

Homes that don't cost the earth: a consultation on Scotland's Sustainable Housing Strategy

Response by the Council of Mortgage Lenders to the Scottish Government Consultation paper

Introduction

1. The Council of Mortgage Lenders (CML) is the representative trade association for mortgage lenders. Our 113 members and 86 associates comprise banks, building societies, insurance companies and other specialist mortgage lenders who, together, lend around 95% of the residential mortgages in the UK. In addition, the CML's members have lent over £60 billion UK-wide for new-build, repair and improvement to social housing.
2. CML Scotland welcomes the opportunity to respond to the Scottish Government consultation on Scotland's Sustainable Housing Strategy.

Background

3. While we are supportive of the vision and objectives set out in Sections 19 and 20 for Scotland's Sustainable Housing Strategy we are concerned with the comments in the Financial Market Transformation about creating long term change among surveyors, lenders and consumers of the real value of low carbon, energy efficient houses –in order to drive the market. Our members are aware of the benefit of more energy efficient houses in terms of potential reduced running costs and lower carbon emissions but it is not our members who determine value and we do not believe that we are in a position to drive the market in terms of value. Market Value will be determined by there being a willing buyer and seller and a range of factors relating to the property itself. The value will assist the lender in determining the maximum amount which they are prepared to lend but the primary consideration for any lender has to be whether or not any loan they are granting is affordable. The key to any transformation in our view has to be to convince the consumer of the benefits of low carbon and energy efficient homes.

National Retrofit Programme

4. We fully agree that a primary focus of tackling fuel poverty and reducing energy emissions must be to improve the energy efficiency of the existing stock. We note that the Scottish Government proposes to achieve this by introducing a National Retrofit Programme.
5. We are supportive of the introduction of such a programme. It will however be necessary to overcome apathy amongst homeowners to energy efficiency measures. We see the main barriers for installing energy efficiency measures as being understanding the cost benefit of such measures particularly with a lot of the costs being short term whereas the benefits tend to be long term, the ability to finance and the perception that they may not add value to the property or improve its marketability.
6. Our preference would be to see a "fabric first" approach to a retrofit programme but for this to work then the fabric needs to be tried, tested and covered where possible by a recognised warranty provider. In addition the those carrying out the inspection and work on existing houses need to be properly skilled and trained to ensure that the energy efficiency measures fitted are appropriate for the type of property concerned. Should this not be the case the saleability and value of houses could be adversely impacted where the wrong solution is put in place to improve energy efficiency.
7. As the paper recognises it will be also important that consumers understand how newly installed energy efficiency measures work so that the benefit of them can be achieved.

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8. The plethora of funding schemes available for energy efficiency perhaps makes it difficult for consumers to understand where assistance can be obtained and there is perhaps a case for rationalisation and simplification of such schemes.

The role of Standards

9. We believe that to achieve the Scottish Government's reduction in emissions target will require a range of measures, some of which will require owners and landlords to take action to improve the energy efficiency of their property and others which will incentivise them to do so. Clearly the introduction of standards falls into the former category and the use of tax incentives into the latter.

10. In principle we would support the development of one standard which would apply cross all sectors of housing in Scotland owner occupied, private rented and social rented. Clearly however there is quite a wide disparity between the tolerable standard which applies in the owner occupied sector and the Scottish Housing Quality Standard which is to apply from 2015 in the social rented sector with the former really being a simple standard which makes the house fit for occupation. If a common standard is to be developed for all types of housing then particularly in the owner occupied sector and the private rented sector adequate time will require to be given to bring properties up to standard. The key will be how to enforce and it is extremely unlikely that Local Authorities will have the resource to do so. It is much easier in the social rented sector with the regulation of the sector and in England a start has been made in the private rented sector by not allowing properties to be let out if they have not achieved a certain level of energy efficiency. In the owner occupied sector a start could perhaps be made in the Home Report by highlighting when a property is being exposed for sale to say whether or not it complied with any new standard and if not what needed to be done to make it do so. The monitoring of whether the necessary work was undertaken would be much easier if a central database of Home Reports was maintained which was something which we suggested at the time of their introduction in 2008.

11. Should it be decided to introduce a new common standard we would be supportive of Local Authorities having the current range of powers in terms of work maintenance plans, work notices and charging orders to bring properties up to that standard.

12. We appreciate the issues in relation to the common areas of tenement properties caused either where the majority of owners agree to maintain and repair a communal area and some owners do not wish to meet the cost of doing so or where there is a mixture of owner occupiers and tenants of a social landlord where the latter is required to bring the property up to the Scottish Housing Quality Standard and the owner occupiers do not wish to co-operate. We would favour Local Authorities being given increased powers in this regard and we would suggest that the development of sinking funds should be considered whereby owner occupiers were required to set aside each year a sum towards common repairs. Clearly rules would require to be developed around the operation of such funds, particularly around sale and purchase but these should not be insurmountable. They would be a way of alleviating some of the high costs of a one off repair which can cause issues for owner occupiers.

Financial Market Transformation

13. In 2005 a report from the Centre for Sustainable Energy 'Making mortgages energy efficient' considered whether financial incentives combined with an energy efficiency report would encourage home owners to be more energy efficient. The report concluded that *"we are faced with an indifferent home-buyer and a mortgage market 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."*

14. Unfortunately the conclusion of that report still remains the case today and while the definition of a Green Mortgage has been developed (see Appendix A) there are few lenders offering such a mortgage as the commercial benefits of doing so are not clear to them. We are aware that this is an area which our members on an individual basis review from time to time but we are not aware of any plans which would see a transformation in this area in the short term.

15. While agreeing with comments in the consultation of the need to transform attitudes to the benefits of sustainable homes and that this needs to be an incremental process that starts with changing perceptions we do not believe that this can be either lender or surveyor led.

16. The valuation of properties is influenced by a range of factors including market conditions, supply and demand, location, the sale price of comparable properties in the area, condition, council tax banding, running costs and whether the property is of a type which a lender is prepared to grant a mortgage against. As energy prices continue to rise and energy efficiency schemes such as the Feed in Tariff and the Green Deal become more common they are likely to become an increasing factor in valuation. It should however be remembered that some energy efficiency measures added to the exterior of properties may not be aesthetically pleasing which may put off prospective buyers thus dampening the value of these properties. As the consultation paper recognises RICS has developed guidance on valuing sustainability in homes and this guidance covers the issues well, however it is unclear what impact the guidance has had on valuation of properties as yet. Until the wider public have a better knowledge of the potential benefits of energy efficiency and sustainability measures, it's unlikely that valuations will be greatly influenced. As noted above, this changing of perception will be more evolution than revolution.

17. We do agree that there should be better disclosure of energy related matters when a house is exposed for sale and would agree that the Home Report and its associated documents would be the best place to disclose matters such as whether a feed in tariff or Green Deal exists on the property. This should also include information on other matters regarding whether items such as solar panels have been bought outright or leased, and any replacement or repair costs. This would assist both surveyors and prospective purchasers in assessing the implications of any energy efficiency technology.

18. The paper asks what changes would be required to lending practice to enable mortgage lenders to take account of income from new technology or savings from energy bills. Mortgage lenders are of course subject to regulation by the Financial Services Authority (FSA) and Chapter 11 of the Mortgage Conduct of Business Rules covers responsible lending. In FSA's latest consultation paper (CP/11/31) on their review of the mortgage market the FSA is proposing to strengthen further the responsible lending rules. We understand their final proposals will be published in the autumn of 2012.

19. The key principle of the responsible lending rules is that the mortgage must be affordable and that as part of any assessment the lender has to verify income and consider any foreseeable changes in the pattern of income being received by the borrower. Clearly energy efficiency measures are likely to reduce the running costs of a house compared with a house which does not have such measures and therefore potentially to provide the customer with a greater level of disposable income and if this were the case there is the potential to lend the customer more funds based on an affordability calculation but this should only be considered if the customer is prepared to pay more for the property. Unless the savings are significant it is highly unlikely that they will materially impact on the amount which the customer can borrow. It should be emphasised that savings made through lifestyle changes cannot be considered as there is no guarantee that these changes and any benefit derived will be sustained.

20. While energy efficiency measures are likely to have a positive impact on disposable income it has to be borne in mind that the repair, maintenance and replacement costs of some of the new technologies associated with energy efficiency can be significant.

21. The appraisal of the property condition and value over which the lender will be granted security in respect of the mortgage loan form an integral part of a lender's underwriting process from a risk mitigation and limitation point of view. In doing so lenders in the UK rely on the expertise of RICS qualified surveyors to carry out the appraisal in accordance with RICS "Red Book" and to understand the underwriting criteria of the lender who has asked them to carry out the appraisal. Lenders have their own individual underwriting criteria which will outline the types of property which the lender may or may not lend against.

22. During the lifetime of the mortgage it is the clear responsibility of the customer who is the owner of the property to keep it in good repair and to make any appropriate improvements to it.

New Build Market Transformation

23. We intend to restrict our comments in this section to innovative methods of construction. Our members have no intrinsic preference for any particular mode of construction but they do have one overriding requirement that properties considered in relation to a mortgage must be capable of standing as security for a loan of up to 35 years.

24. In practice, this means that the property must be saleable and maintain, or increase, its value over the term of a mortgage loan. In relation to innovative methods of construction, lenders have been concerned about the ability of some designs to meet this criterion in key respects:

- Durability: achieve a life span of at least 60 years.
- Whole life costs (WLC) at a level comparable to traditional construction. This is particularly relevant for lenders to social housing providers.
- Reparability: no undue repair costs, and ability to use a range of local repair services.
- Adaptability: the property should, without difficulty, support the usual range of adaptations/extensions such as a porch and conservatory.
- Insurability: buildings insurance should be available on normal terms.

25. Lender concern in the area of innovative methods of construction has been, in part, fuelled by the relatively poor track record of past generations of non-traditional construction. Lenders providing individual mortgages for home-ownership and lenders providing private finance for new-build in the social rented sector have similar concerns.

26. We are aware of the work of the British Board of Agreement in the assessment and issuing of certificates in respect of innovative methods of construction and at one stage the Buildings Research Establishment were involved in the development of a standard LPS 2020 which was meant to cover the design and manufacture, the erection and registration of the property upon completion. We understand that work on LPS 2020 is now in abeyance due to the costs being unacceptable. We do believe that for innovative methods of construction to be more acceptable to lenders that recognised standards need to be developed around design, manufacture and erection. The property being covered by the backing of a warranty provider such as NHBC would also assist.

Skills and Training

27. We believe both in new build and the retrofitting of existing houses that the work should be carried out by suitably skilled, trained and qualified staff. That is why over the years we have supported and been represented on bodies such as NHBC and the Construction Licensing Executive in Scotland. An example of our support for work in this area was recently demonstrated in the area of solar panels where lenders will normally only give their consent where solar panels are being leased and installed on a house subject to a mortgage when the panels are being installed to a suitable standard by someone accredited under the Microgeneration Certification Scheme.

28. While we supported the Microgeneration Certification Scheme for solar panels it is fair to say that there have been issues with regard to the likes of cold calling and it is important that the right consumer protection measures are in place.

29. Measures which will further up skill, train and further develop accreditation schemes are likely to have our support.

Further contact

30. This response has been prepared by the CML in conjunction with its members. Any comments or enquiries should, in the first place, be directed to:

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Appendix A

The Energy Efficiency Partnership for Homes Home Purchase and Finance Group

What is a Green Mortgage?

Definition

A green mortgage (home loan or further advance) offers a financial incentive which encourages the home owner to buy or to work towards a high energy performing home. Energy use is just one aspect of homes' impact on the environment and a green mortgage may also offer incentives for other positive environmental features of a new or existing home.

The Home Purchase and Finance Group of the Energy Efficiency Partnership for Homes have defined a green mortgage as follows:

- It encourages consumers to buy, or to work towards, a high energy performing home
- It offers one or more defined financial incentive(s) linked to the home's energy use (see below)
- It encourages the consumer to access advice and support on domestic energy use prior to making improvements (advice to be provided by external approved body, eg, EEAC)
- It has defined qualifying criteria, based either on a minimum energy standard, or a commitment to make certain improvements to the home (see below)

Characteristics of a Green Mortgage

Financial Characteristics of the Product

The type of incentive could include one or other of:

- Lower rate mortgage – a competitive rate for the individual lender organisation

- Cashback
- No early repayment charge
- Fee free
- Higher loan to value
- More favourable length of term

Qualifying Criteria

Either

- Home has an energy performance measurably (using an agreed standard) better than the minimum building regulations standard* .

Or

- Home owner commits to undertake action either from the list of recommended measures in their Home Energy Report, or where this is not available (eg in a remortgage situation) from a general list of suitable measures. Action taken could include:
 - o Cavity wall insulation/interior or exterior cladding/ roof insulation
 - o Boiler replacement
 - o Micro-renewables measures, such as solar photovoltaic panels, solar hot water heating, ground source heat pumps

* Sustainability and energy standards for homes are currently under review by the Government, and in particular the new Code for Sustainable Homes (which will have a minimum energy performance standard) is in development. The group will recommend a specific level using the EST Best Practice Standard, the Code for Sustainable Homes or equivalent.