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Minimum Energy Efficiency Standards (MEES) Impact on UK property management and valuation



Minimum Energy Efficiency Standards (MEES): Impact on UK property management and valuation

An insight paper for valuers, asset managers and their clients

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Contents

Executive summary	1
1.0 Introduction to MEES and the potential implications	2
1.1 Introduction	2
2.0 Scope, exemptions and enforcement	3
2.1 Introduction	3
2.2 Non-domestic properties	3
2.3 Domestic properties	5
2.4 Summary	6
3.0 Property management – impact of MEES on landlords	7
3.1 Introduction	7
3.2 Action-planning advice	7
3.3 Summary	10
4.0 Property valuation – impact of MEES on owners and lenders	11
4.1 Introduction	11
4.2 Due diligence	11
4.3 Bases of valuation for which MEES should be considered	11
4.4 Impact of MEES on value	15
4.5 Impact of MEES on lending	15
4.6 Further valuation considerations	16
4.7 Reporting	16
4.8 Valuation approach, method and model	17
5.0 Glossary of terms	19

Executive summary

Background

- UK government has a legal commitment under the *Climate Change Act 2008* to reduce carbon emissions by 80% from 1990 levels. Buildings are major emitters of carbon. To meet the target, many buildings will require upgrading in terms of their energy efficiency standards.
- As part of their strategic approach, the government are introducing regulations under the *Energy Act 2011* to impose a requirement for Minimum Energy Efficiency Standards (MEES) on investment buildings in England and Wales. These requirements apply to all let buildings, domestic or non-domestic with certain exemptions.
- The date of commencement is **1 April 2018 for all new lettings**. The regulations will be phased in and will apply to continuing lettings from **1 April 2020 for domestic buildings** and **2023 for non-domestic buildings**.

EPCs

- The minimum standard required under current regulations is an Energy Performance Certificate (EPC) E; buildings that have an EPC of F and G must be brought up to standard before they are let or from the 'backstop' date, subject to some conditions, exemptions and relief.
- It will continue to be lawful to trade properties that are not compliant with MEES but it is anticipated that values will be affected not just for those with an F- or G-rating, but an E as over time the standards required are likely to become more stringent, as may the calibration of EPCs.

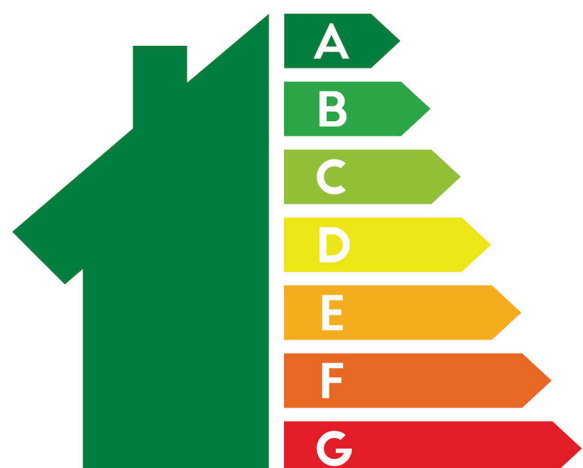
Exemptions

- The regulations apply to private sector lettings, with limited exceptions, but including properties owned by the public sector and let out. The regulations do not apply to properties that are held by registered housing providers or by the public sector and let out as affordable housing.
- It is possible that some properties can be brought up to the minimum standard quickly and at a reasonable cost. Where they cannot, there may be a temporary exemption from the regulations.
- There are several other exemptions, some of which are temporary, including where a tenant or superior landlord refuses consent; others are permanent, including where upgrade works would be incompatible with the preservation of historic listed features of a building.

Management and valuation

- It is critically important that valuers and asset managers understand the likely impact of the regulations and the implications for their clients.
- Asset managers are advised to work with building owners to ensure they have a strategic plan to ensure their portfolios are brought into compliance, thus protecting investment values and reducing portfolio risk. They will also need to work closely with tenants whose cooperation will be vital.
- Valuers should be aware that energy efficiency is increasingly affecting the behaviours of some market participants and should, therefore, reflect where this is the case. The introduction of MEES regulations presents cases where a value implication is most likely. Even if there is no clear evidence of market value change, their due diligence, under the *RICS Valuation – Global Standards 2017* (the Red Book), extends to accounting for any risks posed by MEES.
- When valuing properties, valuers should assess the level of risk posed by MEES and consider the extent to which the market rent, yield and possible rental growth will be affected. They should be aware that properties of poor specification and low energy efficiency, even if currently compliant, may reduce in value. In many cases valuers may need to work with energy experts or/and building surveyors to assess the works likely to be required and the costs of upgrade in order to reflect this accurately in their valuations.

See Table 1 for a summary of the possible impact of MEES on value (pages 13–14).



1.0 Introduction to MEES and the potential implications

Principal message

MEES are a key part of the strategic approach of the UK government to significantly reduce carbon emissions. Meeting these targets requires improvement of much of the built stock. This will have an impact on both domestic and non-domestic property markets. This insight paper is designed to inform property owners, managers and valuers of the potential implications of MEES, which come into force on 1 April 2018.

1.1 Introduction

In 2008, the UK government enacted the *Climate Change Act* requiring a reduction in carbon emissions by 80% by 2050 from 1990 levels. This ambitious target requires widespread upgrading of much of the built stock if it is to be achieved.

Fossil fuels are the chief source of carbon emissions and, therefore, the UK government has a strategy to:

- reduce and, by 2100, eliminate the use of fossil fuels as a source of energy and move to renewable, carbon free or low carbon sources and
- reduce, through energy efficiency measures, the amount of energy used by both domestic and commercial consumers.

Buildings are one of the key sources of energy use and carbon emissions, being responsible for an estimated 34% of all emissions (see the *Climate Change Committee Building Factsheet* (2015): <http://bit.ly/2DdHrQG>). If targets are to be met there is an imperative that the building stock reduces its reliance on carbon sources. The UK has some of the oldest building stock in the world and it is the intention of the UK government to create the regulations and incentives to promote a transformation of the existing building stock. A recent estimate by the European Commission is that 75% of stock across EU member states is not energy efficient.

To stimulate this process, statutory and regulatory measures have been put in place to promote the refurbishment of the least energy efficient buildings. The introduction of Minimum Energy Efficiency Standards (MEES) is a key part of this strategy.

This insight paper discusses the potential impact of MEES for property owners, managers and valuers. The paper discusses the possibility that investors and occupiers may discriminate against poor-rated buildings within their portfolio strategies and seek to divest of stock that is either at risk or fails to meet the standards. Alternatively, other investors may take a positive approach by seeking out

such assets where they can be brought up to standard at economic cost. It is considered that, in many cases, the regulations may cause a price correction and/or affect cash flow of non-compliant stock. While some buildings will be exempt from MEES, either permanently or temporarily, as discussed in section 2, the impact on some may be to render redevelopment more probable. The potential valuation impacts are discussed in section 4.

In terms of the implications for property management, the MEES impose an obligation on landlords to make improvements where buildings fail to meet the minimum standard, subject to certain exemptions and caveats. For buildings to be within scope of the regulations, they need to be let, or in prospect of letting and have a valid EPC. As explained later in the paper there are some buildings that are exempt either through the nature of the landlord or the characteristic of the building or where there is no valid EPC or requirement to obtain one.

The regulations are being introduced gradually:

- April 2018 for new lettings
- April 2020 for continuing domestic lettings and
- April 2023 for continuing non-domestic lettings.

Note: at the time of writing, the government is consulting on potential changes to the domestic regulations.

In theory, the property market has had several years to adjust to the likely impacts, but it has only been since the publication of guidance in 2017 that the details have become known, enabling owners and their advisers to fully evaluate the position and respond accordingly, although some landlords have undoubtedly already adjusted their strategies and some values may have been reviewed with the regulations in mind (see the government guidance for domestic and non-domestic landlords: <http://bit.ly/2yCwYQS>).

MEES regulations only apply to let properties in the private rented sector but this includes public sector landlords. The regulations, as currently written, do not extend to the social housing sector, even where they let properties on tenancies of a type that would normally fall within the regulations. It is estimated, therefore, that the regulations apply to approximately 20% of all residential units. It is estimated that, by value, some 55% of non-domestic buildings is let and potentially falls within scope (see the Property Industry Alliance's *Property Data Report 2017*: <http://bit.ly/2FDu9BZ>).

2.0 Scope, exemptions and enforcement

Principal message

MEES on investment property are being introduced through a phased process from April 2018. By April 2023, all let properties, domestic and non-domestic, with some exceptions, will be affected. It is critical that valuers and asset managers understand the likely impacts of this and the details of exemptions.

2.1 Introduction

The regulations governing MEES that apply to privately rented buildings were introduced in the *Energy Act 2011* and are effective from 1 April 2018. The regulations apply to both domestic and non-domestic properties and are slightly different for each sector. This section sets out the main provisions of the regulations, their scope and the exemptions and enforcements. It does not, however, provide the full detail. Property managers and valuers are advised to consult the full guidance issued to landlords to supplement their understanding.

2.2 Non-domestic properties

The regulations apply to a large number of non-domestic properties. Almost half the non-domestic stock is currently held within investment portfolios and nearly one in five buildings is currently below the new minimum standard, with many more only just meeting standard.

The regulations make it **unlawful for a landlord to let a non-domestic building that has an EPC rating of F or G** until all qualifying improvements have been made.

The regulations do not say that F- and G-rated buildings cannot be let under any circumstances. It is expected that many buildings will still have an F- or G-rated EPC once all necessary improvements have been made. These buildings will be temporarily exempt from the regulations and can still be let without penalty. The key is to know what 'qualifying improvements' must be undertaken.

Scope

The regulations apply directly to all landlords who let non-domestic buildings on leases of between 6 months and 99 years where there is a valid EPC with a rating of F or G.

Importantly, the regulations do not prevent the sale of buildings and do not affect the assignment of an existing lease, but they do prevent renewals and subletting (when a tenant becomes the landlord of a subtenant). This means that the implications of the new regulations will need to be carefully considered by occupiers who might be considering subletting and by owners who occupy their own premises as it may affect both the cost of disposing

of surplus accommodation and, perhaps, the ability to use property as security for business loans.

Buildings with A–E EPC ratings are outside the scope of the regulations. However, some existing EPC ratings are expected to change when properties are next re-certified and it is widely believed that the government will raise the minimum standard from E–D in the future. Landlords and tenants, investors and occupiers should consider the potential implications for E-rated buildings, even though they are not covered by the regulations at present. This may affect a further 15–17% of non-domestic buildings.

As a general rule, buildings that do not require an EPC will be exempt from the regulations, even if they actually have an EPC. These include:

- places of worship
- planned life of less than 2 years
- low energy buildings – such as certain industrial, agricultural buildings, etc.
- small standalone buildings with a useful life of less than 50 sq m.

Some listed buildings are also exempt but only where works necessary to bring into compliance with MEES would unacceptably alter the character of the building. Some listed buildings will, therefore, require an EPC and, if given a sub-standard rating, fall within scope of the regulations.

Buildings that have yet to require an EPC under the original *Energy Performance in Buildings Directive* (EPBD) because they have not been marketed for sale or for a letting since April 2007 will also be out of scope until the time that an EPC is required.

Buildings that have been certified voluntarily are also outside scope if the circumstances making certification compulsory have not yet arisen (i.e. there has been no marketing).

An EPC is valid for a fixed period of 10 years. Buildings with expired EPCs are outside the scope the regulations but will require a new EPC when next marketed for a sale or letting. A building with an expired F- or G-rating will be outside scope but if, when re-certified, it is given a sub-standard rating, it will be back within scope.

It is possible that the rental or capital values of some buildings will be compromised by an F- or G-rating even if it they are currently outside the scope of the regulations or temporarily exempt.

Timing

From 1 April 2018, MEES will apply to all new lettings and to the renewal (or extension) of existing leases. From 1 April 2023, MEES will apply to all leased buildings that



have EPCs (or should have an EPC) regardless of when the lease was granted.

Qualifying improvements

A landlord's obligation to make improvements is limited to measures that improve the energy efficiency of the building and are 'permissible', 'appropriate' and 'cost effective'. If works that fall within this definition do not raise the EPC to an E, a letting will be lawful even if the property has an F or G certificate. It is probable that many older properties may still be let even though they are F- or G-rated. Any owner who is claiming an exemption on the grounds that they cannot fulfil the obligations to make improvements must register this claim.

Permissible: The landlord is permitted to do the works and the regulations make clear that this is not always the case. There are three main situations where works are not 'permissible':

- Works that require statutory consents, such as planning permission, and the landlord can prove that, despite using 'reasonable efforts', permission has been refused.
- Consent from a tenant or from a superior landlord is required in order to undertake works and consent, though sought, has not been given.
- Consent from a third party is required and has been given but is subject to conditions with which the landlord cannot 'reasonably' comply; it is as yet unknown exactly what conditions this will encompass.

Appropriate: The government only expects property owners to undertake improvements that make sound financial sense. To protect the value of buildings in extreme cases, a building is exempt if, as a result of works that otherwise qualify, the value of a building would reduce by more than 5%. The government does not expect this exemption to apply very often and, to claim this exemption, it is necessary to have 'before' and 'after' valuations carried out by an appropriately qualified valuer.

To claim this exemption, the valuation must disregard the cost of the works and only take into account any measurable adverse effects such as, for example, a reduction in lettable floor space brought about by the installation of energy efficiency measures.

There are specific provisions for wall insulation which will not qualify if an expert surveyor certifies that its installation would have a negative impact on the fabric or structure of a property.

Cost effective: Works will be exempt if the amount of the projected energy cost saving is less than the cost of the work spread over a fixed period of seven years (including interest calculated at the Bank of England's base rate). This is called the 'seven-year rule'.

Time limits for exemptions

Exemptions are temporary and the grounds for exemption will need to be re-assessed every five years. Exemptions cannot be transferred and, if an exempt building changes

hands, the new owner will need to assess whether the building still qualifies for an exemption and make a new entry on the register. New landlords are given a period of six months in which to comply with the regulations.

For exempt buildings, there is a potentially arduous administrative burden in registering and then maintaining temporary exemptions, which in itself may make sub-standard buildings less attractive in comparison with ones that meet the minimum standard.

Enforcement and penalties

The regulations are to be enforced by local Trading Standards Officers. Landlords must prove, if challenged, that they have complied and, if they are unable to do so, will be given a short time in which to comply or face a penalty. Penalties for unlawfully renting out a property in contravention of the regulations are based on Rateable Values. The penalty will be between £5,000 and £50,000 for contraventions of up to three months, rising to between £10,000 and £150,000 for longer periods.

In addition to the penalties, landlords found to have been in breach of the regulations will be named on a public register.

Claiming exemptions

To claim an exemption, it is necessary to register on an online Exemptions Register which will be available to help local authorities to target enforcement activities. There is a fixed penalty of £5,000 for providing false or misleading information on the Exemptions Register.

2.3 Domestic properties

The regulations for domestic buildings broadly follow the regulations for non-domestic buildings with some important differences.

Scope

Domestic property is within scope if it is legally required to have an EPC and is let on either an assured tenancy, a regulated tenancy or a domestic agricultural tenancy.

Social housing

The minimum standards do not apply in the social housing sector.

Bedsits

There is no obligation to obtain an EPC on letting an individual unit within a property if the unit is not self-contained, such as bedsits or rooms in a house in multiple occupation. These will be outside scope unless the building as a whole already has an EPC because it has been marketed for sale or a letting of the whole during the period since EPCs were introduced. In these circumstances, individual units may not be re-let until the rating of the whole building has been brought up to the minimum standard.

Holiday lets

An EPC is not required for furnished holiday accommodation where the holiday-maker does not pay for energy and holiday lets are, therefore, outside the scope of the regulations.

Timing

From 1 April 2018, the regulations will apply to all new lettings and to the renewal (or extension) of existing leases, as for non-domestic buildings. The deadline for existing tenancies is 1 April 2020.

Cost effectiveness

The test of cost effectiveness is also different for domestic buildings and the 'seven-year rule' does not apply. Instead, works to domestic buildings are exempt if funding is not



available to cover the full cost of purchasing and installing the improvement through:

- a Green Deal plan
- an energy company obligation
- free funding provided by central government, a local authority or a third party.

The principal difference between rules for domestic and non-domestic landlords is that domestic landlords are obliged to seek out and explore grants and funding offers from government, energy suppliers etc. and cost effectiveness is assessed over the entire lifespan of an improvement, rather than a fixed period of seven years.

This is based on a principle of 'no cost to the landlord' as the cost of improvement is either met through government funding or recovered from the electricity bill payer – which is usually the tenant – under a Green Deal. This may be subject to change, however, as the government is considering the removal of the 'no cost' principle and protecting landlords from excessive costs by introducing a cap on the amount that any landlord would need to invest in an individual property.

Enforcement and penalties

The procedure for enforcement is the same as non-domestic properties but the penalties are less. For unlawfully renting out a property in contravention of the regulations, the fine is up to £2,000 for a period of less than three months, rising to £4,000 for longer periods. The fixed penalty for providing false or misleading information on the Exemptions Register is £1,000.

2.4 Summary

The regulations are intended to have a wide scope across the whole investment property sector but recognise that there are some properties that are hard to treat and not cost effective to bring up to standard. Others are prevented from some alterations due to a conflict with recognised heritage features. There is recognition by the government that owners may need some time to adjust; therefore, the regulations are being introduced in a phased way and with a range of temporary exemptions. But there is clear intent and the penalties for non-compliance are significant. It is likely that over time the minimum level of energy efficiency will be raised.



3.0 Property management – impact of MEES on landlords

Principal message

Some 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 strategic plan and work closely with tenants to protect investment value and reduce the danger of assets losing value.

3.1 Introduction

It is likely that the majority of buildings (currently rated C or lower) will ultimately fall to a sub-standard level on re-review. Those at the current D (which is the median rating) or E may fall into the sub-standard category much sooner unless upgrade works are carried out. One of the reasons for this is due software updates since the EPC inception and this has varied the EPC results accordingly.

If and when a building's EPC is renewed after the original has elapsed through time, it is likely that the achieved grade, in the absence of improvements having been carried out, may be reduced due to more stringent standards now required since EPCs were introduced in 2007. If this makes the property non-compliant this will create a management issue and possible loss of income for many landlords who haven't prepared adequately for the legislation. The clear message is that landlords are advised to plan for how they will manage their assets, not just for the impending regulations but beyond. In the immediate term, landlords should consider the position in relation to properties let on short-term leases and all leases where the EPC was issued prior to 2012 when the methodology of assessment became more rigorous and reliable.

Since the announcement in 2011, prudent landlords have been assessing their properties and preparing plans for managing risks to sub-standard properties. However, it is believed that many landlords remain unaware of MEES or at least the implications of it on their assets.

This section sets out advice for property managers to discuss with their investment clients any actions that might be appropriate to protect their assets' value and saleability.

Surveyors acting for tenants should also be aware of the implications of the regulations and are advised to consider carefully the government guidance that have been published.

The following action-planning advice applies to domestic and non-domestic properties. However, property managers should be aware that for mixed-use buildings, it will be necessary to determine under which set of regulations the property is to be considered (domestic or

non-domestic). In the case of domestic property, managers should also be aware of the rights of tenants to request their landlord to undertake energy efficiency works; such requests should not be refused without good reason. The right is contained in the government's private rented sector *Tenants' energy efficiency improvements provisions* available from: <http://bit.ly/22L98LM>

3.2 Action-planning advice

Plan ahead

A failure to plan adequately could result in delay in letting or selling any asset in the portfolio or in aborted negotiations. It could also result in value reduction in the portfolio. MEES planning should also be considered in the case of intended acquisitions.

When discussing the implications of MEES, it is suggested that plans may need to be for:

- immediate action consequent on the initial introduction of MEES
- medium term when the regulations apply to continuing lettings (2020 for domestic and 2023 for non-domestic)
- longer term if the regulations and/or calibrations of EPCs alter potentially bringing more properties into scope.

A failure to plan for MEES over the various time horizons could result in adverse tenant relationships, the necessity to undertake works in an unplanned manner and potentially adverse valuation implications.

Assess the risk

Failure or likely failure to comply with MEES represents a risk to the landlord. It is essential to identify the risks and then mitigate where possible.

The first step will be deciding whether or not an audit of the portfolio is required. This will normally be recommended to establish:

- What properties have EPCs and if they do, the date of grant/expiry especially taking note of those where the EPC will lapse shortly. Close attention should be paid to EPCs that were obtained between 2008 and 2010. Not only are these likely to be less accurate than recently obtained certificates, but in the case of continuing lettings, there is no obligation to obtain a new certificate until a 'trigger' event, such as a re-letting or sale, takes place.
- Whether any properties are exempt, either because of listing or other, temporary factors, for example, where

a tenant or freeholder has refused consent for upgrade works. Where any properties are exempt, it should be ensured that these are listed on the Exemptions Register.

- Any requests from tenants for energy improvements to take place that have not been previously noted and/or actioned.
- The level of the EPC in each case and whether any works have taken place that would result in a likely change on re-assessment; in particular all properties with an E-, F- or G-rating should be noted.
- Details of the current leases to establish the expiry dates and any breaks that could trigger the need for a new letting. It should also establish the landlord's right to carry out work and arrangements for access to carry out work. The lease should also be interrogated to establish whether there is an obligation on the tenant to cooperate with the landlord where works are required. Many leases place tenants under an obligation to either undertake or pay for works required under statute. However, MEES are specific in that compliance is a matter for landlords not tenants.

Short-term strategic decisions

There are many reasons why a landlord might be recommended to obtain voluntary EPCs where there is no requirement so to do or to update existing certificates. This will normally be regarded as part of good estate management practice and should promote beneficial landlord and tenant relationships if upgrade works identified are carried out. It will also demonstrate a responsible attitude towards government policy and environmental aims.

However, in some cases there may be an argument to allow an existing certificate to lapse or a lack of certificate to persist. For example, where the certificate is F or G but the certificate is due to expire prior to the date when the regulations impact on continuing tenancies but the lease expires sometime later, the landlord may wish to delay works until the tenancy expires and then carry out a deep refurbishment. In this case it does not make economic or logistical sense to carry out the required energy efficiency works in isolation to other planned works and to disrupt the tenant's quiet enjoyment.

Such a position is less likely to occur with residential lettings as the full implementation is so close (2020), tenancies are mainly shortholds with a higher tenant turnover and the impact of energy bills may play a more critical role in tenant choice where scarcity of provision is not an issue. In some locations, it is also the case currently with residential properties that the recent higher levels of house building means that E-, F- and G-rated buildings are beginning to fall behind 'normal' expectations more rapidly than for commercial.

The result of the audit may also trigger a discussion about any retain/sell decisions. Whether a landlord will wish to retain and invest will depend on their financial position, their general estates strategy and their position in terms of social and environmental responsibility. For residential property

the possibility of grant funding must also be considered within any strategic discussions.

In summary **it is essential that landlords know what the risks are to their properties** and have assessed these and developed a plan of action that balances the practical with their strategic objectives. In the case of residential portfolios, information of grant availability should also be considered. Surveyors representing building occupiers should also ensure that their clients understand their rights under the legislation and, in the case of residential tenants, their right to ask the landlord for energy efficiency improvements to be undertaken. Where acting for a head lessee who is intending to sublet, their consequent liabilities as landlord under the regulations must be pointed out to the client.

Plan cost-effective improvement works

Once a strategic position regarding the portfolio has been determined, it is important to develop a plan of the works required to make the property compliant, including the gaining of any necessary consents. In preparing the plan, the requirement that all works needed to meet the conditions of the non-domestic regulations should be cost effective in accordance with the guidance given in the regulations. This provides that if value of savings on energy bills (S) is greater or equal to the calculated cost of repayment (R) then the project has met the seven-year payback and will not be exempt.

Figure 1 is reproduced from the current government guidance (<http://bit.ly/2Ag2O6l>).

Measure	Gas Saving ²⁵ (kWh/y)	Savings over 7 years (S)	Capital plus installation cost (C)	Interest Rate Factor (F) (based on 0.5% base rate)	7 year repayment cost (R) (CxFx7)	Meets 7 year Payback
Condensing boiler ('A' rated)	6,609	£1,750	£2,000	0.145729	£2,040	NO
Thermostatic radiator valves	4,213	£980	£600	0.145729	£612	YES
Package of measures (boiler plus TVRs)	10,822	£2,730	£2,600	0.145729	£2,652	YES

Figure 1: Worked example reproduced from *The non-domestic private rented property minimum standard, 2017*

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Note that this is a worked example and the calculation should be done based on actual energy costs and on prevailing interest rates and costs of work. Where the 7-year payback cannot be achieved there is no obligation to undertake the work.

However, from an estates management viewpoint, many landlords may wish to consider combining such work with other types of retrofit or refurbishment that are carried out during the life cycle – such as when a tenant vacates. Consideration of the impact of the works on the EPC rating can be critical, especially when combined with other

refurbishment. Research from The Green Construction Board (*Mapping the impacts of minimum energy efficiency standards for commercial real estate* 2014) has shown that it is often more cost/value effective to carry out schemes of work that upgrade the EPC by two or more grades rather than simply to upgrade to the minimum standard, thus further ‘future-proofing’ the investment.

In the case of domestic properties, the seven-year payback period does not apply and the landlord is under an obligation to investigate the grant position. Under the current regulations, domestic landlords are only under an obligation to make improvements to satisfy MEES if the improvements can be made at ‘no cost to the landlord’ with the costs being met through the ‘pay as you save’ provisions, grant funding or subsidy, as laid out in the government guidance (<http://bit.ly/2yCwYQS>).

However, the government has consulted on proposed changes to the ‘no cost’ provisions to require a landlord to spend up to £2,500 per property to achieve a minimum of a band E, although they estimate that the cost per dwelling to meet this requirement is likely to be significantly lower at an average of £865. In considering strategy for residential property the landlord will, therefore, have to consider the cost effectiveness but should also be aware of the tenant’s right to request improvements. They may also wish to bear in mind the government’s ‘direction of travel’ in terms of the expectation on landlords’ obligation to pay for improvements together with any market value/market rent implications of continuing to hold stock that is below the market average in energy standards.

Finally, when developing an action plan, landlords are advised to consider the longer-term implications for maintenance. In the case of commercial properties or blocks of flats where service charges are imposed on tenants, the potential benefit of holding a building where the service costs of common parts are reduced due to energy savings should be considered.

Collaborate with tenants

Works of upgrade are normally better done ‘in-cycle’. They tend to be more cost effective and they make it easier to integrate energy efficiency work. This can often coincide with when a property is vacant. However, where the property is let on a long lease, or where the tenant wishes to remain in occupation, it is essential to maintain good relationships; carrying out works that will reduce occupational costs may help to achieve this. It also has potential value implications in the longer term for the landlord.

A similar argument exists for domestic property. Where tenants may be on low incomes and reluctant to spend on heating bills, energy efficiency measures that reduce the outlay for tenants can offer them health benefits and, in the case of ‘visible’ improvements, such as double glazing, may enhance capital value and are not disruptive to a tenant in occupation. Other improvements, such as installations of new boilers or central heating systems are more appropriately undertaken in line with other work such as the refitting of kitchens and bathrooms.

In all cases, it is good management practice to discuss proposals well in advance of carrying out works, ensuring compliance with any lease terms.

Tenant-initiated work

Tenants of non-domestic properties who have leases of longer than, say ten years, may wish to undertake improvement work or alterations to the premises. It is advisable that the landlord ensures that the tenant cannot commission an EPC without specific consent as there may be good reason why the landlord would wish any existing EPC to lapse. Further, in approving any tenant’s scheme of works, at fit-out or subsequently, it is important that the intended works will not adversely affect the EPC rating. If necessary the advice of a specialist should be sought before granting works approval.

Similarly, when drafting a new lease at initial letting or renewal it is advisable to put in a requirement that the tenant does not commission an EPC at any time without consent. It is important that the landlord retains control over what is, essentially, a landlord liability.

Special cases

There are two specific sets of cases that warrant special consideration:

- the letting of a commercial building on ‘shell and core’ terms and
- listed/heritage buildings.

Shell and core

It is fairly common practice to effect commercial lettings on longer leases on a ‘shell and core’ basis in which the services such as heating, air conditioning and ventilation are installed by the tenant to a prescribed building regulation standard.

The guidance to landlords issued by the government is silent in terms of requirements and liabilities. However, in most cases a tenant will be taking a lease of a fully finished building so the responsibility lies with the landlord. In shell and core lettings the fit-out is the tenant’s responsibility and it would be sensible to prescribe compliance not just to building regulation (which should in any event ensure compliance on energy standards) but to require a minimum EPC standard such that the building is future-proofed against possible changes to the regulations. It may also be advisable to place responsibility on the tenant that the EPC is maintained at this level or better.

Listed buildings

Listed buildings are not automatically exempt from both the need for an EPC and from MEES, although there is a common misunderstanding that this is the case. Listed properties, and buildings within a conservation area, will not necessarily be exempt from the requirement to have a valid EPC. It is the responsibility of the owner of a listed building or a building in a conservation area to check whether or not their property is required to have an EPC. This applies equally to domestic and non-domestic

buildings. If an EPC is required then the building is 'within scope' for MEES.

However, if the works needed to achieve compliance would 'unacceptably alter the character' of the building or would require listed building consent (and such consent if not forthcoming) there is no liability. For example, if the building is listed because of its windows featuring medieval stained glass, it would be entirely inappropriate to require upgrades to the fenestration. Similarly, a landlord would not be required to install solid wall insulation where such works would negatively impact the fabric or structure of the building.

3.3 Summary

Where an investment property under management, domestic or non-domestic, is currently either non-compliant for MEES or in the 'at risk' level, it is often the case that works to upgrade are both advantageous in terms of:

- future economic returns
- tenant satisfaction, health and well-being and
- landlord and tenant relationships.

However, such works should be carefully planned and often combined with other improvements and undertaken 'in-cycle'. It may also be cost effective to upgrade beyond minimum compliance. In the case of domestic properties, the 'no-cost to the landlord' principle is enshrined in the current regulations, due to the presence of funding deals and subsidies. However, owners and managers should be aware that this may change in the future. Finally, in planning compliance work it is essential that the manager or adviser is fully aware of any exemptions, temporary or permanent and that, wherever possible, the landlord works closely with tenants in occupation.



4.0 Property valuation – impact of MEES on owners and lenders

Principal message

Awareness of the impact of energy efficiency levels on buildings on the behaviours of some market participants is growing and valuers should, therefore, reflect where this is the case. The introduction of MEES regulations presents cases where a value implication is most likely. Even if there is no clear evidence of market value change, valuers' due diligence, under the RICS Red Book, extends to accounting for any risks posed by MEES. Properties in prime locations are less likely to be affected negatively in value terms by MEES, but all properties of poor specification and energy efficiency, which are expensive to upgrade, may reduce in value.

4.1 Introduction

This section looks at the potential impact on market value, market rent and investment value, as defined in the Red Book, of the MEES provisions.

All valuations are to be carried out in accordance with the provisions of the *RICS Valuation – Global Standards 2017* (the Red Book).

4.2 Due diligence

Consideration of the impact of MEES should form part of the due diligence process in terms of inspection and analysis of evidence and of reporting (Red Book VPS 2.3.3 and VPGA 8.2.6). Within the introduction of MEES, EPCs are now, more than before, a potential source of risk, so certificates must be obtained where available and considered carefully before the valuation figure is prepared. At this juncture it is critical that the valuer does not:

- Stray outside their area of competence, give advice or make assumptions that then prejudice their own professional indemnity insurance. This is particularly the case when a value may, in part, be based on estimates of costings to bring a building into MEES compliance.
- The valuer may identify where risk exists, but must recognise their limitations and only incorporate likely capital expenditure charges, having obtained them from a reliable source and discussed them with the client; the report must refer to the source of the figures.

If the property asset is being traded, then the valuer must request the EPCs; failing that, they should consult the EPC Registers. It is possible that, if the property is not being traded, for instance, because it is being refinanced, or existing lettings pre-date the 2008 legislation, EPCs may

not be available, although these situations are becoming less common. However, it is possible that a property had an EPC and that this is 'life expired'. The valuer should establish if this is the case: if it is, there is no obligation to gain a new EPC until a trigger event (re-letting or sale) takes place. This can be critical in establishing whether or not an existing tenancy will come into scope on the effective date (2020 for domestic; 2023 for non-domestic).

Some properties are exempt from MEES, permanently or on a temporary basis (see section 2). In order to establish whether or not the subject property is exempt, it will be an expectation that a valuer should consult the Exemptions Register noting whether it carries a permanent or a temporary exemption and if the latter, the date at which the exemption will terminate.

Given the potential impact on value of non-compliance with MEES on an investment property, failure to fully investigate the position regarding the liability to have a valid EPC and the MEES regulations could be deemed to be negligent in respect of the process of due diligence.

Where it is likely that money would have to be expended to bring the property up to standard, the valuer may very well not have the competence to assess the likely costs, and hence the impact of cost on value. In such cases, **valuers are reminded that they must only operate within their skills and competence** and should advise the client that costings advice will be required. This is the most likely scenario when considering large, commercial buildings. Within the residential market, however, there may be occasions when the most likely purchaser would base their offer price, not on a fully valued scheme of work, but on a 'guesstimate' of refurbishment costs. In this case, the valuer may consider that their competence extends to valuing the building on the presumption of undefined works of improvement.

4.3 Bases of valuation for which MEES should be considered

MEES is only an issue in valuation where the property to be valued is:

- let or in prospect of letting and/or
- of a type that when traded would likely be purchased by an investor or possibly an owner-occupier who, for reasons such as environmental awareness, would not wish to purchase any property deemed to be 'sub-standard' in energy efficiency terms.

In the majority of cases, the valuer is required to calculate market value as defined in the RICS Red Book. Market value is an estimate of exchange price and may be

determined by whatever method the value considers appropriate (Red Book VPS 5).

As defined in the Red Book:

‘Market value – The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.’

‘Investment value – The value of an asset to the owner or a prospective owner for individual investment or operational objectives ... [May also be known as worth.]’

The valuer needs to determine how MEES affect the value of the individual properties and reflect that in the market valuation or investment value, remembering that MEES only directly affects properties that are let or are to be let.

Market value is an estimate of price in the market and not a subjective opinion of the worth of the property to the owner (or potential purchaser). For income producing properties, the market value is normally found by capitalising the existing and future likely rental income using a yield obtained by analysis of recent transactions of similar properties.

Therefore, in analysis of transactions, it will be critical to know the EPC rating of the comparables as well as that of the subject property and whether comparable properties are in scope for MEES.

When considering capital value for an individual investor (worth), the computation will reflect the likely cash flow that the property will produce and the possibility of that cash flow stopping. If, after fully investigating the regulatory position, the valuer concludes that there will be a disruption to the income flow and a requirement for capital injection, they will either discount the income expected to be received over the proposed holding period back to today using an appropriate raised risk-adjusted discount rate (the investors required rate of return) or build any anticipated void and estimated costs of compliance explicitly into the cash flow. In this latter case an adjustment to the required return may not be required.

As previously noted, it is expected that some F- and G-rated buildings will be either permanently or temporarily exempt from the regulations and can still be let without penalty. A valuer would need to consider the impact on the rental and capital value in that situation.

In the case of a valuer acting at the time of a sale, it should be noted that there is no prohibition as to the sale of a property that is in scope and has an F- or G-rating, regardless of whether the property is vacant or let. Further, the purchaser will have a short period in which to bring the property to the minimum standard. However, it is likely that if the sale is to an investor, the purchaser will consider the impact of MEES. Even where it is likely that the ‘willing buyer’ (as determined by the market value definition in the Red Book) would be an owner-occupier, if they have knowledge of MEES and the property has an F- or G-rating this could affect their perceptions and the amount they would be prepared to offer.



	The property is ...	Possible impact on value
1	Compliant and likely to remain so	It is unlikely that MEES will have any impact on value but for any revaluation monitor to assess the impact of potential future changes in regulations.
2	Non-compliant but costs to achieve compliance are very low	Investigate whether non-compliance is a result of an early/unreliable EPC rating. If works are minimal and could be undertaken without disruption to occupation, make cost deduction or consider slight yield adjustment as the property is likely to remain at risk of subsequent changes in MEES.
3a	Domestic and non-compliant but upgrade costs to comply are deemed to be capable of being met within the Green Deal or other third-party funded scheme	Despite the 'no cost to the landlord' principle in the current regulations, there is likely to be an adverse effect on value, even if the investor can fund the works through a grant or other incentive scheme. The amount of reduction in value will depend on the local market and whether other comparable but MEES-compliant stock is available to buy or rent. Further, there is a risk that the 'no cost' principle will be changed.
3b	Non-domestic and non-compliant but upgrade costs to comply are deemed to meet 'test of reasonableness'	There is a probable negative impact on both market and investment value; this could be substantial depending on the costs and location. The valuer should consider not just the cost of the work, for which specialist advice should be sought, but potential loss of income during the works. They should consider any possibility of an extended void period.
4	Non-compliant and will likely remain so even after all 'allowable works' completed	The valuer should fully investigate whether the property cannot be brought into compliance and should check the Exemptions Register. The valuer should also consider whether meeting the test of reasonableness is likely to change at the end of a temporary exemption period. If the property cannot now comply, it may continue to be let but the valuer should bear in mind that it could be unattractive to both tenants and investors alike and this could result in lower rental values and higher yields. The valuer should investigate whether the property might be attractive to an owner-occupier and whether redevelopment or 'deep' refurbishment provides a higher market value.
5	Incapable of being brought into compliance due to nature of the construction and will remain continuously exempt because no works would qualify	These are so-called 'hard to treat' properties. Where they are situated in areas of comparatively low rental values and high yields and they are typical of local stock, the impact on value may be small, but it is important that the valuer establishes that the exemption will continue. However, some properties, notably residential, may be highly desirable for owner-occupation despite being sub-standard in energy terms. The valuer should consider this but may also consider whether redevelopment would be a realistic prospect.
6	Subject to temporary exemption either because the landlord could not obtain consent (from the tenant or a third party or through planning) or because the landlord has only recently purchased and has a short-term period to bring the property up to standard	In these cases, it is likely that compliance will be required in future; in the case of the recent purchase it is within 6 months. In such cases the valuer is advised to assume that the compliance will be required and value accordingly, building in for costs and possible voids or/and yield adjustments.

Table 1: Possible impact of MEES on value

	The property is ...	Possible impact on value
7	A heritage or listed building and the works required for compliance would be incompatible with the nature of the listing or heritage features	The valuer should satisfy themselves that the property will continue to remain exempt and value on the assumption that it can continue to be let. Whether it will show value decline will depend on the likely continued attraction in the market. Many such properties will have few comparables and may occupy desirable locations. In such cases, they may continue to command a 'rarity' premium. This is particularly the case for domestic properties where a buoyant owner-occupation appeal underpins values.
8	Does not have/require an EPC	Many properties have no EPC either as no 'trigger' event has occurred or an EPC has expired through effluxion of time. The valuer may be asked to value for any number of purposes unconnected with a 'trigger' [e.g. secured lending or accounts]. In such cases, the valuer is advised to discuss with their client the nature of any assumption regarding the potential EPC level, should one be obtained. The valuation should contain a caveat in relation to whether or not compliance would be achieved when/if an EPC were to be obtained. They are not qualified to make a judgement in relation to the level that would be achievable but their valuation should reflect the likely risks moving forward. See suggested wording later in section 4.
9	Likely to attract grants or subsidies which would reduce the costs of compliance	Currently this is the case for some domestic properties but not non-domestic. Where they are available, valuers should consider whether the presence of such grants or subsidies would impact on the value obtainable. They should also be aware that sometimes grants and subsidies can be withdrawn or changed at short notice.

Table 1 continued: Possible impact of MEES on value



4.4 Impact of MEES on value

MEES regulations are a risk that may impact on value where the subject property is either below the minimum standard or likely to become so. As with any increased risk, this may have a negative effect on market or investment value. Alternatively, if the risk can be quantified, the market value should reflect the cost of the works required to make the property compliant, including an allowance for any void period, but only insofar that a well-informed purchaser would so account for these specific costs.

Increased risk can be reflected in a valuation in different ways. If the valuer is using conventional growth implicit models (i.e. models that look at rents in today's terms), it may result in a higher capitalisation rate, a deduction of an estimate of both the cost of works required (using costs supplied by a specialist consultant if appropriate) and any void period before the property can be re-let. Depending on the specific property, any or all of these adjustments may be used.

In growth explicit models (i.e. discounted cash flow), the same adjustments may be reflected in the projected cash flow. The degree of change in all the above will vary according to the submarket and, over time, market comparables will help support the level of adjustments required, albeit it will remain difficult to separate out impact of energy from other value drivers.

MEES may also impact on the rents themselves. Although there is currently limited evidence of rental adjustments specifically related to EPC ratings, the prospect that the property they are occupying or intending to occupy may be deemed an 'unlawful letting' requiring works of updating by the phased-in date is likely to adversely affect a property's attractiveness in the letting market. That said, it will be a transitional market and comparable evidence will adjust in line with the market. In time, as buildings are brought up to standard even those with a D or E rating may be regarded by prospective tenants as less desirable.

Note that a number of large-scale hedonic analyses have been conducted that suggest that the EPC rating could be connected to levels of rents in some submarkets; this is not necessarily the case and the valuer should undertake their own investigation as to any impact of energy ratings in the light of local evidence; they should not rely on the findings of macro-level studies.

There has been much discussion about the impact of sustainability on market values but many believe that a 'brown discount' is stronger than a 'green premium'. Properties that are perceived to be more at risk by not being sustainable are valued at a discount relative to a more sustainable property. This is particularly the case where the most likely tenant and landlord are organizations with highly developed corporate responsibility policies.

The valuer should take into account that the risk to the projected income flow does not only apply to non-compliant properties (F or G ratings) as a just-compliant EPC may represent an investment risk in the long term, particularly if the calibration of EPCs changes or the regulations are tightened.

From a valuation perspective, the valuer will need to know how MEES impacts on the subject property. In each case, the valuer will need to consider the possibility of a temporary exemption.

Essentially the value of all properties is a market supply/demand issue and the impact of MEES will vary according to the submarket in question. As a general rule, the more efficient and transparent a submarket, in terms of market knowledge and awareness, the more likely that a valuer will find that comparable sales from which to draw evidence have priced in the potential impacts of MEES.

Another risk to value is not loss of income through not being able to let – it is through incurring large sums on improvements and not getting a payback. This is possible as, although the works may render the property cheaper to run due to energy cost savings and more comfortable to occupy, there may not be evidence of rental value increase. Where the works are undertaken with no tenant in situ, these are often part of a refurbishment programme and a subsequent letting may be at an enhanced rent. However, in the event that they are undertaken during the continuation of a tenancy in response to the regulations, the landlord will have to wait until rent review or lease renewal to gain any increase and then only if the evidence and terms of the lease would support this.

In some cases, there will be an obligation to carry out works but the building will still be below MEES. In these cases, although the property may still be able to be let, it is likely to be regarded as risky by the market. However, if within a particular submarket, the majority of the stock is of similarly low energy efficiency the value impact may be less.

MEES apply to both domestic and non-domestic property values but with domestic property the existence of grants may lessen the net cost of making the property compliant. At the time of writing, the government are reviewing the regulations that apply to the domestic sector and costs of compliance to the landlord could potentially rise.

As the MEES regulations relate to the (possibility of) restrictive letting of properties, where the market is dominated by owner-occupiers, MEES is less likely to have a significant negative effect on values.

In prime locations it is likely that the majority of stock will be compliant, or if they are not, they will be capable of being brought up to standard economically. However, there may be some buildings which, due to their specification, are 'hard to treat' and expensive to bring up to standard. This is most likely with city centre office stock and lower-grade residential properties where there is a strong letting market.

4.5 Impact of MEES on lending

Lenders are interested not just in property values but in the risks associated with the loans they make. This is a separate matter to the assessment of risk that will be built into a market valuation by the valuer. However, banks are increasingly instructing valuers to provide comments on the valuations they commission. The lender may wish to be advised not only as to the market value today but also of

the risks that will impact value over the lifetime of the loan. Currently banks are not normally asking specifically about energy efficiency and MEES. However, going forward, it is likely that MEES will be a risk that lenders will wish to evaluate in formulating their lending policies; they may then adjust their mortgage offer based on their perceived risks. If finance for the purchase of sub-standard properties becomes more difficult or more expensive to obtain, this could negatively impact on the value.

4.6 Further valuation considerations

Exemptions

Valuers should be aware of whether or not the property is subject to an exemption, either temporary or permanent.

Seven-year payback analysis

When considering exemptions, one of the criteria is to ensure that the cost of undertaking the work is viable. This is established via a payback analysis.

In simple terms, if the value of savings on energy bills (S) is greater or equal to the calculated cost of repayment (R) then the project has met the seven-year payback and will not be exempt.

If energy costs change then this may impact the outcome of the seven-year rule and the decision on exemption.

Unlawful lettings

Owners of properties with an EPC rating of F or G cannot initiate a new letting from 1 April 2018 or allow a continuing letting from (2020 for domestic and 2023 for non-domestic). However, it is possible that, as part of their due diligence process, the valuer may discover that the landlord has been in breach. In this case, the valuer is advised to discuss the matter with the commissioning client.

The fines for non-compliance are high and a property that is subject to an unlawful letting will, almost certainly, be value impaired as the valuation should reflect the reality. To make an assumption that the letting is lawful when it is not would constitute a special assumption (Red Book VPS 4 section 9) and is not recommended.

4.7 Reporting

All valuations of let properties assume cash flows continue for the duration of the existing lease and, normally, for a new (hypothetical or real) lease thereafter. This insight paper highlights that the introduction of MEES adds a level of complexity in terms of assessing the likelihood of the income continuing in the cases where either the property is known to be non-compliant as a consequence of its current EPC rating or is thought to be at risk of non-compliance, for example, where no EPCs exist but where the next 'trigger' event will result in non-compliance. Depending on the scenario, there may well be a negative impact on either/both rental and capital value.



In reporting to the client, care must be taken to ensure that the valuer is explicit in identifying the risks that the valuer perceives and how the value has been impacted. To assist the valuer it is prudent to incorporate explanatory text about the regulations within valuation advice. The illustrative wording below is intended to provide clarification to the clients of valuations.

4.8 Valuation approach, method and model

The introduction of MEES does not require any new approach to valuation and there is no reason why valuers should not continue to use the bases and methods that are currently appropriate to the instruction. The choice will depend on: the purpose of the valuation; the nature of the property and the market in which it is situated, geographically and in terms of value cycles. This applies equally to domestic and non-domestic properties.

However, there are a number of considerations that the valuer is advised to take into account. MEES may have an impact on the perceived risk attached to that property. This may lower the price.

- In residential markets where let properties are in direct competition with owner-occupation, the impact will not materialise financially as the value will be determined by direct capital comparison of previous (mainly owner-occupied) sales. The impact may be that fewer properties will be sold for investment and some currently let properties may revert to owner-occupation.
- For commercial investment properties, the likely valuation method will be the investment method and the choice of model (as a single asset) is likely to be an implicit capitalisation model, with yield adjustment to incorporate any risks in relation to MEES. Where it is identified that the property is/may become non-compliant, the valuer should consider whether and how any void periods are included and the level of

Suggested wording for the scenarios illustrating the potential impact on value

There is no current EPC

We understand that there is no current EPC rating for this property and have checked the Private Rented Sector (PRS) Exemptions Register to verify this information. Accordingly, our valuation is based on the assumption that the subject property[ies] will meet the Minimum Energy Efficiency Standards specified in the extant regulations made under the *Energy Act 2011* and that there will be no adverse impact on value and marketability. It is advisable to obtain an expert's opinion to advise whether (an) EPC[s] should be commissioned and if the building[s] is[are] likely to meet with the legislative requirements.

EPC is above the minimum required standard

The existing EPC certificate[s] that has[have] been provided indicates that the subject property[ies] falls within the acceptable energy performance range for the purposes of the regulations under the *Energy Act 2011*. Although the legislation is not expected to be reviewed again until 2020, the method of assessment may have changed since the EPC certificate was issued; further that on renewal of the EPC the rating may change. We have assessed the considered risks to value moving forward in the light of the current EPC rating and any risks relating to a future re-rating of the asset. It is therefore advisable to obtain an expert's opinion on whether the building would still comply with the minimum standard if the building[s] were re-certified under the current methodology.

EPC is below the minimum required standard

The existing EPC certificate[s] that has[have] been provided indicates that this property does not/may not meet the Minimum Energy Efficiency Standards for the purposes of the regulations under the *Energy Act 2011*. Unless the property qualifies as exempt, capital expenditure may be required in order to upgrade the property[ies] to an acceptable EPC rating standard. Failure to do this may result in a new letting of this property being unlawful and from 2020/2023 any continuing letting similarly being unlawful. Our valuation recognises that the property[ies] is[are] not exempt and reflects the fact that a strategy of improvement will be required in order to bring the property[ies] up to the required Minimum Energy Efficiency Standards. In arriving at our valuation, we have considered the associated impacts on marketability and value but we have not costed the likely works required to bring the property into compliance; however, we have taken a view as to the likely market view in relation to need to carry out work. Therefore, it is advisable that an expert's opinion is obtained to (further) investigate costs and that the valuation is reviewed in the light of the opinion received.

The property holds an exemption from the MEES regulations

The existing EPC certificate[s] shows that the subject property does not meet with the required Minimum Energy Efficiency Standards under the regulations of the *Energy Act 2011*. However, we have been informed and have verified that the property currently holds a temporary/continuing exemption from the provisions. In assessing the impact of the regulations on the value of the property, we have taken into account the exemption status of the asset. However, note that the regulations regarding exemption may change in the future and it is advisable that an expert's opinion is obtained to the likely costs that would result if/when exemption ceases and that the valuation is reviewed in the light of the opinion received.

works required, noting the requirement at all times not to go beyond their areas of competence. The valuer is not a cost consultant and should, if possible, take a view as to the likely market response to the property and the availability of grants (if any). In many cases it is anticipated that the costs of bringing the property to a compliant standard will be small. In such cases, a reversionary valuation model (layer or term and reversion) could be used with an increase in the equivalent yield or just on the yield used on (riskier) reversion. Such adjustments should be based on comparable evidence.

- If the property is reversionary, the preferred model will be to value as if the property can be relet at reversion and deduct the (estimated) cost of retrofitting to conform with an E (or above) rating together with an allowance for a void period. Alternatively, the property may have a rating above E but it is possible that the market will still consider that the risk has increased with the introduction of MEES. In such a case, a reversionary valuation model (layer or term and reversion) could be used with an increase in the equivalent yield or just on the yield used on (riskier) reversion. Such adjustments should be based on comparable evidence.
- In some cases, it is likely that the cost of compliance will be high. The valuer will need to consider whether this falls within the 'seven-year rule' but to do so will normally require the advice of a cost and/or energy consultant. Further, whether or not it falls within the rule, the quantum of works required might trigger either a significant retrofit or a redevelopment. In such cases the valuer is advised to consult the client with a view to obtaining cost consultancy advice.

It is likely that the properties that might give rise to the most difficult value judgements are those for which the costs of compliance lie at the cusp of whether or not the works would meet the payback analysis. As previously noted, the valuer should not stray outside their area of competence and advice should be sought from a qualified professional to estimate the cost of retrofit or redevelopment.

In conclusion, MEES may, in many cases, have no direct value implication. This is the case where the subject property and those within the same submarket are either likely to transact for owner-occupation or where the majority are compliant. The issues as to value are most likely where the predominant market is investment, many properties in the locality are non-compliant and the likely costs involved render some difficult to upgrade within the requirements of the payback analysis.

The key message is that valuers should:

- be aware of and knowledgeable about the regulations
- understand the key exemptions
- consult with the client and other cost consultants if necessary and
- be able to take a considered view as to the risks that MEES present to the asset moving forward.



5.0 Glossary of terms

Term	Definition	Notes
Energy Performance Certificate (EPC)	<p>A certificate (and associated report) that sets out the energy efficiency rating of a property and contains recommendations for ways in which the efficiency of the property could be improved.</p> <p>Source: Department of Business, Energy and Industrial Strategy</p>	EPCs are needed whenever a property is built, sold or rented.
Energy Performance in Buildings Directive (EPBD)	<p>The <i>Energy Performance of Buildings Directive</i> is an EU measure designed to tackle climate change by reducing the amount of carbon produced by buildings. The requirements of the Directive were implemented on a phased basis by the <i>Energy Performance of Buildings (Certificates and Inspections) (England and Wales) Regulations 2007</i> as updated.</p> <p>Source: Ministry of Housing, Communities and Local Government</p>	Its objective is to improve energy efficiency and reduce carbon emissions as part of the government's strategy to achieve a sustainable environment and meet climate change targets agreed under the Kyoto Protocol.
Green Deal	<p>The Green Deal was a government initiative that was designed to help business and home owners to employ more green technologies in their properties.</p> <p>Source: Department of Energy and Climate Change</p>	The scheme was introduced for domestic properties but subsequently scrapped with the scheme being sold into the private sector as the Green Deal Finance Company (GDFC). This is a consumer credit company focused on setting up, financing and administering Green Deal loans, which provide customers with accessible financing to improve their homes by installing energy efficiency products. It was never introduced in the non-domestic sector. References to the Green Deal in the regulations are explained in the guidance to landlords [http://bit.ly/2yCwYQS].
Listed building	<p>A building that has been placed on the Statutory List of Buildings of Special Architectural or Historic Interest. A listed building may not be demolished, extended, or altered without special permission from the local planning authority.</p> <p>Source: Department of Business, Energy and Industrial Strategy</p>	Listed buildings are not automatically exempt from MEES.

Term	Definition	Notes
Minimum Energy Efficiency Standards (MEES)	MEES, previously known as Minimum Energy Performance Standards (MEPS), are the prescribed energy efficiency standards with reference to a building's EPC that will make it lawful for a landlord to let their building from April 2018. MEES are being introduced by virtue of the <i>Energy Act 2011</i> . The standards are therefore the collective term given to regulations in England and Wales relating to the government's package of energy efficiency policies. Source: RICS	These requirements will apply to all private rented properties in England and Wales – even where there has been no change in tenancy arrangements – from 1 April 2020 for domestic properties and from 1 April 2023 for non-domestic properties.
Minimum level of energy efficiency	The prescribed minimum EPC band (band E) allowed under the regulations for non-domestic private rented property that is let (including renewal) from 1 April 2018 or that continues to be let from 1 April 2023, subject to any qualifying exemptions. Source: Department of Business, Energy and Industrial Strategy	The intention is that landlords will undertake requisite works (subject to exemptions) to improve individual properties and make them more energy efficient. Ultimately, this will improve all the UK building stock.
Non-domestic private rented property	Any privately rented property that is not a dwelling, meaning a building or part of a building occupied or intended to be occupied as a separate dwelling. A property may be a whole building, or may be a unit within a building. (The meaning of non-domestic private rented property is set by regulation 20(1), as defined by section 42(1)(b) of the <i>Energy Act 2011</i>). Source: Department of Business, Energy and Industrial Strategy	It includes government-owned buildings, except affordable housing units but not stock belonging to Registered Housing Providers, also known as Registered Social Landlords.
Private Rented Sector (PRS) Exemptions Register	A register on which landlords of sub-standard property may register certain information relating to the property (including grounds for exemption from compliance with the regulations). Source: Department of Business, Energy and Industrial Strategy	The register is open to domestic and non-domestic landlords.
Standard Assessment Procedure (SAP)	SAP is the methodology used by the government to assess and compare the energy and environmental performance of dwellings. Its purpose is to provide accurate and reliable assessments of dwelling energy performances that are needed to underpin energy and environmental policy initiatives. Source: Department of Business, Energy and Industrial Strategy	SAP was developed by the Building Research Establishment (BRE) in 1992, as a tool to help deliver its energy efficiency policies. The SAP method is based on the BRE Domestic Energy Model (BREDEM), which provides a framework for calculating the energy consumption of buildings.

Term	Definition	Notes
Standard Building Assessment Method (SBEM)	SBEM is a calculation method used to define the CO ₂ emissions of the designed building and compare this to the target standard. Source: Building Research Establishment (BRE)	It is an effective and relatively swift energy modelling tool to use and incorporates a wide range of building energy features.
Non-compliant or sub-standard building	A privately rented property with an EPC rating of F or G. Source: Department of Business, Energy and Industrial Strategy	Note that the government may change the level at which compliance is achieved in the future.



Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the valuation, development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to markets and effecting positive change in the built and natural environments.

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