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"Knowing [MEES], Knowing You"
A Guide for Commercial Property Landlords

The Energy Efficiency (Private Rented Sector) (England and Wales) Regulations 2015 will come into force on 1st April 2018. The regulations will herald a significant change for the commercial property market and will impose minimum energy efficiency standards (MEES) on property owners.

The backdrop to this change results from UK Government carbon reduction targets. Guidance from the Department for Business, Energy and Industrial Strategy (DBEIS) indicates that the energy used to power commercial property in the UK amounts to 12% of the UK's total emissions.

The new regulations are designed to reduce energy emissions and ultimately create a new energy-savvy property market that gives greater credence to energy efficiency. Whilst landlords are the obvious audience for these changes, it should also be noted that existing tenants seeking to assign or sublet a lease will also be caught by the regulations.

"No More Carefree Laughter?" – energy efficiency standards are now a statutory hurdle

Whilst the energy efficiency factor may be of some interest to current landlords, it would be fair to say that energy efficiency has not always stood out as a glaring priority compared to factors such as rent or location. However, the new regulations make energy standards a vital consideration for landlords. When the regulations come into force in April, it will be illegal to rent out any property below the energy rating of 'E'. The current Energy Performance Certificate (EPC) rating is classified on an A-G scale, meaning any properties in the F or G category will be classified as 'substandard'. It is estimated that approximately 20% of non-domestic properties are categorised below the 'E' rating and 47% of the same are at the 'borderline' level of being 'D' or 'E' rated.

It is important to note that the 2018 deadline concerns only the granting of a new lease or the renewal/extension of an existing lease. From 1st April 2023, all other commercial property leases (existing or otherwise) will be hit by the regulations automatically.

"Walking through an empty (building)" – consequences for non-compliance

The MEES regulations were designed to afford limited escape routes for landlords as well as providing for substantial financial penalties for breaches. The penalties are based upon the rateable value of the property and the maximum fine is up to £160,000 per asset in breach.

Example scenario:

Brett is a landlord who owns four commercial units on a business park – all of which have an EPC rating of 'F'. Brett will be penalised for each individual breach of each of his four individual units – resulting in a sizeable fine.

It should be stressed that the MEES regulations do not create positive obligations on the landlord to remedy 'substandard' EPC ratings on their properties. The regulations serve only to restrict the ability of the landlord to lease/assign/sublet until the 'E' rating is attained.

"Good days..." – exemptions from regulations compliance

Definitive Exemptions

The following types of owner will not need to comply with the MEES regulations:

- Owners of properties that are not required to have an EPC (i.e. industrial sites, workshops, certain listed buildings, some agricultural buildings).
- Owners of properties where the EPC is over 10 years old.
- Owners of properties with tenancies of less than 6 months (not within the 1954 Landlord and Tenant Act).
- Owners of properties with tenancies of 99+ years.

Temporary Exemptions

Similarly, landlords may avoid the regulations if they can demonstrate:

- Lack of 3rd party consent – the landlord must show that consent for the improvement works have not been granted by a superior landlord, lender etc.
- Decrease in value – the landlord must confirm that the works will result in a decrease in the value of the property by 5% or more.
- Commercial unsustainability – the landlord must confirm that the improvements required to bring the property up to 'E' rating are not cost-effective.
- Sudden appointment – if the landlord has 'suddenly' come into the role of landlord and it would be unreasonable to expect them to carry out the works. Examples include (but are not limited to) guarantors, insolvency matters and new leases granted under s.2 LATA 1954.

If a landlord can demonstrate that they fall into one of these categories, they must provide details and evidence of the same to be put on an 'Exemptions Register'. These exemptions will last for five years only, allowing landlords the opportunity to meet the requirements of the MEES in that time span.

Non-Transferability of Exemptions

It should be strongly emphasised that exemptions are 'non-transferrable' – meaning that they cannot be passed on to new landlords. However, the regulations give new landlords a six month grace period to carry out the works.

During this grace period, new landlords will need to make an informed decision – to either (a) carry out the works or (b) rely on another exemption (if applicable).

"Breaking up is never easy..." – a quick note on Brexit...

With the uncertainty surrounding Brexit negotiations and the legal position of the UK with regards to laws emerging from Brussels, there is always the chance that the UK Government could depart from standards outlined by directives and regulations from the EU.

With this in mind, MEES regulations could be altered, scrapped or modified in the coming years to reflect a (currently) unidentified government position on the future of UK carbon emissions targets and energy efficiency.

Interesting commentary regarding the impact of Brexit from the advisory body, The Committee on Climate Change, can be found here.

"We just have to face it" – next steps for landlords

In light of the changes being introduced by the new regulations, landlords may be wise to consider the following:

- Burden of paying for improvements – will this be carried out and/or paid by the landlord or tenant? Does the landlord wish to change the repairing obligations within the lease? How will the cost be reflected if paid by the tenant – in the rent or by service charge?
- Selling properties – sale of 'substandard' rated properties will prove difficult if non-compliant, as the burden of repair may prove to be a bargaining chip for potential buyers.
- Energy assessments– unless already known, landlords should consider carrying out individual energy assessments and EPC reviews, especially if properties within a portfolio are older.
- Business rates – current guidance on the MEES regulations is silent on whether properties that have become empty/untenantable (due to their EPC rating) are still subject to paying rates. As there is nothing suggesting the contrary, landlords or occupiers may be forced (subject to there being no property relief scheme they can benefit from) to pay out for empty commercial buildings.
- Possibility of downgrading – the new regulations could 'raise the bar' and the EPC grading system could be more severe. Landlords in 'borderline' territory (i.e. 'D' or 'E' rated properties) should be particularly cautious.
- Reviewing leases – whether there is an existing lease in place or landlords are entering into a new lease; terms and timings in light of the MEES regulations enactment will be important.

The above is intended as a commentary, not legal advice and should therefore not be considered exhaustive. You should always discuss your individual circumstances with a legal expert before you assess the impact on your business or property investment, as the rules and regulations are complex and cannot be covered in full within the scope of this article.

For further information regarding how the MEES regulations may affect your business or property portfolio, please contact a member of the Commercial Property team on 020 3814 2020.