CREFC Europe

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Date: 9 June 2021

Introducing a Performance-Based Policy Framework in large Commercial and Industrial Buildings in England and Wales

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 willingness to explore additional, complementary policy tools alongside EPCs and MEES, and its continuing engagement with industry in this policy area.

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 separate consultation on EPC B; we lack the technical expertise or resources to respond to the consultation focused on offices). 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.

- The UK's introduction of MEES was instrumental both in forcing the entire market to pay at least some attention to at least some aspects of the energy performance of at least some commercial and industrial buildings. But while EPCs have the virtue of a simple and standardised metric, they are a poor proxy for how buildings actually perform, as noted in Chapter 1 of the consultation paper. The introduction of performance-based ratings could be transformational, especially if the new framework can establish a clear, single, universally recognised market standard for assessing and tracking the energy performance of commercial and industrial buildings.

- In particular, for lenders seeking to pursue their own path to net zero or to drive green transition in commercial buildings that they finance, a significant challenge is getting visibility of the energy usage by occupiers. Measures that encourage or require occupiers to measure and reveal their energy usage – like measures that encourage or require occupiers and landlords to cooperate and collaborate to reduce energy usage – would be very welcome.

- We welcome the fact that the scope of the proposed performance-based rating framework for larger commercial and industrial buildings includes owner-occupied as well as leased stock of relevant size. This prompts us to question (in our response to the EPC B consultation) why EPCs and MEES should continue to apply only to privately rented (and not also to owner-occupied) buildings.

- The consultation paper briefly notes the vital role played in Australia by the public sector as a user of property in driving the success of NABERS. If the UK government is serious about decarbonisation, it must put the weight of our public sector as occupier firmly and visibly behind the new framework. [***Relevant to Q4 and Q12*** (a government commitment as to the minimum rating of office buildings it occupies or has control over should attain over a given time horizon would be a useful additional element in phase one, and could drive improvements in ratings).]

- As in the case of MEES, 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). [***Relevant to Q5***]

- A key driver of improved energy and carbon performance that is not identified in the graphic on p51 of the consultation paper is better or cheaper access to finance, as lenders increasingly focus on both the risks associated with lending against (or to businesses with) obsolescent assets and the benefits associated with driving decarbonisation and green transition and supporting businesses that are not behind that curve. [***Relevant to Q12***]

- 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. It would be a mistake for them to focus solely on whether the asset lent against is 'green' or 'brown' and ignore the intentions of the owner and lender. If policymakers work together to get this right, we agree that this framework will provide an excellent basis for lenders to facilitate the retrofitting of affected buildings. [***Relevant to Q13***]

- While the performance-based rating framework as initially proposed is light touch, its effectiveness to drive decarbonisation of commercial and industrial buildings in the rented sector will, like MEES and EPC B, be vulnerable to the economics of particular buildings. Low-hanging fruit based on behavioural change should be strongly encouraged; but if investors cannot recoup the cost of an intervention through service charge or higher rents, that intervention is unlikely to happen. This may be seen not only at the level of particular buildings, but across entire towns and regions where the economy and rental expectations are too weak to justify capital expenditure. It may not be easy to find effective solutions to this challenge. [***Relevant to Q13 and Q14***]

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.