The European Renovation Loan: An innovative financial instrument to Repower EU

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By Peter Sweatman, CEO of Climate Strategy

Peter Sweatman is chief executive of Climate Strategy (CS)[1] and has worked for over 30 years in finance. In the last 18 years, Peter worked in climate finance with a focus on energy efficiency and buildings renovation investments. Here is a full bio.

INTRODUCTION - EUROPE IS IN A RACE TO ACHIVE ENERGY INDEPENDENCE

Given the ongoing war in Ukraine, Europe has launched REPowerEU plan to address its independence from Russian oil, coal, and gas before 2030, in which much is expected from energy demand reduction and efficiency.

Gas consumption provides the most significant share of energy use in residential and non-residential EU buildings[2] (36%)[2]; and is crucial for buildings heating in a significant number of member states. As we are also in a buildings' renovation crisis, where renovations are insufficiently frequent and insufficiently deep, Climate Strategy proposes the rapid roll-out of a new financial instrument the "EU Renovation Loan" (ERL) via mortgage lenders.

The ERL provides a homeowner a new way to cost-effectively unlock home-equity for a deep renovation with nothing to pay until sale, transfer or after 30 years.

SYNCHRONIZING EU RENOVATION EFFORTS

Launched in late 2020, the EU Renovation Wave Strategy to improve the energy performance of buildings calls for doubling the renovation rate to cut emissions, boost recovery and reduce energy poverty.

More specifically, this strategy targets 35 million buildings renovated by 2030 requiring a total investment of nearly a trillion euros (€900 billion). Experts assert that achieving these objectives requires the EU to more than double the renovation headline rate of 1% per annum and increase the number of deep renovations by a factor of ten.

It is undeniable that buildings energy efficiency measures deliver energy security, protection against price volatility, monetary savings, comfort and health benefits and more valuable homes. Sadly, most homeowners don't yet prioritise them and don't feel they can afford them. Governments and lenders are also struggling in their own distribution of support to the just-able-to-pay sector which may not be eligible for grants for energy efficiency but doesn't have savings in the amount of a new car for this purpose.

LEVERING THE POWER OF GREEN EQUITY

European residential buildings are estimated to be worth €17 trillion and house 220 million homeowners. There are around €7 trillion of mortgages in Europe, and therefore there is €10 trillion of home equity against which owners can borrow for the deep renovation and transformation which most of these buildings require by 2050. These savings must be unlocked efficiently.

[1] CS is an unregulated consulting firm offering strategy and business consultancy in areas related to Clean Energy, Clean Technology, Energy Efficiency, Sustainability and Climate Change and related Policy work. Climate Strategy is not a financial advisor and it does not provide nor promote financial investment, fundraising nor financial advisory services.

[2] European Commission. (2022). *Energy use in Buildings: Energy consumption*. [Website]. Retrieved from https://ec.europa.eu/energy/eu-buildings-factsheets-topics-tree/energy-use-buildings_en

DEFINING THE EU RENOVATION LOAN

The EU Renovation Loan is long-term (30 year) financing with a zero-coupon structure[3]:

- **Homeowners borrow the amount they require to transform their home through a deep renovation.**
- **They do not have to pay cash interest and it accrues until the property is sold or transferred (or the loan matures in 30 years).**

At a time when energy prices have spiked up, unlocking just 10% of the €10 trillion of European home equity, often in the hands of the older generations[4], will stimulate renovation jobs, increase comfort, security, and lower energy costs.

EU Renovation Loans can be offered to underserved families and backed by an EU-guarantee. Their interest would accrue at EU borrowing costs (plus a small spread) and be distributed through mortgage lenders alongside top-up or commercial mortgages. We argue that the necessary EU loan funding can be created by a conversion of the underutilised loan component of the recovery plans into EU Renovation Loans, authorised by Member States.

Not making cash interest payments on an ERL makes them cheap to manage (for banks, as you don't have to collect interest nor worry about default until maturity). ERLs would hold a second and junior lien on the home (payable upon sale or transfer) and all the cash savings (from lower energy bills and associated operational costs) will be felt immediately. This benefit is especially relevant for those in retirement.

This zero-coupon financial instrument will be backed by a junior lien on the property (so as not to impact the senior "first" collateral available to the existing mortgage) and should benefit from central bank liquidity for holders to guarantee a secondary market for this asset. Lenders can make fees through ERL origination (to cover deep renovation processing costs), they will improve the creditworthiness of their clients, green their mortgage books and hence align their assets more quickly with the Paris Agreement.

Example:

If the deep renovation of an EU semi-detached home costs €20,000 and the zero-coupon interest rate was set at 1% (above EU borrowing costs), then the borrower would have to pay back around €27,000 (ex. distribution fees) in 30 years. It is hard to imagine, and inconsistent with the past, that the value increases due to that renovation investment and overall market trends would not cover this amount.

[3] Investopedia. (2021). *What Is a Zero-Coupon Mortgage?*. [Website]. Retrieved from https://www.investopedia.com/terms/z/zero-coupon-mortgage.asp

[4] The Economist. (2020). *Home ownership is in decline*. [Website]. Retrieved from https://www.economist.com/special-report/2020/01/16/home-ownership-is-in-decline

EU Renovation Loans are not a replacement for grants due to the vulnerable and energy poor. Nevertheless, there are insufficient grants to deliver the RW's 35 million renovations, and the attractive zero-coupon structure allows homeowners without savings and with tight budgets access to deep renovations. Grants and EU Renovation Loans are compatible instruments and when used in conjunction can address all the lesser able to pay segments of society.

CONCLUSIONS

Europe needs to accelerate energy savings in the face of the crisis triggered by the Ukraine crisis and can deploy energy efficiency finance through a new and nimble instrument that can be introduced in the REPowerEU action plan.

- **An EU Renovation Loan can resolve the renovation finance gap at the right scale:** At present, there are no banks in the EU offering a zero-coupon low cost deep renovation loan product. The EU Renovation Loan can guarantee homeowners cash savings immediately along with all of the other multiple benefits of a deep renovation, including resilience in the face of energy shortage and skyrocketing prices. The ERL's junior status and EU guarantee makes it accessible to all homeowners who demonstrate their home is not in negative equity. At EU borrowing rates the rolled-up interest cost is likely to be lower than the house price inflation over the next 30 years, and while not directly subsidised this will make ERLs attractive ways to bridge a generational and inequality gap for Europeans.

- **Retail banks can be more engaged to "green" their existing mortgage portfolios:** The existence of a bank distributed ERL that provided customers enhanced credit (positive cash from day 1) and that does not impact the expected payments nor recovery of the existing mortgage, and yet earns distribution fees is a very strong way to engage the millions of retail bank customers and deliver millions of deep renovations.

Picture courtesy of Marcus Lenk