

Managing UK Regulation Surrounding Energy Use and Energy Efficiency

Transcript

Speaker	Dialogue
Sam Levy	<p>Hello everyone and welcome to this afternoon's next instalment of our BCLP Environmental Bulletin series. Today's session will focus on energy use and energy efficiency regulation and how to deal with it in the context of UK real estate transactions. I'm Sam Levy from the BCLP Environmental Team and I'll be asking the questions today, with answers coming from my colleagues Aidan Thomson, and Isabelle Laborde. If anyone has any questions throughout the session, then please do ask them in writing using the questions function, which you should all see on your screens. We'll reply to these in writing after the session. Right. Without further ado, let's get started.</p> <p>To begin, Aiden, where have all these energy use and energy efficiency laws come from?</p>
Aidan Thomson	<p>Well, only a few years ago there weren't really any laws on this at all, but zero and low carbon properties are becoming increasingly important as we move to a low or even zero carbon economy.</p>
Sam Levy	<p>So how would you generally describe the legislation as it currently stands?</p>
Aidan Thomson	<p>Well, I think you can say in broad terms there are two kinds of legislation. First of all, there's regulation that applies requirements to transactions involving individual buildings, like energy performance certificates or EPCs and minimum energy efficiency standards, or MEES. And then, the second type where there are reporting obligations that require companies to annually totter [<i>Inaudible</i>], if you like, the environmental impacts and make returns to regulators so that they and the public at large can see your footprint.</p>
Sam Levy	<p>Okay, so aside from hard legislation, there's loads of other softer rules, policies etc. aren't there?</p>
Aidan Thomson	<p>Yeah, absolutely, yeah. But the list, then, of these sorts of softer energy efficiency or energy use and sustainability provisions is really long. But they might develop a hard edge if they become part of, say, a planning commission. For instance, many people in the property and development world come across BREEAM ratings and certification in relation to sustainable development. And you sometimes see references to BREEAM in planning conditions for new commercial developments.</p>
Sam Levy	<p>Understood. Okay. But for today's session, let's focus not on those softer rules and policies but instead on the two types of legislation you mentioned earlier Aiden. So, let's start with EPCs and MEES, and then we'll move on to the reporting side of things.</p> <p>So EPCs – Isabelle, what actually is an EPC?</p>
Isabelle Laborde	<p>Well Sam, essentially an EPC is a certificate that contains information on a property's energy use and costs, and recommendations on how to reduce energy use and save money. As far as the – it gives the property in an energy efficiency rating from A, the most efficient, to G, the least efficient.</p>
Sam Levy	<p>Okay. So if I need to get my hands on an EPC, then what do I do?</p>
Isabelle Laborde	<p>Well, you'll need to commission an EPC by instructing an assessor.</p>

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Sam Levy	Why do I actually need to do this? What if I am a property owner, and I just don't bother to getting an EPC?
Isabelle Laborde	Well there isn't a general obligation to have an EPC, but there are certain trigger points where an EPC is required.
Sam Levy	Okay, so what exactly are those trigger points?
Isabelle Laborde	Basically we're talking here about sales of lease or letting assignments of leases, significant alterations to existing buildings and improvement to energy efficiency. If you want to do any of those things – as an owner, seller, lessor or assignor – then you need an EPC.
Sam Levy	Okay. You mentioned alterations there. What exactly do you mean by alterations?
Isabelle Laborde	Well, some... most alterations to existing properties do not trigger a need for a new EPC. However, one is needed, <i>[Inaudible]</i> is more or fewer parts of the property are designed for separate use, for example, such as splitting a unit within an industrial space. And the alterations affect distinct services of that property, for heating, hot water, air conditioning or ventilation. In these circumstances, a new EPC must be obtained by the person carrying out the works.
Sam Levy	Alright, okay. So, other types of transactions that don't trigger the need for EPC, presumably there are?
Isabelle Laborde	Yes, Sam, there are. So, for example, share of sales of corporate entities which own properties won't trigger the need for an EPC. And neither will certain property management type of transactions, such as lease renewals, extensions or surrenders, but also finance transactions like the grant of the mortgage or compulsory <i>[Inaudible]</i> . There are also some types of buildings that do not require an EPC. These are usually very small buildings, and buildings that do not use much energy, such as agricultural buildings, buildings that are due to be demolished, but then only when the relevant consents are in place, or listed buildings.
Sam Levy	Okay. So, at its heart, the requirement for an EPC is triggered by the owner, seller, lessor, assignor, selling, refurbishing or letting a property asset. So when does the EPC actually have to be in place?
Isabelle Laborde	Well, if it's a refurbishment, then it's very simple. You get your EPC when the works are completed. But if it's a transaction, the EPC must be in place or at least formally commissioned with all relevant information from the get-go; that is even before the property goes on the market. You cannot just leave it to the last minute, post-exchange or even post-completion. The idea is that the buyer knows from the very beginning exactly what it's buying.
Sam Levy	So, how quickly could you get an EPC <i>[Inaudible]</i> if you needed to sell quickly?
Isabelle Laborde	It sort of depends on the property. But often the process, is quite quick. We've recently seen a seller procure a new EPC within a week.
Sam Levy	And what happens if the seller, lessor or assignor doesn't have an EPC in time or at all?

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Isabelle Laborde	Well, there are a limited legitimate excuses where an EPC cannot be obtained, and in each case, you must be able to show that you have used all reasonable endeavours to obtain an EPC by the relevant trigger date. The penalty charges for noncompliance will vary, depending on the type of property. There is a range from £200 for residential dwellings to between £500 and £5,000 for commercial properties, depending on the rentable value of the building.
Sam Levy	Okay. So do EPCs, once they've been created, have a shelf life? In other words, when you sell, can you reuse an old EPC that was put in place, for example, when you bought it a few years ago and give that to your buyer?
Isabelle Laborde	Of course you can. EPCs generally expire after ten years. You can rely on them again within that time frame, as long as there is no significant alterations to the property that would require a new EPC.
Sam Levy	And when they do expire, do you need to get a new one?
Isabelle Laborde	There isn't any obligation to get a new EPC to replace an old one. It's still all about hitting those trigger points. So, if someone has purchased a property, and the EPC has later expired, then they will need to commission a new one if they want to sell the property or let the property out. However, if you get a new EPC, do not be surprised if it shows a low rating than the previous one as standards do more on.
Sam Levy	Okay, so it sounds to me as though an EPC is an important piece of paper for a seller, lessor or assignor to have. But it doesn't really [<i>Inaudible</i>] to actually do any of the energy [<i>Inaudible</i>] recommendations that the EPC contains, even if the property doesn't have a very good energy efficiency rating [<i>Inaudible</i>] EPC?
Isabelle Laborde	That's right, until recently. If the buyer was happy to buy or a tenant was willing to rent notwithstanding a poor energy performance, then no improvements needed to be made.
Sam Levy	You said until recently?
Isabelle Laborde	Yes. This is where the minimum energy efficiency standard – or MEES – came in. Basically now, if a property has an EPC, with a rating of F or G to write down the bottom-line, then it's deemed to be substandard. This means that the owner of that property is likely to be restricted in its dealings with the property until it upgrades the energy efficiency of that property to insure it's no longer substandard.
Sam Levy	Right, okay. So this sounds pretty critical. So, without an EPC showing a [<i>Inaudible</i>] energy efficiency rating, a landlord might not be able to grant tenancies because the property is substandard.
Isabelle Laborde	That's right, Sam. But on top of that, from first, as of April 2023, as well as not being able to grant new leases, commercial landlords won't be allowed to continue letting substandard properties on existing leases.
Sam Levy	Right, so it's very important for owners to be aware of this.

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Isabelle Laborde	Yes. MEES has indirect impact on freehold sales, but if the freehold building contains a number of units let out or to be let out, then the substandard EPC rating could directly go to value, as vacant units could not be let until improvement works are completed.
Sam Levy	Right, okay. What if you lease out a property that is substandard?
Isabelle Laborde	Well, Sam, the prohibition is not absolute, but if there are no legitimate reasons or exemptions, then the breach of the MEES regulations can result on the imposition of civil penalties, which can be either financial or reputational.
Sam Levy	So, the MEES rules on letting substandard properties have really increased the importance and impact of EPCs. This really does show why buyers should be alive to EPC in their due diligence, doesn't it? Especially in the context of tenants and buildings?
Isabelle Laborde	Absolutely. In tenants' buildings, the EPC is going to be vital in determining whether works are going to be needed in the short term. Even though a valid EPC is in place, a buyer might want to suggest that a new EPC is commissioned before completion to make sure the rating hasn't fallen below E.
Sam Levy	Okay. Thank you very much, Isabelle for that. That was a really useful summary as to why you ignore EPCs at your peril. So, let's move on to the other side of things that we mentioned earlier, the i.e. energy laws that require periodic reporting. So Aiden, what are these all about?
Aidan Thomson	Well, a few years ago, it was entirely up to companies how much energy they used and how efficient they were, nobody really published that sort of information. And they weren't, said companies certainly weren't required to do so. Stakeholders and the wider public just weren't really very interested. But then things started to move on in response to things like international climate change commitments, but also in increasing awareness amongst the public about the need to reduce environmental costs.
Sam Levy	So how did it all kick off?
Aidan Thomson	Well, it was really the start of the EU emissions trading scheme northeast and under that, certain types of operations effectively had to acquire a greenhouse gas emissions permit and start measuring their greenhouse gas emissions. They had to buy special allowances to emit for every ton of greenhouse gas and then report their compliance to the environment agency, and if they didn't, they were fined.
Sam Levy	What sort of operations did these cover?
Aidan Thomson	Well on the one hand, with greenhouse gas heavy operations like metal smelting, power generation, cement manufacturer. But on a small scale, smaller scale things were caught too, like combustion of fuels in boilers and engines, which would cover a variety of the smaller local heat and power facilities used in real estate.
Sam Levy	And how has the EU ETS survived BREXIS?
Aidan Thomson	Well as far as the UK is concerned, it has morphed into something called the UK ETS, which is essentially the same.

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Sam Levy	Okay. So, is it something to look out for when buying property there, i.e., where there's any operation like power or heat generation from fossil fuels that could be obliged to participate in the UK ETS?
Aidan Thomson	Yes. I mean, if you're buying a property that has one of these greenhouse gas installations, or a company that has a property that has one of these installations, you're going to need to make sure that the relevant greenhouse gas emissions permit is in place and that the company or the business is being monitored properly and reporting and surrendering the allowances that it needs to by the due date.
Sam Levy	What if those things haven't been done?
Aidan Thomson	Well I mean, criminal offenses might have been committed, and the civil penalty is going to be applied, which will be a lot more expensive than the allowances that you failed to purchase. It could be a quite a lot of money, especially if the noncompliance has gone on for a long time.
Sam Levy	Right, so, if you're buying a property with an installation like power or heat generation, or if you're buying a company that has such properties in its portfolio, then you need to be thinking about UK ETS compliance?
Aidan Thomson	Absolutely, yes.
Sam Levy	Right, okay. So, what else is there apart from UK ETS then?
Aidan Thomson	Well, there is ESOS.
Sam Levy	ESOS, okay. So that's the Energy Savings Opportunities Scheme, isn't it? Could you tell us a little bit more about that?
Aidan Thomson	<p>Well, yes. This derives from EU law, too, but we've retained it post-BREXIT. ESOS imposes a requirement every four years. If you're a part of a group of companies where there is at least one UK company that either, on the one hand, employs more than 250 people, or on the other hand, has an annual turnover of the sterling equivalent of 50 million euros, and a balance sheet in excess of the sterling equivalent of 43 million euros, then the UK based group has to prepare an assessment of total energy consumption and identify energy-savings opportunities every four years and submit that to the environment agency.</p> <p>Now, there's no need to carry out the recommendations, but the idea is that when you see how easy it is to make these efficiency changes, you'll make them anyway. And obviously, for most companies, most energy consumption and recommendations will be directly related to real estate holdings. That's what will drive this assessment.</p>
Sam Levy	Okay, so, how should we consider ESOS in a property transaction?
Aidan Thomson	Well, if you qualify for ESOS and you're taking on a new property, or you're divesting it, or you're divesting a [Inaudible], that will make a difference to your next ESOS assessment, which, by the way, is due in 2023. You'll need, you'll need to take the increase or reduction

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	in your energy emissions as a result of the acquisition or divestiture into account. If you buy a company into your group that owns property, you'll have to do the same.
Sam Levy	Right, okay. So are there any other reporting obligations?
Aidan Thomson	Yes, aside from ESOS, there's something called SECR, which stands for Streamlined Energy and Carbon Reporting.
Sam Levy	And what exactly is SECR?
Aidan Thomson	SECR is a replacement for the old CRC Energy Efficiency Scheme, which a lot of people will be familiar with, from the last decade or so. SECR requires quoted companies and qualifying, large unquoted companies and large LLPs to report their UK greenhouse gas emissions in their Director's Report in a manner that makes it possible to compare the company's performance with the performance of other companies.
Sam Levy	Right, so, what large unquoted companies and large LLPs qualify?
Aidan Thomson	Right. Well they qualify if they satisfy two or more of the following: one – 250 or more employees; two – a turnover of £36 million or more; three – a balance sheet total of £18 million or more.
Sam Levy	Got it. Okay so, it is a little bit like ESOS covering similar sized organizations, then?
Aidan Thomson	Yes, I suppose broadly that's right. Although, technically, ESOS is looking at energy, energy use and SECR is all about greenhouse gas emissions, which is slightly different. And ESOS only comes around every four years, whereas SECR is a requirement every year. And SECR falls within the ambit and the enforcement regime of the Companies Act of 2006.
Sam Levy	Right, okay. So how should we consider SECR in a property transaction?
Aidan Thomson	Well, if you're taking on a new property or divesting of a property, that will make the difference in your new, in your next SECR report. You'll need to take the increase or the reduction in your greenhouse gas emissions as a result of the acquisitional divestiture into account. If you buy a company that owns a property, you'll have to do the same.
Sam Levy	Okay. So it's pretty inescapable that, although SECR reporting and ESOS assessments apply to all energy use and emissions, of a company or group in question, they're largely driven by the energy use of the UK real estate holdings?
Aidan Thomson	That's right. Getting to grips with real estate energy use is a major aspect of getting the reporting and the assessments under SECR and ESOS right.
Sam Levy	Okay. So what I notice about SECR and ESOS, and also the UK ETS is that they're broadly speaking, backward looking, to account for the past. They don't require to look to the future and make promises about where a company is going from an energy use and efficiency standpoint?
Aidan Thomson	That's right, they are backwards-looking. But things will soon be changing in that regard.

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Sam Levy	How so?
Aidan Thomson	Well, corporate reporting in the UK across a great many types of company will soon have to be TCFD aligned, and that is aligned to the recommendations made by something called a Task Force on Climate-Related Financial Disclosures. Disclosures under TCFD will be much more detailed and much more forward looking about how companies plan to deal with the opportunities and risks posed by climate change. And this will lead them to deal with their environmental footprints, including making and announcing plans for real estate performance efficiency elements to that footprint is an inevitable part of that.
Sam Levy	Okay, so reporting could be getting a whole lot different then?
Aidan Thomson	Yes, it could, and this could drive some important behaviour for those involved in real estate regarding energy efficiency of property that they build and hold, or want to hold, so that it matches what their shareholders and their stakeholders expect.
Sam Levy	Understood. Well thanks, Aiden. Well, I think that's that probably a good point at which to end this afternoon's session. So, I hope you all found that informative. Thank you very much for attending, and we look forward to seeing you at our next session in a week's time on PFAS. Thanks again everyone and have a great rest of your afternoon.