

Carbon Reduction Commitment and the landlord and tenant relationship

Owners of tenanted property should be aware of the potential impact of the Carbon Reduction Commitment Energy Efficiency Scheme (CRC) on the value of their investments. Property owners need to ask themselves a number of questions and make decisions now on how they approach CRC. It is wrong to assume that all the costs of CRC can be passed down to tenants in the same manner as other outgoings. As a result, landlords are likely to find themselves carrying the cost of CRC and this may have a negative effect on value. Likewise, tenants need to be alive to the issues so that they do not find themselves unfairly treated.

The first question to ask is who is responsible for the energy supply contract. For multi-let properties or those with inclusive rents, landlords are probably the counterparty to the supply contract even if the tenant reimburses the costs of their energy usage. If it is the tenant, then the landlord does not need to consider the property as part of its CRC assessment. A landlord who is responsible for the energy supply contract must consider the property as part of its CRC assessment.

Landlords currently outside CRC need to ask themselves the same question. Why? Because the impact of CRC may affect the value of the property on a sale to a buyer who is a participant in the scheme or if the landlord becomes a participant in the future.

CRC has a number of potential costs associated with it including registration, annual subsistence fee, staff or management costs incurred in ensuring compliance, the cost of involving consultants as well as the price paid for the CRC allowances less the recycling payments received.

Where a property is part of the landlord's CRC responsibilities, it has three options. The first is to absorb the costs itself, the second is to try to pass them onto the tenants and the third is to take the property outside the landlord's CRC responsibilities.

The first option is the "market forces" position or the "head in the sand" position. It is likely to be the most common course of action for the immediate future. The landlord hopes the rents achieved reflect the costs it incurs, but are landlords and tenants really that sophisticated when it comes to agreeing an open market rent? Landlords adopt this approach to inclusive rents and accept that the risk falls on the landlord if it gets its sums wrong. However, with CRC the level of risk is not yet fully quantifiable. No one can be certain of the actual costs or that rents will reflect the cost to the landlord of complying with CRC.

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The instant reaction from most landlord clients is that they want to pass the costs onto their tenants by treating CRC in the same way as any other outgoings and recover them via a service charge. However, CRC is a charge on organisations and not on buildings. This creates practical problems as well as legal problems when an attempt is made to allocate CRC charges to specific buildings and tenants. This will cause problems for landlords, as many existing leases will not enable a landlord to recover CRC costs. Therefore, new drafting is needed in leases so that landlords can recover their CRC costs from tenants. There are a number of ways to achieve this. However, until the real estate investment market adopts a standard approach this is likely to result in protracted negotiation with new tenants and so delay important transactions. The BPF recently published the responses to its consultation on reaching a cross-industry consensus for apportioning CRC costs between landlords and tenants in new leases. In short, there is little or no consensus but the BPF is shortly to produce a second edition of its guide for landlords.

The CRC scheme effectively rewards those who reduce their electricity usage and penalises those that do not. The third option requires making a tenant responsible for its own electricity supply and therefore taking its premises outside of the landlord's CRC provision. If it is easy to have a tenant contract for its electricity supplies direct with the supplier then the landlord only needs to concern itself with supplies to common areas. A landlord is more likely to be in control of the electricity use of common areas than the tenanted areas. However, this may not be a cost-effective or practical solution.

One question that will keep cropping up is what is fair? Is it fair for a landlord to bear all the costs of CRC when the tenant's electricity use so directly impacts on those costs? What is going to be the fair way of apportioning CRC costs across a landlord's portfolio and then across each individual tenant at a particular building? Is it fair for a landlord to reward tenants for good performance and punish them for poor performance? Answers on a post card ...



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