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## EXTENSION OF THE LANDLORDS ENERGY SAVING ALLOWANCE

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### PURPOSE AND INTENDED EFFECT OF MEASURE

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#### The Policy Objectives

**8.1** This Regulatory Impact Assessment considers the extension of the existing Landlords Energy Saving Allowance (LESA). This extension comprises four elements:

- extending LESA to corporate landlords to bring more private rented properties within the scope of the allowance;
- extending the existing sunset clause from 2009 to 2015;
- applying the cap to the allowance (£1500) per property rather than per building, ensuring that smaller properties have access to the full value of the allowance; and
- including the cost of acquiring and installing floor insulation as qualifying expenditure, expanding the range of energy efficiency measures available to landlords within the allowance.

**8.2** Installing insulation is one of the most cost-effective means of improving household energy efficiency; LESA provides an allowance for the insulation of properties within the private rented sector. Extending LESA expands the scope of the scheme and therefore increases the incentives for energy efficiency savings to be made in line with the Government's environmental objectives.

#### Background

**8.3** Households produce over a quarter of total UK carbon emissions and, while existing measures have helped to reduce emissions in this area, properties within the private rented sector are not on track to meet the emissions reduction targets that have been set for it. Such properties have low energy efficiency levels compared to the rest of the housing sector and typically produce around 500kg of carbon dioxide per year more than other houses. One reason may be the particular market failure, whereby landlords are disincentivised to invest in energy efficiency because the benefits of doing so, in the form of lower energy bills and increased comfort, flows not to them but to the tenants.

**8.4** Budget 2004 took the first steps to address this market failure with the introduction of the Landlords Energy Saving Allowance (LESA), offering a deduction against taxable profits for private landlords' expenditure on loft and cavity wall insulation. In the intervening two years LESA has been extended to include solid wall and hot water system insulation as well as draught proofing. Budget 2006 announced work on extending the allowance to corporate landlords as well as raising its profile within the sector.

## Rationale for Government Intervention

**8.5** A particular market failure exists in the private rented sector where cost savings from investing in energy efficiency are difficult for landlords to recover in increased rent and unlike private house owners those investing are not those who benefit. In Budget 2004, the Government took action to address this market failure by introducing LESA. The Government believes that further energy efficiency gains could be realised in the private rented sector by extending the allowance in four ways:

- extending the scheme to corporate landlords – thus making the allowance available to an extra 25 per cent of properties within the sector;
- extending the sunset clause from 2009 to 2015 – thus allowing corporate landlords a longer investment window and providing an incentive to landlords purchasing properties post-2009 to invest in energy-saving measures;
- applying the allowance per property rather than per building – ensuring that even smaller properties such as flats within a block have access to the full allowance; and
- including the acquisition and installation of floor insulation – thus giving landlords a wider choice of insulating all parts of a property when carrying out energy efficiency improvements.

## CONSULTATION

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**8.6** No formal public consultation has taken place to date. However, informal discussions have taken place with representatives from the energy efficiency and rental industries. The proposals were well received both in terms of the incentive to landlords to improve the standards of properties as well as the increased benefit to the environment.

## OPTIONS

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### 1. Do Nothing

**8.7** Doing nothing would mean that the existing allowance would continue to apply to individual landlords until 2009. The cap of the allowance (£1500) would continue to apply on a per building basis. The group of insulation products that qualify for expenditure under the scheme would remain unchanged.

### 2. Extending the Landlords Energy Saving Allowance

**8.8** Expand the scope of the existing allowance through:

- the extension of LESA to corporate landlords (subject to State aid approval);
- the extension of the existing sunset clause from 2009 to 2015;
- the application of the allowance per property rather than per building; and
- the addition of the acquisition and installation of floor insulation as a qualifying expenditure.

## COSTS AND BENEFITS

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### Economic impacts

- Exchequer costs (loss of tax revenue of all extensions planned) up to £10 million.
- The extension to corporate landlords will mean that all landlords within the private rented sector will now have access to allowances for expenditure on insulation.
- There will also be a negligible impact on HMRC in terms of increased compliance activity.

### Social impacts

**8.9** It is not anticipated that there would be any additional impacts on devolved regions, human rights, rural areas or crime.

### Race and Equality Impacts

**8.10** There will be no race or equality impact arising from this measure.

### Environmental impacts

**8.11** It is not anticipated that there will be any adverse impacts on the environment.

**8.12** The extensions to the allowance are likely to result in a carbon dioxide saving of 0.15-0.67 MtC in 2010/11 – this is dependent on the take-up by corporate landlords.

### Sectors and groups affected

**8.13** The extension to the LESA will mean that corporate landlords benefit from the allowance for the first time. The overall additional administrative burden that will result for these companies is estimated to be less than £100,000. The other three aspects of the extension will also apply to private landlords, who are already eligible for LESA. There will be an indirect benefit to companies providing insulation materials. There will also be a benefit to tenants in the form of reduced utility bills and increased comfort.

### Benefits

#### Option 1 – Do nothing

- No exchequer costs.
- No additional administrative burden on corporate landlords.

#### Option 2 – Extend the Landlords Energy Saving Allowance

- The extension of LESA to corporate landlords will provide incentives for them to install energy saving materials in their properties, benefiting their tenants in terms of their reduced energy bills and improved

accommodation. This will also lead to a small reduction in carbon emissions as a result of decreasing energy demand.

- The extension of the sunset clause will: provide a longer window for all landlords to invest in residential properties; incentivising all new and existing landlords purchasing properties after 2009 to also invest in the energy efficiency of their property.
- The application of the allowance per property rather than per building will simplify the allowance and increase uptake. It will also encourage more energy efficiency measures in smaller properties.
- Extension of LESA to floor insulation will increase the range of qualifying insulation types available to landlords when carrying out improvements to their property.

## Costs

### Option 1 - Do nothing

- A significant proportion of the private rental market (i.e. corporate landlords) would continue to have no economic incentive to invest in energy efficiency measures in their properties, as they do not directly benefit from the improvements.
- LESA would not be available to landlords making improvements to properties after 2009.
- Blocks of flats etc. would continue to receive a smaller allowance per property and therefore would have less incentive to invest.
- Choice of insulation would be restricted.

### Option 2 - Extend LESA

- Exchequer costs (in terms of revenue foregone) up to £10 million per year.
- Increased overall administrative burden for corporate landlords of less than £100,000 per year.
- For HMRC, the extension to corporate landlords would require updated guidance including changes to the notes on the Corporate Tax Return.

## SMALL FIRMS IMPACT TEST

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**8.14** There will be no disproportionate burden on small firms. There is no compulsion to deduct the expenditure and the benefit received from the allowance would outweigh the associated administrative cost. Corporate landlords will only be required to deduct the appropriate amount as part of their profit or loss computation and do not have to provide details on the Corporation Tax return, reducing the administrative burden.

## COMPETITION ASSESSMENT

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**8.15** Extensions to LESA level the playing field across the private rented sector. Other incentives are in place to improve energy efficiency in commercially rented properties.

**8.16** The impact of the proposed extension to LESA was assessed by applying the competition filter to the private rental market. It was found that an in-depth competition assessment is not warranted.

**8.17** The proposed extension to corporate landlords has been formally notified to the European Commission to request approval of a State aid on environmental grounds.

## ENFORCEMENT, SANCTIONS AND MONITORING

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**8.18** The proposed extension to LESA will be monitored and enforced through HMRC's existing processes for administering the tax system, including the authority to enquire into tax returns where appropriate.

## IMPLEMENTATION AND DELIVERY PLAN

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**8.19** Individual landlords claim LESA as a relief from income tax. The implementation of the extensions to these landlords runs to the following timetable:

1. Finance Bill 2007 will contain clauses extending the sunset clause from 2009 to 2015.
2. On 13 March 2007 existing legislation was amended by the Energy-Saving Item Regulations 2007. These Regulations, which were laid before the House of Commons on 14 March, ensure that the £1500 cap for the allowance applies per property rather than per building.
3. On 14 March 2007 a Statutory Instrument was laid extending LESA to cover the acquisition and installation of floor insulation.

**8.20** Corporate landlords will claim LESA as a relief from corporation tax. The extension to corporate landlords is subject to State aid approval – the European Commission has been notified of the proposed extension to the scheme.

**8.21** Provision will be made in Finance Bill 2007 for the extension to come into force by Treasury Order once approval has been received from the Commission. Companies will then be able to deduct expenditure incurred after the date on which the extension comes into force. If State aid approval is not received it will not be possible to extend the availability of LESA to corporate landlords in this way. The additional three elements of the extension (extension of the sunset clause, extension to smaller properties and extension to include floor insulation) will also apply to corporate landlords from that date.

**8.22** The LESA will allow corporate landlords to deduct the appropriate expenditure as part of their profit or loss computation (submitted with their Corporation Tax return). Individual landlords will continue to claim in the same way as previously (by means of their income tax return).

## POST-IMPLEMENTATION REVIEW

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**8.23** The LESA is time limited and is due to expire in 2015. The scheme will be continually reviewed to ensure that it is effective in incentivising landlords to improve the energy efficiency of properties within the private rented sector.

## SUMMARY AND RECOMMENDATION

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**8.24** We recommend option 2 – extending the Landlords Energy Saving Allowance.

**8.25** The extension of LESA will incentivise corporate landlords to install energy efficiency measures in their rental properties; allow more time for the allowance to operate, thus incentivising landlords to improve their properties after 2009; give a more generous allowance to properties in shared buildings and give landlords a greater choice of insulating materials by also making floor insulation a qualifying installation.

**8.26** The additional administrative and regulatory burden associated with this measure would be minimal. There will be no additional burden to those landlords who are already eligible for LESA. Corporate landlords will incur increased administrative costs of less than £100,000. There is little additional administrative burden to HMRC.

**8.27** The extension of LESA is consistent with the Government's objective to protect and improve the environment by using instruments that will deliver efficient and sustainable outcomes through evidence-based policies.

## Contact Point

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## REGULATORY IMPACT ASSESSMENT

### Extension of the Landlords Energy Saving Allowance

#### Statement of Ministerial Approval

I have read the Regulatory Impact Assessment entitled and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

JOHN HEALEY MP  
FINANCIAL SECRETARY TO THE TREASURY

Dated: 19 March 2007