Our Ref: MMB/lo'd

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Tim Blackwell
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Dear Tim

Re: 19 John Street, London WC1N 2DL

Reference is made to your request for a brief Market Report relating to the premises 19 John Street. This report is for the purposes of the current freeholder GFZ Developments Limited to support their various planning documentation and to be used in conjunction with their Financial Viability Assessment. We understand GFZ own the freehold of the premises and we have not made any further investigations into the Title, and forms of restrictions on use and have assumed that the premises have unfettered vacant possession and were in the condition that we found on our inspection of the 11th April 2016. Farebrother are a leading firm of local Chartered Surveyors that concentrate on the Midtown Office market and specialise in the letting, and acquiring of office buildings, but also providing generally consultancy advice to a wide range of Midtown owners, investors and occupiers.

We have relied on the various documentation that has been passed to us which includes:

- Area Schedule provided by Marek Wojciechowski Architects.
- Supporting Loss of Employment Statement by Montagu Evans.
- Budget Cost Estimates by Coll Associates.
- Planning Application Drawings

Premises

19 John Street is a mid-terraced period property on the eastern side of the street, constructed in the early 1800s over lower ground, ground, and 3 upper floors, it forms part of a terrace of 11 houses dating from 1799-1824. John Street lies to the north of Theobalds Road. The subject premises are situated just to the south of the intersection with Roger Street. 19John Street is currently not let and is currently is in a dilapidated state. The building is Grade II Listed constructed of multi coloured stock brick with rusticated stucco at ground floor. The property lies within the Bloomsbury Conservation Area.

The building totals 4,649 sq ft on a Gross Internal Area basis and from the Rating List we note that the Net Internal Area basis under the 6th Edition of the Code of Measuring Practice, shows an area of 3,193 sq ft, with the largest floor 661 sq ft. The property does not benefit from a passenger lift. The general layout of the building is a series of rooms off a hallway and stairs. The ground and lower ground floors have a rear extension wing. The toilets and the kitchenette on the first and second floor levels are at half landing level.

The accommodation has at some point had the insertion of air conditioning in some of the rooms of which the condensers have been placed on a flat roof to the rear, but it is unclear whether these additions have had planning permission.

Condition

The premises are in a dilapidated state and whilst the floors still have some floor coverings and wall finishes, the premises are unlettable in our opinion in their current state. Substantial repair works will be required to bring the property up to modern standards. There is also serious water penetration at party wall and roof level above the stairs which will need to be repaired, reinstated and redecorated.
The works required to make the premises lettable include external works such as repairing the external structure, scaffolding, and substantial works to the doors and windows that are in poor condition. Internally works will include repairs to the floor and the floor coverings, plaster repairs and all the associated finishes with this, installation of new heating and extensive lighting and power works. New WCs will need to be installed along with all of the various plumbing and servicing for a kitchenette too. A decision will also need to be taken as to whether some form of comfort cooling will be provided. All of these repairs and improvements to bring the property into a lettable condition will need to be carried out under the Listed Building requirements.

- Floor levelling at ground (front and rear including extension) and first floor levels.
- Ceiling repairs to historic ceilings at ground and first floors
- Overhaul of water and heating infrastructure within the property

Bearing in mind the need for Listed Building consent for many of the works that would be required to make the property lettable, and the uneconomic option of doing the works without any financial guarantees that the works will have any form of payback on money invested, we are of the view that spending even small sums of money on repair or upgrading would not make the premises lettable to the current market demand. With no guaranteed return on money invested no investor will take any action in its current use.

Letting agents would advise owners that a marketing campaign to try and let the space in as near to current condition format, would be a meaningless exercise that a commercial agent would simply not embark on. So in this instance a marketing campaign would be a waste of resources, time and effort simply to ensure a planning condition is met.

Midtown Office Market

Farebrother undertake Quarterly research on the Midtown Office Market that we publish every quarter measuring the total level of take up and the levels of availability within the Midtown Market. Our research is well respected and is relied on by large numbers of investors, owners and occupiers of property within Midtown.

The continuing reduction in the supply of available office space has continued throughout 2015 and into the first quarter of 2016 which has culminated in the current Midtown Office availability rate now sitting at 3.6% out of an office stock of 41.6m sq ft.

Within the WC1 postcode, of which John Street sits, the position is slightly different with the WC1 availability rate currently at 5.2% with availability at the end of the 1st Quarter 2016 standing at 487,256 sq ft out of a total stock of 9.3m sq ft.

Whilst the Office Market has low availability and we are experiencing strong levels of rental growth it should be stated that there are still properties that are in a poor and dilapidated condition that will not let regardless of how low the availability rate falls. Occupier demand is not buoyant, market conditions coupled with a recovering economic condition has given occupiers confidence that the economic stability will continue in the short to medium term, but demand is steady. Larger occupiers are faced with higher occupational costs as the costs of rent have been increasing, so many are faced with decisions whether to stay in Central London or to consolidate and potentially move out of the higher value property areas. Smaller occupiers have become increasingly looking for flexible space that will enable them to adapt to the needs of their business. So we are seeing reduced length of leases for space under 5,000 sq ft and even shorter leases for space below 2,000 sq ft, occupiers are tending to not want to commit much beyond 3 years but generally leases for this size of suites tend to be for a maximum commitment of 5 years term certain.

For an occupier to take 5,000-6,000 sq ft it is extremely unusual for them to be satisfied to take this in a building that is over 5 different floors and almost unheard of in a building that is not only split over several floors but is split into two different constituent parts per floor. It would have to be a very unusual occupier who would be willing to take 19 John Street as a whole no matter what condition it was in. So this would lead to the building almost certainly being let as a multi let building with letting in individual sizes of between 400 and 1,000 sq ft. The type of occupiers willing to take leases on this amount of space are unlikely to be willing to commit to anything more than 3 years, so the best letting g outcome for this building in my opinion would be 5 years lease with tenant only breaks at the 3rd year.

Small and medium-sized enterprises (SMEs) are loathe to commit for lease terms that landlords are seeking for them to get a suitable return on their capital investment in their properties. This has resulted in many buildings being converted to alternative uses as the level of demand for many of the period properties has dwindled and only large landlords who have longer term views are willing to undertake refurbishment to many buildings of a standard that occupiers are ideally looking for. The number of period properties that come to be let in the open market is very small and the ones that do, tend to be the ones that have been substantially refurbished in the last few years.

SMEs have also been provided with the growth of an alternative property solution. Service office providers have been around for many years and recently there has been an explosion of the number of differing types of providers whether they are collaborative working, flexible working solutions or the traditional work station model, the range of options and the types of provider have changed radically. New entrants into this field have attracted many SMEs who are looking for a flexible leasing structure, varying size capabilities and also the ability to meet and be around similarly like-minded organisations. From Workspace through Regus to WeWork the options are meeting the many requirements of the Central London occupiers. In Midtown recently this has seen a major growth in take up by these groups in the 3rd Quarter 2015, with WeWork taking 69,807 sq ft at nearby Fox Court, Grays Inn Road and also The Office Group taking 54,229 sq ft at 10 Bloomsbury Way. In the 4th Quarter 2015 WeWork have taken a further 38,000 sq ft at 3 Waterhouse Square, Holborn EC1 in a further expansion of their Fox Court holdings. These two large acquisitions, along with the existing options of Regus at Holborn Gate and 88 Kingsway as well as Orega Serviced Offices at 16 High Holborn and 5 Chancery Lane provide a huge amount of serviced office space in this location. The varying offers will enable SMEs to be able to find the space that works well for them and the competition for period buildings will struggle to cope with the need from a landlord for a sizeable commitment compared with SMEs needs of short term flexible space.

Rental Levels, Cost of Works & Economic Viability

As a Listed Building there are very little enhancements that would be allowed for a building of this nature, however due to its very basic internal layout and flack of features I could envisage some form of cooling system to be permitted.

As with all forms of refurbishment there are a range of levels of refurbishment that could be undertaken. For the purposes of this exercise we have looked at three options a Minor Refurbishment, a Medium Range Refurbishment of Existing Building and a Cat A Standard High Quality Refurbishment of the Existing Building.

Minor refurbishment - this is basically doing the minimal amount of works to convert the property to be lettable and even in a relatively low supply market this will still involve a substantial spend. On the Coll Associates costs for a minor refurbishment they see this as being in the region of £611,000. However the relatively low level of refurbishment that takes place here would not give tenants huge confidence in the building and I cannot believe that many tenants would be willing to commit for anything more than a maximum period of 3 years. The level of rents are at historically high levels and with a basic refurbishment in the order as described in the Coll Associates report the maximum rental value that I could see being achieved a san aggregate of a large number of small lettings would be in the order of a maximum rent of £45.00 per sq ft and a total maximum rental aggregate of £110,000 per annum. The costs to be spent are a multiple in excess of 5.5 years annual rent, and this is before marketing voids, letting voids and rent free incentives are added into the equation. For a maximum guaranteed terms of 3 years I cannot understand why a commercial landlord would be willing to undertake this investment in a building where the costs he would incur would not be met by the first tranche of any lettings.

The buildings as a partially refurbished building will not be as attractive in the investment market and may command a pre refurbishment equivalent yield of mid to high 5%s.

Medium Range Refurbishment – these works are more substantial and whilst they include all of the works within a minor refurbishment, they do also have a longer period of scaffolding, some structural alterations, refurbishment of the roof and gutters, installation of a lift and a raised floor. These additional elements will enable a higher rental to be achieved of £52.50 psf but for all of the upper floors with no discount for the walk up floors. The costs of these works are higher being estimates of £874,000. However the likely level of rent achieved will also be higher which would be an annual rent of c £135,000. These works equate to a costs of nearly 6.5 years! Whilst the building has been refurbished to a higher level and quality I would expect the yields applicable to be at low to mid 5% yields.

Major refurbishment – these works are likely to be more time consuming and more expansive in their intentions, so these will involve longer term view of many of the works so bigger level of structural alterations, the additional feature of secondary glazing, alternative flooring solutions and more robust and more substantial lift arrangements. These costs have been looked at again by Coll Associates and are looked at in some detail at arriving at a cost of approximately £1,070,000. Clearly the works will create a better product to let and may encourage some tenants to pay a higher rent perhaps as much as £55.00 per sq ft on best office space. Again the leases may only be for 3 years bit there might be some parties willing to take a 5 year commitment to reflect the addition and comprehensive investment that the landlord has put into the building. I calculate that the maximum likely aggregate rent would be up to £142,500 per annum. As a proportion of years rent received compared to capital spent, as a major refurbishment this is well in excess of 7.5 years rent! So with all the same issues of marketing voids, letting voids and rent free incentives are added into the equation again I cannot see the logic for any commercials landlord to do these works based upon these returns.

The buildings as a fully refurbished building will be a lot more attractive in the investment market and may command a post refurbishment equivalent yield of mid to high 4%s.

So combining the lack of a commitment beyond 5 years and the time and effort in achieving this level of repair, the economic viability of undertaking these works to get the building into a lettable condition just do not make any financial sense. This assessment of viability does not even reflect the time it will take to do the works, the cost of borrowing monies to do the works and then the overall level of incentive that will need to be offered to an incoming tenant.

Bearing in mind some of the works will be in place for a longer period than 5 years, such as the lift works, this does not mean it will never take place, but with the current office market demand and the supply of alternatives for occupiers and SMEs, the need will be for a landlord to take either a non-profitable approach or an alternative 10 plus year strategy will be required.

Commercial letting agent advice would reiterate that a potential letting is possible in this building only if a substantial amount of work is undertaken. For smaller occupiers the risk of undertaking those works themselves would be too great at a skillset that is likely to be very different form their own business skills. Where a substantial bespoke fit out is likely then tenants may negotiate with landlords to do the works 'themselves' but for a property of this nature the ability to create a different bespoke fit out is hugely unlikely as Listed Building consent constraints would limited the scope. So the combination of the size of the premise, the Listed nature and the anticipated fit out that a prospective tenant would require do not combine to create a commercial situation where a tenant would commit to a building of this type in advance of works or repairs actually being done. There are much larger examples of this such as WeWork taking space in Fox Court and receiving a substantial capital payment form the landlord. 19 John Street cannot be looked at in those terms.

Summary

The levels of rents that are being achieved even in a low availability Midtown Office Market are not sufficient to offer owners of buildings of this size and style, the levels of return to complete refurbishments of this scale. Historically, when tenants were not looking for as flexible space as they are now, or they did not have the alternative of a differing myriad of occupational solutions, then the option of a period property may have encouraged them to take longer leases. So currently even the balance of the market being in landlord's favour, it does not mean that occupiers will see buildings such as 19 John Street as a solution to their occupational needs. This is forcing landlords to review their reasons for holding properties of this nature and to investigate economically viable alternative solutions. We are also seeing an increasing number of period properties being bought by owner occupiers who can take a much longer view of how long the return on their capital investment is looked at.

Period property solutions for office occupiers currently only tend to make economic sense if the buildings are in a good order and do not require substantial investment, which for 19 John Street is not the case. The works have been priced at between £610,000 and £1,070,000 in return for a finished level of aggregate rents of between £110,000 and £142,500 respectively. This equates to either approximately 5.5 or 7.5 years annual rent. Coupling this with the difficulties of the building being a Listed Building means the property will be a difficult property to let and almost certainly will be a multi let property rather than a letting to a single tenant.

To find a landlord who would be willing to invest that level of capital in the building to achieve that return no matter how little or indeed how much money that have spent in purchasing the property, is not in my opinion a realistic proposition in the current Midtown Office Market. Neither is the prospect of a tenant coming along willing to do the works themselves. Providing a marketing campaign for the property would be an exercise merely to fulfil a planning condition but the combination of disrepair, the costs of undertaking the works required and the relatively modest financial returns for doing the works means that a change of use is required or the property may sit in its current condition for many years as a sensible commercial landlord will not spend monies without the prospect of positive returns.

Kind regards

Yours sincerely

Malcolm M Brackley

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