



**Shawbrook
Bank**

Confronting the EPC Challenge

White Paper

**Property
Finance.**



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Research Methodology

Shawbrook Bank contracted Opinium to undertake research between 18th and 25th November 2021 to understand landlords' awareness of the upcoming changes to the Energy Performance Certification (EPC), which will require properties to be rated 'C' or above by 2025 in order to begin a new tenancy. A total 1,000 UK landlords were surveyed.

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Foreword.



The property market has experienced remarkable change in recent years. From the growth of second home ownership and the Buy-to-Let market following the UK's staycation boom, through to incentives and schemes from successive governments for first-time buyers such as Help to Buy, Shared Ownership and the Lifetime ISA.

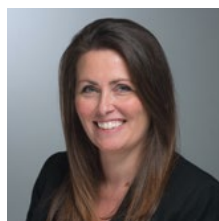
Perhaps in the more immediate memory, the market experienced a near total shutdown following the first national lockdown in March 2020. The pendulum then swung in the other direction and what followed was one of the busiest ever periods for the market, in part thanks to the Stamp Duty Holiday introduced by Chancellor Rishi Sunak to stimulate activity up and down the chain. Possibly more effective than the government could have ever imagined, the market has enjoyed a sustained period of record growth in both house prices and transaction levels as buyers have been forced to compete and pay a premium for quality stock after a period of reticence that stemmed back even further than the pandemic.

Throughout these peaks and troughs of activity, landlords have remained steadfast despite also having to manoeuvre through significant changes to tax relief. This naturally led to a small percentage of landlords leaving the market, though fortunately a significant number have remained and continue to play an important role within the Private Rented Sector (PRS).

The next challenge presented to landlords, and the wider market, is closely tied to the increasingly important Green Agenda, and the overarching manifesto pledge from the government to tackle climate change and cut carbon emissions to zero by 2050. In short, it has been proposed that landlords will be required to carry out improvement works across their current and future properties to ensure all reach an Energy Efficiency rating of 'C' or above - by 2025 for all newly rented properties and 2028 for all rental properties. These proposals that

will for now only impact the Private Rented Sector are a clear indicator of the future direction of travel for the market. We welcome the legislative changes and the opportunity this will provide for the property market to play a key role in the UK's green revolution. However, we believe more must be done between now and 2025 to support and guide landlords through the process. The market is responding with a strong commitment to meet the deadline, despite questions still remaining unanswered. The reality is that a failure from landlords to make changes, and from legislators to offer clarity on what needs to be done, could see landlords unable to begin new tenancies on their properties, with a significantly detrimental impact on their income stream.

There is also a significant risk for tenants if landlords are unable to make the necessary changes and therefore are forced to exit from the market. With a depleting supply of available quality housing on the market already, there simply may come a point where tenants are forced to look elsewhere for viable housing.



Emma Cox
Sales Director at
Shawbrook Bank

Introduction

In 2015 the government introduced the Minimum Energy Efficiency Standard (MEES) that requires landlords to reach an Energy Performance Certificate (EPC) rating of C or above. Under the proposed changes, by 2025 all newly rented properties will need to have reached this target. This will be extended to all rental properties by 2028.

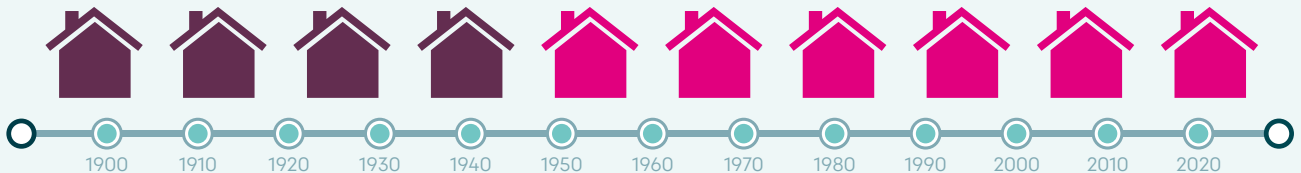
However, such an ambitious target could pose a series of challenges to the market. It's worth considering the significant proportion of housing stock across the UK that was built before 1940 and therefore unlikely to be rated C or above. The proposed changes to rules will not only affect a substantial number of landlords already in the market but could also come to affect future landlords whose property choice may evolve as a consequence. Carrying out work in the short term will take both time and money, especially for those with significant portfolios or particularly old properties. There is a real concern that some landlords will struggle to meet the deadline and could be left with properties that are not just unrentable but also run the risk of becoming unmortgageable.

This white paper explores the current EPC challenge and investigates how knowledgeable landlords are on the proposed changes, their plans for the future, and the support they need from government and the wider industry to carry out the level of work that may be required. We consulted with landlords to get a clear picture across the UK of what they already know about the legislative changes, what work they think will be needed prior to the deadline, the estimated cost, the impact any work will have on tenants and what more they would like to see in terms of support.

Part One: How big is the problem?

36%

More than a third of current properties within the PRS were built before 1940.






4 in 10

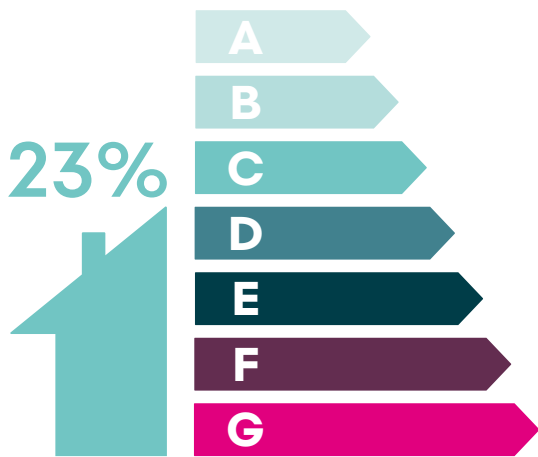
Regionally, four in ten landlords said that their properties in London were built prior to 1940, with a similar picture in the South West, Scotland and Wales.



Most common house type: Regional view

The most common house type across the UK was built between the 1950s and 1990s. These properties were the most common in eight out of the twelve regions in the UK, including the South East and the East of England. By comparison, properties built since the 2000s were most common in London and the West Midlands, and those built in the 1940s or before were found to be in Northern Ireland and the North East of England.

-  1940s and before
-  1950s – 1990s
-  Since 2000



Close to a quarter of landlords admitted that their properties are rated D or below for energy efficiency, and therefore they will not be able to begin a new tenancy by 2025 without actively making improvements.



Victorian properties, particularly common in cities such as Bath and London, make up

13%

in the PRS according to landlords.

Perhaps unsurprisingly, older homes were found more likely to have a poor EPC rating, with 30% of landlords with Victorian properties stating that their property is rated D or below.



A quarter of landlords don't know the current energy efficiency rating of their property



Older homes may also prove to be more difficult or complex to renovate with any work often required to match the style of the property or original technique. Properties with thatched roofs or sash windows for example can be expensive to update but will also require more specialist labourers to do so. The greater the work required, and time it takes, all adds to the final bill for landlords. With historical, period properties at risk of falling out of favour amongst landlords who need to guarantee yields, the wider market could see these, and particularly Grade listed properties, disappear from the PRS.

In addition to the already high number of properties that landlords know to be rated D or below, a further quarter (27%) of landlords don't currently know the rating of their property and therefore may be unaware of the level of work needed.

With such a significant proportion of properties expected to need improvement, landlords could be left exposed to void periods or falling income if they don't take the necessary steps towards improving their properties now.



Part Two: The knowledge gap

With the proposed legislative changes expected to have a significant impact on all corners of the property market, a lack of awareness from landlords will prove challenging for the wider industry in the short and medium term.

One in seven (15%) private landlords admit that they are unaware of the proposed EPC changes and 2025 deadline.

Moreover, a quarter (26%) of landlords said they had little to no knowledge of the changes, with long-term landlords - those who have been renting out properties for more than 10 years - the least likely to know details around the change.

Shawbrook Bank viewpoint:

“The considerable proportion of landlords not fully understanding the impact that the EPC changes will have on them, and their business model, suggests a greater issue. An element of this could be how the message has filtered down to landlords. It is also likely that the message may not yet have filtered into conversations between landlords and their mortgage broker/lender. Moving forward, it is paramount that our industry is speaking to clients on a regular basis to help them to start thinking about what steps they need to take.”

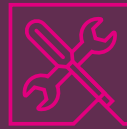
Even if we take the impending proposed deadline out of the equation, when asked about the current energy efficiency rating of their property, 27% of landlords admitted to not knowing. In some cases, landlords with more than one property said they only knew the current energy efficiency rating for a few of their rental properties, or not all. As a consequence, a quarter (25%) of landlords don't know if, or what level, of work will be needed in order for their properties to meet the minimum 'C' rating.



Nearly half (47%) of landlords would like to see guidance around what the proposed EPC legislation will mean for them, specifically, understanding what it means in practice and where they should start.



37% of landlords would like to see the wider industry introduce incentives such as favourable borrowing rates in order to help them on the journey to make the necessary changes ahead of the proposed 2025 deadline.



29% of landlords want suppliers who can help them meet the new minimum rating to be signposted to them.



For more than a third (34%) of landlords, guidance on timings and how to phase the implementation of changes is crucial. With such a tight deadline, taking steps quickly could be the difference for some landlords in making or losing rental income.



29% of landlords feel they would benefit from guidance on how to communicate to tenants what work is being carried out and how to best manage the improvement process.



One in five (21%) landlords would like a space for them to be able to discuss shared problems and shared solutions, working together to make changes and improve housing stock efficiently.



Part Three: The cost of the challenge

Landlords who are required to make improvements to their property estimate it will cost £5,900, on average. However, amid the surge in the cost of both labour and materials alongside an expected spike in demand as other landlords update their properties at the same time, this figure could be largely under-estimated.

In addition, it's worth noting that 22% of landlords say they have no idea how much updating their properties would cost. Landlords with fewer than three properties are the most likely to be unsure about the final bill for any work required.

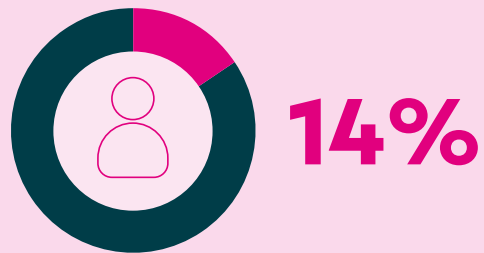
We are already seeing proactive landlords taking steps to improve their properties. To date, landlords have spent an average of £8,900 updating their properties – nearly 50% more than landlords expect they will need to spend. This discrepancy could result in landlords not having the necessary funds in place to complete the works required to achieve the EPC level required.



When asked if they have the necessary funds available to pay for any required energy efficiency changes



Of landlords said they would only just have enough.



Don't have access to the funds.



Simply don't know.

Market Insight: Peter Foulds, Director of Risk Management at Appraisers UK, comments:

"The picture remains an uncertain one for landlords and property investors in light of the proposed changes to EPC ratings. In the most extreme of cases where properties will simply never reach a rating of C or above, it's not yet clear what course of action the landlords should adopt. What is needed is further guidance from the government, so the wider property industry can prepare for these changes.

There is also a challenge with older EPC certificates awarded to currently tenanted properties. Historically EPC certificates have not been as accurate as they will need to be under the new proposals. Prior to these proposed changes, there was no clear link with the value of a property and more stringent modelling will be needed from the market if Energy Efficiency is set to be a defining part of whether a property can be let. In terms of cost, a poor EPC rating in the longer term will undeniably impact a property's value and could potentially restrict the supply of rented accommodation even further, with rents rising exponentially."

Our Changing Face of Buy-to-Let report found that 19% of landlords are currently funding refurbishments with credit cards or short-term finance products¹. In addition, 60% are utilising their personal savings or investments to pay for a refurbishment.

Both options come with financial risk, from depleting crucial savings to the high interest rates associated with unsecured short-term finance products. An effective alternative could be a bridging loan, providing landlords with access to short-term capital to make updates or changes quickly, without the need to re-mortgage or use their own savings.

1. Shawbrook Bank contracted Opinium to undertake research between 26th May and 3rd June 2021 to ascertain landlord and tenant viewpoints. A total of 1,000 landlords, including 150 portfolio landlords, and 1,000 private tenants were surveyed on their property portfolio and rental situation respectively.



Case Study

EPC Improvements in Action:



Working closely with broker partner, Monarch Financial Services, Shawbrook Bank has supported a client with a £400,000 light refurbishment bridging loan, in order to improve the EPC rating of the property. The client was originally looking to purchase a flat in a prime location in Manchester via a Buy-to-Let Mortgage with the aim of letting the property. However, due to the property's poor EPC rating of F they were unable to obtain the necessary mortgage. With the previous owner of the property unwilling to carry out the works to improve the rating, the client was at risk of losing the property. Shawbrook Bank was able to offer the client a first charge bridging loan which enabled them to purchase the property and carry out the necessary works to make the property mortgageable. Once the work has been completed and the EPC rating improved, the customer will be able to move onto a Buy-to-Let mortgage as planned.



While the cost of renovations may be the most immediate issue for landlords, it isn't the only one. Two fifths (42%) of landlords said that their tenants would need to vacate the property while improvements were made. Concerningly, 38% of landlords said their tenants would need to leave for up to four weeks but in more extreme cases, landlords believed that works could take up to four months to complete.

Those with older properties were most likely to say the improvements would take longer, with landlords owning Victorian era properties predicting that renovations would take more than five months.

On average, landlords expect they need to start making changes to their rental property within the next 14 months in order to improve its energy efficiency rating ahead of the currently proposed 2025 deadline. At the more extreme end of the spectrum,

Shawbrook Bank viewpoint:

“Brokers have a unique opportunity to work with both lenders and landlords to support the improvement of the UK's overall housing stock. Regular communication with landlords, particularly those with complex or large portfolios; which may provide significant challenges, will be invaluable for both parties at such an unchartered moment for the market.”



7% of landlords say they will need to start their improvement works in the next three to six months in order to have all work completed by 2025.

On top of having to pay for the work to be carried out, it is estimated that this would see landlords sacrifice on average £5k in rental income for the period that tenants were unable to stay in the property. This combined with the expected £5.9k cost of carrying out the work means that landlords expect to spend more than £10k in order to ensure they can continue to let their property out.

Part Four:

Implications for wider market

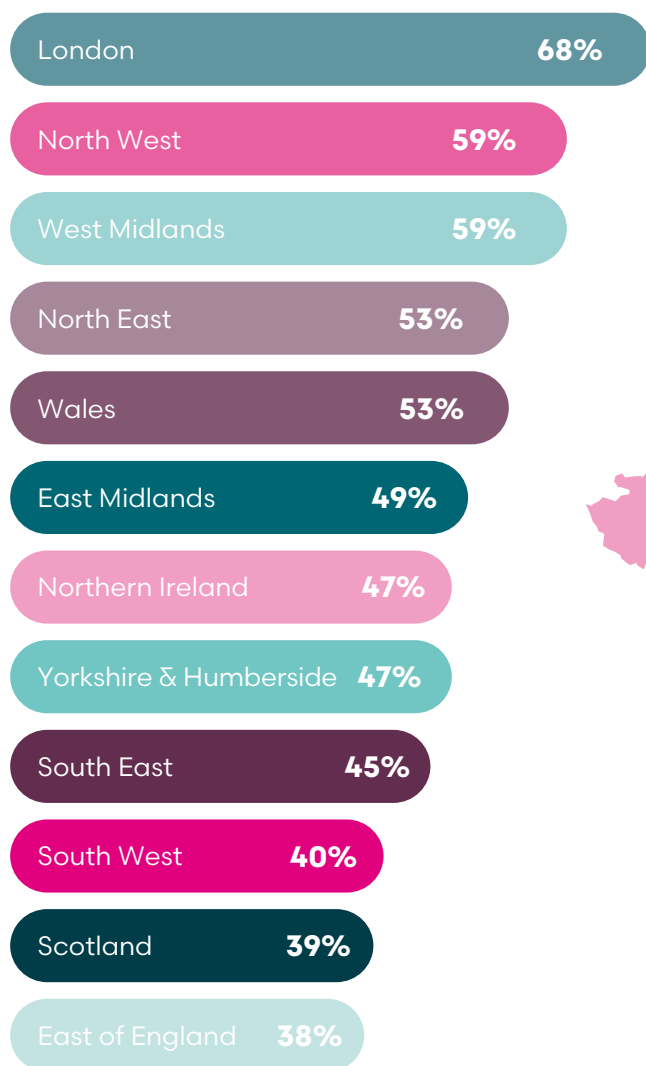
The changes to EPC rules could have an impact on tenants as landlords consider how to fund the improvements. Some might see their rent rise as landlords contemplate passing on the cost of improving their properties' energy efficiency rating directly onto their tenants.

More than half of landlords said they will pass at least some of the costs onto their tenant, with fewer than a quarter (23%) saying they would not pass the cost on at all.

Tenants in London, where average rents are £1,589 per month are most likely to see costs passed onto them by their landlords. In total, 68% of landlords in London said they would pass at least some of the costs on to their tenant. Overall, the research found that those who have been a landlord for between 11 and 15 years are the most likely to pass all the costs onto their tenants.

Landlords in London were most likely to pass at least some of the costs onto their tenant.

Most Likely



Least Likely



Looking ahead to when the works have been completed, 18% of landlords expect rents to naturally rise due to the improved EPC rating. This is because tenants can expect lower energy bills, with these properties being more likely to have a range of energy-efficient features as standard including: better insulation, energy-saving appliances, heating controls, high-performance windows and LED lightbulbs.

The proposed EPC changes are also expected to impact landlord buying decisions when adding to portfolios. A quarter (25%) of landlords said that they will now avoid buying a property with a low energy efficiency rating. A further 30% said they would be inclined to buy a property which already holds a rating of C, avoiding having to carry out immediate works to guarantee rental income. 24% of landlords would be more likely to prioritise buying a property with the potential to reach a C or above. Perhaps more surprisingly, more than one in 10 landlords (15%), admitted that they will now only buy properties that have been built in the last twenty years, with the hope that newer properties will have better EPC ratings from the outset.

Landlords will change buying habits as a direct result of new legislation

15%

of landlords will now only buy properties that have been built in the last twenty years

24%

of landlords will prioritise buying a property with the potential to reach a rating of C or above

30%

of landlords would be inclined to buy a property which already holds a C rating

25%

of landlords will avoid buying a property with a low energy efficiency rating



With just 30% of current properties in the PRS built since 2000, a change in the buying habits of landlords pose an issue for the UK's housing market. Such a shift in approach from landlords underlines just how substantial the EPC requirement is and the huge implication it could have on the PRS.

With older properties falling out of favour this could leave current owners unable to sell their properties without making the necessary improvements themselves.

It won't be possible for landlords to ignore this drive towards improving the overall quality and energy efficiency of current housing stock.

And while the directive is coming from the UK government at this stage, 28% of landlords admit that tenants have complained at least once about the property's EPC rating.



16% have had complaints from tenants on multiple occasions. Tenants do have the opportunity to be drivers of change in this scenario, a notable 61% of landlords said they would be more likely to make updates to their property if their tenants requested it and 25% said they would be strongly inclined to make the necessary updates, if their tenant requested it.

A quarter of landlords would be strongly inclined to make the necessary updates to a property, if their tenant requested it



In cases where a significant level of work is required, lenders may decide to pull back from properties with a poor EPC rating. With landlords unable to rent their properties, without making improvements, but unable to access the finance they need, we could see a proportion of landlords being left with low quality stock that they can't rent, sell or improve.

Shawbrook Bank viewpoint:

"Despite our research pointing to a lack of knowledge about the legislation more generally, it's important for landlords to know that there is support and advice available. Lenders are able to provide a wealth of knowledge and understanding about what the changes will mean for individual landlords and their properties. Lenders and brokers can also help landlords to demystify the costs associated with carrying out the work and how best they can access finance. The **Gov.uk website** is also a useful preliminary resource for landlords who may currently be unsure about the Energy Efficiency rating of their property and the level of improvement work that will be required. From a wider market perspective, we are already seeing incentives emerge onto the market from some lenders, we expect this will only grow as we move closer towards the 2025 deadline."



Conclusion

It's clear from our research that the next three years ahead of the proposed 2025 deadline will be a challenging period for landlords and the wider Private Rented Sector. We've identified a clear lack of knowledge and understanding over how these proposed EPC changes will impact landlords individually and how much the necessary works will cost to carry out.

Our industry needs to prioritise support for landlords to help them make improvements as soon as possible. If there are situations where access to the necessary financing is causing a delay, it's important that lenders and brokers work together to come to practical and effective solutions. Technology and innovation have a key role to play and will allow brokers and lenders to quickly and effectively inform landlords on how they can best finance the works. While in the longer term we expect to see a greater range of incentives and green mortgage products entering the market, for now short-term bridging could provide a viable alternative for landlords looking to make the first move.

There are also landlords with a significant number of period properties who may be faced with homes that are never able to reach an EPC rating of 'C' or above. We cannot simply write off this housing stock – especially when the market is already experiencing a severe supply shortage.

Another key learning is the desire from landlords to have access to an external working group, giving them the space to discuss the legislation and their situation with lenders, brokers and other landlords. A place to share knowledge and recommendations to help carry out the necessary work, which will help landlords understand that they are not facing this challenge alone. In response to this finding, Shawbrook Bank are committed to establishing an External Working Group in 2022, creating an open environment for key voices within the industry to come together and agree solutions to one of the proposed biggest overhauls in legislation the market has seen in recent years.

