CREFC Europe

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The Non-Domestic Private Rented Sector Minimum Energy Efficiency Standards – Implementation of the EPC B Future Target

Response of the Commercial Real Estate Finance Council (CREFC) Europe

The Commercial Real Estate Finance Council (**CREFC**) Europe is a trade association promoting a diversified, sustainable and successful commercial real estate (**CRE**) finance market in Europe that can support the real economy without threatening financial stability. Our membership includes a range of different bank and non-bank lenders, intermediaries and advisory businesses, and real estate firms that use debt to finance their activities.

Energy efficiency and sustainability issues have become increasingly mainstream issues for the CRE lending community in recent years, both in the UK and more generally across our membership. In part, this is because of a growing focus specifically on climate change issues, but also more broadly on ESG considerations; but an additional and very important driver was the UK's introduction of minimum energy efficiency standards (**MEES**) for non-domestic privately rented property, which made the subject impossible for lenders to ignore in due diligence and risk management. We welcome the Government's continuing engagement with industry in this policy area and are pleased to provide our input.

Our membership and the wider CRE finance market are very interested in this area, but most are by no means expert in it; many members have expressed their appreciation for the dialogue that officials have encouraged. Unfortunately, this response is heavily reliant on our general understanding of the issues and the perspective of lenders – we have received very little direct feedback from member firms and suspect that, despite their interest, few feel able to comment on far-reaching and ambitious proposals in an area where they lack deep expertise (or the resources swiftly to acquire it). However important debt may be to fund the retrofitting and decarbonisation of commercial buildings, we suspect most lenders do not feel it is for them to try to shape the agenda, but prefer to wait and respond to the emerging policy landscape and borrower behaviour and preferences.

Headline responses

Notwithstanding the limited member feedback we have received (as mentioned above), we felt it important to respond to this consultation to provide a few observations of our own, based on our reading of the consultation paper, our understanding of the market and our conversations with members, as well as our review of the draft responses kindly shared with us by the Better Buildings Partnership and the British Property Federation, with which we are broadly in agreement, deferring to their specialist and more detailed expertise in this area.

We welcome the approach outlined in this consultation paper (and as read alongside the one proposing performance-based ratings for larger commercial and industrial buildings). We have a small number of points to make, set out below, noting where a point is relevant to a particular consultation question. Where we have not commented specifically, please assume that our views align with those of the BBP and BPF.

- We understand the reasoning behind the 'phased' approach with a 2027 EPC C 'interim milestone' seeks to address, but we think that proposal misconceived. The right time for upgrade works to be

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carried out will depend on building lifecycle and lease structure, and a 2030 goal should allow most building owners to identify a suitable intervention window that they can use. Setting an interim target in 2027 risks creatin confusion about what building owners should be seeking to achieve; and without a suitable exemption, it could penalise building owners whose intervention window to achieve EPC B isn't until the last two or three years of this decade. A better approach would seek to incentivise building owners (particular smaller and less sophisticated ones) to identify and use any early intervention window available to them, and to discourage them from waiting until a later intervention window. [***Relevant to Q2***]

- While we recognise that this may fall outside the ambit of the consultation, members have reported two specific concerns about the potentially counterproductive nature of the EPC framework. First, they report that the way EPCs ratings are derived can mean that a void unit may achieve a better rating than a unit that has been fitted out for a tenant to use [***possibly relevant to Q4?***]. Secondly, because the recommendations from EPCs are based on current building regulations without regard to forthcoming changes, they may encourage actions which run counter to a net zero pathway – for example, by recommending the installation of a newer, more efficient gas boiler rather than identifying the opportunity for moving away from gas boilers altogether.

- With suitable support, lenders could play a key role in helping building owners (particularly smaller and less sophisticated ones) to understand and plan, as well as finance, building upgrades required to meet the EPC B challenge, because a relatively small number of lenders can reach a very large number of building owners. Broad market access to rich, easily readable data about buildings and their EPC status would helpfully complement a simple metric (the EPC ratings scale), providing greater clarity and certainty [***Relevant to Q7***]. Measures that encourage or require tenants and landlords to cooperate and collaborate to improve reduce energy usage (or indeed to measure and reveal their energy usage) would be very welcome [***Relevant to Q15***].

- Having said that, we would stress the importance of coherence and alignment across strands of policymaking that may not traditionally work together. The easy choice for lenders seeking to boost their ESG credentials is to finance new buildings that meet obvious environmental targets or social needs; but the most important role they can play in supporting the green transition is to finance the upgrading of existing (older, less glamorous) buildings. Financial regulators need to ensure that the incentives in terms of regulatory and disclosure requirements affecting banks and other regulated lenders positively encourage and reward the financing of 'brown' buildings to make them greener, rather than rewarding only loans against 'green' assets that already present low climate risk.

- Especially in the context of MEES (which will affect a higher proportion and number of smaller businesses than performance-based rating requirements), we have heard concerns from lenders that there is no meaningful public information campaign from government to encourage SMEs, in particular, to think about and act on the decarbonisation agenda – it is falling to lenders and property consultants to do that. Further, lenders have suggested that some SME customers are likely to need a degree of financial incentivisation to get onto the right path (for example through grant funding for smart metres or an element of required retrofit, reduced business rates or other mechanisms).

- We suspect there will be many buildings – indeed, potentially entire towns and regions – where retrofit interventions are not cost effective, because rent levels and the prospect of rental growth are simply too low, and will not repay the investment required. If investors cannot recoup costs through service charge or higher rents (which could make sense for occupiers because their energy bills are lower and user experience in the building is better), either the relevant upgrades will not happen, or the requirement for them to happen will reduce the attractiveness of real estate as an investment. There will inevitably be implications for the decarbonisation process and for real estate investment more broadly. [***Relevant to Q13 and Q14***, albeit not really a response to those questions.]

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- Especially compared with the scope of the proposed performance-based rating framework for larger commercial buildings (applying to owner-occupied as well as leased stock), the fact that EPCs and MEES apply only to privately rented commercial buildings seems odd. Would it not make sense to signal to all owners of commercial property (whether owner-occupiers or landlords) that they need to be aware of, and actively improve, the energy performance capability of their property? Failing to do that risks distorting the market, as well as missing an opportunity to drive decarbonisation across the owner-occupied commercial property stock.

- Especially compared with the almost 'real time' nature of the proposed performance-based rating framework for larger commercial buildings (with annually updated information and site visits every four years), the ten year validity period of EPCs seems anomalous. In the absence of a different trigger for a new EPC, would it not be sensible to have a shorter validity period, both to send a signal and to make it easier to reflect the evolution of the market, technology and expectations?

If you have any queries in relation to this submission, please contact Peter Cosmetatos, chief executive of CREFC Europe, on 07931 588451 or pcosmetatos@crefceurope.org.

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