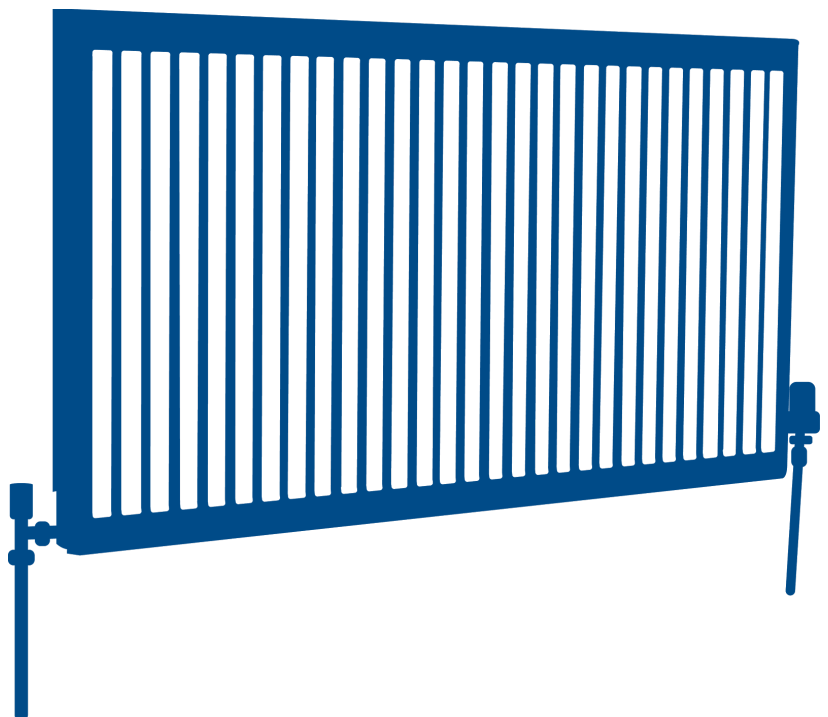


# Effective energy efficiency standards for private renters



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## Key points

More and more people are renting their home in the private sector. Many are paying a high price to live in homes which are inefficient, cold and expensive to heat. There is little business incentive for landlords to improve energy efficiency.

In its Clean Growth Strategy, the government committed to tackling this issue. The strategy recognises that the current policy aimed at improving the worst performing private rented properties will fall short. It announced a plan to make it more effective.

We commissioned economic research to assess the impact of such a move. Specifically we looked at a policy requiring landlords to pay for measures, with a cost cap to exempt properties where the costs are particularly high. We looked at three typical properties, covering different regions and types of property, and three different cost cap scenarios.

Our research shows a more effective minimum standard would bring a substantial net benefit to tenants, by reducing their energy costs, and because the impacts on the rental market would be limited.

Based on the findings, **we recommend that the government bring in a minimum energy efficiency standard, with a £5000 cost cap.**

## High prices and low quality for tenants

From the Housing Act 2016<sup>1</sup> to the 2017 election campaign, the private rented sector (PRS) is increasingly in the policy spotlight. This trend seems set to continue.

The number of people renting privately has more than doubled since 2000, and continues to grow. The increasing unaffordability of home ownership, mean more and more people are renting for the long-term<sup>2</sup>. The sector increasingly includes families with children. They made up 36% of renting households in 2015-16, up from 30% in 2005-06<sup>3</sup>.

As demand increases, so do rents. This squeezes the disposable income of struggling households. According to government analysis, the average couple renting privately spends about half their salary on rent<sup>4</sup>.

Despite high costs, the condition of rented homes is often poor. According to the English Housing Survey, in 2015-16, nearly a third of PRS properties were not classed as a decent home<sup>5</sup>. Over a sixth contained a serious health and safety hazard<sup>6</sup>. From renting out these unsafe properties alone, landlords bring in around £4.2 billion a year<sup>7</sup>.

It is hard for tenants to get their problems solved. 40% of renters we surveyed avoided asking for repairs because they worried about how their landlord would react<sup>8</sup>.

It is not surprising that politicians are looking to do more to fix this market.

## Cold homes in the private rented sector

The incentives on landlords, and the needs of tenants are mismatched when it comes to improving the energy efficiency of a privately rented home. Whilst the tenant typically pays the energy bill, the landlord is responsible for how energy efficient the property is. This is determined by what heating it has and whether or not it has insulation. The less efficient a property is, the higher the energy bills will be.

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<sup>1</sup> [Housing and Planning Act](#), May 2016

<sup>2</sup> Citizens Advice, [A state of disrepair: Why renters deserve a better deal](#), February 2017; [A nation of renters](#), May 2015

<sup>3</sup> DCLG, [English Housing Survey 2015-16](#), February 2017. .

<sup>4</sup> Citizens Advice, [A state of disrepair: Why renters deserve a better deal](#), February 2017.

<sup>5</sup> 28%. DCLG, [English Housing Survey 2015-16](#), February 2017.

<sup>6</sup> Known as a Category 1 Hazard in the Housing Health and Safety Standard Rating System (HHSRS) used by local councils. See Shelter, [Health and safety standards for rented homes \(HHSRS\)](#), January 2016

<sup>7</sup> 17% of the total. Citizens Advice, [Paying a high price for a faulty product?](#), December 2016.

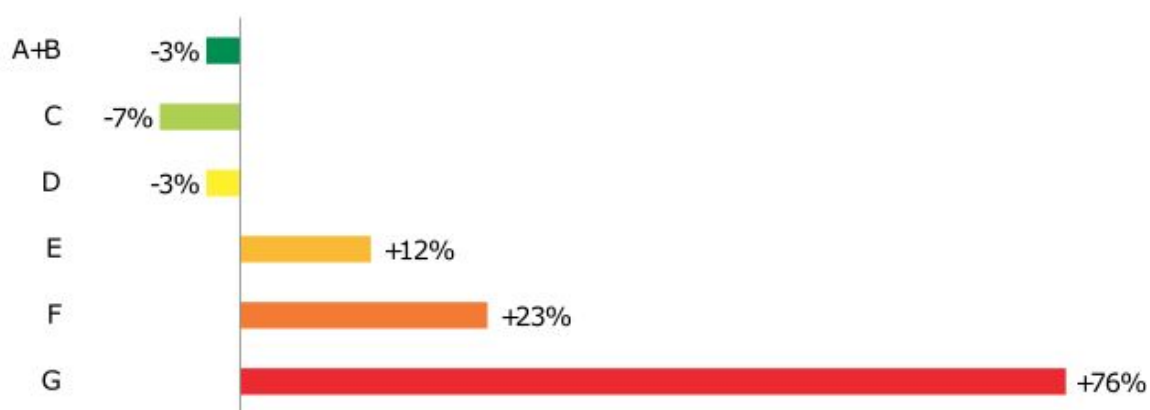
<sup>8</sup> Citizens Advice, [A state of disrepair: Why renters deserve a better deal](#), February 2017.

There is little evidence that tenants consider energy performance ratings when deciding where to rent, so there is little impetus for landlords to improve energy performance<sup>9</sup>.

The story is different in social housing, which benefited from minimum standards and investment<sup>10</sup>. Energy performance in that sector has gradually increased and social tenants tend to benefit from living in homes with better energy ratings than owner occupiers, as well as private tenants.

The result is that, compared to those who own their home or rent in social housing, the private rented sector has relatively more properties with the lowest energy efficiency ratings and fewer with higher energy efficiency ratings.

**Figure 1: The proportion of PRS properties in each energy efficiency band, compared to the general population.**



Source: English Housing Survey 2015-16<sup>11</sup>

In turn, private renters are more likely to be in fuel poverty and unable to heat their home adequately<sup>12</sup>. Renters in G rated properties have to spend around twice as much as the average household to reach the same level of warmth<sup>13</sup>. Households in fuel poverty end up either paying so much for their energy bills they are pushed into poverty, or living in a cold home.

<sup>9</sup> Link to Frontier report

<sup>10</sup> Notably the Decent Homes Standard. Department of Communities and Local Government, [A Decent Home: Definition and guidance for implementation](#), June 2006

<sup>11</sup> DCLG, [English Housing Survey 2015 to 2016: private rented sector](#), July 2017

<sup>12</sup> In England, Fuel poverty is measured using the Low Income High Costs indicator, which considers a household to be fuel poor if: they have required fuel costs that are above average (the national median level); and were they to spend that amount, they would be left with a residual income below the official poverty line. See BEIS, [Annual Fuel Poverty Statistics Report 2017 \(2015 data\)](#), June 2017

<sup>13</sup> An estimated £2,600 annually, compared to £1,210. Citizens Advice, [Private renters in poor quality homes face £1,000 higher costs to heat their homes](#) (press release), October 2016

21% of private rented households in England are living in fuel poverty, compared to 11% of all households. They in also tend have a higher fuel poverty gap. This is the extra annual income required to adequately heat their home. For private tenants in fuel poverty the average gap is £410<sup>14</sup>.

The very lowest energy efficiency ratings, F and G, are home to around 750,000 tenants live in homes<sup>15</sup>.

- They are twice as likely to experience damp and mould:
- Half a million have no central heating
- Nearly two thirds have no wall insulation
- Less than half have modern condensing boilers, which have been mandatory for any new or replacement installations since 2005.

Many F and G-rated homes are classed as a serious health and safety hazard, because of the risk of dangerously cold temperatures. Every year these homes bring in around £2.9 billion in rent for landlords<sup>16</sup>.

According the Fuel Poverty Committee<sup>17</sup>, because of the lack of other incentives, regulation of the private rented sector is essential to delivering the fuel poverty target for England. This target is to make as many homes as is reasonably practicable reach a minimum by Band C, by 2030, with interim milestones of Band E by 2020 and Band D by 2025.

Improving the energy efficiency of rental properties would give tenants a financial boost, reducing energy bills which are often a household's biggest utility bill. It would also make tenants healthier and happier. There is a well-established link between cold homes and physical and mental health<sup>18</sup>.

The poor efficiency of these properties is not just a problem for those paying the bills. The Committee on Climate Change has shown that a 'comprehensive policy package to improve efficiency of existing buildings' is required to meet our climate targets<sup>19</sup>. Minimum standards in the private rented sector are a key

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<sup>14</sup> BEIS, [Annual Fuel Poverty Statistics Report 2017 \(2015 data\)](#), June 2017.

<sup>15</sup> Around 300,000 properties. Citizens Advice, [Private renters in poor quality homes face £1,000 higher costs to heat their homes](#) (press release), October 2016.

<sup>16</sup> Citizens Advice calculates the average rent in band F and G properties to be 2.5% lower than the average in the private rented sector, giving an estimate of £174 per week. Citizens Advice, [Private renters in poor quality homes face £1,000 higher costs to heat their homes](#) (press release), October 2016

<sup>17</sup> Committee on Fuel Poverty [CFP report on initial positions](#), September 2016

<sup>18</sup> See for example: Building Research Establishment, [The cost of poor housing to the NHS](#), 2011 and Age UK, [Reducing fuel poverty – a scourge for older people](#), 2014

<sup>19</sup> Committee on Climate Change, [2017 Report to Parliament – Meeting Carbon Budgets: Closing the policy gap](#), June 2017,

component of this<sup>20</sup>, and any shortfall in this area is likely to be picked up by more expensive carbon policies elsewhere.

## More effective regulation is needed

The Energy Act 2011 made it a legal requirement for landlords to bring rented properties up to an E rating, from 2018<sup>21</sup>. However, landlords only have to comply if work can be funded through either the Green Deal or the Energy Company Obligation (ECO) energy schemes. Neither scheme has worked as originally planned and neither is on course to deliver the regulation.

ECO is a subsidy scheme where energy companies have to meet targets for energy efficiency installations. It is ultimately paid for by consumers, through their energy bills. Under ECO, spending is determined by how energy companies decide to meet their targets. The scheme has shrunk in recent years, and it does not guarantee any support for rental properties<sup>22</sup>.

The Green Deal is a loan scheme paid for through a charge on energy bills. In rental properties this would generally be paid for by tenants. It had far narrower appeal than planned, and was mothballed before last year was sold by the government to a private finance company. On top of this, growing concerns about rental conditions, have made the idea of tenants paying for improvements to the landlord's property increasingly unattractive.

The good news is that the government is aware of this gap and planning to take action. In its recent Clean Growth Strategy, the government set out its intention to make the existing private rented sector energy efficiency regulations more effective<sup>23</sup>.

The clearest way to do this is to move to a cost-cap approach. This would require landlords to make the improvements, except for a small proportion of properties where the costs are particularly high. The approach has been supported by the Committee on Fuel Poverty, the government's advisory group. It suggests a £5000 cost cap<sup>24</sup>.

Making the current regulations more effective is not just important for the F and G rated homes that it targets, but because it is the foundation for further action in the future. The Clean Growth Strategy sets out an aim to upgrade all private

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<sup>20</sup> Committee on Climate Change, [Meeting Carbon Budgets - Progress in reducing the UK's emissions 2015 Report to Parliament Committee on Climate Change](#), June 2015

<sup>21</sup> The requirement for minimum energy efficiency standards in private rented properties by 2018 was introduced in the 2011 Energy Act and is implemented through the Private Rented Sector Energy Efficiency Regulations (Domestic), a statutory instrument introduced in 2015. This is to apply from 2018 for new tenancies and 2020 for existing tenancies.

<sup>22</sup> See the Citizens Advice, [Response to the Help to Heat consultation](#), August 2016

<sup>23</sup> BEIS, [Clean Growth Strategy](#), October 2017

<sup>24</sup> Committee on Fuel Poverty [CFP report on initial positions](#), September 2016

rented homes EPC Band C by 2030, where practical and cost-effective. This move is necessary to meet our carbon and fuel poverty targets. But it will only deliver if the standards put in place will deliver.

## What we asked

Citizens Advice wanted to understand the impact this policy change might have. This prompted several questions:

- Would landlords respond to the regulation by putting up rents? Would this have an impact on the supply of properties?
- How will the anticipated consumer benefits in terms of reduced cost and increased warmth weigh up against these impacts?
- How will these impacts vary across different house types and regions?

We asked Frontier Economics, an economic research consultancy, to analyse the potential impacts. They modelled three different archetype properties, covering a representative spread of regional and property characteristics.



## The benefits for tenants

The research found in all cases a minimum standard would bring a substantial net benefit to tenants<sup>25</sup>.

The following chart shows how the average household in each property type will benefit. The expected benefits are higher for tenants in the worst properties (Band G) despite, on average, the higher cost of works. The lighter bars represents the variation between the low and high benefit estimates from the research.

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<sup>25</sup> Frontier Economics - report for Citizens advice, [The Impact of Minimum Energy Efficiency Standards in the Private Rented Sector](#), October 2017



**Figure 2: Expected benefits for tenants moving from EPC Band F**



**Figure 3: Expected benefits for tenants moving from EPC Band G**



Source: Frontier Economics analysis, based on a £5000 cost cap

The gap between the high and low benefit estimates reflects uncertainty about whether the landlords would be able to pass the cost of measures through to tenants, by increasing rents. However, even if they do, the research predicts any potential rent increases will be outweighed by the benefits to tenants from reduced energy costs. One reason for this is that landlords would be forced to minimise the level of any rent increases by spreading the increases over time. In practice, the proportion of costs passed through is expected to be limited, in part because F-G rated properties represent a small portion of the market.

### Other impacts

The research anticipates that in response to the policy, few, if any, properties, will be taken off the market. One reason is that the supply of homes is relatively inelastic, which means it does not change much in response to changes in price. It also reflects that fact the cost of the required improvements is also generally a small proportion of overall property value. Properties where it would be higher are exempted by the cost cap.

Even if landlords recoup the cost of works through rent, making the improvements could increase the resale value of their property. There is

evidence that when buying a home, as opposed to rented one, people will pay more for a home that is more energy efficient.

### **The cost cap**

The finding above are based on a cost cap of £5000. This strikes a balance between the proportion of households helped and the risks associated with carrying out very expensive works. We also considered a £3500 cost cap, but this would improve only 70% of F and G properties, while the £5000 would improve over 90%. While the lower cost cap would see a slightly higher net benefit for tenants who received improvements, this is far outweighed by the lower number of tenants being helped. Meanwhile the £5000 cap would still avoid risks associated with no cost cap at all, because the last 10% includes a long tail of properties that are prohibitively expensive to improve.

**Based on the findings we recommend that the government bring in an effective minimum energy efficiency standard, with a £5000 cost cap.**

## **What else needs to be done?**

### **A tenants' improvement fund**

A £5000 cost cap would mean 10% of tenants in the coldest properties still miss out on improvements. Citizens Advice recommends the government set up a fund to help pay for works outside the cost cap. The fund could be paid for by increasing (from 3% to 4%) the stamp duty levy on buy-to-let homes, which would raise over £200 million. It could also help landlords who want to go beyond the current minimum standard and make early progress to the Band C target. The fund would also reflect that fact that historically the PRS has not received a proportional share of funding from government energy efficiency schemes.

### **Better enforcement**

The regulation will only be effective if landlords know that it will be properly enforced. Citizens Advice recommends the introduction of appropriate and proportionate sanctions for non compliance, and monitoring the implementation of the regulation by landlords. This regulation should be supported by wider measures to tackle disrepair and rogue landlords in the private rented sector. The Committee on Fuel Poverty recommends that the

government consults on the scope for developing a nationwide landlord licensing scheme<sup>26</sup>. Other measures we recommend include<sup>27</sup>:

- Give local authorities the power to ban landlords who repeatedly fail to fix disrepair.
- Require certification of properties against all national minimum standards before they can let out.
- Following other consumer sectors, introduce Alternative Dispute Resolution (ADR) for disputes between landlords and tenants in the private rented sector.
- If their landlord fails to uphold their legal responsibilities allow tenants to leave a fixed-term contract early without a penalty.

The regulation also relies on the accuracy of Energy Performance Certificates, which has at times fallen short<sup>28</sup>. In part this is because the quality assurance framework does not provide the right incentives to really drive up quality<sup>29</sup>, a key issue that was a driver behind the Each Home Counts Review of Consumer Advice, Protection, Standards and Enforcement for Energy Efficiency and Renewable Energy<sup>30</sup>. When landlords are required to act on the basis of their EPC results, there could be an increased incentive to bend or break the rules. So, it is essential that Each Home Counts delivers effective quality checks on energy assessments. This will involve targeting auditing where the risks are greatest, better coordination between schemes and organisations, and effective sanctions.

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<sup>26</sup> Committee on Fuel Poverty, [Committee on Fuel Poverty annual report 2017](#), October 2017

<sup>27</sup> Citizens Advice, [It's broke let's fix it](#), July 2017

<sup>28</sup> See our blog: [Cutting bills, not cutting corners](#), June 2015

<sup>29</sup> See Pye Tait, [Quality assurance in energy efficiency and low carbon schemes in the domestic market - report for Citizens Advice](#), June 2015

<sup>30</sup> See Dr Peter Bonfield, OBE, FEng, [Each Home Counts An Independent Review of Consumer Advice, Protection, Standards and Enforcement for Energy Efficiency and Renewable Energy](#), December 2016

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