



UK Market in Minutes

Where is office to residential conversion viable?

April 2013

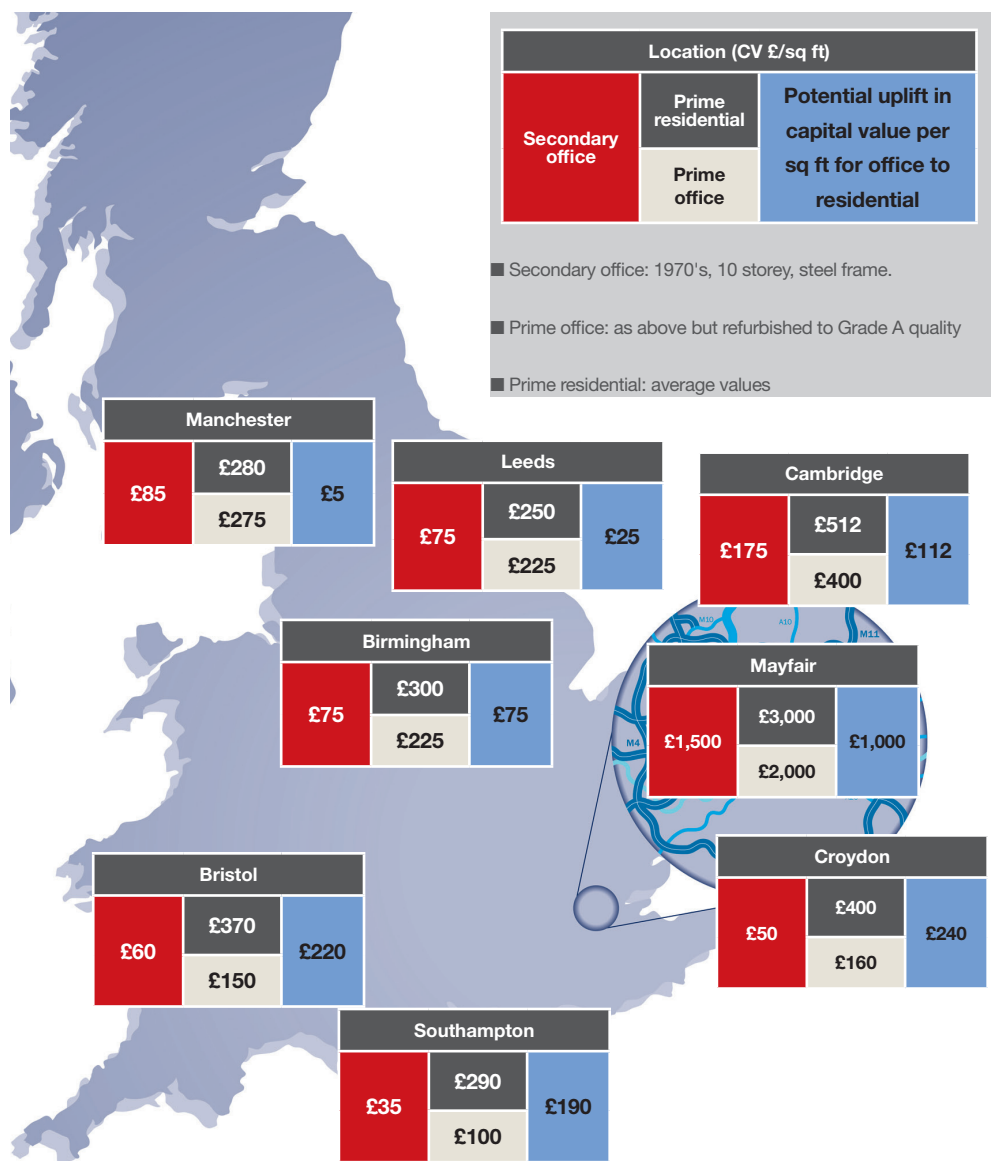
■ The relaxation of planning policy to allow conversion from office to residential uses will come into force on the 30th May 2013. Driven by a desire to speed up housing delivery and deal with high office vacancy rates in some parts of the country, the three-year exemption from the planning rules appears effectively to remove the requirement on developers to build affordable housing (Section 106). If this is the case, the changes will give developers an extra incentive to convert office space. However, the policy is still dependent on residential values being higher than office values but is this always the case?

■ The map on this page looks at differences in office and residential capital values per square foot across some key English cities. We have assumed that the decision facing a landlord or developer is what to do with a hypothetical 10 storey, steel-framed, second-hand office building is whether to refurbish it for office use, or go for a residential conversion. We have also assumed that the office building is in an area which is suitable for residential use. Also, we have ignored the very highest residential values in each location, as most markets can only support a handful of such schemes, and the extra fit-out costs to get to this peak level can be double the norm.

■ The received wisdom is that residential values are far ahead of office values, but this is clearly not the case. Throughout the country the prime residential value is higher than the prime office value, but how much higher does it have to be to make conversion viable?

■ In London's West End, where office to residential conversion is already

TABLE 1
The gap between office and residential capital values



Source: Savills

→ viable in many cases, the exemption from planning rules and by extension the burden of Section 106, could almost double the potential uplift per square foot. Other areas where residential prices are high such as Cambridge, the removal of affordable housing requirements could increase the value uplift per square foot by almost a third. Even small differences would be magnified many times once the cost of conversion is taken out. However, while the requirement for Section 106 might be waived, the change of use may trigger Community Infrastructure Levy particularly where offices have been empty for over six months.

■ Our experience tells us that even without the need to go through a traditional planning process, you need to factor in at least £100/sq ft for a basic office to residential conversion.

■ This means that only half of our sample locations offer a wide enough gap between prime office and prime residential capital values to even start considering such a move. However, the rumoured exemption from Section 106 payments would increase viability in some of these locations.

■ The locations with the greatest potential are generally in the South, where residential values are high on the back of undersupply.

Implications

■ Although the number of applications from local authorities for exemptions has been high, Nick Boles, Planning Minister, has signalled his intention to push through with the plan. Local

authorities that have applied for borough-wide exemptions such as Kensington & Chelsea and Croydon are less likely to be successful than those which applied for exemptions for small specific areas.

■ The reasons behind these applications are varied, but those that we questioned generally stated that they wanted to ensure the strength of the CBD, facilitate jobs growth, or protect income from business rates. Furthermore, there is a lack of clarity over how onerous the discussions with the planning authority will be.

■ The new permitted development rights will be in place for an initial period of three years that may be extended indefinitely. It will only cover change of use. Any associated physical development that currently requires a planning application will continue to need one. This factor as well as the requirement to satisfy building control and energy performance regulations may deter some developers.

■ Secondly, you have to question how easy it will be to borrow speculatively to undertake an office to residential conversion. Lenders are certainly more amenable to lending on residential development than office (at least in London and the South East), but will they view a conversion as inherently more risky? Our straw poll of lenders that are currently prepared to provide residential development finance indicates that they would be open to discussions about projects in London and the South East.

■ Finally, there is the issue of whether the residential market is active enough to stimulate this development and whether the type of product that will be delivered is what the buyer wants. In the centre of some regional cities such as Leeds and Birmingham the demand is greatest for rental homes, for example. Buyers in Manchester city centre remain price sensitive. The shape and size of the final apartments will also be restricted by the office's floor plate, ceiling height and availability of natural light which may limit demand. Local knowledge will undoubtedly be a key factor in the decision to convert or not. ■

Conclusions

■ If permitted development effectively allows developers to bypass Section 106 requirements, the changes will provide a major incentive to convert offices to residential use.

■ In central London, where conversion is already viable in many cases, exemption from Section 106 could almost double the potential uplift.

■ However, the exemption from planning rules will be less attractive if affordable housing provision continues to be a requirement. In this case, permitted development is unlikely to have a huge impact outside London and sought-after southern towns.

■ Developers will still be faced with the Community Infrastructure Levy in some cases.

■ Local authorities' attempts to inhibit the rollout are likely to be limited.

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