Coworking

Flexible workspace vs. traditional office space

Flexible workspace has become a huge buzzword in the commercial real estate industry. Over the past decade, we have seen emerging companies such as WeWork, Galvanize, Shift Workspaces, Thrive, Grid, Serendipity Labs and many others enter the Denver metro office market.

Some question if coworking is a fad that will eventually die out, as well as whether it will become profitable. Time will tell, but for now, flexible workspace appears to be gaining momentum and significantly impacting traditional office leasing.

It's easy to see why flexible workspaces have become so popular. They allow companies to be agile and also can positively impact recruitment and employee retainment. They're modern, hip, have all the amenities you could ask for, and generally they're located in desirable locations. But perhaps their most attractive quality for potential tenants is their flexibility with lease terms. Whereas most traditional landlords prefer long-term leases, flexible workspaces will accommodate just about any term. Shared workspace clients have memberships versus leases, a big difference from the traditional office leasing world.

One of the biggest hurdles leasing brokers must overcome in regard to tenants and landlords is the term length of the lease. Tenants want flexibility to grow or downsize as their needs change, while traditional landlords are looking for long-term stability.

Tenants generally want a cool space in a desirable location with

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lots of amenities, while landlords want to keep costs low and tend to be risk averse. We are realizing that both coworking office solutions and traditional office leasing have their place in the world because they service different needs for the tenant.

Flexible workspaces began by primarily partnering with startup companies that weren't sure what the future would hold with regard to growth. These types of companies weren't interested in leasing traditional office spaces because of the overhead involved and longer lease terms many landlords require.

A typical flexible space user would be a software engineer looking to collaborate on projects with other like-minded tenants. Although these small startups are still very prevalent in flexible workspaces, there is a new trend of large enterprise companies entering the flexible workspace market. Companies like IBM are discovering the advantages of being agile in today's real estate market.

This is a shift in mindset for these larger corporations where flexible lease terms outweigh the desire for having a unique, customized workspace. I have heard that many large corporations have up to 35% of their office space in these flexible workspaces. It's a great option if you are testing a new market or need time to ramp up in a new market.

Most flexible workspaces offer a

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combination of open space, private meeting space, collaborative space and communal space, and come furnished. They can be leased in a coworking environment where different users share space and amenities, or in a private setting where one company occupies an entire floor or multiple floors. Some also offer meeting rooms and/or large training rooms that members may only need on occasion.

The big difference from traditional office leasing is that the flexible workspace has a generic layout that the tenants must fit into versus a customized space that needs to be re-customized every time a new tenant moves in. Unless a tenant knows its exact growth as a company every five to 10 years, the financial risk in leasing office space increases as it expands and contracts. More and more tenants realize the financial benefit of paying a bit more and being nimble rather than paying less while committing to a long-term lease obligation that may eventually fail to fit their needs.

So, are these flexible workspaces here to stay? Here are some interesting statistics that I have borrowed from a May 10 article written by Cecilia Amador on allwork.space:

- There are approximately 35,000 flexible workspaces in the entire world, which represents 521 million square feet of flexible space.
- The global market value of flexible workspaces is estimated at approximately $26 billion.
- Up until 2022, the number of coworking spaces is expected to grow at an annual rate of 6% in the U.S. and 13% elsewhere.
- In 2018, the number of coworking spaces rose 16% in the U.S.
- Forty percent of flexible workspace demand is forecast to come from large and corporate companies.

Currently, these types of spaces comprise a relatively small portion of the office leasing ecosystem. There always will be a need for traditional office leasing, but flexible workspaces also have their place in the market. The two can work together and complement each other, as they serve different functions and needs for tenants. We will see how this concept holds up in a down cycle, but as for now, they remain popular and are growing more popular every day. ▲

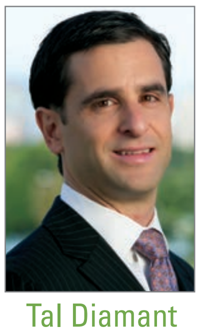
Coworking spaces balance location, amenity, term

In the current leasing market, it is becoming increasingly important for landlords and tenants to adjust their expectations in order to find the proper balance between costs, amenities and the term of the lease.

Tenants' desire for amenities to be included in their leasehold can be costly for landlords, who are trying to minimize leasing costs and increase income. At the same time, tenants seem to be seeking shorter lease terms that also cut against the landlord's desire for stable long-term income and reimbursement of initial leasing costs.

With the increased commute to work, tenants want their employees to have some daily necessities close to the office. However, amenities come with a cost to the landlord. Landlords are trying to find the appropriate balance of amenities they need to create within the building and amenities that exist in the area surrounding the office.

One solution to tenant requests for additional amenities is location. If there are amenities close to the office building, landlords might not have to include such amenities within the building and can incur less expenses. For example, if there are restaurants or gyms within walking distance of the office building, the building itself may not need a restaurant or gym. In order to attract tenant employees to the local gym, landlords can work out a deal with the gym for discounted memberships based on the volume



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of people coming from the office building.

In addition to moving traditional office amenities outside of the office building itself, the location of supplemental amenities like child care and dry cleaning is key to obtaining valuable tenants. Tenants want to ensure that their employees can accomplish their daily work with minimal commute and time consumption.

One amenity that typically is nonnegotiable for tenants is connectivity. The building must have Wi-Fi and cell phone service throughout to attract today's tenants.

As we know, landlords desire longer lease terms in most cases. This helps to increase the asset value and offset the costs of tenant improvements and allowances granted by the landlord. In today's economic climate, many tenants want shorter lease terms to hedge against profitability issues and for flexibility with respect to size and location.

One reason that tenants no longer want to sign longer-term leases is that they are concerned that the space will not be big enough for them as they continue to grow. A simple solution would be for a landlord to offer the tenant an option

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or first right on additional space, should it become available.

In order to accommodate shorter lease terms, landlords should avoid heavy costs for specialized tenant buildouts, and instead make sure that such space is easily and inexpensively convertible for future use.

One option that would allow landlords to optimize all of these lease considerations could be the uptick in coworking spaces. There are a number of coworking arrangements, ranging from hot-desks to shared areas to full-fledged office space rentals. Some coworking operators afford users the ability to utilize locations around the country and facilitate such users' access to a convenient work environment.

Coworking companies are able to solve the landlord's above-referenced lease-term dilemma as they are able to sign long-term leases since their business model is based on subleasing and licensing space to their users. Coworking companies generally demand flexibility to manage their leased premises as their business model relies on interacting with a wide range of users.

This loss of control is not always welcomed by landlords, who want oversight as to who occupies their building. Yet, unless there are compelling reasons for landlords to control a shared concept operator's users, the landlord should by and large appreciate the opportunity to have a larger tenant pay rent for a longer period of time.

There is a current debate whether the coworking space concept is here to stay. The amount of coworking operators has increased rapidly. However, a growing number of landlords are hesitant to rent large areas to coworking companies, since this is still a relatively new concept that has yet to stand the test of time. Landlords would be prudent to request guarantees and other credit enhancements from coworking companies.

If in fact coworking companies become a proven concept, they present a beneficial balance between the landlord's desire to have long-term leases and the tenant's goal to have shorter, more flexible leases.

As tenant demands and expectations are changing, landlords are forced to balance their objectives of accommodating tenants against maximizing investor profits. Landlords are attempting to reduce their costs by locating their buildings in an area that has myriad tenant-desired amenities. The solution to the proper balance between length of lease and cost minimization, at least in the near future, appears to be coworking spaces. ▲