

Confronting the EPC Challenge:

The path to a sustainable rental market



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Foreword

"The private rented housing sector is an extraordinarily diverse part of the British economy. There's a huge assortment of property owners, from vast institutional investors to landlords with just one house or flat. The properties themselves are cottages, Victorian terraces and ultra-modern high-rise buildings. They are home to millions of tenants, all of whom have different individual situations and priorities.

It is not straightforward to draw up a housing policy that can be applied to the whole sector, but this is what the energy performance certificate (EPC) system is designed to achieve. Improving the efficiency of the UK's homes is, of course, an essential part of the long-term journey to net-zero carbon emissions, but the delivery of policy also has an impact on landlords, tenants, and the level of stock available.

Landlords are already banned from letting homes with a rating of F or G, and, as this white paper will set out, the standards are likely to become tougher in the future. The government has previously set out an aspiration to change the minimum EPC rating for rental properties to C from 2025. Although this target has not yet been put into law, there has been a clear direction of travel towards tougher efficiency standards.

As an industry, the property sector has been making great strides towards improved awareness of the potential for tougher EPC requirements. The lending industry, including Shawbrook, is stepping up with mortgage and bridging discounts linked to EPC improvements, and continues to help drive the conversation around energy efficiency, health, and sustainability.

Since our last EPC research was published at the start of 2022, rising energy bills have been a significant contributor to the UK's cost-of-living crisis. This has added a new dimension to the conversation around energy efficiency standards, as well as the behaviours and preferences of landlords and tenants. As a result, both groups are undoubtedly more alert to movements in the energy market.

As part of the drive towards a more sustainable future, government and industry stakeholders need to do everything possible to support landlords to make changes to their properties. As the findings of our latest research show, progress is being made, but there is more to be done. Perhaps the top priority is for policymakers to confirm their plans, so landlords know exactly where they stand on regulation.

A failure to act risks making thousands of landlords' businesses unviable in the long-term, stretching the supply of rental housing to breaking point. At Shawbrook, we are committed to bringing together all industry stakeholders to develop the conversation around EPCs and make real progress towards our shared goals. I hope this report goes some way to bridging the gaps and moving the issue forward."



Emma Cox

MD Real Estate, Shawbrook Bank

Introduction

The UK has some of the oldest, draughtiest and leakiest housing stock in Europe¹. Addressing poor energy efficiency is an essential part of the government's plan to meet its net zero target for carbon emissions by 2050, and, as domestic gas and electricity bills reach record levels, a way to achieve significant cost savings for renters.



Although it has not yet been put into law, the government has previously proposed a required minimum energy efficiency standard (MEES) of EPC C or above for all newly rented properties in England and Wales by April 2025. The measure, should it be progressed, could also apply to existing tenancies from 2028.

Ministers have also suggested there could be changes to the cap on total refurbishment costs. This flat rate – currently £3,500 – is the maximum amount a landlord is expected to pay in order to improve a property's energy efficiency rating, regardless of its market value and the final EPC achieved. Under the proposed reforms, this level could be raised to £10,000.

Britain's varied and ageing housing stock presents a number of challenges in making efficiency improvements. Costs of installing new windows, a boiler, heat pump, or insulation, for example, are significant, and may be out of reach for many landlords, especially at the higher cap level. They are also likely to represent a much greater percentage of a property's value in some parts of the country.

Based on research carried out in the summer of 2022 – a time of unprecedented financial challenges for many families – this white paper will examine the views of landlords, tenants and property finance brokers in facing the EPC and sustainability challenge. It will build on Shawbrook's previous report to review the sector's progress, particularly in light of cost of living pressures.

1. Institute for Government, Tackling the UK's energy efficiency problem – September 2022

Part one

The Knowledge Gap

The scale of the challenge is still huge. Our research shows that only a quarter of landlords' portfolios contain properties that all meet the EPC C target. Nearly four-in-ten (38%) have properties that are all rated D or below, a proportion rising to 58% of investors in London. Some 71% of all landlords still own at least one property in this category. If the proposals go ahead, landlords will not be able to begin new tenancies in these properties beyond April 2025.

While eight-in-ten (78%) landlords say they have now heard about the 2025 EPC proposals, a significant knowledge gap remains. Of that group, more than

a third (37%) admit to knowing only 'a bit' about the plans, and more than one-in-ten (11%) say they don't know anything at all about the requirements. However, this is down from 15% in our last survey, carried out in November 2021, suggesting some improvement in awareness.

Perhaps unsurprisingly, landlords with four or more properties are much more likely to have heard about the proposals than other investors. Some 95% have knowledge of the plans, compared to those with one rental property (61%) and two-to-four properties (86%). However, despite that level of awareness, half of landlords in this group admit that all their properties are rated D or below.

Spotlight

The Guidance Gap

73%

Nearly three-quarters (73%) of landlords say the government has done a poor job of communicating its EPC proposals. Ministers have been expected to introduce legislation several times but are yet to formalise the regulations. As such, the industry is moving towards the 2025 deadline with the expectation – not certainty – that the rules will change.

A lack of information on how to make improvements is also a key barrier to change, cited by

31%

of landlords in our research.

A similar proportion say improved guidance would be the most effective way to help them make the necessary upgrades.

Landlords also see lenders and mortgage brokers as key sources of information about EPC requirements. Some

36%

have spoken to a lender and more than

26%

have addressed the issue with a broker. However,

41%

have not spoken to either a broker or lender about EPCs, despite the importance of ratings in some lending decisions.

75%

of brokers are concerned their BTL clients are not aware of proposed EPC changes



Part two

The cost-of-living trigger



In October 2022, the median household's energy bill stands at around £2,500 a year – and would be higher without government capping of unit prices. It means a typical bill for gas and electricity is around £210 a month, compared to just over £90 a month in October 2020. The sharp rise in energy costs, combined with inflationary pressure across the economy, means the vast majority (85%) of tenants are taking steps to manage the rising cost-of-living.



This level of financial pressure brings home energy efficiency into sharp focus. Our research shows that in the last 12 months, more than a fifth (21%) of tenants have spoken to their landlords about making EPC improvements. The majority of renters (58%) say they would be less likely to look at a rental property with a rating of D or below and nearly three-quarters (72%) of tenants aged 18 to 34 check a property's rating before signing a contract.



The rising cost-of-living appears to be providing the impetus for many landlords to make improvements, long after the EPC change proposals were first put forward. More than half (54%) have made changes to their properties in the last six months to improve efficiency. Of those who have implemented upgrades, 63% had brought forward their plans because of inflationary pressures. A further 28% would not have made changes without the cost-of-living trigger.

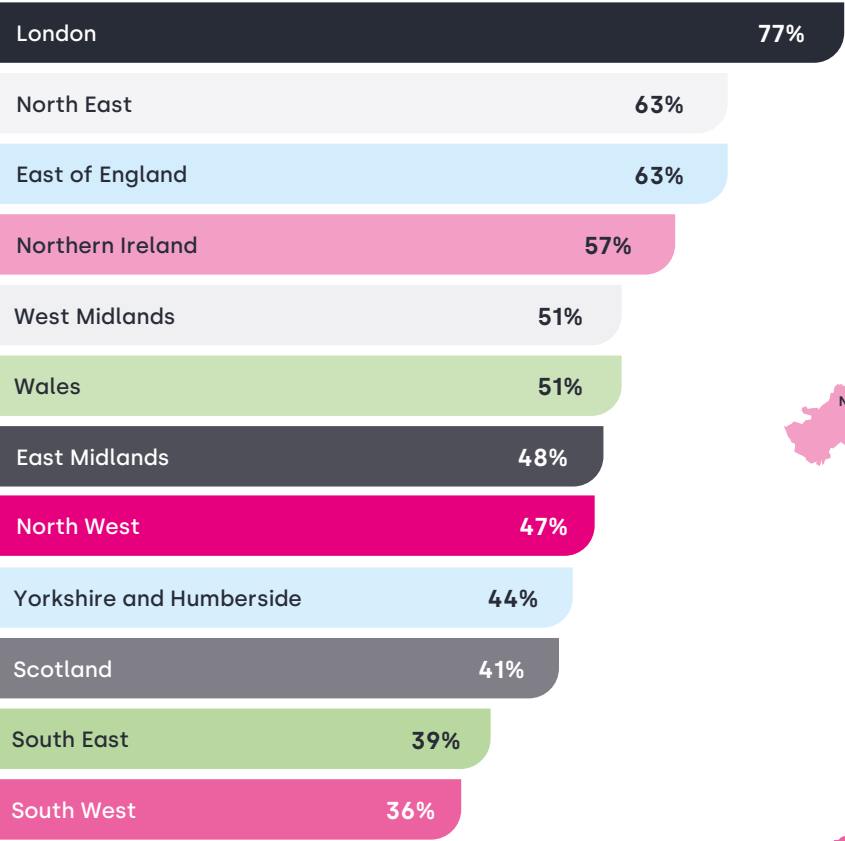


Nearly half of landlords (48%) see lowering energy costs as the key benefit in making efficiency improvements. They are also mindful of the attractiveness of efficient homes to prospective tenants, with nearly two-in-five (38%) saying they would make changes for that reason. The same proportion would make improvements to increase the value of a property.



Regionally, landlords in London have been making the most improvements recently, with 77% doing so in the last six months. Our research shows landlords in the West Country have lagged behind, with only 36% taking action over the same period.

Heatmap of the UK:



Spotlight

How landlords are supporting their tenants with rising costs



75%

of landlords have taken steps to support tenants during the cost-of-living crisis

- 22% have made improvements to their properties in the last six months specifically to improve energy efficiency
- A quarter (25%) have frozen rents
- More than a fifth (22%) have reduced rents for tenants who are struggling
- One-in-seven (14%) haven't made changes but would be prepared to do so



85%

of tenants are taking action to address the rising cost-of-living

- More than half (55%) have been forced to cut back on 'unnecessary' expenditure
- Tenants aged 18-34 are the most affected age bracket (93% taking action)
- Nearly half (45%) have been forced to turn down heating
- More than a third (34%) say they've been forced to cut back on essentials
- Some 36% would consider asking for a reduction in rent



Part three

Where does the responsibility lie?

There are benefits for both tenants and landlords in making properties more efficient. Tenants can make an almost immediate difference by switching to low-energy consumables, such as LED lighting, or asking their energy supplier to install a smart meter. Investment by landlords can ensure the long-term viability of their properties while reducing costs for tenants.

This shared benefit may explain why only 14% of landlords believe they should shoulder sole responsibility for a property's energy performance. Nearly half (49%) say this should be an equal split with tenants, and a third (33%) say responsibility should be shared but with a greater burden on landlords.

The majority (60%) of landlords have asked tenants to contribute to energy-saving measures, including low-energy lightbulbs, and arranging the installation of smart meters. This figure rises to eight-in-ten (81%) of landlords in London, where 47% say they have asked tenants to implement their own improvements multiple times

Whether tenants implement practical changes or not, they are likely to shoulder at least some of the cost of EPC improvements. More than half (52%) of landlords who have made efficiency upgrades in the last six months have increased rents, with a further 28% expecting to do so. Of those that have or are planning to increase rents, the average increase is 11.6%.

Our research also points to a lack of knowledge about energy efficiency requirements among private tenants. Only 28% have some awareness of regulatory changes in the next five years. Another 27% have no awareness of EPCs at all. However, as outlined in the previous section, this awareness is increasing, possibly as a result of the cost-of-living trigger.

Where landlords believe tenants can contribute to improvements:



(63%)

Low-energy lightbulbs



(43%)

Water-saving taps



(43%)

Smart meters



(29%)

Draught proofing



Only **7%** of tenants know
'a lot' about EPC requirements



Part four

The barriers

Our research is clear – the key obstacle to energy efficiency improvements in the private rented sector is the cost of changes, including double glazing, insulation, heat pumps and boilers. More than four-in-ten (44%) landlords say affordability is the main barrier to improving their property's EPC rating by the proposed 2025 deadline, rising to more than half (51%) of landlords with only one property in their portfolio.

On average, landlords estimate the cost of bringing a property with a rating of D or below up to the C standard at just under £2,000. Given the huge variation in property construction and condition, nearly one-in-ten (9%) expect the work to cost more than £5,000. A third (33%) are concerned that pressures linked to supply chain disruption will drive these costs higher, and a similar proportion (29%) are worried about a shortage of skilled tradespeople.

Under the current rules, most properties must meet the E standard on the EPC scale unless they qualify for a high-cost exemption. This cap currently stands at £3,500 – the highest amount a landlord has to spend on improvements before their property can be let with a lower rating. As part of the proposed change to a minimum C rating, this cap is expected to be raised to £10,000.

Our research shows that 70% of landlords believe £10,000 is too high, and more than a third (35%) agree there would need to be a lower cap to meet the proposed deadline. Industry voices, including the National Residential Landlords Association, have also warned about the regional variation in home values. The proposed cap represents a far greater proportion of £163,000 – the average house price in North East England – than £544,000, the average price in Greater London².

In terms of meeting the costs, 57% of landlords who have already made energy efficiency improvements have used their cash savings, followed by 30% borrowing on credit cards, and just under a quarter (24%) taking out a personal loan. Landlords also re-mortgaged (17%), took out a business loan (16%), utilised equity release (16%), a second charge mortgage (14%) or a bridging loan (12%) to fund work.

More than 63% of landlords say the burden of EPC improvements makes them more likely to sell their properties in the next five years. Again, cost is one of their leading concerns. More than four-in-ten (41%) say they can't afford improvements, 42% say it is too much hassle, and a third (33%) believe they won't be able to make the required upgrades by 2025.

23%
concerned about future
regulatory changes

26%
not enough information
about requirements

33%
can't make upgrades
before the deadline



63%
of landlords more likely to
sell up in the next five years

42%
too much hassle

41%
can't afford improvements



Viewpoint

The National Residential Landlords Association

"Residential property is a significant contributor to the UK's greenhouse gas emissions. It stands to reason, therefore, that in order to hit the government's net zero target, the efficiency of our housing stock will need to improve.

The challenge for the private rented sector is two-fold. On the one hand, there is the matter of the split incentive, where landlords are necessarily required to pay for the works but see little or none of the benefit. On the other, there is the net cost of the works required, which is substantial to say the least.

When the target was to improve all F and G rated properties the solutions were relatively simple, if still often costly. A lot of properties could be bootstrapped with low-intervention investments, such as loft and cavity wall insulation. However, with the low-hanging fruit picked, retrofitting the approximately three million properties which are currently unable to obtain a C rating is a very different problem.

The kind of deep retrofit needed in a great many properties goes beyond lightbulbs and lagging. The measures many properties will require range from solid wall insulation (around £8-15,000) to solar PV (around £5,000 for a typical house), or air source heat pump installation (typically £7-18,000).

The cost of these measures is perhaps justifiable for a homeowner who can calculate how many years they might take to 'pay for themselves' in savings, but for a landlord it is non-recuperable. Depending on the location of the property it may also dwarf the capital available to draw upon to fund such a retrofit.

The investment required in our housing stock represents a potential burden for many landlords that they are highly unlikely to be able to shoulder alone, without significant changes to the tax system and some form of financial assistance along the way".

Chris Norris

Policy Director at the NRLA







Part five



The industry

As well as the need for clarity from policymakers, the industry has a significant role to play in supporting landlords to make EPC improvements. Only by working together can the housing sector play its part in reducing energy consumption, helping the UK towards its goal of reducing carbon emissions, and safeguarding the long-term future of the private rented sector.



Lenders

Mortgage lenders are often the key point of contact for buy-to-let clients to discuss regulatory changes. Our research shows that more than a third of landlords who are aware of the EPC changes have spoken to a lender about the requirements.

As well as those who use cash savings and personal borrowing to fund EPC improvements, many landlords also use products offered by lenders to meet the cost. Of those who have already made changes to their portfolios, 14% used a second-charge mortgage, and 12% took out a bridging loan.

Four-in-ten (41%) of landlords would like to see the industry come forward with more mortgage products linked to energy performance ratings. This is one area where the sector is stepping up to meet demand. Some 71% of landlords are aware of energy efficiency discounts available from lenders, such as Shawbrook. Portfolio landlords are much more likely than average to be in the know, with 90% awareness of these products.

As it stands, nearly a fifth (18%) of landlords are making use of energy efficiency mortgage discounts, and nearly six-in-ten (59%) would consider taking advantage of them in the future. In addition to direct discounts, a third (33%) of landlords would like to see lenders help them come up with an action plan to improve ratings.



Brokers

Intermediaries are a crucial pillar of the UK's private rented sector, backed by their knowledge and experience of many clients and transactions. When it comes to EPCs, half (50%) of mortgage brokers have had buy-to-let clients come to them for advice about the proposed changes to the system.

Given with the volume of property transactions they help to facilitate, only 15% of brokers have not heard about the proposed changes to the EPC improvement cost cap, and more than a quarter (27%) say they know a lot about the planned reforms. Their experiences can help us develop a deeper understanding of the challenges of the rating system.

Our research with brokers supports many of our earlier findings about the landlord knowledge gap. Three-quarters (75%) are concerned that their buy-to-let clients are not aware of the proposed changes to the EPC system. A greater proportion (82%) say their clients are not familiar with the support available to make efficiency improvements.

Many are also seeing landlords' behaviour change in response to potential regulatory changes. Nearly two-in-five brokers have seen buy-to-let clients exit the market rather than make energy efficiency improvements. For those landlords who decide to press ahead with property improvements, 78% of brokers expect them to re-mortgage to fund the changes, and a fifth (20%) believe their clients will use a bridging product.

Our research also shows that mortgage brokers are unimpressed by the level of support for landlords from both lenders and policymakers. Just 13% think the government has handled the introduction of the proposed changes well, and nearly three-quarters (75%) believe ministers should introduce grants to ensure the private rented sector meets the proposed efficiency requirements by 2025.

Some 80% of brokers are concerned that the lending industry is not doing enough to support buy-to-let landlords to make EPC improvements, but they are supportive of efforts to incentivise and reward improvements. More than half (52%) say energy efficiency mortgage discounts, such as those offered by Shawbrook, are becoming more popular – but only 35% think there are enough options in the market.



51%

of brokers have experienced difficulties obtaining buy-to-let mortgages for properties with EPC ratings of D or below.

Viewpoints



Lender Viewpoint Shawbrook

Emma Cox, MD of Real Estate

"Whether government proposals around EPC standards come into law this year or not, it's clear that this is the way the wind is blowing. Landlords – supported by the industry – need to make changes now to help secure the future of the rental market. It's in the interests of the whole sector for efficiency improvements to be completed as soon as possible.

As a specialist lender, Shawbrook has been developing innovative ways to help landlords improve their properties and working to address many of their key concerns. Most importantly, we shouldn't simply reward those with properties that are already up to standard, but also incentivise those who need to make improvements.

Shawbrook recently announced an energy efficiency discount of up to 60bps on buy-to-let arrangement fees for properties with an EPC rating of A, B and C. For properties below this level, customers can benefit from the scheme by applying for a partial refund, plus the cost of a new certificate up to the value of £100, when improvements are made during the mortgage term with us.

We're also planning to roll out further support to help landlords on their way to becoming more energy efficient. As it is in the interests of the whole industry – and society more widely – we would strongly encourage others to do the same. At Shawbrook, we're committed to building on the findings of this research – and the conversation around it – to developing new solutions to drive the sector forward."



Landlord Viewpoint G2M Group

Paul Morton, CEO

"Professional landlords have always responded to challenges within the market and we're confident that G2M will continue to lead the way despite the ongoing lack of clarity from government.

The planning of any changes whilst minimising impact on residents represents a hugely challenging exercise. However, working alongside Shawbrook, we remain well placed to continue our programme to improve the efficiency and standard of the UK's housing stock and

to work with our customers to reduce the impact of energy costs.

Initiatives such as smart meter installation, energy improvement assessments, high-impact efficiency works and our significant investment in property technology underline our long-term commitment to the sector and enable us to drive environmental performance throughout the Group.

These changes also make business sense. With this research showing that the next generation of renters will be both more informed of the impact of energy efficiency and more likely to choose properties based on energy performance, the direction of travel is clear.

The requirement for large-scale, sustainable, efficient rental stock is only going to grow. We look forward, alongside our investors, to continuing to innovate whilst building, at scale, a sustainable legacy. Whilst challenging, the private rented sector remains a fast-paced, fascinating market in which to be involved."



Surveyor viewpoint APPRAISERS UK

Peter Foulds, Director of Risk Management

"EPC uncertainty stalks the market, and this does no one any favours. Much of the UK's housing stock is incapable of achieving a C rating, and many of the recommended works have significant unintended consequences. How do you monitor the quality of the improvements? For example:

- 1. External cladding is potentially a route to sealing in damp*
- 2. Internal cladding can reduce room sizes*

Does the existing assessment system need an overhaul? There appear to be far too many assumptions which can lead to an incorrect assessment. The difference in future between a D and a C could be the difference between being able to let or having to dispose.

Is the proposed exemption of £10,000 really equitable, when comparing a two bedroomed terraced house in Oldham with a two-bedroomed house in Chelsea?

The UK's PRS is already under pressure, and this may well force landlords to exit the market which will reduce supply further and put further pressure on rents, just at the time when other financial concerns are starting to bite."



Conclusion

It is clear from the findings of our latest research that the soaring cost-of-living is foremost in the minds of private tenants, landlords, and industry stakeholders. They are now far more sensitive to changes in the energy market. The situation has only increased awareness of the need to improve efficiency and reduce households' consumption of electricity and gas.

Concrete changes to regulation are less clear, however. The change in leadership at Westminster, combined with the urgent need to tackle inflationary pressures, could lead to another delay in the government's EPC proposals becoming law. This risks some landlords putting off work as they await confirmation of the new statutory requirements.

However, it remains highly likely that these changes are coming at some stage. If the 2025 deadline stands, landlords have a huge amount of work to do to bring their properties up to standard. And as is clear from our research with private tenants, there is also growing demand for properties with higher EPC ratings.

Industry stakeholders need to do everything possible to support landlords and it is clear that improvement costs are a leading concern for investors, and particularly those with smaller portfolios. For lenders and brokers, providing this support means mortgage and bridging products tailored to their needs and ensuring the availability of most up-to-date and accurate guidance.



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