Reshaping Spaces

Building Back Better

BY ALEX MORTON AND JETHRO ELSDEN

Centre for Policy Studies

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Acknowledgements

Many thanks to those who have reviewed and helped on this report, not least Tom Clougherty, Robyn Stavely and James Heywood for their comments, Elizabeth Dunkley in helping prepare the report, and Robert Colvile for his excellent editing. Particular thanks go to Landsec, who supported this report. Any mistakes are, as ever, the author's own.

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Executive Summary

Commercial centres are the beating hearts of communities. But the Covid crisis has had a cataclysmic impact. Even as normal life returns, it is likely that the pandemic will end up accelerating shifts in retail, working patterns and office use that were already under way.

This report explores how we can turn the challenges of the pandemic into an opportunity to 'build back better', in the Government's phrase, by reviving Britain's high streets, communities and commercial centres. If we get this right, the next few years will see a hum of activity and development and a wave of private sector investment, avoiding a rash of silent dereliction.

Part 1: The Scale of the Opportunity and Challenge for Commercial Centres

- Even before Covid-19 there was already a long-term shift towards online retail and away from the bricks and mortar high street. The pandemic will accelerate this shift.
- Vacancy rates were already high pre-pandemic, ranging in 2019 from 9% in London to 19% in the North East, and 13% across the whole country. Pre-pandemic estimates were that 25% to 40% of current retail space would no longer be viable/necessary.
- In 2005, retail vacancies were lower than all other types of commercial property. By 2015, they were higher, with the gap growing over subsequent years. In other words, the sector was already troubled even before the pandemic.
- In retail, the sector that is currently doing best, and is best placed to thrive, is experiential (often high quality) retail, and so there needs to be scope to improve retail offers for consumers to entice them to shops.
- Office space is also likely to face a period of acute pressure as working from home becomes more common post-pandemic. That said, the most lurid predictions of collapse seem unlikely given strong preferences for hybrid working (i.e. retaining offices for most companies even if staff are not there full time). Polls show repeatedly that most people want to work a mix of days in the office or at home.
- However, even this will create a need for major changes in what offices are and how they are laid out, and may impact on locations and types of offices – so there needs to be flexibility to help companies, landlords and developers to respond.
- High streets and unused commercial space can be reinvented and reused – as has occurred in many shopping malls in America, or former industrial/warehouse areas such as central Manchester. We face a future where commercial centres need to be reshaped as retail and office demand changes.

- In addition, in some places, it is likely that commercial space can become homes. For example, given even before the pandemic 40% of retail space was estimated to be needing to be repurposed, this alone would create at least half a million homes using figures for the average sized property and flat built in this country. This doesn't take into account changes around offices, new higher density mixed use regeneration, or post-Covid falls in retail demand.
- Reshaping spaces and allowing for regeneration of areas also allows for mixed use regeneration, which can help increase new residential space even further by densification and creating opportunities where previously none existed.
- This could unleash tens of billions in private finance to "build back better". Landsec alone has set aside £4 billion for reshaping commercial space and regeneration – the equivalent of the entire Towns Fund.
- This could be a major part of levelling up if got right – or it could mean increased vacancies and semi-derelict commercial centres if we get it wrong. The risk and opportunity is huge.

Part 2: Not acting on high streets will have serious political impacts

- This issue is politically crucial. The Government's biggest priority is levelling up and ensuring we build back better after the pandemic, and commercial centres are the heart of each community and help define how people feel.
- 7 in 10 people say they would judge a town by its high street, and find their high street an important part of their community. Pre-pandemic, nearly 60% of people visited their local high street more than once a week and only 10% did not visit their high street once a month or more often.
- Perhaps even more crucially for the Government, regions with high commercial vacancy rates are correlated with areas where the Conservatives picked up more seats in the 2019 election. The North East had both the biggest gains for the Tories and the highest vacancy rate.

Vacancy rates in retail and Conservative gains in 2019 in England

Region	Con MPs gained in 2019	Gains as % of regional MPs	Vacancy rate
Greater London	0	0%	9.4%
South East	2	2.3%	11.3%
East of England	2	3.4%	12.6%
South West	1	1.8%	13.1%
East Midlands	7	15%	14.5%
West Midlands	9	15%	15.6%
Yorkshire & the Humber	9	16.6%	16.5%
North West	12	16%	16.5%
North East	7	24%	19.2%

- There is a risk that commercial centres become hollowed out, which will in turn make rhetoric about levelling up and building back better hollow.
- This will also make the crucial but controversial task of planning reform harder because MPs will see derelict or vacant brownfield sites and will therefore say no greenfield development is needed.

PART 3: Councils must lead in reshaping space via commercial assessments

- Councils have a crucial role in ensuring the success of local commercial spaces. The ability of land and buildings to be used for particular purposes is set by councils, including commercial centres.
- The Government has liberalised this through a new use class 'E' which encompasses most commercial uses, where previously offices, shops and other uses all had separate use classes which restricted what buildings could be used for.
- Yet fundamentally councils will still have control over two key areas:
    - The total **amount** of commercial space in an area.
    - The **location** of this commercial space.
- It is councils that decide these two issues, and so councils which are partly to blame for continuing high retail vacancy rates in many areas. It also means that they will have a key role post-Covid in ensuring that their area recovers from the impact of Covid.
- A major problem is that the Government's new planning reforms will slow council engagement with developers until the new system is drawn up and new local plans are created, which will take several years. This creates a major risk of stasis and high vacancies.
- On top of this, councils often want to keep commercial property in their area even if unviable. This partly relates to tax impacts but also to the idea that redesignating commercial space as residential will 'destroy jobs'.
- <u>We propose that the first part of each council's new local plan should be a commercial assessment of their area's needs</u> (i.e. in practice, a largely brownfield assessment). This should be completed by the end of 2022.
- Councils would work with developers and landlords to come together with a genuine assessment of what is needed and where. This will release land, allow mixed use regeneration and let land move to residential purposes as necessary.
- This would be a genuine 'brownfield first' policy which encourages homes. It fits with the Government's focus on housing supply being increased in urban areas and its promise to ensure that while greenfield is needed to meet housing need in many areas, it will be spared where possible.
- This will also encourage and speed up 'building back better', releasing investment in commercial centres rapidly.
- As an incentive, councils should also be able to put in place limited Article 4 directions once they have completed their commercial assessment, which will be

an incentive to do so swiftly. (Article 4 directions restricted permitted development, and will ensure that commercial areas do not become pockmarked.)

- We envisage most councils moving swiftly and collaboratively. But councils that fail to prepare a realistic commercial assessment should have one put in place for them by Government. This means either where no assessment is completed by the end of 2022 or where the assessment is subject to complaint by landlords controlling over 33% of local commercial space.
- We do not think that this should be necessary in almost any area – but there has to be something as a last resort in terms of ensuring that commercial centres are not just left to decay or left unmodernised.
- It is important to note the public are likely to be supportive of such intervention – by nearly 3 to 1 people feel local government is not playing a positive role in the future of the high street.

Part 4: Getting the right incentives to help reshape space

- The next element is to get the right incentives in place to help councils to make the right decisions and get building back better. These fall into three areas.

Future-proofing planning reforms

- The Government's proposed infrastructure levy needs to ensure that commercial property is not taxed at the same rate as housing, because commercial property is usually more complex, often on brownfield, and is valued differently.
- It should be taxed at a lower general level, with different tiers for greenfield, brownfield and complex brownfield (e.g. requiring heavy remediation and converting existing space rather than building new space). This should include residential within mixed use where the mixed use is heavily commercial.
- The Government should also scrap or limit plans to charge the infrastructure levy on change of use via permitted development. The average planning gain is £50,000 per unit which would make many permitted development changes unviable. If it must be applied this should only be to large scale, high value conversions and at a lower rate than general residential.

Removing business rate disincentives

- Business rates need a major overhaul. They are erratic, too high, deter sensible recycling of commercial space, and are not spread evenly or fairly. Business rates mean taxes are seven times higher on commercial property than residential. This falls particularly on the retail sector, for which business rates represent 42% of all taxes paid. This is fundamentally unworkable given the impact of Covid and the aftermath.
- More immediately, the incentives through business rate retention need to change. The formula prioritises total commercial space, including vacant properties. Currently councils which lose commercial space are penalised through the business rate retention scheme, worth £2.4 billion. Thus, councils which keep vacant properties are treated better than those which allow conversion to residential, which makes no sense.

- We propose that vacant property business rates are subtracted in the business rates retention formula, so that it is better to see them convert than to keep them vacant. This would also allow a 'name and shame' approach to councils with higher vacancy rates. If areas argue that they are too deprived for it to be worth vacant property switching to other uses, then this should be handled on a transparent case-by-case basis, and it could be that these are undesignated as commercial space and become sui generis.

Incentivising councils

- We propose a one-off grant for councils to deliver commercial assessments, based on a formula around a core flat rate and an adjustment for each area's population size/region. The cost of this should be less than £1 billion across the 300 relevant councils.
- Once councils have completed their commercial assessment, they should be rewarded with an environmental improvement fund, linked to the regional vacancy rates, size of the commercial area, size of the urban area, and wealth of the area. This fund would not fundamentally change the incentives or be too costly, (e.g. £1 billion), but it would support minor changes to improve commercial centres, and encourage commercial assessments to come forward rapidly – which in turn will help unlock substantial private funding.
- Finally, to help reduce pressure on commercial planners, Government should look at removing some minimal non-nuisance changes to commercial buildings (e.g. creating an additional entrance or exit, letting in more or less light on a commercial frontage) from planning and putting these in permitted development. Obviously major changes or ones that might be a nuisance should remain within the existing system.

Part 1 – The scale of the opportunity and challenge for commercial centres

The Brexit vote and its political consequences have rightly focused the Government on an agenda of building back better after Covid-19, at whose heart is a promise to improve the quality of life for all the people of this country.

Commercial centres are the beating hearts of communities. Not only do people see their high street as crucial to how they feel about the places they live, but in 2019 retail vacancies were highest in the areas where the Government made the highest electoral gains. In other words, the voters to whom this Government owes its position are those who live in the areas whose commercial centres have highest rates of dereliction and may deteriorate further.

Even before the pandemic, this was a vital political issue: witness the repeated campaigns to 'save our high street', and the focus in the Conservatives' 2019 manifesto on the importance of place and community, with multiple initiatives designed to support and strengthen commercial centres.

'Commercial centres are the beating hearts of communities. Not only do people see their high street as crucial to how they feel about the places they live, but in 2019 retail vacancies were highest in the areas where the Government made the highest electoral gains'

In the wake of Covid-19, those concerns have become even more pressing. It has already accelerated the shift to online retail, and the rise in remote and hybrid working is likely to have an equally seismic impact on office space and other commercial uses.

But while the dangers are certainly very real, we believe that with the right policy changes, this crisis can also be an opportunity to 'build back better'. At the heart of this report, indeed, is a belief that the commercial core of our cities, towns, retail and office parks have always been able to adapt to change. The task of Government is to enable that to happen as quickly and painlessly as possible.

As this report sets out, councils have a critical role to play since they control the amount and location of commercial space in each area. They must take a lead, working with the private sector in a spirit of collaboration to help drive this agenda. At the moment, they are heavily incentivised to keep property vacant, rather than releasing for the kind of brownfield housing that could ease the pressures of the housing crisis and help regenerate commercial centres.

Getting this right will be fundamental. There is a wave of tens of billions waiting to be unleashed, with a single company putting aside the equal of the entire Towns Fund for commercial regeneration. Government has to step up and help firms and communities to reshape space, in order to level up the country.

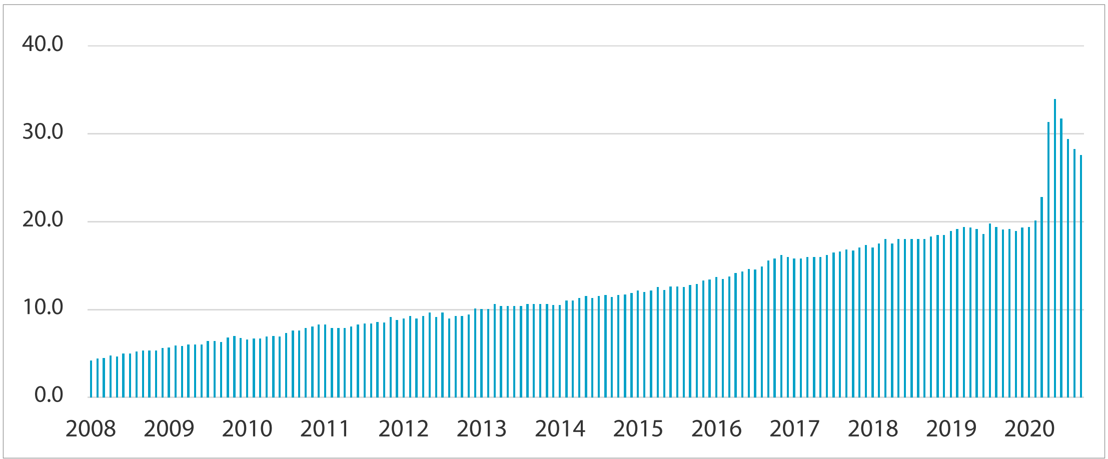
This report therefore focuses on 'commercial centres' – whether in town or out of town, whether office based or retail based. By this, we mean areas with high shares of commercial property. Of course, within these there is often residential usage, and the boundary with residential is invariably blurred at the edges. But we consider the term to be clear enough in terms of areas that are primarily commercial rather than primarily residential (e.g. a retail park, shopping mall, central business district or office park). As is clear from this report, we think such terminology is useful, despite the inevitably fuzzy nature of the term. And we think that policy needs to urgently focus on the opportunities and challenges for such centres.

The long shift toward online – and experiential - retail will be accelerated by the pandemic

One of the biggest issues for retail in recent years is the clear long-term trend towards more online shopping. The average weekly value of online shopping grew from £213.4 million in January 2008 to £1.38bn by January 2020, or from under 5% of all retailing to over 20% by 2020.[1]

The pandemic has boosted this shift: By August 2020 average weekly online shopping had increased to £2.03bn, or close to 30% of all retail sales.[2] While this has fallen back, it is likely to remain elevated. Online sales remained at well over 25% in September after much of retail sector had reopened, despite the fact people had been prevented from in-person shopping for much of the year. And from this new higher base it seems likely they will also continue to trend upward over time just as they did before.[3] Therefore it seems likely that by the mid-2020s around 30-35% of all retail spend may well be online, and it seems unlikely to be below 25%.

Figure 1. Internet sales as a share of all retailing



We can also almost certainly expect a continuation of the ongoing shift from traditional retail spaces towards more experiential shopping: away from retail which simply involves buying products, and towards one built on an overall experience. This goes hand in hand with the move to online, since the internet by definition cannot provide an experience, but can allow you to buy almost anything you would be able to purchase in person.

Retail parks, for example, are for many people an experience in themselves – people will drive to them and have a 'day out' and go to multiple large stores, with food often purchased on site, and often a cinema trip. In addition, the retail park often has larger stores as well.

1 ONS, *Internet Sales Index: Table ISCPSA3.* Link
2 ONS, *Internet Sales Index: Table ISCPNSA2.* Link
3 CBRE, *Market Update: United Kingdom Logistics.* Link

An analysis of high streets in 2019 by the Centre for Cities showed that despite perceptions of widespread decline, *'not only do the UK's most successful city centres have fewer empty shops, the businesses filling these units are also of much higher 'quality' of retail, such as high-end shops'.*[4] What people want is a pleasant experience – whether through high-end shopping at the high street, or driving to a retail park with their family for an afternoon out shopping. This is reflected in substantially lower vacancy rates for these types of 'experiential shopping'.

Vacancy rate by type of retail[5]

Type of retail	Vacancy Rate H1 2019
Retail park	8.1%
High street	12.1%
Shopping centre	14.4%

This appears to be a phenomenon that the public is entirely supportive of. Some 59% of shoppers predict the majority of retail space will be dedicated to providing experiences by 2025, and 75% think this will have happened by 2027 at the latest.[6] Some 73% of UK consumers said they would spend more time, and crucially money, in stores that offered in-store experiences rather than just products.[7]

Yet even with the rise of experiential shopping, the retail industry was facing high rates of closures before the pandemic, particularly around high street store fronts. The first half of 2019 saw a net decline of 1,234 chain stores on Britain's top 500 high streets - the highest number since analysis by PwC and the Local Data Company began in 2010. This equates to an average of 16 store front closures per day.[8]

Overall, the vacancy rate for retail across Great Britain rose to 13% in the first half of 2020, the eighth consecutive quarterly rise. However, there is significant variation across the country as can be seen in the table below. Greater London suffered the least at 9.4%, while the problem is most severe in the North East with a rate of 19.2%. Unsurprisingly all regions have seen increases in the rate of vacancy compared with the same period in 2019.[9]

Retail vacancy rate by region

Region	**Vacancy rate, H1 2020**
Greater London	9.4%
South East	11.3%
East of England	12.6%
Scotland	12.7%
South West	13.1%
East Midlands	14.5%
West Midlands	15.6%
Yorkshire and the Humber	16.5%
North West	16.5%
Wales	17.7%
North East	19.2%

4 Rebecca McDonald, *Quality streets: the city centres offering the best retail experience.* Link
5 Get from further on in report
6 Unibail-Rodamco-Westfield report, *How we shop the next decade.* Link
7 Ibid. See Appendix 10.
8 PWC, *Store closures hit record levels as restructurings drive largest net decline in testing retail climate.* Link
9 Local Data Company, *Retail and Data Analysis 2020.* Link

This issue of retail vacancy is only likely to get worse as the economic shock of the pandemic manifests itself – although we do not yet have accurate data of how this will play out once normality returns.

> **'Even before the pandemic, Savills estimated that the UK could be 'over spaced' in retail by up to 40%. A similar study by JLL found that the UK had around 25% too much retail space'**

But regardless of the exact post-Covid impact, it's clear there is significant retail space in the UK which now may no longer be needed and could be turned over to other uses. Even before the pandemic, Savills estimated that the UK could be 'over spaced' in retail by up to 40%.[10] A similar study by JLL found that the UK had around 25% too much retail space.[11]

A pre-pandemic Housing, Communities and Local Government Select Committee report on "High streets and town centres in 2030" identified systemic issues that have developed over time:[12]

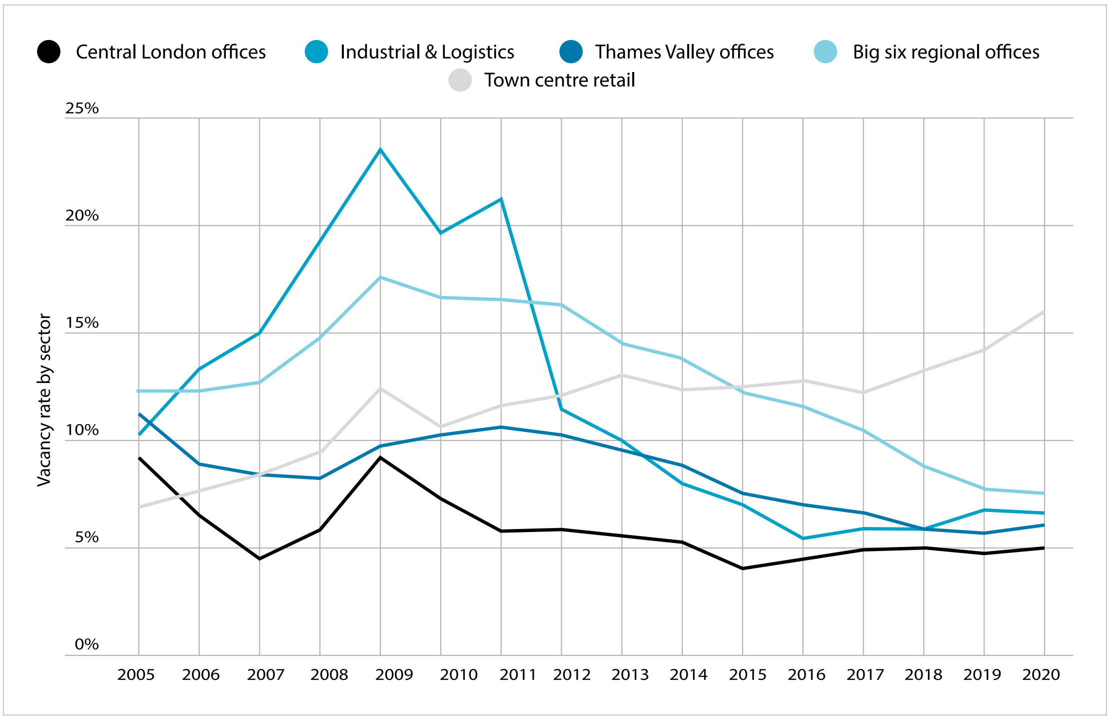
- There is simply too much retail space. Towns have become over-reliant on retail as their main anchor and have used expansion of space to compete for footfall with other areas.
- Ownership is fragmented across different types of management, including pension funds, insurance companies, private equity and individual owners. Foreign investors own 28% of UK commercial real estate held as investments.[13] Different types of landlord have vastly varying interest and involvement. In smaller towns, where ownerships tends to be most diverse, it is especially difficult to build a coordinated response to challenges.
- Fixed costs are high, in terms of business rates and rent. Retail pays around a quarter of business rates, hospitality pays 10% and pubs pay 2.8%. Long rents with upward-only rent reviews have distorted rents away from market values.

The report concluded: 'Unless… urgent action is taken, we fear that further deterioration, loss of visitors and dereliction may lead to some high streets and town centres disappearing altogether.'[14]

Retail policy has been badly handled, leading to excess vacancies

Despite the fact that the trends above have been under way for some time, policy has not yet adapted to the new realities. The chart on the following page from Savills outlines vacancy rates by various sectors and subsectors over the last 15 years just before the Covid crisis hit.[15] It shows that vacancy rates remain lower than before the previous peak (during the global financial crisis). The clear outlier is town centre retail, which is the only sector in which rates have tended to chart upwards. It is clear that the usage of space is lagging substantially below supply.

10 Savills, *Impacts: Tipping Point, How climate, politics, demographics and technology are transforming real estate.* Link
11 Landsec and JLL, *Reimagining empty retail space: transforming UK towns and cities for future communities.* Link
12 Housing, Communities and Local Government Committee, *High streets and town centres in 2030.* Link
13 Property Industry Alliance. Link
14 Housing, Communities and Local Government Committee, *High streets and town centres in 2030.* Link
15 Kevin Mofid, *Market in Minutes: UK Commercial.* Link



There is, as we shall see, a significant policy component to this. The shifts under way in retail over recent years have resulted in excessive vacancy rates in some locations, predominantly town centres and secondary, underfunded locations. We need to both correct the mistakes and avoid making the same mistake in other areas.

The office sector is about to undergo substantial changes post-Covid as well

This point about commercial needs changing rather than just shrinking also applies to the office sector, due to a shift in working patterns that has been massively accelerated by Covid.

Pre-pandemic, there was already a slow shift taking place to more working from home either all or part of the time. The rise of shared office spaces (e.g. WeWork) might have been overhyped at times, but it nevertheless represents an incremental but steady change in market and economic demand.

For example, a research report by The Instant Group from 2019 focusing on the market for flex workspaces – flex space is any space, desks or more comprehensive office space, on short term leases, at variable prices or alternatively on a membership basis – found that firms of all sizes were looking for more flexible space. This led to the rapid growth of the market for flex space in recent years with the number of flex centres growing from 4,000 in 2015 to over 6,000 in 2019. This was beginning to impact on the wider market with the sub-5000 sq. ft lease market gradually being eroded – indeed there is now more sub-5000 sq. ft leased space on the market than at any time since 2009.[16]

According to Eurostat, 18% of the UK workforce worked from home at least some of the time prior to lockdown, a figure higher than the EU average.[17] The proportion of those

16 The Instant Group, *UK Market Summary: Flex is Leading the Way.* Link
17 Eurostat, *Employment and unemployment (LFS) Database.* Link

in employment who worked mainly from home had also risen fairly rapidly, from 1.5% in 1981 to almost 5% in 2019.[18] There was also a clear trend toward densification, where businesses have been using an ever-shrinking amount of space for each office worker, with the average space per workstation falling from 11.8 sq. metres in 2008 down to 9.6 sq. metres in 2018.[19]

Advancements in telecommunications and IT have both made the shift possible and have also made it possible to gain agglomeration effects even if someone is not in the office full time. (Agglomeration effects are the added economic benefit from economies of scale and network effects that arise when firms and people are located close to each other.)

Yet despite the rise of flexible offices, overall demand for office space prior to Covid was high. Analysis by consultants JLL showed that at the end of 2019, due to an unprecedented low level of supply, office space vacancy across the Big Six (Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester) fell to a historic low of 4.2%, while for Grade A space it was even lower at 1.2%.[20]

‘The pandemic has forced many more firms and workers to experiment with working from home, and while not all have benefited from the change, many have’

Changes towards more flexible and remote working were, in other words, outweighed by other forces that increased the demand for office space, which rose across the UK from 856 million sq. feet in 2000/01 to 946 million sq. feet in 2019/20.[21] For example, combined public sector and private sector employment rose from 28.1 million in 1999 to 32.3 million in 2018.[22] There was also a steady rise in the share of the economy made up by the service sector, which is largely office based, from 72% in 1997[23] to 79% by 2019.[24]

Demand for offices is thus harder to predict than many think – since in recent decades there has been a growth in home working and yet an increase in office space needed. But in the medium term there is likely be a sharper shift in office demand patterns. The pandemic has forced many more firms and workers to experiment with working from home, and while not all have benefited from the change, many have.

The CIPD surveyed over 1,000 employers on this very issue and found that expectations are that post-pandemic the proportion of the workforce regularly working from home will roughly double to 37%. The report stated, *‘there is a high probability that there will be no return to business-as-usual post-crisis. The pandemic has probably changed for good the distribution of work between the regular workplace and home for many workers.’*[25] Other surveys show a similar preference for hybrid working, with a survey of office workers in London finding that around 2 in 10 wanted to work primarily from home or from the office, but that the vast majority wanted 2/3 days in each.[26]

18 Alan Felstead and Darja Reuschke, Wales Institute of Social and Economic Research, *Homeworking in the UK: before and during the 2020 lockdown.* Link

19 Francesca Perry, *This is what a return to the office will be like when the lockdown lifts.* Link

20 JLL, *UK Big 6 Report H2 2019.* Link

21 Valuation Office Agency, *NDR Business Floorspace Tables, 2020.* Link

22 ONS, *Long-term trends in UK employment: 1861 to 2018.* Link

23 ONS, *Changes in the economy since the 1970s.* Link

24 House of Commons Library, *Components of GDP: Key Economic Indicators.* Link

25 Chartered Institute of Personnel and Development, *Embedding new ways of working: implications for the post-pandemic workplace.* Link

26 Landsec polling shared with the CPS

Other data found almost nine out of ten (88.2%) of those who worked at home during the lockdown said they would like to continue doing so at least some of the time. Perhaps even more strikingly, nearly half (47.3%) said they wanted to continue working at home often or all the time.[27] An impressive 69% reported in a different survey that their productivity hasn't fallen below pre-pandemic levels, including 41% who say they are now more productive. To quote the report: *'Many employees liberated from long commutes and travel have found more productive ways to spend that time, enjoyed greater flexibility in balancing their personal and professional lives, and decided that they prefer to work from home rather than the office.'*[28]

> **'The pandemic has forced many more firms and workers to experiment with working from home, and while not all have benefited from the change, many have'**

It is therefore likely that most companies will be keeping their offices but that they may need less space if many employees spend at least part of their working week at home.

The pandemic could also shift office layouts with a move away from a single central office in expensive inner urban areas towards smaller central offices in central city locations, with and more use of satellite offices and co-working locations closer to where employees are actually located rather than in the middle of cities.[29] Again, if this is the case the core offices in high value cities may become prestigious headquarters and places where meetings within and between senior teams take place, rather than gigantic white-collar factories, and this will mean a need to reinvent these spaces.

We cannot be sure how much office space is needed over the medium term – nor where demand is likely to fall – this will only be clear as the economy returns to normal in the months following the rollout of the vaccine. But it seems both the wilder predictions of near-universal home working or a return to almost exclusively office-based working are likely to be trumped by hybrid models, possibly in a new different mix of office locations.

This shift to a hybrid space also makes a high-quality mixed-use environment around offices more important, since if people have greater choice over where they work, the surrounding space that the office is embedded in becomes more important. Thus, in order to make sure that commercial office space is more attractive, the wider setting has to be attractive as well.

On top of this, how office space is used will also need to change. If many more workers are at home much of the time then there will be less need for individual desk space, and instead offices will shift to being spaces more for collaboration. This might limit any reduction in overall office demand.

The situation is well summed up by a passage from a recent McKinsey article on this issue: *'A transformational approach to reinventing offices will be necessary – it is not just about adjusting existing office space incrementally, but instead 'companies should take a fresh look at how much and where space is required and how it fosters desired outcomes for collaboration, productivity, culture, and the work experience.'*[30]

27 Alan Felstead and Darja Reuschke, Wales Institute of Social and Economic Research, *Homeworking in the UK: before and during the 2020 lockdown.* Link

28 McKinsey & Company, *Reimagining the office and work life after COVID-19.* Link

29 Cushman & Wakefield and the Center for Real Estate and Urban Analysis, The George Washington University, *Workplace Ecosystems of the Future.* Link

30 McKinsey & Company, *Reimagining the office and work life after COVID-19.* Link

Commercial needs and areas – including those based on retail – can be reinvented

Fortunately, such reinvention is possible and has been done successfully before. Voids left by departing retailers or where office space shrinks can be used for numerous alternative functions such as events venues, educational facilities, exhibitions, civic and commercial offices, as well as residential. As market pressures force occupiers to innovate the range of alternative uses expands and exciting new concepts develop. A key example of this is the rapid growth, especially in city centre areas, of new leisure operators.[31]

The Centre for London's 2018 report into 'Meanwhile' use – temporary occupation of a site for a range of 'pop-up' uses such as food and retail outlets, bars, art galleries, football pitches, to temporary housing or workspaces – shows there is considerable scope to bring in new uses.[32] While it might be thought that this would only apply to more affluent areas such as London, the renaissance of Manchester city centre began with artists, musicians, club promoters and others moving into the warehouses and industrial units left vacant after deindustrialisation.

'The USA leads the world in repurposing dead retail space. 200 shopping malls are being redeveloped into new hospitals, university campuses, or mixed-use centres, often in less than affluent city locations'

Another good example of the move from purely retail to a more mixed-use space is that of Westfield London, which recently gained planning permission to turn its House of Fraser department store into a more flexible workspace area with half retail and half offices. There are also plans to turn other vacant units into a more experiential shopping area for families, with the longer-term plan for the area to become far more mixed use than it currently is.[33]

Meanwhile in Sheffield, a less affluent centre, an old Co-op store vacant for a decade was successfully repurposed into a mixed-use space with a food hall and flexible workspaces ideal for new startup firms. This has regenerated activity in the area and has led to spillover effects with new operators moving into the area and neighbouring buildings being refurbished for a range of uses.

The USA leads the world in repurposing dead retail space. 200 shopping malls are being redeveloped into new hospitals, university campuses, or mixed-use centres, often in less than affluent city locations. For example, in Denver the failed Cinderella Mall has been successfully turned into a new city suburb, with town hall, 440 apartments, office space, a light rail station, and medical and education facilities. This has acted as kickstart for growth in the area, which now supports a workforce of 25,000.[34] China is also repurposing existing space – for example in Bejing, redeveloping the Pacific Century Place shopping centre into a mixed-use development with experiential retail, offices space, residential towers and social spaces.

31 Cushman & Wakefield, *UK Retail Outlook 2019.* Link

32 Nicolas Bosetti and Tom Colthorpe, *Meanwhile, in London: Making use of London's empty spaces.* Link

33 Pui-Guan Man, *Westfield to ditch department store for desks.* Link

34 Savills, Impacts: Tipping Point, *How climate, politics, demographics and technology are transforming real estate.* Link

By creating a space that fuses high-quality office and high-quality retail, you create a more attractive experience-based approach than either alone. Making a place that people actually want to visit, as well as combining work and leisure (so you can meet your friends after work for example), is often better than just high-end office or retail space alone. There is a reason that Apple's new UK headquarters, at Battersea Power Station, will sit on top and within a massive retail complex.

Away from the high end of the market, it is also the case that the reinvention caused by online shopping needs significantly more warehousing capacity in order for the logistics to work. For example, a recent report by the logistics specialist Prologis suggests that e-commerce requires three times the logistics space of traditional physical retail.[35] While traditional retail can share the burden of stock storage between shopfront and some warehousing capacity, in the case of online retail, 100% of inventory is stored in warehouses.

'A CBRE report from June of this year points out the pandemic has accelerated the transition to online retail and that a rise in online grocery demand, which seems likely post-pandemic, will further change the retail sector'

Overall, what is likely is a shift in where investment in the retail sector occurs: from multiple retail centres to prime and attractive locations on the one hand and out of town locations where additional warehousing is located on the other. Though a larger online retail sector will demand more warehousing capacity in urban areas to minimise delivery times and maximise customer convenience, the majority of extra space demanded will be in cheaper out of town areas. Such a shift could significantly boost those areas where new logistics facilities are located.

The logistical systems that a bigger online retail sector needs are varied. Large mega warehouses outside urban areas, which can serve as regional hubs, will definitely increase but there will be higher demand for smaller urban warehouses, as online retail platforms compete to provide consumers with a more convenient service, and minimise distances from warehouse to customer.[36] A CBRE report from June of this year points out the pandemic has accelerated the transition to online retail and that a rise in online grocery demand, which seems likely post-pandemic, will further change the retail sector. Supermarkets will likely invest in extra purpose-built logistical space, including niche facilities such as micro-fulfilment urban centres and cold storage in order to support increased online demand.[37]

As ever, rather than trying to hold back change, there are opportunities here. For example, it could help the Government achieve its levelling up agenda if demand and investment shift to areas where the costs of building, renting and running warehousing and logistics hubs is cheaper. Helping encourage high-quality mixed-use developments should reduce the number of vacant properties on high streets and in commercial centres. If the Government fails to support these changes or tries to roll them back, the result is likely to be a worse experience and potentially higher prices due to lower efficiencies on the side of consumers and lower job creation and investment in the economy.

35 Prologis, *Global E-Commerce Impact on Logistics Real Estate.* Link

36 Deloitte, *The shed of the future E-commerce: its impact on warehouses.* Link

37 CBRE, *Market Update: United Kingdom Logistics.* Link

Substantial commercial space needs to either be reimagined or recycled into new homes

In the short term there has been a clear impact from the Covid-19 pandemic. By the end of Q3 2020 the amount of empty office space in central London had increased by almost 45% since the start of the pandemic, rising from 9.9 to 14.3 million square ft. Much of this increase has been driven by the second-hand market where vacancy rates have risen, and which has seen marketed space increasing by almost 50% in the last 6 months.[38] Although vacancy rates are lower for new space, even here vacancies are beginning to rise as recent developments reach completion and come on stream.[39] By early 2021 the vacancy rate for commercial office property across the UK was estimated at 7.6% outside London and 6.8% within London.[40]

> **'By the end of Q3 2020 the amount of empty office space in central London had increased by almost 45% since the start of the pandemic, rising from 9.9 to 14.3 million square ft'**

Some of this needs to be reimagined – as set out above. But some of this could be recycled into new homes. The Centre for London estimated that in 2018, well before the pandemic, 24,000 commercial units, particularly retail, in London were empty, and most of these had been so for at least 6 months. Almost half (11,100 units) representing some 6.5 million square metres of commercial space had been vacant for over two years.[41]

There will not be a large one-off shift in demand this year in office space, not least because the average lease is around six years, and because most companies are likely to retain much of their office space as set out above.[42] However, over the next few years, a very large number of firms may seek to reduce their office needs if they move to a more hybrid model, and also seek to reconfigure office space.

Around 40% of leases are less than four years, and another 30% are less than nine years. Even of the 30% of leases longer than this, some will fall due over the early 2020s. So, by the middle of the decade, the total impact of any changes in office demand will be substantial, even if it does not all happen in the next twelve months.

In many ways, this gives policy makers a window of opportunity to get policy right - but also means any negative impact from the pandemic will start to become clear very rapidly.

As set out above, attractive mixed-use commercial centres may well be able to evade any negative impact, particularly where there is a controlled switch of some commercial units to residential, shrinking any surplus commercial property – whether retail, office or other uses – and so retaining an attractive feel. But without such changes, there could be a significant impact on commercial centres across the country – including those that have until now been thriving.

Analysis has found that a higher share of office space in a city centre tends to go alongside higher productivity and lower vacancy. The Centre for Cities noted that

38 JLL, *Central London office market report.* Link

39 Carter Jonas, *The London Office Market Q3 2020: A Guide to rents, rent free periods & market trends.* Link

40 Cushman & Wakefield, *Marketbeat United Kingdom Office Q1 2021.* Link

41 Nicolas Bosetti and Tom Colthorpe, *Meanwhile, in London: Making use of London's empty spaces.* Link

42 MSCI and BNP Paribas, *UK Lease Events Review 2019.* Link

economically thriving city centres had 62% of their space dedicated to offices – nearly three times that of weak city centres, which were struggling, with just 23%.[43] These stronger areas tended to be larger urban centres (though not always) and be more expensive than other parts of the country. They included two main groupings – large flourishing cities like London, Bristol, Leeds and the smaller but successful cities such as Milton Keynes, Oxford and Brighton, usually located in the South.

A shift in office demand may hit these areas particularly hard – unless they are able to reinvent themselves.

> **'With an estimated 345,000 new homes needed per year in England alone, only 241,000 new homes were built in 2018/19'**

One option, of course, is to turn surplus space into housing. There is a clear current shortfall in the supply of new housing in the UK. With an estimated 345,000 new homes needed per year in England alone, only 241,000 new homes were built in 2018/19.[44] Given the average property size, the long-term vacant properties in London, outlined in the study above, would have delivered 70,000 homes – nearly four times the homes work started on in London in recent years.[45]

Already in recent years, a reasonable element of new homes has come from converting commercial buildings into residential properties. While the number of dwellings created by change of use has fallen slightly in the last few years, the most recent figure of 26,930 in 2019/20 is still far above the levels seen in 2014/15 and the years preceding, and over the last five years a total of 153,750 new houses have been created via change of use.[46]

According to the figures for business rates, there was around 87.9 million square metres of office space in England and Wales last year, and 105.8 million square metres is retail space. Given the earlier projections of a 40% surplus in retail space, even before the Covid-19 crisis, this would mean around 42 million square feet is surplus to requirements and could be repurposed.[47] This is assuming no office space is repurposed, which gives us confidence around the figure, since while we are taking the higher figure, this was before the Covid-19 crisis.

Given an average property size of 92 square metres this could mean up to 456,000 homes potentially from retail alone. Given a higher share are likely to be flats, which are just 57 square metres, meaning the average size is likely to be slightly smaller, it is likely that there is enough superfluous retail space for well over half a million homes.[48] With offices, it is harder to tell the opportunity given we do not yet know what the demand for office space will be, but again it seems likely there is a substantial opportunity for new homes in at least some locations (even if we cannot yet tell what they are or will be.) There is also likely to be mixed use regeneration in these areas that sees more dense and attractive new mixed use spaces, including retail and residential, being created. So this half a million figure is likely to be an underestimate.

43 Rebecca McDonald and Paul Swinney, *City centres: past, present and future, Their evolving role in the national economy.* Link

44 House of Commons Library, *Tackling the under-supply of housing in England.* Link

45 ONS, *House Building: Permanent dwellings started and completed by English region,* Link

46 Ministry of Housing, Communities and Local Government, *Housing supply; net additional dwellings, England: 2019-20.* Link

47 Valuation Office Agency, *NDR Business Floorspace Tables, 2020.* Link

48 Savills, *Size Matters.* Link

This also allows for new residential as part of mixed-use regeneration

Such conversion of commercial space may also be able to unlock other mixed-use regeneration, including new residential homes. In many areas, by redesigning the whole area you can unlock high density but attractive housing opportunities that would otherwise not exist – as a mix of office, retail and residential can be more attractive than simply one or two of these alone. Additional office and residential can help support a better retail offer, while the more attractive retail space can help to encourage people to take office space or buy a home in an area.

> **‘Additional office and residential can help support a better retail offer, while the more attractive retail space can help to encourage people to take office space or buy a home in an area’**

Thus, the shift to a more experiential retail offer and a rise of hybrid office working makes it all the more important to create more desirable places, that are attractive to shop, to work and to live in. By creating a more desirable place, density can be increased more than would otherwise be possible. Thus the overall opportunity is greater than simply calculating any change in total floorspace.

This is after all the whole insight behind the increased focus on ‘place’ in recent years – the need for a holistic approach to development rather than a piecemeal approach. The pandemic’s after effects are likely to make this more attractive.

Getting commercial property policy right could unleash tens of billions in investment

There are substantial amounts of potential investment that could be unleashed if the Government pursues the correct policies and provides the commercial space market with the flexibility it needs. This would massively support the Government’s proposed levelling up approach at no cost – ensuring additional homes in many cases as well.

Large commercial property developers like Landsec have identified mixed use as a key growth area and are planning to reorder their property portfolios to reflect this.[49] Landsec is selling off a £4bn chunk of its £12.8bn property portfolio that it considers to offer limited returns (such as leisure, hotels, and retail parks) in order to reinvest in areas of the market such as mixed use which offer better returns.[50] So a single company in this sector is planning to recycle an amount equal to the recently announced Towns Fund in the 2020 Autumn Statement.

There has already been significant investment in this area of the market over the last decade. For example, looking at Manchester, the retail and leisure scene have undergone significant adaptation, with the transformation driven by an infusion of new mixed-use developments.[51]

As the pandemic ends and the economy recovers, investment levels are likely to recover to pre-pandemic levels, in part driven by new investment in mixed-use

49 Landsec, *Capital Markets Day.* Link

50 George Hammond, *Landsec to sell off a third of its portfolio in shift from retail.* Link

51 Savills, *Mixed-use developments offer bags of opportunities for Manchester’s retail and leisure scene.* Link

developments and redevelopments. Interest in conversion and repurposing of commercial space by landlords was already high prior to the pandemic. According to a survey of landlords by Savills carried out in 2019 for its Re:Imagining Retail report, 18% of those surveyed had already completed a repurposing project and a further 75% were considering undertaking such a project in the near future.

> **‘According to a survey of landlords by Savills carried out in 2019 for its Re:Imagining Retail report, 18% of those surveyed had already completed a repurposing project and a further 75% were considering undertaking such a project in the near future’**

Possible alternative uses for the surplus retail space were varied, including mixed use retail space, residential, health and community, and last mile logistics to tap into the growing ecommerce market.[52] It must be assumed that in light of the pandemic and the growth in working from home that interest by landlords and levels of potential investment will have increased significantly.

Bad policies mean fewer homes, more derelict and struggling high streets, and less levelling up

The pandemic has been a significant shock to the commercial space market. At least some of this shock will be permanent, given greater working from home and the trend towards online retail. It is not just cyclical disruption but structural changes that mean that retail and office space needs to be able to adjust and evolve in order to stay competitive and survive.

It has long been clear that more flexibility is needed in how commercial space is used and how owners and investors of high street property reconfigure space in order to stay relevant and profitable, including recycling to residential where appropriate. This was the conclusion of a report by Oxford Economics for BCSC back in 2011.[53] The Government has responded, as we will see, with the recent creation of a new use class – but this alone will not be sufficient to prevent a rise in vacancies more broadly.

Vacant spaces will not be in anyone’s interest, and may well have a snowball effect on the wider commercial centre around them. As the Communities and Local Government Select Committee report into 2030 high streets and town centres put it: ‘We know from our experience that the loss of a shop—particularly a long-established ‘anchor’ store—can be crushing for a place; the impact was described to us as “massive” and the empty space that remained a “scar”. The surrounding shops are also affected by the loss of a “pull” into the town centre.’[54]

Landlords will obviously lose out through lost rent, but local authorities will also pay a monetary price as business rates income will fall. Furthermore, the wider community suffers as vacant properties are linked to increased crime.[55]

52 Mark Garmon-Jones and Tom Whittington, *Savills reveals three quarters of retail landlords are considering repurposing projects.* Link

53 BCSC, *Empty Shops: What does the future hold for town centres,* Link

54 Housing, *Communities and Local Government Committee, High streets and town centres in 2030.* Link

55 Retail Think Tank, *What impact do shop vacancies have on towns and cities across the UK and what can be done to address the problem?* Link

The more that office space can be reinvented or converted as necessary, the more attractive office based town and city centres will be. It is in the interests of all those involved that greater flexibility is allowed in terms of commercial space so that it can be repurposed and evolve into a more economically sustainable form - and so that lots of buildings don't end up standing vacant losing money for their owners and the local authority and degrading the local area and economy.

> **'It has long been clear that more flexibility is needed in how commercial space is used and how owners and investors of high street property reconfigure space in order to stay relevant and profitable, including recycling to residential where appropriate'**

However, as the rest of this report will show, without reform, it will be difficult for commercial space to be repurposed as quickly and widely as is necessary. Inevitably, that will mean more vacancies and more high streets which are not in a fit or competitive state. Towns and cities are unlikely to revive if they are filled with dead or dying high streets - so it is imperative that policies are put in place to avert such an outcome.

Part 2: Not acting on high streets will have serious political impacts

As was set out in Part 1, a massive shift in how we think about space in our towns and cities is under way. The tough choices that will need to be made add a highly political dimension to how space should be reshaped. They also add urgency. While elements of the economic fallout from the pandemic are reversible, many of the patterns identified in Part 1 are an acceleration of pre-existing trends away from high street retail, allied to a shift toward a new type of hybrid office working. At the very least, there is going to have to be a reshaping of commercial space to add a dimension which online aspects cannot replicate.

If action is not taken fairly rapidly over 2021 and 2022, the Government faces going into the next election with vacant town and city centres, gutted by the combination of long-term issues and changes due to Covid.

People really care about their local commercial centres

The political salience of the high street is born from the fact it is an important focal point for most people. Polling undertaken just before Covid hit in early 2020 by the Nationwide Building Centre found that over seven in ten people found their high street an important part of their community - but over two-thirds also said that their high street had declined in the past five years.[56]

> **‘Polling undertaken just before Covid hit in early 2020 by the Nationwide Building Centre found that over seven in ten people found their high street an important part of their community - but over two-thirds also said that their high street had declined in the past five years’**

Additionally, over seven in ten people said that they would judge a local town by the state of the high street alone. This is all circular – most people know that they and others judge the area they live in by the quality of the local high street, which focuses even more attention on it.

Research by the agency Public First has found that nearly 60% of people visit their local high street more than once a week, and that less than 10% do not visit their local high street at least once a month or more.[57] So this is the practical barometer for many people in terms of their local economy, a key part of their subjective wellbeing and assessment of how the economy is doing.

56 Elias Jahshan, *What high street shoppers want: more family-run businesses, fewer vape & betting stores.* Link
57 Public First, *Town Centres and High Streets: Survival and Revival.* Link

Indeed, the main source of identity for a large minority of people is their village, town or city. In the North West 27% of people identified primarily with their settlement rather than the UK as a whole, their nation within the UK, or their wider region, while in Yorkshire and the Humber this figure was 34%, and in the North East 35%.[58]

Thus a downbeat and failing commercial centre for the areas that people live in will have a serious impact on how people feel that the Government is managing their local area, and by extension, the wider economy.

The issue of commercial space is even more critical in areas the Government wants to level up

The issue of commercial space is even more critical in areas that the Government wants to level up. Below is a table that shows the number of Conservative gains in England at the last election, and the vacancy rates of 2020 for retail.

As was seen in the first part of this report, the highest rates of vacancy in terms of retail are in the North East, and the lowest in London. This is the exact opposite of the patterns of gains seen in the 2019 election.

One interpretation of this is that people will vote for the Government whatever the state of their high streets. But the truth is more that the Government's majority is increasingly dependent on those areas with the highest rates of retail vacancy, and therefore where the state of high streets and commercial centres will be a more pressing concern. Turning this situation round should therefore be a priority - just as Labour needs to develop policies that could help these areas if it wishes to make inroads.

Vacancy rates in retail and Conservative gains in 2019 in England[59]

Region	Con MPs gained in 2019	Gains as % of regional MPs	Vacancy rate
Greater London	0	0%	9.4%
South East	2	2.3%	11.3%
East of England	2	3.4%	12.6%
South West	1	1.8%	13.1%
East Midlands	7	15%	14.5%
West Midlands	9	15%	15.6%
Yorkshire & the Humber	9	16.6%	16.5%
North West	12	16%	16.5%
North East	7	24%	19.2%

There is also an understandable link between vacancy rates and prosperity. Data analysed by the Centre for Cities suggested that in 2017/8 that: *'City centres within the Greater South East – the most productive group of cities – on average have much lower vacancy rates than cities in other parts of the country. Cities in the East Midlands, Wales, and across the North tend to have higher vacancies.'*[60] They noted

58 Public First, *Polling on the UK Highstreet for Primark.* Link

59 House of Commons Library, *General Election 2019: results and analysis, Second Edition.* Link

60 Anthony Breach and Rebecca McDonald, *Building Blocks The role of commercial space in Local Industrial Strategies.* Link

that high street vacancies ranged from 24% in Newport to 7% in Cambridge. Again, the areas where newly returned Conservative MPs are most common are the areas where there is the biggest need for improved outcomes.

The areas that need levelling up are likely to be badly hit post-Covid

Unfortunately for the Government, some analysts think that the areas which will be hardest hit in the aftermath of Covid are likely to be areas which were already struggling.

Local Data Company (LDC) analysis suggests that those which will take the most pain are those with a vacancy rate higher than the GB average pre-pandemic at the start of 2020, and those with a low number of essential retailers which have not been able to retain as much footfall during lockdown. To quote an analysis from early on in the pandemic: *'Town centres with low levels of long-term vacant units (units vacant for over 3 years) will have a greater buffer to absorb the high number of store closures expected due to COVID-19. Cathedral towns dominate those with the lowest long-term vacancy rates, such as St. Albans (1.9%), Canterbury (1.6%) and York (1.4%). These towns are likely to be more resilient going forwards.'*[61]

'The Centre for Cities noted that weak city centres, as it termed them, tended to have a very high level of retail in their mix – at around 43%'

The Centre for Cities noted that weak city centres, as it termed them, tended to have a very high level of retail in their mix – at around 43%.[62] Given the acceleration of online shopping in the pandemic, this is likely to leave many areas struggling to get back to where they were. It is likely that the places that have the lowest level of vacancy are more likely to 'bounce back'. It seems no coincidence that cathedral towns, attractive places that provide an attractive offer in terms of place, were those that were doing well prior to the pandemic.

The risk here is that those places that were already struggling may enter a spiral of decline. While most places will of course see many shops, pubs, restaurants and so on reopen in 2021, businesses that were on the brink are unlikely to return. These weak city centres include many swing seats at the last election – Stoke, Derby, Blackpool - as they tend to be medium-sized towns, not the large city centres dominated by Labour.

In other words, even if the absolute impact of the pandemic is highest in city centres (so for example large cities see a higher fall in the next couple of years), they start from a higher base – and are most likely to be able to reinvent themselves more quickly. London, as a global city with a major tourism industry, could much more easily withstand a fall in spending of say 5% over the next couple of years than a medium-sized town such as Hartlepool. In addition, London would be most able to easily convert additional space to residential given property values.

61 Local Data Company, *The Impact of Covid-19 on UK Town and City Centres.* Link

62 Rebecca McDonald and Paul Swinney, *City centres: past, present and future: Their evolving role in the national economy.* Link

A final point is what might happen if rents for commercial properties decline. Again, there is a greater scope for a fall in rents in high value areas than low value areas, without it leading to widespread dereliction. Even with a fall in prices, in high value areas commercial properties are probably viable to remain within commercial use. Whereas a fall in prices in lower value areas may mean that the costs of maintaining and running commercial buildings reach a point where it simply is easier to abandon them.

This happened in the 1970s and 1980s for large swathes of industrial buildings and land in our cities – with some of this land still vacant or derelict today. This obviously will be a more serious problem in say Walsall than Westminster, or in Burnley than Brighton. And if it does happen, this surge of derelict or vacant buildings may make it harder to regenerate these areas in future.

In other words, it is in places where the need is greatest that there is the greatest need for an attractive place-based offer to try to halt any decline - and the shortest window of time in which Government needs to act.

Failing to reshape space will also harm the Government's planning reforms

Getting this agenda right is key as part of the levelling up agenda. But there is another political headache for the Government on the horizon. If the shift to greater working from home means cities with high levels of commuting and office need see a decline in office space, there will be greater political pressure to recycle space and buildings toward much needed homes.

> **'The Government has already announced, after pressure from MPs, that it is going to prioritise brownfield sites in terms of meeting its new housing targets'**

Even a moderate shift in office demand is likely to result in higher vacancy rates – and because these will be in highly visible commercial centres, people are likely to overestimate the levels of brownfield land and scope for new homes on these sites as a whole. This will increase opposition to planning reforms and new housing.

This will be particularly true in office-centric commercial centres, which are often areas of high housing demand - either flourishing regional powerhouses such as Leeds or London, or high-pressure local housing markets like Cambridge or Brighton, where prices and rents are costly.

The Government has already announced, after pressure from MPs, that it is going to prioritise brownfield sites in terms of meeting its new housing targets. The Government has U-turned over the new housing formula published last summer, which generated significant opposition, including a debate in parliament where many Conservative MPs explicitly called for delays to the reforms.[63] After the past reforms were proposed, polling showed around 70% of Conservative councillors wanted to increase the size of the green belt to afford more protection of land against construction.[64]

63 Hansard, *Planning and House Building Debate, 8th October 2020.* Link

64 Krystian Groom, *Conservative Councillors views spell trouble for the Government's Planning Reforms.* Link

'If the Government is to successfully push planning reforms through parliament later this year, it will need to show that its plans will ensure that brownfield land is recycled as a priority'

If the Government is to successfully push planning reforms through parliament later this year, it will need to show that its plans will ensure that brownfield land is recycled as a priority. It will therefore need to avoid vacant brownfield land in commercial centres creating opposition to new greenfield developments. Thus, it makes sense for Government to start planning now how its reforms fit with the possibility of an increase in the availability of brownfield commercial sites for housing, both in terms of converting space, but also in terms of mixed use regeneration and redevelopment more widely.

Part 3: Local councils lead in reshaping spaces via commercial assessments

The first half of this report has set out the scale of the challenge facing our commercial centres, and the crucial political importance of reinventing and reinvigorating them in the aftermath of the pandemic.

The rest of this report will set out policies across two areas to help boost reshaping space in response to these trends. This chapter will focus on the necessary role councils can play, and the next one ensuring that incentives are aligned both for councils and developers. Because getting this right is not just about what is done in Whitehall - above all, it requires a successful partnership between the private sector and the public sector at a local level.

Recent reforms increased flexibility but councils still determine commercial quantum and location

The public sector, and in particular local government, plays a key role in how far local high streets and other commercial areas are successful, to an extent that is frequently not understood. Setting aside other crucial areas - such as parking, public and private transport, the public realm (with a few notable exceptions like Canary Wharf and other privately operated estates) - then the single most important elements of commercial areas, the amount and location of commercial space, are determined as much by the state through the planning system as the private sector through market signals.

The ability of land and buildings to be used for different purposes is governed in the planning system via the use class system, a government-controlled regulatory system that sets out how buildings can be used.

The use class system tries to sort out different relevant uses and put them together so that commercial clusters occur and nuisances are minimised. The use class of a home for example is C3, whereas the use class for a warehouse is B8.

Even most free marketeers accept that there is a clear need for a planning system to govern the use of different buildings. Clearly someone opening a shop in the house next door to you, or a heavy industrial unit, is an imposition on your own quality of life. There is also a clear benefit, all other things being equal, for development to occur on brownfield sites rather than greenfield sites, since most people would rather an under-used or vacant piece of brownfield was converted into a different use than new building go on nearby greenfield. So councils need to retain a strong voice in how their area is shaped.

However, there is also a clear need for the planning system, and the uses that buildings are put to, to not just focus on trying to minimise nuisance or push commercial or other uses together. The planning system needs to take account of market signals – or else buildings risk being under-utilised or even left vacant or derelict.

The Government has already undertaken a major and welcome reform of the use classes order that governs which uses buildings can be put to. In September 2020, the use classes for A1/A2/A3, and B1, as well as some other uses such as creches or nurseries, were all replaced with a new single use class, E.[65] Broadly speaking, this single category covers previous use classes A1 (shops), A2 (financial services such as estate agents and banks), A3 (restaurants and cafes), and offices, research or light industry with no side effects such as noise or pollutants (B1).

Changes in use classes from September 1 2020[66]

Use	Old use classes	New use classes
Shops	A1	E
Financial & Professional Services	A2	E
Food & Drink (mainly on the premises)	A3	E
Business (office, research and development and light industrial process)	B1	E
Non-residential institutions (medical or health services, crèches, day nurseries and centres)	D1	E
Assembly and Leisure (indoor sport, recreation or fitness, gyms)	D2	E
Non-residential institutions (education, art gallery, museum, public library, public exhibition hall, places of worship, law courts)	D1	F1
Shop no larger than 280sqm (selling mostly essential goods and at least 1km from another similar shop); community hall, outdoor sport/recreation area, indoor or outdoor swimming pool, skating rink	A1	F2
Public House, wine bar, drinking establishment	A4	Sui generis
Hot Food Takeaway	A5	Sui generis
Cinema, Concert Hall, Bingo Hall, Dance Hall, Live music venue	D2	Sui generis

Crucially, changes of use within use Class E are not subject to full planning permission: you can convert a bank to a restaurant to an office without submitting a planning application. This is a sensible liberalisation that focuses council powers on changes of use that have a clear impact on the neighbouring buildings and individuals (e.g. drinking establishments, hot food takeaways, industrial uses with clear amenity impacts, which are all excluded from this new use class).

65 Ministry of Housing, Communities & Local Government, *Permitted development rights and changes to the Use Classes Order.* Link

66 Ibid.

As a result, there is now less need for councils' local plans to try to micromanage the number of, say, offices, compared to space given for financial establishments or restaurants and cafes. The new use class will also allow continued change of use to residential (in the jargon, from use class E to use class C3) through a prior approval process which should help increase flexibility as well.

Local councils will, however, still have to grant permission for major refurbishments which require 'material change' to a building, even if the building maintains its existing use. While it is true that interior alterations (other than mezzanine floors larger than 200 square metres) are not counted, fundamental redevelopment of buildings usually counts as development if it materially affects the external appearance of a building, there are structural alternations, or it involves substantially redeveloping a building.[67]

Despite all this councils will retain control over two elements:

1. The total **amount** of commercial space in an area.
2. The **location** of this commercial space.

These are fundamental decisions that will have a major impact on how successful commercial spaces are over the next decade or so.

New local plans as required by Government will slow down reshaping space

The impact of council decisions in the coming years is even more important because Government is in the midst of planning reforms which will require councils to draw up new local plans that will set out land and building uses across their local area. The Planning White paper published in August 2019 set out that once the Government's planning reforms are completed, new local plans should be developed and put in place within 24 to 30 months.[68] It is likely that the planning reforms will be in place - and so the starting gun fired - by the middle of 2022. This would mean new local plans in place by 2025.

> **'The Planning White paper published in August 2019 set out that once the Government's planning reforms are completed, new local plans should be developed and put in place within 24 to 30 months'**

These new local plans are likely to lead to a fundamental reassessment of how land is used in this country. They will set out the amount of commercial property and land, and the location of this commercial property and land. The Government has proposed that all land should be put into three new categories – 'growth', 'renewal', and 'protected'. This means that all land could be assessed with fresh eyes.

Since these local plans, once complete, are likely to only need moderate revisions in the coming years, they are likely to have a major and lasting impact on how commercial space is managed - and the politically sensitive areas of retail and high streets and brownfield regeneration and redevelopment.

67 Ministry of Housing, Communities & Local Government, *When is permission required?* Link

68 Ministry of Housing, Communities & Local Government, *Planning for the Future White Paper.* Link

However, a significant problem is emerging. Many developers are finding that decisions are currently on hold, while councils wait to find out what is going to emerge as a result of the planning reforms. Even once councils know what the new local plans will require, until they are actually in place there will be a hiatus during which councils are likely to be reluctant to make major decisions on how space in their area might change or develop. This could mean a damaging gap until the middle of this decade, as councils pause to pull together new local plans (and that assumes that councils will meet the deadline imposed by Government, which seems pretty optimistic).

This will be particularly damaging as it will be happening at a time when commercial centres are undergoing particularly high rates of vacancy and change, which means that councils will be seeking to delay these decisions just when business needs these decisions and leadership from their local councils more than ever.

Many councils are reluctant to see commercial space shrink or change leading to high vacancies

For these local plans to be successful, councils have to be realistic about what level – and what type – of commercial property is likely to be needed in their area, or risk creating unworkable designs.

The problem is that many councils want to keep commercial property in their area – even if it is unviable. Part of this is for reasons related to taxation, which are discussed further on. But part of it is due to the fact councils tend to see commercial property and space as 'creating' jobs (even where they are underused). This makes councils feel as if redesignating commercial space is 'destroying jobs', an entirely fallacious way of viewing the system.

'There are also widespread problems with resourcing and skills in many planning departments, and a lack of political leadership that means it takes too long for private capital to build new homes, jobs and communities'

There are also widespread problems with resourcing and skills in many planning departments, and a lack of political leadership that means it takes too long for private capital to build new homes, jobs and communities. Many councils are unwilling to face up to the reality of what their area needs, creating a less attractive reality on the ground than is necessary.

This can be shown by the way that councils have failed to address the problem of vacancies across the country. As discussed earlier, the growth of retail vacancies has been steady in recent years, moving from the type of commercial property with the lowest rate of vacancy to the highest. In addition, many areas have tended to see high rates over time, as even when it becomes clear that there is limited economic rationale for their current use, councils are reluctant to allow change.

It is easy to say that these persistent vacancies are the natural result of differing economic circumstances across the country. But this is largely misplaced. There is no reason that there should be such major consistent differences in vacancy rate and a constant increase in the vacancy rate as a whole – unless the policy environment is making it harder than it should be for the market to adjust to commercial reality, either by lowering the cost of running a retail operation or facilitating the conversion of those properties.

Indeed, in a logical world, it is hard to see what the social and economic costs of converting vacant retail units to other purposes are. You would expect councils and landlords to work together to drive vacancy rates down but something is clearly not working as it should.

Councils should prioritise a commercial (i.e. brownfield) assessment when drawing up local plans

By the end of 2021, and certainly by the middle of 2022, it is likely that the nature of the post-Covid 19 world will be much clearer. The problem will be that councils will only really be beginning to get to grips with the procedures to put in place a new local plan by this stage, even as developers and commercial property owners are desperate for decisions and guidance as soon as possible.

‘There is a therefore a strong case that the new local plans should start with an assessment of the commercial space councils need in their area and how and where land can be released or redeveloped as necessary’

There is a therefore a strong case that the new local plans should start with an assessment of the commercial space councils need in their area and how and where land can be released or redeveloped as necessary. This process would create a review of the brownfield potential sites that are available or could be redeveloped locally either into attractive new commercial sites or the new homes that the country sorely needs.

This would fulfil one of the main goals of the planning system – to prioritise the development of brownfield sites by proactively supporting brownfield, rather than blocking greenfield homes in the hope that somehow this will be made up by brownfield sites. This proposal would be a genuine ‘brownfield first’ policy which actually ensures we meet housing need and develop our urban areas in a way that serves the community.

Given that it will take time for the rest of the local plan to be created, this could also allow permissions to be granted in the interim on these new brownfield sites while the rest of the local plan is drawn up, with brownfield sites already in the five-year plan or those which are less controversial granted permission ahead of the completion of the full local plan.

This fits very well with the announcement on December 16 that the Government wants to concentrate the main increase in housing numbers on brownfield areas, particularly the top 20 largest urban areas. It means that in each area, brownfield sites will be prioritised, and the new higher targets that are being set in these urban areas will be easier to achieve. It also means that by 2023, even if local plans are not in place everywhere, there should have been a brownfield assessment made with new sites and homes coming forward in brownfield areas.

At present, there is a real risk that over the next few years the flow of new land into the system will dry up since councils will be able to (legitimately) argue they are in the midst of setting out a new local plan. Even if the entire country sees local plans put in place within 24-30 months, it could substantially slow development for some time. There is however a strong risk that the brisk timetable the Government has set out is not going to be met everywhere, meaning it is possible for such a major hiatus in new land coming into the system to last in some areas well into the 2020s.

'Even if the entire country sees local plans put in place within 24-30 months, it could substantially slow development for some time'

Another benefit from pushing councils to consider their commercial and brownfield needs first is that it would allow landlords and businesses to apply for the necessary changes to redevelop commercial spaces into what the post-Covid world needs as rapidly as possible. Thus, prioritising the assessment of commercial needs as the first step in new local plans is likely to help ensure that the economy is reinvigorated as rapidly as possible, by converting commercial space to new configurations. This fits with the 'build back better' theme promoted by Government.

On retail, setting out what a post-Covid world is likely to look like will allow for a fast repurposing of shops and changing the way these operate. The growth of retail as a 'destination' is a constant in current reviews of the sector and Covid-19 makes this more urgent. With the likely increase in working from home, these new commercial assessments would help encourage developers to remake offices into the spaces that will endure for the next few decades around the hybrid model that the evidence shows is likely to be prioritised by companies and individuals.

Announcing that councils will have to focus on assessing the commercial spaces and brownfield sites in their area first should also buy popular support both at a national level and in individual areas for these new plans and the broader planning reforms that the Government wants. The damage done to areas by Covid-19 will be repaired in commercial centres as rapidly as possible, allowing for repurposing of commercial areas and regeneration into attractive mixed-use areas.

Councils should have financial incentives and support put in place around this process

In the next chapter we propose a series of incentives around these commercial assessments so that financial support is put in place. Such financial incentives can help unlock very substantial amounts of money in the private sector (remember that a single company, Landsec, has set aside the equivalent of the entire Towns Fund). We discuss this further later on, but the principle should be that Government supports and encourages this process through collaboration as much as possible.

Allowing limited Article 4 Directions in support of local plans as an incentive for councils

As noted, under the current system of permitted development rights, there is a clear presumption in favour of conversions. Once a developer gives notice of a scheme, the local council is only able to consider very limited matters around highways and transport impact, contamination and flood risks, and the potential for noise and disruption.

Concerns about the loss of employment space have in recent years led councils to gain more control over residential conversions through Article 4 Directions. An Article 4 Direction is made by a council to restrict the scope of permitted development in a particular area, site or type of development in the authority's area, requiring full planning permission.

When permitted development rights were introduced, an exemption was provided for London's Central Activities Zone.[69] After the Government announced that this exemption would be withdrawn in May 2019, the 10 borough councils in the CAZ have been working to introduce their own Article 4 Directions to fill the gap.[70] Manchester City Council brought in an Article 4 Direction for the city's commercial core in 2013, expanding this in 2019 to effectively cover the whole of central Manchester.[71]

> **'When permitted development rights were introduced, an exemption was provided for London's Central Activities Zone'**

Larger cities without blanket city centre Article 4 Directions for office to residential conversion include Leeds, York, Birmingham, Portsmouth, Liverpool and Newcastle. Many smaller cities and towns have likewise no general protections in place for their core commercial areas, but do have individual Article 4 Directions covering business parks or individual premises.

It is legitimate for councils to put in place measures to ensure that the cores of their commercial centres are not pockmarked with residential conversions. We would therefore propose that alongside the commercial assessment, councils are able to put in place any supporting Article 4 directions which protect the commercial cores of their area.

Yet it is also important that these controls are not too strict. It is not legitimate to put these into operation to try to freeze in place the entire area councils are overseeing. Rather, they should be used to ensure that particular clusters are kept as predominantly commercial. The Secretary of State has power to amend or strike out Article 4 Directions and we propose that as each commercial assessment is made, he or she should review any new Article 4 Directions and existing Article 4 Directions. This would act as an incentive for councils, working with commercial landlords and companies, to create a good commercial assessment that would then justify these Article 4 Directions by protecting the key commercial centres, while allowing permitted development more widely across most of the local area.

69 Greater London Authority, *Strategic evidence to support London borough Article 4 Directions in London's nationally significant office.* Link

70 Greater London Authority, *Planning Datamap.* Link

71 Manchester City Council, *Article 4 Directions: changing the use of a property from office to residential.* Link

Councils that fail to prepare a realistic commercial assessment should have one done for them

While we want to Government to be collaborative with councils in bringing forward a realistic commercial assessment, there has to be a penalty for failing to do so. Government will be seen as culpable rather than councils if local people see their area failing. Politically, doing nothing will not be an option. So as well as the incentive above (and the measures proposed in the next chapter) then there has to be a sanction for councils that fail to prepare an assessment of commercial space or create an assessment of commercial space that is not realistic.

> **'We propose that councils which fail to prepare a realistic commercial assessment should have one done for them'**

Therefore, we propose that councils which fail to prepare a realistic commercial assessment should have one done for them. The Government could undertake this only when certain criteria were fulfilled, for example:

1. By the end of 2022 no commercial assessment of space and proposed changes has been completed.

OR WHERE ONE IS COMPLETED

2. The assessment is subject to formal complaints by commercial landlords who control more than 33% of the local commercial space either by volume or value.

Thus, where councils are refusing to take a lead; refusing to accept a change in the level of commercial property; or refusing to support modification to their existing commercial properties, the Government would intervene.

However, this would not be about simply replacing the council with national control. Instead, any amendments would follow the rules set out below.

1. Sites that the council has indicated for redevelopment or for continuing as commercial space, where the landowner agreed with this, would be incorporated into any commercial plan prepared by Government.
2. Other commercial sites proposed by their owners for either redevelopment into mixed use, commercial use, or residential use would be judged on their merits, with the design aspect and the views of local people given priority within any formal process.

How exactly this second point would work is something that the Government can and should consult widely upon. It may be that where local design codes have been signed off, then there would be a presumption that if the applicant can show there is an oversupply of the existing type of property, as evidenced by vacancy rates, that they will be given planning permission. But action of some kind is necessary.

It is important to note the public are generally supportive of action where local councils are failing to look after and promote commercial space locally. Many people have noticed that their local authority is not supporting the local high street. A poll in 2019 found that by nearly three to one, people felt that local government was not playing a positive role in the future of the high street.[72]

This is backed up by other work. For example, polling by Public First found that the second most popular way to boost high streets, according to local people, would be lower parking charges - which are controlled by the council.[73] There is a realisation that councils are not always doing the best they could, and Government should be aware of this and not be afraid to act.

'The key point is that Government cannot simply let councils off the hook'

The key point is that Government cannot simply let councils off the hook. Indeed, if councils cannot even undertake the task of assessing commercial brownfield sites in their area and determining which should be recycled into new homes, it will be a pretty big red flag in terms of the wider local plan, which deals with more complex and controversial issues like greenfield and green belt.

Developing policies which set out how Government can intervene around this area could not just help deliver on the reshaping of space, but potentially be extended to other parts of the local plan process. Since 2015, the Government has, in theory, been committed to developing local plans in consultation with local people if councils do not put them in place.[74] This commercial assessment should and could act as a way to trial intervention over local plans more widely.

72 ComRes and Hume Brophy, *High Street Survey.* Link

73 Public First, *Town Centres and High Streets: Survival and Revival.* Link

74 HM Treasury, Fixing the foundations: Creating a more prosperous nation. Link

Part 4: Getting the right incentives to help reshape spaces

The final element that needs to be tackled are the significant issues with the current tax system that act as barriers to reshaping space – both in the short and long term. The current system both makes it hard to reshape space, and creates distortions that can lead to an inefficient use of space and make it hard to effectively recycle it.

Within this, there are three areas. The first of these concerns the new Infrastructure Levy being created within the new planning bill. This has the risk of making new development and mixed-use development in particular more difficult. We therefore propose to *'future-proof planning reforms'*:

1. Having a lower rate of Infrastructure Levy on commercial uses.
2. Limiting plans to charge the Infrastructure Levy on permitted development change of use.

However, this alone is not sufficient, since preventing negative changes do not go far enough. There are currently problems with how the business rate system operates on multiple levels that penalise commercial space and discourage investment or commercial regeneration, so we therefore propose around *'removing disincentives'*:

1. Shifting business rates to a fairer level and changing how business rates retention operates.

Finally, we propose two measures that would help with the cost of drawing up commercial plans for councils so that they have more resources for commercial assessments, under *'helping councils'*:

1. A one-off grant to support development of commercial assessments.
2. Expanding the scope of external structural changes to non-nuisance changes.

Taken together, these would remove potential issues coming down the tracks, address current disincentives, and ensure that councils had the resources necessary to undertake a commercial assessment in their area. This should ensure that the incentives are aligned for councils to be able to work with developers and local employers, and build back better.

Future-proof planning reforms

1. Having a lower rate of Infrastructure Levy on commercial uses

Currently the Government is proposing merging the two main forms of planning gain capture, the Community Infrastructure Levy (CIL) and Section 106, into a single new 'infrastructure levy'. The White Paper published in August 2020 proposes replacing the CIL with a 'nationally set, value-based, flat-rate charge', equal to a fixed proportion of the development's final value, above a yet-to-be-determined threshold that would be levied on the scheme's completion.[75] This Single Infrastructure Levy is intended to 'deliver more of the infrastructure existing and new communities require by capturing a greater share of the uplift in land value that comes with development'.[76]

There are some advantages to this new infrastructure levy system. Above all, moving to a more simple tax on development is easier to understand, calculate and collect. At the same time, it will be crucial that the rate of tax is set correctly – and a single flat rate levy mitigates against this. This is particularly true for movement between commercial uses, and redevelopment of commercial areas, and for developments involving brownfield.

'Instead of charging a national flat rate on all commercial development, there should be a lower rate set by councils as part of their local plan'

Charging, say, a flat 20% on the value of a greenfield development makes more sense because there is limited value in farmland (usually between £10,000 and £20,000 a hectare, as opposed to millions per hectare in commercial or residential land in much of the country), so you are just charging on what is new. The uplift on a £200 million residential development on a simple to prepare greenbelt development is fairly close to £200 million minus planning costs and construction (before the infrastructure levy or any other planning gain uplift is calculated, obviously). But the uplift on a £200 million development which involves demolishing and rebuilding on brownfield sites, and changing from existing (valuable) uses, will vary wildly.

The net result of this is likely to work strongly against the Government's proposed desire to see more homes being built on greenfield, and make large urban regeneration sites less attractive for developers. This is the exact opposite of what will be needed in the next few years.

Instead of charging a national flat rate on all commercial development, there should be a lower rate set by councils as part of their local plan. This should ideally be tiered. So a developer pays a higher rate for development on greenfield, a slightly lower rate for mixed use regeneration without complex remediation or where there is a large increase in new floorspace, (for example taking a low density 'big box' store and building an office and retail complex in its place), and the lowest rate of all (if anything) where the development is brownfield regeneration with complex remediation or where most of the floorspace is changing uses (rather than being entirely new).

This will allow for an assessment of the likely sensible rate during the local plan period. This should also apply to regenerations where the overwhelming majority of the value comes from commercial property rather than residential, allowing private investment to help repurpose our towns and cities after Covid-19 and renew areas that otherwise may end up becoming under-used and housing vacant buildings and land.

If, for example, a mixed use development is 80% commercial and 20% housing, applying this lower rate across the whole regeneration project is likely to be simpler and preferable than trying to tangle out the value of the residential and commercial spaces. A threshold (perhaps 20%) might apply so such mixed use regeneration is used carefully.

75 Ministry of Housing, Communities & Local Government, *Planning for the Future White Paper.* Link

76 Ibid.

2. Scrapping or limiting the infastructure levy on change of use via permitted development

Another proposal within the same consultation is to charge the new infrastructure levy on permitted development change of use, particularly when buildings move from one use to another. As set out in the previous chapter, the key way that space is allocated and reallocated is in local plans, and most large scale commercial regenerations are likely to be in local plans. But in-between local plans there needs to be a way that commercial spaces can convert.

As noted, since 2013, developers in England have been able to convert some types of commercial space, principally offices, into residential use without planning permission through permitted development rights. Initially this was a temporary measure to increase the supply of homes but it has since become a permanent feature of the planning system under the General Permitted Development Order (GDPO) 2015. This has helped increase the flow of homes in recent years.

Charging the infrastructure levy on change of use would mean a fairly substantial increase in the cost, and reduction in the desirability, of these new homes coming forward. This is likely to reduce the attractiveness of converting underused office space to residential spaces.

Given the £7 billion raised by planning obligations in 2018/19,[77] spread over 140,000 or so private homes,[78] we can calculate a rough rate of around £50,000 per property - though obviously this will be more in high value areas and less in cheaper areas. This means that applying such levies to change of use will have a substantial effect. For example, a 20% infrastructure levy on a commercial building being turned into 3 flats at £200,000 each would mean an additional £40,000 per flat or £120,000 on the whole building. This would clearly make a difference to the viability of such conversion.

‘Charging the infrastructure levy on change of use would mean a fairly substantial increase in the cost, and reduction in the desirability, of these new homes coming forward’

There will inevitably be a risk that instead of taking on the risk of converting commercial buildings to other uses, some commercial landlords may simply hold onto vacant properties, hoping that their rivals will instead convert to other uses, resulting in a prolonged standoff which results in both fewer homes and higher levels of vacant homes.

There is a further risk that potential changes to developer contributions could also affect the incentive to rebuild versus refurbish. Currently, by proposing to impose the new Infrastructure levy to change of use while pushing the concept of ‘demolish and rebuild’, the Government is creating perverse incentives to tear down good buildings and build anew at a higher density rather than recycling existing buildings.

77 Ministry of Housing, Communities and Local Government, *The Incidence, Value and Delivery of Planning Obligations and Community Infrastructure Levy in England in 2018-19.* Link

78 Ministry of Housing, Communities and Local Government, *Live tables on house building: new build dwellings: Table 253: permanent dwellings started and completed, by tenure and district.* Link

Furthermore, if you are going to have to pay 20% on the value of the new homes, the numbers may only stack up if you increase the floorspace substantially. While there is nothing wrong with demolish and rebuild versus recycling buildings, it is generally less disruptive and more environmentally friendly to refurbish, all other things being equal. It certainly would not be helpful if the decisions over refurbishment or rebuild was driven by distortions introduced in the tax regime.

Therefore we propose that this exemption should be reversed. If this is not possible politically or thought desirable, then we suggest that the levy should only apply where there is a particularly large conversion within high value areas, and be capped at a national level (e.g. for a large office block in central London converting to flats then a 10% infrastructure levy rate would apply).

Removing disincentives:

1. Shift business rates to a fairer tax and change how business rate retention operates

Business rates are a significant cost to business, with the last full year before the pandemic giving a total of £25 billion raised (net of reliefs).[79] This cost must be paid even where there has been no revenue or profit made (unlike, for example, corporation tax).

There are two problems with business rates. Firstly, and more broadly, the current system of business rates is simply unfit for purpose:

- Valuations are erratic and revaluations undertaken too rarely.
- Business rates are simply too high.
- Business rate retention deters sensible recycling of commercial space.
- Business rates are not spread evenly or fairly compared to other taxes.

In reality these issues all fuse together – part of the reason revaluations are put off is that business rates are too high and unfairly spread which makes changes difficult. The fact business rates are not spread evenly makes the fact they are too high even more damaging.

On the first issue, the lengthy gaps between revaluations leads to major shocks both in how much firms pay and in how much revenue local government can raise. The tax is unresponsive to economic conditions, with firms paying rates based on out-of-date valuations. Businesses in 2014 were paying rates using a valuation from 2008 – before the economic crash and recession. They will currently pay rates calculated in 2015 until 2023 at the earliest.

Not only does this lead to erratic values out of line with real economic circumstances, it is also a rather complex system, and the appeals process which firms can use to challenge the valuations means that local authorities face financial uncertainty about how much revenue they will actually get.[80]

Yet the issues around revaluation are related to the fundamental problems with business rates – they are simply not a fair or reasonable tax in terms of the funds raised. Business rates raised around £25 billion, net of relief, in 2018/9. This is not

79 Ministry of Housing, Communities and Local Government, *National non-domestic rates collected by local authorities: England 2018-19 (revised).* Link

80 Andrew Carter, *Five reasons why the business rates system doesn't work – and how to fix it.* Link

far off the £29.5 billion raised in council tax.[81] Yet commercial property is worth just 13% of the built environment. Residential property is valued seven times more highly, yet pays roughly the same amount in property tax. So commercial property is taxed about seven times more heavily than residential properties - which, as discussed below, is one obvious reason why councils are reluctant to exchange commercial property for residential.

The CBI and others have been highly critical of the current business rates system, noting the burden of the tax has now reached unsustainable levels, with the tax rate over 50% and increasing. Any further increases caused by the revaluation planned for 2023 would come with a significant economic cost, reducing investment by firms just at the moment when Government is trying to drive it up.

Finally, the current distribution of business rates as a tax within the business sector is unreasonable. For example, despite all the rhetoric around protecting high streets and supporting town centres, the retail sector is particularly badly hit by the current business rates system. Business rates now represent 42% of all taxes paid by the retail sector.[82] While retail contributes less than 10% of UK GVA, the sector pays 25% of all business rates revenue. This is obviously concentrated on the non-online element of retail. For example, Amazon reportedly paid £63.4m in business rates in 2019. That was almost £40m less than Next, despite Amazon's UK sales being more than double the clothing retailer's.[83]

Analysis suggests that across the economy, rates make up an estimated 6% of firms fixed costs. This means that any change in business rates directly impact a firm's bottom line, affecting whether they can afford to invest in buildings, plant and machinery.[84]

'Business rates now represent 42% of all taxes paid by the retail sector'

Given the amount of investment that will be required in order to repurpose and redevelop commercial space so as to speed up the evolution of the UK's retail sector and high streets into more economically sustainable spaces, there is an urgent need to review business rates in order to help free up money to support reshaping spaces.

The Government has already recognised the weakness of the current business rates system in regards to how it affects traditional retail firms. Even before the pandemic there was considerable relief for certain businesses – for example small business rates relief. And in January 2020 the government announced a 50% discount for retail properties, cinemas and live music venues with a rateable value of £51,000 or less. This in turn built on previous business rate relief schemes specifically targeting the retail sector.[85] The Government also committed in its 2019 manifesto to a fundamental review of business rates, due to report back in Autumn 2021.

81 Ministry of Housing, Communities and Local Government, *Council tax levels set by local authorities: England 2019-20.* Link

82 Centre for Retail Research, *Business Rates and the Future of the High Street.* Link

83 Anthony Dixon, *A new era for our high streets? Link. Verified by Sarah Butler, Amazon confirms it pays UK business rates of only £63.4m.* Link

84 CBI and Allison Young, *Over-rated Making the case for business rates reform September 2020 Tax and Regulation.* Link

85 House of Commons Library, *Business Rates.* Link

If the Government is serious about reshaping space for the better, it needs to reform business rates in a fairly fundamental way – even if not done in one year - so that the current skewed corporate tax system is rebalanced between sectors rather than leaning so heavily on those businesses which use land more intensively than others.

This is a huge topic that we cannot cover in this report, but we do note that the Government particularly needs to fix the way that business rates retention works, since it presently acts as a barrier to sensible redistribution of commercial to residential property.

Currently, the Government allows councils to retain their council taxes and business rates, and then distributes central grant to ensure that areas which are more deprived and have greater need are not left too disadvantaged.

In theory, this means that councils have no incentive to retain or expand commercial space. However, both short- and long-term incentives mitigate against loss of commercial space. In the short term, councils are able to retain their 'growth' in business rates from a baseline, last set in 2013-4. This was worth some £2.4 billion in 2018/19 across the system, so around 5% of the total spending power available to councils of £46 billion or so.[86]

In the longer term, the Government's rhetoric has consistently favoured a system where councils are fully self-financing, which obviously would have serious implications for those which have limited commercial space, while benefiting those who have high levels of or high-value commercial space.

'We therefore propose that the retained business rates system should be amended so that vacant property does not count toward the business rate retention system - and in fact counts against the council'

While everyone (including Government) assumes that these discussions would involve a heavy level of redistribution from some councils to others, a lack of certainty makes councils understandably nervous about reducing their commercial space.

The Government had been due to undertake a reassessment of how the business rates system was working for councils in 2020, and to reset the baseline for business rate retention incentives.

The problem is that this assumes that loss of commercial space is a bad thing after the reset – whereas post-Covid 19 this may be the natural outcome in some areas. The incentives will slow down the repurposing and redevelopment of redundant commercial space as councils will want to increase their commercial space rather than see it become homes.

We therefore propose that the retained business rates system should be amended so that vacant property does not count toward the business rate retention system - and in fact counts against the council (so you subtract it from the growth in total business rates calculated in the area). In other words, if you had grown your business rates by 10%, but 10% of the property in your area by value was currently vacant, your 'growth' for the purpose of business rates retention would be 0%.

86 House of Commons Written Parliamentary Question UIN 170922, 5 September 2018, Link, and House of Commons Written Parliamentary Statement UIN HCWS102, 6 February 2020, Link

Of course, it would be possible that business rates retention in this system was negative (so that the council lost out and had to return funds).

This would improve the situation by encouraging councils to recycle space rather than see it remain vacant. It would also allow central government to publish rates of vacant property in each local authority, which would help encourage councils via a 'name and shame' approach. This could also go along with a 5% reduction in business rates for vacant properties, to act as an incentive for owners to make prompt declarations and ensure that the data Government holds is up to date, depending on how far the sums add up.

If councils argue that they are being unfairly penalised, then the option of allowing properties to apply to be undesignated as commercial buildings (so that they were simply sui generis) and this would indicate that the site should be used for other uses (most likely housing) could be explored – but at present even councils where a shift in the building use is possible can get away with not letting this happen.

Incentivising councils

1. A one-off grant to support development of commercial assessments.

As part of helping councils to deliver a commercial assessment on time, there should be a one-off grant given automatically to councils to help them deliver this promptly. This could be based on a flat-rate assessment combined with population and regional weighting (e.g. £2 million + £1 for each person in their area + between £100,000 to £900,000 depending on their region, with the North East given the most given its high vacancy rates and London given the least).

> **'As part of helping councils to deliver a commercial assessment on time, there should be a one-off grant given automatically to councils to help them deliver this promptly'**

This should be ring-fenced for planning resources around this commercial assessment. If the council fails to put in place a commercial assessment within the timeframe set out earlier, they should have to pay it back. This would help ensure that councils prioritised this and could not use resource constraints in order to say that they were unable to develop such a commercial assessment.

The costs of doing this would be likely to be less than £1 billion even if all councils delivered their commercial assessment on time (given just over 300 councils at the relevant level, a population of just under 60 million and the top up payment above), but it would help substantially increase the chances of areas having a good commercial assessment in place fairly swiftly and so allow the Government to deliver on 'building back better'.

2. Rewarding areas that complete their assessment with an environmental improvement fund.

As well as offering funding for these assessments, we propose that as a reward for each area that develops them, the Government should release a pool of money for the commercial centres.

We would propose that this should be a £1 billion fund – this will not change fundamentals but it can help with improving the public realm once the commercial assessment is completed. This should be focused on areas that need it the most, with a formula that takes account of:

- Regional vacancy rates in 2019 for retail.
- Total size of the commercial area.
- Ease of regeneration in terms of size (i.e. larger cities should receive less proportionately since it is easier to regenerate a larger city compared to a small town).
- Ease of regeneration in terms of wealth (i.e. Gross Value Added per worker in the area so that a poorer area receives more than an affluent area).

The goal of this should be to show that the Government will support those councils and areas that are trying to regenerate their areas, and will encourage councils and developers to come forward with plans as soon as possible.

‘As well as offering funding for these assessments, we propose that as a reward for each area that develops them, the Government should release a pool of money for the commercial centres’

This money should be released as soon as the commercial assessment is completed once it meets the criteria above around being a realistic commercial assessment. This, in tandem with the grant above, would act as a way to help encourage councils to bring this forward. This will help to put in place aesthetic and other improvements to get the commercial assessment going, and of course this whole process will unlock a great deal of private funding.

3. Expanding the scope of external structural changes to non-nuisance changes.

One final change that will free up resources is to remove some of the smaller planning changes necessary in commercial areas. Although use class E makes it easier to change commercial uses without full planning permission, planning permission will still be required in order to make external structural changes. While there is some allowance for minor external changes (such as painting the walls), anything that ‘materially affects’ the external appearance of the building must be approved.

While it is right that major changes to the façade of buildings are covered, this is unnecessarily restrictive. It does not allow, for example, for putting in new entrances or exits. In theory, any change to the external façade that is clearly visible could fail this test.

In central London, where less office floorspace is on the ground floor, and there are many large purpose built blocks, this may have less of an impact, but in other areas it is more problematic. These restrictions can significantly inhibit the ability of properties to move swiftly into new uses or to operate most effectively in their new use.

To take one example, entrances for offices or shops, like large revolving or automatic glass doors, are often not appropriate for residential purposes. Or if some parts of a building are to be converted to residential use while are maintained for commercial use – creating a mixed-use building between residential and office – two entrances would probably be best. Either could require planning permission, even though they are both desirable and have no fundamentally bearing on the surrounding streetscape.

> **'In central London, where less office floorspace is on the ground floor, and there are many large purpose built blocks, this may have less of an impact, but in other areas it is more problematic'**

Another example would be where the front of a commercial building is altered, for example if a solicitor's converts to an estate agent and the new firm wants to change the front from brick to glass. While replacing a brick wall with a large neon light show should require permission, changing the functionality in a way which does not cause more 'nuisance' to the public should not be covered by planning permissions.

It should be noted that this is separate from say, rules set by landlords, or work by Business Improvement Districts to standardise or improve the feel of an area (e.g. work to improve the look and feel of particular shop fronts). But this would free up the resources of council planners to help draw up realistic commercial assessments working with the private sector, rather than having to be involved in minutiae that does not actually impact the public.

Conclusion

This report has shown a vision of a potential future for our commercial centres in the aftermath of Covid-19. By 2023, we see every part of the country having delivered a complete commercial assessment, with work under way to regenerate and redevelop areas. Brownfield regeneration including new homes would be being put in place.

With the incentives corrected and councils working with developers and local businesses, and the funding released from Government for initial improvements, local people would be able to see that a plan was in action to help build back better. Tens of billions would be being invested to help turn slogans and ideas into reality from the private sector and show how areas were improving.

> **‘As the country reopens in the aftermath of the Covid-19 crisis, policy urgently needs to shift in order to make sure that the future is a bright one, and that we make it as easy as possible to reshape space, in order to build back better’**

Yet this requires action in the here and now. An alternative reality exists where councils fail to take a lead, and landlords and businesses are held back, and Government fails to set out any requirements or action either at a national or local level. In that future, there are more empty offices, more derelict high streets - and fewer new brownfield homes.

As the country reopens in the aftermath of the Covid-19 crisis, policy urgently needs to shift in order to make sure that the future is a bright one, and that we make it as easy as possible to reshape space, in order to build back better.

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for Policy
Studies

57 Tufton Street, London, SW1P 3QL
July 2021
ISBN 978-1-914008-04-7