



Minimum Energy Efficiency Standards: The Final Countdown!

“Net-zero” continues to be the buzzword of 2023 and beyond as the Government threw down the gauntlet following the publication of its *Net Zero Strategy: Build Back Greener* in October 2021 which sets out the UK’s ambition of reaching net-zero by 2050.

The real estate sector has not escaped the reach of the Government’s energy efficiency ambitions, and the proposed amendments to the *Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 (as amended)* (“**PRS Regulations**”), brought into force in 2015 and which established the existing Minimum Energy Efficiency Standards (“**MEES**”) for privately rented property in England and Wales, are a very good example of the important role the real estate sector has to play in helping to reach the net-zero target. The PRS Regulations are not to be confused with the *Energy Performance of Buildings (England and Wales) Regulations 2012 (as amended)* that set out the requirements for an Energy Performance Certificate (“**EPC**”). The pandemic may have previously diverted the real estate sector’s attention to more pressing matters but for landlords with extensive property portfolios the proposed amendments and impending deadlines will fast approach. The next key date is **1 April 2023** – see further detail below. Notably, it is not only the UK that is seeking to amend existing energy efficiency standards; the EU recently announced a raft of proposals including a requirement that the worst-performing 15% of the building stock of each Member State be upgraded from an EPC rating of “G” to at least “F” by 2027 for non-residential buildings and 2030 for residential buildings, a markedly lower standard than the UK Government’s proposals. In this article, we remind you of the rules as they currently stand in England and Wales, as well as focussing on the amendments to the PRS Regulations and MEES that we expect to see with respect to non-domestic properties in England and Wales.

What are the MEES?

The PRS Regulations established the existing MEES in England and Wales in 2015. They were introduced to target the least energy efficient properties and reduce the overall CO₂ emissions in accordance with the UK’s targets for decarbonisation. The MEES currently prevent non-domestic properties from being let to **new** tenants or re-let to existing tenants if the property has an EPC rating of “F” or “G”, the lowest two ratings. As a result, all non-domestic properties must have a minimum EPC rating of E in order for the property to be let to new or existing tenants. This requirement has been in place since April 2018. Non-compliance with the MEES can result in a fine, which currently ranges from £5,000 up to £150,000 depending on the severity of the breach.

What is about to change?

Minimum EPC “E” rating for existing non-domestic lettings from 1 April 2023: following the latest Government consultation published in March 2021, the MEES are set for a shake up as the screw is tightened on landlords whose properties are currently demonstrating poor energy efficiency standards. The most immediate revision is that from **1 April 2023** it will become unlawful for landlords to **continue** to let non-domestic properties (as opposed to granting new leases which was all that was caught by the PRS Regulations until now) if they have an EPC rating of “F” or “G” (ie where there has been no change in tenancy arrangements). The Government estimates that around 10% of all rented non-domestic properties have an EPC rating below E, and landlords will therefore be required to act before that date.

Are there any exemptions?

As expected, the proposed amendments to the PRS Regulations and MEES do not constitute a three-line whip and there are certain exemptions available to landlords. These are typically valid for a period of five years and which, in certain circumstances, can be claimed more than once. However, it is important to note that these exemptions do not pass automatically on the purchase of a property. To benefit from an exemption the landlord must register it on the PRS Register and upload appropriate evidence. The existing exemptions include the following:

- > **Third Party Consent:** the landlord has been unable to obtain third party consents (eg from a tenant, superior landlord, mortgagee or local planning authority) to the works despite using reasonable efforts to do so, or consent has been given subject to a condition with which the landlord cannot reasonably comply. This exemption ends on the expiry of the five year period from the date of registration or, if earlier, when the landlord sells its interest in the property or the end or earlier assignment of the lease.
- > **Devaluation of Property:** the landlord has obtained a report by an independent surveyor which says that making the energy improvements would reduce the market value of the property by more than 5% or have a negative impact on the fabric or structure of the property.



- > **Seven-year Payback Test:** the “relevant” energy improvements do not pay for themselves in energy savings over a seven-year period. The PRS Regulations prescribe a detailed formula for this purpose. It is intended that this exemption will be improved with the introduction of a payback calculator.
- > **Recommended Improvement Works:** where a landlord has carried out “relevant” energy efficiency improvement works but the property still obtains an EPC “F” or “G” rating then the property will remain eligible for an exemption.

In certain circumstances temporary exemptions apply which are designed to give landlords a six month breathing space where they have recently taken on a lease, eg where the landlord has bought a property which is subject to an existing lease; the lease has been renewed under the 1954 Act; or the lease has been granted pursuant to a contractual obligation eg an agreement for lease entered into before 1 April 2018. When the six months have expired, the landlord must either carry out the necessary energy efficiency improvements or register a “full” exemption. In addition to the existing above exemptions, the March 2021 consultation also proposes the following additional exemptions:

- > **Listed Buildings:** the March 2021 consultation proposes to bring listed buildings within the scope of the PRS Regulations and MEES (ie a listed building must obtain an EPC). However, where any necessary works to increase the energy efficiency of the listed building would unacceptably alter the listed building’s character or appearance, an exemption can be registered.
- > **Shell and Core Properties:** landlords previously were undertaking fit out works to meet the MEES threshold that tenants were subsequently removing and replacing. The consultation suggests a temporary six month exemption for these properties before a local authority can take enforcement action for failing to comply with the MEES to allow for improvements to be made to the property after it has been let and having first consulted with the tenant.

Move to minimum EPC “B” rating for all non-domestic lettings by 1 April 2030: the March 2021 consultation also consulted on the framework for the implementation of an EPC rating of B for all non-domestic rented properties by 2030 the future trajectory of which was confirmed in the *Energy white paper: Powering our net zero future*. Estimates suggest that over the last 10 years only 12% of all registered non-domestic properties had an EPC rating of B or above. This is a trend that is showing few signs of reversing with only 15% of the roughly 91,000 non-domestic EPCs registered in 2019 having an EPC rating of “B” or above – an increase of only 3%! Based on these estimates, circa. 88% of non-domestic properties will be required to significantly improve their energy performance by 2030 if the Government’s target EPC rating of “B” is to be met. The Government’s response to the March 2021 consultation has yet to be published, however, it seems likely that the following amendments to the PRS Regulations and MEES will in any event be implemented in respect of non-domestic properties:

- > There will be a phased implementation of the EPC rating of “B” for 2030, with an interim EPC rating of “C” required by 2027. These target ratings will be achieved in two stages by means of two “compliance windows” as follows:
 - > **First Compliance Window: EPC “C” Rating (2025-2027)**
 - > 1 April 2025: landlords of all non-domestic rented properties in scope of MEES must present a valid EPC.
 - > 1 April 2027: All non-domestic rented properties must have an EPC rating of “C” or greater, or register a valid exemption.
 - > **Second Compliance Window: EPC “B” Rating (2028 – 2030)**
 - > 1 April 2028: landlords of all non-domestic rented properties in scope of MEES must present a valid EPC.
 - > 1 April 2030: All non-domestic rented properties must have an EPC rating of “B” or greater, or register a valid exemption.

- > The phased approach of two compliance windows is intended to make it easier for local authorities to enforce the MEES because they will be able to identify which non-domestic properties are compliant, which non-domestic properties still need to be improved or to have registered a valid exemption and, by process of elimination, which non-domestic properties have not complied with the requirement to submit a valid EPC. As is currently the case, both EPCs and exemptions must be registered on the PRS Exemptions and Compliance Register. To encourage continual energy efficiency improvements, the Government proposes that all properties must review their existing exemptions at the start of each compliance window.
- > While the compliance windows are intended to allow landlords to take a phased approach to improvement works, the Government has stressed that a two-step process is not mandatory and that landlords are encouraged to undertake the process of obtaining a revised rating in a manner that is as cost-effective and non-disruptive as possible.
- > Finally, the Government is planning to change the way that EPC ratings are calculated. Changes to the emissions factors used to calculate performance coupled with new minimum standards for ventilation and thermal efficiency are expected, meaning that some non-domestic properties may in fact see a worsening of their EPC rating without any physical changes having been made to the property.



The bottom line...

It goes without saying that many **landlords** will have to incur significant capital expenditure on improving the energy efficiency of their properties to ensure compliance with the proposed increased EPC ratings should they be brought into force. They will need to ensure that any new leases that are granted contain sufficient reserved rights to enable landlords to comply with their existing and future obligations under the PRS Regulations and MEES. Existing service charge provisions should be reviewed to ascertain if the cost of works can be passed on to tenants, particularly as tenants will likely benefit from substantial cost savings as a result of a more energy efficient property.

Tenants will similarly want to check their properties where they may wish to sublet, and review any lease obligations to contribute to the costs of energy efficiency improvements. Landlords are also likely to require more control over alterations carried out by tenants to ensure that any tenant fit out works do not alter or lower the EPC rating of the property.

Finally, **lenders** will also need to be alert to the potential for decrease in value of a property that does not have an “E” rating by 1 April 2023 and which may be subject to void periods or be generally less attractive to tenants, and include suitable protections in their security documents.

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