Shared Space: Disrupting the Traditional Office

Yardi® Matrix

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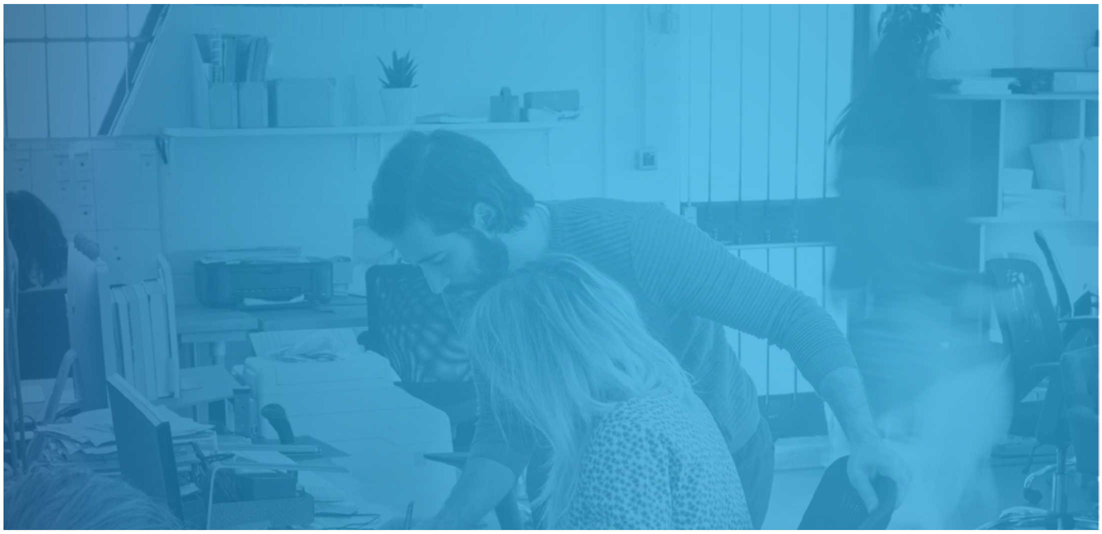

Moving Into the Mainstream

Shared office space is a fast-growing part of the office market landscape, fueled by the evolution of the technology industry and the way people work, and the demands of businesses and workers. Simply put, what is expected out of the office is slowly changing and will continue to develop for years to come.

In that light, not only is the amount of shared spaces growing dramatically but the business model is rapidly evolving. Landlords and brokerage firms have jumped into the fray to support the demand for space with more amenities and flexible lease arrangements. The sector is in a nascent phase, so the pace of growth is likely to pick up in coming years.

Yardi Matrix's latest study of coworking space in 20 U.S. metros found that 43.5 million square feet of office space was being rented as shared space, 1.7% of total inventory in those markets. Our first study in the fourth quarter of 2017 found 26.9 million square feet in those same metros. The proportion of shared space in markets was higher in metros with high concentrations of technology employment and metros where space was at a premium. Coworking was a higher proportion of total space in urban submarkets (2.2%) than suburban (1.2%).

Manhattan is the coworking capital of the U.S., ranking first in both overall amount of space (13.7 million square feet) and as a percentage of total stock (3.0%). Coworking also has a significant presence in Miami and San Francisco.

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Growth Market

Shared space isn't a new concept, but until the current economic cycle it was a small niche. Growth is driven by a slew of factors, including the increase in "gig economy" independent workers, corporations deploying more workers remotely, the need to attract workers with a relaxed environment and companies looking for more flexibility with the space they occupy.

The industry's growth has become publicized as more large companies enter the space, both as operators and tenants. WeWork, for example, has attracted a large amount of institutional capital, while behemoths such as CBRE and Tishman Speyer have announced plans to throw their hats into the ring in various capacities.

Still, numbers on the segment's reach are not easily available. Yardi Matrix conducted a study of 20 markets in the fourth quarter of 2017 and found 26.9 million square feet of coworking space, representing 1.2% of the total market. We revisited those same markets in the early fourth quarter of 2018 and found 43.5 million square feet, up more than 50% from a year earlier, representing 1.7% of total stock (the study encompassed buildings with at least 50,000 square feet of space).

By total square footage, Manhattan easily topped the list with 13.5 million square feet, followed by Los Angeles (4.7 million square feet), San Francisco (3.0 million), Dallas (2.2 million) and Seattle (2.15 million). As a percentage of stock, Manhattan was again on top at 3.0%, followed by Portland (2.5%), Miami (2.4%), San Francisco (2.3%) and Austin (2.2%).

Coworking is more prevalent in urban submarkets. We found 27.7 million square feet in urban markets, representing 2.2% of stock, compared to 14.7 million square feet in suburban submarkets, or 1.2% of total stock. Coworking is growing as a percentage of office stock in all areas, but it is a more natural fit in urban settings due to the proximity to a greater number of workers, easier commute to urban locations and greater availability of small rental spaces in suburban areas.

Shared Space by Metro

Market	# Locations	Total Sq. Ft.
Manhattan	373	13,690,332
Los Angeles	175	4,730,015
San Francisco	91	2,957,922
Dallas	127	2,227,551
Seattle	49	2,159,725
Houston	95	1,913,590
Denver	79	1,862,506
Bay Area	59	1,688,333
Atlanta	81	1,642,086
Austin	35	1,323,654
Orange County	58	1,319,145
Miami	69	1,309,039
Portland	22	1,200,958
Phoenix	60	1,064,517
San Diego	50	965,279
San Antonio	11	740,906
West Palm Beach	29	471,613
Fort Lauderdale	26	461,332
Sacramento	22	427,016
Inland Empire	10	163,258
Total	1,521	42,318,775

Source: Yardi® Matrix

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Coworking Suburban

Market	% Coworking	Sq. Ft.
Portland	2.6%	545,890
West Palm Beach	2.1%	439,088
San Antonio	1.9%	471,486
Los Angeles	1.9%	1,513,605
Miami	1.9%	626,062
Austin	1.6%	756,374
San Francisco	1.4%	650,093
Orange County	1.4%	1,319,145
Fort Lauderdale	1.4%	248,410
Denver	1.3%	1,013,769
San Diego	1.2%	752,917
Phoenix	1.0%	709,678
Houston	1.0%	1,168,297
Seattle	1.0%	440,760
Dallas	1.0%	1,578,579
Atlanta	0.8%	952,815
Inland Empire	0.8%	163,258
Bay Area	0.8%	1,030,169
Sacramento	0.8%	271,738
Total/Average	1.4%	14,652,132

Coworking Urban

Market	% Coworking	Sq. Ft.
Austin	4.1%	567,280
Miami	3.1%	682,977
Manhattan	3.0%	13,690,332
San Francisco	2.7%	2,307,829
San Antonio	2.6%	269,420
Portland	2.5%	655,068
Seattle	2.4%	1,718,965
Bay Area	2.2%	658,164
Los Angeles	2.0%	3,216,410
Denver	1.9%	848,737
San Diego	1.8%	212,361
Fort Lauderdale	1.7%	212,923
Sacramento	1.2%	155,279
Atlanta	1.2%	689,271
West Palm Beach	1.1%	32,525
Phoenix	0.9%	354,839
Dallas	0.9%	648,972
Houston	0.7%	745,293
Total/Average	2.0%	27,666,644

Source: Yardi® Matrix

Metro Drivers: Tech and Vacancy Rate

There is a large gap in the success to date between metros. Of the 20 markets in our study, coworking space represents 2.0% or more of office stock in eight, while it comprises 1.0% or less in seven. What accounts for the difference?

One factor appears to be presence of technology industries in a metro. Most of the metros on the top of the list either in terms of total coworking space or as a percentage of stock have a strong tech industry presence. Manhattan, for example, has more technology workers than any city in the U.S. and is drawing many small tech startups, particularly to Midtown South; the expansion of Google and Amazon in New York City will fuel more growth. Portland, San Francisco, Austin and Seattle are among the top metros in the U.S. for tech workers as a share of total employment, according to Cushman & Wakefield's Tech Cities 1.0 report, while San Antonio's tech sector is small but growing in relation to the overall market.

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Compared to other industries, the tech sector has a larger percentage of startup and small entrepreneurial firms that prefer short-term leases during their ramp-up phase. Venture capital funds advise the small tech firms that they seed to avoid long-term leases. Plus, tech firms have young workforces that prefer the "fun" and amenity-rich environment that coworking sites strive to achieve.

Another factor on the metro level is the availability of space. Coworking as a percentage of stock is generally higher in markets in which the occupancy rate is low. Manhattan (8.9% vacancy), San Francisco (7.9%), Seattle (8.4%), Portland (10.6%) and Austin (10.2%) are among the metros with the lowest vacancy rates and highest percentage of coworking stock.

On the other hand, Houston (21.2% vacancy), Dallas (19.4%), Phoenix (17.2%) and Atlanta (16.6%) are all large and growing markets where coworking is lagging as a percentage of stock, in part because the vacancy rate is well above the national average. It does seem logical that coworking would grow more in markets where attractive space is harder to find. However, since coworking is a relatively new market segment, it remains to be seen whether the correlation between coworking space and vacancy rates persists.

Market	Coworking Space % of Total Sq. Ft.
Manhattan	3.0%
Portland	2.5%
Miami	2.4%
San Francisco	2.3%
Austin	2.2%
San Antonio	2.1%
West Palm Beach	2.0%
Los Angeles	2.0%
Seattle	1.9%
Average	1.6%
Fort Lauderdale	1.5%
Denver	1.5%
Orange County	1.4%
San Diego	1.3%
Bay Area	1.0%
Phoenix	1.0%
Atlanta	1.0%
Dallas	0.9%
Sacramento	0.9%
Houston	0.9%
Inland Empire	0.8%

Source: Yardi® Matrix

Evolving Business Model

Coworking remains dominated by a handful of firms. Regus, with 17.3 million square feet of space in our 20 markets, and WeWork (13.4 million) represent about two-thirds of all shared space. Other large coworking companies include Spaces (2.1 million square feet), Premier Business Centers (1.6 million), Industrious (1.3 million) and Knotel (1.2 million).

At the same time that coworking is rapidly increasing its footprint in the office market, the business model is changing. The traditional model involved a coworking company leasing space from a building owner and then leasing that space in small units to users. The coworking firm typically builds out the space and provides services such as phones, internet access, furniture, exercise/entertainment facilities, mail and concierge services, and kitchens. Clients could, in

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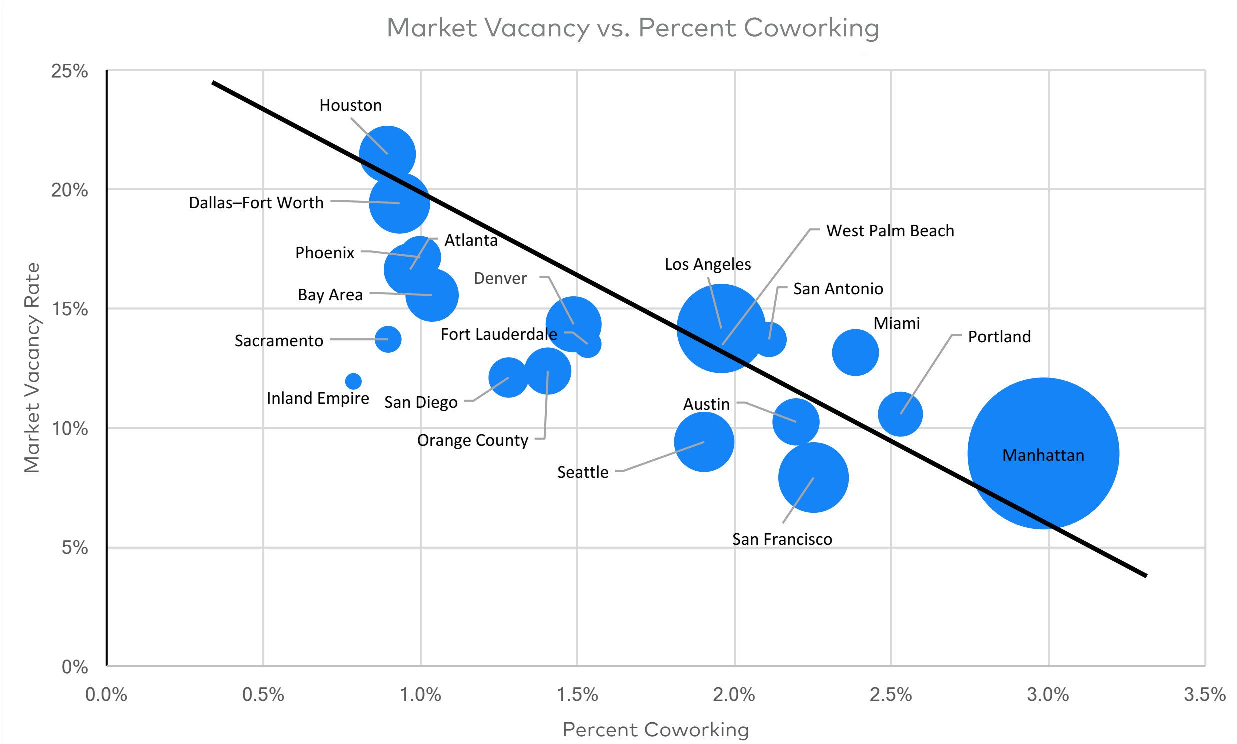

Source: Yardi® Matrix

most cases, lease space for anywhere between a portion of a day and a year.

However, building owners and service providers have seen the growth in coworking and aren't content to be passive viewers anymore. Some are deciding to cut out the middleman or change the incentives. One way to do this is for the landlord to enter into a joint venture or licensing agreement with a coworking provider or other firm in which the coworking agent does not sign a lease. Under the JV arrangement, the coworking provider will build out space at a building and market the space for the landlord. Instead of signing a lease, the coworking provider will work for a percentage of the rent and/or share in the upside of the building value.

Such arrangements make use of the skill of coworking firms to create space that is attractive to employees. Owners and brokers also want to leverage their existing relationships in a way that enables them to provide the services that clients want. These types of coworking spaces also require large blocks of space.

Some examples of the new model: Global brokerage and service firm CBRE recently announced the start of a business called Hana that will partner with building owners to provide coworking space starting mid-2019. Owner/developers such as Hines and Tishman Speyer are working on a partnership that will focus on branding their office space. Coworking companies including Industrious, Premier Business

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Centers and Knotel work both under the old lease model and in newer-model partnerships with building owners.

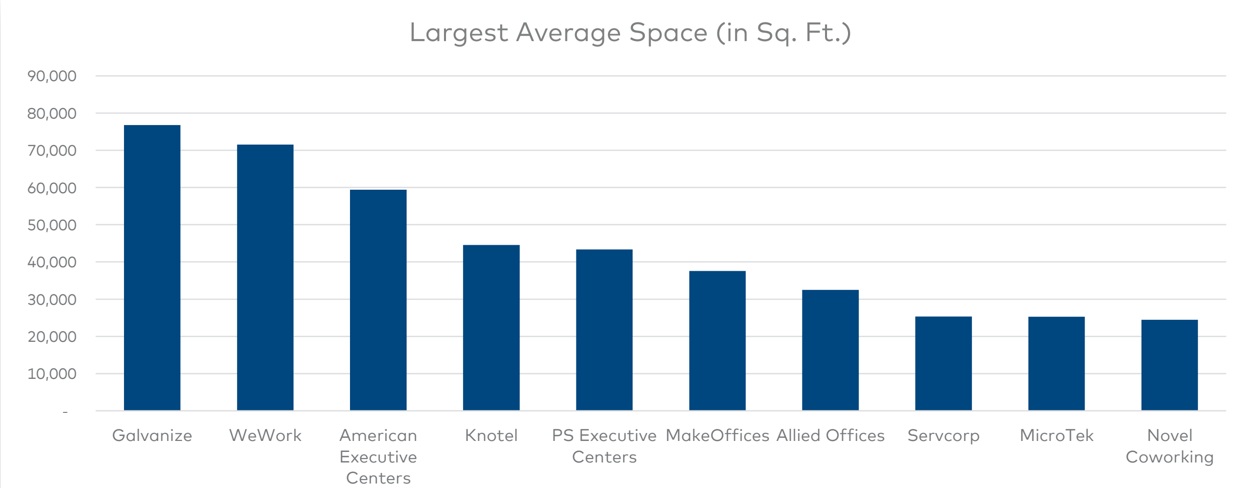
Another (related) evolution in coworking is the growth in large tenants. Many Fortune 500 companies realize they have too much space, or that the space they have is not in optimal locations, or they want more flexibility and are willing to pay more for space if it comes with shorter leases and amenities they need such as collaborative space.

Corporations are also mindful that with unemployment so low, competition for skilled and knowledge workers is fierce, and providing an amenitized workplace environment is increasingly prized by corporations. And it's not just Millennials—market players say workers of all ages are attracted to work spaces that have a community feel and pleasing environment.

Shared Space by Top Operators

Operator	# Locations	Total Sq. Ft.
Regus	782	17,360,872
WeWork	227	13,422,918
Premier Business Centers	83	1,561,947
Knotel	64	1,236,263
Industrious	55	1,261,770
Spaces	53	2,124,198
Boxer Property	53	1,178,559
Breather	52	238,844
Office Evolution	43	746,723
Intelligent Office	41	854,350

Source: Yardi® Matrix



Source: Yardi® Matrix

Long-Term Growth Inevitable

Coworking is in the early stages of its development, and the risks are evident. The industry's growth comes during a long and sustained period of economic growth. How it will retain clients and revenue during a downturn is an open question. The short-term lease model has more upside during an expansion and more downside during a recession. The barrier-to-entry issue is also evident in the spate of new players. Owners and service providers that have access to vacant space are likely to join the coworking fray, providing competition that could potentially oversaturate the market.

Of course, every good new product has its imitators—coworking is being copied because it gives the market what it wants: attractive workspaces with flexible terms for tenants. Given that demand for office space is almost certainly going to be evolving in that direction, coworking is likely to keep growing into the foreseeable future, whether or not the current group of providers or business models endure.

—***Paul Fiorilla***, *Associate Director of Research*