THE GREEN DEAL IN COMMERCIAL BUILDINGS:
A Recommendations Report by the Green Deal Commercial Property Group

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SECTION 1: INTRODUCTION

The Commercial Property Sector

The Commercial Property Industry makes up a major part of the UK economy in its own right, as well as providing a platform for virtually all of the country’s other major industries. It is a sector which plays a crucial role in providing places in which people work, shop and enjoy leisure activities. Larger than banking, leisure, communications and the transport sectors, commercial property is also a significant investment asset for the pensions industry and so contributes to the financing of many people’s retirement.

Commercial property also contributes to just less than a fifth of all UK carbon emissions, and the Intergovernmental Panel on Climate Change (IPCC) have said that the built environment holds the greatest opportunities for cost-effective emissions mitigation of any sector. These opportunities will require investment in building management, energy efficient refurbishment skills and installation capacity, as well as in design, manufacturing and fabrication of energy efficient products and measures, all of which can play their part in contributing to the growth agenda.

The Green Deal Commercial Property Group welcomes government efforts to provide a mechanism to tackle the energy use and associated emissions from non-domestic buildings through the Green Deal. We welcome the publication of the Green Deal consultation document in November 2011. This report does not constitute a formal response to the consultation (formal responses may be submitted separately by members of the group), rather it is intended to advise the Department of Energy and Climate Change (DECC) on some of the key issues which could prevent the effective working of the Green Deal in the non-domestic sector, focussing in particular on commercial property, and some of the unique challenges posed.

Background to the Green Deal Commercial Property Group

The Green Deal Commercial Property Group is a sub-group of the Maximising Energy Efficiency in Buildings Forum which is an official advisory group to DECC on the development of the Green Deal. The Green Deal Commercial Property Group’s purpose is to explore specific issues for non-domestic property in respect of the introduction of the Green Deal, on its own initiative or under instruction from the Maximising Energy Efficiency in Buildings Forum or Department of Energy and Climate Change officials directly.

The group’s primary focus has been upon the unique challenges posed for the Green Deal in the rented commercial property sector as it is larger than the commercial owner-occupied sector. Rented property poses a number of challenges which are not experienced by owner-occupiers due to the complexities arising from the split incentives and responsibilities.

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3 According to the Property Data Report 2011 (see footnote 1), around 61 per cent of commercial property by value is rented.
as regards energy procurement, use and control. Commercial properties for rent may also be subject to minimum energy performance standards regulation by April 2018; this underscores the importance of ensuring the Green Deal is an effective and viable option for rented commercial property. The main focus of this report has been upon commercial property, but in discussions the Group has established that some issues may have a wider applicability across the non-domestic\textsuperscript{4} built environment; we have sought to make clear throughout the document where issues are thought by the Group to be cross-cutting in this way. It is possible that there are specific issues relevant purely to properties which are publicly-owned (such as hospitals and schools) that have not been considered as part of this report. The main themes of the Group’s considerations have been:

- **Commercial effectiveness** – how to make the Green Deal commercially viable and attractive to owners and occupiers.
- **Fiscal incentives** – what fiscal incentives could government offer to complement the Green Deal and increase its attractiveness.
- **Eligible measures** – what measures would be appropriate for Green Deal finance in non-domestic buildings.
- **Consents** – how could existing leases for rented commercial buildings interact with the Green Deal.
- **Promotion** – how could the Green Deal be communicated to owners and occupiers.

Where possible the Group has made cross-cutting and mutually reinforcing recommendations which transcend the boundaries between the themes set out above.

Secretariat to the Green Deal Commercial Property Group has been provided by the British Property Federation\textsuperscript{5} with support from the UK Green Building Council\textsuperscript{6}. The chair of the group has been Miles Keeping, GVA\textsuperscript{7}. Extensive input to the sub-sections in Section 3 has been provided by Michelle Hubert, CBI (Commercial Effectiveness), David Rees, Davis Langdon (Fiscal Incentives), Peter Williams, Eversheds, Christopher Brigstocke, Squire Sanders Hammonds, Chris Edwards and Charles Woollam, SIAM (Consents), Hywel Davies, CIBSE (Measures) and Keith Bugden, Better Buildings Partnership (Awareness). The membership of the Green Deal Commercial Property Group was cast widely so as to represent as broad a cross-section of the players involved in the non-domestic built environment as possible. The members of the Group are set out in the **Acknowledgements** section above.

\textsuperscript{4} Non-domestic property includes all non residential property, encompassing a range of commercial and public property building types and sub-types. CIBSE Guide TM42 gives a good survey of the types of commercial property available.

\textsuperscript{5} http://www.bpf.org.uk

\textsuperscript{6} http://www.ukgbc.org

\textsuperscript{7} http://www.gva.co.uk
Summary of Findings

Across the different work streams, the following key issues are highlighted in this report:

- Currently it is difficult to make a business-case for energy efficiency improvements in rented commercial property as improved energy efficiency performance is not linked to improved rents, reduced void periods or higher capital value.

- The division of responsibility between the owners and occupiers of commercial property creates significant difficulties in respect of demonstrating (with a view to sharing) the costs and benefits of making energy efficiency improvements.

- Operational and behavioural improvements within non-domestic property hold great potential for reducing energy demand and ought to be considered in parallel to physical building alterations.

- Traditionally capital allowances and other funding options have not been well promoted to industry, and awareness of them is low. With the down-turn in property values and returns on developments, such fiscal incentives may invite more interest and take-up if better communicated to industry. Linking such incentives to the Green Deal will be helpful in boosting the Green Deal’s take-up.

- For a Green Deal to take place in rented commercial property, new agreements between the landlord and his or her tenant(s), framed in a licence, are likely to be needed. This is because most existing commercial leases will not fit with the Green Deal financing arrangement whereby the tenant pays for improvements and will not usually deal with works that encompass both landlord and tenant controlled areas.

Key Recommendations

Each chapter within this document contains a list of recommendations. The most critical of these for the success of the non-domestic Green Deal are:

- The benefits of energy efficiency must be clearly demonstrable and communicated widely – owner-occupiers, landlords and tenants need to make the case for implementing energy efficiency improvements and the Green Deal, and so they must be able to see clear demonstrable benefits. The government’s plan to make F and G Energy Performance Certificate-rated (EPC) property unlettable (unless all Green Deal measures have been undertaken) by 2018 could act as an effective incentive for Green Deal take-up for the worst performing properties. However, in order to be effective and drive the right responses, the proposal must be implemented in a manner that is sensitive to the complexities of rented commercial property. The detailed regulations must also be set out well in advance of implementation so as to provide clarity and certainty to the market on what will be required. Evidence of tenant willingness to accept the Green Deal charge on new tenancies would grant market confidence that undertaking a Green Deal is unlikely to put off potential new tenants. Tenants should be encouraged to see energy efficiency as a beneficial feature of prospective premises, derived from protection/enhancement of their reputation, improved building comfort levels, cost savings and increased resilience to energy price rises and resource scarcity.
mandatory roll-out of Display Energy Certificates (DECs)\(^8\) to all commercial property (undertaken in a way that is sensitive to cost burdens) would raise awareness of energy use amongst landlords and tenants and drive interest in the Green Deal through reputational drivers drawn from the act of display of an energy certificate\(^9\).

- **Better use and awareness of existing fiscal incentives would promote Green Deal uptake but further incentivisation may be needed** – there are already fiscal incentives attached to investment in energy efficient kit, but their availability is not widely known and understood. Information on the available incentives and how they link with the Green Deal should be provided to potential non-domestic Green Deal customers. If the Government intends to incentivise comprehensive retrofit to commercial buildings, it needs to consider using further tax levers to incentivise large scale works such as façade replacement/enhancement and moving to mixed mode or natural ventilation, as such improvements are unlikely to be economic even via the Green Deal.

- **Technical solutions to building energy efficiency must be supported by complementary changes in occupier and management behaviour** – in order to achieve significant reductions in energy use from existing non-domestic buildings, the Green Deal assessment process must not only consider physical building improvements but also operational, managerial and behavioural improvements. We therefore propose that the scope of the Green Deal allowable works is extended to include a range of alterations which are aimed primarily at stimulating beneficial behaviours, such as smart metering. Without understanding how a building is used, interventions that yield significant energy reductions at low or no cost may be missed, and physical improvements may fail to deliver expected savings due to operational inefficiencies. This may undermine the credibility of the Green Deal in non-domestic buildings.

- **Consent from a property’s owner should be required before a Green Deal can proceed** – although it may be difficult to enforce, a duty to co-operate could be put in place to encourage all parties with a stake in a property, not least the property’s owner, to positively engage with the Green Deal. However consent should not be mandated from any one party, especially the property owner who must carry the ultimate obligation for the Green Deal debt on the electricity bill.

- **The complexity of the Green Deal must be overcome in its promotion** – all those involved in the promotion of the Green Deal – government, industry, professional bodies and Green Deal providers need to ensure that the complexity of the Green Deal does not overshadow the benefits. Commercial organisations, especially SMEs, are unlikely to have the resources to assess the risks involved in highly complex issues that do not offer an opportunity to increase company profits. Each stage of engagement with the Green Deal, from initial requests for information, right through to the ongoing relationship between customer and Green Deal provider, needs to be straightforward and intelligible.

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\(^8\) Display Energy Certificates are an occupancy-based rating based on actual energy use, compared with the Energy Performance Certificate which is a theoretical rating based on only the fabric and fixed energy using services within a building.

\(^9\) For further details about the benefits of a mandatory roll out of DECs to commercial property, please see the UK GBC and BPF submission to the Energy Bill Committee and the UK GBC’s task group report on DECs and the CRC.
SECTION 2: CONTEXT AND CHALLENGES

Commercial Property and Retrofit

Whilst much can be done to improve the energy efficiency (and to reduce the associated emissions) of new property, for instance through better design and applying leading edge technology, tackling the existing non-domestic property stock remains a much more challenging proposition.

Over 90% of non-domestic property stock was built before 1986 when requirements for better thermal performance standards began to be introduced. Much of the stock built before then is relatively poor by today’s standards. With annual replacement rates of commercial property of only 1 – 2%, around 60% of the existing stock will still be here in 2050. Tackling energy performance in existing commercial property is a crucial but so far relatively neglected element of any credible strategy for reducing aggregate energy demand and for mitigating the climate impact of commercial property.

It is important also to recognise that the commercial property sector is highly diverse, encompassing offices, retail premises, industrial units, leisure facilities and government buildings. Even within these broad headings there is a myriad of sub-sectors, each exhibiting a great deal of variety in terms of age, size and quality. Furthermore, a commercial property will undergo changes in occupation over the course of its lifetime resulting in accompanying changes to the building’s energy demand profiles.

There are also unique challenges posed in improving heritage and listed property (which due to time and resource constraints have not been covered in this report). The complexity and diversity of commercial property makes it much harder to tackle than the relatively homogeneous residential sector.

The costs associated with energy, water and waste still represent a comparatively small percentage of overall occupation costs for most commercial property occupiers. Although it is recognised that the much faster than Retail Price Index rises in energy costs will change this balance to some degree, traditionally cost has remained a secondary concern by comparison to other motivational factors in relation to building energy efficiency. Reputation has, for example, featured as a strong driver for a relatively small section of occupiers, such as those with written corporate social responsibility policies or those which are prominent high street names, which tend to be concerned by the potential negative impact to their brand arising from any perceived failure to mitigate their environmental impact.

For the majority of occupiers, therefore, reducing energy use and tackling other sustainability goals remains, at least for the moment, a relatively marginal issue which is liable to rank lower on the list of priorities than projects which will increase company profits. While blue-chip developers, owners and occupiers are unlikely to build, own or occupy a ‘non-green’ building, for the majority of smaller companies there are a range of economic and business issues which rank higher on their list of priorities. For example, there is a perception, accurate or otherwise, that energy efficient buildings cost more than other buildings. This perception has meant that such buildings are currently unlikely to attract returns commensurate with the perceived higher cost of providing them and as a result owners and investors have little incentive to supply them.
There is a body of research, mainly from the United States and Australia, around the issue of ‘green value’, which seeks to make the case that some buildings carrying sustainability certification may attain higher rental and capital values than non-sustainable buildings i.e. that there is a divergence between the values of certificated and non-certificated stock. There are many reasons cited for this divergence, which is found primarily among ‘prime’ office stock, including that this stock is most likely to be let to occupiers who have strong sustainability policies. A key driver for such occupiers in seeking sustainable property, or avoiding non-sustainable property, is the protection of their reputation rather than energy cost savings.

Although energy efficient buildings do enjoy lower running costs, this is of greater attraction to owner-occupiers who can also potentially benefit from the anticipation of lower levels of functional obsolescence as they will be more resilient to rapidly changing environmental regulations. In respect of tenants, reputational drivers may be more pronounced in respect of the desire to demonstrate environmental responsibility than to achieve marginal cost savings via energy bills.

A number of other industry initiatives are seeking to investigate further the relationship between sustainability performance and value, and to promote the incorporation of sustainability features within the data sets collected by valuers, and used as a tool to analyse comparisons between buildings. These include:

- **Two years ago the Valuation Professional Group of the Royal Institution of Chartered Surveyors (RICS) produced a paper to advise valuers of commercial properties on how to factor sustainability into their valuations.** The guidance made clear however that the valuer’s role is to reflect the prevailing market; acting as ‘score keepers’ and not ‘score makers’. Accordingly, while the paper may help focus attentions on sustainability, what it cannot do is tell valuers to attach a value to energy performance if the market does not do so. This guidance is now to be updated and strengthened and will encourage better data collection and analysis as a means of affecting market transformation\(^\text{10}\).

- **The Investment Property Databank (IPD) is now tracking the returns achieved by ‘more sustainable’ properties sitting within their UK database compared with the rest of the tracked portfolio.** Whilst this currently does not show differential investment performance, as it is based on valuations (not transactions) it is unlikely to demonstrate differential values until valuers can differentiate sustainability within their valuations.

- **The Global Real Estate Sustainability Benchmark\(^\text{11}\)** was launched this year and is seeking to provide institutional investors with a benchmarking tool against which they can measure their sustainability performance. It is based on an annual survey.

- A collection of over 40 property investment companies, supported by academic and trade organisations, collaborating as the **Sustainable Investment in Real Estate programme**, are engaging in research to determine the extent to which a range of

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\(^{10}\) A caveat to this is that the Valuation Information Paper 13 is shortly to be revised and it is likely to highlight the increased risk of obsolescence in commercial real estate assets to be derived from the failure to mitigate environmental risk.

\(^{11}\) [http://www.gresb.com/background.html](http://www.gresb.com/background.html)
sustainability features set out in the Global Reporting Initiative Construction and Real Estate Sector Supplement relate to actual financial performance.12

- **The World Green Building Council is collating evidence of the value of sustainable buildings internationally.** Their intention is to publish a bi-annual, peer-reviewed report on the business case for green buildings, with the first report expected next year.

- Some preliminary UK based empirical work13 is seeking to make the case for a potential link between labelling, occupancy and rents.

Unlike in other countries such as Australia and the USA, there is no empirical evidence at present from the UK market to suggest that it attaches rental or capital value differentials that can be tracked directly to a building’s sustainability (including energy efficiency) characteristics. One of the reasons why identifying a sustainability and value link is challenging in the UK in particular is the range of tools currently in use to determine the sustainability performance of buildings, with each tool varying in its methodology and scope. Furthermore, with such a plethora of tools, it can be difficult for the valuation community to choose just one which represents an appropriate denominator for valuing purposes. It is expected that the energy performance of a building, as demonstrated by the Energy Performance Certificate (EPC) rating, may begin to have an effect on value by virtue of the government’s intention to introduce minimum energy efficiency performance standards for rented homes and non-domestic buildings from 2018. Yet as EPCs are assessed only occasionally and provide only an asset rating not a full energy appraisal, they are unlikely to translate into pricing evidence as other ratings systems such as Energy Star, used in the US, are able to.

The fact that most commercial buildings are rented creates further challenges for improving their environmental performance. That is not to say that there are not also challenges facing owner-occupied stock, and in particular, smaller retail space which is more akin to domestic property in its building services arrangements and construction methods. However, where commercial properties are rented the property is split between landlords and tenants according to lease terms, many of which do not take account of the risk and reward of failing to mitigate environmental risk or which can place other issues before them in the hierarchy, for example:

- Terms in leases can often require landlords to compensate tenants who are subject to disruption, which can prevent mid-lease renovations to improve the building’s sustainability performance;

- Leases very rarely allow for the exchange of data between landlord and tenant concerning energy consumption and environmental performance (e.g. energy, water, waste data). As a result, low cost and no cost improvements to performance arising from better management or use of resources can lie hidden and unexploited;

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12 [http://www.s-i-r-e.ch/](http://www.s-i-r-e.ch/)


14 According to the Property Data Report 2011, around 61% of commercial property is rented (by value).
- The lease normally sets out the precise circumstances in which the costs of improvements to a building’s performance can be recouped from the tenant. Improvements to buildings often have a limited or no effect on the value of the asset, and if the cost of the improvement cannot be recouped via the service charge, there may be little incentive for the landlord to make the investment;

- With shortening lease lengths (in 2010/11, the average lease length for commercial property was 5.3 years\(^1\)), the ability to recoup investment monies over the lease period is challenging.

Over the last 7 years there has been an international drive, emanating from Australia, to develop so-called ‘green leases’ which seek to develop a landlord and tenant contractual relationship which works towards data sharing and the introduction of terms to support environmental improvements. Although such leases have been actively promoted in the UK, their uptake is still largely embryonic for anything other than some institutional grade stock. There are also challenges in enforcing ‘green’ clauses. This is because where they are found within the lease itself, they often do not carry the ultimate sanction of forfeiture for non-compliance, or where they are found within a memorandum of understanding, they are not legally binding.

It is in this context, with the challenges of evidencing a value for energy efficiency in the market and the difficulties posed by the split incentives of landlords and tenants in rented commercial property, that we must explore the potential of the Green Deal.

**Application of the Green Deal**

In theory, the Green Deal should benefit both landlords and tenants. The landlord should benefit from the Green Deal as their asset will receive an upgrade with the tenant bearing the cost. The tenant also benefits from lower energy bills and potentially enjoys a more comfortable building. This apparent simplicity belies a number of challenges however, including that:

- it cannot be assumed that a landlord stands to gain an increase in the property’s value as a result of the improvements as demonstrating increased value for energy efficient buildings is not yet backed with evidence;

- there is a lack of evidence of whether the existence of the Green Deal charge will act as a disincentive for potential new tenants or building purchasers;

- the Green Deal charge reverts to the landlord during void periods even though the landlord may not be enjoying the full benefits of the Green Deal measures. Given the current rising levels of voids, particularly in the retail sector, this issue may be significant;

- there are no guarantees that a Green Deal will result in lower energy bills;

- many existing leases will not allow the passing through of the Green Deal charge to tenants via the service charge; and

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\(^1\) BPF / IPD Annual Lease Review 2011.
in rented property, Green Deal measures may cut across landlord and tenant controlled areas.

The implications of these issues will be explored in more detail within the following chapters.
SECTION 3: OVERCOMING INSTITUTIONAL BARRIERS TO A SUCCESSFUL GREEN DEAL

Sub-Section 3a: Commercial Effectiveness

Recommendations:

- Where a Green Deal is sought for a property with a tenant in situ, it may be the case that a landlord will seek to implement a Green Deal plan only for the duration of the term left on the lease in order to avoid exposure to the charge following a tenant’s departure, and to avoid the risk of putting off future tenants. The Green Deal assessment methodology should therefore identify the effective interventions with short payback periods that can be paid off within a tenant’s remaining lease period.

- Evidence of tenants’ willingness to take on an existing Green Deal charge should be communicated to industry so as to encourage landlords to undertake longer term Green Deal plans. Industry bodies such as those represented in the Green Deal Commercial Property Group have a role to play in this task. Government and industry bodies represented on the Green Deal Commercial Property Group should engage with tenant groups and their advisers to address concerns and potential misunderstandings about the commitment of taking on a tenancy with a Green Deal charge attached.

- The implementation of the provisions within the Energy Act 2011 to make it illegal to let properties with an F or G rated EPC rating must be conducted in a manner that is sensitive to the complexities of rented commercial property. The detailed regulations must also be set out well in advance of implementation so as to provide clarity and certainty to the market on what will be required. A mandatory roll-out of DECs to all commercial property (that is sensitive to cost burdens) could help to raise landlord and tenant awareness about energy use, generate interest in energy efficiency and increase sharing of information between landlord and tenant.

- It is imperative that the interest rates for Green Deal plans should be low so as to be sufficiently commercially attractive. Low interest rates will be even more important for shorter Green Deal plans where there will be limited Green Deal money available for measures.

- Landlords should be invited to compete with the rates charged by Green Deal providers as they may be able to offer better terms. Large commercial landlords could themselves potentially register as Green Deal providers so they are able to offer finance and place a Green Deal charge on their energy meters.

- We suggest that DECC monitors Green Deal take up by building type and section of non-domestic property (schools, retail, office etc), to identify those property types most and least likely to take up the Green Deal in order to seek lessons learnt and identify sector and building type specific challenges.
In order for the Green Deal to be successful it must be a sufficiently commercially attractive proposition. There are a number of issues that will be important to ensuring that the Green Deal is viewed as commercially attractive and these are set out below:

Ensuring that the Landlord Sees a Benefit

Demonstrating increased value as a result of energy efficiency improvements in rented property is critically important because the degree to which a landlord will be motivated to obtain Green Deal finance will be dependent upon his/her being able to weigh the costs (administration, inconvenience, possible reduced income for the duration of the works) with the benefits of undertaking such works. In short, there must be a business case with an expected positive return on investment.

Although improvements to a property may in theory lead to a reduced risk of voids and delayed obsolescence, the application of the Green Deal may undermine this potential benefit as prospective tenants may be unwilling to accept a Green Deal charge which is already in place, and in particular if the wider property market offers properties of an equivalent rated energy performance without this additional financial obligation (especially if the anticipated cost savings haven’t materialised). Part of the challenge for convincing tenants to accept the charge may be in convincing tenants of the wider non-financial benefits of the Green Deal measures. Indeed, as highlighted previously, energy cost-savings are unlikely to be a priority for many tenants in any case. It may be that other benefits associated with energy efficiency such as reputational protection and enhancement, as well as more direct benefits of increased comfort will need to be better promoted to tenants to convince them that the benefits are worthy of the charge. A mandatory roll out of Display Energy Certificates (DECs) to all commercial property (that is sensitive to cost burdens) would also help to drive interest due to concerns about reputation.

Concern about tenant response to the Green Deal charge is likely to be a challenge to uptake, at least in the early stages of the Green Deal, and until either tenants see that the benefits of the measures are worthy of the charge, or the existence of the Green Deal charge on electricity bills becomes ubiquitous and thus becomes ‘the norm’ for rented property. It will take time for evidence of tenant attitudes to the charge to emerge, but government and industry associations will have a role to play in communicating and raising the profile of encouraging signs from the market.

The government’s commitment within the Energy Act 2011 to introduce minimum energy efficiency performance standards based upon Energy Performance Certificate (EPC) ratings may provoke greater interest from landlords in the energy efficiency performance of their property as demonstrated by the EPC rating. However as the details for this provision have yet to be set out in secondary legislation there are a number of as yet un-clarified aspects to the minimum standards, not least whether the intention to make F and G EPC rated property unlettable by 2018, will affect all leases or only new leases signed after the entry into force of the provisions. The detail must be sensitive to the realities of rented commercial property and should be set out as early as possible in order for the market to have the necessary clarity and time to respond.
Landlord Exposure to the Green Deal Charge

As the Green Deal finance will be attached to the meter of the property, it will track the property and not the initial recipient of the finance. In rented property, when a tenant vacates, the responsibility will fall to the property’s next tenant. However during periods when the property is empty, we understand that the Green Deal charge will become the responsibility of the landlord. Landlords already pay empty property rates during vacancies and owners will wish to avoid further exposure to costs during these periods; the landlord may therefore consider more carefully the solvency of their existing tenants (and thus their likelihood of remaining at the property and paying the Green Deal charge) and the minimum term left on their lease (taking into account any break clauses), when considering whether to consent to a Green Deal. This could have the effect of limiting Green Deal packages to those that can be financed by the minimum lease length of the tenant in situ\(^\text{16}\) rather than an extended period of time that spans across multiple tenancies that was envisaged by the original proposals for the Green Deal. Ensuring that the Green Deal assessments can identify recommendations tailored to specific timescales that are likely to be considerably shorter than the 25 year limit for Green Deals will be important. There may be scope for commercial property Green Deal assessments to split packages of measures into short, medium and long-term payback in order to encourage owners to weigh their options.

Interest Rates

A key factor in the Green Deal’s commercial effectiveness is the cost of the Green Deal finance itself. The Green Deal must offer very competitive interest rates on Green Deal finance. If rates are too high, the attractiveness of Green Deal finance will be severely undermined. The threshold at which the interest rate is commercially competitive is likely to vary from landlord-to-landlord (taking into account portfolio size and composition and loan-to-value ratios) but the Green Deal offer to each must be equal to or better than what they can already access from the market. Ensuring that the interest rates are low will be especially important where Green Deals are taken out for the duration of a single lease, as suggested above, otherwise the range of measures that could be financeable would be significantly limited due to the short time span in which the package of measures must be paid for and the requirement to meet the Golden Rule (which states that the Green Deal plan, including finance costs, must not increase energy costs).

If the market cannot provide low rates without assistance, the Green Investment Bank may need to play a role in part-subsidising Green Deals to ensure that they are commercially attractive, at least until the market is able to reduce its rates. The recently announced Green Deal Finance Company, a consortium of commercial organisations drawn together to provide competitive finance for Green Deals in the domestic sector, could also be encouraged to extend their remit to non-domestic property.

\(^{16}\) The average annual lease length is 5.3 years according to the BPF / IPD Annual Lease Review 2011.
Landlords could offer tenants their own financing terms alongside any Green Deal provider offer as a means to ensure rates of finance are competitive, as some landlords who have revolving credit facilities may be able to match or better the rates that Green Deal providers are able to offer. Owners seeking to take this step should register as Green Deal providers so that they abide by the codes of practice attached to the Green Deal and are able to attach Green Deal debt to electricity meters (should they choose to). Encouraging owners to develop financing options would be in line with the government’s policy intent for the Green Deal, which is for it to be a framework around which the market can innovate.
Sub-Section 3b: Fiscal Incentives

Recommendations:

- The Green Deal should complement existing fiscal incentives for energy efficient retrofit such as capital and enhanced capital allowances. The variety of options for financial assistance and how they may inter-relate should also be set out in industry guidance.
- Green Deal finance could be offered as ‘top-up’ finance where wider improvement works are planned. This would help to enable the installation of energy efficient measures that may not fit within the budget of planned works.
- If Government seeks to offer additional incentives for Green Deal take-up or larger scale energy efficient retrofit in commercial property, empty property rates relief, Stamp Duty Land Tax (SDLT) and business rates are areas worthy of detailed exploration.

As we have seen in the above sections of this document there are a number of non-financial barriers to energy efficient retrofit which apply to all properties, but predominantly to those which are rented. As many of these barriers are not solely financial, they are perhaps beyond the power of the Green Deal to influence. Yet in addition to the wider challenges that need to be met in order to raise the significance of energy efficient retrofit, it is clearly important that the Green Deal, and indeed energy efficient retrofit more broadly, makes as much economic sense as possible.

It can be argued that the price of carbon should be increased in order to raise the cost of using energy to the extent that it becomes material for occupiers, in turn stimulating more demand for energy efficient buildings. However, the Chancellor of the Exchequer has noted that a disparity between the price of carbon in European markets and that of the UK could put the UK at a competitive disadvantage. If increasing the cost of energy is not an option, decreasing the cost of energy efficient retrofit must be explored.

Fiscal Incentives in the UK

Fiscal incentives to invest in energy efficiency improvements are currently based upon the capital allowances regime which dates back to the 19th Century. The principle of these allowances is that they allow the taxpayer to write down the cost of capital expenditures on qualifying plant and machinery against annual tax liabilities over time (rather than as a single deduction). The Capital Allowances Acts have set annual rates for this purpose.

Machinery which currently qualifies for capital allowances can be divided into two broad groups:

- **Integral features** – heating and cooling, hot and cold water, electrical systems, lifts and escalators.
- **Fit-out for the purposes of the trade being carried on** – which may be additional systems such as data cabling but extends to cupboards, kitchens, blinds, fire alarms – and up to 240 other items.
More recently, capital allowances have been joined by enhanced capital allowances for energy technologies which offer a first year 100 per cent relief for the cost of qualifying low-carbon or energy-saving equipment.

The application of the above to a major refurbishment of a 1970s office block might result in the majority of the expenditure being tax-relievable which demonstrates that there are opportunities available. Yet despite the existence of these reliefs, take up is very low. Part of the reason for low take-up is that the appeal of tax reliefs has followed the fortunes of the wider economic outlook for construction. As development returns have increased during economic upturns, the marginal benefit to be obtained from capital allowances and enhanced capital allowances was downgraded to a tax administration exercise for accountants, which in turn has meant that consultants, contractors and architects are less than familiar with the reliefs available today. It is likely that the extended austerity period for construction in which the market finds itself will lead to a resurgent interest in the reliefs available which may serendipitously coincide with the advent of the Green Deal.

Other than capital allowances, property owners or investors might seek other funding deals – and to this end the Carbon Trust has for some years been offering interest-free funding backed by government. This scheme has recently been replaced by a new Carbon Trust Energy Efficient Funding Scheme in a partnership with Siemens17. Thus it may be possible to anticipate situations where a building’s improvement project is perhaps partly underwritten by Green Deal funding and partly by Carbon Trust funding. With Green Deal funding, Carbon Trust funding, and high levels of tax relief available for the renewal of systems, fit-out and insulation of existing buildings, it is possible that considerable cost mitigation might be available to an individual or organisation seeking to undertake building improvements.

At this stage it is difficult to model the scope of Green Deal actions but it is possible to see that a comprehensive upgrading may cost more than the available funding and therefore other financing and the additional support may become pivotal in achieving success. Certainly for many older obsolescent buildings, looking forwards in time, limited Green Deal interventions could prove a poor investment where comprehensive updating is required to increase the economic life of that asset. Given the gap that often exists between what commercial lenders can provide and borrowers’ needs, banks might also perhaps be encouraged to recognise Green Deal funding as a source of top-up finance contributing to the viability of a more general property improvement scheme. This would have the benefit of encouraging property owners to undertake additional improvements during an appropriate period in the building’s lifecycle, and would avoid piecemeal improvements to property that would benefit from larger scale works.

In order to avoid confusion we suggest the production of non-technical guidance that explains the options available for energy efficient retrofit, including how each option fits and complements each other. The customer can then decide on the mix that best suits their circumstances.

One key issue that will need to be addressed in the context of producing industry guidance will be the interaction between the Green Deal and the capital allowances regime. It is not immediately clear who the entitlement to claim capital allowances will fall to as the Green

Deal funding is not a conventional debt to be repaid directly by the ‘borrower’. This may be further complicated by landlord/tenant relationships as plainly both cannot claim the same relief.

New Incentives

It is the view of the group that linking the Green Deal with existing capital and enhanced capital allowances so as to ensure that the financing options complement each other, and raising overall awareness of the options available, would be an important first step before considering any use of wider incentives. Indeed such existing incentives may be sufficient for the likely smaller scale improvements anticipated for the Green Deal in the non-domestic sector. Yet for encouraging larger, more ambitious energy efficiency improvements, new additional incentives may need to be put in place.

We believe that a thorough study of the impact of any new incentives would need to be undertaken before being introduced in order to ensure that best value is provided for tax payer funds. However below are some suggestions that we believe are worthy of further investigation:

Empty Property Rates Relief

The imposition of empty property rates has a particular impact on secondary commercial property where landlords are already in a position of financial uncertainty with tenants at risk of default. In order to encourage engagement of this section of the market with the potential implementation of energy efficiency improvements, we suggest that a waiver with one or two years of relief could be offered where an energy efficient retrofit is taken up. The basis of the award could be set with reference to the energy performance attained as demonstrated by the EPC rating following the retrofit, with the threshold for relief increased over time to ensure best value for money and encourage ever higher levels of energy efficiency. We would not suggest tying eligibility for this relief to Green Deal funded works however, as some landlords may prefer to finance the works themselves.

This would have the benefit of promoting improvements when the potential application of a Green Deal will be simpler: when a property is vacant and a landlord does not need to consider the challenges posed by obtaining consents from tenants in situ, both for access to undertake an assessment and works, and in agreeing to accept the charge on the electricity bill. A landlord would also not need to consider the potential disruption of works to tenants in situ. Such relief would also help to mitigate concerns that a tenant may be put off by a Green Deal charge, or may seek to negotiate landlord payment of the charge. This is not to say however that encouraging improvements to property where there is a tenant in situ is not also important, indeed it will be a necessity if significant levels of take up are to be achieved.

VAT Reductions

The ‘Cut the Vat Campaign’ is calling for a reduction in the VAT rate for Green Deal measures to 5%. Currently only some energy efficiency measures qualify for the 5% rate while others retain the standard 20% rate. This disparity risks creating perverse incentives whereby certain measures in a Green Deal assessment are preferred over others due to the
VAT differentiation (and thus a difference in cost). It would be sensible for the lower rate to apply to all Green Deal measures for simplicity, to reduce the overall cost of a package of measures (and thus increase the amount of work possible with the golden rule), and for use as a marketing tool to encourage interest in undertaking Green Deal improvements.

**Stamp Duty Land Tax (SDLT) Reductions**

Whilst a reduction in VAT will help some commercial landlords, fully-taxable landlords will probably feel little benefit from it. Such landlords may, however, be more effectively incentivised to engage in energy efficiency activities via relief from SDLT. Basing any policy, especially tax policy, around EPC ratings would however require considerable improvements to the underlying methodology for EPC assessments in order to ensure that they produce sufficiently robust and reliable assessment outcomes. However with the current subdued market, the benefits of SDLT changes are unlikely to result in significant responses at least until the market picks up again.

**‘Greening’ Business Rates**

Amending the discount rate modifier for business rates so as to take into account property energy performance may have the benefit of engaging occupiers, especially SMEs. This incentive may be a longer term goal, with careful consideration required as to the appropriate level of incentive for energy efficiency set to avoid disproportionately affecting smaller property owners who will never be able to compete with larger property owners in making energy efficiency improvements. Furthermore, owing to the complexities of the rating system and the timing in respect of the review of local finance, such an approach would need to be very carefully considered.
Sub-Section 3c: Green Deal Measures

Recommendations:

- Green Deal assessments should consider both operational and physical improvements taking into account an understanding of how the property is being used, in order to identify the most appropriate interventions, which may include those that are low and no cost.

- In terms of physical improvements, many of those listed by DECC as potentially eligible for the Green Deal are unlikely to apply to non-domestic property. We suggest that DECC considers adding the following measures for the non-domestic Green Deal:
  
  o Insulation on HVAC ducting;
  
  o light sources (LEDs etc);
  
  o passive measures including daylight pipes to boost internal uses of daylight, reflective paint, solar shading and solar film for glazing;
  
  o energy efficient glazing including secondary glazing; and
  
  o integrated control systems and smart meters.

- The types of measures that are potentially eligible under the Green Deal are limited mainly to fabric, plant and machinery, and as such fall largely within the purview of the landlord’s control, although some measures may cross over into tenant fit-out (lighting for example). Accordingly, we suggest that energy efficient tenant fit-out should be encouraged via means other than the Green Deal. This should include the promotion of existing incentives and allowances that apply to tenant fit out work.

- The list of eligible measures should take in-to account measures required under Building Regulations. This would ensure that any measures deemed to produce energy efficiency savings within the Building Regulations are eligible under the Green Deal.

Building Energy Management

Before proceeding to talk about measures, we think it best to take a step back to underline the issues that the Green Deal should be seeking to overcome. Energy use remains high in non-domestic buildings in spite of efforts to improve energy efficiency. The Chartered Institution of Building Services Engineers’ (CIBSE’s) recent review of DECs shows that heating use has decreased in relation to previous benchmarks but this positive result has been undermined by growth in electricity use, which has a high primary energy and carbon intensity. This may be partly due to assets being used more intensively (i.e. more heads per square metre of usable floor space) but there is a tendency toward greater energy inputs rather than greater energy efficiency in the services that are installed in buildings. While individual fittings are getting more efficient (and are likely to continue to do so in view of the Energy Related Products Directive), we are simply putting more of them in buildings. In addition, the last decade has seen the mainstreaming of IT services as a natural feature of
every office and electronic till systems in retail outlets; again this is undermining the steps forward we have made in respect of reducing overall energy demand for heating in buildings.

All this is taking place during a ratcheting-up over time of energy efficiency standards for new buildings and for existing buildings on major refurbishment. While these interventions on regulated energy (the fabric, heating, cooling, hot water and fixed lighting) will undoubtedly have helped to contain the carbon and energy increases set out above, they are insufficient to arrest the growing increases in unregulated energy use.

The building energy measurement and monitoring instruments (e.g. Part L of the Building Regulations, EPCs) that are mandated by legislation focus solely upon energy used for regulated purposes (heating, lighting, cooling, hot water, internal lighting, ventilation) and make theoretical assumptions about occupancy, hours of operation and maintenance. Quite often these theoretical assessments give results which are quite different from how buildings are found to be operated in actuality. In fact, when performance is analysed more closely, we see that there is often a significant difference between the design and the operational performance of buildings. The only legislative instrument that does apply to actual energy use in respect of some private sector rented buildings is the Carbon Reduction Commitment. The Carbon Reduction Commitment again suffers from a lack of contextual data which can be used to support interpretation of the data collected and provides no meaningful benchmarks by which it can be determined whether building energy-use is high, low or typical.

**The Importance of Behavioural and Operational Factors**

In considering eligible measures, it is vital that any technological approach toward emissions reductions is accompanied by a behavioural approach. The latter should include observation of how the building is actually being operated and performing together with suggested corrective action to ensure that performance is as close to as-designed performance as possible. We are pleased to see that according to the Green Deal consultation document, 'no and low cost measures' will be included within the non-domestic Green Deal assessment (p54) and recommend that this encompasses tenant and landlord behavioural and operational improvements. Without behavioural and operational improvement recommendations, the focus on fabric improvements risks overlooking low or zero cost interventions. Changing the behaviour and management approach of building users and operators can deliver significant reductions in carbon emissions and energy use without any installation of physical energy efficiency measures.

Many industry players have achieved impressive reductions in energy use both within common parts and in tenant demises via operational measurement combined with engagement strategies. This process can then identify anomalous performance, which can be addressed through management interventions:

- Changing hours of operation, temperature settings, labelling of switches, security and cleaning routines.
- Making simple repairs (e.g. missing insulation) and replacing outdated and damaged items.
- Simple technical upgrades (e.g. better control devices).
• Adjusting, re-commissioning or otherwise improving controls and zoning of services.
• Creating interest and involving staff in making savings (e.g. carbon champions).
• Reviewing purchasing policies for outsourced services and supplies to take more account of energy and CO2.
• Involving support staff (security, cleaning, maintenance) in avoiding waste and providing help, feedback and ideas.

Ideally, scrutiny of such opportunities should be a key feature of Green Deal assessments (as opposed to simply an assessment of which Green Deal measures would be appropriate in a given building).

We understand that the non-domestic Green Deal assessment will be underpinned by a variant of the SBEM software that has been used to generate non-domestic EPCs. We have concerns about the ability of SBEM to adequately assess the vast array of different types of non-domestic property each with varying levels of complexity, and think it vital that some form of post-occupancy appraisal accompanies any Green Deal proposal for a building. This could be in the form of DECs or something lighter touch, but we believe that without this, any energy efficiency improvements under the Green Deal could be made without their predicted energy savings being realised. We are pleased that the Green Deal consultation document states that actual energy bills will be included in the non-domestic Green Deal assessment (page 55), rather than standardised assumptions, which will be essential. We also believe that air leakage and thermographic testing should be a feature of Green Deal assessments to determine which improvements are appropriate.

The Proposed List of Eligible Measures

The government’s emerging thinking in respect of likely technologies to be covered by the Green Deal for both homes and non-domestic buildings is set out in Box 2 below.

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<tr>
<th>Box 2: Measures</th>
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<tr>
<td>Heating, ventilation and air conditioning</td>
<td>Condensing boilers</td>
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<td>Heating controls</td>
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<td>Under-floor heating</td>
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<td>Heat recovery systems</td>
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<td>Mechanical ventilation (non-domestic)</td>
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<td>Building fabric</td>
<td>Cavity wall insulation</td>
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<td>Flat roof insulation</td>
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<td>Draught proofing</td>
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<td>Heating system insulation (cylinder, pipes)</td>
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<td>Energy efficient glazing and doors</td>
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<td>Lighting</td>
<td>Lighting fittings</td>
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<td>Lighting controls</td>
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<td>Water heating</td>
<td>Innovative hot water systems</td>
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<td>Water efficient taps and showers</td>
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In respect of non-domestic buildings, metering (in particular advanced and automatically read meters) is not as widespread as it might be given the age of the non-domestic stock. We would therefore recommend that in reference to non-domestic buildings, smart meters are included as a qualifying technology (or at the very least a prerequisite for funding). Other technologies that should be considered include:

- insulation on HVAC ducting.
- lighting – not only fittings and controls but also light sources (LEDs etc).
- passive measures – daylight pipes to boost internal uses of daylight, reflective paint, solar shading, solar film for glazing.
- energy efficient glazing including secondary glazing.
- integrated control systems.

The full list of measures and the requirements of PAS 2030, the installation standard for the Green Deal, should be aligned with Building Regulation requirements (found within the Planning Portal’s Non-Domestic Services Compliance Guide18). Alignment of the Green Deal measures with the Building Regulations will be of particular importance due to the anticipated extension of Part L’s requirements for ‘consequential improvements’ where the following alterations are made to property:

- building an extension;
- installing fixed building services - such as heating, ventilation and air conditioning - for the first time; and/or
- expanding existing building services.

Consequential improvements require that where the above works are undertaken the property owner must undertake certain energy efficiency improvements at the same time. Currently the rules only apply to non-domestic property which is over 1,000 sq metres but this threshold will be lowered as a result of the Energy Performance of Buildings Directive Recast. Given this change, it will be sensible to ensure that Green Deal finance is accessible to facilitate any consequential improvements that may be required under the Building Regulations.

Where an improvement is undertaken primarily to enhance energy efficiency, the works will be covered predominantly, but not exclusively, by Part L (Conservation of Fuel and Power). Building Regulations permit defined types of work to be undertaken without the direct involvement of Building Control, although they must comply with the Regulations, where the work is undertaken by a competent person. If a Competent Persons Scheme for energy

efficiency measures was created, then it would be possible for the designers of the energy efficiency works to oversee the works and to sign them off as compliant with Building Regulations in the manner of other Competent Persons Schemes. This would reduce the regulatory burden for the client, and reduce the associated workload for Building Control, by transferring responsibility for compliance to the engineer.

Whilst we recognise DECC’s rationale for including only measures that are not readily portable as eligible under the Green Deal (so they cannot be removed from the property with a Green Deal charge attached), this means that such measures are predominantly, although not solely, fabric, plant and machinery. This means that it is likely that Green Deal assessments will offer Green Deal packages that will fall largely within the landlord’s responsibilities. This may complicate the applicability of recommended Green Deal packages following an assessment, which is explored in more detail in the following chapter on consents.

Given the emphasis on improvements that fall within the landlord’s purview, further incentivisation of energy efficient retrofit of interior fittings (those that fall within the tenant’s fit out) within buildings may be required. Wider use of capital allowances and enhanced capital allowances to stimulate the installation of more efficient kit would help.
Sub-Section 3d: Green Deal Finance and the Consent Process

Recommendations:

- The existing rights and obligations of landlords and tenants of domestic and non-domestic properties should not be interfered with in order to facilitate a Green Deal.

- There could be a duty to co-operate on landlords, tenants and any other interested parties where one party wishes to explore a Green Deal to encourage engagement amongst the relevant parties, but this duty should not compel any party to consent to a Green Deal plan. The only possible exception to this principle would be where a failure to adopt the Green Deal plan would be likely to result in another interested party being subject to a legal penalty or sanction. However it would be preferable if the inability to obtain any such consent simply gave rise to an exemption from any such penalty or sanction.

- In view of the potentially long term nature of the Green Deal we consider that the owner and any other parties with a legal ownership interest in the property (for instance as freeholder or superior landlord) as may be appropriate should, as a pre-condition for any Green Deal plan, have to approve or refuse to approve a Green Deal plan that is proposed for a property.

- Whilst it may be necessary for a legal owner to obtain a mortgagee’s consent to a Green Deal plan being created we do not believe that it should be necessary for evidence of this to be provided to the Green Deal provider as this should be a matter for the legal owner to arrange in giving its own consent.

Multi-Tiered Ownership, Consent and the Green Deal

In order to examine the interaction between the commercial lease and the Green Deal, it is first necessary to identify which parties are likely to obtain Green Deal finance directly and from whom they must obtain consent.

Tenanted commercial property always involves an occupying tenant and a landlord receiving rent. However, there may be others with an ownership interest. Most commonly there may be a separate owner of the freehold reversion receiving a small ground rent from the landlord. This sort of structure is common in cases where the freehold belongs to a government department, local authority privatised utility or similar, where for political or other reasons the grant of a long lease and retention of the freehold is preferred to a sale of the freehold.

Occupational leases are typically granted in return for rent, whereas a head-lease is more commonly granted as a long leasehold interest in return for a premium (i.e. an upfront capital sum) with a very small ground rent payable each year. More complex structures are relatively uncommon (and rare in the context of small local shops, for example). They are much more likely to be encountered in the case of larger assets, for example:

- where commercial property is subject to a ‘sale and lease back’ (a sort of financing arrangement that broadly replicates, through leasing arrangements, a secured loan); and/or
where a structure involving ‘geared leases’ is used to achieve a split of economic interests between different parties who are commercially both the ‘landlord’ of a leased property; and/or

where an occupier finds himself with surplus space and sublets some or all of it to a third party, thereby himself becoming an intermediate landlord (not uncommon in the current economic environment). This situation is not limited purely to large assets.

Combinations of such situations are possible and could result in three or more tiers of property ownership. Such tiered ownership could make obtaining consent a complicated process, particularly in the case of multi-tenanted properties.

An important distinction can be drawn between leases granted for an upfront premium (‘capital leases’), and leases that are granted for a commercial rent (‘rack-rented leases’). The tenant of a capital lease has paid the price for the property and acquired an asset, whereas the tenant of a rack rented lease may view the lease as an asset today (focusing on the valuable right to occupy), but as a liability tomorrow (focusing on a rent that no longer feels affordable).

The landlord perspective will also differ depending on the type of lease. The landlord of a rack-rented lease is likely to be sensitive to cash-flow volatility, and to take a close interest in liabilities entered into by a tenant to which he may be contingently exposed (he will also generally have strong consent rights in relation to alterations, sub-letting, assignment, etc.). On the other hand, the landlord of a capital lease will generally enjoy an effective buffer against any issues encountered at the occupier level; and even if his tenant’s (the intermediate landlord of the rack rented lease) business fails, the administrator or liquidator will almost certainly dispose of the lease to another investor rather than give it back to the landlord, as it has already been paid for.

An effective right to give or withhold consent to Green Deal finance would be very important to a rent-receiving landlord. The landlord of a capital lease, on the other hand, may have limited consent rights generally, and should be well insulated from the risk of contingent liability in respect of the Green Deal finance in any event.

At any level of ownership (ignoring for the present that of occupational tenant), the ‘landlord’, whether freeholder or leaseholder, may be complex:

- **Legal and beneficial ownership may be split**: legal title may be held by a trustee or nominee(s), and there may be one different beneficial owner, or thousands.

- **Management control and economic ownership may also be quite separate**: particularly where property is held in a fund or trust structure for numerous beneficial owners, the economic ownership will rest with them but management decisions in relation to the fund and the property will be taken by professional service providers (which, again, will not be the same as the legal owner(s)).

Such complexity creates real challenges for the operation of other environmental legislation (such as the Carbon Reduction Commitment in the context of tenanted commercial property). However, we suggest that it should not present problems in relation to landlord consent rules for the Green Deal.
Landlord consent provisions are very common in leases (particularly rack-rented leases), and it is invariably the legal owner who formally gives or withholds consent. That makes sense, because the tenant will not necessarily know who else is interested in the property, but he will always know who the legal owner is. It is for those who have the economic/beneficial interest (or who manage the property on their behalf) to regulate, under the terms of the arrangements entered into by them, how decisions are made as to whether the legal owner should give or withhold consent or seek further guidance from the beneficial owners. We would suggest that any statutory provisions for landlord consent rights in relation to Green Deal finance should similarly confer those rights on the legal owner and look no further.

Consent to the Measures

Alterations to properties occur as a natural part of the property leasing cycle. For owner occupiers, this can be a relatively straightforward process, with complications only arising in respect of obtaining the necessary legislative consents for any notifiable works under planning rules or building regulations. The latter issues apply in respect of rented buildings, but they are accompanied by another raft of concerns which arise as a result of the fact that commercial property law has developed without some of the fundamental concepts behind the Green Deal in mind.

It is important to understand that in a tenanted building, unlike owner-occupied premises, there are a number of ways in which energy efficiency measures in theory can be delivered under the Green Deal for any particular building. For example, a tenant could apply for a Green Deal in respect of their individual demise, or an entire building if there is sufficient funding available and buy-in is obtained from all tenants and the landlord. The feasibility of initiating such discussions may depend on existing arrangements between landlord and tenant, with discussions more likely to take place where communication and negotiation channels on energy efficiency issues are already established (such as where there is a Green Lease or Green Memorandum of Understanding in place between landlord and tenant). Alternatively, a Green Deal could be pursued by a landlord in respect of upgrading the parts of a building within the landlord’s purview, including the building’s common parts and services, but would need to get the permission of any tenants in situ if the improvements required access to their demise. If the landlord wanted to pass on the Green Deal charge to existing tenants, the landlord is likely to have to negotiate with tenants to allow for this. This is because the majority of commercial leases will not have anticipated the type of financing arrangement that the Green Deal proposes. As the Green Deal is likely to be a separate line charge on the electricity bill, it is unlikely to be swept up by standard outgoings or energy cost clauses.

As Green Deal eligible measures are restricted mainly, although not solely, to fabric (by which we take to mean exterior and structural alterations), plant and machinery improvements, it is likely that a tenant would not have the right to carry out Green Deal works. This is an important point, since the presumption in respect of interior alterations has been that the landlord should not unreasonably withhold their consent, but in respect of fabric, plant and machinery improvements, the same presumption does not apply and a tenant’s ability to make such requests is limited by individual lease clauses. In many cases, specific prohibitions apply.
There are other reasons why standard arrangements between landlords and tenants may not mesh well with the proposed Green Deal arrangements. In particular, landlords invariably require tenants to remove any alterations at the end of the tenancy, and reinstate the property into the state it was in at the start of the lease. Alternatively they reserve the right to ask the tenant to re-instate, if they expressly require it before the lease ends. In either case, this is to avoid any risk of the landlord having to pay compensation to the tenant for improvements left in situ pursuant to Part 1 of the Landlord and Tenant Act 1927. It is not possible for the parties to contract out of this statute so there is no other way for the landlord and the tenant to agree that no compensation will be due to the tenant at the end of the lease. However, under the Green Deal, it seems likely that the Green Deal charge would continue to be levied on the meter even after any improvement has been removed at the end of the lease.

A further problem arises in respect of alienation and assignment. If a tenant wishes to assign their lease to another tenant for the remaining term of their lease (i.e. to dispose of their interest in the property to another tenant) and the incoming tenant wishes to alter the fit-out of the space to be let, then the landlord may wish to exercise its right to withhold consent (provided that the Green Deal charges are of significant magnitude).

The above factors suggest that if non-structural or non-fabric improvements are included within a Green Deal package (or at least those that are within the scope of the tenant’s fit-out) they run the risk of being removed at the end of the lease for reasons which are understandable from a commercial perspective but which are not ideal from the point of view of broader sustainability objectives (such as embedded energy and carbon and disposal of waste electrical equipment). Although the manner and speed of introduction of minimum performance standards for rented property remains a subject for debate elsewhere, it is probable that their introduction will help to arrest this cycle since it will have a concomitant effect on the value and worth of properties and it is likely that this will incentivise landlords to waive dilapidations charges to encourage tenants to make improvements.

Given the above issues, where a Green Deal package includes measures that span across both landlord and tenant’s areas, this split between responsibilities is likely to cause complications, resulting in:

- the minority of items which fall within the tenant’s area (lighting for example), are not implemented as part of a Green Deal package; or
- a Green Deal package is limited to the period of a tenant’s lease (assuming there is a tenant in situ) because a tenant is required to remove their own fixtures and fittings upon vacating the property; or
- legislation will be needed to validate an agreement under which landlord and tenant agree that a landlord does not have to pay the tenant compensation for a Green Deal improvement which is left in situ following the end of their lease.
Consent to Finance

Whereas there are established processes in respect of alterations to buildings (see previous section), it is less clear what the process should be in respect of how landlords and tenants should come to an agreement in respect of the financial implications of the Green Deal.

The Green Deal has been designed as a finance mechanism where the energy bill-payer funds energy efficient retrofit retrospectively in return for acceptance that energy-savings will be reduced by the value of a finance charge which repays the cost of the energy efficient retrofit.

For owner-occupiers, the risks and rewards of ownership and energy procurement, control and use are aligned and we do not expect there to be significant complications in respect of consents unless there are restrictive covenants in place as a result of lending.

In larger rented non-domestic buildings, and in particular those which are multi-tenanted, as explained earlier in this document, many tenants will receive energy via a variety of different sources. The implications of this are that it would be possible for a tenant to undertake a Green Deal in respect of their own demise or a landlord could apply for a Green Deal in respect of improvements to common parts of the building or in the case where a working Green Lease is in place, whole building retrofit including both common areas and tenant demises could be considered.

There are a number of issues which will arise in a landlord and tenant context in respect of the Green Deal as regards to consenting to the finance charge. Firstly, tenants may wish to access Green Deal finance, but because the Green Deal charge attaches to the meter at the property, the landlord will need to consider whether they are willing to agree to pay the finance charge in the event that the property falls vacant or in the event of tenant insolvency before the property can be re-let.

If the Green Deal is attached to the main fiscal meter at a property, the landlord is likely to wish to pass on the Green Deal charge to the tenant. Most existing leases will not permit this and legal costs may be incurred in verifying whether this is possible. In instances where this is not possible, a deed of variation to the lease may have to be agreed between the landlord and the tenant for the purpose. If the tenant does not agree to pay the Green Deal charge, it is likely that the landlord will have little incentive to pay the charge itself unless the property is likely to fall within the scope of the ban on letting properties with an F or G rating.

The landlord is likely to want significant collateral warranties from the Green Deal provider to guarantee the promised performance levels from the kit which is recommended to be installed as a result of the Green Deal assessment. If the landlord does not obtain such guarantees, they are likely to be at risk of tenant dissatisfaction if energy savings are not realised and the tenant continues to pay the same or more in terms of energy costs with the addition of the Green Deal charge.
Sub-Section 3e: Promoting Awareness

Recommendations:

- The Green Deal has many constituent parts involving a number of different actors. It is important that when communicating the Green Deal, it does not seem complicated, costly and administratively intensive. Messages about the Green Deal from Government and Green Deal providers should be simple, specific, transparent and credible.

- The government could use trade and professional bodies to communicate to their members and their wider constituents. Promotion of the non-domestic Green Deal via articles by ministers and media reports would also be useful and would have the benefit of giving credibility to the Green Deal. A strong presence from Government officials at industry events, especially during the first phase of the Green Deal, would be helpful for dealing with myths and rumours.

- The government may also like to explore new avenues for reaching industry such as including information about the Green Deal with the new business rates, facilitating an online resource for those with experience of the Green Deal to share experiences, extending the SuperHomes network to cover commercial or non-domestic property and the production of a Green Deal toolkit.

Essential to the success of the Green Deal in the non-domestic sector is the effective communication of the scheme to industry. In this section of the report we have split the issue of promoting awareness of the Green Deal into two parts; managing the messages behind the Green Deal and using communication routes to reach industry.

Managing the Message

We advise that information on the Green Deal communicated to industry needs to be:

Simple

Most organisations, particularly SMEs, do not have resources to consider a complex scheme with burdensome paperwork, which on the face of it does not make them any money and will distract them from their core work of running a business. Information on the Green Deal must be accessible and easy to understand, with any unnecessary complexity stripped away.

The Green Deal has different elements to the overall service which when combined may appear complicated. Each element needs to be set out simply so that the scope is clear, so for example, it is easy to understand what a Green Deal assessment entails including what kind of advice will be offered, and what types of measures will be eligible for Green Deal financing.
Specific

The benefits of the Green Deal for a landlord will be different to those for a tenant and so the information advertising the benefits of the Green Deal will need to be tailored to suit tenants and landlords separately.

Green Deal guides for each property type and for each section of the industry (e.g. landlord, tenant, surveyor etc) would be useful. Each guide would only need to set out the elements of the Green Deal of relevance to the relevant property type and section of the industry; there is no need to explain all the complexities of the Green Deal to all sections of industry.

Transparent

Industry needs to feel confident about how the scheme will operate and that there won’t be major changes to it following roll-out. If potential changes to the scheme are expected these should be made clear. Recent changes to the Feed-in Tariff will inevitably result in concerns that the rules may change and the scheme may become less attractive over time.

Case studies for non-domestic energy efficient retrofit which showcase a range of eligible measures for different types of property would be useful for setting out how the Green Deal could work. Financial benefits must be clearly identified, but any assumptions used (e.g. assumed fuel price increases or interest payments) in case studies should be clearly set out so as not to be misleading.

Credible

Information that is government backed (e.g. information on the product guarantees and installer standards for Green Deals) will engender greater levels of trust that the information is reliable. Government must, however, provide categorical assurance that the scheme rules will not change, resulting in a less attractive proposition over time.

A single authoritative source of information and guidance, such as the planned national Green Deal helpline is vital. This helpline will need a non-domestic section to deal with questions that are specific to the sector.

It is essential that the Green Deal has the support and endorsement of a good number of well respected commercial property owners, tenants and property advisors. Such organisations will not, however, provide such support or endorsement until such time as full details of the scheme are known and they are convinced that it is robust and likely to be effective.

Accessing Communication Routes to Industry

There are many different avenues by which government and Green Deal providers can reach the non-domestic property sector, but below are a few ideas to consider:

- Industry trade and professional bodies such as those represented on the Green Deal Commercial Property Group are in a good position to interpret and disseminate Green Deal information to their members via committees, publications, events and through the media. Whilst trade bodies and professional bodies only incorporate a small percentage of their respective sections of the industry, the information they
disseminate is likely to be picked up by wider industry via word of mouth, internet presence and media coverage.

- It will be important that information reaches those operating across the UK and not just those based in London and the South East. The Royal Institute of Chartered Surveyors (RICS) undertakes road shows around the country and it may be worth delivering messages through this route. Similarly the British Chambers of Commerce (BCC) are well placed to spread information across the regions to smaller landlords and businesses via its regional Chambers network.

- Articles by ministers in the trade press would help to reach those who may not be members of trade or professional bodies.

- Government attendance at industry events is an effective way of dispelling myths, providing assurances and increasing awareness of policy.

- When the new business rates are issued, DECC could simultaneously issue information about the Green Deal.

- The online tool ‘Huddle’ which allows forum discussion and the sharing of documents could be used for an ongoing space for sharing information.

- There could be an extension of the SuperHomes network to cover non-domestic property so that people would be able to see first-hand how the non-domestic Green Deal works in practice.

- Easy to use ‘tool kits’ would be helpful, allowing users to input their own data and assumptions to test whether the Green Deal would be useful in their particular circumstances.
SECTION 4: CONCLUSION

The Green Deal offers owners and occupiers of non-domestic property a new and novel way of financing energy efficiency improvements that removes the need for upfront capital by allowing for improvement measures to be paid for from the savings that they create. Whilst there are significant challenges in the application of the Green Deal to non-domestic property, we believe that this core concept holds great potential for unlocking energy efficiency improvements in the existing non-domestic property stock.

This report highlights the importance of acknowledging the very real existing barriers to energy efficient retrofit, especially for rented commercial property, when considering how the Green Deal might be applied. The current lack of a proven connection between market value of a property and its energy efficiency performance, and the challenges posed by the division of landlord and tenant responsibilities are unlikely to be overcome by the Green Deal on its own. Nevertheless this report has identified a number of practical recommendations for government, industry and private companies involved in Green Deal delivery to take forward in order to help make the non-domestic Green Deal as effective and successful as possible.

The report makes the following key recommendations to help make the non-domestic Green Deal a success, which are:

- **The benefits of energy efficiency must be clearly demonstrable and communicated widely** – owner occupiers, landlords and tenants need to make the case for implementing energy efficiency improvements and the Green Deal and so they must be able to see clear demonstrable benefits. The government’s plan to make F and G EPC rated property unlettable (unless all Green Deal measures have been undertaken) by 2018 could act as an effective incentive for Green Deal take-up for the worst performing properties. However in order to be effective and drive the right responses, the proposal must be implemented in a manner that is sensitive to the complexities of rented commercial property. The detailed regulations must also be set out well in advance of implementation so as to provide clarity and certainty to the market on what will be required. Evidence of tenant willingness to accept the Green Deal charge on new tenancies would help give market confidence that undertaking a Green Deal is not likely to put off potential new tenants. Tenants should be encouraged to see all the benefits of energy efficiency, such as the protection/enhancement of their reputation and improved building comfort levels, and not just the financial benefits. A mandatory roll-out of Display Energy Certificates (DECs) to all commercial property (undertaken in a way that is sensitive to cost burdens) would raise awareness of energy use amongst landlords and tenants and help to raise interest due to concerns about reputation.19

- **Better use and awareness of existing fiscal incentives would promote uptake although further incentivisation may be needed** – there are already fiscal incentives attached to investment in energy efficiency, but their availability is not widely known and understood. Information on the available incentives and how they

19 For further details about the benefits of a mandatory roll out of DECs to commercial property, please see the UK GBC and BPF submission to the Energy Bill Committee and the UK GBC’s task group report on DECs and the CRC.
link with the Green Deal should be provided to potential non-domestic Green Deal customers. If the government intends to incentivise comprehensive retrofit to commercial buildings, it needs to consider using further tax levers to incentivise large scale works such as façade replacement/enhancement and moving to mixed mode or natural ventilation, as such improvements are unlikely to be economic even via the Green Deal.

- **Buildings must be improved through both physical and operational changes** – in order to achieve significant reductions in energy use from existing non-domestic buildings, the Green Deal assessment process must not only consider physical building improvements but also operational, management and behavioural improvements. We therefore propose that the scope of the Green Deal allowable works is extended to include a range of alterations which are aimed primarily at behaviours, for example smart metering. Without understanding how a building is used, interventions that yield significant energy reductions at low or no cost may be missed, and physical improvements may fail to deliver expected savings due to operational inefficiencies. This may undermine the credibility of the Green Deal in non-domestic buildings.

- **Consent from a property’s legal owner should be required before a Green Deal can proceed** – although it may be difficult to enforce, a duty to co-operate could be put in place to encourage all parties with a stake in a property, not least the property’s owner, to positively engage with the Green Deal. However consent should not be mandated from any one party, especially the property owner who must carry the ultimate obligation for the Green Deal debt on the electricity bill.

- **The complexity of the Green Deal must be overcome in its promotion** – all those involved in the promotion of the Green Deal – government, industry, professional bodies and Green Deal providers need to ensure that the complexity of the Green Deal does not overshadow the benefits. Commercial organisations, especially SMEs, are unlikely to have the resources to assess the risks involved in highly complex issues that do not offer an opportunity to increase company profits. Each stage of engagement with the Green Deal, from initial requests for information, right through to the ongoing relationship between customer and Green Deal provider, needs to be straightforward and intelligible.