February 2018

How Coworking is Shaping the Office Market

By Andrea Arata

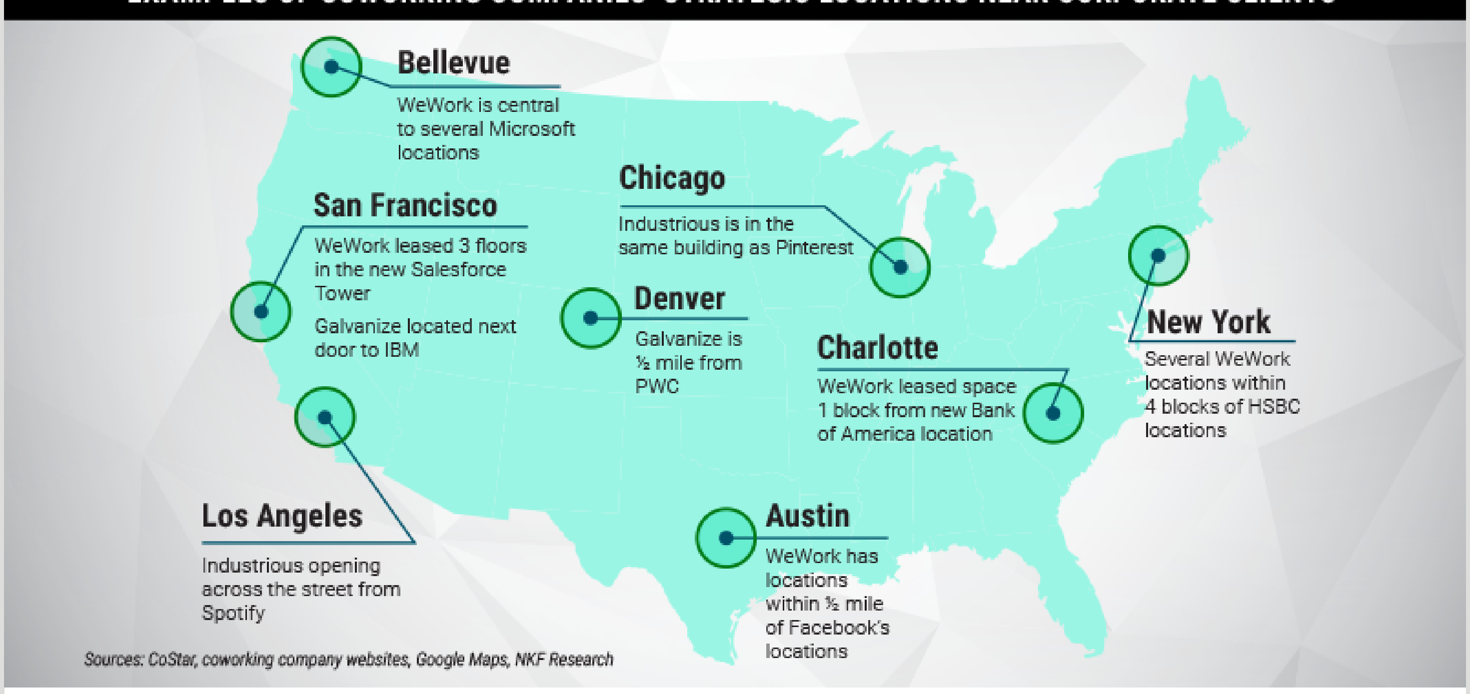
The National Trend: Coworking Firms are Targeting Large Tenants

The coworking landscape is rapidly expanding and evolving, attracting companies of all sizes from every type of industry to nearly 14,000 locations worldwide. WeWork is the largest coworking company, with locations across 20 different countries, including 160 locations in the United States that comprise more than 10.7 million square feet. However, Impact Hub, Industrious and Knotel each have dozens of locations and are growing, while Serendipity Labs recently launched a franchisee program and currently lists more than 100 new locations under development.

From a tenant's perspective, the wide selection of coworking options and the pay-as-you-go rent model offers a lot of flexibility – if a tenant does not like what her coworking space is offering, she can easily move to a different one. This dynamic forces operators to remain nimble. Coworking companies can differentiate themselves by offering a variety of locations, hosting seminars taught by industry experts, holding pitch events, curating tech-only tenants who work in non-competing areas of the sector, and offering discounted health insurance plans to members.

Importantly, coworking companies with multiple locations have expanded their targeted tenant type, and now are using their economies of scale to appeal to large corporations. Industrious and Galvanize each have several Fortune 500 partners, and companies with more than 1,000 employees now constitute between 25 and 30 percent of WeWork's business. Large companies use coworking to satisfy a variety of needs, such as "landing pads" as they search for new satellite locations, swing space while waiting for tenant improvements to be built-out, temporary locations for special project teams, and for right-sizing when necessary. More importantly, coworking space provides corporate real estate teams the luxury of a "just-in-time" solution while long-range planning is in flux, easing the burden that comes with short-term expansion or contraction. As a result, coworking companies often strategically locate just a short distance from their largest clients, as illustrated in the adjacent graphic.

EXAMPLES OF COWORKING COMPANIES' STRATEGIC LOCATIONS NEAR CORPORATE CLIENTS



Sources: CoStar, coworking company websites, Google Maps, NKF Research

Featured Market: San Francisco

Coworking in San Francisco has grown by 120% in the last three years, encompassing 1.4 million square feet, or 1.7% of the market, at the end of 2017. These companies tend to lease carefully selected locations, opening in tech-centric SOMA or within steps of new developments that appeal to growing tech companies. For example, WeWork not only recently leased space in Salesforce Tower, but also three locations within two blocks of 350 Bush Street. WeWork has targeted blocks of traditional Class A space that had lingered on the market: a coworking space can bring a lot of new energy to a quiet building, although existing and potential building tenants do not always appreciate a daily influx of young tech workers. At the other end of the spectrum, owners of Class C properties and sublessors of older space north of Market Street are realizing that they are competing with space options that have greater amenities and much nimbler term lengths. Those owners and sublessors are beginning to adjust their pricing accordingly. Further down the peninsula, WeWork has subleased two buildings from LinkedIn in Mountain View totaling 457,800 square feet, and in turn is rumored to lease the space entirely to Facebook.

What Are the Implications for Our Clients?

The popularity of coworking is not diminishing; in fact, its popularity may increase with the new accounting standards set by the FASB, which require companies to report existing leases on their books as both an asset and a liability beginning in 2019. (For more information on the evolution of the financial services industry, please see our recent white paper on that topic.) Further, new companies and services are popping up, such as Breather, which provides a network of private professional meeting rooms; LiquidSpace, an Airbnb-type website for short-term office space; and restaurants that are opening their dining rooms as coworking space during daytime hours. These next-generation coworking services raise the question of over-saturation: at some point, the market may have too many temporary office options. Property owners who count coworking firms as tenants need to balance the reward of leased space now with the risk of what happens to that space when the market turns.

For large corporate tenants with growing office space needs, coworking facilities offer flexible, amenity-rich options, often in premier locations. Ultimately, all parties need to adapt to the rapidly changing definition of what constitutes an office. Just as the sharing economy has changed our demand pattern for services, so has it changed our perception of the spaces where we log on to our laptops each day.

Research

About the author: **Andrea Arata** is the Director of Research in Newmark Knight Frank's San Francisco office.
For more information: **Alexander (Sandy) Paul**, Senior Managing Director of National Research, 202.312.5783 APaul@ngkf.com