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Planning For Opportunity in 2023

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As we come to the end of a turbulent year economically and politically, it is a time when many of us will be kicking back to take a well-earned break and just breathing a sigh of relief over a glass of mulled wine – or something stronger!

However, it's also a time to reflect on possible trends and opportunities for development in 2023 and to consider where we might take balanced risks and make this coming year a good one for property development or investment.

I am not an economist nor is what follows intended to be investment advice. There is no substitute for independent due diligence and proper enquiries and none of what follows can release readers from such an obligation. However, as a chartered surveyor and planning and development consultant, often at the coalface with our own clients, the following observations are, I hope, at least a trigger for further thought and investigation.

Key drivers to 2023

If it was not already abundantly clear, the UK economy is about to go into a prolonged recession (if it's not already in one). We do not know exactly for how long. Some say 18 months, some say less than this. Together with Brexit-related pressures on food markets, inflation due to the Ukrainian conflict, and supply pressures overhanging from Covid, the pressure on disposable domestic incomes is a worrying reality for many.

As a result of such acute pressure on disposable incomes, this will filter through (and is doing so currently) to retail traders on the high street and the suppliers and wholesalers that rely on the vibrancy of this aspect of our economy. Cash flow, being such an important aspect for many retail and supply-chain businesses, could suffer significantly as a result of such a dramatic drop in the velocity of money (i.e. the speed or frequency at which money circulates around the economy and is used to purchase domestic goods and services).

The growth in online shopping has for larger retailers helped them to cope with losses on the high street but has not been enough on its own to stop the need to exit from many existing premises. Marks and Spencer, for instance, earlier this year reported plans to accelerate the closure of many stores, especially those in under-performing older and more tired buildings. By 2028, it aims to have 180 "full-line" shops selling food, clothing and homeware products, down from 247. That's one in four stores (Source: BBC).

If this is how large and well-established retail giants are faring, then it will certainly be very difficult for many smaller retailers to continue. Some retailers may look to renegotiate leases or rents downwards, cut down on the space occupied or surrender their leases altogether. Some landlords might in turn see this as an opportunity to sell. Much of this might not have filtered through to the economy yet, but most expect that by the summer of 2023, at the present rate, there is likely to be much stronger pressure on vendors and landlords.

Improving existing commercial value

The most important thing for an existing landlord seeking to maintain asset value (or at least avoid the prospect of a complete loss of income) is to pivot as quickly as possible without planning or other regulatory obstacles.

Use Class E offers a route out of difficulty for commercial space faced with a possible loss of the existing tenant. Space can be converted into other uses within the same Use Class, such as from an office to medical use, or from light industrial workshop to gym or fitness studio.

This flexibility in Use Class E also helps to make development potential more viable. Often in smaller commercial conversion schemes, the developer's own share of ▶

the profit stack (after paying off the bank and equity investors or private lenders) will be in either the last one or two residential units, or in the commercial space that's left. If the commercial space can be relet by changing it away from its current unviable use into another use in Class E that does work, then the developer has sufficient incentive to proceed with the deal.

Looking at local market trends, especially amongst recession-proofed, 'Amazon like' tenants, will be important to spotting possible sectoral advantage to secure space on a long term 'full repairing and insuring' (FRI) lease and manage risk in the commercial side of the development. Local commercial agents will be a source of information about those such companies that might be looking for space in the area and the type of space or location that they require. Networking, knowing your area, and being informed are vital.

Tenants might be happy to stay but might not want to nor need to occupy space to the rear of some shops and, possibly, much less the storage or office space in the floors above. This gives rise to the prospect of mixed-use commercial lettings to smaller businesses. For instance, a medical use might be looking for space on an upper floor of a building, or there might be a reasonably strong argument for a serviced office premises on the upper floors. None of these changes in use would require either full planning permission or prior approval.

The attractiveness of movement within the commercial use class, rather than to residential use (subject to the delay and costs caused by the need for consent), might also be bolstered if the local area is seeing new housing development come forward, which might positively impact on local demography or the demand for different shops and services.

Commercial-to-residential development

Commercial to commercial development helps to spread portfolio risk and avoid deal friction through encounters with the planning regime. Where it is viable, it can either produce a great fall-back position to secure viable returns in a deal, or a longer-term investment play. However, for sheer return on investment, in most parts of the country, the return on conversion to residential use is likely to be greater.

Commercial conversion to residential use provides a stronger return in many cases, either to flats or to HMOs. Prior Approval, under Class G or Class MA (where premises are in commercial use under Use Class E) are popular strategies. Either enable planning approval for the conversion of commercial premises to flats in 56 days, or by deemed permission if longer, without the need to prove lack of demand for an existing commercial use or establish an appropriate dwelling mix, and with no contribution to affordable housing. Conversion to HMO use, either for up to 6 people sharing (Use Class C4) or larger (Sui Generis) will in any event require full planning permission as conversion under the new Class G or via Class MA and then on to a small HMO (Use Class C4) is blocked in law.

Mixed-use development, through Class G rights or under Class MA if part of an existing shop is retained, also helps to balance commercial and planning risk. In some high street locations, especially in conservation areas where retail use is part of the historic character, then it is important to retain a viable trading space toward the front. Local commercial agents should be canvassed to check how much space needs to be retained in order to offer a viable commercial unit to the local market.

Co-living schemes on larger development sites will also continue to offer opportunity. In their proper planning sense, these are larger schemes that create a 'community-feel' to the project with living, working and leisure space often mainly for the benefit of on-site residents. With more and more people working, eating and going out closer to home and seeking to cut down on costs of commuting, such developments make a lot of sense.

Care will still need to be taken as to the value in converting to residential and the profit obtained depending on the exit strategy. In the last quarter, 13% of landlords have left the residential sector due to an inability to make a profit (source: Propertymark, Sky News); faced with being taxed on rent and not on profit, a rising tax burden and increased costs (like heating), this is compounded by the inability in some cases to pass these additional costs on to tenants. On the capital side, Halifax reported a 2.3% fall in UK house prices in November 2022, the biggest monthly fall in 14 years. The annual rate of growth in property prices has now dropped from 8.2% to 4.7%. (Source: BBC).

Where possible, the development of roof tops and extra storeys (known as 'air rights') will also offer opportunities for further value. However, this has not quite lived up to the initial excitement that it caused when announced in 2021, with additional structural and parking considerations adding costs and uncertainty. In addition, the Planning Inspectorate and most planning authorities apply the legal conditions and limitations in such a way that there is little difference between the scope of considerations via prior approval for extra storeys and the full planning permission route.

Sustainability and 'green' development will become a growing theme in terms of options for development and can help in some cases to add significant positives to a finely balanced scheme, that might then make it acceptable overall. This area of planning is constantly evolving and has only recently been given greater weight through national policy (the NPPF). It will never be sufficient to make a fundamentally bad scheme or development that is 'in principle' non-compliant with policy, acceptable, but rather should be considered as important to integrate early into the design of good schemes. More and more funders, echoing their own social and environmental responsibility policies, are stipulating this as a key funding criterion.

Location specific

This article focuses mainly on sectoral opportunities. However, certain locations will continue to have a strong demand for certain forms of development. For instance, many seaside locations are seeing guesthouses and BnB's become available, with the opportunity for conversion to either serviced accommodation or to private flats.

Development at ports and new airports or runways will create the need for more housing, subject to the obvious environmental considerations, as will similarly any area that has reserved a significant local plan allocation for employment sites. University expansion in some areas creates a constant need for HMOs and for larger co-living schemes.

Financial and deal considerations

There is of course no point in targeting a strategy if finance is unlikely to be available. However, funding risk might be managed through having a clear strategy. Firstly, the development team can be a factor, bolstering inexperienced developers with more experienced partners in a deal. If the scheme relies on obtaining prior approval or full planning permission, then it is critical that the deal is appraised on the basis of the existing use and the strength of the market for this. Hence, a commercial-to-commercial strategy might always need to be part of the thinking, even if this might not be the ideal or ultimate aim.

Ensure investors are fully appraised of all available exits and conduct thorough sensitivity analysis on the appraisal on all exits, such as on an investment basis under commercial use with no planning, then PD for residential conversion and then either redevelopment or 'air rights' development.

It is advisable to always check the existing use and PD rights or any other fall-back position; commercial agents' particulars might not be correct.

Furthermore, it may be essential to be creative in the possible deal options, dependent on the vendor's priorities and what a good deal looks like to them. This might include the possibility of options or an assisted sale, such as where it is important to manage the risk through the deal and not through planning. Exchange with delayed completion, especially on commercial-to-residential deals using prior approval (e.g. under Class MA) can often help in securing 100% finance for the development once consent has been obtained. It is better to buy well from the start rather than make oneself a hostage to fortune by then hoping you will get the maximum desired development from the Council just to make a profit (or worse, just to break even).

All in all, quite a lot to digest along with your mince pies! However, education/experience, networking and hard work are and will remain the central pillars of development success in any market. That and a bit of luck and good timing.

Wishing you all Seasons Greetings and a happy, healthy and wealthy New Year and 2023! PIN