Model
Commercial
Lease

Discussion paper on proposed amendments to the Model Commercial Lease to take account of the Minimum Energy Efficiency Standard regulations and the Heat Network regulations

7 October 2015

Overview

The working party that drew up the Model Commercial Lease (MCL) is seeking the views of users and potential users of the MCL on changes that should be made to the text of the MCL to take account of new regulations relating to energy efficiency and the Heat Network Regulations

Minimum Energy Efficiency Standard

The Energy Efficiency (Private Rented Sector) (England and Wales) Regulations 2015 bring into effect what is being termed the Minimum Energy Efficiency Standard (referred to in this paper as MEES).

The rules will affect both commercial and residential properties, but this paper considers only the implications for commercial properties.

Broadly, from April 2018 it will not be lawful to grant a lease of a property with an EPC rating lower than E (as shown by a current valid EPC) unless all cost-effective works have been carried out (or there are no such works), or unless one of the exemptions applies.

Furthermore, from 2023 it will not be lawful to continue to let such a commercial property, with the same caveats.

A letting in breach of MEES will create a valid lease, but a civil offence will have been committed. Local authorities will be in charge of enforcement, and will be able to levy penalties of up to £150,000. The names of landlords who let in breach of the regulations will be published.

The rules will not apply to properties that do not need an EPC, and to properties that do not in practice have an EPC.

There are various exemptions in the regulations. If an exemption applies, a landlord will be able to let a property even if its EPC rating is lower than E, so long as the exemption is registered in a register to be set up by DECC. The standard exemptions last for only five years, after which a new exemption must be established. In a limited number of cases, exemptions last only six months.

DECC has promised non-statutory guidance, although it is not expected to be available in final form until 2016.

Heat Network regulations

The Heat Network (Metering and Billing) Regulations 2014 (as amended) require landlords of buildings that contain communal heating systems to notify the National Measurement and Regulation Office of their existence, and provide considerable technical detail about them, by 31 December 2015. They are a requirement of the EU Energy Efficiency Directive.

A communal heating system is one that provides thermal energy in the form of heat, cooling or hot water and serves at least two end users. Large numbers of commercial buildings are expected to be affected by these new regulations.

The Heat Network regulations also require landlords to install meters for each individual occupier, where it is cost-effective and technically feasible to do so. Where this is not the case, landlords have alternative responsibilities. The regulations contain rules for establishing cost-effectiveness and technical feasibility.

Breach of the Heat Network regulations may be a criminal offence or a civil offence. Enforcement is by the National Measurement and Regulation Office.

Amendments to be made to commercial lease precedents

As with any new piece of legislation, landlords may think it desirable to include new or altered provisions in their commercial lease precedents to govern tenants' obligations in relation to MEES or to provide that costs should be shared between landlords and tenants.

The working party that drew up the Model Commercial Lease (MCL) is seeking the views of users, and potential users, as to whether any changes are appropriate in the MCL.

The working party's original intention when drawing up the MCL was that it should strike a fair balance between landlord and tenant, and represent – in the majority of cases – the compromise position that is reached in a typical lease negotiation. Clearly, with a new piece of legislation, it is difficult to establish what such a compromise position should be.

The working party's initial views are set out below. Readers' views will be most welcome. Please send them by e-mail to consultation@modelcommerciallease.co.uk to arrive by 6.00 pm on **Monday 26 October 2015**.

Further information about the legal issues can be found in a two-part blog article entitled "The effect on commercial leases of the Minimum Energy Efficiency Standard" at www.falcolegaltraining.co.uk.

The issues discussed in this paper, and in the blog article mentioned above, may be relevant to other forms of lease. However the purpose of this paper is to consider only changes that may be appropriate to the provisions of the MCL.

1. Alterations

Should there be a prohibition of any alterations that adversely affect the Environmental Performance of the premises?

The MCL already contains an exception to the provision that the tenant may carry out internal non-structural works to the premises without consent where the works would have an adverse effect on the Environmental Performance (a defined term) of the premises. In

such a case, landlord's consent would be required. "Environmental Performance" is widely defined and includes "the consumption of energy and associated generation of greenhouse gas emissions".

But should the landlord be able to prevent the tenant carrying out any alterations that might adversely affect the Environmental Performance of the premises, or (more simply) that would result in a lower EPC rating?

The working party's initial view is that such additional provisions are not needed. The concept of reasonableness is wide enough to allow the landlord to withhold consent on any occasions when this would be appropriate.

The working party also considered that making reference to the EPC rating when considering alterations is unrealistic, given that it would be unusual for a new EPC rating to be obtained merely because alterations are carried out to a building. According to the Government's guidance document "A guide to energy performance certificates for the construction, sale and let of non-dwellings", a new EPC is required only where "a building is modified to have more or fewer parts than it originally had and the modification includes the provision or extension of fixed services for heating, air conditioning or mechanical ventilation".

Tentative conclusion: no change is required.

2. Energy Performance Certificates

It has been suggested that tenants should be prohibited from obtaining an EPC unless it is legally required; and that in such a case the landlord should be given the opportunity of commissioning the EPC using the landlord's energy assessor, with the tenant contributing to the cost of obtaining the EPC.

The reason why the landlord may wish to commission the EPC itself is that the EPC is likely to be more accurate if more data about the building has been provided. It is likely that only the landlord will have access to that data.

This seems a sensible suggestion. A tenant will not be disadvantaged by the inclusion of such a provision in the MCL.

At the moment, the obligations in respect of EPCs are in the sustainability schedule, which may not be included in every lease. We therefore propose moving the EPC clauses into clause 6 of the Lease so that they are not inadvertently omitted if the sustainability schedule is deleted.

Tentative conclusion: include such a provision and move the EPC clauses to the main body of the MCL.

The suggested new wording is

> "The Tenant must not obtain or commission an EPC in respect of the Premises unless required to do so by the EPB Regulations. If the Tenant is required to obtain an EPC, the Tenant must (at the Landlord's option) obtain an EPC from an assessor approved by the Landlord or pay the Landlord's costs of obtaining an EPC for the Premises."

3. Rent review

Should there be any new rent review assumptions to take MEES into account? A rent review provision assumes a notional letting of the actual property to a notional tenant on the rent review date. If – at a rent review after April 2018 – the landlord is required to carry out works in order to comply with MEES (because the property has only an F or G rating), the tenant could argue that any notional letting would be unlawful, which could mean that it would have no letting value at all, or at least a reduced letting value.

The MCL already contains an assumption that is intended to take account of this difficulty:

> "the Premises may lawfully be let to and used for the Permitted Use by any person throughout the term of the Hypothetical Lease"

It is thought that this is sufficient to enable the landlord to argue that the notional letting envisaged in the rent review provision would not be unlawful

Tentative conclusion: no additional wording is required

4. Recovery of costs

Compliance with MEES may entail the landlord expending money on the building, which it may wish to recover (in whole or part) through the service charge provision or the statutory compliance provision.

Where the cost of energy efficiency improvements is, in legal terms, merely repair (such as replacing a piece of kit because it needs to be replaced), the landlord will be entitled to include the cost in the service charge.

There is an exclusion in the service charge schedule for the costs of improvements, subject to carve-outs, one of which is that "replacement or renewal is reasonable and cost-effective and will reduce operating costs for the benefit of the tenants or improve for the tenants the Environmental Performance of the [Building][Centre]."

Additionally, there is already a head of recovery in the service charge provision that permits the landlord to include in the service charge

"Auditing the Environmental Performance of the [Building][Centre] and, where reasonable and cost-effective to do so, implementing the recommendations of any environmental management plan the Landlord has for the [Building][Centre] from time to time"

Compliance with the Heat Network regulations will inevitably include cost for the landlord but this will be covered under the provision that allows recovery as falling within the head of recovery "carrying out any works … that are required under any Act …"

It is therefore thought that there is no need to include any further drafting.

Tentative conclusion: no change

5. Yielding-up

It has been suggested that there should be an additional provision in the yielding-up clause that the tenant should yield up the premises with an EPC rating either (1) at least the same

as at the date of the letting, or (2) no lower than the minimum energy efficiency standard rating from time to time.

The working party believes that this could require the tenant to improve the building and therefore would not be appropriate.

Additionally, there is a possibility that EPC ratings could be affected by changes in building regulations, which would mean that a building that is rated E today could be rated F in the future. For that reason also, it seems inappropriate to require a tenant to maintain the EPC rating.

Tentative conclusion: no new provisions are required

6. Sub-letting

Should there be any requirement on a tenant to improve the premises before sub-letting it, if this is required by MEES ?

The working party thought that such a provision would not be necessary, since ensuring that the premises met the minimum EPC rating (or merited an exemption) would effectively be a pre-condition to the tenant being permitted to sub-let in the first place. Additionally the tenant is required to comply with legislation, and this would require the tenant not to sub-let the premises without complying with MEES.

Tentative conclusion: no new provisions are required

7. Landlord's right of access for MEES works

Should there be a landlord's right of access to the premises to carry out energy efficiency improvements? The working party has found this the most difficult area and would particularly welcome readers' views.

It was thought that most landlords would be unlikely to want such a provision, since it is arguable that this could deprive them of the right to claim the exemption that provides that the landlord need not carry out any works unless the tenant gives its consent.

As an alternative, it was suggested that the tenant should be required to repay the landlord the cost of any such works, if the tenant did consent to them (since it would be the tenant who benefited from the works). However, the tenant should have an absolute discretion whether or not to consent to the works. Requiring the tenant to pay for the works in these circumstances does not seem unreasonable, since the tenant has the final say as to whether they are carried out.

Tentative conclusion: include additional wording as follows

We suggest that the following additional provision should be added into the lease in an appropriate place:

> "The Tenant must pay on demand the Landlord's costs (including legal and surveyor's charges) and disbursements incurred by the Landlord in carrying out works to the Premises to improve their Environmental Performance where the Tenant, in its absolute discretion, has consented to the Landlord doing so."

This could be coupled with the following new reservation in Part 2 of Schedule 1:

> "To enter the Premises to carry out any works to which the Tenant has given its consent under clause [number].

8. Landlord's right of access for the Heat Network regulations

In addition, we propose ensuring that the landlord has a sufficient right of entry to carry out any investigations or works that the landlord is required to carry out under the Heat Network (Metering and Billing) Regulations, including the installation of thermostatic radiator valves and heat cost allocators.

Tentative conclusion: add additional wording into the reservations in Schedule 1 as follows

We suggest that paragraph 3.3 of Part 2 of Schedule 1 should be altered by adding in the wording in bold italics below so that the Landlord is specifically given the right to enter

> "…to do anything which the Landlord is expressly entitled or required to do under this Lease ***or under or pursuant to any Act*** or for any other reasonable purpose."

(end)