

# A bite-sized update on the Energy Efficiency Regulations

Edward Glass advises practitioners on preparing their landlord clients for the minimum energy efficiency standards



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The Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 became law in March 2015, establishing what have now widely become known as minimum energy efficiency standards (MEES). It is now less than 18 months until the MEES restrictions on letting take their first 'bite' in respect of both domestic and non-domestic property.

Despite much commentary on MEES, particularly focusing on how best to prepare, it seems that many commercial landlords have not yet fully engaged with the impact of the regulations. Described in the property press as a 'green time bomb', the results of a Bilfinger GVA survey, published in May 2016, revealed that 43 per cent of property companies had still not assessed their exposure to MEES. As the actual restrictions loom closer, it is clear that practitioners should emphasise to clients that the clock is ticking.

However, with key dates approaching, there is still much uncertainty around MEES. Brexit, the abolition of the Department of Energy and Climate Change (DECC), and the continued lack of non-statutory guidance all present questions which are difficult to answer. For practitioners advising on MEES risk, where do we stand and what can we hope to see in the coming months?

## A recipe for disaster?

The majority of practitioners will be familiar with the basics behind MEES. The regulations make it unlawful for landlords to let premises that fall below a certain level of energy efficiency. The regulations use the current energy performance certificate (EPC) regime to measure energy efficiency and the minimum certificate rating, at the outset, will be an E. There are separate regulations depending on whether the premises are classed as domestic or non-domestic.

For non-domestic property, the restrictions will apply to any new lettings from 1 April 2018 (including the extension or renewal of an existing tenancy), and then all lettings, including existing lettings, from 1 April 2023. For domestic property, the 'second' deadline takes effect on 1 April 2020. This article will only further consider the impact of MEES on non-domestic property.

If a property is F or G EPC rated, a landlord must either undertake work to bring the building up to the minimum required standard, or rely on an exemption. As a minimum and to benefit from an exemption (lasting five years), a landlord must look to undertake relevant energy efficiency improvements (REEI). In summary, these are works that present a payback of seven years or less (i.e. improvements which pay for themselves through energy bill savings over a seven-year period).

A landlord can benefit from an exemption where all REEI have been carried out notwithstanding which the EPC rating remains F or G, or where the landlord has not carried out REEI because a sub-exemption applies (lack of third-party consent or devaluation). If a landlord lets the premises in breach of the regulations, the lease is valid but the landlord's actions will be unlawful. It will risk civil penalties, both financial and 'naming and shaming' on a public register.

### **Brexit: A potential showstopper**

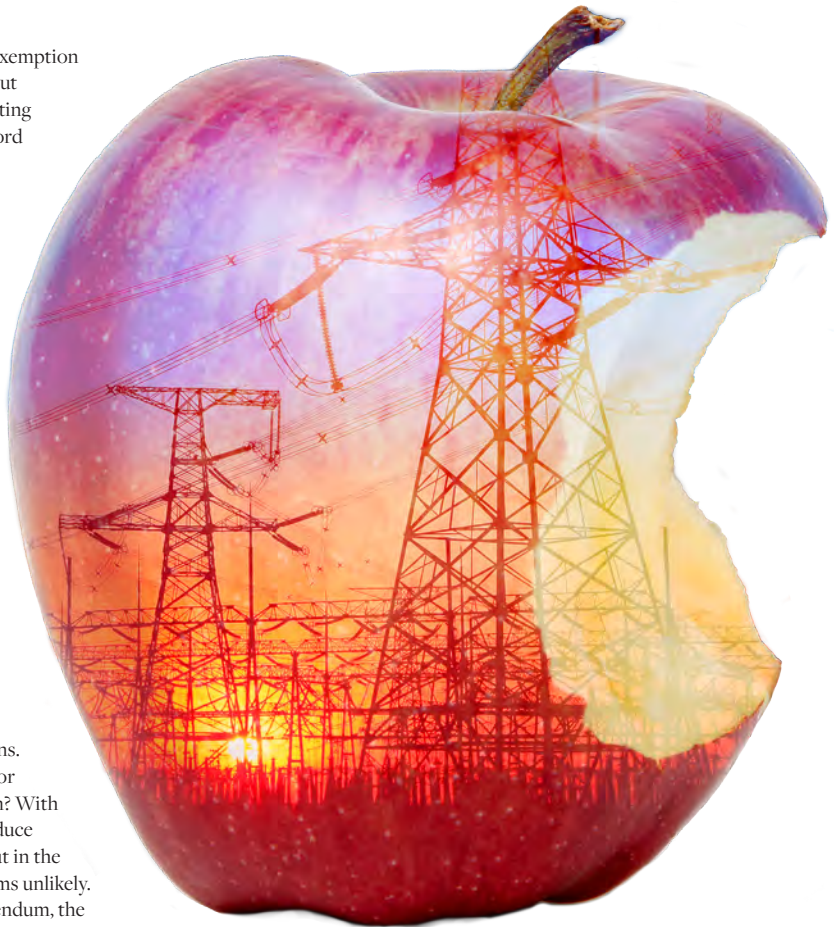
Since MEES became law, the UK has voted to leave the EU and the DECC has been abolished. Landlord clients may ask whether the time bomb is still ticking. MEES originate in an EU directive but the law itself, and that in respect of EPCs, is set out in the standalone UK regulations. Is the government likely to amend or possibly even repeal that legislation? With the UK's statutory obligation to reduce greenhouse gas emissions, as set out in the Climate Change Act 2008, this seems unlikely.

Even in the week after the referendum, the Conservative government announced new, legally binding carbon targets for the 2030s, which are tougher than those in place as a consequence of membership of the EU. It is not unreasonable to assume that MEES form part of the strategy to meet these targets and there is no indication, at least at this stage, that MEES are under threat.

### **The technical challenge**

The legislation has been in place since March 2015, but even as the 2018 deadline approaches, there is still much uncertainty as to how MEES will work in practice. The legislation is, in part, based on the availability of Green Deal financing for commercial property. This has never actually been available in practice, and the government withdrew the limited Green Deal funding for domestic property in July 2015. The drafting of the regulations requires updating.

In addition, there is still no substantive guidance on the legislation, which was promised by the DECC in consultation.



Despite the abolition of the DECC, there are murmurings that publication is imminent. So what can practitioners hope to see in terms of additional clarity, potentially in the form of published guidance, amended regulations, or government announcements?

- **EPCs:** It seems that MEES will apply if an EPC is in place, even if that EPC is not strictly required. Conversely, if an EPC is not required or, in breach of that regime, has not been commissioned, then it appears MEES will not apply. It is hoped that the guidance will provide further clarity on how the EPC and MEES regimes are intended to interrelate;
- **Third-party consent exemption:** Generally, the exemptions are an area that requires more clarity. For example, the landlord may benefit from an exemption on the basis that a third party, including a sitting tenant, will not provide consent to

## The impact of MEES will depend on how rigorously breaches are enforced

REEL. It is for the landlord to demonstrate that there is a lack of consent, and that they have used reasonable efforts to obtain it. As it stands, landlords will have to provide 'correspondence and documents' evidencing such efforts. Again, it is hoped that further detail will be given as to the lengths the landlord must go to;

- **Financial penalties:** Where there is a breach of the regulations, the penalty to be imposed is dependent on the rateable value of the property and the length of time that the landlord is in breach. For a breach of three months or more, the penalty is the greater of £10,000 and 20 per cent of the rateable value of the property, subject to a cap of £150,000. This penalty does not, however, escalate to reflect any further continuing breach. Clarification is needed where there is continuing breach. It is envisaged that enforcement agents will serve successive penalty notices;
- **Enforcement:** There is no doubt that the impact of MEES will depend on how rigorously breaches are enforced. Some commentators have queried whether local authorities will keep the penalty proceeds, which may in turn incentivise their enforcement efforts. Others have doubted whether local authorities will have the resources to enforce. Arguably, greater clarity on enforcement plans, together with government commitments, will give much of the industry a wakeup call on the imminent arrival of MEES; and
- **Future trajectory:** Before its abolition, the DECC made it clear that the minimum threshold would increase, but declined to provide a trajectory. The secretary of state is under a duty to review the 'operation and effect' of the MEES regulations 'at intervals of no more than five years'. It remains unclear whether the minimum standard applied or the stringency with which EPCs are prepared will be revised, and when this will be applied. The industry would no doubt appreciate longer-term investment certainty. A landlord may wish to 'de-risk' now, undertaking improvement work that takes the EPC rating well beyond the current threshold.

### How to be a star baker

Typically, for landlords with large, high-value portfolios, MEES have been on the radar for some time and preparations are underway. However, other, less sophisticated landlords will not necessarily be alive to MEES risk.

The uncertainty, particularly prompted by Brexit, cannot help. In the run-up to April 2018, practitioners may wish to consider the following:

- For landlord/lender clients, does the impending MEES risk need highlighting? It is potentially 'sitting', often small landlords, with assets held on longer-term leases and with no immediate requirement to consider MEES, who will need a timely reminder. Practitioners can add value by flagging the imminent risk to existing or prospective landlord clients and their funders;
- How can clients defuse the time bomb, or at least mitigate the risk? For practitioners, a key focus is on lease drafting, incorporating provisions that mitigate against MEES risk in the future. For example, it is now usual to see provisions that prevent tenants from prejudicing the landlord's MEES position (e.g. undertaking alterations that lower the EPC rating or obtaining EPCs without landlord consent). In addition, with the statutory obligation on the landlord to comply, covenants on the tenant to comply with statute (as typically worded) are unlikely to assist with shifting the burden of compliance to tenants. It is likely that specific additional wording is needed in this regard. In summary, even though MEES are yet to bite, the key is now future-proofing leases for the years ahead, thereby preserving the client's investment value; and
- Finally, for tenants potentially approaching a re-gear, renewal, or break right, this may present opportunities in their negotiations with landlords who are soon to assume these additional statutory obligations. For example, on a re-gear, it may be in the interests of both parties to undertake improvement work. The tenant may benefit from lower outgoings and, at the same time, the landlord addresses its MEES risk. With the statutory obligation on the landlord, arguably it is the tenant with the upper hand in negotiation, particularly on a renewal under the Landlord and Tenant Act 1954.

The MEES deadlines are rapidly approaching, and there is no indication that the substance or the timing will change. The evidence suggests that many landlords are not alive to or prepared for MEES risk. While we still await greater certainty on how MEES will work in practice, practitioners (in conjunction with agents and surveyors) should emphasise the potential 'green time bomb', and advise clients accordingly.