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Planning the Climate Transition: A Guide for Smaller and Mid-Sized Mortgage Lenders

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Introduction

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 guide 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. SME lenders have, unsurprisingly, taken fewer steps to plan the transition when compared to their larger, better resourced peers. This guide is designed to highlight ways in which they can quickly and easily catch up by identifying the best practice steps and data required to meet regulatory requirements, and drive towards decarbonisation goals.

The second highest scoring lender in our ranking, Ecology Building Society, is setting an example for SMEs by showing that it is possible to implement industry-leading action plans without the resources typically available to larger lenders.

"We published our plan because Ecology Members expect us to take a lead.

Our transition planning continues to evolve. We started from what the planet needs, which helps us prioritise the right activities while we understand and improve the quality of data available to measure our progress.

Ultimately the net zero transition is about helping our Members to decarbonise their homes, particularly those properties we lend on, and how we operate our business to support that, considering other environmental and social impacts as well.

As a smaller building society, we monitor developments in regulation and reporting frameworks for our sector and businesses more generally, so we can translate these proportionally and follow best practice whilst keeping focused on action."

Stephanie Landymore
Sustainability Lead, Ecology Building Society

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.

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A data-driven starting point for SME lenders

The climate transition impacts lenders of every size. SMEs have to rapidly adopt new roles, report on new risks, and confront new responsibilities to continue lending sensibly. While this is true across the industry, SMEs have to manage the transition with smaller teams and generally fewer resources, making clarity in direction, and where help can come from, just that more critical. Kamma's SME-specific package recognises these challenges, and offers solutions that take the burden off of teams so that lenders can continue focusing on their top line.

85 UK lenders were analysed for this report, and 41% scored zero, or very few, points. These lenders currently have no public climate plans or reports, or very little information available – and the vast majority of these are SME lenders.

Whilst many of these lenders fall outside of current TCFD and ISSB reporting requirements, all lenders qualify under SS3/19. In the five years since this supervisory statement there has been little to no climate response from the majority of SME lenders. With growing climate risks on the horizon, is it time for these organisations to take a more proactive approach to planning the transition?

42 of the lenders analysed for this report are SMEs.

Company size (% of lenders analysed)

Small (0-49 employees)	6%
Medium (50-249 employees)	43%
Large (250+ employees)	51%

8% of large lenders have under 500 employees.

Of these SME lenders, three-quarters have no publicly available climate plan or reporting and a further 20% report on climate only as a small part of their annual report. It's clear that SME lenders, as a whole, are at the start of their climate journey.

Only 1 SME lender has a climate transition plan, which is (unsurprisingly) Ecology Building Society with their interim (to 2030) net zero transition plan, published in 2022. A further two SME lenders have a specific annual sustainability report: Gatehouse Bank and Octopus Real Estate (who have the advantage of being part of the wider Octopus Group).

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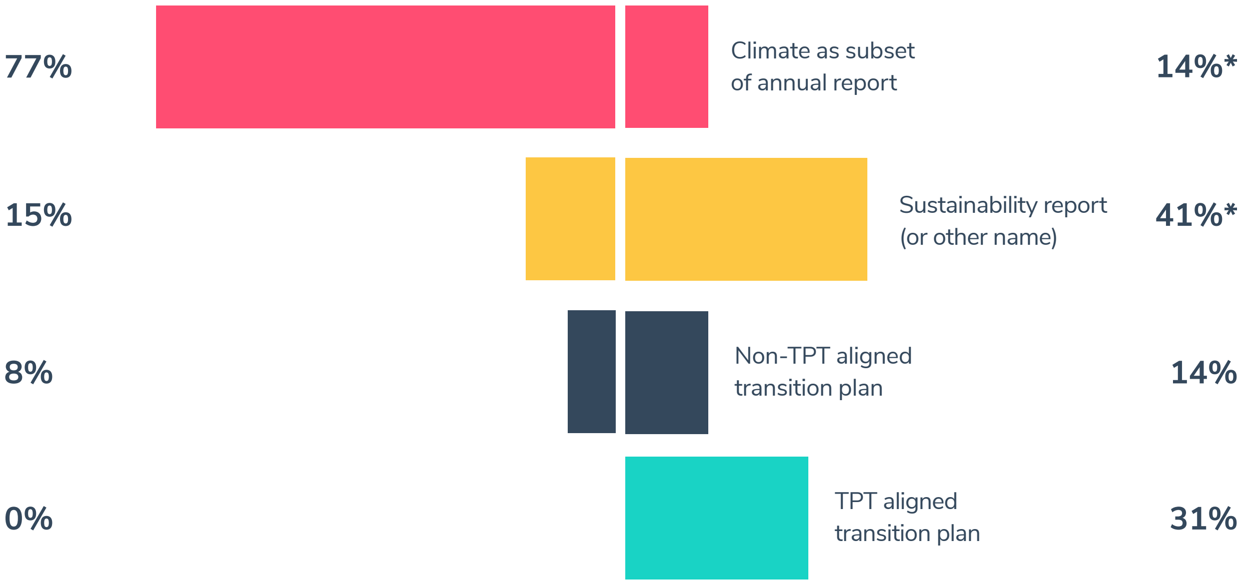
How are lenders choosing to report? SMEs (left) vs the rest of the market (right)



Source: Kamma analysis of 42 SME lenders (left) and Kamma analysis of 43 lenders, August 2024, based on large lenders reporting on climate (right)

* including one large lender with under 500 employees

In the UK SMEs are not yet legally required to report on climate, but it is expected they will need to do so in some form by the end of 2025.

This means that those SME lenders that are already disclosing their emissions and action plans are doing so voluntarily, and should be commended for this.

It also means that all SME lenders should be making it a priority to prepare for mandatory climate reporting in the near future. Plus, whilst they might be currently exempt reporting regulations, SME mortgage lenders are not exempt from climate risks within the mortgage book – including physical risks like flooding as well as transition risks like heightening legislation – which could damage the business.

So what are the best starting points for SME lenders?

1. Align climate plans with up-to-date standards
2. Ensure clean and complete address data for the mortgage portfolio
3. Acquire accurate climate data
4. Segment the portfolio to understand the level of risk and action required across different types of lending
5. Identify low cost and high impact ways to decarbonise the mortgage portfolio

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1. Align climate plans and reporting with up-to-date standards

From 2024 onwards, the IFRS Standards by the International Sustainability Standards Board (ISSB) are the standards used within UK legislation (as well as many other countries) on corporate climate reporting.

Whilst SMEs are not yet mandated to report in the UK, they will be soon, especially for the 8% of lenders with nearing 500 employees, and this will be under IFRS. Under SS3/19 all lenders should identify, manage, monitor and mitigate climate risk, so risks should already be reported, even if emissions are not.

So, it's best to get ahead of the game on the key components involved:

- Calculating financed emissions (see steps 2 and 3)
- Quantifying exposure to climate risk. Transition risk is particularly important due to its complex nature for lenders who must account for unknowns related to future energy efficiency policy – and scenario analysis is vital for understanding the implications of this to achieving your climate targets.

Including this information in your annual accounts is a great way to future-proof against IFRS and SS3/19 reporting.

2. Ensure clean and complete address data for the mortgage portfolio

An accurate calculation of the financed emissions from the mortgage portfolio is, arguably, the most important place to start when it comes to climate as a lender. This is because it's impossible to ensure robust and credible targets and actions for reducing those emissions without an accurate baseline to base these on – as well as being vital for ISSB reporting.

The first step is to ensure clean and complete address data for all homes in the mortgage portfolio. Without this it's impossible to match mortgaged homes with their EPC to understand energy efficiency and emissions.

This seems like a simple task, but it can actually be a major obstacle for many lenders. It's common for addresses to be logged in slightly different ways across different documentation and systems. This is especially true for apartment buildings, where the same property might be referred to as 'Ground Floor Flat' 'Flat 1''101a', and so on. The advent of Unique Property Reference Numbers (UPRNs) has helped, but until 2021 EPCs were not issued with a UPRN so there is no way to verify that EPCs issued before this date actually refer to the correct property.

Checking your address data and ensuring it is up-to-date, accurate, and as clean as possible will help make financed emissions calculations much easier from the word go.

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3. Acquire accurate climate data

Gathering accurate climate data (including the EPC, SAP score, and financed emissions) for the homes in a mortgage portfolio is vital for regulatory reporting and transition planning, but is a complex and time-consuming process. Done manually, it means trawling through the government's EPC register or EPC open data portal.

Furthermore, as featured in our full Climate Transition report, even once you have the EPCs in hand there will be many homes that do not have a valid EPC, and there are typically large inaccuracies in EPC ratings due to the flaws in the methodology used.

Therefore, you'll also need to determine an approach to account for missing EPCs and ensure emissions are reflected as accurately as possible.

It's highly recommended to work with a data and analysis partner like Kamma to outsource this data acquisition step for increased speed, accuracy, and cost effectiveness – bearing in mind this process will need to be re-run at least once a year once reporting requirements kick in.

4. Segment the portfolio to understand the level of risk and action required across different types of lending

When we work with lenders on climate data and analysis, we typically find that there are certain segments of the mortgage portfolio that are much more energy inefficient and, therefore, high carbon, than others.

For example, private rental homes are typically more energy inefficient than owner occupied properties, therefore meaning a lower EPC rating and SAP score. Property characteristics such as age and location are an important factor too – old properties and rural properties tend to be more energy inefficient and have higher carbon emissions.

Understanding how emissions vary across different segments of the portfolio enables you to be much more targeted in your approach to climate targets and plans. For instance, there will be a portion of mortgages in the portfolio that are relatively close to an EPC C standard (likely to become the minimum allowed) wherein supporting customers with retrofit awareness and education could be the best action.

On the other hand, there will likely also be a portion of mortgages that are far away from an EPC C and would require relatively high retrofit costs to achieve this – and this is then identified as the highest risk portion of mortgages in terms of transition risk and reducing financed emissions.

5. Identify low cost and high impact ways to decarbonise the mortgage portfolio

Whilst government policy is an important lever for improving energy efficiency and decarbonising the mortgage portfolio, lenders are also responsible for identifying ways in which they can drive decarbonisation themselves. Scenario analysis, as mentioned in part 1, is crucial for understanding where lenders have influence on decarbonisation and where government policy is needed.

The typical outcome for mortgage portfolios is that there are a significant portion of homes that have a high potential to reach a minimum standard of EPC C (and, therefore, significantly cut their emissions) through lender action on retrofit education campaigns and retrofit financing products that support mortgage customers with the upfront costs of retrofit.

For smaller lenders, and especially building societies that work closely with the local community, there's a particular opportunity to launch localised retrofit lending products, potentially through a green savings bond. This is a great way to reduce emissions towards climate targets, whilst also building a community-focused case study to support brand recognition and reputation – highlighting how a local lender has helped local people to improve home energy efficiency, increasing comfort and property valuation whilst reducing energy costs in a tough economy.

Get started with ease, with Kamma's bespoke package for SMEs

We've put together an SME-specific reporting package that gives you all the data you need to get ahead of the latest regulations and reporting standards, at SME-relevant pricing.

For as little as £4,500 we'll deliver the most advanced view available on the environmental performance of your mortgaged back book, uncovering financed emissions with better PCAF scores than the high street banks and benchmarking levels of physical and transition risk against the wider industry.

Kamma gives you all the data you need to inform internal conversations and report with ease.

To find out more, contact
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