Count MEES in

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Nick French and Sarah Sayce introduce an RICS insight paper for valuers, asset managers and their clients that explains the impact of the Minimum Energy Efficiency Standards

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The Minimum Energy Efficiency Standards (MEES) were introduced on 1 April, so it is useful to rehearse the possible implications for domestic and non-domestic property markets. Accordingly, RICS has published the insight paper Minimum Energy Efficiency Standards (MEES): Impact on UK property management and valuation .

MEES are a key element of the UK government?s strategy to reduce carbon emissions significantly. While the requirements apply to all buildings let in the private sector, whether domestic or non-domestic, they do not cover properties that are not required to have an energy performance certificate (EPC), or those held by registered housing providers or the public sector and let as affordable housing.

The government intends the MEES regulations to have wide-reaching impacts, but has taken a phased implementation approach. The start date of 1 April 2018 relates to all new lettings, extending to continuing lettings of domestic buildings from 1 April 2020 and to non-domestic buildings from 1 April 2023.

Energy efficiency

The government aims for MEES to promote the refurbishment of the least energy-efficient buildings as considered in terms of their EPCs, which rate buildings from A to G. The regulations apply to all landlords who let buildings on leases of between 6 months and 99 years where there is a valid EPC with a rating of F or G. Buildings that do not yet have an EPC because they have not been marketed or let since its introduction are beyond the scope of MEES until a certificate is required.

It is now unlawful to let non-compliant buildings until the landlord has made qualifying improvements. While many leases oblige tenants to undertake or pay for works required by statute, the MEES specify that compliance is a matter for landlords. From 2020 and 2023, it will be unlawful for landlords to continue letting domestic and non-domestic buildings until certain improvements have been carried out.

Under the MEES, the landlord?s obligation to make improvements is limited to measures that increase the building?s energy efficiency and are 'permissible', 'appropriate' and 'cost-effective', in the regulations? terms. However, it is expected that many buildings would still have an F or G rating once all such improvements had been undertaken. These will thus be temporarily exempt for up to 5 years from the regulations and can still be let without penalty.

MEES are key to the UK government?s strategy to reduce carbon emissions significantly and apply to all buildings let privately

Therefore, many older properties could still be let even with an F or G rating. The guidance for non-domestic properties provides information on calculating what costs are deemed reasonable; for domestic properties, required works are limited to those that can be executed at no cost to the landlord, but a possible change to this is under consideration by the government.

Other temporary exemptions can be claimed where a tenant or superior landlord refuses to give consent for improvement works. Some exceptions are permanent, for instance, when upgrade works would be incompatible with the preservation of historic listed features of a building. Understanding the regulations requires knowing what count as 'qualifying improvements' and what exemptions are allowed.

Importantly, the regulations do not prevent the sale of buildings, neither do they affect the assignment of an existing lease, although they do extend to renewals and sublettings.

Property management

Many properties can be brought up to the minimum standard quickly and at a reasonable cost. However, building owners and asset managers need to have a strategy and work closely with tenants to protect investment values as the regulations start to bite and tenant aspirations are raised.

Since the announcement of the proposed regulations in 2011, prudent landlords have assessed their properties so they are fully aware of the energy-efficiency levels and developed plans to ensure they are compliant. But many landlords may remain unaware of the implications of MEES and it is recommended that they undertake an audit of their portfolio to establish:

- what properties have EPCs and any date of grant and expiry;
- whether any properties are exempt and correctly listed on the national private rented sector exemptions register;
- any requests from tenants for energy improvements that have not been previously noted or actioned;
- the rating of the EPC in each case and whether any works have taken place that would result in a likely change on reassessment; all properties with an E, F or G rating should be noted; and
- details of current leases, to determine the expiry dates and any breaks that could trigger the need for a new letting.

The audit will mean working closely with tenants, whose cooperation will be vital. It may also influence decisions as to whether to retain or sell the property and the timing and nature of refurbishment works; energy-efficiency improvements are normally best undertaken as part of any planned refurbishment. Asset managers must understand the likely impact of the regulations and the implications for their clients.

Valuation issues

The new regulations may well have an impact on values in some submarkets. Properties in prime locations are less likely to be affected because the costs as a proportion of rental value will be less than elsewhere. In lower-value areas, many properties with poor specifications and low energy efficiency that are expensive to upgrade may fall in value even if they are temporarily exempt from the regulations.

Some market participants are increasingly aware of energy efficiency in buildings and valuers should reflect this. Even if there is no clear evidence of change in market value, due diligence under the Red Book extends to accounting for any risks posed by MEES. As the current regulations may well be tightened over time, it is anticipated that MEES present a risk to most E-rated and possibly some D-rated assets. As new stock comes forward with high EPC ratings, older properties falling below the market?s expectations of energy efficiency or sustainability will be deemed of lower value, a phenomenon referred to as 'brown discounting'.

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MEES should be part of the due diligence process in terms of inspection and analysis of evidence and reporting, again under the Red Book?s requirements. EPCs are a potential source of risk, so certificates must be obtained where available and considered carefully before preparing the valuation figure. The valuer should not stray outside their area of competence, offer advice or make assumptions that then prejudice their professional indemnity insurance.

The valuer should identify risks, but also recognise their own limitations. They should only incorporate likely capital expenditure charges obtained from a reliable source and discussed with the client; their report must refer to that source. If the valuation is prepared to advise on a market value before a sale or mortgage, the valuer must obtain sight of the EPC or EPCs.

Figure 1: Even after improvements, many properties could still be let with an F or G rating

So the valuer must determine the MEES? effect on individual properties and reflect this in the market or investment value. There are generally 3 main scenarios for current valuations of investment-grade properties:

1. valuations where no EPC is provided have an inherent risk due to the uncertainty surrounding a potential rating;
2. valuations where the EPC is rated E or above may experience little change in value, although properties with an E rating represent a heightened risk because they may not be classed as compliant in the future; and
3. valuations where the EPC is rated F or G require careful consideration of the likely continuation of an income stream.

The introduction of MEES does not need any new approach to valuation and there is no reason why valuers should not continue to use existing methods that are appropriate to the property and the market in which it is situated, both geographically and in terms of value cycles. The impact of MEES on value will normally be considered either in terms of the costs of improvement, with possible inclusion of a void period, or by a yield change to reflect greater risk perception in the market.

Insight on impacts

The regulations are intended to apply across the whole property sector, but recognise that some properties are hard to treat and therefore not cost-effective to bring up to standard; others cannot be altered because energy improvements would conflict with recognised heritage features. Furthermore, the government realises that owners may need time to adjust, so the regulations are being introduced in a staggered way and with a range of temporary exemptions.

Chartered surveyors must fully understand the new regulations and their impact on management and value, and the insight paper is designed to help them to do so.

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Further information

- Related competencies include: Housing maintenace, repair and improvement ; Property management
- This feature was taken from the RICS Property Journal (July/August 2018)
- Related categories include: Landlord and tenant