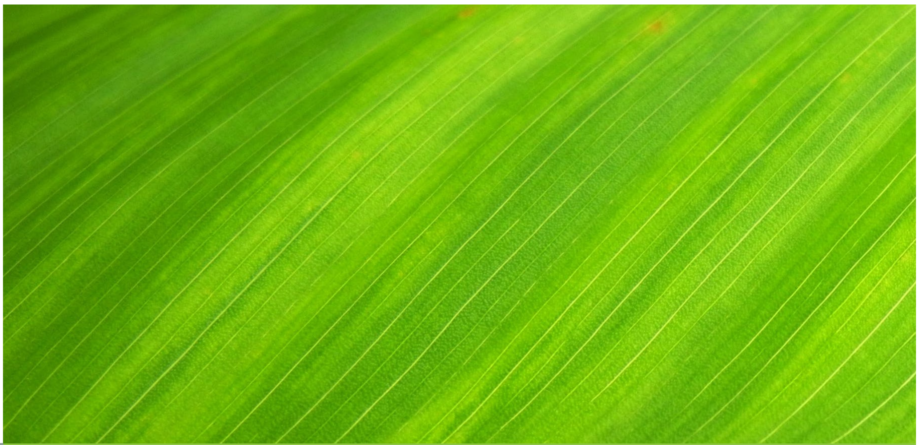
EuroPACE



EUROPACE READINESS ASSESSMENT:

LEGAL AND FISCAL ANALYSIS OF THE EU-28

MARCH, 2018

THIS REPORT WAS DEVELOPED BY THE EUROPACE PROJECT

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INTRODUCTION

This document is part of the Deliverable 2.1 under the EuroPACE project. The deliverable has been developed by Center for Social and Economic Research. To learn more, please visit www.EuroPACE2020.eu.

EuroPACE intends to develop an innovative financing mechanism to boost energy efficiency investment in existing residential buildings. The concept of EuroPACE is inspired by the success of a financing model called PACE, launched in California in 2008. In the US, the PACE market reached over $6 billion in funded projects, including the retrofit of over 220,000 homes, which resulted in more than 50,000 new local jobs and the creation of hundreds new companies. PACE can be used to pay for energy efficiency, renewable energy, and water conservation upgrades to homes and buildings. PACE financing covers up to 100% of a project's costs and is repaid as a special charge added to a property tax bill over a term of up to 20 years. EuroPACE combines the best practices from the US PACE market with project partners' substantial experience in improving energy efficiency in European buildings. EuroPACE intends to further enhance the reach, scope, and overall impact of the PACE financing model, well beyond the American experience.

EuroPACE is a three-year project that started in March 2018. Throughout the following years, the project intends to:

1. **Assess Market Readiness:** Conduct an assessment of the EU-28 to determine viability and attractiveness of EuroPACE financing across Europe.
2. **Deploy EuroPACE in Spain:** Design and launch the first residential EuroPACE pilot in Olot (Catalunya, Spain).
3. **Scale Across Europe:** Facilitate and support 4 Leader Cities willing to set up EuroPACE platforms.

This document represents the first phase of the market readiness assessment focusing on the legal and fiscal analysis. Its aim is to develop a methodology to assess the feasibility of EuroPACE implementation from a legal and fiscal standpoint and to analyse European Union Member States (EU28 MS) using this methodology. As a result, 7 EU countries were identifies as more suitable to implement an EuroPACE. The specific objectives are as follows:

1. **Analyse the legal and fiscal conditions in each EU28 MS relevant for the effective implementation of the EuroPACE mechanism.**
2. **Rank each of the EU28 MS and produce a readiness map, illustrating countries' preparedness for the implementation of EuroPACE.**

Currently, there is no single holistic analysis on the possibility of the implementation of EuroPACE mechanism for the EU28. This report aims at filling that gap.

A second phase of this research, currently under development, will focus on the market potential of the seven selected countries. Specifically, it will cover the needs to improve EE in residential buildings, homeowner characteristics, barriers to implement an EuroPACE and existing policies and financial support to carry out EE investments in residential buildings.

EU Policy Context

EU buildings, residential and non-residential, account for approximately 40% of energy consumption and 36% of CO_2 emissions. About 35% of the EU's buildings are over 50 years old and almost 75% of the building stock is energy inefficient, while only 0.4-1.2% (depending on the country) of the building stock is renovated each year.[1] Thus, improving energy efficiency of buildings is a key objective for the EU. The European Commission (EC) presented a set of legislative proposals ("Clean Energy for All Europeans") aimed at achieving secure, clean and affordable energy for all Europeans.[2] The package provides the legislative framework to stimulate investments in renewable energies and EE to make Europe a global leader in the clean energy transition. Specifically, in June 2018, the EU announced its intention to increase energy and greenhouse gas (GHG) emissions targets for the period up to 2030, reinforcing its commitment to the

1 EU Energy Efficiency, Buildings: https://ec.europa.eu/energy/en/topics/energy-efficiency/buildings
2 European Commission, 2016

Paris Agreement. Its latest goals foresee a share of at least 32% renewable energy consumption by 2030 and an indicative target for an improvement in EE at the EU level of at least 32.5% (compared to projections), which corresponds to a reduction of GHG emissions by at least 40% compared to 1990 levels.[3] EuroPACE is directly in line with the EC's objectives of (1) putting EE first, including the development of renewable energy use in buildings and (2) contributing to the EU's global leadership.

The statistics vary, but in general, Europeans spend approximately 90% of their time indoors; and while time spent in workplaces, schools, and public spaces is relevant, it is the time spent in our homes that accounts for two-thirds of the total.[4] Indoor environment has an impact on people's health, well-being and productivity. EuroPACE in uniquely positioned to boost home renovation and bring real benefits to all Europeans.

3 2030 Climate and Energy Framework: https://ec.europa.eu/clima/policies/strategies/2030_en

4 The Regional Office for Europe of the World Health Organization: http://www.euro.who.int/__data/assets/pdf_file/0020/248600/Combined-or-multiple-exposure-to-health-stressors-in-indoor-built-environments.pdf

EUROPACE IMPLEMENTATION CRITERIA

Typically, energy efficiency improvements in homes are funded with savings, personal unsecured loans, and to a lesser extent with other financing tools. The innovation of EuroPACE lies in the collection and repayment mechanism; financing is attached to the property and is repaid regularly with charges liked to a property.[5] EuroPACE is a flexible financing mechanism and program design can vary based on the local context. Typically, there are four main stakeholders involved in a EuroPACE program: a local government, investors providing financing, energy experts/energy services contractors, and homeowners undertaking retrofits. The roles and interactions of the stakeholders are depicted in Figure 1 below.

5 For more information on PACE financing see: https://pacenation.us

EUROPACE CRITERIA

These criteria are divided into two categories: key criteria, which make the implementation possible, and complementary criteria, which make the implementation easier.

KEY CRITERIA FOR EUROPACE IMPLEMENTATION

The existence of property-related tax at the country level

Effective enforcement procedures in cases of tax delinquencies

The existence of senior liens

The financing would not consolidate as public debt

The municipality would act as the legal guarantor but would not be responsible for the payment*

COMPLEMENTARY CRITERIA FOR EUROPACE IMPLEMENTATION

Tax should be collected by the municipality, which serves as the main body transferring the payment between the household and the investor

Should a programme administrator be created along with the participation of the local municipality, this type of activity should not consolidate in the municipal budget

Preferably, local taxes should benefit from the ability to foreclose in the event of delinquency

The non-acceleration of the outstanding balance in the event of a default. Investors will price these assets much differently if this is not in place

* As confirmed by various researchers, including Fischbacher, Schudy, and Teyssier (2015), guarantees whereby governments or energy providers share not only the risks, but also the chance to benefit from future savings related to EE renovations reduce the perceived risk of the investment.

METHODOLOGY

There is not yet an active EuroPACE programme in Europe, this project is pioneering this financing tool in the EU, starting with a pilot in Spain. The EuroPACE financing models is often referred to as 'on-tax financing' because, in the US where PACE financing was conceived, it is linked to a property via a property tax bill. In this report, on-tax financing is used to refer to financing attached to a property via *property related* taxes or other non-fiscal charges. The methodology to evaluate the readiness of a country to implement EuroPACE financing is complex and consists of six stages.

STEP 1. IDENTIFICATION OF FISCAL AND REGULATORY CONDITIONS

Based on the US experience with PACE financing and research conducted in Olot, Spain as part of this project, the fiscal and regulatory conditions required to successfully implement EuroPACE have been divided into four areas:

Area 1. Suitability of the legal framework for on-tax financing: This area assesses the suitability of the national legal frameworks for EuroPACE implementation, specifically focusing on property-related or similar taxes and charges. Property related taxes differ among countries. Issues essential for the legal implementation of EuroPACE, such as the existence of a property-related taxes, capacity for their systematic collection, and a relatively low level of exceptions in the collection mechanism were assessed.

MAKING HOME RENOVATION EASIER, FASTER AND MORE AFFORDABLE FOR ALL EUROPEANS

Area 2. Municipal capacity to develop an on-tax financing mechanism – municipalities' experience and policy objectives concerning EE and/or climate mitigation: Municipalities play a vital role in realising the EuroPACE mechanism, as they provide policy support to implementing EE solutions and are also relevant actors in the creation of private-public partnerships (PPPs) or initiatives to promote EE/RE in buildings. In order to approximate the experience of municipalities in working on comparable assignments and to assess their readiness to implement EuroPACE, this area refers mainly to municipalities' capacities to manage EE projects or programmes at the local level and experience working with the private sector to implement broadly defined investment programmes.

Area 3. Enforceability of local taxes and/or property-related taxes and assessment of charges, defaults, and delinquencies: This area analyzes the enforceability of local taxes and/or property-related taxes and offers an assessment of fees, defaults, and delinquencies. The roles and responsibilities of the local authorities that provide guarantees (including senior liens) to investors are also assessed. In particular, this area focuses on the progress made towards fair, standardised, and transparent administrative processes as well as possible penalties, tax liens, and, eventually, foreclosure procedures in cases of the non-payment of taxes or charges. A fully developed guarantee mechanism over the payment of property-related taxes is considered as a key market enabler.

Area 4. Political, institutional, and social perceptions and acceptance of EuroPACE: This area refers to the political, institutional, and social perceptions and acceptance of property-related taxes. It is difficult to compare the attitude towards property-related taxes, as these vary significantly among the EU28 MS. There is a vast set of secondary country-specific data on the impact local taxes have on elections and on local and national debate in general. While in some countries politicians barely mention such taxes, in others, increases in local taxes could lead to mass protests and can have a significant impact on the results of local (or central, if the government is fully in charge of local taxation) elections. In principle, it can be concluded that the more stable and institutionally continuous the tax is, the easier it will be to use it as a basis for EuroPACE implementation.

STEP 2. DATA COLLECTION

The information for this analysis was collected through the desk research of regulatory and legal documents, available market studies, and other relevant assessments. Country experts prepared or reviewed the national reports, so that the findings reflect their experience on the ground. This approach has some drawbacks, which are related to the difficulties to compare systems among countries, as they depend on local socio-historical developments. However, this approach also provides valuable insights relevant for recommendations. Last but not least, 16 finance ministries were contacted to validate the information gathered during the research phase and 14 replies were received. All together during this Step, 112 tables were prepared – 4 for each of the 28 MS.

STEP 3. WEIGHTING

Once this information was collected, data analysis commenced. The research included an examination and comparison of the countries with respect to their: property-related tax schemes, the possibility to introduce an on-tax financing mechanism, and the legislative capacity of local governments to put in place on-tax financing, among others.

To assess a country's readiness, each criterium was assigned a weight. The following three elements receive 3 points each, while others were assigned 1 point.

1. **Existence of property related taxes and charges:** a structure that might be suitable for financing energy efficient home renovation
2. **An effective foreclosure mechanism:** the aim is to assess if the property-related taxes that might be suitable for EuroPACE financing provide a consolidated, effective, and a well-functioning foreclosure mechanism in cases of delinquencies or defaults. This is a key element that distinguishes on-tax financing from other types of EE financing, like unsecured consumer loans. It is also the most relevant element from a credit risk standpoint.
3. **Property liens:** the third key element that needs to be addressed concerns the possibility of registering a lien on the property associated with the EuroPACE financing. For instance, even when there is a mortgage on the building, the municipality can still have its own "administrative lien" on it, which will be senior to the mortgage. Such possibility was be addressed here.

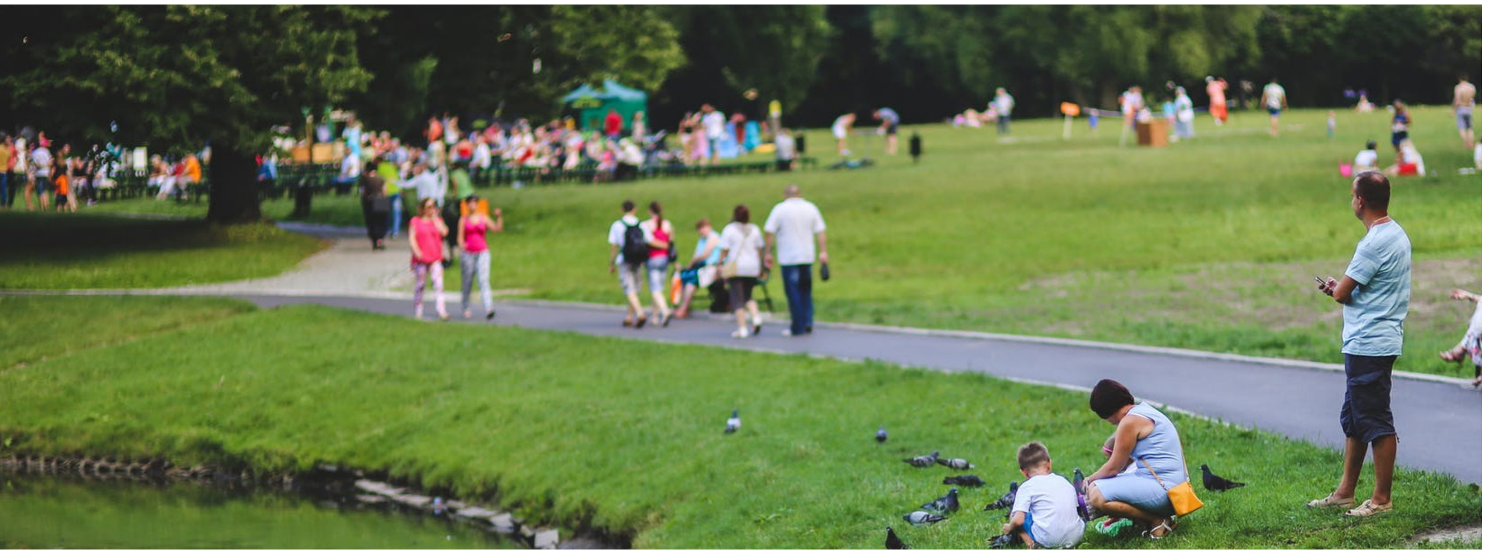
STEP 4. GRADING

Taking into account the criteria and their weight, the readiness of the EU28 MS has been assessed. The maximum number of points a country could receive is 28. The table below presents the results of the analysis.

Readiness Map Index	Country Assessment
28-23	Very adequate countries (9): Austria, Denmark, Germany, Luxembourg, the Netherlands, Portugal, Romania, Slovenia, and Spain – countries where all, or at least two of the three key criteria have been met; oftentimes, those in which on-tax financing has already been piloted
22-19	Moderately adequate countries (10): Belgium, Bulgaria, Finland, France, Hungary, Ireland, Italy, Poland, Sweden, and the UK – predominantly countries with stable and well-institutionalised property-related tax systems, but with weak enforcement procedures or insufficient experience in cooperation with the private sector
18-11	Less adequate countries (6): Czechia, Estonia, Greece, Latvia, Lithuania, and Slovakia – predominantly countries in which the administration and collection of property-related taxes is centralised
10-0	No-go options (3): Croatia, Cyprus, and Malta – countries with no property-related taxes in place

It is important to note that the grading of a country is relative to the grading of the other countries. Furthermore, even a suitable country (indicated with green) may require some legal changes and other conditions in order to develop EuroPACE effectively. Apart from a cumulative assessment, each EU28 MS received a colour-coding and a grading per criteria or area. On this basis, a Readiness Map Index (RMI) was produced using the information gathered at the country level in the four areas mentioned before.

By combining grading given to the four key areas, a map was created reflecting the possibility of EuroPACE implementation.



NEW FINANCING FOR A NEW ERA TO COMBAT-CLIMATE-CHANGE

STEP 5. SWOT ANALYSIS OF COUNTRIES BASED ON LEGAL AND FISCAL ASSESSMENT

Given the fact that there are substantial differences in the property related tax legal framework, as well as in municipal capacities to implement EuroPACE, a detailed EU-wide comparison was not possible. For this reason, SWOT analyses of legal and fiscal frameworks have been carried out, as a complementary element to the EU-wide readiness map. These analyses lay out the possible strengths and weaknesses as well as the opportunities and threats, which facilitate recommendations for EuroPACE implementation.

STEP 6. QUALITATIVE ASSESSMENT

As stated above, the methodology adopted for the creation of the Readiness Map is complex innovative and is based on data gathered from EU28 MS by different country experts. This type of methodology will not be objective and fully comparable. Therefore, in order to validate the evidence, a qualitative assessment has been carried by the EuroPACE Steering Committee Group consisting of energy efficiency finance experts, with specific expertise in PACE and EuroPACE financing. Committee members have been working to implement EuroPACE in Olot, Spain and across Europe. This type of quality check helped assess the credibility of information gathered by country experts and to create the criteria to identify seven most suitable countries for the second step of the analysis. In the second phase of the research, a detailed market analysis will be carried out for these seven countries in order to identify four leader cities where EuroPACE will be implemented under the auspices of this project.

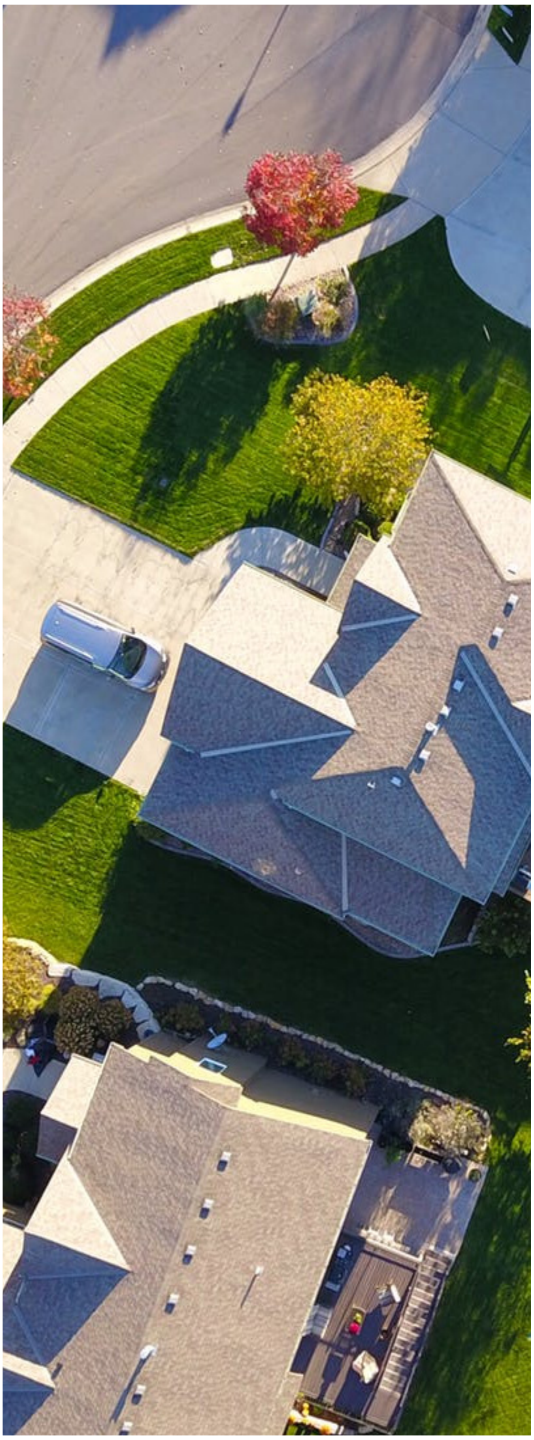
THE EUROPACE READINESS MAP

The map below shows which countries are fully, moderately, or less ready for the development of a EuroPACE initiative, as well as those which should be excluded.

THE EUROPACE READINESS TABLE

The table below depicts more detailed scoring of the EU 28MS. For more information and country tables, please refer to the Deliverable 2.1: Report on on-tax financing feasibility available on www.europace2020.eu.

Country	Legal framework suitability max: 10	Municipal capacities max: 3	Enforceability of local taxes and property taxes max: 13	Social perception and acceptance max: 2	Total	%
Austria	8	3	13	2	26	92.86%
Belgium	8	2	10	2	22	78.57%
Bulgaria	7	2	9	2	20	71.43%
Croatia	1	2	3	0	6	21.43%
Cyprus	2	1	7	0	10	35.71%
Czechia	6	0	7	2	15	53.57%
Denmark	8	3	10	2	23	82.14%
Estonia	6	0	9	1	16	57.14%
Finland	7	2	10	2	21	75.00%
France	8	3	10	1	22	78.57%
Germany	9	2	13	1	25	89.29%
Greece	5	2	6	0	13	46.43%
Hungary	8	0	11	1	20	71.43%
Ireland	7	3	10	1	21	75.00%
Italy	7	3	10	2	22	78.57%
Latvia	5	1	5	0	11	39.29%
Lithuania	6	2	5	1	14	50.00%
Luxembourg	9	1	13	2	25	89.29%
Malta	0	1	3	0	4	14.29%
Netherlands	7	3	13	2	25	89.29%
Poland	8	3	9	2	22	78.57%
Portugal	8	3	11	1	23	82.14%
Romania	7	3	13	2	25	89.29%
Slovakia	8	1	6	1	16	57.14%
Slovenia	7	3	13	0	23	82.14%
Spain	8	3	10	2	23	82.14%
Sweden	6	3	10	2	21	75.00%
UK	8	2	10	1	21	75.00%



SUMMARY OF FINDINGS

For more information and country tables, please refer to the Deliverable 2.1 Report on on-tax financing feasibility: EU28 legal and fiscal readiness for the adoption of an on-tax financing mechanism on www.europace2020.eu.

- Currently, based on the legal and fiscal assessment, none of the EU28 MS meet all criteria for EuroPACE implementation. In fact, all MS may need to adjust their legislation to some extent to enable EuroPACE. Even Austria, the country that scored the highest (26/28; 92.86%), failed when trying to implement a Business Improvement District (BID), as the relevant legislation enabling BIDs was found unconstitutional.

- Overall, property taxation across the EU is well established, as there are only three countries that do not levy taxes on property (Croatia, Cyprus, and Malta). Particularly in Croatia, negotiations are being held in order to introduce property taxation. However, the social perception of an additional tax burden is negative, which resulted in protests in early 2018 putting this policy proposal on hold.

- Property tax system varies significantly by MS; in some countries (i.e. France), property tax is a well-established concept with a long-standing tradition while in other countries, particularly in Central and Eastern Europe (CEE), property-related taxes are newer, having been established in the early 1990s after entering the market economy.

- Municipalities in all EU28 MS are familiar with SEAPs and other internationally recognised climate-oriented plans and commitments, but the degrees of their implementation differ. For example, municipalities in wealthier countries (i.e. Nordic countries and Austria) are more engaged in such initiatives, while, typically, in countries with smaller GDPs, municipalities are less active in this respect. This trend is also present in smaller countries where the central government is taking the lead in the clean energy transition. However, it can be concluded that the pace of joining climate-oriented associations and designing ambitious EE strategies by local governments is rapidly growing: every year EU municipalities proactively adopt additional EE plans confirming their commitments to national and EU-wide climate goals. Oftentimes, they cooperate with private actors to achieve these climate goals.

- In general, in all EU MS, enforcement procedures exist and are well defined. Depending on the country, the procedures are more or less institutionalised and effective. In countries like Denmark, foreclosures can be considered extremely effective. Conversely, in Italy, while enforcement procedures are technically in place, they are viewed as time consuming and complicated. Moreover, even though it is difficult to assess all the data per category, of all the key EuroPACE criteria, senior liens proved to be the least common among EU28 MS. This issue might not be feasible to address at the EU-level, instead, a county-by-country approach, involving working closely with national actors may be needed.

- Various countries across the EU, including Germany, France, and Slovenia, to name a few, plan to reform their property-related tax systems in the near future. This increases uncertainty, but also opens the window of opportunity for legislation promoting property attached financing.

CONCLUSION AND NEXT STEPS

Based on this legal and fiscal analysis of the EU 28 MS, the Steering Committee Group chose **seven countries: Austria, Belgium, Netherlands, Italy, Poland, Portugal, Romania, and Spain**, for the second phase of evaluation. These countries were selected based on the scoring outlined in this document and two additional considerations developed by the Steering Committee Group. First, a diverse geographical distribution of the countries was an important element for the selection of these seven countries. Secondly, the knowledge and expertise of the Steering Committee Group about the potential market opportunity was taken into consideration during the selection process.

The second phase of this research will be released in 2019 and it will provide a market assessment of the seven selected countries.

The fact that some of the high scoring countries were not selected for the second phase of this research doesn't mean that EuroPACE implementation in those countries is not feasible. EuroPACE is a flexible financing instrument and it can be adapted to fit a variety of local legal, political and market conditions. The EuroPACE consortium is open to further explore the potential for EuroPACE financing programmes in other countries on a case by case basis. Afterall, EuroPACE is a market driven initiative and it will continue seeking business opportunities across Europe. **Let's accelerate the clean energy transition together!**

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