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The State of the Climate Transition for UK Mortgage Lenders in 2024

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About Kamma

Kamma is a geospatial technology company delivering a data-driven climate transition for UK property. Kamma makes transition planning simple for mortgage lenders through accurate property data and expert analytics across climate risk, regulatory reporting, and retrofit optimisation.

Introduction

A word from Orla Shields, CEO of Kamma

The last decade has seen pressure rise for financial institutions to act on climate. This has brought with it many and varied approaches to communicating emissions calculations, climate targets, action plans, and progress reports to regulators, investors, and customers. The variance in approaches makes it difficult to assess and compare progress industry-wide, leading to an overall lack of clarity and transparency.

Lenders are facing new risks, new reporting requirements, and are being asked to play new roles in supporting their customers to improve old and energy inefficient properties. Whilst previous government policy has been inconsistent, a new Labour government has brought with it renewed optimism and determination in 2024. Market regulation may now finally start to align with the Climate Change Committee's pathway to net zero for residential property, which states clearly that 89% of homes must be EPC A-C by 2035. With specific regulations (such as the proposed increase in Minimum Energy Efficiency Standards) impacting slower moving sectors, an effective transition plan is more important than ever before.

Climate transition plans create climate consistency. They're also making their way firmly into UK legislation. The Transition Plan Taskforce (TPT) was launched by the UK government's HM treasury in April 2022 to develop a gold standard framework for private sector climate transition plans – which was published in October 2023. The framework will now be embedded within mandatory climate reporting via FCA climate disclosure rules and the ISSB's climate disclosure standard IFRS S2. With this has come a well-defined, consistent format for what a climate action plan should include.

"A net-zero transition plan is a set of goals, actions, and accountability mechanisms to align an organisation's business activities with a pathway to net-zero GHG emissions that delivers real-economy emissions reduction in line with achieving global net zero."

– Glasgow Financial Alliance for Net Zero (GFANZ)

However, not all financial institutions yet have a TPT aligned transition plan.

A large part of the challenge for mortgage lenders is that the vast majority of climate risk and financed emissions comes from energy inefficient homes lent on within the portfolio. Measuring the impact of these homes and making plans to decarbonise them is critical for lenders to manage climate risk and meet their climate targets.

This is tricky because of the lack of reliable data on housing emissions and the interplay between lender action and government policy on energy efficiency. It's made more challenging because Risk and ESG Professionals are often acting alone or in small teams within their organisation, trying to figure out the best approach for the mortgage portfolio, without knowing how other organisations are tackling the issue. With deadlines approaching, it's vital the sector moves from planning to execution and from challenge to opportunity.

Increased transparency and knowledge sharing across the mortgage sector is vital. That's why we created this report. The report analyses publicly available climate plans by UK mortgage lenders, as well as sharing insights directly from lenders via a survey. Through this, the report monitors progress on lender transition planning, bringing the successes and challenges to the surface.

We hope it provides the inspiration you need to take further steps, and the benchmarks required to support senior decisions, as we strive to achieve our decarbonisation goals from 2030 to 2050.

Orla Shields, CEO of Kamma

Executive summary

How are lenders rising to the challenge of climate transition planning in 2024?

This executive summary brings together the most important indicators from this report, that illuminate the climate transition progress so far by UK mortgage lenders and inform what the top priorities for the year ahead should be.

Lack of data is restricting effective transition planning

93% of the ESG professionals we surveyed at UK mortgage lenders chose data quality as the top challenge they face in climate transition planning. Inaccurate and missing EPC data (35% of the mortgage portfolio has no valid EPC on average) cause particular issues for financed emissions calculations and data-driven target-setting.

Given this, it's unsurprising that improving data quality is also the number one priority for ESG professionals to address in the next 12 months, chosen by 90% of survey respondents.

Lenders are failing to meet new IFRS regulatory standards

2024 is the first year in which the new IFRS S2 by ISSB has replaced TCFD as the standard for climate-related disclosures. This brings with it three major changes relating to climate transition planning that lenders are not yet prepared for.

Firstly, lenders must now disclose the availability of a climate transition plan, including how the company plans to achieve climate targets. Alongside this, the UK government commissioned 'gold standard' Transition Plan Taskforce (TPT) framework is expected to be included in regulations too. Currently, only 26% of lenders have a climate transition plan and just 5% have one that is aligned with TPT.

Secondly, reporting on downstream scope 3 emissions associated with the mortgage book is mandatory under IFRS 2.71% of the lenders who report on climate do not currently disclose their financed emissions. Even amongst those that do, there is significant variance in approach (absolute emissions vs emissions intensity, overall financed emissions for investments vs financed emissions specific to the mortgage portfolio) which makes it difficult to compare and understand whole-industry progress.

Finally, the new IFRS standards also require lenders to measure and report on climate risks within the mortgage portfolio, including stress testing transition risk exposure, which previously was not mandatory. We, therefore, haven't factored this into our scoring approach this time round, but it's an area that we know lenders struggle with and will have to build into their climate approach before the next reporting period, so it's important to flag.

The best transition plans focus on delivering what they can control, and quantify dependencies to track what they can't

A reliance on external dependencies is cited as a top barrier for 87% of lenders. However, whilst many do reference this in climate plans, only 10% of lenders have quantified the impact of external dependencies on targets and action plans. This is vital to set realistic targets and to understand lender progress against those targets alongside the factors that can accelerate or hold progress back – especially given disclosures requirements are already becoming more rigorous with the switch from TCFD to IFRS. It's also vital to demonstrate the role of government and to push them to take responsibility too, given they have far more influence on housing decarbonisation than the lending industry. Without this step, lender targets run the risk of being under-ambitious or unachievable.

When it comes to delivering on decarbonisation the picture is equally mixed. Driving customer retrofit through education and financing is crucial and this is reflected in 34% and 30% of lender action plans, respectively. So far, though, green lending products are not seeing the consumer demand they should, with 52% saying uptake has been lower than expected. However, three leading lenders have been able to deliver real impact, reducing mortgage emissions by at least 7.5% year-on-year. If that impact can be replicated industry-wide then the UK's mortgaged properties will be well on track for net zero by 2050.

So, what can we learn from these climate-leading lenders so that this impact can be scaled? That's what we'll cover in detail throughout the rest of this report, so keep reading for more.

Analysis: lender climate transition plans in 2024

Financed emissions from a financial company's investment portfolio are, on average, over 700x larger than the company's direct emissions[1]. For mortgage lenders, the vast majority of those financed emissions come from the energy inefficient properties lent on within the mortgage portfolio. In fact, our analysis finds that the average UK mortgage portfolio contains 58.2% of homes below an EPC C.

Addressing this is vital for lenders to meet their climate commitments and to reduce risk in the portfolio – given the policy direction heading towards enforced minimum energy efficiency standards of EPC C by the end of the decade. Because of this, a credible climate transition plan must prioritise quantifying the climate risk exposure and financed emissions from the mortgage portfolio, and developing a robust and data-driven approach to reduce this.

For this Lender League Table we've analysed the publicly available climate plans and actions of 85 UK lenders to find out which are making strong progress on this and to highlight the most challenging areas across the board, where further progress is needed.

The scoring system, in brief

Lenders have been scored based on publicly available information, across five key areas with a focus on actions for the mortgage portfolio:

1. Clear climate plans [5pts available]

Lenders should transparently communicate their plans to tackle climate risk and financed emissions, with a Transition Plan Taskforce (TPT) aligned transition plan being the ideal scenario.

2. Mortgage emission calculations [10pts available]

Lenders should calculate absolute emissions and physical intensity for mortgages using the PCAF methodology and transparently disclose data sources used and resulting PCAF score.

3. Robust targets for the mortgage portfolio [5pts available]

Lenders should use scenario analysis to determine a realistic but ambitious decarbonisation pathway for the mortgage portfolio, with detailed targets along the way.

4. A clear action plan [5pts available]

Lenders should outline the actions required to meet targets for the mortgage portfolio, which should include retrofit education and financing products to support improved energy efficiency.

5. Progress reports [10pts available]

Lenders should already be making progress on decarbonising the mortgage portfolio, transparently reporting on this against targets.

Lenders that are a subsidiary of a larger parent lender have not been included.

To see the full criteria and scoring methodology go to page 33.

The top 10 lender transition plans of 2024

Based on our analysis, the top lenders who authored the leading transition plans are:

Ranking	Name	Total score	Section 1: Plan score	Section 2: Measure	Section 3: Targets	Section 4: Actions	Section 5: Progress
1	Nationwide Building Society	24.5	3	8	4.5	4.5	4.5
2	Ecology Building Society	24	2	6	4	4.5	7.5
3	Handelsbanken	23.5	2	4.5	4	4.5	8.5
3	OneSavings Bank Plc	23.5	2	8.5	4	4.5	4.5
5	Lloyds Banking Group	21	2	4	4.5	4.5	6
6	Virgin Money	20	1.5	7	2.5	4.5	4.5
7	Santander	19.5	2	8.5	1	4.5	3.5
8	Paragon Banking Group	19	2	7	1	4.5	4.5
9	NatWest	18	3	4.5	4.5	2	4
10	Aviva Equity Release	17.5	2	5.5	3.5	1.5	5

While there is still room for improvement by all of these lenders, the key elements that set them apart as climate leaders are as follows.

What sets the climate-leading lenders apart?

Transparent and detailed reporting on climate

Publicly available reporting on climate plans and progress which is easy to locate and clearly covers all the key information is crucial. Interestingly only two of the top ten have a deliberate Transition Plan Taskforce aligned climate transition plan (Nationwide and NatWest), but the others do include the elements that would be expected to be covered in this.

Robust financed emissions calculations for the mortgage portfolio

All of the top lenders specifically disclose the financed emissions for the mortgages that they lend on – rather than giving a top-level financed emissions figure for all investments. They also disclose emissions intensity alongside an absolute figure to allow for comparison across lenders with different portfolio sizes.

Further, they each explicitly follow the PCAF methodology for calculating the financed emissions for their mortgage portfolio, and disclose the PCAF score for this. Nationwide, OneSavings Bank, Lloyds, Virgin Money, Paragon, and Santander all have a better than average PCAF score (3.5), indicating higher data quality. This is, in part, due to their handling of missing EPC data, with 3 of the top 10 using an intelligent modelling approach to predict missing EPC data.

Data-driven targets for decarbonising the mortgage portfolio

All of the top lenders include detailed targets relating to reducing the absolute emissions and/or emissions intensity for their mortgage portfolio. This bolsters the transparency of climate plans and enables regulators, investors, and customers alike to easily understand the progress of the lender against that target.

Further, all lenders also use scenario analysis to inform their targets for mortgages, to ensure a data-driven approach to target-setting which accounts for external dependencies – especially the role of government policy on energy efficiency.

However, it's worth highlighting that even amongst these top 10 lenders, only two (Nationwide and OneSavings Bank) have gone a step further to quantify the dependencies identified during scenario analysis, highlighting their actual impact on climate targets and plans. This quantification is vital to truly understand expected decarbonisation pathways and ensure targets are met. Nationwide, for instance, are clear that their actions alone will not allow them to achieve their targets, but by identifying these dependencies they are able to track and report on progress against them.

Accountability through a retrofit-focused action plan, with progress already underway

All of the top lenders clearly outline an action plan for decarbonising the mortgage portfolio, and report progress against targets transparently.

Importantly, their action plans include robust commitments relating to both increasing retrofit understanding amongst their customer base and supporting customers with the upfront costs via financing options.

And action is already underway. Three of the lenders have already made significant progress in reducing the emissions from their mortgage portfolio[2]. This was defined as achieving year-on-year reductions of -7.5% or more, in line with the UN pathway for staying within 1.5 degrees of warming. Replicating this across the industry would deliver a step-change in the pace of decarbonisation of mortgaged properties.

The leading lenders have taken strides on actions to influence retrofit amongst their customers – with all 10 having educational content or a retrofit financing product already available for customers. At the same time, they are very open about the challenges they face in driving retrofit activity amongst customers, citing those vital external dependencies that we've already mentioned. However, by acting early and putting actions into place now instead of waiting for policy changes as target deadlines draw closer, they give themselves ample time to test, learn, and iterate to identify the actions that will truly support customers and drive down emissions.

Key findings from the transition plan analysis

As we mentioned when celebrating the climate leaders within our analysis, there's still much room for improvement overall in lender progress on decarbonising the mortgage portfolio.

The overall trend is that whilst many lenders are moving in the right direction on climate, there is no lender in the UK today whose mortgage portfolio entirely reflects climate-conscious decision-making.

Whilst most lenders have a climate plan (of some kind) in place, these plans are not consistent and are not yet driving significant progress. UK housing stock is notoriously older than elsewhere in Europe, and so today's homes were not built for today's challenges. All lenders need to push for further action on retrofit amongst customers within their climate plans and actions.

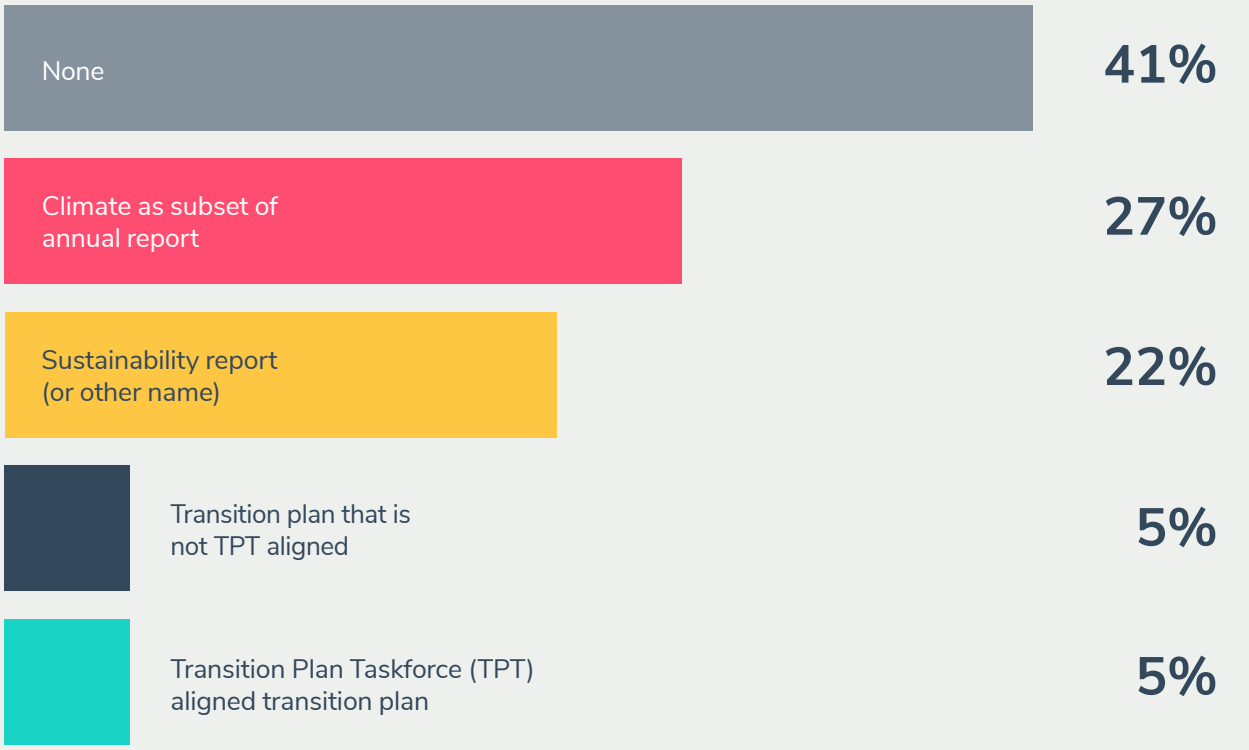
Diving a little deeper into this overall narrative, there are five key findings:

1. Climate planning across lenders is inconsistent
2. Data quality is a major challenge for mortgages
3. Striking the balance on ambitious but realistic climate targets is a challenging task
4. Lenders are relying on policy to decarbonise mortgages, but struggle to quantify this
5. All lenders need more ambitious plans to drive retrofit uptake amongst mortgage customers

Key finding 1: Climate planning across lenders is inconsistent

When we look at the spread of the total scores given in the league table, it quickly becomes clear that there is huge variance in terms of how lenders are approaching climate planning in the first place. This reflects the variance in where lenders are within their climate journey – some lenders are still at the starting point, whereas others have made progress already.

Climate reporting format (% of UK lenders)



Source: Kamma analysis of 85 lenders, August 2024

Many lenders are today transparently reporting on climate. However, the gold standard approach is to have a publicly available transition plan which is in line with the best practice Transition Plan Taskforce (TPT) framework, and only 5% of lenders actually have this in place.

One of the key benefits of a well-established transition plan is that it brings together baseline calculations, climate action plans, targets, and progress reporting all in one clear medium – during our analysis we found that many lenders have their climate reporting in several disparate places, making it difficult to understand. For instance, they might have a climate action plan which outlines their roadmap and key action areas, an annual sustainability report which reports on actions performed against that roadmap, and a climate disclosures report which contains the data on financed emissions and targets.

As we can see from the data above, it is also still common for organisations to have no climate information at all. 41% of lenders analysed have published no climate plan of any kind. A further 27% of lenders report on climate risk and emissions only as a small subset of their annual report, without a standalone climate plan – and many of these provide very limited insight. It is worth noting, however, that many of these are SME lenders who are less well resourced and who are not yet legally required to report on their climate impact and progress (see page 27 for a more detailed discussion on this).

We asked the lenders[3] who don't have a climate transition plan whether developing one is a priority for the next 12 months and, encouragingly, the majority say that it is, so it seems there is real urgency around this.

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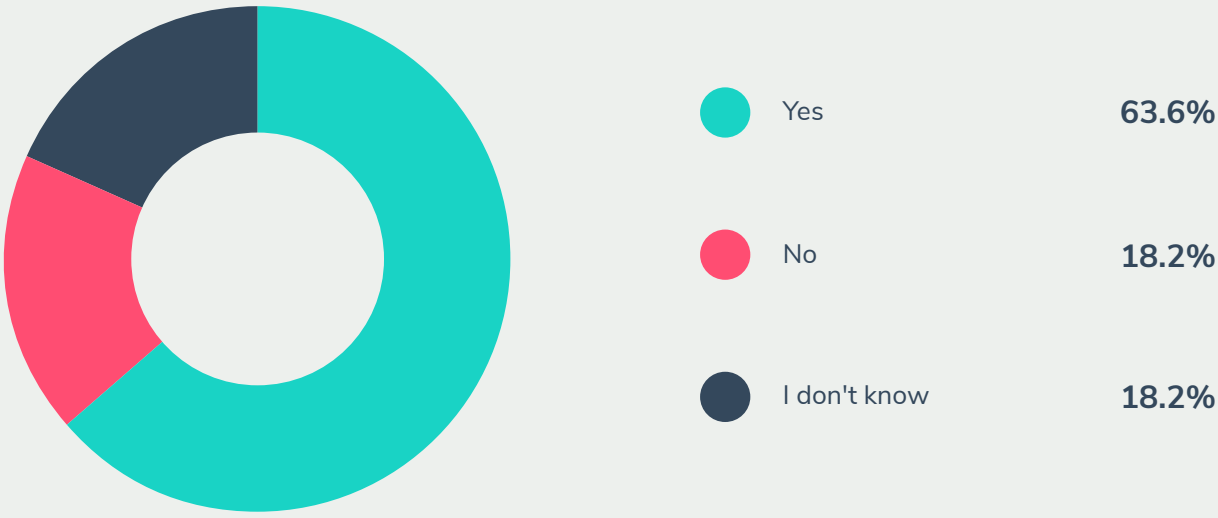
Most of those who don't have a climate transition plan are aware that they need to develop one

If you don't already have one, is creating a climate transition plan a priority for the next 12 months?



Source: Kamma survey of 22 lenders, August 2024

Unsurprisingly, the biggest driver of prioritisation is the need to comply with tightening climate reporting requirements, with the impact of climate risk a close second.

Regulations and climate risk are driving action

What are the key business drivers for creating a climate transition plan? (multiple choice)

Source: Kamma survey of 22 lenders, August 2024

Key finding 2: Data quality is a major challenge for mortgages

Almost three-quarters (71%) of the lenders who report on climate do not disclose their financed emissions calculations.

Initial climate reporting requirements in the UK based on the Taskforce on Climate-Related Financial Disclosures (TCFD), advise that scope 3 emissions should only be reported if material, with no indication of the specifics that should be covered – so this makes sense. From 1st January 2024, however, reporting must be aligned to the International Sustainability Standards Board (ISSB) IFRS S1 and S2. This means that reporting on financed emissions is now mandatory (see page 32).

Financed emissions calculations[4]

Source: Kamma analysis of 85 lenders, August 2024

In this context, it is all the more concerning that the majority of lenders still struggle with the quality of environmental data available for UK housing. Energy Performance Certificates (EPCs) are the primary data source for understanding the energy efficiency and carbon emissions of homes, but they are an unreliable source, impacting the availability and accuracy of financed emissions calculations.

The 6 major problems with EPCs as a data source for property emissions

For more information on the issues with the methodology used to determine EPC bands and carbon emissions for UK properties, head to our article on the topic. Read more.

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One particular issue with EPC data is the amount of mortgaged homes without a valid EPC. Many lenders do highlight this within their climate plans, enabling us to calculate that the average lender is missing EPC data for 34.6% of the mortgage portfolio. It's a big problem, leaving lenders with a high degree of uncertainty on the true climate impact of mortgage portfolios.

Missing EPCs should be addressed by lenders within their financed emissions calculations to avoid skewing their financed emissions and transition risk measurements. In our analysis of lender climate plans it's clear that lenders struggle with this challenge. Only a quarter of lenders transparently disclose the amount of missing EPC data for their portfolio.

Percentage of mortgaged homes with an active EPC

With an active EPC	65.4%
Without an active EPC	34.6%

Source: Kamma analysis of 85 lenders, August 2024

Missing EPC data (% of UK lenders)

Mortgaged homes missing an EPC is disclosed	27%
Mortgaged homes missing an EPC is not disclosed	73%

Source: Kamma analysis of 85 lenders, August 2024

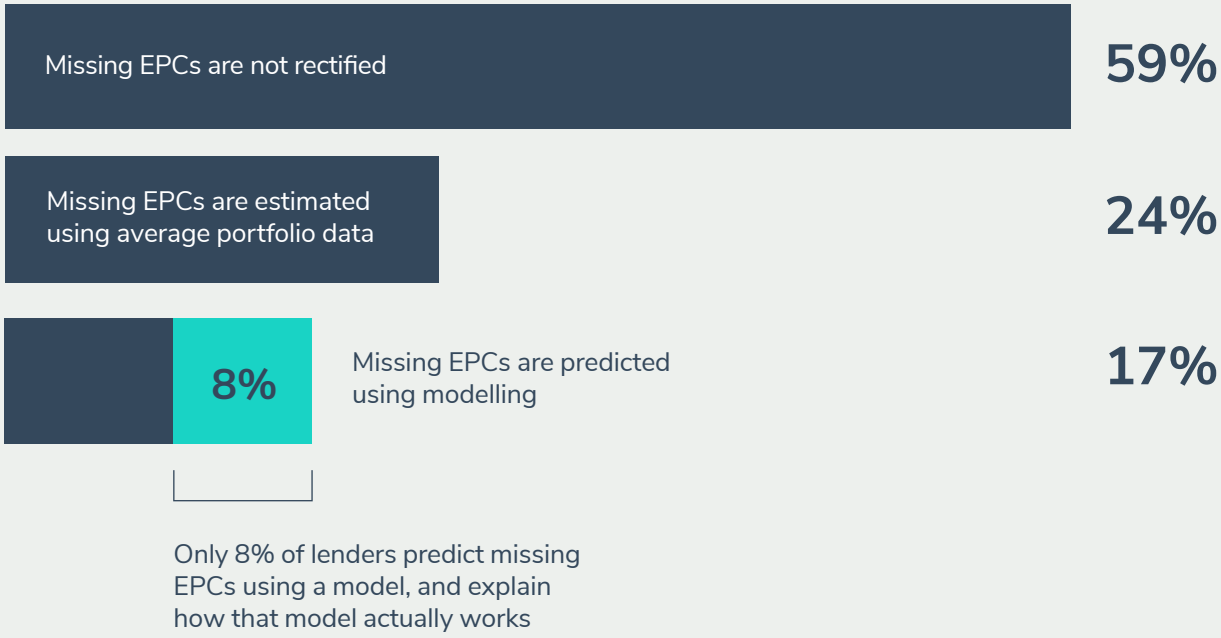
Ideally, this missing EPC data should be addressed by estimating the EPC rating in the most accurate way possible. For mortgage portfolios with a high number of valid EPCs, the best way to do this may be through using a portfolio average to predict the missing EPCs. For portfolios with a higher proportion of missing EPCs (which is the majority of lenders), a more intelligent modelling approach should be used which uses property characteristics to predict EPC ratings.

How to handle missing EPC data: using predictive modelling to fill the gaps

For more information on best practice approaches to estimating EPC bands for mortgaged homes, head to our article on the topic. Read more.

Most lenders are not yet doing this. Of the lenders that do disclose the amount of mortgaged homes missing an EPC, over half are not predicting the missing EPCs at all, leaving a major blind spot in their calculations. 24% use estimations based on the valid EPCs in their portfolio. Just 17% are using a modelling approach – and only half of those using a modelling approach transparently explain the methodology behind that.

How is missing EPC data handled by those lenders that disclose it? (% of UK lenders with a climate plan)



Source: Kamma analysis of 85 lenders, August 2024

Even for those mortgaged homes that do have an EPC, the flawed methodology and outdated baselines used in the SAP calculations that determine EPC bands and associated emissions leaves the data highly unreliable and further reduces data quality for lenders.

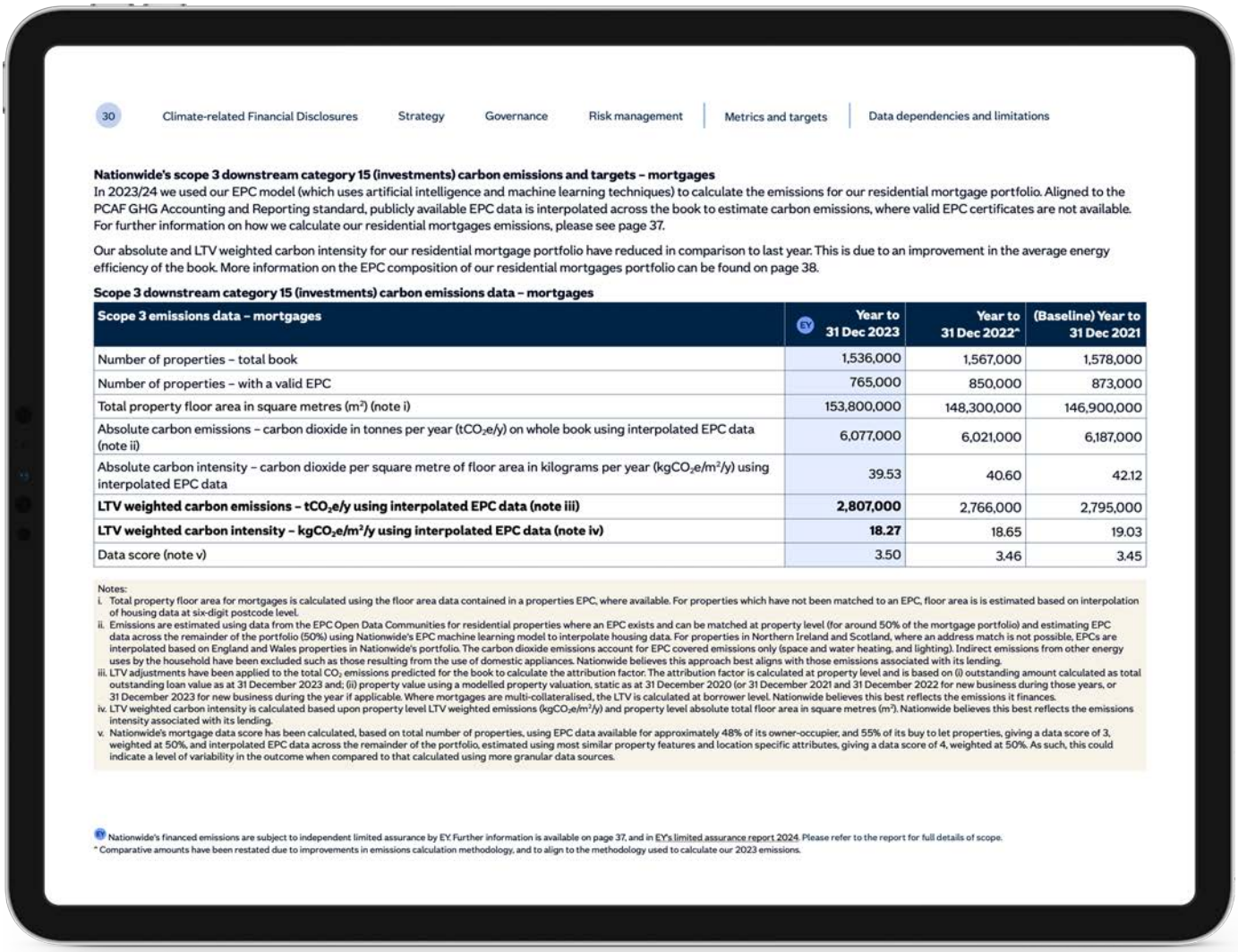
This could go some way to explain why there is a large range within the climate impact that lenders report for their mortgage portfolio. The most commonly reported measurement is physical emissions intensity (kilograms of carbon dioxide equivalent per square metre of floor space in homes). Across the lenders analysed, the average physical emissions intensity is 36.0kg CO_2e/m^2 – but with a range from 15.0 to 47.3 kg CO_2e/m^2.

The wide range of physical emissions intensity across UK lenders (CO_2e/m^2)

Source: Kamma analysis of 85 lenders, August 2024

This range is hugely surprising and points to the challenges with data accuracy. Whilst some homes are, of course, more emissions intensive than others, this should even out to an extent across a large mortgage portfolio.

As well as unreliable EPC data, this range could also be in part due to inconsistencies in the methodologies that lenders use for calculating emissions. For instance, some lenders may report an LTV weighted emissions intensity whereas others report on the total. It's difficult to tell: only Nationwide and Ecology openly reference an LTV weighted emissions intensity, and report on both this and the total. Again, this points to the importance of consistency in reporting across the industry to enable understanding and comparison.



Nationwide's scope 3 downstream category 15 (investments) carbon emissions and targets – mortgages

In 2023/24 we used our EPC model (which uses artificial intelligence and machine learning techniques) to calculate the emissions for our residential mortgage portfolio. Aligned to the PCAF GHG Accounting and Reporting standard, publicly available EPC data is interpolated across the book to estimate carbon emissions, where valid EPC certificates are not available. For further information on how we calculate our residential mortgages emissions, please see page 37.

Our absolute and LTV weighted carbon intensity for our residential mortgage portfolio have reduced in comparison to last year. This is due to an improvement in the average energy efficiency of the book. More information on the EPC composition of our residential mortgages portfolio can be found on page 38.

Scope 3 downstream category 15 (investments) carbon emissions data – mortgages

Scope 3 emissions data – mortgages	Year to 31 Dec 2023	Year to 31 Dec 2022*	(Baseline) Year to 31 Dec 2021
Number of properties – total book	1,536,000	1,567,000	1,578,000
Number of properties – with a valid EPC	765,000	850,000	873,000
Total property floor area in square metres (m^2) (note i)	153,800,000	148,300,000	146,900,000
Absolute carbon emissions – carbon dioxide in tonnes per year (tCO_2e/y) on whole book using interpolated EPC data (note ii)	6,077,000	6,021,000	6,187,000
Absolute carbon intensity – carbon dioxide per square metre of floor area in kilograms per year ($kgCO_2e/m^2/y$) using interpolated EPC data	39.53	40.60	42.12
LTV weighted carbon emissions – tCO_2e/y using interpolated EPC data (note iii)	**2,807,000**	2,766,000	2,795,000
LTV weighted carbon intensity – $kgCO_2e/m^2/y$ using interpolated EPC data (note iv)	**18.27**	18.65	19.03
Data score (note v)	3.50	3.46	3.45

Notes:

i. Total property floor area for mortgages is calculated using the floor area data contained in a properties EPC, where available. For properties which have not been matched to an EPC, floor area is is estimated based on interpolation of housing data at six-digit postcode level.

ii. Emissions are estimated using data from the EPC Open Data Communities for residential properties where an EPC exists and can be matched at property level (for around 50% of the mortgage portfolio) and estimating EPC data across the remainder of the portfolio (50%) using Nationwide's EPC machine learning model to interpolate housing data. For properties in Northern Ireland and Scotland, where an address match is not possible, EPCs are interpolated based on England and Wales properties in Nationwide's portfolio. The carbon dioxide emissions account for EPC covered emissions only (space and water heating, and lighting). Indirect emissions from other energy uses by the household have been excluded such as those resulting from the use of domestic appliances. Nationwide believes this approach best aligns with those emissions associated with its lending.

iii. LTV adjustments have been applied to the total CO_2 emissions predicted for the book to calculate the attribution factor. The attribution factor is calculated at property level and is based on (i) outstanding amount calculated as total outstanding loan value as at 31 December 2023 and; (ii) property value using a modelled property valuation, static as at 31 December 2020 (or 31 December 2021 and 31 December 2022 for new business during those years, or 31 December 2023 for new business during the year if applicable. Where mortgages are multi-collateralised, the LTV is calculated at borrower level. Nationwide believes this best reflects the emissions it finances.

iv. LTV weighted carbon intensity is calculated based upon property level LTV weighted emissions ($kgCO_2e/m^2/y$) and property level absolute total floor area in square metres (m^2). Nationwide believes this best reflects the emissions intensity associated with its lending.

v. Nationwide's mortgage data score has been calculated, based on total number of properties, using EPC data available for approximately 48% of its owner-occupier, and 55% of its buy to let properties, giving a data score of 3, weighted at 50%, and interpolated EPC data across the remainder of the portfolio, estimated using most similar property features and location specific attributes, giving a data score of 4, weighted at 50%. As such, this could indicate a level of variability in the outcome when compared to that calculated using more granular data sources.

EY Nationwide's financed emissions are subject to independent limited assurance by EY. Further information is available on page 37, and in EY's limited assurance report 2024. Please refer to the report for full details of scope.

* Comparative amounts have been restated due to improvements in emissions calculation methodology, and to align to the methodology used to calculate our 2023 emissions.

From Nationwide's Climate-related Financial Disclosures, 2024

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The Partnership for Carbon Accounting Financials (PCAF) is an initiative aiming to overcome some of these data issues by producing industry-wide methodologies that enable consistent financed emissions reporting.

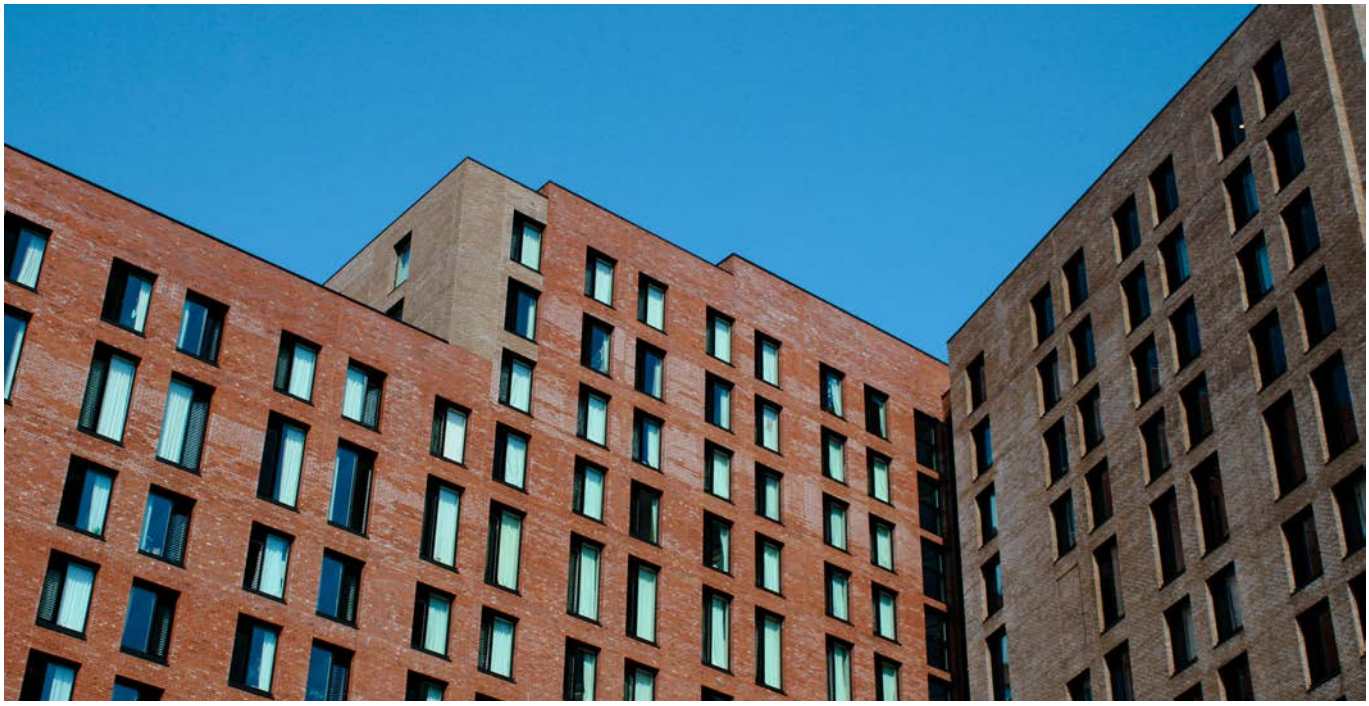
Their methodology for calculating real estate financed emissions is the current best practice approach, which lenders should be aligning with to ensure their data and calculations are standardised and comparable with the wider industry – so this was included as a key factor in our scoring of lender climate transition plans. As you can see from the data below, only 48% of lenders with a climate plan currently state that their financed emissions calculations are aligned with the PCAF methodology. Positively, for those that do use the methodology, there is a relatively high level of transparency around the PCAF score for data quality.

Use of PCAF in climate plans (% of UK lender)

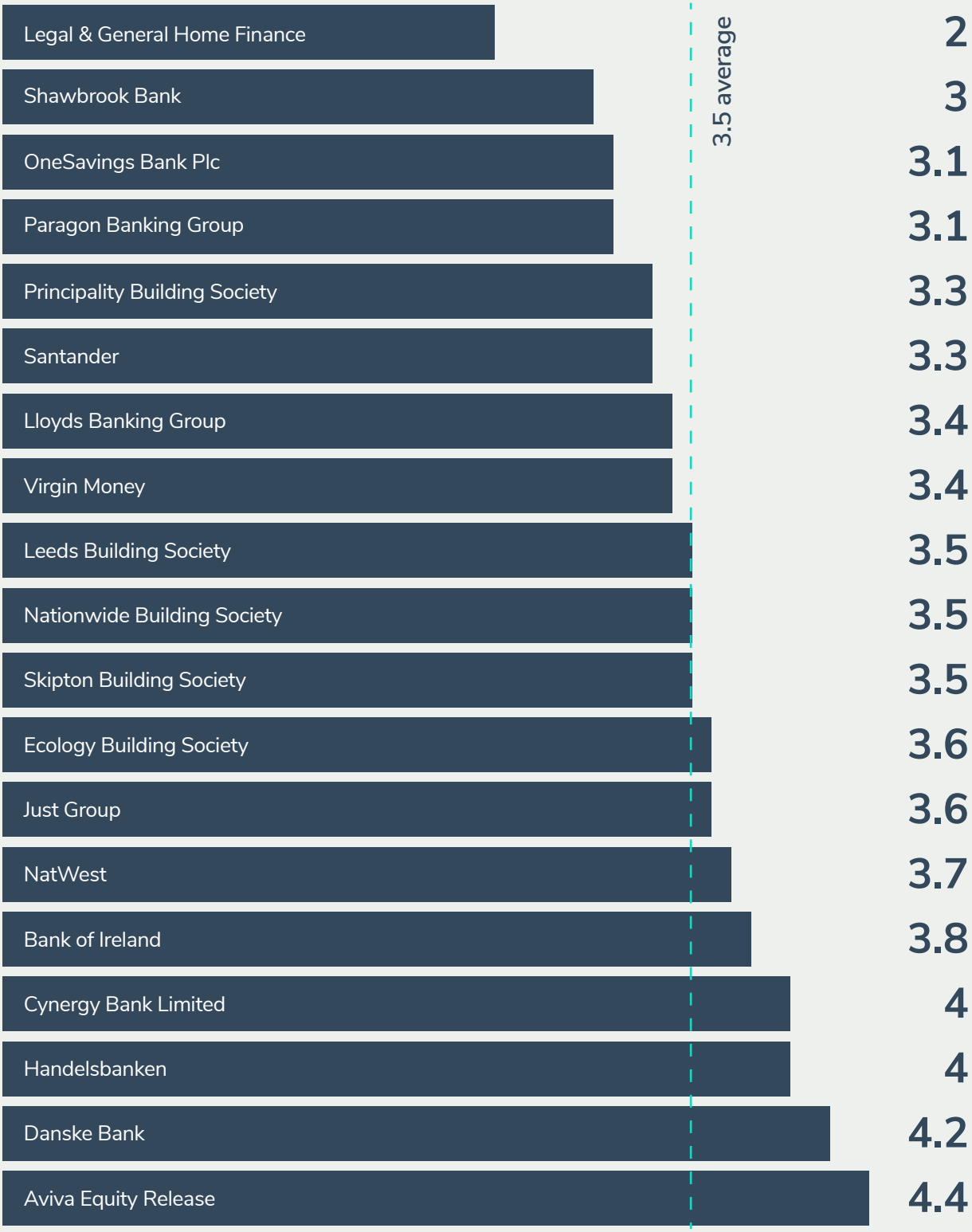
PCAF score is disclosed for mortgages (subset of those that use PCAF)	79%
PCAF methodology is used for mortgage financed emissions	48%

Source: Kamma analysis of 85 lenders, August 2024

PCAF scores range from 1-5, with 1 representing the highest quality data. In our analysis the **average mortgage portfolio PCAF score is 3.5**. This is, unfortunately, a reflection of the poor quality of EPC data and the many homes lacking an EPC which leads lenders to rely on estimates.



PCAF score for mortgage financed emissions[7] (Lenders)

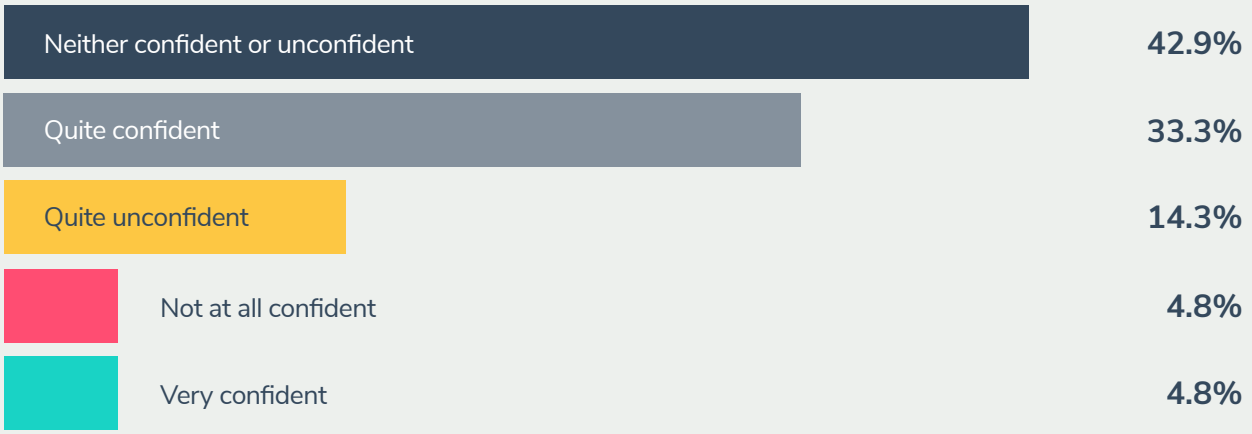


Source: Kamma analysis of 85 lenders, August 2024

This is reflected also in the findings from our survey of lenders. Most ESG professionals do not feel confident in the climate transition plan for their company.

Room for improvement: only 38% of lenders are confident in the effectiveness of their transition plans

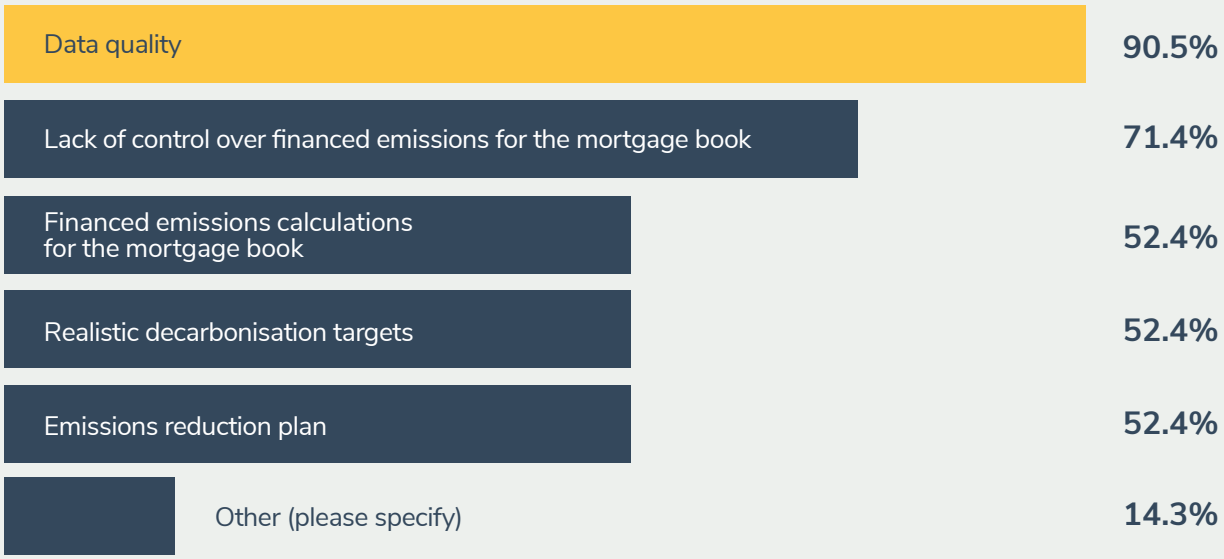
How confident are you in the effectiveness of your climate transition plan compared to other lenders?



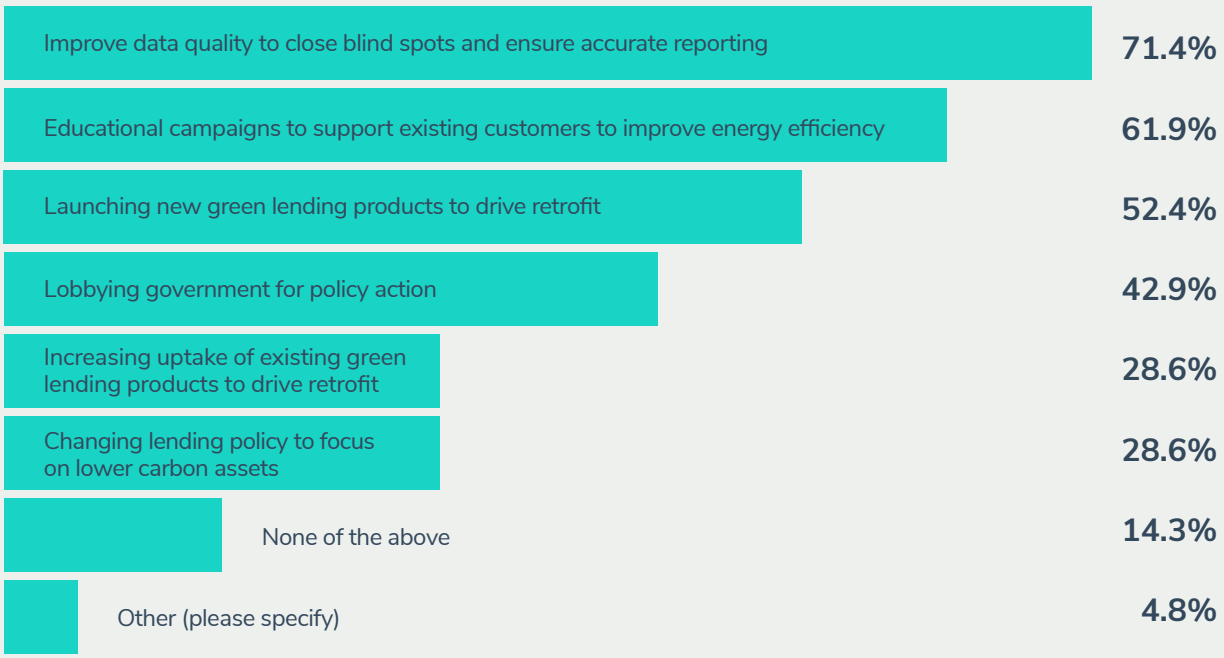
And when asked which elements of transition planning they feel their company could improve on, 93% indicated that data quality was a problem area. Further, data quality was also cited as the no.1 priority across ESG professionals surveyed in terms of actions for the next 12 months.

Poor quality data is one of the biggest challenges, and the number one priority to solve

Which elements of your company's climate transition plan do you think need to be improved?



What actions has your company planned for the next 12 months to reduce financed emissions for the mortgage portfolio?



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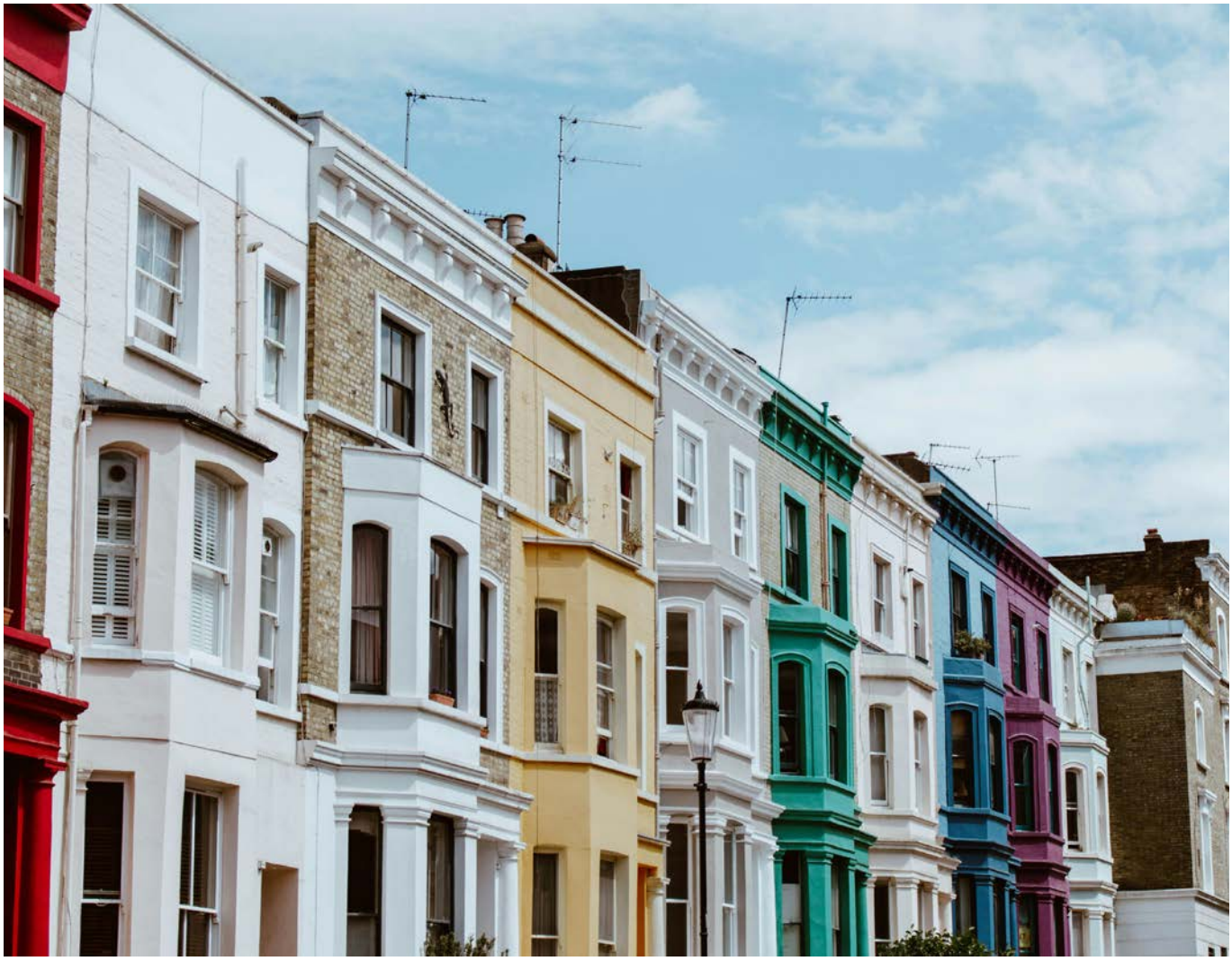
Good data is the backbone of a robust climate transition plan – without it, the other elements highlighted in the survey (emissions calculations, targets, emissions reductions plan) are built on uncertain ground.

This creates even more of a challenge in future years when the pace of the transition needs to increase. Setting targets on an inaccurate baseline now will cause major issues later when data quality issues are discovered, as reported data needs to go through a major recalibration exercise to be made correct. This may also render previously stated targets unsuitable as inaccurate financed emissions data means that lenders have set targets that are either too high or too easily achievable to contribute meaningfully to the fight against climate change.

Improve your PCAF score with Kamma

Kamma's advanced data and analytics for energy efficiency and emissions ensures lenders can achieve a best-in-class PCAF score. Atom bank's PCAF score improved to 3.02 through partnering with Kamma, for instance. A strong PCAF score demonstrates the sophistication of your company's climate reporting to regulators, investors, and customers. Find out more.



Key finding 3: Striking the balance on ambitious but realistic climate targets for the mortgage book is a tricky task

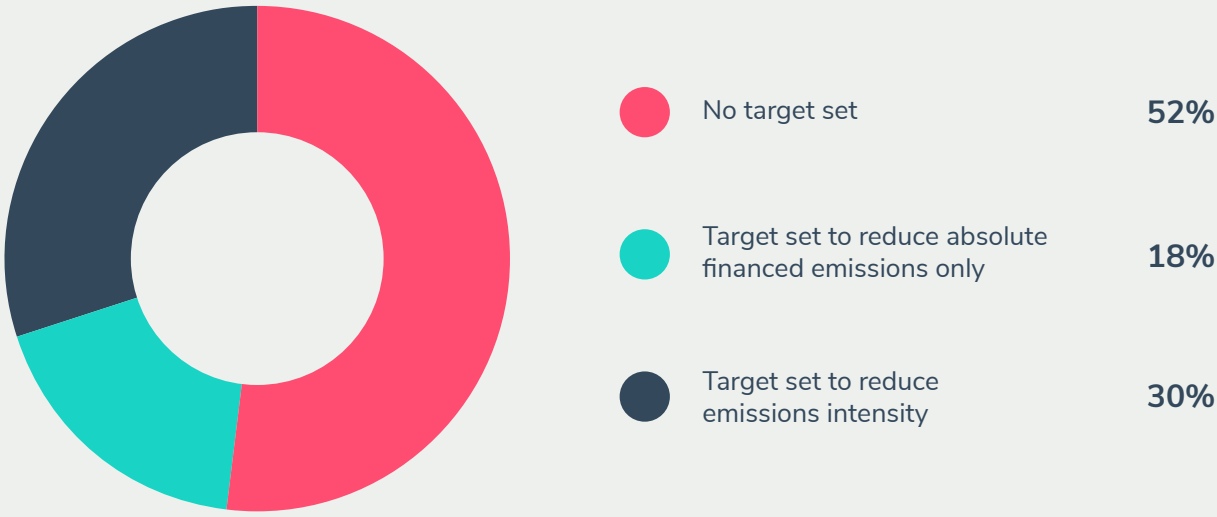
Within those lenders that are transparently reporting on climate plans and progress, approaches vary when it comes to setting targets relating to reducing financed emissions from the mortgage portfolio.

Having an ambitious target for mortgage emissions is critical for climate transition planning because, as we've seen, those financed emissions are the vast majority of a lender's impact. At the same time, it's also critical that targets are realistic – an ambitious target with no chance of achieving it becomes dangerously close to greenwashing, which has implications for the reputation of a lender's brand.

Within those that do have a target, there is a lack of consistency in how that target is set. Many have opted for a 'net zero by [date] for financed emissions' style target. Others give a specific figure for the absolute tco_2e reduction from the mortgage portfolio. Others still have a target to reduce a percentage of emissions intensity for mortgages from a set baseline.

Roughly one-third of lenders have not yet set a target. A further 10% of lenders have set a target only based on cutting absolute emissions – a target based on reducing emissions intensity is best practice because it enables comparison across lenders with different sized mortgage portfolios.

Target type for mortgage book emissions (% of UK lenders with a climate plan)



Source: Kamma analysis of 85 lenders, August 2024

The differing approaches to targets makes it difficult to interrogate and compare the level of ambition across UK lenders. Lenders are clearly aware of this as a problem area too, with 64% citing setting realistic targets as an area of transition planning that needs improvement in their company (see page 18).

The ideal scenario would be an industry-wide standardisation of how to set targets for the mortgage book which is incorporated into the best practice transition plan framework for lenders. This could be, for instance, an agreement to align with the Climate Change Committee's carbon 'balanced pathway' for the residential sector[8], which has two key milestones: a 43% reduction in total emissions for UK residential by 2035, and 100% by 2050.

As a general note, the best way to ensure the right balance of ambition and realism is through taking a data-driven approach to target setting which steers well away from arbitrarily plucking targets out of the air. This means first having a clear understanding of the current impact of the portfolio and then applying detailed scenario analysis which illuminates the different pathways for decarbonising the portfolio.

This challenge of setting ambitious targets is a challenging area personally for many of those employees responsible for climate transition planning within lender companies. ESG is now a specialism within company structures, and it's therefore most likely today that ESG or sustainability professionals will be responsible for climate transition planning.

Sustainability is now a specialism: majority of organisations surveyed have set up specific teams to plan the transition

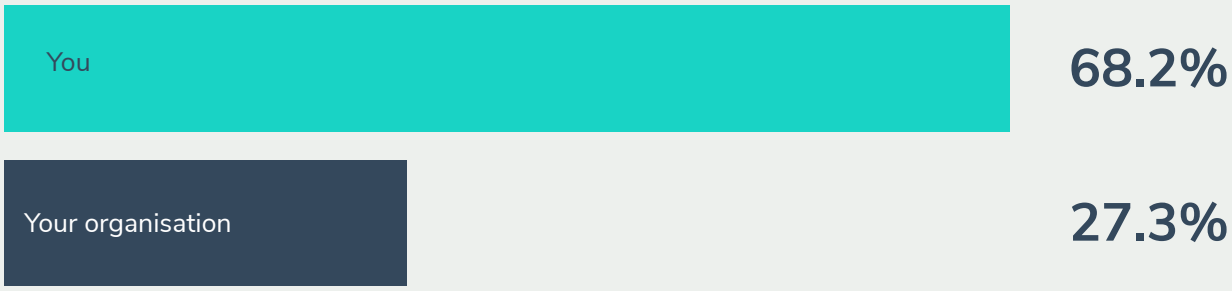
Which team is primarily responsible for climate transition planning? (%)

Source: Kamma survey of 22 lenders, August 2024

When we asked survey respondents about the importance of climate action, the overall feeling is that their companies see climate as much less of a priority than they do. In all likelihood, we have ESG leaders who care about climate action on a personal level, and want to set much more ambitious targets, but have to compromise to balance this with competing needs across the business.

Mind the gap: tackling climate change is a bigger priority for those working in ESG than wider organisations

How much of a priority is climate change for... (% high)



Source: Kamma survey of 22 lenders, August 2024

How are lenders disclosing transition risk in their climate plans?

This report focuses on lender climate transition plans, which focus on the strategy and actions to reduce emissions, and don't explicitly call out transition risk analysis.

However, this is, of course, closely related to transition risk for lenders. Mortgaged homes that are energy inefficient and have high carbon emissions will become high-risk assets as climate policy targeting this ramps up.

This is reflected in the TPT framework which references climate risks as part of the 'strategic' element of a best practice transition plan: "[objectives and priorities] for enhancing the entity's resilience to the changing climate and responding to the risks and opportunities that arise from the transition to a low-GHG emissions, climate-resilient economy."

Transition risk and transition plans are also becoming closely aligned within legislation. From 2024 the IFRS Foundation is taking over responsibilities for monitoring progress on companies' climate-related disclosures, from the TCFD. As part of this transition, IFRS published the IFRS Sustainability Disclosure Standards in June 2023, developed by the independent International Sustainability Standards Board (ISSB). The UK is set to adopt the new IFRS standards in 2025.

IFRS S2 is the new standard for climate-related disclosure, which builds on the TCFD recommendations and includes disclosures on climate-related risks and opportunities. IFRS S2 increased reporting obligations in a few key ways.

Importantly in the context of this report, any climate transition plan must be disclosed:

"... the company is required to disclose any transition plans it has and how the company plans to achieve its climate-related targets." – from Comparison of the IFRS S2 Climate-related Disclosures with the TCFD Recommendations, July 2023

But the most important factor to note is that, whereas TCFD gave financial institutions the flexibility to report on the aspects of climate risk and opportunity that they felt important, IFRS makes it mandatory to report both financed emissions and exposure to all forms of climate risk (including transition risk).

For lenders, this means that it's going to become even absolutely vital to have a robust method for calculating financed emissions and quantifying transition risk within the mortgage portfolio (including a rigorous stress testing approach) – and, as we've seen throughout this report, these are two particularly challenging areas for lenders.

Most lenders are equipped with accurate measurements and analysis for their mortgage book in terms of physical risk, particularly flood risk. The same isn't true for transition risk, despite it impacting over a much shorter time frame. Only a handful of lenders today have a robust methodology for quantifying and stress testing transition risk within the portfolio. This is becoming increasingly important, as new policies and regulations aim to close the gap between decarbonisation targets and decarbonisation progress, with residential property reducing emissions by just 14% since 1990. Labour have signalled their intent to close this policy gap, making the stress testing of transition risk a top priority for all lenders in 2024-5.

Key finding 4: Lenders are relying on policy to decarbonise mortgages, but struggle to quantify this

Almost all lender climate plans emphasise their reliance on government policy to decarbonise UK homes. Survey respondents also highlighted this as one of the biggest challenges in climate transition planning (see page 18)

This is entirely valid, but there seems to be a struggle to quantify the role of policy compared to actions the lender is able to drive themselves.

Around half of UK lenders rightly reference the use of scenario analysis to inform their target setting, identifying the key dependencies that impact their own emissions reductions e.g. decarbonisation of the National Grid or introduction of Minimum Energy Efficiency Standards (MEES) legislation.

However, very few of these actually include a quantification of the impact of those dependencies on emissions reduction in the mortgage portfolio i.e. how much would the introduction of these policies speed up the rate of decarbonisation towards the targets set?

Inclusion of external dependencies in climate planning (% of UK lenders with a climate plan)

44% use scenario analysis to identify dependencies and inform target-setting for the mortgage book

10% quantify external dependencies to fully understand their impact

Source: Kamma analysis of 85 lenders, August 2024

Without this, it's very difficult to understand the relative contribution of the government and the lenders' own intended actions to decarbonise. This causes inertia, as lenders feel they cannot progress emissions reduction without new policy, which, returning to our 'key finding 3', could actually be a very important factor holding back some lenders from more ambitious climate targets.

The uncertainty around which policies will actually be implemented, when, and how aggressively they will ramp up makes target-setting a challenge. It also impacts the actions that are prioritised to reduce emissions in the mortgage portfolio: 57% of our survey respondents said that lobbying the government for policy action was a key action for the next 12 months (see page 18).

This also brings us back to the question of lenders' ability to influence mortgage customers to improve energy efficiency, with many macro factors having a material impact on the pace of decarbonisation. By identifying and quantifying these factors, lenders achieve two things: firstly they outline the dependencies in their transition plan, highlighting their reliance on government policy and homeowner appetite to achieve their goals. Secondly, they can track the progress of these driving factors so under or overachievement can be clearly explained to all stakeholders.

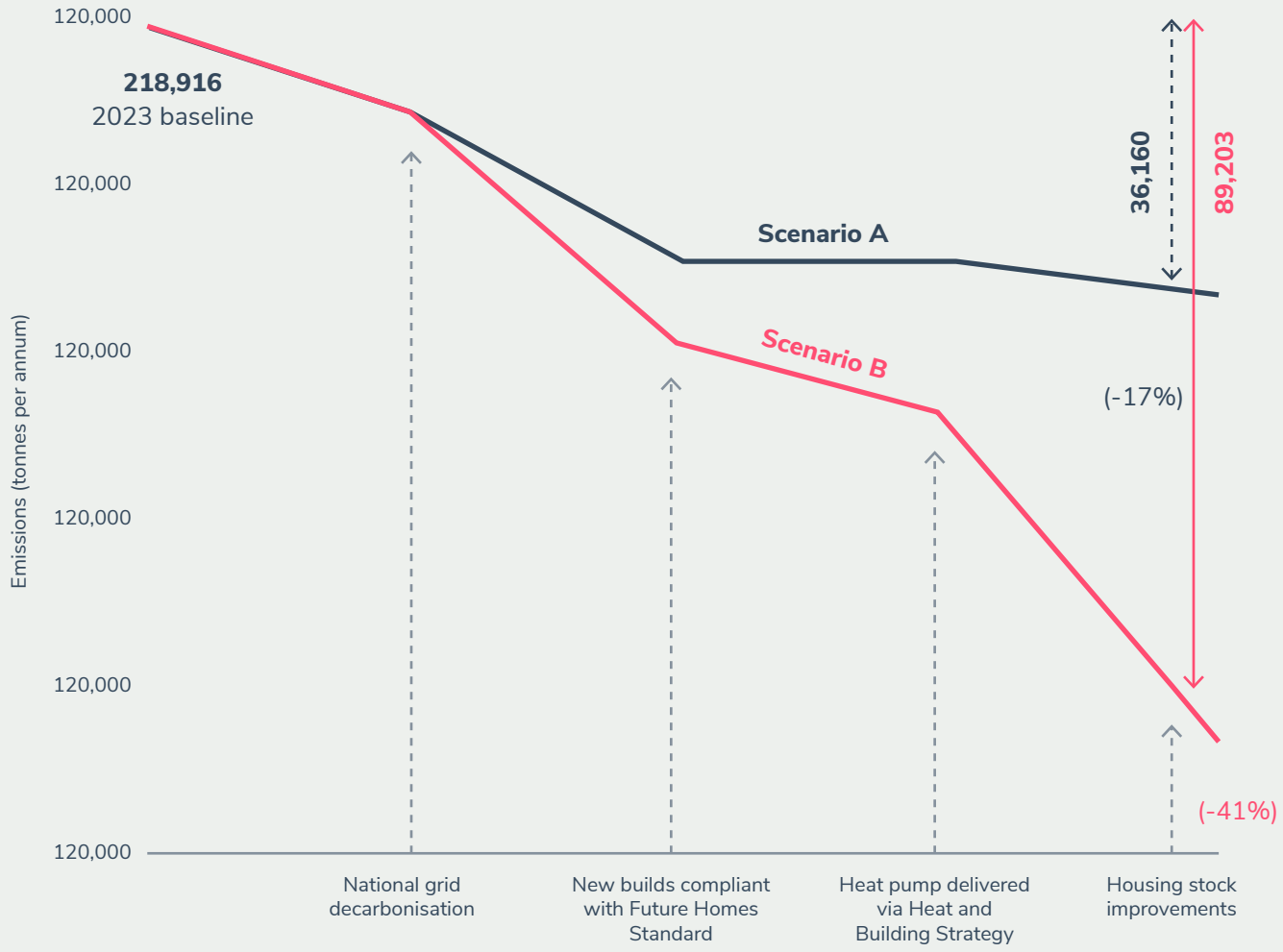
How to quantify external dependencies: Kamma case study

A climate-forward lender worked with Kamma to conduct scenario analysis and model the impact of expected government policies on their rate of mortgage portfolio decarbonisation, towards their target of a 50% reduction in emissions by 2030.

Scenario A highlights the current rate of decarbonisation based on existing policy commitments and historical progress. Scenario B models how the rate of decarbonisation would be impacted if existing and anticipating policies relating to housing decarbonisation are realised.

Emissions reduction under each scenario

The analysis highlighted that if the lender continued at their current rate, they would achieve 17% emissions reductions in the mortgage portfolio by 2030. Government policy is expected to contribute an additional 24%. A 9% reduction would be outstanding to meet their target. This quantification has given the team a core focus to close that 9% gap between their current rate of decarbonisation and the rate needed to meet their target by 2030.



Key finding 5: All lenders need more ambitious plans to drive retrofit uptake amongst mortgage customers

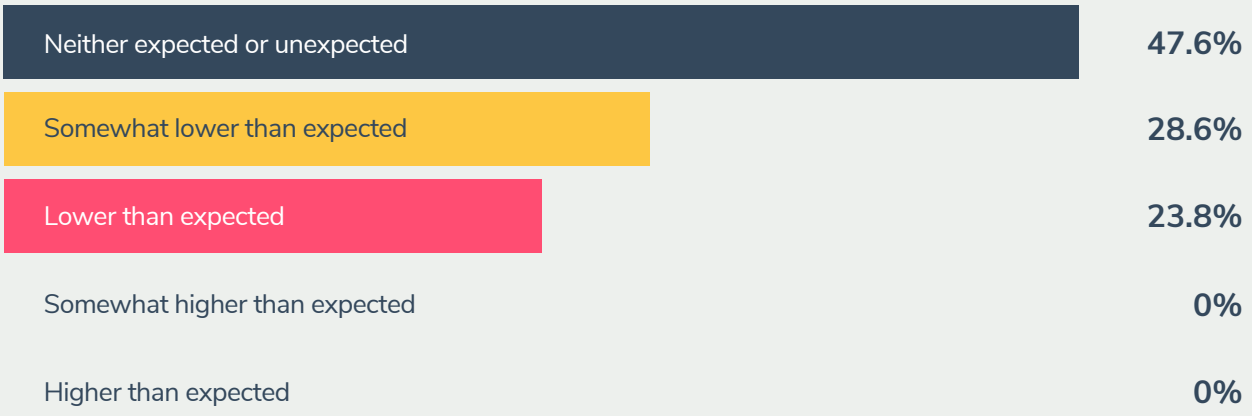
Following on from the previous finding, whilst policy does have a huge role to play in decarbonising housing, this has to be in combination with actions by lenders themselves.

Lenders have an existing relationship with homeowners. This should be harnessed to educate on the benefits of improving energy efficiency effectively, as well as to provide retrofit financing products that help them cover the upfront costs of energy efficiency measures. This is vital not only for reducing financed emissions, but also for supporting the 'just transition' by ensuring that customers do not end up stuck in an energy inefficient home which has become worthless.

However, so far only 30% of lenders reference the role of retrofit financing products e.g. a retrofit improvement loan or additional borrowing mortgage for retrofit. We know that lenders have struggled with uptake of their green lending products (either a retrofit financing product or a green mortgage), and this is reflected in survey responses too.

Slow uptake of green financing is diminishing the effectiveness of lender transition strategy

On a scale of 1-5 how has your green lending proposition performed compared to your expectations?



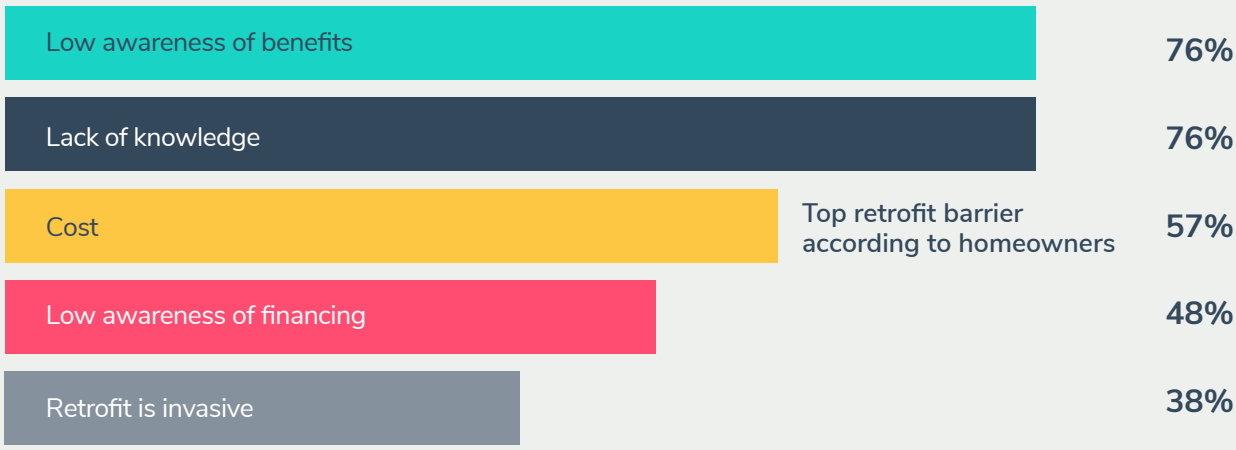
Source: Kamma survey of 22 lenders, August 2024

This is one of the reasons that retrofit education is also important alongside products: to increase awareness of financing options to cover the costs of energy efficiency improvements. Lenders are well aware of this, with 71% of survey respondents highlighting upfront costs as a key barrier for mortgage customers to retrofit their homes and 57% noting a lack of awareness about financing options to reduce the financial burden.

Interestingly, the upfront costs were not seen as the top barrier by lenders surveyed, despite this consistently being found to be the number one barrier for homeowners – retrofit is seen as prohibitively expensive, with a long payback period.

Lenders understand some of the barriers their customers face, but prioritise different challenges

Top retrofit barriers according to lenders



Source: Kamma survey of 22 lenders, August 2024

The ESG professionals surveyed see the biggest barrier to retrofit as a lack of awareness amongst customers of the benefits of improving home energy efficiency – with 86% of survey respondents highlighting this. This is definitely also important, because without this acknowledgement, homeowners are unlikely to consider retrofit in the first place, let alone look to their mortgage lender for financing options.

Despite this, only 34% of lenders specifically reference the role of retrofit education as an action to reduce financed emissions from the mortgage portfolio.

The role of retrofit in emissions reduction (% of UK lenders with a climate plan)

34% included retrofit education in the action plan for reducing financed emissions

30% include retrofit financing in the action plan for reducing financed emissions

Source: Kamma analysis of 85 lenders, August 2024

However, it's encouraging to see that the majority of lenders are making retrofit education a priority in terms of their planned actions for the next 12 months (see page 18).

It's also very encouraging that the vast majority of lenders that do reference retrofit have already put actions into place on this. 100% of the lenders who include retrofit in their action plan already have educational content available (of varying breadth and depth), and 94% have a retrofit financing product e.g. green additional borrowing mortgage available to customers. It seems that once encouraging retrofit is cemented in a publicly available plan, it's more likely to come to fruition.

However, it's worth noting that many of those lenders that do have retrofit education available have relatively light touch webpages which may not represent strong enough messaging and awareness-raising to impact homeowner action on energy efficiency.

An area where improvement is possible is for more lenders to provide a retrofit planning tool to support homeowners to identify their own home's retrofit options, as well as the likely costs and ROI. Only 28% of the lenders that reference retrofit education within their action plan have such a tool available. Lenders could also consider investing in direct marketing to ensure the message actually reaches customers.

Furthermore, it's also vital to consider the role of brokers. The route to market is a major challenge for lenders looking to increase customer retrofit because, as an intermediated market, lenders have less control over the customer journey and need to convince both brokers and customers of the benefits of retrofit loans. Whilst the increase in drawdown for a retrofit loan may not offer a material incentive to intermediaries, it's important to highlight that retrofitting may be an opportunity that unlocks greater lending and, therefore, greater commission for brokers. Landlords and home buyers are more likely to invest in inefficient homes if they understand how to improve them. If some of the data on the impact of energy efficiency on asset value is to be believed, then inefficient homes may represent an appealing option for investors and first time buyers. Cheaper homes that can be easily improved may be an underappreciated opportunity, widening the market and supporting more people onto the housing ladder.

Methodology

Lender transition plan analysis

All lenders listed by UK Finance and Finder have been included in the analysis. Lenders that are a subsidiary of a larger parent lender have not been included. This is because these lenders are only required to submit climate reporting at a parent level.

Lenders have been analysed based on public information available on their website, across five key areas with a focus on actions for the mortgage portfolio:

- **Section 1**: Clear climate plans – 5 points available.
- **Section 2**: Mortgage emissions calculations – 10 points available. This section has been given a higher weighting because accurate baseline calculations ensure that everything else (targets, action plan, progress reporting) are based on robust assumptions, and to reflect the particular challenge of data quality in climate transition planning for lenders.
- **Section 3**: Robust targets for the mortgage portfolio – 5 points available.
- **Section 4**: The action plan to reduce mortgaged emissions – 5 points available.
- **Section 5**: Decarbonisation progress so far – 10 points available. This section has been given a higher weighting to recognise the comparative importance of action over planning.

There's more information on the criteria behind how points are given, and why this criteria was chosen, in the tables below.

The total score given is out of 35 points.

Section 1: Clear climate plans

Lenders should transparently communicate their plans to tackle climate risk and financed emissions, with a Transition Plan Taskforce (TPT) aligned transition plan being the ideal Scenario.

Criteria	Points if yes
Are they transparently reporting on climate?	1
Do they have a Transition Plan Taskforce aligned transition plan? **Rationale:** Whilst opinions on the approach vary, the Transition Plan Taskforce is currently the most widely accepted framework for formulating a transition plan, and is being incorporated into climate disclosures legislation by the UK government. For this reason, we've included it as the industry best practice approach within our scoring criteria.	2
Do they have an non-TPT aligned transition plan OR standalone annual sustainability report?	1
Are they reporting on climate as a subset of their annual report?	0.5
Have they announced plans to publish a TPT aligned transition plan?	0.5

Section 2: Mortgage emission calculations

Lenders should calculate absolute emissions and physical intensity for mortgages using the PCAF methodology and transparently disclose data sources used and resulting PCAF score.

Criteria	Points if yes
Do they disclose absolute financed emissions for the mortgage portfolio?	0.5 if overall 1 if mortgages separated
Do they disclose emissions intensity for the mortgage portfolio? **Rationale**: Emissions intensity holds importance because it enables comparison across lenders with different sized mortgage portfolios.	0.5 if overall 1 if mortgages separated
Do they disclose LTV weighted emissions intensity for the mortgage portfolio? **Rationale**: Weighting the emissions intensity based on LTV gives a more accurate view of the financed emissions associated with mortgaged homes.	1.5
Have they used PCAF methodology to calculate financed emissions? **Rationale**: Whilst opinions on the methodology do vary, PCAF is currently seen as the industry-standard for financed emissions calculations and monitoring the data quality of the data sources for those calculations. Therefore, we include it in our scoring as the best practice approach.	1
Do they disclose the data source(s) used to calculate financed emissions for the mortgage book? **Rationale**: Data quality is a major challenge for mortgage lenders due to the incomplete and inaccurate nature of EPC data. Because of this, it's vital that lenders are transparent about the data source and approach for calculating financed emissions from mortgages.	1
Do they account for missing EPC data using estimation? **Rationale**: The average mortgage portfolio is missing EPC data for 35% of loans. It's therefore important that lenders account for this within their calculations. One approach to this is to use estimates of EPC ratings based on averages or on housing characteristics.	1
Do they account for missing EPC data via a modelling approach? **Rationale**: Modelling the missing EPC data using geospatial data and/or machine learning is typically a more robust way to account for the missing data (unless there is a very high proportion of active EPCs in the portfolio) and so we have scored this more highly in our approach.	1.5
Do they disclose the PCAF score for mortgages?	0.5
Is the PCAF score below average (3.5)? **Rationale**: Given the challenges with EPC data, lenders are not expected to have perfect data for their mortgage portfolio emissions. However, a lower PCAF score indicates progress towards improving data quality and so we have rewarded this in our scoring.	1.5

Section 3: Robust targets for the mortgage portfolio

Lenders should use scenario analysis to determine a realistic but ambitious decarbonisation pathway for the mortgage portfolio, with detailed targets along the way.

Criteria	Points if yes
Do they have targets for reducing absolute financed emissions from the mortgage portfolio?	0.5
Do they have targets for reducing the emissions intensity of the mortgage portfolio? **Rationale**: Emissions intensity is given higher weighting as it enables comparison across lenders with different sized mortgage portfolios.	1 if top level 2 if detailed
Are targets aligned with Science Based Targets (SBTi)? **Rationale**: SBTi is currently seen as the industry standard for setting robust climate targets.	1
Are targets informed by scenario analysis, accounting for key dependencies? **Rationale**: Mortgage lenders are reliant on external factors for some part of decarbonising the mortgage portfolio, particularly policy decisions around energy efficiency standards and the decarbonisation of the National Grid. Lender climate targets and action plans, therefore, should reflect this.	1
Are the dependencies quantified? **Rationale**: Quantifying the dependencies means that lenders are able to indicate the actual impact of external dependencies on their climate target, adding confidence to their plans and targets.	0.5

Section 4: The action plan to reduce mortgaged emissions

Lenders should outline the actions required to meet targets for the mortgage portfolio, which should include retrofit education and financing products to support improved energy efficiency.

Criteria	Points if yes
Do they outline a clear action plan for reducing the impact of the mortgage portfolio?	1.5
Do they state that development of an action plan is in progress?	0.5
Is retrofit education included in planned actions? **Rationale**: Mortgage lenders have a vital role to play in encouraging energy efficiency improvements amongst their mortgage customers. A major barrier currently is a lack of awareness and understanding about home retrofit, so educational campaigns by lenders hold importance because they can help to overcome this.	1.5
Is retrofit financing included in planned actions? **Rationale**: The upfront costs of retrofit improvements are another major barrier to energy efficiency currently. Retrofit financing options by lenders e.g. green additional borrowing mortgage or green mortgages that reward retrofit improvements, hold importance as they can help to overcome this.	1.5
Does the plan rely on only rewarding homes that are already energy efficient (green mortgages) rather than supporting improvements (retrofit financing)? Are the dependencies quantified? **Rationale**: So far, the most common green lending products have been green mortgages that reward already energy efficient (EPC A-C) homes with preferential rates or cash back. This does not encourage inefficient homes to retrofit and, therefore, does not drive decarbonisation.	-1

Section 5: Progress so far

Lenders should already be making progress on decarbonising the mortgage portfolio, transparently reporting on this against targets.

Criteria	Points if yes
Is progress on reducing financed emissions reported against targets for the mortgage portfolio?	1
Have significant reductions been made in the last 12 month reporting period? **Rationale**: The most important factor in climate progress is, of course, whether the actions taken are resulting in decarbonisation, and so this is highly weighted within our scoring. We have defined 'significant reductions' as a 7.5% decrease in emissions or emissions intensity in the previous 12 month reporting period. We have discounted progress which relates to factors outside of decarbonisation actions e.g. improved data quality or new originations on EPC A or B homes.	4
Do they have educational content on retrofit for customers?	1.5
Do they have a retrofit planning tool for customers? **Rationale**: A retrofit planning tool has the double benefit of providing customers with education on how best to approach a retrofit for their home, and support with understanding the costs.	1.5
Do they have a retrofit financing product for customers?	2

Please note that this is the first iteration of this report and the scoring approach, and we are very open to feedback, comments, and discussion to ensure the methodology is refined over time and accurately reflects the steps that determine ambitious climate action by lenders.

If you have any questions or comments with regard to the methodology used for this report, please contact **hello@kammadata.com**.

Endnotes

[1] Climate Disclosure Project (CDP), Financial Services Disclosure Report 2020

[2] Defined as year-on-year reductions of -7.5% or more, in line with the UN pathway for staying within 1.5 degrees of warming.

[3] 22 lenders surveyed. The survey targeted those responsible for ESG at UK mortgage lenders. The vast majority of respondents are in ESG or sustainability roles, with a small handful in either Risk or Finance teams.

[4] There is overlap between the figures in this chart as some lenders report both absolute financed emissions and emissions intensity, so the total is not 100%.

[5] Absolute financed emissions is the overall figure of indirect emissions attributed to a lender's financing activities, given in tonnes of carbon emissions (tCO_2e) per year. Emissions intensity is the amount of emissions from a given unit of activity: in the case of financed emissions for residential lending this is either economic intensity i.e. the tonnes of carbon emissions per £1 million lent (tCO_2e / £) or physical intensity i.e. the tonnes of carbon emissions per metre squared of property (tCO_2e / m^2). Emissions intensity enables comparison across lenders with different book sizes, and so is a more best practice approach.

[6] Many of the lenders analysed operate as high street banks as well as mortgage lenders, meaning that they have additional financed emissions outside of their mortgage portfolio. Some of these lenders disclose an overall figure for their financed emissions, rather than splitting out the relative impact of each type of investment, which would be the best practice approach for accuracy and transparency.

[7] The portfolios of these lenders varies, with some including only residential mortgages (owner occupier and BTL) and others covering commercial mortgages too. The data challenge for commercial properties is even greater than for housing, which can pull the PCAF score down – which may explain some of the variance here too, as most lenders disclose the PCAF score for their whole mortgage portfolio. In this list, only Skipton have specified that the given PCAF score is only for their residential mortgages.

[8] Development of trajectories for residential heat decarbonisation to inform the Sixth Carbon Budget: A study for the Committee on Climate Change (2021)

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