

Energy Efficiency and Local Taxation

A paper for the Commission on Local Tax Reform

Contents

1. Executive Summary	3
2. Introduction	4
3. The wider context	5
3.1 Greenhouse gas emissions reductions	6
3.2 The eradication of fuel poverty.....	6
4. Delivering against emissions reduction and fuel poverty targets	6
4.1 The need for additional policies	7
5. Existing council tax discount schemes in Scotland	8
6. Variable Council Tax Rates	9
7. Local taxation and energy efficiency – an international perspective	10
8. Conclusions.....	11

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1. Executive Summary

Energy Saving Trust met with the secretariat for the Commission on Local Tax Reform in May 2015. The Commission is interested in exploring whether energy efficiency could be brought into the design of any new tax in some way. This paper seeks to consider this issue within the current policy and economic context in Scotland.

It is clear that if energy efficiency installation rates are to be ramped up to the levels necessary to ensure that the housing sector's potential contribution to the delivery of greenhouse gas emissions reduction and fuel poverty targets is optimised a range of additional support – both financial and otherwise – will be required. This is the context within which the potential for linking energy efficiency with local taxation needs to be considered.

For more than ten years organisations working in the fields of energy and the environment have suggested that such a linkage could play a key role in encouraging the installation of energy efficiency measures in the UK's housing stock. Work commissioned by Energy Saving Trust in 2004 is regarded as “the most extensive study [of this issue] to date”¹. This work, together with detailed consumer research, sat behind an Energy Saving Trust report published in 2005² which explored the likely impacts of introducing changes to existing taxes in order to encourage the uptake of energy efficiency measures. Subsequently, as a result of provisions in the Climate Change (Scotland) Act 2009, local authorities in Scotland have been required to reduce the amount of council tax householders pay where improvements have been made to the energy efficiency of their properties. Available data suggests that these energy efficiency discount schemes have not been hugely successful. However, these schemes were not necessarily implemented as originally intended which resulted in them competing with as opposed to adding to existing schemes. There appears to be a real need to evaluate, in more detail, the success, or otherwise, of these schemes and to explore whether the relevant provisions in the Climate Change (Scotland) Act 2009 could be used more effectively.

More recently there have been calls in other parts of the UK to consider the introduction of variable council tax rates with higher rates for less efficient properties and lower rates for more efficient properties. However, we do not think that this is currently a viable way forward for Scottish energy efficiency/local taxation policy. With 87 per cent of households living in EPC Band F and G properties being in fuel poverty such a scheme would essentially “penalise” the fuel poor.

Given the need for additional evidence and analysis - in terms of the operation of existing schemes in Scotland, the international experience and the wider policies that are likely to enable Scotland to meet its climate change and fuel poverty targets, we think it would be sensible if provisions were made within any new framework for any new system of local taxation that would allow for links to be made with energy

¹ UK Green Building Council, “Retrofit Incentives – Boosting take-up of energy efficiency measures in domestic properties”, 2013

² Energy Saving Trust, “Changing Climate, Changing Behaviour: Delivering household energy saving through fiscal incentives”, 2005

efficiency. Such provisions would not need to be used straight away or indeed at all but would allow for such links to be more easily made at some point in the future if deemed necessary.

2. Introduction

Energy Saving Trust met with the secretariat for the Commission on Local Tax Reform on 20 May 2015. The Commission's remit is to "identify and examine alternatives that would deliver a fairer system of local taxation to support the funding of services delivered by local government", and they are interested in exploring whether energy efficiency could be brought into the design of any new tax in some way. They have asked that we present our views on this at their meeting on 19th August and provide them with a paper in advance of this. This is that paper.

The idea of linking local taxation – specifically council tax - and energy efficiency is not a new one. For more than ten years organisations working in the fields of energy and the environment have suggested that such a linkage could play a key role in encouraging the installation of energy efficiency measures in the UK's housing stock. These views were based not only on policy analysis but also on evidence from the ground - between 2003 and 2004 a number of councils in England, notably Fenland District Council and Braintree District Council offered council tax rebates to residents who installed specific energy efficiency measures.

Work commissioned by Energy Saving Trust in 2004 is regarded as "the most extensive study [of this issue] to date"³. This work, together with detailed consumer research, sat behind an Energy Saving Trust report published in 2005⁴ which explored the likely impacts of introducing changes to existing taxes in order to encourage the uptake of energy efficiency measures. Subsequently, as a result of provisions in the Climate Change (Scotland) Act 2009, local authorities in Scotland have been required to reduce the amount of council tax householders pay where improvements have been made to the energy efficiency of their properties, and a range of organisations, including but not limited to, the UK Green Building Council (UKGBC), the Association for the Conservation of Energy, Friends of the Earth and Unison have called for the introduction of a link between council tax and energy efficiency to be introduced in other parts of the UK. The UKGBC has also produced a report which considers the possibility of linking council tax and energy efficiency and recommends that consideration be given to the introduction of a system of variable council tax rates under which council tax rates "could be varied according to the energy efficiency of a property, with discounts for high performance properties and increased rates for those with poor energy efficiency".

Both the policy context and the wider economic situation have changed considerably since the publication of the Energy Saving Trust report. This, together with the fact that one of the report's key recommendations (the introduction of council tax rebates) was adopted in Scotland means that there is

³ UK Green Building Council, "Retrofit Incentives – Boosting take-up of energy efficiency measures in domestic properties", 2013

⁴ Energy Saving Trust, "Changing Climate, Changing Behaviour: Delivering household energy saving through fiscal incentives", 2005

little sense in furnishing the Committee directly with a copy of our original report. This paper therefore seeks to consider this issue – whether energy efficiency could be brought into the design of any new local taxation system in some way - within the current policy and economic context in Scotland.

3. The wider context

Improving the energy efficiency of Scotland's existing housing is seen, by the Scottish Government, as a fundamental part of meeting Scotland's statutory greenhouse gas emissions reduction targets and fuel poverty targets. The additional benefits that energy efficiency can deliver, and the fact that they can make a positive contribution to many different policy objectives – not only those related to greenhouse gas emissions reductions and fuel poverty alleviation - are increasingly being recognised. Indeed recent work by the IEA⁵ has identified 15 prominent co-benefits of energy efficiency including, but not limited to, greenhouse gas emissions reductions, improved energy security, improved health and well-being, poverty alleviation, employment, and increased disposable income.

As noted above linking council tax and energy efficiency is seen as a potential way to encourage greater numbers of households to install energy efficiency measures. A number of reasons are given in the existing literature for the on-going policy interest in the potential to link council tax and other taxes with energy efficiency as opposed to relying solely on existing financial levers (loans and grants). Firstly, taxes are not always popular and evidence suggests that linking energy efficiency with taxation could prompt consumers into taking action. The consumer research undertaken as part of Energy Saving Trust's 2005 work indicated that incentives linked to council tax provided in tandem with existing offers "were likely to act as triggers for consumer action", and the 2013 UKGBC report argues that "Due to the broad impact of council tax and its unpopularity, such a system has the potential to be a significant incentive for driving retrofit". Secondly, there is the potential to make such systems revenue neutral to both central and local governments, which is a particularly attractive attribute in times of constrained public budgets, and thirdly, as highlighted in the 2013 UKGBC report such systems could have a "possible role in linking energy efficiency to house prices".

In short, linking council tax and energy efficiency is seen as a means of helping to drive the uptake of energy efficiency measures in the household sector in order to deliver against climate change and fuel poverty targets, as well as contributing to the delivery of a range of other policy objectives. The Energy Saving Trust work saw such links as a way of encouraging those that would not necessarily respond to traditional means of financial encouragement (i.e. loans and grants) alone to install energy efficiency measures (i.e. in combination with other financial support they have the potential to provide the "nudge" necessary to get certain householders to take action).

⁵ IEA, "Capturing the multiple benefits of energy efficiency", 2014

3.1 Greenhouse gas emissions reductions

In 2009 Scotland's Climate Change Act was passed, and it is seen by the Scottish Government as "world leading"⁶ legislation. Part one of the Act sets targets to reduce greenhouse gas emissions by 42 per cent by 2020 and 80 per cent by 2050, and requires that Scottish Ministers set annual targets, in secondary legislation, for emissions from 2010 and 2050. Other parts of the Act include, amongst other things, provisions relating to reporting, advisory functions, duties on public bodies, public engagement, the promotion of energy efficiency and – of particular relevance here – provisions relating to the establishment of schemes for "reducing the amounts which persons are liable to pay in respect of council tax where improvements are made to the energy efficiency of chargeable dwellings". These provisions are discussed in more detail below.

The Committee on Climate Change's (CCC) recent report on Scotland's progress towards meeting emission reduction targets⁷ concluded that "Good progress has been made in a number of key sectors. However, further action will be required, in terms of policy development and implementation, to meet the targets set by the Scottish Government", and recommended that "the Scottish Government strengthens policies for low-carbon heat, energy efficiency, the public sector, transport, and agriculture and land use".

3.2 The eradication of fuel poverty

The Housing (Scotland) Act 2001 set a statutory duty on the Scottish Government to eradicate fuel poverty in Scotland by November 2016. Scottish Government figures released at the end of last year estimated that 39.1 per cent of households in Scotland were living in fuel poverty in 2013. This is up from 35.2 per cent in 2012, and an increase of around 100,000 homes. While the Scottish Government's on-going commitment to eradicating fuel poverty is arguably demonstrated by its continued provision of significant funding for fuel poverty programmes, it is clear from the figures that the 2016 target will not be met. Indeed the Committee on Climate Change's (CCC) recent report on Scotland's progress towards meeting emission reduction targets noted that "While Scottish energy efficiency policy is well developed and more comprehensive than that available in England, fuel poverty remains a serious problem".

4. Delivering against emissions reduction and fuel poverty targets

Energy efficiency is typical of many policy areas that have been devolved to Scotland since 1999. Devolution has created a complex policy framework and energy efficiency, which is an issue that crosses multiple departments and policy areas, is no different. While fundamental powers over energy policy remain with the UK Government, the Scottish Government has power over housing, building regulations and the promotion of energy efficiency and renewable energy. However, policies such as the

⁶ See: <http://www.gov.scot/Topics/Environment/climatechange>

⁷ Committee on Climate Change, "Reducing Emissions in Scotland – 2015 Progress Report", 2015

Energy Company Obligation (ECO)⁸ are controlled by Westminster as they are associated with regulation of the energy markets. The Scottish Government therefore has to develop policies on energy efficiency that effectively adapt to the existence of UK-wide energy policy. For example Home Energy Efficiency Programmes for Scotland (HEEPS) is the Scottish Government's own unique series of programmes but is designed in a way that leverages as much ECO funding as possible.

The existence of ECO and its predecessors, and indeed wider Scottish Government programmes have had a significant bearing on the implementation of the council tax discounts schemes required under the Climate Change (Scotland) Act in Scotland. These issues are discussed in more detail in section 4 below.

4.1 The need for additional policies

It is widely recognised that a step change in installation rates of energy efficiency measures in the domestic sector will be required if fuel poverty is to be eradicated and if the necessary emissions reductions from the housing sector are to be made. Earlier this month the Scottish Government, in response to calls from energy experts, environmental NGOs and the Committee on Climate Change for “intensified action on energy efficiency”, announced that energy efficiency would be designated as a National Infrastructure Priority. At the centre of this National Infrastructure Priority will be Scotland's Energy Efficiency Programme – a new programme which will “provide an offer of support to all buildings in Scotland – domestic and non-domestic-to help them achieve a good energy efficiency rating over the next 10-15 years”. No further details about the programme are currently available and the Scottish Government has indicated that these will be set out in the Infrastructure Investment Plan later this year. Nevertheless it is clear that if installation rates are to be ramped up to the necessary levels to ensure that the housing sector's potential contribution to the delivery of greenhouse gas emissions reduction and fuel poverty targets is optimised a range of additional support – both financial and otherwise – will be required. This is the context within which the potential for linking energy efficiency with local taxation needs to be considered.

As noted above, the UK's economic situation has changed since the publication of our 2005 report, and it is also important to consider this issue (linking local taxation and energy efficiency) within the current context of tighter, more constrained budgets at both central and local government levels. Indeed, the variable council tax rates scheme proposed by the UKGBC has the advantage that it could be made revenue neutral – which may make it particularly interesting in the current context as this would involve no direct Scottish Government funding – other than costs associated with administration and set up.

⁸ The Energy Company Obligation (ECO) is a government programme that requires larger gas and electricity suppliers to deliver energy efficiency measures to domestic premises in Great Britain. Suppliers are allocated a proportion of the overall ECO targets, depending on their relative share of the domestic gas and electricity market. Suppliers achieve their obligations by delivering energy efficiency measures in domestic premises.

5. Existing council tax discount schemes in Scotland

As noted above the Climate Change (Scotland) Act 2009 included provisions relating to the establishment of schemes for “reducing the amounts which persons are liable to pay in respect of council tax where improvements are made to the energy efficiency of...dwellings”. Specifically, it amended the Local Government finance Act 1992 (c.14) to include a requirement that “a local authority must establish a scheme for reducing the amounts which persons are liable to pay in respect of council tax where improvements are made to the energy efficiency of chargeable dwellings”, and termed these schemes “energy efficiency discount schemes”. The Act went on to set a number of conditions for these schemes, including that the minimum reduction that can be provided under these discount schemes is £50, and that improvements to energy efficiency need to be “made during the same financial year to which the reduction of the amount which the person is liable to pay in respect of council tax relates”. This latter condition implies that these discounts are one-off as opposed on-going in nature.

No additional funds were made available to local authorities to deliver these schemes. Local authorities therefore worked to ensure that these schemes were funded under CERT⁹, and were therefore cost-neutral to them. However, it soon became apparent that the offer for householders under these energy efficiency discount schemes was less favourable than other CERT offers on the market (i.e. the overall cost to the householder of getting the measure installed would be less if they did not take advantage of the energy efficiency discount scheme). Subsequently, two Scottish Government energy efficiency schemes (HIS and UHIS) were introduced under which free offers of insulation were available for some householders. Taken together these developments meant that it was no longer in householders’ best interests from a financial perspective to take advantage of the available energy efficiency discount schemes.

It is important to point out that while the way in which these schemes was implemented (i.e. with CERT funding) was entirely understandable, it was not necessarily done in the way that was originally intended or in a way that was likely to maximise uptake. As noted above the 2005 Energy Saving Trust work saw the provision of this type of discount as an additional discount (i.e. a discount in addition to existing CERT offers) that would provide the “nudge” necessary to get certain householders to take action. However, funding these schemes solely under CERT meant that the discounts were essentially re-packaged CERT offers and not CERT offers *plus* a council tax discount and meant that these schemes competed with, as opposed to added to, existing CERT offers.

The Climate Change (Scotland) Act required that “The Scottish Ministers must, as soon as practicable after 31 March 2012 and annually thereafter, lay before the Scottish Parliament a report on the operation of energy efficiency discount schemes established under section 80A of the Local Government Finance Act 1992 (c.14), which must include an assessment of whether the reductions thereby provided for have contributed effectively to promoting energy efficiency”. The most recent available figures on uptake under these schemes show that to date 645 properties have received relief from council tax through

⁹ CERT is the scheme that ECO replaced.

energy efficiency discount schemes (from 2011-12 to 2013-14)¹⁰. Only two properties received this relief over the course of 2013-14. These figures suggest that these energy efficiency discount schemes have not been hugely successful. Given the issues outlined above this is not surprising.

At least two local authorities still appear to be running, and publicising, their energy efficiency discount schemes¹¹. However, it is not immediately clear whether other local authority schemes are still operational or not. Indeed, information on a number of local authority websites about these schemes appears to be out of date.

There appears to be a real need to evaluate the success, or otherwise, of these schemes to date and the reasons for this and to explore whether the relevant provisions in the Climate Change (Scotland) Act 2009 could be used more effectively.

6. Variable Council Tax Rates

In their report “Retrofit Incentives - Boosting the uptake of energy efficiency measures in domestic properties” the UKGBC note that there are two key forms that a council tax based scheme could take and indeed these are the forms that were analysed in the 2005 Energy Saving Trust report. These are either a) a council tax rebate/discount for households that install energy efficiency measures, or b) variable rates of council tax which rewarded/penalised more/less efficient homes. It is the former that has been adopted in Scotland (and that was recommended in the 2005 Energy Saving Trust report) and that latter that the UKGBC propose.

The UKGBC argue that “Council Tax rates could be varied according to the energy efficiency of a property, with discounts for high performing properties and increased rates for those with poor energy efficiency”, and that “such a design would allow the scheme to be revenue neutral”. They propose that “individual councils would need to use appropriate local property data to establish a baseline level of energy efficiency. Properties above a given point (i.e. those that are more energy efficient) could be given a percentage discount on the council tax bill, while properties below the baseline would have a percentage added. Households making energy efficiency improvements would simply supply evidence (potentially in the form of an updated EPC) to demonstrate the change, and to apply for a reduction in their council tax going forward. Done this way the incentive could be constructed to be made revenue neutral with total penalties matching total discounts, with the potential for councils to revise the baseline over time as the average standard of the housing stock improved”.

The UKGBC paper also proposes a phased roll-out in which “the scheme would be launched with an initial year in which there were no penalties or discounts to those that were in low or high efficiency properties. Households would simply receive information on how the scheme, at a high level, was due to

¹⁰ Scottish Government, “The Third Annual report on the Operation of Section 66 of the Climate Change (Scotland) Act 2009”, February 2015

¹¹ See for example Highland Council’s website: http://www.highland.gov.uk/info/701/council_tax/407/council_tax_-_discounts_for_properties/8 and Perth and Kinross Council’s website: <http://www.pkc.gov.uk/article/10665/Energy-Efficiency-Discount-Scheme>

work. Following this, the level of energy efficiency above/below which households were rewarded or penalised would be progressively tightened. Those properties without EPCs would initially be assumed to be of average efficiency, but as the scheme progressed this would be tightened to apply an ever decreasing rating to uncertified properties. Over this period, therefore, households could choose whether to stick with their assumed rating or to have an EPC survey". The paper also highlights that the local administration of such schemes lends the approach well to testing via a small number of pilots which would "allow proof of concept, and facilitate the longer-term, nationwide roll-out".

The paper goes on to consider how potential negative impacts on vulnerable households could be mitigated. This issue is particularly pertinent in Scotland where 87 per cent of households living in EPC Band F and G properties (the worst performing properties in energy terms) are in fuel poverty. This figure drops to, a not inconsiderable, 58 per cent for those living in Band E properties and, as noted above, compares to a Scotland wide figure of 39 per cent. So, any scheme that "penalises" homes with poor energy performance is also likely to "penalise" households living in fuel poverty. It is therefore difficult to see how such a scheme could be either politically or morally acceptable, as it would essentially increase the amount of local tax that fuel poor households pay. The UKGBC paper suggests that existing schemes "would help to ensure that a significant proportion of people could make significant improvements to their homes at little or no up-front cost", and that those "in homes that were the hardest and most expensive to treat would be those that receive the lion's share of the total ECO funding pot". However, it is unrealistic to assume that *all* householders in fuel poverty living in an energy inefficient property would take advantage of this funding either before or during the start-up period of such a scheme. The introduction of such a scheme would therefore result in fuel poor households (who already struggle to pay energy bills) paying relatively more council tax.

In addition such a scheme would essentially "penalise" householders who have no control over the energy efficiency of their homes (i.e. those living in the privately and socially rented sectors). While it would be possible to focus such a scheme solely on the owner occupied sector this would increase its administrative complexity. The introduction of a variable council tax regime would also result in some households being "rewarded" for energy efficiency that they had not undertaken (if, for example it was undertaken by previous occupants), and for work that they had already undertaken (i.e. they would receive a "reward" even though it was not the prospect of receiving that "reward" that had incentivised them to undertake the work).

7. Local taxation and energy efficiency – an international perspective

We are aware that local systems of taxation in other parts of the world incorporate energy efficiency. For example, many states in America offer or have offered tax incentives to encourage the installation of energy efficiency measures. To date we have not had the resource to research these schemes and their results in any detail. We believe that a review of international experience of using local tax systems to encourage the uptake of energy efficiency measures would provide useful insights and evidence that could aid consideration of these issues in Scotland.

8. Conclusions

We draw the following conclusions from the evidence presented above:

- We agree in principle that linking energy efficiency to some form of new local taxation could encourage householders to improve the energy efficiency of their homes.
- We therefore recommend that provisions are made within any new framework for any new system of local taxation that would allow for links to be made with energy efficiency. Such provisions would not need to be used straight away or indeed at all but would allow for such links to be more easily made at some point in the future if deemed necessary.
- However, we do not think that the idea of variable rates of local tax which reward/penalise more/less efficient homes as proposed by the UKGBC is currently a viable way forward for Scotland. With 87 per cent of households living in EPC Band F and G properties being in fuel poverty such a scheme would essentially “penalise” the fuel poor.
- Rather, we believe there is a need to evaluate in more detail the success, or otherwise, of the existing council tax discounts in Scotland and to explore whether the relevant provisions in the Climate Change (Scotland) Act could be used more effectively.
- We also suggest that there is a need to review the international experience of using local systems of taxation to encourage the take up of energy efficiency measures. This could provide useful insight and evidence that could aid consideration of these issues in Scotland.
- Consideration of this policy issue cannot be undertaken in isolation. It needs to sit within a wider analysis of the range of policies – from both the UK Government and that Scottish Government - that will deliver climate change targets. This is to ensure that policies are delivered in the most cost effective way, and to ensure that there are unlikely to be any unintended consequences resulting from policy interactions (e.g. the interaction between CERT and the “energy efficiency discount schemes” referenced above). If other policies are able to deliver the necessary levels of emissions and fuel poverty reduction in a more cost-effective or indeed a more acceptable way then there would be no need to link any form of new taxation with energy efficiency.