



RICS CPD Foundation

MEES and Rent Reviews

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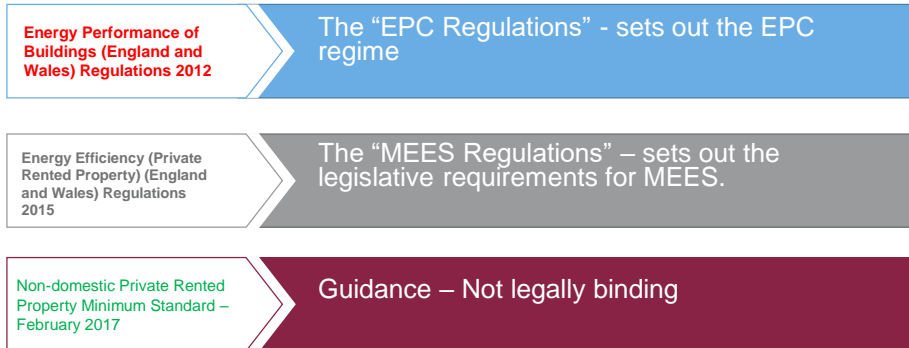
• Background to MEES

- Introduced by legislation in 2015 to tackle the least 'energy efficient' properties in England and Wales.
- Requirement that all rented properties should be EPC 'E' rated or above.
- Fits into a wider strategy to tackle climate change – the Government has estimated that 18% of commercial properties currently hold the lowest EPC ratings (E and F).

Energy Efficiency Rating		Current	Potential
Very energy efficient - lower running costs			
(92 to 100)	A		
(81 to 91)	B		
(69 to 80)	C		
(55 to 68)	D		
(39 to 54)	E		
(21 to 38)	F		
(1 to 20)	G		
Not energy efficient - higher running costs			
England & Wales		EU Directive 2002/91/EC	

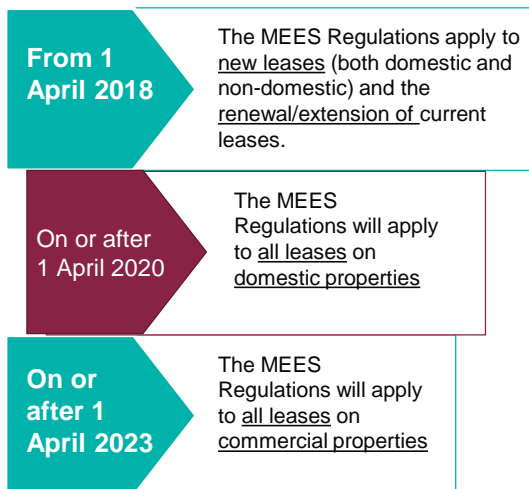


Legislative Framework



The MEES Regulations

Timescales

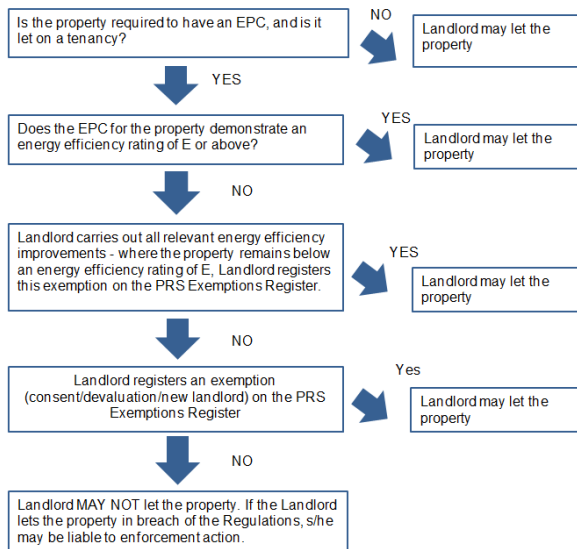


The Regulations - Scope

- Regulations apply to buildings required to have an EPC (Energy Performance of Buildings (England and Wales) Regulations 2012)
- EPC Exemptions
 - Religious buildings, Industrial sites, workshops and non-residential agricultural properties with a low energy demand, holiday lets (debate over listed buildings)
- EPC Triggers
 - New properties built
 - Existing properties sold/leased (excluding lease renewals)
 - Significant alterations



Compliance Decision Process



Relevant Energy Efficiency Improvements

- Landlord has flexibility on how to improve the energy efficiency of his property to achieve an EPC “E” rating.
- Relevant improvements are those recommended in “relevant recommendations report”, a report prepared by a surveyor or a Green Deal Advice report.
- Commercial properties must meet the ‘Seven Year Payback Test,’ i.e. improvements should only be carried out where they are expected to deliver, within seven years, energy bill savings of at least the cost of purchasing/installing, plus interest at the Bank of England base rate.
- If relevant works have been done and the property remains below an “E” rating, this exception must be registered.



Exemptions

Consent Exemption

Available where, in the previous 5 years, a landlord has been unable to increase the EPC rating due to the tenant not cooperating or third party consent being refused.

Devaluation Exemption

Available where, in the previous 5 years, the EPC rating has not increased due to an independent surveyor's report which states that making an improvement may devalue the property by more than 5% of its market value.

Temporary Exemption

Available to Landlord until six months after a certain event occurs, such as grant of a renewal lease under the 1954 Act.

N.B (1) exemptions must be registered on the PRS Exemptions Register

N.B (2) exemptions do not pass over on a sale



The MEES Regulations

Enforcement

Compliance Notices

A request for information which will enable the enforcement authority to decide whether a breach has occurred.

Financial Penalties

Breach less than 3 months – fine greater of £5,000 and 10% of the rateable value of the property). Cap of £50,000.

Breach over 3 months – fine greater of £10,000 and 20% of the rateable value of the property . Cap of £150,000.



- ▶ Applicability of MEES to Rent Reviews
- ▶ Hypothetical letting will require an EPC.
- ▶ If hypothetical premises are/would be an F/G rating, then need to consider impact on valuation.
- ▶ Could be by reference to existing EPC (if < 10 years old) or new EPC, provided this is not prohibited by lease or RR assumptions.
- ▶ NB: Conditions for EPC ratings have become more stringent over time – an older EPC may indicate a higher rating than would now be the case.



Impact of compliance with covenants and/or tenant's works

What impact is an assumption that tenant has complied with all covenants likely to have when considering the impact of MEES?

What if tenant has put the premises into a non-compliant condition?

- ▶ Likely to be an assumption that tenant has complied with all covenants. If effect of this would be to increase rating to 'E' or above, then assumed premises would be MEES compliant.
- ▶ Conversely, if premises are only below 'E' rating as a result of tenant's alterations, standard disregard of alterations would mean we should assume compliant building.
- ▶ NB: often disregard is limited to alterations with consent of landlord. Therefore unauthorised tenant's works (particularly strip-out) might be problematic.



Notional Premises

What if assumed premises are different from actual fit-out?

What if we are asked to assume fit-out which has no/limited plant?

- ▶ If RR valuation based on notional premises, then EPC will have to reflect the assumed condition/fit out of the notional premises (this may require a hypothetical EPC, even where an EPC based on the actual fit-out already exists).
- ▶ If RR clause requires the parties to value notional premises which do not have plant and machinery, an EPC would still be required.
- ▶ Assessment based on assumption that the property will be fitted out with the most energy intensive fixed services which would be allowed under Part L of the Building Regulations.



What if actual/notional premises are F/G rated?

Can we assume nil rent on basis that letting would be unlawful? ▶ Letting in breach of MEES regulations will not invalidate the lease.

- ▶ Cannot assume that there is no transaction (or nil rent) – will be assumed that landlord is willing to let premises (*FR Evans (Leeds) v English Electric (1977)*)
- ▶ Must also assume that tenant is willing to take premises in condition specified in RR clause, even if this would be unattractive in the market.
- ▶ Must also assume that premises are capable of being lawfully let, even if this is not actually the case (*IRC v Gray [1994]*).



What is the assumed condition of the premises?

Do we assume that landlord will do works to bring premises up to minimum rating? ▶ Should not imply additional landlord works to premises pre-letting, even if reasonable landlord in the market would actually do such works (*IRC v Gray*).

If so, can you rentalise such works?

- ▶ Therefore cannot rentalise works which would be required to bring premises up to 'E' rating.
- ▶ Equally, cannot factor the risk of the landlord having to pay fines for breach into the hypothetical negotiations, as it is assumed that the premises can be lawfully let.
- ▶ However, the energy performance of the premises would be relevant to valuation, regardless of MEES, so EPC will have an impact.



What is the assumed position of the parties?

Will tenant be assumed to be willing to co-operate with landlord in relation to improvements to building?

Can we assume that parties will collude to circumvent MEES?

- ▶ Assume a willing landlord and a willing tenant who are prepared to enter into the hypothetical lease on the specified terms.
- ▶ However, hypothetical tenant is rational, commercial entity. Not willing to pay more than market rent or operate in a manner which would be contrary to its commercial interests.
- ▶ Therefore, unless required by RR clause, should not assume that tenant will allow landlord access to do onerous works.
- ▶ If so, could landlord apply for (hypothetical) consent exemption in any event?



Future sub-lettings

Will the assumptions be the same in relation to (hypothetical) future lettings of the premises?

- ▶ Although we assume willing landlord/tenant in relation to hypothetical letting, this assumption does not apply to any future sub-lettings that the hypothetical tenant might want to grant.
- ▶ Therefore, if premises are F/G rated, tenant would have to carry out improvements to property before being able to sub-let – may depress rent.
- ▶ Also, would tenant be able to get landlord consent to carry out works? This might lead to an exemption.



Tactics

- ▶ New lease terms (consider whether onerous term):
 - ▶ Assume certain EPC level at rent review?
 - ▶ Express assumption that premises can be lawfully let?
 - ▶ Ability to recover cost of MEES works via service charge?
 - ▶ Obligation to return premises in MEES compliant condition?

- ▶ Consider obtaining new EPC – is this likely to increase/decrease rating?
- ▶ Obtain advice on scope of landlord's Relevant Energy Efficiency Improvements based on hypothetical premises – would these be sufficient to bring building above 'F' rating if they were undertaken?
- ▶ What will cost of Relevant Energy Efficiency Improvements be?
 - ▶ Practically, are they sufficiently significant to have an impact on rental valuation?
 - ▶ Will they meet seven year payback test?
- ▶ Will any MEES Exemptions apply?



Further considerations

- ▶ Listed buildings
- ▶ Service charge provisions – are improvements recoverable by landlord? Particularly relevant, looking forward to 2023.
- ▶ Minimum EPC standard is likely to rise in the future – ambition is minimum 'C' rating.
- ▶ Requirement to re-apply to register exemptions after 5 years.



