May 2017

# The Clean Growth Plan:
## An offer to all householders

For the last twenty years, the Government has helped all types of households make home energy efficiency improvements, with support provided primarily through grants under energy efficiency supplier obligation programmes. Going forward, the government has indicated that this sort of supplier obligation funding will only be available to households identified as at risk of fuel poverty. This paper argues that energy efficiency support for all households should remain a vital element of carbon reduction and fuel poverty policies. In particular we call for a mix of new, smart financial incentives for home energy efficiency including grants, loans and tax (fiscal) incentives. We call on Government to announce such policies in the Clean Growth Plan.

**An incentive open to all householders**

From 2018, the Energy Company Obligation (ECO) – the only national funding programme for home energy efficiency – will be entirely focused on a group of households on income and vulnerability-related benefits, who are identified as being at risk of living in fuel poverty. This leaves the large majority of households unable to access government financial support for home energy efficiency.

Of those that are not eligible for ECO, two main groups can be distinguished. The first can be termed "**struggling households**", in this category we include householders who are in fuel poverty but are not currently eligible for support through ECO (because they do not meet the qualifying benefits criteria for that programme). This group also includes householders who, although not technically in fuel poverty (according to the official definition), often struggle to pay their energy bills. The 2014 English Housing Survey reports that 18% of households state that they find it difficult to meet their energy costs[1]. Many in this group of people may overlap with what the Prime Minister termed the "just-about-managing" or JAMs.

The second group in contrast have the means to make home energy improvements, they are "**able-to-pay**" for measures, however are not necessarily inclined to do so unless nudged or incentivised.

It is vital that any incentive Government puts in place adequately addresses the differing needs of these two groups.

**Why is policy support on home energy efficiency important?**

To help end the misery of fuel poverty it is vital that government has programmes targeting all households. ECO targeting of the fuel poor is only 50% effective[2], and without a funding programme

[1] 'English Housing Survey: Energy Report' – DCLG, 2014: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/539570/Energy_report.pdf

[2] That is, only half of households in fuel poverty are on the welfare benefits that qualify then for support under ECO fuel poverty alleviation programmes. p19 'ECO transition final stage IA' BEIS, 2017:

open to all households, many fuel poor households in cold homes risk having no access to support to make their home warmer and cheaper to heat.

Looking beyond fuel poor households, a financial support programme is needed for two reasons. Firstly, the market for cost-effective energy efficiency improvements in buildings has multiple market failures and barriers to participation for both customers and potential suppliers. Building a market at a scale where investment can be made to overcome those barriers requires government support.

Secondly, many homes have now been fitted with the most cost-effective energy efficiency measures, often as a result of earlier incentive schemes. Additional energy efficiency measures may not be, or be only marginally cost-effective for these households – and achieving small annual energy bill savings simply may not be their top priority[3]. However, while home energy efficiency may not be cost-effective for individual households, it may be a highly cost-effective for the UK as a whole in reducing our overall energy demand and in meeting our 2050 carbon targets. The government subsidises nuclear and renewable energy generation – there is an even stronger case for the government to subsidise cuts in energy demand. Investing in energy efficiency to reduce demand is in line with the idea (that the European Commission is pushing strongly) of energy efficiency as the 'first fuel', identifying that the cheapest and cleanest energy is the energy that is not consumed.

For these reasons, all households need to be effectively encouraged to make improvements to their homes and the Committee on Climate Change[4] (CCC) has stated that such an incentive is essential to achievement of carbon targets in the building sector. The Energy Saving Trust is making a simple call on Government: to set out appropriate financial incentives, open to all householders, to encourage home energy efficiency improvements.

**What does a good incentive look like?**

The CCC have said that a good incentive should be "[…] simple, provide a stable and long-term framework, develop trusted intermediaries, help households to overcome financial barriers and the range of nonfinancial barriers (e.g. information,

**The Green Deal**

The Energy Saving Trust strongly supports the Green Deal's pay-as-you-save mechanism: it is an effective way to minimise the financial barrier of making energy efficiency improvements. However the Green Deal is a payment method and does not incentivise making improvements in itself. The Green Deal (or other pay as you save mechanism) would be most effective if provided alongside a financial incentive, such as the ones listed in this document.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/586266/ECO_Transition_Final_Stage_IA__For_Publication_.pdf

[3] To put this point in economic terms, the transaction costs and opportunity costs of long payback energy saving improvements may be too high for households to bother with the improvements.

[4] Meeting Carbon Budgets – 2016 Progress Report to Parliament' – Committee on Climate Change, 2016: https://www.theccc.org.uk/wp-content/uploads/2016/06/2016-CCC-Progress-Report.pdf

perceived risk, hassle, and social norms) and have effective delivery and communication.”[5]

There is no shortage of ideas on possible incentives as a variety of different mechanisms for households have been explored over the years, including:

Fiscal Incentives

- Council tax rebates
- Cutting VAT for energy efficiency measures
- Stamp duty land tax rebates

In 2005, the Energy Saving Trust published research on the use of fiscal incentives linked to council tax or stamp duty land tax to encourage householders to make energy efficiency improvements. Since then, many other organisations have developed thinking about how fiscal incentives for energy efficiency could work, adding further detail to the stamp duty and council tax incentives idea and exploring other concepts such as VAT cuts. There is now a wide-ranging literature examining the ins and outs of different mechanisms linked to taxation.

Grants and subsidised loans

- Zero or reduced rate loans
- Taxpayer funded grants for energy efficiency
- Mortgage-linked cashback schemes
- Equity release schemes

Low interest loans, grants and cashback schemes are a common part of the energy efficiency policy landscape (see for instance the Green Deal Home Improvement Fund or the Scottish Government’s zero interest loans and cashback scheme[6]). They are generally popular with householders as it is a simple to understand mechanism.

Behavioural economists argue that the power of “free” can often be a powerful message against more complex financial incentives. Cashback or direct grant schemes can be linked to low-interest loan schemes to increase their attractiveness. UK interest rates are low and borrowing from banks, particularly on mortgages is cheap in the UK: a cashback scheme could also be introduced to encourage householders to borrow commercially. Under such a model, homeowners would get a small government payment when they increase the mortgage to make energy improvements.

Equity release schemes allow homeowners to withdraw some of the capital from their home to pay for energy efficiency improvements, repaying the money at the point the home is sold. They are often seen as suitable for older, equity-rich homeowners. Scottish Government are currently trialling an equity release scheme in two local authority areas.

[5] p100 ‘Meeting Carbon Budgets – 2016 Progress Report to Parliament’ CCC, 2016: https://www.theccc.org.uk/publication/meeting-carbon-budgets-2016-progress-report-to-parliament/
[6] http://www.energysavingtrust.org.uk/scotland/grants-loans/heeps/heeps-loan-scheme

May 2017

Feed-in tariffs

- Energy efficiency feed-in tariffs

An energy efficiency feed in tariff would see householders given a subsidy for every kWh of energy they save. Whilst perhaps more difficult to implement, energy efficiency feed-in tariffs are considered to show potential due to the popularity and success of feed-in tariffs for renewable energy generation. There remain a number of barriers to overcome before energy efficiency feed-in tariffs become possible to implement however, primarily around how the savings would be measured, rebound effects and funding.

**How should incentives be paid for?**

When it comes to funding, the incentives listed above could be paid for through various different methods (general taxation or other fiscal measures, levies on energy bills, carbon taxes, energy company fines, etc.). Most energy efficiency funding up to now has come from energy company obligations. These obligations work well as mass schemes, where the energy suppliers install cost-effective and low-cost energy saving measures for large numbers of homes. To the extent that such large-scale, low-cost opportunities are still available in UK homes, energy company obligations may still have a role to play in the policy mix. However, as outlined in our parallel paper on fuel poverty we are concerned about using ECO as the principal or sole delivery mechanism for home energy efficiency. This is because increases in energy bills negatively impact vulnerable households who may not then benefit from the scheme. Instead of ECO, we suggest that simple, well targeted incentives should be funded from government taxation (or in the case of fiscal incentives, foregone tax receipts): noting the wide economic benefits to the UK resulting from energy efficiency investment.

**Incentives that work as part of a wider policy mix**

There is no silver bullet on home energy efficiency and the Energy Saving Trust believes a variety of different tools, combining incentives, zero interest loans or pay-as-you-save mechanisms, for instance, are needed. This approach is being applied in Scotland where zero interest loans, cashback schemes and, in some areas, equity release programmes are in place. Such an approach needs to be seriously considered as part of the Clean Growth Plan. It must also be recognised that incentives alone will not necessarily drive demand and to be truly effective incentives need to be considered as part of a wide range of policies, including regulation. Effective regulation needs to be in place both to act as a backstop and to ensure that all tenures are adequately covered.

This paper is primarily about building demand however it should also be noted that there is a need for supply side interventions to ensure adequate skills and standards. Confidence in industry is vital to build demand: householders need to feel comfortable investing in home energy efficiency improvements which is not always the case at present.