NATIONAL HOUSING FEDERATION

Response

Response to Commission's consultation on 'financial support for energy efficiency in buildings'

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Briefing from the National Housing Federation

The National Housing Federation represents more than 1000 not-for-profit independent housing associations. Our members provide 2.5 million affordable homes to over 5 million people in England. Housing associations have been able to access European Regional Development Funds (ERDF) as grants or JESSICA loans in some English regions since the 2009 legislation amendment that allowed member states to redirect up to 4% of their ERDF allocation to energy efficient refurbishment for social cohesion purposes. Our members have also bid/are bidding for European Investment Bank (EIB) funding for retrofit and renewable projects and have been part of consortia of local authorities that have accessed ELENA funding for technical assistance. Some of them are delivering Intelligent Energy Europe (IEE), INTERREG or Framework Programme 7 (FP7) projects with European partners.

Housing associations in England have been keen to access funding for energy efficient refurbishment as the client groups they serve and house are those who tend to be in or at risk of fuel poverty due to being on low-income.

The National Housing Federation is also a member of CECODHAS-Housing Europe, the European Federation for Social and Cooperative Housing, which represents 46 regional and national federations across 19 EU member states. Together we provide 26 million homes to over 70 million Europeans.

The National Housing Federation is pleased to take part in this Commission’s consultation and welcomes the opportunity to comment on existing European funds linked to energy efficiency and suggest new mechanisms.

Executive summary

The National Housing Federation represents 1000 not-for-profit independent housing associations. Our members provide 2.5 million affordable homes to over 5 million people in England. Our comments on European funds and energy efficiency are as follows:
-One of the barriers missing from the Commission's document is the fact that low-income households such as those in social housing are likely to require a certain amount of subsidy in order for renovation work to be financially viable for them. This is because they tend to underheat their homes, meaning energy efficient work will not lead to the same energy bill savings as for standard households. In addition most of the cost-effective work is likely to have already been done in social housing properties.
-Market barriers ought to be addressed at EU level when it comes to EU funds and finance. However the Federation does not believe that further EU regulations are required to address them at member state level.
-EU cohesion funds need to be made simpler to access and less bureaucratic. They also need to be available as grants and not just financial mechanisms, to cater for the issue of low-income households and those living in social housing often needing a bit of subsidy to improve the energy efficiency of their homes, even if an ESCO mechanism is available to them.
-Overall EU funds including cohesion funds set up as JESSICA mechanisms, EIB finance and Commission-held finance such as the EEEF fund need to be tweaked in order to address the need for low-cost, long-term finance and first loss guarantee revolving funds to attract more private finance institutions to the energy efficiency sector.
-The EU ought to lead by example and projects funded through EU financial mechanisms and funds should work as demonstration and educational projects to attract more investors in this investment area.
-Technical assistance needs to continue to be made available but should be provided on a risk-sharing basis, with the provider sharing the same level of risk as the bidder, should the project not reach bankable stage.
-EU regulations such as state aid need to be simplified and relaxed particularly in the case of energy efficiency improvement for low-income households and social housing and where Services of General and Economic Interest (SGEI) providers are involved.
-Managing authorities and administrations need to receive technical assistance to understand state aid regulations and how it affects setting up large-scale renovation financial schemes.
-The EU can also help with the sharing of experience and good practice from other EU member states. In the UK for example, a scheme is being set up that will address the split incentive between landlords and tenants and can be compared to a 'public ESCO'.

1 Addressing market failures

a)Are the barriers identified in this document the most important ones? If not, which barriers are missing and why are they important?

Overall the document has identified the key barriers to enabling effective finance to low-carbon refurbishments. In particular of relevance to our sector are the following barriers:
-Some building improvement works come with an 'inconvenience' cost as tenants need to be decanted to another property for a period of time. These costs cannot always be recouped by the landlords and might add to the bill of renovation work.
-Energy efficient improvements equate to a high level of initial investment costs, which only yield a low payback over a long period of time, typically 25 to 30 years. Financial institutions tend to prefer shorter-term and higher yield projects.
-There is an information failure within the financial sector around renewable and energy efficiency projects, making access to finance more difficult for this sector.
-Financing institutions usually provide asset-based lending rather than project finance and limit the debt amount to 70-80% of marketable asset value. This presents a barrier to our sector who needs their assets to access capital funding to build more affordable homes due to the reduction in government

grants.
-There is a split incentive in the social housing rented sector, where landlords have little room to recoup the costs of energy efficient refurbishment, as rents are set by government. This is likely to change with the implementation of the Green Deal, an ESCO type mechanism whereby upfront finance will be available over 25 years to landlords and homeowners for energy efficient measures. These will then be paid back through the savings on energy bills, the caveat being that the costs of the measures implemented cannot be higher than the savings on energy bills they generate over 25 years, the so-called Golden Rule.
-There is evidence that this mechanism is unlikely to work without subsidies within the social housing sector who typically house people on low-income. Indeed, Affinity Sutton, a London-based housing association, worked out that they would face a shortfall of £130million if they were to apply a £6,500 Green Deal work package across their 56,000 unit stock. This is due to the fact that social housing tenants are more likely to underheat their homes as they tend to be on low-income. Therefore the savings generated post energy efficient improvements are unlikely to be as high as those expected for standard households. In addition, cost-effective improvements are likely to have already been implemented in social housing stock, which means that further improvements will be more costly.
-A systemic approach to avoid dependency on grants for projects which do not stack up financially is unlikely to work in the case of the Green Deal. Bundling various projects, some yielding returns, others not, to gain economies of scale, reduce transaction costs and ensure a sufficient rate of return is unlikely to be a workable option for the Green Deal. The Green Deal is indeed a market mechanism and customers entering such a deal would not agree to pay a higher cost for their refurbishment to allow social housing tenants to benefit from energy improvement measures. They will go for the cheaper, best-value offer.

b)Which market failures would be most urgent to address? At what level (i.e. EU, national/regional/local) would these failures be best addressed?
We believe that market failures need to be addressed nationally, but that the EU can help by providing financial mechanisms that address these market failures at EU level through EU funds and EU finance. For example, one of the key issues faced by the social housing sector is the lack of access to long-term, low-cost finance that does not require asset securities, i.e. is either project finance or a guarantee. Financial mechanisms such as the EEEF could be reworked to answer this specific need.

Our experience and research have shown that social housing retrofit will often require a level of subsidy. EU structural funds could provide grants towards social housing retrofit or to help those on low income access energy efficient refurbishment and lower energy bills.

The EU can also be useful in sharing knowledge and mechanisms that work in some countries and could be exported to others to address some of the financial barriers mentioned in the Commission’s paper. One of them could be the Green Deal, the UK’s ‘public ESCO’ which, once in place and hopefully answering the needs of our sector, could address the ‘split incentive’ problem encountered in many other EU countries. The use of white certificates in the UK has also had some success and this model could be reproduced elsewhere.

c) How could these failures be best addressed? For example; how could behavioural change needed for quicker uptake of energy efficiency measures by society be triggered at national level? How could the development of an energy services market for households be further stimulated? What could be done to increase awareness raising and promotion of energy efficiency in buildings? How could the business community (e.g. building sector, ESCOs, local banks, etc.) be better supported in delivering energy efficiency in buildings? How could the split incentive problem be best tackled?
Please see answer to question 1b.

2. Improving access to finance

a) Are the current EU-level financial tools for energy efficiency in buildings effective? How could the uptake of EU-level funding for energy efficiency (including cohesion policy funding) be improved? As a complement to tailor-made national or regional financial instruments (e.g. set up with a contribution from cohesion policy funds), what could be the future role of centrally-managed financial instruments at EU level in this context?

EU-financial tools for energy efficiency in buildings are not as effective as they could be:

Cohesion funding: Structural funds were recently made available following the 2009 legislation amendment for energy efficient improvement for 'social cohesion purposes. Unfortunately the legislative amendment came half way through the 2007-2013 programming period, making it difficult for managing authorities to review their operational programme and agree the new priority with their steering committees. This means that the uptake from the current programme is not as high as it could have been, if the investment priority have been made possible at the start of the programme.
In addition, there have been other specific issues linked to the regulations of cohesion funds, making it difficult for bidders to put together projects, and access ERDF grants:

-Feed in Tariff (FiT) revenues were deemed incompatible in England as potential match-funding due to state aid issues. This is surprising as ERDF regulations allows for a certain level of revenue generation in projects linked to renewable energy and/or provided by Services of General and Economic Interest (SGEIs) providers. The decision from the English managing authorities was even more unfair as French bidders were allowed to use FIT revenues as match-funding.

-Some managing authorities seemed confused over state aid and chose not to allocate ERDF grants to housing associations in England in order not to fall foul of the regulations. This despite housing associations qualifying under EU procurement rules as 'bodies governed by public law' and being SGEI providers. Going forward, technical assistance to help managing authorities understand the complex and technical issue of state aid would help resolve this particular problem.

-Managing authorities and their desk officers argued that changing an operational programme was too complicated and therefore did not feel able to incorporate the new priority. This despite the Commission making it clear that any operational programme change request would be sped up and that they would make amendments easier to make.

-Because the investment priority was new and managing authorities were not used to it, they attached to the delivery of retrofit projects targets that had been defined at the start of the programme for different type of projects. For example, some bidders were required to create 40 new jobs per £1million invested and ensure the jobs were still in existence three years after the end of the project, at a time of economic difficulty. Similarly, they only allowed bidders to use 10% of the grants in some cases to pay for capital investment, asking that the remainder 90% funds research.

-Managing authorities also worried about the EU funds complementary principle and only allowed projects to go ahead for which existing funding could not be used. This did not take into account the fact that some of these sources of funding were not on a 100% basis, nor that the innovation element that ERDF could bring was to scale up projects.

To sum up, cohesion funds as grants still need to be made available in particular for social housing retrofit and to help those on low income access energy efficiency work. But the regulations of cohesion funds need to be simplified so that access to them is made easy and technical assistance and support ought to be made available to managing authorities to address issues linked to state aid.

ERDF as a JESSICA mechanism (low-cost loan) In two UK regions, ERDF was set up as a below-market loan to provide cheaper finance for retrofit work. However in both cases we came across the following issues, which make the funds inaccessible for the sector:
-The term of the loan is only 10-12 years, despite the fact that we know we need a minimum of 25 years to make any energy improvement project viable due to the longer payback period.

-The fund was not created to fit in with existing policy, for example the introduction of the Green Deal in England in the Autumn of 2012, which is a 25-year financial mechanism. Had the JESSICA mechanism been created with existing policy in mind, it could have provided a 25-year below market loan to implement the Green Deal within the social housing sector.
-The rate of the loan is dependent on state aid regulations as well as on the risks perceived by the fund manager of the project and the credit rating of the bidder. Asset-based securities lower the rate and project finance tends to come with a higher rate as no asset is secured. This makes it difficult for housing associations to access the funds as they need their assets to access new finance to develop new homes.
-The fund manager will always pass on an administration cost to the cost of the finance. It is therefore important that they are not-for-profit, otherwise the benefit of lower cost finance is lost.
-The National Housing Federation was keen for the JESSICA mechanism to be used as a revolving first loss guarantee fund, to attract longer-term, lower-cost finance and resolve the issue of assets having to be used as securities. Unfortunately, although article 44 of the ERDF regulations allows for ERDF to be used as guarantee funds, the regulations also request managing authorities to have spent the monies by 2015. Those we have spoken to have therefore argued that a guarantee fund is not compatible with this latter obligation.

JESSICA could become a useful source of finance to the social housing sector to pay for social housing refurbishment provided the loans are long-term, low cost and ideally do not require asset securities, i.e. is used as a first loss guarantee to attract additional lower cost, longer term finance. This can only work though if the fund manager does pass on the benefit of the low cost finance, and state aid regulations allow for a below-market rate, based on the fact that the fund is there to address a market imbalance. For social housing providers, the state aid regulations could be relaxed on the grounds that SGEI providers need some form of subsidies (cheaper finance could be one of those) to make retrofit projects among their lower-income tenants stack up financially.

European Energy Efficiency Fund (EEEF)**:**The fund is worth €250million and was set up to provide finance for energy efficiency and renewable projects among others. It is made of Commission’s Economic Recovery Plan money, EIB finance and is managed by Deutsche Bank. The fund provides direct equity or debt finance to projects or a 15-year guarantee, subordinate debt or senior debt via a financial intermediary. The limitation of this fund is the fact that the term of 15 year falls short by ten years of the typical requirement for an energy efficiency project. In addition, the rate of the finance appears to commercial rather than below-market. The only advantage of EEEF finance therefore seems to be the fact that it comes with an ELENA or technical assistance facility. But this facility usually takes time to access (up to a year) and comes with the risk to the bidder that, should the project not reach a bankable stage within three years, the public body who bid for it will need to reimburse the full ELENA amount.
This type of finance would really meet its objective of ‘targeting a market imbalance’ if the loan terms were of at least 25 years, at below market rate level, and could take the form of either debt finance, project finance or a guarantee. The guarantee can only be accessible through a financial intermediary. It is important that this type of finance comes with the requirement to the financial intermediary of passing the advantage of low-cost finance (like EIB finance at present) to bidders, or the benefit of low market rate would be lost.
Finally, ELENA should possibly provide some sort of risk-sharing facility, where for some types of projects, only 50% of the amount received need to be reimbursed, should the project not reach bankable stage after three years.

ELENA facilities (EIB, kfw, IEE) The ELENA facility that is provided via the EIB, KfW, Deutsche bank and in the last two IEE Programme calls is helpful in that technical assistance funding which pays for the costs of researching and setting up a large energy efficiency project is really needed.
However the feedback we have received so far is that access to the facility is a lengthy process. Often the need for technical assistance is immediate and having to wait nearly a year before getting it is not quick enough. The requirement that the technical assistance will need to be paid back should the project

not reach bankable stage within three years is difficult and placing all risks onto the bidder. Energy efficiency is a new area and needs some risk-sharing arrangements to grow. It would be useful for instance if for some projects, the funder was willing to take on half of the risk and only request 50% of the funding back should the project fail for example. Finally, access to ELENA is only open to public bodies or bodies governed by public law who have a strategic role in reducing greenhouse gas emission reduction. It would be useful to make this funding available to providers that are not necessarily public bodies but fit the wider definition of 'Services of General and Economic Interest (SGEI) providers'.

Research programmes: Intelligent Energy Europe (IEE), Framework Programme 7 (FP7)

These programmes have been helpful in enabling the sharing of knowledge and experience and to address some specific issues. They tend, however, to be research programmes and requirements to access the funds are usually that the area is innovative and has not received any funding before. This is useful as it enables projects to be set up to test whether a solution or a product might work. But it also means that the funds can finance projects or products that are too costly or too complicated to ever be mainstreamed. We would recommend that projects which look at scaling up the implementation of energy efficiency measures or that are mainstreaming financing schemes to pay for these measures are funded as a priority.

European Investment Bank (EIB):

The European Investment bank has been a good source of finance and has recently started investing in energy efficiency. They provide long-term, below-market rate lending on a 50% basis. They cannot provide guarantees unfortunately. It would be useful if EIB money could be used as a guarantee fund to attract lenders that would otherwise be put off from investing in energy efficiency by the perceived risks.

b) How could more private financing (both from institutional investors as well as building owners) for energy efficiency projects be mobilised? What would be the role of public funding (both at EU and national level) in this context? Is access to (project development) technical assistance an issue and how could it be provided most efficiently at the national, regional and local level? How could both national and EU financing schemes be improved to best cover all segments of the market (residential, commercial, public buildings, etc.)?

Private finance institutions would benefit from information about energy efficiency projects and the advantages of investing in such projects.

Private finance institutions can be put off from investing in this sector due to the requirements for long-term finance and the relatively low returns on investments. They might also perceive this investment as higher risk than others because it is a developing area for them. One way of attracting investors would be to use European funds as a revolving first-loss guarantee fund to de-risk private investors' finance. This means that their finance would then be cheaper and come with better terms for bidders. An example of how this first-loss revolving guarantee could work can be found in housing association's Radian and GESB's report, which was funded by European Regional Development Fund (ERDF). The principle of the Revolving Retrofit Guarantee Fund (RRGF) is to provide credit support for the lender who finances the retrofit projects. The guarantee acts as a security against default of the loan portfolio.

The Guarantee Fund is designed to cover an agreed default rate on the loan portfolio. In the event of a loan default for any of the loans, 100% of loss of principal experienced by the lender on the defaulted loan will be covered by a drawdown from the guarantee fund up to the limit of agreed default rate. In this way the lending should be more secure than 'mainstream' unsecured lending.

This innovative scheme replaces traditional security requirements such as mortgage requirements for home owners or landlords. More information on this financial model can be found at
http://www.radian.co.uk/201004072131/retrofit.html

There is a need for technical assistance to help project bidders set up consortia, resolve procurement and state aid issues and design the best structure to attract finance institutions. ELENA is helpful but as mentioned before, takes too long to access and places all risks on the bidder.
One of the key issues that authorities have when setting up large-scale renovation projects by using EU grants or finance is with EU state aid regulations. If the Commission is serious about kickstarting investment in the renovation sector, then it needs to acknowledge that there is a need for technical assistance to managing authorities and governments on specific state aid issues; and it needs to relax state aid regulations so that projects aimed at the low-income population or provided by Services of General and Economic Interest (SGEI) providers can benefit from a lower rate of finance than the Commission base rate yet remain compatible with the EU Treaty.

c) Is there a need for guarantee systems related to building efficiency investments? If so, what guarantee systems for efficiency investments would be necessary and how should they be designed? Is there a need for other enabling mechanisms (e.g. risk-sharing, investment vehicles?)

There is a need for EU funds and finance (EIB e.g.) to be used as first loss guarantee funds so as to de-risk investment in energy efficiency and attract private finance institutions. An example of how this guarantee fund could work is provided in the Radian/GESB report referred to previously.
It would be useful as well if ERDF and EIB could be used as guarantee funds.
ELENA should provide a risk-sharing facility and the requirement for the funds to be fully reimbursed should the project not reach a bankable stage within three years be reduced.

d) How could the capacity, knowledge and risk perception regarding energy efficiency investments be improved, both at financial institutions as well as with private investors and administrations at all levels?

A programme of information to finance institutions on the advantages of investing in energy efficiency projects, particularly in the social housing sector would be useful.
EU funds and finance made available as a first-loss revolving guarantee fund would help de-risk the investment and attract further finance institutions.
The EU reviewing its own funds such as EEEF to lead by example and provide the type of finance that bidders require would be useful as it would demonstrate to other finance institutions that this type of projects is viable and does not carry additional risks.
Technical assistance to administrations on state aid and how to put together finance and funding arrangements without falling foul of state aid regulations is urgently required.
The Commission relaxing its state aid rules to address current market imbalances and allowing for projects led by SGEIs or targeted at low-income households to benefit from a lower than Commission based rate would be helpful.

e) Are there examples of good practice at national or regional level (with data on costs and benefits) that could be applied more widely?

The UK is developing a ‘public’ ESCO called the Green Deal, which will address the split incentive. We are working with the government to ensure that this scheme works for the social housing sector, which often needs subsidies in order for it to work.
Radian and GESB have developed a ‘first loss revolving guarantee fund’ model to attract additional finance to the energy efficiency sector and de-risk projects to private finance institutions.

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3. Strengthening the regulatory framework

a)Is there any need for further EU-level regulation to stimulate energy efficiency investments in buildings beyond the Commission proposal for a new Energy Efficiency Directive? If so, what should these measures entail?

The Federation does not believe that there should be any more EU regulations to stimulate this sector and area of investment.

b)What could be specific measures to be taken at national level to implement and complement most effectively the EU-level regulatory framework for energy efficiency?
The Federation has no comment to make on this question.

c)What are the specific needs for policy guidance and awareness raising among different stakeholder groups?
Managing authorities and administration need clear guidance and information on state aid regulations and how to put together funding schemes without falling foul of them. They also need clear information on what can be done with specific EU funds such as cohesion funds.