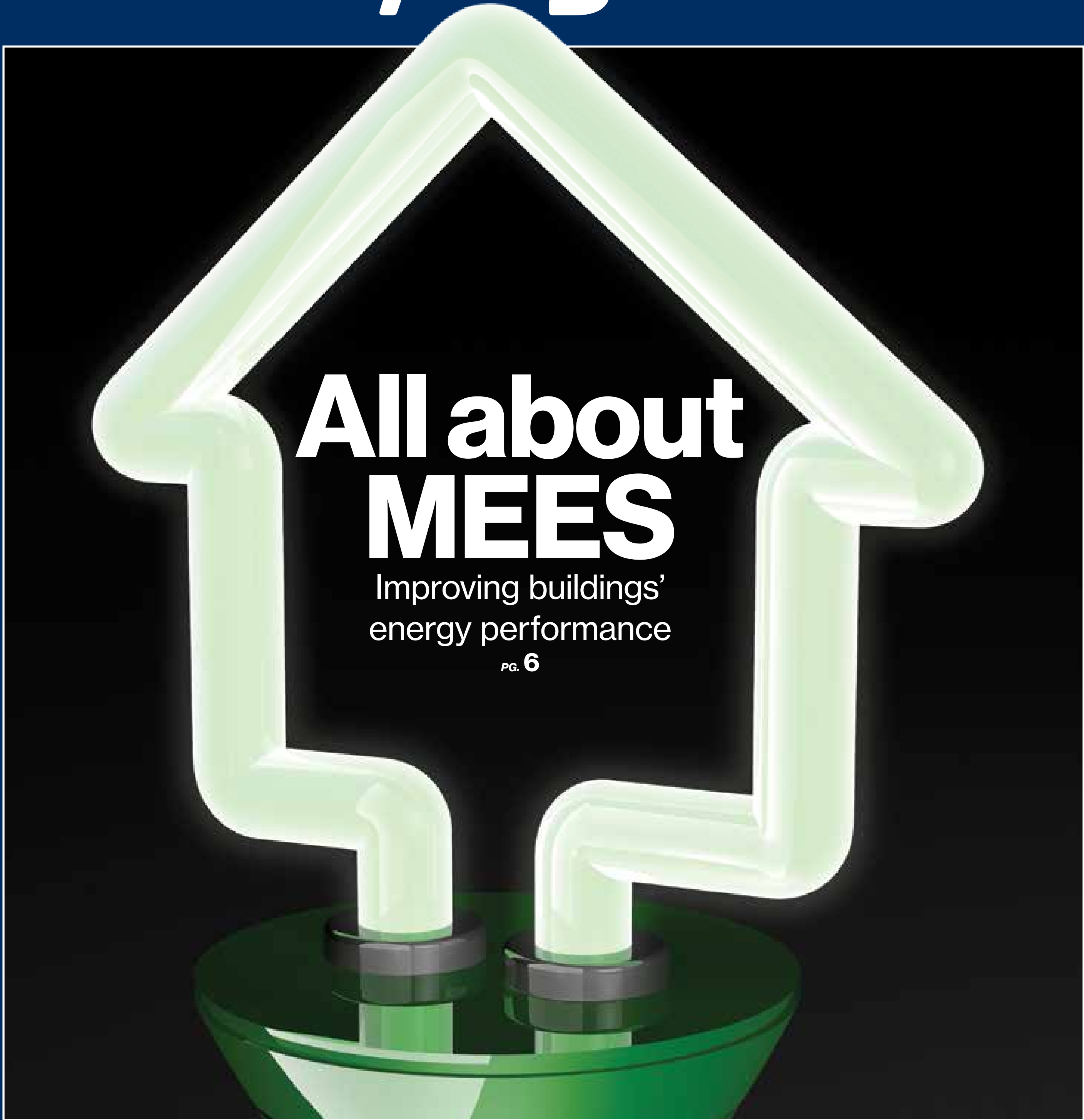
RICS

Incorporating Building Conservation Journal

Building Surveying Journal



After the floods
Have communities' concerns been properly addressed?
PG. 11

Safest solutions
What CDM Differently means for designers
PG. 20

BUILDING CONSERVATION
Conflicting accounts
Throwing light on dark heritage
PG. 30

December 2016 / January 2017
rics.org/journals

All about MEES

Mat Lown encourages landlords to do more than addressing the theoretical energy performance of properties in responding to the Energy Efficiency Regulations

The Tuffin Ferraby Taylor *Energy Survey 2016* found strong awareness of energy performance among property companies, investors and managers. The survey also found that consideration of energy efficiency is widely seen as a "business as usual" activity, and that improvement measures are not usually regarded as too complex (*http://bit.ly/2dvdjps*).

However, the survey also identified that there are still barriers to improvement. This prompts several questions. What is driving awareness, and how is the market responding? If energy efficiency measures are not too complex, then what barriers are there?

Policy context

Under the Climate Change Act 2008, which is independent of EU legislation, the UK is committed to reducing its emissions by at least 80% by 2050 compared to 1990 levels (*http://bit.ly/2drE2Xr*). The act established a system of carbon budgets covering five-year periods to ensure the UK remains on track to meet the 2050 commitment, and on 30 June, the government set the fifth of these, for 2028–32, with the aim of reducing UK greenhouse gas emissions in 2030 by 57% relative to 1990 levels.

Parliamentary approval of the ambitious target has provided much-needed certainty and sends a clear signal that the UK intends to stay on track in meeting its long-term targets, whether it is in or out of the EU. Its emissions continue to fall, with the independent Committee on Climate Change's provisional figures for 2015 showing that they are 38% below 1990 levels (*http://bit.ly/29hAT7c*).

However, this is almost exclusively a result of reducing emissions in electricity production – due to a decline in coal-fired power generation and a rise in renewable energy sources, particularly wind – rather than a reduction in energy demand.

Furthermore, it is estimated that the property sector accounts for around 32% of the UK's emissions and that more than 80% of the buildings that exist today will still be in use in 2050. As a consequence, if we are to meet the long-term targets, it is essential to reduce demand by improving the energy performance of such buildings.

Minimum Energy Efficiency Standards

In April 2018, Minimum Energy Efficiency Standards (MEES) will come into force under the Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015, meaning that landlords will face a significant penalty if they let property with an F- or G-rated energy performance certificate (EPC). The regulations not only apply to lease renewals, where an EPC exists, but also to subletting, covering tenants who wish to dispose of unwanted space.

From 1 April 2020, the regulations will become more onerous, covering all property leases where an EPC exists, not just new transactions. Initially, the regulations will target landlords of domestic properties, but from 2023 will extend to cover non-domestic properties as well.

Exempt properties include those that are not required to have an EPC under the Energy Performance of Buildings Regulations 2012 or those with a short or long lease; that is, briefer than six months or greater than 99 years respectively. Other exemptions include the following situations:

- all cost-effective improvement works with a simple payback period of seven years have been undertaken
- a landlord cannot obtain third-party consent, for example from the planning authority, lender or a superior landlord
- the improvements would devalue the property by more than 5%.

Exemptions last for five years and to qualify, a landlord must register the property on the publicly maintained Private Rented Sector Exemptions Register, stating the reasons for doing so.

There is uncertainty as to whether or not listed buildings are exempt from MEES: a strict interpretation of the regulations suggests that they should be, because lettings involving listed buildings are not required to have an EPC. However, draft guidance from the government, which has not yet been widely circulated, would indicate otherwise.

Penalties for non-compliance with MEES range from £2,000 to £150,000 and are based on the rateable value of the property. There does not appear to be any limit on the number of penalties that can be issued.

Market response

Given the associated financial and reputational risks, it is perhaps no surprise that MEES have caught the attention of property investors and asset managers. They are proving very resilient, having survived many rounds of regulation-culling, and this should help to build confidence in them in the property sector. The survey also established that financial considerations are both a key driver and a constraint, especially in terms of payback periods.

With April 2018 fast approaching, we are witnessing exponential growth in demand for strategic MEES advice, which entails assessing the risks and devising portfolio-specific action plans to mitigate any liabilities. Typically, these plans include a programme of capital expenditure improvements and the provision of asset and property management tools such as policies and guidance for suppliers and team members.

It is important when devising these plans to evaluate improvements to the EPCs in the context of the intentions for each property. Quite often a rating can be improved when carrying out cyclical or planned replacement works, which can be highly cost-effective and minimise disruption to occupants. Not only will works improve the EPC rating, they should also help reduce operational energy demand.

MEES do not apply to sales transactions, but given the potential impact on an asset's financial performance and the risk of disruption to future rental income, investors are increasingly concerned with energy performance when undertaking their due diligence. It is essential that any exceptional expenditure is identified, so the prospective purchaser can factor it in to their investment appraisal; this in turn may entail negotiation of a discount for poorly performing assets.

Conversely, when preparing a property for sale, it is important to consider MEES and take appropriate steps to mitigate any associated risks. These could range from carrying out works to being sufficiently well informed to challenge a prospective purchaser's attempts to negotiate a price reduction.

Looking at lease events

Lease events are increasingly seen as an opportunity for landlords and tenants to consider energy efficiency improvements. For example, a break could provide a chance for a landlord to make improvements in consideration for a tenant agreeing to stay or extend their lease, not only responding to MEES but perhaps more importantly preventing a void in rental income.

A tenant's fit-out or alterations might have a detrimental impact on an EPC rating, so property managers and surveyors are also paying closer attention to the impact of these. If there is scope to improve the rating, then a conversation with the tenant's team could help explore the possibility for incorporating improvements into the scheme, especially when the changes have no or minimal cost impact.

When refurbishing buildings or replacing major plant, it is essential that the scope and cost of EPC improvement works that can be sensibly incorporated into the project are evaluated. Accurately modelling improvements is therefore essential, using all relevant data and dynamic simulation software, and particularly appropriate for more complex projects or where there is a need to secure a BREEAM rating.

Compliance with regulations is clearly a motivation for investors and managers; but is anything driving the market to go beyond compliance and make improvements that reduce occupiers' actual energy consumption? Interestingly, we find that financial considerations serve as both a motivator and a barrier to taking such measures in property portfolios.

A significant number of property investors recognise the potential to improve energy performance and have undertaken audits that identify opportunities to do so, but are then reluctant to carry out these works. This is because they are concerned about the return on investment and inadequate government incentives. Perhaps more significantly, they also lack confidence as a result of uncertainty, policy and regulatory complexity, and have doubts about the quality of advice, specifically whether it is impartial.

It is clear that appropriate policy and regulation are vital in driving awareness, and the fifth carbon budget has been very helpful in this regard, providing welcome clarity after the EU referendum. Reassuringly, many major property investors and asset managers are taking a lead in implementing measures that go beyond compliance. However, barriers remain, with work to be done in terms of building confidence; this principally means further clarity is required from government, as well as ensuring provision of independent, impartial advice. ●

Mat Lown is Partner and Head of Sustainability at Tuffin Ferraby Taylor
mlown@tftconsultants.com

Related competencies include **Construction technology and environmental services, Legal/regulatory compliance, Sustainability**

Image © TFT