MAKING SMART REAL ESTATE DECISIONS FOR YOUR COWORKING SPACE

Yardi® Kube

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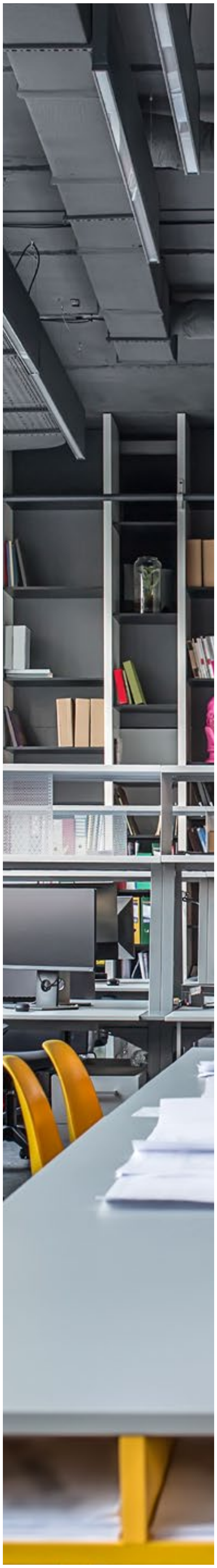

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Introduction

In this ebook, we'll lay the foundation for what to look for in a market and then teach you how to narrow down your choices from the spaces available. We'll also dive into lease metrics to keep in mind when negotiating and explore the question of whether leasing is your best option or purchasing should be considered.

Part 1: Selecting the Right Location

Whether you're opening your first coworking or shared space, or trying to expand to multiple locations, selecting where to open is step one. The difference between markets throughout the country will shape the decisions you make regarding location.

Ryan Hoopes, senior associate at Colliers International, summarized first and foremost why this industry is important to operators and investors.

"At its core, flexible workspace and coworking provides a low-barrier-to-entry solution in a high-barrier-to-entry environment," Hoopes said.

One of the main factors to look at in the area you're targeting is the vacancy rate. Target a market with low vacancy rates because that implies, in general, a high office demand. Small startups or satellite offices, who may need only 1,000-2,000 square feet, are likely to consider coworking spaces, as it is going to be the best alternative in a crowded market.

Selecting a location with high vacancy rate will put you up against traditional office space, especially in a market with low rental rates. Not an ideal strategy.

I. ANALYZING DEMOGRAPHICS

Casey Godwin, vice president of Swearingen Realty Group, explains that when selecting a city within a larger census metropolitan area (CMA) or region, demographics should be considered first.

"Look at the population, the current/existing workforce and what trends are evolving there. You're trying to tap into growth, so you're looking for emerging technologies or businesses that are moving to that area or growing," Godwin said.

"We really analyze work-from-home densities in a given market, in correlation to average household income, as well as education level," Hoopes added.

It's important to research metrics such as age distribution and urban vs. suburban population in the area you're exploring. The chart below details some of the key metrics to explore when making a commercial real estate location decision and where to find them.

Jerome Fried, managing director at Savills Studley, says that while there may be a lot of areas that make sense, picking the right location to start your first space is very important.

"You don't want to parachute into a market you're unfamiliar with and just pick a location that checks some of the boxes," Fried would say when advising a client.

Visibility is critical. For example, even though downtown Toronto has a lot of coworking spaces, you could be just fine starting in Hamilton or Oshawa. While the concern on profitability may reign supreme, visibility should remain a key factor in your decision.

Once you've selected your primary location, it may benefit you to expand eventually. For example, in cities that are spread out (like the Greater Toronto area or Greater Vancouver), it may take an hour and a half to commute from one side to the other. So, in the case of Greater Vancouver, if you started in Surrey, let's say, consider Burnaby, Richmond and then downtown Vancouver, because your members will have easier access wherever they are.

DATA TYPES	SOURCES OF DATA
Population Size and Demographics	Statistics Canada Census Program
Unemployment Rate	Statistics Canada Labour Force Survey
Household Income	Statistics Canada 2016 Census Income
Housing Prices	Statistics Canada Housing Statistics
Interest Rates	Bank of Canada Interest Rates
Daily Traffic Counts/Volume	Local Municipality/City Website
Public Schools	Statistics Canada Data
Building Permits	Statistics Canada Building Permits
Commercial Real Estate Sales	CoStar

II. URBAN VS. SUBURBAN LOCATION

Don't ignore secondary or even tertiary markets. CMAs are defined as one or more municipalities with a 100k+ population, of which 50k+ must live in the core. These areas can provide a strong starting point for coworking operators to enter a market prior to saturation — generally at lower price points than the major markets. As of 2016, according to an estimate by Statistics Canada[1], there are 35 CMAs that fit that description. This is expected to increase over the next couple years.

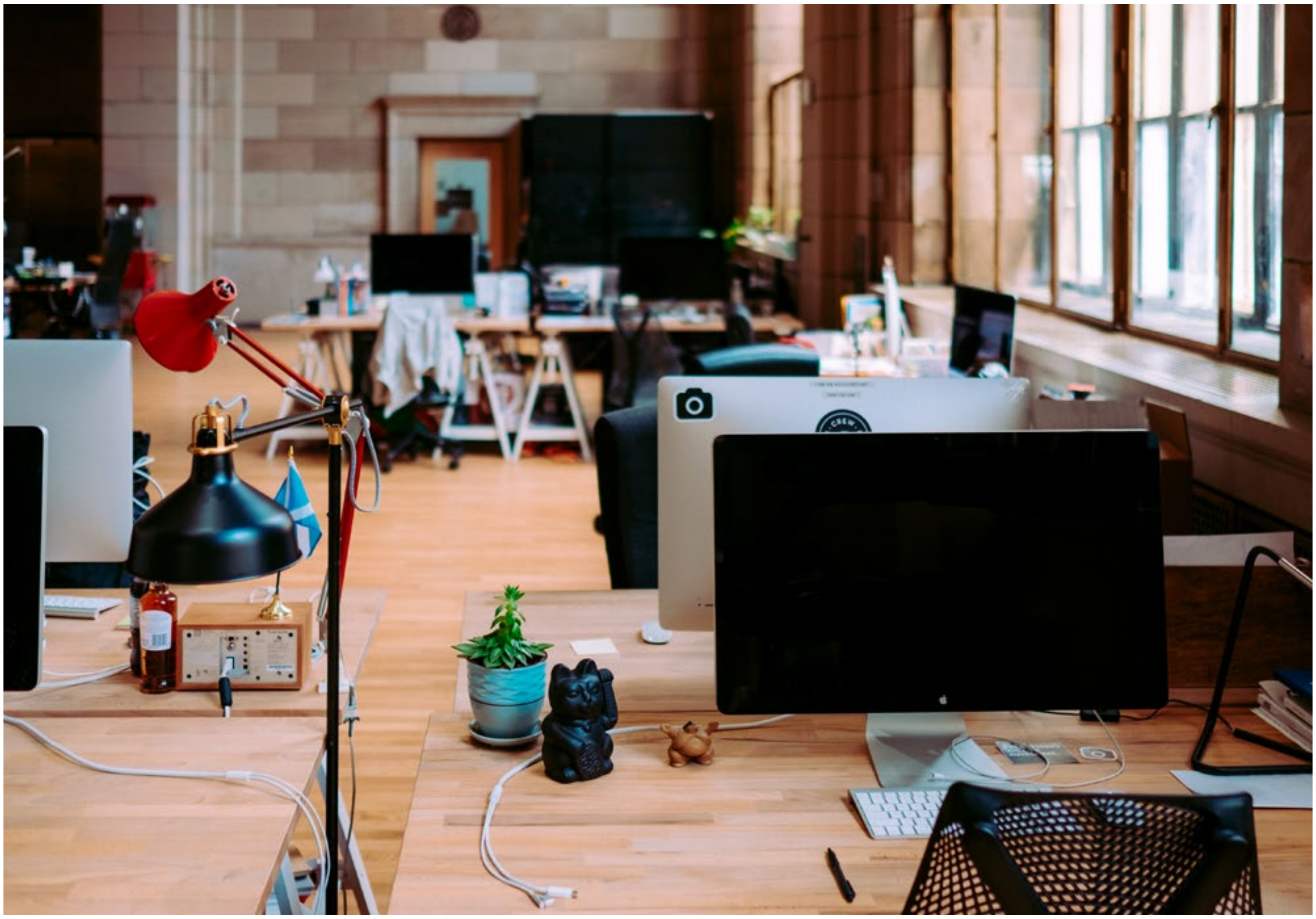
"You're looking for growth in the population as well. You want to stay away from stagnation, and you want to make sure that a high concentration of workforce population is in the urban core," Godwin said.

Of these 35 markets, only two saw population declines in the last four years. So based on Godwin's suggestions, there are plenty of options to explore on a preliminary basis that fit his criteria.

For huge urban cores like Toronto, Montreal, Vancouver and others, opening your location in suburban neighbourhoods could place you closer to a large percentage of where the workforce lives. Eliminating long commutes to work for those potential members, as well as establishing a foothold in an area that may be underserved, could serve your brand very well.

[1] https://www.statcan.gc.ca/eng/subjects/standard/sgc/2016/introduction

Part 2: Identifying the Right Space



You've narrowed down to the market that checks off the most boxes. Now you want to get to the business of picking the space within that city that is best for you and your brand.

Fried detailed an interesting concept: piggybacking off of WeWork. "A lot of our clients," he said, "have used proximity to WeWork as one of their criteria for site selection."

WeWork has done a very good job of site selection themselves. It's important to understand that they've had the time and financial resources to research the economic and socioeconomic factors we detailed in Part 1. The average operator may not have the ability to dig as deep as WeWork has.

I. PHYSICAL AMENITIES

Do you want to be in a Class A office building, on a high floor? Would you rather have ground floor space? Do you need/want outdoor space, whether it's a patio, backyard or rooftop? How important are natural light and windows?

Your answers to those questions will all play a vital role in where you choose to establish your new space, and they depend largely on your member base and how you want to market your space.

Understand the parking situation in the area. In markets such as Toronto, where there is extremely limited parking, or egregious parking prices, proximity to public transportation is a major factor.

"A lot of these buildings are offering three parking spaces for every thousand square feet of rentable space. So, if you've got a 20,000 square foot facility, you may have the right to 60 spots. I've got a [client] right now in 10,000 square feet, and we need about 9-10 spaces per thousand square feet, so we have to leverage parking lots all over the neighbourhood," Fried said.

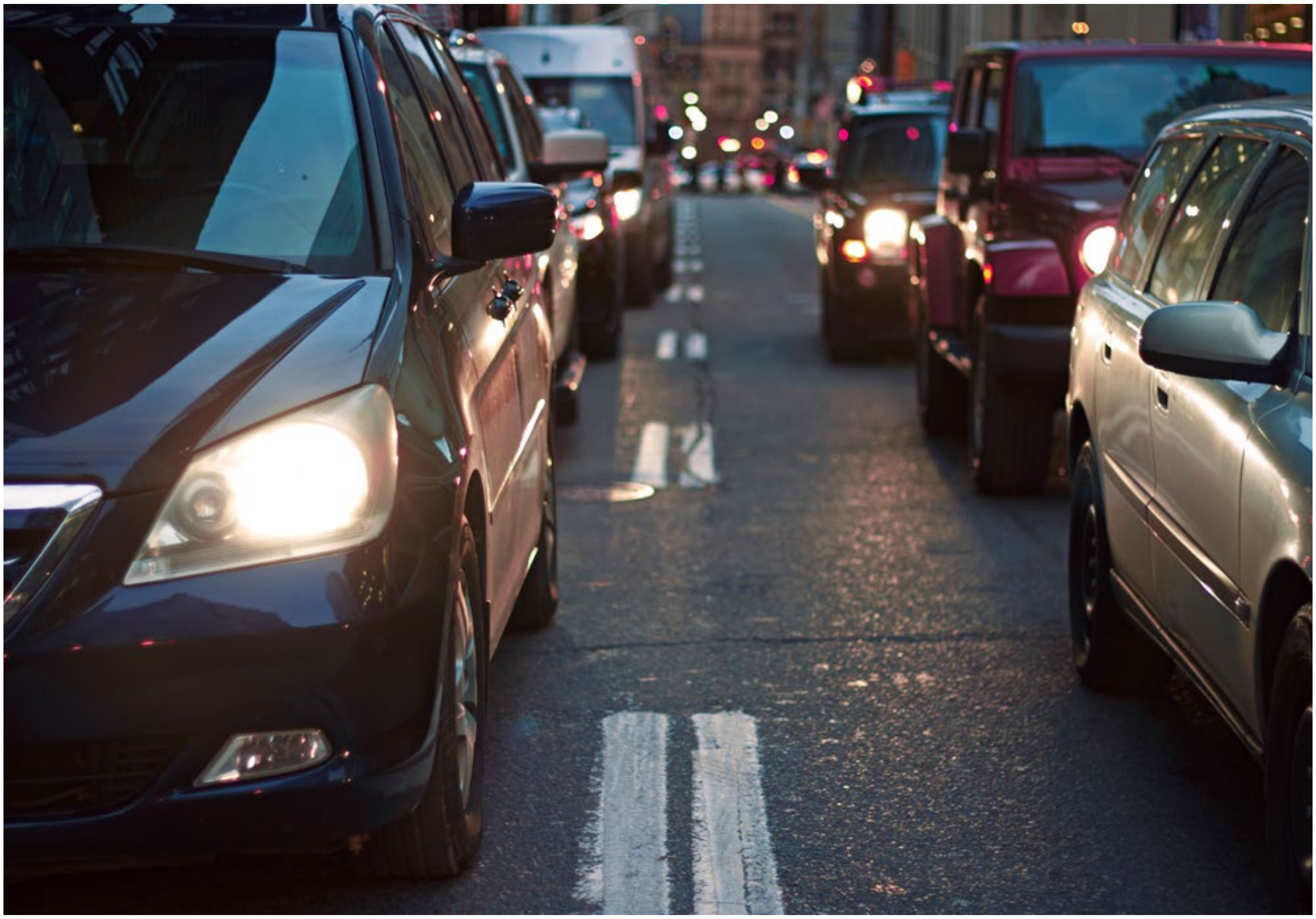
In a market like Vancouver, driving is the much more common means of transportation. So certainly, the proximity to mass transit is a plus, but it's not a core factor like it would be in other areas.

COWORKING FACTORS	2017	2016	SHIFT
1) Social and enjoyable atmosphere	59%	66%	-7%
2) Interaction with others	56%	74%	-18%
3) Community	55%	72%	-17%
4) Close distance to home	51%	44%	+7%
5) Like-minded people	47%	58%	-11%
6) Good value for money	41%	39%	+2%
7) Good transport connections nearby	41%	41%	--
8) Basic office infrastructure	38%	57%	-19%
9) Knowledge sharing	35%	37%	-2%
10) A big open workspace	34%	32%	+2%

Deskmag, The 2017 Global Coworking Survey, as presented by GCUC Canada in "15 Facts About Coworking Space Members"

FACT

The more coworking spaces members can choose from, the more important the distance to their home becomes. And less important other criteria become.



"The main thing is, you don't want to have to get in your car in order to go to lunch, to coffee, to happy hour," Fried said.

Maybe some amenities that are normally considered important aren't as valued as we perceive.

"Some of the buildings have gyms. I think that members haven't really taken advantage of that, and I don't think it's that important to operators," said Fried. "People like to be able to walk out of the building or walk down the street."

And as per the 2019 Office Tenant Preference Survey conducted by Informa, elevator access, conference rooms and a parking lot are amenities tenants would not rent without.

"We really look at the landlord just as closely as the site itself because we need to identify a landlord that understands and is interested in the use," Fried added.

More specifically, not all landlords are capitalized. There are many who won't be able to put in the necessary dollars in tenant improvement (TI). And others who financially may seem like a good fit but are not willing to adapt to the flexible workspace movement.

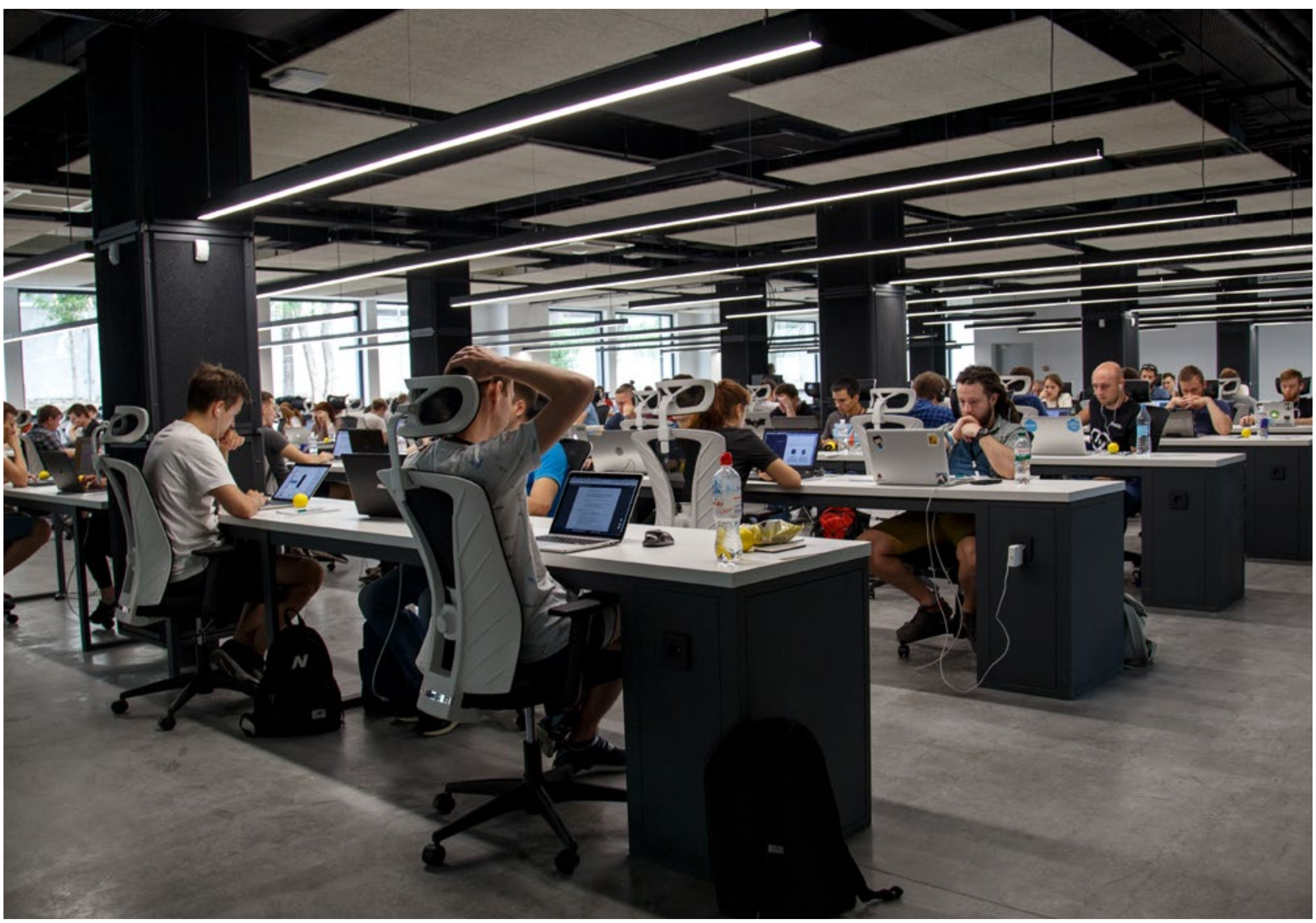
II. COWORKING AMENITIES = EVERYONE'S AMENITIES

There's an evolving trend where operators are targeting ground floor space because of the movement toward a pseudo "live, work, play" environment that is becoming more popular. It may not even be as much about amenities within the actual building, as much as desirable assets within walking distance.

Internet connection is one of the top concerns for any working professional. Make sure to ask what internet service providers are used in the building.

"You can't operate a coworking space and not have substantially adequate up and down speeds, so you don't want to wait until lease negotiation to be asking those questions," Fried asserted.

In broad terms, what is important to professional adults as a whole? Internet reliability/speed, entertainment, retail, dining and transportation options are always going to play a role in where to locate your shared space, in the same way they would for any commercial real estate decision.



Part 3: Key Metrics in a Lease Negotiation

I. FINANCIAL CONSIDERATIONS

One of the most important strategies is to keep a broad list of options. Avoid narrowing your list of potential buildings too soon.

"What I've seen as potential pitfalls, for individual coworking groups that try to do this on their own, they identify a property that they consider to be the 'it' property, and they try to negotiate with that one building. Once the impression is given to the landlord or the leasing agent that there's no other competition, there's a lot of leverage that's lost," Godwin explained. "Get 2-4 proposals in hand so you can start putting them against one another."

Of course, a lot of the negotiating points begin with your prior history, performance of any existing spaces and how much capital you have allotted for expansion.

One factor to consider is how much free rent you can get up front. Coworking operators tend to value front-loaded free rent because, while there are exceptions, most operators need time to fill their space and recoup some of the initial investment into the space to hit the break-even point.

When you pay your first month up front, plus your deposit or letter of credit, try to structure the deal where you'd ideally get 2-10 months of the lease free of rent. While in some markets that's simply not feasible, in other markets, it's not unheard of to get a month and a half of free rent per year of term. In a 10-year lease, that would be 15 months of rent.

"The shortest lease that a lot of coworking operators should be looking at is 10 years," Fried stated. "Since there's such a large capital expenditure in the building out of the space, even a 5-year deal with options, you're just not going to get the value, and the TI dollars that you need from the landlord and the security of knowing that you've got control of the space for a long period of time."

II. FLEXIBILITY

For coworking groups, flexibility cannot be overlooked, in terms of first right of refusal to expand, so that in the case you have a full floor and it booked out relatively quickly, you aren't left landlocked without room to continue your growth in the building.

"It's important for mid rises and high rises to have an exclusive within the building," Godwin said. "Within that exclusive, it's not only to bar out any other flexible workspace centre, but it's where we say the landlord cannot lease space to any tenant below 1,000 square feet."

At that point you'd be creating a competition between the landlord and the coworking operator for those small businesses and entrepreneurs who want space in the building. You want to create a partnership with the landlord. There is potential for a small business or entrepreneur to grow within your coworking space and eventually branch out to where they lease a space within that same building themselves.

Aim for a space where you can identify the building as part of your marketing. That can be immensely helpful when starting out. Also, get the landlord to commit to providing a temporary sales office during construction of your space. These factors will maximize your success prior to the grand opening.

Part 4: Leasing vs. Purchasing

I. YOU NEED EXPERIENCE

Is it feasible and should it even be a consideration to purchase rather than lease your space? The answer isn't as simple as yes or no. There are situations and circumstances for the operator and the landlord where one route is more beneficial than the other.

In many cases, it's as much about having experience as it is about having the funds.

"Everyone wants to buy. Before considering that route, you have to understand: Are you capitalized enough to be able to beat out other competition to purchase the kind of asset that you'd need to purchase for coworking?" Hoopes stated. "You're looking for a highly attractive asset, likely off-market, and you're competing against seasoned buyers."

Overall, the main groups who are successful have decades of experience buying assets, whether it's in the flexible workspace industry or any other field. The more experience you have closing deals, the more likely you are to beat out a relative newcomer. Operators opening a first location generally aren't best suited to win this type of battle.

How much capital will you need for the buildout of the space? Do you have extra savings in case breaking even takes longer than expected?

"What do you want to use your capital for? Do you want to use it for one location, or do you want to grow multiple locations?" Godwin said.

Even though you need to have more capital initially, historically speaking, companies will use their capital to grow and have hopes of opening more than one space. Building market share is a top goal for most operators in this or any field, but you have to be aware of the financial obligations it will take from the start.

II. ALTERNATIVES TO TRADITIONAL LEASES

Partnerships and other joint ventures provide an alternative to leasing and traditional purchases.

"Frankly, leasing is now not even the most desired way to secure your space. Most seasoned operators are now looking to align as much as possible with the landlord in the form of management agreements and joint venturing with the landlords," Hoopes said.

Because of this, Fried is not an advocate of purchasing from an operator's perspective.

Maybe for a 'mom and pop' operator who's going to be fine with one location, Fried stated that he would certainly do a lease vs. buy analysis for that client, but overall the best route, is to pair up with a developer or traditional owner.

"I don't think it makes sense typically for operators to buy. I think it ties up way too much capital, more capital than you should, if you're looking to expand," he said.

"When we find a building that could be made available for sale, we have the developer underwrite it, and see if 'hey, can we buy this building?'" Fried said. "We can do an operational management contract agreement or just a traditional lease with this group."

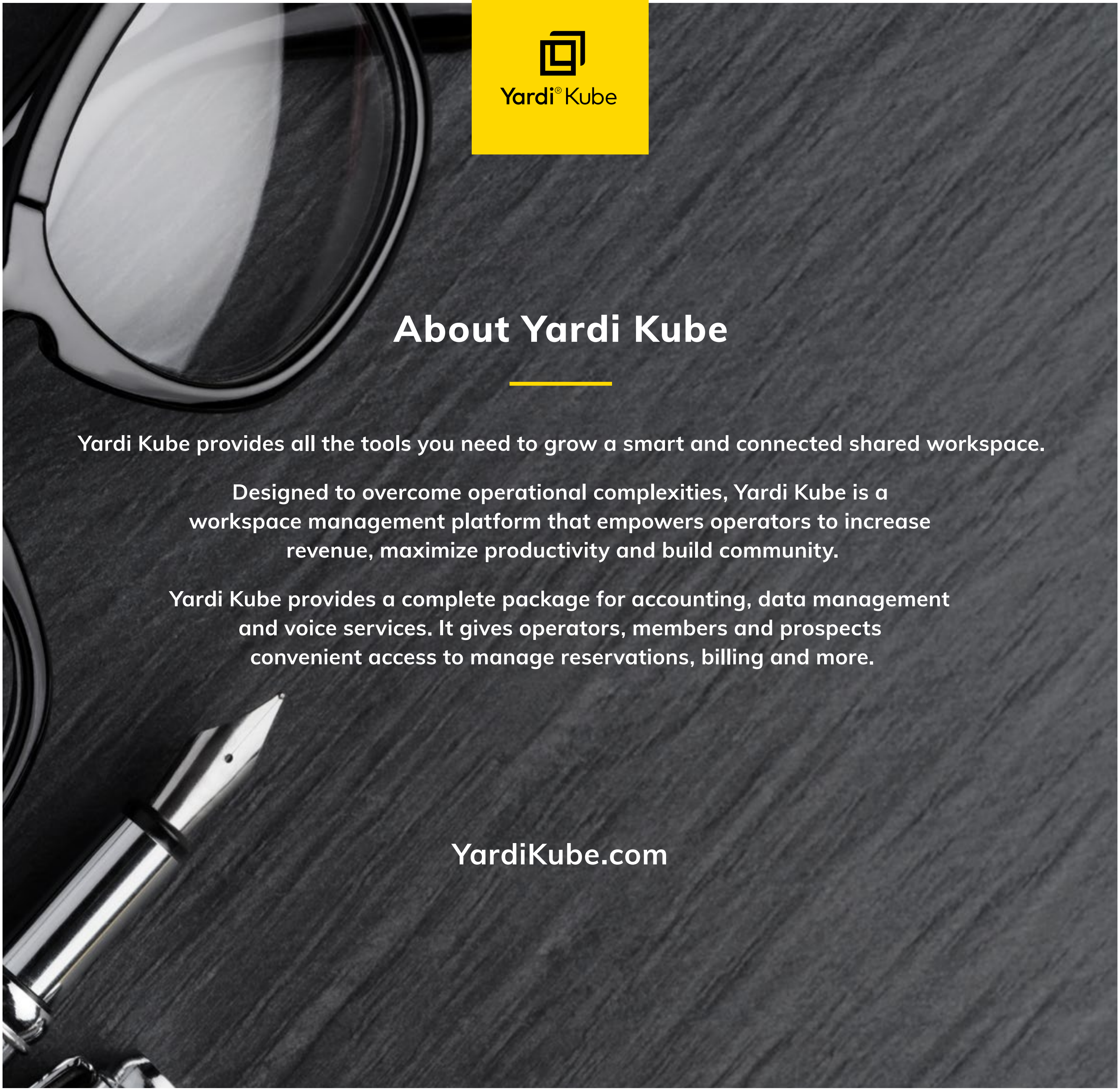
In a great partnership, that developer or investor could potentially buy the building, and lease it to you, the operator, for the desired 10-15 years.

Coworking operators are looking to do longer term leases, as Fried mentioned in Part 3. That's really where the best investment practices lie. Just make sure you're being advised by a CPA who can account for any upcoming changes, because the trend is for most corporate office leases coming down to about 3-5 years.

Godwin certainly isn't shutting the door on purchasing as an option.

"If there's a great opportunity, maybe a great asset that's been overlooked, maybe there's a large vacancy within the building, you have potential to reposition the asset. With the right investors behind them, it could be an opportunity to pick up that asset."

Whether your space is big or small, whether you're just starting out in this industry or you're a seasoned veteran, it's important to always do your homework. Make sure you cover all your bases and speak to the right professionals when making real estate decisions. Following the guidelines laid out in this ebook, you'll be able to minimize your risk and maximize your potential for a successful space.



Yardi® Kube

About Yardi Kube

Yardi Kube provides all the tools you need to grow a smart and connected shared workspace.

Designed to overcome operational complexities, Yardi Kube is a workspace management platform that empowers operators to increase revenue, maximize productivity and build community.

Yardi Kube provides a complete package for accounting, data management and voice services. It gives operators, members and prospects convenient access to manage reservations, billing and more.

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