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Deal or No Deal?

Exploring the implications of the Green Deal for London

Ben Harrison

"Through our 'Green Deal', we will encourage home energy efficiency improvements paid for by savings from energy bills. We will also take measures to improve energy efficiency in businesses and public sector buildings."

The Coalition: our programme for government (May 2010)

"The Green Deal will be the biggest home improvement programme since the Second World War shifting our outdated draughty homes from the past into the future, so it's vital people can trust it."

Greg Barker, Climate Change Minister (June 2011)

Introduction

The Green Deal is the Government's flagship energy saving plan to transform homes and commercial premises across the country to make them warmer and more energy efficient. Building on work developed under the previous Government, the Green Deal will enable companies to offer householders accredited advice and recommendations regarding home energy efficiency improvements at no up-front cost. The process will be designed to provide residents and property owners with co-ordinated offers for energy efficiency works, and reassurance that work is of a high standard. In simple terms, residents and property owners will receive a long term loan tied to the property itself to fund improvement works. Repayments to this loan will be drawn from a proportion of the savings that result to that property's energy bills over the long term (for example, 25 years), meaning that residents and property owners see some direct benefits of the improvement works, and funders see a stable return on their initial investment.

However, a number of challenges remain in terms of the implementation of the Green Deal. The Government has been clear in its view that the Green Deal represents a framework, but that ultimately, its success or failure will depend on the emergence of competition within the marketplace. So, policymakers need to consider now where demand will come from for Green Deals, and how the right package of financial and other incentives can be created to persuade residents and property owners to buy into the process. Linked to this, securing investors for Green Deals will require certainty and stability to be running through the framework, and they will need to see a clear profit margin available to them as a result of making the up front investment. Accordingly, there are a number of risks to be mitigated when administering and regulating the Green Deal, for instance, in relation to energy price rises.

With these factors in mind, this paper seeks to explore what activities policymakers at all levels can undertake in order to facilitate the success of the programme. In particular it considers the following questions in detail:

- What are the specific mechanisms that will underpin the Green Deal?
- What are the key challenges to implementing the Green Deal in London, and how can they be met?
- What should policymakers be doing now to ensure that the Green Deal is viable across London and the rest of the UK, and can be applied to as many properties as possible?

An Overview of the Green Deal

Before considering those questions in more detail, this section sets out how the Green Deal will actually work. The UK is committed to achieving a 34% reduction in its CO2 emissions by 2020 relative to 1990 and at least an 80% reduction by 2050.[1] Meeting this target will require major investment in new technologies to renovate our buildings, the electrification of much of our heating, industry and transport, and cleaner power generation. It requires major changes in the way energy is used by individuals, by industry, and by the public sector.

A major part of this challenge is improving the energy efficiency of existing buildings. The UK has a large number of properties, domestic and non-domestic, that through lack of investment, have poor energy efficiency ratings. This is despite the fact that investment can produce savings on future energy bills. Domestic and non-domestic buildings account for a quarter of carbon emissions and there remains a considerable amount of cost-effective abatement-potential from energy efficiency measures, which is currently being underexploited.[2]

To this end, both residential properties and commercial properties will be included within the Green Deal, with occupiers paying nothing up front for the cost of energy efficiency improvements, and repayments instead being explicitly linked to the property and drawn from energy savings made as a result of greater energy efficiency.

While a number of the details underpinning the specific mechanisms of the Green Deal are yet to be finalised, the overarching approach can be broken down into the following steps:

1. **Energy Assessment**: Individual properties will be offered a comprehensive energy efficiency assessment, while a accredited assessor also produces a fabric and behaviour assessment. These assessments will be undertaken against an agreed, standardized methodology. The necessary measures to increase energy efficiency will be evaluated and costings produced for mitigation measures. At this stage, property owners will be under no obligation to enter into a Green Deal with any given provider.

2. **Financing improvements**: Should the property owner decide to install improvements, finance to deliver these will be provided by a range of accredited providers. There will be no upfront capital required from the property owner and, critically, the repayment of this initial investment will be tied to the energy meter of the property, not the consumer of that energy. The owner is responsible for payment whilst they consume energy at the property, but not after they move out. It is currently thought that loans will likely be in the region of up to £10,000 per household, although this may change as proposals are finalised.

[1] The Climate Change Act 2008
[2] ibid

3. **Installing improvements**: Energy efficiency measures will be installed by accredited firms and providers, who will need to meet certain standards to operate under the Green Deal. The installation company will be required to manage the process of making improvements and providing them with sign off, thus informing the Green Deal Provider that repayment can begin.

4. **Repayments**: Repayments will be collected through the property's energy bills, with the Green Deal charge shown as a separate line on the bill. This will have no impact on the energy customer switching suppliers for their energy requirements, and provisions will be made for long term vacancies in rental properties, early repayments or demolition of the property. The critical component of these arrangements is that the improvements that have been made reduce the customer's energy bills sufficiently to allow repayments to take place, as well as some savings to be made on energy bills.

Box 1 – Planned legislative timetable for the Energy Bill

The proposals underpinning the Green Deal Framework are part of a wider package of measures contained within the Energy Bill. The timetable for their introduction is currently set out as follows:

- **December 2010** – Bill introduced into Parliament
- **Ahead of Autumn 2011** – Policy development
- **Autumn 2011** – Consultation begins
- **Autumn 2011**- Bill receives Royal Assent
- **Early 2012** – Secondary legislation laid in Parliament
- **Spring 2012** – Detailed guidance prepared
- **Autumn 2012** – First Green Deals appear

Underpinning this process will be a series of consumer protections and guarantees which must be met before works are commenced. The most important of these will be the **"Green Deal Golden Rule"** which states that it should be clear that likely bill savings resulting from improvement works must be larger than the loan repayments required. Other important protections and guarantees include:

- The need to secure appropriate consent, including from freeholders, landlords and tenants, before a Green Deal is taken out on a property;
- The need for full disclosure of the existence of any active Green Deal arrangements to future owners / renters of the property;
- The extension of the existing regulatory regime for collection of energy debt for the Green Deal – including protection for vulnerable consumers; and,

- The provision that only approved measures by accredited installers following an accredited assessment will be permissible under Green Deal arrangements.

Challenges to implementing the Green Deal in London

Despite the progress that is being made in establishing a framework for the Green Deal, there remain a number of significant challenges to its successful implementation.

The basic principles underpinning the arrangements will seem familiar to a number of practitioners in the capital. After all, a number of policy programmes and measures have been introduced over the past decade to encourage greater energy efficiency in relation to the built environment in London, led at both a local and regional level. However, a number of interested parties, including major business organisations, and eco-groups, have raised concerns in recent months, that uptake for the Green Deal will not match Government expectations.[3] In particular, there is concern that these measures will be insufficient to incentivise people to put energy efficiency high up their list of priorities, and that the scale of funding currently talked about by Government will not bring about the kind of change we need to see across the UK to contribute to overall carbon reduction commitments.

The key concerns and objections that have been raised to date in response to the Green Deal proposals as they currently stand are each considered in greater detail below.

How can Government encourage demand for the Green Deal?

A major challenge for Government is how the right package of financial and other incentives can be created to persuade property owners to take up the Green Deal. The exact make up of these incentives may well need to vary in different parts of the country and according to household income and tenure.

Overall, the UK has a relatively poor track record of demand for energy efficiency retrofits compared to the energy saving opportunities available. The traditional approach to overcoming this has been to provide subsidies. To date the Government's Carbon Emission Reduction Target ("CERT") programme – subsidised by £5.5bn in funds from energy suppliers – has saved 169 Mt CO_2 emissions reductions (58% of the current target of 293 Mt CO_2).[4] However, despite programmes such as CERT, a large commercial market for energy efficiency has not emerged. To remedy this, the Green Deal seeks to remove the perceived barriers that exist to implementing energy efficiency measures, for example by providing greater clarity on the implications of specific energy efficiency improvement works, and providing low interest loans to provide up-front capital for these improvement works.

Nevertheless, it should be acknowledged that, for many, savings or mortgage extensions and personal loans have long been readily available in order to provide upfront capital for energy efficiency investments yet, to date, they have not been utilised at any great scale. Given that the broad principle is not a new one, then, the specific commercial conditions, and in particular the interest rate that is applied to Green Deal loans, will be critical to their uptake. A recent survey conducted as part of the Great British Refurb Campaign which surveyed over 2,000 UK adults to examine public appetite for the Green Deal found that

[3] '*A Real Deal: Making the Green Deal Work*', Confederation of British Industry, 2011
[4] '*Financing the Green Deal,*' E3G, 2011

while 56 per cent of respondents said they found the principles underpinning the Green Deal attractive, only 7 per cent of respondents said they were prepared to take it up at a 6 per cent interest rate.[5]

The findings of this survey indicate that while residents and property owners may be convinced of the merits of improved energy efficiency from a climate change perspective, the Green Deal will need to be attractive financially to secure engagement. The "Green Deal Golden Rule"(which states that likely bill savings resulting from improvement works must be larger than the loan repayments required, in order to provide the resident or property owner a tangible benefit in return for engaging in the process) acknowledges the fact that clearly demonstrating that monthly savings can be achieved for the resident or property owner, in addition to any repayments made, will be vital to securing widespread demand.

However, many of the conditions upon which such an arrangement will be predicated, such as consistent energy use, wider energy prices, and the specific commercial aspects of individual Green Deals, will vary significantly across the country, and are likely to be outside of policymakers' direct control once the Green Deal is rolled out. Therefore, to have confidence that this rule will apply for the majority of properties across the UK, the Government should be clear about the most likely packages of energy efficiency measures required to make a real difference to energy consumption, the likely "rebound effects" that will take place as residents choose to use some savings for extra energy use in light of improvements made, as well as providing clear guidance to residents and investors as to an appropriate interest rate to be placed on Green Deal loans and the structure of repayment schedules.

How can London Boroughs be 'Green Deal Friendly'?

London Boroughs can play a key role in supporting the implementation of the Green Deal. London Boroughs have an intimate knowledge of their localities, residents and properties that in most cases private Green Deal providers will not be able to match. As a result, they have a capacity and ability to reach a far larger proportion of local populations, and could have a significant role in engaging with residents and property owners by outlining the potential benefits of the improvement works included within the Green Deal could provide them, as well as providing clarity over the likely levels of disruption they might cause.

Furthermore, those London Boroughs keen to support the Green Deal should consider what kind of additional incentives they can offer to residents and property owners to take up the Green Deal. According to the Great British Refurb's 'Green Deal Public Appetite Market Research', a one-off council tax rebate could be a real motivator for residents and property owners, with 49 per cent of respondents saying they would be likely to take up the Green Deal if the Government can offer a £500 council tax rebate.[6]

And there are other incentives that London Boroughs could consider which would not have significant or direct financial implications for them. For example, Boroughs could pledge to streamline and potentially fast track future planning application responses for residents and property owners that take part in the Green Deal, in relation to residential extensions or other such works. In addition, there is clearly a role for measures to promote wider behaviour change on behalf of residents and property owners, that could underpin further energy saving.

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[5] *'Green Deal: Public Appetite Market Research*' Grand Designs, 2010

[6] Ibid

Finally, it will be important for London Boroughs, together with the Greater London Authority, to be clear about how the Green Deal framework is going to interact and exist alongside the current RE:NEW scheme. RE:NEW is a partnership between the GLA, London Councils, the Energy Saving Trust and the 33 London Boroughs aimed at bringing together all of the disparate energy efficiency programmes that exist across the capital. It provides a coordinated offer of a range of free-of-charge energy saving measures, from changing to low-energy light bulbs to installing stand-by switches and providing water and energy-saving advice across London. While the focus of the Green Deal is likely to be on funding more substantial, physical energy saving measures for Londoners, there will almost certainly be overlap between the programmes and it will be important to minimise any potential confusion for residents and property owners in this regard, while taking advantage of any opportunities that coordination between the programmes might provide.

What are the risks for those providing capital to invest in Green Deal measures that policymakers need to understand and mitigate against?

In order to secure the initial low cost upfront capital required to deliver energy efficiency improvements, the Government will need to provide potential investors with a certain and stable policy framework that reflects an understanding of the specific risks associated with such investments, mitigates these where possible, and allows for investors to realize a clear profit margin over the long term.

As things stand, Green Deal loans could be regarded to carry a number of potential risks by many of the likely providers of upfront capital to finance Green Deal loans in the first instance (banks and utilities for example) and by the eventual holders of securitised Green Deal loans (institutional investors). While some of these are being addressed – for example, through the establishment of accreditation standards for firms installing improvements – until these risks are proved to be insignificant through the creation of a track record of successful investment, they will increase the cost of borrowing and push up required returns.

Some of the risks likely to be of concern to potential investors include the potential for the 'Green Deal golden rule' to be broken in many instances, particularly in light of likely future energy price rises, leading to a situation whereby householders are unlikely to save more on their energy bills in absolute terms than they pay out on loans. In addition, a lack of data on both the performance of Green Deal assets once installed, and on likely loan default rates, will be a cause of concern for potential investors, as will the current lack of clarity on who will ultimately bear the risk of a Green Deal loan default.

What about the private rented sector ("PRS") – how can a mix of regulation and incentives ensure that private landlords take up the Green Deal?

Understanding how the principles of the Green Deal could incentivise residents and property owners who themselves pay their energy bills directly is relatively straightforward. But what about private landlords who own a property but do not pay for the energy consumed within it? Why would they engage in a process which will tie a long term loan to their property but which will not provide them with direct savings, and where the repayment of the loan is dependent on their tenants?

Finding the answer to this question will be critical to the success of the Green Deal framework. The PRS has the largest proportion of lowest-rated (EPC band G) properties of all tenures (6.2 per cent, compared with 3.4 per cent in owner-occupied accommodation).[7] Improving this situation could have a big impact on the energy efficiency of housing stock in the capital. However, while the Government hopes that landlords in the PRS will use the Green Deal to improve energy efficiency performance of their properties, evidence contained within DECC's Energy impact Assessment suggests that landlords have previously not taken up existing, and heavily subsidized, energy saving measures. Leading eco-groups, such as Friends of the Earth, continue to express concern that energy efficiency will not improve in the PRS without additional regulation, imposing a deadline for making improvements.

In response to this, the Energy Bill will provide new powers to allow the Secretary of State in England and Wales to make future regulations requiring private landlords to make relevant energy efficiency improvements to their buildings. These regulations could only come into force after a review into energy efficiency in the PRS has been conducted, and could not come into force before 2015. However, it remains to be seen what impact this will have in reality, and if the programme is to be truly successful, more work is likely to be required to incentivise private landlords to take up the Green Deal.

Conclusion

The Green Deal remains an opportunity to significantly improve the energy efficiency of homes in London and across the UK. However, debate continues on how the right package of incentives can be devised to encourage residents and property owners to take up the Green Deal, and for investors to provide up-front capital to deliver the necessary improvements. The Government has been clear in its view that the Green Deal simply represents a framework, and that its success or failure will depend on the emergence of competition within a newly created marketplace.

However, the Government has a key role to play in setting the rules of the game, and will ultimately be judged on the success or failure of this framework in meeting their stated objectives. With this in mind, there are a number of areas where policymakers at all levels should focus their attention in the coming months, namely:

- Central Government must ensure that mechanisms are put in place to enshrine the "Green Deal Golden Rule", which is critical to the operation of the entire framework. To have confidence that the Golden Rule will apply for the majority of properties across the UK the Government should be clear on which energy efficiency measures will make a real difference to energy consumption, the likely "rebound effects" that will take place as residents choose to use some savings for extra energy use, as well as providing clear guidance to residents and investors as to an appropriate interest rate to be placed on Green Deal loans, and the structure of repayment schedules. Ultimately, ensuring that this rule can be widely applied will be critical not just for enticing residents and property owners to engage in the Green Deal, but also for potential investors, who require a stable and reliable framework to be in place, to ensure that they will realise the projected returns on their initial investments.

- For their part, London Boroughs should be thinking now about what it might mean to be a "Green Deal Friendly" Borough, in particular, focussing on the range of additional incentives that they might be able to provide, as well as the broader education, coordination and facilitation role that they could fulfil to Green Deal providers and residents and property owners. Furthermore, as the policy framework is finalised, London Boroughs, together with the GLA, should consider the scale at which Green Deals

[7] Department of Energy and Climate Change website, *Energy Bill: private rented sector* [on 4 May 2011]

could be structured to make them attractive to potential investors in London. This may require the establishment of sub-regional or pan-London arrangements, potentially underneath the existing RE:NEW programme, which stretch across existing administrative boundaries and encompass housing from multiple authorities and provide the scale of investment and returns that will attract the capital required to make the Green Deal work.

- Finally, if demand is to be generated for the Green Deal, the 'public perception challenge' will need to be tackled, in terms of how the benefits of the framework can be effectively sold to residents and property owners who may not see the rationale for improving energy efficiency in their own homes, particularly in light of the perceived disruption it may cause to their day to day lives in the short term. Making the right arguments in favour of the Green Deal, combining both energy efficiency and direct financial benefits for residents and property owners, will be critical to its uptake.

Future of London will be exploring these policy challenges, and others, over the coming months, with future events and research outputs planned.

Ben Harrison is Director of Future of London. For further information regarding Future of London's 2011 programme see www.futureoflondon.org.uk

6th Floor, Palestra
197 Blackfriars Road
Southwark
London SE1 8AA

www.futureoflondon.org.uk