Grantham Research Institute on Climate Change and the Environment

July 2020

The London School of Economics and Political Science

Policy brief

Financing a just transition to net-zero emissions in the UK housing sector

Headline issues

- All of the UK's 28 million homes need to become net-zero and resilient to climate change impacts well before 2050.
- The process requires a just transition, particularly focusing on customers, as well as construction workers and local communities.
- Finance, especially bank finance, will be essential to make this happen, through new product solutions and regionally-focused innovations.
- To kick-start change in the sector, government needs to connect post-COVID-19 recovery with climate action and social inclusion.

Summary

Action to green the UK's building stock lags far behind what is needed to meet the UK's net-zero emissions by 2050 target. The installation of measures to improve energy efficiency are a fraction of what is required and household demand for financial solutions is limited. Another barrier is the lack of strategic focus on the social dimension of the housing transition.

A just transition in the housing sector has to be inclusive and place-based. This means focusing on customer needs, e.g. ability to pay, as well as the interests of workers in the supply chain, e.g. in skills and working conditions. This needs to be done in the context of specific local opportunities and vulnerabilities.

Banks can actively support the just transition as part of a strategic approach to climate action. This means introducing new housing-related lending and investment products and participating in collaborative initiatives, such as the Coalition for the Energy Efficiency of Buildings, to drive market transformation.

Government policy and action is also needed to provide the long-term framework. This would combine post-COVID-19 stimulus with strategic measures such as creating a National Investment Bank and issuing sovereign bonds that deliver green and social outcomes in housing.

Policy briefs provide analysis on topical issues, presenting specific recommendations to inform ongoing policy debates. Drawing on the Grantham Research Institute's expertise, they summarise either our research findings or the state of knowledge about a particular issue.

This policy brief has been written by **Nick Robins** and **Sophia Tickell.** It complements the full-length report *Financing climate action with positive social impact: How banks can support a just transition in the UK* by Nick Robins, Sophia Tickell, Will Irwin and Andrew Sudmant.

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Housing and climate change action in the UK

The UK's 28 million homes are responsible for 12 per cent of the country's annual carbon emissions, but progress to decarbonise these buildings and make them resilient to the physical shocks of climate change lags far behind what is needed. For example, only 27,000 lofts were insulated in 2019, compared with the 545,000 per year that the Committee on Climate Change says is required (CCC, 2020).

Across government, business and finance as well as civil society, there is increasing agreement that a new approach is needed, one that is fully consistent with the UK's legally binding net-zero by 2050 target and that upgrades the housing stock at scale and speed. Banks will be critical to this effort, given their role in providing mortgages and other housing-related loans. Housing finance is the largest segment of bank balance sheets and decarbonisation means that all housing finance – from banks and building societies – will need to be aligned with the net-zero goal. This focus on the environmental dimension of housing finance now needs to be complemented by action on the social dimension, in other words a focus on a just transition.

In this brief, we look at what a just transition in the UK's housing sector means in practice and how banks can make it happen, underpinned by government policy and institutions.

The just transition in housing

To be successful, climate action in the housing sector will need to be designed so that it produces positive social impact and is seen to be fair. Perceived fairness is one of the strongest predictors of both support for climate action and achieving behaviour change (Whitmarsh et al., 2019). This is the agenda of the just transition and it is gaining increasing traction across the UK.

Core to the just transition is the need for climate action to be inclusive. It needs to acknowledge that some individuals, communities and businesses will be more vulnerable to the transition than others. It also needs to respond fully to gender, class and racial inequalities.

In our work on the just transition, we have focused on the following stakeholder groups: workers, communities, small and medium-sized enterprises (SMEs), consumers and citizens. Workers are at the heart of the just transition and our estimates suggest that construction is the sector most in need of reskilling as part of the transition (Robins et al., 2019).

Questions of fairness are critical for consumers, too, and the just transition resonates with the long-standing challenge of addressing fuel poverty, which averages at over 10 per cent at the UK level but is as high as 22 per cent in Northern Ireland. Better energy efficiency in homes is key to reducing fuel poverty.

Overall, climate action in the housing sector will be more successful if fairness is placed at its heart, overcoming perceptions about the disruption and cost that ambitious efforts involve. This means rebalancing incentives, favouring those that take early action and prioritising the needs of those most vulnerable to change. Some of the strategic implications of the just transition are set out in brief in Box 1.

Box 1. A just transition for the UK's housing sector means:

- Ensuring that the costs of decarbonisation are shared fairly across different household groups.
- Focusing efforts so that the needs of vulnerable consumers are prioritised – particularly households facing fuel poverty.
- Maintaining access to finance for households whose properties have poor energy and environmental performance and commit to making net-zero investments.
- Taking care that efforts to green the building stock do not have unintended negative consequences for consumers (such as reduced access to capital).
- Building an effective supply chain that provides decent work for the broad range of jobs and small businesses needed to deliver decarbonisation.
- Finding innovative ways of involving communities in the design of net-zero strategies for housing, particularly at the local level.

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Banks' role in driving market transformation

The market for finance in the housing sector will need to be transformed to support the goals of climate action with positive social impact. The pursuit of the just transition for housing will need to respond to the core economics of the sector, its competitive dynamics and institutional structure. For banks, the housing sector will be a key priority in translating their strategic commitment to the just transition into practical delivery. Banks will need to consider how to incorporate net-zero emissions, resilience to extreme weather shocks and social impact goals as key features of finance for buildings and housing.

Different household needs

Careful market segmentation will be needed to enable finance providers and policymakers to design packages of services, incentives and regulations to meet the specific needs of different householders. Solutions will need to take into consideration different tenure types and what is currently known about different ability and willingness to pay for measures to green their homes. In fact, similar proportions of households in fuel poverty are owners-occupiers (46 per cent) and renters (54 per cent) (HM Government, 2019) – with being in fuel poverty meaning less ability to pay. A critical factor in ability to pay is a household's energy costs as a proportion of their income: these costs are proportionately higher for people on lower incomes, ranging from 9.7 per cent of household spend for the lowest income decile to 2.9 per cent for the highest (ibid.).

How banks can transform the market

Building the framework for market transformation needs to go hand in hand with real world innovation and practice. The growing green, social and sustainable bond market is one way banks can raise capital and ringfence this for activities that support a just transition. Banks are already introducing specific products to assist households and firms seeking to green their lifestyles and operations. For example, Ecology Building Society

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has been a longstanding green mortgage provider, with discounts to incentivise energy-efficient newbuild and renovations, and recently Nationwide has introduced a mortgage top-up product to support green building renovation at a lower interest rate to the standard rate. The task ahead now is for such measures to become widespread across the whole sector, and for the products to reflect the social dimension, both to recognise vulnerability and also to seek out opportunities for positive impact.

The cost of capital will also be important as will ensuring that this reflects the long-term benefits of efforts to accelerate decarbonisation and increase social inclusion. By extension, given that the cost of capital for loans to buildings with poor environmental performance is set to rise, questions are emerging about how the social implications of this are to be managed, and how 'transition finance' is arranged.

Policymakers and financial institutions will need to address these issues. They will also need to make plans to ensure that tighter building regulations do not lead to 'stranded households' who are unable to upgrade buildings that have sub-standard energy and environmental performance. In this regard, any implementation of minimum energy standards for owner-occupied homes, such as proposed in Scotland, will need an established and trusted supply chain, as well as access to affordable finance in order to ensure a just transition.

Another critical dimension is the time horizon. As mortgages are increasingly made affordable by extending the repayment horizon to beyond 30 years, banks will need to address the risks associated with degraded or stranded housing stock. This is particularly relevant in light of increasing physical risk to building stock resulting from extreme weather events. Banks and building societies will have to consider what this might mean for the risk profile and repayment terms for housing finance, such as mortgages, and how to ensure that it does not discriminate against those least able to pay.

Collaborative initiatives are an important way to generate pre-competitive innovation in housing finance and the just transition. The Green Finance Institute's (GFI) Coalition for Energy Efficiency of Buildings (CEEB), for example, aims to coordinate efforts and to develop the market for financing net-zero-aligned and climate-resilient buildings in the UK. It has identified 21 scalable demonstrator projects to overcome key market barriers, many of which support a just transition, including ideas such as a sustainable housing label, property assessed clean energy (PACE) style financing, 'Help to Green' loans, leaseholder financing via social landlords and community municipal bonds (GFI, 2020a).

Connecting with the construction value chain

Making this transformation happen will also require a significant upgrading of the construction value chain, both for new-build and retrofit. A major barrier to decarbonisation efforts is the absence of retrofit options that are trusted, high quality and attractively priced. Currently, the customer journey is highly complex and difficult to navigate. Guidance is often contradictory, efficiency surveys are not always accurate, making payback periods hard to gauge, and it is difficult for customers to find trusted and experienced tradespeople to carry out upgrades.

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Banks and building societies can play an important enabling role here, acting as an intermediary between end-clients and the construction value chain. In working towards achieving net-zero there is an opportunity to provide a large volume of high-quality jobs with decent working conditions. Involving workers in the decarbonisation of the building stock will be essential to deliver breakthrough solutions: workers have vital transition-related knowledge and every worker should have access to the funding needed to improve their skills (TUC, 2019).

Self-employed builders as well as larger SMEs will feature strongly: a fifth of UK SMEs work in the construction sector. Any long-term housing plan that includes the just transition in its design needs to factor in the multiple and differing needs of the SME workforce. Banks and other finance institutions can help enable this by introducing conditionality on loans to the construction industry to support strong social standards and decent work standards.[1]

Place-based solutions

Addressing the question of decarbonising the building stock provides another opportunity to address imbalances in the UK in and between regions and devolved nations. There is significant appetite for place-based climate solutions, highlighted by the growing number of climate emergency declarations issued by local authorities, cities and regions, many of whose goals are far more ambitious than the UK's as a whole. A growing number of localities, cities and regions – such as Belfast, Edinburgh and Leeds – are also establishing dedicated Climate Commissions to drive the process; housing is a key priority for all of these.[2]

Banks can create place-based partnerships with local authorities, cities and regions that have ambitious housing decarbonisation plans. These partnerships can trial and test financial innovations in the building sector that could then be scaled up nationally.

Engagement by banks in these bottom-up initiatives will enable them to counter some of the negative impacts of branch closures. It appears that some banks are anticipating reversing the decline in their physical presence as businesses adapt to remote working and demand for services in the regions increases in the aftermath of COVID-19. To be anchor institutions at the local

1. See Tickell and Robins (2020) for more about financing UK SMEs in the just transition.

2. See pcancities.org.uk

Among the measures to drive job creation through a green recovery included in the Government's *Plan for Jobs* announced in July 2020 was a new Green Homes Grant of up to £5,000 for homeowners and landlords in England to install energy efficiency measures. Low-income households could receive double this level of support (HMT, 2020).

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level, banks will have to be able to provide responses that are tailored to specific requirements. There will also be a particularly important role for regionally connected financial institutions to play, such as building societies, credit unions and community development finance institutions (CDFIs). A crucial feature of this approach will be cooperation between banks and other finance providers with local and regional government (including Local Enterprise Partnerships). Blending commercial finance with public funds often will be essential to delivering a just transition on the ground, notably with the forthcoming Shared Prosperity Fund. Social finance innovators can also provide access to new pools of capital for low-income housing with high environmental standards.

The right government policies and institutions

Banks can make considerable contributions to the just transition through their own efforts. However, their scope for action is significantly influenced by the policy regime in terms of incentives, regulations, governance and deployment of public funding.

The COVID-19 crisis has amplified the need for swift action on the just transition and provides a strategic opportunity to introduce recovery packages for the construction sector with the combined aims of decarbonisation, tackling fuel poverty and boosting job creation (GFI, 2020b). In its July 2020 *Plan for Jobs*, the UK Government introduced a number of measures to drive job creation through a green recovery. This had a focus on buildings with £2bn towards a Green Homes Grant and £1.1bn for public sector and social housing decarbonisation (HM Treasury, 2020). The link between the green recovery and social benefit has been made in two measures: first, a Social Housing Decarbonisation Fund, linked to one of the Conservative Party's 2019 election manifesto pledges; and second, the provision in the new Green Homes Grant for low-income households to receive double the level of standard support at up to £10,000. These positive first steps will need to be supplemented by further action given the extent of the COVID-19 crisis and the potential for socially-focused efforts to green the housing sector to deliver strong economic multipliers in terms of jobs and inequality.

Such recovery measures need to be part of a longer-term strategy that recognises the critical distributional and public acceptability dimensions of the transition in the buildings and housing sector. In turn this would support a transformation in the range of finance available to support these goals. Not all solutions will be commercial. Current policy and regulatory frameworks do not yet provide the incentives or the requirements for finance to move at scale.

National investment banks can play a strategic role in mobilising capital for housing retrofits by providing both long-term low-cost capital and vital quality assurance. Germany's KfW has longstanding experience, as do the European Investment Bank and France's Caisse des Dépôts. In the UK, the new Scottish National Investment Bank and the Development Bank of Wales are well-positioned to play this role.

The creation of a new all-UK National Investment Bank with a mandate to support decarbonisation of housing could provide long-term low-cost capital as well as vital quality assurance. It could be pivotal to supporting retrofitting at scale in line with the recommendations of the National Infrastructure Commission. Homes England, the non-departmental public body that funds new affordable housing, could also play an anchor role by incorporating just transition principles in its partnerships and procurement.

Policy recommendations

In our wider project we identified eight steps that banks can take to support the just transition across sectors in the UK, and six major policy steps for government (Robins et al., 2020). This brief builds on these recommendations to identify how banks can support the housing sector, and also highlights the relevant steps for government.

Recommendations to banks

1. **Commit to net-zero emissions, climate resilience and social impact goals in housing-related lending and investment:** e.g. introduce green mortgages and community municipal bonds.

2. **Actively participate in savings and lending demonstrator projects of the Coalition for the Energy Efficiency of Buildings** with a just transition focus: e.g. affordable rent, affordable living and leaseholder financing.

3. **Create place-based partnerships with local authorities, cities and regions** that have ambitious housing decarbonisation plans to trial and test financial innovations in the building sector that could subsequently be scaled up nationally.

4. **Introduce conditionality on loans to the construction industry** to support decent work standards for the workers and small businesses that are needed to deliver decarbonisation.

Recommendations to government

1. **Introduce a just transition plan for the construction sector** to identify social priorities, building on the existing programme of sector deals under the Industrial Strategy.

2. **Kick-start the just transition with a post-COVID-19 stimulus package for the construction sector** that combines decarbonisation, creation of decent jobs and locally-led, place-based retrofit and energy efficiency programmes.

"National investment banks can play a strategic role in mobilising capital for housing retrofits by providing both long-term low-cost capital and vital quality assurance."

3. Create a National Investment Bank with a mandate to support the decarbonisation of housing, by providing long-term low-cost capital as well as vital quality assurance, including labour standards.

4. Issue green sovereign bonds to channel savings into a just and sustainable recovery programme, with a major focus on housing retrofit and clear impact reporting on social benefits for workers, communities and consumers.

What's next?

The importance of the just transition as a core part of the UK's strategy for overcoming climate breakdown has been propelled forwards by the COVID-19 crisis. There is huge potential for progress in bringing the just transition to life. The banking sector is a key agent of change, and so too are other actors in the financial system such as non-bank finance, institutional investors, capital markets, public finance and community finance initiatives. There is a real possibility to create targeted partnerships in key regions, bringing together policymakers, financiers, business, trade unions and civil society to deploy capital that responds to local priorities.

To help realise this, a Financing the Just Transition Alliance could now be formed to support this system-wide approach. The Alliance would bring together banks and investors, local and national policymakers, business and trade unions, civil society and researchers across the country. The Alliance would seek to co-create breakthrough financial innovations that show how climate action can deliver with positive social impact and do this at scale. Delivering housing decarbonisation that addresses fuel poverty, improves working standards in the construction value chain and the resilience of housing stock to extreme weather shocks would be a critical part of the Alliance's work to show how the just transition can help the UK to build back better.

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This policy brief is an output of the Banking on a Just Transition project, led by the Grantham Research Institute on Climate Change and the Environment working with the Sustainability Research Institute at the University of Leeds, in partnership with UK Finance and the Place-based Climate Action Network (PCAN). The project is funded by HSBC and the London School of Economics' KEI Fund.

The authors would like to thank the Banking on a Just Transition project's Advisory Committee for their support, guidance and contributions. This policy brief has benefitted from additional support and insights of John Barry, Paul Chisnall, Ian Christie, Sophia Cox, Andy Gouldson, Emma Harvey, Stephen Pegge and Alex Wall. The authors also thank Will Irwin and Natasha Kunesch for research assistance.

Georgina Kyriacou edited and produced this policy brief.

All of the views expressed in this work are the views of the authors and independent of their funding institutions. The authors declare funding from HSBC UK and the KEI Fund of the London School of Economics and Political Science. The authors declare no financial relationships in the previous three years with any organisations that might have an interest in the submitted work and no other relationships or activities that could appear to have influenced the submitted work.