

Minimum Energy Efficiency Standards - the coming changes

The 2019 Energy White Paper

The government's white paper was a wrapper for a number of measures - but the one of greatest interest to anyone involved in commercial property are the changes to be applied under the Minimum Energy Efficiency Standards (MEES). It is expected that as the current Energy Bill progresses through Parliament that the Dept for Business, Energy and Industrial Strategy will simultaneously issue updated MEES Regulations.

MEES Background

When MEES standards were introduced in 2015, they began with a sanction on buildings with 'F' & 'G' rated Energy Performance Certificates (EPCs). The constraint being that such properties could not be let on a new lease, or have an existing lease renewed, unless the EPC rating was improved to raise it at least to 'E'.

Changes to sanction levels

The new proposals will bring about a change from 2027 with the minimum standard being raised to 'C' and subsequently to 'B' from 2030. By way of a comparison EPC level 'C' is approximately the performance level achieved by a new construction under the current Building Regulations. The new MEES levels will considerably widen their impact and current estimates are that as many as 80% of all UK commercial properties will come under this umbrella measure.

Compliance

This is delegated to local authorities and it is recognised that there are insufficient resources in numbers of trading standards or environmental health officers to carry out broad scale enforcement of Minimum Energy Efficiency Standards. So for many building owners it is unlikely to become an immediate issue and therefore risks being put on the back burner. The result could be much greater

inconvenience and potential loss of income downstream when there is a need to do something in the way of a sale or letting and the building is found to be non-compliant.

The role of advisers

It is probably unlikely that the government will, in due course, run a helpful awareness campaign to ensure businesses are up to speed. Property owners will already have other priorities and compliance with MEES will

probably not be one of them. Any professional adviser whose expertise relates to commercial property should be aware of flagging up the issue to clients. Continuing a business as usual approach and assuming someone else will tell the client about it runs the risk of unhappy discovery when a transaction is pending.

Compliance has to become a mindset as there is every likelihood of downstream problems for those who are slow to meet the requirements. It is not a matter for urgent action as soon as the legislation arrives - rather that every time money is being spent on a building even on minor improvements, the thought should be on whether there is an energy performance angle.



Tenancies

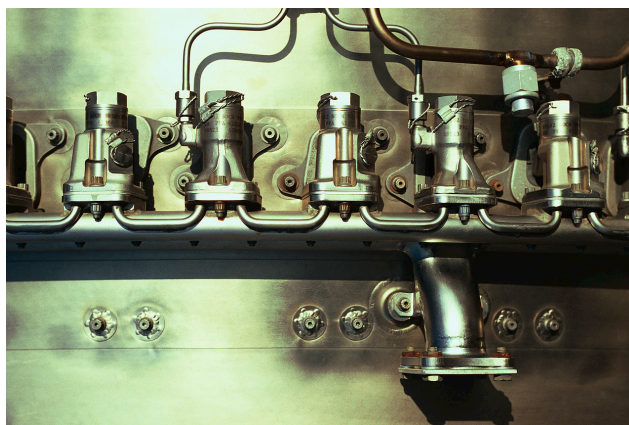
An owner who rents out any part of their property will come under the legislation. Thus by 2027 in most instances it will become necessary to have an EPC level 'C' for the whole building. There are grace periods for compliance but as said above, waiting to the last minute may invite unnecessary risk and complexity. An impending lease renewal within a year or two should be ringing alarm bells. Also, delay is likely to give an existing tenant an argument to use in renewal negotiations, or perhaps even to play hardball by making a complaint to the local authority.

No tenancies

Owner-occupiers in their own buildings without tenants may feel they are less affected by the changes and will have more time in hand to put plans in place. This is true - but only up to a point. There are several downstream scenarios where the EPC rating of the premises could have an impact and potentially affect the choices of actions available to the owner.

Security for borrowing

It is becoming apparent that banks are taking an interest in MEES and will almost certainly be increasingly unwilling to lend on non-compliant buildings. This could foreseeably create difficulties - even where the funding is intended to improve a non-compliant asset. Where a company has a funding facility across its business it should be considered probable that a bank will seek compliance across all assets in a portfolio as a pre-requisite to continuing an existing debt facility.



Sale negotiations

A potential purchaser of a below standard property who intends to continue using it, is almost certainly going to expect a discount from the price to allow for the cost of improvements. Once again a rapid transformation of a building to upgrade its EPC in the run-up to exchange of contracts is unlikely to be a practical solution. Of course there will be ways in which a transaction might be structured to enable works to be completed prior to exchange of contracts, or to be delayed and then undertaken post-completion - but this is never an easy solution and can add tiers of complexity to the legal negotiations.

Sale and Leaseback transactions

Sale and leaseback transactions have been growing in popularity in recent years particularly for businesses such as professional partnerships, as it provides an easier solution to agreeing exit strategies for retiring partners and also reduces the need for younger aspiring partners to have to raise capital sums to buy-in to the equity. Doctors' practices have notably seen sale and leasebacks as a very useful expedient. An investor will, however, be less likely to want to pay the full price if the building is sub-standard and requires considerable expenditure to comply.

Fixing the problem

A rule of thumb going forward is never to incur cost without considering energy performance. Firstly, have an EPC audit from an energy assessor who is preferably a qualified surveyor or other property professional. Choices towards optimisation can be costed and reviewed for their effectiveness, bearing in mind that the requirement becomes EPC 'B' from 2030. A trap to avoid would be carrying out works to get to level 'C' and then find within a year or two this has to be revisited at greater expense

to hit the 'B' target.

In many instances works may be phased to minimise disruption to a tenant.

Exemptions

Without going into the considerable detail of the legislation here, the simple principle of the rules is that it is recognised that probably because of the way it is built or its materials, that a building is likely to have a finite ceiling

for its energy performance. Accordingly, if a building has had all possible works of improvement but remains below standard a five-year exemption may be granted. This exemption will be expected to be reviewed at the end of that period and works undertaken if at all possible.

Capital Allowances

The upside of all of this is that taken together, energy improvements will create marked savings in operational running costs. The other plus for energy improvement works is that the cost will become tax-relieved in various ways. This may either as expenditure on repairs, or as Capital Allowances on new systems such as the heating/cooling or any of the other building systems or its fit-out. The value of the tax savings could help stretch the budget to additional works.

How we can help

When planning improvements, we can provide a preliminary review of the scope and scale of the possible tax savings - which will improve viability and potentially enable a higher specification to support the best possible outcome.

Further advice:

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Each of the Afilia team has over twenty years experience in Capital Allowances on everything from hotels to headquarters buildings.

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