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Insights

The Impossible Task of yielding up 'the same' EPC rating – the Clipper Logistics case

The task of returning a property at the end of a lease with 'the same EPC rating' as at the beginning of the lease is an almost impossible task.

Yet this was the Court's decision in *Clipper Logistics plc v Scottish Equitable plc.*

Here we look at the issues created by this decision.

CARBON FACTORS
COMPLEXITY LEVEL
INSPECTION DATE
SOFTWARE
NATURAL GAS
ASSET RATING
ACCREDITATION
BODY
BENCHMARK

The case centred around a 1954 Act renewal lease, where the landlord had proposed various alterations to the existing lease, with new terms sought including:

1. A restriction on the tenant undertaking alterations or additions to the property which would result in it becoming 'sub-standard' under the MEES Regulations;
2. A requirement for the tenant to pay for a new EPC certificate to be prepared if they went ahead with such alterations or additions;
3. A requirement for the tenant to maintain the current EPC rating (including promptly carrying out remedial works to restore the rating to its current level) and returning the property with the same EPC rating as at the start of the lease.

The EPC referenced was a rating of D(78) dated 1 June 2021. This cited (among other things) that the property assessed measured 18,513 square metres and had a main heating fuel of Oil.

The judge's decision in the case was that the landlord should reasonably be permitted to retain the third requirement, deciding that it was a 'fair and reasonable change'. The judgment details that without this clause the landlord would not have any protection against the tenant's omissions or inaction during the course of the ten-year lease which could result in the property becoming sub-standard.

This decision, however, seems critically flawed on several levels:

1. The court's own starting position was to recognise that it was the landlord's responsibility to comply with the MEES Regulations; the suggestion that the landlord should be protected against the tenant's 'omissions/inaction' resulting in the property becoming sub-standard does not follow that position.
2. The requirement to 'maintain the current EPC rating' during the course of a ten year lease (as was proposed) is a very difficult task. If we assume that an EPC rating is defined as its 'Asset Rating' – '78' in this case (as opposed to the EPC band of 'D') – this would require an

EPC assessment carried out at the end of the lease term specifically scoring precisely the same asset rating. As explained below, this is virtually impossible.

3. On the face of it, this term seems to place the tenant's requirement specifically on keeping the EPC rating the same, inferring that they are not required to – or perhaps should not – improve the EPC rating.
4. It is an established fact that the assessment of EPC ratings changes over time, never more so than in recent years. In June 2022, a fundamental change in EPC assessment occurred which had an overnight impact on assessment result outcomes. The D(78) rating described in this case was registered in June 2021, a year before this change; a repeat of that same assessment done again post the change in June 2022 would inevitably change that result – most likely to a much worse result, thus placing the tenant immediately in breach of this lease term.

EPC Variables

In any given property, there are many aspects that can impact an EPC rating. These are aspects which could result in the same property being assessed on the same day by two separate assessors, each yielding different (but legitimate) results. In no particular order, these include:

- The 'NOS' or 'Complexity' level that the EPC is carried out to;
- Which software the assessor uses to calculate the rating;
- How much the assessor inspects the property and reviews relevant information;
- How many 'default' values are used in the assessment;
- The assessor's interpretation of the use of the property.

In the case of the Clipper Logistics 2021 EPC, this assessment was seemingly carried out at a point after it was known that the landlord would be seeking to place a requirement on the tenant not to worsen it – it was intended to form the datum point that the tenant was not to allow it to move from.

The EPC was carried out by the same assessor who had carried out the previous assessment in 2013, which had identified a rating of E(108). That EPC was still valid in 2021 and there was no legal requirement for a new EPC; it would also have to be assumed that significant improvements were carried out to the property in the intervening period for the same assessor to upgrade it from an E(108) to a D(78). It would follow that – were such upgrades undertaken – these most likely would have been done by the tenant during the course of the initial term, thus having already 'upgraded' the property on the landlord's behalf.

As explained above, the EPC rating of D(78) was achieved at a point before the June 2022 change in assessment. Assuming during the course of the new lease term a new EPC is prepared, this is very likely to see the rating worsen sharply, without the tenant having physically done anything to cause it. This new EPC – when lodged – would superseded the D(78) rating and place the tenant immediately in breach of the covenant allowed to remain by the judge in this case. The apparent requirement upon the tenant would then be to retrospectively upgrade the property to seek best to return it to its previous rating of D(78). In this case, this could involve replacement of the heating system (removing the oil elements), replacing the lighting and possibly upgrading and/or insulating the building fabric of the property.

The tenant's task of returning the property's rating to a D(78) in current assessment terms therefore is likely to require significant and costly works, fundamentally upgrading the property demised to them.

No datum point

The requirement for an agreed 'starting position' in a commercial lease is a familiar quandary and challenge. The use of Schedules of Condition is an increasingly important tool in reaching what is commonly considered a fair and equitable agreement between the parties, whether that be an agreement for the tenant not to return the property in a worse condition than shown in the document, or if they should not be obliged to return it in any better condition. In the case of a schedule of condition, there are physical certainties possible around the lease-start datum point presented in the document produced – a damaged door frame; a slipped roof-slate; three faulty light fittings. An EPC assessment, however, is different – as explained above.

The challenge then is – how could an EPC datum point be reasonably agreed? The approach of trying to agree a certain asset rating being the datum point is flawed, as demonstrated in this case. In the Clipper case, the tenant has effectively signed up to a commitment to upgrade the demised property and take on (at least in part) the landlord's obligations to comply with MEES – contrary to the court's very opening position.

What should the judgment have said?

In light of the issues around the datum point being impossible to identify, a suggestion that the tenant should have to keep (and return) the property with 'the same' EPC rating was always going to be flawed.

The more practicable and enforceable conditions included might instead have been:

- The tenant is not to commission an EPC without the landlord's prior consent – this would prevent the D(78) rating from being superseded;
- The tenant is not to undertake works which would have a detrimental impact upon the EPC rating;

The most legitimate and workable 'datum point' therefore isn't in fact the asset rating produced by the EPC assessment; instead it should have been a detailed schedule of condition of the property, including the identification of the elements likely to affect the EPC rating, e.g.:

- Warehouse lighting – high bay halogen light fittings;
- Warehouse heating – oil-fired warm air blowers.

The further issue with this case is that the property is due to become 'sub-standard' during the course of the new lease term. In 2027, it is proposed that the current 'minimum standard' under MEES will increase to a C-rating. At this point, it will become unlawful for the landlord of the property in question here to continue letting it.

The issue faced will become all the more serious when the landlord has the EPC reassessed at that point and identifies that the registered D-rating is no longer near accurate and in fact the challenge faced is to upgrade the property from (perhaps) a G-rating up to at least a C-rating.

The question then arises – can the landlord viably seek the tenant's contribution towards this significant work required?

This scenario is a mere example of the widespread and complex issues faced in commercial property as a result of the MEES Regulations and confusion and misunderstanding around the importance of EPC assessments.

Contact our EPC and MEES Director to arrange a call or seek a quote for a draft EPC and fully considered holistic advice.

Ben Strange MRICS | Senior Director
bstrange@mobiusbc.co.uk | 020 3355 1500