

A Landlord's Guide to Flexible Workspace

PART I: CRITICAL BUSINESS OUTLOOKS



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Executive Summary

With demand on the rise, flexible workspace is expected to increase to 30% (versus the current 2%) of office inventory by 2030. (JLL). There is massive opportunity for the commercial real estate sector to contribute to this growth while driving revenues and filling vacant or latent space.

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The race is on for landlords, building owners and property developers to sink or swim in this dash to flex-space. As the market matures and gains spotlight attention in the media, tenants are calling the shots. Expectations are high and demands continue to vary case by case. With nothing but options in a fast-growth market, it boils down to “may the best operator win”.

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But running a flex-space operation isn't one-size-fits-all. It's a complex business which, if not carefully planned and executed, can be a big disappointment for investors. Understanding the many moving components of the business model is critical to success, along with attracting and retaining customers, running an efficient and scalable operation, and meeting the varying demands of today's occupiers. Landlords must get the operation right from day one and decide how to position themselves in a new market.



Intro



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Flexible workspace (commonly referred to as coworking) has been turning heads of CRE stakeholders – among them landlords, building owners and property, asset and investment managers.

Many are testing the waters to evaluate whether this relatively new asset class is a viable option for their portfolios.

If you're one of these CRE stakeholders milling over the opportunities and risks of implementing a flexible option across your commercial real estate portfolio, this guide is for you. Below we take a look at the ins-and-outs of flexible workspace to help inform your approach. Flex is the new normal. Regardless of where you sit on the adoption curve. It's not going away and it can't be ignored.



Product to Service

As the office market evolves, flex-space is increasingly a service-led business. To be successful, it requires a shift in mindset for the traditional product focused CRE players. Demand for flex has forced landlords to reconsider aspects of their own business model and to focus on delivering agility, flexibility and the amenities that drive value, productivity and superior tenant experiences.

Flex-space is a complimentary but at the same time differentiated business model from traditional commercial real estate and it should be implemented as such.

Rolling out spec suites or flex-space across a portfolio is more than scattering some desks in vacant space and calling it “coworking”. Flex-space is a viable long-term real estate solution for businesses of all sizes, not just independents or startups. Delivering on the varying requirements of all types customers is critical.

Being service driven in a maturing market full of choice means concentrating operational efforts on meeting tenant expectations and delivering excellent member experiences. It’s more than signing a lease on a space and forgetting about it

until the renewal date is up. You have to build a brand and an operation that lends to flexibility, agility, service excellence and frictionless occupier experiences.

A flexible workspace operation is multi-functional and complex. Integrating flex-space into a portfolio requires considerations of each core business unit that a traditional occupier with a long-term lease would generally be responsible for independently. From office management and technology to finance and hospitality, it’s a business model that requires expertise across multiple disciplines.

Check out our Guide to Opening a Coworking space

Moving to a service model allows landlords, space providers and other classes of CRE stakeholders to better align to tenant expectations and requirements. Meeting expectations underpins a higher price for space as well as long-term value.

Business Models

A flex-space proposition is deserving of its own proposition, brand and business operation. Landlords have the advantage of



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property and amenities at their fingertips, which makes both testing the waters and scaling up more accessible. Below are some common flex-space business models for entry into the market.

Building or Owning

Owning a property is the ideal situation but not always the most feasible. There are pros and cons. If you own or can purchase property, this may be a great option because it allows you to build equity while running a cash business on top of the asset. You have unique control over each and every aspect of the property, enabling you to deliver a more customized experience to tenants. However, it means that you will be exposed to the full risk of the operation.

Buying a building represents a significant cash out lay. You'll be responsible for the improvements to the building and the space build out, in addition to exposure to the mortgage and operating expenses for the building and the business.



Traditional Leases

Leasing commercial space within your portfolio to a flex-space operator gives your portfolio an edge of flexibility, which can add value given the high demand for this asset class. It removes upfront capital expenditure to purchase the property, but you'll have to fund some of the build out the space through the tenant improvement allowance.

Tenant improvement is rarely enough to build out the space and pay for the furniture, fixtures and equipment necessary to start operating. You'll still have liability because rather than guaranteeing the mortgage, you are guaranteeing the lease to some capacity. In this scenario, you do not have the advantage of tapping into the appreciation of the property.

Non-Traditional Leases

Non-traditional leases such as joint ventures and profit shares are becoming more common in the industry. These generally include some combination of profit-sharing or management fees between the landlord and the operator. The benefit is less risk and capital outlay for the operator. As the landlord you participate in some or all of the capital outlay to build out the space and take a slice of the profits.

These leases are designed to protect the operator from fluctuating real estate prices and market conditions. Rather than locking into a long-term lease you might share build out and construction costs with the operator and then take a below market rent rate in exchange for a percentage of the profits from the workspace. In a profit-share business model, the more lucrative the operator, the better off the landlord. However, the operator is more protected from extreme market downturns and upswings.

Business Models



Management Agreements

Increasingly common, management agreements are entered into by landlord and operator and define exchange for operational services in return for a management fee.

Negotiations can be lengthy and difficult. It's advised that each party clearly defines their objectives and thresholds. The agreement should outline the fees, expectations and specifics of the partnership.

Knowing your risk tolerance and when to walk away from a deal is crucial.

Risk & Valuation

In today's market, office buyers and landlords are changing how they value office leases. The shift from longer to shorter term contracts is forcing the market to re-think and change its mindset on both risk and valuation within the office industry.

For operators, risk is how liable you are for the capital outlay that you're investing. This could be a loan, a letter of credit, personal guarantees, corporate guarantees and your time and effort. If you're a landlord, you could have the same liability as operators. But you'd also have to consider the amount of TI (tenant improvements), commissions, free rent and other concessions you invested.



If you're an investor on the capital market side and purchasing an asset, your liability will vary based on the business models and revenue streams applied to the asset. Historical data can give perspective on the asset's value, cashflow, and existing liabilities. Due diligence is required for a full view of transactions in the past or existing capital investment in the asset. It will be different for every deal and for every buyer.

Risk & Valuation

Risk tolerance can vary based on your business profile. REITs tend to have a lower appetite for risk. They seek stability and healthy cashflow. They typically won't enter into a joint venture or management agreement due to very strict SEC regulations, but a traditional lease would be on the table. Real estate firms investing pension money or managing money for wealthy individuals are willing to take slightly more risk. Meanwhile, entrepreneurial investors are value-add buyers and risk takers. They're willing to take more risk for a higher return.

What will ultimately dictate your real estate strategy and risk tolerance is asking yourself, what are you working to achieve?

To value an asset, you have to look at historical data such as current leases, past transactions, and current financials. Like other industries, commercial real estate has predictable business cycles. A few years of data on previous performance can help you to create a future value roadmap of the asset. Adding a service wrapper to the asset can substantially increase the operating return on the asset investment.



Core Competencies & Operational Hurdles



Guest Contributor
Christine Andrews

If you're venturing into flex-space, you can expect big gaps in the knowledge and expertise required for success in this sector versus traditional real estate management. So, it's best to know what you're up against.

Brand and culture

CREs are historically not fussed when it comes to brand identity. However, with a greater focus on tenant expectation and the broader market shift from product to service, brand is a top priority. Your brand and culture directly impact member experience, occupancy rates and your bottom line. Having a clearly defined brand, culture, values, and vision is critical for success. You can start by analyzing **what you're looking to achieve** and identifying **who your target market is**.

A common mistake is to assume that delivering against category benefits is a sufficient anchor for a brand. However, in an increasingly cluttered

and maturing industry that speaks to flexibility, affordability and other common attributes, category benefits are no longer enough. Push towards your values and take ownership of unique benefits and a differentiated user experience to build a meaningful brand story that will connect with your target demographic.

Your brand and culture directly impact member experience, occupancy rates and your bottom line.

Once you identify your brand, execute it consistently across all channels and touchpoints of the member journey. A booming market with growing demand requires you to clearly define what you are and to whom in order to create a differentiated value proposition. This is possible via community, technology, culture, and a clearly differentiated member experience.

Core Competencies & Operational Hurdles

Create a brand that your tenants and members can buy into without having to abandon their own. The quality and performance of services you offer directly impacts your brand perception and reputation. Ensure that your facilities and amenities can meet changing occupier needs. For many corporates, flex-space must offer the flexibility, security, agility, privacy and benefits of a shared environment. They want to keep their brand identity and will expect it to be visible in their workspace. This has implications on space design and fit-out. Enable a space where they can represent their own brand while still being part of a wider community.

When it comes to target market, the world is your oyster. Flex-space is the new norm for companies of all sizes, from independents and SMBs to corporates. The success factor running an operation that is flexible and agile but can still time deliver on distinct tenant requirements.

Community is king. Include common spaces that foster collaboration and community and build a thriving network of tenants that can sustain itself. Happy customers bring word of mouth referrals which drive occupancy and therefore demand, accelerating growth. And it all begins with your brand identity.



The Human Experience



Guest Contributor
Liz Elam

A coworking space is more than putting a bunch of desks in a room. It's a messy, high-maintenance operation that involves dealing with people and their varying needs. It sounds simple but in reality, it's quite complex. The most important element in this operation is the ability to manage "the humans", and if you miss that piece, you won't succeed in this market.

Our society is facing a loneliness epidemic. Considering that people spend most of their time at work, space providers have a responsibility to curate human experiences.

Make spaces where members can communicate, collaborate and connect through your workspace. Recognizing this as a priority gives you an opportunity to improve the experience for your occupiers. An essential part of doing this is by hiring the right staff. Find an engaging and service-focused community manager who will integrate the community and help to reduce loneliness and depression.

Staffing can be difficult, but it's crucial to find the right person to run your space. Look to the hospitality industry for service focused individuals who understand the impact of excellent, curated experiences on your revenue goals. A community manager needs to understand customer service and should have a great eye for detail. What you think are trivial details can make a world of difference. For example, provide tissue boxes across the space in the winter, pay attention to cleanliness, make eye contact, and have a candy bowl at reception.

Member well-being also includes physical well-being. Consider air and light quality, acoustics and scents in your workspace. Put yourself in your members' shoes and try to imagine the workspace you want. For a successful operation, focus on making your space and staff as welcoming and hospitable as possible while also hitting the mark on efficiency and member productivity.

Design & Architecture



Guest Contributor
Jerome Chang

The biggest hurdle when it comes to design and architecture is budget. As noted above, landlords with traditional leases in hand will have an easier time getting a loan versus those in management agreements or joint ventures as the latter have more risk exposure. Once you overcome the budget obstacle, the second order of business is to decide which architect you'll work with.

A classic mistake is hiring your go-to architect. They may specialize in office spaces, but it's unlikely they have experience designing shared office spaces. You see, traditional office spaces are necessary evils for employers to provide workspaces for their staff. Office spaces typically require significant upfront and recurring expenses. They're seldom revenue generators. Except for shared spaces such as flexible workspaces, coworking and executive suites. In these shared office environments, every square foot can generate revenue, so optimization is crucial. Keep this key distinction in mind when selecting your architect.

In these shared office environments, every square foot can generate revenue, so optimization is crucial.



Another fundamental difference in designing a shared versus a traditional office space is that the users are customers, not employees. They pay for the choice to work in a particular space versus being paid and required to work in a space. Unlike traditional offices where employees work for the same company, in flexible spaces there are multiple employees working for different companies, each with their own work schedules, space requirements, cultures and needs.

Everything down to the type of computers, devices, printers and copiers can vary, versus in a traditional setting, where there is more uniformity across the board, and it's all managed by the company's in-house teams. Work culture is also vastly different. For example, unlike traditional offices, in shared spaces meeting rooms are not typically free. This complicates on-demand usage with financial transactions. An experienced architect will understand how facility operations must better align with user experience and likely locate these meeting rooms closer to the front door and within proximity of the front desk to provide customer service.

Be practical and efficient about space layout and design. Create density. This is the amount of square feet you allocate to each member in your space. Traditional spaces often account for 250 to 350 square feet versus 50 to 100 square feet in a shared workspace. That's almost six times denser than a traditional office! The floor area calculation uses the entire gross floor area of the space, including lobbies, meeting rooms and hallways. Your rent typically accounts for common areas outside of the usable space. So, including bathrooms in the calculation won't heavily sway your numbers.

Design & Architecture

Next, evaluate your money makers. Space matters and each area earns revenue differently (i.e. monthly versus hourly or daily). Size matters too. Be smart about how you size your meeting rooms – some aren't as popular as others. In my experience, those that seat three to four or six to eight tend to be the most popular regardless of market location. Larger boardrooms that seat 12 or more aren't typically popular. However, design flexibly so that a larger boardroom could be arranged to accommodate high demand for classroom or training space. Private offices are great money makers, but they require additional investment. Each private office requires electricity, connectivity ports, AC, heating, and lighting, making it more costly than other spaces.

There are a variety of shared space operators just like there are a variety of hotel operators. More traditional executive suites tend to enclose 70% to 80% of their floor area as private offices and meeting rooms. "Pure" coworking spaces may have 0% private space. Most flexible workspaces fall in the 20% to 40% range while executive suites that want to attract coworking-oriented users fall in the 60% to 70% range. Unfortunately, both often get it wrong:

- Coworking space operators may build private offices that aren't acoustically private, or the opposite, use all glass, which is acoustically frustrating.
- Executive space operators often will just designate an empty room as "coworking" and fail to realize that collaboration and community is what drives the coworking vibe – not cheap seats in a cheap room.

Keep user experience in mind. Too many private offices laid out in a labyrinthic style combined with high density rates might make your members feel packed like sardines and blind rats finding their way out of a maze. I personally find that the 35% to 50% range of enclosed space provides a good balance of user experience and feasible budget.



Design & Architecture

Let's talk design. The nuances can make a big difference in member experience and operational efficiency. For starters, glass walls and concrete floors might be modern and trendy, but they create an echo chamber, making it a potential distraction for your tenants. If not executed correctly, glass walls will offer little privacy to occupiers in an already shared environment.

Operations matters. Try to simplify the variety of desks you choose so that maintaining or replacing them if needed doesn't become a hassle. Keep it lexible. Furniture might need to be swapped or moved between areas, so the more it matches

the easier it will be to keep design consistency.



Speaking of furniture. Typically, interior designers and decorators come in at the tail end of the design process, forcing the furniture selected to fit within predetermined and inflexible layouts. In worst cases, furniture must be customized to fit, which is both time consuming and cost prohibitive. I recommend prioritizing the desk and table specs early in the design process before finalizing wall locations to ensure enough clearance and optimal revenue producing desk layouts. In other words, revenue is generated by each rentable seat, not each available square foot.



Design & Architecture

Remember the basics. Flexible workspace is about community. Like in any home, kitchens are an important gathering spot and a key enabler for culture and collaboration. They should be front and center of your space. Proceed with caution when it comes to bull pens – open areas with many rows of desks. It will make your members feel like another cog in the wheel. Subdivide the desks into smaller clusters across your space. The user experience will be less intimidating, foster greater synergies and help build community. On a technology note, open bull pen layouts make it difficult and expensive to bring in the right data connectivity and power to the middle of the space. Make sure you consider technology at the layout and fit out stage – backfitting for cabling is expensive.



- **NOT IDEAL**
- All private offices on the exterior with
- rows of workstations in the middle



- **IDEAL**
- A better layout that has multiple
- offices and clusters of workstations

Technology, Security & Systems

Historically, in product-focused and transactional-based office real estate, the landlord's tech offering is minimal to none. Tenants are responsible for bringing their own connectivity into their space, managing the tech services and ensuring they are secure and meet the standards for their own organization, whether via in-house staff or third-party consultants.

With flexible offices, the space provider is now responsible for delivering technology services that meet the requirements of varying tenant's need and ensuring business continuity.

This demands an entirely new technical skill set to implement an IT system that can deliver and manage services across multiple tenants. However, a one-size-fits-all approach won't work in a flexible office environment.

To fill the gap, you will need to look at a tech proposition that can overcome the operational complexities of delivering services across multiple systems, tenants, and locations. To compete in the growing flex-space market, it is crucial to consider how to leverage technology to better engage with tenants and drive optimal experiences and productivity.

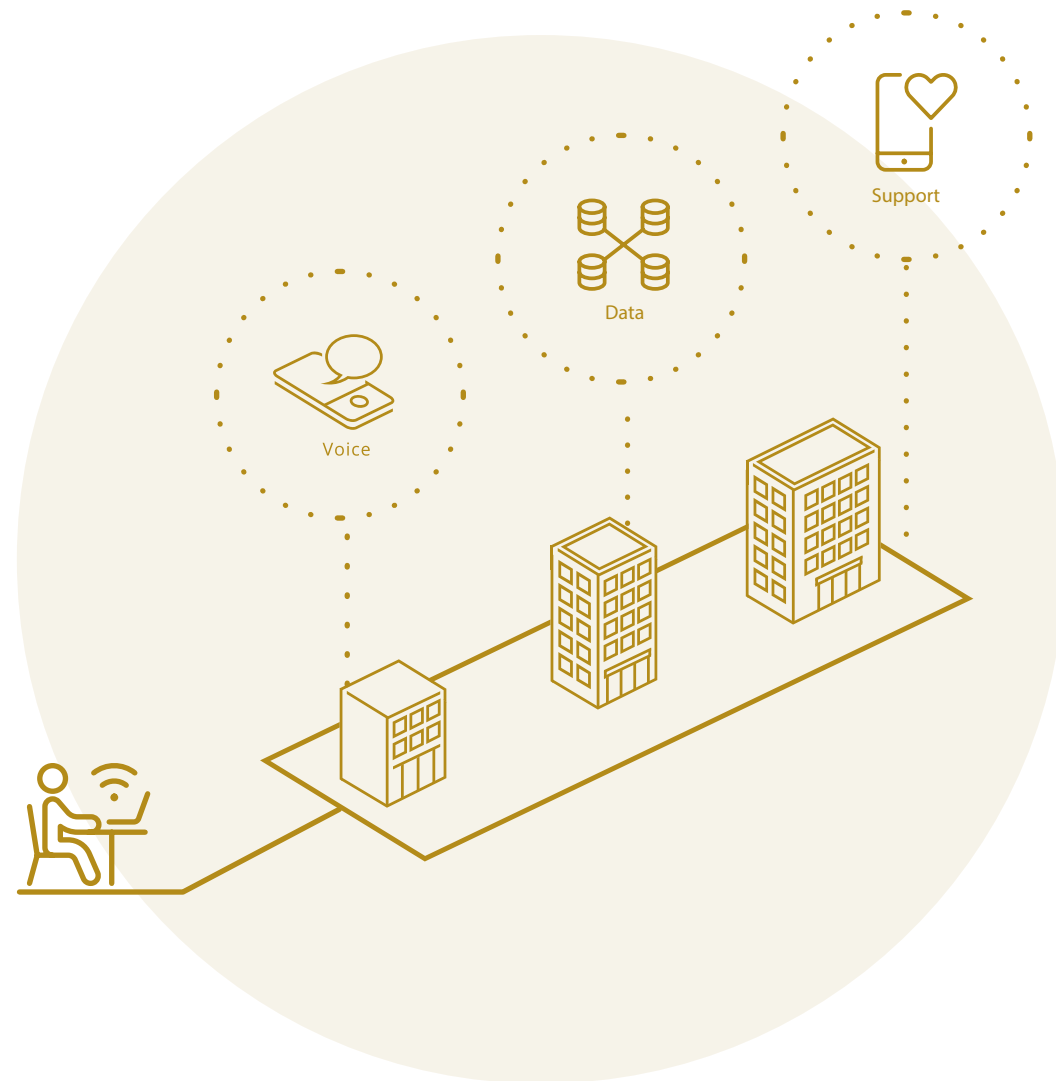
Having data visibility and a means to analyze it to understand business trends and performance is a critical component for success.



Technology, Security & Systems

DIY

Hire an in-house IT director and corresponding staff to design and implement tech infrastructure, tenant experience and data collection apps that span the entire portfolio.



Pros:

- Someone that owns the tech side of things

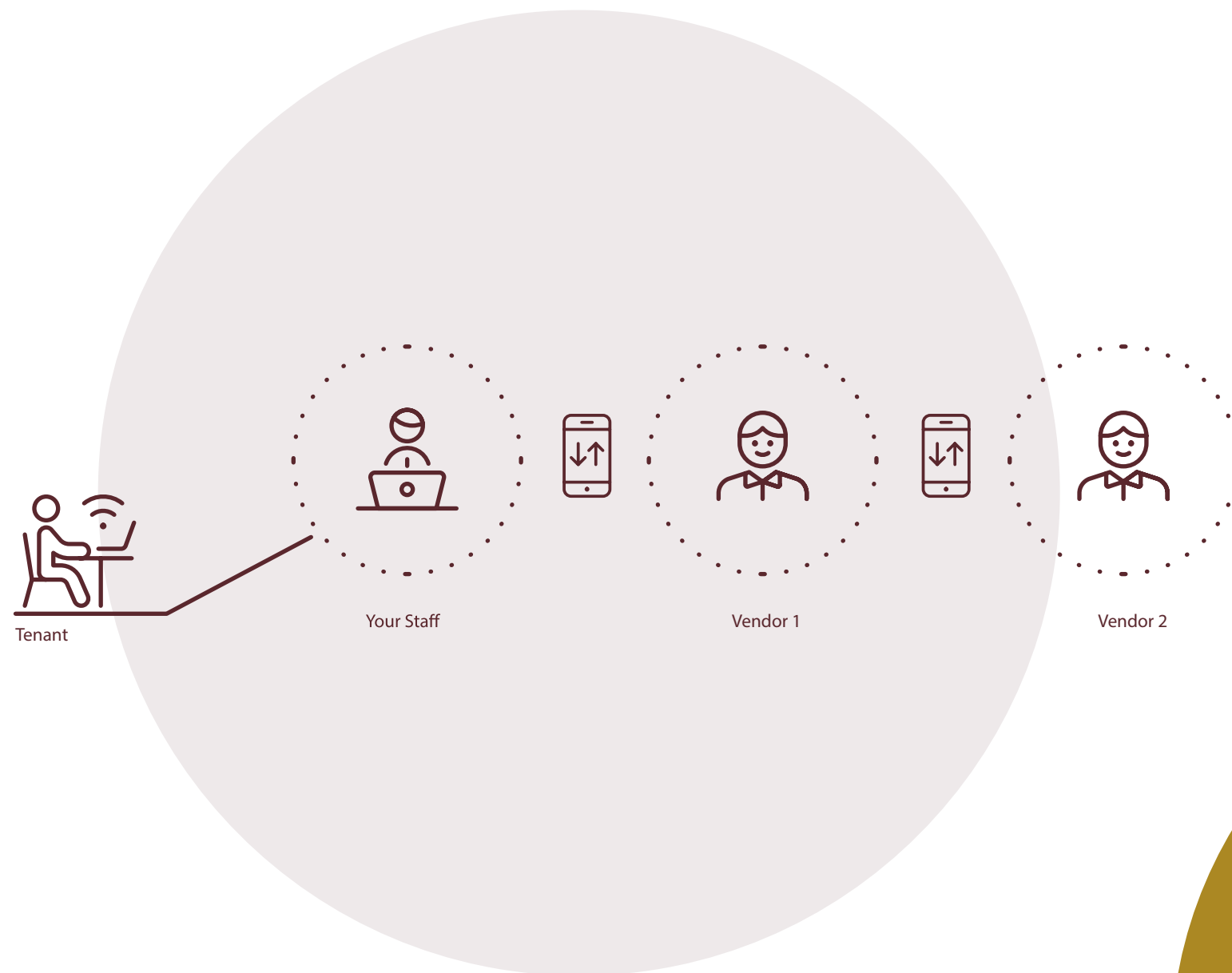
Cons:

- Difficult to scale
- IT expertise is costly
- Need to replicate platforms across multiple locations
- A risk to business continuity
- Limitations to monitoring security of services and meeting customer support expectations
- Difficult to offer an array of tech propositions for varying tenant needs.
- Training customer-facing staff is burdensome and compromises staff retention
- Multiple, disparate systems that fail to provide reliability, control, and visibility over the operation
- Managing multiple vendors
- Service bottlenecks brought about by tickets and escalations
- Difficult to assess cost and ensure margins
- Changes take time and impact tenant productivity

Technology, Security & Systems

Outsource

Outsource technology to a third-party consultant or multiple vendors.



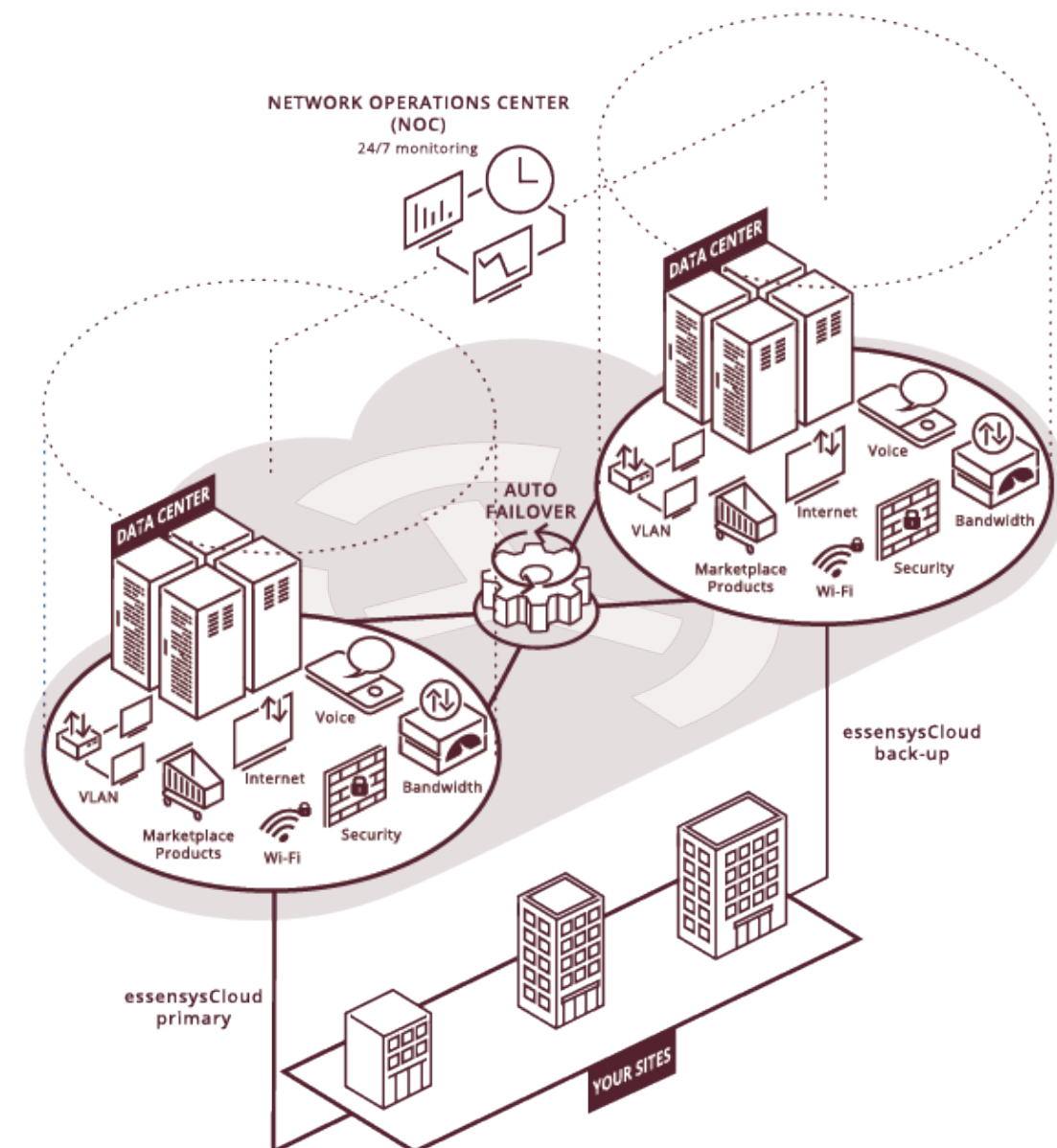
Cons:

- Costly consultant fees
- Not scalable for growth
- Limited availability to troubleshoot issues and provide customer support
- New technologies and upgrades may be out of scope
- Managing multiple consultants, vendors, systems
- Industry-specific services and apps unavailable

Technology, Security & Systems

Partner

Partner with a flexible workspace industry vendor to implement fit-for-purpose flexible technology solution.



Pros:

- Built to scale with multi-site growth
- Infrastructure designed to deliver on varying tech and service needs of multiple tenants
- Security and software upgrades for service reliability and business continuity
- An integrated solution for greater control and visibility
- No IT expertise required
- Mitigate staff churn
- Better quality of service, member experience and customer retention
- A single repository for workspace data to understand usage trends and tailor propositions

Summary

Flexible workspace is a growing segment of the office market. The complexity of the operation demands expertise across the multiple areas of the business to ensure success and stay competitive. With nothing but choice in the market, tenants are calling the shots and you need to be ready to deliver on agility, flexibility and varying service requirements.

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