Financing retrofit

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Financing retrofit

- Whilst there is room for further innovation in financial products and mechanisms for retrofit (number of financial products available for home retrofits increasing; high street banks and building societies have launched green mortgage products), more significant challenges lie in boosting demand for domestic retrofit
- Low returns and long pay back periods often associated with retrofit measures (inc. associated domestic generation measures such as solar PV) = no obvious financial incentive for property owners to undertake work that can be expensive and disruptive
- Issues related to counterparty risk
- Further issues in rented sector where split incentives

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Financing retrofit – private residential sector

- Funds either need to come from an occupier's or landlord's own funds, a bank loan or through a third party share of savings model
- Share of savings model difficult to make work for residential properties as capital spend is small vs and difficult to secure savings from the bill-payer.
- IF economies of scale could be harnessed, through an area based, strategic, mass retrofit project, this may attract more investment because a small percentage of lost revenue could be absorbed
- Green mortgages available that give discounted rates or incentives for energy efficiency improvements or for buying energy efficient homes

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Financing residential retrofit – what is needed to unlock it?

For private sector investment to be unlocked for retrofit of residential properties on a large scale we need:

- long-term clear policies that provide confidence that a return can be made from the investments
- a value needs to be attributed to the improvements and ideally linked to the property itself, not the owner or occupier, to drive structural change
- otherwise relying on mortgage providers to drive the market for whole house retrofit forward, with piecemeal funding being provided for individual measures such as heat pumps

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Financing retrofit – commercial sector

- Retrofitting commercial buildings, alongside social housing and public sector stock, will provide an important stream of work for the retrofit supply chain
- Private sector finance tends to be more readily available as occupiers are more suited to longer term finance, albeit some SMEs have faced difficulties in accessing finance often due to the scale of the investment required being relatively small and their balance sheets being less robust
- ESCO models often used for commercial properties where:
  - energy efficiency measures are designed and installed by the ESCO who contractually guarantees energy savings to be made over an agreed payback period
  - sometimes funded by the ESCO (or a partner); others funded by the organisation having the work done, with the ESCO just providing the services (which may include operation and maintenance of the systems)

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Financing retrofit – social housing

- Energy performance of social housing is generally better than owner occupier and private rented housing
- Social Housing Retrofit Accelerator helps social housing providers bid for the £160m Social Housing Decarbonisation Fund
- Some social housing providers may have balance sheets strong enough to issue green bonds for retrofit programmes, offering long term capital and low interest rates
- Further innovation required in finance for the sector but number of financial institutions already provide funding e.g.:
  - Lloyds Bank: interest rate reduction associated with energy efficiency
  - Natwest: affordable housing social bond with increased focus on retrofit

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Financing retrofit – public sector

- Invest directly using capital or grant receipts but that amount of funding is limited
- May have access to Housing Revenue Accounts and financial resources from DfE for school refurb
- Could also raise funds through:
  - Salix
  - PWLB
  - Public Sector Decarbonisation Scheme
  - Green bonds
  - Local climate bonds

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Engaging people is critical

- To meet the challenges of climate, inequality and sustainability, a combination of political leadership, public will and private capital is needed - £400bn will need to be put into the green economy in the next decade alone
- In order to make a just transition to net-zero, we need to take everyone with us on the journey
- This is especially stark in relation to the retrofit challenge
- As well as providing access to finance, people need to want to make changes. This can be achieved through government incentives (or sticks) but also by further engaging them on why it is important
- One way of doing this is by engaging people through finance: over 60% of Brits put money aside regularly; every year £60bn is invested and saved in ISAs and UK private pension funds were valued at over £6tn in 2018
- **People have funds that could be harnessed for the transition whilst also engaging them on the issues**

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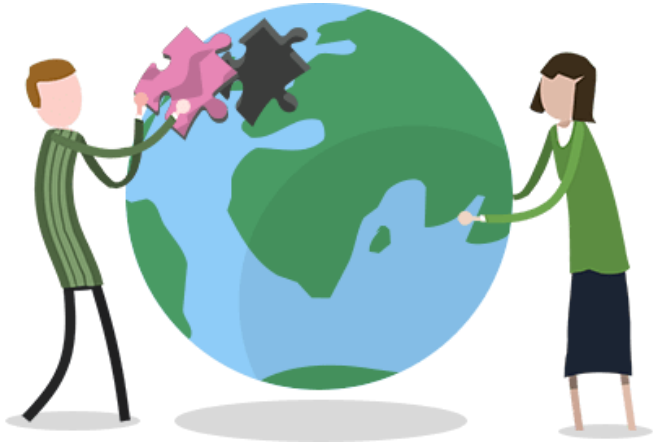
Introduction to Abundance

- The big idea behind Abundance was to enable anyone, from as little as £5, to invest their money (including ISA and pension) in things they can feel engaged with whilst making an appropriate financial return.
- People understand how their money is being used and for what purpose.
- They can see both a financial benefit and a non-financial benefit.
- Our mission is to engage the public and their money in accelerating the transition to ‘net-zero’.
- Abundance is regulated by the FCA and acts as an Arranger and Agent.
- We arrange debt not equity.
- We host a secondary market.



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Ways in which Abundance can raise money

Retail investors / general public / citizens as investors

Abundance platform

Small scale Project Finance

- Money used to build a specific project
- Debt issued by a Project Company
- Interest and capital repaid from cash flows of that project
- Usually has security over assets of the Project Company
- Risk concentrated in the project

Structured corporate debt

- Money used for earmarked corporate purposes
- Debt issued by a SPV
- Interest and capital repaid from cash flows of parent / group / events
- Less or no security
- Risk is on the parent / group

Community Municipal Investments

- Money used for earmarked investment in particular projects
- Debt issued by a Local Authority
- Interest and capital repaid from money available to that LA
- No security over assets
- Risk is on the Local Authority

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Project finance - retrofit case study

Pax Apartments

- £3.1 million, 2.5 years, 10%
- Pax Apartments is a project from innovative property developer Octevo Housing Solutions – **easing the housing shortage by converting a warehouse in the heart of Liverpool into 33 supported living and affordable rental homes**
- Octevo works with RSLand Local Authorities to identify the types of homes that are most needed — in this case, affordable and supported housing.
- It builds / renovates homes specifically for the long term rental market, which offers the secure long term cash flows needed to invest in quality house building, and facilitates low carbon building by spreading up-front costs over a longer period of time. This approach, combined with the funding provided by Abundance investors, creates a unique, sustainable model for building the greener, affordable homes we need for the future.
- Octevo's objective is to build quality affordable homes that its RSL or local authority partners will lease on a long term basis. A RSL must abide by the UK's regulation of social housing, which includes a cap on the amount of rent it can charge for affordable housing.
- Once the homes are constructed and tenanted, Octevo looks to sell the right to the rental revenues to other long term investors to facilitate repayment of this investment.

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Swindon – project finance bond

- Council was looking to build, own, operate two solar parks and share project financing risk
- Abundance structured two 20-year debentures and raised £4.3m
- 33% of investors came from Swindon and immediate postcodes
- 18% invested less than £100
- The result was greater local understanding and engagement with the council's Net Zero plans
- This project led to the Financing for Society Project funded by DCMS's Inclusive Economy Unit.

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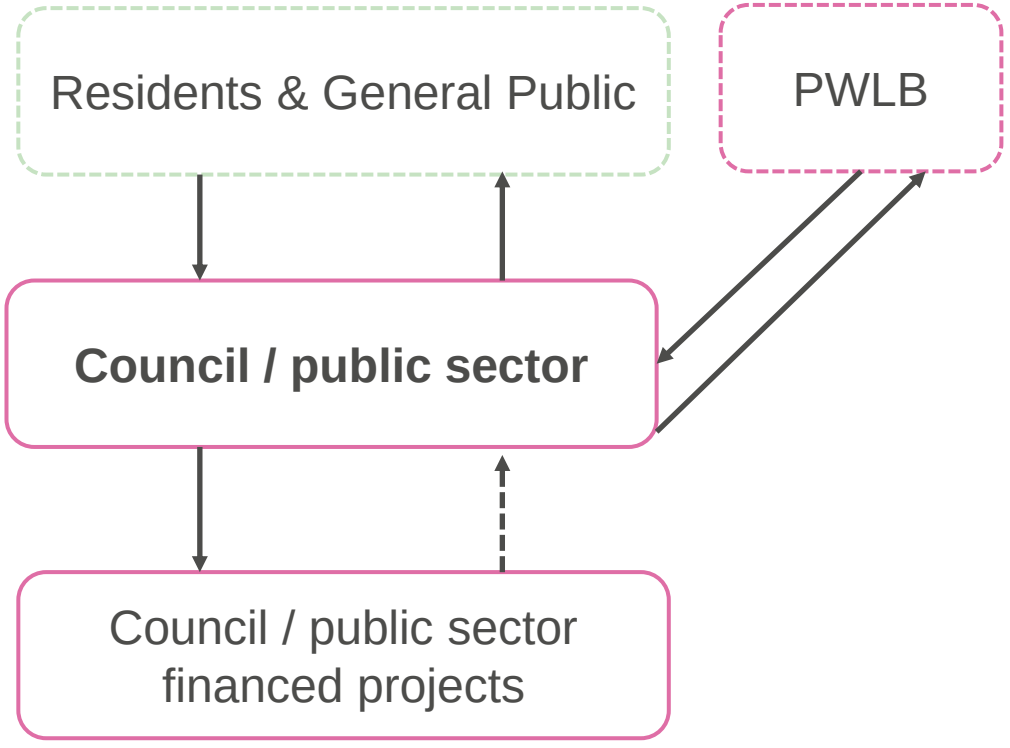
Key Principles: Community Municipal Investments

- **Undercut** PWLB borrowing rates
- **Emulate,** as far as possible, the ease of use of PWLB
- **Platform for communicating** with residents and building trust as well as driving additional social and local economic value
- **Accessible** to ordinary investors; low minimum, helps improve financial security



Some examples – community municipal investments

- Councils were planning to borrow from PWLB to finance projects in their Net Zero / Climate Emergency strategy
- Abundance structured a Climate Municipal Investment – which beat PWLB by 0.5% (including fees).
- Using the innovation of crowdfunding the bond is efficient to issue and manage
- Model sits easily alongside PWLB, so becomes simple way to build a local finance market over time
- Both bonds reached £1m target ahead of schedule
- 25% of investors invested £100 or less
- Created a communication platform and mechanism for receiving Interest Donation - ~10% of interest donated back to each LA from investors
- Generated significant local PR
- Recently launched another with Islington Council – raising funds now

Features of CMI's and how they might be used

Features of CMIs	Use of proceeds – funding retrofits
Cheaper than borrowing from central government	Public sector whole building energy efficiency
Simple, low cost process, templated documents	Heat networks
Highly flexible – both on funding terms and use of proceeds	Individual measures for properties such as heat pumps or insulation
Replicable – they work best when used regularly	Demand management – monitoring & controls
Resident engagement on wider council objectives and plans	Solar
Option for investors to not take all or some of their interest on the basis the donation is used for specific good causes	Assessments and advice

Key messages

- Retrofit is challenging to finance
- Need to engage people
- One way of doing this is for them to invest in net zero projects and organisations working toward net zero
- This increases knowledge of climate change and increases engagement
- Crowdfunding opens up opportunities for more people to invest directly in the projects they care about (locally or in a specific place) at a scale that is meaningful and accessible

"When thinking about finance, knowing the social value of different types of money matters. Assuming the overall cost of capital to be equivalent, if there is a higher social value in one form of capital than another, we would prefer to see this option selected."

Financing for Society, University of Leeds, 2019

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