KAMMA

The Next Generation of Securitisation

How data can meet investor demand for ESG credentials, educate investors and improve the efficiency of capital

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Property: at the centre of global events

Markets are in turmoil.

A single crisis as large as the war in Ukraine, the cost of energy, or the risk of climate change would be enough to unnerve investors. Dealing with all of these concurrently, supercharged by a cost of living crisis and the highest levels of inflation since the 1970s, has impacted markets from Tokyo to London.

There have been sharp falls in valuations in everything from tech stocks to bitcoin and, as both the world's largest asset class, and one of the largest contributors to global warming, property is at the epicentre of global events.

> **"Without the right information, investors and others may incorrectly price or value assets leading to a misallocation of capital."**
>
> Task Force on Climate-Related Financial Disclosures

How property interacts with major events

Not built for purpose, too old, too inefficient

80% of UK homes were built before 1970

58% are classed as "inefficient"

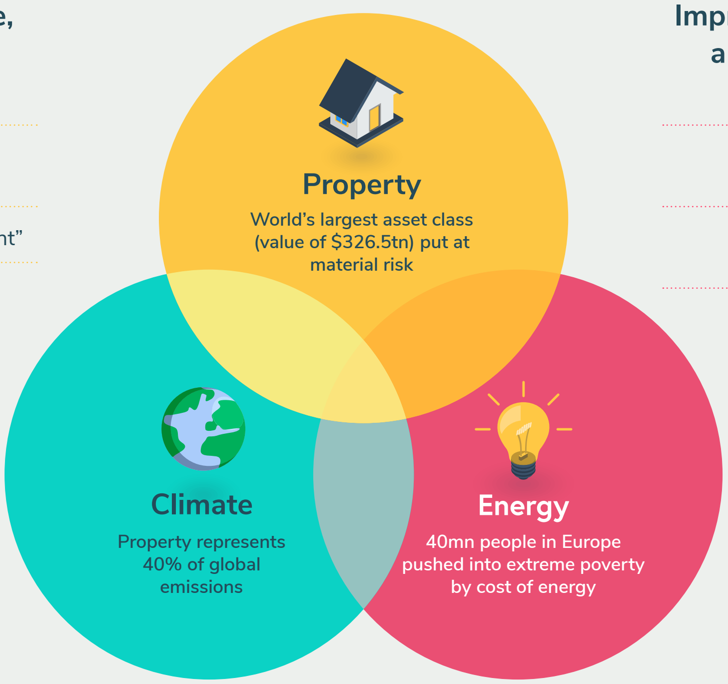
Just 0.3% built to be Net Zero ready

Under huge pressure to decarbonise

13% decarbonisation since 1990, slowest progress of all major emitters

44-fold increase in global climate change laws since 1997

>1,800 climate-related lawsuits filed worldwide by 2022



Improving homes now a matter of national security

Further 80% increase in energy price cap

UK launch of the Energy Security Strategy

EU to end reliance on Russian fuel by 2030

99.7%

of homes need to change

And yet property prices are not yet plummeting. House prices in the UK are yet again at historical highs and, with a 10.8% increase in the past year, may be one of the few true hedges against inflation. Without an immediate impact on house prices then, and with models based on historical data all showing little causes for concern, why are some investors demanding more information?

An era of new risks

The answer comes from a series of new challenges to the asset value of property.

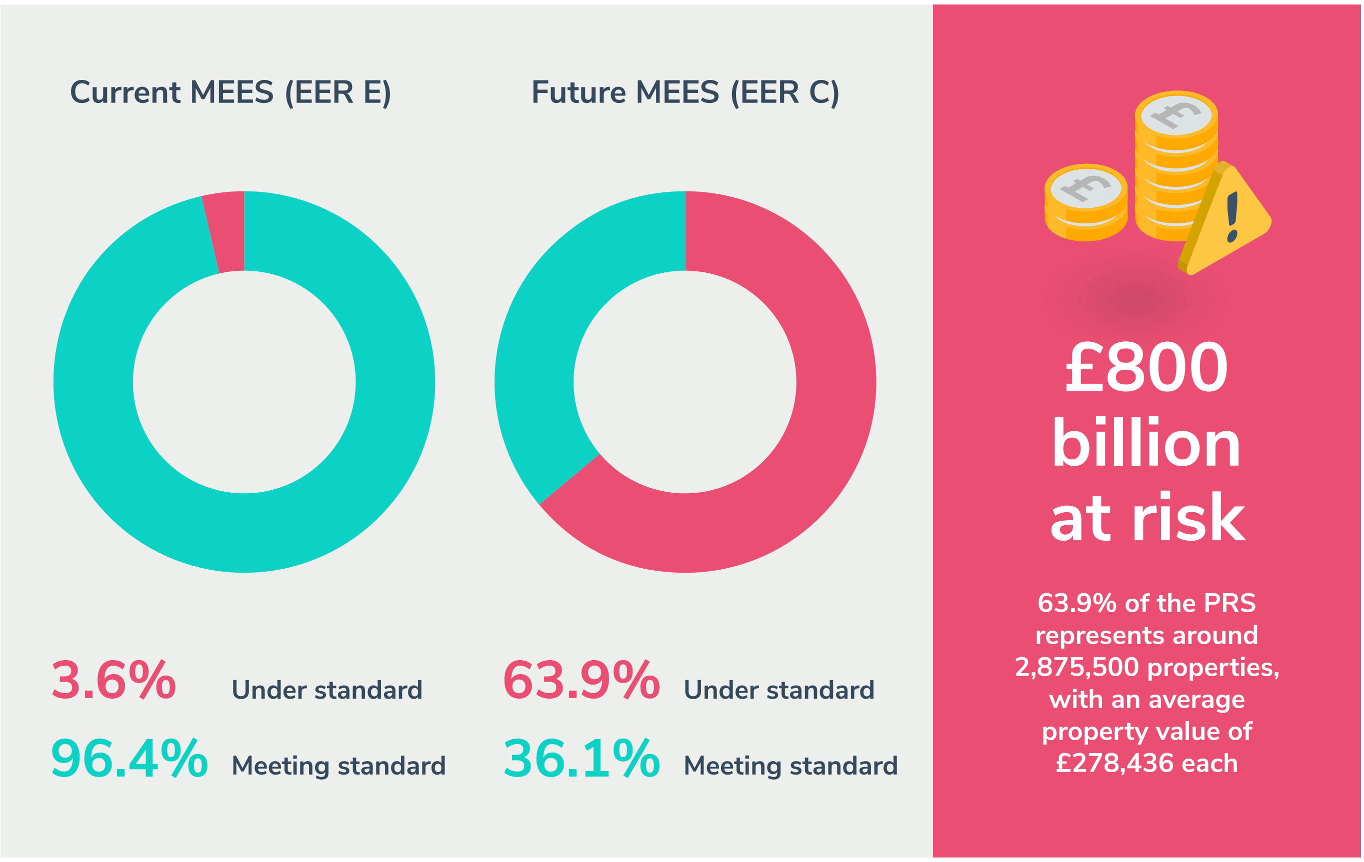
The over reliance on fossil fuels to heat and power homes leads to numerous challenges. Dramatic increases to the price of this fuel will push 40million people in Europe into poverty, increasing arrears risk as hard up households are forced to choose between heating their home or paying their rent or mortgage. Flood risk already impacts 1 in 4 properties in the UK, with more at risk over a single mortgage term without preventative action.

And this preventative action also comes at a cost. Transition risk is defined as challenges that may arise from a disorderly transition to a low carbon economy. Globally, property is responsible for 40% of all carbon emissions, and has been one of the slowest sectors to decarbonise. Driving this change is now a major focus of legislators and regulators alike as they try to deliver the transformation our homes need under an accelerated timescale. The scale of this challenge makes it unlikely to be “orderly”.

The ability to insulate and decarbonise homes is a new variable for investors: it differs dramatically by age and type of home, but has not historically been a driver of asset value. With the cost of energy increasing and regulators demanding efficiency improvements from housing providers and landlords, investors are right to question the ability of assets to maintain their value. Tightening environmental standards planned in the next few years have the potential to rebalance and revalue properties. Buy-To-Let (BTL) lenders and investors are expected to fund an increase in the Minimum Energy Efficiency Standard (MEES) of rental properties from a grade E (2.4% of current rentals fall beneath this standard) to a grade C (62.9% of current rentals fall beneath this standard).

This dramatic increase will require £29 billion in investment, or an average of £9,872 per home. If just half of UK landlords are unable to afford this investment, almost £400bn in assets will no longer be able to secure the income streams that make mortgage payments, and the asset valuation, viable.

Figure 1: New energy efficiency standards are a gamechanger for the Private Rented Sector (PRS)



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The costs of inefficiency

The more inefficient the property is, the more it costs to improve it to these new regulatory standards.

Landlords are already more likely to invest in efficient properties, with those at the lower end of the scale proving harder to divest. Owners of these properties could easily suffer from stranded assets in the years to come. Landlords could instead look to lenders to help them invest in properties through second-charge mortgages or with additional lending.

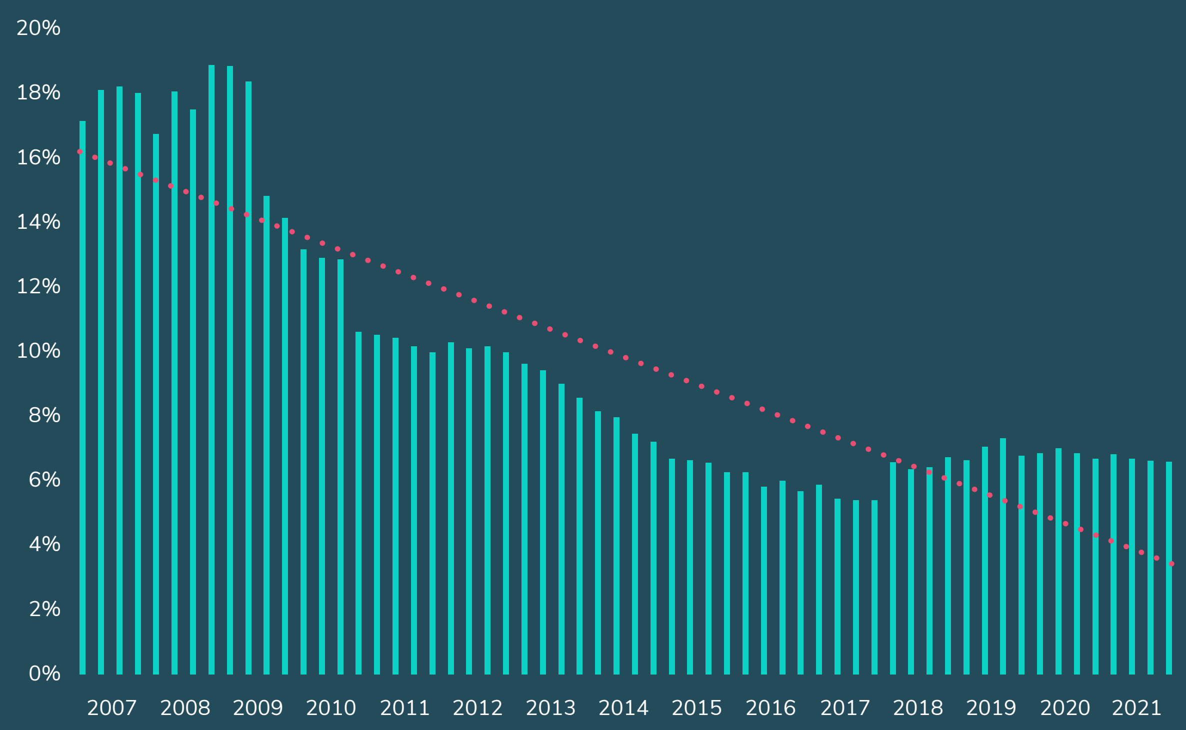
This impacts LTV, however, which can impact the value of a securitisation. The cost to make properties more efficient is fairly even across regions (double glazing costs as much in Liverpool as it does in London), but property prices are not, resulting in an outsized impact in LTV based on the location of the property.

Figure 2: The impact on LTV if the cost of getting to EER C is added to the mortgage: London vs. the North-West

	Average cost to C	Average property value	Percentage of property value
UK	£9,152	£278,436	3.29%
London	£8,615	£523,666	1.65%
North West	£9,561	£205,121	**4.66%**

The real challenge here is that the impact of new risks is hard to quantify. Historical datasets can't account for them and projections are often inaccurate. When risks can't be adequately quantified, investors tend to become more cautious. This is perhaps best illustrated by the slow and cautious recovery of the securitisation market since 2008.

Figure 3: Proportion of mortgaged-assets that were securitised. 2007 - 2021



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Case study - Raising capital in an unstable market: Mortimer IV

In a time of market uncertainty, satisfying investor requirements becomes even more important.

Collectively, new risk factors have combined to make "what are your green credentials?" a key question at investor roadshows. The challenge is finding and deploying the right data to provide the right indicators

This balances out the need for investor education and assurance, with the need for efficiency. In a competitive market, adding footnotes of caveats to one deal can make it stand out for the wrong reasons. The right data, therefore, is not just accurate and exhaustive, it's also concise and effective.

"Investor demand for climate insight on property assets has never been greater, and yet accessing accurate information across thousands of properties contains real challenges. Kamma's technology efficiently and effectively resolved this: delivering the portfolio and property insights needed to assure potential investors, supporting a positive response to this securitisation. In an unstable market, investors require more certainty, Kamma's report delivered this."

Hugo Davies, Chief Capital Officer, LendInvest

What

LendInvest set out to raise funds in April 2022, with market sentiment changing dramatically after Putin's invasion of Ukraine hitting markets from the end of February. This came at a time when the energy price cap rise was already decided, and when substantial amounts of property regulation were already in the pipeline. The securitisation, dubbed Mortimer IV, therefore needed to deploy new data in a new way, to communicate that these risks had been considered, and plans were in place to manage exposure.

How

In a market-first, Kamma were able to accurately map the energy ratings and carbon footprint of every property in the securitisation, providing a top level indicator for the performance of the asset pool in the turbulent times ahead. A detailed report was included in the prospectus, breaking down future scenarios, a projected cost of future compliance requirements, and the steps needed to take to manage this aspect of risk.

Impact

The securitisation was oversubscribed in a challenging market, raising an additional £270 million for the lender and supporting the next phase of lending. The reports delivered an operationally efficient view on a complex area, with the number of ESG surveys to complete reducing from 20 to just three, with a number of investors complimenting the thoroughness of the approach.

Data makes all the difference

The market is already adding "brown discounts" to any stock that cannot pass adequate ESG (Environmental, Societal, Governance) testing, or display credentials that prove these risks have been considered and insulated against.

This regulatory stick is also matched by a market carrot: ESG investment has grown dramatically, with assets expected to be worth $53 trillion by 2025. Assets need to demonstrate compatibility with a goal of Net Zero by 2050 in order to attract ethical investors.

Yet property is not just two-tier, and can be painted in more shades than just green and brown. Some properties are already in-line with new regulatory standards, some will be by the time they come into force, some are exempt as they are listed buildings or in conservation areas. There is also a segment of the asset class that is simply incompatible with these goals, where the price of improving the property to regulatory or Net Zero standards is simply too large compared to the value of the asset. It is these properties that carry greatest risk. This nuance needs to be built into the next generation of securitisation reporting. Investors are demanding to be informed and educated, as well as reassured.

Provision of the necessary property data, however, has typically been subjective, or of poor quality, leading to accusations of greenwashing. By deploying cutting edge technology that resolves the challenges of incomplete, inaccurate or inaccessible information, lenders can improve investor confidence, deliver an accurate and robust assessment of future risk (and how it will be managed) and benefit from increased interest and improved pricing.

Summary

New risks demand new approaches, and new data. Market forces in the form of climate regulations, ESG investors and customer preference are increasingly impactful.

Whilst some investors are aware of these forces and demanding information on green credentials, others are either less aware or less concerned. This creates two new roles for data:

1. To accurately, objectively and effectively qualify assets, in order to answer investor questions
2. To describe the risk in quantifiable terms, in order to educate the rest of the market.

Mortimer IV achieved this, deploying data that successfully demonstrated that each property in the class was capable of achieving compliance with any future regulation. This demonstrated to investors that transition risks were manageable, avoiding brown discounts, whilst educating others on the challenges facing securitisation in the years to come.

Contact us now to find out more about how Kamma can support your business to de-risk, manage and securitise property-related assets

Get in touch

How can Kamma help

Kamma works with mortgage lenders, letting agents, local authorities, property funds and housing associations, supporting their drive to Property Zero. We combine world-leading data collection and address-matching with insightful analysis to articulate the fastest and most cost-effective route to carbon neutrality. We ensure regulatory compliance, manage risk, identify green growth opportunities and qualify green assets.

Visit the site at
kammadata.com

Speak to the team
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Methodology

The EPC data analysed in this report is from Kamma's proprietary analysis of the UK EPC registers and is accurate up to March 2022. Analysis supported by published datasets from BEIS where appropriate. For more information please get in touch.