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What's on the Horizon

The outlook for the real estate sector in 2023

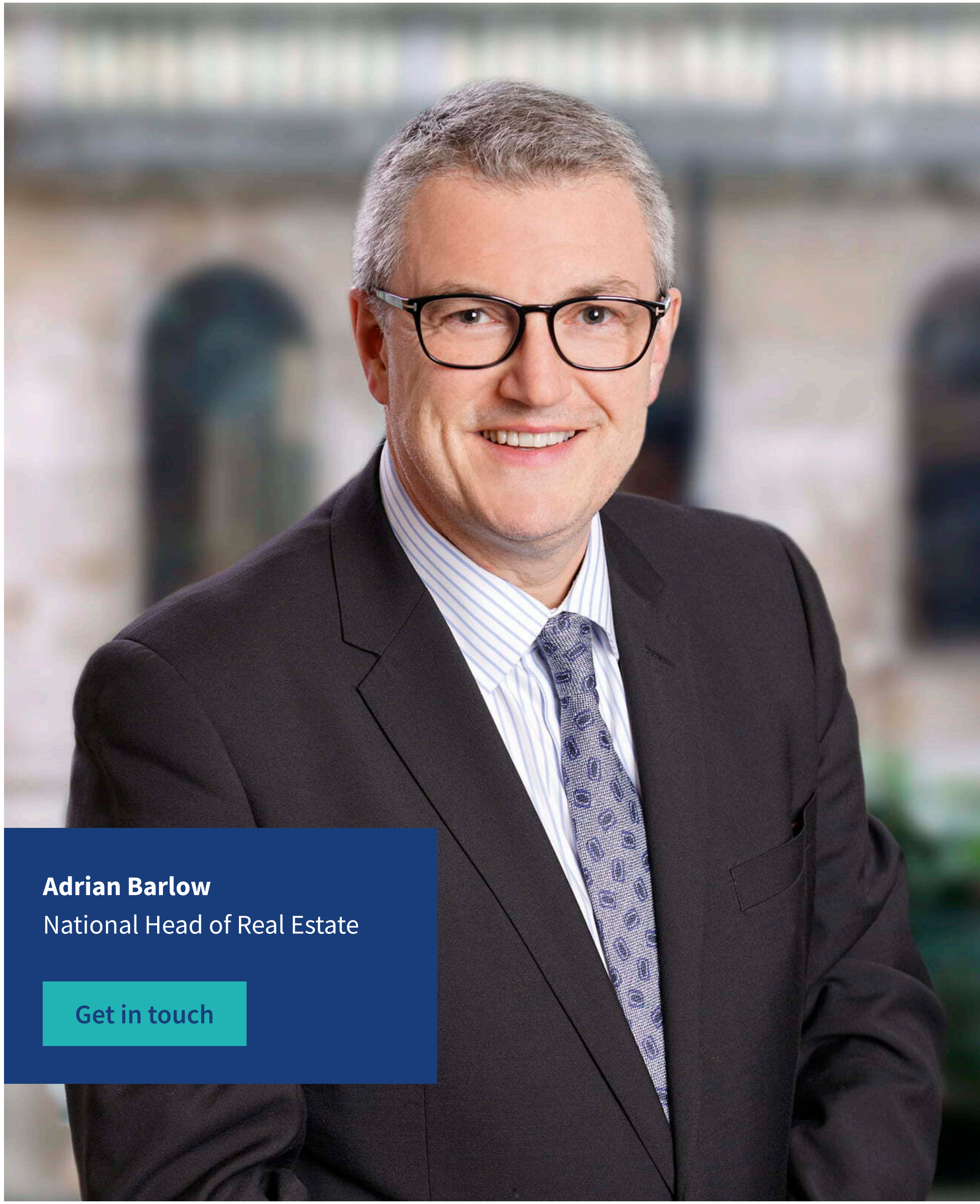
Welcome

Welcome

As we enter 2023, in the midst of a cost-of-living crisis with high energy prices, inflation, and an inconsistent approach to climate change, there's uncertainty about how this year will play out.

What we can already be certain of is the significant and wide-ranging new and proposed legislation on the way. This includes the Levelling-Up and Regeneration Bill, the Healthy Homes Bill, the potential Evictions (Universal Credit) Bill, and the Product Security and Telecommunications Bill.

Here's our summary of what's on the horizon for the real estate sector. We hope you find this a useful tool to help you identify and plan for changes over the coming year.



Adrian Barlow
National Head of Real Estate

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Environment

Environment

2022 has been a turbulent year. The country has faced floods and drought, multiple changes of leadership, and a new monarch.

COP(s) 27 and 15 closed with governments taking an uncertain approach to environmental protection and climate change. This has been pushed to the private sector where investors are taking a risk-averse approach to investment, causing businesses to have a more robust approach to their operations, and consumers and end users wanting to align themselves to organisations which share their values.

This means that, as we head into 2023, there's uncertainty about how the year will play out for the environment and who will pay the price for its protection.

Claire Petricca-Riding
Partner and National Head of Planning & Environment

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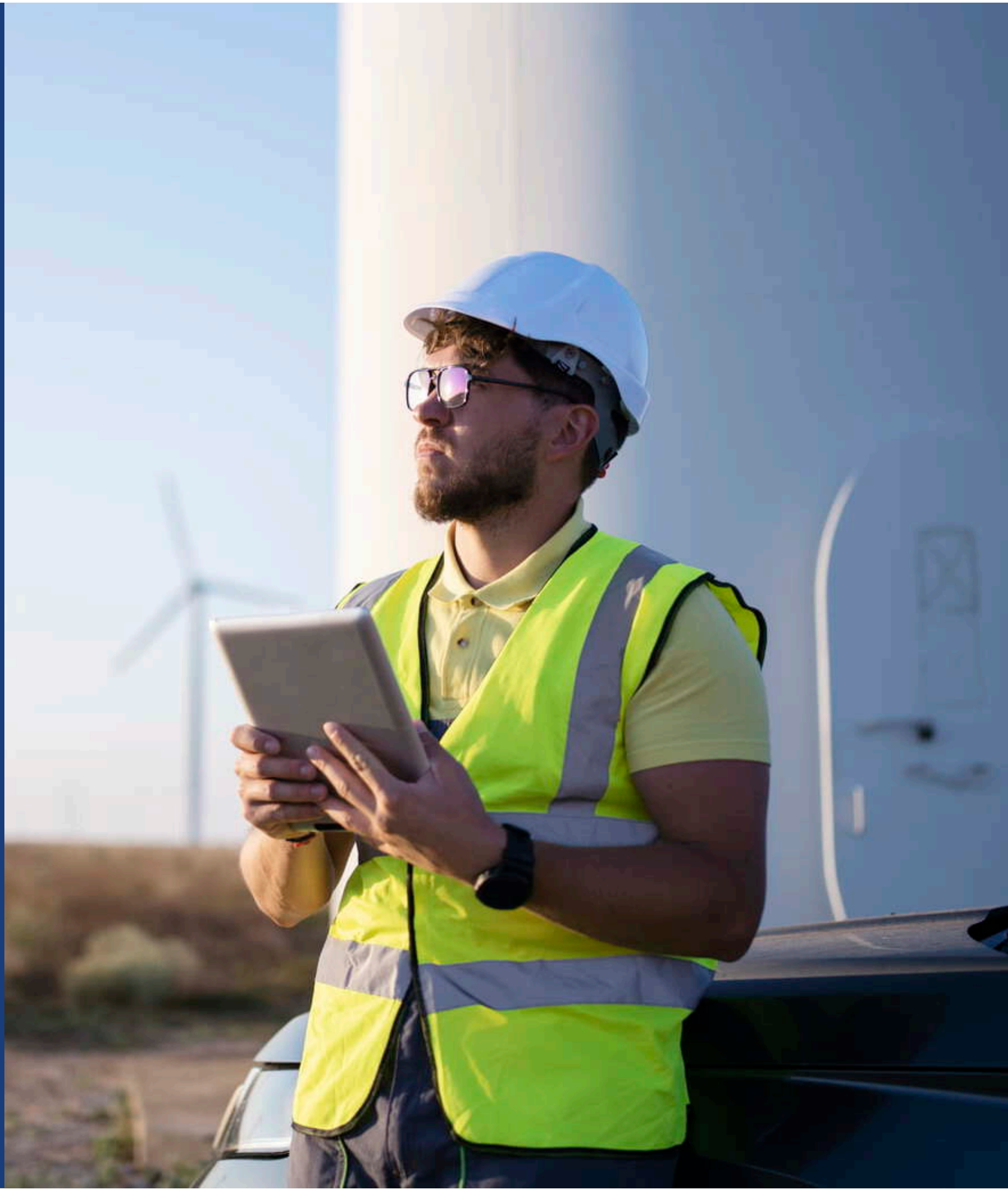

Retained EU Law (Revocation and Reform) Bill

This Bill seeks to remove all EU-derived legislation (not just environmental legislation) from our statute books by the end of 2023 – with a sunset clause at that time. That's unless ministers decide to keep those particular laws, with the current date for extension being 2026.

There are 2,400 reported pieces of legislation, with new ones being found every day. These need to be reviewed and a decision made about whether they're retained or removed. This is an onerous task, yet no further resourcing has been made available. There's the inevitable consequence that meaningful legislation will fall away, or a decision will be made which hasn't fully assessed the consequences. This could lead to a rise of litigation from organisations such as ClientEarth or the Good Law Project. It could also mean that the UK is in breach of international environmental obligations.

The effect this could have on the 25-year Environmental Plan and the targets under the Environment Act 2021, which are underpinned by the raft of EU-derived legislation, are unclear.

It remains to be seen what effect this draft legislation will have and whether it actually makes it to the statute book, but this may feel like a regressive step for the environmental sector.

Levelling-Up and Regeneration Bill

Currently sitting with the House of Lords, this has recently come under particular focus because of the implementation of housing targets.

One critical development for the environmental sector is the Environmental Outcome Reporting system, which will radically alter the Environmental Impact Assessment and Strategic Environmental Assessment regimes.

New methodology of analysis and reporting will need to be implemented, so we expect to see more information on this in the coming months.

Environment Act 2021 targets

In March 2022, the government launched a consultation on environmental targets. These targets are relevant for the UK because they're legally binding and, as the government pointed out in its original consultation, they will "allow for objective scrutiny and accountability of government's progress to society."

On Friday 16 December 2022, over six weeks after the statutory deadline as set out in the Environment Act 2021, the government published the long-awaited response to its environmental targets consultation. This contains the final version of these legally binding targets.

The next step for the government is to issue an Environmental Improvement Plan, which is legally required to be published in January 2023.

Green groups have already published their opinions on these new environmental targets and have qualified them as providing "very little change," being "weak and unambitious" and being only a "job half-done." While we don't take the same stance as these green groups, we understand their frustration as very few of the changes proposed by the consultation respondents were implemented in these targets.

Read more about the targets

Air

An important development in this area is the Clean Air (Human Rights) Bill. This has passed through the House of Lords and is expected to pass in Spring 2023. This will establish the human right to breathe clean air and place a duty on the Secretary of State to achieve clean air and set limits. This is in addition to the air quality targets in the Environment Act 2021 and the air management zones.

Climate change and net zero

Carbon capture

We're likely to see more developments in relation to carbon capture, especially as Contracts For Difference Regulations will include power agreements for carbon capture and storage in the first half of 2023.

Climate change litigation

Increased scrutiny of the government, council decisions and company strategies will increase litigation, especially with companies and sectors which usually fly under the radar. The year-on-year increase in litigation involving climate change, sustainability and environmental protection and will continue into 2023.

ESG

Businesses continue to assess their net zero journeys and environmental, social and governance (ESG) strategies to see how their targets can be met. This is now forming part of the planning application process, with local planning authorities scrutinising applications to ensure developments don't cause councils to breach ESG strategies.

Clothing brand Patagonia is an example of an organisation changing its business model to meet its ESG aims. In making Earth its only shareholder, it's moved away from making commitments to protect the planet as part of its differentiator to protecting it to preserve its raw materials and supply chain. This is being monitored to see if others will follow suit.

Net zero

There will be a review on the Net Zero and Growth strategy following the call for evidence in September 2022. The review is expected to be released in the new year, and will build on the government's net zero innovation portfolio.

Renewable energy

The government announcement of £102 million backing for nuclear and hydrogen innovation in the UK could instigate significant developments in 2023.

The National Planning Policy Framework consultation, closing on Thursday 2 March 2023, proposes several changes that will affect renewable energy projects, including:

- Provisions to ensure the food production value of land is considered when determining planning applications on agricultural land
- Changes to enable the re-powering of renewable and low-carbon energy projects where planning permission is needed
- Making it marginally easier to bring forward onshore wind (by allowing allocation through supplementary planning documents, or permissions to be granted through local development orders), although this is far from the liberalisation that'd been hoped for.

Environmental permitting – waste and water environment

There are likely to be changes to the Environmental Permitting Regime following two consultations at the end of 2022.

This will bring in changes to the standard rules permits – increasing the capacity for some, increasing the responsibilities for fire prevention and operations within certain waste facilities, and bringing in a standard rules permit for combustion plants.

There will also a be a focus on waste minimisation. Following a consultation in 2022, we're likely to see a ban on single-use plastics, specifically:

- Proposals to ban the supply of single-use plastic plates, cutlery, balloon sticks, and expanded and extruded polystyrene cups and food and beverage containers
- The call for evidence focused on wet wipes, tobacco filters, sachets and single-use plastic cups not already covered by restriction proposals.

The items selected are often not adequately processed through current waste management systems, and tend to enter the terrestrial and marine environment at a higher rate.

The water environment continues to be high on the agenda, with storm overflows bringing sewage into our surface watercourses and coastal waters. There have been huge volumes of these occurrences, reportedly 372,544 incidents in 2021 alone.

Addressing the degradation of our waters by the water companies through legal and illegal sewage overflows and 'dry overflows,' agricultural run-off including pollution from intensive poultry, cattle and pig farming will be key.

There's growing uproar from the public and NGOs for the government to overhaul the way private water companies are set up.

This will address the excessive profits being paid to directors and overseas shareholders when there's a clear need for increased investment to improve and update our current sewage system.

Other matters:

- **Non-financial reporting** – this EU directive requires large companies to disclose non-financial information on a number of matters which have both environmental and social impacts, including GHG emissions, air pollution and human rights. Whilst this is an EU directive, in the UK non-financial reporting, it's a requirement under the Companies Act 2006 and the Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016. If companies do trade within the EU, they need to be aware of the additional requirement of the directive

- **Extended producer responsibility rules** – from Sunday 1 January 2023, certain businesses must collect data about the packaging they handle. If a business has an annual turnover of £1 million, or handle/supply over 25 tonnes of packaging per year, they will be required to report on the activity, material, weight, type and waste type they handle and/or supply

- **Political agenda** – this continues to be a challenging environment with the constant change of leadership, direction, and a lack of resource in governmental departments and councils being critical to achieving good environmental outcomes.

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Housing

Housing

With a number of regulation changes to the housing market on the horizon, and uncertainty around when some of these changes will be implemented (if at all), it's safe to say that these are uncertain times.

Changes are particularly prominent in the rented sector, where potential new energy efficiency requirements are being proposed for 2025. This is in addition to the expected abolition of 'section 21' evictions in 2023, and the prospect of new requirements for private landlords to become more pet friendly.

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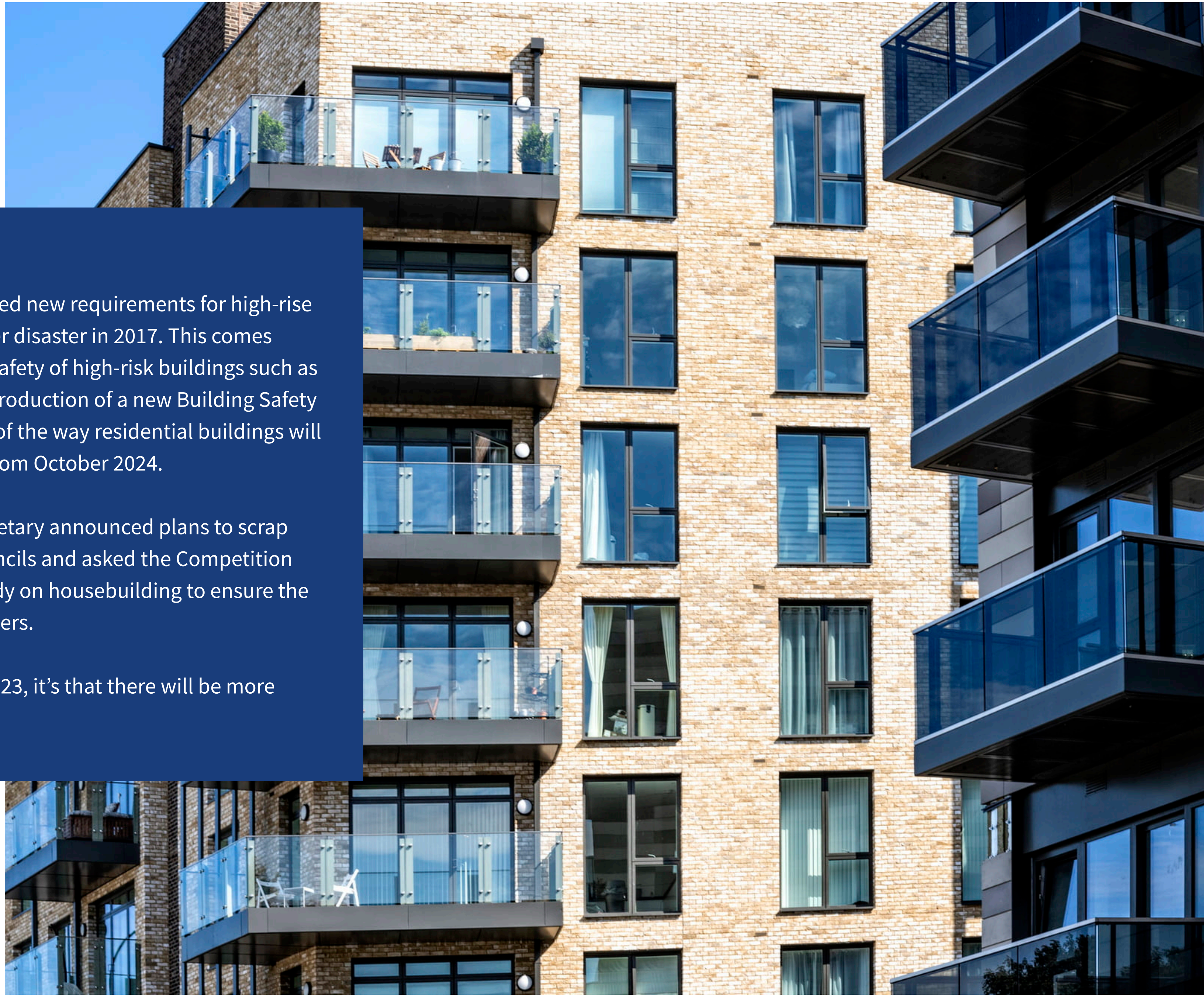
Housing sector overview

The Building Safety Act 2022 has introduced new requirements for high-rise buildings in the wake of the Grenfell Tower disaster in 2017. This comes alongside duties on landlords about the safety of high-risk buildings such as those with defective cladding, and the introduction of a new Building Safety Regulator. There's also been an overhaul of the way residential buildings will need to be constructed and maintained from October 2024.

As 2022 drew to a close, the Housing Secretary announced plans to scrap mandatory housebuilding targets for councils and asked the Competition and Markets Authority to do a market study on housebuilding to ensure the sector is competitive and benefits customers.

If there's one thing we can be sure of in 2023, it's that there will be more change ahead for the housing sector.



- **Mortgages** – the Bank of England raised the base rate nine times in 2022, ending the year at 3.5%. This led to new mortgage products becoming less attractive and put additional financial stress on people who's mortgages linked to the base rate.

- **House prices** – these increased over 2022, but the Centre for Economics and Business Research has predicted a fall in house prices over 2023 as a result of the dramatic rise in mortgage rates, an ongoing recession and lender hesitancy.

- **Building Safety Act 2022** – this new legislation will require all 'high-risk buildings' (mainly high-rise buildings made up of residential units) to be registered with the Building Safety Regulator by October 2023. The Act also brings in other changes relating to health and safety and liability for defective premises.

- **Pet-friendly tenancies** – in June 2022, the government expressed its desire to make it easier for renters in the private sector to have a pet in their home, and for a 'fairer private rented sector.' It's unclear when the appropriate legislation will be introduced to Parliament.

- **Energy efficiency** – the latest proposals will require a minimum of an EPC rating of 'C' for all new tenancies from Wednesday 31 December 2025, extending to all tenancies in 2028.

- **Future Home Standards** – from 2025, new requirements require all new build homes to produce 75-80% less CO2 emissions. This is a step up from the current requirement of 30%, as well as greater insulation and ventilation quality improvements.

- **The Healthy Homes Bill** – this Bill is at committee stage. It sets out the principles that define a 'healthy home' and would establish the office of the Healthy Homes Commissioner.

Renter's reform

The government published it's 'Renters Reform Bill' on Thursday 16 June 2022, which set out its plans to make changes to the private rented sector.

The paper includes a 12-point plan and sets out the government's vision for a fairer private rental sector to fit the needs of the modern world and deliver a better deal for private tenants.

The points included:

- Abolishing section 21 notices or so-called 'no-fault' evictions and establishing a simpler tenancy structure
- A new ground for possession for repeated serious rent arrears will be introduced
- A 'Decent Homes Standard' which is currently adopted by the social rental sector
- Restricting rent review courses
- The introduction of a new property portal to help landlords understand their obligations and give tenants transparent information
- Introduction of the Housing Ombudsman.

The second reading of the Evictions (Universal Credit) Bill is scheduled for Friday 17 March 2023. If enacted, it will place a duty on the Secretary of State to prevent the evictions of Universal Credit claimants in rent arrears.

These changes aren't expected to be put into legislation anytime soon, but the proposals will fundamentally change the private rented sector to make it more tenant-friendly. This could cause issues to many private landlords over the coming months.

Adjustments for disabled tenants

Landlords of multi-let residential buildings may be required to make reasonable adjustments to avoid disadvantages for disabled tenants, following a recent Equality Hub consultation.

This would enhance the duties currently owed to tenants of let premises to amend lease terms and give consents or provide auxiliary aids where these are reasonable to avoid disability-related disadvantages.

If the draft legislation is 'switched on' as expected in 2023, it would require landlords to make reasonable adjustments to physical features in common areas to improve disabled tenants' access into and around their buildings. This would be subject to the tenant covering the costs (upon landlord request) and using the let premises as 'their main and only home.'

Rent repayment orders

We expect rent repayment orders to be in the news courtesy of the upcoming Supreme Court decisions of Rakusen v Jepsen [2021] EWCA Civ 1150.

The Supreme Court has given permission to appeal the decision that a rent repayment order by a tenant under section 41 of the Housing and Planning Act 2016 can only be made against an immediate landlord of the applicant and not against a superior landlord.

As this is in the Supreme Court, it may bring this type of remedy against landlords to the attention of tenants more widely. Depending on the decision, it could be a double whammy for landlords in the private rented sector.

Residential Leasehold

Residential Leasehold

Leasehold reform remains in a state of flux, with further reforms still on the table, but we're yet to see the full extent of the changes that will be proposed.

Last year saw the implementation of the Leasehold Reform (Ground Rent) Act 2022, preventing any new leases being granted reserving a ground rent – although there are a number of exemptions. The consequences of this legislation are now playing out and they include:

- Almost all new developments are being transferred to leaseholder-owned management companies on completion of the development
- Some leaseholders are having to pay higher premiums for voluntary lease extensions, as they're unable to pay a lower premium in return for paying a reasonable ground rent for the duration of the extended lease.

Leigh Shapiro
Partner, Residential Property

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Leasehold Reform (Ground Rent) Act 2022

The government has promised that the Leasehold Reform (Ground Rent) Act 2022 is the first of two pieces of legislation they're looking to enact.

In 2022, the Queen's speech explained "the government will be taking forward a comprehensive programme of reform to improve fairness and transparency in the leasehold market."

While no detail was provided on the timings, this is expected to be introduced in the 2023-24 parliamentary session.

The reforms will change:

- The way lease extensions and enfranchisement claims are valued, with the abolition of marriage value, the creation of an online calculator, and the capping of ground rents for valuation purposes at 0.1% of the freehold value together with the prescription of rates for the valuation calculations
- The rights of leaseholders of houses and flats to enable them to extend their leases "as often as they wish, at zero ground rent, for a term of 990 years"
- The ability of leaseholders to buyout their existing ground rent without the need for extending their lease term.

Governmental considerations

The government has also announced its intention to retain the valuation method used for low-value houses in the new legislation, as well as retaining the discounts in the current valuation methods for improvements undertaken by the leaseholder.
There's been little said about other proposals such as reforms to the rights of collective enfranchisement to incorporate sites including both flats and houses.

While many leaseholder focus groups want to see the whole leasehold structure replaced with commonhold, we're yet to see any proposals about how commonhold may be made to work.

The government is considering:

- Fixing timescales for agents and freeholders to respond to leasehold queries and setting maximum fees for doing so, to speed up and assist the buying and selling process of leasehold properties
- Requiring the regulation of all property/managing agents, following the recommendations of a working group for a regulatory regime
- Establishing a Redress Reform Working Group to include an ombudsman and redress scheme, including the set-up of a housing complaints resolution service.

In the meantime, a number of freeholders have set up a Residential Freehold Association to represent the views of the UK's largest professional freeholders.
The formation of this new organisation was announced in November 2022, so we're yet to see what voice they bring to the sector.

In short, there's a lot going on in the residential leasehold sector.

We predict:

- With Michael Gove back in his old job as the Secretary of State for Levelling-Up, there'll be more draft leasehold reform legislation favourable to leaseholders
- An increase in bad debt litigation and a slowdown in large-scale enfranchisement, where larger premiums are needed
- Changes to the mortgage rates and uncertainty will encourage leaseholders to enforce their rights and pursue individual lease extensions
- An increased requirement for deeds of variation to be entered into by sellers as mortgage lenders expand their requirements on leasehold properties
- Good quality ground rent portfolios will hold their value, but the combination of increased concern about health and safety in poorer portfolios, zero rent increases, and rising obligations will institutional investors to exit the lower end of the market
- Continuing calls to improve transparency and assistance for leaseholders will mean a continued push for regulation of managing agents and deadlines for producing replies to enquiries from freeholders and managing agents, when they come to sell.

We hope that Mr Gove will wake up to the fact that private rented accommodation is central to a competitive and quality housing market, and he'll work with the sector to develop a fair and sustainable buy-to-let solution that will contribute to tackling the UK's housing crisis. We also hope that he'll ensure any leasehold reform is well considered, fair and workable for all parties, which avoids negatively affecting the value of leasehold properties.

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Later Living and Care

Later Living and Care

Starting with the good news, Knight Frank's 2022 UK Care Homes Trading Performance Review states that occupancy levels in the UK care home sector grew year-on-year from 79% to 84%, and is at pre-pandemic levels.

It also reported an increase in profitability across the sector, and reveals that operators are seeing increased demand for beds with average weekly fees increasing by 3.3% to £980 per week.

But, set against this is the impact of high inflation, increased operating costs and the increased cost of debt. The extent to which care homes can further increase fees to account for these over the coming year remains unclear.

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Partner, Real Estate

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Nicola Gooch
Partner, Planning & Environment

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The challenges

- Attracting staff is proving difficult following Brexit. The workaround is to employ staff from abroad, but there are costly immigration issues to overcome
- The October 2023 adult social care cap deadline has been pushed back by the government’s autumn statement until 2025. This gives local authorities more time to plan, but risks introducing further uncertainty in the sector
- Structural problems were highlighted by the House of Lords Adults Social Care Committee, which challenged the government to implement urgent reforms in adult social care in its report published in December 2022. The report calls for better funding, a national long-term plan and the appointment of a Commissioner for Care and Support.
- But there is good news. The National Planning Policy Framework consultation opened in December 2022 and will close on Thursday 2 March 2023. It mentions the need to build on the recommendations from the Mayhew Review, and increase the supply of specialist older persons housing. It also contains an immediate proposal to change the wording of paragraph 62 of the NPPF so it includes an obligation on local authorities to calculate and plan for all types of specialist older persons housing by referencing “retirement housing, housing-with-care and care homes”
- It's encouraging that the government also used the consultation to re-commit to setting up the Older People’s Housing Task Force. But questions remain over the timing, remit, and authority of that task force.

Planning and Levelling-Up

Planning and Levelling-Up

2022 was an eventful year in the world of planning and, for better or for worse, 2023 looks like it will bring even more of the same.

The end of 2022 was disrupted by increasingly frequent announcements that local plans were being withdrawn, paused, or put on hold by local authorities. For at least the early part of 2023, this is a trend that looks set to continue, as councils continue to grapple with the issues of ongoing uncertainty and a lack of resourcing.

Nicola Gooch
Partner, Planning & Environment

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Levelling-Up and Regeneration Bill

The government's Levelling-Up and Regeneration Bill is continuing to pass through parliament. It's a wide-ranging piece of legislation, containing a number of elements that could impact housing developments, including:

- The introduction of a new 'infrastructure levy' based on development land value, which is intended to replace the Community Infrastructure Levy and some aspects of the s.106 regime
- New national development management policies, which will be set by central government, with the ability to override local plans in certain circumstances
- A new mechanism for amending planning permissions, which seems tailor-made for resolving some of the practical issues that have risen following the Supreme Court's decision in Hillside.

But the passage of the bill to date hasn't been without controversy, and how much further it's amended in the Lords, remains to be seen. In late 2022, rebellions from the Conservative back benches on this bill resulted in a number of policy "compromises", which found their way into a consultation over changes to the National Planning Policy Framework.

Environmental considerations

November 2023 heralds the end of the Biodiversity Net Gain (BNG) transitional period. After that point, it will be mandatory for all developments to provide 10% Diversity Net Gain post-development, compared to the pre-development state of the site.

Whilst some preparatory work for the end of the transition period has started, including the recent release of updated guidance on conservation covenants, there's still a lot to be done. We're waiting on detailed guidance about how the BNG credit market is intended to work, and whether you can 'stack' BNG credits with nitrate or nutrient mitigation credit schemes. Similarly, the cost of government credits is yet to be determined.

2023 should also be the year the government's first strategic nutrient neutrality scheme opens, and the pump-primed funding for expanding existing nutrient mitigation schemes begin to take effect.

These schemes will come as a huge relief to developers across the country, who are currently prevented from building out schemes by Natural England's nutrient neutrality advice.

National Planning Policy Framework (NPPF)

The Government opened a new consultation on the NPPF on Thursday 22 December 2022. It closes on Thursday 2 March 2023, and is significant and wide ranging.

The immediate changes proposed include:

Housing requirements

- Removing the requirement for local authorities with up-to-date plans to continually demonstrate a deliverable 5-year housing land supply
- Removing the need for local authorities to include any "buffers" in their 5-year housing land supply calculations
- Allowing councils to include historic oversupply in its five-year housing land supply calculations
- Extending protections to neighbourhood plans that are up to 5 years old, instead of the current 2 years, and removing the requirement for local planning authorities to demonstrate a minimum housing land supply and to have delivered a minimum amount in the Housing Delivery Test before these protections apply
- Clarifying that sustainable development requires “the provision of homes and other forms of development, including supporting infrastructure, in a sustainable manner.”

Standard methodology & Housing Delivery Test

- Re-emphasising that the outcome of the standard methodology is only a starting point, and providing more guidance on the types of "exceptional circumstances" that could justify taking an alternative approach
- Doubling down on the 35% uplift for major urban conurbations, making it clear that this uplift should be provided within the affected boroughs
- “Switching off” the Housing Delivery Test for councils which have granted deliverable planning permissions for 115% of their local housing requirement.

Plan-Making

- Watering down the tests for 'soundness' by removing the requirement for local plans to be ‘justified’
- Clarifying that councils a) don't necessarily have to meet their housing needs in full if it would require building at densities that would change the character of an area, and b) aren't required to review green belt boundaries to meet housing need
- Requiring local planning authorities to plan for the housing needs of older people, particularly retirement housing, housing-with-care and care homes.

Beauty, the environment, and the green agenda

- Emphasising the importance of 'beauty' and strengthening the role of design codes - including asking for more references to plans and materials in planning conditions
- Including express policy encouragement for local authorities to allow “mansard roofs as an appropriate form of upward extension” and “recognise their value in securing gentle densification”
- A rewording to make sure the food production value of land is reflected in planning decisions
- Re-powering of renewable and low carbon energy where planning permission is needed, providing the impacts of any development proposal are, or can be made acceptable in planning terms
- Making it marginally easier to bring forward onshore wind (by allowing allocation in a supplementary planning document, or consent to be granted via an LDO or similar)
- Giving significant weight to the importance of energy efficiency through the adaptation of buildings.

The consultation also includes proposals for longer-term changes in policy direction, including:

- **Housing** – delivering more development on small sites, increasing provision of social-rented affordable homes, supporting community-led developments, penalising developers for perceived "past irresponsible behaviour," and speeding up build-out rates
- **Environment** – supporting targets set under the Environment Act, net zero and the National Adaptation Programmes, new approach to carbon assessments, further guidance on BNG and Nature Recovery Strategies, a review of ancient woodlands and veteran trees protection, and alignment with emerging work on climate risk assessments
- **Plan-making & national development management policies** – transitional provisions ahead of a move to the new plan making system as set out in LURB; setting timelines for preparing local plans, spatial development strategies, minerals and waste plans, and making the case for national development management policies
- **Levelling- Up** – DLUHC is specifically seeking views on how planning policies can support its 12 levelling-up missions, with a particular focus on boosting local economies and economic.

Additionally, the following consultations were initially promised in the Autumn of 2022, and are now expected to emerge over the next twelve months:

- Increased planning application fees,
- The detailed workings of the proposed infrastructure levy
- A consultation on the content of the proposed "national development management policies."

Responding to all these consultations could keep the industry extremely busy for some time.

November 2023 also heralds the end of the Biodiversity Net Gain transitional period. After that point it will be mandatory for all developments to provide 10% Diversity Net Gain post development – as compared to pre-development state of the site.

Whilst some preparatory work for the end of the transition period has been undertaken, including the recent release of updated guidance on conservation covenants, there is still a lot yet to be done. We are still waiting on detailed guidance as to how the BNG credit market is intended to work, not least as to whether you can 'stack' BNG credits with nitrate or nutrient mitigation credit schemes. Similarly, the cost of Government Credits has yet to be finally determined.

2023 should also be the year in which the Government's first strategic nutrient neutrality scheme opens, and the pump-primed funding for expanding existing nutrient mitigation schemes, begin to take effect. These schemes becoming operational will come as a huge relief to developers across the country, who are currently prevented from building out schemes by Natural England's nutrient neutrality advice.

Investment

Investment

Rising interest rates and inflation have triggered repricing in the market, with valuations falling at the highest pace since Brexit.

While investment activity will slow down in 2023, attractive opportunities will remain for cash-rich investors.

Ayesha Hasan
Partner and Head of Investment

Get in touch

Funds under pressure

Changes by the UK government in 2022 led to increased uncertainty and exceptional market conditions, which caused a rush of redemption requests from fund investors. In some cases, funds didn't have sufficient liquidity to meet increased redemption requests, which put pressure on investors to sell property assets.

Given the volatility in the property market, and increased gilt yields, funds are now rebalancing their portfolios to reduce real estate exposure. Under this pressure, funds are accepting a cut in sale prices, leading to a repricing within the market. This creates an opportunity for cash-rich investors who have the means to move quickly.

Foreign investment

The British Pound fell to a record low against the US Dollar following the mini-budget in September 2022, in theory making the UK property market more appealing to international investors. But the backdrop of political uncertainty in the UK made US investors reluctant to invest, which caused a ripple effect with other international investors following suit.

We expect foreign investment to return when there's greater confidence in the UK government to steer the economy. Overseas investors will need to be aware of the new Register of Overseas Entitles in the UK, requiring them to submit information on their beneficial owners before they're able to complete any UK property acquisitions.

Repurposing retail spaces

The COVID-19 pandemic caused major changes, including increased online shopping and working from home. This has led to decreased footfall in city centres and brick-and-mortar stores. The retail sector is suffering from a lack of working capital, so it's likely that there will be lots of distress and restructuring in the market. This gives investors the opportunity to acquire businesses and assets.

It's likely that we'll see trends similar to those in 2008, where diversification such as the opening of cafes and concessions was used to increase footfall and income streams. In 2023, we predict that repurposing will be more focused on leisure, experiences, and residential housing.

Real Estate Finance

Following two years of growth in the property market, we enter 2023 with increased interest rates and declining property valuations, which will shift the real estate finance landscape.

Availability of finance

Given the lower property valuations, lenders are more guarded, and we expect them to take more cautious approaches in their choice of assets and borrowers. This means that the scope for borrowing will reduce and the availability of debt will become less. In 2008, there was only a handful of lenders. We now have a few hundred.

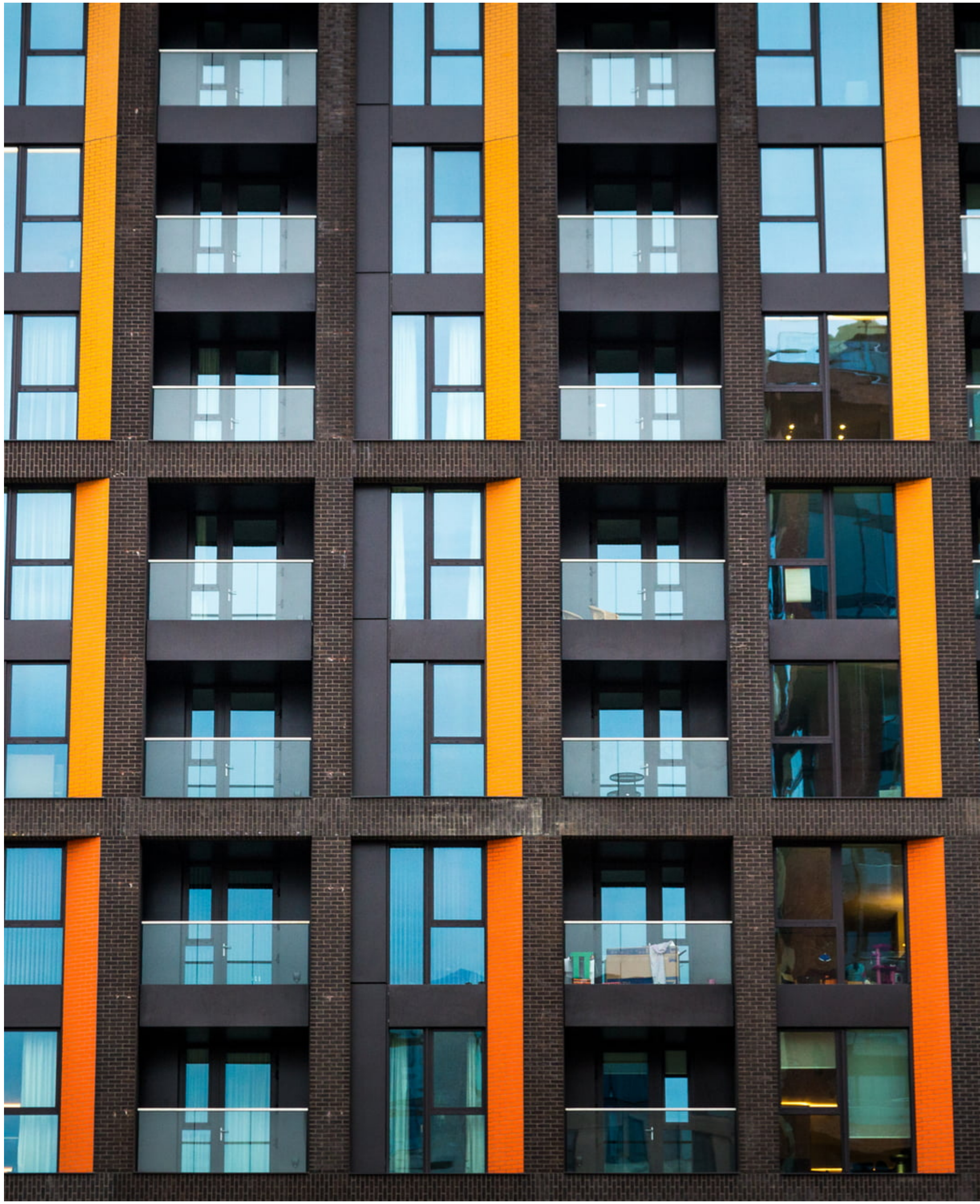
Cost of debt

The cost of debt increased significantly in 2022, with the Bank of England increasing the base rate. Inflation has reached its highest point in over 40 years.

While inflation is expected to drop in 2023, it will remain relatively high as the UK economy remains stagnant. The base rate is likely to continue to increase, so the cost of borrowing will remain expensive.

Refinancing

Given the economic conditions, where properties have already been financed, lenders will be on the lookout for any breaches in the loan terms in relation to asset market values or expected rental incomes. If a breach happens, property owners may be pushed to refinance ahead of schedule.



This will be at a higher interest rate. Some property owners may find themselves in a difficult situation where the cost of debt would exceed projected yields, which may push them to sell.

The knock-on effect of this being a further lowering of property valuations, which will cause lenders to become even more cautious.

Offices

While empty office spaces have hit their highest levels in recent years, appetite to lend against prime office locations may pick up in 2023.

Businesses in the professional services sector are keen to secure the best office locations, and there's a growing interest in office amenities to increase the appeal of office working.

There will be less of an appetite to lend against secondary office spaces, as the valuation outlook will be less positive. The regional office market will continue to be strong in good locations.

Logistics

The logistics sector remains strong. The era of the shed will continue but we expect that the interest in the logistics sector will slow down in 2023. The demand for warehouse space is decreasing because of increased operational costs and a slowdown in e-commerce due to the cost-of-living crisis.

Global supply chain disruptions have prompted the sector to consider switching from a 'just in time' model to 'just in case'. This could reverse the decline in demand for warehouse space, and keep lenders interested.

Real Estate Disputes

Real Estate Disputes

Economic downturns often cause an increase in disputes of all kinds, and we expect the following regulatory changes to be the catalyst for real estate-related disputes in 2023.

Tim Rayner
Partner and joint National Head of Real Estate Disputes

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Energy efficiency

The Energy Efficiency (Private Rented Property) Regulations 2015 introduced a minimum standard of energy efficiency for residential and commercial properties.

From Sunday 1 April 2018, landlords couldn’t grant or renew residential and commercial leases with an Energy Performance Certificate (EPC) rating of F or G.

The regulations are due to change on Saturday 1 April 2023, and will prohibit landlords from continuing to let commercial properties with an EPC rating of F or G.

Similar provisions for residential leases were introduced in 2020. This means that existing leases will fall into scope of the regulations, as well as renewals and new leases.

The regulations don’t apply to certain tenancies and to buildings that don’t require an EPC. Landlords may be eligible to register an exemption, allowing them to continue letting F and G rated properties from Saturday 1 April 2023.

These include:

- The ‘new landlord’
- ‘All Improvements Made’
- ‘Cost Effective Improvements’
- ‘Consent’ and ‘De-Valuation’ exemptions.

For potential purchasers or investors, it’s worth noting that exemptions are not carried over when a property changes hands.

Business rates

On Saturday 1 April 2023, the government will carry out its first full revaluation of business rates since 2017. Valuations will be based as at Thursday 1 April 2021 to reflect the impact COVID-19 had on the rental values. Some ratepayers will see a significant increase in their liability following this revaluation. To tackle this, in the Autumn Statement, the government set out a suite of measures to support businesses in England, which is worth an estimated £13.6 billion over the next five years.

The measures include:

- A Retail, Hospitality and Leisure Relief Scheme, which increases the current relief from 50% to 75% in 2023-24, up to a maximum of £110,000 per business. Although a welcome relief for small businesses, the cap is unlikely to help larger businesses in the sector
- Freezing the business rates multipliers at 49.9p (small business multiplier) and 51.2p (standard multiplier)
- A new Supporting Small Business Relief Scheme to ensure no small business faces a bill increase greater than £50 per month for 2023-24 as a result of losing eligibility for Small Business Rate Relief or Rural Rate Relief
- Transitional Relief Scheme to limit bill increases caused by changes in rateable values. These upward caps will be 5%, 15% and 30% for small, medium, and large properties in the first year. The caps will be applied before any other reliefs or supplements. This will be especially welcome for retailers where a significant fall in value is expected.

Product Security and Telecommunications Bills

2022 proved to be another eventful year in the world of telecommunications.

In the five years since the new Electronic Telecommunications Code was introduced, we've seen more cases before the Tribunal than in the previous 30 years.

As well as a host of significant cases, including the first ever telecoms case before the Supreme Court, 2022 saw the publication of the draft Product Security and Telecommunications Bill, which is awaiting Royal Ascent and looks set to become law in 2023.

The Bill forms part of the government's drive to secure Britain's place on the global stage by supporting the rollout of future-proofed, gigabit-capable broadband and 5G networks.

Once introduced, the Code will provide a host of amendments to the current legislation, including:

1. Express Code rights for operators to share apparatus
2. The right for operators who occupy land under pre-December 2017 'old' code agreements (known as subsisting agreements) to share and upgrade their equipment in a similar manner to those operators who occupy under the current code
3. Amendments to the way rent is valued for agreements renewed under the Landlord and Tenant Act 1954 (1954 Act) to conform with rents agreed for new agreements under the code
4. Landlords of renewed agreements under the 1954 Act will have the right to claim compensation in a manner similar to landlords who receive compensation under the code
5. The Secretary of State will have the power to make regulations for 1954 Act renewals to be dealt with by the Tribunal rather than the County Courts in the same manner as agreements renewed under the code
6. A new procedure for operators to obtain code rights to install equipment in multi-dwelling buildings (such as blocks of flats) even in the face of non-responsive landowners.

These amendments look set to streamline the renewal of agreements under the 1954 Act with agreements under the code, whilst introducing a host of operator-friendly amendments.

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Corporate Occupiers

Corporate Occupiers

The predicted flow of a return to the office has been steady.

Property consultant Remit reported that it expected to see more people returning after the 2022 summer holidays, but office occupancy figures, hampered by public transport strikes, continued to hover around 30% with Tuesday through to Thursday proving to be the most popular office days.

For most businesses, hybrid/flexible working is here to stay. With a lower uptake on desk spaces, corporate occupiers have been left mulling over how to manage their workspaces.

But this doesn't mean the death of the office – occupiers are just being more strategic in considering their options.

Knight Frank says: "[occupiers] are being more precise and intentional about what they're looking for and how their next office will fit their future needs."

Occupiers looking to reduce their office footprint are debating options including early surrenders, exercising breaks, sublettings and lease assignments.

As well as an increase in the uptake of flexible workspaces, we expect to see far more flexibility built into traditional office leases including break options, shorter terms, more incentives such as rent frees and landlord contributions to fit outs.

Tim Rayner
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Sarah Swann
Senior Associate, Real Estate

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Flight to quality

JLL's Future of Work survey 2022 found increasing demand for Grade A space, with 77% of businesses surveyed agreeing that investing in quality is a greater priority than expanding total footprint.

Office running costs have risen to their highest level according to Lambert Smith Hampton.

The average cost of occupying a new build office space increased by 13% during 2022 and 18% for older buildings where levels of efficiency are lower.

Significant contributory factors include the huge uplift in energy costs, strong inflationary pressures in the construction industry (reflected by the 20% annual growth in fit out costs) and in-house printing reprographics increasing by 28% year-on-year in 2022.

That's before we get to April's increase in business rates.

Environmental sustainability

The property sector accounts for 39% of all carbon emissions globally, with some cities, including London, exceeding this figure. Occupiers are now driven by their own values and ESG goals, as well as demands from customers, employees and investors who are recognising the need to prioritise energy-efficient and sustainably constructed buildings in their leasing choices.

Pressure is also mounting as legislation is changing. The Energy Efficiency (Private Rented Property) Regulations 2015 will prohibit landlords from continuing to let commercial properties with an EPC rating of F or G. This means that existing leases will fall into scope of the regulations, as well as renewals and new leases.

Smart occupiers are making forward-looking decisions based on buildings' environmental performance, whilst also factoring into budgets the cost of improving building sustainability. Landlords will look to pass back to tenants through service charges or specific obligations in their leases.

Retail

Retail

Continuing supply chain disruption caused by Brexit, shortages in the labour market, and the cost-of-living crisis will combine to make another difficult year for retailers who'll need to balance their support for customers by keeping prices low, with managing their own spiralling costs.

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Jennifer Ayris
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Bricks-and-mortar retailers

Bricks-and-mortar retailers will need to focus on keeping their property portfolios lean and flexible in 2023. Excess space and underperforming stores will need to be dealt with either by handing stores back to landlords, or sharing space with other retailers. Short-term leases and frequent break clauses will continue to trend, allowing retailers to quickly respond to changes in consumer behaviour.

There will be good news for bricks-and-mortar retailers on Saturday 1 April 2023 when the rating list for the 2023 Revaluation of Business Rates goes live with many retailers seeing a reduction in their business rates liability. The multiplier being frozen, a reduction in rateable value and the removal of downwards transition means retailers with a high street presence will pay significantly lower rates with immediate effect from April 2023.

The retail sector will see an average decrease of 10% on their rates liability, but in some locations the reduction will be significantly more.

Online retailers

Online retailers with warehouses and logistics facilities will see a sharp increase in their business rates, but the government has now shelved plans for an Online Sales Tax. This was originally put forward to rebalance the business rates bills paid by in-store retailers in comparison to their online counterparts.

Sustainable retail

Sustainable retail will remain firmly on the agenda in 2023. As energy price increases bite, retailers will look to sustainability measures to cut their energy costs. They will also face increasing pressure from customers to contribute towards the drive to net zero through changes to their logistics infrastructure and property portfolios.

From Saturday 1 April 2023, it will be unlawful to continue to let a commercial property on an existing lease if that property has an EPC rating of F and G. Although responsibility for compliance with the MEES legislation rests with landlords, avoiding the reputational risk and increased energy costs associated with occupying properties with poor EPC ratings will become increasingly important to retail occupiers.

Ethical retail

Customers will expect ethical retailing with a renewed focus on supply chain practices and the ways that retailers are giving back to their communities. ESG strategies will need to be revamped and communicated to increasingly socially conscious customers looking to buy products and services they consider ethically acceptable.

Labour market

Shortages in the labour market are likely to continue, with many retailers finding it difficult to recruit and retain reliable staff. From Saturday 1 April 2023, the National Living Wage for staff aged 23 and over increases by 9.7%, amounting to an increase of 92p per hour. There are also uplifts to the National Minimum Wage for younger staff up to age 23 with effect from April 2023, which will see retailers having to ensure their pay rates comply with this new statutory floor.

Technology

Continued investment into technology will provide valuable insights into the changing behaviour of customers in 2023, but data collected will need to be handled securely and in accordance with GDPR.

Company Voluntary Arrangements

Unfortunately, we expect to see Company Voluntary Arrangements (CVA) returning to the headlines. The last major challenge to a CVA involved New Look. It was decided that the CVA was valid, but treating various creditors in different ways disproportionally impacted its landlords.

The case reinforced the courts' reluctance to interfere with the restructuring efforts of the retail sector, but no doubt further challenges will come.

Employment

Employment

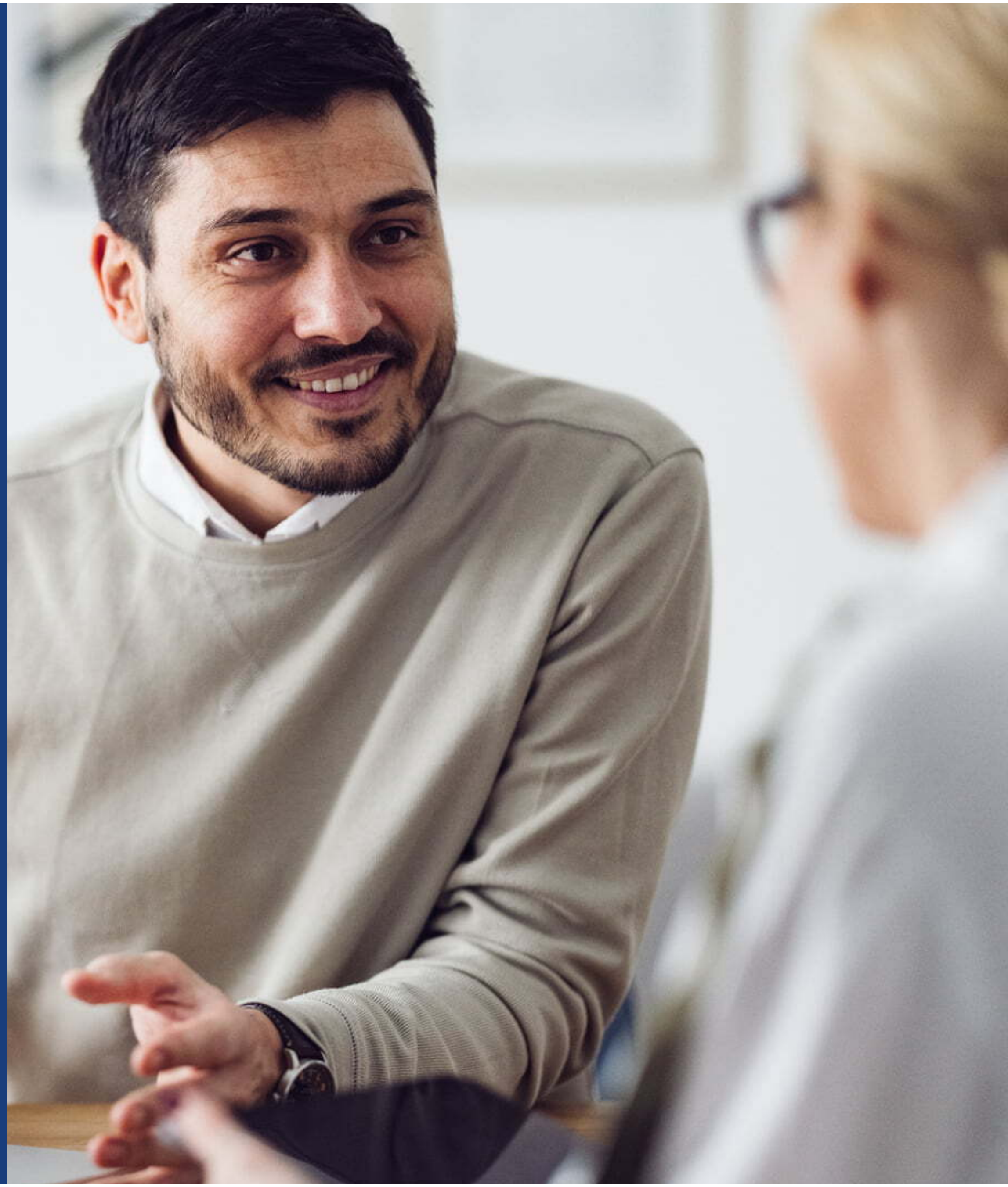
There's still no sight of the long-awaited Employment Bill.

But that doesn't mean that nothing's happening in employment law. The government is pushing ahead with the Retained EU Law (Revocation and Reform) Bill which, if passed, will allow it to "set fire" to all employment and health and safety legislation derived from the EU by the end of 2023.

The government is also putting its weight behind several private members bills, which will deliver benefits to pregnant women, new parents, and carers.

Joanne Moseley
Professional Development Lawyer, Employment

Get in touch



Retained EU Law (Revocation and Reform) Bill

Under the European Union Withdrawal Act, most UK laws in existence on or before Thursday 31 December 2020 were preserved.

The Retained EU Law (Revocation and Reform) Bill will repeal all EU-derived laws by the end of 2023 (although the government will be able to extend that deadline to Tuesday 23 June 2026). This will allow the government to make sweeping changes to established laws in respect of working time and holidays, discrimination, TUPE, agency workers, part-time workers, and fixed-term employees.

The government will have to legislate to re-introduce (or adapt) the EU laws it wants to keep before that deadline. But it doesn't look like it's going to prioritise employment rights, and it's possible that important rights will fall off the statute books without anything in place to replace them. This will create uncertainty, and could result in an increase in staff dissatisfaction (particularly if employers treat new staff less generously than existing staff), grievances and employment claims.

Pregnant women and new parents to get added protection against being made redundant

Pregnant women and new parents will receive additional protection from being made redundant under the Protection from Redundancy (Pregnancy and Family Leave) Bill.

Under the current rules, before making an employee on maternity leave, shared parental leave or adoption leave redundant, employers are obliged to offer them a suitable alternative vacancy where one exists in priority to anyone else who is provisionally selected for redundancy.

The new Bill will extend protection so it applies to pregnant women before they start maternity leave and for six months after they return to work.

It will also protect new parents returning to work from adoption or shared parental leave.

We expect the Bill to come into force in 2023.

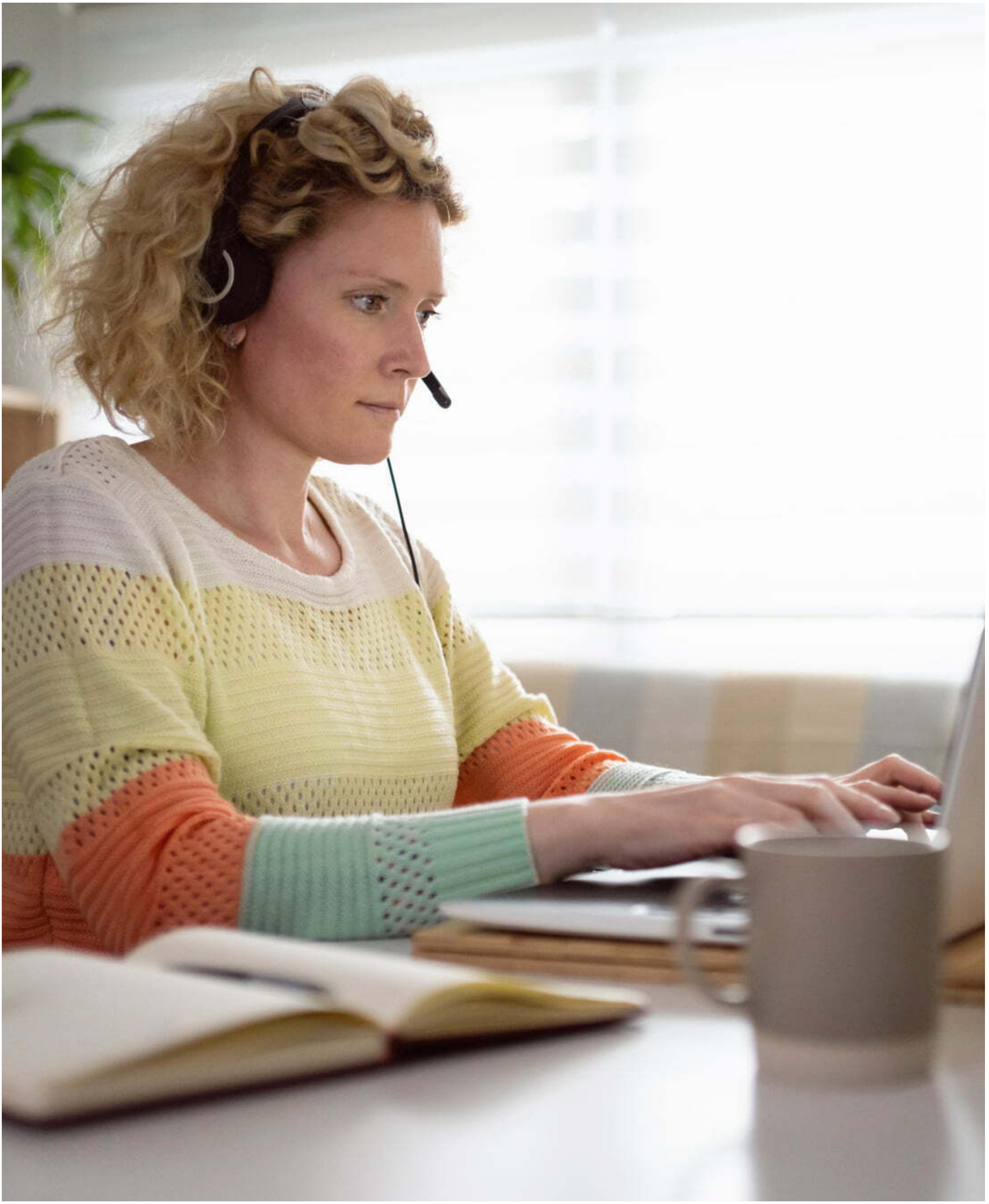
New day one right for paid time off for parents of sick and premature babies

The Neonatal Care (Leave and Pay) Bill will allow parents to take up to 12 weeks of paid leave (in addition to other entitlements such as maternity and paternity leave) to allow them to spend more time with babies requiring neonatal care.

Neonatal care leave and pay will be available as a day one right for parents of babies who are admitted into hospital up to the age of 28 days and who have a continuous stay in hospital of seven days or more. We expect this to become law in 2023.

One weeks’ leave for carers

The Carer’s Leave Bill will introduce one weeks’ unpaid leave to help employees with long-term caring responsibilities balance these with their paid work. It will be a day one right and leave can be taken in one single block or on individual days. We expect this to become law in 2023.



New rules on combating workplace harassment

The UK has approved the International Labour Organisation's Violence and Harassment Convention – an international treaty aimed at tackling workplace violence. The government will introduce a new obligation on employers to play an active role in preventing workplace harassment, both by employees and by third parties such as customers and clients. It's not yet published the details of this.

Once in force, employers will have to update their diversity and inclusion policies to ensure that the training they provide to their staff complies with the new law.

The treaty comes into force on Tuesday 7 March 2023. But we expect new employment legislation to be introduced sometime in 2023.

Changes to rules on flexible working

The government has announced that it will make changes to the right to ask for flexible working.

It will become a day one right. Employees will be able to make up to two requests each year and the employer must deal with the application (and any appeal) within two months.

Employers will still be able to turn down requests if they have a business reason for doing so.

Some of these changes will happen more quickly than others.

We expect the change regarding the number of requests an employee can make and the reduced decision time to come into force in 2023.

Extra bank holiday

To celebrate the coronation of King Charles III, there's an additional bank holiday on Monday 8 May 2023. Employers will need to decide if their staff are entitled to take an additional day's paid leave either on that date or at another date in the holiday year.

The starting point is to look at the holiday clause in the employee's contract of employment. If the contract states that the employee is entitled to, for example, 28 days of holiday, which includes all statutory and bank holidays, employers aren't obliged to give them an extra day of paid holiday. The same will apply if the contract just sets out the number of holiday days the employee can take and doesn't mention bank holidays at all.

On the other hand, if the contract states that they're entitled to, for example, 20 days of paid holiday plus statutory and bank holidays, employers will have to allow them to take an additional day's leave. But if the contract states that they're only entitled to the statutory and bank holidays that are usually observed in England and Wales, they're not entitled to the extra day.

National living wage and national minimum wage

From April 2023, the National Living Wage, paid to workers aged 23 and over, will increase by 92p to **£10.42** per hour.

The National Minimum Wage rates will also increase as follows:

- Those aged 21-22 will receive **£10.18** an hour – an increase of £1
- Those aged 18-20 will receive **£7.49** an hour – an increase of 66p
- Those aged 16-17 will receive **£5.28** an hour – an increase of 47p
- Apprentices under the age of 19 or in their first year will receive **£5.28** an hour – an increase of 47p.

Thank you for reading

What's on the Horizon

Visit irwinmitchell.com to find out how we can help you or your business with legal support and financial planning.