SQUIRE PATTON BOGGS

MEES
UK Commercial Tenants, Where Are We Now?

It is just over a year since the regulations controlling the energy efficiency of buildings[1] (MEES Regulations) started to impact on commercial lettings in the UK. A number of issues continue to occupy landlords' and tenants' minds as the regime takes hold.

The government guidance for landlords of non-domestic private rented property[2] (Guidance) sheds light on how the MEES Regulations are expected to operate, but, inevitably, questions arise around the practical application of the rules.

For tenants, an understanding of which properties are affected, the importance of reviewing portfolios and understanding a landlord's position and likely strategy going forward, particularly on renewal and continuation of tenancies post April 2023, is critical.

1 Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 (SI 2015/962).

2 The Department for Business, Energy and Industrial Strategy issued The Non-Domestic Private Rented Property Minimum Standard in February 2017.

Why Do We Have the Regulations?

The Energy Act 2011 imposed a duty on the Secretary of State to introduce regulations to improve the energy efficiency of both domestic (not examined here) and non-domestic buildings within the private rented sector (PRS) in England and Wales. The MEES Regulations fulfil that requirement and in the process impose potentially onerous obligations on landlords operating within the PRS that will have implications for their tenants.

Effect of the Regulations

Since **1 April 2018**, it has been **unlawful** for a landlord **to let** a non-compliant building and from **1 April 2023**, it will be unlawful **to continue to let** a non-compliant building.

A non-compliant, or "sub-standard", building is a non-domestic privately rented property that has an energy performance certificate (EPC) rating of F or G.

Questions around how landlords are dealing with sub-standard properties on renewal are surfacing and although the 2023 deadline may seem a long way off, tenants should also turn their minds to the future impact of the MEES Regulations where leases will continue into the next phase of enforcement.

Aside from the potential capital outlay required to improve energy efficiencies within a building, there are a number of implications for landlords attaching to carrying sub-standard buildings within a portfolio, including:

- Marketability
- Impact on rent review where open market value is adversely affected by energy performance
- Availability of finance

Therefore, as the 2023 deadline approaches, it is likely that landlords will need to access their tenanted properties to carry out works to bring the properties up to the minimum "E" rating. This has obvious "interruption to business" implications for occupiers, and the big question for tenants will be whether there is anything they will be able to do about it.

Which Properties Are Affected?

The starting point is that all non-domestic properties let under any type of tenancy and which are legally required to have an EPC are caught by the MEES Regulations. However, tenancies granted for 99 years or more are not caught, and neither are short-term tenancies. (Short-term tenancies are lettings that do not exceed six months, unless there are provisions for renewal or extension or the tenant has already been in occupation for a continuous period of more than 12 months at the time of grant.)

There are a number of exceptions to the EPC requirement, among them:

- "Officially protected" buildings – but only up to a point (see our Q and A section below)
- Places of worship
- Temporary buildings with an anticipated service life of two years or less
- Industrial sites, workshops, non-residential agricultural buildings with low energy demand and non-residential agricultural buildings that are in use by a sector covered by a national sectoral agreement on energy performance

However, these are limited. If landlords wish to rely on one of them, the Guidance will need to be read carefully to ensure the exception will apply. Where an EPC is not required, landlords will not need to improve the energy performance of those buildings under the MEES Regulations.

A well-prepared landlord will have been planning ahead. Many institutional landlords will already have been reviewing their portfolios to identify whether or not affected properties are already compliant, uncertified or non-compliant – with all of the implications that brings. Tenants may already have experience of landlords requiring access to their buildings (lease terms permitting) to assess the cost of upgrading energy ratings with a view to landlords either carrying out, or planning, the works, or disposing of any properties that will not be cost-effective to retain where an exemption cannot be claimed.

Compliance Matters!

If a landlord fails to comply with the requirements, there are both financial and publication ("name and shame") penalties. The maximum penalty amounts apply **per property** and **per breach**, so consistent failure to comply could be costly.

Infringement	**Penalty** (less than three months in breach)	**Penalty** (three months or more in breach)
Renting out a non-compliant property	Up to either: • **£5,000** or • **10% of rateable value – maximum £50,000** Whichever is greater Publication of non-compliance	Up to either: • **£10,000** or • **20% of rateable value – maximum £150,000** Whichever is greater Publication of non-compliance
Providing false or misleading information, or failing to comply with a compliance notice	Up to **£5,000** Publication of non-compliance	

Tenants must, therefore, be ready to expect landlords to be actively managing their portfolios. Where a building is sub-standard and does not fall within one of the exemptions, tenants should consider their options in advance of 2023.

Will A Landlord Have to Carry Out Works?

Where a property is caught by the EPC regime, the landlord must carry out the necessary works unless it can rely on one of the few temporary exemptions:

- **Third-party consent exemption** – A landlord may let a sub-standard property where it can demonstrate it has been unable to improve the energy efficiency rating of the property as a result of failure to obtain one or more necessary consents. "Third parties" could include a lender, superior landlord, planning authority and, critically, tenants. The exemption applies for five years or, if a tenant withholds consent, only for as long as that tenant remains at the property.
- **Property devaluation exemption** – A temporary exemption of five years will apply where the landlord can demonstrate that the installation of specific energy efficiency measures would reduce the market value of the property, or the building it forms part of, by more than 5%.
- **Exemption due to recently becoming a landlord** – The MEES Regulations acknowledge that there are some limited circumstances where a person may have become a landlord suddenly. As such, it would be inappropriate or unreasonable for them to be required to comply immediately. If a person becomes a landlord in any of the specified circumstances, a temporary exemption of six months will apply.

Can a Tenant Prevent a Landlord From Interrupting Its Business to Carry Out Works?

Of particular interest to tenants is the "consent" exemption, being the only one over which they can realistically exercise any measure of control.

Where a landlord wants to upgrade the energy performance of a building, a tenant will want to weigh up the benefit of improved energy performance against the impact of any interruption to business the works may cause. If the tenant considers that there is no real benefit and the interruption to business will be significant, the tenant can withhold consent (although it does not have to justify its reasons for doing so). Provided that the landlord has made visible efforts to obtain consent, it will legitimately be able to rely on the temporary exemption.

MEES and EPCs – Uneasy Bedfellows

The EPC and MEES regimes, whilst both seeking to address energy performance issues, do not always sit comfortably together. This is particularly well illustrated by the respective requirements on lease renewals:

- According to the government guide to EPCs (EPC Guidance), an EPC is not required on renewal
- MEES Regulations apply only to properties that are legally required to have an EPC
- If an EPC is not required on renewal (i.e. if the EPC Guidance is correct), then arguably MEES Regulations compliance does not apply on renewal
- This would, however, run counter to the MEES requirement that the MEES Regulations do apply on renewal[3]

The question is, therefore:

"can a landlord rely on the apparent exclusion of the requirement on renewal, as expressed in the EPC Guidance, to disapply the MEES Regulations?"

3 Regulation 27.

This would be a brave approach to take by a landlord. Although the EPC Guidance says that an EPC is not necessary on renewal, the relevant regulations themselves do not say this, whereas the MEES Regulations are absolutely clear on this point.

In that event, however, the result could be that a tenant remains in occupation of a property on renewal that it suspects or actually knows (possibly due to an EPC from the original letting) is sub-standard. Whilst the tenant can take comfort from the fact that any sanctions for failure to comply will fall to the landlord, it may need to think ahead to possible future scenarios.

Sub-letting: A Potential Headache for Tenants

Where a tenant is occupying a sub-standard property, this may well have implications if it wishes to sub-let. As the sub-tenant's landlord, the tenant will need to provide an EPC to any proposed sub-tenant and carry out works to improve the building to comply with the MEES Regulations – works that a tenant might expect its landlord to have carried out prior to letting or renewal.

If tenants do have plans to sub-let in the future, now is the time to speak to landlords to resolve these tricky issues and identify liabilities and costs.

What Else Does the Guidance Tell Us?

The Guidance offers clarity around a number of potentially vexing issues:

Q: Can tenants use a landlord's failure to comply with MEES Regulations as a reason to terminate their lease prematurely?

A: No. The landlord must either improve the property to a minimum rating "E" or register an exemption.

Q: Are a tenant's rights, such as the right to renew under the Landlord and Tenant Act 1954 Act, affected?

A: No. Landlords cannot refuse consent to renew solely on the basis that the property is sub-standard. However, the obligation to improve the property will arise on renewal, and the landlord must either carry out the works or consider one of the exemptions. Tenants may wish to withhold consent to any relevant works due to unacceptable business interruption, or work with the landlord to facilitate the works. Irrespective of the MEES position, it is still open to a landlord to refuse a new tenancy if it can make out one or more of the grounds set out in section 30 of the Landlord and Tenant Act 1954.

Q: Do the minimum standards apply to mixed-use properties?

A: Yes. However, landlords will need to carry out an assessment and apply the MEES Regulations as directed in the Guidance.

Q: Is a listed building excepted from the requirement for an EPC?

A: Not necessarily. The exception of "buildings officially protected as part of a designated environment or because of their special architectural or historical merit" only applies "insofar as compliance … would unacceptably alter their character or appearance".

Q: Will registration of a voluntary EPC mean that the landlord must comply with the minimum standard?

A: No. All requirements must apply for the minimum standard obligation to arise.

Q: If the landlord has made all of the "relevant improvements" but cannot bring the property to the minimum standard, can it let the property?

A: Yes. However, the exception must be registered and it only lasts five years. After that, the landlord must try again to improve the EPC rating.

Q: What if the landlord needs someone else's consent to the works and they do not agree?

A: The landlord may continue to let a sub-standard property if it can demonstrate that it has been unable to improve the rating because it has not been able to obtain appropriate consents. Efforts to obtain consents must have been made, though!

Q: Can a landlord recover the cost of the works from the tenant via the service charge?

A: Whilst the MEES Regulations do not prohibit this, it was recognised that it may not be possible to do so. To a degree, it may come down to bargaining power, but tenants are highly likely to resist any attempts to pass on the costs to them on the basis that the requirement to put the building into a regulation-compliant condition arises before the letting. It may be that if there is provision for the tenant to consent to the works, it might be more amenable to contributing towards them if there is a long-term benefit in terms of energy cost savings.

What Does the Future Hold?

It is worth not losing sight of the fact that these regulations are all about **minimum** energy requirements and many landlords may well want to achieve greater long-term savings that could, in turn, benefit tenants. There is also speculation that the MEES Regulations may become more rigorous, increasing the minimum requirement from an "E" to, potentially, a "C".

We are also seeing a move towards a greater emphasis on "green" leases and improved co-operation between landlords and tenants to achieve energy efficiencies. However, there is a cost attached and careful negotiations need to take place to ensure that the cost falls appropriately and tenants do not find themselves out of pocket as a result both of inadvertently financing energy improvements through service charges, from which they may not benefit in the long term, and/or losing business while works are carried out.

The official Guidance, including tables illustrating the "compliance decision process", can be read on the gov.uk website.

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