

Climate-efficient mortgages – The ins and outs

Opportunities for greener property financing



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Key points at a glance

- Investments to improve the energy efficiency of properties must pay off more quickly to speed up the pace of renovation work and meet climate goals in the real estate sector. The emphasis here must be on the investment decision taken by property owners, supported by competent advice from their bank.
- Many banks are already heavily engaged in actively promoting energy efficiency and providing appropriate advice to their clients. However, a combination of different factors is needed to ensure the climate goals applicable to real estate are achieved: stronger financial incentives, professional client advice, a precise regulatory framework, improved data availability and a higher level of digitalisation.
- The Swiss Bankers Association (SBA) has identified four action areas where additional initiatives can be driven forward: more comprehensive client consulting, classification of climate-efficient mortgages, creating a suitable regulatory framework and maximising the potential of digitalisation.
- SBA members are committed to working with all relevant stakeholders in the action areas identified to deliver concrete results as swiftly as possible.

Introduction

Many different measures are needed if Switzerland is to meet its targets for reducing CO₂ emissions by 2050. The priority is to identify the areas offering the most leverage so the right measures can be implemented.

Buildings are one of Switzerland's biggest sources of greenhouse gas emissions – especially carbon dioxide (CO₂) – accounting for almost a third of the national total, just behind light road traffic (motor vehicles up to 3.5 tons). The average age of Swiss residences is around 45 years and, what's more, a large proportion of these homes were built before the Second World War. Two key factors significantly affect the carbon footprint of this building stock:

- First, their heating systems are still mainly powered by fossil fuels and their efficiency worsens with age. Today, about two thirds of buildings are still heated by fossil fuels or (which is equally problematic) directly by electricity.
- Second, the fabric of many buildings does not provide adequate protection against energy loss. Over a million homes urgently require upgrading to improve energy performance¹.

These two factors are the biggest source of CO₂ emissions from residential buildings and where suitable measures need to be concentrated. In some cases these emissions can already be drastically reduced by renovating the building fabric, upgrading heating systems and applying alternative new technologies. In terms of the overall energy profile, the energy supply can also be made more self-sufficient by installing independent power generation, such as a solar energy system.

Every year, only around one percent of Switzerland's buildings stock is currently being renovated to improve energy performance. According to current knowledge, this rate is not enough for Switzerland to

¹ See: Swiss Federal Office of Energy - Building Programme - Annual Report 2020 (German only)

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achieve its climate goals. Estimates show that, in this area alone, the renovation rate needs to be at least doubled through suitable measures, supported by a corresponding increase in capacity on both the financing and construction sides. The latter can partly be offset by the decrease in new construction, but also offers potential for market growth. The traditional argument that cutting ancillary costs creates sufficient incentive to raise energy efficiency does not therefore seem to have enough impact, partly because the polluter-pays principle is not fully applied to the carbon intensity of the various energy sources. In addition, the incentive for greater energy efficiency is lower for investment properties, especially compared with owner-occupied homes, as landlords pass on energy costs to tenants. All in all, it still takes too long for investments in energy efficiency to pay off financially. Action is needed to redress this “renovation backlog”.

Incentives therefore need to be created in the housing market so as to encourage a marked increase in the speed of renovation and thereby raise energy efficiency.

This paper presents current thinking in this area and highlights areas where the financial sector can contribute towards improving the energy efficiency of residential properties.

Considerations

Decisions to improve energy efficiency are taken by property owners, not by authorities, municipalities or banks. Relevant metrics and tangible, transparent incentives – including stimulus measures – are central to the decision-making process.

The main problem of greenhouse gas emissions is the difficulty in apportioning their negative effects based on the polluter-pays principle. Specifically, the price of CO₂ does not accurately reflect the environmental damage caused. If these greenhouse gas emissions had a “more accurate” price, the market would deliver the necessary emission reductions, but this is not happening at present. Until this obvious problem is addressed, additional measures can at best have a compensatory effect, but can also distort the market and push up costs due to complexity and bureaucracy. This threatens collateral damage in the medium to long term by reducing everyone’s standard of living, which might in turn wipe out the intended incentives. As far as the real estate market is concerned, this means that any measure on the “micro level” could simply evaporate unless similarly targeted measures are taken on the “macro level” at the same time, ideally by setting a fairer “polluter-pays” price for CO₂ and any other greenhouse gas emissions. Consistent implementation of the polluter-pays principle is thus an integral part of the solution. In addition, from a risk-return perspective it is true to say that global warming presents a risk to both property owners and their successors (extreme weather events), and their effects are only likely to increase. And finally, societal pressure will also reduce the appeal of buildings with a large carbon footprint.

While the revised CO₂ Act was narrowly rejected at federal level, numerous concrete measures are already being taken at cantonal level. Effective application of the subsidiarity principle, coordinated on a case-by-case basis by the Conference of Cantonal Energy Directors (EnDK), is thus already in a position to deliver concrete, tangible changes. These measures taken at cantonal level should be suitably complemented and strengthened by a corresponding, nationally coordinated effort on the financing side.

Another potential consideration involves ways of distinguishing between different categories of mortgages. In view of the longevity, attractiveness and also risk profile (intrinsic value) of real estate, an approach that prioritises prudent resource use, and above all energy efficiency, should pay off not only for property owners and tenants, but also for institutions providing financing, in the form of lower risks and

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higher valuations. An approach based on sustainability and longevity should have a positive impact on the long-term value of a property. Under such conditions, the market logic would ultimately ensure that borrowers taking this approach enjoy **more attractive financing terms**. In the current situation, however, the market is not always able to play its role, for a number of reasons. The aim should therefore be to follow concrete approaches and work with the authorities to define standards that create proper market incentives.

This immediately raises questions about **data availability** and the level of digitalisation, without which it would be impossible to produce a clear classification of buildings and their financing or to measure the success of each measure over time. Banks currently offer various mortgage products for climate-efficient buildings. In every instance, the conditions are set by the banks themselves. However, corresponding financing volumes and their measurable impacts are sometimes difficult to measure even at the level of individual institutions.

In the market as a whole there is a wealth of **certificates**, although they tend to differ considerably in terms of standard and relevance. Here there is a need for a certain amount of standardisation and comparability, especially regarding CO₂ emissions as the most relevant metric (i.e. CO₂/m²). A suitable data base is therefore needed that enables comparisons and other analyses to be performed. “Climate-efficient mortgages” must always have measurable impacts on a property’s greenhouse gas emissions, energy efficiency and also life expectancy. The building certificate of the cantons (GEAK) merits attention here. This is already mandatory in some cantons when properties change hands and also attracts financial subsidies in many places. The GEAK is relevant in that it assesses the quality of the building envelope and the overall energy efficiency of the building technology in a comprehensive and standardised manner.

While concrete areas of action are opening up – with the active participation of many banks and other market players – at the level of individual clients, banks and the community at large, none of these potential measures will be sufficient or can be implemented quickly enough unless concrete steps are taken to improve overall market conditions at the same time. Another overriding question is whether there might be a way to cover the real estate sector within the framework of CO₂ certificate trading in such a way that the market already differentiates prices accordingly. This is where policymakers need to actively step in, with the support of the banking sector and other relevant stakeholders.

One thing is key, however: the decision to invest in improving energy efficiency lies with the property owner, in other words the bank client. So this decision needs to be taken whilst ensuring that all relevant aspects – such as current and anticipated incentives (for example existing subsidies, potential interest rate advantage, effect on the property’s intrinsic value, lower ancillary costs, etc.) – are made transparent and fully explained to the client. As far as the bank is concerned, the focus must be on interaction with the client and competent advice. While all the other elements must complement each other seamlessly, the crucial point is the interaction between the client and the bank providing the financing.

The following section outlines possible measures on the political level (“macro measures”) as well as the level of the banking sector (“micro measures”). Relevant action areas are then derived from these measures.

Possible measures

All measures must help to ensure that investments in energy efficiency pay off sooner. For clients to reach a decision, there must be a clear discussion between them and the bank.

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Macro measures: potential measures on the political level (federation, cantons and/or local authorities)

- The long-term goal must always be to set the price for CO₂ emissions to reflect the polluter-pays principle more closely. This will encourage more climate-friendly conduct in the marketplace. As far as the residential property market is concerned, this affects financing decisions for energy efficiency, but also covers other aspects such as “grey energy” (in other words, emissions while constructing a building or generating the energy source). Comprehensive coverage by means of CO₂ certificates would be a good way to develop compensation and price differentiation with a corresponding incentive effect without having to rely on complex, detailed regulations.
- As is the case with extremely damaging chlorofluorocarbons (CFCs), it may be appropriate also to consider specific **requirements** (obligation to provide reasons, or bans), while at the same time allowing a transition phase. These requirements could apply to heavily polluting heating systems, such as a ban on those older than X years and powered by fossil fuels with excessive emissions. It makes sense, however, to combine such bans with incentives to encourage upgrading.
- Specific **standards** to be set for new buildings (wherever possible no fossil fuels, or a net zero target for emissions from day one, for example).
- Encourage property owners to invest and renovate more by means of financial **incentives**, such as targeted subsidies, expansion of the nationwide campaign to improve the energy efficiency of buildings (“Gebäudeprogramm”), guarantee models for additional debt, interest subsidies for “refurbishment loans” and tax benefits for measures to enhance or maintain energy efficiency.
- Review and streamline the **building law framework**, especially the **permit system** (e.g. obligation to notify instead of obligation to obtain a permit for bore holes for geothermal heat pumps).
- Widespread use and **financial incentivisation** of (energy) **certificates**, such as GEAK.
- **Reduce subsidies** for activities that harm the climate.
- **Standardisation and digitalisation measures** (e.g. building permits, land registry offices, building & housing registers, GEAK use, building requirements, subsidies, etc.) to improve the transparency, measurability and accuracy of the measures and create a basis for efficient reporting along the entire value chain. Efficient and low-cost access to central databases holding relevant data of sufficient quality is equally important. A bloated certification system, on the other hand, must be avoided. By contrast, an electronic “building ID” seems to be an effective use of digitalisation to create the conditions for measurability and eco-efficient conduct.
- **A regulatory framework** to encourage eco-friendly conduct, for example by means of minimum standards for green buildings (e.g. for repayments) or crediting investments towards a property’s market value.

Micro measures: potential measures at the level of bank branch/entire bank/individual loans

- **Classification** of buildings and mortgages according to their eco-efficiency and based on an industry standard with defined criteria and key indicators (e.g. heating type, estimated CO₂/m²): this would offer clients greater transparency regarding the energy performance and improvement potential of their property. At the same time, an individual branch can further refine its risk management and also document its progress in the area of sustainability in a more transparent way. The classification system must allow for differences in the initial energy status of new and old buildings. While the emphasis for new buildings is likely to be on clear minimum construction standards, the focus for old buildings will be on the amount of CO₂ emissions saved through renovation.

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- Development of an industry-wide, standardised **database** as a precondition for classification, assessment and reporting: all relevant stakeholders must also receive access (at reasonable terms) to the respective public and private data sources and also be able to interpret the data supplied in a uniform way.
- **An overall regulatory framework** creates potential for cheaper loans, i.e. targeted risk-taking (for example through higher loan-to-value ratios or relevant add-on services).
- **Reporting** (e.g. a bank's overall portfolio of single dwellings) along an established criteria matrix as soon as the database is available.
- Processing of **additional securities** (e.g. guarantees that result in lower interest rates).
- **Advisory process** to be specified, including the systematic inclusion of available incentives depending on the building location and other factors.
- **Individual offers** according to the marketing and climate strategy of the bank providing the loan.
- Promoting the **capital market eligibility** of climate-efficient mortgages, for example, by allowing covered bond issues to be graded according to climate efficiency.
- **Cooperation with the real economy** for launching new combined products/offering such as leasing of solar energy systems.

Conclusion

All relevant stakeholders – in other words, policymakers, the community at large, authorities, banks and other players – must become actively involved so that CO₂ reduction targets can be reached in house building and **investments in climate efficiency pay off more quickly**. In addition, certain measures must be tackled in a coordinated manner while others can (or must) be taken independently by individual stakeholders based on free competition and the principle of subsidiarity. Ultimately, however, the decision to improve energy efficiency always rests with the property owner, or client, and the focus must be on this decision.

Banks can – and should – concentrate their activities on those measures and areas that are in their immediate sphere of influence, have a measurable effect on client behaviour, do not undermine their competitiveness and provide a balanced cost/benefit ratio. Based on these premises, the SBA wants to develop – in some cases through collaboration with all other relevant players – solutions in the following action areas:

- Action area 1 – Expand the current client advisory service for planning and financing renovation work, including the training of staff and networking with specialised service providers, such as cantonal energy experts.
- Action area 2 – Develop a system for classifying climate-friendly mortgages:
 - Establish the required database; incorporate and improve the comparability of existing certificates (including GEAK).
 - Create efficient and low-cost access to central databases and third-party data sources (e.g. building & housing register) for all market players.
 - Work with private providers of valuation models to establish how energy efficiency can be given more deliberate and long-term consideration when assessing properties.

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- Action area 3 – Liaise with authorities and policymakers to create better framework conditions (e.g. CO2 certificates and/or copy the EU in accounting for value-added through energy investments²) and remove any existing regulatory hurdles.
- Action area 4 – Cooperate with the authorities to discuss and exploit digitalisation possibilities in the building sector (e.g. a “building ID”).

We in the banking sector are committed to developing self-regulation for financial advice (action area 1) and working with the authorities to establish the necessary conditions for classifying mortgages according to efficiency criteria (action area 2). This differentiation will allow banks to document their progress in improving resource efficiency and to publicly report this in a transparent way once the framework conditions for this are in place (action area 3).

At the same time, we are ready to work with the real economy, policymakers, the authorities and other relevant stakeholders to explore potential opportunities for digitalisation (action area 4).

Finally, we believe an overriding concept is needed that pulls together the private-sector initiatives of the various interest groups along the “renovation value chain” to produce a consistent overall strategy. This must also give due consideration to political solutions on the macro level. We are ready to develop and implement such a concept in collaboration with all the relevant stakeholders.

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² See “Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor”, page 120: “Modifications made to the property that improve the energy efficiency of the building or housing unit shall be considered as unequivocally increasing its value.”