# UKGBC Response to BEIS Consultation on a Future Trajectory to 2030 for the Non-Domestic Private Rented Sector Minimum Energy Efficiency Standards

**January 2020**

### *Introduction*

The UK Green Building Council (UKGBC) is an industry network with a mission to radically improve the sustainability of the built environment, by transforming the way it is planned, designed, constructed, maintained and operated. As a charity with over 400 member organisations spanning the entire sector, we represent the voice of the industry's current and future leaders who are striving for transformational change.

### *Executive Summary*

We welcome the opportunity to respond to this consultation. The Non-Domestic Minimum Energy Efficiency Standard has started to be a key driver of energy efficiency improvements in the privately rented sector, particularly among landlords with larger property portfolios. In contrast to the residential sector, most non-domestic landlords have been enthusiastic about the MEES since the Energy Act was first passed in 2011. They accepted from the early days that a trajectory for tightening MEES was both inevitable and desirable. We therefore welcome the key consultation proposal to introduce a trajectory for increasing the MEES to EPC Band B by 2030. In order to ensure that the necessary improvement works are undertaken – and emissions savings are achieved – well in advance of 2030, phased milestones to 2030 are preferable to a single backstop date.

There are clear problems with enforcement that need to be addressed urgently if the MEES is to work as effectively as it should. Consideration should also be given to the introduction of a longer payback test to take account of increasing costs of measures and longer payback periods as the Band B target draws nearer. More broadly a range of attractive financing options and incentives – such as variable business rates and the reintroduction of enhanced capital allowances – needs to be put in place to ensure early action and the buy-in of landlords across the entire sector.

### *Responses to individual Consultation Questions:*

**Question 1: Do you have any evidence which can improve the Government's understanding of energy use in the non-domestic building stock?**

No response.

**Question 2: It has now been over a year since the minimum energy efficiency standards for the non-domestic private rented sector were introduced. What have been the positives and areas for improvement of their introduction?**

*The positives*

- Our members tell us that the Non-Domestic MEES is beginning to have a transformative effect on the sector, as landlords with larger portfolios start proactively to improve the energy performance of their assets to ensure that they will not be stranded. A number of these landlords are taking the opportunity to improve their properties well beyond EPC Band E.

- There is ever-increasing market awareness of the MEES and the likelihood of its being ratcheted up over time.

- The existing regulations are already beginning to spark interest from the finance community about the potential for lending which is conditional on energy efficiency improvements.  Whilst this interest is just at an early stage, a trajectory to 2030 could help to accelerate the development of these types of products.

*Areas for improvement*

- The picture is very different among smaller landlords, who are either not aware of the MEES or are not sufficiently worried about the consequences of non-compliance.

- Enforcement is a real problem and must be tackled.  Local trading standards departments are already overwhelmed by the plethora of other statutory duties they are required to perform, in relation to product safety, fair trading, age limits and restrictions, and weights and measures.  These are duties with which they are already familiar and which, for understandable reasons, they may consider to be more important.  Our suggestions for improving enforcement follow in response to Q. 12.

- Seven-Year Payback Test: our members take the strong view that the requirement to obtain three quotations is unnecessarily cumbersome and not fit for purpose.  There are opportunities for 'gaming' at the EPC F/E margin; and installers are reluctant to quote for work they know they are unlikely to undertake.  Our recommendation for changing this requirement follows in response to Q. 7.

**Question 3: Do you agree that 2030 is the appropriate date to set the future trajectory?  Does this allow a long enough lead-in time for landlords and businesses to plan effectively, as well as providing the energy efficiency market with medium to long-term certainty of demand?**

We agree that 2030 is the appropriate date for the future trajectory and, as long as the Government acts swiftly to enshrine this in law, it will give the sector long enough to plan effectively and make the necessary investment decisions.  It will likewise be beneficial to an energy efficiency market which has all too often been scarred by the frequent chopping and changing of policies.

**Question 4: To what extent do you think an EPC B trajectory provides sufficient certainty of demand to encourage suppliers in the energy efficiency market to grow, scale and innovate?**

See response to Q. 3.  However, the market needs not just one firm policy, but a suite of them, to encourage it to scale up and innovate in the way the Government wants.  Policies in the non-domestic sector must include:

- An urgent move towards the introduction of mandatory operational energy ratings, starting as soon as possible with requirements for monitoring and disclosure, and the establishment of a central data collection point;
- The tightening of new build standards to avoid the need for costly energy efficiency improvements in future;
- Making the ESOS more robust in order to incentivise investments in energy efficiency;
- A clear trajectory for ramping up CCL rates over time;
- Variable business rates dependent upon energy performance ratings.[1]

**Question 5: What do you think are the opportunities and challenges of the Government's preferred 2030 EPC B trajectory?**

We have already outlined the opportunities in our responses to Qs. 3 and 4.

[1] For a full list of UKGBC's recommended non-domestic sector policies, see: https://www.ukgbc.org/wp-content/uploads/2019/12/UKGBC-Submission-to-BEIS-Select-Committee-Energy-Efficiency-Inquiry.pdf

As previously outlined, challenges include:

- ensuring optimal levels of compliance and enforcement; and
- ensuring that the exemptions regime remains fit for purpose, especially the payback test. Our suggestions for improving it follow in our response to Q. 7.

**Question 6: We estimate an EPC C trajectory will only bring 42% of the non-domestic PRS building stock into scope of the regulation. Are there any alternative approaches that could complement an EPC trajectory that would guarantee the necessary action across the remaining stock to drive clean growth and deliver sufficient energy and carbon reductions?**

As we have made abundantly clear in our executive summary, we believe that EPC Band B is the correct trajectory for all the reasons outlined in the consultation response. We cannot meet our UK or international climate targets by opting for a lesser trajectory. Our members have long called for an ambitious trajectory beyond Band E to be set, and they stand ready to deliver on the Band B target.

As regards 'alternative approaches', as stated in our response to Q. 4 we believe that a suite of policies is needed to address the problem that emissions in the non-domestic sector have been flatlining for years and are now on the rise again. But these policies should be *additional to*, not *instead of*, a Band B trajectory.

**Question 7: Can you identify any issues regarding the current administration of the seven-year payback test which could be improved to support the goals that a tightened regulatory trajectory to 2030 aims to deliver?**

As indicated in our response to Q. 2, our members take the strong view that the requirement to obtain three quotations from qualified installers for purchasing and installing a measure is unnecessarily cumbersome and not fit for purpose. The requirement should be changed so that a report by a RICS-accredited professional – likely a building surveyor or quantity surveyor – is sufficient proof of the cost-effectiveness, or otherwise, of an energy-saving measure for the purposes of the seven-year payback test.

Also, we believe that early consideration should be given to amending the regulations to mandate packages of measures that collectively have a payback of less than seven years. The current guidance acknowledges that certain measures which might, individually, fail the seven-year payback test, may pass the test when installed as part of a package. However, the existing regulations do not mandate the installation of relevant packages. As the trajectory ratchets up and the required measures become costlier and have longer payback periods, it is surely appropriate that a package approach be adopted. This would allow savings from shorter payback measures to contribute to the installation costs of those with longer payback periods. The two worked examples below illustrate the difference at the same property between selecting (1) a group of measures that all pay back in less than seven years, resulting in the property only achieving a C rating; and (2) a different set of measures, one of which does not pay back in less than seven years, but which, when installed as a package, result in a B rating at a lower capital cost overall and with a shorter energy payback period.[2]

[2] Worked examples by Arbnco. Measures in green have a seven-year payback or less; measures in red have a payback period of longer than seven years.

| 1 | All MEES compliant recommendations | | | |
|---|---|---|---|---|
| | **Recommendation Name** | **Lower Cost** | **Upper Cost** | **Affected Area** |
| | Replace local electric, central air distribution, forced-(un)flued heating systems in warehouse/industrial environments and/or existing radiant heating systems with new, radiant systems | £10305.6 | £13397.28 | 687.04m² |
| | Replace T8 fluorescent tubes with LEDs (lamp and luminaire) | £1680.7 | £2184.01 | 78.73m² |
| | Replace tungsten lamps with LEDs (lamp and luminaire) | £546.48 | £710.42 | 8.28m² |
| | Replace high pressure mercury/sodium lamps with T5 fluorescent tubes (lamp and luminaire) | £4493.24 | £5853.58 | 687.04m² |
| | Install lighting controls | £280.32 | £364.42 | 93.44m² |

**Cost (£):** 17,306 to 22,509 **Discounted Payback Period (yrs):** 4.1 to 5.4 D 86 → C 53

**Energy reduction (kWh/m²/yr):** 87.2 **Emissions reduction (kgCO₂/m²/yr):** 34.1

| 2 | Maximised EPC rating with longer payback period | | | |
|---|---|---|---|---|
| | **Recommendation Name** | **Lower Cost** | **Upper Cost** | **Affected Area** |
| | Add weather compensation controls to heating system | £1549.0 | £2013.7 | 687.04m² |
| | Replace existing local electric heating and/or air source heat pump with a new air source heat pump system | £1390.12 | £1807.16 | 30.22m² |
| | Replace tungsten lamps with LEDs (lamp and luminaire) | £546.48 | £710.42 | 8.28m² |
| | Replace T8 fluorescent tubes with LEDs (lamp and luminaire) | £1680.7 | £2184.01 | 78.73m² |
| | Replace high pressure mercury/sodium lamps with T5 fluorescent tubes (lamp and luminaire) | £4493.24 | £5853.58 | 687.04m² |
| | Install lighting controls | £280.32 | £364.42 | 93.44m² |
| | Install destratification fans | £979.03 | £1288.2 | 687.04m² |

**Cost (£):** 10,918 to 14,221 **Discounted Payback Period (yrs):** 2.2 to 2.9 D 86 → B 50

**Energy reduction (kWh/m²/yr):** 96.2 **Emissions reduction (kgCO₂/m²/yr):** 37.9

**Question 8: Would a single backstop date in 2030 or phased milestones to 2030 be the more effective method for implementing the trajectory options? Does it depend on the trajectory option? If a single backstop were favoured by the Government, what type of financial and non-financial incentives could encourage landlords to install measures earlier than the 2030 deadline?**

We believe that phased milestones to 2030 are the preferable option. The consultation describes many of the reasons why this is so. Principal among these, in our view, is that phased milestones will ensure that improvement works are done - and emissions savings are achieved – well in advance of 2030. There is of course a slight risk that landlords will undertake staged improvements (as the consultation identifies), but the larger asset owners will almost certainly use the interim milestones as an opportunity to improve their properties all the way up to Band B. Smaller landlords can be incentivised to do so by means of attractive financing options, a business rate incentive and the reintroduction of enhanced capital allowances for energy-saving improvements.

Consideration should also be given to encouraging ongoing improvements in energy performance for properties that are unable to meet Band B by 2030 with an alternative compliance mechanism using operational ratings (see Q.4). Properties that cannot be brought up Band B would have the option to comply with MEES by achieving a specified rating for operational performance, thereby demonstrating that they are being operated efficiently.

**Question 9: Are there any reasons why any of the current exemptions will be less effective under a tightened trajectory?**

See our response to Q. 7. Consideration should also be given to a payback period longer than seven years to take account of the higher costs of measures as we draw nearer to a Band B target. We note from the Impact Assessment that an alternative 10-year payback period was modelled for the purposes of this consultation. As a result of this modelling, BEIS has concluded that 'the small additional contribution to the government's emissions reduction targets is insufficient to justify the additional financial burden'. We struggle to understand this conclusion, as the Impact Assessment makes clear that a 10-year payback period results in an increased NPV and increased carbon and energy savings compared with a 7-year payback. While there is, apparently, a 'somewhat increased private financial burden' associated with the longer payback, this must surely be offset by the increased benefits across all the other indicators modelled? We would urge BEIS to think again - and to share more detail about its modelling of financial burden (which is scant in the Impact Assessment).

**Question 10: Are there any ways in which the market can overcome situations where the tenant has fit-out requirements and is willing to fund the improvement of the building at the start of the tenancy?**

'Shell and core' buildings are common for retail and industrial uses. For these buildings not all the services will be installed (especially heating, mechanical ventilation and air conditioning), and fit-out works are left to the tenants before occupying the building. The current structure of the MEES therefore commonly results in a scenario where property owners are effectively required to obtain two EPCs, one to market the given property – which is likely to result in a poor EPC rating due to the use of default/worst case values – and another to allow for a lawful lease to be granted once the occupier has completed their bespoke fit-out.

In the case of such buildings, it would make sense to adjust the time period for compliance with the MEES, to allow for the fit-out to be taken into account in the EPC assessment. We would suggest a period of, say, 3-6 months between the date of the lease and the lodging of a MEES- compliant EPC. The responsibility for complying with MEES clearly rests with the landlord, but there could be a way of configuring leases to require a tenant to fit out the building in such a way that it will be compliant. In reality, however, all buildings are different, as is each set of landlord/tenant relationships. This means that it will be impossible to legislate for a particular outcome – and the exact route to MEES compliance should be left to the transactional relationships between landlords, tenants and their respective lawyers.

**Question 11: Are there any unique challenges that the tightened trajectory will pose to SMEs or any individual sector? How could the sector look to overcome that challenge?**

As already noted, SMEs are on the whole less aware of the MEES and are less likely already to be taking proactive steps to comply with it. Many SMEs are time-poor and don't have the internal capacity or skills to develop and implement energy efficiency projects. They are incentivised to stay with 'Business As Usual' activities because energy efficiency improvements have to compete with business cases for other investments they know about.

A clear trajectory, as proposed by this consultation, should help change this. However, as already noted, there is also a need to introduce incentives and a range of attractive financing options to encourage early action.

**Question 12: At this stage we welcome views on how the Government could most effectively improve enforcement of minimum energy efficiency standards under an EPC B or C by 2030 trajectory.**

As far as we understand it, no enforcement proceedings have yet been undertaken by local authorities in respect of alleged non-compliance with the MEES. The threat of enforcement proceedings is therefore not yet real.

Local authorities need to be adequately resourced and have the appropriate skills to start to make enforcement a reality. The penalties for non-compliance are significantly higher than for residential properties, with a maximum fine of £150,000 for a non-compliant property let out for more than three months. It can be anticipated therefore that once weights and measures departments start to see these kinds of sums arriving in their coffers, levels of enforcement will start to increase. However, local authorities are currently facing a 'standing start', as they do not have a pot of funds with which to pump-prime enforcement activity. We therefore believe that some seed-funding for local authorities should be injected by central Government. This should be time-limited, perhaps for one or two years, after which local authorities could reasonably be expected to have raised sufficient funds with which to continue enforcement activity. This in turn would send a clear signal to recalcitrant landlords that non-compliance is no longer an option.

**Question 13: As illustrative examples, do the costs, bill savings and private payback periods that our modelling assumes for these building types approximate your experience?**

No response.

**Question 14: The table lists the costs and benefits we have identified as a result of the proposals. Are there any impacts relevant to your sector or organisation/business (e.g. SME, civil society organisations) that are missing? If so, can you provide us with any supporting evidence?**

No response.

**Question 15: We understand that there are natural void periods when leasing a property, due to finding a tenant and refurbishing a building. Is there any evidence to suggest the proposals are likely to increase void periods and by how long? Please provide as much detail as you can.**

As we understand it, there has been very limited evidence to date of the MEES leading to increased void periods. It is possible that there will be an increased incidence of void periods as the EPC target is ratcheted up, but it is our view that this is not something that the regulations can – or should – address. It is a management issue, which should be addressed as part of the business planning cycle. 2030 is far enough ahead to allow for proper forward planning.

**Question 16: Under both trajectory options, landlords of buildings below EPC B or C will be required to invest money upfront to improve the energy efficiency of their building. If you are a landlord, what are the key factors that would determine the pass-on cost to the tenant, and the length of time under which you would seek a return on your investment? We anticipate key factors could include: investment cost, bill savings delivered by the measure, payback period of the measure, lifetime of the measure, maintenance costs and market forces. If you are not a landlord, we also welcome any evidence you could provide.**

No response.

**Question 17: Is there a possibility that under certain types of lease arrangements (for example green leases) the costs of improvements might be shared between landlords and tenants?**

Moving towards more widespread adoption of green leases is of course an excellent goal. However, in reality this often needs to be preceded by 'softer' interim stages – perhaps starting with an environmental management plan. We would commend the work of the Better Buildings Partnership in this area. They have been promoting Green Building Management Groups – bringing owners, occupiers and building management representatives together to oversee the environmental performance of the building and work towards its more efficient operation. This activity can lead to or be supported by a memorandum of understanding, under which the operational management of the building is agreed with a view to improving its environmental performance. These softer forms of agreement are seen as easier to achieve than green leases, though they may be a step on the way there.

**UKGBC**
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