Briefing paper: Rent-based Finance

Overview

One of the key barriers to uptake of new energy technologies by low-income customers and renters is the high up-front cost. To overcome this issue a range of organisations are developing finance products that enable the customer to pay back the cost over a period of time. One of them is the rent based mechanism which allows community/social housing providers to introduce renewable energy or energy efficiency upgrades for which tenants pay for via their rent over time.

Repayment mechanisms are important in making new energy technologies easy for customers. Further, some of these repayment mechanisms address additional barriers such as landlord-tenant split incentives.

To enable rent-based financing for clean energy the following policy measures are needed:

- Facilitating and supporting the development of pilot projects with community housing providers (CHPs)
- Co-funding capital costs of renewable energy or energy efficiency technologies
- Help broker relationships between community energy groups and other key stakeholders working in the field and CHPs

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Description

Repayment through rent refers to a model that specifically applies to community/social housing providers that would allow them to collect repayment for renewable energy or energy efficiency upgrades through their tenants' rent. As such CHPs as landlords are in a great position to help their low-income tenants to access new clean energy technologies and enable cost savings through reduced electricity bills. The advantage of this model is that CHPs have well-established processes and administrative procedures (e.g. rent collection) that would allow for efficiently collecting of repayments from tenants. Additionally they have a good understanding of the needs of their tenants which will help to tailor and communicate programs effectively.

CHPs that are willing to go the extra mile for their tenants have different options to finance and thus increase access to renewable energy or energy efficiency upgrades:

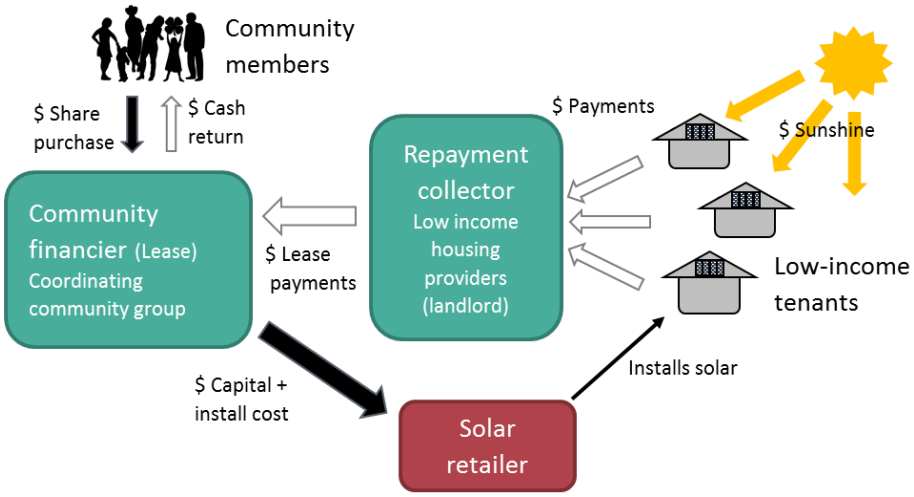
- Self-funded, all costs are covered by the CHP, which collects the repayments from the tenants;
- Third party financing, hereby the CHP receives finance for the installation of the

solar and other clean energy assets from a third party. Example third parties include traditional finance institution e.g. a bank, charity lenders, community investors etc.

- Another option is financing provided through solar retailers

Figure 1 shows an example of how rent-based financing could work. In this case when a CHP collaborates with a community energy group, a CHP takes out a solar lease with a community energy organisation. The community energy organisation installs and manages the solar assets on the low-income households' roofs. The landlord is responsible for paying the lease until the end of the contract period. The community group will raise the funds for capital, installation program costs via an equity crowdfunding approach and manage the returns to investors over the contract period.

Figure 1: Rent-based finance mechanism via a community housing provider and a community financier. Source: Cooper et al (2015): Low-income Community Solar – Options Assessment for South Coast Solar Saver Project. Report.



In order to implement a rent-based program that benefits low income households, it is important to ensure that

- independent and trusted information are provided and assistance is offered to the households
- the capital cost of a solar power system or energy efficiency upgrades are spread over a sufficiently long time period to ensure that the ongoing benefits through electricity bill savings exceed the repayment costs
- the program contributes to a better understanding of the benefits of a solar powered system and thus may help to educate the beneficiaries
- the business model of the program is foremost designed to benefit the participating low income households by reducing their electricity bills over time

Why Rent-Based Finance?

In recent years, the reduction in capital costs of distributed generation technologies has allowed more and more households in Australia to counterbalance the soaring electricity

costs through the installation of for example solar PV systems. Clean energy systems greatly contribute to better manage electricity bills and help to reduce costs of living.
However, many low income households are not able to access renewable energy or energy efficiency measures due to a number of barriers. For example they often do not have disposal income available to fund a capital intensive new technologies, nor are they able to access debt finance due to their income level and, if renting, lack collateral in the form of property. Furthermore tenants are exposed to the split incentive issue or landlord-tenant problem, which refers to a situation where the landlord is reluctant to invest in e.g. solar, because the benefit would accrue to the tenants over time through lower energy bills. Meanwhile the tenant is reluctant to pay for investment in solar if they may not remain a tenant long enough to reap the benefits

Yet, rent-based finance addresses these barriers and helps low income households to access renewable energy or energy efficiency technologies because:

- It provides certainty for the landlord or CHP and reduces the risk for financiers
- Rent carries a low risk of default
- No ongoing adjustments to legal documentation, and therefore no complications when the tenant moves out.
- Less stakeholders involved with this model than with other repayment models.
- Helps to overcome the landlord/tenant problem to an extent as the cost pass-through can be agreed upon mutually by landlord and tenant

According to a study by Cooper et al (2015) households participating in a rent-based solar program (assuming 60% self-consumption) could benefit between $60 and $231 each year. Over the lifetime of the technology, the tenants could be $8,744 to $10,792 better off relative to the same household who did not install solar. The total savings are forecast to be at least three-times as much as the cost of participating.

Status

The authors are not aware of any operating examples of rent-based repayment projects in Australia. However in NSW different community groups (e.g. Solar Suburbs, Clean Energy of Newcastle and Surrounds, South Coast Health and Sustainability Alliance in Eurobodalla, Repower Coffs) have started to collaborate with a number of CHPs to explore the options of the repayment which include rent-based models.

Currently, many low-income housing providers are not able to pass on rent increases. This may be due to government funding conditions or rent increase restrictions. In such cases, a separate ‘utility charge’ similar to a water charge could be recovered by the landlord. Such a charge is expected to be permitted under funding and regulatory rules; however, it is less preferable (relative to rent) as it is an additional bill and therefore higher administrative costs and higher default rates are expected.

It should be noted that as with many of these repayment options, solar and energy efficiency provision is not core-business for social housing providers and as such there may be other cultural and institutional barriers to implementation that need to be overcome.

It should further be noted that both the NSW Government and Clean Energy Finance Corporation have both released clean energy programs targeting community housing providers.

Example

Rent-based finance is an innovative solution to enabling tenants' access to new technologies. While it is new to Australia, a number of different international examples indicate how it can be applied.

In Germany landlords can pass along the costs of a building upgrade (e.g. solar heating or insulation) to their tenants through the "Modernisierungsumlage", which is basically a leasing rate or modernisation allocation. This leasing rate is regulated in the civil code law §559 BGB and represents a special form of rental increase, which should incentivise the landlords to modernise their building stock and reclaim some of the costs in the form of a rental repayment. In order to protect the tenant, the regulation only allows for an annual rental increase of 11% of the costs associated with the refurbishment (that means for refurbishment costs a rental increase of € 9.17/ month is permitted). As such modernisation upgrades apply to a single house but also to multiple apartments, in the latter case the landlord has to distribute the costs equally across all tenants. The landlord is furthermore obligated to disclose (in writing) the rental increase including a detailed calculation of the costs and the new rent.

Modernisations or building upgrades usually comprise measures such as solar PV, heating system improvements, façade insulation, solar water heating, double-glazing windows and water or energy meters. However these measures can only justify a rental increase if they provide primary energy or water cost savings for the tenant.

There are other international examples that are designed on Grant or Feed in Tariff mechanisms.

Specific policy asks

- **Facilitating and supporting the development of pilot projects** with community housing providers (CHPs), to ensure greatest likelihood of success of the model. Realising that early pilot projects with CHPs is important to demonstrate the feasibility of the business model and encourage other community groups to initiate their own projects and/or collaborate with existing projects.
- **Co-funding for capital costs** of renewable energy or energy efficiency technologies to ensure that low-income households benefit from installations through reduced bills.
- **Help broker relationships** between community energy groups working in the field and CHPs. This includes facilitated information sharing between community energy groups to ensure a greater distribution of lessons learned.
- **Support stronger collaborations** between existing initiatives of community energy

projects that investigate rent-based finance options in partnership with CHPs. To that purpose we believe it is worth exploring whether the establishment of a joint entity of community energy groups, which is responsible for administrative tasks and book keeping, would help to support community energy groups to overcome the financial barriers of implementing such projects.

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