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Minimum Energy Efficiency Standards  
Briefing Note for Commercial Real Estate Investors

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# Minimum Energy Efficiency Standards

## Implications for Commercial Real Estate



### Background

The Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 were introduced in March 2015. These bring into force Minimum Energy Efficiency Standards (“MEES”) which will have implications for those seeking to let properties and may result in income risks being experienced. This guidance note applies to non-domestic property (i.e. not homes; separate but comparable rules apply to domestic properties).

### What do the new MEES rules mean?

There are two significant MEES dates:

- From 1 April 2018, a landlord will be unable to let a non-domestic property if it has an Energy Performance Certificate (EPC) rating below an E. From that point onwards, F or G rated properties will be known as “sub-standard properties”. The regulations also apply to landlords seeking lease renewals (where an EPC exists) as well as to tenants wishing to sublet.
- From 1 April 2023, the regulations apply to all property leases (where an EPC exists for the property) and not just to new lettings.

Penalties may be levied against those not complying with the regulations.

### Exemptions

There are some exemptions:

- Properties with leases which are very short (6 months or less) or very long (99 years or longer);
- Historic buildings (currently defined as those which are Listed Buildings);
- Buildings in which cost-effective energy efficiency improvements have been undertaken (cost-effective being defined as those with a payback period of seven years or less);
- If an independent valuer determines that such improvements to the property would diminish its value by more than 5%;
- Where necessary third party consents cannot reasonably be obtained (e.g. from a tenant); and
- Other exemptions may apply depending upon individual circumstances.

All exemptions will need to be placed upon a public register (“Private Rented Sector Exemptions Register”) and will only last for 5 years. Exemptions cannot be novated to new owners of a building upon its sale; if a sub-standard property is sold, the new owner has only 6 months either to comply with the regulations, or to justify a fresh five-year exemption.

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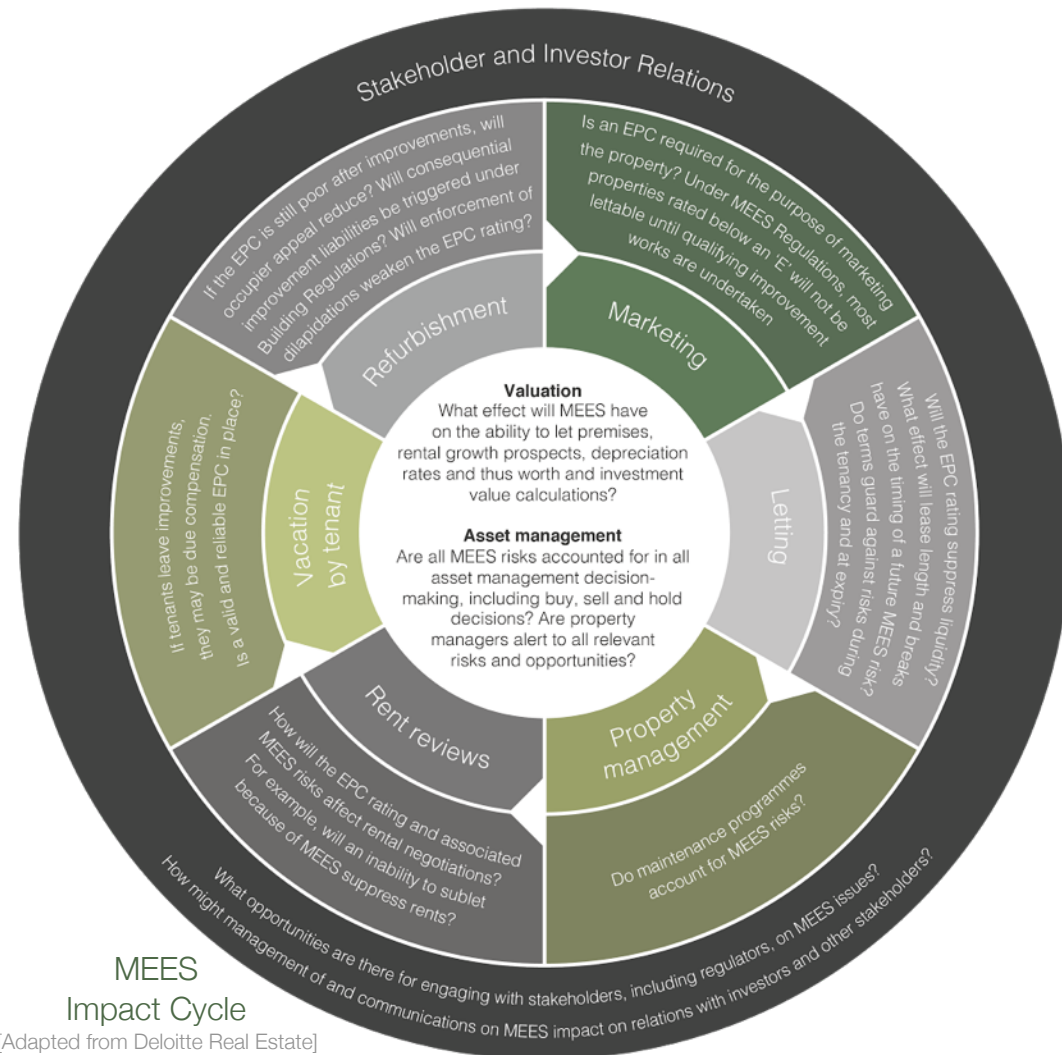
### How will MEES affect investors?

Investors will need to ensure that their fund and asset managers are fully prepared to deal with the MEES liabilities that will almost inevitably exist, and that they have robust procedures in place to deal with these and any future risks.

Those acquiring non-domestic buildings will need to undertake careful due diligence. Landlords are also advised to investigate the status of their existing portfolios, being careful to examine how MEES will put their income at risk and at what point in time these risks may crystallise.

Hillbreak has helped a number of landlords to consider how factors such as lease type, lease events, tenants, income profiles and regulatory timetables present particular risks to their portfolios which could result in significant income loss, liquidity impacts or capital works being required. With careful planning, Hillbreak has been able to minimise these types of risk with its clients.

It is important for investors, as well as their fund and asset managers, to appreciate that MEES risks may arise throughout the property lifecycle. It is therefore necessary to put in place appropriate principles, policies and procedures to minimise risks throughout the investment process.



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### Dealing with uncertainty

The main risk faced within most portfolios is that posed by uncertainty. With MEES, this factor is a double-edged sword. First, most portfolios contain high levels of uncertainty pertaining to the EPC ratings of individual units and buildings. This comes about for a variety of reasons, including that EPC record-keeping has often been poor, EPC assessments have often been inaccurate and that anyone, including tenants, can procure and register an EPC at any time (with more recent EPCs superseding previous ones).

The second aspect of uncertainty risk lies in the fact that there is still a significant amount of uncertainty about how the regulations will be implemented. Hillbreak has pointed out to the government that guidance is urgently needed to help building owners and others to understand how a range of factors will be influenced by the regulations, such as the effect of tenant alterations, obtaining consents for improvement works, the cost-effectiveness test, enforcement of the regulations and other matters. Fortunately, we are informed by the Department for Energy & Climate Change that guidance will be issued in the near future.

We do know that increasingly stringent energy regulations are likely and the UK government has been clear that MEES will be one of the key means by which it ensures better energy efficiency in the property sector. It is most likely that MEES will be reviewed and the standard tightened by 2023.

### Contacts



Miles Keeping

+44 7971 457959  
miles@hillbreak.com  
@miles\_keeping



Jon Lovell

+44 7825 531031  
jon@hillbreak.com  
@lovell\_jon



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