Small Offices and Mixed Use in CAZ

Prepared for The GLA
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August 2015

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Contents

Management Summary

This study examines London's Central Activities Zone (CAZ) in terms of the supply of, and demand for, small offices and mixed use development, specifically the balance between office and residential development. It is framed within the policy context of the London Plan and the National Planning Policy Framework (Section 2.0), will inform the preparation of Supplementary Planning Guidance for CAZ.

London's CAZ is the capital's economic core and a business location of global significance. However, the GLA is concerned that office and residential value differentials there have led to a loss of office space to housing, even though the area is (currently) exempt from the Government's liberalisation of Permitted Development Rights, which allow the conversion of office stock to residential use. The GLA is particularly concerned at the loss of smaller and more affordable office stock which, if sustained, might erode the strategic offer of CAZ as a competitive office location.

London's business geography is undergoing rapid change, and Section 3.0 describes the drivers of change. Areas that were formerly regarded as fringe locations have become mainstream; and buildings that would have previously been described as 'secondary' or 'low grade', can now command prime rents. The new geography of demand reflects changes in workstyles resulting from the changing priorities of businesses and reflected in evolving workplaces. London's economy is also shifting from one dominated by financial services to a more diverse one; and it has a particularly vibrant profile of small and micro businesses.

It is within the context of these broad, and generally positive drivers of change, that there is a growing concern over the supply of small offices. Anecdotal evidence suggests that small firms are being squeezed out of some areas by rising rents, and by office to residential conversions (Section 3.0). There is also the question of whether the operation of mixed use policies might be reducing the viability of development that could result in the provision of small office space.

It is our understanding that Government may now be considering the extension of PDR and the removal of exemptions in Central London and northern Isle of Dogs. If this becomes reality, a co-ordinated approach to the introduction of Article 4 Directions by the relevant Boroughs would be needed to ensure that London's nationally and internationally significant business locations are sustained.

We have examined the statistical evidence on small offices over the period since 1995. We quantified the supply of small units and mapped their evolving spatial distribution (Section 4.0). Our evidence suggests that there is cyclical pressure on the supply of small units. Values for both office and residential property are strong enough to support development activity and any development is likely to be at the expense of the most cost effective small units - which are generally found in buildings nearing the end of their lifecycle, or in smaller, heritage stock.

Small office units (those <500 sq m) make up 14% of all floorspace, and 62% of occupied units in CAZ. We found, as we expected, that small units are distributed throughout CAZ but our spatial analysis identified strong clusters in: Clerkenwell, Mayfair, north east City fringe, Soho/Covent Garden, South Bank and St James's.

The amount of office space in CAZ occupied in small units grew from 2.07 million sq m in 1995 to 2.6 million sq m in 2010 but the total stock of offices expanded at a greater rate. The proportion of stock made up of small units has declined since 1995 in every sub-market except South Bank and Midtown.

There is evidence that the small office market is increasingly being accommodated within modern, good quality buildings. This process is being encouraged by the rapid expansion of the flexible space market: serviced office stock within CAZ doubled between 1995 and 2015. Indeed, the rise of the flexible space market suggests that property pricing is not an inhibitor in the small office market.

The circumstances of a hedge fund paying £150 sq. ft. for an office in Mayfair are clearly different to a technology start-up facing great uncertainty in business income. The question of property prices for small offices is therefore an important one, as discussed in Section 5.0. Some locations have experienced sharp rental growth, driven by a new generation of businesses prepared to pay a premium to secure the right address. Together with the rising value of low specification office space, this has created a perception that there is a shortage of small, economically priced units.

It is our view that, while some businesses that have been long-established in fringe locations will face sharp rental increases at rent review, CAZ is able to offer an acceptable range of rental values. The average rent achieved in CAZ ranges by £40 per sq. ft., from the lowest to the highest value; while the lowest average rent in a sub-market was 41% of the highest. We consider this to be a sustainable and healthy range. The question therefore is whether businesses are sufficiently footloose to take advantage of lower cost locations.

There is strong evidence of new locations being sought out and occupied by small businesses. For instance there is a discernible flow from Shoreditch into Aldgate, a new cluster is emerging around King’s Cross; there has been an increase in small units at Paddington as it matures as an office location, and the South Bank is growing in importance as a market for small office users.

Our evidence shows that demand from the digital and creative sectors has been satisfied beyond the core Tech City area and that the growth in digital content firms has been faster in London generally than in Tech City. It appears that demand for small offices in the digital economy is being satisfied in a wide range of locations adjoining CAZ. The desire for digital and other firms to cluster is accepted here, but not their perceived need to cluster specifically in Tech City. Indeed, the Tech City cluster is one of the more diverse small unit clusters.

It now seems likely that, if pressures on land in Central London persist, as they seem certain to do, clusters will emerge in other locations centred on transport nodes and residential communities. Tottenham and Brent Cross were cited to us as possible beneficiaries of an expanding business population. Old Oak Common has been mooted as a green tech cluster; Richmond has been named as a tech cluster, while Stratford and Croydon are being promoted as low cost alternative locations.

Given these overall conclusions, how has spatial planning responded? And how should it continue to respond? There are difficulties surrounding policy intervention (Section 6.0). For example, it is difficult to control/dictate the structure of units *within* buildings; while protection of older stock can cause difficulties where the stock is in effect obsolete due to condition, layout, access and servicing, etc. Likewise, the imposition of residential units in office schemes, based on absolute or percentage uplifts, can impact negatively on viability (and therefore deliverability of schemes).

While Policy 4.3Bc allows for office protection where justified by strategic office demand and supply assessments or by particular demand, there is currently little direct protection for small offices (Section 7.0). Some protection is afforded indirectly by policies protecting employment uses and by heritage protection (Section 7.0). Most Boroughs require evidence of viability and marketing in assessing applications, but there is little consistency either in their requirements or the responses. It should also be stressed that these are approaches to the protection of employment use, rather than small offices specifically.

Policy 4.3Aa allows for developments to provide for a mix of uses, including housing, where the increase in office floorspace exceed a specified threshold. Eight of the ten CAZ Boroughs have not employed any thresholds to date in policies designed to protect office uses or to trigger the provision of housing in mixed use policies. It is clear that the extent to which both market and affordable housing has been delivered as a result of office/mixed use policies is relatively limited. Just over 29,000 affordable housing units have been delivered between 2005 and 2015 on schemes that have involved a net gain or loss of B1 office floorspace. At the same time, over £328m of cash in lieu payments have been made.

Overall, spatial planning currently affords little protection specifically for small offices; and its implementation of mixed use policies to encourage the delivery of small units has had a limited impact. Moreover, policies that encourage the development of mixed use in office buildings have had mixed results.

Recently pressure on land values arising from rising residential prices has led to the situation where office use is frequently cited as non-viable. However, short-term assessments of viability are highly sensitive to minor changes in rents, yields and costs. Planning can take a longer view of the needs of the market and can consider the implications of viability five years hence or five years previously (Section 8.0).

There is growing recognition that successful placemaking includes a mix of uses, particularly at street level, to promote diversity and activity throughout the day, week and year. Small businesses are understood to be a critical component of a flourishing business ecosystem and thus it is important to make provision for small business units, if not directly from the building owner, then via a third party flexible workspace provider.

Our overriding conclusion here is that, on balance, the provision of small offices in the current market broadly matches the level of demand. This is not to deny that some specific areas have experienced sharp rental hikes caused in part by supply constraints. But across the whole CAZ there remains sufficient choice. The market, both in the form of commercial developers and flexible space providers has, in recent times, responded to the demand for small units in a way that was not previously the case. Neither does our overriding conclusion convey complacency. While current conditions might be relatively benign in the small office sector, market dynamics can and do change markedly, and we have shaped our recommendations accordingly (Section 9.0).

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Current heritage policies can protect small offices by default Buildings preserved through heritage policies provide protection for small and economically priced office space. Small units can be accommodated successfully within larger, sub-divided buildings, and so policies to protect small buildings can be inappropriate for addressing the needs of small occupiers.

Policies to protect employment uses help resist conversion to residential CAZ-wide policy protecting employment use is effective in assisting Boroughs to resist conversion across the whole area.

There should be no CAZ-wide policies specifically to protect small offices Small units are dispersed across CAZ, and areas with high proportions of small office buildings are generally protected by heritage policies. Given that a large and growing proportion of small units are accommodated in multi-let buildings, and that this is the office type of choice rather than necessity, then the protection of small buildings would not, in any event, meet the need for small office space.

Small units should be provided within large-scale developments While there should be no CAZ-wide policies, we suggest that there should be policy to ensure that, particularly in areas where there are existing concentrations of small units, or the character of the area is attractive to small businesses, there should be provision within large development projects for space that can be used as small units.

Rental discounts should count towards S106 agreements We recognise that it is important that to ensure an adequate range of rental values for small units (to ensure availability of economically priced space). In order to encourage provision of economically priced space recommend that, if units are provided at a discount to market value, then that should be able to count towards a S106 agreement. An appropriate discount would need to be 40% of prime market rent.

We recommend a series of market monitoring benchmarks The benchmarks could provide early warning of impending shortages and trigger a policy response. We recommend that these benchmarks include measures for stock (including the flexible space market); availability (small offices as a proportion of total availability) and rent (‘affordable space as a proportion of prime rents). The benchmarks will identify emerging clusters and areas of greatest demand for small offices.

There should be a Central Activities Transition Zone (CATZ) This transition zone would extend outwards beyond the CAZ boundary to ensure that employment uses are afforded additional protection. Given the continuing pressure from residential values in London outside CAZ, such a transition zone would offer additional support for small office users by extending the protection of employment uses within CAZ to the area most critical to their locational needs.

Policy should exercise caution on mixed use policies We believe that policies aimed at including residential units *within* office buildings, especially more moderately sized buildings, can discourage redevelopment. We recommend greater encouragement of small units in larger developments, particularly within Opportunity Areas, where there is an opportunity to provide residential and workspace within the same scheme, but in discrete buildings/parcels of land.

Small Offices and Mixed Use in CAZ

1.0 Introduction

The Greater London Authority (GLA) commissioned Ramidus Consulting in March 2015 to undertake this study of London's Central Activities Zone (CAZ). The focus of the study comprises two distinct but interrelated parts. The first addresses the market for small offices; while the second looks at mixed use development and the balance of office and residential development.

The study is framed within the wider policy context of the London Plan and the Government's National Planning Policy Framework (NPPF). The work will inform the preparation of Supplementary Planning Guidance (SPG) for CAZ; and it will also inform a full review of the London Plan and the preparation of Local Plans and planning frameworks.

1.1 Project background

London's CAZ is the capital's economic core and a business location of global significance. The London Plan seeks to enhance and promote the economic significance of CAZ, as well supporting a rich mix of strategic as well as local uses. The area's retail, leisure and cultural roles are of national and international significance; and in 2011 the area was home to 237,000 residents.

The GLA is concerned that office and residential value differentials within CAZ have led to a growing loss of office space to housing even though the area is (currently) exempt from the Government's liberalisation of Permitted Development Rights (PDR). While the current level of development activity is considered sufficient to support demand for new provision, the GLA's strategic monitoring[1] suggests that there is a tightening of supply relative to demand in Central London. There is a concern that sustained loss of generally more affordable office stock through residential conversions could erode the strategic offer of CAZ as a competitive, nationally important office location.[2]

The GLA has particular concerns over the loss of smaller scale offices in CAZ, which it considers an accepted element of vibrant, mixed use localities. In their recommendations to the Mayor, the London Office Review Panel (LORP) suggested that consideration be given to supplementing London Plan policy to enable Boroughs to have the flexibility to protect small scale offices (<500 sq m).[3]

For example, Boroughs could consider raising local thresholds for the application of mixed use Policy 4.3 to a level which will actively encourage office renewal but still contribute to housing provision. The Mayor supports Boroughs in sustaining office capacity in particular areas, provided that such action can be justified in terms of strategic and local assessments of office need.

1.2 Project brief

The brief for this project involved five areas of investigation, as summarised below.

Analyse strategic and local evidence of demand and supply for small offices in different parts of CAZ Drawing on strategic and local planning evidence, and other relevant sources, undertake a review of demand and supply of small offices in different parts of CAZ.

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- Quantify the stock of small offices (those of 100-500 sq m and those of 500-1,000 sq m) relative to the total stock of office space in the different sub-markets of CAZ, taking into account small office space in larger office buildings, and including a time series of five snapshots (1995, 2000, 2005, 2010 and 2015).
- Analyse the stock of permissions and starts for small offices in different parts of CAZ and trends over time.
- Analyse London Development Database (LDD) and Borough monitoring data on small office development (approvals, completions, unimplemented permissions) and monitoring data on conversions/losses of office space to other uses (by size category as above).
- Define broad areas within CAZ where there might be a particular need for small office provision having regard to the available strategic and local evidence.

Assess strategic and local implementation issues in connection with London Plan Policy 4.3Bc in different parts of CAZ An assessment of strategic and local implementation issues in connection with London Plan Further Alterations (FALP) small office Policy 4.3Bc in different parts of CAZ.

- Analyse issues raised in the operation of policy, and any potential solutions that have been developed.
- Prepare recommendations of criteria to guide local assessments of need for small offices.

Analyse how London Plan Policy 4.3Aa is being implemented, including Local Plan policies and through development management To provide an assessment of Local Plan office/mixed use development policies, including approaches to thresholds (absolute versus percentage based) and a literature review of the evidence base associated with these policies.

To include a fine-grained analysis of development decisions in different parts of CAZ, drawing on monitoring data from the London Development Database and Boroughs. The analysis to include the following.

- Net increases in office floor space in planning approvals separating out those that include a residential component.
- Proportion of schemes delivering development uplift in floorspace (absolute and percentage) in different parts of CAZ.
- Housing and affordable housing output from planning approvals that include net gains or net losses to office stock.
- Quantify and analyse housing (and affordable housing) delivered on-site, off-site and payments in lieu through London Plan and Local Plan office/mixed use development policies.
- Provide examples of the operation of land use swaps/packages and mixed use/housing credits.

Analyse how viability is impacting on development activity and decisions in relation to offices and mixed use in different parts of CAZ To provide an evidence-based context for the justification of thresholds and mixed use and to establish how the market responds to pressures and constraints of supply and demand in CAZ and particularly the competing demands for office and residential development sites.

- Analyse trends in relative land and property values including offices, retail, leisure and residential in different parts of CAZ.
- Provide high level viability assessments of mixed use development with increases in office space to illustrate the impacts on viability associated with variable thresholds in FALP Policy 4.3Aa.
- Provide high level viability assessments of residential developments of different scales that would be required under FALP Policy 4.3Bd to make proportionate contributions to new office space within or nearby the development.
- Drawing on the findings of Task B1, analyse how development viability is impacting on development activity and decisions in relation to offices and mixed use development (including redevelopment and refurbishment of offices) in different parts of CAZ over time.

Analyse trends in the balance between offices and residential development in different parts of CAZ To identify, quantify and map trends in the balance between offices, residential and other development in different parts of CAZ. The emphasis here is on spatial variation in, for example, pricing, take-up and availability.

- Quantify and analyse trends in the total supply of offices, of different scales, in different parts of CAZ.
- Summarise trends in office availability, quality, vacancy and take-up in different parts of CAZ and across business cycles.
- Quantify and analyse the balance between office and residential development over time and in different parts of CAZ.
- Analyse trends in the pricing of office, residential and other development in different parts of CAZ, including high level data showing office rents and residential prices in different parts of CAZ.

1.3 Method statement

The study comprised a number of workstreams, and these are summarised below.

- Extensive use was made of EGi data relating to the stock of small offices (by unit of occupation) and to map the distribution and concentrations of units over time. Analysis was undertaken for unit size bands of 100-500 sq m and 500-1,000 sq m.

- A questionnaire was distributed to CAZ Boroughs to gather detailed information on local plan policies aimed at protecting small offices; the use of thresholds to protect office uses or trigger housing provision; the extent to which additional housing and affordable housing has been delivered as a result of London Plan and local plan office/mixed use development policies, and the use of land swaps and mixed use/housing credits.

- A workshop was held with CAZ Boroughs to share experience and evaluate the actual and potential impact of the policies that form the focus of this study, and to provide a ‘bridge’ between the tactical decisions and issues of local implementation, and the lessons for strategic planning policy.

- Borough monitoring data and the London Development Database (LDD) were used to generate a fine-grained analysis of development decisions in different parts of CAZ, including the following.
  - Net increases in office floor space in planning approvals separating out those that include a residential component.
  - Proportion of schemes delivering development uplift in floorspace (absolute and percentage) in different parts of CAZ.
  - Housing and affordable housing output from planning approvals that include net gains or net losses to office stock.
  - Quantify and analyse housing (and affordable housing) delivered on-site, off-site and payments in lieu through London Plan and Local Plan office/mixed use development policies.
  - Provide examples of the operation of land use swaps/packages and mixed use/housing credits.
- Detailed interviews with market practitioners (developers, agents and planners) to investigate mixed use and development viability; the small office market dynamics and responses to London Plan Policy 4.3.
- Prior approval data were provided by the GLA in order to allow an assessment of the scale of office-to-residential conversions.
- Central London office market data from various sources was analysed in order to gain a detailed picture of value and rental trends, supply and demand dynamics and sectoral change.
- Small unit market activity was analysed using disaggregated data supplied by Cushman & Wakefield on availability, take-up and rents.
- The geography of CAZ is as defined by the London Plan. For the purpose of our spatial analysis and mapping we have excluded North of Isle of Dogs (Canary Wharf).
- The market boundaries used by EGI in their London Offices Database and Cushman and Wakefield in their market analyses are shown alongside the CAZ boundary in Appendix 1.
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1.4 Acknowledgements

This study was undertaken with the generous help of a number of people, and we would like to acknowledge their assistance and contribution of insight and experience (Figure 1.1).

Figure 1.1 Consultations with policy makers and market practitioners

Boroughs and workshop participants
Camden: Gavin Polkinghorn
City of London: Peter Shadbolt
Hackney: Katie Glasgow
Islington: Ben Johnson
Lambeth: Alan Vinall
Kensington & Chelsea: Rob Krzyszowski
Southwark: Juliet Seymour
Tower Hamlets: Chris Horton
Wandsworth: Sarah Dixey
Westminster: Lisa Fairmaner and Andrew Barry Purssell

Owners, advisors and academics
Argent: Nick Searl
British Land: Adrian Penfold
City & Westminster Property Association: Charles Begley
Cushman & Wakefield: Digby Flower; Elaine Rossall and James Bain-Mollison
Derwent London: David Silverman
Dorrington Properties: Alan Leibowitz
Farebrother: Charlie Thompson
Grosvenor: Charles Howard
Hatton Real Estate: Shaun Simons
Helical Bar: Gerald Kaye
Igloo: Chris Brown
Lancer Estates: Duncan Ferguson
Land Securities: Kaela Fenn-Smith & Oliver Gardiner
London School of Economics: Max Nathan
Monmouth Dean: Jason Hanley
Portman: Fiona McKellar, Simon Loomes & Tom Knight
Savills: John Watson
Sellar Property: John Davies
Soho Estates: John James

We would also like to thank Cushman & Wakefield for the generous contribution of office market data to underpin our analysis of availability, take-up and rents in the small office market, particularly in Section 5.0.

Small Offices and Mixed Use in CAZ

2.0 Context

There are two important aspects of context to the small office market within CAZ. These are spatial planning, as expressed in the London Plan; and the supply and demand dynamics of the commercial office market. These are examined below. This is then followed in Section 3.0, with an analysis of the key drivers of change.

2.1 Spatial planning

The London Plan, launched in March 2015, sets the context for much of the discussion in this report.[4] Chapter 2 of the Plan, London's Places, sets out strategic policies for CAZ (Policy 2.10, CAZ Strategic Policies). This states that the Mayor and Boroughs should seek the following priorities.

> *A(a) Enhance and promote the unique international, national and London-wide roles of [CAZ], supporting the distinct offer of the Zone based on a rich mix of local as well as strategic uses and forming the globally iconic core of one of the world's most attractive and competitive business locations.*
>
> *A(b) In appropriate quarters … bring forward development capacity and supporting infrastructure and services to sustain and enhance the CAZ's varied strategic functions without compromising the attractions of residential neighbourhoods where more local uses predominate.*
>
> *A(c) Sustain and enhance the City of London and, although formally outside the CAZ … the Isle of Dogs as strategically important, globally-oriented financial and business services centres.*
>
> *A(e) In appropriate parts of the CAZ and the related area in the north of the Isle of Dogs, ensure that development of office provision is not strategically constrained and that provision is made for a range of occupiers especially the strategically important financial and business services.*

In Policy 2.11, CAZ Strategic Functions, the Plan states that the Mayor, Boroughs and other relevant agencies should seek the following.

> *A(a) Ensure that development proposals to increase office floorspace within CAZ and the north of the Isle of Dogs Opportunity Area include a mix of uses including housing, unless such a mix would demonstrably conflict with other policies in this plan.*
>
> *A(b) Seek solutions to constraints on office provision and other commercial development imposed by heritage designations without compromising local environmental quality, including through high quality design to complement these designations.*
>
> *A(g) Ensure development complements and supports the clusters of other strategically important, specialised CAZ uses including legal, health, academic, state and 'special' uses while also recognising the 'mixed' nature of much of the CAZ.*

In particular, Chapter 4 of the Plan – London's Economy – sets out the strategic objectives for the office market. London's role as a global city is recognised in terms of strategic objectives to ensure that the city "*meets the challenges of economic and population growth*" and that it remains an "*internationally competitive and successful city*" (Para 4.1). The Plan enshrines these objectives in Policy 4.1, in terms of

> *ensuring the availability of sufficient and suitable workspaces in terms of type, size and cost, supporting infrastructure and suitable environments for larger employers and small and medium sized enterprises, including the voluntary and community sectors.*

The references to a breadth of workspace types, sizes and costs and small and medium sized enterprises (SMEs) are significant here. The Plan also recognises that economic change is a feature that is likely to continue, and that the "*role of planning is to facilitate that change in ways which ensure that all parts of London and all kinds of enterprise can flourish*" (Para 4.3). Again, this is relevant to our investigation of small offices within CAZ.

The Plan goes on to state that its policies are "*intended to provide the basis for success of all kinds and sizes of enterprise*", and that SMEs represent c48% of London employment, and more than 600,000 self-employed Londoners (Para 4.5). It reinforces this message by stating that "*the Plan seeks to ensure that there are workspaces, environments, skilled workforces and infrastructures that enterprises of all kinds and sizes need to develop and innovate*". (Para 4.6)

Having recognised the role of small businesses in these ways, the Plan then goes on to state that

> *Whilst availability of workspaces that are both suitable and affordable is a key concern for small and medium-sized enterprises (SMEs), in overall terms there is currently sufficient market provision, though there will be particular locations with significant constraints that need addressing, and it will be important to ensure that there continues to be sufficient capacity into the future.* (Para 4.8)

The concern expressed here, to ensure the on-going supply of suitable and suitable priced workspaces for SMEs, forms the genesis of this report.

Following on from the observation in Para 4.3 that economic change is a continuing feature, and that the role of spatial planning is to facilitate that change, the Plan then notes that the London economy has become "*increasingly service-based, and this is likely to continue. As a result, ensuring there is enough office space of the right kind in the right places is a key task for the London planning system*" (Para 4.10). This is a theme that has been rehearsed elsewhere: "*London's business geography has changed over the past three decades. The new, polycentric business geography, with large concentrations in mega schemes reflects a far more dynamic property market*."[5] These spatial patterns have been driven by important changes in the structure of demand, which are discussed more fully in Section 3.0 of this report.

The role of spatial planning in this context has become increasingly important as pressure on land has led to greater competition between employment and other land uses, particularly residential. London's population recently passed eight million and is set to exceed ten million over the coming two decades. Such growth can only be absorbed through a step change in housing provision and this, inevitably, is placing enormous pressure on employment land. In this context, while that Plan argues that in overall terms there is currently sufficient market provision of suitable and affordable workspaces, there will be circumstances in Central London where "*to meet the requirements of CAZ, workspace may need to be secured through planning agreements as part of mixed use development".* (Para 4.8)

The Plan's policy response to these tensions begins with a strong statement of the Mayor's intentions to

> *support the management and mixed use development and redevelopment of office provision to improve London's competitiveness and to address the wider objectives of this Plan, including enhancing its varied attractions for businesses of different types and sizes including small and medium sized enterprises.* (Policy 4.2A)

Policy 4.2Ab develops this further, dealing with offices within CAZ (below). The plan also quantifies the scale of need in the office market through to 2031. It suggests that indicative office floorspace demand for CAZ and North of Isle of Dogs (NIOD) will be in the region of 2.3 million sq m through to 2031.

> *recognise and address strategic as well as local differences in implementing this policy to:*
> *– meet the distinct needs of the central London office market, including the north of the Isle of Dogs, by sustaining and developing its unique and dynamic clusters of 'world city' and other specialist functions and business environments, and*
> *– consolidate and extend the strengths of the diverse office markets elsewhere in the capital by promoting their competitive advantages, focusing new development on viable locations with good public transport, enhancing the business environment including through mixed use redevelopment, and supporting managed conversion of surplus capacity to more viable, complementary uses.*

The Plan highlights the role of mixed use development and also the role of small occupiers. One of the key outcomes of recent market dynamics has been increasing pressure on more 'marginal' and 'lower quality' space. Whether located in the fringe of CAZ or in its core, smaller occupiers are now competing for space in a market where rising rents resulting from low supply as much as growing demand, are placing the buildings they occupy under intense redevelopment pressure.

The Plan goes on to set out three policies which form the focus of this study, namely: Policies 4.3Aa, 4.3Bc and 4.3Bd. These address concerns about the provision of office space in CAZ and provide a framework for implementation in Local Plans. The Policies were supported in the Public Inspector's report from the recent London Plan EIP, although their application must be based on robust, timely and integrated strategic and local demand and supply assessments.

Policy 4.3Aa sets the strategy in terms of the relationship between new office provision and mixed use development.

Within the Central Activities Zone and the north of the Isle of Dogs Opportunity Area … increases in office floorspace, or those above a justified local threshold, should provide for a mix of uses including housing, unless such a mix would demonstrably conflict with other policies in this plan.

This is then supported by Policies 4.3Bc and 4.3Bd which address the balance between office and residential development.

… where justified by local and strategic office demand and supply assessments and in areas identified in the LDF as having a particular need for local office provision, provide protection for small scale offices (under 500sqm or a justified local threshold) within the CAZ. (Policy 4.3Bc)

… where justified by local and strategic office demand assessments and in areas identified in LDFs as having a particular need for local office provision, require residential proposals within the CAZ which would otherwise result in the loss of office space to make a proportionate contribution to provision of new office space within, or nearby, the development. (Policy 4.3Bd)

This report investigates the implications and outcomes of these policies, to provide findings that might inform the preparation of SPG for CAZ; and inform the full review of the London Plan.

2.2 Commercial office market

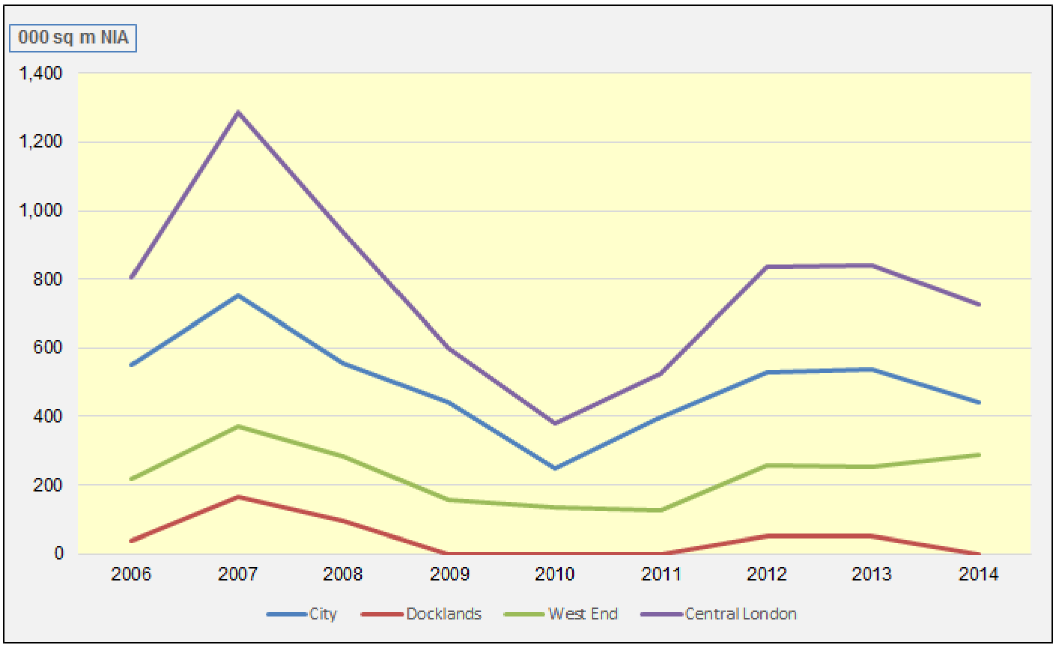
This section sets out the Central London commercial property market context for the discussion which follows. [6] It sets out important trends in the office market with particular reference to changes in occupier demand, the demand for small units and the pressures acting on the balance between office and residential development.

Supply of space in CAZ has been constrained in recent years, not least because of the prolonged impact of the Financial Crisis. Figure 2.1 shows construction levels in Central London between 2006 and 2014. The impact of the Financial Crisis is clear, with sharp falls in all sub-markets after 2007. Modest recovery in 2011 has been followed by a moribund performance, no doubt influenced by on-going uncertainty and the recent impact of the General Election.

Knight Frank note that availability (which includes expected completions over the 12 months ahead) in Central London was 1.2 million sq m[7] in Q4 2014, 20% lower than at the same point the previous year.[8] At the same time, vacancy (defined as space being actively marketed) stood at 5.6%, "*well below the long-term quarterly average of 8.9%*" (Figure 2.2). Knight Frank expect the vacancy rate to tighten during 2015: while almost 500,000 sq m of new and refurbished space was completed during 2014, just 380,000 sq m is due to be completed in 2015, more than half of which is already pre-let.

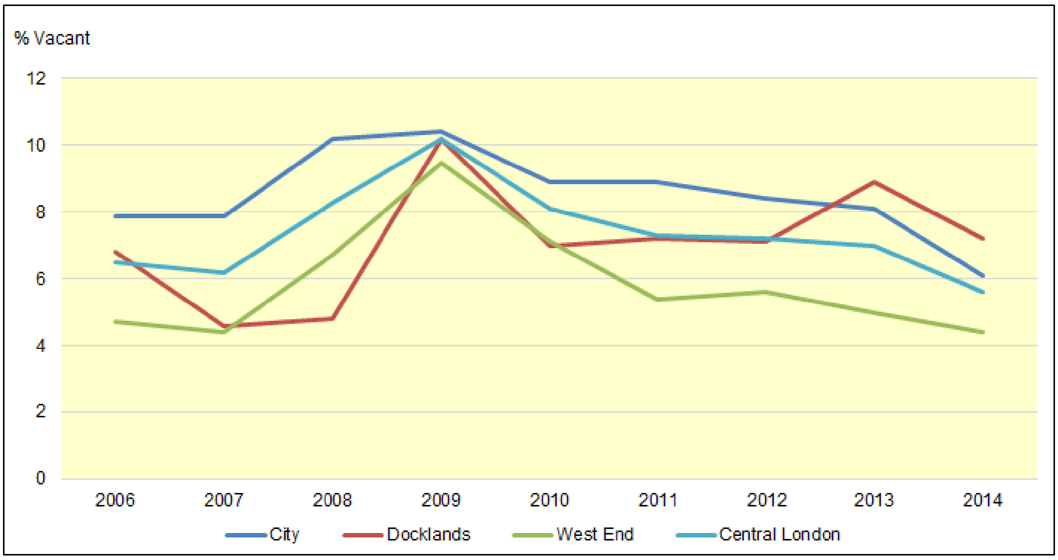
Knight Frank forecast these dynamics to continue into 2016, with a "*lack of supply and continued strong demand to place significant upward pressure on prime rents across all markets*". The declining rate of vacancy across sub-markets is having an inevitable impact on rent levels.

Figure 2.1 Central London office construction, 2006-2014



Source: Knight Frank (various) *Central London Quarterly Offices*

Figure 2.2 Central London vacancy, 2006-2014



Source: Knight Frank (various) *Central London Quarterly Offices*

Furthermore, constrained supply and low vacancy will add pressure to the small office market as they will in turn constrain churn at a time when demand from SMEs is rising. An inactive development market will add to the availability of small, relatively cheap units in buildings that are at the end of their economic life but not being redeveloped.

According to CBRE, prime rents rose steeply in all sub-markets in 2014.[9] Prime headline rents now stand at £62.50 per sq ft in the City; £112.50 in the West End; £65.00 in Midtown; £55.00 in South Bank, and £40.00 in Docklands. During the course of 2014, South Bank saw the strongest rental uplift, with growth of 15.7%.

The tightening market conditions have continued into 2015, with Central London vacancy falling to 3.3% in Q1 2015, and prime rents rising in all markets apart from Docklands.[10] Conditions are likely to continue in the same direction until a stronger development pipeline begins to deliver new stock in 2016.

The headline rents hide important variations according to location and specification. Thus, for example, some rents in Mayfair and St James's well exceed the £112.50 per sq ft cited above. During the final quarter of 2014, two deals in Mayfair were reported at around £150 per sq ft. Wealth management firm SG Hambros Bank took 800 sq m at 8 St James's Square; while oil firm Trafigura leased 1,300 sq m at 30 Berkeley Square. More recently, it has been reported that a private family office has taken 300 sq m at 8 St James's Square for £185 per sq ft.

While such deals are clearly for 'super prime' space by high margin firms, their impact trickles through the market. Thus, leasing activity at King's Cross has exceeded the City benchmark described above. For example, in two Q4 2014 sub-lets, pharmaceutical company Astra Zeneca took 650 sq m at £70 per sq ft, while train manufacturer Bombardier took 650 sq m, at £80 per sq ft.

The pattern of rising rents is driven by the constrained supply and low vacancy referred to earlier. The question is here is whether the rising rents are causing particular issues for small occupiers. There are clearly differences between small occupiers in high margin businesses that can afford prime space in, for example, St James's Square and those seeking secondary space in less expensive locations. It is the latter where greater pressure is likely to be felt. However, rising rents are a normal feature of property cycle upswings, and so the question remains whether rising rents are causing structural problems or merely cyclical problems.

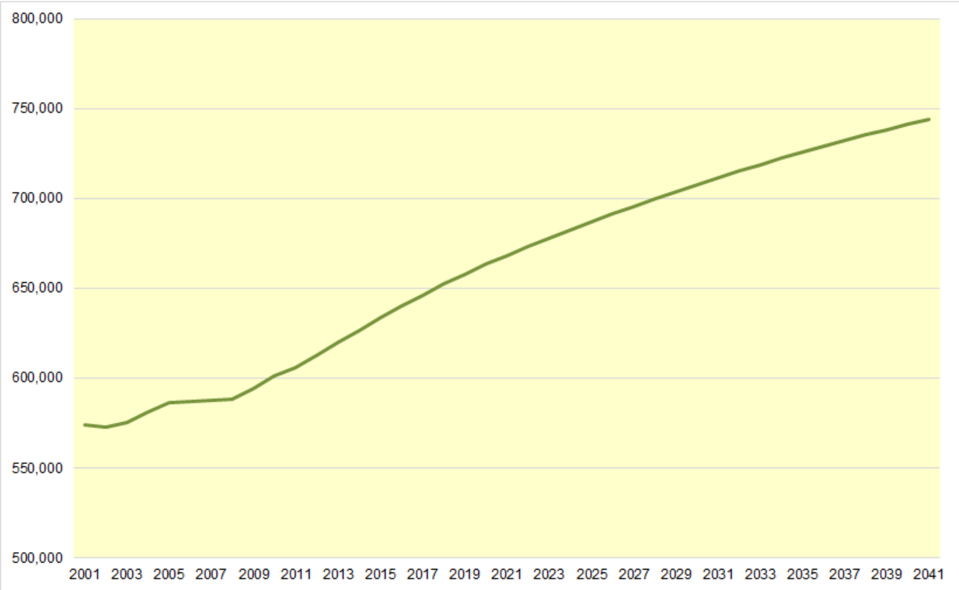
2.3 Defining CAZ

In 2012, CAZ (including NIOD) generated £154,690m GVA, which represented 47% of London's total GVA. In 2013 the same area accommodated 1.74m employees. Of this total 447,000 jobs were Professional, Scientific & Technical; 299,000 were Financial & Insurance; 219,000 Information & Communications, and 218,000 Business Admin & Support Services.[11]

In the context of this study examining small offices (and to a lesser degree the impact of residential development), it is also worth noting that CAZ and Central London are home to a substantial residential population. The population of Central London stood at 605,733 in 2011, up from 574,199 in 2001 (Figure 2.3). This is forecast to grow to 668,358 in 2012; to 711,475 in 2031 and to 743,938 in 2041.[12]

Almost two decades ago, Regional Planning Guidance helped define what became known as CAZ. In *RPG3 Strategic Guidance for London Planning Authorities* (1996), it was recognised that Central London was not only a world business and commercial centre, but also a location for cultural, retail, tourism and other services which are of national and international significance. It stated that the central area contained *the historic core of the capital and many of the features which define London's image, including ceremonial, state, historical and traditional locations and activities. The area also contains a significant residential population which contributes to the life and character of London as well as including elements of the workforce vital to the centre's economic and other functions.* (Para 2.21)

Figure 2.3 Central London population growth and projections, 2001 to 2041



Source: GLA (2015)

The Guidance argued that Boroughs should co-operate to improve the quality of the activities and attractions in the centre. It also argued that planning policies should promote and facilitate these, and that *“developers and other agencies should consider how their actions might bring forward suitable development to enhance London's standing and be of lasting benefit”.* (Para 2.22)

The Guidance then went on to the matter of area definition, noting that historically the area of Central London had generally been delineated as the area between the main railway termini, but that Boroughs had tended to take different approaches to the definition of areas within Central London. The Guidance called for greater consistency in approach, and for Boroughs to “*agree on the criteria to be adopted to define central functions and ensure that definitions are consistent across Borough boundaries”.* (Para 2.23)

The Guidance provided help on this matter by suggesting that “*The Secretary of State considers that a realistic definition of the Central Area extends from Kensington and Knightsbridge in the west to Whitechapel in the east and from Marylebone and King's Cross in the north to the South Bank between Vauxhall and Tower Bridge.”* This area covered all of the City of London and parts of the City of Westminster and the Boroughs of Camden, Hackney, Islington, Kensington and Chelsea, Lambeth, Southwark and Tower Hamlets. The Guidance suggested that *“Boroughs should agree on a detailed definition of the Central Area which should be justified in each UDP and shown on Proposals Maps.”* (Para 2.24)

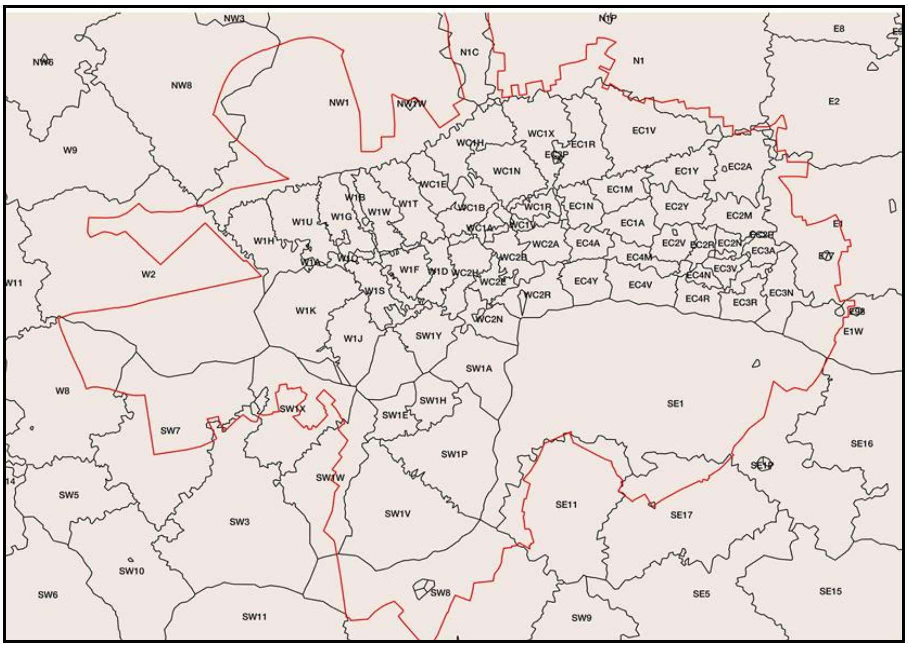
The Guidance then became more specific in terms of the need for consistency.

> *It is important that policies for the Central Area as a whole are compatible across Borough boundaries. To that end, UDPs should contain policies for it and explain how cross Borough issues have been resolved. Boroughs will be expected to present policies in a way that enables users to compare policies across boundaries. They should therefore agree, in consultation with LPAC, a common presentation for illustrative material and their Proposals Maps.* (Para 2.25)

The CAZ is described in the London Plan (2015) as including: "*London's geographic, economic and administrative core*", bringing together "*the largest concentration of London's financial and globally-oriented business services*". The Plan also notes that nearly "*a third of all London jobs are based there and, together with Canary Wharf, it has historically experienced the highest rate of growth in London. As the seat of national Government it includes Parliament, the headquarters of central Government and the range of organisations and associations linked with the legislative and administrative process*". (Para 2.44)

The London Plan CAZ does not neatly coincide with any property market data sources and so compromises must be made in analysis. In this study, much of the analysis of office stock is based on post codes. Figure 2.4 shows and outline of CAZ overlain by the post codes.

Figure 2.4 The London Plan CAZ and post codes



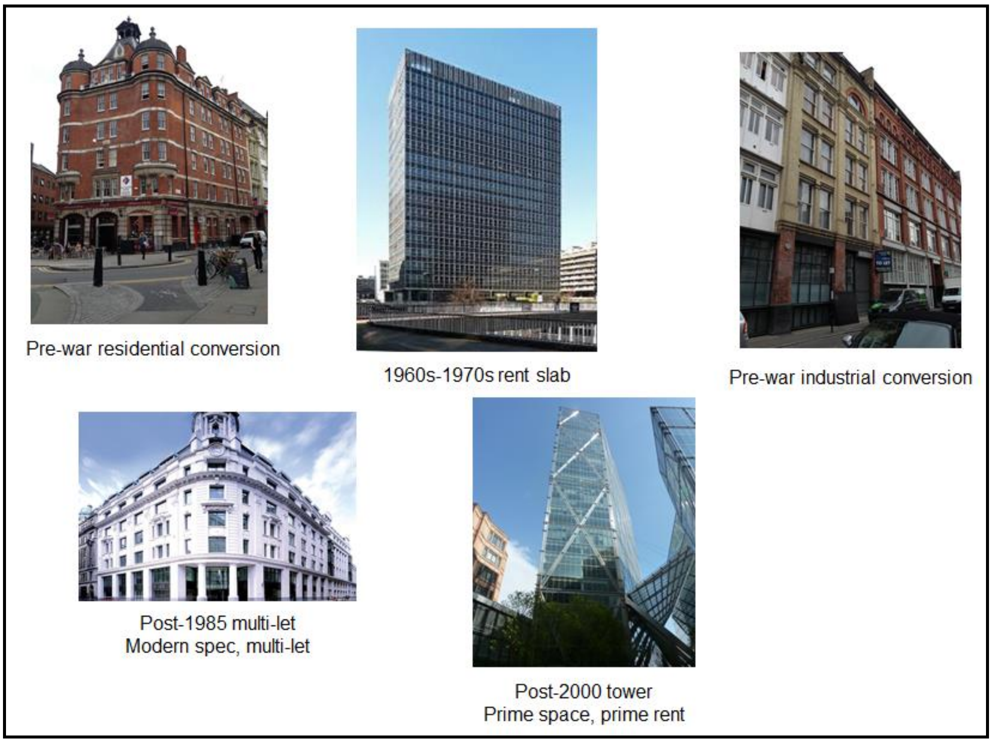
2.4 Defining small offices

The GLA's definition of small offices is taken as those with a net internal area of 500 sq m or less. However, there are no data sources available that can provide relevant data on offices of <100 sq m. For this reason, small offices in this report refer to those of between 100 sq m and 500 sq m. Data are also provided in the report for the 500-1,000 sq m size band where appropriate.

It should also be noted that a ‘small office’ in this context refers to an occupied unit and not a building.

As well as defining small offices in terms of size, it is also important to recognise that small offices are provided in a range of formats and, significantly, a range of pricing levels (Figure 2.5). For example, a small office unit within a prime Mayfair building where rents exceed £100 per sq ft will have a different target market (such as hedge funds and private banks) to one within a ‘tired’ 1970s secondary building in the northern fringes of the West End (such as professional consultancy or creative firms). Yet both are classed as small offices. This highlights the importance of the question of affordability, which we return to later in this report.

Figure 2.5 Diversity of buildings accommodating small offices



The significance of this distinction lies in the question of policies to protect small offices in specific, evidence-based circumstances, as suggested by London Plan Policy 4.3Bc, discussed above. It is important to be clear about what *kind* of offices are being discussed, as well as what *scale* of offices.

3.0 Drivers of change

There are a number of drivers of change, currently unfolding in the London office market, which are expressing themselves in terms of demand for property. And these drivers, ultimately, have a very significant impact on the nature of the small office market.

3.1 Growth in self-employed businesses

Since 2005 there has been substantial growth in London's SME population, particularly in the 0-4 person size group.[13] At the start of 2012 London had 805,085 SMEs (Figure 3.1), a figure that had changed only marginally since 2002.[14] They make up 99.8% of all London's private sector businesses; and employment in SMEs represents 49.8% of all London employment (including employee jobs and self-employment). SMEs make up 47.7% of business turnover (excluding financial and insurance industry), equal to £430bn.

Figure 3.1 Firm size breakdown, London 2012

Firm size band	Business		All employment	
	Number	% of total	000s	% of total
No employees	615,995	76.0	660	15.0
Micro (1-9)	156,965	19.0	578	13.0
Small (10-49)	27,185	3.0	520	11.0
Medium (50-249	4,940	1.0	497	11.0
Large (250+)	1,345	0.2	2,277	50.0
Total	806,430	100.0	4,532	100.0

Source: Business Population Estimates 2012, BIS

Within the overall SME picture, there has been a significant growth in the number of self-employed people. Self-employed people are defined as those who run their own businesses and take responsibility for success or failure; have several customers at the same time; can decide how, when and where they do their work, and who are free to hire other people to do the work for them or help them at their own expense.

In the year ending Q4 1996 there were 511,250 self-employment jobs in London. By the year ending Q4 2012 there were 724,000, an increase of 212,750, (or 41.6%). During the same period, employee jobs in London increased by 840,750 (or 24.5%) to reach 4,264,250. Within this overall total, higher occupations have seen the largest increases, including jobs in the professional/scientific/technical, and finance/insurance/real estate sectors.

There has thus been a major growth in self-employment in London over recent years. One of the outcomes of this process has been rising demand for space (and flexibility) that cannot be satisfied in the conventional leasing market.

3.2 Change in the occupier market

Central London occupiers are continuing to evolve and their requirements for premises are doing likewise. Today's office workplace is, typically, being managed as a corporate resource, and it is increasingly being used to convey brand and values. There is a far sharper focus on increasing flexibility and enhancing community, amenity and wellbeing, as well as reducing cost. There is a trend to design for continuous adaptability and diverse usage patterns. The design and management of buildings are much less about the 'hardware' of work – desks, partitions, technology, electricity, and so on, and more about the 'software' of work – the cultural, social and value systems of the organisations.

In recent years office occupiers have experienced enormous change as they meet the challenges of technological innovation and economic pressures. Two features that seem to be almost ubiquitous are the need for organisations to be 'agile', to continuously adapt to volatile market conditions, and the need for connectivity – between workers, with customers, and through supply chains. Organisations are adopting leaner and flatter structures, and experiencing an almost continuous level of change as they respond to market opportunities and pressures. And the evolving pattern of work to reflect these traits is one that is increasingly mobile, collaborative and technology-enabled.

As a result of these trends, workplaces are being designed and managed so that they can react to new and sometimes unpredictable operational priorities. Whether responding to a merger, to changing markets or to new technology, organisations need to respond quickly; and this means workplaces that can be reconfigured with ease.

Agile working practices are increasingly used to help attract new talent and are increasingly reflected in workplace design and the diversity of work settings now on offer in growing numbers of workplaces. However, agile working is not simply a benefit for staff, it is also a means of controlling costs through restricting demand for expensive real estate. Many organisations are balancing staff demands for choice and flexibility with a Board-level priority to reduce costs. To achieve this many organisations are optimising their use of space by increasing density and utilisation through desk sharing.

Far fewer companies own their workplaces today; property has become more akin to a commodity rather than a defining feature of the business itself. Managing real estate as a resource (rather than as an asset) leads to a shift in focus from 'managing buildings' to 'managing people'. As a result, workplaces are increasingly designed and managed less as static backdrops to routine solitary work, and more as 'flexible', 'hotel-style' facilities that provide a high level of service and experience to workers.

The increased use of thin client technology and mobile devices enables the removal of drop ceilings to expose the structure and create more volume and light in spaces. Workplace design and management is increasingly allowing occupiers to continuously adapt to changing economic and market circumstances. Emerging office needs focus consistently on addressing the following issues.

- Space being a medium for expressing corporate culture and values.
- Design for continuous adaptability and diverse usage patterns.
- Activity-based workspaces providing for collaboration, concentration, communication, creativity, confidentiality and contemplation.
- Use of shared spaces as a means to facilitate collaboration.
- Provision of amenities and services (food, wellbeing, events etc.).

- Creating and managing memorable experiences to attract talent.

While the changing needs of large corporate occupiers are less relevant to this report, there are a number of outcomes that are directly relevant.

- Larger organisations are occupying small units of space in tech clusters to take advantage of the cluster benefits, including the tech skills available there.
- There is an increasing use of outsourced supply chains (everything from products to high value consultancy). Many of these smaller organisations are now looking for small unit space in close proximity to clients.
- Large organisations are using increasing numbers of temporary and/or contract staff. Many of these are self-employed, often working for more than one client. The use of flexible space is common within this group.
- Occupiers are practicing 'spaceless growth' whereby they use densities and utilisation to grow headcount/output without taking on additional space. This often involves taking smaller units of flexible space (see below).

3.3 A changing business geography

One of the key issues addressed in this report is whether changing land value dynamics are having an impact on where firms are locating. In other words, are rising rents forcing firms out of their traditional clusters? There is some evidence to support this assertion.

For example, recent research from Cushman & Wakefield quantified the general shift of business from west to east.[15] The research analysed 327 transactions in excess of 1,000 sq m that occurred during 2014. These transactions accounted for over 80% of total leasing volume in the year. More than half of the moves involved West End occupiers migrating to either the City or Docklands sub-markets.

In recent weeks two west-to-east moves have been announced:

- World Association of Nuclear Operators moving to 800 sq m in 25 Canada Square, E14 from Wigmore Street, W1, and
- Wavex Technology moving to 950 sq m in Prescott Street, E1 from Livonia Street, W1.

It is notable that both moves involve relatively small amounts of space.

Mayfair in particular has witnessed significant out-migration. During the 1980s and 1990s it was home to a wide variety of corporate headquarters, the property industry, advertising firms and other organisations willing and able to pay the comparatively high rents there. However, in more recent times, Mayfair has lost many businesses and large employers.

One of the early leavers was insurer Royal & Sun Alliance which left Mayfair in 2003 when rents passed £70 per sq ft. Property companies then followed suit (e.g. Hammerson), followed by their advisors, including CBRE, Cluttons, Cushman & Wakefield, Donaldsons, DTZ, King Sturge and Knight Frank. Corporate businesses fleeing the Mayfair area in recent times include high profile companies such as Akzo Nobel, Astra Zeneca, Cadbury Schweppes, General Electric, Rio Tinto and Statoil.

The scale of this exodus would be ameliorated if other businesses were moving in to replace them. However, this appears not to be the case. The hedge fund cluster has been successful, but firms in this sector are typically very small, often occupying around 500-700 sq m and rarely over 1,000 sq m. It takes a large number of such occupiers to make up for one 7,000-8,000 sq m leaving occupier.

A dearth of large new buildings in recent years, the ready availability of large, high specification buildings in neighbouring areas (e.g. Victoria and Paddington), sharply rising occupancy costs and Westminster City Council's mixed use policy have all conspired to both encourage businesses to leave Mayfair, and deter others from moving in.

3.4 Small offices and the flexible space market

The small office market was, until relatively recently, heavily reliant upon taking sub-leases within other occupiers' demises and in generally older, lower specification buildings. However, this position has changed significantly with the emergence of the flexible space market – particularly since the mid-1990s.

Serviced offices appeal both to micro and small companies, and to larger corporate organisations looking for temporary space to house, for example, project teams. Demand is being driven by a growth in SMEs and the impact of digital economy which is transforming business structures.

The importance of serviced offices within CAZ was shown in recent research for the City of London Corporation.[16] This work revealed that there are a total of 85 centres within the City of London (compared to 25 in 1995), with a combined area of almost 200,000 sq m (compared to 50,000 sq m in 1995) and an average size of 2,150 sq m. As such, serviced offices represent almost 3% of the City's total stock of office space.

The research suggested a typical occupier requirement of between five and nine workers, with an average of eight. Within the wider definition of 'the City', including fringe areas, the research estimated 100 serviced offices housing around 22,000 workers. Other research estimates that there are 365 centres across Central London[17], which represents a growth of over 25% since 2012.

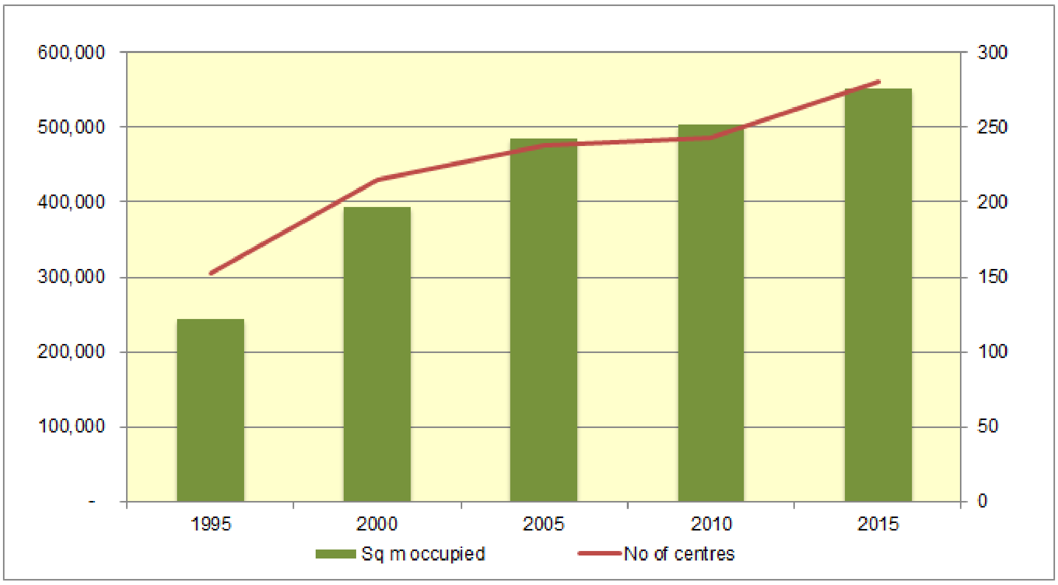
Since the research for the City was undertaken, we have analysed EGi data in order to replicate the data across the whole of Central London, and the expansion of the sector since 1995. The analysis found that while serviced office operators occupied 243,500 sq m in 1995 in 150 centres, by 2010 they were in 504,600 sq m (Figure 3.2); and by 2015, this had risen to around 550,000 sq m and 280 individual centres.

As a proportion of all office stock that represents a shift from just under 2% to 3%. If we add serviced office stock into the small unit component of all office stock (without adjusting the total stock because their space is already included as larger occupational units), the proportion of stock accounted for by small units rises rather than falls over time, from 16% in 1995 to 17% in 2010.

Alongside serviced offices, there has recently been the emergence of co-working spaces. These provide a 'less corporate' style of space than serviced offices, and respond to "*technology enablement, the growth of the tech, online and creative industries … and an increase in micro businesses and independent workers*". [18]

And they provide "*clubs where members can work alone or interact with like-minded people on a pay-as-you-go basis".*[19]

Figure 3.2 Growth of serviced offices in Central London, 1995-2015



Source: EGi data/Ramidus Consulting

The serviced office and co-working business models are providing an important supplement to the traditional corporate office market. They are providing choice and flexibility for growing numbers of small businesses seeking to have a presence in the City centre on terms that suit their business models. At the same time they are providing further agility and flexibility for larger corporate organisations. The key to their sustainability will be their resilience to property markets cycles.

Clearly, the sector has grown rapidly in recent times. The critical point here is that there is a strong demand within CAZ (and elsewhere) from a relatively new market sector that caters specifically for small occupiers. The offers range from relatively cost effective packages to 'five star' arrangements, but the common denominator is a steady supply of space that can be heavily sub-divided for small occupiers.

3.5 Office-to-residential conversion activity

This study takes place against the background of the Government's decision to increase Permitted Development Rights (PDR). The change, which occurred on 30th May 2013, allowed for the conversion of B1a office stock to C3 residential use without any longer the need for formal planning consent.

The measure was put in place for a temporary period of three years, and the underlying motive was to encourage residential development particularly in those areas suffering from structural vacancy in office stock. Following a consultation exercise, 33 areas within 17 local planning authorities were made exempt from PDR – in London this included areas lying within CAZ, Tech City, North of Isle of Dogs, the Royals Enterprise Zone and the Royal Borough of Kensington and Chelsea.

Small Offices and Mixed Use in CAZ

In July 2014 the Government published a consultation document in which it proposed an amended PDR for change of use from office to residential from May 2016. The document suggested that the exemptions would be removed from the 33 areas that had successfully opted out of the new PDR rules: "*exemptions which apply to the current permitted development right will not be extended to apply to the new permitted development right*". It also stated that the Government would amend the existing PDR to "*extend the time for completion for developments with prior approval from 30th May 2016 to 30th May 2019*".

Government has considered extending PDR for a further three years, although there remains uncertainty over whether this will happen.

While the PDR amendment was introduced with good intention, it has had a major unintended consequence for the office market. As residential land values have risen sharply against a background of rising demand, so many owners have begun to realise the potential uplift in value from an office-to-residential conversion. Moreover, owners have begun to vacate *occupied* buildings to allow conversion, thereby displacing economic activity.

While this is not yet a concern for CAZ, the potential withdrawal of exemption rights means that it might be so in the future. Even with their exemption from PDR, those local authorities with areas inside CAZ must have a robust case for refusing consent for an office-to-residential conversion. Westminster, for example, did not have any explicit office protection in place, and was unable to protect its office stock. Figure 3.3 shows a small sample of recent office-to-residential projects. These three projects alone represent a loss of over 100,000 sq m of office stock.

Figure 3.3 Sample of large office-to-residential schemes in Westminster

21 Tothill Street & 15 Dacre Street	Both prime site properties were bought in Q1 2015 by hospitality group Whitbread for a combined investment in excess of £80m. The company plans to redevelop both for its new 'Hub by Premier' format. Subject to planning, the sites will yield a combined 450 bedrooms.
New Scotland Yard	Following property rationalisation by the Met Police, the site was bought by Abu Dhabi Financial Group in Q4 2014. At £370m, the price paid was 50% higher than the asking price. Subject to planning, the office block will be redeveloped to provide "*luxury apartments*".
55 Broadway	This is the Grade 1 listed iconic home of London Underground, built in 1929. In Q4 2014, Transport for London submitted plans to transform the building into "*a landmark residential development*". The plans detail how the scheme will deliver 22% affordable and social housing.

A number of the recent conversion schemes (completed and proposed) have involved major, purpose-built office buildings. Notable among these have been Centre Point, WC1 (29,000 sq m); Marble Arch Tower, W1 (17,000 sq m); Millbank Tower, SW1 (38,000 sq m) and Portland House, SW1 (29,000 sq m).

Additionally, many schemes have involved the loss of much small units of office stock. For example, in autumn 2014, a Bahraini investor paid £16m (double the asking price) for the 1,000 sq m Midori House, W1 for a residential conversion. In

November 2014, a 750 sq m vacant property at 64 Lincoln Inn Fields, WC2, was bought by James Taylor Construction for £9m. And in early-2015, a private SE Asia investor bought the 900 sq m 13-16 Jacob's Well Mews, home of advertising firm WPP's Spafax, for £12.5m, to be converted into a "*Shoreditch style luxury residential scheme*" (Estates Gazette, 26th January 2015).

And not all office conversions result in residential property: a growing number have involved conversions to hotel use. For example, in 2014, Whitbread (owner of Premier Inns) bought 21 Tothill Street, SW1 for £55.4m and 15 Dacre Street, SW1, for £25.5m to be converted to Hub by Premier formats.

While CAZ is currently exempt from PDR, the sheer pressure of demand for residential development has led to a significant disruption in the office market, not least because the viability equation has shifted in favour of residential and made office development less viable, particularly in CAZ Fringe areas.

In December 2014 the City of Westminster started public consultation on mixed use and office-to-residential conversions, amid concerns that the balance between office and residential development had tipped too far in favour of the latter, and that "*if these extremely strong market trends continue the mixed character of the Core Central Activities Zone (CAZ) is in danger of being lost as the office stock is further eroded*".[20] The report illustrated the scale of losses in the office market: while over the period 1996-2010 Westminster had gained c400,000 sq m offices, in the four years between 2011 and 2014, it lost c170,000 sq m. These completed schemes delivered 1,278 homes.

Almost 75% of the losses over the past four years resulted in residential; a further 11% was hotels, with retail, restaurants and other uses making up the remaining 15%. Almost 70% of the offices that have been converted to residential had a floorspace of <500 sq m, and were therefore classified as small offices. Of these, over 80% were originally built as residential.

The loss of offices from schemes currently under construction in Westminster, will create a further 2,220 homes, but represents the loss of a further c160,000 sq m of office floorspace. Looking ahead, while many permissions are not converted to finished schemes, extant permissions represent a net loss of c183,000 sq m of offices, and a gain of 1,624 homes.

Our analysis of development data from the London Development Database and Borough Monitoring is set out in Figures 3.5 and 3.6. The data include all schemes in CAZ Boroughs involving a net change in office floorspace (gain or loss) that have been built or given planning consent since 2005.

Over this period, the accumulation of all office space lost and gained results in a net gain overall of almost two million sq m (Figure 3.4). Of that, 576,000 sq m has been completed and just under 1.1 million sq m is under construction (Figure 3.5). Clearly the rate of gain in the period 2005 to 2014 was relatively low (around 50,000 sq m per annum) and much lower than the current rate of construction (as much as 500,000 sq m per annum if we assume that all space currently under construction will complete within two years). This reflects the cyclical nature of office construction, and the period 2005-2014 spanned a deep Financial Crisis when development funding was scarce and confidence low. The data demonstrate that the market has responded, as demand and development finance have recovered, with an increase in development activity.

Only three Boroughs of the ten have the prospect of a net loss of office space if all schemes completed, under construction or planned are taken into account. Westminster stands to make by far the greatest loss. It could, if all schemes were implemented, lose 826,880 sq m of offices. All of that net loss is the result of over 2,000 projects that involved some element of residential use.

Figure 3.4 Schemes granted consent 2005-2015 involving a net gain/loss of B1 in CAZ Boroughs

Borough	No residential element		Residential element		All schemes	
	No. schemes	Net B1 gain/loss	No. schemes	Net B1 gain/loss	No. schemes	Net B1 gain/loss
Camden	477	-48,635	520	392,447	997	343,812
City of London	223	1,186,136	436	-209,997	659	976,139
Hackney	190	10,372	327	92,782	517	103,154
Islington	337	128,619	382	-57,496	719	71,123
RBKC	91	-27,506	139	-65,335	230	-92,841
Lambeth	162	28,538	243	-49,434	405	-20,896
Southwark	76	255,270	259	-68,418	335	186,852
Tower Hamlets	64	620,775	245	446,931	309	1,067,706
Wandsworth	46	-1,443	303	85,884	349	84,441
Westminster	252	19,567	2062	-846,446	2314	-826,879
Total	**1,918**	**2,171,693**	**4,916**	**-279,082**	**6,834**	**1,892,611**

Source: GLA LDD and Borough Monitoring Data

Westminster is very much the outlier in this data. Substantial gains in office space were made in the City of London and Tower Hamlets (Canary Wharf) which each gained around one million square metres, and in Camden which gained 343,625 sq m – the majority of that at King's Cross.

Westminster lost office stock in all but two years between 2005 and 2013, with the heaviest losses in 2009 and 2011. Wandsworth has also lost space consistently, though not on the same scale. Kensington and Chelsea began to lose space in 2010 and the rate of loss has increased significantly (Figure 3.5).

Over the study period, (2005 to 2014) there were 6,837 schemes in CAZ Boroughs that involved an element or gain or loss in office space (Figure 3.6). Of those, 2,988 schemes caused a loss of <500 sq m, while 1,340 caused larger losses. While some of the <500 sq m loses could have been small reductions in overall space, incurred as part of mixed use schemes, it is reasonable to infer from the data that there has been a significant loss of small buildings in CAZ Boroughs.

Figure 3.5 Net gain/loss of B1: schemes by year completed, under construction or planned, 2005-2015, CAZ Boroughs

Completion year	Camden	City of London	Hackney	Islington	RBKC	Lambeth	Southwark	Tower Hamlets	Wandsworth	Westminster	Total
2005	2,063	5,867	5,039	15,018	-94	304	10,334	115,550	-3,368	-31,378	**119,335**
2006	-3,609	-19,129	13,645	-2,677	3,527	11,629	97,679	25,491	5,155	54,582	**186,293**
2007	-21,835	28,274	2,016	-16,297	-359	7,625	4,127	-8,823	19,087	-21,201	**-7,386**
2008	-21,484	202,341	10,070	15,691	9,328	11,487	29,777	14,497	-4,449	-21,487	**245,771**
2009	-9,511	25,471	-37	41,610	539	13,075	20,513	117,955	6,200	4,226	**220,041**
2010	23,838	62,771	10,296	8,356	262	-18,209	65,365	-26,041	-5,012	-131,666	**-10,040**
2011	-4,104	44,269	-411	-6,623	-7,765	-17,732	8,026	-9,324	-4,654	15,804	**17,486**
2012	-19,000	-23,558	525	-258	-5,256	-6,521	-10,733	-1,233	-5,005	-119,875	**-190,914**
2013	31,366	-1,841	-10,615	518	-3,542	-16,235	-10,452	3,573	-10,672	-13,345	**-31,245**
2014	-27,243	113,893	2,443	-6,603	-7,710	4,013	-5,248	-2,974	-613	-43,367	**26,591**
2015	-3,267	2,613				54					**-600**
Total completed	-52,786	440,971	32,971	48,735	-11,070	-10,510	209,388	228,671	-3,331	-307,707	575,332
Under construction	439,245	416,261	-9,713	8,692	-89,111	11,837	8,480	424,470	-3,601	-124,936	**1,081,624**
Total committed	386,459	857,232	23,258	57,427	-100,181	1,327	217,868	653,141	-6,932	-432,643	1,656,956
Not started	-42,647	118,907	79,896	13,696	7,340	-22,223	-31,016	414,565	91,373	-335,713	**294,178**
Not recorded										-58,523	**-58,523**
Total	**343,812**	**976,139**	**103,154**	**71,123**	**-92,841**	**-20,896**	**186,852**	**1,067,706**	**84,441**	**-826,879**	**1,892,611**

Source: GLA LDD and Borough Monitoring Data

Small Offices and Mixed Use in CAZ

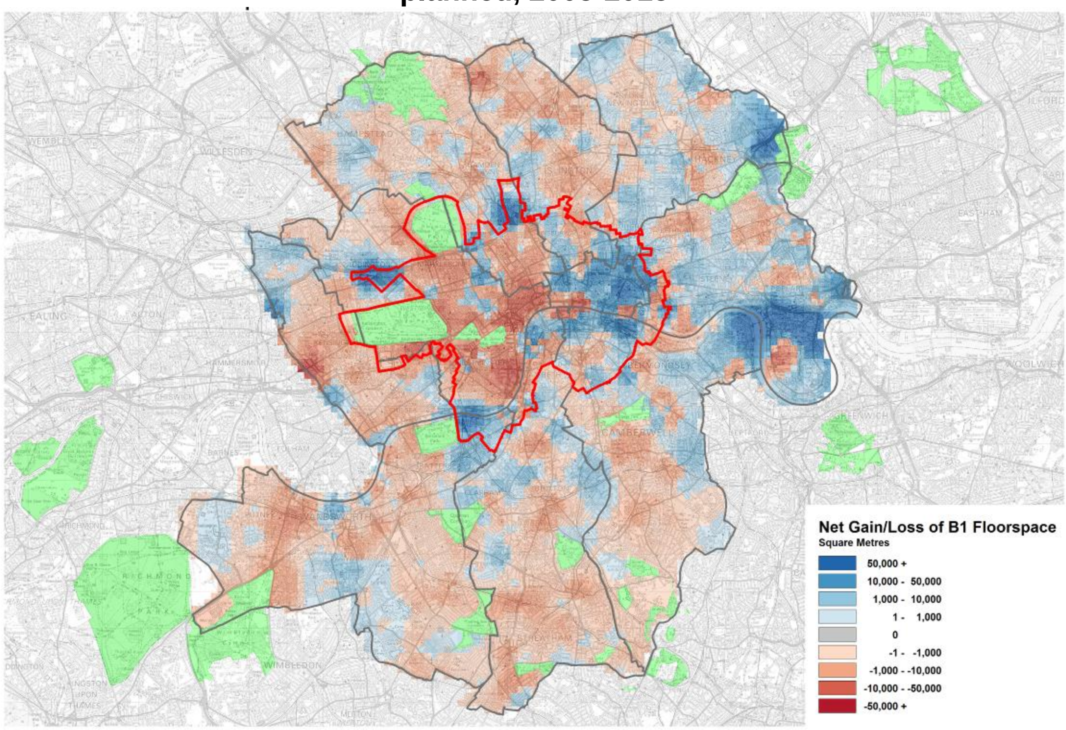
Figure 3.6 Schemes involving gain/loss of office space, by size of gain/loss in CAZ Boroughs

Borough	Net gains in offices			Net losses in offices			No change	Total
	<500	500-1,000	>1000	<500	500-1,000	>1000		
Camden	265	33	47	456	97	68	33	999
City of London	122	15	98	265	67	92		659
Hackney	153	44	35	186	24	30	45	517
Islington	220	29	54	287	48	46	35	719
RBKC	48	7	15	118	13	20	9	230
Lambeth	120	16	33	140	30	39	28	406
Southwark	64	7	49	122	24	41	28	335
Tower Hamlets	63	24	41	96	32	45	8	309
Wandsworth	39	6	28	199	26	38	13	349
Westminster	471	54	92	1,119	259	301	18	2,314
Total	**1,565**	**235**	**492**	**2,988**	**620**	**720**	**217**	**6,837**

Source: GLA LDD and Borough Monitoring Data

The pronounced imbalance in loss of office space between the east and the west of CAZ is evident in the map in Figure 3.7. The highest concentrations are around Victoria, the Strand and Covent Garden.

Figure 3.7 Net gain/loss of B1: schemes completed, under construction or planned, 2005-2015



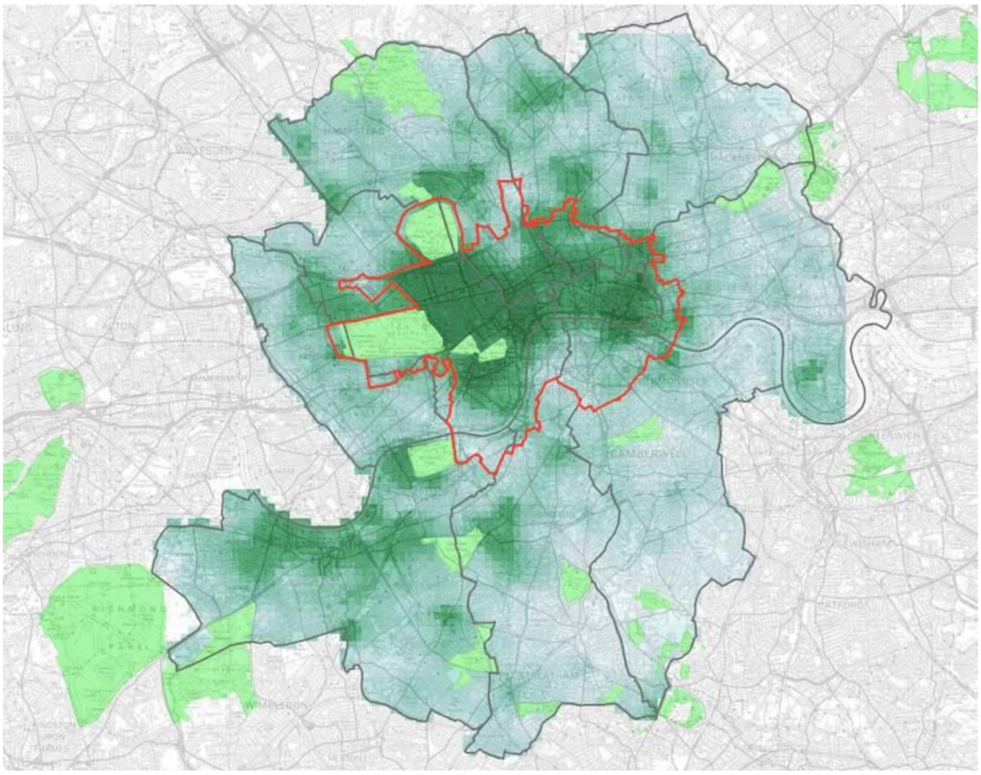
Source: GLA LDD and Borough Monitoring Data/Ramidus Consulting

Small Offices and Mixed Use in CAZ

The map shows all CAZ Boroughs and it is clear that net losses have been incurred beyond the CAZ boundary in all directions but particularly across RBKC, Camden and Islington. Where the CAZ boundary cuts though an area of contiguous net loss around Whitechapel on the eastern boundary of the City, as well as through Clerkenwell to Islington.

Loss of small unit stock in conversions from office to residential has been particularly marked around Green Park and St James's Park, and widespread across Mayfair, Marylebone and Soho/Covent Garden. However, Figure 3.8 demonstrates that the City has also allowed many small offices to be converted. In the area beyond CAZ, small office losses have been most marked in Wandsworth along the riverfront and adjoining green space next to Clapham Common, Battersea Park; Regent's Park and north of Hyde Park. Clerkenwell is also highlighted.

Figure 3.8 Net B1 losses of <1,000 sq m: schemes completed, under construction or planned, 2005-2015

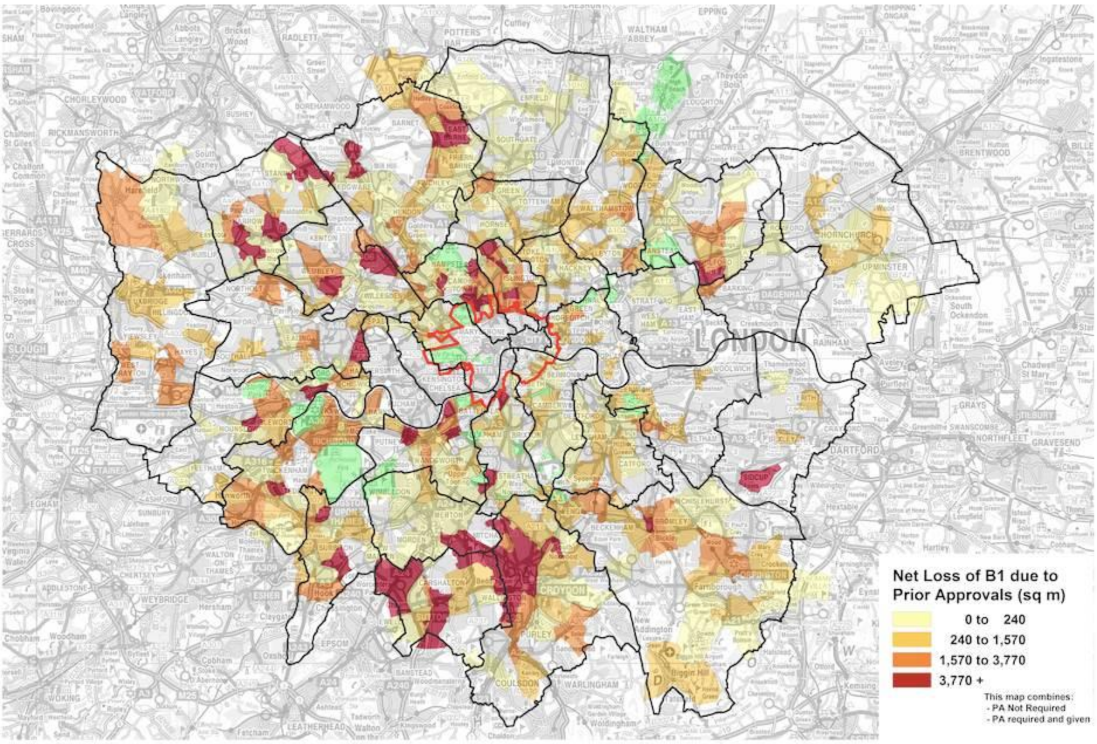


Source: GLA LDD and Borough Monitoring Data/Ramidus Consulting

Figure 3.9 shows the distribution of prior approvals for change of use from office to residential space. The pale yellow indicates small numbers of prior approvals and the deep red areas show where the highest numbers have been granted. Close to the CAZ boundary, there are distinct clusters in Camden and Islington and a further hotspot on the South Bank in Lambeth. Further out, there are clusters in Acton, Croydon, Harrow on the Hill, Sidcup, Sutton and Wembley. Other areas that have incurred high losses are Bromley and Richmond. These are not high value office locations and the primary loss will be affordable office space often let in small units.

This might conflict with the overflow of demand from small businesses looking for space beyond CAZ.

Figure 3.9 Prior approvals granted under PDR, May 2013 to September 2014, by post code sector



Source: GLA, Boroughs and Ramidus Consulting

4.0 Occupied stock of small offices

In this section we analyse the occupied stock of small offices in CAZ. The key data source for this is our EGi archive database, which lists all office occupational units of over 100 sq m in Central London at four dates: 1995; 2000; 2005 and 2010. The database identifies the business occupier; size of unit occupied and address.

Using this database, we were able to analyse how London's office stock is being used by sub-market, by business sector and size band and to monitor how it has changed over the past two decades. This time period spans some profound cyclical fluctuations including the dotcom bubble and crash around the year 2000 and the financial boom and bust around 2007-2008. It also enables us to map the distribution of small units and business sectors across CAZ to highlight clusters and to show shifts in those clusters.

We used the small unit clusters identified in the mapping, to select a subset of the occupied stock data for 2015, so that we could examine the most recent occupier patterns by business sector.

4.1 Stock of offices

We estimate that there are some 97,000 small office occupiers in CAZ (Figure 4.1). These are occupiers in units of <500 sq m (5,000 sq ft). The vast majority of these use <100 sq m. We estimate that 81% of occupational units in CAZ are <100 sq m. This is based on analysis of ONS data and EGi London Office Database. The method is described in Appendix 2.

Figure 4.1 Estimated number of office occupations in CAZ, 2012

Size band	No. of office occupiers
<100 sq m	79,417
101-500 sq m	11,401
501-1000 sq m	3,343
>1000 sq m	3,522
All office occupiers	**97,683**

Source: EGi London Offices Database/Ramidus Consulting

The fine-grained analysis in this section is based on EGi's London Offices Database. It contains records of 19,200 occupational units of more than 100 sq m in Central London.[21] Of those, 18,266 are in the Central Activities Zone. This is consistent with ONS data for the number of businesses registered for VAT or PAYE in Central London and engaged in office-type activities.

Businesses needing <100 sq m do not usually occupy space in the conventional leasing market. It is more likely that they will occupy under more flexible terms, either in serviced offices, or some form of flexible workspace. More importantly, it is our view from research undertaken elsewhere[22] that this market will expand as flexible workspace becomes the accommodation of choice for a growing proportion of small occupiers (see Section 3.4). For this reason, we consider that an analysis of the market for units >100 sq m is an appropriate universe for this study to assess the supply-demand balance and anticipate future need.

Small Offices and Mixed Use in CAZ

The EGi data show a total stock of occupied offices in Central London is just under 18 million sq m (Figure 4.2). Since it is a measure of occupation rather than total built stock, it is subject to fluctuations in the prevailing vacancy rate. In 2010, 74% was occupied in units >1,000 sq m and the balance of 26% was fairly evenly split between units of 500-1,000 sq m (12%) and those <500 sq m (14%).

That balance of size bands remained virtually unchanged in the 15 years from 1995 to 2010. Units below 500 sq m made up 15% of the total floorspace in 1995 and 14% in 2010 and that marginal change occurred between 2000 and 2005. There is no trend evident in this data to suggest that small units have become a more significant component of the Central London office market.

Table 4.2 Occupied stock by size band, 1995-2010 (sq m)

Year	<500 sq m	500-1,000 sq m	>1,000 sq m	All space
1995	2,068,084	1,559,862	10,583,397	14,211,343
2000	2,620,493	2,034,929	13,291,037	17,946,460
2005	2,440,261	2,065,044	12,932,706	17,438,011
2010	2,571,057	2,160,121	13,142,511	17,873,689

As % of total				
1995	15%	11%	74%	100%
2000	15%	11%	74%	100%
2005	14%	12%	74%	100%
2010	14%	12%	74%	100%

Source: EGi London Offices Database/Ramidus Consulting

Indeed, when we look at the number of small units, as opposed to the amount of floorspace used as small units (Figure 4.3), we find that they comprise a much smaller proportion of the total in 2010 (62%) than they had in 1995 (68%).

However, we flag up two caveats to this finding.

- First, as already mentioned, this occupier data does not take account of units <100 sq m and other evidence points to growth in this segment of the economy (see Section 3.1).

- Secondly, we know that over the same time period the amount of space occupied by serviced office operators has risen by 107%, which is almost certainly absorbing a growth in small unit occupations.

Section 3.4 of this report describes the growth in serviced offices. It is safe to assume that the majority of occupiers in serviced office space are small occupiers – many in <100 sq m, then this adds an additional 550,000 sq m to the stock of small occupational units.

Table 4.3 Stock by size band, 1995-2010 (no of units)

Year	<500 sq m	500-1,000 sq m	>1,000 sq m	All units
1995	11,036	2,697	2,390	16,123
2000	12,874	3,129	3,499	19,502
2005	10,854	3,171	3,462	17,487
2010	11,401	3,343	3,522	18,266

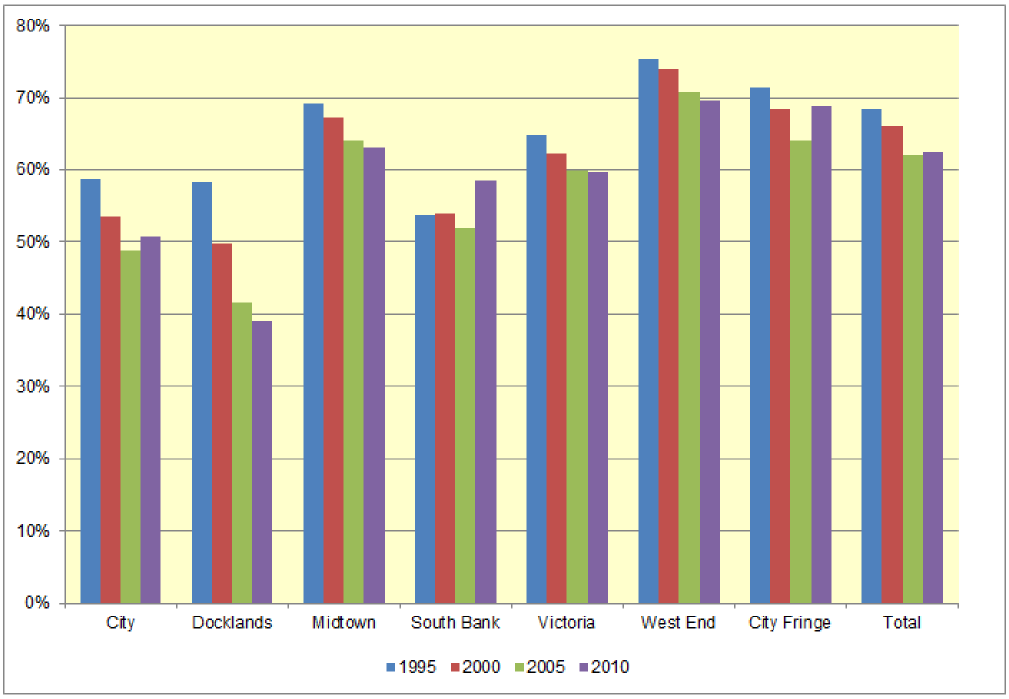
As % of total				
1995	68%	17%	15%	100%
2000	66%	16%	18%	100%
2005	62%	18%	20%	100%
2010	62%	18%	19%	100%

Source: EGi London Offices Database/Ramidus Consulting

4.2 Spatial distribution of small units

Examined over the 15 years from 1995 to 2010, the proportion of office space let in small units declined across Central London and in all of the sub-markets with the single exception of South Bank where small units made up a larger proportion of office space in 2010 than they had in 1995 (Figure 4.4). However, in the five years 2005-2010, small units did not decline overall and rose in the City and City Fringe.

Figure 4.4 Small units as a % of all units, by sub-market, 1995-2010



Source: EGi London Offices Database/Ramidus Consulting

Small Offices and Mixed Use in CAZ

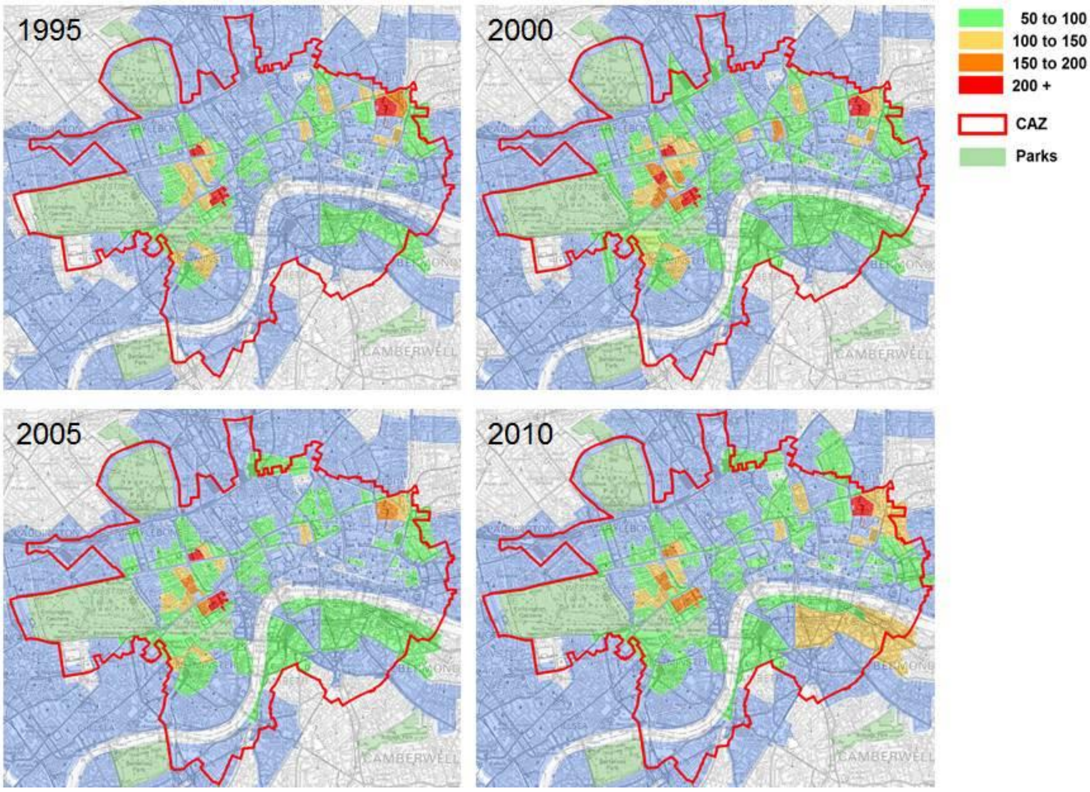
The Dotcom Crash in 2000 almost certainly accounts for much of the decline in small units between 2000 and 2005 – implying that a lack of demand rather than a supply constraint caused the decline. Then, between 2005 and 2010, small units were growing from a lower base, i.e. a smaller number of small occupiers, and so the existing stock was able to absorb additional demand from growth in the number of small businesses, even though the economy was strong in the mid-2000s.

The Financial Crisis of 2008 effectively created even more capacity for growth of small businesses, in space vacated by the contraction of larger occupiers. This enabled the proportion of small units to increase in City and City Fringe. South Bank probably responded to different drivers. Its share of small businesses rose consistently over the whole period from 1995 to 2010 and we believe that it reflects a longer term structural change in this market as it carved out an expanding role in the provision of small office space for Central London.

Between 55% and 70% of units are <500 sq m in all sub-markets except Docklands. However, the proportion declined in all sub-markets except South Bank between 1995 and 2010. Of course, small units are not evenly spread between sub-markets.

Mapping the data at a finer grain shows distinct concentrations in smaller units of geography. Figure 4.5 provides a set of maps for 1995, 2000, 2005 and 2010, highlighting these concentrations. It is also clear that the clusters change over time. Between 1995 and 2000, the West End cluster had spread north and westwards.

Figure 4.5 Concentrations of <500 sq m units, 1995-2010



Source: EGi London Offices Database/Ramidus Consulting

By 2005, the cluster to the north east of the City, had spread southwards and the Soho cluster had become less intense. The South Bank also emerges as a strong cluster around this time. By 2010 the pattern is more dispersed and has intensified to north east of CAZ, around King's Cross and across Midtown. The South Bank cluster has strengthened further by this date.

To analyse how these patterns evolved between 2010 and 2015, we took a sample of the data, based on the post codes with the strongest small unit clusters in 2010. We then analysed standard market indicators (availability, take-up and rents) to assess the impact of cyclical patterns in the market so that we could distinguish between cyclical and structural pressures on the supply of small units. We analysed the stock of units <100sq m in the 'small unit clusters'. The data were based on the cluster maps above and Figure 4.6 shows the post codes selected for each cluster.

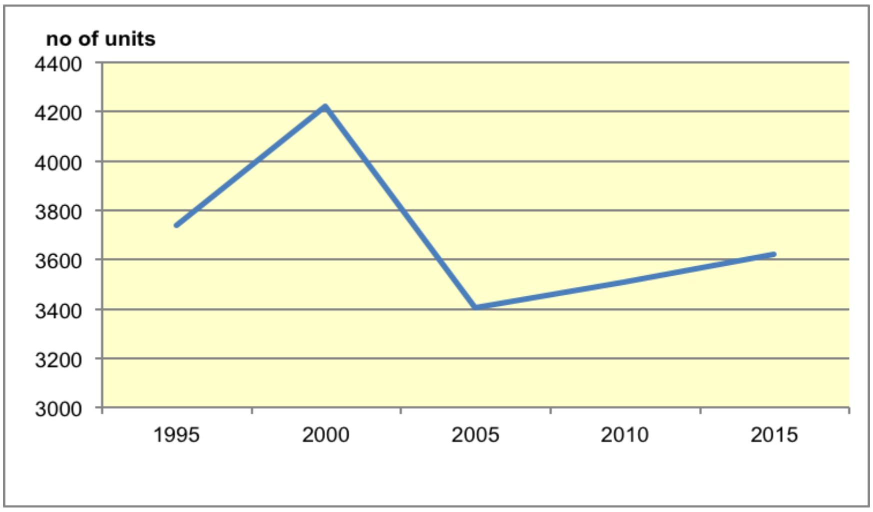
Figure 4.6 Post codes selected to represent a small unit cluster

Cluster	Selected post codes
Clerkenwell	EC1N; EC1V
Mayfair	W1K; W1S; W1F; W1D
South Bank	SE1 1
St Giles/Covent Garden	WC2E; WC2H
St James's	SW1Y
Tech City	EC2A; E1 6; E1 7

Source: EGi London Offices Database/Ramidus Consulting

Taken as a whole, there were 4,975 units <1,000 sq m in the selected post codes in 2015 and 3,621 <500 sq m. The number declined steeply between 2000 and 2005, consistent with the whole market and almost certainly as a direct result of the Dotcom Crash (Figure 4.7). It then began to rise once more, consistent with the whole market from 2005 to 2010, and followed a similar trajectory, 2010 to 2015.

Figure 4.7 Units of <500 sq m in small unit clusters, 1995-2015

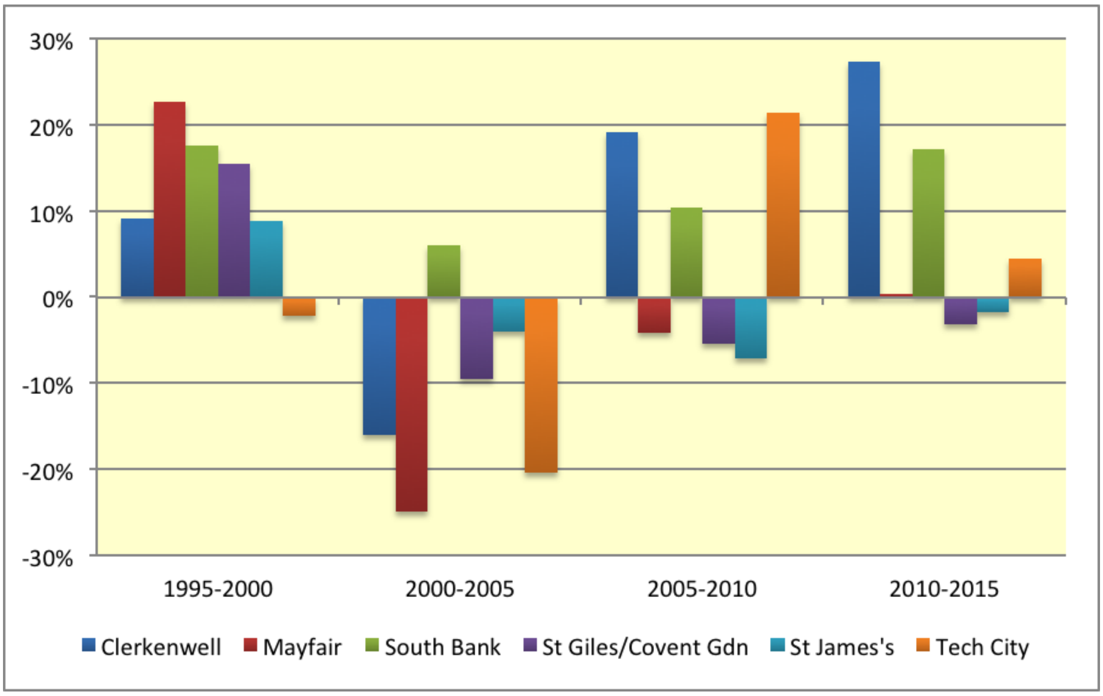


Source: EGi London Offices Database/Ramidus Consulting

This suggests that the number of small units in Central London's small unit clusters have been able to expand consistently over the past decade. However, as noted above, we note that the shape and extent of these clusters has changed over time.

In order to assess whether the circumstances vary from cluster to cluster, we analysed the percentage change, in the number of small units in each cluster, for a series of five year periods. This showed up distinct variations between the clusters (Figure 4.8). Between 2010 and 2015 the number of small units continued to expand in Clerkenwell, Tech City and South Bank, while they declined in Mayfair, St James's and Covent Garden/St Giles.

Figure 4.8 Change in number of units, <500 sq m, five year time periods



Source: EGi London Offices Database/Ramidus Consulting

This analysis does not provide incontrovertible evidence that there is no supply constraint on small office, particularly as the geographies of these clusters has changed over time. Indeed the clusters that have expanded may simply be taking overspill demand from the more constrained areas. However, it does show that Central London was able to accommodate growth over the period. Our analysis of availability, take-up and rents will shed further light on what is driving these occupation patterns.

4.3 The role of multi-let buildings

Our EGi Central London offices database lists 18,266 occupational units in 2010 and they are distributed among 7,075 buildings. This is calculated by counting the number of unique building addresses in the database. This suggests that, across Central London, there is an average of 2.6 occupational units per building – always remembering that the database includes units >100 sq m and excludes businesses occupying space on a license in a serviced office centre.

More than half of buildings (3,860) are occupied by a single tenant (Figure 4.9). There are 235 buildings with more than 10 occupiers.

Figure 4.9 Buildings by number of occupiers, 1995-2010

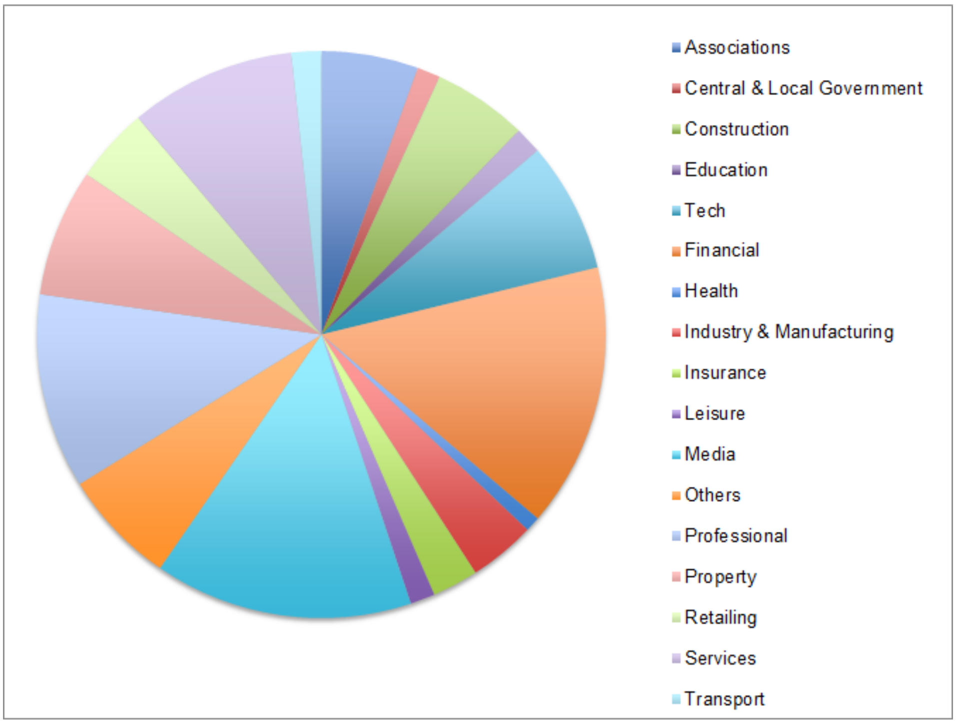
No units	1995	2000	2005	2010
Single occupier	3,654	3,920	3,914	3,860
2 to 5 units	3,081	3,371	2,945	2,901
6 to 9 units	60	73	77	79
Ten plus units	154	239	200	235
Grand total	**6,949**	**7,603**	**7,136**	**7,075**

Source: EGi London Offices Database/Ramidus Consulting

4.4 Small occupiers by sector

Small units (<500 sq m) are occupied by a very wide range of business sectors. The highly colourful pie chart (Figure 4.10) serves primarily to demonstrate that fact and also that there is no single dominant sector.

Figure 4.10 Small occupiers by business sector, 2010



Source: EGi London Offices Database/Ramidus Consulting

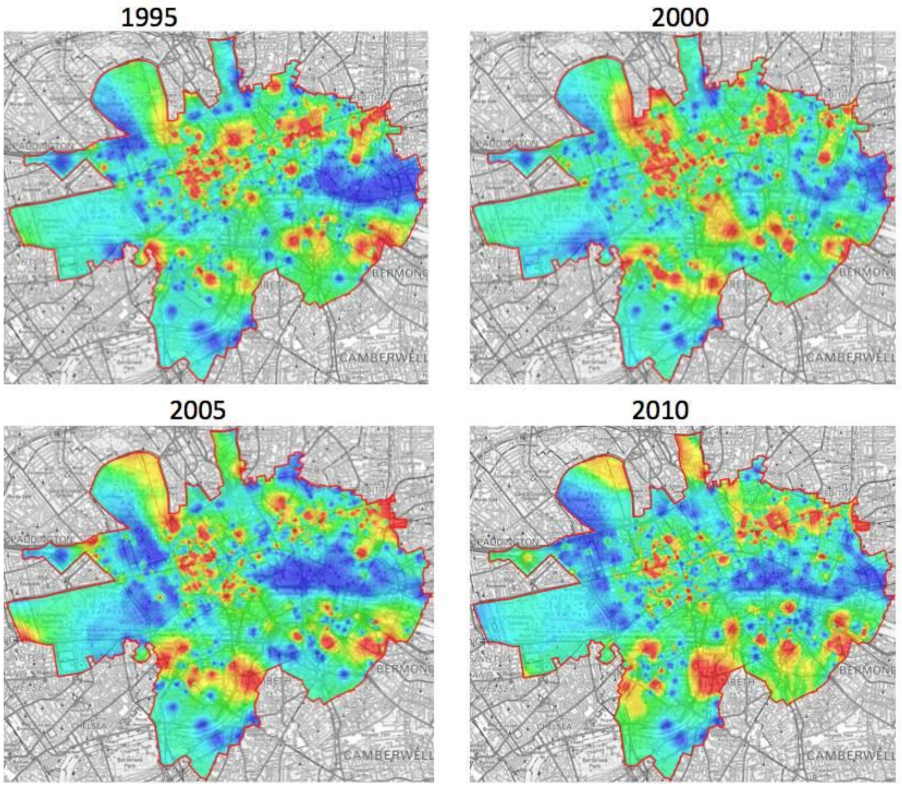
The biggest shares are held by the Financial and Media sectors, each accounting for 15% of the total. The Professional sector (which encompasses law, accountancy and management consultancy) accounts for 11%. No other sector has more than a 9% share. The Tech sector accounted for 7% of small units in 2010, the same as Property and marginally less than Services.

Small Offices and Mixed Use in CAZ

Figure 4.10 is based on 2010 data, but there was very little variation over time between 1995 and 2010. However, we did find changes over time in the geographical distribution of sectors in small units.

For example, the concentration of Media businesses around Soho and West of Tottenham Court Road, which is particularly prominent in 2000, is far less marked by 2010 (Figure 4.11). Instead, a corridor has emerged across the north side of the City and Holborn around Clerkenwell, and there is also a new cluster emerging at King’s Cross and on the South Bank around Bermondsey Street, and between Vauxhall and Waterloo.

Figure 4.11 Distribution of units, <500 sq m, Media sector, 1995-2010



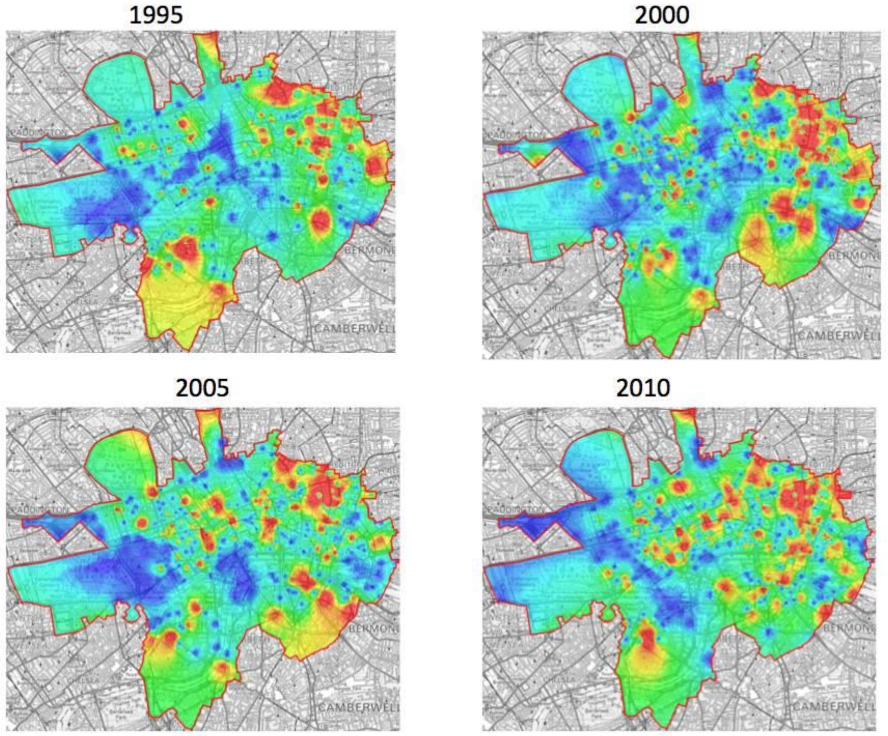
Source: EGi London Offices Database/Ramidus Consulting

Similarly, Figure 4.12 illustrates the evolving distribution of the Tech sector in Central London. These maps demonstrate the significance of the area to the north east of the City, which was already prominent in 1995, and particularly around 2000, long before it acquired its Tech City brand. In fact, the cluster has dispersed more recently, spreading along a west-east axis and down the eastern edge of the City to the South Bank.

In 1995 the Professional sector clustered in between the City and the West End in Holborn with a secondary concentration to the south west of the core West End markets where rents were lower (Figure 4.13). But by 2010, it had a dominant presence across much of the central area of CAZ in a diagonal band from south west to north east.

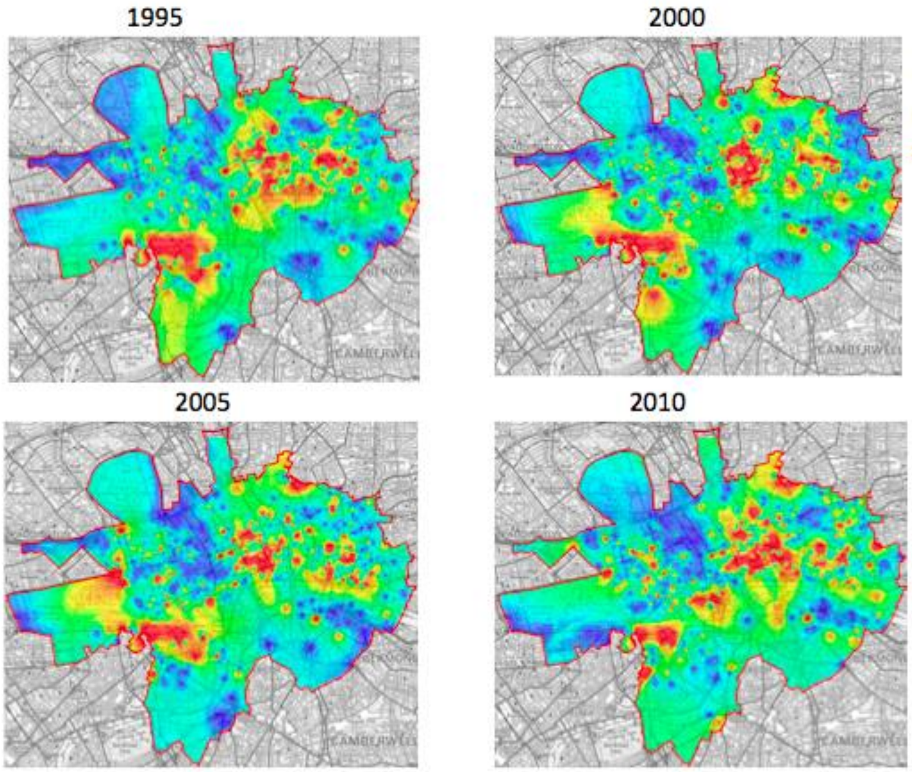
Small Offices and Mixed Use in CAZ

Figure 4.12 Distribution of units <500 sq m, Tech sector, 1995-2010



Source: EGi London Offices Database/Ramidus Consulting

Figure 4.13 Distribution of units <500 sq m, Professional sector, 1995-2010

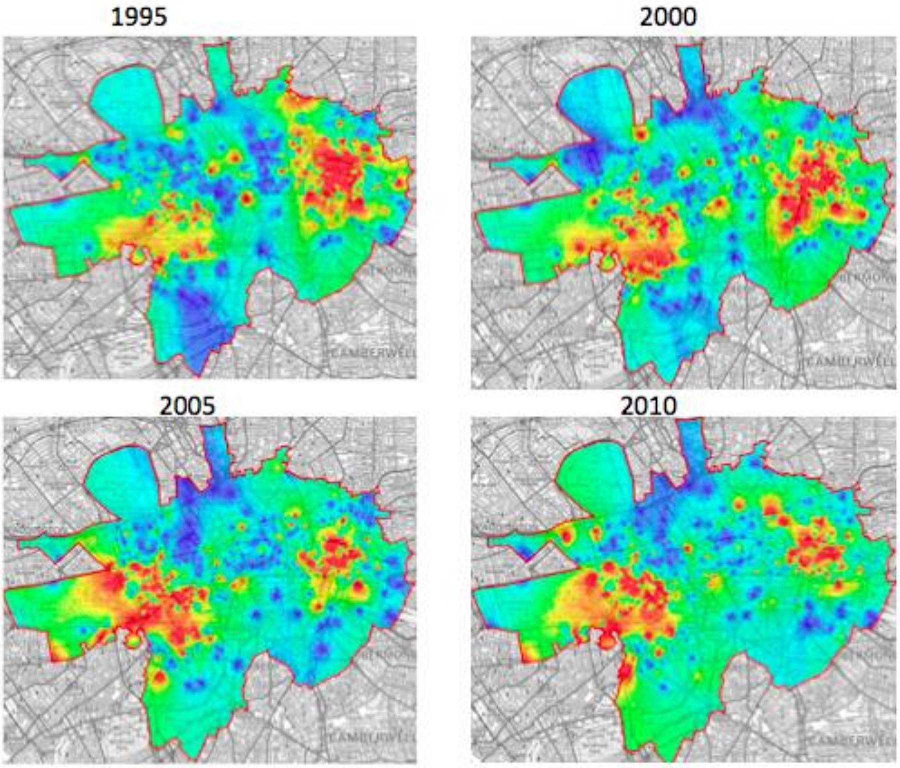


Source: EGi London Offices Database/Ramidus Consulting

Small Offices and Mixed Use in CAZ

Small occupiers in the Financial sector were strongly clustered in the City in 1995 but by 2010 the most pronounced cluster was in the West End – the preferred location of hedge funds and private equity advisors (Figure 4.14).

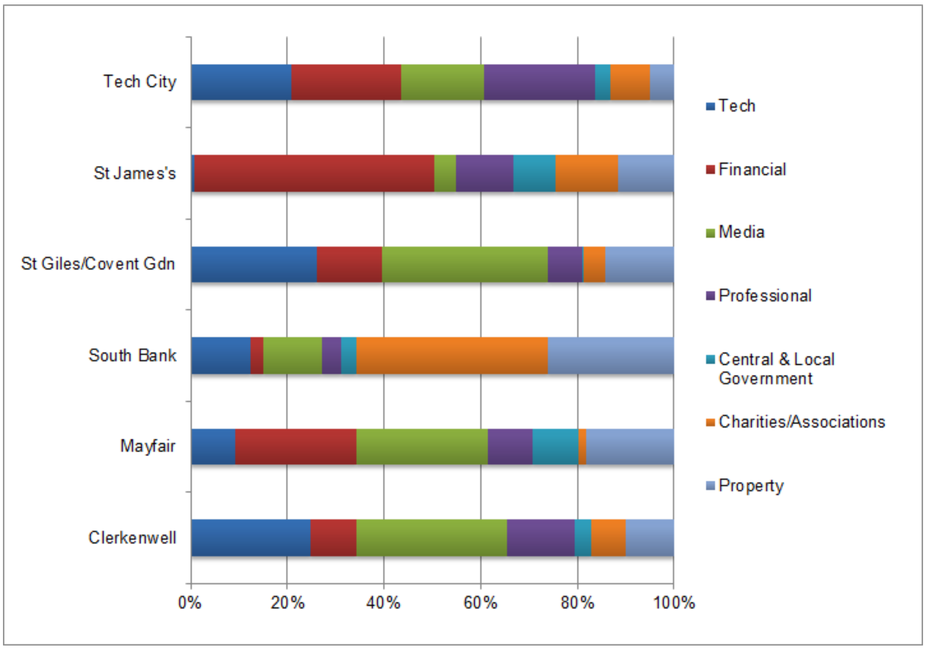
Figure 4.14 Distribution of units <500 sq m, Financial sector, 1995-2010



Source: EGi London Offices Database/Ramidus Consulting

An analysis of the selected small unit clusters for 2015, showed some distinctive clustering of business sectors within these areas (Figure 4.15). For instance, Media is most strongly represented in St Giles/Covent Garden and Clerkenwell areas, while Financial was very much the dominant sector in St James's. Perhaps more surprising was the diversity of sectors represented in the Tech City area. While Tech had a significant presence, with 20% of the total, Professional and Financial were equally dominant.

Fig 4.15 Distribution of business sectors in small unit clusters, 2015



Source: EGi London Offices Database/Ramidus Consulting

4.5 Summary

Our analysis of the stock of office space in Central London is based on 18,266 occupied units of >100 sq m and these add up to a total of just under 18,000 sq m in 7,075 separate buildings. Our key findings are as follows.

- Over one quarter (26%) of the floorspace is occupied in units <1,000 sq m, which is fairly evenly split between units of 500-1,000 sq m (12%) and those <500 sq m (14%).
- The balance, measured by floorspace, has not changed significantly over the time period 1995-2010.
- Around 80% of the units are <1,000 sq m and 62% are <500 sq m.
- The proportion of small units declined between 1995 and 2005 and then stabilised overall but continued to decline in most of the sub-markets, with a compensating increase on the South Bank.
- There are clusters of small units that broadly coincide with the geography recognised as: Tech City, Soho/Covent Garden and South Bank.
- These clusters have spread over time.
- No single sector is a dominant occupier of small office units – they are used by a very wide range of business sectors.
- The largest user of small office space is the Financial sector.
- The distribution of the Media sector has become less concentrated.
- The distribution of the Tech sector has spread along a west-east axis.
- The Tech City small unit cluster has a broad occupier base. Financial, Tech and Professional each have similar proportions of the occupied space.
- St James's small unit cluster is dominated by Financial occupiers.
- In St Giles'/Covent Garden and Clerkenwell the Media sector is dominant.

5.0 Trends in demand and supply of small offices

Our analysis of occupied stock showed a gradual increase in the number and total floorspace of small units in CAZ but this was against a backdrop of a growing city and, while they grew in absolute numbers, small units declined as a proportion of the total stock of offices in CAZ and in all but one of the sub-markets.

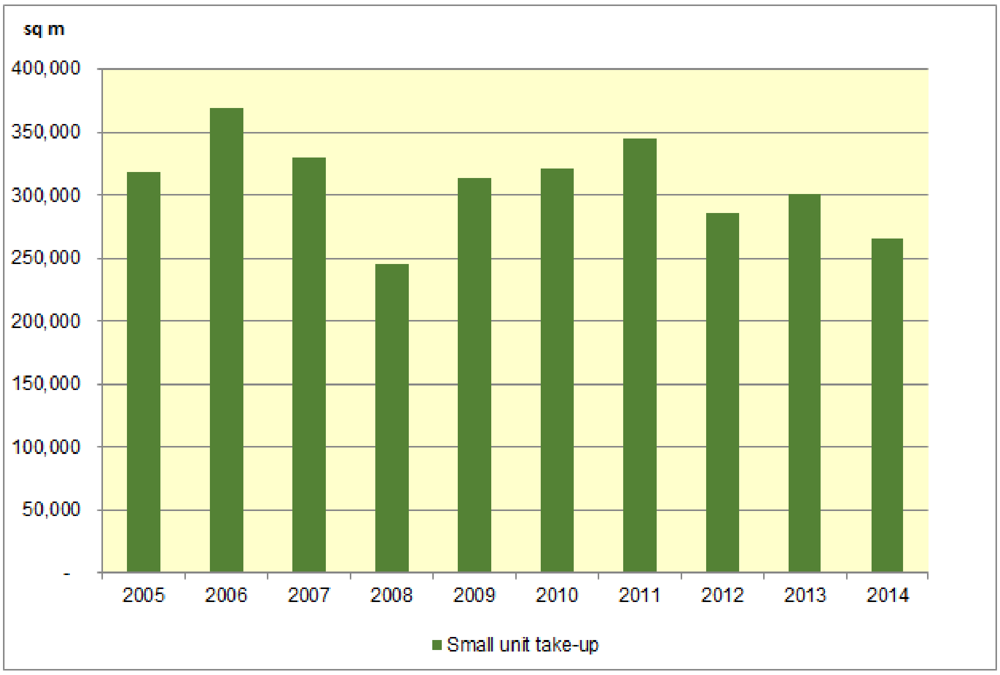
It is difficult to assess whether this has been driven by a change in demand or by constraints on supply. In other words, there has been change but that change may, or may not, reflect a problem. In order to interpret the changes, we have turned to time series on the letting market and analysed trends in take-up, availability and rental values.

The data for this analysis was provided by Cushman and Wakefield. Overall, it covers an area of Central London broadly coincident with CAZ and is segmented by size and sub-market. While the sub-market boundaries do not precisely mirror the geography of our stock analysis, the match is close enough to offer valuable insights into the cyclical dynamics of small offices in different parts of CAZ. Take-up is monitored for units >100 sq m and supply for units of >500 sq m. The prime rent time series is based on a hypothetical unit and the average achieved rent series is based on units >100 sq m where the rent is known.

5.1 Take-up

An analysis of take-up of small units (<500 sq m) during the decade from 2005 to 2014 shows that it was strong in 2006-7 and then dipped as the recession hit in 2008, but it does not seem to mirror economic trends in the years since then (Figure 5.1). This suggests that there might be other constraints or pressures.

Figure 5.1 Take-up of units <500 sq m, 2005-2014



Source: Cushman & Wakefield/Ramidus Consulting

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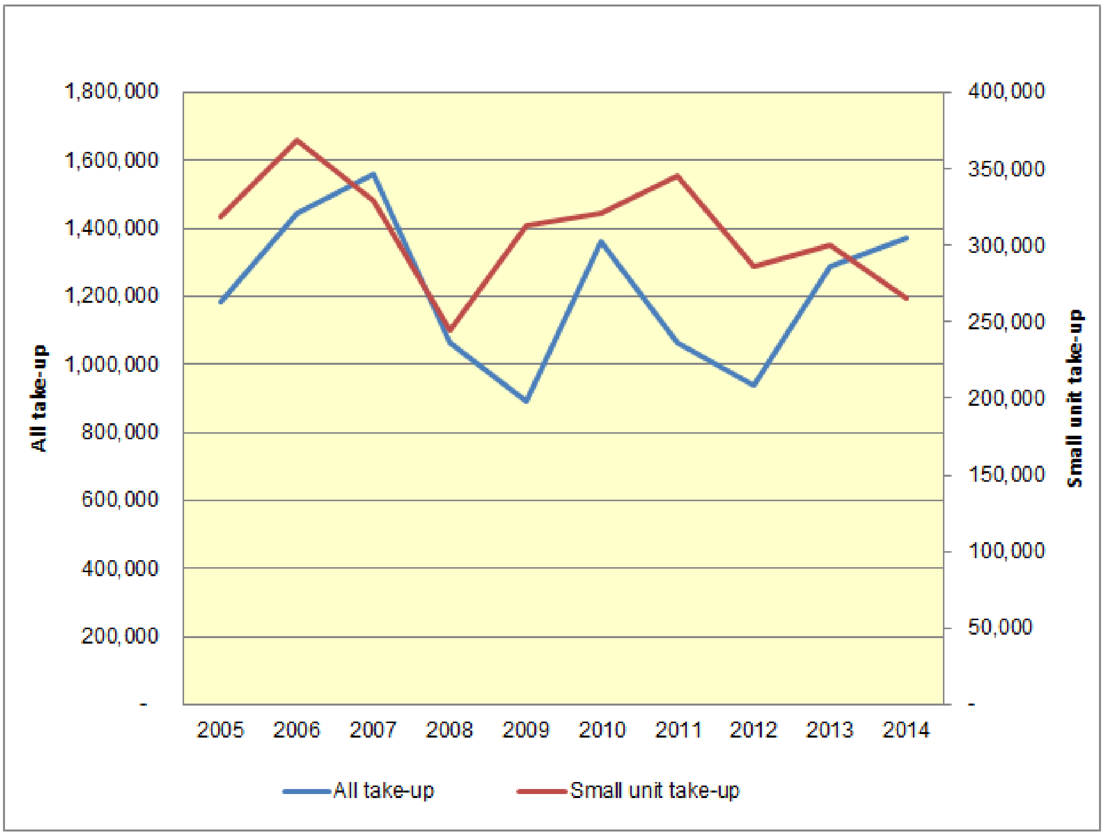
Take-up-quickly recovered even as the recession persisted and then declined as the economy recovered. In other words take-up of small units does not fluctuate in direct proportion to the strength of the economy. In fact take-up of small units has trended downwards since 2011 and during 2014, when government data indicated a strengthening economy, take-up was only slightly higher than the low point in 2008.

For more insight we compared small unit take-up with the whole market (Figure 5.2) and then segmented small unit take-up by sub-market (Figure 5.3). The market as a whole fell sharply in 2008 and further in 2009; there was a brief spike in 2010, and then in 2011 and 2012 it fell back again before beginning a recovery in 2013, which was cemented in 2014.

This shape is closely aligned to the UK economy - which also had a brief rally in 2010 when for a time the worst of the recession appeared to have passed, before slipping back in 2011 when talk of a double dip recession was rife.

So small unit take-up seems to have behaved quite differently to the whole market. When whole market take-up is compared to small unit take-up, the contrast is apparent. Small unit take-up dipped only briefly and then recovered until 2011 when it dipped once again and continued to trend downwards. For this pattern to emerge at a time when more small businesses are being created and when overall take-up is still rising, suggests that fluctuations in take-up of small units are reflecting factors other than demand.

Figure 5.2 Take-up, small units (<500 sq m) and all units compared, 2005-2014

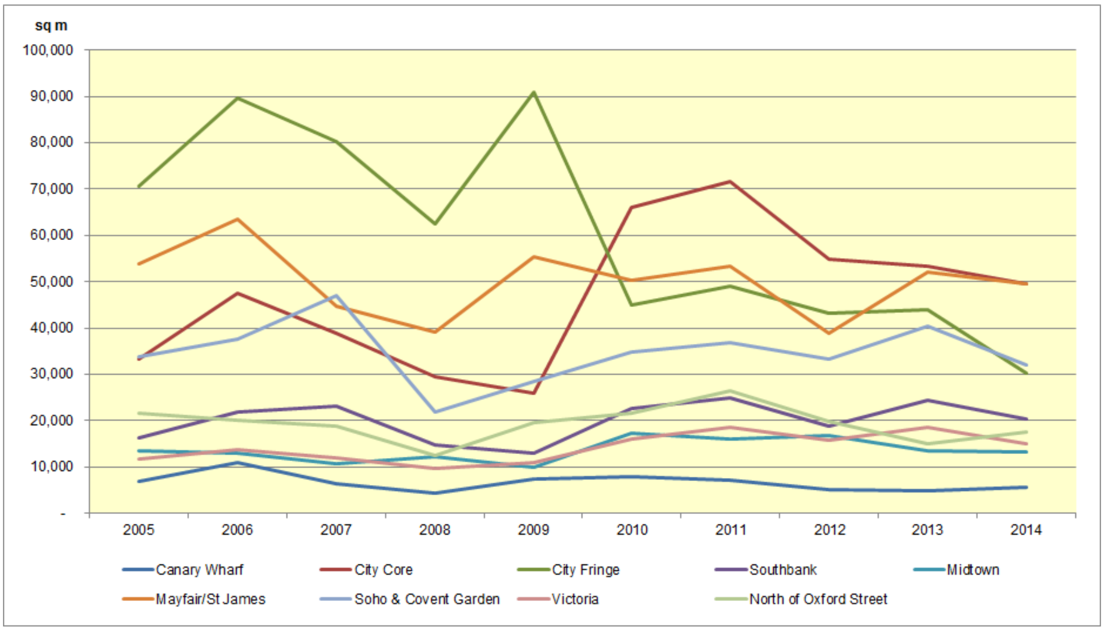


Source: Cushman & Wakefield/Ramidus Consulting

This could be the result of constraint on supply, preventing occupiers expressing a desire for small units, or it could be that the demand for small units is being met in other ways - such as in the flexible space market or in alternative locations. The analysis of trends in supply (Section 5.2) and rental value (Section 5.3) help to shed more light on this.

Segmentation by sub-market shows that take-up of small units declined most steeply on the City Fringe, where the level in 2014 was only a third of 2009 (Figure 5.3). Furthermore, it went from being the highest volume of turnover by a significant margin in 2009, to the middle of the pack in 2014. Again, the rent and supply analysis (Sections 5.2 and 5.3) will help to interpret this trend.

Figure 5.3 Take-up of small units, <500 sq m, 2005-2014



Source: Cushman & Wakefield/Ramidus Consulting

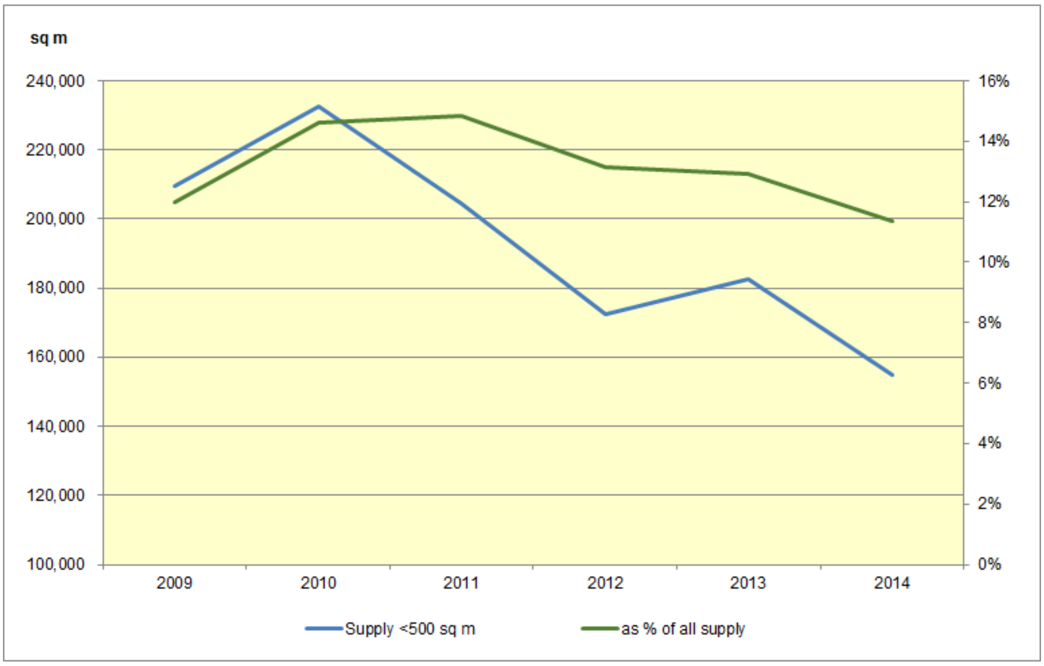
The steep increase in small unit take-up in the City Core between 2009 and 2010 and 2011 begs the question of whether it had picked up occupiers from the City Fringe and, although take-up declined in 2012 it then settled at a higher level trend rate.

None of the other sub-markets showed such distinctive patterns as the City Core and Fringe. Even in Soho and Covent Garden where we might have expected to see some evidence of supply constraint, the range was moderate and there was no significant decline after 2008.

5.2 Availability

The supply of small units available to let in Central London fell by 33% between 2010 and 2014 (Figure 5.4). Not only that, but small units also made up a diminishing share of space on the market, declining from 15% of total supply in 2010 to 11% by the end of 2014. In other words, the supply of space in small units declined at a faster rate than the rest of the market. Total supply (all sizes) also declined from 2010 to 2012 but only by 25% and then it stabilised.

Figure 5.4 Availability of small units, <500 sq m, 2009-2014



Source: Cushman & Wakefield/Ramidus Consulting

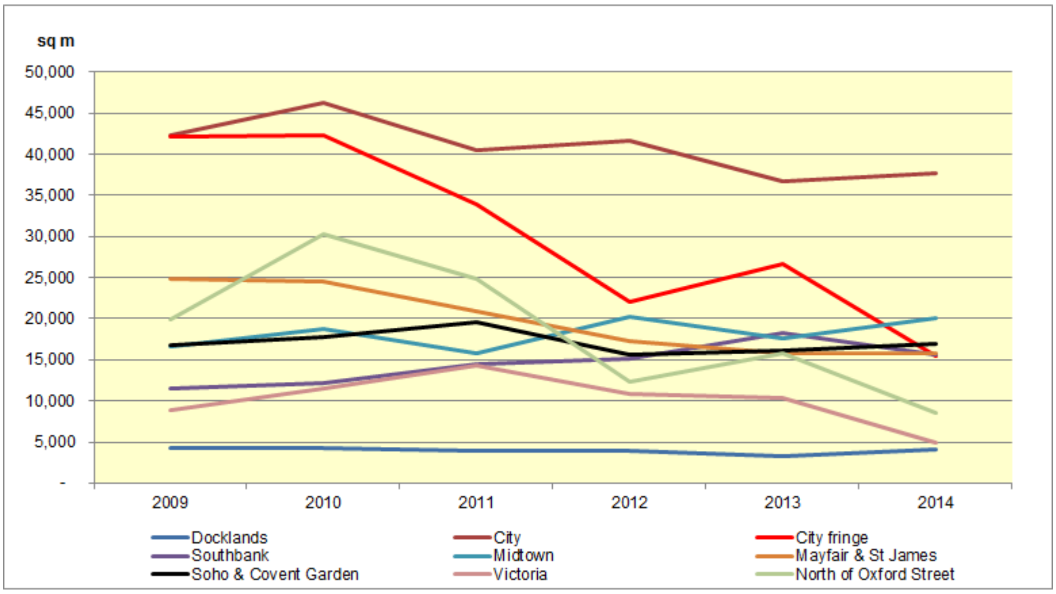
When we segmented the data into sub-markets, we found distinct variations in the patterns of supply (Figure 5.5). The City Core consistently had the largest supply of small units available to let over the five year period from 2009 to 2014 whereas on the City Fringe there was a sharp decline of 63% over the same period. In 2009 the City Fringe accounted for 20% of the supply of small units and by 2014 it had declined to just 10%. The performance of the City Core probably reflects both its attractiveness to small businesses and the on-going protection of heritage stock there.

The other sub-markets to experience a sharp decline in the availability of small units were North of Oxford Street (57%) and Mayfair/St James's (37%). We did not find a similar trend in Soho/Covent Garden, the reasons for which are unclear.

To address the question of whether constrained supply had led to the decline in take-up in some of the sub-markets, we compared percentage change in supply between 2009 and 2014 with percentage change in take-up (Figure 5.6). If we found a steep decline in take-up in a market where supply had also fallen steeply, this would suggest supply constraint. We explore this further by looking at rental trends in Section 5.3. If, on the other hand, supply had not reduced, then the fall in take-up almost certainly had a different cause.

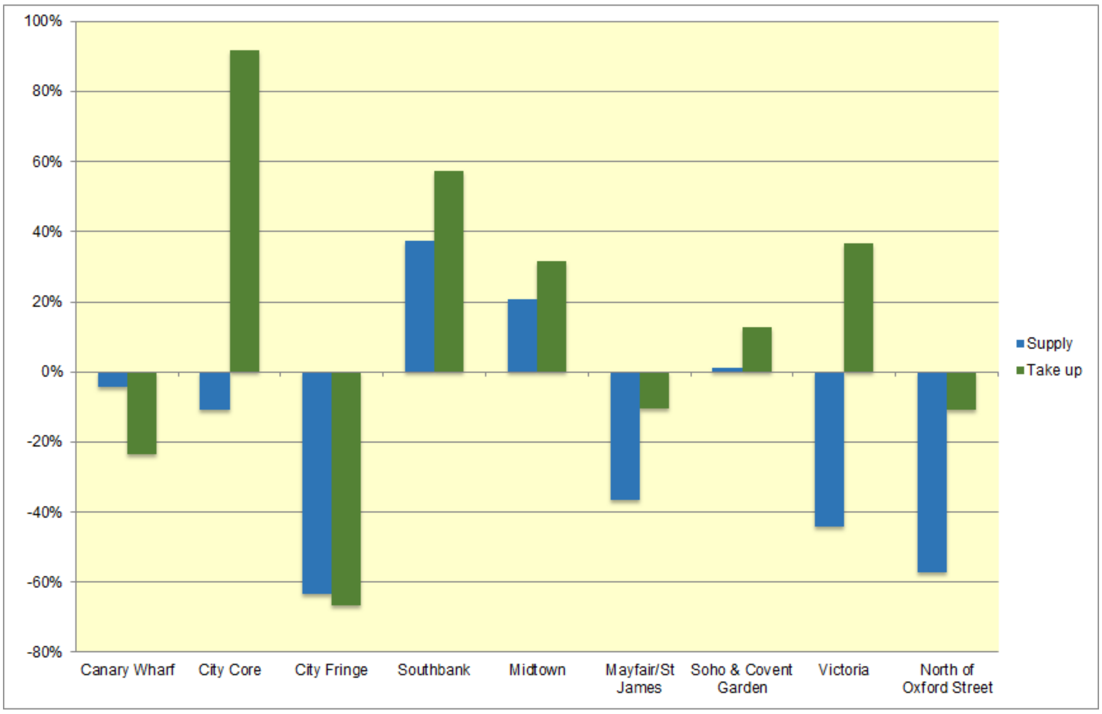
There was a marked decline in both supply and take-up on the City Fringe. Mayfair/St James's and North of Oxford Street, also both exhibited falls in supply and, to a lesser extent, take-up. Victoria and the City Core – both markets that are characterised by large units – combined a steep increase in take- up of small units with a decline in supply, perhaps indicating a change in the shape of occupational need.

Figure 5.5 Availability of small units, <500 sq m, by sub-market, 2009-2014



Source: Cushman & Wakefield/Ramidus Consulting

Figure 5.6 Comparing supply and take-up, small units, <500 sq m, by sub-market, 2009-2014



Source: Cushman & Wakefield/Ramidus Consulting

The scale of the decline in both supply and take-up on the City Fringe suggests that there could be supply constraint driving lower rates of take-up. If this is the case, we would expect to see it reflected in upward pressure on rents (Section 5.3).

An analysis of the Digital Economy in Tech City, based on firm data from the Business Structure Database, shows that the number of firms has grown at a slower rate in Tech City between 1997 and 2014 than in London as a whole. This supports the view that the geographic ties of the sector to this location are weaker than is sometimes supposed, and that demand is more footloose than generally assumed. However, supply constraints are also a contributory factor as rising demand has outstripped new supply, leading to a sharp spike in rents and, therefore, to affordability issues. The evidence is included as Appendix 3.

For the other two markets with falling supply and take-up – Mayfair/St James's and North of Oxford Street, supply fell by a far greater degree than take-up, implying that these markets were not under the same pressure as the City Fringe. Again evidence from rental trends (Section 5.3) will help to interpret this data.

Supply of small units flouted the downward trend in two sub-markets by increasing over the period 2009-2014 – these were: South Bank and Midtown. In both cases take-up rose too. It is possible that higher supply levels enabled these markets to accommodate some of the overspill from other, more supply-constrained locations.

Soho/Covent Garden experienced a small increase in take- up over the five years, even though its supply fell slightly; it could be that increased take-up caused the fall in supply which might imply that pressures are building in this location as well.

We turned to rental data to try to shed more light on these patterns.

5.3 Rents

Rents for small units began to rise at about the same time as supply began to fall, in 2009. We were able to analyse average rental trends over the 10 year period from 2005-2014 and it is clear that 2009 was a low point after the Financial Crisis in 2008, and that rents were effectively starting from the same level as they had been in 2005 (Figure 5.7).

This means that average growth over the whole 10 year period is relatively modest, even though average growth in the past five years has been much steeper. It is also worth noting that rental growth since 2010 has taken place in a historically low inflation economy and will therefore represent growth above inflation.

Although rents varied considerably between different parts of London, all of the sub-markets followed similar rates of growth and exceeded their pre-crash levels sometime between 2010 and 2012.

We analysed the average achieved rents for units below 500 sq m in seven sub-markets of Central London. Average achieved rents in five of the seven ranged between £29.57 and £40.79 per sq ft in 2014. The two sub-markets outside this range were Soho/Covent Garden at £53.39 per sq ft and the most expensive, Mayfair/St James's, at £67.47 per sq ft.

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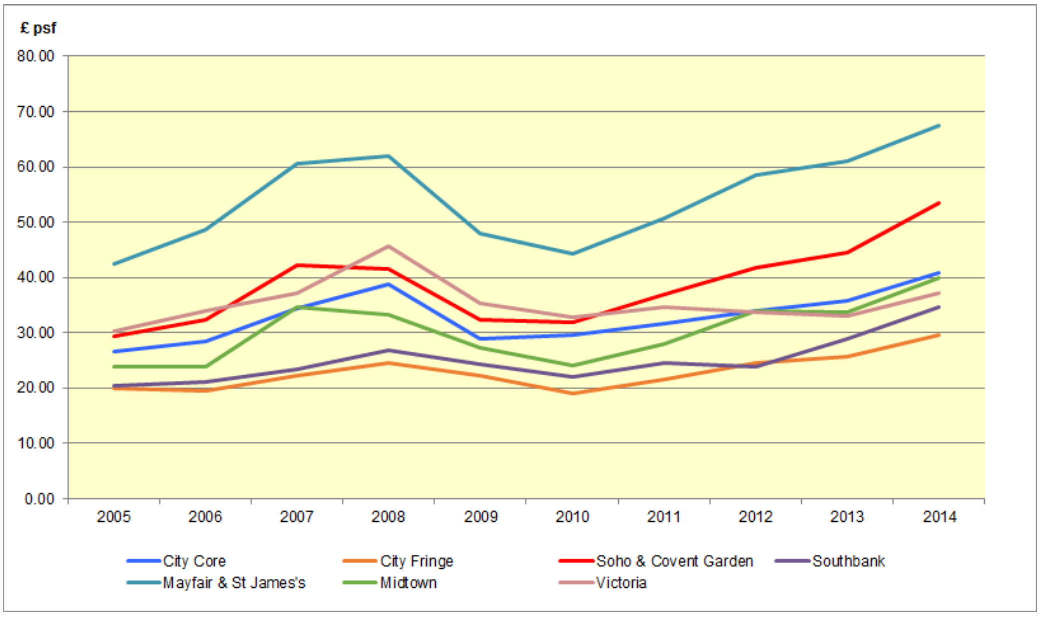
Figure 5.7 Average rents achieved, small units, 2005-2014



Source: Cushman & Wakefield/Ramidus Consulting

Figure 5.8 shows the percentage change in achieved rents for each sub-market over a 10 year period, and allows us to compare with the growth for large units. The data reveal considerable differences.

Not only did the City Fringe sub-market have the lowest average achieved rent in 2014, but it also experienced relatively low rental growth over ten years compared with the other sub-markets. Interestingly, there was far greater pressure on the City Fringe in the size range 500-999 sq m, which falls within the definition of 'move-on space', where the rents achieved rose by 66% in ten years.

Figure 5.8 Rental growth 2005-2014 (based on average rent achieved)

Sub-market	<500 sq m	500-999 sq m	>1,000 sq m
City Core	53%	56%	28%
City Fringe	48%	66%	27%
Soho/Covent Garden	81%	53%	50%
South Bank	70%	126%	103%
Mayfair/St James's	59%	70%	70%
Midtown	68%	49%	58%
Victoria	23%	-14%	-1%

Source: Cushman & Wakefield/Ramidus Consulting

It is our view that the pressure of demand for space on the City Fringe, which has been widely reported in commentaries on the market, has been dissipated because occupiers have sought out alternative locations rather than bid up rents in competition with less cost sensitive occupiers. The appeal of this location is not so great that it cannot be substituted.

To some extent the pressure is relieved by spilling eastwards beyond CAZ towards Haggerston, Dalston and Whitechapel, but office stock is limited in these locations and there is competition with residential uses. However, there are several locations within CAZ with strong emerging office markets that are, in our view, effectively interchangeable with the City Fringe, such as South Bank and King's Cross. This view was corroborated by our interviews with landowners and developers and market practitioners when we discussed viability (see Section 8.0).

Soho/Covent Garden on the other hand, had the second highest rents in 2014 and it had the highest rental growth for units <500 sq m, at 81% in ten years. The data also suggest that there is less pressure on the market for larger units, since the rate of rental growth fell to 53% for units >500 sq m and 50% for units >1,000 sq m.

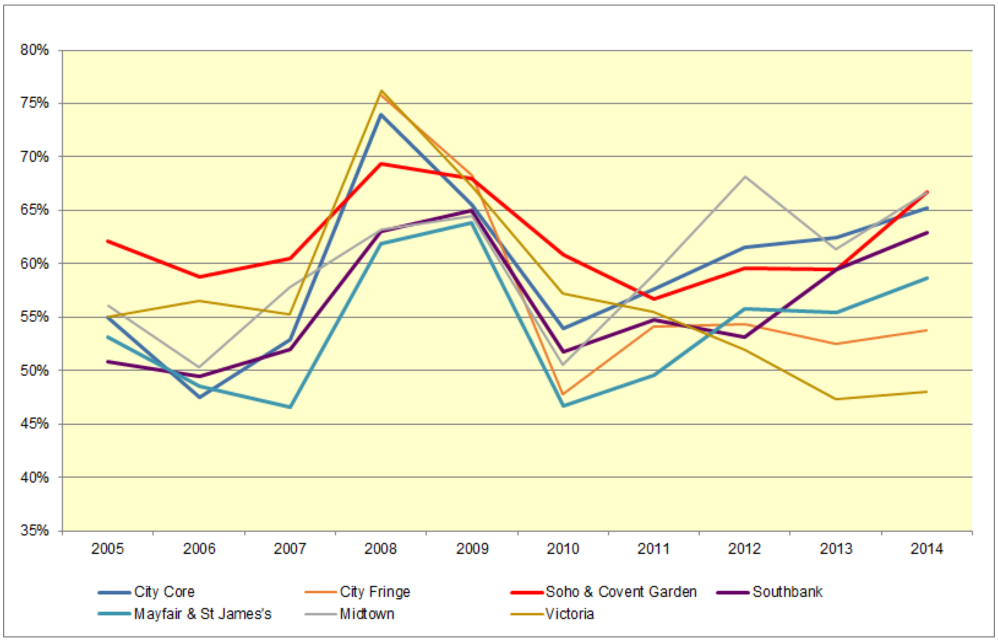
The growth in rents achieved for small units on the South Bank suggests that there has been considerable price pressure in all three size categories, despite the expansion of this market and most acutely for 500-999 sq m. Victoria on the other hand seems to have slipped down the hierarchy if pricing is a measure of popularity.

It should be noted that rents dipped in all markets in 2008 and that rental growth over the past four years has been much steeper than these ten-year growth rates imply. Average rental growth has been 14% per annum on the City Fringe and South Bank since 2010, and 17% per annum in Midtown and Soho/Covent Garden.

Despite these rates of growth, all of the achieved rents for small units remain at a significant discount to the prime rent in the same sub-market. The size of the discounts fluctuated over time but in 2014 they ranged from 48.1% (where the small unit rent was 48.1% of the prime) to 66.7% (Figure 5.9). At no time over the 10 year period did the achieved rents for small units fall below 45% of prime, and the differential was at its narrowest in 2008, when rents for small units in City Core, City Fringe and Victoria were between 75% and 76% of prime. By 2009, the gap had settled so that small units were achieving between 63% and 68% of prime rents and then, from 2010 to 2013, the differential settled at a larger discount to prime but began to narrow again in 2014.

We suggest that achieved rent for small units as a percentage of prime rent in each sub-market would be a useful indicator to use as a benchmark to monitor the supply-demand balance of small units. As the gap between rents achieved and prime rents narrows, this will suggest a strengthening of demand relative to supply of small units. Conversely, as the gap widens, this would suggest a weakening of demand relative to supply and/or no supply constraints. In 2014, the difference in rent per sq ft for average rents achieved in small units was 41% and they were, on average, at a 50% discount to prime rents (Figure 5.10).

Figure 5.9 Rents achieved, small units, as % of prime, 2005-2014



Source: Cushman & Wakefield/Ramidus Consulting

Figure 5.10 Rental analysis 2014 (based on average rent achieved)

Rental benchmark	
Average achieved rent	£39.66
Range of rent	£40.00
Lowest	£27.40
Highest	£67.47
Lowest as % of highest	41%
Prime rent	£78.93
Discount average to prime rent	50%

Source: Cushman & Wakefield/Ramidus Consulting

5.4 Summary

- Take-up of small units has been on a declining trend since 2009.
- Small unit take-up has trended downwards, even as overall take-up has trended upwards.
- The decline in take-up was most marked on the City Fringe.
- The availability of small units fell by 33% between 2010 and 2014, a much steeper decline than overall availability and small units made up a diminishing share of all space available.
- The sharpest decline in availability was on the City Fringe (63% down between 2009 and 2014).
- The City Core consistently had the highest level of availability.

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- Mayfair/St James's also experienced steep decline from 2009 to 2014 but Soho/Covent Garden was relatively stable.
- South Bank and Midtown experienced rising supply and take-up – suggesting that these two areas may have been able to accommodate overflow from more constrained markets.
- Rental growth between 2005 and 2014, based on rent achieved for small units, ranged from 23% (2% pa) in Victoria to 81% (8% pa) in Soho/Covent Garden.
- The equivalent annual rental growth for the years 2010 to 2014 was 14% on City Fringe and South Bank and 17% in Midtown and Covent Garden.
- In 2014, the average achieved rent was 50% of prime rent.
- In 2014, there was a 41% differential between the average rent achieved in the highest and lowest value sub-markets.
- City Fringe data suggest supply constraint, but rents have not spiralled. It is not as geographically sensitive as has been widely understood. In fact it is amorphous and is leaking into neighbouring areas.

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6.0 Strategic and local implementation of Policy 4.3Bc

In this section we assess strategic and local implementation issues in connection with FALP's small office Policy 4.3Bc in different parts of CAZ. We focus in particular on policies to protect small offices. Policy 4.3Bc states that

> *… where justified by local and strategic office demand and supply assessments and in areas identified in the LDF as having a particular need for local office provision, provide protection for small scale offices (under 500sqm or a justified local threshold) within the CAZ.*

6.1 Issues and policies for protecting small offices

We asked the Boroughs which policies were being used in their Local Plans to protect small offices and small office uses; how workable these have been in practice, and whether any issues had arisen in implementation. The responses are set out below.

> **Camden** Under Core Strategy Policy CS8 the Council seeks to maintain a strong economy by safeguarding existing employment sites and premises that meet the needs of modern industry and other employers. While not specific to small premises, this commitment follows through to Policy DP13 under which the Council seeks to retain land and buildings that are suitable for continued business use and resist a change of use to non-business.
>
> Where applications involve premises or sites that are suitable for continued business use, the Council will consider redevelopment proposals for mixed use schemes provided that premises suitable for new, small or medium enterprises are provided. Furthermore if a proposal involves the loss of a business use, the Council considers whether the existing site provides a range of unit sizes, particularly those <100 sq m.
>
> At the time of writing, the Council is consulting on a Draft Local Plan. Revisions include policy requiring two year marketing evidence where the proposal involves loss of office floorspace. References to 100 sq m are removed, but there is a strengthened approach to protecting premises suitable for start-ups, small and medium sized enterprises (Policy E2). When considering suitability of existing employment premises, Council will take into account the range of unit sizes provided, particularly suitability for small businesses.
>
> **City of London** Policies CS1, DM1.1, DM1.2 and DM1.4 all seek to protect existing offices, including small offices. Other land use policies in the Plan allow for change of use from office only where the proposal is not contrary to Policies CS1 and DM1.1. Office protection policies are reinforced by the Office Use SPD which outlines the evidence required to support proposals involving a loss of office accommodation. Proposals are required to be supported by detailed marketing and viability information to demonstrate that office use is not viable in the longer term.
>
> Most schemes seeking a change of use have involved older office stock, small scale offices or offices in listed buildings or within conservation areas, where there is limited scope for refurbishment or redevelopment. To date, the City has not refused any change of use/redevelopment schemes under this policy alone – it is seen as an additional test which is used to support other policies. Where

loss has been accepted the space has generally been older stock which has not been refurbished for 15-20 years and where the cost of refurbishment to Grade A standard exceeds the viable return to be gained from letting the building.

Hackney The Council does not specifically protect small offices, but takes a broader approach to offices. Core Strategy Policy 18 (Promoting Employment Land) and DMLP Policy DM14 (Retention of Employment Land and Floorspace) require applicants to provide justification for the loss of employment floorspace through robust marketing evidence. This evidence must demonstrate that there is no demand for the existing land and or in its current or former use.

Islington Office to residential PD rights (outside CAZ) have exacerbated loss of small offices, and circumvented local policies. The Council takes a direct approach to small offices. In its Core Strategy Policy CS13 the Council seeks to protect units suitable for SMEs. General policies to protect office uses (DM5.2 and BC8) apply regardless of size. Policy DM5.4 has a specific focus on small office floorspace, although it relates more to affordability and promotion of new uses than to protection (which is covered by other policies). Policy distinguishes different types of SME space, either self-contained small units or affordable workspace.

There are two main ways in which applicants can seek to justify the loss of office space. First, they can submit two years marketing and vacancy evidence. Secondly, in certain exceptional circumstances, they can submit a market demand analysis. The Council notes that experience has shown that the quality of marketing and vacancy evidence has been mixed, and there have been a number of circumstances where a market demand analysis was accepted in circumstances which were not considered exceptional. In cases were an application has been refused due to loss of office, and subsequently appealed, decisions have been mixed, reflecting potential inconsistency in decisions regarding quality of evidence that they find acceptable.

Lambeth Core Strategy 2011 (Policy S3); the Saved UDP (Policy 21), and the emerging Lambeth Local Plan Policies ED2-3 all offer protection. Loss of offices is allowed if it can be shown through marketing evidence that there is no demand for continued use. In these instances conversions to hotels or residential have been approved in CAZ.

RBKC Policy CF5 seeks to protect all offices (of all sizes) in larger town centres. There is a presumption against the loss of offices in CAZ. The principal exemption is that within a larger town centre (e.g. Knightsbridge), an office can be lost when being replaced by a social and community use which serves Borough residents or another (non-residential) town centre use where this allows the expansion of adjoining premises.

The Borough's share of CAZ is small, and has only a limited amount of B-Class floorspace within it. However, the approach has proved successful: there are no known applications which have resulted in the loss of B-class floorspace within CAZ since the adoption of the Core Strategy in 2010.

It is believed that the Borough has benefited from the Borough-wide exemption to the PDR relaxation. Not only has this retained the ability to determine such applications – but has also been used (successfully) as evidence that the office sector is of particular value, and that any loss will be negative.

Southwark Core Strategy Policy 10; Policy 1.4 and Policy 1.5 have been adopted and are regarded as being effective. The Council requires robust evidence on marketing, demand and viability to be submitted to support development proposals which involve a loss of B-class floorspace. In the draft New Southwark Plan 2014 (Issues and Options consultation paper which will eventually replace the Core Strategy and Saved Southwark Plan), there is detailed information on what is expected in terms of evidence of viability and marketing. The Borough is also proposing to continue the approach taken in the current policies.

Tower Hamlets Core Strategy Policy SP06 (2b) states that Preferred Office Locations (POLs) are not appropriate for housing. The Council notes that this has provided protection to offices but has also been an issue in POL areas where developers have sought to implement housing schemes that are consequently not deemed policy compliant. Like Islington, the revised PDR for office to residential conversions have undermined a number of Local Plan policies but most markedly DM16 of the Managing Development DPD (2013) and SP06 of the Core Strategy (2010). The proposed removal of exemption areas to new PDRs is not supported by the Council (in common with the other CAZ Boroughs).

Wandsworth Adopted DMPD Policy DMTS13 protects offices in town centres as well as A2 uses which can include office-type businesses, such as solicitors' offices above shops, which tend to be smaller and more locally-based. Evidence in the 2010 Employment Land Review identified a need/demand for local office-type accommodation above shops. To date there have been no issues with implementation, notwithstanding PDRs. DMPD Policy DMI3 covers protection of employment land in the Thames Policy Area which includes B1a uses. Any loss must be justified against criteria, including marketing information. Again, this is evidenced by the 2010 Employment Land Review.

Westminster No policies currently offer protection for offices or small office uses. A previous policy which protected small offices in the UDP was not 'saved'. This policy sought to prevent smaller offices being turned into larger offices. The policy was considered to be problematic because (a) the majority of small offices are within bigger buildings; (b) as demises within larger buildings, they are not subject to planning permission and (c) the Council did not wish to be constraining development potential. Any new small office policy would need to be based on the loss of small offices to other uses, securing them through legal agreement. The Council is not specific but S1 has a section on a range of accommodation. At the time of writing, Westminster's approach to protection of office is under review.

6.2 Summary

The question here asks whether local plans offer some protection for offices or small office uses; how workable these have been in practice, and what issues have arisen in implementation. Responses suggest that all Boroughs, except Westminster, provide general support for offices (on grounds of employment growth, supporting London's role, etc.). However, only half of the Boroughs offer at least some protection specifically for small office premises. These range from protecting existing premises from conversion (Southwark; Wandsworth) to securing new provision in larger new schemes (Camden, Islington, Lambeth).

Figure 6.1 Summary of small office protection policies

Borough	General support for offices?	Protection for small offices?	Specific policy for small offices?
Camden	Yes	Yes	Camden Draft Local Plan 2015 Policy E2: "*We will consider redevelopment of the premises or sites that are suitable for continued business provided that … the proposed premises are suitable for the continued use of the existing businesses or they are suitable for start-ups, small and medium enterprises, such as managed affordable workspace*".
City	Yes	No	The general office policies of the City afford some protection to small offices.
Hackney	Yes	No	The general office policies of Hackney afford some protection to small offices.
Islington	Yes	Yes	Core Strategy Policy 13: (a) for new employment space: "*requiring a range of unit types and sizes, including those suitable for SMEs*"; and (b) for existing employment space: "*protecting units which are suitable for SMEs in terms of their type and size*".
Lambeth	Yes	Yes	Saved UDP Policy 21 (iid) states that large-scale office developments "*should include an element of small office suites on site or in the vicinity … A significant element will be required where the existing site includes small office suites or where an alternative permission exists, or is proposed for a site, which includes small units*". Also small office units are protected in Brixton town centre (unless these are longstanding vacant space above shops).
RBKC	Yes	No	n/a
Southwark	Yes	Yes	CS Policy 10: "*Protecting small units … and encouraging provision of flexible space to help meet the needs of the local office market and independent retailers".*
Tower Hamlets	Yes	No	n/a
Wandsworth	Yes	Yes	Policy DMTS13(b): "*Net loss of B1a office floorspace in town centres, through change of use or redevelopment (including floorspace above shops), will not be permitted unless there is compelling evidence which clearly illustrates that there has been no demand for such space and that there is not likely to be in the foreseeable future"*.
Westminster	No	No	n/a

Small Offices and Mixed Use in CAZ

While not specifically for small offices, most of the Boroughs require evidence of marketing activity and of demand and viability in order to justify a loss of office space. However there is little consistency in approach between the Boroughs.

Marketing evidence normally involves proof of active marketing for 18-24 months, with evidence of vacancy and of the marketing campaign itself (including number and details of enquiries received, viewings undertaken, etc.). LB Southwark directs that the premises/site should be marketed at a price and associated terms that are commensurate with market values; and that the lease terms offered should be attractive to the market.

Market information requested often includes up-to-date information on business floor space available in other similar properties within the market area; rents achieved, and independent commentary on the current and likely future demand for floorspace within the area.

Viability evidence supporting an application is normally expected to cover information relating to the existing use of the building and the proposed alternative use, and might include survey information refurbishment requirements; the cost of existing and prospective building maintenance, the costs and practicalities of refurbishing or redeveloping the building for office use; information on rents and capital values, anticipated rates of return and an existing use valuation.

It should be stressed that these are approaches to the protection of employment use, rather than small offices specifically. It is also tacitly acknowledged that the quality of marketing and viability information is variable, and that there are some difficulties in maintaining these at a high level. This is acknowledged by market practitioners, and it is difficult to see how this could be different, given the variability of market information readily available. A marketing period of 18-24 months would seem to be more than adequate (certainly in a market up-swing, and probably during a downturn).

7.0 Implementation of London Plan Policy 4.3Aa

In this section we address two distinct elements of the project brief. The first part includes an analysis of how London Plan Policy 4.3Aa is being implemented in practice, including Local Plan policies and through development management. Policy 4.3Aa states that

> *Within the Central Activities Zone and the north of the Isle of Dogs Opportunity Area … increases in office floorspace, or those above a justified local threshold, should provide for a mix of uses including housing, unless such a mix would demonstrably conflict with other policies in this plan.*

In other words, the policy requires increases in office floor space in CAZ to contribute to housing provision. FALP introduced local flexibility in the operation of the policy with thresholds for increases in office floorspace above which the policy would apply.

The second part (Section 7.5) includes a fine-grained analysis of development decisions in different parts of CAZ, drawing on monitoring data from the London Development Database.

7.1 Thresholds

This section describes how London Plan Policy 4.3Aa is being implemented in schemes. We asked the Councils whether that had employed any thresholds to date in policies designed to protect office uses or to trigger the provision of housing in mixed use policies. The responses were as follows.

> **Camden** does not have policy thresholds for protecting office space. The guidance states that the Council will take into account the size of office floorspace when considering change of use. Office premises of <100 sq m are considered small. Under Development Policy DP1, where more than 200 sq m (gross) of additional (any) floorspace is provided, the Council requires up to 50% of all additional floorspace to be housing.
>
> **City of London** does not operate a policy allowing for the mix of office and residential development. New office and other commercial development is required to make a financial contribution towards the provision of affordable housing elsewhere in the City or in close proximity to the City (the scale of the contribution is set out in the City's Planning Obligations SPD). Office protection policies are applied to all schemes where there is the potential for the loss of office floorspace, except where the loss is to an identified complementary use which is considered to support the wider business city. There is no numerical threshold over which office protection policies apply.
>
> **Hackney** does not have thresholds within its policies designed to protect office uses or to trigger the provision of housing, but seeks to protect all employment floorspace within the Borough. Core Strategy Policy 18 states "*The Council will protect employment land and floorspace last used for employment purposes anywhere in the Borough*."
>
> **Islington** does not use thresholds to protect office uses. The CAZ mixed use policy in BC8 (Part D) and DM5.1 (part E) is triggered on major applications. Where housing comprises less than 20% of total net increase in office

floorspace within an application, an off-site housing contribution is sought, based on a formula set out in Council Planning Obligations SPD.

Lambeth does not operate thresholds, except in order to define small offices – 1,000 sq m.

RBKC uses Policy CF5 which protects all offices in areas with a PTAL of 4 or above (all of the Borough's CAZ area). Elsewhere, the Council introduces different approaches for small offices (up to 300 sq m), medium offices (301 to 1000 sq m) and large offices (>1000 sq m).

Southwark's saved Southwark Plan Policy 1.4 has exception criteria (marketing, viability and feasibility criteria (a) and (b)). However, criteria (c) of Policy 1.4 permits the replacement of B-class floorspace in town centre locations with suitable A-class or other town centre uses. Where an increase in floorspace is proposed, the additional floorspace may be used for suitable mixed or residential use. However The Council has proposed in the New Southwark Plan a more restrictive approach, permitting only the ground floor to be used for suitable town centre uses.

The recently adopted Section 106 Planning Obligations/CIL SPD requires a planning contribution from developers who cannot meet any of the criteria set out in the saved Southwark Plan Policy 1.4 (and in exceptional circumstances where the scheme is considered to be acceptable). The planning obligation will contribute towards skills and employment programmes where employment floorspace in protected employment locations is lost.

Tower Hamlets does not apply thresholds. Its Annual Monitoring Report monitors the following but not as a threshold: applications for loss/gain of floorspace within Preferred Office Locations (sq m), and applications for loss/gain of B1 floorspace within Local Office Locations (sq m).

Wandsworth does not use thresholds

Westminster is currently considering whether
Office protection - considering whether or not being purpose built for residential should be a reason to let it go - consultation results are polarised. In terms of mixed use, the Council had a 200 sq m (400 sq m for retail/private social/community) threshold; and is moving towards a more lenient uplift threshold (30%+ applied flexibly, 50% + full requirement). The Council is also looking at introducing a mixed use requirement for commercial from office to residential conversions.

Summary
Eight of the ten Boroughs have not employed any thresholds to date in policies designed to protect office uses or to trigger the provision of housing in mixed use policies. The other two were not unequivocal.

In some areas outside CAZ, RBKC has different approaches for small offices (up to 300 sq m), medium offices (301 to 1000 sq m) and large offices (>1000 sq m).

7.2 The extent to which housing has been delivered

We asked the Councils to comment on the extent to which additional housing and affordable housing has been delivered as a result of London Plan and Local Plan office/mixed use development policies. The responses were as follows

Camden's priority is for the on-site provision of any secondary uses as part of mixed use developments, particularly where the proposals involve additions of more than 1,000 sq m. Where the proposal involves <1,000 sq m of additional floorspace, the Council will consider an off-site contribution. Para 1.17 of Development Policies sates that exceptionally, where a secondary use is appropriate for the area but cannot be achieved on site, and it is demonstrated to the Council's satisfaction that no alternative site is available in the area for the secondary use, it may accept a payment in lieu of provision, directly related in scale and kind to the development proposed.

The Council's experience has been that most additional floorspace comes from office premises and secondary use would be housing as that is the priority use class in Camden. Negotiations usually involve viability of secondary uses on site. For example, housing requires separate entrances/cores which make it difficult to justify due to high development costs. Furthermore, affordable housing Policy DP3 requires provision of affordable housing where the proposal is for the creation of 1,000 sq m of more residential floorspace. Change of use to residential is also covered by this Policy. Where that is the case the Council expects affordable housing on site which would have another separate entrance/core for easy management by housing associations/the Council.

City of London does not operate a mixed use policy, but seeks financial contributions from new office development towards the delivery of affordable housing elsewhere in the City or in close proximity to the City. Contributions are sought on the uplift in office floorspace over 500 sq m, at a rate of £20 per sq m. Details are set out in the City's Planning Obligations SPD.

Hackney is able to provide data on net changes in B1a floorspace as any change in this floorspace (even below 1,000 sq m) has been recorded on the LDD along with details of net housing and affordable housing. Details on cash in lieu and off-site affordable provision are not readily available.

Paragraph 4.10.10 of the DMLP states that "*Proposals in the CAZ for redevelopment of floorspace other than office floorspace must comply with the other requirements of Policy DM17 [Development Proposals in Priority Employment Areas (PEAs)]*". Policy DM17 states that residential as part of mixed use schemes in PEAs are acceptable as part of employment-led mixed use development. In exceptional circumstances residential floorspace may exceed commercial floorspace in development.

Council Policy on in-lieu contributions in relation to housing is covered by policy DM21 – Affordable Housing Delivery, which requires 50% of all dwellings in amended planning applications (i.e. through re-submissions or variations of existing planning applications or submission of a new planning application for an extension resulting in an increase in existing homes) that would provide 10 or more units in total, to provide affordable housing preferably on-site, or if not then in lieu.

Islington's Policy BC8 Part D applies; and there is just one known instance where it has been applied. In earlier drafts of the policy, the Council had specified a 'mixed-use exception' designation related to application of the off-site contribution, but this was subsumed into more general policy. Islington has a policy which states that proposals which reduce land available for conventional housing will be refused. Housing, particularly affordable housing, is a priority for Islington. But there is a question of balance on a case-by-case basis. In certain locations, and given certain site constraints, it might be more appropriate to promote a purely office-led scheme.

Lambeth's current policy on affordable housing is set out in Policy H2 of the Lambeth Local Plan. On-site provision is normally required, but off-site provision can be considered (as can payments in lieu in exceptional cases) as per the policy. Provision of additional housing as a result of mixed use development policies has been limited – the Council tends to secure mixed-use development through the conversion of offices to other uses.

RBKC reports that there has been no (very limited) creation of housing within CAZ.

Southwark's office floorspace is largely concentrated in CAZ and is the priority area in the Borough for the development of new office floorspace. For the assessment of all development schemes involving a loss or gain of B1a office floorspace, the starting point is assessing policy compliance in line with CS policy 10 and Policy 1.4 of the Southwark Plan.

A full justification needs to be provided for the loss of business floorspace, along with the provision of affordable housing off-site or payment in lieu, through a viability appraisal. Below are a few large schemes in CAZ where the Council has secured planning obligations for payments in lieu.

The Council secured a S106 financial contribution for the loss of business floorspace in the redevelopment of a site near Blackfriars Road (Samson House and Ludgate House). The Council also secured £65m for the payment in lieu of affordable housing.

The Council secured off-site affordable housing as part of the redevelopment of Fielden House site at London Bridge Street, with a payment of £18.8m if a land survey for donor sites is not agreed within a specified time period.

At Kings Reach Tower, Stamford Street, an affordable housing payment in lieu was secured for around £27m. The site was in business use, and now in mixed use.

Tower Hamlets ensures that development will be required to maximise affordable housing in accordance with the Council's tenure split (70% Social/Affordable Rent and 30% Intermediate) as set out in the Core Strategy.

Development should maximise the delivery of Affordable Housing on-site. Any off-site affordable housing will only be considered in circumstances where it can be demonstrated that (i) it is not practical to provide affordable housing on-site;

(ii) to ensure mixed and balanced communities it does not result in too much of any one type of housing in one local area; (iii) it can provide a minimum of 50% affordable housing overall; (iv) it can provide a better outcome for all of the sites including a higher level of Social Rent family homes and (v) future residents living on all sites use and benefit from the same level and quality of local services.

If a suitable site cannot be found, as stated in parts (i) to (v), in exceptional circumstances the Council will consider payments in lieu, ring-fenced for additional affordable housing output.

Wandsworth Former industrial areas and the Nine Elms area were identified as mixed use areas in the Core Strategy (2010) and London Plan. In general, performance on housing delivery in these mixed use areas, and especially in Nine Elms has been strong. However in some areas such as the Thames Policy Area, it has been difficult to prevent some losses of employment uses to housing where this has been justified on a site -by-site basis by evidence of unsuccessful marketing of the B1a uses.

There has been no off-site provision of affordable housing –the approach is to accept a commuted sum, in line with the approach in the London Plan, Core Strategy Policy IS5, and the Council's SPD on Planning Obligations.

There is one example where, on a riverside site, a commuted sum was received to provide Extra Care housing elsewhere in the Borough. No payments in lieu have been accepted relating to B1a uses.

7.3 Land swaps or packages involving offices and housing

We asked the Councils whether they had agreed to any land swaps or packages involving offices and housing. Camden and Westminster responded in the affirmative, and the former is cited below.

Camden particularly protects the legal character of the Inns of Court. SPD Camden Planning Guidance CPG5 – Town Centres, Retail and Employment, allows specifically for swaps between office and residential uses in the area to provide flexibility for legal businesses, while maintaining the overall stock of residential and office floorspace. This flexibility is used occasionally rather than regularly, with a case every three of four years.

In association with Policies CS1 and DP1, in the Central London Area and larger town centres, the Council seeks to ensure that significant additions to non-residential floorspace (>200 sq m) also provide an addition to residential floorspace.

Policy DP1 and supporting text para 1.16 allow the Council to take account of all related sites when assessing the housing requirement, and take account of any reduction of non-residential floorspace removed in conjunction with the off-site housing contribution. This provision effectively allows a land-use swap, with office floorspace consolidated in one location and office floorspace converted to housing in another location.

7.4 Mixed use housing credits

We asked the Boroughs whether they had agreed any mixed use/housing credits. Again, Camden and Westminster responded in the affirmative, and the former is cited below

> **Camden** makes an explicit provision for mixed-use/housing and affordable housing credits in its SPD Camden Planning Guidance CPG2 – Housing. This provision was introduced in April 2011, only applies in the Central London Area, and has not been used extensively.
>
> An example of use of an affordable housing credit and creation of a housing credit is provided by 2012/2045/P, "Erection of a part 3/4/5 & 6 storey building plus basement level for a mixed use development comprising 11 residential units (C3) and 253 sq m of office (B1) floorspace at part basement and ground floor level, following demolition of existing buildings at 73-75 Charlotte Street & 34-38 Tottenham Street and 4 Tottenham Mews". This scheme was banked as a housing credit as c1,700 sq m of housing was created on a site with a previous non-residential use. The scheme also took advantage of existing affordable housing (social rent) credits nearby at Suffolk House, a scheme originally proposed as a mixed market/affordable housing development, but now being delivered as a wholly affordable development. Delivery of the affordable elements at Charlotte Street and Suffolk House were secured by S106 planning obligation.

7.5 Analysis of development decisions

This section presents a fine-grained analysis of development decisions in different parts of CAZ, drawing on monitoring data from the London Development Database. The data cover the period 2005 to 2015, and relate to the ten Boroughs lying wholly or partly within CAZ.

Figure 7.1 summarises the average affordable housing associated with schemes involving a net gain/loss of B1 space, banded by size of B1 gain/loss. It can be seen that overall an average of 20 units were delivered (with none off-site). The average cash in lieu is almost £184,000, with wide variability. Where the loss was >1,000 sq m cash in lieu is obviously far higher that on smaller schemes.

Figure 7.2 analyses the same information in terms of the amount of affordable housing generated by schemes involving a net gain/loss of B1 space, banded by size of B1 gain/loss. It can be seen that over 29,000 units were delivered, with less than 1% of this provided off-site. Cash in lieu of affordable housing amounted to around £328m.

Only a fraction of approvals are actually realised in the form of completions, an issue not just confined to the CAZ boroughs, but across London as a whole. Appendix 4 presents the data contained within Figures 7.1 and 7.2 in terms of percentage based net gains and net losses.

Figure 7.1 Average affordable housing on schemes involving net gain/loss of B1 space, 2005-2015, CAZ Boroughs (gross approvals)

Size band (sq m)	Affordable units proposed, mean no per scheme	Affordable units acquired off-site, mean no per scheme	Cash in lieu of affordable housing units, mean £ per scheme
Gain over 1000	108	0	£777,436
Gain 500-1000	43	2	£269,028
Gain 400-500	19	0	£4,163
Gain 300-400	24	0	£15,156
Gain 200-300	26	0	£48,485
Gain 100-200	11	0	£14,964
Gain up to 100	6	0	£3,850
No change	16	0	£13,080
Loss 500-1000	10	0	£42,675
Loss over 1000	39	1	£1,383,331
Loss up to 500	4	0	£8,048
Grand Total	**20**	**0**	**£183,661**

Figure 7.2 Affordable housing on schemes involving net gain/loss of B1 space, 2005-2015, CAZ Boroughs (gross approvals)

Size band (sq m)	Number of affordable units proposed	Number of affordable units acquired off-site	Cash in lieu of affordable housing units
Gain over 1000	12,410	0	£34,984,638
Gain 500-1000	2,939	100	£12,644,323
Gain 400-500	325	0	£62,445
Gain 300-400	827	0	£485,000
Gain 200-300	1,070	0	£1,600,000
Gain 100-200	1,638	0	£2,050,000
Gain up to 100	1,252	2	£870,000
No change	208	0	£536,290
Loss up to 500	2,267	17	£6,961,521
Loss 500-1000	1,037	12	£6,742,691
Loss over 1000	5,222	65	£261,449,480
Grand Total	**29,195**	**196**	**£328,386,388**

Figure 7.3 provides a breakdown of the data by Borough in terms of average per scheme. It can be seen that, with the exception of the City and Westminster, there is reasonable consistency across the Boroughs. Tower Hamlets provide the largest average per scheme, at 82 units. Unsurprisingly, while not contributing significantly to the total, the City and Westminster generate large cash in lieu averages; although

even these are eclipsed by Southwark where average in lieu payments total over £412,000 per scheme.

Finally, Figure 7.4 analyses the number of units by Borough. The table is dominated by Westminster's cash in lieu figure of £237m (72%) of the total. The City makes the second-highest contribution (at £37.4m); while most Boroughs have quite modest figures.

Figure 7.3 Average affordable housing associated schemes involving net gain/loss of B1 space, by Borough, 2005-2015

Borough	Affordable Units proposed, mean no per scheme	Affordable units acquired off-site, mean no per scheme	Cash in Lieu of affordable housing, mean £ per scheme
Camden	51	0	£39,317
City of London	2	0	£389,246
Hackney	63	0	£64,574
Islington	68	0	£89,753
Kensington and Chelsea	72	0	£8,427
Lambeth	66	0	£0
Southwark	49	0	£412,502
Tower Hamlets	82	1	£73,483
Wandsworth	66	0	£58,500
Westminster	1	0	£219,435
Total	**20**	**0**	**£183,661**

Figure 7.4 Affordable housing associated with schemes involving net gain/loss of B1 space, by Borough, 2005-2015

Borough	Number of affordable units proposed	Number of affordable units acquired off-site	Cash in lieu of affordable housing
Camden	2,075	2	£2,830,815
City of London	50	6	£37,367,657
Hackney	4,673	0	£4,197,290
Islington	3,592	0	£3,051,594
Kensington and Chelsea	1,156	21	£750,000
Lambeth	3,306	0	£0
Southwark	2,978	0	£26,400,154
Tower Hamlets	6,735	100	£10,949,000
Wandsworth	3,362	17	£5,850,000
Westminster	1,268	50	£236,989,878
Grand Total	**29,195**	**196**	**£328,386,388**

The data in Figure 7.1 to 7.4 are as currently recorded through the LDD. We note that the database is reliant upon the input of data from the Boroughs and that it might not reflect the full extent of cash in lieu or off-site contributions.

8.0 The impact of viability on development activity

The brief required us to consider the impact of viability on the scale and mix of office development in different parts of CAZ over time, and to consider in particular, the implications of mixed use and the competing demands for office and residential use.

In general, viability is determined by the residual financial difference between 'end investment value' and the 'all-in' costs of construction. If the residual is positive the schemes is viable and vice versa. However, the reality is more nuanced. Viability is a matter of judgement. Thus, what makes commercial sense for one owner, does not satisfy the commercial priorities of another. The cyclical dynamics of supply and demand mean that viability varies over time and from location to location. A tired secondary building that is economically obsolete in one sub-market, could perfectly well meet demand in another and command a prime rent.

8.1 Overview

For this study, our assessment of viability is based on a series of interviews with landowners, property companies and advisors who are active in the Central London property market and are accustomed to making practical market-based judgements about development viability. We discussed with them the factors that influenced their development decisions.

These discussions took place in April and May 2015 against the backdrop of a decade of strong demand for residential property across London – albeit tinged with a relatively new concern that prices were becoming unsustainable in the central area – and a more recent resurgence in demand for office space with renewed rental growth in the office market after several sluggish years. Other than that, there were structural changes shaping the nature of demand for office space – and small units in particular – which have been described in Section 3.0.

In considering how planning can be effective in protecting the provision of small offices, two questions arise concerning viability.

- Is it appropriate or effective to use a viability test in any negotiations relating to a planning consent?
- How does the requirement for affordable housing affect the development decisions of owners and property companies – in other words, does it inhibit the normal flow of redevelopment?

We created a high-level viability model to table in the interviews, as a basis for discussing the differences between sub-markets and the economics of new build versus refurbishment or office versus residential. The components of the model were as follows.

- Office rent per square foot
- Office investment yield
- Residential unit sale price
- Construction costs

We did not make any adjustment for consistent variables such as the developer's profit or interest rates. Nor, based on the opinions of our interviewees, did we make any allowance for variations in the length of construction period or the extent of planning obligations although both of these vary widely, since they do not vary consistently by geography or type of scheme. The difference in construction period between a refurbishment and a new build is particularly significant in office schemes but can range from 6 months or less to 18 months or more, however in a low interest environment, the additional borrowing cost arising from a longer build-period is less significant. As for planning obligations, they are in theory, dictated by policy but in practice they are subject to negotiation between applicant and the planning authority and can vary with each individual scheme.

Figure 8.1 summarises the viability model. Each alternative development option is expressed as '£ per sq ft', since this is the metric used in the industry to measure office rents and is widely used to compare residential values. The model is highly stylised for the reasons explained above but provides a benchmark to demonstrate:

- how viability varies between sub-markets and
- that more than one type of development may be viable on the same site at the same time.

Thus, a development decision that makes sense in one market may not be the most appealing option in another and on the other hand, just because one scheme is the most viable at a point in time, does not mean that another scheme may not also be viable at the same time.

Figure 8.1 Modelling development options to compare viability

Prime office redevelopment	City Core	City fringe	Mayfair	Soho	South Bank	Midtown
Rent per sq ft	£ 64.50	£ 55.00	£ 120.00	£ 80.00	£ 55.00	£ 62.50
Yield	4.3%	4.5%	3.5%	3.8%	4.5%	4.0%
End investment value	£ 1,518	£ 1,222	£ 3,429	£ 2,133	£ 1,222	£ 1,563
Construction costs	£ 350	£ 350	£ 350	£ 350	£ 350	£ 350
adjust for void and rent free	0%	0%	0%	0%	0%	0%
NET VALUE PER SQ FT	£ 1,168	£ 872	£ 3,079	£ 1,783	£ 872	£ 1,213
Office refurbishment	**City Core**	**City fringe**	**Mayfair**	**Soho**	**South Bank**	**Midtown**
Rent per sq ft	£ 55.00	£ 55.00	£ 70.00	£ 65.00	£ 45.00	£ 55.00
Yield	4.5%	4.8%	3.8%	4.0%	4.8%	4.3%
End investment value	£ 1,222	£ 1,158	£ 1,867	£ 1,625	£ 947	£ 1,279
Construction costs	£ 100	£ 100	£ 100	£ 100	£ 100	£ 100
adjust for void and rent free etc	0%	0%	0%	0%	0%	0%
NET VALUE PER SQ FT	£ 1,122	£ 1,058	£ 1,767	£ 1,525	£ 847	£ 1,179
Residential conversion	**City Core**	**City fringe**	**Mayfair**	**Soho**	**South Bank**	**Midtown**
Sale price per sq ft	£ 1,000	£ 1,000	£ 2,000	£ 1,500	£ 850	£ 1,000
Conversion costs	£ 325	£ 300	£ 350	£ 300	£ 275	£ 275
Adjustment	0%	0%	0%	0%	0%	0%
NET VALUE PER SQ FT	£ 675	£ 700	£ 1,650	£ 1,200	£ 575	£ 725
Residential New build	**City Core**	**City fringe**	**Mayfair**	**Soho**	**South Bank**	**Midtown**
Sale price per sq ft	£ 1,500	£ 1,000	£ 3,000	£ 2,000	£ 1,500	£ 1,800
Construction costs	£ 400	£ 400	£ 500	£ 450	£ 425	£ 400
Adjustment	0%	0%	0%	0%	0%	0%
NET VALUE PER SQ FT	£ 1,100	£ 600	£ 2,500	£ 1,550	£ 1,075	£ 1,400

In the recent past, new build residential would have produced the highest value across much of the CAZ and, without the control of planning, all sub-markets were highly vulnerable to the further loss of office space. It is no longer the case that residential is always the development of choice and there have been several high profile examples of sites with consent for residential being re-submitted for office development.

In this, admittedly highly stylised model, only South Bank and Midtown produce highest residual values for new build residential. However, it also shows that, even if residential produces the highest residual value, it does not mean that office development is not viable. Indeed office development also produces attractive residual values.

The various options in the table assume the same quantum of space for purposes of comparison and the values are expressed as £ per sq ft. This helps to explain the fact that redevelopment is more advantageous only when there is a significant net increase in floorspace. In practice there are many factors that might influence development viability and these are described in the rest of this section.

8.2 Factors influencing development viability

We combined the feedback from our interviews with analysis of market data and the following text summarises the factors that were reported to us as having a material bearing on development viability.

> **Refurbishment versus redevelopment** Refurbishment is faster than redevelopment and it reduces the length of time that a building is not producing income for the owner. That alone is a significant attraction.
>
> In today's market office rental value is no longer directly proportional to the quality of the specification. In fact, as discussed elsewhere, many occupiers actively favour 'character' or 'simplicity' in an office space. This kind of space is far cheaper to deliver.
>
> Firstly, it generally shortens and simplifies the planning process, which represents a considerable saving of cost in planning and design fees, as well as reducing the lapsed time to bring the completed building to the market.
>
> Construction costs are lower for a refurbishment. They can be as low as around £50 per sq ft for a simple 'paint job' rising to £200-£230 per ss ft for a complete re-clad, structural alteration and new plant, in which case all that is preserved is the frame and foundation. In our model, we took a typical construction cost for a refurbishment to be £100 per sq ft compared with £350 per sq ft for a new build.
>
> A new build of around 10,000 sq m takes around 30 months from demolition to completion. A similar sized refurbishment takes between 12 and 18 months and that equates to a substantial saving of interest payments on construction debt and reduces the risk of a change in market conditions between taking a decision and bringing the completed building to the market. The rental value per sq ft for refurbishment in the current market might well be the same as a new build, as one interviewee pointed out: *"For a high quality full*

refurbishment we see no rental differential compared to a brand new building. Indeed a refurb may be more attractive to many tenants".

Development density is a major factor in determining viability If the site is fully developed and there is no scope for adding rentable floorspace, it is rarely economically viable to redevelop office space, since the additional rent per sq m almost certainly will not justify the additional construction cost and time delay. In these circumstances an owner will seek other ways to maximise or enhance value, and change of use is likely to be considered against the prospects of letting the space in its existing or refurbished condition.

If, on the other hand, there is potential to add significantly to the rentable floorspace on the site, redevelopment is likely to be the most economically attractive option. In the City for instance, many of the newest towers replace buildings that were less than half the size of the new tower. In this case, the uplift in rental value per sq ft, combined with the additional rentable floorspace, boost the end investment value and outweighs the higher construction costs of a tower. In other words, even though the differential in rental value per sq ft between new build and refurbished space has narrowed considerably (see below 'the premium for high specification office space has reduced'), the increase in density on the site (and thereby rentable floorspace) may be enough to tip the balance in favour of redevelopment.

The changing relative land value for offices versus residential Values for residential property rose consistently over the past decade, while office values fluctuated and, for part of the period, declined. These dynamics meant that relative land values shifted and change of use from office to residential became an attractive and economically viable option in many instances.

There was a period in the Central London market, after the financial crash, when office and residential uses appeared to be complimentary as demand for residential property took up the slack in the office market. Indeed, in 2008-11 much of Central London had rising office vacancy rates and falling rental values. In those circumstances the conversion of office space to residential often represented a welcome prop for investment values.

Recent anecdotal evidence suggests that the balance is tipping in many parts of the market and that offices are becoming the more economically attractive use once more. In other words, the balance in value between office and residential space is proving to be cyclical rather than structural in CAZ and the widespread appeal of residential land use was temporary, at least in economic terms. This is an important point because once a building has been changed from office to residential the change is long-term, even though the economic case may only have been short-term. That underlines the role of planning in protecting the urban fabric from the vagaries of short-term market cycles.

Differential rental growth While rental values in the City Core have changed little in 30 years, other locations have experienced steep growth as the relative values of different locations have changed. Office markets once considered to be 'fringe', have acquired the status (and value) of prime offices while mixed use, 'scruffy' streets have become desirable addresses. Again this underlines the role of planning in counterbalancing short-term shifts in value and popularity.

The nature of the existing building affects viability Buildings originally built as homes are often difficult to adapt as high specification, Grade A office space. The fact that many are protected as heritage stock restricts their use and their value to small units of low cost office space. Unsurprisingly, this kind of space lends itself most successfully to residential conversion and as demand for residential rose in Central London, competition between office and residential uses was particularly keenly felt on the provision of this kind of small and low cost office space. This is one reason for the particular pressures on supply in Mayfair, Soho and Covent Garden, which are reflected in falling vacancy (now less than 4% in the West End) and rising rental values.

The premium for high specification office space has reduced Changing occupier preferences have eroded the premium rental value associated with high specification office space. This has a profound impact on viability. Many occupiers in today's market express a clear preference for a more simple style of office with, for instance, bare brick walls, exposed ducts and concrete floors. In the area around Tech City for instance, occupiers often actively favour space that would conventionally be considered to be low specification and, as a result, the differential in rental value between low specification and high specification space is very slim, while location and building style are valued more highly.

This shift in the relative value of small, secondary units of office space compared with large, high-specification units, is part of a wider change in the nature of work and working styles described in Section 3.0. It has a material impact on viability calculations because it means that the cost to a landlord of delivering the kind of office space that occupiers want, has fallen dramatically. Nevertheless it may be a short-term preference and the relative values could easily shift again.

> "*a 1950s or 1960s building may have great character that can be retained and this may be more desirable than a new steel and glass creation".*

Time horizons of landowners affect their view on development viability The strength of the Central London residential market has made it possible to accrue large capital gains from developing and selling homes in Central London. Long-term landowners however, emphasise the importance of place-making at a local level and diversity of uses across an estate, in the interests of long term investment value and sustainable estate management. These priorities often mean that, even when residential development would yield the highest short-term return, their long-term strategy determines that retaining office use is the preferred option.

In addition the income yield is lower on residential than commercial property. The effective yield on residential property is 1.25%, compared with 3.5% or more for offices. So, for a long-term, income-driven investor intending to hold the asset, offices make more economic sense.

Residential landlords also shoulder the risk that the leaseholder will exercise their right to enfranchisement and in the long-term, another feature counting against residential for the long-term investor and estate manager.

Mixed use at ground level enhances value but residential within an office building is detrimental Mixed-use can add value to a building if it activates street frontage by creating interest and amenity at street level such as a coffee shop or retail presence. *'Retail and restaurants are a natural fit'.*

Residential use usually has a negative impact on value when it is an integral part of an office building because it creates a need for a separate entrance, and has implications for security and lease terms. One response, on larger sites, is to divide buildings into discrete uses: in other words, the mixed use is split vertically rather than horizontally. This enables individual buildings to be redeveloped or even sold separately. If the split is horizontal it creates conflicts in the design by requiring additional staircases or lifts and entrances and it severely constrains the landlord's ability to redevelop or refurbish the office space at any date in the future.

The high cost of construction for residential property affects viability The cost of finishing residential properties to the standard demanded by the market is very high and the contrast is particularly marked in comparison to the basic standard of finish in office space currently preferred by businesses such as tech and media. This tips the viability equation in favour of office use for income-driven investors especially those who intend to hold the investment for the medium- to long-term.

Requirement for affordable housing reduces profitability
While it is widely accepted that a planning consent carries with it an obligation to contribute in some way to the wider public good, an overly onerous requirement can lead to a development being shelved, or a renegotiation. The possibility of renegotiating planning obligations, where it can be shown that there has been a material change in circumstances or that the obligation would be detrimental to viability, has been the cause of growing debate.

There is no doubt that a requirement for affordable housing contributions and other planning requirements can, in some circumstances, tip a scheme from viable to unviable. In our discussions with developers, there was support for the notion that the requirement for affordable housing should not be a hard and fast rule but subject to negotiations, scheme by scheme, to ensure that projects are not shelved.

While this might seem to be a pragmatic approach, it relies heavily on a full disclosure and a sophisticated understanding of the financial equation on both sides of the negotiation as well as up-to-date knowledge of a very dynamic marketplace. In other words, in a less than ideal world, it may not produce the most balanced outcome.

Requirement for affordable workspace can render a development unviable One interviewee gave the example of a 3,000 sq m building purchased two years ago for £10 million and now valued at £15 million in its existing state. Planning consent to redevelop was granted with a requirement for 5% affordable workspace at £6-9 per sq ft, which tipped the viability calculation in favour of keeping the building in its existing state. That meant that the developer did not contribute any S106, rating uplift or stamp duty.

8.3 Summary

Even when it is arguable that almost any building could be more viable as high value residential than any other use but that does not mean that the building is not viable in office use. The temptation for an investor with short-term horizons to make a case for non-viability for any use other than residential has been, at times in the recent past, enormous.

Owners who invest for the long-term generally put the value of a whole place above the value of an individual building. In other words, they do not necessarily seek to maximise the value of a single site. That contrasts with owners of individual sites who will almost certainly to seek to maximise value on that site, at that point in time, since they have no pressing reason to be concerned with a longer term perspective.

Planning is in a position to take the long view and has an important role to play in preserving a 'whole place' and protecting buildings from decisions made in the interest of short-term gain.

There is growing recognition that successful placemaking includes a mix of uses, particularly at street level, to promote diversity and activity throughout the day, week and year. Small businesses are understood to be a critical component of a flourishing business ecosystem and thus it is important to make provision for small business units, if not directly from the building owner, then via a third party flexible workspace provider.

At this point in time, the priorities of many long term investors seem to be aligned with the priorities of planners and they share a desire for successful placemaking. That may not always be the case and neither is it necessarily the case with all investors or developers. For this reason, it is important to have policies in place to 'step in' when interests of the place and the wider community are in conflict with the interests of individual owners.

Our interviews together with the illustrative model, demonstrate that short term assessments of viability are highly sensitive to minor changes in rents, yields, costs and so on. Planning must take a longer view of the needs of the market and should consider the implications of viability five years hence or five years ago.

In the recent past, residential development has produced the highest value land use in every sub-market and without the protection of employment space, CAZ could have been very vulnerable to the further loss of office space. That balance has begun to shift in the very recent past in favour of office uses in which serves to illustrate the importance of policy designed to protect the long-term function of CAZ.

9.0 Conclusions and recommendations

9.1 Context

London's business geography is undergoing rapid change. The central area is expanding around its periphery. Areas that were formerly regarded as fringe locations have effectively acquired prime status such as City Fringe, King's Cross, Paddington and areas of the South Bank. Buildings that would have been described as 'secondary' or 'low grade' in the traditional market, can now command prime rents. Changes in workstyles are being driven by changing priorities of businesses and reflected in evolving workplaces. London's economy is shifting from one dominated by financial services to a more diverse one; with a strong growth in micro and SME firms. These changes are structural, or permanent, rather than cyclical responses to short-term economic cycles.

London is at a pivotal point in its evolution from a service economy dominated by large corporates based in monolithic office blocks, to a more diverse business ecosystem, based in more flexible workspaces with small businesses at its core.

Within this context, the Central London office market is functioning efficiently. It currently has a cyclical shortage of supply but a healthy development pipeline (albeit, at year end 2014, five very large schemes accounted for 26% of consented space[23]). Demand as expressed in take-up is strong. The London economy and office jobs look set for further strong growth (latest estimates show a growth in jobs from 5.5 million to 6.4 million, between 2014 and 2036[24]), which will encourage development activity. There is no evidence to suggest a looming high level capacity issue.

These things said, this project was instigated, at least in part, by a concern that there was a growing problem in the supply of small offices. For example, anecdotal evidence of small firms being squeezed out of Tech City (and elsewhere in CAZ) by rising rents; and of older office buildings being converted to residential use, have been interpreted as evidence that small firms are finding it more difficult to operate within CAZ; while the operation of mixed use policies might be reducing the viability of development that could result in the provision of small office space.

It is widely recognised and understood that change is occurring. But the question remains: is it a problem?

In particular, are supply and demand dynamics, and perhaps planning policy, inhibiting CAZ from providing for small businesses? Are they being squeezed? This is a particularly important question given the enormous pressure being exerted by the residential market on land values, and the resulting vulnerability of secondary commercial property. And as commercial values rise and development picks up, that too could further threaten the supply of affordable space and small units.

We have examined small offices not only in the context of current market dynamics but also in the longer term, with data from 1995-2014. We have quantified trends in the supply of small units and we have mapped their evolving spatial distribution. We have also quantified and assessed the impact of the office to residential conversions in order to assess its impact on small office supply. We have focused our analysis on CAZ while taking into account market dynamics in the CAZ fringe.

9.2 Providing for small offices

The evidence that we have examined suggests that there is some cyclical pressure on the supply of small units, but not a structural shortage. Values for both office and residential property are strong enough to support development activity and any development is likely to be at the expense of the most cost effective small units - which are generally found in buildings nearing the end of their lifecycle, or in small, heritage stock. These types of building are vulnerable both to redevelopment as prime offices and also for conversion to residential.

Small units <500 sq m make up 14% of the floorspace and 62% of the occupational units in CAZ. We found, as we expected, that small units are distributed throughout CAZ but our spatial analysis identified clusters in: Soho/Covent Garden; north east City Fringe; South Bank; Clerkenwell; Mayfair and St James's.

The amount of office space in CAZ occupied in small units increased from 2.07 million sq m in 1995 to 2.6 million sq m in 2010 but the total stock of offices expanded at a greater rate, and the proportion of stock made up of small units has declined since 1995 in every sub-market except South Bank and Midtown.

In these two sub-markets, small units made up an increasing proportion of the total – which strongly suggests that these areas have been able to accommodate overspill from other more constrained locations. Our analysis was confined to CAZ but we would expect to find similar pressures just beyond the boundary of CAZ, in the neighbouring markets.

There is now very strong evidence that the small office market is increasingly being accommodated within mainstream stock. Rather than occupying secondary, or even tertiary space, growing numbers of small businesses are accommodated in modern, good quality buildings. Whereas in the past institutional owners tended to focus entirely on large single occupiers, there is growing recognition that small occupiers play a critical role in the wider business ecosystem and as a seed-bed for larger occupational units. Past resistance to dividing buildings to lease to small office occupiers per se might, in time, become an old-economy problem.

This process is being encouraged by the rapid expansion of the flexible space market. Serviced office operators and workspace providers operate in between landlords and occupiers to manage the provision of small units on flexible terms. While the sector still only accounts for around 3% of all office stock in CAZ, our analysis of EGi data suggests that it has risen from 243,500 sq m in 1995 to 550,000 sq m in 2015 and from 150 centres to almost 300 over the same period.

The circumstances of a hedge fund paying £150 per sq ft for an office in Mayfair are clearly different to a technology start-up facing great uncertainty in business income. The question of property prices for small offices is therefore an important one. This is especially so as the link between rental value and building specification weakens: the quality of the specification is no longer directly proportional to rental or capital value.

Some locations have had disproportionate growth in rental value, driven by a new generation of businesses prepared to pay a premium to secure a pitch at the right address. This, together with the rising value of low specification office space, has created a perception that there is a shortage of small, economically priced units and of occupiers being 'priced out'. It is our view that, while some businesses that have been long-established in fringe locations will face unsustainable rental increases at rent review, CAZ is able to offer an acceptable range of rental values.

We analysed the range of rental values within CAZ for small units, based on rents achieved, and found that the average rent achieved ranged by £40 per sq ft from the lowest to the highest value. The lowest average rent in a sub-market was 41% of the highest. We would consider that to be a sustainable and healthy range.

9.3 The distribution of small offices

Indeed there is strong evidence of new locations being sought out and occupied by small businesses. For instance there is a discernible flow from Shoreditch into Aldgate, a new cluster is emerging around King's Cross, there has been an increase in small units at Paddington as it matures as an office location and the South Bank is growing in importance as a recognised destination for small office users.

We have shown how demand from businesses in the digital economy has been satisfied beyond the core Tech City area and that the growth in digital content firms has been faster in London than in Tech City. This serves as case study for demand for small units. We have anecdotal evidence that demand from the digital economy can be satisfied in a wide range of locations adjoining CAZ and elsewhere in London (such as Croydon, Richmond and Stratford). Its need to cluster is accepted but not its need to cluster specifically in Tech City. Indeed, the Tech City cluster is one of the more diverse small unit clusters.

It now seems likely that, if pressures on land in Central London persist, as they seem certain to do, clusters will emerge in other locations centred on transport nodes and residential communities. Tottenham and Brent Cross were cited to us as possible beneficiaries of an expanding business population. Old Oak Common has been mooted as a green tech cluster; Richmond has been named as a tech cluster, while Stratford and Croydon are being promoted as low cost alternative locations.

Small offices are, to some extent, dependent upon fringe locations that act as pressure valves when supply pressures build, leading to rapid rental growth. This being the case, then PDR could be a problem just beyond the CAZ boundary and there may need to be a transition or buffer zone between predominantly commercial and predominantly residential areas.

Some locations have experienced disproportionate loss of office space to residential and steep and continuous rental growth. This begs the question of whether these locations might merit some special protection. There is no doubt that the loss of office to residential space has created pressures in the core West End markets of Mayfair and St James's.

9.4 Policy issues

Given these overall conclusions, how has spatial planning responded? And how should it continue to respond? We have analysed the policy context with respect to small offices in all ten Boroughs covered by CAZ. There are a number of difficulties surrounding spatial policy intervention.

- Too much intervention (however that is defined) can have a repressing impact on the market. A delicate balance is required.
- It is difficult to control/dictate the structure of units within single buildings.
- Protection of older stock can cause difficulties where the stock is in effect obsolete due to condition, layout, access, servicing, etc. Though this is merited in the case of listed buildings.
- Encouraging small units in the case of new developments must ensure that the right kind of units are made available.
- The imposition of residential units in office schemes, based on absolute or percentage uplift measures, can impact negatively on the viability (and therefore deliverability of schemes).
- We have also outlined practical and investment value around mixed use within single building structures.

In terms of Policy 4.3Bc which allows for office protection where justified by strategic office demand and supply assessments or by particular demand, there is currently little direct protection for small offices, though protection is afforded indirectly by policies protecting employment uses and by heritage protection. Some Boroughs seek to protect and encourage start-ups and small business units (though not exclusively office).

In terms of resisting the loss of office stock, though not specifically for small offices, most of the Boroughs require evidence of marketing activity and of demand and viability. Marketing evidence normally involves proof of active marketing for 18-24 months, with evidence of vacancy and of the marketing campaign itself. Viability evidence supporting an application is normally expected to cover the existing use of the building and the proposed alternative use. There is little consistency between the Boroughs.

It should be stressed that these are approaches to the protection of employment use, rather than small offices specifically. It is also tacitly acknowledged that the quality of marketing and viability information is variable, and that there are some difficulties in maintaining these at a high level.

Policy 4.3Aa allows for developments to provide for a mix of uses, including housing, where the increase in office floorspace exceed a specified threshold. Eight of the ten CAZ Boroughs have not employed any thresholds to date in policies designed to protect office uses or to trigger the provision of housing in mixed use policies. It is clear that the extent to which both market and affordable housing has been delivered as a result of office/mixed use policies is relatively limited. The use of land swaps and mixed housing credits has been even less.

Our analysis reveals that just over 29,000 affordable housing units have been delivered between 2005 and 2015 on schemes that have involved a net gain or loss of B1 office floorspace. At the same time, over £328m of cash in lieu payments have been made.

Overall, spatial planning currently affords little protection specifically for small offices; and its implementation of mixed use policies to encourage the delivery of small units has had a limited impact. Moreover, policies that encourage the development of mixed use in office buildings have had mixed results.

9.5 Policy recommendations

Our overriding conclusion here is that, on balance, the provision of small offices in the current market broadly matches the level of demand. This is not to deny that some specific areas have experienced sharp rental hikes caused in part by supply constraints. But across the whole CAZ there remains sufficient choice. The market, both in the form of commercial developers and flexible space providers has, in recent times, responded to the demand for small units in a way that was not previously the case.

Neither does our overriding conclusion convey complacency. It is fully understood that while current conditions might be relatively benign in the small office sector, market dynamics can and do change markedly. It is for this reason, that we have outlined here a number policy implications and recommendations.

Current heritage policies can protect small offices by default Small units are not synonymous with small buildings. Small units can be accommodated successfully, often more successfully, within larger, sub-divided buildings. Policies to protect small buildings are not therefore particularly appropriate for addressing the needs of small occupiers. That is not to say they are not necessary for reasons of character or heritage; but they can have low value as office space because they do not suit modern workstyles. Having said that, buildings preserved through heritage policies can by default provide protection for small and economically priced office space.

Policies to protect employment uses help resist conversion to residential CAZ-wide policy protecting employment use is effective in assisting Boroughs to resist conversion across the whole CAZ and all office building types. CAZ exemption from PDR has enabled Boroughs within CAZ to implement their employment protection policies and the City has shown that these can be effective. In Westminster, where no policies were in place to protect employment uses, the loss of stock to residential has been substantial, and Westminster is now addressing this situation.

CAZ has a large stock of small units and has the capacity to resist change of use and so we do not see the need for CAZ-wide policies to protect small offices; and we remain cautious about the prospect of unintended consequences of planning policy.

It is our understanding that Government may now be considering the extension of PDR and the removal of the current exemptions in Central London and northern Isle of Dogs. If Government does remove the exemptions a co-ordinated approach to the introduction of Article 4 Directions by the relevant boroughs would be needed to ensure that London’s nationally and internationally significant business locations are sustained.

There should be no CAZ-wide policies specifically to protect small offices In the current market, the interests of long-term investors and spatial planning are aligned around a place-making agenda and the need for a balanced business ecology. The value of a mix of uses and a diverse business community is acknowledged to offer economic, social and environmental returns. We cannot assume that interests will always be aligned in this way and we should monitor market conditions (see ‘benchmarks’ below).

Small Offices and Mixed Use in CAZ

Small units are dispersed across CAZ, and areas with high proportions of small office buildings are generally protected by heritage policies. Given that a large and growing proportion of small units are accommodated within large multi-let buildings, and that our research suggests that this is the office type of choice rather than necessity, then the protection of small buildings would not, in any event, meet the need for small office space.

Small units should be provided within large-scale developments While there should be no CAZ-wide policies, we suggest that there should be policy to ensure that, particularly in areas where there are existing concentrations of small units, or the character of the area is attractive to small businesses, there should be provision within large development projects for space that can be used as small units. In the current market, developers with long-term or large scale interests are highly likely to provide for small units within a scheme, but there have been times in the market cycle when large single occupiers have been the preferred option for landlords, and this sentiment could return.

The level at which small office provision might be set should be the subject of further consultation, but a figure of between 3% and 5% of NIA might be appropriate. However, we recommend that the requirement should only apply to schemes in excess of 25,000 sq m, and that there should be a sliding scale of provision in which larger schemes provide more small units.

Rental discounts should count towards S106 agreements We recognise that it is important that to ensure an adequate range of rental values for small units (to ensure availability of economically priced space), and to monitor locations that are subject to upward rental pressure. We believe that locations beyond CAZ will play a critical role in meeting the need for a wide range of rental values. In order to encourage provision of economically priced space recommend that, if units are provided at a discount to market value, then that should be able to count towards a S106 agreement.

We recommend a series of market monitoring benchmarks Reflecting those adopted in the LOPR process, benchmarks of market dynamics could provide early warning of any impending shortage and trigger a policy response. We recommend that these benchmarks include measures for stock (including the flexible space market); availability (small offices as a proportion of total availability) and rent (‘affordable space as a proportion of prime rents). The benchmarks will identify areas of greatest demand for small offices, thereby enabling early policy responses.

- **Small office stock** Small offices currently comprise 14% of all CAZ office stock. This seems to represent an adequate ratio given current demand profiles. We suggest that monitoring should adopt this as the benchmark ratio for market balance in terms of supply. If and when small office stock offices falls below 14% of total stock, then this should be taken as a signal.

  We also recommend, given its rising significance, that the stock benchmark includes the flexible space market. Currently at c3% of stock, this would give an overall benchmark figure of 17% of all stock.

Small Offices and Mixed Use in CAZ

- **Availability of small offices** The extent to which small offices are being marketed indicates the level of choice available to small occupiers. We recommend that the availability benchmark should mirror the overall supply figure (i.e., currently 14%). If and when the availability of small offices falls below 14% of total availability, then this should be taken as a signal.

- **Rent levels of small offices** This benchmark seeks to identify whether the market is providing a range of prices and, in particular, that there is an adequate supply of ‘affordable’ or economically priced offices. The average rent achieved across the whole CAZ market should be taken as the base for this benchmark. If this average is at 50% or less of prevailing prime rents, then it might be considered that adequate choice is available.

These benchmarks have been suggested as suitable measures to indicate the health of the small office market, but we recommend that further work is undertaken to verify their veracity before being adopted.

There should be a Central Activities Transition Zone (CATZ) This transition zone will extend outwards beyond the CAZ boundary to ensure that employment uses are afforded additional protection (Figure 9.1). Given the continuing pressure from residential values in London outside CAZ, such a transition zone would offer additional support for small office users by extending the protection of employment uses within CAZ to the area most critical to their locational needs.

Figure 9.1 Proposed Central Activities Transition Zone

We suggest that the CATZ should form a one kilometre band wrapped around the CAZ, although we emphasise that the CTAZ as shown is indicative: further work would be required to define its boundary more precisely. **We further recommend that the benchmarks described above extend into the CATZ.**

Policy should exercise caution on mixed use policies We believe that policies aimed at including residential units *within* office buildings, especially more moderately sized buildings, is detrimental to encouraging redevelopment. We recommend greater encouragement of small units in larger developments, particularly within Opportunity Areas, where there is an opportunity to provide residential and workspace within the same scheme, but in discrete buildings/parcels of land. At master planning stage this can help to integrate a richer ecosystem of businesses uses that is more difficult to achieve at later stages of delivery.

The direct impact has been greatest in Westminster where net loss of office space has been most extensive. Rental growth has been steepest in Mayfair and St James's. However that has, in turn, exerted pressure in other locations, which have experienced demand from businesses displaced from the more traditional core office locations.

Appendix 1 The CAZ and boundaries used for market data

Figure A1.1 GLA CAZ boundary overlaid on London postcodes

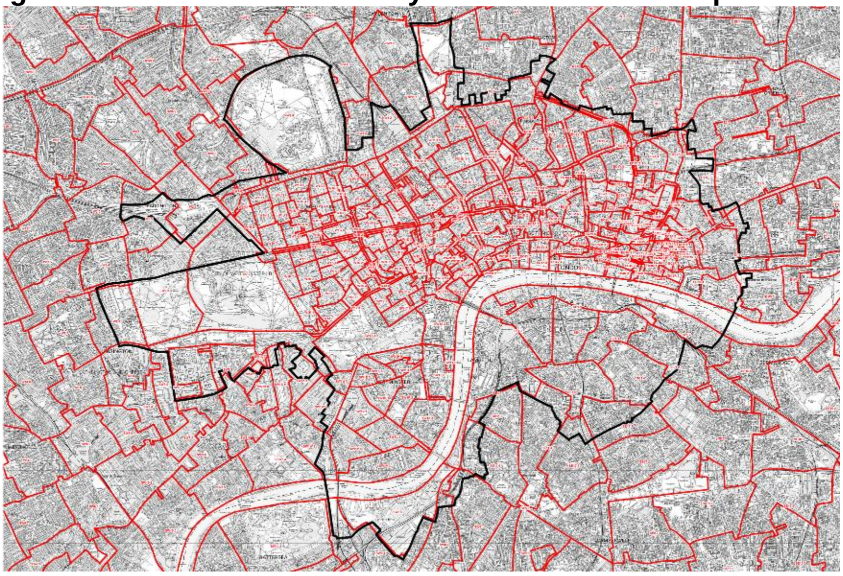


Figure A1.2 EGi London offices database: sub-market boundaries

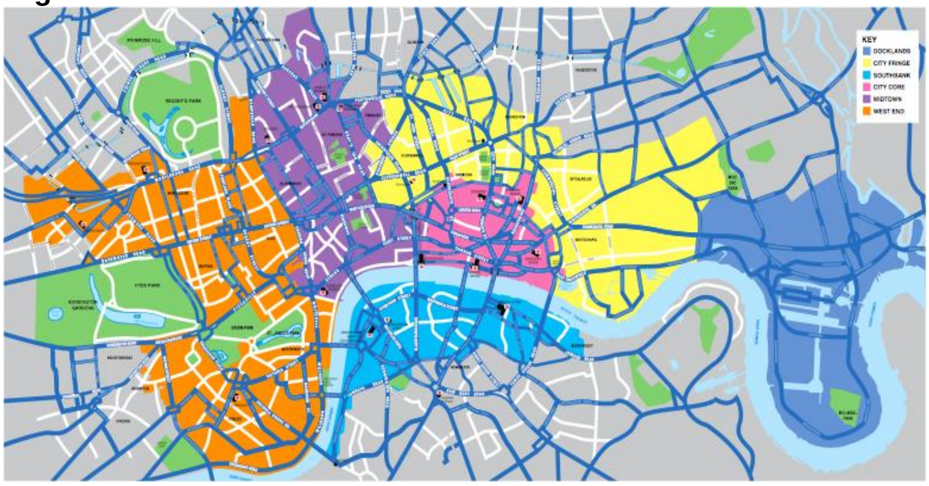
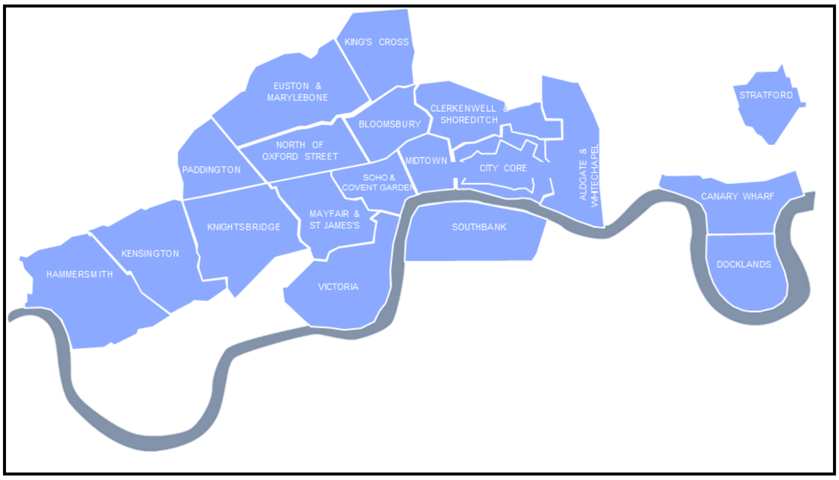


Figure A1.3 Cushman and Wakefield: Central London sub-market boundaries



Appendix 2 Calculating the number of small office occupiers in CAZ

The EGi London Offices Database is a comprehensive list of all occupations in office space in the Central Activities Zone and beyond into Central London. However, it has a minimum size threshold of 100 sq m (1,000 sq ft). In order to estimate the number of office occupations <100 sq m (1,000 sq ft) and also to verify the EGi data, we drew on ONS employment data which is collated at Borough level and segmented by either number of employees or 2007 SIC code.

Unfortunately there is no way to make a precise sub-set for CAZ, for size of occupational unit, or for office-based employment. We therefore made the following assumptions.

- An occupational unit of 100 sq m (1,000 sq ft) or less, equates to a business with 10 employees or less.

- The following sectors are mainly office-based: Business Administration & Support Services; Defence; Finance & Insurance; Information & Communications; Professional, Scientific & Technical; Property and Public Administration.

We calculated the percentage of all businesses in Inner London Boroughs with less than 10 employees (Table A2.1) and applied that ratio to the number of office-based businesses in Inner London(Table A2.2), to derive an estimate of office-based businesses in units of <100 sq m (Table A2.3).

Figure A2.1 Number of businesses by size, 2012, Inner London Boroughs

Borough	Total No. businesses	<10 employees	> 10 employees	% with < 10 employees
Inner London	**221,040**	**183,463**	**37,577**	**83%**
Camden	25,195	20,912	4,283	83%
City	16,795	12,596	4,199	75%
Hackney	11,815	10,397	1,418	88%
Hammersmith and Fulham	12,040	10,114	1,926	84%
Haringey	9,690	8,624	1,066	89%
Islington	14,495	11,886	2,609	82%
Kensington and Chelsea	12,885	10,823	2,062	84%
Lambeth	11,595	9,972	1,623	86%
Lewisham	7,940	6,987	953	88%
Newham	7,550	6,342	1,208	84%
Southwark	14,155	11,607	2,548	82%
Tower Hamlets	12,935	10,736	2,199	83%
Wandsworth	15,430	13,733	1,697	89%
Westminster	48,520	38,816	9,704	80%

Source: ONS/Ramidus Consulting
Note: Based on: ONS data for UK local units in VAT and/or PAYE based enterprises.

Small Offices and Mixed Use in CAZ

Figure A2.2 Number of office-based businesses by Borough, 2012

Borough	Office type businesses (No.)	As % of all businesses
Inner London	**120,110**	**54%**
Camden	14,355	57%
City	12,920	77%
Hackney	6,030	51%
Hammersmith and Fulham	6,270	52%
Haringey	4,065	42%
Islington	7,885	54%
Kensington and Chelsea	6,275	49%
Lambeth	5,820	50%
Lewisham	3,330	42%
Newham	2,660	35%
Southwark	7,465	53%
Tower Hamlets	6,635	51%
Wandsworth	8,170	53%
Westminster	28,230	58%

Source: ONS/Ramidus Consulting

Once we had found the number of office-based businesses for Inner London, (120,110) we were able to derive an estimate of the number of small office-based businesses in the CAZ. To arrive at that estimate, we took the following steps.

- Take the number of office-type businesses in Inner London (120,110).
- Multiply by the share of Inner London businesses with <10 employees (83%) to estimate the number of office-type businesses with <10 employees (99,960).
- Multiply by proportion of businesses in City and Westminster with <10 employees (77%) as a proxy for the CAZ.
- Estimate 79,417 businesses in the CAZ with <10 employees.
- This is our estimate for the number of office occupations <100 sq m.

Figure A2.3 Number of office type occupations

Component of calculation	Inner London	CAZ
No of businesses	120,110	
Estimated no with <10 employees	99,690	79,417
Estimated no with >10 employees	20,420	

Source: ONS/Ramidus Consulting

We cross-checked the estimate by comparing it with the number of office occupations recorded in the EGi London Offices Database. EGi records 19,200 office occupations >100 sq m in Inner London, of which 18,266 are in CAZ. The method, based on ONS data for the number of businesses (local units), estimates 20,420 in the CAZ. Thus we are comfortable with our estimate for small businesses <100 sq m.

Appendix 3 Analysis of growth in the Digital Economy in Tech City

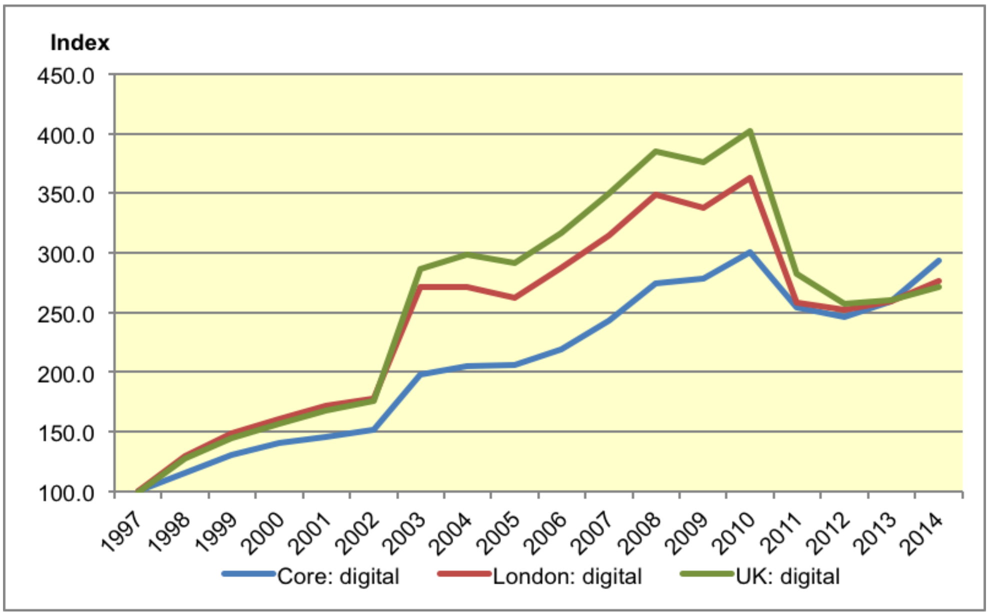
This analysis is based on research undertaken by Max Nathan at SERC and NIESR: London's Digital Economy: Firms and Jobs, 1997-2014: Analysis using plant data. SDS PROJECT 56588: EAST LONDON.

The research outlined some key facts about the digital economy in London. It compared firms and job counts in East London 'core wards' (Clerkenwell, Hoxton and Haggerston) with Greater London, and with the UK as a whole for the period 1997-2014. It used micro-data from the Business Structure Database (BSD). The BSD is provided by the Secure Data Service (SDS).

The research defined the digital economy following the BIS 2010 definition, and explored the two main components, ICT and digital content. It used SIC2003 codes to allow continuous analysis from 1997 through to 2014. In order to avoid disclosure, raw data is translated from plant-level (Local Units) observations to area-level aggregates, pooling across 4-digit SIC codes.

Figure A3.1 shows that the growth in number of firms in the Digital Economy grew faster in London and All UK than it did in Tech City between 1997 and 2010. After that, Tech City appears to have been more resilient. The number of firms fell in all three geographies – showing that Tech City suffered the same cyclical decline as other parts of London and the UK but to a lesser degree. Since 2013, the number of firms has expanded more in Tech City than for London or the UK.

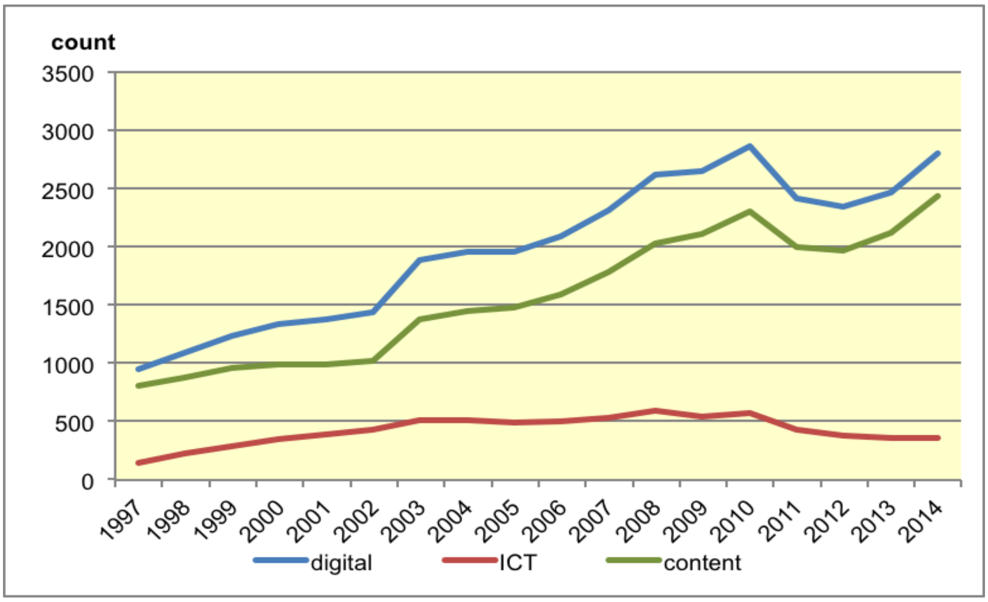
Figure A3.1 Firm counts for digital economy: indexed 1997=100



Source: BSD/SDS/Ramidus Consulting

An analysis of firm counts within the Tech City core wards shows that the growth in the digital economy has been driven by digital content rather than ICT firms (Figure A3.2).

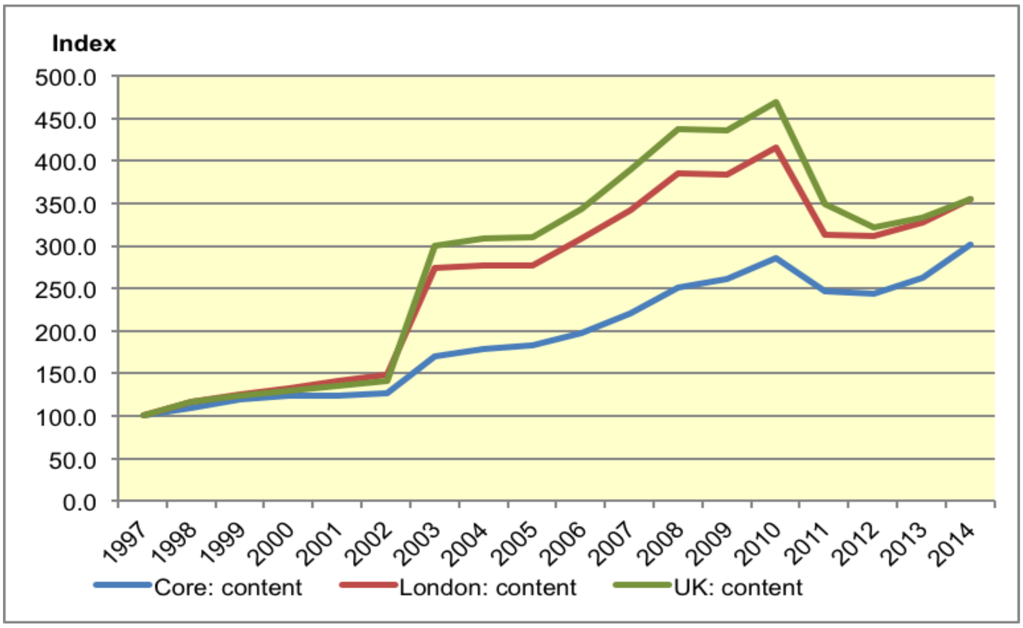
Figure A3.2 Firm count for digital economy, indexed 1997=100, for core wards (Tech City), 1997-2014



Source: BSD/SDS/Ramidus Consulting

However, the rate of growth in digital content has been higher in other parts of London than in Tech City as demonstrated in Figure A3.3. This supports our contention that tech businesses are not strongly tied to the Tech City geography.

Figure A3.3 Firm count for digital content, indexed 1997=100, for core wards (Tech City), 1997-2014



Source: BSD/SDS/Ramidus Consulting

Notes

(1) This analysis is based on data for business counts and employment numbers, taken from the Business Structure Database (BSD), - a version of the IDBR available to researchers.
(2) Digital economy firms are defined using a set of 4-digit SIC2003 codes, to make the analysis time-consistent.
(3) This data analysis uses wards to demarcate Tech City.
(4) 'Firms' in this data are 'plants', or 'local units' (branches of the business). This approximates more closely to our analysis of occupied units of office stock.
(5) Businesses enter the dataset once they have: a) at least one employee on PAYE and/or b) are paying VAT. They leave the dataset if they fall below this threshold.
(6) Data for company startups (from Companies House) show a significant increase in the past few years, whereas plant counts have been falling. But it is hard to say exactly where some of these new companies are trading, even if they are registered at a London address.

Disclaimer
This work includes analysis based on data from the Business Structure Database, produced by the Office for National Statistics (ONS) and supplied by the Secure Data Service at the UK Data Archive. The data is Crown copyright and reproduced with the permission of the controller of HMSO and Queen's Printer for Scotland. The use of the ONS statistical data in this work does not imply the endorsement of the ONS or the Secure Data Service at the UK Data Archive in relation to the interpretation or analysis of the data. This work uses research datasets that may not exactly reproduce National Statistics aggregates. All the outputs have been granted final clearance by the staff of the SDS-UKDA.

Appendix 4 Affordable housing on schemes involving net gain/loss of B1 space, 2005-2015, CAZ Boroughs

Figure A4.1 Affordable housing associated with a scheme involving net gain/loss of B1 space, banded by % of B1 gain/loss (gross approvals)

Size band	Total affordable units	Total off-site afford units acquired	Total cash in lieu Affordable Housing	Actual net/gain loss of B1
Gain 1-10%	846	0	£1,496,000	25,881
Gain 10-20%	329	0	£2,844,484	72,127
Gain 20-30%	79		£990,150	96,401
Gain 30-40%	91	0	£400,000	90,190
Gain 40-50%	737	0	£7,826,280	513,905
Gain 50% +	3,222	0	£8,541,020	2,490,859
Loss 1-10%	952	0	£1,867,320	-8,882
Loss 10-20%	251	0	£0	-29,454
Loss 20-30%	524	0	£0	-70,787
Loss 30-40%	258	0	£64,000	-7,571
Loss 40-50%	1,140	0	£788,951	-52,665
Loss 50% +	5,401	94	£272,433,421	-3,713,731
No or neglible change	150	2	£2,050,000	274
No prior B1	15,215	100	£29,084,762	2,484,849
Grand Total	**29,195**	**196**	**£328,386,388**	**1,891,396**

Figure A4.2 Average affordable housing associated with a scheme involving net gain/loss of B1 space, banded by % of B1 gain/loss (gross approvals)

Size band	Average affordable units	Average off-site affordable units acquired	Average cash in lieu affordable housing	Actual net/gain loss of B1
Gain 1-10%	53	0	£106,857	320
Gain 10-20%	37	0	£406,355	949
Gain 20-30%	26		£990,150	2,351
Gain 30-40%	18	0	£66,667	2,200
Gain 40-50%	37	0	£411,909	3,835
Gain 50% +	107	0	£502,413	15,666
Loss 1-10%	60	0	£169,756	-148
Loss 10-20%	23	0	£0	-545
Loss 20-30%	31	0	£0	-1,573
Loss 30-40%	26	0	£8,000	-280
Loss 40-50%	60	0	£37,569	-667
Loss 50% +	7	0	£238,349	-912
No or neglible change	13	0	£170,833	5
No prior B1	27	0	£58,170	1,290
Grand Total	**20**	**0**	**£183,661**	**276**

References and notes

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