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MINIMUM ENERGY EFFICIENCY STANDARDS:
NON-COMPLIANCE RISKS SIGNIFICANT FINES, MAJOR COMMERCIAL
RESTRICTIONS AND A DAMAGED REPUTATION. BUT COMPLYING IS NOT
ARDUOUS, AND CAN EVEN BE BENEFICIAL.





MINIMUM ENERGY EFFICIENCY STANDARDS

On 1 April, the minimum energy efficiency standards (MEES) come into effect under The Energy Efficiency (Private Rented Property)(England and Wales) Regulations 2015¹ and it will be unlawful for a landlord to let or renew a lease of a property if the Energy Performance Certificate (EPC) rating is an F or a G (known as a sub-standard property). This includes sub-lettings and so tenants who wish to dispose of unwanted space must comply with the regulations, too.

The regulations become more burdensome from 1 April 2020 by applying to all domestic properties with an F or a G rating and then, from 2023 capturing all sub-standard properties.

Financial risk

The introduction of MEES represents a significant financial risk for landlords due to the potential for loss of rental income, irrecoverable capital expenditure on improvements and penalties for non-compliance that range from £2,000 to £150,000. Compliance also adds another layer of complexity to transactions that is especially problematic for short term lettings where a landlord wishes to prolong the rental income stream (for example, when redevelopment had been planned but is postponed due to market conditions).

Multiple fines can be issued for each non-compliant transaction and significantly, local authorities retain the revenue from the fines, which given their current budgetary constraints should drive enforcement (in a similar way to parking penalties). Furthermore, if a landlord does not pay the penalty, the local enforcing authority can recover the outstanding fine as a debt.

Although MEES does not apply to sales transactions, prospective purchasers are increasingly paying close attention to EPC ratings given the potential financial implications of MEES, which for owners of sub-standard or at-risk properties may disrupt or delay the sales process or result in a reduced sale price.

Many practical and energy-conscious landlords already have plans in place and so the formal introduction of MEES should not be a worry. However, research² suggests it is unclear how much progress landlords have made in seeking to mitigate their risks.

Government has published further guidance³ on MEES but there are several grey areas and complications, particularly in relation to listed buildings, voluntary EPCs and retail properties.

Although MEES apply to F and G rated properties, the methods used to prepare EPCs have become more stringent and their quality has improved. Therefore, when an E-rated, compliant property is reassessed today, there is a risk of the rating dropping to an F or a G, especially if it was assessed shortly after EPCs were introduced in 2008–09. Conversely, accurate assessment of a property's EPC using dynamic simulation modelling, factoring in any energy efficiency enhancements, can often improve a rating.

Exemptions

The regulations do not capture all F and G rated properties. Properties with a short lease (defined as less than 6 months) or with a long lease (greater than 99 years) are excluded.

Properties that are not required to have an EPC under the Energy Performance of Buildings Regulations 2012 (EPBR)⁴ are also excluded; for example, buildings to be demolished. However, though there is uncertainty over whether lease renewals and re-gears – that is, when a landlord grants a tenant a new lease under different terms,



typically to prolong their occupation - require an EPC, such transactions are within the scope of MEES.

Exemptions arise when:

- All relevant energy efficiency improvement works that have a simple payback period of seven years have been undertaken. These works include replacing inefficient mechanical and electrical services installations, fabric improvements and the provision of renewable technologies.
- A landlord is unable to obtain third party consent, for example from the planning authority, tenant, lender, superior landlords, etc.
- An independent surveyor determines that the energy efficiency improvements would devalue the property by more than 5% (such as providing thermal insulation to the internal face of external walls).

Exemptions last for five years, and to qualify a landlord must list the property on the public Private Rented Sector Exemptions Register. There are a few points to note in relation to this.

- Exemptions are not transferrable, which means that when a property is sold the new owner or landlord must either improve it to meet the minimum standard or register another exemption.
- A temporary exemption exists when a substandard property is sold, allowing the new owner or landlord six months to comply. This may prove to be a costly and time-consuming exercise for complex properties.
- When registering an exemption because improvements do not pass the seven-year payback rule, the evidence must include copies of three quotes from qualified installers – which may present difficulties when installers realise there is no prospect of securing work.

Also of note, when registering an exemption because improvements do not pass the seven-year payback rule, the evidence must include copies of 3 quotes from qualified installers, which may present difficulties when installers realise there is no prospect of securing work.

LISTED BUILDINGS

There is a common misunderstanding that listed buildings or those within conservation areas are MEES exempt because such properties are not required to have an EPC. A listed building will not be required to have an EPC if “compliance with certain minimum energy performance requirements would unacceptably alter their character or appearance”³ of the listed building. If the answer is yes, then an EPC is not required.

RETAIL PROPERTIES

When an existing retail unit is refurbished and marketed as a shell – that is, without any lighting or heating, which will be installed by a new tenant – convention requires that the assessor’s model must use the most energy-intensive default inputs allowable under the version of Part L of the Building Regulations applicable at the date of construction of the base building.

The same rules apply where an existing unit is enlarged or sub-divided and no services are installed. In both scenarios, it is highly likely that when assessed the property would have an F or a G rating, which is significantly



worse than the C or D rating that would be achieved if the energy model were based on a tenant's Part L2B-compliant fit-out.

Although an F or a G rating could be used for marketing purposes, a landlord would be prohibited from completing a letting and the poor rating could also be off-putting for a prospective tenant.

A pragmatic approach would be to adopt the protocol for new retail units where an assessor can assume a Part L-compliant fit-out when preparing the EPC. The resolution of this conundrum is the subject of ongoing discussions with the relevant government departments, which will take time to resolve.

In the meantime, when undertaking the refurbishment, extension and sub-division of retail properties careful consideration must be given to MEES to ensure that you are able to let the property on completion.

VOLUNTARY EPCs

Many diligent landlords obtained EPCs voluntarily when there was no legal requirement to do so at the EPBR's introduction in 2008; these certificates will therefore be expiring shortly after MEES come into effect. Properties with such EPCs are not required to meet the minimum standard.

However, if a voluntary EPC is lodged on the Landmark register it will supersede any earlier EPC, which could conceivably have been a compliant rating. Therefore, it is essential that landlords pay close attention to all EPCs lodged on their properties.

WHAT DOES IT MEAN FOR LANDLORDS?

As stated earlier, the introduction of MEES will not be a cause for concern for proactive landlords that recognise the importance of energy performance and have well-established plans in place.

However, more reactive landlords; those that do not have a strategy in place or perhaps thought that listed buildings are exempt, could find that they are "at-risk", lose rent and if a non-compliant property is let, incur significant penalties. In addition, as names of landlords in breach of the regulations will be published on the PRS Exemptions Register, non-compliance damages their reputations.

The Government's publication of energy performance data allows greater analysis and knowledge of a portfolio's poor energy performance and that could in turn have a detrimental effect on a company's or a fund's financial performance.

MEES may well bring several softer benefits in terms of meeting CSR objectives and helping landlords to differentiate their properties in the marketplace. Well performing, efficient buildings which provide positive environments are proving to be increasingly popular with occupiers as such workplaces can play a vitally important role in the battle for talent and staff retention and improve productivity. MEES will provide a tangible benchmark in support of corporate reputation and send positive signals to prospective customers and clients of the occupying business.

WHAT TO DO?

Firstly, it is important to assess the risk, identifying any properties currently with an E, F or G rating. That must include verifying the accuracy of the existing EPCs, as variations in assessments can lead to incorrect ratings.



Prioritise consideration of those properties with lease events in the near future or where asset liquidity is important.

Close attention must be paid to certificates produced shortly after EPCs were introduced in 2008 and to those where there is a reliance on default settings in the calculation of the rating. This is particularly important for landlords with domestic properties in their portfolios as the regulations' teeth start to bite from 1 April 2020.

Next, once the potentially "at-risk" properties have been identified, develop a plan of improvements and determine what works can be incorporated within regular maintenance and refurbishment works. Quite often, a rating can be improved at little or no extra cost when improvements are undertaken as part of a planned package of works. In fact, in our experience simply re-modelling a property using accurate data can improve the rating without carrying out any works.

Collaboration is essential as it is unlikely that leases will include provisions for you to carry out energy efficiency improvement works within tenanted areas. It is also important that landlords and their property managers maintain good relationships with their tenants and discuss your proposals with them well in advance of the commencements of any works. When entering into new leases (or renewing existing ones) consider the inclusion of provisions or attaching a memorandum of understanding to the lease that provide flexibility and an additional framework for collaboration. In addition, when reviewing tenants' alterations and fit-outs, pay close attention to the proposals to make sure that they do not have a detrimental effect on the EPCs. This also presents a chance to identify any opportunities to improve a rating. For non-compliant or at-risk properties, the landlord may be willing to contribute towards the cost of the improvements, which could be of benefit to the occupier by reducing energy costs.

When evaluating works, consider whether they will have any impact on the value of your property and consider what consents are needed. It could be that an F or G rated property is exempt and if it is, ensure that property is listed on the PRS Exemptions Register, noting that any false or misleading information could incur a penalty.

If you are concerned about funding your improvements works, there are an increasing number of funders specialising in energy efficiency retrofitting.

For those properties at risk or non-compliant, investors will want to know whether compliance with MEES will have financial implications, and if it does, how they can then factor this into their investment appraisals. It may well be that compliance has an impact on the investment value, which in turn influences the price investors are willing to pay for the property. Occupiers should consider whether compliance with MEES might constrain any future plans to sublet part of the space.

For transactions concerning listed buildings without an EPC, an initial view must be given on the likely rating. If it is E or better, then prepare and lodge the certificate. If it is F or G, establish what works are necessary to secure an E, which may require support from a heritage specialist to assess whether the improvements would have a detrimental effect on the property's character or appearance. All of which could prove to be a lengthy process.

When assessing MEES-driven EPC improvements it is also important to consider these in the context of operational energy savings and associated reduction in service charges. EPC ratings can be easily improved by like for like replacements but if done poorly this might not translate into actual cost savings for the landlord and tenants. With the emerging importance of ratings based on operational energy performance (from real estate benchmarks such as GRESB and NABERS) it could also be a way to future-proof their assets against the risk of a potential introduction of minimum performance standards based on operational performance, as has happened in Australia.



HOW CAN TFT HELP?

TFT adopts a qualified, holistic approach to energy efficiency. This builds on a firm understanding of landlord and tenant matters, leases, statutory compliance, experience with historic buildings and expertise in risk management. We have extensive portfolio experience and have devised and implemented MEES strategies to assess and improve assets and property portfolios.

A highly accurate, forensic approach to energy modelling qualifies plans which are formulated promptly and implemented to schedule. Applying our complementary expertise in building surveying, cost consultancy, sustainability, M+E services and project management, we integrate planned improvements within maintenance, repairs and refurbishments, in a cost-effective and efficient way. We place energy efficiency within a commercial context, providing due diligence to inform both risk and opportunity.

TFT can provide in-house CPD sessions which address MEES and the issues and opportunities arising out of the regulations.

Like it or not, MEES come into force on 1 April but with TFT's help the introduction need not be traumatic.

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