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Office to Residential Conversion: One Year On

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Kevin is a regeneration professional, having previously worked for a variety of public sector organisations, specialising at different times in physical, economic and social regeneration. He has managed various commercial property portfolios and in particular dealt with the various challenges and opportunities associated with vacant commercial property. He is currently a Post Graduate Researcher at Northumbria University, recruited to investigate the incidence, impact and options available to address office vacancy in town and city centres in the UK.
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Preamble

The following article fulfils two purposes, first it offers a reflection on last year's rule changes regarding office to residential conversion; secondly it provides an update regarding the ACES endorsed Northumbria University research project: *'Investigating the Impact of Vacant Office Buildings on Town and City Centres in the UK.'*

Acute Office Vacancy - Problem or Opportunity ?

Reaction to recent office-to-residential change of use regulation in the UK has ranged from congratulation, to outrage, fear, pessimism and confusion, in both public and private sectors. In the 11th January 2014 edition of the Estates Gazette, Damian Wild illustrated the political success of temporarily removing the need for planning permission for office to residential conversions, while at the same time indicating that the policy may already have outgrown its original intentions. More than 2,250 notifications for office to residential change of use have been submitted to councils in the first 6 months alone, significantly more than the Government estimate of 140 applications p.a..

How many of these applications will actually come to fruition? How much of a contribution will such conversions make to housing supply? What impact will such changes have on towns and cities in the UK? Crucially, it is unclear whether there is a correlation between those properties for which applications have been submitted for office to residential conversion, their relative degree of redundancy and obsolescence, or suitability for adaptive re-use. In other words, the number of notifications isn't necessarily a sign of success, as it doesn't guarantee that the buildings are even

vacant, let alone suitable for conversion. The result is an uncertain detente between regulation and re-development potential.

It is questionable whether anyone has a UK wide appreciation of:

- How much vacant office property exists;
- Where it is located;
- What types of office building are most likely to be vacant;
- What types of office property have the greatest potential for adaptive re-use

As such it is difficult to evidence the case for or the potential success of the policy change. Moreover there isn't any means of justifying the need for change of use or linking this with overall office supply within a specific locality, which presents challenges for those in charge of regulation to positively engage with a policy tool that, in the appropriate circumstances, could lead to more efficient allocation of property resources and land use allocation.

The Scale of the Problem

Traditionally it has been difficult to create a reliable evidence base that articulates office vacancy across the UK, or a model that indicates its typological characteristics. A data collection exercise conducted by the authors for case studies of Leeds and Newcastle, has revealed that problems persist with access, conformity, comparability and transferability of office market data in part due to existing data sources having been created at different times for diverse purposes. The Government based its own business case on statistics published in 2005, thus a policy decision has been made using nearly 10 year old data from before the recession. Data sources that have been used, during the last 20 years, to estimate commercial vacancy are listed in Table 1; many were created for other purposes or are no longer in use.

Table 1: Understanding Vacancy

Resource	Description	Issues
DCLG 1998-2005 vacancy statistic.	Local authority level estimation of vacancy utilising information collected for business rates purposes.	Methodological estimations present inaccurate picture.
Neighbourhood Statistics commercial and industrial floor space statistics 1998 – 2008.	Summary statistics at Medium super output (MSOA), local authority district (LAD) and government office region (GOR) level. Specifically hereditament, m ² , £ /m ² and rateable value.	Dated and cannot be compared to recent VOA data release due to incompatible methodology. Although similar to the DCLG statistic for the same period it is perhaps unique in providing data below the local authority level.
DCLG Industrial and Commercial floor space statistics 1998 -2008.	Summary statistics regarding hereditament, m ² , £ /m ² and rateable value.	Dated and cannot be compared to recent VOA data release due to incompatible methodology.
Valuation Office Agency Experimental Statistic 2000-2012.	Provides local authority scale commercial property data, including hereditament, m ² , £ /m ² and rateable value.	Methodologically incompatible with previous data releases.
Valuation Office Summary Valuation.	Contains similar information to the rating list but also includes floor	Provides building attribute information but does not

	space, number of floors and their usage. Not all properties have summary valuation. This information covers about 80% of the property on the rating list.	account for vacant accommodation. Vacancy has no influence on valuation.
Valuation Office Rating List.	Includes details of all non domestic properties (approx 1.8 million entries), addresses, postcodes, descriptions, classification codes, rateable values.	Provides building attribute information but does not account for vacant accommodation. Vacancy has no influence on valuation.
National Land Use Data Base 2001-2009.	Yearly information regarding previously developed land and premises. Last data published 2009.	Premises based information is based on site rather than building attribute.
National Non Domestic Rate Returns (NNDR).	Accurate record of vacant commercial properties within a locality collected for business rate purposes.	Does not regard buildings, only hereditament. No regard to building attributes.
Commercial Data Resources.	Organisations such as Estates gazette and Co-star Focus publicises vacant property according to their own market intelligence.	Partial in scope but arguably the most current data resource.

Adapting research in the previous decade² our study exploits National Non Domestic Rate returns and Valuation Office Summary Valuation data to create aggregated building profiles that describe the characteristics of office vacancy, in particular its nature, scale and geography.

Office Vacancy in Leeds and Newcastle

Our initial case study findings offer some insight into office vacancy in Leeds and Newcastle and provide a potential means of linking recent regulatory change with those properties that most overhang office markets. Figure 1 depicts longitudinal analysis in Leeds for the last 10 years. It utilises a concept of 'compound loss', a composite indicator utilising rateable value as a measure of rental value and empty property rate costs (a proxy measure of holding cost), as a representation of the financial impact of office vacancy in Leeds over the last decade. Compound loss has utility on several fronts: it can be used to represent the cost of vacancy over a variety of geographical scales; it can also be used to evaluate and stress-test investment portfolios and potential acquisitions; on an individual property basis, it can be used to justify redevelopment, finding common ground between book and residual values (discord between the two being a common obstacle in the redevelopment of vacant office accommodation).

In addition to entirely vacant properties, compound loss can be used to demonstrate viability or lack thereof in partially vacant properties, which is a matter of some concern. One of the early findings in the study is that many of the poorest performing properties are not entirely vacant, especially the biggest ones in central locations due, in part, to landlords offering advantageous lease terms to reduce their holding costs. In such situations, where buildings remain part of overall office stock but may still be considered to be obsolete, compound loss' can evidence (non) viability on a cost/value basis rather than relying on levels of overall vacancy.

Compiled from more than 14,000 separate incidences of vacancy, Figure 1 confirms the continuity of vacancy over the last decade and its amplification since the recession. Empty property rates liability has increased almost threefold between 2007/8 to the present. Notably, rateable value didn't increase significantly until 2011/12, increasing by almost £18m in 2 years, demonstrating the

immediate impact of revised empty property rate legislation in 2008, and the lagged impact of the recession upon rents. According to our analysis, compound loss has increased 64% between 2004/5 and 2013/14 (£39m-£64m).

Figure 1: The Cost of Vacancy in Leeds

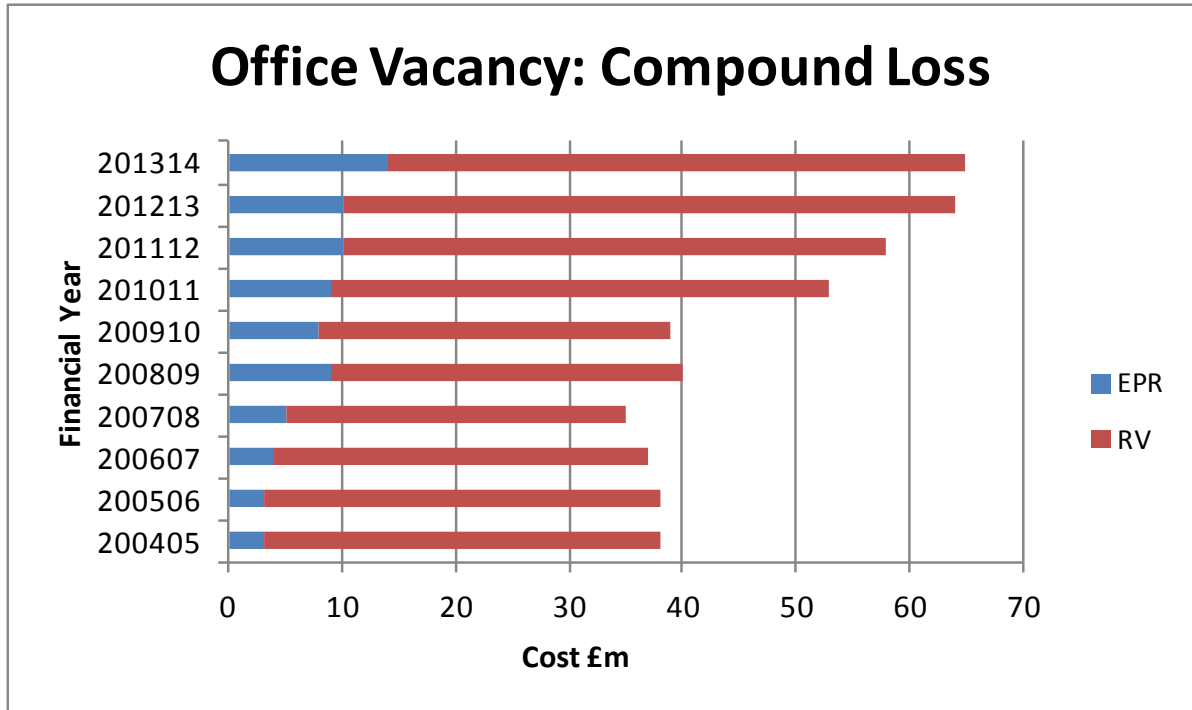
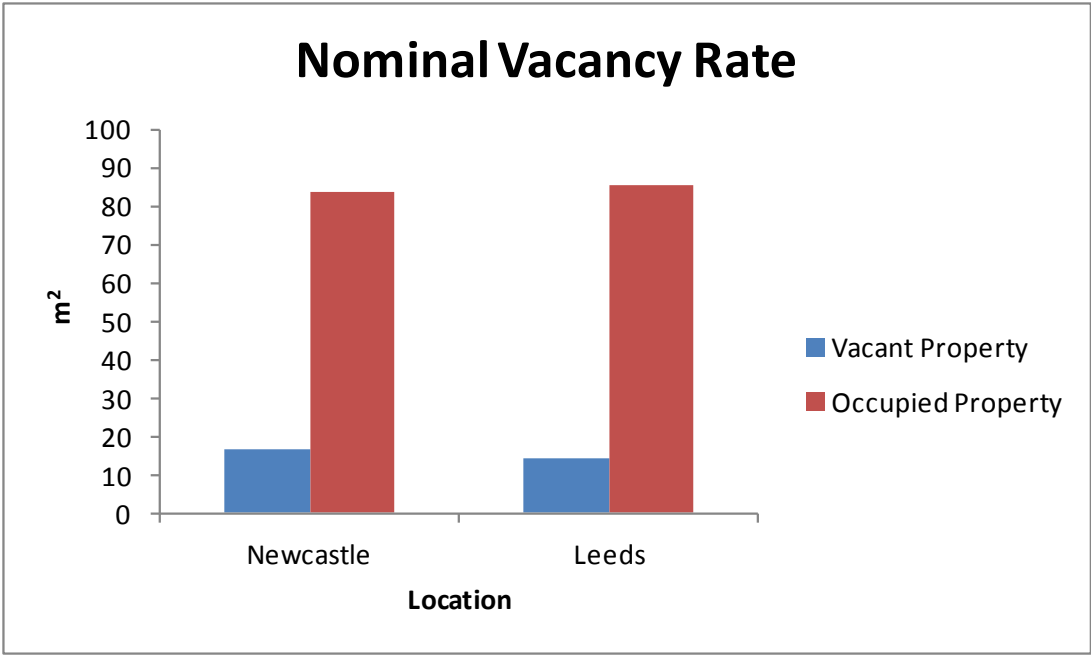


Figure 2 describes the nominal vacancy rate based on 449 vacant office properties in Leeds and 258 in Newcastle. In Leeds the vacancy rate for 2012/13 was 14%, in Newcastle it was 17%, which equates to 267,000 m² of vacant office floor space in Leeds and 155,000 m² in Newcastle, illustrating the magnitude of wasted space in both areas. Utilising rateable value as a proxy measure of rental value, the vacant space in Leeds and Newcastle represents £48m and £21m in lost revenue respectively.

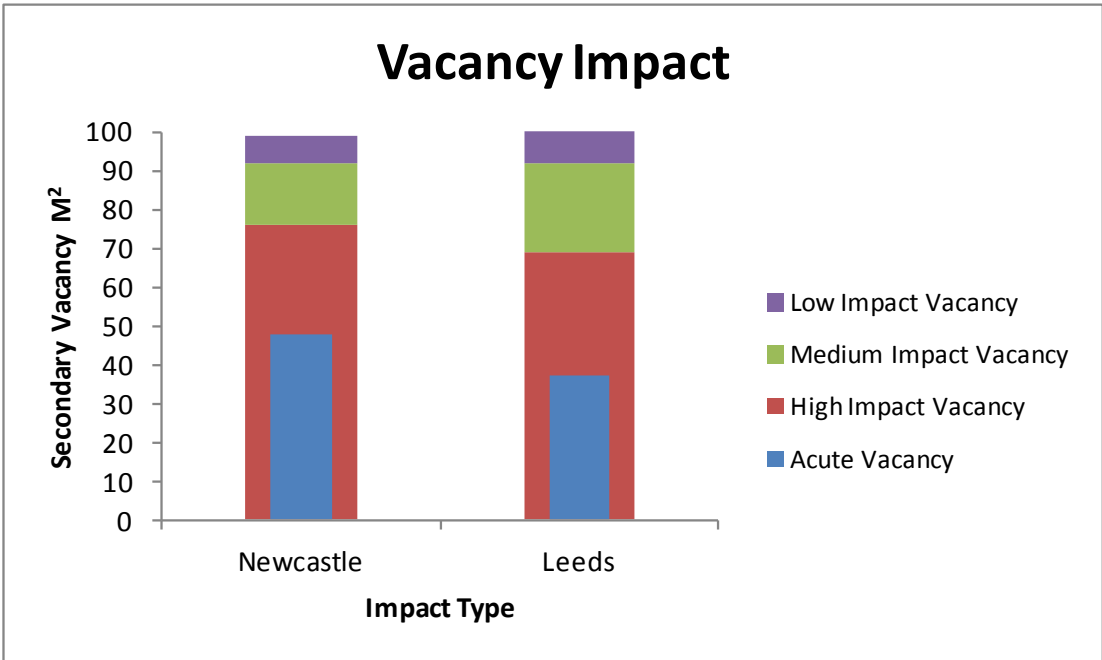
Figure 2: Nominal Vacancy Rate



NB: excludes modern office parks and tertiary property

Figure 3 represents secondary office market vacancy, segmenting vacant office properties into ‘low’, ‘medium’ and ‘high’ impact. Each figure is based on an equal number of properties. In both cities, high impact vacancy accounts for roughly 70% of all secondary office property vacancy, demonstrating that a minority of vacant buildings disproportionately impact the secondary office market.

Figure 3: Vacancy Impact



NB: Prime property removed from data set

Win-Win Situation

Within 'high impact' vacancy, a further subset of properties exists, that of 'acute vacancy' that captures those properties, which because of their specific characteristic^{s3}, overhang the secondary office market to the greatest degree. In Leeds and Newcastle, acute vacancy accounts for only 37 and 24 buildings respectively, but these buildings equate to approximately 40% and 50% of all vacant secondary office property in the two cities, corresponding to 78,529 m² of floor space in Leeds and 60,922 m² in Newcastle, the compound value of which, based on rateable values, is £12.6m in Leeds and £8.8m in Newcastle.

Such buildings are typically located in city centres, constructed between 1960-1980 and suffer from obsolescence and redundancy to some degree. Relevant to the current permitted development rights debate regarding office to residential conversion, such buildings are also potentially the most viable in terms of adaptive re-use because of their inherent characteristics. Thus, if local authorities, public sector agencies, investors and developers focused attention on buildings identified as 'acutely vacant', secondary office vacancy may be reduced by up to 40% in Leeds and potentially halved in Newcastle.

Whilst our case studies of Leeds and Newcastle offer findings that may be used to articulate and maximise the potential impact of the recent relaxation of office to residential change in use regulation, there are a number of critical, questions that will influence the suitability and viability of specific buildings for adaptive re-use:

- Is there sufficient floor to ceiling height to allow mechanical and electrical service improvements? This is negated to some extent by wireless technologies
- What is the building's thermal efficiency? Buildings of this era typically have a large area of single glazing and inadequate curtain walling.
- What is the buildings energy performance? In 2018 it will be illegal to let a commercial building in the U.K. with an energy performance certificate (EPC) below grade E
- Does the building configuration and depth provide adequate natural light and opportunity for passive ventilation?
- Will the general access arrangements and lift system need to be remodelled?
- What is the environmental condition of the building with respect to asbestos and other contaminants?
- Are the building's fire safety arrangements supportive?
- What is the local planning authority's attitude toward re-use? 'Acute vacancy' generally resides in 'prime' areas; will change of use or mixed-use be countenanced in such areas?
- Is there likely to be need for planning permission as a consequence of external alterations?
- Is there demonstrable demand for potential re-use?
- What evidence based resources and appraisal/solution models are available to practically assess technical feasibility and financial viability?

Our on-going research is seeking to investigate these and many other questions relating to the adaptive reuse of vacant office buildings in the U.K.

Endnotes

1. Prime: generally the best specification, 'blue-chip' tenants and highest rents

Secondary: usually older with dated specifications; often associated with various types of obsolescence and have difficulty maintaining existing and attracting new tenants
Tertiary: not considered part of the 'real' office market; often in marginal location and typically exhibit functional, economic and physical obsolescence

2. DCLG (2006) Technical Report: Development of commercial and industrial property vacancy statistics; Katyoka, M. & Wyatt, P. (2008) An investigation of the nature of vacant commercial and industrial property. *Planning Practice and Research*, 23 (1). pp. 125-145; Myers, D. and Wyatt, P. (2004) Rethinking urban capacity: identifying and appraising vacant buildings, *Building Research & Information*, 32(4), 285-292
3. Characteristics: robust land value and expectant property value; good access to amenities and transport; generous car parking; sound overall building structure which supports adaptation and alterations to external cladding; generous overall size which supports critical mass; appropriate building depth allowing access to natural light; appropriate floor to ceiling height which allows retrofitted mechanical and electrical alterations; minimal structural obstruction which allows flexible space planning and sub division; consensus for change

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