The Energy Efficiency (Private Rented Property) (England and Wales) (Amendment) Regulations 2022

Lead department	Department for Business, Energy and Industrial Strategy
Summary of proposal	Amending the energy efficiency (private rented property) regulations to require property owners to raise the energy performance of their privately-rented homes to energy performance certificate (EPC) band C, up to a maximum £10,000 spend per property
Submission type	Impact assessment (IA) – 24 March 2022
Legislation type	Secondary legislation
Implementation date	1 April 2026
Policy stage	Final
RPC reference	RPC-BEIS-5172(1)
Opinion type	Formal
Date of issue	21 April 2022

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The IA's assessments of direct impacts on business and impacts on small and micro-businesses are sufficient. The IA includes a good monitoring and evaluation plan. The IA would benefit from further assessment of potential market impacts.

Business impact target assessment

	Department assessment	**RPC validated**
Classification	Qualifying regulatory provision (IN)	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£446.2 million	£446.2 million
Business impact target (BIT) score	£2,231.1 million	£2,231.0 million
Business net present value	-£7,725.3 million	-£7,725.3 million
Overall net present value	£2.88 billion	£2.88 billion

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. RPC ratings are fit for purpose or not fit for purpose.

RPC summary

Category	Quality[2]	RPC comments
EANDCB	**Green**	Following RPC comments on the consultation stage IA, the Department correctly treats landlords passing on some of the cost of installing energy efficiency measures to tenants, in the form of higher rents, as an indirect benefit to business. The IA would benefit from providing further breakdown of the costs and benefits of individual measures, in particular to identify separately the impacts associated with the primary powers in the proposed Energy Bill.
Small and micro business assessment (SaMBA)	**Green**	The IA provides information on the distribution of property portfolios for private landlords and a useful discussion of mitigation of the impacts on small and micro businesses (SMBs). The SaMBA would benefit from further discussion of potential difficulties for SMBs in paying up-front capital costs.
Rationale and options	**Satisfactory**	The IA provides a summary of the rationale for intervention, with further detail at its Annex A. The IA discusses the rationale for regulation over non-regulatory policies, such as fiscal incentives, and provides a justification for the preferred option over other regulatory options considered during consultation. Given existing measures, introduced only recently, the IA would benefit from explaining further the evidence and rationale for additional intervention at this time.
Cost-benefit analysis	**Satisfactory**	The IA sets out helpfully, clearly and in some detail, its modelling approach and key input assumptions. It provides a good discussion of risks and uncertainties. The IA would, however, benefit from discussing why its estimates are significantly different from those at the consultation stage. The IA would benefit from further analysis of the impacts of different levels of fines and private rented sector (PRS) market impacts (see below).
Wider impacts	**Weak**	The IA would benefit significantly from further assessment impacts on the PRS market, including the potential for a significant reduction in supply as landlords exit the market.
Monitoring and evaluation plan	**Good**	The monitoring and evaluation plan discusses the results so far from an evaluation of the existing regulations and sets out its approach to monitoring and evaluating the proposal. This includes setting out a 'theory of change', questions that will be asked, the variables to be monitored and the datasets to be used.

[2] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Please find the definitions of the RPC quality ratings here.

Summary of proposal

Under the current Energy Efficiency (Private Rented Property) (England and Wales) Regulations, landlords of homes with an energy performance indicator certificate (EPC) rating of bands F and G, are required to spend up to £3,500 in improving the energy performance of these properties - to EPC band E. The proposal would amend the regulations so that PRS homes will need to have a band C EPC rating, with a maximum £10,000 improvement spend per property. The new standard will apply to new tenancies from April 2026 and to all tenancies by April 2028.

The proposal is estimated to cost around £10.6 billion in present value terms, with the large majority being incurred by landlords in installing energy efficiency measures. Benefits are estimated at £13.5 billion, with around two-thirds being accounted for by reduced carbon emissions, with fuel bill savings being the next largest benefit. Overall, the proposal is, therefore, estimated to have a net present value of £2.88 billion (£2.56 billion in 2019 prices and 2020 present value base year). The costs to business (landlords) translates to an EANDCB of £446.2 million.

EANDCB

Direct/indirect impacts

The Department's classification of impacts into direct and indirect is consistent with RPC guidance. Following RPC comments on the consultation stage IA, the Department correctly treats landlords passing on some of the cost of installing energy efficiency measures to tenants in the form of higher rents as an indirect benefit to business. Treating this benefit as direct would have resulted in an EANDCB of around £308.2 million.

Counterfactual

The IA provides a reasonable description of the counterfactual (page 21). However, the IA would benefit from discussing further, other related policies and how the impacts of these are distinguished and attributed compared to those of the proposal (for example, the discussion of off-gas grid regulations at paragraph 89, page 29).

Non-monetised costs

The IA would benefit from providing a breakdown of the costs and benefits associated with each individual measure listed on pages 11-13. In particular, it would be helpful to identify separately within the overall estimates, the impacts associated with the primary powers in the proposed Energy Bill. For example, the IA could present within the overall capital cost estimate the amount associated with extending EPC scope to houses in multiple occupation and listed buildings. This would also help identify more clearly where the Department may have judged that a particular measure was not proportionate to monetise (for example, perhaps the removal of the 7 to 28 days 'grace period' before landlords must provide a valid EPC before marketing or letting a property - page 13).

The present IA captures the impact of using primary powers in the proposed Energy Bill pertaining to the PRS regulations. It is the RPC's understanding that the primary powers in the Bill pertaining to the energy performance of buildings (EPB) regulations will be addressed in a separate IA supporting amendments to those regulations. The RPC expects that IA to be submitted for scrutiny, subject to better regulation framework requirements at the time.

See also comments under 'cost-benefit analysis' below.

SaMBA

The IA provides information on the distribution of property portfolios for private landlords and assumes that all landlords in the domestic sector should be classified as SMBs for better regulation framework purposes (45 per cent have just one property and a further 38 per cent between two and four properties). The SaMBA provides a useful discussion of how the design of the proposal, and other related policies, are expected to help mitigate impacts on SMBs. The discussion about disproportionality could be strengthened to take account of the potential particular difficulty for SMBs in affording up-front capital costs, linking this to an extended discussion of the potential availability of third-party funding.

Rationale and options

The IA provides a summary of the rationale for intervention, with more detail at its Annex A. The discussion refers mainly to market failure, including externalities and misaligned incentives, and equity considerations, noting that a relatively high proportion of tenants in PRS homes with an EPC rating of below band C have low income and can be described as in 'fuel poverty'. The IA reports interim evaluation evidence of the success of the existing PRS requirements and that an extension to EPC band C fits the broader government strategic objectives, notably 'net zero'. The evaluation also indicated less than 100 per cent compliance, explaining the measures within the present policy package aimed specifically at compliance and enforcement. Given that the amended PRS requirements came into force for all PRS properties as recently as April 2020, and that a final impact evaluation will not take place until 2023, the IA would benefit from explaining further what evidence is available of the impact of that measure and why additional regulation is necessary now.

The IA provides a discussion of the rationale for regulation over non-regulatory policies, such as fiscal incentives, and a justification for the preferred option over other regulatory options considered during consultation. Following RPC comments at the consultation stage, the IA helpfully includes an explicit discussion of the policy choice in terms of balancing the achievement of the policy objectives and affordability for landlords (paragraph 33). The IA explains why the carbon-based environmental impact rating (EIR) metric for measuring EPC is now preferred over the existing costs-based energy efficiency rating (EER). Given that fuel bill savings are expected to be lower using EIR, the IA would benefit from additional discussion of the justification for the change of metric.

Cost-benefit analysis

Evidence and data

The IA appears to be based upon a good range of evidence and data. The assumptions for each cost element and source data used are set out in some detail at its Annex C.

Methodology and assumptions

The IA helpfully sets out its modelling approach and the key input assumptions in detail at its Annex C. The IA would benefit from setting out more detail of the calculations involved in producing its overall estimates. The IA would also benefit from describing why the NPV estimates are significantly different from those at the consultation stage, particularly as the proposal appears to be close to the preferred option at the consultation stage. Both estimated costs and benefits are substantially lower (both estimated capital costs and energy savings have fallen sharply). Benefits have fallen by less than costs, as a result of a large increase in carbon savings (presumably reflecting the more-recent higher Treasury Green Book values), meaning that the overall NPV has increased from £0.3 million to £2.9 million.

The IA uses a 53-year appraisal period (2022-2074). The end point for the appraisal period reflects the point at which all measures installed are expected to reach the end of their economic life. Given that the implementation date for the proposal is 2026, the IA would benefit from describing further the costs that are incurred ahead of 2026.

The IA provides a good discussion of risks and uncertainties (pages 49-55). This includes a useful sensitivity analysis and application of optimism bias. The IA is usefully transparent on the positive NPV not being robust to the lower carbon price sensitivity (paragraph 175 and table 26, page 54). The IA would benefit from discussion around risk mitigation to support why the optimism bias factor is applied to generate only a ‘high estimate’, rather than providing a more realistic central estimate.

The NPV (but not the EANDCB figure) includes reduced profits for energy companies due to lower demand. The IA would benefit from explaining why this cost is not offset by potential increased profits for other companies as energy consumers buy other products with their higher disposable income.

The proposal includes a maximum fine of £15,000 per property in breach of the regulations. The IA reports stakeholder concerns that the £30,000 level proposed during consultation could have driven some landlords to exit the sector if they feared unintentionally breaching the regulations. The IA would benefit from discussing further the evidence to support the chosen level of fine, including whether there had been modelling to help determine its optimal level.

Wider impacts

The IA provides an assessment of distributional impacts, including calculation of equity-weights NPVs, equality assessment (page 42 with further detail at its Annex D) and place-based analysis (pages 42-45). There is also an assessment of possible impacts on the PRS market and the potential for landlord exits. However, this assessment should be strengthened significantly in some key areas.

The assessment of the number of properties likely to be removed from the market and the subsequent impact on tenants in terms of price increases or property shortages should be strengthened significantly. This would address further the concerns expressed by landlords during consultation. The IA refers to previous growth in the number of PRS homes between 2010-2019 and compares the proposal with previous changes, such as higher stamp duty and reduced tax relief. This discussion would benefit significantly from recognising that the 2010-19 growth coincided with a large increase in rental prices (and, therefore, attractiveness of the sector to landlords) and that the proposal appears to be much more significant than previous changes to the market, in affecting homes that are already being let. The IA refers to the PRS sector moving towards a smaller number of landlords who each have many properties but who would benefit from analysing the effect of this on the market and whether this is a desirable outcome, particularly as the proposal seems likely to accelerate this trend. Overall, the IA would benefit from addressing specifically the potential impact of the proposal on the attractiveness of, and incentives for, being a landlord.

The IA would also benefit, in particular, from specifically addressing impacts on the very short-term rental market, and potential consequential impacts on the PRS market as a whole. The IA should address explicitly the scope of the measure in relation to *Airbnb* and other very short-term rentals. If, as appears, these are in scope, the IA should address what this means for individuals who live in their homes but want to let them occasionally. If very short-term lets are not included, the IA should address the potential for landlords to switch to this approach to avoid the cost of upgrading their energy ratings.

The IA provides substantial analysis on energy poverty but would benefit from further assessment of possible impacts on potential rental poverty. The IA assesses impacts on health and monetises environmental and public sector impacts (see ‘cost benefit analysis’ above). The IA would be improved by proportionately assessing any impacts on innovation, competition and trade.

Monitoring and evaluation plan

The IA provides a good monitoring and evaluation plan. The plan discusses the results so far from an evaluation of the existing regulations and sets out its approach to monitor and evaluate the proposal. This includes setting out a ‘theory of change’, questions that will be asked, the variables to be monitored and the datasets to be used. Given that the new standard will not apply to new tenancies until April 2026 and all tenancies in April 2028, the Department has set a review date of 2031. Given this, and the ongoing evaluation of the existing regulations, the IA would benefit from presenting its timeline for evaluation more clearly and confirming that key evaluation findings will be available at the most appropriate time to inform future policy decisions.

Regulatory Policy Committee

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Two members of the Regulatory Policy Committee did not participate in the scrutiny of this case to avoid a potential conflict of interest.