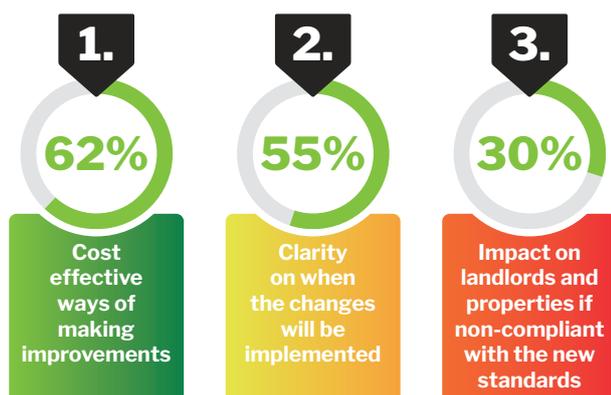
It is likely that landlords could benefit from support if they are to achieve what seems to be an ambitious goal. The nature of the challenge they face means that this support could take a number of different forms.

With many landlords having already made some form of non-energy related enhancement to at least one of their properties, they will have an understanding of the costs associated with refurbishment works. As a result, the cost of improving the EPC rating of their portfolio is an important concern and information about the financial implications is something that landlords would value.

Unsurprisingly, given the ambiguity around the details of the proposed regulatory changes, the need for more guidance on the policy is also a common theme - over half of survey respondents would like clarity on when the changes will be implemented.

Property improvement information needs

THE TOP THREE





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