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INCENTIVISING ENERGY EFFICIENCY IMPROVEMENTS FOR PRIVATE RENTERS

AUTUMN BUDGET BRIEFING

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A quarter of renting households in England live in fuel poverty.[1] The government has consulted on tightening regulations on energy efficiency that could save renters £570 per year on their energy bills.[2] Through introducing fiscal support at the Autumn Budget, the Treasury can pave the way for higher standards in the private rented sector. This will help landlords get ahead of regulatory changes and help lower renters' bills.

> **There are significant benefits for renters, landlords and the government** associated with higher efficiency standards. These include lower energy bills, higher property values, increased rentability and lower risk of rent arrears. Through permanently lowering bills, the government can reduce the amount required to bail out renters' energy bills in the case of future energy price shocks, which amounted to around £8bn from October 2022 to March 2023.

> **Tax nudges can spur investment:** Simple changes to the tax system, including making energy saving improvements to properties deductible from income tax, can make energy efficiency upgrades more attractive for landlords.

> **Attractive green lending and demand aggregation schemes** can support attractive finance offers, potentially via the UK Infrastructure Bank.

[1] Department for Energy Security and Net Zero, 2023. **Annual Fuel Poverty Statistics in England, 2023**

[2] E3G, 2023, **Cutting energy bills and raising standards for UK private renters**

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Incentivising energy efficiency to lower renters' bills

There is a compelling case for boosting energy efficiency in the private rented sector. Citizens Advice highlighted that renters face widespread problems with damp, mould and cold, with 1.6 million children exposed to these conditions.[3] Around two-thirds of privately rented properties in England and Wales fall below EPC C, the government's target rating for all fuel poor homes by 2030.[4] According to government data, 970,000 properties – almost one in four privately rented homes – would "likely not meet" the Decent Homes Standard, requiring homes to provide "a reasonable degree of thermal comfort".[5]

The government spent £40bn between October 2022 and March 2023 to subsidise household bills.[6] Since 20% of households are renters, a simple breakdown suggests that around £8bn went towards renters. E3G's analysis suggests renters could save on average £570 per year through planned efficiency improvements[7] – an aggregate saving of £1.75bn, which could have decreased government spending.

There are wide-ranging benefits associated with improved efficiency. Government-backed research shows that houses rated EPC C typically sell for 6% more than EPC band D.[8] There is evidence that upgrades which improve comfort and affordability of properties improves their rentability. Reducing tenants' energy bills also reduces the risk of rent arrears.[9]

The government consulted on increasing energy efficiency standards in the private rented sector to EPC C by 2025 for new tenancies, and 2028 for existing tenancies, with a £10,000 cost cap. The impact assessment calculated that the average property spend would be £4,700, although for homes rated EPC D the cost could be less than £1,000. Government has not moved ahead with implementation. In *Powering Up Britain*, the government committed to publishing a summary of responses to the 2020 consultation – but did not commit to providing a timeline for the introduction of stronger standards.

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[3] Citizens Advice, 2022, **Damp, cold and full of mould**

[4] DLUHC, July 2022, **English Housing Survey: Private Rented Sector, 2020-21**

[5] DLUHC, July 2022, **English Housing Survey: Private Rented Sector, 2020-21**

[6] Government, 2023, **£40bn Spent protecting families and business from energy costs**

[7] E3G, 2023, **Cutting energy bills and raising standards for UK private renters**

[8] BEIS and the University of Cambridge, September 2020, **Do house prices and rents in the private sector reflect energy efficiency levels?**

[9] Property 118, August 2022, **Fears over winter rent arrears crisis as energy costs soar**

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The role of incentives to boost efficiency

The Treasury can pave the way for fair and affordable regulation that permanently lowers bills by introducing fiscal measures and attractive finance to support landlords to increase the efficiency of their properties. Landlords with low-income tenants are eligible for energy efficiency schemes such as the Energy Company Obligation (ECO) and the Home Upgrade Grant (HUG). However, more generally, recent tax changes have not incentivised property improvements. The end of the landlord wear and tear allowance in 2016 means that while like-for-like replacements are deductible from rental profits, improvements such as energy efficiency upgrades are not.

There is evidence that tax deductibility could play an important role in making investments affordable and thereby incentivise early action. Research from the National Residential Landlord Association found that 72% of landlords who were not planning to make investments to improve their property in the next two years would reconsider with a change to tax deductibility rules.[10] Other countries have introduced tax incentives and green loans to support higher standards.

> **France**: When landlords retrofit their properties, they can subtract the costs from their income revenues – reducing the amount taxed.[11] For efficiency measures, landlords can deduct up to €21,400 per year to upgrade from EPC E, F or G to EPC A, B, C or D (according to French standards of calculation).[12]

> **Germany**: Germany allows landlords who make their buildings more efficient to raise rents outside of existing rent control restrictions. Germany increased building code standards in its Energy Savings Ordinance and Renewable Energy Heating Act.

> **Scotland:** A low-interest Private Rented Sector Landlord Loan is available for landlords listed on the Scottish Landlord Register.[13] Up to £15,000 is available for energy efficiency and £17,500 for renewable systems, plus £6,000 for energy storage systems. The Energy Saving Trust provides advice and support to landlords through their network of "one-stop shops", complemented by home visits and specialist landlord financial advisors.[14]

[10] National Landlords Association and Residential Landlords Association, 2020, **Budget 2020: A private rented sector that works for all**
[11] French Government, 2023, **Notice pour remplir la déclaration des revenus fonciers**
[12] Rappel, 2023, **Le mécanisme du déficit foncier devient plus incitatif pour les bailleurs réalisant des travaux de rénovation énergétique**
[13] Home Energy Scotland, 2023, **Private Landlord Loans**
[14] Energy Saving Trust, 2021, **Energy Saving Trust programmes in Scotland**

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Options available to spur landlord investment

We encourage the Treasury to consider options to incentivise landlords to boost the energy efficiency of properties. There could be a role for means testing to ensure that landlords with low-income and vulnerable tenants, or those with properties located in areas with the lowest rental incomes, will benefit the most from subsidies and incentives. We note that this would require more complex implementation than simpler, universal measures. Tools and evidence such as proof of rental income, zoned approaches and indices of deprivation might be used and developed to allow the introduction of targeted support, if the government sought to taper out universal support.

Tax-deductible efficiency improvements

Individual landlords pay income tax on their rental properties at the same rates of tax as other earned income. Before they work out how much they will be taxed, landlords may deduct costs of managing the property, legal fees, replacement furniture, insurance, utility bills, ground rent and maintenance and upkeep – but not energy saving improvements. Changing the rules to allow energy efficiency improvements to be offset against rental income – and therefore income tax – could help make investment more attractive for landlords. The current system does not allow improvement costs to be deducted in the year they occur, but instead allows for capital gains tax deduction at the point of sale of the property.

By shifting deductibility from capital gains to income tax, the government would help landlords by giving tax relief in the year of the expense, and remove the existing incentive for landlords to sell up. Making this change would represent maximum tax revenue foregone by the Treasury of £1.3bn to 2028, or around £0.26bn per annum over five years.[15] This would result in energy bill savings which recur annually, freeing up household income to be spent elsewhere in the economy. A portion of this would be paid to the Treasury in the form of increased VAT receipts.

An allowance could be set per year per property for improvements that result in an increase in the Environmental Impact Rating within the EPC or are included in an agreed list of measures to improve the energy performance and reduce the carbon of the property. Landlords living in areas where the average income is below the national medium could have an uncapped allowance.

[15] E3G own calculations – see appendix

Case study: Landlord's Energy Saving Allowance

Available between 2004 and 2015, the Landlord's Energy Saving Allowance (LESA) was a tax allowance which let landlords claim on their income or corporation tax return against the cost of buying and installing certain energy saving items. Tax relief was for a maximum of £1,500 per property. The policy lasted just over a decade, with allowances possible for specific types of insulation over this period. But by the time LESA was removed, the government had been disappointed by the low level of take-up from the sector. However, according to the National Residential Landlords Association, landlords are now more engaged about net zero, and more likely to utilise available support options if re-introduced. They recommend a new tax allowance of £4,500 per property, enabling landlords to undertake significant works tax-free.[16] They recommend a new tax allowance of £4,500 per property, enabling landlords to undertake significant works tax-free.[17]

Subsidised lending through the UK Infrastructure Bank

Linking green finance solutions to fiscal incentives could help drive uptake and demand for energy efficiency improvements. Financial institutions are stepping up their green finance products and services, including green mortgages. Examples include Nationwide's 0% interest loan[18] and Octopus's partnership with Halifax to support low-cost heat pumps.[19] There are also several loans specifically designed for "buy to let" properties, with the Green Finance Institute identifying nearly 20 products for this market.[20]

The availability of attractive finance will be an essential enabler to boost the success of incentives. However, alone, finance cannot drive demand. Indeed, despite increased availability of green lending, uptake of green home finance products remains relatively low for several reasons.[21] The introduction of incentives linked to green lending (both secured and unsecured) could help boost the market, accelerate take-up of products and services, and encourage

[16] NRLA, 2021, **Energy efficiency and tax allowances - LESA revisited**

[17] NRLA, 2021, **Energy efficiency and tax allowances - LESA revisited**

[18] Mortgage Strategy, 2023, **Nationwide launches green additional loans**

[19] Halifax, 2022, **Green living – heat pumps**

[20] Green Finance Institute, 2023, **Green Mortgages**

[21] For example, see Natwest, April 2023, **Energy efficient housing tracker – April 2023 update**

innovation. We note that long-term certainty on the timelines for tightening regulation will also play an important role in spurring investment.

Treasury could work with the UK Infrastructure Bank (UKIB) to further support the take-up of green lending opportunities:

> **Aggregate demand in the private rented sector.** There are opportunities to create economies of scale through the establishment of financing mechanisms that aggregate demand in different regions. For example, on-street student private rented accommodation in university cities could act as an anchor in areas where there are many landlords with homes that need more expensive measures like external wall insulation – with a potential role for universities or local authorities to act as coordinating bodies.

> **Providing subsidy support linked to green lending**. The Treasury could provide a ring-fenced subsidy to retail lenders via the UK Infrastructure Bank to offer subsidised loans for landlords, with a higher subsidy available for greater energy efficiency improvements. Clear terms should be provided to retail banks regarding how they could access this subsidy pot, and the conditions under which subsidised loans can be provided to landlords.

Inspiration can be taken from the successful German KfW retrofit programme. For every €1 invested by KfW, building owners invested a further €6.[22] Applicants can access low-interest loans via retail banks, and renovation projects can access higher repayment subsidies by achieving higher efficiency standards.

Monitoring and enforcing standards

The government should introduce a national register of landlords, as it has previously indicated it would.[23] Such a register would make it significantly easier to enforce minimum energy efficiency standards, a responsibility of local authorities. We note that more capacity is needed at a local level to ensure compliance with existing EPC standards (EPC E). A national system would also likely reduce compliance costs for those landlords currently covered under the more piecemeal selective licensing schemes which some local areas have introduced. It would also be an opportunity for early adopter landlords to demonstrate that their properties are performing to a higher energy performance standard.

[22] Calculated: Institut Wohnen und Umwelt & Fraunhofer Institut, 2018, **Monitoring der KfW-Programme "Energie-effizient Sanieren" und "Energie-effizient Bauen" 2016**; BFM, 2016, Haushaltsgesetz 2016.

[23] The Times, 31 January 2022, **Levelling-up plans target rogue landlords in the private sector**

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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

More information is available at **www.e3g.org**

Appendix: Tax foregone calculations

Tax foregone
The analysis estimated the policy cost by comparing taxes raised under the existing system where energy efficiency measures are offset against capital gains compared to the suggested shift to offsetting against income tax. The two main reasons for losing tax revenue are:

> Income is taxed at higher rates than Capital Gains Tax. Therefore if expenditure is offset against income rather than capital gains, a higher amount of tax income is foregone.

> Costs associated with a delay in when tax income is received.

Previous analysis by the Joseph Rowntree Foundation found the switch leads to approximately 8% loss in revenue by switching energy efficiency works from Capital Gains Tax to income tax.[24]

[24] JRF, March 2018, **Using incentives to improve the private rented sector: three costed solutions**

Calculations

The cost to the Treasury of offsetting the cost of these efficiency measures against income tax as opposed to Capital Gains Tax (CGT) is calculated as outlined in Table 1.

Table 1: Calculation of total cost to Treasury

Calculation (values in £m)		Explanation
	12,700	Total investment
	4,064	CGT offset
–	3,048	Income tax offset
=	1,016	Tax revenue forgone by the Treasury due to allowing energy efficiency improvements to be offset against rental income, rather than CGT.
+	279	Cost of tax revenue delayed. Collecting revenue offset against rent instead of capital gains affects cash flow which creates a cost. The cost was calculated using Consumer Price Index (around 2% a year) and the HMT policy discount rate (3.5% a year), divided by 8.5 years (only in the 5-year policy window).[25]
=	**1,295**	**Total cost to Treasury over 5 years**

The analysis used cost estimates from the government's impact assessment for the consultation on improving the EPC of all privately rented homes in England and Wales to EPC C.[26] This places the total investment need for energy efficiency measures at £12.7 billion cost to landlords.

[25] If the average home is owned for 17 years, it can be assumed, on average, works will be undertaken at the mid-point, meaning there are 8.5 years where the investment is affected by interest and discount rates.

[26] BEIS, September 2020, **Improving the Energy Performance of Privately Rented Homes in England and Wales**