Yardi® Kube

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Making Smart Real Estate Decisions for Your Coworking Space

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Featured Industry Experts

Casey Godwin

Vice President of Swearingen Realty Group

Casey is the Vice President of Swearingen Realty Group and heads up the flexible workspace advisory group, SRG Cowork. During Casey's time with Swearingen he has advised some of the largest office and retail companies in the US with their national portfolio management and growth strategy initiatives. Over the past decade Casey has had the privilege of overseeing transactions in 40+ states and almost every major US market, Canada, and Puerto Rico. Recognizing the evolution of work and how corporations utilize workspace, Casey has pivoted to exclusively serve flexible workspace operators specializing in creative deal structures to assist with the opening their 1st location to regional and national rollouts. Casey is passionate about the continued evolution of the flexible workspace and provides free consultations to those interested in learning more.

Jerome Fried

Managing Director at Savills Studley

Jerome is a corporate real estate advisor and Managing Director with Savills Studley, a New York headquartered Tenant Representation firm. Based in Los Angeles, Jerome focuses on supporting the national and global expansion of his coworking, technology and media clients. With an expertise in both traditional leases and management contracts, Jerome has an in-depth understanding of the coworking and workplace-as-a-service industries.

Prior to joining Savills Studley, Jerome co-founded CBRE's Coworking and Alternative Workplace Group and was responsible for managing the real estate portfolios of several regional and national operators. Jerome was born in Brussels, Belgium, is a native French speaker and an avid traveler.

Ryan Hoopes

Commercial Real Estate at Colliers International

Ryan is a commercial real estate corporate services advisor with Colliers International who specializes in advising corporate office users and flexible workspace operators in their real estate strategy. Ryan has worked with and represented clients in these categories in nearly every major U.S. market. Ryan is a founding member and principal of Colliers' Flexible Workspace Advisory Services practice, which is a team that is globally focused on all facets of the space-as-service industry- such as coworking, business centers, non-core real estate providers, executive suites, accelerators, incubators and more. His practice is dedicated to building relationships and servicing all constituents of this fast-growing real estate segment including operators, landlords and corporations.

Introduction

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

The ebook features the thoughts of three industry experts who have worked with a wide range of clients in the coworking and flexible workspace industries.

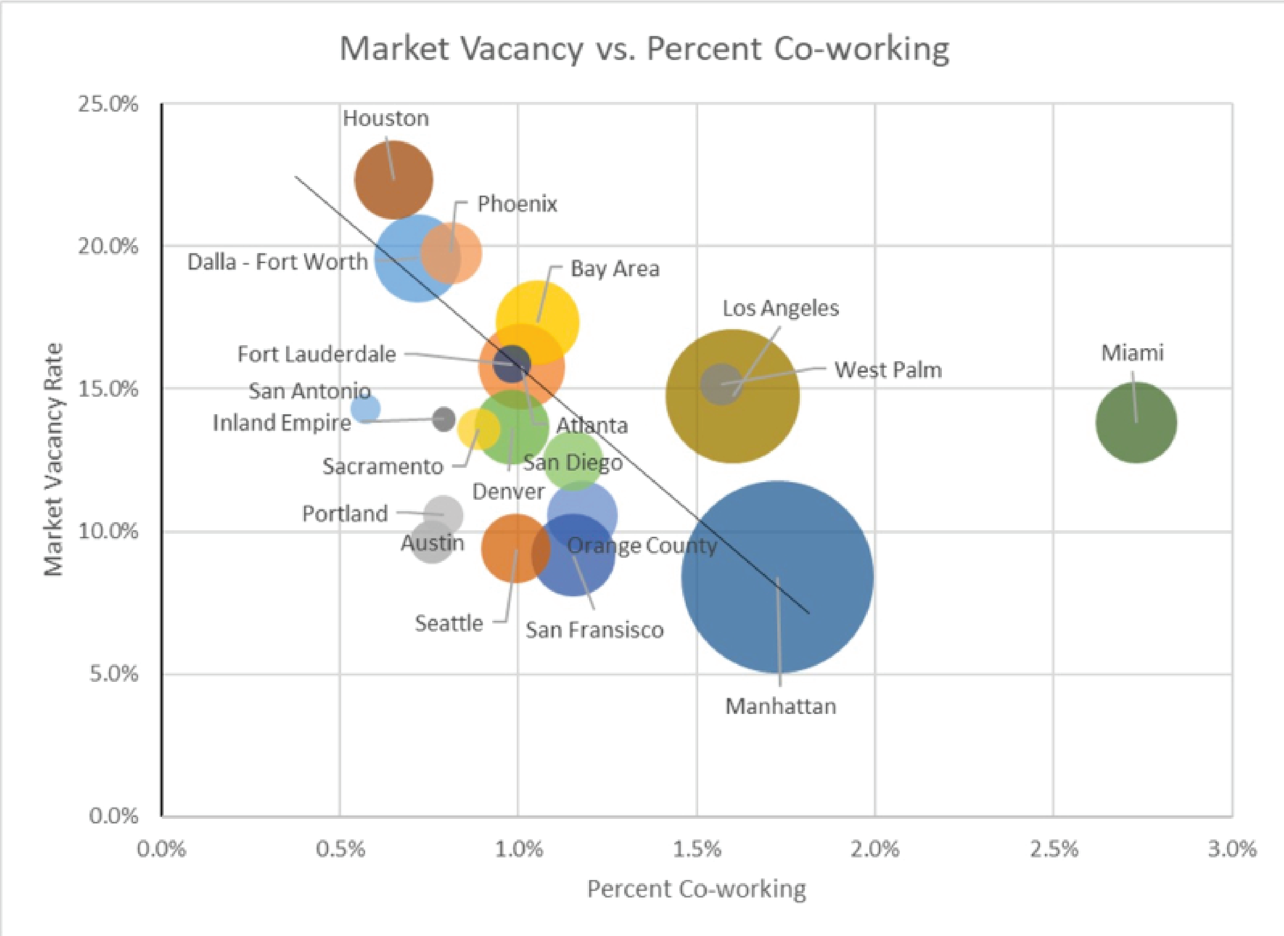
Part I: Selecting the Right Location

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."*

One of the main factors to look at in a specific city you're targeting is the vacancy rate. Target a market with low vacancy rates, because that implies, in general, a high office demand. So for startups or satellite offices, who may need 1,000-2,000 sq ft, they can turn to coworking, 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 MSA or region, demographics obviously will be the first factor to understand. Of course, you want to look at labor analytics, drive time analysis, and other common measuring points as well.

“Look at the population, understanding 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,” he said.

“We really analyze work-from-home densities in a given market, in correlation to average household income, as well as education level, [bachelor or higher],” Ryan added.

Research metrics such as age distribution and urban vs. suburban population in a city 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.

Data Types	Sources of Data
Population Size and Demographics	US Census Bureau
Unemployment Rate	Bureau of Labor Statistics
Household Income	Bureau of Labor Statistics; US Census Bureau
Housing Prices	FRED economic research; HUD
Interest Rates	FRED economic research
Daily Traffic Counts	Data.gov
Public Schools	Data.gov
Building Permits	Data.gov; Local city offices
Commercial Real Estate Sales	Costar; LoopNet

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,” he said. “It’s incredibly important to pick an area that’s high visibility, so for example, even though downtown Los Angeles has a lot of coworking, I would lead typically with something like Santa Monica or Venice if possible,” when advising a client. These areas are going to attract much more visibility than downtown.

And while the concern on profitability may reign supreme, remain confident in that visibility should remain the key factor in your decision.

“Even if your margins are little smaller, you want to make a splash,” Jerome said.

Once you have your main location, in a lot of cities that are spread out (like LA or Miami), it benefits you to expand eventually because it may take an hour and a half to commute across the city. So, in the case of the LA area, if you started in Santa Monica, let’s say, consider Hollywood, or downtown, and then the Valley, because your members will have easier access wherever they are.

ii. Urban vs. Suburban Location

Don't ignore secondary or even tertiary markets. Defined as MSA's with 1M+ population, these areas can provide a strong starting point for coworking operators to enter a market prior to saturation, and generally at lower price points than the major markets. As of 2017 estimates, there are 53 MSA's in the US which fit that description, with a few more joining the club as early as next year.

> *"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," Casey said.*

Of these 53 markets, only 4 actually saw population declines in the last decade. So based on Casey's suggestions, there are plenty of options to explore on a preliminary basis that fit his criteria.

According to the 2017 GWA Industry Survey, 29% of respondents operated a space in a suburban location, and that number has grown consistently. Even though the same study showed that urban locations are more profitable on a sq ft basis, don't discount benefits of penetrating a suburban area.

For huge urban cores like Chicago, NYC, LA, Miami and others, opening your location in suburban neighborhoods 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.

Part II: 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 selecting the space within that city that is best for you and the brand you've established or are working toward establishing.

Jerome detailed an interesting concept: piggybacking off of WeWork.

> *"A lot of our clients," he said, "and we're working with several right now, have used proximity to WeWork as one of their criteria for site selection."*

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

Basically, keep in mind that their locations are going to be successful for the most part. And piggybacking off their selection may be a smart shortcut of sorts when choosing a site.

i. Physical Amenities

When it comes to focusing on the building itself, think about what you value or need most. 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 its a patio or backyard or rooftop? How important is natural lighting 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 San Francisco, New York City, and others, where there is extremely limited parking, or egregious parking prices, proximity to public transportation is a major factor.

Jerome mentioned allotment of parking spaces in crowded cities, such as LA, is a problem as well.

“A lot of these buildings are offering 3 parking spaces for every thousand sq ft of rentable space. So if you’ve got a 20,000 sq ft facility, you may have the right to 60 spots. I’ve got a client right now in 10,000 sq ft and we need about 9-10 spaces per thousand sq ft, so we have to leverage parking lots all over the neighborhood", he said.

In a market like Dallas, Casey and Ryan’s home, driving is the much more common means of transportation. So certainly the proximity to mass transit is a plus, but not a core factor like it would be in other areas. Make sure you’re well aware of these patterns. A location where your members can get to and from easily is going to be one of the key components to your decision.

“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,” Jerome 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,’ he added. “People like to be able to walk out of the building or walk down the street.”

In addition to the physical amenities of the building, Ryan stressed the importance of understanding the landlords in a specific submarket. Do they grasp the value of the coworking and shared space industries?

“We really look at the landlord just as closely and in tandem as the specific site itself, because we need to identify a landlord that understands the use and is interested in the use,” he said.

More specifically, not all landlords are capitalized. There are many who won’t be able to put in the necessary dollars in TI. And others, who financially may seem like a good fit, are not willing to adapt to the flexible workspace movement. Some landlords simply do not have the risk tolerance which is necessary to consider coworking in their building.

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. Amenities within the actual building are as desirable as the assets within walking distance.

Inside your space, internet speed is one of, if not the most valuable resource for any working professional, coworking obviously included.

> *“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,” Jerome added.*

So as Jerome stated, take a step back and think about not just what’s important to coworking members.

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. Don’t necessarily try to make an exclusive case out of coworkers as if they would need different sets of amenities.

Part III: Key Metrics in a Lease Negotiation

Let's discuss some of the most important metrics to look for when it's time to negotiate the lease for your space. One of the most important decisions you can make is to keep a broad list of options. Avoid narrowing your list of potential buildings too soon.

Factors to Consider in a Lease Negotiation

2-4 PROPOSALS
Have 2-4 proposals in hand

FREE RENT
Front-loaded free rent

8-10 YEARS
Attempt for a longer lease

Exclusivity within the building

Temporary sales office

i. Financial Considerations

"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," Casey explained.

"Get 2-4 proposals in hand so you can start putting them against one another," he added.

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

One factor to take into account is how much free rent you can get up front. coworking operators as a whole 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.

"In this business, cash is king," Ryan said. "There's a significant ramp up that needs to be accounted for when launching a coworking, executive suite, or flexible workspace business. We generally fight tooth and nail for as much up front rent relief as you can possibly handle by cultivating a competitive environment for our client."

So 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 months 2-10 of the lease free of rent. Of course, this can vary by location, because in some markets that's simply not feasible. In other markets, like downtown LA, it's not unheard of to get a month and a half of free rent per year of term. Do the math. In a 10 year lease, that would be 15 months of rent you don't have to worry about.

"The shortest lease that a lot of coworking operators should be looking at is 10 years," Jerome 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 + Exclusivity

For coworking operators, flexibility cannot be overlooked, in terms of right of first 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," Casey said.*

"Within that exclusive its not only to bar out any other flexible workspace center, but it's also a step further, where we say the landlord cannot lease space to any tenant below 1,000 sq ft," he added.

Another not-so-small detail that can often be overlooked, is the ability to identify the building as part of your marketing. Being able to have a building in a landmark location, plus signage and advertising opportunities within and around the building, can be immensely helpful when starting out.

In addition, getting the landlord to commit to providing a temporary sales office during your buildout, can help you fill your space faster. These factors will help your success prior to grand opening.

Part IV: Leasing vs. Purchasing

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.

i. You Need Experience

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," Ryan stated.*

"You're looking for a highly attractive asset, likely off-market, and you're competing against seasoned buyers," he added.

Overall, the main groups who are actually successful taking this approach 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.

You have to understand where your money is going to be alloted to. How much will you need for the buildout of the space? Do you have extra savings in case getting to break 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?," Casey said.

Yes, you'd need to have more capital initially, but historically speaking, companies will use their capital to grow, and have hopes of opening more than one space. Building market share is of course 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. And have the experience to understand that one mistake is not going to doom your future plans.

ii. Alternatives to Traditional Leases

Yes, having experience is necessary to purchase a space, but consider a different route. Partnerships and other joint ventures are providing an alternative to leasing, as well as 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 to open these spaces," Ryan said.*

Because of this, Jerome 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, Jerome stated that he would certainly do a lease vs. buy analysis for that client, but overall the best route, if you are adamant about wanting to own a space, 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, much 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 (who can be a friend/collegue) underwrite it, and see 'hey, can we buy this building?'," Jerome 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.

Another key component to consider when debating a lease vs a buy, is that there are new leasing laws coming into play soon that will shape your decision.

“We have to start converting these leases into capital leases. Historically, leases provide a deductible expense opportunity for a tenant, so you can write it off and you don’t have to show the entire lease obligation as a liability on your balance sheet,” Casey explained.

“However, as of January 2020, that’s going to change,” he said. “Companies are going to have to convert the way they allocate their assets on their balance sheets.”

Coworking operators are looking to do longer term leases, as Jerome 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 the upcoming changes, because the trend is for most corporate office leases coming down to about 3-5 years.

Casey certainly isn’t shutting the door on purchasing as an option.

“If there’s a great opportunity, maybe a great asset that’s been underlooked, 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.”

This is especially true in amenity-rich areas of places with great weather year round, like California, Florida, Texas, etc.

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 to help in 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.

About Yardi Kube

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

Designed for overcoming operational complexities, Yardi Kube is a workspace management software and technology platform empowering operators to increase revenue, maximize productivity, and build community.

Yardi Kube provides a complete package for accounting, data management and voice services. Kube empowers operators and members with greater accessibility when it comes to billing, booking spaces, managing opportunities, and communication.

Increase Revenue

Maximize Efficiency

Build Community

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