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Minimum Energy Efficiency Standard regulations for non-domestic properties

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This is a very long article. I have therefore prepared a PDF version of it, to make it easier to read and print out.

PDF version of this article

The Department for Energy and Climate Change (DECC) published its response to the consultation on the forthcoming Minimum Energy Efficiency Standard Regulations on 5 February 2015. I wrote about the response – so far as it relates to non-domestic properties – in my article entitled "Publication of Minimum Energy Efficiency Standard Regulations for non-domestic properties" on the same day.

That article just copied out text from the Government's response. Now here are some thoughts, after having read the Government's response in full, and the draft regulations as well, to enable me to write an article for next weekend's Estates Gazette.

In passing, let me remind you that the MEES regulations apply to both residential and commercial properties. But I am going to concentrate (in this and future articles) on commercial properties, as that is my area of (ahem) expertise.

I will split up the article into three: what we already knew, what is new, and areas that I don't fully understand yet. Remember what follows applies only to commercial properties. Different rules may apply for residential properties.

WHAT WE ALREADY KNEW

The Government made its intentions pretty clear in last year's consultation paper, and there are few changes to what was proposed.

Timing – MEES will apply to new leases as from 1 April 2018 and to existing leases as from 1 April 2023. I continue to feel that the 2023 date is too early. If it had been five years later, many fewer leases would have been brought into the net and landlords' lives would have been that much simpler. And I'm not sure that very many opportunities would have been missed for improving energy efficiency. I think the opportune time to carry out improvements is when a property is empty.

But the 2023 date will only bite for those properties that already have an EPC, as section 49 Energy Act 2011 says that MEES applies only where there is an EPC for a property. Obvious really. There is, incidentally, nothing in the MEES regulations that requires a landlord to obtain an EPC. The main EPC regulations continue to govern that aspect (construction, sale and letting are the only triggers).

EPC rating – this will be E as widely expected, but this is included in the regulations themselves. So varying the rating will require varying the regulations. I had anticipated a separate set of regulations containing the rating.

An EPC for this purpose has to be a valid EPC (obviously, but the regulations still say it). So an expired EPC is not an EPC for this purpose.

There is a great definition in the regulations – "sub-standard". That describes a property that falls below the E rating. I think I suggested introducing a definition like that, but I didn't coin the phrase. Well done to whoever did.

Scope of properties – MEES covers properties that need an EPC under the EPC regulations. So properties that do not need an EPC will be outside MEES. The key ones will be listed buildings – assuming the Government corrects the existing EPC regulations. The current definition has been botched by a lousy bit of copying from the EU directive. It makes no sense and no-one knows whether listed buildings need an EPC or not. I wrote about what needs to be done in my article "EPCs and listed buildings" on 18 August 2014. It is now VITAL that this is sorted out. It is arguably ridiculous having two Government departments dealing with these different areas (DCLG for EPCs and DECC for MEES).

Short and long leases not in scope – as expected, short leases (six months or less) and long leases (99 years or more) are not in scope. The six months exception is subject to a 12 month maximum period of occupation (as assessed at the date when the latest lease is granted). I suggested using the same wording (slightly improved) that is used in section 43(3) of the 1954 Act for the exemption, which has been adopted.

Exemptions – there is to be an exemption where the landlord cannot obtain necessary consents. The list of people from whom consents are needed is illustrative not exhaustive (which is good). I still think that tenants are likely to say no more often than yes, just to avoid the inconvenience of having the landlord carry out works to the building during the currency of the lease.

There are other exemptions (mentioned in the next section).

Length of time for exemptions – exemptions will last for five years. After that time, the landlord must comply or demonstrate a new exemption. Originally it was proposed that an exemption would end when a tenant who had refused consent left. I think that has been abandoned but I'm not 100% sure.

WHAT IS NEW

Quite a lot is new.

Lease renewals – are within scope (I'm even beginning to write like a civil servant now). I still think this is nonsense. The essence of MEES is that the landlord has a choice whether to bring the property up to standard and grant the lease, or not bring the property up to standard and forgo the letting. So being required to upgrade the property when being compelled to grant a renewal lease (under the 1954 Act) doesn't make sense.

Even worse, DECC says a lease renewal is within MEES but DCLG says that no EPC is needed for a lease renewal. They can't both be right. Actually, it's DCLG that is wrong. I'm sure a lease renewal under the 1954 Act is a "letting" for the purpose of the EPC regulations. But people don't like to hear that, and the guidance says it isn't, so we are in a very strange position with renewals.

It gets worse. As mentioned above, section 49 Energy Act 2011 says that MEES applies only where there is an EPC for a property. So a lease renewal is within MEES when by chance there is already an EPC but not within MEES when by chance there is no EPC. That really penalises a landlord who has voluntarily obtained an EPC. Talking of which:

Voluntary EPCs – there is no distinction made between an EPC obtained in advance of a transaction and a voluntarily-obtained EPC. I suspected that that would be the case, as (a)

the two are indistinguishable on their face and (b) an EPC obtained voluntarily may have been used later for the purpose of a transaction, meaning it is no longer voluntarily obtained (sort of). Anyway, there is no distinction. I suspect it is unimportant. Most landlords who obtained EPCs voluntarily will either (a) have modern energy-efficient buildings or (b) have granted leases recently (or both) so the EPCs are no longer voluntary.

Leases granted with no choice – as well as renewal leases, there are a number of different situations listed (suggested by me, originally, with help from a certain person now no longer living in the UK) where the landlord had no choice over granting the lease. This includes a contractual obligation, an overriding lease under the 1995 Act and a lease by operation of law. In such cases I wanted the landlord to be exempt. Instead the regulations provide that the landlord has six months after the date of the grant in which to comply with MEES (subject to exemptions applying).

A lease granted to a guarantor after the disclaimer of the lease by the tenant's liquidator was meant to be included as well, but the wording in the draft regulations has become scrambled. Not sure if that can be rescued now. I think Parliament has to approve or reject the draft regulations in their entirety. Perhaps there is a "slip rule" to correct obvious errors. I will speak to DECC about it.

Buyers – this came out of the blue. It was not mentioned in the consultation although it might have been discussed in roadshows. An exemption from MEES will not transfer to a buyer. A buyer of a non-compliant property will either need to bring a property up to an E rating within six months of acquisition or establish a new exemption. I think that logically this can apply only from 2023, because until then MEES applies only to new lettings.

Cost-effective improvements – this is the most complicated part of MEES and I have not fully got to grips with it yet. Landlords will be exempt from reaching an E rating for five years where they have carried out all possible cost-effective improvements. This may be established by using the Green Deal's golden rule (as originally envisaged) or under a new provision that requires improvements to pay for themselves within no more than seven years. I'm confused as to whether these are conjunctive or disjunctive (ie – is it "either/or" or "both/and"). While there is no commercial Green Deal, that doesn't matter, I suppose.

Paying through the Green Deal is obviously preferable, as the costs are then passed down to the tenant, so there really is "no upfront payment" for the landlord. The alternative method means the landlord ends up paying itself, which was never envisaged when the policy was devised in about 2010.

There is a complex explanation of what "paying for itself within seven years" means. I'm not going to comment on it here, as it's lengthy and it needs discussion with valuers and surveyors. There is a formula in paragraph 28 that will raise a few eyebrows. I have tried to reproduce it but failed. I sense there will need to be an entire blog article devoted to just this one issue before too long.

The list of all possible improvements that landlords must consider in this alternative scenario is by reference to Table 6 of the Building Regulations Approved Document L2B. I haven't looked at it, nor do I have any idea at present how one is actually meant to approach the question of which improvements will need to be costed, to see whether they fall within the seven-year payback test. Then, if they do, how does one decide if one on its own will be sufficient to get you above E, or whether a combination will be needed ? This is all thoroughly mysterious at present. Relying entirely on the Green Deal was so much simpler.

DECC is promising some guidance (non-statutory, I imagine). I hope there is a long chapter on this aspect.

Exemption for works that would devalue the property – this was raised in the consultation document. DECC has plumped for a reduction of 5% in value, as certified by an independent surveyor (and "independent" is actually defined!). The exemption is limited to five years.

Unexpectedly, there is another exemption (for five years, once again) where wall insulation required to improve the property would damage the property. I think that is addressing the concern that external wall insulation (EWI) can trap moisture within buildings in certain cases. We need to understand more about that.

Register of exemptions – DECC is to create a centralised register in which landlords will need to log evidence of exemptions, such as (presumably) a letter from a tenant refusing consent. DECC will make the exemptions public, it appears.

An exemption will not be valid unless it has first been registered. This is actually quite clever. It creates a stigma for "sub-standard" properties.

Penalties – Enforcement will be the responsibility of local authorities. Penalties for breach could be significant – up to £150,000 although local authorities will have considerable discretion. There will be a complex appeal system. The regulations do not state whether local authorities will be permitted to keep the proceeds of penalties. If this proves to be the case, this will be a massive incentive on local authorities to enforce the MEES regime.

The future – There was a suggestion that the regulations would provide for the EPC rating to be progressively raised over time, to encourage long-term investment in energy-saving measures. The government has not gone down this path. Instead it says that MEES will be reviewed in 2020.

WHAT I DON'T YET UNDERSTAND

Cost-effective improvements – discussed above. I need to see the guidance, and discuss it with a surveyor or ten.

Guidance is needed urgently – the regulations are a first step, but without the guidance on how to work out which cost-effective improvements to pursue, investors are still all at sea.

What does seem clear at this stage is that if you have a tenant under a lease that will run beyond 1 April 2023 and you don't currently have an EPC that will be valid on that date, don't commission an EPC voluntarily now. So long as you have no EPC on 1 April 2023, you will not be under any obligation to do anything.

On the other hand, if you are granting a lease between now and 2018 that will last beyond 2023, you will simplify your life immensely (and make your property more saleable) if you bring the property up to an E rating before you grant the lease. Speak to your friendly sustainability consultant about how best to achieve this. Changing a few light-bulbs can effect a remarkable improvement, apparently.

How consent needs to be sought – I still do not understand what order steps have to be taken in. If I have a tenant whose consent I will need after 2023 in order to carry out works, do I cost the works and then ask the tenant, or ask the tenant first (on the basis that if it says no, I don't need to waste time costing the works)? But if the tenant doesn't know what I am planning to do, how can it reasonably consider my request? This will be covered in the guidance, we are promised. (The landlord's obligation is "reasonable efforts … to obtain third party consent" – paragraph 31 of the draft regulations.)

Deliberately not obtaining an EPC – as I said in my consultation response, penalties for breaching the EPC regulations are relatively low. I am not recommending anyone to do this, but completing a new letting without getting an EPC seems to avoid MEES, with its potentially significant penalties, completely. This is a very perverse incentive indeed.

Other issues – I'm sure there are plenty of issues that I haven't yet thought of. I anticipate we will need a further article on MEES next week.

Training and raising awareness of MEES – I'm already booked to speak about MEES (along with Charles Woollam of SIAM) at an evening talk at the CPD Foundation on 26 March 2015. Perhaps I will see you there.

Otherwise I am happy to present a one-hour talk on MEES in-house for you and/or your clients. My rates are remarkably reasonable.

Your thoughts – please do e-mail me (info@falcolegaltraining.co.uk) with any thoughts.