



The rental sector energy challenge

The need to improve the energy efficiency of the UK's privately rented homes is clear, but doing so presents significant challenges. The property sector must support landlords to overcome these, facilitated by Government policy that considers any potential negative impact of its implementation.





An introductory note from Richard Rowntree

Domestic properties account for approximately 30% of energy use and around 19% of greenhouse gas emissions in the UK, according to Business, Energy and Industrial Strategy Committee data.

Minimising this impact is a central component of the Government's drive towards Britain producing net zero carbon emissions by 2050 and it appears that private rented sector properties (PRS) will be the first to be subject to new laws requiring homes to be more energy efficient.

The Government has proposed that from 2025 all properties let under new tenancy agreements will need to be rated Energy Performance Certificate (EPC) C or above. This would then extend to all PRS properties by 2028.

Looking at the existing Minimum Energy Efficiency Standards (MEES) regulations suggests that landlords are engaged and largely compliant with the environmental aspects of their lettings business.

Despite this, a lack of awareness of the proposals is evident and little in the way of detail has been provided by the Government.

Awareness of the proposals is just one issue; another considerable challenge is the cost of upgrading PRS properties to meet what is expected to be the new required standard.

The stock profile of the PRS means that a large number of properties were built decades ago, many pre-Second World War before some of the sustainable construction methods and materials of today had been developed. Ensuring these homes hit EPC C will likely require costly retrofitting of technologies that help to make heating, insulation and lighting greener.

This means that mortgage lenders have an important part to play in supporting landlords.

Without this support, and the full backing of politicians, we may see landlords cut their losses and exit the sector altogether, concluding that the challenge is greater than the reward.

With rental costs facing upward pressure resulting from increased overheads for landlords and an imbalance between the supply and demand of rented homes, fewer privately rented homes is a scenario that would not be welcomed by those that understand the need for housing tenures that work in harmony.



Richard Rowntree
Managing Director - Mortgages
Paragon Bank

The scale of the issue

EPC profile of PRS stock

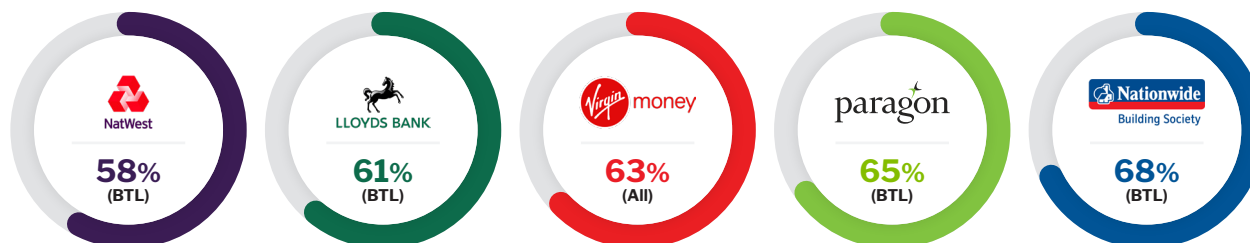
A substantial number of private rented sector (PRS) properties will need to be upgraded to meet proposed changes to EPC regulations.

Data published as part of the English Housing Survey shows that significant progress has been made in improving the energy efficiency of privately rented homes. In 2009 13.5% of homes had Energy Performance Certificate (EPC) ratings of A, B or C, but by 2019 this proportion had more than doubled, increasing to 38.3%. As you would expect, this corresponded with a fall in the portion of homes with lower energy efficiency scores.

This is consistent with more recent data published by Paragon and other lenders showing EPC ratings of mortgages written, highlighting that a sizable number remain below the level that will be required if the new regulations proposed by Government are introduced.

This improvement correlates with growth in buy-to-let lending, which grew steadily during the period following a contraction of the market as a result of the global financial crisis. In addition, the Government introduced the Minimum Energy Efficiency Standards (MEES) regulations in 2018, requiring privately rented properties to achieve EPC E or above.

Proportion of mortgages written on properties below EPC C



An Office for National Statistics bulletin on energy efficiency of housing in England and Wales found that 'in England, when property type is taken into account, private rental properties emerge as the tenure that had the lowest median energy efficiency scores'.

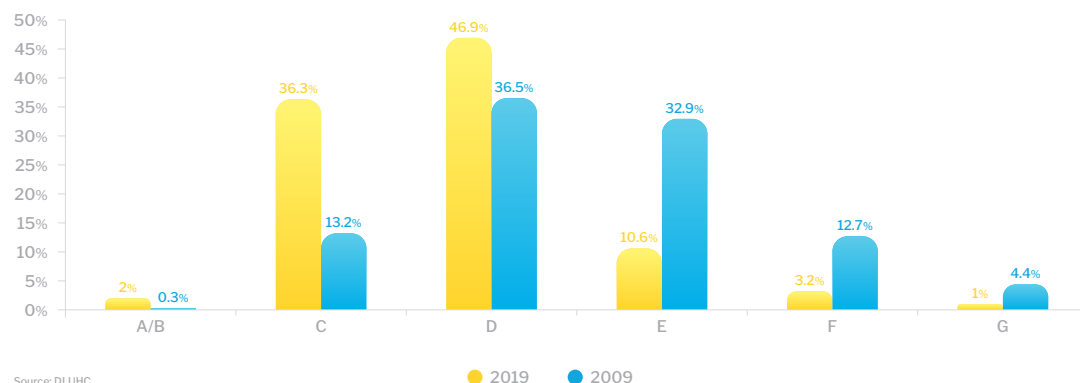
This is unsurprising given the profile of PRS stock.

It is acknowledged that the age of the property is the biggest single factor in energy efficiency of homes because as well as the wear and tear they have been subject to over the years, building techniques and regulations have changed over time.

Data on the profile of housing stock included in the English Housing Survey shows that 32.4% of PRS homes date back to pre-1919, a significantly higher proportion than the 19.9% of owner-occupied properties and the 6.5% registered in the social housing sector.

In addition, landlord research highlights how terraced houses are the most common buy-to-let property, owned by just under one in six. Considering that a significant proportion of terraced homes date back to the Victorian era, we start to see how the PRS has such a large proportion of properties that exhibit inefficient energy characteristics.

EPC rating by proportion of stock in PRS



Minimum Energy Efficiency Standard (MEES) Regulations

Looking at awareness and adherence to the regulations already governing the sector gives a clue to property investor attitudes towards energy efficiency requirements and the sort of response we may see if new regulations are introduced. Of course, due to the limitations of some properties to achieve EPC C and any associated costs, there may be a difference in how landlords respond to the new regulations compared to those currently in place.

The Domestic Minimum Energy Efficiency Standard Regulations set a minimum energy efficiency level for domestic private rented properties.

Introduced in 2018, MEES require all domestic private rented properties let on assured, regulated or domestic agricultural tenancies to have an EPC rating of E or above, unless not legally required to have an EPC.

As part of a survey of over 700 landlords, undertaken on behalf of Paragon, landlords were asked about their awareness of MEES regulations.



The results showed that 97% have an awareness, with the majority, 88%, indicating full awareness and understanding, while 9% said they were aware but didn't understand the details. The remaining 3% of landlords had no awareness of the legal requirements.

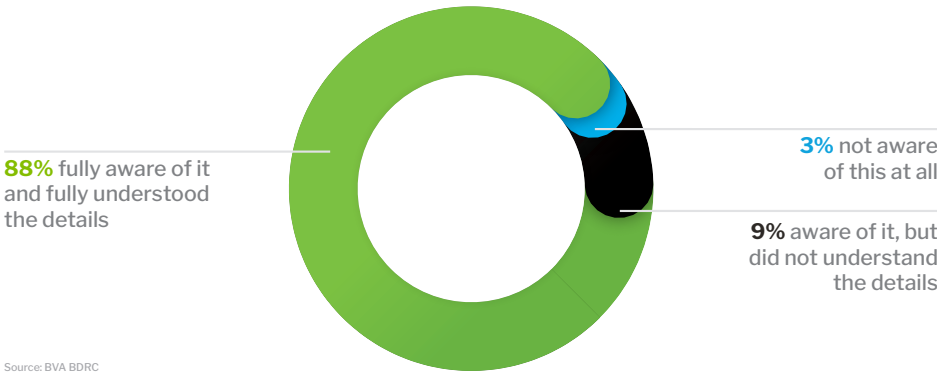
A correlation is seen between engagement with MEES and portfolio sizes, levels of awareness and understanding of the regulations increasing in line with the number of properties owned.

A similar question was posed to over 9,000 landlords and lettings agents taking part in the most recent English Private Landlord Survey (EPLS), published May 2022 by the Department for Levelling Up, Housing and Communities (DLUHC).

Almost two-thirds (64%) of landlords recorded awareness and full understanding of regulations, while an additional 22% reported being aware but with a lack of understanding of the details. No awareness of the legal requirement was indicated by the remaining 14% of landlords.

This variation in awareness could be, in part, attributed to the differences between the two study cohorts and indicative of a higher propensity for awareness and adherence to MEES regulations amongst professional landlords. While landlords for Paragon's survey were recruited from the National Residential Landlords Association (NRLA) membership base, their involvement in such a body increasing the likelihood of them being professional landlords, the EPLS uses a much broader spectrum of landlords.

Awareness of EPC 'E' legal requirements (%)



Source: BVA BDRG

Portfolio size

1	2-3	4-5	6-10	11-19	20+
8	4	3	2	3	0
17	9	7	7	6	5
76	88	91	91	91	95

Landlord EPC proposals awareness

Although largely compliant with current energy efficiency regulations, not all landlords are aware of the proposed changes.

Considering the fast-approaching deadline and limited availability of materials and tradespeople needed to undertake upgrades to properties, awareness and understanding of the proposed changes to EPC requirements is relatively low.

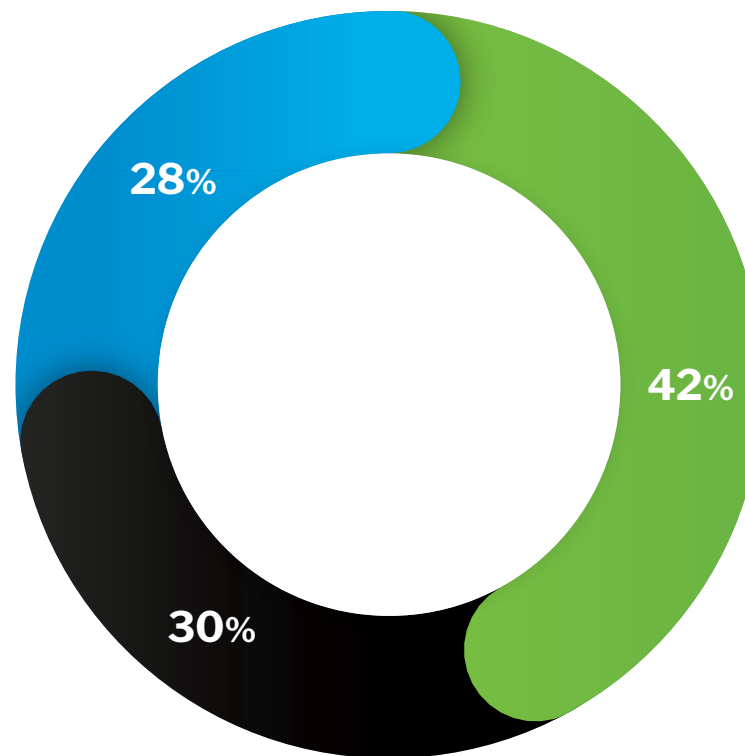
Just over four in 10 (42%) of respondents to a survey of over 800 landlords said that they had no awareness, with a further 28% aware but with a lack of understanding of the details.



28%

of survey respondents are aware of EPC requirements but lack the understanding of the details.

Landlord awareness of EPC changes



- No awareness
- Aware, fully understood the details
- Aware, but don't understand the details

Source: BVA BDRC

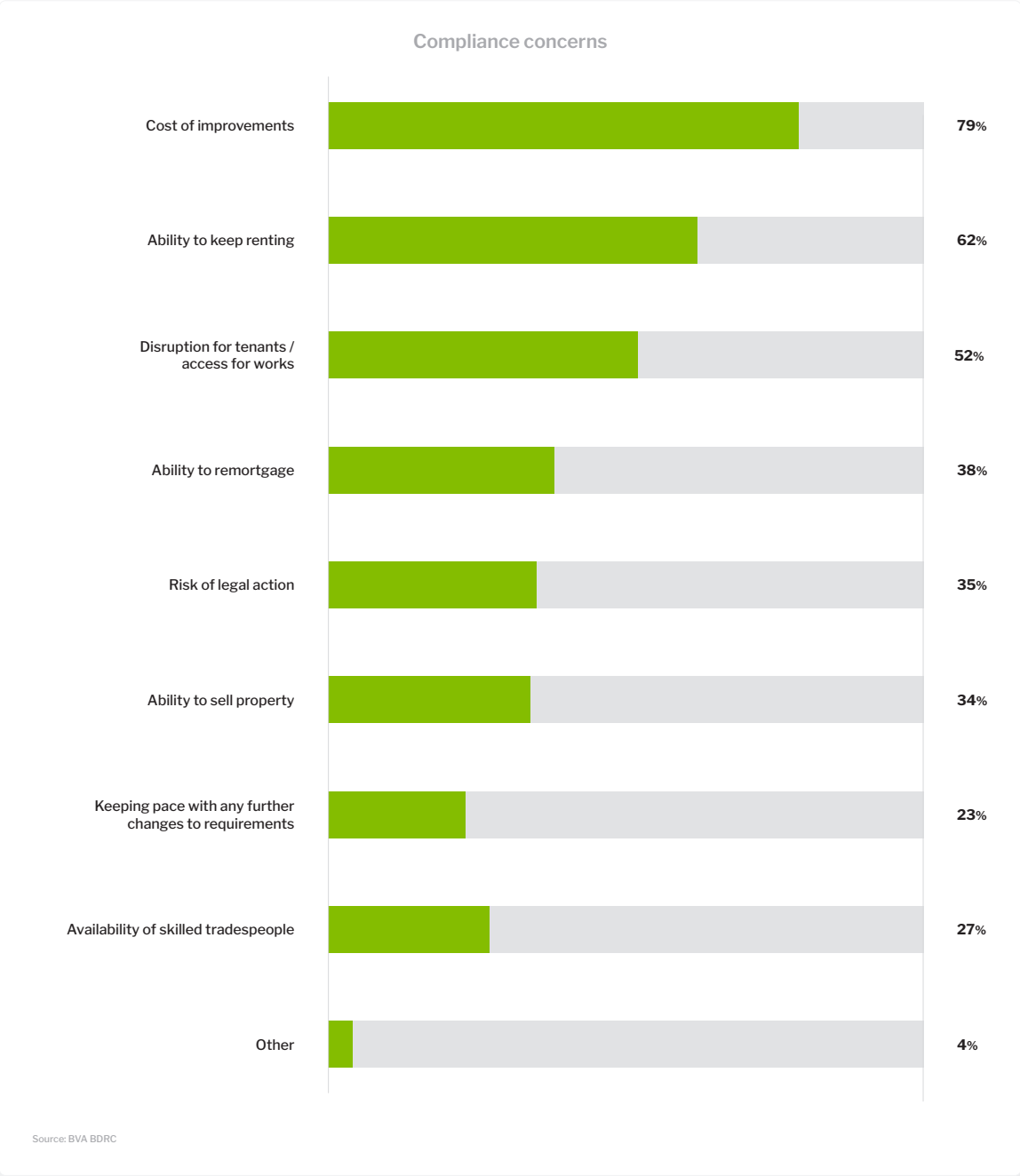
Landlord response to the issue

Compliance concerns

Landlords expressed a variety of concerns about complying with proposed new EPC requirements.

For landlords that are aware of the proposed changes, the greatest concern in achieving the required EPC rating is the cost of making the necessary improvements, selected by just under eight in 10 (79%) of those surveyed.

This was followed by two concerns that arise from the expectation that works required to improve the energy efficiency of properties cause disruption to tenants and therefore have potential to limit the ability for landlords to keep renting.



Landlord likely courses of action

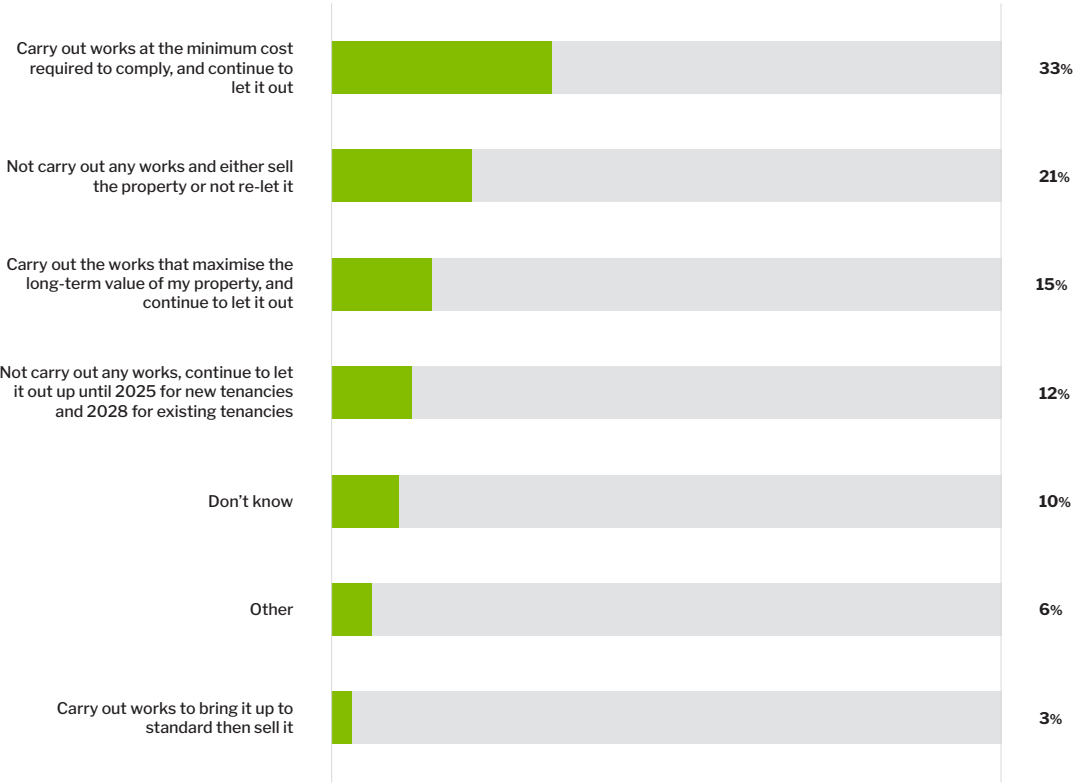
Landlords are divided on their response to proposed changes to EPC regulations, with some willing to upgrade their properties, while others may exit the sector altogether.

Considering the challenges they are likely to face, landlords were asked how they would be most likely to respond to the proposed changes.

A third said that they would undertake the minimum required works and continue letting, the most common anticipated course of action. Just over one in five (21%) landlords feel that they would not carry out any works and either sell the property or not re-let it.



Landlord response to the issue – likely courses of action



Source: BVA BDRC

Financing necessary upgrades

Although a range of finance sources exist, there may be a gulf in what necessary upgrades are likely to cost and what landlords are willing to pay.



Those opting to carry out the works necessary to bring properties up to EPC C or above would use a range of different funding methods. Using savings is the most common source, chosen by six in 10 landlords. Just over a quarter (27%) would increase rent, while just under a fifth (19%) would opt for Government funding such as a grant, if available. Further advances from mortgage lenders or loans would be utilised by 8% of investors and a similar proportion, 7%, would look to release equity from their portfolios.

Landlord source of funding for EPC upgrades



60%
Savings



27%
By putting up
the rent



19%
Government grant
or funding



8%
Further advance from
a mortgage lender



8%
Loan



7%
Release equity from portfolio



5%
Other

Source: BVA BDRC

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Recognising the need to support landlords, Paragon was one of the first of an increasing number of lenders to have introduced 'green mortgages'. These products incentivise increasing the proportion of energy efficient homes in the PRS by offering favourable rates or terms to borrowers purchasing properties with EPC ratings between A - C.

Of course, this doesn't address the issue of the many PRS properties that require costly retrofitting of energy efficient technologies so lenders have also introduced further advance products to provide additional funding.

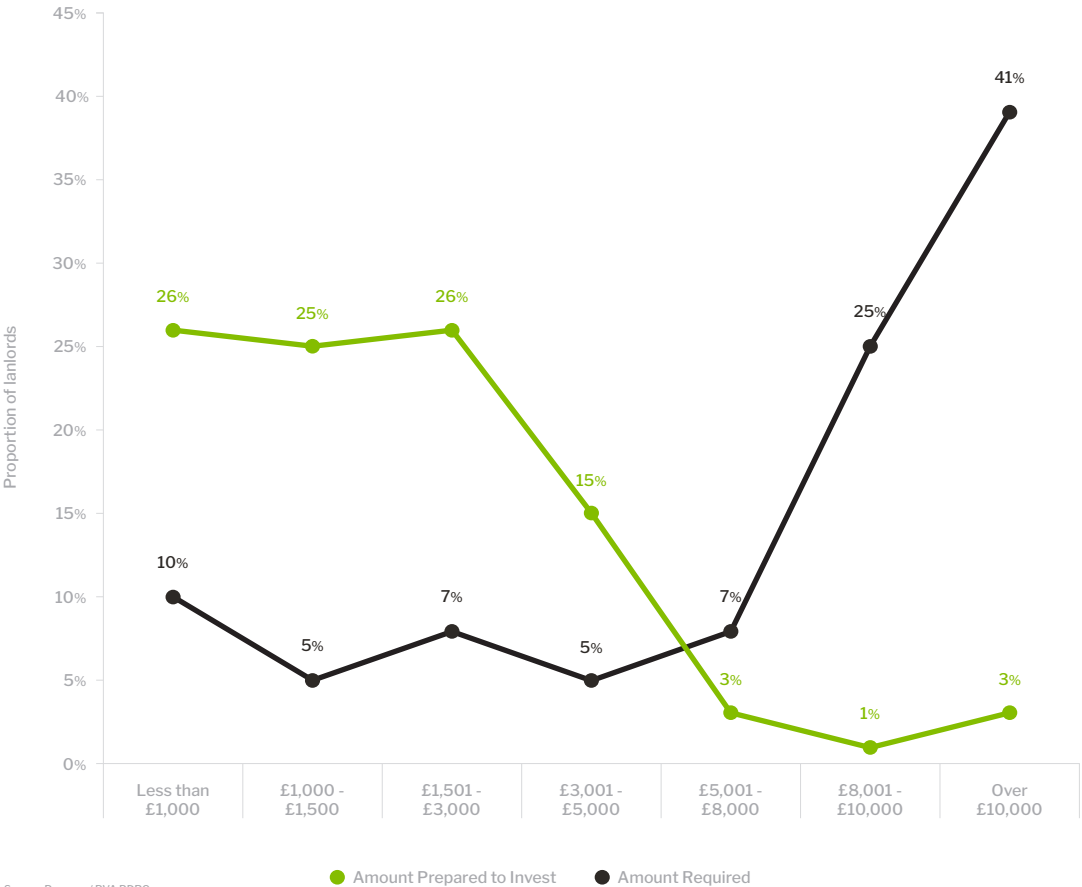
The willingness amongst PRS landlords to meet the new requirements, or at least their chosen method of funding, may be impacted by the substantial difference in the estimated cost of doing so and what landlords are actually prepared to spend.

A survey found that just over three quarters, 77%, of landlords are willing to spend up to £3,000 to bring each property they own up to EPC C or above but Paragon analysis shows that 78% of landlords would need to spend over this amount.

Paragon's analysis shows the average cost to upgrade a property to EPC C is £10,560, although the Government has proposed a cap of £10,000 per property.



Cost of upgrading properties to EPC C or above - amount need to spend vs willing to spend



77%
of landlords are willing to
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Future investment in PRS property

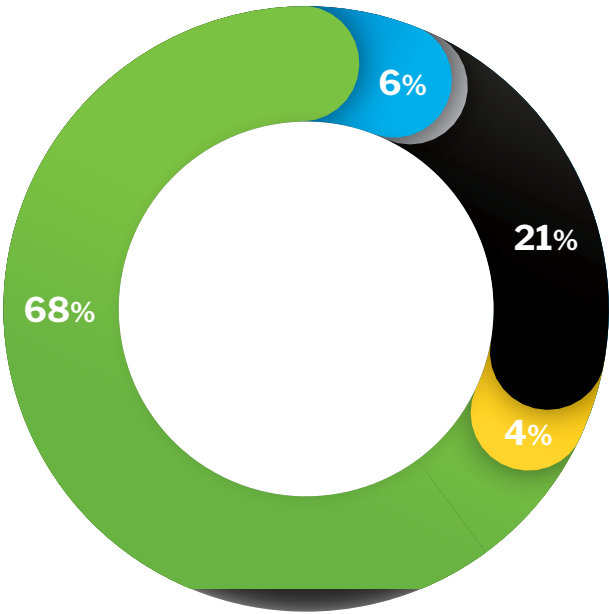
Alongside the challenge of upgrading existing PRS stock, the proposed changes to home energy efficiency requirements may influence prospective buy-to-let investment.

Responding to a survey, just over two thirds of landlords (68%) said that in future they are less likely to acquire homes rated EPC 'D' or lower due to the potential new regulations. Just over one in five (21%) said that a change in the rules wouldn't impact their future investment behaviour and 4% of landlords stated that they would be more likely to purchase a property if it was rated below EPC C.



21%
of survey respondents
said that a change in the
rules wouldn't impact
their future investment
behaviour.

Propensity to acquire EPC D or below rated property



- Less likely to purchase
- No difference
- More likely to purchase
- Don't know
- Rather not say

Source: BVA BDRC

The impact of changes to EPC regulations

Evidence shows how tax and regulatory changes have resulted in some landlords exiting the PRS. Changes to EPC regulations could have a similar impact, resulting in unwelcome consequences for housing in the UK.

So, if the gulf in the anticipated upgrade costs and what landlords are willing to pay is too great, and some landlords exit the sector, what impact are we likely to see?

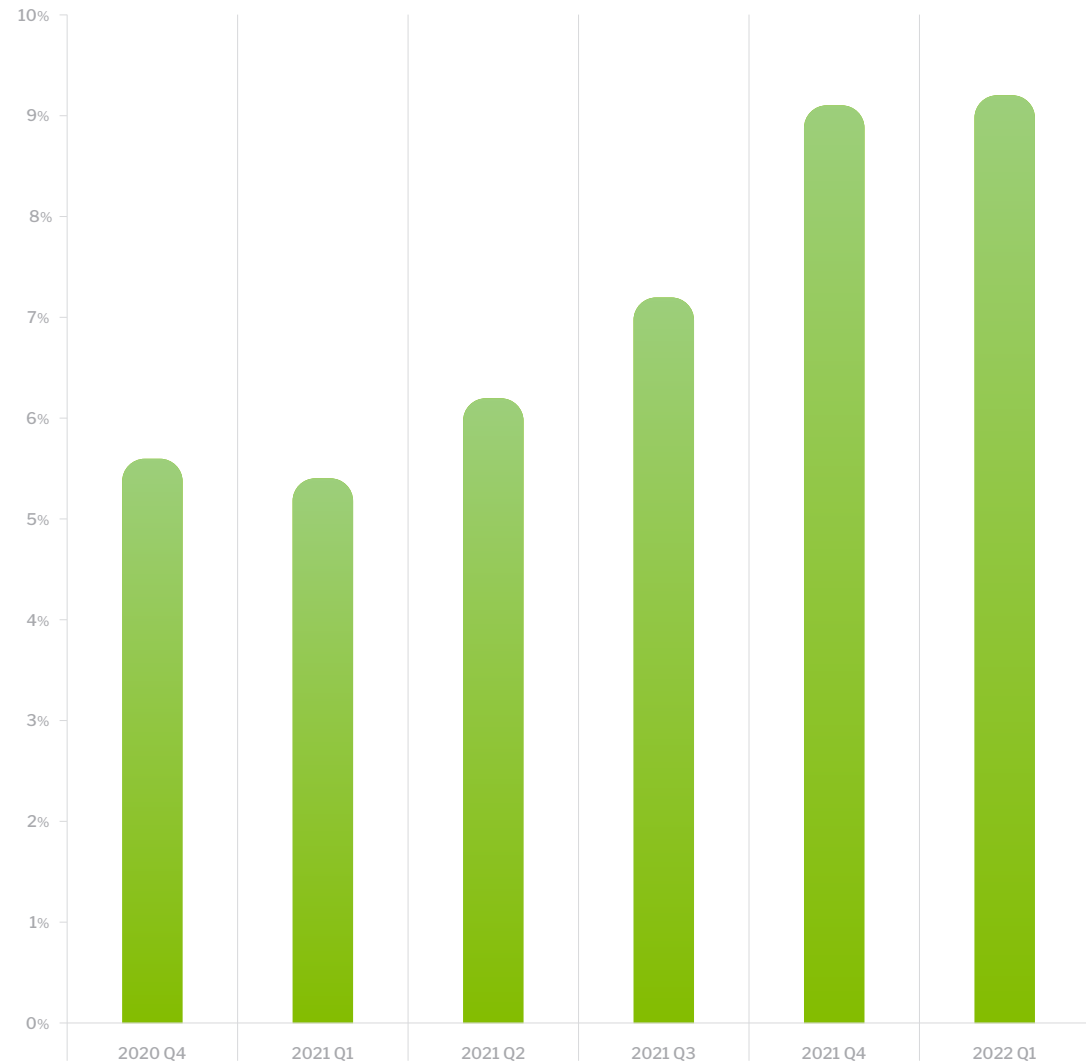
Zoopla data shows a steady increase in the proportion of previously rented properties that are now listed for sale. While no figures exist to help us understand the reasons why these previously rented properties are being sold by landlords, and whether they are being purchased by other investors or moving across to the owner-occupier tenure, this rise is a worrying trend considering the imbalance between PRS supply and demand.

Speaking to landlords offers reassurance, however; it seems that those with larger portfolios are less likely to exit the sector compared to those with one or two properties.

Naturally, investor decisions are influenced by a wide range of factors but professional landlords tell us that their larger portfolios mean they are well equipped to mitigate potential disruption caused through retrofitting of properties. In addition, we know that these landlords have overcome challenges in the past, such as the Global Financial Crisis, and this has led to confidence in the stability of buy-to-let as a long-term investment.

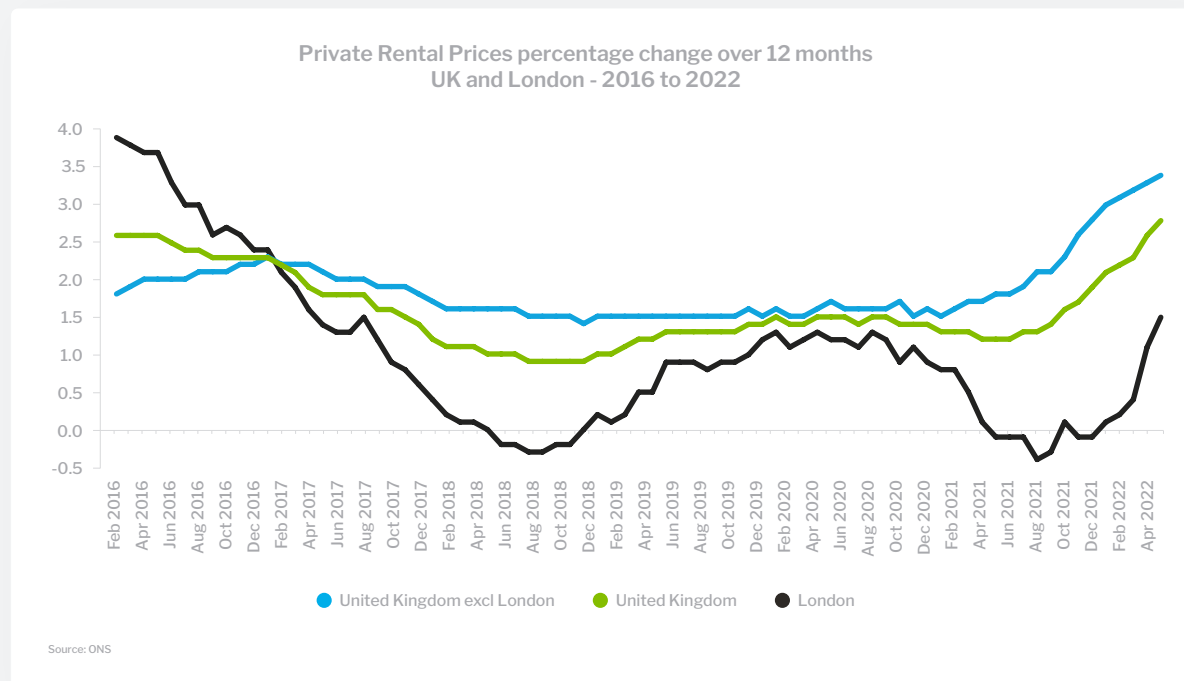


Previously rented properties listed for sale



Source: Zoopla Research

A contraction of the PRS could place further pressure on rental costs which have risen at the fastest rate since 2017, according to figures released by the Office for National Statistics. This is as result of increased costs for landlords – tax, energy, property maintenance – and an unprecedented imbalance of supply and demand which could be exacerbated with fewer private landlords managing lettings businesses.



With the current cost of living crisis negatively impacting the ability of first-time buyers to save for deposits and tightening mortgage affordability, along with limited space for people to remain or return to family homes due to the rise in homeworking, the demand for privately rented property is likely to remain for some time.

This highlights the need for well thought out policy that helps the Government achieve its objective of becoming a net zero carbon emitting nation by 2050 while protecting the UK's second largest housing tenure, enabling people to choose the homes that best suit their needs.

And as we set a pathway taking us towards net zero, it becomes obvious that a shift towards properties rated EPC C is not the endpoint; the housing stock across the UK, including those of the PRS, has to move further. It is important then that there is a realistic transition plan that will see us surpass shorter-term arbitrary targets and achieve an overall ambition of homes that exist in harmony with the environment.

While this poses an even greater challenge than that detailed here, it also presents opportunities for the sector to support the investment that will undoubtedly be needed.

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privately rented
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