U.S. SHARED WORKPLACES

PART 3

A LANDLORD PERSPECTIVE: OPPORTUNITY OR THREAT?

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EXECUTIVE SUMMARY

The shared workplace, especially coworking, continues to grow. Coworking spaces globally grew by 36% in 2015, and are projected to grow further in the near term. This industry was among the top 10 active leasers in Manhattan and Washington, D. C. over the past 12 months.

Not all operators are alike. Skeptics have valid concerns about the longevity of this model through the next economic cycle. However, those operators that display diversity in membership and offerings are likely to have more stability through the next cycle.

More than just a tenant. Although this model challenges the normal landlord/tenant relationship, many landlords believe it presents an opportunity for amenities, tenants, innovation and partnership within their property portfolios.

Amenities to enhance the tenant experience. Many landlords now acknowledge that shared workplaces have the power to contribute to the “guest experience” in ways that will help retain their corporate tenants for the long-term, pull people out of informal workspaces such as cafes and living rooms, and in turn differentiate and give life to their assets.

Pipeline of prospective tenants. One-third of coworking end users expect to graduate to leased offices at some point in the future. Approximately one-third are undecided, presumably creating opportunities for landlords to market direct-lease space to these tenants as their needs evolve and scale shifts.

Laboratory for workplace innovation. Shared workplaces provide a real-time laboratory for understanding how people work productively in dense, high-utilization and fluid environments. They provide a lens on how building systems, office furniture, operations and maintenance must evolve.

Potential for creative partnership. Landlords can experiment with and use the model in creative ways to stay current with workplace and tenant trends. This suggests the potential upside for creative, win-win partnerships between landlords and shared workplace providers.

Take notice if you haven’t already. While shared workplace accounts for less than 1% of the total office market, it offers a new channel for landlords to tap into a growing and dynamic market that is satisfying user needs.

INTRODUCTION

This is the third in a series of reports focused on the shared workplace and, specifically, developments in the coworking space. The series examines this market segment from various perspectives, including those of the investor, landlord and occupier, and focuses on the dynamic impacts this type of space can have on each one.

In the first report of this series, *The Rise of the Shared Workplace in the Sharing Economy*, we identified four megatrends driving the development of the contemporary shared workplace model: economic uncertainty, technology-driven workplace innovations, urbanization and a growing interest in collaboration and community-building.[1] These drivers are durable and promote the current growth of the contemporary shared workplace segment.

In the second report, *An Occupier Perspective: Why a Shared Workplace May Be Right For You*, we focused on three critical differentiators that commercial real estate professionals and small business executives should consider when they evaluate the merits of a contemporary shared workplace: culture, connectivity and cost.[2] A key finding was that the contemporary shared workplace aligns well with today's workplace priorities including flexible space, freedom of work style, creating a sense of community and containing costs.

This third report highlights implications of the growth of contemporary shared workplaces for landlords. In it, we will explore some non-traditional views that may expand a landlord's perspective of this growing space-sharing, community-based model. A relationship between a coworking provider and a landlord may take the form of a typical tenant/ landlord agreement; however, landlords who believe the benefits of these agreements outweigh the rent roll alone are seeing that the addition of this model into their space provides:

- **An amenity to revitalize property and enhance the tenant experience;**
- **A pipeline of prospective tenants;**
- **A laboratory for workplace innovation;**
- **The potential for creative partnership.**

As with any tenant/landlord relationship, the shared-workplace concept does not come without risk. In interviews conducted for this series, some landlords and investors were skeptical of the segment, based on their experiences in past business cycles: Coworking facilitators are viewed as profiting from the lease arbitrage between negotiated lease rent and the price point charged to users, thus any turn in market dynamics could upset profitability. Meanwhile, new entrants to the market and variations on the business model are proliferating, raising questions about their staying power. Landlords who do enter into this agreement need to be aware of the operating history and target market of any prospective tenant, and this model is no different especially given the variability and perceived cyclical nature of the shared workplace business model. Ultimately it is up to the landlords to ensure that their tenant portfolios are diversified appropriately.

Landlord exposure to shared workplace remains very limited, but the spike in leasing activity of coworking facilitators cannot be ignored. New York City – the largest coworking market – is a microcosm of what is happening in this industry globally. In Manhattan, only 1.5% of the market is

1: *The Rise of the Shared Workplace in the Sharing Economy*, CBRE Research, January 2016.
2: *An Occupier Perspective: Why a Shared Workplace May Be Right For You*, CBRE Research, March 2016.
3: *The Global CoWorking Survey*, Deskmag, 2015-16.

occupied by shared workplace providers. However, this industry was among the top 10 active leasers in the market over the past 12 months ending Q1 2016. WeWork was the single largest leaser of space across any industry in Manhattan during that time frame with more than 750,000 sq. ft. leased.

This activity has led widespread discussion about the topic, and landlords are gaining first-hand experience with shared-workplace operations, the demographics they attract, and how the space works in the larger context of a building, campus or neighborhood.

WHY DO LANDLORDS NEED TO UNDERSTAND THIS TENANT RELATIONSHIP?[3]

- The number of coworking spaces grew by 36% in 2015
- Projections indicate growth to 10,000 coworking spaces worldwide by YE 2016 and 12,000 by YE 2017
- 62% of all coworking owners expect to expand their spaces
- Half of all coworking facilities have lease expirations approaching within the next three years and will need to renegotiate or relocate

IS TENANTING A COWORKING PROVIDER A THREAT TO YOUR PORTFOLIO?

“We’ve seen this movie before. They didn’t last very long,” said one Toronto-based office property owner.

Despite the rapid growth and visibility of shared workplace, a number of landlords and investors question the merits of having these operators as tenants due to the following perceived weaknesses:

- The limited track record and credit history of shared workplace startups and the memory of economic challenges operators faced in previous market cycles – especially those exposed to the dot-com bust in the early 2000s;
- The non-traditional business terms that these providers negotiate such as below-market rents, revenue sharing and increased tenant improvement allowance, which all transfer more risk to the landlord;
- The potentially negative dynamic created by mixing traditional incumbent corporate tenants with entrepreneurs and small businesses that populate the coworking space;
- The increased demand on building systems and cost of services associated with very dense occupancies and extended hours.

IS THIS REASONING VALID?

These are all valid arguments, especially when the rapid rise of the coworking industry—driven by demand from startups and small businesses—has caused concerns that an economic downturn could burst what some see as a bubble. Although these weaknesses are real and should not be discounted, there are coworking providers that offer more stable opportunities than others. Diversity in membership and offerings is especially important.

As noted in the second report in our series, large occupiers seeking flexible, lower-cost and attractive solutions are beginning to show interest in shared workplaces, and thus can add stability to the membership pool.[4] Currently, changes to accounting standards that bring leases on balance sheet could drive a shift towards using shared service providers to accommodate short-term space planning options. CBRE Research found that more than 40% of survey respondents made up of large global occupiers are using or considering shared workplaces.[5] New business formation typically slows and business exits accelerate in a recession, but in terms of revenue, shared workplaces could see an influx of larger companies seeking to downsize legacy assets while still delivering a high level of amenities that retain and attract talent.

At the same time, there also are structural shifts in the workforce, specifically with independent workers and small-to-medium businesses, which will challenge the traditional space model. Independent contractors are expected to comprise 40-50% of the U.S. workforce by 2020, bolstering the potential sustainability of the shared workplace model in the future.[6]

Offering a range of amenities and services also creates the opportunity to flex operating leverage, notes John Rutledge, CEO of development firm Oxford Properties. In short, if done right, coworking and serviced office can be recession resistant, contends Ronen Olshansky, CEO of Los Angeles-based Cross Campus. Having a diverse community of members and offerings can add resilience to the business model.

4: *The Rise of the Shared Workplace in the Sharing Economy*, CBRE Research, January 2016.
5: *Americas Occupier Survey*, CBRE Research | CBRE Institute, March 2016.
6: www.thehill.com; Sizing the inependent workforce: a by the numbers breakdown, February 17, 2016 Gene Zaino.

DO THE OPPORTUNITIES OUTWEIGH THE DOWNSIDE?

AMENITY TO REVITALIZE PROPERTY AND ENHANCE TENANT EXPERIENCE OVERALL

Many landlords now acknowledge that shared workplaces have the power to contribute to the "guest experience" in ways that will help enhance their overall user experience, retain their corporate tenants for the long term, pull people out of informal workspaces such as cafes and living rooms, and in turn differentiate and give life to their asset. In interviews conducted for this series, landlords spoke broadly of their increasing interest in offering amenities such as enhanced hospitality, concierge-like services, and social and cultural programming in order to enhance the experience and satisfaction of their tenants. Jackie Levy, EVP of Operations for retail developer Caruso Affiliated, notes that delivering consumer services — from shopping to meal delivery — can be a powerful addition to an office's amenities package. In this light, corporate real estate is shifting from a business-to-business relationship to more of a business-to-consumer relationship, observes Bert Dezzutti, SVP, Southern California Region for development firm Brookfield Properties.[7] The workplace increasingly is becoming a lifestyle place that merges the traditional distinctions between working and living. "The connection of one use and another creates vitality," contends architect Thom Mayne of Morphosis.

We want our guests to stay in our buildings for the rest of their careers.

Jackie Levy, Executive Vice President of Operations, Caruso Affiliated

Coworking models also are built on this guest experience and already exhibit many of the hallmarks to which landlords aspire today. In many ways, developments in shared workplace mirror and amplify these trends in the broader workplace, retail and hospitality markets, and landlords can tap into shared workplace to assist with their building and portfolio strategies. Shared workplaces, and coworking in particular, typically sell on community, services, culture and value. Branding is key and images of informality, youthfulness, creativity and choice dominate their marketing. These attributes are common to consumer-goods marketing and "lifestyle" brands, and they have the potential to activate and differentiate properties as well.

Coworking is a logical extension of what we are seeing in the marketplace. It's a subject of great interest to us.

Michael Emory, President, Allied Properties REIT

Shared workplace offerings can be an important part of a landlord strategy to attract and retain tenants, asserts Georgia Collins, Senior Managing Director in CBRE's Workplace Strategy group. For example, putting coworking on the ground level can activate the street, make better use of palatial (and often empty) lobbies, give tenants greater flexibility in how they manage peak demand for workspace, and offer spaces and services that smaller tenants may not be able to invest in for themselves. Some owners are heeding

7: Ben Munn, Andrew Baum, Guiseppe Boscherini, and Christopher Perri, *The WorkShop*, CBRE Research, 2012.

REVITALIZATION STORY

WEWORK AND BROOKLYN NAVY YARD

Dock 72 is under development by Rudin Management and Boston Properties. The first building in this major development is a 675,000-sq.-ft. commercial office building that will be anchored by a 220,000-sq.-ft. WeWork location. The Brooklyn Navy Yard is a city-owned industrial park and is designed to promote economic growth. “This project is going to help bring ideas, innovators and startups to the Yard, where they can scale up their businesses, hire more New Yorkers and manufacture their products right here in Brooklyn.”
— New York City Mayor Bill de Blasio.

Young entrepreneurial companies can positively contribute to the overall energy of a building, potentially reinvigorating an aging or stale-feeling environment.

Jay Chernikoff, CEO, DeskHub

this advice and using shared workplaces to fill vacancies in underutilized Class B and C office buildings, industrial properties and shopping centers. Benjamin Dyett, co-founder of Grind, a New York City-based coworking provider, notes that their first facility was in a Class B Midtown Manhattan building with chronic vacancies. Once the operation had established itself as an active hub with an innovative design, the landlord was able to fill the rest of the building. "We attract tenants to a building," he says. Liz Elam, founder of Austin, Texas-based Link Coworking, notes that once her first operation was up and running in 2010, landlords started contacting her to become an anchor tenant in shopping centers. According to a survey by trade journal Deskmag, coworking spaces rarely are found in new buildings. Forty-two percent are in buildings that are 50 years or older, and only half are located in spaces that were originally designated as commercial units. Many coworking spaces are not only revitalizing forgotten buildings, but also are leading to a significant revitalization of the surrounding area.[8]

Increasingly, landlords are viewing shared workplace as a solution to fill Class A properties as traditional occupiers, such as professional and financial services firms, consolidate their space needs. Businesses, eager to retain and attract employees in a highly competitive labor market, are increasingly focused on providing a workplace with the right environments—collaborative and creative opportunities, attractive amenities, and location to maximize productivity and satisfaction.[9]

In today's highly competitive markets, landlords are looking for novel ways to distinguish and differentiate their buildings. Because shared workplaces attract a variety of users, the model supports the trend away from single-purpose buildings to a diversity of uses. Michael Emory, President of Toronto-based developer Allied Properties REIT, notes that the esteem of "community buildings" is rising versus "corporate buildings," adding that "more and more, people want diversity and variation in their workplace." Diversity in a building or campus can also boost the creative potential of tenants.

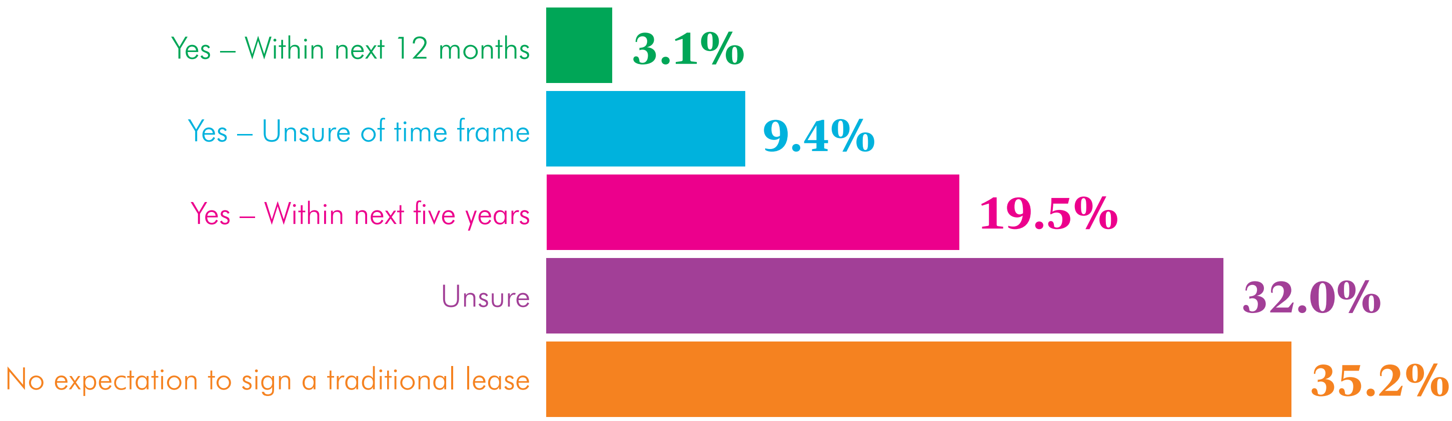
PIPELINE OF PROSPECTIVE TENANTS

Shared workplaces also offer landlords access to a potential pipeline of new traditional tenants as they graduate from the coworking model but seek to stay in the vicinity.

One-third of coworking users surveyed by CBRE Research expect to graduate to leased offices (Figure 1). At Bespoke, a retail technology-focused coworking site in San Francisco, some firms graduate in as few as five months, reports community manager Judith Shahvar. Approximately one-third are unsure of graduating out of coworking space and into their own leased office, presumably creating opportunities for landlords to market direct-lease space to these tenants as their needs evolve and scale shifts.

8: *The Global CoWorking Survey*, Deskmag, 2015-16.
9: *An Occupier Perspective: Why a Shared Workplace May Be Right For You*, CBRE Research, March 2016.

FIGURE 1: WILL YOU GRADUATE OUT OF CO-WORKING INTO A LARGER LEASED OFFICE OF YOUR OWN?



Source: CBRE Research user survey, October–November 2015.

Moreover, 34% of those surveyed by CBRE Research said it was important to stay in the same building or neighborhood if they do graduate to their own leased space. RocketSpace, a high-tech coworking provider, has nurtured more than 700 start-ups, with 15 valued at over $1 billion and a collective $12 billion in investment funding raised. "That one location has generated this much activity is astounding," asserts RocketSpace CEO Duncan Logan. Members and alumni include Spotify, Converse, British Airways and Tata Communications. With 40% of shared-office users receptive to moving to a new neighborhood and a direct lease, perhaps this is the greatest opportunity for landlords to market to this tenant base. Creating amenities and offerings in any portfolio that generate stickiness with tenants will ultimately drive loyalty and make users want to stay in that building and neighborhood (Figure 2).

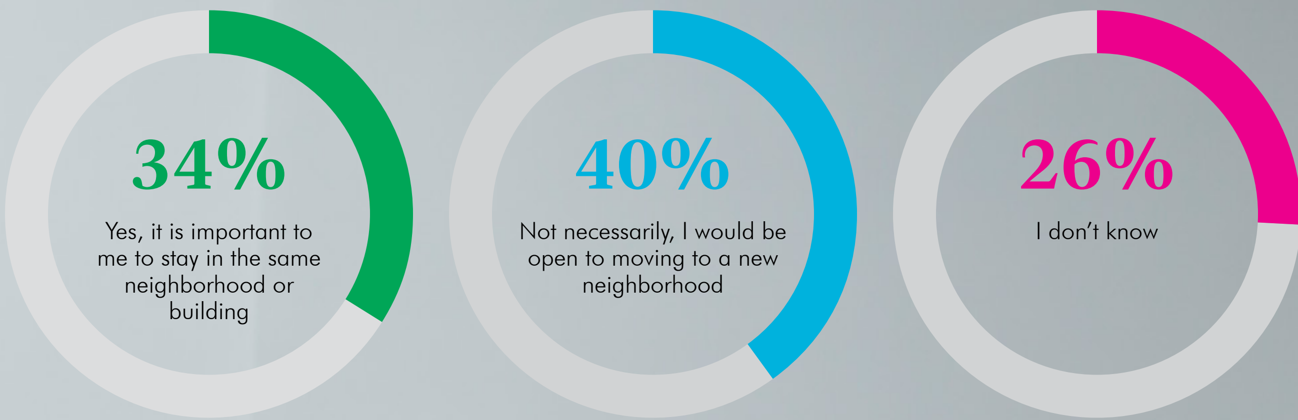
LABORATORY FOR INNOVATION

The shared workplace segment is evolving very quickly as operators mature, new capital flows into the segment and business models proliferate. Developments in the segment mirror many contemporary workplace and occupier trends, and in several instances coworking organizations are on the cutting edge of change. This creates the potential for learning and partnerships.

Densification is a dominant trend in corporate real estate, with the average office space per seat decreasing and the majority of occupiers undertaking efficiency measures in the past year.[10] Shared workplace is much farther along the curve: Coworking operators tell CBRE Research that they allocate just 50–65 sq. ft. per seat and sell up to 10 memberships per workplace in order to maximize utilization and income.

10: *Americas Occupier Survey*, CBRE Research | CBRE Institute, March 2016.

FIGURE 2: IF YOU LEASE OFFICE SPACE OF YOUR OWN, WOULD YOU CHOOSE THE SAME NEIGHBORHOOD?



Source: CBRE Research user survey, October–November 2015.

PROSPECTIVE TENANT STORY

FROM START-UP TO TENANT

August is an organizational development consultancy that is based in a Brooklyn coworking facility. According to founding partner Alix Zacharias, the young firm wanted a comfortable and welcoming workplace that offered clients an enjoyable experience. The founders also wanted quality workspaces to support "inspired work," as well as the opportunity to share experiences with other startups. As the firm grows, however, Zacharias expects August will invest in its own purpose-built space.

CREATIVE PARTNERSHIP STORY

WORKBAR AND STAPLES

WorkBar and Staples are collaborating to bring WorkBar spaces to Staples stores. The theory is that Staples has convenient locations, ample parking and extended hours—all of which could satisfy an unmet coworking user base in regional suburban areas. WorkBar is building a hub-and-spoke model that links urban centers and suburban locations. In turn, Staples is enhancing its customer offering and making use of vacant space in their stores as their inventory shrinks due to changing goods and the ecommerce dynamic.

We are going to learn a lot from our coworking partnership. They will demand a lot from us. We are very interested in how this will improve the character of our buildings.

Bert Dezzutti, Senior Vice President, Southern California Region, Brookfield Properties

Shared workplace thus provides a real-time laboratory for understanding how people work productively in such dense, high-utilization and fluid environments. They provide a lens on how building systems, office furniture, operations and maintenance must evolve. Given the rapid evolution of the workplace and businesses' needs, coworking operators such as WeWork are pioneering new approaches to rapid and low-cost build-out, furnishing and repurposing of workplaces, observes Tom Eich, CTO of global design firm IDEO.

Shared workplace, and coworking in particular, is creating a distinct market where one didn't exist. It's also tapping into a fundamental shift in business strategy towards "asset light" and agile operations. Common phrases echoed in our discussions about shared workplace are "outsourcing" and "office as a service." The concept could have fundamental impacts on how buildings are branded, leased and operated in the future.

CBRE Research's survey of coworking users revealed that they first and foremost seek out providers with convenient locations. They also highly value quality and aesthetics that they perceive will help them in building professional and social communities. Consumers of this space are passionate and vocal about their surroundings. Similar to the hotel sector, the rise and fall of memberships provides a real-time indicator of user preferences. Landlords should seek out such detailed end-user data.

POTENTIAL FOR CREATIVE PARTNERSHIP

While the space-sharing model has clearly garnered interest in the marketplace, we would not at this time describe it as a disruptive threat to the traditional landlord business model. Rather, many landlords are leveraging coworking spaces to their benefit. Not only are they marketing coworking spaces as an amenity for existing tenants, but they are using the spaces to show prospective tenants what is possible. Many end-users are looking for space that aligns with today's trends, says CBRE's Georgia Collins. Given the emphasis coworking organizations place on innovative design, access to natural light and efficient space utilization, more and more landlords are using these office designs to help tenants visualize what their space could look like in the future.

Partnerships being formed between otherwise traditional landlords, occupiers and coworking providers are far from traditional lease agreements, but they are arrangements that offer value and opportunities for success to both parties. Below are a few highlighted stories that shed light on some of these more complex and growing partnerships.

CREATIVE PARTNERSHIP STORY
VERIZON AND REGUS

Verizon is partnering with a variety of coworking organizations to provide its workforce with a global network of flexible space. The strategy will allow Verizon to save significant cost over a standard lease, but also will provide a more dynamic work platform for its employees. To implement the strategy, Verizon has teamed with Regus to assemble much of the needed infrastructure. Verizon already has moved two locations in the LA area, with more transitions due in NYC, Tucson, Texas and other areas, impacting more than 300 employees in its first year. “While other corporations are using coworking to solve a temporary or ad hoc need, we have created a way to place our permanent administrative teammates on this platform to maximize the end-user experience and reduce our overall cost burden,” says Jim Tousignant, Director of Global Real Estate for Verizon. The program has the potential to impact up to 2 million sq. ft. of Verizon’s current leased space over the next five years, with an estimated average cost reduction of up to 60%.

CREATIVE PARTNERSHIP STORY

M7 AND REGUS

Regus, the global workspace provider, and M7 Real Estate, the pan-European real estate investment and asset manager, have a strategic partnership deal that operates on a profit-share model. Regus provides M7 with a share of the profit generated at the M7 sites. For Regus, the relationship provides an attractive portfolio of M7 locations for the company to further grow its flexible workspace network and client base throughout Europe. And for M7, the deal provides higher potential returns on its investment compared to those achievable at existing rental levels, while at the same time helping the company to absorb vacant space and save empty rates charges.

CONCLUSION

Shared office is tapping into many durable megatrends, including the economic revitalization of gateway urban centers, economic uncertainty and technology enabled mobility.[11] Both large and small occupiers are looking at this space as a means to build culture, connectivity and address cost.[12]

While shared workplace accounts for a very small share of the total office market, it offers a new channel for landlords to tap into a growing and dynamic market that is satisfying user needs. Moreover, shared workplace can be seen as both building tenants and building amenities that add new demographics, diversity and energy to a building or campus. Finally, trends in this niche reflect and are shaping many important developments in the workplace more broadly—from flexible working arrangements to an emphasis on community and collaboration.

Though operators and business models are likely to evolve through the next business cycle, the concept is unlikely to go away and its fast pace of change makes it a powerful laboratory for workplace innovations. Landlords and investors should be watching and perhaps engaging with the shared workplace segment, and at the very least should be taking notice if they haven't already. Competitive advantage for landlords is paramount to success and the contributing factors to that advantage are evolving rapidly. Keeping pace with that evolution is the winning strategy.

11: *The Rise of the Shared Workplace in the Sharing Economy*, CBRE Research, January 2016.
12: *An Occupier Perspective: Why a Shared Workplace May Be Right For You*, CBRE Research, March 2016.

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ABOUT THIS REPORT

This is the third in a series of CBRE Research/Longview Global Advisors reports on developments in the flexible or shared office segment. Research for this report was conducted between September and November 2015. The findings are based on conversations with more than 50 thought leaders and representatives around the U.S., including occupiers, users, landlords, investors, and workplace design and strategy professionals. The report also draws on findings from two surveys—one involving more than 30 corporate real estate professionals in the financial services sector and the other more than 130 coworking users.

ABOUT LONGVIEW GLOBAL ADVISORS

Longview Global Advisors is a research and advisory consultancy that helps business leaders make sense of a complex world. Drawing on a network of social science experts, the firm focuses on the connections between business, economic, political, and social trends and provides issues-monitoring and analysis, thought leadership, and corporate and executive positioning.