



## Financial support for renovation and energy efficiency

– a focused initiative in certain housing areas

The Swedish National Audit Office (Swedish NAO) has audited the financial support for renovation and energy efficiency improvements in multi-dwelling buildings containing rented housing in areas with socio-economic challenges.

### Background and rationale for the audit

The support was introduced on 1 October 2016 and was an important part of the Government's overall initiatives in the area of housing. Support of SEK 800 million per annum was proposed for 2016–2019. The support was discontinued from 2019, a decision made by the Riksdag during the time this audit was completed.

The background to the Government introducing the support was that a large part of the housing stock in Sweden is more than 50 years old and was considered to be in extensive need of renovation. The intention was that the support would boost the pace of renovation and energy efficiency in order to contribute both to the overall housing policy objectives of a good living environment and the energy policy goal of achieving more efficient use of energy. The support was also intended to protect tenants from unreasonable rent increases. The Government's intention was to concentrate the support to housing areas with socio-economic challenges.

The support was split into two parts. The renovation part comprised a rent rebate to the tenants, administered by the property owner, while the energy efficiency part went directly to the property owner. The County Administrative Boards made the decisions regarding the support and the National Board of Housing, Building and Planning (Boverket) administered the payments.

All the funds initially allocated have not been used because there were too few applications. During the period the support was open for applications, a total of only about SEK 350 million was granted, distributed across 129 buildings. The support has also been criticised, partly due to its complicated conditions and high administrative costs, as well as the fact that property owners had to take too high a risk. The Riksdag has asked for a report from the Government as to how the funds for the housing policy initiatives were used, how they were distributed and what results were achieved. The purpose has therefore been to audit whether the support was appropriately designed to be able to contribute effectively to the objectives in the area of housing and energy policy.

## Audit findings

The Swedish NAO's overall conclusion is that the financial support for renovation and energy efficiency was not designed appropriately so that it could contribute effectively to the housing and energy policy objectives. There were several deficiencies in the Government's design of the support, which explains why there was little interest in the support and also why the support has only marginally contributed to increase the rate of renovation and energy efficiency. It is also unclear to what extent the design of the support could protect tenants from unreasonable rent increases.

### The support was not sufficiently simply and attractively formulated

The audit shows that one reason for the low interest in applying for the support was that property owners generally considered it to be too much of an administrative burden and that the risks were too high in relation to the amount of the support. The rent rebate, conditions and the long-term horizon of the support contributed to the application process and the follow-up procedure being seen as complicated. Several factors were perceived as uncertain: the property owners did not know in advance how large the support would be, it is difficult to calculate the expected profitability of energy efficiency and they saw a risk that the rent rebate could create unfair rents among tenants in the same housing area. Thus, from the perspective of the property owners, the support was not designed in a sufficiently simple and attractive manner to be worth applying for. The support was also difficult to administer for the authorities who were processing it, which could have caused major problems if the application pressure had been higher.

### Difficult to achieve accuracy in multi-purpose support

The Swedish NAO considers that the support was not accurately designed to achieve the objectives stated by the Government when it was introduced. One reason was that the support was designed to solve several types of problems which do not necessarily overlap. Tenants' low payment capacity and the need for renovation and energy efficiency are different problems that are difficult to solve effectively with a joint instrument. Instead, the support risks only being able to contribute marginally to any of the Government's objectives.

The audit shows that only about 11 per cent of all multi-dwelling buildings with rented housing were entitled and had reason to apply for the support. The Government's selection of area boundaries has also been questioned by property owners. Several housing areas with renovation needs and energy efficiency potential have been excluded from applying for the support. Housing areas that are usually included as areas with socio-economic challenges have also been excluded because the area definition is only based on low purchasing power, which is a narrow definition.

The support was not aimed at multi-dwelling buildings with major renovation needs and greater potential for energy efficiency. The Government's selection of area boundaries meant that the eligible housing has similar average renovation needs to all multi-dwelling buildings in Sweden. Furthermore, the average energy performance is only slightly worse among the eligible housing compared with all housing. The average median income among residents in eligible housing is slightly lower than in all multi-dwelling buildings, which led to a certain degree of accuracy. However, the rent rebate is distributed to all tenants in the building being renovated, regardless of income level. This means that it was not sufficiently accurately designed to reach tenants with low payment capacity, since there could be residents with a relatively high income who could also benefit from the rebate. Conversely, low-income tenants living in a building in the same type of housing that has already been renovated without support, do not receive the rebate.

### The design of the support did not provide the basis for contributing to the objectives

Even if there had been greater interest in the support, the Swedish NAO still considers that the support did not provide sufficient incentives for property owners to implement measures to effectively contribute to the objectives. One explanation is that the support was not designed to address the most important obstacles to increasing the pace of renovation and energy efficiency or reducing the risk of unreasonable rent increases.

*The support did not provide sufficient incentives to increase the pace of renovation and energy efficiency*

Lack of profitability is the main obstacle to renovation and energy efficiency. Since the renovation part of the support goes to the tenants in the form of a rent rebate, the support does not directly affect the property owner's profitability analysis. In order for the renovation to be profitable, property owners need to be able to increase the rent or lower their operating costs. The support can only help to initiate new renovation by property owners whose renovation is already profitable, but who have refrained from renovating due to tenants' low payment capacity. The profitability problem is not addressed for property owners who, due to the market situation, do not have the scope for rent increases. According to the Swedish NAO, the support has thus provided only weak incentives for property owners to initiate new renovation and has only been able to make a marginal contribution to the pace of renovation.

As the energy part of the support went directly to the property owner, there was a somewhat stronger incentive to implement energy efficiency measures. However, too low levels of support and uncertainty about the amount of support the property owner would ultimately receive provided only marginal incentives to increase the rate of energy efficiency compared to the Riksdag's objectives for energy efficiency. According to the Swedish NAO's example calculation, the energy efficiency part of the support accounted for only 1.5–2 percent of the property owner's total renovation costs.

*Risk that measures financed by the support will not be effective*

The Swedish NAO's assessment is that there is a risk that measures financed by the support will not be effective. There is nothing in the ordinance for support issued by the Government that prevented support from being provided for renovation already required under existing statutory requirements and in particular, energy efficiency when rebuilding. Also in the cases where the measures exceeded the statutory requirements, it is possible that the measures would have been taken even without support, since the property owners needed to have advanced relatively far in their planning of the renovation before they could apply for support.

*Unclear to what extent the support can protect tenants from unreasonable rent increases.*

The ordinance for the support does not affect the actual rent setting. When renovation has been completed, the new rent is determined according to the normal procedure in the rental system. The support's rent rebate is then deducted from the new rent for seven years. The rebate thus mitigates the rent increase, but does not prevent a situation with a sharp rent increase after the renovation has been completed.

Since, according to the rental system, only measures which raise the standard allow for rent increases, property owners have strong financial incentives to renovate to new production standards. This, together with the fact that tenants have little influence over renovation, increases the risk of unwanted renovation from the resident's point of view and subsequent sharp rent increases. Excessive renovation is not consistent with the Riksdag's objectives for housing markets: that supply must meet demand and the needs that exist. There is nothing in the design of the support that reduces the risk of excessive renovation and sharp rent increases. Thus, there is no guarantee that the rent rebate will cover the entire rent increase. According to the Swedish NAO, it is therefore unclear to what extent the support can protect tenants from unreasonable rent increases.

### The Government's basis for decision was insufficient

One explanation for the fact that the support was not designed appropriately is that the Government's basis for decision was insufficient. There was no analysis of which problems the support was intended to address and no impact assessment of possible effects. However, existing analyses provided indications of problems with the design, not least with regard to the accuracy of the support. But the problems were not dealt with at the formulation stage of the support; instead the Government chose to go ahead and introduce the support, despite the indications of problems.

The fact that the area boundaries resulted in few property owners being entitled and having reason to apply for the support is an example of information that would have been important to obtain before formulating the support package. According to the Swedish NAO, the restrictions on possible recipients may partly explain the low level of applications. If analyses similar to those carried out by the Swedish NAO in its audit had been carried out and taken into account before the support was introduced, it could have been designed more appropriately.

## Recommendations

The audit indicates several deficiencies in the design of the financial support for renovation and energy efficiency in housing areas with socio-economic challenges. There are several explanations for the low level of interest in the support. Among other things, there needs to be a long-term perspective and credibility in government support, so that those who are expected to apply can make long-term plans for their investments. Even if interest in the support had been greater, the audit indicates other deficiencies in its design, meaning that the support package lacked the prerequisites to effectively contribute other than marginally to the

Government's objectives with the support or to the housing and energy policy objectives. If Government considers introducing similar support for renovation and energy efficiency in the future, the Swedish NAO makes the following recommendations:

- Formulate the support based on an analysis of the specific problems it will address and an impact assessment of the possible effects of the support, including how it will interact with other instruments.
- Analyse the consequences of restricting support to specific housing areas before introduction, to avoid boundaries that result in many recipients with renovation needs and the potential for energy efficiency being excluded from seeking the support.
- Review and simplify the application and follow-up process, based on property owners' planning horizon requirements when formulating the support.

The audit shows that there may be other more effective ways of dealing with some of the underlying problems: incentives for excessive renovation that lead to sharp rent increases on strong housing markets, special challenges in mortgaging properties to finance renovation on weak markets, and the fact that even necessary rent increases may be unreasonably high for tenants with low payment capacity.

To help reduce property owners' incentive to renovate excessively and the social problems that may be associated with renovation and to improve the conditions for renovation for property owners in weak housing markets, the Swedish NAO makes the following recommendations to the Government:

- Review the incentive structure in the rental system so that it does not reward excessive renovation.
- Consider other more effective ways of compensating tenants with low payment capacity for rent increases as a result of renovation.
- Consider other efforts aimed at weak housing markets to address the specific financing problems faced by property owners in these markets.