



THE MEES REGULATIONS - the driving force for commercial property

Ben Strange bstrange@mobiusbcb.co.uk

Ben, at a presentation to ACES' Eastern Branch, alerted practitioners to the real challenges ahead to meet energy performance standards, and potential costs of doing so, if you are to keep your buildings let: "this is set to prove to be the most significant piece of legislation to affect existing building stock in a generation." Ben here presents a useful tactical approach to MEES.

Ben is a chartered building surveyor and Director of Mobius Building Consultancy, an independent practice established in 2019 providing Building Surveying services to clients across the UK and Ireland. Ben also provides specialist advice to private and public sector clients on the impact of the 'MEES Regulations' and their impact upon commercial leasehold property.

The 'MEES Regulations' (1,2) are currently in force for leasehold commercial property in England and Wales to prohibit the letting of commercial properties which do not achieve the current minimum standard of an EPC rating E. Through imminent changes ahead, this is set to prove to be the most significant piece of legislation to affect existing building stock in a generation.

The UK Government has now declared its intention to increase the minimum standard to an EPC rating B by 2030 (3). This is a seismic shift which will require stakeholders substantially to rethink their property strategy for the decade ahead.

In this article we seek to identify what is at stake, some of the difficulties faced, and what those facing this challenge could and should be doing next.

Risks - enforcement

Failure to comply with the MEES Regulations can lead to enforcement action from the local authority in question. While instances of enforcement remain low, it remains the case that financial penalties are as follows:

n.b. these penalties apply per instance

Up to 3 months' infringement	10% of rateable value	Minimum £5,000	Maximum £50,000
Over 3 months' infringement	20% of rateable value	Minimum £10,000	Maximum £150,000

and not per building – landlords of multi-let properties should be particularly aware of this where aggregate penalties could easily escalate into millions of pounds.

Non-compliance

The principal contraventions under the regulations are as follows:

1. Granting a new lease of a 'sub-standard' (4) property at any point since 1 April 2018
2. Granting a renewal lease of a 'sub-standard' property at any point since 1 April 2018
3. Granting a lease extension of a 'sub-standard' property at any point since 1 April 2018
4. Allowing a lease (which has otherwise lawfully been granted) of a 'sub-standard' property to continue as of 1 April 2023.

It is necessary to expand on this final point, given that it remains a source of significant confusion for many, with incorrect advice still being given by agents, advisers, solicitors even.

1 April 2023:

- Is **not** the date as of which every property needs to have a valid EPC
- Is **not** the date on which the minimum standard is due to change
- Is **only** a relevant date for those properties which have been subject to a lawful prior letting/ renewal/extension where those lettings then become unlawful on this 'backstop' date of 1 April 2023, where the Regulations then apply to ongoing leases (as opposed to just new lease entities).

For illustration, a couple of instances where the 1 April 2023 date is relevant:

1. A new 10-year lease granted in 2015 of a property with an EPC of F (from 2015). This lease was lawfully granted in 2015 (prior to the MEES Regulations applying to new leases), remained lawful as of April 2018 because the lease was already in play), but becomes unlawful as of 1 April 2023 due to it having a valid 'F' rating (so defining the property as 'sub-standard') and the lease continuing
2. A 5-year lease granted in 2021 of a 'D' rated property which – subsequent to tenant alterations – has been reassessed and achieves a 'G' rating. This lease was lawfully granted in 2021 under the previous 'D' rating but will be unlawful as of 1 April 2023 due to the downgrading to 'G' through the tenant's consented works.

With this latter example, one can identify how easily a landlord can face a significant problem where a tenant's works are not carefully pre-assessed for their impact upon the EPC rating. This takes us on to the arguably far greater risk of tenants using MEES to their tactical advantage.

Risks – tenant behaviour

Although in previous years, the EPC rating of a given asset has been largely unimportant for most, this is no longer the case. While landlords are now rapidly turning their attention to the matter, tenants are increasingly recognising various reasons for which EPC ratings are relevant to them. Below listed are just some of these reasons, arguably in order of increasing concern for their given landlord:

1. ESG (5) – many tenants/occupiers (particularly corporate entities) are strongly driven by ESG criteria, of which one significant element is energy monitoring and usage. It is therefore increasingly common to see tenants commissioning their own EPCs for this purpose.

Landlord concern: this tenant-commissioned EPC result could be poor and result in the subject letting being deemed unlawful

2. Lease negotiation – well-advised tenants undertaking due diligence prior to agreeing a lease now seek an accurate EPC rating of the subject property to be demised. This firstly identifies the likelihood of the landlord having to undertake disruptive improvement works during the course of the lease, but secondly, will impact the extent, nature, and cost of the tenant's required fit-out works.

Landlord concern: the tenant may pull out of the transaction if the existing EPC rating is poor. Equally, the tenant may use a poor rating to drive a hard lease negotiation on the basis that the property is at risk of obsolescence through non-compliance with MEES

3. Renewal negotiations – while an EPC is currently not required for a lease renewal, a well advised tenant considering a renewal/extension would seek one to ascertain their position and potentially drive a similar negotiation per the above example in 2.

Landlord concern: a tenant in a multi-let building taking this action could lead to further tenants doing the same and lead to a significant income/rental shortfall

4. Rent review – tenants faced with a landlord pursuing a significant rental uplift at review supported by comparables may commission an EPC as part of their response. Where they are able to identify that the landlord's comparables are of properties with good/compliant ratings and the subject property has a poor/non-compliant rating, then they may sufficiently argue that the

comparable rents cannot be applied to the subject property.

Landlord concern: if the tenant is successful in their argument, the landlord may face years of suppressed rents

5. Service Charge – tenants (particularly a group of tenants in a multi-let property) receiving a landlord's claim for service charge works on their property can seek to challenge such claims where they can identify that the works included are directed by the landlord's need to comply with MEES. Although the landlord may assert that this is legitimate as they are seeking to ensure the statutory compliance of the property, this will be challenged further where the tenant can sufficiently demonstrate that the works will not represent value for money for them.

Landlord concern: service charge works may be undertaken and whole claims challenged by one or a group of tenants, leading to non-recovery of expenditure

6. Dilapidations – tenants facing substantial dilapidations claims are now using MEES as a substantial tool to reduce their landlord's claim. Where a landlord's claim has been prepared without due understanding of what the outcome EPC rating would be of the 'yielded up' property requested back, tenants may be successful in arguing that the subject property would be 'sub-standard' and thus the value and validity of the dilapidations works requested would be questioned.

Landlord concern: well-advised tenants will leave properties at lease-end with a sub-standard EPC rating, with no dilapidations works completed and a reasoned argument to contribute nothing even if the landlord subsequently does the work.

Draft EPC assessments

One of the most common 'next steps' advised is the commissioning of a 'draft' EPC assessment. This advice applies as much to the tenant seeking to use the EPC to their advantage (per above), as to the landlord seeking to stave off such risks.

An assessment can be fully prepared

and calculated in the appropriate software to model what the EPC rating of a given property would be. This rating does not have to be lodged and instead, these draft assessments are increasingly being used as consultancy tools.

Draft assessments, however, can be used by tenants in a different manner; again in context of some of the negotiating strategies above. For instance:

1. Lease negotiation

A tenant is considering letting a floor of a subject multi-let office building from a landlord. The property has an EPC rating of 'D' for the whole property from an assessment in 2015. As part of their due diligence, the tenant commissions a draft EPC rating which identifies that the current accurate rating is actually an 'F'. The prospective tenant's drafted sub-standard rating would be hugely detrimental to the landlord if it was lodged (potentially rendering existing lettings in the building in breach as of 1 April 2023). With this knowledge, the prospective tenant may lean on the landlord to press for an additional six months' rent-free, in exchange for agreement that the EPC will not be lodged.

2. Rent Review

A subject building on a single let 25-year FRI lease to a tenant is due for rent review in 2023 after 10 years. The property had a 'G' rating at the start of the lease which has now expired. With no EPC in place, there is no MEES breach. The landlord proposes a 50% rental uplift. The lease does not prohibit the tenant from commissioning an EPC and at rent review, they commission a draft EPC which is now an even worse 'G' rating. They present the landlord with the alternatives:

- a. Agreement to a negotiated 30% uplift and the EPC will be lodged, resulting in a MEES breach and local authority enforcement of up to £150,000 per three-month breach
- b. Agreement to nil increase – the EPC will be discarded and a side agreement put in place that the tenant will not commission an EPC without the landlord's consent.

Lease drafting

The above example raises the importance of careful lease drafting. While there have been improvements in recent years to the benefit of landlords, the following are imperatives:

1. No EPC clause – while this is now included in almost all leases to restrict a tenant's ability to commission an EPC, most do not go nearly far enough
2. Tenant's alterations – while landlords are typically obliged within their leases to not unreasonably withhold consent for their tenants' alterations, they do not specify when it would be reasonable to withhold; one such scenario should be in a case where the landlord identifies that the tenant's works will lead to a downgrading of the EPC rating
3. Rent review – while assumptions and disregards may offer some opportunity for a landlord to push back a tenant's argument on rent review, very few go far enough to specify that the EPC rating should not be a factor in such discussions
4. Dilapidations – the majority of dilapidations claims are now able to be challenged on the basis that the landlord will undertake some level of modernisation to the premises (typically to improve the EPC rating to a 'B') which will then result in an element of supersession on the claim. This may be as simple as the existing old and faulty lighting system being replaced with a modern equivalent LED system. Were the lease to include a proviso that the landlord can include for reasonable modernisation in such a claim, then the claim is less likely to be successfully challenged.

Unwanted consequences

While the result of the MEES Regulations having their full effect, as described above, will perhaps justifiably be applauded by many in terms of the contribution towards achieving the country's carbon reduction commitments, there are undeniably some unwanted – and likely unintended – consequences.

Take, for instance, many smaller property investors who may hold property primarily to act as a pension fund e.g. a SIPP (6), for whom significant capital outlay on improving their properties to an EPC 'B' is not an option. There is no affordability argument or exemption based on pure commercial viability (or lack thereof) hence many of these property owners will inevitably end up unassailably being in breach of MEES, with many likely being forced to sell.

Another unfortunate repercussion is for community use leased properties, e.g. nursery schools, scout halls, charity uses, etc. The MEES Regulations apply to leasehold properties whether the annual rent is a peppercorn or £1m; the exclusions of there being no EPC, or the lease term being less than six months or 99 years plus, are unlikely to apply for such properties and hence they will be caught by MEES. Many such properties perform poorly on EPCs and thus the landlord in question (typically a local authority) will be in breach but again, with limited or no commercial justification for the required investment to improve the property to the minimum standard.

Next steps

While required action in each case depends upon a multitude of factors (e.g. time to lease expiry, extent/nature of tenant alterations, age of existing EPC assessment, etc.), below outlined are steps for landlord entities to consider in assessing and addressing MEES risk across their portfolios:

Audit – Portfolio lists/schedules need to include EPC ratings and their expiry dates; with this information alongside other property data such as size, property age and lease data, an initial strategy can be put in place to set out which properties need prioritising for further action

Baseline – EPC ratings can be subject to significant change through seemingly innocuous factors, including a tenant's fit-out, better building documentation being provided, an existing EPC having been carried out several years prior, or a previous EPC simply being poorly prepared. It is therefore imperative to be assured that an existing EPC is completely accurate before using it as a baseline and acting upon it (i.e. considering improvement measures)

Context – Several factors can impact the urgency with which one should consider addressing a property's EPC rating, e.g. if there is a lease end on the horizon, before looking at improvements, it should be considered whether the rating may improve through the tenant removing their fit-out (or whether it is only poor because of the fit-out). Similarly, if an existing EPC is due to expire, it may not be in the landlord's interests to immediately lodge another rating (this may be unnecessarily putting the property prematurely in breach of MEES)

Draft – obtaining accurate advice on the current EPC position is now critical; this does not mean you have to lodge a new EPC. Find a competent professional able to undertake an EPC in draft only – this does not have to be lodged. If it is suitably accurate and detailed, you can then use it to inform next steps

Enhancements – do not rely on a 'Recommendation Report' to guide on required improvements; this is a report automatically generated by EPC software which does not consider the practicalities

of measures proposed or offer certainty on what an outcome rating may be. Instead, a reputable professional should be engaged to provide a report to propose practical improvement measures (or package of measures) and advise on what outcome rating those measures will achieve, in order that certainty can be gained before expenditure is considered

Finance – Where expense on improvements is unavoidable, seek out means of sharing or recovering that expenditure. It may be that a tenant is bound or willing to contribute; equally there may be funding schemes available for certain improvement measures. For those UK tax paying entities, it may be that significant portions of the required outlay can be recovered through 'Capital Allowances'.

Conclusions

The MEES Regulations seem likely to lead to a polarising result: those stakeholders who understand it the best, and deal with it the most proactively, will see significant advantages in the form of future-proofed,

efficient property portfolios able to be well-rented; whereas those who choose to disregard it are likely to be most heavily impacted by enforcement action and well-advised tenant strategies put into practice.

References

1. The Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015
2. MEES – 'Minimum Energy Efficiency Standards'
3. Energy White Paper: Powering our Net Zero Future, HM Government, December 2020
4. A 'sub-standard' property is one which has a valid EPC rating below the prevailing minimum standard (currently EPC 'E')
5. Environmental, Social, Governance – a widely used and broad term covering many elements of corporate responsibility
6. Self-invested Personal Pension.



A NAME YOU CAN TRUST IN PROPERTY

IN ADDITION TO A WIDE RANGE OF SERVICES AVAILABLE TO PUBLIC SECTOR CLIENTS, OUR KEY SPECIALISMS INCLUDE:

RATING APPEALS

Advice regarding the 2017 Revaluation and the forthcoming 2021 Revaluation including exemptions and relief



WH&E REVENUES ASSURANCE - RATE RETENTION

- Full rates retention support
- Appeal risk forecasting 2005, 2010 & 2017
- Rate yield enhancement
- Added Value Services – advice on all rating issues

VALUATIONS

Services include:

- HRA & GF Portfolio valuations (Full & Rolling programmes)
- One off Best Value Valuations
- 'Right to Buy' valuations further to s.125 notices
- Acquisition & Disposal work
- Specialised Property Valuations
- Landlord & Tenant

BUILDING SURVEYING

Services include:

- Dilapidations for both Landlord & Tenant's
- Building Reinstatement Valuations
- Defect Diagnosis & Maintenance Planning
- Planning Advice
- Party Wall Matters

Get In Touch:
020 7637 8471
wilks-head.co.uk

Wilks Head and Eve LLP, 3rd Floor,
55 New Oxford Street, London WC1A 1BS
gharbord@wilks-head.co.uk



All services prepared in line with the relevant RICS regulations