

# The practical challenges for landlords and occupiers

Occupiers could face higher service charges if their landlords fall under the CRC regime and fail to prepare for it properly, warns **Melita Thomas**.

*Melita Thomas is a partner with Remit Consulting, which advises real-estate businesses on strategy, business process and outsourcing, information systems and finance. Tel: 07919 448018, email: melita.thomas@remitconsulting.com or visit www.remitconsulting.com.*

**T**he Carbon Reduction Commitment Energy Efficiency Scheme (the snappy new title for the CRC) is now officially under way. While this article does not attempt to cover the complex rules in detail (there are various government publications that do this), it is a whistle-stop tour for the uninitiated. For detailed advice, please consult appropriate energy experts or lawyers.

## THE OBJECTIVE

The purpose behind the CRC scheme is to help meet the UK's commitment to reducing its energy consumption by 80% by 2050 through the introduction of the country's first mandatory carbon-trading scheme. In summary, it is a cap-and-trade auctions-based emissions-trading scheme aimed at the non-energy-intensive sector.

## WHO IS COVERED?

An organisation will qualify for the CRC if it:

- has any half-hourly metered supply of electricity; and
- has consumed more than 6,000 megawatt hours (MWh) of half-hourly metered electricity between January and December 2008. At today's prices, this is roughly equivalent to total half-hourly electricity bills of approximately £500,000 per year.

If you are within this group, then all of your energy (not just electricity) needs to be counted. Groups of companies have to aggregate the amount of energy they use, with the parent organisation being responsible for reporting.

If you have half-hourly metered supplies, but do not consume the 6,000MWh, you must still provide certain information. In practice, that means that any landlord who is supplying electricity to a multi-let building and charging it back via the service charge is likely to be covered. If the landlord is only supplying power to common parts, and tenants are responsible for their own individual supplies, then the amount used by the common parts will count towards the landlord's overall use. The landlord must also include energy consumed at its head offices in its total.

## WHAT IS COUNTED?

All energy, including (but not limited to) electricity, gas, coal, liquefied petroleum gas and diesel is counted.

It is essential to get your base figures right. To do this:

- by the last working day of March 2011, ask your energy suppliers to give you an annual statement, containing a list of all unique meter ID numbers and the amount supplied through each;
- request such a statement of consumption from every supplier and for every account – suppliers are obliged to supply this within six weeks of the end of the scheme year;
- subtract domestic accommodation, transport and unconsumed supplies (such as coal still in the bunker); and
- check whether any part of your organisation is covered by a Climate Change Agreement, in which case emissions relating to that part may be exempt, depending on the details.

Using this data, you can then work out your carbon emissions and submit your footprint report. This must also include all the evidence on which you have based your calculations.

The technical details of how to do this are contained in the legislation. You must file your report by the last working day of July 2011 or face a fine of £5,000.

## BUYING ALLOWANCES

Having calculated current energy use, you can then calculate what your use is likely to be in the following year. Participants will be able to purchase allowances in advance for anticipated energy use in the next year at a fixed price of £12 per allowance in the three-year introductory phase. Later, they will bid for allowances through a government auction.

During the introductory phase, there is no cap on the number of allowances that can be purchased but subsequently the government will reduce availability. These allowances can then be traded in a secondary market. Also, under a complex "safety-valve" mechanism, extra allowances will be purchasable during the year.

Each July, organisations will report on their energy use in the previous year and surrender an allowance for each metric tonne of carbon emitted. Unused allowances may be banked or sold.

## REVENUE RECYCLING

Each October, payments will be "recycled", according to a league table. This revenue recycling is not related to the allowances initially purchased, but to the

relative position and movement of your organisation in the league table compared with the base year.

The scheme is designed to be revenue neutral to the state, using a “carrot and stick” approach towards participants. Good performance by one organisation (meaning a reduction in carbon use) is rewarded by transferring funds from poorly performing participants.

2010 is the beginning of the three-year introductory phase and a reporting year only.

The scheme is self-monitoring, with about 20% of organisations being audited annually by the Environment Agency. Under-reporting will attract heavy fines.

**PRACTICAL IMPLICATIONS**

If you are still with me after that descent into Kafkaesque complexity, let us turn to the practical implications. What will this mean for how landlords and tenants each manage energy, and for the facilities manager who often has to mediate between the two?

**Leases**

How will current property leases be affected? As the vast majority were drawn up before the scheme was introduced, it is possible that the cost of allowances will not be chargeable to the service charge. Neither, however, would the landlord be obliged to deduct any recycled payment from the service charge.

So how can the parties compromise? An obvious way would be to agree, by means of a lease variation where necessary, to include both allowance costs and any recycled payment as part of the service charge. However, because any recycled payments would be made on the basis of the landlord’s overall consumption, it might be tricky to allocate any repayment to an individual service charge. Then there are the costs of administering the scheme – should they be part of the service charge?

Also, what is the position if the landlord is subject to the legislation only because of the aggregation of its energy use across its whole business? Why should the tenants have to pay an additional amount for their energy use, which they would not incur if they had a smaller landlord with lower overall emissions, or if they provided their own electricity?

It might be sensible, in principle, for landlords to back away from providing electricity through the service charge and for tenants to provide their own supply. However, this could be hugely impractical – imagine dozens of separate supplies going into one shopping centre. Also, the tenants would not be able to benefit from any economies of scale currently achieved through larger, single supplies.

Another factor to consider is the requirement to purchase allowances at the start of the year. What if the landlord does not purchase enough and has to buy more at penal rates? Should the tenants be penalised for the landlord’s poor planning? Perhaps allowances should be purchased and “ring-fenced” for individual properties.

These issues also need to be properly considered for all new leases.

**ACTION POINTS**

There are six things that landlords and tenants should do now:

- identify obvious sources of wasted energy in their properties and combat them where it makes financial sense to do so;
- look at the practicalities of separate supplies of energy for individual tenants, thus tying consumption to payment;
- identify where energy can be recycled within a building or scheme (there is no reduction in allowance cost for energy from renewable sources, as the scheme is designed to reduce overall energy use rather than offer incentives to use renewable energy, but internally recycled energy can be excluded);
- identify the high energy users within multi-let properties and work with them on schemes to reduce consumption;
- work with lawyers to ensure that new leases have appropriate service-charge clauses to deal with the CRC and that transition arrangements are made on sale or purchase; and
- when developing new schemes or refurbishments, consider what design features should be incorporated to reduce energy consumption. Should licences for alteration and approval of tenant’s works’ schemes require an energy- consumption audit? Perhaps excessive energy consumption would be a reasonable ground to refuse a scheme.

**Capital and rental values**

There are a number of questions about the CRC’s potential effect on property values and rents:

- Will individual tenants who consume low amounts of energy be worried about the activities of their more energy-profligate fellow tenants? Will this lead to them asking for lower rents to share a building with high users of energy?
- Will overall energy consumption and the question of whether the landlord is covered by the scheme become a factor in the choice of location, reflected in slightly higher rents for landlords who are not part of the scheme?
- Will rents fall at review if the building has been sold to a scheme participant – or rise if the new landlord does not qualify for the CRC?
- If the building is sold to a new owner who is not a participant in the CRC, how would any allowances already paid for in the service charge be refunded to tenants?

These issues need to be taken into account in the due diligence prior to sale or acquisition.

**REDUCING CONSUMPTION**

The CRC’s overall objective is to reduce energy consumption. However, by splitting the responsibility for paying for consumption allowances away from the actual users of the energy (the tenants), the scheme creates difficulties in allocating incentives appropriately.

Initially, the scheme is not too painful, the costs are not high and allowances are not capped. However, this will change to make energy consumption much more expensive, and landlords and occupiers need to think about the future.

