

Minimum energy efficiency standards for commercial rented property – more lettings caught from April 2023

November 2022



By Fiona
Larcombe

Since 1 April 2018, it has been unlawful to grant a new lease of “sub-standard” commercial property (which currently means a property with an EPC rating below E), unless an exemption applies. From 1 April 2023, this will be extended to all leases, whenever granted and which are still in place, so that continuing to let a sub-standard property will also be unlawful if no exemption applies. Landlords who continue letting in breach of these rules could face financial penalties of up to £150,000.

How you might be affected

- If you already have a portfolio of commercial rented property, you should review it now, to identify any sub-standard properties with tenants continuing to occupy beyond 2023 under leases granted before 1 April 2018 and continuing after 1 April 2023. These will need to be improved, unless an exemption is available.
- If you are considering buying commercial property that is already let, you should look carefully at EPC ratings (especially for leases granted pre-April 2018) to spot any below E. A new owner who becomes the landlord of a sub-standard property with a lease granted before 1 April 2018 can claim only a 6 month temporary exemption from the date of their purchase. After that, either the property must achieve an EPC rating of E or above, or the landlord must establish that another exemption applies.

What exemptions are available?

- *The 7 year payback test:* Landlords are not expected to carry out energy efficiency improvements unless they are “cost-effective”, which means that the improvements will achieve expected savings in energy bills over 7 years at least equal to the cost of the works. If the landlord has carried out all cost-effective improvements – or there are none that can be made – the landlord can claim an exemption and carry on letting a property with an EPC rating below E. To claim this exemption, the landlord must get three quotes as evidence of capital and installation costs and follow a complex formula to set these costs against likely energy savings. This will be time-consuming and may be expensive.

- The consent exemption: If a landlord needs consent from a third party (for example, a superior landlord, a lender or the occupying tenant) to make improvements and that consent is refused or only given subject to unreasonable conditions, there may be a "consent" exemption. Attitudes to energy efficiency have changed significantly since 2018. It is now more common for leases to include a right for the landlord to carry out improvements during the lease term but that would have been unusual before April 2018. If a landlord needs and asks for the tenant's consent and the tenant refuses, this will allow the landlord to claim an exemption.
- There are a couple of less common exemptions which may apply to a small number of properties:
 - carrying out energy efficiency improvements would reduce the market value of the property by more than 5%; or
 - carrying out insulation work on external walls would have a negative impact on the fabric of the property.

Points to note about exemptions

- Exemptions do not transfer when the property changes hands. A new owner must establish and register its own exemptions, even if the previous owner had already done this.
- Apart from the 6 month exemption for new owners, exemptions last for a maximum of 5 years, although they may be claimed more than once.
- An exemption based on a tenant refusing consent may end before 5 years have passed, if the lease expires. The exemption may also end if the lease is assigned to a different tenant, on the basis that the new tenant may take a different view and the landlord should make a new request for consent. The rules are not clear and this point has not yet been tested.

Which lettings are NOT in the scope of MEES?

- Short leases - less than 6 months, unless there has been continuous occupation for 12 months
- Long leases - 99 years or more
- Occupational licences

Longer term proposals

The government consulted on extensive changes to the MEES and EPC regimes in 2021 but we are still waiting for their formal response. Proposed changes include:

- EPCs to be compulsory for all commercial rented buildings within the scope of MEES, including listed buildings and those in conservation areas. Expired EPCs would have to be renewed and it would be compulsory to get a new EPC after improvements are made. Landlords will also be obliged to provide letting agents with a valid EPC before a property is put on the market.
- Two stage uplift in minimum EPC rating required:
 - 1 April 2027 – minimum C rating
 - 1 April 2030 – minimum B rating

- Valid EPC to be produced and registered 2 years before each compliance deadline, creating two “compliance windows”:
 - 1 April 2025 (with improvements being undertaken by 1 April 2027 if required to get to EPC C)
 - 1 April 2028 (with improvements being undertaken by 1 April 2030 if required to get to EPC B)
- Exemptions to be reviewed at the start of each compliance window (i.e. April 2025 and April 2028), with evidence submitted if required.
- Enforcement would move away from the point of letting and focus on compliance windows. Penalties would stay the same as they are now.
- For shell and core lettings, the landlord would be able to register a temporary exemption to stop enforcement until the tenant had been in occupation for 6 months, to allow time for tenant’s fit out. This is intended to solve the problem of poor EPC ratings for shell buildings. In practice, this would mean landlords wanting to impose new contractual obligations on tenants to fit out to an agreed specification (or by reference to the minimum EPC rating required) and for fit-out works to complete within the 6 month temporary exemption period.
- There is a vague suggestion that landlords and tenants should have more obligations to co-operate and that there should be new duties imposed on tenants. There is no detail at this stage and this would require primary legislation.
- There will be a simplified calculator to help landlords assess the 7 year payback test, removing the need for three quotes in most cases. As part of this, landlords would be required to undertake a suggested package of cost-effective measures.

You can find a more detailed discussion of what these changes might mean for lease drafting in our [companion note](#), which we will update once the government publishes its response. Meanwhile, if you would like to discuss how the rules on minimum energy efficiency may affect your portfolio from April 2023, please contact [Dellah Gilbert](#) or your usual contact at Maples Teesdale.