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Plan ahead

Mat Lown reviews MEES and how landlords and property owners can mitigate the associated risks by having an effective strategy in place

Last year, the Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 (<http://bit.ly/1bxnsOC>) brought into force the minimum energy efficiency standard (MEES). This was introduced by the UK government to meet its obligations under the Energy Act 2011.

From 1 April 2018, a landlord will be unable to let a property with an F or G rating on its Energy Performance Certificate (EPC), known as a substandard property. The regulations not only apply to lease renewals where an EPC exists, but also to sub-lettings, covering tenants who wish to dispose of unwanted space.

From 1 April 2023, and from the same date in 2020 for domestic properties, the regulations become more onerous by applying to all property leases, where an EPC exists.

Furthermore, the government proposes to review MEES in 2020, so we may see the standard tighten.



Landlords may face significant penalties for non-compliance

With the prospect of being unable to let a property, and the potential loss of rental income, awareness of MEES has grown among the property investment community, and this has led to an increased focus on EPCs. A landlord who has properties with predominantly C or D ratings may take the view that there is an acceptable margin of error in the rating to mitigate the potential risk of being left with unlettable properties. However, it is possible that the actual ratings are, in fact, far worse; conversely, the rating may be significantly better than the EPC suggests.

Exemptions

Some F- and G-rated properties fall outside of the scope of MEES, including those that are not required to have an EPC under the Energy Performance of Buildings Regulations 2012 – for example, listed buildings. In addition, properties with a short lease – defined as less than six months – or with a long lease – greater than 99 years – are excluded.

Exemptions also arise when:

- all cost-effective improvement works that have a simple payback period of seven years have been undertaken, which include replacing inefficient mechanical and electrical services installations, fabric improvements and the provision of renewable technologies
- a landlord cannot obtain third-party consent for the improvement works, 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)
- the Green Deal's golden rule applies, where the cost of the improvement works exceeds the value of the total energy savings. However, there are doubts as to whether this exemption is applicable now the Green Deal scheme has been effectively withdrawn.

Exemptions last for five years, and to qualify, a landlord must register the property on the public private rented sector (PRS) exemptions register, stating the grounds for doing so.

Non-compliance penalties

In addition to finding themselves at risk of being unable to let properties, landlords may face significant penalties for non-compliance, which range from £2,000 to £150,000, according to the rateable value of property.

Penalties also apply where a landlord has registered false or misleading information on the PRS exemptions register. To encourage compliance, the worst offenders may find that their contravention is made public.

Finally, the government's publication of energy performance data allows greater analysis and knowledge of a portfolio's poor energy performance, which in turn could have a detrimental effect on a company's or fund's financial performance.

What should landlords and property owners do?

First, it is important to assess the risk, identifying any properties that currently have an E, F or G rating. This must include verifying the accuracy of the existing EPCs, as variations in assessments can lead to incorrect ratings. Close attention must be paid to the following certificates:

- produced before April 2011, when the EPC calculation software was updated to reflect changes to the Building Regulations



There are an increasing number of funders specialising in retrofitting energy efficiency measures

- prepared shortly after EPCs were introduced in 2008, when methodologies and best practice were in their infancy
- 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, because the regulations' teeth start to bite from 1 April 2020, shortly after the EPCs prepared in 2008–09 become invalid.

Next, determine how to improve the EPC ratings, which may entail carrying out physical improvements to the property or remodelling the energy performance using accurate data. When works are necessary, assess the cost and timing of the improvements. It is also important to consider the impact of any tenants' alterations, as such works may have a detrimental effect on the rating. If a tenant's fit-out is responsible, check that the lease or any licences contain suitable reinstatement provisions.

If there is a need to prioritise the evaluation process, focus on the properties that could present a considerable financial risk, especially those that generate significant rental income or where a disposal is likely in the next few years.

When evaluating improvements, consider carefully the timing of the works in the context of the investment strategy and any asset plans for the property or portfolio. In practical terms, this means carrying out the works as part of regular maintenance and refurbishments, as quite often a rating will be improved by merely undertaking cyclical or planned replacement works at little or no additional cost. Future lease events or plans to sell the property are also an important consideration when determining the timing of improvements.

If there are plans to sell an at-risk property, and no improvements are undertaken, it is conceivable that a prospective purchaser will attempt to negotiate a discount in the purchase price to cover the cost of the works and/or loss of rental income. In this scenario, understanding the scope and cost of improvements is likely to prove invaluable to help counter any over pricing of works. Furthermore, it is quite possible that improving the rating may incur no additional cost; for example, where a tenant's alterations are responsible for the poor EPC rating or the improvements would form part of a future refurbishment.

Tenants and leases

The lease should also pay close attention to the respective rights of the landlord and tenant. It could be that cooperation with occupiers is essential because it is unlikely that the leases will include provisions for landlords to carry out energy efficiency improvement works in tenanted areas or where the recovery of costs through the service charge is likely to be contentious. It is also important that landlords maintain good relationships with their tenants and discuss proposals with them well ahead of the start of any works.

When landlords enter into new leases, or renew existing ones, they should consider the inclusion of green lease provisions or a memorandum of understanding to provide flexibility and a framework for cooperation. In addition, it is important that landlords pay closer attention to their tenants' fit-out proposals to ensure that they do not have a detrimental effect on a property's EPCs.

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

If there are any concerns about funding improvements works, there are an increasing number of funders specialising in retrofitting energy efficiency measures.

Finally, when completing due diligence, it is important to make sure that the EPC is reviewed to determine whether the property could be at risk. Where this is the case, determine the cost and timing of the improvement works. This information can be useful for prospective purchasers when re-evaluating their investment appraisals and/or negotiating a purchase price. Occupiers should also consider whether compliance with MEES might constrain any future plans to sub-let part of the space.

If a sub-standard property is sold, the new owner has only six months to comply with the regulations if they seek to let it, making this an important due diligence consideration for prospective purchasers and occupiers.

MEES should not be a cause for concern for proactive landlords who recognise the importance of energy performance and have well-established plans. For those who have yet to devise plans, it is important that you do so sooner rather than later as 1 April 2018 is fast approaching.



Mat Lown is a chartered building surveyor and Partner and Head of Sustainability at Tuffin Ferraby Taylor
mlown@tftconsultants.com
[@matlown](https://twitter.com/matlown)



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