Split incentives in the building sector across the EU

Dr Marina Economidou, Renewable Energy Unit, Institute of Energy and Transport, Joint Research Centre

POWER HOUSE Divided/Cooperative ownership Task Force Workshop

12 June, Tallinn

What are split incentives?

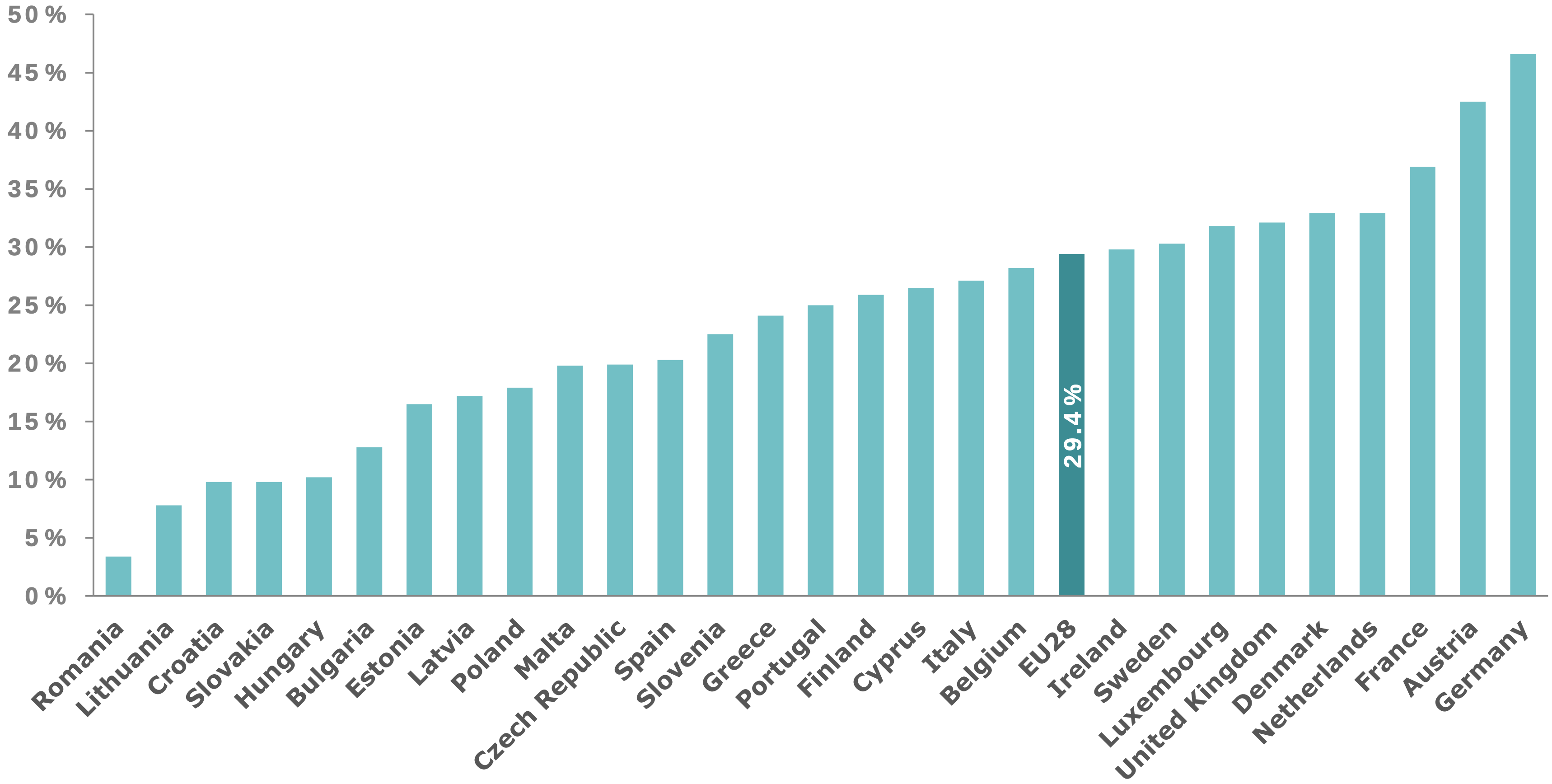
"Transaction where benefits do not accrue to the person who pays for the transaction"

- Split incentives between tenants and landlords

Owner makes energy efficiency investment → Energy savings accrued by energy efficiency upgrade → Tenant benefits from energy savings

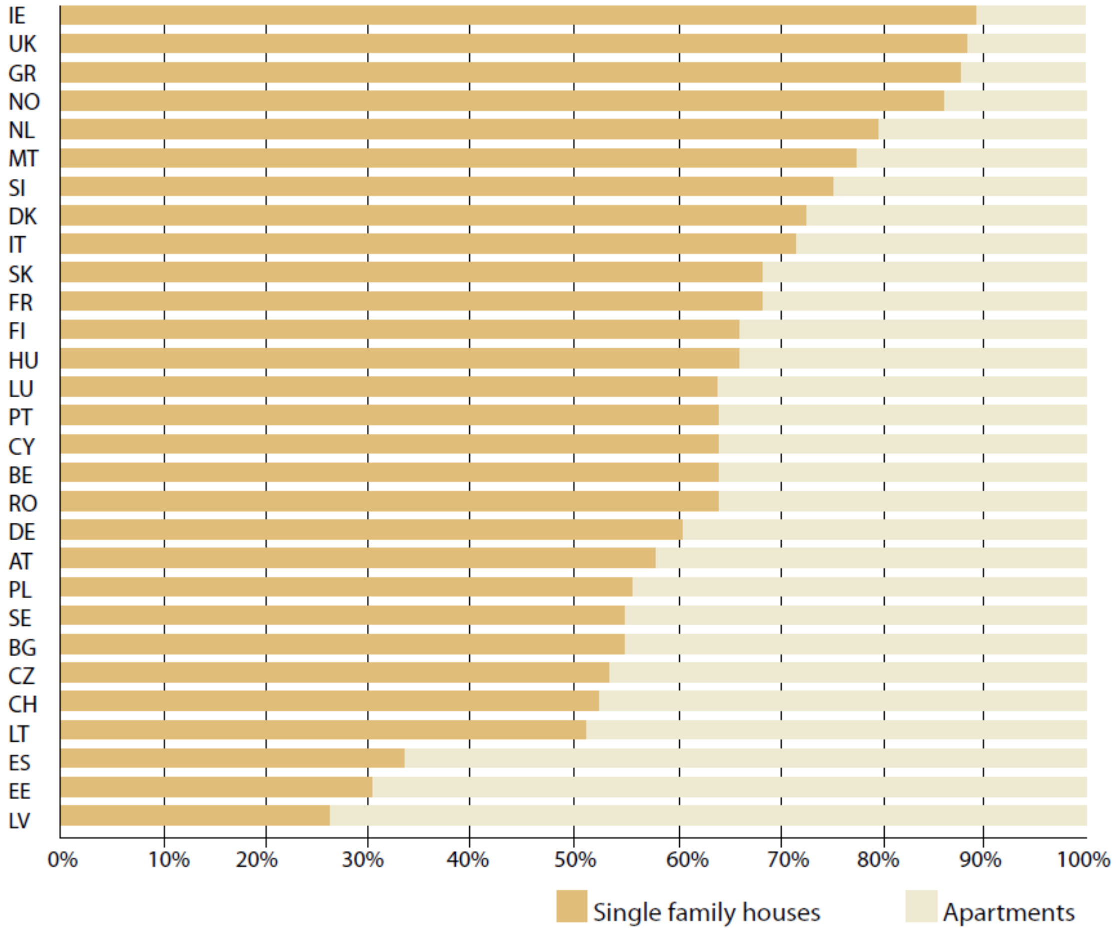
- Reverse split incentives (inclusive rent)
- Temporal split incentives
- Misaligned incentives with other actors, e.g. utilities

Tenants (% population)



Source: Eurostat
Year: 2011

Single and multi-family dwellings in Europe



Source: BPIE
Year: 2011

Various homeownership and tenancy lengths

- Length can vary from our around a few years to more than 10 years

  - United Kingdom – homeownership: 10 years; tenancy: 18-19 months
  - Germany – tenancy: 8-15 years
  - Sweden – tenancy: 4-5 years (commercial)

- High upfront capital cost investment in efficiency can be quite risky if a move is possible

Article 19(1)(a) of Directive 2012/27/EC

Member States shall evaluate and if necessary take appropriate measures to remove regulatory and non-regulatory barriers to energy efficiency, … , in particular as regards:

(a) the split of incentives between the **owner** and the **tenant** of a building or among **owners**, » with a view to ensuring that these parties are not deterred from making efficiency- improving investments that they would otherwise have made by the fact that they will not individually obtain the full benefits » or by the absence of rules for dividing the costs and benefits between them, including national rules and measures regulating decision-making processes in multi- owner properties;

Split incentive workshop, March 2014

- Organised by the Joint Research Centre on behalf of DG Energy
- Focused on social housing, private residential and commercial buildings
- Discussed various solutions, e.g.:
  - mandates
  - inclusive rent
  - green leases
  - EPCs
- Proceedings and workshop summary can be downloaded at the JRC website

Social housing practices - Netherlands

- An average energy index of 1.25 (label B) for social housing dwellings by 2020
- Revision of social rent ceiling evaluation to include energy performance in criteria list
- Social landlords can charge a lump sum (rent plus utility costs), but need to assure total housing cost guarantee
- Dutch social housing sector acts as one large revolving fund
- Regular monitoring of the energy performance of the social housing stock at a yearly basis on a national level

On-bill finance programmes

On-bill financing allocates the financing responsibility to the utility and maintains the loan attached to the property (temporal split incentives)

Mostly in the US, first programme is the UK Green Deal

If designed to address rented properties, they need to be designed to provide incentives to all participating groups:

- Landlords to receive small incentive
- Tenants to gain savings
- Utilities to be protected from risk/default; decoupling is critical

Under such programme, social landlords should be compensated for transaction cost in order to undertake energy efficiency investments in social housing units.

Minimum performance for rented properties - United Kingdom

- A law under which all properties of energy label F or below cannot be let out after 2018

- Tenants are allowed to demand energy efficiency upgrades on their properties from 2016 onwards

- Tax break scheme supporting residential landlords in the transitional period 2014-2017.

Warm versus Cold Rent

- Warm rent: base rent + utility costs for heating and sometimes DHW
- Dominating residential lease type in Sweden, including commercial leases
- All operating expenses are borne by the landlord. Any capital expense that reduces operating expenses is solely in the landlord’s domain
- Limits in the consumption – landlords can regulate the maximum indoor temperature during the winter months
- If not feedback is provided, risk of reverse split incentives

Packaged solutions in Denmark

- Revised rent acts:
  - increased incentives for landlords
  - Clearer guidelines
  - Tenant democracy
- Energy labels – quality improvements and introduction of repercussions
- Energy efficiency obligations – focus on housing and prioritising rented properties
- Actions to further facilitate ESCO activities
- Green leases

Green leases (commercial buildings)

- Traditional forms of leases create asymmetries in the relationships between landlords and tenants
- Under a green lease, investment costs can be compensated by a small amount of energy cost savings.
- Different versions of green lease language, e.g. 20% buffer zone practiced in NYC
- In Europe, passing costs of energy savings to tenants can still be an obstacle.

Conclusions

- A successful energy efficiency policy needs to include strategies addressing split incentives
- No one-size-fits-all solution due to particularities across various building sector segments/different national conditions
- Packaged solutions are needed as proposed in the Danish case
- Successful approach consider splitting costs and benefits in a balanced way between all actors involved
- Improvements in existing tools is required, e.g. Energy Performance Certificates. Measurement of energy efficiency is still an issue

Thank you for your attention!

Marina Economidou
marina.economidou@ec.europa.eu

http://iet.jrc.ec.europa.eu/

Joint Research Centre