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Legal Alert

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What does it all MEES?

2018 means the arrival of "MEES". Below are ten practical top tips for landlords and property investors for understanding and preparing for the upcoming enforcement of the new minimum energy efficiency standards (MEES) which will soon land on our doorsteps.

1. 'What does it all MEES'?

MEES were introduced by the Energy Efficiency (Private Rented Property) (England and Wales Regulations) 2015 ("Regulations"). MEES set a new minimum EPC standard of E rating for non-domestic property, the enforcement of which will start this year. From 1 April 2018, it will be unlawful to grant a new lease and permit a lease renewal or a lease extension of an existing lease to a tenant of a non-domestic property with an EPC rating of F or G. From 1 April 2023, this requirement will also extend to existing leases, making it unlawful for lettings of F or G rated properties to continue.

2. Who is responsible for obtaining an EPC?

In general, a landlord is responsible. On a sale, letting or construction of a non-domestic property, an owner/ landlord is required to provide a valid EPC to a prospective buyer or tenant. A new EPC is also likely to be necessary if a building is modified to have more or fewer parts than it originally had and the modification includes the provision or extension of fixed services for heating, hot water, air conditioning or mechanical ventilation. A new EPC which is required because of alterations, should be issued by the party carrying out the works. If a tenant carries out work it may therefore be required to obtain a fresh EPC.

Where an existing property does not already have an EPC, or where an EPC has expired, there is no obligation to commission a first EPC or produce a new one. A valid EPC will only be required when the property is next sold, let or significantly altered. Whilst valid for 10 years, it is worth bearing in mind that an EPC from, for example, 2010 for a rating of D or E may no longer be accurate and there is a risk that any re-assessment may cause a property to fall into non-compliance due to the stricter requirements for achieving a minimum E rating. As EPCs can be commissioned by both owners and occupiers of a property, neither of which is under an obligation to inform the other (unless there are notification requirements in the lease) situations can arise where a landlord is unaware that a new EPC has been commissioned by its tenant.

3. Granting short term leases prior to 1 April 2018 - a loophole?

Potential penalties for non-compliance may be avoided in the short term where new leases of sub-standard properties (those properties rated F or G) are completed before 1 April 2018. Landlords may therefore be keen to push through any lettings in the pipeline prior to the deadline. However, a well-advised tenant will know it holds much of the negotiating power due to the impending deadline and may try to push through more favourable lease terms, putting pressure on a landlord to agree the terms. In any event, circumnavigating penalties in this way is a short-term strategy because where a lease term continues into April 2023 then MEES will bite.

4. Sub-standard property - who is liable for the upgrade works and costs?

The party responsible for undertaking/paying for the upgrade works for a non-compliant property should be determined by the express wording of the lease (which will be the result of a commercial negotiation). In the absence of any wording in the lease to the contrary, the landlord will be responsible for undertaking and paying for the upgrade works and will suffer the consequences (see below) if it fails to comply with the Regulations.
There are, however, a number of ways a lease can be drafted in order to pass the responsibility on to the tenant, for example the costs of the works may be passed to the tenant through the service charge. Alternatively, where the lease enables the tenant to undertake upgrade works, the landlord may want to ensure that the lease provides that if the tenant's works do not bring the property up to a compliant EPC standard, then the landlord has the right to carry out any additional works required to achieve a suitable EPC rating (a landlord's right to enter the property to carry out the additional works will also be required). In this case, the landlord will want to ensure it can recover the costs of the additional works from the tenant. It is worth bearing this in mind when drafting new leases and reviewing the provisions of existing leases.

5. What if a tenant's works downgrade an EPC rating?

There is no statutory obligation on tenants which prevents them negatively affecting a property's EPC rating. However, many landlords now try to include provisions in a lease that restrict a tenant's ability to carry out works which lower an EPC rating. Another option is for a lease to require the tenant to indemnify the landlord against the cost of carrying out works to improve the property's EPC rating to comply with the Regulations. A Lease could also include a tenant obligation to remove fit-outs which adversely affect an EPC rating. Again, it all depends on the express terms of the lease.

6. What happens if the liable party doesn't do the works?

If the owner/ landlord or tenant does not carry out the improvement works to achieve the minimum E rating, then it is the landlord who will be unlawfully letting a sub-standard property and a fine of up to £150,000 may be imposed.
For a breach of less than 3 months there is a financial penalty of up to £5,000, or of up to 10% of the rateable value of the property (whichever is greater), subject to a maximum financial penalty of £50,000.

For a breach of 3 months or more there is a financial penalty of up to £10,000 or 20% of the rateable value of the property (whichever is greater), up to a maximum of £150,000.
And if that isn't enough to persuade you that MEES mean business, the enforcement authority may also publicise the details of the infringement and further fines may be imposed for any ongoing failure to comply with an enforcement action.

7. Can the landlord step in to do the works if the tenant does not?

If the tenant is the liable party and does not undertake the improvement works, look to the individual provisions of the lease to see whether the landlord can step in to do the works instead. Where a clause has been negotiated for the tenant to undertake upgrade works, a failure to carry out such works would be enforceable under the lease. A landlord would want to ensure it could recover the cost of the works under the lease. If a landlord does not have a right to step in and carry out the upgrade works and it does not have the consent of the tenant to do so, it may be able to rely on the third party consent exemption (see below).

8. On renewal will there be a difference between 1954 Act leases being renewed and contracted out leases being renewed?

On renewal the parties can apply for changes to existing leases to be made to make those leases compatible with changes in the law. A landlord may be successful in arguing for amendments which allow it to carry out works to raise the energy efficiency of the building but whether or not they can pass the costs of such works on to tenants will depend on the terms of the existing lease.

If a lease is contracted out it will be down to what the parties can agree between themselves. In a landlord-friendly market, a landlord may find it can present what it wants on a 'take it or leave it' basis, including the right to reserve the ability to step in to do the upgrade works and recover the costs of doing so. However, if the market is such that tenants are hard to find then such terms are far less likely to be agreed by tenants.

9. Exemptions

There are a number of exemptions for landlords which should be considered before undertaking any upgrade works:

- Third Party consent may be required for certain energy efficiency improvements (for example where superior landlord consent is required for structural works such as external wall insulation or installation of solar panels). The third party consent exemption applies where a landlord cannot carry out works because they don't have the consent of the third party, e.g. tenant, superior landlord or planning authority consent.
- A landlord can benefit from the property devaluation exemption where it has obtained a report from an independent surveyor advising that the installation of the specific energy efficiency measures would reduce the market value of the property or the building it forms part of, by more than 5%.
- The Regulations acknowledge that where a party suddenly becomes a landlord, such as when a party purchases a property which is already let, it would be unreasonable for them to be required to comply with the Regulations immediately. There is therefore an exemption from compliance for 6 months after the date they become a landlord (e.g. from the date of completion of a purchase).
- EPC's are generally not required where the building is a listed building and where compliance with certain minimum energy efficiency requirements would unacceptably alter their character or appearance.

- A further exemption is the 7 years' payback test, where the expected value of savings on energy bills that the energy efficiency improvement works (such as upgrading heating systems more than 15 years old) are expected to achieve over 7 years, is equivalent to or greater than the cost of the works. The Government has published guidance on how to calculate this. If the payback test is not satisfied, then the landlord benefits from an exemption.
- It is also important to note that if a landlord seeks to rely on an exemption, that exemption must be registered on the central government PRS Exemptions Register before the landlord can rely on it.

10. Drafting suggestions being advocated in the property market for leases

The following examples of drafting suggestions in leases can help avoid a landlord incurring penalties for non-compliance with MEES:

- A provision explicitly restricting the tenant's ability to make alterations or do acts which worsen the EPC rating of the property i.e. reduce it to an unacceptable rating;
- Landlord's right of entry to undertake upgrade works, an express reservation, and to recover the cost from the tenant although this is potentially onerous and the rent review implications should be considered;
- Restrict a tenant's ability to commission a new EPC (to minimise the chances of the emergence of a poorer rating);
- A tenant obligation to inform the landlord of any new EPC obtained;
- For the tenant to pay for upgrade costs either via the service charge (for a lease of part of the property) or through a tenant covenant (in respect of a lease of whole), although it is worth bearing in mind this could be quite onerous so requires consideration of its effects on any rent review;
- A tenant obligation to carry out energy efficiency works that are needed to keep the property from becoming sub-standard; and
- A tenant obligation to yield up the property in a lawfully lettable condition would pass the onus on to the tenant to carry out any improvement works on yielding up but would not assist the landlord in improving the EPC during the term of the lease in isolation.

In practice many leases are currently widely drafted and include tenant covenants to comply with existing laws, to carry out works to the premises and not to do any act on the premises which may result in the landlord incurring a fine. Service charge heads of costs also often include the costs of compliance with laws in respect of the building. It is doubtful whether or not such provision will allow the landlord to recover the cost of such works from tenants as the Regulations to do not require the landlord to carry out any works but rather make lettings of sub-standard properties unlawful.

As April 2018 is on the near horizon it should be at the forefront of the minds of property owners and landlords to review any current leases of properties with an EPC rating of E or below in order to check where any liability might sit and to bear the above drafting suggestions in mind when negotiating a new lease.

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