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A&R Legal Briefing

The Energy Act implications are looming

The Energy Act 2011 is still at the forefront of the government's energy policy as a way to help it reach its carbon reduction targets by 2020. I commented on it at the time but now that the EPC deadline is fast looming, here again are some of the implications for commercial property landlords, tenants and lenders.

EPC Deadline

The two aspects of the Act that will have the greatest effect on property are the Private Rented Sector Regulations (PRSR) and the Green Deal. Although these are dealt with separately, they are interrelated. The PRSR now states that by 1 April 2018 all commercial and residential buildings must be raised to a minimum energy efficiency rating of "E" before they can be rented.

Check your EPC. Landlords with buildings that have F or G ratings will not be able to let them from 1 April 2018, unless sufficient efforts have been made to reduce the rating to at least level E. It is thought that 18% of commercial properties alone fall into this category and immediate action is needed to prepare for the deadline.

Review Now

Anyone with property interests should review their portfolio right now and consider what action should be taken. At the very least, knowing the current EPC rating of your building is crucial, whether you own it or occupy it. This must be followed by a review of potential options for improving the energy rating and minimising potential problems. Landlords could simply dispose of poorly rated stock in favour of higher energy efficient buildings and any buildings that are to be kept for long–term strategic reasons may have to be improved to ensure their lettability by next year. It is thought that the minimum requirement will even be raised in coming years so action taken for the current requirement will help you stay on track for when these further changes are brought in.

Take Action

This is where the Green Deal comes in. This provides the funding mechanism to ensure that any works required to raise the EPC rating of a building can be implemented without any upfront costs to the landlord by providing for the cost of the works plus finance charges to be recoverable through the energy bills for the property rather than from the party that carried out the works.

The intention is to avoid the situation where landlords or occupiers fail to carry out energy efficiency works because the payback period is too long in comparison to the planned occupation. The DECC website suggests that a landlord who has carried out the maximum package of measures funded under the Green Deal (or Energy Company Obligation) will not fall foul of the restrictions on letting even if this does not take the property above an F rating.

There are of course other exemptions, and there will be financial penalties for non-compliance.

Service charge management

The implications of the Act are likely to be felt in the management of properties, and in particular, service charge management. It is doubtful that anyone would disagree with the sentiment of a typical "green" clause. Lower consumption is common sense, but Landlords may be encouraged to make capital expenditure on new plant and machinery in order to deliver this benefit.

In many cases the work will not be covered by the service charge provisions, because it is not "repair" and it does not come within any other head of charge. Naturally, a landlord is likely to face resistance from tenants who are asked to pay for the work, on the ground that it represents an improvement outside the terms of the lease, even if the repayments are made through energy bills.

This promises a lot of lively discussion and argument until the regulations are clear.

Air conditioning upgrades

As a result of separate legislation, R22 coolant has been prohibited in air conditioning systems since December 2014. As well as that, aged air conditioning plant can, for example, be a major factor in driving EPC ratings into the lower F and G categories.

The landlord may wish to upgrade the air conditioning plant in a building if it covers the common parts and lettable areas. Once again, this will affect the whole building, being for the long–term benefit of its occupiers, but tenants may well regard it as an improvement and is therefore not recoverable as a legitimate service charge expense.

Such problems (amongst others) will no doubt test the drafting of the Act and the regulations in the run up to 2018. Savvy tenants of new leases are already attempting to remove any liability on their part to pay for upgrades to achieve improved energy performance. Contracting parties therefore need to consider the problem now.

Mortgage security

To maximise asset value, significant expenditure may be required by the mortgagor to bring a property into band E. It seems reasonable for the lender to question how this will be funded during the loan term, whether that be through the Green Deal or otherwise. For example, lenders should be asking if the cost has been factored into the borrowers' business plan. Some lenders have not woken up to this problem on new lending, let alone existing lending.

Conversely, those lenders who have considered the point may be faced with customers who do not seem to appreciate the scope of the problem, but merely regard it as yet another excuse for the lender not to advance funds.

Both borrower and lender should be facing this problem square on and working out a strategy for dealing with it, especially if upfront funding is required to implement improvements in time for next year.

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