

Legal Business Solutions Academy

ESG in Real Estate

Thursday 30 November 2023



An ESG focus on Real Estate



The session will look at the EPC and MEES Regulations, retrofitting property and what future 'green leases' might look like.

PwC's Legal Real Estate team



Our team advises clients on all aspects of the lifecycle of property from pre-acquisition, finance, planning, development, asset management and disposal. We advise a wide range of clients spanning from large institutional investors to private clients and private businesses to public bodies. We have a particular focus on establishing a UK real estate presence for foreign companies and investors as well as restructuring.



Suzanne Nethaway

Real Estate Team Lead

suzanne.nethaway@pwc.com



Jennifer Douglas

Senior Manager

jennifer.x.douglas@pwc.com

Agenda

- | | |
|----|--|
| 01 | EPC and MEES Regulations |
| 02 | Market Impact |
| 03 | Retrofitting / Fit-out Considerations |
| 04 | Green Leases |
| 05 | Questions |



1

EPC and MEES Regulations



What is an EPC?

An EPC is an Energy Performance certificate.



▶ They last for 10 years.

▶ The intention was to advise purchasers or tenants of properties how energy efficient a building/ part of a building is and how much it probably costs to heat and light the premises in its current state. It also estimates how much £££ could be saved by upgrading the energy efficiency.

▶ Grades are A – G, with A being the “gold standard”.

▶ Historically most owners/landlords aimed for a minimum E.

Legislation

The Energy Performance of Buildings (Certificates and Inspections) (England and Wales)(Amendment No. 2) Regulations 2008

This imposes 3 obligations upon landlords of commercial property:

01

Commission an EPC before marketing a property.

02

Put the EPC rating on any advertisement to sell or let the property, and

03

Make a valid EPC available to prospective buyers or tenants.



Exemptions

Some properties are exempt from having to have an EPC.



These include:

Places of worship.

Listed buildings.

Stand alone buildings less than 50m² (e.g. garden sheds).

Agricultural buildings not using lots of energy (e.g. cow sheds).

Temporary buildings used for less than 2 years (e.g. “festival” venues, Santa’s Grotto etc!); and

Residential buildings not intended to be let for less than 4 months per year.

When might an EPC not be required

The EPC Regulations do not require an EPC to be provided in various situations, such as:

01

**Renewal leases
to the same tenant**

02

**Lease
extensions**

03

**“Not for value”
transactions**

What are the MEES Regulations?



From 1 April 2023, the Energy Efficiency (Private Rented Property)(England and Wales) Regulations 2015 (known as the 'MEES Regulations') require all landlords of commercial properties who are **continuing to let** or **intending to sell** those properties to have an EPC rating of at least an **E**, unless an exemption applies.

The required rating will continue to increase in the coming years as follows:

By 1 April 2027 – Rating of C or higher

By 1 April 2030 – Rating of B or higher



MEES Exemptions

Various exemptions apply. The most notable are:

1

Tenancies granted with a term of more than 99 years.

2

Where the cost of improvement measures exceeds the savings made over a 7 year period.

3

The improvement works would devalue the property by more than 5%.

4

All improvement works possible have been carried out.

5

The landlord has attempted to make improvements, but the tenant refuses entry.

Note:

Exemptions must be registered on the PRS Register and most only last for 5 years. A new application would then have to be made. The benefit of the exemption does not run with the land, so a new buyer would have to register an exemption itself.



Consequences of non-compliance

Local Authority is the enforcing body and the penalties can be:

For breaches lasting less than 3 months – a fine which is the higher of £5,000 or 10% of the property's rateable value up to £50,000.



For breaches exceeding 3 months – a fine which is the higher of £10,000 or 20% of the property's rateable value up to £150,000.



QUIZ Time



Question 1

Floor 5 of a central London office building is let to Tenant Investments Limited on a 5 year lease from October 2022. An EPC was obtained in October 2022 with a rating of F. Will the Landlord be required to comply with the MEES Regulations?

QUIZ Time



Question 1

Floor 5 of a central London office building is let to Tenant Investments Limited on a 5 year lease from October 2022. An EPC was obtained in October 2022 with a rating of F. Will the Landlord be required to comply with the MEES Regulations?



Yes

QUIZ Time



Question 2

A hotel in Cornwall is let to Accommodation Limited on a 999 year lease from January 2020. An EPC with a rating of E was obtained when the lease was entered into. Will the Landlord be required to comply with the MEES Regulations?

QUIZ Time



Question 2

A hotel in Cornwall is let to Accommodation Limited on a 999 year lease from January 2020. An EPC with a rating of E was obtained when the lease was entered into. Will the Landlord be required to comply with the MEES Regulations?



No

QUIZ Time



Question 3

A church rents out the accompanying church hall to a community nursery for 3 mornings a week, on a short term lease. Will the Landlord be required to comply with the MEES Regulations?

QUIZ Time



Question 3

A church rents out the accompanying church hall to a community nursery for 3 mornings a week, on a short term lease. Will the Landlord be required to comply with the MEES Regulations?



Not in relation to the church itself but yes in relation to the church hall (assuming the two areas are separate enough to be deemed separate properties for the purposes of the legislation). The Church is an exempt property but the nursery is not an exempt use.

QUIZ Time



Question 4

A retail unit is let to Fashion Limited on a 10 year lease from January 2015. A new EPC with a rating of G was obtained in November 2020. The landlord plans to undertake remedial works to the property and needs access to the unit. It has verbally asked Fashion Limited twice for access, but Fashion Limited has refused. Would the landlord be able to rely on an exemption?

QUIZ Time



Question 4

A retail unit is let to Fashion Limited on a 10 year lease from January 2015. A new EPC with a rating of G was obtained in November 2020. The landlord plans to undertake remedial works to the property and needs access to the unit. It has verbally asked Fashion Limited twice for access, but Fashion Limited has refused. Would the landlord be able to rely on an exemption?

May be

Depends on the terms of the lease and the actions of the parties. The landlord needs to provide evidence of its attempts when registering an exemption and that might not be sufficient.

2

Market Impact

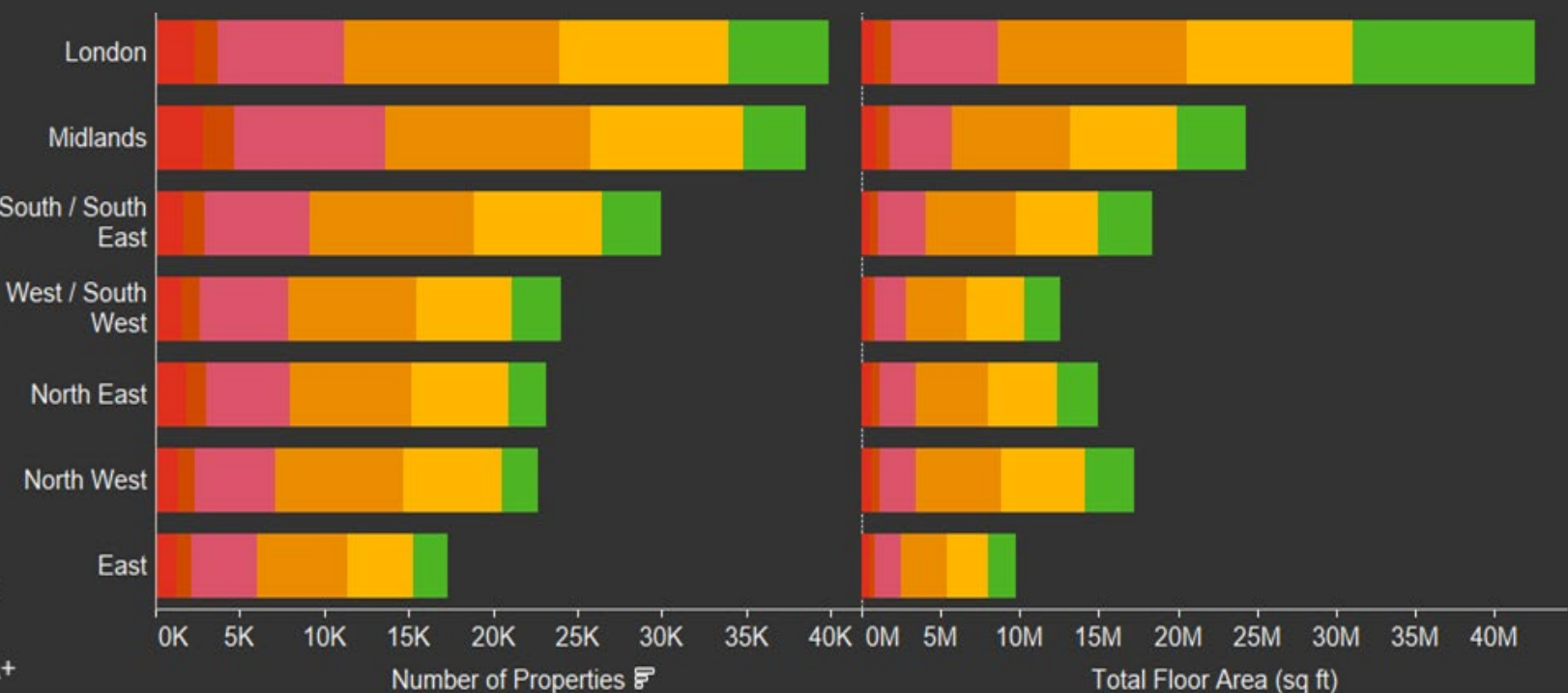
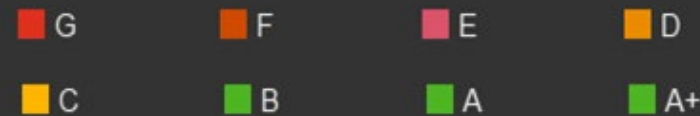


Energy Performance Certificates & Minimum Energy Efficiency Standards

The regulatory landscape

Office EPC Rating by UK Region

Asset Band Rating



The market impact

Market commentary

- The landscape of the 'green premium' and 'brown discount'.
- Levelling up in the regions - stranded assets.
- Political landscape.
- Important to be alive to EPC and MEES in transactional work.



Looking to the future

- Future proposals for the minimum standards to be increased to band 'C' by 1 April 2027 and band 'B' by 1 April 2030.
- Property Owners (both landlord and tenant side) need to be prepared now.



Lending

- Lending - EPC rating has become a lot more important because of MEES regulations.
- New Builds - we are seeing bank only lending on properties with a EPC rating of B or above.
- Lenders are now having to audit existing loan book.



3

Retrofitting / Fit-out Considerations



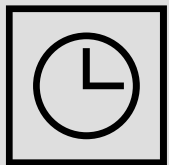
Break Out Session

Scenario:

There is a large 9 storey central London office, in Westminster, that could do with some work to bring it up to EPC Grade B by 2030 (it currently has a Grade E EPC). The property is owned by an institutional landlord and rented to a large management consultancy and audit practice.

We are going to split you into two groups: Group A, led by Jennifer, will consider the Landlord's perspective and Group B, led by Suzy, will consider the Tenant's perspective.

Please have a think about what your respective parties may want to consider if they are the ones pushing for the alterations to take place.



You have
8 minutes

Improvement works - considerations for landlords

- Tenant's quiet enjoyment covenant.
- Temporary rent reduction?
- Access Licence.
- Recoverable via service charge?
- Insurance.
- Stakeholders and Net Zero commitments.
- 'Best in class' property.
- Ability to finance/ re-finance inc cost associated.
- Stranded asset.
- Keeping the tenant happy.
- MEES Regulations and 2030 deadline.
- Construction costs.
- Tenant break clause.



Improvement works - considerations for tenants



Cost savings v construction costs.

Stakeholders and Net Zero commitments.

Employee satisfaction.

Mental health of workforce – during and after works.

Market for assigning the lease in due course.

Length of time for works – loss of amenities.

WFH culture v office working.

Insurance.

Reputation.

Any undertenants.

Negotiations with landlord
(e.g. rent reduction, remove landlord break).

Landlord relationship – will they be happy with the works.

Dilapidations/yielding up.

Case Study

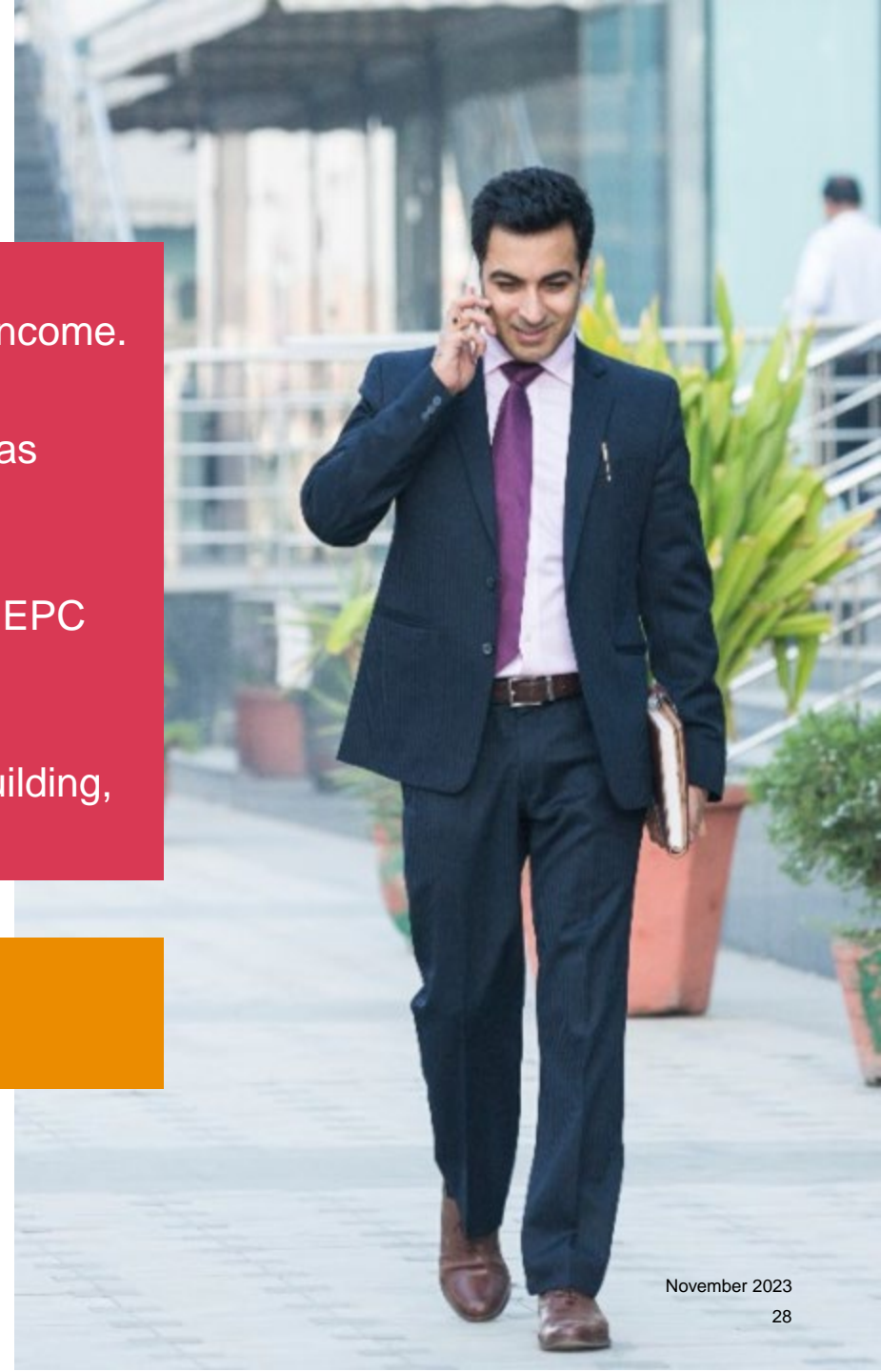
Tenant Investments Limited has a head lease of a whole office building in central Manchester. It intends to sub-let the floors of the building to tenants to generate income.

The lease was completed in January 2023 with a 30 year term and the building has an EPC rating of E. The lease is a “full repairing and insuring” lease.

Tenant Investments Limited is looking to the future and would like to improve the EPC rating of the building to ‘future proof’ it and attract tenants.

Assume that the works required will be to install solar panels on the roof of the building, upgrade the air conditioning unit and improve the lighting inside the building.

How should Tenant Investments Limited go about making these improvements?



First: Check the lease alterations clause



Alterations

- (a) Not to erect any new building on the Premises nor to make any alterations or additions to the structure or exterior of the Premises or which affect the external appearance of the Premises nor (save as may be permitted under clause(c)) to make any other alterations or additions to the Premises.
- (b) Not to make any alterations which would or may have an adverse impact on Environmental Performance or on the Energy Performance Certificate rating of the Premises (whether directly or indirectly).
- (c) Not without the Landlord's prior written consent (which shall not be unreasonably withheld or delayed):
 - (i) to make any internal non-structural alterations or additions to the Premises; or
 - (ii) to make any alterations or additions to the plant, equipment, conduits or mechanical and electrical systems in the Premises[,save that it is agreed that provided reasonable advance written notice is given to the Landlord by the Tenant of its intention to carry out such works, no such consent shall be required for the Tenant to install, alter or remove non-structural demountable partitioning or racking in the Premises.]
- (d) To supply to the Landlord such drawings and specifications as the Landlord reasonably requires to identify any proposed alterations or additions whether or not requiring the consent of the Landlord and to carry out such alterations or additions only in accordance with such drawings and specifications in a good and workmanlike manner and to the reasonable satisfaction of the Landlord.
- (e) To obtain all necessary consents and approvals for any proposed alterations or additions whether or not requiring the consent of the Landlord and to supply copies to the Landlord.
- (f) To execute a formal licence in respect of any proposed alterations or additions requiring the consent of the Landlord in such form as the Landlord reasonably requires which may include an obligation to [consider and where reasonable implement any suggestions][implement any directions]made by the Landlord to avoid or minimise potential or actual adverse effects (whether direct or indirect) on the Environmental Performance and/or on the Energy Performance Certificate rating of the Premises.

Other clauses to consider

Repairing obligations - will you need to keep the alterations in good repair and condition?

Notice requirements - how do you need to serve notice? Who to?

Yielding up - what is the position at the end of the term? Do you need to strip out the works?

Rent review - will any alterations or improvements be rentalised?

Underleases - what rights do you (as landlord) have to do works? Any tenant works?

Before making an application for consent

- Appoint professional contractors and draw up plans.
- Warranties/indemnities.
- Cost considerations.
- Materials available.
- Who is best placed to produce plans?
- Health & Safety file.
- Construction (Design and Management) Regulations 2015.
- Practical considerations: employee presence, busiest time of the year, hot/cold weather, overnight work.
- Planning consent – listed buildings, conservation areas.



Making an application for consent - considerations

Approach the landlord to seek formal consent for the works.

Comply with the notice requirements in the lease.

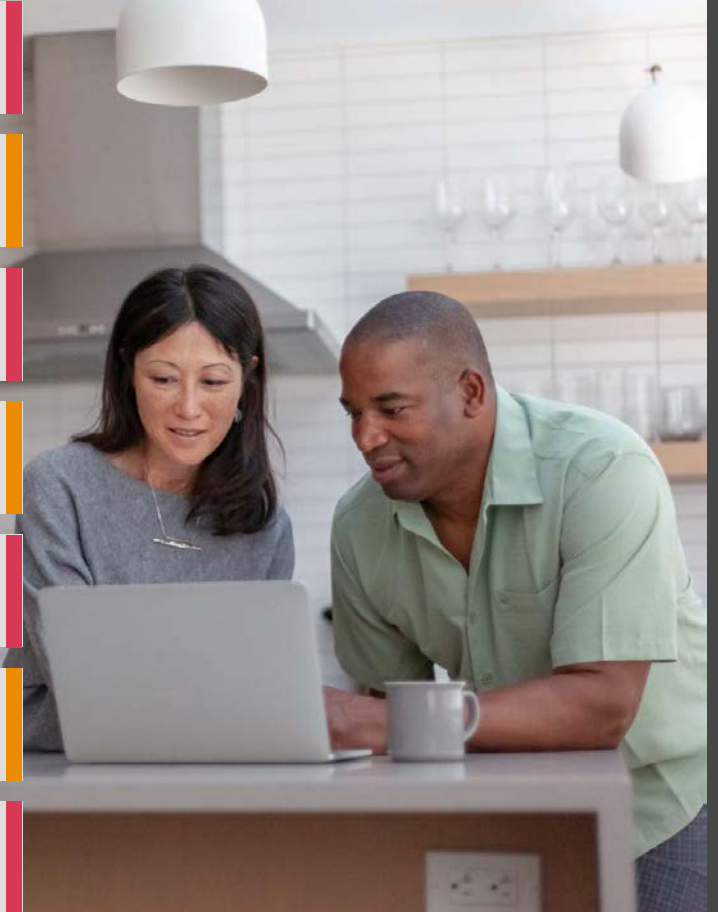
Timings: 'consent not to be unreasonably withheld or delayed'.

Number of copies of plans, to scale, any fees.

Do you need access to common parts or other demised areas.

Are there limitations on times of the year (e.g. avoiding Christmas period).

Can you combine applications: e.g. undertenants also undertaking works.



QUIZ Time



Question 5

In our Case Study, it has now been 5 weeks since the formal application for consent was sent to the landlord and no response has been given. Would the landlord be considered to be unreasonably withholding consent?

QUIZ Time



Question 5

In our Case Study, it has now been 5 weeks since the formal application for consent was sent to the landlord and no response has been given. Would the landlord be considered to be unreasonably withholding consent?

May be Depends on the facts. Seek legal advice.

Consent is granted “in principle”



In the Case Study, the Landlord has now approved the works in principle but requires the Tenant Investments Limited to enter into a Licence for Alterations to document the works. What do you do next?

- Approach the Landlord’s solicitor for the draft Licence.
 - Instruct your solicitors
 - An undertaking for fees will be required. Landlord’s solicitors, surveyors, other professionals. Cap the undertaking!
-
- What is the position at the end of the term? Check the Yielding Up clause.
 - Do you need to document a different agreed position? Consider ESG / improvements / cost of removal.
 - Rental increases - make sure alterations are excluded.
 - Variations to the underlying lease - remove break clauses. Beware “surrender and regrant”

Quiz Time



Question 6

The impact of the works on rent review: Would you need to vary the lease to exclude the works from the rent review?

Quiz Time



Question 6

The impact of the works on rent review: Would you need to vary the lease to exclude the works from the rent review?



Not if you have a licence for alterations – this is usually catered for in the licence. A failure to notify the landlord and/or document the works in a licence could result in the works being rentalised.

4

Green Leases



Green Leases



Clauses are not compulsory

Green Leases contain a series of additional provisions that impose an obligation on the landlord and tenant to manage and reduce the environmental impact of a property by way of improvements.

Covers energy and water savings, reduce greenhouse gas emissions, enhance indoor environment.

They tend to only relate to commercial properties.

Future: Green premium v brown discount.



Examples of Green Lease clauses

Data sharing



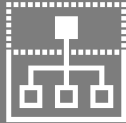
**Renewable energy
and water supply**



Reservations



Metering



Repair



**Cost of carrying out
environmental works**



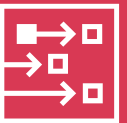
**Collaboration and
cooperation**



Alterations



Service charge



Thank you

[pwc.co.uk](https://www.pwc.co.uk)

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2023 PricewaterhouseCoopers LLP. All rights reserved. 'PwC' refers to the UK member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

RITM14522677

