



Institutional Framework conditions for Energy Efficiency Retrofit Investments in the Rental Housing Market Sector

(Summary of WP4)

KEY FINDINGS

The mainstream institutional barriers to energy efficiency retrofit investment initiatives across all of the consortium countries were found to revolve around:

- The institutional conditions reflect the past national housing policies so the different strengths and weaknesses of the private rented housing sector. Four typical cases have been identified (D.4.2.); the former C.E.E.C. case (Czech Republic and Poland), the Mediterranean case (Spain, Italy), the Northern countries case (Scandinavia, Germany, the Netherlands), the „mixed“ case (France, UK). The percentage of the rental housing stock varies from 13% (Spain) to 56,7% (Germany) of the total housing stock and in the rental housing stock, the percentage of the rental market subject to market rents varies from 8,3% (Nederland) to 96% (Germany).
- With an average of two thirds of the private rented housing stock in the RentalCal countries, the private natural landlords are by far the first institutional target group. This group is not homogeneous, between 50% and 70% of it consist in natural investors owning few dwelling units. Their lack of information and competences makes the needs for external and local support a key factor to enhance the energy efficiency of the private rented housing sector.
- Public policies consider usually the private housing sector to be self-independent and self-sufficient from an economic point of view (France, Germany, Spain). So politicians do not put too much efforts and budget to support this sector privileging the owner-occupiers housing sector in their energy efficiency policies notwithstanding in terms of tax incentives.
- There is a great variety of legal forms used by the investors (limited liability company, public limited company, cooperative,...) but the legal form is less important than the tax system attached with the activities operated by the landlord (e.g. the legal form of the public limited company may be used either by a non-profit or by a profit organization). Tax incentives and subsidised credits are remaining the main drivers.
- The gap in the implementation of the energy efficiency policies between institutional investors and private natural landlords is growing in all European countries. Policy makers which face a failure in the energy efficiency refurbishment of the rented housing stock owned by private natural landlords should take into account the characteristics of the private natural landlords. An efficient policy should be a mix of tax incentives (tax credits, accelerated and shortened depreciation...), financial incentives (e.g. grants), subsidised credits (e.g. zero percent eco loan) which may be subscribed individually or collectively,...) and a global and multidimensional support provided at the local level by all different stakeholders. If one of these dimensions is missing, brakes appear rapidly due to the structural weaknesses of the private natural landlords



CROSS-COUNTRY FINDINGS

Institutional barriers to Energy Efficiency Retrofit Investments

The ownership structure of the private rented housing stock

- The three main investor types in the private rented housing sector are by order of importance 1) the natural private landlords (Spain (98%), France (95%), United-Kingdom (73%), N-L(63,5%)), Germany,...), 2) the institutional investors with a public background (Germany, Holland (20,6%), Czech republic (37,2%),...) 3) the private institutional investors (R.E.I.T., banks, insurance companies, housing companies...). This third investor type remains marginal privileging investments in commercial premises and their higher rental yields.
- The skills and competences to decide and to lead the implementation of energy efficiency investments is strongly related to the size of the housing stock managed individually by each investor. From few dwellings with regards to private natural landlords (Spain, France, United-Kingdom) to tens of thousands of housing units in case of municipal companies or cooperatives (Germany, Czech republic, Denmark). In all participating countries, regarding the energy concept and the potential energy efficient measures, private natural landlords require external services. Regarding the technical and the financial matters, they have personally no information, knowledge and capacities (e.g. Energy performance contracting (EPC) in the Czech Republic (2014) is rather underdeveloped in the private housing sector yet quite developed for institutional investors especially in the commercial and public building sector. EPC providers or Energy Services Companies (ESCOs) need large scale projects for profitability).

The tenant-landlord dilemma

Two dimensions have been identified

- The tenant-landlord dilemma : the economic dimension
 One of the most specified constellations in the Rental countries appears when the landlord has no interest in an energy retrofitting. There is no „a priori“ incentive for the landlord to bear the upfront capital investment of energy efficiency measures regardless of the payback period or IRR of the investment. As long as the utility costs will be paid by the tenant, the landlord has no incentive to make investments improving the energy efficiency. On the other side, due to the higher rate of residential mobility in the private rented housing sector (France, United-Kingdom, Germany...), the tenant has no interest in sharing the investment. In fact, compared with the social housing sector, the differences of calculation horizon between a private natural landlord and its tenants are too important to generate a shared and common interest.
- The tenant-landlord dilemma: the social dimension
 Among the RentalCal EU participating countries, the proportion of the population living in the market rented sector whose housing costs exceeded 40 % of their disposable income varies. At one extreme there is Spain with a proportion exceeding 47.5%. In the average, Czech Republic (29.9%) and Poland (25.5%). At the other extreme, France (19.1%) Germany (15.9%), Denmark (15.6%) and the Netherlands (15.4%), with the lowest



percentage of the population living in the private rented sector and spending more than 40% of their disposable income on housing. A significant part of the households represented in the first quartile of incomes lives in the private rented stock (e.g. 30% in France¹). This social dimension impacts the tenants' financial capacity to share the benefit of the energy savings and their difficulties to co-invest and accept a rent increase. It explains also the caution of the policy makers in containing rent increases after energy efficiency works (France, Czech Republic, Germany).

The particular case of the condominiums.

- **A fragmented ownership:**

In France, Germany, United-Kingdom and Czech Republic, a significant amount of the private rented housing stock is part of jointly condominium associations. In these associations, it is extremely difficult to make a decision for an energy retrofit, as their needs to be consent regarding the set of measures, their financing and the distribution of costs between the different owners (owner-occupiers, landlords,..) are too different. This is why the retrofit investment decision becomes extremely intricate in condominiums for which the costs and benefit accrue to different parties.

- **A problem of governance:**

The boards of the condominium associations, even assisted by property managing firms, have no technical knowledge and competences to assess all the aspects of an energy retrofit. So, the condominiums are in arrears both in modernisation rate (France, Germany, United-Kingdom and Czech Republic) and in percentage of energetic retrofitted buildings. The problem will be more and more crucial regarding the large prefabricated housing estates built in the 60's and 70's.

- **A failing legal framework:**

in France, United-Kingdom and Germany, the policy makers have recently (2010-2015) decided to reinforce the legal framework about the financial reserves, the rules of the majority in the decision making process and in case of financing requirement of external capital, the securing of the repayment of the loan to the banks to guarantee the liability of the condominium.

The recent legal adjustments in France are representative of the last tendencies all over the RentalCal countries. They focus on the obligation to propose in the general assembly of the condominium associations a plan about the energetic retrofitting of the estate in case of classification of the E.P.D. in the classes E,F,G. A financial reserve for building works is now mandatory but its level remains insufficient (5% each year of the estimate budget).

The governance of the cooperatives (Denmark, Czech Republic and Poland) seems to be more adapted to the modernization of large estates in terms of mandatory financial reserves.

¹ Marché locatif privé : état des lieux et évaluation des dernières mesures gouvernementales, Sabine Le Bayon, Pierre Madec, Christine Riffart, Science Po/OFCE, Paris, 2013 available at : <http://www.ofce.sciences-po.fr/pdf/dtravail/WP2013-05.pdf>



POLITICAL IMPLICATIONS

For too long, the energetic retrofitting of the private rented housing sector had been the poor relation of public energy efficiency policies. Progresses are actual but remain too slow to compensate for delays.

1. The private rented sector often houses low-income families and a young urbanised population. It is the first barrier for energy retrofitting investment in the private rented housing sector and explain the social weakness of the tenants' demand. The perception of that investment amount will never be recovered through a reflection on rents or prices increase is widespread. In fact, to protect this social demand, existing legal restrictions to rent increases exist in different ways in almost all RentalCal countries and explain the perception that energy retrofitting investment in the private rental housing stock are sunk costs.
2. To cope with this problem, public policies give generally private landlords an access to favourable loans (zero interest eco loan in France and Spain, lower interest rate in Germany and/or grants for refurbishment measures and/or installation of renewable energy systems (Spain, France, Germany, Czech republic, ...). Nevertheless, tax incentives policies continue to privilege owner-occupiers neglecting landlords.
3. In all RentalCal countries, the general lack of knowledge and competences of the private natural landlords makes the needs for external and local support a key factor to increase the annual rate of energetic retrofitting in the private rented housing sector. Initiatives (2010-2015) have been taken (Germany, United-Kingdom, France) to coordinate at the local level the different shareholders (economists, technical experts, building companies, financing institutions,...) to propose private landlords an overall and continuous support in every step of their energy retrofitting projects in an unique contact point.
Generally, these supporting platforms are in the hands of the local public authorities (Germany, United Kingdom,...) but may also result from the law (France). These innovative initiatives being relatively recent, it's too short to assess their actual impacts.

INVESTOR'S PERSPECTIVE

There is a clear need to distinguish professional and non-professional landlords.

Different motivations according to the investor type.

- The most mentioned motivations for professional landlords consist in preserving the asset value and reducing the vacancy risk. On the other side, regarding professional landlords, the policy (state or local authorities) pressure was also often mentioned as a key factor for the Netherlands, Germany and Spain but this pressure exists also in different ways in Denmark, United Kingdom and France.
- Regarding non-professional landlords, tax incentives are mentioned as playing the key role in almost all participating countries. It underlines the importance of the national tax policies to enhance the energy efficiency in the private rented housing stock but it also sheds light. Old-age provision is also mentioned, it confirms indirectly



the importance of the tax policy as it underlines the private natural landlords' reluctance to invest in energy efficiency. As the difficulties to get middle-term and long term credit from banks are increasing with the ageing (most of the time no term of the loan after 70 years old), the tax credit is sometimes the only parameter which can influence the decision and speed up their acting out.

Parameters of decision making.

The results show that almost all decision making parameters (tax rate, return expectations, subsidised credit...) are in common for all participating countries even if their concrete contents may vary from one investor type to another type in each country. Nevertheless, there is no country in which the investor in private rented housing integrates consciously the green value in its calculation to justify energy efficiency investments. On the contrary, the data collected regarding the financial conditions show a greater homogeneity among the countries depending on the prevailing investor types.

Calculation and choice of the term.

The calculation horizon is shorter for private natural landlords as it could be, depending on the way the natural investors are financing their activities and investments. However, there is a disconnection between the horizons of technical depreciation and financing especially in Denmark, Holland and in Germany.

Normally the calculation horizon of an investment is a mix, connected to the terms of its lifetime and its financing. The private landlords prefer to use the term of the financing. Concerning the insitutional investors managing thousands of dwelling, the financing is no more related directly to a precise real estate but with the solvency of the institutional investor which finances and manages its extraordinary maintenance and its new developments globally. The maturity of the debt is shortened and re-financed regularly. So, in their calculation, they prefer to use the term of the actual technical depreciation mixed with an average interest rate of the burden debt.

Expectations (R.O.E.).

More "private" the landlord is, higher are the expectations in terms of return on equity (R.O.E.) (France, Germany, Czech Republic). Cooperatives, social housing firms and municipal companies integrate more easily the tenant perspective or global environmental issues related to local policies in their decision making process compared with private landlords, housing companies and institutional investors even when they manage private rented housing stocks. These differences in the requested level of R.O.E. may explain the differences of energy performance reached by the respective stocks of the different owners and why the „pure“ private players are in arrears in terms of energy efficiency modernization.

SUMMARY

The findings of this report highlight the following points:



1. The natural private landlords are by far the main investors (Spain (98%), France (95%), United-Kingdom (73%), NL (63.5%),...) in the private rented housing sector all over Europe. Regarding the energy efficient measures, they have personally no knowledge, competences and capacities. They need from all stakeholders a global and multidimensional support at the local level to favour and guide their acting out. Consequently, calculation tool needs to be adapted according to the different investor types and their capacities.
2. Often mentioned in the scientific literature, the tenant-landlord dilemma should be approached in a practical manner and less overestimated. The public policies which tried to implement rent increases or sharing of the energy savings in the private rented housing stock remain inefficient for many reasons, the main one being that it neglects the actual social role of the private rented stock which houses a significant part of young urbanized families and low incomes households. Interests and horizons of the tenants and the landlords are too different.
3. Tax incentives (tax credits, accelerated and shortened depreciation...) and financial incentives (e.g. grants, subsidised credits (e.g. zero percent eco loan) remain the main drivers to implement measures of energy efficiency. Public policies should be based upon an equality of tax treatment between owner-occupiers and private landlords.
4. The particular and crucial case of the condominiums illustrates the growing awareness of the public policies in the recent year in almost all RentalCal countries. Targeting the problems of governance, financing and competences, similar legal frameworks are implemented to encourage the energy retrofitting of large prefabricated housing estates.

FURTHER READING & SOURCES

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